Finance New Mexico

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Stay Stable with Balanced Cash Flow

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Cash-flow imbalance is the leading cause of business failure in a healthy economy, according to the U.S. Small Business Administration. So when the economy is sputtering toward its prior vigor, it's more urgent than ever to maintain a balance between what's flowing into the business and what's flowing out.

In business, cash is king. It's used to pay short-term bills, cover unexpected emergencies and invest for future business needs. Savvy business owners look beyond income and expenses by keeping an eye on cash to manage all cash inflows and outflows.

The operating cycle – the way cash flows into and out of a business —is a matter of timing. It's supposed to work like this: Capital enters the business through investment from owners and loans from creditors. It is then used to produce goods or services and flows out to pay wages and purchase buildings, equipment, materials and supplies. Next it flows back to the business as payment for goods or services. Finally, it flows out again to pay taxes and debts and return money to owners before starting again at the beginning. Breakdowns at any stage can cause a business to falter.

Breakdowns often happen in current assets, the cash reserves and other liquid assets such as inventory and accounts receivables the business expects to convert to cash within a year. Of these, accounts receivables are the most difficult to convert to cash. Business owners can avoid the danger of falling short by closely monitoring accounts receivables and establishing firm collections and credit policies before extending credit.

The time between buying or producing inventory and unloading it poses another potential obstacle in the cash-flow current. Rather than keeping a large inventory of raw materials on hand, a company might consider only buying materials as they are needed. Old and obsolete inventory can be sold to free up cash for other uses.

Expanding a business too quickly can also impede cash flow. A business should not expand until employee overtime is piling up, the business has outgrown its operating plant or office space and there's a list of customers waiting to buy a product or service. It's a good idea to develop a financing plan that anticipates contingencies before using precious cash to expand a business.

Business failure isn't always the fault of bad planning or mismanagement of money or resources. When markets freeze and retreat as they have around the world, many businesses fail for lack of credit, loss of consumer confidence and other reasons over which an individual business owner has no control. But a stash of cash is the best assurance of keeping cash flow positive and having reserves to fall back on during hard times.

For help with cash flow planning, visit one of the 20 New Mexico Small Business Development Centers. Find NMSBDC centers at www.nmsbdc.org.

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