

Cash Flow: Solid Defense Helps Create Easy Offense

By Dustin Lubertazzi, Senior Consultant, Sageworks, Inc.

The common sports clichés, “defense leads to offense” and “defense wins championships” carry plenty of weight on the fields and courts, but what relevance do they have in managing cash flow? If one were to define “defense” as hoarding and holding cash, some would say that such a business is successful. Others might say the business is limiting its potential by not asserting its offense (i.e. spending power). These opinions, albeit polar, both hold water and have applications in different circumstances. Ultimately, however, the key to managing cash flow is finding a balance – ensure you have enough cash when you need it, but don’t let it sit idly when you could be using it to achieve other goals.

Proper cash flow management is necessary for businesses of all shapes and sizes. Even companies experiencing growth should practice certain disciplines in case they experience cash flow shortfalls caused by over-hiring or over-purchasing. Carter Heim, President of HeimLantz in Annapolis, MD stresses to his clients that “cash flow management and planning become critical when your business is growing. Plan for the increase in receivables and to pay personnel and other costs at higher levels.” Below you will find a list of items to consider, no matter your current cash position and goals, as you aim to establish a dynamic relationship between your defensive strategies and offensive tactics.

1. Industry Data What are the key metrics that define success in your industry? How do you know if your business is actually doing well? A reliable source of current industry data is paramount in [understanding your performance and determining where working capital adjustments should be made](#). Industry data will help you benchmark your business against peers and set both short and long term goals.

2. Receivables and Payables Collecting receivables and paying bills sound simple enough, but far too many business owners get stuck with a cash gap. Assuming a 30-day cycle, should you pay bills as soon as you receive them, at the beginning of the month, or at the end of the month? The answer depends when you normally receive payments from customers. For some businesses, a steady inflow might occur throughout the month, and for others receivables may come in sporadically, only at the end or beginning of the month. If you don’t have a collections system in place, make it a top priority because improved invoice and collections management can help you cut down on time wasted chasing down customers. If you have difficulties with delinquent customers, consider an incentive for early payments or strict penalties for tardiness.

3. Inventory All business owners want their product or service to be in high demand at all times. But it’s important not to overestimate that demand and exhaust your liquidity on inventory you can’t use. You should certainly take advantage of discounts available by purchasing in larger quantities, but be diligent and still maintain adequate levels of working capital while stocking your shelves. Heim agrees that “effective management [of working capital] ensures the company access to financing and strengthens vendor relationships.” Let’s not ignore the flip side of the coin though – too sparse an inventory can lead to missed opportunities or higher costs. Finding the balance of inventory ebbs and flows should be a strong consideration for all businesses, regardless of cash position.

4. Projections and Planning A major tenet in cash flow management is planning, as previously mentioned. One key to a good plan is a [well-constructed projection or forecast](#) – anticipating both revenues and expenses for a future period. A strong projection will help business owners predict when cash will be abundant or scarce and forecast best and worst case scenarios. Will you need to store a cash reserve? Are there budgetary changes that should be made? Having a contingency plan for “unexpected” problems can make all the difference in the

viability of a business. Don't forget about tax planning, either. Having a good sense of expected profits and tax obligations can help you avoid cash flow shortages at the end of the year.

Similar to a head coach, business owners and managers must build a game-plan with attention given to all moving parts. Every business model lends itself to different vulnerabilities, especially cash flow. A comprehensive analysis of working capital processes, including inventory, payables, receivables (and even owner salaries) is necessary in maintaining stability in any economic environment. Just like halftime adjustments in a football game, business owners often need to revise and tweak their plan. Wayne Gehris, CPA at Herbein+Company, Inc., agrees that "even the slightest improvement in accounts receivable and inventory management can have a significant impact on working capital." While we say, "defense wins championships," a well-rounded team or organization is nimble and can afford to take swift action in order to reach the pinnacle of success.

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