Strategic Treasurer
Consultants in Treasury

SAP Ariba

Overcoming Obstacles

TO ACHIEVE BREAKTHROUGHS IN WORKING CAPITAL MANAGEMENT

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John Petersson, *SAP Ariba*

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Today's Presenters

Craig Jeffery, CCM, FLMI

Founder & Managing Partner
Strategic Treasurer

Craig Jeffery formed Strategic Treasurer LLC in 2004 to provide corporate, educational, and government entities direct access to comprehensive and current assistance with their treasury and financial process needs. His 20+ years of financial and treasury experience as a practitioner and as a consultant have uniquely qualified him to help organizations craft realistic goals and achieve significant benefits quickly.

Phil Beck

SVP Payments and Financing
SAP Ariba

Phil Beck is responsible for all aspects of the company's strategy and execution to transform global B2B payments. Prior to his work at Ariba, Mr. Beck was a member of PNC Bank's Energy, Metals and Mining corporate finance team where he structured and led multiple high-yield bond, asset securitization, revolving credit and treasury management transactions.

John Petersson

VP, Payments and Financing
SAP Ariba

John Petersson manages the SAP Ariba Payables Customer Success Organization. An expert in B2B payments, supplier enablement, client implementation and product management, he brings 25 years of experience to this role. Prior to joining SAP Ariba, he was co-founder of several FinTech companies in North America and Europe and led the design, launch, and operation of three proprietary payment processing systems.

Topics of Discussion

Intro to Working Capital

- Definition & Key Metrics
- Application for Treasury

Working Capital: Key Obstacles Faced

- Forecasting Inefficiencies
- Float (Invoicing, Processing, Mail, Etc.)
- Payment Delays by Buyers (DPO Extension)
- Dissatisfactory Returns on Short-term Investments
- Competing KPIs: Misaligned Internal Objectives
- Case Study

Working Capital: Elements Impacting Success

- Consolidated Data Repositories
- Making The Switch to E-processing
- Discounts Vs Extensions
- AP as a Profit Center
- Internal Communication: Establishing a Working Capital Council
- Case Study

Final Thoughts

Definition and Key Metrics

Working Capital

The available cash and other current, liquid assets available to a company to satisfy short-term cash flows.

Generally, the definition of working capital can be thought of as the difference between current assets and current liabilities.

Accounting: Working Capital Definition

Working Capital=Current Assets-Current Liabilities

Treasury: Working Capital Definition

Adjusted Working Capital=A/R + Inventory – Accounts Payable

Cash Conversion Cycle

The primary measure of a firm's working capital efficiency, which is comprised of three components: Days Payable Outstanding (DPO), Days Sales Outstanding (DSO), and Days Inventory (DIO).

Key Metrics for Measurement

- Cash Conversion Cycle = DSO + DIO – DPO
- DPO = Accounts Payable/COGS x 365
- DSO = Accounts Receivable/Revenue x 365
- DIO = Inventory/COGS x 365

Application to Treasury

A Primary Responsibility

Working Capital Management is a pivotal component of overall cash management, which is one of treasury's primary responsibilities.

A Balancing Act

Treasury is tasked with ensuring the company has adequate liquidity to meet upcoming cash outflows, while also ensuring that there is not too much "idle" cash on hand that could be invested or utilized elsewhere.

Liquidity Optimization

The task of determining the appropriate mix of capital (i.e. deciding how much cash to keep on hand, how much can or should be invested, if it makes more sense to pay down debt, etc.) is a delicate process that treasury must manage with care.

Optimize, Not Increase

It is important to remember that the goal is not to increase or reduce working capital, but to find the optimal balance.

Which of the following best describes your balance sheet for working capital requirements?

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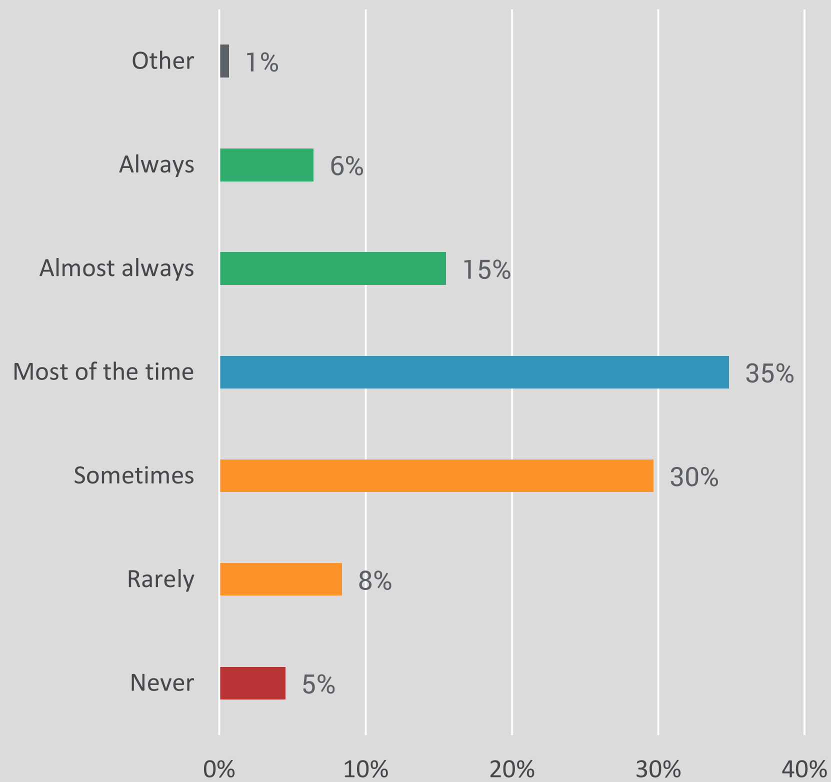
Forecasting Inefficiencies

Forecasting can be one of the most challenging and frustrating components of treasury's cash management responsibilities

- The success of any working capital strategy depends upon accurate and timely information regarding upcoming cash flows (interest expense, AP, etc.) and available cash streams (from AR, sales, etc.)
- If data is inaccurate or incomplete, treasury's task of optimizing working capital will be harrowing and may result in cash shortages or excess balances.
- This damages the company's returns and may result in excess cost if treasury has to borrow additional cash on short notice.
- Inefficient working capital strategies can often be traced back to sub-optimal forecasting practices.

Please complete this statement: "My access to the bank balance and AP/AR information I need enables me to forecast operational flows accurately..."



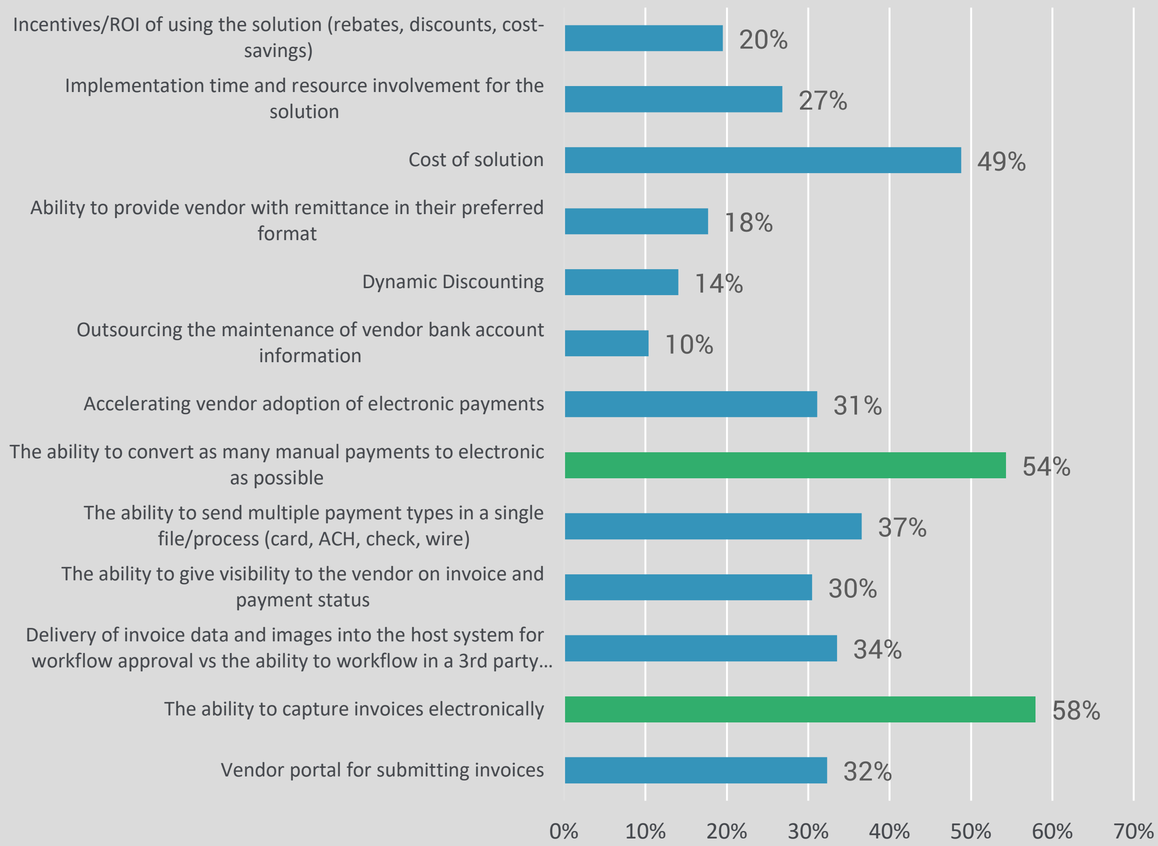
Strategic Treasurer & Bottomline Technologies 2017 Cash Forecasting & Visibility Survey

Handling Float

The Issue of Float

- Primarily affects companies that deal with paper-based or manual processing workflows.
- Continues to be a challenge in North America due to the high number of physical (paper) checks still in use and reliance on such instruments.
- Examples include:
  - invoicing float
  - processing float
  - payment float, etc.
- Can be costly for an organization waiting to be paid.
- Every juncture at which float occurs adds additional delays for payment is received, effectively restricting an organization's incoming cash flows.

When contemplating an accounts payable automation solution, which of the following are most important to your organization? (Select all that apply)



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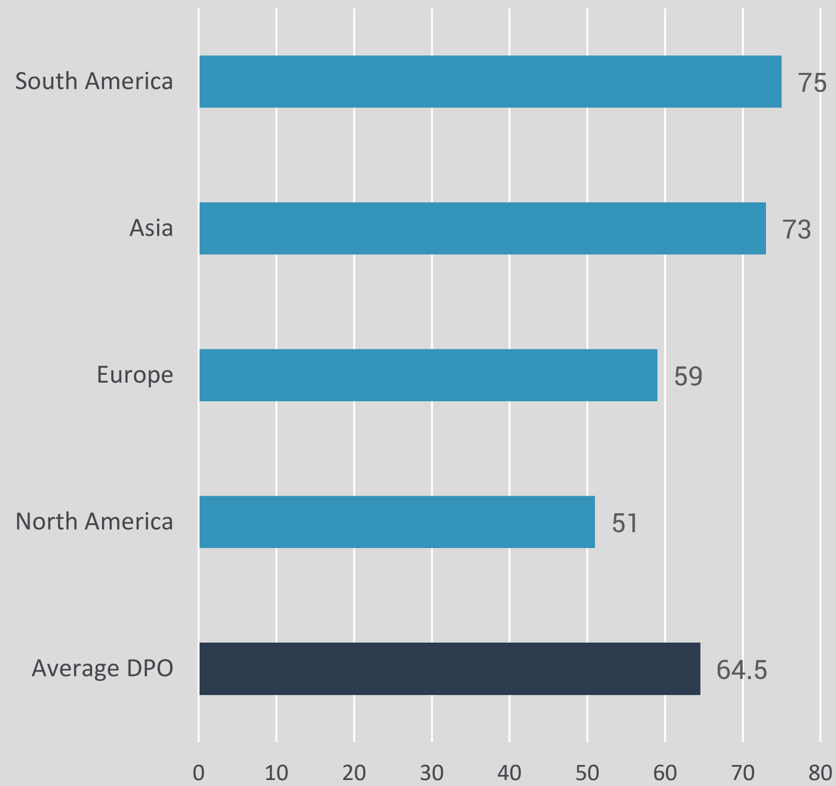
Payment Delays

Many organizations will *intentionally negotiate longer payment terms* with their vendors/partners.

- This is done to maximize the length of time they can hold onto cash for purposes of investing it, earning returns, and maximizing available cash for as long as possible.
- As the average firm must wait 64+ days to be paid, this can cause a severe drain on working capital and effect the firm's ability to invest cash or meet short-term outflows.
- As many firms are both buyers and suppliers, they are usually playing both sides of the coin:
  - AR is focused on collecting sales made on credit as quickly as possible.
  - AP is focused on extending amount of time until funds must be disbursed.
  - However, it is usually the largest and most creditworthy firms that have the largest sway in negotiating advantageous terms.

Days Payables Outstanding (DPO) by Region: 2016



Source: S&P Capital IQ Data: 2016

Ineffective Interest Rates

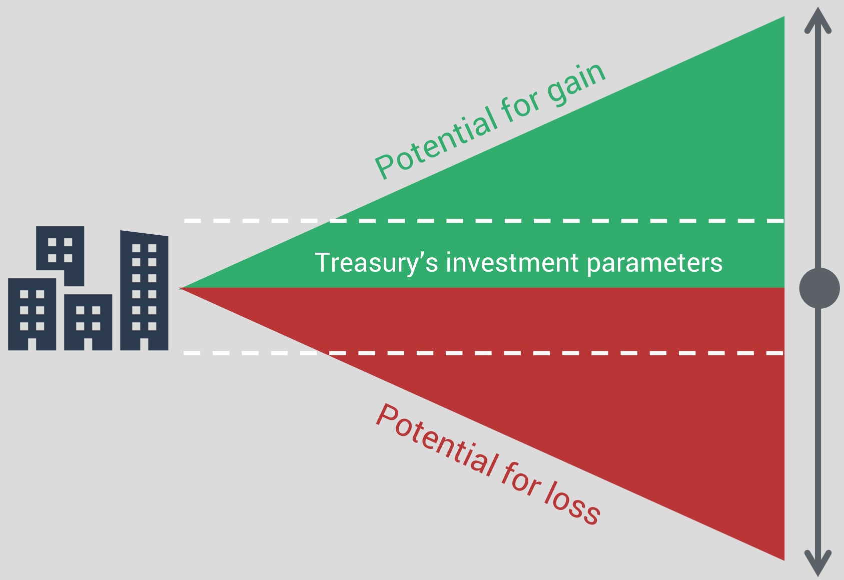
Treasury's Short-Term Investment Agenda

- The primary strategy/goal for most treasury departments for short-term investments Is preservation of principal (i.e. safety).
- The secondary strategy/goal for most treasury departments for short-term investments is maintaining adequate liquidity.

Obstacle for Treasury:

- Most short-term investments earn minimal returns in the market.
- Most organizations lack any high-return investment opportunities short-term without generating substantial risk.

While this is not necessarily a large problem, it would be advantageous for organizations to identify alternative opportunities where greater returns can be earned without added risk.

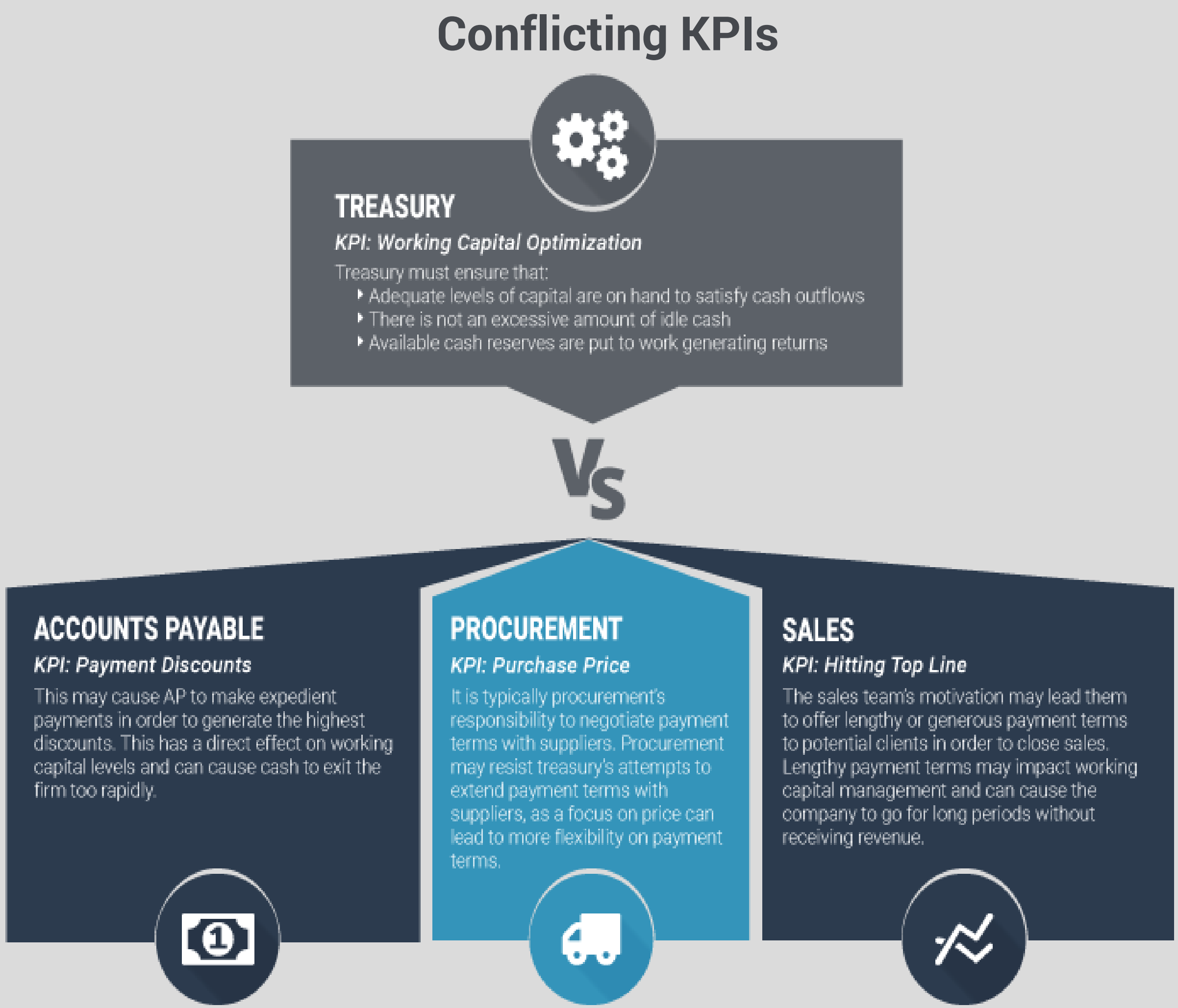


Generally, there is a strong correlation between the returns that investments are capable of generating and the risk associated with that investment. As treasury's primary objective with short-term investments is safety, this means that most investments utilized are low-earning.

Competing Internal KPIs

While treasury can be thought of as the steward of working capital, they are not the only department with a stake in it.

- There are multiple departments whose operations impact working capital, including sales, AP, AR, procurement, etc.
- These departments do not always have the same set of goals or objectives, as varying KPIs may be used to measure the success of each department.
- This can create conflict when attempting to create a definitive working capital strategy, as departments may resist adhering to policies that damage or hinder their respective KPIs.



Case Study: Managing Payment Terms to Generate Free Cash Flow

Company
Fortune 500
Pharmaceutical company

Headquarters
US

Industry
Pharmaceutical

Products and Services
Medical equipment;
Pharmaceutical

Employees
> 100,000

Revenue
> US 60 billion

Problem:

- Need to optimize working capital
- Adapt working capital program by region to comply with local regulations
- Improve quality of vendor master data

Desired Solution Capabilities:

- Develop unique payment terms to meet specific country-regional requirements
- Dynamic discounting functionality
- Consulting expertise to help develop and execute global payment term strategy
- Support vendor master data cleanup

Benefits/Outcome:

- Extended supplier financing program globally across 38,000 suppliers in 40 countries
- Generated $338M in free cash flow to invest in new drug development, >$10m contribution to income statement
- Expanded capture of early payment discounts by 12% over previous year to ~$6.6m
- Helped with master vendor file cleanup to ensure accuracy of supplier payment term and contact data

Notable Stats

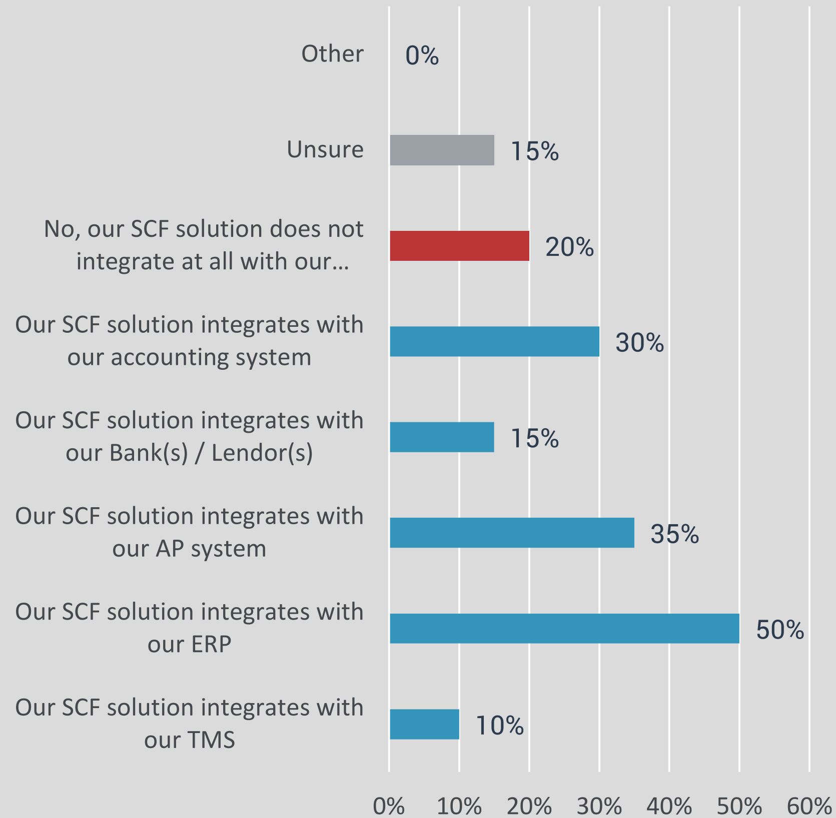
- **$338 mm**
  generated in free cash flow
- **>$10mm**
  to income statement from early-payment discounts
- **38,000**
  suppliers in finance program, across 40 countries

Consolidated Data Repositories

The establishment or implementation of solutions or systems that can capture all pertinent data related to cash flows will:

- Allow treasury to better forecast their cash and optimize working capital
- Ideally integrate with a TMS, ERP, AP system, etc. or come as an add-on one of these solutions so that all relevant data could be pulled automatically, with little intervention or manual work on behalf of treasury
- Result in accurate forecasting (i.e. within a few percentage points of actuals) and subsequent optimization of working capital.

Does your SCF solution integrate with your existing technology infrastructure? (Select all that apply)



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From Paper to e-processing

Switching from physical to electronic processes

- One of the primary methods for optimizing the cash conversion cycle and liquidity is through adopting e-processes for the supply chain.

Includes:

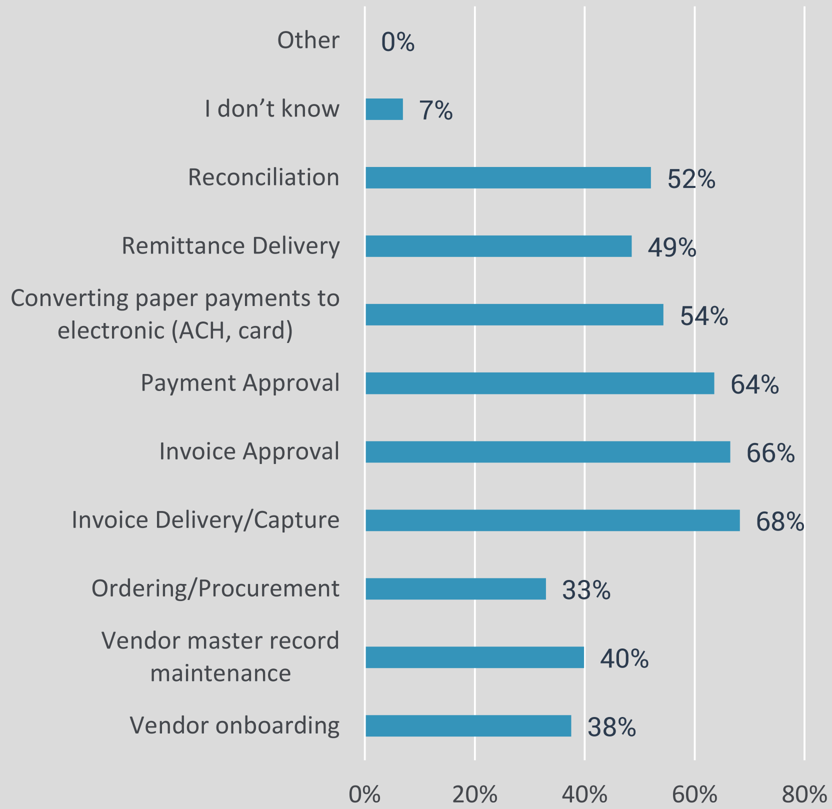
- E-processing of invoices and purchase orders
- The adoption of electronic payment methods in place of physical checks.

Ideal Result:

- Reduced processing costs and a more efficient cash conversion cycle
- The ability to quickly reinvest cash to generate returns or pay off debt.

While e-payments methods are mature in Europe, many organizations in North America still use physical checks and paper invoices/purchase orders. This represents an area of significant growth potential.

When you hear "AP Automation" what part(s) of the process come to mind? (Select all that apply)



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Utilizing Discounts & Extensions

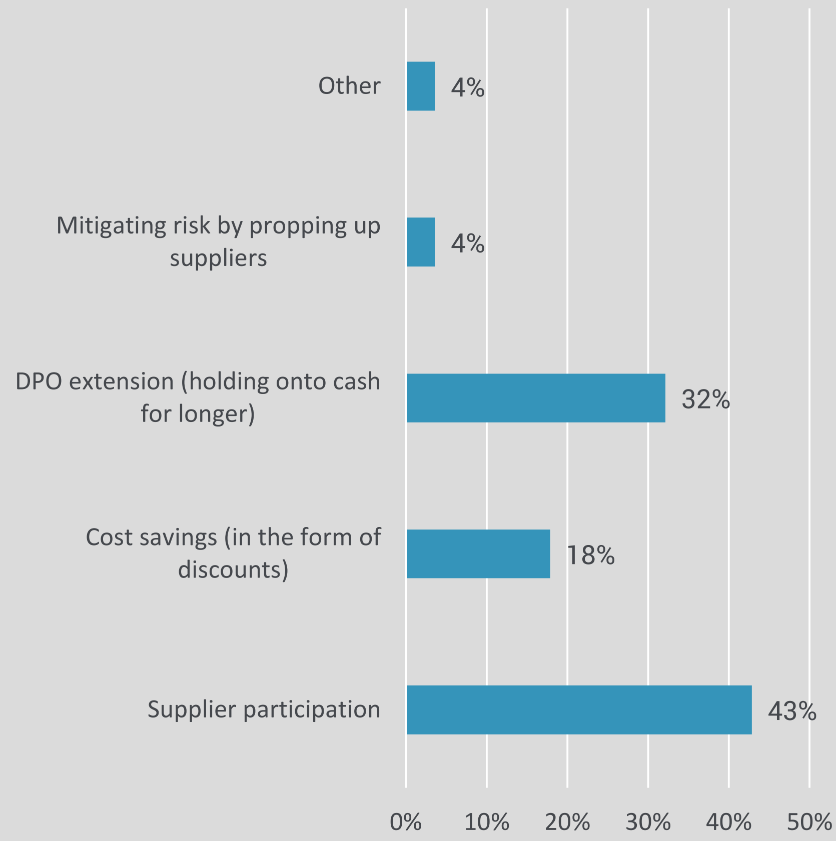
Organizations' needs vary. . .

- Some are not necessarily looking for large returns on short-term investments.
- Others would invest in short-term investments with higher returns if such instruments were available without drastically increasing the level of risk inherent in their portfolio.

. . . but opportunities exist:

- The provision of early-pay discounts: Many vendors/suppliers offer discounts with much greater savings compared to rates on short-term investments (especially via dynamic discounting techniques.)
- Supply chain financing techniques such as reverse factoring: Provides the ability to extend payment terms without causing a drain on suppliers.
- The more suppliers participate, the more opportunities are created.

Buying Firms: What do you see as the most crucial factor contributing to the success of your SCF program?



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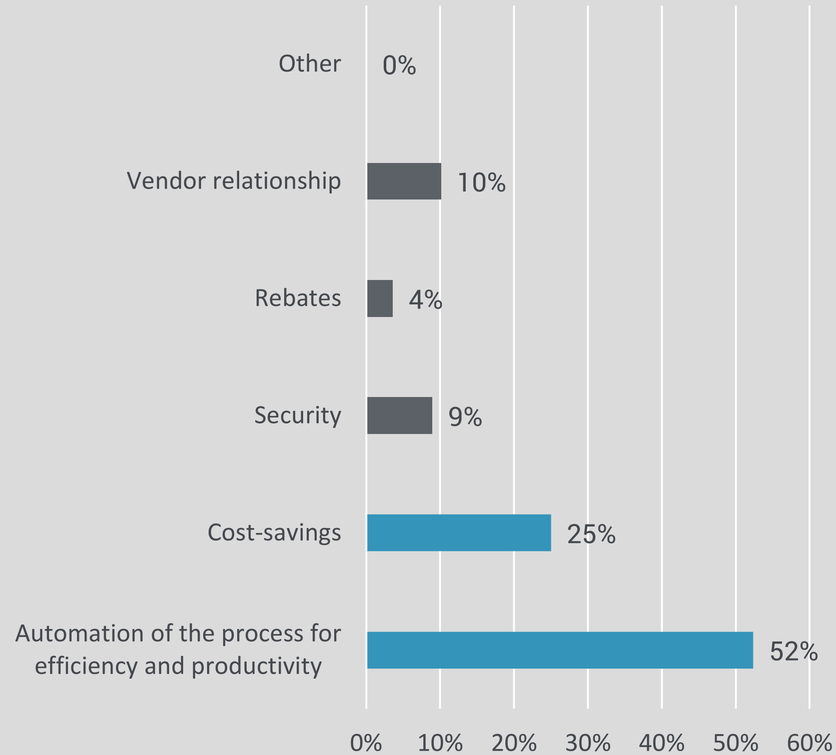
A/P's Role as a Profit Center

The shift of AP's internal function from a cost center into a profit center:

- Historically considered a cost center, the opportunities to streamline AP processes to achieve discounts and reduce processing costs, or to optimize terms to take advantage of extended payment terms, has allowed AP to take on greater importance internally.
- This is especially true from treasury's standpoint as they seek to manage working capital.
- Developing payment terms strategies can be managed or co-managed by treasury, but the execution is ultimately carried out by AP.

Treasury should be frequently communicating with AP regarding working capital opportunities, as well as with AR for opportunities on the opposite side.

From the accounts payable side, which driver is most important?



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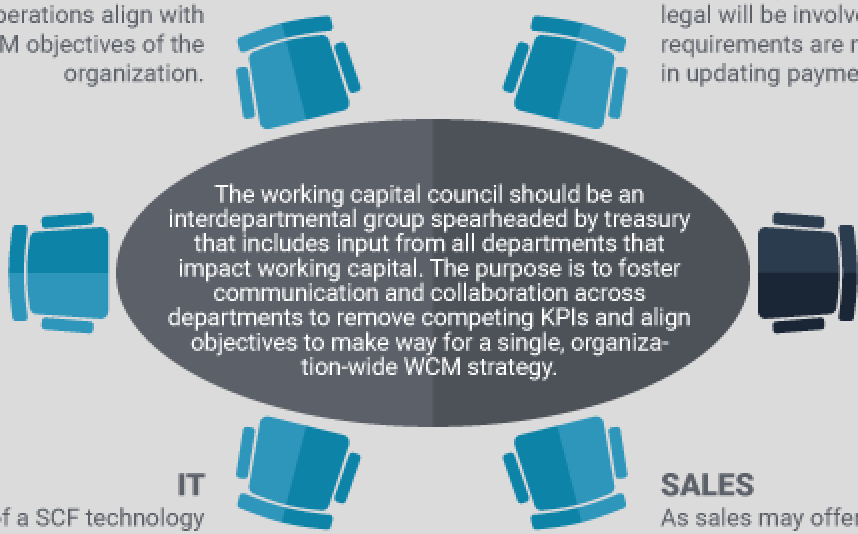
Create a Working Capital Council

AP
AP has direct oversight over payment terms with suppliers. As such, it is pivotal that their operations align with the overarching WCM objectives of the organization.

LEGAL
For compliance-related working capital programs (e.g,. cross-border SCF programs), legal will be involved to ensure all regulatory requirements are met. Legal also plays a role in updating payment terms with suppliers.

PROCUREMENT
Procurement should be involved in any WCM discussion, as they are directly involved in the purchase of inventory and regularly interact with suppliers.



TREASURY
The working capital council should be led by treasury, who is the owner of working capital and is charged with ensuring that adequate capital levels are on hand.

IT
Regarding the adoption of a SCF technology solution, IT needs to be included in the implementation so that they understand how the solution will fit into the company's existing technology infrastructure.

SALES
As sales may offer payment terms to clients or be involved in discussing terms with potential clients, they must understand how these terms affect working capital and what acceptable limits are for offering extended terms.

Case Study: Managing Payment Terms to Generate Free Cash Flow

Company
Electricity supply company

Headquarters
US

Industry
Utilities

Products and Services
Electric service

Employees
> 10,000

Revenue
> US $10 billion

Objectives

- Drive costs out of the financial supply chain
- Expand capture of early-payment discounts
- Maintain or improve supplier relationships

Resolution

- Deployed Ariba® Network and Payables solution
- Automated invoice processing and workflow to accelerate discount capture
- Leveraged working capital management services to optimize payment terms
- Engaged in the rapid ramp program for assistance with supplier targeting and onboarding

Benefits/Outcome:

- Contributed to more than $18 million in annual financial savings through better management of payables across the enterprise
- Enabled sliding-scale discounts, delivering a discount capture rate that is close to 100%
- Built an effective communication program, helping strengthen supplier relationships

Notable Stats

- **$18 million**
  In annual financial savings
- **98%**
  Discount capture rate
- **~21%**
  Of spend eligible for early payment

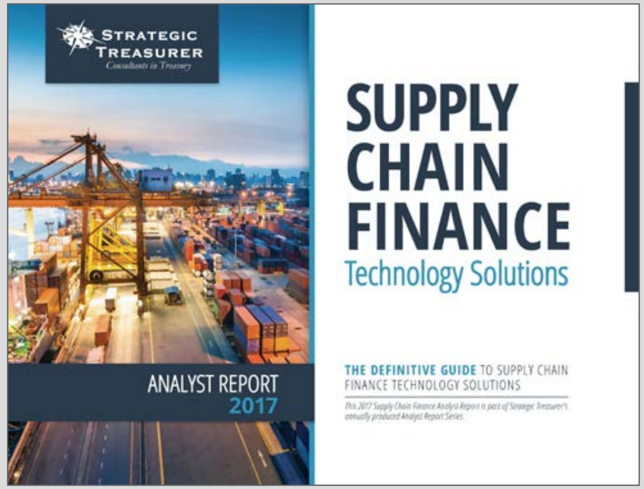
Final Thoughts

Key Takeaways for Treasury:

- Treasury is tasked with the overall management of working capital and the effective implementation of strategies that optimize it.
- The key challenges faced by many firms revolves around forecasting errors, payment delays caused by float and delayed terms, and a lack of viable investment options in the short-term.
- These challenges can be improved upon through the effective use of new technologies, as well as by fostering greater communication amongst key departments internally.
- If treasury is to truly optimize working capital, these strategies are pivotal.

Additional Resources

Download now by clicking on the thumbnail or by visiting ***strategictreasurer.com***



Thank you for participating in this event!

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