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Cash Flow Management Prevents Financial Problems

If customers paid immediately, you could avoid cash flow worries — but this rarely occurs

By Jim Peduto

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Every organization experiences ups and downs when it comes to cash. This has nothing to do with whether or not a business is profitable — even profitable businesses experience cash flow issues. While standard financial reports include valuable information, they frequently do not indicate whether or not there will be enough cash at a given time to pay suppliers, creditors, and employees. And if you can't afford to cover these costs, you're out of business. For this reason, cash flow management is essential.

Cash flow is simply the movement of money into (inflows) and out (outflows) of a business. Inflows include bank loans and money from providing services to customers. Outflows are generally the result of paying expenses such as products and equipment, fixed assets, paying back loans and funding accounts payable.

Cash inflows and outflows should not be confused with sales and profits. Cash flow reflects the timing of the inflows and outflows. Poor timing results in gaps in cash flow when you have more cash outflows than inflows. To prevent these gaps requires cash flow management, starting with learning to predict cash flow.

One way to predict is with a cash flow forecast. This planning tool uses results from weighing factors such as your customers' payment histories, upcoming expenses and your suppliers' payment flexibility. This projection can cover the next year, next quarter or next week, depending on the ebbs and flows you experience.

Start with adding the amount of cash that's on hand at the beginning of the period with other cash to be received from various sources. Then consider the amounts and dates of upcoming cash outflows, including when money will be spent and on what. This forecast will help you plan for the use of cash and prepare to avoid gaps.

Update the forecast and adjust it frequently depending on business activity, payment patterns and supplier demands. The goal is to speed up cash inflows and delay outflows of cash as long as possible.

If your customers paid you immediately or even before you provided services, you could avoid cash flow worries. But because rapid payment like this rarely occurs, you'll have to develop other ways to improve cash inflows. You can speed up payment by getting invoices out earlier, offering discounts or incentives for customers who pay their bills early, requiring credit checks for non-cash paying customers and following up with slow-paying customers.

The opposite rule applies when it comes to disbursing cash. You want to keep cash in your hands as long as possible and pay bills close to their due dates. Use business credit card accounts for travel and small expenses to buy time. Meanwhile, invest the cash on hand or use it to pay down debt. The key is to keep little money sitting in the bank.