THE BENEFITS OF A HOLISTIC APPROACH TO WORKING CAPITAL MANAGEMENT

Against a backdrop of lengthening supply chains and economic uncertainty, comprehensive working capital management programmes are growing in popularity. Adeline de Metz, UniCredit's Global Co-Head of Trade and Working Capital Solutions outlines how a holistic approach to working capital management can lead to significantly better results over time.

News headlines over the past few years have made grim reading for those with a stake in global trade and supply chains. Rising economic unrest coupled with the concerted globalisation of supply chains over the last decade have heightened the need for corporates around the world to bolster their working capital and supply-chain stability with more effective working capital management solutions.

There is still much to explore in this respect, but progress starts from a simple realisation: corporates and banks currently focused on individual solutions can improve the way they work together by creating tailored working capital management programmes that address the full breadth of the company's financial situation and associated needs. This is an approach that can yield immediate results, but that's not to say that it is a short-term fix. In fact, when taking a more holistic approach, corporates will find that the benefits compound over time.

Changing the approach

So, what do we mean by a more holistic approach? Traditionally, the typical working capital sales process begins with a series of meetings between the corporate and different product teams within the bank – each pitching their own capabilities. This product-driven mindset often means that the big picture gets ignored – leaving efficiencies on the table. The key to a holistic approach is for corporates to have just one point of contact with the bank for all working capital solutions. From here, the bank contact can conduct an in-depth study of the corporate's financial situation – factoring in its specific challenges, needs and objectives. Armed with this information, corporates and their banks can determine a more nuanced solution – often involving a combination of financing techniques to provide a comprehensive answer to all the corporate's working capital requirements.

This streamlined approach is a relatively new concept. The traditional, siloed structure of banks has historically made the necessary inter-departmental co-operation something of a challenge. Yet as these silos begin to break down, holistic working capital management is becoming possible and its long-term benefits are clear.

Customising the solution

The constituent parts of a comprehensive working capital programme will always come down to the specific objectives of the corporate. These objectives vary, but often include improving liquidity (popular among small and medium-sized enterprises), optimising free cash flow, and improving the leverage ratio (both common requests from multinational corporations). Working capital management is also sought as a means to mitigate the risks associated with trade and as a preparatory measure ahead of high-level activities like M&As or capital expenditure.

Which techniques, or combination of techniques, is most appropriate also hinges on a number of other factors, including the corporate's credit rating, size, access to liquidity, the state of its balance sheet (for example, whether there are any covenants on outstanding loans), as well as its geographical footprint and the currencies in which it is conducting its business. All these variables will have a direct impact on how any working capital programme is executed.

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Once the goals and parameters have been determined, the bank's advisory team will propose an optimal blend of financing tools. In general, these techniques fall into three groups: single-name receivables finance (also known as forfaiting), financing of portfolios of receivables (for example, through securitisation) and factoring. Each of these techniques come with their own advantages and disadvantages, depending on the corporate's specific circumstances. Forfaiting programmes, for instance, are well-suited to large corporates, since they offer a flexible and attractively-priced working capital solution. Implementation, however, involves considerable administrative work, meaning this technique is best suited to very large programmes based on a small number of debtors.

By weighing up the various benefits of different tools, corporates and their banks can construct a more sophisticated, balanced and comprehensive programme that addresses the company's needs in a sustainable way.

Holistic working capital management in practice

In 2016, one of UniCredit's German clients was looking to replace an expensive, inflexible and non-growth oriented factoring programme. The client, owned by a private equity firm, had a high leverage ratio with considerable refinancing costs and strict covenants governing its debt. As such, the client was looking for a financing programme that would have a positive impact on its balance sheet.

Responding to this challenge, UniCredit arranged a EUR 110 million global securitisation programme – a significant undertaking in terms of the administration and data-gathering involved, but one justified by the need to achieve tight financing and positive balance-sheet impact.

Two years later, in 2018, the same client carried out an IPO – raising capital and drastically improving its leverage ratio and credit rating. This created an opportunity to further enhance the company's working capital in new ways.

We responded to this opportunity by increasing the value of the client's existing securitisation programme to EUR 135 million and establishing an ongoing dialogue on various working capital topics, with an early-stage involvement in payables finance opportunities.

Indeed, with just one person from the bank reviewing the client's financial position and reaching out to the various product factories, we were able to establish that, with significantly less debt on the balance sheet, the company could also speak to the bank's supply chain finance team and use payables finance to extend its payment terms with suppliers, while simultaneously stabilising its supply chain.

This second stage would not have been possible without the holistic approach. If, for instance, the client had simply been in contact with the securitisation team – as is typically the case under traditional working capital management practices – the supplementary solutions from other areas of the bank may never have been considered.

This example shows that a holistic working capital management model for banks and corporates not only benefits corporates in the near term, but promotes further efficiencies over time. This looks to be a promising way forward – forging a future in which banks continue to help corporates meet the demands of an increasingly globalised economy, and in turn, strengthening working relationships all the way down the supply chain.

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