Cash Flow 101:

A Complete Guide to Understanding Cash Flow

Bplans + FUNDBOX

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1. Introduction & Cash Flow Basics

Maybe you remember studying it for a semester or two however many moons ago. Maybe your business has always been flush with cash and you've never given the concept a second thought. Or maybe you've never even heard the words put together before.

Whatever the case may be, here's a quick refresher: Simply defined, cash flow refers to the revenues a business generates (and collects) compared to the expenses it pays out over a fixed period of time. Broadly speaking, businesses bring in money through sales, financing and returns on investments. And they spend money on supplies and services, as well as utilities, taxes and other bills.

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However, business owners can't predict the future—particularly when it comes to any unforeseen expenses they might incur (e.g., a truck breaking down prematurely and needing to be replaced or a data breach resulting in a forced increase in IT spend). And they also can't know for certain that their clients will pay their bills on time.

Together, these uncontrollable variables lead to a rather logical conclusion: Cash flow problems affect many businesses. And the data backs it up: According to a recent survey, **three out of every five businesses** experience them. Still, while cash flow problems are not uncommon, businesses owners are better off doing whatever they can to avoid them altogether.

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2. The Benefits of Positive Cash Flow

Back to the basics: Positive cash flow can be defined as ending up with more liquid money on hand at the end of a given period of time compared to what was available when that period began.

Businesses that master cash flow management can:

- **Pay their bills.** Positive cash flow ensures employees get checks each payroll cycle. It also gives decision makers the funds they need to pay suppliers, creditors and the government.
- **Invest in new opportunities.** Today's business world moves quickly. When cash is readily available, business owners can invest in opportunities that may arise at any given point in time.
- **Stomach the unpredictable.** Having access to cash means that whenever equipment breaks, clients don't pay their invoices on time or new government regulations come into effect, businesses can survive.

3. Symptoms of Poor Cash Flow

Though they're by no means uncommon, cash flow problems can cripple businesses of all sizes. Without access to capital, companies are unable quickly adapt to today's ever-changing business world. As such, they're unable to grow.

The good news is that cash flow problems aren't entirely out of your control—and they're not unpredictable, either. Proper budget forecasting coupled with an understanding of symptoms that might indicate cash flow problems are in your future can help you protect your business from scrambling to figure out where to get its next infusion of cash.

If your business is suffering from any of the five following symptoms, cash flow problems may very well be on the horizon:

1. Your accounts receivables are high.
2. You have too much inventory on hand.
3. You're overextending your business.
4. Your sales are declining.
5. Your business just isn't profitable.

4. Make Sure You Have a Cash Flow Statement

In order to make sure that your business is always able to access the cash you need to grow, build a cash flow statement quarterly to ensure you will have enough cash on hand.

Most simply, cash flow statements very quickly tell the story of how much revenue a company has coming in (inflows), and how much it has going out (outflows). That information can be leveraged to gauge an organization's liquidity and to predict where a company will stand financially in the near future.

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4.1 Operating activities

How does your business make money on a day-to-day basis? Your organization's operating activities include everything that relates to how you generate revenue. Cash inflows are generated whenever customers buy your products or services; outflows occur when you pay employees, suppliers, taxes or interest, among other things.

4.2 Investing activities

Most transactions relating to the sale or purchase of property, equipment, or other non-current assets are included in your investing activities, as are any expenses tied up in mergers or acquisitions.
If your business plays in the stock market at all, you'll also have to indicate when you buy or sell securities here as well.

4.3 Financing activities

This section of the cash flow statement includes information about taking out loans to buy property or equipment; issuing stock to employees, the public, or other stakeholders; paying out dividends, and so on.
Your cash flow statement is one of the key financial statements that your business should produce and is prepared along with your balance sheet and profit and loss (P&L) statement. If you want to learn more about how to build a cash flow statement, read more here.

5. Building Your Cash Flow Statement

5.1 Building a cash flow statement: The indirect method

Many businesses choose to construct their cash flow statements using the indirect method because the numbers they need are easily gathered from the accounts and numbers they already maintain. Cash flow statements generated this way reconcile reported net income with cash generated through operations.
To construct an indirect cash flow statement, you first need to focus on operating activities. To do that, determine net income and remove non-cash expenses (e.g. depreciation and amortization) from that number.

Next, you need to consider your gains and losses on any sales of assets made during the pertinent reporting interval. You also need to report changes in receivables, payables and inventories, as well as any bad debts you might decide to write off.
Once you've figured out your net cash provided by operations, you need to then record your cash flows from investing and financing activities. These two sections are reported in the same manner on cash flow statements prepared using both the indirect and direct methods using the criteria discussed above.

5.2 Building a cash flow statement: The direct method

Due to the differences in reporting operating activities, cash flow statements prepared via the direct method provide a much clearer view of how cash moves through a business. But they're harder to prepare—which is why they're less common.

Instead of starting from net income, cash flow statements made through the direct method instead focus on gross cash inflows and gross cash outflows that occur naturally through operations. Businesses that use the direct reporting method need to consider cash received from client accounts; cash paid to employees and suppliers; interest payments; income tax payments; and any interest or dividend revenue that was received.

Unlike the indirect method, when cash flow statements are generated through the direct method, it's considerably easier to see where cash payments were made and where cash payments were received. But because most accounting reports don't include the necessary information the direct method requires, many businesses choose to take the easier route and produce their statements of cash flow using the indirect method.

6. The Best Ways to Manage Cash Flow

So you have a cash flow statement and you understand the pitfalls of cash flow problems. Now, let's talk about how you can manage your cash flow even better.

1. Know when to lease and know when to buy
Virtually all businesses need equipment, facilities and property in order to operate. Whether they should buy or lease those items is another question. If your business is strapped for cash, you might want to consider leasing equipment and renting retail or office space rather than buying it outright.

2. Make it a habit to shop around for better prices
How confident are you that you're getting the best deals on your supplies, systems and utilities?

While it's probably counterproductive to shop around for new suppliers every other day, it might be worth reassessing your operations on a regular basis—whether that's monthly, quarterly or even yearly will depend on the scope of your business.

3. Consider increasing the prices of your products and services

When is the last time your company raised its prices? While your customers might not like it, just ensure your business is carefully planning your price increases and marketing them effectively. You'll be able to generate more revenue—and maybe even more sales—while padding your bottom line.

There are a variety of tactics you can employ to reduce the likelihood your customers will get angry when your business raises its prices. For starters, don't increase your prices unless you're sure that your customers are thoroughly satisfied. You can also consider trying to time your price increases with improvements to your products.

4. Bill on a more immediate basis

It's not uncommon for businesses to wait until the end of the month to invoice their customers all at once. If you're having cash flow problems, you might want to consider accelerating your billing process, sending out invoices the moment when jobs are complete and orders are shipped. In doing so, you ensure that your clients get their invoices faster—which hopefully means you'll get paid quicker.

5. Incentivize customers to pay sooner

Who doesn't like paying less for products or services? To solve your cash flow problems, you might want to offer customers favorable payment terms if they pay their invoices early. For example, offering 2/10 net 30 terms means your clients get a two-percent discount if they pay their bills within 10 days; otherwise, full payments are required to be made within 30 days.

6. Devise new campaigns to boost sales

If your business is struggling with cash flow and if sales are stagnating—or even if they're not—from time to time, you might want to consider retooling your campaigns. No matter your vertical, switching things up a little bit may very well direct more attention on your brand, without even necessarily costing you that much. One need look no further than Coca-Cola, whose recent "Share a Coke" campaign has been credited with bringing the beverage company a two-percent spike in sales.

The best part? Coke didn't really have to do a whole lot to generate these new sales; the whole campaign consists of simply having names printed on bottles and cans, the idea being that customers would buy ones featuring their own names, as well as names of their friends, coworkers and loved ones.

7. Make your invoices work for you

If you invoice your customers and net 30 is routinely turning into net 60 or even net 90 you might want to look into a cash flow optimization tool like Fundbox. With Fundbox, business owners are able to access the cash they need to grow immediately, even if their customers are slow in paying their bills.

Here's how it works: For a small fee, Fundbox advances payments on the outstanding invoices of your choosing. Once you've set up an account and selected which invoices to advance, money is transferred to your bank right away. You then have 12 weeks to repay the advance (the sooner you repay, the lower Fundbox's fees end up being).

Instead of stressing over where you'll find the money to pay your own bills or grow your business, **Fundbox** gives you the peace of mind that comes with knowing you always have access to capital you need to grow your business.

8. Maintain cash flow statements

By producing cash flow statements, you'll be able to make the right adjustments to your business should you need to—whether that's increasing prices, reducing expenses or embarking on new campaigns—to make sure your organization always has the money it needs to thrive on hand.

9. Leverage modern technology

Because the right technology makes your employees more productive, it follows that you'll have more goods and services to sell than you would with employees relying on outdated technologies. According to a recent study, today's workers are 84-percent more productive than their peers who worked during the 1970s thanks to the introduction of modern technology to the workplace.

10. Focus on cash flow instead of profit

Even if yours is the best business plan ever written, without access to the cash necessary to respond to new opportunities and meet your obligations, you might not get a chance to see your company reach its full potential. Instead, you could end up having to close down shop sooner than you expected.

For example, your business might generate a considerable amount of profit. But a good majority of that profit could be tied up in receivables, which doesn't do you much good when it comes to you needing cash to cover your operating expenses.

But when you direct more focus on consistently maintaining a positive cash flow, the profits you seek will almost certainly follow.

7. Growing Your Business

If you've taken these points into consideration and you've solved some of your cash flow problems, it's time to figure out how exactly you want to approach growing your business.

Unfortunately, since the needs and strengths of every organization are different, there isn't really a cookie-cutter approach you can take to ensure your business will expand effectively. As such, it's important you do your due diligence prior to investing your capital. After all, you don't want to find yourself overwhelmed with cash flow problems right after you've solved them.

Here are some ideas as to how your business can grow:

1. Expand to new locations.
Whether you're running a retail shop, a medical practice, a restaurant or even a business-to-business technology company, you may be able to generate higher profits by expanding your organization to new physical (or even digital) locations.

2. Develop new products.
No matter what your business is selling, chances are you'll be able to sell at least one more complementary product. For example, if your business is a copywriting agency, you might want to think about hiring a graphic designer so that you can sell infographics, logos and other visual assets.

3. Look for new partnerships. Help me help you.
Being a small business owner can be difficult, particularly when you're trying to make a go of it on your own. But the good news is that by establishing partnerships with other like-minded businesses, you may very well see your profits increase as your brand is exposed to a whole new community of supporters.

4. Launch new marketing campaigns.
With more money in your company's bank account, now is probably as good a time as any to go back to the drawing board and figure out whether your brand stands to benefit from embarking on new marketing campaigns.

8. Conclusion

Remember, successfully solving your cash flow problems and growing your business won't happen overnight—it can be a long, tiresome and stressful process. But with the right plans in place, you'll be able to grow organically. Sooner or later, cash flow problems may very well become a distant memory.

About Fundbox
Fundbox is the easiest way to get paid for your outstanding invoices. There's no more waiting 30, 60 or even 90 days for invoices to be paid. Access up to $30,000 and have it deposited directly into your bank account. There's no application process or lengthy forms to fill out, just connect your accounting software and you're ready to go.

About Bplans
For the past 15 years, **Bplans** has been one of the top small business resources for entrepreneurs and business owners all over the world. More than one million people visit us each month in search of business planning and management advice, and more than 300,000 of our readers subscribe to our weekly email newsletter.
We're dedicated to giving our readers the best information there is on **how to start a business**.