GroFin STEP
Success Through Effective Partnerships

BUSINESS SUPORT GUIDE

Working Capital Management

Best Practice for SMEs

Finance + Expertise = Success

Contents

1. About this Document

GroFin invests in small and growing businesses (SGBs) that rely on the local entrepreneur's skills and knowledge to take the organisation forward. We believe that business support is as critical as finance in ensuring the success of a business, and robust financial management and monitoring in particular are critical for a sustainable venture.

To talk of financial management and not touch upon working capital management is not possible. Accordingly, our first financial business support guide will centre on working capital management to help entrepreneurs understand the basics of working capital, its management, its constituent elements and the importance of working capital management in ensuring a sound financial future for the organisation.

2. Working Capital Management – the basics

Before delving into working capital management, it is important to define what precisely constitutes working capital. Working capital refers to the funds needed to carry out your recurring and routine business operations. It allows you to meet your short-term debts and operational expenses as they fall due, which can be particularly important for start-ups and growing businesses.

It is only too true that expenses tend to outstrip income at the start of a business venture and only too few, if any, new businesses are profitable as soon as they are launched. It takes time for a business venture to reach its breakeven point and to start making a profit. Hence, keeping a tight control on working capital is essential for entrepreneurs who are focused on a long-term horizon, as a sustainable business can only be built on efficient working capital management systems.

Simply stated, working capital management is the process of managing activities and operations related to working capital. To break it down into its constituent elements, the management of working capital involves managing inventories, accounts receivables, accounts payables, and cash.

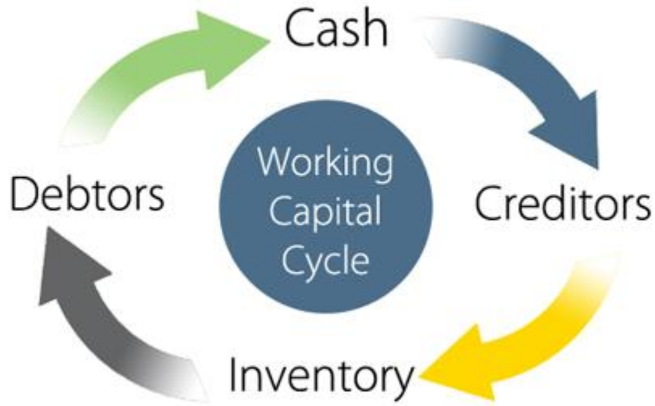
The goal of working capital management is to place the company on a firm footing to continue its operations and enable it to meet both short-term obligations and operating expenses as and when they fall due.

Working Capital Cycle

A good metric to evaluate the efficiency of working capital management is the duration of the working capital cycle. A working capital cycle measures the time taken from receipt of raw materials from supplier to realisation of cash from debtors. It is in the interests of the organisation to keep its working capital cycle as short as possible to ensure that cash is received into the business with minimum delays and can be used to fund the next sales opportunity. The shorter the turnaround time for a transaction from purchase to receipt, the more the number of sales opportunities that can be met in a given period.

A typical working capital cycle consists of the following elements:

- Cash (funds on hand)
- Creditors (accounts payable)
- Inventory (stocks on hand); and
- Debtors (accounts receivable)



One or more elements of the working capital cycle may find their relative importance lower or higher, depending on the industry type and the stage of maturity of the business. For instance, a services organisation will not have a marked inventory element, other than petty items such as stationery and tools for office use. Hence, inventory management will not be an important element for such an organisation. Similarly, a start-up may not have too many product lines it is dealing with, hence the scope of inventory management may be limited. As the business expands and diversifies into different product lines though, it may find itself using more complex inventory management systems and inventory, as a part of working capital, may find itself gaining increased importance in the business as it matures.

Working capital formula

As a rule of thumb, you can measure the working capital in your business in terms of the difference between the current assets and current liabilities of your business. Refer to your latest balance sheet to correctly assess the level of working capital in your business.

Working Capital = Current Assets - Current Liabilities

Remember, current assets are items that are either cash, a cash equivalent, or can be converted to cash within the year. Current Assets cover cash, accounts receivables, stock, pre-paid expenses and short term securities. On the other hand, current liabilities are debts or obligations that are due within the year. Current liabilities cover accounts payables, wages, dividend and taxes.

However, while the working capital formula allows you to arrive at the exact figure of working capital held in your business, it does not allow you to gauge the safety margin that your current level of working capital offers. In other words, do you need more working capital to stave off the creditors, or can your business make do with less working capital and invest idle funds in interest-yielding avenues? To arrive at the margin of safety, you must calculate the ratio of current assets to current liability and evaluate the liquidity position of your business.

Working capital ratio

The working capital ratio (more commonly referred to as the current ratio) refers to the relative proportion of current assets to current liabilities and shows the ability of the business to meet its current liabilities with the use of its current assets.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

A ratio above 1 means current assets exceed liabilities, and the higher the ratio, the better the safety margin it affords the business on a liquidity front. A low ratio would imply that a business might fall short of meeting its current obligations with the current resources at its disposal, putting it at risk of payment default.

However, a ratio that is too high could also mean that the business is not efficiently using its current assets or short term financing facilities. Indeed, depending on how its components are allocated, a high current ratio may suggest that that company is not using its current assets efficiently, is not securing financing well or is not managing its working capital well. In such a situation, a quick ratio (also called an acid test ratio) may be a better indicator of the short-term liquidity of the business.The quick ratio measures a company’s ability to meet its short-term obligations with its most liquid assets. It excludes inventories from current assets to arrive at a more accurate measure of the ability of the business to meet its current liabilities with its most liquid assets – cash, debtors and short-term securities.

$$\text{Quick Ratio} = \frac{(\text{Current Assets} - \text{Inventory})}{\text{Current Liabilities}}$$

Elements of Working Capital

As is clear by now, working capital consists of four elements – cash, creditors, inventory and debtors. We shall consider each element of working capital one by one, to arrive at an in-depth understanding of working capital management.

3. Cash management

Cash management is a critical element of working capital, as all the other parts of working capital are geared towards ensuring the quick turnaround of cash in your business. How quickly you covert debtors and stock to cash can be an important index of the liquidity of your business, and reflect its ability to meet current obligations such as accounts payables, wages, dividend and taxes.

Ultimately, cash is king. Sales are important, yes, but making sure that you get paid in time for what you are selling is equally, if not more, important. To highlight the importance of cash to a growing business, many entrepreneurs have told us that while their sales increased year-on-year, they still lacked funds to cover their overhead costs. Ultimately, inadequate credit and collections policy were found by our team to be the underlying cause.

With its thoughtfully designed and well-structured suite of business support services, GroFin can add value to your business in the critical area of cash management. Based on our wealth of experience in helping entrepreneurs manage their business without facing a cash crunch, we bring to you six ways in which you can improve your cash flows:

1. **Speed up collections from clients:** Focus on getting money back into your business as

quickly as possible. Ask customers to make deposits when orders are taken. Reward good customers with discounts. Keep an eye on new customers and implement compulsory credit checks for noncash customers. Preferably, avoid giving credit as far as possible. Track accounts receivables proactively, and institute a cash on delivery mechanism as an alternative to refusing to do business with slow-paying customers. Finally, even if a customer goes “bad”, don’t stop collection efforts – negotiate a compromise or stretched pay-off plan, and turn the account over to a collection agency if all else fails.

2. **Get favourable supplier credit terms:** If you reward good customers for paying early, why shouldn’t you expect the same from your suppliers? Negotiating small discounts with your suppliers can have a big impact on your cash flows. Pay your bills before time and request your supplier to extend discounts for early repayment. Also, plan your requirements in advance so you can buy in bulk and negotiate more favourable payment terms with your suppliers. However, at times, buying in bulk could itself be the reason for cash flow problems as you could find yourself sitting with the stock for extended periods and unable to convert it into much-needed cash. Bottom-line: Buying in bulk could be beneficial but it must be done by weighing its benefits in the form of discounts against potential losses that could arise from holding stock for extended periods.

3. **Trim inventory levels:** Outdated inventory is like last year’s fashion – there is no sense keeping it in the closet and paying for its storage and upkeep if you can get rid of it, even at a discount. Strategies like stocking only fast-moving items and getting suppliers to ship custom-made items from their warehouses will ease the stress of having to stock and sell slow-moving inventory. Declare sales on slow-moving inventory before it gets obsolete, and make sure you consider stocking and maintenance costs as well as potential losses due to wear and tear of sluggish inventory before deciding discounts on items for sale. Dead or slow-moving stock must be sold as quickly as possible even if it is below cost.

4. **Lower your overheads**: While you are busy growing your business, overhead costs can pile up only too quickly, whether in operations, marketing, administration or human resource management. Focus on minimising rent and labour costs, which are typically two of the biggest expenses that growing businesses face. For instance, undertaking robust resource planning and forecasting human resource requirements accurately can accrue significant savings. Hiring part time employees for peak periods and giving employees the flexibility to work from home would enable you to work from leaner premises with lesser staff, allowing you to save on both rent and labour expenses. Another tip to ensure your overheads can be safely met is to calculate your daily break-even sales, especially if you operate a retail outlet, and then track sales against that target.

5. **Avail an accountant's services:** Working with an accountant may mean added expenses in the short run, but the recurrent savings from applying their expert recommendations could more than outweigh the additional pay-out. An accountant would help you review cash-flow projections, prepare quarterly cash forecasts and identify periods of excess cash and cash shortages. During periods when the business is cash-rich, the excess cash can be reinvested into the business to stimulate further growth, or invested in fixed deposits and other savings instruments to earn interest for you; and you can prepare for anticipated cash shortages with the added interest income from cash rich periods, as well as boosted advertising efforts to win more business in slow periods.

6. **Grow revenues at a higher rate:** After you have managed to plug gaps in your receivables and inventory on one hand, as well as negotiated favourable terms for your payables and reduced overheads on the other, if you are still facing a cash crunch, it may be time to re-look your core business strategy and grow your revenues at a higher rate. To achieve the required business boost, consider avenues to grow your revenues sustainably over the long term, such as channelling more cash flows into higher-margin products, selling existing products in more profitable markets or a combination of both.

Growing your revenue at a higher rate does not come without its inherent requirement for additional funds. Choose your finance partner with care, and make sure that you select a financier who aligns your repayments with your cash flows. Discuss your growth needs with your finance partner upfront and also candidly indicate the approximate timelines over which you expect to see the returns from your business expansion project. Finally, practise cash flow management as an integral part of the working capital management of the business, and ensure that you monitor your cash flows consistently, in order to meet repayments and expenses as and when they fall due.

4. Inventory Management

Inventory management is critical, particularly for the stock intensive manufacturing, wholesale or retail space, where inability to convert inventory to debtors, and debtors to cash in a time-bound manner, can cause your business to have idle or slow-moving stock. This in turn, will cause your business to undertake needless expenses to store such stock, take care of it, and at the worst, dispose of it at a loss.

We must reiterate that inventory/stock purchases are an important part of the cash cycle or “operating cycle” of any business. First, the company makes payments to suppliers and then receives the stock (supplier days or payable days). Next, the stock is processed –depending on whether it is finished/ready to sell stock or raw materials that will be part of the production cycle – so the processing time should also be factored into the operating cycle.

Finally, a critical component of the operating cycle of a business are the sales terms, whether on cash or credit terms. Hence, the nature of the inventory, order amount, payment terms, time of receiving the stock, and processing time should be evaluated against sales and collection of monies from customers (receivable days) so that you can accurately assess your operating cycle and your business does not face cash shortages.

With its thoughtfully designed and well-structured suite of business support services, GroFin helps you add value to your business in the critical area of inventory management. Based on our wealth of experience in helping entrepreneurs manage their business without getting swamped with excess inventory, or facing a stock-out situation, here are eight ways in which you can optimise inventory levels:

1. **Categorise inventory:** Before you take a decision on inventory, you must first break it down into levels such as safety, replenishment, and excess or obsolete. Every business needs a minimum level of safety stock to ensure that it can meet an average threshold of customer

orders even if there is a manufacturing breakdown or bottleneck, or there are delays in distribution or delivery of fresh inventory. Next comes the replenishment level ("reorder point"), which refers to the inventory threshold at which an order must be placed, taking into account the average delivery time from your supplier. A trigger for replenishment orders is when you hit your reorder point which is essentially a sum of safety stock and demand to be met during the waiting time when you are expecting inventory from your suppliers. Finally, the last level, excess or obsolete stock, is an unwanted category but an unavoidable assessment if you wish to declare sales on the outdated stock, clear storage space for new inventory, and keep accounts updated with write-offs on obsolete inventory.

2. **Prioritise inventory items:** Manage by exception and focus on items that have frequent demand and high turnover. As a rule of thumb, it is estimated by inventory management experts that 15-20% of your items will generate as much as 75-80% of demand. Give more time, effort and frequency to forecasting, reviewing and reordering the A category items in your inventory composition. The second category should consist of "B" items that comprise a third of your inventory but generate only 10% of your sales. These items do not need as much attention as "A" category, so the frequency for reviewing "B" items would be necessarily less than that for "A" items. Finally, we come to the least important category of "C" items that account for as much as half the items stocked but generate as little as 10% of your sales. This category can be reviewed at a lower frequency compared to "B" items, considering that it has the lowest per unit contribution to turnover compared to the large base of inventory that it comprises.

3. **Look at inventory in the broadest sense:** Keep in mind that inventory consists not only of finished goods sitting in your warehouses, but also raw materials, work in progress, spare

parts, stationery, and goods at your retail outlets. In fact, these items are likely to constitute as much as half of your inventory and are as critical to keep track of as your finished goods. To decide how much stock to maintain for each component, ask yourself some basic questions: Are you in a position to accurately assess demand? Is the price of the item steady or volatile? Do you get discounts for bulk purchases? How efficient and reliable are your current sources of supply? Are there alternative suppliers in the market, in case your main supplier falls short or is unable to meet your demand in time?

4. **Choose optimum inventory management techniques:** Your business can follow either of two primary inventory management techniques – Just in Case (JIC) or Just in Time (JIT).

5. JIT is a modern technique companies employ to increase efficiency, decrease waste and reduce inventory holding costs by receiving goods only as they are needed in the production process. Made famous by Japanese automotive major Toyota, JIT works best for companies that have repetitive manufacturing functions and where producers are able to accurately forecast demand. If your business deals in high variety, perishable, fashionable, and high obsolescence products, JIT could save it from both high holding costs as well as write-offs. Efficient inventory management with accurate reorder points is crucial for firms that use a JIT approach since supplies arrive just as they are needed for use in production or for re-sale. When using JIT, companies maintain little or no safety stock and purchase materials & products in small quantities whenever they need them.

   On the other hand, the traditional, JIC technique requires that companies keep large quantities of inventory on hand and incur associated inventory costs, to minimise the probability that a product will run out of stock and cause it to lose out on sales opportunities. For example, a hospital which needs life-saving drugs on hand at all times to meet emergency situations cannot afford to follow a JIT system as it must keep a sensible safety stock margin. Accordingly, for such businesses, the reorder point will be triggered with sufficient lead time to receive fresh supplies, as well as enough buffer in the form of safety stock to meet any unforeseen requirements, just in case. Also, a new business that is just making its first few customers might want to follow the JIC technique to begin with, as there would be difficulty in accurately assessing demand given lack of business history, as well as higher potential risk of losing a customer for good if stocks are not available immediately to meet demand.

6. **Use software/spreadsheets to order and track inventory:** When it comes to ordering inventory and tracking its movement in the business, it may save costs in the long run to purchase an inventory management software. Increasingly, businesses are using inventory management databases or inventory management software to decide when and what order sizes need to be placed. Many businesses also develop tracking systems over spreadsheets or software to control inventory and ensure that the purchase manager is aware of inventory

movements through the business. A regular exercise/ or stock audit can be performed to compare “on the ground stock” with that recorded on the software/system. If differences arise, it allows you to dig deeper and address the underlying causes of such discrepancies – which could range from intentional factors such as theft or negligence to inadvertent factors such as inaccuracy or waste.

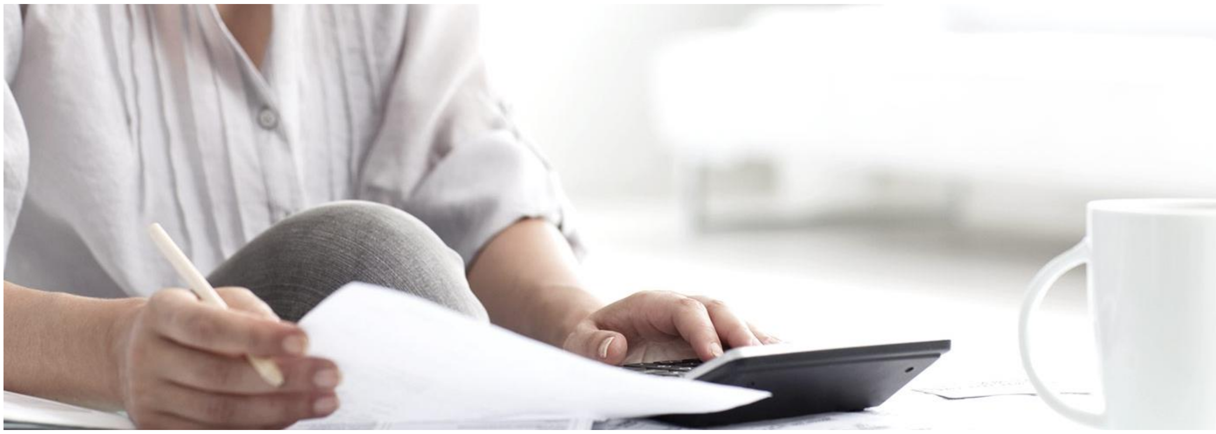
7. **Use consistent item descriptions for inventory:** Whether you automate inventory management or do it manually, the basics of any good inventory management system stay the same – location names must be well-organised and easy to explain, and location labels must be easy to recognise and unambiguous. Item descriptions used must be unique and can be reinforced with reference numbers to ensure that these items are tracked correctly. Finally, units of measurement, whether defined in terms of weight (such as kilogrammes or pounds) or batches (such as bags or crates) or individual items (such as pieces or units), must be consistent to facilitate placing of orders and tracking of inventory through the business. Your business may be small today and tagging items by label, description, and number may seem like too much effort to invest for a few inventory items, but once it grows big, it will be that much tougher to monitor inventory, unless such simple but essential details are fleshed out from the start.

8. **Prepare policies & operating procedures and train people on their use:** Ultimately, it is the people who use the inventory system that are the most critical determinant of its success. Ensure that your staff knows what to do with deliveries received; stock held for immediate sale, kept for future use, maintained as a safety buffer and needed in production; what to do in case of emergency, who will be in charge and what will be the protocol followed, among others. In case orders must be placed urgently, your staff should also know the concerned people who can undertake such transactions. Having policies in place that are easy to understand and simple to implement will ensure that training staff on inventory does not take time, and once trained, they are easily able to order and track inventory in line with provided guidelines. Staff must also be briefed on the protocol for inventory movement in and out of warehouses such as receipt voucher, disbursement slips as well as approvals/signing by authorised employees, among others.

9. **Make inventory a joint responsibility:** Whether it is about inventory policies, or about inventory ordering, avoid making inventory the responsibility of only one key person in your business. For starters, do not show haste to pinpoint the production or sourcing manager as the sole person accountable for all inventory related decisions. Instead, sit down with him first to formulate clear policies around critical factors such as the depth and range of goods offered by your business, and the optimal manufacturing or distribution pattern for such products. Similarly, do not place responsibility for ordering inventory only on the shoulders of the production or sourcing manager, but also involve the sales and marketing manager to more accurately forecast the expected sales of the items, and work backwards to ordering inventory. A marketing campaign might cause the sourcing manager to run short on his purchase orders when it is launched and shoots up sales in what could normally be an off-peak period for your business.

   Thus, if 'cash is king', it is equally true that 'Inventory is a necessary evil.' Having too much inventory exposes your business to the risk of potential write-offs of unsold and obsolete stock, as well as to the pitfalls of committing money to slow-moving inventory when the same could be required soon for more immediate expenses – such as rent, labour costs or utility charges. On the other hand, having too little inventory could cause your business to lose out on a large order because you have insufficient stock on hand and there are delays in receiving much-needed materials for the production process or re-sale, or pile-on expenses of ordering small volumes of inventory at higher rates because bulk purchases ran out mid-month. Avoiding either extreme is the essence of good inventory management, which must be practised consistently as an integral part of sound working capital management, to keep your stock moving and to convert it into cash as quickly as possible.

5. Accounts Receivable Management



Managing your debtors is an essential element of working capital management, as sales made must be evaluated against the timely receipt of monies from your clients. Bottom-line: Until you get paid by your client, the sale is not closed.

Indeed, we often hear clients saying that sales are up but they encounter cash flow problems as a result of the very sales that they have made – on credit terms. Customers pay late, or, in some cases, not at all, effectively ensuring that the money has not yet been received against sales made but cash has already been paid by the entrepreneur to buy the goods meant for sale.

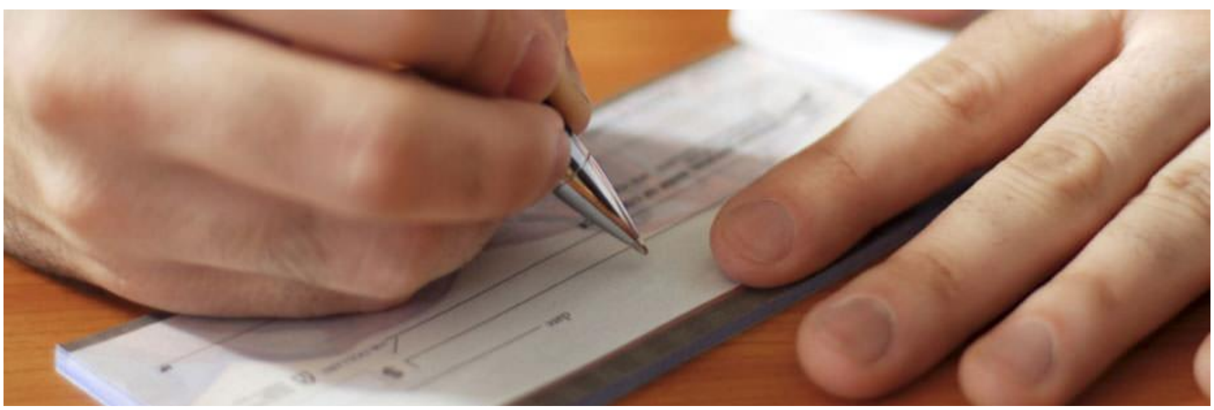
In effect, collecting money from customers can be one of the toughest tasks that your business faces, especially when it is an entrepreneurial venture where timely receipt of monies from your clients can mean the difference between paying your staff their salaries, and telling them to wait yet another month till pay day. In the worst case, delayed payments from your customers could force you to re-negotiate and stretch payments to your own suppliers, causing your creditworthiness to take a nosedive.

With its thoughtfully designed and well-structured suite of business support services, GroFin helps you add value to your business in the critical area of accounts receivables management. Based on our wealth of experience in helping entrepreneurs manage their business without facing delays in payment, here are 10 ways in which you can manage collections for your business efficiently:

1. **Understand accounts receivables management:** Most businesses define accounts receivables management narrowly as encompassing credit control, collections and payment

processing. However, it is best considered as the entire “quote to cash” process, covering all the steps from creating a quote for a prospect or customer, order management and invoicing, to receipt of cash against the sales made. Also, apart from understanding the process itself, it is important to know how to track accounts receivables. The most comprehensive measure your business can use is the days sales outstanding (DSO), which gives you the average time taken to collect money from your debtors (calculated as Receivables / Average Sales per Day). A lower DSO ratio points to a conservative credit policy but could also mean that your business is restricting sales by keeping its credit terms too stringent. Conversely, if the DSO ratio is high, or increasing over time, it could be a sign that sales are being made to less credit-worthy customers, or salespeople are being forced to offer increasingly liberal credit terms to win orders (such as, for instance, from trophy clients).

2. **Establish credit policies:** The selection of customers that will benefit from credit sales is crucial and should be based on a sound credit policy. Indeed, this is one of the key areas where GroFin extends business support to its clients. It is critical to establish clear, written guidelines that set out, first and foremost, the terms and conditions for supplying goods on credit; secondly, criteria for customer to qualify for credit; thirdly, the collections procedure, and finally, steps to be taken in case a customer defaults. Most importantly, if you are planning to extend credit to a customer, you must assess their capacity to repay. Credit checks may be expensive, but it may be a worthwhile investment to make before you entrust your valuable goods to a customer and expect to be paid at the end of the credit period with reasonable certainty. While lack of data has limited the efficacy of credit searches in the past, increasingly, initiatives such as the International Finance Corporation’s Africa Credit Bureau Program are ensuring the build-up of advanced credit reporting information in several African countries.



3. **Use credit selectively and within limits:** Remember, credit is a tool you use to show a customer that they are important to your business, and that you respect their patronage. It is

not to be used indiscriminately across clients but rather, offered as a select privilege to a few customers who have shown themselves to be creditworthy over time. Indeed, based on our experience with clients, we would even go so far as to say that one of the worst mistakes an entrepreneur can make is to sell goods on credit at a nascent stage of business. However, if credit must be extended, either because of high bargaining power of a customer or due to competitive pressures, the terms an entrepreneur gives customers should be less favourable than what he gets from suppliers. For example, if your suppliers give you 45 days to pay, you should give your customers 30 days to pay. Use a credit limit to begin with and keep it low for a start so that you can monitor your debtor's payment pattern before extending full-fledged credit across all orders from a particular customer. Once you decide to extend credit to a customer, make sure you get him to sign a contract that makes it clear what terms you are operating upon, timelines for payment and late payment penalties.

4. **Employ financial incentives intelligently:** Whether it is penalties for late payment or discounts for early payment, financial incentives are important to reinforce good payment behaviour or to discourage bad payment habits. Be clear in communicating to customers both the discounts that will be extended for prompt payment, as well as the charges they are likely to pay for overdue payments. Feel free to employ creative incentives to get the customer to prioritise your payments. For example, declaring an early payment discount of 2%/10, net 20 days (translating into a 2% discount if the customer pays in 10 days against a payment due in 20 days) against, for instance, an average industry standard of 2%/10, net 30 days. If the payment is due in 10 days anyway, the client is less likely to forego a discount, and that much more likely to pay before time. Where finance charges are concerned, be careful to stay within legal limits and check with your state's usury laws before deciding upon penalties for past due payments.

5. **Use technology to your advantage:** Whether it to send invoices timely to your customers, receive payments promptly or track overdue payments, use technology to your advantage. Emails used to send invoices to clients have the added benefit of allowing you to fix the exact date for the credit period to begin, unlike snail mails where you would need to follow up with the client to establish receipt. Also, many businesses now use Electronic Funds Transfer (ETF) to receive payments from corporate clients, so you can go ahead and specify on your invoice that you would like to be paid by ETF, giving your ETF banking information – your bank, branch and account number. Additionally, on the collections front, make it a practice to run an aged receivables report from your accounting software and pay special attention to receivables due beyond a limit, such as 15 or 20 days. Finally, you can also use SMS reminders as an effective tool for payments due in a few days, or already overdue. Friendly SMS reminders in advance of the due date can also be used as marketing tools for new products, festive sales, or stock clearance alerts.

6. **Establish personal relationships with your clients:** The client must be recognised as an individual rather than merely another customer number. We appreciate that this may not always be possible but addressing a customer by name is worth a great deal. Especially if yours is a small business operating in a few locations, keep your customers close. While personal relationships and informal networks can go a long way in securing orders, such connections can go equally far in terms of ensuring that you get paid against such orders. Indeed, customer relationship management (CRM) is an integral part of accounts receivables management. And, CRM has never been easier, with the endless possibilities that social media offers. Follow your clients over platforms such as Facebook, LinkedIn and Twitter, and make sure you listen to their updates, like their posts, and comment on their newsfeed. This will show your clients that you are paying attention to them and deepen your bond. Besides, following your clients over social media will show them that you have the resources and capacity to keep tabs on them, and they will have greater respect for you and your efficiency in running your business. Combine this with regular informal in-person visits with your clients (if this is feasible). A client that has just shared a coffee or a tea with you is more likely to pay fast than someone who has not seen you in months.

7. **Start with reminders and begin early:** Establish a set process to follow up with your customers for payments, with regular reminders worded in a manner that suits the occasion.

   → *Remind customers of payments due in a few days:* If there is a week to go till your customer's debt becomes overdue, do not hesitate to remind him that there is a payment deadline around the corner – make it clear what the amount is, when it is due, and what the penalty for late payment is. However, considering that the debt has not yet gone into overdue status, and there is every possibility that the client will pay within acceptable timelines, do not strike the wrong note in your communication. Be firm but remember that being polite can go a long way, with terms like “Please” and “Thank You” significantly increasing your chances of getting paid.

- → *On the due date, if not paid, a further reminder should be sent:* Of course, as soon as a payment is past due, a reminder becomes even more critical. If the client is a first-time offender, you could take a softer approach on the assumption that they inadvertently missed out on making the payment. However, for a chronically late-paying customer, you may emphasise the late payment clause, and make it clear that such behaviour could result in more stringent credit terms, or revocation of credit altogether.

8. **Make that collections call and prepare for customer excuses:** If no payment is received within an agreed period, the client should be called to enquire reasons thereof and to negotiate new terms. The golden rule here is that if a customer contacted the entrepreneur informing them that they cannot pay for whatever reason, they had all intentions to pay but could not pay. The flipside is that if the entrepreneur has to call the customer to ask why he has not paid, he had no intention of paying in the first place. However, at all costs, you must steer clear of getting emotional about late payments and avoid losing your cool over the time and effort spent in chasing debtors for overdue payments. Agreed, it is your business and your money, and that makes it intensely personal, but you must bear in mind that calls made in haste and conducted in an abrupt manner can be ruinous to a budding client relationship. A good tactic to keep your cool over a collections call is to be adequately prepared for the various excuses that a late paying customer is likely to throw your way.

9. **Use instalment plans to restructure payments:** If all else fails, and the client appears to have a genuine problem with meeting payments on time, do not give up and write-off the debts in a hurry. Instead, sit down with your customer, discuss a viable repayment schedule for his overdue debts, and prepare an instalment plan with his support and buy-in. Needless to say, it is much better to get some cash back, rather than nothing at all. Also, if the customer is genuinely facing a temporary stretch, they will deeply appreciate it if you support them at a time when they most need it and may return the favour with greater patronage when their tough times are behind them.

10. **Turn to the experts:** You can supplement all the steps outlined above with discerning advice and valuable support from the experts. Whether turning to a collections agency to make collections calls on your behalf or approaching a factoring company to sell your debts at a discount, it may become necessary to use the services of experts when the sales of your business and its collections needs are growing. However, such agencies are normally fairly expensive and, for SMEs, especially those at a nascent stage, additional expenses contingent on such collections outsourcing should be avoided as far as possible, and only undertaken if absolutely needed, at properly negotiated terms.

To conclude, it is important to reiterate that accounts receivables management is not only critical when there are few clients, but also as the business is growing and gaining increased clientele. Indeed, it is at times noted that entrepreneurs become victims of their own success as they go on to win big-ticket orders from ‘trophy’ clients, essentially large companies with great market reputation and strong market clout. Getting flooded with large orders from such trophy clients could give your business great mileage and add several successful case studies to your marketing suite, but it could also mean unwarranted delays in payment amid an inability to bring pressure to bear on such sensitive and valuable clients. It is often seen that such sales wins culminate in over trading, as big clients demand stretched credit terms which are invariably more favourable than supplier terms. This, taken together with additional funds that need to be injected into the business to execute such big orders, is likely to lead to cash flow constraints for the entrepreneur. Thus, consistent and efficient accounts receivables management throughout the stages of maturity of your business, and not at the start-up stage alone, is integral to sound working capital management.

6. Accounts Payable Management

Accounts payable management or creditor management is an important part of working capital management, and, of all your creditors, suppliers are easily the most critical category.

Thus, managing payments to your suppliers could easily be the biggest worry you face while running your growing business, especially if the supplier has more bargaining power than you do. And, higher bargaining power on the part of your suppliers is an eminently possible scenario when yours is a small business that is just beginning to spread its wings, while your suppliers are established business houses that have been dealing with the cut-throat corporate world for many years.

Another important aspect of account payables management is to manage your relationship with your suppliers in an optimal manner. Considering that stock is the life blood of any business, any path that causes your relationship with your suppliers to take a hit is clearly not to be pursued.

How then, can you manage payments to your suppliers in a manner that ensures that you enjoy the grace of the full credit period provided by them, while at the same time avoiding costly penalties by inadvertently missing out on paying your bills in a timely manner.

With its thoughtfully designed and well-structured suite of business support services, GroFin helps you add value to your business in the critical area of accounts payables management. Based on our wealth of experience in helping entrepreneurs manage their business without straining relations with suppliers, here are 8 ways to ensure that you can manage your suppliers more effectively:

1. **Select reliable suppliers and review their performance:** Selecting the right suppliers is important, as uninterrupted supply of stock is integral to the operations of your business. Take time to research and identify reliable and competitively priced suppliers, since this is an investment in the core operations of your enterprise. Your own competitive edge in terms of product pricing and distribution will be determined by the cost-effectiveness and timeliness of your suppliers, so make sure you identify the right suppliers at the outset. Also, when you have time, ensure that you review your suppliers' performance. Look into pricing, timeliness of delivery, discounts extended and credit period provided so you can be sure that you are getting the best deal at all times. Enquire into new product innovations and fresh deals, especially when end-of-season or festive sales are likely to be due.

2. **Ensure a clear and consistent payment policy:** You will want the supplier to agree to your payment terms, so make sure that these are realistic and will likely be acceptable to the party negotiating across the table. Also, be sure to keep an open mind. If your supplier has his own payment terms that are in conflict with yours, you would both need to relook your respective agreements and arrive at a written agreement that is acceptable to both parties. Always do your homework and be aware of the general payment terms prevailing in your industry. If, for instance, 30 days credit is the norm, make sure that your supplier is aware of it, and is extending the same to your business under a clear and concise written agreement. Without clear agreements in writing, misunderstandings can develop as your expectations fail to match those of the supplier. Bottom-line: Ink important supply agreements at the outset.

3. **Maintain robust records:** Keep track of your account payables with robust records to make sure that you are meeting all your bills payables in a timely manner and taking advantage of relevant discounts for prompt repayments. Maintain an ageing schedule for your account payables and review it regularly to ensure that you do not have to pay costly penalties for missing out on payment deadlines. Also, a missed payment is not merely about added interest payments, but also adversely impacts your relationship with your supplier as your creditworthiness takes a dip. To keep tabs on your accounts payables, match all supplier invoices with purchase orders and goods received notes.

4. **Tie prompt payments with relevant rewards:** As a small business owner, we understand that you may come under undue pressure from big suppliers. However, stick to the written agreements and make payments only within the documented credit periods. Do not yield to pressure to make prompt payments unless accompanied by relevant rewards in the form of discounts. Considering it is your hard-earned money, do not part with it in advance and forego interest on funds lying in the bank, unless the suppliers makes it worth your while with attractive discounts. Also, check out supplier deals. Some of your suppliers might want a larger piece of your business and will flood you with special deals and discounts. Avail such special offers and promotions as and when you can. However, avoid the temptation of buying more in bulk, simply in order to avail a significant discount. Stock lying at your warehouse can ultimately cost you more than the savings that you accrue by buying in bulk over a special deal.

5. **Track demand and inventory**: Track information on sales, orders and market trends on a real-time basis, so that you can make changes in stock ordered accordingly. This, coupled with accurate information on stock, will allow you to ensure that your stock moves fast and

converts to cash, in turn enabling you to pay your suppliers in a timely manner. Reverse engineering your stock requirements from the market demand and potential orders could save you from the pitfalls of stocking items that are no longer in fashion and take up unnecessary space in the warehouse. Next, inventory control that allows you to have the right stock in the right place at the right time, will ensure you accurately assess and meet your stock requirements to turnaround your stock as fast as possible. Paying your suppliers in time is possible only if your stock converts to cash within the forecasted operating cycle.

6. **Improve supplier payment systems:** Follow a simple rule of thumb while paying your suppliers – either extend the period of credit by paying over an instrument such as a credit card unless the supplier charges extra fees for it, or, stretch payments to your supplier till the last day by using efficient electronic mechanisms such as Electronic Fund Transfer (EFT) so that you can earn interest on your funds in the bank till the payment's due date. Also, do not come under pressure to pay your bills early, unless you are accruing significant savings from early payment discounts. Remember to be reasonable though and do not jeopardise your relationship with your supplier by unnecessarily delaying a payment till the last minute. In this context, regular communication with the supplier is key to keep him in the loop and to not keep him guessing about when to expect the scheduled payment from your end.

7. **Keep communication channels open:** To maintain good relations with suppliers, it is critical to keep communication channels open. Identify critical creditors and get in touch with the people who are managing your account. Establish a people to people connect so they know you as a name and not just an account number. Also, never put a supplier relationship at risk by waiting till the last minute to inform them in case of payment delays. Let them know in advance in case of issues with meeting payment deadlines. They are more likely to agree to a stretched repayment or settlement schedule in case you give them ample time for discussion and negotiation rather than leaving such communication till the last minute.

8. **Match your payments with your receipts:** In managing the end-to-end working capital cycle, comprising accounts payables on one hand and account receivables on the other, it is critical to align the payments of your business with its receipts as far as possible. For instance, if your suppliers extend you 60 days' credit, and your stock takes 30 days to process and prepare for onward sales, try to keep the debtor days as close to 30 days as you can negotiate with your customers, so that the stock funds itself. At the heart of a sound working capital cycle is alignment between the account payables and account receivables of your business.

To conclude, it is seen only too often that companies react to a temporary cash crunch by asking their accounts payables department to stretch payments to their suppliers, considering that payments to 'inflexible' creditors such as the bank and taxation authorities are regarded as sacrosanct. However, this “solution” can prove to be costly in the long run, by causing your suppliers to tighten your credit period, or to cease giving credit to you altogether. In effect, consistent and efficient accounts payable management is the only real solution to ensure that your suppliers are managed well and extend due credit to your business, contributing to predictable cash flows and sound working capital management in the process.

7. Working Capital Management – In Practice

Your GroFin Investment Manager can assist you in evaluating your current working capital management systems and in putting a more efficient working capital management system in place.

Good luck. Do not hesitate to ask your GroFin Investment Manager for assistance with evaluating and optimising your working capital management systems.