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Financial expertise for your business

Business Basics: Understanding Cash Flow

Predicting the peaks and troughs of your cash flow throughout your financial year can help to reduce the impact in negative periods.

Cash flow refers to the amount of cash you have available to pay your bills, whether it comes straight from retained profits, your overdraft or some other loan facility. The bottom line is that if you can't pay your creditors they may refuse to continue to supply you with the goods and services you need to fulfil your contracts with customers.

Cash flow and Profitability

These two terms have different meanings.

Profitability is the net difference between the total amount your business earns and all of its costs

Cash flow on the other hand is your ability to pay your bills on a regular basis. Cash flow is not just about the amounts of money moving in and out of your bank account. It is also about the timing of these transactions and also includes capital expenditure and periodic outlays such as VAT.

The importance of forecasting

Cash flow management is much easier if you can predict the peaks and troughs in advance and take steps to reduce the impact of any period of negative cash flow.

To do this you'll need to produce a cash flow forecast that gives you a month by month prediction of the amount of cash you are likely to require. An accurate cash flow forecast can give you an indication of your borrowing requirements or alternatively, the amount of excess cash you may have available for investment, development or contingent liabilities.

Ways to improve your company's cash flow

- **Invoice Promptly**

If you don't have a process in place, create one and start billing for goods and services on a regular basis. When taking on longer-term projects or clients, negotiate in advance for regular payments instead of allowing the amount due to build up until completion of a contract.

- **Customer Payment**

Know your customers payment process in detail including approval process, required documentation and when payment runs are made.

- **Consider incentives for faster payment**

Encourage your customers to use electronic payment methods or pay by other methods such as standing orders. Make sure that you put the necessary details on your invoice. Small businesses can sometimes significantly cut the time spent waiting for payment by offering a discount for quick payment.

- **Avoid slow pay/no pay customers from the start**

Weed out the slow payers or no pays before you become reliant on their business. This means checking out credit references and calling other businesses that have a relationship with the client.

- **Use barter instead of cash**

You could reduce the strain on your immediate cash if you need goods or services from someone and can barter goods or services of your own in return. Remember, however to always exchange invoices or you may incur a VAT exposure.

- **Consider consolidating your loans**

If you have several business loans or related loans such as cars, equipment, credits cards etc. you may be able to consolidate two or more of these into as lower interest account and improve your cash flow. It may also be worth taking out a longer-term loan agreement in exchange for lower monthly payments. Match the debt to the asset or service being acquired- if you are buying a large capital item its often best to fund with a mortgage or lease rather than from an overdraft.

For more information about how we can help you improve cashflow, email us at clientcare@efm.uk.com or visit www.efm.uk.com