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## Manage Suppliers and Customers

No matter what size your organization is, you can probably learn from the cash flow techniques practiced by Proctor & Gamble, one of the world's largest companies. Used effectively, they can help your company control its cash flow when credit is tight and the economy is slumping.

In its 2009 annual report, the consumer products giant boasted: "Our cash position is consistently strong because we are relentlessly focused on working-capital management. For example, P&G is the receivables leader of the industry, operating more efficiently with fewer days of receivables outstanding than any consumer products competitor."

In other words, P&G closely watches its cash cycle and its cash flow, and is aggressive about collecting its accounts receivable. That's a business tactic your company can strive to emulate.

The more effectively your company manages its cash cycles, the greater the opportunity to pay off debts, invest in the business, expand, and become less dependent on external financing. Two simple ways to boost cash are to collect accounts receivable faster and maximize the time you hold cash before paying bills.

### Speed Up Collections

To reduce the time it takes to collect receivables, first determine the average number of days it takes your company's customers to pay. Do this by calculating your company's average daily credit sales by dividing monthly credit sales by 30. For example, if your business sells an average of \$83,000 on credit each month, the daily average is \$2,766.

Divide that into your organization's accounts receivables outstanding of, say, \$200,000, and you find that on average it takes 72 days to collect what it's owed. Shorten that time by just one day and cash flow improves by \$2,766. Trim the 72-day average to 45 days and your company has \$74,682 of cash at the end of the shortened period. (See right-hand box to understand how to calculate your company's cash cycle.)

Here are seven tips that can help speed up your collections process:

### Understanding Cash Cycles



Knowing your company's cash cycle can help you understand the time and money required to generate cash and continue operations. Here are the four essential calculations that clarify this concept:

**1. Average daily sales**, which is calculated by taking annual sales divided by 365 (days in a year).  
**2. Average daily cost of sales**, which is calculated by taking the yearly cost of sales divided by 365.

**3. Number of days of investment in accounts receivable**. To arrive at this sum, take the sum of billed and unbilled accounts divided by average daily sales.

**4. Number of days that vendors finance products or services payable**. To calculate, take accounts payable divided by daily cost of sales.

The difference between the third and fourth calculations is your company's cash cycle, excluding operating expenses. That is the number of days your organization has to stay in business by selling and paying for products and services.

Convert the days to a dollar amount by multiplying them by the daily cost of sales. The result is the amount your business must spend to support its operations and generate its gross profit.

If you want to include operating expenses in your cash cycle calculations, it requires more complex variations on these basic formulas. Your business advisor can assist with these computations. By

**1. Send bills online** and encourage electronic payments. Urge customers to pay by credit card or set up automatic debits from their bank accounts for recurring bills.

**2. Set up a lock box.** Have customers send payments directly to a lock box at your bank. The money will immediately be credited to your company's account. Negotiate with the bank to use some of the deposited funds to pay down lines of credit as funds are available, which will cut interest costs.

**3. Provide discounts** on bills paid within 15 or 30 days. But keep the discounts small -- one percent rapidly adds up to 12 percent a year.

**4. Revise billing schedules.** Sometimes, due dates aren't in sync with a customer's cash flow. Altering the date can facilitate regular, timely payments.

**5. Tighten up collections.** Make sure invoices stipulate clearly the date payments are due. When payments are late, don't delay in calling, as well as sending letters and e-mail messages.

**6. Switch accounts** that are 90 days overdue to cash on delivery.

**7. Turn over delinquent accounts** to collection professionals. Consider hiring a credit and collections manager. Good collections procedures can generate more cash in an hour than a salesman can produce in a week.

knowing months in advance that your company is going to run out of cash, you can arrange financing before it happens.



There's an old saying: You can lose money indefinitely but you only run out of cash once. When the economy is good, it's easy to take cash management for granted. But don't assume your company will always have enough operating funds. To understand your organization's cash cycles over the long term, you must make reliable forecasts. That, in turn, will help plan for your company's cash needs long before you need them.

## Stretch Out Payments

Increasing the time you wait before paying bills is another way to boost your bank balance. Here are some ideas to help your company hold onto its cash for as long as possible:

**Wait 30 to 45 days** before your company pays bills if you are in the habit of paying them upon receipt. This can open up one to three weeks of available cash and may help your organization improve the alignment of cash inflows and outflows.

**(Re)negotiate terms.** Payment terms are typically 30 to 60 days after invoicing. Your company could, however, ask for consignment terms so it pays for inventory only when sold. Another solution is to ask for dating terms in which your business pays vendors in equal installments over, say, 90 days.

**Pay electronically.** Going online to pay bills allows you to submit the payment at the last minute. Using direct debit for regularly recurring bills and accounts payable also sets up a just-in-time schedule where the bills are automatically paid on a specified day, which would typically be the due date.

**Mail payments** on Thursday or Friday to take advantage of the "float."

**Pay employees twice a month.** Pick a cycle that gives you the most cash for the longest time. For example, rather than paying salaries every other Friday, choose a specific date each month when your business has the most cash and the least amount of payables.

**Arrange smart leasing terms.** If your industry is seasonal and business is always slow during certain

months, try to arrange lease terms that match. For example, a traditional lease may be 12 equal monthly payments over three years, but you may be able to set up a four-year lease with payments during the good months but not during the bad. Your organization may be able to negotiate similar terms on bank loans.

**Use credit cards** for travel and expenses to stretch out payments. However, watch your credit limit and make monthly payments on time to avoid high interest charges and fees.

Your business advisor can provide more suggestions on controlling cash flow. In addition, there are many tips in the recent book *100 Ways to Profit in a Volatile Economy - Battle Tested Business Strategies* (Capital Books).