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Keeping Cash Flow in Focus While Driving Business Performance

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By Raymond Boggs, Vice President, Small/Medium Business Research

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Introduction

One of the most basic business axioms, held dear by all firms but especially small companies, is that cash flow is king. Customer payments are essential to fueling all other business activity from staff salaries, to raw materials, to rent. Growing firms need to be especially attentive to cash flow because sales increases typically require new investments associated with product or service production before payments are received. The ideal is for a firm to have the cash on hand to meet payroll and pay bills on time but not be holding on to more cash than is needed, even when unanticipated expenses are considered. This requires management to apply both art and science, and a company's situation can change significantly in a short period of time, which means that continuing attention to cash flow needs to be an important business priority.

The Spending Dynamics: Understanding and Managing Input/Output Flows

The classic management tool to track and forecast incoming funds is receivables aging. This lets you know how much money should be coming in as well as who may be behind in payments. Timely information is especially important when previously reliable customers face difficulties, which could make them less reliable, a situation to which businesses from every region are increasingly sensitive. Changing business conditions for your customers have a clear connection to your own financial health.

Related to incoming funds is the potential to encourage timelier customer payments. One of the more effective approaches is to provide discounts for prompt payment — typically a 2% discount for payments made in 10 days of invoicing, with the net due in a standard 30 or 60 days. Of course, standard interest rates should be charged beyond that, although it's a good idea to keep these rates at relatively low standard bank rate levels (10% to 15%) rather than higher credit card interest rate levels (18% to 25% or more). The idea is to encourage payment without irritating the customer.

Paying bills is one of the most valuable monthly exercises a business owner or general manager can conduct. Smaller firms may know every vendor personally and can get a feel for changing business dynamics as part of the monthly bill paying process. Some business owners like to sign checks themselves rather than delegate the task because of the direct hands-on sense it gives them regarding where payments are going and how things might be changing. As companies grow, however, the process becomes more complicated and formalized, with growth in both the numbers of vendors being paid and the different policies that may be applied.

In many respects, though, the true art of managing your accounts payables is in determining who you can "slow pay" without penalty or interest if times get tight. It's always best to stay current with suppliers that charge you the most interest, but understand that creditors can be flexible too, especially if you have a history of reliability and (more important) likelihood of continuing or even expanding your business relationship.

One of the more important actions you can take with creditors is also one of the most difficult: reaching out in advance of problems. Timely communication is always important, especially if there are large bills that circumstances will keep you from paying on time. It's always best to contact suppliers proactively to set up payment terms rather than the other way around. This lets them know that you are on top of things and then sets the stage for a collaborative rather than a confrontational relationship. It is the kind of thinking that should similarly guide the relationships you have with your own customers that may be behind in payments.

Establish and Strengthen Financing and Lines of Credit *Before* You Really Need Them

Of course, the ironic aspect in arranging for bank loans is that the more you need them, the less likely you are to get them. For that reason, it is wise to strengthen your credit lines when times are good in anticipation of future need. Your accountant can work with you to help determine what credit levels you will need as your company grows.

Just as communication with creditors is important, regular communication with your bankers is important in both good times and bad times. Quarterly or even monthly meetings can be invaluable, with monthly frequency more appropriate if your business community is smaller or more intimate. An informal lunch or breakfast is all you need to discuss business conditions and how you're doing. These kinds of relationships can be especially important if business conditions take an unexpected turn. They can also provide intelligence about how other businesses in your community are doing.

Separate from the independent financing you arrange is the credit provided by others that you can leverage. Providers of vehicles, advanced technology, and other capital equipment may offer special financing. Of course, you will need to incorporate zero interest or low-cost financing and other options into price calculations so that you're able to make the most informed acquisition decisions when comparing two purchase proposals. But preserving your capital cushion will be an additional benefit that vendor financing can provide.

Use Advanced Technology to Provide Real-Time Windows into Financial Performance

Understanding the past is important, but understanding the present is even more valuable when it comes to business performance and your cash flow position. An accurate assessment of current activity is essential to ensure that business operations are being effectively supported.

And even more important is understanding and anticipating the likely future. Can you develop the cash flow predictions you will need using your current financial measurement tools? The ideal is to have up-to-the-minute visibility into current activities and, related to this, a clear understanding of what the next 30, 60, and 90 days will likely look like in terms of cash flow requirements. Understanding anticipated shortfalls as well as overages will allow for optimal cash management.

Related to the understanding of current and anticipated cash flow positions are the basic insights that come with a close personal understanding of business dynamics. This is less a problem for small firms, where everyone is aware of who the major customers are and how the business is doing. But as small firms grow to midsize firms, there is a real opportunity to provide alternative ways of maintaining insight into basic customer dynamics and the ordering and payment process. The pace of "orders to cash," which once might have been apparent, may now require more detailed analysis to calculate. The time spent at different stages of product/service delivery and payment collection is invaluable information. The goal, of course, is to find ways to shorten the "critical path" at every step.

A variety of technology resources can help provide insight with regard to current and anticipated cash flow. The ideal solution would provide up-to-the-minute visibility into current operations and the associated financial requirements. Advanced business performance tools like enterprise resource planning (ERP), customer relationship management (CRM), and business intelligence (BI) software can offer insights into different parts of your business that can provide the guidance needed to improve cash flow. Reducing production time, understanding which products are the most profitable, and identifying the customers whose business is worth an extra effort can make big performance differences. The key is to remember that a variety of resources can be used to improve cash flow and that the most successful firms are using every tool they can to improve their financial health.

While cash flow is often considered from a tactical management perspective, designed to achieve the goal of "keeping the lights on," it actually is an important measure of strategic success and long-term viability. Positive cash flows can point to a healthy business even if profits don't provide the same assurance (just wait until those receivables catch up!). Strong cash generation can confirm that you are on the right growth path and can even set the stage for business expansion. The key is to make sure that you are developing accurate cash flow information and then acting on the results.

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