

Working Capital Demystified – Part IV

How to manage the company's net working capital and working capital requirement:

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Here are some steps you can take to address and mitigate high working capital needs:

- Analyze the situation
 - Identify the specific factors contributing to the high working capital requirements, such as slow accounts receivable turnover, excessive inventory levels, or fast payables turnover.
 - Determine whether the high working capital requirement is a short-term or systemic requirement, the latter will require a comprehensive solution.
- Improve Accounts Receivable Management
 - Implement more effective credit and collection policies to accelerate the collection of outstanding invoices from customers.
 - Offer discounts or incentives for early payments to encourage prompt settlements.
 - Implement an invoice factoring program to accelerate cash flow.
- Optimize inventory management
 - Streamline inventory practices and implement Just in Time (JIT) inventory systems to reduce excess inventory levels and associated carrying costs.
 - Identify slow moving or obsolete inventory and consider strategies to liquidate or repurpose it.
- Negotiate with Suppliers
 - Work with supplier to negotiate more favorable payment terms, such as extended payment deadlines or discounts for early payments.
 - Consider forming strategic partnerships with key suppliers to enhance collaboration and flexibility.
- Improve Operational Efficiency
 - Focus on improving operational efficiency to reduce costs and enhance cash flow.
- Rework Pricing Strategies
 - Review and adjust pricing strategies to reflect the company's costs, market conditions, and desired profit margins.
 - Consider whether price adjustments can improve cash flow without negatively impacting sales.
- Explore Financing Options
 - Explore alternative financing options, such as revolving lines of credit or asset-based loans to bridge cash flow gaps.

Continuous monitoring of your cash flow and working capital position will help management make informed changes. Be prepared to adjust and adapt strategies as needed with changing circumstances. For business owners, potential buyers, and sellers understanding working capital and the working capital requirement is more than just a financial metric-it's about ensuring the heartbeat of the business, funding its daily operations. Regularly assess your net working capital and working capital requirement, especially before major financial decisions to gain insights and help prevent unforeseen liquidity challenges. ¹

¹<https://ecapital.com/blog/what-is-a-working-capital-requirement-a-guide-for-business-owners/>