# SEVEN

# If We're Making All This Money, How Come We Never Have Any Cash?



*I can't help from making money, that is all.*

*– Helena Rubenstein*

Buy low, sell high — you think that's a miracle of the obvious? Sure it is; everybody from Exxon peddling liquid gold down to the local junior high PTA peddling cookies at a cake sale knows *that*. Collect early, pay late — you would think that's obvious too. But in twenty-five years of teaching and consulting, I've learned that you can *never* say too much about collect early, pay late — it just doesn't come as naturally to most people. So here's more about collect early, pay late, plus Sam's fish cart, and the difference between profit (on paper) and cash (that you clutch in your hot little hand). After Chapter 7, let's hope that collect early, pay late is also miraculously clear and perfectly obvious.

## PROFIT VS. CASH FLOW, FUNDAMENTALS, AND A FISH STORY

### *Which Is Which?*

If you apply the buy low, sell high maxim successfully, you will eventually report high profits — assuming that you don't let your overhead (and your diddling, too) get out of hand. But reporting high profits has a lot to do with the witchcraft of modern accounting. And sometimes when you're downright brilliant at buying low and selling high, you still run out of cash, which has nothing to do with modern accounting — it just means that there ain't no money in the bank to pay bills. Finding yourself in that embarrassing situation (i.e., telling your creditors your profits are high but you don't have any money to pay them) usually means that you've forgotten to invoke the second part of the maxim (i.e., the collect early, pay late part). Confusing profit with cash flow is easy to do; business

people have been doing it for years, always discovering the differences painfully. Clearing up that confusion and giving you some rules to play by is the purpose of this chapter, so here's Rule One: profit is generated by applying the buy low sell high maxim. Cash flow problems are avoided by invoking the collect early pay late part. This advice is so good you ought to do it in cross-stitch and frame it.


*Who Started All This Trouble Anyhow?*

Way back when life was simple and accounting was counting, there was no real difference between profit and cash flow. Look at this income statement from the year 1911.

**Sam's Fish Cart**
**Took-in, Paid-out**
**(last year)**

| | |
|---|---|
| Fish sold | $10,000 |
| Less: Fish returned | 500 |
| Net fish sold | $ 9,500 |
| Credit given | — |
| Cash taken in (money put in cigar box) | $9,500 |
| Cost of fish (money taken out of cigar box to pay Ben for fish every morning | 6,500 |
| Cost of old newspaper | 50 |
| Money taken out of cigar box to pay cop on corner every Friday | 100 |
| Bills owed | — |
| Taxes owed | — |
| Depreciation claimed | — |
| Profit from fish business | $ 2,850 |





| | | |
|---|---|---|
| Money taken out of cigar box for Sarah (wife) to buy food, clothes, and pay rent ($50/week) | 2,600 | Reconciliation of business profit, cash flow, cash account with family expenses (mine, not Sam's) |
| Money left in cigar box | $250 | |

You see, as long as Sam priced the fish a little higher than he bought them, and as long as he did all his business on a cash basis (even with the cop on Fridays), cash flow was no problem for him. His profit for the year was $2,850, and that was exactly the amount of cash he had accumulated in his cigar box (before he took out the $50 a week his family lived on). Profit was $2,850 and it all wound up as cash in the box. You can't get much simpler than that.

*Enter Credit*

Sam's business flourished, and by sheer dint of hard work, long hours, and a somewhat inelastic demand for fish that year, he increased his sales to $20,000 a year (and Sarah's household allowance to $75 a week). They moved from the lower East Side up to a nice fourth-floor walkup in the South Bronx. He even bought a new push-cart, with an umbrella yet. And since he knew most of the folks in the neighborhood, he began giving them credit, letting them pay him when they drew their money on Fridays. Most paid on time, a few didn't.

At the end of 1912, Sam got out his stubby pencil and prepared another income statement that looked something like this:

**Sam's Seafood Company**
**Sales and Expenses**
**1912**

| | | |
|---|---|---|
| Fish sold | | $20,000 |
| Less: Fish returned | | 1,000 |
| Net fish sold | | $19,000 |
| Credit given | $4,000 | |
| Credit paid | $3,000 | |

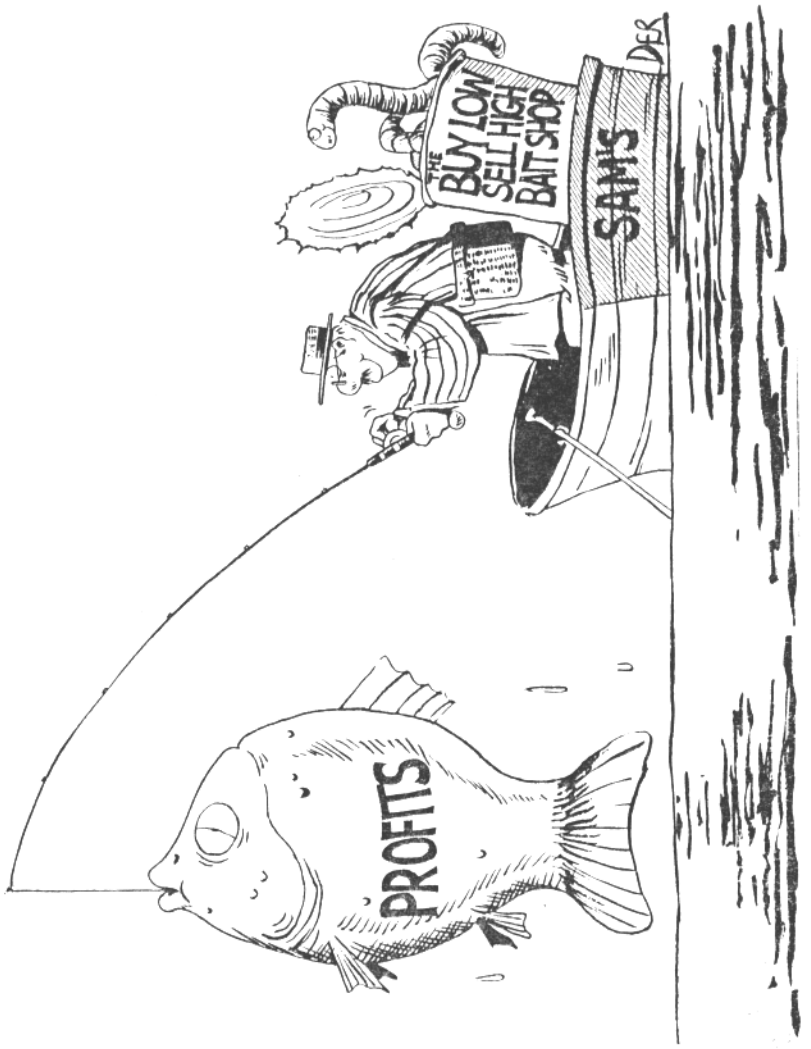
| | |
|---|---|
| Credit owed | 1,000 |
| Cash taken in (money put in cigar box) | $18,000 |
| Cost of fish (money taken out of cigar box to pay Ben for fish every morning | 13,000 |
| Cost of old newspaper | 100 |
| New pushcart (incl. unbrella) | 700 |
| Money taken out of cigar box to pay cop on corner every Friday | 200 |
| Bills owed | — |
| Taxes owed | — |
| Depreciation claimed | — |
| Profit from fish business | $ 4,000 |

| | | |
|---|---|---|
| Money taken out of cigar box for Sarah (wife) to buy food, clothes, and pay rent ($75/week) | 3,900 | Reconciliation of business profit, cash flow, and cash account with family expenses (mine, not Sam's) |
| Money left in cigar box | $100 | |

*Enter Morris Schwartz, Accountant*

Sam was no financial wizard. He knew a lot about whiting, pike, and flounder but zip about accounting; he puzzled quite a bit over his situation. Business was terrific, so why was there still only $100 in the cigar box at the end of the year? Yes, business was twice as good but Sam was nearly out of money. "Oh," he said one day, "I got it! It's the money those miserable customers owe me for the fish. That's it." Now Sam was smart, and he began to realize he needed a financial consultant to help him keep track of this growingly complex fish business, so he made a mental note to do something about it next year. In the meantime Sam worked longer hours, sold more fish, traded in his old pushcart on a new bicycle-pedaled pushcart for $900 difference (with an umbrella, of course), and gave more folks more credit. Some paid, more didn't. Sam also raised Sarah's household allowance to $90 a week and promised





Sarah that, if things continued as well as they were now, he would take her to Atlantic City for a week in August (a slow month for fish). Sarah was pleased, Sam was pleased, and Sam's credit customers were pleased (he didn't have much time to collect, and besides he trusted people).

The year finally came to an end and Sam was puzzled again. In the last few weeks, there had been two instances when there was not enough money in the cigar box to pay Ben for the fish. Ben had let it go with a wave of the hand but had suggested that Sam get Morris Schwartz, Accountant, to help him "get his affairs straight." Sam was beginning to realize that he needed help, and Ben's suggestion did the trick for him. He called Morris, who came by the cart, asked Sam a lot of questions, took the cigar box and the receipts in it, and told Sam he'd be back in a week. Sam pedaled on that morning, feeling better about the whole thing. True to his word, Morris Schwartz, Accountant, returned in a week and gave Sam (1) a bill for $200 and (2) these two neatly typed statements.

**Mr. Samuel Moss, Fish Retailer**
**Income Statement**
**Calendar Year 1913**

| | | |
|---|---|---|
| Fish sold | | $30,000.00 |
| Less: Fish returned | | 1,500.00 |
| Net fish sold | | $28,500.00 |
| Expenses | | |
| Supplies for resale | $19,500.00 | |
| Wrapping supplies | 150.00 | |
| Local protection consultant | 300.00 | |
| Accounting services | 200.00 | |
| Depreciation on fixed assets | 320.00 | |
| Total expenses | | 20,470.00 |
| Net profit | | $ 8,030.00 |





**Mr. Samuel Moss, Fish Retailer**
**Balance Sheet**
**December 31, 1913**

| | | | |
|---|---|---|---|
| **Assets** | | | |
| Current Assets | | | |
| Cash | $ 50.00 | | |
| Receivables | 6,000.00 | | |
| Inventory | 100.00 | | |
| Total current assets | | $6,150.00 | |
| Fixed assets | | | |
| Transportation equipment | 1,600.00 | | |
| Less: Accumulated depreciation | −320.00 | | |
| Total fixed assets | | $1,280.00 | |
| Total Assets | | | $7,430.00 |
| **Liabilities** | | | |
| Trade account payable | 1,000.00 | | |
| Federal income taxes due | 630.00 | | |
| Professional services due | 200.00 | | |
| Total liabilities | | | $1,830.00 |
| **Owners' Equity** | | | |
| Capital account | | | |
| Contributed capital | 100.00 | | |
| Retained earnings | 5,500.00 | | |
| Total owners' equity | | | $5,600.00 |

"Sam," said Morris, "you are to be congratulated. You have built a nice fish busine you made a hell of a nice profit last year — over $8,000. And your balance sheet is strong — nearly $6,000 of equity. Oh, Sam, as soon as you think of it, let me have the $200 for the accounting work, OK?"

Sam was less sanguine about his financial position. "Morris," he said, "you are an educated man. You know how to cipher numbers real good, and you looked at my cigar box for a whole week. How come if I'm doing so

well and made over $8,000 in the fish business. I owe Ben $1,000, I ain't been able to pay Sarah the house money for two weeks, and I now owe you $200 and the United States Government over $600?" Morris thought for a moment carefully. "Sam," he said, "it's complicated but I'll lay it out for you nice and simple:

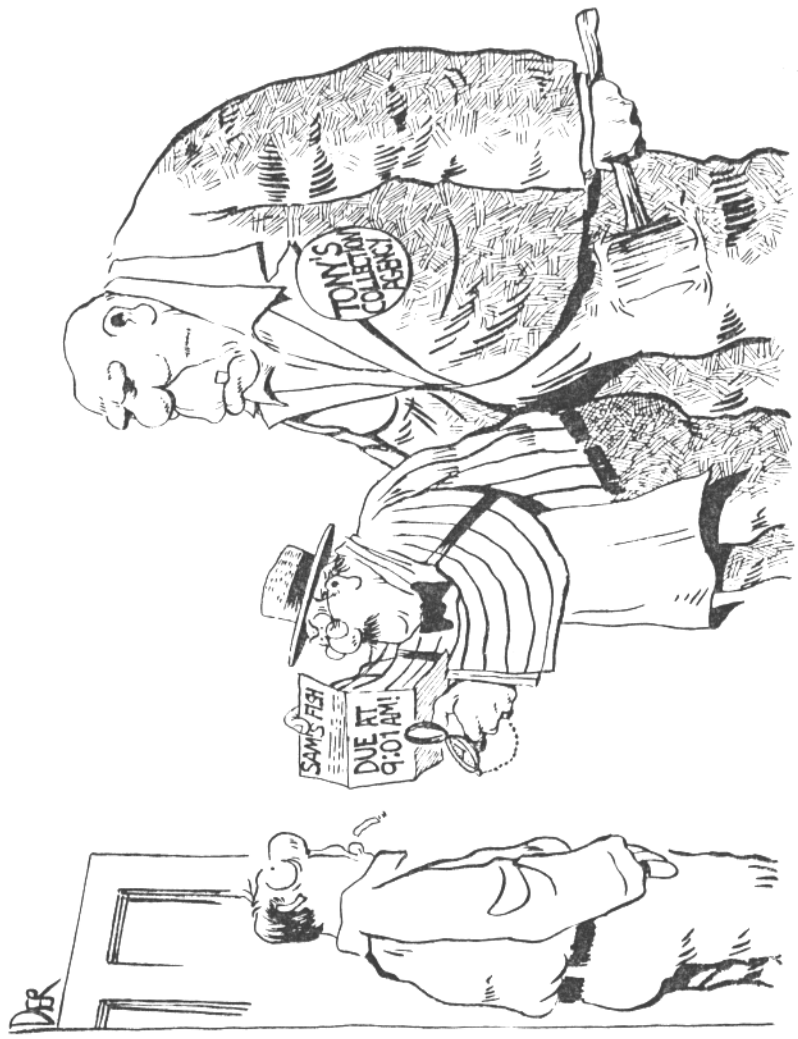
1. I recognized your income on the accrual basis for last year; all the big companies are doing it now, and it makes for a more descriptive set of books, especially now that you are granting credit to your customers.
2. As your business grows and makes more money you need to make provisions for supplying the additional capital it needs. Sam, you are undercapitalized, that's all there is to it.
3. You had not depreciated your assets like you should, so I set up your transportation equipment on a five-year life using straight-line depreciation, with no salvage value.
4. And, Sam, the U.S. Government has just passed what they call an income tax. That's right — they now take a certain percentage of everything you make. I have shown that as a current liability."

Sam was now deflated. Not to mention depressed. "Morris," he said, "I look to you for help. What do I need to do to stay in the fish business? It's the only thing I know." Morris answered with great deliberation, "I think you need to go down to the bank and borrow some money, Sam."

*Sam and Morris, Reprise*

Sam didn't take Morris Schwartz's advice. Instead he went to see his friend Tony. "Tony," he said, "I got this problem with folks who don't pay me for the fish, and it's killin' me. I hear that you deal in collections." Tony (who looked something like a Coca-Cola machine with a head on it) said, "Not to worry, Sam old man. You just give me a dime on the dollar of everything I collect, and I'll take care of your problem right away." Sam knew a good deal when he saw one, and in a month Sam had money in the cigar box again, Ben was all paid off, and Sarah was happy now that her allowance was fully paid up and was looking forward to





the Atlantic City trip in August. Sam put Morris's bill for $200 in the cigar box and promptly forgot about it. Morris waited till the end of the year (fiscal year, of course), then wrote it off as uncollectible. After twenty-five years, Sam owned the largest fish store in the Fulton fish market. He sold only for cash. Morris Schwartz worked upstairs in Sam's place as a bookkeeper — grade IV.

*Buchwald, My Hero*

Thinking about Sam's fish cart reminds me of my favorite Art Buchwald story . . .

Dalinsky's Drug Store in Georgetown decides to merge with Fischetti's Meat Market in Bethesda. Dalinsky and Fischetti can't agree on which name to use, so they call the company The Great American Drug and Meat Company. A stock offering is immediately sold out.

They take over the Aetna Curtain Company, Markay Life Insurance Company, Mary Smith Pie and Bakery Company, Winston Life Preserver Company, Washington Green Sox Baseball Club, the Norfolk (basketball) Warriors, and a bank, another bank, a mutual fund, a fried chicken franchise company, and so forth. In less than three years, their original $55 investment has provided $50 million apiece on paper and control of $3 billion worth of business.

Buchwald concludes, "The only danger is that if either Dalinsky's Drug Store or Fischetti's Meat Market loses the lease on its store, the whole conglomerate pyramid could fall down. When you get right down to it, that's the only part of their business that Dalinsky and Fischetti understand."

## DOING IT WITHOUT THE CIGAR BOX

*What Makes It Complicated*

To understand in your gut the difference between profit and cash flow, first you've got to understand three things: (1) the accrual method of recognizing income, (2) the effect





of collection lags, and (3) the cash flow effect of depreciation expense. Nothing to it once you've got those three. A word about each in turn.

*Number One:* As Sam found out from Morris, it *has* become the practice to recognize income on the accrual basis, that is, to count as income anything you bill — for income statement purposes at least. Therefore, as soon as you send out an invoice, your accountant generally reflects that as income this month. But since it has not yet been collected, he carries it on the balance sheet as a receivable. Theoretically, it is possible under an accrual system to sell on credit all year, collect nothing, and still show normal profits. In practice, of course, this would be ridiculous, since normal credit terms generate payment within a month. In theory, though, it's possible. For this reason, you must *never* confuse profit with cash. *Profit* is what your accountant ciphers up using rules he has been trained to use in common with everybody else in the accounting industry. *Cash*, on the other hand, is what is left in your cigar box. There's a difference. How big the difference is depends partly on . . .

*Number Two:* The longer it takes you to collect your bills, the worse your cash situation becomes — and all the merry while you may be making a profit (figured on the accrual basis, of course). If your customers take three months to pay you, then you have a three-month lag between billing and receipt. During this time, of course, your suppliers all want their money, your employees expect to get paid every week, and you need to take something out of the cigar box to live on too. Since you can't pay these folks or yourself with receivables (until they are collected), you experience a cash shortage — the old cash flow problem. The longer you let your customers lag their payments from the time you bill them, the worse your cash flow problem becomes. Unless your balance sheet is unusually healthy, or unless you are unusually rich, you can't play the lagged collections game very long before you're in deep trouble. Banks are not in the business of lending money to folks who never collect their own bills. And, besides, the interest cost would soon eat up your profits, even the paper profits

reported on the accrual basis. If you do collect your bills within a reasonable time, however, banks (and other financial institutions) *will* lend you money on your receivables. But even *with* this financing source, excessively long collection lags will eventually bankrupt you.

### *How Much Is That Worth in Dollars?*

Listen, even financial institutions sometimes get collect early, pay late backwards. One such lending institution in my neck of the woods got its liquidities all screwed up and found itself the possessor of a ten-year-old apartment complex with a thirty-year note, which it desperately wanted to get off its books in a hell of a hurry. The lender let it be known in the community that sealed bids would be taken from prospective purchasers; bids should include both price and terms.

A few of us who invest in Chapel Hill real estate figured that the project was worth at least $1,400,000 but decided to play the collect early, pay late game with the savings and loan. We put in a bid for $1,100,000 with the entire note to be paid off within two years. The other bidders (and there were three more) all put in bids near $1,400,000, but with terms ranging from twenty to thirty years. The savings and loan sold us the building. It was simple. They were OK as far as profits were concerned, and since they had foreclosed on the building for a bit more than their mortgage, they didn't stand to lose money. What they did need was *liquidity*. They needed to show that the old mortgage would be wiped clean from the books and fast! We were only too happy to oblige them with our modestly low bid. What happened after the two years? Knew you'd ask that. We converted the building to condos and sold it out for nearly $2,400,000. Had to carry the mortgages ourselves, though.

*Number Three:* The third element in the cash flow game is depreciation. As we pointed out in earlier chapters, depreciation is a *noncash* expense. That is, you never write a check to anybody for "depreciation." Therefore, when we are thinking about cash flow, we recognize that depreciation expense never "left the company cigar box" as Sam's payments for fish did. For that reason, to find our cash position, we *add depreciation back* to whatever figure our books show as profit. After all, if depreciation expense was deducted to calculate profit and if it was not real money paid to anybody, then in a sense it's still here. OK?





### *Revealing Numbers*

Look at this example involving all three elements, the accrual method of recognizing income, lagged collections, and depreciation:

| | | |
|---|---|---|
| Sales billed (this month) | | $1,000,000 |
| Collections (this month — includes money billed in previous months) | | 900,000 |
| Expenses (includes $50,000 of depreciation | | 850,000 |
| Profits this month (before tax) $1,000,000 sales – $850,000 expense | = | 150,000 |
| $900,000 collected – $800,000 cash payments | = | $100,000 |

OK, that's $150,000 profit on paper and $100,000 in the old cigar box. You seem quite comfortable with that one, so let's complicate it a bit. It's fashionable to refer to "after-tax cash flow" these days. All that means is "what's in the cigar box after you pay Uncle Sam." So here we go with a tax example:

| | | |
|---|---|---|
| Sales billed (this month) | | $1,000,000 |
| Collections (this month — includes money billed in previous months) | | 900,000 |
| Expenses (includes $50,000 of depreciation | | 850,000 |
| Profits this month (before tax): $1,000,000 sales – $850,000 expense | = | 150,000 |
| Taxes (our tax rate here is 40%) | | 60,000 |

After-tax profit:

| | | |
|---|---|---|
| $150,000 − $60,000 | = | 90,000 |

After-tax cash:

| | | |
|---|---|---|
| $900,000 collected − 800,000 cash payments − $60,000 tax paid | = | 40,000 |

Want to check it just to be sure? Easily done with the two-cigar-box method, watch:

| In Cigar Box | | Out Cigar Box | |
|---|---|---|---|
| Collections | $900,000 | Expenses (net of depreciation) | $800,000 |
| | | Taxes paid | +60,000 |
| Total in | $900,000 | Total out | $860,000 |

In — Out = $40,000 (see, it *does* match up)

See how easy it really is once you get the whole thing arranged in a simple, orderly format? Sam the fishman would love it!

Speaking of fishmen, the contractor who built my cottage down at the coast is named R.T. R.T. has a five-person carpentry crew consisting of Pap (R.T.'s eighty-year-old father), Otis (R.T.'s brother-in-law), Harry (a preacher from Marshallberg), Benny (R.T.'s son-in-law), and Jimmy Noel (the foreman, who doesn't seem to be related to anyone as far as I know). What does R.T. do? As near as anybody can tell, he signs contracts for the construction work and fishes. You can imagine from that job description that R.T. tends to be somewhat lax in his cash flow practices.

Last summer I asked R.T. if he would build us a half-bath under the house to cut down on the distance from the beach to the john (great when you get to be my age and cuts down on sand in the house too). Well, R.T. sent the "boys" by, and I drew the outline in the sand for them. (They don't build with plans.) A week later the bath was





finished. Weeks, then months went by, but no R.T. and no bill. Finally, just last week I got a bill from R.T. for the job, almost a year after he did the work. R.T. is reputed to be Salter Path, North Carolina's most affluent citizen, and you know it's true if he can afford lagging his collections by a year.

If you ask me, I think it has to do with Helen, R.T.'s wife. Helen is into accounting, cash flow, and all those progressive things. She runs a very profitable gift shop in Salter Path — you know, buy very low, sell very high. Helen doesn't give credit to anyone. I think Helen's cash flow supports R.T.'s fishin' and laggin'. The contracting business? Oh, that's a family welfare operation — has nothing to do with business!

### *Combinations*

Profits and cash flow can go in some funny directions, depending on how fast you collect accounts, how much depreciation you take, and how well you control costs in your business. There are four possible combinations of cash flow and profit that we need to look at, situations where

1. There is both profit and cash (hallelujah!).
2. There is profit but no cash (cold comfort).
3. There is cash but no profit (O.K. for a while).
4. There is no profit and no cash (wailing and gnashing of teeth).

The accompanying diagram illustrates each of these situations and has notes on it to help you find your way around.

What was that you said? You like Sam the fishman's cigar-box system better? Can't say I blame you, but these are the four outcomes that *can* happen and you'd best be able to recognize them — before they happen to you, please!

## On Paper and in Your Pocket — Four Ways

| Profit and Cash | | Profit but No Cash | |
|---|---|---|---|
| Sales billed this month | $120,000 | Sales billed this month | $120,000 |
| Collections this month | 115,000 | Collections this month | 95,000 |
| Expenses (incl. $10,000 depreciation) | 110,000 | Expenses (incl. $15,000 depreciation) | 115,000 |
| Profit this month (before taxes) | 10,000 | Profit this month (before taxes) | 5,000 |
| Taxes (we are paying 40%) | 4,000 | Taxes (we are paying 40%) | 2,000 |
| After-tax profit: $120,000 − $110,000 − $4,000 = | 6,000 | After-tax profit: $120,000 − $115,000 − $2,000 = | 3,000 |
| After-tax cash: $115,000 − $100,000 (cash payments) − $4,000 = | 11,000 | After-tax cash: $95,000 − $100,000 (cash payments) − $2,000 = | −7,000 |
| **Cash but No Profit** | | **No Profit, No Cash** | |
| Sales billed this month | $120,000 | Sales billed this month | $120,000 |
| Collections this month* | 125,000 | Collections this month | 90,000 |
| Expenses (incl. $20,000 depreciation)† | 130,000 | Expenses (incl. $20,000 depreciation) | 130,000 |
| Profit this month (before taxes) | −10,000 | Profit this month (before taxes) | −10,000 |
| Taxes (we are paying 40%) | 0 | Taxes (we are paying 40%) | 0 |
| After-tax profit: $120,000 − $130,000 = | −10,000 | After-tax profit: $120,000 − $130,000 = | −10,000 |
| After-tax cash: $125,000 − $110,000 = (cash payments) | 15,000 | After-tax cash: $90,000 − $110,000 = (cash payments) | −20,000 |

*A near miracle, appears about as often as Haley's comet.
†Probably spent all his time collecting instead of watching costs.



## WHY WORRY ABOUT CASH

*Checklist*

Under the no free lunch doctrine, even though it's a lot of work looking after cash flow (for someone, if not for R.T.), paying attention to cash has tremendous benefits for businesses. Here is a quick and dirty list of reasons you should get into the cash forecasting business in *your* company (unless it's a cover-up for a gift shop, that is). Find a couple that suit you and come on in.

1. Knowing what the cash situation is and is likely to be avoids embarrassment — for instance, having to tell those lies like "the check is in the mail." No one, especially bankers, likes it when you run out of money.
2. During hard times, if you know what your cash level is going to be and therefore what your cash needs will be, you can borrow exactly what you need and no more, thereby minimizing interest. With interest rates as high as they have been, minimizing interest should appeal to most folks (not counting R.T.).
3. Walking into the bank with a cash forecast impresses the hell out of bankers. It really does. We teach them all this fancy stuff in MBA programs; then they go out and find hardly anybody who does it the way we taught it. So when you walk in with your cash needs all ciphered up so neat and pretty, they go out of their MBA minds. Listen to this story.

I have this friend, Ritchie, a botany professor, who decided to open a bicycle shop a few years ago. He went down to see Gordon, one of our local bankers, and requested a loan of $75,000. Gordon asked Ritchie for his pro formas (you know, his future income statements, balance sheets, and cash forecasts — all nicely typed columns and rows from here to eternity). "Pro-what?" said Ritchie. "Pro formas," said Gordon, "can't lend you any money without them. Essential for business success, an absolute must." A distraught Ritchie dropped by my office later that day and told his tale. I dragged my PORTACOM computer terminal out from under the desk and dialed up our local time-sharing service on the phone. What do these bikes cost, Ritchie? "About $70." And what will they average at retail? "About $165." And what will you spend a month, and what will be your average collection lag, . . . and so on for a

dozen other questions he quickly answered. In five minutes using a PRO FORMA program I had written, I had Ritchie three imposing pages of computer output containing pro forma income statements, balance sheets, and cash budgets by quarter for five years. Full of wild cost and market assumptions to be sure, but neat, precise, and orderly to the letter. Ritchie went back to the bank the next week, and when he showed Gordon the pro formas Gordon nearly died. "Now this is what I call a real business plan!" says Gordon. Horse manure — bad times came on the bicycle business in a year and Ritchie lost his ass. No, sorry, make that half his ass — Gordon paid for the other half.

4. Working up future cash needs avoids surprises. It lets you worry about cash needs at a time when you've got your wits together and not in one hectic horrible moment when somebody tells you that you've just run out. Most of us think better with a little advance notice. Thinking about cash needs is no exception.
5. It is difficult going into the bank just after you've bounced a big one. Your banker doesn't like it at all. It sort of cuts the hell out of your negotiating advantage vis-à-vis amount to be borrowed, interest rate, and repayment schedule. When you show up to cover one, you show up hat in hand and you take whatever terms your banker wants to give you. When you show up two months ahead of time, you can be a real cool dude — turn down the first two offers of terms and still have time to negotiate some more. But never when he knows *why* you're in the bank so early this morning.

## PUTTING THE COLLECT EARLY, PAY LATE ROUTINE INTO PRACTICE

### *More Lists*

Collecting early and paying late is a mindset you need to develop. Business schools don't teach it; banks don't teach it; lawyers don't teach it — accountants don't even understand it. Nope, like skiing, like sex, like flying, you have to experience it to get the hang of it, and the more you do it, the easier it is. That's the reward. But the best incentive is pain. Try running out of cash before you run out of your good ideas once or twice — that will make a





real believer out of you. OK, so if you've had enough sex, skiing, and flying to develop your mindset, here's another quick and dirty list of ways to implement the collect early, pay late routine.

1. Always pay on time, right on time. Not one damn day early! Mail your bills out so they are postmarked on the last possible day before penalties accrue. Never, never pay early. Once more with feeling: never pay anything early, unless you get one hell of a big discount.
2. Make sure discounts offered to you are worth taking. Cipher up the discount and compare it with the cost of the money you are using to pay it. If it ain't a bargain, make them wait for their money to the very last moment.
3. Don't save up deposits. Make daily deposits to your bank so that the balance is maximized all the time. Dead cash helps no one, least of all you.
4. Consider using a money market arrangement that lets you write large checks on it while it pays you the maximum interest all the while. This is not the same as using some savings account that pays a paltry rate of interest. This is a method for earning money market interest rates on everything. Also, the float is usually longer with these funds. Write all the checks you can here, they take longer to clear.
5. Don't let your banker wrassle you into compensating balances. You know who these balances compensate? The banker, not you. If he lends you money, it's your money, dammit, and yours to use the way you want, too. Compensating balances should have gone out with corsets and stays.
6. Bill customers every day; bill them as soon as you finish up the work. Arrange to bill them when the materials are delivered to the job site before work begins. Never let unbilled work accumulate. Be just like the guy who owns the gas station near the race track in Rock Hill, South Carolina. He sells about 7,500 gallons of gas daily, all for cash, and gets ten days' payment terms from his gasoline supplier. Hell, he is one of the few folks I know who *makes* money off his inventory.
7. Spend a lot of time collecting. It's a simple matter of asking people to pay you the money they owe you. Call folks up and tell them you will be in their area this afternoon and would like to stop by to pick up the check. Rebill ten days after the first bill if you haven't received payment. All the

hundreds of studies that have been done over the last fifty years on collection practices come up with the same finding: the more times you ask for it, the more you get. Ask, ask, and keep asking.

8. Collect by telephone. And don't call without having your spiel all worked out. Be ready to counter any and all possible objections with alternatives of your own. Always pause a few seconds after you have identified yourself; it puts the ball in the customer's court and may provoke an explanation right away. Have counterproposals ready on the tip of your tongue (e.g., "Well, can you let me have a check for half of it if I come by in an hour?"). Concessions like that. Make the customer commit to a repayment plan: if it's not today, then next week, but make him commit. Get to his guilt feelings and let them motivate his commitment to you.
9. Make it profitable for customers to pay you on time or even early. Write it into the contracts you negotiate with them from the very beginning to give it legitimacy. Give discounts for quick payment, and make them attractive. After all, you can add 2 or 3% to the cost of work you do for other folks and they tend not to complain; but when they are chronically late paying you, it puts you out of business.
10. Run a check on checks you write to your ten largest suppliers. Watch for a couple of months to see how long it takes from the time you write the checks until they hit your bank. Develop different check-writing rules for different suppliers; for instance, for the ones that take longer to process checks, mail them theirs later. After all, you can always negotiate an overdraft agreement with your banker on an "as-needed" basis. In the meantime, if your suppliers are obviously inefficient with cash flow, go ahead and capitalize on it.
11. Work up a simple system for estimating cash that will be coming in and cash that will go out in the months ahead; teach someone in your office to use it and demand that they keep it up to date. Rely on it, make your cash judgments based on the information it contains, and think of your cash flow projections as being just as useful as your income statement or balance sheet.
12. Make certain any cash on hand but not needed is invested wisely. If you're not into money market funds with check-writing privileges, then make certain you know the simple definitions and rules of the other short-term investments open to you. In case you don't, here is a short primer on that subject. (Information current as of 1982.)





Investments That Bear Interest

a. Negotiable certificates of deposit are time deposits at a commercial bank; the interest rate for certificates of deposit less than $100,000 is controlled (limited) by the Federal Reserve System, but for any deposit larger than $100,000, the interest rate is negotiable. Maturities range from a month to a year.
b. Commercial paper is short-term promissory notes issued by industrial concerns, finance companies, and the like; examples are Commercial Credit Company and General Motors Acceptance Corporation. Interest rates on commercial paper are higher than rates on U.S. Treasury bills and maturities generally range from a month to nine months. Financial rating organizations like Moody's and Standard & Poor assign safety ratings to most commercial paper.
c. Treasury bills are obligations of the U.S. government and mature in a year or less; generally a new issue of bills is sold each week; these can be purchased through your bank (at issue) or through your broker (at any time); maturities can be from a few days up to a year. Usual minimum amount sold at issue is $10,000.
d. Treasury notes are similar to Treasury bills except that maturities range from two months to seven years.
e. U.S. government agency securities generally offer higher interest rates because some of them carry only the "implicit" guarantee of the government; government agencies that offer these securities include those shown in the accompanying table.

| Agency | Maturity | Minimum Denomination | Guaranteed by U.S. Gov't. | State and Local Tax |
|---|---|---|---|---|
| Banks for Cooperatives | 2 wks. to 2½ yrs. | $5,000 | No | Exempt |
| Export-Import Bank | 6 mos. to 5 yrs. | $5,000 | Yes | Not exempt |
| Farmers Home Administration | 6 mos. to 15 yrs. | $25,000 | Yes | Not exempt |
| Federal Financing Bank | 8 mos. | $10,000 | Yes | Exempt |
| Federal Home Loan Bank | 1 wk. to 10 yrs. | $10,000 | No | Exempt |
| Federal Intermediate Credit Bank | 2 wks. to 3 yrs. | $5,000 | No | Exempt |
| Federal Land Bank | 2 mos. to 9 yrs. | $1,000 | No | Exempt |

(Table Continued)

| Agency | Maturity | Minimum Denomination | Guaranteed by U.S. Gov't. | State and Local Tax |
|---|---|---|---|---|
| Federal National Mortgage Assoc. | 3 wks. to 18 yrs. | varies $1,000 to $10,000 | No | Not exempt |
| Gov't. National Mortgage Assoc. (participations) | 30 mos. to 14 yrs. | $5,000 | Yes | Not exempt |
| Gov't. National Mortgage Assoc. (pass-throughs) | about 30 yrs. | $25,000 | Yes | Not exempt |

Which, of course, brings us to the final section of this chapter — how to use a system for estimating cash sources and cash needs in your business.

## AN UP-TO-DATE TWO-CIGAR-BOX CASH SYSTEM

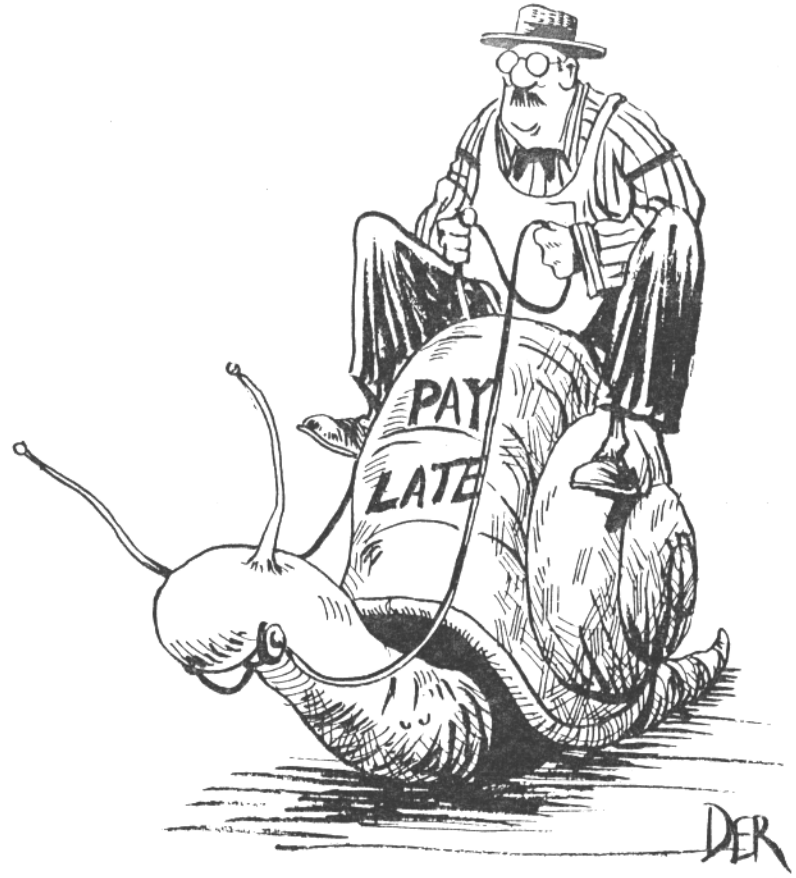
*They All Give the Same Answer*

I care not which cash system you use — which system is the eleventh on a list of three things that you worry about when it comes to cash. The point is only that you pick a system you understand, one that fits the needs of your particular business, one you can teach someone else to use, and one that has a high probability of being kept up. Understandable, appropriate, teachable, useful. Nothing else really counts.

There are at last count more than 611,413 different cash systems to keep track of cash (in and out, you know). I have my favorites, and I'm sure you have yours. The one my friends seem to keep using was designed originally by my friend John of Raleigh, N.C., himself an astute businessman and very successful consultant. John's system has gone through about twelve different versions with eight variations on each (that's more than Paganini ever








dreamed of), and here comes the final version, all gussied up ready for your inspection.

*John is John, What Else Can You Say*

Friend John believes in maximum leverage on his balance sheet; therefore, it is consistent that he also believes in and strives to maintain nearly zero cash balances. In point of fact, John likes to end the month with about $2,000 in the bank, which for a $5 million company is not bad at all.

**John's Twelve-Month Cash Flow Projection**

| 1. Item | JUN | JUL | AUG | SEPT |
|---|---|---|---|---|
| 2. Beginning cash balance (without borrowing) | 40,480 | 21,334 | 26,585 | 11,618 |
| 3. Projected profits (before taxes) | 3,259 | 5,959 | 5,741 | 7,560 |
| 4. Taxes (income) | (9,697) | 0 | 0 | (7,478) |
| 5. Depreciation | 1,400 | 1,400 | 1,400 | 1,400 |
| 6. Capital expenditures | (3,000) | 0 | 0 | (6,000) |
| 7. Notes payable | (12,108) | (2,108) | (12,108) | (2,108) |
| 8. Change in accounts receivable | 1,000 | 0 | 0 | (4,000) |
| 9. Change in inventory | 0 | 0 | 0 | 0 |
| 10. Other | 0 | 0 | (10,000) | (10,000) |
| 11. Cash balance in checking account (without borrowing) | 21,334 | 26,585 | 11,618 | (9,008) |
| 12. Balance of any interim loans (total) | 0 | − 0 | 0 | 11,008 |
| 13. Balance on investment | 19,334 | 24,585 | 9,618 | 0 |
| 14. Final balance in checking account (with borrowing) | 2,000 | 2,000 | 2,000 | 2,000 |

(Are you listening, John?) Perhaps the best way to introduce this system is to show it to you and then review the parts one by one in case these need a bit of clarification or explanation. So here goes.

*Legend*

*Row 2:* The beginning cash balance for the month; also, of course, the ending cash balance for the month immediately preceding (unless you robbed a bank between the thirty-first and the first).

*Row 3:* Projected before-tax profits for the coming twelve months. True, it's only an educated guess, and only last year's financial statements are precise, but as we pointed out in Chapter 2, that precision is often an illusion of certainty too. So do your best and make a pro-





| OCT | NOV | DEC | JAN | FEB | MAR | APR | MAY |
|---|---|---|---|---|---|---|---|
| (9,008) | (6,776) | (3,765) | (28,731) | (25,587) | (17,293) | (518) | 12,639 |
| 5,940 | 6,719 | 11,801 | 10,852 | 12,002 | 8,810 | 5,865 | 4,720 |
| 0 | 0 | (10,059) | 0 | 0 | (17,327) | 0 | 0 |
| 1,400 | 1,400 | 1,400 | 1,400 | 1,400 | 1,400 | 1,400 | 1,400 |
| 0 | 0 | 0 | (3,000) | 0 | 0 | 0 | 0 |
| (2,108) | (2,108) | (2,108) | (2,108) | (2,108) | (2,108) | (2,108) | (2,108) |
| (3,000) | (3,000) | (20,000) | (4,000) | (3,000) | 20,000 | 8,000 | 8,000 |
| 0 | 0 | (6,000) | 0 | 0 | 6,000 | 0 | 0 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (6,776) | (3,765) | (28,731) | (25,587) | (17,293) | (518) | 12,639 | 24,651 |
| | | | John's maximum loan | | | | |
| 8,776 | 5,765 | 30,731 | 27,587 | 19,293 | 2,518 | 0 | 0 |
| 0 | 0 | 0 | 0 | 0 | 0 | 10,639 | 22,651 |
| 2,000 | 2,000 | 2,000 | 2,000 | 2,000 | 2,000 | 2,000 | 2,000 |

jection — otherwise go into the ministry; or there is always the government.

*Row 4:* Quarterly income tax payments that will be due (that is, if your profit guesstimates come out true, too). Since this is a cash outflow, it is shown in parentheses. If a loss is projected and a refund is expected, this is shown on row 4 (without parentheses, silly).

*Row 5:* Depreciation. As we've said any number of times already, since depreciation is counted as an expense for figuring profits (line 3), but since it isn't actually paid out to anyone, it is a noncash expense and is added back here.

*Row 6:* Capital expenditures. Thought you'd never ask how you pay for things you buy when you never count depreciation as a cash expense. Well here it is! Whenever you plan to buy a piece of equipment, you indicate so in

this row under the appropriate month (in parentheses since this is an outflow). If the $3,000 in this row under June represents only the down payment on the machine, then the other payments would be entered in the appropriate columns later in the year, and the interest would already have been deducted from the profit figure in row 3.

*Row 7:* Notes payable. Here you enter payments that you are obligated to make on notes owed, both principal *and* interest. After all, cash is cash and that's what the noteholder wants to get paid with. (Interest has already been deducted to figure profits.) Notice again, notes payable is in parentheses — that's the official cash-out notation.

*Row 8:* Change in accounts receivable. Ah, here's a brand-new wrinkle! Anytime you want to give folks more credit, that takes money — your money — thus it's a use of cash (i.e., you get less). And anytime you *reduce* the amount of your receivables, you generate cash (i.e., you get more). The row 8 entry for June indicates that accounts receivable have been reduced by $1,000 (no parentheses); you got that much from collections. In September, we intend to *increase* accounts receivable by $4,000. Matter of fact, September begins John's busy credit season; he gives more then. Remember to use parentheses in September.

*Row 9:* Use the same treatment for inventory that you did for accounts receivable. Whenever you intend to increase inventory, show the amount in parentheses, indicating a use of cash. Whenever you intend to bring inventories down, show that in row 9 without parentheses, since it's cash coming in. The zeros in this row all the way across until December show that John's inventory will remain constant until December; at that time he will add to it by $6,000. In parentheses, of course.

*Row 10:* Other.* This is sort of like a miscellaneous row where you can enter any use of cash you may anticipate or any source of cash you like. The two $10,000

*If your accounts payable tend to vary significantly from month to month, then you'd add another row to handle that.





entries in August and September indicate John's plan to take $20,000 out of the business during those two months. (He must be going somewhere — R&R.)

### *Checking and Savings, Just Like Down Home*

Rows 11 through 14 show John how to keep up with what's in the checking account, what he has to invest, and what he needs to borrow. A few words about each of these rows in turn, then over to you.

*Row 11:* This is his checking account balance, the cash balance if you please. How did we get it? Simple, we just added up rows 1 through 10 algebraically — you know, letting the pluses and minuses cancel each other. This row is the sum. After all, if you start with your cash balance at the beginning of the month (row 1) and then add and subtract everything you put in and took out, it would be weird if the answer didn't come out to be what you had left at the end of the month, wouldn't it? Cash systems aren't weird, and I wouldn't do that to you.

*Row 12:* Loans outstanding are shown in row 12. John tells us that he does not anticipate any loans during June, July, and August, but the negative beginning cash balance projected for September 1 of ($9,008) will require a loan of that amount plus $2,000 (if he wants to end the month with a $2,000 positive cash balance). Remember, he's the financial cowboy who does $5 million of business on a $2,000 ending cash balance.

*Row 13:* Here we keep track of the cash we have invested (not in the bank account). Row 13 always has a positive entry in it whenever the cash balance in the checking account (row 11) is larger than the final target $2,000 balance in the checking account. Putting it another way, when more than $2,000 is in cash forecast, everything over $2,000 is invested for that month. This row shows how much it will be.

*Row 14:* This is John's target balance in his checking account, always $2,000 as his goal.

OK, there you have it, a simple way to keep up with your cash. One that can be learned quickly, taught easily, used lovingly, and long remembered by all. What did you say — you like the two-cigar-box approach to the collect early, pay late routine? Oh hell, so do I. (Where'd we park the fish cart anyway?)