# Table of Contents

**Introduction** ............................................................................................................. 1

- About This Book ........................................................................................................ 1
- Conventions Used in This Book .................................................................................. 2
- What You’re Not to Read ............................................................................................. 3
- Foolish Assumptions .................................................................................................. 3
- How This Book Is Organized ..................................................................................... 4
  - Part I: Fitting Cash Flow into the Big Picture of Running a Business ......................... 4
  - Part II: Using Financial Statements to Assess Cash Health ..................................... 4
  - Part III: Getting Intimate with Your Company’s Cash Flow Needs ......................... 4
  - Part IV: Managing Your Business with Cash Flow in Mind .................................. 5
  - Part V: The Part of Tens ......................................................................................... 5
- Icons Used in This Book ............................................................................................. 5
- Where to Go from Here ............................................................................................... 6

**Part I: Fitting Cash Flow into the Big Picture of Running a Business** ......................... 7

**Chapter 1: Getting in Sync with the Rhythm of Cash** .................................................. 9

- Not Letting the Well Run Dry .................................................................................... 10
- Outlining Profit Accounting Basics .......................................................................... 11
  - Reviewing revenue accounting .............................................................................. 11
  - Examining expense accounting ............................................................................. 12
- Contrasting cash- and accrual-basis accounting ....................................................... 13
- Seeing Why Profit and Cash Flow Are Different Bottom Lines ................................. 14
  - Considering what the income statement doesn’t say about cash flow .................... 14
  - Exploring cash flow from profit ............................................................................ 15
- Identifying and Reporting Basic Types of Cash Activities ......................................... 19
  - Cash flow from investing activities ...................................................................... 20
  - Cash flow from financing activities ...................................................................... 20
  - Cash flow from operating (profit-making) activities .............................................. 21
- Putting cash-flow activities together .......................................................................... 21
Chapter 2: Why Accrual Accounting Is Essential ................................. 23

Finding Out the Four Functions of Accounting ..................................... 24
Keeping records (Bookkeeping) ............................................................ 25
Giving company management the information it needs ........................ 26
Complying with tax laws .................................................................. 28
Reporting financial information ......................................................... 29
Examining the Nature of Accrual Accounting ...................................... 31
Uncovering the inadequacy of cash-basis accounting ......................... 32
Recognizing accrual accounting in financial reports ......................... 32
Reporting Assets and Liabilities in the Balance Sheet .......................... 34

Chapter 3: The Big Three Financial Statements ................................. 37

Why Financial Statements Are Essential .............................................. 38
Who gets financial statements and why .............................................. 40
Who doesn’t get financial statements and why .................................. 41
Facing Off: The Balance Sheet .............................................................. 42
Strolling through the balance sheet .................................................... 42
Putting accounts in their right places ................................................. 44
Dealing with the limitations of the balance sheet .............................. 45
Tracing revenue and expenses in the balance sheet ......................... 47
Managing capital .............................................................................. 49
Making Profit: The Income Statement .................................................. 52
Moving from the revenue top line to the profit bottom line ............... 54
Deciding which is more important: Revenue or expenses ................ 54
Showing cash flow from operating (profit-seeking) activities .............. 56
Listing other sources and uses of cash ............................................... 57

Chapter 4: Getting a Grip on the Statement of Cash Flows .................. 59

Distinguishing Cash Flows ................................................................. 60
Adjusting your way to cash flow from operating activities ................ 62
Cogitating on cash flow from investing activities .............................. 66
Considering cash flow from financing activities .............................. 66
Getting to Know the Dual Personality of the Statement of Cash Flows .................................................................................. 69
Spotting changes in financial condition ............................................. 69
Building the year-end balance sheet ................................................ 70
Comparing Cash-Flow Scenarios ....................................................... 72
Starting with cash flow in a steady state ........................................... 73
Assessing cash-flow effects of growth and of decline ...................... 75
Understanding negative cash flow .................................................... 76
Recognizing Problems with the Statement of Cash Flows .................. 77
Getting skipped by small businesses ............................................... 77
Providing too much or too little information .................................... 78
<table>
<thead>
<tr>
<th>Chapter 5: Mining the Balance Sheet for Cash</th>
<th>83</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reading the Balance Sheet from a Cash-Flow Perspective</td>
<td>84</td>
</tr>
<tr>
<td>How assets are listed in the balance sheet in relation to generating cash</td>
<td>85</td>
</tr>
<tr>
<td>How liabilities are listed in the balance sheet in relation to consuming cash</td>
<td>89</td>
</tr>
<tr>
<td>What the balance sheet doesn’t disclose about cash flows</td>
<td>91</td>
</tr>
<tr>
<td>Giving the Balance Sheet a More Thorough Examination</td>
<td>93</td>
</tr>
<tr>
<td>Using key balance sheet performance-measurement tools</td>
<td>93</td>
</tr>
<tr>
<td>Evaluating your assets</td>
<td>96</td>
</tr>
<tr>
<td>Taking a closer look at your liabilities</td>
<td>100</td>
</tr>
<tr>
<td>Scrubbing the Balance Sheet Clean for Its Users</td>
<td>103</td>
</tr>
<tr>
<td>A case study: Scrubbing the balance sheet of ACME Distribution, Inc.</td>
<td>103</td>
</tr>
<tr>
<td>Aiding internal business management</td>
<td>109</td>
</tr>
<tr>
<td>Providing confidence to outsiders</td>
<td>109</td>
</tr>
<tr>
<td>Unlocking Hidden Cash from the Balance Sheet</td>
<td>110</td>
</tr>
<tr>
<td>Turning over current assets</td>
<td>110</td>
</tr>
<tr>
<td>Investing in long-term assets</td>
<td>111</td>
</tr>
<tr>
<td>Leveraging your current liability friends</td>
<td>111</td>
</tr>
<tr>
<td>Using notes payable, loans, and leases appropriately</td>
<td>112</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Chapter 6: Digging Deeper into Cash Flow</th>
<th>113</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tying Up Cash Flow in a Neat Bundle</td>
<td>113</td>
</tr>
<tr>
<td>Presenting financial statements for analyzing cash flows</td>
<td>114</td>
</tr>
<tr>
<td>Cutting the balance sheet down to size</td>
<td>115</td>
</tr>
<tr>
<td>Reviewing sources and uses of cash</td>
<td>119</td>
</tr>
<tr>
<td>Zeroing in on changes in financial condition from making profit</td>
<td>119</td>
</tr>
<tr>
<td>Developing Benchmarks for Cash Flow</td>
<td>121</td>
</tr>
<tr>
<td>Comparing cash flow with sales revenue momentum</td>
<td>121</td>
</tr>
<tr>
<td>Using other tools for cash-flow analysis</td>
<td>124</td>
</tr>
<tr>
<td>Massaging Cash-Flow Numbers</td>
<td>127</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Chapter 7: Understanding Liquidity versus Available Cash</th>
<th>131</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defining Business Solvency and Liquidity (Hint: Not the Same Thing)</td>
<td>132</td>
</tr>
<tr>
<td>Applying Business-Solvency and Liquidity Measurement Tools</td>
<td>137</td>
</tr>
<tr>
<td>Measuring and monitoring solvency</td>
<td>137</td>
</tr>
<tr>
<td>Keeping tabs on liquidity</td>
<td>140</td>
</tr>
</tbody>
</table>
Avoiding Liquidity Traps ................................................................. 143
  Tying up cash in company assets .................................................. 143
  Using debt inappropriately ............................................................. 145
  Assuming that business growth is always good ......................... 147
  Assuming that a shrinking business always represents trouble .... 148
Discovering Untapped Sources of Liquidity .................................... 149
  Liquidating assets ....................................................................... 149
  Leveraging assets ........................................................................ 151
  Relying on available lending sources ........................................... 152
  Approaching creditors, customers, and other partners ............... 153
  Using equity and off-balance-sheet sources of capital ............... 154
Financial Leverage: The Good, the Bad, and the Downright Ugly ... 155
  The good ..................................................................................... 155
  The bad ....................................................................................... 156
  The downright ugly ..................................................................... 156

Part III: Getting Intimate with Your Company’s Cash Flow Needs ...... 157

Chapter 8: Creating a Business Plan to Secure Cash ....................... 159

  Outlining the Basic Business Plan ................................................ 160
  The executive summary ................................................................. 161
  The market assessment ................................................................. 161
  The operational overview .............................................................. 162
  The financial summary: Performance and required capital (Cash) .... 163
  Developing a Business Plan ........................................................... 163
  Outlining your plan by using BOTE, WAG, and SWAG ............... 164
  Getting the process going ............................................................. 165
  Using two simple but powerful tools: SWOT and KISS .............. 167
  Incorporating Third-Party Information into Your Plan ............... 169
  Gathering the info ....................................................................... 170
  Using only reliable info ............................................................... 170
  Riding the CART Concept: Complete, Accurate, Reliable, and Timely ................................................................. 171

Chapter 9: Building Best-in-Class Projection Models to Manage Cash .... 173

  Rounding Up Resources to Build Financial Forecasts ............... 173
  Planning with the Big Picture in Mind ......................................... 174
  Deciding on a top-down versus bottom-up projection strategy .... 174
  Identifying your critical business economic drivers ................. 176
  Building the Basic Projection Model ........................................... 178
## Table of Contents

Making the Most of Your Projections .................................................. 181
  Getting familiar with some useful terms ........................................ 181
  Treating forecasts as living, breathing management tools .......... 183
Understanding the difference between
  internal versus external projections ........................................... 184
Preparing multiple projection scenarios: The what-if analysis ....... 185
Integrating forecasts into the active
  management of your business.................................................. 188
Broadening the use of projections even further......................... 191

### Chapter 10: Identifying and Securing

External Sources of Capital ...................................................... 193
  Getting a Grip on the Capital Concept ....................................... 194
  Understanding the Basics of Equity Capital .......................... 195
    Equity preference .................................................................. 195
    Equity and management influence ........................................ 196
  Starting to Look for Capital ................................................... 196
    Looking in the mirror .......................................................... 197
  Turning to family, friends, and close business associates ...... 198
  Seeking Equity Sources of Capital .......................................... 199
    Angel investors .................................................................. 200
    Venture capitalists (VCs) ....................................................... 201
    Private equity groups (PEGs) ............................................. 201
    Other private investment groups ........................................... 202
  Accessing Public Sources of Capital ....................................... 203
  Putting Your Capital to Good Use ......................................... 204
  Looking at the Reality of the Current Capital Markets .......... 209
  Ten tips for raising capital .................................................... 209
  Five realities of the current capital markets ......................... 210

### Chapter 11: Knowing When to Use Debt to

Finance Your Business .............................................................. 213
  Understanding the Basics of Debt Capital .......................... 214
    Debt maturity .................................................................. 214
    Debt security ................................................................. 214
    Other debt attributes ....................................................... 216
  Determining When Debt Is Most Appropriate ..................... 216
    When you can offer security or collateral ......................... 217
    When business is stable ................................................... 217
    When you have financial strength ..................................... 218
  Using Loans, Leases, and Other Sources of Debt ................. 218
    Borrowing from banks .................................................... 218
    Making friends with asset-based lenders .......................... 220
    Leasing as a source of capital .......................................... 221
    Tapping government programs and the SBA .................. 223
    Using other sources of debt-based capital .................... 223
Getting Creative with Capital ................................................................. 224
Generating internal cash flow ................................................................. 224
Leveraging unsecured creditors ................................................................. 225
Going after government aid, gifts, and grants ............................................. 225
Partnering up ......................................................................................... 226
Leveraging Uncle Sam for Cash ................................................................. 226
Four government-endorsed strategies
to help improve cash flow ........................................................................ 227
Don’t forget the SALT: State and local taxation ........................................ 235

Part IV: Managing Your Business with
Cash Flow in Mind .................................................................................... 239

Chapter 12: Covering the Basics of Cash and Cash Activity ................. 241
Managing the Unique Characteristics of Cash .............................................. 242
Understanding that cash ends up being one side of almost every transaction ......................................................... 242
Tuning in to the constant cash hum .............................................................. 244
Deciding what a normal cash balance should be ......................................... 245
Implementing Fundamental Cash Management Practices ............................... 249
Establishing cash and bank accounts ............................................................ 249
Controlling cash and bank accounts ............................................................. 252
Maximizing your business’s cash ................................................................. 254
Understanding Cash in the Digital Age ........................................................ 255
Moving and processing cash transactions electronically ................................ 256
Establishing cash controls in electronic-based accounting systems ............. 259
Working with Cash as a Key Business Indicator .......................................... 262
Knowing the seasonal ebb and flow of cash ............................................... 263
Setting periodic cash level benchmarks ....................................................... 265

Chapter 13: Preventing Cash Losses from Embezzlement and Fraud ....... 267
Setting the Stage for Protection ................................................................. 268
Preventing loss with internal controls ........................................................ 268
Recognizing the dual purpose of internal accounting controls .................... 269
Struggling with fraud committed by the business ........................................ 270
Putting Internal Controls to Work .............................................................. 272
Going down the internal controls checklist ............................................... 272
Considering some important details of internal control ............................. 276
Recognizing Limitations of Internal Controls .................................................. 278
  Keeping internal controls under control ....................................................... 279
  Finding fraud that slips through the net ....................................................... 279

Chapter 14: Managing the Selling Cycle to Improve Cash Flows . . . 281

Understanding the Entire Selling Cycle: Start to Finish ......................... 282
  The accounting/financial view ................................................................. 282
  The strategic view ..................................................................................... 282
  Why the sales cycle is the biggest consumer of cash ............................... 283

Implementing Basic Controls in the Selling Process to Manage Cash ....... 284
  Qualifying the customer ............................................................................. 284
  Being prudent with credit review and approval ......................................... 286
  Setting proper terms and conditions .......................................................... 289
  Supplying CART — complete, accurate, reliable, and timely — invoices ... 291
  Managing past-due accounts and collection efforts .................................. 292

Getting Creative to Improve Sales-Related Cash Flows ....................... 296
  Using discounts: The double-edged sword ................................................. 296
  Offering creative payment terms .............................................................. 297
  Using deposits, advances, and prepayments ............................................. 299
  Accepting alternative forms of payment ................................................... 300
  Managing seasonality in the selling cycle ............................................... 303

Managing the Lending Agreement in Relation to Your Sales Cycle ..... 304
  Defining eligible receivables ................................................................. 304
  Understanding advance rates and dilution ................................................. 305
  Watching for hidden time bombs in your lending agreement ................. 306
  Driving a lending agreement to improve liquidity and access to cash .... 309

Chapter 15: Managing the Disbursement Cycle to Improve Cash Flows . 311

Tracing the Entire Disbursement Cycle ..................................................... 311

Taking Critical Steps in the Disbursement Cycle to Manage Cash ....... 313
  Qualifying suppliers and vendors ........................................................... 313
  Establishing proper disbursement cycle controls .................................... 314
  Managing external creditors ................................................................. 316

Getting Creative to Improve Cash Flows from the Disbursement Cycle.. 318
  Leaning on vendors and suppliers ......................................................... 318
  Using JIT payment strategies ............................................................... 320
  Grading your vendors and suppliers ....................................................... 320
  Floating along ......................................................................................... 322
  Creating cash from inventory ............................................................... 323
  Tapping vendor-provided financing ....................................................... 324
Leveraging Your Employees for Cash .................................................... 324
Timing commissions and bonuses .................................................. 325
Connecting compensation to performance .................................... 326
Utilizing noncash forms of equity compensation for employees ................................................................................ 327
Checking out other benefit strategies and ideas ............................. 328

Part V: The Part of Tens ................................................................. 331

Chapter 16: Ten Keys to Managing Cash Flows in a Small Business ................................................................. 333
Respect and Understand Financial Statements .......................... 334
Plan, Do Projections, and Plan Some More ................................. 334
Focus on Capital and Cash: The Lifeblood of Any Business .......... 335
Understand Your Selling Cycle ...................................................... 336
Manage Your Disbursements Cycle .............................................. 336
Be Creative to Generate Cash ....................................................... 337
Balance the Balance Sheet ............................................................. 338
Understand External Capital Markets ......................................... 338
Protect Cash at All Times ............................................................... 339
Always Think of CART ................................................................. 340

Chapter 17: Ten Tales of Cash-Flow Woes ................................. 341
Misunderstanding Trade Account Receivables ......................... 341
Letting Good Inventory Go Bad .................................................. 342
Improperly Investing in Soft Assets ........................................... 343
Falling into the Taxable Income Trap .......................................... 344
Misapplying Available Debt-Based Capital ................................. 345
Failing to Prepare for the Economic Hard Landing ..................... 346
Getting Left in the Cold by Changing Market Conditions .......... 347
Making Overly Optimistic Sales Forecasts ................................. 348
Robbing Peter to Pay Paul ............................................................. 349
Growing Yourself Out of Business .............................................. 350

Index ......................................................................................... 351