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# Financial Foundations

Practical Points for Predicting Cash Flow  
Managing cash in and cash out is the foundation of a successful business.

By Michelle Long

Because cash flow is of vital importance to small businesses, it is important to predict and monitor it. Without sufficient cash, a business may not be able to continue operations—even though the income statement may indicate that the business is earning a profit. So how can you predict cash flow and make the appropriate business decisions to ensure that there isn't a cash shortage?

## Analyzing Cash Inflows

The primary source of cash inflows should come from customers or clients. Unless your business receives cash at the time of sale (e.g., a retailer), you should have accounts receivable—customers who owe you money. By reviewing accounts receivable, you can determine the amounts due from customers. You also need to estimate when those customers will pay based on the due dates and their previous payment history.

Other cash inflows may come from loan proceeds, owner investments or the sale of assets. This is something the owner of the business should be able to forecast, since it results from decisions the owner has made.

## Analyzing Cash Outflows

It is necessary to estimate the due dates of upcoming bills. In addition to the normal monthly expenses, you should try to identify other expenses that may get overlooked since they aren't monthly expenses. For example, are there semi-annual insurance premiums due, quarterly sales taxes, payroll taxes, property taxes or other expenses?

In addition to the expenses, consider capital expenditures. Will it be necessary to buy capital equipment, furniture, vehicles or other capital assets?

By starting with the cash on hand and adding in the anticipated cash inflows and subtracting the estimated cash outflows, you get the ending estimated cash on hand. If there is any period with a negative cash balance, then you must take preventative measures to ensure a positive cash balance.

There are several ways to manage cash flow.

## Managing Cash Inflows

To improve cash inflows, invoice customers frequently. Also consider shortening the terms of payment—offering a discount for prompt payment. In a severe cash shortage, you could call delinquent accounts and offer a 10 to 15 percent discount if they promptly pay in full. A factoring or collection company will buy your accounts receivable, but will charge fees to assume the collection risks.

You may also require customers to make a deposit or prepay part of the total amount agreed upon. This will help improve the collection period. Also, it is a good idea to establish a line of credit with a bank so that funds are available if and when you need them. As a business owner, you might also find it necessary to put personal funds into the business from time to time. When you take that step, it is important that you specify whether the money is a loan or equity investment into the business.

## Managing Cash Outflows

If you discover that cash is tight, you may want to talk to your suppliers about extending your terms for payment or accepting partial payments. It is better to be direct with suppliers and vendors about difficult situations, as they often will be willing to try to help you through the cash crunch.

If cash is tight, you should also delay any discretionary purchases or expenditures. Postpone whatever you can until cash flow improves. In difficult cash flow situations, you may consider selling your accounts receivable to a factor company at a discounted amount. Other options include selling assets, using credit cards, or borrowing funds.

## Making Business Decisions

As the owner of a business, any business decision you make should consider the cash position of the business. Even if cash flow is good, you may need to exercise caution if the business is seasonal. If you have a seasonal business, you may need to build up cash reserves for the off-season months when you experience negative cash flow.

When it comes to asset purchases, always evaluate whether it is better to lease or buy the asset. The cash flow situation of your business may make a difference in your decision-making.

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The best situation is to monitor and predict cash flows on a regular basis. That will ensure that funds are available to pay the necessary expenditures to continue operations. Establishing a line of credit early on will ensure that funds are available for unforeseen circumstances.

Predicting cash flow is an important part of managing a growing business, and it can be the most critical factor to ensure continued viability of the business.

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