

Mind Your Own Business

In our last article we discussed the *Income Statement*. If you remember, the *Income Statement* is the second of the three most important financial documents in your business. We learned that the *Income Statement* tells you if your horse business was profitable over a given period of time. We also learned that the *Income Statement* can be a double edge sword if you are not careful. It can be tremendously useful, but can also be tremendously dangerous because it can be misleading. If you look at only your *Income Statement* you can think you have money to spend when you don't. Remember my warning in the *Balance Sheet* article about the perils associated with 'Checkbook Accounting'. You can think everything in your horse business is financially healthy when some parts are not healthy at all. We learned that the *Income Statement* is not about cash. The *Income Statement* only tracks the *promise and agreement* part of a business's transactions.

In this article we are going to discuss the last of the three financial documents, the *Cash Flow Statement*. As I have said previously, the *Cash Flow Statement* is my personal favorite because of what we learned about the *Income Statement* – ***'Profit is an accounting opinion, cash is fact'***.

A positive bottom line on your *Income Statement*, showing that your horse business is making a profit, is a good thing. However, profitability is no guarantee of success or even survival. Every day thousands of businesses fail. They 'grew broke.' A very wise person once told me; "You can operate a long time without profit, but you can't survive one day without cash." Cash is real money. Information about cash coming in and cash going out of your business isn't abstract, it is fact.

A *Cash Flow Statement* doesn't tell you what things were worth in the past, or how much they have been depreciated since they were purchased. It doesn't assume that you could sell a horse or get a new horse in training tomorrow. What a *Cash Flow Statement* tells you is how much you deposited in your business's bank account, how much you wrote checks for, and what the difference was during a specific period of time.

Cash information helps lenders or vendors know if you can pay them back. Cash information tells you whether you can buy a horse or a truck today, and still pay your ranch help next week.

Cash information is the other half of your business's transactions. It is the part where you settle up with you 'hay guy' and get paid by your customers. Just as the *Income Statement* has nothing to do with cash, the *Cash Flow Statement* has nothing to do with the *promise and*

agreement part of a business transaction. The *Cash Flow Statement* shows what is actually going in and what is actually going out of your horse business. *It tells you how good a job you are doing at turning your profits into cash.*

I have heard accountants tell their clients that they should rely on their *Income Statement* rather than your *Cash Flow Statement* to see how their horse business is doing – *I disagree*. You need both your *Income Statement* and your *Cash Flow Statement*, not one or the other, along with your *Balance Sheet*. You also need a *direct Cash Flow Statement* like the one produced by *equineGenie's Horse Business Management Software Program*. A *direct Cash Flow Statement* is like your checkbook register. You don't need to be a financial person to understand it. It shows the cash that is actually going in and actually going out, but organized into cash flow categories that are useful in managing your horse business. The advantage of a *direct Cash Flow Statement* is that it clearly shows cause and effect that help you understand what you need to do to correct any cash flow problems. However, to be fair, an *indirect Cash Flow Statement* produces the same operating cash flow results. However, the indirect statement is not intuitive and much more difficult for non-financial people to understand. A *direct Cash Flow Statement* meets the criteria for everything you want to know about your horse business's cash flow.

- It shows clearly whether the cash generated from everyday business operations is positive or negative for the period of time you are looking at, and by how much.
- It shows how much cash was invested in your business, how much was received from lenders and investors (you if you are a sole proprietorship), and how much was paid to lenders and investors (you if you are a sole proprietorship).
- It shows whether the cash you received from all sources was more or less than the cash you paid out, and by how much.

Like the *Income Statement*, the *Cash Flow Statement* is a 'movie' of events during a given period. It shows you the cash side of what happens in your business.

The real strength of a *Cash Flow Statement* is it can be broken down into three categories, each of which reveals important information about your business.

- *Cash Flow from Operations (CFO)* – shows the cash your horse business is generating internally from everyday operations.

- *Fixed Asset Cash Flow (ACF)* – covers the cash you spend for fixed and intangible assets, and any receipts from the sale of any assets.
- **Financing Cash Flow (FCF)** – shows the cash received from lenders and investors minus any cash paid out to them.

Cash Flow Statement Example

Category	Description	Account Total	Total
Cash Flow from Operations			\$ 10,292.42
	<i>Boarding Income</i>	\$ 14,900.00	
	<i>Training Income</i>	\$ 7,800.00	
	<i>Event Income</i>	\$ 200.00	
	<i>Lesson Income</i>	\$ 3,510.00	
	<i>Horse Hauling Income</i>	\$ 3,729.00	
	<i>Farrier Income</i>	\$ 3,060.00	
	<i>Farrier</i>	(\$ 2,740.00)	
	<i>Horse, Bedding</i>	(\$ 1,068.47)	
	<i>Horse, Grain</i>	(\$ 1,134.32)	
	<i>Horse, Forage (Hay)</i>	(\$ 6,400.00)	
	<i>Horse, Supplements</i>	(\$ 457.64)	
	<i>Contract labor</i>	(\$ 9,220.00)	
	<i>Fuel, Gasoline</i>	(\$ 156.91)	
	<i>Fuel, Diesel Fuel</i>	(\$ 750.50)	
	<i>Maintenance, Vehicles</i>	(\$ 270.90)	
	<i>Tires</i>	(\$ 707.84)	
Fixed Asset Cash Flow			(\$ 2,758.23)
	<i>Mortgage, Ranch</i>	(\$ 2,412.45)	
	<i>Vehicle Payment</i>	(\$ 345.78)	
Financing Cash Flow			\$ 0
		Change In Cash	\$ 7,534.19
		Beginning Cash	\$ 8,356.43
August 1, 2012 – August 31, 2012		Ending Cash	\$ 15,890.62



The three categories are used together to make two simple equations.

$$OCF + ACF + FCF = \text{Change In Cash}$$

and

$$\text{Ending Cash} = \text{Beginning Cash} + \text{Change In Cash}$$

Knowing your operating, investing and financing cash flows lets you manage your horse business's change in cash.

Cash Flow from Operations (CFO) is the life blood of your business. A business generates cash in only three ways – from operations, from selling assets and from lenders and investors (borrowing money or selling stock). But... cash from operations is the most important of the three. A business cannot live long just selling assets and if you cannot generate cash from operations, no lenders or investors are going to give you their money. You should be thinking about your CFO every day and checking it often. *equineGenie lets you check your CFO as often as you want.* Your CFO is the most important line on your *Cash Flow Statement*, more important than ending cash or change in cash or anything else. The horse businesses that really need a lot of cash in the bank are those that do not have a healthy CFO, or are just starting up and do not expect to have positive CFO for a while, or those that do not have financing in place.

Cash Flow from Assets (CFA) is a good measure of your business's investment in its future. That makes the most important line in your CFA section the amount you are spending on fixed assets. Potential lenders or investors will compare your CFO to your Financing Cash Flow (FCF) to see how you are funding your fixed asset investments. They want to know if you are funding your investments with cash from operations or do you have to borrow money or sell stock. Over the long term you want your CFO to be greater than your FCF. You want to fund investments internally to reduce your dependence on outside sources for financing.

Financing Cash Flow (FCF) shows your relationship and dependence on lenders and investors. It lets lenders and investors know the following:

- Are you repaying your outstanding loan or is your indebtedness growing?
- Do you have to sell more stock in your business to finance your cash needs?
- Are you paying your shareholders dividends?

Your total FCF can be positive or negative, depending on the age and circumstances of your business. You must always know why your cash is what it is – where your cash is going and where it is coming from.

This article completes the discussion on the three key financial statements – *Balance Sheet*, *Income Statement*, and *Cash Flow Statement*. Knowing what is on each statement is only the beginning of using your financials to run your business better than you have previously. Next we will look at understanding how your financial statement fit together. Understanding how your financial statements fit together will enable you to see the big financial picture and better understand what is going on in your horse business.

To be successful in a horse business does not require a finance education, but it does require an understanding of what your financials are telling you. This understanding will enable you to make better business decisions. A good *Horse Business Management System* will do the calculations for you and analyze and report the results with comments or suggestions. A good *Horse Business Management System* will save you valuable time you can then use to improve your business.



Think – plan – organize – execute – make/save money.

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