

SMALL BUSINESS STRATEGIES

Forecasting Cash-flow Success

Tips to Prevent Financial Distress

By David L. Auchterlonie

One of the most frequent questions asked about a financially distressed business is "How did this company get into so much trouble?" Unfortunately, the vast majority of time the answer is, "Because the company lacked relatively simple cash-flow management techniques." So how do you keep your business from becoming financially distressed and a casualty of this recession? Start by asking yourself these questions:

1. HOW MANY DAYS OF SALES ARE INVESTED IN INVENTORIES?
2. HOW LONG DOES IT TAKE TO COLLECT MY RECEIVABLES?
3. DO I PAY MY PAYROLL SEMI-MONTHLY?
4. DO I REVIEW A DAILY CASH FORECAST AND COMPARE IT TO ACTUAL RESULTS AT LEAST ONCE A WEEK?
5. WHAT IS MY MONTHLY OPERATING BREAK-EVEN POINT?

Chances are, your answer is "no" or "I don't know" to one or more of these questions. If so, this article may help you to refocus your attention to the only critical component in every business — cash flow.

CASH FLOW- A HISTORICAL PERSPECTIVE

Before the era of generally accepted accounting principles (GAAP) and Financial Accounting Standards Board (FASB) pronouncements, our grandfathers and grandmothers kept track of cash by using the cigar box located at the end of the counter. Indeed, the cigar box contained the receipts for that day's business, and our grandparents purchased inventory, paid salaries and bought operating supplies out of the cash contained in the cigar box. The important thing was that the cigar box had cash in it at the end of each day.

Regardless of the size or type of business, establishing cash-flow principals created by our grandparents' cigar-box techniques will keep your company healthy today.

THE STARTING POINT AND MEASUREMENTS DEFINED

Start by having your controller or accountant prepare a daily cash flow forecast for a six-week period. Yes, daily. The objective is to never spend more cash than is collected each day. Just as our grandparents did using their cigar boxes.

Identify receipts and disbursements separately and by logical category. As an example, collection of accounts receivable should be identified and supported with specifics by customer. The date each customer pays its account should be a matter of historical record and can be easily predicted in most instances. Frequently,

businesses have other cash receipts in addition to normal sale activities, such as tax refunds, insurance settlements and other similar items. These should also be scheduled on the cash forecast by anticipated date of receipt.

Similarly, disbursements should be organized in logical categories. Payroll and related payroll taxes obviously most typically fall on specific payment dates. Likewise, purchases from suppliers for inventory should be scheduled based upon production scheduling requirements, again by specific date. Purchases of capital equipment, repayment of debt, payment of income tax and insurance premiums should also be scheduled by specific payment date.

At this point, your controller or accountant will be most likely questioning the value of financial statements prepared in accordance with GAAP and the FASB. This is not an exercise in accrual basis accounting. Remember, the objective is to keep the cigar box, your company's bank account, with cash in it at the end of each day.

Now, include the beginning cash balance on the forecast and roll it forward by each day for the minimum six-week period. This cash forecast should be the most important report you receive from your controller or accountant.

ESTABLISHING ACCOUNTABILITY

Using this cash-flow forecast, establish accountabilities for each line item included in the forecast. As an example, your credit manager or controller should be responsible to forecast accounts receivable collections and payroll. Your production manager should provide you with weekly inventory purchases and capital spending requirements.

Now, weekly, compare the actual performance to that forecasted by each person responsible for his portion of the cash forecast.

Something very interesting occurs. By establishing accountabilities, usually after two or three weeks of rather poor results, the organization starts to do a better job. By establishing accountabilities and responsibilities for expected cash-flow results, the forecasts become more accurate over time. Sometimes within 20 to 30 days. But another very interesting development also occurs. Managers typically want to minimize cash spending and find creative ways to control cash. And you, the business owner and manager, can establish what your expectations are for each line item in the cash forecast, thereby providing motivation for those accountable for the results.

After a period of three to five weeks, the entire organization

gets the message that cash flow has now become the most critical measuring device. As you begin using this tool, extend the forecast period to include the next 12 months by month. This gives you a perspective of how spending and cyclical sales trends will affect cash.

You may then want to adjust sales campaigns, defer spending or curtail capital spending.

Remember, at the end of each day, your company should never spend more than it takes in. Otherwise, the cigar box — cash in the bank — will be empty and the firm won't be able to meet its requirements for growth and enjoy prosperity.

Furthermore, changing payment practices frequently provides a permanent improvement in cash flow. For instance, converting weekly payrolls to semi-monthly payrolls, wherever possible, provides immediate cash flow, allowing the company to meet other cash requirements.

Do everything in your power to cut expenses by looking at every major expense category. Reorganize departments, computerize functions, shorten manufacturing cycle times, employing "Just In Time" inventory techniques and consider downsizing the work force. And no more Mr. Nice Guy — remember your charge is to increase the daily and monthly cash flow of your organization, allowing it to survive and prosper.

While business activities are obviously more complex and more competitive today, it is never too late to embrace the wisdom, taught through our grandparents' example. The disciplines established with cigar-box cash management techniques can keep your business from becoming a casualty of this recession.

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