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CASH FLOW MANAGEMENT AND

WORKING CAPITAL

By Brendon Falk

The savvy buyer will be aware that every business requires working capital to operate smoothly. Working capital is a difficult concept for people to grasp much less, to attempt to manage once they take over. But working capital is simply the amount of money required to operate your business on a daily, weekly or monthly basis and once this figure is correctly estimated, it should be smooth sailing. I've had many buyers ask 'how much working capital do I need to operate this business?' Given that every business and industry is different, to answer this question is - you need to become familiar with the cash flow movements of the business. In particular you need to ask yourself:-

When are the cash inflows due? This will depend greatly on the type of business your in. For example, a convenience store does not run debtor accounts for their customers and hence, all sales are cash sales. Given that you are not extending credit to your clients, you know that cash inflows will commence once you begin trading. In this situation, your allowance for working capital is usually minimal as the business is generating cash flow immediately. Alternatively, wholesale or trade businesses typically run accounts for their clients. Accounts can vary from 7 to 30 days which means that despite raising sales invoices, there is no cash in the tin to pay the bills. You would normally have to wait a complete payment cycle (i.e. 1 month for 30 day accounts) before the business is generating its own cash.

When are the cash outflows due? If you can manage to run credit accounts with your suppliers, this will help to reduce the amount of working capital required until your cash flow stream commences. Savvy operators have their stock creditors effectively financing their working capital. That is, the stock is sold and income collected before the accounts are settled. However, stock and Cost of Goods Sold (COGS) is not the only major business expense. Other large expenses such as wages and rent which creep up very quickly after takeover. Similarly, quarterly utilities, super and GST are also worth factoring in to your cash flow analysis. There are also some windfalls such as the GST credit you receive when purchasing the stock at settlement from the seller. Buyers should also consider a small amount for advertising to ensure that trade stays strong and steady following takeover. A decrease in sales will increase your working capital requirement.

What is my average sale? A business that has 500 x $20 transactions per day to all different clients hardly presents any significant risk or impairment to the cash flow should a single client default on payment. However, if there are 10 x $20,000 transactions per month on a 30 days account and just one client fails to pay on time, you should consider increasing your working capital to allow for slow payers (debtors). Instead of budgeting working capital for 30 days, you might decide that 45 or 60 days is more prudent.

What is your contingency plan? The best estimates are still estimates and its easy to run out of cash. However, you don't want to be in a situation where you hit rock bottom 30 days after taking over. I've seen this happen due to a lack of planning and poor cash flow management skills. Although this comes with experience, you can look at measures such as bank overdrafts and debtor finance. Sometimes if you not watching your bank balance, you can hit rock bottom without even realising it. At least with an overdraft you have a financial buffer which forms a safety net under your business. Whatever your contingency plan, make sure you can get access to cash in a hurry if your working capital runs out.

Should you require any further information or assistance on this topic, I invite you to contact me on my landline (07) 4124 4677, my mobile 0412 311 803 or by email bfalk@foresightbusiness.com.au.

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