# The Importance of Cash Management

**Cash Management**
Business analysts report that poor management is the main reason for business failure. Poor cash management is probably the most frequent stumbling block for entrepreneurs. Understanding the basic concepts of cash flow will help you plan for the unforeseen eventualities that nearly every business faces.

**Cash vs. Cash Flow**
Cash is ready money in the bank or in the business. It is not inventory, it is not accounts receivable (what you are owed), and it is not property. These can potentially be converted to cash, but can't be used to pay suppliers, rent, or employees.
Profit growth does not necessarily mean more cash on hand. Profit is the amount of money you expect to make over a given period of time, while cash is what you must have on hand to keep your business running. Over time, a company's profits are of little value if they are not accompanied by positive net cash flow. You can't spend profit; you can only spend cash.
Cash flow refers to the movement of cash into and out of a business. Watching the cash inflows and outflows is one of the most pressing management tasks for any business. The outflow of cash includes those checks you write each month to pay salaries, suppliers, and creditors. The inflow includes the cash you receive from customers, lenders, and investors.

*Positive Cash Flow*
If its cash inflow exceeds the outflow, a company has a positive cash flow. A positive cash flow is a good sign of financial health, but is by no means the only one.

*Negative Cash Flow*
If its cash outflow exceeds the inflow, a company has a negative cash flow. Reasons for negative cash flow include too much or obsolete inventory and poor collections on accounts receivable (what your customers owe you). If the company can't borrow additional cash at this point, it may be in serious trouble.

What Are the Components of Cash Flow?
A "Cash Flow Statement" shows the sources and uses of cash and is typically divided into three components:

***Operating Cash Flow***. Operating cash flow, often referred to as working capital, is the cash flow generated from internal operations. It comes from sales of the product or service of your business, and because it is generated internally, it is under your control.

***Investing Cash Flow***. Investing cash flow is generated internally from non-operating activities. This includes investments in plant and equipment or other fixed assets, nonrecurring gains or losses, or other sources and uses of cash outside of normal operations.

***Financing Cash Flow***. Financing cash flow is the cash to and from external sources, such as lenders, investors and shareholders. A new loan, the repayment of a loan, the issuance of stock, and the payment of dividend are some of the activities that would be included in this section of the cash flow statement.

**How Do I Practice Good Cash Flow Management**?

Good cash management is simple. It involves:

- Knowing when, where, and how your cash needs will occur
- Knowing the best sources for meeting additional cash needs
- Being prepared to meet these needs when they occur, by keeping good relationships with bankers and other creditors

The starting point for good cash flow management is developing a cash flow projection. Smart business owners know how to develop both short-term (weekly, monthly) cash flow projections to help them manage daily cash, and long-term (annual, 3-5 year) cash flow projections to help them develop the necessary capital strategy to meet their business needs. They also prepare and use historical cash flow statements to understand how they used money in the past.

*Source: U.S. Small Business Administration*