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Value Partnering with Procurement to Increase Working Capital

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The Benefits of Value Partnering with Procurement on Working Capital

As markets become more volatile, prices of goods and services continue to increase and working capital becomes harder to procure. As markets become more volatile, prices of goods and services continue to increase and working capital becomes harder to manage.

As you'll learn in this whitepaper, there are compelling ways that partnering with Procurement can help deliver working capital targets:

1. Procurement can help establish payment term consistencies through negotiations
2. Train Procurement to identify when extended payment terms bring more value than savings
3. Supplier performance management delivers better quality, terms and conditions
4. Creating and maintaining clean supplier and spend data empowers better decision-making

WHAT IS WORKING CAPITAL, REALLY?

Working Capital sounds like a simple topic, but it is deceptively so: It measures the amount of money coming in and going out of your company, as well as inventory. Calculating it does not take much work, but trying to increase it can be a heavy lift for multiple departments throughout your organization. That's where the "simple topic" becomes complex.

Before we get into it, here's a simple glossary to make sure we're all speaking the same language:

NWC – Net Working Capital:
In simplest terms, your company's current assets minus current liabilities

TBO – Target Business Outcomes:
The end results/goals your company sets for which you focus resources and efforts (additional capital for acquisitions, gain market share and increased profits, etc.)

DIO – Days Inventory Outstanding:
The number of days of inventory your company has on hand

DSO – Days Sales Outstanding:
The number of days it takes your company to get paid once you sell something

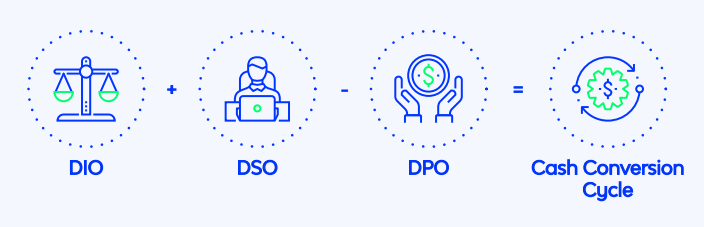
DPO – Days Payable Outstanding:
The number of days it takes to pay your suppliers

CCC – Cash Conversion Cycle:
Also called the Net Operating Cycle, it shows how long a company needs to sell inventory and collect receivables, and how much time it has to pay invoices

THE IMPACT OF CASH FLOW ON WORKING CAPITAL

Positive NWC is best for achieving any growth-related Target Business Outcomes; the more working capital you have, the easier it becomes. Negative NWC becomes a hindrance to growth, making it difficult to reach key Target Business Outcomes.

Since cash flow is critical to positive NWC, a very simple formula can be used to understand the cash conversion cycle of a company.



Let's say you want to increase your company's working capital. To achieve that, you could do one or more of the following:

1. Work on negotiating better payment terms with your suppliers, increasing your DPO
2. Get paid faster by your customers, reducing your DSO
3. Move your products faster or hold less inventory, reducing your DIO

Obviously, these things are easier said than done:

DPO is often considered the easiest way to increase working capital, but that can be difficult if not executed properly. Simply paying suppliers late may free up some short-term working capital, but the long-term ramifications will likely outweigh any immediate benefits.

DSO works in a similar way; Many companies work with customers at contract renewal time (or new prospects when going through redlines) in order to get payment terms shortened. But salespeople often lack the ammunition needed to enforce the terms.

DIO is the trickiest one, requiring a careful balance across the manufacturing and operations teams to ensure inventory is low but meets business needs.

As you can see from all this, Working Capital is not a difficult concept to understand, but trying to increase it can be a futile endeavor if you do not have the right resources at your side to ensure the highest success rate.

AREAS WHERE THE PROCUREMENT FUNCTION IS WELL PLACED TO AFFECT WORKING CAPITAL

As economies continue to bounce back from the global pandemic, companies are working hard to rebuild and reassess how to drive growth. That's because most businesses don't invest into the concept of cost transformations until they're already feeling financial pressure.

In the post-Covid era, cost savings is at the top of every C-Suite priority list. That is forcing Procurement teams to focus even more than usual on cost-centric measures as companies rethink Procurement's role and influence on cash management. The areas where Procurement can contribute most to positive cash flow and generate cash very quickly are by partnering with, 1) Accounts Payable (AP) focusing on DPO numbers, and 2) Accounts Receivable (AR) contributing to your DSO.

Procurement is the first point of contact for suppliers, and is certainly well placed to affect the conversations mentioned earlier and shape contracts to optimize these cost-centric measures to create value for the organization.

WORKING CAPITAL DO'S AND DON'TS

Plenty of organizations are paying increased attention to working capital strategies. But pursuing any strategy without a clear eye on outcomes can lead to trouble, and working capital is no different. Here is a quick do's and don'ts list when it comes to working capital:

Do's

- Understand where your organization is headed and build a working capital strategy that will get you there
- Ensure your working capital targets are attainable, sustainable and enable long term growth
- Carefully balance the roles each function plays (e.g. finance, manufacturing, customer facing teams such as sales, procurement, etc.)

Don'ts

- Use cash on hand for efficiency gains
- Push to collect additional working capital without a plan to effectively utilize it
- Damage supplier relationships in pursuit of just better payment terms

OUR FRAMEWORK / APPROACH TO WORKING CAPITAL

At Corcentric, we help our clients free up significant working capital by identifying areas/gaps in your processes, such as payment term inconsistencies. Our recommended approach is simple and holistic, and consists of the following steps:

	A VISION which is aligned with corporate strategy and supported by executives
	A HYPOTHESIS DRIVEN APPROACH based on experience that focuses efforts on areas with significant benefit potential
	Design a **PORTFOLIO OF INITIATIVES** that creates an integrated roadmap for change
	EXPERIENCED PROGRAM MANAGEMENT and **CHANGE MANAGEMENT** equipped with a robust methodology & supporting tools that drive execution
	A robust **BENEFIT TRACKING PROCESS** that is embedded within existing processes to drive accountability and realization
	An effective transition of initial programs into **SUSTAINABLE** on-going functions

WHY NOW?

As business and supply chain disruptions become the norm, organizations must ensure that they have a solid working capital strategy built on having a clear vision of business outcomes. Otherwise, like any other program, a working capital strategy may actually end up hindering your growth in the long run.

Conclusion #1:

Stay true to the original vision that your working capital programs were meant to support.

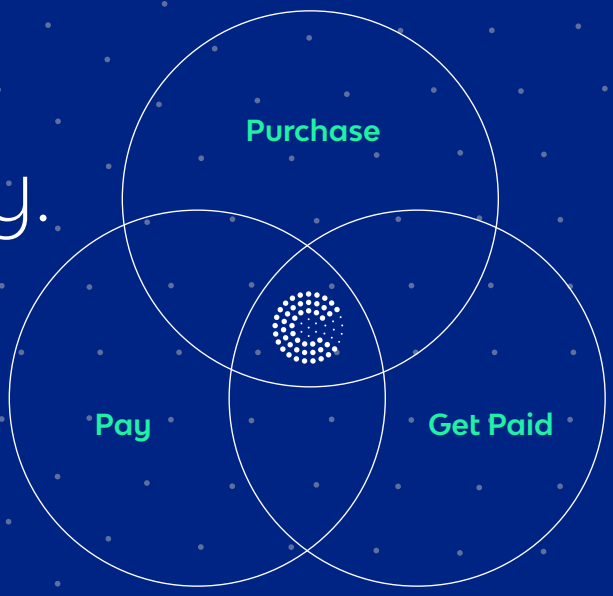
Conclusion #2:

Don't put supplier relationships in jeopardy for short-term sprucing up of your balance sheet.

Conclusion #3:

Plan, execute and track every line item, and be aware of the consequences.

Spend smarter, optimize cash flow, and drive profitability.



Corcentric is a leading provider of procurement and finance solutions. We help companies reduce costs and improve working capital by optimizing the way they purchase, pay, and get paid.

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