Creditor-Customer Collaboration Crucial in Small Business Cash Flow Management

Starting and maintaining a small business is no easy feat. Roughly half of all start-ups fail within the first five years with only one-third of them surpassing a decade, according to 2017 data released by the U.S. Small Business Administration's Office of Advocacy. Once the doors open, the mindset of owners and operators may shift to sales and marketing, leaving cash flow management on the back-burner.

Watching how small businesses manage cash flow is part of making any reasonable, sound credit decision. In offering guidance to small businesses, credit professionals emphasize the importance of proper cash flow management and why it should be achieved prior to seeking additional funding.

Small businesses—no more than 500 employees—that are failing and heading toward bankruptcy pose "a huge problem" for credit managers, said Credit & Financial Development Division (CFDD) member Chris Montross, CBF. With about six million new businesses starting every year and then only 800,000 of them filing for bankruptcy, the remaining businesses are closing their doors. Creditors can be part of the solution by actively engaging with customers.

"It's something that we have to be conscious of. The No. 1 reason why these businesses are failing is because they're undercapitalized," Montross said. "We need to look at how to direct them to make sure they're managing cash flow a lot better and what we should be looking out for when trying to grant [credit] to somebody who's a brand-new business or a small business that doesn't have that longevity."

The first step is simple: communicate. Have customers share their business plans and dive into how they're managing their accounts receivable. In some cases, creditors might recognize entrepreneurs who are overachievers and display exorbitant amounts of self-confidence. They think they know anything and everything about business operations; meanwhile, Montross said, they don't have a person(s) dedicated to handling the financials.

Although medium, or even large, businesses might have a staff to manage accounts receivable, Montross said small businesses typically only have one or two employees whose main job is to manage cash flow. Both the creditor and customer should ask themselves, "How does cash coming in compare to cash going out?" At the very least, he said, businesses should shoot for neutral cash flow.

"Most entrepreneurs are really great marketers and sellers, but they're not always great business managers," Montross said. "For the accounts receivable portion of it, making sure they've got good cash flow is really important. … Without a healthy cash flow, small businesses end up over-leveraging their vendors and/or won't get that additional capital to continue to advance their operations."

It comes back to asking more questions and ensuring the small businesses are operating efficiently. Making sure business owners understand their total cost of entry and can cover the costs of their ongoing business needs, such as maintaining inventory, rent and payroll, are critical to their longevity and solvency. Credit professionals should be willing to share their knowledge with small businesses to ensure a mutually beneficial relationship. Sharing best practices on credit applications, terms and collection efforts can help small businesses improve their accounts receivable, which in turn makes it more likely the creditor will get paid timely.

One thing creditors should avoid, though, is granting extended terms to unproven business entities. An increasing amount of small businesses are negotiating, or sometimes demanding, longer payment terms, said Val Hardesty, CCE, CICP, a director of credit. Hardesty, also a CFDD member, said she understands it's a way for businesses to hold on to their cash a little longer, but it's something creditors, like herself, are trying to "stand up against."

Sometimes, a creditor's guidance is a must, even if the customer doesn't want it, she added. For example, she said, a customer might improperly manage their inventory by ordering more than they're selling. This creates a disrupted cash flow, which backfires when it's time for the customer to pay back the creditor.

"Order what you need, convert it quickly and then you'll have the cash," Hardesty said, because you don't want the customer's payment slipping further and further past due.

-Andrew Michaels, editorial associate