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Building a Balanced Company (Part III)

This is part III of a multi-part article. To request a copy of the entire article, please contact us at:

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Current Assets

You get money from 1 of three places; you get it from your customers, your vendors, and from everybody else. Getting it from your customers is the cheapest. Optimum cash management requires balancing these three sources of capital. Operating cash flow is greatest when you get the largest share of capital from you customers. Take a look at your cash flow statement. Do you have positive cash flow from operations?

Since the creation of Just in Time Inventory, many experts have come to view inventory on hand as a liability. Is you inventory a cash cow, or a long term asset? There are many companies that do not have Just in Time inventory, they have "Just in Case" Inventory. Do not let your excess inventory start celebrating birthdays. A good manager knows not only how to purchase and sell his inventory, but how to get out of bad inventory fast.

Look at your accounts receivable; have you become a banker to your customers? Many companies get into trouble because they fail to pay attention to collections. Set policies regarding extending credit, payments and collections. Then remain firm. Selling products does no good if no one is paying for it. If you extend terms to your customers, price your product to include carrying costs. This includes how much interest you will have to pay your lender to provide cash to you when your customer does not.

One of the most important calculations you can make regarding your company is the cash cycle. The cash cycle of your business is the number of days from the purchase of raw material to receiving cash on hand, including check clearing time.

Dividing 360 by the number of days in the cycle will give you your cash turn-over rate. By breaking this cycle into raw materials, work in progress, finished goods, and accounts receivable, you will have a better handle on where the cash cycle slows down and where you can improve.

To figure out how much cash you should have on hand, look at the combined number of days in the cash cycle. Calculate your operating costs and divide by the cash turn-over. This is the cash you should have. How much credit you need is a factor of the cost content of your receivables. In other words, if my margin is 24% and I have $100,000 in receivables, $75,000 is the maximum credit limit I should need. Your cost content should include carrying costs of your financing.

Maintaining cash flow is like walking backwards on an elevator. If I am only going as fast as the elevator, I am not gaining any ground. If I stumble, I have to run faster just to catch up.

Conclusion

Einstein once said, "We can't solve problems by using the same kind of thinking we used when we created them." Building a successful company requires leaders with a vision, the ability to articulate that vision and to motivate the employees to achieve the company's goals. It requires cooperation and communication. And it requires information, timely, accurate information. Without adequate analysis, it will be difficult for management to make meaningful changes and decisions.

Cost cutting is not as crucial as the reallocation of resources to those areas that will provide the Most return. Keeping an eye on your balance sheet will help you see the effect of your decisions on the strength of the company. Efficiencies gained in every area will create cost reductions through the elimination of repetition and costly mistakes.

To implement changes, it is imperative to understand how things are being done, and to gather new ideas about how they can be done better. It requires the ability to measure performance and analyze results. And it takes decisiveness.

For more information about improving the performance, and therefore the value of your company, contact **Lazarus Resources Group** today.