

HOW TO BE PROFITABLE DURING BOTH GOOD AND BAD TIMES – CASH FLOW PROJECTION

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In a different article, I described the preparation of an annual budget, the third step in planning to be profitable. As a re-cap, the five steps to being profitable are:

1. Prepare an annual Gross Margin Plan
2. Use an Open-To-Buy
3. Prepare an annual pro-forma Income Statement (budget, done by month)
- 4. Prepare an annual Cash Flow Projection (done by month)**
5. Track the productivity of their selling staff

In this, the fifth installment of this 6 part series, we will discuss putting together your annual Cash Flow Projection to make sure you have the cash needed to pay your bills and keep your business functioning.

Cash Flow Projection

After the Pro-forma Income Statement (Budget) is completed to your satisfaction, the next step is to prepare a Cash Flow Projection. You must always keep in mind that Profit does NOT equal Cash. And you must have cash to stay in business.

A retail store without cash is like a fish out of water -- it cannot exist very long. It cannot pay for merchandise, nor can it pay its sales or office personnel or its overhead costs. **A company can operate for a time without making a profit -- but it cannot operate without enough cash to pay its bills.**

Cash flow management is an essential business function for all retail operations yet very few actually prepare a formal written Cash Flow Budget. With a well-prepared Cash Flow Budget you will:

*Know ahead of time when extra operating funds will be needed so there will be time to search for and negotiate the most advantageous loans and terms.

*Be able to pay all bills on time -- not early and not late -- to take advantage of all cash discounts and improve your credit standing.

*Remain in business.

The method I use is to start with Net Profit and make adjustments as needed to convert it to cash. With the accrual method of accounting, the goal is to match sales and expenses monthly. This means that the month in which you pay for something and the month in which it is expensed are many times not the same. For example, store insurance for property and liability is many times paid semi-annually or even annually, but it is expensed monthly. Also, there are items that use cash that do not show up on the Income Statement. For example, any payments to loan principal do not show up on the Income Statement (only interest does). So, any payments of loan principal need to be deducted from Net Profit in the Cash Flow Projection.

A simplified way of thinking about this is that any increase in an Asset is a use of cash and any reduction in an Asset is an increase in cash. Conversely, any increase in Liabilities means that we have not used any cash but instead incurred a liability. Then, any decrease in a liability is a use of cash and reduces our cash reserves.

Below is a copy of the format of the Cash Flow section of the budget I prepare for retailers I work with, since I consider it important enough to ALWAYS be included with the budget.

CASH FLOW ADJUSTMENTS:

Inventory Change (increase) decrease

A/R Trade-Adjustments

Other Receivables-Adjustments

Prepaid Expenses-Adjustments

Fixed Assets-Adjustments

Other Assets - Deposits

A/P Trade-Adjustments

Other Liabilities Adjustments

Depreciation/Amortization

Bad Debt Expense

N/P-ST/Seasonal -Adjustments

N/P-LT-Adjustments

Total Cash Flow Adjustments

Monthly Cash Flow

Seasonal Debt-Additions

Seasonal Debt Payments

Additional Pd In Cap. (Dividends)

BOY Cash Balance

CASH BALANCE - EOM

Now, lets go over each line of this form. You need to be aware of how each affects cash and how you adjust Net Profit to arrive at your monthly cash balance.

Inventory Change: If inventory increases, it is a use of cash and conversely, if inventory decreases it is an increase in cash. That is why on the Inventory Change line above it shows a negative for increase.

A/R Trade: When you sell merchandise on account you are not generating any cash, therefore, it is a reduction in cash. (You sold the merchandise but have not received any cash.) Conversely, when a customer makes a payment on account it is an increase in cash. The net effect of this is the A/R Trade Adjustment.

Other Receivables: This works the same as A/R Trade above. When it is created, it is a reduction in cash and when it is paid it is an increase in cash. Other Receivables are things such as Returned Checks or could be funds advanced to employees.

Prepaid Expenses: Prepaid Expenses are items you pay for immediately but show as expenses in the Income Statement later. An example of this is your business property and casualty insurance. Normally you are paying for this either every 6 months or 12 months. However, the expense is recorded in the Income Statement by month. When this is paid, it is a use of cash. When the item is expensed it is not using cash so is added back to cash when adjusting the Net Profit figure.

Fixed Assets: The purchase of capital assets represents a use of cash-whether the cash is internally generated or obtained from a loan. Conversely, the total proceeds from the sale of a capital asset should be presented as a source of cash and added to earnings.

Other Assets – Deposits: This is generally used for deposits on such things as rent or utilities. As such, it is a use of cash and the original payment and any increases must be deducted from cash.

A/P Trade: An increase in the Accounts Payable balance is added back to earnings since we have received merchandise but not yet paid for it. A decrease in the Accounts Payable balance indicates a use of cash and is thus subtracted from the cash balance.

Other Liabilities: An increase in accrued liabilities, such as Accrued Property Taxes represents a charge against earnings not requiring cash and this must be added back to earnings. A decrease in liabilities reflects a use of cash greater than the expenses charged against earnings and thus must be subtracted from earnings. Also, items such as State Sales Taxes Payable does not affect the Income Statement but is an inflow of cash one month and a payment of cash the next month (for most states).

Depreciation/Amortization and Bad Debt Expense: These are non-cash items which have been charged against earnings and so must be added back to earnings.

N/P-ST, N/P-LT and Seasonal Debt: For all loans, when you receive the loan proceeds, it is an increase in cash and when you make a payment of principal on the loan it is a use of cash and reduces cash. For example, if your loan payment is \$750 but \$467 is interest the principal payment of \$283 is a reduction of cash. The \$467 interest is already included in the Net Profit figure since interest is an expense.

Additional Pd In Cap. (Dividends): When you invest more into your business, it is an increase in cash. Conversely, when you take money out of the business by paying a Dividend it is a use of cash.

IN CONCLUSION

All our planning is now in place. We have completed the Gross Margin Plan, Open-To-Buy, Budgeted Income Statement, and Cash Flow Projection. However, **our ultimate goal is not to plan - but to use the plans as a yardstick against which to measure our performance during the course of the year.** Therefore, it is critical to compare your actual results every month to the plans and make adjustments whenever the need is seen, either by adjusting your way of doing business or changing your plan to match reality. For example, if your electric rates have been increased and you are already doing everything you can to reduce your use of electricity in your store, it is best to go ahead and enter the new, higher expense into your budget. That way, you can review all the other expenses in your budget to see if you are able to reduce some other expense to make up for this increase. The budget and cash flow projection should be dynamic tools to be reviewed every month and adjusted as needed to keep them realistic.

Next month we will move on to our Salespeople, specifically tracking their productivity. It is only by tracking how they are doing that we can gain the knowledge we need to help them improve their performance.

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