

Small Talk

Beyond Profit: Why Cash Flow is the Key to Business Success

IMPROVE LIQUIDITY TO FOSTER GROWTH AND RESILIENCE

Most business owners tend to focus on profitability — earning more than they spend — as their primary financial goal. But there's another critical measure that can't be overlooked: cash flow. Even a profitable business can run into trouble if it runs out of cash to cover day-to-day needs. That's why it's vital to monitor and optimize how money moves in and out of your business.

Cash flow reflects your liquidity — the cash available to pay employees and suppliers, cover rent and utilities, make loan payments and handle unexpected expenses. Even with strong sales, have you considered what might happen if payments aren't collected in time to cover these costs? It could put your business in a tough spot.

In this article, we'll break down how to measure and manage cash flow and share practical tips to keep your business financially healthy year-round.



MEASURING CASH FLOW

Keep in mind that cash flow isn't the same as revenue. It's not just what you earn — it's how much you have on hand to operate your business. Ensuring adequate cash flow involves striking a balance between two key factors:

- ➔ **Cash inflows:** Mostly payments from customers, but may also include investment income or proceeds from sales of assets.
- ➔ **Cash outflows:** Includes operating expenses like payroll, rent, taxes, debt payments and insurance.

To assess your cash position, start by calculating your **Operating Cash Flow Ratio:**

**Operating Cash Flow Ratio =
Cash Flow from Operations / Current Liabilities**

A ratio above 1.0 means your business generates enough cash to cover short-term obligations. A ratio of 1.25 or higher offers more breathing room. If it's below 1.0, you could be at risk of falling behind on bills.

You can also calculate your **Debt Service Coverage Ratio (DSCR):**

DSCR = Net Operating Income / Total Debt Service

This ratio assesses your company's ability to pay its debts (principal and interest). A DSCR of 1.25 is generally considered healthy. A lower score may hurt your ability to qualify for financing and limit your capacity to invest in growth, such as buying new equipment or opening a new location.

DIFFERENT BUSINESSES, DIFFERENT CHALLENGES

Cash flow challenges often come down to timing. Your goal is to always have enough cash coming in to cover what's going out. That requires a clear understanding of how your business operates, how you make or deliver your product or service, and how and when you get paid. For example, product-based businesses must closely manage inventory and supply chains, ensuring they meet demand without tying up cash in unsold goods. Meanwhile, service-based businesses may deal with irregular payments on long-term contracts or slower seasons that still require covering fixed costs.



TIPS TO IMPROVE CASH FLOW

Implementing good cash management practices from the start can set you up for long-term success. And if you're struggling to make ends meet, these steps can help:

- 1 **Create a cash flow statement** with your CPA and review it quarterly to spot shortfalls and adjust as needed.
- 2 **Cut unnecessary expenses** to reduce overhead and increase flexibility.
- 3 **Accelerate receivables** by invoicing promptly and consider offering small discounts for faster payment terms. Whenever possible, choose to receive payments electronically to avoid delays.
- 4 **Negotiate longer payment terms** with suppliers, buying you more time to collect the cash you need.
- 5 **Use accounting software** that can automate routine tasks and provide helpful financial insights.
- 6 **Work with a merchant services provider** to accept more payment methods — like cards and digital wallets — offer auto-billing and speed up collections.
- 7 **Establish a line of credit** with your bank, which can provide a safety net for unplanned expenses.

Not sure where to start? Lean on a trusted partner. The business banking team at Frost can help you evaluate your company's financial health and recommend strategies to keep your cash flow strong.