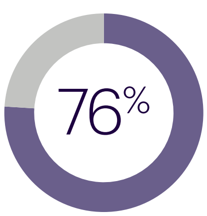
Free up working capital to unlock hidden business value

To run your company efficiently, you need to retain a certain amount of cash for your day-to-day operations. This cash—your working capital—is used to maintain your inventory, order goods and services, and offer your customers competitive payment terms.

More and more businesses are starting to realize the importance of managing working capital effectively, especially after a year where extra cash allowed them to react to economic challenges.

Companies experiencing growth also feel the need for cash. A survey conducted by Truist shows that 83% of companies are planning for expansion, but only 24% are confident in their ability to access the capital they need.[1]



aren't confident in their access to capital[1]

The number-one financing strategy among business leaders is using cash on hand, and managing working capital can provide more cash. Tightening up on your payables, receivables and inventory—the core components of working capital—can release cash and help you avoid spending time searching for funds to meet your short and long-term goals.

Even if your business has funds to grow, there's still an opportunity to improve how your working capital is managed. Freeing up working capital can allow you to pay off debt, support strategic investments, or return capital to owners.

Working capital funds have already been absorbed by your business. Freeing funds comes from focusing on low risk financial improvements that can boost value as much as strategies that absorb far more organizational attention.

As you unlock funds tied up in working capital and put it to work in more productive ways, you'll be making your company more appealing to investors and lenders who will value the returns you can generate with less capital.

Manage your working capital more efficiently and put your company on the path to stronger financial management, capital efficiency, and added value with these four steps:

1. Benchmark your working capital.
2. Assess the value of improving your working capital.
3. Eliminate your working capital bottlenecks.
4. Create a cash culture to preserve your gains.

Step 1: Benchmark your working capital.

Looking for a better way to monitor your working capital and pinpoint opportunities to improve efficiency?

Key Performance Indicators (KPIs) are used to quantify and evaluate the success of certain activities. Working capital KPIs can provide you with an assessment of your cash flow and show how effectively your company manages working capital so you can identify ways to put it to better use. Think of them as quick-read thermometers for your cash cycles.

Cash conversion cycle

Inventory days + AR days - AP days = Cash conversion cycle

A working capital KPI can be a simple figure, or it could involve an equation. Consider your cash conversion cycle. To find it, add your inventory days (days inventory outstanding – DIO) to your AR days (days sales outstanding – DSO), then subtract your AP days (days payable outstanding – DPO). The lower the number, the less capital you tie up maintaining inventory and operations while awaiting payment.

While your cash conversion cycle provides an overall measure, you might be able to gain more control over your working capital by focusing on each of the cycle's components. Decreasing your DSO, increasing your DPO, and reducing your DIO can add up to substantial improvements that will shorten your cash conversion cycle, release capital, and benefit your business.

Zero in on the KPIs that hold the key to tightening up on working capital and use them to establish benchmarks and set goals for improvement. Be sure to use both your past and present numbers when creating benchmarks. If a KPI was better previously, use that figure as a realistic target.

External benchmarks can be just as useful, so make sure you compare your own KPIs to industry standards to see how your company's performance matches up to similar companies. If others are performing better in some areas, look for ways to improve and set your goals accordingly.

You'll find working capital benchmarks using:

1. **Truist *Financial Insights*** — Your relationship manager and Truist team use industry standards to help you better understand your opportunities for improvement and set working capital benchmark targets.
2. **Middle market research** — The National Center for the Middle Market has compiled industry-specific benchmarks and offers an online Working Capital Benchmarking Tool to help you establish goals for your business.
3. **Industry trade groups, professional associations, and government agencies** — These organizations often generate key benchmarking statistics or point to relevant sources of data.
4. **Business data** — Timely and detailed industry information is available publicly online and through subscription services.
5. **Professionals who know your business** — Turn to advisors like your accountants and industry consultants for information on local and industry metrics.

Step 2: Assess the value of improving your working capital.

Can you get more out of your working capital?

Use your industry benchmark KPIs as targets for working capital levels. Evaluate all aspects of your working capital and look for opportunities to improve your accounts receivable, inventory, and accounts payable.

Consider the following case study for Acme Distribution. Shaving just five days from accounts receivable releases $1.37 million. Improvements across all working capital KPIs (shown below in white) would yield $5.9 million.

Case study: impact of working capital improvements

($ in thousands)

	Days of	Current	Cash released by working capital improvements of:			
			1 day	5 days	10 days	20 days
Account receivable	31	$8,400	$274	**$1,370**	$2,741	$5,482
Inventory	107	$24,165	$227	$1,134	**$2,268**	$4,537
Account payable	24	$5,349	$223	$1,115	**$2,230**	$4,460

improvement to highlighted levels releases

$5.9MM

of cash to be deployed as needed

Next, look at how working capital improvements affect owner value, which is equal to the value of the business minus any debt. Acme Distribution is valued at a price/earnings multiple of 5x EBITDA, subtracting its debt still leaves a total value of $26.8 million.

With working capital improvements, debt is cut by a third, owner value is up by 22% to $32.7 million. That means more capital can be used for reinvestment, debt reduction, expansion, owner dividends, or other purposes. Plus, investors are attracted to businesses with low capital needs and high rates of return.

Case study: working capital impact on owner value

($ in thousands)

EBITDA ($M)		Multiple		Business value		Current debt		Working capital reduction		Owner value
$9,308	X	5	=	$46,540	-	$19,746	+	$5,906	=	**$32,740**

22%

increase in owner value

1/3

debt reduction

Step 3: Eliminate your working capital bottlenecks.

Making your working capital more efficient isn't complicated, but it does require a thorough examination of your company's financial operations. Start by identifying bottlenecks—things like increasing inventory, unpaid customer bills, and missed opportunities to extend supplier payments—then implement strategies to keep cash moving.

In a study conducted by Truist, surveyed business leaders indicated they were increasingly concerned about obtaining credit and meeting payables.[1] Releasing cash from working capital bottlenecks can provide instant relief.

Accelerating collections, reducing inventory, and taking advantage of payment terms offered by your suppliers can help reduce your cash conversion cycle and free up capital for other uses.

Analyze the three main components of your working capital to find and release cash tied up in bottlenecks.

Accounts payable

Are invoices paid too quickly?	Paying suppliers early ties up cash and creates fluctuations in cash flow. (Business experts often refer to early payments as "interest-free loans" to your suppliers.)
Can you negotiate better payment terms?	Most suppliers will agree to mutually beneficial payment terms, including early payment discounts, volume discounts, and longer payment windows.
Do you pay electronically?	Automated clearing house (ACH), consolidated payment files, and electronic data exchange offer precisely-timed payments and efficient processing to take advantage of supplier terms.
Do you pay suppliers by card?	A purchasing or virtual card allows you to extend your DPO—generally 30-45 days—while paying suppliers quickly.

Accounts receivable

Do you have a receivables strategy?	Think about ways to reduce your receivables while still maintaining a consistent collections policy. If your customers insist on extended payment terms, will you bring in more in sales?
Are invoices generated at time of sale or delivery?	The easiest way to improve your receivables cycle is to send out invoices or collect payments as soon as products are delivered.
Can you tighten up on your terms and remain competitive?	Find out industry standards for payments, discounts, and delivery expectations, then set terms that reduce your days sales outstanding (DSO).
Do you offer early payment discounts?	Getting paid right away frees up capital sooner.
Is it easy for customers to pay you?	Accept credit cards and encourage electronic payments to speed up your receivables and provide you with financial tracking and reporting. You'll discover even more ways to manage your working capital effectively.

Inventory

How do you manage your inventory?	Push inventory systems maintain as much inventory as possible, while a "just-in-time" system obtains inventory as needed. Just-in-time can reduce your inventory and working capital.
What is your days inventory outstanding (DIO)?	To calculate DIO, take your average inventory, divide it by the cost of goods sold, and multiply it by 365. Review your turnover rates to uncover ways to reduce your inventory.
Are your employees committed to offloading inventory?	Use incentives to encourage your staff to keep inventory moving.
Have you explored innovative inventory methods?	Successful companies use approaches like Lean, Six Sigma, Kaizen, ROI, and value tracking to deliver products just in time and avoid tying up capital in excessive inventory reserves.

Step 4: Create a cash culture to preserve your gains.

You'll need the help of your entire workforce to improve your working capital KPIs. Staff in charge of managing your inventory, accounts receivable, and accounts payable can help identify bottlenecks tying up capital and find solutions to keep cash moving.

Remember, employees at all levels play a role in your business. For example, if you want to stretch accounts payable, make sure that everyone who might initiate an order from a supplier understands the role that terms play.

Take these actions to create a cash culture and increase your capital efficiency:

- **Talk about working capital** — Your entire company should be thinking of ways to reduce working capital tied up in your day-to-day operations. Offer training to your employees so that they understand the concept and how their actions can free up cash to meet targets for working capital KPIs.
- **Establish goals and accountability** — Clearly communicate SMART (Simple, Measurable, Attainable, Relevant, and Timely) goals for cash management, payables, receivables, and inventory. Establish targets for KPIs so that all employees understand how important it is to reach them.
- **Make working capital management a top priority** — Keeping your focus constant and consistent will tighten up your working capital and create business value. Be sure to incorporate working capital improvements into your long-term planning and always consider return on capital.
- **Empower your staff** — Let employees take action that will influence your working capital as much as possible. If you want a collections staff member to help reduce your days sales outstanding, make sure that employee has the authority and tools to assess relationships with delinquent customers, partner with staff who interact with those customers, and recommend suspension of new purchases until the account is current.
- **Reward your employees** — Link employee compensation to your working capital KPIs.

When you improve your working capital KPIs, let everyone know. Show your employees that managing working capital efficiently releases cash and creates opportunities. That way, they're more likely to help you maintain and improve your gains.

Access more cash and boost your company's value.

Ask your relationship manager how Truist can help you release working capital so that you can pursue your business goals.

Truist.com

[1] 2021 Truist Business Pulse survey of businesses, $2 - 500 million in revenue