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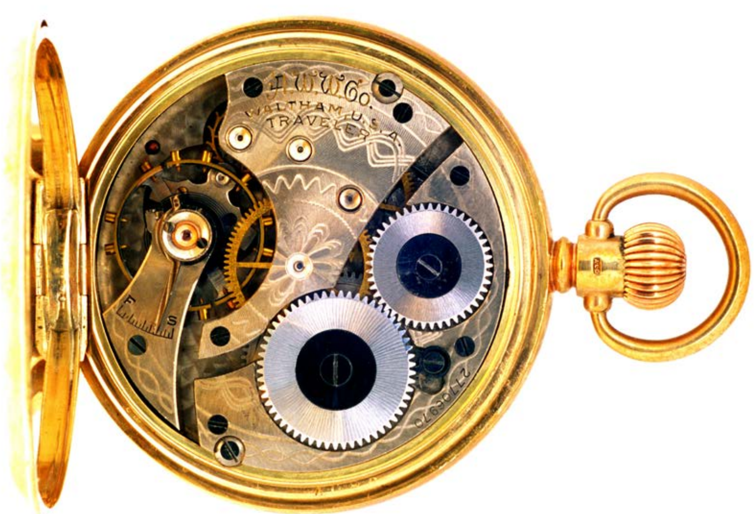
CFO Insights
Making working capital work

Many companies have the opportunity to increase shareholder value by managing working capital in a more efficient manner, but are often held back by a number of internal challenges. Indeed, when participants of a recent Deloitte* webcast were asked to evaluate their organization's ability to drive working capital performance, more than 80% said they were "somewhat or very concerned."[1]

Still, with working capital optimization increasingly on boards' radar as they look for opportunities to enhance shareholder value, CFOs may want to address those internal challenges—to free cash that can be used to fuel growth. And in this issue of *CFO Insights*, we will examine the challenges to optimizing working capital and offer some steps on how to unlock the rewards.



Challenges to working capital optimization

As CFOs well know, there are multiple challenges to optimizing working capital, including:

- **Limited access to needed information.** Many companies lack the real-time data and metrics needed to evaluate the effectiveness of working capital and improvements.

- **Lack of a formal structure for working capital improvement efforts.** Whether improving working capital is a cross-functional effort or driven by finance, it can be difficult to sustain the effort without a formal structure. Few companies have a formal optimization program with clear ownership across the organization or the organizational tools and the capabilities to implement a program.

- **The number of working capital stakeholders and their differing perspectives.** The distributed nature of working capital, in which one stakeholder within finance may own accounts payable and another accounts receivable, can make it difficult to implement a working capital improvement program. Each stakeholder is likely to have a different perspective on how to enhance working capital, and their views could also differ from those who are running operations.

- **Time constraints.** Organizations often struggle to focus on optimizing working capital because of other priorities competing for attention.

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Developing a working capital optimization plan

How to address these challenges? As guardians for working capital, CFOs are often positioned to do the strategic visioning and lead a working capital optimization effort. Moreover, establishing the infrastructure to support working capital improvement is in the tool belt of finance.

Some steps companies can take to implement and support a sustainable working capital optimization program include:

1. **Mandate and communicate.** An effective working capital optimization program should start with a tone-at-the-top mandate from the board, CEO, and CFO. Senior management should make clear that improving working capital is an organizationwide priority, and that working capital improvement is linked to both business and individual performance.

2. **Collaborate and coordinate across the organization.** Because working capital touches so many different parts of an organization, CFOs should collaborate with other leaders within the business to embed the goal of improving working capital into their organizations' systems, analytics, and performance metrics.

3. **Identify optimization levers and use them consistently.** There are levers throughout an organization that can help drive working capital improvements, such as more efficient inventory management, embedding specific working capital metrics in forecasting, and improved management of working capital items. Companies have to understand, however, which levers may be more effective and use them consistently.

4. **Measure effectiveness with metrics.** Metrics should be built into the optimization program's goals and used as a constant feedback mechanism so that Financial Planning & Analysis and Treasury can monitor the program's effectiveness and impact on, for example, the cost of capital. Analytics also can play a role in improving working capital. For example, they can be used to determine the capital required to fund manufacturing processes or to create dashboards that provide daily views on metrics that affect cash flow and working capital over time.

5. **Align incentives with improvement.** To sustain working capital improvements, there should be incentives that foster management focus and change. Incentives should be made available throughout the company, and there should be tangible linkage to business performance and overall compensation, as well as flexibility to adjust for external factors that may adversely affect working capital.

The reward: freeing up cash

The reasons to consider working capital improvements are compelling. Many companies, after all, remain capital-intensive. Some still see low levels of turnover for accounts receivable and higher turnover on the accounts payable side, conditions that can point to a need to improve working capital management. Moreover, boards understand that efficient management of working capital can potentially free up cash for other uses that can build shareholder value, such as mergers and acquisitions. For CFOs charged with growth and determined to steer strategy, there may be no better place to look for that cash than in working capital improvements.

Endnote

[1] Deloitte Dbrief webcast, Working Capital Performance: Innovations Aimed at Creating Enterprise Value, November 2012.

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