

To Cut Working Capital, Try Bonuses

Pay incentives for hitting working capital targets proved effective during the recession, although companies are already starting to scale them back.

One big reason companies sometimes find it hard to set up continuous working capital improvement practices is that their managers suffer from short attention spans. During the recent credit crunch, many finance chiefs decided to milk their companies' supply chains for extra cash, resorting to short-term measures such as wholesale inventory liquidations or "unilateral decisions not to pay their suppliers," says Mark Tennant, president of REL, a working capital management consultancy.

But what happens when the banks ease up and the economy starts to recover? The lesson of the recession should be that "you can quickly exhaust your cash" and that companies should develop "sustainable" supply-chain efficiencies, says Tennant. Better to have made use of the downturn by installing or expanding cash-flow or working capital improvement targets, he says.

In 2009 a number of companies hit such targets by increasing bonuses tied to the targets and making more people eligible to collect them. For example, Cytec Industries, faced with \$250 million in debt coming due in 2010 and projecting hard times ahead, reduced its emphasis on earnings and tied 40% of the compensation of most salaried employees to the achievement of working capital goals, says CFO David Drillock. (For more on efforts at Cytec and other companies to improve their working capital performance, see ["Working It Out"](#) in the June issue of *CFO* magazine.)

Similarly, pharmaceutical maker Allergan expanded the use of incentive-compensation metrics such as days inventory on hand and days sales outstanding from top management to all eligible employees in 2009. Partly as a result of setting "aggressive" working capital targets, the company was able to cut 22 days of inventory on hand, says Jeff Edwards, Allergan's CFO.

Before 2009 at Heineken USA, only members of the financial and operations groups could enjoy a pay boost if the company hit working capital performance targets, according to Dan Sullivan, chief financial and operating officer of the U.S. subsidiary of the Dutch beer company. Last year, however, motivated by the parent company's goal of generating free cash flow, Heineken USA held all of its employees and executives to a working capital improvement target.

Launched in 2007, the parent company's "Hunt for Cash" program gained momentum when the company took on a large amount of debt to buy part of the assets of brewer Scottish & Newcastle in

2008. As part of the initiative, which included executive-comp incentives, the finance, commercial, supply-chain, and production groups of the entire company all took "a hard look at ways to reduce complexity, improve efficiencies, and ultimately generate cash," says Sullivan.

The U.S. unit then determined how it could contribute cash to the parent company's coffers. "As we looked at the levers we had to pull to improve our cash — whether it was reducing our inventory cycles, streamlining our cash receipts, or introducing a new payables tool — we recognized that although the initiative was led by finance, it needed to be embraced and supported throughout the entire company," says Sullivan.

For 2010, however, only members of Heineken USA's finance department will have cash-generation incentives built into their pay, according to Sullivan. The rest of the company will return to bonuses that are based on the company's financial results. The beer importer's efforts during the past 18 months have enabled it to hit its cash targets, explains Sullivan, and best practices for accounts receivable, accounts payable, and inventory management have become "widespread and ingrained."

Other companies, like Allergan, are also scaling back working capital pay incentives after having achieved their goals. Is there a point of diminishing returns for such incentives? "We couldn't possibly take 22 days inventory out of the channel this year," CFO Edwards says. "You get to a point where you believe you've found the fine line between sufficient and insufficient inventory to meet end-user requirements." Still, he says, Allergan plans to continue looking for ways to refine inventory management.

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