Track 14 Unit 3 B 2 Exercise b.

Presenter: Good morning, and welcome to this week's edition of Money Minders. Today we'll be looking at cash flow, and here in our studio to discuss the subject is Dr Malcolm Norris, Professor of Finance from Dumbarton Business School. Dr Norris, thank you for coming all the way from Dumbarton to talk to us!

Norris: Good morning! And thank *you* for inviting me.

Presenter: Dr Norris, I'd like to start by asking a basic question. How important is cash for business?

Norris: Absolutely vital. A business can survive for a while without sales or profits, but without cash, it'll die. It's like oxygen. And that's why it's important to manage the inflow and outflow of cash very carefully.

Presenter: Is the aim to have more money flowing in than flowing out?

Norris: Ideally, yes. You want your income to be higher than your expenditure. But the difficulty is that inflows usually lag behind[i] the outflows, for example when customers pay late. It becomes a big problem when they don't pay at all, or when demand[ii] falls and you don't get as many orders as you'd expected. Basically, effective cash management is all about speeding up the inflows and slowing down the outflows.

Presenter: So what can a business do to improve everyday cash flow?

Norris: I would say that the key is customer management. You need to manage your customers so that they pay sooner rather than later, and that means setting clear payment terms that your customer understands. Then you need to issue your invoices quickly, but check them before you send them. Just one small mistake in an invoice can cost time and money.

Presenter: Yes, you don't want to give your customers an excuse to pay late! So what else can a company do to prevent late payment?

Norris: As I said, a lot depends on the terms and conditions you set. For example, you could ask your customer to pay in advance[iii], either in part or in full. If it's a big contract, you could negotiate staged payments[iv].

Presenter: Staged payments?

Norris: Yes, for example, a third of the payment with the order, a third on delivery, and a third after delivery. By asking your customers to pay in stages, or in instalments[v], you keep the money flowing in. You could also offer discounts for paying by a certain date or for paying within, say, seven days of the invoice date. At any rate, you should always set a credit period. If you don't, the law sets a standard period of thirty days.

Presenter: Thirty days … from when?

Norris: Ah – good question. It's either from when the goods are delivered, or from when the customer receives the bill. Whichever is the later date.

Presenter: Something we haven't talked about yet is creditworthiness[vi]. Don't you need to check how creditworthy[vii] your customer is?

Norris: Yes, I was just coming to credit risks. It's extremely important to do a credit check, especially when you're dealing with new or potential customers.

Presenter: How do you do that, exactly?

Norris: Ask them for references – or get them to complete a form that authorises you to get references from a bank or credit agency. Remember that if you don't know their credit history, you risk being paid late or not at all.

Presenter: Right, so it's clear that there are ways of ensuring that customers pay on time. But you may find that some still pay late – despite your best efforts. What are your options then?

Norris: Again, you need a strategy. You can telephone the customer to remind them that payment is overdue. Or send reminder letters. And if you think your calls and letters are being ignored, send emails or faxes. And don't forget to set a clear deadline for payment. It's not enough to just say 'as soon as possible'.

Presenter: Dr Norris, you haven't mentioned lawyers yet …

Norris: Yes, threatening legal action can be very effective.

Presenter: After all, companies have legal rights, don't they?

Norris: Yes, you can charge interest for late payments, for example, or even claim compensation[viii] for debt recovery[ix] costs. But you should only take legal action if it's really necessary. It depends very much on your relationship with the customer.

Presenter: Dr Norris, we've talked about customer management, but what about the suppliers? On the one hand, you're waiting for your money, but on the other hand the suppliers are waiting for theirs! Isn't this the basic problem in cash flow management?

Norris: Absolutely, and it’s important to pay your suppliers on time. If necessary, you can ask your suppliers for an extension of credit[x], in other words you can ask them for more time to pay. Indeed, this is what normally happens in business. However, the problem is that …