WORKING CAPITAL & LIQUIDITY MANAGEMENT

Ade Ikhwan
Finance & Business Control Director
PT Wartsila Indonesia

Background

Businesses face ever increasing pressure on costs and growing financing requirements as a result of intensified competition in globalised markets.

Many of them are therefore considering ways of making themselves more efficient. In identifying possible options it is important not to focus exclusively on income and expense items, but also to take the balance sheet into account. Improvements to the existing capital structure can free up valuable resources and bring increased efficiency.

Active working capital management is an extremely effective way to increase enterprise value. Optimizing working capital results in a rapid release of liquid resources and contributes to an improvement in free cash flow and to a permanent reduction in inventory and capital costs.

Background

For the purposes of optimising working capital, the most important factors are current assets — accounts receivables and inventories - and accounts payable.

Typical problem	Effect of active working capital management
Pressure on margins as a result of intensifed competition in globalised markets	Permanent reduction in funds tied up in working capital
Unsatisfactory cash flow performance in recent years	Increase in profitability
Expensive acquisitions resulting in excessive debt and depressed profts	Optimisation of business processes through indentification of working capital drivers
Shortage of capital to fnance growth	Protection of liquidity

Background

Reduction in Account Receivables

Significant factors
Terms of payment
Invoicing
Credit control

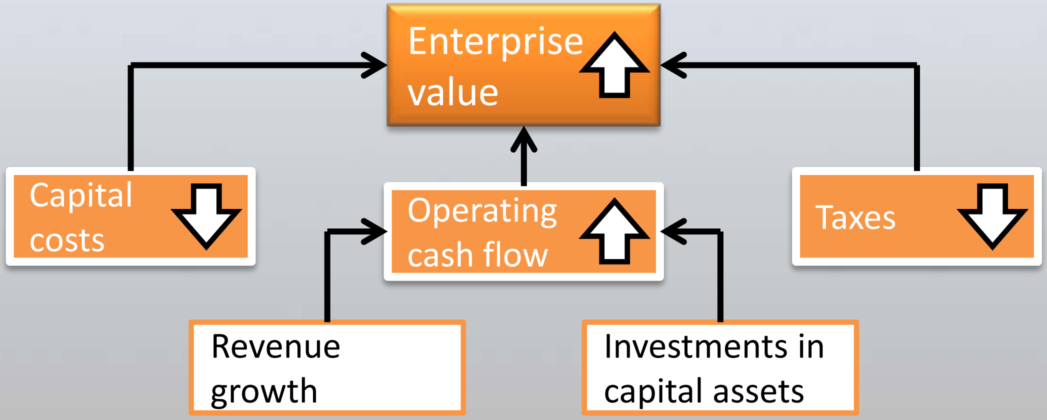
Effect
Increase in operating cash flow through reduction in terms of payment and effective collection procedures
Reduction in losses on receivables through systematic credit control
Optimisation of business processes through indentification of working capital drivers

Background

Structural improvement of working capital results in lasting improvement in enterprise value

Together with cost saving programs, working capital optimization improves business profits. In this context it is important to recognize which elements of working capital are the significant factors, in order to optimize the relevant business processes and achieve a permanent reduction in working capital.

Active working capital management brings a reduction in the operating costs of managing inventories and receivables, thus improving liquidity. This strengthens the balance sheet and reduces borrowing costs. Active working capital management thus leads to an effective increase in enterprise value.



Background

Starting point for active working capital management

A prerequisite for a permanent reduction in working capital is systematic analysis and identification of structural drivers and causes of the high levels of working capital.

They can be found in:

- A business's processes and structures (such as decentralized inventory management, poor incentives)
- Corporate strategy and culture
- Monitoring and control systems (e.g., the failure to use ratios in relation to working capital)

WÄRTSILÄ

CFO/Controller Role – Practical Example

-CFO/Controller involvement in Account Receivable /Credit Management

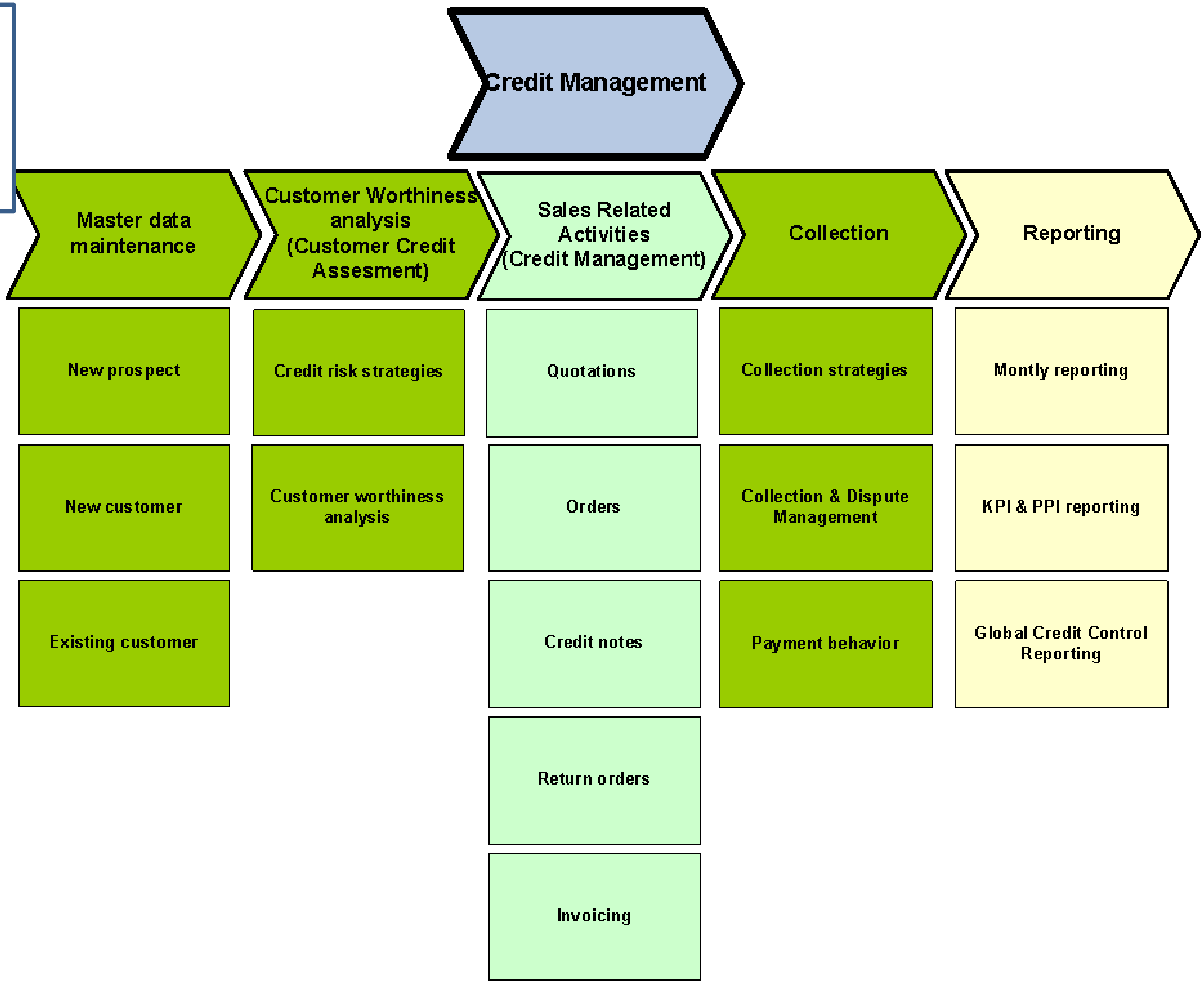
-CFO/Controller involvement in Inventory Management/Control

-CFO/Controller involvement in Account Payablea

Main processes – Global Credit Management

- The main processes of the Global Credit Management are following the **Sales process**

Credit Management processes



Roles & Responsibilities

Wärtsilä

Account Manager | Credit Controller

- In **Sales** we have the **Account Manager**
- In **Credit Management** we have the **Credit Controller**
- Account Manager and Credit Controller are the **counterparties with in Wärtsilä**
- **Together** they will take care of the customer relations

What is a Credit Worthiness Assessment?

Credit Worthiness Assessment is series of actions that are aiming to:

1. **Understand the customer background**
   → customer structure, risks, possibilities, ..
2. **Understand the customer needs from Sales point of view**
   → global sales volumes, timing of the sales,
3. **Make the risks visible for the stakeholders**
   → dividing the customers in risk categories
4. **Give a recommendation how to do business with this customer**
   → recommended Credit Limit, payment terms, validity of the assessment
5. **Send the assessment result for approval**
   → If approved, the risks are accepted by the stakeholders based on the approval matrix

Why the Credit Worthiness Assessment?

1. **To agree how much risks will W-S tolerate with this customer**

   →Global rules which terms to use and how much credit exposure is allowed
2. **To pinpoint where the main focus in Credit mgmt should be**

   →Main focus to the riskiest accounts
3. **To enable smooth order processing**

   → Credit Limit blocks are coming only for valid reason
4. **The basis for the monitoring activities (Credit Control)**

   → When CWA done in co-operation with Sales, the monitoring is more valid
5. **"Money is not for free – Wärtsilä is not a bank"**

   → It should be understood that the money is not free for Wärtsilä i.e. selling on credit basis should not be taken for granted!

Collection & Dispute management

- The Collection actions in Local Collection are divided into External and Internal collection actions
- The *external* collection actions are by default phone calls towards the customer and the internal collection actions are by default email actions towards the Local Sales Contact
- The collection actions are done in harmonized way i.e. with common templates, common time frames and common roles &responsibilities
- The collection process can differ from the default only by legal requirements which can affect on the template content, the time frames of the collection actions as well as the number of the actions.

How does the collection logic go?

In the new process there are 3 ways how to contact the customer

1. By phone
2. By email
3. By letter

For each action, there are 3 expected alternative outcomes

1. Promise of payment
2. Payment plan
3. Dispute

Each outcome is followed automatically and individually by OnGuard

Dispute management

- Dispute mgmt is **different** than the current notification process in WE-SAP

- Dispute mgmt is part of Collections in Credit Management

- Dispute mgmt is
  - Identifying dispute
  - Identifying dispute owner
  - Assigning the dispute to the owner
  - Reminding the owner **once** to resolve the dispute
  - Reporting to SU and NWC mgmt on weekly basis the money tied into the disputes

Collectiondefinitions

		-5 d	**+5 d**	**+14 d**	**+28 d**	**+35 d**
Delivery	**Invoicing**	**Credit days (payment term)**	**Due date**	**Over due**		
		Proactive dunning action	1st dunning action	2nd dunning action	(3rd dunning action)	
				Local request 1	Local request 2	(Local Collection block)
New customer		**LCC**				**(Local Collection Block)**

CFO/Controller involvement in Inventory Management/Control

1. **To ensure that there will be no sales stock**

   →All the purchase related to sales has to be support from customer's PO

2. **To ensure that there is no excessive purchase of inventory**

   →All the purchase of inventory has to be support by the maintenance & operation part replacement

3. **To control the inventory aging**

   →To ensure that the inventory who has the aging more than 6 months are the inventory which related with the safety stock

CFO/Controller involvement in Account Payable

1. **Involvement in early stage of contract/agreement with vendors**

   →Other than concern with governance, tax issues and any other contingency event, to ensure that the term of payment in accordance with internal payment policy and no excessive financing made to vendors

2. **Master data maintenance**

   →Together with procurement, to monitor & control the vendors master data for optimizing the payment process

3. **To minimize and control the invoices without PO and/or Contact and or one time vendor**

Challenges & Opportunity - Working Capital Management

1. Understanding & involvement in the key business process

2. Balancing between the opportunity & to secure the Company assets

3. Setting the mitigation control to overcome the business & financial risk

Thank You