

CHAPTER**1**

The Importance of Proper Cash Flow Management

Effective cash flow management is vital to nonprofits; it is a key element in planning and in the efficient functioning of all aspects of operations. The phrase “cash is king” is as applicable in the nonprofit sector as it is in the business sector. Earning income is a primary concern (or should be) for both nonprofit and for-profit entities. However, “making money,” although of major importance to ensuring good cash flow, is not the only significant aspect of cash flow management. When cash inflows and outflows—money received and money paid out—are not successfully planned and monitored, organizations may not be able to pay employees and vendors in a timely manner. Thus, without good cash flow management, an organization may be “profitable” based on its financial statements yet unable to pay bills when they are due. For example, an organization may have billed counseling clients a total of \$50,000 over three months. Based on the organization’s revenue versus cost for providing these services, it may be showing a “profit.” However, if clients pay their bills slowly or not at all, this organization may still be unable to meet its payroll.

A. How Can Nonprofits Benefit from Effective Cash Flow Management?

Effective cash flow management can be “profitable” in and of itself. Cash shortages result in increased costs, such as interest charges on loans, late-payment penalties, and loss of vendor discounts for paying bills promptly. Cash flow improvements can eliminate these costs and create the opportunity for more favorable payment terms on some types of purchases. Ultimately, organizations that improve the manner in which they receive and expend cash will be more successful. They will also be able to increase their income.

B. What Issues Are Important in Cash Flow Management?

Unique circumstances in many nonprofits make cash flow management a complicated task. Our more than three decades of work with a wide variety of nonprofits, from “store-front” agencies to billion-dollar institutions, have shown us the necessity of understanding the different cash flow characteristics of nonprofit organizations. For example,

in a typical for-profit business with \$1 million of annual revenue, there may only be one source for the revenue (such as sales of merchandise or fees for services). Frequently, a nonprofit with the same amount of revenue will have several different sources of income.

The types of income an organization receives determine the cash flow management issues that will be most important. In turn, these particular cash flow issues will determine the strategy that must be used to improve cash flow management. For example, the budgeting, cash flow planning, and cash flow management strategies of nonprofits that depend on contributions as their primary source of income will be quite different from those of organizations that collect fees for services. Nonprofits that are primarily grant funded will have their own unique challenges in managing cash flow. These differences and the ways they can be handled most effectively are the basis for *The Cash Flow Management Book for Nonprofits*.

C. Who Will Benefit from a Better Understanding of Cash Flow Management?

The Cash Flow Management Book for Nonprofits was written to assist all who are involved in the financial management of nonprofit organizations. It is meant to be a comprehensive guide for:

- Identifying and understanding an organization's cash flow characteristics, strengths, and weaknesses
- Creating cash flow forecasts and using other tools for more effective cash flow planning and management
- Improving cash flow through implementing relevant strategies
- Using cash flow information to improve overall operations

D. Who Should Be Involved in Cash Flow Management?

Ideally, all staff, management, and board members of nonprofits should develop a "cash flow awareness." Everyone in your organization can help improve cash flow by understanding the relevant issues. For example, line staff may often be involved in making purchases for the organization. If a staff member fails to follow proper procurement policies and procedures, it will affect cash flow negatively. The same would be true if a staff member found out about a sale of office products and made a bulk purchase, thinking this purchase was saving the organization money in the long run. However, if this cash outflow was not in the cash flow forecast, the organization could have a problem paying the large unexpected bill. In order for line staff to use effective procedures for purchasing, policies must exist, be understood, and be supported. When staff lacks clear guidelines, lacks understanding, or does not support policies, cash flow will be compromised.

Staff and board members must understand their roles in effective cash flow management. Staff and management at every level can become more involved in improving cash flow if cash flow issues are regularly addressed during staff meetings. Creating an ongoing forum for awareness, questions, and feedback can help ensure that everyone is working toward the common goal of cash flow improvement.

All staff members in nonprofit organizations should have an awareness of basic cash flow issues. Personnel who are more directly involved in planning and managing cash flow must allocate time specifically for cash flow planning and management. Such personnel often include finance department staff, fundraising staff, the CEO, the CFO, program staff, and the board of directors. Organizations would see a dramatic improvement in their fiscal health if those who are involved in managing cash flow gave it the same level of priority as they do in their personal lives.

E. An Example

A number of different management theories, concepts, and methods have come and gone since management formally became a topic of study in the nineteenth century, beginning with Frederick W. Taylor's work. One approach Taylor employed that we believe is timeless is the use of "stories" to help provide context in applying management theories to real-world situations. Our story concerns a hypothetical nonprofit organization, "Universal Nonprofit," that is experiencing a number of cash flow-related problems. Universal Nonprofit's characteristics and the interventions we recommend to this hypothetical organization are composites of the characteristics of the many organizations for which we have worked and the recommendations we have made as consultants. The purpose of including this story is to help illustrate the more complex concepts we present throughout the book. You will notice that some of the examples we provide in later chapters use as a point of reference the circumstances we describe here for Universal Nonprofit.

The Universal Nonprofit Story

Universal Nonprofit is a medium-sized nonprofit organization located in a suburban area just outside of a large city. The organization has existed for ten years and has grown considerably in that time from a one-program grassroots health clinic to a multiservice community center offering a variety of comprehensive services to economically disadvantaged community residents. We will assume that Universal Nonprofit engaged our services as consultants to address what it described as a "severe cash flow problem."

Universal Nonprofit depends on a number of sources for income. It receives two large federal grants and a smaller state grant (which support two programs), has a small endowment as the result of a major-donor drive several years ago, enjoys ongoing support from a foundation, and

receives several annual corporate grants. In addition, Universal Nonprofit bills for some of its medical and mental health services.

The CEO made it clear that our primary task would be to find some solutions quickly, as the organization was having difficulty paying its bills. After a few interviews with staff at various levels, it became clear that the issue was not just cash flow: a significant overall financial management problem existed and was causing the cash flow problem. Our analysis of the organization's operations uncovered errors in the financial reporting system, a lack of cash flow forecasts sufficiently detailed to properly monitor cash flow, and poor billing and collection methods. Moreover, we found that Universal Nonprofit's inventories were not properly managed and that large amounts of operating funds had been invested in assets that were not readily convertible to cash.

We concluded that cash flow planning and management had never been a priority for Universal Nonprofit. As we began working to develop solutions, our understanding that cash flow is not one financial management issue but is linked to and embedded in the overall financial management of organizations was demonstrated over and over again. We found that many of our solutions to cash flow problems involved a lot more than just fixing cash flow. It became apparent that improving overall financial management, especially in its relationship to cash flow management, would be the only way of ensuring long-term financial stability and solvency.

Real experience garnered from our consulting work with organizations much like Universal Nonprofit is incorporated into many of the examples used in this book. Moreover, in several cases, we present specific strategies and materials we created in the course of our professional work. For example, the grant checklist for cash flow planning and management presented in Resource B was originally developed to help an organization much like Universal Nonprofit improve grant cash flow management, and Chapter Twenty details the steps that organization took to improve its cash flow management.