

# Advanced Working Capital Management



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# What is Working Capital Management?

- Focus on the short term in real time
- Primary and secondary elements
  - Primary: Cash, A/R, Inventory, A/P
  - Secondary: ST Investments, Notes Payable
- Organizational functions involved
  - Primary: Treasury, A/R and A/P (Supervision), ST Investment/Debt
  - Secondary: Inventory/Production, Purchasing, Credit, Billing/Paying

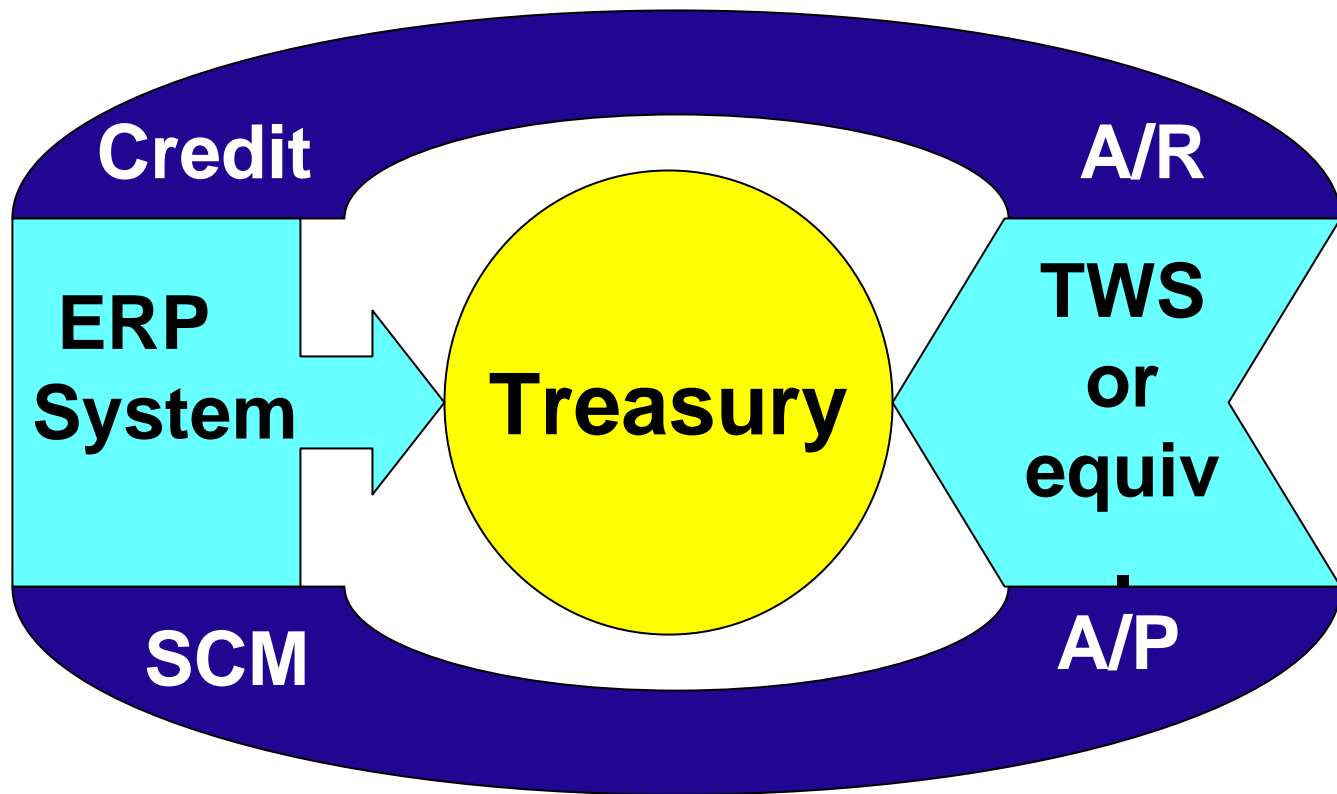
# What is Working Capital Management?

- Short-term financial management
  - Current portion of balance sheet
  - Mostly focused on cash flow since cash reflects what happens with WCM
- Managing liquidity
  - Converting non-cash assets to cash
  - Controlling timing of liability payments
- Little lead time for decisions or actions

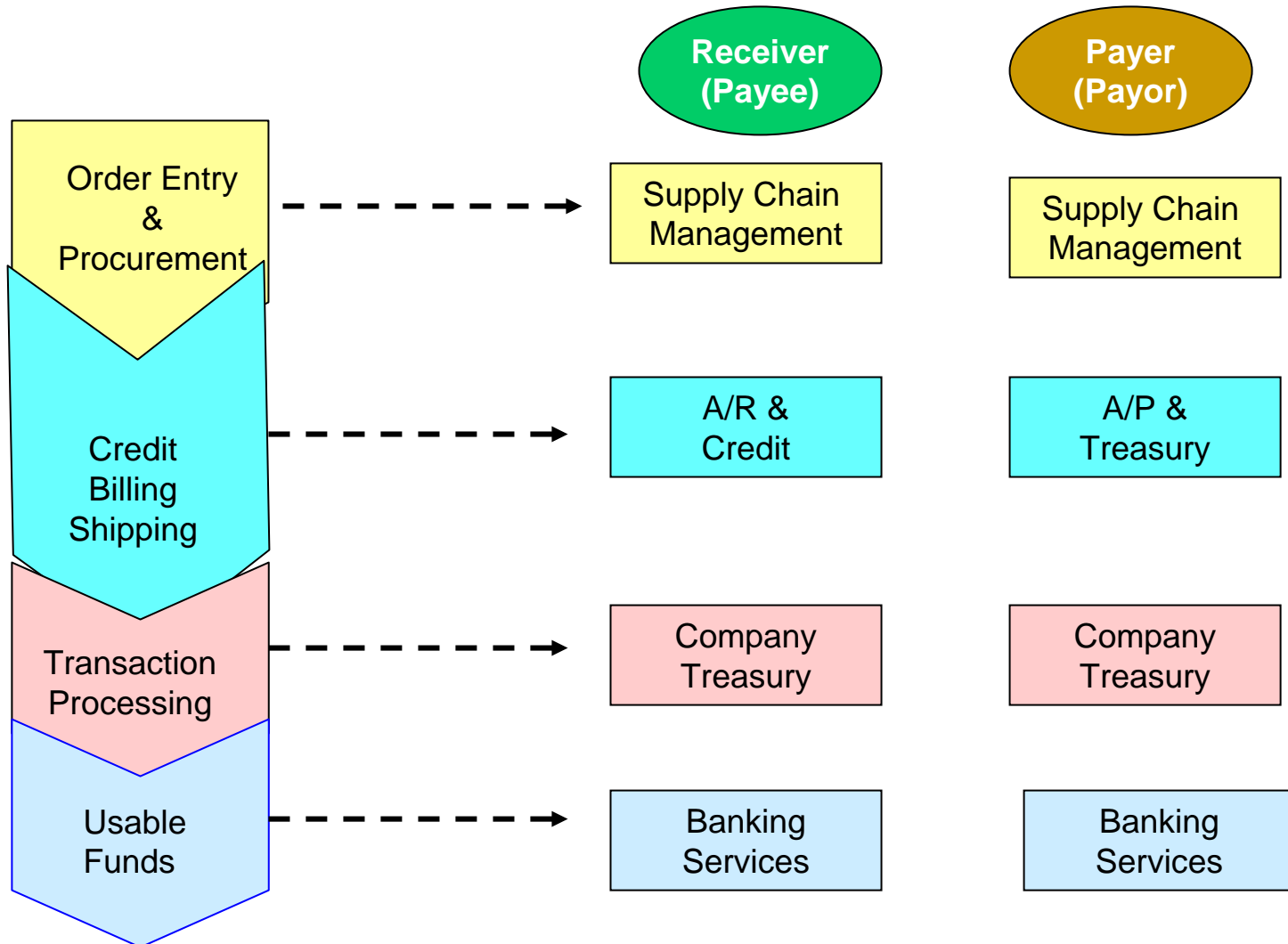
# Working Capital Focus

<p><b><u>INFLOWS</u></b></p> <ul style="list-style-type: none"> <li>• Collections</li> <li>• Trade Credit</li> <li>• Discounted AR</li> <li>• Inventory Sales</li> <li>• Investment Inc.</li> <li>• Loan Draws</li> </ul>	<p>R E C E I P T S</p>	<p>C A S H</p>	<p>P A Y M E N T S</p>	<p><b><u>OUTFLOWS</u></b></p> <ul style="list-style-type: none"> <li>• Disbursements</li> <li>• Payroll Pmts.</li> <li>• Taxes</li> <li>• Loan Pmts.</li> <li>• Dividends</li> <li>• Investments</li> </ul>
<p><b><u>DRAGS</u></b></p> <ul style="list-style-type: none"> <li>• Uncollected Receivables</li> <li>• Obsolete Inventory</li> <li>• Low Investment Rates</li> <li>• Tight Credit</li> </ul>				<p><b><u>PULLS</u></b></p> <ul style="list-style-type: none"> <li>• Early Payments</li> <li>• Shortened Credit Limits</li> <li>• Limited Credit Lines</li> <li>• Low Liquidity</li> </ul>

# Integrated WCM System



# Working Capital Time Lines



# Factors Influencing WCM

- Internal factors
  - Company size, organizational structure
  - Sophistication of WCM, financial function
  - Net borrowing and investing position
- External factors
  - Banking services
  - Interest rates
  - Technology
  - Economic performance

# WCM Diagnostic Review

- Review of WCM “System”
  - Functional review
- Best practices
  - Automation – electronic payments and receipts
  - Centralization – of key functions, such as cash collection, concentration, and disbursements
  - Better productivity – benchmark review



# WCM Diagnostics

Cash management	<ul style="list-style-type: none"><li>■ Level of excess bank balances</li><li>■ % fees paid (non-credit services)</li><li>■ Level of bank costs</li></ul>
Investing	<ul style="list-style-type: none"><li>■ Average maturity of investments</li><li>■ Comparative return</li><li>■ Adherence to policy</li></ul>

# WCM Diagnostics

A/R & Credit	<ul style="list-style-type: none"><li>■ Efficiency of system<ul style="list-style-type: none"><li>● % deposited via lockbox, OTC, electronically</li><li>● % cash applied “cleanly”</li></ul></li><li>■ Bad debt write-offs</li></ul>
Inventory	<ul style="list-style-type: none"><li>■ Efficiency of supply chain management<ul style="list-style-type: none"><li>● Supplier “report card”</li><li>● % of inventory &gt; 1 yr. old</li></ul></li></ul>

# WCM Diagnostics

A/P, et al.	<ul style="list-style-type: none"><li>■ Efficiency of A/P system<ul style="list-style-type: none"><li>● % of payments made electronically</li><li>● Uses of direct deposit</li></ul></li></ul>
Borrowing	<ul style="list-style-type: none"><li>■ No. of credit line banks</li><li>■ % of credit lines used, maximum outstanding vs. total lines available</li><li>■ Effective/comparative costs</li></ul>

# Finding Hidden Cash

1. Possible payables stretching “opportunities”?
2. A/P department’s performance?
3. Handling discounts?
4. Other payables savings suggestions?

# Measuring WCM Performance

- Productivity units of measurement
  - Costs per unit of revenue, per FTE
  - Timing involved
- Comparison with target
  - Benchmarking vs. history, goal, others
  - Best practice utilization
- Sources
  - AFP/Hackett Group
  - Special studies

# WCM Benchmarks

- Cash [management]
  - Costs and bank fees as % of revenue\*
  - Days sales in cash (bank balances)
- ST Investments
  - AFP Investment benchmark for working capital portfolio
  - Comparison vs. t-bills or other security

*\*Source: AFP/Hackett Group*

# WCM Benchmarks

## ■ Receivables

- A/R cost per remittance\*
- Days sales outstanding (DSO ratio) or average collection period

## ■ Inventory

- Procurement cost as % of total purchasing cost\*
- Days Sales in Inventory (DSI ratio)

*\*Source: AFP/Hackett Group*

# WCM Benchmarks

## ■ Payables\*

- A/P cost per remittance\*
- Days payable outstanding (DPO ratio)

## ■ ST Borrowing

- Comparison with money market rate
- Comparison with internal goal, history, other firms

*\*Source: AFP/Hackett Group*



# RFPs



- The four C's for RFPs
  - Competition
  - Convenience
  - Commoditization (of services)
  - Cost control
- Perceived objectivity

# Receivables Review

- (See Figure 1 for full checklist.)
- Major points to consider.
  - Develop the “big” picture.
  - Track the flow of information, etc.
  - Are there processing holdovers?
  - Review follow-up procedures.
  - How are unearned discounts handled?
  - How many customers pay on time?
  - What percentage of \$ comes into a lockbox?

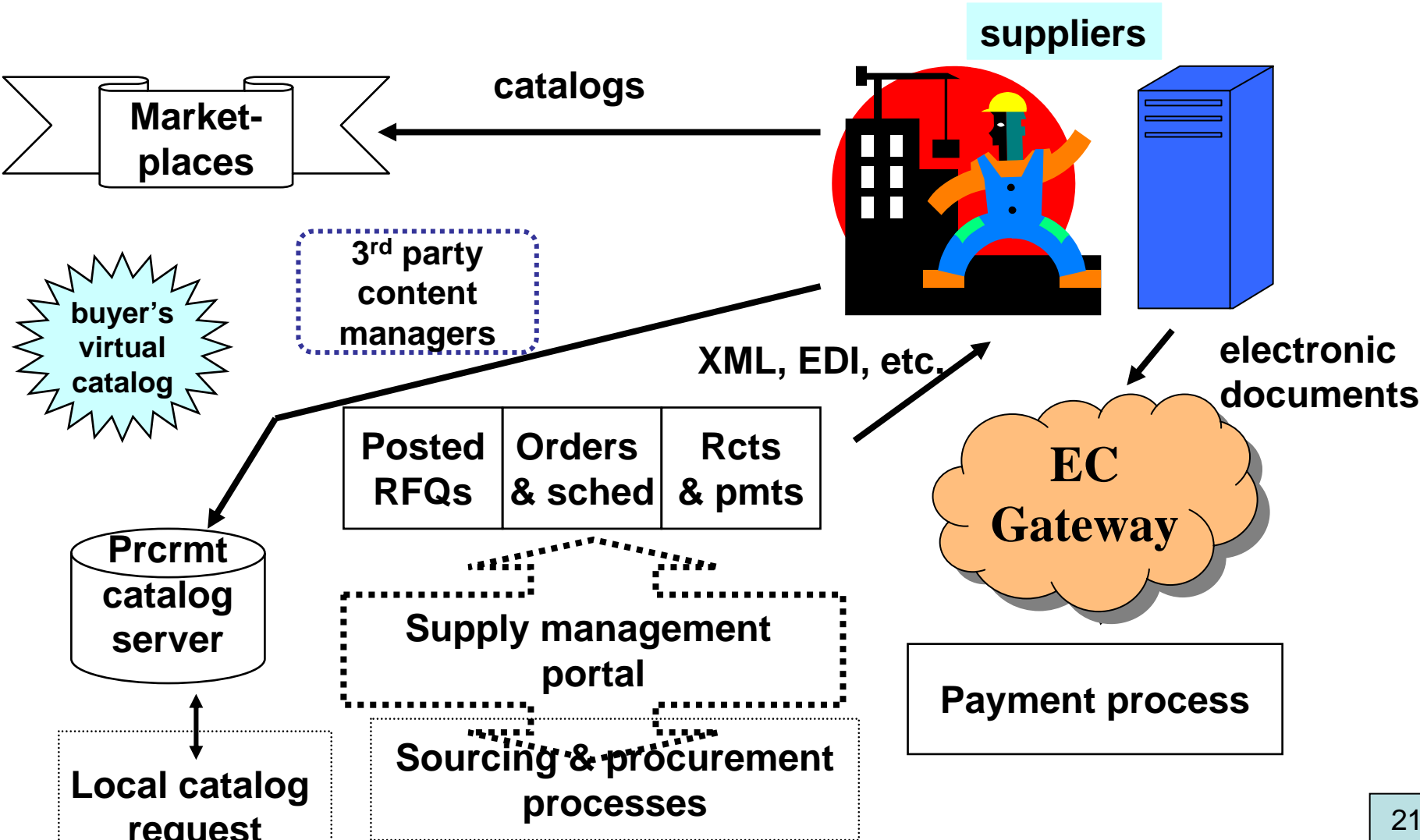
# Payables Review

- (See Figure 2 for full checklist.)
- Major points to consider.
  - Is there a “preferred vendor” list?
  - How flexible are terms? Do you have options?
  - Are payments made on time?
  - How long does it take to pay?
  - Are discounts evaluated and/or taken?
  - Proportion of electronic payments?
  - Are bank reconciliations used to develop

# Supply Chain Management

- “Holistic” view of purchasing
- Managing the supply chain
  - Substitutions and eliminating obsolete inventory
  - Improving the procurement cycle
  - Maintaining good trading partner relations
  - Evaluating new technologies
- E-Procurement: Purchasing using the Internet
  - Stronger reliance/alliance with suppliers
  - All electronic

# The E-Procurement Cycle



# Inventory Management

## ■ Motives

- Transactions – Precautionary – Speculation

## ■ Approaches

- JIT
- MRP (materials resource planning)
- Combined JIT-MRP approach
- Paid-on-production or vendor-held inventory
- Limited use of EOQ-ROP

# Managing Multiple Portfolios

- Having an investment portfolio and a debt portfolio may be unavoidable
- Typical situation: investment return  $<$  borrowing rate
  - Monitor net difference over time
  - Need to set target for differences
  - Possible “bonus” situations (short-lived)

# Major Global Differences

## ■ Differences

- Foreign operations often much smaller
- Standard “tools” unavailable
- Banking practices and controls
- Accounting practices



# Potential Problem Areas

- Local financial transactions
- Bank-related problems: funds transfers, payment handling
- Non-bank-related problems: payment disputes
- Internal company problems: non-payments
- Lack of working capital focus or mind set

# Costs of Ignoring Locations

- Higher interest expenses
- Slower collections
- Increased receivables costs
- Inefficient payable practices
- Lost opportunities

# What Lies Ahead for WCM?

- More technology (and impact)
  - Less drags on payment systems
  - Faster “cycle” for WCM
  - Enabling integration of WC elements
- Further business consolidation
  - Changes in approaches
  - Ability to deal with risks
- Slow growth of e-commerce

# Key WCM Issues

- How will further integration of working capital elements occur?
- Is e-commerce going to be a major agent of change for working capital management?
- How will external parties, such as banks, affect how working capital is managed, especially with regard to payments, information, and systems compatibility?
- How will the outsourcing “movement” affect working capital management?
- Will the growth of mega-companies in all businesses, including banking, be a positive or negative force on working capital management?

# Tips and Traps

## Tips

- Keep a big picture focus
- Know where things are—have a road map
- Tap into as many company systems as possible
- Use outside services efficiently
- Spend time on communications

## Traps

- Avoid lapsing into the details too quickly
- Don't take shortcuts
- Avoid assuming what your ERP system will provide
- Avoid outside services based on cost savings
- Don't assume non-response from an area means "no problems"

# Any Questions?

