

WORKING CAPITAL MANAGEMENT

Best Practices



By
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As the festive season approaches and the cash registers commence their merry ringing, how do companies optimise their working

capital? According to the latest 2014 Finance Priorities Survey by Protiviti, managing cash flow and working capital efficiently and effectively is key¹.

Working capital management involves managing inventories, accounts receivables and payables. Improved working capital management can help strengthen a company's financials and help grow its business. A Hackett Group study has shown that through effective working capital management, top performing organisations are able to free up US\$2.9 billion more in working capital than the typical Global 1000 organisation².

As cash tied up in inventory or

accounts receivable has an associated cost of capital, working capital management naturally has a bottomline impact. By reducing the level of working capital required to support its ongoing operations, companies are able to channel the resulting cash savings to alternative higher yielding purposes.

Against this backdrop, most CFOs find working capital management as a very important or critical key performance objective³. "Companies which are able to unlock trapped liquidity in their working capital have more flexibility to take advantage of opportunities as they arise and are less dependent on external financing. Its importance is reflected in our ISCA CFO Survey, in which 88% of the CFO respondents indicated working capital management as a very important or critical work responsibility," said Yee Cheok Hong, Executive Director, Policy and Strategic Planning/Industry Development, ISCA.

This article shares best practices of companies improving their working capital through enhancing inventory management and also briefly covers the accounts receivables and payables aspects, as well as the short-term working capital financing options available to manage seasonal funding needs.

¹ <http://blog.protiviti.com/2013/10/28/top-priorities-for-cfos-and-finance-professionals-in-2014/>

² www.thehackettgroup.com/expertise/working-capital-management.jsp

³ <http://research.isca.org.sg/wp-content/uploads/2013/11/ISCA-CFO-Survey-2012-Report.pdf>



PHOTO: SHUTTERSTOCK



1 ENHANCING INVENTORY MANAGEMENT

For manufacturing companies, significant amounts of working capital may be invested in inventories of raw materials, work-in-progress and finished goods. Inventory management is a delicate art which requires companies to forecast and strike a balance between demand, production and ordering stock.

Holding unnecessary levels of the wrong stocks can be a significant drag on working capital. In the case of holding excess stock, there are costs involved in writing off obsolete inventory and cost of cash tied up in inventory. On the flip side, companies may also face the risk of insufficient stock to meet client's demands. This translates to foregone revenue, reduced cash flow and potential loss of market share to a competitor.

From a retail perspective, V Alagappan, CFO, Jay Gee Group, shared, "There is no single bullet to eliminate overstocking or stocking the wrong inventories. However, increased forecast accuracy serves as a key weapon. As a retailer, we practise prudence and vigilance all year-round. We use the bases of market condition, customers' preferences, demand of our products etc. For fashion on season, we work on the basis of forecasted sales by months, the actual inventory available at the start of the period, tolerable inventory holding already set for the end of each month during the period and we work backwards to calculate our permissible purchase quantity. Inventory at the end of the season is kept to the bare minimum in our workings because new seasonal products will start coming in during this transition period. The interest rate, cost of warehousing and transportation are also factors in determining the amount of holding inventory."

To achieve efficiency in the working capital cycle of the company in the long term, the tone from the top is important, especially in increasing the organisation's sensitivity to the working capital implications of its operating

decisions. The support of senior management is critical in facilitating the success of working capital optimisation where they may have to spearhead changes and be prepared to invest in technological systems that can centralise and standardise processes and provide better visibility of the company's business data.

Retailers, for example, can leverage on Enterprise Resource Planning (ERP) systems to better manage their inventory. They are able to integrate point-of-sale (POS) systems among different retail locations, thus providing more real-time information which makes for better decision-making. One of the benefits is knowing, in real time, when inventory is sufficient or needs restocking. After a retailer enters the inventory values in an ERP system, the software can automatically order products when stock levels are low or approaching a "safety" stock level. To replenish the products, the ERP system can also factor in the lead time from the vendor and estimate how long the current inventory will last, based on seasonally-adjusted historical sales information. This helps prevent stock outs and excess inventory, thus improving inventory management and boosting companies' operational efficiency.

With more than 70 brands and 1,000 stores in 11 countries across Southeast Asia, the Middle East and South Pacific, strong inventory management is paramount to RSH Limited. Lelaina Lim, its Group CFO, elaborated on how the ERP system has helped her company.

Citing an example of customer service personnel on the shop floor, an ERP system enables them to be more efficient. Previously, they had to telephone their colleagues at another outlet to inquire about the stock level. Now, they can independently and promptly key the product code into the system to address the customer's query about stock availability, in the required size, colour and style, at the other outlets. Staff can also reserve the item for the customer, thus reducing

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V ALAGAPPAN
CFO, Jay Gee Group



PHOTO SHUTTERSTOCK



lost sales and also providing a better customer experience.

Festive seasons like Christmas and New Year contribute a significant amount to the year's revenue. Having "visibility" of the inventory and reducing the inventory turnover period will translate into tangible savings, from holding and warehouse costs to improved sales and lower obsolescence of aged inventory.

Ms Lim added that successful implementation of ERP is not just about the hardware, it also involves getting the employees' buy-in and appreciation of its benefits. There are times when such changes may evoke fear among employees as they worry about being replaced by technology. This is where good change management comes into play, and employees' fears can be assuaged by far-sighted plans to re-deploy them to perform higher-level work.

To leverage on the potential offered by technology, companies should tap on the Productivity and Innovation Credit (PIC) Scheme if they have not done so. The incentives can help companies to alleviate the cost of automation and facilitate them in embracing technology for higher productivity.

While the importance of working capital management may be known among the finance professionals, the other departments in a company must also appreciate its importance. This can be done through education and an alignment of a company's reward system with measurable targets and metrics. Best practice companies are successful in adopting and instilling a collaborative culture among cross-functional teams.

Improved communication and sharing of information between

The December festive season is also a busy season for accounting professionals. How does this affect your professional and personal life?

"In the accounting industry, November and December are the months when work starts picking up. Planning work comes to a close and interims for the December year-end audits are set to commence. January to May are considered the peak period as many companies will be preparing to close their accounts, announce their results and publish annual reports.

On a professional level, this period is a testing time when you need to juggle numerous tasks and client accounts. Your management skills are tested and prioritisation is key. Fortunately, despite the busyness at Deloitte, we are encouraged to adopt a healthy work-life balance; the Singapore

practice also creates a work environment that allows staff to lead well-rounded working lives. There are year-round social, sports and corporate responsibility activities for everyone to participate in.

On a personal level, lesser time will be spent with loved ones and friends during this peak season. However, it is also during such busy periods that you will cherish the small things in life, like having a meal with your family and spending quality time with them. I also further appreciate my parents' concern over my well-being during this period.

From a professional standpoint, I try to plan my schedule to ensure sufficient time is given to respective client accounts and tasks that

I foresee may come up during the busy period. Planning is key. Sitting down with my managers to discuss the possible timelines and the anticipated challenges that the engagement team may face enables better scheduling with adequate time for various tasks.

On a personal level, I try to take time off to spend more time with loved ones and friends before it gets too busy. I use this time to recharge before the start of the peak period."



DARYL KOH
Audit Senior
Deloitte Singapore

different departments, such as finance, sales, operations, procurement, to discuss and forecast the expected sales based on the previous year's revenue and sale of individual products, while taking into consideration the current economic environment and consumers' spending patterns in the months leading up to the festive season, is a dynamic cross-functional process. In particular, for regional and international companies where operations span across geographies, the visibility and communication of information is imperative for decision-making.

2 ACCOUNTS RECEIVABLES AND ACCOUNTS PAYABLES MANAGEMENT

For effective accounts receivables management, the assessment of the credit worthiness of customers, effective control of credit terms granted and an efficient collection of money owed to the company are key areas to look into. According to ISCA's inaugural productivity benchmarking study, the average days sales outstanding (DSO) for the Singapore respondents

was 47.5 days. However, the overdue accounts receivables at 20.2% is significantly higher for the Singapore finance function as compared to the global average peer group of 11.2% and top 25% of the peer group at 3.0%⁴. A high percentage of overdue accounts receivables can adversely impact working capital management, which is crucial to the sustainability of small and medium-sized enterprises (SMEs).

In the accounts payables aspects, simple operational changes such as requesting e-invoices and making online payments help minimise manual errors and voluminous paperwork, thus raising efficiency. Companies should also maintain a good working relationship with their suppliers in order to negotiate for better credit terms.

SHORT-TERM FINANCING TO MEET SEASONAL WORKING CAPITAL NEEDS

Jay Gee Group's Mr Alagappan commented on the importance of having accurate cashflow projections to manage the company's cashflow and maximise returns. This helps



EXAMPLES OF SHORT-TERM WORKING CAPITAL FINANCING

- + Overdraft** If a company already has a relatively good relationship with a bank, it is likely that the bank will be able to extend an overdraft facility. An overdraft facility is generally easier for the bank to set up and no additional documents are required to draw on this facility. However, the company will tend to pay a higher premium for this facility.
- + Factoring** A company can look to onboard a factoring programme with a financial institution or a factoring house where the company's entire receivables turnover is sold to these institutions which will also handle the collections from the company's debtors. Any non-payment from the debtor will result in a recourse back to the company.
- + Invoice discounting** This is a form of asset-based financing which enables the company to release cash tied up in an invoice due for payment some days later. This is unlike factoring as the company will retain control of the administration of the collections from its debtors.
- + Account receivables purchase** A company targets to optimise its balance by monetising its receivables to cash as early as possible through a true sales of its receivables to a bank. This is unlike factoring as this is usually done on a transactional and limited-recourse basis.
- + Short-term or bridging loan or inventory financing** A company may request for a line of credit from a bank to finance its temporary working capital needs for specific purpose.
- + Account payables financing** A company approaches a bank to finance the purchase of its imports. With this financing, the company can take ownership of the goods and use them to grow the business. While it varies, it can be up to six months before the company needs to pay for the goods.
- + Banker's guarantee** A company approaches a bank for a banker's guarantee as a substitute for a deposit or prepayment, for example, a rental deposit for three months. Doing so can release cash unnecessarily tied up for long periods of time in such deposits, prepayments and other receivables. This is often a forgotten form of working capital redeployment.



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The support of senior management is critical in facilitating the success of working capital optimisation where they may have to spearhead changes and be prepared to invest in technological systems that can centralise and standardise processes and provide better visibility of the company's business data.

The December festive season is also a busy season for accounting professionals. How does this affect your professional and personal life?

"Work in the audit profession is subject to seasonal influences. For instance, the busy season starts from January to April, and may extend to June if we are involved in the auditing of companies' financial statements for the year ending March. We are also busy with reviewing the quarterly results which listed companies are required to announce.

At KPMG in Singapore, we strongly believe that high performance and productivity are sustainable only if our people have a healthy work-life balance and are happy. We have invested significantly in initiatives

to promote work-life balance and make KPMG in Singapore a great place to work in. We also monitor the situation on the ground by ensuring that staff do not work long hours for prolonged periods on a regular basis

Getting organised, planning ahead and relaxing on a regular basis will help every accounting professional get through the busy season with less stress and improved productivity. I also keep in touch with my clients constantly to understand and resolve their audit and accounting issues throughout the year so that the year-end workload can be alleviated.

Having been in the

audit profession for some time, I am able to plan my personal commitments around the busy periods. I also make the effort to spend more time with my family and go on family vacations during my children's school holidays. Regular exercise, good eating habits and the occasional short weekend getaways all help to make sure that I manage my stress and stay healthy."



KAREN LEE
Audit Partner
KPMG in Singapore

him to plan the company's need for bank borrowings and ensure there are sufficient banking facilities available to meet the seasonal changes in funding needs. He added, "Forecasting is an important component; companies must ensure that the cash is put in places where it is most efficient to mitigate opportunity cost."

To meet the seasonal changes in funding needs, companies can also consider short-term working capital financing methods which are usually cheaper and more flexible than long-term ones.

MOVING FORWARD

Clearly, an organisation-wide mindset change, better processes and technology adoption form key components with regard working capital optimisation. These best practices allow companies to deliver operational efficiency, cost reduction and increased cash flow.

The Finance department should leverage on its unique position to

be the inhouse mindset champion and educate other functions such as Sales and Marketing as it is a cross-functional responsibility. This involves understanding the trade-offs between conflicting priorities and their impact on working capital optimisation. Industry peer benchmarking and top executive support through regular reporting to the Board helps.

Working capital provides critical insights into the state of a company's financial performance. As such, lenders or investors often examine the availability of a company's working capital on a balance sheet. The level of current assets is a key factor in a company's liquidity position, as highlighted by the recent financial crisis. As Warren Buffet has cautioned, "Only when the tide goes out do you discover who's been swimming naked." ISCA

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⁴ <http://download.icpas.org.sg/IND/ICPAS-SAP%20Productivity%20Scorecard%20and%20Benchmarking%20Survey.pdf>