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Connecting Australia's bookkeepers with business

Control Your Cash

10-steps to protecting your business from a Cash crunch

SMALL BUSINESS GUIDES

There are not too many SMEs which do not have cash control issues (even crises!). And too many go into business believing that an accounting profit will 'take care of everything'. It won't: in small business cash is king. This guide will become an essential guide for the cash flow of your (or your client's) business.

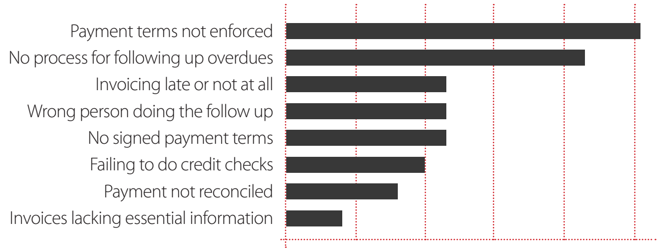
An accounting profit is an important guide to how well your business is travelling, but it is the cash flow statement which determines its ultimate survival and health. The business could be making a profit on paper and still be headed for insolvency. If what is going out every week exceeds what is coming in at the bank then trouble is brewing. Few SMEs are adequately capitalised to be able to handle a cash flow drain on their resources (cash and lines of credit).

What is the most common problem faced by SMBs?

The recurrent cause is that companies with debtor issues simply aren't communicating the right information to their debtors on a regular basis. In their recent blog, our colleagues at *DebtorDaddy* reported that the two most common causes of aged debtors (as identified by the MYOB2015 attendees) were:

1. Firms failing to enforce their payment terms. That is, it wasn't so much that payment terms weren't clearly documented and agreed with a customer, it was that they simply weren't reminding late payers of their obligations.
2. Tightly aligned to cause #1, was the perception that firms with debtor issues didn't have a process for following up their receivables on a regular basis.

Other common causes, albeit with lower priority, were: invoicing late, having the wrong person doing follow ups and failing to do credit checks.



SOURCE: *debtordaddy.com/2015/03/06/axing-your-aged-debtors-what-do-the-experts-think/*

Saying "No" to a new customer

Actually good cash control begins with good credit control. And that starts with ensuring your customers are able to pay you.

Let's pause for a moment and consider cash flow management as a discipline and one that has several moving parts:

- The **credit worthiness** of business customers
- **Credit policies** and procedures of the business and their effectiveness
- **Collection policies** and debt recovery action.

Setting ***payment terms*** from the beginning is, simply, essential. There's two ways you can approach this:

- Have a separate payment terms agreement that your customer signs
- Include the payment terms in the proposal that your customer signs.

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Some business customers are, simply, not worth having. Assessing their credit worthiness is a critical first step. Patrick Coghlan, Commercial Director of *Creditor Watch* believes that the credit report is an essential component of good cash flow management. He notes that bad debts are one area which can be disastrous to a business. “Bad debts can make or break a small business.

“You need to make sure you do your due diligence on new customers and ensure you keep a close eye on new and current customers. You need to keep monitoring.

“The question needs to be put: *will they be able to pay?*

“A company can very quickly get into difficulties; it pays to get updates on your customers.

Turning away sales can feel like sacrilege for business owners, especially when their business is new or their cash flow is tight. But longtime entrepreneurs say that being selective about whom you work with, and on what terms, is a crucial step in building a successful business — and a step that is increasingly complex.

The proactive bookkeeper

Managing cash flow management is also about systems and processes. Collections process can only take overdue accounts so far. Inevitably a business owner finds that they hanging on to accounts which have blown out beyond ‘normal’ limits.

According to Patrick Coghlan, if an account is 60 days overdue, then the chances of being paid at 90 days are reduced, there is even less chance of it being paid at 120 days.

“The older a debt is, the greater is the chance that it will become a bad debt.”

Although many bookkeepers are more comfortable keeping the heads down and not stand in the line of fire between recalcitrant debtors and agitated business owners, there are resources and services at hand that can assist the business owner in better managing their cash flow.

Creditor Watch makes it easier for business to manage customers more effectively.

Creditor Watch (www.creditorwatch.com.au) is an Australian credit reporting bureau that has been running for over five years and has over 30,000 clients. Creditor Watch enables businesses of all sizes to access credit reports on any company in Australia to determine what sort of risk they represent to their business. Patrick Coghlan explains that the automated Creditor Watch platform makes it easier for businesses to manage customers more effectively. “On top of credit reports, Creditor Watch will closely monitor customers and send email alerts for important changes that could affect their ability to pay their bills.

“Users can also utilise a range of debt collection tools, including letters of demand, which will help improve company cash flow. These tools are invaluable for business owners and managers with no credit management, AR or debt collection experience.

“Our typical (small) business client is anywhere between “$1 million to $5 million in turnover.”

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Using cloud-based tools

Bookkeepers will be familiar with the array of cloud-based tools being promoted by the various accounting software suppliers. Creditor Watch is one of many partners now integrated with the major accounting software providers such as Xero and MYOB, enabling users to receive automated credit reports, access more in-depth credit reports and to analyse their debtor's ledger. Collection tools include automated late [payments systems, such a provided by providers including Debtor Daddy, IODM. And, in terms of the more formal, legal tools, debt recovery by an organisation such as Prushka is often a necessary (and often painful) option.

Here are 10 rock-solid, proven tips for getting control of your cash flow and keeping it under control:

1. DO A CASH FLOW FORECAST

The forecast should inform you who you are paying, when the payments are due, who is paying you and when that's coming in. The forecast also sets out all your costs for the months. A good forecast model can anticipate problems so you can take action to prevent them.

It can be used to develop assumptions on sales, costs, credit and funding to produce monthly cash flow projections well ahead and assess the impact of cash flow on future sales, costs and credit terms and replacement of assets, such as computers, furniture (for example café or restaurant), tools and machinery.

Don't know where to start? Ask your bookkeeper to help you build a cash flow forecast. It will be the best investment you've ever made!

2. TIME YOUR INVOICES

It's too easy to put off doing the admin, preparing the invoices and sending them off. A key to cash flow management is to invoice more frequently. If you were doing it on and end-of –month basis until now; change to weekly. If you were doing weekly, change to daily. Consider if you have $30,000 a month coming in and you don't invoice it for two weeks, that's actually $60,000 less in working capital you have to work with.

The golden rule: invoice as soon as the job is done or the goods shipped out.

3. TAKE PAYMENT UP FRONT

Many law firms do it; kitchen cabinet suppliers do it. Many businesses take money upfront for the job. It may be a deposit or it may be the whole amount but depending on your relationship with customers, the strength of your business and the particular job, it pays to collect money upfront.

Most obvious is the deposit. Advertising agencies for example may work on 25% deposit up front and some suppliers of goods want 40 percent of payment up front and the balance on the work being completed.

4. TRIAGE PAYMENTS

This is typical of the building and construction industry where payments are staggered across the process. This is often in keeping with bank finance arrangements. The first payment comes when stage one is completed, the next when the second is done and so on. This makes cash available for resources needed to complete the work.

5. REWARD EARLY PAYERS

Some businesses offer incentives for early payments, such as 2 per cent off the price and up to 10 percent in some cases. Some offer discounts for payments several months in advance.

This brings in cash sooner and when you need it, compensating for a lower margin on the job.

6. AVOID PAYING IN CASH

Many small business owners have cash in their businesses arising from cash payments from customers. This is best avoided as it can 'slip between the fingers".

As soon as cash comes in, bank it. Ensure that all payables are done electronically by EFT where possible. Whenever possible, use a business credit card for travel, meals and minor expenses. This leaves more cash in your hands and defers payment. If you stick with due dates on your credit card and pay balance in full, you will avoid high credit card costs and give yourself interest free loan.

7. MANAGE YOUR RECEIVABLES CAREFULLY

Create a schedule of what's owned and stick to it. Call in overdue accounts and make sure you understand the debt recovery procedure. If you have followed the notes earlier in this guide and set terms from the outset and have signed payment terms, then you must have a system in place that sends a prompt follow up if the payment terms are not met. Otherwise all you have is a barking dog, with no bite.

For example, if your payment terms are 14 days, then you should be sending your first reminder at 15 days assuming you've reconciled any recent payments that have come in to your bank.

This rapid follow-up signals to your customer that you are aware that they've missed the payment and that payment is now expected immediately Debt collection agencies such as Prushka can provide a pro forma letter for late payers.

You might also consider adding a late payment fee for the account.

8. MONITOR INVENTORY

Remember that inventory consumes cash. You have to purchase it before you can sell it and regardless of whether or not you sell it, your vendors will want to be paid.

Every dollar you spend on inventory is a dollar less cash.

9. STAY ON GOOD TERMS WITH YOUR BANK

If you know you are in for a short terms cash flow shortfall, make sure you have a plan and keep the bank in the loop. (Follow rule #1 and have you bookkeeper prepare a cash flow forecast and monitor it closely)

10. TIME YOUR PAYABLES

Best to negotiate with suppliers upfront: negotiate terms to stretch the payment terms as long as possible. By doing that, you are creating an interest-free line of credit. At the same time, however, don't do this at the expense of a solid relationship with suppliers. You need to work with them and talk to them often. That supplier

this becomes a lender. In these terms if it is a company and if a cash crunch is being experienced then it no longer has the liquidator taking the debt into account.

If there is a real cash crunch, don't hide it from suppliers, talk to them. What can happen is that people try and keep juggling the cash flow: chasing debtors and squeezing their suppliers. Or worse, borrowing on the credit card.

You are always better off negotiating with a supplier. It's when you develop a kind of mental obstacle and keep a lid on things that suppliers will become adversarial. When we go on too long we feel that we cannot deal with a supplier. But I have found that if say to a supplier

> something like "I can't pay you right now but will pay this off over the next say 6 weeks. In future I can pay you cash." Or you could say that you would pay weekly with say 10% off the outstanding bill.

There are rules for cash flow. They will vary from business to business but generally, most companies adhere to these variations of them. Cash flow management makes the difference between good and bad business. What a compelling argument for being a proactive advisor to a business decision-maker with this knowledge under your belt!