Dealing with cash flow problems

Most small businesses experience cash flow problems from time to time and urgently need working capital. Business owners immediately think of the bank or loans when they're short of money. But there are many more resources you can draw on before you ask for that expensive overdraft or an overdraft extension.

You can often free up funds from within your business by re-examining your business systems. The money you need might already be there, locked up in stock, assets or your debtors' book. Below are some suggestions on how to unlock those funds.

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Revisiting your debtors' book

Are you letting some, or most, of your customers pay late, effectively giving them interest-free use of your money for months? In most small businesses, the owner is usually so busy getting the business off the ground, products out the door, or services completed, that they don't pay enough attention to basic business procedures. Many customers will take advantage of this, but you're not in business to run a free loan service.

Here's how you fix the problem: Get invoices out promptly. This is your future cash flow so you want to receive payment as soon as possible. Send the invoice with the goods, and date the invoice from the day the service was completed rather than following the standard 'last day of the month' date for invoices. The earlier the invoice date, the earlier you're likely to get paid.

Change the terms for some of your customers, or for new customers. Can you reduce the payments terms to 7 days or 14 days from date of invoice?

Follow up promptly when invoices aren't paid by due date. Be polite but firm. If you haven't got the time to do this yourself, then appoint someone to do it for you.

Establish the average age of your Accounts Receivable and set yourself the goal of reducing this age by a set target every month. If your customers or clients have been taking advantage of you because of your previous laxity in invoicing, then you may need to re-educate them. Do this politely so you don't offend customers.

"Have you received our invoice, Peter? I'm just checking that you're happy with the goods/services we provided?"

"We've got a new invoicing system going here because we've been a bit lax in the past. My accountant has set some tough goals for me to meet in reducing the average age of our Accounts Receivable, so if you could settle that invoice promptly, I'd be most obliged."

Consider offering a discount for prompt payment. If you're going to pay a fee for factoring, why not try offering a discount to your customers instead? Discounts are not a good option for low-margin businesses, but can be an option for high-margin operations. You have to work out whether the use of money gained earlier is worth the discount you're offering. Never give the discount if the person has missed the due date for the discount offer. Yes, some will try this.

Find out more about the importance of trade terms, setting your terms of payment, managing debtors and how to collect debts.

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Consider factoring

Factoring involves selling your debtors to a finance company. So instead of having to wait 30 days or more until an invoice is paid, you receive your money upfront from the finance company that, in turn, collects the money from your customer. The finance company will of course charge you a commission for this service. Be aware, though, that there are pros and cons to consider. For example, the finance company might be quite heavy-handed about collecting the debts it has bought from you and antagonise your customers. Have a talk to them first about their collection methods.

Find out more about invoice discounting and debt factoring.

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Freeing up cash tied up in stock

Do you have too much money tied up in stock? This can occur two ways:

- Carrying high levels of items that you could obtain from suppliers at short notice.
- Having too many slow-moving items (and too few fast-moving items).

You need to regularly review your stock levels, your stock turnover rates and your purchasing policies. Can you free up money by reducing stock? What about moving out of the slow-moving lines or having a quick sale of the slow-moving stock? It might pay you to reduce some items quite heavily to get some money in quickly.

Can you approach suppliers to take back some excessive stock you may have ordered? They might help you out of a temporary tight corner as a goodwill gesture if you explain you have a temporary cash flow crisis, but that you do wish to build a long-term relationship with them.

If you need additional funds to purchase more stock, make sure that you're replacing slow-moving stock with the faster selling lines.

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Unlocking money invested in other assets

Your assets include pre-paid expenses, vehicles, plant and equipment, fittings and property. Each of these is a possible source of funds.

Pre-paid expenses

Pre-paid expenses often relate to services. You might, for example, pay your insurance bill for the year all in one hit, but you could arrange to pay small monthly amounts. There might be an additional cost for doing this, but you must weigh the extra cost against the advantages of 12 small payments that your cash flow can comfortably handle versus one large annual payment. Then approach your accountant. Instead of facing a substantial bill once a year, ask if you can pay a set amount monthly.

Do the same with your electricity bill – ask to average out your electricity bills, instead of paying relatively small bills in summer and being hit by big ones in winter. Watch out for automatic payments, too. These can often throw out your cash flow projections because you've forgotten to include them in your cash flow forecasts.

Fixed assets

Fixed assets can often be the source of a significant amount of cash. Do you really put all your assets to full use? You might be able to sell off little-used assets and hire suitable replacements when you require them.

You might be able to sell vehicles or old, unused machinery and then lease when needed for a lower price instead.

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Customers and suppliers as sources of more liquidity

Apart from the good debt collection habits already discussed, you could consider not offering credit to keep the funds inside your business rather than locked up in Accounts Receivable. If your customers are cash-strapped, they can use their business credit cards for purchases from you. However, be aware that you'll have to pay a percentage in commission on credit card purchases. You might want to take this into account in your terms of trade by including a surcharge for payment by credit card, but this might discourage some customers from dealing with you.

If you supply goods over a period of time, or if you're a service business, invoice for agreed periodic progress payments. This is a common method of ensuring you get some cash flow during a project instead of waiting until the end of a project or delivery period to invoice – and then still waiting at least another 30 days for payment.

There's another benefit here, too. If the customer turns out to be dodgy, you'll discover this early on, allowing you to cut your losses before they mount up and drag your business down.

Ask your suppliers for extended payment terms to give you the opportunity to sell the goods first before you have to pay for them. If your supplier won't budge, try to tighten your ordering process so that you order items just in time, rather than have them in stock for longer periods.

Get some more ideas on leveraging your finances when you have none.

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