

All tied up

Working capital management
report 2014



Building a better
working world

Foreword

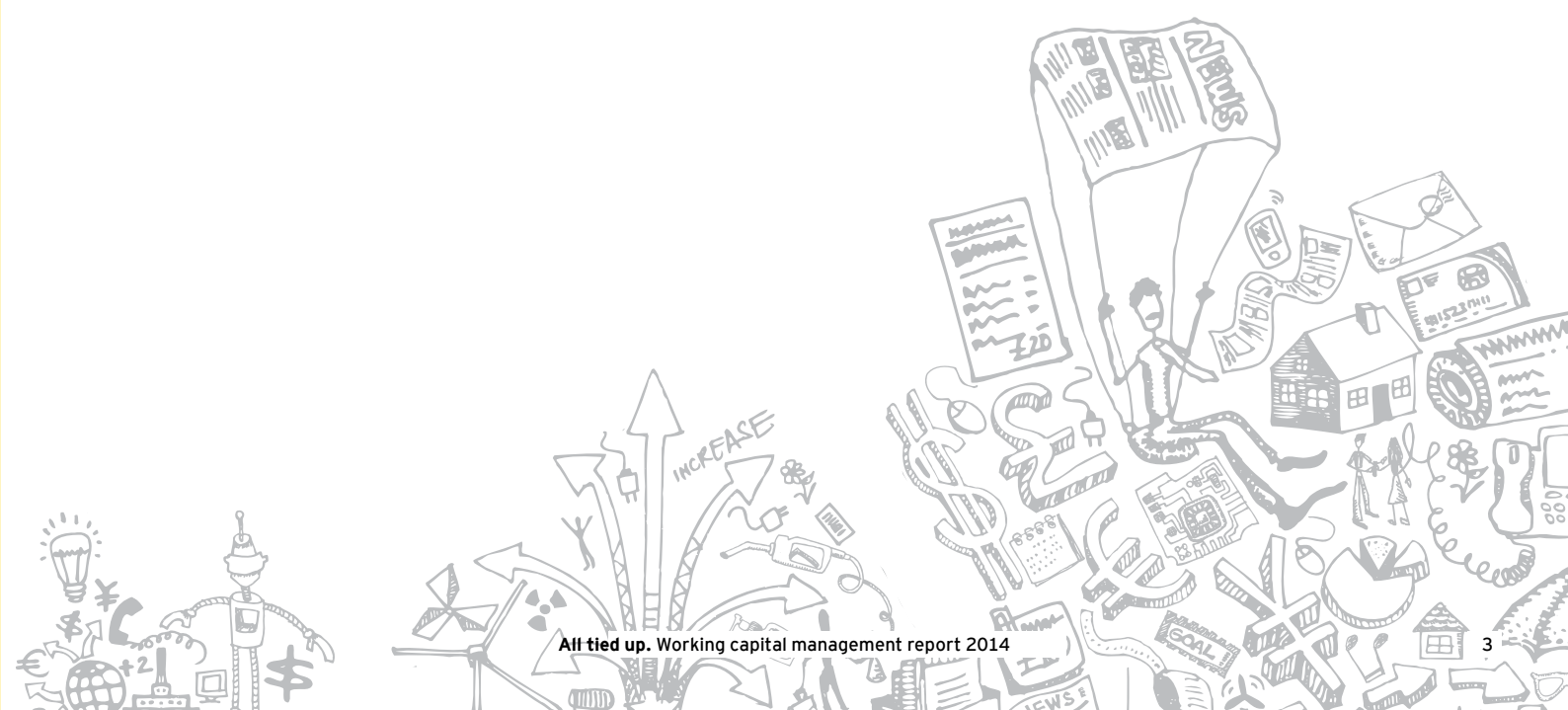
All tied up 2014 is the seventh annual publication in a series of working capital (WC) management reports based on EY research, reviewing the WC performance of the world's largest companies.

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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Executive summary

Compared with 2012, our analysis of the WC performance of leading companies in the US and Europe in 2013 shows a further deterioration in the US and relative stability in Europe. For the US companies analyzed, C2C¹ increased by 1% from its 2012 level, after a rise of 2% in the previous year. For Europe, this year's stable performance contrasts with the progress made the year before, when C2C fell by 4%.

However, further analysis reveals wide variations in the level and direction of changes in C2C both between industries, and between sub-regions and countries in Europe. These variations were exacerbated by differences in the intensity of management focus on cash and WC, as well as by the impact of changing commodity prices and exchange rates.

Companies in other regions and countries fared better in 2013, with overall C2C falling by 2%, after an increase of 3% the year before. However, had the oil and gas, and metals and mining industries been excluded from our calculations, C2C would have been unchanged from 2012.

Interestingly, SMEs and larger companies performed to similar levels in 2013. This marked a halt to the narrowing of the WC gap between the two segments that we had observed in previous years.

Overall, our research findings suggest that most companies continue to have huge opportunities for improvement in many areas of WC. A high-level comparative analysis indicates that the leading 2,000 US and European companies still have up to US\$1.3t of cash unnecessarily tied up. This amount is equivalent to nearly 7% of their combined sales. In other words, for every US\$1b in sales, the opportunity for WC improvement is, on average, US\$70m.

To realize these WC benefits, companies will need to drive continuous operational and structural improvements, addressing "root and branch" aspects of WC policies, processes and metrics. Key initiatives should include:

- ▶ Managing WC as a strategic initiative, including aligning executive compensation with appropriate performance measures
- ▶ Further streamlining of manufacturing and supply chains
- ▶ Closer collaboration and process alignment with customers and suppliers
- ▶ Better coordination between functions and processes in supply, planning, manufacturing, procurement and logistics
- ▶ Improvements in billing and cash collections and more effective management of payment terms
- ▶ Intensification of spend consolidation and standardization
- ▶ Implementation of more robust supply chain risk management policies

Addressing this opportunity would boost companies' return on capital, as well as offering potential for higher cash returns to shareholders. Additionally, by continuously managing the business to achieve improved or top-tier WC performance, companies would send a positive signal to the capital markets. This would likely be rewarded with a higher valuation in comparison to their peers.

¹C2C: cash-to-cash.



US and Europe

WC performance deterioration in the US and stability in Europe

A review of WC performance among the largest companies in the US and Europe reveals a further deterioration in the US and relative stability in Europe in 2013 compared with 2012.

For the US companies analyzed, C2C increased by 1% from its 2012 level, after a rise of 2% in the previous year. For Europe, this year's stable performance contrasts with the progress made the year before, when C2C fell by 4%.

Table 1: Change in WC metrics by region, 2012-13

US	2013	Change 13/12
DSO	38.5	2%
DIO	30.5	2%
DPO	31.7	2%
C2C	37.3	1%

Europe	2013	Change 13/12
DSO	49.5	0%
DIO	33.6	1%
DPO	44.3	1%
C2C	38.8	0%

Source: EY 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 2013 resulted from poor results in both receivables and inventory (DSO and DIO were each up 2%), partly offset by a better showing in payables (DPO was up 2%). Europe's flat WC performance was the net result of a deterioration in inventory performance (DIO up 1%), offset by better results in payables (DPO up 1%), while receivables performance remained unchanged.

WC performance drivers

Slow and uneven global growth: For both the US and Europe, WC results for 2013 have continued to be affected by the impact of rapidly changing global economic and financial conditions during the year. Economic activity in the US has picked up during 2013, helped by a recovery in housing and automotive sales, and easier lending conditions. In the euro area zone, activity has been stabilizing in the periphery and recovering in core economies. In the UK, recovery has been gathering pace and Japan experienced an impressive increase in output on the back of the Bank of Japan's monetary easing. In contrast, growth in rapidly-growing economies has been generally disappointing, affected by falling commodity prices, slowing credit growth, less policy support and spillovers from planned US tapering. Compared with 2012, overall sales growth for leading companies in the US was up 2%, while turning negative in Europe (down 2%), dragged down by a more benign inflation environment, as well as by negative currency effects.

Continued attention to WC management: Against this challenging background, companies in the US and Europe have remained cautious, while generally more upbeat on economic growth for the coming year. The focus has been on cost reductions, capital expenditure optimization, control over cash and asset efficiency (including spinning off or selling underperforming assets). The heightened attention on WC has included actions with regard to lean manufacturing, billing and cash collection, spend consolidation, global and local sourcing optimization, renegotiation of payment terms, supply chain efficiency, and simplification of structures.

Weaker commodity prices: Prices for food and metals in 2013 were generally much lower than in 2012, while the average crude oil prices were little changed. The lag effect of changing commodity prices (smoothed by the use of hedging policies)

US and Europe (continued)

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.

Persistent volatility in exchange rates: Variations in exchange rates played a significant role in driving WC performance in 2013. For companies reporting in US dollars, the relative weakness of the US dollar against the euro at the end of 2013, 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 against the US dollar, but also against the Japanese yen and other currencies in rapidly growing economies, had a beneficial impact on WC performance.

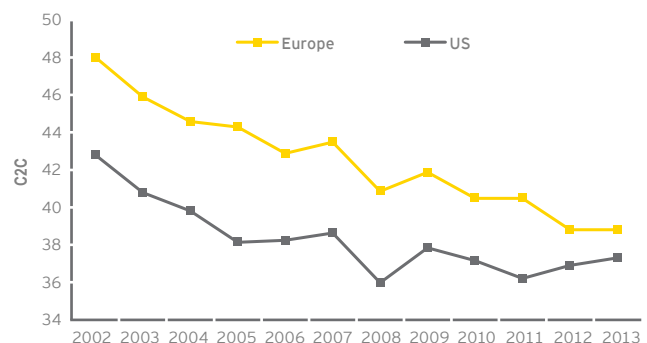
Changes in DSO and DIO impacted by sales patterns, commodity prices and exchange rates: The reported changes in DSO (higher in the US and flat in Europe) and DIO (higher in both the US and Europe) largely reflect the combined impact of contrasting sales growth patterns during the year and variations in commodity prices and exchange rates. In both regions, these results also derive from the impact of specific actions that companies have taken to improve billing and cash collection, and drive greater efficiency in manufacturing and supply chain operations.

Stronger payables performance: In both the US and Europe, improvement in payables performance continued to be supported by better management of procurement and payables processes. Companies are seeking greater efficiencies by leveraging and consolidating spend, extending payment terms, standardizing processes and working more closely with their own suppliers (with tangible results coming this year from consumer products, diversified industrials and pharmaceutical companies). Note that, in Europe, payables performance may have been affected by the adoption of a revised European directive aiming at capping corporate payment terms by March 2013 at the latest in each member state.

The reported changes in payables also reflect companies' varying strategies and tactics. For example, some companies chose to stretch terms with their main suppliers (while, in some cases, offering supply chain financing to help them mitigate part of this impact), or reduced their supplier base to achieve greater leverage in negotiations. Others opted for faster payments in return for enhanced cash discounts.

The results for 2013 bring the total reduction in C2C achieved since 2002 to 13% 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 7% and 1% respectively, while DPO rose by 5%. In Europe, DSO and DIO dropped by 12% and 4%, respectively, while DPO was up 4%.

Table 2: WC performance for the US and Europe, 2002-13



Source: EY analysis based on publicly available annual financial statements.



Company performance review

In the US, 51% of the companies included in our research reported a deterioration in WC performance, while 53% of those based in Europe showed an improvement.

In the US, slightly more than half of the companies analyzed showed a deterioration in WC performance in 2013, compared with 2012. However, these results were better than in the year before, when the comparable figure was 58%. A high proportion of companies (58%) reported weaker receivables performance, which more than offset the number of those showing stronger payables performance (56%). In addition, only 49% of companies scored better in inventory performance. Forty-five percent of the companies in the US that showed an improvement in WC performance in 2012, compared with 2011, achieved further progress in 2013.

In Europe, 53% of companies reported an improvement in WC performance in 2013 compared with 2012. By way of comparison, in 2012, a higher proportion (59%) had shown an improvement on 2011. In 2013, a majority of companies posted better results in payables. For receivables and inventory, the number of companies showing an improvement in performance was similar to those showing a deterioration. Half of the companies in Europe that showed an improvement in WC performance in 2012, compared with 2011, achieved further progress in 2013.

Table 3: Proportion of companies showing improved performance, 2013 vs. 2012

	C2C change 13/12	
	US	Europe
DSO reduction	42%	50%
DIO reduction	49%	50%
DPO enhancement	56%	53%
C2C reduction	49%	53%

Source: EY analysis based on publicly available annual financial statements.

Industry performance review

In 2013, there were wide variations in the level and direction of changes in C2C between various industries across the US and Europe, partly reflecting differences in the degree of management focus on cash and WC, as well as the impact of changing commodity prices and exchange rates.

For example, automotive suppliers in the US and Europe reported much lower C2C in 2013 than in 2012 (down 5% for each region). Progress came from better management of procurement and payables processes, as well as from the positive impact of lower commodity costs.

In contrast with the previous two years, pharmaceutical companies reported better WC results in 2013 (C2C down 2%), with progress driven by improvement in payables and, to a lesser extent, in receivables performance (DPO up 6% and DSO down 2%). This was partly offset by higher DIO (up 3%).

For the food products, and household and personal care industries, 2013 was a year of accelerated improvement in WC performance, driven by an increase in DPO (notably on the back of further extension in payment terms) and a reduction in DIO (exacerbated by lower commodity costs). Companies also highlighted further progress in streamlining manufacturing and supply chain, expanding shared-services, harmonizing processes and systems, and simplifying structures. Companies have been focusing much more on cash and WC management to grow returns on capital and increase cash returns to shareholders, a trend partly prompted by increased pressures from shareholder activists.

For electric utilities, WC performance in 2013 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 progress made by these utilities in transforming their business models against a backdrop of ever-changing energy policies and regulatory frameworks.

US and Europe (continued)

For the oil and gas industry, WC has become an area of much stronger focus. However, measuring “like-for-like” progress remains difficult due to movements in both global oil prices and the US dollar exchange rates against the euro. Compared with 2012, C2C was lower for oil and gas companies based in Europe and higher for those in the US.

Table 4: Most significant WC changes among major industries, 2013 vs. 2012

Major industry	C2C change 13/12	
	US	Europe
Cyclical		
Automotive supplies	-5%	-5%
Chemicals	1%	-1%
Industrials*	2%	-1%
Semiconductors	4%	7%
Steel	8%	-4%
Non-cyclical		
Food producers	-10%	-7%
Food and general retailers	8%	-2%
Household and personal care	-5%	-6%
Pharmaceuticals	-2%	-2%
Other		
Electric utilities	1%	3%
Oil	10%	1%

* diversified industrials and electrical components

Source: EY analysis based on publicly available annual financial statements.

US vs. Europe performance comparison

The WC performance gap between the two regions narrowed further in 2013, with Europe outperforming the US by 1%.

However, comparisons between WC performances in the US and Europe 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 reflect global market conditions to some degree, as well as conditions 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 2013 was 1.3 days, or 3% below that of Europe. This was primarily due to a strong performance in inventory (minus three days, or 9%). The differential between receivables and payables cycles (DSO – DPO) across both regions was 1.7 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: companies in Europe tend to have more SKUs (stock keeping units) to serve different markets and customers in different currencies, while the US benefits from the absence of national borders and a unique trading currency. Transport also takes longer and logistics costs are higher in Europe than in the US.

That said, our expectation is that the WC performance gap between the US and Europe will continue to narrow in coming years, given the trend toward globalization in sales and procurement, and sharing of common leading WC practices.



European country performance comparisons

Of the seven main sub-regions and countries in Europe, WC performance was better for three, worse for three and flat for the remaining one.

France saw a further improvement in WC performance compared with 2012 (C2C down 5%), driven by the combination of a decrease in DSO and an increase in DPO, partly offset by a higher DIO. Aerospace and defense, and oil and gas companies, and electric utilities all made progress in reducing C2C, while food and general retailers reported a flat performance after two years of deterioration.

Switzerland also reported an improvement, primarily due to a strong showing from one major food company (C2C down 23%) and two large pharmaceutical companies (C2C down 8%).

In Benelux, WC performance was slightly better. Food producers and telecommunications operators reported improved results, but consumer electronics companies and food retailers had a poor performance.

In contrast, the UK reported a higher C2C (+2%), due to poor results in receivables (DSO up 3%), insufficiently offset by improved payables (DPO up 1%). Aerospace and defense, and oil and gas companies, and food retailers scored poorly, while food producers and pharmaceutical companies put in a better showing.

For the Nordic and Southern European countries, WC performance was worse but heavily skewed toward the performance of certain industries. For example, in the Nordic countries, had the oil industry been excluded from our calculations, the increase in C2C would have been limited to 2% instead of 5%. In this sub-region, telecommunications operators achieved better results, but paper and forestry, and telecommunications equipment companies scored badly. In Southern European countries, electric and gas utilities saw a deterioration in WC performance, in contrast with oil and gas companies and telecommunications operators which managed to reduce their C2C.

For Germany, overall WC performance remained unchanged, but performance between industries was varied. Automotive suppliers and chemical companies achieved good progress, while performance was disappointing for electric utilities, industrial companies and telecommunications operators.

Table 5: WC changes by European sub-region and country, 2013 vs. 2012

Country	% weighting		C2C change 13/12
	Sales	Companies	Overall
Benelux	11%	9%	-1%
France	21%	15%	-5%
Germany	18%	13%	0%
Nordic countries	9%	14%	5%
Southern Europe*	12%	11%	8%
Switzerland	6%	7%	-2%
UK	21%	28%	2%
Other	2%	3%	nm
Europe	100%	100%	0%

*Greece, Italy, Portugal and Spain

Source: EY analysis based on publicly available annual financial statements.

US and Europe (continued)

Opportunity for improvement

The wide variations that our research reveals in WC performance between different companies in each regional industry point to significant potential for improvement – amounting to an aggregate of up to US\$1.3t of cash for the leading 2,000 US and European companies.

This 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 2013 performance of each of its WC components with that of 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\$370b and US\$670b of cash unnecessarily tied up in WC, 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 €280b and €480b of cash unnecessarily tied up in WC, 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\$1.3t 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 should 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, 2013

Region	Cash opportunity					
	Value		% WC scope*		% sales	
	Average	Upper quartile	Average	Upper quartile	Average	Upper quartile
Europe	€280b	€480b	11%	19%	4%	7%
United States	US\$370b	US\$670b	12%	21%	3%	6%

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

Source: EY analysis based on publicly available annual financial statements.



Other regions and countries

Improvement in WC performance in 2013

Companies based in the other seven regions and countries (Asia, Australia and New Zealand – Aus/NZ, Canada, Central and Eastern Europe – CEE, India, Japan, and Latin America – LatAm) covered by our survey reported an improvement in WC performance in 2013, compared to 2012, with C2C falling by 2%. However, had the oil and gas, and metals and mining industries (O&G and M&M which accounted for 23% of total sales in 2013) been excluded from our calculations, C2C would have remained unchanged.

These overall results are in marked contrast to the deterioration in WC performance seen in the previous year, when C2C increased by 3% (by 4% excluding the O&G and M&M industries).

Table 7: Change in C2C, 2012-13

Regions and countries	2013	Change 13/12
Asia	33	-3%
Aus/NZ	29	3%
Canada	26	-1%
CEE	41	-1%
India	49	-2%
Japan	62	7%
LatAm	29	-12%
C2C	42	-2%

Source: EY analysis based on publicly available annual financial statements.

Table 8: Change in C2C excluding the O&G and M&M industries, 2012-13

Regions and countries	2013	Change 13/12
Asia	40	-2%
Aus/NZ	28	2%
Canada	31	-5%
CEE	39	-4%
India	65	-2%
Japan	63	8%
LatAm	28	-12%
Other Regions	47	0%

Source: EY analysis based on publicly available annual financial statements.

Last year's stronger WC performance was due to better results in receivables and inventories (DSO and DIO down 2% and 1%, respectively), partly offset by a weaker showing in payables (DPO down 2%). Excluding the O&G and M&M industries, the stability in WC performance arose from better results in receivables and inventories (DSO and DIO down 1% each), offset by a weaker showing in payables (DPO down 2%).

In 2013, five out of seven regions and countries posted an improvement in WC performance compared with 2012. Only Japan and Australia/New Zealand scored worse.

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

Other regions and countries (continued)

Table 9: Change in C2C per Asian region and country, 2012-13 O&G and M&M industries, 2012-13

Asia	2013	Change 13/12
China	11	-2%
Indonesia	65	3%
Malaysia	56	7%
Singapore	53	11%
South Korea	57	0%
Taiwan	39	1%
Thailand	21	-5%
C2C	32	-2%

Table 10: Change in C2C per Asian region and country, excluding the O&G and M&M industries, 2012-13

Asia	2013	Change 13/12
China	12	-7%
Indonesia	65	3%
Malaysia	56	7%
Singapore	53	11%
South Korea	59	0%
Taiwan	38	2%
Thailand	32	-3%
C2C	40	-1%

Source: EY analysis based on publicly available annual financial statements.

Table 11: Change in C2C per LatAm country, 2012-13

LatAm	2013	Change 13/12
Argentina	19	-15%
Brazil	34	-8%
Chile	35	-8%
Colombia	6	-78%
Mexico	20	-21%
C2C	29	-12%

Table 12: Change in C2C per LatAm country, excluding the O&G and M&M industries, 2012-13

LatAm	2013	Change 13/12
Argentina	25	-9%
Brazil	31	-10%
Chile	35	-8%
Colombia	10	-29%
Mexico	19	-25%
C2C	28	-12%

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.

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.

Source: EY analysis based on publicly available annual financial statements.



Table 13: WC metrics by main region and country

	Asia	Aus/NZ	Canada	CEE	India	Japan	LatAm
DSO	39	33	41	45	44	71	36
DIO	36	31	31	36	48	44	30
DPO	42	36	46*	40	43	52	37
C2C	33	29	26*	41	49	62	29
DSO – DPO	-3	-3	nm	5	1	19	-1

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	47	37	43	54	65	73	40
DIO	39	29	30	34	51	43	31
DPO	46	38	42*	49	51	54	43
C2C	40	28	31*	39	65	63	28
DSO – DPO	1	-1	nm	5	14	19	-3

* includes accrued expenses

Table 15: WC metrics by Asian region and country

	China	Indonesia	Malaysia	Singapore	South Korea	Taiwan	Thailand
DSO	26	32	53	39	55	49	29
DIO	35	61	41	51	34	37	25
DPO	51	28	38	37	32	48	33
C2C	11	65	56	53	57	39	21
DSO – DPO	-25	4	15	2	23	1	-4

Source: EY analysis based on publicly available annual financial statements.

Other regions and countries (continued)

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

	China	Indonesia	Malaysia	Singapore	South Korea	Taiwan	Thailand
DSO	39	32	53	39	58	50	30
DIO	38	61	41	51	34	38	37
DPO	65	28	38	37	33	50	35
C2C	12	65	56	53	59	38	32
DSO – DPO	-26	4	15	2	25	0	-5

Table 17: WC metrics by LatAm country

	Argentina	Brazil	Chile	Colombia	Mexico
DSO	34	41	41	19	27
DIO	38	33	37	19	21
DPO	53	40	43	32	28
C2C	19	34	35	6	20
DSO – DPO	-19	1	-2	-13	-1

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

	Argentina	Brazil	Chile	Colombia	Mexico
DSO	41	43	43	24	31
DIO	33	30	39	38	26
DPO	49	42	47	52	38
C2C	25	31	35	10	19
DSO – DPO	-8	1	-4	-28	-7

Source: EY analysis based on publicly available annual financial statements.

Other regions and countries (continued)

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.

For example, the WC performance of food producers in other regions is much weaker (with the notable exception of China and India) than in the US and Europe. As well as lacking the benefits of size, many of these companies deal with a dispersed customer base and operate comparatively inefficient supply chains.

The O&G 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,

O&G 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.

Steel companies in both Asia and Australia/New Zealand carry the lowest levels of C2C, while their counterparts in CEE, LatAm and Japan display much higher levels.

In the case of telecommunications services, WC performance in individual regions and countries varies considerably, largely influenced by the distribution of revenues between fixed-line and mobile on one hand and between pre-paid and post-paid on the other hand, as well as by local payment practices, payment methods and levels of capital expenditure.

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

C2C	Asia	Aus/NZ	Canada	CEE	India	Japan	LatAm	US	Europe
Automotive supplies	40	nm	33	69	54	61	72	35	54
Building materials	59	64	56	nm	42	92	48	55	49
Chemicals	54	50	63	45	84	94	nm	64	66
Electric utilities	32	21	10	30	49	20	14	36	29
Food producers	54	55	30**	59	66	54	34	41	31
Industrials*	47	nm	47	56	nm	91	57	71	86
Machinery makers	85	nm	120	nm	107	166	129	101	82
Oil and gas	12	23	1**	38	23	56	25	6	27
Steel	58	60	79	108	68	87	88	71	76
Telecommunications	-21	42	5**	14	-26	49	8	10	-2

* diversified industrials and electrical components

** includes accrued expenses

Source: EY analysis based on publicly available annual financial statements.



SMEs and large companies

Stability in the WC performance gap between SMEs and large companies in 2013

The gap in WC performance between SMEs and large companies has remained unchanged in 2013, having narrowed by 2% in the previous year.

Compared with 2012, our 2013 study shows a stability in C2C for both SMEs and large companies. However, further analysis based on each WC component shows greater variability and diverging trends between the two sub-groups. SMEs reported a deterioration in receivables performance (DSO up 2%), offset by a combined improvement in both inventory and payables performance (DIO down 1% and DPO up 1%). Large companies scored poorly in both receivables and inventory (DSO and DIO up 2% and 1% respectively) offset by further progress in payables performance (DPO up 2%).

Among both the SMEs and large companies included in our survey, there were a similar number of companies reporting increases or decreases in C2C. A majority of SMEs (54%) saw an improvement in payables performance, but only a minority did so across both receivables and inventory. Among large companies, a higher proportion (58%) reported better results in payables, with a minority showing improved performance in receivables and inventory.

Table 20: Change in WC metrics for SMEs and large companies, 2012-13

Days	Change 13/12	
	SMEs	Large companies
DSO	2%	2%
DIO	-1%	1%
DPO	1%	2%
C2C	0%	0%

Source: EY analysis based on publicly available annual financial statements.

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

A comparison between 2013 and 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 gradually closing the WC gap with large companies.

For SMEs, the stability in WC performance over the reviewed period was the net result of a reduction in DIO (down 4%) fully offset by a lower DPO (down 8%). DSO remained unchanged. For large companies, the deterioration in WC performance arose from much higher DIO (up 11%), partially offset by lower DSO (down 2%) and higher DPO (up 4%).

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

- ▶ Large companies have reported stronger receivables performance, benefiting from progress made in improving billing and cash collections. For SMEs, the stability in DSO probably reflects 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 market conditions by paying more quickly, in return for enhanced cash discounts.

SMEs and large companies (continued)

- ▶ With regard to inventory performance, large companies have seen a significant deterioration, partly 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 2013, 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. SMEs scored slightly better than their larger counterparts in inventory management. Several factors may explain the difference in performance. For example, SMEs may have simpler product offerings and supply chains. Large companies are also 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 use of outsourcing may have also played a significant role in driving inventory performance.

Table 21: WC metrics differential between SMEs and large companies, 2013

	SMEs vs. large companies differential	
	%	days
DSO	14%	6
DIO	-4%	-1
DPO	-26%	-8
C2C	26%	13

Source: EY analysis based on publicly available annual financial statements.

Performance by industry

Comparing the relative WC performance of large companies and SMEs in the same industry shows that SMEs in almost two-thirds of industries have higher C2C than large companies. In 2013, the median C2C differential figure at an industry level between SMEs and large companies was nine days (median being used as a more appropriate measure in this case, given the uneven distribution of companies by industry).

The most meaningful variations at a C2C level for major industries are reported in the table below. Among electrical components and communications technology companies, for example, SMEs' C2C is 60% and 46%, respectively, above that of large companies. For chemical and diversified industrial companies, the corresponding figures are 19% and 10%, respectively. In contrast, SMEs in the oil equipment industry display lower C2C (-28%) than their larger peers.

Table 22: C2C differential by industry between SMEs and large companies, 2013

	C2C differential	
	%	days
Electrical components	60%	36
Communications technology	46%	26
Semiconductors	30%	17
Chemical	29%	19
Clothing and fabrics	21%	15
Diversified industrial	13%	10
Software	0%	0
Oil equipment	-28%	-28

Source: EY analysis based on publicly available annual 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.

How EY can help

EY's global network of dedicated working capital professionals helps clients to identify, evaluate and prioritize realizable improvements to liberate significant 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 so as to sustain those improvements.

Companies that undertake working capital improvement initiatives often realize a high return on investment (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. Improved processes also increase the quality of services both internally and externally. Our working capital professionals are there to help, wherever you do business.

We have 150 dedicated working capital professionals across the globe.

We consistently help 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 1,000 companies), Europe (1,000) and seven other main regions and countries – Asia (570), Australia and New Zealand (100), Canada (300), Central and Eastern Europe (150), India (400), Japan (230), and Latin America (250).

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\$1b, while large companies are those with sales exceeding US\$1b. 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 2013 reports. Performance comparisons have been made with 2012 and with the previous 10 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: 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.
- ▶ 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.

Contacts

Working Capital Services contacts

Americas

Steve Payne
+ 1 212 773 0562
steve.payne@ey.com

Asia

Alvin Tan
+ 65 6309 8030
alvin-cy.tan@sg.ey.com

Australia

Wayne Boulton
+ 61 3928 88016
wayne.boulton@au.ey.com

Benelux

Danny Siemes
+ 31 8840 78834
danny.siemes@nl.ey.com

Canada

Simon Rockcliffe
+ 1 416 943 3958
simon.rockcliffe@ca.ey.com

Chris Stepanuik
+ 1 416 943 2752
chris.stepanuik@ca.ey.com

France

Benjamin Madjar
+ 33 1556 10067
benjamin.madjar@fr.ey.com

Germany

Dirk Braun
+ 49 6196 9962 7586
dirk.braun@de.ey.com

Bernhard Wenders
+ 49 2119 3521 3851
bernhard.wenders@de.ey.com

Latin America

Matias De San Pablo
+ 54 11431 81542
matias.de-san-pablo@ar.ey.com

Nordics

Johan Nordström
+ 46 8520 59324
johan.nordstrom@se.ey.com

Peter Stenbrink
+ 46 8520 59426
peter.stenbrink@se.ey.com

Switzerland

Thomas Pallgen
+ 41 5828 64008
thomas.pallgen@ch.ey.com

UK and Ireland

Jon Morris
+ 44 20 7951 9869
jmorris10@uk.ey.com

Matthew Evans
+ 44 20 7951 7704
mevans1@uk.ey.com

Paul New
+ 44 20 7951 0502
pnew1@uk.ey.com

Mike Mills
+ 44 20 7951 8899
mmills1@uk.ey.com

Julia Scott
+ 44 20 7951 0421
jscott@uk.ey.com

Marc Loneux
+ 44 20 7951 3784
mloneux@uk.ey.com

US

Edward Richards
+ 1 212 773 6688
edward.richards@ey.com

Eric Wright
+ 1 408 947 5475
eric.wright@ey.com

Mark Tennant
+ 1 212 773 3426
mark.tennant@ey.com

Peter Kingma
+ 1 312 879 4305
peter.kingma@ey.com



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