All tied up

Working capital management report 2011

Central and Southern Europe region

Ernst & Young
Quality In Everything We Do

Summary

All Tied Up Central and Southern Europe Region 2011 is the first annual working capital (WC) management report, focusing on the leading 150 companies in the CSE region. It complements the previously released All Tied Up 2011EMEIA survey and is the latest in a series of WC management reports published by Ernst & Young.

Comparing 2010 with 2009 shows contrasting WC results for the largest CSE companies. Cash-to-cash (C2C) dropped by 6%. Had the oil & gas sector been excluded from our calculations, it would have risen by 2%. These latest findings bring the total reduction in C2C achieved since 2005 to as much as 14%. However, excluding the oil & gas sector, CSE companies would have reported an increase of 5% in C2C.

By comparison, Europe* and the US reported a reduction in C2C (excluding the oil & gas sector) of 3% and 4%, respectively since 2005, suggesting that leading CSE companies have been significantly underperforming their peers in the last five years.

Altough the analysis shows similar levels of C2C between CSE, Europe and the US in 2010, the trends raise the question of whether CSE companies have been paying less attention to WC management when planning and executing their responses to a more challenging environment.

Going forward, it is therefore critical that business leaders in this region take account of these changes to rebuild truly effective WC management strategies suited to this new environment. These include identifying, adapting and improving best-practice solutions; working more closely and collaboratively with key customers and suppliers; building greater agility into their systems and processes; having robust risk management policies; and executing constantly against these requirements. This also means taking an approach across all these areas that balances cash, cost and service levels.

Key WC results

Change in WC metrics

Comparing 2010 with 2009 shows contrasting WC results for the largest CSE companies. C2C improved by 6%. Had the oil & gas sector (which accounts for 40% of total sales) been excluded from our calculations, it would have worsened by 2%.

This overall performance occurred in the context of diverging patterns of economic growth among CSE countries and heightened volatility in currency and commodity prices.

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Table 1: Change in WC metrics, 2005-10

CSE	2010	Change 10/09	Change 10/05
DSO	45	-1%	-5%
DIO	38	1%	5%
DPO	48	4%	12%
C2C	35	-6%	-14%

Table 2: Change in WC metrics excluding the oil & gas sector, 2005-10

CSE	2010	Change 10/09	Change 10/05
DSO	55	2%	3%
DIO	37	5%	10%
DPO	51	5%	5%
C2C	41	2%	5%

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

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

Last year's weaker WC performance (excluding the oil & gas sector) was due to an increase in levels of both receivables and inventories (DSO and DIO up 2% and 5%, respectively), which was only partially offset by higher levels of payables (DPO up 5%). WC performance patterns since 2005 were similar to those found last year, with DSO and DIO up 3% and 10%, respectively, while DPO was up 5%.

By comparison, Europe and the US reported a reduction in C2C (excluding the oil & gas sector) of 3% and 4%, respectively since 2005. Each WC component contributed to this improved performance. These results mean that CSE companies have been significantly underperforming their US and European peers in the last five years.

Company performance review

A majority of the companies included in this survey reported an improvement in WC performance in 2010 compared with 2009 and with 2005, but with diverging results in each WC area.

There was a high proportion of companies reporting better payables performance (62% and 58% in 2010 compared with 2009 and with 2005, respectively), with a minority of companies showing stronger receivables performance (44% and 46%, respectively). For inventory, a slight majority of companies (52%) showed better performance in 2010 compared with 2009, a proportion falling to 47% when comparing 2010 with 2005.

Table 3: Proportion of companies showing improved performance, 2010 vs. 2009 and 2005

	C2C change	
	2010 / 2009	2010 / 2005
DSO Reduction	44%	46%
DIO Reduction	52%	47%
DPO Enhancement	62%	58%
C2C Reduction	52%	58%

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

Sector performance review

Table 4: Most significant WC changes among major sectors, 2005-2010

	C2C change	
Major sector	2010 / 2009	2010 / 2005
Auto parts	-17%	-29%
Building materials	-5%	-3%
Chemicals	-8%	-25%
Electric Utilities	-1 day vs. 7 days	-1 day vs. 4 days
Food producers	16%	9%
Food and general retailers	-9 days vs. -7 days	-9 days vs. -9 days
Oil & gas	-19%	-40%
Pharmaceuticals	14%	9%
Steel	14%	33%
Telecommunications	-38%	-17%

Note: In case of Electric Utilities and Food and geenral retailers percentage change is not meaningfull.

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

The biggest improvements in WC reported in 2010 compared with 2009 and with the prior five years include the auto parts, chemicals, electric utilities, oil & gas and telecommunications sectors.
By contrast, food producers, pharmaceutical and steel companies scored poorly.

* Sample companies for Europe region excludes those involved into this study

Regional performance review

In 2010 compared with 2009, only two countries out of seven (Czech Republic and Romania) managed to report an improvement in WC performance. In 2010 compared with 2005, three countries (Turkey in addition to Czech Republic and Romania) posted better WC results.

A note of caution, however, is required when reviewing country performance, as volatility in local currencies against other main currencies may have affected yearly WC variations.

Table 5: Change in C2C by CSE country excluding the oil & gas sector, 2005-2010

	C2C change	
CSE	Change 10/09	Change 10/05
Croatia	4%	21%
Czech Republic	-4 days vs. 5 days	-4 days vs. 1 day
Hungary	10%	13%
Poland	3%	6%
Romania	-19%	-2%
Slovenia	13%	17%
Turkey	1%	-3%
Total	2%	5%

Note: In case of Electric Utilities and Food and geenral retailers percentage change is not meaningfull.

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

WC comparisons with the US and Europe

WC comparisons

Comparing the WC performance of leading CSE companies with those in Europe and the US shows significant variations overall and for each metric. Note, however, that regional comparisons should be approached with caution. Some of the business done by top country-headquartered companies takes place outside their home regions. Thus WC results to some degree reflect global market conditions as well as those at home.

Table 6: WC metrics by region excluding the oil & gas sector, 2010

	CSE	Europe	US
DSO	55	54	40
DIO	37	35	31
DPO	51	48	30
C2C	41	41	41
DSO - DPO	4	6	10

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

Analysis shows similar levels of C2C between CSE, Europe and the US in 2010, but with significant variations among metrics between the former two and the last region.

CSE and Europe score particularly poorly in receivables and inventory compared with the US, fully offset, however, by a much stronger performance in payables. For the US, the high differential between receivables and payables cycles (DSO vs. DPO) is compensated at the C2C level by a strong showing in inventory.

The DSO and DPO performance gap across regions can be explained to some extent by variations in local payment practices (payment terms and behaviours, payment usage, legal frameworks and cash collection effectiveness).

Marked differences also exist in the degree of management focus on cash and process efficiency among these regions. These partly reflect variations in strategies deployed and in degree of process maturity among companies composing each one of them, as they respond in different ways to distinct economic and financial conditions and opportunities.

WC comparisons among sectors across regions

Analysis of WC performance by sector across regions reveals a large divergence, exacerbated by the impact of factors that are specific to each local sector.

Compared with Europe and the US, electric utilities in the CSE region boast a superior performance in C2C, helped by much higher levels of payables.

In the case of telecommunications services, the performance by region is largely influenced by the fixed-line/mobile and prepay/post pay mix, local payment practices, payment methods and levels of capital expenditure.

For the oil & gas sector, the discrepancy in performance across regions is partly due to variations in business models, with companies operating at various points of a complex, sometimes integrated, capital intensive value chain.

Food producers in the CSE region exhibit much weaker WC performance. Companies there do not have the benefits of size, while dealing with a dispersed customer base and having generally less efficient supply chains.

In the pharmaceutical sector, the poor WC performance reported by CSE companies relate to receivables, due to much longer local payment terms.

Table 7: WC metrics by sector across regions, 2010

C2C	CSE	Europe	US
Auto parts	66	61	34
Chemicals	55	69	62
Building materials	86	53	55
Electric Utilities	-1	34	36
Food producers	78	30	40
Oil & Gas	26	34	5
Pharmaceuticals	93	84	84
Steel	133	86	59
Telecommunications	8	0	15

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

How Ernst & Young can help

To support companies in gaining greater control over their cash flows and addressing WC opportunities and challenges, Ernst & Young helps identify, evaluate and prioritize realizable improvements in WC derived from process improvements, elevated compliance levels or changes to commercial terms. We also help companies implement the relevant metrics, identify these WC and cash flow improvements and realize the resulting benefits.

To help organizations make the transition to a cash-focused culture, we also help them implement and identify the relevant metrics and areas for improvement in cash fl ow forecasting practices. We can then assist in implementing processes to improve forecasting as well as frameworks to sustain improvements.

WC improvement initiatives are often self-funding. In addition to increased levels of cash, signifi cant cost benefi ts may also arise from process optimization, through potentially reduced transactional and operational costs, and from lower levels of bad and doubtful debts and inventory obsolescence.

Methodology

- The report contains the findings of a review of the WC performance of the largest 150 companies (by sales) headquartered in the CSE region (comprising Croatia, Czech Republic, Hungary, Poland, Romania, Slovenia and Turkey).
- The analysis draws on companies' latest fiscal 2010 reports. Performance comparisons have been made with 2009 and with the prior five years.
- The review on which the report is based is segmented by region, country and sector, with numbers calculated on a sales-weighted basis. It uses metrics to provide a clear picture of overall WC management.
- Because of differences in industry weightings and in the level of international activity within each economy, an analysis of the WC performance gap across CSE countries 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 when this information is available.

Glossary

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

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