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Is Cash Flowing Into Your Business?

Business activity results in many types of processes and actions that may increase or decrease cash. This article illustrates the answers to three questions: Are your business activities resulting in an increase or decrease in cash? What does the change in cash really mean to your company? What affect does the change in cash have on the business?

The change in cash is depicted in one of the three basic financial statements—the Cash Flow Statement. This statement is most important to a company decision-maker when faced with decisions about whether sufficient cash is or will be available for operations, investing and financing.

The business activities previously mentioned are portrayed in the Cash Flow Statement as contributing to an increase or decrease in cash. It is important to note that cash in itself is not productive, and any amount of cash that is not needed in the short-term should be employed to earn interest. Ordinarily, excess cash will be invested in short-term securities that can be easily liquidated.

Decisions that impact the success of a company often include whether to purchase equipment, hire employees, or take out long-term debt. Cash becomes a focal point of these decisions because it will eventually be needed to make purchases, to pay employees and related taxes, and, to meet note payments. The decision-maker must understand how cash flows before such decisions are made. Most often, decision-makers will seek advice from a professional consultant. Independent consultants can assist the decision-maker in estimating the amount of cash to be used over a period of time and comparing it to the estimated amount of cash to be received over the same period of time. The results of the comparison will show whether plans will cause a positive or negative change in available cash. The comparison will help the decision-maker plan the necessary activities.

One question the decision-maker must get answered is whether the business' operations (selling of its product or service) result in providing cash or using cash. The Cash Flow Statement reflects the activities involved in selling the company's products or services. Oftentimes, the sales that are generated are uncollectable for thirty days or more after the sale occurred. Such delays in receiving cash payments create a customer receivable that if not managed properly could be disastrous for a business in dire need of cash. A primary reason businesses' fail to pay current obligations is due to uncollected cash from its sales. Very often, sales that are profitable can fail to produce cash, thereby contributing to a negative cash flow. The decision-maker can gain important information about necessary changes in its customer credit and collection policy by analyzing the company's Cash Flow Statement.

Cash is also affected by business activities that are not a direct result of customer sales. For example, a business decision to purchase an asset such as equipment, is an investment decision. Such a decision is reflected in the Cash Flow Statement as a use of cash through investing activities.

Another common scenario among businesses is depicted in the Cash Flow Statement. When a company becomes obligated for long-term debt, the transaction may result in an increase in cash from financing activities. However, decision-makers must be careful to plan future cash needs for maturing debt payoffs to prevent defaults in payments.

Business decision-makers must consider the net affect of all operating, investing, and financing activities in calculating the net provision or net use of cash. The affect of these three types of activities on the business is a question to be posed to the company's accountant. The answer is important in determining whether cash will be available for future plans.

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