Increase Velocity to Increase Profits

Most people know the importance of cash flow. There are many businesses that look good on their income statement. It is only when you look at their cash flow that problems become clear. As a mentor often tells me

Cash is king.

Part of velocity is how quickly you get paid. How quickly do you invoice? What are your payment terms? How effective is your collections process?

Even more important is how quickly you turn your inventory. The best explanation I've heard comes from What the CEO Wants You to Know. This great book is a quick read and covers financial statements in a down to earth manner.

The author tells a story of street vendors in India. The vendors borrow money at 2.5% per month and sell items on a slim - 5% - margin. How can this work? ***Velocity***. By turning the goods several times a day they pay for their product, pay off their loan, and still make a profit. The more times she turns her inventory the more money she makes.

Dell has turned velocity into an art form. Between their payment terms and JIT manufacturing they make a better profit. How does this work? A customer places an order and they receive payment from VISA (less than a week). The parts for the computer sit on a shelf for a short time (often days) and they pay for them on favorable terms (often net 45). This *gap* between getting paid and paying their bills is free money for Dell. They only earn a little interest on the money but that difference is big when you look at their volume. It also has several other benefits:

- Improved profit
- Evens out their cash flow
- Leverage their profits. Since they have minimal *Dell* money tied up in the sale it increases their ROI.

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