BERR | Department for Business Enterprise & Regulatory Reform

Managing Cashflow Guides

Knowing your Customer

Unless you know exactly who you're trading with, you won't be able to check if they are good for the amount of credit you need to grant, you won't be able to invoice them correctly, and you won't be able to commence legal action effectively if it becomes necessary.

Can you answer yes to all these questions?

- Do you know the exact name and trading style of the business? The people or company that own the business, and are liable for any debts, may not be the same as the name under which the business trades. Types of business include, amongst others, limited companies, partnerships and sole proprietors.
- If it's not a limited company do you know the name(s) and personal address(es) of the proprietor or partners?
- Have you seen headed paper or documentation that verifies this information?
- Have you used a credit reference agency to check their details and credit status?
- Does the information support the amount of credit they'll need? There are many sources of information, the most common and readily available being credit agency reports and references.
- Have you talked to other suppliers of the business to obtain references?
- Do the details on the order match those you were given earlier?
- If they were previously dealing with your competitor, are you happy at their reasons for coming to you?

Five Top Tips

1. Check out the exact name and legal status of the business you're supplying. If it's a sole trader or partnership, the proprietor or partners are personally liable so make sure you have their full details. Businesses can disappear much more quickly and easily than individuals! *For limited companies you can undertake a free check on a limited company's basic details using the Companies House WebCHeck service. Visit www.companieshouse.co.uk*
2. Don't be afraid to push for all the information you need – if you can't get it now, it will be far more difficult later.
3. Watch out for 'friendly' references that the potential customer gives you. Referees that you choose are far more effective.
4. Invest in credit reference information – it could save you a bad debt.
5. Set some rules that you (and all your employees) always follow and don't be tempted to break them, even if you're put under pressure to supply urgently.

Credit Insurance

The fact that a business is here today and is credit-worthy does not mean that it will be tomorrow, next week or next year – or in fact that it will still be in business. If a customer becomes insolvent and cannot pay money that is due to your business it can be catastrophic, especially if the amount involved is large.

Insurance companies and brokers offer Credit Insurance to meet the specific needs of clients, industry sectors and specific transactions to protect against non-payment by your customers and their insolvency. Good credit insurers can often provide detailed information on prospective customers, and can sometimes provide access to cheaper business financing.

Can you answer yes to all these questions?

- Are you confident that your most important customers are not at risk of failure?”
- If the ‘riskiness’ of a customer rises, do you have sufficient controls and monitoring in place to ensure you see it happening?
- Can your business take on all the risk itself and still achieve the level of turnover you want with each of your customers?
- Are you happy with the amount of detailed information you can gather on your potential and existing customers?
- Can your business afford the risk of expanding into new and unknown markets?
- Can your business achieve sufficient and profitable growth while taking all the risk itself?
- Does your business have all the necessary credit management expertise in-house?

Five Top Tips

1. If your business would be more comfortable trading with protection against bad debts or, in certain circumstances, late or non-payment; then credit insurance is worth considering.
2. Credit insurance can give you a stronger balance sheet and (because the risk of bad debts is reduced) it can make finance through traditional overdraft, factoring, or invoice discounting more readily available (possibly at a cheaper rate).
3. Credit insurers have access to more up-to-date and detailed information than is readily and publicly available. This can open up larger credit lines or more flexible payment terms allowing your business to grow its profitable sales.
4. There are a number of credit insurers and insurance brokers, who offer a variety of insurance products. It’s always worth shopping around for the most suitable type of policy and best rates, just as it is for any other insurance product.
5. Credit insurers can be a real asset in helping you introduce good credit management practice into your business.

Invoicing

If you don't raise an invoice, you won't get paid. Invoicing should not be seen as a back-office administrative nuisance. Rather, it is a vital first-step in achieving healthy cashflow.

Can you answer yes to all these questions?

- Do you raise an invoice immediately after you have supplied the goods or service?
- Do you make sure that everything the customer requires appears on the invoice?
- Do you have a process for investigating and resolving disputed invoices immediately the query is raised?
- Do you log the details of disputes so you can fix any avoidable root causes?
- Do you keep a record of the customers that dispute invoices so you can spot any who do so regularly as a way of avoiding prompt payment?

Five Top Tips

1. The sooner you ask, the sooner you can get paid; send by first class post or, better still, electronically or by e-mail.
2. Get invoices right first time; raising credit notes and re-issuing invoices take up resources and time better spent elsewhere. It also changes the payment due date.
3. Ask customers what they need on the invoice in order to approve it simply and quickly. Include at least the following:
    - Correct customer name
    - Correct customer address
    - Delivery address (if different)
    - Delivery date and method
    - Customer Purchase Order number
    - A clear description of the goods or service supplied
    - Accurate quantities, prices, discounts and total amount due
    - Payment terms and due date
    - How payment should be made with bank details
4. Include the words: *"We will exercise our statutory right to claim interest (at 8% over the Bank of England base rate) and compensation for debt recovery costs under the Late Payment legislation if we are not paid according to our agreed credit terms"* on every invoice, and print your terms and conditions on the back.
5. Have a system for resolving disputed invoices promptly, especially if a customer is using a small query to withhold payment of a much larger invoice.

Payment terms

If payment fails to arrive for goods or services you have provided, your cashflow can be under real pressure. Cashflow keeps business in business and - if you think you are being paid on one date and your customer has a different date in mind - you could be in trouble! Making assumptions is dangerous and formally agreeing payment terms in advance is vital.

Can you answer yes to all these questions?

- Do you discuss and agree payment terms with your customers (and with your suppliers) before you accept (or place) an order?
- Do you confirm the agreed payment terms in writing before you accept (or place) an order?
- Do you make sure that the terms on which you agree to pay your suppliers are longer than the terms on which you are paid by your customers?
- If the answer to the question above is no, do you have finance or a finance facility in place to bridge the gap between the time you pay and the time you get paid?
- Do you produce, and then regularly review, a cashflow forecast to ensure everything is under control and there is nothing waiting to surprise you?
- Do you have standard payment terms in place and a policy within your organisation saying that they cannot be changed unless properly authorised?
- Is the payment due date clearly shown on all invoices?
- Do you have a strategy in place for dealing with requests from customers who suddenly and unilaterally demand a longer time in which to pay?
- Do you include your right to make late payment and interest charges on your contracts and invoices?

Five Top Tips

1. Set out and agree payment terms in advance and in writing. It’s better to know what to expect than to leave things to chance and wonder why the money hasn’t arrived later.
2. Watch out for any wording in documents from your customer that change the agreed payment terms. If you accept their order, you might also be accepting their changed payment terms. If their documents contain terms that are different to yours and you fail to challenge them, theirs will take precedence.
3. Whenever you write about payment terms, and on your invoices, include the words: “We will exercise our statutory right to claim interest (at 8% over the Bank of England base rate) and compensation for debt recovery costs under the Late Payment legislation if we are not paid according to our agreed credit terms.” Even if you don’t intend to do so, it can be a useful deterrent against late payment.
4. Raising a further invoice for interest and late payment charges is an excellent way of gaining your customer’s attention and raising the profile of your outstanding invoices.
5. If your customer unilaterally tells you they are going to take longer to pay in future, you will have to decide how important their orders are to your business. If they’re claiming the extended payment terms for invoices already raised, you should demand payment under the previously agreed terms for goods or services previously supplied.

When cash runs short

Cash keeps business in business. However healthy the order book and profit margin, if a business runs out of cash it won't be able to pay its suppliers, its wages, or its overheads and it will fail.

Can you answer yes to all these questions?

- Do you have sufficient cash or finance availability to meet commitments as they fall due?
- Are you confident that this will remain the case for the foreseeable future?
- Are your major customers paying you promptly and not putting you under pressure to extend payment terms?
- Is your product or service so vital to your customers that they will pay your invoices first if they have to choose who to pay?
- Are you sure that none of your customers are having financial difficulties that might prevent them from paying you promptly?
- Are you implementing good credit management practice? (see other guides in this series for advice and tips).

Five Top Tips

1. Plan your cashflow requirements carefully allowing for differences in the payment terms you receive from your suppliers and those you give to your customers.
2. Monitor stringently against the plan so that you spot any variance as early as possible
3. If you think you might have a cashflow problem, talk to your bank or financier immediately. They might be able to help and the earlier you speak to them, the more options there will be.
4. If you can't pay a supplier on the due date, talk to them as soon as you know you cannot do so. Again, the earlier you talk to them, the more flexibility they'll be able to show and the more likely they are to be able to accommodate an extension to payment arrangements.
5. Remember, early communication is key – if you avoid talking to suppliers, your bank and other parties, you might find supplies or finance have been withdrawn or legal action has started and things will quickly escalate. There were over 70 corporate failures every working day between May and July 2008, many of these through lack of cash; you need to make sure your business doesn't become a statistic.

Factoring and financing options

Most businesses extend credit to their customers and extending credit requires finance. Unless a business has the cashflow to support the difference in timing between the cash it collects and the cash it has to pay out, it can be in trouble. Managing cashflow effectively means staying on top of finance and ensuring funds are available when they are needed.

Can you answer yes to all these questions?

- Do you have sufficient cash reserves to meet commitments and pay suppliers on time?
- Are you getting longer payment terms from your suppliers than you're giving to your customers?
- Is the product or service you supply so vital that you can dictate payment terms?
- Is the level of your bank overdraft or short-term finance sufficient?
- Do you monitor the creditworthiness of your customers?

If you can't answer yes to all the questions opposite, you might need to consider these alternatives in financing your business.

Five Top Tips

1. Don't wait until things become critical. You need time to put arrangements in place and it's easier when you're not under too much pressure.
2. **Factoring** – the factor agrees to pay an agreed percentage of approved debts as soon as they receive a copy of the invoice; 80-85% is common. The balance, less charges, is paid when the customer pays and the factor will undertake all credit management and collections activity following an agreed credit policy. The advance is likely to be 'with recourse' (meaning that the factor will be able to reclaim its money from you if your customer does not pay) so the option of bad debt protection should be strongly considered.
3. **Invoice Discounting** - immediate cash for up to 80-85% of the approved invoice value is available. However, responsibility for the sales ledger operation and credit management activity remains with the organisation and the service is normally undisclosed to its customers. Payments received are paid into a bank account administered by the invoice discounter, after which the company is credited with the balance, less charges. Again, this advance is likely to be 'with recourse' (meaning that the discounter will be able to reclaim its money from you if the customer does not pay) so the option of bad debt protection should be strongly considered.
4. **Supplier Finance** – sometimes called reverse factoring, is an option where you are a regular supplier to a large organisation that has an appropriate arrangement in place. Invoices are paid immediately (and ahead of terms) when the buyer confirms it has approved the invoice for settlement. The buyer then repays the financier according to the original contract payment terms. This allows you to receive an immediate cash payment, less a discount that is based on the buyer's credit rating and is without recourse (meaning that money will not be reclaimed from you if your customer fails to pay).
5. **Project Bank Accounts** – ensure that the contractor and his supply chain receive promptly monies rightfully due through certified interim payments. The Project Bank Account is set up in trust for the whole supply chain and is the medium through which payments are made. The Project Bank Account makes payment on receipt of an instruction signed by both the project client and contractor, and the supply chain is notified of the day they will receive payment from the Project Bank Account. Project Bank Accounts have Trust Status which prevents a receiver seizing the proceeds of the account in the event that the contractor goes into receivership.