7 Steps to Keep Your Business ‘Cash Healthy’

Success Strategies for Today’s Workplace

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"In the business world, the rearview mirror is always clearer than the windshield."
Warren Buffett

If you find it difficult to maintain adequate levels of cash in your business, before long you may not **have** a business. The game of business is all about cash flow.

Cash flow is the movement of money into or out of a business usually measured during a specified, limited period of time. Measurement of cash flow can provide a great deal of information regarding a company's value or health. It is a highly under-appreciated measurement. After all, a well-managed flow of cash-- is indicative of a healthy business, while poorly managed cash flow can cause problems that ripple throughout the entire business.

Sources of Cash: Services sold by the business, borrowings by the business, or equity investment into the business, owner capital contributions, the selling off of assets and revenue.

Uses for cash: purchase of goods, to pay off debt (repay creditors), to pay employees (salaries), to pay shareholders and to pay for costs related to operations.

OTHER TYPES OF “CASH FLOW”

Discounted cash flow: An estimation future cash flows for the business and discounting them back to the present using the time value of money principle. This analysis is widely used in investment finance, real estate development, corporate financial management and patent valuation.

Operating cash flow also known as "cash flow from operations": This represents cash generated by day-to-day operations of the business, such as collecting accounts receivable, buying inventory, or generating income.

Free cash flow: A measure of how much cash could be returned to shareholders while keeping the business as it is now or expand. Financial performance calculated as operating cash flow minus capital expenditures.

Investing cash flow also known as "cash flow from investing": Money made or spent on long-term assets the company has purchased or sold. Also includes purchases of other companies.

Financing cash flow also known as "cash flow from financing": Measures cash generated or used in the issuing or paying of debt or the payment of dividends or the repurchase or sale of shares of the company. Measures the flow of cash between a firm and its owners and creditors.

Cash Flow Challenges Throughout History

A business experiencing cash flow problems isn’t anything new. Entrepreneurs have been coming up with creative methods to overcome cash flow problems for centuries. For example, factoring, purchase order finance agreements and trade finance all have roots going back to the Dutch East India Company back in 1602 which was created to profit from the Malukan spice trade. The principles of factoring date back 4,000 years to the dawn of trade and commerce during the reign of Mesopotamian King Hammurabi. We also know that the ancient Romans, some 2,000 years ago, sold promissory notes at discounted prices and Roman merchants employed collectors to settle trade debts.

By the end of the 12th century Italy had taken the lead in Europe, especially in the arena of commerce, banking and the organization of credit. The Italians were more than two hundred years ahead of the rest of the world. Modern banking can be traced back to medieval and early Renaissance in Italy.
The Bardi and Peruzzi families dominated banking during the 14th century, establishing branches in many other parts of Europe.

Up until the 18th century cash flow accounting was the main system of reporting transactions. There was little need for profit measurement or accounting allocations because most transactions were conducted on a cash basis,. The industrial revolution period of 1760 to approximately 1840 changed all that. The business growth during that time often required more funds than most businesses generated. An explosion of both the complexity and number of transactions brought about the need for a more formal method of measuring profit and financial position.

During the first half of the 18th century, the demand for cotton, furs, timber and wool spurred on lucrative trade arrangements between American colonists and Europeans, including Great Britain. The Americans sent raw materials to Europe but had to wait months for payment. Bank financing was slow, and the colonists couldn't afford to wait months for the goods to be delivered before receiving payment. In the meantime the colonists had no profit to work with. To make sure they had cash to fund their operations factors advanced money against the colonial account receivables. This allowed the colonists to continue to plant, harvest and process orders. This gave form to international trade markets.

What Are The Causes Of Cash Flow Problems?

A cash flow problem arises when a business struggles to pay its debts as they become due.

Unfortunately, many times when companies face cash flow crunches they react by simply throwing money at the problem, which is at best, a temporary solution. This is like trying to treat diabetes with drugs alone. And just as a doctor would encourage their patient to eat well, increase their physical activity and reduce stress, successful cash flow management requires more than just a "money" fix. It requires a more overall approach that focuses on making a company's entire "order to cash" process operate more efficiently. After all, the faster goods move from seller to buyer, theoretically the faster sellers can be paid. In truth, it doesn't matter how quickly your company gets the goods to your customer unless your billing, credit and collections departments have a crisp process in place for invoicing and collecting the money owed in a timely manner.

Common causes of cash flow problems:

1) Over-extending credit to certain customers or extending credit to the wrong customers.

2) Seasonal product / service demand. If a business knows it's business cycles well, hopefully they can prepare for their annual ebbs and flows.

3) Inflated inventory levels. Especially slow moving or obsolete items.

4) Unsatisfactory profit levels or business losses

5) Hyper-growth. Sometimes companies grow too fast. Ideally growth must be brisk but managed correctly.

6) Over-investment in equipment that does not produce revenue

It is important to mention that a cash flow problem is really just a symptom of a much broader issue within your organization. A business ultimately needs to repair the structural problems in their "order-to-cash" process and supply chain to show positive results.

Maintaining A Positive Cash Flow Position For Your Company

Each organization must manage and monitor its cash flows closely. Thankfully, some customers pay their invoices in a timely manner. Others however, must be reminded and in some cases aggressively pursued. Once cash is received it must be recorded and managed. At all times, there must be enough cash to pay bills. For many businesses the main cash inflows or receipts will be from sales; the main cash outflows or payments will be for supplies and overhead business expenses such as rent, wages, or utilities.

Hard as it may be to believe but some companies actually have too much cash. If that is the case the organization needs to put that cash to work. An example might be in a deposit account or other investments where it will earn interest. In most cases there is too little cash. In those instances the business needs to determine how much it will have to borrow to cover the shortfall and for what period of time. Borrowing money also has associated expenses which need to be managed. Good cash flow management requires timely information, professional training and solid management decision making.

Cash flow is the lifeblood of any business enterprise. It is even more important than profit! Extending credit means taking on risk. There is no way to avoid it. In your efforts to grow your business consider what an acceptable level of bad debt would be. That's right. Trying to avoid *any* bad debt will most likely actually limit your sales potential. Here's how to reap the best of both worlds:

Step #1: Make it a habit to contact your customers as soon as their invoices are coming due. Just ask if you can receive a pay schedule. It's totally expected and the accounts payable department will likely have your invoice already scheduled for payment. Of course, you will run into the old, "We don't have a copy of your invoice." Be prepared to submit another copy ASAP. Hoping that a late payer will "get religion" and clean up past due balances happens rarely, not often enough to rely on; especially in a challenging economy.

Step #2: Avoid extending more favorable terms to a friend of the CEO. My attitude on this scenario is that if the boss wants the transaction done like that, then fine. But I would make sure to get his or her signature approving those *special* terms. In addition, keep that signed copy for yourself ask backup just to make sure that it doesn't "disappear". If it's for your own company be sure to handle the account in a professional, businesslike manner. If your friend or relative can't understand why you insist on following protocol, you're probably better off walking away from the deal. You must establish credible ground rules up front to avoid disaster down the road.

Step #3: Maintain documentary proof of the debt. Believe me, you **will** have customers that claim they don't owe you any money, or that they only owe a portion of the outstanding balance. Hold onto purchase orders received (and signed) from the customer, signed quote letters, packing lists, proof of delivery, email communications, everything and anything that provides backup to the fact that service has been rendered as stated.

Step #4: Always get as much credit information as possible from your customer while you are completing the *initial* sale. When the customer is hot for your product or service they are much more willing to provide information that they might hesitate to give you later on. You can also avoid hearing, "You didn't need that on all the other orders!" as well. Besides, you can never have too much information if and when an account goes south. Structure your credit application to secure the data you need.

Step #5: Establish a system for determining when to place delinquent accounts for collection. I had a manager that insisted we work our accounts to the 'nth' degree before referring them out for collection. That makes complete sense. When we referred accounts out to a third party for collection, it was rare that they collected a substantial amount of what we placed. Whatever your process before referring accounts, work it expeditiously and once satisfied get it off your desk and out for third party resolution! The longer you wait, the worse things will become.

Step #6: Unless you're dealing with a familiar company, do yourself a favor and check the majority (if not all) of your customers' references. Make sure you get enough information to at least make an informed credit decision. Ask for at least three trade and one to two bank references. Be on the lookout for inconsistencies in the information that you receive. For example: Your prospective customer claims to have been in business for 15 years but none of their references report info back any further than 5 years.

Step #7: Providing additional services /products to a customer that is already past due on earlier orders. When a customer comes back to you for more business before paying earlier invoices, that is a perfect time to leverage their desire for more product (or service) as a way to receive payment. I can't count the number of times that I used a COD (equal to the past due amount) method of delivery in order to get the customer his product and get their account brought current. A real win-win for everyone.

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