TAKE CHARGE OF YOUR CASH FLOW, OPTIMISE YOUR WORKING CAPITAL MANAGEMENT RATIOS – December 2024

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Challenges Facing UK Companies: Brexit, Geopolitics, Security, and Regulatory changes

The current UK economic landscape, particularly in the aftermath of Brexit, has significantly impacted Trade Finance and Working Capital Management for UK companies. According to the recent "Atradius Payment Practices Barometer 2024", trade credit remains a vital part of B2B sales strategies, with nearly two-thirds of sales conducted on credit. This approach is crucial to retain competitiveness, especially, but not only, in sectors like automotive, retail, construction, information technology, and electronics, where longer payment terms are more common. In addition, late payments now affect around 40%[1] of all B2B sales in the UK, leading to liquidity challenges that can ripple through the supply chain as businesses delay payments to their suppliers.

Financial strains are compounded by recent geopolitical tensions, such as conflicts in the Red Sea, which have led to a 66% reduction in ships using the Suez Canal. This critical route previously handled about 12% of global trade, but increased shipping times and costs have made it less attractive for now and companies are looking at alternative trade routes. Compounding this even more, the Panama Canal[2] also faced restrictions due to droughts in late 2023 and early 2024, thereby further disrupting global supply chains. As a result, many companies now prefer the longer route around Africa, which offers greater reliability than the Panama Canal and is currently safer than the Suez Canal route.[3] The impact, however, is that companies have higher working capital requirements and face considerably longer transportation times.

In addition, over the last few months we have seen an increase in energy as well as metal commodity prices. These increases do not compare to the high reached in June 2022, but nevertheless the impact is that it increases the cash and capital requirement for corporates. With continued tensions in the Middle East, commodity prices are likely to stay elevated for the foreseeable future.

To navigate these disruptions effectively, companies are considering alternative sourcing strategies such as:

- Air Freight: For high-value or time-sensitive goods. Air freight offers a viable, although much more expensive, alternative to sea routes.
- Regional Suppliers: Sourcing from closer regions, such as Europe, can reduce reliance on long-haul shipping routes. Shifting from just-in-time inventory management to strategies like near-shoring can enhance supply chain security and reliability but comes with its own set of challenges (e.g. pricing, quality, reliability, sourcing of new suppliers).
- Increased stock level: In view of volatile commodity and raw material prices, it can also make sense to increase stocks to guarantee the ability to deliver to customers in times of supply chain disruptions.

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[1] https://atradius.co.uk/reports/payment-practices-barometer-b2b-payment-practices-trends-western-europe-2024.html

[2] https://www.ft.com/content/15ed10db-71d2-45ed-bd69-6f584b97b623

[3] https://www.maersk.com/insights/resilience/2024/07/09/effects-of-red-sea-shipping

Regulatory Changes

Proposed changes to EU late payment regulations have raised concerns, especially in industries that depend on longer payment terms due to their business cycles. Although the proposal was subsequently revised and after the revision included more flexibility—allowing up to 60 days for standard transactions and 120 days for seasonal goods—widespread concerns persisted. Ultimately these regulatory changes have not yet been enacted, and it was announced recently that the plans have been stopped, however the likelihood of future tighter regulations remains, and it is a clear stated goal of the European Commission to enact changes.[4]

Additionally, while this primarily affects smaller UK based companies - especially Sole Traders and Partnerships - unincorporated companies also face challenges from the UK's HMRC Basis Period Reform[5]. Effective from the 2024/2025 tax year, this reform requires businesses to align their profit calculations with the tax year (April 6 to April 5). Unincorporated companies which have seasonal peaks and troughs may find the transition a lot more challenging due to the mismatch between their accounting periods and the tax year. [6]

This transition could mean having to report profits from more than one accounting period in a single tax year, resulting in higher tax liabilities and reduced cash flow, potentially affecting balance sheet capital around the 31st of January 2025, when any balancing payment is due for 2023/24. [7]

UK Businesses - Strategic Financial Management for Resilience

UK businesses face multiple challenges, from Brexit related economic shifts to geopolitical disruptions and evolving regulatory landscapes, including the proposed EU late payment regulations and HMRC Basis Period Reform.

Effective working capital management is essential for maintaining financial stability and operational resilience amidst these headwinds. Leveraging strategies such as alternative sourcing, inventory management, and supply chain finance solutions can help businesses navigate disruptions and optimise their cash flow.

Supply Chain Finance (SCF) can be highly beneficial when managing working capital. Traditional SCF, however, faces challenges such as divergent goals between procurement and treasury departments, where procurement aims to reduce costs, and treasury focuses on enhancing liquidity. Aligning these goals is critical for a successful SCF implementation. Other challenges include managing multiple buying entities and planning for IT resources with sometimes complex IT integrations. Most importantly the success of such programs depends on the participation of suppliers. If no suppliers join, these programs end up not having the desired working capital results.

Often buyers have a much higher working capital goal than can be achieved from their existing programs as overall participation is generally not more than 30-40% of their supplier base. Buyers with large suppliers who have strong credit ratings often struggle to onboard these suppliers in SCF programs. Although, factors beyond credit ratings may still encourage these suppliers to participate, uptake in this segment is typically quite low.

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4 https://www.gtreview.com/magazine/the-supply-chain-issue-2024/eu-shelves-late-payment-reforms-after-industry-backlash/

5 https://www.icaew.com/insights/tax-news/2024/jun-2024/basis-period-reform-what-you-need-to-know

6 https://www.gov.uk/government/publications/basis-period-reform/basis-period-reform

7 https://www.rsmuk.com/insights/advisory/changes-to-basis-period-reforms-financial-impact
https://www.evelyn.com/insights-and-events/insights/hmrc-reform-of-income-tax-basis-periods-in-preparation-for-making-tax-digital/

Innovative SCF tools, such as payment solutions which do not require onboarding of the suppliers can provide the flexibility and control needed to manage liquidity effectively. They have several advantages:

- Suppliers benefit from early payments, while the companies are not charged until 60[8] days later.
- Easy and simple integration. There is no need to involve IT or purchasing departments - companies simply open a new bank account with their core bank and immediately see the benefits.
- Treasurers have much greater control over the working capital metrics, allowing companies to optimize cash flow by balancing payment terms for customers and suppliers.

[8] Individual Customer payment target set according to the cash conversion cycle and average supplier payment term.