PUTTING YOUR WORKING CAPITAL TO WORK

MARIA ROBINSON

Sequel CFO

Working capital is the lifeblood of your business. It is the money available to fund a business's day-to-day operations. Technically, working capital is the current assets (cash in the bank and assets that can quickly be converted to cash such as debtors) minus the current liabilities (creditors, loan repayments etc.). Before you start a business you need to work out how much working capital you'll need and you'll then also need to monitor your working capital during the operations of your business.

> **While you work towards your current assets building up and getting to a ratio of greater than one, you'll need to inject working capital into your business.**

You can use the working capital ratio to determine your position. The working capital ratio is current assets divided by current liabilities. If the resulting number is greater than one, your current assets exceed your current liabilities. The higher the number, the better. If the number is less than one, your current assets are less than your current liabilities and this is not a good situation to be in. A good working capital position is often deemed to be a ratio of two or more.

Prior to commencing a business you'll need to prepare a cash flow forecast to determine how much money you'll need to cover your set-up costs and working capital. New businesses generally operate with a working capital ratio of less than one until they become more established; that is, the current assets are less than the current liabilities in the early stages of a business. While you work towards your current assets building up and getting to a ratio of greater than one, you'll need to inject working capital into your business. This can be done through a number of sources including:

- borrowings
- investors
- directors or shareholders loaning money to the business
- sale of capital assets.

You will need to monitor working capital in your business throughout its operation. Working capital challenges are not only evident during the start-up phase of a business. One of the main reasons businesses collapse is related to poor management of working capital. For example:

- not managing debtors well can result in non-payment by debtors or too many debtor days (it takes too long to be paid by those who owe you money)

- business owners taking cash out of the business, often for personal use, and then not having sufficient funds to pay creditors
- insufficient cash reserves
- having excessive stock on hand
- mismanagement of creditors.

Businesses can also experience working capital challenges if they take advantage of an investment opportunity. There may be an expansion or investment opportunity that is too good to pass up; however, it may be premature from a working capital perspective. This can be something as simple as discounted stock that you decide to bulk buy but won't be able to move for several months. A decision like this can help improve your margins but it could be at the expense of your working capital position.

Your working capital position should be monitored on a monthly basis. To achieve this, your bookkeeping will ideally be completed in real time (using cloud accounting software) and you will have a month-end financial reporting process. A balance sheet reconciliation is required at the end of each month which can then generate your working capital ratio. Generally a small business will have an accountant. But small businesses may also decide to utilise the services of a bookkeeper or virtual CFO.

If you have concerns about your working capital it is best to contact your accountant, a bookkeeper or a virtual CFO as soon as possible to ensure you have all the information you need in order to then make decisions accordingly. ■

"There may be an expansion or investment opportunity that is too good to pass up; however, it may be premature from a working capital perspective."

Maria Robinson is CEO of Sequel CFO, a franchise network which offers experienced CFO expertise and insights to SMEs on a retainer or contract basis.