Managing cash flow in challenging economic times

Management issue paper

During economic instability and slowdowns, cash flow management becomes critical to both the short and long term success of a business. Of course, generating sales and managing your business is also very important, but ensuring that cash from sales is collected and your daily cash flow requirements are managed is even more important.

Anticipating cash requirements

Managing cash flow begins with an understanding of the specific cash requirements of your business. During difficult times, cash resources can be stretched to their limits, leaving business owners scrambling to meet their obligations. Proper planning, in anticipation of these requirements, can help avoid serious cash shortages. Planning includes the preparation of cash budgets. These budgets should be prepared on a monthly basis to incorporate fluctuations in cash requirements due to the effects of seasonality on the business. Also, anticipating the effects of an economic slowdown on your customers and suppliers is important. Will your sales levels remain the same? Will your customers continue to pay their bills, or will collections slow, increasing your need for working capital? Will your suppliers continue to provide you with the goods and services you require to operate?

Working capital management

Managing the flow of cash from operations is extremely important. If done effectively, it can be a source of additional cash. However, during adverse conditions, a more realistic goal is to prevent the amount of operating cash required to run the business from increasing. This can be done through effective monitoring and management of accounts receivable, inventories and accounts payable. A frequent review of receivable balances outstanding will provide useful information with respect to collection periods.

Are you preparing and reviewing monthly aged accounts receivable listings? Increased efforts to collect old receivable balances can have a positive impact on cash flow. Thorough credit checks on new customers can reduce the negative impact of bad debts. Also, receivables from groups of related companies should be identified and monitored. Often the weakest link in the group will impact on all the companies.

Maintaining inventory balances, although necessary for business, is a drain on operating cash flow. Inventory turnover and production processes should be analyzed to determine whether the amount of inventory can be lowered, reducing the amount of cash tied up in inventory.

Accounts payable provides a source of operating cash flow. Utilizing terms provided by creditors allows for the deferral of cash payments necessary to finance sales. Negotiating an increase in credit terms with existing suppliers can free up some operating capital, however, you must be careful not to jeopardize relationships with your suppliers. Initiating credit terms with more of your suppliers may be a more effective way to defer operating cash outflows.

Review discretionary spending

A review of the amount and timing of discretionary spending items may reveal expenditures that are not critical to current operations and so can be eliminated or deferred. Discretionary operating expenditures may include travel, meals, entertainment, advertising and promotion and bonus payments. Discretionary capital expenditures may include leasehold improvements or an upgrade of the current computer systems. But use caution...do not eliminate or defer spending that will adversely affect the ability of the business to generate revenues

Review existing borrowing facilities

Review existing borrowing facilities to determine if the business's borrowing capabilities are used to the fullest. Review the capital structure of the business to be sure the short-term operating requirements are being financed with current assets and that the long-term capital requirements are financed with long-term assets. Your Grant Thornton adviser can be of assistance in conducting these reviews. A business with a need for more cash may consider borrowing from an alternative lender capable of providing increased margining of current assets. A business with lower borrowing requirements may want to consider less expensive traditional bank financing.

Generate cash from redundant assets

On occasion, a business will own assets, which are not considered necessary for day-to-day operations. Examples of redundant assets may include marketable securities, vacant land or equipment not currently being used. The sale of these non-core assets can provide the business with additional cash flow.

Generate cash through sale-leaseback arrangements

Additional cash flow can also be generated through the sale and subsequent leaseback of long-term operating assets. For example, plant and equipment used for production could be sold to unlock the equity in these assets, providing a significant amount of cash to the business. These assets can then be leased back by the business. Professional advice from your Grant Thornton adviser should be obtained before entering into this type of arrangement, however, so the tax considerations are addressed appropriately.

It is always important to manage the cash flow in your business well. In challenging economic times it is critical. A Grant Thornton adviser would be happy to review your cash flow situation and provide recommendations to help your business prosper. Make cash flow management a major part of your day-to-day operations.

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