Informita News

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When will it end?

How long will the current liquidity crisis last?

In most countries we are seeing that headline inflation rates are declining. But central bankers are still increasing interest rates because they say that core inflation is still rising. For commercial banks this means that the cost of credit is higher and the level of credit risk is going up and companies continue under the strain of continued inflation and high borrowing costs. The same commercial banks are not extending additional credit to these companies that would ease this pain, so many find themselves in a cash squeeze. There are many companies who have done their scenario planning and believe they still have plenty of headroom before any liquidity issues may arise. But there are many others who have now been bleeding cash for more than a year and cannot yet see any improvement in sight. Many of these companies have performed very well for many years and are simply not conditioned for the quick changes that maybe required to guarantee their survival. Most will recognise that they need to reduce their need for liquidity. A simple way of doing that is to delay payments to suppliers. It has a good short term effect but can actually be very damaging. Credit risk agencies look for these late payment patterns. It can result in reduced credit limits with your suppliers, introduce the need for expensive bank guarantees and ultimately drive shorter supplier payment terms that in the end increase the level of net cash outflow. There are many other things that can be done that are more sustainable, will strengthen the balance sheet in the medium to long term and stem the cash haemorrhage. Examples would be improving cash collection performance, reducing customer payment terms and optimising inventories. In times of crisis, these opportunities are often not properly recognised.

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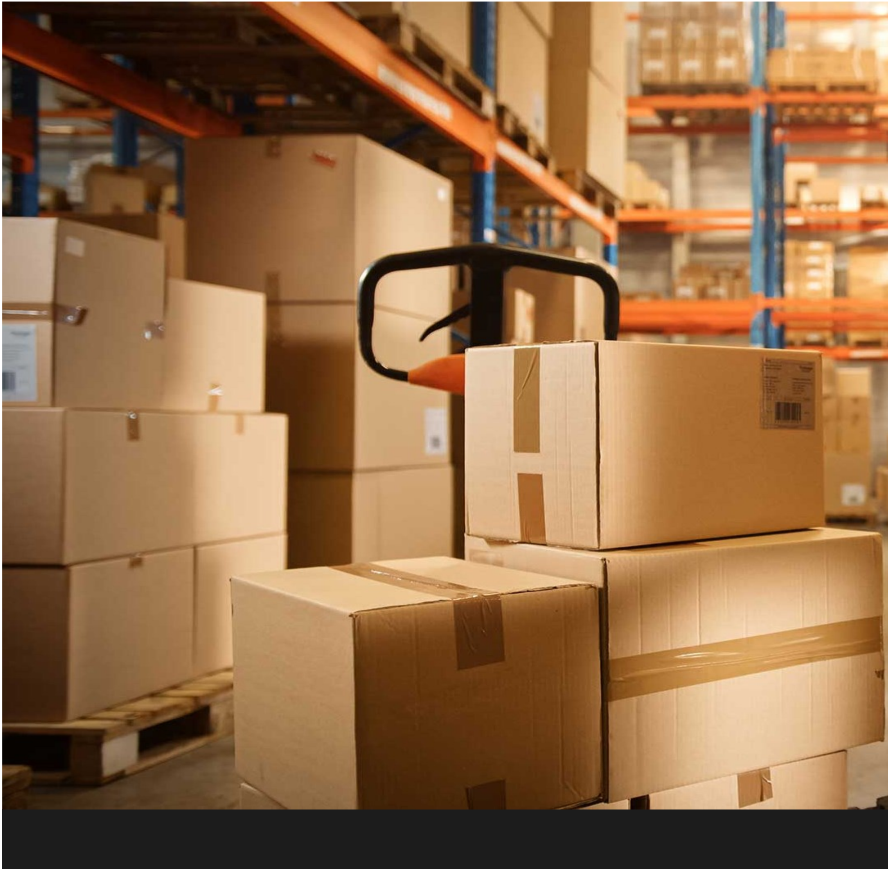


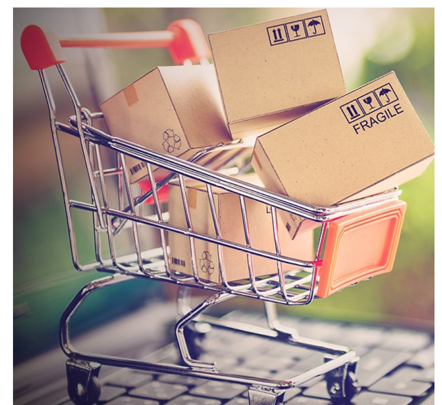
Capacity Constraints

Keeping inventory low?

There are many manufacturing and distribution environments that complain that they are capacity constrained. Usually production managers complain about capacity constraints that prevent them producing in larger batches and at a reduced unit price. At one distribution company inventories were growing as sales were rising. This was good news until the warehouses were full to capacity. One decision could have been to acquire new warehousing space, but they actually took the decision to change their inventory management methodology so that they could manage an increased level of demand through the same cubic space. The result was that the warehouse expansion decision could be delayed by 2 years and less borrowing was required for that investment. In one process manufacturing environment our standard inventory models showed that the company was holding a lot less stock than was required to service customer demand. Normally this would be classified as potential lost sales, but the reality was that to expand the capacity would have a required a massive fixed asset investment that could not be justified by the additional sales. One effect of that situation was that finished goods inventories were extremely low. What was more interesting was that the managers of the company were not fully aware of this constraint until we delivered our working capital analysis. That means there are many cases where your fixed assets introduce constraints that prevent inventories ballooning to unsustainable levels and sometimes it is a blessing in disguise. For those looking for reductions in working capital, understanding the working capital effects of your operations can prevent you from chasing working capital ghosts.

One time vendors

Most large companies have some version of “One time vendor” accounts. The logic is supposed to be that we should not be setting up supplier records for small value suppliers that we might never use again. The problem is that this rarely is the case. At one client, the one time vendor account is the 9th largest spend on the ledger. That will mean that spend is being badly fragmented, the visibility of the spend is obscured, it opens the door to those who are maverick spenders and it can even help fraud to be committed. In a perfect world you would have many of these small items being purchased through and expense system or with the use of purchase cards. But that is not always possible. But there should be regular reviews of these one time vendor accounts to understand where there are repeat purchases and where maverick spend is occurring. Then steps can be taken to name and shame the offenders and maybe even save a little cost.



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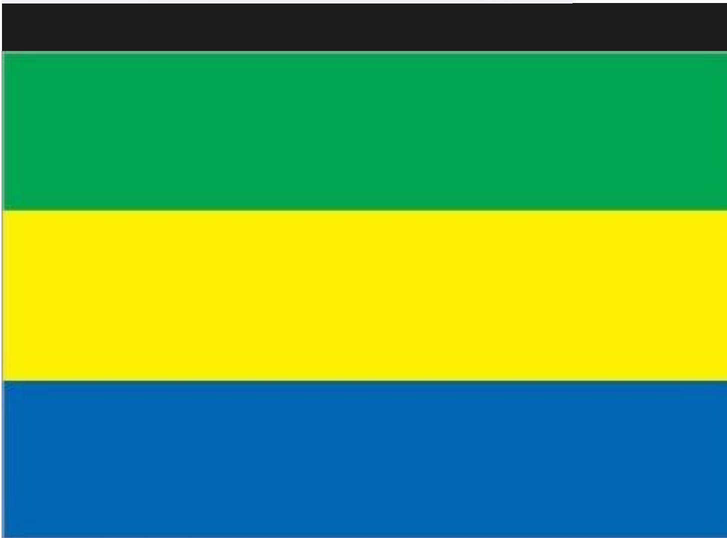
Mergers and Acquisitions

The need for lean working capital

Very often the last piece of a company's sale price will be the value of working capital on the date of the acquisition. That will mean that the selling company has an incentive to reduce working capital as much as possible by that date in order to maximise the sale price. That's all well and good but there may not be a lot of time between when the deal is agreed and the transaction date. Therefore there is not a huge amount that can be done at that late stage. It is much better for the selling company to begin reducing working capital as soon as they decide they want to sell. That can often be a year or more before the sale and this gives enough time to take steps that can take a large chunk out of working capital to the benefit of the selling shareholders.



Gabon: Oil cursed

Oil revenues constitute roughly 46% of the government of Gabon's budget, 43% of the gross domestic product (GDP), and 81% of exports. And oil production is declining. Like many other countries with oil, the country has been stricken by the oil curse. What should have been great wealth has turned into economic mismanagement driven by short term political goals. The IMF has repeatedly criticised the government for overspending on off-budget items, over-borrowing from the central bank and slipping on the schedule for privatisation and administrative reform. The next most valuable resources are logging and manganese mining. The country is still dependent on French imports more than six decades after independence. In fact, the economy is still largely run as a colonial economy of the 1950s. There have been many promises of economic transformation, but progress has been very slow. All these circumstances keep foreign investors away. And this lack of investment means that the economic mismanagement continues. All contributing factors to the latest political instability.

iPhones or Cars?

Foxconn transforms

Many will know that Foxconn as the company that make iPhone for Apple. But they actually do an awful lot more. If you have an iPad, a Kindle, a Nintendo gaming systems, a Nokia device, a Cisco product, a Sony PlayStation, a Google Pixel device, a Xiaomi device or a Microsoft Xbox it was probably made by Foxconn. In fact they make something like 40% of all the consumer electronics devices made on the planet. Not bad for a company that started making electronic components in 1974. Their talent has been to learn what we want and then make it well. There future strategy is to make electric vehicles (EVs), semiconductors and robots. If they keep understanding our needs it is likely that they will expand beyond the giant footprint they already have.

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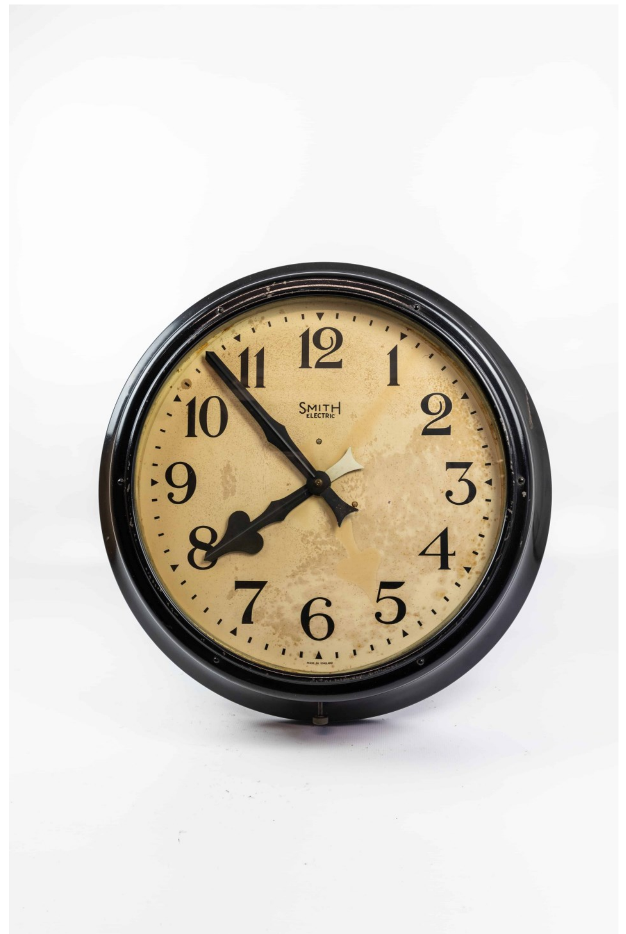
Why Pay Early?

We continually come across companies that pay invoices before they are due. You might ask why this happens and there are numerous good reasons for it to occur. Examples might be that you have reached your credit limit with the supplier and if you don't pay at least part of the balance that your next delivery will be delayed or even cancelled. But there are many other reasons where people are being unnecessarily being nice. Recently we observed one client who made payments every work day and invoices that were due on the weekend would be paid on the Friday before the weekend. This is being nice to the supplier but it is not expected or required. Other times we see that invoices are being "pulled forward", i.e. invoices are selected for today's payment run that are due between today and the next scheduled payment run. Again it is not the expected practice and it is not a legal requirement anywhere. So how do companies get themselves into such working practices? Most often it is because people are trying hard not to pay late and are trying to do what they perceive as being the right thing. But this has a disastrous implication for cash flow. Most surprisingly, the vast majority of companies have no reporting that would tell them exactly how much they pay early. When we do our analyses, our clients are often shocked to see how common the practice has become. The good news is with some very simple controls, this practice can be minimised. It will never be eradicated since there will always be some emergency that will require an early payment.



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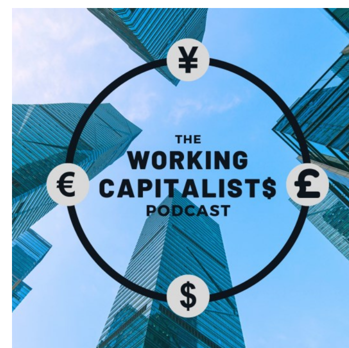

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