

BUSINESS FINANCE

CASH FLOW VS. PROFIT: WHY YOUR BUSINESS CAN BE PROFITABLE YET STILL RUN OUT OF CASH

THE HIDDEN FINANCIAL PARADOX THAT CATCHES EVEN EXPERIENCED BUSINESS OWNERS OFF GUARD

Picture this: You've just reviewed your quarterly P&L statement, and the numbers look fantastic. Revenue is up, expenses are controlled, and your net income shows a healthy profit. You should be celebrating, right? Instead, you're staring at your bank account wondering where all that money went—and more importantly, how you're going to make payroll next week.

If this scenario sounds familiar, you've encountered one of business finance's most perplexing mysteries: the **profit-cash flow disconnect**. It's a phenomenon that has blindsided countless successful entrepreneurs and can turn a thriving business into a struggling one overnight.

THE TALE OF TWO FINANCIAL STORIES

Your business tells two different financial stories simultaneously, and understanding both is crucial to your success:

Profit lives in the world of accounting principles. It's the difference between your revenues and expenses as recorded on your income statement, following rules that prioritize matching revenues with the expenses that generated them. Profit answers the question: "Is my business model working?"

Cash flow lives in the real world. It tracks the actual dollars moving in and out of your business accounts, regardless of when transactions were recorded for accounting purposes. Cash flow answers the question: "Can I keep my doors open?"

The disconnect happens because these two measurements operate on different timelines and follow different rules. You can have excellent profit margins while facing a cash crisis, or conversely, maintain strong cash flow while showing accounting losses.

THE FOUR CASH FLOW CULPRITS

Several common business scenarios can create this profit-cash gap:

1. **The Accounts Receivable Trap**

When you invoice customers, accounting rules require you to record the revenue immediately—even if payment won't arrive for 30, 60, or 90 days. Your P&L shows the sale, but your bank account remains unchanged. As your business grows and sales increase, this gap often widens, creating what I call the "success penalty."

2. **The Inventory Investment**

Manufacturing and retail businesses often tie up significant cash in inventory purchases. While this inventory appears as an asset on your balance sheet (not an expense on your P&L), it represents real cash that's no longer available for operations. The larger your inventory investment, the tighter your cash position becomes.

3. **The Capital Expenditure Reality**

When you purchase equipment, vehicles, or other capital assets, accounting spreads the expense over several years through depreciation. However, you pay the full amount upfront. A \$50,000 equipment purchase might only impact your monthly P&L by \$1,000 in depreciation, but it immediately removes \$50,000 from your available cash.



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4. **The Debt Payment Dilemma**

Principal payments on loans don't appear as expenses on your income statement—they're simply a transfer from cash to debt reduction on your balance sheet. Yet these payments can represent substantial monthly cash outflows that must be managed alongside your operational expenses.

A REAL-WORLD LESSON FROM THE FIELD

I witnessed this disconnect firsthand. The head of the organization, despite having an MBA and strong business acumen, was puzzled why our healthy revenue performance wasn't translating to improved bank balances.

The answer lay in our accounts receivable management. Parents paying tuition on monthly payment plans weren't always making timely payments, causing our receivables to grow steadily. On paper, we were hitting our revenue targets and showing strong financial performance. In reality, our operational cash flow was under pressure because the actual money was delayed or sometimes missing entirely.

This experience reinforced a fundamental truth: even the most profitable business model can falter without proper cash flow management. The solution wasn't to change our educational programs or pricing—it was to implement better receivables management and cash flow forecasting systems.

FOUR STRATEGIES TO BRIDGE THE GAP

1. **Accelerate Your Receivables Cycle**

The faster you convert sales into cash, the stronger your cash position becomes. Implement clear payment terms, offer early payment discounts, and establish consistent follow-up procedures for overdue accounts. Consider requiring deposits for large orders or recurring payment setups for regular customers.

2. **Optimize Your Inventory Investment**

Examine your inventory turnover rates and identify slow-moving stock. Implement just-in-time ordering where possible, negotiate better payment terms with suppliers, and consider drop-shipping arrangements that eliminate inventory holding entirely.

3. **Strategic Capital Planning**

Before making significant equipment purchases, evaluate leasing options that spread the cash impact over time.

When purchasing is necessary, time these investments carefully around your cash flow cycles and consider financing options that preserve working capital.

4. **Implement Cash Flow Forecasting**

Create rolling 13-week cash flow projections that track expected inflows and outflows. This forward-looking approach helps you identify potential cash shortfalls before they become critical, allowing time to implement solutions rather than react to crises.

THE BOTTOM LINE

Profitability validates your business model, but cash flow determines your business survival. The most successful companies master both metrics, understanding that they serve different purposes and require different management approaches.

Many business owners focus intensely on their P&L while treating cash flow as an afterthought. This approach works until it doesn't—and when cash flow problems emerge, they often require immediate attention that can disrupt operations and limit strategic options.

The solution isn't to choose between profitability and cash flow—it's to manage both proactively. This requires systems, processes, and often the expertise of someone who understands the intricate relationship between these financial metrics.

Is your small or mid-sized business experiencing the profit-cash flow disconnect? Don't let cash shortfalls derail your profitable business. Jeff Solomon and [CFO On The Go](#) specialize in bridging this critical gap before it becomes a crisis. With more than 25 years of experience helping businesses master both profitability and cash flow management, Jeff implements the systems and forecasting tools needed to ensure your bank account reflects your business success. Jeff offers part-time CFO services in flexible 5, 10, or 15 hour per month models, giving you access to expert financial leadership without the burden of a full-time hire.

The longer you wait, the wider the gap becomes. Let's schedule a call this week to discuss how CFO On The Go can transform your financial management.

Contact Jeff@CFOontheGo.biz or (737) 314-0060