Working capital & Maximising Cash

November 2020

An important message

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Working Capital

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….the capital of a business which is used in its day-to-day trading operations, calculated as the current assets minus the current liabilities.

Pain points by the numbers

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40% of businesses report their customers are paying late	39% of businesses report their suppliers are reducing payment terms	28% of businesses are paying their ATO obligations late	3 out of 4 businesses are using personal credit cards to cover short term funding needs
On average, 16% of a businesses revenue is overdue	8% of businesses wrote off bad debts or lost a key debtor through Insolvency	56% of businesses offer early payment discounts	22% of business are unable to take on new work due to cash flow restrictions

Source – East and Partners Growth Index March 2019, September 2019, April 2020

7 key cash drivers

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Profit & Loss

- Sales ↑
- Price ↑
- Cost of Goods sold ↓
- Overheads ↓

Balance Sheet

- Accounts Payable ↑
- Accounts Receivable ↓
- Inventory holds ↓

Inputs and influences

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Accounts Payable

Extend terms

$$\frac{\text{Accounts Payable}}{\text{Total Purchases}}$$

This formula reveals the total accounts payable turnover. Then multiply the resulting turnover figure by 365 days to arrive at the number of accounts payable days.

Accounts Payable

58 days

Accounts Receivable

Reduce terms

$$\frac{\text{Accounts Receivable}}{\text{Annual Sales}}$$

This formula reveals the total accounts receivable turnover. Then multiply the resulting turnover figure by 365 days to arrive at the number of accounts receivable days.

Accounts Receivable

43 days

Inventory Management

Reduce terms

$$\frac{\text{Current Inventory}}{\text{Total COGS}}$$

This formula reveals the total Inventory turnover. Then multiply the resulting turnover figure by 365 days to arrive at the number of Inventory days on hand.

Inventory on hand

60 days

Cash conversion cycle

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DAY 01	DAY 58	DAY 60	DAY 103
Inventory received	Pay for Inventory	Sale	Receive cash

Inventory 60 days on hand

Payable 58 days

Receivable 43 days

WC required 45 days

The Business has $4,000,000 Turnover

COGS	$2,800,000
Overheads	$500,000
	$3,300,000

$$\frac{\$3,300,000}{365}$$

= $9,041 per day x 45 days

TOTAL WORKING CAPITAL REQUIREMENT

~$400,000

The impact of discounts

Be careful when offering discounts!

Make sure you build/reverse engineer any discounting into your pricing model.

For example – business that has a 30% GP margin target, has a $10,000 sale that would look like this:

Sale Price	$ 10,000
COGS	-$ 7,000
GP$	$ 3,000
GP%	30%

The impact of discounts

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Assume the same facts, but the business offers a 5% discount to a customer for early payment:

The impact:

Sale Price	$	10,000
Discount	-$	500
COGS	-$	7,000
GP $	$	2,500
GP%		25%

- $500 reduction in gross profit
- 5% reduction in GP%

The biggest impact – the business now has to sell another $2,000 (20% increase in sales!) to recoup the discount/reduction in GP$:

Sale Price	$	2,000
Discount	-$	100
COGS	-$	1,400
GP $	$	500
GP%		25%

$2mil annual turnover, 2% discount = $140k in additional sales, or 7% increase in sales required to achieve same GP$

Lazy Balance Sheet

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A 'lazy balance sheet' is when there is excess cash in business that isn't working for you, or your business, as hard as it could be

Excess cash considerations:

- Increase wealth through investments outside of the business
- Reducing risk exposure
- Extracting cash tax effectively
- What if business needs the funds?