

5 Common Cash Flow Mistakes

By John Formento Jr., Analyst, Sageworks, Inc.

Effectively managing [cash flow](#) is one of the most integral parts of finance in a business environment. Any cash flow missteps can wreck havoc on an organization and ultimately contribute to its failure. In order to [ensure effective cash flow management practices](#), avoid these five common cash flow mistakes:

1. **Poor monitoring of [accounts receivables](#):** One of the biggest mistakes businesses can make is to neglect accounts receivable (AR). Businesses should either select an employee as an AR manager to review AR once a week or review it themselves once a week to ensure that payments are being received from customers. If there are customers who are taking longer than the established grace period, then measures need to be taken to speed up the payment process and decrease AR days outstanding.
2. **Paying bills before they are due:** It only makes sense to pay a bill early in one case— if the vendor offers a discount for early payment. Even if there is a discount offered for early payment, it's the CFO's job to weigh the benefit of receiving the discount versus keeping the cash on the balance sheet. Some companies think that paying a bill 10 or even 15 days in advance is a smart move, but actually they are just decreasing their cash holdings sooner than they have to. Strategically planning all cash outflows, such as paying utility bills or paying for product inputs, can help a company maintain its cash position for a little longer, which can help during a growth period. Chris Anderson, from TheManager.org, says "In accounts payable our focus is on increasing the size of the asset, while maintaining a solid credit rating - and increasing the velocity of the process."
3. **Granting credit without due diligence:** One trouble area for businesses is granting credit to customers without proper due diligence. Before granting any customer credit, an investigation into the potential customer's history of paying creditors should be examined. One way to qualify a customer for credit would be to ask for references from a supplier that the company has worked with in the past. Once the references have been obtained, a quick phone call should be placed to the reference(s) to ensure that the potential customer has a history of making timely payments. If the customer in question is a new business and does not have any references to shed light on its payment history, a credit check could be run on the owner of the business to gauge credit worthiness. If the business or owner's references do not speak highly of them, do not extend credit to them.
4. **Unnecessary expenses:** One common mistake that businesses make is tying up capital in needless expenses. Whenever there is a cash outflow there should be a defined reason for that outflow. By implementing a policy that requires all expense and purchase requests to be accompanied with a justification document that a manager has to review, any unnecessary purchases can dramatically decrease. Instead of tying up cash on purchases that are not mission-critical, the cash can be used to grow the business.
5. **Cash tied up in inventory:** Poor inventory management practices can suck up a lot of cash and leave a company with more inventory than it needs. However, on the opposite side of the equation, too little inventory can leave a company unable to fulfill orders. The key is to accurately forecast sales, which can be used to predict needed inventory levels. Companies can also implement inventory management practices such as [just-in-time \(JIT\) inventory management principles](#), which encompass procuring inventory just in time to make the sale.

While these are just five of countless mistakes that can be made in regards to cash flow, these examples highlight some important things to monitor. When you couple these things to avoid with positive cash flow management practices, a financial leader has the basic ingredients that lead to the success and profitability of a company.

About John Formento Jr.: John Formento Jr. is an Analyst at [Sageworks](#), a financial information company and Inc. 500 honoree. Formento is responsible for marketing and product development activities to improve the brand awareness and customer retention for Sageworks financial software applications. Prior to Sageworks, he founded Eye-Tee LLC, a company that provided IT and marketing services to small businesses. Formento graduated with honors in Business from the Schreyer Honors College at The Pennsylvania State University.

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