Go With the (Cash) Flow

THE EIGHTH COMMANDMENT

PROJECT, MONITOR, AND CONSERVE CASH AND CREDIT CAPABILITY.

Cash is the blood of a growth business. A company's ability to continue is determined daily by the contents of the checking account, not at year's end by the financial statement. Keeping money in hand or readily available for both planned and unplanned events is not only prudent but necessary in unsettled times. Cultivation of financial sources is an ongoing duty.

Probably no other commandment is violated more broadly and regularly than this one. Cash gets consumed in many ways, some of them quite unexpected. In recent years, corporate scandals and upheavals, roller-coaster interest rates, international tensions, and suspicious investors have driven even the largest corporations into wild patterns of financing themselves. Many of the approaches involved sophisticated financing schemes that only a chosen few could decipher. As chronicled in the *Wall Street Journal, Fortune, Forbes, Business Week,* and elsewhere, many of the new instruments have resulted in big bruises on organizations as diverse as Procter & Gamble and Orange County, California. At one point in the last 20 years, interest expense alone consumed nearly 45 percent of corporate net profit before taxes, up from only 14 percent in the 1960s, according to Henry Kaufman, the chief economist at Salomon Brothers.

The squeeze on cash available for operations due to changes in interest rates on borrowings is one example of how unplanned events can cripple a company, regardless of its size. A second cash sump that periodically catches high-growth company managements napping is inventory. A few years back scores of semiconductor companies found themselves with months and months of product on hand, and no customers. The cash accounts on their balance sheets dwindled; the inventory accounts ballooned. But normally you can't pay a payroll with inventory. More than one emerging company has found it necessary to let key people go during cash-squeeze circumstances, a high price to pay for failing to protect cash reserves as a market cools or the economy shifts.

The third great cash consumer tends to be accounts receivable, the money your customers owe you. Without intending to do so, many entrepreneurs start out being a manufacturer or service-provider and end up being a bank (of sorts).

CASE T. A young, well-degreed couple started a consulting business aimed at cashing in on the booming racquetball, squash, and indoor tennis market. They offered a full range of services based on their own backgrounds and athletic prowess. They could give a client a turn-key package, everything from court layout and building design to retail merchandise selection and club management procedures. The couple did very well during their first two years in business. They even expanded into wholesaling certain types of equipment—special shoes and racquets, clothing for left-handers, etc. In their third year they got their "big break"—a contract with a major land developer to do a chain of twelve racquet complexes in five southwestern cities. The contract required concentrated effort stretching over a fifteen-month period. The two consultants worked very hard and billed the developer for fees and expenses at the end of each month. When they had not received any payments after the third month, they expressed some concern to their client. He assured them the delay was strictly administrative and that a check was in the mail. A month later they received a check for the first month. But no more checks were forthcoming. By the end of the sixth month the couple had invoices outstanding of over $150,000, and they had incurred over $35,000 in out-of-pocket expenses for lodging, food, and continuous travel to the client's twelve sites. The client repeatedly assured them the delay was only temporary.

The couple engaged an attorney. She went after the developer. He fired the two consultants. They went to court. In the meantime, their successful, pre-big break consulting business was derailed due to lack of attention. To date, eighteen months later, they still haven't collected a portion of the money they claim they are due. But they still show it on their balance sheet in accounts receivable.

Is there a moral to the story? Yes. Watch out when you start extending credit. Don't become a finance company unintentionally.

Usually, the management of a new enterprise assumes that it must conform to the prevailing practices of the industry or industries in which it will operate. If the industry standard is to allow *net thirty days* on the payment of invoices, then the entrepreneurs allow net thirty days. Doing so is very understandable. But two questions should be asked. One, if the new company does indeed have a better mousetrap of some sort, does it need to meet the industry standard? Perhaps tighter terms can be sold. Two, what actions will be taken if whatever terms adopted are violated by customers—as in Case T above?

Many entrepreneurs shy away from these types of administrative issues. They are hardly the stuff dreams are made of, particularly in the early days of a new venture when everyone is aglow with visions of empires, self-fulfillment, service to society, capital gains, or all of the above. But, honored reader, you are admonished to recognize the cold fact that a business without cash is like a sailboat without wind. Depending upon who's aboard, sitting dead in the water, windless, may be interesting, even fun, for awhile. But at some point, survival becomes an issue. Projecting, monitoring, and conserving cash is not an optional feature of entrepreneuring. It is the major part of a high-level, heavyweight task for one of the primary participants. Another part of that task is the continuing cultivation of financial sources.

The thrust of this book has been toward building growth companies. Almost by definition, growth companies usually need more money than they can generate internally. That incremental money has to come from outside. The range of normal outside sources is pretty well known:

Individual investors (the public)
Private investors (wealthy individuals)
Professional investment funds (venture capitalists)
Foundations (money for special causes)
Corporations (joint ventures and equity investments)
Creditors (banks, SBA, individuals)
Credit companies (accounts receivable financing)
Suppliers (extended payment terms)
Customers (payments in advance)
Employees (stock purchases, wage/salary concessions)

Chances are that sooner or later you will have to rely on one or more of these ten sources to supply some additional wind for your sails. The time to go after money is before you need it.

It is a well-known phenomenon that it's relatively easy to get a loan, for example, when you've already got plenty of cash on hand. In such circumstances your credit is five-star (or AAA) and any creditor has little worry about getting repaid. It follows that the time to cultivate relations with potential future sources of capital is when you are doing well, meeting your plan, and running smoothly. Essentially what the entrepreneur must do is build confidence on the part of others—confidence in his or her management team, the business concept, and the future of the combination. How is this efficiently done? Pick one or two target sources from the list of ten and court them from day one.

One of the key products of your business plan, your blueprint, is a thoughtful indication of how much money is required at various points along the way in the early years of the business. The business plan, or more likely, updated versions of it, can be your basic tool in courting potential sources of initial as well as later rounds of financing. Let your targeted individuals read the plan. Ask for comments. Then keep the intended investors and creditors informed of your progress.

In addition, include your targeted sources in periodic mailings. Visit them. Draw them into the life of the company in ways convenient to you. Should you let your potential sources of future debt or equity know why you are cultivating them? Of course! You're not playing a game with your business. You are going after needed funding in the same way you would go after needed raw materials or vital parts or a person you would like very much to hire. There's nothing sacred about money. It just happens to have more mystique than other business ingredients. Go after it. There's generally more money around than there are good, thought-out business ideas and plans. Once you've done your homework, figure "they" need you more than you need them. This is not to suggest arrogance on your part, merely conviction.

There is evidence of the dawn of a new day for progressive business management. The old day featured a rapidly growing population, apparently unlimited natural resources, cheap energy, a stable currency, low interest rates and low inflation, relative isolation from overseas competition, and a compliant work force that understood hard times. The new day features just the opposite. And the hard times of the transition to the new day are especially aggravating to the most recent generation of employees who had come to take good times, economically speaking, for granted. As the dawn gives way to the new day, managers in general and entrepreneurs in particular have to deal skillfully with the fundamentals of business.

Customer service is already a battle cry across the nation. The effective linking and full use of talent at all organizational levels is becoming fashionable, but it will receive increasing attention as the new century deepens. Marketing will be tightened up in many ways. For example, the proliferation of me-too products will fade as the buying public increasingly seeks real value, rather than the cosmetic appearance of value. Production processes are already undergoing a revolution. Purchasing has increased markedly in stature as a vital business function. Finance now is a global activity that never sees a sunset. The Internet and the information highway, or “farmer's market” as it is called by Microsoft's Bill Gates, continue to trigger whole new vistas of opportunity for those around the world who have their antennas raised. In this time of seemingly unlimited opportunity, cash will continue to be the life blood of a growth business. Entrepreneurs by nature tend to favor hard cash over paper assets anyway. This new century is made for them.