



Financing starts at home, not with the banks

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Overview

Working Capital and its metrics are some of the most important Key Performance Indicators your business has. They show how a whole range of important functions are performing – or failing to perform. And they give a pretty good prognosis of the well-being of your business.

Working Capital is therefore simply too important to restrict to the Finance Function alone. Every manager should know something about their operation's Working Capital performance. They should know what it means, whether it is strong or poor and what actions to take to improve it.

The Cash Culture

Historically, many Senior Executives have considered borrowing their way out of operational difficulty as a legitimate course of action. The cash culture, by contrast, encourages everybody to look for areas where cash can be realised and released, ultimately deriving a potential further increase in shareholder value.

Marginal benefits or mainstream impact?

The Financial Times recently estimated that the annual cost to Eurozone companies alone in lost profit deriving from capital costs is around €65 billion. Across the enterprise, from sales and operation planning to supply chain, money is being tied up as Working Capital. Yet it is neither doing real work nor offering any real value as capital. In times of easier credit access, these 'sleeping losses' may have been overlooked. But those times have gone.

For today's business executive, the key question becomes not just how much profit is being made on paper, but how much cash is being generated.

What are the danger signs?

Poor cash flow visibility, high debt levels, frequent cash calls to bank and parent company and high or obsolescent inventory levels are just some of the important indicators of a Working Capital malaise.

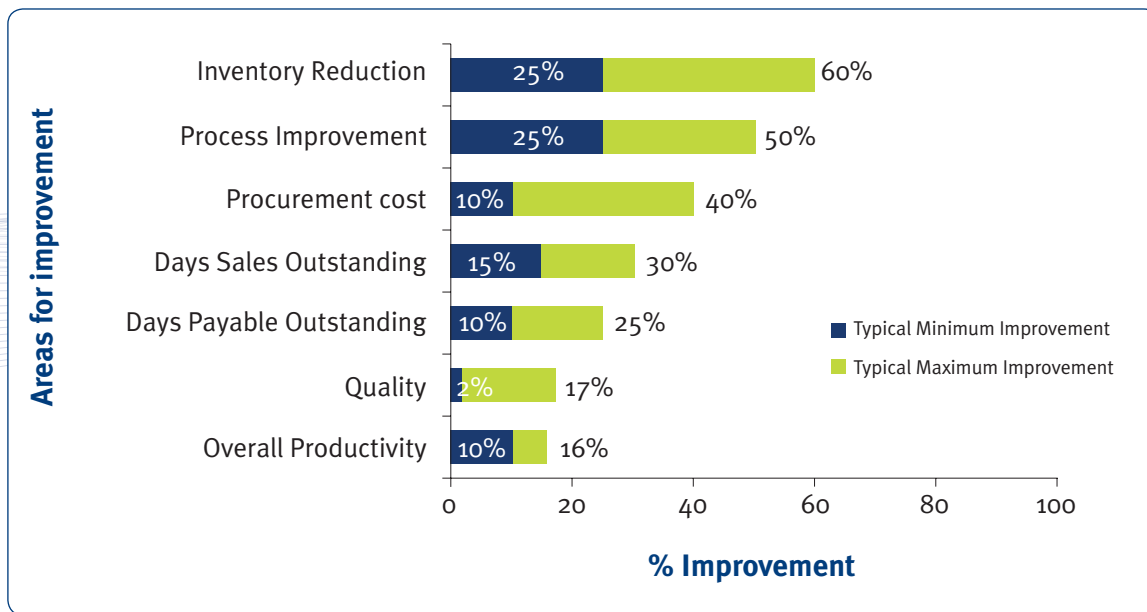
Can you fix it?

Yes. Improvements in Working Capital metrics, often up to 40% are possible and have been proven. The answer doesn't lie in balance sheet manipulation alone. It is to be found in the heart of your operation, through building a real and sustained cash culture right across your business.

Why change your approach to Working Capital?

Working Capital is a vital sign of the health of the whole operation. Its three core elements – payments made, payments received and inventory – are all directly influenced by processes elsewhere in the business.

Yet Working Capital still does not enjoy the same visibility as other key business metrics. Often it is not universally understood by a broader audience beyond the Finance Function. And its language is unfamiliar to many of the people at the heart of the business. The tendency is to ‘leave it to Accounts’. Yet Working Capital is a direct indicator of the effectiveness of the people in the front line. They need to know, share and then act quickly on the information it contains.



Range of improvements delivered through better use of Working Capital on Celerant client engagements

Working Capital isn't simply a balance sheet abstract

If there is something amiss with Working Capital, there is almost always something wrong with the business. The following list of symptoms confirms the reach of Working Capital issues across the day-to-day operation:

- Poor cash flow visibility
- Poor demand forecast accuracy
- High level of bad debts
- Lack of aged debt reporting
- High stock levels
- Inventory obsolescence
- Frequent breaches of banking facilities
- Frequent orders placed outside approved supplier list or standard terms
- Frequent cash calls to parent
- Frequent disputes with both suppliers and customers

If a business displays all or any of the symptoms listed above, then urgent action must be taken. The only real and sustainable solution is to quickly embed a cash culture across your business.

Benefits of the cash culture

The cash culture in action:

Inventory down. Profits up. A world leader in the manufacture and sale of welding products delivered a reduction in inventory of some 30%, yielding in turn a 40% increase in overall profitability.

This shared approach to responsibility for Working Capital focuses on its role as a key indicator of lost performance due to poor processes. Its benefits are not restricted to cash flow enhancement. They also include productivity and service level improvements and a higher return on project investment.

As a cash culture takes root, you can expect to see positive symptoms that include more accurate demand forecasting, more effective relationships with suppliers and more profitable product portfolio management, together with more efficient inventory management and, most importantly of all, more satisfied customers.

How does the cash culture work?

In a cash culture, people throughout the business look for quantifiable improvements in process performance that unlock cash in a variety of ways. Across functions and divisions, people succeed at improving processes and changing behaviours. Tangible results include reduced process costs, elimination of excess Working Capital, giving benefits to both the P&L and balance sheet simultaneously.

What are the challenges?

There are many, ranging from poor process designs, through poor performance tracking to silo thinking.

Often, people working for the same company, but in different areas, take a fundamentally separate approach to their work. Some of the typical findings of a Working Capital analysis are summarised below:

- Too many different systems and processes
- Divisions, departments, individuals sourcing/invoicing differently
- No transparent process for purchasing, so information is difficult to access, extract and measure
- Roles are not clear at key decision points
- Purchasing power is not maximised
- No enforcement of a shared approach
- No link to budgets (going over budget is often inevitable)
- No measurement of inventories
- Obsolete stock
- Outmoded warehouse distribution
- No executive sponsor
(nobody with authority to lead a cash culture)

What practical actions are available?

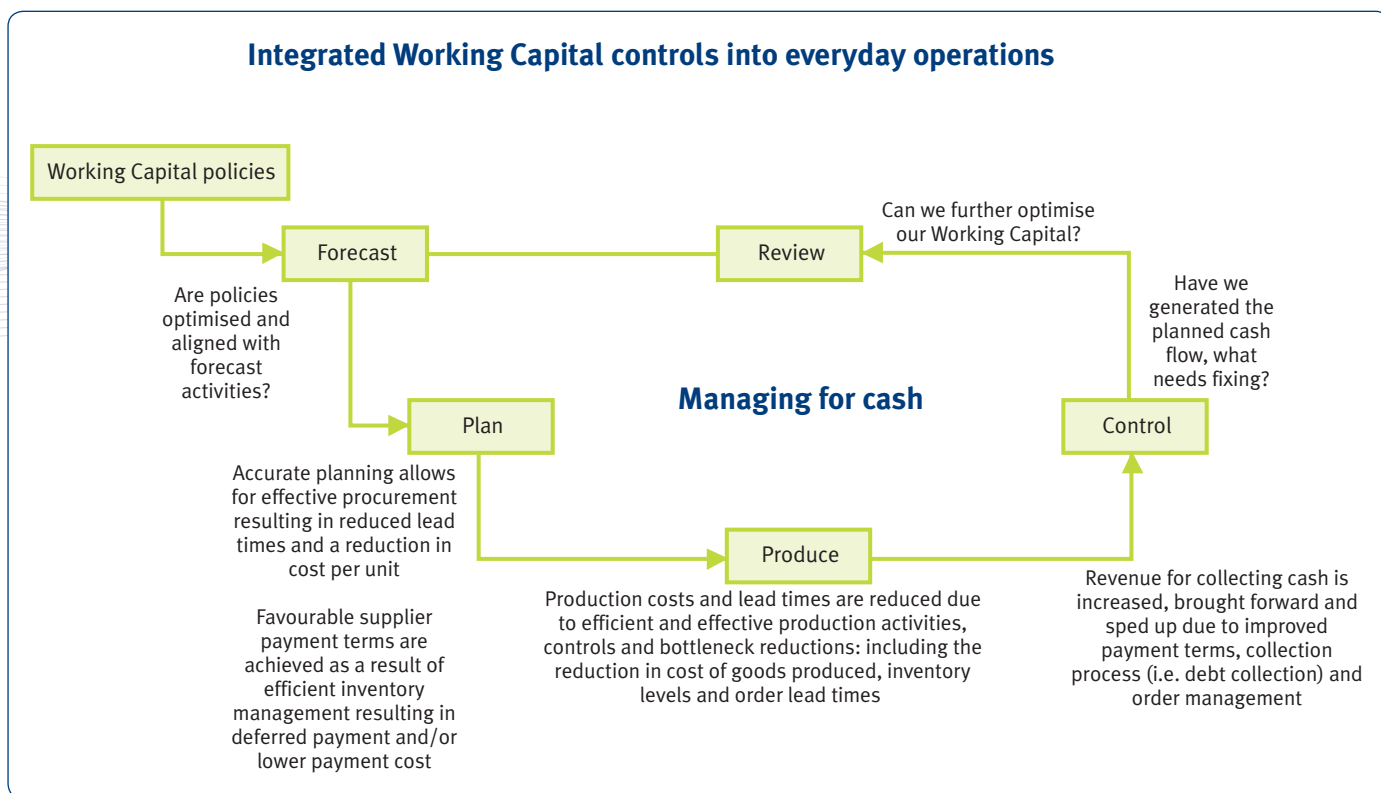
The cash culture in action:

A leading European manufacturer of agricultural fertilizers installed new performance indicators and control mechanisms that focused on continuous improvement rather than financial reporting exclusively. Inventories fell. Renegotiation with suppliers and re-specification of materials reduced supply chain costs still further. More effective control of customer incentives increased margins.

Everybody needs to know about the numbers and about their role in improving them.

The cash culture, above all, is collaborative. New internal working relationships may need to be established. People have to be able to work together, and in coordinated ways, to ensure that Working Capital policies are optimised and aligned with forecast activities.

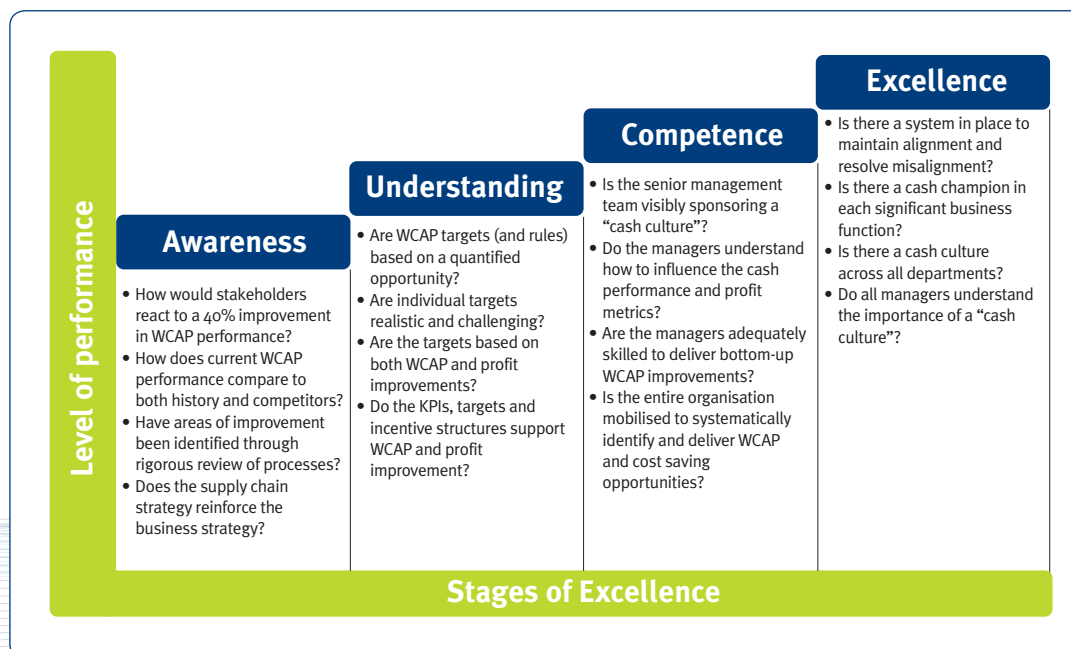
As the individual areas play their part (see illustration below), control mechanisms should be in place to represent the voice of the whole business. They check that every element has contributed to ensuring planned cash flow has been generated. And they ensure that any issues requiring resolution are identified, along with steps to fast corrective action.



The cash culture pervades every link on the value chain

The path to cash culture excellence

You start this by considering reality based questions. Like many improvement programmes, there is a journey to travel from awareness and understanding through competence before you can get to excellence. Below we have captured some key questions you should consider, summarised in the table below:



Interesting questions. Do you have – and do you like – the answers you're getting?

If your organisation's response to all or any of the questions listed above is not as strong as you would like it to be, or if you don't have the data to answer, you may want to consider running a health check over your Working Capital. There are desktop tools available that will give quick and accurate preliminary diagnostics. They may well identify areas of Working Capital concern that have been developing 'under the radar' for some time.

Conclusion

Every business looking towards self-reliance, shareholder value, innovation capacity and sector leadership needs to embrace a strong cash culture. And any acquirer of an existing business needs to be able to instil a working cash culture quickly and effectively.

The actions of individuals, teams and departments right across your value generation - from Planning to Procurement and from Sales to Supply Chain - will directly shape Working Capital performance and the ability of your company to generate a healthy cash flow.



About the Author

Micael is a Vice-President of Operations with Celerant, and also leads our Supply Chain capability in Europe. Micael has worked with leading companies across several industries with a variety of Supply Chain related business issues, including industries as diverse as Oil and Gas, Automotive, Steel and FMCG. Prior to Celerant Consulting, Micael worked in Motorola's Integrated Supply Chain, where he held a number of positions over a career that spanned almost two decades. Micael's position immediately prior to leaving Motorola was that of international operations director for the firm's Connected Home Solutions business in the Asia/Pacific (A/P) and Europe, Middle East and Africa (EMEA) regions.

In this capacity, Micael was primarily responsible for providing supply-chain solutions encompassing planning, order management, customisation/localisation and aftermarket support. Key deliverables of the role included: on-time delivery of high-quality product with efficient aftermarket support, enabling the best possible total supply chain cost for Motorola and its customers.

Micael is an associate member of the Ashridge Alumni, a network formed around Ashridge, one of the U.K.'s leading business schools, where Micael completed finance and management training.



About the Author

Cédric Parentelli, Senior Project Manager, Operations

With over six year's consulting experience focused primarily on Supply Chain Management and Business Transformation, Cédric has undertaken a wide range of assignments throughout Europe, across a range of industries, including: Telecommunications, Manufacturing, Public Sector, Financial Services and Retail. Cédric's expertise lies in the field of Supply Chain Strategy, strategic sourcing and procurement, logistics, inventory management, performance management, cost reduction, and continuous improvement.

Cedric holds an MA in Management from Durham Business School, and a BSc in Engineering, Marketing and Management. He lives in London.

We have offices in 10 different countries and we will always go where our clients need us to be.

If you want a conversation about the ways we can help your business achieve results, every time, you can call us on:

Americas	+ 1 781 674 0400	Germany	+ 49 (0) 211 58 33 00 33
Belgium	+ 32 (0) 2 762 52 38	The Netherlands	+ 31 (0) 20 570 5400
Denmark	+ 45 35 45 90 01	Norway	+ 47 22 43 29 23
Finland	+ 358 10 396 8800	Sweden	+ 46 (0) 8 670 6579
France	+ 33 (0) 1 56 69 53 00	United Kingdom	+ 44 (0) 20 8338 5000

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