CLOSE THE CASH GAP AND OPTIMIZE WORKING CAPITAL

Learn how to bolster your financial operations for better cash flow

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A SMART APPROACH TO MANAGING WORKING CAPITAL

Working capital plays an important role in the health and efficiency of your financial operations. **According to Investopedia, an effective working capital management system helps businesses not only cover their financial obligations but also boost their earnings.**[1]

To seize opportunities for future growth, businesses should familiarize themselves with the ins and outs of working capital as well as the potential roadblocks that may stand in their way. One way businesses are overcoming obstacles and optimizing their financial operations is by adopting new tools and strategies, such as advanced payment services and corporate credit cards.

Learn more about the challenges of working capital and key tactics to help improve cash flow so you can invest and grow.

EXPLORE THIS E-BOOK TO LEARN MORE

WORKING CAPITAL 101

What is working capital?

Working capital is **the difference between a company's current assets and its current liabilities**.[2]

Current assets: All the assets of a company that are expected to be conveniently sold, consumed, utilized or exhausted through the standard business operations[3]

- Cash[4]
- Accounts receivable[5]
- Inventories of raw materials and finished goods[6]

Current liabilities: A company's short-term financial obligations[7]

- Accounts payable[8]
- Short-term debt[9]
- Dividends payable[10]

One way to calculate working capital

There are numerous ways to calculate and represent working capital. Here's just one illustrative example of a working capital calculation.

Current assets

− Current liabilities

Working capital

WORKING CAPITAL 101 (CONTINUED)

Why does working capital matter?

If a company has substantial positive working capital, then it should have the potential to invest and grow.[11] If a company's current assets do not exceed its current liabilities, then it may have trouble growing or paying back creditors.[12]

Did you know?

Even a healthy company may experience periods where its working capital is negative if it has unexpected short-term expenses.[13]

What is the difference between working capital and cash flow?

Some people may confuse working capital with cash flow. However, the two actually serve unique purposes. **Whereas working capital relates to a company's current financial situation, cash flow can extend into the future** and, if positive, can lead businesses to ask, "What else can I do with my cash?"

UNDERSTANDING CASH FLOW

What is cash flow?

Cash flow is **the net amount of cash and cash equivalents being transferred into and out of a business.**[14]

Why does cash flow matter to working capital?

Working capital requires monitoring a company's assets and liabilities to maintain sufficient cash flow.[15] Cash flow can be positive or negative. **When working capital is well managed, operating cash flows are stronger, supporting the ability to invest and expand.**[16]

Positive cash flow indicates that a company's liquid assets are increasing, enabling it to meet its many objectives:[17]

- Settle debts
- Reinvest in its business
- Return money to shareholders
- Pay expenses
- Provide a buffer against future financial challenges

61% of companies around the world said they struggle with cash flow, which can lead to negative outcomes:[18]

- Lost business
- Inability to pay vendors and employees
- Increased borrowing costs

UNDERSTANDING CASH GAPS

As with anything in life, unexpected circumstances can happen in business. Even well-managed working capital can be susceptible to cash flow gaps. The key is to have smart strategies and plans in place to help minimize the gap and enable growth.

What is a cash gap?

The cash gap is the **number of days from when you pay** for goods and services you have purchased **to when you receive receipt of payment** for the goods and services when they are sold. The more days between these two occurrences, the larger the cash flow gap is within your business.[19]

Businesses must always have sufficient cash to meet short-term financial obligations.[20]

Yet over **56%** of small and mid-sized businesses (SMBs) simply **live with liquidity problems.**[21]

Smaller, newer businesses are hit harder, with over **65%** reporting **chronic cash shortages**.[22]

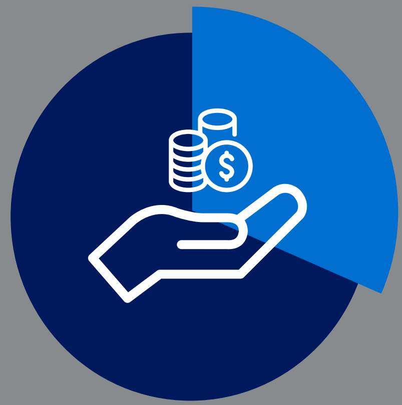
UNDERSTANDING CASH GAPS
(CONTINUED)

Why do businesses struggle with cash gaps?

Late payments and **market volatility** are among the biggest reasons why SMBs and larger enterprises struggle with cash flow.[23]

Understanding why you may be experiencing cash flow challenges can help you determine the best path to overcoming barriers to healthy working capital. To start, businesses could look at five key practice areas:

1. Average age of inventory
2. Days sales outstanding
3. Emerging payment services
4. Days payable outstanding
5. Corporate cards



Nearly 30% of businesses that were paid late had to take measures to correct cash flow or were forced to delay payments to their own suppliers.[24]

5 WAYS TO OPTIMIZE WORKING CAPITAL (PAGE 1 OF 2)

When it comes to growth and development trajectories, a company should first take a deeper look at its inventory and cash conversion cycle. Consider these practices to help close any cash gaps and boost your working capital.

1. **Decrease the average age of inventory:** Inventory turnover can be important to businesses that sell physical goods, and any inventory should be viewed as cash. Having too much inventory on hand, without the sales to offset it, may tie up your cash flow.
   - **Uphold a "just in time" inventory stock model.**[25]

2. **Decrease days sales outstanding:** The faster invoices head out the door, the greater chance of getting paid sooner. There are a couple ways you could reduce the number of days it takes to collect payments:
   - **Speed up invoicing** — Invoice customers as soon as possible and offer multiple payment options.[26]

3. **Invest in new payment services:** Nearly half of corporations are using or interested in using new and emerging payment services.[27]
   - **Explore immediate payment functions,** such as real-time payments, same-day automated clearing house (ACH) and blockchain, which can assist suppliers in streamlining overall financial operations.

5 WAYS TO OPTIMIZE WORKING CAPITAL (PAGE 2 OF 2)

4. **Increase days payable outstanding:** A company with a higher value of days payable outstanding takes longer to pay its bills, which means that it retains the available funds for a longer duration.[28] It may allow the company an opportunity to utilize the available cash in a better way to maximize the benefits.[29]

5. **Use and accept commercial cards:** In addition to freeing up cash, a company can use commercial cards to enhance security, streamline and control spending, and simplify reconciliation. They also offer opportunities for you company to access additional business tools and programs that can help better manage your working capital.
    - **Explore the added perks of going digital:** Commercial cards work well with businesses' drive to digitize back-end systems and processes[30] by helping to enable payments automation and visibility.

Businesses can maintain a healthy cash flow and optimize their working capital by using corporate cards to pay for expenses they may typically pay for with cash.

For example, small businesses use a credit card to pay for a vast array of business expenses:[31]

73% — Travel, meals and entertainment

64% — Procurement

54% — Online services like web hosting

53% — Advertising and marketing

51% — Operating capital

48% — Insurance

47% — Utilities

OPTIMIZE WORKING CAPITAL WITH COMMERCIAL CARDS (PAGE 1 OF 3)

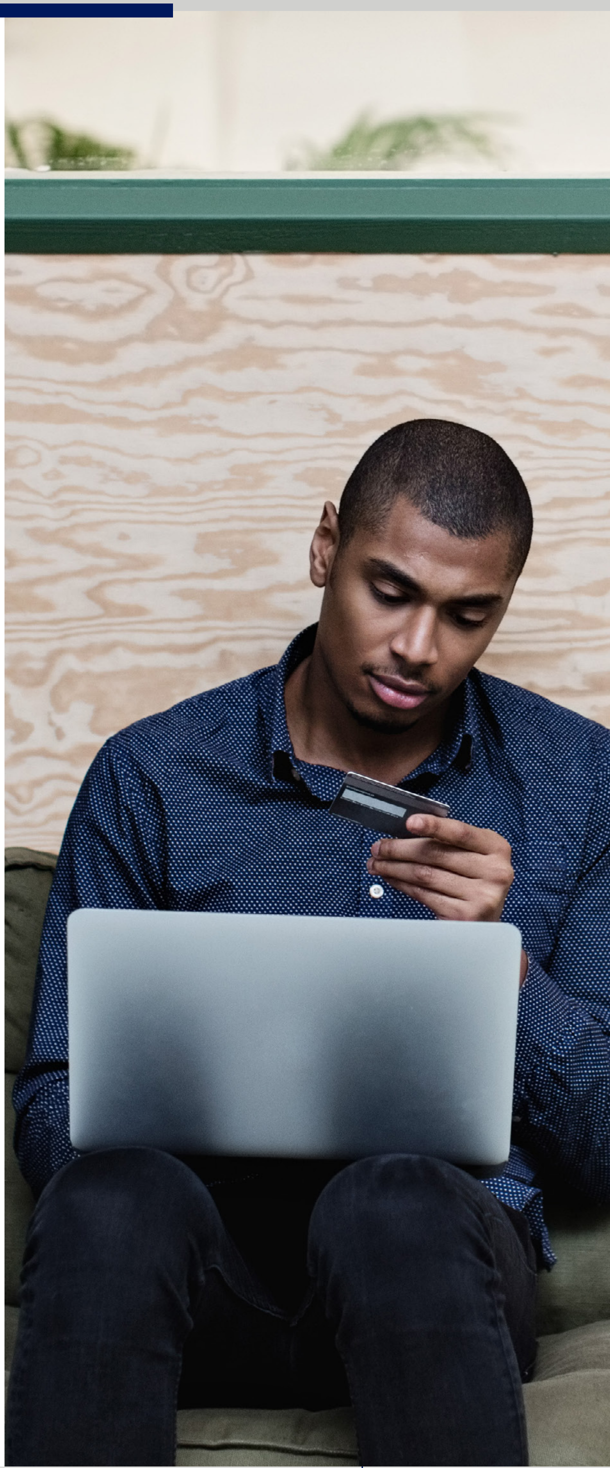
With commercial cards, businesses can have more flexibility to reinvest their cash for growth. Consider the perks for your business — and your customers.

Accepting cards: Benefits for suppliers

Increased security: Secure payments could mean spending less on threat remediation and more on reinvesting those resources elsewhere, such as acquiring new clients. Suppliers that use Enhanced Authorization — a free solution from American Express — typically see increased approval rates, reduced false positives and fraud reduction of up to 60%, while maintaining a seamless customer experience.[32]

Faster payments: Across B2B payments, the use of checks often results in slower transactions and manual processing. Accepting cards can help suppliers optimize their working capital by not only speeding up business payments but also boosting efficiencies.

Simplified reconciliation: Moving to a more automated payable process can help suppliers diversify business channels, bring in new clients and grow volume.[33] Automation can cut costs by 81% and improve efficiency by 73%.[34]



OPTIMIZE WORKING CAPITAL WITH COMMERCIAL CARDS (PAGE 2 OF 3)

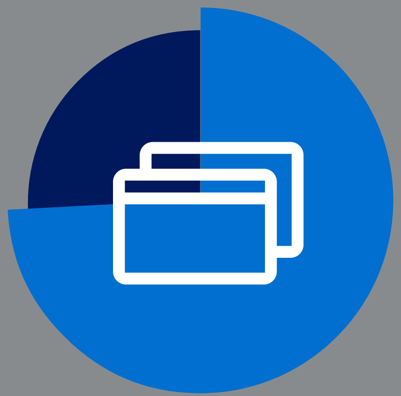
Using cards: Benefits for buyers

Greater spend potential: Buyers will have more freedom to make larger purchases using a commercial card versus drying up their cash on hand.

Faster payments: Cards also offer the ability for corporations to make faster invoice payments, thereby capturing early payment discounts without actually letting go of capital more quickly.[35]

More data insights: Buyers have the opportunity to use corporate cards to obtain expense data and analyze spend habits.[36]

Corporate cards will popularize for business expenses in the US, with volume growing 33% to $763 billion by 2022.[37]



75% of small businesses use business credit or charge cards.[38]

OPTIMIZE WORKING CAPITAL WITH COMMERCIAL CARDS (PAGE 3 OF 3)

Card benefits for suppliers and buyers

Accelerated payments: Quicker payments can help minimize potential cash gaps. With card acceptance, vendors can get paid "significantly sooner" on a cost structure that is more affordable than the cost of factoring their outstanding invoices, while allowing clients to maintain their current days payable outstanding.[39]

Payment flexibility: While suppliers are paid immediately, cards also offer more flexibility for buyers by allowing them to pay on time and still access flexible or extended billing periods. Bonus: Brands that add payment terms to the mix stand to improve customer satisfaction and create opportunities for a boost in business.[40]

Improved customer satisfaction: By bringing aboard the preferred payment options of B2B buyers, sellers have the opportunity to boost buyer satisfaction and even increase average order volume along the way.[41]

IS YOUR BUSINESS READY TO OPTIMIZE ITS WORKING CAPITAL?

From improving your cash conversion cycle to accepting commercial cards, there are numerous ways to ensure your working capital is working for your business goals. With the right steps and smart strategies in place, you can pave the way for your company's long-term financial health, operational success and growth while accommodating buyers' payment needs.

When it's time to start your journey, or when you need a partner along the way, American Express is here to help. We offer innovative solutions — including Buyer Initiated Payments, vPayment and corporate cards — that could help you optimize working capital and grow your business.

WANT TO LEARN MORE?

If you want to find out more about improving your working capital and other important B2B industry insights, American Express can help.

LEARN MORE

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