

# *Cash for Change*

## Working Capital Trends in the Automotive Sector

2017/18





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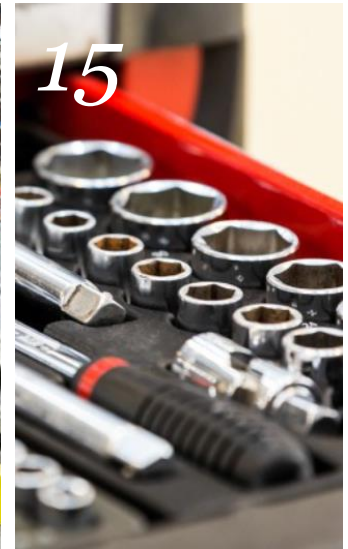
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## *Preface*



***Felix Kuhnert***  
Partner,  
Global Automotive  
Leader

The year 2017 was yet another record year for the global automotive industry, although total production growth was hampered by weakness in the US and China. Still, on the back of record sales for the leading manufacturers, revenues and liquidity flowed satisfactorily on the OEM level, leading to an overall softening of working capital indicators – while suppliers kept their controls tight and continued to improve financial efficiency. Most saliently, DIO performance decreased four days for OEMs, while the non-OEM sector remained stable.

The automotive industry – especially with their OEMs - is still one of the leading sectors when it comes to NWC days. However, negotiating power in payment targets and conditions leads to significant differences in the performance of automotive companies. This gets especially visible if you look at Tier-1 suppliers that are directly serving OEMs. In the downstream sector – such as wholesale of spare parts – on the other hand, companies regularly operate with negative working capital due to their smart leveraging of negotiating power towards their suppliers and customers.

We hope that you will find this report insightful and practical for your daily operations. We would be happy to provide you with any additional information and discuss the topic further with you.

**€215bn**

of cash is tied up in the balance sheets of selected automotive companies



**OEM performance deteriorated**

year on year (YoY) by 11% leading to a marginal deterioration of 2% over a five year horizon



**Non-OEM performance improved**

year on year (YoY) by 2% continuing the trend of the last years and resulting in a five year improvement of 8%



**Both OEMs & Non-OEM** have seen deterioration in **DSO**



**DIO** performance has deteriorated for **OEM by 4 days compared to stable DIO performance for Non-OEM**



For both OEM and Non-OEM **DPO** Performance has improved by a **stretch in payables**



**9 out of 15 OEM** have seen improvement in NWC days since 2012

**Finance functions**

spend only 24% of time on insight generating activities and could do more to help the Business understand the cash impact of operational and commercial decisions



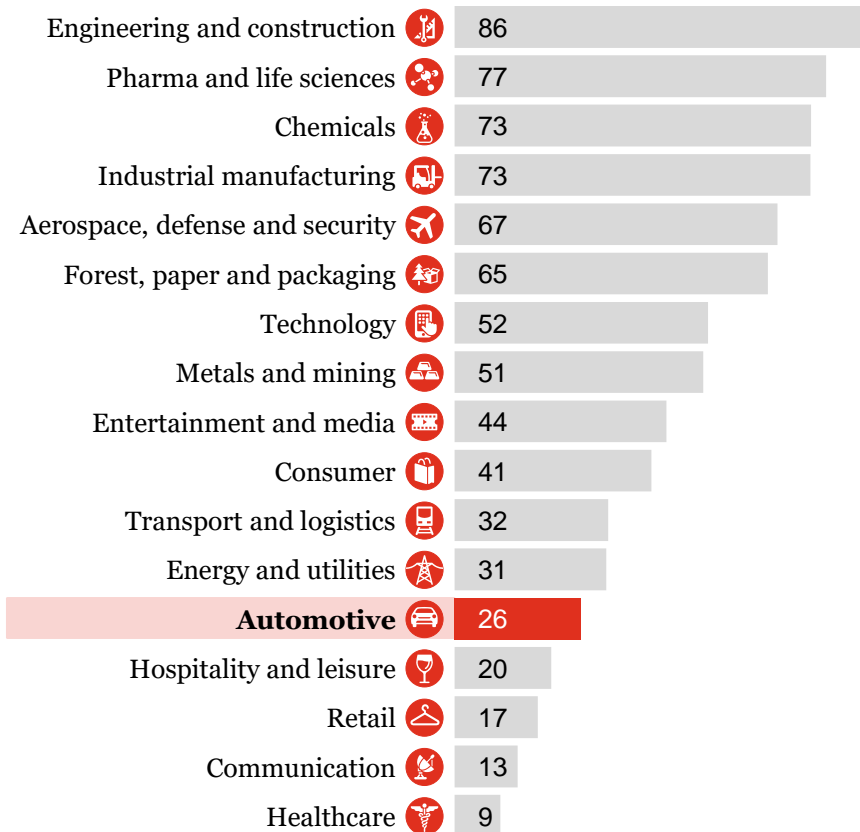
**Overall NWC performance deteriorated**

year on year (YoY) by 1 day driven by the OEM working capital performance deterioration

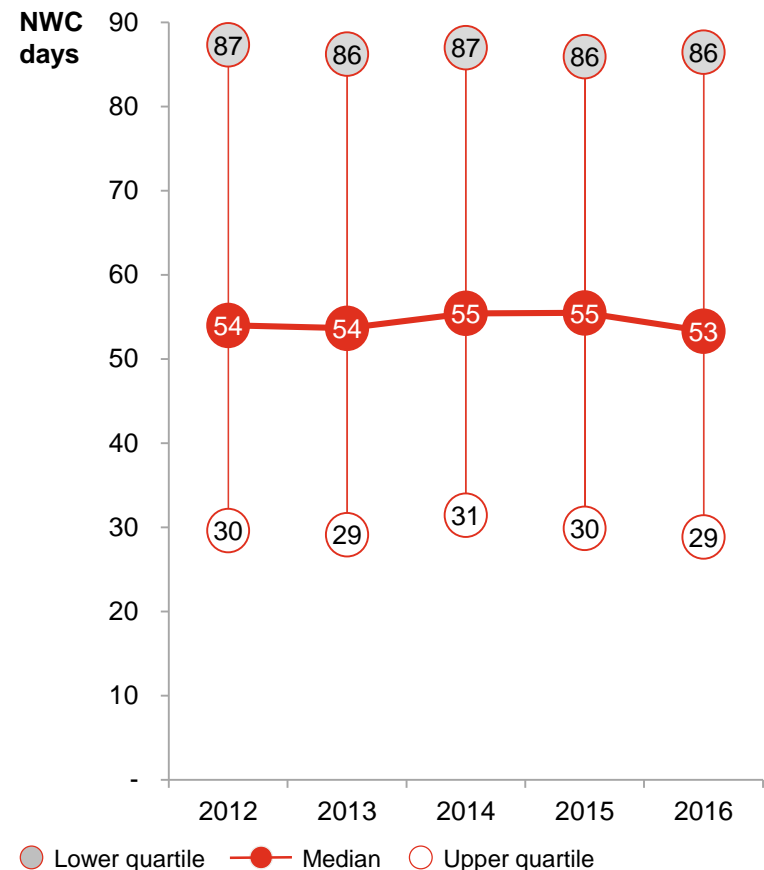


# Despite positive working capital trends in the last years, recent deteriorating working capital performance leads to €215 billion in cash being tied up on the balance sheets

## 2016 average NWC days per sector

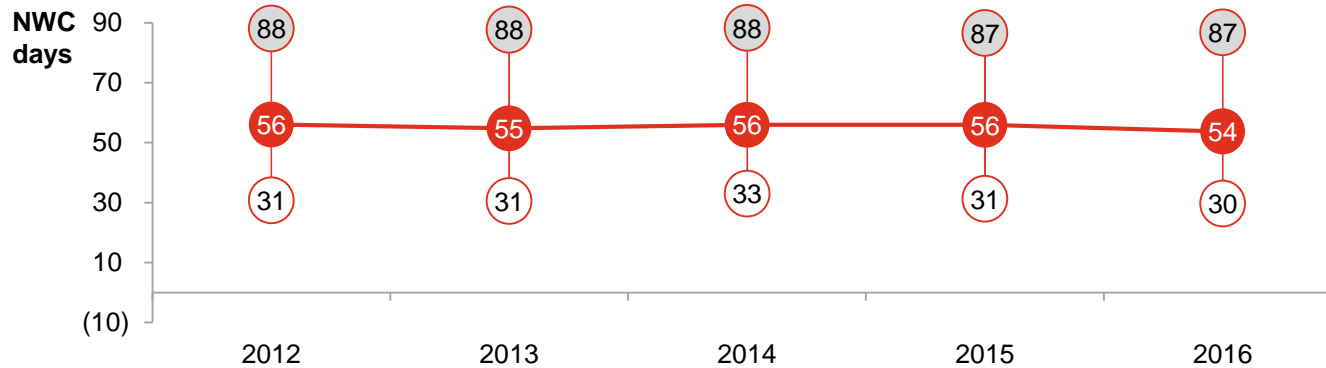


## Overall WCM Quartile and Median Performance

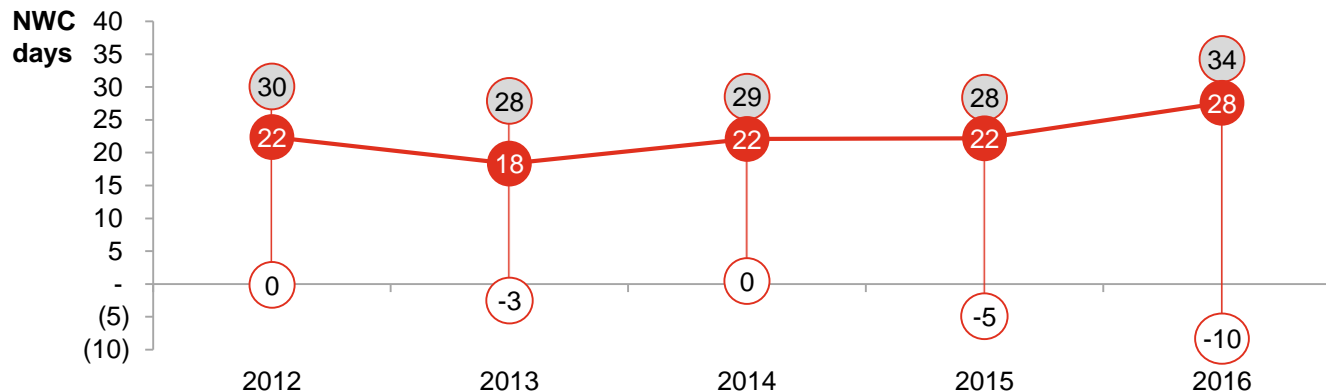


***OEM companies show a deteriorating working capital performance trend whereas non-OEM have improved their performance over the last years. Still, each area has cash tied up, €84bn for OEM and €131bn for non-OEM***

***Non-OEM***



***OEM***



● Lower quartile ● Median ○ Upper quartile

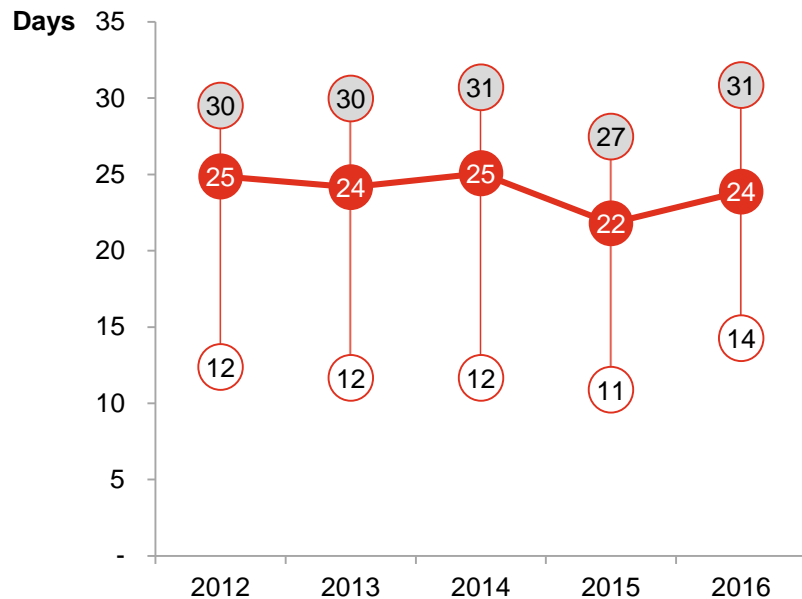
***There are big differences between OEM and Non-OEM and also within the two groups.***

The discrepancy between OEM and non-OEM (automotive suppliers) is partly driven by different business models and customers served but also fundamental differences in the management focus on cash and working capital.

We have identified a deterioration in the OEM sector of close to 11% compared to last year, whereas the non-OEM group improved by 2% over the same time period.

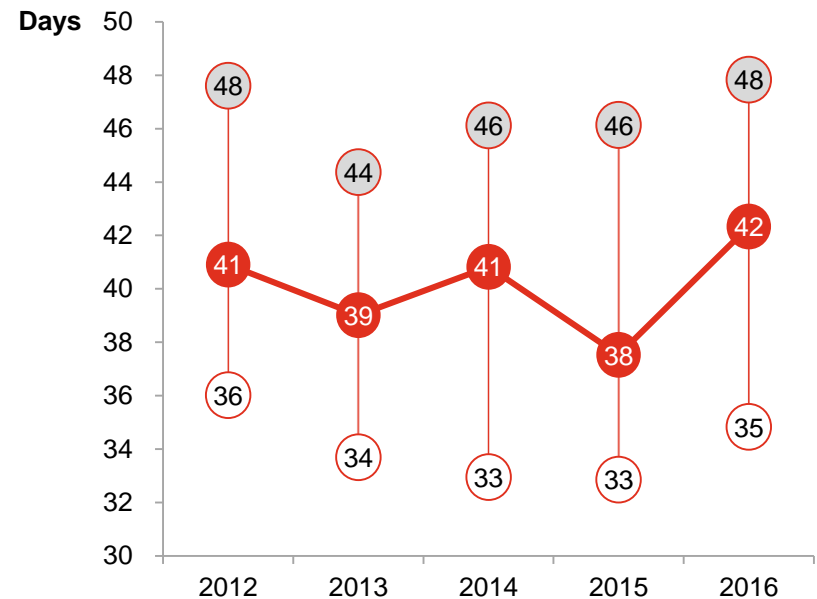
## OEM's deteriorating working capital performance is mainly driven by increasing DSO and DIO levels...

**OEM – DSO Trend**



**DSO improved marginally** between 2012 and 2015 partially through improved receivables management in the field of joint ventures and strategic alliances. However this improved level could not be maintained and **DSO has deteriorated by 8%** compared to last year.

**OEM – DIO Trend**



After slight improvements in the past, **DIO levels have increased in the last year** by 9%, leading to a 5-year-high in DIO levels.

This indicates that initial successful DIO reductions were not sustainable and good working capital management practices are hard to maintain and require constant effort and focus.

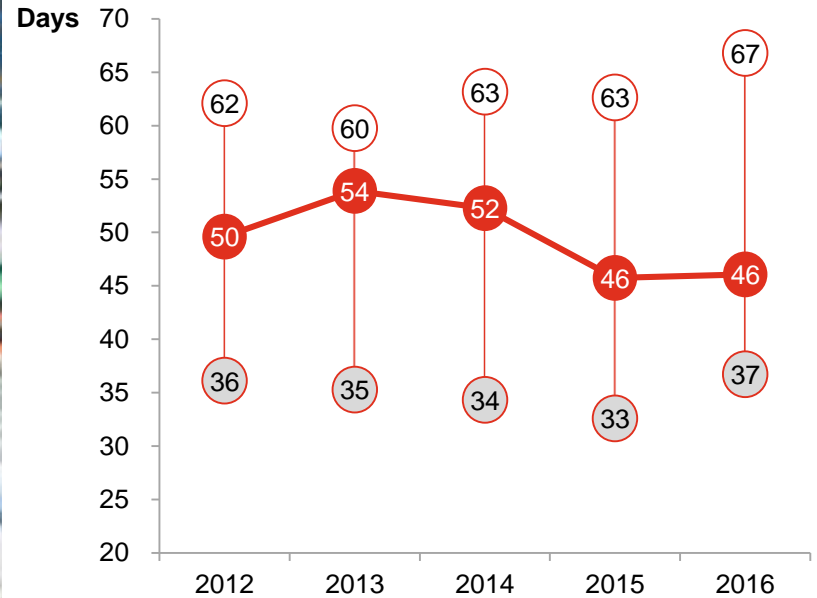
● Lower quartile ● Median ○ Upper quartile



... resulting in more than €84bn in cash tied up



### OEM – DPO Trend



**DPO has increased** by 8% compared to last year's performance. Whilst the median performance is fairly stable, the upper and lower quartile's performance increased last year.

In these areas continued spend consolidation and the use of financial instruments like supply chain finance have contributed to higher performance levels.

# There is a significant gap in DSO between the different categories of Non-OEM companies, with body and interior suppliers achieving the best DSO levels...

## Observations/drivers for working capital performance:



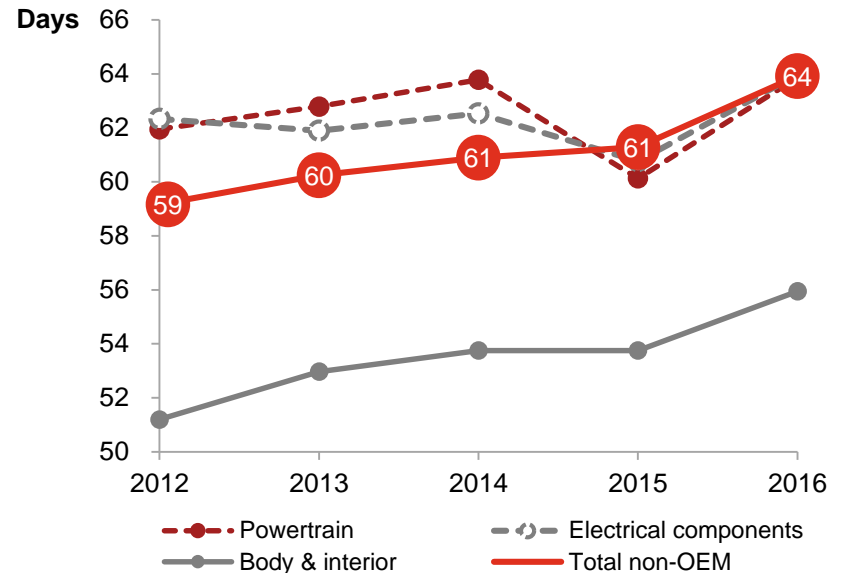
Automotive suppliers' working capital performance depends on product footprint, regional set up and the level of collaboration with OEM.

Inventory is the area with the largest spread between the supplier segments caused by a different set-up of the supply chain, varying footprints as well as the dependency of the OEM.



Many suppliers have reported actions in the area of working capital management, especially in the area of billing and cash collection, supplier payment terms, and supply chain efficiency.

## Non-OEM DSO performance 2012 - 16

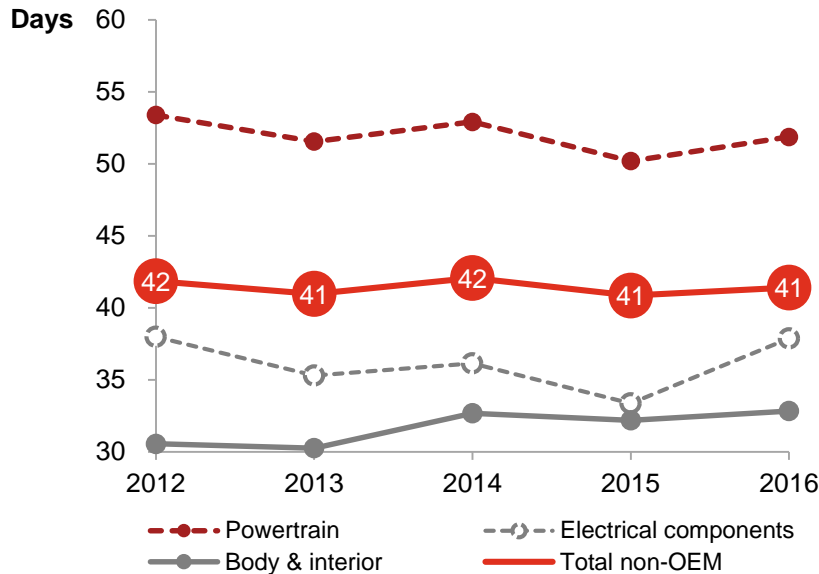


**Gap between body and interior and other suppliers.** There is a discrepancy between body and interior and other suppliers for all working capital areas with the largest one on the receivables side, with a delta of 8 days compared with all non-OEM companies.

**The general DSO performance deteriorated to 64 days.** In line with the positive DPO development at OEM level the non-OEM DSO levels are deteriorating – the fairly constant performance of the past four years could not be maintained.

**... whereas the Non-OEM DIO and DPO trends show a wider range of performances resulting in more than €131bn being tied up**

**Non-OEM DIO performance 2012 - 16**

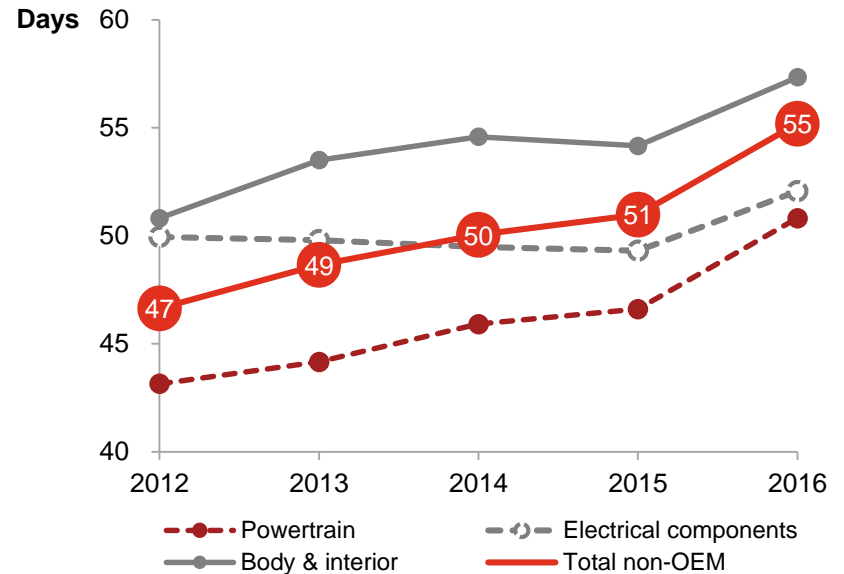


**Converging performance**

Besides a deterioration for electrical components the overall Non-OEM group shows a constant DIO performance around 41 days.

The marginally positive reduction of the past couple of years could be maintained. Key drivers in this area are more upstream and downstream collaboration in demand forecasting, better process coordination, and global sourcing optimisation.

**Non-OEM DPO performance 2012 - 16**



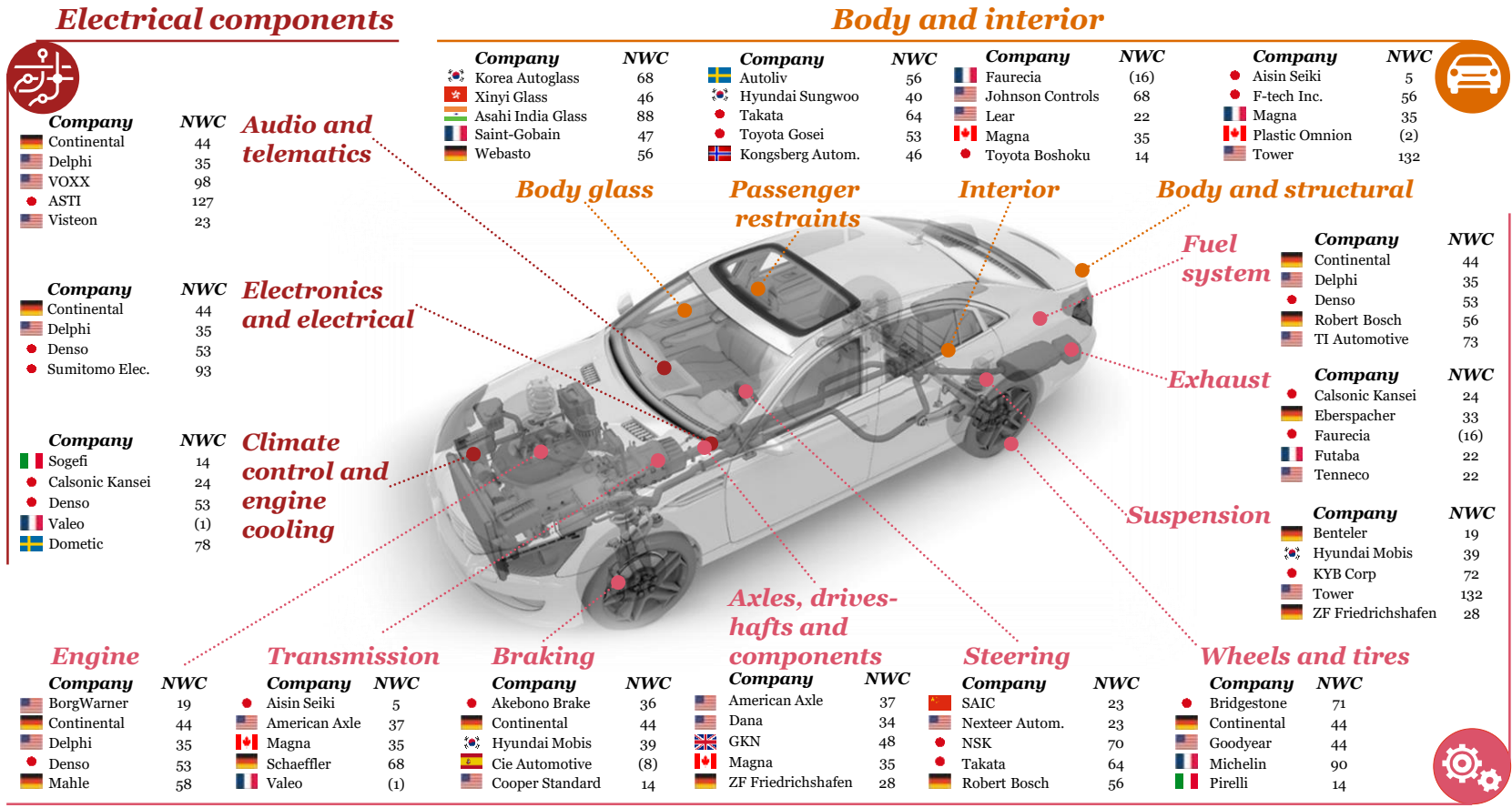
**Top non-OEM are DPO leaders**

Focus on procurement and working capital management has benefitted all segments over the past five years.

As a result, 2016 levels show a strong increase by 18% compared to performance levels of 2012.

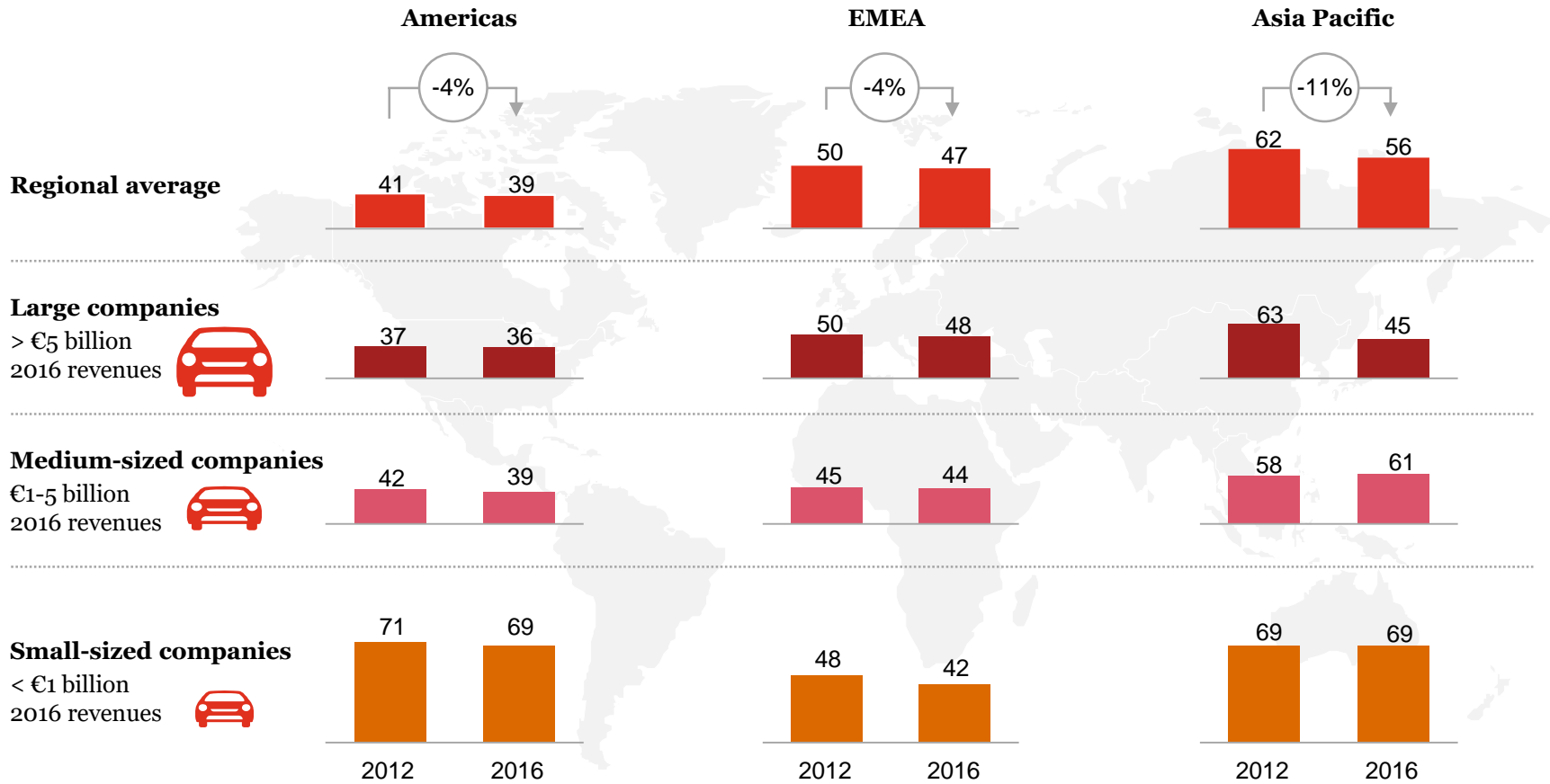
Key drivers for the recent improvements are spend consolidation, supply chain streamlining, and global sourcing programs.

# There are significant differences between – and even within – different automotive supplier segments



# Size generally affects Non-OEM's average NWC days position but regional influence has a bigger impact

## Evolution of Non-OEM suppliers' NWC days 2012 - 16



# The role of the finance teams in working capital management

Only **24% of finance time** is spent on insight-generating activities



## How leading finance functions are pulling ahead:

- 1 Building a clear role for business partners with the right skills to impact business decisions.
- 2 Investing in emerging technologies (e.g. data analytics, tailored collections pathways and robotic process automation).
- 3 Driving behaviour and cultural change across the organisation.
- 4 Driving large scale business transformation based upon sound financial analysis and measurable benefits.

The finance function traditionally plays a central role in the coordination of working capital management. In fact, businesses often place an overreliance on finance to solve working capital problems when many of the underlying drivers are operational rather than financial.

Working capital management is a broad topic with commercial and supply chain touchpoints where the value of cash is not always front of mind. Finance has a big role to play in helping the business to make good decisions in the midst of often competing financial

objectives and incentives. The reason that organisations turn to finance to play this central role is that often it's the finance team who are responsible for sourcing, validating and analysing the disparate data sets and inputs to this complex process.

The role of the new breed of finance business partner needs to focus on business outcomes. Working capital improvement is one area where positive business outcomes can really benefit the organisation and the finance team can help cross functional stakeholders to understand the cash impact of commercial and operational decisions.

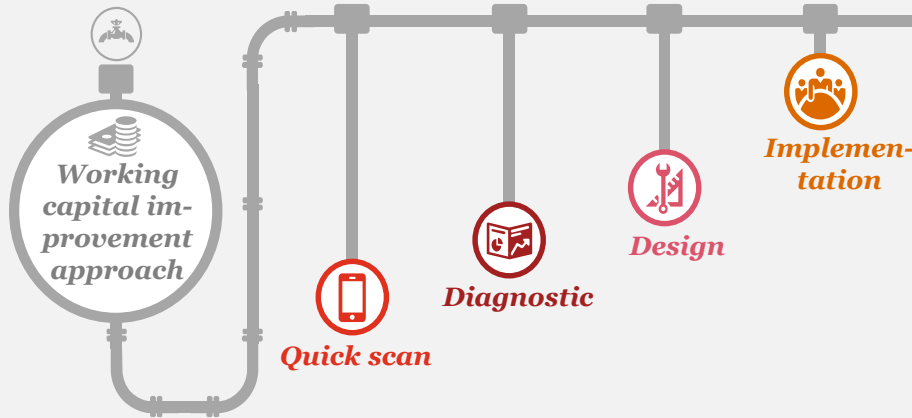
### Stepping up:

How finance functions are transforming to drive business results.

In our 2017 Finance benchmarking study we saw that less than a quarter of finance time is spent on delivering business insight. In order to help different functions to manage complex trade offs and identify improvement opportunities less time needs to be spent on transactional work, such as sourcing and reconciling data and more on these value adding tasks, including analysing data in order to generate actionable business insights.

To overcome this challenge our clients are investing in emerging technologies to increase process efficiency, upskilling business partners and driving behavioural change across the business.

# How we can support you



## We help our clients to deliver the following outcomes:

- Identification and realisation of cash and cost benefits across the end to end value chain.
- Optimised operational processes that underpin the working capital cycle.
- Digital working capital solution and data analytics.
- Rapid cash conservation in crisis situations.
- “Cash culture” and upskilled organisation through our working capital academy.
- Roll-out trade and supply chain financing solutions.

## Examples of areas where PwC could help you to release cash from working capital:

<b>Accounts receivable</b>	<ul style="list-style-type: none"> <li>• Tailored, proactive collections</li> <li>• Credit risk policies</li> <li>• Aligned and optimised customer terms</li> <li>• Billing timeliness &amp; quality</li> <li>• Contract &amp; milestone management</li> </ul>	<ul style="list-style-type: none"> <li>• Systematic dispute resolution</li> <li>• Dispute root cause elimination</li> <li>• Alternative B2B Collection approaches</li> <li>• New players with pre-payment terms</li> </ul>
<b>Inventory</b>	<ul style="list-style-type: none"> <li>• Lean &amp; agile supply chain strategies</li> <li>• Global coordination</li> <li>• Forecasting techniques</li> <li>• Production planning</li> <li>• Inventory tracking</li> <li>• Balancing cost, cash and</li> </ul>	<ul style="list-style-type: none"> <li>• service level considerations</li> <li>• Inventory parameters &amp; controls defining target stock</li> <li>• Inventory build up due to new technologies (e.g. Batteries)</li> </ul>
<b>Accounts payable</b>	<ul style="list-style-type: none"> <li>• Consolidated spending</li> <li>• Increased control with centre-led procurement</li> <li>• Avoid leakage with purchasing channels</li> <li>• Payment terms</li> <li>• Supply chain finance benefits assessment &amp;</li> </ul>	<ul style="list-style-type: none"> <li>• implementation</li> <li>• Payment methods</li> <li>• Eradicate early payments</li> <li>• Supply chain finance</li> <li>• Payment methods and frequency</li> </ul>

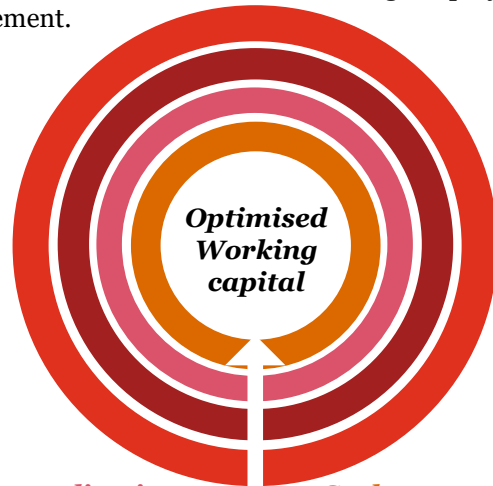
# Our approach to sustainable working capital

## Change management

Establish a more cash-focused culture that is able to sustain the higher levels of performance and drive continuous improvement.

## Stakeholder management

Ensure that key stakeholders remain engaged during the project.



## Benefits realisation

Ensure that cash generation objectives are achieved and maintained.

## Cash management

Ensure effective utilisation and forecasting of cash.

**We supplement our working capital and cash management methodologies with core consulting approaches to make sure that improvements are tangible and sustainable.**

## Case study:

### **Global Supply Chain Finance roll-out and implementation for Tier 1 Automotive Supplier**

#### **The key issue**

The customer is a global automotive supplier with 11.8 billion of sales and 81,800 employees. With 136 production sites in 29 countries all over the world he was looking for an advisor to implement a global SCF-program. To ensure a successful global roll-out individual regional challenges and restrictions had to be considered and solved.

#### **How we helped**

Following the selection of banking and the design of Supply Chain Finance processes, the client wanted to start the roll out of Supply Chain Finance including:

- **Trained 200+ of client staff** across **4 continents** on the concept of Supply Chain Finance, next steps and roll out
- Linking between client and bank to **ensure robust set-up in all countries, KYC and legal requirements** fulfilled
- Locally setting up the **interface between client (SAP) and bank (SCF Portal)** and joint testing of functionality
- Developed a **validated Purchasing Framework on local and group level**, recommended target term
- Recommended and developed **Global Payment Terms for relevant suppliers**, leveraging economies of scale and ensuring standardised approach on supplier level within local legal requirements

#### **The result:**

**Successful implementation of the global SCF-program covering 8000 suppliers, 8 billion spend For 58 legal entities in 17 countries**



# Working capital team and global network

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## ***Basis of calculation and methodology***

<b><i>Metric</i></b>	<b><i>Definition</i></b>	<b><i>Basis of calculation</i></b>
<b>NWC %</b> (net working capital %)	NWC % measures working capital requirements relative to the size of the company.	(Accounts receivable + inventories – accounts payable)/sales
<b>NWC days</b> (net working capital days)	Indication of the total days to complete the full cash conversion cycle.	(Accounts receivable + inventories – accounts payable)/sales x 365
<b>DSO</b> (days sales outstanding)	DSO is a measure of the average number of days that a company takes to collect cash after the sale of goods or after services have been delivered.	Accounts receivable/sales x 365
<b>DIO</b> (days inventories on-hand)	DIO gives an idea of how long it takes for a company to convert its inventory into sales. Generally, the lower (shorter) the DIO, the better.	Inventories/sales x 365
<b>DPO</b> (days payables outstanding)	DPO is an indicator of how long a company takes to pay its trade creditors.	Accounts payable/sales x 365

<b><i>Term</i></b>	<b><i>Definition</i></b>
<b>OEM</b>	Original equipment manufacturer. Data includes the 15 most relevant OEM based on 2016 revenue and available data; financial services have been excluded.
<b>Non-OEM</b>	Range of companies manufacturing automotive parts and components based on Capital IQ primary industry. Data includes 596 suppliers based on 2016 revenue and available data.
<b>Powertrain</b>	Selection of non-OEM companies based on Primary SIC code: producing components that generate power and deliver it to the road surface (engines, transmissions, wheels, etc)
<b>Electrical components</b>	Selection of non-OEM companies based on Primary SIC code: producing components related to transformers, meters, electrical coils, etc.
<b>Body and interior</b>	Selection of non-OEM companies based on Primary SIC code: producing components related to car bodies, plate work, seats, etc.

### ***Methodology***

Automotive data is based on the publicly available data (CapitalIQ) of 611 companies in the automotive sector, according to Capital IQ sector segmentation.

The division in non-OEM is based on Capital IQ Primary Industry classification, whilst the segment categorisation is based on Capital IQ primary SIC codes (data available for 42% of sample). Division in regions is based on Capital IQ Primary Country.

OEM data is derived from the annual accounts of a selection of the top automobile manufacturers in terms of revenue. For OEM data the financial services arm has been excluded.



