Keeping the Pipeline Full: How Working Capital is Important to Drive Sales Growth

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Working capital has always been the lifeblood of a company. Faced with a myriad of macroeconomic and business challenges, corporates across a wide variety of sectors are looking for new ways to drive sales. As a result, many are looking within to harness working capital efficiencies.

While the US economy remains robust, the macroeconomic outlook in many geographies is expecting a potential slowdown. Moreover, volatility brought about by the US-China trade war, Brexit and increasing recessionary concerns are increasing uncertainty for many companies, prompting some to maintain higher cash levels. Others are preparing for significant changes to their supply chain structures. Longer-term trends, such as stagnant or falling incomes in some countries, are particularly problematic for consumer-focused firms.

Meanwhile, companies face additional business and sector-specific challenges. Growth in the fast-moving consumer goods (FMCG) sector is now in the low to mid-single digits compared to high single digit growth just five years ago, for instance.

Similar trends are evident across a wide variety of sectors, as new business models combine with technological innovations. Sales teams today need to invest in digital platforms to help tailor their approach and prioritize their efforts. This requires significant investment and running a streamlined working capital model can help make sure resources are allocated efficiently.

Meanwhile, emerging market growth — though slower than a few years ago — continues to be roughly twice that of developed markets. Consequently, companies are eager to increase their emerging market exposure to target the growing middle class and consumers with rising incomes. Moreover, while gaining access to these markets is more challenging with higher risk profiles than developed markets: emerging market sales growth requires more working capital given complex routes to market.

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Even in developed markets, changes in business models are prompting a renewed focus on working capital. For instance, in many countries, retailers are under pressure from online competition and are seeking to move to a direct-to-consumer model. Improvements in working capital are a key focus to ensure that companies are fit for growth. Increasing sales requires improvements in accounts receivables, and a larger inventory. Necessarily, this puts more stress on working capital.

Working capital management is central to overcoming challenges

The backdrop described above threatens companies' ability to grow and maintain margins. Historically, cash flows from operations provide an important source of funds to meet capital expenditure requirements as well as paying dividends or funding growth, either by acquisition or organically.

Profit growth is no longer keeping pace with growth of invested capital: the capital base is expanding faster than corporates' ability to grow sales. Return on invested capital is becoming a greater priority for companies as equity analysts pay increasing attention to it. PwC's 2018-2019 study of the largest companies' working capital performance shows that if companies were to improve their working capital efficiency to the level of the next performance quartile, this would be enough for global companies to boost their capital investment by 55% — without needing to access additional funding or put their cash flows under pressure.[1]

Breaking the cycle to unlock new opportunities

As revenue generation has slowed, including in emerging markets, shareholders demand a higher return on invested capital. Consequently, companies have increasingly chosen to unlock working capital through trade finance and other working capital solutions rather than taking on long term debt or asking shareholders for equity.

In OECD countries, supply chain financing, trade finance loans, receivable financing and other working capital solutions are long established among large corporates.

Moreover, in much of the rest of the world, many commodity-based companies which have tended to be resilient to market fluctuations, are now in recent years, looking to improve working capital. As an example, until recently, firms in sectors such as petrochemicals and metals and mining industry in the emerging markets may not traditionally have regarded working capital as a top KPI. However, as additional capacity is being invested in and access to new markets is a top priority, the trend is shifting to unlocking working capital and corporates in these regions are taking a closer look at working capital given changes to commodity prices and broader structural shifts, such as many governments' visions to diversify their economies and support the growth of their SMEs. Similar trends are seen in a number of other industries, like capital goods, software or hardware, for example with the investment needs for 5G technology.

Harnessing a global network and taking a holistic approach

Efforts to improve working capital efficiency to drive sales growth are not just purely about trade finance solutions: working capital touches payables, collections, cash and liquidity management solutions as well. Nor should working capital management be seen solely in terms of its impact on a company's overall capital position. It can also play an important role in managing risks associated with expansion into new markets, especially emerging markets, or exposure to unfamiliar counterparties as well as new currency exposures, for instance.

As well as traditional working capital solutions, such as supply chain finance and receivable financing, companies should consider the wide suite of products now available. Best results can be obtained by considering a company's entire working capital position in a holistic solution agnostic manner. Banks can combine a range of products to specifically address the client's working capital needs, geographical footprint or inventory, payment or collection profile.

Furthermore, there is growing interest in tools that might seem peripheral to working capital but which actually can have significant implications, such as on cash forecasting and expediting the matching of open invoices with incoming receipts.

Working capital solutions can now be fully tailored to clients' needs. Citi's geographical footprint and broad product range, empowers companies to find new ways to improve their working capital and drive sales growth. In these increasingly challenging times, it is therefore especially important to work with a bank with the experience and resources to help clients tackle their problems and take advantage of new opportunities.

[1]https://www.pwc.com/gx/en/working-capital-management-services/assets/pwc-working-capital-survey-2018-2019.pdf

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