Manage the impact on Working Capital

What the COVID-19 response teaches us

Since the first reports of the appearance of COVID-19 in China reached us at the end of last year, the situation has escalated quickly to a global level. Today, the impact of this new viral disease is widespread and can no longer be avoided.

In an attempt to contain the spread of the virus, the Belgian government has announced several drastic measures. Many other countries have also issued either negative traveling advice for their residents, discouraging foreign travel or have prohibited their residents from travelling to other countries altogether. Aside from these government-imposed measures, it is the responsibility of each and every one of us to do everything in our power to protect public health and to apply physical distancing measures.

It is important that every Belgian company takes some time to reflect on the impact of COVID-19 on their organization. Not only should the impact of COVID-19 on the companies' employees, fiscal, legal, and tax implications be reflected upon, the organization should also be aware of the going-concern risk that they may eventually face the coming days/weeks/months when running out of cash. Cash and working capital management are important factors within this assessment.

Challenges

- Will the company be able to collect their (outstanding) receivables and fulfil their suppliers' conditions?
- Will the company be able to monitor their payroll liabilities?
- What about (un)expected (cash) expenses?
- If cash-in flows are lower than cash-out flows, how long can we face this situation?

Domains

People **Legal** **Finance** **Tax**

Which measures can we take to prevent further cash destruction?

A lot of companies don't have the luxury to worry about future implications, but are struggling to survive as we speak. Many are impacted by decreasing customer demand and disrupted supply chains. On short notice, fiscal and legal measures will have to be considered and applied to give the company the space and time to further deepen and improve their working capital position for the coming weeks and months.

Immediate actions

Businesses with extensive presence in - or direct ties to - affected areas must take immediate actions to assess organizational exposure, positioning them to appropriately support key stakeholders, employees, and customers.

Manage working capital risk

- Create a response team to facilitate the open and consistent flow of accurate information between key stakeholders, maintaining stakeholder confidence and informing customers who will be impacted.
- Establish a team to focus on credit collection and supply chain. This team will work to review contracts with key customers and suppliers to understand obligations and liabilities.
- Determine business exposure by identifying current and buffer inventory, building tier-transparency and short-term action plans.

Safeguard people

- Leverage HR expertise to maintain employees' physical and mental wellbeing.
- Develop a (back-up) plan for impacted staff that may include contingencies for more automation, remote-working arrangements, or other flexible resourcing in response to personnel constraints.
- Leverage available internal and external technology to aid collaboration and equip employees with necessary tools to work remotely both in affected areas and with individuals in affected areas as seamlessly as possible.

Tax implications

- Pay attention to the corporate income tax and VAT consequences due to changing business income and expenses. Request a payment plan or apply for refunds if needed.

Legal implications

- The fulfilment of contractual obligations might become strained. You may invoke "force majeure".
- Consider which actions are needed in terms of corporate law (such as the shareholders-meeting, annual report, and annual accounts).

Medium-to-long term actions

Beyond immediate actions, organizations should value the opportunity COVID-19 provides to reflect on the ability to navigate a crisis and going forward, consider actions to increase agility and become more resilient in the future.

Scenario planning: Organizations must act with imperative when developing and implementing enhanced risk management practices, focusing on the opportunities scenario planning offers in creating action plans. Scenarios enable organizations to see the bigger picture and make effective trade-off decisions. Simulations can be run swiftly to identify rapid "low hanging fruit" opportunities. By further analyzing past events and hypothesizing future threats, organizations are able to identify strategic and concentrated customers and suppliers that are at risk.

Customer and supplier identification: Real-time customer and supplier data should be monitored, assessed and reviewed, to be able to manage the customers and suppliers at risk. Ensure communications are made with principal stakeholders, such that the performance is not affected and terms and conditions are guaranteed and followed. Identify the legal consequences and risks that may arise from doubtful debtors or suppliers.

Review impact on business operations and processes: Review and assess what impact an event will have on your day-to-day operations. Not only will it impact your process, but workforce planning and process management will also have be monitored and critically reviewed. Do you have already a view on your automated/manual process?

End-to-end systems and reporting: A lot of opportunities and weaknesses are not identified if the operations, transactions and processes are too manually monitored. If the lead-time between the different steps are too high, this will result in a longer cash-conversion-cycle time. IT-systems should support you in enabling an end-to-end reporting experience to be able to track-and-trace from A to Z the whole process.

Create an agile and visible working capital framework: Working Capital Management is not only a financial term. Working Capital is measured through financial KPI's, but if you want to improve those KPI's, you will have to optimize the underlying process. It is an operational issue that impacts the income statement of your company and can be improved by 20-30% via process optimization.

Improved and optimized operations and processes will result in an improved cash flow, cost reduction, an improved balance sheet position and your increased cash position will allow you to an improved funding position

As tomorrow's disruption is surely already brewing, the business world should always be ready to adapt to constant changes.

What can help your company to face this crisis and prepare for other crises to come?

Working capital management is an important and powerful tool to prepare for and manage foreseen and unforeseen future events, including disasters such as the financial crisis of 2008 and the COVID-19 pandemic that companies are currently facing.

To say that companies could have been fully prepared for such an event sounds a little far-fetched, but nonetheless holds a certain level of truth. In the aftermath of the 2008 financial crisis (where companies faced similar liquidity challenges), working capital management arose and treasurers and credit controllers became a strategic partner for businesses. Companies who heavily invested in their working capital management and supporting tools back then, will be better prepared and more resilient when taking on the COVID-19 challenges of the present.

Preparing for any such changes requires in-depth knowledge of the company's current financial situation, including an accurate up-to-date view on the day-to-day and future expected liquidity position.

If you don’t know how much liquidity you have right now, how would you ever be able to predict, prepare, and act upon changes in the future? This includes not only the amount of cash available, but also the location and the time required to access it. Companies therefore need to have clear insights into their financial statements, including cash balances, credit lines, covenants and outstanding receivables, payables and inventory levels.

Once these are available, predictions (based on data and planned transactions) can be made, including:

— Daily/weekly/monthly evolutions in cash flow
— Daily/weekly/monthly liquidity available
— Future scenarios and their impact

The following overview outlines the different sub-processes for order-to-cash, forecast-to-fulfil and purchase-to-pay that your company needs to understand, as well as which measures and actions you can take to improve your working capital cycle.

Order to cash

1. **Customer acceptance**
2. **Sales management**
3. **Credit risk management**
4. **Order management and invoicing**
5. **Collection**
6. **Dispute management**
7. **Cash**

1 Customer acceptance

It all starts with pro-active and preventive customer account requests and actions upon accepting a (new) customer that will lead to a profitable and sustainable customer relationship – this is your first line of defense. Make sure that all relevant and necessary data information is captured, to be able to take the correct conclusions from the credit and other checks review. Transform into appropriate contracts via contract approval that will be legally and financially binding so that all parties can rely on the contractual terms and obligations set. Payment terms, credit limits and other billing information will have to be defined during the customer account set-up.

— Is a credit check carried out for new customers? What does it involve?
— Does the company use customer contracts prepared by a legal department?
— Is the customer data managed, checked, and updated?

2 Sales management

During the customer acceptance process, it is most convenient to have a strong interaction with the sales management. Alignment on the quote/price, payment methods and terms should be stipulated in the contract’s definitions and terms. Sales management should be aware of the customer profitability. An effective and efficient sales force incentive structure can help to measure and follow up both the customer and sales KPI's.

— Is the sales department informed and aligned with credit and collection management of customers?
— Are standard sales conditions (payment terms, payment methods, contractual obligations, etc.) defined and in use?
— Is the profitability and KPI's of individual customers/products monitored?

3 Credit risk management

Your company may be over-exposed to certain customer types or industry sectors, increasing bad debts risk. Perform a customer risk assessment and monitor the ongoing risk appetite and payment behavior of your clients. Clear risk control procedures and roles should be in place to pre- and post-assess the customer and be able to intervene (credit limit management). Flexibility to process amendments to terms, limits, billing information and frequent cross-checking between the contract database and the Masterfile can help to ensure that customer contract information is captured. Credit risk management will be your second line of defense in ensuring a robust and reliable cash flow.

— Is the credit management process clear and followed (e.g. credit policy, authorization levels, timeframes)?
— Is there a regular review of customer credit limits/payment performance?
— Is the information in the system Master Data File (MDF) accurate and up-to-date?

4 Order management and invoicing

An automated order management will help to monitor correct order entries, inventory levels and order fulfilment, which will result in higher-quality customer service and fewer complaints. It will further reduce the lead time for invoicing and production, as well as the manual work of possible invoice corrections and verification. Deductions management and exceptional invoicing should be used to a minimum extent, where possible, or incorporated into the process to avoid delayed ordering or invoicing.

— Is there an automated process between order fulfilment and invoicing?
— What performance metrics are measured (e.g. order differences, late deliveries, returned goods, etc.)?
— Are frequent one-off invoices captured for financial reporting and collection?

5 Collection

An effective collection procedure is at the heart of your company. Taking into account the previous steps, you will have to define a, specific, customer collection strategy and cash targets. Upon monitoring and measuring your DSO (Days Sales Outstanding), a company will receive triggers to start the dunning process, take bad debts and write-offs or eventually stop the customer relationship. Avoid contract litigations and be pro-active. Cash flow management will give you insights into your working capital needs and opportunities.

— Is there a customer collection procedure in place and adhered to?
— Is collection and dunning organized and monitored?
— Are write-offs and doubtful debtor (triggers) reported to Finance and investigated as appropriate?

6 Dispute management

Should you come into a dispute with your customer, it is important to gather the information on the root cause. This will help you in identifying the dispute in an early stage of the order-to-cash process, which will enable you to resolve and prevent the error. Credit notes cause invoices to be re-aged and may cause significant impact on unexpected cash-outflows. Unsolved disputes should be avoided to not disrupt your whole order-to-cash process.

— Do you have a (standard) procedure to manage around any credit limit issues?
— Are disputes identified, measured, and resolved?
— Is dispute management performed in-house or externally in an automated way?

7 Cash allocation

Cash postings should not be labor intensive so that you have an up-to-date view on the company's current cash situation and can monitor future cash-in/out flows. The unallocated cash should be reduced to a minimum. Ledger and customer account reconciliations will enable you to reconcile and monitor that (future) cash is posted to the correct accounts.

— Are actual payments consistent with the amounts due or are there frequent discrepancies?
— Is there a clear policy and process for dealing with unallocated and unapplied cash?
— Is unallocated and unapplied cash monitored?

Forecast to fulfil

1. **Product portfolio**
2. **Sales and manufacturing planning**
3. **Procurement and replenish-ment planning**
4. **Manufacturing sales and execution**
5. **Inventory management**
6. **Distribution and delivery**

1. Product portfolio

Prior to product portfolio management, a company needs to have a clear corporate strategy (Operational Excellence, Customer Intimacy or Product Leadership). Depending on the corporate strategy, a product range will either be more focused, broad or highly variable.

— Has the product portfolio developed taken capital needs into consideration?
— When is a product range broad and deep enough and how do you manage the product lifecycle?
— Does the portfolio have a high variety of products and models?

2 Sales & Manufacturing planning

A solid Sales & Manufacturing plan harmonizes manufacturing processes with customer demand/forecast. Organizations will be able to address critical cross-functional business decisions across product lifecycles and deliver alignment on planning and execution processes. Aggregate manufacturing planning decisions will enable operational decisions in terms of cost, equipment utilization, employment levels, and customer satisfaction.

— Are your Budgeting, Planning, and Forecasting processes siloed? Do you know how to integrate them such that your financial commitments are backed by a solid operational plan?
— Can you say that there is low interdependence and coordination lacking between sales and production?
— Do you know how to avoid being surprised by not meeting demand

3 Procurement and replenishment planning

Replenishment planning determines the best balance between customer service level and inventory. It reconciles customer demand with an organization's manufacturing, distribution, or procurement capabilities, enabling rapid response to changing requirements.

— Does your company need a high safety stock to guarantee (flexible) product availability?
— Is there a clear overview of preferred suppliers and their terms?
— Does your procurement department target discounts instead of payment terms?

4 Manufacturing scheduling & execution

The aggregate manufacturing plan is broken down into specific product requirements in order to determine labor requirements (skills, workforce size), materials and inventory requirements. The result of disaggregating the aggregate plan is a Master Production Schedule (MPS). This schedule indicates the quantity and timing of planned completed production.

— To which extent are variations in demand and supply affecting the planning? Frequency and size of variations?
— Is your manufacturing measured on utilization of equipment?
— Are there long throughput times in production and distribution?

5 Inventory management

Inventory management involves planning and control of all types of inventories (batch inventory, safety stock, seasonal stock, capacity stock, WIP, strategic stock, obsolete stock). Besides the decision as to whether an item should be in stock or not, inventory management requires two major decisions: when and what to order.

— Do you know how to reduce your overall inventory costs while improving customer service?
— In your company, is there a high amount of slow moving goods?
— Is there a low transparency and/or accuracy on stock levels?
— Is the company lacking investment in automated warehousing?

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Purchase to pay

1. **Procurement strategy**
2. **Supplier selection and contracting**
3. **Requisition and order management**
4. **Receiving and supplier management**
5. **Discrepancy management**
6. **Invoice processing and payment management**

1. Procurement strategy

If people are able to buy from suppliers without control, a company has no purchasing policies/framework in place. However, this framework should allow you to identify the different purchasing channels and control them. A defined segmentation model and supplier strategy will help to further fine-tune the payment terms, method, channel and goals per supplier/segment. Critically monitoring the (purchase) budget per supplier will further control the expenditures and cash-out flows.

— Are procedures documented for purchasers to follow and do they include a list of approved suppliers?
— Does the company segment their suppliers and define supply chain management strategies per segment?
— Is the Purchasing department considered to be proactive in identifying cost-saving opportunities and in challenging budget assumptions?

2 Supplier selection and contracting

A first line of defense should be to integrate a supplier (selection) framework in your procurement strategy. Make sure that all relevant and necessary data information is captured (supplier master file management), to be able to take the correct conclusions from the credit and other checks review. Transform into appropriate contracts via contract approval that will be legally and financially binding so that all parties can rely on the contractual terms and obligations set. Payment terms, credit limits and other billing information will have to be defined during the contract creation and management.

— Are formal contracts constructed by a legal department?
— How often are contracts cross checked to the A/P ledger to help ensure consistency of terms?
— "Do contracts assess and agree:
  — the impact of pricing + terms on cash flow, margins and working capital?
  — the service levels/impact of delays in the contract (e.g. penalties)?
  — the requirements/documents for billing and collection?

3 Requisition and order management

Gain control over the purchase process and implement a second line of defense environment by installing:

— requisition and order management to prevent by-passing-orders and delays in approving invoices,
— demand management with clear requirements on quantity, price, terms, and discounts - approved by (senior) purchasing people;
— procure order management with a formal method of communication between company and supplier (e.g. PO).
— a four-eyes approval and review process on purchasing authority limits to prevent, detect and resolve an ineffective purchase to pay process.

— Who is allowed to buy and what restrictions/authorization levels are in place over what they can buy?
— Is adherence to purchasing channels regularly monitored?
— Does the system get updated when:
  — Goods/services are received?
  — Goods/services are rejected and returned?
  — Invoices are received?

4 Receiving and supplier management

Critically review and monitor your supplier (supplier performance management) on a continued basis. Inspection and registering of delivered goods and services not in line with the terms and conditions are important to signal as soon as possible. Poor record management at sites creates matching and payment issues (goods service receipts and order tracking). Errors not noted or reported will mostly likely result in an increased cash-out flow.

- Do you report on late/early deliveries against the PO requested date?
- Is there an automated on-line system for processing the receipt of goods/services?
- Does the company have documented inspection and registration procedures in which a.o. supplier performance and issues are tracked?

5 Discrepancy management

Should errors occur or discrepancies be resolved, it is important to first do a root cause analysis to allow proactive root cause elimination and understand the nature of the error. Discrepancy processing and resolution have to be captured to monitor the service level agreements defined with your supplier. The more preventive controls embedded, the less volume of credit notes on the creditor ledger have to be managed (credit note management recovery).

- Are discrepancies tracked and reported on?
- Are any controls in place to make sure that credit notes are forwarded to A/P in a timely fashion?
- What is the average time to receive a credit note (Invoice Date to 'Payment' date)?

6 Invoice processing and payment management

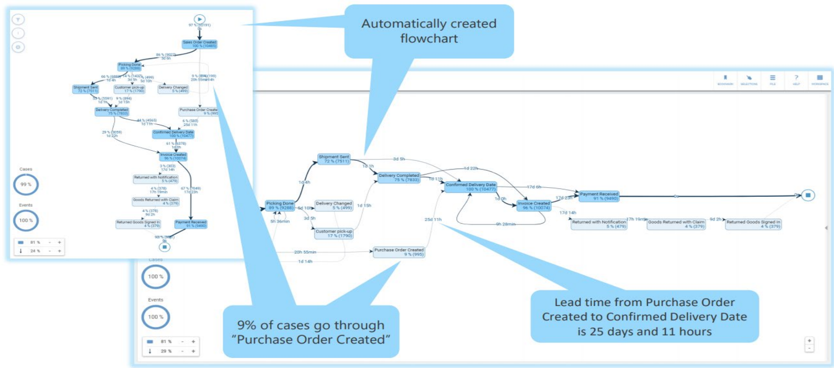
Cash forecasting can only be done when accurate A/P management is embedded. Some important elements are to be followed up on a daily basis, which includes invoice matching and discount/terms management. If no regular review of aged credit listing by A/P can be reported or reconciled, your company will not be able to have accurate insights into payment frequency and payment method, which leads to inefficient and increased cash-out flow.

- What is the average time from invoice date to date of receipt and to date of registration?
- Does the company have formal documented payment methods?
- Are goals and targets set to measure Treasury and cash flow effectiveness?

Which solutions may be critical to resolving the challenges companies are facing right now

Disruptive challenges require hands-on, agile solutions, which support companies by providing access to immediate insights that help them to define and take appropriate actions.

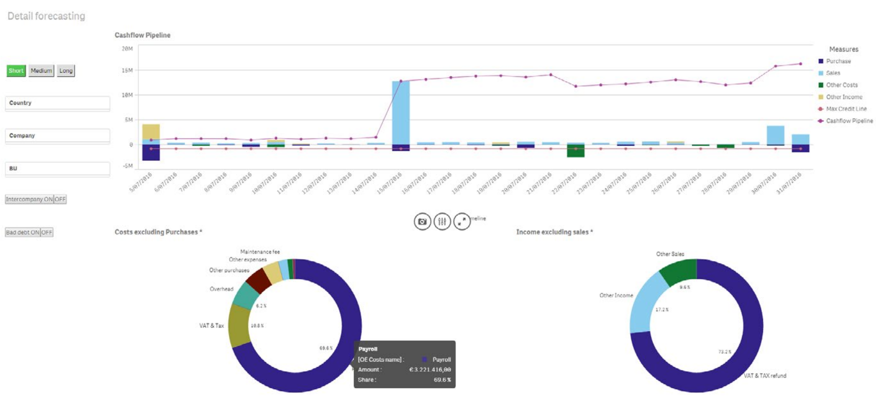
Process mining is an approach which can **automatically reconstruct** the entire process (including sub-processes, tasks and events) to provide **insights** into the occurrence and location of **process bottlenecks** and **inefficiencies.** Process mining provides companies the opportunity to discover and implement (alternative) processes in a easy and quick manner. This to guarantee the same high quality to customers and suppliers in times when accessibility (of people, resources, tools, etc.) is challenging.



The working capital analyzer is a dashboard tool which enables your company to analyze both the financial data (top-down approach via G/L transactions) and the operational data (bottom-up approach via invoice data) following the DAR methodology (dashboard, analyze, report). The main objective is to **optimize the liquidity** of a company to **free up the necessary cash** to survive the challenges of today.

A Top-down approach starts with the financial statement figures and G/L-transactions to calculate the KPI's. A Bottom-up working capital analyzer follows the same DAR methodology, but also uses the operational data from the ERP system(s). The bottom-up approach serves the same goal as the top-down approach and helps you analyze your data in your organization, but based on operational information, down to the invoice and SKU level.

The cash flow forecaster is a tool which provides a company the opportunity to visualize the current and forecasted **cash and liquidity position** at any moment. The tool is combining (historical) financial and operational data retrieved automatically from the ERP system(s) and a **set of predefined manual variables**, which are tailored to the organization. These variables can be modified, giving the opportunity to **predict the future outcomes** of possible optimizations in the current way of working.



Your advantages

- — **Immediate** implementation, compatible with all systems;
- — Accessible both **remotely** and on-premises;
- — Direct insights that **add value** in the **short-term** and for the **future**;
- — Solutions which are **user-friendly** and **easy** to further tailor to your needs

Our recommendations

COVID-19 is disrupting the business world in such ways that companies are not only impacted today but will still feel the impact long afterwards. While some scenarios are impossible to predict, some companies have already proven that it is possible to be prepared for the worst, through working capital management, developing expertise, and having the right tools in place. Particularly important is to:

- — Determine the amount of available cash, its location and the time required to access and transfer this cash to wherever it's needed;
- — Determine the forecasted short- and mid-term cash and liquidity requirements;
- — Determine the cash value of assets able to turn into cash on a short-term notice;
- — Determine the measures and tooling in place, their reliability and effectiveness.

By investing in your treasury and working capital process, you will enable your company to deal with this crisis and other crises to come.

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