# Keep communicating

**PETER WILLIAMS** LISTENED IN TO THE CONVERSATIONS AT THE ACT THAMES VALLEY REGIONAL HALF-DAY CONFERENCE ON THE WORKING CAPITAL CYCLE.

It is hard to underestimate the importance of working capital. A glance at the financial headlines proves that a business without sufficient working capital is a business in trouble. Lesley Flowerdew, tax and treasury director at multinational engineering and design consultancy WS Atkins, presented a graphic picture at the ACT conference on the working capital cycle of the importance of working capital, and suggested some tools which treasurers could use to manage working capital.

Working capital issues have a real impact on all sizes of business and across all sectors. Working capital is the operating capital necessary to maintain day-to-day operations. It can be described as current assets minus current liabilities or stock plus debtors less creditors. In the final analysis there are only two sources of capital funding: bank borrowings or cash reserves. With bank borrowing still seen as extremely difficult, it seems likely that companies will have to fund working capital from their own cash reserves.

Flowerdew said: "The industry you are in will determine how you manage the different faces of working management." For many service-based industries, including WS Atkins, stock can be excluded from the working capital equation. However, it could be argued that in some sectors such as professional services, hours worked but not yet billed equate in some way to stock or work in progress, and should be viewed as such from the point of view of efficient billing.

There are some elements in a business that cannot be moved, such as the date on which employees are paid. So for many service companies the main focus of working capital management has to be around debtors and creditors. Flowerdew said: "At a time when cost of debt is increasing, covenants are getting tougher and banks are withdrawing support where they can, the level of scrutiny for working capital has never been greater." Tools for managing working capital include:

- cash forecasting;
- ratio analysis: debtors collection days can be measured as either (trade debtors ÷ sales) x 365, or (trade debtors ÷ sales) x 100. Many companies are doing this sort of analysis by specific business units and by key accounts;
- technologies such as e-procurement (just in time) and e-invoicing can produce efficiency gains and improve liquidity management;

## Executive summary

- **The objective of the conference was to raise awareness of the importance of working capital, to look at the actions that could improve working capital, and to examine ways that organisations can continuously improve by providing tools to measure and monitor progress.**

- supply chain efficiencies; and
- debt factoring and invoice discounting.

In many businesses cash forecasting, which can vary from the basic to the highly sophisticated, is an extremely difficult and complex process. This problem, difficult at the best of times, is made even more challenging during periods of volatility. Flowerdew said: "Understanding the business and what makes your clients tick is very important. WS Atkins works on large infrastructure projects which span a considerable period of time and which can be varied at a moment's notice – extended, reduced, postponed, all of which produce spikes in forecasting."

For more companies, cash forecasting is becoming a weekly exercise and absorbing greater levels of management time. Understanding the viability and the financial position of your client is an early warning to your own business. For example, if you notice that the debtor days figure for a key client is rising, it may be a indication you need to go and talk to that client to understand what is going on and the impact it may have on your own business."

Flowerdew also spoke of a particular incident at WS Atkins in 2002. She said: "The company is open about the events and does not shy away from what happened. This is all in the public domain and we use this as a learning experience."

She explained that the period had been one of great change; the company had been on a growth strategy and was seeking to increase revenues and there were changes in the senior management structure. At the same time it was introducing a shared service facility and making sensible moves designed to centralise functions and improve services such as cash collection and a new accounting and control system.

The switch-over happened without parallel running and teething problems meant the company had a reduced ability to bill. As a result cash dropped away. The company issued a profit warning with the inevitable impact on the share price. Debtors and unbilled collections increased significantly and the latter problem meant collecting cash was a tough task. The company focused on billing, collections and cutting discretionary spend. In many ways WS Atkins was doing in 2002 what many others are facing up to doing today.

IT IS STAGGERING HOW MANY GROUPS SUFFER FROM POOR COMMUNICATION BETWEEN THE CENTRE AND THE BUSINESSES.

**Box 1:** A live issue

Working capital stories in the press mentioned by Lesley Flowerdew included reports, courtesy of Google, that credit insurers had withdrawn cover from certain sectors, companies that needed an immediate injection of working capital to survive and, from November 2007, a warning that Southampton FC might have to sell players to meet working capital requirements. The government realised the importance of working capital with a promise given in the Pre-Budget Report late in 2008 to help exporters with short-term financing.

Fundamentally, the business was strong and the bank group remained supportive. The company had rightly predicted that net debt would increase; what it hadn't foreseen was how long it would be in a net debt situation and the level of the deficit. From the nadir in October 2002 it took about 18 months for WS Atkins to go into a cash-positive position, which as Flowerdew pointed out is a strange position because as a service business it should be cash-rich.

Flowerdew said: "I cannot stress the importance of bank relations at these times and the importance of working with your banks."

This case study highlights the importance for treasurers of ensuring that their bankers understand their business. Such a lesson is crucial at a time when it appears that banks are seeking reasons to withdraw support from particular businesses or sectors.

At the low point, WS Atkins' net debt was £105.4m, but the reversal of fortune can be seen in the latest set of results, which shows that as at September 2008 the company had net funds of £164m. Along with the healthy funds the company today has a successful shared service centre with good automatic processes, good credit control and keen billing facilities. Information flow is good with weekly debtor reports and daily overview cash reports.

Flowerdew said: "Fundamentally, we have communication. It is staggering how many groups suffer from poor communication between the centre and the businesses. The centre can act as an early warning sign for the businesses and help them when their working

**Box 2:** International complexities

If a business is international this can add to the working capital management complexities. It can, for instance, mean having to deal with issues such as currency volatility and local regulatory issues such as exchange control and tax issues. If these are not understood and managed, they can quickly erode expected cash to the centre. The recession and the credit crunch has exacerbated the risk of local territories changing regulations, making the repatriation of cash more difficult.

capital position is removed from where it ought to be."

For Flowerdew communication means talking and going out from the treasury department to learn about the business and to try to avoid the frustrations that can otherwise build up. This means moving out of comfort zones and should be a two-way education process.

Such an approach allows the unit to carry on with its core activity as well as protecting the overall business. Flowerdew stressed that cash would always be king but that maximising profitability, growth and liquidity in the present climate was challenging for corporates.

**TRADE CREDITORS** After the corporate treasurer's perspective, John Mardle, a Develin & Partners leader in the area of working capital optimisation, looked at trade creditors. Where cash is tight and becoming critical, companies need to talk to investors and bankers first, and then think about communicating to key suppliers and staff.

One of the standard ways to preserve cash would be to extend creditor days. This should not be done as a fait accompli, but rather in negotiation with identified suppliers. Topics to be discussed are the date, method and precise value of weekly or monthly payment. The methods could include letters of credit or BACS and could be based on invoice value or milestones (for longer-term contracts) or round sum amounts. Mardle said: "Allow for flexibility, but be very clear with a timeline/action-driven written agreement." He suggested that companies had to be aware of the impact of extending payment terms, which could include:

- creating uncertainty among key suppliers, which may curtail supplies and communicate the wrong message, which may be fed back to employees and others;
- causing volatility of share price through publicity given to actions or disputes with suppliers;
- facing scrutiny from external bodies such as trade associations and HMRC; and
- causing problems in the supply chain by increasing or decreasing inventory, which will then have an impact on the supply line.

Mardle said: "In today's global economy where bad news travels fast you need robust lines of communication to, through and from trade creditors. In today's credit crunch climate, creditors are your lifeblood by what they supply and what they communicate to others. Suppliers are lending you cash and so they require respect."

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*The ACT Thames Valley regional half-day conference on the working capital cycle took place in November 2008 in Reading. The ACT course the Nuts and Bolts of Cash Management is a one-day training course in London on 31 March 2009. See www.treasurers.org/training.*