Analysis Based on the Importance of Cash Flow Management in Business Management

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How to cite this paper: Okan Karaaslan. (2023) Analysis Based on the Importance of Cash Flow Management in Business Management. Journal of Humanities, Arts and Social Science, 7(9), 1879-1883. DOI: 10.26855/jhass.2023.09.033

Received: August 31, 2023
Accepted: September 30, 2023
Published: October 31, 2023

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Abstract

Cash flow refers to the monetary income and expenditure that objectively exists during the development and operation of the enterprise. Cash flow can reflect the dynamics of the economic activity of the enterprise, and can control and safeguard its monetary income and expenditure effectively. Cash flow is the sum of cash and equivalents during the management of an enterprise. Cash equivalents usually refer to different types of non-cash investments with high liquidity, short maturity, low risk of changes in value, and easy conversion into a definite amount of cash. Cash flow management, as one of the basic elements of business management and capital operation, affects the production and development of enterprises. This paper analyzes the importance of cash flow management based on the characteristics of enterprise management. At the same time, this paper also explores how to promote sustainable business management by controlling enterprise cash flow.

Keywords

Business management, cash flow management, financial management

Introduction

Enterprises are market-oriented and their financial operations determine their potential for growth, such as cash flow, profit and loss, etc. If an enterprise has sufficient liquidity, it shows that the management of the enterprise is dynamic, on the contrary, there are barriers to management. In this regard, enterprises should pay attention to cash flow and the information behind the data representation in achieving the goal of achieving business benefits, and strive to promote the maintenance of a dynamic and balanced cash flow, so that cash flow management can be effective and thus help enterprises to maximize their business value.

1. What is enterprise cash flow

1.1 Corporate cash flow

Cash flow is the abbreviation of net cash flow, which can be simply understood as the result of cash changes. Cash flow is the total amount of cash inflows and cash outflows that occur in an enterprise during the investment cycle of a project, and it is mainly used to evaluate the benefit output of an investment project, as shown in Table 1 below.

1.2 Enterprise cash flow characteristics

Different enterprises have different characteristics of cash flow management at different stages of development. For example, in the early stage of business creation, its cash inflow mainly comes from shareholders or other investors or creditors belonging to borrowed funds; in the middle stage of business development, the scale of investment or business management area matures, sales revenue begins to show growth or tends to stabilize, and the phenomenon

DOI: 10.26855/jhass.2023.09.033

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Journal of Humanities, Arts and Social Science
of rapid growth of business cash flow also occurs, which in turn may exceed the revenue of the previous stage; in the mature stage of business development, the Stable in all aspects of business; the decline stage of business operations, due to product or sales and other aspects of the problem, the attractiveness of customers to enterprises began to decline, which in turn affects the market development space, resulting in a lower market share, cash flow also declined, even to difficult to meet the needs of business production and operation.

Table 1. Cash Flow

<table>
<thead>
<tr>
<th>Categories</th>
<th>Items</th>
<th>content</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash inflows</td>
<td>Investment in fixed assets</td>
<td>Capital expenditures for direct purchases or construction of fixed assets</td>
</tr>
<tr>
<td></td>
<td>Investment in liquid assets</td>
<td>Funds tied up in inventory, funds currency and accounts receivable are required for project investment</td>
</tr>
<tr>
<td></td>
<td>Operation costs</td>
<td>Expenses incurred in operating and managing investment projects, such as overhead, production costs and selling expenses, are generally expressed as the subtraction of all component costs from the depreciated balance</td>
</tr>
<tr>
<td>Cash outflows</td>
<td>Gross sales</td>
<td>Revenue from product sales, etc. in business management</td>
</tr>
<tr>
<td></td>
<td>Disposal incomings or Residual incomings</td>
<td>The residual value of fixed assets at the end of the trial period, or the capital income generated from the sale of fixed assets by the enterprise when the fixed assets have not reached the trial period</td>
</tr>
<tr>
<td></td>
<td>Recovered current assets</td>
<td>Amount of asset investment recovered at the end of the project investment cycle</td>
</tr>
</tbody>
</table>

2. The importance of enterprise cash flow management

2.1 Impact of cash flow management on enterprise value

Cash flow is the key factor to guarantee the smooth operation and management of enterprises. Without sufficient cash flow, a business cannot operate smoothly and economically, and the value of business operations is nonsense. The value of business management can be measured in terms of the riskiness of cash flow during the operating period, or terms of the discounted value. To maximize management efficiency, an enterprise must ensure that the net cash flow is maximized risk is minimized and that benefits and risks coexist. In some cases, high benefits and high risks go hand in hand. The balance between the net cash flow and the benefits and risks should be achieved, so that the benefits can be maximized. In other words, maximizing cash flow is an important foundation and one of the ultimate goals of business management to achieve maximum operating efficiency. In this regard, how does cash flow determine the value of an enterprise? What are its determinants?

Cash flow is an element of business management, which is integrated into all aspects and processes of internal control, and also represents the market value of the enterprise.

First, in the process of production and operation of the enterprise, the flow of funds from money to the purchase of production materials and labor costs of expenditure. Among them, labor and production materials need to be purchased in money, and this part belongs to the enterprise prepaid capital value. The purpose of business operation is to obtain business benefits, occupying market share and expanding sales channels are important means for enterprises to obtain benefits, and their benefit income is also a guarantee to promote sustainable development of enterprises. In addition, to ensure that the enterprise itself is in the market competition to obtain favorable conditions, the formulation of long-term goals, strategic means differentiated operation, and other promotion work also need a lot of capital.

Second, the impact of cash flow on the survival and development of enterprises. With sufficient capital, enterprises can purchase production materials and pay labor wages, but in production, enterprises still need to keep paying money to maintain smooth operation until they obtain products and other income, i.e., cash recovery, cash flow has a “return” to promote the gradual balance of enterprise expenditure and income. For growing companies, cash flow is very important. As the profit index under the accrual system is easy to operate, but it does not reflect the business strength, it is still the cash flow that maintains the normal operation of the enterprise and obtains the operating profit, which can reflect the ability of the enterprise’s cost expenditure. In the process of operation, some enterprises have balance in their books but insufficient cash flow, which will also lead to poor business operation; some enterprises have
serious losses in their books, but sufficient cash flow can continue to maintain business. In other words, cash flow and its related management work are the yardstick to measure the high degree of profitability of business operations.

Third, cash flow determines the market value of the enterprise. From the perspective of project investment, the effectiveness of enterprise operation can be judged from cash flow, which is convenient for investors to investigate the project profit, understand the value of project investment, and avoid investment risks. According to the valuation theory related to enterprise value, enterprise value refers to the statistical analysis of the cash flow value of future operations and thus can predict the possible changes of enterprise cash flow, and thus provide a basis for business management activities such as investment or M&A. At the same time, future cash flows need to refer to historical cash flows, and from the perspective of correlation, a small correlation between the market value of an enterprise and profit indicators will have a large correlation with cash flows. Many theories, for example, can show that cash flow can be an important reference element for measuring operating results.

2.2 Positioning enterprise value maximization to implement cash flow management

Enterprise cash flow management looking for a “One Central Task and Two Basic Points” methodology, that is, the enterprise in the implementation of cash flow management is based on a sustainable development strategy, from financing decisions, investment decisions, cash budget, financial management and distribution system performance of the current capital flow and earnings, and the latter is to emphasize the combination of long-term and short-term earnings, cash flow, and the latter to serve the former.

First, the cash flow management cycle is divided into short-term cash budgets and long-term cash budgets. The enterprise prepares a cash budget in conjunction with the operating conditions and future planning, which concentrates on reflecting the cash turnover of the enterprise, such as cash shortage or excess, to facilitate the financial planning, and excess funds are used for operation or financing in the short-term period to enhance the effectiveness of enterprise capital budget management and ensure the standardization of capital management. In contrast, long-term cash flow budgeting provides a basis for business decisions and facilitates the rational arrangement of funds to ensure investment efficiency. It can be said that the preparation of a cash flow budget and cash budget can help enterprises to understand and manage cash flow in an integrated manner, and enhance the effectiveness of internal control of enterprises through the refinement of cost management, decomposition of indicators, delineation of the scope of application of costs, and clarification of the approval and use rights of costs and expenses, which will lead to more effective cash flow management of enterprises.

Second, daily cash flow management and control. The essence of the enterprise to strengthen internal control is to ensure the accounting revenue and cash flow turnover, enhance the value of business management, and reduce business risks. That is, since enterprises ensure that cash is sufficient to pay for daily operations, and can reduce the use of restricted funds. In this regard, enterprises speed up the return of accounts receivable and delay cash payments based on ensuring market credit and internal risk control.

The third is the management of the efficiency of cash use, i.e., flow rate management. The maximization of enterprise value should accelerate the flow rate of cash flow and reduce the turnaround time of cash or accelerate the turnaround rate. This can be improved in the following three aspects: inventory turnover, accounts receivable turnover, and accounts payable turnover. Accordingly, enterprises can shorten the turnover period of inventory and accounts receivable, as well as extend the turnover period of accounts payable and speed up the cash flow or reduce the time lag of cash recovery. In this regard, enterprises must choose a reasonable settlement method according to the actual situation, collect settlement documents promptly, and complete the settlement procedures and credit assessment quickly.

2.3 Enhance the ability of enterprises to resist risks

There is also a correlation between the anti-risk capacity of an enterprise’s business period and the effectiveness of cash flow management, and effective cash flow management strengthens the anti-risk capacity of an enterprise’s business to risk. Companies with sustainable development potential have better and more feasible cash flow management processes and institutional systems. If an enterprise’s cash flow during the project investment cycle may be at risk, including environmental risk and capital flow risk, the enterprise must reduce investment risk by controlling cash flow management. Typically, companies analyze their cash flow situation through financial analysis, such as cash flow ratio and adequacy indicators.
3. The value of cash flow management in enterprise financial management

3.1 Analysis of profitability

In business management, financial management uses the main business cash flow profitability index to analyze the cash flow profitability. The former is the ratio between cash flow and sales of the operating business, i.e., the ratio of resource investment and cash recovery, and thus understand the business capital situation. If the main business cash flow rate is larger, it indicates that the business is better operated and shows better profitability (Zhao Yongmei, 2022).

3.2 Earnings quality analysis

The ratio between net operating cash flow and net profit reflects the profitability quality of the enterprise. If the relationship between the ratio of surplus cash security multiple and earnings quality is positive, and the ratio between the two is less than 1, it means that the enterprise has not completed the cash income, and the earnings quality is low, which can also indirectly reflect the profitability of the enterprise, that is, the capital chain has problems; the ratio between the two has been less than 1, or even a negative number, it means that the enterprise’s earnings quality is very poor, and there may be a problem of capital chain breakage, which will affect the enterprise daily operation (Yang Kai, 2020).

3.3 Solvency analysis

The solvency of cash flow management is reflected in the short-term solvency and long-term solvency. The short-term solvency is generally analyzed by the cash maturity debt ratio indicator and the cash current liabilities indicator, while the long-term solvency is generally analyzed by the total cash debt indicator. The analysis of enterprise solvency should calculate the ratio between net cash flow and current liabilities, that is, to judge the enterprise’s ability to repay debts, and the ratio is also an important indicator to evaluate the annual operating results of the enterprise. The ratio of net cash flow and debt repayment cash (including principal and interest) is the relationship between the net cash flow from operating activities and the multiplier of the current borrowing principal and interest payment in the enterprise cycle. If the ratio is not less than 1, it indicates that the enterprise can properly operate and repay debts at maturity; if the ratio is less than 1, it indicates that the enterprise cannot repay debts. In addition, the ratio between net cash flow and current capital expenditure can reflect whether the enterprise operates well and has room for development, if the ratio is larger, the enterprise has better development potential and debt servicing ability (Zhong Quantao, 2020).

3.4 Analysis of the relationship between cash and profit

Profit is the goal of business operation, advanced is the embodiment of enterprise profit gain, and the accrual system is used to prepare the reference basis of enterprise financial statements. The actual internal control process of enterprises, and financial management work is affected by human factors, such as the quality of reporting there are certain differences (Yang Han, 2018). Enterprises must make a judgment on cash flow concerning the cash flow statement at the same time, mainly because the cash flow statement objectively reflects the recovery of operating income and cash equivalents of enterprises and is not artificially manipulated. For example, if an enterprise has good operating efficiency and a high-profit margin for several years in a row, but the net cash flow from operating activities indicator is negative, it means that the enterprise’s profit is mostly inventory or accounts receivable, rather than the net cash inflow from the enterprise’s operation. In this case, if an enterprise relies only on financing to improve cash inflows, it may have business risks. At this time, the enterprise cannot successfully raise funds or liquidate assets to enhance cash inflows, and the enterprise will have a financial crisis due to cash flow interruption, or even face the risk of bankruptcy, so the function of the cash flow statement should be played in enterprise management (Wu Yi, 2021). However, it should be noted that the relationship between profit and cash is very close. If the business is in good operating condition, the cash flow is mainly in an inflow state, and if the current year’s income is mostly accounts receivable, the following year’s recovery will still result in an incremental cash flow. On the contrary, it means that the cash outflow is significantly greater than the inflow, which in turn reflects that the enterprise is not operating well. Therefore, companies should adjust their supply chain, specifically: first, as a supplier, they should try to delay the payment period; second, if they have inventory (including raw material inventory, manufacturing and
processing, storage, and shipping), they should shorten the production cycle and shorten the storage period; third, as a customer, they should cancel or shorten the credit cycle and shorten the term of accounts receivable. It boils down to the need for suppliers to delay the payment period, as well as in their production cycle, integrating the supply chain and accounts receivable into advance receipts (Zhao Yongmei, 2021).

4. Conclusion

Therefore, the enterprise's internal control objectives of the line of sight are to ensure that the enterprise operation compliance, legal, asset security, and other security, to enhance the effectiveness and efficiency of business operations and promote the strategic development of the enterprise necessary elements. Therefore, enterprises should be reasonable management and control of cash flow, and strict control of business risks, including sales growth, repayment situation, business strategy, control of credit risk, or else prone to the problem of county cattle cut-off, by paying close attention to the speed of capital turnover, improve the capital turnover rate, to avoid the enterprise in business difficulties.

References


