Managing Cash Flows is Vital to Your Company’s Success

A business can be profitable and still go under due to poor cash flows. What a profound statement. Even though your business is showing a profit it can be difficult to pay suppliers and make payroll on time. This difficulty is typically caused by a delay or fluctuation in revenues. Cash flow shortages are usually caused by slower paying customers, seasonal sales, or your company suddenly experiences growth.

When customers do not pay with cash on delivery (COD), a gap is created between the receiving of the revenues and the payment of expenses. Payroll, rent, utilities, suppliers etc. all need to be paid on time. Lets say in one month you sell $100K worth of product with a profit of $20K. The $80K in expenses needs to be paid right away but your customer does not pay for 30 days. This creates a gap in cash flows. You need to pay out $80K before you see the $100K in revenue. You are profitable but do not have the cash on hand to pay your bills. This is why profitable companies can still go under. When your company experiences growth this gap in cash becomes far more difficult to manage because your costs are increasing faster then the revenues coming in.

Good management and planning for this shortage in cash flow is vital to your company’s success. At a minimum, a one-year cash flow analysis needs to be completed and reviewed on a monthly basis. The gaps in cash flow must be identified with a plan to overcome these gaps. The ideal situation would be for a company to keep a cash reserve to draw against when a cash flow gap is created. Unfortunately this is not a viable option for many companies. Some businesses have the luxury of a generous line of credit with a bank to overcome these cash shortages. In today’s tough lending environment these generous line of credits are difficult to come by. Although this situation sounds grim there is another viable alternative called Accounts Receivable Funding.

Accounts Receivable Funding or Factoring is a type of financing that is tied directly to your accounts receivables. Qualifying for factoring is much easier than traditional bank financing. A bank will focus on your company’s financial history and cash flow while a factor will focus on the creditworthiness of your customers. This is because a factor ties financing directly to your accounts receivable or invoices. These invoices are a “promise to pay” from your customer. If you customer has good credit then a factor is happy to lend you money against it.

Factoring invoices is an excellent financial tool to help maintain proper cash flow in your organization. When you sell your product or service a factor will generally advance you in cash up to 90% of the value of the invoice. Now you have closed the cash flow gap and are able to meet payroll, pay expenses and pay suppliers on time. When your customer finally pays the invoice the remaining amount of the invoice will be forwarded to you minus a fee. As your organization grows, so does your funding.

There is a cost for this type of financing so you need to carefully weigh the reduction in profit to the benefit of being able to make your payments on time. You need to also include the benefit of the redirection of your time. Instead of trying to juggle customer payments with paying bills you can concentrate on running and growing your business.

If you investigate this type of financing, don’t forget to shop around. Fees for factoring can range significantly. To see how factoring can help your organization there is a cash flow calculator at Cashflowtool

Simply model your company’s current cash flow situation, add the cost of factoring to your cost of goods, lower your collection days and watch how your cash flow improves.

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