DEFINE, DEVELOP, EXECUTE:
PUTTING TOGETHER AN EFFECTIVE WORKING CAPITAL MANAGEMENT PLAN

FIFTH THIRD BANK
The curious bank.

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Cash flow is the lifeblood of your business. One of the few positive effects of the recent financial crisis has been to reinforce the importance of implementing an effective cash management program. By taking a strategic approach to managing working capital, treasurers can free cash flow and maintain a healthy financial state. However, the challenge many CFOs, controllers and treasurers face is devising a working capital management plan that supports the organization's growth objectives, and then putting that plan program into action.

To achieve optimal results, treasury professionals should follow a three-pronged approach – define, develop and execute – when creating a working capital management strategy. By dissecting an organization's cash conversion cycle (the amount of time it takes in days for a business to convert purchases into cash receipts from buyers), and applying industry best practices, you can create a working capital management plan that will yield sustainable results.

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DEFINE: HOW LONG DOES IT TAKE TO COLLECT A DOLLAR?

The most effective approach in the development of a successful working capital management strategy is to begin with a thorough review of your cash conversion cycle – the amount of time needed to sell inventory, the amount of time needed to collect receivables and the length of time the company is afforded to pay its bills. This in-depth examination of how your business operates, from invoicing and inventory, to its ability to integrate receivables and payables, can yield insights into processes that would benefit from improvement.

Depending on the size and sophistication of your organization's treasury function, you should start by looking for bottlenecks that may be slowing down collection efforts. For example, examine how receivables are being processed. Identify Day Sales Outstanding (DSO), and how this impacts the inflow of cash. Consider questions, such as:

- Has your company taken steps to reduce the number of paper checks being processed, replacing them with faster electronic payment receipts?
- Does treasury receive complaints from customers or business partners, which might be indicative of faulty processes?
- What receivable challenges exist as your business looks to expand into new markets?

While examining the disbursement processes, use the Days Payable Outstanding (DPO) metric to determine what, if any, initiatives exist to meet critical targets. Questions to ask, include:

- What is your company doing to reduce the number of check payments issued and increase electronic payment frequency?
- What measurements have you taken to manage payment fraud?
- Do you have sufficient tools to evaluate payment terms to take full advantage of discount opportunities with suppliers?

Measuring the Days Inventory Outstanding (DIO), can help to determine if manufacturing processes are aligned properly with actual customer demand and forecasted demand. Examine the following:

- Do you know your inventory carrying costs?
- Is your inventory turning over at the same pace as your industry?

Fifth Third Bank can help you benchmark DSO, DIO and DPO performance against industry peers. This will enable you to pin-point where working capital management improvements can be most effective. Using the information from your cash conversion cycle examination, you can now establish your working capital management goals. Before you begin to develop a plan, you must first understand your intended goals. For instance, you may decide that your plan should focus on receivables improvements since your DSO is growing well beyond the industry averages.

DEVELOP: IF YOU PLAN IT, THE CASH FLOW WILL COME

Once you have accurately documented the current state of all your processes, it is important to examine each activity and determine if it is required and/or adds value to your customer. Those processes that fail to meet this litmus test should be eliminated or changed.

There is a tendency at this stage to quickly work through the checklist of current state elements because of your familiarity with the processes involved. Organizations should consider bringing in someone from outside the treasury operation, such as a banking partner like Fifth Third Bank, who can provide an objective perspective. Fifth Third has tremendous expertise in working capital management, and can ask probing questions and challenge the status quo during the planning phase, which can guide you to making critical process improvements.

Having identified activities that are contributing to pain points and bottlenecks in your collection process, you can begin to formulate a working capital optimization strategy with clearly defined goals designed to meet your business objectives. This plan should consider the current work environment, as well as the capabilities of your staff to execute once completed. Making substantial changes to treasury processes can prove difficult and time consuming, but you shouldn't lose sight of the benefits your company will eventually reap. The sports adage, "no pain, no gain," is certainly true when it comes to developing an effective working capital management plan that delivers substantive change.

EXECUTE: DIVING IN HEAD FIRST TO DRIVE BUSINESS SUCCESS

Having identified gaps in the cash conversion cycle and created initiatives to overcome those gaps, you must now prioritize plan implementation. Plan execution can be done in phases, depending on the scope and scale of your process changes. Taking a phased approach also allows for course corrections when needed, as well as presents a unique opportunity to assess the value being attained from each change.

To ensure your plan is capable of delivering the desired results, it should be carefully measured against established goals. Due to the dynamic nature of the business environment, you should periodically review your plans in order to make changes to the treasury function in keeping with critical objectives.

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This illustration shows the impact of a working capital management plan on an organization's balance sheet. Presenting the potential positive impacts on the balance sheet can be used to help gain sponsorship from senior management and support from the organization to drive the changes needed to implement a successful working capital management plan.

WORKING CAPITAL OPPORTUNITY EVALUATION

Fifth Third Ban

Consolidated Steel Works, Inc.
100 Manufacturing Lane
City, State ZIP

Financials as of: Year Ended 2010
Prepared By:
at

BALANCE SHEET AFTER OPPORTUNITY APPLICATION

FINANCIAL KPIs	BEFORE	AFTER	CHANGE
AR Days Outstanding	30.64	28.14	(2.50)
Inv Days Outstanding	103.64	103.64	0.00
AP Days Oustanding	23.58	26.08	2.50
Cash Conversion Cycle	110.70	105.70	(5.00)

FINANCIAL KPIs	BEFORE	AFTER	CHANGE
Adjusted Working Capital	$ 24,218	$ 22,966	$ (1,252)
Adjusted Working Capital / Net Sales	24.21%	22.96%	(1.25%)
Working Capital (Traditional)	$11,032	$ 11,125	$ 93
Total Liabilities-to-Equity Ratio	1.85	1.80	(0.05)

ASSETS ($000s)	BEFORE	AFTER	CHANGE
Current assets			
Cash and cash equivalents	412	505	93
Short-term investments	-	-	-
Accounts receivable	8,399	7,714	(685)
Inventories	24,165	24,165	-
Deferred income taxes	-	-	-
Prepaid expenses and other current assets	811	811	-
Total current assets	$ 33,787	$ 33,195	$ (592)

LIABILITIES & OWNERS' EQUITY	BEFORE	AFTER	CHANGE
Current liabilities			
Notes payable	12,750	11,498	(1,252)
Current maturities on long-term debt	848	848	-
Accounts payable	5,349	5,916	567
Dividends payable	179	179	-
Income taxes payable	97	97	-
Accrued expenses and other	3,532	3,532	-
Total current liabilities	$ 22,755	$ 22,070	$ (685)

Figure 1. Balance Sheet view of implementing a Working Capital Management strategy

Throughout the execution of these three steps, you would be well served to work with a banking partner, like Fifth Third Bank, to take advantage of the tools and expertise needed to develop and validate a plan, and help execute the right strategy. Fifth Third can make all the difference when it comes to meeting your working capital management goals and driving business success for your organization.

For more information please visit
www.53.com/treasurymanagement
or contact your Relationship Manager
or Treasury Management Officer.

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