All Tied Up

Working Capital Management Report 2021 – India

Enter

Building a better working world

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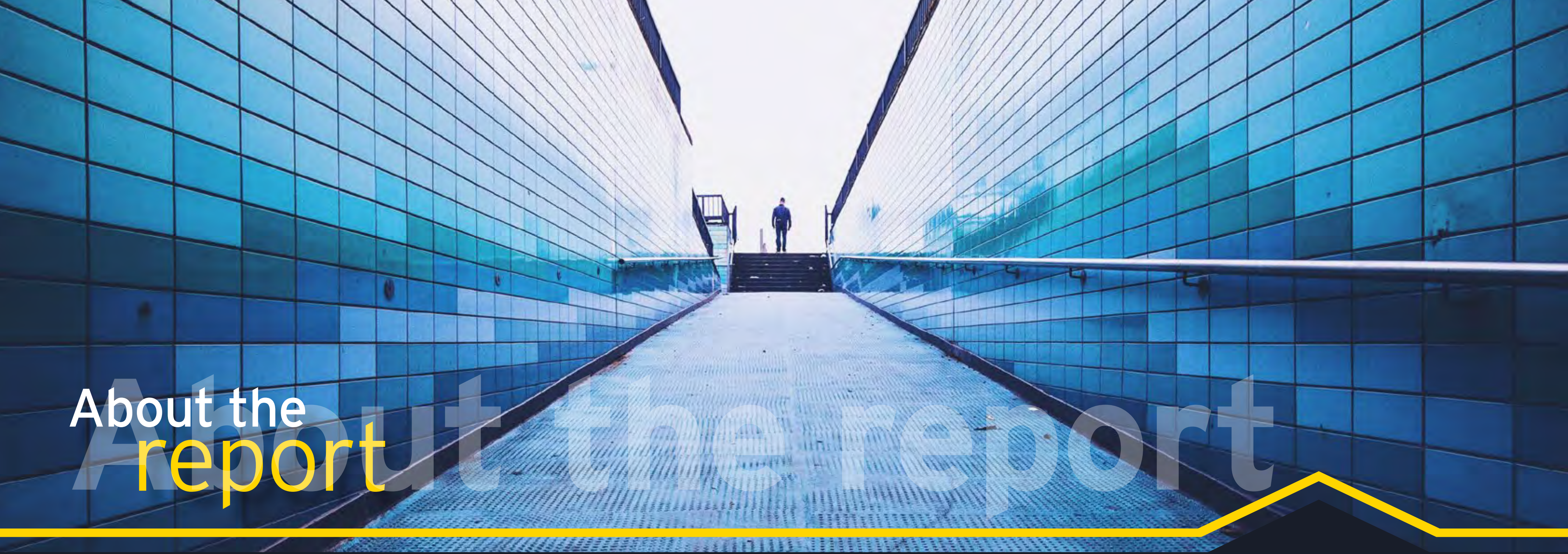

About the report

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EY *All-Tied Up* is a publication in a series of working capital management reports based on Ernst & Young LLP (EY) research on working capital performance of India's largest companies.

- What is the impact of COVID-19 on working capital for India Inc?
- What measures were taken by businesses to optimize their working capital?
- How to leverage technology for working capital management?
- How can businesses approach working capital management in the future?

Methodology

- The EY All Tied Up results for India are based on an analysis of working capital performance of the largest 500 companies as per revenue as listed in the BSE Stock Exchange.
- Companies in the financial and real estate sectors have been excluded from the analysis for comparability reasons.
- The sample constitutes a total revenue of ₹62.4 lakh crores, EBITDA of ₹9.2 lakh crores and Short Term Debt of ₹6.7 lakh crores.
- The sector analysis includes top 12 sectors consisting of over 90% of revenue of the sample.
- For the purpose of size segmentation, the rank ordered data set has been divided into 3 groups as per percentiles, using FY20 revenue as an indicator for each company's size.

Executive summary

There is a considerable need for Indian companies to focus on working capital optimization

2 pp* Deterioration in working capital as a % of revenue

6 days Deterioration in C2C

India Inc observed a delayed collections and supply chain disruption across sectors as a result of the pandemic

Large enterprises are able to effectively manage their working capital

29 days Difference between C2C of large and small enterprises

Large enterprises enjoy better leverage as well as have automated processes in place for better working capital management

Sectors which experienced improvement in C2C

Automobiles	Chemicals	Cement & Building Products
13 days	12 days	7 days

Automobiles, Chemicals and Cement & Building Products were the best performing sectors in C2C in India

Sectors which experienced deterioration in C2C

Power	Engineering & EPC Services	Oil & Gas
34 days	17 days	10 days

Power, Engineering & EPC and Oil & gas were the worst performing sectors in C2C in India

Overall Cash Opportunity for India Inc

₹ 5.2 trillion

Cash on the table

Note: *All comparisons are for LTM 30-Sep-20 vs 12 months ended 30-Sep-19*

**percentage point*

Improved Deteriorated

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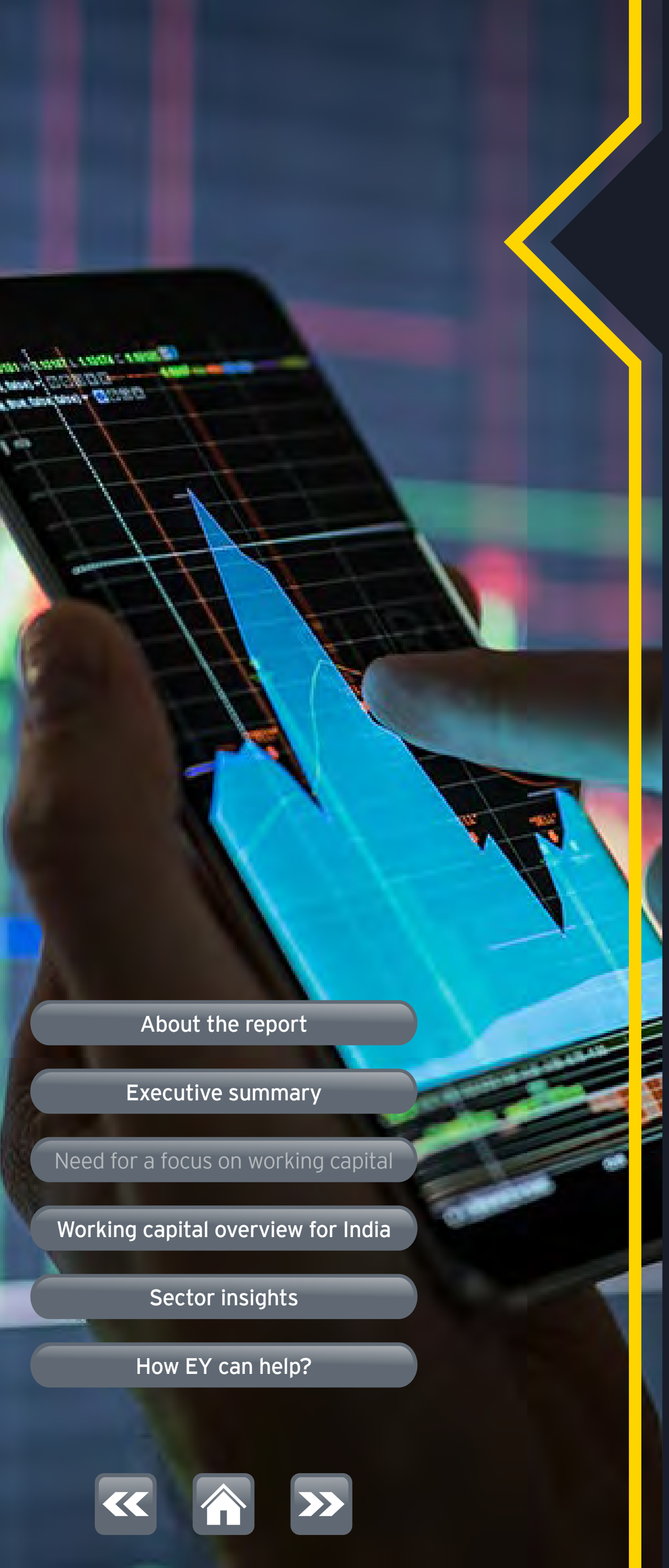
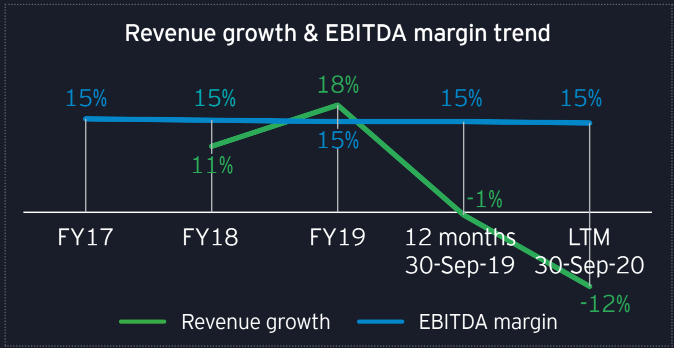
1 Need for a focus on working capital

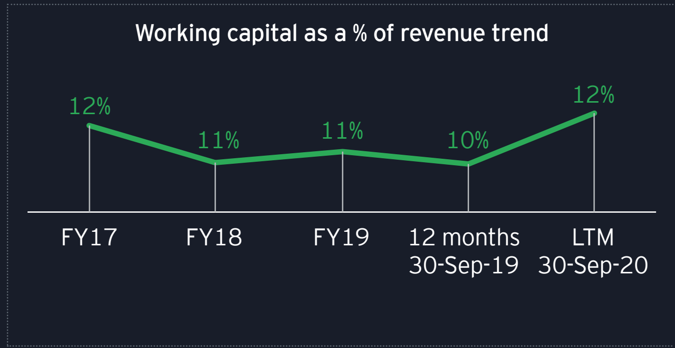


Firms must optimize working capital and free-up cash in the wake of the COVID-19 pandemic

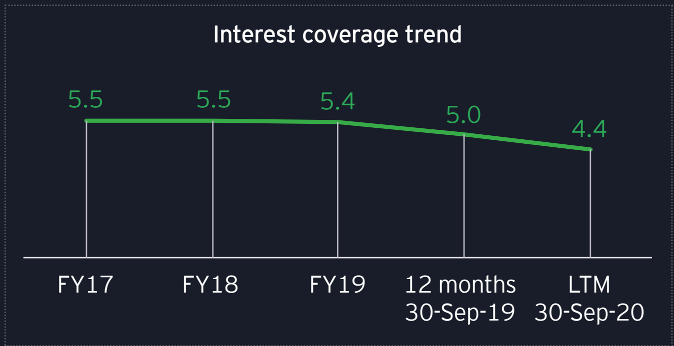
Need for working capital optimization



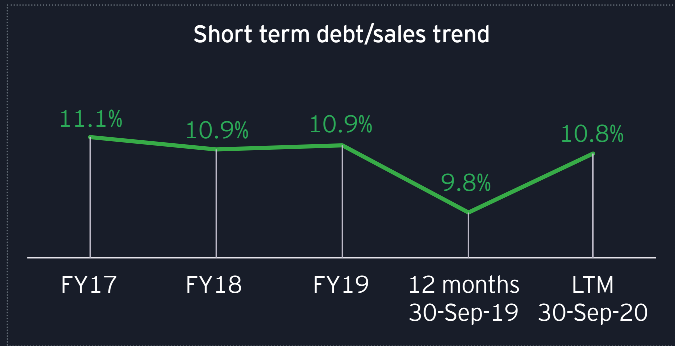
Revenue growth & EBITDA margin trend



Working capital as a % of revenue trend



Interest coverage trend



Short term debt/sales trend

- While companies were able to maintain their EBITDA margins, revenue growth declined drastically as a result of the pandemic induced lockdown
- Falling revenue was combined with an increase in working capital as a % of revenue, mainly due to substantial impact of lockdown across the value chain
- Falling revenues and increasing working capital requirements have pushed up the need for increase in short term debt funding

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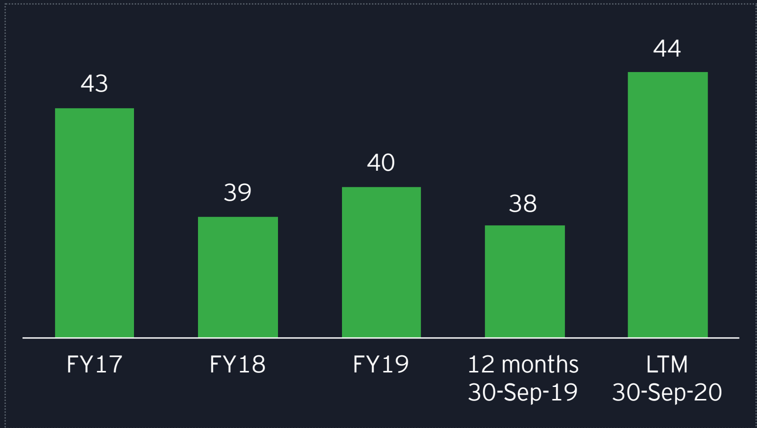
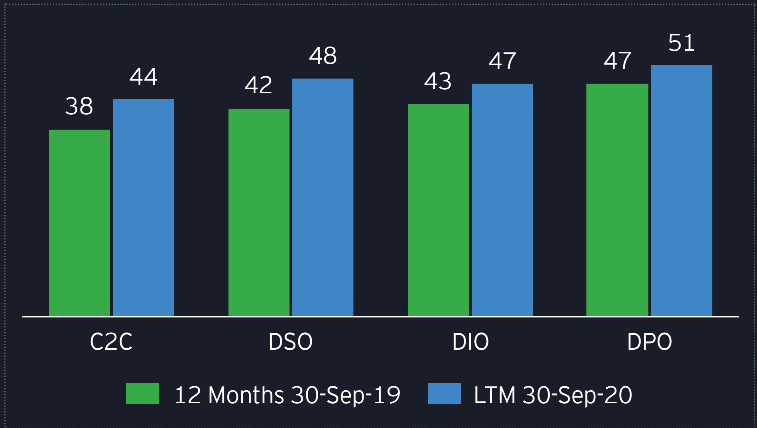
The pandemic caused significant challenges in managing working capital due to supply chain disruptions

C2C trend for India Inc

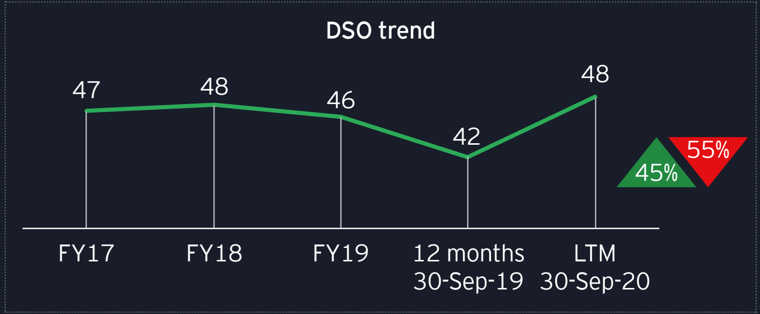


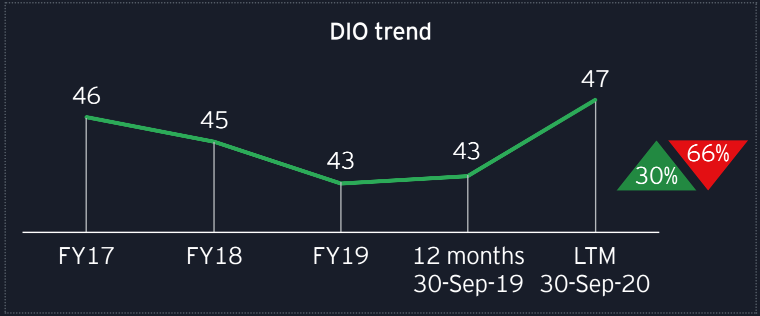


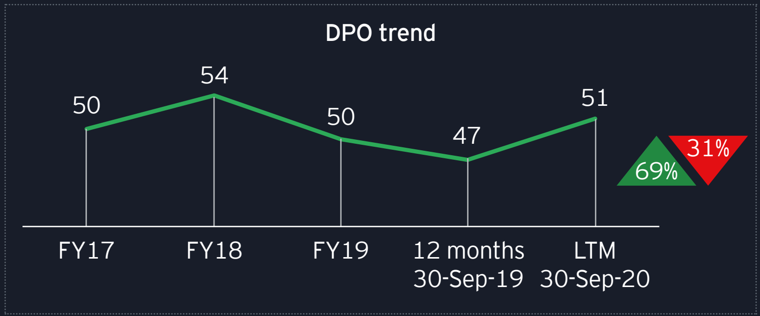
- There has been a steady improvement in overall Cash to Cash cycle (C2C) between Mar-16 (FY17) and Sep-19
- However since March 2020, the COVID-19 pandemic has disrupted working capital management for all companies, which has significantly increased the overall Cash to Cash Cycle
- The deterioration in C2C by Sep-20 has been driven by c.15% increase in DSO and c.9% increase in DIO, partially offset by c.8% increase in DPO

India Inc balanced its working capital requirements during the pandemic by stretching payables to offset increased inventory balances and reduced collections

Breakup of working capital for India Inc







- During COVID-19, receivables days increased for more than half of the businesses, as companies sought to preserve cash and extend credit periods, combined with loss of revenues during the period (due to subdued demand)
- c.66% of companies reported significant increase in inventory days (combined with decrease in revenues). This appears to be mainly due to unsold inventory, as well as companies maintaining additional inventory buffer to mitigate the supply disruptions
- c.69% of the business stretched their payables to maintain acceptable levels of short term liquidity

% companies for which the metric Improved in LTM 30-Sep-20 vs 30-Sep-19

% companies for which the metric deteriorated in LTM 30-Sep-20 vs 30-Sep-19

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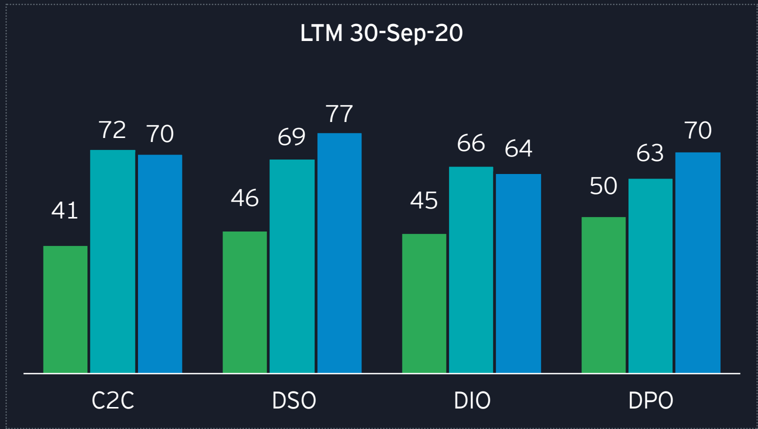
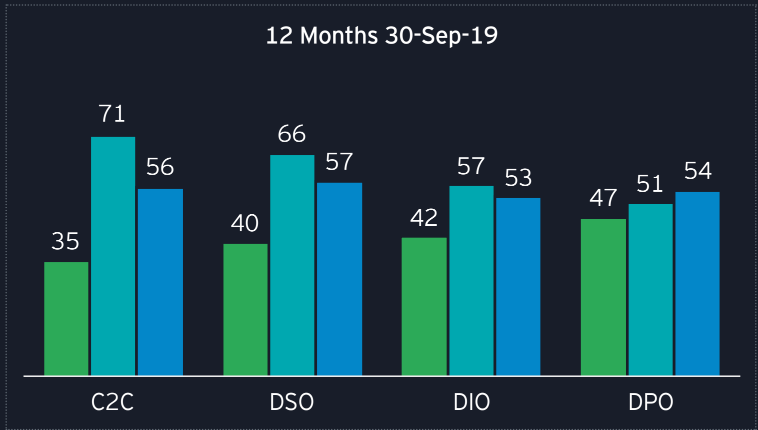
The biggest impact on working capital has been for small companies during the pandemic due to lack of scale, processes and systems

Working capital performance as per size



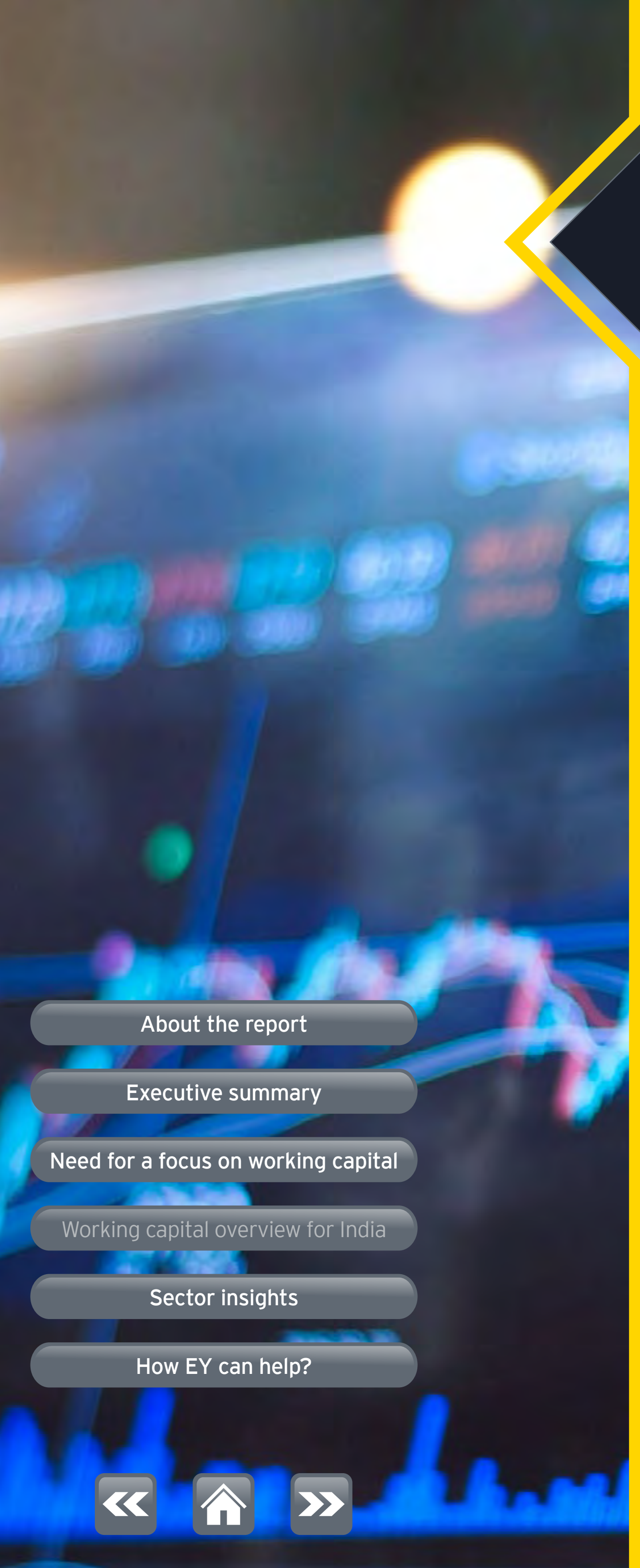


- There continues to be a significant difference in overall C2C days between large, medium and small enterprises.
- Larger enterprises are more efficient in managing their working capital as these businesses:
  - can leverage their scale and demand longer credit periods from suppliers
  - use their selling power to have a higher inventory turnover
  - have automated invoicing and collections processes
  - efficient business processes to track and proactively manage overall cash and working capital
- The biggest impact on working capital has been for small enterprises during the pandemic due to lack of the scale, processes and systems

Large sized companies: FY20 revenue greater than ₹51 billion

Medium sized companies: FY20 revenue > ₹24 bilion and < ₹51 billion

Small sized companies: FY20 revenue lower than ₹24 billion



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Indian companies have significant opportunities to implement better working capital practices when compared to advanced economies

Working capital performance as per geography

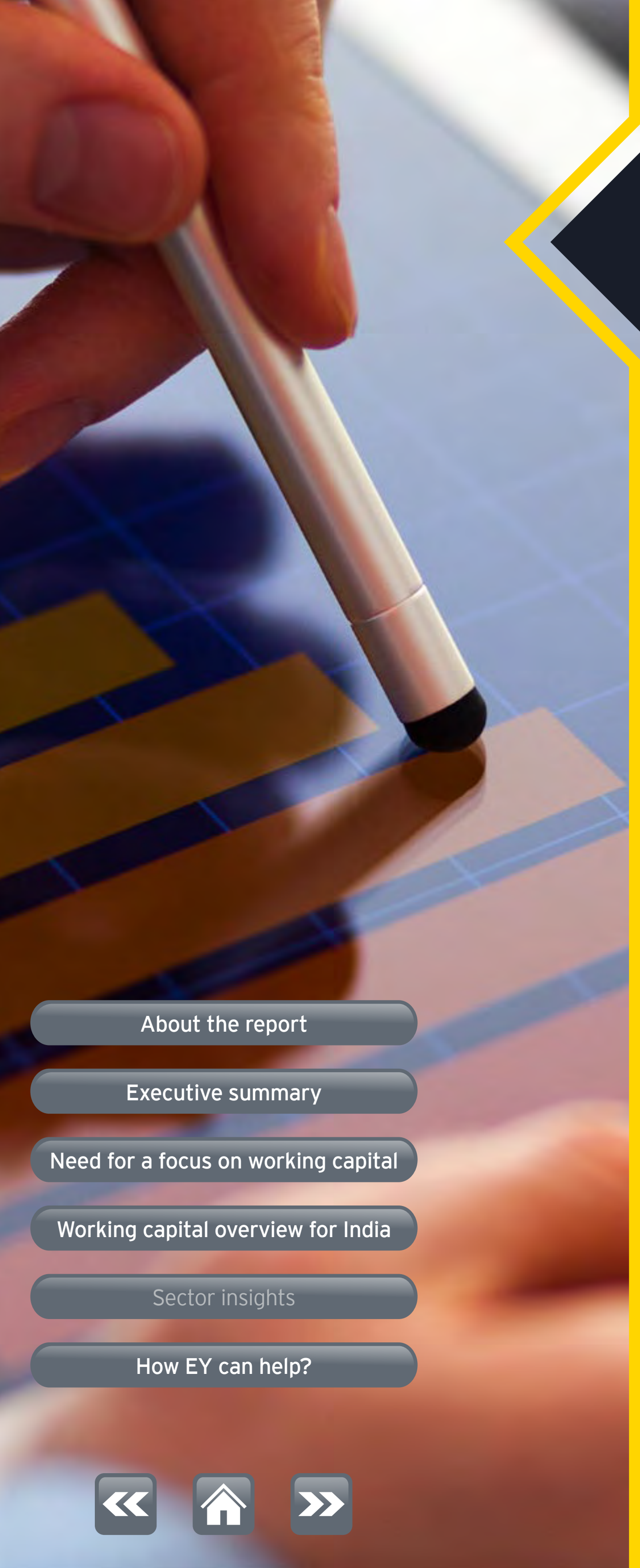
FY20*	India	US	UK	China	Brazil
DSO	42	38	38	57	53
DIO	43	32	33	58	36
DPO	47	38	38	72	43
C2C	38	32	32	43	46

- Compared to developed economies, Indian companies have significant opportunities to implement better working capital practices
- Improvement in working capital will release cash in several sectors including Power, Technology and Consumer & Retail with highest C2C as compared with the advanced economies
- DSO for the Power sector was more than 5 times higher than the other 4 countries, leading to the highest C2C
- C2C for the Technology sector, mainly driven by a high DSO, is the highest compared to advanced as well as emerging markets
- In addition, higher levels of inventory by Indian Retail & Consumer companies have driven higher working capital needs as compared to the US, Europe and China

Source: EY analysis

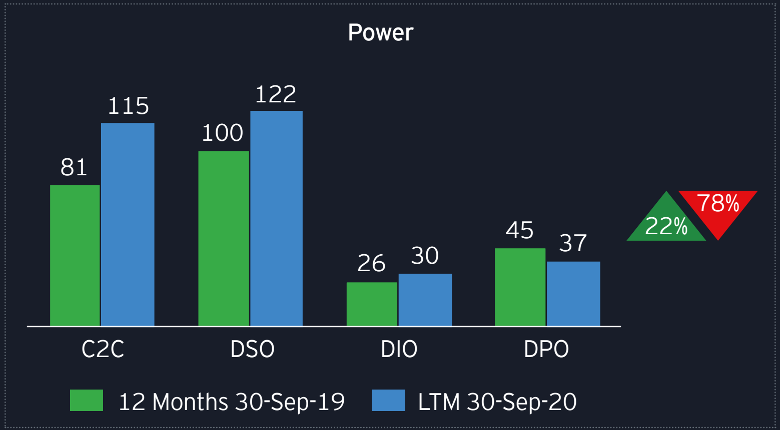
**Year ending December 2019 / March 2020*

3 Sector insights

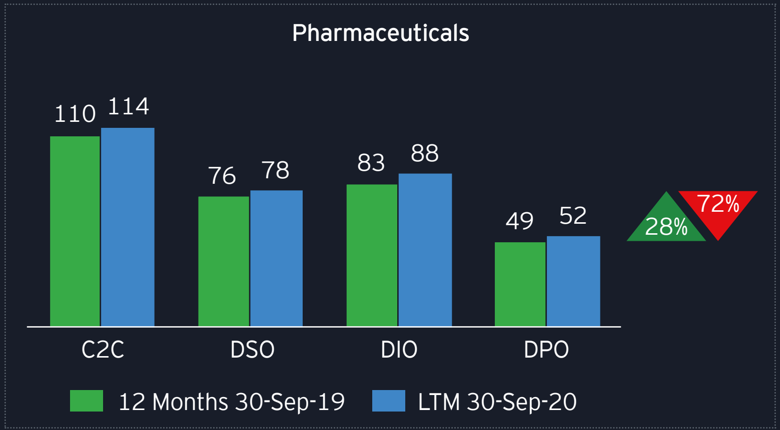


Deterioration in C2C days was led by reduced collections for the Power sector and inventory build-up for the Pharma sector due to supply chain disruptions

Working capital performance as per sector



- Being an essential service, plant operations in the sector were not significantly impacted during COVID
- However, for c.78% of the companies there was a deterioration in receivables predominantly driven by decrease in bill collections from end consumers



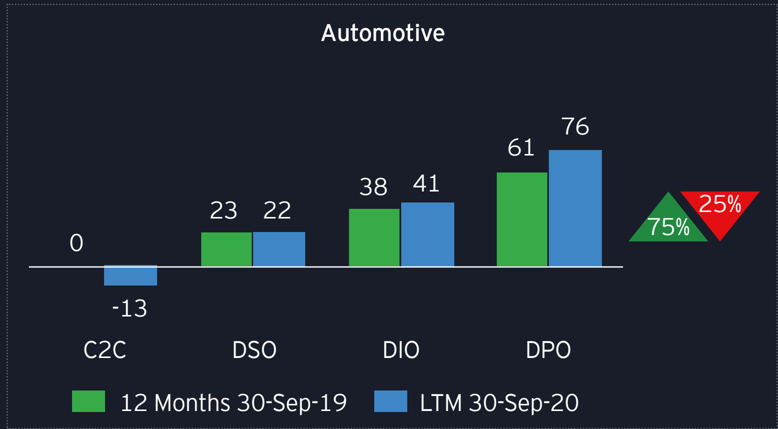
- Being essential services, the sector remained largely operational. Though c.72% of the companies experienced increase in C2C days
- Intermediates, API and FDF manufacturing business experienced inventory build-up, supply chain, transport and labour disruptions

% companies for which C2C Improved in LTM 30-Sep-20 vs 30-Sep-19

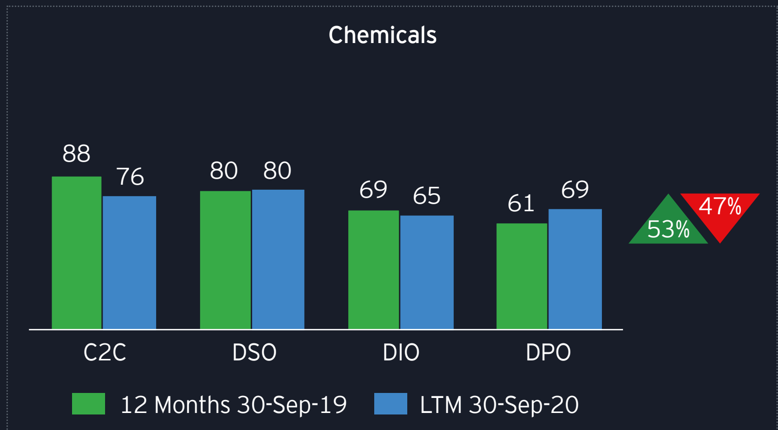
% companies for which C2C deteriorated in LTM 30-Sep-20 vs 30-Sep-19

Auto OEMs extended payables to offset significant reduction in sales and a diversified product portfolio helped the Chemicals sector increase its resilience

Working capital performance as per sector



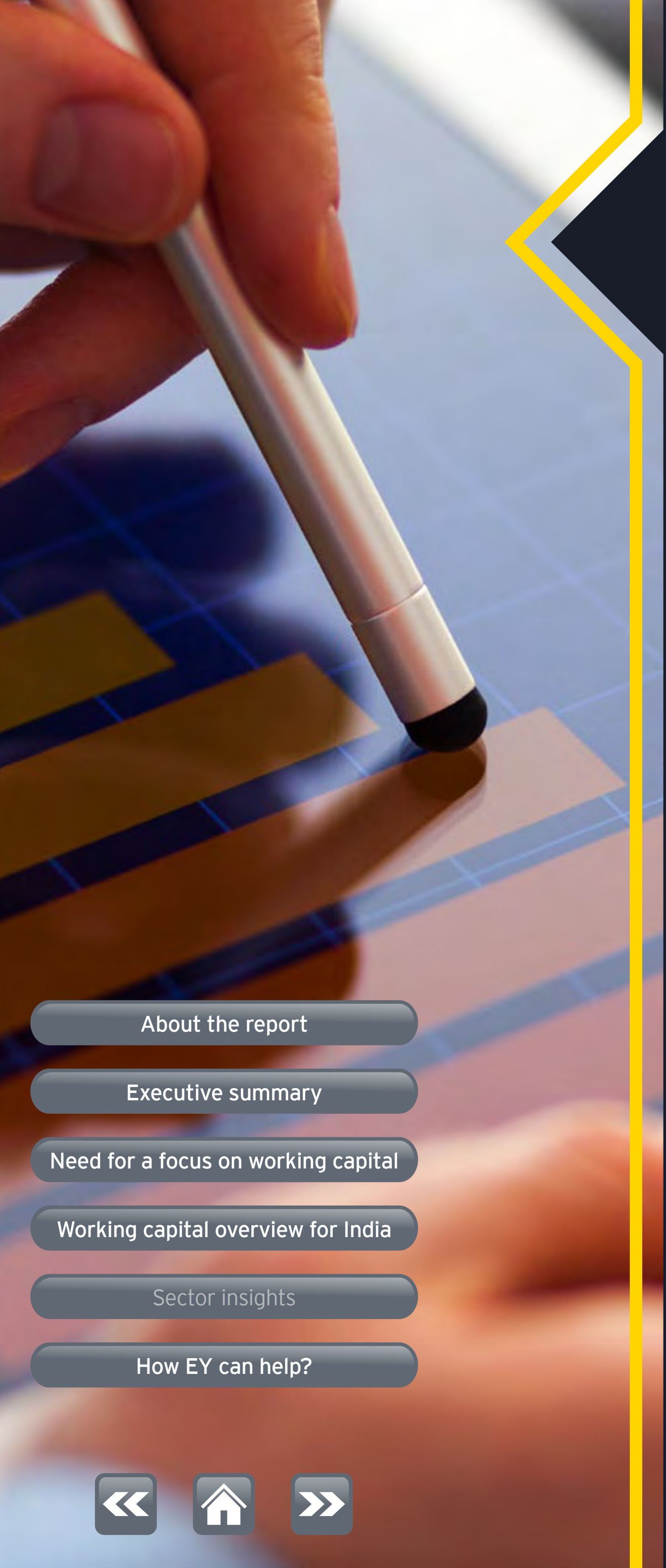
- Despite significant reduction in sales/ revenues due to lockdown and disruptions in distribution network, Auto OEMs improved their C2C days by extending supplier payments
- Post lockdown and reopening of production facilities, companies realigned their production levels to compensate for the loss of sales volume



- c.53% experienced an improvement in C2C days mainly driven by increased demand in some of end use sectors such as pharma, food packaging, sanitary and medical applications (e.g. sanitizers etc.)
- Further, short term supply disruptions from China led to increased order inflows from global companies which had a positive impact on the DIO

▲ % companies for which C2C Improved in LTM 30-Sep-20 vs 30-Sep-19

▼ % companies for which C2C deteriorated in LTM 30-Sep-20 vs 30-Sep-19



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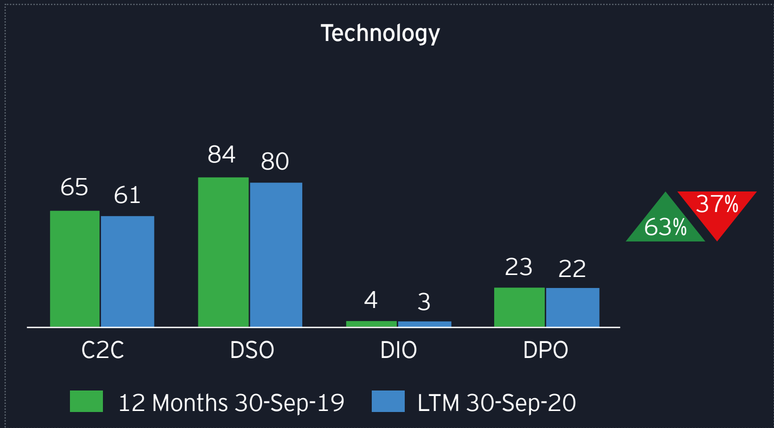
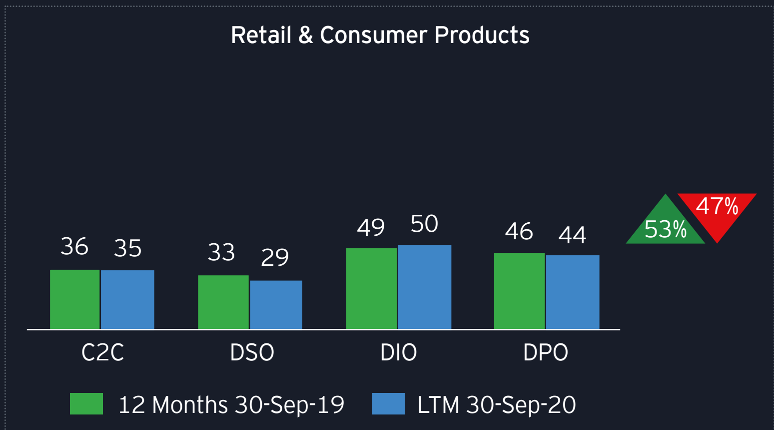
A shift to online sales channels and digital investments by businesses drove improvement in C2C days across Retail and Technology sectors respectively

Working capital performance as per sector



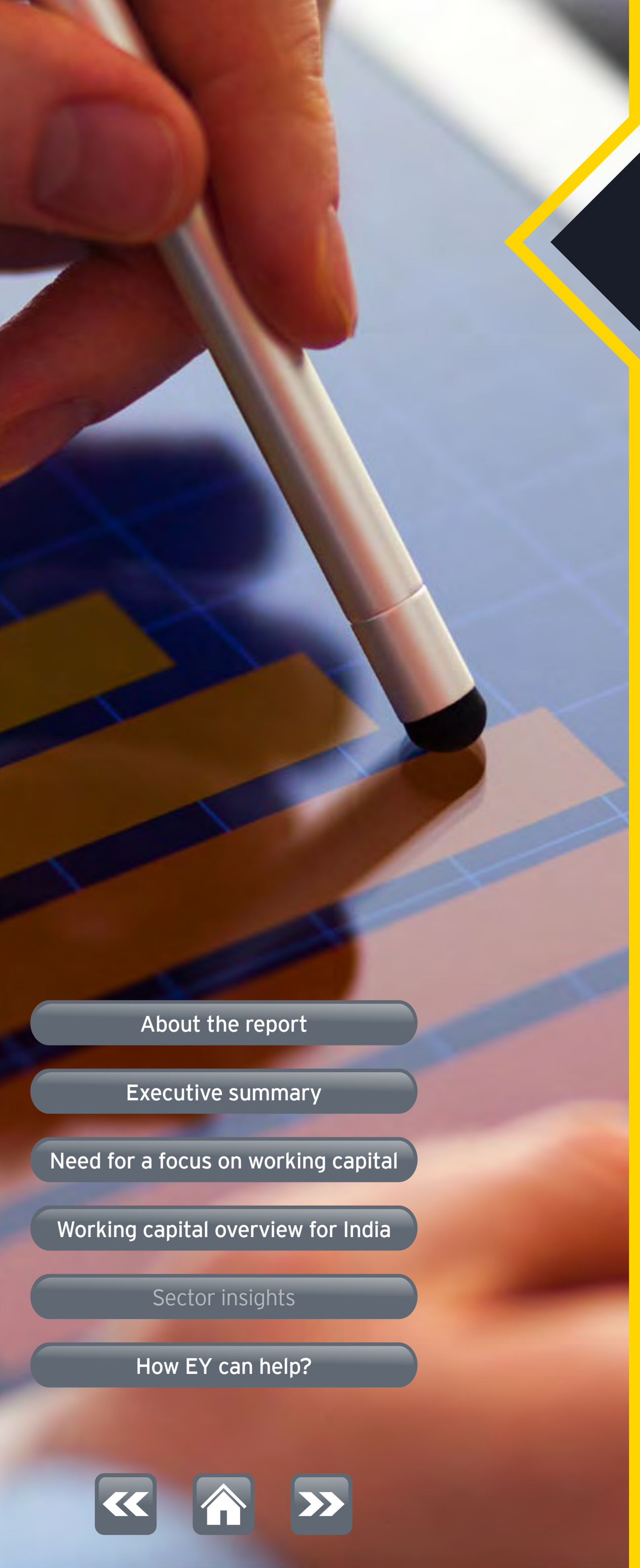
- Technology sector saw increased activity as companies accelerated digital investments to support business continuity during the pandemic
- The accelerated digitization by businesses led overall increase in revenues for the Technology sector, thus driving down the C2C for majority of companies (c.63%)



- Increased sales through e-commerce and MT channels complemented by focused initiatives has resulted in an improved DSO days
- DIO in the sector remained broadly stable as decrease in sales of non essentials was largely offset by increase in sales of essential products

▲ % companies for which C2C Improved in LTM 30-Sep-20 vs 30-Sep-19

▼ % companies for which C2C deteriorated in LTM 30-Sep-20 vs 30-Sep-19



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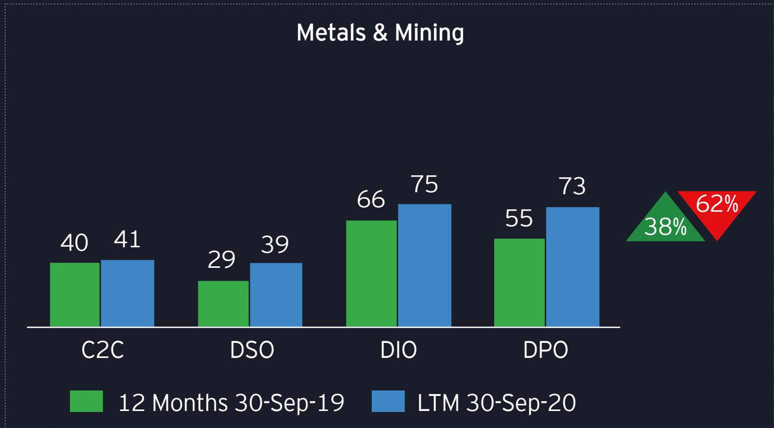
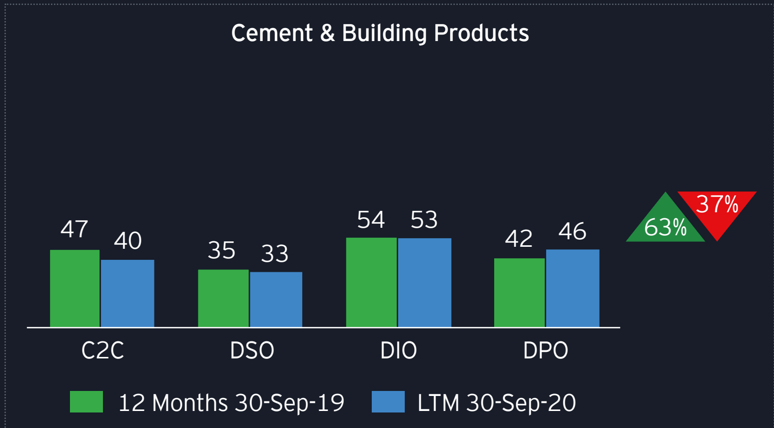
Inventory pile-up drove significant deterioration in C2C days for Metals & Mining while Cement businesses stretched their payables to preserve working capital

Working capital performance as per sector



- 62% of Metals & Mining businesses experienced a deterioration in C2C days primarily driven by muted demand across infrastructure and automobiles sectors
- DIO across the sector increased as plants continued to produce at a minimum viable capacity, irrespective of off-take during the lockdown period to prevent expensive shutdowns



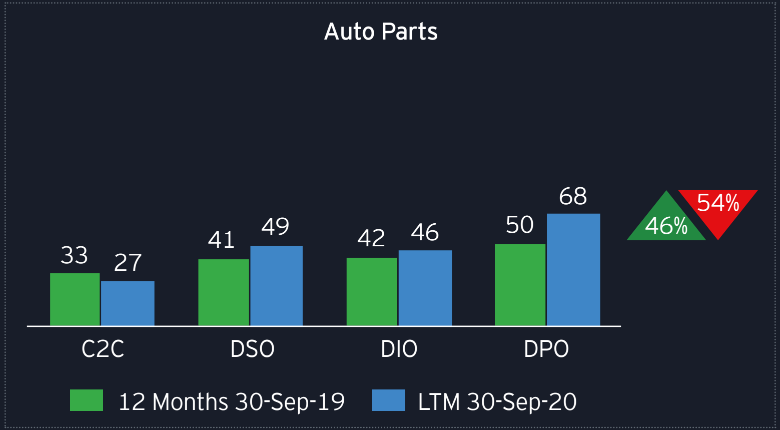
- Post lockdown government projects, rural/ sub-urban areas and North India, led demand recovery due to labour availability
- Businesses preserved cash through focused collections, offering stricter credit terms to customers and delayed payments to suppliers
- DIO across the sector decreased due to lower inventory valuations driven by drastic decline in prices of petroleum coke

▲ % companies for which C2C Improved in LTM 30-Sep-20 vs 30-Sep-19

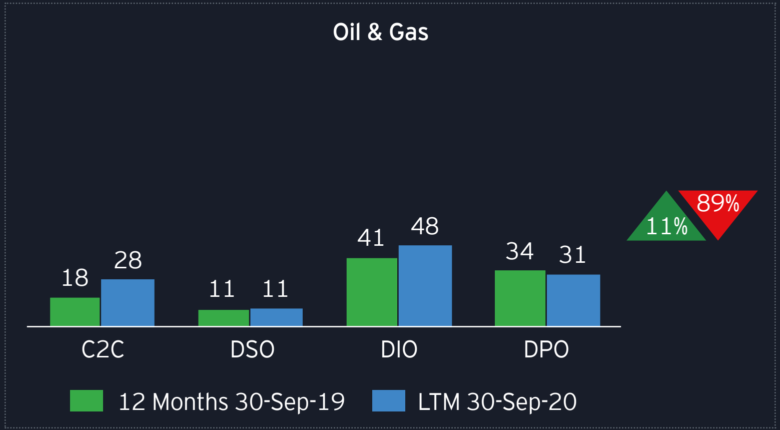
▼ % companies for which C2C deteriorated in LTM 30-Sep-20 vs 30-Sep-19

Auto Parts companies stretched their payables to offset reduction in demand and inventory pile-up drove significant deterioration in C2C days for Oil & Gas

Working capital performance as per sector



- Working capital across the Auto Parts sector was severely impacted by drop in end customer demand
- However, a large number of businesses managed their short term liquidity by stretching payables considerably



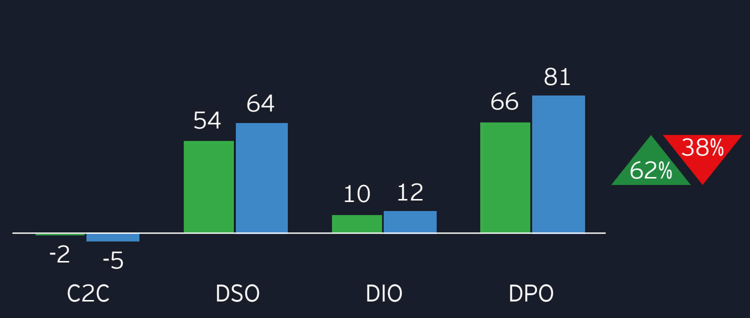
- 89% of O&G businesses suffered significant increase in C2C days, mainly due to collapse of demand for crude oil, leading to crude & product inventory pile-up
- Unlike other sectors, extending supplier payments has not been possible as majority of payments (e.g. for crude oil) are bound by global contractual terms

▲ % companies for which C2C Improved in LTM 30-Sep-20 vs 30-Sep-19

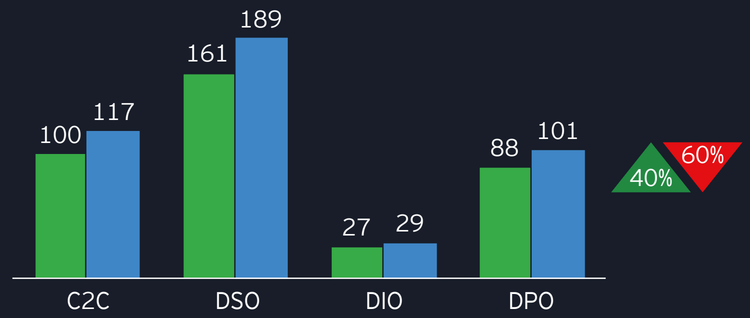
▼ % companies for which C2C deteriorated in LTM 30-Sep-20 vs 30-Sep-19

Across the utilities sector, impact of reduced collections was offset by stretching payables while project delays due to lockdown resulted in a high C2C in EPC

Working capital performance as per sector



- While the household consumption of gas, power and water increased during the lockdown, billings and collections reduced considerably
- In turn, majority of the Utilities sector (62%) stretched supplier payments (e.g. to power companies) to fund short term liquidity needs



- 60% of the companies in the sector experienced increase in C2C due to delayed collections driven by issues such as work stoppages, delays in claims settlement, agreement on extension of time, inability to complete project milestones, delay in arbitration awards etc.

▲ % companies for which C2C Improved in LTM 30-Sep-20 vs 30-Sep-19

▼ % companies for which C2C deteriorated in LTM 30-Sep-20 vs 30-Sep-19

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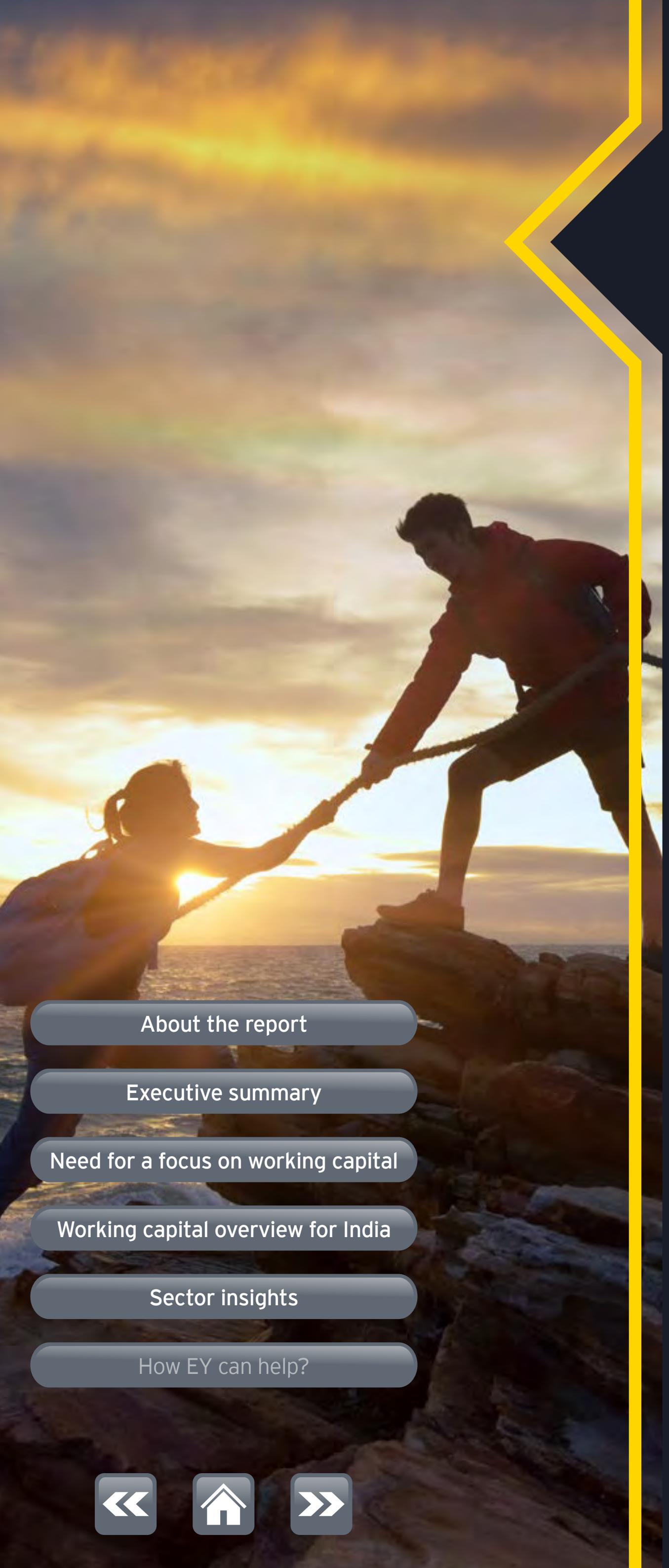

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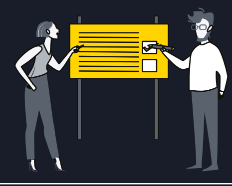
It is imperative for firms to have a structured approach to mitigate working capital management issues, especially during the current economic scenario

Scenario planning

- Evaluation of impact on business plan and re-forecast
- Assess demand shifts / channel shifts and adjust plan
- Identification of potential production shift to high-demand products

Set up "collection cells"

- Dedicated cash management team to drive collections
- Review credit limits and credit periods for customers with respect to revised sales plan and criticality of customer
- Consider use of early payment discounts, bill discounting
- Assess customer liquidity



Spend management

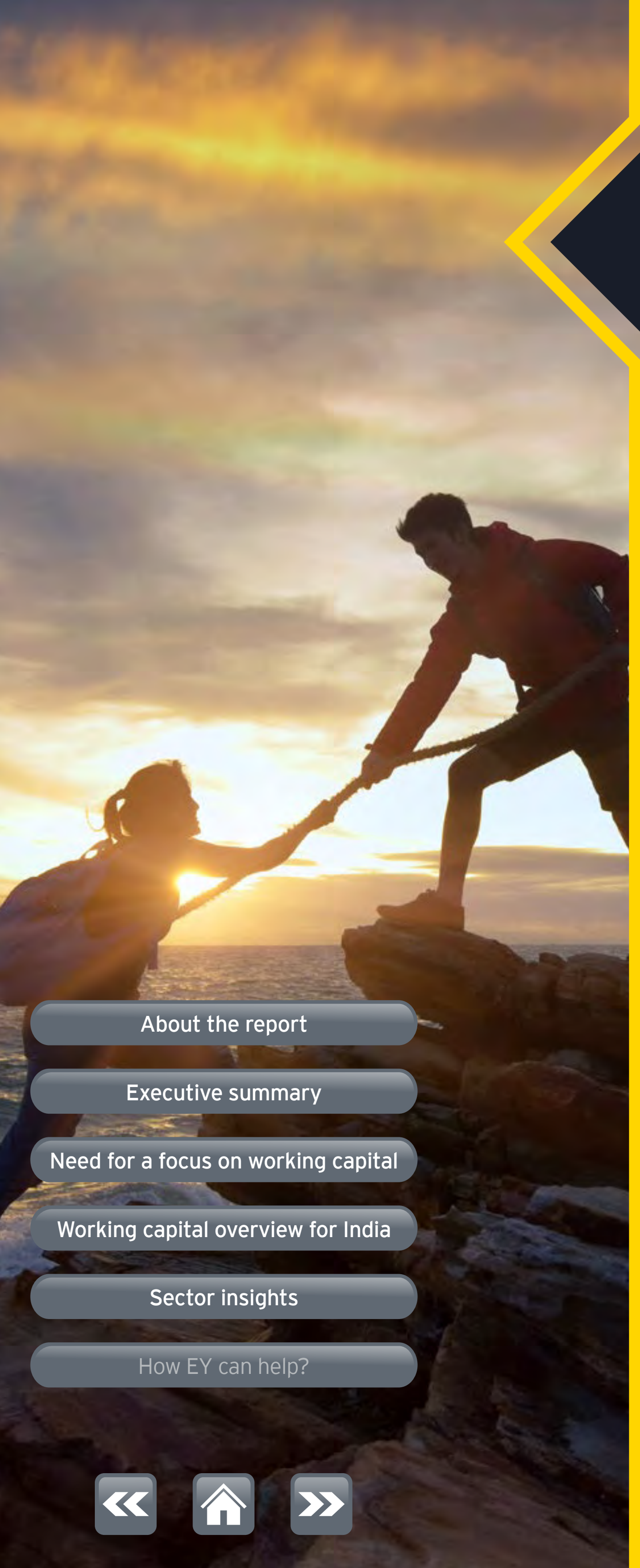
- Review direct / indirect expenditures criticality, ability to defer or cancel
- Identify opportunities for "stagger and delay"
- Assessment of open orders to identify critical supplies
- Vendor financial assessment to flag potential risk of vendor's non-performance

Short-term cash flow forecast

- Undertaking short and medium term cash forecasting under crisis scenario
- Centralize all decision making linked to cash and burn rate monitoring
- Implement daily/weekly rolling forecast on a quarterly basis

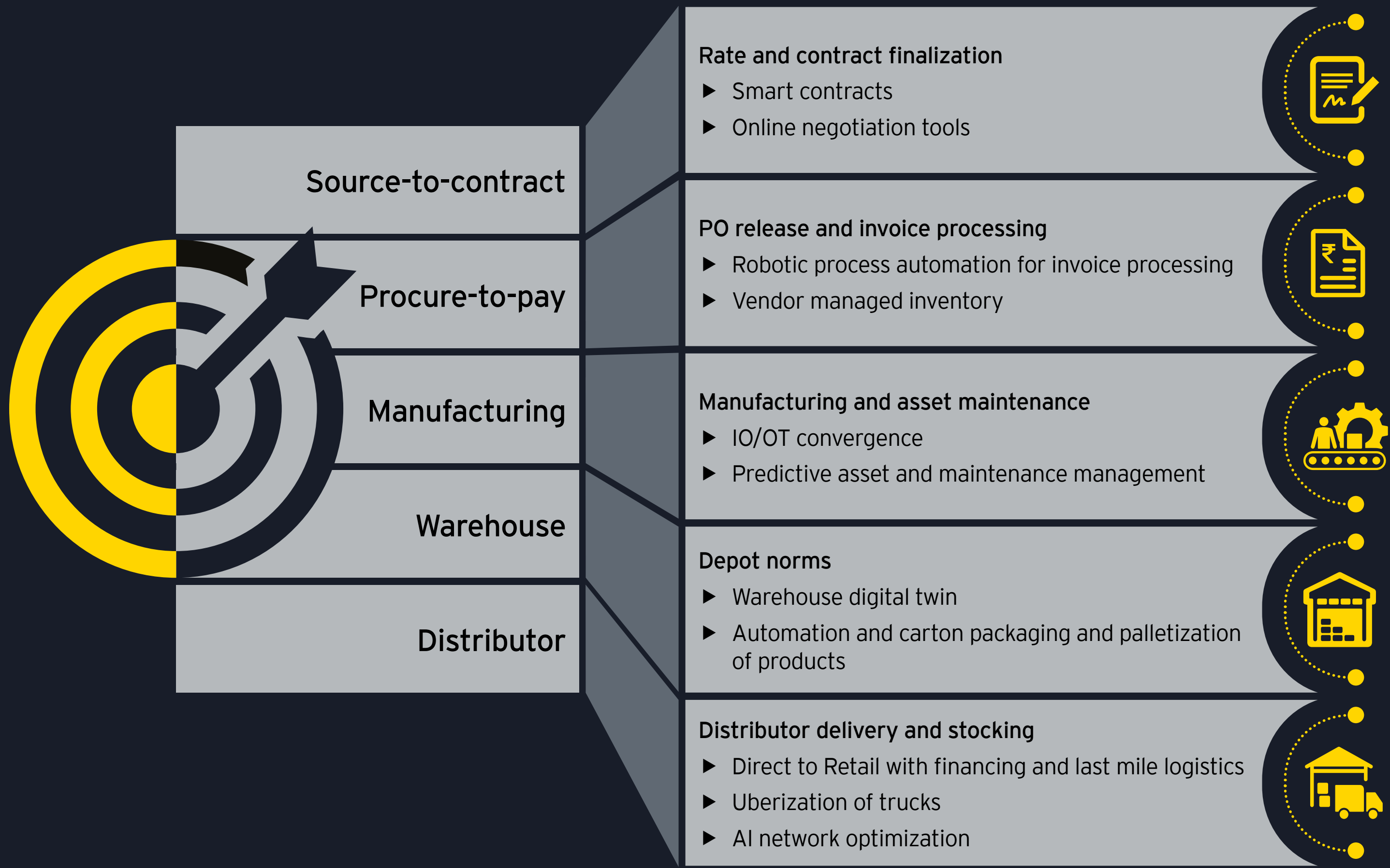
Governance and incentives

- Define incentive mechanism and KPI's, more inclined towards cash
- Introduce "collection reward programs" to incentivise timely customer payments
- Establish robust governance and monitoring structure



Businesses are leveraging technology and data analytics to drive business decisions and improve working capital management

Examples of emerging technology solutions



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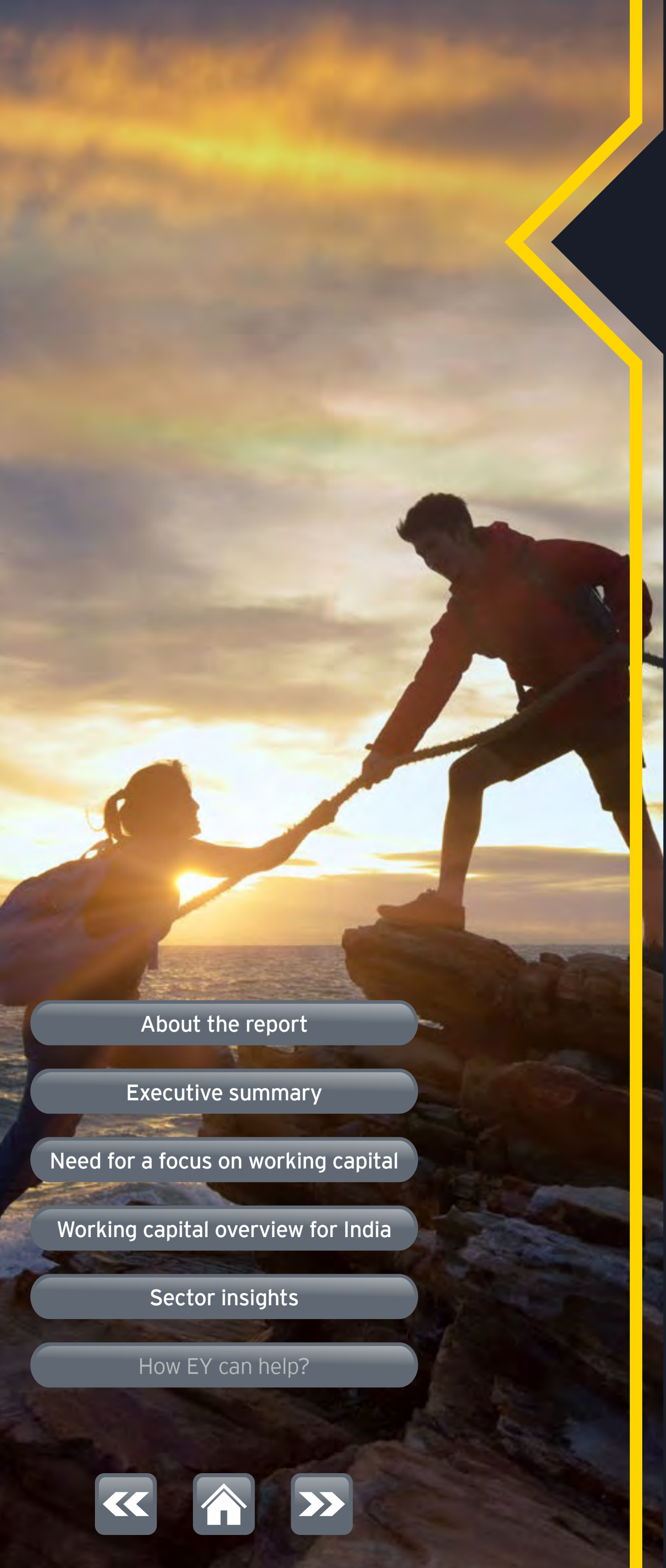

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EY's working capital team can help identify, evaluate and prioritize realizable process improvements to release significant cash tied up in working capital

Illustrative initiatives

Agile supply chain: conduct robust sales and operations planning combined with flexible supply chain to meet dynamic demand requirements

Supplier management: leverage "timely payments" as a tool to develop better supplier relationship and reduce sourcing costs

Customer engagement: facilitate greater collaboration with customers, resulting in better payment terms and collection efficiencies

Enhanced role of finance: move from a "transactional" approach to business partnering to help functions manage trade-offs between cost and cash

Analytics: use big data to enhance control through improved visibility and decision support

Cash culture: embed a Cash Culture in the organization across functions

Robotic Process Automation (RPA): use emerging technologies such as RPA for automating repetitive transactional processing

Organization structure: establish adequate role definitions and clearly defined RACI

Automation in supply chain: leverage upcoming advances such as drone technology in warehousing and logistics

Management focus: strike a balance between competing priorities and appropriate incentives for "cash" focus

Digitization: implement an end-to-end integration application to eliminate manual processes

Governance: establish a robust governance structure, metrics and regular reporting

Our offices

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