Build Your Business

An eNewsletter for CEOs looking to grow their companies.

High-value, "how-to" articles on customer-attraction, sales development, leadership, and best-practices in HR, IT, product development, communication, financial operations, engineering and M&A/value creation.

How to Improve Your Company's Cash Flow

Do you need extra cash? Are you searching for new sources of capital to help you survive & thrive? Cash flow is the main 'artery' of every successful business. No business can survive without positive cash flow. *This article is written for the nonfinancial CEO* and discusses the different "levers" you can pull to improve your cash flow.

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Building Businesses in the Digital Age

How to Improve Your Company's Cash Flow

Do you find yourself not having enough cash run your company? Do you know how to generate more cash? What steps can you take to improve your company's cash position?

What does cash flow *really* mean?
The definition of **Cash flow** is the movement of *cash* into or out of a business, project, or financial product. It is usually measured during a specified, finite period of time like a month or fiscal year.

There are two components of cash flow; sources and uses of cash – with a listing of the broad categories for each. These are a general listing for purposes of illustrating why cash flow is king.

<u>Sources of Cash</u>
- Revenue Deposited for the accounting period
- Decrease in Accounts Receivable
- Decreases in Inventory
- Increase in Accounts Payable
- Increase in Accrued Expenses
- Proceeds from loan proceeds

<u>Uses of Cash</u>
- Increase in Accounts Receivable
- Increase in Inventory
- Decreases in Accounts Payable
- Repayment of loans

How is cash flow determined?

The best way to explain it is by a metaphor. A financial statement has a balance sheet and a profit and loss statement (P&L). The balance sheet is like a Polaroid snap shot at one point in time and the P&L is like a video tape that is stretched over time. A cash flow is derived from both statements.

The annual change in accounts receivable, inventory, accounts payable, accrued expenses and loan proceeds are derived by the difference in the balance sheets from one year to the next year. Revenue is derived from the P&L.

To illustrate the powerful affect your decisions can have, two examples are provided below. Changing a few items in the cash flow assumptions (read: 'decisions by the CEO') can have a major affect on the amount of cash a company has. Basic assumptions in both examples are total deposits of $4,000,000 (Net sale).

➔ Example 1: The following assumptions are used for the first example:

- Twelve- month fiscal year.
- Accounts receivable collection takes 60 days. This was an increase from the prior year when collections took 32 days. The daily collection rate is $10,000.
- Only 10% of sales were in cash.
- Accounts payable were paid in 45 days based on a daily rate of $6,667. 30 days should be the standard.
- Inventory for the year is $2,400,000 or a $666 daily rate, with a 90-day supply on hand.
- Accruals for the year are $1,000,000 or a daily rate of $2,778.
- Company took out a $2,500,000 bank loan to purchase a new machine. The loan is a 5-year term.

Sources of Cash	
• Revenue deposited	$4,000,000
• Decrease in Accounts Receivable	
• Decreases in Inventory	
• Increase in Accounts Payable	
• Increase in Accrued Expenses	
• Proceeds from loan proceeds	$2,500,000
Total Sources of Cash	$6,500,000
Uses of Cash	
• Increase in Accounts Receivable	$280,000
• Increase in Inventory	$60,000
• Decreases in Accounts Payable	
• Asset purchases	$3,125,000
• Repayment of loans	
Total Use of Funds	$3,465,000

In this example, the free cash flow is $3,035,000 ($6,500,000 - $3,465,000)

➔ Example 2: This example takes place one year later. The company has been presented with the opportunity to purchase a competitor. The bank has told the company they will not loan any more money at this time. The current recession has hampered sales growth. Sales remained flat for the year and came in at just under $4,000,000. Management needed to generate more cash and improve relationships with vendors. They will need their help in funding the acquisition by providing additional vendor credit.

This is what they did.

1. *They first improved the collections of accounts receivable*. They offered customers 2%Net 10 sale terms. (2% is the price discount the company offers it the customers if they pay in full within 10 days of invoice.) This resulted in 40% of the accounts paying right away. The balances of the accounts were told they had to pay within 30 days or they would be put on credit hold. The products they sell are critical to their customers' success. This allowed them to be more stringent when dealing with their customers. By offering 2N10 terms, it cost them $32,000, but they collected $1,600,000 within 10 days of sale.

2. *Next they dealt with inventory*. The way to look at inventory is cash sitting in the warehouse - not making any money. The company went to each customer and got the amount to be purchased in the coming year. Now they had an ordering schedule. They then contacted their UPS carrier to conduct an order processing efficiency study. The UPS recommendations provided the company with huge productivity gains. Prior to the study, it took the company on average of one hour and twelve minutes to process an order. The company implemented the recommendations and the average order processing time dropped to twelve minutes.

3. *The company now knew how many products to order and when to order.* They worked on getting close to just-in-time processing. UPS could deliver products to the company by 10:30 AM and then repackage the products and shipped them out to their customers by 4:00 PM when UPS had its next pickup. The result was the company no longer had to maintain a 90-day supply on hand. They now only needed a 12-day supply on hand. Inventory was reduced by $51,948.

4. *The company next addressed sales operations processing*. They switched to an electronic billing process. This short-circuited one of the biggest issues they experienced with their customers. When they shipped a product, the invoice was included in the shipment. At the customer's office, many of the invoices never made it to the accounts payable desk. Electronic invoicing solved most of these problems. The company did not have a system in place to process customer payments in a timely manner. They used to process customer payments once a week and take the deposit to the bank. They started focusing on cash flow. They contacted their bank and got a check scanner system from them. This meant they could process each payment when it came in: Put it through the check scanner and have the funds *immediately* credited to their account. They no longer needed to leave the office, which also saved significant time, increasing productivity.

5. *The next step was to improve supplier relationships*. They currently were paying suppliers in 45 days. They made a management decision to pay suppliers in 28 days. This meant they would they would have to pay $113,339 to pay their suppliers in this new time-frame. They felt they needed to do this to rebuild relationships with suppliers. They went one step further by setting up electronic payments. The suppliers were delighted, because they received cash payments in 28 days. 120 days later the management went out on a road trip visiting each major supplier. They rebuilt the personal relationships

and then shared the company's vision to grow by acquisition and needed the supplier's support and help. The result was overwhelming support from their suppliers.

After all the above changes were made, the new cash flow situation looks markedly different that the first example.

Sources of Cash	
• Revenue deposited	$ 3,968,000
• Decrease in Accounts Receivable	$ 200,000
• Decreases in Inventory	$ 51,948
• Increase in Accounts Payable	
• Increase in Accrued Expenses	
• Proceeds from loan proceeds	
Total Sources of Cash	$ 4,219,948
Uses of Cash	
• Increase in Accounts Receivable	
• Increase in Inventory	
• Decreases in Accounts Payable	$113,339
• Asset purchases	
• Repayment of loans	$ 500,000
Total Use of Funds	$613,339

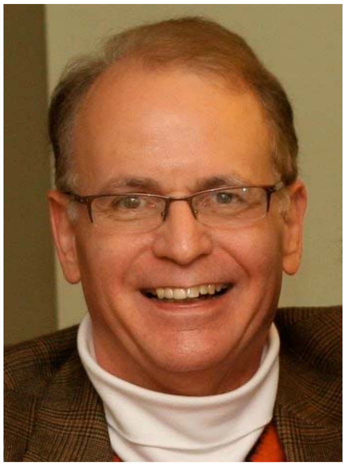
In this example the company was able to increase their cash flow by *over a half million dollars:* ($3,606, 609* - $3,035,000 [old cash flow, Example 1])

*** New cash flow [example 2]: $3,606,609 = $4,219,948 - $613,339**

Key decisions can be worth a million dollars

Pulling certain financial levers can have a major effect on the cash you have to fund your company. This is essential when you cannot obtain external financing to grow your business.

Currently, this company is in negotiations to acquire a competitor. They are doing their due-diligence and financial evaluation to determine if this would be a worthwhile purchase.



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March's eNewsletter summaries are provided below. If you would like to receive the three trial issues, please go to: www.synergy-usa.com/eNews.html.

How a $3 million/yr Company was Acquired for nearly $20 million: in 6 Months **Mark Paul**
Are you looking for ways to increase the value of your company? As one CEO found out: Attracting significantly more "A" customers, while decreasing expenses is the surest way.

How to Improve Your Company's Cash Flow **Patrick Wheeler**
Do you need extra cash? Are you searching for new sources of capital to help you survive & thrive? This article is for nonfinancial CEOs and discusses the different "levers" you can pull to improve your cash flow.

Using HR to Boost Company Performance **Iris Sasaki**
If you are interested in dramatically increasing your employees' and managers' performance, there is a little-known secret that will leverage your strengths – and those around you – to accomplish far more.

Simplifying the Sales and Channel Strategy **Bill Etheredge**
Is your sales and channel strategy defined? Have you assessed the effectiveness of existing strategies? Are changes in market conditions causing chaos in your strategy? This article defines what to do to boost effectiveness.

How to Really Get Things Done **Alexander Stein**
Are you always short on time? Does your To-Do list only get longer? Are you at the end of your rope with trying to get ahead? In this article, learn how to get you and your business ticking.

How to maximize the value of IT in your business - IT Outsourcing **Manoj Garg**
You know that you spend a lot of money on IT and that you need to maximize the value of your investments in IT. Do you know if you have made the right decisions on make vs. buy on IT functions and services?

Are You Jumping on the Lean Bandwagon? **Rick Pay**
Are you trying to reduce operations cost – and considering Lean Manufacturing? Companies are climbing on the Lean bandwagon in droves, but how do you know if Lean is the right approach for your organization?

Got Heart? **Dan Duggan**
Is morale an issue at your company? Do employees act listless? Is absenteeism beginning to be a problem? Learn how to recognize and transform "lost heart" into "loving your work".

Ten Reasons to go International **Richard Biggs**
If you are pondering whether to go global, recognize the fact that you are already "global", in that you very likely have global competitors. You are in a competitive global marketplace.

Engineering Resources: Captive or Consultant? **Mike Miles**
Too many projects and too little staff? Can't afford to hire anyone full-time? This article outlines how CEOs can clarify what is important in choosing to hire technical staff or to retain an outside consultant.

Can you do it in 6:40? **Dave Yewman**
Chances are your presentations are too long. Why? Because everyone's presentations are too long. So how do you fix that? Here's one option, a radical option. Are you feeling brave?

How to Find & Attract Capital to Grow Your Company **Brent Freeman**
If you have ever had to find capital to grow your company, this article will show you how prepare critical documents required to find capital from non-traditional sources.

This is the third edition of a three-month trial of the Build Your Business eNewsletter. We are interested in your thoughts via a survey. To receive past months' articles and to take the survey, please 'subscribe' at www.synergy-usa.com/eNews.html. Thank you.