Managing your cash flow

'Cash is King'

Cash flow is the single most important element of any business. It is the oxygen that your business breathes. You can survive for a short time without sales or profits, but not without cash. And risk of running out of cash isn't only for businesses that are struggling to survive. If you are growing rapidly, or you have clients that aren't paying then a cash shortage could be just as dangerous.

The different elements of cash flow management

Cash flow is the balance of all the money that flows in and out of your business each day. It is the actual payments and receipts of money as opposed to sales and purchases made.

There are 5 main components of cash flow:

1) Cash inflow from sales
2) Cash injections from new finance
3) Cash outflow from purchases and expenses
4) VAT and tax payments
5) Loan repayments and investor interest

Have your books in order and forecast your cash flow

The more warning you have of a future cash flow shortfall, the more time you have to deal with it. The key to this is to have your books in order so you can see a snapshot of your current position and effectively forecast the future, both in the short term and longer term.

This can be achieved by doing the following:

1) Invest in accounting software or regularly use the services of a bookkeeper to prepare management accounts.
2) Prepare budgets showing expected sales and profits.
3) Prepare monthly cash flow forecasts. These forecasts should look at least a year ahead regularly updated. Be pessimistic and expect issues and delays.
4) Include Key Performance Indicators (KPIs) that illustrate the health of your business, such as order volumes and numbers of customers.
5) Consider sharing your forecasts and budgets with your bank regularly so they grow to trust your forecasts, and may be more prepared to extend your borrowing facility if required.
6) Compare your forecasts against actual results to hone your ability to make accurate forecasts in the future.

Preparing a cash flow forecast is only worth while if you then actually use them. You need to do the following:

1) Compare your forecasts and actual cash flows against budgets regularly to identify and rectify any issues raised.
2) Before taking on any large financial commitment check you have sufficient cash flow to pay the costs involved by reviewing the latest cash flow forecast.
3) Develop a warning system to automatically identify forecast issues.

Sales

A sale you make today feeds your cash flow tomorrow so it is essential to keep push your sales and profitability.

Your pricing policy should be reviewed regularly. If you are running at full capacity but are making insufficient profits you may be charging too little. Increasing your prices may reduce your sales (and cash flow) in the short term. However, this may be outweighed by a major positive impact on profitability and cash generation over the longer term.

You should also be careful not to over-trade. Even very profitable companies can become insolvent if they have to pay too high a cost to fulfil an order before payment is received from the customer.

When negotiating contracts with customers, make cash flow generation one of your primary objectives. This should include:

1) Negotiate stage payments for lengthy contracts.
2) Ask for an up front deposits.
3) Timetable work completion and include a payment schedule.
4) If additional work is added to existing contracts make sure the work is invoiced quickly and payment terms agreed.
5) If you are short of cash, bring sales forward by incentivising clients to purchase from you quickly.
6) Alternatively you can bring the customer cash payments forward by offering discounts for early settlement.

If cash flow is short you must continue marketing, but focus on short term lead generation rather than longer term brand building.

If you pay commissions for sales make sure the commission payments are linked to cash receipts not the actual sales.

Credit Control

An efficient credit control function reduces the working capital requirement, speeds up cash collection and reduces bad debts.

Control how much credit you provide and to which customers. Consider using a scoring system and set appropriate limits for each customer.

Avoid giving any customer more credit than you can afford to lose. Set reasonable payment periods, and try and include cash up front or staged payments. It may also be worth credit checking all new customers.

A key element of good credit control is to quickly identify late payments and to start chasing for the debts to be settled.

Also note, you have a right to charge interest on late payments.

Purchases

On the flip side, holding off on paying your creditors may also be a necessary form of improving cash flow, but this should be done cautiously as relationships with suppliers are essential to the good health of your business.

You can save money by shopping around and negotiating, including asking for rent reviews.

And finally, look at your business systems to seek out efficiency gains, such as sending emails rather than post and improving stock control.

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