

Intelligent Crisis Prevention: Optimizing Working Capital As A Lifeline For Liquidity

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The banking crisis, the economic downturn and the credit crunch: The competitiveness of companies now depends on effective and fastacting solutions in finance management. As several international studies undertaken by supply chain management consultancy firm BrainNet show, many companies can still activate key cash reserves by better managing their working capital. It is of particular importance to optimize working capital, i.e. the capital tied in accounts receivable, stocks and accounts payable.

Strategically improving working capital involves a multitude of challenges and risks in areas such as debtor management, creditor management, stock management or cash management. During the economic boom period, many German companies paid only little attention to their working capital because delivery capacity took priority. According to BrainNet studies, SMEs in particular were tying up capital in their company 30 to 50 days too long – an unnecessary luxury which companies can barely afford in the current situation. This is because optimizing working capital increases the scope for internal financing in the long term, thereby creating equity capital for necessary investments. It is also a quick procedure, which requires no restructuring measures or major changes to processes.

"Particularly in the manufacturing industry, working capital optimization is currently the number one priority for around two thirds of managing directors and procurement managers surveyed by us," says Sven Marlinghaus, partner and member of the management team at BrainNet. "Because this topic was rather neglected in the good times, around 40% of companies have not implemented a systematic, cross-functional form of working capital management. But this is essential, because the Procurement, Production, Sales and Accounting Departments now have to cooperate as effectively as possible in order to quickly make 'working capital credit leverage' useful. As a rule, working capital can be reduced by approx 15-40%, which can quickly be turned into liquidity with notable success."

The amount of working capital depends on the period in which capital is tied in purchasing materials and customer payment. The key lever is days working capital (DWC), which gauges the average period for which the working capital is tied up when it can thereby not contribute to the company's ability to pay. "A reduction in DWC by just a few days can already have a considerable effect on liquidity. The companies surveyed by us have an average DWC of approx. 84 days – the benchmark of the peak cluster of 34 days shows how much potential this instrument still offers," continues Marlinghaus.

Baseline of one of the companies surveyed			Effects of a reduction in DWC by 10 days	
Turnover	€1.2 billion	Optimization →	One-off liquidity effect by releasing tied capital	€32.9 million
DWC (duration of capital commitment)	72 days		Continuously lower-priced cost of capital, annual	€1.97 million
Weighted average cost of capital	6%			
Working capital	€237 million			

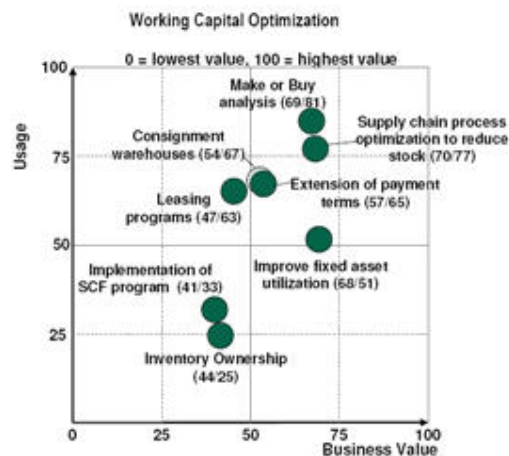
Sample calculation "Potential for optimizing working capital"
Source: BrainNet

Important cross-functional approach

The most important starting points for successfully optimizing working capital lie in internal processes and on both the customer and supplier side. The responsibilities, for example, should therefore be clearly defined in advance for the topic in order to eliminate subsequent conflicts of competence or multiple agreements. "A classic starting point which is critical to success in manufacturing companies is studying and optimizing the stock and production strategy. It is well worth taking a quick and detailed look at consignment stock, single piece flow production, JIT and/or modular kits in this area," explains Marlinghaus. "Process analysis and improvement in the Finance Departments is naturally also of key importance. In terms of debtor accounting, you should for example check whether payment periods are correctly adapted to the various regions and customers, while on the creditor side it is generally a good idea to run a check on terms of delivery e.g. FOB for overseas deliveries."

Effective instruments required

Studies conducted by BrainNet also show the various instruments which companies already use to optimize their working capital. It is primarily German manufacturing companies who could still create much more potential using Supply Chain Financing (SCF). Using this instrument, suppliers can re-finance themselves under the conditions of the buyer – which are usually considerably more favorable – and thereby grant cheaper terms and conditions of payment.



Use and added value of instruments to optimize working capital

Source: BrainNet / SAP, 2008: "Uncharted Territory: Financial Supply Chain Management in Leading Global Companies"

"SCF considerably improves the financial stability of the supplier, increases the transparency of the value creation chain and realizes significant cost savings," stresses Marlinghaus.

"Companies should set all available leverage in motion so they can get through the next few months, which are going to be extremely difficult. Procurement in general and FSCM in particular provide a central starting point for optimization."

About the BrainNet Supply Management Group AG

BrainNet is a leading international brand for supply chain management consultancy. Employing 220 members of staff, BrainNet turns over €30M globally. BrainNet develops and realizes tailored solutions for more than 80 of the companies listed in the Global Fortune-500 and around 240 fast growing SMEs. For years, BrainNet has had offices in Bonn, Boston, Budapest, Chicago, London, Mumbai, Munich, Shanghai, St. Gallen, Tampa and Wroclaw.

Through its close collaboration with the Supply Management Institute (SMI) at the European Business School (EBS), BrainNet offers a totally unique value-creation chain ranging from research and training young talent at leading business schools to implementing consultancy projects and strategic qualification of top managers and supply chain managers. For more information about BrainNet, please go to www.brainnet.com

SOURCE: The BrainNet Supply Management Group AG