

**Deloitte.**

# Managing working capital

## Cash@Risk

**Webinar**  
**October 23<sup>th</sup>, 2009**



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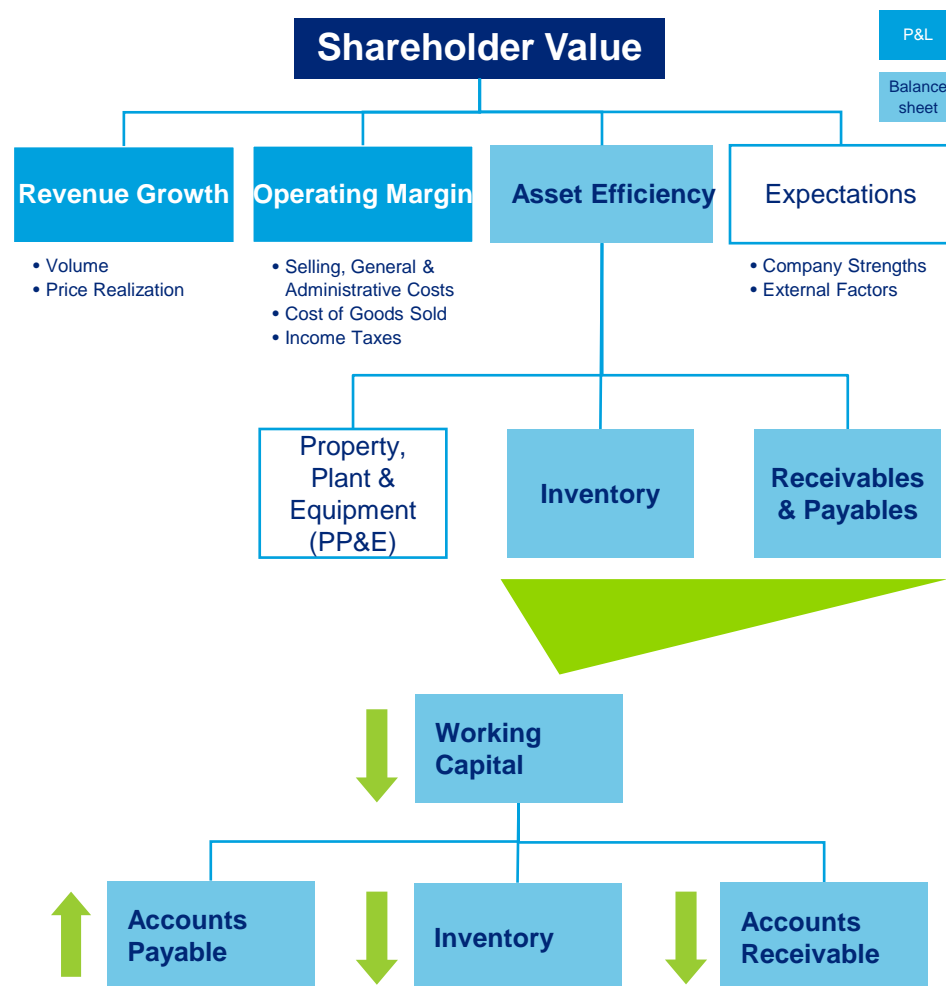
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# Managing working capital: for better and for worse

## Cash is back as King

- When times are rough, companies must do everything they can to free up cash
  - Working Capital is one of the few remaining areas which can deliver significant cash to the business in a relatively short period of time without a large restructuring program
  - Desk research shows that there is a significant potential of untapped capital lying idle – up to € 500 billion in European companies alone according to some estimates
- In an economy coming out of recession, financing the upturn also requires tight cash control
  - With inventories at bare minimum, companies are faced with the challenge of increasing output whilst keeping working capital under control

## Focus shift from the P&L to Balance Sheet



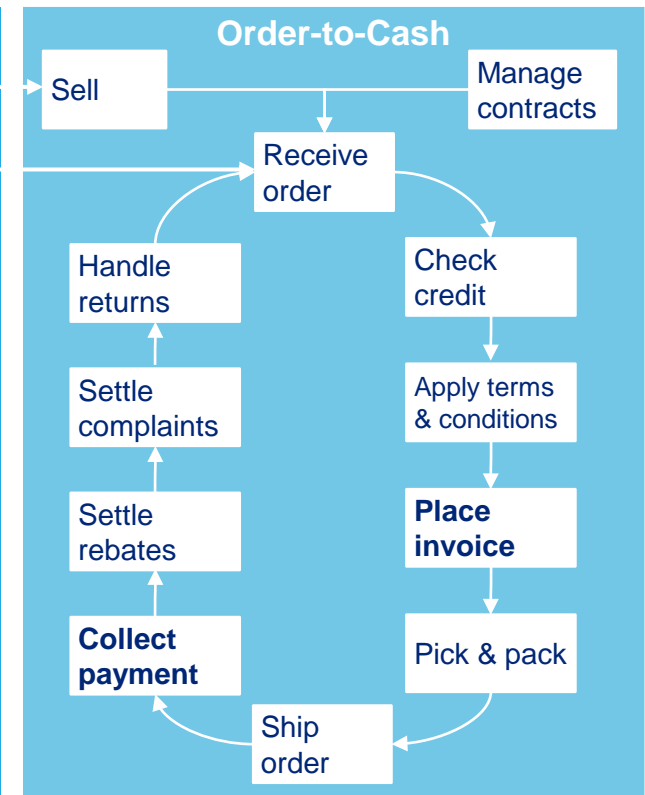
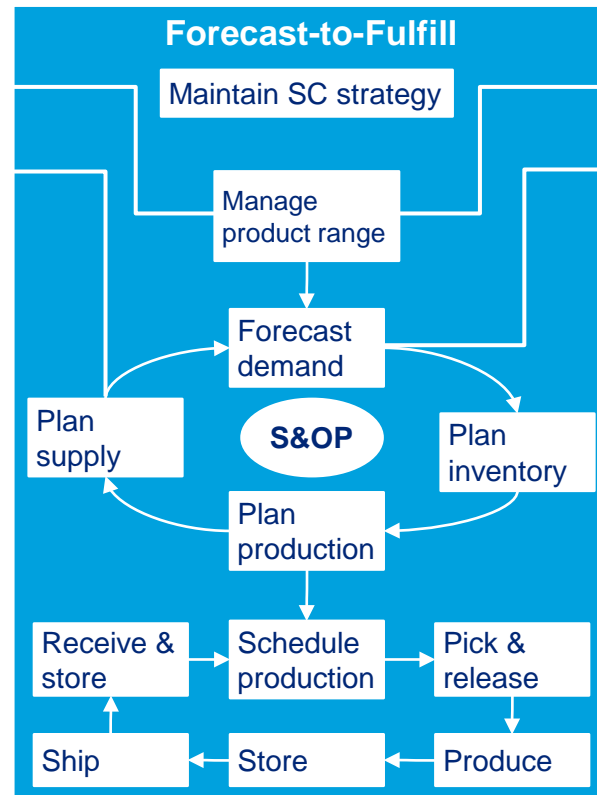
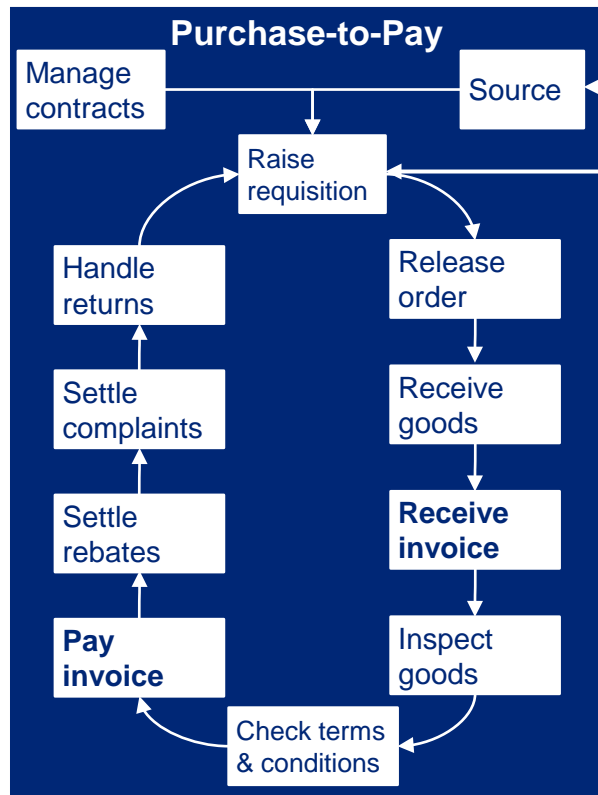
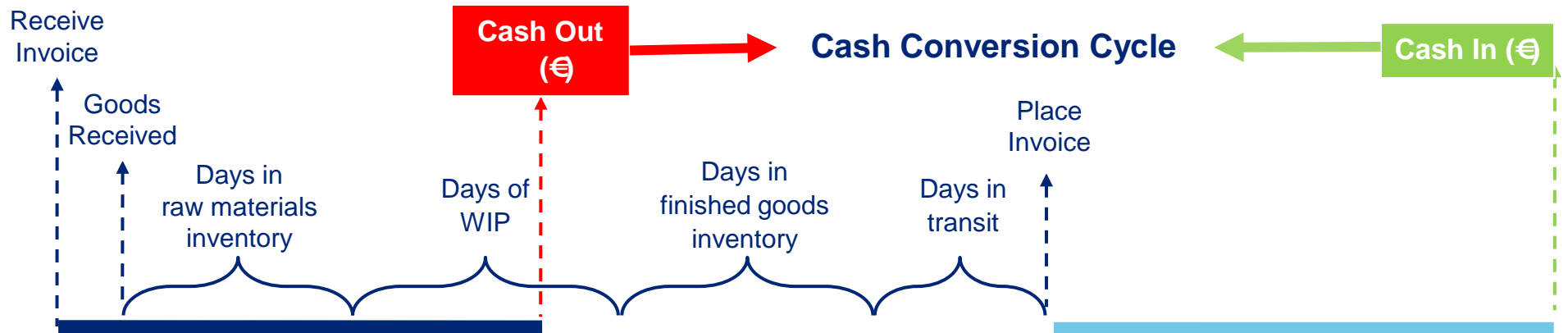
**Definition of Working Capital:** The excess of current assets over liabilities, comprising of accounts receivable, inventory minus accounts payable, represents the liquidity a business requires for day-to-day operations.

# Barriers for optimising Working Capital

Customer & Competition	<ul style="list-style-type: none"> <li>▪ Fear of jeopardising relationships and sales by too aggressively chasing customers for payment</li> <li>▪ Fear of a fall in customer service levels unless holding high levels of inventory</li> <li>▪ Customers are given payment discounts even when not paying within terms</li> <li>▪ Competition is giving longer payment terms</li> </ul>
Suppliers	<ul style="list-style-type: none"> <li>▪ Concern over the likely response of suppliers and risk to supply following a unilateral decision to extend payment terms</li> <li>▪ Impact on the organisation's reputation from negative publicity if extending payment times, particularly for smaller suppliers</li> </ul>
Control & Responsibility	<ul style="list-style-type: none"> <li>▪ Individual's or organisational performance metrics do not reflect the importance of cash</li> <li>▪ Unclear responsibility for working capital. It spans a number of functional areas – no one individual can be given responsibility</li> </ul>
Benefits	<ul style="list-style-type: none"> <li>▪ Are there benefits available? If we restrict liquidity we impact our ability to operate the business day-to-day</li> <li>▪ Are the benefits sustainable? We manage working capital levels down at the end of a financial year but they soon rise again afterwards</li> </ul>

Working  
Capital  
Improvement  
Opportunities

# Managing working capital requires tight control over the cash conversion cycle through the effectiveness and efficiency of three integrated business processes



# Polling question 1

## Does your company have a working capital improvement initiative

1. No, we don't have one and don't need one
2. No, we don't have one but I think we could use one
3. Yes, we have a working capital improvement initiative
4. NA / Don't know

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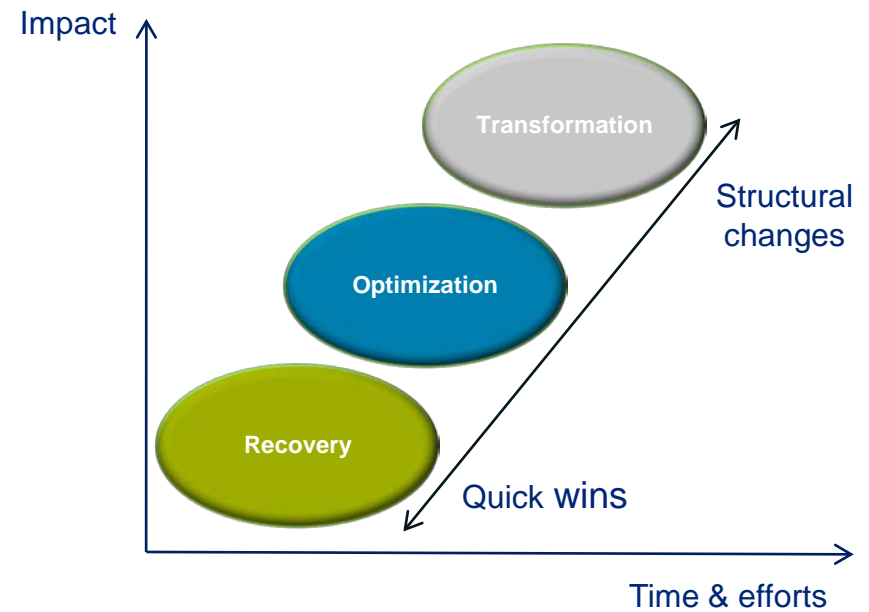
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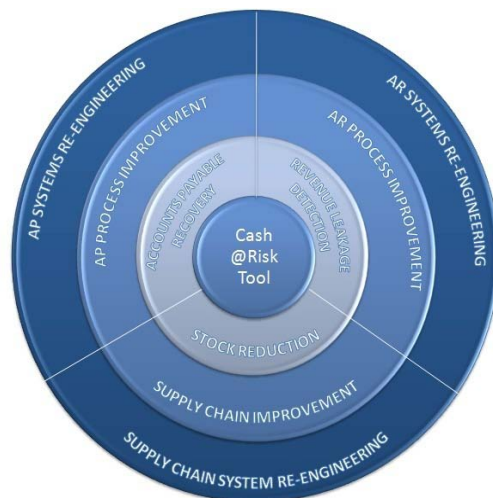
# Cash@Risk: Working capital reduction through data analysis

Our approach is about finding cash in a short time frame without putting significant efforts in process and system re-design. However, data analyses to recover or optimize cash in the short term may lead to insights to transform related processes in the longer term.

- **Recovery:** data analyses on inaccurate, incomplete or double transactions as well as non compliance with contractual terms.
- **Optimization:** strengthen customer payment terms & dunning process, considering cash discounts & analyze actual payment versus payment terms, analyze days of supply versus revenue
- **Transformation:** process, organization and system redesign



## Cash@Risk toolbox and examples of realised savings



Component	Realised savings
Accounts Payable	Up to 39%
Accounts Receivable	Up to 16%
Inventory	Up to 28%

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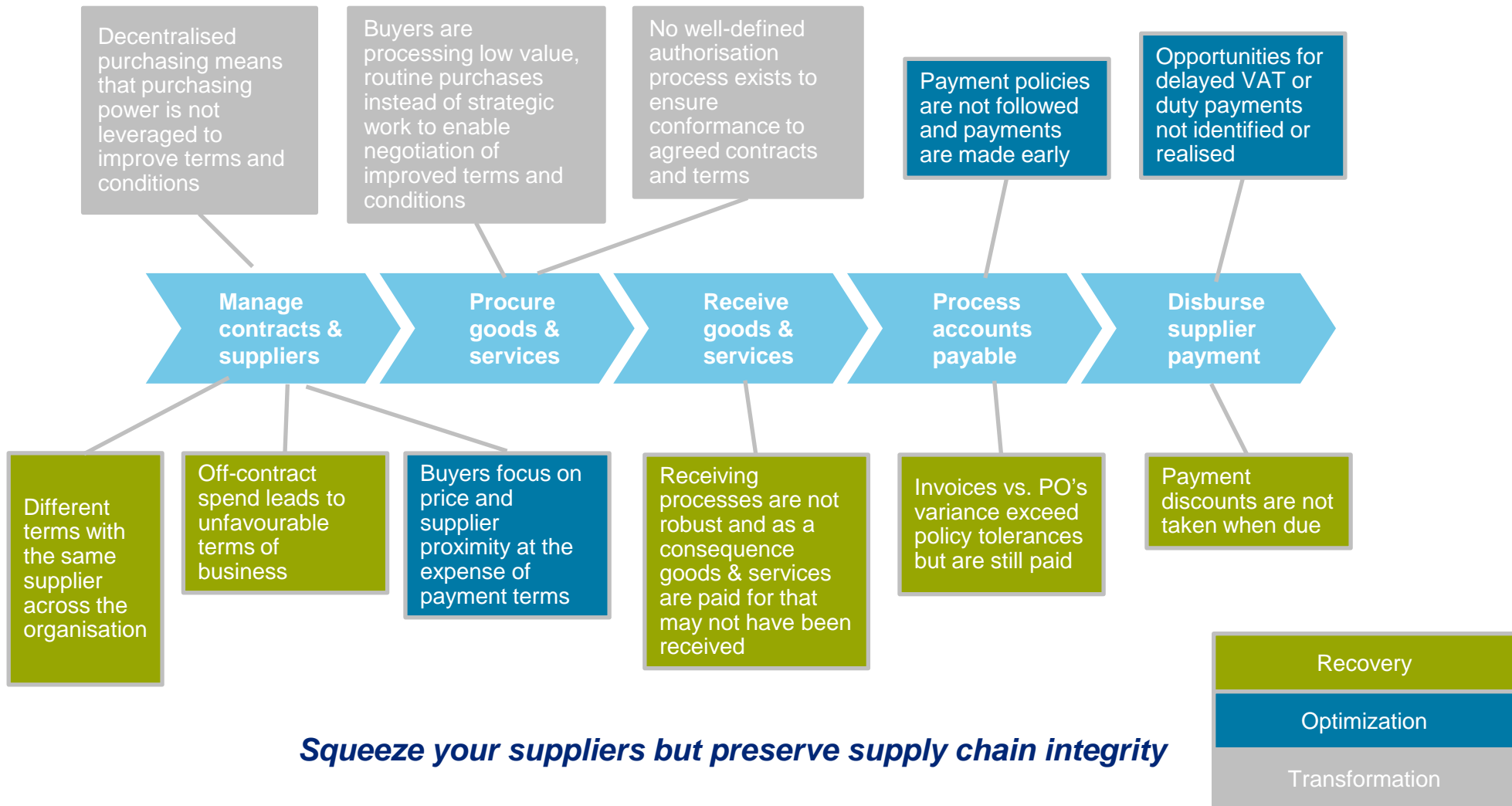
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# Focus on capturing A/P opportunities & tracking benefits rather than implementing sophisticated tools

## Typical issues in Purchasing and P-t-P process



# Accounts payable: Recovery

Opportunities to recover cash in a short time frame are identified by analyzing:

- Double payments to suppliers
- Outstanding credit notes
- Duplicate payments across entities
- Incomplete deliveries
- Returned goods not credited
- Discounts / rebates not credited
- Payments in the wrong currency
- Unrecovered VAT



## Engagement examples

We used our Cash @ Risk tool to perform accounts payable testing at a company in the travel and leisure industry. We identified double payments, unprocessed discounts, payments in the wrong currency and unrecovered VAT. Further root cause analysis showed that manual interventions performed when the reservation system failed eventually lead to double payments when the reservation system rebooted. **Our assistance with recovery and supplier negotiations resulted in a recovery of 2,4% of the total purchase amount.**

We performed a supplier review for a company in the chemical industry. Based on an analysis of the supplier's sales data, it was noted that the supplier had been selling to other customers at a price lower than the price contractually agreed with our client under a Most Favoured Nations (MFN) clause. Reasons given for these lower prices were exchange rate conversions, second-quality products and import taxes. **Our assistance helped the company recover \$13,5M of overpayments.**

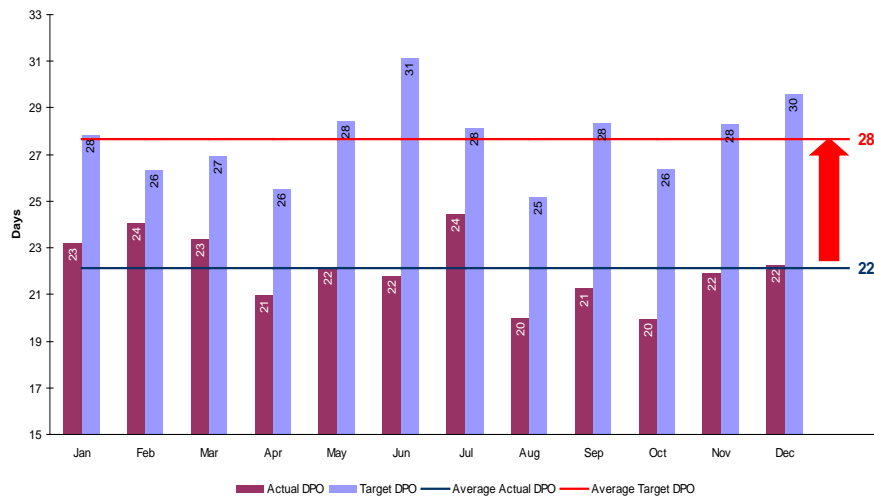
# Accounts payable: Optimization

Opportunities to increase accounts payable in the medium term are identified by analyzing the A/P per supplier compared to its agreed payment terms.

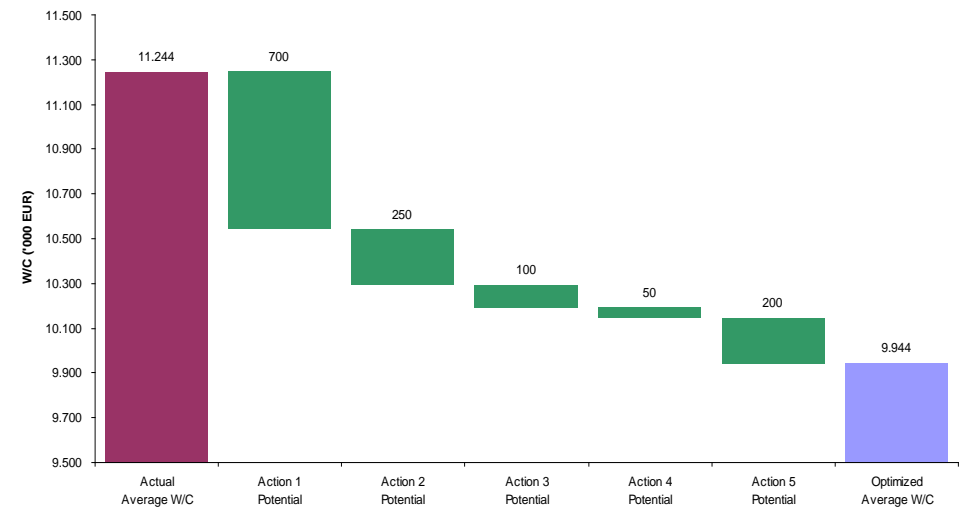
Actions can be taken on:

- Payment quality & frequency
- Payment term negotiation
- Standards definition & enforcement
- Evaluation of cash discounts at early payment

## Measure actual and best possible

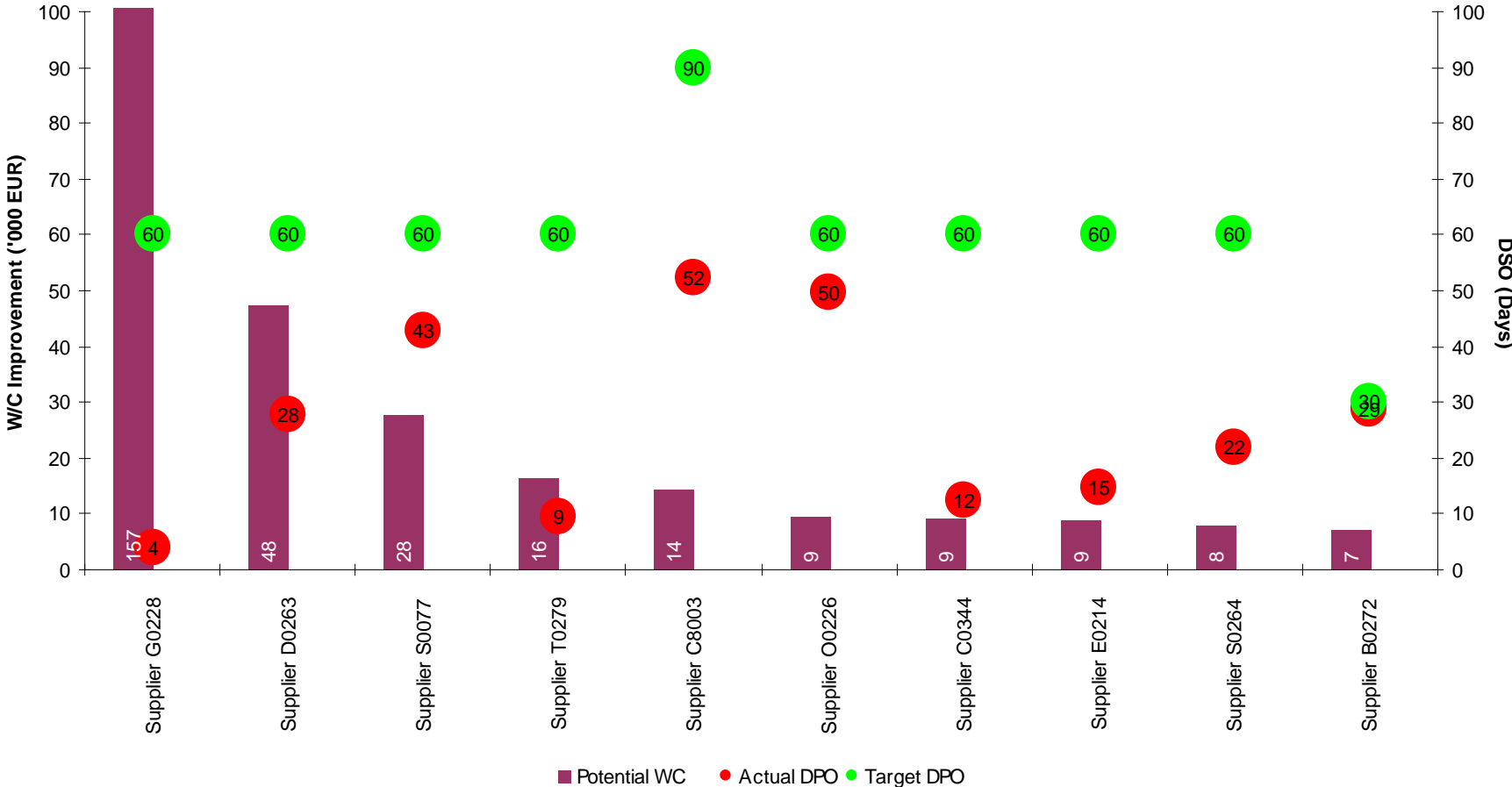


## Set realistic target



# Accounts payable: Optimization (continued)

**Take Action !**



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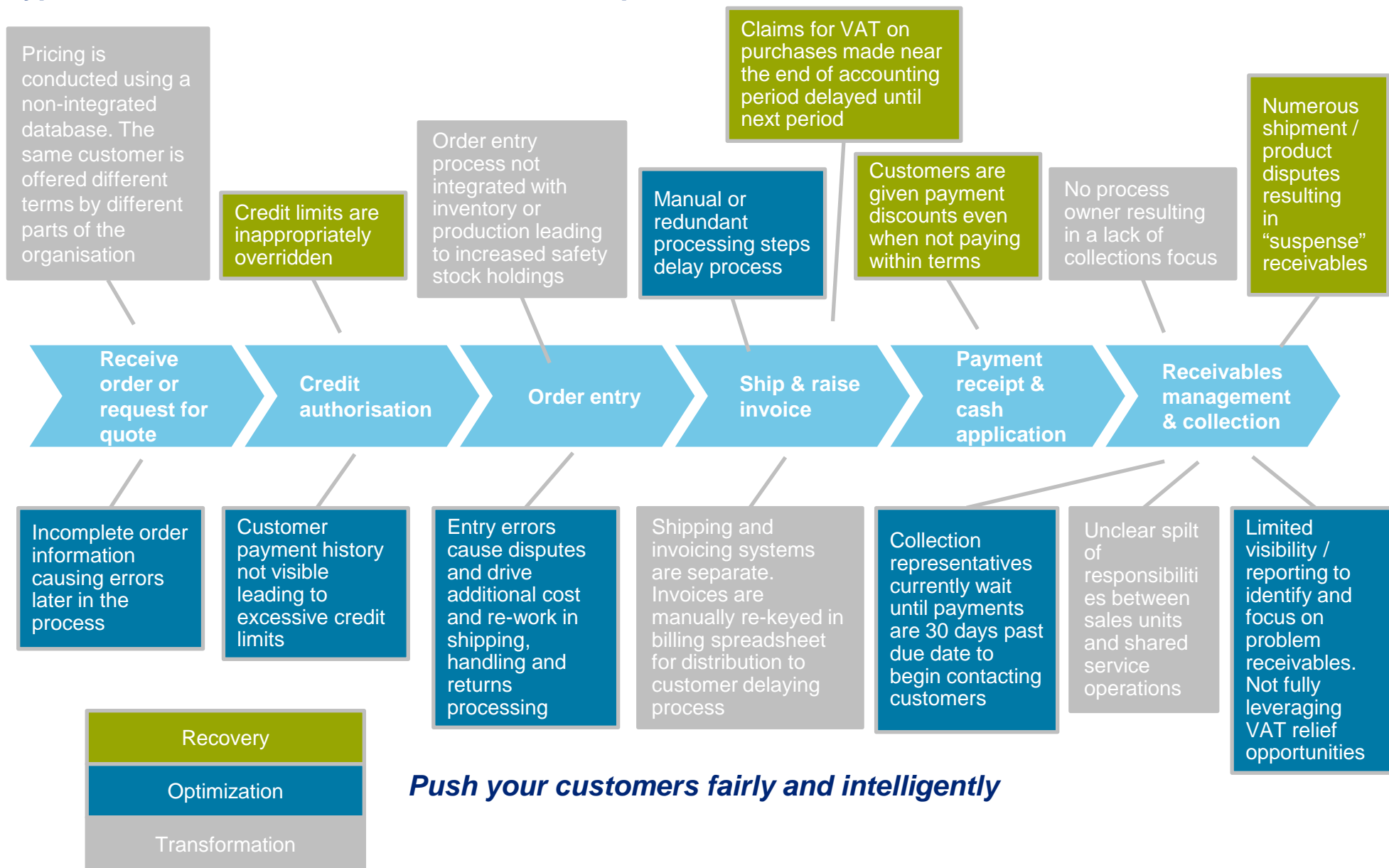
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# Focus on capturing A/R opportunities & tracking benefits rather than implementing sophisticated tools

## Typical issues in customer service and O-t-C process

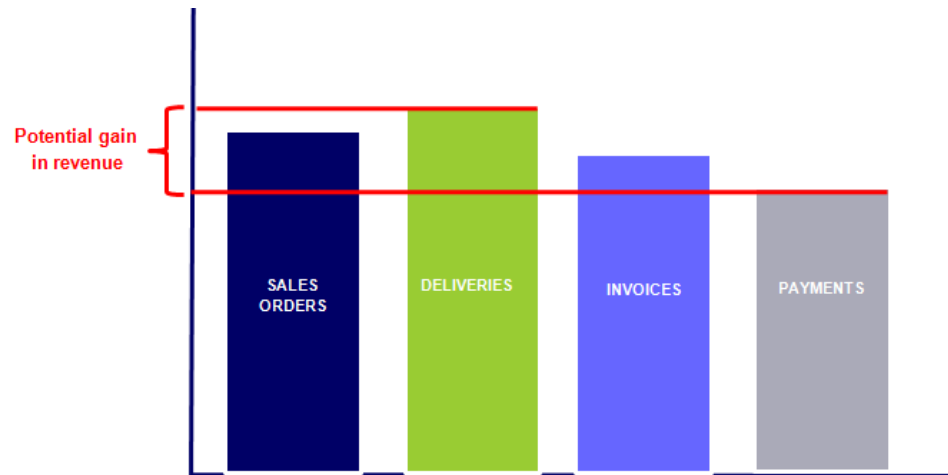


*Push your customers fairly and intelligently*

# Accounts receivable: Recovery

Opportunities to recover revenue in a short time frame are identified by analyzing:

- Completeness of invoicing
- Accuracy of invoicing
- Price changes not invoiced
- Unauthorized discounts
- Revenue leakage
- Unbalanced customer terms



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## Engagement examples

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The CFO of a manufacturing company informed us that he was looking for a quick way to detect unrevealed cash. We used our Cash @ Risk tool to scan the receivables. The tool revealed that 0,95% of the production orders had not been invoiced and 0,25% of the invoices showed negative pricing differences with the master price table. Further investigation showed the presence of duplicate volume rebates due to system errors. **Our assistance resulted in a net cash gain of 0,55% of the revenues.**

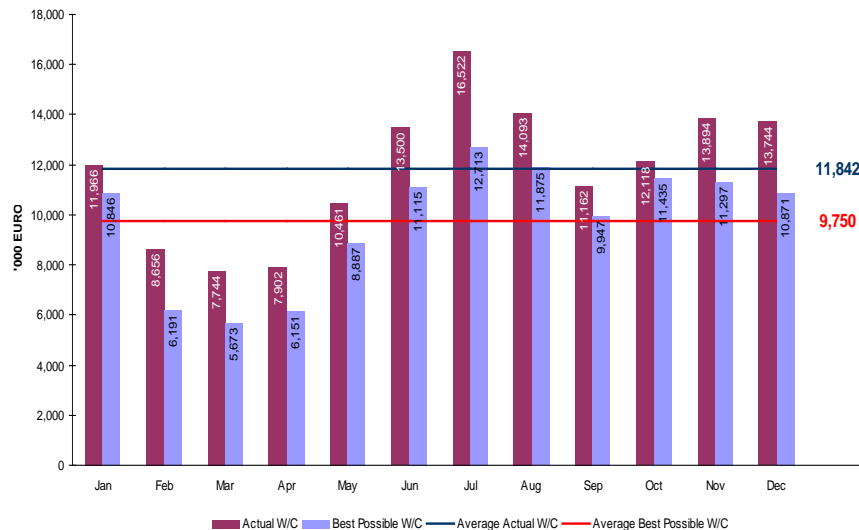
# Accounts receivable: Optimization

Opportunities to reduce accounts receivable in the medium term are identified by analyzing the A/R per customer compared to its agreed payment terms.

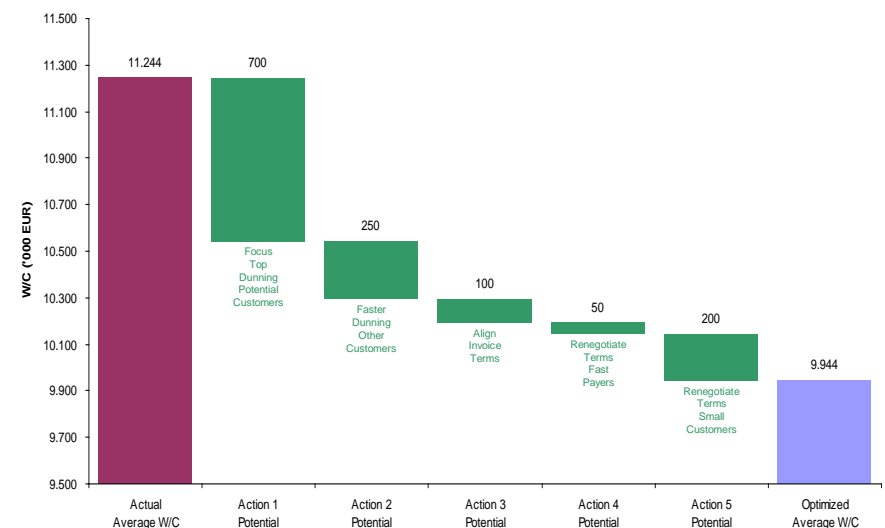
Actions can be taken on:

- Billing quality & frequency
- Dunning process
- Dispute Management
- Payment term negotiation
- Standards definition & enforcement
- Payment term rationalization

## Measure actual and best possible

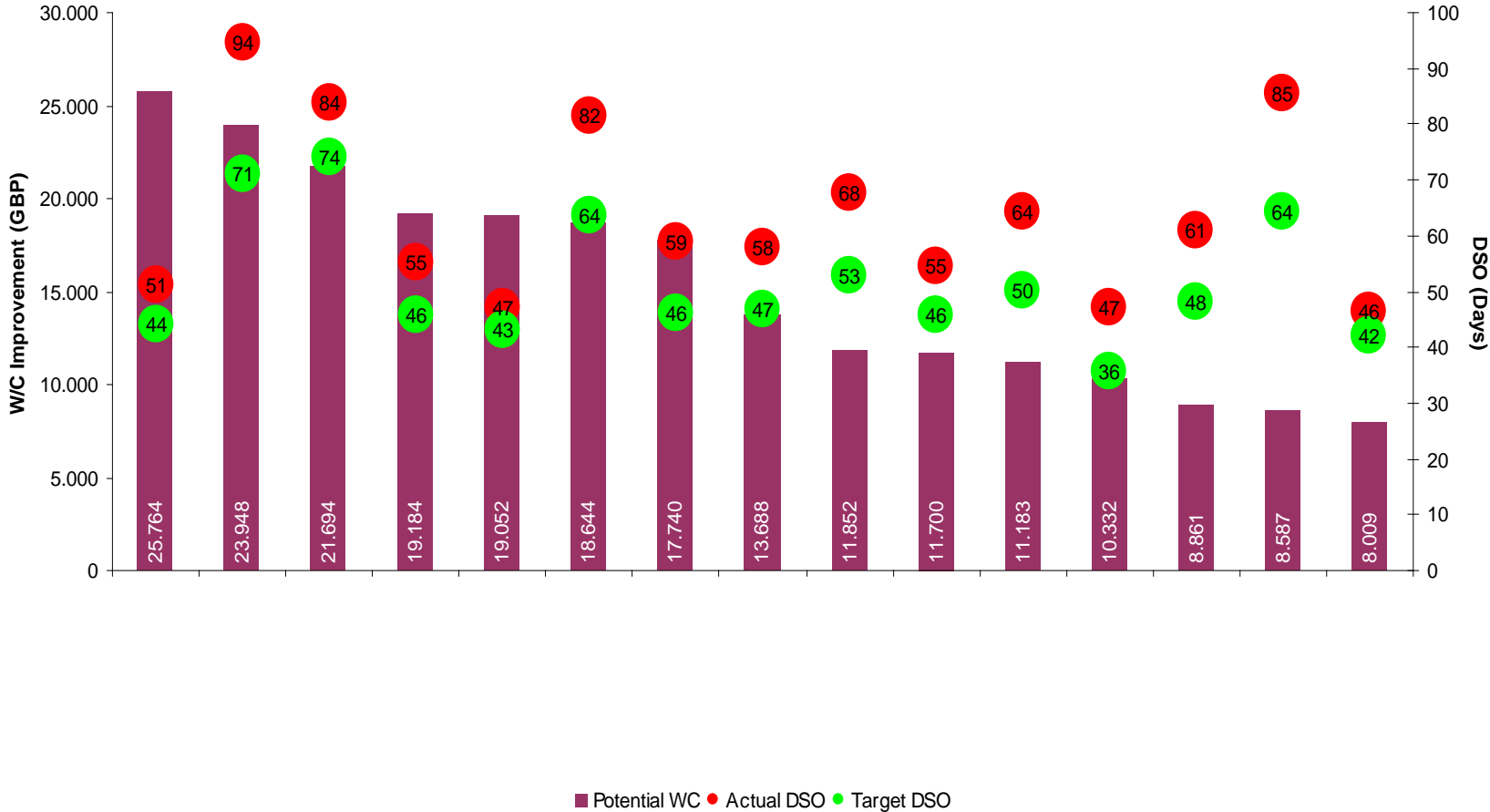


## Set realistic target



# Accounts receivable: Optimization (continued)

**Take Action !**



# Accounts receivable: Optimization - case

Per 2009 the accounts receivable at Company X amounted to €7,5M and had granted an annualized cash discounts of €1,8M.

Our review has identified several areas to improve both working capital and the financial cost related to cash discounts. The current baseline is however not substantially deviating from the simulation taking into account the targeted payment term.

Impact	Accounts receivable	Cash discount
<b>Baseline</b>	<b>€ 7.504.651</b>	<b>€ 1.790.467</b>
<i>Non-compliance to contractual payment terms: cash discounts taken &gt; 3 days too late</i>		-€ 250.135
<i>Renegotiation of 6 payment terms with a significant cost &gt; the cost of Company X targeted payment term</i>	-€ 328.701	-€ 70.939
<b>Result</b>	<b>€ 7.175.950</b>	<b>€ 1.469.393</b>

We would recommend to assess further targeted action to improve the working capital and the P&L:

Unrightfully deducted cash discounts (payment date 3 days beyond contractual date) should not be accepted, or should be deducted from the year end discount (€ 250.135);

The review of 6 specific payment terms could further improve the cash position with €328.701, and could reduce the cash discounts with €70.939.

In addition the company should consider rationalizing its current 54 payment terms, and consider increasing the dunning frequency.

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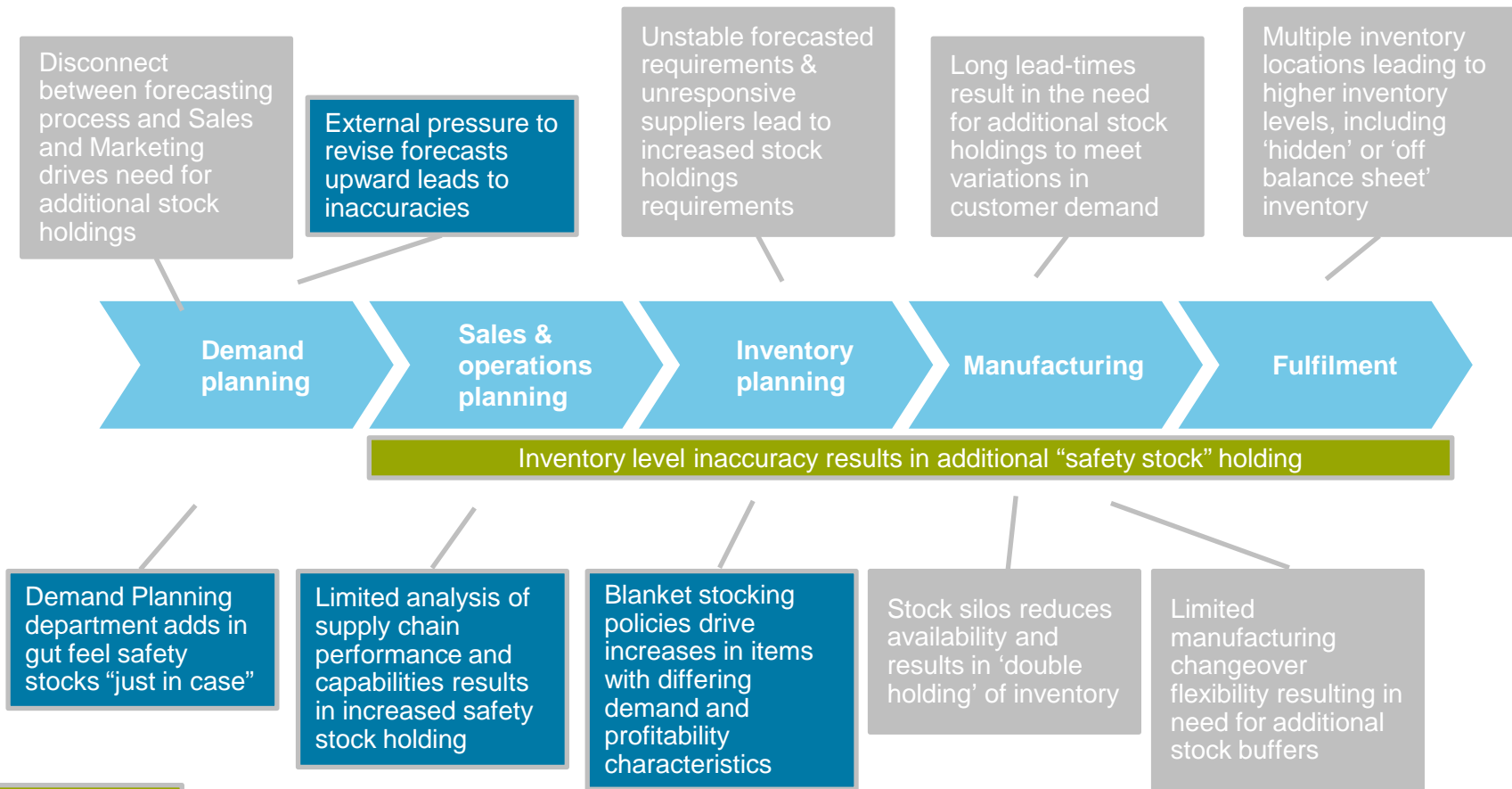
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# Focus on capturing inventory opportunities & tracking benefits rather than implementing sophisticated tools

## Typical issues in Supply Chain and F-t-F process



Inventory level inaccuracy results in additional "safety stock" holding

- Recovery
- Optimization
- Transformation

***Decrease your inventory structurally to still guarantee service levels***

# Inventory: Recovery

Before any action can be taken to optimize inventory, the accuracy of the inventory levels should be properly controlled. Typical issues are:

- Reported scrap
- BOM accuracy
- materials movement accuracy
- Reported obsolete stock
- Other

## Engagement examples

Deloitte was requested to optimize the inventory levels of a client. As a first step, the inventory accuracy was investigated based on defined KPI's. Only after improvement of these KPI's, the actual optimization was started.

Key Performance Indicator	Measurement	Start base	Week 16 (W38)		
			Target	Actual	% evolution
Stock overstatement	Extrapolated value at latest stock count	757 k€	30 k€	133,1 k€	82%
Unreported scrap	% of actual scrap for last 3 counts	36%	5%	8,9%	75%
BOM's reviewed	Issues resolved & % of BOM reviewed	0%	100%	100%	100%
Obsolete stock completeness	% of components reviewed	8%	100%	10%	2%
Unreversed over backflushing	% of actual produced for last 3 counts	13%	1%	-0,1%	100%
Stock accuracy	% of accurate stock locations in WHS/Prod	?	96%	73%	?
Movement registration	% of comp with accurate reg. for last 3 counts	12,5%	95%	95,8%	83%
BOM accuracy	% of quantity and item accuracy	87%	99%	100%	15%
Standard cost deviation	% of components with zero standard cost	4,6%	0,5%	0,6%	87%

# Inventory: Optimization

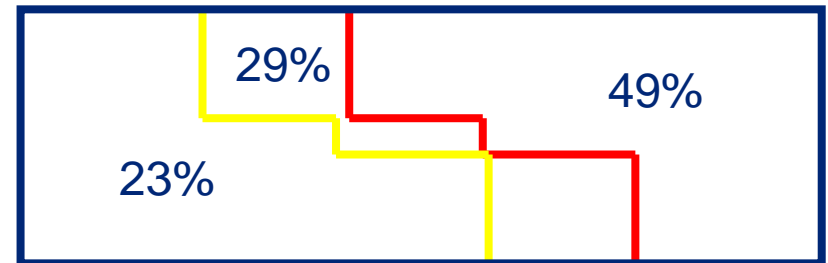
Opportunities to reduce inventory in a short time frame are identified by the following:

- Analyzing the weeks on hand versus the revenue generated per item
- Assessing against industry best practices and averages
- ➔ Providing insight in excess inventory against expectations

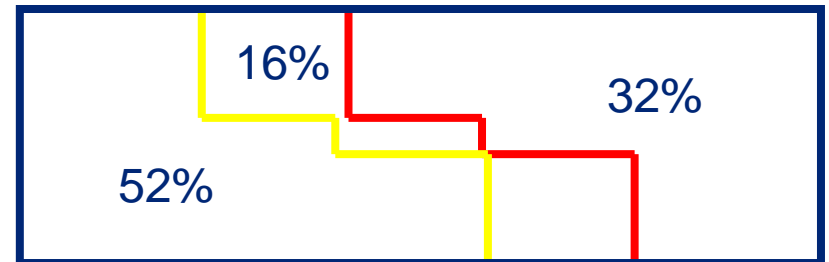
Category of weeks on hand						
ABC on Revenue	C1: <5	C2: 5-12	C3: 13-25	C4: 26-51	C5: 52-99998	Grand Total
A	1.148.761	1.186.811	499.592	256.486	7.240	3.098.890
B	99.614	354.072	444.269	294.082	140.951	1.332.988
C	29.847	95.666	163.508	224.750	618.231	1.132.002
D	2.415	1.590	8.611	19.507	461.062	493.185
Grand Total	1.280.637	1.638.139	1.115.979	794.825	1.227.485	6.057.065

Category of weeks on hand						
ABC on Revenue	C1: <5	C2: 5-12	C3: 13-25	C4: 26-51	C5: 52-99998	Grand Total
A	511	310	99	25	3	948
B	1.366	733	494	206	68	2.867
C	5.210	1.051	1.478	1.623	2.488	11.850
D	72	10	28	46	2.779	2.935
Grand Total	7.159	2.104	2.099	1.900	5.338	18.600

Inventory (excluding D-items)



Number of items (excluding D-items)

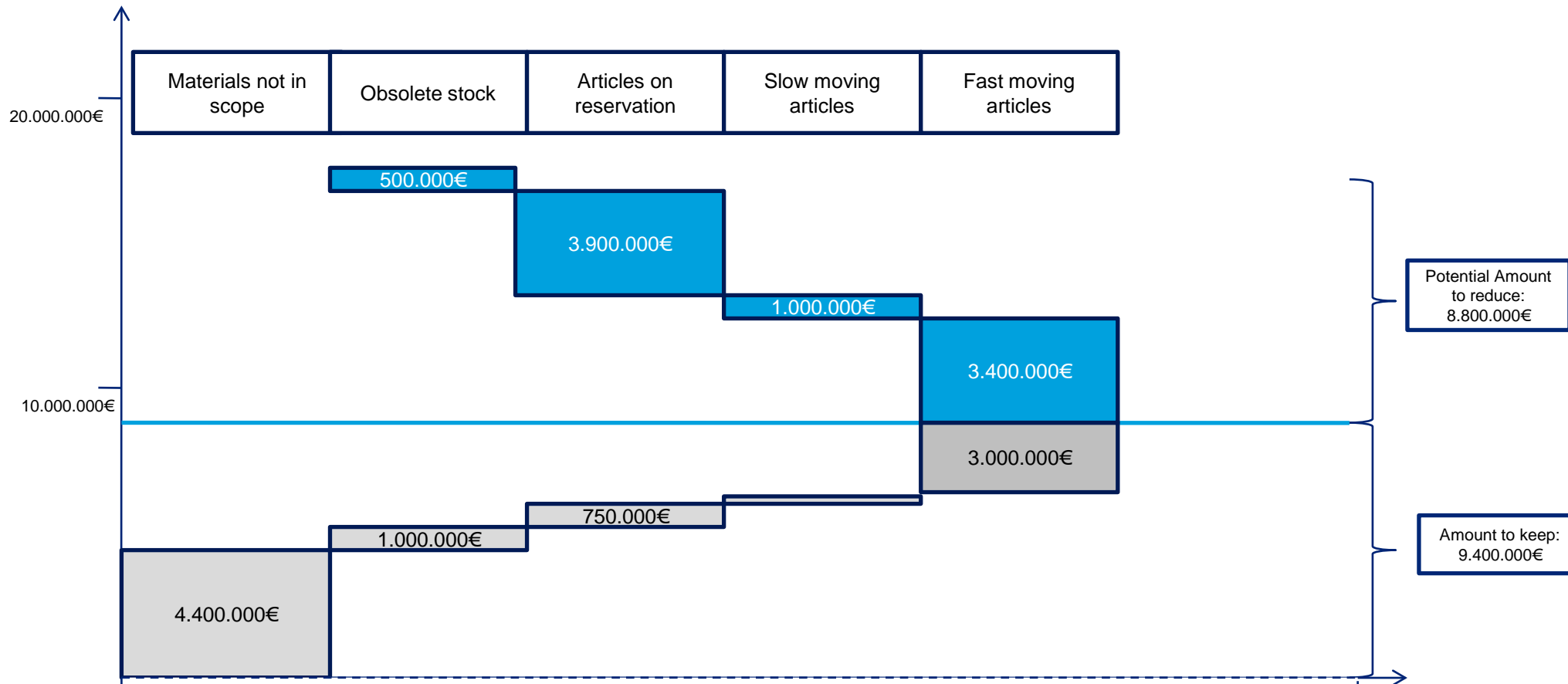


➔ Resulting in short term, quick win actions per SKU like:

- Production and or replenishment stop
- Increasing sales efforts and or price reductions
- Obsolescence review

# Inventory: Optimization (continued)

Sample inventory optimization deliverable



**Some conclusion from this stock analysis were:**

- ✓ The stock in the central warehouse could be reduced with 8,8 million euro.
- ✓ The overstock was mainly due to historical orders
- ✓ An accurate stock policy should be developed for slow movers.
- ✓ The reorder points and order quantity were relatively well defined, but real inventory was higher than the calculated inventory level according to the defined reorder points.

## Polling question 2

**Where do you believe the greatest improvements remain in working capital reduction?**

1. Accounts Payable
2. Accounts Receivable
3. Inventory
4. NA / Don't know

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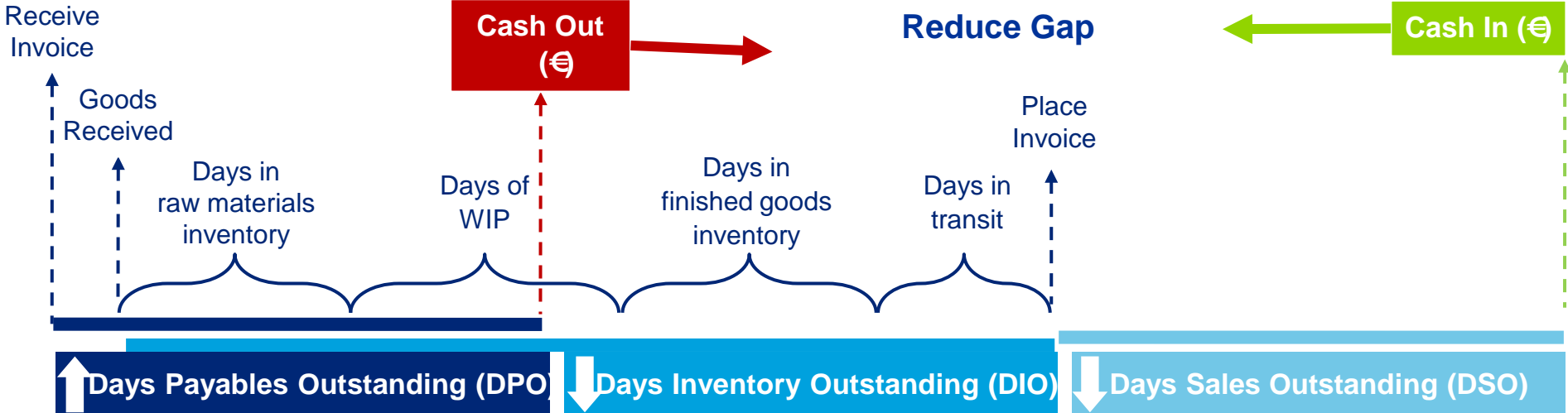
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# Working Capital opportunities are tackled by a variety of improvements on the three pillars leading to optimised asset efficiency



	↑ Days Payables Outstanding (DPO)	↓ Days Inventory Outstanding (DIO)	↓ Days Sales Outstanding (DSO)
Recovery	<ul style="list-style-type: none"> <li>Optimise cash discounts against interest gains and ensure discounts/rebates etc are fully exploited</li> <li>Review payments database for possible duplicate payments, invoice errors, VAT under-claimed and liabilities etc.</li> <li>Review Invoices vs. PO's variance and protest invoice when tolerance is exceeded</li> </ul>	<ul style="list-style-type: none"> <li>Analyse supply chain performance and capabilities to reduce safety stock holding.</li> <li>Review BOM's on their accuracy</li> </ul>	<ul style="list-style-type: none"> <li>Optimise timing for recovery of VAT</li> <li>Track and manage adherence to current terms, including early payment discounts</li> <li>Analyse shipment/product disputes</li> </ul>
Optimization	<ul style="list-style-type: none"> <li>Review procedures for timing of tax &amp; duty payments and understand opportunities to defer payment</li> <li>Review the A/P per supplier with its agreed payment terms</li> </ul>	<ul style="list-style-type: none"> <li>Review safety stock levels and re-order points across different product and customer segments</li> <li>Review policies for slow moving inventory. Set up disposal programmes for obsolete stock</li> </ul>	<ul style="list-style-type: none"> <li>Focus on order management process to ensure no barriers to timely payment</li> <li>contact customers directly when payments are due</li> <li>Eliminate manual or redundant processing steps</li> </ul>
Transformation	<ul style="list-style-type: none"> <li>Redefine purchasing power to improve negotiated terms and conditions</li> <li>Redefine authorizations within the organisation to ensure conformance to terms and conditions negotiated</li> </ul>	<ul style="list-style-type: none"> <li>Review production strategy and planning policies</li> <li>Revise planning processes and responsibilities to improve demand visibility and forecast accuracy</li> <li>Reduce the fragmentation of holding inventory</li> </ul>	<ul style="list-style-type: none"> <li>Align and optimise payment terms and conditions across territories and customers</li> <li>Integrate order entry processes with inventory or production leading to decrease safety stock holdings</li> <li>Align shipping and invoicing systems</li> </ul>

## Polling question 3

**Was this webinar useful for you?**

1. Yes
2. No
3. NA / Don't know

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