How Working Capital Impacts a Business Sale

When you're buying or selling a business, one of the most important numbers in the deal isn't always the purchase price, it's the working capital. How it's defined, calculated, and agreed upon, can have a big impact on both sides of the table.

When buying or selling a business, the way working capital is defined can significantly affect the transaction price. Typically, it's calculated on a cash-free, debt-free basis, current assets minus current liabilities, while excluding cash and tax related accounts.

Since working capital fluctuates daily, parties agree on a net working capital target. The target is usually based on a historical average, often over 12 to 24 months, though other periods may be used depending on seasonality or growth trends. The agreed net working capital target may be structured as a fixed number or as a target range. The goal is to deliver enough working capital to keep the business functioning smoothly right after closing.

Once the deal closes, an actual working capital figure is measured, often 30 to 60 days later, and compared to the agreed target. If actual working capital exceeds the target, the buyer pays the seller the difference. If it's lower, the seller refunds the buyer proportionately. this “true-up” mechanism helps protect both parties from over or underfunded operating capital.

Negotiating working capital involves more than just a simple formula. You'll also want to pay attention to seasonality and growth, non-operating items, and quality of balances. Take into account seasonality and growth by choosing a target period that accurately reflects the business cycle, especially if past months may overstate or understate typical needs. For non-operating items, exclude one-time or related party balances that aren't part of day-to-day operations, such as capital expenditures or internal receivables. When thinking about quality of balances, evaluate accounts like receivables, inventory, and payables, to avoid skewed working capital numbers. Documenting these definitions up front makes it less likely that disputes will arise later.

Working Capital negotiations directly affect the value exchanged in a business deal. A sound approach that is built on agreement around definitions, thoughtful target selection, and clear “true-up” terms can make all the difference. If you're getting ready to buy or sell, having these conversations early with your advisor or broker will help set expectations and reduce surprises down the road.