

It's all about meeting demand

With the economic outlook improving, businesses must be more careful than ever to manage tightly, writes **Paulina Duran**.

Even though the economic outlook seems rosier now than six months ago, when lack of financing forced many bankruptcies, managers should still keep a tight rein on their businesses, paying special attention to cash and working capital.

"There is a change in confidence out there," says Geoff Webster, business services partner at accounting firm HLB Mann Judd. "If that is well placed and the market is turning, then sales will increase and that will put a great deal of stress on business cash flow."

"Companies will have to increase their stock holdings to meet demand, their working capital will grow in that period and unless they are very careful, they will be very successful or very broke."

Balancing working capital productivity and liquidity is not easy. Cash and cash-equivalents should not get too large, especially when opportunities to invest it are ripe, as they are in an economic recovery.

But working capital is essential to meet liabilities as they fall due and if they are not managed properly, the game can quickly turn fatal.

Director at professional services firm Vantage Performance Michael Fingland, whose track record includes helping clients freeing up to an impressive 25 per cent in cash flow, has a few tested tips.

First and foremost is to take a tough approach on inventory and eliminate slow-moving or obsolete stock.

"Fast-growing companies end up with far too many products and warehouses full of inventory," he says.

"The tip is to work out how much money businesses are making in the complete stock range and identify which ones are slow moving and fast moving and cull the ones that aren't profitable or not turning over fast enough," says Fingland.

This can be as severe as cutting out 20 to 30 per cent of the product range but return on working capital should improve significantly if cash flow released from warehouses is invested more profitably elsewhere.

Also topping the list is managing internal behaviour. To every action there is an equal and opposite reaction, or so said Isaac Newton.

Aligning staff pay to key performance indicators that have a focus on cash collection is bound to get results.

Accounts receivable and sales departments should work in tandem. Both groups need to be involved in collecting cash and understand that it is good clients with the will and ability to pay that matter and leave behind a pure focus on raising invoices.

Business advisory partner at



Illustration: Greg Newington

accounting firm BDO, Rana Pala, has a personal favourite: regular (read weekly) forecasting.

"You need good forecasting around both your short term and longer term but also around the customers you have and having arrangements to deal with them, ultimately shedding those who aren't going to pay you," says Pala.

That means being able to track and analyse key operating cycle metrics such as sales data, cash balances, accounts receivable, days receivables, inventory levels, days payable and costs.

Enter good systems and controls. MYOB general manager Julian Smith says business life is much easier when forward-looking cash flow processes are in place.

Some key tips

- Take a tough approach on inventory and eliminate slow-moving or obsolete stock.
- Align staff pay to key performance indicators that have a focus on cash collection.
- Business life is much easier when forward-looking cash flow processes are in place.
- Renegotiate longer terms with suppliers.

"A forecast doesn't need to be accurate but it's about knowing when to expect payments and planning for covering costs," Smith says. "It's about what you think your cash position is going to be in the future."

A by-product of disciplined forecasting is just-in-time purchasing. Avoiding accumulating too much material that might take long to turn over or never be realised (think the home insulator's unexpected misfortunes).

Finally, Fingland recommends an underused and relatively simple strategy: renegotiating longer terms with suppliers.

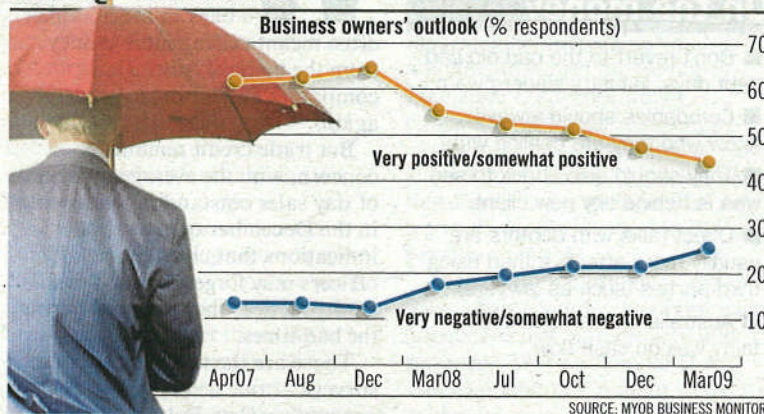
"Do it with your major ones because that will give you most of the benefit," he says.

"Even a five-day extension can mean quite substantial advantages." And Australian businesses should not feel alone in their endeavours. The latest letter from Berkshire Hathaway chairman Warren Buffett to shareholders reveals the experienced businessman's holistic approach.

"We will always arrange our affairs so that any requirements for cash we may conceivably have will be dwarfed by our own liquidity," he writes.

"Moreover, that liquidity will be constantly refreshed by a gusher of earnings from our many and diverse businesses."

Ebbing confidence



SOURCE: MYOB BUSINESS MONITOR