

Managing Cash Flow for a Low-Capital Food Hub Start-up

Starting a food hub is a capital-intensive process. What should a manager do if adequate start-up money is not available?

It is often assumed that starting a food hub is a capital-intensive process requiring large investments in infrastructure, transportation, logistics and personnel at the outset. While grants or loans can provide start-up funds for a new food hub distributing fresh local produce, in many cases these resources are not available. Grants for a new business can be hard to find, and most financial institutions are not willing to lend to start-up operations, especially those that sell perishable food items. Fortunately, there's hope. For the Iowa Food Hub, experience has shown that food hubs can be started with very little capital if their managers pay close attention to cash flow. This publication investigates how new food hubs can grow successfully under money constraints if cash flow is managed strategically.

What is Cash Flow?

Cash flow is the movement of money into or out of a business. For a business owner, cash is the amount of money that the business has in its bank account and on hand – that is, how much money the business has available to spend at a given time, without incurring additional debt or selling something.

Selling goods or services creates positive cash flow (money moving into the business), but not until the business actually receives money from the customer. Likewise, if the business incurs an expense, it will only experience negative cash flow when it pays the bill for the expense. Thus, the flow of cash and the flow of products for a food hub do not always happen on the same timeline, but they impact one another. Consider the following diagram of a food hub's steps in selling products, and how each step affects cash flow:

Flow of Products and Cash



This diagram reflects a cash flow cycle. Once the products are paid for, a food hub manager will want to recover that cash as soon as possible (and hopefully some profit!) by selling the products and receiving payment for them. The faster this happens, the sooner cash can be made available for the next purchasing cycle and for other business activities.

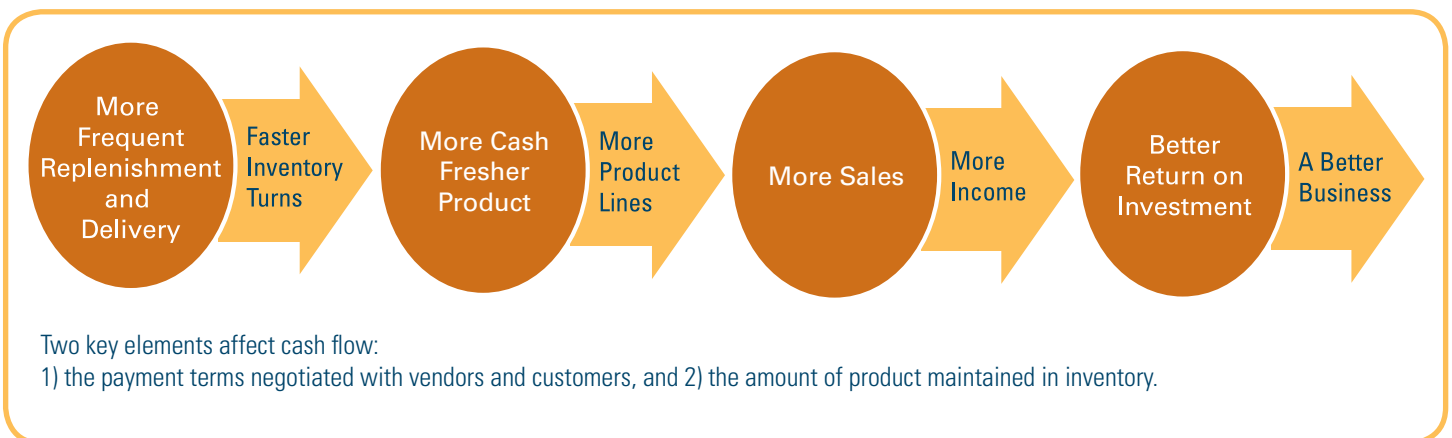
Limited Cash as a Barrier to Growth

Cash flow determines how much money a manager has available to make new purchases, add new customers, pay unexpected expenses, and generally expand the business. Because of uncertainty during the business start-up phase, new food hubs need enough cash on hand to pay expenses as far into the future as possible. It takes new managers time to figure out where sales revenues will come from and at what rate. Having more available cash means having more flexibility and more resources to operate, which improves the chances of landing a big account, finding a new specialized market niche, or simply generating the extra funds needed to achieve business success. Therefore, depending on how well a business manager handles cash flow, it can be either a barrier or boon for growth. For food hubs, it is often a barrier.

Most businesses increase their available cash by obtaining operating loans or lines of credit from a bank. However, things are more complicated for companies,

such as produce distributors and food hubs, that handle perishable inventory. Why? Banks and credit unions often lend on the basis of inventory, or goods the business owns and plans to sell. Banks do this with the understanding that if something goes wrong with the business, any available assets (including inventory) will be liquidated and the bank will get its money back. Most lenders are conservative when it comes to lending against perishable inventory, which will be worth nothing once it spoils. For a produce wholesale business, this makes it difficult to obtain a line of credit that will provide working capital, or cash, in addition to what the business itself generates.

When food hub managers have limited cash, a common approach is to try to minimize logistics and shipping costs so that less cash flows out of the business in the short run. While a mentality of cost-effectiveness is clearly useful, it can also restrict the business from taking risks or adding new customers that would be necessary to increase overall revenues. It is very important to manage cash flow in a way that enables growth, rather than restricting it. Always remember:



Key Concepts for Improving Cash Flow

Payment terms dictate the agreed-upon amount of time between when a bill is received and when it must be paid. When an invoice is received, it usually shows the deadline for payment or the number of days until payment is due; this represents the payment terms. Businesses negotiate payment terms with both suppliers and customers. Expectations for payment terms vary among businesses. Farmers who supply a vegetable or meat product may ask for short payment terms because they need to be paid quickly in order to continue operating their farms. Often they, too, are running businesses that have limited cash flow to cover expenses like worker wages or input costs such as

irrigation, nutrients or feed. As customers, institutional food service buyers may require longer-than-average payment terms because they simply need more time than other customers to process their bills. For a food hub, longer payment terms on accounts payable (bills that the business owes to its suppliers) are better for cash flow. Shorter payment terms on accounts receivable (bills owed to the business by its customers) are better for cash flow.

Another important aspect of managing cash flow is **the amount of inventory kept on hand**. Inventory is commonly described as the quantity of physical product in stock. Once a food hub purchases products that it plans to resell, the cash spent to buy them is temporarily

unavailable to the food hub—it exists only in the form of inventory or the products waiting to be sold.

From a cash flow point of view, food hub managers might wish to keep as little inventory on hand as possible, for as short of a time as possible. However, keeping inventory also has advantages: it offers the freedom to sell more product “on the spot” as opposed to taking orders in advance, and it reduces the risk of running out of product if customers order more than expected. Thus, managers must consider multiple factors and

make strategic decisions about how much inventory to keep on hand.

When a food hub begins, the main question for any business transaction should be: “How long will it take for the cash spent on products (cash out) to cycle back into sales income (cash in)?” By looking at the amount of time between when payments are due to vendors and when cash from sales is deposited into a bank account, as well as the size of the payments, managers can predict how much cash they will need for a particular transaction.

Food Hub Example:

The following illustrates how a food hub manager might make quick projections to determine the cash flow implications of adding a new customer.

Jane, a food hub manager, carries rainbow carrots, which are a difficult-to-obtain specialty product. A new customer, Dale’s Food Service, tells Jane that they want to order the product in large quantities. Jane is excited as this is the break she’s been looking for. Dale’s Food Service wants to buy one order (500 units) of rainbow carrots each week. Jane plans to buy the carrots from local farmers for \$5,000 and sell them to the customer at a 30% markup, or a selling price of \$6,500.

Let’s look at what will happen to Jane’s cash flow if:

- 1) Jane has 7-day billing terms with her suppliers (meaning she pays her farmers within 7 days after receiving their products),
- 2) Jane has 30-day billing terms with her customers (meaning her customer pays her within 30 days after receiving products),
- 3) Jane receives products from suppliers and delivers them on the same day, and
- 4) Jane receives a new order every 7 days.

Jane creates the following timeline to see how this situation would affect her cash on hand during the first two weeks of doing business with the new customer:

Day	Activities	Cash Flow		
		Total Out	Total In	Total Owed to Hub
0	Jane collects the first order of products from farmers and delivers them to the customer. She receives \$5,000 in bills from farmers for the product (due in 7 days). She bills the customer \$6,500 for these products (due in 30 days).	\$0	\$0	\$6,500
7	Jane collects and delivers the second order of products. She receives \$5,000 in bills from farmers for these products (due in 7 days). She bills the customer \$6,500 for these products (due in 30 days). She must pay last week’s \$5,000 in bills to farmers.	\$5,000	\$0	\$13,000
14	Jane collects and delivers the third order of products. She receives a new set of bills from farmers for \$5,000 (due in 7 days). She sends a new bill to the customer (due in 30 days). She must pay last week’s \$5,000 in bills to farmers.	\$10,000	\$0	\$19,500

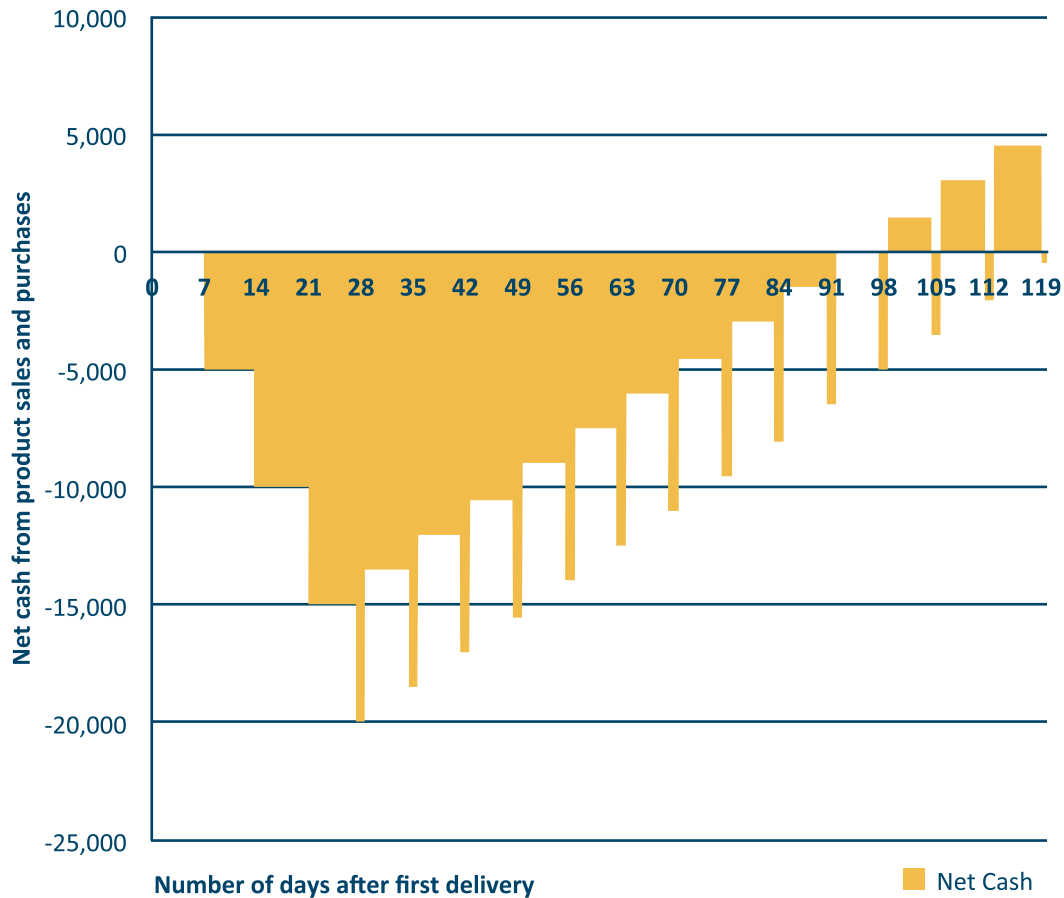
By day 14, we already can see that Jane has a problem. At this point, she has already paid farmers for two weeks’ worth of products (\$10,000 total), but she has not yet been paid by the customer. This situation will continue until day 30, when the customer’s first payment to Jane will be due. By the time the customer’s first payment arrives, Jane will have paid out a total of \$20,000 to farmers.

The example on page 3 is very simplistic. In reality, Jane probably has several different customers that she is serving, and several different products that she is delivering. In determining whether Jane can pay her bills, the overall picture of her cash flow from *all* products and *all*

customers matters more than the cash flow from sales to an individual customer. However, looking only at the cash flow implications of selling to Dale’s Food Service allows Jane to make an informed decision about when and how to add that customer.

The graphic below illustrates the cash-flow situation Jane encounters over the course of 120 days, assuming both she and her customers pay their bills on the due dates.

Cash Flow After Adding a New Customer



As shown in the chart, it takes more than three months before the food hub starts to consistently receive positive net cash flow from selling to this new customer.

In the long run, Jane will probably be paid for all the products she has sold to the customer, and she will hopefully make a profit. In the first three months, though, Jane may find herself very short on cash. If she does not have \$20,000 in cash or credit available to pay her suppliers before the customer pays her, Jane may end up unable to pay her bills on time. She will also have a tough time adding other new customers during this period.

Furthermore, imagine what must be done if Dale’s Food Service makes it clear that they will not tolerate out-of-stock situations. In order to make sure that she always has enough product to fill their orders, Jane decides she needs to stock an extra week’s worth of product in inventory (valued at \$5,000) to ensure she has product on hand. This would increase her maximum cash deficit to \$25,000 before she begins to be paid. Based on these calculations, Jane should consider carefully whether the payment terms and inventory position will work for her business.

Strategies from Iowa Food Hub

The experiences of the Iowa Food Hub (IFH) provide some concrete examples of how to improve the cash flow of a business. IFH was started in 2013 with \$500 in its bank account. With this significant constraint, cash flow has always been a challenge. Each new customer and product line has required finding the right payment terms and level of inventory turnover with the least amount of risk. With this in mind, the IFH relies on four ongoing practices to manage its cash flow:

- 1) Develop markets with favorable cash flow implications. The IFH's initial market was a multi-farm grocery delivery program. This program billed customers weekly and paid farmers monthly. When it was launched, this program allowed the food hub to collect five weeks of cash payments from customers before making its first payment to suppliers. This initial infusion of cash helped the program to expand more quickly.
- 2) Manage logistics to encourage faster inventory turnover. Lower stocking levels (i.e., stocking less inventory) can be accomplished by ordering products more frequently from vendors and delivering products more frequently to customers. While often more costly from a logistics perspective, this approach not only improves cash flow, but can ultimately result in better sales. Delivering frequently to customers allows greater customer satisfaction because it can reduce spoilage of excess product, prevent customers from running out of the product, and reduce the storage space that customers need to keep products in stock.
- 3) Manage vendor terms so 30-day payment is the norm. Manage customer terms so 7- or 14-day payment is the norm. The faster a food hub is paid by its customers and the slower it pays its vendors, the better its cash flow situation will be.
- 4) Closely monitor receivables. When customers are late with payment, IFH makes sure they know product delivery will be withheld if they do not pay promptly. For certain customers who are chronic late payers, it may be best to collect credit card information and bill them right away. This allows a food hub to hold onto customers without draining time and energy on bill collection, as chasing delinquent customers can be very time-consuming. While it may be advantageous to give key customers (i.e., those who represent a large amount of sales and cash flow for your operation), some leeway in their payments, customers who consistently won't or don't provide cash flow effectively should be culled from the customer list. Try to check customers' credit before giving them too much extra time to pay.

Business managers concerned about the cash limitations of their business often construct a **cash flow budget**, which predicts overall changes in levels of available cash over a period of time. Cash flow budgets draw on the business manager's estimates of future cash income and cash expenditures.

An example of a cash flow budget for Jane's food hub is shown on the following page. In the budget shown, Jane has estimated her cash flow on a month-by-month basis, but cash flow budgets can be divided up by week, quarter, or by any period of time. A more detailed explanation of cash flow budgeting can be found at www.bizfilings.com/toolkit/sbg/finance/cash-flow/cash-flow-budgets.aspx.

Sample Cash Flow Budget: Jane's Food Hub

Note: This budget is only a sample. A complete cash flow budget would show projected monthly or quarterly cash flow for the entire year.

	June	July
PROJECTED CASH INFLOWS		
Collections on previous Accounts Receivable	\$32,500.00	\$33,500.00
Sales (produce sold AND paid for during this month)	\$65,000.00	\$67,000.00
Facility rental income	\$200.00	\$200.00
Interest income	\$10.00	\$10.00
Sales of capital assets (e.g. equipment)	–	–
New loans/equity received	–	–
TOTAL CASH INFLOWS	\$97,710.00	\$100,710.00
PROJECTED CASH OUTFLOWS		
Cost of Goods (produce purchased AND paid for this month)	\$37,900.00	\$38,700.00
Operating Expenses		
Employee salaries	\$3,750.00	\$3,750.00
Employee wages	\$3,200.00	\$3,500.00
Employee benefits and other payroll expense	\$1,100.00	\$1,200.00
Contractor services	–	–
Supplies	\$150.00	\$150.00
Equipment repairs and maintenance	\$400.00	\$400.00
Fuel	\$5,200.00	\$5,400.00
Advertising	\$150.00	\$150.00
Accounting and legal	\$500.00	\$500.00
Rent	\$1,000.00	\$1,000.00
Telephone and utilities	\$620.00	\$620.00
Insurance	\$150.00	\$150.00
Taxes and licenses	\$100.00	\$100.00
Miscellaneous operating costs	\$200.00	\$200.00
Other Cash Outflows		
Payments of previous Accounts Payable	\$36,600.00	\$37,900.00
Loan payments	\$380.00	\$380.00
Capital purchases	–	–
Other withdrawals	–	–
TOTAL CASH OUTFLOWS	\$91,400.00	\$94,100.00
CHANGE IN CASH		
Inflow - Outflow	\$6,310.00	\$6,610.00
+ Beginning balance (from previous month)	\$5,500.00	\$11,810.00
= ENDING CASH BALANCE	\$11,810.00	\$18,420.00

Returning to our Example: Jane's Food Hub

Armed with this knowledge, imagine that Food Hub Manager Jane successfully presses her customer for 7-day turnaround on payment for the product and also negotiates with her vendors to accept 14-day payment. Additionally, Jane calculates that it is worthwhile to accept higher logistical costs in order to replenish her stock quickly and frequently, requiring less inventory to keep the customer happy. Furthermore, three months into the sales program her customer, who had been paying in seven days with weekly delivery, misses a payment. Jane catches this, has a serious conversation with the customer, and receives the late payment before she gets too deeply in the red.

By paying close attention to cash flow, including payment terms and inventory turnover, Jane is able to grow her business using the cash she generates. Careful cash-flow management allows her to make new investments without relying on outside lenders to provide her with cash.



About Iowa Food Hub

The Iowa Food Hub (IFH) is a local food distribution business based in West Union, Iowa. Established as a means to facilitate development of the regional food system, IFH programming focuses on food access and equality, small- and medium-sized farm viability, beginning farmers, local economic development, and food system research and education.

An outgrowth of the Northeast Iowa Food and Fitness Initiative (FFI), IFH unites the missions of its partners, nurtures regional collaboration, focuses on rural poverty alleviation, and promotes opportunities for local farmers to engage in the food system.

The Iowa Food Hub is operated by Allamakee New Beginnings, Inc., a 501(c)(3) nonprofit charitable organization. Established as an educational, research-driven food hub, IFH is also supported by the FFI core partners: Iowa State University Extension and Outreach, Ames; Luther College, Decorah; Northeast Iowa Community College, Calmar; Upper Explorerland Regional Planning Commission, Decorah; and the Community Foundation of Greater Dubuque, Dubuque.

Learn more at www.iowafoodhub.com

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