

Working Capital – Too Much or Too Little??

As we move through the busy summer, many times we have so many jobs going we run short on cash. In essence, we are spending at a faster rate than our collections. This is a cash flow problem, but can be remedied by applying basic working capital principles.

First, calculate your working capital. Find your most current balance sheet showing your assets, liabilities and net worth. Next, subtract your Current Liabilities from your Current Assets. If the value you get is positive, you have a positive working capital and if negative, have a negative working capital.

Once you have your working capital number, divide it into your total sales for one year. The value you get is called your Working Capital Turnover. The higher the number, the less cash you have and the more susceptible you are to cash flow problems. The lower the number indicates you have too much cash in the bank and are not investing it properly in your business. Let's discuss three examples.

Dealer A has working capital of \$100,000 and does \$1,000,000 in sales. His working capital turnover is 10. He has the right amount

of working capital for the business, is capitalized well, and can probably cover anytime his collections do not arrive in a timely fashion. If we divide 365 days in a year by 10, he has about 36.5 days of money to cover no collections.

Dealer B has working capital of \$25,000 and does \$1,000,000 in sales. His working capital turnover is 40. He has too little working capital for the business, is under capitalized, and will have cash flow problems. He needs to use credit cards, lines of credit and suppliers' credit to survive. If we divide 365 days in a year by 40, he has about 9 days of money to cover no collections. He is trying to do too much business for the working capital he has and if someone does not pay him, he runs the risk of business failure.

Dealer C has working capital of \$250,000 and does \$1,000,000 in sales. His working capital turnover is 4. He has too much working capital, is not using his cash wisely, is not investing in his company, and is too conservative. If we divide 365 days in a year by 4, he has about 90 days of money to cover no collections. He has enough money to pay all his

bills for 90 days without any Accounts Receivables hitting his door. He is commonly called overcapitalized. He needs to invest in his business by hiring more people, spending more on marketing, and adding assets.

Working capital is so key to many businesses, yet many businesses tend to focus on sales and not cash flow. Working capital defines if you can bill customers and how much you can afford to invest in other areas without diluting working capital. Some contractors have a working capital turnover of 10, but spend their cash on new trucks or business and are left with a working capital turnover of 40.

Watch your sales and your working capital. Calculate your working capital turnover each month when you get a new balance sheet and invest wisely in your business. Collect C.O.C. whenever possible and control your cash. Your working capital will thank you.