

Cycle ranges between 77 and 146 days, from 9 to 78 days longer than that of their best-in-class competitors. Secondly, inventory represents the largest category of working capital. As we will see below, significant savings can be achieved in this area. Thirdly, CIS players tend to get less favorable payment terms from their suppliers.

Once you have reviewed your overall working capital position and defined a target, you should identify a differentiated bottom-up approach for each component of working capital depending on your industry and company.

1. Reduce inventory

Inventory tends to be the richest source of cash—it can allow you to reduce your working capital by up to 50%. Excess inventory has three key root causes:

- **Poor accountability for inventory levels.**

Typically, managers best positioned to optimize inventory have little incentive to do so. For example, raw materials inventory is managed by Production which dictates minimum stock levels. With Production accountable for timely

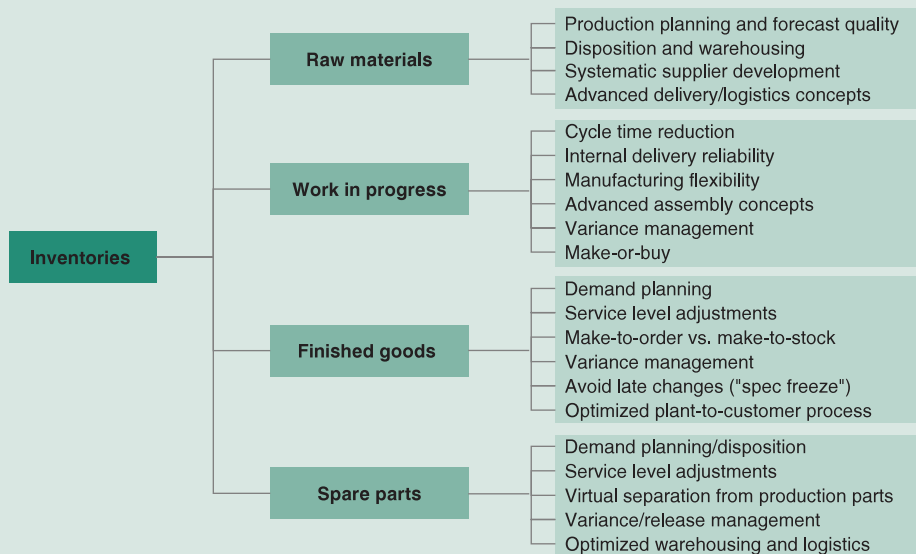
output and reduced downtime, low raw material levels are seen as a liability. While understandable, such thinking eschews responsibility for keeping inventory low.

- **Poor methods of optimizing inventory levels.** Inventory targets are rarely defined analytically. Rather they tend to be based on outdated norms. Recently we have seen an example of target levels for two items defined at 45 days, while the suppliers' lead times for the items were 30 days for one and 10 days for another. Appropriate planning, such as the safety stock method, can improve results dramatically. Also, categorizing inventory positions by size (ABC analysis) can reveal "quick win" opportunities from the application of the safety stock model.

- **Poor Sales/Production planning.** High inventory, particularly of finished goods, may indicate a company's inability to adapt rapidly to changing market conditions. CIS industrial companies tend to organize around a "push" approach—working to rigid production plans and relying on Sales to move finished goods—rather than a "pull" approach, where changes in demand quickly translate into changes in production.

Exhibit 2. Systematic approach to working capital reduction

Example: Inventories



A successful inventory reduction program starts with a systematic look at the drivers of working capital and at ways to address those drivers (see Exhibit 2—similar driver trees apply to payables and receivables). The best levers result in a win-win situation for the company and its suppliers. For example, involving suppliers in the process of operational planning can result in more accurate delivery and shorter lead times, which in turn will lead to lower raw materials inventory for the company and lower finished goods inventory for the supplier.

2. Accelerate collection of receivables

Current market conditions allow little room to negotiate improved payment terms. Nonetheless, many opportunities exist—faster invoicing, stronger collection processes, use of factoring. The sales team might often be reluctant to initiate a discussion of overdue accounts with a particular client, even if while stricter payment policies have been imposed on other clients. Moving all to a level playing field can shave several days off sales outstanding. Based on our experience, an effective tool for reducing account receivables is extension of responsibility for collection from the finance team to the sales team and the reflection of this in the incentives of the sales force.

Further, regular reassessment of the balance of power between you and your clients may provide openings for you to put pressure on those clients that are more dependent.

3. Extend payables

Some CIS companies pay suppliers three times faster than they are getting paid by their clients: a recipe for bloated working capital. Again, the main culprit is a lack of accountability for working capital.

Recent analysis of a CIS company's payments showed a pattern of payments made five to ten days earlier than required. With Sourcing responsible for scheduling payments, relationships with suppliers got priority over working capital costs. It's not surprising, in such a situation, to hear statements like "we pay a bit earlier than due date; there's no advantage to keeping the money longer."

There is also a reluctance to renegotiate payment terms and conditions—perhaps a legacy of the recent boom that put supply ahead of other considerations. Some companies allow customers, but not suppliers, to renegotiate payment terms, even when customer and supplier are one. Internal benchmarking—comparing terms and conditions for similar supplier segments, moving all to best practice—can create longer payable periods, or significant cost reductions.

Furthermore, the selective usage of VMI (vendor managed inventories) and of consignment stocks by suppliers of such items as components, consumables, packaging materials, spare parts, etc. is still underdeveloped in the CIS. We have found this to be a good tool to synchronize payments with real demand, while in addition getting the benefit of having vendors manage their own stocks more efficiently themselves.

Getting it done

The ideas outlined above are simple, yet CIS companies continually falter on execution. Clear focus is critical, with the best approach being a realistic plan with explicit priorities. An overly ambitious agenda might burden internal capabilities and deliver poor results. Companies should focus on the most promising actions and avoid weakening performance and flexibility.

What's needed is an organizational structure with focus and teeth. For example, we worked with a client to manage a "Cash Committee," chaired jointly by the COO and CFO. Besides managing the company's working capital with regular, transparent reports, it also was responsible for examining causes of excess working capital across the value chain, and recommending actions which line managers could take to reduce such excesses. The important lesson is not to rely only on financial tools and metrics—assigning targets and KPIs—but consider radically changing processes or organizational relationships.

Second, trade-offs between working capital, revenue and profitability need to be managed continuously at a cross-func-

tional level. For example, Finance could support an extension of payables, an across-the-board elimination of all pre-payments, and reduction of net working capital, but is unaware of the P&L implications of such a decision, as cash-strapped suppliers often are willing to make steep discounts in exchange for quick cash. To do this, the cross-functional “cash committee” should define rules to manage these trade-offs and be empowered to take decisions quickly to the benefit of the company.

Some successful approaches include:

- **Transparency enforced across the value chain**—avoid creating silos around individual process steps like sourcing, production, sales, or support functions
- **Formal accountability and incentives adjusted** to manage and minimize working capital

- **KPIs and targets assigned to ensure they are measurable and actionable**

- **Capabilities developed to change status quo**—update planning and inventory management systems

What is in it for you?

BCG has developed CIS-specific checklists and quick diagnostic tools that help to identify opportunities and prioritize areas for release of cash. (See example in Exhibit 3). This allows to quickly and effectively determine the biggest opportunities for milking the hidden reservoirs of your cash cow.

Exhibit 3. Wherer are your hidden cash reservoirs?

BCG check list to quick scan opportunity

Overall working capital management

- How are accountabilities for working capital assigned at the board level?
- What are the targets for working capital levels and its elements, how are they cascaded down the organization?
- What was quarterly trend of your working capital levels in 2008? Did you see strong increase in Q3 / Q4? Which element was driving the growth?

Inventory management

- Which function is accountable for inventory levels for raw materials, work in process, finished goods?
- What are the high level KPIs for inventory management?
- What is the current methodology and logic to plan inventory levels? Do you use fixed targets or analytical models?
- What is the share of non- and slowly-rotating items in your inventory?

Receivable management

- What is share of overdue payments from clients and is the trend increasing?
- How do you segment your clients for overdue management?
- What are the defined action steps to manage overdue client in each of the segments?

Payable management

- How fast you pay your suppliers vs. receive money from clients?
- What is the average time you pay your suppliers vs. contractual due date?
- What is the share of pre-payments in the total payables?
- Do you have different payment terms from various suppliers of the same category of goods?