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What a Tough Working Capital Environment Means for Companies

COVID-19 has created many challenges for businesses, but cash and working capital have seen especially meaningful changes in the last year. Generally speaking, Days Sales Outstanding (DSO) and Days Inventory Outstanding (DIO) positions have deteriorated. Meanwhile, S&P 1500 companies saw cash conversion cycles lengthen by 3.2 days in 2020, roughly equivalent to the increase seen in the six years from 2013 to 2019. It is fair to say that the pandemic has dragged working capital and 'cash cultures' into the spotlight.

Shifting attitudes towards inventory and supply chains have significant implications for working capital management. "Broadly, companies relying on just-in-time supply chains and highly lean inventories have suffered most through the pandemic's disruptions", says Cody Chenault, Managing Director at Alvarez & Marsal (A&M). It is difficult to resolve these problems quickly and easily. Supply chains are sensitive: in recent weeks, an ill-timed gust of wind causing a container ship to block the Suez Canal for days has underscored the importance of maintaining headroom in goods and inventory while fostering an appropriately flexible approach to real-time planning.

Resolving working capital challenges promises tangible benefits for companies and management teams, though. Access to external credit is one key factor: even if some businesses have pushed funding facilities and creditor relationships to their limits since the onset of the pandemic, businesses on top of their working capital requirements will benefit from more receptive creditors and investors in what remains a relatively tight capital markets environment compared to previous years.

Consumer buying habits must also be taken into account. "In many sectors, COVID-19 has meant more consignments of smaller packages, affecting logistical complexities and delivery costs," says Sean Laffere, A&M Managing Director. The businesses factoring in a more digital economy and its consequences for working capital will be in the strongest position to grow sustainably in the years ahead.

These factors can only be confronted by adopting a methodical and deliberate approach to resolving working capital pressures.

Converting Insights to Cash

Transforming working capital processes starts with a focus on cash visibility. "Before businesses can address potential optimization opportunities, they need to understand what is driving cash performance and the accuracy of existing cash forecasting. This provides the baseline against which businesses determine the size of the 'cash gap' and the extent to which tactical / sustainable initiatives are required," says Ben Tatham, A&M Managing Director.

Understanding Order to Cash (O2C) and Procure to Pay (P2P) steps, as well as customer and supplier behavior during O2C and P2P processes, provides rich information that can be used to improve DSO and DPO performance. A deliberate focus on segmentation helps companies create bespoke strategies for different suppliers and customers in different markets, responding to sectoral and geographical variances. Leveraging advanced analytics makes it easier for businesses to access real-time forecasts of cash flows and working capital KPIs, enabling more detailed segmentation.

Businesses should leverage data and analytics wherever possible in establishing their 'real' cash position, but quantitative analytics is only part of the picture. Leadership that instills a 'cash culture' around the organization can also bring direct benefits. Working together with a world-leading engineering and manufacturing business, A&M sought to go beyond 'fixing the numbers' by providing relevant training on cash and working capital best practices to finance and non-finance staff, establishing appropriate cash KPIs that were linked to team and individual goals. "The initiative was successful and contributed towards a meaningful improvement to the business's working capital position," says Ben Tatham.

If working capital is a business-critical metric, working capital performance should be factored into assessments of business performance. Ron Orsini, A&M Managing Director and Head of U.S. Corporate Transformation Services, says, "If there is no penalty for poor working capital management, it is harder to change behavior. Businesses can focus attention on this by tying key working capital metrics to incentives and compensation, for example."

As economies around the world continue to grapple with raw materials and supply chain challenges, managing cash effectively could be the difference between lagging return on assets over the long term and post-COVID success.

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A&M Resources

Working Capital Management Trends
For additional insight, read our new article here discussing the Forward-Thinking Steps Companies Should be Taking Now to See Greater Working Capital Returns in the Future.

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