FACT SHEET

Managing your Finances: Cash Flow

Quick Summary

- Understanding the importance of cash flow and implementing good cash flow practice is vital to improve the longevity of your business
- Understand the different types of cash inflows and outflows
- Learn why forecasting your cash flow will help you develop a proactive mind-set that can help you avoid problems before they materialise
- Learn how to slow down outgoing cash and speed up incoming cash, a desired skill to have when managing business's cash flow

Introduction: Cash flow basics

Cash enables a business to survive and prosper and is the primary indicator of business health. While a business can survive for a short time without sales or profits, without cash it will cease to exist. Try not to 'play with fire' and run your businesses with little cash flow as the unexpected might happen and that could leave your business completely cash dry.

For this reason, your business's cash flow needs careful monitoring and management at all times. To trade effectively and be able to grow your business, you need to build up cash balances by ensuring that the timing of cash movements puts you in a positive cash flow situation overall.

Bear in mind that having a lot of cash in your bank does not necessarily make good business sense. If you do not need to use it immediately, put spare cash into an account where it will earn a higher rate of interest, or use it as capital for short-term investments.

You should note that income and expenditure cash flows rarely occur together, with inflows often lagging behind. Your aim must be to speed up the inflows and slow down the outflows.

Here are some examples of different types of cash flows:

Cash Inflows

- Payment for goods or services from your customers
- Receipt of a bank loan
- Interest on savings and investments
- Shareholder investments
- Increased bank overdrafts or loans
- Grant funding or similar

Cash outflows

- Purchase of stock, raw materials or tools
- Wages, rents and daily operating expenses
- Purchase of fixed assets - PCs, machinery, office furniture, etc.
- Loan repayments
- Dividend payments
- Income tax, corporation tax, VAT and other taxes.
- Reduced overdraft facilities

Cash Flow Forecasting

Cash flow forecasting enables you to predict various influxes that your cash balance will inevitably experience. It helps you to plan borrowing and tells you how much surplus cash you're likely to have at any given time.

It's worth noting that if you're thinking about approaching a bank for a loan, many of them require profit and balance sheet forecasts as well as a cash flow forecast before considering granting you said loan.

The cash flow forecast identifies the sources and amounts of cash coming into your business and the destinations and amounts of cash going out over a given period. The forecast is usually done yearly or quarter in advance and divided into weeks or months. In extremely difficult cash flow situations, a daily cash flow forecast might be helpful. It is best to pick periods during which most of your fixed costs - such as salaries - go out.

The forecast should list:

- Receipts
- Payments
- Excess of receipts over payments - with negative figures shown in brackets
- Opening bank balance
- Closing bank balance

It is important to base initial sales forecasts on realistic estimates. If you have an established business, an acceptable method is to combine sales revenues for the same period 12 months earlier with predicted growth. As mentioned before in previous fact sheets, never over-estimate any type of business forecasting. Doing so could mean you are managing your cash flow ineffectively to try to reach unrealistic targets – which could spell disaster for your business overall.

Managing Cash Flow

Effective cash flow management is as critical to business survival as providing services or products. Many of your regular cash outflows, such as salaries, loan repayments and tax, have to be made on fixed dates. You must always be in a position to meet these payments in order to avoid large fines or a disgruntled workforce. This sort of negligence can have a negative domino effect on every single part of your business.

A good tip to avoid cash flow problems is to incorporate warning signals into your cash flow forecast. For example, if predicted cash levels come close to your overdraft limits, this should sound an alarm (not a physical one of course) and trigger action to bring cash back to an acceptable level.

Ideally, you should always have a contingency plan, such as retaining a minimum amount of cash in the business, perhaps in an interest-earning account. This 'rainy day' money can be used to meet short-term cash shortages. Like most things in life, always expect the unexpected. This way you will be prepared for more situations that could leave your businesses in a risky spot.

Inflowing and Outflowing cash

One of the most important aspects of managing your cash flow is minimizing the time gap between outflowing cash and inflowing cash.

Here are some of the key methods to help reduce the time gap.

Customer Management

- Define a credit policy that clearly sets out your standard payment terms
- Issue invoices promptly, and regularly chase outstanding payments. Use an aged debtor list to keep track of invoices that are overdue and monitor your performance in getting paid.
- Consider exercising your right to charge penalty interest for late payment
- Consider offering discounts for prompt payment
- Negotiate deposits or staged payments for large contracts. It's in your customers' interests that you don't go out of business trying to meet their demands
- Consider using a third party to buy your invoices in return for a percentage of the total

Supplier Management

- Ask for extended credit terms. Giving your suppliers incentives such as large or regular orders may help, but make sure you have a market for the orders you're placing. Alternatively, consider reducing stock levels and using just-in-time systems

Asset Management

- Ask for extended credit terms. Giving your suppliers incentives such as large or regular orders may help, but make sure you have a market for the orders you're placing. Alternatively, consider reducing stock levels and using just-in-time systems

Taxation

- You may be liable for several different taxes including income tax, corporation tax, VAT, business rates and stamp duty. It is important to keep good records to help you calculate your liability and complete your returns accurately
- If you are registered for VAT, it makes sense to buy major items at the end rather than the start of a VAT period. This can often improve your cash flow, because you can set the VAT on the purchase off against the VAT you charge on sales. This may help plug a temporary cash flow gap
- HM Revenue & Customs (HMRC) has launched a support service to help businesses struggling to meet tax, National Insurance or other payments owed to HMRC.
  - › If you are concerned that you may not be able to pay amounts that are owed or will soon be owed to HMRC, you can contact the HMRC Business Payment Support Service (BPSS). HMRC staff will review your situation and discuss temporary payment arrangements tailored to your business' circumstances
  - › You can contact the HMRC Business Payment Support Service Helpline on Tel 0845 302 1435

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