The New Liquidity Paradigm:

In this period of greatest financial turmoil since the 1930s, life has changed for corporate treasurers. With a focus on liquidity risk mitigation, treasurers are broadening their remit to working capital as a key liquidity lever, while continuing to enhance treasury practices.

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Focus on Working Capital

The past two years have demonstrated that much of the liquidity previously taken for granted can disappear in an instant. Additionally, the ability to raise funds quickly through money markets or borrow from banks can no longer be taken for granted. This renewed focus on liquidity has inspired treasurers to reduce reliance on external funding. In alignment with these efforts, businesses are seeking opportunities to optimize working capital to extract liquidity trapped within the cash conversion cycle.

The evidence from Citi Treasury Diagnostics, a global benchmarking survey that collated treasury practices from 150 multinational corporations in its first round, is that there is significant opportunity for improvement. In aggregate, working capital management was one of the weaker performing functions—relative to other areas of treasury responsibility, as well as on an absolute basis compared to potential best practice.

Improving Working Capital Management Has Broad Benefits

Effective working capital management is the result of strategically coordinated initiatives across multiple processes, functions, entities and geographies. For even the most sophisticated organizations, achieving sufficient levels of coordination is a challenge.

Many organizations also face self-imposed barriers to achieving results. While the significance of working capital improvement is embraced in concept concerns persist about the broader impact, or even relevance, of tightening practices.

Citi’s Financial Strategy Group conducted an in-depth analysis of 22 working capital-intensive industries, covering 828 of the largest global firms. We found compelling quantitative evidence on the broader benefits of working capital management that dispel some common perceptions as myths.

Myth 1
Investors don’t care.
The 10% of firms who shortened their cash conversion cycle most over Citi’s five year analysis (top cash conversion cycle shorteners) were rewarded by an excess equity return of up to 30%. Companies with high liquidity and organic funding capacity relative to peers enjoy significant equity valuation premiums.

Myth 2
Working capital improvement initiatives limit top line growth.
The top cash conversion cycle shorteners enjoyed sales growth of 700 basis points more than the worst 10% of firms, the ones that suffered the largest working capital deterioration over five years (top cash conversion cycle lengtheners).

Myth 3
The impact on the bottom line is limited.
The typical company can improve return on invested capital (ROIC) by 84 basis points by improving working capital efficiency by a quartile relative to its industry.

Myth 4
Working capital improvement initiatives aren’t relevant for healthy companies with strong access to financing.
The typical investment grade company stands to gain 78 basis points on ROIC by improving working capital efficiency by a quartile relative to its industry.
Myth 5

Within a given industry, working capital patterns affect all players in very similar ways.

There is a sizeable disparity in cash conversion cycles within industries. The median difference across industries in cash cycle between the first and third quartile is 62 days, with the most tightly distributed industry having a dispersion of 29 days. In fact, both the top cash conversion cycle shorteners and lengtheners were evenly distributed across industries.

Getting Results

Other misperceptions that persist at many companies are that working capital improvement initiatives can hurt longer-term relationships in the supply chain, with suppliers, customers and distributors. There is also a belief that commercial considerations call for improvement initiatives to be managed by individual business units rather than as a firm-wide matter.

While there is always a balance between improving working capital management and commercial practicalities, by using the right tools and partners, companies can achieve win-win solutions. And, meaningful benefits can be hard to achieve without organization-wide senior sponsorship and coordination.

The Procure To Payment Cycle

The procure to payment cycle refers to the collective set of processes that begins with issuance of purchase orders to suppliers and ends with payment to these suppliers. Many companies have procurement processes that are managed at a business line or subsidiary level across many markets and do not benefit from centralized internal processes and technology—for example, shared service centres—and banking arrangements.

Such consolidation reduces processing costs, bank fees, and errors. Coordination of payment cycles improves cash forecasting and liquidity management. And, automation
If You Run Out of Liquidity, You Haven’t Got Much Else

Liquidity has surpassed earnings growth in importance to equity markets investors. Since the onset of the current crisis, companies with the ability to self-fund have commanded an increasing equity premium, according to Citi research. Corporate finance strategies have adjusted to the new realities and treasury has come of age as the owner of corporate liquidity. At many companies, CFOs are calling on treasurers to make better use of internal liquidity and reduce dependency on external funding. If you run out of liquidity, you haven’t got much else.

Efficient liquidity structures and working capital management practices are highly effective levers, reducing the level of cash required to run day-to-day operations and providing greater financial flexibility when other alternatives are unavailable or costly. Global cash centralization and pooling structures enable companies to allocate internal liquidity more efficiently across operating entities. Working capital process centralization and supply chain financing solutions shorten the cash conversion cycle, delivering balance sheet and P&L benefits.

The impact is measurable and substantial: we’ve seen large multinationals enjoy a reduction in working capital requirements of up to 30%, translating to 2-3% EPS accretion.

Global banking partners are integral to the process of improving these practices. As financial intermediaries, we help both buyers and suppliers realize their goals. At Citi, we leverage our experience and expertise to help clients assess and realize potential opportunities. We do this by engaging with them in in-depth information gathering on current practices and operating processes across treasury and commercial activity. The first objective is to identify gaps and risks inherent in the current operating environment. By clearly identifying sources of risk, or areas of suboptimal performance, we can then help identify how to mitigate, offset or negate these risks and improve performance. The solution may involve recommended changes in the client’s internal processes, structures and usage of technology, as well as the application of Citi capabilities to optimize liquidity and working capital management in an integrated manner.

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Citi’s Global Liquidity Management Capabilities

Citi’s Global Transaction Services offers innovative, end-to-end global liquidity and investments solutions that help you centralize and invest your cash. Our solutions link global working capital management, liquidity management, and a full range of short-term investment services to maximize yields and control risk.

With an on-the-ground presence in over 100 countries, and having implemented more than 7,000 liquidity management client solutions, Citi has unparalleled experience and the capabilities to help you achieve your objectives—from local to regional to global.
provides real-time information and analytics allowing for better decision-making. The combination of process centralization and associated technology support can have powerful benefits.

Supplier financing programs deliver added benefits to the cash conversion cycle. Firms in a stronger financial position than their vendors can sponsor supplier financing programs through a relationship bank partner. Vendors selected for the program take advantage of the creditworthiness of their buyer to access relatively cheaper financing through the bank.

As a result of the supplier financing program, the buyer can enjoy extended payment terms, while vendors receive lower-cost financing. Having the buyer’s relationship bank in the chain also provides greater comfort to the vendors than traditional, one-off, factoring programs. This can feed back into more advantageous sourcing costs for the buyer and strengthen business relationships for the longer term. In other words, a supplier financing program has the potential to transform what would otherwise be difficult discussions between a buyer and its vendors into a win-win outcome for all.

The Order to Cash Cycle
The order to cash cycle refers to processes on the revenue generation side, from customer order fulfilment to the receipt of cash and application to outstanding receivables. As the number of customers and distributors involved in cross-border
trade has increased, many companies have processes that are even more fragmented than on the procurement side.

By centralizing and automating processes, firms can improve the timeliness and predictability of cash collection and eliminate float in internal processes as well as in banking procedures. Internal process costs and banking fees can also be significantly reduced. As important, firms enhance decision-making on customer credit practices through improved information and analytics.

Additionally, receivables portfolio financing and distribution financing programs can help support sales growth without extending the cash conversion cycle. The seller partners with a relationship bank, which purchases selected customer accounts receivables on an ongoing basis. The bank typically also provides automated servicing and reporting tools. The seller may also choose to give its customers more advantageous payment terms, in turn enabling them to extend their days payable outstanding. Again, the use of a relationship bank in the chain can create a win-win situation and strengthen relationships in the supply chain. The seller is able to increase sales to existing customers without maintaining and financing more receivables on its balance sheet. The technology tools also enable the seller to better monitor and mitigate credit risks. It can also offer customers more competitive payment terms, which enables them to continue to buy, using the liquidity gained between purchase and payment.

Cash Management Processes

Many treasuries are taking the lead in embedding ‘cash flow’ and ‘liquidity risk’ thinking into the responsibilities and incentives of business functions across the firm. But many also need to look inward to assess the adequacy of treasury practices. While most companies have for long centralized corporate finance and foreign exchange/interest rate hedging decisions, too often cash management has been regarded as a tactical function that can be managed at in-country levels based on local commercial considerations. The consequence is that pools of liquidity are trapped within the system and firms struggle with monitoring and mitigating foreign exchange, interest rate, and counterparty credit risks.

With the increasing importance of liquidity, treasuries are moving toward fully centralized approaches to cash management. The process usually entails changes to organization structures, internal processes, and technology infrastructures, and extends into tax planning. As a result, companies are eliminating some of the most persistent sub-optimal practices, such as:

- Too many operating banks, which limits purchasing power and fragments internal liquidity
- Limited global visibility into cash positions and flows, which makes effective cash forecasting, liquidity planning and risk mitigation very difficult
- Ad-hoc funding and repatriation of cash between subsidiaries, which hinders efficient up- or down-streaming of internal liquidity and creates unnecessary external funding costs or foregone yield.

Here too, global banking partners are helping firms consolidate operating processes, rationalize and integrate cash management, and gain global cash visibility and centralization.