FAQ - Financial

Cashflow

Cashflow is the measure of your ability to pay your bills on a regular basis. It depends on the timing and amounts of money flowing into and out of the business each week and month. Good cashflow means that the pattern of income and spending in a business allows it to have cash available to pay bills on time.

Cash balances include:
- coins and notes
- current accounts and short-term deposits
- unused bank overdrafts and short-term loans
- foreign currency and deposits that can be quickly converted to your currency

It does not include:
- long-term deposits
- long-term borrowing
- money owed by customers
- stockInvoice Discounting

Invoice discounting is an alternative way of drawing money against your invoices. However, your business retains control over the administration of your sales ledger. It provides a cost-effective way for profitable businesses to improve their cashflow.

Invoice discounting is only available to businesses that sell products or services on credit to other businesses. It is normally only available to businesses with a proven track record and an annual turnover of at least Â£500,000.

It may not necessarily be the cheapest form of finance and can tie you into a long contract.How invoice discounting works

The invoice discounter will first check the business, its systems and its customers. It may then agree to advance a certain percentage of the total outstanding sales ledger.

You will pay a monthly fee to the invoice discounter and also pay interest on the net amount advanced. This is in addition to advances received or money repaid.

Each month, more money is advanced by the discounter or repaid by you. This will depend on whether the total amount owing has gone up or down.

For example, if the invoice discounter agrees to advance 80 per cent of the total owing and the total of outstanding invoices is steadily changing, then so will the amount you receive. If the outstanding debt drops month on month, you must repay 80 per cent of the fall in debt. If the debt rises month on month, you will receive 80 per cent of the increase.Features of invoice discounting
- You collect the debts and do the credit control. See our guide on getting paid on time.
- Your customers do not usually know about the invoice discounting, although it is sometimes disclosed.
- Annual turnover must usually be at least Â£500,000, although increasingly smaller businesses will be accepted. Generally, discounters will review the credit history and profit track record of your business. They will have stringent requirements regarding the quality of sales ledger systems and procedures.
- The invoice discounter will check regularly to see that your procedures are effective.
- You can choose between recourse and non-recourse facilities, determining who is responsible for recouping unpaid invoices. See the page in this guide on recourse factoring and non-recourse factoring. Overdrafts

An overdraft is a borrowing facility attached to your bank account, set at an agreed limit. It can be drawn upon at any time and is ideal for your day-to-day expenses, particularly to see you through cashflow problems.

It is worth noting that loans are probably more appropriate for long-term funding. An overdraft is likely to cost more than a loan for a long-term purchase. Also, there could be stiff charges if you exceed your overdraft limit and the bank has the right to ask for repayment of the amount you are borrowing at any time.Advantages
- An overdraft is flexible - you only borrow what you need at the time which may make it cheaper than a loan.
- You only pay for the funds you use.
- It's quick to arrange.
- There is not normally a charge for paying off the overdraft earlier than expected. Disadvantages
- It has to be rearranged regularly. An arrangement fee is usually payable when credit is extended, perhaps during the term of the facility.
- It can be called in by the lender at any time.
- You face administration fees if you exceed the agreed limit.

- Overdrafts may be secured against business assets - the lender can take control of these if you don't repay the overdraft.
- Unlike loans you can only get an overdraft from the bank where you maintain your current account. In order to get an overdraft elsewhere you need to transfer your business bank account.
- The interest rate applied is nearly always variable, making it difficult to accurately calculate your borrowing costs.

Bear in mind that what starts out as a good deal may change, and so may your business needs. It's worth reviewing your options regularly.
Difference between cash and profit

It is important not to confuse cash balances with profit. Profit is the difference between the total amount your business earns and all of its costs, usually assessed over a year or other trading period. You may be able to forecast a good profit for the year, yet still face times when you are strapped for cash.The importance of cash

To make a profit, most businesses have to produce and deliver goods or services to their customers before being paid. Unfortunately, no matter how profitable the contract, if you don't have enough money to pay your staff and suppliers before receiving payment, you'll be unable to deliver your side of the bargain or receive any profit.

To trade effectively and be able to grow your business, you need to build up cash balances by ensuring that the timing of cash movements puts you in an overall positive cashflow situation.

Bear in mind, however, that having a lot of cash in your bank does not necessarily make good business sense. If you do not need to use it immediately, put spare cash in an account where it will earn high interest, or invest it in short-term investments. Get advice from your bank, accountant or financial adviser.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 loansÂ 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, to avoid large fines or a disgruntled workforce.

To improve everyday cashflow you can:
- ask your customers to pay sooner - see our guide onÂ invoicing and payment terms
- chase debts promptly and firmly - see our guide onÂ getting paid on time
- use factoring - see our guide on debt factoring and invoice discounting: the basics
- ask for extended credit terms with suppliers - see our guide on how toÂ negotiate the right deal with suppliers
- order less stock but more often - see our guides onÂ stock control and inventoryÂ and manufacturing innovation
- lease rather than buy equipment - see our guide on how to decide whether to lease or buy assets
- improve profitabilityÂ

You can also improve cashflow by increasing borrowing, or putting more money into the business. This is acceptable 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 planÂ 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.Elements of a cashflow forecast

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 forecastÂ andÂ actual amounts respectively.
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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 -Â 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 -Â see our guide on how toÂ forecast and plan your sales. If you have an established business, an acceptable method is to combine sales revenues for the same period 12 months earlier with predictedÂ growth.

Download our sample cashflow projection spreadsheet (XLS).

Note that all forecast figures must relate to sums that are due to be collected and paid out, not invoices actually sent and received. The forecast is a live entity. It will need adjusting in line with long-term changes to actual performance or market trends.Accounting software

Accounting software will help you prepare your cashflow forecast, allowing you to update your projections if there's a change inÂ market trendsÂ orÂ your business fortunes. Planning for seasonal peaks and troughs is simplified and you can also make "what if" calculations. Most banks require profit and balance sheet forecasts as well as cashflow. Many accounting packages will assist with preparing these documents. See our guide on accounting software.