

Working Capital Requirement = Stock + Debtors - Creditors

Increasing turnover generally leads to an increasing in all of the factors above leading to an increase in working capital requirements. This figure can be forecast/calculated using the company balance sheet (a commonly neglected document) and future projections.

Minimising Working Capital Requirements

- Stock – includes raw materials, work in progress (WIP) and finished goods.
 - Reduce stock holdings especially for slow moving items. If a supplier is located in the close vicinity and generally holds the required materials, there should be no requirement to have a company’s “bank account” sitting in the yard/workshop.
 - WIP – if this is too high, a review of the production process should be conducted and efficiencies implemented.
 - Fast moving items. Ensure there is sufficient stock to facilitate timely production and meeting orders.
- Creditors (Suppliers)
 - Whilst it is beneficial from a cash flow perspective to delay payment to creditors for as long as possible, timely payment and a good working relationship will assist the business both from a relationship perspective and especially if the business suffers from any cash flow problems.
- Debtors (Clients) – see below for “Training Debtors to Pay in a timely fashion”
 - Consider conducting credit checks on potential clients
 - Bank/Personal Guarantees
 - Terms of Trade need to be in writing. If a client places an order, confirmation of the order should be sent including your Terms of Trade/Terms and Conditions. This ensures your Terms of Trade take precedence over your customer’s.

TERMS OF TRADE

Rather than the “standard” 30 days from end of the month (EOM), businesses should utilize terms of trade to ensure they don’t suffer or exacerbate cash flow problems. Suitable terms of trade should be implemented and vigorously enforced in accordance with the procedures outlined later. Consider the following:

- Progress Payments – for longer term contracts progress payments are essential. Ideally, this should include an up front payment for the purchase of materials. You should not be expected to be a bank for larger organisations.
- COD; and/or
- 7/14 Days from delivery/date or invoice

INVOICING

The following procedures should ensure that clients receive, are aware of and approve invoices in a timely fashion:

- Ensure that the invoice is correct and complete. Include client purchase order number (if appropriate) and confirm that the invoice is sent for the attention of the appropriate person in the client organisation. A copy to the accounts staff may be prudent if the approving authority works in a separate area and it is a large and/or bureaucratic organisation.
- Send invoices as soon as possible after works are completed. Some large companies may have a cut off of up to 5 days prior to the end of the month for invoices to be approved
- Coloured Invoices – use green paper for problem clients
- In addition to mailing, invoices can be:
 - E-mailed – PDF and “Request read Receipt” (Although this only confirms that the recipient has received the email; not necessarily that the attachment has been received, read and accepted)
 - Faxed – it is preferable to set the fax to print a transmission report that also prints the page that was faxed.
 - Sent with good/service (as well as one of the methods above and/or including a monthly statement)

DEBTOR PAYMENTS - Training Debtors to pay in a timely fashion

- Before Invoice payment is due:
 - Ring to confirm receipt of invoice and confirm that client is satisfied with good/service
- Overdue – initial calls made by accounts staff.
 - 1st day overdue - Ring at 9.00 am and ask if there is any problem with the invoice and if not, advise that payment is overdue.
 - 2nd day overdue – Ring at 9.00 am and ask when payment can be expected
 - 3rd day overdue – Ring at 9.00 am and ask when payment can be expected
 - After this, it is a judgement call whether the manager now calls the client manager to discuss/demand payment and/or implementing the following payment expeditors:
- Partial Payment – if a client is in serious financial difficulty, partial payment or a payment schedule may be agreed. Some of the money is better than none especially if the client may go into administration.
- Late Notices – coloured notices to emphasise late payment status (e.g. Yellow @ 15 days, Red @ 30 days)
- The following actions may be used for consistent bad debtors, however, it must be considered that they may be lost as clients:
 - Letter of Demand and follow up action:
 - Magistrates Court (Small Claims up to \$10K)
 - Engage Solicitors
 - Debt Collectors – may charge up to 40% of the invoice amount

Accounts Staff

The accounts staff should be in regular contact with the accounts staff of all major debtors and creditors. Maintaining good communications between these staff can be beneficial as it is often the accounts staff that will process and make payments; and sometimes even decide which creditors are to be paid.

Consider putting your creditor and debtor accounts staff on the company's Christmas marketing gift list. A box of chocolates or bottle of wine can save a company a lot of money when compared to outstanding debts.

IF YOUR BUSINESS IS EXPERIENCING CASH FLOW PROBLEMS

Don't go quiet – advise creditors that payment may be late (A form letter is suitable). A few will request or demand payment but the majority will appreciate the communication provided you do not have a history of late payment.

One or a combination of the following will assist business owners to manage their cash flow and/or provide a capital injection to overcome cash flow problems:

1. Cash Flow Forecast - Produce a forecast and use it to manage incomings & outgoings. (ESSENTIAL)
2. Factoring – this can be expensive as costs (interest) accrue on a daily basis. It may be useful for major/government contracts where payment occurs on an agreed date.
3. Overdraft – banks will require security for the OD usually in the form of “bricks and mortar”, director guarantees and/or a charge over the company assets.
4. Venture Capital – Investors generally require a very significant return on investment and/or plans to take the recipient company public (IPO).
5. On-Line Payment Portals such as Quadrem – This is an on-line ordering, invoicing and payment site suitable for businesses that already do a fair proportion of their turnover with companies already listed. The benefits, including timely payment of invoices, need to be weighed against the costs of the system. Quadrem is not a marketing forum in itself but is a useful part of a marketing strategy involving approaching potential clients and highlighting Quadrem listing, web-site, products, competitive advantages etc.

For additional information or clarification please contact:

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