<u>DIAGNOSING CASH FLOW PROBLEMS</u>

"DIAGNOSING CASH FLOW PROBLEMS: COMMON CAUSES OF POOR CASH FLOW"

By William F. Elliott

The patient is exhibiting all of the classic signs: unable to pay trade suppliers on time, hoping and praying that customer checks will come in the mail each day, nervous about making payroll every two weeks, hesitant to take that large order, unable to commit marketing dollars, seeking infusions from friends and family.

The patient is your company. The diagnosis? Poor cash flow.

Poor cash flow simply means that your outgoing cash obligations, such as payroll, purchases, other expenses, and loan repayment obligations, exceed the incoming cash generated by your business. Here are some common causes.

<u>Slow Accounts Receivable Turn/ Fast Accounts Payable Turn.</u> Some companies, such as those that import under letters of credit, must pay for purchases shortly after they receive product from their supplier, but they must then extend credit terms to their customers of 30, 60 or 90 days. In these scenarios, a company will have to use existing cash to fund its purchases until payments are received from customers.

<u>Rapid Growth.</u> This is a continuation of the scenario described above. If your company's purchases continue to increase at a faster rate than you can collect from your customers, your cash balances will dwindle as you utilize existing cash.

<u>Seasonality or Erratic Sales.</u> Whenever you have to purchase and pay for inventory during a period in which your company's sales are relatively low, you will put a strain on your cash flow.

<u>Slow Inventory Turn.</u> This is one of the most common causes of poor cash flow. Any inventory that sits in your warehouse hurts your cash flow. Companies that aggressively sell underperforming inventory in a timely fashion generally experience fewer cash flow problems.

<u>Decreasing Profits/Losses.</u> This one is obvious. If your company begins to experience thinner margins or higher overhead levels in relation to sales, your profits (the lifeblood of your cash flow) will be diminished.

<u>Catastrophic Loss.</u> You have had a theft, fire, or flood. Yes, your insurance will replace your loss. Until you receive that insurance check, however, you will be using your cash to cover the shortfall.

Insufficient Financing. Some companies grow faster than the parameters set by their bank. When this happens, and a company's bank line is "capped", the company will have to use existing cash to replace a portion of the bank financing.

Heavy Debt Service. If you have leasing arrangements or any other type of term financing, then you have debt service. Debt service is simply the amount of your monthly payments (principal plus interest) on your term loans. The higher your monthly payments, the larger effect on your cash flow.

While the symptoms of poor cash flow can be life threatening to a business, there are a number of remedies a business can utilize to regain its health. Here are a few of the more useful cures.

Purchase Order Financing. If you have sound purchase orders, there are commercial finance companies that will purchase inventory in your behalf. They will open letters of credit or make payments to vendors in accordance with your purchase terms. They usually want to be paid at the time you ship the order to your customer.

Factoring. Factoring companies purchase your receivables at a small discount, then advance you funds of up to 80% - 90% immediately. Factoring companies usually do not worry about your financial condition or rate of growth, and many factors do not cap your facility. If you are utilizing a purchase order finance company, the factoring company can pay that company directly at the time it purchases the invoice from you. Since the factoring company collects its advance directly from your customer, you do not utilize any cash in this process. If used together, P.O. Financing and Factoring can completely relieve you of the burden of using cash to finance your inventory and accounts receivable.

Inventory Liquidation. If you have a portion of your inventory sitting in the corner of your warehouse collecting dust, you might want to think about turning it into cash. There are inventory liquidation companies that specialize in purchasing your old inventory, then selling the items to secondary markets. You might take a loss on the transaction, but you will have an easier time paying your bills.

Downsizing Expenses. Take a good look at your overhead structure. Any expense reductions you can make that do not have a negative effect on revenues will directly contribute to your cash flow.

Restructuring of Bank Facilities. If you are in trouble, talk to your lender as quickly as possible. You might be able to restructure your bank facility before things get too bad. A typical restructuring might be carving out a portion of your current working capital facility and converting it to a term loan. Remember, however, that your new term loan will create new debt service.

Informal Arrangements With Trade Creditors. Many unsecured trade creditors are willing to term out a portion of your obligation to them instead of risking a complete loss should your company file bankruptcy. This is especially true if you comprise a large portion of that creditor's sales. Unsecured creditors are more likely to work with you if you are forthcoming with information and can furnish partial payments over time.

If your company falls victim to cash flow problems, it is best to act quickly and decisively. Identify the cause and pursue the appropriate cures. Early diagnosis and prevention are the best remedies for any business.