Using working capital to grow and transform your business

Working capital is the money your business has in its pocket.

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How much do you have?

On paper, it's a basic formula:

Current assets
Accounts receivable, inventory, cash

–

Current liabilities
Accounts payable

=

Working capital

How much is enough?

At a bare minimum, businesses need to cover wages and expenses. A working capital ratio (current assets ÷ current liabilities) between 1.5 and 2 is considered ideal, and acceptable is 1 and 2 times[1]. Anything lower indicates a business may have difficulty in meeting its day-to-day financial commitments. Anything higher could indicate assets are not being fully utilised. A generalized analysis which varies between industries and needs to be considered on a case-by-case basis.

Why do healthy businesses still need finance?

Businesses with substantial working capital can still get caught short because cash is tied up in the operating cycle – that is, the time it takes to convert investments in inventory and resources into cash from sales. A long operating cycle can impact liquidity, leaving businesses asset-rich but cash poor. Just-in-time inventory management may minimise lag but unforeseen circumstances like insolvencies, disrupted supply chains or delays can impact an otherwise solid business.

Well-planned working capital finance solutions are essential for SMEs to bridge the gap between money out and money in and maintain the flexibility to pounce on opportunities or ride out bad debts.

What type of finance?

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

Traditional bank overdraft
Applies to the operating bank account. A fluctuating, ongoing facility with interest-only repayments. Can be unsecured but generally secured against business or personal assets.

Traditional bank loan
Generally secured.

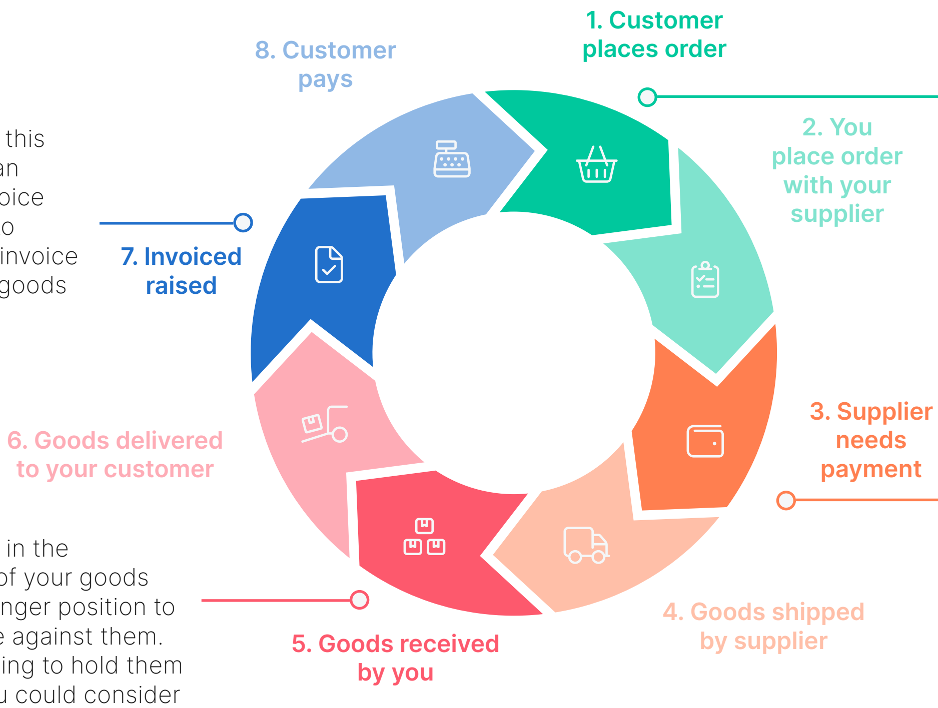
Debtor or Invoice financing
Allows businesses to draw against or sell outstanding invoices.

Line of credit
Similar to an overdraft without the transaction account.

Unsecured loan
Generally short-term, higher-interest loans.

[1] The Working Capital Ratio and a Company's Management (investopedia.com)

Example of how you could finance your working capital cycle



With a confirmed purchase order from a credit-worthy customer, trade finance may be a good option. If you don't have a confirmed order, purchase finance may be an alternative.

You now need to make a sizeable payment ahead of being able to invoice your customer. The right combination of trade, purchase, stock and invoice finance may help.

You are now in the possession of your goods and in a stronger position to raise finance against them. If you are going to hold them as stock, you could consider stock finance.

Invoicing: At this stage you can consider invoice finance, up to 100% of the invoice value, once goods delivered.

Prepare to pounce

Unlike more targeted business loans, working capital finance can be used for a variety of purposes. Get on the front foot to seize opportunities in a recovering market:

Spend on marketing

Get your brand out there. Use videos to demonstrate products and services online, or hire a social media expert to focus on these cost-effective channels.

Rethink your delivery

Convenience is king. Can you provide an unusual product, or up the ante with same-day delivery?

Develop a new product or service

Look for gaps in the market created by new consumer needs or the collapse of competitors.

Insulate against insolvencies

Access to fast credit can prevent a healthy business being dragged under by a failed creditor.