

YOUR GUIDE TO working capital

Working capital is the fuel that powers small business. You need enough in the tank to not only cover day-to-day expenses, but to drive growth.

Understanding working capital, and using it effectively, can lead to a virtuous cycle that benefits your business, your buyers, your suppliers and your customers.

You won't always know when you're going to need money to jump on a fleeting opportunity or shortfall.

Arranging working capital finance ahead of time, means the money is there when you need it.

“ Understanding working capital can lead to a virtuous cycle that benefits your business ”

How much do you have?

Understanding your working capital needs is not that difficult.

On a basic level, subtracting your current liabilities (accounts payable / creditors etc) from your current assets (such as, inventory / stock and accounts receivable / debtors) will give you your working capital.

In reality, substantial cash is tied up in the lag between when a business buys stock and when it receives payment for sales. And businesses have to meet wages and expenses when they are due.

The operating cycle

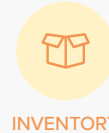
This lag – known as the operating cycle – can have a dramatic impact on your liquidity. A business with a long operating cycle can have substantial assets on paper (in inventory or unpaid invoices) but little cash to hand.

This is where well-planned working capital finance solutions come into play, allowing SMEs to access cash and put it to work more effectively to meet short-term needs.

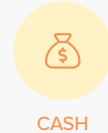
Calculating your working capital

Example: A business with assets of \$160,000 and liabilities of \$65,000*

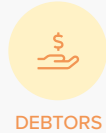
\$160,000
Current Assets



INVENTORY



CASH



DEBTORS

—

\$65,000
Current Liabilities

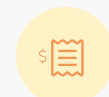


CREDITORS

=

\$95,000
Working Capital

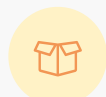
Used to pay:



OPERATING EXPENSES



DEBT



INVENTORY

* The information provided in this example is for illustrative purposes only and is specific to the particular situation described. Individual experiences and results may vary. Past performance is not an indication of future performance and no representation or warranty is made that the information contained within the example is appropriate for any particular circumstances or indicates that a particular course of action should be followed.

How much is enough?

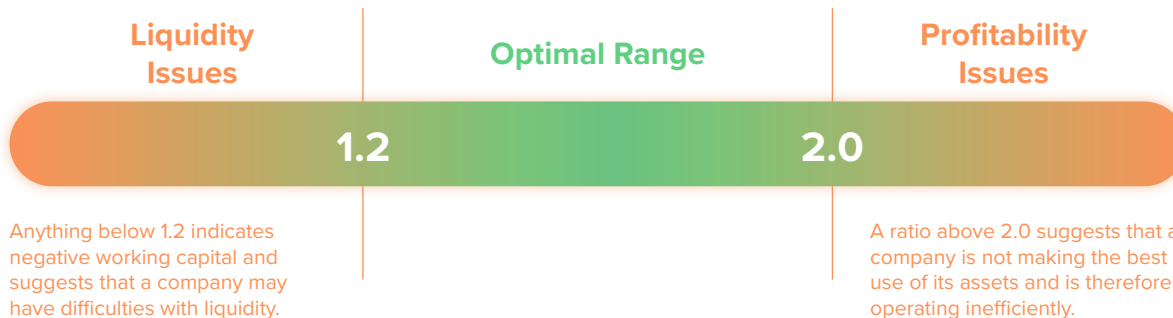
At a bare minimum, businesses need to cover ongoing expenses as they are due.

Successful businesses are focused on growth. That means being able to access enough working capital to hire extra staff as needed, take on big contracts, ride out seasonal fluctuations and smooth unexpected cash flow bumps.

And of course with growth, comes increased stock and higher debtor levels.

A working capital ratio of 1.2 to 2 is generally considered healthy¹. But the length of your operating cycle will factor into your short-term finance needs.

Working Capital Ratio Health Meter



What is your working capital ratio?



working capital ratio = current assets ÷ current liabilities

A healthy working capital ratio is traditionally anywhere between 1.2 and 2.0.

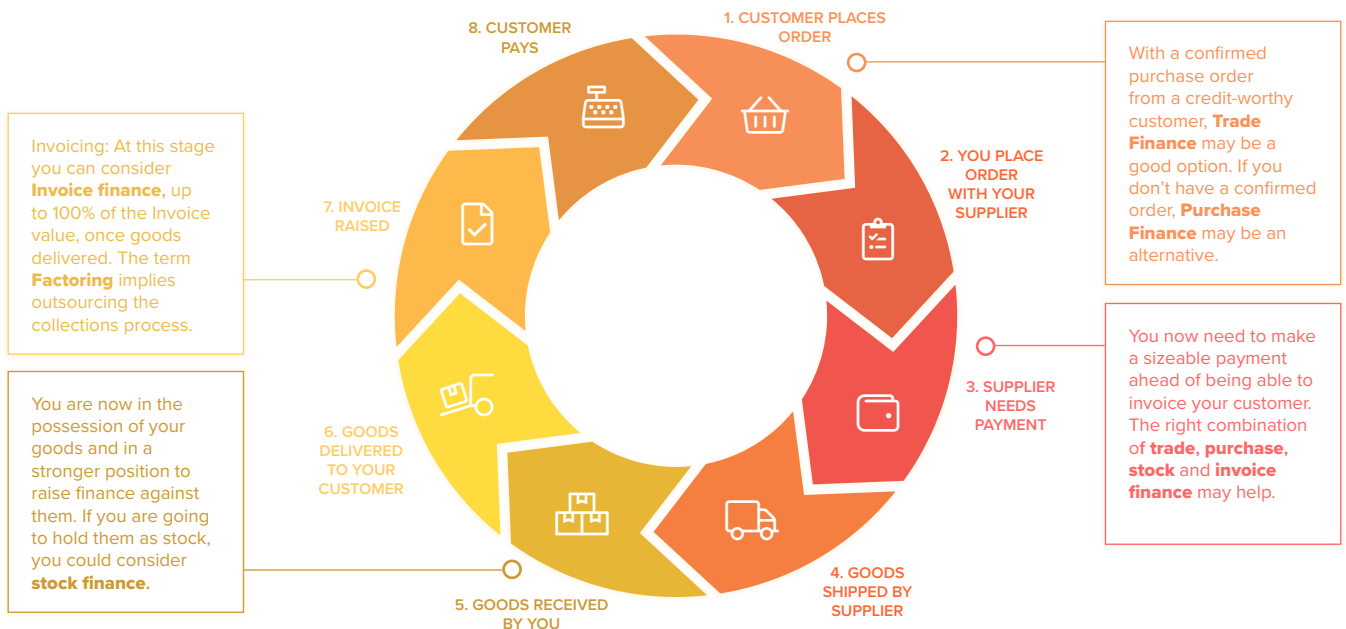
What type of finance?

While its important to manage stock levels and debtor collection, most businesses will require a working capital finance facility.

Options to unlock working capital include (but are not limited to):

- **Traditional bank overdraft.** Applies to the operating trading bank account. Fully fluctuating on-going facility, with interest only repayments. Can be unsecured but generally secured against business or personal assets.
- **Traditional bank loan.** Ideal for business with insufficient capital impacting the working capital cycle. Principal and interest repayments. Generally secured against business or personal assets.
- **Debtor or Invoice financing.** Ideal for growing businesses, this allows a business to draw against unpaid invoices, or sell outstanding invoices to a third-party. Interest only repayments or discount of the debtor value.
- **Line of credit.** Similar to an overdraft but without the transaction account. Interest only repayments. A business can draw funds as needed up to an agreed limit, while meeting a repayment schedule.
- **Unsecured loan.** Generally short term with principal and interest repayments. and although interest rates are higher, generally property security is not required.

Example of how you could finance your working capital cycle²



Get inspired

Unlike more targeted business loans, working capital finance can be used for a variety of purposes.

Embrace the flexibility to:



Cover seasonal shortfalls. Christmas/New Year is notorious for blowouts in late payments that stretch SMEs to the limit. Planning ahead and putting working capital finance in place can help to ensure you don't get caught short.



Bolster your buying power. Buying in bulk can slash your bottom line. Working capital finance can be used to demand a better deal from suppliers, or take advantage of specials.



Ramp up seasonal marketing. Most businesses have a traditional busy period. Plan a marketing blitz to try to capture new customers.



Refresh your online presence. The start of the year is an excellent time to make sure your website and brand are on message. A working capital loan can help pay for services such as Search Engine Optimisation or a new social media campaign.

The appropriate finance can transform your business. Heading into the New Year is the perfect time to get on the front foot and talk to a broker about the working capital finance options for your business.

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■ ¹ Bank of America, [What is working capital – and why is it important?](#), bankofamerica.com.

■ ² Funding Solutions, [How do you fund the cashflow needs of your business](#), Funding Solutions, 21 October 2019