

WHY YOU SHOULD NEVER UNDERESTIMATE THE IMPORTANCE OF CASHFLOW

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The purpose of a business is generally the pursuit of profit. Business owners often focus on levels of turnover and profit and how these may be maximised. However, the importance of cash should not be underestimated alongside these measures of performance.

One of the most common reasons for failure of a business is lack of cash to pay suppliers, HM Revenue & Customs and other creditors. If business owners can pre-empt any shortages of cash, they will be in a much better position to find a way of resolving the deficiency before it is too late. Even where a business is doing well, cash planning is an important tool to manage finances and help with their smooth running.

Cashflow modelling can be used as a measuring tool to assess different parts of a business. If one division is not contributing cash to the business as a whole, but rather sucking cash resources from other divisions, should it continue in its present form? It could be time to consider selling that division, restructuring it, or perhaps all it needs is a refocusing of the cashflow using some of the ideas below.

THE CASHFLOW GAP

What is the length of time between paying a supplier (or employee) for goods or services and receiving payment for those items or work from the customer? This is known as the cashflow gap and represents negative cash. Any business with a cashflow gap needs to consider how this is funded.

GETTING INTO THE DETAIL

Drilling down into the cashflow gap in more detail can provide valuable insight to business owners. Calculating the average amount of time debtors take to pay (debtor

days) and the time the business takes to pay creditors (creditor days) can help business owners to understand the cashflow gap. These measures could be calculated for each debtor and creditor to compare or rank them.

CREDIT CONTROL

Having this data available is the first step towards making positive changes. If debtors are taking too long to pay, perhaps exceeding their credit terms, is more focus needed on credit control? Many of us don't like asking for money but getting paid is an essential part of running a business. A skilled credit controller can transform debt collection, whether they work in the business directly on a full time or part time basis or work as an outsourced function.

CREDIT TERMS

Are creditors paid too early? I have seen businesses where every bill is paid as soon as it arrives on the doormat (or in the inbox) without a thought to planning for cashflow. If creditors offer credit terms, making use of them helps to preserve cash and reduce the cashflow gap.

WORKING CAPITAL FINANCE

Financing of working capital should be considered. How will suppliers and staff be paid prior to receipt of cash from customers? Many businesses rely on bank overdrafts, which can be a great, flexible source of funding. There are many other options available, such as invoice discounting and factoring, which can unlock cash tied up in debtors and significantly reduce the debtor days.

CASHFLOW FORECASTS

Forecasting future cashflow is important to identify pinch points before they arise, enabling business owners to plan for cash shortages rather than having to

manage a crisis when options may be limited and stress levels may be high. The more time that is available to find a solution, the more options there are likely to be.

PLANNING FOR GROWTH

Forecasting for growth is equally important. Overtrading happens when a business increases activity and turnover without adequate resources to support it. It leads to unfulfilled orders, unhappy customers and cashflow problems. Taking some time to consider the amount of funding required to cover increased trading levels and how that will be financed is an important planning tool to help ensure successful growth. It will also provide a level of confidence to any proposed financier in their lending decision.

PROFESSIONAL ADVICE

Finally, professional advisors can be an invaluable resource when it comes to understanding the numbers, talking through business aspirations and looking at the detail of the changes (big or small) which may transform the business for the better. Make use of their networks too – they may be able to make an introduction to exactly the right person to bring an aspiration to reality.

For further information, or to discuss your specific circumstances, please get in touch.



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