

The cash-flow crunch

Big firms are dragging their feet on payables, taking as long as 60 days to settle up, and creating new problems for entrepreneurs

BY MOST ACCOUNTS, business at 5 Stones Group couldn't be better. The film production company, based in Columbus, Ohio, boasts big-name clients like Canon, recently opened a satellite office in New York City, and just completed its most high-profile job yet—filming cyclist Lance Armstrong as he led the Tour of Hope, a charitable drive for cancer research sponsored by Bristol-Myers Squibb. But the company faces one big problem—getting paid on time.

In 5 Stones' contracts, the terms couldn't be spelled out more clearly: The company is to receive one-third up front, one-third mid-project, and the remainder upon completion. The idea, says the firm's president, Mike Edwards, is to ensure the company maintains a steady stream of cash. "Cash flow is critical," he says. "If the client says that a payment will be made next Friday, you have to call next Friday. You have to continually track payments." Unfortunately, his customers aren't always cooperative. It's not uncommon for a 5 Stones crew to show up for a job only to find that the person who writes the checks has decided to stay home. When it comes time to collect the final invoice, clients quibble about when the clock began on the 30-day payment period. Or they balk at paying expenses included in the bill. In the meantime, 5 Stones has its own bills to pay, and the money has to come from somewhere—usually from credit cards or one of the two lines of credit the company has, says Edwards's wife, Tiffany, who manages the company's finances. "Do you go after them, and be faced with not getting repeat business?" she asks. "Our stance so far is that we want the relationship more than the terms. We've given in."

Sound familiar? More companies, especially large corporations that contract with smaller vendors, are dragging their feet on payables. Or they're dictating less favorable terms. Earlier this year, REL Consultancy Group surveyed 1,000 of the largest U.S. corporations on their working capital situation and

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found that the percentage of firms paying more slowly than they did the year before rose from 46% in 2003 to 56% in 2004, while the share of sectors lagging in payables jumped to 65% from 45%. "More companies are pushing on payables," says Andrew Ashby, president of REL Americas.

It's easy to understand what's going on. In a competitive economy, all companies, large and small, are looking at ways to make more of their cash, and for many, that means holding on to it longer. According to Ashby, the 30-day payment period is fast becoming a thing of the past, with many large companies instead paying in 45 or even 60 days. Those vendors that want—or need—to be paid more quickly, he says, increasingly have no choice but to offer discounts in exchange for speedy payment. "There's a lot of pressure on reducing costs, and discount terms are a way of taking out costs," Ashby says.

By consolidating vendors and demanding more favorable terms, large corporations are experiencing an improvement in working capital and liquidity, according to the REL survey. That's sure to make their shareholders happy. But for entrepreneurs already squeezed by rising energy and health care costs, the consequences of the trend can be dire. A mid-September survey of small companies by American Express found that 49% had cash-flow concerns, the largest of which was accounts receivable. In fact, 9% of companies surveyed worried that their cash-flow troubles were bad enough to hamper their abilities to win new business. Indeed, no company can continue to expand if it lacks a steady stream of

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funds to fuel that growth. "If the money is coming in the front door at 100 miles per hour, and going out the back door at 110 miles per hour, that's not a good thing," says Brian Hamilton, chief executive of Sageworks, a financial research firm in Raleigh, N.C., and the former CFO of an Inc. 500 company. "Businesses don't fail because they are unprofitable; they fail because they get crushed on the accounts receivable side."

The solution, of course, is either to put the brakes on growth (no entrepreneur's first choice) or to get a grip on the cash flow (see "Surviving the Squeeze," this page). Randy Ringer, managing partner of Verse Group, a two-year-old branding company based in New York City, wrote his business plan on the assumption that clients would pay their bills in about 30 days. When he learned that it often took

Surviving the squeeze

Longer payment periods don't have to be cash-flow killers. These five steps can help you get payments moving smoothly again.

- 1 Increase your reserves.** Boost your line of credit before you're desperate for the cash. Keep at least three months' worth of cash on hand so you won't be caught short.
- 2 Make some rules.** Do you need payment in 30 days? Or can you manage 45? What happens to clients who don't pay on time? Will they be subject to late fees? The more you've thought about billing terms, and possible billing problems, the better you'll be able to deal with issues when they arise.
- 3 Babysit payments.** If you don't ask, you won't get—and you certainly won't get quickly. Get to know your clients' accounts payable people, and as soon as your payment is one day past due, make sure they know it.
- 4 Stand by your terms.** If clients try to change terms unilaterally, call them on it. If you agree to slower payments, determine how much it will cost you—and raise your own rates to cover the cost.
- 5 Offer discounts for early payment.** Sometimes it pays to provide incentives for customers to pay ahead of schedule. Discounts can sting, but there's nothing more valuable than cash in hand.

twice as long, he and his partner went back to the drawing board and revised their business plan. Verse Group now keeps six months' worth of cash on hand, rather than the three months' it originally planned on. That's helped Ringer ride out the slower payments without having to borrow. The company also instituted a policy of prebilling on jobs that require substantial up-front costs in order to get the cash coming in quicker. Lagging receivables, Ringer says, "have changed how we do business."

Mitch Miller, president of Dynamic Computer Solutions of Topeka, a computer systems integrator with nearly \$3 million in revenue, took a different approach when a handful of his longstanding customers recently attempted to switch from 20 days payable (his standard terms) to 45. Fighting with his clients, Miller realized, would be futile. Instead, he looked at what he needed to do to keep the business profitable and wound up raising

his rates by a few percentage points. In fact, the higher prices have more than offset the costs associated with later payments. And though some clients grumbled, none have left. "You have to be bold," Miller says.

Indeed, while conventional wisdom holds that the large clients hold all the cards, you probably have more bargaining power than you think. According to Ashby, when a number of his corporate clients sent notices announcing that they were changing payment terms from 30 to 45 days, only a handful of vendors bothered to call and complain. Those that did were often able to get the old terms reinstated, he says. "Business owners overstate the constraints," adds Brian Hamilton. "People don't understand that they are not going to lose clients over a stringent accounts receivable policy."

—Amy Feldman

Resources For "10 Absolutely Must-Follow Cash Flow Rules" go to inc.com/resources/finance/articles/20040901/10rules.htm. For more in-depth tactics and advice, check out the book *Essentials of Credit, Collections and Accounts Receivable* by Mary S. Schaeffer.