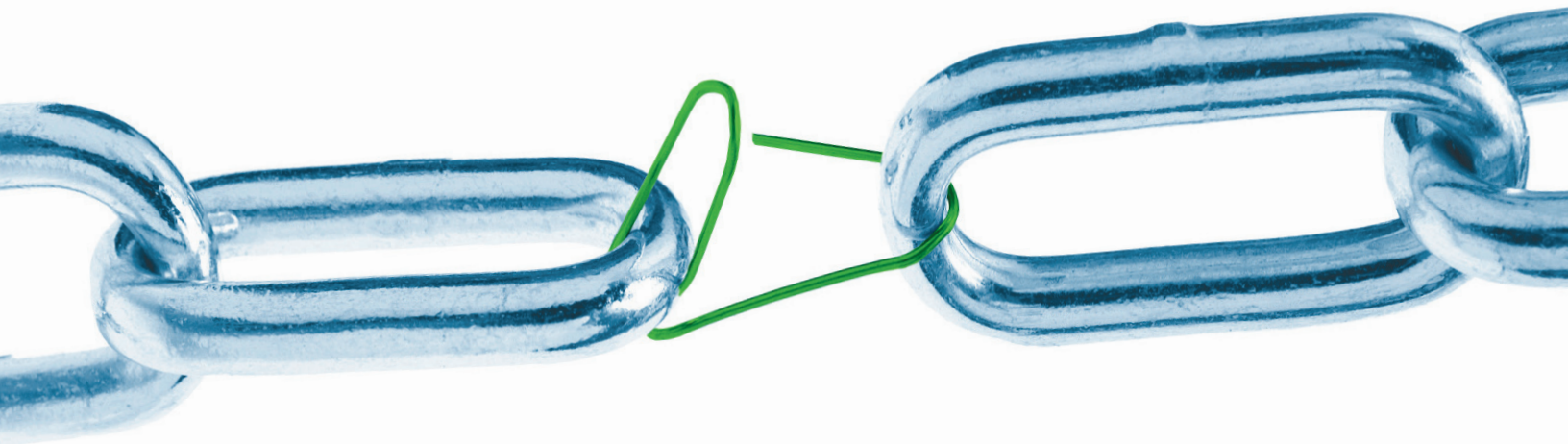


Breathing room.

Ten ideas for squeezing more working capital from your supply chain

In the face of today's unprecedented credit crunch, companies must do everything they can to free up working capital. Even businesses that appear to be in pretty good shape may not be immune. *What would happen if your company's bank suddenly cancelled its line of credit? Could you keep your operations going? And for how long?* The cold, hard truth is that any company that relies on short-term debt may need to rethink their strategy, and soon.



Deloitte surveyed supply chain managers throughout Canada to understand exactly how the current credit crisis is affecting them. More than 80% say their supply chain and manufacturing functions have a high level of responsibility for working capital management at their company. A similar number expect the current credit crunch to have a significant and lasting impact over the next 12 to 24 months – if not longer.

As a supply chain leader, you probably have experience navigating through the choppy seas of recession. But this one is different – both in magnitude and global scope. Methods and techniques that worked well before might not be good enough this time. To tackle the problem effectively, you need to know all of your options. Here are ten useful practices and strategies to consider:

“For long term negotiated contracts expect vendors to come knocking at your door for renegotiation.”

~ Canadian supply chain executive

1. Focus on the cash-to-cash conversion cycle

Under normal business conditions, companies primarily focus on the P&L – growing the top line while managing the bottom line. Routine back-office activities such as paying their bills and turning receivables into cash are often taken for granted. Of course, these are not normal business conditions. That’s why smart companies are shifting their focus from the income statement to the balance sheet. Of the three elements of supply chain working capital – payables, receivables, and inventory – supply chain executives have a tendency to focus on inventory. But in order to minimize working capital requirements during these challenging times, it’s important to apply a coordinated approach that addresses all three areas.

2. Think like a CFO

Supply chain managers generally spend their day thinking about operations and don’t pay much attention to finance and treasury issues. More often than not, inventory levels and other critical business parameters are driven by customer service requirements and operational capabilities, not financial constraints. But what if the situation was reversed? What if working capital was the company’s primary constraint on inventory, and supply chain managers were given the challenge of making it work? How would that affect your supply chain and inventory practices? It’s an interesting question, because unless the credit crisis eases significantly over the next few months, this hypothetical scenario could become a grim reality for many companies.

3. Focus on inventory reduction

Nearly 85% of our survey respondents plan to address the current cash crunch by reducing inventory for finished goods and raw materials. Unfortunately, that may not be as easy as it sounds. Companies that still use simplistic approaches to inventory management might be able to do a quick assessment and find some immediate opportunities to drive down inventory. However, many companies are likely to find that significant inventory cuts have an adverse effect on customer service and production. Sustainable savings will most likely require fundamental improvements in demand planning, inventory and safety stock policies, production planning and scheduling, lead time compression, network-wide available-to-promise, and SKU rationalization. These activities may not deliver immediate savings; however, they can significantly improve your competitiveness in a sustained downturn and position your business for rapid growth when the economy starts to pick up. While inventory reduction projects take time, a relatively fast way to take inventory off the books without impinging operational flexibility is through supplier raw material inventory consignments. The receivables corollary, of course, is to limit finished goods consignments to customers to strategic accounts.

4. Extend payables, intelligently

One way to preserve working capital is to take longer to pay your suppliers. Some companies have unilaterally decided to delay their payments and force the extension on their suppliers. Of course, such an approach is likely to damage your supply relationships. Even worse, it might deprive supply chain partners of the cash they need to maintain their operations, which could lead to late deliveries and quality problems, never mind the strains this adds to supply relationships. One of our survey respondents believes that in this tight credit environment, “any delay in payment will have a negative impact [to our suppliers].” We recommend working with suppliers to establish an agreement that both of you can live with. There might even be situations where you need to accelerate payables for a critical supplier that is on the brink of failure, in order to preserve the integrity of your supply chain and prevent a critical disruption.

5. Manage and expedite receivables

Companies tend to get lax about receivables when credit is easy and the economy is booming. But now that things have tightened up, it’s worth taking a hard look at how your receivables are being managed. We just talked about the strategy of delaying payments to your suppliers. Well, guess what? Your customers are thinking about doing the same thing to you. That’s why it’s important to improve the rigor of your collection processes. Focus on customer-specific payment performance and identify companies that may be changing their payment practices. Also, get the basics right, such as timely and accurate invoicing. Any errors in your billing process can lead to costly delays in receiving payment.

6. Audit payables and receivables transactions

Make sure you are paying the right amount for goods and services you procure and collecting the right amount for goods and services you sell. On the payables side, double check that you aren't overpaying use taxes on purchases, and that your payments arrive just in time to satisfy the payment terms. Also, make sure you are taking full advantage of all available discounts. On the receivables side, look for situations where unearned discounts were applied – and then aggressively pursue the proper payment. Once the audits have been completed, look for longer-term policy and process improvements that can prevent new problems from cropping up.

7. Consider alternate supply chain financing options

One way to generate cash and expand working capital is to use your receivables as collateral to obtain short-term financing. This practice has been around for some time, but gaining traction in recent months. Another option for boosting working capital is to offer customers a discount for early payment. The discount terms can be clearly defined in advance so they don't have to be renegotiated every time; the customer simply calculates the appropriate discount based on a defined payment schedule. With this technique, you are essentially paying customers to provide you with short-term financing. And the cost may be substantial: a conventional "2% net 10" early payment discount translates into a 36% APR. However, when bank credit is tight or nonexistent, this might be one of your only options. However, even after the current crisis subsides, credit is likely to remain much tighter than in recent years, which means there will be more and more cases where supply chain financing isn't just helpful – it's essential.

8. Ensure you have a robust framework for managing supply chain risk

Supply chain management is a complex challenge and finance-related problems only add to the risk. Do you know if any of your customers are in trouble and might be unable to pay for the goods and services you deliver? If you manufacture a product and want to sell it to someone outside your borders, you typically require a letter of credit from a prime bank that proves the buyer can pay. This letter of credit not only provides a source of ultimate payment, it can also be used to secure inventory financing while the goods are in transit. But are these letters of credit still reliable given the current state of many international banks? This problem was highlighted by a recent story in the Financial Post¹. According to the article, the global credit crisis has started to spill into the grain industry as international buyers find themselves unable to come up with payment. In this case, the problem is not supply or demand, it's finding anyone who can come up with the credit to buy.

9. Eliminate fixed costs

In times of uncertainty, it is generally a good idea to swap fixed costs for variable costs wherever you can – preserving your core business while increasing your flexibility on the fringes. Selling assets and then leasing them back is one way to raise emergency cash. You might also want to consider expanding your use of practices such as contract manufacturing, transportation fleet leasing, and third-party warehousing. As the economy limps along, you are likely to find a growing line of vendors willing to offer significant discounts and other incentives in order to win your business.

10. Think beyond your four walls

To maximize working capital, you can't just focus on your own operations and inventory levels. You need to think about your entire value chain. Squeezing inventory out of your operation may not do much good – and could introduce significant risk – if it just shifts the burden to a supplier or customer. The same is true for payables and receivables. It's important to carefully consider the upstream and downstream impact of your actions. One of our survey respondents suggests performing a high-level risk assessment on any critical, sole-source suppliers to identify issues before they become problems. In extreme cases, if a critical supplier is at risk, you might even need to buy a stake in the company or acquire the business in order to protect your supply chain and keep your goods and services flowing.

There's an old saying that strong currents and gusty winds favour the competent sailor. We hope these ten ideas help give you the breathing room to manage through the challenging waters ahead.

“Supply Chain leaders need to be more cognizant than ever of their role in managing working capital and the balance sheet”

~ Jim Kilpatrick, Deloitte

¹ “Grain piles up in ports”, Financial Post, National Post, October 8, 2008.

About the survey

Deloitte recently polled a cross-section of senior supply chain executives in Canada on how the recent credit situation is impacting supply chain operations. The collective responses are intended to provide a general view and do not represent a statistically valid sample.

Respondent profile (n=17)

Industry: Consumer Business, Manufacturing and Life Sciences

To discuss this topic in more detail and to learn more about how Deloitte can help you manage your supply chain, please contact:

Stephen Brown

Partner

stephenbrown@deloitte.ca

416-874-3154

Claude Dion

Partner

cldion@deloitte.ca

514-393-6548

Jim Kilpatrick

Partner

jimkilpatrick@deloitte.ca

416-874-3231

Kurt Ritcey

Partner

kritcey@deloitte.ca

416-874-3315

Key contributors to this report:

Lee Barter

Manager

Toronto, ON

lbarter@deloitte.ca

416-601-4853

Chris Lange

Senior Manager

Calgary, AB

clange@deloitte.ca

Mark Morrissey

Manager

mamorrissey@deloitte.ca

416-775-7017

Scott Daigneault

Senior Manager

sdaigneault@deloitte.ca

416-874-3174

Visit us at: www.deloitte.com/ca/supplychain

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