Title:
Working Capital Is Paramount To A Businesses Livelihood

Word Count:
553

Summary:
All of the planning in the world is an exercise in futility without the working capital to successfully carry out the plan. If a business sells to customers on terms, then working capital availability is dependent on cash flow timing. In most instances a business will incur a cash flow gap between the time cash is required for inventory, payroll and operating expenses, and the time cash is received from customers paying on terms. Let's explore a simple example of this timing ...

Keywords:
working capital, cash flow management, factoring, invoice factoring, account receivable factoring

Article Body:
All of the planning in the world is an exercise in futility without the working capital to successfully carry out the plan. If a business sells to customers on terms, then working capital availability is dependent on cash flow timing. In most instances a business will incur a cash flow gap between the time cash is required for inventory, payroll and operating expenses, and the time cash is received from customers paying on terms. Let's explore a simple example of this timing difference that makes up the cash flow gap:

Day 1: Your business orders materials from suppliers on N/30 terms;
Day 3: Your business receives materials and begins production (which takes 5 days);
Day 8: Your business ships product to customers on N/30 terms;
Day 14: Mid month Payroll is due;
Day 30: Month-end Payroll and supplier invoice are due;
Day 48: Your customer remits payment to you.

In this scenario the cash gap is 34 days, which is from day 14 when payroll is due, to day 48 when customer remits payment. The cash gap encompasses two pay periods and a payment to your supplier, whereas the gap normally includes multiple payments to suppliers for ongoing customer orders. If your business is mature and growing conservatively, or less than 10% per year, then you probably have sufficient cash reserves or a bank line of credit to cover the cash gap. But, if you are a growing business with opportunity, how do you cover the cash gap? Oftentimes a bank line of credit is not sufficient to cover the cash gap for growing businesses because bankers look historically to your company's past to determine how much debt they will lend to your business in the future. Many growing businesses have found themselves caught short on working capital as their cash flow stretched during a period of growth.

Cash flow funding through account receivable factoring may be just the tool needed during periods of rapid growth. Factoring is not a loan or debt, but the selling of frozen assets (invoices) at a discount to obtain the cash in a more timely fashion (typically within 24 hours of invoicing your customer). Your business sends invoices to your customers and a copy of the invoice to the factoring company. The factoring company purchases the invoice from your company advancing 80% of the face amount of the invoice. When your customers pay the invoice, the factoring company remits to you the 20% reserved, less their fee (normally 1-5%).

In the cash gap scenario discussed above, working capital would be enhanced by providing your company with cash (80% of the invoice amount) on day 9! Your company would have cash flow to make payroll on day 14, and pay suppliers and make payroll on day 30. When your customer pays on day 48, the factoring company remits to you the 20% held less their fee.

When planning for growth in your business it is important that you assess the working capital needs and cash flow gap in order to ensure that your plans can be met. Utilizing an accounts receivable factoring program can assist in your successful growth. But, be sure to assess the cost of the accounts receivable program as a percentage of sales. And, make sure that you do not have a term contract with the factoring company so that you may exit the program whenever your business has grown to the next plateau.