Lambert Chapman
Chartered Accountants

Managing business budgets and finances

Introducing the discipline that finance management brings means a business is much better placed to organise and plan its development.

Most financial management is relatively simple to implement, and the advantages of doing so far outweigh the time and resources needed to set up the sort of controls that will help boost a firm's profitability and put its finances on a secure footing.

Credit control

The most common reason why smaller businesses suddenly find themselves struggling to turn in a profit is not the quality of their product or service. Nor is it due to a lack of hard work. Nor to a loss of orders. Most often than not it is the absence of money - the drying up of the cash flow. And the principle cause of cash flow problems is late payment.

In giving a customer credit, a business is effectively offering them a loan on which no interest is charged. Clearly, the sooner that invoices are settled, the sooner the business can use the money to re-invest in itself.

Matters are made worse if a business is having to borrow - say through an overdraft - in order to cover overdue payments; not only is the bad debt freezing much needed capital but it is actually costing the firm money.

For many firms, however, cash flow difficulties are avoidable. The priority is to set up a credit control system; that is, a system of checks and procedures that optimises the chances of being paid and of being paid on time.

One of the most important things a credit control system does is to provide a business with the means to check on a customer's credit worthiness. Businesses should certainly never be embarrassed about drawing up a credit application form for new customers to fill in.

Sometimes a reference from a customer's bank and other traders might be enough to convince of their reliability. When requesting a bank reference, a business should be precise about the information it is seeking; it should specify exactly how much credit is being offered and whether the bank considers this appropriate.

Where larger sums of money are concerned, it might pay to commission a report from a credit reference agency. They will check that customers are who they say they are and that they have the means to pay for the goods or service. The agency will also recommend a credit limit for individual customers. A further advantage in assessing a customer's ability to pay before any sale is agreed is that it gives a business the opportunity to arrange its terms and even its price according the purchaser's payment track record.

Credit reports can help with marketing too: there may be little point investing time and effort targeting potential new business if the firm you have set your sights on has a fragile payment history or is experiencing financial difficulties.

In the case of existing clients, progressively late payments made by customers once timely in settling their bills may be a strong indicator of problems with their cash position. A business should keep an equally close watch on its own finances, monitoring cash flow in case a blip looks as if it might become a trend.

Of course, sound, copper-bottomed existing customers are the bedrock of a business when trading conditions are harsh. So you should make every extra effort to keep such customers happy and loyal: improve your service to them wherever possible; cement your relationship with them by maintaining regular contact and ensuring they still value your service or products.

Terms

Credit terms need not be uniform or set in stone; they can vary. Prompt-paying or reliable customers can be rewarded with more generous terms than those who tend to pay later. In some instances, where there are reasonable grounds for concern, it might even be advisable to request payment on delivery or part payment in advance.

Circumstances, of course, can alter for customers. So the credit terms they are offered should be always be reviewed in the light of any changes in their payment history.

Payment terms must be unambiguous and stated clearly from the outset. The stricter and more precise the terms and conditions you apply to a sale, the less chance there is of payments slipping and sliding. Ensure that customers understand those terms from the outset. Print them on both invoices and delivery notes.

If invoices are to be settled according to a payment schedule, secure a written agreement on when each invoice is to be sent and paid. To encourage prompt settlement of bills, offer an incentive such as discounts for early payments (while always balancing the extent of the price cut with the benefits of an improved cash flow).

As soon as the goods have been delivered or the project completed, an invoice should be raised and sent at once. Invoices must always give prominence to the date by which payment is expected.

Businesses should set customers, and themselves, a strict payment timetable and should keep to it. It is important not to let any payment timetables slip: issue regular statements reminding customers of the sums they owe, how long they have been owed and for which products or services. And, politely but firmly, always be assiduous in chasing overdue amounts.

If your business sells physical products, it may be worth adding a retention of title clause to any contracts. This means you remain in ownership of the items until they have been fully paid for. Should the customer fail, you can reclaim your stock.

Payment collection

Regrettably, there will sometimes come a point when it is clear that no amount of polite coaxing or pleasant reminders will persuade the customer of the need to settle the invoice. Then it might become necessary to involve a debt collection agency (they normally charge up to 5 per cent of the outstanding sum) to secure payment.

Other payment collection options open to a business include credit insurance, factoring and retention of title.

Factoring companies provide finance against outstanding invoices and will assume responsibility for collecting the overdue amounts. In certain circumstances, retention of title allows a business to reclaim, as its own property, any goods that a customer has failed to pay for.

No matter how popular a firm's product or how much in demand its service, a sale is only secure once the customer has handed over their money. Which is why for many businesses success depends as much on an effective, streamlined management of their credit system as it does on delivering an outstanding product or on innovative marketing.