Cash Flow: The Basics

Ettore Palmeri,
MBA, AGDM,
B.Ed., BA

Your accountant confirms that the lab is profitable. That is good news indeed – much better than the alternative. Profit is a must for a business to exist and thrive and our common tendency is to focus on earnings. Profits, however, are not the single determinant of business success.

A company must either be generating cash or have access to cash in order to sustain itself. A positive cash flow is critical for both the short and long term. Cash flow is the lifeblood of any operation and is necessary for its stability and profitability.

Cash flow can be simply described as the stream of money that flows through your business.

The consequences of restricted cash flow can bring about a crisis. Missing a payroll, having a supplier place you on COD or hearing from the bank that your loan is under review could have devastating implications for your business.

The Cash Flow Cycle

A cash flow focus is one of the more effective ways of keeping a finger on the pulse of a company. Time, resources and capital are limited. You can only identify and address current developing problems when you know where to look.

Existing financials help to determine your starting point but keep in mind that those financials only reflect what has already transpired. Managing the cash flow process is all about looking forward to tomorrow and beyond.

The Cash Flow or Working Capital Cycle

The cycle has been appropriately described as the survival cycle. Look at the circular motion and think of the spoke on a bicycle. The faster you can drive those pedals the more efficiently you will be managing your operation. The key for us is to understand what accelerates the cycle in your business and what slows it down.

In my case, a media business, receivables and inventory comprise a significant portion of total assets.

There are two important measurements in the cycle for most publishers. The length of time it takes to convert inventory into a finished and invoiced job and the length of time it takes to collect the outstanding receivables. The sum of these two measurements can be described as the operating cycle.

Statistics reveal that the average business takes 20 days to convert inventory into

a receivable and then 50 days to collect that receivable, for a total operating cycle of 70 days. Compare these benchmarks to your own numbers to determine how efficiently you are turning the pedals.

The Growth Dilemma

It might be tempting to trust that a tough cash situation will improve over time or that increasing sales or margins will fix the problem. Unfortunately, chances are slim that things will improve on their own. The truth is that for most businesses, growth amplifies cash flow pressure. It certainly does for us.

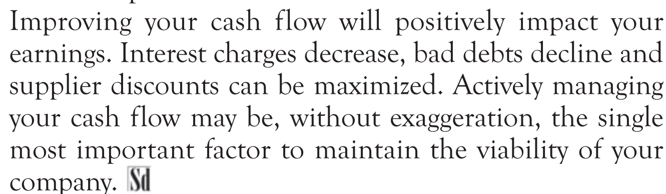
Sales growth creates increased liabilities that are due before the accounts receivables for the sale/service are collected. Depending on the length of the operating cycle, the gap between paying liabilities and receiving payment from customers could be from several weeks to even months. Without adequate access to cash in these circumstances, a company can literally become unable to meet its current obligations. It happens on a regular basis and profitable companies are not exempt. The higher the rate of growth, the deeper the hole becomes and the faster it progresses. This is known as "going bankrupt".

PACE Yourself

Fortunately, it does not have to be this tragic. A proactive, aggressive commitment from management can turn cash flow from a danger zone into competitive advantage. This is accomplished through an understanding of the current position, a strategy for improvement and a continual focus on the process.

This includes the following key actions: planning and updating projections; anticipating seasonal and other fluctuations; communicating with clients, lenders, suppliers and employees and establishing a credit and collection process.

Improving your cash flow will positively impact your earnings. Interest charges decrease, bad debts decline and supplier discounts can be maximized. Actively managing your cash flow may be, without exaggeration, the single most important factor to maintain the viability of your company. Sd



SIMPLY BETTER MILLING

PREMIO burs

Innovative MASTER coatings – the perfect bur solution for every material

call now
866-643-3129

primotec® DIGITAL
www.primotecusa.com
info@primotecusa.com