CASH FLOW MANAGEMENT

Never forget that a company can be profitable (Have a +ve N.I on income stmt.) and at the same time be bankrupt (not have enough cash on hand to pay its bills). Remember: you pay bills with cash! This is because income stmt. Is built on accrual-based accounting.

**Step 1:** Net Income After taxes + Depreciation = Net Income After taxes + Depreciation

**Step 2:** Working Capital From Operations = Working Capital From Operations

**Step 3:** Cash flow from operations = Cash flow from operations


**CASH MANAGEMENT EFFICIENCIES**

- Receivables collection period = (avg. receivables per yr x 365)/annual sales; Indicates how long it takes for firm to collect receivables.
- Payable Period = (Avg. a/c payable x 365) / COGS; Indicates how long firm has to pay its suppliers.
- Inventory Turnover = (COGS)/Avg. Inventory

**RETURNS**

- Gross Profit Ratio (margin) = Gross Profit/Sales
- PreTax profit ratio = PreTax profit/Sales
- ROA = PreTax Profit/Total Assets; ROI = PreTax profit/Equity

**LIQUIDITY tests**

- Quick Ratio: (Cash + A/R) / Cur. Liabilities
- Acid Test: (Cur. Assets−Inv.)/Cur. Liab. (Gives a more clear picture of liquidity)

**VALUATIONS**

- Book value = Total Assets – Total Liabilities; Seldom used as primary basis for valuation.
- Liquidation value: Value of firm if assets were sold in auction style.
- EBIT multiples: 4x – For companies with an unglamorous product line, slow or no growth, low market share; 5-6x – Typical range within which a majority of private companies trade; 7x – Appropriate for opportunities considered to be exceptional.
- Sales multiples: 1-2x; Profit before tax: 3-5x; Profit after tax: 8-10x.

**Collins-Porras Vision Framework**

Vision first, Strategy next, Tactics last. Good Vision consists of: (a) Core Values/Beliefs (b) Purpose and (c) Mission.

1. **Core Values:** are guiding principles for the business. They permeate the org. like ether, via decisions, policies, actions. E.g. 3M: “Thou shalt not kill a new product idea.” Merck: Honesty, Integrity, Science-based innovation, not imitation, etc.
2. **Purpose:** is like a guiding star, always out there on the horizon, never attainable, but always pulling you forward. Why does the company exist? E.g. Merck: We are in the business of preserving and improving life.
3. **Mission:** A specific, “bold, hairy, audacious goal” (BHAG). It has a clear finish line (climbing a mountain). E.g. Mission to the moon by the end of the decade, challenge by JFK (targeting). Missions galvanize employees (by showing enemy—“Maru-C”).

**INTERNAL ASSESSMENT (5 components)**

- Strengths & Weaknesses: Strategy should leverage company’s strengths. (Brand, Cash position, Marketing/sales/distrib./R&D)
- Core Competencies: What is the company better at than any other company?
- Resources: Access to capital, scarce materials, people (hiring), production capacity, distribution channels, etc.
- Innovation: should be able to influence strategy as much as strategy should stimulate innovation. Key to competitive edge.
- 7-S Analysis: Strategy (company’s plan to achieve goals), Structure (org. structure of company), Systems (procedures that shape the behavior of employees), Staff, Skills (capabilities of key people in firm), Style (culture of company), Shared values of firm.

**EXTERNAL ASSESSMENT (6 components)**

- Industry/Market/Technology trends: Porter’s 5-forces analysis would help understand industry dynamics—Industry rivalry, Suppliers, Buyers, Potential entrants, Substitutes. What are customers saying about their evolving needs? Etc.
- Competitor Assessment: Current and potential competitors? Who else is going after the same customer segment? Competitor strengths, weaknesses, future moves, strategies, commitments? Does your firm have a clear, differentiated position w.r.t them?
- Social/Regulatory Environment: Astute anticipation of governmental or regulatory moves can create great opportunities.
- Macro-economy / Demographics: How sensitive is your firm to swings in the economy?
- International: If your company’s tech. has global applicability, then company is de facto in a global market. Beware of this.
- Overall threats and opportunities: List the top 3 threats and opportunities that emerge from your external assessment.

**V-I-E Framework for Small-to-Midsize companies**

- **Vision:** Core Values/Beliefs
- **Internal:** Core Competencies, Resources
- **External:** Market/Technology trends, Social/Regulatory Environment
- **Strategy:** How to achieve goals, how to achieve resources and竟彩
- **Org. Design:** Staff, Skills, Core Values
- **Take Action:** Product/Market Strategy, Cash Flow

**Key Financial Ratios to look at:**

- **Liquidity**
  - Quick Ratio: (Cash + A/R) / Cur. Liabilities
  - Acid Test: (Cur. Assets−Inv./Cur. Liab. (Gives a more clear picture of liquidity)

- **Cash Management Efficiencies**
  - Receivables collection period = (avg. receivables per yr x 365)/annual sales: Indicates how long it takes for firm to collect receivables.
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**Collins-Porras Vision Framework**

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- **Strategy:** How to achieve goals, how to achieve resources and competes
- **Organizational Design:** Staff, Skills, Core Values
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**Internal Assessment (5 components):**

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**Cash Flow:**

- Manufacturing
- Raw materials
- Manufacturing
PRODUCT / MARKET STRATEGY

Customer satisfaction = Performance – Expectations; A consumer who gets more than he expected starts a word-of-mouth campaign.

Customer Analysis: Begin by doing market segmentation. Dimensions: Demographics (age, gender, income, religion, race, etc.); Geographics; Psychographics (lifestyle, consumer attitudes); Behavioral (usage rate, adoption speed); Benefit-based.

Competitor Analysis: Do not be product oriented; focus on the customer market being served; E.g. Rail-oriented vs. Transp. Oriented.

Positioning = Market selection + differentiation; It is not what you do to a product. It is what you do to the mind of the prospect.

Pricing Models:
(1) Cost-based pricing: price is determined based on the fixed and variable costs of developing, marketing, delivering the product, plus a desired profit margin. Unit contribution = Price – Variable cost per unit [Unit contribution is the amount of the selling price available to cover the fixed costs]. Break Even volume = Total fixed costs / Unit contrib. Break Even Price = (Total fixed costs / # units sold) + Variable cost per unit.
(2) Value-based pricing focuses on the value a product offers to the customer. Start with the price for an undifferentiated product + Premium for superior value (better design, reliability, etc.)
(3) Competitor-based pricing involves pricing products in relation to the competition.

Promotion: “Pull” based promotions are targeted at end users and creates demand at the end of the distribution channel. “Push” based promotions are targeted at the distribution channel (volume purchase discounts, high dealer margins, etc.).

Communication Goals: AIDA ➔ Gain Attention; Hold Interest; Arouse Desire; Elicit Action.

ORGANIZATIONAL DESIGN

The builders of great, enduring companies tend to be “clock builders,” not “time tellers.” They build the organization—the ticking clock—rather than hitting the market just right with a great idea (time telling). Clock-building companies invest heavily in the design and implementation of processes through which products result. Instead of focusing on what innovations to make, they focus on what process to institute that will stimulate innovation over and over again. Intentions to build good culture are fine, but tangible mechanisms are what translate from vision to reality. The builders of great companies seek alignment in strategies, in tactics, in organizational systems, in structure, in incentive systems, in building layout (physical), in job design—in everything.