Cash is King or Inventory in Four Part Harmony

***By:* Randy Johnston, Executive Vice President, K2 Enterprises**

In tough times, businesses are more likely to pay attention to the fundamentals. Watching cash flow, focusing on customer service, taking care of employees, improving business processes and managing inventory can all make your business stronger. We have all heard that "cash is king", and cash certainly helps a business weather bad storms. Where can you get cash? Sales, collection of receivables, and reducing inventory are all key ways to drive cash back into the business. Cutting expenses is another method of preserving cash, but I don't believe you can cut your way to profitability. I'm from the school of controlling unneeded expenses from the start. What is one of the quickest ways to get cash? Better inventory management!

Managing Cash and Profitability with Inventory Management – One of the best things you can do for your business is to manage inventory better than you are today. Certainly automating your inventory control with software like Dynamics is a plus. However, besides automation, you need a strategy to follow. Specifically, what you are trying to accomplish is: to drive down the average days in inventory while driving up your gross profit. Consider the following grid:

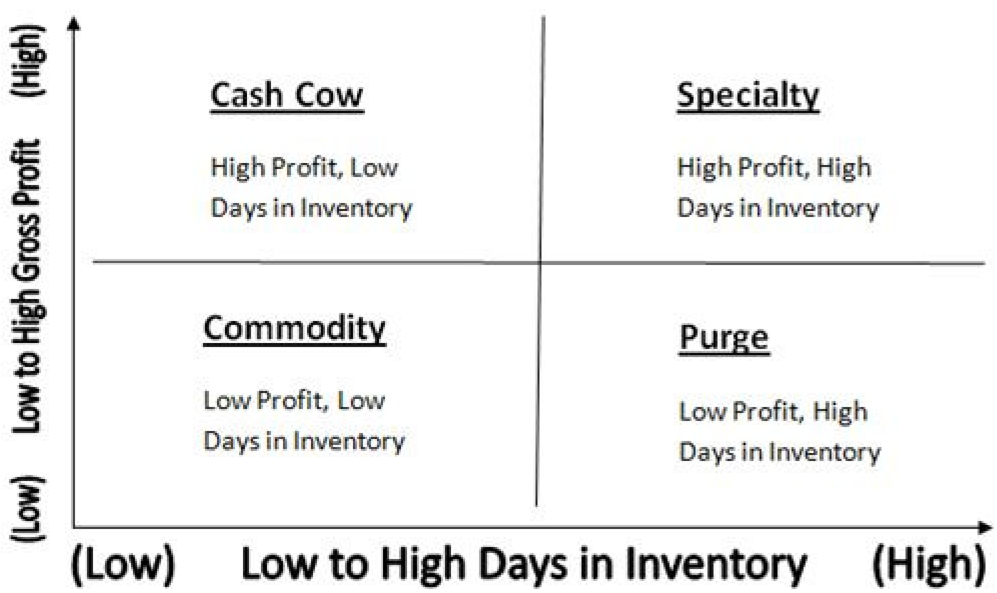

Figure 1

Strategies for Inventory Management – When you consider the four categories of inventory: Cash Cow, Specialty, Commodity, and Purge, it gives you a quick way to think about what has to be done to manage the inventory in each of these categories. You may not be able to make these changes immediately, but the result will be much better management of your inventory. Consider the following ways of managing your inventories based on these categories:

Type of Inventory	Strategy
Cash Cow	1. Look at more opportunities in this category 2. Consider raising prices 3. Make sure you stay in stock, but don't overstock
Specialty	1. Lower Inventory 2. Consider special fees for your expertise 3. The key goals is to lower days in inventory
Commodity	1. Raise price 2. Consider cost and profitability of remaining in this line of business
Purge	1. Don't be emotionally involved 2. Dispose of inventory in this category at almost any cost. You'll feel better. 3. Consider abandoning this line of business

Figure 2

Your accounting software can help you with this effort if you decide managing by type of inventory is a good business strategy. You can simply flag items that fall in these main areas of operations with inventory classifications or flags. Key things you have to be able to manage are the types of inventory, the average days in stock, the amount of inventory left in that category, and the fill rate.

All but fill rate can be reported from your inventory system. Your backorder rate can be determined with appropriate inventory reporting. The goal is to not have 100% fill rate, but a rate that is acceptable to the business. You may need information from your sales team and a CRM system to determine the fill rate on products requested that you did not have at all. More importantly, what you are trying to watch with fill rate is when that customer went somewhere else to buy, resulting in lost business or declines in customer satisfaction. If the customer wound up ordering from you and waiting for the product, then not having the product in stock was OK, and you can see this information from backorder reports in inventory. This also means that the customer thought of you as more of a specialty supplier, and was willing to wait for you based on your value, uniqueness of offering or some other factor.

Cash is King – Besides the inventory strategy outlined above, managing cash can mean staying in business or failing. Consider the following methods of increasing or maintaining cash:
1) Lean inventory as outlined above is one good way to manage cash.
2) Do not take on new lines unless on consignment with full return privileges.
3) Take deposits before ordering for customers.
4) Sell gift cards. Understand you may have some extra reporting to do in some jurisdictions, but gift cards generate cash.
5) Pay down debt whenever possible.
6) Shorten terms and collect AR sooner.
7) Delay payments to suppliers. To insure rapid product flow, you may not want to string suppliers along, because many will note that you have slowed payments, and may be less apt to provide products that you need to generate profits.
8) Put off large capital expenditures.

Prepare for Better Times – Although many of the strategies we have outlined should be used to manage your business most of the time, there are additional things that can help your business that will consume some time and cash. If your business is slow right now, consider the following activities to build a better future:

1) Review and improve your internal procedures.
2) Train your staff.
3) Focus on customer service.
4) Build expertise in an evolving market.
5) Sell additional services and products to your current customers or installed base.
6) Market to new segments that you have not served before.
7) Focus on beating the competition, gaining market share now, so when demand increases, you will be a supplier of choice.
8) Rebuild your infrastructure while times are slower, so you will be ready to scale up quickly when demand increases.

If you choose the items that you believe will help your business and focus on these items alone, you will find that your business will become stronger, and better able to serve your customers.

Mr. Johnston is a shareholder in K2 Enterprises, where he develops and presents technology-related continuing professional education programs to accounting and finance professionals across the United States.