

# The 1% Cash Flow Solution

*Small Changes that Make a Big Difference*

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# 1. Price Increase

- Company annual sales: \$1M.
- Raise prices 1% across the board.
- \$10,000 additional profits!

*Analyze pricing for all services and products*

## 2. Sales Volume Increase

- If sales volume increases 1%, then gross profit and net profit increase by gross profit margin  $\times$  sales volume increase.
- Current sales: \$1,000,000. Gross Profit Margin: 60%.
- Increase in Gross and Net Profit:  $\$1,000,000 \times 1\% \times .60 = \$6,000$

*Sell more*

### 3. Cost of Goods Sold Reduction

- If cost of goods sold are cut by 1%, then gross and net profit increase by the 1% reduction of current COGS.
- Cost of Goods Sold: \$400,000.
- Increase in Gross and Net Profit:  $1\% \times \$400,000 = \$4,000$ .

*Negotiate better prices with suppliers*

## 4. Overhead Reduction

- If overhead costs are reduced by 1%, then net profit will increase by 1% of total overhead cost.
- Overhead: \$450,000.
- Increase in Net Profit:  $1\% \times \$450,000 = \$4,500$ .

*Analyze expenses monthly*

# Profit $\neq$ Cash

**Profit and Loss**

	January	Feb.	March
<b>SALES</b>	\$20,000	\$30,000	\$45,000
<b>COGS</b>	\$12,000	\$18,000	\$27,000
<b>GROSS PROFIT</b>	\$8,000	\$12,000	\$18,000
<b>EXPEN-SES</b>	\$10,000	\$10,000	\$10,000
<b>NET PROFIT</b>	(\$2,000)	\$2,000	\$8,000

**Cash Flow**

	January	Feb.	March
<b>START CASH</b>	<b>\$10,000</b>	\$0	(\$22,000)
<b>CASH IN</b>	\$0	\$0	\$20,000
<b>CASH OUT</b>	(\$10,000)	(\$22,000)	(\$28,000)
<b>END CASH</b>	\$0	(\$22,000)	<b>(\$30,000)</b>

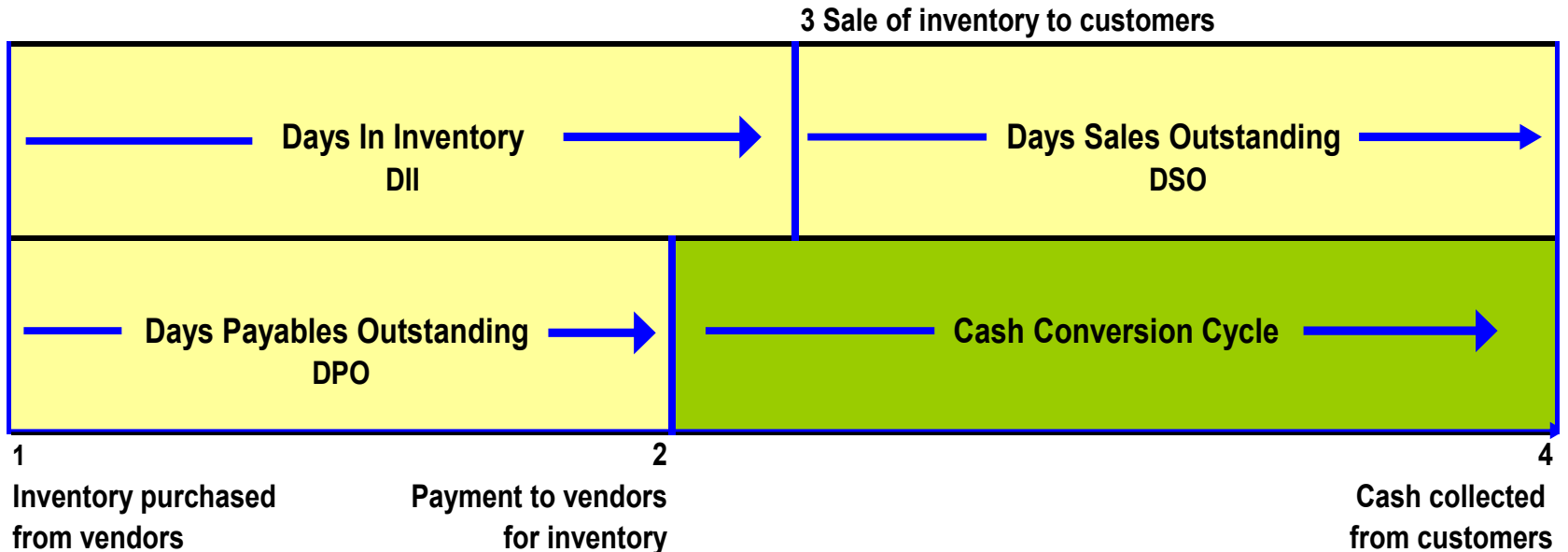
**Assumptions:**

Company starts with \$10,000 cash.

Company pays vendors in 30 days.

Company collects from customers in 60 days.

# Cash Conversion Cycle



Cash Conversion Cycle = Time from paying vendors to collecting from customers

Cash Conversion Cycle =  $DII + DSO - DPO$

**GOAL: Minimize Cash Conversion Cycle**

1. Increase DPO (move line 2 to right - take longer to pay vendors)
2. Decrease DSO (move line 4 to left - collect faster from customers)
3. Decrease DII (move line 3 to left - sell inventory faster)

## 5. Days Sales Outstanding Decrease

### Days Sales Outstanding (DSO)

DSO = 360 Days / Accounts Receivable Turnover

DSO = 360 Days / (Annual Sales / Accounts Receivable)

- DSO is the average time it takes a company to collect cash on credit sales.
- If DSO is reduced by 1 day, then cash flow would increase by 1 Day x (Annualized Sales / 360).
- $1 \times (\$1,000,000 / 360) = \$2,778$

Average Daily Sales

*Collect Faster*



# Tactics to Reduce DSO

- Ask customers for deposits.
- Ask customers to pay sooner. For example: Net 15 instead of Net 30.
- Provide discounts to customers who pay on time or in advance. For example: 2%; Net 15.
- Invoice faster.
- Friendly reminders before deadline that payments are due. For example: 5 days before due date.
- For recurring invoices, obtain credit card authorization from customers to automate on-time payments.
- Improve communication with customers. Understand why your customers are paying late.

## 6. Days In Inventory Decrease

### Days In Inventory (DII)

DII = 360 Days/Inventory Turnover

DII = 360 Days/(Costs of Goods Sold/Inventory)

- DII is the average time it takes a company to turn over their inventory.
- If DII is reduced by 1 day, then cash flow would increase by  $1 \times (\text{Annualized COGS}/360)$ .
- $1 \times (\$400,000/360) = \$1,111$

Average Daily Purchases

*Reduce Inventory*

# 7. Days Payable Outstanding Increase

## Days Payable Outstanding (DPO)

DPO = 360 Days/Accounts Payable Turnover

DPO = 360 Days/(Costs of Goods Sold/Accounts Payable)

- DPO is the average time a company takes to pay trade invoices.
- If DPO is increased by 1 day, then cash flow would increase by 1 x (Annualized COGS/360).
- $1 \times (\$400,000/360) = \$1,111$   
Average Daily Payments

*Take full advantage of payment terms*

# 1% and 1 Day Solution Worksheet

## Seven Levers to Improve Cash Flow: The 1%/One Day Solution

Enter data in green cells

LEVER	LEVER DESCRIPTION	SOLUTION		APPLICATION	ANNUAL IMPACT ON CASH FLOW	
1	Price Increase %	1%	x	Annualized Sales	\$10,000	
2	Volume Increase %	1%	x	Annualized Sales x GPM	\$6,000	
3	COGS Reduction %	1%	x	Annualized COGS	\$4,000	
4	Overhead Reduction %	1%	x	Annualized Overhead	\$4,500	
5	DSO Reduction Days	1	x	Annualized Sales/360	\$2,778	
6	DII Reduction Days	1	x	Annualized COGS/360	\$1,111	
7	DPO Increase Days	1	x	Annualized Purchases/360	\$1,111	
<b>TOTAL ANNUAL IMPACT ON CASH FLOW:</b>					<b>\$29,500</b>	<b>2.95% of Sales</b>

Assumptions		
Sales	1,000,000	100%
COGS	400,000	40%
Gross Profit	600,000	60%
Overhead	450,000	45%
Net Income	150,000	15%

**Company Name**  
**Q1 Budget**

Year	January		February		March		Q1 Total		% of Revenue	
	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual
Total Revenue							0	0	100%	100%
Cost of Goods Sold							0	0	0%	0%
<b>Gross Profit</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>100%</b>	<b>100%</b>

Advertising & Marketing							0	0	0%	0%
Credit Card Merchant Fee							0	0	0%	0%
Dues & Subscriptions							0	0	0%	0%
Insurance - Business							0	0	0%	0%
Licenses & Taxes							0	0	0%	0%
Payroll & Payroll Taxes							0	0	0%	0%
Professional Development							0	0	0%	0%
Professional Fees							0	0	0%	0%
Rent							0	0	0%	0%
Repairs & Maintenance							0	0	0%	0%
Supplies							0	0	0%	0%
Telephone							0	0	0%	0%
Travel							0	0	0%	0%
Utilities							0	0	0%	0%
<b>Total Expenses</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0%</b>	<b>0%</b>

<b>Net Operating Profit</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>100%</b>	<b>100%</b>
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Capital Expenditures							0		0.0%	0.0%
Debt Service (Principal & Interest)							0		0.0%	0.0%

<b>Net Cash Flow</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>100%</b>	<b>100%</b>
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