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2020 DISRUPTED
Complimentary research
April 2020

Preserve and Strengthen Your Cash Position

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With a recession looming, cash and liquidity needs are vital for businesses. Flagging consumer demand and supply chain halts are straining cash and working capital. The continued market and economic uncertainty will only extend the challenges ahead.

The immediate crisis caused a severe liquidity crunch as banks and investors pulled out of corporate debt. However, the threat to liquidity will not dissipate even as recovery starts, because the credit markets are factoring in default and earnings risks into corporate borrowing spreads. During the first quarter, the Federal Reserve intervened repeatedly to buy corporate debt and commercial paper to inject liquidity back into the market. Even if rates are low, that risk premium will stay with us for some time.

Cash is king – even for companies that entered the year in a strong cash position. While most companies have been focused on managing the impacts of the global COVID-19 pandemic, now is the time to immediately develop and execute a turnaround strategy. This should include a sound plan for preserving cash, releasing cash tied up in working capital, and taking advantage of the stimulus funding and near-zero interest rates to restructure and potentially increase use of debt to enhance liquidity and fund strategic growth opportunities. A full view of the cash conversion cycle is imperative because it will have implications for your business and customers.

Seven near-term imperatives

1 Enhance cash visibility.

To manage and control cash, you will need clear visibility into the operations that generate and affect cash on hand. Increase forecasting frequency to daily to reflect this volatile environment, so that management understands the cash position. Additionally, report cash metrics on a daily basis.

2 Revisit capital investments.

Determine the short-, medium- and long-term investments needed to manage and enable your turnaround strategy for the remainder of this year and beyond.

3 Take advantage of free, low-interest and no-interest cash.

With the stimulus programs and the ultralow interest rate environment, it is beneficial to look at available lines of credit and interest rates, and then model scenarios to determine whether you can pay down maturing debt. Consider taking on greater balance sheet leverage to enhance liquidity in the face of volatility and/or to fund strategic growth initiatives.

4 Extend payables.

Strike a balance between extending payables and ensuring that you take care of your supplier base. Focus on updating supplier risk assessments and mapping supplier payment terms to ensure you are taking care of your most critical suppliers. Focus on reviewing goods receipts, invoice timing and payment runs, as well as eliminating early payments where early-pay discounts aren't clearly superior.

5 Expedite receivables.

Focus on reducing overdue receivables, putting in place (or improving) a robust credit risk exposure and write-offs process, enhancing customer payment terms, and addressing high levels of unbilled receivables through quicker and more frequent billing, as appropriate.

6 Reevaluate inventory levels and turns targets.

Assess current supply chain drivers, including inventory buffers and excess stocks, to identify immediate quick wins. Address further opportunities for accelerating inventory turns across the end-to-end supply chain. Stay vigilant by forecasting demand and supply requirements daily. Continuously monitor customers' and suppliers' financial health through the use of detailed demand and supply forecasts by business/product line and geography.

7 Consider alternative supply chain financing mechanisms.

Introduce supply chain finance offerings, including payment terms discounting, to inject liquidity into the supply chain.

Cash and working capital opportunities by industry

The current crisis has had very different cash consequences across industries – and even within certain industries. For example, specialty retail, largely shut down at least on the bricks-and-mortar side, has taken a hard revenue and cash hit, while food and staples retailers have seen a revenue and cash boost due to consumer preparation and panic buying.

The Hackett Group's annual analysis of the top 1,000 US public companies measures working capital opportunities across industries. The latest analysis found that these companies have $1.3 trillion tied up in excess working capital – an increase of $169 billion over the prior year. This included $368 billion in accounts receivable, $446 billion in inventory, and $464 billion in accounts payable. Furthermore, the analysis revealed a sizable variance between industries with large working capital opportunities (e.g., aerospace and defense, retail, and internet software and services) and those with relatively small working capital improvement opportunities (e.g., marine shipping; wireless telecommunications; pulp, paper and forest products; construction materials).

In the figures on the following pages, we have grouped industries in this study into three categories based on cash impact from the COVID-19 crisis: significantly, moderately and minimally disrupted industries.

FIG. 1 Total working capital opportunity – significantly disrupted industries

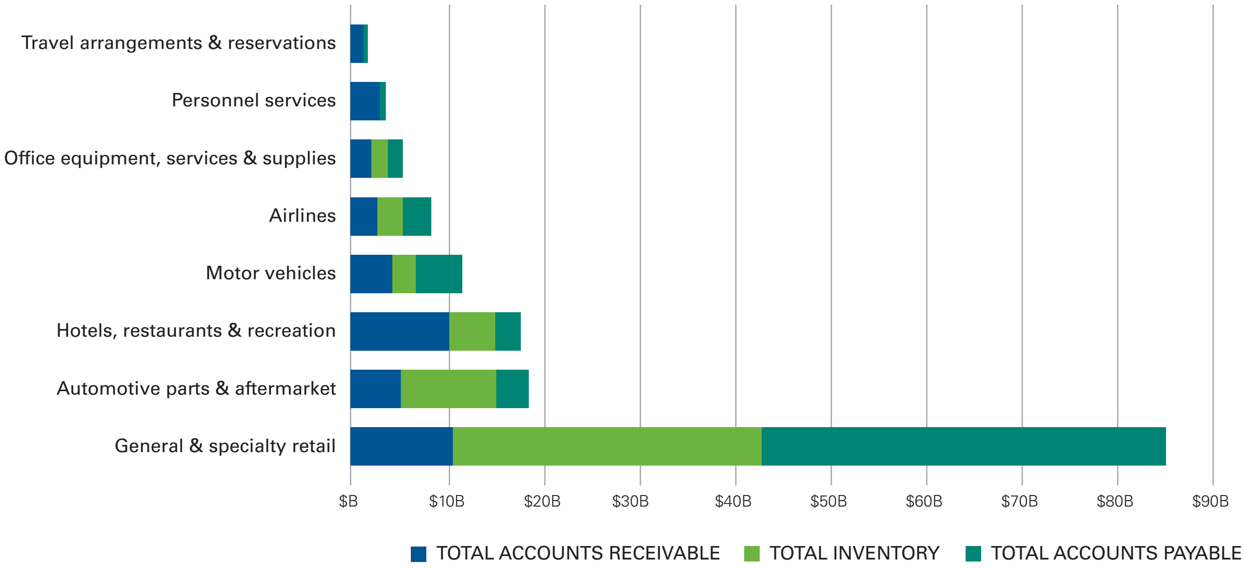


FIG. 2 Total working capital opportunity – moderately disrupted industries

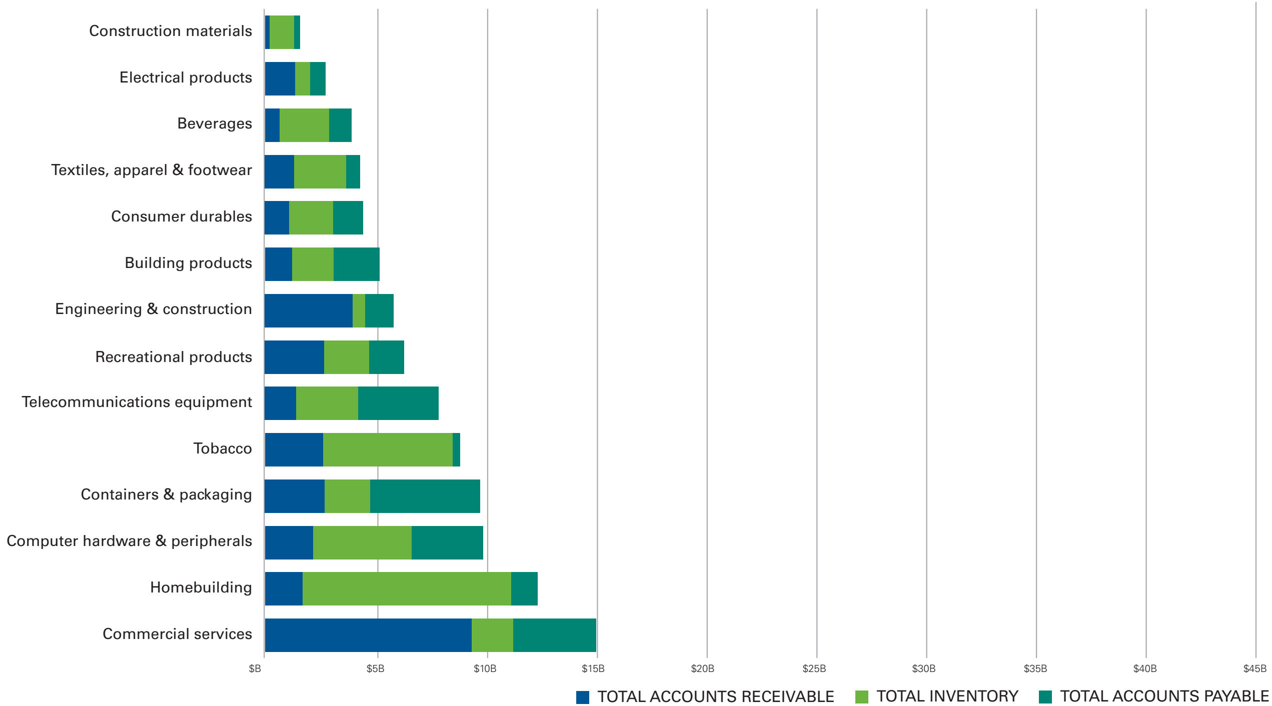


FIG. 2 Total working capital opportunity – moderately disrupted industries (continued)

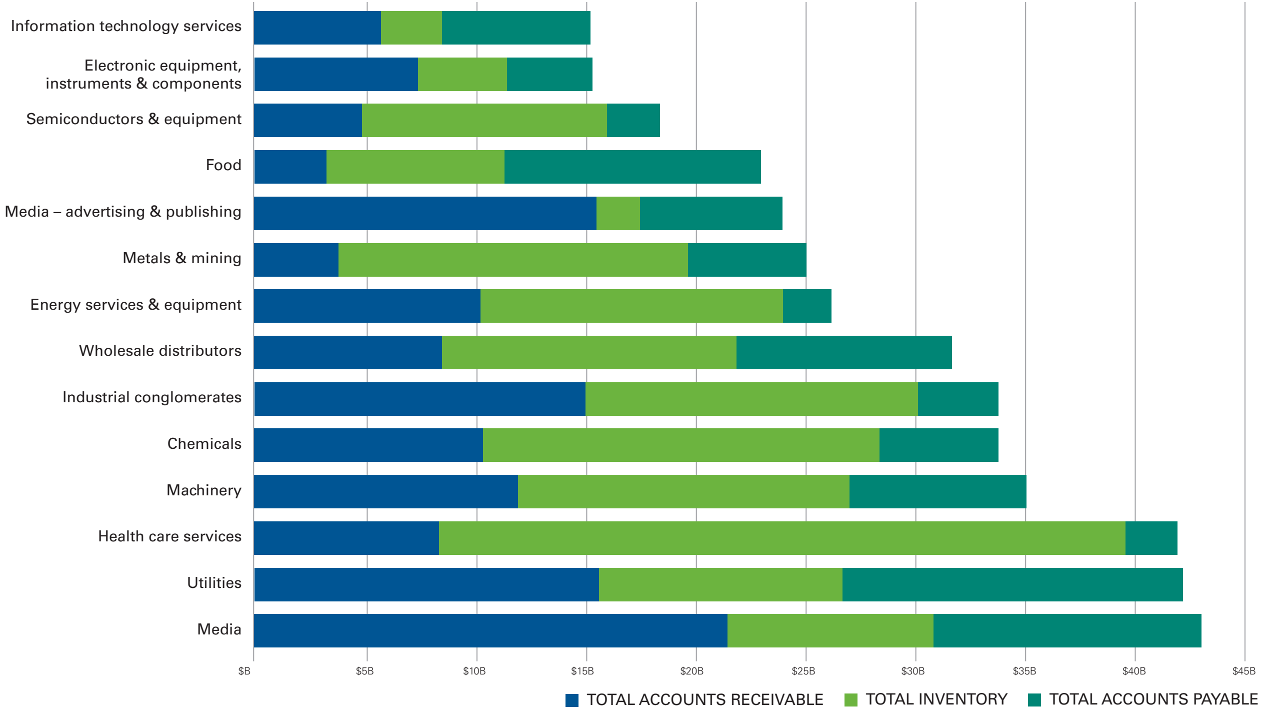
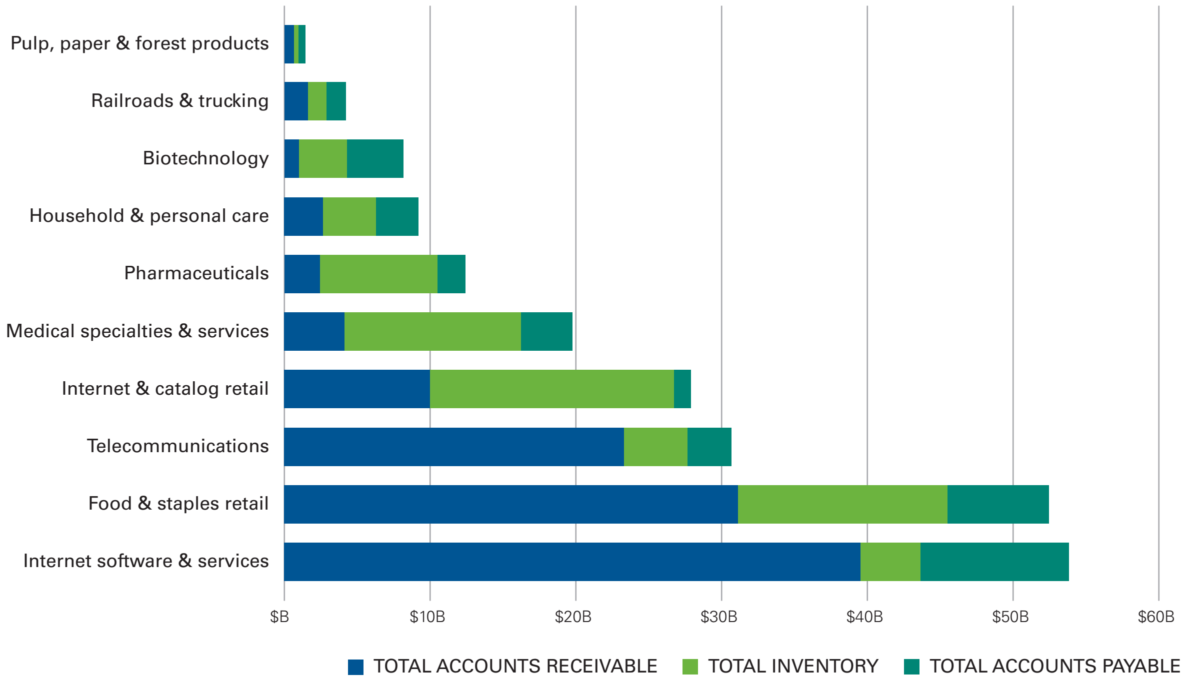


FIG. 3 Total working capital opportunity – minimally disrupted industries



Economic concerns present new issues and opportunities

Some industries with smaller working capital opportunities under normal conditions may now face significant disruption and ongoing economic uncertainty (**Fig. 1** on page 6). For example, automotive parts demand has been disrupted by consumer isolation and vehicle manufacturers' production halts. Organizations may be sitting on inventory piles with payables due, while revenue has declined, and demand may still be disrupted for months to come. Airlines have experienced a massive decline in international and domestic travel. They can mitigate the impact through reduced fuel purchase requirements and labor costs, but they must still cover accounts payable with drastically lower revenue and accounts receivable.

On the other hand, even industries that have experienced only minimal disruption may still find it necessary to address their working capital opportunities due to forward-looking challenges (**Fig. 3** on page 9). For example, while demand for medical specialties and services has increased, these organizations must be able to manage future inventory and sourcing needs as demand patterns reestablish themselves. They also face challenges in collecting accounts receivable from health care systems that may be cash deficient due to costs incurred during the COVID-19 crisis. Railroads and trucking organizations have seen revenues increase due to the need to redirect shipments of essential products and groceries. Looking ahead, though, they will need to be careful that customers are in a position to pay open balances and that accounts receivable balances do not become overdue.

Industry median benchmarks for key working capital metrics (**Fig. 4** on pages 11-13) provide further insight into your organization's specific improvement opportunity.

FIG. 4 Total working capital opportunity and median benchmarks for key metrics – by industry

Significantly Disrupted Industries	Total WC Opportunity	Total AR	Total Inventory	Total AP	Median CCC	Median DSO	Median DIO	Median DPO
Airlines	$8.2B	$2.7B	$2.6B	$2.9B	1	14	12	24
Automotive parts and aftermarket	$18.3B	$5.2B	$9.7B	$3.4B	48	54	61	68
General and specialty retail	$83.5B	$10.5B	$31.6B	$41.4B	23	6	64	46
Hotels, restaurants and recreation	$17.4B	$10.1B	$4.7B	$2.6B	13	23	13	23
Motor vehicles	$11.4B	$4.3B	$2.4B	$4.8B	-10	21	36	67
Office equipment, services and supplies	$5.3B	$2.1B	$1.7B	$1.5B	25	55	18	48
Oil and gas	$314B	$22B	$48B	$244B	-4	37	15	48
Personnel services	$3.6B	$3.0B	$.0B	$.6B	41	73	N/A	32
Travel arrangements and reservations	$1.7B	$1.3B	$.0B	$.4B	-369	67	N/A	435

Moderately Disrupted Industries	Total WC Opportunity	Total AR	Total Inventory	Total AP	Median CCC	Median DSO	Median DIO	Median DPO
Beverages	$3.9B	$.6B	$2.2B	$1.0B	-2	35	53	90
Building products	$5.1B	$1.2B	$1.9B	$2.0B	62	44	60	43
Chemicals	$33.2B	$10.2B	$17.7B	$5.3B	79	52	83	56
Commercial services	$14.8B	$9.2B	$1.9B	$3.7B	30	55	10	36
Computer hardware and peripherals	$9.7B	$2.1B	$4.4B	$3.2B	1	42	53	94
Containers and packaging	$9.6B	$2.7B	$2.0B	$4.9B	35	46	58	70
Construction materials	$1.6B	$.2B	$1.1B	$.3B	63	42	62	40
Consumer durables	$4.4B	$1.1B	$2.0B	$1.4B	45	45	75	76
Electronic equipment, instruments and components	$15.1B	$7.3B	$4.0B	$3.8B	54	68	63	77

FIG. 4 Total working capital opportunity and median benchmarks for key metrics – by industry (continued)

Moderately Disrupted Industries	Total WC Opportunity	Total AR	Total Inventory	Total AP	Median CCC	Median DSO	Median DIO	Median DPO
Electrical products	$2.7B	$1.3B	$.7B	$.7B	76	63	81	68
Engineering and construction	$5.7B	$3.9B	$.5B	$1.3B	55	92	2	40
Energy services and equipment	$25.7B	$10.1B	$13.5B	$2.2B	88	80	66	59
Food	$22.6B	$3.2B	$7.9B	$11.4B	37	21	54	38
Health care services	$41.1B	$8.2B	$30.6B	$2.3B	11	32	26	47
Homebuilding	$12.1B	$1.7B	$9.3B	$1.2B	336	7	351	21
Industrial conglomerates	$33.2B	$14.8B	$14.8B	$3.6B	77	66	85	74
Information technology services	$15.0B	$5.6B	$2.7B	$6.6B	25	60	8	44
Machinery	$34.4B	$11.8B	$14.8B	$7.9B	85	54	84	53
Media	$42.2B	$21.1B	$9.2B	$11.9B	17	42	26	52
Media – advertising and publishing	$23.5B	$15.2B	$1.9B	$6.4B	-40	93	10	143
Metals and mining	$24.6B	$3.8B	$15.6B	$5.3B	69	32	80	43
Pulp, paper and forest products	$1.4B	$.6B	$.3B	$.5B	57	27	56	26
Railroads and trucking	$4.2B	$1.6B	$1.3B	$1.3B	17	41	6	31
Recreational products	$6.2B	$2.6B	$2.0B	$1.6B	71	43	66	38
Semiconductors and equipment	$18.1B	$4.8B	$10.9B	$2.3B	118	48	130	60
Telecommunications equipment	$7.8B	$1.4B	$2.7B	$3.6B	-63	33	19	115
Textiles, apparel and footwear	$4.2B	$1.3B	$2.3B	$.6B	108	40	138	71
Tobacco	$8.7B	$2.6B	$5.8B	$.3B	247	22	288	64
Utilities	$41.4B	$15.4B	$10.9B	$15.2B	15	48	37	70
Wholesale distributors	$31.1B	$8.4B	$13.1B	$9.6B	43	35	43	35

FIG. 4 Total working capital opportunity and median benchmarks for key metrics – by industry (continued)

Minimally Disrupted Industries	Total WC Opportunity	Total AR	Total Inventory	Total AP	Median CCC	Median DSO	Median DIO	Median DPO
Biotechnology	$8.2B	$1.0B	$3.3B	$3.9B	151	57	213	119
Food and staples retail	$52.6B	$31.2B	$14.4B	$7.0B	12	18	36	42
Household and personal care	$9.2B	$2.7B	$3.6B	$2.9B	3	34	80	111
Internet and catalog retail	$28.0B	$10.0B	$16.8B	$1.2B	-33	21	48	102
Internet software and services	$54.0B	$39.7B	$4.1B	$10.2B	22	67	15	59
Medical specialties and services	$19.8B	$4.1B	$12.2B	$3.5B	112	65	101	53
Pharmaceuticals	$12.4B	$2.4B	$8.1B	$1.9B	133	62	202	131
Pulp, paper and forest products	$1.4B	$.6B	$.3B	$.5B	57	27	56	26
Railroads and trucking	$4.2B	$1.6B	$1.3B	$1.3B	17	41	6	31
Telecommunications	$30.8B	$23.4B	$4.4B	$3.0B	-19	59	10	89

WC = working capital, AR = accounts receivable, AP = accounts payable, CCC = cash conversion cycle, DSO = days sales outstanding, DIO = days inventory outstanding, DPO = days payable outstanding

Here's how:

A well-designed program can free up cash for weathering economic turbulence over the next several quarters. It can also help instill sustainable working capital practices that benefit the organization – including optimizing cash needed for strategic growth – over years, not just months. **Fig. 5** outlines a practical series of high-impact activities for rapidly releasing cash tied up in working capital and maximizing current credit and financing opportunities to further build cash reserves.

FIG. 5 Rapid cash release framework

Baseline position – cash visibility

Collect transactional data to baseline against peers and measure term performance

- Review and assess interest rate impacts, including adjustment to cash vs. cost strategy
- Benchmark terms by supplier spend and customer category to measure performance
- Review customer and supplier risk profiles/ creditworthiness
- Perform segmentation across payables, receivables and inventory
- Conduct rapid inventory review (e.g., excess inventories by stock keeping unit and slow-moving and obsolete inventories)

2 weeks

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Map and gap – define the targets

Identify priority payments and critical suppliers, customers, and drivers – map the financing leverage

- Evaluate debt, assess capital structure and model financing/interest scenarios
- Map financing solutions (debt factoring) and supply chain financing options
- Evaluate credit terms – negotiate the best reasonable terms
- Map business-critical suppliers for priority payments
- Quantify inventory cash drivers, including inflated buffer stocks, demand plan error and slow-moving inventories
- Model immediate trade-offs and possible negotiation tactics to accelerate payments

2 weeks

+

Execute the plan – pull the levers

Launch cross-functional team to execute near-term and midterm cash conversion cycle goals

- Launch teams to halt terms leakage, resolution of high-value unbilled receivables and invoice disputes to drive immediate payment
- Accelerate funding and liquidity products to achieve strategic goals
- Develop daily forecast and visibility by understanding variance analysis across business line/product by geography
- Establish team rhythm to continuously monitor accounts

2 weeks

About the authors

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Craig Bailey has 20 years of industry and consulting experience, with an emphasis on working capital and supply chain optimization across five continents. Craig has particular expertise in opportunity identification, global process redesign, cross-functional training and change management. Before joining The Hackett Group, he held supply chain positions at Nestle, IBM, and Sara Lee.

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Over the past 20 years, Sean Kracklauer has advised Global 1000 businesses on strategy, organizational structure and process redesign. He has worked extensively in finance strategy, business performance management, planning and budgeting, financial reporting compliance, and functional design for business intelligence systems. His fields of expertise include leading large-scale cross-functional projects to improve the effectiveness and efficiency of general and administrative service delivery by identifying the optimal strategy, structure, sourcing and enabling technologies to achieve business objectives. Sean has served clients, with revenue from $5 million to over $100 billion, in the financial services, technology, pharmaceutical, telecommunications, energy, health care, retailing, consumer packaged goods, software, broadcasting and manufacturing sectors.

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