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# Cash is King

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# ASK THE SMU PROF

# CASH IS KING

Q: **What can SMEs do to monitor, manage and improve their cash flow?**

A: Cash flow is a perennial issue for SMEs. With an economic slowdown on the horizon, SMEs are facing an even tighter squeeze on their cash flow on many fronts, from delayed payments from customers and declining sales to rising costs of doing business in general.

What can SMEs do to improve their operating cash flow? First, one has to monitor the company's cash flow. A commonly-used accounting metric is the "cash conversion cycle". It simply expresses the time that it takes to sell inventory and collect cash from the sales, less the time it takes to pay suppliers or creditors.

Mathematically, a simple version of the cash conversion cycle can be calculated as: (365 x inventory / cost of sales) + (365 x trade receivables / sales revenue) - (365 x trade payables / cost of sales). If it takes you 30 days, on average, to sell your inventory, and 45 days to collect from your debtors, and in turn, you take 60 days to pay your suppliers, your cash conversion cycle will be 30 + 45 - 60 = 15 days. This is the first step to understanding how effective you are in managing your operational cash flow.

With a better understanding of your cash flow components, you can start managing and improving them. As much as you can, lower your inventory days, lower your debtor days, and increase your payment days. Remember, however, that there are pragmatic limits on the number of days for you to sell your inventory, collect cash and pay your bills!

## PRACTICAL TIPS

Make an effort to understand your credit policy fully. Be clear about your credit terms and expectations when you do the sales, and then be persistent and consistent in following up. If you are (perceived as) accommodating, it is likely that those who are tougher and more demanding will get paid before you. Send invoices to your customers promptly. You know they will take time to pay, so the sooner you send them in, the quicker your invoices join the processing queue. And if you send in erroneous or incomplete invoices when they (eventually) get processed, be prepared to re-issue and join the queue all over again. That will surely hurt your cash flow!

At the same time, manage your cash outflows as best as you can. Hypocritical as it may sound, do not pay anything before it is due. As much as possible, use a credit card when making payments and enjoy "interest-free days" from your card issuers.

Study your inventory needs. Nobody likes to miss out on a sale arising from insufficient inventory, but inventory is never a productive asset. Forecast your sales meaningfully and review them regularly, so that you can adjust your purchasing pattern to match your sales. Be on the watch for slow or non-moving inventory. Never order anything you didn't manage to sell in the last month.

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