Ask the experts:

Finding the responsible course

HOW DO YOU WORK WITH COLLEAGUES AND EXTERNAL PARTIES TO IMPROVE WORKING CAPITAL?

Rachel Chan, chair, Manchester and Construction North West Branch, Chartered Institute of Purchasing and Supply

For many businesses trade credit is an essential tool for financing growth. Many businesses have gone under, not because they were unprofitable but because they suffered from shortages of working capital caused (in part, at least) by extending credit to customers.

There is a conflict of interest at the heart of the effort to maximise working capital. As a supplier a business wants to speed up the receipt of cash, but as a buyer it wants to extend the payment cycle. This conflict can only be resolved by legitimately using supplier credit. All corporates need to abide by agreed payment terms. Companies should not enforce payment terms on suppliers or delay payment without good reason. If disputes arise over certain bills, only the payment in question should be delayed until the dispute is resolved. Finally, it is not acceptable to deliberately misunderstand payment terms.

To avoid problems with trade credit, companies should seek to understand their suppliers and their suppliers' finances. Negotiated payment terms should be realistic and some flexibility should be built into payment processes. Customers and suppliers should think of using mutually beneficial solutions such as purchase cards, supply chain finance and electronic invoicing. Companies should try to think of the overall cost of finance in the supply chain rather than just their narrow interest.

Finally, it would be helpful to everybody involved if companies thought about long-term supply rather than just short-term financial gain.

Philip King, director general, Institute of Credit Management

Credit is a people business, so it is important to have good working relationships with external contacts and that means good communication is key. One of the big lessons I have learned from my years in the business is that it is possible to move your company onto your client's priority list.

As for the internal relations, you have to realise that credit is all about completing the sale: there is no sale until the money is in the bank. Good credit management means assessing risk and bringing value all the way through the chain. Credit professionals do more than just take the cash they are contributing to profitable sales. We shouldn't be hiding behind D&B limits, but should be finding ways of helping organisations to actually do the business. We need to be careful not to focus too much on minimising the risk. Credit is a tool, and it is perfectly acceptable to extend payment terms if the risk and the profit margins are OK.

I worked for many years for a large computer manufacturer and when it was difficult for the company to find routes to market I had to work hard with my colleagues to put deals together. Tools such as consignment stock, third parties, parent company guarantees and escrow accounts were some of the ways we tried to ensure that the sale could still happen. In that way the credit controller belongs to the sales team as much as the finance team.

Every company with business in distinct fields should have separate credit policies. Businesses have to be flexible and credit needs to play its part. This is particularly true when there is not a lot of money washing around the system. It creates pressure on organisations to create their own cashflow and that comes from a combination of paying people slower and collecting faster. Credit control is certainly going to be more in the spotlight. However good the communication and relations, you can expect to see many businesses fail over the next few months as they simply run out of cash.

Jeremy Rayner, partner, finance and treasury tax, PricewaterhouseCoopers

Public perception and corporate social responsibility have been high on the agenda of many businesses seeking to reflect the values and principles that the public increasingly believes should govern how a group does business, and provide the basis for longer-term, sustainable growth.

In good times this is fine and there is little tension with working capital management. Funds are plentiful, banks are willing lenders and focus is typically on growing profits and cost control. As liquidity dries up and the economic conditions become harsher, cash once again becomes king and the focus turns more towards optimisation of working capital.

This brings the potential for tension. Take, for example, a group that is seeing its sales decline and decides to exploit a dominant buyer relationship to squeeze a supplier. It may improve the working capital equation in the short term, but what impact will it have on the supplier? If it goes out of business, the group's entire supply chain may be damaged and its public perception adversely affected, with knock-on effects for brand recognition, customer loyalty, revenues and profits. The same considerations apply in other areas of working capital management.

The first step is for a group to recognise this tension and ensure it is properly considered in any review of working capital management. The most successful groups in the longer term are likely to be those that stay true to the underlying values and principles at the core of their business.

Taking a more holistic view of the working capital cycle will also be helpful. This means optimising the whole working capital cycle rather than maximising the parts. Collaboration and communication rather than confrontation will be key, both internally within departments and externally. Working with banks to help a key supplier acquire finance may be beneficial for both parties. Likewise, if a hard message has to be passed on, it should be done in an appropriate manner and any promises kept.

Getting the basics right will also be important; for example, ensuring the group has relevant and accurate cashflow forecasts. Working capital management is often overlooked in good times. Looking in the first instance to internal efficiencies can help alleviate the above tension.

Finally, enhancing the public perception of a group doesn't have to come at a high cost: doing the little things that matter can be just as important.

Gary Slawther, group treasurer, Speedy Hire

A company that was a good business yesterday does not become a bad business tomorrow. Businesses usually fail because of a lack of liquidity and foresight. When times are difficult companies have to live by cashflow. When a business needs to pay the wages and other bills, then cashflow is more important than profit.

Corporates are just as much a part of the working capital cycle as the banks, and treasurers should drive the thinking in corporates over how to keep it moving. If the working capital market dries up, we will all suffer. Even if individual corporates can hoard cash, in the long run that won't help anyone. We have to manage how we pay money out and get our money in. It is not in anyone's interest to see suppliers go under, especially if they are key to keeping your own business going, but likewise a business needs to keep itself going. As ever, it's a matter of balance and professional judgement: hopefully, a core skill of treasurers.

If banks don't keep lending, it will be to their detriment in the long run. In return for the banks keeping lending, treasurers need to keep them informed about what is happening in their companies. It is essential that we return to the basics of planning and forecasting. Treasurers should talk to lenders and others in the supply chain about anticipated difficulties, but in an informed way and without setting unnecessary hares running.

At any time a business should look to its own balance sheet to provide funds, such as collecting in debtors, managing payments, using surplus assets and so forth, but in the present circumstances it is imperative to look to the business first as its own source of working capital rather than turning to the banks as the first resort. Treasurers really have to understand the business. You will only have efficient working capital management if you understand fully what drives your cashflows. If you don't, then there is no way you can prepare full and accurate cashflow forecasts.

Shara Galvin, head of trade transaction services, Lloyds TSB Corporate Markets

From a banking perspective, corporate social responsibility has a key role to play in working capital management. We want our business clients to be successful, so we want to help them with working capital management wherever possible. One way that we can help is by using our existing relationships with different parts of the business to facilitate dialogue with supply chain participants within the business and externally. Good collaboration can identify opportunities for optimised financial supply chains and effective risk management.

The other role we can play is to offer different tools to help facilitate business between the supply chain partners, giving suppliers certainty of payment and buyers enhanced payment terms. One of the key issues that banks are looking at in working capital or financial supply chain management is some sort of assurance that the companies understand the risks that they are facing. This is especially important at the moment when the risks between supplier and buyer may have altered.

The bank may be in a position to have an overall view of the supply chain but we look to corporates to understand the wider risks and the whole relationship within their supply chains and industry sectors rather than just operating in a silo within their business.

We are seeing situations where larger corporates are realising the importance of dealing effectively with supply chains (both physical and financial) and this is reflected in the fact that supply chain directors are being appointed into board positions, which is something that did not happen in the past. If this is an indication of the future climate, then it is a real positive and needs to filter down into the middle markets to ensure effective and secure supply chain management.