

BUSINESS MADE EASY[!]



Episode 52

Cash Flow vs Profit

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Jason: You're on episode fifty-two of the Business Made Easy podcast. Let's do this, Mia.

Mia: You're on the Business Made Easy podcast where we make business easy. Here's your host, Jason Skinner.

Jason: Good day. Good day and welcome to the Business Made Easy podcast where we make business easy. Jason Skinner, your host here for another week of the podcast which is all about growing your business bottom line and giving you a better life as a result. I, thank you so much for being this week and I am excited. I'm going to tell you we are on episode fifty-two. This is the fifty-second episode of the podcast, that means we've been bringing this out every week for a year now and I can't believe it's the fastest year of my life, I swear. , but it's been a lot of fun and a lot of work, putting this together but, but I wanted to just, firstly, thank you for, for tuning in each week and, and those of you who've subscribed and listened each week, thank you so much. , if you are new to the show, make sure you hit the subscribe button but, it's just been a, a jam-packed year. , I don't know if you know how much work goes into putting these podcast shows together. There aren't just magically appear on your phone each week and there's was a tremendous amount actually but I've gotta -- I'm being thankful to have a, a great support team behind me. My wife, Melissa and, my, PA, Leah and, and our audio, lady, Linda and her team, they, every week, put this show together and, and, and get it all to make sure they all come out every Friday morning and , they had just been doing a fantastic job. So, thank you to them and again, thank you to you for tuning in as well. Alrighty, we have got a great show today but before I get into that, if you've, not joined, our Facebook Community yet, be sure to do so. You can do that at over at, <https://businessmadeeasypodcast.com/community> and there's a great group of people over there, all talking all things, business and, really supportive group actually and it amazes me continually the diversity I guess of skill sets and

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professions and, and business owners that are over there. And we've got everyone from lawyers, you can get help with the legal stuff. You've got, you know, marketing, social media help. I mean, there's a great group of people over there, so if you need help with anything within your business. Be sure to join The Business Made Easy Podcast dot com facebook group and, and jump on board and be part of that <https://businessmadeeasypodcast.com/community>. Really great group of, people. Alrighty then, let's get into today's show. It's a great episode today, in that we are talking about probably one of the most common problems that I see business owners, mistakes. I see business owners making or not understanding and I see it almost daily in, in public practice. And I'll, I'll explain a little scenario and we're gonna be talking today about the difference between cash flow and profit in your business. Now they're both two critically fundamental, figures or, or, or numbers that, that you need to be aware of in your business but you also -- that's not where it stops. You also need to understand how they work together and how they work against each other as well in your business because they're not the same thing. A lot of people -- and I'll go through this scenario -- is that I'll, I'll prepare a, a set of financial statements and accounts etcetera, for, for a client. And, they'll come in and sit down with me and we'll, we'll open up the books and we'll -- I'll sit there and I'll say to them, "Oh look,

Jo and Mary, you, you have a got a fantastic year in business this year. You've, you've made two hundred thousand dollars in profit." And the next thing that usually happens at that point in time is that Jo and Mary look at me and say, ", we don't have two hundred thousand dollars in the bank. That can't be right. There's no way in the world we made two hundred thousand dollars because we only have, -- we're actually an overdraft and we don't have any money in the bank and

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that's just gotta be wrong." And this is where the conundrum starts because Jo and Mary are thinking that, the two hundred, the profit is actually the cash flow. Now when we look at profit, profit is different from cash flow because when we're looking at profit, profit is just a number that, that, that drops out of the bottom. Once you add up what you've sold during the year and you take off your expenses, for running your business during the year, that's what profit or loss is. It's really just, looking at a set time period so a profit and loss can look at, you can run a profit and loss statement for a day, you can run it for a week or a month or a year. But it's, it's whatever period that you choose, to look at, that is the, all the income that you, made or, or products that are sold in that, revenue that you generated in that period less the expenses for that same period and that's all profit and loss is. It's, it's just a, it's a, it's a number that drops out the bottom to see that you're making more, and you're selling things for more than you are paying for them. When I, when I say paying for things, I mean rent, wages, superannuation, cost, you know, advertising, social media spending, advertising, rent, all, all the, all those things so once they will be taken off, the resulting figure should be a profit figure. Cash flow, for instance, cash flow though is completely different. Cash flow is the money that is flowing in and out of the business. So cash flow is like liquid and always use the analogy that if you think of, profit, as the size of your car. So when you,

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when you make a profit, the bigger your profit, the bigger your car is. Cash flow is like the fuel that runs that car. So cash flow is the fuel running into the, into the tank of the car when you go to the service station, the gas station, you fill up the tank, that's cash flow going in and then you're running your business, the, the, the car you're running it along and it's using cash flow to, to exist. So cash flow pays the bills, for instance. Cash flow pays the wages each week and the superannuation and the rent exudes. It pays what it cost. Cash flow pays your loan down. , cash flow pays your supplies and creditors so it's different to profit and loss. Now, so for that reason you won't ever have or very rarely, I mean if you just start a business today, it might be the case but you very rarely have, a situation where your profit is going to one hundred percent represent the cash that's come in, come in to your business or the cash that's in your bank account. Profit won't equal with your bank account and here is the reason for, for this. Let's just say, we start business today. , it's a brand new day; we wake up in the morning, we save some funny reason, we might just start a business. So this business might need rent. It might need, it might need a premises to apply this so we're gonna have rent. , it's going to need -- , we're gonna incur expenses before we actually start this business because we can't just start a business unless you've got something that you've already have, I guess, and you just sold it but even then you still got some form of advertising cost of something like that too, to even sell it. Let's just say, for instance, our startup cost to get our business off the ground, we're gonna need twenty thousand dollars of, of things that we're gonna have to start. We're gonna have to buy some products.

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we're gonna have to buy some things to sell. That is going to require cash flow. So that cash has to come from somewhere. It can't come from the profit that we made in our business because the business hasn't made any. We haven't sold anything. It's day one of our new business. We've got twenty -- we've got to spend to spend twenty thousand dollars on startup cost; we need that money from somewhere. So that money will normally come from maybe a bank. We could go and borrow the money from a bank. It might come from savings that we have in our, in our personal bank account, that we're gonna just invest that, twenty thousand dollars as a shareholder into the business and that's gonna start the business off. Now, there, day one, we've already got a difference between cash flow and net profit because we haven't made any profit. We haven't sold anything but we've had cash come into our business. We've had cash flow come in like fuel in the, in the car. So that money has come from another source. It hasn't come from profit so that's a cash. Then we might go along for a bit; we bought our goods and we're up and running and we've got stock now. So we've, we've invested some of that, twenty thousand dollars in stock. We bought say, ten thousand dollars worth of stock. Well, when we pay for that stock, that's a cash outflow. So that's cash going out of the business because we've had to pay our supplier. Again, we still haven't sold any items. We've only just bought the items. That's all we've done. We've put twenty thousand in and then we bought ten thousand dollars worth of goods and, and products to sell and pay the supplier. So that's a cash outflow and that again still doesn't resemble our, our, our bank balance now which is ten thousand dollars. It doesn't represent any profit or loss

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because we haven't, we haven't sold anything yet. We haven't made a profit. So again, it's another distinct difference as to the cash flow might be different. Now let's just say for instance, that somehow, we get lucky on day two of our business and, we get our first customer come in the door and they wanna buy all the stock we have. But this is just a hypothetical situation. I'm just working with you just to keep the numbers nice and simple and, keep it, relatively easy to understand. But let's say, the customer comes in day two and wants to buy all our stock out. Ten thousand dollars worth of stock we paid for. We're gonna sell that stock for, let's put a, a, a fifty per cent markup on it. So we're gonna sell that stock for, twenty thousand dollars, let's just say. We're going to sell the stock for twenty thousand dollars. Now, the customer says, "I wanna buy all your, stock, will you give me trading terms because I don't have the twenty thousand dollars cash to pay for the goods yet." So I say, "Yeah, no problem, I will give you, you know, a thirty days to, to pay me." Which is an ideal -- mind you, you don't go do this but that's certainly I'm just using this for an example. So if I was to run a profit and loss on the day of that sale happening, again, what will have? I will have a ten-thousand-dollar, profit from the business because I sold the goods for twenty thousand, I bought them for ten thousand, that means that I now have a ten thousand dollar- profit but I don't have that extra ten thousand dollars in my bank

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because it's sitting on my outstanding, customer's register at that time. It's sitting on my account receivable ledger waiting for that cash to come in. And that's another area that the cash won't equal the profit because, yes, my profit and loss says that I sold twenty thousand dollars worth of products but my bank account doesn't show twenty thousand dollars worth of products because I haven't, actually received the cash yet and that's, that would be cash into

the business. So you can see that this is always going to be the difference between cash and profit, cash flow and profit is always going to be different. Now, the critical thing is cash is king, okay? I have seen plenty and plenty of businesses, make lots and lots of profit but not have any cash flow, And this normally happens, if you haven't got cash flow you can't pay your bills. Now, let's say, from my example where I sold my twenty thousand dollars worth of, products and the customer, doesn't pay me for thirty days and then when the thirty days go by, he or she doesn't pay me for 45 days, I can't buy any more. I don't have I'm running low on cash so I can't pay all my bills if I don't get that cash into my business. And this is where this is where a lot of businesses could generate greater profit but not have strong cash flow. And you've got to have a strong cash flow to stay, stay viable in business because cash is king as I say. Cash pays the bills. Cash pays the wages. Cash pays the rent. Cash pays all those, all those expenses and, and it pays you too. So I would -- starting a business with putting twenty thousand dollars in, I want a return on that money.

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I want some from a dividend at some point in time. Well, those dividends can only be paid from cash as well so you know, yes, I've got to make a profit but the cash there to make, to, to make the payment of dividend. So this is where, this is -- because if, if you think about that, if I don't get a return on that twenty thousand dollars, well, I'm really not, doing myself any, any favours because I had a choice. I could have invested that twenty thousand dollars in a term deposit or, or a fixed deposit at the bank and got, got a return on that money. So there's has been an economic cost of me investing that money into my business, I need a return on that money and the cash has to be there to generate that return and give me that return. So some of the some of the areas that, I guess cash can be, locked up if you like and something to pay attention to is, some of the common areas, stock. So if we, , buy stock, buy too much stock then we might end up having to pay for that stock well before we actually, sell the stock. So it might be sitting on your shelves and, you know, while the stock is sitting on your shelf, that's money not in your bank. So, that's where, one of the key metrics that I love to look at with clients that do carry inventory whether they're on online business or, or a, a bricks and mortar business, if you're carrying any sort form of stock at all, one of the ratios we look at is the stock turn rate. And that right tells me quickly and easily how often you're turning that, selling that stock, basically. How many, how many days a year it takes to sell and turn that stock over to, to replace it? Because it's a really, really important, calculation, because, the lower that number is,

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the quicker I'm, getting my money back in the bank. The other important measure area that, that, cash can be vastly different from profit and affect your, cash flow is in, your accounts receivable. Like in my example, where I have the customer wanted, want me to let him pay over thirty days, well, while that they're sitting on -- if you've got, accounts receivable or debtors, as we call them, customers that haven't paid you sitting on, your books, then that's money that's not in your bank account. That's in their bank account. So they're using your cash flow to, , to fund their activities. So you really want to wanna get that money back in your bank as quickly as possible. Now, the measure that you -- so I'm trying to give you some practical measures here that you can, measure this, tangibly. The one that I would look at here is your debtor days. It's what we call your debtor days or accounts receivable days and this is the number of days on average it takes for you to collect your outstanding, moneys. Now, the lower that number, the better. So in both of those cases, stock turn rate or inventory turn rate and, debtor days, the

lower that number, the better that is for your bottom line and the better it is for your, bank account because that, that money, is, is in your -- back in your bank quickly and your customer has paid you. Another, another area that people often, often forget where their cash is going and why it's different to their profit is if you're reducing a loan of any type. You might have a, a business loan or equipment loan or something like that's in your, in the balance sheet of your, your financials or in your books and,

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that, that loan may have reduced over the year. So when -- you can only really reduce a loan at a profits, or if you put the money in yourself and pay it off but generally in the business sense it will come from the profits of the business. So if I make, you know, a twenty-thousand-dollar profit, and I paid ten thousand dollars off my, loan, with the business then I'm not gonna have twenty thousand dollars in my bank account. I'm gonna have maybe ten thousand dollars in my bank account and ten thousand dollars less to pay off my loan 'cause I've used that cash. That cash is going out onto my loan and reduce my loan down. So that's another area that, cash can be absorbed and, and often, overlooked where that cash is going. One of the other areas that, that -- and this is a number but I'm just giving you the key ones to look at -- the other one is the, is if you buy plant and equipment. If you buy equipment for your business so you might spend some of your cash on, on equipment purchases out there. So, in the business, so, so that cash, has had -- you had to pay for that out of your business. It doesn't go into your profit and loss. It goes on your balance sheet as an asset. So it's not even gonna affect your profit and loss but it will affect your balance sheet, your cash, your cash flow, and your cash bank balance. So that is another area that, that can affect your profit and, and the reason why your cash flow or your bank account balance is not gonna equal all your profit and loss in your financials so there's a lot of elements there. But the funny thing is with it, I was finally like understand why people do get chipped out with it is because you generate money when you make profits. So if I sell something for more than I actually buy it for, I make a profit after, you know, paying my overheads and things,

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well, it would be common to think that, that money goes into -- goes straight into my bank account. But it just doesn't happen that way, generally in business because you've got all these other elements playing out. Purchasing equipment, paying down loans, people not paying you on time, , all those sorts of things can, can have an impact, on that profit, on that cash flow. So there you have it. Now I'm getting confused myself there. There you have it, that's cash flow and profit and, I'll, I'll put some, some metrics in the show notes, some to help you calculate those, those, numbers. The stock turn rate and the, , the debtor days. One other quick one, before I wrap up, is also creditors. You, when you -- the time that it takes you to pay your suppliers, , for the goods and services, the longer you can stretch those terms out, that's actually a positive for your cash flow because if you think about that, you're, you're getting the, you're getting the goods, and you're, you're incurring the -- yes you should incurred the expense but you haven't had to -- have the money go out of your bank account yet. So that's, , something people often do so your customers could be even doing this to you. You need to be careful of that but something the businesses often do is string up paying their supplies and try and get as long to pay as possible, , so the money is in, in their bank account longer and it helps keeps their cash flow nice and healthy and, and, you know, robust. So yes, that's trick so the same can work there, you can actually calculate your, creditor days or your accounts payable

days quite easily. And I put the ratio in the show notes as well. , they'll be over on , business made easy podcast dot com slash episode fifty two. , I'll put it in the show note, the links in the show notes for that. But yes, you can use those ratios and calculate

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just how, how, how that's, those, those, elements are working in your business. When you put all these numbers together, you actually come out with what we call a working capital, days. , so working capital cycles, the typical name for it and your working capital cycle is basically, all the money going in an out of you. , how long it's taking in terms of days in and out of your business to, for your money to leave your bank account, turn it into goods and services and then for the -- make the sale and then for the money to come back into your business. So it's your working capital cycle and that's a really important , number to get to understand as well because , when you understand your working capital cycle, you know that if I buy that item of stock there or if I, yes, buy that, that to sell, then that's how long it's gonna take me for , the working capital days is gonna -- that's how long it's gonna take for that money to leave my bank account, get sold, get the product sold, get the money back in my bank account and it's really, really good number to know. Because when you know that, let's just say I've got a working capital cycle of, thirty days, so it takes thirty days for the money to leave my account and come back in with a, with a profit attached to it. , then I know, when I'm doing my planning, how much money I should have in my bank account. I really will probably wanna have about sixty days worth of, or thirty-five at least thirty-five, sorry, want to say thirty days. I do wanna have at least forty-five days of working capital in my bank account so that if anything popped up, I've got always got cash available to, to use or, or, or to, to satisfy that emergency or that need. So you always wanna keep above or

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a buffer, above your working capital days and, as I say, working capital days, is an, is an easy formula too, work out and I'll put that in the show notes for you as well. But it's a great way for people 'cause people often ask, "Oh look, how much should I leave in my bank account or how much money should I have in my business bank account?" If your, if your business is profitable and, and your cash flow is healthy, so that means you're collecting your payments on time. You're selling, you, you know, you're turning your stock over well. You, you're generating good cash flow, you know? You should be out -- your business, that's, that's when you know your business is healthy. It's, it's, it's doing what it should do at that point. , you really don't want the situation where you're having to go and get into overdraft. , there are reasons why people do need to do that. Overdrafts are good for seasonal factors sometimes and when you got a long lead time to before you've got cash available but certainly, we wanna try and avoid overdraft some loans and those sort of things if possible and keep a good healthy cash flow, 'cause it keeps your cost down too. Banks charge money when you go into overdraft. Banks charge money if you -- if there are there to lend you money and, that sort of things, So yeah, you really wanna make sure that you've got a good healthy cash flow, and, and, and looking after it. So I'll put those ratios in the show notes. It is a bit of technical area, I apologize. We haven't spoken about financials and numbers for a little while so I just thought it was time to sort of address that one because I just had the situation again, come up the other day where someone, said, "Oh my profit's not the same as my cash flow." I hope, I hope, and as I explained to, as I explained to them, just as I have to you today, it, it very rarely will be, for that reasons that I mentioned in this episode. As I said, it is technical, quite technical, if you're confused, if I have

confused you, though, I do apologize, but if, if you, you have found it a bit confusing or whatever or want further help with it, just drop me a line at

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jason@businessmadeeasypodcast.com and I'm more than happy to, answer any questions that you have on today's episode. But I hope that if you can just take away from today's episode that can't -- my cash flow, is going to be different from my profit, 99.9% of the time and it's due to the fact that, I don't always have the money in my bank from because it's out in -- might be sitting in the stock or might be sitting with my outstanding customers or I haven't received the money yet or I paid down loan. That's usually the biggest one but I paid down some loans or, or, or even taken dividends or even taken some money out of the bank or I've taken money out to live on or, or what not. So yeah, that's, that can be a common one as well. So there you go, thank you so much for joining me. I hope you found this, a useful episode. I certainly enjoyed bringing it to you, our fifty-second episode. So, here's to a hundred and four, eh? And, I'm sure that if we, happening on your doorstep before we know it but I hope you have a fantastic weekend business. Thank so much for joining me and his to your success. Take us out, Mia.

Mia: Thanks, Jason. You've been listening to the Business Made Easy podcast, where we make business easy.

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Thank you for Tuning In

We hope you enjoyed this episode.

If you have any feedback or questions about the content in this episode please don't hesitate to drop me a line at jason@businessmadeeasypodcast.com I would love to hear from you.

Other things that you might like to help grow your business.

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Thank you again,
I appreciate you !

*Regards
Jason*