



# CATHEDRAL CONSULTING GROUP, LLC

## Intensity of the Cash Position

The current economic situation causes small businesses to focus on the immediacy of cash flow. The intensity of this cash position causes us to focus on the following:

- A. Collecting the Cash
- B. Cash in the bank
- C. Liquidity needs
- D. Processing of funds
- E. Payment schedule

For further discussion on this topic, please see our former paper on [Cash Flow Management](#) which provides instructions regarding knowing your current cash position, anticipating cash needs, improving efficiency of cash flow, and investing extra funds wisely. ([www.CathedralConsulting.com](http://www.CathedralConsulting.com) under Resources)

### Collecting the Cash:

Prior to depositing cash in the bank, payments must be collected. Many small business owners find themselves in the wearisome position of both bill collector and relationship developer. This can, at times, create opposing roles that are not easily reconciled. To help avoid this situation, it is important that a systematic approach be developed to remove any internal hindrances to receiving quick and timely payments.

The establishment of clear terms and timely follow-up should limit the amount of write-offs in your company. Clear payment terms need to be established up front in the price listed, contract, or engagement letter. Invoices should also indicate precisely what the terms are, including late payment fees and the timeframe for receiving payment.

It is important that invoices are both accurate and issued in a timely way. It is unfair to invoice 30 days late and then expect immediate payment. Timeliness in following up on outstanding invoices directly correlates to the amount that is collected. According to the Commercial Collection Agency Association, a company should expect to collect 90 percent of payments received 30 days late. The expectations of collection decrease to 70 percent at 90 days, 52.1 percent at six months, and 22.8 percent at a year late.<sup>1</sup>

Systematic follow-up by sending monthly statements as well as letters indicating that the payment is past-due are important reminders. Phone calls are also powerful, as they are less

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<sup>1</sup> Collection Trends. <http://www.ccaacollect.com/10-18-04COLLECTABILITYCHART.pdf>. In an April 22, 2009 report CCAA indicated a 28.2% increase in commercial accounts placed in collection for the 12 months ending March 2009 compared to the previous 12 month period. As the increase in accounts placed only rose 4.2% from Q4 2008 to Q1 2009, this may indicate that companies have cleaned up their slow-paying accounts.

easy for customers to avoid then mail. As an executive, be sure to review aging receivables and sign-off before staff make any collection calls as there may be a relational issue which causes you to dismiss collections follow up on a case-by-case basis.

### **Cash in the Bank**

Are you aware of what your cash balance is in the bank right now? Many business owners are unable to answer that question accurately. In order to manage cash flow, especially during difficult periods, it is imperative to know your cash position. The ease of access to bank account information through the internet now allows daily reconciliation of funds. If receipts and invoices are entered immediately the financial software should allow quick reconciliation to the bank account. At a minimum, a complete reconciliation should be done at the end of each month. Internet banking eliminates the need to wait for statements to arrive in the mail, allowing the timeframe for reconciliation to be closer to the close of the month. It is vital that the books be kept in order in a timely way that allows the exact cash position to be known at any point in time.

We are seeing a number of clients struggle with cash balance management in today's economic downturn. Where it is weak, there have been bounced checks, late payments, and other embarrassing relationship matters.

### **Liquidity Needs**

Liquidity is defined as "the ability to convert an asset to cash quickly"<sup>2</sup> and the ability to meet obligations when they come due over the next year. Current market conditions are factored into this evaluation. When examining your company's liquidity reserves, evaluate the amount of liquid assets available, including cash, credit lines, and potential capital contributions from the owner(s). In a downturn scenario, the company should have adequate liquid reserves to enable the business to continue operations for a minimum of 12 months. Note that Accounts Receivable may not be considered liquid in this scenario as collections may be difficult to obtain in a downturn situation.

In times of fast expansion and growth, a small business owner might get lax in evaluating with discipline the necessary liquidity for their company. However, in tightening credit markets it is imperative that the successful small business owner focus regularly on managing liquidity. The bank is unlikely in this environment to increase lines of credit in order to cover a new large order of inventory or this week's payroll. Instead, every owner needs to evaluate on a weekly, monthly, and quarterly basis their liquidity needs.

Depending on the business cycle, liquidity needs could be seasonal. Retailers sustain large build-ups of inventory prior to the holiday season, necessitating that much of their cash is sitting on shelves. If the holiday season is successful, their inventory is liquidated and their cash position dramatically increased in the beginning of the year.

One alternative method of liquidity funding to a line of credit is factoring. Factoring includes the sale of receivables at a discount price. A factor typically screens vendors for credit risks before agreeing to factor their receivables, or ensures that the risk of default remains with their client. The factor usually forwards 60-80 percent of the invoice upon shipment of the product and the remaining amount less their fees (likely 3-5 percent per invoice) upon receipt of payment from

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<sup>2</sup> [www.investopedia.com](http://www.investopedia.com)

the vendor. According to Forbes the factoring industry was \$137 billion in 2007.<sup>3</sup> While the annualized fees from a factor make this an expensive option, it remains an alternative for those struggling with cash flow issues.

## **Processing of Funds**

The systematic processing of funds received is vital to relieving the pressure on the company's cash position. Cash and checks should be recorded and deposited on a daily basis. Electronic options such as electronic fund transfers and wires allow funds to be received immediately. If not done automatically, merchant accounts should be transferred daily. This eliminates additional sales being frozen in the case of a merchant dispute where a provider temporarily freezes the account during an investigation.

Credit card processing has become a necessity for most companies--particularly those that sell products-- and required in the online environment. While the shopping cart may seem the same on every website, the providers behind them are quite different. Paypal or Google Checkout are better known turn-key solutions, which might be beneficial to a smaller company. The other alternative is to work directly with a credit card processor, which typically permits better back-end integration, reporting, and shopping cart navigation.

While credit cards allow the receipt of funds within 2-3 days via a merchant account, there are also usually 2-3 percent fees associated with this service charged on the amount of the purchase. In addition there are start-up fees and monthly processing or per transaction fees that quickly escalate, particularly for companies with a low number of total transactions per month. It is important to add up the fees and discover what the cost of this processing really is to your company. MerchantAccountGuide.com provides comprehensive information which allows businesses to evaluate which provider will best suit their needs in the broad range of fees available.

## **Payments Schedule**

Accounts Payable schedules are important not only to cash flow but also to the establishment of trusted relationships with suppliers. Every invoice should be paid on-time with a minimal amount of back-office processing required. Arthur Anderson's study of leading companies revealed that the cost of processing one invoice can vary from \$3.55 in large companies to \$.35 in some of the best finance departments.<sup>4</sup> A basic process should be implemented which allows invoices to be paid on a predetermined schedule of the company's choosing, a system of sign-off to verify the validity of the invoice, and a minimal handling process to ensure that the supplier receives the payment.

Whether the owner of the company writes the checks or simply signs them after they have been processed, it is important to ensure that the company account contains the necessary funds to cover the invoice. Costs incurred from a lack of funds--such as bounced checks-- or a lack of timeliness-- such as late-fees, interest, or missed discount opportunities—can and should be avoided. These are unnecessary fees that can be avoided by the implementation of a basic Accounts Payable process.

## **Tutorials & Articles for Further Reading**

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<sup>3</sup> Farrell, Maureen. "The Check is in the Mail." <http://www.forbes.com/forbes/2009/0511/056-liquid-capital-business-check-is-in-mail.html>. 16 April 2009.

<sup>4</sup> "Best Practices: Accounts Payable." <http://www.inc.com/articles/2000/02/17065.html>

- Mills, William. "How to Collect from Clients: Walk the walk, talk the talk." This article addresses the issues to be faced in developing a consistent and successful accounts receivable program. <http://www.inc.com/articles/1998/03/18937.html>.
- Porter, Glenn. "The Knack to Getting Paid." This article addresses the need to connect sales commission checks with payment in order to include them in the collection cycle. <http://www.forbes.com/2009/05/04/collection-receivables-purchasing-entrepreneurs-sales-marketing-porter.html>
- Oricchio, Renee. "How to Collect Money Online." This article provides the advantages and disadvantages of utilizing a third-party provider such as Paypal versus a credit card processor directly. <http://technology.inc.com/internet/articles/200807/payment.html>

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