ProActive Resolutions

Managing Cash Flow

Cash flow is the money that comes into and goes out of your business.

Money coming in is called 'Receipts' and can include; cash from sales of goods or services, loans, cash from private means, sale of fixed assets (eg. computers), and cash invested to buy company shares.

Money going out is called 'Payments' and can include; cash to suppliers for stock and services, loan repayments, purchase of assets (e.g. vehicles), tax and salaries.

Your goal is to receive more cash than you spend, but if in the short term you find yourself with a cash shortfall, it doesn't have to be the end of the world. It simply means you will have to secure funding to pay your bills until you yourself are paid by customers. The best way to insure against cash shortfalls is to build up a cash balance to plug any gap. You can also ask your customers to pay sooner or ask for extended credit with your suppliers.

Profit versus cash flow

Profit is not the same as cash –a business can make a profit but not have any short-term cash available.

Profit is when a customer buys your product or service for more than it costs you to provide it. That makes you profitable. However, until they actually pay for it, you don't have a cash inflow. This means that even a profitable business can run into trouble if the cash dries up.

How do you manage cash flow?

To keep a ready supply of cash to pay your bills and suppliers, you must employ good practices. Devise a good cash flow management strategy to include the following five key elements:

1. Manage the credit you give

Set out reasonable payment terms and do not be afraid to ask for partial or full payment up front. Payment terms can be up front, on delivery, or a number of days from invoice (usually with a maximum of a month).

You may not feel comfortable doing it, but keep on top of late payments and chase! Send reminder invoices promptly and follow up with a phone call if needed.

You have a right to charge interest on late payments and in serious cases can threaten or carry out legal action to recover monies owed. You might want to consult your accountant, solicitor or business advisor on the best way to go about this.

Set up as many methods of accepting payment as possible, for example credit or debit card, Internet payments etc. The more ways a customer has of paying, the easier it is for them.

2. Update your books

If you have regular inflow and outflow of cash, you can't manage it in your head. Keep accurate up-to-date records of every invoice and transaction. Accountancy software will make this easier, so consider investing in a package if you haven't done so already.

3. Make a contingency plan

An overdraft or credit card facility can help to bolster any shortfall, but if your plan is to rely on these in the event of a cashflow problem, ensure your bank is willing to provide them, particularly at short notice.

4. Pay your bills

The good relationship you will build up with your supplier through paying bills promptly can be very useful if you need a short extension. The better your history with them, the more likely they are to be lenient when you need it most.

5. Set up adequate funding

Ensure you have a supply of cash for short-term expenditure. A good rule is to use long-term borrowing such as a mortgage or bank load to fund fixed assets like premises or vehicles, and short-term borrowing like an overdraft to manage supplier debts whilst awaiting payment from customers.

And remember – you aren't in this alone. Talking to your accountant or business advisor about the best way to manage cash flow can help you to build a better business.

Credit-checking your customers

Credit checks can reduce the risk of bad debt, but many businesses extend credit to customers without thinking about it. If you want to avoid the risk of not being paid, it's worthwhile vetting the customer first to ensure they are creditworthy.

There are many ways to credit check potential customers, but the simplest is to ask them to complete a short form

The form should ask for the following information:

- Full name of the business and the customer
- Company information such as type of business and number of employees
- Amount of credit required
- At least two trade references
- Bank details
- Length of time the business has traded.

If the potential customer is a limited company, they should also supply:

- Company registration number
- Name(s) of directors and date of formation

The more credit required, the greater the risk, so it's worth setting yourself a limit over which you always check references. You can follow up trade references (ideally with a standard questionnaire to ensure you don't miss anything) or you can ask the customer for permission to approach their bank for a status enquiry. However, you will probably have to pay a fee to the bank for this service, and it acts only as the bank's opinion rather than a guarantee so should not be your only source of reference.

Another source is to use a credit reference agency. This only applies to limited companies, as they have to file their accounts with Companies House. The credit reference agency will assess the risk on your behalf (for a fee, of course) and make a recommendation about whether or not you should offer credit.

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What to do when customers owe you money

Bad debt and late payments can destroy your business. If your cash flow dries you, you will be unable to pay your own suppliers and that could spell disaster. Getting paid on time is essential, but if all else fails and your customer ceases to communicate with you, you will have to enter the debt recovery cycle.

Your solicitor or debt recovery company will firstly send a 'letter before action', which outlines the nature of the debt and the requirement for payment. The letter will state that if payment is not made within a certain number of days, court proceedings will begin. This is often enough to jolt a late payer into action, at minimum cost to yourself.

If the debtor still does not pay, you will need to submit a claim form. You will incur costs, and going to court should always be a last resort, but if you have stated your intention clearly in the letter before action, the debtor will be liable for your costs.

When the debtor receives the claim form from the court, the court proceedings are officially started. The debtor will also be sent a response pack to acknowledge or deny the debt.

If the debtor fails to respond to the claim, then you can obtain a judgment which requires them to make a payment. This also applies if the debtor disputes the claim but you have firm evidence to defend it (for example proof of a returned Direct Debit). Your solicitor will handle the application for judgment. A hearing will take place and an official will judge whether or not the debtor must pay, in which case the debtor is usually ordered to pay the debt, interest and costs.

If the debtor still does not pay, they will receive a County Court Judgement which remains on record. You may then take action to secure payment, including use of a bailiff to seize goods or a garnishment of salary. You must do this under the guidance of your legal advisor as both actions require a court order.