

The Benefits of Working Capital Optimisation for Finance Directors

Introduction

There is probably no aspect of any business organisation that cannot be improved by at least 10% if the right expertise is applied to it.

And there are some areas that can be particularly rewarding, more than justifying the application of the time and expertise.

Working Capital – Well Worth Improving

It is well known that working capital is an area that must be kept under control, but with the right expertise it can be a rich source of cash release.

The following is an example of a service business unit carrying some modest stocks:

Annual Sales	€ 100m
Average Receivables	15 (55 days/sales)
Average Payables	11 (40 days/sales)
Average Inventories	5

Let's assume we can make a permanent improvement of just 10% to the way this business manages its receivables, payables and stocks. A permanent improvement of 10% will release € 3.1m from the gross working capital of € 31m.

The permanently released cash can be used for debt reduction, re-investment or return to shareholders - it enhances the value of the business "dollar for dollar".

As a result of making the improvement this business becomes more efficient, return on capital is increased, and management's cash flow targets are exceeded.

Working Capital Optimisation – 10% *Plus*

Our experience in running Working Capital Optimisation in a range of different businesses shows that a 10% improvement tends to be at the lower end of the range achieved. Some of our client businesses have generated up to 25% improvement in their working capital numbers - equivalent to a release of up to € 7.8m in the above example.

How do we do it?

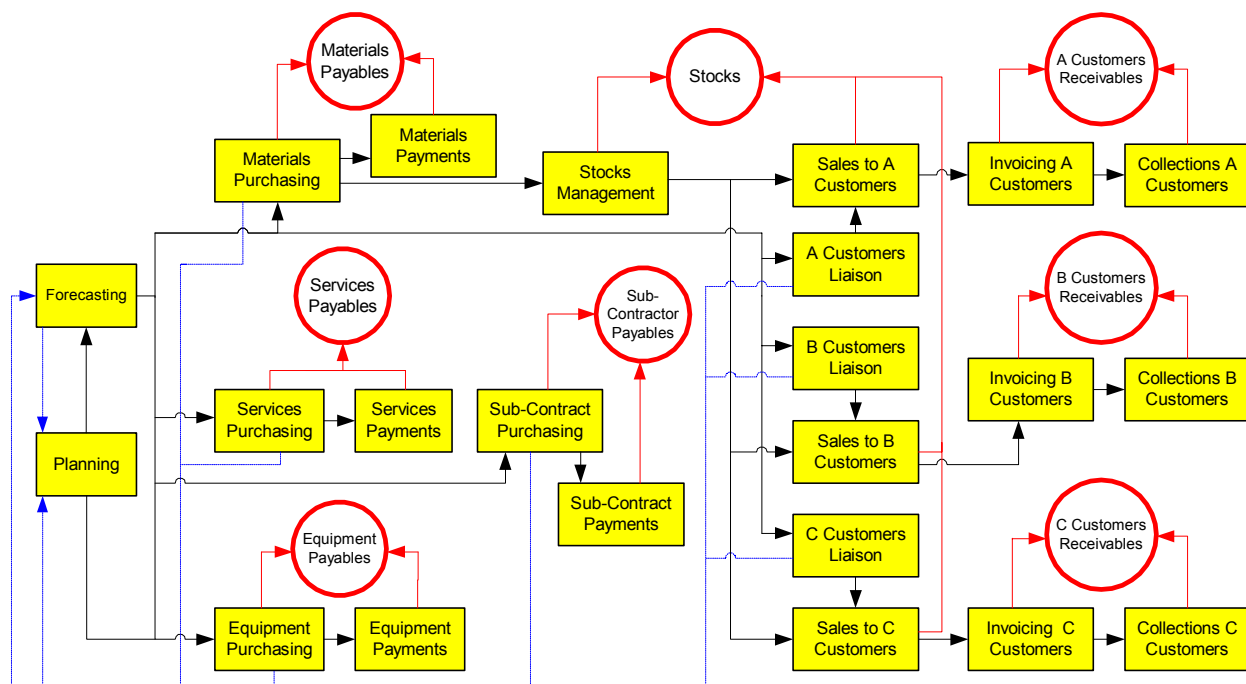
As a business process, working capital is driven by an interlinked series of activities we refer to as a working capital *chain*. Working Capital Optimisation uses what we call a

holistic approach – exploring the detailed processes along the chain and improving the management of working capital from end-to-end.

It helps to see an example of a working capital chain.

The Working Capital Chain

Set out below is a schematic example of the working capital chain for a relatively simple service business carrying some modest stocks:



This schematic shows (in the yellow activity boxes) planning and forecasting driving materials, services, sub-contractors and equipment purchasing. Customer liaison and sales are dealing with different customer categories, and sales are then being invoiced. The collections function is obtaining and, often, making payments. Various sales, liaison and purchasing functions are then inputting back round into planning and forecasting.

A number of these activities are directly driving pockets of working capital (shown in the red circles). But because of all the inter-linking, almost every activity in this chain is involved, either directly or indirectly, in driving or influencing the size of each of the pockets of working capital, and hence the total working capital.

The above schematic shows a relatively simple service business - a manufacturing business will be significantly more complex.

The Finance Director's Problem

Working capital is usually seen as a “financial” matter, and the Finance Director is therefore seen as responsible for ensuring working capital is best managed.

However, as the schematic shows, working capital is mainly driven by people in commercial, not financial, roles. Indeed, the Finance Director suffers from a number of difficulties in fulfilling this responsibility, including:

1. no direct participation in the day-to-day activities actually driving the working capital chain;
2. the ability to spot when things are going seriously wrong, but not the tools to improve “normal” working capital;
3. a lack of visibility of all the right detailed numbers;
4. many other very important things to do.

Although no one person in the organisation has the benefit of the full working capital picture, nor the ability to change the processes involved in driving it, the Finance Director is very much the right person to take the lead in introducing Working Capital Optimisation.

What's the Answer?

N&G specialises in analysing the whole working capital chain and then working with the key people who drive it to enable them to discover improvements.

The key features of this process are:

- it involves the people driving the working capital chain;
- it raises their awareness of the value of time in relation to working capital;
- it shows them the processes they are involved in and how they are performing financially;
- it provides a structure within which they can identify and explore problems and opportunities;
- it enables them to discover how to change permanently what they are doing in order to release cash, both through improvements in internal processes and through changes in the way they trade externally;
- and, crucially, it motivates them to implement those changes.

Conclusion

Improving working capital management by as little as 10% can generate significant cash release, and this is possible even when no obvious working capital problem exists.

Working Capital Optimisation provides a particularly successful approach, enabling substantial cash-releasing changes to be identified, motivating the people who need to make the changes and leading to improvements of at least 10%.

The rest of the company looks to the Finance Director to ensure working capital management is optimised, and the Finance Director can look to N&G to provide the tools and the structure needed to produce some dramatic results.

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