

3.7 Cash flow

The big picture

Did you know that a business can be profitable and can still have cash flow problems? This can happen when a business makes a sale but is not able to collect the money owed in the expected time.

For example, a car manufacturer sells a car on credit and expects payment in instalments. Although the transaction is technically profitable, if the car seller does not receive monthly payments regularly, it may run into cash flow problems.



Figure 1. Extending car loans may result in car sellers having cash flow problems.

Credit: krisanapong detraphiphat, Getty Images

The restrictions caused by the COVID-19 pandemic had a negative affect on the cash flow of many businesses, especially those in the food, hospitality and entertainment industries. Restaurants and cinemas, for example, were not allowed to operate at full capacity. However, they still had to pay rent, insurance and salaries to their employees. The lack of revenue and continuing costs caused cash flow issues. Many establishments went out of business because they had no cash inflow. The businesses that survived often did so because they made dramatic cuts in their costs.



Figure 2. Many restaurants experienced cash flow problems during the COVID-19 pandemic.

Credit: Kanawa_Studio, Getty Images

In [Subtopic 3.5 \(/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/the-big-picture-id-39042\)](/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/the-big-picture-id-39042) you learned how it is important for companies to have cash and cash equivalents (referred to as current assets) on hand to cover daily operating expenses. Cash flow is closely connected with a company's solvency, as issues with cash flow will affect the ability of a business to service its short payments and long-term debts.

Concept

Sustainability

Many people think of sustainability in terms of treatment of natural resources, however **economic sustainability** is often forgotten. The topic of cash flow highlights the idea of responsible and sustainable cash management. This may involve practices such as cutting costs or finding more efficient methods of production.

Businesses often play key roles in a community: they provide for human needs and contribute tax revenue to support public services. Stable cash inflow ensures that the stakeholders of the business are paid on time and the business has operational stability, thus contributing to the community's economic stability.

