



TOOLBOX



Cash Flow Management

Cash Flow Statements

Definition

Cash flow charts are a summary of money coming into and going out of a business. They are usually done monthly and include actual receipts and disbursements.

How it Works

A sample of the items included in a cash flow chart can be found below. All figures in the cash flow chart are *amounts actually paid out or received*. They exclude depreciation. Capital costs are listed in full where they occur.

In completing a cash flow chart for a very small business where the owner does not receive a regular salary but uses money from the business for his living expenses, include an estimated amount in the cash outlays section.

If an investment was made but only the down payment paid in a particular month, then only the down payment would be registered in the cash flow statement. For example, a sewing machine that costs \$120 was purchased in July with \$50 down and \$10 paid each month for the next seven months. In the cash flow chart, \$50 would be indicated as an investment for July, and \$10 for August and so on for the next six months.

Similarly the sales figures are those *actually received*. The net balance on the bottom line for each month is carried forward to the following month and written in the line marked "amount brought forward." This amount is treated as cash received that month.

Analysing the cash flow charts of a business can be very helpful in identifying problems the business may be having. If the net balance at the end of a month is quite low it can be an indicator that production is being limited by a lack of capital to purchase sufficient raw materials. For example, the stock of raw materials may be so low that the business has to wait for income from sales to purchase more materials. Or, it may mean that too much was already spent on an inventory of raw materials.

If the balance is low, it may also mean that raw materials cannot be purchased in quantity. Costs are higher because of numerous small purchases of raw materials rather than receiving quantity discounts.

When there is a large net balance at the end of each month, larger purchases or general expansion could be considered assuming there is a market for the product.

By developing and analysing cash flow projections for businesses, the owner and the credit institution can get a clearer idea as to when and how much credit may be needed (during months when the net balance is negative) or when it can be repaid (months when there is a positive net balance).

Pros, Cons and Other Uses

Cash flow statements will never be found at the smallest end of the business scale – except in the mental calculations these people make on a daily basis. This is practically all they need. As businesses grow, however, such a tool can be a helpful planning device between field worker and client.

Cash flow analysis becomes helpful with larger businesses, especially those of a cooperative nature. It serves a purpose not just in monitoring, but also design. When an NGO helps start these ventures, it is important to know how long it will take to get the business operational, and once in operation, the time required to reach its break-even point. (See the Break Even Point.) Prior to self-sufficiency, external support will be required at varied rates to cover expenses. A cash flow chart can help plan out the transfer and phase out of this assistance.

Cash Flow Forecast

You should always prepare a Cash Flow Forecast whenever you want to start a new business or expand or change an existing one; it will help you to avoid running out of cash, and to calculate how much money you need to raise, from a bank or elsewhere, *before* you undertake any new venture.

To forecast your cash flows, you need to know the *amount* of cash that will be 'flowing' into and out of the business, and *when* it will be 'flowing'. Even if your costs are much lower than your sales, so that you are making a good *profit*, you can still 'go broke' because you have allowed your customers too much credit, or have underestimated the time it takes to produce your goods.

The forecast can be laid out as follows:

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6 etc.
CASH IN						
Balance	nil	-1600	-3200	-4800	-2400	Nil
Capital	1000					
Loans	Nil					
Sales	nil	nil	nil	4000	4000	4000
TOTAL IN	1000	-1600	-32000	-800	1600	4000
CASH OUT						
Equipment	1000					
Wages	500	500	500	500	500	500
Materials	400	400	400	400	400	400
Salary	600	600	600	600	600	600
Other	100	100	100	100	100	100
TOTAL	2600	1600	1600	1600	1600	1600
BALANCE	-1600	-3200	-4800	-2400	nil	2400

The example shows that even a business with monthly profits of \$2400 (sales \$4000 – costs \$1600), and when the owner has enough capital to buy equipment (\$1000) will need a loan of over \$4800 if the time taken between starting production and receiving payment is three months, which is quite normal.