CORPORATE & INSTITUTIONAL

Lloyds Bank Trade Insights

Working capital through the eyes of a treasurer

LLOYDS BANK

At a glance

- 2024 will be a year **defined by energy, security and geopolitics, against the backdrop of a continuous focus on climate change and the transition to Net Zero**. From a significant number of defining elections across the world, to major weather events, conflicts, and attacks on container ships, events on the world's stage are having a significant impact on the operations and supply chains of businesses.
- As a result, **building supply chain resilience is a high priority for many businesses**. While some are on-shoring or 'near-shoring' their supplies and/or production, **others are choosing to pivot from a 'just in time' approach to inventory, to a 'just in case' model**.
- Holding additional inventory requires **improving the management of working capital**.
- In this edition of Trade Insights, **Abel Martins-Alexandre**, Managing Director, Head of Infrastructure, Energy and Industrials at Lloyds Bank and the former Group Treasurer of FTSE 100 company Rio Tinto, **shares his insights into managing working capital from the perspective of a corporate treasurer**.
- Abel discusses the essential role the treasurer plays in **connecting the physical and financial supply chains** and why the treasurer should be firmly **embedded in strategic conversations with all areas of a business** in order to best optimise working capital, improve business processes, address sustainability objectives, and **build resilience into the supply chain**.

The drive towards 'just in case'

There is no doubt that 2024 will continue this decade's overarching theme; **uncertainty**.[1] Seismic geopolitical and economic events around the world continue to have significant consequences for businesses not only in the UK, but further afield. As a result, building resilience remains a topic high on the business agenda.

The uncertainty is set to continue too, with widespread political change around the world looking highly likely. 2024 has been named the "**biggest year in election history**"[2], with 51% of the global population – **equivalent to 4.2 billion people – in more than 50 different countries**[3] going to the polls. The results of elections in countries ranging from the United Kingdom to Uruguay, Ireland to India, even to the European Parliament itself, could mean drastic policy changes and an evolving operational environment for businesses that trade internationally.

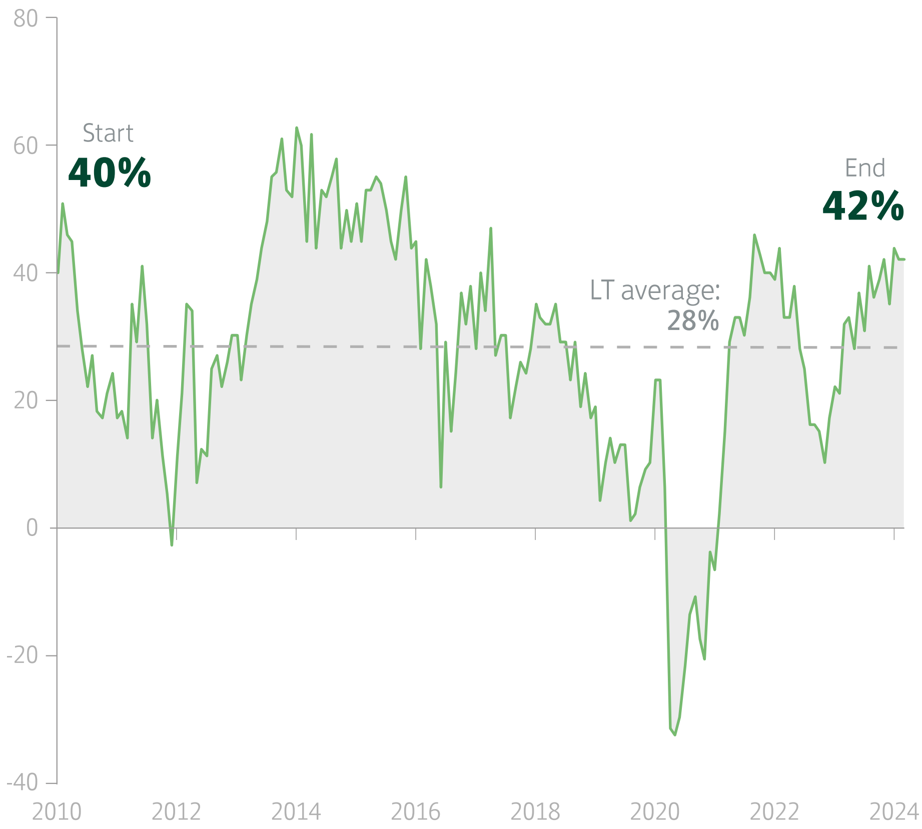
Aside from political developments, businesses are facing a wider range of risks that could affect how and where they trade. Extreme weather events caused by climate change, for example, have the potential to cause disruption to trade – as is already the case in the Panama Canal.

37% of UK firms have been impacted by the trade implications of the attacks in the Red Sea

Each ship that passes through the series of locks along the South American canal uses **200 million litres of water**,[4] all of which then flows into the sea. The water is derived from the same source that caters for more than half of Panama's 4.3 million residents. Under normal circumstances the canal sees more than 40% of the consumer goods traded between east Asia and the US east coast pass through it. However, a recent period of drought has left the canal's water source facing a deficit of 3 billion litres per day. The impact on trade is severe – the number of vessels passing through the canal each day has been reduced from 36 to 24, and some shipping firms have even **resorted to using rail**[5] to bypass the canal. Fewer vessels moving through the canal as well as land transport have caused significant delays for the businesses dependent on this prominent trade route.

Instability in the international arena has also disrupted trade in what is perhaps the world's other most famous canal. Attacks by Houthi rebels on container ships in the Red Sea heading towards the Suez Canal have meant that many freight firms have opted to bypass the canal – which normally sees **almost 10-15% of global trade** [6] – sending their cargo to Europe via southern Africa instead. Diverting these ships via the Cape of Good Hope adds an additional **6,000 nautical miles**[7] to the journey, potentially increasing product delivery times by as much as 3-4 weeks. This costs **$1 million in extra fuel**[8] for every round trip between Europe and Asia. **A survey by the British Chambers of Commerce**[9] has revealed that over a third (37%) of UK firms have been impacted by the trade implications of the attacks in the Red Sea, including more than half (55%) of UK exporters.

Chart 1: Confidence anchored near recent highs



Source: **Lloyds Bank Business Barometer**[10] (March 2024), BVA BDRC

42%

Business confidence in March stayed near recent highs and has been at or above the survey's long-term average for over a year. It is signalling a return to economic growth.

The unpredictability of global events – especially since the global pandemic in 2020 – has exposed the fragility of commerce around the world, which has kick-started a change in mindset for businesses reliant on international supply chains. Many businesses have decided to **on-shore or 'near-shore'**[11] production or the sourcing of supplies, reducing the capacity for their supply chain to be disrupted by global events. Others have focused more on increasing inventory levels to ensure preparation in the event of disruption. This was recently **described by the Vice-President of the European Commission**[12], Josep Borrell, as "a paradigm shift from the primacy of open markets to the primacy of security; from 'just in time' to 'just in case'."

While adopting a 'just in case' approach goes some way to prevent further disruption caused by unpredictable events, it also requires a change to the business model itself. A pivot towards 'just in case' requires businesses to keep higher levels of inventory. In addition, it can also put pressure on the supply chain as a whole, where larger buyers aim to increase Days Sales Outstanding (DSO) and look to suppliers to increase their Days Payable Outstanding (DPO).

Increased levels of inventory, coupled with the additional hurdles of extended sales and payables cycles, has therefore created new financial challenges and put firms' cash flow under stress. As a result, businesses are required to be agile and reactive in order to optimise their working capital.

Despite businesses remaining optimistic, the likelihood is that the pivoting towards 'just in case' will continue as firms brace for further uncertainty. With this in mind, what are the implications for managing working capital?

A treasurer's perspective on optimising the working capital cycle

Global economic turbulence means that businesses need to look at optimising what is becoming an extended working capital cycle, in order to ensure the liquidity of the business, while releasing cash to grow the business. But how can businesses unlock working capital, build resilience into their supply chains, and face the challenges of 2024 and beyond with confidence?

To find out, we spoke to **Abel Martins-Alexandre**[13], who joined Lloyds Bank in 2021 as Managing Director, Head of Infrastructure, Energy and Industrials. Abel was most recently the Group Treasurer of FTSE 100 mining company, Rio Tinto, where he had global responsibility for corporate finance, global treasury operations, structured finance, pensions and insurance, and was a member of its Finance Leadership team.

The custodian of cash

Treasurers face a multi-faceted set of responsibilities, according to Abel. "First and foremost, the role of the treasurer is to ensure the liquidity of the business," he says. "And that means having the right amount of cash in the right place at the right time in the right currency, in the most cost-effective manner." At the same time, the treasurer is responsible for ensuring that the financial supply chain – both sides of the balance sheet – is efficient, effective and well-funded. This, explains Abel, is where the risk management elements of the role come in. "You need to understand the riskiness of your business model so you can adjust your funding plan accordingly," he says. "You also need to understand how good your access to the source of funds is, after you have taken care of your key priority: the operating cash flow."

With this in mind, these responsibilities play a hugely influential role in the way that the business manages working capital. "Working capital means 'cash to be'. Since cash is a group asset and the treasurer is the custodian of cash, if any working capital is not transformed into cash, then the default assumption is that it must be," he explains. This means that the treasurer is responsible for examining the businesses processes – from inventory levels to payment terms within the context of both suppliers and buyers – and ascertaining both how the working capital cycle can be reduced, as well as which elements are absolutely indispensable to the running of the business.

> The key question for the treasurer is not asking 'how do we transform working capital into cash?' Instead, it should be focused on asking 'how effective are we in managing our physical and financial supply chains?' – and getting data to that effect.

Abel Martins-Alexandre
Managing Director
Head of Infrastructure, Energy and Industrials, Lloyds Bank

Managing the physical and financial supply chains

The question of what is absolutely indispensable to the business requires the treasurer to develop a complete and holistic understanding of the operational and commercial running of the business.

To do this, Abel recommends managing the physical and financial supply chains in tandem by embedding the treasurer within the other conversations taking place between different business functions. "The treasurer's involvement in the working capital cycle and the procurement, collections or credit process is absolutely a key driver forward for treasury teams," he says. "Treasurers are becoming more and more involved in marrying financial supply chains with physical supply chains, and data is helping that a great deal." The digitalisation of processes means that the treasurer can use data to understand how to manage working capital in the optimal way, at three levels: operationally, commercially, and financially. As a result, the relevant data provides the treasurer with tangible reasons as to why potentially expensive financing tools shouldn't be used as a standard default and before the business is operating at an optimal level.

When supported by the right data, questions around financing can trigger conversations around operational and commercial optimisation. "The role of the treasurer becomes one of sitting down with procurement, sales and marketing, operations, sustainability and IT, and explaining the value of cash, why there is value in optimising working capital." Abel believes that businesses should think strategically about working capital: "Within an optimal and integrated approach, operational efficiency, health and safety, sustainability and working capital are all part of the same dynamic, and managed together," he says.

Key questions for:

Operational optimisation:

How effective is the business at managing:

- its supply chain?
- its suppliers and lead time, in terms of transforming products or services into the final product or service?
- its clients, not only in terms of delivering to them on time and in full, but also in terms of receivables and payments?
- its work-in-progress and inventory stack, in terms of the number of stock keeping units (SKUs)?

Commercial optimisation:

Does the business have the right counterparties from a credit point of view, on both sides of the balance sheet?

Have you implemented payment terms that are:

- fair?
- in accordance with regulations?
- effective and efficient?
- neither too long nor too short compared to competitors?
- neither too generous nor too constraining, based on the business need?

The four pillars of Supply Chain Finance

Optimising working capital

Improving processes

Strengthening partnerships with customers and suppliers

Using additional cash for a higher return

The power of Supply Chain Finance

Ensuring that the treasurer has a seat at the table for conversations around commercial and operational optimisation can result in four highly beneficial consequences.

The first is that it strengthens the internal partnership between areas of the business and ensures that the treasurer can strategically align the liquidity model to reflect all departments. For example, a pivot towards a 'just in case' business model may mean that the business has to carry higher levels of inventory, but the treasurer may be able to help in quantifying how much inventory is actually needed, how many SKUs are required, whether it's possible to use a virtual warehouse rather than a physical warehouse, or whether other solutions can be applied.

Secondly, these conversations help to achieve excellence in terms of process improvement for all parties. The optimisation of working capital is, first and foremost, both an operational and a commercial process. The role of the treasurer is to support the end-to-end improvement of the relevant processes, including P2P (procure-to-pay) and C2C (contract-to-cash).

Third, collaboration such as this can reveal improvement opportunities that, in turn, will lead to better financing options.

Finally – and perhaps most importantly – these conversations can help to trigger opportunities to improve relationships with suppliers, managing risk and enhancing cash flow. Implementing solutions such as **Supply Chain Finance**[14] can allow suppliers to leverage the buyer's credit rating to reduce their cost of funding, hence building more stability and resilience into the supply chain. In addition, a number of Supply Chain Finance tools improve the quality of, and access to, data – both for the business and its suppliers. This further increases the partnership between parties. Similarly, **Receivables Purchase**[15] allows corporates to accelerate payment for their invoices, providing these suppliers with a means to quickly access liquidity while at the same time managing risk within their customer/buyer base.

For Abel as a former group treasurer, this final point is especially important for internationally trading businesses. "I have experience of managing a working capital project where the imperative was to optimise working capital," he explains. "We achieved that, but it's not where I saw the most value. Where I saw the most value was with the partnership we developed with internal stakeholders and with our suppliers – improving the partnership and resilience." This is the case, he says, because – depending on the size and scope of the business – a company can often provide its suppliers with their liquidity requirements, cheaper than other alternatives. "Without lending your balance sheet, you can support suppliers which may be smaller than you or have a lower credit rating than you. But it means you can provide them with liquidity that they otherwise wouldn't be able to access, let alone be able to pay for. That's very important – because this is providing security of supply chain, providing liquidity, hence stronger relationships."

The challenges associated with embedding the treasurer within these strategic conversations tends to vary based on the type of business, the sector, and most importantly, the size of the business itself. For SMEs, says Abel, it's simultaneously easier and more difficult. "In a small business, by definition, you have fewer people. They all sit in one office – from the management, to the CEO, to the financial director – so it's easy to convene. But at the same time, it's more difficult – not every business is agile and the business depends on the resources, capacity and experience of the staff to understand these ideas and put them into practice," he says. "For larger businesses, the problem is different. There are more people, but they are more compartmented. The best companies are the ones that are capable of breaking the silos; focusing on an operating model that drives optimisation and process improvement."

Regardless of the challenges, Abel believes that by having these conversations with other business functions, the treasurer can help not only the business, but can also help its suppliers to weather economic turbulence. "Treasurers, supported by the banks, have a significant role to play in supporting the resilience of the supply chain," he says.

Efficiency overdrive

Given the treasurer's ambition of converting working capital to cash, what happens at the other end of the scale – when the business finds itself with excess cash? "The risk of being too efficient is a nice problem to have," comments Abel. "But being extra efficient is a journey that never really ends. In an ideal world, you have zero cash – everything works so perfectly that you don't need any. But of course, in the real world there are complexities, so you always have excess cash, unless you sit at the lower end of the rating matrix."

According to Abel, the best course of action is ensuring that you have enough cash to cover your operational needs, in addition to a reserve amount to cover the unlikely – but plausible – scenarios where cash may be needed. Another layer would be strategic cash – if you have the luxury of having some. This should be aligned with your capital allocation framework, which in itself depends on your company's rating. "You need to look at how much you can afford to invest in different products so that you optimise the return on your cash, according to the pecking order of any cash investment strategy; security, liquidity, then yield."

Supply Chain Finance and Dynamic Discounting Solutions are powerful tools for companies with excess cash, says Abel, since they offer the opportunity to reinvest cash into your balance sheet. "Investing in your own balance sheet is the best use of cash," he adds. "After all, who knows your own risk exposure better than yourself? And what better return can you get than one on your own cash via Dynamic Discounting?"

"If you embed the right strategy to optimise liquidity for all parties, improving the quality of data, strengthening the partnership and continuously enhancing end-to-end processes, then that's a powerful combination. It supports a culture of working capital optimisation and builds the resilience of the supply chain."

Abel Martins-Alexandre
Managing Director
Head of Infrastructure, Energy and Industrials, Lloyds Bank

Top tips for managing working capital

Do:

Continually review inventory levels, lead times, payment terms and the potential for disruption.

Ensure that the treasurer is embedded within strategic conversations between business functions to optimise working capital.

Focus on the simplification of processes – from reducing the number of SKUs kept within the inventory, to reducing the number of different payment terms used with customers/buyers.

Explore how tools such as Supply Chain Finance can improve relationships with your suppliers and build resilience into your supply chain.

Be strategic in terms of how and where you invest excess cash.

Ensure the treasury function is aligned with the strategy of the business and is clear on the elements that are absolutely critical to the running of the business.

Explore Trade Finance solutions – such as **Export Letters of Credit and Guarantees**[16] – to reduce the capacity for supply chain disruption.

Instil a 'cash culture', focusing on discipline and excellence – providing the means to tackle late payments and ensure that invoices are paid on time.

Digitise process where possible to provide real-time and accurate data.

Don't:

Ignore potential avenues towards optimising working capital – being efficient is a journey that doesn't end.

Proceed without data. Data can inform and augment many financial decisions, help forecast cash flow, and give the business a unique insight into the state of working capital within the firm.

Over-rely on financial solutions before you've addressed the optimisation of working capital within the business.

Lloyds Bank's solutions include:

Export and Import Letters of Credit: Lloyds Bank's Export and Import Letter of Credit coverage, using an international network of banks, can reduce the risk of exporting to, or importing from, almost anywhere in the world. Using an Export Letter of Credit can give you the confidence to release goods knowing that payment will be guaranteed, so long as the terms and conditions of the Letter of Credit are fully met. Funding options available include Discounting, enabling you to receive payment early. Import Letters of Credit help ensure that you receive (and only pay for) what you ordered.

Bonds and Guarantees: Lloyds Bank's Bonds and Guarantees can be required to bid for overseas business and can demonstrate improved credit-worthiness with your trading partners. They can give your customers confidence in your business and may help you win new contracts or negotiate better trading terms. Lloyds Bank's UK-based centre of excellence can support with wording reviews and drafting, providing you with operational support and reassurance.

In addition, you can use the Lloyds Bank Trade Tracker to check the status of your trade request at any time.

Documentary Collections: A cost-effective way to mitigate the risk of non-payment and help manage your cash flow. Documentary Collections ensure that you receive payment for the goods sent. Your customers can only take delivery of the goods once they have paid for them, or once they have accepted a Bill of Exchange to pay at a later date.

Trade Finance: A comprehensive range of **finance and risk mitigation solutions**[17] to help optimise your working capital cycle when exporting or importing.

Lloyds Bank offers Trade Loans, Pre- and Post-Shipment Finance, Open Account Trade Solutions, Supply Chain Finance and Receivables Purchase. The latter can be particularly useful in the context of exporting, unlocking the money tied up in invoices that have not yet been paid.

Open Account Solutions: Accelerate payments for invoices ahead of agreed payment terms to optimise working capital. Open Account Trade Solutions reduce risk, improve supplier relationships and align the objectives of Treasury, Procurement and Sales for both buyers and suppliers.

The **Lloyds Bank Export Working Capital Scheme**[18], backed by a **UK Export Finance**[19] guarantee, can provide access to working capital to fulfil new export contracts, particularly those that are of higher value than your usual activity.

You can also use the **Lloyds Bank Online Trade Services**[20] platform to manage and operate your international trade activities through one customisable dashboard.

International Trade Portal: Lloyds Bank's powerful insights platform, the **International Trade Portal**[21], provides practical support with both free and unlimited access.

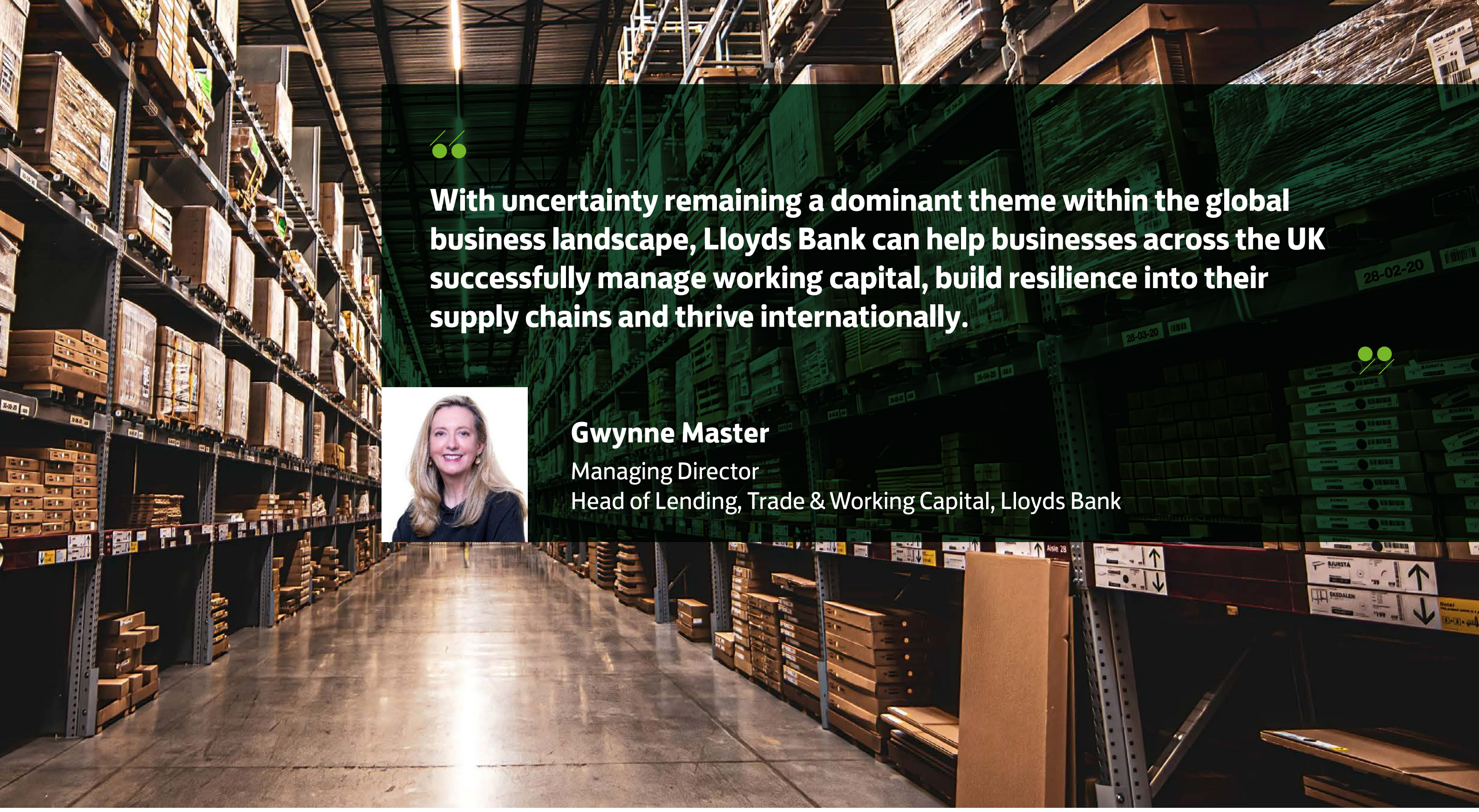
Foreign Exchange: We offer a wide range of foreign exchange products to mitigate the risk of exposure to future exchange rate movements and provide clarity and control over margins.

> Working capital is the lifeblood of any business and maintaining healthy levels is crucial. Lloyds Bank offers the expertise and the solutions to help businesses optimise their working capital – unlocking cash and becoming more resilient.

Mansour Davarian
Managing Director
Head of Trade & Working Capital Sales,
Lloyds Bank Corporate & Institutional Banking

For more information on how Lloyds Bank can support your business when importing or exporting, **speak to one of our experts today.**[22]

You can also get the latest online insights, reports, expert commentary and client case studies direct from **The Source.**[23]



> With uncertainty remaining a dominant theme within the global business landscape, Lloyds Bank can help businesses across the UK successfully manage working capital, build resilience into their supply chains and thrive internationally.

Gwynne Master
Managing Director
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Footnotes:

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