HOW TO MAINTAIN BUSINESS CASH FLOW

WHITEPAPER

CREDIT KEY

INTRODUCTION

Cash flow management is key to business success. To keep the business up and running, it is imperative to have a cash flow management strategy.

According to the data from the U.S. Bureau of Labor Statistics, about 20% of U.S. small businesses fail within the first year. And by the fifth year over half of the businesses close doors. And after 10 years, only around a third of businesses have survived. The pandemic in 2020 has made it even harder for a lot of small and medium-size businesses to keep functioning.

There are multiple reasons why new businesses fail such as lack of demand for the product or service, poor infrastructure and resources, hiring wrong employees, legal problems, etc.

However, one of the primary reasons for businesses to falter is a lack of cash flow. In fact, most failed startups point to cash flow problems as a central issue. Business owners usually focus on increasing sales, getting more customers, revenue, and retaining goodwill in the market while cash flow management gets pushed to the back burner. The awareness of how to manage cash flow is not always prioritized. In this Whitepaper, we have elucidated multiple cash flow scenarios and we will discuss how you can positively impact the financial standing of your business.

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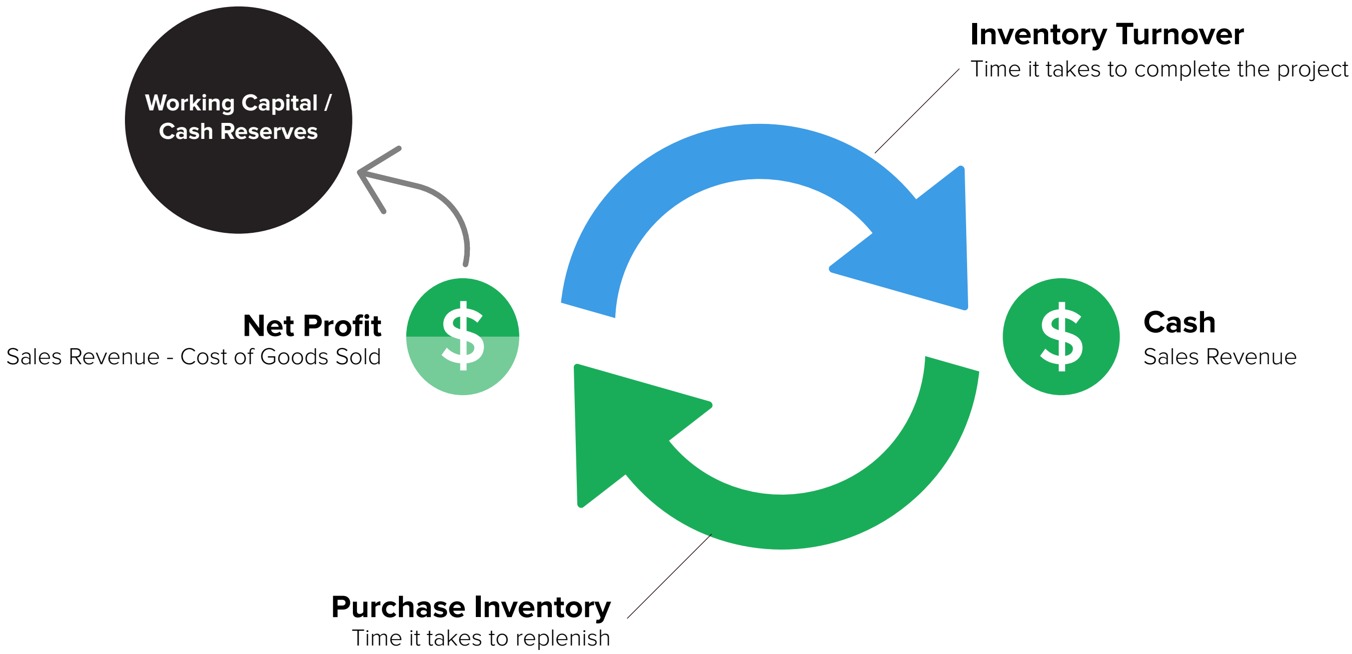
ORDER TO CASH = INVENTORY TURNOVER

Order to Cash = Inventory Turnover

No Extending Credit



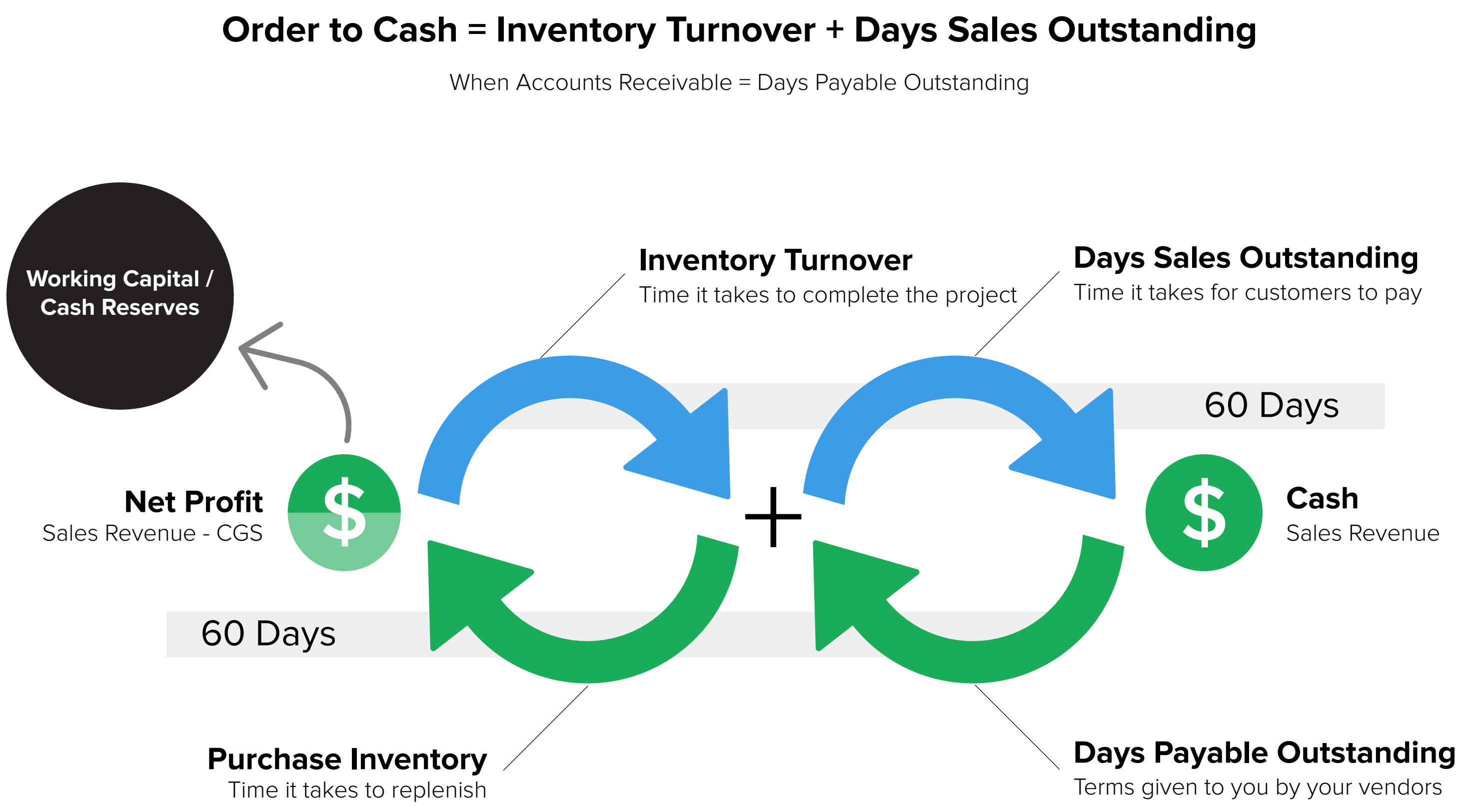
The term **Inventory Turnover** is a measure of the number of times inventory is sold or used in a time period such as a year. It is calculated to see if a business has an excessive inventory in comparison to its sales level.

The goal, especially in a lean organization, would be to limit unnecessary inventory and reorder the inventory to match when current inventory is projected to be out.

In the scenario seen above, it is very simple: make a sale, immediately receive cash, use that cash to pay for the next round of inventory, and take the profits to use as you wish. However, not every transaction is so simple. There are multiple variables that are not factored into.

This scenario above is popular for many B2C companies that only sell directly to the consumer base. Unfortunately, for the majority of B2B businesses, there are other variables that play a role in receiving cash.

ORDER TO CASH = INVENTORY TURNOVER + DSO



The term Days Sales Outstanding or DSO is a metric used by a company to estimate their average collection period. Days payable outstanding or DPO is a company's average payable period. DPO shows how long it takes a company to pay its invoices from suppliers.

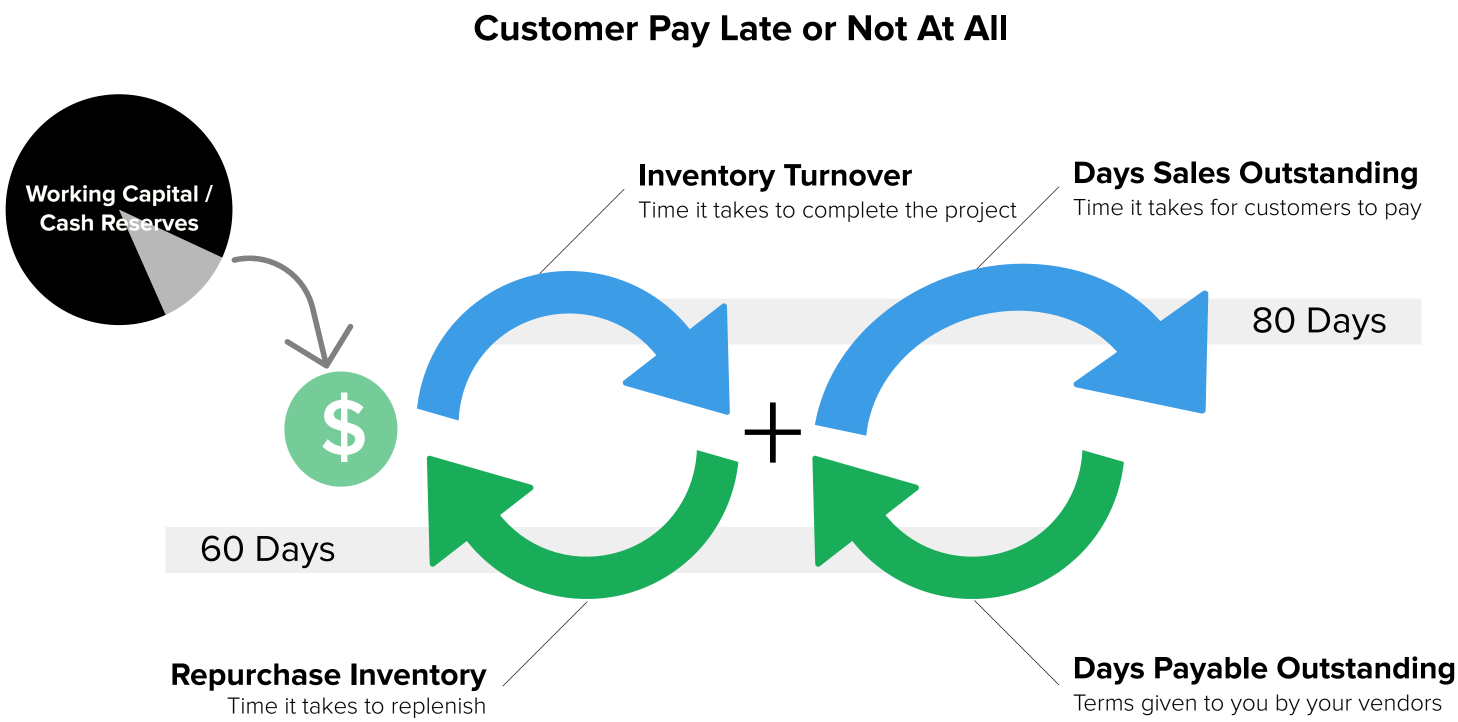
In this scenario, a supplier is extending net 30 terms, and it is taking them 30 days to sell through their inventory. Because an invoice is commonly issued after shipment of the product, the DSO must be added after the inventory turnover making it twice as long as the previous scenario to recognize cash from a sale.

As you can see in the infographic, the process of accounts payable and receivable need to match up so they have the cash on hand to immediately reinvest in new inventory.

The net profit in this scenario would be comparable to the first scenario because no money was lost, it just takes longer to obtain

In a bid to have a steady cash flow, your DSO has to be equal to or less than the days payable outstanding. A business that is low on cash flow cannot repeatedly jeopardize its working capital by offering credit to its customers. Business owners need to factor in that late payments, defaults, or customers that wish for longer payment terms can be temporary or sometimes permanent losses in the cash flow cycle.

WHAT TO DO WHEN CUSTOMER PAYS LATE OR NOT AT ALL



In this scenario, you see what happens when a company pays late. The cycle of reordering inventory is less than the time it takes for you to get paid. Due to the unbalanced nature of this scenario, businesses need to temporarily cover the difference. Common ways businesses cover these costs are through the following ways:

Cash From Reserves

When a business is low on cash flow, a common practice is to pay vendors from the net profits of previous sales / their cash reserves. This is commonly a temporary inconvenience as businesses expect to receive cash soon from the customers that are delayed on their payment. However, owners need to stay alert if this practice becomes repetitive as it severely reduces working capital and can jeopardize the financial health of the business.

Short-Term Loan

Although this option seems like a solution, it does increase the risk for the business owners. Also, this may not be an option for many small or new companies. After taking a low-interest loan to pay off vendors and pay it back when the customer pays. In case a customer does not pay, the business still takes losses from the sale to their customers, while still needs to pay back the bank for the price of the sale - increasing overall financial loss.

Delaying Bill Payment

This approach is frowned upon in the business sector however, based on the customer relationship it may be allowed to do once in a while. This too comes with the great risk of losing company goodwill or losing the relationship altogether or potentially lowering your creditworthiness as a business.

HOW TO MANAGE CASH FLOW

A business might be profitable, but when its cash flow isn't fluid it can't take advantage of key opportunities. While that might seem fine in the short term, lack of cash can hamper real long-term growth. And extending trade credit can exacerbate any cash flow issues a business is experiencing. In fact, a business that is cash strapped likely has trouble extending credit to its customers; after all, it needs to buy raw materials or products for resell to fill orders, which is nearly impossible without having cash on hand or going into debt.

Account receivables create most havoc with cash flow for small businesses. When money is not received on time from the customers, it affects the vendor payments thereby creating an unhealthy financial scenario. To improve the financial health of a business, companies need to have thorough in-house processes to understand when money comes in and when it goes out.

There are multiple ways to minimize DSO and some of the steps are mentioned below:

Customer's Creditworthiness

In an ideal scenario, businesses can extend as much credit to their customers as they can afford. However, it is crucial to make sure to only extend credit to customers you can trust for repayment. Finding a business's creditworthiness should be done before extending credit to them.

Payment Discounts

In a bid to invite customers to pay early or on time, businesses can roll out payment discounts to ensure good customer relationships and healthy financial practices. This process reduces net profit of a sale, but can play a role in lowering DSO.

Clear Guidelines

Reminders and clear guidelines when communicated effectively can make a huge difference in timely payments. For example, instead of using "net 30" companies can use the term "30 days" and witness greater impact in early invoicing.

EIPP

Electronic Invoice Presentment and Payment (EIPP) is a web-based technology that automatically streamlines business processes and transactions through self-service portals, which have proven to shorten invoice collections. It also cuts costs surrounding customer support.

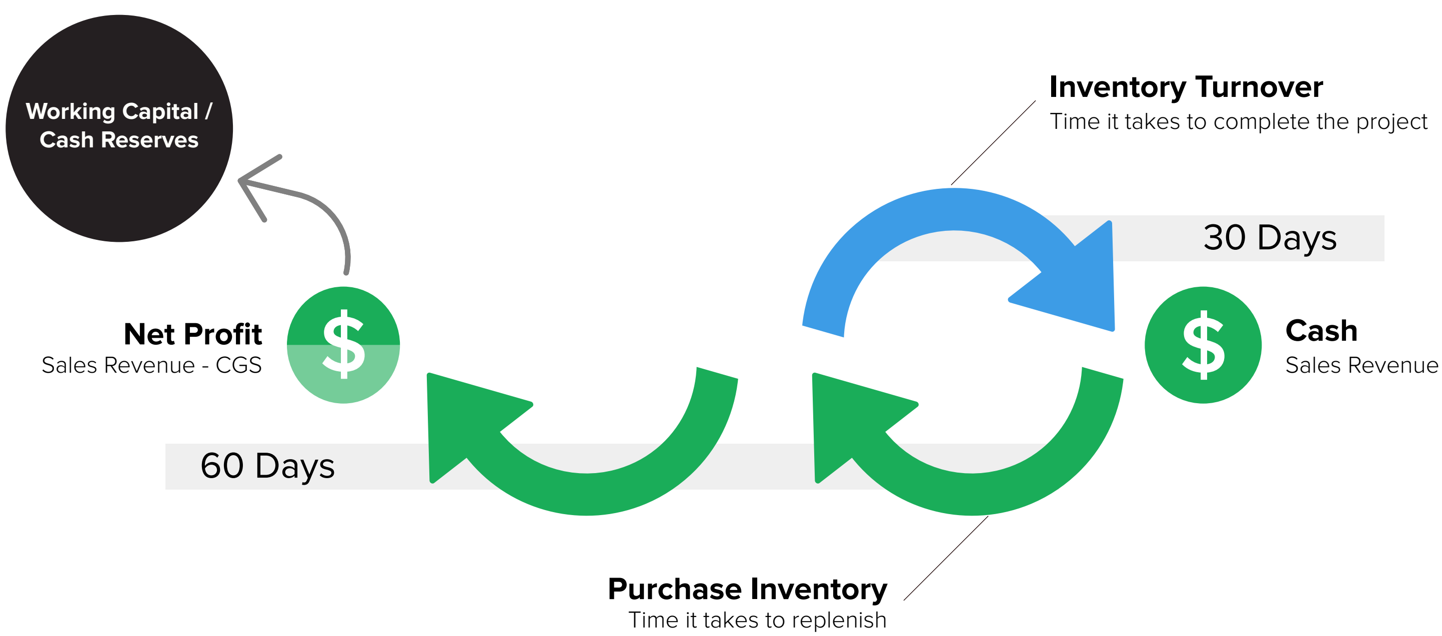
HOW TO CREATE POSITIVE CASH FLOW

The only way to control a business's cash flow is to integrate a third party such as Credit Key into the equation, eliminating the irregularities of B2B payments, as well as the risk associated with lending to a business customer.

When a third party underwrites buyers and the orders they make, each transaction is automatically financed and provides payment to the supplier within 24 hours. In this scenario, the money coming in has no irregularities, allowing a business to have the flexibility to manage its cash and eliminate the possibility of temporary and permanent losses. On top of that, by handing off the risk and underwriting to a third party, a business can drastically decrease the overhead required to manage a credit program. This could include software, human capital, paper expenses and, payment processing as previously discussed.

Order to Cash = Inventory Turnover

No Days Sales outstand, have Days Payable Outstanding



When companies use a third-party underwriter to extend credit, it drastically changes the scenario. Instead of being cash flow equal, or having a slow cash flow, businesses can actively increase cash flow.

This is possible by getting paid immediately on your sales, but yet still having the ability to pay your suppliers in the same net terms they have provided you. This gives businesses an influx of cash per every inventory turnover.

CREDIT KEY

Credit Key allows businesses to extend credit to their business buyers risk-free. Our Buy Now, Pay Later solution offers the ability for you business customers to pay for their purchases in installments up to 12 months, or interest-free for 30 days - and pay you in 1 day.

Buyers that use Credit Key place more orders and often spend more per transaction. Some of the immediate benefits of Credit Key are

- Grow average order value
- Increase order frequency
- Boost sales

Credit Key integrates seamlessly into your order management software or eCommerce platform and approves buyers in instant at the point of purchase.

To set up a demo email at sales@creditkey.com or visit our website www.creditkey.com

CREDIT KEY RESULTS:

Increase in AOV

Increase in Order Frenquency

Increase in Sales