CASH, CREDIT & COLLECTION MANAGEMENT:  
THE LIFE BLOOD OF THE BUSINESS

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David Osburn, is the founder of Osburn & Associates, LLC that specializes in providing seminars, webinars, and keynote speeches to bankers, CPAs, attorneys, and credit managers on topics such as Banking/Finance/Credit, Negotiation Skills, Marketing, and Management.

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I. Overview

A. Credit Analysis (Front End)

B. Financial Statement Analysis (Front End)

C. Cash Management Techniques (Middle)

D. Collection Techniques (Back End)

E. Collection Management (Back End)
II. Credit Analysis

A. The Basics: What is Credit?

-The Granting of terms in a business setting

-Grant Terms = Lend Money

Business Credit:

Ex. Bank Loan (Line of Credit, Equipment Loan, Commercial Real Estate Loan, Letter of Credit, ABL products, Leasing, etc.)

Ex. Trade Credit
(Accounts Receivable) (2/10, NET 30)

Ex. Issue a bond obligation
(School District, Corporation, etc.)

Ex. Commercial Paper
(Large corporate obligation)
B. How Does a Company Really Obtain/Grant Credit?

1) Financial Institution:

- Strict underwriting enforced by Federal and/or State regulators

  *Ex. Commercial bank (Regulated by the FED, FDIC, OCC, or State Banking Commission)*

  *Ex. Federal Savings Bank (thrift, etc) (Regulated by the OCC-previously the OTS)*

  *Ex. Credit Union (Regulated by the NCUA, State)*

Bank Rating:

CAMELS Rating, BauerFinancial, Texas Ratio
2) Traditional Trade Credit

Ex. Accounts Receivable

- Based on the repayment provisions that are part of a credit arrangement

- How is the “Credit Arrangement” established?

- More often than not, by relationship, but what if the relationship is intact, but the company’s financial position has deteriorated?

- How will you know?

- Are Relationships over-emphasized?
If you grant terms (in a traditional trade credit relationship) Are you a:

   Lender?

-If you are a lender, do you properly “underwrite” the borrower and the relationship?

Therefore, are you also an:

   Underwriter?

Related Concept: Are you a “hunter” or a “skinner”? 
C. The Five “Cs” of Credit:

1. *Capital:* Debt versus equity

2. *Capacity:* Cash flow ability

3. *Conditions:* Economic conditions

4. *Collateral:* Assets pledged to support loan

5. *Character:* Moral or ethical quality of the “individual” who is responsible for repaying the loan
E. Advanced Techniques

1) *Underwriting Tools*

Use of Sophisticated Credit Tools: Technology vs. “Human” Interaction

Ex. Credit Scoring, Financial Statement Analysis

2) *The Role of the Underwriter*

How well trained?
How supportive is management?
An evolutionary process?

3) *The Use of the Internet*

Too over-used?
Too over-rated?
Just another tool among many?
III. Financial Statement Analysis

The Four Financial Statements

A. Income Statement (The “P & L”)

B. Statement of Owners Equity/ Retained Earnings

C. Balance Sheet

D. Statement of Cash Flows
III. Financial Statement Analysis (Five-Step Model)

A. The Five-Step Financial Statement Analysis Model:

1) Liquidity

2) Activity

3) Leverage

4) Operating Performance

5) Cash Flow Analysis

1) Liquidity

Working Capital = Current Assets – Current Liabilities

Current Ratio = \frac{Current Assets}{Current Liabilities}

Quick Ratio (Acid test) = \frac{Current Assets – Inventory}{Current Liabilities}
2) Activity (Turn factors)

- Accounts Receivable Turnover

  \((A/R \div Sales \times \text{days in period})\)

- Accounts Payable Turnover

  \((A/P \div COGS \times \text{days in period})\)

- Inventory turnover

  \((\text{Inventory} \div \text{COGS} \times \text{days in period})\)
3) **Leverage**

Debt Ratio = Debt / Net Worth (equity)

4) **Operating Performance**

Common-Sized Analysis:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>Net sales</td>
<td>$5,000,000</td>
<td>(100%)</td>
</tr>
<tr>
<td>COGS</td>
<td>4,400,000</td>
<td>(88%)</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>$600,000</td>
<td>(12%)</td>
</tr>
<tr>
<td>G &amp; A Expense</td>
<td>350,000</td>
<td>(7%)</td>
</tr>
<tr>
<td><strong>Net Profit</strong></td>
<td>$250,000</td>
<td>(5%)</td>
</tr>
</tbody>
</table>
5) Cash Flow Analysis (Life Blood)

-versus CASH

Traditional Cash Flow

EBITDA $1,200M

Less: Debt Ser (P & I) 500M

Margin $ 700M

DCR 2.4X

(EBITDA = Net profit + Interest expense + Taxes + Depreciation +Amortization)
IV. Cash Management Techniques (Basic and Advanced)

A. What is Cash Management?

1) *Cash management* (Treasury Management) is a set of techniques that allows a company to more effectively manage its cash, invest its excess funds, and avoid fraud.

2) Many banks and brokerage firms provide cash management services but generally, the more sophisticated products/services are provided by the larger firms.

(The small firms either provide limited services on their own or partner with larger providers.)
B. What are some simple (basic) cash management techniques?

1) **Bank ACH Services**: Eliminate paper checks by converting to electronic payments. You can track your company’s cash position accurately and make decisions based on exact information. A wide variety of collection and payment transactions can be initiated from the company’s office using Windows-based, LAN-compatible software packages.

2) **Bank Wires**: Move funds quickly and securely via national and international automated networks. The company is able to control cash flow when you need to move large amounts of cash, centralize funds from multiple locations, or disburse funds from a central location. Wires can be transmitted by telephone, through standing order, or using your mainframe computer or PC.
3) **Bank Lockbox (wholesale/retail)**: Eliminate time wasted in the collections cycle. Lockbox reduces mail float and makes funds available earlier for investment or reduction of interest expense on loans. The lockbox service uses **advanced image-capture technology** to help reduce clerical time required for processing and depositing.

4) **Vault Services**: Manage your cash deposits and inventory more conveniently with increased **security**. Vault services includes door-to-door armored car service and allows the company to order **cash and currency** 24 hours a day, 7 days a week via touch-tone phone.
C. What are some sophisticated (advanced) cash management techniques?

1) **Zero Balance Account (ZBA):** Concentrate funds from several accounts into a **single lead account** to make better use of investing, reducing loan balances, or offsetting service fees. You can **consolidate the company cash** while branches, offices, or subsidiaries maintain their own accounts, thereby increasing your security and control.

   **Related Services:** Cash Concentration Services, Sweep Accounts

2) **Controlled Disbursement:** This service allows the company to **know exactly how much will clear the company’s “local” bank** checking account everyday. Using a “controlled” funding from one designated account (usually located at a bank on the other side of the country) eliminates forecasting guesswork and idle cash balances. This service is often compared to having the benefit of a legal “kite”.
3) Positive Pay: This service provides the company with early detection of unauthorized payments so that the encashment of lost, stolen, and counterfeit checks can be prevented. If a check does not match the company’s check issuance record (which has been previously provided via e-mail to the bank), it is flagged for the company’s review and approval to either pay or return.

Reserve Positive Pay: Similar to positive pay, but the process is reversed with the company, not the bank, maintaining the list of checks issued. When checks are presented for payment and clear through the FED, the FED prepares a file of the checks’ account numbers, serial numbers, and dollar amounts and sends the file to the bank. The bank then sends that file to the company, where the company compares the information to its internal records. The bank pays only “true” exceptions, that is, those checks that can be reconciled with the company’s files.
V. Collection Techniques (including Negotiation Skills)

A. Dialing for Dollars: Does it really work?

-The telephone as a negotiation tool

-What is Negotiations?

-Negotiations: A “communicative” interaction between two humans
B. Knowing your customer: How well do you know your customer?

- How well do you communicate with your customer?

1) Oral

2) Written (including e-mail)

3) Non-Verbal (use of body language)

4) “Space” Dynamics
C. The Use of the Hierarchy of Needs

Maslow’s Hierarchy of Needs

1) Survival (Basic Needs) - Food, water, etc.

2) Safety Needs – Lack of fear

3) Social Needs – Humans are social beings

4) Self-Esteem – Feeling good about oneself

5) Self-Actualization – Feeling on “cloud 9”
D. Legal Aspects of Collections

Fair Debt Collection Practices Act (Third Party Consumer Credit Law)

1. No Postcards

2. Represented by an Attorney

3. Time: 8am-9pm

4. Place of Employment

5. No Communication with Other Parties

6. Refuses to Pay, Cease to Communicate

7. No Harassment

Lender Liability: Lender's exposure to financial compensation claims relating directly or indirectly to actions taken by the lender.
VI. Collection Management (A Human Approach)

A. Required Skills for a Top Collection Manager

1) Management Skills

- “People” skills
- Ability to delegate (Management Science: “Jethro” Principle)
- Ability to communicate (Oral, written)
- Ability to motivate
- Ability to negotiate
- Time management

2) Technical Skills

- Accounting skills
- Tax return analysis skills
- Financial statement analysis skills

3) Other: Human Resources (Labor Law), Banking, Marketing
B. Your Management Style: Does it really matter?

1) X (Authoritative)
2) Y (Delegation)
3) Z (Team)

-Are you a Manager or a Leader?

C. Quantitative versus Qualitative Factors

1) Generation
   - Baby Boomers
   - Generation X
   - Millennials

2) Other “human” factors
   - What is empathy?
   - What is ego?
VII. Summary

Cash, Credit & Collection Management: The Life Blood of the Business

Rules for Survival:

A. Be an effective “credit” analyst
B. Be an effective “financial” analyst
C. Be an effective “cash” manager
D. Be an effective “collector”
E. Be an effective “people” manager
F. Be an effective credit leader!

Final Thought: In today’s economy, Cash is not King, Credit is not King, Cash Flow is King!