skills/venture

GUIDE TO CASHFLOW MANAGEMENT

Cash inflows and cash outflows

Ideally, during the business cycle, you will have more money flowing in than flowing out. This will allow you to build up cash balances with which to plug cashflow gaps, seek expansion and reassure lenders and investors about the health of your business.

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

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.

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.

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.

To improve everyday cashflow you can:

- Ask your customers to pay sooner
- Chase debts promptly and firmly
- Use factoring
- Ask for extended credit terms with suppliers
- Order less stock but more often
- Lease rather than buy equipment
- Improve profitability - see our guide on how to increase your profitability

You can also improve cashflow by increasing borrowing, or putting more money into the business. This is suitable for coping with short-term downturns or to fund growth in line with your business plan, but shouldn't form the basis of your cash strategy.

The principles of cashflow forecasting

Cashflow forecasting enables you to predict peaks and troughs in your cash balance. It helps you to plan borrowing and tells you how much surplus cash you're likely to have at a given time. Many banks require forecasts before considering a loan.

The cashflow 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. There are normally two columns listing forecast and actual amounts respectively.

The forecast is usually done for a year or quarter in advance and divided into weeks or months. In extremely difficult cashflow situations a daily cashflow forecast might be helpful. It is best to pick periods during which most of your fixed costs - such as salaries - go out. The forecast lists:

- 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.

Avoiding cashflow problems

No matter how effective your negotiations with customers and suppliers, poor business practices can put your cashflow at risk. Look out for:

- Poor credit controls - failure to run credit checks on your customers is risky, especially if your debt collection strategy is inefficient.
- Failure to fulfil your order - if you don't deliver on time, or to specification, you won't get paid. Implement systems to measure production efficiency and the quantity and quality of stock you hold and produce.
- Ineffective marketing - if your sales are stagnating or falling, revisit your marketing plan.
- Inefficient ordering service - make it easy for your customers to do business with you. Where possible, accept orders over the telephone, email or internet. Ensure catalogues and order forms are clear and easy to use.
- Poor management accounting - keep an eye on key accounting ratios that will alert you to an impending cashflow crisis or prevent you from taking orders you can't handle.
- Inadequate supplier management - your suppliers may be overcharging, or taking too long to deliver. Create a supplier management system.
- Poor control of gross profits or overhead costs.