Chapter 6

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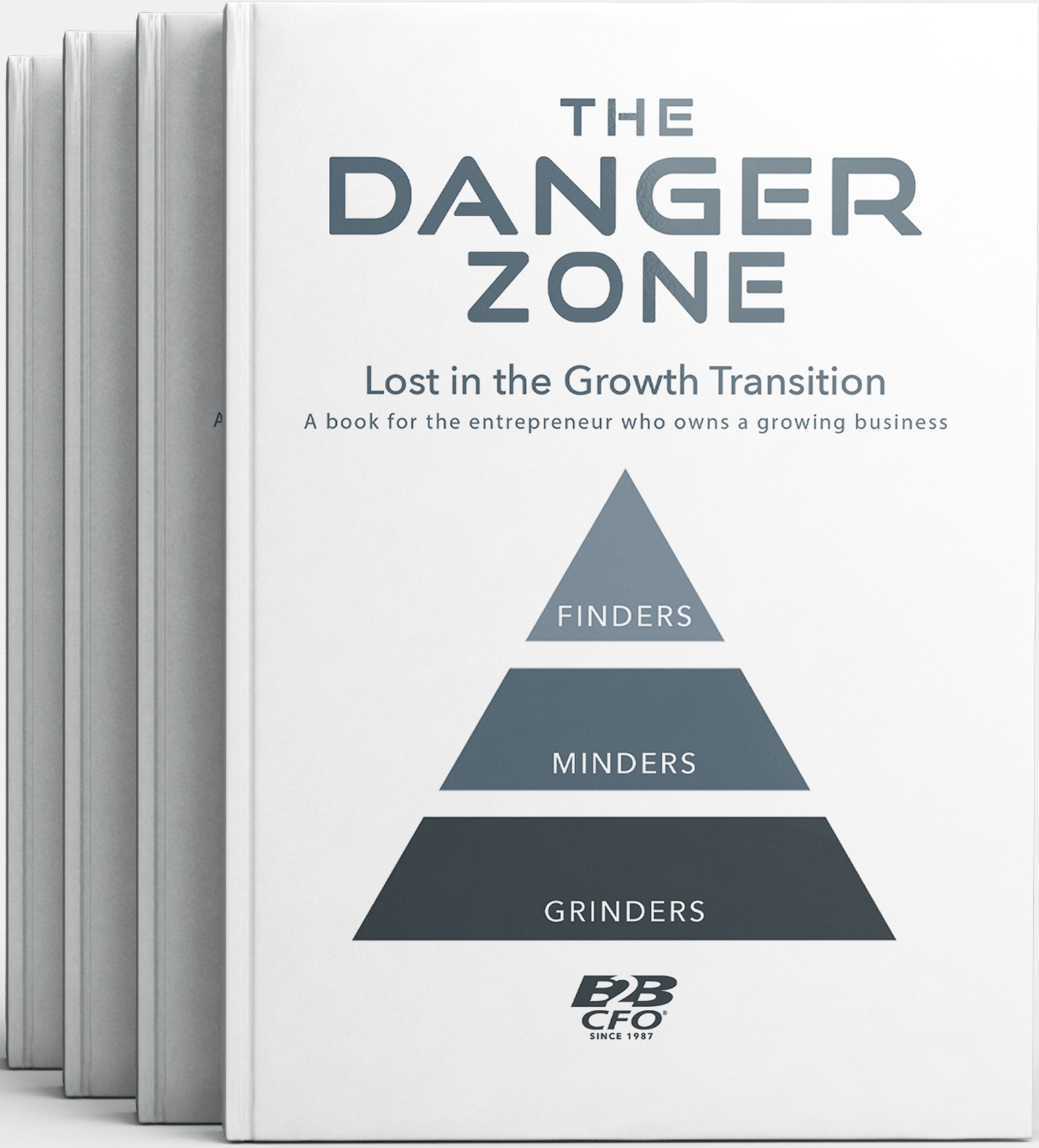
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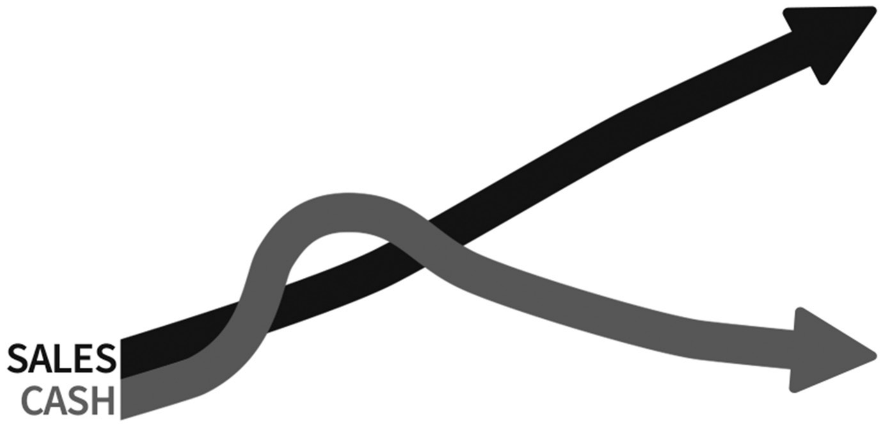


CHAPTER 6
Where does the cash go?

Two frustrated business owners interviewed us at their corporate office a few years ago. They had previously interviewed five other consulting firms and could not get an answer to their questions. They asked us, “Why did we have more operating cash in the bank when we were at $20MM in sales than we have today at $60MM in sales? **Where does the cash go**?”

The answer to their questions took us about two hours to discover. The company had grown in sales to the point where it had more than $10MM in trade receivables. Conversely, the bank line of credit had not increased over the years and was fixed at $1MM in borrowing capacity.

To make matters more difficult, the customers that owed the combined $10MM were very large companies that paid about one hundred days after the invoice date. Meanwhile, their vendors wanted payment in about 30 days. Payroll to their 400+ employees was due weekly.

The company's cash was tied up in trade receivables and the company was in danger of running completely out of operational cash. The two owners were about to lose everything. Their 400+ employees were, unknowingly, in danger of losing their jobs.

They needed a bank that would give them significantly more money in working capital to free the cash that was tied up in trade receivables.

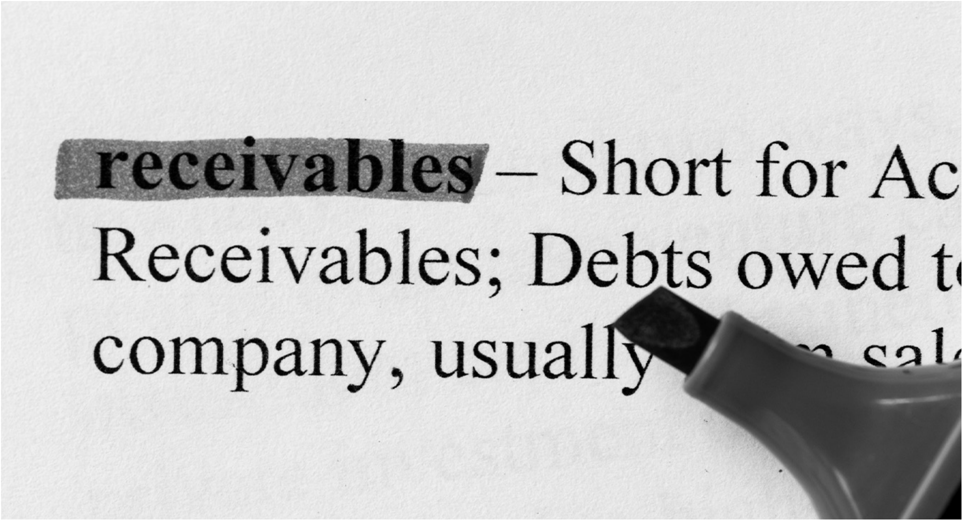
This company hired us and had their new multi-million dollar working capital bank loan within 90 days. The company's bottom-line income increased by more than 12% over the following 12 months.

Few things are more frustrating for a business owner than to see their company's cash unexpectedly disappear. Below are a few areas that can take cash out of a company.

Employee Theft

Employees can steal cash and inventory. They can charge personal items on corporate credit cards or report fictitious time on payroll. One of our three proprietary books, *Avoiding The Danger Zone, Business Illusions*, has this shocking statistic.

> "It is estimated that 95% of all (US-based) businesses experience employee theft and management is seldom aware of the actual extent of the losses or even the existence of theft."
> [17]



Trade Receivables

The collection of cash from receivables can be delayed or permanently stopped by the way customers run the cash management of their own companies. Some customers may not be credit-worthy to be sold on terms.

A privately held company that lends money to customers on terms often, by default, becomes a bank or a lending institution. The company is lending money to customers without any security collateral for the amount that was loaned to the customer with the creation of the receivable invoice. This kind of situation often causes a company's bankers and lenders to get upset to the point where they pause (or end) their banking or lending.

Inventory

Inventory can become a cash quagmire if the company purchases too much, has obsolete inventory and/or purchases inventory at a cost that exceeds the company's ability to earn the expected gross profit margin.

Inventory can be looked at as "idle cash." A company rarely turns over its inventory in thirty days, the number of days their vendors who sell the inventory require payment on their invoices.

Vehicles & Equipment

It is tempting to purchase big-ticket items like vehicles or equipment with operational cash. After all, it is often inconvenient to ask for money from bankers and lenders. It is sometimes easier to write a check for “just this one purchase.” It may be in a company’s best interest to use OPM (Other People’s Money) to purchase such items and to amortize the debt payments over the expected life of the asset.

Vendors

Vendors may unexpectedly change the terms of payment on their invoices. For example, a vendor may historically have given a company 30 days to pay invoices but may suddenly change the terms to 15 days (or Cash on Delivery), which directly impacts a company’s cash flow. Vendors may also take away discounts which may negatively impact both cash flow and the company’s net income.

Debt Principal Payments

A company may have principal payments on notes that may not be in alignment with operational cash needs. If so, the notes payable may need to be refinanced in order to improve cash.

Income Taxes

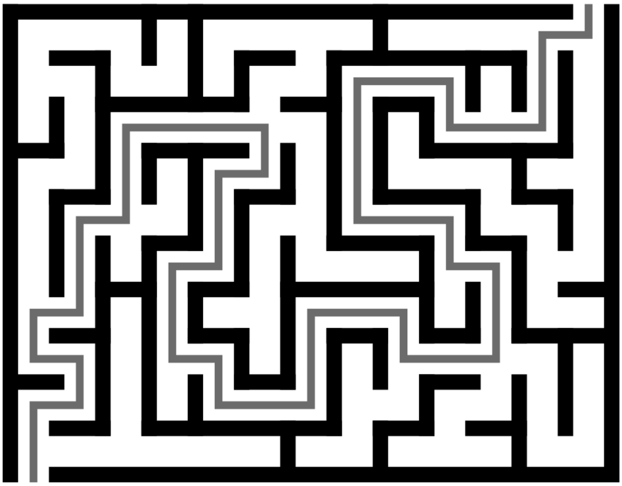
Many privately held companies are pass-through entities (LLCs, LLPs, Partnerships, S-Corporations, etc.). The owners' personal income tax structure may cause cash to be taken out of a company (through distributions) to satisfy the income tax requirements of federal, state and/or local governments.

Cost of Goods Sold

Labor, material, or other costs may begin to increase above the company's KPIs (Key Performance Indicators) and may negatively impact cash.

Administrative Expenses

Administrative expenses may balloon and eat into operational cash. Such expenses can often be compared to the industry KPIs (Key Performance Indicators) to determine if a company is spending too much money.



Complexity

Managing a positive operational cash flow can become very complex and may require a certain degree of sophistication. At some point, owners become unable to manage cash in their heads and need help with this critical matter.

What's Next?

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