

Managing your finances

Cash is king - all businesses need cash to survive. That's why it's essential to manage your finances effectively.

Bookkeeping

Bookkeeping is a necessary process for all businesses. Keeping accurate records of business transactions allows you to:

- keep track of your income and expenses so you can understand how well your business is doing.
- keep all the necessary records for filing your tax return.

Bookkeeping: recording the financial transactions of your business and keeping accounts in order

It's easy to get overwhelmed trying to figure out the finances but you can ask for help from your Prince's Trust contact, business adviser or accountant.

There are various methods of bookkeeping and some are more complicated than others. If your business buys and sells goods and services using cash only, you will simply need a **cash book** to keep records of the flow of cash in and out of your business.

Cash book: a record of all receipts and payments

If you start paying for goods on account or have to wait before being paid by your customers, you will need to add sales and purchase ledgers to your system:

- **sales ledger** - is a record of every invoice issued, of payments received and of amounts owed to the business by its customers.
- **purchase ledger** - is a record of every invoice received, of payments made and of amounts owing by the business to its suppliers.

At the end of every month, all the columns in your cash book should be totalled. Then subtract the payments from the receipts to give the net cashflow for the month. Add the figure 'carried forward' from the previous month to give the 'carried down' figure. This is also the balance that should be in your bank account. If the figure is negative – you have an overdraft – you should carry it forward onto the payments page for the next month. If the figure is positive, carry it forward onto the receipts page.

Annual accounts

In addition to regular bookkeeping of the money coming in and going out of your business, at the end of each year you'll need to do your accounts. This is the annual paperwork you have to complete and send to HM Revenue & Customs (HMRC).

You can do your own accounts with a simple business running on cash but as soon as your business becomes more complex you should think about using an accountant. You may be able to get free advice on your accounting needs from your business adviser or bank or get a recommendation of a local accountant with experience of small business accounting.

Self-assessment: HMRC's system to calculate and pay tax

If you're self-employed, you will usually have to complete a **self-assessment** form and send it to HMRC every year. With a simple business running on cash, completing your self-assessment form will involve adding up all your receipts over the year and subtracting your expenses. The resulting figure is your taxable income. However, there are many exceptions to this rule so you should read HMRC's notes carefully when filling in the self-assessment form. The notes are sent with the form but you can also get a copy by visiting your tax office or calling 0845 915 4655.

If you run a limited company you'll need to prepare formal accounts. You can do these yourself or ask an accountant to prepare them:

- limited companies have to send Companies House an annual return which contains details about who is in your business and how it's financed. For more information call them on 0870 333 3636.
- limited companies must also use information about receipts and expenses to prepare accounts. Your accountant will be able to explain exactly what sort of information Companies House needs.

Record keeping

By law you'll need to keep all the information of your business's financial transactions for at least five years. This includes records of all the monies paid in and drawn from the business, bank statements and cheque book stubs.

HMRC has a series of leaflets which give more detailed advice. You can get hold of a copy by calling 0845 010 9000.

Reviewing your cashflow

Cashflow is the money coming into and going out of a business in a given period. Cashflow may be positive (if more comes in than goes out) or negative. While a business can survive without sales for a while, without cash it will quickly run into problems. One of the major causes of small business failure is running out of cash. Keeping tabs on your cashflow is a way of checking on the financial health of your business and keeping it afloat.

The simplest way to calculate a 12 month cashflow is to:

- list down all the amounts of cash you expect the business to receive (such as sales) and pay out (such as rent, bills or wages) in the next 12 months.
- determine when each cash item will be received or paid – you'll need to make assumptions here so try to be as realistic as possible. Think about whether the cash will be received or paid in one off lump sums or if it will be spread evenly over a number of months.

- in a table similar to the one shown (the example only gives the first 3 months cashflow – you'd need to continue your cashflow forecast for 12 months) enter the cash items in the columns month by month.
- add in the opening amount of cash in the bank or 'opening bank balance'.
- then for each month add the 'opening bank balance' plus the 'total cash in' and minus the 'total cash out' to give you the 'closing bank balance'.
- this 'closing bank balance' for the month (for example January) then becomes the opening balance for the next month (February).

Cashflow forecast	Jan	Feb	Mar
Loans	2,500		
Sales	800	1,100	500
TOTAL CASH IN	3,300	1,100	500

Purchase of equipment	500		
Materials	200	400	150
Office expenses	60	60	60
Vehicle expenses	200	50	50
Insurance	400		
Rent	200	200	200
Other	40	30	70
Wages	400	400	400
Loan repayments		20	20
TOTAL CASH OUT	2,000	1,160	950

OPENING BANK BALANCE	100	1,400	1,340
+ Total cash in	3,300	1,100	500
- Total cash out	2,000	1,160	950
CLOSING BANK BALANCE	1,400	1,340	890

You should aim to have a positive cashflow at all times. If your projected figures

regularly show negative amounts you'll need to find out why and work out if you can keep trading on this basis.

Break-even point

A measure of a successful business is that it generates enough cash to more than cover its costs and so makes a profit. A profit is the difference between sales and costs. Most businesses are not expected to be profitable from day one but they should have a plan outlining when they are likely to become profitable. This plan should include a calculation of the break-even point.

Your business 'breaks-even' when the amount of sales equals the total costs required to produce your product or service. If your business makes sales after this point it will generate a profit, whereas if the business achieves sales below this point it will run at a loss.

$$\text{Break-even point} = \frac{\text{Total fixed costs}}{\text{Price of one unit of your product or service} - \text{Average variable costs to produce one unit of your product or service}}$$

For example, if your business has total **fixed costs** of £2,000 (the costs the business would have to pay even if you didn't produce any product), is selling a product with a price of £100 per unit and has a **variable cost** of £60 for producing each product, the business would have to sell £2,000 / (£100 - £60) = 50 units to

break-even. If the business has only sold 35 units it will be running at a loss, however if it has sold 60 units it will be making a profit.

Variable costs: costs which change in proportion to your business activity, such as materials

Calculating your break-even point before you start trading will help you pitch and price your product or service correctly.

Getting paid

If you're selling direct to the public, you'll probably be paid as soon as you make a sale. Credit and debit cards are becoming increasingly popular, so talk to your bank and arrange for an electronic card reader if you think you will need one.

Businesses usually allow other businesses more time to pay (although you'll find your suppliers will demand immediate payment until they trust you). You may want to offer more generous terms to a business which looks likely to become a long-standing customer.

Invoicing

An invoice is a formal record of trading between you and your customers. It is used as the basis for all financial management and accounting processes in a business and is a key document in business tax records. It is also important to your customers as it acts as a proof of purchase, particularly if you give your customers credit – allowing them to defer payment – when the invoice becomes a debt to the business.

For each transaction where your business supplies goods or services to customers, you should create an invoice. Remember to include:

- a unique invoice number
- date of the invoice
- your business name, address and telephone number
- details about the products or services supplied – what was bought, how much was charged, the date and so on
- your registration number if you're a limited company and your VAT number if you're registered for VAT
- your payment terms – the date you want to receive the money by for example, "invoice payable 30 days from date of issue of invoice"

Chasing late payments

Late payers are a problem all small businesses face. This can usually be solved by making it clear, politely but firmly, that the payment is now overdue. If the problem continues, you have several choices:

- you can use the County Courts and the small claims procedure for debts of less than £5,000.
- you can ask a solicitor to chase the debt for you – this will be expensive and is only really worthwhile for large debts.
- you can hire a debt collection agency, which will charge a fee for chasing the amount.

Get more advice on how to deal with late payers by visiting the Better Payment Practice Group at www.payontime.co.uk, or call the Business Debtline on 0800 197 6026 or visit www.bdl.org.uk.

Controlling costs

Look at all your costs periodically and ask yourself whether there is scope to save money. Start with the critical areas and don't waste time on the small ones. It's wise to take action on spiralling costs as soon as they become a problem – don't put off dealing with them in the hope that they will go away.

Some areas you could look at:

- **stock costs** – could you find a cheaper supplier?
- **sales and marketing** – could you cut out any advertising that isn't working and still promote your business effectively?
- **telephone bills** – could you use email for some things instead of the telephone?
- **utility bills** – how could you cut down on power use?
- **postage and stationery** – could some things be sent by second-class post?
- **wages** – can fewer people be employed to do the same task?

Stock control

Stock control is a system of responding to orders in the most efficient way and another good place to make savings. It allows you to:

- have enough to supply your customers without tying up too much money in stock
- know how much to order and anticipate seasonal or daily changes in demand

Set up a record keeping system for stock so you can monitor your current stock levels and set a trigger value for re-ordering. Setting the right trigger value is important: too low and you will run out; too high and money will be tied up when cashflow is tight.

Running into problems

Sometimes things just don't go to plan. Despite all your efforts and budgeting, you may find your business starts to struggle to repay its bills. Even businesses that are attracting lots of customers can face difficulties so it's important to plan what you will do if this happens.







Financial problems don't necessarily mean your business has to close. If you can persuade your bank or another investor that your business has a future, you may be able to borrow more money. Or you could release cash by removing unnecessary expenses or persuading your customers to pay more promptly.

But if your business doesn't have a viable future and you have to shut it down, you'll need to think about:

- paying your employees and suppliers
- returning loans to banks and investors
- finishing work you've agreed to do and cancelling any orders you've made
- arranging to end your contract with the landlord of the building you're in

Although it can be heart-breaking to close your business, try not to forget the valuable lessons and experiences you've gained on the way. Speak to your Prince's Trust contact, business adviser, mentor, friends and family for support and encouragement.

Top tips

-  Be realistic when planning the amount of cash you need – don't try to start a business without enough money.
-  A short course in bookkeeping can make all the difference to understanding your finances.
-  Keep your cash book up to date by recording every transaction immediately after it is made. Don't put it off – you may forget the details and this will mean a time-consuming task at the end of the month. Keeping on top of your bookkeeping also helps you identify, and deal with, problems early on.
-  Issue your invoices without delay after a sale and check that new customers understand how long they have before you expect payment.
-  Build up reserves of cash in the business so that you have time to manage short-term cashflow problems.
-  Act quickly when you expect a shortage of cash. Talk to your bank, Prince's Trust contact, business adviser and accountant if you think you have problems – they can often suggest a simple solution before things get serious. Also, the bank will be far more receptive to dealing with your cashflow problems if you let them know in advance – they don't appreciate surprises!

Many of our loans benefit from a guarantee provided by the European Investment Fund under the European Community's Multiannual Programme for small and medium sized enterprises.



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