Cash Flow – Time to Take Control!

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Cash flow management is one of the most important and most ignored financial tools available to business owners and managers. *Cash flow management* is not accounting! Many business owners fail to recognize that the rules of accounting define when and how transactions are recorded in their financial statements, which is no help when they need to manage their cash for next week and next month.

True cash flow management must be based on a cash flow projection, a tool which forecasts the actual dates that deposits (revenue) will be made and when, *in the future,* expenses will be paid.

How important is cash flow? Keep in mind that businesses fail every day because they run out of cash, even though their income statement showed the business to be operating profitably.

What to do when you find yourself in a cash crunch? First, understand the factors that drive cash flow and how you can take control. The following factors have the greatest impact on cash flow:

- Accounts Receivable (time between generating the invoice and depositing the cash)
- Accounts Payable (time between receiving the invoice for purchases made and your payment of that invoice clearing the bank)
- Inventory (time between paying for the materials and depositing the income from the sale of the finished product)
- Capital expenditures (cash out to make the purchase vs. recording depreciation expense over the useful life)

Later in this report, we'll focus on cash flow projection tools and techniques. Let's start with some quick fixes that can get you some relief from a cash crunch.

1. Get the Money!
    a. Issue invoices quickly - Don't wait until the end of the week or month to generate and mail invoices
    b. Ask your best customers to accelerate their payments
    c. Offer rewards to customers for quick payment
    d. Offer electronic fund transfers as a method of payment to eliminate "it's in the mail" time
    e. Include promotional flyers with invoices – Offer perks for quick payments or to promote the launch of your new product or service
    f. Require COD on future sales for slow pay customers
    g. Aggressively pursue unpaid invoices, i.e. one day past the due date
        - Call the customer weekly - Take detailed notes of each call and conversation

- Involve the owner of the company - Don't stop at the AP clerk, call the owner directly
- Create a written collections policy and follow it, <u>don't be a "softy"</u> – Define hard timeframes for action. For instance, an invoice that is due in 30 days; at 31 days, <u>call</u> the customer: at 45 days, <u>offer</u> a payment plan: at 75 days, <u>turn over</u> to a collections agency: etc…
- Take legal action sooner rather than later - The longer you wait, the further down the list of creditors you may be

h. Restructure your invoices to define a specific date the payment is due. Your invoice should encourage action, not inaction, i.e. "Payment due June 2" is better than "Payment Due in 30 days".

2. Hold on to your cash as long as you can!

a. Prioritize the payment of invoices - All invoices are NOT created equal!
   - Pay the most important invoices first
   - Minimize late fees, finance charges and penalties – Pay invoices with the highest penalties first

b. Communicate with your lenders sooner rather than later – Your cash issues will get worse before they get better!
   - Negotiate interest-only payments on loans for the next 6 months, <u>without</u> penalties
   - Never promise anything you cannot deliver, especially with your banker - if you can only pay $300 per month, do NOT agree to pay $500 per month

c. Contact suppliers and negotiate extended payment terms, <u>without</u> penalties

d. Search for new suppliers that offer longer payment terms
   - Longer payment terms can be much more valuable than a lower price

e. Consolidate loans, where possible

3. Convert Assets into CASH!

There are many ways to create cash from the assets of your business, some better than others. The following is a list of options for converting assets into cash:

a. Sell off out-of-date inventory, unused equipment; anything else you have around that's not making money
   - Pawn shops, Craig's List, EBay, and inventory liquidation firms are just a few of the options available

b. Consider selling your accounts receivables to a Factoring company
   - Factoring companies will buy your accounts receivables, at a discount - You get the cash quickly, they assume the hassle of collecting from the customers

c. Consider using leasing companies to sell and then lease back your current assets, such as machinery, equipment, computers, software, phone systems and even office furniture

d. Use the inventory you have on hand to secure a loan or line of credit

Prevent a Cash Crunch - Build a Cash Flow Projection!

The best way to understand your cash flows and to give you the knowledge you need to effectively manage it is to build a *cash flow projection*. Based on the realities of your business, (not everyone pays in 30 days…) a cash flow projection and proper management action can prevent the painful and potentially fatal results that can occur from running out of cash.

An easy way to build a *cash flow projection* is to use the FREE Excel template available on the web site neverrunoutofcash.com
www.neverrunoutofcash.com/peaceofminddownload.htm

To make your *cash flow projection* as useful as possible:

1. Revenue and expense categories should align with your income statement
   - Do not lump several categories of revenue or expense into one line item – This significantly reduces the value of this tool and your ability to truly manage your cash flows going forward
2. The first six months of the schedule should be the <u>actual cash activity</u> from your last six months of business
   - Gives you the ability to compare (truth test) your future projections against the reality of your actual history of cash activity
3. Be realistic! Even better, be slightly conservative (however, be careful of "compounding conservatism")
   - Assume cash will take longer to collect
   - Assume you will collect less than 100% of the invoiced amount
   - Assume inventory will turn a little slower
   - Assume expenses will run slightly higher in the future
   - Assume expenses will be paid quickly
4. Don't manage from the bank balance - this is just one piece of a much bigger and more complicated puzzle

After you have built your cash flow projection, study it in detail! Identify the problems that may be lurking in the near future. Using your newly created cash flow projection, define an action plan to manage the issue and your business.

Finally, update your cash flow projection every month. Establish the discipline each month of inputting actual cash activities from the prior period, as well as updating revenue and expense projections for the next few months to align with anticipated changes in your business, the industry and your market.

Once you have established a disciplined approach to building and using a cash flow projection, you now have the tools to eliminate one of the most painful and difficult challenges a business owner may ever face. Without the distraction of cash flow crisis, you can concentrate on serving your customers and sleeping better at night!