

Hidden Sources



Aura Cadis

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Many Romanian companies could improve their liquidity considerably if they used their working capital more efficiently. While cash is short, companies could improve their financial situation relatively easily by freeing capital that is tied up in current assets.

By Aura Cadis

Many Romanian companies are giving away valuable liquidity reserves. This is the amazing conclusion arising from a study among 143 Romanian companies, conducted by consultancy firm Horvath & Partners. Amazing, as it comes in a time of prolonged crisis and limited access to financing. According to the study, less than 50 per cent of the companies questioned have actually achieved a reduction in working capital, converting tied-up capital into liquid assets.

“The majority of the companies could still create considerable increases in liquidity by rigorously anchoring aspects of capital efficiency in their management control systems,” says the head of the study Kurt Weber, managing director of the Bucharest office at Horvath & Partners. “These aspects would include measures such as taking sufficient consideration of capital efficiency in financial performance indicators, integrating it in the target setting process and clarifying responsibilities.”

Actually, most Romanian companies already actively and intensively engage in the management of receivables, liabilities and stocks, not only in capital-intensive industries but across the board. However, it is apparent that working capital management is still a new tool for many companies: only around half of those surveyed had been using it for more than two years.

Moreover, in most cases they rely on traditional performance indicators, focus-

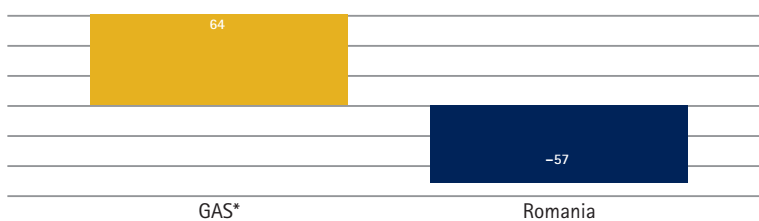
ing on profit and turnover. 50 per cent of the companies surveyed had already made changes to their reporting systems, adding key performance indicators measuring the performance of working capital management. But much is amiss when it comes to responsibilities for receivables, liabilities and stocks.

One problem is that there are often several different people responsible for the

various elements of working capital management. Additionally, most attempts at anchoring capital efficiency in the incentives systems have so far only half-heartedly been implemented, despite the fact that little investment would be required to create the awareness that would be required to generate ideas and concrete measures for reducing levels of tied-up capital.

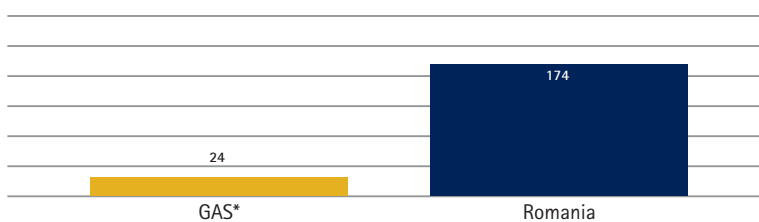
Mirror image: days of working capital

$(\text{Stocks} + \text{receivables} - \text{payables}) / (\text{revenues} \times 365)$



Taking Time: Days Payables Outstanding

$(\text{Payables from trade sales} / \text{revenues} \times 365)$



* German-speaking countries (Germany, Austria, Switzerland)

Source: Horvath & Partners

Expose your exposure

Receivables management is the most important source of potential for improving liquidity. Another finding of the study, however, is that receivables management lacks an integrated approach in many companies. Often, either no information, or only fragmented information is used for evaluating client creditworthiness, resulting in a high client risk exposure. External creditworthiness information which can be a useful addition to internal, historical data, is hardly used at all. Companies often also lack clearly defined procedures for calculating credit limits and setting payment terms. This is also a problem for the quality of dunning and collection – often with dire consequences, as Kurt Weber explains: “The study has shown that companies regularly fail to adhere to working capital and cash flow calculated during planning which, in the worst case, can lead to unnecessary financing costs arising for sales.”

The weaknesses in receivables management of Romanian companies are also expressed by key performance indicators such as days sales outstanding (DSO). Companies in the German speaking world, for example, where the same study was carried out in 2009, manage to cash in outstanding sales in 41 days, almost twice as fast as Romanian companies (78 days).

Liabilities from suppliers come second in the ranking of potential levers for improving liquidity. The study shows that Romanian companies are using this source of liquidity out of proportion, overcompensating the days sales outstanding. They take on average 174 days to pay their trade creditors, while debtors from German speaking countries need only 24 days to do so. This behaviour obviously threatens the liquidity of suppliers, which can easily backfire on companies that delay payments in such a way. A major supplier running into liquidity problems, “results in a major supply side risk for the company,” warns Mr Weber.

In summary, the findings of the study show that capital efficiency is seen by Romanian companies as being increasingly important – especially so in times of uncertain economic conditions and nervous financial markets. Nevertheless, many companies in Romania appear to lack either the will or the ability to add meat to the bones of their own working capital management, even though this would generate much needed stability and release precious liquidity reserves. ||



Aura Cadis,
Managing Consultant
Horvath & Partners

acadis@
horvath-partners.com

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