

# The Keys to Successful Small Business Ownership, Finance and Credit™

## Client Curriculum - Understanding and Managing Cash Flow

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# The Keys to Successful Small Business Ownership, Finance and Credit™

National Foundation for Credit Counseling® (NFCC®) - Small Business Owner Counseling Program

**Client Workbook**

**Version 6.0**

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## INTRODUCTION

Welcome! It is our goal you find this material helpful as it was hand selected to address some of the most common challenges faced by the self-employed or small business owners. We aim for this content to complement budget counseling sessions for people like you engaged with a member agency of the National Foundation for Credit Counseling® (NFCC®) across the U.S.

Whether you just started on a self-employment journey, have a business on the side or have dreams of serving millions, you are important to our national economy and local community by creating a job for yourself or others.

*It is our hope this program empowers you to make informed decisions about being self-employed and a small business owner by providing you access to a NFCC counselor, information, resources and tools. As you develop a greater understanding of personal and business finance best practices, you can choose the best course of action to meet your goals.*

We would like to thank and acknowledge TD Bank, America's Most Convenient Bank®, and the TD Charitable Foundation, the charitable giving arm of TD Bank, for their support of the NFCC Small Business Owner Financial Counseling and Education Program supporting Small Business Owner Financial Wellness.

**Client Overview**  
**Module 2:**  
**Understanding and Managing Cash Flow**  
**Why it Matters**

**Cash flow** is one of the most critical components of success for a small or mid-sized business. Without cash, profits are meaningless.

**Profit does not equal cash flow.** You can't just look at your profit and loss statement (P&L) and get a grip on your cash flow. Many other financial figures feed into factoring your cash flow, including accounts receivable, inventory, accounts payable, capital expenditures, and debt service.

**Positive cash flow** is needed to generate profits. You need enough cash to pay yourself, employees and suppliers so that you can make goods. It's the sale of those goods that helps generate a profit. But if you don't have the money to make the goods, you don't end up with the profit. So....you really need to structure your business to have a positive cash flow if you want your business to grow and increase profits.

## Cash Flow 101

Cash flow is the heart of any business and equally important as the owner's skills, talent and passion. There's an old saying about business that "cash is king" and, if that's so, then cash flow is the blood that keeps the heart of the kingdom pumping. Cash flow is one of the most critical components of success for a small or mid-sized business. Without cash, profits are meaningless. Many a profitable business on paper has ended up in bankruptcy because the amount of cash coming in doesn't compare with the amount of cash going out. Firms that don't exercise good cash management may not be able to make the investments needed to compete, or they may have to pay more to borrow money to function.

"Even though cash is the lifeblood of a business -- the fuel that keeps the engine running -- most business owners don't truly have a handle on their cash flow," says Philip Campbell, a CPA and former chief financial officer in several companies and author of *Never Run Out of Cash* (Grow & Succeed Publishing 2004). "Poor cash-flow management is causing more business failures today than ever before."

Academic studies over the years have found that cash flow problems can be one of the leading causes of failure for businesses. Scholars have found over the years that insufficient capital is one of the main reasons for small business failure, coupled with lack of experience, poor location, poor inventory management and over-investment in fixed assets, according to the SBA.

The following will help you understand what cash flow is, how it impacts profits, and tips on how to improve your cash flow.

What is cash flow? It's basically the movement of funds in and out of your business. You should be tracking this either weekly, monthly or quarterly. There are essentially two kinds of cash flows:

- Positive cash flow: This occurs when the cash funneling into your business from sales, accounts receivable, etc. is more than the amount of the cash leaving your businesses through accounts payable, monthly expenses, salaries, etc.
- Negative cash flow: This occurs when your outflow of cash is greater than your incoming cash. This generally spells trouble for a business, but there are steps you can take to remedy the situation and generate or collect more cash while maintaining or cutting expenses.

Achieving a positive cash flow does not come by chance. You have to work at it. You need to analyze and manage your cash flow to more effectively control the inflow and outflow of cash. The SBA recommends undertaking cash flow analysis to make sure you have enough cash each month to cover your obligations in the coming month.

The SBA has a free cash flow worksheet you can use. In addition, most accounting software packages geared to small or mid-sized businesses – such as QuickBooks will help you produce a cash flow statement. There are also other websites offering free templates, including Winsmark Business Solutions and Office Depot.

### **Profit versus Cash Flow**

Profit does not equal cash flow. You can't just look at your profit and loss statement (P&L) and get a grip on your cash flow. Many other financial figures feed into factoring your cash flow, including accounts receivable, inventory, accounts payable, capital expenditures, and debt service. Smart cash-flow management requires a laser focus on each of these drivers of cash, in addition to your profit or loss. "There is a secret that very few business owners have discovered (and the accounting community has not done a good job revealing): knowing whether you earned a profit (or created a loss) is not the same as knowing what happened to your cash," Campbell says. "Profit, as defined by the rules of accounting, is simply revenue minus expenses. Invoicing a customer for products or services you sold to them creates revenue. Actually, collecting the money on that invoice is what creates cash."

A positive cash flow is needed to generate profits. You need enough cash to pay yourself, employees and suppliers so that you can make goods. It's the sale of those goods that helps generate a profit. But if you don't have the money to make the goods, you don't end up with the profit. So you really need to structure your business to have a positive cash flow if you want your business to grow and increase profits.

"Growing your business puts a huge strain on cash," Campbell says. "You almost always have to make investments and bring certain expenses on ahead of achieving the higher revenue and cash flow that comes with successful growth. Maybe you want to open an office in a new city so you can build the business there. Or, you need to build a new facility so you have the capacity to sell to larger customers. Those scenarios (and others) require cash up front."

### **How to Improve Cash Flow**

Most business owners see growth as the solution to a cash-flow problem. That's why they often achieve their goal of growing the business only to find they have increased their cash-flow problems in the process. Plan for growth and the related cash outlays in advance, so they do not come as a surprise. In the meantime, the SBA recommends that you take the following practical steps to better manage cash flow, especially for the growing business:

1. **Collect receivables** - To speed up the receipt and processing of receivables, the SBA suggests several steps. Spring for a lockbox service, post office boxes serviced by banks so that customers in far flung locations can mail payments there and the checks will be processed by the banks more quickly. Ask customers to preauthorize checks so that banks can draw against their accounts at timed intervals. Centralize your banking at one bank. Ask customers to pay with depository transfer checks, a relatively cheap fund transfer. You can also try offering discounts to customers if they pay bills quickly.
2. **Tighten credit requirements** - Businesses often have to extend credit to customers, particularly when starting out or growing. But you have to do your research beforehand to determine the risk of extending credit to each customer. Can they pay their bills on time? Is their business growing or faltering? Are they having cash-flow problems? The SBA recommends getting a Dun & Bradstreet report on potential customers and asking them to fill out a credit application. You should also check references. Another option to extending store credit is to accept credit cards. This will cost you a percentage, generally from 2 to 5 percent of the sale, but it may be a safer bet for getting paid on time.
3. **Increase sales** - If you need more cash, it seems like a no brainer to go out and try to attract new customers or sell additional goods or services to your existing customers. But this may be easier said than done. New customer acquisition is essential to a growing business, but it can take time and money to convert prospects into sales. Selling more to existing customers is cheaper and you may be able to do this by analyzing what they're buying and why - information that may even lead you to increase your profit margin and, hopefully, generate more cash. But the SBA warns businesses to be careful when increasing sales because you may just increase your accounts receivables and not actual cash if these sales are on credit.
4. **Offer discounts** - One option to increasing cash flow is to offer your customers discounts if they pay early. While this practice may impact your profit margin, it may help your management of cash flow by incentivizing customers to make payments earlier than billing cycles typically require. Your company may also take advantage of this with suppliers and others that you owe, but be careful that your early payments of debt don't leave you with a cash flow shortfall.
5. **Secure loans** - Short-term cash flow problems may sometimes necessitate a business taking out a loan from a financial institution. Some possible types are revolving credit lines or equity loans, according to the SBA. Most of the time this type of borrowing accomplishes its goals, although during the financial crisis many banks were canceling credit lines and calling in loans. Another option is a long-term amortized loan which includes interest and principal until the loan is paid off.
6. **Reserves or Cash on Hand** - While it can seem daunting and impractical as an early stage business owner to stash cash for six months of operations as a best practice, it is important to work toward. Establishing good habits early and processes for managing cash can pay huge dividends down the road help you plan for the future. For instance, perhaps consider putting a small portion of sales in reserves and as the company grows you can reassess your needs. Once past the start-up phase, experts recommend the following steps to setting up cash reserves and determining the right amount.

- Use your balance sheet and income statement.
- On the balance sheet, subtract your current liabilities from your current assets to determine your working capital, which represent your business' short-term liquidity.
- Look at your total operating expenses for the past 12 months on the income statement, and divide that figure by 365 to calculate your daily operating expense – the amount it costs to run your business each day.
- Next, divide your working capital by your daily operating expenses and you can see how many days of funds you have on hand to cover operations.

### **Getting Control of Your Cash Flow**

Ask yourself the following two questions to get a sense about whether you have your business' cash flow situation under control:

1. What is my cash balance right now?
2. What do I expect my cash balance to be six months from now?

One way to keep that situation under control is by tracking your cash flow results every month to determine if your management is creating the type of cash flow your business needs. This also helps you get better and better at creating cash flow projections you can rely on as you make business decisions about expanding your business and taking care of your existing bills.

\*SOURCE: <https://www.inc.com/encyclopedia/cashflow.html>

In addition, consider online videos and resources including:

[https://my.tdbank.com/small\\_business/workshops/CashFlow/main.htm](https://my.tdbank.com/small_business/workshops/CashFlow/main.htm)

[https://www.tdbank.com/small\\_business/workshops/CashFlow/textcash\\_flow.htm](https://www.tdbank.com/small_business/workshops/CashFlow/textcash_flow.htm)

<https://us.accion.org/resource/building-business-credit-low-cash-flow?>

**Client Worksheet:** Thinking about your goals and future, what steps can you take to better manage cash flow?

| GOALS                                                                           | I've Done It | Will Do 1 to 3 mos. | I Will think about it |
|---------------------------------------------------------------------------------|--------------|---------------------|-----------------------|
| Download a cash flow worksheet and apply it to my business                      |              |                     |                       |
| Attend a workshop about cash flow to learn more                                 |              |                     |                       |
| Review my budget, income or revenue and expenses to better understand cash flow |              |                     |                       |
| Set some money aside on a regular basis to help create a cash flow buffer       |              |                     |                       |

## RESOURCES & HELPFUL LINKS

### **Alternative and Online Lenders**

<https://www.nerdwallet.com/blog/loans/what-is-an-online-loan/>

<https://us.accion.org/resource/alternative-lending-landscape/>

### **Assessing Your Business' Financial Needs**

<http://virtual-advisor.org/td/assessingcompanyfinancialneeds/>

### **Business Advising**

[www.businessadvising.org](http://www.businessadvising.org)

### **Business Borrowing 101**

<http://www.venturize.org/borrowing-101/>

### **Business Borrowers Bill of Rights**

<http://www.responsiblebusinesslending.org/>

### **Business Loan Checklist**

<http://www.venturize.org/get-started/loan-app-checklist/>

### **Business Loans for Poor Credit Score**

<https://loans.usnews.com/business-loans-for-bad-credit>

### **Cash flow**

[http://www.score.org/60\\_guide\\_managing\\_cash\\_flow.html](http://www.score.org/60_guide_managing_cash_flow.html)

### **Cash flow management as part of the SBA's financial management series**

[http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/serv\\_capgrowth.doc](http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_capgrowth.doc)

### **Community Development Financial Institutions/Mission Driven Lenders and Education Resources**

<http://www.venturize.org/mission-driven-lenders-locator-map/>

### **Marketplace Lenders**

<http://www.venturize.org/borrowing-101/types-of-lenders/online-only-marketplace-lenders/>

### **Mentoring, Resources and Tools for Small Business Owners**

[www.score.org](http://www.score.org)

### **National Association of Latino Community Asset Builders**

<https://www.nalcab.org/>

### **National Black Chamber of Commerce**

<http://www.nationalbcc.org/>



## RESOURCES & HELPFUL LINKS

### **Small Business Administration Resources and SBA Loans**

<https://www.sba.gov/>

### **SBA Loans**

<https://www.sba.gov/loans-grants/see-what-sba-offers/sba-loan-programs>

### **Women's Business Centers**

<https://www.sba.gov/tools/local-assistance/wbc>

# About the NFCC®

Founded in 1951, the National Foundation for Credit Counseling® (NFCC®) is the nation's first and largest nonprofit dedicated to improving people's financial well-being. With offices serving 50 states and Puerto Rico, NFCC Certified Credit Counselors are financial advocates, empowering millions of consumers to take charge of their finances and their futures.

NFCC member agencies assist individuals and families regardless of income or circumstances to ensure they never have to face their challenges alone. NFCC Certified Credit Counselors nationwide are trained, certified and ready to complete a comprehensive financial review and action plan to help clients meet their financial goals—in person, over the phone or online.

NFCC member agencies provide affordable, one-on-one, customized financial reviews and actions plans to address:

- Credit card debt
- Student loan debt
- Debt management
- Prepurchase housing decisions
- Foreclosure prevention
- Bankruptcy
- Overall money management
- Financial education needs
- Asset building
- Small business owner finances

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