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Growing companies should be mindful of the three C's



TACTICS

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A simple formula can help keep rapidly growing businesses free from financial woes.

And it's as easy as minding the three C's — cash flow, controls and capital structure. Let's start with cash flow.

Growing companies burn lots of cash, so positive cash flow is far more important than recorded "profit" for growing firms. Recorded profit results from accounting rules and principles — not from positive cash flow generation. In fact, recorded profit may have little to do with the amount of cash generated.

It's essential for rapidly growing firms to have a good handle on cash requirements for the next 12 to 18 months. Cash management is pretty straight-forward when management has an accurate read on its money flows.

These forecasts need to be more than wishful thinking: They need to be grounded in the realities of the enterprise. One way to do this is to "sensitize" the projections. An old banker's rule of thumb is to accelerate payables by 60 days and delay receivables by 60 days.

A growing company should know 12 months in advance how much cash it will need, for what purpose and when. That may sound like a lot of lead time. Yet even companies with strong track

records will have a difficult time lining up financing during a cash crunch.

Compounding the crisis is the diversion of management's focus away from exploiting opportunities to lining up financing. Management can take comfort when the sensitized cash flow projections demonstrate that there is sufficient cash to feed the growing appetite of the firm.

The next C refers to controls.

Every firm has a system of financial and operating controls that govern the enterprise and provide a structure for delivering results. In modestly growing firms, these systems can be effective for years, especially if they are well-conceived.

Yet financial and operating controls

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will be severely tested and often fail. Generally, a failure in one area will rapidly disseminate to cause widespread

failures in other control areas — inventory, receivables, distribution and client service, to name a few. It is symptomatic that the firm has outgrown its control structure.

Right-sizing the control structure to the enterprise can be accomplished fairly easily with some thoughtful analysis. The key thing to remember is this: If you can't measure it, you can't manage it.

What are the four or five essential controls that must be effective for the enterprise to continue to grow and satisfy client requirements? Financial controls can provide early warning of excesses or shortfalls. Operating controls can provide early warning of production problems or potential adverse customer impacts.

Make sure there are feedback loops for each of these. And don't ignore early warning signals from your control structure. Rapid growth creates a build-up of pressure that is often unleashed in an unexpected flash. It is often exceptionally difficult to get the proverbial genie back in the bottle once there have been control failures. The loss of employee, customer and investor confidence can be hard to reverse and will require a great deal of leadership attention that ought to be focused on resolving core business issues.

Finally, we turn to capital structure.

Even when cash is sufficient and controls are adequate, fast-growing firms

often outgrow their capital structure. A good rule of thumb is that for every 45 percent growth in revenue, the firm outgrows its capital base.

Most businesses start with the help of owner-supplied capital and funds contributed by friends and family. A booming company will soon outstrip these sources and require bigger chunks of capital to sustain growth.

A common sign of an inadequate capital structure is sustained borrowings at or near bank credit line limits. The inability to reduce those lines is an indication that those funds have transitioned from working capital to permanent capital.

There are a myriad options available to management teams needing more capital. Generally, the supply of capital is inelastic; rather, it is the demand that is elastic.

There is always an abundant supply of investors looking for a way to deploy capital. Options include adding limited partners, partnering with established companies; pension funds and insurance companies; angel investors; venture capital funds; and taking a company public.

Rapid growth will test any enterprise. But by minding the three C's, management can avoid some of the pitfalls that have derailed other promising stars.