Informita News

Issue 02

December 2012

IN THIS ISSUE

Wooden Dollars

There is the old adage that you can't manage what you are unable to measure. This is very true when it comes to working capital measurement. Very often large companies only get aggregate information from their subsidiaries on a monthly basis that often does not distinguish between third party transactions and intercompany transactions. This can cause huge distortions in internal reporting and can mask serious working capital issues. In some cases, the method of settling intercompany balances can compound the problem. While there are many companies that insist that all inter-company transactions are settled and reconciled at month-end (thus eliminating the potential for distortion), there are still many companies where individual subsidiaries delay intercompany payments to window dress their working capital results. The best way to guard against this problem is to ensure that third party and intercompany balance sheet items are reported separately and that your ERP systems have adequate coding and reporting that makes this an easy process. In addition, any bonuses paid to managers based on working capital performance should be based on third party transactions only.

Supply Chain Risk

Have you a viable alternative to your seemingly stable supply chain?

Supply chain risk is getting to be a much talked about subject these days as our global supply chain becomes ever more interconnected. We continually see news items about violence in Afghanistan, Syria and Yemen. So it seems pretty obvious to keep away from these places. But it's easier said than done. A very good example was Libya. International trade was rapidly returning to the country before the wholly unexpected revolution happened. Mali is another example where the transition from model African state to instability happened in a matter of months. An increasing factor in the management of supply chain risk is natural disaster. Earthquakes in Japan and New Zealand, floods in Pakistan and Bangladesh, forest fires in Spain and Portugal have all had their impact on supply chains in the last year and the scientists are warning us that the risk of these natural disasters is increasing in conjunction with the pattern of global warming. So it might seem logical to stick to North America and Europe and avoid these more exotic locations. In today's economy that is increasingly unrealistic. The growth of consumerism in places like China, India and Brazil means that having sales channels that reach the entire globe are fundamental to most corporations' business models. Equally, the level of price competition between manufacturers means that the employment of cheap labour from low cost countries such as Vietnam and Mexico have become a necessary part of the supply chain footprint. Also many of these countries are pretty small in relation to the total global economy, so oftentimes the impact of disasters in these places is fairly limited. But that is not true for North America or Europe. The recent Superstorm Sandy is continuing to have its effects in parts of the North-East United States. There are still factories that are not yet up and running. International shipping schedules were seriously disrupted. The volcanic eruptions in Iceland in 2010 had the obvious impact of shutting down the air industry in Europe. A less obvious impact was that some fruit growers in Israel and Kenya were unable to transport fresh produce to key Northern European markets as a result. One solution is to buy insurance to cover any potential financial losses. But this type of insurance only covers limited risks and doesn't do much for customer retention. The other approach is to ensure that there is an alternative supply chain. This is the case for dual sourcing, but such a strategy must be balanced against the probable additional costs. Supply chain risk cannot be avoided but it can be managed. (Read more in our Supply Chain Risk Survey at www.informita.com.)

Data Manipulation: An underrated skill

Back in the days before decent ERP systems, obtaining transactional data could be almost impossible. Very few had the skills to extract and then manipulate data into meaningful reports and as a result managers were heavily reliant on instinct rather than facts. You would think that all of this has changed, but that is not the case. Even with the best ERPs and data warehouses, individuals with the ability to understand how to handle large volumes of data easily are still a small minority. It is not a question of intelligence, but is one of aptitude. So when you discover that you have one of these individual's on your staff, treat them preciously.

Why temporary plant shutdowns don't solve your inventory problems

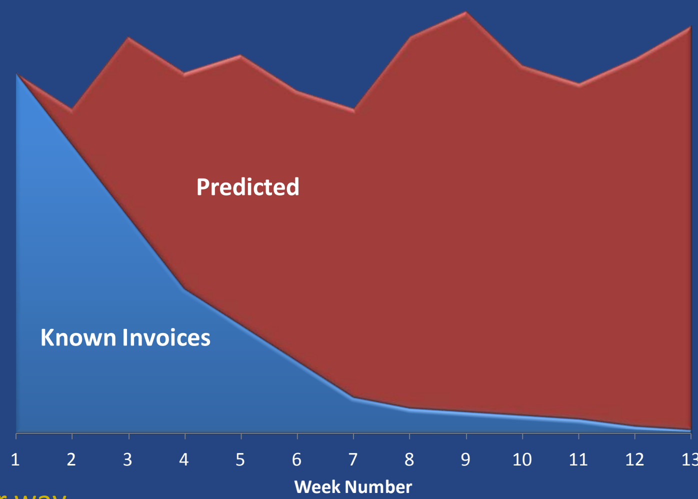
General Motors closed their UK car plants for one week recently in an effort to reduce excess inventories of vehicles. This seems entirely logical, but this action on its own can only be a temporary fix. There is no doubt that if you continue selling your products while manufacturing has stopped, you should expect to see a dramatic fall in inventory levels. The problem is usually that once production starts up again, inventories are likely to reach their former levels quite quickly. This happens because none of the other factors that drive inventory will have changed. The products that sell at a high frequency will fly out the door and thus inventories will decrease rapidly. But those items that are slower sellers or have a more erratic demand pattern will remain in inventory throughout the shutdown. Once production resumes inventory levels of the high frequency items will return to their old level quickly in order to service daily demand. So what can be done to avoid this scenario? Before any plant shutdown it is essential that all demand and production parameters are thoroughly reviewed. The fact that these parameters got out of line is the reason there was excess stock in the first place. It might be necessary to change stocking policies on particular products e.g. moving to make to order rather than make to stock. Customer lead times may need to change. This will involve engagement from the commercial teams to ensue the new lead times are acceptable and communicated properly to the customer. It may be that batch sizes need to be revised. This will help to reduce the peaks of inventory holding. To be sustained an effective sales and operations planning process needs to be in place that is dynamic and responsive to changes in demand.

China: Losing its advantage

Nobody can argue against the fact that the economic advancement of China in the last 35 years has been truly remarkable. But we have already seen that the breakneck GDP growth of previous years has slowed down. Wage rates continue to rise at dramatic speed, there is a massive property bubble that has to burst at some point. Government policy obliges state controlled banks to fund the massive infrastructure developments that continue across the country. On the east coast, the days of cheap labour are rapidly disappearing. Companies are moving ever further west in the search for cheap unskilled workers. Companies are complaining that they can't borrow enough money from the banks to fund the capital expenditure required to properly develop the domestic consumer economy. This doesn't mean that disaster is imminent, but does mean that as China continues to advance and its people enjoy the fruits of economic development the advantages that China has used for the last 35 years are rapidly disappearing.

Sourcing Strategies

Sourcing is a job that is never truly done. As soon as the latest deal is concluded, the world changes again. Technology keeps on improving and offering new ways to process transactions. New parts of the world keep opening up for business like Myanmar and Cambodia. New services become available that means the way you have purchased goods and services in the past requires re-evaluation. Suppliers trading footprints are constantly evolving, providing a more competitive landscape for many procurement professionals. There is always the tendency to become complacent when savings are being regularly achieved. But the very best are always striving to become even better. They seek out new technologies and other opportunities to improve. They continually question themselves in the pursuit of perfection. And the performance gap between the really great performers and the average performer gets wider every year. So no matter what industry you are in, there is no room for resting on your laurels. Change is one of the few real constants.



Cash Flow Forecasting

There must be a better way

The difficulty in forecasting next week's outflows never ceases to amaze treasury professionals. Organisations put huge efforts into meeting sales and profit forecasts, but cash forecasting remains a real difficulty for most organisations. The result of this problem is that many treasurers hold deliberate cash buffers to deal with the inaccurate information they are supplied by the business. Wages, salaries and taxes are the easier ones to predict. The root of the problem is poor process adherence coupled with poor forecasting techniques. We all know that some customers pay late and most companies now have a wealth of data that would allow them to accurately predict cash inflows from customers. But this analysis is largely undone. You would think that it would be easier on the payables side. But it isn't. Process errors will cause late payment. Edicts from above will force early payments. Short term cash forecasting is often a "back of the envelope" calculation. Even in situations where process adherences is quite good, forecast error can be in excess of 20% due to the use of top-down forecasting techniques that are straight-forward but wholly inappropriate for use in situations where there are thousands of independent transactions. The answer is to use your transactional data to build an accurate forecast model, similar to an inventory model. This can then create highly predictive cash forecasts that can respond quickly to changes in revenue and spend patterns. The model can also be used to identify process issues that cause forecast error. So there is a better answer, but the devil is in the detail.

At Informita.com

Go to our website and get a free copy of our Working Capital Survey 2012. This will help you to understand other people's perceptions on working capital and the actions they are taking.

Informita

Website: www.informita.com

Twitter/Facebook: @informita

Email: info@informita.com

Phone: +44-20-3286-4109
+44-7769-260-042

