

The Business Cycle and Your Business

Closely related to working capital is the business cycle. In general, the business cycle is the same for all businesses. For you, however, the timing and issues are different depending on what industry you are in. I want you to learn about the business cycle because it is the rhythm of your business cycle that undermines all of your decisions.

The business cycle keeps time for your company. The pace of your business cycle will determine how much working capital you have. Like a carefully engineered machine or a finely synchronized orchestra, your business cycle is influenced by everything you and all your employees do.

The business cycle is a closed system that really begins when you purchase raw materials or something to resell. If you are in the service industry, then you are buying labor or maybe expertise.

Let's look at the business cycle of Claire's Chocolates. On Friday, Claire places an order for 200 pounds of dark chocolate at \$3.35 per pound. The delivery comes in Monday morning and Claire is ready to make her weekly supply of fresh hand-made chocolates. All week, she single handedly makes and sells the chocolates in her shop. By Friday evening when she locks the doors she has sold every pound of chocolate. In fact, she can not even open the store on Saturday because she is out of chocolates.

Claire checks the register and discovers she has earned \$1,398 because she sold all 200 pounds of chocolate at \$6.99 per pound. Wow! She takes the money to the bank. Let's take Claire's weekly activity and apply a business cycle perspective.

On Friday, Claire placed a chocolate order incurring \$670 in current liabilities because she put the 200 pound chocolate order on her supplier charge account. Come Monday she converted the \$670 worth of raw dark chocolate to hand-made chocolates. She then sold the hand-made chocolates, further converting the \$670 from raw chocolate to shelf inventory to cash.

By Friday, what started out as a purchase order to the supplier was turned into cash for Claire's bank account. How? All by the business cycle. It is remarkable how it all happens so quickly. But you can also see where the pitfalls lie.

Does Claire get to keep all of the cash she made? Of course not. Claire still has to pay off the \$670 she owes her chocolate supplier. And Claire has other expenses too - electricity, plastic wrap, boxes, refrigeration. Still, if we were to pause the business cycle of Claire's Chocolates on Wednesday we could calculate her working capital.

To keep this illustration simple, let's pretend the only thing in Claire's business cycle is the 200 pounds of dark chocolate. Realistically, she is making and selling all varieties of chocolates.

So on Monday, if we calculate the working capital, we get current assets of \$670 for raw chocolate inventory. But Claire also has a current liability of \$670 for the same raw chocolate. By Monday afternoon, however, Claire has moved the raw chocolate into a shelf ready hand-made chocolate inventory. Due to the added value, her inventory is now worth \$866.

Claire now has \$866 minus \$670, equaling \$196 in working capital. By Friday, when Claire has converted all of her chocolates into cash she will have \$1,398 minus \$670, equaling \$728 in working capital. Then Claire gets to decide how to use the working capital.

The key to managing your business cycle is velocity - keep things moving. Like Claire, you can convert your inventory to cash rapidly by operating efficiently. When your inventory sits around, your business cycle is stalled.

A common business cycle problem for many small business owners is the final step where you book your sales. Small companies spend so much time on operations and customer service that they never get around to doing the billing.

If you do not get to your invoicing then your business cycle is stalled. Jump start your cycle and keep things moving so you can bring in cash to fuel your growth to make more cash.

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