Working Capital Management

Understanding the Challenges and Exploring Solutions

By Nic Perkin

Despite the pressures of commoditization, outsourcing, and competition, the structural engineering industry has seen a swell in activity, thanks to new opportunities driven by private enterprise and the restructuring of the country's infrastructure. For firms to pursue new projects, they may need to recruit qualified staff, invest in technology and expand operations–efforts that require sufficient working capital. Unfortunately, given the economy, many engineering firms are finding it harder than ever to get working capital on their terms using traditional methods.

Working capital is defined as current assets minus current liabilities. In simpler terms, it's the amount of cash a company has on hand, and is a measure of a company's efficiency and short-term financial health. Positive working capital means the company has more assets (cash, accounts receivable and inventory) than liabilities, and, therefore, has the cash flow to fund operations or fuel growth. For structural engineering firms, this might mean the ability to take on a large project with little or no outside funding. Negative working capital results when liabilities outweigh assets and there is not enough cash on hand to run a business. In a prolonged negative working capital situation, some form of outside funding can be critical to survival.

	Factoring	Asset-Based Lending	Bank Financing	Online Receivables Financing
Requires long-term contracts?	Yes	Yes	Yes	Yes (non-binding)
Requires all-asset liens and personal guarantees?	Yes	Yes	Often	No
Competitive, market-based pricing?	No	No	No	Yes
Facility fees and other hidden costs?	Yes	Yes	Yes	One-time registration fee & per trade fee
Funds available in less than 30 days?	Yes	No	No	Yes
Notifies your customers?	Yes	No	No	No

Cash Flow a Top Concern? You're Not Alone

A recent survey conducted among executives at U.S. B2B companies found that working capital is a perpetual challenge for small and mid-sized businesses, including private structural engineering firms. Nearly two-thirds of survey respondents cited working capital as their #1 business challenge, edging out escalating costs and margin maintenance.

Why is working capital such a concern? Because it is tricky to manage. CFOs at structural engineering firms are constantly juggling the demands of clients, who want to extend their payables as long as they can (60+ days), and pressing liabilities such as payroll and technology costs that require immediate payment.

Unfortunately, the financing needed to overcome these working capital challenges has become increasingly difficult to secure. The economic downturn has caused most banks and financial institutions to tighten their lending standards. Other traditional financing sources, such as factoring companies and asset-based lenders, impose sizeable fees and require all-asset liens and personal guarantees, making them less attractive options for firms needing access to fast and affordable cash.

Traditional Financing Isn't as Cheap as You Think

Many business owners and finance executives consider bank financing a cheap and simple way to fund a business. However, bank financing often comes with hidden charges and penalties that most don't factor into their costs. Some loans require a company to put up a down payment and pay sales tax on the loan in advance, which can be a significant upfront cost. Businesses can incur penalties for missing a payment, or for paying early, whether to alleviate their debt or to refinance. Add processing fees, documentation fees, third-party fees, and government fees and taxes associated with loans and lines of credit, and the costs add up to far more than merely "principal plus interest."

Further, the cost of factoring, where a company sells or assigns its accounts receivable to a third party, can also carry a heavy price tag. The price paid for the receivables is discounted from their face amount to offset the risk that some of the receivables may be uncollectable. For example, suppose you have $100,000 in receivables. A factor will advance funds to you at a certain percentage of the total amount, often ranging from 75% to 80% (this is called the reserve), based on the quality of the receivable (your client) and your average days sales outstanding (time it takes your clients to pay). In addition, the factor typically charges interest on the advance plus a commission, and some factors have begun charging a fee to monitor an account and for use of their software.

Another traditional financing option is asset-based lending. Asset-based lenders make secured loans against certain business assets – such as accounts receivable, equipment and inventory – which you offer as collateral. Though rates are often better than unsecured loans, asset-based lenders charge relatively high rates, and can legally seize assets if you miss payments.

Personal Guarantees Are Not Worth the Risk

It's also important to keep in mind that traditional financing can carry heavy restrictions and personal risk. To satisfy bank loan requirements, a business is usually required to put up a mix of collateral, including cash and hard assets such as property or equipment. Since the recession, many traditional lending options are now requiring some form of personal guarantees in order to approve (or at least consider) business loans. While it might seem a small concession for a loan, personal guarantees should be avoided. If you sign a personal guarantee and your business hits a rough patch, not only is the company on the line, but your personal assets are as well. You risk losing your house, your car, or your savings.

Online Receivables Financing Offers Flexibility

In the changing economy, it's important for engineering firms and their finance executives to examine innovative alternatives that in many cases are cheaper than traditional financing, and that carry fewer restrictions.

One such alternative is online receivables financing. This option allows you to sell your receivables in a real-time, online auction. Unlike other forms of receivables-based financing, online receivables financing allows you to sell invoices to multiple institutional investors, so you get the most competitive pricing. (Businesses get 99-98 cents on the dollar, on average, in as little as 24 hours.) There are no personal guarantees, all-asset liens, contracts or hidden costs, and there is no obligation to trade.

While sometimes mistaken for factoring, online receivables financing relies on a completely different business model that offers companies flexibility and market-based pricing. With online receivables financing you are not required to monetize *all* of your invoices, but instead you choose when and at what price to sell individual invoices. If your firm needs sufficient capital to fund a new project, online receivables financing may be an ideal option.

The Bottom Line

When all the fees, penalties and risk are added up, traditional financing is not necessarily the most inexpensive or worry-free option. In the changing economy, it's important for small and mid-sized companies to examine innovative alternatives that in many cases may be more advantageous and carry fewer restrictions.▪

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