

When cash is king:

Strategies for surviving and thriving in this economic contraction

March 2009

Now that our political leaders agree that we are in a recession and have been since the end of 2007, what does it mean for the business owner? Before discussing ways a business owner can cope with a recession, let's review the business cycle's four phases:

1. *Contraction* – a slowdown in the pace of economic activity; can turn into a recession if the contraction is severe
2. *Trough* – the lowest point of the business cycle; can turn into a depression
3. *Expansion* – an increase in economic activity
4. *Peak* – the highest point in the business cycle

When the contraction phase turns into a recession, the business cycle can either turn to an expansion or a trough, and in some cases a depression. Predicting when a recession will end — and which way the business cycle will turn after a recession — is very difficult.

Business owners need to plan how they will not only survive this recession, but rebound sooner, stronger, and in a better financial position than their competitors.

Unfortunately, most business owners apply defensive strategies during a recession and do not take advantage of the opportunities a recession might provide. A recession provides opportunities such as forming new alliances and joint ventures, examining and fixing weak corporate structures and internal controls, hiring talent from weak competitors,

developing new products and marketing strategies, and entering new markets.

To take advantage of these opportunities, business owners must take the necessary steps to first survive a recession. Put simply, "cash is king." Generating additional revenues and cutting costs are great for generating profits, but it is *cash* that keeps a company in business. Cash flow from a company's operations is what keeps a business going, particularly during a downturn, when obtaining cash from sources outside the business — such as banks and venture capitalists — is increasingly difficult.

Managing a company's cash flow by increasing cash intakes and decreasing cash outtakes is the most important task of a business owner.

A business must generate cash from its balance sheet and more directly from its working capital. Working capital is based on current assets of a business (inventories and receivables) less current liabilities (accounts payable). Business owners can increase cash flow by more prudently managing working capital and more directly managing inventory, accounts receivable, and accounts payable.

Cash is needed for the inventory process, which consists of purchasing raw materials, transforming the raw materials to inventories, and holding the inventories. Reducing inventory allows a company to save cash throughout the entire inventory process. The first step is to stop inventory growth by cancelling or delaying future raw material purchases. The second step is to reduce current inventory by any and all

means possible. During a recession most businesses get caught with high inventory levels and the costs of holding the excess inventory puts a strain on cash flow.

Every collection of a receivable generates cash. A business has numerous options to help generate cash from its receivables. The business owner might elect to sell the receivables for a reduced amount and let someone else collect. Some business owners offer discounts for customers who wish to pay early, and premiums for those customers who are willing to pay for longer pay terms. A good step for any business owner to take is to increase collection procedures for customers who are not paying simply because they do not feel like paying, and to devise a payment strategy for customers who want to pay but do not have the financial resources to do so. Finally, business owners can choose to simply stop selling to customers who are not paying.

Increasing your payables generates cash. By delaying payment to suppliers, a business is utilizing the supplier's working capital to finance the operations of his or her business. A business owner must decide whether a discount for early payment to a supplier is more favorable than extended payment terms. Cash can be saved by negotiating a bigger discount for early payment or negotiating a longer payment term.

This recession will not last forever. Business owners who manage their cash flow by utilizing the business's working capital to increase cash intake and decrease cash outtake will be the ones who not only survive, but will be positioned to succeed in the future. Managing cash flow effectively will afford a business to take advantage of opportunities to grow during and after this recession.

Scott Handwerger, CPA, is a tax manager at Gross, Mendelsohn & Associates, a CPA and management advisory firm, and can be reached at 410.685.5512 or shandwerger@gma-cpa.com.

This article originally appeared in the March 2009 issue of SmartCEO Baltimore.