GAMECHANGER'S GUIDE TO

working capital optimization

taulia®

Contents

Here's to the Gamechangers

We've produced this guide to help you transform your company.

That's a big claim, but we're confident it's justified.

In the 1950s, the average lifespan of a company listed on the S&P 500 was almost 60 years. Today it's under 20, and companies everywhere are quickly realizing they must change to remain relevant and competitive. Transformation doesn't happen by accident. Transformation happens when individuals have a vision and take action.

We call these individuals *Gamechangers*.

It's easy to spot Gamechangers in CEO roles. Steve Jobs at Apple and Jeff Bezos at Amazon redefined their industries through organizations they created.

For everyone else, it may seem the opportunities for changing the game are more limited. Yet a key enabler of transformation in the modern corporation is cash; cash to power research; cash to fund acquisitions; cash to enter new markets.

Too often, too much cash is locked up in your supply chain due to inefficient processes, assets, or other resources. The Gamechanger is the one who sees how to liberate that cash; making it available for growth opportunities through the transformative power of technology. If you're reading this, there is a strong likelihood that the Gamechanger in your organisation is you.

At Taulia, we've made a business out of empowering Gamechangers.

We constantly monitor and analyze payment trends across our database of more than 1.5 million suppliers transacting billions in annual spend. We put these insights to work by enabling cash flow optimization strategies for our customers.

For the Gamechanger, that's great news. But every Gamechanger needs to start somewhere, and this guide will help you put in place an innovative working capital optimization program so your company can be enabled to transform and grow.

Welcome to the future.

Cedric Bru
Chief executive officer, Taulia

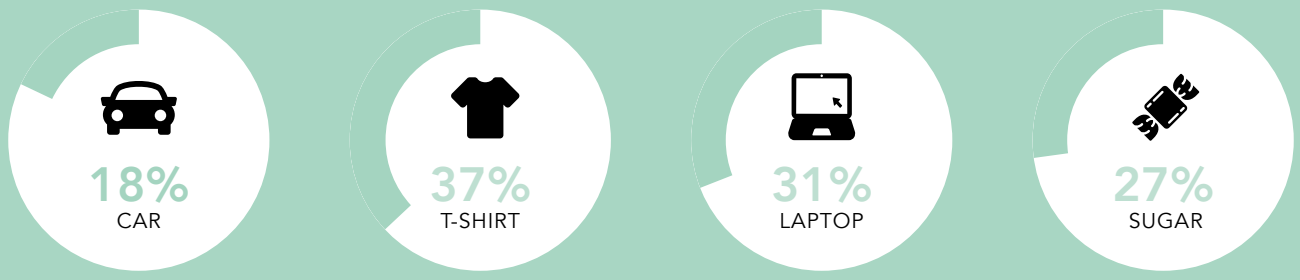
1.

The Gamechanger's guide to working capital optimization

There is as much as $14tr in annual spend volume trapped in global supply chains, which could be released through working capital optimization programs, and currently only $800bn is being addressed through today's solutions.

That's a huge opportunity to free up cash to invest in the transformation needed to prepare for an ultra-competitive digital reality. In fact, Ernst & Young reports that for every US$1bn in revenue, the opportunity for working capital improvement averages US$70m.

Research conducted by The SCF Community further estimates finance costs across the supply chain could account for up to 37% of the retail price of common products (chart above). If smaller suppliers are paying higher rates for the finance they need, that's going to



SOURCE: SUPPLY CHAIN FINANCE COMMUNITY/WINDESHEIM UNIVERSITY RESEARCH

be reflected in what they have to charge you. Reducing these costs for suppliers could lower the cost of goods sold and deliver a significant corporate competitive advantage.

A traditional, incremental approach won't be up to the challenge of liberating the necessary sums to finance the future. Instead, you'll need a game-changing approach – one that understands that it is supply chains that compete, not companies, and therefore recognizes that a cash flow optimization strategy must look across the whole of the supply chain, optimizing cash and working capital throughout.

As Nick Boaro from Ernst & Young points out (see box), cash is becoming a market-sensitive topic and therefore a CFO – and CEO – priority. Yet a successful strategy for optimizing

that cash needs to bring on board every member of the organization, from purchasing to finance to sales and everyone in between – and every member of the supply chain, too.

Over the rest of this guide, we'll take a step-by-step approach to designing and delivering a program that does just that.

From scoping your project, through gaining support, right through to delivery, this guide is your roadmap to success.

GAMECHANGER NICK BOARO: WHY CASH IS KING

There has always been a drive for cash, but in the current economic cycle we see two types of organization.

The first are looking for alternative strategies other than financing because they are tapped out but need to generate additional cash flow. Some of these may be early stage start-ups, others late-stage but distressed.

The other type are industry leaders who are doing well but have always focused on the P&L and never put much discipline around the balance sheet. They've driven a lot of value out of everything else, so for them the balance sheet and cash flow is the next area to focus on.

For public companies, we're seeing a lot more interest from the investor community in cash flow as a barometer for how efficient the business is. And we're seeing CFOs actually committing cash flow guidance to the market. So it's not just about ways to improve the balance sheet, but also about making sure they can predict where it's going to land.

Nick Boaro // EY

2.

Goal setting: the Gamechanger's approach to working capital optimization

Let's be clear: the game-changing opportunity isn't short-term, tactical working capital improvement, but long-term optimized cash flow, which continually improves over time. This will create an efficient enterprise cash culture which reaches beyond your business and to that of your supply chain, benefitting all businesses well into the future.

Many current working capital optimization programs start with tactical, rather than strategic, objectives take for example bank-led programs that look only at the top 100 suppliers. These programs ignore the opportunity that lies across the full length of the supply chain. The Gamechanger acknowledges this limitation. So what should you do differently?

Let's think in terms of the strategic changes we want. Here are five to start with:

Gain true visibility of the cash position across the company and the supply chain.

Enable flexible 'levers' that can be pushed/ pulled to improve working capital, capture early payment discounts.

Develop strong, digital invoice operational processes that are intrinsically linked to an efficient cash flow optimization culture.

Break down silos: establish a cross-departmental committee focused on common cash goals and consisting of representatives from Treasury, Finance, Procurement, IT, and Executive sponsorship.

Don't forget your suppliers – considering their buy-in and early adoption as part of program success is imperative.

Sound good? Of course, there may be others, perhaps specific to your business sector or location, but with these five you're well on the way to a Gamechanging working capital strategy.

Let's drill down into the detail of these changes and how we might work towards them.

1

Gain true visibility of your cash position across the company and the supply chain

The financial health of a modern, connected, company depends on the financial health of its supply chain. Surprisingly, most businesses have very little understanding of the financial health of their suppliers and so the burden of risk, including supply chain risk and customer fulfilment risk fall to the buying business.

The right digital tools can allow the Gamechanger to see both the buyer's and supplier's working capital position across DSO, DPO and DIO – the full cash conversion cycle. An intelligent, data-driven system can go further by benchmarking a buying organization's spend against a live database of actual payment behaviors. This 'window' into supplier health indicators gives the Gamechanger the insight needed to optimize their own company's financial goals, but also to drive enhanced supply chain health.

2

Enable flexible levers that can improve working capital, capture more early payment discounts, reduce supply chain finance costs and improve supply chain health

What is most important for your business? Working capital optimization and cash generation? Better returns on excess cash? Margin improvement? De-risking the supply chain? Improving supplier relationships? What if it's all of these things? The Gamechanger should look for a solution partner who can help you achieve many, if not all of these objectives, as well as keeping an eye towards your future growth aspirations (but let's save that for Chapter 4).

3

Develop strong, digital payables processes linked to an efficient cash flow optimization culture

Take a close look at your payables process – from a supplier's perspective as well as your own – and you may not like what you see. Even the best Gamechanger will struggle to deliver results if AP can't deliver timely, accurate invoice approvals or execute timely payments, for example.

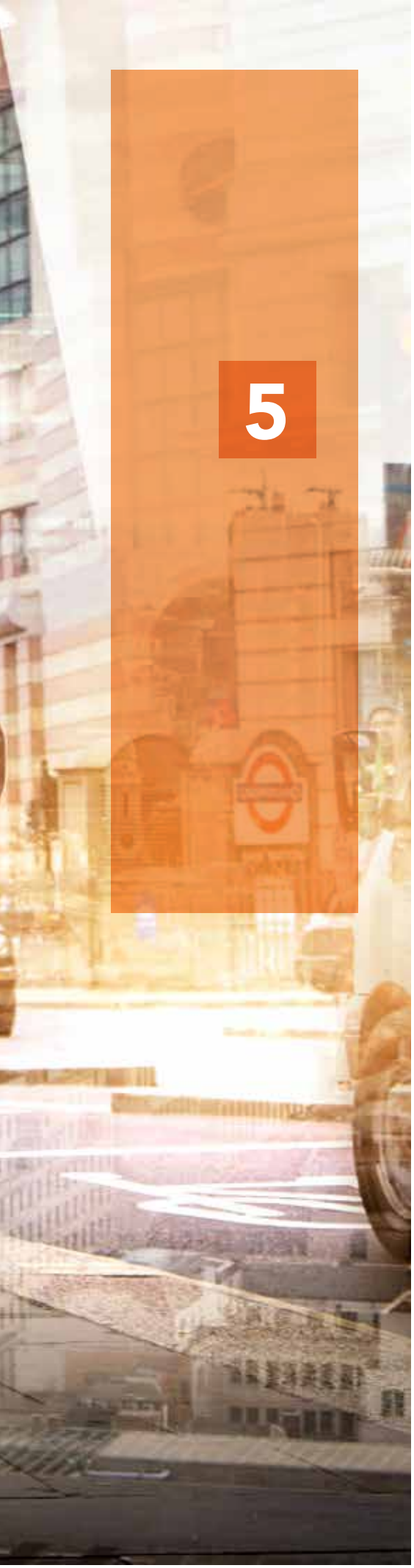
Don't blame AP: traditionally it's been looked at as a cost center and so it's often last in the queue for investment. The Gamechanger recognizes that it's a core component in how companies optimize their cash flows because it dictates when early payment can be made available and, more importantly, is a critical source of data to feed into a data-driven program.

A digital platform can help drive inefficiency and errors out of this process, but you'll also need to embed best practices in the minds of everyone in the business, as well as providing the technology to support them.

4

Break down silos: establish a cross-departmental approach spanning Treasury, Finance, Procurement and IT

Treasury wants to deploy cash for maximum impact at low risk, while Procurement aims to reduce purchasing costs. Finance wants process simplicity while IT wants smooth integration with other systems. It would be easy to leave one of these groups dissatisfied: the Gamechanger brings these groups together to collaborate in a cross-discipline team and align their goals with the



5

corporate strategic objectives. Decision-making is data-driven, using information that can help evaluate the full scale of the opportunity, as well as the trade-offs facing the organization. The result will be common goals for working capital, cost reduction and supply chain health, that every team can understand. You can learn more about building a collaborative team in chapter 3.

Supplier strategy: including your suppliers as you build your objectives and strive to meet theirs

Too often working capital programs are buyer centric. If they do consider the supplier it's almost as an afterthought in seeking not to disadvantage them too much. The Gamechanger takes a different approach. They understand that it's supply chains that compete rather than individual companies and to be truly successful a cash flow optimization strategy encompasses all suppliers as well as the buyer. The Gamechanger will seek from the outset to develop a cash flow strategy that encompasses supplier goals such as DSO reduction, lowering financial borrowing costs, ensuring payment certainty and providing better receivables visibility and control. Just like internal departments it also includes working with suppliers to develop programs from the outset.

GAMECHANGER GRAEME REYNOLDS ON THE VALUE CHAIN

The value chain goes from our suppliers to Vodafone to our customers. That value chain is there to be divided up – but the more value that flows to the people who are financing the value chain, the less there is for everybody else. So if you can take financing costs out of the value chain – regardless of where the banks are taking their money – this means there's more value left for our customers, our suppliers and ourselves.

The pricing of our scheme is based on Vodafone's credit risk, so if you set the interest rate caps low enough, then suppliers will use the SCF scheme. If Vodafone is more expensive, then they won't. So the pricing caps are a tool for making sure that we're shifting the funding cost onto the part of the value chain where it can most cheaply and easily be funded.

Any supplier can sign up for our scheme – so even if you're desperate for cash and in a bad situation, you can still get access to funding.

Graeme Reynolds // Vodafone Procurement

A HOLISTIC APPROACH

As you are setting your working capital goals, make sure you avoid the company-centric approach. It's vital to make allowances for the financial position of the players in the supply chain itself. If your key suppliers are struggling to access finance at acceptable rates, that's going to mean higher prices for you or, perhaps worse, a higher risk that a key supplier will fail for lack of cash and throw your supply chain into chaos. Factor in the cost of capital for suppliers and the extent and timing of their cash needs – lower costs for them can mean lower costs and reduced risk for you.

That's why a game-changing approach considers not only the goals of the organization but the financial health of the supply chain. By understanding where cash is tied up in the supply chain, what suppliers' cost of capital is, where cash can be released and which tools can best be used to unlock it, the Gamechanger can measure the full extent of the working capital optimization opportunity available to the supply chain and negotiate how best to share those benefits.

So what are the potential benefits? They differ for every organization, but some candidates to consider are:

- Working capital cash freed up
- Reduction in finance costs throughout the supply chain
- Margin improvements or returns on cash generated by dynamic discounting
- Supplier satisfaction metrics
- Reduction in supply chain risk.

Whichever benefits you choose have to be aligned with the wider goals of your organization. In a game-changing program, the strategy and goals drive the tools and the metrics – not the other way around. You can find more on metrics in Chapter 5.

3.

Building a game-changing team: leadership and collaboration for working capital optimization

Because our starting point is your corporation's goals, not only those of treasury or procurement, the Gamechanger will ensure that C-level executives, in particular, the CFO, are on board from the start. Only they can commit the necessary resources to conduct the preliminary research, and their backing will be essential to persuading others in the business to support the working capital optimization program.

So who are the key players you need to bring into your Gamechanging team?

TREASURY This is where cash is measured most, so you might think it's the natural home of working capital optimization. Some treasurers, however, still look at options such as supplier finance as adding cost and complexity to the process of moving cash and may need help to understand the wider benefits for the organization. Here's another thing about treasury; in the past, it's been seen as a back-office function which doesn't get out much. But if you're going to recalibrate the enterprise cash culture, treasury is going to need to strengthen ties with the other teams. We know of corporations which have physically relocated treasury to sit alongside procurement, for example. Even if that's not practical for your organization, do the next best thing – get them together, buy them a coffee and get them talking.

PROCUREMENT A secure, healthy and motivated supply chain is what this team values most, and they are likely to react badly to anything which threatens that. Procurement own supplier relationships and with that comes the responsibility to negotiate terms including the introduction of any early payment program. Modern working capital optimization programs, however, can take risk out of the supply chain and create a win-win for both sides of the buyer/supplier partnership. So much so, that it's often procurement which leads the charge on the supplier finance of a cash flow optimization program. Either way, you need procurement to be part of the conversation from the very beginning and without their knowledge of suppliers the program will be difficult to scale.

FINANCE From the CFO down, finance needs to understand the benefits of working capital optimization. The CFO is a key sponsor and supporter – without their backing, you'll find it difficult to overcome any internal resistance to your plans.

ACCOUNTING The accounting treatment of any working capital optimization program can be a minefield for the unwary. You'll need to work with this team, and with legal, if you are to avoid having your payables reclassified as debt, for example (see section 6).

LEGAL As with accounting, a legal opinion on your program is essential, especially when it comes to complex contractual arrangements with suppliers and finance providers.

SHARED SERVICES The people at the 'sharp end' are the ones who are actually processing those payments. If your cash flow optimization program makes their lives harder, why would they cooperate? Engage with them and help them understand why your program is important to the company – and work with them to make sure any changes to processes go smoothly.

IT Your beautifully designed working capital optimization program will rapidly run into the sand if these guys aren't on board at an early stage. Don't try asking them to integrate your digital platform into your company's ERP if they haven't been involved in the planning process from the start.

SALES Often the last area to be considered, but perfectly capable of derailing a working capital optimization strategy if ignored. Many sales teams are incentivized on the value of contracts signed in a given period, but not based on the payment terms. If that's the case, then offering longer payment terms can seem like a painless sweetener. Payment terms need to be built into any incentive scheme if your company is serious about optimizing cash.

BUT WHO'S RUNNING THE SHOW?

Collaboration is great, but every project needs a champion who will drive it forward and push for progress. That's you – the Gamechanger. But as cash flow optimization stops being a project and becomes embedded in the company culture – as it must – that role changes. We've seen many corporations do something radical to make sure the focus on cash doesn't fade with time. These companies are creating new roles with the responsibility to ensure cash stays at the top of the corporate agenda. Call it Head of Working Capital or Chief Cash Officer, this new role is becoming a marker for companies who care about cash.

4.

How the right partner can help

You've established your goals, won buy-in from the CFO and built your cross-functional team. Now it's time to look outside the business. Partner organizations such as a fintech platform provider, finance provider or working capital consultant can play a vital role in helping the organization measure the scale of the cash flow optimization opportunity. These four key questions should help select the right partner:

» **Are the partner's goals aligned with the organization's goals?** The partner's role is strategically important: they should not be regarded as a mere provider but as a true collaborator. They should be 'a good fit' with the organization and in particular with the corporate function that is taking the lead on the program (see Building the game-changing team). In their dealings with the organizations' suppliers, their culture should be to treat them as though they were their own clients. Their efforts to make the onboarding process as simple and painless as possible should be unstinting.

- **Is the technology offer right?** Rich functionality should deliver added value, such as extra insights, reporting and making a range of choices available to users. Scalability and flexibility are important so that the platform can provide tools such as reverse factoring and dynamic discounting – depending on the buying organization's strategy and economic cycles – and be able to offer those options to the whole of the supplier base without having to use separate tools. Finally, the partner should be a complement to systems and programs that are already in place, working easily with them so the organization doesn't have to scrap or reconfigure what is currently working well.
- **Can the partner provide insight?** The right partner should be able to provide insight that is not otherwise available to the organization. They are not being brought in simply as an 'extra pair of hands' to perform a project task, but to deliver value by bringing knowledge, experience and the ability to help the organization learn more about its opportunities. Artificial intelligence provides that by being able to benchmark and predict supplier behavior. It can also proactively prompt when it would be an optimum time to make early payment offers to suppliers.
- **Do the financials stack up?** Of course, the economics have to be compelling: but the business case for using a partner should be built on an ROI that considers the value that the partner brings rather than only the cost.

GAMECHANGER ANDREW WILSON ON SUPPLIER COLLABORATION

The way AstraZeneca works with its suppliers is through collaboration. A more aggressive organization might try to dictate what it is doing, but within pharma that's more difficult. We have some suppliers who are relatively small in terms of dollar spend but are actually quite significant in terms of their value to our organization. So you can't manage them by telling them what you're going to do and then they just have to get on with it. You have to do it much more as a collaboration.

AstraZeneca had a greater need for cash than in recent years, so we wanted to negotiate slightly longer and standardized terms. Our terms are now 60 days and 75 days from receipt of invoice, so they're not particularly aggressive, but they are stronger than they were. We calculated that 75 days was in the middle of a benchmark for the pharma industry, so it felt like a fair place to go. We then adjusted it to 60 days within the European Union because of the Late Payment Directive.

But we wanted a supply chain finance solution that was there for our whole supply network, rather than just a few of the largest suppliers who were served by a bank-led solution we'd had in place for a few years. We didn't want to take advantage of our supply network. We see our suppliers very much as a long-term relationship, so we wanted to make sure that everyone in the network, including ourselves, was doing well. It's no good for us if we're doing well but all of our suppliers are struggling. That's not in our long-term interest.

Andrew Wilson // AstraZeneca

5.

The working capital optimization dashboard

It's one thing to start a working capital optimization project; quite another to maintain the momentum so the benefits endure and increase. Doing that well demands measurement, so the Gamechanger needs a dashboard to ensure the key indicators are going in the right direction. But what are the right indicators?

The standard basic metrics used in any working capital optimization program are:

Days' payables outstanding (DPO): the average time between receipt of a valid supplier invoice and the day the invoice is paid. Lengthening payment terms allows an organization to hang onto its cash for longer.

Days' sales outstanding (DSO): the average amount of time it takes for invoiced sales to be paid for by customers. The more quickly the organization can collect on its invoices, the sooner it can get hold of cash.

DSO
+
DIO
–
DPO
=
CCC

Days' inventory outstanding (DIO): the average length of time it takes for items of inventory to be sold. The lower this figure, the less cash is tied up in stocks, although there may be a higher risk of stocking-out, leaving shelves bare and losing sales.

Cash conversion cycle (CCC): a measure that brings the previous three metrics together into one, explaining how many days elapse between disbursing cash to suppliers and collecting cash from customers.

GAMECHANGER ANDREW WILSON ON MEASURING THE VALUE

We want to move into a more strategic position. A tactical position is one where you've got a working capital challenge, you move out payment terms, you get all the benefit, and the supplier is struggling. An operational position is one where you try to offset that, by introducing a supply chain finance offering that leaves the supplier broadly neutral. But if you move to a strategic space, a value space, then every stakeholder in the supply chain should be able to win. We want to understand what value we're putting into the supply chain because we're putting working capital into the supply chain at costs that are significantly lower than the supply chain currently bears. So there should be a value driver that we are creating within the supply chain by putting in hundreds of millions or even billions of dollars and creating real value. We should then be talking to our suppliers about how we share that value. That then completely transforms the relationship with suppliers because it's not a pure competition anymore. Instead of fighting what the payment terms are, it should be a discussion about how we can all win.

Andrew Wilson // AstraZeneca

The larger an organization's DPO compared to DSO and DIO together, the more efficient its cash conversion cycle. If the figure is negative (because DPO is larger than DSO+DIO), the organization is said to have negative working capital and is receiving cash from customers before suppliers have to be paid.

If an organization with €1bn of spend improves its cash conversion cycle by, say, 10 days (for example by extending payment terms), then it would release €27.4m of working capital (10/365*€1bn=€27.4m).

Alongside these, the standard metrics for payments are:

Average invoice approval time: expressed in days between invoice baseline date (this could be receipt date, date on invoice or ERP system entry date and is different from company to company) and approval date.

Number of invoices processed per day per FTE: the total number of invoices processed per day divided by the number of full time employees dedicated to the task.

You might also look at these other indicators of the success in optimizing your processes:

- Cost (all-inclusive) to process a single invoice
- Time to process a single invoice
- Invoice exception rate
- Percentage of invoices processed straight through
- Percentage of suppliers that submit invoices electronically
- Percentage of invoices linked to a purchase order

What your own organization's targets should be varies from company to company, but benchmarks are available (see box).

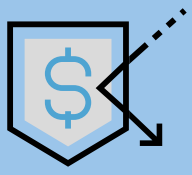
Game-changing invoice processing

The research firm Ardent Partners has analyzed the performance of AP departments across the US. Here's what they found when they compared the 'best in class' to the rest:

Cost (all-inclusive) to process a single invoice:
Best-in-Class: $2.87 All Others: $15.38

Time to process a single invoice:
Best-in-Class: 3.9 days All Others: 17.1 days

These aren't the only metrics you'll need. There will be others that relate directly to your organization's strategic objectives – for example, using surplus cash to boost the bottom line. Here are some examples.



DISCOUNTS MEASURED AS EBITDA/MARKET CAP

If your organization is interested in generating better returns on its cash by offering early payment in return for price discounts, you can compare the value of those discounts – perhaps measured as EBITDA – with the cash committed, providing a calculation that is, in effect, a risk-free return on cash (risk-free, because the suppliers have to be paid anyway). Multiply that EBITDA by an appropriate valuation multiple for the organization, and you can generate a figure equivalent to the market capitalization added to the business by the better purchase prices.

NUMBER OF SUPPLIERS ON STANDARD TERMS

If your business's aims to standardize terms across its supplier base, then the number of suppliers that have agreed to standard terms is an appropriate metric. Even if, overall, payment terms are not lengthened, standardizing them across the organization means that wherever in the world an organization deals with any particular supplier, the payment terms will be the same. Globally-standardized payment terms can be part of the supplier relationship strategy for working with global suppliers.

SUPPLIER SATISFACTION

An important strand of a working capital optimization strategy may be to use an early payment program to improve supplier relationships, making the buying organization a preferred customer and increasing the chances of getting exclusive access to supplier innovations. Your procurement function may already conduct supplier satisfaction surveys which can flag up when you as a buyer have gone up in the supplier's estimation. Measuring the value of innovations that have arisen out of closer supplier collaboration is extremely difficult, with many procurement officers instead using a narrative to explain how their organization has benefitted from innovation delivered by suppliers.

SUPPLIER FINANCIAL HEALTH

The Gamechanger may want to calculate the extent to which early payment facilities have helped take cost out of the supply chain and improved supplier health. Data analytics by a supplier finance fintech such as Taulia may be able to help you understand a supplier's cost of capital, against which the hurdle rate offered by the buying organization's early payment facility will yield a rough estimate.

Another measure is to look at the value of invoices that have been offered up for early payment compared with the value that could have been paid early. Comparing those figures to the supplier's total revenue could provide some interesting insights. If, for example, a supplier is putting almost all of its invoices through for early payment, and the buying organization accounts for 5% of the supplier's total revenue, that could be an indication that the supplier is very appreciative of the liquidity opportunity.

To track these improvements, we could use a metric such as Net impact to Average Payment Days. This measures the effect of your program on suppliers' DPO and is a useful indicator of supplier health.

6.

Game-changing deployment

The Gamechanger understands that setting goals and selecting a partner is just the first stage in changing the enterprise cash culture. Colleagues – especially those in your cross-functional team – may sound supportive in the planning stages, but changing behaviors takes careful planning and excellent communication with every stakeholder.

That's easy to say, but the challenge can be significant – and all the greater with globally-dispersed and decentralized organizations. Working with a trusted partner who has experience in programs like these can reduce the risk of gaps or miscommunications between stakeholders.

Let's assume you have started in the right way by building your cross-functional team (see chapter 3). Careful thought still needs to go into the communication process because, if a supplier finance program is part of your cash flow optimization mix, the most important audience is outside the business, in your supply chain.

The right kinds of messages need to be communicated in the right way, and that can mean that the supplier base needs to be appropriately segmented. Procurement may want to take full ownership of dealing directly with its largest and most strategically important suppliers. The bulk of suppliers in the middle of the tail could be handled by a partner who will be able to handle the communication program for you.

To get the messaging right – and perhaps tailor it for key suppliers – it helps to understand why any particular supplier might be interested in taking early payment. Here are some common reasons:

Filling a cash flow gap (a supplier needs to pay its suppliers sooner than it gets paid by the customer)

Working capital need (supplier needs additional financing for outgoings such as payroll or overheads)

To reduce DSO

Ease of use (no business challenges to solve – taking early payments is easy)

Seasonal cash targets

Collections/ payment predictability

Cash-based accounting

Favorable rates offered (no business challenge to solve – rates are so good, it is worth taking)

So what are some key points to consider when choosing the right partner?

- Technical Integration: your SCF platform is going to need to 'play nice' with a host of other IT systems, and most especially with your Enterprise Resource Planning (ERP) system. How deeply can it be integrated?
- Supplier Segmentation: can your partner help you to segment your suppliers to target each with the most appropriate offer? For example, high spend suppliers might be 'high touch' in communications terms while the 'long-tail' might require less intense contact. Your roll-out will certainly be easier if it can.
- Funding Options: some providers are tied to one source of funding, but if you're to future-poof your program – and mitigate concentration risk – it may be best to look for one that can offer multiple sources.
- Program Management: how engaged will your partner be in ensuring the success of your SCF program? Some just send you a generic specification of a file format and say "send us the data." Look for one that will work closely with you to overcome obstacles and keep driving for that game-changing outcome.

Measuring program success

The first measures of success should be those that are driving the strategy (see section 2). But the implementation project itself has its own success measures. Here are some suggestions:

- Time to go-live: the time taken to implement and activate the technology platform.
- Suppliers advised and onboarded: as the program is rolled out to suppliers, keep a careful watch on the number and proportion of suppliers who have been informed about it and the number and proportion who have enrolled. The difference between those two may shed light on the attractiveness of the opportunity to suppliers or the effectiveness of the communication.
- Suppliers taking early payment: however quick suppliers are to enroll, it's how much they take advantage of the early payment opportunity that is the best measure of its success.

EASE OF IMPLEMENTATION

When AstraZeneca introduced a bank-led program, the KYC process and all the documentation was incredibly burdensome to business stakeholders. They seemed to spend a lot of time pushing bits of paper backwards and forwards between the bank and the supplier and having to get involved in all sorts of conversations. So our suppliers were very keen that the Taulia solution we were implementing didn't require an enormous effort on their part. We were providing them with something that felt a bit like an extra tool they could stick in their briefcase – something suppliers could use if they want. And the stakeholders' involvement in the admin was almost non-existent. They were very keen on that.

Andrew Wilson // AstraZeneca

7.

Bear traps

Even the most committed Gamechanger will meet challenges along the road to changing the enterprise cash culture. Here are some of those that lie in wait for the unwary...

BEAR TRAP 1: ACCOUNTING

When early payment arrangements are put in place, it's important to ensure that the trade payables are not reclassified as debt. Although reclassification makes no difference to the organization in pure cash flow terms, investors look to the financial statements as the most important source of information about the financial performance and health of a business, so it is essential that they reflect the reality.

Money that is owed to suppliers, therefore, has to be recorded separately from money that is owed to finance providers to avoid causing confusion or running foul of the terms and conditions of existing financing arrangements. If, for example, trade payables were to be reclassified as debt, that could take a company's total debt burden over an agreed upper limit, triggering penalty clauses which could include the need to immediately repay long-term finance.

So how does the Gamechanger avoid this fate? Speaking to accounting and legal is essential, but here are three pointers:

» Structure: early payment programs – in particular, reverse factoring arrangements – must be carefully structured so as not to trigger such a reclassification. The basic principle is quite straightforward: the provider of the early payment finance must not be put in a better position than the original trade debtors were in. If a bank, say, can reclaim early payments from suppliers if a buying organization goes into default, then it has better security than the suppliers had, so the arrangements would not meet the usual accounting standards.

» Communication: it is also important to ensure that the way a new early payment program is communicated to suppliers does not in itself trigger a reclassification. This can happen if it is apparent that there is a direct, one-on-one correlation between suppliers that have had their payment terms extended and those that have been offered reverse factoring arrangements. It is important, therefore, that these two strands of the strategy – terms extension and early payment arrangements – are clearly but separately communicated. Explicitly connecting the two creates a linked transaction that will result in trade payables being classed as debt finance. Contractually, the buying organization is not entitled to offer the SCF facility – that's the finance provider's responsibility.

» Offering: it is acceptable to extend payment terms, and it's desirable to offer early payment arrangements. But if the payment terms are only extended to suppliers that enroll for the supply chain finance facility – or, indeed, vice versa: supply chain finance is only offered to those that agree to extended payment terms – then auditors will regard suppliers as being treated as a source of external finance, and the trade payables will be reclassified as debt.

BEAR TRAP 2: LEGAL ISSUES AND SUPPLIER PAYMENT CODES

Governments around the world are increasingly aware of how small and medium-sized enterprises (SMEs) are the 'growth engine' of their economies. They are also attuned to the possibility that SMEs' larger customers may take advantage of their more powerful position in the commercial relationship between them, imposing tough payment terms which make it difficult for SME suppliers to fund their day-to-day operations.

In a growing number of jurisdictions, governments now expect organizations to treat their SME suppliers fairly, and have used a variety of tools to make that happen, ranging from mandatory practice set out in law through to schemes designed to recognize organizations that commit to best practice in supplier payments. Here's how some of those tools may affect your program:

» Payment codes: from the UK to the Netherlands to Australia, reputation-conscious organizations have signed up to government-led payment codes. Typically these provide definitions of 'large' and 'SME' suppliers and require organizations that sign up to the payment code to pay small suppliers within 30 days, for example. Such codes do not have the force of law, but high-profile companies that fail to sign up to such codes – or which sign but then fail to meet the required standards – risk being 'named and shamed' in the media. Organizations should also be conscious that their group head office may have payment codes in place which they expect subsidiary businesses to adhere to – a bear trap that may catch unawares an organization that has recently been the subject of an acquisition.

» Disclosure: the United Kingdom is one country that now requires companies over a certain size to file a public report on a government website providing details of payment practices towards all their suppliers, including disclosure of the proportion of invoices that are paid late. The filings make it very easy to identify organisations that could be perceived to be treating suppliers unfairly. At the same time, the level of detail makes it possible to get more precise information about industry standard practices.

» Legislation: organizations may be required by law to pay SME suppliers within a set period, and may give supplier organizations automatic entitlement to claim interest or other penalties on late payments. In some jurisdictions, such as France, these late-payment penalties are automatically imposed: the supplier does not, therefore, need to risk upsetting a valuable commercial relationship by trying to submit a claim.

BEAR TRAP 3: MANAGING EXISTING BANK RELATIONSHIPS

In addition to extending finance and capital to organizations, banks also provide a range of fee-based services to commercial organizations, such as trade and cash management solutions. Many of these solutions are underpinned by legacy technology, which are both difficult to change and operate in silos. Accordingly, as new innovative fintech entrants enter the market, traditional trade and cash management solutions from banks may not be your first choice for innovation, scalability, efficiency and/or cost. However, choosing a fintech solution or partner – who you have historically never done business with – doesn't mean it must be at the cost of your longstanding trusted bank relationships, you do have the choice to continue to reward long-term bank relationships through participation, and not just one bank – but multiple – thus reducing both technology and concentration risk.

Companies may therefore initially be wary when considering whether to partner with a fintech or non-bank finance provider. However, it is generally possible to invite the organization's preferred bankers to be part of the portfolio of finance providers through the third-party structure, so they can continue to maintain ancillary income that is expected after many years of support.

BEAR TRAP 4: AVOIDING BAD PRESS

Companies can find themselves in an uncomfortable media glare if they take a heavy-handed tactical approach that is company-centric rather than a game-changing approach which makes available shared benefits to the supply chain as a whole. Good communication is, of course, also essential.

» Aggressive payment terms extensions that may provide working capital benefits to the buying organization but increase suppliers' finance costs will attract bad press. The Gamechanger ensures that there are win-win benefits shared across the supply chain

» As we mentioned in Bear Trap 2, there is a growing volume of compulsory late payment legislation and voluntary codes of conduct, often aimed at ensuring that large corporate customers treat their small suppliers fairly. Adherence to such rules and recommendations while also meeting any relevant reporting requirements can go a long way to demonstrating corporate social responsibility towards the supply chain, especially the most financially-vulnerable suppliers.

GAMECHANGER GRAEME REYNOLDS ON TREATING SUPPLIERS FAIRLY

Ten years ago you could push vendors as hard as you could on payment terms without any real reputational damage. Now there are things like the Prompt Payment Code in the UK which has become much tougher over the last 12 months and a similar code of practice in the Netherlands with Betaalme.nu.

Back then, large corporates were basically pushing the capital funding requirements onto their vendors. That pressure certainly isn't as strong today and at Vodafone we have policies that limit our payment terms with small vendors. If the company is a start-up it's even lower. For those companies we have internal policies that say that Vodafone will always be a cheaper source of funding than they can get themselves. It's a total change over the last 10-15 years: it's a lot more focused on treating suppliers ethically.

Graeme Reynolds // Vodafone Procurement

8.

The Gamechanger's work is never done: refine and repeat

If you've reached this point, you'll know that working capital optimization is a task with wide-ranging and significant challenges. You'll need access to financial and technical expertise, but you'll also need to see the bigger picture while at the same time drilling down into the data to measure the full scale of the opportunity.

It may seem challenging enough to push through that initial game-changing project. But ensuring that the success you've achieved 'sticks' and that there is no backsliding to old ways can be just as difficult. Standardizing payment terms, for example, can't be a 'do once' task because there are always new suppliers, new people in old suppliers, and new people in procurement.

It's easy in such instances for new players to plead that newly-favored suppliers are special cases who need more favorable terms than others, opening the door to a parade of 'exceptions'. Soon, all the good work done to improve the working capital position is undermined. Eternal vigilance is necessary to safeguard against backsliding.

Moreover, while competitive advantage is the reward for adopting a game-changing strategy on working capital optimization, that lead will always be nibbled away at by competitors who start to adopt similar strategies. Rather than being a 'do once and forget' exercise, therefore, it has to be something that is continually reviewed and enhanced, with new opportunities for value creation sought out and unearthed.

As we set out in Chapter 3 organizations are recognizing that there is a need for a new corporate role – the Head of Working Capital, to keep the focus on cash well after the initial project is launched. It's a cross-functional role, encompassing as it does the goals of the treasury function, the supplier relationships owned by procurement and the operational matters that are the remit of shared services.

But it must above all be a strategic role, one that can look across the corporate landscape, develop a plan, secure the necessary sponsorship from the chief financial officer, deliver to the plan then measure and report on the results: costs, process improvements, cash released, margin enhancements, supply chain health and resilience.

The person in the role needs to be able to also look at how stakeholders' KPIs act as incentives or disincentives. They need to take responsibility for the system of governance which should embed desired practices and make it necessary to argue a business case if any exceptions to the standard rules are to be permitted.

Above all, this is a leadership role, charged with creating a game-changing culture and building cash-consciousness across the organization.

If you're wondering who that Gamechanger might be – IT'S YOU.

6 STEPS TO CHANGING THE GAME

Prepare by setting clear goals. Clean up existing procure-to-pay processes, standardizing contracts and terms across the corporation.

Ensure your working capital program has support at the top of the company. A forceful leader insisting on compliance is a huge asset.

Encompass internal stakeholders – KPIs and incentives need to be aligned, or old habits will never die.

Avoid the 'Bear Traps'.

Talk to suppliers and make it as easy as possible for them to understand what you are doing and why. If you're implementing a supplier finance program, ensure they can use it and understand the benefits by comparison with their own cost of capital.

Reinforce constantly: continual monitoring and education of both internal and external users is essential.

GAMECHANGER NICK BOARO ON SUSTAINING WORKING CAPITAL OPTIMIZATION

If you're trying to sustain working capital optimization across the enterprise then you need to measure performance so that the key metrics don't revert. But there is also policy and process that needs to change as well, so that as you onboard new suppliers, for example, or have natural staff turnover, your policies are sustainable.

We have established the working capital or cash flow optimization champion role in a number of our clients. In an ideal world it's a temporary role, if you have a cash focus and a cash culture embedded in every function across the organization.

There is a component of education across the business. Everyone needs to know how their role impacts on the company's cash and why that matters. Incentives can help, too, as does measuring performance and holding people to account. That requires something of a roadshow – and it has to impact everyone at the individual level, not just the corporate level.

A game-changing approach is one that has an institutional structure: the C-suite is engaged, they're investing in it and they're going to incentivize the culture change.

Nick Boaro // EY

Taulia would like to thank...

...the following people who generously contributed to this guide by sharing their experiences and views:

» Graeme Reynolds – principal finance manager – decision support, Vodafone Procurement

» Andrew Wilson – working capital lead, AstraZeneca

» Nick Boaro, working capital partner, EY

To find out more about how Taulia can help your organization with your game-changing working capital optimization strategy, please contact info@taulia.com.

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