

Cash flow

Importance to the organisation & How to increase it part 1

What is Cash flow?

Cash flow is quite simply the amounts of cash coming in and going out of your business.

What's the difference between a Cash flow, Income Statement and Balance Sheet?

If a company was the human body we could state the following:

- Cash flow would be the blood
- Income Statement (aka Profit & Loss) would be the heart
- Body weight would be the Balance sheet.

This analogy succinctly describes the importance of cash flow. Just as a body can survive without a heart for some period of time, a company can survive for a period of time without making a profit (it can't survive indefinitely). Body weight is important to your overall health, however the body can generally survive a number of setbacks and still function, a company is similar with most able to absorb poor decisions and survive. Blood is an entirely different matter, the body can't survive without adequate blood supply and a company can't survive without adequate cash flow.

Why Cash flow important?

Cash flow is the most important aspect of your business simply because it allows a company to pay it's debts on time, which in-turn impacts your suppliers' willingness to offer you credit, property owners to offer you premises and staff to work for you. **Cash flow is the one item that keeps your company in business and stops your creditors from closing it down.**

An example of the importance of Cash flow compared to Balance Sheet and Income Statement (Profit and Loss).

Think of two farmers, Pat and Chris. Pat grows potatoes (each plant takes a month to be

ready for harvesting) and Chris grows saplings (each sapling takes six months to mature)

Who would you rather invest in?

If we assume both Pat and Chris make the same initial investment, similar growth rate, achieve the same revenue and experience the same costs. Pat and Chris's Balance sheets and Income Statements would be identical. Which enterprise is a 'safer' investment? The answer is the Cash flow statement as shown below

Cash flow statement for Chris (Sapling farmer)

	Jan	Feb	Mar	April	May	June
Cash at Start of month	3000	0	0	0	0	0
Cash In						
Sales	0	0	0	0	0	6000
Cash Out						
Planting	3000	0	0	0	0	0
Cash at end of Month	0	0	0	0	0	6000

Cash flow Statement for Pat (Potato farmer)

Pat	Jan	Feb	Mar	April	May	June
Cash at Start of month	3000	2500	0	0	0	0
Cash In						
Sales		1200	1200	1200	1200	1200
Cash Out						
Planting	500	500	500	500	500	500
Cash at end of Month	2500	3200	3900	4600	5300	6000

And the Winner is....

While both Chris and Pat made the same profit at the end of the year \$3000 and have the same ending Cash position of \$6000 at the end of June. Some very important differences

should be noted; Chris has no ability to deal with any extra costs that may occur during the January to May period as he had no cash. Chris also couldn't take advantage of any opportunities to grow his business. Pat on the other hand always had access to some funds and is much more able to survive an increase in expenses or additional investments.

Clearly the company with the better cash flow is the safer investment

Where to from now?

Hopefully you now have an understanding of the importance of cash flow. In part 2 of our exploration into cash flow I'll explain practical methods to increase your cash flow.

About the author

Travis Lepp is a qualified C.P.A and consultant for [enunc8](#) a company which specialises in helping business owners make informed, timely and profitable decisions to grow their business.