Speeding Along but Out of Gas (Cash)

By Michael Stier | FocusCFO

Michael Dell, the founder & CEO of Dell Technologies has oft admitted, **"We were always focused on our P&L. But cash flow was not a regularly discussed topic. It was as if we were driving along, watching only the speedometer, when in fact we were running out of gas".**

Like Michael Dell, many small to medium size business owners are laser-focused on profits. However, that's not enough to truly be successful. I am often asked by many successful owners, "We're making money, so why is there no cash in the bank?" It doesn't matter whether they have a $1M or a $50M business, many owners struggle with the concept of profit vs. cash. Understanding that difference is critical to understanding how cash flow works — and employing a CFO to master the practice of proper cash flow management for the business can pay for itself many times over.

It's important to understand: **Your business can be making a profit but still have a negative cash flow.**

Your profits won't equal your cash if you:

1. Did work/sold product but didn't get paid yet (increase in Accounts Receivable)
2. Paid for things, like payroll, before you got paid
3. Made investments for the future (e.g., buying inventory)

Some Best Practice Ideas for Cash Flow Management

- Calculate Gross Profit Margin
- Implement Job Costing
- Understand Your Fully Loaded Labor Costs
- Measure DSO
- Delay in Payroll Start by 2 Weeks
- Automate Invoicing
- Get Paid in Advance (If Possible)
- Get A Deposit Upfront
- Set up a Retainer
- Bill Weekly Instead of Monthly
- Bill Milestones, if not Weekly
- Bill Immediately at Project Completion
- Assign a Collections Owner
- Automate Collections
- Call clients 5 Days Before Due Date
- Prepare for Collections calls
- Fire Low Margin Clients
- Sort A/R Aging by Amount Due
- Semi-Monthly vs. Biweekly Payroll
- Accept Credit Card Payments
- Establish a Written Credit Policy; Check Background, Rating & References
- Audit Expenses
- Implement Pay Slow Rule
- Experiment with Your Pricing Model

Read on for further detail on some of the listed best practice ideas above:

Gross Profit Margin

Gross profit margin provides insight into:

1. Are you pricing your jobs right?
2. How do cost overruns impact profits and cash flow?
3. Which sales reps or marketing campaigns generate the most profits?

Implement Job Costing

The biggest **benefit of true job costing** is knowing that nothing slipped through the cracks and you're getting paid for all the value that you delivered**.**

Understand Fully Loaded Labor Costs

Understanding your true fully loaded labor cost will help make sure your proposals and price quotes achieve your target gross profit percentage. Having visibility into real costs allows you to include details of all your value and time spent in your proposals.

Measure Daily Sales Outstanding (DSO)

DSO measures the number of days it takes to collect a dollar of sales. Every day that you're doing work that your client hasn't paid for upfront, you're essentially giving that client a loan. The easiest way to reduce DSO is with timely billing through lightning-fast invoicing, and fast payment incentives like keeping a credit card on file or shortening net terms for payments.

Automate Invoicing

One of the most important ways to improve cash flow is to map out the steps involved in getting a bill out the door. Ask yourself questions like:

1. How many people are involved in creating an invoice?
2. Once you've completed a job, how long does it take to get the invoice into the clients' hands?

Bill Weekly Instead of Monthly; or Bill Milestones

Billing weekly can significantly improve the timing of payments. According to Vistr, if you issue invoices on the same day each week, the data suggests you should send invoices on the weekends to get paid faster. Whereas invoices sent on Tuesdays, Thursdays and Fridays take a full 10 days longer to receive payment.

Get Paid in Advance or Deposit Upfront

Getting an upfront payment or deposit that covers your out-of-pocket costs will completely change your company's cash flow.

Assign a Collections Owner and Prepare for Collections Calls

A bad collections process will lead to unnecessary cash flow problems. Collections are often the last thing anyone wants to do, so often times it rarely gets done well. Don't assign collections to a receptionist or office manager unless you've made it clear where it fits on the priority list and given them sufficient time to do it right. One quick way to improve collection performance is to train your staff to anticipate what the client might say when you ask, "When can we count on you to pay your bill?"

Audit Expenses

If you can cut expenses by 10%, the effect on your profits will be exponential.

Fire Low Margin Clients

And reassign staff to higher margin projects. Don't be afraid to fire low-margin clients – after all, **Low Gross is Grief** (LGIG). LGIG means your lowest margin clients usually give you the highest amount of grief and eat up your staff's valuable time. Eliminate those clients, and you'll have a more profitable business and a happier team.

Experiment with Your Pricing Model

You should put more thought into optimizing your pricing model, as this will have the biggest impact on cash flow. Consider the pricing model that fits best for your business: Value-Based, Fixed Fee, Time & Material, or Milestone Driven. So how do you optimize your pricing model to increase your company's profitability? You turn to your Dashboard and look at the Key Performance Indicators (KPIs). KPIs should help you figure out if you are pricing your jobs right, and also to help you to really understand who your most profitable clients are, and what makes them profitable.

Do you see practices above that you should be implementing, but not sure how? FocusCFO can help. It is very common for our CFOs to create detailed cash flow models for our client's businesses and implement customized cash flow improvement practices. That allows our clients to know and understand their numbers, and have the confidence that comes with proper cash flow management.

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Founded in 2001, FocusCFO is the leading onsite fractional CFO services provider in the Midwest and Southeast. FocusCFO works closely with small to medium sized businesses helping business owners gain control over three key financial and operational areas: increasing cash flow, reducing business risk, and creating a platform for scalable growth. This allows business owners to then realize full financial control and increased value in their businesses. For more information, visit us at focuscfo.com or follow us on LinkedIn.