
Improving Cash Flow

By Zahid Khalid
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Cash Flow is the lifeblood of every business enterprise and **Working Capital Processes** are the arteries through which this lifeblood flows. The efficiency and effectiveness of these processes is just as critical to the health and survival of a business organization as that of the arteries for a human body. Whether it is a start-up, a Fortune 500, or anything in-between, a lack of liquidity means the business perishes. This fact is borne out repeatedly by events such as the dot-com bust and the economic crisis we are currently faced with. Businesses with less than sufficient liquidity will not be able to weather this storm. Regardless of other metrics such as growth rate, profitability, and brand recognition, this rule of finance always has and will continue to hold true.

Cash flow is measured as follows:

Cash Flow = EBITDA – (Working Capital + Interest Expense + Taxes + Capital Expenditures + Debt Payments)

EBITDA improvement is certainly very important and most companies focus on this as it would improve cash flow. Aside from revenue growth, which is not entirely in the control of the business, the usual approach taken to improve this metric is cost reduction in the form of headcount reduction, reduced service levels or product offering with lower

quality. What is often neglected is the rest of the equation. Among the variables in parentheses in the equation above, little can be done directly about any except *Working Capital* and *Capital Expenditures*, without changing the financial policy (capital structure, debt levels, etc.). Reducing Capital Expenditures may not be desirable without adversely affecting revenues. That leaves *Working Capital* as the only control variable for affecting cash flow at any given level of EBITDA.

Decreasing Working Capital increases cash flow, and Working Capital can be decreased by improving back-office processes that impact the following Working Capital accounts:

- *Accounts Payable*
- *Accounts Receivable*
- *Purchasing*

At present, world class companies are focusing on this area of opportunity for bottom-line results by optimizing their core Working Capital related processes. They have recognized the value of taking this indirect approach to improving EBITDA.

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