The world is changing. Fifteen years ago, it seemed that corporate CEOs were leading their companies in a time of stronger global economic growth. Not surprisingly, capturing that growth was a key priority. Today’s environment appears different - growth is still a priority, but it can be harder to achieve as the global economy slows. Today’s corporate leadership appears to be shifting priorities, and new metrics to measure success have emerged. In the current environment, efficiency is a key focus.

In the years leading up to 2000, rapid economic growth dominated the headlines, sparked primarily by new technological advancements and increased expansion into emerging markets. The typical S&P500 constituent during this time saw annual revenue growth of ~10%; growth was a focal point for CEOs, research analysts, and investors.

Now, just 15 years later, the typical S&P500 company’s annual revenue growth in 2018 has fallen by ~30%. Economic expansion in the U.S. has slowed, and companies are navigating a more challenging and uncertain environment. The U.S. is not alone in facing declining growth: global GDP growth also slowed ~30% over
the same time period. As organic growth opportunities have become scarcer, companies are searching for alternative ways to generate shareholder value. Today, CEOs and investors are more focused on “Efficiency”...generating more from less.

This focus on efficiency has permeated into how companies communicate their priorities to the world. Performance targets are shifting to those that reflect, or help capture, efficiencies. An example is the increased focus by companies and investors on Returns on Invested Capital (or ROIC), a metric that quantifies how efficiently a company deploys the capital that it has acquired. However, while the focus on ROIC has increased, many companies have faced a headwind over the last 5 years: the growth of capital.

Consider the performance of non-financial companies in the U.S. S&P500 index in 2018 relative to five years prior:

- 75% generated higher profit;¹
- 61% generated a stronger profit margin (as a % of Revenue);¹ but
- 60% of these companies generated a lower Return on Invested Capital (ROIC)¹

Over the past 5 years, corporate profits were generally up but returns were generally down. Why? The reason is critical to understanding why working capital strategies matter in today’s world: for most companies in the U.S., invested capital grew faster than profit.

With this in mind, it is telling that more CEOs today appear to be highlighting their focus on efficiency rather than growth in isolation of the investment required to achieve that growth. While the metrics companies use to measure efficiency vary, leadership across Corporate America often highlights three overarching themes:

1. A focus on returns.
2. A focus on cash flows and
3. A focus on working capital.

At first glance, these three themes may seem independent - but they can be, in fact, closely intertwined.

Why does Working Capital matter to CEOs? Because Working Capital efficiencies can have a material impact on both corporate Returns and Cash Flows

In 2018, large U.S.-based corporates held roughly $1 Trillion of Net Working Capital² on their balance sheets - which for the typical company, represents 14% of Total Capital.¹ In other words, $1 Trillion of Capital is “trapped” in the supply chains of large U.S.-based companies. Companies that can unlock this underutilized working capital are better positioned to improve efficiency metrics like ROIC. However, working capital management doesn’t just influence returns, it can also directly impact cash flows - and improved cash flows can allow companies to invest in growth without external capital.

- In 2018, the typical U.S.-based company held roughly $0.13 of Net Working Capital for every $1.00 of Annual Revenue (resulting in a median Cash Conversion Cycle of about 45 days)³
- In 2018, the typical U.S. company retained only $0.05 of Free Cash Flow per $1.00 of Revenues (after investment in CapEx and payment of dividends)³
- For the typical U.S. company, a $0.01 reduction in a company’s Net Working Capital (per $1.00 of Revenue) - or a shortening of the typical cash cycle by 3-4 days - would generate a 20% improvement in Free Cash Flows³

Working capital, cash flows, and returns on capital are interconnected. There is a potential opportunity to release capital within organizations - and the cash flow from this release can be an important resource available to company leaders to re-invest in growth, distribute to shareholders, or de-lever.

If Working Capital matters, are cash conversion cycles shortening in Corporate America?

The focus on working capital management should continue, as improvements can have a material impact on corporate returns and free cash flows. So, one might ask: “are most companies taking steps to improve their working capital performance?” While it is anecdotally clear from public statements and shareholder letters that companies are increasingly focused on working capital, cash flows and returns, finding evidence of widespread improvement in these metrics is a much more complex task.

Broadly speaking, the median amount of net working capital held by companies in the S&P500 per dollar of sales has remained virtually unchanged over the last 5 years. Cash conversion cycles have also remained stable over this time period.¹ Based on these observations alone, one might assume that no progress has been made on improving working capital. However, the stability of broad net working capital metrics actually hides important observations on change within the cash cycle and within the broad corporate universe. Importantly, broad metrics can also miss the benefits that seem to be accruing to those companies that are improving the speed with which revenues are converted into cash. Taking a further look at the data, it is noted:

- Over the past five years, the typical S&P500 non-financial company has experienced considerable pressure on the amount of inventory and receivables carried. Had this pressure been left unchecked, it would have added $130Bn of additional net working capital to corporate balance sheets.¹
Over this same time period, U.S. companies were able to extend payment terms (reflected in DPO) – which mitigated the underlying pressure on working capital assets.

While the “typical” working capital profile across Corporate America has been stable, individual companies (and individual industry sectors) have shifted. About half of companies in the S&P500 have improved working capital over the last 5 years, and those that are making big changes, could see greater potential returns and efficiencies.

To conduct a deeper dive, we recently completed an analysis that compared the characteristics of companies that improved working capital performance relative to those that did not improve. The results are telling.

We found that companies who shortened their working capital cycles:

► Experienced stronger top-line revenue growth;
► Had more robust dividend payouts (larger payout ratios; less frequent dividend cuts); and
► Generated higher Total Shareholder Returns

How is Citi able to help companies improve on the working capital front?

As one of the world’s leading working capital finance banks, Citi can help Corporates and their trading partners achieve greater capital efficiency through accelerated sales and margin performance. Combining a strong track record, a broad array of capabilities, and most importantly, advisory experience gained from working closely with leading companies around the globe, Citi is one of the market leaders in supporting client needs.

Leveraging resources from across the bank, clients may take advantage of a holistic suite of strategies from trade to payments, liquidity, cards and even securitization to help address working capital strategies through a multi-pronged approach.

Within the global trade business, integrating a variety of tools such as supply chain finance and sales finance as well as early discount programs, Citi is positioned to help corporates increase their sources of liquidity in the changing environment.

Finding the right banking partner can be crucial for optimizing working capital. With a global network across nearly every major jurisdiction in which corporates operate, Citi is aligned to help enable corporates to effectively de-risk balance sheets, improve free cash flows and enhance return on capital for the future.