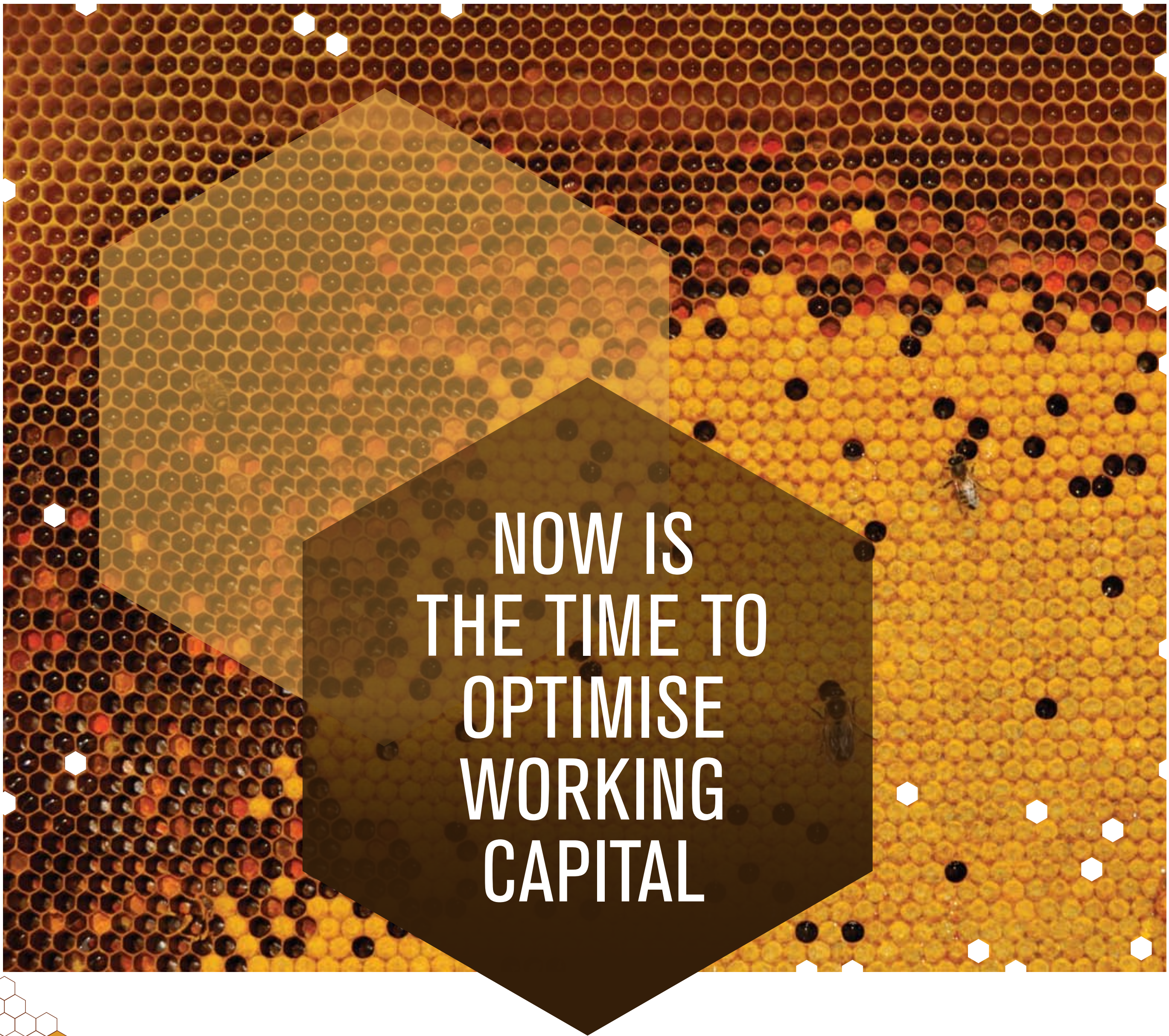

NOW IS THE TIME TO OPTIMISE WORKING CAPITAL

Conditions are perfect for corporates to improve efficiency in their working capital programmes, says *Thomas Dusch*, Head of Trade Finance International Sales Germany at UniCredit.

Part of the reason that now is a good time for corporates to improve their working capital programmes is down to increasing bank risk appetite, as well as newly-developed Supply Chain Finance (SCF) techniques contributing to an environment full of opportunity. This makes now a strong time for corporates to focus on new levels of optimisation in short-term financing.

Such an initiative would not only open up new sources of liquidity for investment – it promises robust risk management, increased bargaining power and long-term supply chain sustainability. As such, this is an objective tied up with the whole trade finance business, and will demand unprecedented levels of co-operation between finance, sales, procurement and treasury departments.

To put these ideas into action – and take full advantage of benign market conditions – a corporate's three main priorities are:

- Inventory management: turning bad capital into good.
- Managing receivables portfolios: improving Days Payables Outstanding (DPO) or Days Sales Outstanding (DSO) while mitigating risk.
- Extending financing to suppliers: ensuring sustainable supply chains and improving bargaining power.

Integration and co-operation

Of these, inventory management is perhaps the most neglected. But for large corporates, it has huge potential benefits. Our most forward-looking clients consider it a constant priority to remove as much inventory as possible from their balance sheets. Doing so opens up capital from previously illiquid assets which can be used for further investment.

Of course, the treasury department – as the natural driver of working capital optimisation programmes – will liaise with banking partners to implement these changes. But this kind of specialised inventory management will also require new levels of co-operation between procurement, finance and sales departments – previously very separate entities with their own responsibilities. These functions have now come to realise that closer working relationships – and the formation of "virtual teams" between departments – can benefit the entire company through increased capital availability and an improved ability to weather financial headwinds. In this context another very important value-adding external party should be included for Inventory Management structures: Logistic Service Providers. Vendor-Managed Inventory (VMI) is just one interesting aspect that can help to improve working capital.

"THE KEY TO SUCCESS IS IMPLEMENTING THESE PROGRAMMES THROUGH THE PROPER PLATFORMS."

Thomas Dusch, UniCredit

Portfolio management

Rationalising receivables financing portfolios is another case in point. In Europe, many corporates are cash rich, and improving DPO or DSO has not been a priority. But risk management is the often overlooked wider benefit.

At present, the difference in cost between uncommitted and committed lines is relatively low – so it makes good business sense to put committed lines in place now, even on receivables contracts. This is also good risk management.

A corporate with exposure to a high number of similarly risky receivables contracts – for example, to counterparties in the same high-risk region – could manage its concentration risks by offloading them in a bundled package attractive for banks or alternative financiers. This not only improves the corporate's DSO, but also the asset quality on its balance sheet. It's the forward-looking, risk management benefit that corporates are beginning to prioritise. And the same principle extends to financing arrangements with suppliers.

Supplier financing

Indeed, larger corporates are using their strong credit profiles to extend their positive financing conditions to suppliers with higher credit risks – known as approved payable finance/discount or erroneously "reverse factoring". This is particularly important for corporates with supply chains extending into emerging economies. Not only does it help to maintain the financial health of crucial suppliers, but it can be used to secure better terms and long-term supply. It also helps to eliminate an often underestimated risk component in connection with forfaiting transactions, the so-called servicer risk.

For instance, if a buyer guarantees its bank payment for certain invoices, the bank can extend liquidity to the supplier based on the buyer's robust credit profile. As such, reverse factoring allows the buyer to benefit from longer payment terms while providing suppliers with immediate working capital at low financing rates.

Undoubtedly, a supplier with a strong financing programme from its buyer has a number of good reasons to maintain the relationship. For them, the task of finding a replacement buyer, negotiating terms and setting up an equivalent financing programme could be prohibitively time consuming and expensive.

In this way, SCF techniques become another tool to help corporates increase the sustainability and affordability of their supply chains – and it's another example of how the finance department can work in tandem with the sales, procurement and treasury departments to improve competitiveness.

Easing the workload

With all these new programmes, treasury departments may well wonder about the number of invoices and items created. In our view, the key to success in working capital optimisation is about implementing these programmes through the proper platforms. Otherwise, the treasury department's workload will increase rather than decrease.

Of course, there is no 'one size fits all' approach, which needs to be understood by the services company or bank providing the solution. While there will inevitably be a degree of standardisation, the individuality of each corporate's supply chain makes a fully standardised offering virtually impossible. Even the supplier on-boarding process alone – potentially spanning geographies and disparate compliance processes – cannot be easily reduced to a tick-box exercise.

Ultimately, what is vital is that each solution allows for full automation and links into corporates' booking systems. This eases the development of new connections between departments, which would otherwise be a tough ask and could undermine ambitious working capital optimisation programmes. That said, the wider benefits to risk management, working capital, supply chain sustainability and competitiveness make them a worthy investment – especially if delivered via the right platform.