PRACTICE MANAGEMENT

## CASH FLOW MANAGEMENT

Cash flow is critical for the survival of a business. Most businesses run into financial difficulties not because of a lack of wealth, but because of a lack of cash flow. Cash flow is necessary to enable the business to pay its suppliers (of stock) and also to pay other operating expenses. A shortage of cash flow will result in the business being unable to meet its short-term commitments to employees, suppliers, landlord, etc.

In order to manage the cash flows of a practice, it is necessary to understand the difference between cash flow and profitability. The fundamental difference between the two is one of timing: to measure profit, we compare 'sales' and 'costs', while to measure cash flow, we compare 'money in' and 'money out'.

Profitability comprises the transactions that the business did in a particular period, whether paid/received or not. Profits or losses will result in the net worth of a business going up or down.

Cash flow comprises the cash receipts or payments a business made during a particular period, irrespective of when the transaction relating to the payment/receipt took place. Cash flow reflects the upward or downward movement in the cash (or bank balance) in the business during a particular period.

In order to manage a business effectively, it is vital for the practice manager to distinguish between profitability and cash flow.

**Table I. Dr A Robertson - profit and loss statement for 2003**

| | Income and expenses (R) | Cash flow (R) | Note |
|---|---|---|---|
| Professional fees | 250 000 | 187 500 | 1 |
| Sales (drugs) | 220 000 | 165 000 | 1 |
| GROSS SALES | 470 000 | 352 500 | |
| Cost of drugs | (150 000) | (137 500) | 2 |
| GROSS PROFIT | 320 000 | 215 000 | |
| Overheads | (166 000) | (166 000) | |
| NET PROFIT | 154 000 | 49 000 | 3 |
| Drawings | (154 000) | (154 000) | |
| RETAINED INCOME | Nil | (105 000) | 4 |

**Notes**
1. Of the total fees/sales in this period, patients/medical schemes took on average 3 months to pay. Only 9 months out of the 12 months' fees were collected in cash.
2. Suppliers of drugs allowed one month's payment terms. From the 12 months' purchases, only 11 months have been paid.
3. Net profit equals R154 000, but net positive cash flow amounts to only R49 000.
4. Of the R154 000 profits, the owner withdrew the full amount.

**Table II. Cash flow statement**

| | Cash in (R) | Cash out (R) |
|---|---|---|
| 1 Cash flow from operations: | 154 000 | |
| Profits made | | |
| Personal withdrawals | | 154 000 |
| Less: amounts not yet received (accounts receivable) | | 117 500 |
| Plus: amounts not yet paid (accounts payable) | 12 500 | |
| 1 Net flow from operations | | 105 000 |
| 2 Cash outflow from investments | | |
| Fixed assets | | 40 000 |
| 3 Cash inflow from financing | | |
| Hire purchase | 40 000 | |
| Owner's capital | 20 000 | |
| Subtotals | 226 500 | 311 500 |
| Net cash outflow | | (85 000) |
| (financed through a bank overdraft) | | |

An example of a profit and loss statement of a medical practice since its inception in month 1 (January) to month 12 (December) is shown in Table I. The statement shows a net profit of R154 000 for the 12 months, but the net positive cash flow from trading is only R49 000.

Other assumptions used in this example are:

- The owner deposited R20 000 in the practice's cheque account when he started the practice.
- R40 000 of medical equipment was purchased at start-up, financed through a hire purchase agreement from a bank.
- The hire purchase instalment is equal to the interest and depreciation cost of the equipment.

Although Dr Robertson withdrew the same amount as the profits the practice made (R154 000), his bank overdraft amounted to R85 000. How is that possible? The cash flow statement in Table II shows why.

The conclusion from the above is that, although Dr Robertson did not withdraw more from the practice than what he earned, the practice needs R85 000 to fund the assets it built up to stay in operation.

It also follows that growth requires cash. If the above example is worked through to the next year, you will note that as the turnover grows, the total accounts receivable increases and the need for additional cash flow increases.

**How to manage cash flows**

There are two main areas where cash is needed in a medical practice:

- financing (funding) of outstanding accounts from patients
- financing of fixed assets (mainly equipment).

The most positive change in cash flow in a medical practice will be experienced when the practice is able to reduce or contain its debtors' book to as small an outstanding amount as possible (i.e. to limit the amount owed to the practice by debtors and also to shorten the time required to collect fees that are outstanding). Various steps can be taken to ensure the shortest collection period. For example, electronic submission of accounts to medical schemes on a daily basis, physical delivery of hard copies of accounts to medical schemes via medical courier companies, and on-line confirmation of available patient benefits with the medical scheme.

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