The Advisor – Spring 2016

Cashflow Management – Part 2

In our last newsletter, we discussed the high level steps to take in order to improve cash flow management, including calculating the cash conversion cycle (or "CCC") on a monthly basis.

In this newsletter, we delve deeper into the components of the CCC to accelerate the conversion of a company's working capital into cash.

Accounts Receivable (AR)

1. **Have a dedicated AR collections employee.** This employee should be the main contact person with respect to the collections of AR. A portion of their compensation should be tied to reducing the company's AR collection days.

2. **Implement monthly AR collection procedures.** This can include: (a) sending out AR statements to customers at the end of each month; (b) calling or emailing customers 10 days after an invoice has been sent out confirming receipt and asking if there are any issues with the invoice; and (c) calling or emailing customers three to five days after an invoice due date to request a payment status on any unpaid invoices.

3. **Use technology.** Email invoices to customers rather than using regular mail. Encourage the use of EFT or wire payments from customers rather than checks. This can easily reduce the number of days to collect.

4. **Tie sales persons' commissions into the payment of customer invoices.** By paying a sale commission after an invoice is paid rather than after the product is shipped or services are rendered, management insures involvement of sales personnel in the collection process. This can accelerate the timing of collections considerably if sales personnel can influence decision making of customers through their relationships.

5. **Have senior management review the accounts receivable listing on a regular basis with collections and sales staff.** This promotes awareness within the company that the collection of AR is considered a top management priority. It also makes management aware of which customers are slow or delinquent in their payments. Eventually a decision can be made to discontinue selling to slow paying customers if required.

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Inventory

1. **Implement a perpetual inventory system.** This involves the implementation of a proper accounting or ERP system to track raw materials as they are purchased and finished goods as they are sold. Management can use perpetual inventory reports to determine which items are fast movers as well as those that are most profitable.

2. **Produce on a "just in time" basis.** If a company can produce the customer order after the purchase order is received, the finished goods inventory will be kept to a minimum. If this is not feasible, then implementing minimum and maximum levels for individual inventory items (or "SKU's) should be implemented to avoid stock outs or overproduction.

3. **Get rid of old or obsolete inventory.** This is a no-brainer but most companies rarely do it, hoping beyond hope that an order for old inventory is forthcoming. It is far better to sell slow-moving inventory at a discount and free up warehouse space than to wait indefinitely to find a buyer who will take it at full value.

Accounts Payable

1. **Have more than one supplier for each production input.** This will allow management to use alternative suppliers if the company is on credit hold with its main supplier due to slow payments.

2. **Negotiate payment terms with suppliers that are longer than the average AR collection days.** If AR is collected on average within 35 to 40 days, management should attempt to negotiate 45 to 60 day terms with its suppliers. This will allow AR cash collections to be used to pay for supplier accounts payable, rather than the company's line of credit with its bank.

3. **Take early payment discounts when possible.** Although this will worsen the CCC, if a company has excess cash or credit facility available, it is worth it to take the discount and pay early. For example, if a supplier's terms are 2% 10, net 30 and management decides to take the discount and pay on the 10th day after the invoice date, the company earns the equivalent of 37% on its money. This benefit will far exceed any interest paid on the operating line by taking the discount.

   Aries Advisory Group has extensive experience in cash flow management. We will work with you to implement cash collection and payment policies similar to those described above to improve your cash position. We will also design cash flow forecasting models in order to anticipate any future cash flow needs. Please contact us at info@ariesag.com or at (416) 467-7878 to see how we can help.