

LEADERSHIP INSIGHTS

For Winning Leaders and Companies



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Zero or Negative Working Capital Committing Less Today By Solving Yesterday's Problems

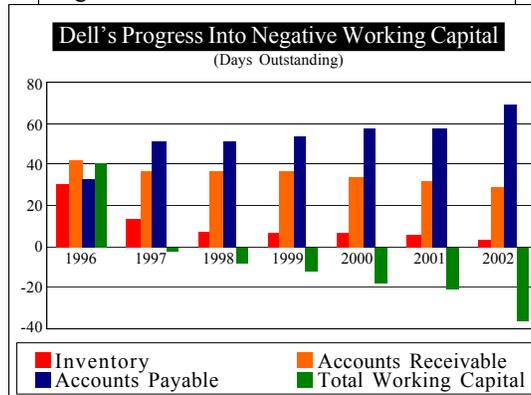
Zero or negative working capital is an exciting concept whose time has come for a number of today's leaders. Many of the past reasons for funding working capital are no longer valid and improvements can now be put in place that allow these funds to be dedicated to more productive purposes. This re-allocation process often begins by challenging basic business assumptions with questions like: "What is the *real* cost of our working capital?" "How can we shrink, eliminate or actually bank-roll our business through changes in our requirement for working capital?" and, "How does zero or negative working capital change the economics of our business model?"

Two early and well-known paradigm busters of the "every-company-needs-working-capital" mantra were Warren Buffett's *Berkshire Hathaway* and Michael Dell's *Dell Computer*. Warren has been using tax liabilities and insurance "float" as a major capital source for more than 30 years (Warren tells his story center page). Michael first achieved success with his "negative" working capital model in 1997 and by 2002 had it bank-rolling his firm to the tune of \$260 million (see Dell's working capital graphic for more details).

The beauty of leadership is that we can challenge the way that our Team Members look at "working capital" expenditures so that we no longer see it just as one of those "cost-of-business" line-items that have always been there, that sounds reasonable when talked about and rarely gets addressed in any meaningful way.

The cost of working capital is expensive and with reasonable problem solving has far fewer credible reasons for its existence than first come to mind. While having empathy for the "that's how we've

always done it" and "our receivables are not any greater than our competitors" and "inventory saves us money," let's take a look at what these change leaders are finding:



Accounts Receivable: A closer look at accounts receivables typically show us some laundry we have put off dealing with for awhile. It often contains the relics of our past mistakes, leftovers from poor customer relations, product or service quality problems, delivery and invoicing errors and a

Warren Buffett's "An Owner's Manual" (circa 1996)

"Berkshire has access to two low-cost, non-perilous sources of leverage that allow us to safely own far more assets than our equity capital alone would permit: deferred taxes and "float," the funds of others that our insurance business holds because it receives premiums before needing to pay out losses. Both of these funding sources have grown rapidly and now total about \$32 billion."

"Better yet, this funding to date has been cost-free. Deferred tax liabilities bear no interest. And as long as we can break even in our insurance underwriting — which we have done, on the average, during our 32 years in the business — the cost of the float developed from that operation is zero. Neither item, of course, is equity; these are real liabilities. But they are liabilities without covenants or due dates attached to them. In effect, they give us the benefit of debt — an ability to have more assets working for us — but saddle us with none of its drawbacks."

sundry of other reasons within our company's control. Also within our domain are the 20% of our customers that are 80% of our payment problems (some no doubt should become our competitors customers).

The way that we contract with customers is also a contributing factor -- often done for historical reasons rather than taking advantage of better processes that exist today. You can see the fruit of Michael Dell's efforts in taking his accounts receivable days outstanding from 42 in 1996 to 29 days today. Leadership expectation tends to be a big differentiator in this area.

Inventory: This is an interesting cost for leaders to improve upon because it is not something we desire, but rather the outcome of numerous intermediate issues and processes. Our controllable drivers include forecasting, production planning and scheduling, quality, economic run quantities, packaging and transportation choices. These all contribute to the amount of inventory we have on hand. Note how Dell has taken his inventory level from 31 days in 1996 to 4 days today. We know that none of those days disappeared easily. But, with a clear objective and the requisite problem solving, Michael gets credit for an 81% improvement in an area many considered already well managed.

Spare Parts and Supplies: This cost is often even more allusive than inventory levels. We each have Team Members who like to buy things, and always want a little extra in case they need it. What we find is a buildup of infrequently used materials, precisely because they are infrequently used, that are difficult and expensive to eliminate. Until proactively addressed, this area usually continues to grow as a working capital problem.

Supply Chain Position: As each of us grows a more competitive business, we must help our Team Members realize "everyday" that our choices improve. Like *Berkshire* and *Dell*, we need to *constantly* take advantage of our relative position to harvest a larger chunk of the value within our supply chain. This improved competitiveness gives us yet more opportunity for growth and profit.

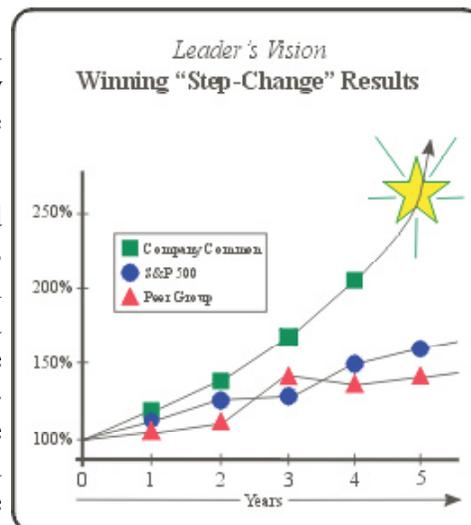
William W. Rutherford and Associates

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William W. Rutherford and Associates helps successful leaders of well-managed companies achieve a “step-change” improvement in their competitive position. Many factors make “winning” increasingly difficult in the world ahead: global competition, maturing products and services, rapidly changing customers and suppliers, and the growing impact of technology. Company performance options that we only began to consider yesterday are becoming a basic requirement for tomorrow’s success.

The Leader’s Challenge: Leaders know those areas critical to their success and want to do what is required to significantly improve their organization’s performance and effect cultural change. Past efforts to design and implement strategies to realize this vision have often been less successful than expected. Internal organizational issues, personal agendas and inadequate skills and capabilities have been problematic. Stakeholder’s lack of varied industry and “outside-their-function” experience further contribute to the challenge of making meaningful “step-change” progress.

Our “Step-Change” Approach: We start with the leader’s required *improvement* and build a specific approach to achieve it. Leaders tell us that with our assistance they make faster, more significant progress in today’s increasingly competitive world. “Step-change results and improved competitive position are a must” is a frequent comment. “We needed a new, more robust approach” and “we needed to double-the-value of our core business” is another. Yet other leaders say that we have “energized their organizations for achievement” and “substantially reduced the time required to successfully attain these results” and “created the environment for accelerated growth and learning.” Effective “step-change” improvement initiatives are a lasting and rewarding leadership decision.



*Measurable and Sustainable Results
For Best-In-The-World Companies*

William W. Rutherford and Associates provides leaders with:

- Step-change results improvement.
- The attainment of significant measurable and sustainable goals.
- Strategic and operational achievements leading to core-business performance breakthroughs.
- Organizational learning, tools, skills, measures and the confidence to accelerate future gains in competitiveness.
- A lasting legacy of success for their businesses and stakeholders.

William W. Rutherford and Associates works together with leaders to make otherwise unreasonable company, industry and market demands achievable. Experience has shown that both tangible and intangible step-change benefits are needed to accomplish the new level of business performance needed to “win” in this environment.

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Helping Leaders Improve Their Company’s Performance