

The working capital cash cow

Does a better focus on working capital management provide the best source of much needed cash — or is it simply a temporary fix that puts customer and supplier relationships at risk?



The downturn has triggered a mad dash for cash, and some think **improving** working capital performance is the magic answer. Others claim they've already done what they can to improve working capital by focusing on inventory, accounts receivable and accounts payable and believe the costs of additional improvements are too high in terms of customer dissatisfaction and relationships with suppliers.

	Point	Counterpoint
<p>Working capital improvements are the Holy Grail</p> <p><i>"This is the fastest way to free up cash when you're up against the wall."</i></p>	<p>Companies can rapidly reduce inventory levels to free up cash by using approaches that focus on quarter-end inventory goals.</p>	<p>Sure you'll meet short-term inventory targets, but this approach will have a negative impact on customer satisfaction. And it's not effective for sustaining low levels of inventory.</p>
	<p>Reining in terms on customers — and extending terms to suppliers — can deliver immediate working capital improvements.</p>	<p>It's a zero-sum game. You're going to alienate suppliers and end up paying for it one way or another. And you run the risk of disgruntled customers, too. That could cost you volume that you can't afford to lose right now.</p>
<p>Don't put relationships at risk for a short-term fix.</p> <p><i>"This is not the time to lose customers and valuable suppliers."</i></p>	<p>Satisfied customers are your most precious asset in a downturn. Lose them now, and you may not get them back.</p>	<p>By upgrading the core capabilities that drive inventory performance, companies can reduce inventory <i>and</i> improve customer service.</p>
	<p>Suppliers react to accounts payable pressures with price increases.</p>	<p>At the extreme that's true, but many companies can get improvements just by enforcing compliance with the terms they already have. Don't assume you have to go draconian.</p>

My take

Dan Kinzler, Principal, Deloitte Consulting LLP, Supply Chain Planning Practice Leader

There has never been a better time to take a hard look at improving working capital performance. For decades, access to cash has been relatively inexpensive. As a result, the underlying processes a company has hard wired into their organization to manage working capital, such as inventory, AP and AR, have not been a major focus area. Shortfalls in processes such as forecasting, AP terms setting, credit and collections — all processes that drive inventory, AP and AR performance — have been tolerated. Now that cash has become a much scarcer and more expensive commodity, reevaluating and improving these underlying working capital capabilities may release a gold mine of cash.

Companies that focus on working capital improvements in a disciplined way may see significant benefits. One client I worked with was able to free up \$500 million in cash by reducing the inventory required to run the supply chain by more than 30 percent while improving customer service. Another saw a similar sized cash flow benefit by focusing on AP. Both companies focused on improving the underlying capabilities that drive working capital performance.

So why don't other companies see similar results? Some companies focus on the temporary fixes such as cutting production without going after the underlying drivers in a systematic way. These companies may see quarter-end and year-end improvements, but these improvements are not sustainable and often come at the expense of poor customer service. Others assume that improvements to working capital are costly, so they drag their feet. That's not necessarily true. Short-term actions may result in big gains in working capital, with no new technology investments and little risk to customers or suppliers. Here are some things to focus on.

- **Numbers please.** Some companies use rules of thumb to guide inventory decisions, when they should be using targets based on their supply chain capabilities. The analysis you'll need to upgrade your inventory strategies can be completed in a couple of months and will help determine whether you have any areas where you can safely remove inventory.
- **Not all improvements are created equal.** Once you've established the proper inventory strategies based on key supply chain capabilities, such as forecast accuracy, lead times, manufacturing response time, etc., you now have a way of figuring out the level of impact improvements to these capabilities will have on inventory levels. Knowing which improvements will move the needle is half the battle.
- **Get excited about AP.** Do you know how your company performs on AP by purchase category? If you're like most, the answer is no. Lack of visibility to actual AP performance by purchase category means, based on my experience, there's a good chance you have at least 15 percent improvement opportunity within easy reach.
- **Armed with information.** In negotiations with suppliers and customers when setting AP and AR terms, we have found that critical information not in the hands of one of the negotiating parties can have a significant outcome on the negotiated terms. For example with respect to AP, industry benchmarks by purchase category are critical for negotiations. For AR, the history of how often a customer pays on time is important to have at your fingertips.
- **Compliance, compliance, compliance.** It may not seem sexy, but focusing on compliance to your current AP and AR terms can be an excellent way to drive working capital improvements quickly. A sample transactional data pull will tell you the opportunity in this area, and we have yet to pull the sample transaction set that does not point to a significant and quick opportunity here.

If you're finding it hard to improve working capital without hurting customers and vendors, it may be time to rethink your approach. Because contrary to conventional wisdom, it's not a zero-sum game. You may be able to drive big improvements without sacrificing important relationships. Get the cash cow — without killing the golden goose.

A view from life sciences

Scott Sopher, Principal, Deloitte Consulting LLP, Life Sciences Supply Chain & Operations Practice Leader

Compared to other industries, Life Sciences companies have not emphasized supply chain efficiencies as much, and therefore there are greater opportunities for improvement.

For many, working capital is often overlooked, which means there are likely opportunities for substantial improvements just from basic planning and process management.

One of the biggest problems for life sciences is their often fragmented view of supply chains. Companies often manage inventory on a limited basis by region or facility — rarely worrying about an end-to-end view. They've had a sharp focus on service levels, cost has been secondary. But that's shifting.

Life sciences companies are recognizing both the need for — and the value of — working capital improvements. With multi-tier supply chains that are more complicated and costly to manage, they're losing some of their ability to sense demand. And they know it. Forecasting is more critical than ever, especially in new markets where supply chains may be under-developed.

If you don't have good inventory and forecasting capabilities, consider putting some simple tools into place that could help improve your visibility. And be sure to read Deloitte Consulting LLP Senior Manager Ken Olsen's take on **CPG supply chains**. The messages can be important in the OTC business. You'll want to pay special attention to the working capital impacts of trade promotions.

A view from the technology sector

Marco Sguazzin, Principal, Deloitte Consulting LLP

In my experience, the tech sector is generally under-performing when it comes to contract compliance on terms for AP and AR. Consider looking there first for working capital improvements. It's the lowest hanging fruit.

After you get that handled, turn to tougher challenges involving inventory. There's a window of understanding open right now — no one is expecting great revenue performance for the tech sector. Is this an opportunity to clean up your product portfolio? Look especially for lines you can drop entirely. Then for areas where you can reduce inventory radically. Think SKU by SKU.

The same kind of thinking should apply to your customer portfolio. Do you have the tools in place to match service level delivery with customer value?

Finally, many of the tech companies I work with are not lowering their forecasts as quickly as they should be. They're under pressure to make numbers and keep production running at capacity. Forecasting accuracy has become a secondary concern, which could lead to potentially huge inventory risks. If you're in that boat, trade promotions could prove to be key. In a sector where an entire product line can lose its value overnight, you'll want to master the art of getting rid of inventory quickly.

For more information, please visit: www.deloitte.com/us/debates/cashcow.

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