

BPM TECHNOLOGY DELIVERS NEW TOOLS
FOR “WORKING CAPITAL MANAGEMENT”

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It has been said that, in business, “cash is king.” If so, working capital is the power behind the throne in any commercial enterprise.

Working capital refers to the money that companies use to fund their operations. The flow of working capital is a cyclical phenomenon. Cash comes into the business via accounts receivables. Cash goes out via accounts payables. The companies that effectively manage this “working capital cycle” are best able to attain profitability and effect sustainable corporate growth.

In many respects, there is nothing new about the working capital cycle as a financial imperative. It is a timely concept, nonetheless. In today’s volatile economic environment, the need to actively manage the cycle has never been more vital. This is a result of factors spawned by global economic and geo-political conditions. For example, since many of the working capital processes are highly transactional, many global companies have established Shared Service teams that focus specifically on these functions. Shared Services teams offer higher cost efficiencies by servicing multiple business lines or operating units across the world with smaller but highly specialized teams of personnel. In this respect, working capital functions have recently received a sharper focus based on their ability to offer competitive cost advantages to many companies.

Additionally, the spotlight on working capital has been an offshoot of new government directives that mandate better internal accounting systems and broader disclosure of financial transactions.

The most far-reaching government directive, of course, is the Sarbanes-Oxley Act of 2002 (SOX). The provisions of SOX closely relate to the elements and the specific practices underlying working capital management.

SOX: Section 404

At the core of Sarbanes-Oxley is Section 404: the requirement that a public company's officers certify the existence and efficacy of their organization's internal controls. SOX makes mandatory internal controls-related disclosures ... information that must be included in quarterly and annual filings. Corporate officers must report whether there have been significant changes in the internal controls infrastructure or in other factors that could affect controls-related policies and procedures. In short, Section 404 ties to management's need to regularly assess the effectiveness of their controls and financial reporting procedures.

So what does all this mean in terms of working capital management?

The answer has to do with the level of transaction-related specificity and documentation now required by the SEC. Senior officers can no longer be vague about accounts-payable and –receivable reporting issues. SOX's call for greater transactional detail necessitates monitoring the working capital cycle more carefully than ever before.

BPM and the Working Capital Cycle

Sarbanes-Oxley emphasizes the importance of collecting accurate data for financial reporting purposes. Business Performance Management (BPM) evolved as a

natural response to SOX compliance requirements. Over time, BPM has further developed into a managerial mindset and series of best-practices that, collectively, help support working capital management.

BPM is focused on creating an organization where all managers work toward common goals. They do so by tracking key performance indicators (KPIs) vis-a-vis strategic and financial metrics. In complex organizations, robust information technology systems are a prerequisite for BPM data management. Thankfully, powerful BPM-focused technology has been developed to help companies both comply with SOX and heighten their competitiveness using BPM principles.

As stated, Sarbanes-Oxley calls for greater financial detail and documentation. BPM, by definition, calls for strategically amassing (and disseminating) that same level of transactional specificity to best monitor business performance. Let's look at two cash-related challenges that point up the benefits of using BPM tools and techniques for SOX compliance and for managing the working capital cycle. The two challenges are:

- Bad debt
- Reducing DSO (days sales outstanding)

Bad Debt

Bad debt refers to situations where certain revenues from sales will never actually be received by the selling organization (e.g., an indebted vendor goes bankrupt). This is a problem that plagues all companies, albeit to varying degrees. Historically, public companies were able to report statements of bad debt in decidedly vague terms. That's no longer the case with Sarbanes-Oxley.

Prior to SOX, companies were able to cite, with minimal detail, the level of bad debt they had incurred in a given financial reporting period. SOX now mandates that management document a specific audit trail that answers such questions as:

- Why the bad debt was incurred?
- What specific explanations were provided by the customer to explain the situation?
- What actions did management take to try to avoid incurring bad debt?
- What was the end result of management's attempts to resolve the individual dispute or situation?

The upshot is this: managements cannot simply say, "We incurred X-amount of bad debt." They must explicitly detail what steps were taken to avoid the situation before writing it off as a corporate deduction. The greater detail is applicable from a BPM and working capital management standpoint.

By tracking data that must be ultimately be included in audited financial statements, management arms itself with intelligence that can forestall future bad debt situations. By studying relevant data using BPM technologies, managements can spot problem situations and trends early on -- before they escalate into irreversible financial set-backs. Better information leads to better decision-making.

The ability to monitor and manage bad debt is just one benefit of deploying BPM tools to comply with SOX and improve working capital management. Another benefit ties to the concept of "days (of) sales outstanding" (DSO).

Reducing DSO

DSO refers to the payment terms specified by a seller relative to when monies for goods are due.

It is in a company's best interest to minimize its DSO. That's because with lower DSO, an enterprise generates more working capital. With more working capital, a company needs less borrowed dollars from loans, lines of credit, and other financing sources. When that's the case, there are lower levels of interest payments. This reduces the overall cost of operations. Importantly, technology systems deployed for BPM can also assess DSO trends as a means of enhancing this all-important financial performance metric.

By actively approaching working capital management through the use of BPM tools, companies are able to lower costs and heighten profitability. In terms of bad debt, collection efficiencies are achieved. In terms of DSO, data analysis and resultant customer policies can help balance the flow of cash in and out of the enterprise.

The advent of Sarbanes-Oxley has highlighted the importance of managing the working capital cycle. As a catalyst of BPM, Sarbanes-Oxley -- introduced to ensure greater accountability and shareholder protection in the post-Enron business world -- could not have come at a better time.

To some, the greater level of fiscal detailed required by SOX poses bad news from a reporting standpoint. But the good news is this: SOX requirements provide a strong impetus for better managing the working capital cycle. Using BPM as a methodological frame of reference, working capital management becomes a timely tool for ensuring corporate success.

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