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SBA
U.S. Small Business Administration

Common Sense Cash Flow Management

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Strategic Management Learning Series

Building America's Future

Common Sense

In This Workbook

CASH FLOW
THE 8 STEPS

1. List cash inflows (sources)
2. List cash outflows (uses)
3. Identify when (by date) cash flows in or out
4. Examine TIMING: cash inflows minus cash outflows
5. Identify the major consequences of cash as it currently flows
6. Show constraints: inflows or outflows which cannot be changed
7. Identify inflows and outflows which can be changed - rescheduled
8. Establish a plan for positive cash flow

CASH FLOW

Controlling Your Cash Before It Controls You

WHY CASH FLOW?

Watching a business floundering, running out of cash even as it makes great sales and profit advances, is painful. Painful though it may be, it is common and frequently the cause of small business failure.

Our concern in this workbook is how to identify, then avoid or control this problem.

Much of our material in ***Common Sense*** centers on various aspects of control. As times change, as populations shift and other businesses start up and go out of business for various reasons, as new competitors armed with new ideas and energy enter your market, and as new products are developed and marketed with positive (or not so positive) implications for your product line - you have to do more than merely react! You must understand these changes and then, when they occur, be ready to respond or even turn them to your own advantage.

You have two ways to run your business: reactively or proactively.

A **reactive** management is always struggling to catch up with the latest outside development - change comes from outside; the business passively responds. A reactive firm is at the mercy of its environment, pushed about by forces it cannot affect.

On the other hand, a **proactive** management anticipates problems which may crop up and plans ways to either turn them into opportunities to be exploited or blunt their negative impact by forming strategies to handle them if they come to pass. This puts the proactive management in control of the business, not the business in control as is the case with reactive management. The choice is either to control the situation or be controlled by it.

Recognizing these choices, developing an understanding of different management techniques is only part of the process. Needed also is a strategic context for both analysis and action. This means understanding what you are going to do and why.

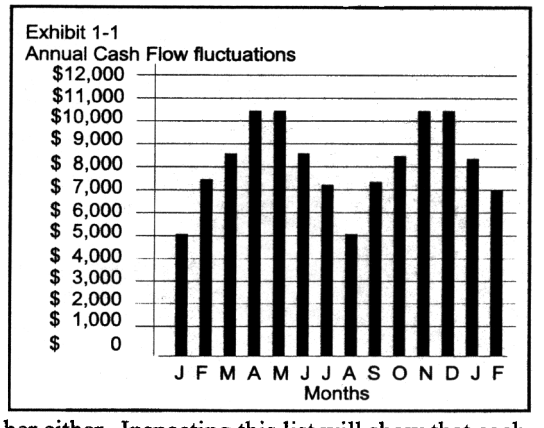
Small business survival calls for many functional skills - cash flow management is one example - but underlying those skills must be the will to apply them: a proactive management will use tools to shape its business's future, and will survive. A reactive management won't "waste" the time planning cash flow until the crisis is already overwhelming, and so will not survive.

We prefer the proactive approach.

That's **COMMON SENSE**.

WHAT IS CASH FLOW?

In its simplest form, cash flow refers to the ***flows of cash***, literally, into and out of the business. Think in terms of actual cash, dollar bills, flowing in and out of your business, and then identify both their sources and uses to identify cash flow fluctuations over an annual period (see Exhibit 1-1).



The sources of cash (inflows) are limited to:

1. New Investment,
2. New Debt,
3. Sale of Fixed Assets, and
4. Operating Profits.

That's it. There are no other sources, no hidden springs to be tapped in dry times. Oh yes, about your fairy godmother - don't count on her either. Inspecting this list will show that each of these sources has important limitations on it as well. The only source that can be depended on in an ongoing fashion is operating profits.

Five Severe Warning Signs of Cash Flow Problems

1. **Decreased Liquidity -** Running out of working capital
2. **Overtrading -** Turning inventories over more than trade averages
3. **Over-Reliance -** Excessive reliance on short-term debt
4. **Dropped Discounts -** Over-term payables
5. **Slow Collections -** Elderly receivables

"If you suffer from one or more of these, you have a CASH FLOW PROBLEM!"

This is what makes profit planning such an important activity for any business. It is only by profitable operation, and only when that profitable operation is accompanied by a positive cash flow, that the business can grow.

The uses of cash (outflows) are as varied and as idiosyncratic as businesses and business owners. The more obvious outflows are identified on the income statement as expenses, except for such noncash items as depreciation. By definition, these noncash items are not a part of your cash flow because they are an accounting process to prorate the cost of equipment or other capital goods which have already been purchased, and so do not represent an actual use of cash in the present period. On the other hand, the total purchase cost of a new piece of equipment would be a cash outflow even though only a portion of that cost is transferred to the income statement as depreciation. Similarly, another item to be added to the list of cash outflows is the principal portion of loan payments which, while not an expense, is still a use of cash.

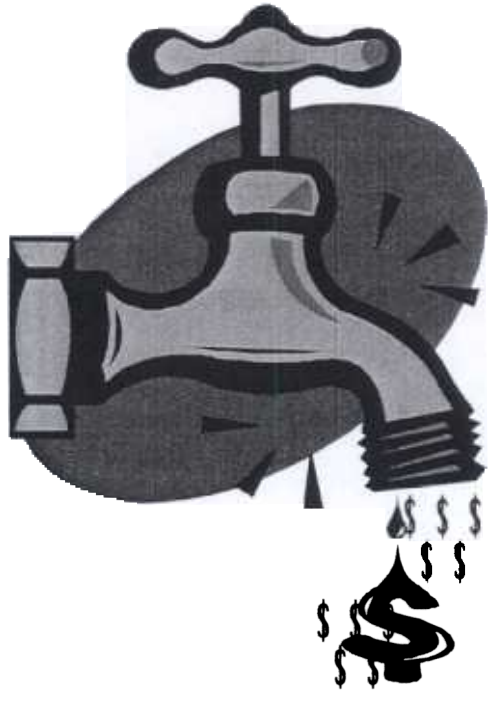
The most useful way to conceptualize this process is to think of actual cash, dollar bills, flowing in and out of the business, and then to identify its sources and uses. *This is cash-flow analysis*. Cash-flow analysis is described here as an eight-step process which will help you understand your own business better. For many users, this provides a somewhat different view than they have had of their business previously. In addition to improving profits, cash-flow analysis is particularly useful in helping to cope with seasonal fluctuations and to avoid money crunches caused by rapid growth. The underlying objective of the process is to make your business planning and operation more profitable.

Why is cash flow so important? If the cash inflows exceed the cash outflows, your business can continue operations. If the cash outflows exceed the inflows, your business *RUNS OUT OF CASH* and grinds to a halt. Even if the imbalance is only for a short period, it can spell disaster.

Cash management, controlling the cash flow, is vital to businesses of all sizes. Small businesses are especially vulnerable to cash flow problems since they tend to operate with inadequate cash reserves or none at all, and worse, tend to miss the implications of a negative cash flow until it's too late.

TIMING and cash flow are inseparable. Payments to your suppliers are typically expected, often even before your customers pay you. As a result, you are very likely to have a negative cash flow when your business grows dramatically. Periods of change are always reflected in an altered cash flow. If sales fall off, the cash flow slows down. Interestingly enough, even if sales increase, the cash flow may stop completely (see MINICASE: INDUSTRIAL CLEANERS) or even become negative (more out than in). Think of the impact of credit sales on your cash flow, for example. Such changes could be triggered by one time events such as population shifts or changes in competition. More commonly, seasonal fluctuations of your business may also pose cash flow problems where a buildup of inventories must precede the sales cycle (such as a toy business prior to the Christmas holidays).

Whatever the cause, the underlying message is simple: Run out of cash and you are in trouble. Even if you can raise more money from other sources, sooner or later you must match the timing of cash inflows and outflows if you are to remain in business.



How do you get your cash flow under control? It's not easy. Some businesses never achieve cash flow control. These businesses are always in trouble, chronically overdrawn, slow in paying bills, and will eventually fold. They fold though, only after their owner/managers have spent a great deal of their time worrying and probably spent all of their personal assets trying to cover the operating deficits. This kind of complication need not be an integral part of business management. Instead *PLAN* and *SCHEDULE* so that cash flow for your business is positive.

HOW TO MANAGE CASH: The Eight Steps

The process of cash flow management does not need to be mysterious or complex. Cash flow management is all about timing inflows and outflows. Control will naturally follow cash flow planning. The following eight step process has been designed to show the sequence of activities and how they can be applied in any business situation in order to bring about a positive cash flow.

COMMON SENSE Cash Flow Management - 8 Steps

1. List cash inflows (sources).
2. List cash outflows (uses).
3. Identify when (by date) cash flows in or out.
4. Examine TIMING: cash inflows minus cash outflows.
5. Identify the major consequences of cash as it currently flows.
6. Show constraints: inflows or outflows which cannot be changed.
7. Identify inflows and outflows which can be changed - rescheduled.
8. Establish a plan for positive cash flow.

These *EIGHT STEPS* take time and thought - otherwise they won't help. Take time to experiment with combinations of different alternatives. A controlled cash flow, the end result of this process, will more than repay the time and effort you give to it. In fact, it may save the life of your business - and your own future as well.

STEP 1: List Cash Inflows (Sources)

While new investment and new debt are sources of cash, they cannot be relied on as permanent or repeat sources. Nor can the sale of fixed assets. These three sources are not to be ignored, but they are secondary to operating profits.

In a later workbook (No. 6), we will treat *FINANCING* as a major management technique, including an analysis of the different types of bank credit and the most important type of small business credit for many - trade credit. For now, you should note that the main interest of your creditors is how you will repay your debts. What is your cash flow?

FOCUS ON OPERATIONS AS YOUR MAIN SOURCE OF CASH

Operating profit, unlike new investment, debt, or sale of fixed assets, is ongoing. As such, it is more difficult to keep track of. Since it is ongoing, it must be constantly monitored, reviewed, and controlled.

Money flows into profitable businesses and away from unprofitable ones. Although a stable operation which makes a profit will not usually have any cash flow problems, *any* business which grows dramatically will. Growth, unless carefully financed, can put a profitable business into bankruptcy even as the income statement shows increasing profits. This represents a real tragedy. A business which is growing and making profits can suffer liquidity problems (the cash runs out), fail to meet its obligations, and then be forced to shut down.

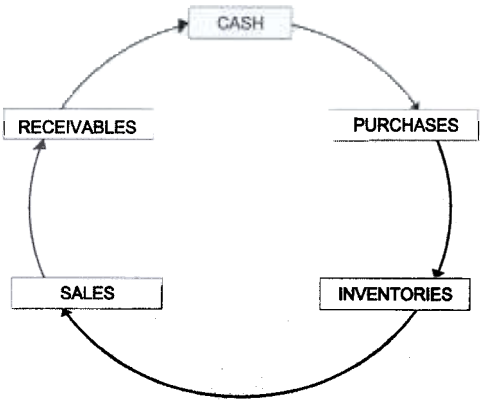
Why? Suppose you offer 45 day terms to your customers (or they take 45 - it works out the same way) while you must pay your suppliers on the terms they offer, say 30 days, or even cash (COD). As sales grow, so will your receivables. Meanwhile you continue your own payables on a current basis, and the gap between payables and receivables gets wider and wider: a negative cash flow. Pretty soon you run out of cash.

Can this be prevented?

Yes. That's what *COMMON SENSE CASH FLOW MANAGEMENT* is about.

THE CASH FLOW CYCLE

Cash flows through a business by taking different forms



Notice the direction of the arrow. This is how cash flow can be a problem if the order is interrupted.

TIMING and operations go together. For example, you may discover that a small customer who pays promptly is more profitable for you than a large customer who pays slowly. In fact, upon analysis, you may even determine that you can't afford the larger customer! (The payment uncertainty and resultant cash flow strain is an unacceptable risk to your operation.)

Cash flow problems are frequently caused by collection problems. If you have many chronic

"Focus on operations as your main source of cash."

STEP 1:

List Cash Inflows (Sources)

"Timing is everything!"

"Don't be afraid to ask for the payment."

STEP 2:

List Cash Outflows (Uses)

"Where is the cash going?

good question.

slow payers (which is endemic to some industries), either step up your collection efforts, find some other way of jarring that cash loose (perhaps discounts), or consider the possibilities of factoring or some other form of accounts receivable financing.

In any case, if you have one or more large slow-paying customers, analyze such accounts. They may be costing you cash that you can't afford. Even though it may seem crazy, you may have to stop doing business with such a customer. The more these slow payers purchase, the less you can afford to handle their orders.

Another problem that begins to sneak up on many businesses is that the period in which their customers pay their bills begins to get longer and longer. This problem can be identified in its development stages through an ongoing process of *aging the receivables*. This will help you spot the slow paying and the super-slow paying customers. Aging receivables is done by listing your accounts receivable in categories according to when they were originally invoiced: 30, 60, 90, 120, and more days. If you aren't aware of slow paying customers, you can't very well improve your collection efforts.

Incidentally, successful collection efforts are often only a phone call or two away, though sometimes letters of a more formal nature (sometimes from your attorney), or even a small claims court appearance may be needed.

One of our clients, pushed into our arms by his bank, admitted that it was indeed possible that his customers, Fortune 1000 companies, would pay their bills if asked to do so - and on time. He then simply asked them to pay and they did. After that his fortunes improved rapidly - so did his cash flow.

Another area of operations to examine closely is *inventory*. It is often wise to take advantage of special bulk-rate offers, but it is also important to recognize that you may end up buying problems. A bloated inventory will slow anyone's cash flow down needlessly.

At the same time, don't ignore the opposite problem - trying to make a slim inventory and too little capital work overtime. This is called overtrading and its usual result is disaster. Overtrading is likely to result in stock outs which will discourage and perhaps lose customers and an inability to take advantage of volume discounts for purchases or shipping. If just one customer fails to pay on time, or one supplier fails to deliver on time, the entire business blows apart.

List your cash inflows, either by product or by customer (or both). This will help you identify trouble spots which hang up your cash flow and, in combination with an aging of your receivables, will begin to focus your attention on the *timing* of your cash flow.

STEP 2: List Cash Outflows (Uses)

Start with your cash journal and your checkbook. If you don't have either, you shouldn't be in business. These are the heart of any cash control system.

Cash control failures are relatively rare (fidelity/theft) - though they do impact your cash flow. More frequently, proper business practices are followed (which includes cash control) but the small business still runs out of money.

The first thing to determine in this step is:

WHERE IS THE CASH GOING?

This is a serious exercise. Every banker we've asked about this has agreed that departing from the budget "just this once" is a leading killer of small businesses, because bending the budget rapidly becomes a habit.

There are many variants: petty cash accounts that amount to 50% of gross sales, salary increases which bear no relationship to productivity and profits, a new Oriental carpet for the office, even long trips to buy lunches in New York City (because big business tycoons lunch in New York?). The list is endless.

Put it all down. List EVERYTHING! Track down as many of the expenses as possible and begin to ask: "Is this necessary or can we get along without it? Postpone it? Is the timing OK? Would it make more sense to pay it earlier or later? Can it be done less expensively?"

The answers here may save you some money immediately. We all tend to fall into habits, which is certainly OK. Habits help us be efficient. But some habits are costly. Paying bills as they come in is one habit that many small businesses fall into. Prompt payment is fine, but if your customers are paying on a 45 day basis while you pay on a 5 day basis, your cash flow is being pinched unnecessarily - and your working capital borrowing will compound the problem.

TIMING is everything. Ideally, inflows are a bit faster than outflows. However, over time, they must at least balance.

If you cannot determine where the cash is going, that's the clearest possible sign that you need better and more timely information. Ask your CPA for help. Your accounting system contains the answers here. If you don't have an accounting system, you can't determine what is happening - it's just that simple.

For many smaller businesses, a checkbook

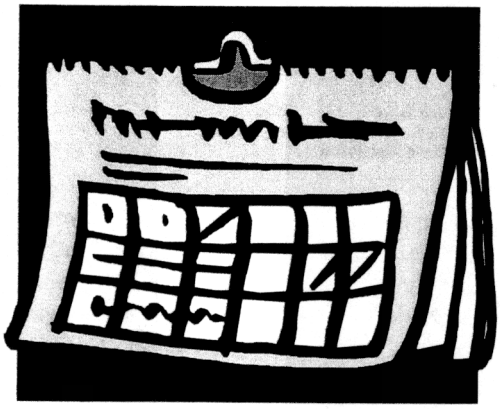
can provide an adequate daily record of cash disbursements. So-called "one-write" systems are checkbooks which have a carbon block on the back of each check or use mark sensed paper to automatically record the transaction in your journal as you write the check. This forces you, as you write the check, to identify the account that the expenditure should be charged to, rather than trying to remember what happened at the end of the month.

A "one-write" system may be very satisfactory for many businesses but inadequate for others. Your accountant should help you design an accounting system that serves your needs for information about your business. If your accountant isn't cooperative - doesn't help you produce information in a timely manner and in a format that you can understand, or doesn't answer your questions satisfactorily - get another accountant. These professionals work for you and so must be responsive to your needs. Along with this however are your responsibilities as well. It's your business and if you don't cooperate with them, they can't do their jobs.

IF YOU CAN'T AFFORD THIS TYPE OF HELP YOU SHOULDN'T BE IN BUSINESS!

STEP 3: Identify When (by date) Cash Flows In or Out

The most useful tool for this step of the process is a calendar. Get one large enough to make notations in each date block, and begin to list - according to their timing - the major cash inflows and outflows you have discovered in the first two steps. To be most useful, one full business cycle should be displayed. For most businesses, especially those with any sort of cyclical variation, a year will be a useful period of time to be examined, although monthly or perhaps even weekly periods may be relevant units of time for inspection.



A handy technique here is to begin by listing those fixed outflows which have fixed dates: paydays, tax deposits, bank debt repayments and perhaps other obligations if applicable. Begin listing these dates as you think of them. Keep listing over a period of time because your list will not be complete the first few times you try this. You simply won't think of everything.

We have occasionally suggested that this be done in a rough fashion with 3X5 cards. This allows you to begin shuffling the cards, quite literally, as you begin examining the timing of these cash outflows and perhaps begin to realize that some of the fixed payment dates are more flexible than they may first appear.

Once the payment dates, or cash outflow dates, are known, you can start putting down cash inflows. This will result in a conservative cash flow if you allow for your receivable experience and your seasonal or periodic sales fluctuations. Your aim is to balance inflows and outflows to suit the peculiarities of your own business. If you can achieve this, then you can grow with minimum interference from creditors and maximum ability to take advantage of opportunities that may occur in your own business situation.

STEP 4: Examine Timing - Cash Inflows Minus Cash Outflows

A positive cash flow is one in which inflows are ahead of outflows. This must be true not just as an average throughout the year, but consistently throughout the normal business cycle. The reality is that any negative cash flow for any operating period must be funded from somewhere. That funding may come from a 90 day note or from the normal operating cash balances, but it must be available. If it is not available, then the business has a problem.

This is not to say that an occasional negative cash flow will spell trouble. There are times when it makes more sense to adopt a negative cash flow temporarily (a growth spurt for example). However, in order to survive, in the longer run your cash flow MUST be positive.

Most businesses have a rhythm. Farmers need time to grow their product, then must wait for payment, then receive a lump of money which is used to pay off old debt, make necessary improvements and purchases, and perhaps even to relax with. However, during the same time that they have no cash inflows, they have substantial outflows. They have the initial seasonal expenditures for seed, fertilizer, labor, and other such costs along with ongoing expenses which cannot be shifted but must be paid as and when they become due. Consequently, many farmers have a chronic cash flow problem.

In many states contractors have a similar situation. They must register their heavy

"Make sure that your accountant works for and with you."

STEP 3:

Identify when (by date) cash flows in or out

STEP 4:

Examine timing - Cash inflows minus cash outflows

"Know your business rhythm."

"Know your business cycle."

"Are you in phase or out of phase?"

"Look for industry data."

"Try your trade association.

"Don't forget the Small Business Administration (SBA)!"

equipment in March - at the beginning of their earning period, and typically at the end of a long non-earning spell.

Earlier we mentioned the seasonal effects for a toy retailer. Inventories must be built for the fall and Christmas selling season - on the heels of the summer quarter when sales are typically lowest. Following the completion of a (hopefully great) Christmas, the toy seller has converted inventories into cash, and so is able to pay for the essential preseason inventory buildup.

Some of these payment clusters are unavoidable. Some may even be desirable. But in the long run, it is the balance, the timing, which is critical.

Consider the pattern of two companies: one whose sales are level or increasing slowly, making a modest profit, and one whose sales are zooming, with rapidly growing profits but an increasing liquidity problem (Exhibit 1-2). The level company will plod along, growing slowly. The rapidly growing company will find money trickling in - and flooding out. Payables tend to fall due faster than receivables can be collected. It is possible through this process to be so successful that you go broke. The business becomes illiquid, and you run out of cash.

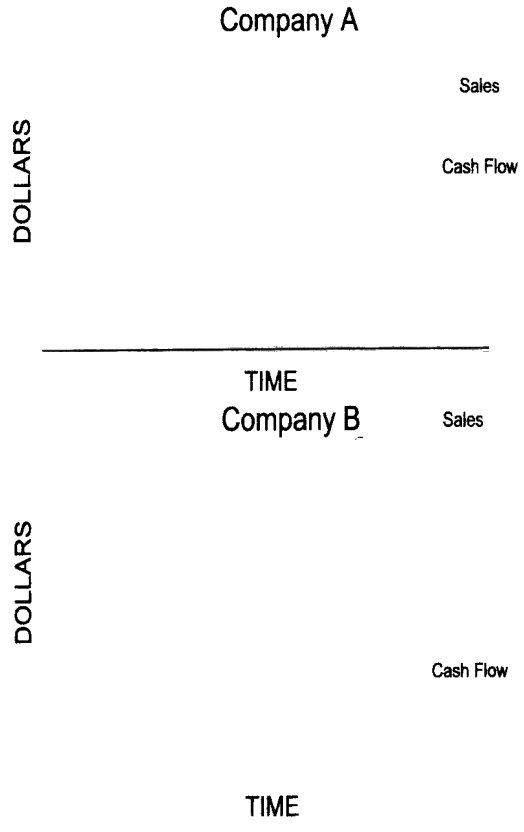


Exhibit 1-2
Business Growth Patterns

Your historical purchasing and sales rhythms must be understood, thought through and compared with your industry patterns. For example, Exhibit 1-3 reflects the cyclical purchasing and sales pattern of the construction industry whereas Exhibit 1-4 reflects the men's wear industry. The point is, if you are seriously out of phase with your industry, you had best be doubly careful because those patterns are powerful and not easily changed. There are many sources for determining the pattern for your business. Your accountant should help. Your industry may have a trade association that collects and publishes such data for its members.

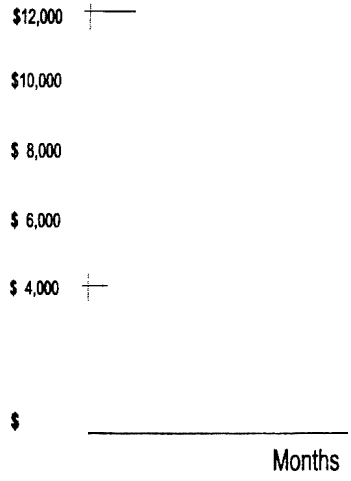


Exhibit 1-3
Cyclical Purchasing & Sales Pattern,
Construction Industry

The SBA and other similar agencies can generally provide this data. Finally, there are published sources you can find at the library such as *RMA Statement Studies,* along with others listed at the end of this workbook.

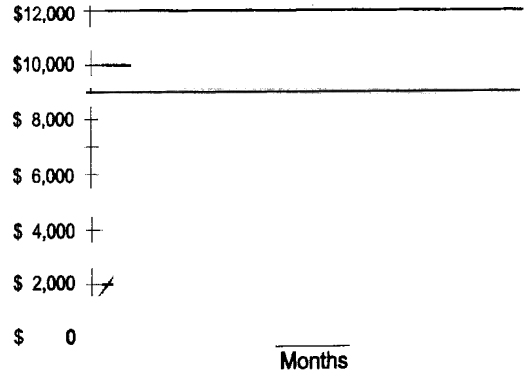


Exhibit 1-4
Cyclical Purchasing & Sales Pattern
Men's Wear Industry

One important result of this step is that you will be able to determine how fast you can afford to grow. This may seem paradoxical because many businesses see their major problem in trying to determine how they can grow faster. Unfortunately, businesses with a substantial amount of market demand may instead have to consider ways of repressing this growth.

Assuming a positive cash flow (cash inflows exceed cash outflows) and assuming that growth

uses cash, you can grow at the rate that the inflows exceed the outflows. If you attempt to grow at a rate faster than this, you will simply run out of cash. Industrial Cleaners (Mini Case) encountered this problem and it almost finished them off. Growth planning as well as survival planning needs to be a carefully structured process. More on this subject in our workbook on *FORECASTING.*

STEP 5:
Identifying The Major Consequences Of Cash As It Currently Flows

Performing this step does not require numerical calculations so much as it requires honesty about your actual operations. For many business managers, this may become an unpleasant, surprising, or discouraging confrontation with reality.

The greatest problem small businesses have with cash flow stems from the human tendency to believe that because you try to pay your bills on time, so does everyone else. That's admirable, but dangerous. It is more reasonable to expect that your customers will pay slowly. They have their own problems and other reasons for doing so.

PLAN ON PAYMENTS BEING SLOWER THAN YOU EXPECT.

It occurs to almost everyone in business eventually, that one way to improve cash flow is to slow down the outflow while speeding up the inflow, particularly in a tightening economy. The result is that payments are slow all the way around. Plan on it.

Subcontractors find this is a way of life, especially those who subcontract to government contractors. It's a cost of doing business which is not fatal unless it is unanticipated. We've seen one small wholesaler who sold housing products to large contractors more than double his profit by taking note of this fact. He arranged both trade and bank credit around an anticipated 18 month payment cycle (Exhibit 1-5). As the major contractors were on 12 month contracts, this worked out fine. They were paid in stages over 15 months and his receivables came in a month or so later than theirs. His credit improved (because he paid off his obligations on a timely basis - and as agreed) and so he made more money borrowing wisely.

Planning your cash flow is profitable. By looking at the timing of cash inflows and outflows, you will find ways to improve your profits by both cutting costs and by increasing your opportunities. However, you can't plan unless you are aware of your industry patterns as noted earlier.

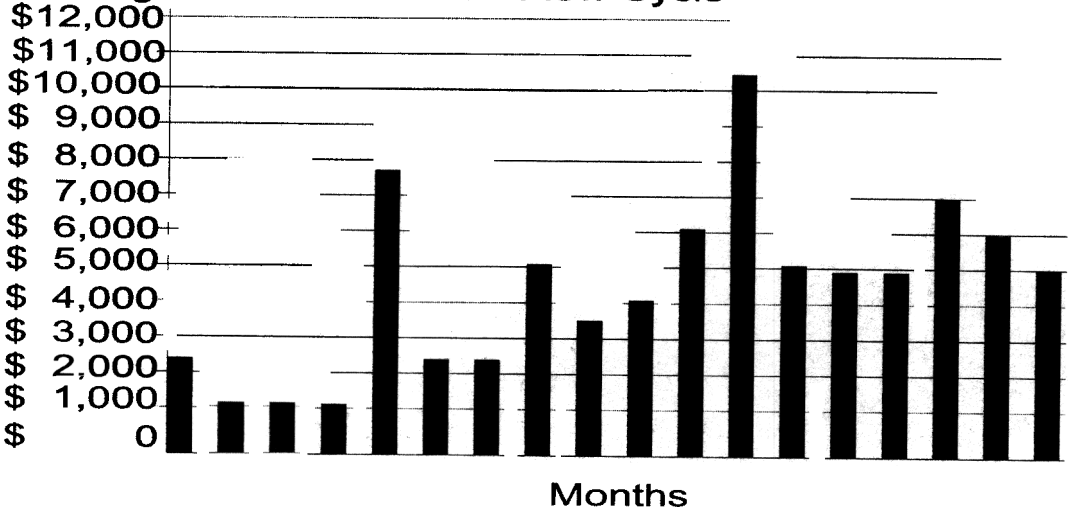
Another major problem, particularly for small retailers, is cuff credit - the informal credit businesses extend to their customers. Businesses frequently feel obliged to extend credit when they actually cannot afford to tie up their working capital in this manner and may in fact not need to provide this cuff service at all. Can you afford to extend credit - or do you even have any choice? Many smaller retailers feel that they simply must.

CREDIT DECISIONS ARE BEST MADE BY PROFESSIONALS.

Ask your banker about bank credit card arrangements. Perhaps by taking the standard discount (around 3 - 3.5%) you will speed up your cash flow and gain enough new customers (to say nothing of avoiding collection problems) to more than offset the cost.

It is important to note also that costs of participating in these credit card plans are often negotiable just as are interest rates of loans. Many smaller businesses do not realize this and quietly (and happily) accept whatever rate their friendly banker quotes to them. It makes good

Exhibit 1-5
An Eighteen-Month Cash Flow Cycle



"Payments will be slower than you plan.

- Plan on it!"

STEP 5:

Identify The Major Consequences Of Cash As It Currently Flows

"Learn your own cash flow patterns. They will become foundation stones for your plan."

"Can you really afford to offer credit?"

"Leave credit to the credit professionals."

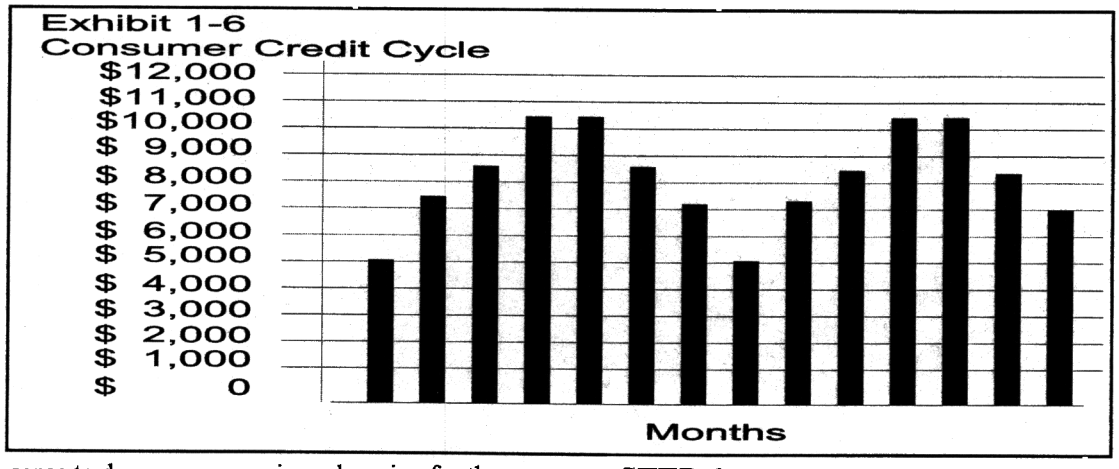
"Plan your payments along with your cash receipts - balance the two. It can be done."

STEP 6:

Show Constraints - Inflows Or Outflows Which Cannot Be Changed

"The Case: An illustration of the good news, bad news of cash flow."

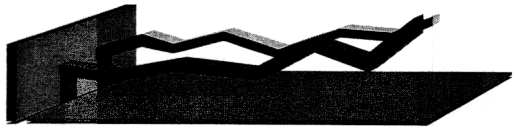
"Turning down new business is never easy. But, can you afford the new commitments? IC could not."



sense to do some comparison shopping for these "credit" purchases just as you would do for any other item you have to buy for your business. After all, why should you pay more than you have to?

Credit patterns take different forms. For example, consumer credit payments tend to lag around Christmas and again around the summer vacation months, pick up briskly in the spring as tax refunds come out, and pick up again in the fall. Can you handle that kind of seasonal shift without being aware of it? Can you handle it even if you ARE aware of it (Exhibit 1-6)?

Don't run the risk. Find out what the rhythms are - then use them.



STEP 6:
Show Constraints: Inflows or Outflows Which Cannot Be Changed

Not every payment can be rescheduled though (refer to Step 7), and not every collection effort pays off. Your cash flow planning must respect these fixed constraints.

By identifying the most likely sticky places in the cash flow (both by analyzing the past and by planning the future), you can prevent the real disasters of cash flow blockage.

WHICH PAYMENT SCHEDULES CAN BE CHANGED - AND WHICH CANNOT?

You won't have much luck altering tax dates, and tinkering with payday is not legal. Insurance payments tend to be rigid. After you have elected your schedule and have missed a payment, your insurance may be cancelled.

CASE IN POINT
The Industrial Cleaners - Or - The Threat of Success

Why "The Threat of Success?" We all are working for success, so why is it a threat? In this context, it is when the business grows faster than its cash flows can support. This can happen in virtually any business. For example, in a manufacturing business, investments in production and inventories must precede sales and receivables. A cash flow gap develops which must be funded from some source. Ignoring this gap WILL NOT make it go away.

The problem can be compounded in service businesses. Such labor intensive businesses, whether simple or sophisticated, are even more apt to suffer from a cash flow lag than a manufacturing business.

Why? You can put off or reschedule payments on capital goods. You can usually even delay payments to your suppliers. However, you cannot put off paying your labor force.

You must also, one way or another, pay the withholding and other regular tax liabilities. Yes, under certain circumstances, you can sometimes "cut a deal" with the IRS or state taxation agency, but it is not a wise or normally workable strategy. Still, in any event, the help **MUST** be paid, and paid regularly, or you won't have any!

This simple truth came close to destroying the ***Industrial Cleaners*** (*IC*), one of our long-term clients. In three years, they grew from nothing to almost $1,500,000, with net profits of $250,000.

They also almost strangled from a lack of liquidity.

A family operation run by four brothers, *IC* used many casual, temporary and part-time laborers. The core staff (the brothers and their wives) acted as crew managers, knew their business well and, as a result of their experience and interest, were able to use this low-paid labor effectively. Accordingly, it was relatively easy for *IC* to be highly competitive.

Their customers were delighted. *IC* got many referrals, and took them on as fast as they were referred. These weren't trivial

Identify the apparently inflexible outflows. Some will be necessary, some may not be. List them; plan around them. If they are really necessary and inflexible, you have no choice.

With cash inflows the matter is different. While we can't always speed cash inflows to our satisfaction, we can identify those customers who create snags and deal with them on a one-by-one basis. Over time, this can significantly help your cash flow, but it must be done consistently and selectively. We all have customers we cannot afford to let buy our products. Even if they eventually pay up, think of the sales lost while they tied up our cash.

A painful example of this was a service station owner who allowed his customers to run up substantial cuff credit accounts, and then watched these customers, embarrassed by their inability to pay off the account, go to his competitors and pay cash.

Remember: cash flow management is timing inflows and outflows. A positive cash flow is essential. A negative cash flow, over time, is fatal.

STEP 7:
Identify Inflows and Outflows Which Can Be Changed Or Rescheduled

At this stage, your major fixed cash flow points have been listed, your timing examined, your rhythms explored, and your cash flow business habits carefully scrutinized. Can anything be changed?

Sure. We often think that because something has been done on a certain schedule in the past, that's how it must be.

Nonsense. There's a lot to be said for *NOT* paying bills on the 1st and 15th.

We were asked to help a car dealer get his information together for a loan proposal. He was caught in a cash squeeze caused by growth and needed an additional $45,000 in working capital. His business was sound and could afford the debt. We discovered as we analyzed his business that he really didn't need the loan. He paid his bills as they were received - a noble but unnecessary habit. The custom in the trade was "net 30." We also noted that his purchases were averaging $45,000 per month. Our advice - don't pay your bills for one month. He got his needed $45,000 in working capital and saved his borrowing capacity for some other need. He also saved himself the annual interest charges that the new debt would have incurred.

We don't suggest that you stop paying your bills, but we do suggest that you analyze the process and make sure that you are taking advantage of such opportunities if they are normal in your business.

There's merit in talking with your creditors and working out a payment schedule which fits your needs, not theirs. A surprising number of larger companies and banks are happy to work out different payment arrangements. If they can help you prosper, they prosper too.

Take advantage of it!

Suppose your analysis has shown that in

customers either. They were substantial businesses with particular cleaning needs which *IC* had demonstrated the ability to handle.

What happened? *IC* billed on 30 day terms. Their customers paid 45 to 60 days **after** the work was performed. (Consider - *IC* billed at the end of the month. Therefore, they had a month's worth of costs. It took a couple of weeks to invoice, send the invoice, and have the customer receive the invoice. The customers typically paid 30 - 45 days after they received the invoice. Add it up - this 45 - 60 day lag is not uncommon!) This represented 45 to 60 days of labor that had to be paid almost on a daily basis, a huge cost for an undercapitalized company such as *IC*. Each new contract made the problem worse. If a new contract was begun on August 1, the first billing went out on September 1, and the first payment received in the first week or so of October - leaving at least a sixty day lag from the first day work was performed. All the while *IC* had to continue paying laborers who were doing the work. A serious cash flow gap. Cash outflows exceeded cash inflows.

To overcome this, *IC* was rolling over 90 day notes, which it could not repay from current earnings. When the payments came in - they had no problem with defaulters - the cash went straight to the lenders and was then re-borrowed. The cycle simply became worse and worse - even as they became more and more successful.

The solution? A moratorium on new contracts, a term loan from a supportive banker for working capital purposes, and speeded-up collections from a few of their larger and more sympathetic clients. This COMMON SENSE strategy allowed them to generate more working capital which in turn allowed them to slowly add new contracts and pay off their working capital loan.

It took *IC* three years to get our of the woods - but they made it finally, and are now growing again at a pace they can afford (i.e., support with a positive cash flow). They could only afford success up to a certain level. Above that, disaster. They are now profitable **and** sound - the critical double ingredients of success.

"Delayed payments are one way to improve cash flow."

STEP 7:

Identify Inflows And Outflows Which Can Be Changed Or Rescheduled

"Negotiate with your creditors. They may be more flexible than you might guess."

"The case is real. The problems are real too. The good news is that these problems can be avoided. But only by careful planning."

"Timing - That's the real key. Cash inflows must equal cash outflows... ...or, in the longer term, you cannot survive."

STEP 8:

Establish A Plan For Positive Cash Flow

"Most importantly, be honest with yourself."

Manage your business - don't let it manage you!"

"...It's only COMMON SENSE."

June and November you have extra cash, while in March you're chronically short. Balloon payments help here. So will pre-planned nonpayment months. Your larger creditors are interested in their own cash flow, but what they most need is to know when they'll be paid. They have experts studying this problem. Take advantage of their skills. If that March payment is going to be uncomfortably tight, let them know well in advance, replan the schedule, and you'll both be better off for it. You will also find that your relationship with these supplier/creditors improves dramatically.

How can you change customer paying habits to be more in your favor? Ask your banker for credit help. He should know or be able to tell you who can help with decisions such as offering discounts, partial payment plans, credit cards, billing and collection arrangements, selling receivables to a factor, finance company or other financing house or any of the other myriad ways to speed up cash inflows and restore a positive cash flow balance.

Don't forget your trade organization. The odds are that if you have a problem with customers who pay slowly, so do your colleagues. They represent a resource which you can and should tap.

TIMING: that's the key. Slow down the outflow, speed up the inflow - and make sure that it is not a one time effort. You must monitor this process constantly. It is much easier to keep your customers from becoming delinquent than to try to collect once they have become troubled accounts.

STEP 8: Establish A Plan For Positive Cash Flow

This final step involves going back to your large calendar and repeating Step 3 with more detail.

1. Indicate the cash flow items which cannot be changed to other dates.
2. List your anticipated cash inflows, allowing a margin for safety. If your credit terms provide 30 days for your receivables, plan on a 45 day average for safety. Check your historical experience to make sure that this is realistic.
3. Allocate payment dates to suit the needs of your particular business. Do not forget to take full advantage of trade credit; it is an excellent source of free working capital.
4. Identify the periods of negative cash flow, and determine the actual amounts of the deficiencies. If you have shortfalls or gaps in your schedule where cash outflows will exceed cash inflows, it probably means that you've done a realistic job in examining your business operation. You can now plan on how they will be subsidized when they do occur.

Once you have followed the eight steps of cash flow management, you will have the substance and information that you require for establishing your cash flow budget. Forecast on a monthly basis, the cash flow budget becomes one of your most powerful tools. The form on the following page is often used to set up such a cash flow budget and outlines how actual performance can be quickly and easily compared against the budget on a regular basis, especially to point up developing problems so that you can correct them before they become disasters. Copy this form or make a variation and use it as a powerful planning and control tool in your own business.

SUMMARY

Cash flow for a small company is more important than profit. Analysis of small business successes and failures shows that the small company that focuses on cash flow rather than profit lasts longer, and is more profitable in the long run.

For financing purposes, cash flow analysis is more important than any other single form of financial management. Ask your banker which he wants most: a balance sheet, an income statement, or a cash flow analysis. The overwhelming majority we have asked have requested the cash flow - because they get repaid from the cash flow, not from collateral or depreciation.

For your own purposes, cash flow analysis as practiced in the *EIGHT STEPS* will help you understand your own business better, and from a slightly different view than you may have had before. This can only help you run your business more effectively.

Manage your business - don't let it manage you.

That is COMMON SENSE.

COMMON SENSE WORKSHEET

CASH FLOW ANALYSIS & PLANNING

Enter prior weeks, line #33 Total Cash Available figure

Enter Line #1/Week 1 Opening Checkbook Balance

Line		Week 1	Week 2	Week 3	Week 4	Total
1	Opening Checkbook Balance:					
2	Add: Cash Contributions					
3	Net Cash Available (line 1 + 2):					
4	**ADD: CASH INFLOWS** (Sources)					
5						
6						
7						
8						
9						
10	**Total Expected Cash Inflows** (sum of lines 4 through 9)					
11	Total Cash Available (line 3 + 10)					
12	**LESS: CASH OUTFLOWS** (Uses) List *Direct* and *General & Administrative* Costs					
13						
14						
15						
16						
17						
18						
19						
20						
21						
22						
23						
24						
25						
26						
27						
28						
29						
30						
31						
32	**Total Cash Outflows** (sum of lines 12 through 31)					
33	**TOTAL CASH AVAILABLE** (line 11 - 32)					

Four week projected calculations reveal whether there will be a positive cash flow or a negative cash flow.

COMMON SENSE
Strategic Management Learning System

COURSE OVERVIEW

CS-1 Cash Flow
Controlling your cash before it controls you

CS-2 Forecasting
Understand where you want to go - then plan how to get there

CS-3 Management Control
Decide what needs to be done, who will do it, and how you will know when its done

CS-4 Target Marketing
The key to marketing success - focus, focus, focus

CS-5 Time Management
Time is an asset - once gone, it's gone

CS-6 Financing
Use and abuse

CS-7 Human Resource Management
The right personnel for the right reasons

CS-8 Inventory Control
Inventory control = profit control

CS-9 Marketing Communications
How much & why

CS-10 Credit & Collections
Easy to put out, hard to get back

CS-11 Strategic Analysis
The sum of the parts equal more than the whole

CS-12 Knowledge Management Systems
Turning people, process, and technology into knowledge

INFORMATION RESOURCES

Almanac of Business and Industrial Financial Ratios
Published Annually, Prentice Hall
Provides financial data ranked by small, medium and large companies, by 22 financial factors in 180 fields of business.

Dun's Financial Record Plus
Updated quarterly by Dun & Bradstreet
Financial ratios and trends on 750,000 US businesses.

RMA Annual Statement Studies
Robert Morris Associates
Average balance sheet and income data along with 5 year trend data for 392 different industries.

Disclosure Database
BRS, DIALOG, Dow Jones News/ Retrieval, and NEXIS on-line, in-depth financial ratios and trends for over 12,500 companies based on reports filed with the SEC.

On-Line Information
There are a great many sources of financial performance ratios and trends increasingly available on the Internet. Use a keyword search for the ratios and type of business you are interested in.

US Small Business Administration
The SBA has a wealth of practical pamphlets and booklets dealing with a wide range of topics. These topics deal with popular and current business management issues. Check your phone book for the office nearest you or check *http://www.sba.gov* . There are also SBA and EDA funded Small Business Development Centers at most land grant colleges and universities. Check your local educational system for information.

COMMON SENSE is a complete learning system...

COMMON SENSE is a Strategic Management Learning System (SMLS) designed to help you help yourself.

The SMLS consists of twelve management topics, each presented in a single workbook. Each workbook focuses on a critical strategic area of business management in a way designed to strengthen and develop your skills. The twelve workbook topics represent the same core components offered in a contemporary business management degree program, yet COMMON SENSE delivers this knowledge in a format that you can use now. Unlike complex software programs, voluminous text books and manuals, you can pick up COMMON SENSE any time, anywhere and learn efficiently. When applied over a period of time, this knowledge will provide an education far more enduring and beneficial than any number of intensive workshops or seminars, and at a fraction of the cost. It will stick with you.

COMMON SENSE is designed to help you think systematically about your business management processes, plan your course rather than drift at the mercy of the fates, and take active control over your future rather than react to whatever comes along. You are the person best qualified to make important decisions about your business responsibilities. You're investing the time, effort and money to succeed. You provide the effort, COMMON SENSE provides the proven knowledge for sound business management practices.

COMMON SENSE delivers the conceptual framework, practical knowledge, applicable worksheets, real-world case histories and qualified references to ensure your learning. Most importantly, this learning system provides proven management techniques that will help you and your business succeed and prosper. Remember the old adage: Give a man a fish, you've given him a meal - but teach him to fish and you've fed him for a lifetime. COMMON SENSE believes the moral of this story is still valid. COMMON SENSE will help you help yourself.