



Financial Reporting for Business

Cash Flow

Transcript

Narrator: The number one reason small businesses fail? Poor cash flow. Cash refers to the money a business has in the till or bank that can be used to pay for everyday expenses. Cash is the lifeblood of business. It's highly liquid, which means it's easy to access when needed. So, ensuring a business has a positive cash flow is critical to its survival.

Let's look at the significance of cash inflow and outflow, the difference between cash and profit and how businesses keep track of it all with a cash flow statement.

Cash flow is the money that flows in and out of a business.

Nicholas Walt: Cash inflow is literally the cash that comes in from your sales. There's cash in, and then there's cash out, which is literally what you have to pay out for expenses and supplies.

Narrator: Good cash flow is critical to a business' ongoing survival.

Nicholas Walt: Cash should really be seen as a kind of lubricant, and if you don't have lubricant, the engine stalls. So if you're growing fast, you can run out of cash very, very, very quickly and that can quickly also become the end of the business.

Narrator: The level of cash, or working capital, that the business needs should enable them to sustain current operations while meeting any current debt it still must service. It's important to remember, however, that the amount of cash a business has available is not the same as profit.

Martin Petrin: Cash and profit are really two completely different concepts. Cash is just money in the bank or in a box or a safe that the business has, whereas profit is the difference between what the company earned and what is spent.

Narrator: Profit refers to the money that remains from sales revenue after all the business' expenses have been subtracted. Profit is the business' net income. Sometimes a profitable business can have a cash flow problem, because there isn't enough cash flowing in at the right time.

Nicholas Walt: You can make galloping profits and run out of cash very quickly. If you're in a business growing 30% a year, you've got to find the stock and finance the stock. So it's a very common way of going bankrupt in a





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good business by not getting the cash flow tailored to the demand. Cash flow is really the most important thing of all.

Narrator: Alternatively, a business may have a steady stream of cash flowing in from sales, only to flow back out to pay for expenses, leaving little profit, or even a loss. Managing the flow of cash into an out of a business is critical. With that in mind, let's look at where a business' cash comes from and where it goes.

Martin Petrin: Cash inflow means money or funds that came into the business. For example, you sell a service or you sell a good. Customers pay you. That's a cash inflow.

Nicholas Walt: It can also be money invested by third parties, possibly even the director who is also a shareholder, or it could be a bank. You can also sell an asset, sell a building, sell a piece of machinery, sell a vehicle, so that would be cash generative.

Narrator: As cash flows into a business, it also flows out.

Nicholas Walt: Cash out, the most obvious item is salaries, wages. But in addition to that, you've got to pay suppliers, you've got to pay the landlord, you may have to repay the bank or someone for a loan. Those are the major constituents. It could involve also buying assets and buying more stocks. If you're growing very fast, this is often what happens.

Martin Petrin: You have to pay taxes, you have to pay charges. Maybe someone sued you and you have to pay damages. So anything that you have to pay, an invoice, any bill, any judgment against you results in cash and money leaving the business and that's a cash outflow.

Narrator: To keep track of money that flows in and out, businesses use the financial report known as a cash flow statement. The cash flow statement shows money coming into the business from activities, cash receipts from sales, debts collected, sale of assets and other income. It also shows the amount of money that's flowing out of the business—costs such as wages, purchasing stock and supplies, new computers and software. Other items listed as cash outflows include lease payments, transport costs, marketing, taxes and utilities.





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The cash flow statement shows a business' revenue and expenses over a certain period of time, usually a 12 month period. The report can be critical to the survival of start-ups that are doing well in the early stages of growth.

Martin Petrin: Without cash, the business is unable to pay any bills. So that's the most fundamental reason why it needs cash. For some time it could probably survive by saying, "I'm not going to pay you know, I'll pay you later" or "Can you give me this material?" or "Can you heat our facilities for credit?" But at some point it has to pay.

Narrator: Positive cash flow can be the difference between a business' success or failure, because if you don't have cash coming into a business, you don't have a business.

