Advisory Alert: Working capital -how to find extra cash for growth

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Introduction

Most middle-market businesses are satisfied with their current working capital performance. But is their satisfaction justified? At many companies, if there's enough money to meet payroll and pay the bills, the discussion on working capital ends. That is a missed opportunity, as even modest improvements in working capital performance can free up millions of dollars for strategic investments in organizational priorities. Furthermore, the development of a strong and pervasive working capital culture lays the groundwork for a more efficient organization that generates higher growth and improved profitability. These are among the findings of a recent survey on working capital management by the National Center for the Middle Market (NCMM), sponsored by Grant Thornton.[1]

Working capital management solutions that improve your entire business

1. Build a culture of working capital management

The key to success is establishing a culture of working capital management. Organizations are not created with a cash culture. They need to create one and nurture it.

Three steps organizations can take toward building a cash culture are:

- **Determine where the company currently stands in terms of cash culture**
  What tools and data are available and which are employed? What infrastructure is in place to support working capital policies and procedures?

- **Decide on organizational best practices**
  For instance, top managers should meet regularly — in some companies as often as once a week — to discuss working capital management.

- **Dedicate time to improve the cash culture continuously.**
  For instance, periodic reviews of policies and procedures are critical: customers need to be pursued on payment, and vendor terms need to be reviewed regularly. The key to create conditions for steady progress is to pursue continuity and to repeat the process regularly since no company gets to best-in-class in a month.

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2. Integrate all aspects of working capital

Traditionally, the principal elements of working capital are accounts payable (A/P), accounts receivable (A/R) and inventory. Yet rather than focusing on each one of these separately, companies need to take an integrated approach to working capital, as there are nuances around each aspect of working capital, including the industry in which each company operates and its life cycle stage.

Two measures to implement today to free up cash are:

- Benchmark A/P and A/R practices.
  This will help your company achieve faster receipt of cash and free up the finance department for higher-value work streams. One way to do this is to focus on improving the number of outstanding days as a key performance indicator (KPI). Improving this indicator for both A/P and A/R often entails upgrading internal policies and procedures, as well as the company's communication with customers and vendors.

- Perform an in-depth analysis of inventory.
  This will maximize profitability through improved business operations, such as stock reductions or improvement of the entire supply chain. e.g., Which vendors are being used? Why are they being used? And how do vendor choices make geographical sense? Additionally, this analysis can lead the company to re-examine its long-term strategy, marketing and positioning within its industry segment, including product categories and mix, and the stock keeping units (SKUs) for maximum profitability.

3. Ensure that working capital management cascades from the top down

Take the following 3 steps to move forward with working capital management:

- Gain the commitment of top management.
  A cash culture is driven from the top down.
- Align staff incentives to improvements.
  Working capital must be part of the KPIs and other measures for evaluating staff.
- Provide the necessary data based on the answers to the following questions:
  — Does the data exist?
  — Is it being communicated in ways that lower-level employees can understand?
  — Is it being shared among all stakeholders?

4. Digitalize the enterprise

The survey found that relatively few companies are happy with their digitalization efforts for working capital.

Two areas that can see added benefits from digitization are:

I. Receivables

The collection of receivables may be expedited by providing early pay discounts or other incentives to customers. Alternatively, this can be achieved through technology offerings — such as automated clearing houses and other auto-pay options. Companies that still rely heavily on paper for their payables could adopt vendor management systems to create ways to save money.

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II. Inventories

To optimize inventories (e.g., to support decisions related to target inventory levels and order timing), many systems can be improved by new technology or, at a minimum, by strategic data analysis. Some industries, such as automotive, are more advanced in their drive toward a more fully integrated supply chain. However, many sectors lag and have ample room for improvement. The initial investment for these systems can sometimes be high, but there are also smaller steps companies can take to achieve digital gains. As mentioned above, identifying potential action steps and focusing on an iterative process may be a great solution.

Source: https://www.grantthornton.com/library/survey-reports/CFO-survey/2017/ncmm-working-capital-management.aspx

Conclusion

The art of the possible

The effort to improve working capital should be tempered by a heavy dose of realism. Gains in working capital metrics that appear achievable in theory are often impossible to produce in practice — and sometimes not even desirable. Putting working capital management on the back burner, however, stalls improvements in free cash that would ultimately allow the company to pursue other strategic goals, including increasing returns, making acquisitions and paying down debt. It also curtails an in-depth investigation of each working capital element — especially inventory — that could dramatically improve business operations and boost ROI.

To avoid working capital complacency, companies would benefit from instilling a culture of working capital management that requires a sustained commitment at every level of the organization. Steady gains in working capital management can yield efficiencies along the entire supply chain, effect improvements in product categories and mix, and optimize SKUs for maximum profitability.

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