# EYE ON FINANCE

## by Alistair Cooke, Director, ASM Chartered Accountants

Whilst many of us regard the measurement of profit or turnover as a sign of success in a business the most important element which many people overlook is cash flow.

Without cash flow even the most successful businesses in terms of turnover or profitability will not survive. Like the body needs food so a business needs cash to live.

We do not have to think hard to recall some very large businesses which have gone out of business lately, Carillion, House of Fraser, BHS, Toys 'r' us. The list could go on. Without knowing the detail behind each failure we cannot say the precise reason for failing but no doubt cash, or lack of it, played a major part in each of these failures.

So why is cash flow so important?

- It provides liquidity. If I sell something on credit to you I have made a profit, but until you pay me I have no cash. If in the meantime I need to pay my suppliers I will have a negative cash-flow.
- Being paid on time means that I can pay my suppliers promptly. Being put on stop can cause major problems to a client who needs the job done.
- It will enable the business to meet its tax liabilities on time.
- It will reduce costs, for example interest charges.
- Having a positive cash-flow provides a feel-good factor; it keeps you in control and makes it possible to plan thus avoiding rushed decisions.
- In the long term a positive cash-flow results in a good reputation for the business.
- It protects the wider economy. If small businesses go out of business larger ones will be affected and vice-versa.

### So what things can have a negative impact upon our cash flow?

- Poor credit control. Making a sale is great, but until you have been paid you will have no cash flow.
- Carrying too much stock. Whilst there is a need to carry stock to be able to fulfil your customer's orders, remember all stock has a cost and may need to be paid for before you have made a sale.
- Bad credit history with suppliers. If you have experienced problems paying suppliers on time in the past you may find suppliers requiring payment quicker or even in advance.
- Insufficient funding. Particularly for a new business, many start-ups under-estimate the amount of money required to get a business over the ground and how long they will have to wait until they will get paid. This all has to be funded in some shape or form.
- Extracting too much money from the business. Sometimes business owners see a business as their own 'piggy bank'. Once the money starts coming in they begin spending it without a thought about the bills due.

### So what can a business do to improve their cash flow position?

Before you start trying to improve it, you have to know your starting point. Therefore it is essential that the cash flow position of a business is monitored. Prepare a cash flow projection and update it daily or weekly as necessary. It is always easier to find a solution to a problem in advance rather than at the last minute. Remember this is only a projection; you will never get it exactly right, so always allow a buffer in any projections.

- Chase outstanding debts - some people will only pay their bills when they are asked. You could also consider getting paid by direct debit or standing order perhaps on a monthly basis to enable you to forecast the receipt better. It may also be beneficial to offer an early settlement discount to customers who tend to over extend their credit terms.
- Manage your stock levels - there is no point holding 50 of an item in stock if you only sell 20 of them a year. Stock is a very easy way for cash to be tied up in a business but with careful management it need not be a drain.
- Be careful of over-trading. This is where a business grows too quickly and cannot keep up with demand perhaps because they cannot buy the stock required to service orders at they don't have sufficient credit terms with their suppliers.
- Make sure you are not tying up cash which will be needed soon in a long term asset such as a property or equipment. Long term assets need long term funding such as a bank loan or hire purchase finance.
- Consider such things as invoice finance which can offer you cash in advance of being paid for your invoices. This can be a very useful tool for a growing business and it should be easier for your lender to increase this facility as you grow and generate more sales.
- Speak to your suppliers to see if they are in a positon to offer you favourable credit terms. Sometimes even if you have only been trading with a supplier for a few months they may be able to offer you some credit and this can make a big difference rather than having to pay in advance of receiving goods.

Finally, improve profits not just turnover. A sales-driven business with a large order book which does not improve its profitability has a greater risk of going out of business than one with limited but profitable work.

**The content of this article is for information purposes only and advice particular to your circumstances should be sought from a professional advisor.**

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