

All tied up

Working capital management
report 2013



Foreword

All tied up 2013 is the sixth annual publication in a series of working capital (WC) management reports based on Ernst & Young research, reviewing the WC performance of the world's largest companies.

The survey focuses on the top 2,000 companies in the US and Europe, examining their WC performance at a company, regional, industry and country level. It also provides insights into the WC performance of another 2,000 companies in seven other regions and countries. In addition, it sets out the findings of a review comparing the WC performance of small and medium-sized enterprises (SMEs) with that of large companies.

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US and Europe

A deterioration in WC performance in the US in 2012, but an improvement in Europe

A review of WC performance among the largest companies in the US and Europe during 2012 reveals sharply diverging results, with C2C increasing by 2% in the US from its level in 2011, while dropping by 4% in Europe over the same period.

For the US, these headline results almost wiped out the gains achieved in the prior year (when C2C fell by 3%). By contrast, Europe reported significantly improved WC performance after a stable outcome the year before. In both cases, these results have to be viewed in the context of the slowdown in global economies during the year and increased volatility in commodity and exchange rates.

Table 1: Change in WC metrics by region, 2011-12

US	2012	Change from 2011
DSO	38.5	1%
DIO	30.2	3%
DPO	31.0	2%
C2C	37.7	2%
Europe	2012	Change from 2011
DSO	50.0	-4%
DIO	33.6	-2%
DPO	44.4	-3%
C2C	39.2	-4%

Source: Ernst & Young analysis, based on publicly available annual financial statements

Note: DSO (days sales outstanding), DIO (days inventory outstanding), DPO (days payable outstanding) and C2C (cash-to-cash), with metrics calculated on a sales-weighted basis

For the US, the deterioration in WC performance in 2012 resulted from poor results in both inventory and receivables (DIO and DSO were up 3% and 1%, respectively), partly offset by a better showing in payables (DPO was up 2%). For Europe, the stronger WC performance was driven by progress in both receivables and inventory (DSO and DIO were down 4% and 2%, respectively), partly offset by a poor showing in payables (DPO was down 3%).

WC performance drivers

A challenging environment, with contrasting growth trends across and within regions: Rapidly changing global economic and financial conditions in 2012 significantly affected WC results for both the US and Europe. After picking up at the start of the year, global economic growth weakened considerably during the course of 2012, weighted down by the effects of the sovereign debt crisis in the Eurozone, the uncertainty surrounding the US fiscal outlook and softening demand in all four of the BRIC countries. Companies responded to this deteriorating environment by reducing production, cutting costs and delaying capital expenditure, as well as tightening control over cash and WC. Compared with 2011, sales growth slowed to 3% in the US and 6% in Europe in 2012 (the difference in growth rates between the two regions primarily reflects the impact of changes in exchange rates during the year). But while sales in the US grew at a similar rate in the final quarter of the year compared with the full year 2012, Europe saw a significant decline in sales growth toward the end of the year, as much of the region fell back into recession. For Europe, this trend means that much of the reported WC improvement appears to have come from much lower sales and therefore purchases in the last months of the year, compounded by expectations of continued weakness in demand in the first months of 2013, resulting in reduced balances of both receivables and payables.



Increased volatility in commodity and exchange rates: Changes in commodity prices and exchange rates also played a role in driving reported WC performance in 2012. Commodity prices remained highly volatile throughout 2012, adding significant stresses to WC management and supply chains in particular. Compared with 2011, metal and food prices in 2012 were much lower on average, while oil prices remained almost unchanged. At the end of 2012, the price index for each commodity group was close to the level reached at the end of 2011. However, it is worth noting that within each commodity group, there have been wide price variations between sub-groups during the year and at year-end relative to 2011. The lag effect of changing commodity prices (smoothed by the use of hedging policies) means that the reported inventory performance generally improves in the short term when prices fall and deteriorates when prices rise. However, these trends are partly mitigated by changes in payables performance.

For companies reporting in US dollars, the relative weakness of the US dollar against the euro at the end of 2012 compared with its average during the year was a negative contributory factor to WC performance. In contrast, for those reporting in euros, the strength of this currency had a beneficial impact on WC performance.

Continued attention to WC management: While the external factors mentioned above contributed significantly to last year's changes in overall WC performance, many companies in both regions have also continued to pursue new initiatives in this area, especially with regard to lean manufacturing, billing and cash collection, spend consolidation, low-cost country sourcing, renegotiation of payment terms, and supply chain efficiency.

Increased focus on inventory: As global demand began to soften at midyear 2012, companies focused on reducing production to prevent inventory build-up, resulting in a significant drop in the absolute levels of inventory between the third and the fourth quarter of the year for many of them.

However, the results of these actions were far from uniform, with wide variations in the degree and direction of change in DIO between industries within each region. This reflected not only the varying ability of supply chains to keep pace with changes in demand, but also the impact of competing strategies, as each industry tried to shift inventory up and down the WC value chain.

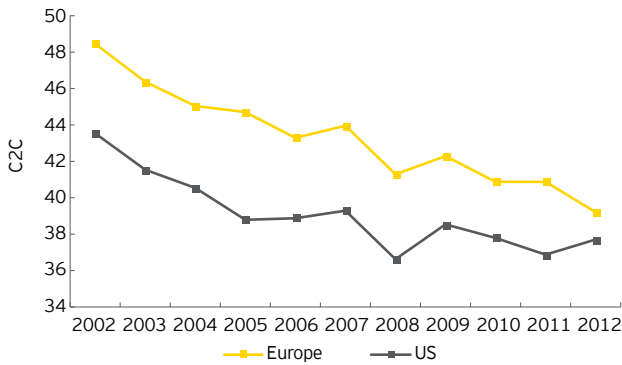
Varying receivables and payables performance: In the US, unfavorable changes in exchange rates probably exacerbated the increase in both DSO and DPO. In Europe, the decrease in DSO reflected the decline in sales, while the drop in DPO was primarily caused by reduced production levels in the final months of 2012. In both regions, these results also reflect the impacts of specific actions that companies have taken to improve billing and cash collection and drive greater efficiency in procurement operations and payables processes.

In both the US and Europe, the reported changes in payables also reflected companies' differing strategies and tactics. For example, some companies have been stretching terms with their main suppliers or reducing their supplier base to achieve greater leverage in negotiations. Others have been choosing to pay faster in return for enhanced cash discounts. Overall, credit problems remained relatively limited, except in those southern European countries facing financial difficulties.

Disproportionate impact of the oil and gas industry on overall WC performance: For the US and Europe, oil and gas companies accounted for as much as 12% and 17%, respectively, of total sales of our sample of companies in 2012. Had the oil and gas industry been excluded from our calculations, the increase in C2C for the US in 2012 would have been reduced to 1.6% (down from 2.3%), and the decrease in C2C for Europe would have been limited to 3% (down from 4%).

The results for 2012 bring the total reduction in C2C achieved since 2002 to 14% for the US and 19% for Europe. Each of the WC components contributed to this improved performance. In the US, DSO and DIO fell by 9% and 3%, respectively, while DPO rose by 3%. In Europe, DSO and DIO dropped by 12% and 5%, respectively, while DPO was up 3%.

Table 2. WC performance for the US and Europe, 2002-12



Source: Ernst & Young analysis, based on publicly available annual financial statements

Company performance review

In the US, 58% of the companies included in our research reported a deterioration in WC performance, while 59% of those based in Europe showed an improvement.

In the US, only 40% of the companies analyzed showed an improvement in WC performance in 2012 compared with 2011. These results are in sharp contrast with the year before, when the comparable figure was 54%. A majority of companies saw a deterioration in receivables and inventory performance, while for payables, there were almost identical numbers of companies underperforming and outperforming. Only one-third of the companies in the US that showed an improvement in WC performance in 2011 compared with 2010 achieved further progress in 2012.

In Europe, a significant majority of companies (59%) reported an improvement in WC performance in 2012 compared with 2011. By way of comparison, less than half of these companies showed an improvement in the year before. In 2012, most companies posted better results in both receivables and inventories, but only a minority did so in payables. Half of the companies in Europe that showed an improvement in WC performance in 2011 compared with 2010 achieved further progress in 2012.

Table 3. Proportion of companies showing improved performance, 2012 vs. 2011

	C2C change 2012-11	
	US	Europe
DSO reduction	45%	61%
DIO reduction	43%	58%
DPO enhancement	51%	38%
C2C reduction	42%	59%

Source: Ernst & Young analysis, based on publicly available annual financial statements

Industry performance review

In 2012, industries across and within regions diverged widely in WC performance, partly reflecting the impact of contrasting economic growth patterns and changes in exchange rates during the year.

For most cyclical industries, the divergence in WC performance between the US and Europe can be largely explained by many of the same external economic and financial factors mentioned above.

For example, for the automotive supply industry, 2012 was characterized by sharply diverging trends in automotive production between regions (up 17% in the US and down 6% in Europe from their levels of 2011). Against this difficult background, automotive suppliers in the US reported significantly higher C2C, while their European peers still managed to reduce C2C.

Among non-cyclical industries, pharmaceutical companies in the US reported higher C2C, while those in Europe posted lower C2C. Both regions saw a significant deterioration in inventory performance, affected by the impact of patent expirations on levels of inventory on hand (DIO up 14% and 6%, respectively, in the US and Europe). For European companies, this impact was more than offset by much higher DPO and lower DSO, while for US companies, progress in both receivables and payables was not big enough to reverse poor results in inventory.

For electric utilities, WC performance in 2012 was again heavily influenced by the impact of unusual weather conditions during the year, and especially in the last quarter, compared with the same periods the year before. Last year's industry results also reflect the progress made in transforming its business model against a backdrop of ever-changing energy policies and regulatory frameworks.

For the oil and gas industry, changes in exchange rates between the US dollar and the euro played a significant part in explaining the variations in WC performance between the two regions. Companies in Europe reported a further significant improvement, while those based in the US posted a stable performance. These results were achieved in the context of oil prices that have remained almost unchanged in US dollar terms in 2012 compared with 2011.

Table 4: Most significant WC changes among major industries, 2012 vs. 2011

Major industry	C2C change 2012-11	
	US	Europe
Cyclical		
Automotive supplies	5%	-8%
Chemicals	7%	-4%
Diversified industrials	3%	-2%
Semiconductors	6%	16%
Steel	6%	-6%
Non-cyclical		
Food producers	3%	-13%
Food and general retailers	-1%	-7%
Pharmaceuticals	5%	-3%
Other		
Electric utilities	2%	-9%
Oil	0%	-11%

Source: Ernst & Young analysis, based on publicly available annual financial statements



Regional and country performance review

US vs. Europe performance comparison

The WC performance gap between the two regions narrowed significantly last year, with Europe regaining almost twice the amount of ground it lost in the previous year (outperforming the US by 6% after having underperformed by 3%).

Comparisons between the WC performances of the two regions should be approached with a particular nuance in mind. Since some of the business done by North American and European companies takes place outside their home regions, their WC results to some degree reflect global market conditions as well as those in the regions where they are based.

Nevertheless, the US continued to exhibit much lower levels of WC compared with European-based companies. Overall C2C for the US in 2012 was two days, or 5% below that of Europe. This was primarily due to a strong performance in inventory (minus four days, or 11%). The differential between receivables and payables cycles (DSO-DPO) across both regions was two days, with the effect of generally longer trade terms in Europe than in the US being mitigated at the net level. The wide variations in trade terms between Northern and Southern Europe should be noted, however.

There are many possible causes for the gap in WC performance between the US and European regions: production, logistics and distribution facilities in Europe tend to be smaller and dispersed over many different countries; transport also takes longer and logistics costs are higher in Europe than in the US; and the US benefits from a unique trading currency and the absence of national borders.

European country performance comparisons

In Europe, each sub-region and country except the UK reported an improvement in WC performance.

Of the seven main sub-regions and countries in Europe, the UK was the only one reporting worse WC results in 2012 compared with 2011. Its C2C increased by 4%, wiping out the entire gain registered in the year before when the country significantly outperformed its peers. This deterioration in performance came mostly from poor results in inventory (DIO up 6%). Construction, mining and tobacco companies scored poorly, while aerospace and defense, consumer products and pharmaceutical companies put in a better showing.

In contrast, France, Germany, Benelux and Nordic countries managed to report a solid improvement in WC performance.

France saw a drop of 6% in C2C, driven by a combined decrease in both DSO and DIO. Cyclical and oil industries and electric utilities all made progress in reducing C2C, with the drop reported by cyclical companies exacerbated by the fall in activity in the final months of 2012. In contrast, food and general retailers scored poorly, still affected by the regulatory decision to cap corporate payment terms, although some exceptions are allowed.

Germany showed significantly improved WC performance (C2C down 4%), after a slight deterioration the year before. But performance between and within industries was varied: for example, it was mixed for electric utilities, chemical and diversified industrials companies, and strong for automotive suppliers and consumer products companies.

Benelux posted a further reduction of 6% in C2C, with a strong showing from oil companies and consumer products. For the Nordic countries, WC performance remains heavily skewed toward the performance of certain industries. For example, had the oil industry been excluded from our calculations, the reduction in C2C for this sub-region would have been limited to 2% instead of 7%. Strong results were achieved by telecommunications equipment and paper and forestry companies.

In other regions and countries, Southern Europe and Switzerland reported a fall of 7% and 1%, respectively, in C2C. For Switzerland, it is worth noting the strong performance of one major food company which accounted for one-quarter of the country's total sales (reversing the ground lost the year before). In contrast, the two largest pharmaceutical companies reported diverging results.

Table 5: WC changes by European sub-region and country, 2012 vs. 2011

Sub-region	% weighting		C2C change 2012-11
	Sales	Companies	Overall
Benelux	11%	8%	-6%
France	21%	16%	-6%
Germany	18%	13%	-4%
Nordic countries	10%	15%	-7%
Southern Europe*	12%	11%	-7%
Switzerland	6%	7%	-1%
UK	20%	27%	4%
Other	2%	3%	nm
Europe	100%	100%	-4%

* Greece, Italy, Portugal and Spain

Source: Ernst & Young analysis, based on publicly available annual financial statements

Opportunity for improvement

The wide variations in WC performance between different companies in each regional industry point to significant potential for improvement – with up to US\$1.3 trillion of cash tied up in WC of the leading 2,000 US and European companies.

The range of cash opportunity is defined as the sum of the WC cash opportunity derived for each company. This has been calculated by comparing the 2012 performance of each of its WC components with the average (low estimate) and the upper quartile (high estimate) achieved by its industry peer group.

On this basis, the 1,000 US companies included in this research would have in total between US\$360b and US\$660b of cash unnecessarily tied up in WC. This range of cash opportunity is equivalent, respectively, to between 12% and 21% of their WC scope (defined as the sum of trade receivables, inventories and accounts payable) and between 3% and 6% of their aggregate sales.

The 1,000 European companies would have in total between €290b and €490b of cash unnecessarily tied up in WC. This range of cash opportunity is equivalent, respectively, to between 11% and 19% of their WC scope and between 4% and 7% of their aggregate sales.

In total, the leading 2,000 US and European companies would have up to US\$1.3 trillion of cash unnecessarily tied up in WC, equivalent to nearly 7% of their aggregate sales. This figure is similar to last year's.

Our 'cash potential' analysis reveals that the opportunity is distributed across the various types of WC components, with 35% coming from each of receivables and payables and 30% from inventory.

The reported figures for the cash opportunity have to be treated with a degree of caution, as they are based on an external view of each company's WC performance within its industry based on public consolidated numbers. The top end of each range is likely to be ambitious, as it ignores differences in commercial strategies (impacting cash discounts and payment terms), customer base, supply, product mix, country sales exposure and local payment terms practices, which can vary widely, especially across Europe. The consolidated figure would also be lower if intra-company benefits were excluded. On the other hand, the opportunity is calculated for each company's WC component by comparing its performance not against the best performer, but against the top quartile of its industry peer group.

Table 6: WC cash opportunity, 2012

Region	Cash opportunity					
	Value		% WC scope*		% sales	
	Average	Upper quartile	Average	Upper quartile	Average	Upper quartile
Europe	€290b	€490b	11%	19%	4%	7%
United States	US\$360b	US\$660b	12%	21%	3%	6%

* WC scope = sum of trade receivables, inventories and accounts payable

Source: Ernst & Young analysis, based on publicly available annual financial statements



Other regions and countries

Deterioration in WC performance in 2012

Companies based in the other seven regions and countries (Asia; Australia & New Zealand, or Aus/NZ; Canada; Central and Eastern Europe, or CEE; India; Japan; and Latin America, or LatAm) covered by our survey reported a deterioration in WC performance in 2012 compared with 2011, with C2C rising by 3%. Had the oil and gas and metals and mining industries (O&G and M&M, which accounted for close to 20% of total sales in 2012) been excluded from our calculations, the increase in C2C would have been higher at 4%.

Table 7: Change in C2C, 2011-12

Regions and countries	2012	Change from 2011
Asia	33	3%
Aus/NZ	28	-6%
Canada	26	2%
CEE	38	12%
India	51	5%
Japan	57	6%
LatAm	34	-4%
C2C	42	3%

Source: Ernst & Young analysis, based on publicly available annual financial statements

Table 8: Change in C2C excluding the O&G and M&M industries, 2011-12

Regions and countries	2012	Change from 2011
Asia	39	5%
Aus/NZ	28	-2%
Canada	32	0%
CEE	39	5%
India	67	6%
Japan	57	6%
LATAM	33	-6%
C2C	46	4%

Source: Ernst & Young analysis, based on publicly available annual financial statements

Last year's weak WC performance was due to poor results in receivables and inventories (DSO and DIO up 2% each), partly offset by a better showing in payables (DPO up 1%). Excluding the O&G and M&M industries, the deterioration in WC performance also arose from poor results in receivables and inventories (DSO and DIO up 4% and 3%, respectively), partly offset by a better showing in payables (DPO up 2%).

In 2012, five regions and countries out of seven (or four if we exclude the O&G and M&M industries) posted a deterioration in WC performance compared with 2011. Only two regions (Australia & New Zealand and Latin America) reported better results. For Canada, WC performance would have remained unchanged had the O&G and M&M industries been excluded from our calculations.

More specifically, within the Asia and LatAm regions, there were wide variations in the degree of change in C2C among countries.

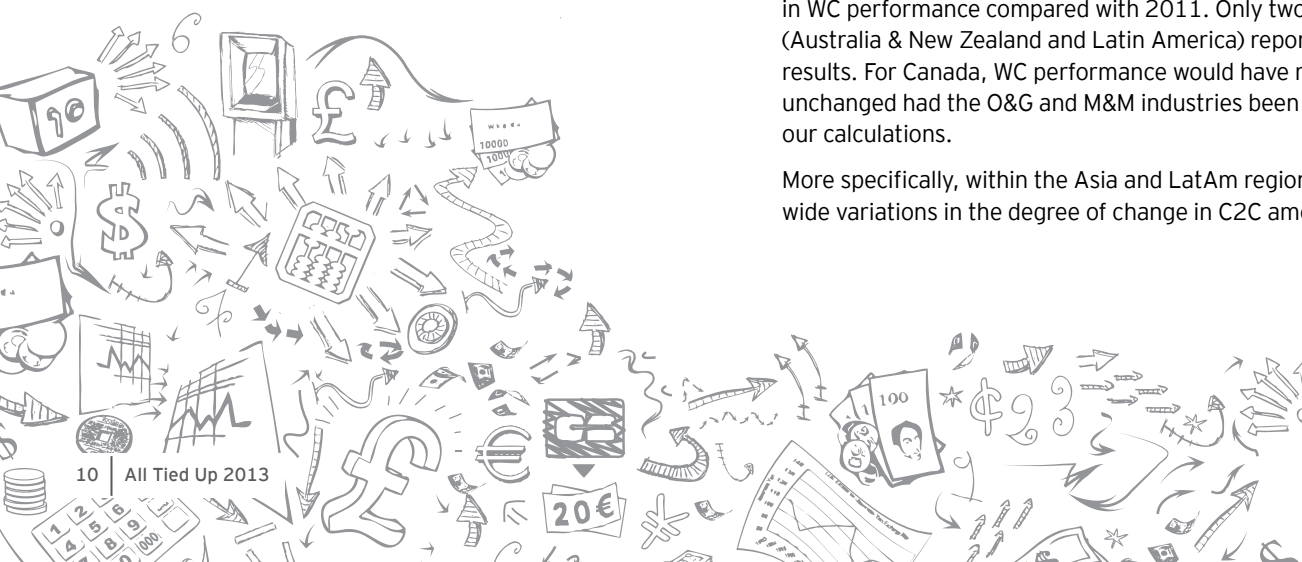


Table 9: Change in C2C per Asian country, 2011-12

Asia	2012	Change from 2011
China	12	49%
Indonesia	63	2%
Malaysia	51	14%
Singapore	46	-3%
South Korea	54	0%
Taiwan	39	11%
Thailand	25	-7%
C2C	33	3%

Source: Ernst & Young analysis, based on publicly available annual financial statements

Table 10: Change in C2C per Asian country, excluding the O&G and M&M industries, 2011-12

Asia	2012	Change from 2011
China	14	33%
Indonesia	62	3%
Malaysia	51	14%
Singapore	48	-1%
South Korea	55	2%
Taiwan	38	12%
Thailand	34	-5%
C2C	39	5%

Source: Ernst & Young analysis, based on publicly available annual financial statements



Table 11. Change in C2C per LatAm country, 2011-12

LatAm	2012	Change from 2011
Argentina	21	-14%
Brazil	39	-5%
Chile	42	-6%
Colombia	23	9%
Mexico	25	8%
C2C	34	-4%

Source: Ernst & Young analysis, based on publicly available annual financial statements

Large distribution of WC performance

A review of the WC performance of the largest companies across other regions and countries reveals significant variations overall and for each metric. These variations would have been even bigger had the O&G and M&M industries been excluded from our calculations.

Table 12. Change in C2C per LatAm country, excluding the O&G and M&M industries, 2011-12

LatAm	2012	Change from 2011
Argentina	26	-8%
Brazil	35	-10%
Chile	43	-1%
Colombia	21	-18%
Mexico	24	7%
C2C	33	-6%

Source: Ernst & Young analysis, based on publicly available annual financial statements

It is worth noting, however, that regional and country comparisons should be approached with a particular nuance in mind. Since some of the business carried out by top country-headquartered companies takes place outside their home regions, their WC results to some degree reflect global market conditions, as well as those in the regions where they are based.

Table 13. WC metrics by main region and country

	Asia	Aus/NZ	Canada	CEE	India	Japan	LatAm
DSO	39	33	40	46	46	66	39
DIO	38	31	31	39	49	42	32
DPO	44	36	45	47	44	52	37
C2C	33	28	26	38	51	57	34
DSO-DPO	-5	-3	nm	-1	2	14	2

Source: Ernst & Young analysis, based on publicly available annual financial statements

Table 14. WC metrics by main region and country, excluding the O&G and M&M industries

	Asia	Aus/NZ	Canada	CEE	India	Japan	LatAm
DSO	46	37	42	58	68	68	43
DIO	40	28	31	36	50	42	34
DPO	47	37	40	56	51	53	43
C2C	39	28	32	38	67	57	33
DSO-DPO	-1	0	nm	2	17	15	0

Source: Ernst & Young analysis, based on publicly available annual financial statements

Table 15. WC metrics by Asian country

	China	Indonesia	Malaysia	Singapore	South Korea	Taiwan	Thailand
DSO	27	33	47	40	55	47	27
DIO	36	57	40	44	37	40	26
DPO	51	26	36	38	38	48	28
C2C	12	63	51	46	54	39	25
DSO-DPO	-24	7	11	2	17	-1	-1

Source: Ernst & Young analysis, based on publicly available annual financial statements

Table 16. WC metrics by Asian country, excluding the O&G and M&M industries

	China	Indonesia	Malaysia	Singapore	South Korea	Taiwan	Thailand
DSO	39	32	47	40	58	48	30
DIO	39	57	40	46	36	39	38
DPO	64	27	36	38	39	49	34
C2C	14	62	51	48	55	38	34
DSO-DPO	-25	5	11	2	19	-1	-4

Source: Ernst & Young analysis, based on publicly available annual financial statements

Table 17. WC metrics by LatAm country

	Argentina	Brazil	Chile	Colombia	Mexico
DSO	34	43	45	25	32
DIO	40	35	39	19	22
DPO	53	40	42	21	29
C2C	21	38	42	23	25
DSO-DPO	-19	3	3	4	3

Source: Ernst & Young analysis, based on publicly available annual financial statements

Table 18. WC metrics by LatAm country, excluding the O&G and M&M industries

	Argentina	Brazil	Chile	Colombia	Mexico
DSO	41	45	48	34	36
DIO	34	33	42	40	30
DPO	49	42	47	53	42
C2C	26	36	43	21	24
DSO-DPO	-8	3	1	-19	-6

Source: Ernst & Young analysis, based on latest publicly available annual financial statements

Our analysis shows that India and Japan were the worst C2C performers among these regions and countries in 2012, scoring particularly poorly in receivables and inventories. Japan also exhibited the highest differential between receivables and payables cycles (DSO vs. DPO). At the top of the WC rankings (excluding Canada) were Australia & New Zealand, thanks to their strong performances in both receivables and inventory, partly offset by poor results in payables.

For Canada, DPO figures for a large number of companies were inflated (and therefore C2C deflated) by the inclusion of accrued expenses in the absence of detailed financial disclosure. Canada's DSO and DIO were among the lowest globally.

With regard to the other regions, the C2C performance of Asia, CEE and LatAm appeared to be close to each other, but with some notable differences between each component of WC and between different countries in each region.

Factors behind the WC performance variations

Industry bias. For some regions and countries, results are heavily skewed toward the WC performance of certain industries. For example, the O&G and M&M industries represent as much as 42% of total sales of our sample of companies for CEE, but only 7% for Japan. Electric utilities and telecommunications services account for 19% of sales in Latin America, but for only 9% in Australia & New Zealand. The O&G industry represents as much as 37% of total sales of our sample of companies for India, but only 7% for Japan. Steel accounts for 8% and 6% of sales in India and Asia, respectively, but for only 1% in the US and 2% in Europe.

Payment practices. Payment practices (payment terms and behaviors, payment usage, legal frameworks and cash collection effectiveness) vary widely across and within regions and countries. Payment terms, for instance, are generally longer in Asia, CEE and Latin America than they are in the US. For Australia & New Zealand and Canada, terms are comparable to those applied in the US. With regard to payment usage, there is a strong preference for cash payments in Brazil, China, India and Russia. Cash is also prevalent in more mature economies, such as Japan. While growing fast, credit card usage remains low in Asia and Latin America, with the exception of Brazil and South Korea. At the same time, developed countries have generally high card penetration. Checks are almost nonexistent or

becoming obsolete in many developing countries, but their usage remains high in India and Latin America. Significant disparities in the levels of payment delays and defaults (and subsequently in provisioning and write-offs policies) can also be observed between regions and countries. While payment usage plays a role, these differences can also be explained by local behaviors, as well as by variations in the degree of effectiveness of credit management policies and legal enforcement procedures.

Logistics and distribution infrastructures. The efficiency of logistics and distribution varies greatly across regions and countries, leading to significant differences in local supply chain costs, service levels and risks, as well as in WC performance (notably in the form of inventory levels and cash and costs trade-offs).

The World Bank reports regularly on logistics performance by calculating scores based on six core indicators: efficiency of customs and border management clearance, quality of trade and transport infrastructure, ease of arranging competitively priced shipments, competence and quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach consignees within scheduled or expected delivery times. According to the World Bank's latest ranking of logistics performance, the US, most European countries and Japan are among the top 10 countries (out of 155), while the bottom 10 are mostly in Africa. China and India rank 26th and 46th, respectively. Developing countries have been slowly catching up with the high performers, but the logistics performance gap between the two remains wide.

Modern trade or organized retail is also at very different stages of development. In developed countries, its share exceeds 70% to 80% of total retail, whereas in developing countries, the traditional sector dominates, but with varying degrees (from 95% in India to 80% in China, two-thirds in Brazil and 45% in Malaysia).

Focus on cash and process efficiency. There are marked differences in the degree of management focus on cash and process efficiency among these regions and countries. These partly reflect variations in the commercial and industrial strategies deployed, as well as differences in the degree of process maturity among companies, as they seek to respond in varying ways to distinct economic and financial conditions and opportunities.



WC comparisons among industries across regions and countries

An analysis of WC performance by industry across other regions and countries, and in comparison with the US and Europe, reveals substantial divergences, exacerbated by the impact of factors that are specific to each local industry.

In the case of telecommunications services, the WC performance in individual regions and countries varies considerably, largely influenced by the fixed-line/mobile and prepaid/postpaid mix, local payment practices, payment methods and levels of capital expenditure. China and India lead the field for WC performance in this industry. Both countries carry a negative C2C figure, benefiting from high payables (on the back of large capital expenditure requirements) and low receivables (due to the importance of mobile revenues, combined with a high proportion of prepaid subscribers).

The oil and gas industry also exhibits wide variations in WC performance between the different regions and countries, partly due to differences in business models, with companies operating at various points in the value chain. For example, oil and gas companies in Japan are mostly refiners, which carry much higher WC requirements than those involved in exploration and production.

Interestingly, machinery makers report high levels of WC across all regions and countries, reflecting the global nature of this industry.

For food producers in China, India and Latin America, C2C is generally lower than in the US and Europe, while for those in CEE, they tend to be higher. For other rapid-growth markets, such as Africa, Middle East and Asia outside China, anecdotal evidence suggests that C2C is relatively higher overall.

Table 19: WC metrics by industry across main regions and countries

C2C	Asia	Aus/NZ	Canada	CEE	India	Japan	LatAm	US	Europe
Automotive supplies	60	nm	34	81	61	60	76	36	57
Building materials	65	65	nm	100	33	84	56	56	51
Chemicals	53	49	66	49	76	87	nm	64	67
Electric utilities	36	18	0	11	37	22	21	35	32
Food producers	57	53	42**	72	37	53	40	47	32
Industrials*	48	nm	38	67	nm	79	81	69	88
Machinery makers	78	nm	122	nm	nm	139	132	102	83
Oil and gas	12	23	-4**	34	29	53	31	5	28
Steel	71	64	91	125	86	87	99	67	78
Telecommunications	-34	40	11**	6	-2	40	9	10	-3

* Diversified industrials and electrical components and equipment

** Includes accrued expenses

Source: Ernst & Young analysis, based on latest publicly available annual financial statements





SMEs and large companies

Tightening WC performance gap between SMEs and large companies in 2012

The gap in WC performance between SMEs and large companies narrowed in 2012, as SMEs regained some of the ground lost the year before.

Compared with 2011, our 2012 study shows that SMEs reported slightly higher C2C, owing to a combination of higher DSO (up 2%) and DIO (up 1%), partially offset by higher DPO (up 3%). Large companies saw a larger increase in C2C (up 3%), due to a higher DIO (up 5%) and DSO (up 1%), partially offset by higher DPO (up 3%). Last year's sales growth for SMEs exceeded 5% compared with just 3% for large companies. This difference probably reflects the fact that large companies tend to be more affected than SMEs by unfavorable change in exchange rates, since they are more likely than smaller companies to sell outside their home regions.

Among both the SMEs and large companies included in our survey, a majority of each sub-group (57% and 60%, respectively) reported a deterioration in WC performance in 2012. For each component of WC, a majority of SMEs posted worse results than in 2011. Among large companies, a majority saw a deterioration in receivables and inventory performance, while for payables, there were identical numbers of companies underperforming and outperforming.

Table 20: Change in WC metrics for SMEs and large companies, 2011-12

Days	Change 2012-11	
	SMEs	Large companies
DSO	2%	1%
DIO	1%	5%
DPO	3%	3%
C2C	1%	3%

Source: Ernst & Young analysis, based on publicly available financial statements

SMEs have been closing the WC gap with large companies since 2005

Comparing 2012 with 2005 shows SMEs reporting stable C2C over the intervening period, while large companies saw an increase of 3%. This means that, since 2005, SMEs have been closing the WC gap with large companies.

However, further analysis based on each WC component reveals greater variability and sharply diverging trends. For SMEs, the stability in WC performance was the net result of lower DSO and DIO (down 2% and 3%, respectively), fully offset by weaker DPO (down 9%). For large companies, the deterioration in WC performance arose from much higher DIO (up 10%), partially offset by lower DSO (down 4%) and higher DPO (up 2%).

A variety of factors may help to explain these contrasting WC performance patterns:

- ▶ Both sub-groups have reported stronger receivables performance, benefiting from progress made in improving billing and cash collections. For SMEs, however, the reduction in DSO has been more limited, probably reflecting the ongoing pressure from large customers to extract better payment terms.
- ▶ Large companies have managed to drive improvement in their payables performance, taking action to leverage and consolidate spend, change payment terms, standardize processes and work more closely with their own suppliers. In contrast, the payables results for SMEs have been much weaker since 2005. This may have been partly due to changing strategies and tactics, with a higher proportion of companies choosing to respond to more challenging credit conditions by paying more quickly in return for enhanced cash discounts.



- ▶ Large companies' inventory performance has deteriorated significantly due to increased investment in inventories to serve fast-growing emerging countries and commodity price inflation (which was partially mitigated by a corresponding increase in DPO). In contrast, SMEs registered an improvement in inventory performance.

Much-higher current C2C for SMEs than for large companies

Performance by company

SMEs continue to exhibit much higher C2C than large companies. In 2012, SMEs' C2C was 26% (equivalent to 13 days) higher than that of large companies on a sales-weighted basis.

Compared with SMEs, large companies display superior performance in both receivables and payables, reaffirming the view that scale provides greater opportunities to negotiate favorable payment terms with customers and suppliers. Perhaps more surprisingly, SMEs scored slightly better than their larger counterparts in inventory management. Several factors may explain the difference in performance. For example, large companies are more likely than smaller companies to sell outside their home regions, potentially giving rise to longer lead times and excess safety stocks. On the other hand, lean practices and vendor-managed inventory arrangements are more widespread among large companies. Increased outsourcing and global sourcing may have also played a significant role in driving inventory performance, although the extent of this impact remains difficult to assess for each sub-group.

Table 21: WC metrics differential between SMEs and large companies, 2012

	SMEs vs. large companies differential	
	%	days
DSO	17%	7
DIO	-5%	-2
DPO	-24%	-7
C2C	26%	13

Source: Ernst & Young analysis, based on publicly available financial statements

Performance by sector

Comparing the relative WC performance of large companies and SMEs in the same sector shows that SMEs in almost two-thirds of sectors have higher C2C than large companies. In 2012, the median C2C differential figure at a sector level between SMEs and large companies was eight days (using median in this case as a more appropriate measure given the uneven distribution of companies by sector).

The most meaningful variations at a C2C level for major sectors are reported in the table below. Among electrical components and communications technology companies, for example, SMEs' C2C is more than 50% above that of large companies. For chemical and diversified industrial companies, the corresponding figures are 20% and 14%, respectively. In contrast, SMEs in the oil equipment sector display lower C2C (-21%) than their larger peers.

Table 22: C2C differential by sector between SMEs and large companies, 2012

	C2C differential	
	%	days
Electrical components	56%	33
Communications technology	52%	29
Semiconductors	46%	24
Chemical	20%	13
Clothing and fabrics	18%	13
Diversified industrial	14%	10
Software	0%	0
Oil equipment	-21%	-22

Source: Ernst & Young analysis, based on publicly available financial statements

Relationship between size and WC performance is not always direct and linear

While we have identified a strong relationship between the size of a company and its WC performance, there are many other factors that can have an impact.

These include the size of the company in relation to its customers and suppliers; the availability of alternative sources of offer and supply; the choice of commercial, manufacturing and logistics strategies and the subsequent trade-offs between cash, cost and service; and the degree of management focus on cash and process efficiency.

These factors mean the relationship between size and WC performance is not always direct and linear. The benefits of size may also vary according to the level of sales, with rising or diminishing effects below or beyond certain thresholds.

For example, our analysis reveals a C2C differential of 40% between SMEs and large companies, with sales of over US\$10 billion, a threshold that is generally viewed as a tipping point for corporate efficiency. In contrast, the gap is only 30% between SMEs and large companies, whose sales exceed just US\$1 billion.



How Ernst & Young can help

Ernst & Young's global network of professionals helps clients to identify, evaluate and prioritize realizable improvements to liberate cash from WC through sustainable changes to policy, process, metrics and procedure adherence.

We can assist organizations in their transition to a cash-focused culture and help implement the relevant metrics. We can also identify areas for improvement in cash flow forecasting practices and then assist in implementing processes to improve forecasting and frameworks in order to sustain those improvements.

Companies that undertake working capital improvement initiatives often realize a high ROI. In addition to increased levels of cash, significant cost benefits may also arise from process optimization, through reduced transactional and operational costs and from lower levels of bad and doubtful debts and inventory obsolescence. Our working capital professionals are there to help wherever you do business. It is how Ernst & Young makes a difference.

We have over 150 dedicated professionals across the globe.

We consistently identify and deliver increased cash flow of between 5% and 20% of annual sales

Methodology

The report contains the findings of a review of the WC performance of the largest 4,000 companies (by sales) headquartered in the US (consisting of 1000 companies), Europe (1,000) and seven other main regions and countries – Asia (600), Australia & New Zealand (100), Canada (300), Central and Eastern Europe (150), India (400), Japan (230), and Latin America (270).

This report also sets out the findings of a review comparing the WC performance of SMEs with that of large companies. Using sales as the indicator of each company's size, SMEs have been defined in this report as companies with sales under US\$1 billion, while large companies are those with sales exceeding US\$1 billion. A total of 1,200 companies (all domiciled in the US for comparison purposes) were analyzed, evenly divided between the two sub-groups.

- ▶ The overall analysis draws on companies' latest fiscal 2012 reports. Performance comparisons have been made with 2011 and with the previous nine years in the case of the US and Europe and seven years for SMEs and large companies.
- ▶ The review on which the report is based is segmented by region, country, industry and company. It uses metrics to provide a clear picture of overall WC management and to identify the resulting levels of cash opportunity.
- ▶ Each of the companies analyzed in this research has been allocated to an industry and to a region or country. Reported global, regional and country numbers are sales-weighted.

- ▶ The overall review excludes financial institutions. The auto manufacturing industry (OEMs) is also excluded due to the difficulty of assessing its "true" WC performance, given the intertwined nature of its industrial and financial activities.
- ▶ The performance trends at the country and industry level need to be treated with a degree of caution for two reasons. Firstly, the approach is based on consolidated numbers in the absence of further local details, with each company being allocated to the location of its headquarters. Secondly, factors such as year-end reporting, changes in the trade-offs between the profit and loss account and the balance sheet, exchange rates, and merger and acquisition activity may each have had a significant effect on year-on-year comparisons.
- ▶ Because of differences in industry weightings and in the level of international activity within each economy, an analysis of the WC performance gap across countries in Europe would not have been useful or meaningful.
- ▶ The WC performance metrics are calculated from the latest publicly available company annual financial statements. In order to make the figures as comparable and consistent as possible, adjustments (see glossary) have been made to the data to reflect the impact of acquisitions and disposals and off-balance-sheet arrangements.

Glossary

- ▶ DSO (days sales outstanding): year-end trade receivables net of provisions, including VAT and adding back securitized and current financial receivables, divided by full-year pro forma sales and multiplied by 365 (expressed as a number of days of sales, unless stated otherwise)
- ▶ DIO (days inventory outstanding): year-end inventories net of provisions, divided by full-year pro forma sales and multiplied by 365 (expressed as a number of days of sales, unless stated otherwise)
- ▶ DPO (days payable outstanding): year-end trade payables, including VAT and adding back trade-accrued expenses, divided by full-year pro forma sales and multiplied by 365 (expressed as a number of days of sales, unless stated otherwise)
- ▶ C2C (cash-to-cash): equals DSO, plus DIO, minus DPO (expressed as a number of days of sales, unless stated otherwise)
- ▶ Pro forma sales: reported sales net of VAT and adjusted for acquisitions and disposals when this information is available

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