

Cash Flow is equally important as Profit

by Prof. Andy J. Ferreria, Ed.D

There are enterprises that have no profit but have plenty of cash. There are firms with no cash but plenty of profits. When and why do these situations happen?

The plenty of profit but little cash happens when the sales that was the source of profit is not collected and therefore in accounts receivables. This is not good. It becomes even worrisome when the payments from the sales become past due. There is profit but no cash. The worst is when the past due accounts are never collected. In this case there are two issues – there is no cash and also the profit is gone. What's more, there are costs that went with the uncollected sales.

Meanwhile, the plenty of cash but no profit situation happens when the enterprise sells below cost (therefore no profits) but does not pay creditors/suppliers. This means there are overdue payables.

In both cases, Accounts Receivables and Account Payables play an important part in the financial management of the enterprise when correctly analyzed. When reviewing the income statement of the business, the entrepreneur is therefore advised to also take a close look at the cash collection, cash flow and cash position.

Important questions to ask are:

1. How was the cash collection distributed in the previous month? How much of the collection came from cash sales and how much are from current and past due accounts? Do we have enough cash balance?
2. Did we deliver to accounts that have Accounts Receivables which are past due? Did the past due Accounts Receivables increase?
3. Do we have payables that are past due? Why?
4. What is our projected sources and uses of cash for the next 4 weeks (weekly)?

As such, an important monthly report for any enterprise aside from the usual income statement is the aging of Accounts Receivables and Payables with corresponding movements as indicated in the cash flow. It provides the entrepreneur insights on the company's profitability and cash position.

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