

Upcoming  
Events

**MBBI Illinois Event**  
**Summer Rooftop Networking**  
August 8, 2017 | 4:30 to 7:00 PM  
185 N. Franklin St. Fifth Floor  
Chicago, IL 60606

**IBBA MBBI Event**  
**Pricing and Recasting**  
**Educational Summit**  
August 28-30, 2017  
1515 E. Woodfield Road  
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## MBBI Newsletter July 2017 Working Capital Confusion

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**BOOTSTRAP CAPITAL**

In the transactions we pursue, the negotiations concerning working capital are often the most difficult. It can be easier to settle on the overall purchase price than to agree on how to treat working capital. We can spend weeks working through the theory of why a going concern needs working capital to operate, agreeing on how to calculate it and setting a net working capital target. More than once, we have had to bid for only the hard and intangible assets of a business in order to avoid the discussions around working capital altogether.

### Why is Working Capital so Troublesome?

It is unclear exactly why working capital is such a troublesome topic in the lower middle market, but there seems to be a confluence of factors all playing a role.

1. Working capital is not something an entrepreneur actively seeks to create. Rather, it's something that naturally develops in the business and may not get much attention along the way;
2. Working capital is not reflected as a single line item on the financial statements, nor is it a fixed investment number. Rather it is comprised of many accounts which can be volatile, especially in project-based or seasonal industries. As a result, it is hard to think about it in summarized and static terms;
3. Sellers feel like they have "earned" the net investment in working capital and do not think of that investment in the same terms as the investment they made in equipment;

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4. Business education tends to focus much more heavily on how to value companies than the composition of the balance sheets needed to operate their underlying businesses; and

### Why Not Buy the Business Without Working Capital?

The simplest solution can be to bid for just the fixed and intangible assets and let the sellers keep the working capital. We have done that, for instance, by offering a price for the "base business" and also to buy the inventory balance at closing for book value. This can help avoid the confusion around working capital, but it is not ideal.

One problem is that it can make our bids look lower than other offers. When we bid for the base business, we simply subtract the working capital target amount from our enterprise value. If other bidders are bidding for all the assets, their bids may appear more attractive. And, if we get a chance to explain why our bid is lower, it may open up the whole working capital discussion we were hoping to avoid.

The other problem is more operational in nature. After we purchase a company, we want to control the interactions with customers. In asset deals, when we are opening new bank accounts, we also want to minimize the confusion about where to send payments. When we do not purchase the working capital, the sellers sometimes feel entitled to receiving customer payments and are less willing to let us collect them on their behalf, creating confusion among the customers.

### Recommendations

We do not know of a silver bullet for negotiating working capital. Our perspective is that it is a topic that simply requires patience, dialogue and flexibility. We believe that industry associations and accreditation authorities could make considerable headway in reducing the time dedicated to working capital negotiations by developing educational material and other resources for sellers, buyers and professional advisors alike.

**John Honney** is a Managing Director for Bootstrap Capital John is a Member of the MBBI Board of Directors. You can reach John by phone at 312.735.7534 or by email at [JHonney@Bootstrap-Capital.com](mailto:JHonney@Bootstrap-Capital.com)

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