THE IMPORTANCE OF WORKING CAPITAL IN THE SUPPLY CHAIN

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Report Highlights

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Best-in-Class companies have a cash-to-cash cycle half as long as that of their competition.

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Best-in-Class companies have over 82% of their freight bills audited.

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The percentage of companies shipping direct to customer is up to 61%, which *now exceeds* those shipping to or through a DC.

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Fewer than 25% of all companies have accurate cost-to-serve data.

This report will examine how companies can leverage their freight spend as an untapped opportunity to improve working capital by partnering with freight audit and payment providers that offer a trade finance solution.

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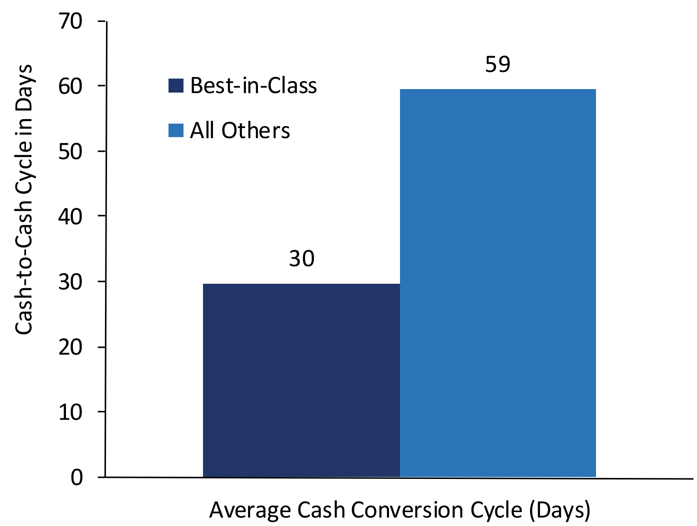
Most companies do not even consider the untapped opportunity in leveraging their freight spend to increase the flow of working capital.

All companies strive to increase their working capital, either by reducing the need for it or by increasing its flow from existing operations. Best-in-Class companies excel in this regard as shown in Figure 1, which compares the Cash-to-Cash cycle for the Best-in-Class to that of their competition (see sidebar for the performance metrics that define "Best-in-Class").

Figure 1: Best-in-Class Working Capital Advantage vs. All Others



Source: Aberdeen Group, January 2016

Best-in-Class companies have a cash-to-cash cycle that is half as long as that of their competition. This accelerated access to working capital from operations can provide funding for acquisitions or capital equipment as well as reduce the dependence on borrowing, resulting in fewer interest payments and a positive P&L impact.

Only good things come from improving working capital, which is why it is surprising that many companies fail to take advantage of one readily available source for doing so in their supply chain: freight spend.

Leveraging Your Supply Chain to Increase Working Capital

When thinking of their supply chain, most companies immediately zero in on inventory reduction as a means for increasing working capital, since this reduces the capital employed and is therefore always worthy of discussion. However, this approach is not “new news.”

What most companies do not even consider is the untapped opportunity in leveraging their freight spend to increase working capital. The companies that have adopted this approach have seen their working capital grow as a result.

Leveraging Your Freight Spend – How It Works

The key here is that some banks who offer Freight Audit and Pay (FAP) services may also provide *trade financing* in addition to their audit and payment services, which can increase working capital for both the shipper and the carrier, while also improving the shipper/carrier relationship. Freight spend itself commonly ranges from 3%–12% of revenue, making it a large untapped resource for working capital improvement.

Table 1: Freight Audit Costs & Percentage of Invoices Audited

Freight Audit Performance	Best-in-Class	All Others
Average cost to process an invoice (in USD)	$9.81	$14.15
Non-Parcel — the percentage of company’s invoices currently audited	85%	32%
Parcel — the percentage of company’s invoices currently audited	82%	51%

Source: Aberdeen Group, January 2016

Best-in-Class Definition

Based on performance metrics:

- Best-in-Class – Top 20%
- Industry Average – Middle 50%
- Laggards – Bottom 30%

Many shippers saw their costs increase over the last year and some obvious causal effects such as port costs and resulting premiums can be readily identified, but what is not so obvious are the structural changes that are occurring as a result of B2B and B2C Convergence.

As Table 1 shows, the Best-in-Class outsource 2.7 times the percentage of invoices for their non-parcel shipments compared to All Others and 1.6 times the percentage of invoices for their parcel shipments vs. All Others. As a result, their average cost to process a freight invoice is 31% less than All Others ($9.81 for Best-in-Class vs. $14.15 for All Others).

The real surprise is the *high* percentage of All Others (80% of the companies — see sidebar on Best-in-Class definition) who choose *not* to outsource their freight audit. Of that percentage, even fewer use a third party for the settlement process, which is where the trade finance solution option can solve so many problems for the shipper and the carrier.

How? Most negotiations with carriers, when handled directly, cover payment terms, as well as the cost of the service being contracted. However, where a bank can offer trade financing, these payment terms can be eliminated from the discussion. The carrier can get paid immediately or at least within a few days, and the shipper can extend their "Days Payables Outstanding" (DPO) to as much as 90 days, adding 2 or more months of working capital for the freight component of their total spend and related cash flow.

The net result:

- Carriers, who need cash to fund operations, get paid faster (within 5 days).
- Greater working capital for the shipper, who may be facing mandates to extend out their credit terms with suppliers. The extended payment terms can be as long as 90 days without renegotiating rates.
- In addition to the financial benefit, trade finance takes the stress out of the relationship between shippers and

carriers over payment issues and allows them to focus on the business.

- Automation streamlines the processing and eliminates the costs associated with billing errors, late payments, collections, and reconciliation.

Impact on Working Capital

Below are straw man examples showing the potential impact on working capital when shippers and carriers use a trade finance solution.

- Shipper Assumptions – Average cost of capital at 10% - 100% participation in the trade finance solution
  - Assumes current DPO is 25 days on 30 day terms
  - $100,000,000 – 30 day terms
  - 60 day terms – *$607,000 – Increased working capital*
  - 90 day terms – *$1,127,000 – Increased working capital*
- Carrier Assumptions – Average cost of capital at 10%– 100% participation in the trade finance solution
  - $100,000,000 – 60 day terms (typical for carriers)
  - *$386,000 – Increased savings – 5-day payment received*.

Structural Changes Are Adding Cost

Many shippers saw their costs increase over the last year. Some of this increase can be readily identified as stemming from event-driven incidents such as port slowdowns and resulting

Related Research "B2B and B2C Convergence: A Call to Action"

Related Research "Operational Readiness for B2B and B2C Convergence: Are You Prepared?"

premiums. What are more difficult to pin down are costs stemming from the structural changes associated with B2B and B2C Convergence, a trend we have documented in our research report, B2B and B2C Convergence: A Call to Action (July 2014). The shifts in logistics flows this convergence has brought about (detailed in Table 2) can be summarized as follows:

- **Shipping to or through a traditional distribution center**. Currently 60% of companies utilize this model. Two years ago that figure was 75%–85% — a definite decline.
- **Shipping direct to customer**. Currently 61% of companies utilize this model. Two years ago it was fewer than 50%. This represents a significant increase and we expect this trend to continue.

Table 2: Logistics Flows Spanning B2B and B2C Activities

New Multi-Channel Logistics Trends Across B2B & B2C Companies	
Shipping Direct-to-Consumer	61%
Shipping to or through a Traditional Distribution Center	60%
Shipping through Vendor DC bypass, 3PL or e-Fulfillment provider	56%
Shipping through a break-bulk facility (i.e. Cross Dock, Transload, or DC Flowthru Facility)	53%
Shipping through a Free Port, Freeport Zone, or FTZ for customs	43%
Shipping Direct-to-Store	38%
Plan to add capabilities in other areas not indicated	15%

Source: Aberdeen Group, January 2016

The net effect of these changes is an increase in the percentage of parcel shipments for all shippers at the manufacturer, wholesaler, and even retail level, since the latter must provide "pick up in store service." *The issue here is that parcel shipping is 3–5 times greater than the cost of shipping in some form of bulk freight (carton, box, pallet, etc.).* In other words, to support omni-channel workflows, freight costs are increasing for nearly all shippers. In most cases, the shippers (manufacturers, wholesale distributors and "brick and mortar" retailers) have to absorb the freight cost to compete with online retailers, or they risk losing the order.

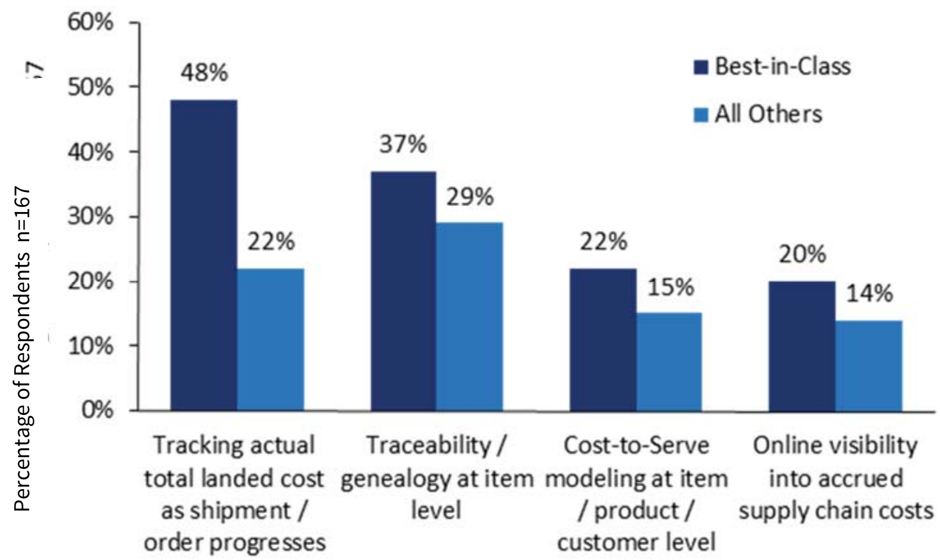
These costs must be covered in some manner or there will be an unfavorable hit to the bottom line. *Using a trade financing solution may be the only untapped resource left to prevent this outcome*.

Overcoming Internal Behaviors That Hide Visibility

In addition to the dealing with the increasing freight costs associated with supporting B2C logistics flows, companies are scrambling to understand, identify, and properly allocate their supply costs in a timely manner so as to determine whether these new flows are profitable or not. As discussed in our report, Operational Readiness for B2B and B2C Convergence: Are You Prepared? (December 2014), the majority of companies are behind the curve in capturing these costs and properly allocating them. Figure 2 shows the current state of such capabilities for the Best-in-Class and All Others.

Most organizations have not adopted the approach to leverage their freight audit and pay solution partner to provide trade financing for total freight spend. Awareness of the opportunity and visibility to the opportunity are the two main reasons for the "Call-to-Action."

Figure 2: Cost-to-Serve Modeling Capabilities



Source: Aberdeen Group, January 2016

Across the board, the picture here is not great. In fact, fewer than 50% of Best-in-Class companies have adopted any of the necessary capabilities to truly capture cost-to-serve, and the competition (80% of companies surveyed) is in the twenties and teens in terms of adoption rates. If you consider the most critical capability, capturing the true cost-to-serve in order to determine profitability, only 22% of the Best-in-Class possess it, and only 15% of All Others do. The bottom line is that all companies are struggling to get their hands around the new consumer workflows.

How does this affect visibility to freight spend? In order to properly allocate costs, the preference for cost accounting is to include freight in the landed cost of the product in order to make accurate comparisons. However, that process detracts from efforts to aggregate the freight and view it as a spend category. The large organizations, often referred to as "big box" retailers, have already taken over control of their freight spend because they have the advantage of scale and are able to dictate policy to their suppliers. The majority of companies cannot take that approach, and, as Figure 2 shows, are consequently struggling to understand and allocate costs in order to make profitable decisions.

A trade financing solution can help solve this problem as well. Since managing and analyzing the data is a key attribute of their business, a trade finance partner can help address the visibility issues most companies face and tie costs and events together. In fact, many of these providers indicate that they can do this in near real time, while keeping sight of the total freight spend.

In addition, trade financing providers can offer multi-lingual services and one common currency for companies that are operating globally, making a broader, more transparent view and analysis of the total freight spend possible.

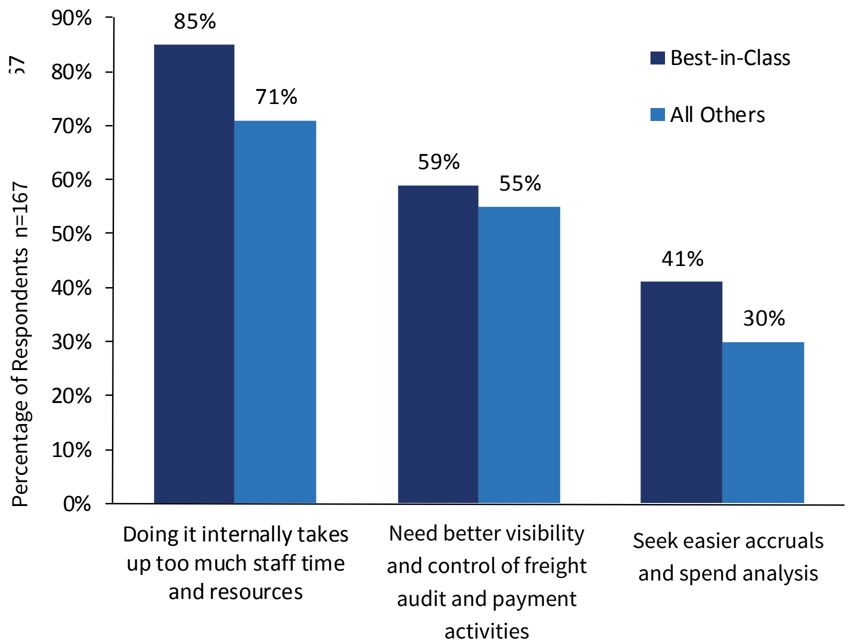
The optimal solution to the challenges companies are facing today would allow them to leverage their total freight spend as working capital while giving them visibility into proper cost allocation. A freight audit and payment service that provides trade financing for the freight spend does just that.

What Motivates the Choice of a Freight Audit Partner?

Most organizations do not leverage their freight audit and pay solution partner to provide trade financing for their total freight spend. Lack of awareness to the opportunity, and lack of visibility to the actual size of the freight spend itself, are the two main reasons for the “call-to-action.” When considering their freight spend, most companies are only thinking of the auditing as a means to control costs.

As Figure 3 indicates, the overwhelming rationale for outsourcing freight audit and payment is the desire to eliminate the transaction headache of managing numerous bills.

Figure 3: Motivation Behind Freight Audit Partner Choice



Source: Aberdeen Group, January 2016

With freight spend ranging from 3%–12% of revenue for most product based companies, the opportunity exists to significantly increase working capital.

There is some desire for better visibility into audit and payment activities, and some emphasis on creating an easier accrual process, but companies are simply not yet looking to leverage trade financing with an eye to improving working capital.

Key Takeaways

Leveraging total freight spend to improve working capital through a trade finance solution is an untapped opportunity for the majority of companies.

With freight spend ranging from 3%–12% of revenue for most product-based companies, this approach could significantly improve working capital.

Best-in-Class companies (top 20%) operate with a cash-to-cash cycle that is half that of their competition. Conversely, their competition, those companies that make up the remaining 80%, comprised of the Industry Average (middle 50%), and Laggards (bottom 30%), operate with a cash-to-cash cycle that is nearly double that of the Best-in-Class. As a result, they are at a severe competitive disadvantage and would be well-served to heed this approach to improve their cash-to-cash cycle.

Furthermore, a trade finance solution may be a necessity for companies facing increased freight costs due to parcel shipments stemming from increased B2C activities. The savings generated by increased working capital may help to defray these freight costs.

A trade finance solution can also tie events and costs together, offering near real time visibility into those costs. This, too, is a huge issue for those facing the impact of increased B2C activities.

Companies should act now to increase their company's working capital by leveraging freight spend and partnering with a freight audit and payment provider with trade finance capability.

For more information on this or other research topics, please visit www.aberdeen.com.

Related Research	
Supply Chain Cost-to-serve Readiness for Convergence; February 2015	*Operational Readiness for B2B and B2C Convergence: Are You Prepared?*; December 2014
Best-in-Class Practices: Maximizing Your Inventory Performance; January 2015	*B2B and B2C Convergence: A Call to Action*; July 2014

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