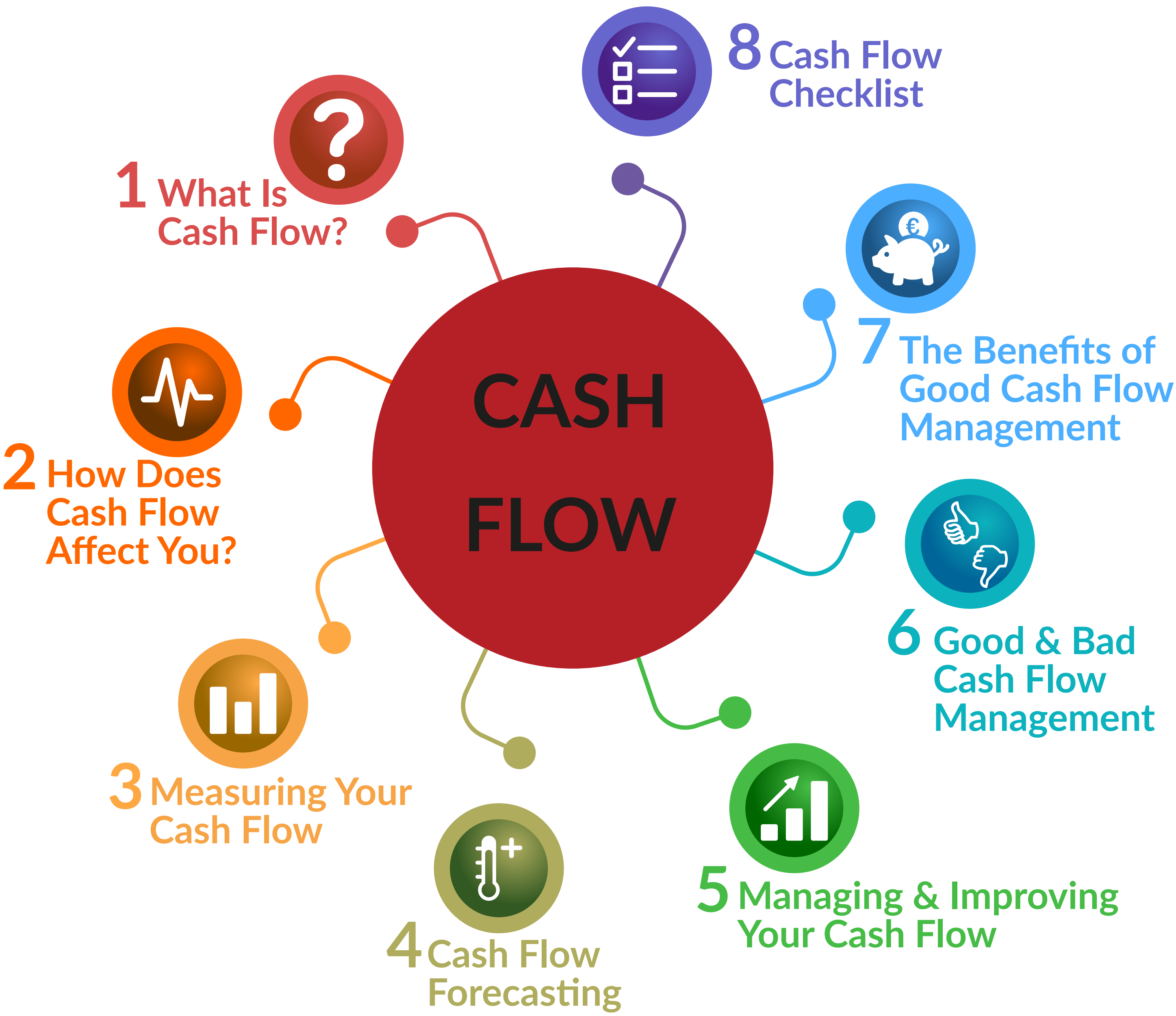
Cash Flow

Introduction

We fundamentally believe that your ability to understand your accounts is directly related to the performance of your business. We also believe that your ability to manage your cash flow is directly related to the very survival of your business.

The statistics for both new and existing businesses shows that a lack of understanding of cash flow can cause profitable businesses to fail. Armed with this information, what should you do?

1. Read this guide again and again and again. Know it inside out.
2. Check our Account-Ability, our 6-part video series on the basic of accounting. The last video, arguably the most important one, deals exclusively with cash flow.



What Is Cash Flow?

Cash flow is the movement of money into a business from sales or client fees and money out in the form of purchases, wages and expenses.

Not to be confused with profit, a company can have positive cash flow yet make a loss, or it can show a profit but fail because of negative cash flow. This occurs when, on paper, a profit exists due to sales completed but owed revenues have not been collected. The net result of this situation is that there is insufficient cash to keep the business afloat.

Example: A busy high-street café
Some customers may pay with cash, but more and more are using credit and debit cards, as well as contactless payments. The bank may only transfer payment to you several times per month, but you buy ingredients and local produce on a daily basis, and wages are paid weekly so you need the cash flow to manage this. Managing cash flow is paramount to the business remaining successful.

It is very important to distinguish between profit and cash flow. Even if your business is profitable, you need to be on top of your cash flow.

How Does Cash Flow Affect You?

There are short and long term implications for your business when managing cash flow, as there are regular outgoings (such as salaries and utility bills) and unusual or once-off costs (equipment upgrade or replacement):

- **Paying Employees:** you must have sufficient cash flow to cover all salaries as well as employer's taxes due to government. If you regularly have trouble covering salaries, this will damage your relationship with your employees and could lead to a high level of staff turnover.

- **How You Analyse Your Business:** the most important aspect of your daily business existence revolves around cash flow, not how profitable your company is. Cash flow should be uppermost in your mind when making decisions regarding your business' finance, such as pricing and paying suppliers.

- **Serving Your Customers:** not paying your suppliers on time will have massive consequences for your business, as it may prevent you from sourcing everything you need to operate your business. For example, if you have unfulfilled orders due to no stock (because cash flow prohibits you from buying what you need) this will affect the long-term performance of your business. In turn, existing customers could look elsewhere for similar products or services.

  Without the necessary supplies you may not be able to fill outstanding orders. It could also mean a restricted offering for your customers. This could affect your sales which could lead to recurring cash flow issues.

If your company is confident of growth, then managing cash flow is probably the most important aspect of that growth, as it will underpin everything related to the growth, including paying down loans.

Measuring Your Cash Flow

Your Cash Flow Statement will give a true measurement of your current cash flow status, helping you to plan for the immediate future. At its core, cash flow is the difference between cash received into the business and cash paid out.

Cash Receipts − Cash Payments = Net Increase/Decrease in Cash

Previous Cash Position +/− Net Increase/Decrease in Cash = Current Cash Position

A positive cash flow position indicates that all your liabilities have been met; whereas the opposite holds if your cash flow is negative, and you may have problems covering salaries and outstanding invoices.

Cash Flow Forecasting

The ability to foresee cash flow for the coming months is critical to your business' success. This will enable you to predict your cash position going forward and whether or not you can cover mandatory payments. Forecasting, will isolate potential future issues so you can plan to rectify them. The success of your business could depend on how accurate your forecasting shows your cash flow position to be.

Managing & Improving Your Cash Flow

Adhering to these best practice guidelines will help you keep track of your cash flow and lay a solid foundation to ensure the viability of your business.

Plan: awareness of repeated outgoing and incoming revenues will make you understand your cash position and help draw your attention to any business surprises. Planning will help you establish preventative measures to maintain a healthy cash flow situation.

Invoicing: always invoice for a sale on the day it occurs. Every day you delay invoicing a customer is a day added to the time it takes for them to pay you. Ensure your bank details are correct and that the invoice has been sent to the relevant accounts section of the invoiced company to facilitate prompt payment.

Identify Major Outgoings: your accounts will offer transparency on what your largest overheads have been and could be. For example, if you are spending a lot on electricity and telephones, perhaps it's time to source a new supplier. Alternatively, maybe you need to consider buying in bulk to reduce unit cost of products required for operating your business?

Credit Control: it is essential to have a good credit policy with clear guidelines on what is permissible. Streamlining which supply companies receive credit will immediately improve your cash flow. You may need to impose a credit limit on customers who have a bad record of paying. You should require a deposit for large transactions to facilitate meeting the costs of providing the goods/services whilst mitigating any impact on your cash position. When necessary, don't be afraid to seek cash on delivery of goods or services, or limit the value of goods or services that someone can buy in a given period without payment. Don't neglect to remind customers to pay.

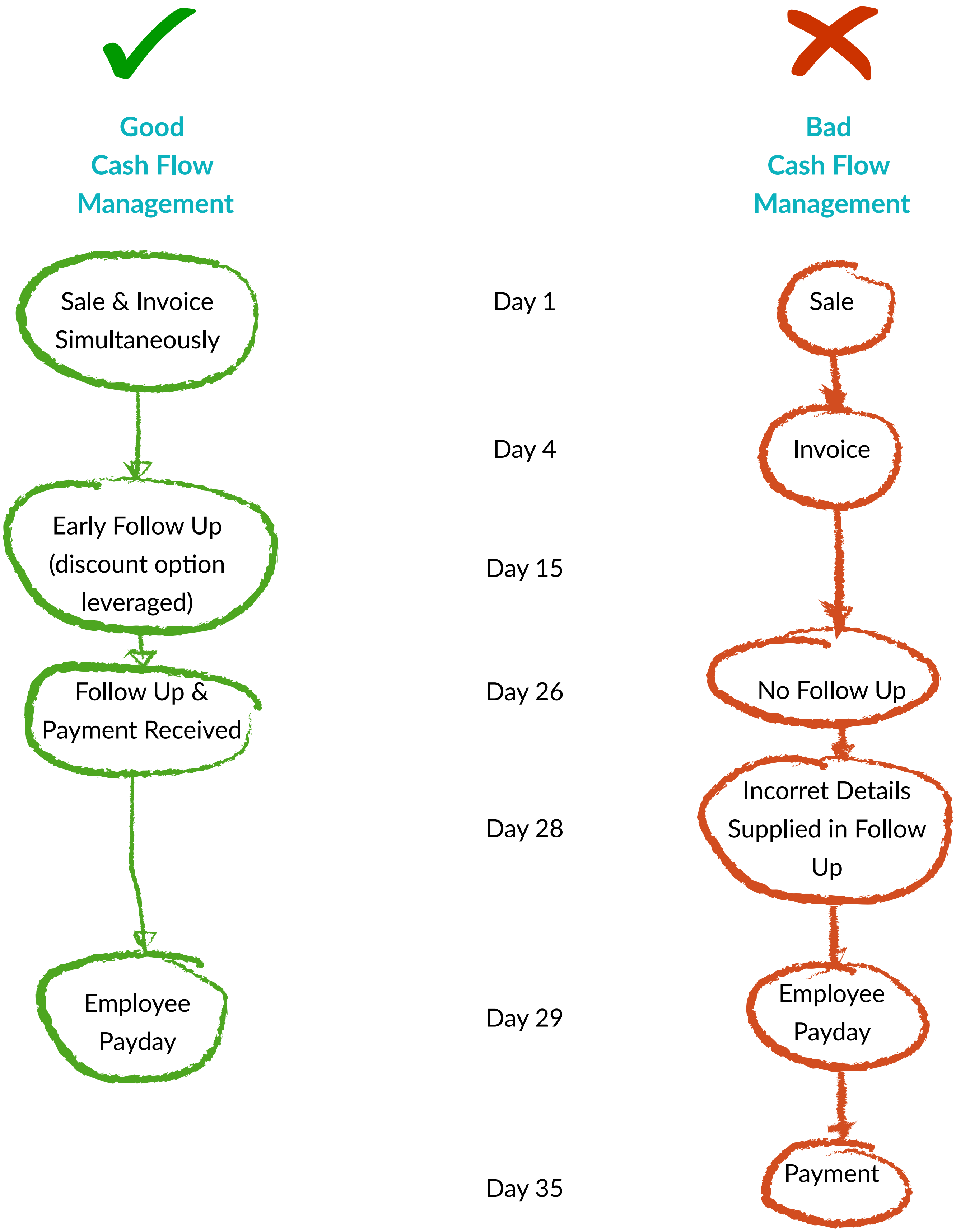
Payment Terms: being paid in advance or only offering short payment terms will go a long way to improving your cash flow. This means that cash comes into the business quickly.
Conversely, when paying your suppliers, only clear your invoices when the debt is due. This is considered free credit for your business, so you should maximise the term agreed to maximise your cash flow.

Tax Collecting: money that accrues as taxes must be set aside, as it doesn't belong to the business, but to the government. To keep on top of what comes in and what will be owed, it is advisable to open a separate bank account for this purpose, with restricted access. By doing this, you will have what's owed to the taxman when you need to pay it, thus avoiding possible interest and penalties.

Payroll: it is advisable to invest in a simple payroll system to ensure that salaries (one of the main costs to your business) and liable taxes are processed correctly.

Your Relationship With Your Bank: As discussed in *Bank relationships guide*, maintaining an open and honest relationship with your bank will help your business both in the short and long term – particularly if you need overdrafts, loans or a moratorium on loan repayments. Send regular updates including your cash flow forecasts.

Good & Bad Cash Flow Management



The Benefits of Good Cash Flow Management

A successful, thriving business means managing your cash flow. Otherwise your business may not be sustainable and expansion impossible. Positive cash flow maintains liquidity in your business, as well as contributing to growing your business

Pay Your Debts: good cash flow means that you can honour your debts and pay on time. By doing so, you strengthen your relationship with suppliers. Consequently, if there are times when you experience cash flow problems, your suppliers may be more sympathetic in extending credit terms. It will also help your credit rating if ever you seek financing. However, if you are habitually late when paying debts, when you do need a favour, suppliers might not be so inclined to assist you.

Less Stress: with good cash flow, it should follow that you will worry less about the daily operations of your business. If you are wondering week to week where the next cash injection will come from and whether you can meet your financial obligations, then your energy is not being utilised to positively drive the company's expansion. At a personal level, stress can create health issues and conflict within the company if employees' wages are threatened. A positive cash flow position allows you to spend your time building a successful company.

Expansions: good cash flow can reduce your reliance on external resources if you're trying to expand your business and avoid high interest. If external resources are required (for example a bank loan), you may be in a stronger position to negotiate repayment terms, especially interest rates.

In summary, good cash flow is paramount to a business' success.

Cash Flow Checklist

Forecast:

Plan for future incomings and expenditure, particularly large, reoccurring overheads.

Invoice Immediately:

Is there a time lag between closing a sale and invoicing for that transaction?

Details:

Make sure the invoice is sent to the relevant person to process payment promptly and that your business address and bank details are correct.

Payment Term:

Does your payment term reflect well on your cash position?

Follow Up:

What is your strategy to clear late debtors?

Deposit:

Is a customer's order large with cash flow knock-on effects? Consider asking for a deposit to facilitate your ability to supply.

Credit Limit:

Dealing with customers that are habitually late payers. Maybe you need to introduce a credit limit to protect your own cash position?

Your Bills:

Avail of the full payment term before settling your bills so you can take advantage of the period of free credit.

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