***What is working capital?***

Working capital is all the cash tied up short term in the business cycle. It’s the short term elements that are changing day by day, not the long term “fixed assets” (property, vehicles, equipment, furniture etc) that we’ve bought to keep. You’ll see working capital every day – even if you’ve never called it that, or thought about its implications.

**The supermarket**

Think about your local supermarket. Every time you visit, it’s the same building, the same shelves, fridges and freezers, and the same tills and trolleys. They’re the fixed assets.

The working capital is the goods on the shelves. Every day customers take things off the shelves, and the staff restock them. What’s the cost of the goods on the shelves (and in the store-room at the back of the shop, and in the company’s delivery lorries)? That’s working capital: if that cash is tied up in stock, it isn’t in the bank account.

**The car showroom**

Visit a car showroom. How many cars are for sale, and what’s their value. That’s a lot of metal sitting out in the rain going rusty!

**The housing development**

Next time you pass a housing development, think about the working capital. The housebuilder has paid for the land, and all the work on the half-finished and unsold houses. It’s not until the new owner completes and moves in that the housebuilder gets their money back. How much do you think has been spent so far on the housing development you’re walking or driving past? Financing that working capital is a real issue for housebuilders!

**Creditors: letting suppliers take the strain**

Not all the stock or half finished work (work in progress, or WIP) that we’ve looked at so far has been paid for. Tesco will get at least a month’s credit from their suppliers, so they’ve usually sold the goods a considerable time before they pay for them.

Car showrooms may get up to 3 months’ credit from manufacturers, but they’ve probably paid cash (or part-exchange) for the second hand cars on the forecourt.

Housebuilders may get up to 3 months credit from their suppliers, but it takes longer than 3 months to build and sell a house!

**Debtors: waiting for the customer to pay**

The 3 businesses we’ve looked at are all cash businesses, so they get paid as soon as they sell their goods. (We might take 25 years to pay off the mortgage, but the housebuilder is paid by the bank on completion.)

But think about the subcontractor digging the foundations for the housebuilder. They’ll invoice at the end of each month, but won’t get paid until perhaps 3 months later. If they’ve agreed to invoice once they’ve finished digging all the foundations, rather than invoicing monthly, they’ve got an even bigger problem…

**Working capital in your business**

How does this relate to your business? Walk around your warehouse and look at the stock of raw materials and finished goods. Look at the half completed goods, or think about the work your business has done but hasn’t yet invoiced.

How many unpaid invoices are out there with customers? Are your customers paying you on time, or paying late?

And how much do you owe your suppliers?

**Think of a sponge!**

Working capital is like a wet sponge. A sponge soaks up water, working capital soaks up cash. We can squeeze water out of a sponge, we can squeeze cash out of working capital.

But the problem is that if our cash is in working capital (in the warehouse, in our customers’ bank accounts), it isn’t in our bank account. And that gives us a cashflow problem!

So what do you need to do in your business to help squeeze cash out of working capital?