Hammonds

Chartered Accountants and Business Advisers

Improving cashflow

A guide to maintaining a healthy balance between money coming in and out of your business.

If your business does not have a steady stream of money flowing into it, you will be unlikely to be a going concern in 12 months.

On the other hand, every business will have regular costs that they have to pay out. These payments can range from the cost of buying materials to making sure your staff remain sufficiently caffeinated.

A successful business needs to keep the balance between money coming in and money going out, weighted on the side of the former.

Why cashflow is important

Thinking of good cashflow as a balancing act can be a useful metaphor. Your instinct may be to tip the scales heavily in favour of maximising the amount of cash you have. This however, could have negative consequences because cash is not a productive asset when stored away.

It might be a better option to use your money to buy assets or equipment that will help you increase your sales. This would result in a temporary tip of scales towards money going out, but it could put you in a healthier long-term position.

Conversely, if your monthly outgoings are roughly equivalent to your incomings then you may not have the resources at your disposal to capitalise on opportunities.

Good cashflow management will also give you a clearer picture of your ability to take out and repay loans. Being able to see exactly how much money is coming in and when it tends to arrive will allow you to build an efficient repayment plan.

Achieving and managing the kind of cashflow that is suited to your business is crucial to its long-term survival and its ability to evolve and grow.

Talk to us about your business' finances today.

Improving cashflow

Once you have worked out your cashflow position you should be able to identify the weak spots in your business' finances. For example, what effect would an increase in the price of your essential commodities have? Do you have the cash to upgrade your software licenses to the latest versions?

It is unlikely that your cashflow will be perfect and there is no room for improvement. Inefficiencies can build up over time in any system and lead to wastage that can be hard to spot.

There is no one-size-fits all solution for improving cashflow, but the following points are some common strategies.

Money in

Payments terms

Your relationship with your customers is vital for any business and agreeing payment terms in writing in advance can help ensure continued good will. Other points to consider:

- include text informing the customer you will exercise your statutory right to claim interest on invoices
- raising a further invoice for interest and late payment charges will ensure it comes to their attention.

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Improving cashflow

Having a range of methods that customers can pay you can also be an important way of facilitating quick payments. You could also consider rewarding quick payments with discounts.

Invoice correctly

An effective invoice contains all of the relevant information that a customer needs to know in a concise and easy to read format.

Payment terms and conditions should be printed on your invoices. You may want to send out more detailed payment terms once they have been agreed so that you can include an abridged version on the invoice.

A customer should never be surprised at anything they find on an invoice. Your service charges and product prices should have been clearly explained earlier in the transaction process.

It may be helpful to give your client a breakdown of the costs that will be found on the invoice before you send it.

Money out

Cut your costs

The most obvious way of improving your cashflow is to control your outgoings.

Some areas where you could save money:

- travel and travel expenses (conducting meetings over the internet for example)
- moving internal IT systems to the cloud
- use of contractors.

Bear in mind that reducing costs too far may negatively affect your cashflow by hurting your ability to make sales, maintain relationships or incentivise your staff.

Stock management

If you have lots of stock that sits in your warehouse for months this is tying up assets in a non-productive way.

You need to understand the average time you hold your stock before you sell it as well as using your sales forecast to see if you are holding the right amount. Buying the right amount of stock and selling it on quickly will have a positive effect on your cashflow.

If you have a diverse range of stock with some high-sellers and lots of low-selling items, you may want to focus on where the majority of your profit comes from. You can either offer less or hold fewer of the low-selling items in stock.

Discount terms

Just as you may want to reward good customers, your suppliers may want to do the same to you.

Making sure you pay promptly will allow you to negotiate better deals or discounts for early or fast payments. Having a strong relationship also means telling suppliers as early as possible if a payment is going to be delayed.

Tax efficiency

A firm's tax liability is likely to be a large part of its regular outgoings so any actions that increase tax efficiency will affect cashflow.

A full breakdown of the technical details of business taxation is beyond the scope of this article. Contact an expert to explore tax planning further.

Some examples of the tax reliefs that may apply to your business:

- **R&D relief** - companies can obtain a 230% tax deduction for qualifying projects
- **holdover and rollover relief** - postpone tax on the disposal of qualifying assets
- **patent box** - reduces corporation tax to 10% for profits based on UK or European patents.

We can help your business become more tax-efficient.

New payments reporting rules

From April 2017, large companies and limited liability partnerships are required to publicly report their payment practices and performance twice a year.

This includes the average time taken to pay supplier invoices.

Failure to publish the required information on time or giving inaccurate information is a criminal offence.

For SMEs that are having consistent problems with large companies and late payments this will have 2 main benefits:

- the ability to see a large customer's payment records before choosing to do business with them
- identify companies with high average invoice payment times.

Contact us about business reporting obligations.

Cashflow forecasting

Being able to accurately forecast your cashflow over a long period of time is incredibly valuable. If your business is seasonal in nature or has busy periods, you will be able to plan accordingly.

Before you can start creating a cashflow forecast you will need:

- **sales forecast** - how much you expect to sell over a period time
- **profit and loss forecast** - your business income and its day-to-day running costs, giving a profit projection.

There can be a lot of complexity involved in creating the above forecasts, so seek expert help if you are unsure about any aspect.

To create a cashflow forecast, you should look at the following:

Money in = your sales forecast + any non-sales income

Money out = your profit and loss forecast + any other costs (such as tax and Christmas parties).

The combination of these 2 figures is an estimate of your future cashflow.

Talk to us about forecasting.