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Unearthed Treasures by Unlocking the Secrets of Forgotten Cash through Dynamic Cash Flow Analysis

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ABSTRACT

Cash flow is an important aspect of company finances which reflects the company's financial health and ability to fulfill its financial obligations. Cash flow statements allow stakeholders to understand how cash flows are generated and used in a given period. This research aims to gain an in-depth understanding of cash flow management, financial innovation, risk management, and modern business practices. Through a qualitative approach with literature studies, this research explains various aspects related to cash flow, starting from definitions, classifications, and problems that may occur, to the analysis techniques used. There are three main categories in the cash flow report, namely operating, investing, and financing activities. Cash flow problems can occur in the form of a deficit, break-even, or surplus. Cash flow analysis includes various ratios that measure a company's financial performance, such as operating cash flow/net sales, free cash flow, and other ratios. The results and discussion highlight the cash flow analysis techniques used, such as the calculation of operating cash flow/net sales and free cash flow, as well as various ratios that measure a company's financial performance. This research concludes that cash flow analysis is an important key in understanding company finances and making better strategic decisions. Cash flow statements help identify potential financial problems and ensure the long-term continuity of a company's operations. As suggestions for future research, this study suggests exploring the impact of technology in cash flow management, the influence of financial innovation on cash flow, risk management strategies, dividend policies, best practices in cash flow management, comparison of methods for preparing cash flow reports, the influence of tax policy, and the impact of CSR on cash flow.

Keywords: Cash Flow, Cash Flow Management, Cash Flow Report, Cash Flow Analysis, Cash Flow Analysis Techniques, Corporate Finance

Field: Accounting, Management, Finance

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INTRODUCTION

Cash is money, a place to store money, a place to pay and receive money. Meanwhile, cash in accounting (Arum et al., 2023) is any measuring instrument accepted by the bank for the purpose of saving, which includes: banknotes and coins.

Cash and cash equivalents refer to funds held by the treasurer and deposits kept in banks, readily available to support local government operations or short-term investments. These assets are highly liquid and easily convertible into cash, without being subject to substantial fluctuations in value.

Some characteristics (Saitri et al., 2023) of cash are as follows:

- Cash is a company's most liquid asset
- Cash can be used as the most common standard of exchange (Eddy et al., 2023; Renaldo, Vomizon, et al., 2023).
- Cash can be used as a basis for calculations and measurements

Cash flows are inflows (receipts) and outflows (expenses) at different points in time that occur during the life of the project. Cash Flow is the flow of money in and out per period of time in a company or institution. According to KBBI, cash flow is a company's cash expenditure and income on a daily, weekly and other time period.

Cash flow problems in businesses are usually when expenses are greater than income. In fact, income that is greater than expenses can also cause cash flow problems. There are at least 3 (three) categories that cause cash flow problems:

1. Deficit: Expenditures > Income = Debt

   This happens when you are forced to go into debt to cover expenses, and often happens because you often prioritize personal desires and satisfaction, rather than needs.

2. Breakeven: Revenue = Expenses

   This condition is not as serious as the deficit and occurs because the allocation of funds cannot provide deeper financial benefits. Not being careful in managing your income can also result in no income remaining.

3. Surplus: Income > Expenditures = Good

   This condition will look fine, where all expenses and income are in accordance with financial planning, meaning you have succeeded in controlling expenses below your financial capabilities.

LITERATURE REVIEW

Cash Flow Statement

In a cash flow statement, it's typical to find three primary classifications in the notes: operating activities, investing activities, and financing activities.

1. Operational (Operating)

   This activity is a collection of activities that can affect the company's cash or finances (Ndruru, 2023). This activity is further divided into two, namely incoming activities and outgoing activities. Operating activities from cash inflows generally come from the receipt or sale of goods and services, or receipts resulting from providing loans. Meanwhile, operating activities from cash out usually come from paying employee salaries, paying company needs such as taxes (Estu et al., 2023) to the government, or debts and loans to the company. For instance, under operating activities, you'll find transactions such as sales of goods/services to customers, purchases of inventory, acquisition of equipment with an estimated useful life of less than a year, payments to suppliers, and various other operational expenses.

2. Investment (Investing)

   This cash flow activity is related to the income or expenditure of funds that are related to the purchase or sale of fixed assets, namely company assets that have long-term benefits and are not for sale, such as buildings, land, shops, or warehouses to support company activities. Cash inflows in this activity usually come from sales of fixed assets such as property sales. Meanwhile, the outflow in this activity comes from expenditure on purchasing fixed assets. As an example, under investing activities, you may encounter transactions involving the acquisition or disposal of fixed assets or other long-term investments.

3. Funding (Financing)

   Funding activities usually come from transactions related to adding or reducing capital. Where, the inflow can come from the sale of equity securities (Purba, 2023), for example, company shares, or it can also come from the receipt of bonds. Meanwhile, outflows in this activity come from purchasing shares and paying off long-term debt to recover shares. For example, initial capital deposits, bank loans or bonds, and share issuance.

This report is not only needed by large-scale businesses or companies but is also needed by small or home-scale businesses. Where, this cash flow report can be a basis for making financial strategies and can help you when you want to make financial evaluations, to map opportunities and risks based on existing finances.

How to Make a Cash Flow Report

After knowing the function of the cash flow report and the three types of activities that are sources of cash and flow into the company's cash, you must also understand the methods (Sinaga, 2024) used in making cash flow reports. There are at least two methods that can be used to prepare cash flow reports (Renaldo, Sally, et al., 2023), namely the direct and indirect methods.

The difference between the two is only based on their preparation, for example, when using the direct method, the preparation is based on the cash book or bank report. Where, when using this method, one must report groups of cash expenditures and receipts from the company's operational activities, and continue on investment and financing records.

Meanwhile, when preparing indirect cash flow reports, the preparation is based on the profit and loss report and the balance sheet financial report. Where, the profit or loss statement is compared with the effect of transactions, not with cash. Both past and future cash expenditures, and not the value (Suyono et al., 2023) of investments or receipts.

Both of these methods have their respective advantages. For the direct method, the report will be easier to understand and more complete. Later, it will be easier to make decisions related to finances. However, direct methods require greater costs (Chandra et al., 2024), and data collection methods are more difficult.

Meanwhile, the indirect method does not require data collection, where the data collected can be obtained more easily and the costs required are relatively small. This is because the materials or data required come from cash and the company's balance sheet. Once the required materials and data are complete, the creation of the cash flow report can begin. The writing can be categorized according to cash flow activities and according to financial inflows and outflows.

METHODOLOGY

This research uses a qualitative approach. This research was conducted based on a literature study. Conduct an in-depth literature review to understand the theory and best practices in cash flow management, financial innovation, risk management, and modern business practices. Investigate previous research relevant to cash flow optimization and the factors that influence it.

Mathematical Modeling: Developing a mathematical model to predict future cash flows (Renaldo & Murwaningsari, 2023) based on the variables that influence it. Conduct simulations to identify scenarios that could impact cash flow and design mitigation strategies. This research will explain several financial ratios relating to cash and cash flow.

RESULTS AND DISCUSSION

Cash Flow Analysis Techniques

The cash flow from operations, as outlined by Renaldo, Purnama, et al. (2023), can be determined through either the direct or indirect method. In the indirect method, the calculation commences with net income and then incorporates adjustments for non-cash expenses and alterations in working capital.

A fundamental approach to computing cash flow involves summing up the current assets and deducting the total current liabilities. Once the cash flow figures are obtained, they can be employed to compute various ratios, such as the operating cash flow divided by net sales, facilitating a more comprehensive analysis of cash flow.

Operating Cash Flow/Net Sales

This ratio, expressed as the percentage of a company's net operating cash flow to its net sales, or revenue (from the income statement), tells us how much cash it generates for each sale.

Formula:

Net Cash Flow from Operations / Net Sales

Interpretation: Measures the percentage of revenue that is converted into cash flow. The higher this ratio, the better the company manages its cash flow.

There isn't a specific percentage to aim for, but generally, a higher percentage is preferable. It's important to acknowledge that industry-to-company ratios can vary significantly. Investors should monitor the performance of this indicator over time, as highlighted by Putra & Kudri (2024), Renaldo, Suyono, et al. (2023), and Zulkifli et al. (2023), to identify substantial deviations from the company's average cash flow to sales ratio. Additionally, it's valuable to compare the company's ratio with similar companies in the industry to gain insights into its relative performance.

It is also important to monitor how cash flow increases as sales increase because cash flow must move at the same rate over time.

Free Cash Flow

Free cash flow (FCF) is commonly described as the net operating cash flow deducted by capital expenditures. This metric holds significance as it indicates the efficiency of a company in cash generation. Investors utilize free cash flow to assess whether a company possesses adequate cash reserves, post funding its operations and capital expenses, to distribute dividends and execute share buybacks.

To derive FCF from a cash flow statement, locate the item denoted as cash flow from operations, also termed as "operating cash" or "net cash from operating activities," and subtract the capital expenditures necessary for ongoing operations.

Free Cash Flow (FCF) = Operating Cash Flow – Gross Investment in Operating Capital

First of all, you need to know the size of the operating cash flow and the gross investment in operating capital.

Expanding the components included in the free cash flow figure can provide a more comprehensive view. Apart from capital expenditures, dividends can be incorporated into the amount deducted from net operating cash flow to derive a more inclusive free cash flow figure. This broader figure can then be juxtaposed with sales figures, as demonstrated previously.

In practical terms, if a company has a history of dividend payments, it may encounter challenges in suspending or eliminating them without adversely affecting shareholders. Even a reduction in dividend payments, though not necessarily catastrophic, may pose concerns for many shareholders. In certain industries, investors perceive dividend payments as essential cash outflows, akin to capital expenditures.

Monitoring free cash flow across multiple periods and comparing the results with companies in the same industry is crucial. A positive free cash flow signifies the company's capability to meet its obligations, including funding its operational activities and honoring dividend commitments.

Other Ratios

1. Cash Flow to Debt Ratio:

   Formula: Net Cash Flow from Operations / Debt

   Interpretation: Shows the company's ability to pay debts with the cash flow generated. A high ratio indicates better debt repayment ability.

2. Cash Flow to Assets Ratio:

   Formula: Net Cash Flow from Operations / Total Assets

   Interpretation: Measures a company's efficiency in generating cash flow from the assets it owns. A high ratio indicates good efficiency.

3. Cash Receipts Ratio:

   Formula: Net Cash Flow from Sales / Net Sales

   Interpretation: Indicates the percentage of sales received in cash. A high ratio shows the company's ability to obtain cash from sales.

4. Cash Payments Ratio:

   Formula: Net Cash Flow from Purchases / Net Purchases

   Interpretation: Measures the extent to which a company pays for purchases with cash. A low ratio can indicate a good payment policy.

5. Free Cash Flow Ratio:

   Formula: Net Cash Flow from Operations - Capital Expenditures / Debt

   Interpretation: Measures how much cash is left after meeting capital and debt requirements. A high ratio indicates the ability to generate free cash.

6. Investment Cash Flow Ratio (Cash Flow to Investment Ratio):

   Formula: Net Cash Flow from Investments / Investment Expenditures

Interpretation: Shows the company's efficiency in generating cash flow from investment activities.

7. Cash Turnover:

   Formula: Net Sales / Average Cash.

   Interpretation: Shows how often cash turns over in a period. The higher this ratio, the more efficient the company is in managing its cash.

8. Capital Expenditure Ratio:

   Formula: Net Capital Expenditures / Cash from Net Operations.

   Interpretation: This shows how much capital expenditure is compared to cash from operations. This ratio indicates the extent to which a company relies on cash generated from operations to support its capital expenditures.

9. Cash to Debt Ratio:

   Formula: The formula is Cash and Cash Equivalents / Debt

   Interpretation: Measures a company's ability to pay its debts using the cash it has. This ratio provides an overview of the company's liquidity level in paying its debts.

10. Free Cash Ratio (Free Cash Flow Ratio):

    Formula: The formula is Free Cash Flow / Net Sales

    Interpretation: Shows how much cash is available for use after meeting working capital requirements and capital expenditures. This ratio can provide an idea of the extent to which the company can generate free cash for investment activities or distribution to shareholders.

11. Cash Flow Volatility:

    Formula: $\sqrt{\frac{\sum_{t-1}^{n}(CF_t-\overline{CF})^2}{n-1}}$

    Note: n is the number of periods (for example, months or years), CF_t is the cash flow in period t, and $\overline{CF}$ is the average cash flow over n periods.

    Interpretation: Cash flow volatility measures the extent of fluctuations or changes in a company's cash flow from period to period. This volatility can provide important information (Chandra et al., 2018; Nyoto et al., 2023) about the company's financial stability. The formula above uses the concept of standard deviation to measure how far data points (cash flows) are spread out from the average. Standard deviation is expressed in the same units as cash flows, and the greater the standard deviation value, the greater the volatility of cash flows (Renaldo, Sudarno, et al., 2023).

CONCLUSION

Conclusion

Cash flow analysis is an important key in understanding a company's finances. Through a cash flow report, a company can describe where its cash flow comes from and is used during a certain period. Some key points and cash flow analysis techniques that need to be considered include:

1. Cash is the most liquid and vital asset in company operations. Cash flow reflects a company's financial health and ability to meet financial obligations.
2. Cash Flow Categories: (1) Operating Activities: Relates to cash receipts and payments from the company's core business activities. (2) Investment Activities: Related to expenditures and cash receipts from long-term investments. (3) Financing Activities: Shows cash expenditures and receipts from financing, such as debt and equity.
3. Cash Flow Problems: (1) Deficit: Expenditures exceed income, leading to debt. (2) Break even: Revenue equals expenses, resulting in a stagnant situation. (3) Surplus: Income is greater than expenses, indicating financial success.

4. Benefits of Cash Flow Statement Classification: (1) Provides information about cash inflows and outflows. (2) Facilitate financial evaluation and decision-making. (3) Become a reference for financial strategies and increase investment.
5. Content and Form of Cash Flow Report: (1) Reports net cash generated or used from operating, investing, and financing activities. (2) Reconciliation is used to link net profit (Hia, 2023) with net cash flow from operating activities.
6. Cash Flow Analysis Techniques: (1) Operating Cash Flow/Net Sales: Shows the percentage of income converted into cash flow. (2) Free Cash Flow: Measures how efficiently a company generates cash after capital expenditures. (3) Other Ratios: Cash flow to debt, cash flow to assets, cash receipts, and payments.
7. Cash flow statements are an important tool for understanding a company's financial condition and making better strategic decisions in managing cash flow, investment, and funding. Cash flow analysis helps identify potential financial problems and ensures the long-term continuity of a company's operations.

Suggestion

This research can be focused on strategies and methods for optimizing cash flow in a modern business environment (Sudarno et al., 2024). Some research suggestions that could be explored include:

1. Application of Technology in Cash Flow Management: Research can explore how technology, such as digital financial systems (Suhardjo et al., 2023), artificial intelligence, and data analysis, can help companies manage their cash flow more efficiently and effectively.
2. Impact of Financial Innovation on Cash Flow: Examining the impact of financial innovation, such as blockchain technology or digital payment methods, on a company's cash flow. How companies can leverage this innovation to increase liquidity and optimize their cash flow.
3. Risk Management Strategy for Cash Flow: Examining risk management strategies that can be implemented to protect cash flow from market fluctuations, changes in interest rates, or other risks that can affect the company's liquidity (Renaldo et al., 2022).
4. Analysis of Dividend Policy and Its Effect on Cash Flow: Exploring the relationship between a company's dividend policy and cash flow. How dividend policy can affect free cash flow and the sustainability of company operations.
5. Implementation of Best Practices in Cash Flow Management: Analyze the best practices in cash flow management of successful companies. How these companies manage and optimize their cash flow to achieve sustainable financial and growth goals.
6. Comparison of Methods for Preparing Cash Flow Statements: Comparing direct and indirect methods in preparing cash flow reports. Identify the advantages and disadvantages of each method and their impact on decision-making.
7. Analysis of the Effect of Tax Policy on Cash Flow: Examining the impact of tax policy on company cash flow. How changes in tax policy can affect a company's cash receipts and expenditures.
8. The Effect of CSR (Corporate Social Responsibility) on Cash Flow: Examining how a company's CSR activities can influence cash flow, both directly and indirectly. Can investments in sustainability have a positive impact on company liquidity?

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