VOL. 8.3 **FINANCING** | COST FORECASTING • WORKING WITH BANKS • RETHINKING THE BUSINESS

retailer's guide

FOR INDEPENDENT RETAILERS AND STORE MANAGERS

A PUBLICATION OF RCC the voice of retail Retail Council of Canada

SPONSORED BY RBC Royal Bank®

GOING AGAINST THE CASH FLOW

To manage cash flow better, retailers need to know the numbers of their business, inside and out.

BY ROBERT PRICE

Here's a common retail situation. Before the holiday season, the store purchases inventory and cash reserves fall to the lowest position of the year. Assuming the store can sell its inventory—and that assumes the store's managers purchased the right goods for the season—the store will be in its highest cash position of the year after the holiday season. The store will go from flat to flush in a matter of weeks. So how does the independent retailer get through those times when sales might be stagnant and cash low?

This *Retailer's Guide* looks at some of the principles underlying cash flow and offers tips to help retailers survive the highs and lows of high and low cash flows.

WHAT AFFECTS CASH FLOW?

Cash flow touches nearly every part of the store, from inventory to purchasing, from salaries to capital expenditures. In particular, cash flow—that is, the amount of cash the store has on-hand at any given time—changes depending on the seasonality of the store, how quickly the store turns over inventory, the number of employees on payroll, the retailer's inventory management practices and just about every other aspect of the retail operation. When cash is flowing through the store, the business is alive. When cash is flowing out of the store, it's quickly dead.

Tip: Forecast costs with a budget

Jim Mulligan, National Director Retail and Consumer Services at RBC, says business planning is a fundamental part of managing a store's cash flow. "You want to have a good business plan in place so you know when you're going to need the cash in the future. At the same time, you're going to want to take a look at when that cash will need to be available," he says.

INTERROGATING INVENTORY

What to ask about inventory:

- What's my spoilage and breakage rate?
- What am I losing to theft?
- How much does it cost to store inventory?
- Am I using storage space smartly or do I have wasted space?
- What's moving and how quickly does it move?
- What do I need to purchase more of?
- How quickly can I get stock from vendors?

Forecasting will include three important documents: the business plan, the budget and a current financial statement.

A good business plan takes into consideration short- and long-term expenditures. It's the mission statement of the store, the plan for how the store will get from Point A to Point B, and it includes research on the store's customer base, sales seasons and merchandising strategies—all crucial to generating sales. A well-designed budget (an important part of the business plan) gives retailers information about projected expenditures and revenues. And the third document, the current financial statements, gives the retailer a sense of how the actual sales relate to the budget.

Good forecasting will have the retailer consulting what they know about the market with what they know about previous sales. Forecasting doesn't have to be MBA-level complex. But what it does need are actual numbers. Retailers who want to forecast cash flow accurately need to stay on top of their finances and know where they are and where they hope to go.

Inventory is illiquid cash. Too much inventory at moments of low cash is not only frustrating, it's bad business.

Tip: Keep an eye on inventory

Inventory is illiquid cash. Too much inventory at moments of low cash is not only frustrating, it's bad business.

"For retailers, the biggest hindrance for the cash flow is how much money they have invested in their inventory," says Alistair Ellis, Senior Product Manager for Sage Simply Accounting.

Freeing up cash is as much about good money management as it is good inventory management. (Depending on how you look at it, good money management and good inventory management are the same thing.)

Retailers need to know how much inventory they have on their shelves and how much they have in their storerooms. How much cash is invested in inventory? How long will it take to turn this inventory over to free up the cash? This is the fundamental skill, Ellis says, of good retailing: knowing what items are selling, knowing when that inventory hit the shelves, restocking what's moving as quickly as possible, and eliminating SKUs that don't sell.

Mulligan says retailers need to make sure they use technology that gives them the most control over their inventory. "If you're a retailer that is able to sell a lot of inventory, then you're going to need very tight controls over obsolescence. Does your inventory control system identify the age of the inventory and can you quickly isolate the inventory that's not selling?"

One of the other costs associated with tying cash up in slow-moving inventory is the cost of storing inventory. Ellis recommends retailers assess the cost of their backroom. How much space do they have, how much of the space do they use, and how much of this space is used to house slow-moving inventory? Retailers may want to look at downsizing their storage space to a more economical square footage.

"When you look at what's selling, what you're keeping in the back room, buying at volume discount might not be helping because, if you need credit to pay for it, you're not taking the benefit of that discount amount. You end up paying more to store that inventory," says Ellis.

Tip: Know how payroll affects cash flow

Paying an employee $3,000 to work 300 hours at $10 an hour will cost a lot more than $3,000. But how much more?

Ellis says independent retailers sometimes overlook how payroll cuts into cash flow. All the costs associated with payroll—labour, taxes, EI and CPP, insurance and everything else—need to appear in the budget. A retailer never wants to be surprised by the real costs of employees.

Having a contingency plan—should you cut employee hours or cut staff levels—is essential during times when cash is low. "What are you going to do if you find yourself in a situation where you

don't have the funds to cover the payroll?" asks Ellis. One answer is to forecast when cash will be low and build reserves to get through tight months.

Tip: Work with suppliers

When cash is low, it's probably because suppliers just cashed the cheques you wrote them. Ellis says maintaining open relationships with suppliers is good for stabilizing a store's cash flow. Suppliers want to be paid, but many know what it's like when cash is low—and they can empathize.

Renegotiate contracts. "A lot of retailers don't feel like they can ask [for more attractive payment terms] because they don't feel they have strong leverage with suppliers," says Ellis. This isn't true. Good suppliers are willing to work with retailers to develop arrangements that benefit both parties. They want the retailer's business. Retailers just need to ask.

Tell suppliers when their payment is going to be late. "A lot of companies don't feel they can talk to suppliers unless they have the cash on hand to pay them," says Ellis. "Suppliers are much more open to being talked to than being shut out. If you don't talk to them, they don't know what's going on."

Work out payment plans. "If you're getting into a situation when you cannot get the bill paid, it's much better to talk to the supplier and discuss what's going on," says Ellis.

Pay strategically. "Look at what invoices have to be paid and when. Don't assume what's written on the invoice is cast in stone," says Ellis. "Suppliers are businesses as well. They understand cash flow." If the bill can wait until next month, after the big sale, then pay it next month.

Tip: Work with the bank

Mulligan says retailers should feel comfortable speaking to their bankers about the ebb and flow of their business. The banker, he says, is a particularly good sounding board for the store's business plan.

"Reviewing a business plan with their banker is one of the first things that retailers should always do," says Mulligan. The banker can provide guidance on what kind of loans, credit and savings options are available to the store. Retailers should discuss how the store spends its funds and the source of funds and ask the banker for help determining, with greater precision, when cash will normally come into the store.

RECONCILIATIONS

Ellis encourages retailers to reconcile their bank accounts once a week. "Make sure there are no surprises on the deposits," he says. "People are people and they err." Retailers will want to make sure that the deposits they made were keyed into account correctly (did you deposit $200 when you meant to deposit $2000?) and that the cheques they've written and the cheques they've cashed have cleared.

The bank will be especially helpful in determining how and when to disperse capital. Mulligan says one of the most common mistakes he sees retailers make is using short-term operating funds to pay for long-term investments. For example, a retailer might buy a fixed asset, like new shelving units, with the cash they have on-hand. Later on, when they need that cash, they'll discover—perhaps to their horror—that the cash they need is tied up in the shelving unit.

"Shelves would normally have a lifespan of three to five years and you want to make sure you're using term loans to finance fixed assets. Use your working capital for inventory purchases," says Mulligan.

Retailers who don't have inventory controls may want to look at account software programs on the market.

Tip: Work with accountants

Don't fear the reaper and don't fear the accountant. Like the banker, the accountant has the expertise to help retailers understand their spending and to adjust the business to improve cash flow.

"It's very easy for a business person to have ideas of where they want to be in three years, but it could be very challenging to know what steps to take to get there," says Ellis. "That's what accountants go to school for. That's what they thrive on. That's what they love figuring out."

Retailers who don't have inventory controls may want to look at various account software programs on the market. They offer accounting solutions but also have rudimentary inventory systems that can help keep track of what's selling, what's broken and what's lost.

Tip: Rethink the business

Sales are down. Cash is low. So what to do? One thing to do is to increase sales.

The first question to ask is: Why are sales down? If the answer is "because we're a seasonal business," then the next question is: What can the store do to bring more customers through the door during the off-season?

Think about the bike store that doubles as a snowboard shop in the winter. Or think about the sunglass store that expanded to sell cellphone accessories to attract a new group of customers.

When retailers talk about the "quiet months," Ellis says he wants to ask: "Why do you have those quiet months?" Recalculating the store's goals may be one of the smartest efforts over the long-term. Can the store expand its product offerings to attract new business? How is the store's target customer changing—and how does the store need to change? Is there something else the store should be selling to make quiet months busy?

"Retailers need to plan out not just how to get through July, but plan out what the store is going to be like in February," says Ellis. "Are you going to sell something else or are you going to shut down?"

Tip: Treat credit carefully

Credit is good for bridging the gaps between periods of high and low sales and high and low cash flows. It's good for paying off long-term investments because it frees up short-term cash and amortizes the costs of capital expenditures.

But the problem with credit—as everybody who's fallen behind in their credit card payments knows—is how debt eats into cash flow. "Credit is, unfortunately, the easiest method of payment to use, whether you're talking about personal or you're talking about business. It makes for a quick and easy payment," says Ellis.

He says that retailers should maintain equity in the business so they don't fall into the trap of misusing credit. "If you're getting to the point of running your business on your credit card, that's a dangerous situation. Unless you're paying them off right away, then you're already into your cash negative situation," says Ellis.

Make the most of credit by paying bills on time, using credit only to make calculated purchases and working with the bank to find loans and rates that suit the needs of the retailer. RC