Write Up 4  
 Managing Cash Flow Ch6

02/27/23

Financial planning is important for ventures at all stages of development. At the development stage the venture must screen business ideas, prepare business model/plan, obtain seed financing. At the startup stage, an organizational form has to be chosen, a financial statement has to be prepared as well as startup financing has to be secured. After follows a survival stage, where the company has to monitor financial performance, project cash needs and obtain first-round financing. Before entering an early mature stage, venture has to pass rapid growth period, within which venture creates and builds value, obtains additional financing and examines exit opportunities. Lastly, venture enters an early mature stage and manages ongoing operations, maintains and adds value, obtains seasoned financing. During all of these stages, a venture has an option to liquidate, regroup, or continue. At later stages of development, it is also possible to harvest, proceed with staged liquidation or exit.

**Early-stage ventures -** firms in their development stage, startup stage, survival stage, or just entering their rapid-growth stage.

At this stage of development, ventures have a hard time finding financing and when eventually they get funded due to being young and inexperienced, there is a lot of panic involved in monitoring cash flow of the venture.

Looking at the example PDC, it is easy to understand the use of balance sheet. It gives a snippet of the cash flow in the company at a certain point of time. It can be treated as a reference point from where cash flow could be monitored.

I liked how PDC’s tasks were described, and implementation was given. I thought it was important to include those 5 tasks, since they give high level overview of what a startup has to do to monitor cash flow cycle.

Task 1: Budget Cash and borrowing position for the next n months.

Implementation:

(a) Use the sales forecast to determine the monthly cash collections from the current month’s cash sales and collections of receivables on the previous month’s credit sales.  
(b) use the inventory policy to determine the inventory expenses and schedule their payments.  
(c) schedule the wages payments according to the semimonthly pay arrangements.  
(d) put these items together with the other assumptions and determine cash needs before financing.  
(e) complete the cash budget by determining the necessary borrowing and repayment provisions, including interest payments and funds available in checking account.

**Cash budget -** a venture’s projected cash receipts and disbursements over a forecast period.

Task 2: Prepare PDC’s pro forma income statement for the four months.

Implementation:  
(a) Use the summaries of the revenue and expense items to create four months of income statements that include the interest expenses determined in Task 1.

Task 3: Prepare PDC’s pro forma balance sheet for July 31.   
Implementation:   
(a) Adjust the initial balance sheet, excluding the cash account, for each of the four months of changes; (b) make sure the equity account reflects each month’s net income;   
(c) calculate the cash account balance, which is consistent with total assets 5 total liabilities 1 equity  
(d) verify that the resulting cash account balance agrees with that from the cash budget.

Task 4: Prepare PDC’s statements of cash flows for the four-month period.   
Implementation:   
(a) Refer to our discussion of the construction of the statement of cash flows and the presentation of cash flow statements   
(b) apply the cash flow from operations, investing activities, and financing activities to the data for PDC; (c) verify that the resulting ending cash flow agrees with the cash budget and the cash account balance on the pro forma balance sheets.

Task 5: Calculate the change in the cash account balance in a spreadsheet that uses only the beginning and ending balance sheets and net income.   
Implementation for this task is straight forward.

**Conversion period ratios** - ratios that indicate the average time it takes in days to convert certain current assets and current liability accounts into cash.

**Operating cycle** - time it takes to purchase required materials, assemble, and sell the product plus the time needed to collect receivables if the sales are on credit.

**Cash conversion cycle (C3)** - sum of the inventory-to-sale conversion period and the sale-to-cash conversion period less the purchase-to-payment conversion period.

**Inventory-to-Sale Conversion Period** - when a venture can decrease the amount of time between the cash outlay for materials and labor and the production of a salable good, fewer dollars get tied up in production costs.

**Inventory-to-Sale Conversion Period** = Avg. Inventories / (Cost of goods/365) = 365\* Avg. Inventories / Cost of goods

**The sale-to-cash conversion period** - measures the average days of sales committed to the extension of trade credit.

**The sale-to-cash conversion period =** Avg. Receivables / (Net Sales/365) = 365 \* Avg. Receivables / Net Sales

**The purchase-to-payment conversion period** - measures the average time from a purchase of materials and labor to actual cash payment.

**The purchase-to-payment conversion period** = 365(Avg. Payables + Avg. Accrued Liabilities) / Cost of Goods

**The cash conversion cycle (also known as C3)** - indicates the average time it takes a venture to complete its operating cycle less a deduction for the days supported by trade credit and delayed payroll financing.

**Cash Conversion Cycle** = (Inventory-to-Sale Conversion Period) + (Sale-to-Cash Conversion Period) –(Purchase-to-Payment Conversion Period)

After covering all of the theory for monitoring cash conversion cycles, I wondered is there any suggestions online for how to do it in the most effective way.

Here are some of the tips from Statrys(1):

1. Monitor Cash Flow Regularly
2. Cut Costs
3. Get Customers to Pay Faster
4. Get Cash for your Assets
5. Obtain Credit Lines or Loans
6. Rent, Don't Buy Equipment
7. Keep Up with Invoices
8. Finance Long-term or Large Order
9. Delay Payments to Vendors
10. Choosing a Business Credit Card

However, there is an even more modern approach to track cash flow in your company. Company Cash Analytics provides a software tool that give you a financial forecast (2)

1. - <https://statrys.com/blog/tips-for-managing-cash-flow#:~:text=The%20most%20effective%20way%20to,positive%20or%20negative)%20every%20month>.
2. <https://www.cashanalytics.com/cashflow-forecasting-software/>