ALL ROADS LEAD TO WORKING CAPITAL

SEAN WILES AND MARTIN SEWARD

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When assessing the financial performance of a businesses, it is commonplace for management teams to only think about revenue and earnings. Analysts scrutinise and rate companies on their profitability, owners link dividends to earnings, and executives, sales and operational staff are typically incentivised through bonus structures linked to either sales or earnings, or both.

However, this approach neglects one key aspect of what makes a business tick: cash flow. Sales and earnings do not mean much unless they can be converted into cash, quickly, and to do this companies need good working capital management. The shorter a business's working capital cycle, the better its cash flow, and the more flexibility it has in making business decisions.

McGrathNicol Advisory recently explored the working capital cycle of a sample of 146 ASX listed companies across nine sectors, including the transport and distribution sector. It found that this sector experienced the greatest deterioration in working capital performance in 2018, with all but one of the sampled companies having lengthened their working capital cycles.

At a macro level, transport and distribution is typically an industry where cash flow can come under pressure from business-critical suppliers (e.g. fuel, subcontracted labour, warehousing) that are unlikely to extend credit for long periods, exacerbated by large retail, mining and manufacturing customers imposing high levels of bargaining power.

Despite these forces, we believe there is a twofold solution to improving the working capital of companies within this industry.

Firstly, a disciplined approach to working capital management is required to ensure cash flow is optimised and any residual 'funding gap' is well understood and minimised.

This may sound simple but clear procedural steps are required to ensure that accurate invoices are raised as quickly as possible - and that customers pay on or before the invoice due date. Similarly, on the supplier side, paying late or stretching creditors is not sustainable, however, there is generally no good reason to pay early, unless there is a discount on offer and even then, that discount must be better than the financing rate than having the cash in the business' own bank account. Clearly setting out the steps in the procurement-to-pay cycle and assigning responsibilities help ensure suppliers are paid on time and no earlier.

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This part of the solution has not always been well understood by transport and distribution companies, particularly when it comes to the type of financing arrangements available to further reduce their 'funding gap'. However, American Express is seeing a growing take-up of business credit and charge cards by savvy business owners wanting to extend the settlement timeframe on supplier payments, with this sometimes providing up to 55 days of extra cash flow, giving owners the extra breathing space they seek whilst also allowing them to earn rewards points.

Many of American Express' transport and distribution clients can have a funding gap of around 20 or 30 days. In some cases, full payment for services isn't received until completion of contract and this can make things very tight, especially for businesses operating on thin margins.

Getting working capital right can be challenging for operators in the transport and distribution sector, but those that do can carve out a real competitive advantage and set themselves up for long-term success.

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