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WORKING CAPITAL....

A Contradiction in Terms....For most organizations it’s just NOT working and that's the problem!

Today, many companies are having difficulty meeting customer expectations while operating with satisfactory financial performance. The demand for shorter delivery times and a wider variety of products and services will continue to increase. Action by competitors to satisfy both needs will also increase the pressure.

Corporations will have to continue to realign their capacity to the market demand and remain focused on customer satisfaction to secure the present level of business. However, they will soon start to see that the only way to continue to ensure business stability, profit margin and shareholder satisfaction is to also reduce working capital through improved cash-flow in all forms within the business.

Some leading corporations have already started to refocus on the working capital and cash flow side of the business success equation while still securing a satisfied customer, and both these initiatives are essential for business survival!

Our Angry Bear Story summarizes the survival issue:

Two business leaders decide to get away from it all and go on a bear hunting trip.

They pack their guns and backpacks, wear all the correct outdoors gear and head for the woods ....

They meet up with a bear all right! But he's just like some of their customers! Angry, dissatisfied and ready to maul and kill any businessman he can get hold of!

That's when our two hunters remember they have forgotten to pack the bullets...! The bear starts to move towards them to make the attack...

One of the business men who is very traditional in his operating style, takes immediate action! He turns tail and starts running as fast as he can in panic!

The other business leader stops to think... takes off his heavy backpack and boots... pulls on a pair of running shoes ..

The other businessman looks back and screams don't bother.. we can't out run an angry bear. They are faster than humans..

I know that says the lighter and more fleet of foot businessman as he easily overtakes the more heavily laden and plodding business competitor... But you see I don't have to out run the bear... I just have to out run YOU!

So that's the answer and it's plain and simple!

The answer and it's always been there is that while still trying to satisfy your customers you must learn to carry less operating load or working capital to stay ahead of your competition!

We are talking about corporations being able to divert cash from wasteful inventories and all other forms of unnecessary work-in-process and nonessential activities to self fund better Return on Investment strategies such as new products and services or even new market ventures!

This key initiative will also reduce the cost of goods sold, improve the operating margins and provide the internal opportunity cash flow to re-invest in the business, without always going to the sometimes nervous shareholders..

Improve your working capital? It's about time!

The missing dimension is not the cash itself the inventory tied up, or how to measure it - it's the time it stays in the business that's the issue!

The technical term to understand the staying time is Business Cycle Time. The science of reducing this Cycle Time is called Cycle Time Management.

Developing a game plan to undertake an initiative to improve the cycle time to dramatically improve productivity, working capital, financial performance and profits is what all the real fuss is about!

This brings a fresh meaning to the saying by Benjamin Franklin Time is money

What is Total Business Cycle Time?

A company's total business cycle time is measured from the time a customer's need is identified, until the receipt of payment from that customer for the finished product. The best analogy is a relay race. The time begins with the starting gun and ends when the last runner breaks the tape at the finish line. It includes all the time required to run each leg, as well as the time required to transfer the baton at the end of each leg.

Working Capital and Cycle Time!.

Although the amount of working capital can be reduced by shedding excess baggage or unnecessary waste items in the business, the real reduction in working capital is possible only after the business cycle time is reduced. This entitles the reduction of the previously necessary cash or inventory in all forms in the business.

In our angry bear in the woods analogy, we assumed that both of the fleeing business men -were equal in fitness. In reality, the winner will be a combination of how much waste can be reduced (backpack), how much initiative or change in operating practices the organization can undertake (running shoes) and how effective is the cycle time of the business process (the fitness or speed of the business men).

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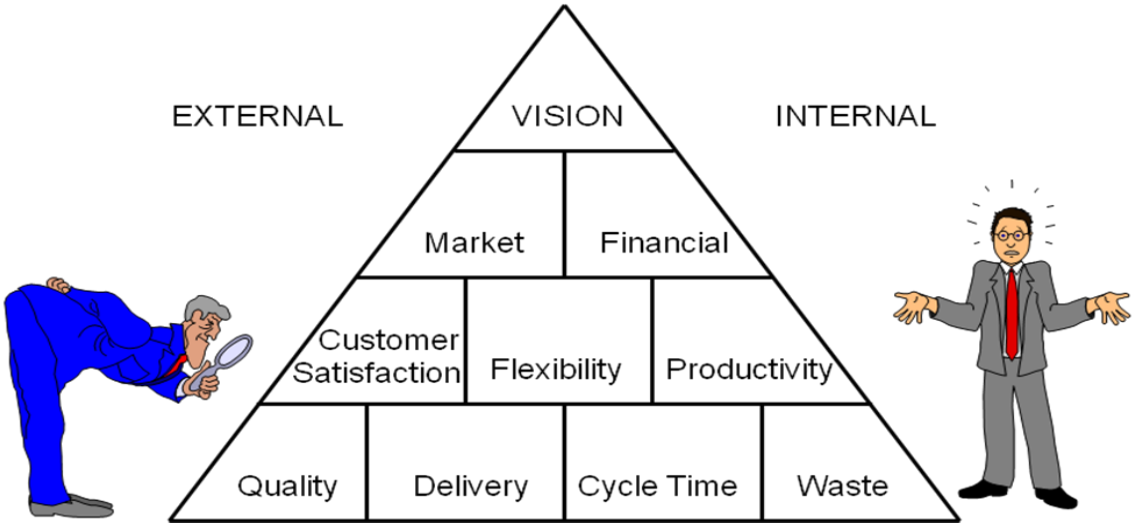
<u>The Relationship between Customer Satisfaction and Working Capital!</u>

The relationship between customer satisfaction and working capital is that they are both important parameters for business success!



Looks good to me! …says the customer... But don't forget the shareholder!

This performance pyramid model defines the business vision as needing to focus on both market (external) and financial (internal) forces for a business to fully define its overall performance. Many interpretations and versions of this model exist but for the purpose of this study, we will define a reduction of working capital as the financial performance measurement of a business.

<u>The Market (External Customer) Side of the Pyramid</u>

To meet the demands of the external customer, an organization must improve Customer Satisfaction.

Customer Satisfaction is very often defined as the performance in providing quality products and services, with excellent delivery. To meet the high demands of the modem market place will also require increased flexibility to meet that demand ... especially if the market is turbulent or where share retention, due to negative growth or high competition, is an issue.

If we take this flexibility issue further, in many markets today the speed of change for the demand for new products, services and technology, frustrates the strategy of mass produce it! stock it! and convince the customer to buy it!... and hope it sells!
Not only does the customer demand high quality and a great price but they also expect availability of the latest product, at a competitive time to market!......

So it's important to note that flexibility is at the center of this interactive model and is linked to the market requirements via the delivery measurement.

<u>The Finance (Internal Shareholder) Side of the Pyramid</u>

Shareholder satisfaction is directly measured by the utilization of capital employed such as return on net assets and other investment ratio models.

To improve the capital employed it's got to work harder (working capital). The greater the internal productivity then the better will be the utilization of the working capital!

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But that’s Not Enough

Productivity is just not enough. Working capital must also be flexible so it can be deployed in the right places in the more rapidly changing market! m other words, high inventory of finished goods for a product, even when produced with perfect efficiency and direct cost excellence, may take care of the customer side of the pyramid, but it will not create sound utilization of working capital in a fast changing marketplace where the capital may be better deployed in new product or new
market ventures, etc.........

This combination of flexibility and productivity is the new measure of the performance of business working capital. Flexibility in a business is the central performance measure that may have been forgotten or overlooked by many businesses and is sometimes tougher to understand, quantify and improve. However, it's a common requirement to both the external customer and the shareholder via the ability to rapidly satisfy the customer, yet operate with less working capital in terms of inventory and activities in process, via short cycle time operating practices.

Cycle Time is the Place to Start Your Improvement Process!

Our belief is that cycle time reduction is the place to start your improvement activities because it will expose quality and cost components of waste. It will also expose the lack of flexibility issues and will, in parallel, attack or address the delivery performance issues.

Although many businesses have already looked at quality/cost initiatives such as Total Quality Awareness (TQA) programs, they have found it difficult to bridge the gap between customer quality on the external side and waste and productivity in the business, even when they can see the need for improved productivity.

The reason is that true productivity opportunities and improvements do not become fully exercised without a cycle time or flexibility component. Although waste reduction projects may fix the cost leaks in operational productivity, they will not expose the hidden inflexibility in working capital in the business that can only be mobilized by time-based or cycle time driven initiatives.

The business must focus on improving productivity in two ways...........

Waste Reduction: by reducing waste in all forms such as rework and scrap, warranty costs from the customer as well as more hidden waste such as the cost of poor quality and inspection surveillance, etc.

Cycle Time Reduction: by reducing non value adding activities such as change-over time, rework, repairs bottlenecks, delays, slow decision making, bureaucracy and other cycle time impediments.

When do you get it?…where is the NEXUS??

If you have a Cycle Time reduction initiative, you probably already do get it. Cycle Time is the correct operating term to use on your organization (improved working capital utilization is the outcome). Cycle Time Management will be the NEXUS for the next business decade for all organizations, except perhaps the benchmark leaders.

Cycle Time is a new business initiative for most corporations.
Most are still focused on the obvious manufacturing or related distribution inventory, if so, you do get it, but you're just scratching the itch!

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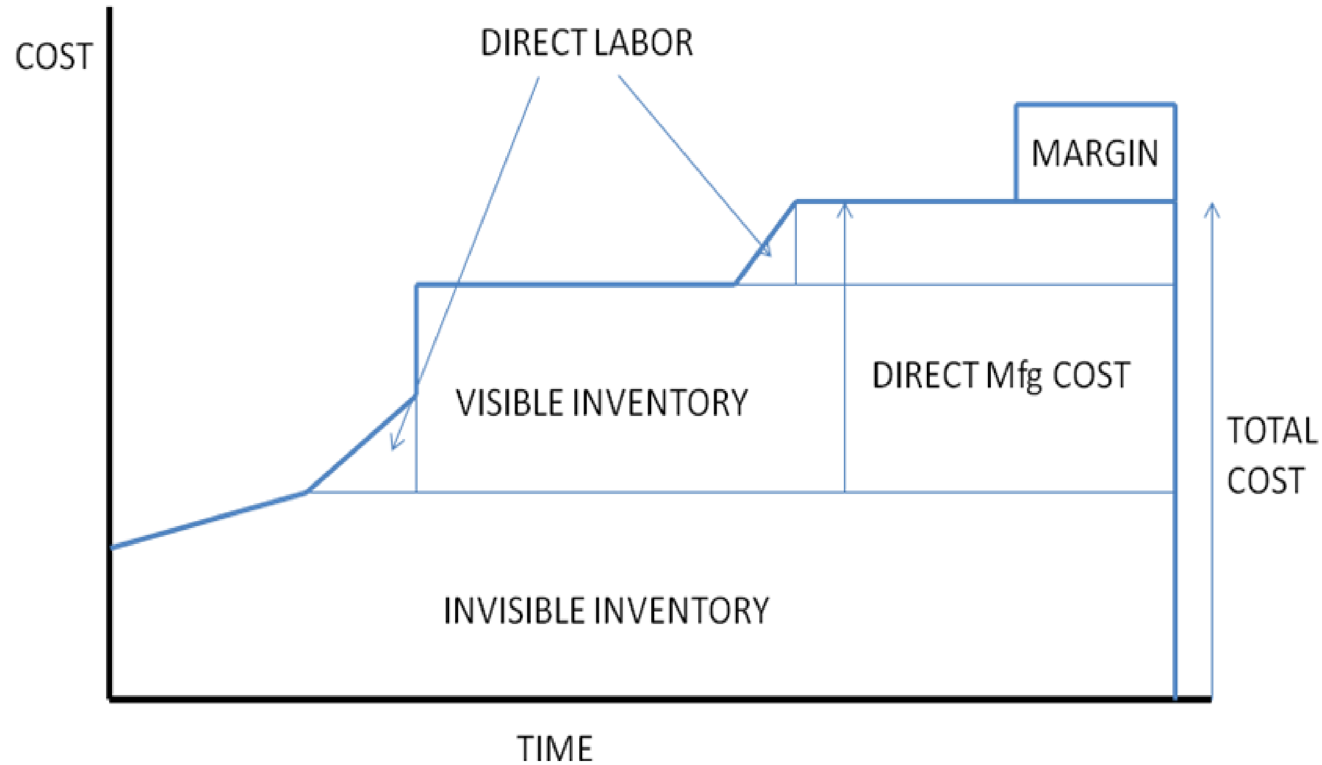
Use a Cost -Time Profile of your Business to Expose the Working Capital

This provides a profile for cost and time that depicts your organization's working capital opportunities.

Look at the area under the curve (draw horizontal and vertical segments as shown)



The total area under the cost-time profile represents the working capital required to operate the business.

The relationship to inventories, both physical and invisible, cash receivables and all non value adding activities can be illustrated on this profile, as well as the impact of cycle time on working capital and the profit cycle!.

The scope of your working capital reduction quest should be expanded to include all forms of cash and expense. Vast amounts of area resides outside the part covered by traditional costing realms.

Please notice that direct labor or direct value adding activities form a very small part of the whole area and that physical inventory is usually a more significant part of the whole.

These non-value adding items such as inventory, delays and non-essential activities are only possible to reduce once they are focused upon and the impact on the overall business performance and working capital understood. You must be sure that activities, not organizational levels or departments, are the focus of the review.

Also make sure non-value added activities have been clearly defined and that you are entitled to remove them.

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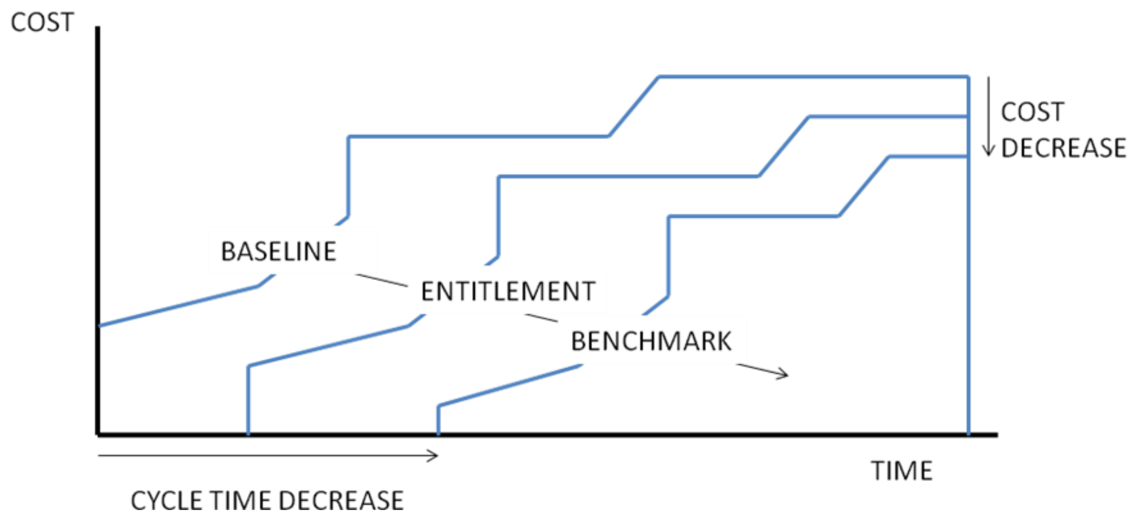
Moving from BASELINE to Entitlement, and then to Benchmark



The goal should be to shrink the profile to some level that the organization can be entitled to operate at without more capital injected so that the working capital that remains will work harder (this is easier to say, than do!).

BASELINE is defined as the present level of performance of the business in terms of the amount of working capital required to run the business.

ENTITLEMENT is defined as the improvement possible without additional capital or technology invested.

BENCHMARK is defined as the best in class performance with future technology and investment.

The difference in area between BASELINE to ENTITLEMENT represents the entitlement (or less need) for working capital to operate the business at the same level of revenue after the reduction in cycle time and the reduction in operating cost through improvements in operating practices without adding any new capital or technology.

Please remember that as cycle time improvements are made, waste becomes exposed. This will further provide focus and reduce costs so that the area should shrink in both axis to improve the profit, as well as the cash position of the business.

Benchmarking Helps to Force a Vision!

Another profile should be developed for the best in class or Benchmark organization (or the organization you would like to have in your wildest dreams).
Many competitive Benchmark techniques now exist that can be applied to this what if I had that performance kind of study. To more clearly see how far the improvements in performance can be taken, many organizations use benchmarking against competitors and other best in class performers.

Visioning Skills - an Organized Approach and Special Improvement Tools will be Needed!

Working capital reduction and the macro areas of opportunities can be displayed by a Cost Time Profile. Determining how to improve from BASELINE to Entitlement and then toward Benchmark will also require an organized approach to change and special planning and visioning skills to effectively improve the business process and evolve the practices employed to operate the business.

Waste Elimination - Simplification and Elimination are Key!

One outcome of a cycle time reduction initiative is a focus on the simplification of the existing processes and the elimination of waste or non-essential activities. The departmentalization of business functions has inhibited business process linearity and competitiveness. All of the functions in a business must be simplified and then integrated if total business cycle time is to be reduced and a global competitive capability achieved.

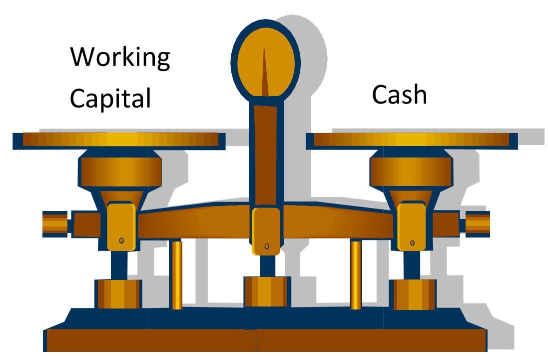
The reality is that as many as 90 percent of the existing activities are non-essential and can be eliminated. This elimination of non-essential process time usually creates a one-time working capital reduction and a recurring reduction of the cost of working capital. This frees up credit or cash and will help to release the scarce and expensive resources required, eventually to further reduce cycle time, purchase new technology, reduce loans, or fund new research and development

Reduce Working Capital = Reduce Cycle Time!

When cycle time is reduced, operating CASH $$ is released from the inventory and overhead/operating accounts in the business and the business can operate with less
working capital. This is a prime ingredient for a healthy, more robust business into the next century!

Make a Start..

Cycle time reduction is an excellent starting point.



The symptoms are obvious and the tools for improvement are readily available.

However, it must be a global company strategy to reduce the total business cycle time and the utilization of overall working capital.

Such a strategy can create a realignment of the whole organization to a compelling purpose.

A common and holistic goal which can bridge the barriers between departments.

It can redirect the creative energies to achieve competitive superiority.

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The advantages of one total short cycle-time business process are clear:

o It provides flexibility and agility in all aspects of business practices to stay competitive.

o It enables the company to respond promptly to customer requests and future markets.

o It ensures quick delivery of high quality, low cost products, present and future.

It provides the appropriate lever to move towards excellence in the use of working capital and shareholder satisfaction.

The Way Forward

Many corporations are now more comfortable with the relationship with their customers in terms of delivery and quality and have also come to terms with the internal capacity/size issues through downsizing and organizational realignment.

At the very best they have better aligned the business capacity with the real market demand and maybe through market pressure have restructured to improve the relationship to the all important customer. (But have they really improved the internal fabric of the business in the operating sense?)

Only a few have already grasped the real intent of business re-engineering and have successfully grappled with the paradigm of conventional business operating practices-

Unfortunately, many companies have only focused on the customer satisfaction aspect of business excellence and have not even started to reduce their total business cycle times to improve the working capital position!

The result is that not only are they denied short New Product Development and Strategic Planning cycle times, but they are also failing to meet rising customer expectations for shorter delivery times, higher quality and wider product variety.

What's next?? Many have tried the magic slimming pill of restructuring and are now looking to internal improvements to not only support the business recovery and capacity consolidation but also provide cash into the business, even m negative growth. (Share growth is probably just not possible in most markets, so share performance is where it's at!)

The recovery of internal cash in terms of working capital is probably the only way to provide the return on shareholder investments and this will certainly require a complete new set of operating practices with a focus on business cycle time!

Note: This paper is a follow-on from the book*: CYCLE TIME MANAGEMENT..The fast track to productivity improvement *by Nigel Southway of NEXUS

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