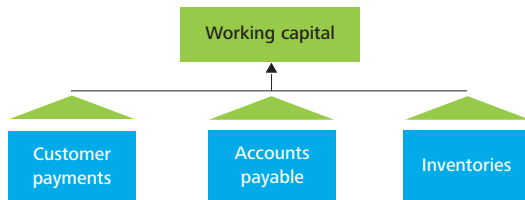


Working capital management – The consultant's response

Due to the current economic crisis, the construction industry has hit choppy waters. The previous few years have been characterised by full order books, which had led to a relaxed liquidity situation. However, since the end of 2007 the granting of credit to the construction industry has clearly tightened.

But fresh capital need not necessarily come from external sources. Liquid funds are also hidden in the companies themselves; therefore, additional sources of finance may be produced through effective management of working capital and to free up working capital, in particular in the areas of accounts receivable, accounts payable and inventories. Below we have examined what can be considered in these key areas.



Customer payments

The construction industry has various unusual elements in the production process that give rise to working capital management challenges. The uniqueness of every construction project; the turnover of contractors (particularly at large-scale projects); and the long-term nature of construction orders, clearly distinguish it from other industries.

Opportunities for the sustainable improvement of customer cashflow arise within the company, as well as externally. Massive potential exists in the invoicing/receipt of the customer payments process. Here it becomes obvious that optimising administrative processes can lead to a noticeable reduction in the length of time between the rendering of services and the receipt of payments (time-to-cash). For example, the invoicing process starts still too often only after the acceptance of individual construction stages, even if it could have been done significantly earlier.

Regarding external factors, construction contracts and customer relationships have to be structured against the background of cash management. As it is difficult to adjust payment terms during projects, the contract formulation for upcoming projects is all the more important. Possible elements include detailed advance payment plans, tight payment terms and penalties in case of non-compliance. Constant monitoring of compliance with payment terms and chasing customers are additional key elements of effective customer management.

Accounts payable

While at construction firms the number of customers is generally low and the project volume high, the opposite is true of suppliers. As there is usually a high number of subcontractors, there is scope for negotiation with regard to payment terms.

In general, a consciously forced liquidity driven spread of a company's payment terms between customers and suppliers can lead to the identification and use of working capital reserves.

Framework agreements that lead to higher volumes may make it easier to achieve such advantages. In this respect, before adjusting payment terms a detailed analysis of the supplier structure is essential.

In particular, the possible dependence on some few suppliers has to be considered.

Inventories

Within the construction industry, the management of inventory with regard to properties being built is traditionally one of the core skills, and compared to other industries overall performance is generally good. However, major differences between individual companies arise, with the key reasons including ineffective warehousing and the absence of active inventory management.

Appropriate software can increase transparency with regard to inventories and thus clearly reduce the cash-to-cash cycle or use it more optimally. In addition, it enables companies to not only cut costs, but also to increase profits through an optimised purchase, in particular strategic inventories.

Also, the maintenance of stocks for so-called B and C goods (like office supplies or work clothes), as well as the procurement of services like energy, cleaning and insurance, offer significant cost reduction potential which should be actively managed and not underestimated.

Our experience working on supply chain management projects across several industries, shows that cost reduction achieved via optimised inventories and procurement can correspond to sales growth of at least 8-12%.

Gaining competitive advantage

Because of the interaction between working capital management and other corporate goals, the isolated realisation of single measures rarely leads to sustainable success in practice.

Therefore, companies that maintain a transparent, key ratio-based, control framework within which customer payments, accounts payable and inventories can be identified and managed, show significantly better results around working capital management. Key performance indicators that highlight processes and liquidity risks, are key for transparent corporate control and sustainable success, and should be measured against best practice benchmarks.

Against the background of strong competition in the construction industry, measures for the optimisation of working capital present an opportunity for generating liquidity and therefore, increasing competitive advantage. Transparency in this sector is also an important driver in terms of credit ratings for bank loans. Transparency and working capital management go hand-in-hand and are decisive success factors in companies emerging from the crisis in a stronger position.

