The Sales Volume Lever to Increase Small Business Cash Flow

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This is a continuation in our series of the 8 Levers to Increase Cash Flow in Your Small Business. In this article we turn to the Entrepreneur's go to fix for cash, increasing sales.

Let's be clear, we're talking about increasing sales volume, not pricing (which I cover in this article). If you're like me and most business owners, we have a mindset of sales cures all ails. Unfortunately, that is not always true, and if not handled correctly, increasing sales volume can actually HURT cash flow.

The Cash Cycle

So let's look at what is necessary to increase cash from increased sales volume. In order to sell something, you have to have the item or service. Usually, though not always, increasing sales volume requires additional inventory (items) or people (service). For this discussion we're going to leave out any "fixed" costs such as rent. At some point all costs go up with increased sales volume, but for now we're just going to focus on the incremental costs of adding sales volume.

Once you have the costs in place to sell additional volume, you sell the item/service, and then you have to collect the money. No big deal if you are a cash business, but many small business sell on credit, and it takes time to collect the money. This time frame is referred to as the cash cycle. An example:

Inventory 30 days
Accounts receivable 30 days
Less: Accounts payable 15 days
Net Cash Cycle 45 days

So if you normally turn your inventory every month, that means that you have 30 "days" inventory on hand, and if your normal terms for your customers is 30 days, that means it takes 60 days to realize the cash from increasing sales volume. Your vendors give you 15 days to pay, so that nets to 45 days, but you get the idea. Increasing sales volume doesn't always equal instant cash.

Life Time Value of a Customer

Determining the Life Time Value of a Customer is critical in evaluating increased sales volume strategies. The calculation is straight forward, but you need some key data first: Average Annual Revenue of Customer and Average Tenure of Customer. Alternatively, and better in the long run, is to use average annual gross margin by customer, but is not necessary initially. So you simply multiply the average revenue times the average tenure to equal the lifetime value of a customer. So if your average customer spends $500 per year with you, and they stay with you an average of 5 years, their lifetime value is $2,500.

This information should be used to determine how much you can spend to acquire a new customer. Obviously you don't want to spend $3,000 to acquire a customer that is worth $2,500. Using gross margin instead of total revenue gives you a better number, since it is going to cost you money to service that customer, but starting with annual revenue can give you a ballpark of what you can spend to acquire a new customer.

Strategies

Short Term Sales: Basically how can you increase short term sales without incurring additional costs? This might be liquidating slow moving inventory (see this article for more on inventory lever of small business cash flow) or maximizing output of people or machinery. Assuming that you already are doing a good job of asset management, this will not be sustainable, but might provide temporary cash flow.

Cross Selling: Are there additional items/services or additional quantities that you can sell to current customers? Depending on the type of business, this can have a huge potential impact. The best time to cross sell is at the initial sale, since people are already "in the mood". The question is, is there anything else I can sell you? A classic example of this is McDonald's "Do you want fries with that"? Pricing strategies also play a role here. How do you bundle your low margin items with your higher margin offerings (read more about the pricing lever of small business cash flow in this article)?

Sales Incentives: Looking at your lifetime value of a customer, and your cross selling strategies, is there a way to incentivize your employees? It doesn't have to be money! In fact, studies show that the long term effect of cash incentives can actually be negative. Non-cash incentives and competitions can provide great motivation and team building

Networks: Are there additional networks that you can use to sell your goods/service? Related industries are ideal, because you have customers looking for similar items. An example would be an event venue selling with wedding planners, caterers, and florists. The ideas are limitless, and don't have to necessarily be just "selling". Added value can come in many ways, so get together with some related industry owners and brainstorm.

Other networks worth pursuing are those that are marketing to the same prospects. The idea is similar, but maybe less direct. For instance, an accountant and a lawyer maybe both pursuing the same small business customers, but the customer probably isn't shopping for both at the same time. This can be a simple referral network, or a more formalized cross-marketing agreement with compensation paid.

If you would like to discuss how you can increase cash flow in your business, schedule a FREE, no-obligation consultation to discuss how we can help.