Talk to the business

JOHN GROUT REPORTS FROM AN ACT EVENT THAT REINFORCED THE OLD MESSAGE THAT TREASURY DEPARTMENTS MUST KEEP THEIR LINES OF COMMUNICATION TO THE BUSINESS OPEN.

For the treasurer, effective working capital management means getting down to operational levels in the business as well as ensuring that financial support systems are robust and well adapted. And it must be done as a continuing part of the job, not just a one-off in the current climate. This was the message from the ACT's working capital breakfast in Birmingham, sponsored by Barclays Commercial, held at the end of March.

The economic climate may be dark and uncertain, but treasurers are simply treading well-worn paths. They need to be permanently engaged with the business if they are to optimise both the provision and availability of finance and risk management.

Meanwhile, the ACT is spending a lot of time worrying about the prospect of a shortage of capital backing corporate lending, with each dollar of that capital able to support less lending. There is also the possibility that revised regulations may make it harder and more expensive for companies to access even that reduced borrowing.

The working breakfast looked at how companies can ensure they hold only the current assets really appropriate for their business and what lenders are likely to be looking for in working capital management in their borrowers.

David Manson, head of liquidity management at Barclays, started by examining what had made the present circumstances so difficult. But however those circumstances arose, companies have to examine and possibly redesign their working capital arrangements from order (to the supplier) through to receipt of payment (from the customer).

Purchase to pay (days payable outstanding), stock turn (days inventory outstanding) and order to cash (days sales outstanding), together with management of temporary surplus cash and cash equivalents (cash inventory), must all feature in the treasurer's vocabulary, said Manson. The vocabulary of the organisation's business is just as important, and treasury staff need to be out there talking with operational managers, who hold the keys to speeding up the working capital cycle and optimising the level of funding that needs to be tied up in it.

Manson said it was vital to plan ahead and explore with operational management – along with the business's invoicing, receivables and payments centres and its external payments system operators – all that can block, stop or slow the working capital cycle. Scenario planning can highlight what can go wrong and enable processes to be put in place to prevent or to respond quickly to problems.

IMI group treasurer Greg Croydon explained how his company is responding to these demands. The board and investors have

developed a greater focus on all treasury issues and risks given the obvious problems: scarce and expensive funding, wider borrowing and depositing spreads, greater credit risks, and the hoarding of cash by operating units responding to lack of confidence and poor, pessimistic forecasting.

YOU SHOULD AIM TO GIVE YOUR FINANCE PROVIDERS CONFIDENCE THAT YOUR BUSINESS MANAGES CASH AND WORKING CAPITAL WELL.

IMI tackled these problems by centralising cash (nationally, cross-border and cross-currency) in notional pools to raise confidence in intercompany funding. The company has also pooled cash where legal or tax issues prevent intercompany loans. Everywhere it has to be ready to deal with transfer pricing and tax issues (including withholding taxes), legal issues and, in some cases illiquid currencies. Cost/benefit analysis is constantly in mind. The company now has a matrix of treasury companies and operating subsidiaries funding in various currencies.

IMI also needed to focus on converting profits to cash at a time of falling revenues. Priority was on forecasting, with a new emphasis on short-term (one week – for greater accuracy) stock and collecting receivables. "Leave no excuse not to be paid!" advised Croydon.

He cited as an example of how to improve performance IMI's provisioning of US food service businesses from a list of 100,000 spare parts. Despite its own multiple barcode checks, the company had only 96% accuracy in despatches – there was often something not quite right with a delivery. Investigating the problem uncovered the reason: component suppliers were labelling incoming packs inaccurately. The introduction of verification of incoming goods (with fast feedback to suppliers) has raised despatch accuracy to 99.8%, improved cashflow and lowered costs.

The approach was used throughout the business. Another example Croydon gave was supplying drinks dispensing equipment in the US, where, again, fast customer response is essential. IMI held a diverse range of finished goods, and with many products coming from China, there were high "safety" stocks too. The solution was twofold. Consignment stock with a supplier warehouse was agreed for long lead items. Then products were redesigned around base platforms, stocked semi-finished alongside modular sub-assemblies easily fitted to achieve the needed customisation on order.

So far, IMI has seen both inventory and debtor days reduced significantly (by 19% and by six days, respectively). As growth resumes, the business needs to hold onto its current achievements and to go on improving the processes throughout the company.

IMI is a listed company with a 2008 turnover approaching £2bn, borrowings of £300m and EBITDA of £269m. But the same attention is needed whatever the size of the company.

Gary Slawther is interim group treasurer at logistics provider TDG, which is owned by AIM-listed value investor DouglasBay Capital. TDG's 2008 turnover was about £750m with underlying operating profit of about £27m. It is financed by what can be seen as a whole-business securitisation backing a £160m bank facility and an intercompany loan of about £100m. The bank loan is divided into amounts available for real property (transport facilities), equipment and receivables.

Receivables drive debt capacity. Payables drive debt requirement. Net working capital drives headroom. Volatility concentrates the mind!

TDG is a service provider and does not hold its own stock. It is in the business of helping customers manage their working capital by holding and moving stock more efficiently so that less is required, which lowers working capital usage.

The company itself focuses on the receivables and payables in its working capital. Everyone needs to know that working capital is a key component of the commercial relationship. For TDG customers, this means knowing and following the invoicing cycle and invoicing basis, and agreed margins (with many customers TDG discloses subcontractor costs) and payment terms. It also means getting it right each time so there is no excuse for delayed receipts (which go into an account controlled by the bank lenders under the securitisation).

TDG suppliers need to know their relative strength, commercial importance, what drives TDG's cash usage and what TDG's impact is on the suppliers' cashflow. Getting proper, clear, defined terms with suppliers was one of Slawther's first tasks.

Credit risk is very important to all parties throughout the supply chain. Can the company withstand a bad debt from major customer? What happens if a supplier goes out of business? What is the impact on your own trade? Are there alternative suppliers? How reliable and quickly available are they, and do they offer reasonable terms, etc?

Trade credit insurers are very important to businesses like TDG. Can suppliers get cover on TDG, and can TDG get cover on its own customers? Managing credit insurers is an important and active task: is there anything TDG can do to help, any more information or explanation needed? Credit reference agencies are less than useful. And in TDG's trade, the best credit advice (credit given or taken) is to keep an ear to the ground.

Slawther's main tip is to communicate, across the group, at home and abroad. Let your colleagues know what is important for financing. And listen: they will let you know what is commercially important. With TDG's built-in financing inflexibility, he places great importance on forecasting accuracy, with continual learning by all involved. Poor forecasts, he said, are like driving at night with the headlights off.

In business you need a blend of flexibility with financial, commercial and risk management disciplines. There is no one right, simple unchanging answer, but even so, you should aim to give your finance providers confidence that your business manages cash and working capital well.

The speakers were joined by Matthew Chevassut, EU treasurer at global biopharma company Cephalon, for the discussion panel that closed the session. The main new topic at this stage was supply chain finance, especially purchaser-driven supply chain finance where the initiative is taken by a buyer to arrange the possibility of financing for its suppliers. This is a growing field of great interest to many. Such a scheme was described in the April 2010 issue of The Treasurer (Free Your Suppliers, p22) and there will be more announcements on this subject in the next month or two.

John Grout is director, policy and technical, at the ACT.
jgrout@treasurers.org
www.treasurers.org