Trading through the Economic Downturn

A MoneySense for business Guide

Make it happen

RBS The Royal Bank of Scotland

About MoneySense

MoneySense is RBS's financial capability programme to help people to understand and manage their money. For 15 years it has provided financial education in secondary schools and, in the last year alone, over 700,000 young people have benefited from lessons.

It doesn't matter what stage we are at in life, we all need to be in control of our finances and MoneySense also provides free and impartial money guidance to adults to help make a real difference to their understanding of money and how to manage it. Further MoneySense information is available online at **www.rbs.co.uk/moneysense** and in our branches.

About Business Debtline

A free, confidential and independent service for small businesses is provided by Business Debtline, run by the Money Advice Trust charity and supported by RBS. RBS is the leading private sector supporter of crisis debt advice for businesses. For further information please call 0800 197 6026 or visit **www.bdl.org.uk**

BUSINESS DEBTLINE

About the Editor

Niki Chesworth has been a national newspaper finance journalist for 20 years, is a regular contributor to The Telegraph and is the author of more than a dozen books including The Recession Buster's Handbook, which she wrote to help small businesses during the last economic downturn. She launched one of the first small business sections for a newspaper, is a former Money Editor of The Daily Express and has also run her own business for more than a decade, so understands first-hand the challenges owner-managers face in both good times and bad.

The RBS team who have shared their insights in this booklet have decades of experience between them:

Keith Whittaker, Relationship Director at Teesside Business Centre, who works with businesses ranging from manufacturing companies to professional partnerships, has been advising small businesses for over 20 years.

Paul Burrows, Relationship Director at Long Eaton Business Centre in Nottingham, has been in business banking since 1989 so has first hand experience of how the recession of the early 90s impacted on small businesses.

Mike Ford, Senior Business Manager at North Staffordshire Business Centre, has been in banking for more than 30 years and works with businesses across a range of sectors.

Rising to the challenge

Paul Lynam, Chief Executive, Business Banking

"When economic conditions deteriorate, small businesses are usually the most vulnerable. They tend to have fewer resources, less capital and typically rely on a smaller number of customers than larger businesses.

However, it is not usually lack of profitability that causes their failure – it's lack of cashflow.

If suppliers restrict credit or demand to be paid sooner and at the same time customers take longer to pay – or in some cases don't pay at all – businesses find themselves paying out money faster than it is coming in.

This cashflow 'hit' can be compounded by a squeeze on profit margins.
As overall spending in the economy reduces, there is a shrinking pot of possible income to chase – and to win this business, prices are often cut.

However, unless a business has reduced its overheads – and its breakeven point – it could fall into that other dangerous trap of chasing sales at any cost and taking on loss-making business.

These are just two of the pitfalls that businesses need to avoid in these turbulent times.

We at the bank have been through many economic cycles before and so we know what small businesses can do to prepare to meet the challenges they may face.

That is why I have asked some of our most experienced staff as well as outside experts including Business Debtline, with whom we are very pleased to be working, to share their insights and expertise with you in this booklet.

We are here to help. So please come and talk to my team if you feel we can assist in any way."

Managing your cashflow

'Cash is King'

It is a cliché – and like many clichés it is true. The reason why most businesses fail is that they run out of cash to pay their bills. They run out of cash because they have failed to keep on top of cashflow.

To keep in control of cashflow businesses need to have the right management information and systems in place – and to act on warning signs before they become problems.

Of course all businesses have systems in place. It is just that in an economic downturn these may need to be tightened, particularly as 8 in 10 businesses say they are seeing an increase in the number of their customers paying late.

Remember being paid – and paid on time – is not a given

- If you are worried about the customer paying on time – or at all – consider stage payments or even cash on delivery to reduce your risk of bad debts
- Set your terms of business before doing business – and put them in writing. You will not be paid in 30 days unless your customers know that's what you expect
- Do credit checks before doing business – and monitor late payments. If companies are taking longer and longer to pay, find out if there is a problem. Do not wait until they leave you with a bad debt
- Encourage prompt payment. Consider charging interest on late payments (your legal right on debts outstanding after 30 days) or – if your profit margins allow – offering a discount for prompt payment
- Invoice promptly – and once again make payment terms clear
- Check the customer is happy – there may often be a reason for late or non payment. Never give a customer a reason not to pay
- Make it easy for them to pay by offering as many ways of getting paid as you can. BACS payments are fast and attract lower bank charges. Or a standing order can be used if they pay the same amount regularly. With cheques your late payers can always use the excuse "it's in the post"
- Contact customers to check they received the invoice and then find out when they are going to pay

"The key thing is certainty – knowing when you are going to get paid so that you can adjust your cashflow forecasts accordingly. If you know a customer is going to take 75 days to pay, you can plan ahead. If you expect payment with 30 days and the payment takes 75 days your business risks running out of cash to pay its outgoings – and that is when businesses run into difficulties."

Phillip King, Director General, Institute of Credit Management.

Smart credit management is...

- Ringing on day 40 to check you will be paid on day 60

Lax credit management is...

- Waiting until day 65 to ask why you were not paid on day 60

Getting it right

- Many businesses concentrate on getting orders in, but getting paid should also be a priority
- Visit **www.businesslink.gov.uk** for free online guides to preventing and recovering late payments and how to check the credit worthiness of customers
- Learn about 'Correct Credit Management Procedures' on a course run by the Institute of Credit Management **www.icm.org.uk**. Courses start at £125 + VAT

Communication is key

- At times like this you need to cement your key relationships with customers – as well as your suppliers and your bank – as this could be vital to the survival of your business. It is not just about keeping customers happy. It is about working together and understanding their needs. Good communication will also help you to find out if they are having problems that could impact on your business

Example

Your biggest customer is being squeezed on payment terms by a major high street chain which says it will not pay until 100 days from invoice. Your customer has started to take longer and longer to pay you as a result.

If you do not talk to your customer about this problem you may rely on prompt payment at 30 days to pay your bills and find your business has run out of cash.

If you talk to your customer about this problem you may be able to come up with a solution. For example, you could extend payment terms to 60 days and in turn readjust your cashflow forecasts and get finance in place. This could also be an opportunity to re-negotiate your price upwards for the extra flexibility you are giving your customer. As the business from this client is still profitable, your business – and their business – will hopefully continue to prosper.

Cashflow forecasts

A cashflow forecast is an essential management tool. You need to know what monies are owed to you at any one time and when payment is likely to be received. You then need to know what bills you have to pay and when – and reconcile the two to make sure you have enough cash to meet your outgoings.

> *"What we often find is that businesses come in asking to extend their overdraft facility because they are not being paid on time or they have suffered a bad debt. Often they leave this until the last minute – when they need the money rather than arranging an adequate facility well in advance. The reason why they are in this situation is usually because they don't have an adequate cashflow forecast – or any at all. If you cannot prepare one of these yourself, ask your accountant."*
>
> **Mike Ford**, Senior Business Manager, North Staffordshire Business Centre.

Calculate the worst case scenario in terms of cashflow – and that is the facility you should be trying to arrange. Also look at ways of reducing your need to borrow such as:

- Reviewing who you are extending credit to – and how much credit you are extending to each customer
- Reviewing how long you are allowing your customers to pay you – and seeing if this can be shortened
- Negotiating longer payment terms yourself – so you have longer to pay

For free planning software visit www.rbs.co.uk/businessplanning

Financing cashflow: the options

Overdrafts: Ideal for day-to-day cashflow needs – but you may need to consider other options if you are near your limit, cannot arrange a larger facility, or want to reduce the monthly cost or free up your facility for working capital.

Loans: These spread the cost of borrowing over a longer period – consider putting the element of your overdraft that is "solid debt" into a loan to free up your working capital.

Invoice discounting: This will release cashflow more quickly. Invoice Finance can give you up to 90% of the invoice value when it's issued, and the rest (less fees) when it is paid. It can provide bad debt protection too as the invoice discounter can assess your customers and set credit limits for each of them. If a customer becomes formally insolvent, you will be paid 100% of what is owed provided you trade within these limits.

Asset financing/leasing: This can release cashflow tied up in depreciating assets such as company cars, computers and machinery and equipment. The finance is secured on the asset itself, freeing up your other security (often your property) to secure and raise other forms of finance. Installation, maintenance, servicing and insurance can all be included, making your life easier.

Keith Whittaker, Relationship Director at Teesside Business Centre, suggests “It is vital that businesses see the trouble coming and talk to their bank before cheques are bounced. If we work together we can help prevent foreseeable problems. We can review all the options and perhaps could relieve cashflow by agreeing a payment holiday on a loan, arranging finance over a longer period to reduce the monthly cost, or by agreeing a better form of finance.”

Example:

“Like many businesses we relied on an overdraft and a business credit card and our finances were a bit hand-to-mouth. We would have carried on like that but for our Relationship Manager. He advised that we took out a loan which improved our cashflow by £500 per month.”

Colin Wonford of clothing company Top T’s.

Free Help Online

If you are a RBS Business Banking customer you can produce online cashflow forecasts for your business using our free online business planning software at **www.rbs.co.uk/businessplanning**. If you do not already bank online, sign up so that you can have your bank information at your finger tips.

The Separate Pot Solution

In any economic cycle, businesses can encounter unexpected expenditure and you don’t want to find you haven’t got the money to pay, say, your tax or VAT bill. That is why we would encourage you to manage cashflow forecasts by setting aside money you are going to need for a specific purpose in a separate savings account.

“Many small businesses overlook savings accounts because they think they cannot afford to save – but a savings pot is not just about earning interest; it is a way of safeguarding cash to ensure it does not get swallowed up in general cashflow.”

Martin Moore, Head of Business Savings at RBS.

Dealing with bad debts

On average small and medium sized businesses write off £14,000 in bad debts each year, according to the Credit Management Research Centre. If they have a 5% profit margin that means they need additional sales of £280,000 just to make up for this loss.

Think about how a bad debt could impact on your business. How much extra turnover would you need to cover this loss? And would your businesses be able to survive?

Prevention is best:

Know your customer – a simple check with Companies House can confirm they are who they say they are and enable you to check their accounts.

Check they are a good risk – by checking with a credit reference agency, by asking for bank and trade references and by searching the Registry of County Court Judgments to reveal if those running the business are in financial difficulties.

Set clear credit limits for every customer – to limit potential losses.

Consider credit insurance – it will cover the debts owed to you.

Watch out for warning signs:

Mistakes on cheques – they forget to sign, words or figures differ, or cheques are wrongly dated. These may be genuine errors or may be a means of buying extra time.

Constant queries – about the product or service or about the invoice. Again these could be delay tactics.

Excuses – like the cheque is in the post.

Rumours – staff often pick up on these first.

Trading at their credit limit – if a customer is continually trading up to the limit or asking to exceed it, it should ring alarm bells. However, it may be that they are buying more from you and so need an increased limit.

When faced with a late payment that could become a potential bad debt:

Is it can't pay, or won't pay?
There may be a reason they have refused to pay. Perhaps there is a problem with the goods or service. Decide how much you need the customer. If this is a valued customer you may want to be more diplomatic to avoid losing their business.

Something's better than nothing.
See if you can get a part payment or staged payments.

If it's won't pay, is it worth the fight?
If you are going to get nothing back, don't waste your time or money.

If there is a chance they will pay, consider court action – but send a solicitor's letter first. In around half of cases this works. You can use an online service to send a solicitor's letter 'before action' for as little as £5. If that does not do the trick then you can start proceedings. For debts over £750, you can issue a statutory demand. Alternatively try the Small Claims Track (for debts up to £5,000) or the fast-track procedure in the County Court (for claims up to £15,000). The Small Claims limit in Scotland is £3,000.

For more information go to Business Debtline at **www.bdl.org.uk** or call **0800 197 6026**.

If the worst happens: talk to your bank if you need additional funding and tell HMRC – you may be able to reclaim the VAT on bad debts.

The other side of the coin

Cashflow does not just involve getting money into the business. The other side of the coin is paying money out. When the economy takes a downturn suppliers may want to protect their financial position by:

- **Reducing the amount of trade credit they will advance you**
- **Asking for payment more quickly**
- **Asking for stage payments or even cash on delivery**

To ensure that you are not being squeezed on both sides you need to manage this side of the cashflow equation and remain a low risk for your suppliers.

Make sure you know when you are expected to pay – not all suppliers have clear terms and conditions.

Pay on time – and if you can't do so, contact your suppliers to explain why.

Protect your credit rating – don't wait until the start of court proceedings to pay. Once your credit rating is damaged, you may find it hard to get any credit at all.

Try to negotiate longer payment terms if you are finding your customers are taking longer to pay you – if not, see if you can get a discount for prompt payment.

Profit is sanity

'Turnover is vanity, profit is sanity' – so the business saying goes. But what does that mean in practice? In an economic downturn, sales often start to fall and so businesses scramble to replace this lost turnover.

Competition intensifies and prices are cut to win business. But instead of replacing lost turnover to help cover your costs, you have unwittingly taken on unprofitable business that will leave you with a loss.

"It is not uncommon for businesses to believe they have solved their problems by bringing in extra turnover. I had one customer who grew 300% before he realised he was making less profit than when his business turned over 100%. This was because he was taking on less profitable business and his costs had crept up."

Paul Burrows, Relationship Director, Long Eaton Business Centre.

Is that new business worth it?

- Cost each product or service: do not take on business if it does not make a profit
- Look at ways to reduce costs: this will allow you more scope to reduce prices
- Be wary of big orders: this can lead to overtrading when the business takes on more work than it can handle and runs out of money to finance it

"Be particularly careful about taking on big jobs for large customers," says Paul Burrows. "They will often want long payment terms so it could be months before you get paid and the margins will be lower. You also run the risk of overlooking the needs of your smaller but more profitable customers. You could end up working all hours of the day and night, waiting a long time to get paid and running out of cash."

Maintain Profit Margins

The flip side of price is cost – you can maintain profit margins even if you are reducing prices, provided you also reduce the cost of what you are making or providing. "Many small businesses only make cosmetic cuts in costs – they feel like they are doing something but it is not big enough or long term enough," adds Paul. "You need to stand back and make hard-headed financial decisions. For example, don't hang on to things you don't need – it costs you to house, insure and maintain them. Consider selling surplus machinery or unsold stock, even if you don't make a profit, to release some working capital."

It is vital to keep overheads down but avoid cutting:

• Stock levels to such a low point that you cannot fulfil new orders

• Staff you need to run your business

• Sales and marketing expenditure which you need to attract new business

• Investment in equipment or product development that enables you to remain competitive

• Insurance as you could leave your business inadequately covered

On cutting costs

Don't get emotionally involved. Make hard-headed business decisions. You may want to keep a particular office open because it was where you started or a certain product line because you created it. If it is losing you money, you have to lose it – or risk losing your business.

Make decisions based on the facts. A "gut feel" is not good enough. It is only when you see what is profitable and what is not that you can make a decision.

Start with non-essential expenditure – then tackle fixed costs such as utilities, stationery and other outgoings.

Pass on price cuts. If you are under pressure to cut your prices ask your suppliers to do the same – if you can. If they won't negotiate on price ask for longer payment periods or shop around.

Are you making the most of management information?

Knowing which products are going to sell best and bring in the most profits and which costs are rising and could hit your margins, is vital. For that, you need to have the right management information. The key difference between this economic downturn and the recession of the early 1990s is information technology.

"Businesses have much more ammunition now because they have online banking and spreadsheets giving them information at their finger tips. Use this technology – do credit checks online, produce cashflow forecasts and make the most of the information about your market and your competitors. But combine this technology with some old-fashioned controls."

Keith Whittaker, Relationship Director, Teesside Business Centre.

Profit is sanity

The Key Barometers

There are usually four or five barometers that indicate the health of any business. You need these to be annual rolling totals either on a monthly or even a weekly basis. Check the actual figures against those forecasted and against the previous year's. These key indicators will vary from business to business but could include:

Turnover – not just the total but some key figures. For example, a café may monitor cups of coffee sold per day.

Enquiries – or foot traffic, number of visits to your website or another key indicator of interest in your product or service.

Stock – if too much of one item is piling up it is a reflection that sales of that particular product are falling. The danger is that too much cashflow will be tied up when you need it for day-to-day needs.

Costs – keep track of how these are rising. As has been seen in recent months, some costs – such as fuel – can rise rapidly.

Late payments – you need to keep a daily eye on how quickly money is coming in so you can spot potential problems early on.

Then you need to act on the information. For example, by selling off surplus stock or putting up prices to reflect rising costs.

Example

Emma Harrop runs a chain of four shops, called Velvet, that sells gifts, furniture and clothes in the Brighton area. Every night the sales information from the tills is downloaded to her computer at home where she monitors what is selling well and what is not. She can then make changes in light of consumer demand – something she does on a weekly basis.

"Three years ago when low-cost clothes chains started to dominate the high street our fashion sales were hit," she says. "We instantly spotted a shift in customer demand and as our interiors were doing well we brought in more furniture into our shops."

Spread your risk

A lot of smaller businesses rely on just one or two customers and one or two products and services. In an economic downturn all it takes is for one customer to move to a cheaper supplier or even go under and the business is no longer viable.

"Many small businesses are started with one great customer and they are reluctant to turn away the golden goose, but that has major risks," says RBS's Paul Burrows. "How would your business cope if your major customer decided to source its products overseas or to move to a cheaper service provider?"

"In the past recession the businesses that suffered were the ones that had failed to go out to get new customers and/or to develop new product ranges or ideas to take them forward. The successful businesses were the ones who had not just looked at today but also the future."

Who earns you the most profits?

Identify your most profitable customers – then seek to bring in new customers with a similar profile.

> *"The definition of a good customer, is one that makes you money. Bear in mind the 80/20 rule – 20% of your customers are likely to make you 80% of your profits so concentrate on them. Ring fence these key customers and concentrate on getting more business from them. And then seek out other customers like them. If you cannot beat bigger competitors on price, offer something else – better service or quality."*
>
> **Paul Burrows,** Relationship Director, Long Eaton Business Centre.

Watch your back

While trying to pull in new customers do not neglect those vital 20% who earn you the most profits. It costs four or five times as much to get a new customer as it does to keep an existing one.

> *"Target your effort on existing customers – in a downturn you are more likely to get new business from an older or existing customer."*
>
> **John Westwood**, Author, 'How to Write a Marketing Plan'.

Spread your risk

Expanding your prospects

One way to attract a wider customer base is to make the most of the internet. “In the last economic downturn companies could not do that – so make the most of the technology available today to sell to a different geographical area,” says Mike Ford, the Senior Business Manager of the RBS North Staffordshire Business Centre.

“Selling online enables you to approach a wider audience and even an international market. I had one customer who tried to supplement the income from his shop by selling his light fittings online. He did so well, he no longer needed the shop.”

What to watch out for:

- If you are expanding into new markets or need new equipment to remain competitive, avoid using cashflow to finance this – you may need this cash to keep you afloat. Use alternatives such as asset finance.
- Avoid taking on more than you can handle. This is known as overtrading – an imbalance between the work you take on and your capacity to do that work. Once again you can run out of cash to finance these new orders.

Getting help

Make the most of the professionals you employ and the services available to:

- Free up your time to concentrate on what you do best
- Speak to your bank Business Manager and get expert advice on taking your business further

"Listen to the advice you are given – even if it is something you don't want to hear or it means slimming down or cutting your losses. There are usually three partners in a business – you, your bank and your accountant – and you need to work together. Remember you cannot affect the economy – but you can affect your business."

Keith Whittaker of the RBS Teesside Business Centre.

Outsource:

If you are not an expert, employ someone who is.

This could be a freelancer from an online marketplace who can produce a PowerPoint presentation overnight when it would take you days.

Use your contacts

There is a world of support available to you.

- Check your local papers for advertisements for local business seminars and events – this is a great way to meet other business owners and network
- There are also a number of reputable networking sites where you can join forums and speak to other businesses to share experiences and contacts

To get you started we've included a list of useful links on the back page of this Guide.

Where to get help directory

Additional help and advice can also be found at:

www.rbs.co.uk/moneysense

www.bdl.org.uk for help and advice from Business Debtline

www.britishchambers.org.uk for economic news and business information

www.businesslink.gov.uk for free downloadable guides to cashflow and credit management

www.companieshouse.gov.uk to search company information and accounts

www.creditmanagement.org.uk for tips on getting paid on time

www.fpb.org for the Forum of Private Business' online credit reports service

www.insolvency.gov.uk for steps to take if you are owed money by an insolvent company

www.payontime.co.uk for details of how to charge interest on late payments and an online calculator

www.registry-trust.org.uk to check if a customer has any County Court Judgments awarded against them in England and Wales for non-payment of a debt

www.rbs.co.uk/business

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