Managing Your Cash Position – Four Methods
By Darlene Horton, Analyst, Sageworks, Inc.

Effectively managing your business' cash is a practice that can be boiled down to a single, straightforward concept: to optimize your company's cash position, you must manage the relationship between current assets and current liabilities, so that at any point in time you have enough of the former to service the latter.

Putting this principle into practice has proven difficult for many companies. Due to the increasing difficulty of securing financing on attractive terms, many small businesses have recently turned back to a tried-and-true method for improving liquidity. In order to maximize cash flow, managers must first manage working capital accounts.

Prudently managing accounts receivable (A/R), accounts payable (A/P), and inventory can produce invaluable long-term benefits. Below, we consider methods for optimizing working capital levels and making informed cash flow forecasts.

1. **Accounts Receivable**
   Intelligent invoicing and customer segmentation allow a company to free up cash from their receivables.

   • Employ analytical tools to predict which accounts are most likely to be delinquent.
   • Provide incentives for customers to pay in advance of their agreement.
   • Create an A/R system with electronic collections to minimize manual input errors.
   • Segment customers based on relationship importance and credit risk. Implement a proactive service approach that manages customers accordingly.
   • Inspect payments for unauthorized deductions.

2. **Accounts Payable**
   By analyzing the health of key suppliers and vendors, a company can better understand the effects its partners have on operations and determine where cash is available.

   • Request fixed terms and/or negotiate terms to free cash from A/P.
   • Consider granting favorable payment terms (or extending credit) to important, at-risk suppliers, if their demise would have negatively profound effects on your company's operations.
   • Flesh out the full effects any payment cycle extensions will have on suppliers.
   • Monitor suppliers' financial health and determine if changes to current procurement practices are necessary. Particular attention should be given to vendors who provide integral products or services to your company.

3. **Inventory**
   Information gleaned from suppliers' and customers' financial statements can be used to more accurately predict inventory procurement needs.

   • Proactively monitor key vendors' and customers' financial health to avoid costly reactionary measures.

• Maintain open communication with all parties to gain valuable, precursory information that may influence decision-making.
• Use financial analytics to track and forecast sales trends and adjust inventory levels accordingly.
• Balance "just-in-time" and stock inventory to reduce your company's vulnerability to inventory price increases and high warehousing costs.

4. **Cash Flow Forecasting**
   By mitigating large swings in working capital balances, the aforementioned tactics can increase the accuracy of projected cash receipts and disbursals. Ideally, projections should forecast within a 5% margin of error.

   • Outline realistic short-, mid- and long-term cash flow requirements.
   • Examine the effect tax expenditures may have on cash; your company should keep enough money aside to be able to meet future tax obligations based on earnings.
   • Invest in enterprise software that will continuously gather pertinent data scattered throughout the company in order to improve forecasting accuracy. Maintaining constant, transparent communication among all departments is essential.
   • Put forecasts to the test; test conservative and worst-case scenarios to understand and prepare for the impact on cash.

Anton Butov, the CFO of NVGRES Holding Limited, which operates in the construction and engineering industry for energy creation, recommends that working capital increases should not outpace a company's sales growth. Butov elucidates, "As our business has cyclical recurrences within the year, we develop limits of [working capital] changes each month. At the end of every business day, I receive a report about how much of this limit is left. If the situation is not good, I discuss the issue with commercial and business departments to identify which payments can be postponed or accelerated [for accounts receivable]."

Butov notes the invaluable benefits of this practice: "As we prepare this report every month, which is also available to our Board, it helps us not only to track actual performance but to prevent us from inadequate planning as well. In my company we do not use any extravagant methods of managing cash position. Just accurate planning and tracking actual performance [versus planned]."

Sometimes, the simplest measures can produce the most infinite gains. Jonathan Gindes, CFO and SVP of Business Development of Affinergy, Inc., a company that develops coatings and medical devices for orthopedic and cardiovascular markets, has a general rule of thumb: "If we wouldn't spend our personal money in a particular fashion then we usually won't spend our corporate money in the fashion."

About Darlene Horton: Darlene Horton is an Analyst at Sageworks, a financial information company and Inc. 500 honoree. Horton is responsible for marketing and public relations activities to improve the brand awareness and customer retention for Sageworks financial software applications. Horton received her master's degree from Duke University's Fuqua School of Business, and a BA in Communication from North Carolina State University where she graduated summa cum laude.

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