Mystery Solved

Cash-flow problems have just a few possible causes. More often than you might think, business is all about the basics

Start Clean Andrew Blitstein didn't truly understand his janitorial business until he examined his top two accounts.

I'm often amused by the reactions of people who come to me for help. I usually start by interviewing them in my office. They explain the problem they're having. I ask them a few questions. They answer as best they can. I then tell them something about their business that they can't believe I could know. They think I'm a genius. If only it were true. In fact, I'm just applying the basic business knowledge that allows you to analyze what's going on in a company. Once you have that knowledge, you can do the analysis on your own.

Consider Andrew Blitstein, who took charge of his family's cleaning service a few months ago after his father passed away. Up to then, Andrew had been handling sales for the company and had little or no experience in other areas of the business. He came to see me at the insistence of his mother, who'd worked with her late husband, and his uncle, who was an old friend of mine. From Andrew's demeanor, I could see he wasn't convinced that he needed my help or that I had much to teach him about a business in which I had no experience. But he did want to expand the company and make some money, and he was having trouble figuring out how to do the latter.

I started, as I usually do, by asking Andrew general questions about himself and his company. It was a more or less typical commercial janitorial service. In addition to cleaning offices on a regular basis, the company did special jobs, like shampooing the rugs and washing the windows. As for problems, he said he was having a tough time with cash flow. "I see," I said. "Are you having trouble collecting your receivables?" No, receivables weren't a problem, he said. "How about bad debt?" No, bad debt wasn't a problem, either. "Then do you have a big office with lots of people?"

"Oh, no, no," he said. "We run pretty lean." So excessive overhead apparently wasn't a problem, either.

Now, cash-flow problems are common in business, and people often have a hard time figuring out what's behind them, but there are actually just a few potential causes. You could have too much cash tied up in receivables or—if you have a product-based business—in inventory. Or you could have too many deadbeat customers. Or you could be spending too much on overhead. But if receivables, inventory, bad debt, and overhead are all under control—as they appeared to be in Andrew's case—there really is only one other likely culprit: weak gross margins, which could mean prices are too low, direct costs are too high, or some combination of the two.

I asked Andrew how much he was paying his employees. He said they earned about $20 an hour. "No," I said. "I mean, what's the hourly cost fully loaded with all the taxes, benefits, and so on?" He didn't know, which is not unusual. I would have been more surprised if he did know. "So you don't know what your costs are," I said. "It's hard to make a sale—at least a good sale—if you don't know your costs. How do you price a job?"

"Well, when we do the carpet cleaning or the window cleaning, I figure out approximately how much it's going to cost us, and then I try to double it."

"OK," I said, "that's good. But how do you price the regular cleaning service?"

"We just try to be competitive," he said. "We have a lot of competitors, and we want to get the long-term contracts. We make our money on the extras."

So he didn't know how much the regular clean-

FROM TOP: EVAN KAFKA; MARTIN POOLE/GETTY ing service was costing or what a good price for it would be. "Let's take your two biggest clients," I said. "How much business do they do?" He said he had one contract that paid about $350,000 a year and another that paid $300,000. "How much money do you make on those contracts?"

"I don't know," Andrew said. "Not much. But they also use us for the extras."

"And how much do they pay for the extras per year?"

"About $20,000 or $25,000," he said.

"So, given how you price the extras, they contribute $10,000 or $12,500 to covering your overhead," I said. "That's not a lot for accounts of that size. My guess is that you're losing money on them."

Andrew gave me a skeptical look. "No, that's impossible," he said. "Besides, you don't understand. We need those accounts for cash flow."

"How do they help your cash flow?"

"They pay us on the first of the month with an American Express credit card," he said. "It's automatic. We can count on it."

"OK, but American Express is charging you an extra 3 or 4 percent for that service," I said. "That just steepens your loss." He wasn't swayed. "Listen," I said. "Why don't you go back and take those two largest accounts and break them down. I'd be shocked if you weren't losing money on them. Then, if you want to come back, I'd be glad to sit down with you."

I could read his thoughts as he left: Who is this guy? How can he possibly know what he's telling me? But four days later, Andrew contacted me and said he wanted to get together again.

"You were right," Andrew said as he sat down in my office. "We're losing money on those accounts. I figure that, fully loaded, I'm paying $31 an hour."

"OK, well, let's see what fully loaded is," I said. We started to go through his numbers on one of the accounts, and it quickly became apparent that he had underestimated the costs. By the time we finished, we could see he was losing from $50,000 to $60,000 annually on the account. "Think of it this way," I said. "If you stopped doing business with this customer today, you'd make an extra $50,000."

"I don't know...," Andrew said.

"I'm not telling you to get rid of the client," I said. "There may be reasons to keep the account. But do you really think any of your competitors would take this account away from you and lose $50,000 a year on it?"

He smiled at the absurdity of the idea. "But I'd have to increase my price something like 20 percent just to break even on the account," he said. "I can't do that."

"Maybe not," I said. "I realize that it's hard to increase prices in a recession. But the client has to recognize that it will never find a company willing to do the work at the rate it's paying you." I suggested that he put everything down in writing—every single direct cost he had—and then go to the customer. "Show him the numbers. Tell him it's being going on for a long time, but you accept responsibility for the past. You just can't go on losing $50,000 a year on the account. You have to at least break even, or you'll go out of business."

Andrew said he would think about it. I'm sure he will come around eventually. Meanwhile, he has made significant changes in the way he sells. He told me about one prospect who wanted to use him but felt that his bid was a little high. Rather than reduce the price, Andrew stood his ground. "You're talking about saving 10 cents an hour, but look what you get for those 10 cents," he said. "Our service is far superior."

He got the account. More to the point, he got the concept. And he realizes that you don't need to be a genius to deal with cash-flow problems. You just have to know how business works.

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