



# What Is Cash Flow?

To be successful, firms need to understand cash flow, not just profit and loss. Cash flow is the lifeblood of enterprises and essential for helping them function.

But how does it work?

## Cash flow can be a confusing concept. Here's what you need to know:

Cash flow is the movement of cash-on-hand and cash equivalents in and out of a firm



Cash the company receives from customers or other organizations is called "cash inflow."



Cash the company pays out to employees, vendors, or the government is called "cash outflow."



Companies generate cash inflow by selling products and services.



Companies generate cash outflow when they pay suppliers, wages, interest on loans, and taxes



Firms can still have good cash flow even if they are operating at a loss if lenders are providing them with access to credit or they are selling their assets



## How Is Cash Flow Different From Profit?

There is a significant difference between cash flow and profit. However, the distinction isn't always obvious to entrepreneurs. Here's what you need to know:



Cash flow relates to the cash that a company has on hand (e.g. in its business bank account).



Profit is the money a company generates after subtracting expenses from revenues in a given accounting period.

### Companies can be profitable but have negative cash flow if:



They are waiting for customers to pay (i.e. they have a positive balance on their accounts receivable).



They have not yet generated enough revenue to cover their costs in the current accounting period but will do so later.



They have made a major expense that will generate profitable revenues in the future

### Companies can be unprofitable but have good cash flow if:



Creditors are willing to lend to them



Creditors believe that they will be profitable in the future



They have assets they can sell to generate cash, such as plant, equipment, or equity in other firms

### High profitability can lead to poor cash flow if companies:



Reinvest the majority of the profits they receive in plant and equipment



Provide staff with large bonuses



Distribute cash dividends to shareholders

## The Consequences Of Not Understanding Cash Flow

Entrepreneurs sometimes do not understand cash flow. A lack of cash can result in:



An inability to pay suppliers and wages



Problems securing new inventory



Damage to brand and reputation



Worsening credit rating



Lower profits due to interest costs to cover immediate expenses

