

CASH MANAGEMENT

Cash is back in fashion, but is it here to stay?

Insights from 2009 research into
cash and working capital management

ADVISORY

In 2009 KPMG in the UK commissioned CFO Research Services, an Economist Group business, to conduct research into cash and working capital management. The research is based on survey responses from 350 finance executives from large European and US organizations, covering all major industries. The annual revenue of the organizations ranged from US\$250m to over US\$20b in the United States and from £250m to over £20b in Europe and Canada. CFO Research Services conducted the survey and the interview program for this research; however, all content, views and opinions outlined in this report are the responsibility of KPMG in the UK.

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Andrew has more than 12 years of professional services experience in the areas of sales, marketing, SG&A cost reduction and cash and working capital management. He graduated in Economics and Corporate Finance from Brunel University and started his career as an equity analyst with Kleinwort Benson. Andrew joined KPMG to lead the corporate cash and working capital practice.

He specializes in helping companies improve cash flow from operations. Prior to KPMG he was the US and then European President of a specialist consulting company focusing on cash and working capital management. Andrew works with companies to help them identify opportunities for improving their visibility and control of cash flow around the business and supporting them with programs to release cash locked up in working capital, tax, capex and other assets.

Andrew has been involved in over 40 working capital programs either as the project leader or advisor. Many projects have been global requiring effective program management and co-ordination of multiple teams in different regions. The majority of projects have been focused on the implementation of sustainable improvements in working capital, achieved by driving behavioural change across businesses.



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Roger joined KPMG in 1998. He specializes in operational restructuring and turnaround of businesses in the consumer and industrial markets sector. Roger works with management teams to create and execute operational restructuring programs.

He has worked with numerous companies, from multi-billion dollar global businesses to £50 million single site operations. Roger has led projects aimed at all areas of the Profit and Loss and cash flow including new product development; supply chain reorganization; site consolidations and outsourcing; rationalization of back office functions, property moves and operational improvement initiatives.

Recently, Roger has led a major operational restructuring for a FTSE 100 scale industrials business aimed at taking out 15 percent of the cost base and improving cash performance. Roger started his career as an engineering apprentice with Jaguar Cars.

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Executive summary

KPMG's second annual cash survey has found that companies have pushed cash generation up the agenda in response to the changing demands of analysts, lenders and ratings agencies. As was predicted in last year's survey, many stakeholders have placed increased pressure on companies to maximize cash generation.

Where many companies last year were most worried about the rising cost of debt, they are now responding to the demands of their banks and other stakeholders to improve cash management. The majority of lenders have been looking for evidence that companies have explored all self help options before turning to external sources for additional funding.

Companies have reacted by turning up the heat on working capital to release any available cash back to the business. While only 37 percent of respondents had implemented a working capital improvement program last year, over half of all companies surveyed have now instigated an improvement program. According to this survey of 350 CFOs in the US, UK and Europe, cash management is the number one priority for more than a quarter of the respondents (28 percent), while a further 58 percent describe it as one of the top priorities for the business as a whole.

Greater focus on cash is having a positive impact on cash flow forecasts; while only 14 percent of companies said they had hit their targets last year, this has now jumped

to 28 percent. Indeed a third of respondents exceeded their cash flow forecasts this year. While it's always better to exceed forecasts than miss, poor accuracy necessitates higher credit facilities than may be required restricting cash available for other business opportunities. The survey highlights that cash flow forecasting remains a key weakness for many organizations, despite a significant increase in the use of short term forecasts. Later in the report we highlight some of the common drivers of low forecast accuracy.

While some companies have been able to reduce working capital as a result of this increased focus, over 40 percent of respondents reported deteriorating trends suggesting there is still a lot of work to do. This may reflect the tactics employed by companies in last year's survey to improve working capital. The major focus was on stretching supplier payment terms and squeezing customer credit lines. In this situation there are always winners and losers.

The survey results and interviews conducted for this year's survey suggest alternative tactics at play.

While tightening customer credit lines remains a priority, in many cases necessitated by greater default risk, more companies have turned their attention to slashing capital expenditure as a key lever for cash preservation. Sixty-four percent of respondents have cut or stopped capital expenditure programs in the last 12 months and 63 percent expect this to continue for the next two years as companies deal with the economic uncertainty. This focus on restricting investment does not play well for a sustained economic recovery in the short term.

Despite all the focus on cash, many companies are still failing to explore all opportunities for cash generation. The research demonstrated that improvement programs typically focus on operating working capital, treasury and capital expenditure. Few companies are seeking improvements from indirect tax and duty, property and pensions, all of which could provide much needed cash flow. Tax is one of the biggest cash flow items for many companies and a review of operating processes could yield significant results.



Looking forward respondents are not positive about the future: the majority expect no improvement in working capital over the next 12 months. Companies seem most concerned about customers stretching payment terms and getting into financial difficulty and suppliers demanding faster payment. They also foresee a significant deterioration in customer performance, with 55 percent expecting an increase in their bad debt exposure over the next two years.

It is clear the focus on cash and working capital management from stakeholders is here to stay, at least for the next 12 – 24 months. Companies should seek to maintain clear visibility on cash and ensure that the business is planning appropriately for any signs of economic recovery.

What remains to be seen is whether companies have been successful at embedding cash into the operating culture. When the economy eventually recovers it will be clear how many companies have achieved sustainable improvement in their working capital. Our prediction is many companies have not and there should be a rapid growth in capital employed as companies adjust to greater economic prosperity.

Key data:

- 54 percent of respondents said the main trigger for focusing on cash was pressure from stakeholders, compared with just 19 percent last year;
- 72 percent missed cash flow forecasts this year, compared with 86 percent in 2008;
- 41 percent saw a deterioration in working capital;
- 53 percent of respondents have instigated a working capital improvement program this year, compared with just 37 percent last year
- In response to the tightening credit market: 64 percent are reducing or stopping capital expenditure; 63 percent are seeking to improve cash generation and 43 percent are tightening credit lines to customers (multiple choice).

64%

OF COMPANIES ARE REDUCING OR STOPPING CAPITAL EXPENDITURE AND 43 PERCENT ARE TIGHTENING CREDIT LINES

53%

OF RESPONDENTS HAVE INSTIGATED A WORKING CAPITAL IMPROVEMENT PROGRAM THIS YEAR, COMPARED WITH JUST 37 PERCENT LAST YEAR

Stakeholders turn up the heat on cash

As the global financial and economic crisis wears on, many companies are still struggling. Amid unrelenting profitability pressure and tight financing conditions, cash remains scarce.

Research conducted for this report, part of KPMG firms ongoing documentation of cash and working capital management practices around the world, indicates clearly that CFOs and their teams are sharpening their focus on cash and working capital. Their efforts, aimed at freeing cash on their balance sheets and providing evidence of good management to internal and external stakeholders have shown a marked escalation since KPMG published *The Importance of Preserving Cash in a Downturn* in November 2008.

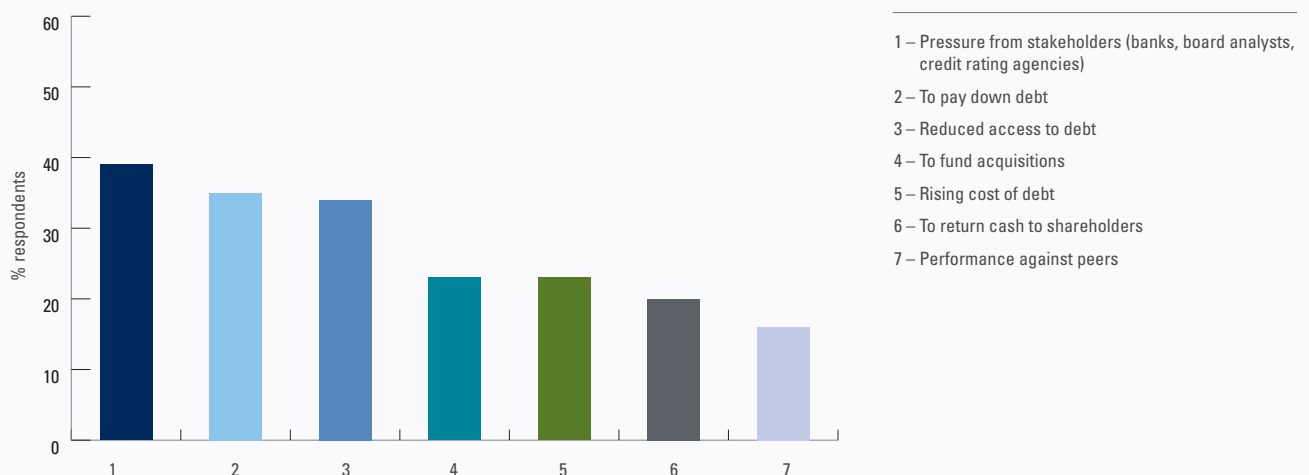
Guy Rudolph, Group Financial Controller at U.K. mobile telephony operator Vodafone Group, highlights the importance of the shift of focus towards cash management a focus that Vodafone, like other companies, has intensified in recent months: "Following the appointment of our CEO (Vittorio Colao) in July 2008, we issued an updated strategy for the group that November," he says. "The first plank of the strategy is to strengthen our free cash flow generation."

The results of our most recent survey indicate this concern for cash is widespread among companies in North America and Europe.

A majority of survey respondents (58 percent) say that cash management ranks among their companies' top strategic priorities, with more than a quarter (28 percent) citing cash management as their "number one priority". Similar results are seen for working capital, with 63 percent placing working capital management as a high priority, and 28 percent, the "highest priority".

Figure 1. Respondents are most likely to cite stakeholder pressure as their companies' primary motivation for increasing attention on working capital.

What is the main trigger for your organization to increase its focus on working capital?





Survey results confirm that increased pressure from the board and from lenders, analysts, ratings agencies, and other stakeholders is a primary motivation for companies' renewed efforts to improve cash and working capital management. (See Figure 1.) That is a stark contrast to pre-crisis times, according to Andrea Crenna, CFO at Italian appliance maker Indesit Company. He says, frankly,

“Equity investors, before the crisis, very seldom raised questions about the balance sheet,”

“If everything looked OK, they were perfectly happy.”

But with 63 percent of survey respondents saying that the prolonged economic downturn will force their companies to reduce capital

expenditures, and 49 percent saying that economic conditions will cause their companies to restrict investment, it's clear that satisfying stakeholders isn't the only reason companies are working hard to extract cash from their balance sheets. In some cases, these efforts can help companies avoid at least some of the hard choices that face them as they seek to maintain competitive advantage and to position themselves for the eventual recovery.

Forecasting still not up to scratch

The increased spotlight on cash is forcing companies to improve cash flow visibility. In the last 12 months this has driven greater use of short term cash flow forecasting measures to highlight what is happening to the cash in the business.

Survey results indicate an improvement in cash flow forecasting over the past year, but respondents report that performance still isn't up to scratch. A gap is apparent between the importance that companies are attaching to forecasting, and their ability to forecast accurately in current volatile conditions. Eighty-six percent of respondents to last year's survey said their companies had missed their cash flow forecasts. This year, nearly three quarters (72 percent) say their companies missed their cash flow forecasts in the last 12 months, with 24 percent missing forecasts by 20

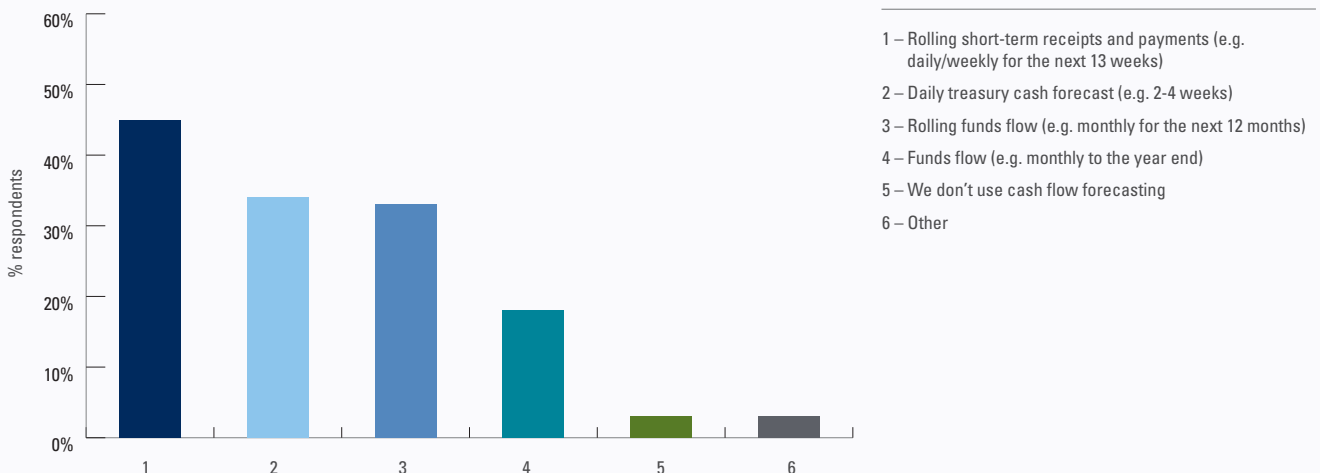
percent or more. Certainly recent sales volatility has made cash flow forecasting harder, however KPMG firms repeatedly see the same issues affecting forecast accuracy. Failure to engage the operation and key functions and implement a robust governance process are the most common causes of inaccuracy. While responsibility for cash flow forecasting falls to finance, the people making decisions in the business and managing day to day operations (including sales, procurement, accounts payable, tax, etc), hold the key to timely and accurate data input. These functions should

be engaged and held accountable for inputting to the forecast.

It's important to remember that forecast accuracy is likely to be initially poor. To improve requires a structured process of challenging assumptions, measuring and reporting on variances and reviewing feedback with the stakeholders to educate them on how to increase accuracy. Effective operational cash flow forecasting is a valuable management tool and it can enable companies to make informed decisions, it is therefore worth investing the time and effort to get it right.

Figure 2. Most respondents to this year's survey say their companies use short-term cash-flow forecasting methods.

Which of the following describes the type of cash flow forecasting that your organization uses?



How companies are responding to the cash management challenge

As pressure on the enterprise grows to improve cash management, a majority of responding companies (53 percent) have or are in the process of conducting working capital improvement programs.

Results show that companies that ran a working capital improvement program in the last five years are more likely to have lower working capital compared with their peers who haven't run such a program (43 percent of those who have run a working capital improvement program vs. 34 percent of those who have not). (See Figure 3.)

It's likely that a growing number of enterprises will initiate such programs and that more companies should see tangible results in the coming months.

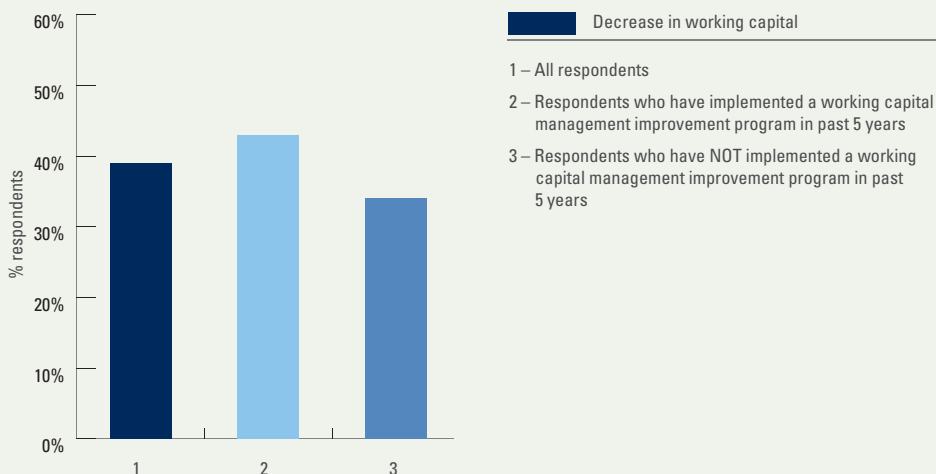
Vodafone is one company tackling its working capital by means of a structured program. It launched its working capital offensive as part of the first plank of its new strategy free cash flow generation launched in late 2008. The program, led by the company's Head of Working Capital, Chris Allen, started as a pilot in two countries; now, armed with a tool kit of about 100 ideas to improve working capital performance, he is rolling the program across all the regions Vodafone operates in. Mr. Allen won't

put a figure on the results Vodafone is hoping for from the program however, analyst estimates point to a reduction in working capital in the range of £300 million for the financial year to end March 2010. This is potentially a significant contribution to the company's targeted free cash flow of £6.0 – 6.5 billion.

Despite the increase in programs to improve performance, companies appear to be leaving cash on the table. The majority of programs focus on the traditional operating working capital,

Figure 3. Survey results show that working capital improvement programs have yielded positive results.

Compared to three years ago, has your organization's working capital decreased?



% of respondents in each segment reporting a decrease in working capital versus three years ago



(debtors, inventory and creditors). Fewer companies are looking to tax, real estate, and pensions in order to release cash. These are potentially huge areas of opportunity which can often be under exploited, but could help companies release much needed cash.

1 Inventory management— Fine tuning production and sales processes

For many senior finance executives looking to tackle their working capital management practices, inventory may be the first place to start. Already, our survey shows that many companies have realized improvements in working capital in the past year through better control of inventories. A manufacturer like Indesit typifies this trend. Says CFO Mr. Crenna: “We were starting from a point [12 to 18 months ago] of high inventories, due to the slowdown of the market in the final part of 2008. So we fine-tuned production at the beginning of the year. In 2008 we ended up with 1.4 million units, and we are planning to reduce this by 500,000 units, by reducing production by over 20 percent.”

In some instances, companies are fine-tuning their production capacities by stalling production for a time, sending workers home on almost full pay or moving staff to a shorter working week. These short-term measures help companies stay in position to respond to a change in circumstances, such as a sudden uptick in demand. Mr. Crenna is the first to point out that managing

inventory is not just as simple as stopping production and selling through stock. “It’s easy to reduce inventories. But you have to find the right balance between that and smooth production processes, and quality of service for your customers. It’s not just a question of cutting.” For some companies, the financial and economic crisis may raise the question whether their business models are flexible enough to respond to shocks in customer demand.

Better sales planning can also help companies gain control of their inventories, according to our sources. Paul Reilly, CFO at U.S. supply chain services company Arrow Electronics, recently looked at the causes of slow moving inventory that are tied to sales activities. In cases that are related to customer relationships for example, if a customer were consistently having trouble forecasting its own sales and buying patterns Arrow executives approached the customer directly to work more closely with them, in hopes of reducing the safety stock that Arrow needed to hold for the client. In the case of internal problems for example, if Arrow’s sales staff were regularly overstating expected sales in order to ensure ample stock if they landed a big order, the finance and marketing teams reassured their colleagues in the sales function. As Mr. Reilly puts it, “We would go to the sales teams and say, ‘We can prove to you that we can ensure the inventory you need is within our company. We have a system that is 99.9 percent reliable.’”

2 Receivables management— Improving credit and collections processes

Our survey indicates rising concern about receivables: 47 percent see customers’ stretching payment terms as the top pressure on working capital, up from 38 percent a year ago. Throughout the survey, respondents express concern with managing receipts from customers and the power that buyers have over sellers’ working capital. Sixty-three percent of respondents anticipate that customer pressure to stretch payment terms will be acute in the year ahead, ranking first or second among their top pressures (see Figure 4). Similarly, 41 percent of respondents are concerned that their customers will fall into financial difficulty. These findings raise the question; if companies have appropriate tools in place to spot potential financial difficulty among counterparties and to act proactively to minimize exposure. In addition, are companies arming the sales force with ideas on how to manage payment term discussions.

41%

OF RESPONDENTS ARE CONCERNED WITH THAT THEIR CUSTOMERS WILL FALL INTO FINANCIAL DIFFICULTY

55%

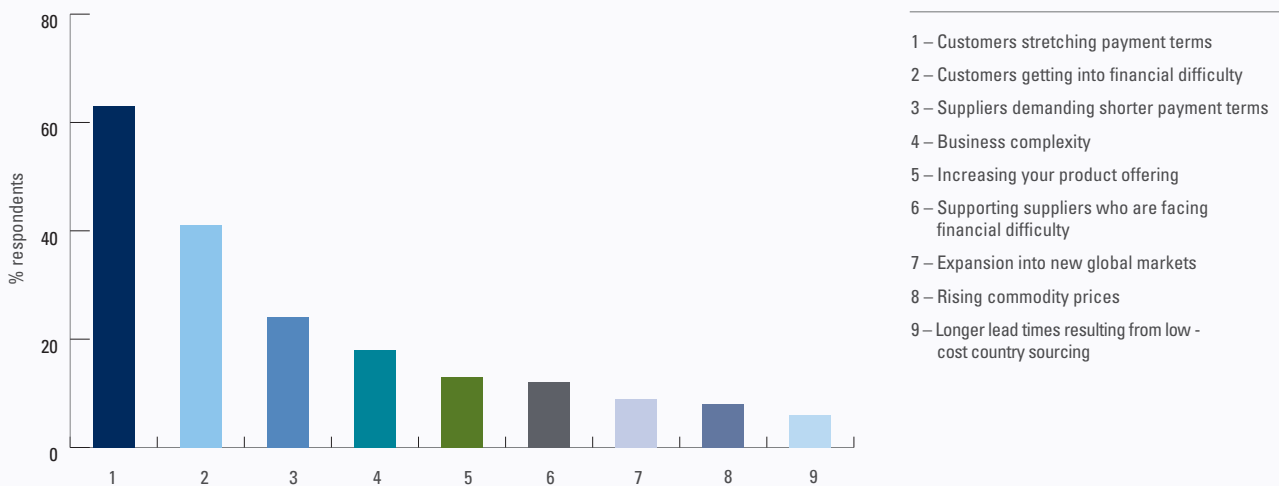
OF EXECUTIVES EXPECT BAD DEBT TO MOUNT UP IN THE NEXT 24 MONTHS

63%

OF RESPONDENTS ANTICIPATE THAT CUSTOMER PRESSURE TO STRETCH PAYMENT TERMS WILL BE ACUTE IN THE YEAR AHEAD

Figure 4. Respondents express concern with receivables in a “buyer’s market.”

Over the next 12 months, what do you think will be the top three pressures on your organization’s working capital performance?



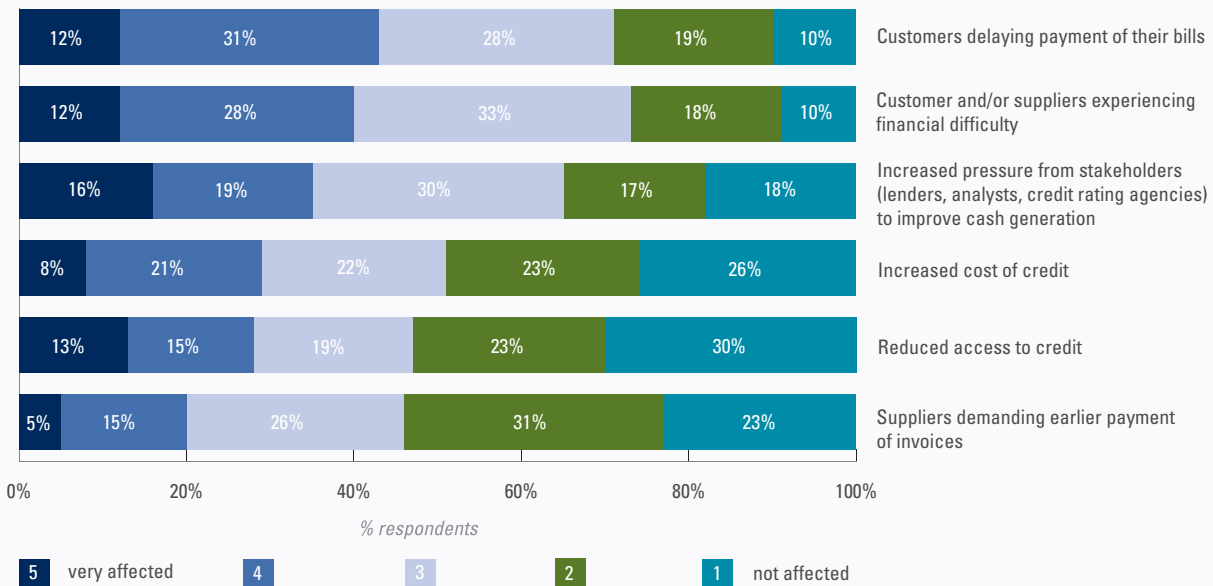
Delinquencies are on the rise; fully 55 percent of executives surveyed for this research said they expected bad debts to mount in the coming 24 months, as customers file for bankruptcy or otherwise default on payment. “I consider the biggest risk bad debt,” says Mr. van Kesteren of Kuehne & Nagel. Accordingly, he says that around 60 percent of the company’s receivables are now insured, up from 50 percent a year ago. In this difficult situation, Mr. Crenna of Indesit explains how CFOs are torn between bolstering the top-line and preserving the bottom line: “We have to be selective in terms of credit to customers. But you don’t want to be so selective that you stop selling. It’s a trade off between risk and sales,”

he says. “It’s a stop-go, stop-go, exercise in trying to avoid overexposure, while not losing sales or market share.” Some companies are optimizing their product and service offerings in an effort to squeeze more performance out of accounts receivable. Vodafone, for example, is looking at service design: having end-customers pay in advance rather than in arrears for some aspects of their service. “It makes a month’s difference to the collection of a sizeable chunk of our revenues,” says Mr. Allen, Head of Working Capital at Vodafone. For a company of Vodafone’s size, that’s no trifling contribution to cash flow.

Others, such as Arrow Electronics, are fine-tuning their internal processes. When reviewing customer payment patterns, Arrow’s CFO Mr. Reilly says, he noticed many delinquent invoices were not paid on time because of some dispute or discrepancy. In response, the company started calling customers 10 days ahead of the due date, to clear up any outstanding issues. At the same time, the company has been working to resolve the root causes of any disputes or discrepancies in its own processes and systems. “So we became more efficient and built quality in the front end,” he says. “And we were also calling companies, not after they went delinquent, but before they went delinquent.”

Figure 5. Respondents' top concerns include worries about customer payments.

Has the economic environment adversely affected your organization in any of the following ways?



3 Payables – Treading with care

While survey results reflect an almost palpable concern with receivables, finance executives seem less concerned with payables. When asked about the economic downturn's effect on their businesses, respondents were most likely to assign high adverse effect scores to "customers delaying payments of their bills" and "customers and/or suppliers experiencing financial difficulty." Far fewer, only 20 percent, assigned such high adverse/ affect values to "suppliers demanding

earlier payment of invoices," and a majority of respondents place it at the low end of the scale. (See Figure 5.) In a difficult economy, however, some companies are cautious about stretching payments particularly with critical suppliers for fear of pressing a supplier to the brink of failure. Mr. Rudolph of Vodafone, which is one of the world's largest telecommunications operators, says his company understands the power that goes with being such a large company, and is careful to handle this with care. "It's very, very important for us that we have a choice of suppliers,"

he says, "and that we maintain a strong, diversified supplier base."

Still, in order to extract more from its payables without paying suppliers late, Vodafone is scrutinizing its internal payment processes by looking through contract terms with a fine-tooth comb, ensuring payment details are correctly entered in the finance function's IT systems, and reviewing the timing of weekly payment runs relative to contract terms, to eliminate early payments. Mr. Allen says that the company is moving to a shared services model that will standardize its procurement practices.

For the time being, though, most of the company's operating units still have stand-alone purchasing functions. As a result, he says, "each finance function has slightly different ways of going about processing and paying invoices, and there is usually scope for refining each in turn."

At Arrow Electronics, the finance function is not only looking at how best to extend payables but it's also using its own financial strength as a source of advantage in dealing with suppliers. Specifically, the company is reviewing whether it is getting the best deal from prompt payment discounts; it is also offering to pay financially

weaker suppliers sooner, in exchange for better pricing. Says CFO Mr. Reilly: "We looked at those on an individual supplier basis, to determine what we should do from a good economic sense, from a good business sense, to ensure that each company benefited from whatever transactions we struck."

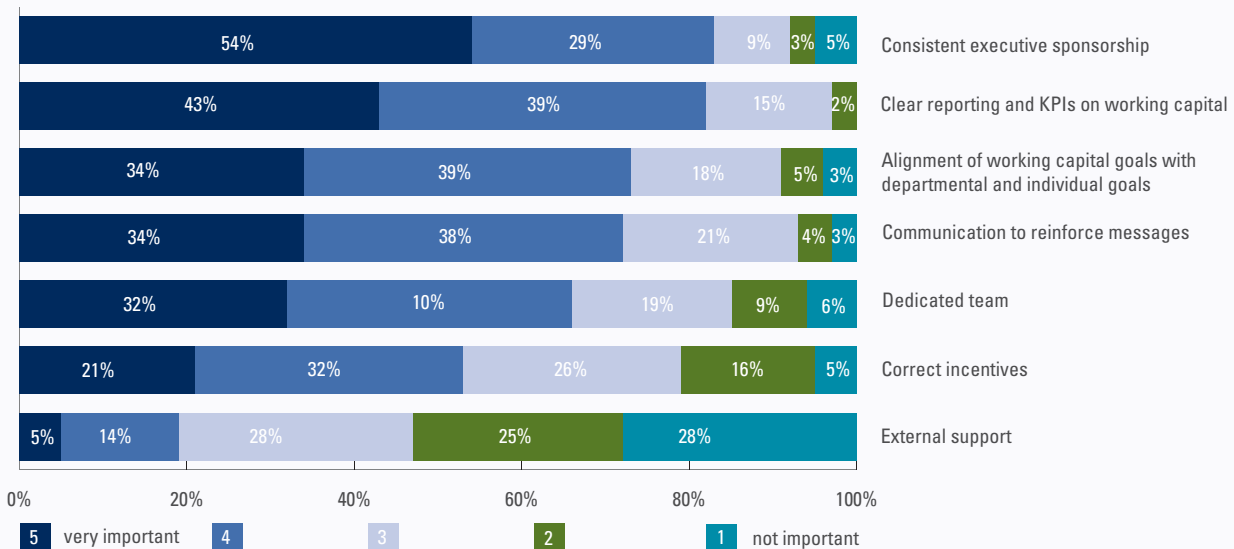
One idea that is gaining traction is supply chain financing. This is where a company leverages its credit rating to enable suppliers access to faster payment at a lower cost than the supplier could obtain financing. It is likely this will continue to gain exposure over the next 12 months.

4 Engaging the organization in cash management

Pulling the levers of working capital is all well and good – in theory. In practice, however, it's unlikely a finance function can do this in isolation. Those who report running a working capital improvement program say that "consistent executive sponsorship" is the key to success. "The recession has helped me convey the full importance of working capital management to the owners and to secure their support," comments one survey respondent.

Figure 6. Executive sponsorship is key to managing working capital.

How would you rank the importance of the following factors in achieving a positive result from your organization's working capital improvement program?



% respondents that have run a working capital improvement program in the past five years



That sentiment has been echoed throughout the interview program carried out as part of this research. For his part, Mr. van Kesteren of Kuehne & Nagel says that due to the change in the economic environment, he now sits down once a week with the group CEO and with specialist working capital staff from the finance function, to discuss working capital receivables, mostly. These meetings typically take up to two hours, indicating the degree of top-level commitment to working capital discipline.

Furthermore, our research indicates that the finance function is increasingly cutting across silos in the enterprise in efforts to tighten working capital. One priority is managing the tensions between sales and finance where sales wants to be sure of a sale, and finance wants to be sure of collecting cash from a sale. "In some organizations, the sales team sees the credit team as 'sales prevention' or 'commission control.' What they mean by that is that we are passing up good sales because they are not risk takers in the receivables area," says Mr. Reilly of Arrow Electronics.

In an effort to overcome these tensions, companies appear to be involving the sales team more closely in bringing working capital into line. "The first call that a customer will make, after getting a credit call from you, is to your sales guy," says Robert Ryder, CFO of U.S. wine, beer, and spirits company Constellation Brands.

"So ahead of time, we have to get the sales guys on board and agree on a strategy for engagement." In some companies, finance is also leveraging the sales team's contacts to secure high level access to delinquent customers. Most of the CFOs interviewed for this survey agree, though, that sales staff should not get too involved. Their job, CFOs point out, is to sell.

Using standardized, easy-to-understand metrics is critical to including line-of-business executives in working capital, say senior finance managers. Education is of paramount importance, too, as working capital may be a new concept for many operations staff. "We had quite a decentralized organization, and there were several different calculations for all of those things," explains Mr. Ryder of Constellation Brands. "We spent a reasonable amount of time on education, and on standardizing calculation methodologies."

Many finance executives are sticking to the basic measures of the three levers of working capital, expressed in relation to sales DIO, DSO, DPO or variants on these. In many cases, they are trying to make these metrics more timely and more reliable, and

eliminate the distortions that can creep into such working capital metrics. Some are moving from single, end-of-period figures to more frequent measures, or rolling averages.

Mr. Reilly of Arrow Electronics who has moved to more frequent measures to keep closer tabs on

working capital performance: "Many folks can move the lever for one day at the end of the quarter. But we're trying to look at more data points throughout the quarter." In the past year, Arrow has moved from an

end-of-quarter metric, to a four-point average for each quarter that gauges working capital levels at the beginning of the quarter, and at the end of each of the three subsequent months. Accordingly, the company's annual metrics now include 13 data points throughout the year.

"The ideal I would like to get to, is a weighted average working capital metric, which avoids measurement at a specific point in time."

Mr. Ryder of Constellation Brands

5 Incentives, incentives, incentives: Linking cash performance and pay

As finance increasingly includes operational managers in efforts to manage working capital, many companies are linking more variable compensation to cash flow related measures. But surprisingly, perhaps, only 36 percent of survey

respondents link cash flow targets to management compensation. However, anecdotal evidence from the interview program suggests that use of such variable compensation linked to cash flow measures is expanding.

Arrow Electronics is one company that has recently rolled out cash flow targets into its long term incentive compensation plans, according to its CFO Mr. Reilly. "We felt it was critical to our financial strength, financial foundation, and competitiveness, to have more cash and greater liquidity," he says. "So we modified our compensation plans." At Vodafone, meanwhile, 25 percent of managers' annual bonus was linked to free cash flow in 2008; since then, the figure has risen to 35 percent.

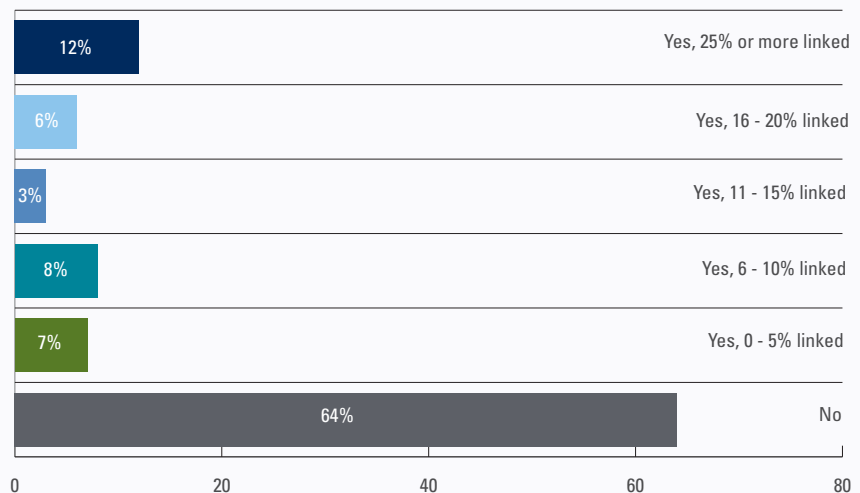
Such incentive compensation plans are apparently bearing fruit. Of those survey respondents that have variable compensation linked to cash flow targets, 42 percent say their working capital decreased versus three years ago. Among those with no incentive compensation linked to cash flow targets, the figure was lower: just 37 percent. Mr. van Kesteren is one executive who says he has seen the benefits of his company's compensation plan. "We started this in 2005, and since then, we have had

"We make people responsible, we give them the information, we give them the transparency—then we reward them with money if they do the right thing."

Mr. van Kesteren of Kuehne & Nagel

Figure 7. A minority of companies link cash flow to variable compensation.

Are cash flow targets part of the management teams' incentives package at your organization, and, if so, what percentage of the package is linked to those targets?



a steady decrease of total working capital intensity," he says.

In the case of Kuehne & Nagel, Mr. van Kesteren says that regional managers may have a monthly base salary in the region of USD 10,000-15,000. The company operates a bonus scheme linked to regional earnings. The corporate center levies a capital charge between the EBIT and EBT lines of the income statement, based on the capital

employed in the regional business. A high level of working capital in the regional unit drives down its profit, which in turn is reflected in the manager's bonus. The bonus element appears highly leveraged: "The regional manager can earn USD 20,000, if he does the right thing," says Mr. van Kesteren. Embedded in the organization, such arrangements are likely to ensure a lasting focus on cash efficiency.

Smaller companies feel the squeeze

Our research shows clearly that smaller companies are feeling the brunt of the financial and economic crisis. (See Appendix for details on company size segmentations.) It's also plain that smaller companies trail behind larger ones in their working capital efforts.

Consider payables. Smaller companies usually buy less and, therefore, have less purchasing power, so they often feel greater pressure to pay than their large counterparts. "Vendors are quick to cut us off if we slow payments," says a finance executive who works for a company in the automotive sector with \$250 million-\$500 million in annual revenues.

It's a similar picture in receivables. Here, 50 percent of small companies say they expect customers' stretching payment terms to be a top pressure on working capital. Smaller companies often have less bargaining power than their larger counterparts in collections efforts.

And it's worth noting that in forecasting, the smallest companies in the respondent pool appear to be doing worse than the largest companies; 49 percent of respondents who work for the smallest companies reported missing forecasted cash flow in the past year, compared with 40 percent of respondents from the largest companies.

And smaller companies are less likely to run a working capital management improvement program than larger ones: only 48 percent of smaller companies say they have run such a program, versus two-thirds of medium

and large companies. Accordingly, just 30 percent of respondents who work for smaller companies are linking employee remuneration to cash performance, versus 55 percent from the largest companies.

It's little wonder, then, that smaller companies are less optimistic about future cash savings from working capital, than their larger peers: while 53 percent of the largest companies foresee an improvement in their working capital in the coming 12 months, among the smallest companies the figure is just 37 percent.

Why the stark contrasts? The most likely explanations are all tied to the scale and scope of smaller companies. Small companies are less likely to prevail in negotiations and disputes with suppliers and customers that are large. Another reason may be that fewer small companies have sophisticated IT platforms in place, leaving finance staff with fewer tools with which to work. A third possibility is that some smaller companies, with fewer staff in the finance function, don't have the resources to dedicate to managing working capital.

Whichever factors are at play, it's likely smaller companies will continue to feel the pressure for some time to

come even as a possible recovery in business conditions appears on the horizon.

Given restricted access to financing, it's possible that small companies will face fresh financing challenges as the economy recovers. It is therefore critical that they adopt some of the tactics used by larger companies to manage their working capital.

37%

OF THE SMALLEST COMPANIES FORESEE AN IMPROVEMENT IN THEIR WORKING CAPITAL IN THE COMING 12 MONTHS COMPARED TO 53 PERCENT OF LARGE COMPANIES

30%

OF RESPONDENTS WHO WORK FOR SMALLER COMPANIES ARE LINKING EMPLOYEE REMUNERATION TO CASH PERFORMANCE, VERSUS 55 PERCENT FROM THE LARGEST COMPANIES.

The road ahead

As we look forward, it is clear pressure to improve cash management will remain a corporate priority for at least the next 12-24 months. It is likely to take longer than many anticipate for economic output to return to pre-credit crunch levels.

Maintain close visibility and control

of cash: It is just as important to keep a close eye on cash as the economy shows signs of recovery. Previous upturns indicate that companies often get into cash flow difficulty in trying to respond to an upturn in demand as working capital builds and places strain on financial headroom. One of the keys is ensuring the company acts rationally on the first sign of recovery. In some cases, a small uptick in orders may simply be the effect of re-stocking, following a period of de-stocking rather than an underlying recovery in trade.

How do companies ensure they react appropriately? By maintaining a good handle on what customers are doing, for one thing. Says Mr. Ryder of Constellation Brands: "We'll get at that analytically. We try to correlate IRI and Nielsen data, which is measuring consumer spending, and we have a general feel for how much inventory is at retail and at distributors. So it's not an exact science, but we can assess supply and demand trends. This helps us to gauge inventory levels to ensure that we will be able to meet the demand for our products."

Continued focus on driving accurate short term cash flow forecasts can provide an effective management tool to see what is happening in the

business in the coming months. It can enable management to keep a check on sales expectations and help ensure the organization is not gearing up for an artificial recovery.

Challenge the status quo to unlock

trapped cash: One of the biggest obstacles to improving working capital is overcoming organizational barriers to change. "That's the way we've always done it," is not acceptable as a justification for not changing. Companies that really move the needle on their working capital will drive their managers to examine the existing operating model and look for alternative ways of working that limit cash requirements. These could range from how companies contract with customers to assessing make versus buy options for the business.

In addition to challenging the operating model, aim to ensure all areas of cash flow have been reviewed and opportunities for improvement assessed. In addition to the debtors, inventory and creditors, review activities around indirect tax, transfer pricing and excise duty, the management of property

contracts around the world and the funding of the pension scheme. Monitor prepayments in the business to assess if any could be spread over time. In the same way that procurement are typically focused on negotiating the best price, the tax department is focused on optimizing the tax rate, not on cash management.

Focus on sustainability:

Driving sustainable improvement in cash management is not easy. For one thing, managing working capital spans the entire organization requiring strong alignment across functions to work towards a common goal. Indeed, many finance people say

"There are always a million reasons why operational business managers can't commit to working capital improvement. It is the role of finance to guide management through the obstacles to decreasing working capital."

Mr. Ryder of Constellation Brands

that if the finance function does not keep up the pressure, improvements in working capital practices don't stick. "There are always a million reasons why operational business managers can't commit to working capital improvement," says Mr. Ryder of Constellation Brands. "It is the role of finance to guide management through the obstacles to decreasing working capital." This may be especially true

when times are difficult; 44 percent of respondents who have run a working capital improvement campaign in the last five years say that it's harder for their organizations to drive working capital improvements in the current economic environment. (Only 23 percent of those respondents say that it's easier to improve working capital in this environment.)

As finance seeks to maintain its focus on working capital management in the coming year, it's clear that variable compensation plans are likely to remain an important tool. For his part, Vodafone's Group Financial Controller, Mr. Rudolph, says, "We will continue to maintain the incentives, and the metrics, and challenging people through the performance management cycle," he says. "And everyone is incentivized to maximize free cash flow, and they really understand the need." How does Kuehne & Nagel's Mr. van Kesteren plan to keep working capital at the forefront of his colleagues' minds in the coming year? His answer is plain: "By paying them money to do the right thing."

To drive sustainable change there are several key foundations to consider. Addressing one element in isolation will not yield results. All elements should be adopted to truly change the business.

The foundations include:

- Roles and responsibilities for cash need to be clearly defined and ownership assigned for cash and working capital at each point in the process;
- Reporting and KPIs should be consistent across the business and provide clear visibility of performance and insight into changes;
- Targets and objectives need to be embedded into individual's goal setting, not just at the top of the organization but down to the shop floor;
- Controls and policies need to be established that govern behavior and set parameters for decision making; and
- Cash is a consistent item on the management agenda at meetings.

Finally share ideas and successes. Whether you're in a large global business or small enterprise share leading practices and insights to help.

Cash management is good business practice:

For one thing, few senior finance executives expect the pressures on working capital to ease in the years ahead. For another thing, it may be that improvement efforts embed good

processes and practices genuine management discipline that becomes "business as usual" that could yield lasting benefits, even as pressure from stakeholders eases, and management's focus returns to growth.

Mr. Allen of Vodafone is one executive planning to maintain a sharp focus on working capital practices: "We need to make sure that everything we achieve, we lock in and keep. And we will be looking to do that in 2010." The pressure from stakeholders to maintain working capital discipline is likely to remain well into 2010, of course. Mr. Allen points out that the cash generated from a working capital project is essentially a "one-time win." Analysts and investors, he says, vary in their approach to valuing the cash flow generated by working capital improvements, as these cash flows are not recurring.

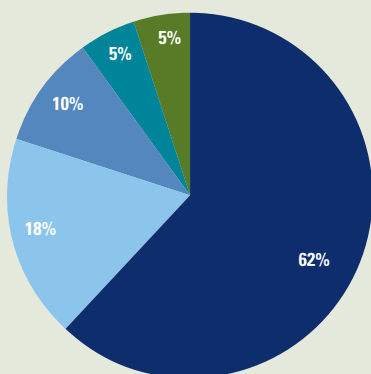
Conclusion

So it seems cash is likely to stay in fashion for some time to come. Those companies that continue to thrive through all economic cycles are those that recognize that cash never loses its appeal.

Appendix

A total of 350 finance executives were surveyed by CFO Research Services through an online questionnaire in June 2009. Almost every major industry is represented. Here is further information about the respondents.

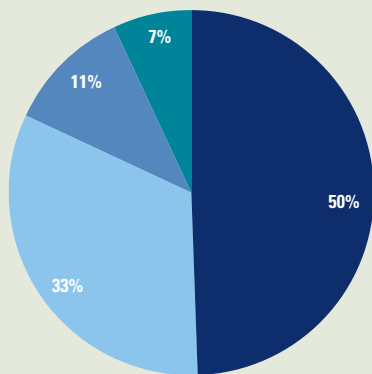
Which of the following best describes your job title?



- CFO or finance director
- Controller
- VP of finance
- Treasurer
- Other

Percentage of respondents

In which country is your position held?

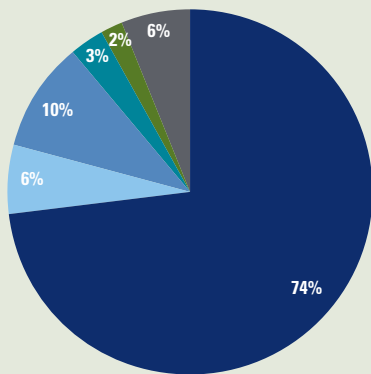


- Continental Europe*
- United States
- United Kingdom
- Canada

Percentage of respondents

What were your organization's worldwide revenues in its most recent fiscal year?

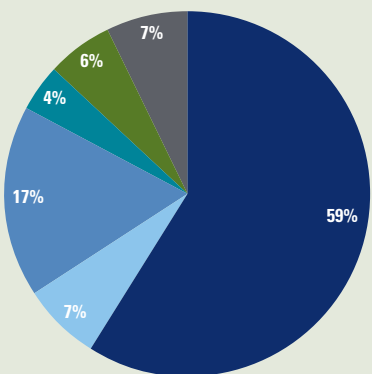
U.S. Respondents.



- US\$250m - \$500m
- \$500m - \$1b
- \$1b - \$5b
- \$5b - \$10b
- \$10b - \$20b
- \$20b+

Percentage of respondents

Respondents from Canada, the United Kingdom and Continental Europe.



- US\$250m - \$500m
- \$500m - \$1b
- \$1b - \$5b
- \$5b - \$10b
- \$10b - \$20b
- \$20b+

Percentage of respondents

*Data from Continental Europe includes responses from executives in Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Finland, France, Germany, Gibraltar, Greece, Guernsey, Iceland, Ireland, Italy, Latvia, Lithuania, Malta, Netherlands, Norway, Poland, Portugal, Russia, Spain, Sweden, Switzerland and Europe.

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