Being a successful entrepreneur takes a unique mix of skills and practices. You need to generate exciting ideas, deliver desirable products or services, maintain a winning attitude, set goals, undertake strategic planning and more, all while keeping an eye on the life’s blood of your business -- its finances. To track your business’s performance and plan effectively for future growth and opportunities, you must have a thorough understanding of how money flows through your business. You’ll want to understand the important statements that reveal the company’s financial position and how to measure the business’s performance using accepted standards. This document offers you straightforward guidance to managing your company’s financial information.

The Louisville Small Business Development Center is committed to providing educational resources that help entrepreneurs like you make the most of every busy, rewarding day. Small businesses are the heartbeat of this region’s thriving economy, and we’re here to help you succeed.

David Oetken, MBA CPM
Director, Louisville Small Business Development Center
Managing Your Business’s Cash Flow

When you’re running a business, money comes in (sales) and goes out (expenses)—this is your cash flow. In order to operate successfully day to day, you need to keep track of your cash flow and be sure you have enough cash on hand to cover your costs and pay your bills.

But there’s more than that to understanding and managing your cash flow. Your business’s operating cycle involves purchasing raw materials or inventory, making sales, and collecting for those sales. Each of those steps takes time. Depending on your industry and specific business, it may take you longer to produce goods, so perhaps you have a lot of cash tied up in materials. Maybe you run a service business, and almost everyone who buys from you pays immediately; or perhaps you sell products to companies that take a month or two to pay their bills.

A shorter operating cycle means you get cash back in hand more quickly, so you can buy more inventory and take advantage of supplier discounts.

Cash drives your operating cycle.

However, having a positive cash flow doesn’t always mean a business is profitable, and having a negative cash flow doesn’t always mean a business is not profitable. If you use the accrual method of accounting, you record sales when they’re made even if they aren’t paid for until later; and you record expenses when, for example, goods are delivered to you, even if you don’t pay for them immediately. You may have made and recorded many sales this year, but if they haven’t been paid for yet, your cash flow may appear unrealistically high.

You must be aware of where your cash is, how it’s working for you and what drivers affect your cash flow and your operating cycle. Then, you can find ways to help both your cash flow and your operating cycle run more quickly and more smoothly by making changes in these areas:

- Accounts receivable (money customers owe you)
- Accounts payable (money you owe suppliers)
- Inventory management

Managing Accounts Receivable

When people or companies buy from you on credit, the money they owe you is your accounts receivable. As long as buyers have that money in their pockets, it’s not doing you any good. Thus, collecting on sales is a vital driver of your operating cycle. It’s important to have effective processes in place to turn sales into cash quickly.

Here are some ways you can improve your collection of receivables:

- Send out an invoice as soon as a sale is made or work is completed.
- Make it simple for customers to pay you via credit card, PayPal or automated electronic payments to your bank account.
• Do a credit check for new customers. Order a credit report, and talk to their bank and to existing customers to determine whether their credit history shows any risks from lending to them.

• Set customer credit limits. Based on the credit check, you can set an appropriate limit. Then make sure you stick to it. Periodically review customers’ credit checks and payment history to see if a higher (or lower) limit is warranted.

• Print your credit terms on every invoice. That way, customers know them up front.

• Be sure your terms are being followed. Keep track of who owes you, send payment reminders on a regular basis, and act immediately if payments are overdue.

• Offer discounts for early payment to encourage customers to pay more quickly.

If a payment is late:

• Get in touch with the customer, first by letter and then by phone, to see if there are any problems (perhaps they’re unhappy with the goods or services purchased, or for some reason they aren’t able to pay in full).

• Stop any current or future work/sales for the customer until the balance is paid.

• Set up a payment plan that will let the customer clear the debt over time.

• As a last resort, if necessary, use a professional collection agency.

Managing Accounts Payable

When you purchase supplies, finished goods, services, or other business items on credit, the money you owe is your accounts payable. Part of being a successful small business is being a good customer: paying your bills on time and maintaining a good relationship with your creditors. That way, they will continue to do business with you, you’ll maintain a good credit history, and you can be assured of obtaining the services or inventory you need. Thus, the way in which you handle payables is another key driver in your operating cycle.

Here are some ways to manage your payments:

• Keep an eye on your spending. Buy only what you need, and if sales decrease, reduce spending accordingly to avoid cash-flow issues.

• If multiple suppliers are available, determine which one(s) you prefer by running credit and reference checks and talking with them to see what sorts of payment terms you may be able to negotiate. Review the suppliers’ terms regularly to see if someone else might give you a better deal—and if your current supplier might be willing to match it.

• Give negotiating a try. It never hurts to ask whether a supplier will give you a discount for paying within a certain time frame. On the other hand, if your cash flow is such that you need extra time to pay, you can ask for extended payment terms (say, 45 days instead of 30).

• Print your standard payment terms on your purchase orders. Be sure your terms agree with those of the supplier.

• Be clear that your terms begin when you receive complete—not partial—delivery.

• Pay within the terms. Don’t pay any earlier than you need to (as long as you have the money, it’s like a free loan), but don’t pay late. If for some reason you can’t pay on time, be proactive about contacting the supplier and arranging for a payment plan.
• Ask about quarterly payments. Especially when you’re dealing with a large company that you pay on a regular basis, they may be willing to be paid quarterly rather than monthly.

Managing Inventory

When you’re selling goods, you always want to have enough on hand to satisfy customer demand. At the same time, excess inventory sitting on a shelf means some of your cash is tied up and can’t be used to help grow your business. Keeping inventory on hand for the shortest time possible means it’s converted back into cash, thus driving your operating cycle.

Here are some approaches to inventory control that will help you make sure you have just enough inventory on hand at any time:

• Periodically (at least yearly) do a thorough review of your entire inventory. Determine what items are selling well, which ones aren’t, which items provide the best profit margin, whether you have inventory that is losing value due to age, and so on. This review will help you plan future purchases by showing you the appropriate purchase volume for each item.

• Take whatever action is needed to move older and/or excess stock. You may need to sell goods at a discount or even sell them below cost or donate them, in order to free up cash that you can invest in faster-moving, profitable inventory.

• Be aware of items you must never run out of. These basic items that your customers demand should always be in stock.

• Stay away from discounts that are based on volume purchases or on items you don’t know you can sell. A steep discount on a large number of items may sound appealing—but if making the purchase cuts into your cash flow, or if you aren’t certain you can sell that many of that item in a reasonable time, don’t buy. You’re better off buying what you know you can sell, in smaller quantities that fit within your cash flow.

• Order fewer items more frequently, and negotiate for the best possible delivery schedule. These changes let you keep less on hand at any given time and mean less cash is tied up in inventory, while still guaranteeing you can meet demand for popular items.

Keeping an Eye on Your Cash Flows

Your business’s Statement of Cash Flows is a summary of all the money that comes into and goes out of your business during a specified period of time. You can see a complete example on page 6. By compiling and reviewing this statement every month, you’ll always know if you have enough cash on hand to:

• Take care of your day-to-day expenses
• Pay your bills
• Purchase equipment
• Cover unforeseen costs
• Invest in the business

Before long, you’ll become familiar enough with it that you can forecast your business’s cash flows in the time ahead.
# Resova Inc., Statement of Cash Flows
January 1 - December 31

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<th>Apr</th>
<th>May</th>
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## Cash Receipts

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## Total Cash Available

|  | 300,500 | 315,200 | 305,298 | 317,298 | 305,298 | 305,898 | 286,698 | 289,098 | 294,298 | 296,498 | 314,698 | 334,198 |

## Cash Paid Out

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<td>271,000</td>
<td>264,000</td>
<td>281,000</td>
<td>254,900</td>
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## Cash on hand (end of month)

|  | 50,000 | 50,800 | 51,798 | 51,998 | 51,998 | 42,098 | 31,498 | 29,798 | 29,798 | 40,898 | 40,098 | 53,698 | 79,298 |
Expenses Greater than Income? Consider Your Financing Options

There are many reasons a business can find itself with a negative cash flow. These are just a few:

- You received a large order and had to pay for materials and labor, but you won’t receive payment for the finished goods until after you’re out of cash.
- You’re carrying excess inventory.
- You invested in new equipment that is taking longer than expected to come online.
- You’re spending to expand your business to new products or new markets.

Whatever the reason, you’ll need cash to keep your business operating, whether in the short term or over the long haul.

Before you decide how to finance your business needs, do your homework:

- Determine exactly how much money you need and what you’ll use it for.
- Determine how much collateral you have (via an appraisal if necessary), and be sure you have enough to balance the amount of the loan you want.
- Create a forecast version of your Statement of Cash Flows, and be sure you can add a loan payment to your expenses without causing further cash-flow problems.
- Compare the types of financing available and their interest rates, and research the lenders involved.

Now you’re ready to choose the financing that’s right for your business.

**Line of Credit**

A financial institution (usually a bank) determines the maximum amount it’s willing to loan you. You can then borrow as necessary, up to that maximum. You make a monthly payment that varies depending on the total you’ve borrowed.

**Business Credit Card**

Credit cards provide a convenient way to supply short-term funding. You can obtain a card to be used by your business, with a credit limit sufficient for your needs. But be sure to pay off any balances as quickly as possible—ideally, before interest accrues. Otherwise, the total cost of purchases may end up being much higher than planned.

Credit card companies also offer cash advances, but the interest rates are generally extremely high, making this option viable only in an emergency.

**Asset-Based Lending**

You sell your business’s receivables to a factoring company that specializes in such transactions. You receive immediate cash; the factoring company takes responsibility for future collections and any unpaid debts, and in return gets a percentage of what is collected. Similar types of loans are available based on your business’s inventory or purchase orders.

**Peer-to-Peer Loans**

A group of individual investors lends money to small businesses via an online platform. The platform takes care of vetting companies that seek loans and finding investors. Loan amounts are generally small, but interest rates are usually reasonable for businesses with a good credit history that may not be able to obtain a bank loan.
Nonbank Loans

Many businesses can’t meet the requirements to obtain a bank loan. Perhaps the company is very small or is seasonal in nature. Such companies can work with a for-profit or non-for-profit financial institution that analyzes their cash flow and other performance data and determines loan terms accordingly.

Small Business Administration (SBA) Loan Programs

The SBA doesn’t make loans directly. Rather, it has a number of programs that offer indirect financial assistance to small businesses. For example, the SBA sets guidelines for loans that are made by partners (including banks and microlenders) and guarantees that those loans will be paid. The SBA also has a public-private venture-capital program; again, the SBA works with partner investment firms to provide funding for qualified small businesses.

In addition, the SBA has loan programs for new and expanding businesses, disaster recovery, businesses owned by veterans, and various other categories. These are outlined at www.sba.gov.

Intermediate and Long-Term Loans

Your business may need to obtain financing in the intermediate (one to three years) or long (three to ten years or longer) term. Such loans are generally made by banks and are backed by your company’s collateral (generally your assets). The length of such a loan should be tied to the life of whatever it is you’re financing. For example, buying a computer system with an expected life of three years is an appropriate use for an intermediate-term loan. A large expense for a new building that will last many years is an appropriate use for a long-term loan.

Before you try to obtain a long-term loan for equipment or other capital purchases, check to see whether leasing the item might be a better option. Remember to take into account the up-front and monthly costs of leasing versus the total cost and interest if you obtain a loan to make a purchase.

How easy it is to obtain a loan will depend on many factors, including your business’s financial history, your business segment, the state of the economy and so on. Lenders will examine your company’s credit rating and financial statements. They will also be interested in your personal financial history and credit rating. In particular, they want to see whether you (personally) and your business already have outstanding debt, whether you carry balances and for how much, whether you make your payments on time, and whether you’ve ever declared bankruptcy. It’s best to have all your personal and business financial documentation in order before applying for financing, to save time and trouble.

Income Greater than Expenses? Time to Invest

If you’re running a profitable business, it’s easy to get caught up in day-to-day work and let your profit take care of itself. Except—it won’t take care of itself. It will sit in your bank account rather than earning you interest or helping you grow your company.

You need to manage your money so it’s doing the most to help you and your business. Here are some options to consider.

Bank Accounts

Some checking and savings accounts pay interest. In addition, money market accounts pay a higher interest rate in return for you keeping a higher bank balance.

Certificates of Deposit

A CD pays interest, like a savings account, but you invest your money with the bank for a fixed period of time (say, twelve months or five years). After that time, you receive your money back, plus the interest. Your ability to access your money during the CD’s term is limited, and you may forfeit some or all of your interest.
Treasury Bills
A T-bill is a short-term debt issued by the U.S. Treasury. T-bills don’t pay interest. Rather, you purchase them at a discount: when they mature, your return is the difference between the purchase price and the redemption value.

Bonds
Bonds may be issued by governments or companies. Each bond is like an IOU: you loan money to the issuer for a certain term, and in return you receive a certain interest rate. Bonds carry varying levels of risk, depending on the issuer.

Stock
Buying a share of stock means you’re purchasing a bit of a company. If the company does well, you may be paid a dividend as your part of the profit. Over time, the overall value of each share may also go up—or down.

Property
Property can include land or buildings. You may receive rental income, and the property itself may gain value (equity) over time. However, prices and values can fluctuate considerably, and it’s always possible that property will lose value rather than gain.

Bond Funds and Mutual Funds
These funds are financial products offered by professional money managers. Each fund includes a number of stocks, bonds, or other types of investments. Such a fund lets you diversify your money by spreading it over a range of investments rather than focusing on, say, a single stock.

Alternative Investments
These include investments that fall outside the standard categories discussed so far. They include commodities such as gold and other precious metals, foreign currency and financial derivatives such as options and futures. These alternatives carry varying levels of risk and generally require more expertise on the part of the investor.