

2018/19

# Navigating uncertainty: PwC's annual global Working Capital Study

Unlocking cash to shore up your business







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## Executive summary

# Why working capital matters

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# 55%

Reducing excess working capital could pay for a 55% increase in Capex.

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# 3.6%

A steady decline in Capex spend relative to revenue at a compound annual rate of 3.6%.

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**Cash is the lifeblood of any company. It's more important than ever for businesses to optimise this fundamental aspect of financial performance if they're to maintain a steady course in these uncertain times. Given that working capital is the cheapest source of cash, nothing is more vital than having a cash culture and good liquidity on board.**

This year's study of the largest companies' working capital performance and related key indicators shows that while course corrections have been made, these have been marginal, with no clear leap forward. Looking at the journey ahead, the signs are that more cash will be needed – and with monetary policies tightening globally, the costs of failing to chart the right route are set to increase.

If all the companies in our study were to improve their working capital efficiency to the level of the next performance quartile, this would represent a cash release of €1.3tr. 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.

Our study of the financial performance of the largest global listed companies over the past five years indicates that there are four challenges on the horizon.

### **Converting cash is becoming harder**

While revenues are up by 10% on last year, this year we've seen a decline in companies' ability to turn higher revenue into cash.

### **Capital expenditure is continuing to decline**

Capital expenditure (capex) as a percentage of revenues has plummeted during the last five years, suggesting that companies are managing cash flows by cutting investment. In the long run, this will leave companies under-invested, posing a threat to their growth. By optimising working capital, global companies can release the funds needed for continued investment without squeezing their cash flows.

### **The cost of cash is increasing**

During the recent sustained period of cheap borrowing, the cost of cash may not have presented cause for concern. However, given the current outlook of fiscal tightening and uncertainty around global trade, now is the time for companies to shore up their balance sheets to be ready for all eventualities.

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\*Figures from PwC analysis unless otherwise specified.



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# 68 DPO

Creditor days continue to be high

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# €1.3 tr

could be released from the balance sheets of global listed companies by addressing poor working capital performance.

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# 5 years

DSO and DIO finally show first improvement in five years.



The message is clear, amid today's prevailing uncertainty, now is the time for companies to focus on what they can control – including working capital.

## **Working capital has improved only marginally – signalling a missed opportunity**

The overall findings on companies' Net Working Capital (NWC) performance reveal a small improvement this year of 0.4 NWC days. Companies have achieved this by turning the tide on Days Sales Outstanding (DSO) and Days Inventory On-hand (DIO) performance, both of which saw modest improvements of 0.1 and 0.7 days respectively – the first improvement in five years.

As we reported last year, Days Payables Outstanding (DPO) is still at a high level, representing a potential risk to supply chains at a time when unpredictable trade winds are blowing.

In light of this threat, companies are increasingly taking a more holistic approach to managing the health of their supply chain. One example is their growing use of supply chain finance, which can enable them to bolster their own cash position while also offering a lifeline to their suppliers.

Taking all this together, the message is clear. Amid today's prevailing uncertainty, now is the time for companies to focus on what they can control – including working capital. By improving working capital performance, businesses can navigate the optimal route, simultaneously maintaining operating cash flow (OCF) and freeing up funds for investment.

## Navigating uncertainty

# Companies have corrected their course – but working capital challenges still loom



**Our study shows that overall working capital performance has improved for the first time since 2014, with net working capital (NWC) days falling back slightly from their highest (worst) level in 2016.**

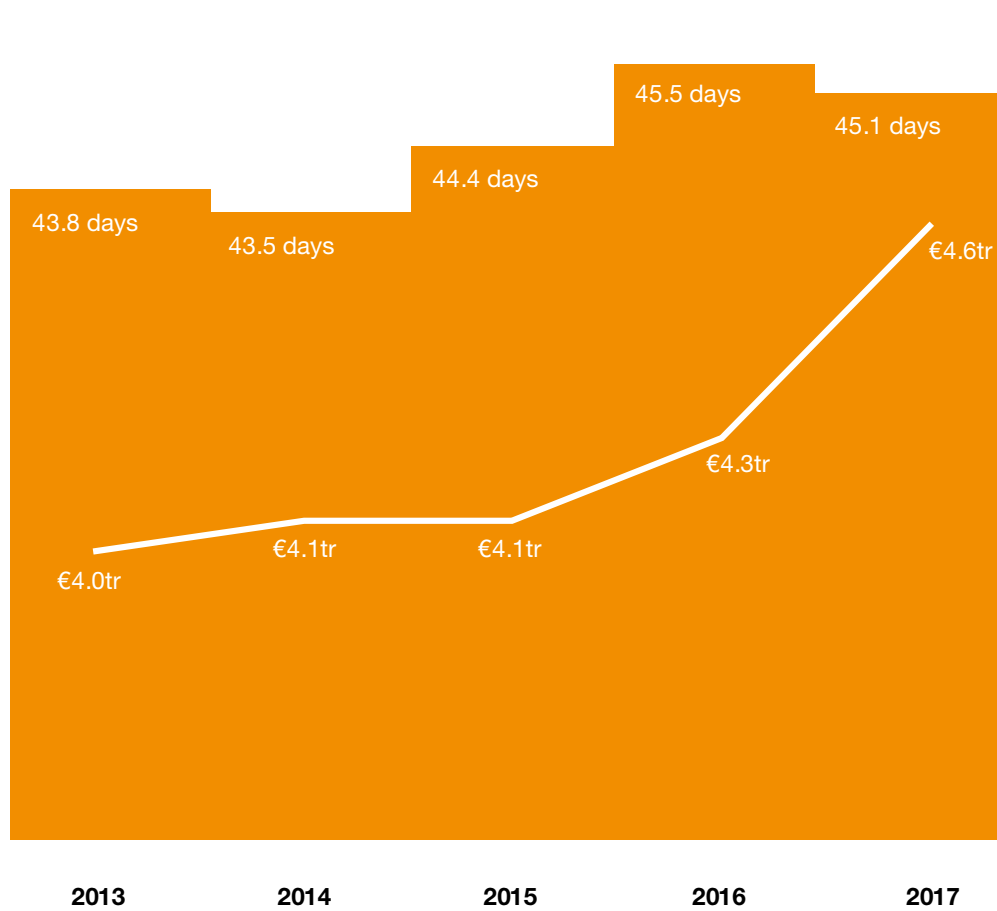
The modest improvement in NWC days was driven from the asset side of companies' balance sheets – namely receivables and inventory. Both DSO and DIO turned the tide after four years of deterioration, posting improvements of 0.1 and 0.7 of a day respectively. Given that the pressure on suppliers reported in last year's study is continuing, companies will need to increase their focus on these two areas if they're to make further gains.

That said, it appears that 2016 may have seen the high-water mark in terms of squeezing suppliers. DPO levels dropped by 0.7 days in 2017, possibly signalling a recognition among companies that their existing hard-line approach to suppliers was unsustainable.

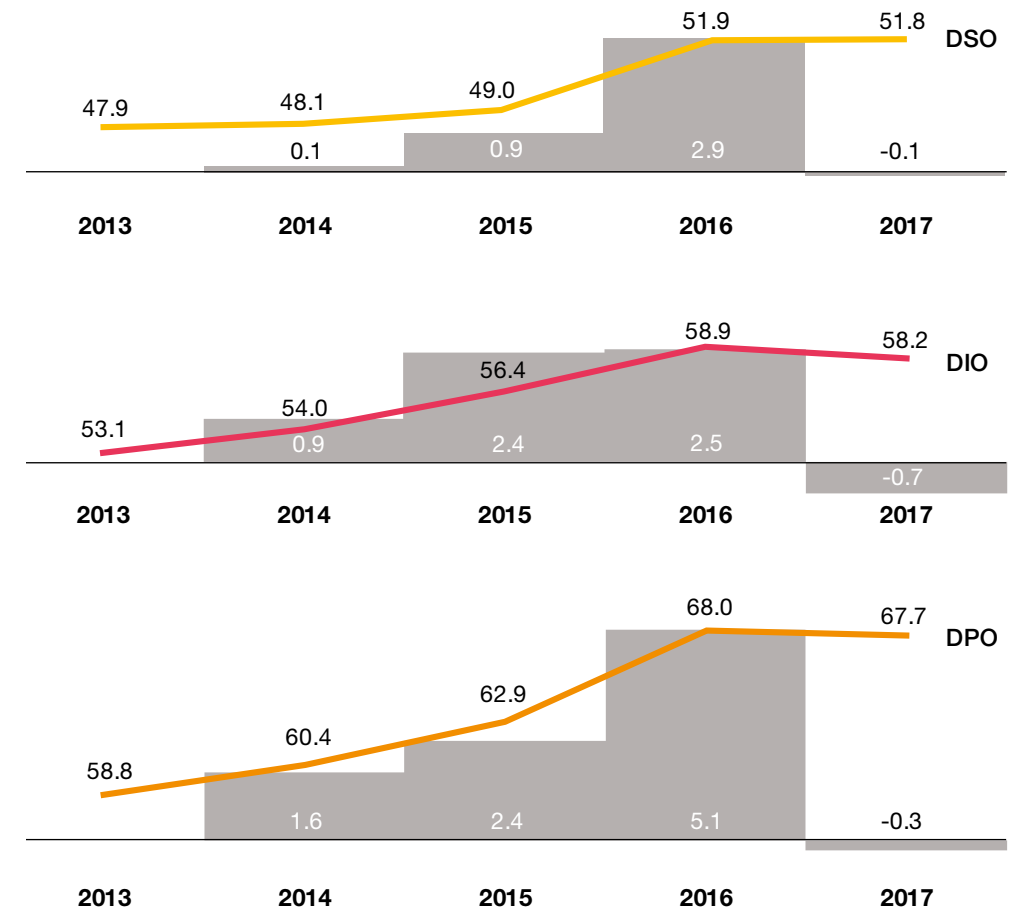
Although the overall headline numbers look promising, a closer inspection reveals that the oil & gas sector was a major contributor to the top-line growth during the past year, masking the real direction of travel. When the working capital performance of oil & gas is excluded, the outcome actually deteriorated by 0.1 days.

What's more, absolute values of Net Operating Working Capital (NOWC) increased by 10.3% in 2017 from the previous year. This represents €300bn of additional cash consumed by working capital.

## Net working capital and working capital days



## DSO, DIO and DPO trend



Days change year on year

# Declining cash conversion and investment point to troubles ahead

**While modest improvements in working capital have begun to manifest themselves, the levels of cash and investment relative to revenue have declined more dramatically.**

In the past five years we've seen a steady decline in Capex spend relative to revenue at a compound annual rate of 3.6%. By this measure, companies' relative capital expenditure is now at the lowest level we've seen.

This year has also seen a drop off of 6.5% from the previous year in operating cash flows relative to revenue. Although working capital performance has improved very slightly during the year, companies have failed to translate this into increased operating cash flows as a proportion of revenue.

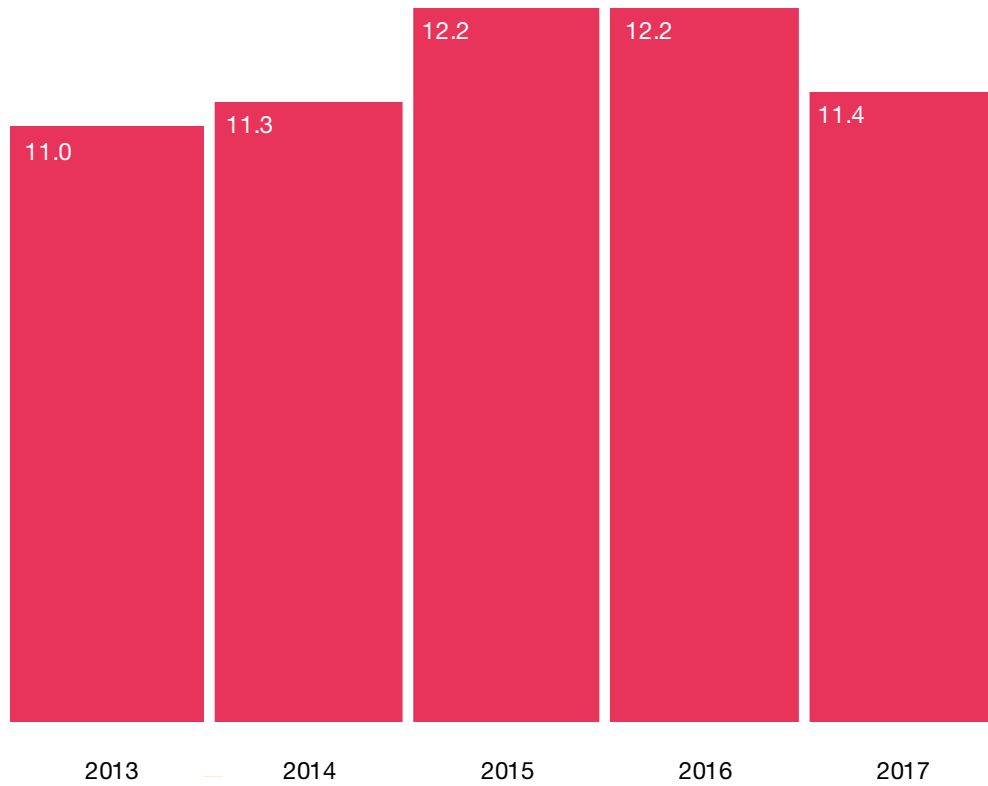
Coupled with the broadly flat working capital performance, the ongoing uncertainty in the global trading environment is likely to have contributed to the decline in Capex.

However, a rebound in capital investment may be needed for companies to realise opportunities in an evolving global trading landscape and limit the need for external sources of financing – which are likely to become more expensive in the medium term.



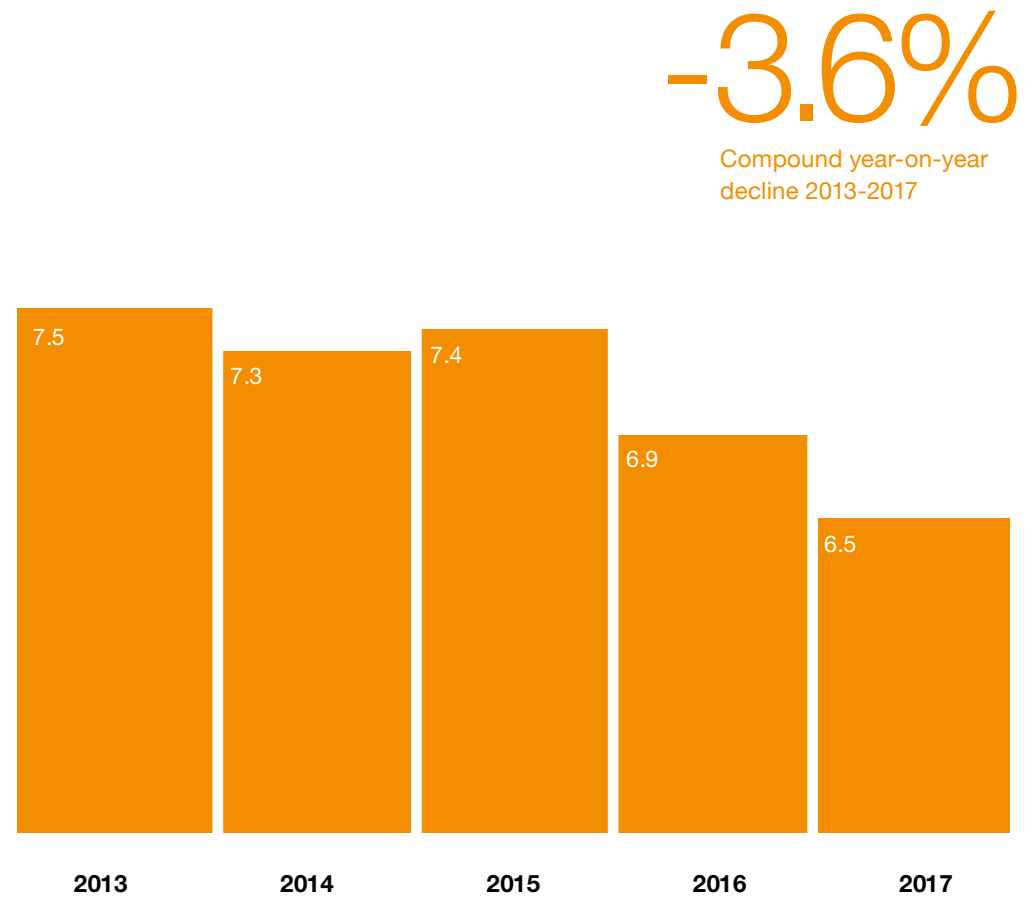


## Operating cash flow/revenue trend



OCF/revenue %

## Capex/revenue trend



Capex/revenue %

## Economic outlook

# Global growth is strong, but Eurozone and UK growth momentum is softening

**The economic outlook suggests that the impact of holding excess working capital could be amplified by increased interest rates on the horizon. Until about two years ago, the post-crisis recovery story was mixed with strong growth in the E7\* and disappointing growth in the G7\*\*. This changed in the middle of 2016, with growth advanced economies – and, in particular in the Eurozone – accelerating. Looking at the specific economies in turn though, paints a more nuanced picture.**

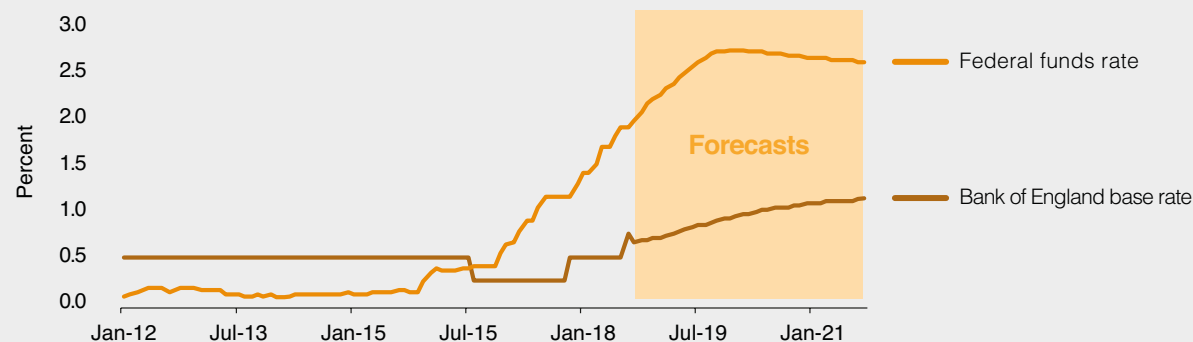
For the 2018-19 period, we expect the US to grow at an average rate of about 2.5% per annum, partly fuelled by the corporate and household tax cuts as well as strong growth in business and household spending. In the Eurozone, we expect growth to be in line with its estimated trend growth rate, expanding by an average rate of about 1.5% per annum assuming trade relations between the US and the EU do not deteriorate.

The UK economic sentiment remains soft relative to the Eurozone. We expect growth to average about 1.5% per annum, somewhat lower than its estimated trend growth rate of about 2% per annum. This moderate growth outlook assumes that the Brexit negotiations will proceed reasonably smoothly, and therefore that the UK will avoid an extreme, 'hard Brexit'.

The interest rate outlook heavily influences businesses' cost of capital, which in turn amplifies the impact of excess working capital. The graph on the left suggests that the Federal Reserve in the US is expected to continue to tighten its monetary policy, at a much faster pace compared to the UK or the Eurozone.

While monetary policy is expected to remain relatively accommodative in the UK, there are significant uncertainties from the implications of Brexit. This is particularly true for the UK manufacturing industry for three reasons. First, manufacturing is more capital intensive. Second, some sectors within manufacturing such as automotive have an extensive international supply chain. And third, the high value of goods produced and sold by the manufacturing affects payables, making working capital performance even more important.

### Interest rates which impact Corporates Cost of Capital



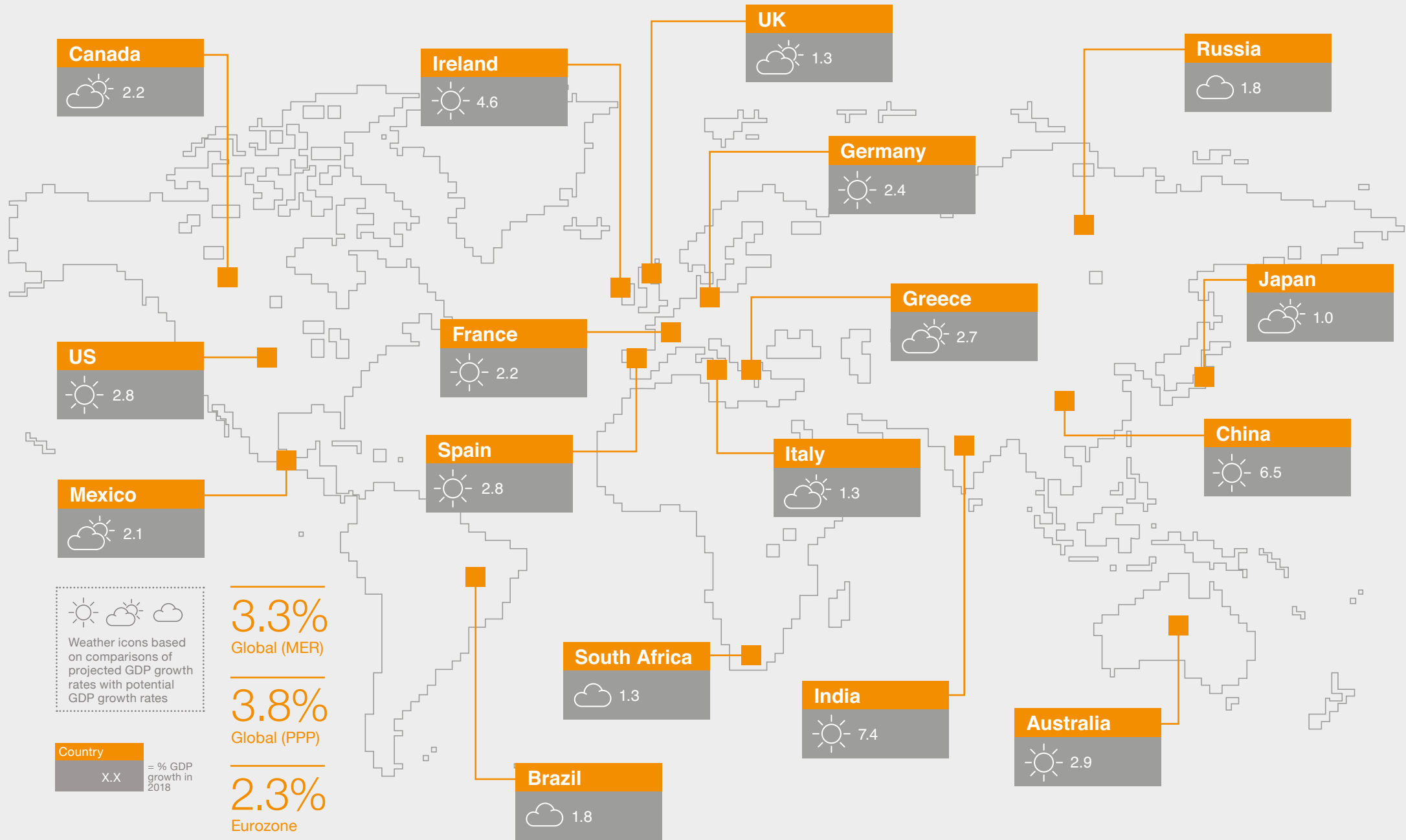
Source: PwC analysis, Thomson Datastream and Bank of England August 2018

\*E7: Refers to the seven large emerging economies of the world which are: Brazil, Russia, India, China, Turkey, Mexico and Indonesia.

\*\*G7: Refers to a club of advanced economies which are: the US, UK, Canada, Germany, Italy, France and Japan.

\*\*\*Figures from PwC analysis unless otherwise specified.

Global growth is strong but we are seeing some softening in the Eurozone and UK growth momentum (PwC analysis)





## Industry performance

# 11 out of 17 sectors have improved their working capital performance since 2016

**Some sectors have fared significantly better than others when we look at how performance has evolved over the last year. In fact the overall balance is positive with 11 sectors out of 17 having achieved an improvement in 2017.**



Of the companies that showed an improvement over this period, those in the energy & utilities sector saw the biggest reduction in NWCD. This was coupled with a dramatic increase in revenues over the same period, which suggests they did not take their eye off the ball in pursuit of growth.

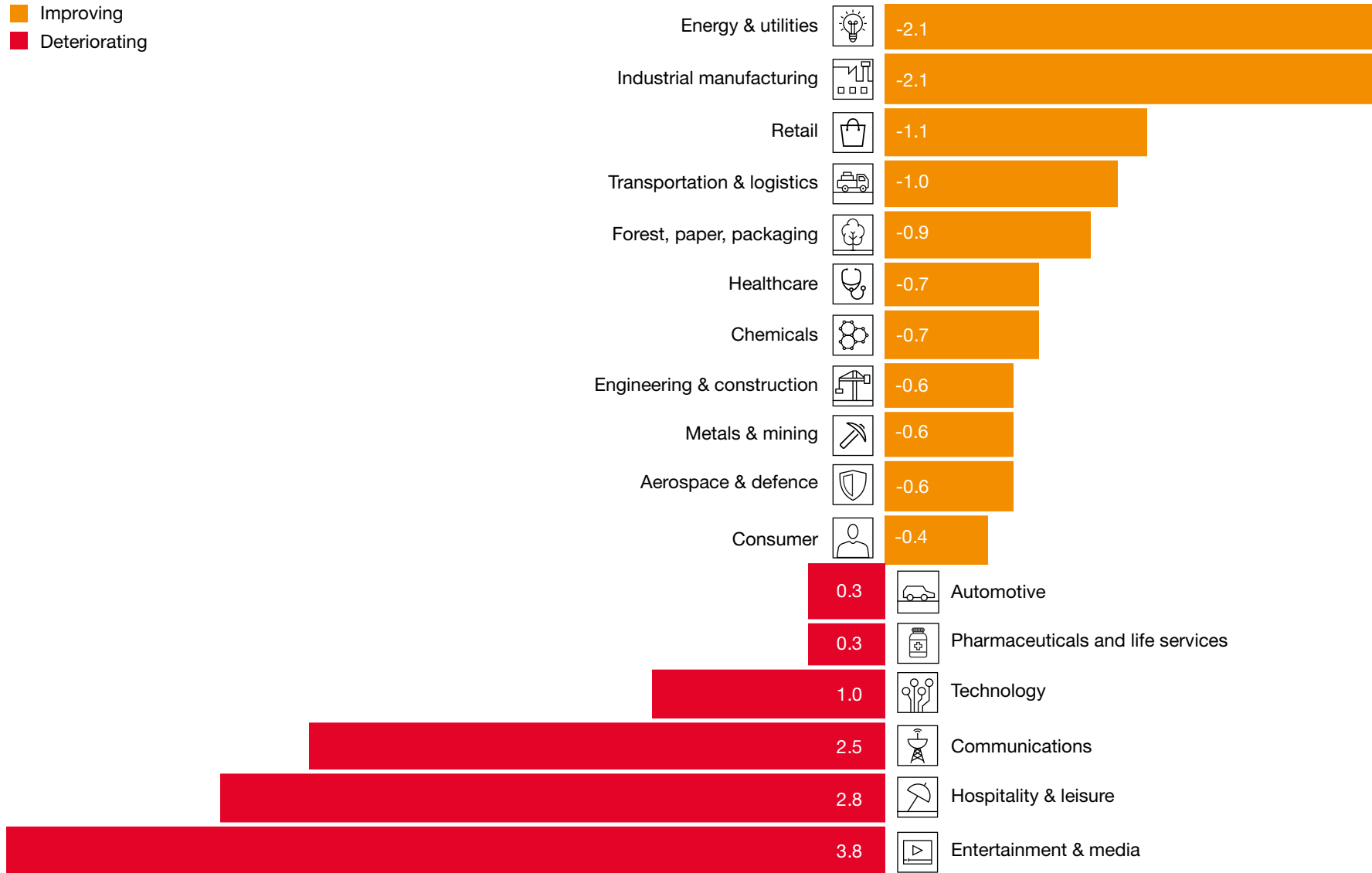
The healthcare sector also experienced a decline in NWCD, due to the impressive revenue growth of some 6.0% that the sector delivered in 2017.

As revenues have risen in the entertainment & media, hospitality & leisure, and technology sectors, working capital performance has suffered.

While sector-level trends give us an indication of the challenges facing certain industries, there are wide variations in performance between different companies within each sector.

## Working capital change 2013-2017 expressed in days

■ Improving  
■ Deteriorating





# Many sectors are still leaning on their suppliers to improve their working capital

**As the diagram on page 13 shows, the majority of sectors – those shown in orange – saw a reduction in net working capital days in 2017 compared to the previous year.**

However, this has often come at a cost to suppliers. Since 2016, 11 sectors have further stretched their payable days – an approach that, as we've previously highlighted, could be risky in the long term – compared to only five that have improved their asset days (receivables and inventory).

Sectors in the bottom right-hand quadrant have seen deterioration across all elements of the balance sheet, which suggests greater focus is needed. The urgency may be greater for sectors where global supply chains are prevalent, such as the automotive industry.

In contrast, sectors in the top-left quadrant have seen improvements in all areas. Industrial manufacturing, for example, has achieved reduced NWCD through improvements in both asset and payables performance. However, it's important to think carefully about the sustainability of enhancements in DPO.

In our experience, the tendency to focus heavily on payables to maintain working capital is driven by three basic factors:

1. payables is often seen as the easiest lever to push
2. changing the supply chain is perceived to be difficult, painful and slow
3. the fear of lost revenue is the ultimate barrier to driving receivables performance.

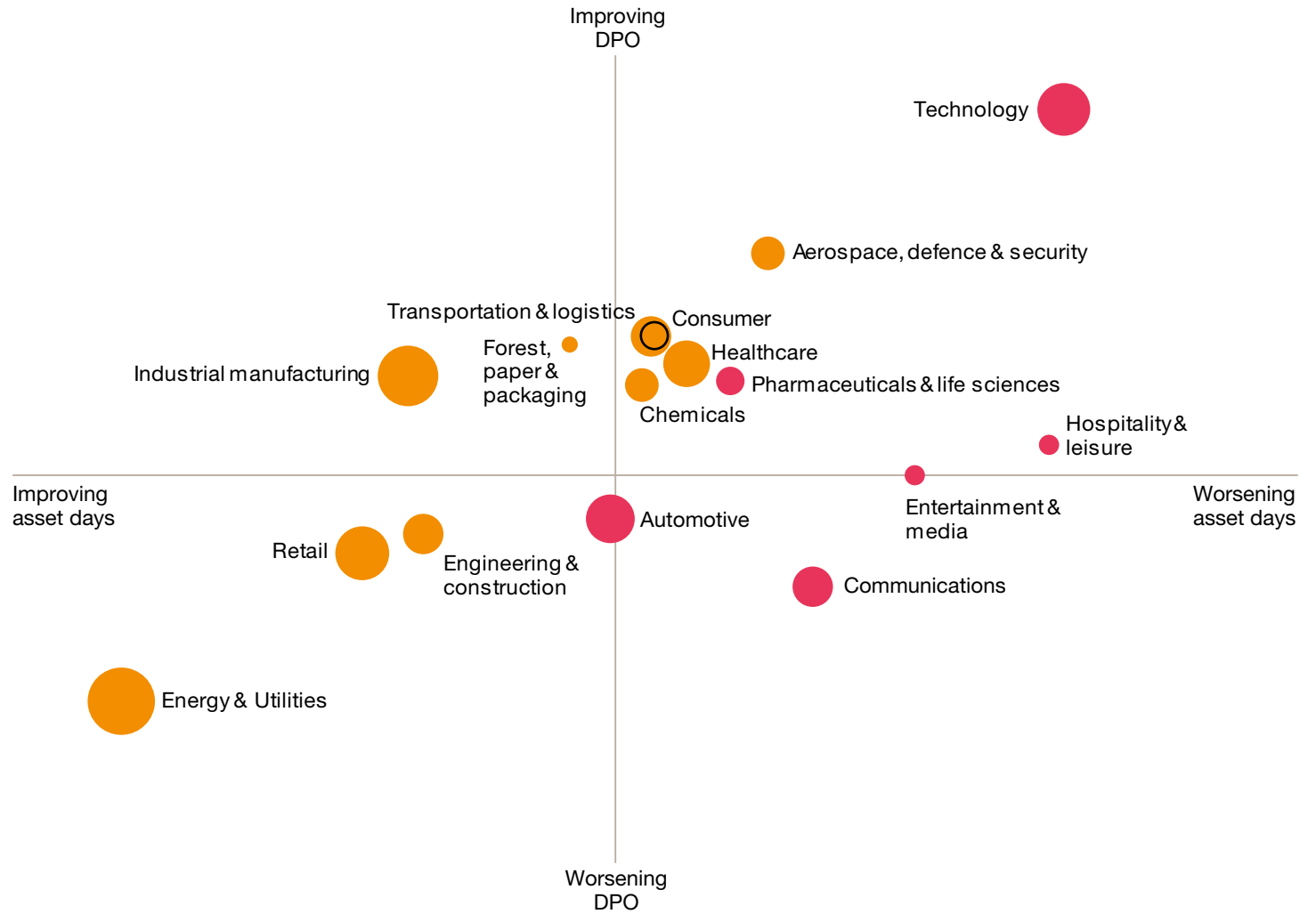
We discuss how payables can be improved sustainably on p18



## DPO/Asset days

● Deterioration in NWCD 2017 vs. 2016

● Improvement in NWCD 2017 vs. 2016



Asset days = (trade receivables and inventory) \* 365

# The difference between the best and the worst in each sector is still significant

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**At a global level, the gap between the best and worst working capital performers has narrowed.**

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**At a global level, the gap between the best and worst working capital performers has narrowed. Significantly, this has been driven not by a worsening performance among companies in the top quartile, but by an increasing focus on working capital performance among those at the lower end of the ranking. It follows that companies in the bottom quartile that are not yet taking action need to raise their game as a matter of urgency, or risk being left behind.**

A more detailed look at the disparity between the top and bottom quartiles shows that the DPO gap has narrowed by 0.2 days – a change that has resulted from the top quartile holding steady and the bottom quartile improving DPO by 0.2 days. Similarly the DSO gap has narrowed by 0.5 days, driven by an improvement in the bottom quartile of 0.4 days and a decline in the top quartile of 0.1 days.

DIO is the only metric where both the top and bottom quartiles have improved, however the greatest movement came from the bottom quartile, reducing by 1.6 days versus the 0.4 day improvement achieved by the top quartile.

The overall trend is not consistent across industries, either in terms of the size of the gap or the change from the previous year. For example, aerospace & defence has the largest gap between top and bottom quartile – 108 days – in stark contrast to transportation & logistics, where the gap is only 34 days. Also, some sectors have seen their gap narrow significantly in 2017:

- The engineering & construction sector has seen a reduction in the gap of five days, as a result of an improvement of five days in the bottom quartile set against a very small improvement among the top quartile companies.

- Industrial manufacturing has seen its gap decrease by two days, again driven by improvement in the bottom quartile.

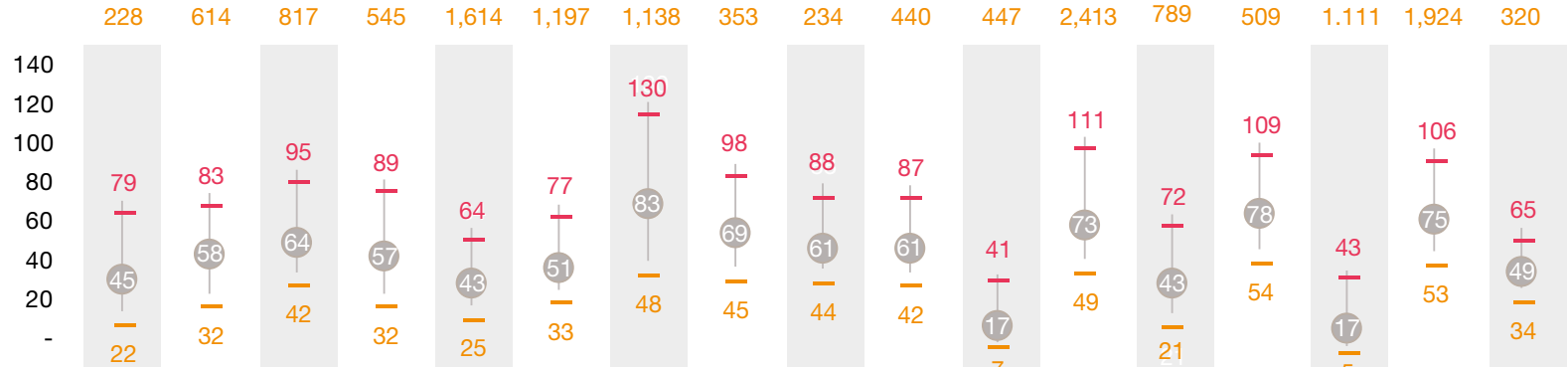
Conversely, some other sectors have seen the opposite, with their gap widening during the past year:

- Pharmaceuticals & life sciences has seen an increase in the gap of nine days. This bucks the trend seen in other industries, as this sector's bottom performers have suffered a decline in performance of eight days while those in the top quartile have improved by one day.
- The communications sector has also seen its gap widen, in its case by five days. This was driven by the top performers improving by two days, while the bottom performers weakened by three days, indicating a lack of focus on working capital.

Number of companies

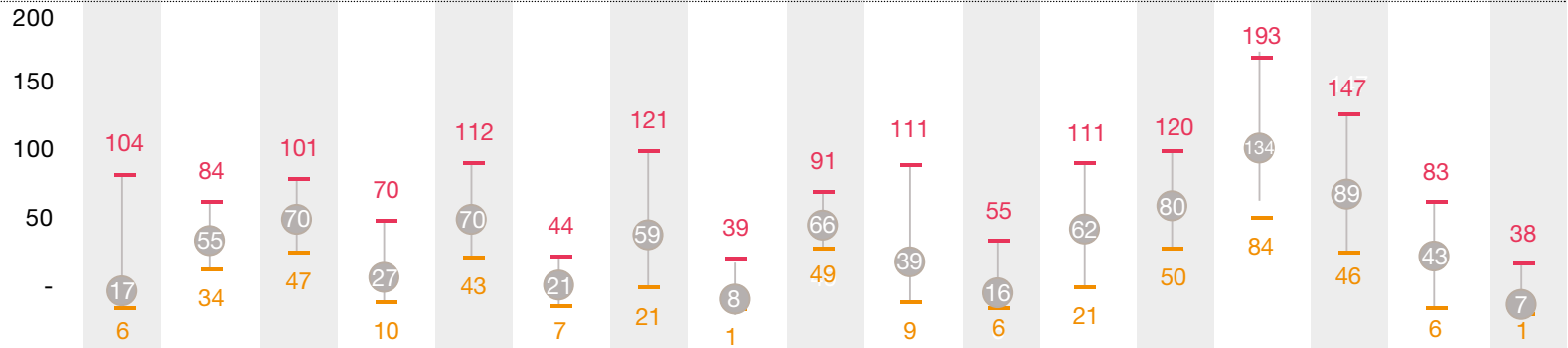
DSO

- Top performers
- Median
- Bottom performers



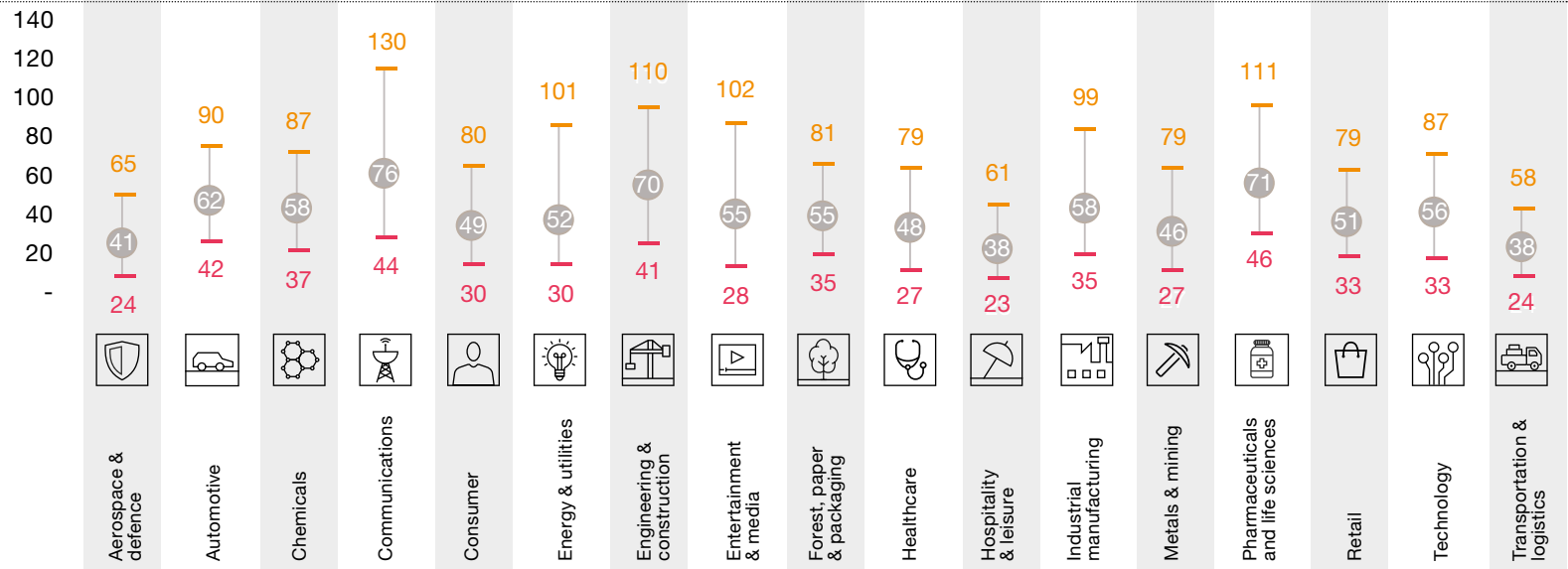
DIO

- Top performers
- Median
- Bottom performers



DPO

- Top performers
- Median
- Bottom performers





## Company size

### Size still matters

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# 9.3%

Large companies generate a higher level of return on capital employed (ROCE, at 9.3%)

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# 27.8 days

The other main driver for the size gap is inventory performance, with a difference of 27.8 days between the DIO of large and small companies in 2017.

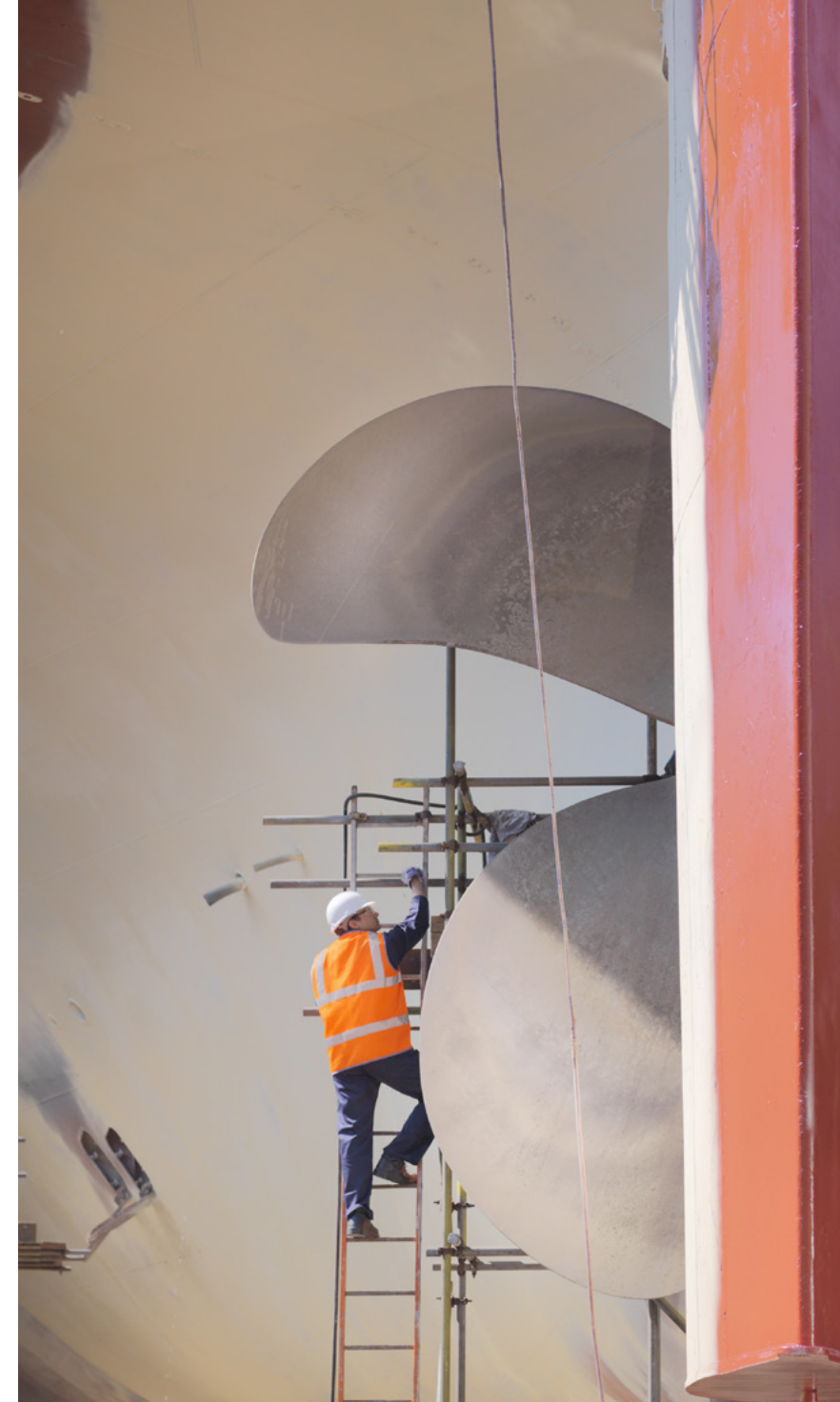
**When it comes to working capital performance, size remains an important factor – and is becoming more so.**

The gap between the largest and smallest companies in our study has widened from a difference in NWCD of 39.6 days in 2013 to 46.8 days in 2017.

The widely-held assumption is that large companies achieve this performance by using their spending-power and market muscle to squeeze their smaller suppliers. While this undoubtedly has some truth in it, the numbers actually show that small and medium-sized companies have much longer payables cycles than larger companies.

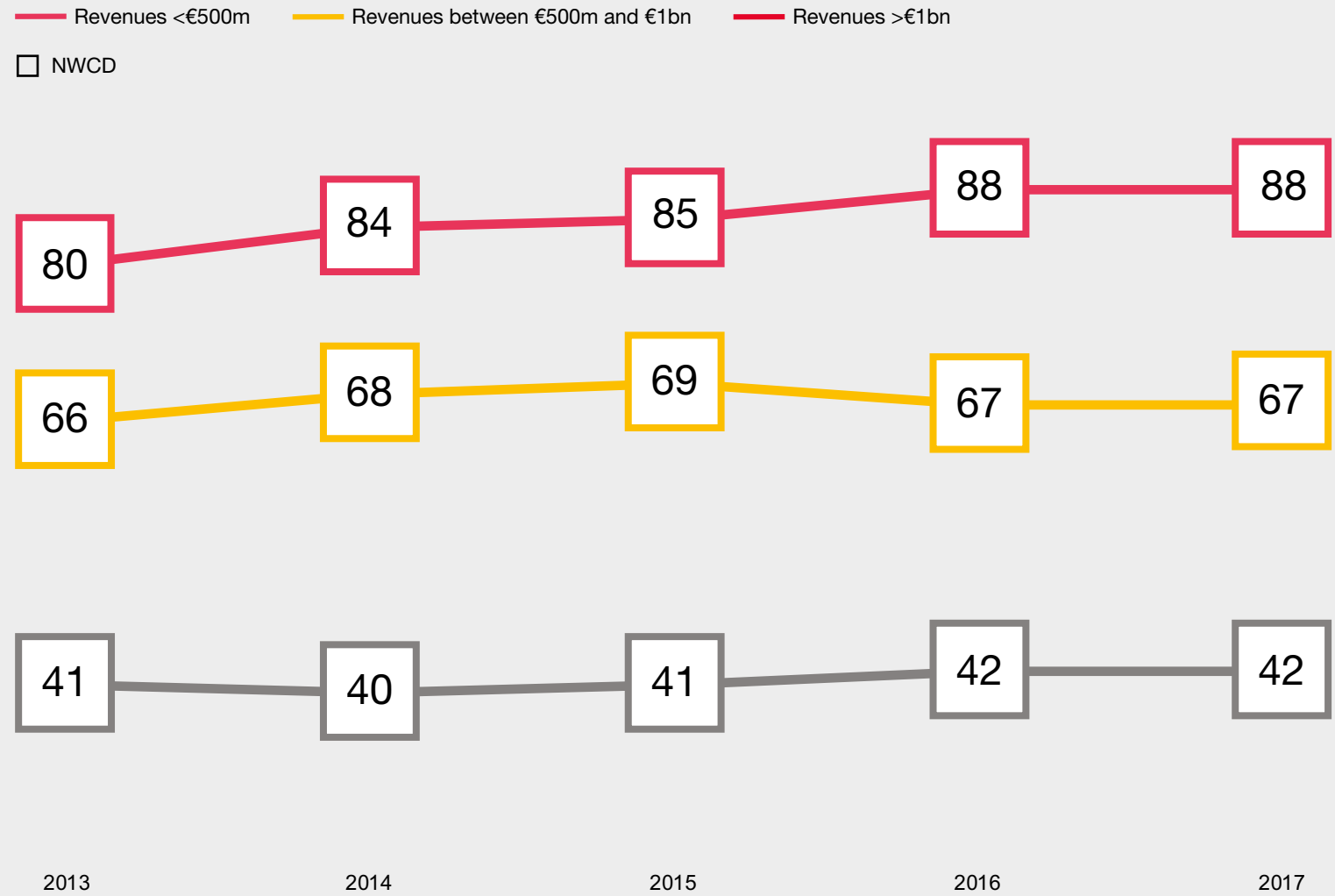
The other main driver for the size gap is inventory performance, with a difference of 27.8 days between the DIO of large and small companies in 2017. However, this gap is narrowing steadily, having declined from 30.0 days in 2013 – a trend that suggests smaller companies are taking greater interest in managing their inventory.

Large companies also generate a higher level of return on capital employed (ROCE, at 9.3%) than small and medium-sized enterprises, whose ROCE stands at 7.8% and 7.0% respectively. This can be explained partly by larger companies' slightly higher profitability and partly by their better working capital performance, with large companies leading at 42 days, medium-sized businesses second at 67 days and small enterprises last at 88 days.





## Net working capital days by company size



# Supply chain finance

## Supply Chain Finance can be an attractive way for SMEs to sail towards better cash flow

**The use of vendor financing to shore up suppliers or drive Days Payables is gathering pace. Adoption rates have increased significantly since 2014, particularly driven by increased uptake from companies below £5bn in annual revenues.**

The primary motivation for companies to adopt SCF continues to be the optimisation of working capital. This is in line with our finding of a sharp increase in DPO over the last five years.

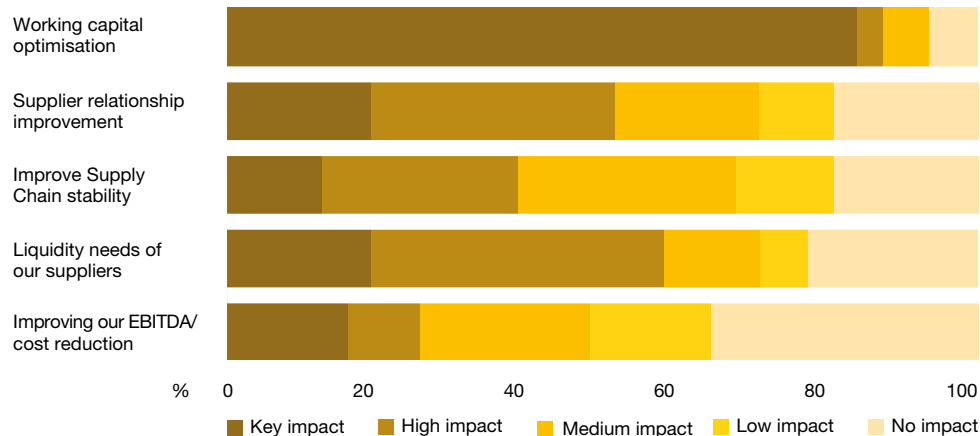
Improving supplier relationships, as well as the overall supply chain stability of the buyer, were also key considerations when implementing SCF programmes.

Although financing solutions have seen an increase in popularity, our 'SCF Barometer' shows that the level of spend typical programmes cover remains relatively limited. Nearly half of all programmes include only up to 25 suppliers.

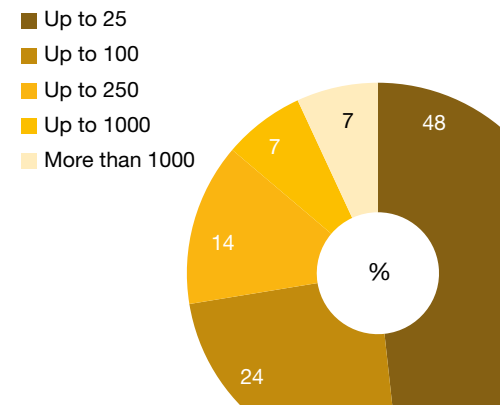
Also, the majority of programmes cover only 20 percent of overall spend, which tends to focus on the larger and most stable suppliers. Often this is driven by the complexities of implementing traditional SCF programmes.

SCF Barometer 2017/2018, joint initiative of PwC and the SCF Community Previser SME Study, December 2017

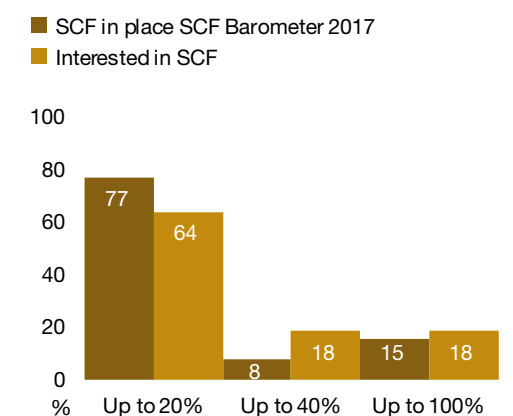
### Principal reasons for implementing an SCF programme



### Number of suppliers who joined the programme



### Spend covered by SCF: Actual vs expectations





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# 36 days

is the average time to get paid by large corporates from the date of invoice.

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# 77%

of SMEs experience slow payments from large corporates.

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# >1/3

of SMEs spend a moderate to significant amount of time and resources chasing large corporates for payment.

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Credit cards, overdrafts and loans were the most popular sources of external finance for SMEs.

Traditionally, Supply Chain Financing programmes have focused on the largest suppliers in order to get the biggest impact at the most acceptable levels of risk for funders. However, this ignores the group of suppliers that would benefit most from vendor financing, namely small and medium sized suppliers.

A recent survey of small and medium enterprises (SMEs) undertaken with Previser, a fintech company, has highlighted that this group of companies faces the largest challenge on liquidity. It also showed that SMEs have a higher adoption appetite for early payment programmes.

Converting invoices to cash is taking SMEs 36 days on average, with 20% of participants dissatisfied at the length of time it took to receive payment. 77% of respondents cited cash flow as a key concern resulting from slow payers.

Significant time and resources are invested to chase payment. Larger SMEs with >150 employees felt this most strongly and also experienced high financing cost when turning to external debt as their lifeboat.

Whilst the SCF landscape has seen innovative new solutions, the most commonly adopted solution – for now – is still reverse factoring through banks.

However, increasingly, large corporates are looking to extend existing SCF programmes to cover a larger share of their spend, with the inevitable challenge of covering a large volume of smaller suppliers. SCF is an attractive way for SMEs to sail towards better working capital, accessing cash at competitive rates, and benefiting from predictable cash flow.



## A global view



Europe has exhibited the biggest year-on-year improvement in working capital, making more drastic course corrections towards a cash culture than other regions.

**Within any given region around the globe there are wide variations in working capital performance, reflecting differences in market maturity, legislation and cash focus.**

Based on the companies surveyed for this year's study, what is most notable is that Asia is continuing to represent an ever growing slice of the pie, underlining the continuous gravitational pull to the east.

This makes it even more significant that Asia – along with Europe – has been one of the key regions driving improvements in working capital performance. However, Asia's performance continues to lag behind western economies, mostly as a result of higher receivables and inventory days.

Europe has exhibited the biggest year-on-year improvement in working capital, making more drastic course corrections towards a cash culture than other regions. But Europe still has a long way to go to catch up with the US and Canada, which continue to show consistently stronger performance, particularly on asset days.



## Region weighting

Macro Region

**Asia**

Number of companies

**8,600**

Revenues (€) – total (annualised)

**15,039,667**

**Europe**

2,417

9,556,817

**Latin America**

487

1,036,232

**Africa**

266

274,461

**Australasia**

316

472,418

**Middle East**

335

319,258

**USA, Canada**

2,273

10,882,408



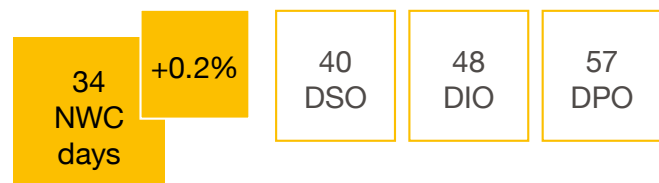


## Companies in Europe and Africa have turned the tide, while performance has slipped in Latin America



### Europe

While Europe was previously characterised by lengthening DSO, DIO and DPO, the tide appears to have turned in 2017, with a reduction in all working capital ratios as companies placed greater focus on receivables and inventory. There have also been reductions in Capex and ROCE. To reverse these declines, European companies need to focus on stimulating investment by optimising working capital performance.



### USA, Canada

While the USA has seen an increase in its asset days from the previous year – in particular a 1.8 day increase in DSO – it has been able to maintain NWCD by stretching suppliers. US and Canadian companies have seen the second highest revenue growth after Asia in the past year. This growth and increasing margins have driven an increase in ROCE. But it shouldn't be taken for granted that this trend will continue, as stretching suppliers and decreasing Capex may not be sustainable in the long run.

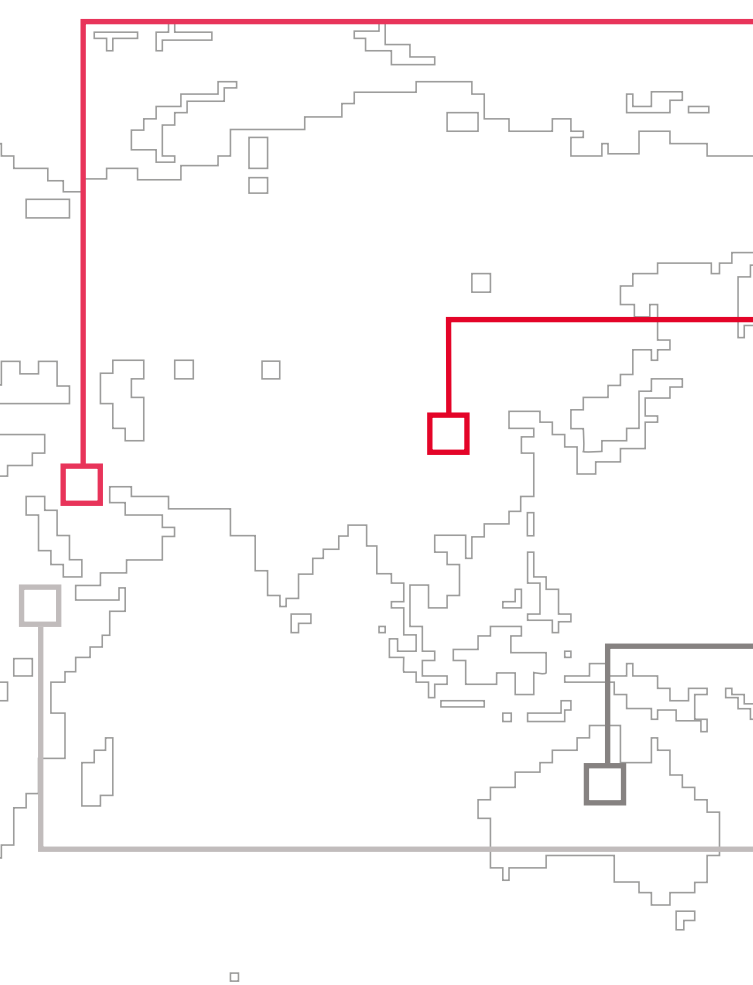


### Latin America

On average, Latin American companies have seen a significant deterioration in NWCD in 2017, reversing the recent trend of four successive years of improvements. This reversal has been primarily due to a worsening receivables performance of 4.8 days. The region has continued to grow its revenues, which increased by 7% from the previous year. However, companies must focus on improving their working capital management if they're to release sufficient cash to invest in their future growth.

% = Year on year change





### Middle East

The Middle East is the region with the highest NWCD position. There's a clear need for companies in the region to do much more to release additional cash for investment, in order to continue to support innovation and stimulate growth. Further struggles in the region are visible from the fact that it is the most highly leveraged region globally – with net debt at 60.7% of revenue – and has the lowest ROCE.

### Asia

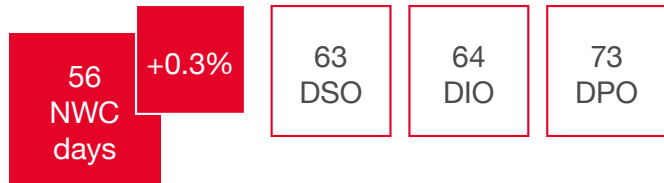
Over the past five years, companies in Asia have increased their NWCD by an average of 2.7 days. However the past year has seen an improvement in the region's working capital performance, driven by decreasing asset days partially offset by a worsening payables performance. There's also a continuing trend in the region towards reducing investment and debt levels. Now seems to be the perfect time for businesses in Asia to focus on releasing cash to reverse the current declines in Capex.

### Australasia

Australasia has the best NWC performance globally. However, in the past year its performance has fallen back – underlining that companies must not take their eye off the ball if they're to maintain their position as global leaders.

### Africa

African companies on average have seen a reduction in debt levels – but this has been achieved at the expense of lower profitability and Capex investment, and therefore ROCE. Maintaining the momentum towards reducing the average NWCD is the best approach for continuing to get rid of debt, while also maintaining investment and improving returns.



## How we can help

### We help our clients to:

- identify and realise cash and cost benefits across the end-to-end value chain
- optimise operational processes that underpin the working capital cycle
- implement digital working capital solutions and data analytics
- achieve rapid cash conservation in crisis situations
- create a 'cash culture' and upskilled organisation through our working capital academy
- roll-out trade and supply chain financing solutions.



### Working Capital improvement approach

Quick scan  
Diagnostic  
Design  
Implementation

## Where we could help you to release cash from working capital

### Accounts receivable

- Tailored, proactive collections
- Credit risk policies
- Aligned and optimised customer terms
- Billing timeliness and quality
- Contract & milestone management
- Systematic dispute resolution
- Dispute root cause elimination

### Inventory

- Lean and agile supply chain strategies
- Global coordination
- Forecasting techniques
- Production planning
- Inventory tracking
- Balancing cost, cash and service level considerations
- Inventory parameters and controls defining target stock
- Inventory replenishment methodologies

### Accounts payable

- Consolidated spending
- Increased control with centre-led procurement
- Avoid leakage with purchasing channels
- Payment terms
- Supply chain finance benefits assessment and implementation
- Payment methods
- Eradicate early payments
- Supply chain finance
- Payment methods and frequency
- Eradicated early payments

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