

Ready to grow your e-commerce business?

Understanding these accounting basics will help

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You've decided to start a new e-commerce business. It's an incredibly exciting time, and you have all the ideas and drive you need to succeed.

But managing your finances and your time could be a challenge.

Don't worry – we've put together this guide packed with expert advice to help you boss your accounting for your online business and successfully grow it.

An introduction to e-commerce accounting basics

Selling goods and services online can be a great way to carve out market share, increase brand awareness, and build margins. But, while many budding entrepreneurs know their product and customer well, the financial principles behind a successful e-commerce business can be a bit more difficult to grasp.

When selling online, it's essential to have a finance function sophisticated enough to help you work the way you want to.

Simple bookkeeping – which is just a backward-looking record of money flowing in and out of your business – is not enough.

Proper accounting allows you to track key performance indicators (KPIs) in detail, including [cost of goods sold](#) (CoGS), inventory (the goods you hold ready for sale or production), [cash flow](#), and [gross profit](#) to make sure your business runs smoothly, profitably and sustainably.

You'll also need reliable [accounting software](#) to make sure the financial aspects of your business integrate seamlessly, and help you stay compliant no matter where in the world you're shipping your products too.

If you're selling online, your accounting should be there too.

This allows you to access information about your e-commerce business in real time on any device. It means you can tackle challenges and opportunities as they happen, rather than at the end of the quarter or year, when it's too late.

Accounting services and software also help you understand and track sales taxes and foreign exchange transactions, which are the key to success for most e-commerce businesses.



How to get started with your accounting

To set up the accounting side of things, you'll most likely need a specialist e-commerce accountant at some stage, who can advise you on all the choices below and how they work together. Accounting software will be essential from the start.

First, you need to choose the appropriate business structure.

In the UK, you can choose to operate either as a sole trader or limited company, and figuring out which one is right for you depends on a [range of factors](#). If you're unsure which option to go for, it's worth speaking to an accountant.

For most fast-growing e-commerce businesses, a limited company will be most appropriate due to the tax benefits and limit on personal liability.

As an online trader, you're often reliant on other supplier and services. But if any issues crop up, your liability is limited to the company, not your personal assets as is the case if you are self-employed.

The main advantage of being a sole trader is that it's simpler in terms of administration and faster to set up, so you could start out that way and become a limited company later.

Next, you'll need a business bank account that can link to your accounting software, e-commerce platform and other software you plan to use such as inventory management.

If you have employees, you may need a payroll function (although there are [exceptions](#)) and [payroll software](#), which your accountant can help with.

Finally, you need to decide whether to [register for VAT](#).

HMRC does not require you to do this until your turnover reaches £85,000, but you can register before that if you want to if, for example, it helps you to reclaim the VAT you're charged by other businesses.

Again, your accountant can help you do the sums on that and choose which of the various [VAT schemes for retailers](#) to use.

They'll also guide you through any law changes you need to be aware of, such as, for instance, those surrounding [changes to e-commerce VAT in the EU](#) coming into effect on 1 July 2021.

How to choose e-commerce accounting software

Accounting software helps e-commerce companies in myriad ways.

Best practice is to integrate your software with your [payment gateway](#), e-commerce platform (software that enables online buying and selling), bank account and [inventory software](#) to help your business run as smoothly and efficiently as possible.

Cloud-based software will enable you to can see your transactional figures and KPIs in real time, anywhere, and allows you to improve record keeping with a direct flow of transactional data.

Software saves you a lot of time by automating many of the manual financial processes. But really good software also includes budgeting, planning, cash flow, and forecasting tools that integrate with your sales software to track performance as it happens, and provide business insights.

Zamir Cajee, founder and director of e-commerce electricals provider [iQualTech](#), says accounting for an online sales business should be easy in that the data is all digital and connected.

“Make it as integrated as possible so everything is working for you with minimal effort,” he says. “For example, Shopify apps can automatically bring all your sales figures into your accounting system and reconcile payments, while other apps integrate stock figures.

“The software allows us to see beyond transactional sales data towards key metrics such as profitability per item and analytics tools.

“That is critical for maintaining cash flow and running the business.

“For example, your sales may be growing but your cash flow can’t support that growth because you have too much stock. It’s important to know that in real time so you can [avoid cash flow problems and] keep your business sustainable.”

These challenges can be critical for early stage businesses, so Zamir advises implementing accounting software from day one.

He says: “It is a minimal cost, even for a small business.

“But the amount of time it saves, the insights and help it gives in growing your business – it’s an investment.”

As your business grows, a more sophisticated e-commerce [enterprise resource planning \(ERP\)](#) system can also help you manage online sales, logistics, finance, performance and more all from one easy-to-use system.

What an e-commerce accountant does, and how to find one

No matter how shiny your e-commerce website or online platform, your business won’t succeed if you don’t manage your finances effectively.

For most small businesses, this involves hiring a specialist e-commerce accountant who can give you a thorough breakdown of metrics such as cost per click, cost of goods sold, break even point, and [gross profit](#).

Rob Jones, founder of [RJF Accounting and Business Support](#), says: “E-commerce owners don’t always know or understand key aspects such as the cost of their stock, how to manage inventory, nor the impact of cash flow.

“A simple profit and loss account won’t reveal the cash tied up in stock.

“A specialist accountant will help you understand all these areas and others such as VAT, which owners often forget but can also mess up your margins.

“To find a good accountant, ask other e-commerce owners directly or on social media.

“Anyone can set up an accountancy business, so make sure yours has professional qualifications. Check their website and look at their specialism and e-commerce experience.

Also, check their fees and try to get a fixed fee. Don't forget, if you work online, your accountant can be online too, so they don't have to be local.

"One of the most frequent reasons for people leaving their accountant is they never hear from them until their accounts are done, so look for one that's proactive. Their goal should be to help you grow your business, so interview a few and make sure you get on with them and understand each other on that level."



Tax for your business and customers

Understanding [online and distance selling regulations](#) is vital for any e-commerce business, as is understanding tax.

[VAT rules](#) are complex, and even more so if you import and export as each country's tax laws and rates are different. You need to understand how to register for sales tax, your potential liabilities in each country, and how to set these up in your accounting system.

The same goes for duties and tariffs on exports and imports.

The European Union's (EU's) [One Stop Shop](#) initiative should help those who operate in multiple EU countries, but the overall picture is still complicated for the majority of businesses.

Most experienced e-commerce accountants are aware of European and US requirements, at least, so should be able to help you do this or refer you to partners in other countries who can.

Registering for VAT in the UK means you will have to charge 20% tax on your VATable products and services. So you may want to wait until you hit the £85,000 threshold to do this. But, well before that, you must make sure your business will still be viable once registered.

Rob says: “Will your market allow you to add 20% to your prices or can you swallow that 20% in your margin? If you add it, you may lose market share. An alternative would be to find ways to reduce costs.”

E-commerce business owners must understand taxes that apply to their [limited company](#) or [sole trader](#) status.

If you have employees, for example, to cover demand surges or support growth plans, you also need to understand [PAYE and National Insurance](#).

If you’re trading internationally, you need to be aware of cross-border corporation taxes. For example, if you set up a distribution centre or marketing division in another country, you may need to comply with [permanent establishment rules](#).

Not to worry. There are many sources of good information about tax, including the [HMRC](#) website, so learn as much as you can alongside advice from an accountant.



More financial management tips

Remember to keep all the right [accounting records](#). Limited company owners must do this legally or risk a ban. Sole traders also need to maintain accurate, organised records [for at least five years](#) in case of an HMRC inspection.

How you [manage cash flow](#) for your e-commerce brand depends on your business model and whether you sell goods, services or digital content.

For example, if selling you're physical goods, you need inventory management to make sure you have the right stock levels.

Too much and this will threaten your cash position.

Plan to hold enough cash to sustain the business as it grows.

"We had one client who reached £2.5m turnover but never had enough cash to pay her VAT bill," says Rob. "She didn't have a handle on inventory, so wasn't selling enough to cover stock that wasn't selling.

"To avoid this, monitor your KPIs, including gross margins, sales and stock turnover, regularly.

"Many tools are available to help you manage cash flow and inventory. These should integrate with accounting systems, but they need to be kept up to date and are only as good as your accounting function."

Zamir adds: "At the start, many e-commerce owners feel the worst that can happen is running out of stock so the temptation is to buy large. But running out means you've sold everything – you're doing well. Just place the next order and go on. Worse is to buy a load of stock that doesn't sell.

"Plan and forecast your cash level, inventory and sales into your budgets so you know when to place the next order to avoid running out of stock or cash. Then monitor those in real time, delay the next order if you sell less, or bring it forward if you sell more.

"Most young businesses can't grow much faster than they planned to.

"If you are running out of cash, you might need to cut back on marketing to slow sales and stay within your means."

Your accounting function should also help you understand market opportunities, test and measure yourself against them, and plan contingencies accordingly.

"Understanding cost of goods sold, alongside fixed costs, is also crucial," says Zamir. "CoGS is not just the cost of buying the product, but includes sales taxes, processing and delivery.

"Marketing is another cost that often trips people up.

"This is highly variable, so plan for marketing going over or under budget and understand the implications of both."

Lastly, exchange rates can be an important factor when your international sales volumes increase.

At that point, [forward contracts](#) to fix exchange rates can help protect you from currency price changes, but it's another complex issue.

“As with all these challenges and opportunities, bringing in someone who understands financials – and listening to them – is key,” says Zamir.

Final thoughts on accounting for e-commerce

E-commerce is one of the most dynamic areas in which to start a business, with great potential if you get your finances right.

To help ensure success, get as much advice as possible from other experienced traders.

Use this guide to build sound financial management into your business plan.

And start shopping around for the best accountant and [accounting software](#) you can find.

With all these things in place, you’ll have a solid foundation on which you can build a thriving business.
