Challenges in the consumer and healthcare sectors: treasury to the rescue?

While the consumer and healthcare sectors are driven by different dynamics, both face pressure on margins. By leveraging cash and treasury management solutions, the treasurer can play a critical role in countering these challenges, according to Peter Cunningham, EMEA Head of Consumer and Healthcare Sales at Citi.

The similarities between household detergent, high street fashion and drug companies are not immediately obvious and the origins of the challenges they face can be wide ranging and industry specific. Nevertheless, these industries do face some common challenges that the treasurer, working with banking partners, can address. Specifically, there is an arsenal of cash management and trade solutions available to help companies navigate choppy waters.

The consumer sector faces significant margin pressure, both as a result of higher input costs and sales challenges. Incumbents’ market share is threatened by evolving market trends such as the unbundling of consumer’s shopping baskets. For the past two decades, a limited number of brands have dominated their sectors and erected high barriers to entry. Now, consumers, and especially millennials, are buying new products in new ways (most obviously online).

The emergence of niche products, offered by small and nimble companies that often concentrate on just one product type, has had a significant impact. For example, the men’s
Headwinds in healthcare

Just as in the consumer sector, many companies in healthcare face significant margin pressure. Perhaps the greatest challenge facing branded drug companies is the rise of generics and bio-similars (copies or similar versions of brand-name drugs), and the expiry of blockbuster drug patents. Pharmaceutical companies rely on a strong pipeline of new drugs with patent protection: when drugs come off patent the price falls by around 80% within weeks. In the US, 90% of the unprotected market is now dominated by generics and globally they will account for 36% of global medicine spend in 2017. The increasing focus on value-based healthcare that can demonstrate a clear link between outcomes and healthcare spending is further increasing price pressure.

Meanwhile, there has been a dramatic consolidation of buyers. In the US, there are now just three major buyers of medicine and similar trends are occurring in Europe. This aggregation of spend enables buyers to exert downward pressure on prices. Scrutiny of pricing practices is also increasing, especially in the US, with lawsuits and political and media pressure coming to bear on both branded and generic producers.

How treasury can help

While business challenges must be addressed at an operational and strategic level, treasury has a key role to play in supporting the business – in both the consumer products and healthcare sectors.

There is significant scope for improvement at many consumer goods companies: net working capital performance ranges from 15 to 89 days. An improvement from one end of this range to the other represents a $6.5 billion free cash flow opportunity for a $30 billion sales company.

Treasuries, working with their partners in procurement and across the sales and credit control functions, can help unlock some of this free cash that can then be reinvested to help the company respond to emerging business models and the demands of the 21st century consumer.

Similarly, companies can reduce the cost of goods sold by using dynamic discounting. This works in a similar way to supply chain finance but uses the company’s own cash rather than a bank’s – enabling companies both to reduce their supply costs and generate yield – an appealing proposition in the current negative interest rate environment. In addition, selling, general and administrative expenses can be cut by using commercial card programmes that provide greater visibility and control over discretionary spend.

In emerging markets, where economic growth is on average twice as fast as developed markets, the existence of many small retailers results in a complex route to market for the consumer industry. One solution that can support sales growth is for treasury to inject liquidity into distributors, which often have inventory cycles and working capital challenges that act as a bottleneck, so that they can order more goods and fulfil unmet demand.

In healthcare, there appears to be clear opportunities for many companies to improve net working capital performance, which ranges from 54 to 133 days. For a pharmaceutical company with $30 billion sales, an improvement from one end of this range to the other might generate around $6.6 billion in free cash flow.

Perhaps most importantly, treasury has a role to play in addressing the greatest pressure the sector faces – the enormous cost of drug development. A new drug takes an average of more than seven years to develop and costs $2.6 billion. Treasury can optimise the company’s funding, including its use of internal cash, by improving days sales outstanding, using accounts receivables structures, and days payables outstanding, via supply chain finance and card solutions and pooling structures that mobilise and centralise group cash to maximise internal sources of funds.

The evolving role of treasury

Treasuries support the business’ operational goals by ensuring that appropriate cash and liquidity structures are in place and the range of risks emanating from trading relationships and the company’s geographic footprint are mitigated: these are the fundamental tenets of treasury management. However, many of these functions have now gained a strategic imperative especially in the consumer and healthcare sectors.

Not only is cash more important to the business in an environment where margins are under pressure, but collaboration between treasury and other functions such as procurement is growing. While collaboration between treasury and functions on the order-to-cash side is at an earlier stage, it seems certain that sales will work more closely with treasury in the coming years. More generally, treasury in both the consumer and healthcare sectors is taking a greater advisory role and partnering with the business to provide advice – around issues such as risk, FX, and working capital – that inform and facilitate strategic decisions.