Cash Management

As the economy dips down, and banks and investors get more skittish, more and more businesses will feel a liquidity pinch. Companies without strong cash management skills will be taken advantage of by companies that are more adept at holding onto their money. Cash is the lifeblood of every company, and in an environment starved for liquidity there is no truer saying than “only the strong survive.”

While often delegated to a mid-level employee who does not have much clout within the organization, cash management is not for the faint-hearted. Good cash management requires a strong personality able to keep a steady course in rough seas, financial acumen, and the ability to forecast at least the immediate future with a good degree of accuracy.

The most critical aspect of cash management is understanding the flows – the business cycle of the company, where cash is generated from, and where it is going.

Start with the company’s operating plan (assuming that it realistically projects what management expects to happen in the coming months). The plan should be built from the bottom up and detail revenue by major customer, major location, or other appropriate delineator of the significant sources of revenue. Once you identify the revenues, identify the expenditures that must be made to support those revenues.

The next element of the flow to identify is the timing of each element in the cycle – how long it takes to collect revenues, how long vendors can be stretched out, etc.

13-week critical plan

In critical situations, cash flow should be planned in extensive detail in 13-week intervals. Specifically identify each major source and use of cash, and forecast with as much accuracy as possible the exact timing of when the cash will be received or disbursed. Two key actions must be done with this plan – update it each week and compare forecast activity to actual activity. This comparison will allow you to test your assumptions, hone your technique, and make adjustments for unexpected items. Utilizing the plan in this manner will allow management to be proactive and influence the timing of both receipts and disbursements.

The 13-week cash flow plan should be used interactively by management to set targets and monitor progress in all aspects of working capital management. Some of the key elements of this are:

- For accounts receivables, establish management procedures to improve:
    a. Average collection periods and aging
    b. Credit quality of the receivable portfolio, risk of slow-pay or no-pay customers

c. Invoicing procedures to reduce slow payments due to paperwork issues and bottlenecks or slowdowns in the billing process
d. Conversion of receivables to cash

Generally, good operating discipline will ensure good customer payment.

- For inventory, establish management procedures to:
  a. Better determine economic order quantities at different levels of forecasted cash balances
  b. Improve inventory turnover – evaluate safety stock levels, buying procedures, etc.
  c. Turn obsolete inventory into cash
  d. Focus on cash instead of gross margin or other profitability measures

- For accounts payable, establish management procedures to:
  a. Allow the company to be less reactive to vendor threats (prioritize vendors, find alternate vendors, etc.)
  b. Consistently stretch out average payment terms
  c. Obtain discounts or some other concession when faster payment is demanded.

Vendors will generally accept slower payment than they would like as long as management is upfront and honest, has a credible plan to restore the company to solvency, and treats each class of vendor fairly.

Keep them informed

Communication is critical for effective cash management – managers need to know what their spending limits are, creditors need to know when to expect payments if they are not going to be made on a timely basis, and constant contact must be maintained with customers to ensure that their payments are received on a timely basis.

Cash flow

Remember that GAAP accounting often bears little relationship to cash flows. If a company imports a product from Asia, it may pay for the goods on day one, have the goods shipped on day 90, receive the goods and clear customs on day 120, store the goods until their customer orders them on day 150, and get paid by the customer on day 240. According to GAAP accounting, nothing happened (other than the acquisition of an asset called "inventory") until day 150, when the company recognized both sales and profit. From a cash standpoint, the company spent cash on day one and did not receive cash in return for that expenditure until day 240.

The long and short of it

The most critical element of proper cash flow management is keeping in mind that there is no long-term without a short-term. Too many management teams are looking so far ahead at how much money they will make as a result of the new machinery and equipment that they have purchased, the tremendous bargains that they got by buying materials or supplies in huge quantities, and the opportunity that could not be passed up, that they neglect to plan how they can pay for them in the short term. Growth usually requires cash expenditures to provide the new products or services before they can be billed and paid for.

It bears repeating – cash is the life-blood of every business, and there is no long-term if you bleed to death in the short-term. Pay close attention to your cash flows.

For more information, please go to www.michaelgoldman.com