

Digging Deeper into Cash Flow

How a cash-flow-sensitivity analysis can help you prepare for any eventuality.

Contrary to conventional wisdom, “people have it wrong when they say ‘cash is king,’” asserts Scott Berger, tax principal with Kaufman Rossin & Co., a half-century-old accounting firm in Miami. “Managing cash is king today.”

Experts say one positive aspect of the economic downturn is that small and midsize companies are starting to perform detailed cash-flow analyses, giving them the ability to anticipate and react to cash shortfalls faster. “When cash is flowing in, you don’t have to plan that much,” Berger points out. “Now you do.”

Get sensitive

Particularly in turbulent economic times, experts say that small and midsize companies should put greater emphasis on cash-flow-sensitivity analyses. These are the cash-flow “what if” scenarios that help you prepare for any eventuality, such as changes in sales, new budgets and headcounts, or increased material costs.

Conducting a cash-flow-sensitivity analysis means looking at issues that impact revenues as well as how cost streams and net cash flows are affected by competitive issues, cost drivers, and other factors of the market-at-large.

“One of the biggest reasons small and midsize businesses fail is because they tend not to pay close enough attention to cash flow,” says George Cloutier, founder and CEO of the consulting firm American Management Services and author of *Profits Aren't Everything, They're the Only Thing*. “They don’t operate with a day-to-day, week-to-week cash-flow plan, so if they have two weeks of poor collections, they find themselves in trouble.”

Link processes

A key step in improving cash-flow management is more tightly linking business processes across the organization. For example, when an order is entered by a sales executive, that information must be relayed to a plant manager to start planning production. The plant manager must release the purchase order so it can be sent to the supplier for confirmation. The sales executive must track the delivery status. The CEO needs the order information to get an accurate sense of sales forecasts.

By quickly collecting and analyzing this information across all functions, a company gets a sharper view of its liquidity gaps and cash-flow issues. This information can help companies take quick corrective action, such as deciding who to extend credit to and whether billing strategies, production schedules, and staffing need to be adjusted.

“Tough economic times make the timeliness of decision-making more critical,” Berger says. “If you wait too long when circumstances require you to close a location or let people go, it will seriously drain your assets and make it much worse in the long run.”

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Make It Easy to View

For maximum benefit, cash-flow-management processes must be “doable by existing staff,” Berger says. This means allowing personnel to view financial data in convenient ways; creating and running sales reports without the help of IT; and getting automated alerts when a key performance indicator (KPI) goes off track.

“Everybody is working at capacity, so it’s important that you provide the right people with the critical data they need—but not overwhelm them with data they don’t want,” Berger says. “The data needs to be timely, accurate, and meaningful.”

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

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