CASH FLOW ANALYSIS

What is Cash Flow and Why is it Important to the Small Business Owner?

Cash Flow is defined as the movement of money or money equivalents in and out of a business. Positive cash flow is where money coming in is greater than money going out. For a business to survive long term the Business Plan's finance section should describe how and when positive cash flow will be achieved.

The number one reason for business failure is cash, not enough money to pay the bills. In simple math terms, revenues are less than expenses referred to as *negative cash flow*. To turn a profit, the business must either increase revenues or decrease expenses, referred to as *positive cash flow*.

Let's review some cash flow basics.

Cash Flow = Revenue (sales) – Expenses.
Revenue = Total Sales = (Price x Volume (units sold)).
Expenses = Fixed Expenses + Variable Expenses.

Total Sales has two components, price and units sold. To increase sales revenue, you can increase the price or increase the number of units sold. Both are dictated by your customers. Your customers determine the price they are going to pay and the amount they are going to buy. If the price of your product or service is too high, you lose customers.

The product price is determined by expenses and profit margin. Small businesses usually operate on small profit margins and depend on units sold to increase revenue. When the cost and price are too high, there are two options: reduce price (costs) or add value. Value-added costs are everything the customer is willing to pay for.

Communicating value-added expenses must be part of the total Marketing Strategy – Marketing, Branding, and Market Analysis. A good example of costs the customer is willing to pay for is extra costs due to social awareness like no testing on animals. Using this as a marketing tool can differentiate your product from the competition.

Reducing expenses is also part of the equation. This takes analysis. It starts with raw material purchasing all the way to product delivery. Every decision that is made to reduce expenses can have unintended consequences or could affect product quality.

Our book, "Don't Burn the Hot Dogs", will aid you in defining the details of the Business Plan that support positive cash flow. Top-notch Marketing and Risk Management Plans are key elements addressed in the book.