

Board Perspectives: Risk Oversight

Working Capital Management: A Tool for Optimizing Costs and Reducing Risk

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While the cliché “cash is king” is old, it never gets tired. Positive cash flow after all necessary operational and maintenance expenses and debt service is a sign of a healthy business if it isn’t overleveraged. Three fundamental building blocks of managing cash flow are: (1) working capital¹ and cost optimization, (2) cash flow forecasting, and (3) liquidity management. Below, we focus on aspects of the first building block.

Key Considerations

Last year, APQC, a leading benchmarking and best practices research organization, and Protiviti released a report showcasing how organizations have developed effective strategies and processes to reduce working capital requirements and optimize cash used to fund operations.² The report highlights the exceptional performance and approaches around working capital management of three companies and provides specific examples of four broad categories of best practices in action:

- **Vision and strategy for improving working capital management** – Best-practice organizations find quantifiable economic benefits from improving working capital processes at the operational level through linking them to the achievement of strategic goals. Executive-level support for and involvement in working capital optimization are prerequisites for reducing the

amount of cash invested in operations. Centralization and standardization of financial transaction processing to drive efficiency and draw meaningful insights out of data, as well as a cross-functional approach to working capital accountability and continuous improvement of receivables and payables processes, are also important.

- **Analytics and measures to enable better working capital management** – The identification of relevant data, drivers and measures to enable effective decision-making is the core purpose of managing working capital. Best-practice organizations use data from an enterprise resource planning (ERP) system to inform daily credit and collection units; conduct real-time analysis of cash flow drivers to ensure reliable forecasts and optimize spare cash; and measure, analyze and advise operating units on how to increase returns on working capital invested in operations. They design custom measures of working capital that are relevant to their business models, such as days sales outstanding, percent past due, days inventory outstanding/inventory turns, days payable outstanding, and procurement card percentage of spend. These organizations measure performance among their functions, look for opportunities to improve processes, and educate employees on their roles in working capital management through metrics, measures and monitoring.
- **Performance management principles and measuring process improvement** – While linking operational discipline around improving working capital management to the achievement of strategic goals

¹ “Working capital” generally is defined as current assets (cash, marketable securities, accounts receivable and inventories) minus current liabilities.

² “Improving Working Capital Management and Cash Flow Intelligence,” APQC and Protiviti, 2011, available at www.protiviti.com.

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and implementing metrics, measures and monitoring are both important, so is a strong commitment to continuous process improvement. Best-practice organizations apply quality and productivity tools to process improvement efforts and leverage change management principles and practices in finance, identify and resolve data discrepancies on the front end of the process, and manage working capital risk. Building in quality early in the process synchronizes company, vendor and customer systems, facilitating more cost-effective procure-to-pay and order-to-cash cycles.

- **Information technology strategy/application** – Best-practice organizations use supporting technology to increase the efficiency of their working capital management processes. They embrace the concept of self-service to drive efficiency and conduct transactions electronically whenever possible, and work with vendors and customers so they can do the same. Often, the necessary tools to implement these practices require minimal IT support and allow finance, other staff, vendors and customers to access the information they need when they need it.

The APQC report outlines four calls to action for strengthening a company's working capital management capabilities:

1. Align working capital management processes with corporate strategy, centralize financial transaction processing, and provide sufficient executive-level support and involvement.
2. Use relevant drivers of working capital management value and risks to develop metrics that complement unique aspects of the business model.

About Protiviti

Protiviti (www.protiviti.com) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit. Through our network of more than 70 offices in over 20 countries, we have served more than 35 percent of FORTUNE® 1000 and Global 500 companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

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3. Commit to cross-functional engagement to continuously improve working capital management.
4. Use enabling technology to increase efficiency and support related process improvements.

Questions for Directors

Following are some suggested questions that boards of directors may consider, in the context of the entity's business model and risks inherent in its operations:

- Are there indicators confirming a need for an assessment of financial and operational working capital practices, such as liquidity constraints; excessive, obsolete or growing inventories; inadequate forecasting and demand planning; recent credit rating downgrade; aging receivables; payables leakage (duplicate payments, etc.); poor working capital ratios; fragmented spend; and workforce layoffs/targeted facility closings?
- How do the company's working capital management capabilities compare against best-practice organizations from an efficiency and effectiveness standpoint?

How Protiviti Can Help

Protiviti helps companies improve process capabilities, cut costs and recover potentially lost funds. We advocate a four-step proactive approach to improving the management of working capital: (1) uncover sources of new and existing risks impacting working capital demands, (2) analyze operations and benchmark peers to diagnose working capital issues, (3) reassess working capital policy in the context of the company's business model and risk tolerance, and (4) optimize working capital existing in such areas as cash and marketable securities, sourcing, procurement, receivables, payables and inventory.