

Cash Flow

A Conversation with Students of the University of Washington, Bothell
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The purpose of financial statements

In accounting, the financial activities of a given organization are recorded in a series of statements, in a very specific, standardized way. These **financial statements** *communicate the financial position* of an organization in a matter that is **relevant, consistent and comparable**.¹

Some primary uses of these statements are to:

- Evaluate the health of the organization for **investment purposes**.²
- Provide a consistent measure for the application of **laws and taxes** so that all organizations are treated fairly.

The primary consumer of these statements include **investors, lenders, governments and management**.²

¹The Generally Accepted Accounting Principles (GAAP) and the International Financial Reporting Standards (IFRS) are two examples of accounting standards.

²Investors and lenders require a consistent foundation for comparing different opportunities.

³Management is often involved with the generation of financial statements to manage investors, lenders and the Internal Revenue Service (IRS).

The relationship between financial statements

The most basic set of financial statements will include:

- **Income Statement** – Describes *how* an organization makes profit.
- **Statement of Retained Earnings** – Describes any *changes* in earnings.
- **Balance Sheet** – Documents the *tangible value* of an organization.
- **Statement of Cash Flows** – Describes *operating activities*.

Articulation is the term used to describe how information flows between different financial statements. An example of this is provided below.

| Income Statement | | Balance Sheet | |
|---------------------------------|-----------------|---|-----------------|
| Revenues | | Assets | |
| Net sales | \$ 4,000 | Cash | \$ 2,000 |
| Other revenue | \$ 1,000 | Inventory | \$ 500 |
| Total revenue | \$ 5,000 | Facilities & land | \$ 5,000 |
| Expenses | | Total assets | \$ 7,500 |
| Wage expense | \$ 2,000 | Liabilities | |
| Cost of goods sold | \$ 1,000 | Accounts payable | \$ 1,000 |
| Utilities expense | \$ 250 | Total liabilities | \$ 1,000 |
| Total operating expenses | \$ 3,250 | Owner's equity | |
| Net Income/Loss | \$ 1,750 | Retained earnings | \$ 6,500 |
| | | Total owner's equity | \$ 6,500 |
| | | Total liabilities and owner's equity | \$ 7,500 |

| Statement of Retained Earnings | | Statement of Cash Flows | |
|--|-----------------|------------------------------|-----------------|
| Retained earnings - January 1st | \$ 5,250 | Operating activities | |
| Plus: Net income | \$ 1,750 | Cash received from customers | \$ 4,000 |
| | \$ 7,000 | Cash received from interest | \$ 400 |
| Less: Dividends | \$ 500 | Cash paid for salaries | \$ (2,000) |
| Retained earnings - December 31st | \$ 6,500 | Cash paid for other items | \$ 1,250 |
| | | Cash provided by operations | \$ 3,650 |
| | | Financing activities | |
| | | Payment of dividends | \$ (500) |
| | | Net increase in cash | \$ 3,150 |
| | | Cash - January 1st | \$ 2,350 |
| | | Cash - December 31st | \$ 5,500 |

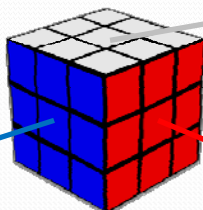
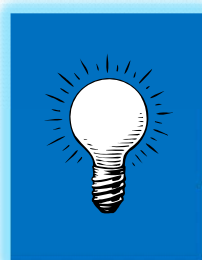


How it all fits together

Some people find financial statements puzzling for planning purposes and in many ways, they can be. This is, again, due to the fact that *the main purpose of financial statements are for the evaluation of an organization.*

You can think of each financial statement as being a different side of a Rubik's cube. *Each are views into the operations of your organization, but they are not the only possible views.*

When planning for or operating your company, the most important thing is to pick a model/view that makes the most sense to you. *Your understanding is everything.*



| Income Statement | |
|---------------------------------|-----------------|
| Revenues | |
| Net sales | \$ 4,000 |
| Other revenue | \$ 1,000 |
| Total revenue | \$ 5,000 |
| Expenses | |
| Wage expense | \$ 2,000 |
| Cost of goods sold | \$ 1,000 |
| Utilities expense | \$ 250 |
| Total operating expenses | \$ 3,250 |
| Net Income/Loss | \$ 1,750 |

| Balance Sheet | |
|---|-----------------|
| Assets | |
| Cash | \$ 2,000 |
| Inventory | \$ 500 |
| Facilities & land | \$ 5,000 |
| Total assets | \$ 7,500 |
| Liabilities | |
| Accounts payable | \$ 1,000 |
| Total liabilities | \$ 1,000 |
| Owner's equity | |
| Retained earnings | \$ 6,500 |
| Total owner's equity | \$ 6,500 |
| Total liabilities and owner's equity | \$ 7,500 |

*“Too often we measure everything and understand nothing. The three most important things you need to measure in a business are customer satisfaction, employee satisfaction, and **cash flow**.” – Jack Welch*

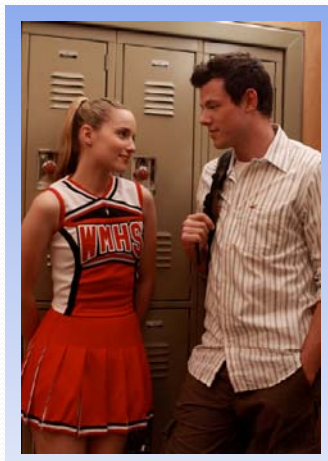
Introduction to cash flow

Cash flow is simply the *relationship* between money *inflows* and *outflows* over a *period of time*.

It is used to determine **solvency**, which is the ability of an organization to pay off debts.

Managing cash flow is the single most important activity in business.

A Gleeful cash flow example



- This is Finn Hudson and his girlfriend Quinn Fabray.
- Finn and Quinn are both high school students who have become expectant teen parents.
- Finn needs to find himself a job to support their new arrival.
- Unfortunately, Finn is not too bright and his only talents are football and singing. Since the NFL does not draft players out of high school, Finn has decided to start a vocal performance business.
- This is the most simple kind of business; other than wages, there are no real expenses (like cost of goods sold, rent, etc.).

Forecasting expenses

| | Salary | Start Date | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 | Total |
|----------------------|----------|------------|--------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|----------|
| Cash Outflows | | | | | | | | | | | | | | | |
| Finn Hudson | \$45,000 | 01/01/10 | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |
| Total | | | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |

- Finn would like to start his business on January 1st, 2010. The table above depicts his projected outgoing cash flows for the year.
- Finn would like to pay himself a salary of \$45,000 a year. This equates to \$3,750 each month.
- Please note that even though Finn started on January 1st, his salary outflow is calculated in the pay period after his start date (February in this example) because **wages are paid after each work period**.
- To operate his business for a year, Finn will need to find \$41,250 (annual salary minus the first pay period). More importantly, these funds will need to be spread out in \$3,750 increments each month. **Managing cash flow is ensuring that there are enough available funds to pay all expenses each month.**

The first opportunity

- Proctor and Gamble has decided to launch a new marketing campaign for its Scope brand of mouthwash.
- As part of this campaign, Scope is being positioned as a mouthwash so clean and refreshing that it makes your voice want to sing.
- The advertising executive for this campaign happened to see one of Finn's vocal performances and was so impressed that he offered Finn a two month, \$14,000 contract to sing and record radio commercials for this marketing campaign.



Sales, invoices and payments

| | Salary | Start Date | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 | Total |
|----------------------|----------|------------|----------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|----------|
| Sales | | | | | | | | | | | | | | | |
| Scope Promotion | | | \$14,000 | | | | | | | | | | | | |
| | | Total | \$14,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Invoices | | | | | | | | | | | | | | | |
| Scope Promotion | | | | \$7,000 | \$7,000 | | | | | | | | | | |
| | | Total | \$0 | \$7,000 | \$7,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Cash Inflows | | | | | | | | | | | | | | | |
| Scope Promotion | | | | \$7,000 | \$7,000 | | | | | | | | | | |
| | | Total | \$0 | \$7,000 | \$7,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Cash Outflows | | | | | | | | | | | | | | | |
| Finn Hudson | \$45,000 | 01/01/10 | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |
| | | Total | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |

- Here we can see that Finn has recorded this \$14,000 sale in January.
- The work will be **performed** in January and February.
- Invoices (bills) can only be **submitted after work** has been completed. Notice that there are **two invoices of \$7,000 each**, one for the work done in January and the other for February.
- Invoices are **paid only after** the invoice is **received**. Payments are typically made between 30, 60 or 90 days after an invoice is received (Net 30, 60 or 90). Payment periods are typically negotiated during contract negotiations.
- Notice that Finn will be paid (receive an inflow) **two months after he performs the work**.

Monthly cash flow and cash reserves

| | Salary | Start Date | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 | Total |
|----------------------|----------|------------|----------|-----------|---------|---------|-----------|-----------|-----------|------------|------------|------------|------------|------------|------------|
| Sales | | | | | | | | | | | | | | | |
| Scope Promotion | | | \$14,000 | | | | | | | | | | | | |
| | Total | | \$14,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Invoices | | | | | | | | | | | | | | | |
| Scope Promotion | | | | \$7,000 | \$7,000 | | | | | | | | | | |
| | Total | | \$0 | \$7,000 | \$7,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Cash Inflows | | | | | | | | | | | | | | | |
| Scope Promotion | | | | | \$7,000 | \$7,000 | | | | | | | | | |
| | Total | | \$0 | \$0 | \$7,000 | \$7,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Cash Outflows | | | | | | | | | | | | | | | |
| Finn Hudson | \$45,000 | 01/01/10 | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |
| | Total | | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |
| Cash Flow | | | | | | | | | | | | | | | |
| | | | \$0 | (\$3,750) | \$3,250 | \$3,250 | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) |
| Cash Reserves | | | | | | | | | | | | | | | |
| | | | \$0 | (\$3,750) | (\$500) | \$2,750 | (\$1,000) | (\$4,750) | (\$8,500) | (\$12,250) | (\$16,000) | (\$19,750) | (\$23,500) | (\$27,250) | (\$27,250) |

- A complete cash flow projection for Finn’s business is depicted above.
- Monthly cash flow can be calculated by *subtracting cash outflows from inflows*.
- Cash reserves (your bank balance) are calculated by *adding the current month’s cash flow to the previous month’s balance*.

Analyzing cash flow for planning

| | Salary | Start Date | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 | Total |
|----------------------|----------|------------|----------|-----------|---------|---------|-----------|-----------|-----------|------------|------------|------------|------------|------------|------------|
| Sales | | | | | | | | | | | | | | | |
| Scope Promotion | | | \$14,000 | | | | | | | | | | | | |
| | Total | | \$14,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Invoices | | | | | | | | | | | | | | | |
| Scope Promotion | | | | \$7,000 | \$7,000 | | | | | | | | | | |
| | Total | | \$0 | \$7,000 | \$7,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Cash Inflows | | | | | | | | | | | | | | | |
| Scope Promotion | | | | | \$7,000 | \$7,000 | | | | | | | | | |
| | Total | | \$0 | \$0 | \$7,000 | \$7,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$14,000 |
| Cash Outflows | | | | | | | | | | | | | | | |
| Finn Hudson | \$45,000 | 01/01/10 | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |
| | Total | | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |
| Cash Flow | | | | | | | | | | | | | | | |
| | | | \$0 | (\$3,750) | \$3,250 | \$3,250 | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) | (\$3,750) |
| Cash Reserves | | | | | | | | | | | | | | | |
| | | | \$0 | (\$3,750) | (\$500) | \$2,750 | (\$1,000) | (\$4,750) | (\$8,500) | (\$12,250) | (\$16,000) | (\$19,750) | (\$23,500) | (\$27,250) | (\$27,250) |

- Looking at Finn’s cash flow projections, we can see that Finn will need to borrow \$4,250 to finance his business through April (the first month he makes any money).
- We can also see that Finn is in dire need of additional sales and that he will need to *perform* at least \$1,000 worth of work in March in order to make it through May. *Remember that due to the sales, work and invoicing cycle, it will take at least two months from when Finn does the work for him to be paid for it.*

The competitive environment

- Finn has managed to close his first business client but his business is still operating well in the red.
- He needs to perform \$1,000 worth of work in March in order to cover his expenses through May. This means that he needs to close at least \$1,000 of sales by February.
- Finn is also having a difficult time securing the next sales opportunity. He is experiencing a business challenge in that his current value proposition is limited. There are only a limited number of opportunities for Finn, positioned the way he is.
- Finn has identified a new \$21,000 opportunity to sing at a series of new mall openings across America. Unfortunately for him, his competition for the opportunity sing duets and he needs to also offer this in order to compete effectively.
- **He is considering hiring his friend Rachel and would like to know how that will affect his cash flow.**



Considering growth

| | Salary | Start Date | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 | Total |
|----------------------|----------|------------|----------|-----------|----------|-----------|-----------|-----------|-----------|------------|------------|------------|------------|------------|------------|
| Sales | | | | | | | | | | | | | | | |
| Scope Promotion | | | \$14,000 | | | | | | | | | | | | |
| Mall Opening | | | | \$21,000 | | | | | | | | | | | |
| Total | | | \$14,000 | \$0 | \$21,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$35,000 |
| Invoices | | | | | | | | | | | | | | | |
| Scope Promotion | | | | \$7,000 | \$7,000 | | | | | | | | | | |
| Mall Opening | | | | | | \$7,000 | \$7,000 | \$7,000 | | | | | | | |
| Total | | | \$0 | \$7,000 | \$7,000 | \$7,000 | \$7,000 | \$7,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$35,000 |
| Cash Inflows | | | | | | | | | | | | | | | |
| Scope Promotion | | | | | \$7,000 | \$7,000 | | | | | | | | | |
| Mall Opening | | | | | | \$7,000 | \$7,000 | \$7,000 | \$7,000 | | | | | | |
| Total | | | \$0 | \$0 | \$7,000 | \$7,000 | \$7,000 | \$7,000 | \$7,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$35,000 |
| Cash Outflows | | | | | | | | | | | | | | | |
| Finn Hudson | \$45,000 | 01/01/10 | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | | | | | | |
| Rachel Berry | \$52,000 | 03/01/10 | \$0 | \$0 | \$0 | \$4,333 | \$4,333 | \$4,333 | | | | | | | |
| Total | | | \$0 | \$3,750 | \$3,750 | \$8,083 | \$8,083 | \$8,083 | \$8,083 | | | | | | |
| Cash Flow | | | | | | | | | | | | | | | |
| | | | \$0 | (\$3,750) | \$3,250 | (\$1,083) | (\$1,083) | (\$1,083) | (\$1,083) | (\$8,083) | (\$8,083) | (\$8,083) | (\$8,083) | (\$8,083) | (\$8,083) |
| Cash Reserves | | | | | | | | | | | | | | | |
| | | | \$0 | (\$3,750) | (\$500) | (\$1,583) | (\$2,667) | (\$3,750) | (\$4,833) | (\$12,917) | (\$21,000) | (\$29,083) | (\$37,167) | (\$45,250) | (\$45,250) |

Previous

| | | | | | | | | | | | | | | | |
|--|--|--|--|--|--|--|--|--|--|--|--|--|--|--|--|
| | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | |

- Finn is using the cash flow projection above to evaluate whether or not he should hire Rachel.
 - In order to get Rachel on board, Finn must pay her a higher salary which is reflected above.
 - Notice the **short term improvement** in cash flow coupled with the **increased long term responsibility** from the previous projections over the same time period without Rachel.
- Also notice the affect the hire will have on his cash reserves (bank balance).*

Considering growth (continued)

- Finn **cannot afford** to hire Rachel based on his previous cash flow projections.
- Though his short term cash flow improves a bit (due to the new sales opportunity they can win together) his monthly cash flow is still negative because his cash outflows are greater than his inflows.

| | | |
|----------------------|---------|---------|
| Cash Inflows | | |
| Scope Promotion | \$7,000 | |
| Mall Opening | \$7,000 | \$7,000 |
| Cash Outflows | | |
| Finn Hudson | \$3,750 | \$3,750 |
| Rachel Berry | \$4,333 | \$4,333 |
| | \$8,083 | \$8,083 |

- This is responsible for the hemorrhaging of his cash reserves. Even companies with strong reserves **cannot afford to operate with negative cash flows** for very long.
- Some industries are seasonal (like the retail industry) and may operate with negative monthly cash flows for some duration of time which are made up later (holiday sales season).
- It is important to **recognize and plan for the trends in your industry**. This allows you to set *appropriate minimum sales targets*.
- **Monitoring and managing your cash flow** is one barometer you can use to evaluate the health of your organization and identify problems.

Which brings us to the question, what is the solution for Finn?

Don't stop believin'

- Though it is important to plan, monitor and manage cash flow, it is also important to remember that **cash flow is not what your organization does, it's how it does it**.
- Finn's solution for building a successful company has always been based on the value it provides.
- Inspired by his friend Mercedes' "Bust the windows out your car" Jazmine Sullivan cover, Finn approached Ford Motor Company who is launching a marketing campaign for a new line of automobiles that will bust the windows off their competition.
- As a result, he is able to hire both Rachel and Mercedes and secure both the \$21,000 Mall opportunity (because his trio differentiated itself from the duet competition) and a \$150,000 contract from Ford for TV commercials.



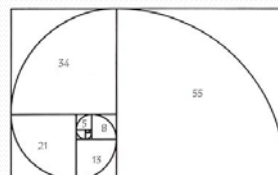
Solvency

| | Salary | Start Date | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 | Total | |
|----------------------|----------|------------|----------|---------|-----------|-----------|-----------|-----------|----------|----------|----------|----------|----------|----------|------------|-----------|
| Sales | | | | | | | | | | | | | | | | |
| Scope Promotion | | | \$14,000 | | | | | | | | | | | | | |
| Wall Opening | | | | | \$21,000 | | | | | | | | | | | |
| Ford Commercials | | | | | | \$150,000 | | | | | | | | | | |
| Total | | | \$14,000 | \$0 | \$21,000 | \$150,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$185,000 | |
| Invoices | | | | | | | | | | | | | | | | |
| Scope Promotion | | | | \$7,000 | \$7,000 | | | | | | | | | | | |
| Wall Opening | | | | | | \$7,000 | \$7,000 | \$7,000 | \$7,000 | | | | | | | |
| Ford Commercials | | | | | | | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | 25,000 | 25,000 | | | |
| Total | | | \$0 | \$7,000 | \$7,000 | \$7,000 | \$32,000 | \$32,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$0 | \$0 | |
| Cash Inflows | | | | | | | | | | | | | | | | |
| Scope Promotion | | | | | \$7,000 | \$7,000 | | | | | | | | | | |
| Wall Opening | | | | | | | \$7,000 | \$7,000 | \$7,000 | | | | | | | |
| Ford Commercials | | | | | | | | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | 25,000 | 25,000 | | |
| Total | | | \$0 | \$0 | \$7,000 | \$7,000 | \$7,000 | \$32,000 | \$32,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$0 | |
| Cash Outflows | | | | | | | | | | | | | | | | |
| Finn Hudson | \$45,000 | 01/01/10 | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |
| Rachel Berry | \$52,000 | 03/01/10 | \$0 | \$0 | \$0 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$39,000 |
| Mercedes Jones | \$54,000 | 05/01/10 | \$0 | \$0 | \$0 | \$0 | \$0 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$31,500 |
| Total | | | \$0 | \$3,750 | \$3,750 | \$8,083 | \$8,083 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$111,750 |
| Cash Flow | | | | | | | | | | | | | | | | |
| | | | | \$0 | (\$3,750) | \$3,250 | (\$1,083) | (\$1,083) | \$19,417 | \$19,417 | \$12,417 | \$12,417 | \$12,417 | \$12,417 | (\$12,583) | |
| Cash Reserves | | | | | | | | | | | | | | | | |
| | | | | \$0 | (\$3,750) | (\$500) | (\$1,583) | (\$2,667) | \$16,750 | \$36,167 | \$48,583 | \$61,000 | \$73,417 | \$85,833 | \$73,250 | |

- Notice how monthly cash flow slips into the red in December but how the cash reserves Finn built up have become adequate to absorb that.
- Also notice that Finn's cash reserves of \$73,250 in December give him enough operating capital to continue operations for ~5.8 months (\$73,250/\$12,583) assuming no new sales land.

Final things to consider

- Think very carefully about the composition of your company and **do not go on reckless hiring binges**. This will hemorrhage your cash reserves.
- Pay attention to and determine **your own golden ratios**. Ratios and indicators (monitored variables) can help provide you key insights into how different aspects of your company interact with each other. These can be used to set useful targets and are helpful for building balance and sustainability.
- It's better to ask people to **do a little more work** than to not have enough work around for people to do.
- Failure to develop and execute on a good operations strategy will **inevitably** lead to cash flow catastrophes.
- Failure to develop and execute on a good business strategy will **sometimes** lead to cash flow catastrophes.
- Here's a real world case of a failed business strategy impacting cash flow. The case study may look familiar.
<http://www.time.com/time/magazine/article/0,9171,947356-1,00.html>



"Talent wins games, but teamwork and intelligence wins championships." - Michael Jordan

Appendix: Transposing a projection to a statement

- The cash flow examples used in this slide deck were constructed using a view that is an amalgamation of *sales, invoicing and cash flow projections*.
- A cash flow financial statement is nothing more than a *snapshot of cash flow taken at a given time, covering a period of time*. Publicly traded companies report these every fiscal quarter and fiscal year.
- The diagram below transposes Finn's projections into a cash flow financial statement. Note that some information in the cash flow statement does not apply due to the fact that the Finn example is a simplistic view of a business.

| | Salary | Start Date | Jan-10 | Feb-10 | Mar-10 | Apr-10 | May-10 | Jun-10 | Jul-10 | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 | Total |
|----------------------|----------|------------|----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|------------|
| Sales | | | | | | | | | | | | | | | |
| Scope Promotion | | | \$14,000 | | | | | | | | | | | | |
| Mail Opening | | | | \$21,000 | | | | | | | | | | | |
| Ford Commercials | | | | | \$150,000 | | | | | | | | | | |
| Total | | | \$14,000 | \$21,000 | \$150,000 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$185,000 |
| Invoices | | | | | | | | | | | | | | | |
| Scope Promotion | | | | \$7,000 | \$7,000 | | | | | | | | | | |
| Mail Opening | | | | | \$7,000 | \$7,000 | \$7,000 | | | | | | | | |
| Ford Commercials | | | | | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$185,000 |
| Total | | | \$0 | \$7,000 | \$7,000 | \$7,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$185,000 |
| Cash Inflows | | | | | | | | | | | | | | | |
| Scope Promotion | | | | \$7,000 | \$7,000 | | | | | | | | | | |
| Mail Opening | | | | | \$7,000 | \$7,000 | \$7,000 | | | | | | | | |
| Ford Commercials | | | | | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$25,000 | \$185,000 |
| Total | | | \$0 | \$7,000 | \$7,000 | \$7,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$32,000 | \$185,000 |
| Cash Outflows | | | | | | | | | | | | | | | |
| Finn Hudson | \$45,000 | 01/01/10 | \$0 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$3,750 | \$41,250 |
| Michelle Berry | \$52,000 | 01/01/10 | \$0 | \$0 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$4,333 | \$41,250 |
| Mercedes Jones | \$54,000 | 01/01/10 | \$0 | \$0 | \$0 | \$0 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$4,500 | \$41,250 |
| Total | \$0 | \$3,750 | \$3,750 | \$8,083 | \$8,083 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$12,583 | \$113,750 |
| Cash Flow | | | | | | | | | | | | | | | |
| | | | \$0 | (\$3,750) | \$3,250 | (\$1,083) | (\$1,083) | (\$1,083) | (\$1,083) | (\$1,083) | (\$1,083) | (\$1,083) | (\$1,083) | (\$1,083) | (\$13,583) |
| Cash Reserves | | | | | | | | | | | | | | | |
| | | | \$0 | \$3,750 | (\$500) | (\$1,583) | (\$2,667) | \$16,250 | \$36,167 | \$48,983 | \$61,000 | \$73,417 | \$85,500 | \$97,917 | \$73,250 |

| Statement of Cash Flows | |
|--|--------------|
| For the period ending Dec. 31 st , 2010 | |
| Operating activities | |
| Cash received from customers | \$ 185,000 |
| Cash received from interest | \$ - |
| Cash paid for salaries | \$ (111,750) |
| Cash paid for other items | \$ - |
| Cash provided by operations | \$ 73,250 |
| Financing activities | |
| Payment of dividends | \$ - |
| Net increase in cash | \$ 73,250 |
| cash - January 1st | \$ - |
| cash - December 31st | \$ 73,250 |