

Mistakes To Avoid: Not Understanding Cash Flow Dynamics

Money pays the bills and allows you to make the most of business opportunities that come along. So you need to take control of cash flow to ensure your business has funds available.

With most small businesses, cash is king. By that we mean that one of your most important tasks is managing your company's cash flow to ensure there is money available for operating needs and to let you take advantage of growth opportunities.

Optimizing your operating cash flow really boils down to three basic rules:

1. Get the money your business is due as fast as possible.
2. Pay money you owe as late as possible.
3. Earn as much as you can on your cash balances.

Unless you are in a retail business, most receipts for sales or services performed take place sometime after the sale actually occurs. A sale is made, goods are shipped or services are performed, an invoice is presented, and you wait for payment. What you want to do is accelerate those payments and here are three ways to go about it:

Identify a billable event, other than a delivery. It is common to have partial billings on large or long jobs. Consider using some event or milestone as a trigger to send out an invoice. It could be passing a design review, completing a critical test or receiving a large amount of material. If negotiated into the sale, you can start issuing invoices and receiving payments before the job is finished.

Set payment dates. Your customers are trying to optimize their cash flow the same as you. In the sales process, and on the invoice, state when payment is due. Whether it is the common "30 days" or with a "one percent discount for payment within 10 days", customers will be more likely to respond to specified dates and terms. Sales to poor credits should be Collect on Delivery. Once you set a date in a contract, it is a legally enforceable document.

Establish late payment penalties. As Oscar Wilde said, "Nothing focuses the mind like the sight of the gallows." Customers respond and your chances of collecting interest from delinquent accounts improve with a stated policy.

Holding on to your money as long as possible also improves your operating cash flow and enables you to earn interest on your funds.

Try to negotiate a more flexible payment schedule with major suppliers. They want your business and are often willing to respond with payment terms, especially if the materials you are buying are being used over an extended period. The time to approach the supplier is when placing the order. They are more willing to consider this before they have your order in hand.

Look for a discount for prompt payments. While the practice has become less common, some organizations still offer a one percent or two percent discount if their invoices are paid within a shorter period. A one percent discount for payment within 10 days is tantamount to a 36 percent annualized return on your money. If your cash flow allows it, taking advantage of prompt payment discounts may be the best return on your investment.

Finally, make sure your excess cash balances are earning as much as they can. Two suggestions:

1. Certain banking laws may restrict paying interest on commercial accounts. Check with your own account representative to learn what may be available at your bank.
2. Some banks, including FBFC, offer "sweep" arrangements that automatically move amounts exceeding a set minimum into an interest bearing account. Talk to your banker.

Cash and time are two of your company's most precious resources. Spending some time setting accounts receivable policies, negotiating payment schedules with vendors and finding the right account(s) for your cash will help maximize both.