Working Capital Strategies to Drive Shareholder Value

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Working capital management has emerged as one of treasurers' most important priorities over recent years. According to Deloitte's 2015 Global Treasury Survey, in which 23% of respondents represented the technology, media and telecoms (TMT) sectors, nearly 70% of treasurers have been mandated by the CFO to drive working capital improvement initiatives, not simply for tactical reasons, but to drive shareholder value. Despite this mandate, however, the survey revealed that working capital optimisation does not yet appear to be a treasury priority, which suggests that both treasurers' and CFOs' commitment, or ability to influence working capital may be limited.

The value of working capital

An important issue for investors in TMT companies is to maximise the efficiency of the asset base. This has been evidenced recently through a series of high profile acquisitions, mergers and divestures within the technology sector, including Dell, HP, eBay and most recently Xerox, as companies re-evaluate the structure of their businesses to unlock shareholder value. However, the role of working capital as a driver of capital efficiency is often overlooked in terms of asset pricing and how the asset base is used. With significant stock market volatility, and growing competition for high quality investment, CFOs and treasurers can no longer afford to be complacent about their working capital performance, nor ignore the contribution that effective working capital strategies make to return on capital invested.

Although the global financial crisis prompted a renewed interest in working capital when market liquidity was more constrained, many companies quickly became complacent. Although access to liquidity narrowed, large, creditworthy organisations in many industries continued to enjoy easy access to credit, encouraged further by the attraction of low interest rates. As a result, many companies boosted their balance sheet in response to the global economic crisis to create a cash buffer, so working capital was pushed down the list of priorities. The lack of working capital focus is not only a historic phenomenon. As economic performance in countries such as US and UK improve, and growth continues in Asian economies, albeit at a more modest rate, companies are focusing more on revenue growth, while strong existing margins, facility headroom and surplus cash also distract from the importance of working capital.

As a result, while treasurers may be mandated to focus on working capital in theory, the reality is that there is often a lack of senior management leadership or motivation, and linking senior management remuneration to return on capital may not be enough. However, given investors' search for optimal, stable returns in volatile markets, treasurers and CFOs cannot ignore the opportunity provided by optimising working capital processes and metrics, setting the right level of working capital for the business, unlocking cash for investment and growth and therefore maximising capital efficiency and shareholder value.

Driving working capital strategy

An obvious first question is ‘who owns working capital?’ This is not easy to answer given that a number of departments and business units play a part in the supply chain and therefore influence working capital. In this situation, there needs to be a single point of focus not only to co-ordinate initiatives across departments, but to define working capital strategy, and identify, prioritise and drive initiatives to achieve this strategy.

In many organisations, treasury is the most logical owner of working capital strategy and delivery, but this is not always apparent to other parts of the business, which often see treasury more as an aggregator of transactions and business reporting rather than a business function that is in a position to influence the business flows that contribute to working capital.

Treasury possesses a number of unique attributes that position it as a natural ‘owner’ of working capital. Since the global financial crisis in particular, treasury’s role and profile has been elevated as company boards became more aware of the importance of treasury’s cash, liquidity and risk management responsibilities. As treasury’s role has expanded into new areas, such as enterprise risk management etc. it is becoming a facilitator of change, but in many cases, this change management role does not yet encompass the financial supply chain.

Treasury also offers a unique perspective on business flows and working capital metrics, by bringing flows together and analysing the net impact, whereas departments such as accounts payable, accounts receivable and procurement have responsibility for a single element of the financial supply chain. It is therefore a logical next step to use this data collated in ERP or TMS, supplemented where necessary with subsidiary ledger information, for example, to analyse working capital opportunities.

Leadership in practice

An essential way in which treasurers can start to exert an influence on working capital is to engage with the business in a constructive way, not simply for reporting. For example, an obvious link into the working capital cycle is through the cash flow forecasting process, an area in which treasury typically has an ownership role already. Rather than simply collating flows, treasurers have the opportunity to work with business units to understand flows and how they originate and are processed in more detail, creating a foundation for working capital improvements. There is also the benefit of being able to enhance forecasting accuracy by challenging and refining ways in which forecasts are created.

By building relationships and understanding the business dynamics, treasurers are in a better position to take the lead on, rather than simply co-ordinate working capital initiatives. Furthermore, treasurers have skills that are highly complementary to the wider business and can therefore influence their success. For example, shared service centres (SSCs) are often well-resourced and experienced in managing financial processes; however, they typically have fewer resources to analyse these processes and identify improvements. Given treasury’s analytic skills, and experience in managing business-critical transactions, it offers a natural complement to SSC expertise.

Overcoming obstacles

While treasury’s ability to drive working capital strategy and performance, and the benefits of focusing on working capital may be clear on paper, or even to some parts of the business, its involvement will not necessarily be universally welcomed.

Firstly, senior management support is essential to avoid organisational roadblocks and ensure that working capital participants are similarly incentivised to focus on group-wide objectives rather than individual metrics. For example, working capital management is an individual strategic objective for the CFO of media giant WPP as a management tool to address the principal risk associated with economic cycles. Treasury is responsible for monitoring performance and working capital targets are set for the group’s major operations. This common motivation is essential to a successful working capital strategy. At every point in the supply chain, there is a balance to be struck between commercial and working capital objectives, so every department needs clear parameters to maintain this balance. For example, a technology company offering extended credit terms may boost sales revenues, but the impact on days sales outstanding (DSO) is negative. These credit terms may differ across sales units, countries and ERPs, so it is essential to understand what levers are available and where greater consistency could be beneficial. Similarly, offering better service levels is often a way to provide customers with more value whilst maintaining pricing levels, but this can be a detrimental if there is a risk that the company will need to hold too much, or out of date stock, a particular concern for items such as mobile handsets.

Secondly, treasury needs to be sensitive to the culture of the organisation, including the business units' or departments' autonomy, and their identity as a business function. The more integrated and less isolated treasury can become, the better able it is to add value to process efficiency and return on capital. Working capital optimisation can be one element of a wider dialogue with business units and departments, or a means of starting this process of engagement.

Treasury has the capabilities, network and motivation (if not always the capacity!) to develop and deliver a working capital strategy, with experience of benchmarking and influencing skills to demonstrate the benefits of a co-ordinated, systematic approach rather than isolated initiatives that do not necessarily result in a change of behaviour or group-wide value. Furthermore, with better visibility and control over financial assets, treasury is in a position to forecast cash flow with greater accuracy, and to monetise these assets using financing techniques to enhance working capital further. In addition, it is then able to make more strategic recommendations such as lowering borrowing headroom to reduce the cost of borrowing and improve debt/equity ratios, and pursuing investment programmes, therefore creating greater confidence amongst investors and credit rating agencies.

A working capital partner

At HSBC, we recognise the compelling opportunities that working capital improvements offer to businesses across all sizes and industries. Although our comprehensive range of payables, receivables, cash management and trade finance solutions offer the tools to create working capital efficiencies, it is essential to adopt the right combination of solutions in a way that meets a company's specific working capital priorities. To facilitate this, we have built an expert advisory and benchmarking function, with senior practitioners from corporate treasury, and working capital and cash consultancies, offering insights, experience and practical expertise in implementing working capital projects. Our advisory team supports clients in identifying working capital opportunities and priorities, and creating the relevant business case. In our experience, the saying 'what gets measured gets done' resonates strongly in many corporations, so dashboards and visual analytics that allow users to model the impact of changes to working capital metrics and cash flow measures can make the business case more compelling and more easily demonstrable to the wider business.

One of the ways we do this is benchmarking, not only to analyse a company's performance in isolation, but also in comparison with industry peers. There is typically a correlation between the best performing companies and working capital performance, so we help clients to pinpoint similarities and differences, and where improvements could be made. Our ability to do this is greatly enhanced with an innovative application that uses publicly available data to benchmark working capital performance across sectors and geographies in real time.

Our commitment to working capital is not restricted to a single department, however, and we want working capital to be a key part of our customer dialogue. To do this, we have established an extensive training programme across our business so that our sales, relationship management and delivery teams understand clients' working capital drivers and are therefore more closely attuned to their business needs.

In summary, working capital management is now firmly established amongst the world's most successful companies as a management tool to improve return on capital and drive shareholder value, none more so than Apple with research firm Gartner ranking Apple's supply chain as the best supply chain in the world every year from 2010 to 2013. Corporations that take the time to explore, identify and prioritise opportunities for improvement, and leverage the solutions and expertise that are available, are likely to derive significant operational and advantage, and develop confidence amongst shareholders, analysts and credit rating agencies. HSBC has placed working capital at the heart of our customer strategy, with expertise and solutions that have been built over many years with the world's most highly respected companies.

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