

# Welcome



*Welcome to  
“Cash Flow  
Budgeting and  
Collections”*

*You are going to  
love this program!*

**Tom Grandy,**  
*president*

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## What Will We Cover?

### We will talk about:

- Three periods of growth that can put you out of business!
- Why month-by-month (as opposed to annual) cash flow budgeting is important
- How to create a month-by-month, department-by-department cash flow budget to project profitability and monthly cash flow needs
- Monthly tracking (covered in other seminar)
- Collections

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## Three Points Of Growth That Can Put You Out Of Business!

- Owner moving from the field into the office
- Gross sales approach \$1,000,000/year
- Any period of rapid growth (over 15% a year)



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## Cash Flow vs. Accounting

There are significant differences in cash flow and accounting. Most company owners have already experienced the differences!

Cash flow deals with the “real” dollars that flow in and out of a company on a daily basis. Accounting tends to work with “paper” dollars.



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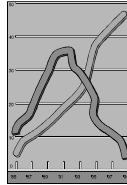
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## Cash Flow Vs. Accounting

Cash flow and accounting will show significantly different bottom-line profit margins!

Two major differences in cash flow and accounting:

1. Equipment replacement costs vs. depreciation.
2. How loan payments are handled.



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## Equipment Replacement vs. Depreciation



- Depreciation deals with what a piece of equipment cost several years ago
- Equipment replacement deals with what it will cost to replace it several years from today (and builds the costs into today's pricing)

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## Loan Payment Differences



**If you have a \$500 loan payment and \$100 is interest:**

- Accounting only shows the \$100 interest on the Income Statement.
- Cash Flow shows "all" \$500 as flowing out of the company.

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## Cash Flow Vs. Accounting

	Accounting	Cash Flow
Sales:	\$ 800,000	\$ 800,000
Cost of Materials	- 320,000	- 320,000
Cost of Labor	- 160,000	- 160,000
Overhead:		
Depreciation	- 20,000	-
Equipment Replacement cost	-	- 35,000
Interest on five loans	- 6,000	-
Full loan payment on five loans	-	- 24,000
Other overhead costs	- 280,000	- 280,000
Profit =	+ \$14,000	< \$ 19,000 >

*That is a bottom line difference of \$33,000!*

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## To Really Understand What Is Going On Within A Company You Have To Create A Budget

**What will a budget do for you?**

- Forces you to understand what the "real" costs of doing business are
- Provides accountability within the company
- Helps you make good economic decisions
- Helps the company begin to PLAN for the future - not simply evolve

Drew Page

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## Every Company Needs To Be Departmentalized To Understand What Is Going On



*“Overall profitability can look good with one or more departments actually losing money.”*

- When the company first started, it did only one thing (just service, retrofit, new construction, etc.)
- Now, 5-10 years later, the company does lots of things.
- One department can easily be subsidizing another and the owner not even know it!

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## Overall Company Income Statement

Sales:	<b>\$ 1,000,000</b>
Cost of Materials	- 300,000
Cost of Labor	- 200,000
Overhead:	
Fixed and Variable Overhead	- 350,000
Profit =	<b>\$ 150,000</b>

Everything “appears” to be in good shape. The company is producing a 15% overall profit.

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## It Is Important To Look At Departmental Profitability?

<u>Department</u>	<u>Profit</u>
Service	\$ 80,000
New Construction	<\$ 20,000>
Retro-fit	\$ 90,000
Profit	= \$ 150,000

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## What If A Department is Losing Money?

### **REMEMBER**

*Even if a department proves to be unprofitable **DO NOT** automatically eliminate it!*




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## It *May* Be Okay To Lose Money In A Department If The Department Is:

- Absorbing a significant amount of fixed overhead cost therefore allowing the other departments to be profitable
- Creates profitable work for other departments (service, S/A, replacement work, etc.)

*Watch what can happen if you automatically eliminate a department that is losing money!*

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## Watch What Can Happen When a Department Is Eliminated!

	<u>Service</u>	<u>Retro-Fit</u>	<u>New Construction</u>	
Sales	\$ 150,000 (25%)	\$ 250,000 (42%)	\$200,000 (33%)	
- Labor	45,000	65,000	60,000	
- Materials	30,000	85,000	85,000	
- Dept. F / V-OH	20,000	15,000	12,000	
- General F-OH	37,000	62,000	<b>48,000</b>	← Watch what happens to this fixed overhead
Net Profit	\$ 18,000	\$23,000	\$ -5,000	
% profit	12%	9.2%	-2.5%	

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### Watch What Happens When the New Construction Department Is Eliminated!

	<u>Service</u>	<u>Retro-Fit</u>	<u>New Construction</u>
Sales	\$ 150,000	\$ 250,000	
	(37.5%)	(62.5%)	
- Labor	45,000	65,000	
- Materials	30,000	85,000	
- Department			
Overhead	20,000	15,000	
- General Fixed			
Overhead	55,125	91,875	← 48,000
Net Profit	- \$ 125	- \$ 6,875	
% profit	-.08 %	- 2.8%	

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### Cash Flow Can Put You Out Of Business!

#### Question

Is it necessary to do a month-by-month cash flow budget – as opposed to a simple annual budget?

Cash flow is the #2 killer of small businesses today. We must know what is projected to happen each month during the year!

*Let's look at a sample company.*

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### ABC Sample Company

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Gross Sales	2	1	3	12	30	25	20	10	18	22	10	3
Less Cost of sales	6	5	7	10	20	18	16	9	16	17	9	6
Net Profit/Loss	-4	-4	-4	2	10	7	4	1	2	5	1	-3
Cum. Profit/Loss	-4	-8	-12	-10	-	7	11	12	14	19	20	17

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## Items Unique To Cash Flow Budgeting

- Equipment replacement costs vs. depreciation
- Loan payments
- Matching payroll taxes



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## How To Develop Monthly Equipment Replacement Costs

**A nearly new service truck was purchased in 2006 for \$28,000 and is estimated to last another three years.**

Estimated cost for a new truck three years from today is \$30,000.

Calculation:

$$= \$30,000 / 3 \text{ years}$$

$$= \$ 10,000/\text{year}$$

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## Loan Payments

- **Accounting Point of View**  
*\$500.00 monthly payment*

*\$100 - Interest*

*\$400 - Principle*

- **Cash Flow Point of View**

*All \$500.00 flowed out of your checkbook*



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## Matching Payroll Taxes

These are dollars paid by the **employer** over and above normal gross wages:

Social Security/Medicare- 7.65%

State Unemployment ----- 2-10%

Federal Unemployment -- .8%



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## Matching Payroll Taxes

Consider a separate checking account for payroll:

Example: Gross wages= \$2,500

Matching tax 12.5%

= \$ 2,500 x 1.125

= \$ 2,812.50

Jim Brown

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## Estimating Gross Sales

- Past History - Look at last three (3) years on a month by month basis.
- Market conditions and general economy
- Planned changes in marketing strategy
- New products or services that will be offered.



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### Estimated Field Labor Costs

**Example**

Field labor dollars for last year = \$65,000

Last years Gross Sales = \$356,000

**January estimated sales for the coming year = \$26,000**

Step 1:

Field labor % =  $\$65,000 / \$356,000$

= 17.8%

Step 2:

Estimated January field labor costs =  $\$26,000 \times 17.8\%$

= \$4,628 for January

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### Estimated Material Costs

**Example**

Step 1:

Last years gross sales = \$ 365,000

Last years material costs= \$ 89,500

Material as a percentage of sales:

=  $\$89,500 / \$365,000$

= 24.5%

Step 2:

Estimated January sales =  $\$ 26,000 \times 24.5\%$

= \$ 6,370

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### Estimating Overhead Costs

**NOT**

*Departmentalizing*

Method:

1. Look at last years overhead (how much and when paid)
2. Estimate next years costs based on last years costs
3. Add additional costs that were not part of last years budget.
4. Keep in mind - INCREASE IN PROJECTED SALES WILL CAUSE AN INCREASE IN OVERHEAD!

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## Estimating Overhead Costs

### *Departmentalizing*

**Method:**

1. Is the overhead cost DEPARTMENT SPECIFIC?
2. Is there a LOGICAL breakdown?
3. Remaining "General Overhead" must be spread to each department as well

*General overhead costs need to be spread by department*

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## How To Spread General Overhead Costs

### *Spread by Gross Sales*

Method 1:

Dept A .....	= \$ 155,000
Dept B.....	= 89,000
Dept C .....	= 25,000
	<u>\$ 269,000</u>

*Total General Overhead= \$28,456*

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## How To Spread General Overhead

### **Calculation of General Overhead Going To Department A**

Department "A" Percent (%) of sales:

$$= \$155,000 / \$269,000$$

$$= 57.6\%$$

*Dollars of General Overhead Going To Department "A"*

$$= \$28,456 \times .576$$

$$= \$16,390$$

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## Completed Budget

	Jan	Feb
Sales .....	\$ 35,200	\$ 30,400
Cost of Sales:		
Field labor dollars .....	6,550	5,800
Salesmen Commission --	2,200	2,000
Matching taxes (above)-	895	792
Materials .....	12,575	11,690
Overhead:		
Total overhead .....	9,600	9,200
Net Profit/Loss for month =	3,380	918
Less Non-Cash Items:		
Equipment Replacement	450	450
Cost of Account Rec....	120	120
Cost of Inventory	150	150
"TRUE" profit/loss	= 2,600	198

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## Projected Budget Is Complete

### Ask Ourselves:

1. Is the projected Profit/Loss of our company acceptable AS A WHOLE (all departments combined)?
2. Are all the INDIVIDUAL DEPARTMENTS profitable?
3. Even if each department, and the company as a whole, is profitable? CAN YOU LIVE WITH THE MONTH-BY-MONTH CASH FLOW?

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## Reviewing The Completed Budget

If the answer to any of the previous questions is **NO** then management needs to determine what changes need to be made!

### REMEMBER

*Even if a department proves to be unprofitable you **DO NOT** automatically eliminate it!*

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## Our Collections Objective

*Collect as much as possible, as soon as possible, at the least possible cost, without losing important customers you wish to keep, ..... with little or no stress!*

- Fear of loss (afraid to tell our customers how we want to be paid)
- If you don't spell out the payment policy, guess who will!



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## Create An "Internal" Collections Policy

- Have a written policy
- Stated time for invoicing to take place. The same day is best or at least within 24 hours.
- When payment is past due, a second notice should be sent out IMMEDIATELY, requesting payment within ten (10) days.
- If payment is not made in 10 days, then call the customer and find out why. Get a commitment of when payment will be made (accounting person should make the initial call).
- Follow up with a second call if payment is not received as promised (owner or manager should call)
- Begin use of an attorney or collections agency

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## What Does It Cost The Company When Payments Are Late?



What's the best thing you can do for your customer - hardware store!

### Your Shrinking Credit Dollar (based on the time value of money)

30 days past due -----	\$.97
60 days past due -----	.90
90 days past due -----	.83
120 days past due -----	.75
Six months past due -----	.67
One year past due -----	.45
Two years past due -----	.23
Three years past due -----	.05
Five years past due -----	.01

Source: U.S. Dept. of Commerce

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### Check List To Be Sure You Get Paid

**Before the Job Begins:**

1. Are all the payment arrangements settled up front while the job is being sold?
2. Is it clear whether payment will be made by cash, credit card, personal check, or billed to an open account?
3. Does the property owner, or responsible party, fill out a company credit application BEFORE credit is extended?
4. Has a credit limit been set on each open account?
5. Is the status of an account checked BEFORE additional credit is extended?

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### Check List To Be Sure You Get Paid

**Before the Job Begins (continued):**

6. Established a target amount of credit our company will extend? (20% of sales is max)
7. Does the contract include a schedule of dates or events when progress payments are to be made?
8. Do we collect in advance at least the wholesale cost of any special order items to prevent loss from canceled or changed orders?
9. Are advance payments negotiated (deposit on job) to cover the cost of labor thus relieving cash flow pressures?

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### Check List To Be Sure You Get Paid

**While The Job Is Being Done:**

1. Is the customer's written authorization to proceed with the work obtained when completing repair work?
2. Are all change orders written up and signed by the customer within 48 hours?
3. Are change orders invoiced separately, and billed immediately?
4. When payment is in stage disbursements does the customer understand that delaying payment will halt production?

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## Check List To Be Sure You Get Paid

### When the Job Is Done:

1. Are service tickets and installation paperwork filled out completely, legibly and accurately?
2. Is a promissory note printed on the back of the Service Ticket to prevent a C.O.D. call from becoming an unauthorized charge?
3. Are charge customers sent a bill immediately after the job is completed?
4. Is a nominal bookkeeping charge stipulated on the bill to motivate timely payment?
5. Are monies held in retention rigorously followed-up on?

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## Your Attitude During The Collections Process Makes A Difference

*Be persistent... but light hearted*



### Have some fun!

Write a few light hearted complaint letters to manufacturers and see what happens.

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## Complaint Letter #1

Use the reminders as the cover letter with a copy of the invoice enclosed as well.

We realize the mail is sometimes very slow!



However, if your check has not been mailed please send it ASAP!

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### Complaint Letter #2

Send this a week later, again with a copy of the invoice enclosed.

I don't understand? We sent the product requested, sent an invoice and then we send a reminder and still no check?



Please pay the enclosed past due invoice immediately!

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### Complaint Letter #3

Again, this reminder follows the last a week later. Be sure to enclose a copy of the invoice.

Our accountant is getting a little concerned about your past due invoice!



Please mail your payment today (not next week, not tomorrow but TODAY!)

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### Complaint Letter #4

Reminding the customer they can pay by credit card sometimes gets the invoice paid. Fill in the invoice number and amount for them!

**Perhaps writing a check is to difficult!**



**Choice #1:** Call us at 1-800-432-7963 and place your invoice on VISA/MasterCard  
**Choice #2:** Fax this form to our office-no questions asked!

Invoice Number: \_\_\_\_\_ Amount: \_\_\_\_\_  
Card Number: \_\_\_\_\_  
Exp. Date: \_\_\_\_\_ Signature: \_\_\_\_\_

Our fax number is:  
**1-270-684-7425**

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### Complaint Letter #5

Credibility is important. If you said you were going to begin calling after a week - call!

**Five notices is enough!**



If payment is not received within a week we are going to begin calling you .....daily!!!  
(Get the hint, we are not going away until your invoice is paid)

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### Complaint Letter #6

Again, this reminder follows the last a week later. Be sure to enclose a copy of the invoice.

**Time is running out!**



We have sent notices and we have called. If your check is not received within the next five business days your account will be turned over to our collections agency!

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### A Few More Collections Ideas!

- Use fax reminders when applicable



- Print a box on your invoice

If you prefer, your invoice may be paid via VISA or MasterCard:

Card Number: \_\_\_\_\_

Exp. Date: \_\_\_\_\_

Signature: \_\_\_\_\_

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### A Few More Collections Ideas!

- Offer a cash discount if payment is received within a certain period of time (remember the 2% we built into overhead!)
- If your customers tend to question the amount of time they are being billed, create a simple 3x5 card showing the start time, ending time and total time on job. Then have them sign it before you leave the job and enclose a copy with the bill
- On the average 20% of residential customers move each year. Print in the upper left-hand corner of the envelope:

Address Correction Requested  
or  
Forwarding Postage Guaranteed

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### A Few More Collections Ideas!

- To be sure your statement envelop gets opened, add to the front of the envelop the word "Personal", "Confidential" or "Personal and Confidential"
- Amnesty – Offer a 30% discount on accounts over 9 months (at best they are only 20% collectable at this point)
- If the customer wants to make payments ask, for post dated checks (they are legal). Even volunteer to call the day before you deposit each one.
- Negotiating tip – If the customer volunteers to pay any amount less than the full amount, realize their offer is always less than they hope to get away with. Refuse the offer (blame it on the accountant)!

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### Options When Payment Is Not Made (continued)

- **Small Claims Court** – Cost \$35-\$60 to file and serve papers. The Clerk at the County Court Office will explain the process.
  - Nationally 1/3 pay when they receive the papers
  - Nationally 1/3 don't bother to show up in court – you win!  
(County clerk can tell you how to collect at this point)
- **Have an attorney send a letter for you** - Lots of hungry lawyers out there! Call state Bar Association to get a list of current law graduates.

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## Options When Payment Is Not Made (continued)

▪ **Collections Agency** – Good news, no up front cost to use them. It will, however, cost you 25% to 50% of the invoice amount if, or when, they do collect the money

- They are experts at finding people who don't want to be found
- They are experts at finding money that people don't want found



*"Collections agencies find people who don't want to be found!"*

Poll: Who has had a good experience with a collections agency?

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## There Is A Better Way!

### Transworld Systems Inc. (TSI)

- 156 offices across the country
- TSI's collections service collects 60% to 70% of your money (if used when past due is less than 90 days old) – waiting 4-6 months will drop recovery to about 50%, which is still very good!
- Cost is only \$12.99 per account (flat fee)
- Must purchase a minimum of 50 "accounts" at a time so your total investment to begin with would be about \$650. You will have two years to use the accounts.

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## Summary!

### Summary:

- Create and track a month-by-month, department-by-department cash flow budget:
  - Project monthly cash flow needs
  - Project overall profitability, by department
  - Basis for tracking (covered in other seminar)
- Collections:
  - Create a formal collections policy
  - Institute many of the collections "tips"
  - Watch flow improve!

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