Working capital management

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Working capital

Working capital is the cheapest and most accessible finance available. It provides businesses with a crucial opportunity to pay down costly debt and regain borrowing headroom.

A focus on working capital can help management drive transparency and accountability throughout the organisation. Most companies focus on reducing debtor days and bringing down inventory instead of a whole-of-business-approach to working capital. Many organisations are struggling to understand and institutionalise the cultural and structural changes to enable long term benefits from working capital reduction.

Create long term value

Focusing on working capital provides managers with the opportunity to create lasting value. Working capital is a lens through which management can examine their organisation's productivity and efficiency. Implemented correctly, working capital management will make companies stronger tomorrow than they are today.

In order to permanently improve working capital, companies need to take a cross-organisational view of the cash conversion cycle including purchase to pay, forecast to fulfilment and order to cash. They need to break down and scrutinise the individual components of the entire supply chain and then piece it back together in a way that creates a lasting step change in cash efficiency.

This enables companies to refocus away from purely growth-oriented processes which were developed during the economic boom towards more cash efficient ways of doing things.

A 'whole-of-business' approach

The fundamental problem with tackling working capital improvement is that typically no one person looks after it. The responsibility for billing and collections, sales contracts, procurement and logistics typically reside in different parts of the business that may have competing agendas. Sales people want to offer good credit terms and access to readily available stock, finance want short credit terms and lowest possible inventory investment.

If companies want to shrink the cash conversion cycle they need to get everyone in the supply chain-from procurement to production and treasury through to customer service, working together and thinking like a CFO.

Our experience has shown that companies can best manage working capital by creating cross functional teams with business unit sponsors. This helps create a common view and shared responsibility for outcomes.

Team members need to collectively agree on cash targets and key performance indicators. This ensures that every team is held accountable to each other and to the organisation. Also it is critical that non-performance has consequences, reward and compensation need to be tied to these collectively reached cash-flow targets and KPI's.

The myths and realities of working capital

Until companies have done the required analysis and possess the data required to turn myth-based decisions into fact-based decisions, they will not achieve true cash conversion efficiency.

Overcoming the myths of working capital initiatives are key to success:

Working capital reduction is all about easy 'quick wins': Quick wins are good as far as they go. But without a wholesale process and cultural change they are just that – quick wins –easily dissipated and with an impact that is all too short-term. Management need to make working capital changes stick to drive a sustained increase in profitability and value.

Working capital reduction is just a balance sheet challenge: Working capital is a 'whole-of-business' problem. Speeding up the cash conversion cycle is a function of all parts of the business.

Working capital reduction is a CFO issue: Yes, the CFO sees the benefits, but in fact the only way to optimise cash is to get everyone in the organisation thinking like a CFO. For example, if the warehouse manager understands the impact on the bottom line of overstocking and if business unit leaders are accountable for cost of funds, working capital will decrease.

Working capital reduction is rocket science: We believe the secret to simplifying the working capital conundrum is to focus on capturing and tracking the cash benefits that flow from specific changes.

Working capital reduction is a one-dimensional exercise: Working capital management is a strategic process that runs through the organisation. It addresses issues from culture and mindset, through to data quality and management, policy and procedural compliance, and the effectiveness of systems.

Working capital reduction means shifting the burden to suppliers through accounts receivable and customers through accounts payable: Managing supply chain payments are an important part of working capital management, but organisations do not exist in a vacuum. The impact your organisation has on its supply chain partners is a crucial strategic element that must be integrated with the 'whole-of-business' perspective.

Asset

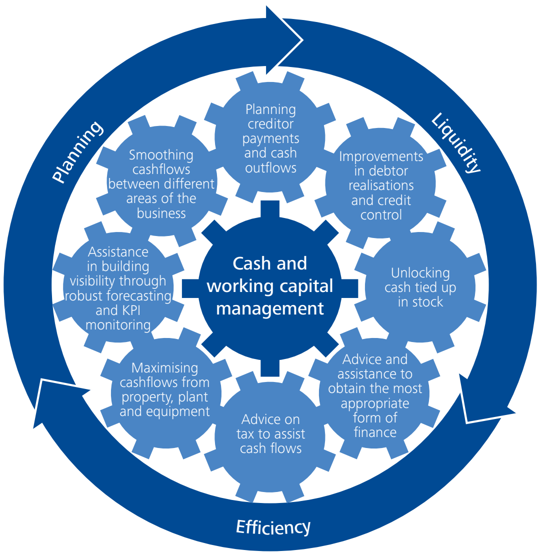
Our approach to working capital

At Deloitte, we see working capital management as a continuous cycle that moves from planning, through liquidity to efficiency and back again.

Each of these phases incorporates its own actionable segments, together building the whole-of-business perspective that guides the entire process.

The **Planning** phase is based on creating a cash flow mindset. It integrates a cash flow thinking through the organisation by developing robust forecasting processes and appropriate performance measures. This involves planning cash outflows and supply chain interactions. Companies need to understand what cash flow interactions cost the company's working capital and work through how to make these interactions more cost effective.

The **Liquidity** phase includes identifying quick wins and determining how to cement these for a long-term step change in value. This includes making improvements in debtor realisations and credit control, unlocking cash tied up in stock, as well as revisiting financing arrangements in order to identify the most efficient and appropriate form of financing.



The **Efficiency** phase embeds the financing changes. Companies can achieve major cash gains by addressing the funding of its infrastructure and maximising tax planning opportunities.

Creating a cash flow mindset

Companies need to build a cash flow mindset that is integrated throughout the organisation from the shopfloor through to the executive suite.

Remove the emotion: Early in the planning phase, management needs to determine what success will look like and how it can be measured. Targets and KPIs need to be determined and communicated, consistently measured and tracked. Achievements must be rewarded and non-performance acted upon.

Sweat the deal: Managers need to examine their organisations through their cash goggles – find out where cash is locked, and plan how to permanently release it. Decisions must be based on objective analysis.

Act like an entrepreneur: Not every decision will be the right one, but acting will move the company in the right direction faster than prevaricating. Managers need to create the appropriate sense of urgency. 'Quick wins' remain important but failures too should be quick and cheap.

Build on successes – communication is critical. Celebrate the wins to overcome inertia in the organisation and energise teams.

Cement the change: Build working capital teams throughout the organisation. These teams need to be equipped with robust forecasting tools, shared goals and common working capital related vocabulary.

This is hard work but taking an enterprise view of the company's working capital management will focus the organisation squarely on cash management.

Working with Deloitte

Deloitte helps you optimise cash and liquidity and manage your working capital. We have helped clients realise billions of dollars of liquidity by combining the delivery of quick wins in the short term with sustainable structural changes in the long term.

We have the experience and frameworks to dissect your business and see exactly where cash is being trapped so you have a real understanding of the issues that you are dealing with.

Our 'hands on' approach and strong analytics will help you understand why cash is locked up in your business and what process changes need to be implemented to manage the blockage. Our team of experts will understand and focus on your highest priorities to improve free cash flow.

Our methodology helps companies gain clarity on business performance and be well placed to identify drive and track working capital efficiencies to secure and sustain working capital optimisation.

We also train companies in cash flow management to ensure that we leave behind not only an organisation with efficient processes but a team of people who truly understand how to manage working capital and continually drive incremental efficiency.

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