How You Can Preserve Cash Flow to Strengthen Business in a Slowing Economy

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Use good cash flow management to succeed in any economic condition.

The lifeblood of any organization, operating capital is one of the key factors that keep companies running in both smooth and challenging economic conditions. When a distributor has cash flow, it can make payroll, pay its suppliers, keep the lights on and even manage the unexpected costs of running a business. Without this financial cushion, companies quickly find themselves operating invoice to invoice, and pulling resources from one area to cover expenses in another.

With the national economic recovery in its 10th year, wholesale distributors may have forgotten what it takes to keep the lights on and the wheels running in a more challenging selling environment. Despite industry disruptors like Amazon Business, geopolitical issues such as trade wars, and a massive uptick in business-to-business e-commerce, wholesalers have been posting healthy year-over-year sales growth.

Distributors saw their top-line revenue numbers and profits grow in 2018, according to the National Association of Wholesaler-Distributors' most recent State of the Industry report. Most segments of the industry experienced record-high levels of activity. In total, the industry reached a record-high $6.01 trillion in sales for 2018 (up 7.5% from 2017), and now comprises 29% of the U.S. gross domestic product. Based on various earnings reports and quarterly announcements, 2019 will be a year of similar results.

But there's a wind of change in the air. Unlike other post-recession years, 2020 brings some uncertainty with it. By the second half of 2019, for example, some economists and analysts were predicting a downturn within the next 12-24 months. NAW was also picking up on some "slowing growth" occurring in the industry. This braking was expected to last through 2019 and into early 2020.

"The current 12-month growth rate (12/12 rate-of-change) is 7.5%," NAW states, "but the quarterly growth rate is a smaller 4.7%, confirming that the industry is on the back side of the business cycle."

This is one of several signs that distributors can use to prepare ahead. As part of that preparation, companies can carefully examine their cash flow positions and take the necessary steps to build and/or retain those reserves. In this white paper, we explore the current business environment, show how it could evolve over the next year or two and provide actionable advice that all companies can use to preserve cash flow in any economic condition.

125 Months of Positive Growth

Since emerging from the grips of the Great Recession in 2009, the U.S. economy has been in growth mode. After contracting sharply in the Great Recession, the economy began growing in mid-2009, following enactment of the financial stabilization bill (Troubled Asset Relief Program or TARP) and the American Recovery and Reinvestment Act.

Economic growth has averaged 2.3% annually since then, with growth reaching above 3.5% during several quarters and just two quarters of negative growth. Through November 2019, the U.S. economy has grown for 125 months without any significant decline in economic activity that would mark the beginning of a recession, according to the National Bureau of Economic Research. This puts the current expansion as the longest on record in NBER dating, which goes back to the 1850s.

But all economies are cyclical, which means at least some level of downturn is likely lurking around the next corner. The distributors that take this into account now, and that examine and shore up their cash flows sooner rather than later, will be in the best position to ride out the storm and even come out stronger.

In the mid-2000s, very few companies followed this advice the last time around. By the time the recession took its toll on work pipelines, available capital and new projects, many companies had to scramble to cover payroll, pay their bills and keep the lights on. Far-reaching and long-lasting, the recession claimed numerous victims on many different fronts. Wholesale distributors weren't immune, and many of them either had to dramatically scale back their operations or go out of business entirely.

Companies are now in the midst of a presidential election year, impacted by as-yet unresolved trade wars (and the resultant tariffs), international issues like Brexit and the early signs of a softening U.S. economic cycle. Concurrently, the yield curve, confidence indexes, employment data, the Fed's recession probability model and the Leading Economic Index (LEI) were all beginning to flash "yellow" at the end of 2019, with each revealing some potential for a downturn in the next 1-2 years.

Sentiment among American consumers and businesses remains historically elevated, Bankrate reports, but did begin to dip in early 2019. Bankrate credits the tariff wars and trade tensions with creating at least some of that uncertainty. "Consumer confidence remains historically elevated, though it tumbled in early 2019 as a result of the lengthy government shutdown. It's since recovered and held stable."

8 Ways to Preserve Cash Flow

The total amount of money received and doled out over a given period (usually a quarter), cash flow can either be positive or negative. Positive cash flow indicates that a company's liquid assets are increasing, enabling it to settle debts, reinvest in its business, return money to shareholders, pay expenses and provide a buffer against future financial challenges.

Companies with strong financial flexibility can take advantage of profitable investments. They also fare better in downturns, by avoiding the costs of financial distress. Once the money going in and out of the business has been calculated, companies can come up with a "free cash flow" number or FCF. This is the money that the distributor has left over to expand the business or return to shareholders, after paying dividends, buying back stock, or paying off debt.

Because they effectively bridge the gap between manufacturers who make products and the end user customers that need those goods, wholesale distributors can find themselves in a sticky spot on the cash flow spectrum. This can turn into a more serious problem when economic conditions begin to soften.

Here are eight steps distributors can take now to start preparing for a more challenging economy:

1) Spend your pennies wisely. While it may be tempting to view everything as an "investment," smart companies look at whether those expenses are absolutely necessary … or not. If that additional employee, warehouse expansion or new storeroom floor isn't going to positively impact your bottom line over the next 6-12 months, you may want to put a pin in that idea until the economy stabilizes.

2) Open a business line of credit. "Set up a line of credit while you're flush with cash," software provider Logiwa advises. "Banks won't be as willing to help you out when your business is struggling, so it's best to arrange a line of credit in advance." It's important to note that this doesn't displace the need to maintain a positive cash flow, but it is an additional way to make ends meet when sales pipelines start to slow.

3) Use an inventory management system. By their very nature, distributors have a lot of resources tied

> "When growth slows, looking at internal investments to improve your inventory position and cash flow can be the difference between making a plan or missing it."

up in inventory. Some track inventory by hand, others use spreadsheets and others do it through their enterprise resource planning systems. Another good option is a robust inventory management system that can be used to track inventory in real-time, set reorder points, manage barcode or RFID scanning and/or integrate with existing distribution systems (i.e., a warehouse management system). "Connecting your IMS to other ERP systems streamlines workflows, maintains the accuracy of your data and leads to efficiencies that generate cost savings," Logiwa points out.

4) Stay on top of your receivables. Run a report and determine which customers are paying on time or in arrears. Call any that fall into the second category — and particularly those that have already or are close to extending past the agreed-upon terms — and start collecting. "Offer incentives for companies that pay their invoices early and follow through with charging the interest or late fees outlined in your original contract," Logiwa advises. "This will discourage customers from paying you late."

5) Use technology to get your money faster. By delivering invoices electronically rather than via mail, you can speed up billing and collection. By implementing a vendor portal, you can give vendors electronic access to invoices, enable electronic payments and reduce the time it takes to resolve disputes. "These solutions also tend to provide organizations with timely and robust reporting that can help you take proactive steps to resolve delinquent accounts or take advantage of supplier discounts," Deloitte advises.

6) Understand your expenses. In MDM's Operating in a Downturn: Avoiding the Mistakes of the Past, distribution expert Albert D. Bates gives distributors pointers on how to prepare for a potential "slower growth" period. As part of that process, he tells companies to look carefully at their fixed and variable expenses and ensure that they fall within these ranges:

> **Fixed expenses** are "overhead expenses." The key factor is that once a budget is set for the year, these expenses will only change if management takes specific actions to change them, such as negotiating a lower rent. For most firms, fixed expenses represent somewhere around 80% of total expenses.
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> **Variable expenses**, in contrast, rise and fall automatically as sales rise and fall. They include sales commissions, interest on accounts receivable and the like. For the typical firm variable expenses are estimated to be 5% of sales.

7) Don't hoard your cash. A common reaction to declining sales, hoarding cash is a no-win proposition during a downturn. "Inevitably, this leads to converting inventory and accounts receivable into cash," Bates says. In fact, lowering inventory almost always involves a "stop buying"

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Using technology to get your money faster is key to improving profitability

Improving your Cash Conversion Cycle by a few days can help you make your annual profit target

edict that causes the firm's service level to deteriorate. "Accounts receivable reductions have a similar impact on sales," Bates cautions. "Lowering either of these will simply drive sales down at a faster rate."

8) Use good forecasting practices. An important aspect of cash management and profitability, forecasting involves looking at both income and cash flow statements and linking your cash flow forecasts to key working capital metrics from the balance sheet, such as DIO (days inventory on-hand), DSO (days sales outstanding), and DPO (days payables outstanding). Deloitte tells firms to also include capital expenditures, debt repayments and other operating cash flows into the equation. "To enhance the accuracy of these forecasts, consider automating this process rather than relying on error-prone and labor-intensive spreadsheets," the firm advises. "Also, be sure to integrate cash flow forecasting with your profit & loss (P&L) statement and balance sheet so you can track performance against a range of indicators."

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Disruption vs. Economic Conditions

Examining all 19 wholesale distribution sectors, recent research from MDM paints a picture of a selling environment where consumer and government spending are keeping the economy healthy, but where manufacturing continues to soften. Annual revenue changes for the industry overall represented 1% growth in 2019 versus 2018. "We're expecting a rebound in activity in 2020," Indian River Consulting Group's J. Michael Marks said in a recent MDM webcast.

Despite his bullish outlook, Marks cautions distributors to look more closely at industry disruption versus economic conditions, and to factor the former into any good cash flow management approach. These steps go beyond shoring up balance sheets, taking out lines of credit, and doing a better job of A/R collections. They range from getting sales involved in the process to collaborating with key suppliers to developing "moats" that help your distributorship stand out from the pack.

Defined as "hard-to-digitize services," these moats have helped companies like Anixter maintain competitive advantage in both good and challenging selling environments. "Anixter created a moat and was very public about it; they've been doing it for years," says Marks. "Ultimately, it's about being able to separate out a percentage of revenue every month that doesn't sell well using a part number on a website."

On the supplier collaboration front, Marks encourages distributors and manufacturers to have frank discussions with one another versus just sending invoices and payments back and forth. "Look at who's doing what in the channel, and figure out ways to reduce redundancies," he advises. "That advice stands in any economic conditions."

Marks tells any distributor that wants to preserve through a recessionary period and/or an industry disruption to focus on building a great customer experience. "Most managers and owners don't know their customers; they just get information from their salespeople," he says. "Gather the data and insights that lead to a better understanding of your customers, and then allocate resources appropriately."

Finally, Marks points out that companies only gain market share on the shoulders of an economic cycle, and not when everyone else is going strong and growing quickly. "No one had cash to grow at the bottom," he notes. To best position themselves for success during and after a possible downturn, Marks says not waiting until it's too late to get aggressive with receivables collections and inventory reductions will go a long way in helping to preserve valuable cash.

"Pay attention to your cash-to-cash cycles, knowing that most distributors tend to get complacent with 10 days of cash to withdraw," says Marks, "and don't be afraid to dramatically reduce inventory, knowing that manufacturers will sell at lower prices when they're stuck holding finished goods inventory and everyone's cancelling orders."

Don't Paddle Your Boat Without an Oar

Seventy-five percent of economists believe the U.S. will tip into recession by 2021, according to the National Association for Business Economics. The outlook reflects growing skepticism among economists and investors that the U.S. economy will be able to withstand a protracted trade war with China without serious harm amid a weakening global outlook.

The cornerstone of any successful business, good cash flow management is one way to future-proof a distributorship and keep it on track during challenging economic times. Whether a recession takes hold in 2020 — or waits a few years to show up — there are specific steps that companies can take at all times to shore up their coffers and preserve cash flow.

"Trying to run a business without managing cash flow is like trying to paddle a boat without an oar," QuickBooks points out. "Even if you succeed, it will be an upstream exercise guaranteed to wear you out. Not to mention, poor cash flow management can result in your business shutting down completely. With poor cash flow, it only takes one major downturn or disaster to leave you washed up."

To avoid these and other problems associated with poor cash flow, distributors can start instituting good cash flow management policies now, while business is good. That way, they won't be caught off guard if and when project pipelines dry up and a sales slowdown ensues.

As an added bonus, those companies that do maintain healthy cash reserves during a recession are often in the best position to make strategic acquisitions, invest in their businesses, open new locations and hire the best (and recently laid-off) people to round out their teams.

"The good news is that all recessions end," Bates says. "Even the so-called Great Recession ended with a sustained period of sales growth. While the next recession hasn't even started, now is the time to plan for it. Furthermore, planning should not only focus on what to do during the recession, but also how to build momentum for when the recovery starts."

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About VersaPay ARC

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Make customers happy to pay you.

VersaPay ARC helps you get paid faster while reducing the burden on your in-house team,

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- Easy and convenient invoice presentment with multiple, integrated delivery options available: online portal, email, and even legacy formats if required. Customers can access real-time, shared information, and create customized downloads 24/7/365.
- Provide your customers with flexible payment options, including credit cards, ACH, and EFT, and access to apply discounts and credits. Enable customers to set-up automatic payments to make their lives easier. Automate the cash application process to make your life easier.
- Enable zero-touch collections, communicate with customers in real-time, and gain access to actionable insights and key performance metrics.
- VersaPay ARC is PCI Level 1 (Tier-1 bank grade), and SOC 1/SOC 2 certified. Ensure payment information entered by customers is never seen again by anyone else on your team or theirs.
- Get up-and-running fast with pre-packaged, quick install interfaces for leading ERP systems. Easily tailor VersaPay to your business through out-of-the-box configuration settings—no coding.
- Strategic partnerships with world-class payments companies, including RBC and Mastercard.

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