

Briefing

SPECIAL EDITION

**The art of cash
management**

Cash has never been more in vogue

Effective cash management will not only make your business more profitable it will ensure your business has a future. In the following pages we examine the cash cycle from forecasting you cash requirements through to tactical debt recovery. Each article has been written by a chosen specialist. I do hope you find them useful.

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“Every day I get up and look through the Forbes list of the richest people in America. If I’m not there, I go to work”

~Robert Orben



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“Always borrow money from a pessimist, he doesn’t expect to be paid back”

~Unknown



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“Business is the art of extracting money from another man’s pocket without resorting to violence”

~Max Amsterdam



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“No man’s credit is as good as his money”

~E.W. Howe

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“Creditors have better memories than debtors”

~Benjamin Franklin

Forecasting your cash requirements

Successfully securing finance for your business starts with clearly establishing your cash requirements. Times are tight, and the banks – the traditional “first port of call” for most businesses – are continuing to readjust their lending models. No matter who you speak to, the starting point is a clear assessment of just how much you need. Here are the essential steps in forecasting your cash requirements.

Should we have debt?

Before speaking with anyone, do your homework – there are some basic questions that you must be prepared for. So, a few ground rules are:

● **Make sure you know how much you need.**

Too many businesses fail to raise the finance they need simply by not being clear about the amount they require.

● **Timing is everything** – know when you need it, and for how long.

● **Be clear about what you need the money for and about how and when you are going to repay.**

● **Research your audience diligently** – bankers and investors are all human – all different, with particular likes and dislikes. Work with advisors who can help you target the right individuals and who can help you hone your presentation to perfection. Often, you have only one chance to get this right.

● **Cover all the bases** – when it comes to preparing your financial projections, include profit and loss, cash flow and balance sheet projections – all three are critical in presenting a robust and well integrated projection of your business. One or two out of three just doesn't work. Too many business owners fail to grasp the critical difference between profits and cash – your profit and loss projection will demonstrate your profitability, but only your cash flow can reflect your working capital requirements and accurately establish your cash requirement. And don't forget the balance sheet either – having established your funding requirement, all funders will want to see monthly balance sheet projections to assess your asset cover at the point of your peak funding requirement.



● **Start with a solid foundation** – robust financial projections need a good starting point and your opening position is critically important. Use your most recent management accounts and your most up to date balance sheet as your starting point. Review this balance sheet carefully – line by line – and make an honest assessment of the cash implications of each item. Assess when your debtor balances will be received and when creditors need to be paid. Don't kid yourself. Too many financial projections go way off beam in the first few months simply because unrealistic assumptions are applied to opening balances – it isn't realistic to assume that all of your debtors will pay you in 30 days – don't ignore bad and doubtful debts and those balances that you know will take time and effort to collect.

● **Tempus fugit, so don't let your financial projections go stale.** Funders will inevitably take time to review your projections and by the time you meet them your opening position and possibly your first month's figures will be out of date. Nothing will destroy your credibility more than a projected cash balance at the end of month one which is significantly at odds with the figure on your bank statement. Keep refreshing your financial projections and keep your opening balance sheet as up to date as possible.

● **Keep it simple** – prepare monthly and annual profit and loss, cash flow and balance sheet projections for maybe three or four years. Each should fit on one side of A4. Include a schedule of your key assumptions and leave it at that. Too many business owners fail to attract the funding they require through sloppy presentation – financial projections which run to 30 pages with poorly set print ranges could go straight in the bucket.

● **It may seem counter intuitive, but let the funders be creative.** Having established your peak funding requirement, don't second guess how your funders will structure your finance. Adding new loans and finance costs to your projections can distract and confuse – particularly in these uncertain times. Keep it pure – make sure your cash flow projections clearly show the peak requirement without any new finance in place and then actively engage with your funders to establish the most appropriate and cost effective funding solution.

● **Be realistic.** Too many businesses fail, simply by not raising enough cash to meet their peak requirement. Test your assumptions to destruction and err on the side of caution – assume that everything will take twice as long and will cost twice as much.

● **We've all heard it a thousand times before, but don't forget that cash is king.** The easiest business to fund is one that doesn't need funding! If you only do one thing, focus on making your business as cash generative as possible. Your financial projections may look the part, but nothing will make a bigger impression with your funders.



Understanding debt

There has never been a more important time to have your business debt structured appropriately. This is a topic which many businesses don't understand and ignore at their peril. We look at the key principles.

Should we have debt?

Very few businesses or people can go through life without having any debt. If as a business you are in the luxurious position of being able to ask yourself the question, the answer will almost certainly be yes. Business debt and personal debt are different. Personal debt beyond an affordable mortgage or car loan is generally bad; business debt is not.

A business which has debt will generally be able to spread the risk of financing its operations, grow more quickly and produce a higher return for its shareholders than a business which is debt free. This may seem counter-intuitive but it is true. A business which has debt should produce higher returns in the good times than a business which is debt free. Conversely, and perhaps more pertinently, a business with debt will produce lower returns than a debt free business when times are tough.

There are a number of parameters we can look at in determining the amount of debt a business should have but the overriding factor for an SME will be the attitude of the owners to risk. Attitude to risk is a personal issue and as such it is not an advisor's role to say if a particular attitude is right or wrong.

What do we mean by structuring debt?

When people refer to the structure of debt they mean "What type of debt do you have?" and "When does it have to be repaid?" Your business may have an overdraft, a term loan or both. We're all familiar with the fact that overdrafts are generally repayable on demand (i.e. short-term) whereas term loans are for a fixed period of time, usually 3 to 15 years or beyond (medium to long-term).

There are many other forms of finance beyond overdrafts and term loans. For example, your business may also use- trade credit, factoring, hire purchase agreements, preference shares, etc.

What are the security implications of different types of debt?

Irrespective of the term or type of debt, all debt

falls into one of two categories. It is either secured or unsecured. As the lender will usually pass any legal and valuation costs on to the borrower, secured debt is more expensive to arrange than unsecured debt. On the plus side, secured debt will generally have a lower rate of interest than unsecured debt as the lender bears less risk. If the borrower defaults, the lender should be able to recoup the funds they've advanced by selling the assets which have been used as security.

A bank may be willing to accept a guarantee from a high net worth individual without attaching any legal claim to a particular asset as security. This is referred to as an uncollateralised guarantee. Normally, lenders will require the security to be asset backed. For the purposes of valuing the assets for determining how much security they require, lenders will normally discount the market value of assets. A bank may discount the value of commercial property by 20%, trade debtors by

50% and stock by 80%. As borrowers generally don't know the discount factors which a bank may apply, they usually feel that the bank has asked for too much security. Banks apply these discounts to the market value so they can be confident of recouping their cash from the sale of assets even in a fire sale situation. As much as discount factors may pain borrowers, the recent developments in the economy, particularly with regard to commercial property values, have only underlined the wisdom of applying discount factors.

What are the cost implications of different types of debt?

Unsecured debt will generally have a higher rate of interest than secured debt. There should be a positive correlation between security and the interest rate. The better the quality and marketability of the security which the borrower provides, the lower the interest rate the bank should charge.

When pricing facilities, banks typically refer to 'the margin'. When they refer to this, they mean the number of percentage points above the base rate or, now more typically above, LIBOR at which they intend to charge you

interest. So a margin of 4% would mean LIBOR + 4%. Although the base rate and LIBOR have fallen significantly as banks have increased their margins, many businesses find they are paying interest at a similar level to when the base rate was much higher - so whilst a business may have previously been paying base plus 2%, they are now paying base (or more probably LIBOR) plus 5%.

Although some term loans may have a fixed rate of interest, most overdrafts and loans from banks are offered to borrowers at variable rates. As with many things in life, it is easy to be wise after the event about the merits or demerits of taking a fixed rate loan. As with the absolute level of debt, the decision may depend on your attitude to risk. As a guiding principle I would suggest that it may be better to consider what you could lose rather than what you could gain.

How do we decide the correct structure?


You are probably better able to answer this question than you think. If we look at personal finance - most of us will have financed the purchase of our homes with a 25 year loan, the purchase of our cars with a 3 year hire purchase or lease agreement and perhaps have a mobile phone on a pay as you go contract. So, matching the term of the debt with the purpose of the debt is the key principle in determining how you should structure debt.

Essentially we need to apply the same reasoning to our business finances. Who of us have asked the bank for an overdraft to buy a house or a term-loan to buy a new phone? Yet I've often seen businesses use overdraft finance for everything - buildings, fixed assets and stock. They may get away with this in the short-term but if they use all their overdraft facilities for fixed assets they may find themselves in a tight spot if they find their customers taking a bit longer to pay and their cash resources squeezed.

When should we use short-term debt?

Short-term debt should be used for short-term needs, for example, financing stock and debtors. An overdraft facility is a very effective type of short-term-debt. It is an efficient way to

"Personal debt beyond is generally bad; business debt is not."



**It could be your
debt that is
keeping you
afloat.**

borrow precisely the amount of money you need; you don't pay for the credit you don't use. There is no point in borrowing more money than you need; the interest cost on your debt will exceed the interest income you will earn on the surplus cash so you will be out of pocket.

An overdraft will be subject to renewal on an annual basis. The lender will charge you a fee for the annual review. Typically the fee is a percentage of the amount of the facility. Although many overdrafts are offered to borrowers on an unsecured basis, the lender will use the annual review to assess the sufficiency of their security position as well as considering the interest rate they wish to charge you.

So although an overdraft can be flexible and efficient it is short-term. It is a facility which could be withdrawn at the next annual review. If you have an overdraft which never dips below a certain level of indebtedness you have core borrowings in a short-term facility. If your bank has a change of heart you could find yourself in a tight spot. You should consider switching the core element of the overdraft into a term-loan.

When should we use long-term debt?

Long-term debt should be used for long-term needs, for example, financing fixed assets. Moreover, you should match the term of the loan to the life of the asset. So you may agree a 20-year term for a building and a 7-year term of an item of equipment. This is applying the pay as you go principle.

There will be an arrangement fee which is a percentage of the facility but unlike an overdraft this is not payable on an annual basis. There may be costs associated with putting security in place but as already noted, if your debt is secured you should pay a lower rate of interest compared to an unsecured facility.

Generally term loans can be repaid early without the borrower incurring penalties. Unlike an overdraft, a term-loan is not subject to an annual review. So as long as you keep within the terms of the loan, it is a source of finance which is guaranteed to you, the bank cannot withdraw it from you. You may find it easier to sleep at night if your debt is long rather than short-term. ■



Managing your suppliers of finance

The most obvious supplier of finance to your business will be your bank but there are probably a number of others you haven't considered. Managing the businesses relationships with all of your suppliers of credit has never been more important.

Here are practical ways of keeping the suppliers of finance to your business inside.

Who are they?

Finance is elemental; no business can survive without it. You may think that it is only your bank who supply credit to your business. You will probably get credit from your suppliers for your materials, overheads and stock. Your fixed assets may be financed by hire purchase or lease agreements, you may have non-bank loans from say the Carbon Trust or family members, you may owe money to the financial institution which provides you with invoice discounting, you may have local authority grants, you probably owe money to HMRC, you may have a director's loan account and you probably have shareholders. Some of your customers may pay you in advance so you owe money to them too!

Let's look at some of the key suppliers of credit to most businesses and see how we can ensure that we create and maintain healthy business relationships with them and use them to best effect.

Credit rating agencies

Although credit rating agencies are not a source of credit, they do influence the amount of credit which your suppliers will be willing to give you. Most businesses now have credit approval procedures and given the low-cost and ready availability of credit rating agency reports they are used widely.

Two factors have resulted in a deterioration in the credit rating given to many businesses. Firstly, as a result of the recession, the major credit rating agencies have changed their risk assessments of certain industry sectors. So even if your financial results are holding up your credit rating may be weaker. Secondly, for the businesses who have filed their 2009 financial statements, and where these figures are poorer than 2008, the decline in performance is reflected in a weaker credit rating.

You should establish your credit rating with the main agencies (Dun & Bradstreet, Equifax, etc). Speak to the agency to confirm that they have classified your business in the correct sector; this can make a big difference. And, ensure that they understand your balance sheet. When preparing your annual financial statements, discuss the classification of liabilities with your accountants. The greater the proportion of liabilities which can be classed as "due after more than one year" rather than "due within one year" the stronger your credit rating.

Trade creditors

As well as supplying you goods and services, your suppliers also supply you with credit. The more credit you can get from your suppliers the less credit you have to get from other sources. Trade credit is an excellent source of finance to your business. It is generally free and unsecured. It is better to owe £100,000 to your suppliers than to your bank – no interest charges, no arrangement fees and no security. If you are on good terms with your suppliers consider asking them for extended terms - it is about as close as you can get to a free lunch!

We all like to be paid on time. If you can pay your suppliers on time then do so. If you can't, contact them and agree revised payment terms. I know it may sound like a cliché but timely and honest communication is essential to creating and maintaining good relationships with your suppliers. If you demonstrate to your creditors that you are on top of the situation, even if you are behind with payments, they will have more confidence in you and will be more likely to cooperate with you.

Avoid making lump sum payments; this is seen as a warning sign that you are struggling. It is always better to pay specific invoices.

Banks

I have seen instances where the fact the bank has felt it has been misled by a business has been a key factor in them deciding not to continue supporting a business. I make no apology for saying again – timely and honest communication is essential.

If your business has significant bank debt then they have probably asked you for regular financial information. The bank may also have advanced the funds to you on the condition that your business maintains certain financial ratios. These types of requirements are referred to as covenants. If you breach your covenants the bank may have the right to withdraw the funding or renegotiate the terms. Unless you've been on the moon for the past 18 months you'll be aware that banks are using every opportunity to re-price facilities and switch pricing from base rate to LIBOR – in the words of the song "the only way is up". Keeping on the right side of your covenants is crucially important.

If you don't know what covenants you signed up for – find out; check the facility letter your bank sent you when you initially drew down the finance.

HMRC

You may think that this is an unlikely source of credit. The Business Payment Support Service is designed to help companies and the self-employed who are not able to pay their taxes on time. It covers, corporation tax, income tax, VAT, PAYE and National Insurance. In most cases you can make an agreement over the telephone to settle tax liabilities by instalments.

This source of credit has been a lifeline to many businesses.

Moreover, if you owe corporation tax or income for last year and expect to make a loss in the current year, HMRC will now take the anticipated loss into consideration when rescheduling the payment of the previous year's liability. In effect, you are getting loss relief up front.

You

It is common for directors of private companies to give a loan to their company. The amounts involved can be substantial. It is rare for this type of loan to have any documentation; an omission which could leave the director exposed.

The existence of loans from directors is often a symptom of funding difficulties. If you are owed money from your company consider the company making loan repayments to you rather than salary payments. As the loan repayments are free of NIC and PAYE, you can get the same cash in your hand every month for a much lower cash outflow from the company.

Shareholders

I've seen a number of companies who have moved from the start-up stage to having 3rd party shareholders make mistakes with their shareholder relations. Whilst the entrepreneur recognises that the new shareholders have provided funds, he or she fails to see the need to keep the shareholders up to date. This is not a good start to the relationship.

There are lots of things which from a legal perspective you may not need to tell your shareholders about, but if you want them to support you and provide further rounds of funding you ignore them at your peril. Agree the frequency and format of reporting to shareholders and stick to it. ■



Collecting cash

Nobody has ever gone out of business because they had too much cash. Cash management and debt collection are not the same. And, if you think debt collection starts once the invoice is past its due date, then you've missed a trick. Most businesses are paying more attention to cash management than ever before.

Credit control

Collecting cash starts with credit control and credit control starts with deciding to whom you'll give credit and on what terms. It doesn't start with getting on the telephone to chase overdue payments. A good credit control system should improve your cash flow and minimise bad debts.

Before you give credit to a new customer ensure they complete a credit application form. As well as including all the basics like business name, addresses, legal status, amount of credit required, the dates of their supplier payment runs, you should ask for the names of the owners, the name of the person you should contact about payment queries and the contact details for two trade references.

This may seem like unnecessary administration but do take up the references – bear in mind how much you need to sell to make up for a bad debt. Get a credit rating report; these are widely available on-line. Decide how much credit you want, and can afford, to give. Set a credit limit and stick to it. If you're concerned that your potential customer may not be in good shape, ask for cash up front or get personal guarantees from the company's directors. Bear in mind how much credit the potential customer has asked for and apply these measures sensibly. Let your sense of how much you would be hurting if your business lost £x act as your guide to the amount of checking and information gathering you conduct.

Given the times in which we live very few people will object to you taking these precautions. If they do, don't give them credit.

Ensure your terms of business and payment terms are clear – print them on the credit application, sales invoices and statements – and ensure they are comprehensive. Do you allow early settlement discounts? Do you apply interest to overdue accounts? Do you exercise retention of title? Ensure that your sales invoices include details to enable customers to pay you by post, BACS or on-line. Having clear sales invoices will minimise the likelihood of errors, delay and

mis-understandings. You may find it useful to have your solicitor review your standard sales invoice format to ensure they are clear and legally competent.

Delivering the goods

Observe the agreed protocols – don't let the absence of, say, a purchase order number hold up your customer processing your paperwork. We'll work on the assumption that you get the order right and both parties have followed their own procedures for purchase orders and despatch. Then, always obtain proof of delivery and ensure your customer is satisfied.

Sales invoices and statements

Send your invoices out quickly – ideally the same day the goods are despatched. Send statements early in the month, every month. Many businesses will not pay an invoice until they receive a statement.

Chasing up

He who shouts loudest generally gets paid first. Chase up overdue debts quickly. Phone calls can be very effective. The key thing is doing what you said you'd do when you said you'd do it. If you say you'll call back on Tuesday, then you must. This helps build up a head of steam and will also send your customer a very clear message – you are serious. Your customers will soon get wise to the fact if you don't follow through. If they do, they'll ignore you!

Delaying tactics

If you're told that "we haven't received your invoice" then send a copy immediately. Most of the other usual excuses – "it hasn't been passed for authorisation", "we can't pay it as it doesn't quote a purchase order number" etc – should be addressed by your credit application form. If you've done your homework at the credit application stage they shouldn't

be able to give you the run around now. Alternatively, take a note of these details and update your records.

If you're told "the cheque's in the post" (I know, it is difficult to say with a straight face)

ask for the cheque number and date of posting. Be wary of round sum payments – these may suggest that your customer is in financial difficulty and is only paying what they can. (Alternatively, if you are in financial difficulty, always pay whole invoices). If you do get a hint that your customer may be in financial difficulty, then escalate your efforts immediately.

If no cash is forthcoming we now move further down the track from routine credit control to debt collection.

Debt collection

If the debts are overdue then stop supplying immediately – don't add to your risk. Send them a 7-day letter; if that doesn't result in cash or an acceptable payment plan then you need to decide if you're going to "go legal". As a last resort, a personal visit to the customer can also be very effective. It also gives you an insight into the condition of their business.

There's not sufficient space in an article of this length to cover the ins and outs of the whole legal process. Appoint a good debt collecting agency or firm of solicitors. They will advise you on the efficiency and efficacy of your options. There are a number of DIY options but, again, take professional advice on these options in the first instance.

The more you know about your debtor and their circumstances the greater chance you have of collecting your cash. This takes us back to credit applications again!

Avoid the hassle

You could save yourself much of this hassle by factoring or invoice discounting. As most factors offer 80% of your sales invoices within 24 hours it will speed up your cash flow. This is not the right solution for every business; much depends on the nature of your debtor book. If you do look at this be sure to go in with your eyes open to the charges you'll be liable for, the length of the contract, the notice period and the costs you'd incur for early cancellation of the contract.

And finally,

I haven't been able to trace the author of the well known saying "The only man who sticks closer to you in adversity than a friend is a creditor." I do know it is a good practice to follow. ■

"Send your invoices out quickly – ideally the same day the goods are despatched. Send statements early in the month, every month"

Tactical Debt Recovery:

A beginner's guide to getting tough

You have done the marketing, recruited and trained the staff, made the contacts, done the deal and delivered the goods. Payment doesn't arrive on time. What next?

Credit control

Too often well run businesses do everything right just to have their profit cruelly snatched away by reluctant debtors. Cash flow is the life blood of any business. But what can you do when payment is not made? Debtors can be neatly packaged into 4 categories: Follow these tips and hopefully payment will start winging its way to you ...

The Friendly Debtor

Who: Long standing client/customer, friend, acquaintance, business colleague. You like them. Despite no apparent problems payment never arrives.

Tactics: De-personalise the situation. Hand over the reins to someone else eg: your accounts department, lawyer, factor. Remember, this is your profit. You have the moral high ground. Stop feeling bad about asking for payment.

Action: Send 7 day letter. Any agreed payment plan should be carefully formalised in writing. This will allow you to sue with ease if the payment plan is not honoured.

The Failing Debtor

Who: The cheque is always in the post but never arrives. Repeated promises are broken. This debtor is like the Titanic – they have hit the iceberg but have not yet gone down.

Tactics: The louder you shout the more chance you have of being paid. You have to make sure that if this debtor goes down you have already been paid.

Action: Threaten insolvency, either personal bankruptcy or liquidation. Hopefully, the threat or the commencement of proceedings will produce prompt payment. You need legal input on this one so make sure that you keep a close eye on expenses. And remember, you can only threaten liquidation of a company for a debt of over £750. For an individual the debt has to be over £3k.

The Fleeing Debtor

Who: They are on the move. They have ceased trading from their usual premises. The business or their premises is up for sale/let.

Tactics: This time it is not how loud you shout but how fast you can move that will maximise your chances of payment. The courts offer a variety of useful tools to maximise recovery of your debt. Again, you need specialist legal advice on this one but if you have a good lawyer you can obtain the benefits of an arrestment or an inhibition. Arrestments allow you to freeze monies in the hands of a 3rd party. That might be freezing a bank account or money that is owed to the debtor by one of their own customers. An inhibition will allow you to stop heritable property being sold without you first having a chance to secure payment.

Action: Instruct your lawyer. Make sure you give your lawyer as much information on the debtor as you can to include: their bank account details, property interests and details of their customers/clients. Of particular value is any knowledge you have on when customers are due to pay the debtor. Your lawyer can then look at intercepting that payment for your benefit.

The Fighting Debtor

Who: They will argue black is white to avoid paying you.

Tactics: Don't waste any more time talking. Fire must be fought with fire. Instruct legal action immediately. If there is any risk of the debtor also being a failing or fleeing debtor then you should consider arrestments and inhibitions. However, the basic rule is that the quicker you get into court, the quicker you'll get a decree and your money. The courts are wise to this kind of debtor and if a spurious defence is put forward the court will be keen to grant you decree at an early stage.

Action: Instruct your lawyer to get this into court. Give your lawyer all of the relevant information in as concise and organised a manner as possible – it cuts down enormously on fees.



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