THE HIGHLAND GROUP

CONSULTANTS

The 2,000 largest companies in the USA and Europe are wasting $1.1 trillion by tying cash up unnecessarily in working capital.

How much is your company wasting?

SUCCESSFUL COMPANIES FOCUS ON OPTIMISING CASH IN UNCERTAIN TIMES

Market-leading companies have been able to free up cash fast and improve operational performance:

- **A mining company achieved €49 million in cash savings in 20 weeks**
- **A major manufacturer implemented €50 million in savings in 48 weeks**
- **A life sciences business reduced logistics and distribution cost by €8 million**
- **A global procurement business gained €50 million in savings**
- **An automotive supplier increased revenue by €31 million**
- **A leading manufacturer released €15 million in working capital**
- **A diagnostic business identified and defined €10 million in savings**

Source: Highland Group Case Studies

The Imperative to Unlock Cash and Improve Performance

"Many businesses across multiple industries have vast amounts of cash tied up in excess inventory, or wasted through poor asset utilisation, inefficient working practices or poor client and supplier management."

If the 2,000 largest companies in the USA and Europe are wasting $1.1 trillion by tying up cash unnecessarily in working capital, how much is your company wasting?

A study by Ernst & Young of USA and Europe's 2000 largest companies in 2011 showed that a total of $1.1 trillion was tied up in unnecessary working capital. The top 1,000 European companies accounted for between €270 billion and €460 billion in excess working capital. That equates to between 4% to 7% of sales. Market-leading companies are implementing effective working capital management practices combined with operational improvements, which result in freeing up millions of Euros of cash lying dormant that can be put to better use.

What does that equate to in cash that you could free up?

How could you use that cash to create value?

Cash can be released quickly – It is a real and sustainable opportunity

Working capital is not the only area where cash can be generated. Improved efficiencies also frees up cash. By taking a comprehensive and focused approach to working capital management and operational efficiency, The Highland Group has been able to generate tens of millions of Euros from a multitude of sources in a way that makes savings ongoing and sustained, while maintaining or actually increasing output. The examples listed on the front page show that many businesses across multiple industries have vast amounts of cash tied up in excess inventory, or wasted through poor asset utilisation, inefficient working practices or poor client and supplier management. Companies could be using the cash for business acquisition, reducing debt, improving customer service or developing new markets and new product lines. This is not to suggest that companies are badly run – some of the companies that have released tens of millions of Euros are global leaders in the markets in which they operate.

"The Highland Group has helped companies release over €500 million in cash."

The global and complex nature of large businesses means that gaining a clear picture of where cash is poorly utilised, identifying the root causes of waste and engaging the organisation in working smarter is vital in reducing working capital. It takes real expertise and experience to release cash that others cannot see in a business. For example, The Highland Group has assisted clients in releasing over €500 million in cash. This is an opportune time to really focus on managing cash, as it will enable you to maximise your advantage over weaker competitors who are cash poor and therefore can't invest in the future. Since free cash flow is a key influencer of shareholder value, companies should place much greater focus on working capital management and operational efficiency because they are mutually supportive.

A comprehensive approach delivers sustained results

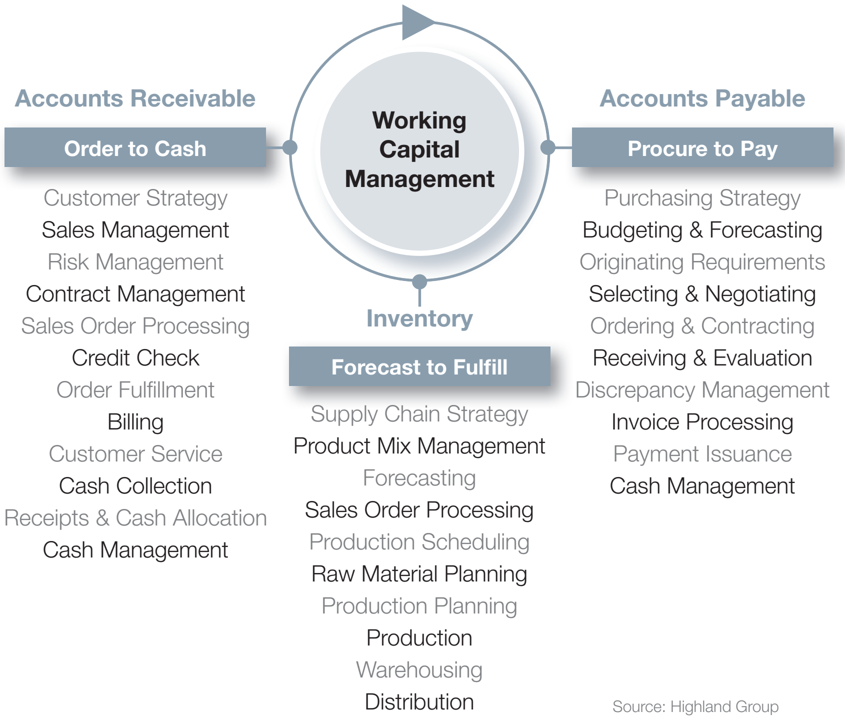
We find that executives are often surprised by the level of excessive working capital and inefficiency they have in the business even though many had already undertaken a number of efficiency initiatives and were confident that there was little room for improvement. On further investigation, we have found that improvements had been achieved but the activity had been sporadic and disjointed. For example, an improvement in one area has led to greater inefficiency and waste in another. That's why companies need to move the focus of working capital management from a sporadically considered activity in times of financial stress to an ongoing business and operational imperative.

Generating cash by improving working capital

Companies can improve working capital management and generate cash fast by optimising three major areas:

- Accounts Receivables – getting cash quicker into the business
- Accounts Payable – reducing outflows and optimising costs
- Inventory – converting raw materials, finished goods and maintenance and repair items into cash or using them more productively

An Integrated Approach to Optimising Cash



Source: Highland Group

"Fast cash is typically extracted from improvements in two areas that contribute to cash release: working capital reduction and cost reduction."

By focusing on enabling the business to generate more cash in the short term while ensuring that the improvements introduced are sustained and supported by a robust System for Managing ensures that what gets implemented remains sustainable into the future. Fast cash is normally extracted from improvements across the business in two areas which aggregate to release cash – working capital reduction and quick wins in cost reduction. For example:

- Small changes in Days Working Capital Outstanding can have a dramatic impact on cash flow acceleration, but the contribution to lowering Days Working Capital may come from almost any part of the business.
- Simple improvements to receivables, payables and inventory processes typically result in improved cash flows and better cash-forecast accuracy as well as reduced transaction costs which positively impact the P&L.
- Minimising accounts payable through cost reduction programmes – improving management of supplier discounts, contractor management, inventory reduction, improved maintenance, repair and operations costs.

Quite modest improvement in these areas can release significant amounts of cash in a short timeframe with a complementary impact on the P&L. Additional cash can be generated if working capital reduction activity is supplemented by efficiency and productivity improvements.

"An international manufacturing company implemented savings of €50 million by week 48 of their working capital improvement and cost reduction programmes, leading to annualised savings of over €70 million."

What can be achieved in practice?

Effective working capital management offers immediate and lasting savings for companies of all industries and sizes. One international manufacturing company implemented working capital improvement and cost reduction programmes that led to €50 million in cost savings within 11 months, and eventually to annualised savings of over €70 million. Contributions came from improvements across a range of areas. For example, a complete overhaul of the procurement system alone contributed €38 million in savings primarily through improved discounts, with the added benefit of enhanced cash flow management and improved payment terms.

A multinational electronics company with three distinct types of businesses achieved a €22 million increase in operating margin. Improvement areas included:

- **Order to cash –** implemented consistent policies and procedures worldwide, reduced rework, implemented new organisational control over products and pricing to improve margins and streamlined the order-to-dock process.
- **Procure to pay –** created a new purchasing organisation and made their back office operations more efficient by focusing on strategic cost-saving initiatives, eliminated duplicate parts and vendors while improving information to leverage material purchasing, which achieved an annual benefit of €5 million alone.
- **Inventory reduction –** removed thousands of obsolete parts, developed a single worldwide master scheduling process and implemented new controls to ensure full information on new parts to allow for effective purchasing and production.

In another example, The Highland Group worked with a large manufacturer's procurement department to renegotiate pricing and terms with their top suppliers. This work achieved savings of €6.9 million in year one and a further €30 million in savings in year two. In addition, Days Payable Outstanding (DPO) improved from 21 days to 38. The Highland Group then worked closely with the business to ensure that the terms were clearly understood so that maximum savings would be achieved.

Our experience with Accounts Receivable has been that if payment terms are clear and communicated to all stakeholders, processes are optimised to support and enforce them, the likelihood of bad debts are minimised and the draw on working capital is both controlled and predictable.

Working capital improvement and operational efficiency are mutually supportive

Taking a comprehensive approach to generating cash should enable working capital reduction activity to drive improvement in operational efficiency, but it does require expertise in both areas to optimise the synergies.

Take the case of a large international client who was seeking to reduce inventory. To achieve this objective, The Highland Group reduced process variability: established the right balance between incoming material consumption, equipment operating parameters and equipment maintenance: and implemented comprehensive inventory management systems. The result was a 35% reduction in inventory, saving €340 million and an increase in production output that was 8% above the previous year average.

"From a working capital perspective, companies should seek to shorten the cash conversion cycle – the time it takes to turn resources into cash."

A further example of the complementary nature of working capital and operational improvements is illustrated by a manufacturer of windows and doors. The company's goal of reducing production and operating costs was entirely funded by the cash extracted by savings in reducing the level of accounts receivable and inventory.

Maximising assets supported and sustained by operational efficiency improvement

From a working capital perspective, companies should seek to shorten the cash conversion cycle – the time it takes to turn resources into cash. In the search for "fast cash," seek assets that would be better in cash or reducing the cash consumed by those

"Combining operational and working capital needs enables businesses to free up cash and improve operational performance."

assets. Typical examples would be reducing Maintenance, Repair and Operations costs (MRO) and cutting contractor costs. Underpinning these reductions through operational efficiency improvement ensures the savings are sustained. For example:

Reducing MRO – operationally the key is to move from a reactive maintenance programme to a proactive one where replacement and maintenance requirements are anticipated, scheduled and monitored. This brings predictability to the types and number of spares required, as well as the level of inventory carried, while improving productivity, output and safety. A recent MRO reduction programme for a global mining business saved €3 million.

Contractor Management – companies who employ large numbers of contractors often fail to apply the same degree of oversight and rigour as they do when managing their own employees. Rates paid to contractors are often inconsistent and poorly negotiated while decisions about hiring contractors are often reactive, based on poor information and suboptimal productivity from existing employees.

The Highland Group's approach of combining operational and working capital needs enables businesses to have a more forward-looking and data informed assessment of what contractor support is required, which leads to the ability to cut working capital by negotiating better rates and more precise service level requirements with contractors. By taking this approach, a chemicals client saved €3.8 million annually through a combination of reduced contractor costs, improved productivity and reduced overtime.

"Companies need to move working capital management from being a"housekeeping" exercise to being a core business strategy."

In a similar fashion, a utilities company improved transport utilisation by 34%, which in turn enabled them to cut inventory without adversely affecting service capability. Of course, in the search for "fast cash," it is tempting to simply cut inventory across the board. However, without the input and expertise of a specialist operational consultancy, you risk having insufficient spares cover on operational and output-critical machinery, as well as short-lived savings because they are not underpinned by operational performance improvement.

In troubled and uncertain times, "Cash is King" and as a consequence, companies place much more focus on reducing working capital. We recommend companies take a robust and comprehensive approach that moves working capital management from being an occasional "housekeeping" exercise that freed up cash to being a core business strategy. This strategy includes the most effective and efficient use of all company assets and is underpinned by clear responsibilities, effective management, well-negotiated contracts and service level agreements, all supported by optimal key performance indicators.

Summary – Those who optimise cash will emerge the winners

It is no coincidence that well capitalised companies are buying up companies at this time; they have large amounts of cash to invest. Taking a more comprehensive and focused approach to working capital management underpinned and supported by operational efficiency will enable your business to generate cash that is lying dormant in your business.

By applying some or all of the recommendations we have described, you will be able to take full advantage of the business and market opportunities that recession inevitably brings as weaker competitors go out of business. Companies that manage and utilise cash well will be the ones that emerge stronger from recessionary times while those that wait until a crisis hits are likely to become just another government statistic. There is no such thing as too big to fail; every business needs access to cash. We can help you release the cash in your business so you can put it to better use. If you don't, there is a real danger someone else will.

About The Highland Group

The Highland Group is a global operational consulting firm committed to delivering measurable financial results for its clients. Founded in 1991, the firm serves industry-leading companies around the world from its offices in Europe, North America, South America and Africa. The Highland Group's senior professionals bring extensive business experience from a wide variety of industries and disciplines, including cost optimisation, engineering, maintenance, sales and marketing effectiveness, shared services, working capital management, supply chain management, finance and accounting, private equity value creation, warehousing and distribution, organisational development and more. The firm's collective expertise, combined with its "needs-based" approach, ensures solutions are custom-tailored to help its clients meet their goals and realise their full potential.

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