FINANCE Research

Market research for executives

The Role of Treasury in Working Capital

A pan-European survey

FINANCE

Das Magazin für Finanzchefs

Deutsche Bank

Content

1 Foreword

Dear Reader,

Stringent management of a company's working capital has become a critical instrument of corporate strategy. Indeed, "cash is king" has become an international rallying cry in the wake of the financial crisis. Almost overnight, working capital improvements took centre stage as a cheap and reliable source of cash.

The ramifications for corporate treasurers have been massive. Tasked with meeting their groups' liquidity needs, their focus shifted from external sources of funding to internal ones. Many treasurers, who were previously trained in dealing with bankers, had to learn to win the battle for cash against other departments, most notably sales and procurement. It has thrust them into a completely unexpected position, for better and for worse.

This has resulted in a sea change both in the relevance of working capital strategies to corporate performance and the role treasury plays in them. The issue has found its way into boardroom discussions and even annual shareholder meetings. Meanwhile, corporate treasurers have earned a seat at the crucible of corporate strategy by making their voice heard in company-wide working capital initiatives.

Surprisingly, however, the new role this has spawned for corporate treasurers has received little attention from researchers as yet. While reports extolling the role of treasurers in working capital abound, few take the time to look at how it has evolved. This report seeks to fill this gap by painting an accurate and detailed picture of the current position of treasury in Europe's working capital practices.

To achieve this goal, we polled a group of 122 corporate treasurers across Europe, over half of them from large companies with turnover of more than €1 billon, on their role in their groups' working capital programmes. We then fleshed out the findings by interviewing distinguished treasurers with proven working capital experience. The resulting case studies are also featured in this report.

Deutsche Bank and FINANCE Research are pleased to present you with the findings of this ambitious research project and trust you will find them useful in your continued effort to drive company performance.

Sincerely,

Michael Spiegel
Global Head of Trade Finance and
Cash Management Corporates
Deutsche Bank AG

Steven Arons
Editor-in-chief
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FINANCE Research

2 Executive Summary

The importance of working capital

The survey reveals that working capital initiatives are a frequently used element of corporate performance management, with 60% respondents saying that they have a programme in place. In addition, working capital targets are a part of the company's key performance indicators for just over half of all respondents.

Another survey result further corroborates the importance of working capital management for European companies: It serves as a source of funding at just under two-thirds of companies (64%). This makes working capital initiatives one of the most important financing instruments that companies have at their disposal as well as an integral part of every corporate treasurer's tool kit.

Past improvements through working capital initiatives, however, have been less effective than expected given their prevalence. Only 19% of respondents said that their cash conversion cycle, the broadest working capital metric, had decreased – signifying improving working capital – while 28% said it had contracted.

One explanation for this seeming contradiction is the positive business outlook that the vast majority (75%) of survey respondents has. The expectation of growing sales leads companies to build up inventories to ensure that production can be maintained once orders surge. It enables companies to be more generous in terms of payment terms for customers, and it can also enhance their willingness to shorten their own payment terms for suppliers.

There is, of course, another explanation for the efficiency paradox: Working capital programmes may simply be less effective than expected. Slightly less than one-quarter of respondents (23%) were anticipating a decreasing CCC while 18% said that it would expand. This is significantly more than what was achieved over the past 12 months, suggesting that programme expectations might be overoptimistic.

The role of treasury

The survey points to two root causes of this ineffectiveness: the relatively low usage of KPI coupled with blurring lines of responsibility. Contrary to what would be expected, not all companies with working capital initiatives in place use working capital KPI. This lack of controlling can explain low programme success. In addition, two out of five (40%) companies split working capital responsibility among finance and other corporate functions, which can lead to blurred responsibilities.

It should be noted that staffing levels did not correlate with the degree of a company's treasury function. Treasuries with less than ten employees were just as likely to have overall working capital responsibility as those with ten and more employees.

A sizeable share of 20% of survey respondents said that treasury has primary working capital responsibility within their groups. In fact, there are two areas where treasury takes more of a lead than in anywhere else: accounts receivable (A/R) and accounts payable (A/P). These two areas were almost unanimously identified by the survey respondents as strongly under treasury control. Only a tiny fraction of less than 5% named inventory.

While treasury usually plays a significant role in working capital, the survey also finds that it is rarely the driving force behind it. This suggests that treasury is not generally perceived as being best placed for a leading working capital role.

More often than not, the CFO is ultimately in charge of working capital, with treasury playing a vital support function. This set-up makes sense because working capital management primarily revolves around cash considerations and is very much a data-driven exercise. There are simply few places aside from finance where these conditions would come together in any relevant way.

It should be noted that not all treasurers are happy with the status quo. While almost half say that the working capital set-up at their respective companies is how it should be, almost one in five believes that it is “bad” or even “very bad”. This significant level of dissatisfaction is an important indication that working capital practices at European companies could be improved.

One possibility to improve satisfaction with working capital practices and perhaps raise efficiency as well would be to strengthen the role of corporate treasurers. Indeed, a sizeable segment of respondents (27%) was of the opinion that treasury should play a “more prominent” role in working capital management.

However, almost twice as many (46%) said that treasury should not be prominent in working capital. It is therefore fair to say that a good deal of European companies has achieved a good level of working capital management.

Outlook

Change is afoot, especially through straight-through processing and centralisation. Both are widespread trends in European treasuries, the survey suggests. In fact, automatisation and increasing STP are the most commonly named top priorities for corporate treasurers over the next 12 months, with 36% picking STP for the top slot.

But where precisely will the largest improvements occur? For just over half of corporate treasurers (52%), the answer is clear: accounts receivable (A/R). Corporate treasurers decidedly see less potential in accounts payable (A/P). Only about a quarter of respondents (24%) thought that the biggest working capital change at their company would occur in this area. The reason is understandable: it is much easier to revamp internal systems so as to send out invoices more quickly than to take longer to pay.

3 Survey Results

3.1 Importance of working capital programmes

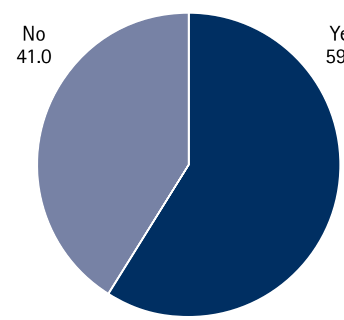
Quick reads

- >> Strong prevalence of ongoing working capital programmes (60%)
- >> Most companies use working capital for internal funding
- >> Confident business outlook pushes other topics up the agenda
- >> Large companies have an edge on implementation over smaller ones
- >> Lack of effectiveness points to implementation weaknesses

At the heart of corporate strategy

Stringent management of working capital has become a hallmark of prudent business administration in the wake of the financial crisis. It is clear from the survey results that this is still the case: working capital initiatives are widespread. Two-thirds of European companies continue to focus on improvements in this area. Just under 60% of respondents say that they currently have a working capital programme in place. An additional 6% say that they have completed a programme less than 12 months ago or plan to launch one less than 12 months from when they were asked.

Companies with WC programmes in place
(in %)



Source: FINANCE Research

The prevalence of working capital improvements is borne out by the role that these programmes play in corporate strategy. The survey shows that in just over half of all respondents, working capital targets are a part of the company's key performance indicators. They consequently form an integral part of both corporate strategy and personal incentive systems to ensure that targets are actually met.

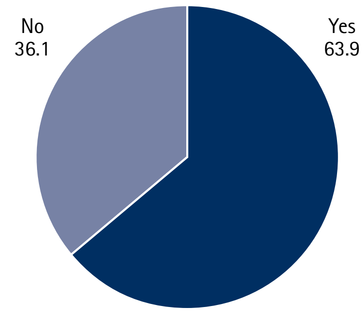
SWISS is a case in point. The national flag carrier of Switzerland is part of a group-wide working capital programme that was launched by its parent company Lufthansa last year. One important element of that programme was to introduce working capital KPIs, says SWISS group treasurer Cédric Suchet. "We're really going into the nitty-gritty to achieve some improvements here," he says. The positive effects of the programme are already being felt, he adds.

Working capital improvements play such an important part in corporate strategy because of the crucial contributions they make to meeting financial objectives. The survey reveals that they serve as a source of funding at just under two-thirds of companies (64%). This makes them one of the most important financing instruments that companies have at their disposal as well as an integral part of every corporate treasurer's tool kit.

However, the fact that just over one-third of companies do not use working capital improvements for internal funding points to considerable potential. In other words, the survey results suggest that a significant share of companies fails to make the best use of their money. This should serve as a wake-up call to corporate treasurers who might want to ask themselves if their companies are deploying their liquidity in an optimal way.

Indebted companies may find this tool especially appealing because it helps raise liquidity without counting towards debt ratios and sometimes, it even improves covenant ratios. Guy Ingram, Regional Treasurer at SAB Miller Europe, reveals in a case study for this report how his company has deployed the tool to reduce its debt burden. "After the acquisition, the senior management put a growing focus on working capital as we needed to free cash to repay our debt," he says.

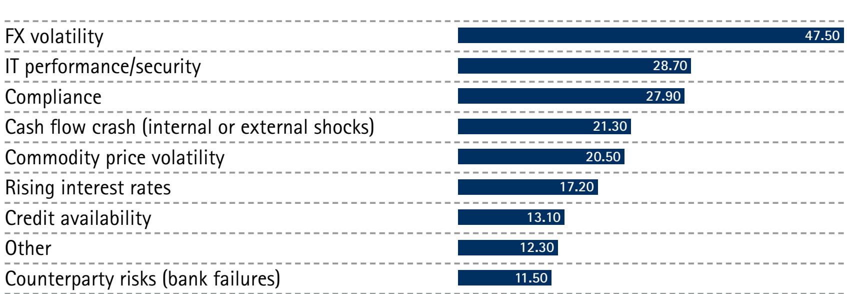
Companies that use WP improvements for internal funding (in %)



Source: FINANCE Research

It is noteworthy that working capital is considered an important source of funding even though credit availability is no longer a major concern for corporate treasurers. Survey respondents ranked credit availability close to the bottom on a list of nine treasury risks. At the same time, many corporate treasurers are faced with substantial refinancing needs, which emerged as the second most frequently named top priority among treasurers for the next twelve months. With money still being a hot button issue for European treasuries, there should be little incentive for treasurers to ditch their working capital efforts.

Greatest treasury risks over the next 12 months (in %)



Source: FINANCE Research; two answers per respondent

A shifting focus

The importance of working capital programmes seems to stand in contrast with their effectiveness. Even though a large majority of respondents said that they were actively looking into working capital improvements, only 19% said that their cash conversion cycle (CCC), the most popular working capital indicator, had decreased, i.e. they improved their working capital performance. Indeed, significantly more respondents (28%) said that they now needed more time than 12 months ago to convert their money spent on purchases into money from clients.

One potential explanation for the paradox is growing optimism among companies. The survey highlighted an extremely confident outlook. An overwhelming majority of 75% said that they expected revenues to increase over the next 12 months; 70% forecast the same for profits. An almost negligible share of 7% and 11%, respectively, thought that those readings will fall.

A buoyant business climate typically has several ramifications that can impact a company's working capital metrics. For instance, the expectation of growing sales leads companies to build up inventories to ensure that production can be maintained once orders surge. It also enables companies to be more generous in terms of payment terms for customers, and it can enhance their willingness to shorten their own payment terms for suppliers. In short: growing business confidence can slow efforts to manage working capital more carefully. Strict cash management becomes less of a must and more of an add-on.

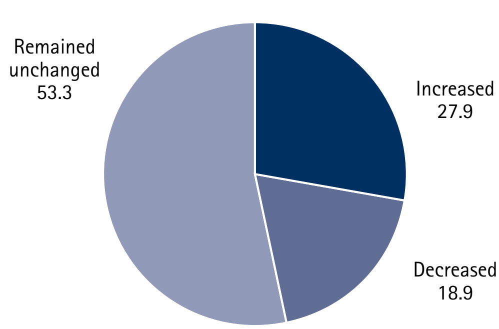
Another survey result supports this explanation. Few treasurers are currently concerned about credit availability or bank failures. With credit amply and cheaply available for most, the perceived need to use working capital as a funding source has declined.

International studies offer further proof. In its latest working capital survey, which uses companies' annual reports to track working capital levels over time, PwC found that working capital in Europe dropped sharply in 2010, one year after the peak of the economic crisis. Since then, the pace of improvement has been much slower and sometimes even stagnant.

This is especially the case because working capital ratios, though important, are not a goal in and of themselves. Other strategic objectives will take precedence. The interview with SWISS group treasurer Suchet offers an illuminating example. The approach taken by the group is a pragmatic one, he says, and P&L considerations will trump working capital effects if the latter threaten to affect the former negatively. One practical application of this principle is that ticket prices are not derived from working capital targets.

These climactic factors are currently coming together to make working capital improvements somewhat less imperative than in previous years. With business objectives other than stringent cash management being prioritised, an unchanged CCC, as anticipated by the vast majority of respondents (59%), may be the best outcome than many corporate treasurers can hope for.

Over the past 12 months, CCC (in % of responses)



Source: FINANCE Research

Failing programmes?

But there is another explanation for the contradiction between the prevalence of working capital programmes and the achieved results: working capital programmes may simply be less efficient than expected.

One piece of evidence for this hypothesis is that expectations for future CCC reductions were somewhat better than actual results. Less than one-quarter of respondents (23%) were anticipating a decreasing CCC while 18% said that it would expand, yielding a net of 5% of companies that are expecting significant working capital improvements. This is significantly more than what was achieved over the past 12 months, suggesting that programme expectations tend to be overoptimistic.

This observation is supported by several survey results that point to potential weaknesses in working capital programmes. The aforementioned KPIs are a case in point. All companies that have working capital programmes in place would be expected to use these as management tool and perhaps even a few more. The opposite is true – working capital KPIs are used by 53%, while 59% have working capital programmes in place. It follows that some companies with ongoing working capital initiatives do not adequately track their success, even though working capital KPIs such as Days Sales Outstanding (DSO), Days Payables Outstanding (DPO) and Days Inventory Outstanding (DIO) as well as their aggregate number CCC are common metrics.

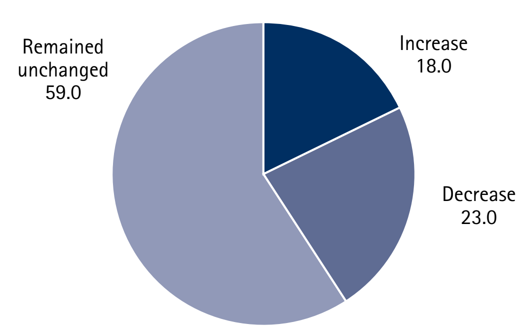
The relative scarcity of KPIs is compounded by a short-sightedness regarding investment decisions. A surprisingly low share of 42% of respondents said that they apply a hurdle rate (weighted average cost of capital, WACC) to their working capital requirements. This can make it harder to decide on appropriate cash allocation and offers further evidence that not all companies have fully developed their working capital strategies.

A lack of inter-departmental delineation of responsibility also comes to mind. The survey shows that working capital tasks are frequently divided among many parts of the organisation. Two out of five (40%) companies split working capital responsibility among finance and other corporate functions. While this organisational set-up can make sense for a host of different reasons, the resulting overlap and blurring of responsibilities also means that efficiency is lost along the way.

These findings illustrate that many companies have room to enhance the effectiveness of their working capital programmes. It should be kept in mind that the ease with which working capital improvements can be achieved is countercyclical. Better payment terms can be negotiated more easily when companies are confident. Even though other departments may oppose an immediate tightening of the cash conversion cycle, it may be a good time for treasurers to put their foot down.

Over the next 12 months, CCC will

(in % of responses)



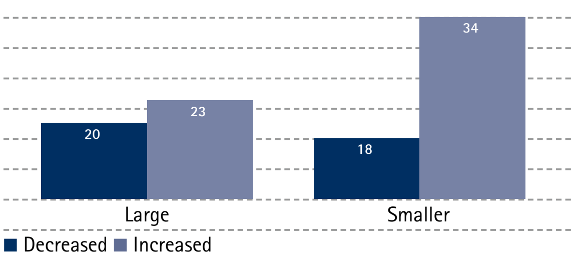
Source: FINANCE Research

Size matters, a bit

The finding holds true for companies big and small. Large companies with a turnover of more than €1 billion, which made up slightly more than 50% of the survey sample, were just as likely as smaller companies to have a programme in place.

Large companies, however, seem to be more successful in implementing and maintaining working capital initiatives. While more than one-third of smaller companies saw their cash conversion cycles expand, this happened to only about one-fifth of large companies. In addition, a greater share of large companies than smaller companies recorded CCC decreases, signifying working capital improvements, than did smaller companies. In other words, a net of 3% of large companies saw their CCC expand; among smaller companies, that was a net of 16%.

CCC change over past 12 months for large and smaller companies



Source: FINANCE Research ; large company = more than €1bn turnover)

Several forces could be at work here. Not only do large companies generally have more leverage over their trading partners, making it easier for them to renegotiate payment terms and other crucial determinants of working capital, but they also tend to find it easier to permanently assign working-capital related tasks to appropriate staff, frequently a precondition for a lasting working capital effect.

Interestingly, however, the diverging success rates do not translate into diverging expectations for the future. Although large companies are just a bit more optimistic, with 24% saying that their CCC will shrink compared with 21% for smaller companies, the differential seems statistically insignificant.

3.2 Role of treasury

Quick reads

- >> 20% say that treasury plays a leading role in working capital
- >> A/P and A/R are main areas of treasury responsibility
- >> Greater centralisation seems to lead to stronger treasury involvement
- >> Working capital is mostly a CFO or shared responsibility
- >> Blurring lines of responsibility is a potential weakness in set-up
- >> Strong undercurrent of dissatisfaction creates risk of friction

Treasury takes the lead

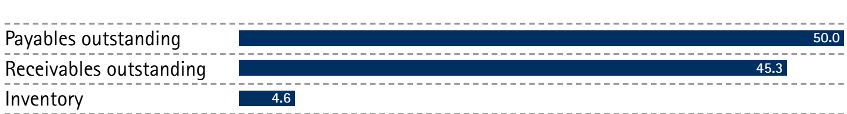
Over the past several years, the role of treasury has broadened in most organisations. In addition to the traditional cash management function, treasurers are now involved with tasks as diverse as financial risk management, capital markets and bank relationships. Their role in working capital is no exception. Many CFOs rely on their treasurers to keep an eye on payments, ensuring them a pivotal place in the working capital matrix.

In fact, in some organisations, treasury takes the lead role in working capital management. A sizeable share of 20% of survey respondents said that treasury had primary working capital responsibility within their groups. In other words, those corporate treasurers lead cash management efforts that go far beyond finance. The survey results confirm the strategic role of treasury and the growing recognition it has gained in many businesses. It shows that treasury units can achieve leadership roles in group-wide efficiency programmes.

This is only partially surprising. Treasurers can bring a lot to the table in working capital discussions. They are the experts in payments, cash inflows and outflows and liquidity management. They know about the group's liquidity needs and short- to medium-term cash flow outlook. This expertise makes them an irreplaceable part of any working capital effort.

There are two areas in which treasury takes more of a lead than anywhere else: accounts receivable (A/R) and accounts payable (A/P). These two areas were almost unanimously identified by the survey respondents as strongly under treasury control. Only a tiny fraction

Treasury leads in (in % of respondents who said that treasury leads)



Source: FINANCE Research

of less than 5% named inventory. These results identify the areas in which corporate treasurers deliver the greatest value to their businesses. Their unrivalled expertise in payments makes them natural sparring partners for A/P and A/R.

Perhaps unfortunately for corporate treasurers, the survey does not allow for the conclusion that stronger treasury involvement brings about better working capital results. The CCC changes over the past 12 months, positive or negative, did not significantly change for companies with and without treasury lead.

It should also be noted that staffing levels did not correlate with the degree of a company's treasury function. Treasuries with less than ten employees were just as likely to have overall working capital responsibility as those with ten or more employees. Setting the value to five, which is the median staffing level of treasury functions in the survey sample, did not change this finding. The opposite may be true. Anecdotal evidence suggests that group treasurers who achieve high levels of straight-through processing, thereby doing away with the need to maintain generously staffed treasury units, may find that this enhances their role in working capital management.

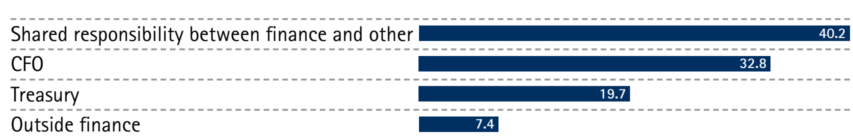
Autoneum can be seen as a case in point. The Swiss car parts supplier has recently introduced group-wide SAP. As a result, all payments now pass through treasury, giving the unit unprecedented insight into payment flows and positioning it at a crucial crossroads. "Each entity can initiate the payment, but within five years, all of them will have to pass through us," says Janko Hahn, Head of Treasury Operations.

A shared responsibility

While treasury usually plays a significant role in working capital, the survey also finds that it rarely is the driving force behind it – an observation that was confirmed by the five case studies completed for this report. This suggests that treasury is not generally perceived as being best placed for a leading working capital role.

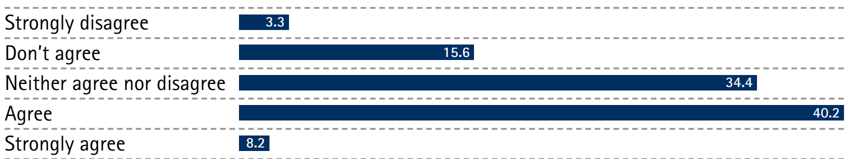
In many cases, it probably should not play that role. Not only is it frequently too far removed from corporate strategy to be capable of aligning working capital objectives with the overall goals of the organisation, but it also has a vested interest in a cash surplus, potentially leading it to set working capital goals that can conflict with other considerations and, in turn, with other departments.

Primary working capital responsibility sits with (in %)



Source: FINANCE Research

"My company has good working capital practices in place" (in %)



Source: FINANCE Research

More often than not, the CFO is ultimately in charge of working capital, with treasury playing a vital support function. This set-up makes sense because working capital management primarily revolves around cash considerations and is very much a data-driven exercise. There are simply few places aside from finance where these conditions would come together in any relevant way.

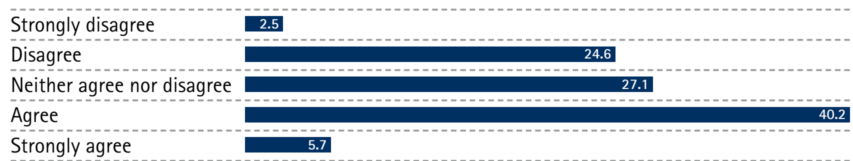
But if working capital is such an important facet of finance, why is it frequently a shared responsibility among finance and other corporate functions? One obvious explanation is that working capital is comprised of three elements: payables, receivable and inventory. The one area that forms a kind of outlier, at least from a finance perspective, is inventory. Given the operational and technological complexities involved in deciding what volumes are needed of which parts, inventory responsibility cannot really reside within finance. Finance may raise questions about the slow turnaround of inventory and thus set in motion a fruitful discussion. It cannot, however, actually decide to replace one part with another.

The lack of clear-cut answers to organisational working capital set-up points to yet another challenge: a lack of clearly defined responsibility. The fact that working capital improvements have cross-functional implications means that all those functions – sales, procurement, production etc – need to be involved at least with implementation and ideally in planning. Bad cooperation and communication among departments can quickly lead to results below expectations.

Setting up a clear division of labour is the only option. SABMiller serves as an example. Europe Treasurer Guy Ingram says that the group's financial planning and analysis unit makes sure that local businesses have optimised payment terms and credit control in place while treasury is responsible for implementing financial supply chain solutions and procurement. Accounting and several other units are involved as well. "SABMiller has ensured that a cross-functional team is addressing this challenge," he says.

The relatively low usage of working capital KPI among companies is yet again an illuminating insight in this context. With few metrics to offer guidance and with responsibility spread out across the organisation, the working capital outcome may not always be optimal.

"The role of treasury in working capital is as prominent as it should be at my company" (in %)



Source: FINANCE Research

Not everyone is happy

It should be noted that not all treasurers are happy with the status quo. While almost half say that the working capital set-up at their respective companies is how it should be, almost one in five believes that it is "bad" or even "very bad". This significant level of dissatisfaction is another indication that working capital practices at European companies should be improved. Considering the efficiency shortcomings identified earlier, this survey seems to identify a substantial potential for working capital improvements that corporate treasurers can still tap.

Of course, senior management may not share this assessment and could argue that existing working capital practices do not need to conform to the ideas of treasury. Nonetheless the strong undercurrent of dissatisfaction points to shortcomings or at least points of friction in many working capital programmes that need to be addressed. Regardless of whether corporate treasurers are right in their assessment, the mere presence of dissatisfaction can result in pools of resistance that will inevitably lead to efficiency loss.

This finding is compounded when considering the share of respondents who declared themselves neither satisfied nor dissatisfied with the status quo. A neutral attitude such as this one typically stems from the opinion that improvements are possible but achieving them would create a trade-off, for example a heavy re-allocation of resources. While this does not mean that improving working capital practices is considered a priority, it does suggest that things could be better.

One possibility to improve satisfaction with working capital practices, and perhaps raise efficiency as well, would be to strengthen the role of corporate treasurers. Indeed, a large segment of respondents (27%) was of the opinion that treasury should play a "more prominent" role in working capital management. The survey also gave respondents the possibility to say that treasury should play a less prominent role, an option chosen by only a negligible share of respondents (2%).

These findings must be put into perspective. Just under half of the respondents (48%) said they thought that working capital practices at their company were "good" or even "very good". Almost as many (46%) said that treasury should not play a prominent role in working capital. It is therefore fair to say that many European companies have achieved a good level of working capital management.

3.3 Outlook

Quick reads

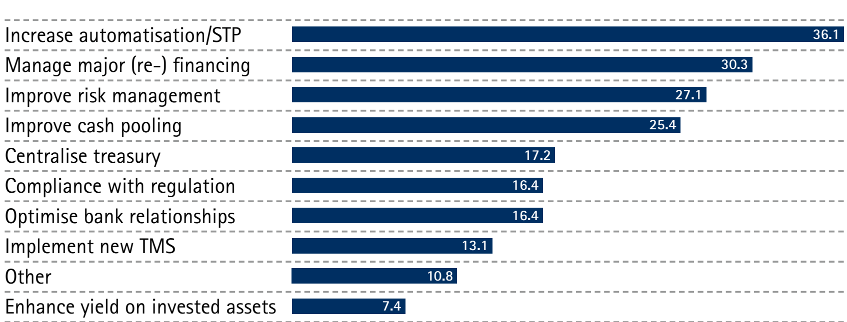
- >> Treasury centralisation is likely to continue, with positive side effects for working capital management
- >> Treasurers see largest room for improvement in A/R
- >> A/P might offer overlooked potential
- >> Interviews suggest attractive potential in supply chain finance

Biggest changes expected in A/R

Change is afoot, especially through straight-through processing and centralisation. Both are widespread trends in European treasuries, the survey suggests. In fact, automatisation and increasing STP are the most commonly named top priorites for corporate treasurers over the next 12 months, with 36% picking for the top slot. Although centralisation is less important, with only 17% saying it was their top priority, it is still in fifth place out of ten.

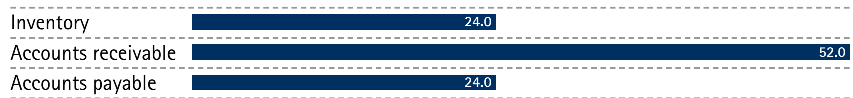
These system improvements should enable treasurers to gain better visibility of their organisations' working capital flows and thus take a more proactive role in their managements. This is good news, both for companies and their treasurers. For companies, it enhances their fundraising capabilities and makes them less dependent on banks and the capital markets. For corporate treasurers, it strengthens their role in an area with group-wide implications and, even more crucially, direct bearing on group liquidity.

Top treasury priorities for the next 12 months
(in %, multiple answers possible)



Source: FINANCE Research; two answers per respondent

The biggest changes will occur in (in %)



Source: FINANCE Research

But where precisely will the largest improvements occur? For just over half of corporate treasurers (52%) the answer is clear: accounts receivable (A/R). The other half was equally divided between A/P and inventory. The response is in line with other surveys, such as the one conducted by Kyriba and Aite Group last year, which consistently find that treasurers are more likely to focus on A/R than on A/P.

This result is not surprising. Past experience shows that substantial A/R improvements can be achieved fairly easily and quickly. Accelerating the invoicing procedures is a typical approach since this does not require difficult negotiations with customers nor does it entail a huge amount of inter-departmental coordination. Indeed, technological innovations such as e-invoicing have facilitated the quest for working capital improvements here. Offering early payment discounts to get customers to pay more quickly is another popular technique that offers a non-intrusive avenue for better Days Sales Outstanding (DSO) and an interesting way to enhanced cooperation between finance and sales.

In addition, A/R is traditionally the area where corporate treasurers have become greatly involved. Their focus on cash and sometimes considerable expertise in IT selection and implementation make them good catalysts for organisational change. A treasury focus on A/R makes sense both from an organisational and procedural perspective.

A neglected candidate?

Corporate treasurers see decidedly less potential in accounts payable. Only about a quarter of respondents (24%) thought that the biggest working capital change at their company would occur in this area. The reason is understandable: It is much easier to revamp internal systems so as to send out invoices more quickly than to take longer to pay. The extension of payment terms with suppliers will always be a matter of controversial negotiations.

Even in A/P, however, there are a number of things that treasurers can do to improve DPO without running into resistance right away – especially given the fact that slightly more respondents said that treasury takes the lead in A/P than in A/R. For instance, SWISS group treasurer Suchet launched an analysis of the group's actual payment behaviour and found that it actually paid before the deadline given by the payment terms. A rigorous systems check is the least treasurers can do to boost working capital performance in A/P.

In fact, the examples of SWISS and SABMiller, two of the case studies examined for this report, shine a light on the interesting possibilities available to corporate treasurers in A/P.

In addition to aligning systems and procedures with organisational goals, they pinpoint supply chain finance as a potentially attractive tool.

Other reports seem to support the idea that A/P contains some untapped potential. The PwC report mentioned earlier found that European DPO evince a trend that goes against the grain of the general working capital development. They actually worsened between 2009 and 2013, falling (which is a negative trend in DPO) from 45 to 43. By contrast, DSO improved from an average of 53 to 46 between 2009 and 2013. There was no improvement last year, suggesting that A/R improvements have become much more difficult to achieve.

This is why the survey results suggest that corporate treasurers may be neglecting improvements that can be had from A/P. It is clear that time is a scarce resource, and treasurers have too much on their plates to waste it on working capital initiatives that go nowhere. A closer look at payables may nonetheless be warranted. The fact that treasury takes the lead in A/P as much as it does in A/R lends further support to this observation.

Supply chain finance

The accompanying interviews revealed supply chain finance (SCF) as one particularly interesting working capital tool. Both SABMiller and SWISS are weighing whether to adopt SCF. SWISS has conducted a feasibility study, which turned out positive; it has yet to analyse.

This apparently makes them the rule rather than the exception. Though the use of SCF is still rare among companies, many express strong preferences for the tool, a recent report published by Kyriba and Aite Group showed. In spite of 63% saying they were potentially interested in the technique, only 14% of surveyed organisations had reverse factoring programmes, one of the most popular forms of SCF, in place.

Our interview partners point out that reverse factoring is not for all suppliers. In times of cheap money, some may not be interested in early payments and the discounts they have to grant as a result; being paid in full may matter more to them. The model does not work for all customers since they generally need to have a lower credit rating than their customers to benefit from lower financing costs. With SWISS, which counts many large oil companies among its suppliers, that is not always the case. However, for the large remainder, SCF could be a viable option.

This is an area where treasury indubitably has to take the lead, both in terms of deciding whether to use SCF in the first place and then how to implement it. Outside help could prove crucial. The fact that few treasurers said that they were in need of such help – with only 10% saying that they were – may be a sign that supply chain finance is not receiving the attention it might deserve.

4 Case Studies

SWISS: "We're going into the nitty-gritty"


SWISS

Cédric Suchet,
Group Treasurer, SWISS

Basel-based airline SWISS is a special case in terms of working capital. Customers decide when to buy the tickets considering the prices. If they do so a long time before actually taking the flight, their decisions lead to negative Days Sales Outstanding (DSO). "Cash is nonetheless king at SWISS," says Group Treasurer Cédric Suchet. The carrier is a member of Lufthansa group, which launched a group-wide working capital initiative in 2013. "We have a working capital initiative in place," he says. "We're really going into the nitty-gritty to achieve some improvements here."

As a first step, the company has been trying to raise awareness of the value of cash-oriented corporate indicators as opposed to a corporate management solely tailored towards P&L performance. Introducing two working capital KPIs, trade working capital and CCC, has been a key part of this effort. While improved working capital ratios are important, they are not a goal in and of themselves. "The approach taken by the group is a pragmatic one," Suchet says, "and P&L considerations will continue to trump working capital effects if the latter threatens to negatively affect the former." For this reason, ticket prices are not derived from working capital targets.

The group is already beginning to see the positive effects of the new initiatives. "The internal perception of cash as a success factor has increased," says Suchet. Interestingly, the increased focus on cash has broadened the role of the treasury. "Treasury is thus more deeply involved in business processes than it was before," says Suchet. "Management now seeks advice about, for example, the trade-off between speed of payments and discounts, so treasury's role has expanded thanks to this programme." In fact, the group treasurer plays a critical role in the working capital programme. "Treasury was involved in target-setting," he says. "I did this together with the line functions and now prepare the progress reports."

Bring spare parts down, keep aircraft up

There is room for improvement in receivables, but it is smaller and will require more time to be achieved. For structural reasons, the focus of the working capital programme is on inventories and payables. For SWISS, this means a better management of spare parts. "Of course our priority is to have the necessary stuff ready for the aircraft and thus secure our operations at all times," says Suchet. "But we also need to make sure that we don't have too much stock piling up and that we turn it over as often as possible."

This is an area of working capital where treasury is less involved. SWISS has a special inventory team set up outside of finance as part of the technical department. Their targets are even greater than those of treasury and as a result, the treasury collects data from the inventory team but leaves more freedom to this dedicated team on how to achieve these targets.

SWISS' working capital achievements in inventory are still noteworthy. One is a redoubled effort on the part of the airline to remarket unnecessary inventory where possible, for example, following a change in the aircraft or engine fleet. The spare parts make up the other area. Suchet says, "Here it's about fine-tuning: how we reorder the parts. That is, how much do we need of a given item to keep our aircraft in the air considering the right balance for the orders between size and cycle?" One possibility is to "unbundle" the orders, to have lower volumes at hand, he explains. This, however, comes with the trade-off that lower order volumes can result in higher unit prices – a clear example of a case in which P&L considerations would take priority over the working capital initiative. This possibility is also subject to the delivery lead time of the supplier, i.e. in case of maintenance emergency, priority one remains to keep the aircraft flying.

Check your procurement contracts!

The biggest potential for working capital, and the one where treasury plays the biggest role, is with suppliers. Supply chain finance (SCF) is one area where Suchet sees potential opportunities. Although SWISS is, as yet, in the assessment phase, an initial study has uncovered some potential. An implementation assessment still needs to be completed, but Suchet trusts that SCF in some form is likely.

Invoicing is the other area of improvement. SWISS recently introduced e-invoicing after a thorough assessment, resulting in several interesting effects. "One thing we did was to check if our actual payments were in line with our payment terms and to prevent early payments by all means, except in case of discount," says Suchet. Interestingly, improved invoicing efficiency meant that the speed of payments actually increased in some cases, and SWISS still has to take appropriate measures to prevent the negative side effects of efficiency gains in processes on working capital.

Another challenge was vagueness in SWISS' previous procurement contracts. Only some of them specified whether the payment countdown should start on the day the invoice was received (invoice receipt date) or the day it was issued by the supplier (invoice date). SWISS used to assume tacitly that it was the invoice receipt date. Introduction of e-invoicing to gain process efficiency, however, virtually shrank the difference to zero, thus effectively paying the suppliers faster than before e-invoicing. "I've warned my colleagues about getting too fast when they introduce e-invoicing," Suchet says.

Cash deposits with lessors? "Unfair"

SWISS' leasing contracts is the final area that offers potential working capital improvements. The airline is often responsible for both maintaining the leased aircraft and preparing them for their return to the lessor at lease end as per leasing agreement. The challenge, according to Suchet, is that some lessors still require cash deposits to guarantee the good execution of maintenance work. "Under these 'unfortunate' contracts, SWISS must cover both the maintenance events costs to the supplier, sometimes including the pre-payments, i.e. before the work is done, and the maintenance reserve to the lessor. But SWISS can only claim back the security deposit at a far later point once maintenance is completed, all invoices are received and cost split between SWISS and the lessor is finally agreed upon," Suchet says. "I find this absolutely unfair as it ties down a lot of cash."

Suchet hopes that he can renegotiate some of those contracts. "Other airlines, even smaller ones, have managed to renegotiate, so I'm optimistic," he says, adding that one option could be a simple match between the return of our deposit and the payment SWISS must make to its maintenance providers. Alternative forms of collateral rather than cash are another potential option. "As soon as we have paid the maintenance provider, we should get some money from the lessor," he says.

SABMiller: "Reverse factoring works for us"


SABMiller

Guy Ingram,
Regional Treasurer Europe,
SABMiller

For UK-based SABMiller, working capital management became a focal point for senior management in late 2011. The world's second-largest brewing company had just acquired Australian Foster's Group, a move that brought it closer to its main rival Anheuser-Busch InBev, but also added $10.7 billion to its overall net debt pile of $17.86 billion at the end of fiscal year 2011/2012.

In order to reduce its debt burden, improving working capital management became an essential task. Guy Ingram, Regional Treasurer for Europe at SABMiller says, "Following the acquisition of Foster's Group, senior management emphasised a focus on working capital given their intention to reduce leverage."

Working capital has since become one of the brewer's top financial priorities. Meeting certain goals in terms of working capital is now an element of the local business managers' annual targets, and it is used as part of their bonus evaluation. Free cash flow and the cash conversion cycle are the most important KPIs for SABMiller as well as the cycle's three main components: days sales outstanding (DSO), days payables outstanding (DPO) and days inventory outstanding (DIO).

Reverse factoring

As Regional Treasurer, Ingram is particularly interested in the payables side. His team is currently rolling out a reverse factoring programme across SABMiller's European suppliers to improve the group's DPO. After a six-month preparatory phase, the first pilot suppliers were on-boarded with the programme. "Reverse factoring works for us as well as for most of our suppliers because the bank provides short-term financing based on SABMiller's credit profile," Ingram says. It's a win-win situation: SABMiller pays later and the suppliers get their money earlier.

Yet, according to the treasurer, two groups of suppliers are not very keen on implementing reverse factoring – which requires some technical and legal work on the side of the suppliers as well. "If a supplier has surplus cash, getting paid early may not make sense for him," Ingram says. This holds especially true with current low interest rates, which present few opportunities for investment. The other group of suppliers are those with a better credit rating than the brewing company: Moody's currently rates the group Baa1; S&P rates it A-. But because the bank finances the deal with respect to the conditions of the customer – which is SABMiller in this case – some suppliers may be able to finance themselves cheaper. Reverse factoring does not make sense for them.

Basics first

This is one reason Ingram is hesitant about being over-reliant on financing solutions. As he puts it: "That's a trap to be avoided. As a first step, you always have to do the basics." For him, the basics include using the traditional working capital adjustment tools such as paying suppliers just in time and optimising payment terms before putting financial supply chain solutions into place. "The key with suppliers that don't want to implement reverse factoring is to exhaust the old-fashioned tools," the treasurer says. Suppliers with abundant cash are more likely to grant SABMiller an extension on its payments than those that are cash-short.

That caveat notwithstanding, the brewer decided that financial supply chain instruments generally makes sense for its payables. However, it decided against supply chain finance for its receivables, at least for the time being. “For the group as a whole, the cost of receivables financing is currently higher than the cost of our corporate debt facilities,” Ingram says. There are still certain circumstances under which the UK-listed company would consider financial supply chain solutions for its receivables: “If a large customer with a better credit rating than SABMiller’s were to offer reverse factoring to us, we may be interested.”

Who is responsible?

Ingram believes that SABMiller still has potential in the third area of working capital management, inventory. “At present, we don’t utilise any inventory financing solutions, but we are considering these,” he says. As a treasurer, however, this will not be his immediate focus.

The question of which department plays what part in working capital management is always a challenge for large corporates. For example, the financial planning and analysis unit makes sure that local businesses have optimised payment terms and credit controls in place, while treasury is responsible for implementing financial supply chain solutions and, of course, procurement. Accounting and several other units are involved in the process as well. “SABMiller has ensured that a cross-functional team is addressing this challenge,” Ingram says.

> **“Following the acquisition of Foster’s Group, senior management emphasised focus on working capital given their intention to reduce leverage.”**

The first signs of success

SABMiller can still make some tweaks to optimise its working capital management. Yet, its sharpened focus on the issue has already shown the first signs of success: In the fiscal year 2013/2014, which ended in March, the company reported $651 million worth of accumulated improvements in working capital. Cash flow from working capital saw an inflow of $93 million. Naming working capital optimisation a priority was also not a means to an end for SABMiller: Since 2011/2012, the brewer has reduced its net debt from $17.86 billion to $14.3 billion, at least some of which is due to better working capital management. More improvements are expected to materialise over the next few years.

Knorr-Bremse: "A never-ending project"

Jens Küsters

Sigurd Dahrendorf,
Head of Group Financing and Treasury, Knorr-Bremse

In an industry where payment terms are traditionally long and supply chains are complex, optimising working capital is no easy task. For Knorr-Bremse, a German manufacturer of brake systems for trains and trucks, it is particularly hard because the company is sandwiched between smaller suppliers that often need money early and large customers, e.g. Daimler and Bombardier, that can use their market power to pay late.

As a result, managing working capital is a never-ending project for Knorr-Bremse. Sigurd Dahrendorf, Head of Group Financing and Treasury, says "Cash has always been king in this company." The German manufacturer has been focusing on working capital management since 1993 – long before working capital entered finance textbooks. Dahrendorf says, "Not much has changed since those past day. We're only asking other questions, and we have more sophisticated working capital solutions in place."

In the 1990s, when Dahrendorf joined the Munich-based company, it was important to measure how much cash Knorr-Bremse needed to generate a turnover of 100 Deutsche Marks. Today, there are KPIs like days working capital (DWC), which currently stands at 40, and its components: days sales outstanding (DSO), days payables outstanding (DPO) and days inventory outstanding (DIO).

Financing internationalisation and securing its rating

The reason working capital management became important for Knorr-Bremse in the first place was because the company needed to finance its internationalisation. Driven by majority shareholder and former CEO Heinz Hermann Thiele, who took over the struggling manufacturer in a management buyout in 1985, Knorr-Bremse acquired several companies between 1990 and 2002. The turnover grew from €328 million in 1990 to €2.1billion in 2002, and in 2013, it stood at €4.3 billion. "We would have hardly been able to finance these acquisitions without a tight focus on our cash flow," says Dahrendorf.

Even after Knorr-Bremse slowed down its buying spree, cash remained a focus for top management. The family-owned company wants to remain flexible for the possibility of bigger acquisitions. The €675 million holds in net cash provide a comfortable cushion. In addition, it is very important for the company to keep its top rating. Moody's rates Knorr-Bremse at A3 and S&P at A-, both with stable outlooks. "The rating agencies take a very close look at the group's access to cash," Dahrendorf explains.

Pioneer in supply chain finance

In 2007, Knorr-Bremse pioneered a supply chain financing solution, a reverse factoring platform with several suppliers, with Deutsche Bank in order to improve its DPO. "It was quite tough to be the first company to implement this platform," Dahrendorf says. Overall, the former CFO was responsible for the project, but Dahrendorf, as Head of Group Financing, managed parts of the implementation. This included long meetings with the company's financial auditor. "We needed to make sure that the system was compliant with the accounting standards," the treasurer says.

Another challenge was the suppliers' unfamiliarity with the solution. This was why Knorr-Bremse and the bank often needed to explain the benefits: Knorr-Bremse pays later, but the suppliers get their money earlier from the bank, which provides financing for the time differential between the two payments. “We even went to see several suppliers to persuade them personally,” Dahrendorf says. Most suppliers have already adopted the new system. “We are well-positioned with regard to payables,” he says.

Optimising receivables much more exhausting

The treasurer, however, still sees room for improvement regarding receivables. “Unfortunately, our industry has adopted long payment terms,” he says. Between 60 to 90 days are common. A new EU directive, which was entered into force last year and requires all businesses to pay their bills within 60 days, has not brought any relief. “Nothing has changed for us,” Dahrendorf says.

Commercial credit insurance is no longer an option for Knorr-Bremse since the manufacturer had a bad experience once. “The insurance let us down when it became necessary,” Dahrendorf says. He believes that the best way to improve receivables is to talk to customers and help them get their processes right: “The vast majority who pays late does not do that maliciously,” he is convinced. The real problem is that even large customers frequently do not have optimal payment workflows in place. It can take weeks until an invoice is approved. Not even e-invoicing would help much in solving the problem. “The only thing that does help is talking to the customers and helping them to improve their workflows. This can be exhausting, but it works.” Knorr-Bremse is currently implementing reverse factoring with Bombardier though this time, the company is on the receiving end.

> **“The vast majority who pays late does not do that maliciously.”**

Investment in new plants to optimise inventory

Knorr-Bremse’s latest development in working capital initiative is in inventory. Having already implemented just-in-time delivery with its suppliers, it is now aiming to optimise logistics within its plants. Within eighteen months , the company inaugurated eight new factories. The one built in Hungary, which amongst others serves the group’s Chinese operations, was designed to keep inventory processing time to a minimum. “It’s known as a five-day-factory because products are manufactured within five days,” Dahrendorf says. “This is top for our industry.”

Even though treasury is not involved, Dahrendorf’s department plays an overall crucial role in optimising working capital management: “Within the CFO resort, the topic is covered by controlling and treasury.”

Autoneum: "Payments will pass through us"

Autoneum

Janko Hahn,
Head of Treasury Operations,
Autoneum

Autoneum, the Swiss-based market leader in acoustic and thermal management solutions for vehicles, whose workforce of 9,600 recorded roughly €1.6 billion in sales last year, has been transitioning to SAP as its new ERP since July 2013. The project is slated for completion within five years from the day it was initiated.

As finance is part of the project, accounts payable and receivable are, too. "This is a big business re-engineering project. Our goal is to standardise all processes throughout the group," says Janko Hahn, Head of Treasury Operations. "And for sure, finance will benefit as well."

Treasury also plays a significant role in the group-wide effort. The department already uses SAP as its new treasury management system as the legal units at headquarters went live first – and so did treasury. More importantly for working capital, the new ERP has replaced previously existing bank interfaces. All payments that Autoneum's legal units execute are now processed by SAP's Bank Communication Management module and routed through a single SWIFT service bureau, FIDES, which then delivers them to the respective bank for execution, be it via host-to-host connections or the SWIFT network.

This places treasury at the heart of payments. "Each entity can initiate the payment, but within five years, all of them will have to pass through us," says Hahn. This has two major implications: It improves transparency and helps treasury keep track of group liquidity outflows.

Complete transparency

Increased transparency is an important positive effect. "This helps us answer questions such as, 'How often are the legal units executing payments?' and 'Is it efficient?' If someone makes, say, three payment runs per week, it might not be optimal. This is something we can flag up," Hahn says. "The new system gives us complete transparency in payments." He adds, however, that the treasury's role is merely to draw attention to such instances; they do not make proposals for operational improvements. Hahn also stresses that treasury neither wields a veto right over payments nor does it exert any sort of content control function for them. Preparation of payment runs is still the responsibility of the legal units' finance teams.

Above and beyond the SAP roll-out, Autoneum is similar to many others in that treasury is not a key driver of working capital management; it mostly plays an advisory and monitoring role within the company by providing visibility for the group's cash movements. "We come into play when there's a discussion about cash and liquidity," Hahn says.

"We come into play when there's a discussion about cash and liquidity."

The treasury department then checks if the cash needs are in line with previous forecasts. "We monitor the liquidity outflows and inflows on an ongoing basis," Hahn says. This happens on a rolling basis. "Most of the group entities report every week their updated short-term cash needs (and also planned cash to be received from customers) for the next four weeks. Those should be matching with the related period in the 12-months outlook submitted monthly." Treasury does not monitor any other working capital-related KPIs though it is a common task for controlling.

Acerta: "Yields are very low"

Acerta's working capital challenge is slightly different than that of most. The leading Belgian HR services provider has next to no inventory and little in the way of payables. What it has to manage, however, is its sizeable financial investments, cash reserves and burgeoning receivables, which together formed over 85% of its total assets in 2013.

Acerta

Michaël Parizel,
Head of Treasury, Acerta

Group Treasurer Michaël Parizel explains that the high level of financial investments is a result of the group's unique role as payroll intermediary. "As a payroll company, we collect the money, about €7 billion per year, from our corporate clients, keep it for 14 days and then send it to the government," he says. As a result, the group has large amounts of money at its disposal for investments. In fact, its financial profit last year exceeded its operating profit.

This has led to a highly sophisticated investment strategy developed under the aegis of the treasury department and Parizel's predecessor Benoît Daem who set up a tailor-made institutional money market fund for Acerta. However, the prolonged period of low interest rates has led the company to take a fresh look at its investments. "We are now facing the fact that yields are very low and will stay low for some time to come," Parizel says. "We are already using other investments in addition to money market funds, and we're optimising the duration of our existing investments."

One of Parizel's biggest challenges is to reconcile the switch to longer durations with a heavy IT investment programme, which is slated to cost the company about €66 million over three to four year. "It's tricky to keep enough money on a short-term basis to fund the IT-investments while trying to maximise the duration of our financial investments," he says.

In addition to financial investments, Acerta is focussing on improving working capital more generally, mostly through raising awareness. "In the past, we did not have an integrated working capital programme because we mostly focussed on cash forecasting," says Parizel. This is about to change. The new CEO – Acerta's former CFO – and the new CFO are behind a working capital drive with the objective of integrating working capital consideration in the daily workflows. "It's a cultural thing, not so measurable in concrete figures, but everybody is working on this," Parizel says.

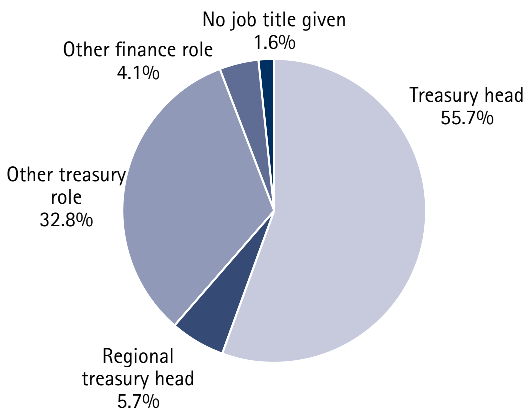
"We're optimising the duration of our existing investments."

The Payroll Services division is one place where this is happening because it is the division through which most of the cash goes. "We sit with them on a regular basis to discuss scenarios, for example, what happens if they invoice later or earlier," Parizel says. Growing working capital awareness is also changing the way the treasury department gets involved in company decisions. "They now come to us when they work on something new. They get us involved because it has cash implications."

The consideration of e-invoicing, which is part of the IT investment programme, is one example. If adopted, the technology would be aimed at accelerating the speed with which customers receive their bills. This would lead to faster payments and more cash, increasing Acerta's investment flexibility further and, in particular, allowing the group to expand durations. Although the decision is not technically one that lies with treasury, Parizel and his team are nonetheless involved in making sure everyone understands the cash implications.

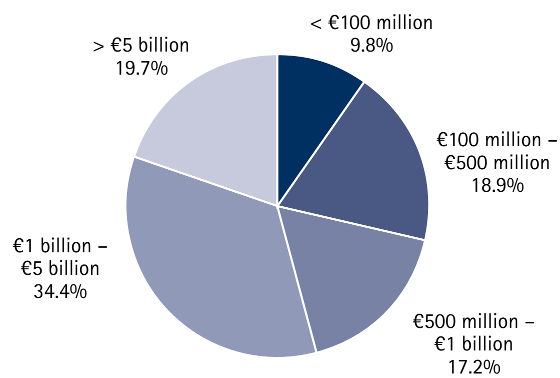
5 Methodology & Demographics

Job function



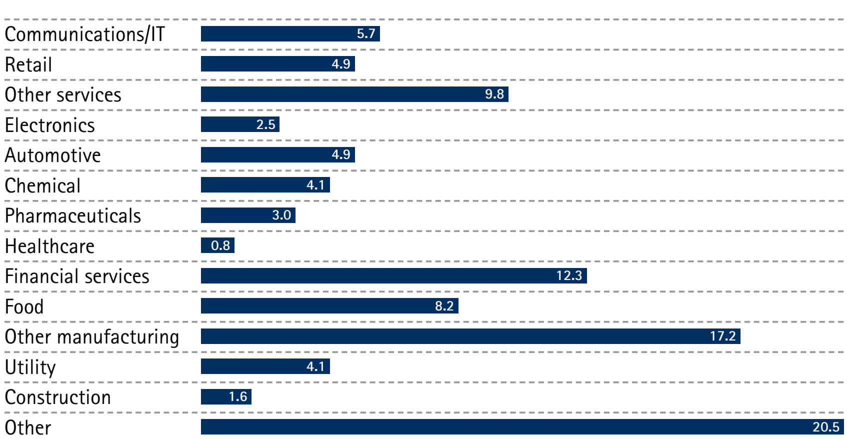
Source: FINANCE Research

Annual revenue



Source: FINANCE Research

Industry (in %)



Source: FINANCE Research

This report is based on an anonymous online survey of 122 treasury professional across Europe, conducted by FINANCE Research in May/June 2014, and five qualitative interviews with senior treasurers experienced in working capital management.

Over half of the respondents were treasury heads with almost all of the rest in advanced treasury roles such as treasury analyst.

Over half of the respondents were from companies with annual revenues exceeding €1 billion. Fewer than 10% were from companies with annual revenues below €100 million.

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