FIRST BANK OF THE LAKE

Demystifying Working Capital Loans

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What Is Working Capital?

Demystifying Working Capital Loans & Business Working Capital

Choosing the right loans for your small business can help you lower risk, enjoy greater profitability and expand the company commercially. The Small Business Administration (SBA) offers options for business working capital loans designed specifically to assist small businesses in growth capital and managing cash flow more effectively. This guide will answer some of the most common questions about working capital loans, including:

- What are working capital loans?
- What are sources of working capital?
- What is the operating working capital formula?
- Why would my business need a working capital loan?
- What are the SBA working capital loan requirements?

First Bank of the Lake can provide the guidance and options you need to make the right decisions for your small business. We work with our customers to address their concerns and to provide the best solutions for building financial stability for small businesses anywhere in the United States. If you need to find working capital loans, our team is here to provide the support you need for your company's financial future.

What Is Working Capital?

Working capital is an important measure of financial liquidity in business though no single working capital definition will apply to all businesses. In general, working capital comprises the money a company currently has on hand to pay its short-term financial obligations. By familiarizing yourself with the accepted working capital meaning, you can often improve your cash flow situation to build your business.

How do you calculate working capital? The most common working capital formula subtracts the current liabilities of a company from its current assets. Liabilities for working capital may include:

- Accounts payable
- Outstanding wages owed
- Interest owed for loans and other financial obligations
- Taxes
- Overhead expenses and utilities
- Outstanding shorter-term debts

Assets in the working capital equation may include:

- Cash on hand
- Inventory ready for sale
- Accounts receivable
- Marketable securities
- Other assets that can be converted into cash within one year

By subtracting liabilities from assets, you can determine whether your business is operating with positive or negative working capital. By taking the time to define working capital and determine your net working capital ratio, you can manage your operating costs more effectively.

Types of Working Capital

Depending on accounting and banking needs, different working capital ratios and formulas may be needed to assess the financial condition of a business. These working capital ratios offer specific insights into overall business operations and financial stability:

- Permanent working capital: Permanent operating working capital represents the ongoing and consistent working capital needs of the business. This minimum operating working capital must always be available to ensure uninterrupted business operations.
- Regular working capital: The regular working capital of your business is used to support your day-to-day workflows and activities. Also known as trade working capital, regular working capital directly relates to the daily workflows and activities of the business. Accounts receivable, inventory, and accounts payable are typically included as part of the regular working capital ratio or formula.
- Reserve working capital: A company's reserve working capital serves as the emergency savings account for the business. It can be used to defray costs for seasonal shifts in the marketplace, unforeseen expenses and emergency situations. The funds for reserve working capital are typically held in the operating account of the business to ensure ready access.
- Fluctuating working capital: Also referred to as temporary working capital, fluctuating working capital considers variable costs that are under the control of the business. For instance, the fluctuating working capital equation would not include consistent overhead costs like insurance and lease fees but would include purchases that can be timed or performed on the company's own schedule.
- Gross working capital: The gross working capital of your business consists only of the assets that are convertible to cash within one year or less. These may include cash on hand, securities that can be liquidated quickly and amounts owed for services and goods delivered.

Working Capital Strategy

Why Is Working Capital Important for Your Business?

Adequate working capital is essential for business operations. Monitoring fluctuations in working capital can allow your company to adjust to market conditions and ongoing expenses. A healthy net working capital ratio can go a long way toward running your business well with stable, predictable cash flow.

Banks and lenders also look at working capital to get an idea of the financial health of any business. By looking at net operating working capital, lenders can determine whether you are a good risk for investment. Many lenders have established working capital requirements as part of their evaluation of loan applications.

What does working capital mean for a business? Far from being a simple benchmark of your financial success, working capital calculations can also play a significant role in the future growth, cash flow and profitability of a business.

What Is Working Capital Used For?

Working capital is used for many core activities in the business environment. Some of the most common day-to-day uses for these funds are listed here:

- Purchasing inventory or raw materials
- Paying for overhead costs that include utilities, rent or lease fees and other ongoing expenses
- Managing short-term debt
- Meeting payroll obligations
- Paying vendors and suppliers
- Stockpiling growth capital for future expansions

Changes in working capital demands can result from shifts in the economy, evolving consumer and customer needs and other issues that may not be completely within your company's control. Working with a trusted financial partner to obtain necessary working capital financing can allow you to navigate difficult financial situations more easily and can help you build a foundation for future success.

Navigating the Strategic Use of Working Capital

Leveraging your working capital can generate significant improvements in cash flow while reducing storage and overhead costs for raw materials and unsold inventory. In some cases, maintaining a stockpile of available materials can allow faster turnaround times for urgent orders. This can assist your company in building a reputation for great service and reliability, which can potentially pay off in increased revenue and an improved market position.

Taking a close look at your available working capital and ensuring that it is being used in the most profitable manner can often help you and your company achieve greater success now and in the future. In some cases, obtaining a business loan for working capital can provide added help in managing any cash flow concerns now and in the near future.

What Is Working Capital Management?

Working capital management allows companies to manage their cash flows more efficiently to adjust to changes in working capital and expenses. Proactive management of working capital needs requires an in-depth understanding of the business, its workflows and revenue streams. To understand how to manage a company's working capital, it is first necessary to introduce the concept of working capital days, which play a significant factor in the overall cash flow of your business:

- The working capital cycle is defined as the number of days it would take to convert working capital into cash by selling inventory, collecting revenue streams from customers and paying outstanding liabilities.
- By adding the amount of time needed to convert raw materials into inventory to the amount of time needed to sell that inventory, companies can determine the total number of working capital days in their business cycle.
- Working capital days can be categorized as payable days, inventory days and receivable days. Payable days encompass the length of time (sometimes 90 days) that a company has to pay its suppliers. Inventory days are the time needed to produce salable goods. Finally, the time needed to receive payment for these goods is counted in receivable days.
- In general, companies that take fewer working capital days to produce profits are more financially efficient. Improving working capital turnover can have a significant effect on the profitability and long-term prospects of your business.

Keeping a close eye on the working capital turnover ratio can often allow your company to achieve higher profits and greater success in the competitive marketplace. It can also help you manage working capital turnover costs and revenues more effectively.

Definitions & Formulas

Working Capital Ratios

A great way to measure the liquidity of a business is through its working capital ratio.

- Working capital ratio: Often used as a catch-all term for all types of working capital accounting, the working capital ratio simply refers to dividing the current assets of a company by its current liabilities.
- Working capital turnover ratio: a high working capital turnover ratio indicates a company is efficient at turning its current assets and liabilities into sales. Generally, the ratio is calculated as net annual sales divided by average working capital.

Managing working capital effectively depends on an in-depth knowledge of your company and of the various working capital definitions. Working with a trusted financial partner can provide insights on how to calculate working capital and on how to create the right conditions for business growth and cashflow.

What Is Non Cash Working Capital?

Non cash working capital, as its name suggests, is all the current assets of your company that are not held in cash. The non cash working capital formula subtracts all current liabilities from all current assets without considering cash on hand. By determining the amount of non cash working capital held by your business, you can identify assets that can quickly be converted into cash to suit your working capital needs.

What Is Negative Working Capital?

Negative working capital occurs when a company's current liabilities exceed its current assets. When the net operating working capital temporarily goes negative, it can be a sign of a timing issue between accounts payable and accounts receivable. If a company has a negative working capital position for an extended period of time, it may be a cause for concern.

For example, a company that is waiting to pay its suppliers as part of its overall working capital management plan can acquire additional inventory that can produce increased profits later. In this case, the suppliers are essentially providing working capital financing by waiting for payment on their invoices. This method for managing working capital can allow companies to manage cash flow requirements much more effectively over the short term without affecting ongoing working capital needs.

The downside of negative working capital, however, is its effect on the company's perceived financial stability. Companies that consistently pay vendors and suppliers late may technically meet the working capital requirements of their company, but may strain the relationship between the vendors and suppliers in the long term.

Other Working Capital Formulas, Definitions and Details

A few other formulas are at the heart of working capital accounting.

- Working capital: This is the simplest formula and simply subtracts all current liabilities from all current assets.
- Operating capital: Operating capital is determined by subtracting operating current liabilities from operating current assets. It is used to determine liquidity for a business.
- Change in working capital: This formula subtracts the working capital from the previous year from the working capital available for the current year. It is useful for identifying trends in your company's financial health and revenues.
- Net working capital: Usually, net working capital can be used interchangeably with working capital. However, net working capital can sometimes be defined by a more narrow definition. By removing cash and debt from the equation, this formula is often used as a reliable benchmark of the company's health. Simply subtract current liabilities excluding debt from the current assets exclusive of cash on hand.

Each of these formulas has a specific purpose in working capital accounting. Understanding how to use them and what they mean for your business can provide a framework for running your business.

Finding Working Capital

Where Can I Find Working Capital?

Locating the right sources for a working capital loan can be a challenge. Our team has the experience and knowledge needed to assess your current financial situation and to recommend the best SBA working capital loans.

Top business publications outline specific ways in which a newer business owner can access funding for their company:

- Angel investors and loans from friends or family can sometimes provide necessary funding. These sources can have long-term repercussions, however, and may not be available to all small businesses.
- Partnership with a fintech company can sometimes allow businesses to access start-up cash for their operations.
- Working capital lines of credit are a popular choice and can provide flexibility for companies that use these financial tools responsibly.
- Business credit cards are a common choice and can provide access to revolving credit for working capital expenses, but have a significant disadvantage with high interest rates.
- Small business loans are one of the most cost-effective options. By exploring SBA loans for your small business, you can access better interest rates and a wider range of choices when selecting a funding solution for working capital.

First Bank of the Lake is one of the largest SBA lender banks in the US and can facilitate your application for SBA working capital loans. By working with professionals with a track record for success, you can increase the odds of accessing SBA 7(a) working capital.

What Is a Working Capital Loan?

SBA working capital loans are generally 7(a) loans used for working capital to fund everyday expenses for small businesses. These can include advertising, marketing, payroll, the purchase of materials and inventory and many other short-term expenses. The SBA offers both 7(a) and 504 loans. However, 7(a) working capital loans are used to pay these ongoing expenses. SBA 504 loans, by contrast, are designed to help small businesses acquire fixed assets, such as real estate and equipment for their operations. While it may be possible to obtain working capital through the SBA 504 program, it is difficult and is less likely to achieve the desired goals. As a result, 7(a) loans are much more common as a way to access working capital.

What Are Working Capital Requirements?

Defining your working capital requirements is an important first step in proactive financial management for your company. Collecting information on your company's regular and occasional expenses and expected revenues will allow you to plan more effectively for your financial future.

Disadvantages of Low Working Capital

Low working capital can create serious issues for your company. Some of the most common problems associated with a consistent lack of working capital are listed here:

- Loss of productivity: If your business has insufficient cash on hand, you may not be able to meet your obligations to pay employees and vendors. This can lead to unplanned downtime and other issues that can severely affect your business.
- Failure to grow: Inadequate working capital can reduce the ability of your company to expand and grow.
- Damage to your reputation: Missed deadlines, missed payments and failure to meet targets can have a catastrophic effect on a company's public reputation.
- Inability to take advantage of opportunities: As a business owner, taking advantage of short-term opportunities for growth can make or break a company. Failure to maintain positive cash flow and a reserve fund can reduce your ability to benefit from these opportunities, which can put you at a significant competitive disadvantage.

Working capital banks are a great resource and can provide information on how to find working capital solutions that will work for you. This can help your company avoid these drawbacks and stay profitable and productive on a consistent basis.

Working Capital Examples

Different companies may have significantly different working capital cycles and revenue streams. For instance, a restaurant may have a very short working capital cycle compared with a manufacturing firm. Service providers like repair companies may have fewer operating expenses and liabilities than comparable retail businesses. Here are a few working capital examples to consider:

- Manufacturing Company Example – A manufacturing firm has $100,000 of current assets, including cash on hand and liquid securities, and has only $40,000 in current liabilities. This leaves $60,000 in working capital to manage future growth.
- Restaurant Example – A restaurant must pay for the groceries and supplies needed to produce meals. Combined with salaries, utilities and marketing costs, this adds up to $500,000 each year in current liabilities. Because restaurant traffic is seasonal, a reserve fund will also be necessary to ensure that adequate working capital will be available at all times during the year. In this working capital example, the restaurant will need to exceed $500,000 in revenues to meet its requirements and maintain a positive operating working capital formula.

- Service Provider Example – An HVAC repair business has a fleet of vans, salaries, insurance and transportation costs. An inventory of commonly used parts are among the assets included in calculating the working capital of the business. Fees received from customers constitute the bulk of the company's current liquid assets. Because the working capital cycle is so short and the cost of goods is passed on to customers, service providers can accommodate most fluctuations in working capital more easily than the other two examples.

Accessing affordable sources of working capital can be a challenging prospect for some businesses. The Small Business Administration offers working capital loans designed to provide funding for those companies that can meet their requirements for approval. SBA enforces strict qualification requirements for applicants.

SBA Working Capital Loans

SBA Working Capital Loans

The Small Business Administration offers solutions for small and growing businesses that include working capital loans designed to help businesses manage cash flow concerns. An SBA 7(a) working capital loan can provide valuable assistance in managing your cash flow. At First Bank of the Lake, we offer assistance in applying for SBA working capital loans and other small business loans for working capital needs. Our team can show you how to find working capital solutions that are a good fit for your needs.

How Do SBA Working Capital Loans Work?

An SBA 7(a) loan for working capital is structured to provide added guarantees for lenders who participate in this program. An SBA working capital loan can be used for a variety of purposes, including the following:

- The acquisition, refinancing or improvement of real estate and buildings
- Both short and long-term working capital
- Refinancing company debt
- Transferring ownership on a complete or partial basis
- Purchase of machinery and equipment
- Purchase of furnishings, fixtures and supplies
- Acquisition of raw materials or inventory
- Any combination of the above activities

The maximum loan amount for an SBA 7(a) loan for working capital is $5 million. These loans are not provided by the SBA directly; instead, a participating lender will work with you to determine which working capital solution is best suited to your needs and your qualifications.

A Simple Working Capital Example

To understand how working capital affects the operation of a company, we can look at the Vita Coco Company, a food and drink manufacturer specializing in coconut water products for consumers. Figures released in 2021 indicated that the company's available working capital decreased by $37.2 million. A similar decrease was reported in 2022 with a reduction of $29.4 million in working capital. 2023 showed a significant upturn in working capital for the company with an increase of $50.3 million based on increased revenues for the third and fourth quarters of 2023.

With an estimated $495.5 million in revenues and an operating income of $68.7 million, Vita Coco Company is improving profitability after a challenging start. By tracking the working capital available to the company and comparing it with net income, operating cash flow and other financial factors, you can see that the company's working capital has a significant impact on the overall success of this business.

SBA Working Capital Loan Requirements

When applying for a small business working capital loan, it is important to keep the eligibility requirements for these loans in mind. SBA working capital loan requirements include the following:

- Your business must operate for profit within the United States.
- The business must meet SBA size requirements for a small business.
- It must not fall into a category of ineligible businesses. Some ineligible business categories include life insurance companies, pyramid sale distributors, government-owned businesses, loan packagers, non-profit organizations and certain gambling enterprises.
- Your business must be creditworthy and able to repay the loan.
- Finally, your company must be unable to obtain the necessary credit on reasonable terms from other lenders not affiliated with government agencies.

The SBA working capital lending program allows select lenders like First Bank of the Lake to offer loans for small businesses that could otherwise not access these funding options. By applying for an SBA working capital loan, you can enjoy access to a range of lending options that are better suited to your needs.

Why Should You Get a Working Capital Loan?

A loan for working capital could be the right choice for your business. Here are some of the most common reasons our customers give for seeking these loans:

- Meeting payroll expenses: Businesses that are expanding or having high demand for their products and services, can experience challenges meeting payroll. By opting for a working capital loan, companies can often overcome short-term cash flow issues to ensure ongoing productivity and profitability.
- Paying for utilities and rent: Working capital loans can also be used to manage rising utility costs, rent or leasing fees. If these overhead costs are excessive, it may make sense to relocate or to upgrade your facilities to reduce these costs for greater profitability.
- Managing debt: Working capital can also be used to pay down debt or to manage monthly debt payments during periods of reduced revenues. Since 7(a) loans can have lower interest rates than some other forms of debt, they can also provide financial benefits for companies that use them to pay down debts with higher interest rates.
- Navigating seasonal fluctuations: Businesses that are primarily seasonal in nature may benefit from increased working capital to manage expenses during the off-season. A 7(a) loan could be an ideal solution for companies that make most of their money during a specific season or seasons of the year.

- Purchasing raw materials and inventory: Manufacturing firms require a steady supply of raw materials to produce inventory for sale. Depending on the length of the company's working capital cycle, however, a source of funding may be necessary to meet vendor payment deadlines while waiting for payment from customers at the other end of the process.
- Taking advantage of opportunities: For some small businesses, a 7(a) loan can provide funds to take advantage of limited-time opportunities. These may include the chance to purchase real estate or raw materials at a discounted price. An SBA loan can provide the necessary funds for these and other advantageous purchases.

First Bank of the Lake can provide you with a clear picture of the advantages of SBA 7(a) loans. We have extensive experience with these loans and can offer valuable guidance for you and your business.

How the SBA Loan Process Works

When you choose an SBA working capital loan from First Bank of the Lake, we work with you at every stage of the loan process to assist you in choosing the right loan and creating an application likely to succeed.

- Application – First Bank of the Lake is an experienced SBA Preferred Lender, and can provide the details about what is required for SBA 7(a) loans and whether you are likely to qualify. For an SBA loan, typically a business plan, tax returns, financial statements and supporting documents are needed for the application.
- Underwriting – We perform in-house underwriting that takes an in-depth look at your specific set of financial needs. Our due diligence allows you to enjoy faster decision times and to approve your loan more quickly if you qualify. Because we have extensive experience in all types of SBA loans, we can streamline the underwriting process.
- Closing – Once the loan is approved, we make closing easier with a dedicated closing team that ensures your process goes smoothly.
- After Closing – Our involvement does not end with the SBA Loan. We are always here to answer questions and to support your company's financial journey. If you need a consultation with our team or ongoing communications about your loan application or your current loan, First Bank of the Lake is always here for you and your business.

Our team of dedicated financial experts can help you determine what type of 7(a) loan you need and can assist you in qualifying for these government-backed loans.

7A Loan Programs from First Bank of the Lake

SBA Loan Programs From First Bank of the Lake

Our team offers two main programs for SBA loans that can be used to boost working capital – the standard 7(a) loan program and the 7(a) small loan program.

7(a) Loans	
Maximum Loan Amount	$5 million
Percent of Guaranty	85% guaranty for loans of $150,000 or less; 75% guaranty for loans greater than $150,000 (up to $3.75M maximum guaranty)
Eligible Use of Proceeds	Term Loan. Expansion/renovation; new construction, purchase land or buildings; purchase equipment, fixtures, leasehold improvements; working capital; refinance debt for compelling reasons; for inventory or starting or purchasing a business. Only owner-occupied commercial real estate is eligible.
Maturity	Depends on ability to repay. Generally, working capital not to exceed 10 years; Equipment, fixtures, or furniture not to exceed 10 years. Except term may be up to 15 years if IRS asset class useful life supports longer term. Lender must document in credit memo justification of any term that exceeds 10 years; real estate up to 25 years. No balloons or demand features permitted.
Maximum Interest Rates	Effective Jan. 1, 2025 $50,000 or less Prime + 6.5% $50,001 - $250,000 Prime + 6% $250,001 - $350,000 Prime + 4.50% $350,001 and greater Prime + 3%
Who Qualifies	Must be a for-profit business & meet SBA size standards; show good character, credit, management, and ability to repay. Must be an eligible type of business. Prepayment penalty for loans with maturities of 15 years or more if prepaid during first 3 years. (5% year 1, 3% year 2 and 1% year 3)
Benefits to Borrowers	Long-term financing; Improved cash flow; Fixed maturity; No balloons; No prepayment penalty (under 15 years)

7(a) Small Loans Is any 7(a) loan $500,000 and under, except the Community Advantage and Express loans	
Maximum Loan Amount	$500,000
Percent of Guaranty	Same as 7(a) Loans
Eligible Use of Proceeds	Same as 7(a) Loans
Maturity	Same as 7(a) Loans
Maximum Interest Rates	Same as 7(a) Loans
Who Qualifies	Same as 7(a) Plus, all loan applications will be credit scored by SBA. If not an acceptable score, the loan can be submitted via full standard 7(a) or Express.
Benefits to Borrowers	Same as 7(a) Loans

Borrowers can choose from several SBA 7(a) loan types when applying for funding through SBA 7(a) lenders. Some of the top SBA 7(a) programs are explained here:

- 7(a) Standard Loans: As one of the most common of the SBA 7(a) loan types, this program offers 85-percent guarantees for loans of $150,000 or less and 75-percent guarantees from SBA for loans over $150,000 and up to $5 million and allows for a wide range of eligible use of proceeds.
- 7(a) Small Loans: 7(a) lenders also offer small loans of $500,000 and under. The percentages guaranteed by the SBA to 7(a) lenders is the same as for standard 7(a) loans. SBA 7(a) requirements may be more streamlined under a 7(a) small loan program.
- 7(a) Express Loans: The SBA Express Loan program features a maximum loan amount of $500,000 with a 50-percent guarantee provided by the SBA. Revolving lines of credit may be available for up to five years of a 10-year overall duration. 7(a) lenders decide whether borrowers qualify for these 7(a) loans.

Other SBA 7(a) programs include the Export Working Capital Program, 7(a) International Loans, and CAPlines. Pilot loan programs have also been introduced by the SBA and 7(a) lenders to assist small businesses located in depressed or underserved markets. Also known as Community Advantage loans, these SBA 7(a) loan programs expired in September of 2023.


First Bank of the Lake

Finding a Working Capital Bank Partner

The right lender can make a significant difference in your company's financial situation. At First Bank of the Lake, we analyze your company's finances to ensure that you have the information you need to make the right decisions for your business.

First Bank of the Lake can assist you in finding the right SBA working capital loan to suit your needs. As a nationwide SBA 7(a) Preferred Lender, we can help you navigate the process of selecting and applying for an SBA loan for working capital. We are here to help you manage your funding needs now and when you need us most.

Why Choose First Bank of the Lake for SBA Loans

Our status as a nationwide SBA Preferred Lender allows us to make the final credit decision on SBA loans – streamlining the underwriting process by not waiting for the SBA itself to review and approve your loan. Our focus on customer service ensures that your loan request receives our full attention. As your business evolves, we stay with you to make sure that you have the right solutions for your changing needs.

By choosing us for SBA loans, you can enjoy the benefits of our experience and expertise. First Bank of the Lake offers loans nationwide but takes a personal and local approach to every customer we serve. In addition, we have deep experience with veteran-owned businesses, franchises, professional services and many medical related businesses. We are one of the largest providers of SBA franchise loans and our veterans loan group is staffed entirely by veterans.

Putting It All Together With First Bank of the Lake

At First Bank of the Lake, we have been serving customers for almost four decades. We are located in the beautiful Lake of the Ozarks and offer SBA Loans for businesses anywhere in the US. For 7(a) working capital SBA loans, our team can quickly assess your financial situation and provide you with the best solutions for you. To learn more about your loan options for a small business loan with us, give us a call today at (888) 828-5689 or visit us online to touch base with our skilled financial team. First Bank of the Lake is here to serve you now and when you need us in the future.

Get Started Today

Contact us today to learn more about how government-backed SBA loans can help you grow your business.

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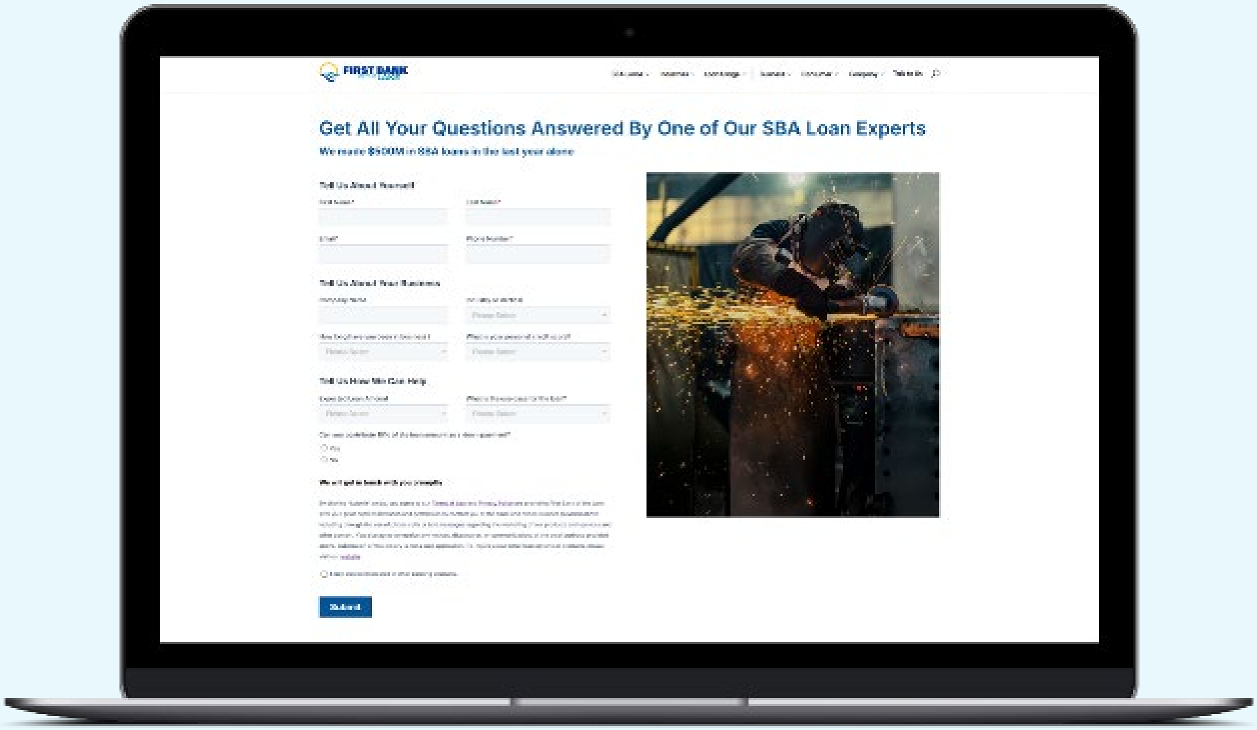

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