

Cash for growth

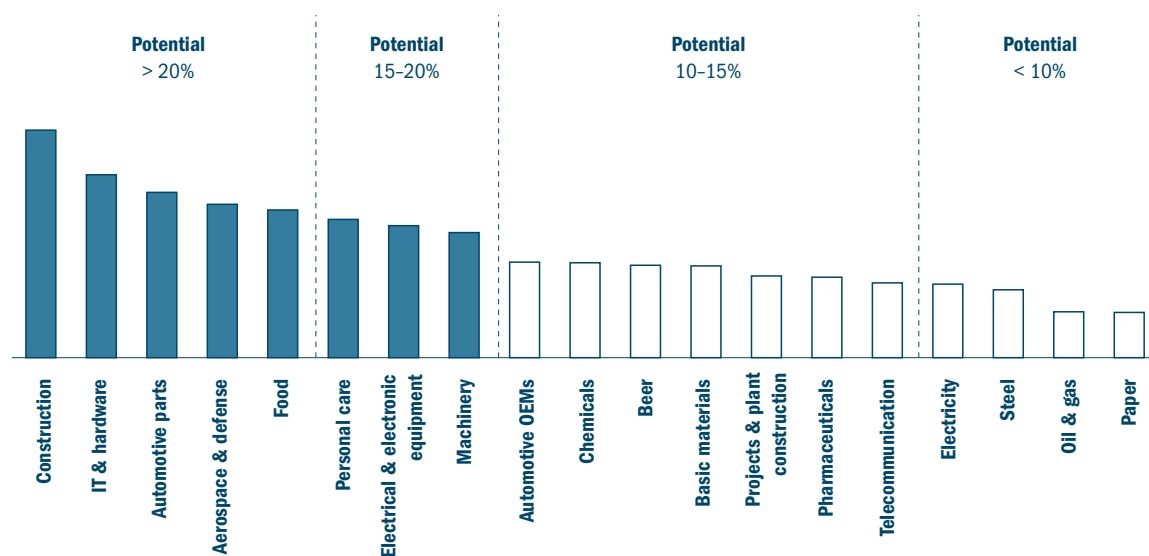
How to unleash hidden potential in your company

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Figure 1: Opportunities in all industries

Cash realization potential by industry
[% of operating capital employed]



A period of fresh growth is on Europe's horizon. At long last, the economy is on the upswing again. Companies are busy devising the next wave of growth strategies and seeking new opportunities. Growth means additional value creation – but it also requires investment.

External funding is harder to come by these days: "Basel II" has further tightened capital adequacy rules, and capital injections from the financial markets and IPOs are constrained by a nervous stock exchange. So the question on everyone's mind is how to finance the next wave of growth.

A recent Roland Berger study gives a clear answer: **Unlock hidden cash reserves in your balance sheet – now!**

Study by Roland Berger reveals potential of more than EUR 400 billion in top European industrial companies

We found major improvement levers in fixed and current assets (see study approach). The study revealed overall potential in excess of EUR 400 billion for the companies surveyed. About 20 percent of this amount is tied up in inventories, one third in receivables and payables, and roughly half in fixed assets.

Based on Roland Berger's experience in realizing cash for growth, about half of the overall potential, or EUR 210 billion, can be realized fast, depending on the general framework and within given ranges.

We estimate that about 60 percent of this short-term potential is in receivables and payables, 25 percent in inventories, and 15 percent in fixed assets. Very ambitious companies aim to realize up to 80 percent of the total potential identified.

Two main levers to unleash potential

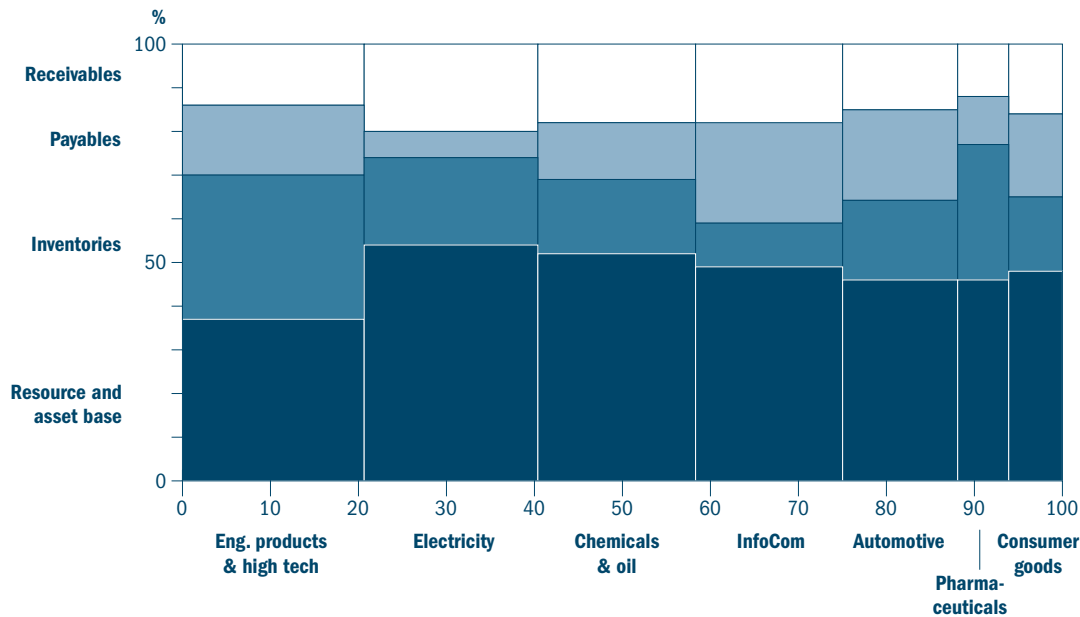
According to our findings, the best companies in each industry need up to 10 times less cash than the laggards of the same industry. A closer look at their business practices reveals two main levers:

- (1) Improving the overall relationship with business partners**
- (2) Optimizing the resource and asset base –**
in particular its regional structure and the relationship between internal and external value creation

The importance and impact of these levers varies by industry. Inventories are still a significant source of cash for growth in industries like pharmaceuticals as well as chemicals and oil. Due to the highly diverse supply and demand base, the greatest potential for optimizing receivables and payables lies in the engineered products industry. Focusing on the resource and asset base in automotive, consumer goods and pharmaceuticals seems to pay off. Companies in these industries are the leaders in asset productivity.

1. Business relationships: Manage interfaces tightly
As the study revealed, there is a EUR 130 billion

Figure 2: Realigning the corporate asset base offers the greatest potential for improvement



reserve in receivables and payables and an additional EUR 80 billion in inventories locked within the companies surveyed. This total potential is linked to less than optimal relationships between companies and their suppliers and customers.

Receivables and payables are usually considered a boring CFO task – so operational managers tend to stay out of it and do not focus enough on cash management. There are four things companies can do to immediately unleash the cash potential in their receivables:

- > Apply rigorous value-based management with a clear focus on the cost of capital and refinancing in customer and supplier relations
- > Structure payment terms and ensure compliance
- > Improve collection processes
- > Introduce comprehensive credit risk management

Several innovative industries have developed highly efficient processes for tight cash management throughout the value chain – some even manage to have their services paid for before actual delivery. The computer manufacturing industry offers a well-known example of successful receivables, payables and inventory management throughout the value chain. Dell beats all competitors when it comes to asset productivity (see figure 3). How is this possible? The company has initiated a whole range of operational actions (such as product standardization and customer behavior management) and uses innovative operating models (such as online sales,

extended contract manufacturing and private label sourcing). Furthermore, Dell is a real master of its value chain and allows its key business partners to benefit from its own efficiency (through lower inventories and a better receivables position).

The other area that still needs improvement is supply chain management and inventory control, where our study revealed cash potential of approximately EUR 80 billion. One of the basic problems is that uncertainty leads companies to build up excessive inventory buffers – thus preventing an optimal balance of raw materials, work in progress and finished goods. Aligning the supply and demand sides to the same objectives is still a challenge for most companies. Often, it is not only the companies themselves who create these buffers, but also their business partners – who face the same uncertainties.

Improving the distribution structure and optimizing the overall supply chain processes and organization will impact both corporate balance sheets and profit and loss statements, as the cost of insurance, handling and storage is reduced. These additional effects can double the actual cash reserve.

A core prerequisite for all measures described here – both in receivables and inventories – is an open trust-based relationship with business partners focused on the same performance-boosting actions and targets. These are the key elements of building the mutually beneficial business relationship that we identified in

Figure 3: Improving performance through best practices throughout the value chain

Asset allocation, Dell vs. peer

[EUR locked assets/EUR revenue]

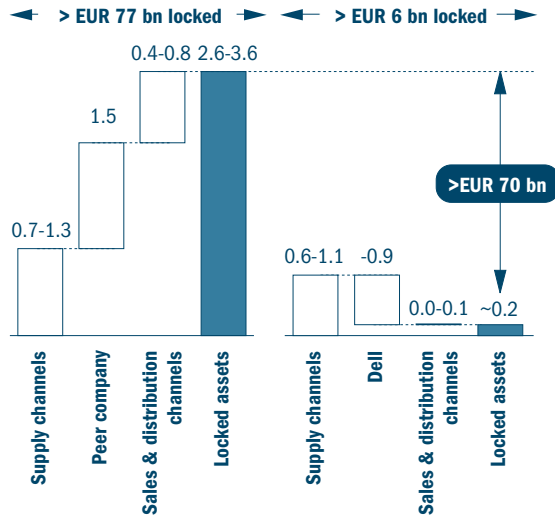
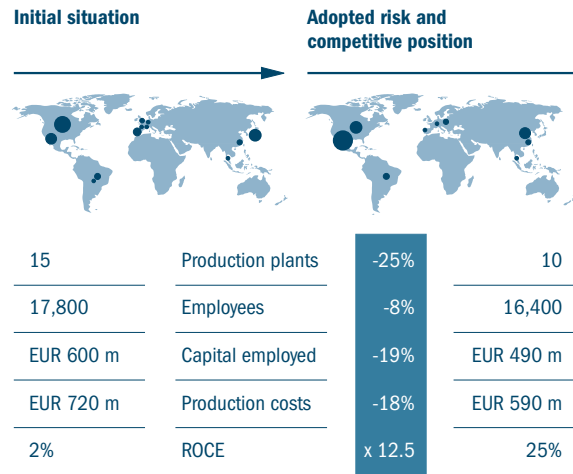


Figure 4: Realigning the asset base and optimizing the value chain position boosted ROCE to 25%



our study:

- > Set up a comprehensive approach including planning, materials and receivables/payables management – which usually means involving at least four business functions: planning, production, procurement and finance
- > Identify clear benefits of the relationship for all partners involved
- > Put one person in charge of all matters relating to a given business partner

Recently, several innovative concepts have emerged, such as collaborative engineering and collaborative planning. While they do point in the right direction, the key challenge lies in rigorous implementation and a clear focus on the key performance levers.

2. Asset base: Redefine your footprint

Fixed assets proved to be the area with the greatest improvement potential – EUR 190 billion in total. By far the largest share of this potential lies in companies' regional structures. European companies are still somewhat reluctant to deal with this topic – but sooner or later there will be no way around it, unless they want to risk falling behind. No global European player can serve its international customer base and markets from its European headquarters.

Often the required transformation lags significantly behind the growth momentum in new markets, which leads to inefficiencies and loss of market position. The same is true for the value chain

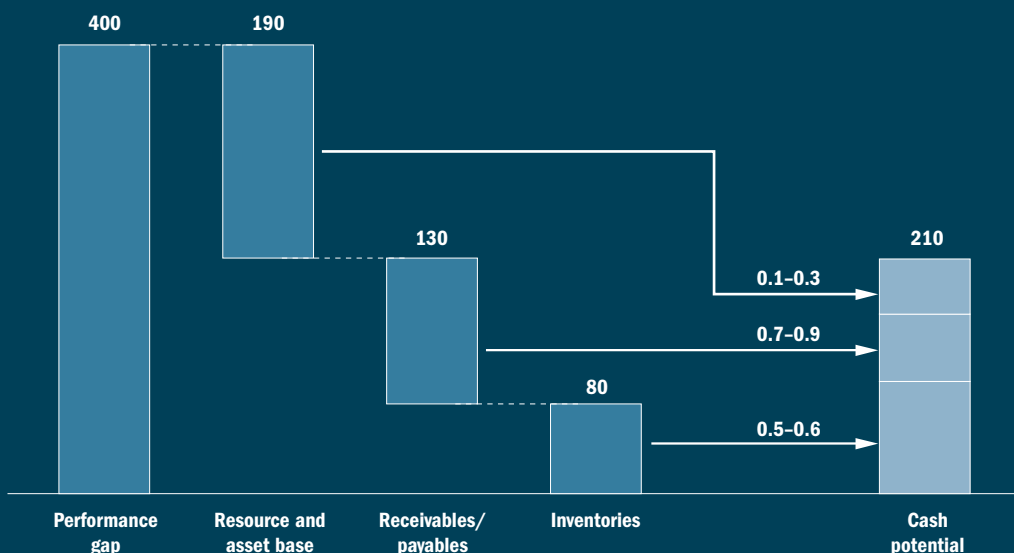
perspective that companies take when considering footprint options. Leaders consider the entire value chain – including value created by other companies.

Roland Berger recently supported a global automotive supplier in recasting its entire value chain. By realigning the current resource and asset base to the business structure as forecast up until 2008 and beyond, the company was able to increase its ROCE (return on capital employed) from 2 percent to 25 percent (see figure 4). The realignment was based on a comprehensive study of the market dynamics of the current and future customer and supply base, including emerging markets and possible competitor moves. We assessed external factors such as regional competitiveness in manufacturing, engineering and service functions, as well as internal factors such as the existing skills base, asset structures and manpower structure. While companies are adjusting their manufacturing, engineering and administrative footprint, they must design a transformation roadmap that considers interfaces and additional coordination efforts.

Companies must regularly review their footprint – rather than seeing it as a one-time event – since the pros and cons of locations change over time, as do the specific challenges to individual industries. One trend, however, is emerging: while higher-value jobs (e.g. in R&D) are still retained in Europe, jobs that require lesser qualifications tend to migrate to other regions.

To unleash hidden potential, fundamental change is essential

Cash realization potential [EUR bn]



Operational asset performance: The RBSC study approach

The operational asset performance study was designed jointly with Prof. Larry Weiss of HEC, University of Lausanne. It covered more than 200 European industrial companies from 19 industries in seven industry clusters: automotive, chemicals & oil, consumer goods & retail, engineered products & high tech, telecom & IT, pharmaceuticals & medical devices, utilities.

Based on publicly available company information as well as input from Roland Berger experts, the study focused on those parts of the capital employed that are closely linked with operational processes and practices. We adjusted the traditional definition of capital employed by excluding non-operational balance sheet items like goodwill, financial and intangible assets. The companies analyzed in our study represent about EUR 1,500 billion in operating capital with sales of about EUR 3,000 billion – or roughly one third of Western Europe's GDP.

The average cash realization potential corresponds to 18 percent of the total operating capital employed in the companies surveyed. These findings apply to virtually all industry groups observed (see figure above). Closing the entire gap would lead to an average increase in operating ROCE of almost 20 percent.

Three areas are particularly interesting when analyzing corporate balance sheets for possible operational measures:

- > Inventories
- > Receivables and payables
- > Net fixed assets

We used a combination of our comprehensive industry expertise and benchmarks to determine the improvement potential in each of the three areas for the companies surveyed. However, rather than comparing them against an individual optimum, we used the 25th percentile in each industry sample as the key parameter for comparison. By further eliminating individual extremes, we derived a comparable sample for each industry.

Finally, based on input from our industry experts and our client base, we considered industry-specific boundaries that would either allow for a more aggressive or more conservative setting of the different improvement levers. These factors were then applied to the initial quantitative results of the survey. The final result was overall potential of EUR 400 billion.

Roland Berger's Cash for Growth Navigator supports plans for concrete actions






Cash for Growth Navigator – example

Cash check

Operating cash profile	
DOS:	54
Payment terms:	22
Inventory days: RM	10
FG/WIP	46
Asset turnover:	1.7
Asset base:	39%

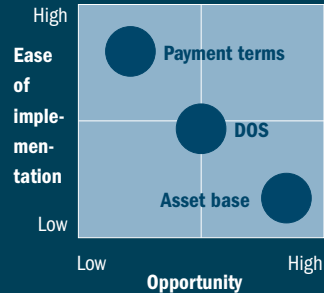
Benchmark	
DOS:	46
Payment terms:	42
Inventory days: RM	10
FG/WIP	45
Asset turnover:	2.3
Asset base:	31%

Process check

Excellence check	
DOS:	
Payment terms:	
Inventory days: RM	
WIP	
FG	
Asset base:	

Process check	
SC planning	✓
Warehousing	✓
VMI	✓
Supplier mgt.	x ⚡
Supplier coll.	✓
F&A	x ⚡

Cash opportunities



Cash for Growth Navigator: New RBSC tool helps companies unlock their reserves

What is a company's total cash potential? How much of it can be exploited at short notice? Where are hidden reserves? Analyzing financial statements with internal performance indicators is not enough. Companies need objective benchmarks to assess their total cash potential and estimate the prospects for implementation. The RBSC Cash for Growth Navigator helps companies identify and tap into internal sources of finance.

Our approach: Compare the cash profile (according to the relevant items in your financial statements) against leading companies in the relevant industry or segment. This excellence check will produce an initial estimate of the "gap potential".

Based on a process check, we will also take a close look at the quality of the relevant operating processes. This highlights the boundaries and conditions required to realize the potential, and shows what changes need to be initiated. Roland Berger Strategy Consultants is an expert in implementing the required change processes. We help create a valid information basis, fundamentally redesign operating models, realign internal processes and optimize supplier and customer interfaces. Clients also benefit from our expertise in enterprise footprint optimization (including manufacturing, engineering,

administration and services), our holistic cost approach (including total cost to serve and innovate) and our experience in coordinating complex interfaces.

In short

There is tremendous potential. A quick start will enable companies to fully benefit from the upcoming recovery.

- > Analyze the company's performance gap carefully
- > Understand the key drivers behind the gap
- > Compare operating models against leading-edge practices in and especially outside the industry
- > Prepare to adjust the business model by designing leading-edge operating models
- > Optimize cash generation to manage the trade-off between speed and realization rate

For further information e-mail:
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