# Business Learning by Dan

## Understanding out Members' Businesses: Cash Flow

Dan Topf, CPT

Cash is the life blood of any business. Cash matters. Cash is King. Cash may be more important than profit. According to a recent New York Times article on the cause of business failures, four of the ten reasons cited link directly to cash. And here's one more quote, "In God we trust. All others pay cash."

You get my point?

> Profit is an "opinion," and cash is "fact."

I remember when I was in college, I frequently ran out of money before I ran out of "month." When that happened, I was forced to use credit or go without. This is true for any company as well. The more we align our learning and development programs to help employees drive cash availability, to use cash wisely, and to generate more cash for the company, the better.

Cash is tracked on the Statement of Cash Flows. It's a financial statement on par with the Income Statement and the Balance Sheet. All companies have one, and it's vital that we understand how it works and how the business decisions we make affect it. The statement tracks the changes in the cash balance of the business over the period in three parts: Operating Activities, Investing Activities, and Financing Activities.

When the cash balance on the Balance Sheet changes, we want to know what business decisions and results explain why. With a keen eye to the Statement of Cash Flows, you can begin to see how a business generates either positive or negative cash flows.

> **Operating cash flows** stem from the business' core operations. These are the inflows and outflows of cash for inventory, cost of goods, revenues, accounts payable, and accounts receivable.
>
> **Investing cash flows** are derived from the business' investment in capital equipment, assets, or investing activities. These are inflows and outflows of cash for plant, equipment, investment gains and losses.
>
> **Financing cash flows** show a business' changes in debt, payment of dividends, and the raising of capital. These include inflows from short term or long term loans.

As we all know by now, the idea is to have more cash flowing in than flowing out over a given period of time. So, it's doubly important for everyone in an organization to understand how their decisions impact the ratio of outflow to inflow of cash.

What do you think? Think you got it? Here's a little test for you. Consider each item. Determine if you believe the business' cash account will increase or decrease in each example. The correct answers may surprise you:

| Business action: | Cash increase or decrease? |
|---|---|
| **1. A small theater group charges a $2.00 premium per ticket on the day of the show.** | |
| **2. A life insurance company pays its vendors sooner.** | |
| **3. A manufacturer takes delivery of raw materials and component parts in smaller lots, more often.** | |
| **4. A company offers a 10% discount and sees a 10% increase in sales volume.** | |
| **5. An insurance company's aggressive new product sales campaign is very successful and volume sold increases significantly.** | |
| **6. The time to consume medical inventory at the clinic increases.** | |
| **7. To take advantage of tax rules, a construction firm accelerates depreciation of specialized equipment.** | |
| **8. Some customers begin to pay in advance.** | |

Answers: 1) Increase. The nominal increase does not affect sales volume. 2)Decrease. Cash leaves the company faster. 3)Increases. Less cash is spent buying inventories at any given period. 4) Decrease. Even if you sell 10% more, the cost of goods sold increases also. The net effect is negative. 5)Decrease. Insurance sales activity takes lots of cash for commissions and expenses up front. 6)Decrease. More cash is tied up in slow moving items. 7)No effect. Depreciation is a non-cash expense. 8)Increase. Customer pay sooner, and money is collected faster.

Employees usually don't handle the business' cash, but they do use their discretion to affect it. Every day, employees make decisions that have direct and indirect impact on cash for the business. Extending payment terms, offering discounts, extending credit, offering refunds/rebates, all affect the cash account. It's important to offer these things to customers, but it's also important to educate our employees on their impact on cash flows.

Profit is an "opinion," and cash is "fact." Accounting rules and conventions determine what values are material to the income statement for a business. There are lots of assumptions and estimates. As for cash, it's simpler. Do you have it? If not, we either get it or we're out of business.

Here are my suggestions for learning and development with regard to cash:

| Target Audience | Cash lessons and principles |
|---|---|
| **Customer Service** | Teach the impact of refunds, delays, and errors to cash. Rework, warranty, and other services require cash outflow without any inflows. |
| **Sales and Marketing** | Teach how pricing strategies affect buyer behaviors. Train in negotiation to know the time value of discounts and incentives. |
| **Human Resources** | Decrease new employee's time to performance. Only hire new employees when necessary. Hire for fit. Quickly re-deploy people into needed roles. Consider salary dollars as cash outflow. |
| **Engineering, R&D, and New Product Development** | Teach phase-gate approach to new product development. Train discipline to develop commercially viable alternatives. Launch only when ready. Forecast volume sold compared to cash flow. |

Yes, cash is of vital importance to the business. As we build business acumen in all our employees, we will see tremendous payoff as people use their understanding of cash to influence their day to day decisions.

Where to learn more:

Free online cash flow illustrator at www.MDI-Learning.com

Celemi Apples & Oranges, a business simulation available from MDI, Inc.

www.Investopedia.com, an online resource for investors of all types.

***Dan Topf, CPT*** *is Senior Vice President for Performance Improvement at MDI, Inc., A Business Learning Company. Dan can be reached at 515-292-2602 or at DanTopf@MDI-Learning.com. His company web site is www.mdi-learning.com.*