

# Assessing Cash Flow and Bank Lending Requirements



## DEFINITION

Lack of cash flow is a major cause of a business failing as, even though it may be turning a profit, if the money does not flow in on time the business will not be able to settle its debts. Cash flow is basically the measure of a company's financial health, showing the amount of cash generated and used by a company in any given period. Cash flow is essential to ensure solvency, as having enough cash ensures that creditors and employees can be paid on time. Banks require companies to show the difference between sales and costs within a specified period, which acts as an indicator of the performance of a business better than the profit margins. Sales and costs and, therefore, profits do not necessarily coincide with their associated cash inflows and outflows. Even though a sale has been secured and goods delivered, payment may be deferred as a result of credit to the customer, yet suppliers and staff still have to be paid and cash invested in rebuilding depleted stocks. The net result is that although profits may be reported, the business may experience a short-term cash shortfall.

The main sources of cash flow into a business are receipts from sales, increases in bank loans, proceeds of share issues and

asset disposals, and other income, such as interest earned. Cash outflows include payments to suppliers and staff, capital and interest repayments for loans, dividends, taxation, and capital expenditure. Cash flow planning entails forecasting and tabulating all significant cash inflows and analyzing in detail the timing of expected payments, which include suppliers, wages, other expenses, capital expenditure, loan repayments, dividends, tax, and interest payments.

A computerized cash flow model can be used to compile forecasts, assess possible funding requirements, and explore the financial consequences of other strategies. Computerized models can help prevent major planning errors, anticipate problems, and identify opportunities to improve cash flow and negotiate loans.

Banks must ensure that a business is viable, which entails asking pertinent questions. Lenders will insist on up-to-date information on the type of industry, management capabilities and experience, business plans and daily operations, key competition, and PR and marketing plans. They have to know that the business makes sense and can repay a loan, and what security is available in case of insolvency. Companies have to keep within their cash limits regardless of anticipated business. Business factoring is an alternative to bank loans—a factoring company buys your credit invoices and provides you with immediate cash in exchange for a small fee ranging between 1.5% and 5.0%. Factoring is more flexible than a bank loan.

## ADVANTAGES

Ensuring good cash flow through a company helps to:

- increase sales;
- reduce direct and indirect costs and overhead expenses;
- raise additional equity;
- gain the confidence of banks and potentially secure more loans.

## DISADVANTAGES

- If your profit margins are already low, you might not be able to afford bank fees.
- The banks have a tendency to up fees and charge for late payments.

## ACTION CHECKLIST

It is essential to keep track of your cash and not allow any surplus to sit idle. Accounts must be carefully monitored and cash invested to maximize returns. There are many ways to increase cash flow:

- ✓ reducing credit terms for historically slow payers;
- ✓ reviewing customer payment performance;
- ✓ becoming more selective when granting credit;
- ✓ seeking other ways to pay rather than all in one installment, such as deposits or staggered payments;
- ✓ reducing the amount of time of the credit terms;
- ✓ invoicing immediately the work has been done;
- ✓ improving collection systems for billing;
- ✓ adding late payment charges.

## DOS AND DON'TS

### DO

Do understand the way your company works, using a detailed analysis of banking procedure and taking into consideration:

- overdraft facilities and investment accounts;
- the number of monthly transactions;
- the number of written monthly checks;
- how customers pay you;
- the suitability of electronic banking for your business;
- cash access facilities;
- interest income;
- overall expenses and fees.

### DON'T

- Don't overestimate sales forecasts.
- Don't underestimate costs.
- Don't underestimate delays in payments.
- Don't forget to check your debtors' credit history carefully.

## » MORE INFO

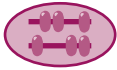
### Books:

Fight, Andrew. *Cash Flow Forecasting*. Oxford: Butterworth-Heinemann, 2006.  
 Mulford, Charles W., and Eugene E. Comiskey. *Creative Cash Flow Reporting and Analysis: Uncovering Sustainable Financial Performance*. Hoboken, NJ: Wiley, 2005.  
 Reider, Rob, and Peter B. Heyler. *Managing Cash Flow: An Operational Focus*. Hoboken, NJ: Wiley, 2003.

### See Also:

- ★ Valuing Start-Ups (pp. 425–427)
- ✓ Preparing a Cash Flow Forecast (p. 880)
- ✓ Retail Banks: Their Structure and Function (p. 930)

**“The debt is like a crazy aunt we keep down in the basement. All the neighbors know she's there, but nobody wants to talk about her.”** H. Ross Perot



# Building a Forex Plan

## DEFINITION

Forex, which is short for “foreign exchange,” is the largest trading market in the world, turning over as much as US\$1.5 trillion every day. There is no central marketplace for currency exchange, which is done over the counter. Currencies are traded on a global basis 24 hours a day, five days a week. Financial transactions involve one party purchasing a quantity of one currency in exchange for selling a quantity of another. Trading commonly occurs between large and central banks, currency speculators, corporations, governments, and other institutions. Currency prices depend on many factors, but ultimately the price depends upon supply and demand.

Forex markets react to trade levels and trends. Trade and investment flows indicate the demand for goods and services, in turn indicating demand for a country’s currency to conduct trade. Trade deficits can have a negative impact on a nation’s currency. A currency loses value when a country experiences rising inflation, which erodes demand for that particular currency. As a generalization, the healthier a country’s economy, the better its currency will perform. Factors to look out for include economic factors, political conditions, and market psychology.

An effective and proven plan can help a company to exploit the forex currency trading system to its best potential. Customizing a forex plan in line with specific issues and needs can help to manage foreign exchange in the most cost-effective and efficient way. It is customary—and wise—to begin with a simulated forex trading account, which does not need any investment upfront but is used to train beginners in the strategies and fundamentals of forex trading.

A well-considered forex plan needs to take into account various elements. Decide whether you will hedge recorded or future assets and liabilities and how. Choose a trustworthy and competitive forex supplier. Plan the scope of activity taking into account objectives and time frames in which to achieve set goals. Make sure you schedule regular assessments of your forex business and revise any activities as needed. A forex plan should be sustainable, so aim to negotiate transactions at the most favorable prices. Keep track of your forex exposure by implementing methods for data capture. A good plan also has internal controls—consider your business processes and documentation requirements, ensure

that you have strict authorization limits, and keep tasks segregated where necessary. Finally, stay familiar with accounting and reporting requirements.

A forex plan should be reviewed at every stage, from the first planning phase and throughout implementation. Senior management should sign off all decisions to ensure that risks are minimized. If the forex plan is of limited duration (for example for a specific project), then a post-implementation review is wise as it can identify areas for improvement and efficiency gains if you decide to enter the forex markets in the future.

## ADVANTAGES

- When a company needs to use forex (for example, if it conducts business abroad), a strong forex plan can boost profits if transactions are conducted with care and insight. A good understanding of how to use forex transactions to advantage can also give an edge over business competitors.

## DISADVANTAGES

- There is always a risk of losing money and thus profit, especially if you ignore

advice and are overconfident about market conditions.

## ACTION CHECKLIST

- ✓ Be as informed as you can on how the forex currency trading system operates.
- ✓ Enroll in a reputable forex trading system course online and familiarize yourself with the forex currency market with a simulated trading account.
- ✓ Learn forex investment strategies, including the buy signals that forex charts give traders.
- ✓ Choose the amount you want to make on every forex trade before you begin trading; this is usually more than or equal to the earnings that you can afford to lose in the forex trade.
- ✓ Select your forex suppliers and counterparts.
- ✓ Negotiate forex transactions at more favorable price points.

## DOS AND DON'TS

### DO

- Watch charts and indicators.
- Work out how much you are willing to risk per trade.
- Review existing general ledger activity in the foreign currency accounts (gain/loss account and other comprehensive income (OCI) accounts).
- Take a sample historical review or monitor current activity to compare forex rates and forex hedge costs.

### DON'T

- Don't ignore factors such as government budget deficits or surpluses, inflation levels and trends, economic growth and health, political conditions, long-term trends, technical trading considerations, and domestic, regional, and international political conditions and events.
- Don't be too greedy—don't expect too much too soon.

## ►► MORE INFO

### Books:

Cheng, Grace. *7 Winning Strategies for Trading Forex: Real and Actionable Techniques for Profiting from the Currency Markets*. Petersfield, UK: Harriman House, 2007.  
Ponsi, Ed. *Forex Patterns & Probabilities: Trading Strategies for Trending & Range-bound Markets*. Hoboken, NJ: Wiley, 2007.

### Websites:

A forex guide for beginners: [www.forex-guide.net/beginner-investing.html](http://www.forex-guide.net/beginner-investing.html)  
Insider's Guide to Forex Trading: [forextradingonlinehelp.com](http://forextradingonlinehelp.com)  
International Financial Services London (IFSL) research report, “Foreign exchange 2007”: [www.ifsl.org.uk/upload/CBS\\_Foreign\\_Exchange\\_2007.pdf](http://www.ifsl.org.uk/upload/CBS_Foreign_Exchange_2007.pdf)



**“We all of us, rich and poor, have to live with the insecurity caused by an out of control global casino with a built-in bias towards instability. Because it is instability that makes money for the money-traders.”**

Anita Roddick