Working capital: the practical levers

Improving working capital should be one of the first steps towards greater corporate investment, especially in times of uncertainty. Gavin Hinks looks at how treasurers can take practical steps to make improvements a reality

Gavin Hinks is a business and finance journalist

Working capital is a core part of the treasurer's role, and perhaps because of that it risks becoming part of the quotidian and the mundane. Speak to many who pay close attention to the topic, they will tell you working capital can often be starved of focused attention.

That's a pity, because working capital can really come into its own when an organisation sets it sights on landmark projects such as M&A, innovation or capital expenditure.

Investment often comes as a response to times of uncertainty, and it often involves serious thought about working capital.

Richard Dammermann, head of cash and working capital management at BDO, says companies often seek advice in uncertain times, such as those facing business now. "Typically, it's for a bigger-burning platform around financial health and then realising, actually, they need to improve their P&L, and a way of improving it is through investment – and the way of getting that investment is through improving their working capital."

Every treasurer will have a story to tell of rising costs tying up increasing levels of working capital. But PwC has research showing that a focus on working capital could have real benefits. According to the firm's Working Capital Study 25/26, globally there could be €1.84tn 'excess' working capital that could be freed up for investment.

Net working capital days are up 48% since 2015. Days sales outstanding are up 5.7%; days inventory outstanding have risen 13.6%.

There is yet another reason why working capital deserves attention: following historically low interest rates, the era of cheap money appears to be over. Borrowing is now an expensive way to fund change.

Three key areas

There are three main areas for treasurers' attention: inventory, receivables and payables. And there are well-rehearsed financing options to improve working capital in each area. As any expert will point out, one sure way to boost working capital is to do a deal on invoice financing or supply chain finance. These can be pulled together in a matter of weeks and lead to some hefty improvements.

But such options come at a cost, are not free and might lead treasurers to overlook fundamentals – management of customers and payments to suppliers.

"Rather than address the root cause of the problem, lots of finance teams will go down these paths of looking for invoice and supply chain finance, which... are useful tools, but they should be used in conjunction with doing what you can internally to improve your process," says Dammermann.

Quick wins in financing are also sensitive to the relationships maintained with providers. Failure to "keep them warm", as Lisa Dukes FCT, co-founder of the consultancy Dukes & King, puts it, could be the difference between an arrangement taking a

Richard Dammermann

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month and a couple of months. Not much in many corporate cycles, but maybe enough to affect the scheduling or outcome of a project.

So, what to do? The key is being prepared. "There's no need to wait for projects to come along to get working capital sorted," adds Dukes.

Indeed not. But it may rely on resolving some difficult strategic questions internally to get to the bottom of the issue. One such question is whether cash flow is a key business metric for managers to monitor. And here's a case for the progressive treasurer to make. Key business functions such as sales and accounting are focused on the P&L statement. Their efforts go into serving those numbers. However, if a company takes seriously the oft-quoted rubric 'revenue is vanity, profit is sanity, but cash is reality', then accounting and sales should also be engaged in maximising cash.

PwC's working capital practice leader, Daniel Windaus, says organisations need to ask themselves serious questions about which metrics they prioritise. "How important is free cash flow and working capital compared with generating a growth number, compared with generating an EBITDA number? And how do you structure the incentive programme for management to make sure cash and working capital are not a stepchild?"

One way to deal with these fundamentals is to ensure cash flow is reflected in the relationship with both customers and suppliers. Windaus says he sees increasing attention at the contract stage, to focus not only on profitability, but also "certainty of future revenue streams, as well as cash generation and the working capital consumption" involved in key arrangements.

Of course, this not just about receivables. Payables are an issue, too. For Anurag Chaudhary, managing director of Pinnacle Trade Finance, the best approach to improving liquidity among suppliers is a split approach. "The real way to do this is a combination," he says. "Divide suppliers into two groups: small suppliers and the large, strategically important suppliers."

With the larger suppliers, the approach is to delicately renegotiate terms in favour of improved working capital conditions. The smaller ones can be placed in a financing scheme that effectively extends payment terms – for example, from 60 to 90 days.

Chaudhary says this approach offers companies a liquidity hit, plus it minimises the impact on what has to be disclosed as bank debt, a factor that could affect the decision-making of lenders.

Lisa Dukes FCT

Daniel Windaus

Anurag Chaudhary

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"How do you structure the incentive programme for management to make sure cash and working capital are not a stepchild?"

Technology

Technology might also help with working capital. New systems are automating payments through tools such as e-billing, but, as Dammermann says, these systems are still evolving, with gains often offset by large-scale invoice errors.

Naresh Aggarwal AMCT, associate director policy and technical at the ACT, points to artificial intelligence as an additional aid supporting working capital management. AI can look in real detail at cash flow, allowing greater insight into client payment behaviour patterns. "Our ability to

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get far more granular enables us to forecast with greater accuracy," he says.

In a world where the cost of credit has risen, working capital is cheaper cash to support any project, whether it be M&A, innovation or capex. However, in many organisations, efforts to become more resilient in response to the pandemic also brought efforts to expand inventory and, therefore, tie up more working capital. That means there is room for improvement in working capital to support those projects. Financing arrangements, whether it be of receivables or payables, are available to score quick wins.

But experts ask: why wait for a project? Why not address some working capital fundamentals first? So, move cash up the corporate agenda and optimise working capital before a new project is tabled. Financing will play a part in that; new technology is becoming increasingly essential. So too is better policy and internal processes.

As the maxim goes, working capital is the 'reality' in the corporate success formula. Best to give it its seat at the table.

SEIZE THE DAY, GRAB THE CASH

Net working capital (NWC) days – the key gauge of the level of capital required to run the day-to-day business – spiked during the pandemic amid uncertainty and supply chain disruption. It has since returned to more normal levels, but this headline stability hides a far shakier reality, according to PwC.

Days payment outstanding (DPO): according to PwC, DPO is up 11.5% since 2015. For years, stretching supplier terms has been the easy way to bolster working capital. But it's a short-term fix that is not sustainable and carries long-term risks, straining supplier relationships. The regulatory tide is also turning, with increasing focus on regulation in the EU and UK, which may constrain firms' ability to stretch payment cycles, placing downside pressure on DPO.

Days sales outstanding (DSO): the PwC analysis has found that, globally, it is taking longer to collect cash. DSO has risen 5.7% over the past decade – from 47.3 days in 2015 to 50.0 days in 2024 – with increases seen across company sizes and regions. Asia's 9.1% jump in the past two years skews the global picture slightly, but even in more stable markets the trend is upward: DSO has climbed 1.8% in the EU and 5.5% in North America over the past decade. The exception is the UK, where DSO has declined compared with 2015. But as PwC reports: "Rising DSO is liquidity left on the table through unreliable cash conversion, and, ultimately, a warning sign of weakened resilience."

Days inventory outstanding (DIO): inventory has become the silent absorber of uncertainty. Companies have built up stocks as a hedge against supply chain disruption, but at the cost of liquidity and efficiency. During the recent period of uncertainty, PwC says it has seen a shift from 'just in time', to 'just in case' to 'just because' stocking, which ties up cash and increases waste, as well as creating unintended inefficiencies. Having spiked during the pandemic, DIO has never returned to previous levels. Medium-sized companies are especially exposed, with an increase of 24.2% (15.0 days), compared with 5.5% (2.9 days) among large companies and 11.5% (8.5 days) for smaller enterprises.

(Source: PwC Working Capital Study 25/26)