The **Working Capital** Forum

Briefing

A treasurer's guide to **receivables finance**

In this report on the latest Working Capital Forum webinar, McKinsey partner Jakob Ruden and Ade Omisore, head of structuring receivables finance at Taulia, look at how receivables finance fits into a working capital strategy.

Research by consultancy firm McKinsey shows that strengthening the balance sheet directly impacts performance metrics and valuation – more than earnings improvement. Focusing on balance sheet health improves capital deployment, reducing the cost of growth through better credit ratings and increasing the funds available for innovation while also improving business resilience.

With that in mind, it's no surprise that companies are increasingly implementing working capital programs designed to improve the balance sheet. Finance departments, CFOs and treasurers are orchestrating these programs by setting out the basis for change and working with different departments across the supply chain to drive improvements.

Managing receivables is a crucial part of any working capital strategy, says Jakob Ruden, partner at McKinsey. Companies should optimize their customer payment terms and overdue management – but this is rarely without its own challenges.

In many cases, there is a mismatch between the profitability of the customer and their payment terms, which is challenging to correct for existing customers and requires a strategy-driven by finance.

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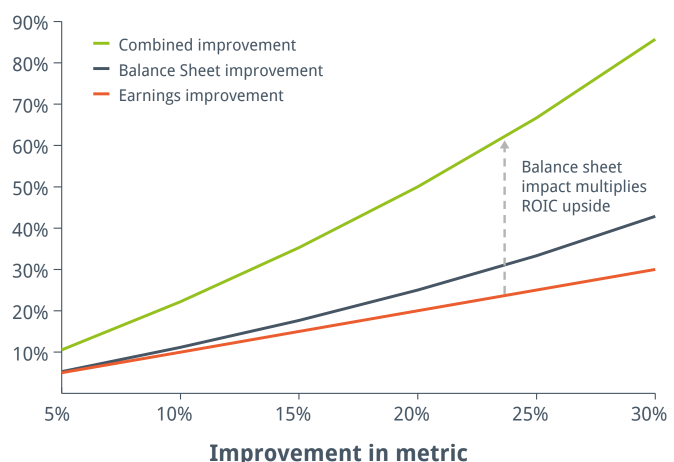
Chart 1

Strengthening the balance sheet has a direct impact on performance metrics and valuation – stronger than earnings improvement

Improvement in ROIC as a % of base case ROIC[1]



1. For example: if Earnings are 20 and Invested Capital is 100, then a 10% boost in earnings to 22 will increase ROIC from 20% to 22% (22/100) or an increase of 10% (22/20) relative to the base case ROIC of 20%. If Invested Capital decreases by 10% with no change to earnings, then ROIC increases from 20% to 22.2% (20/90), or an increase of 11.1% (22.2/20) relative to the base case ROIC of 20%. And combining these 2 effects yields an ROIC of 24.4% (22/90), or an investment of 22.2% (24.4/20) relative to the base case

Source: McKinsey & Company

Jakob Ruden, Partner, McKinsey

"It's vital to consider the behaviors and mindsets that influence the decisions made by all the people in the organization and the extent to which these need to be adjusted, as well as whether KPIs and processes need to be adjusted to help them make different decisions," says Ruden.

It is also essential to explain why this is being done. "Just saying 'we want to improve our ROI' might not resonate with someone who sits in procurement - it needs to be a more interesting story like 'we want to drive innovation to increase growth and make the company more sustainable", he adds.

That strategy requires prioritization and resources on the part of the company implementing the change; buy-in from senior management; change stories that people across the organization can get behind; and finally, a commitment to execution.

With those in place, it's time to look at the tools that can be used to free up cash still further.

Ade Omisore, head of structuring receivables finance at Taulia, points to the benefits of receivables finance as a working capital tool. It provides periodic and ongoing liquidity, which can be deployed towards general working capital use, debt reduction, capital expenditures, M&A activity, or even share buybacks.

AR Financing Optimizes Working Capital and Improves Financial metrics

Financial Impacts

- Periodic / on going liquidity
- True Sale, Off Balance Sheet treatment (not debt)
- Weekly/monthly for liquidity or quarter end only trades, to carry cash over reporting periods
- Risk mitigation on specific/ portfolio debtors
- Sales finance tool to drive sales growth
- Others: Increase Enterprise Value; positive impact on debt ratings; etc.

Improvements to Metrics

- Reduce DSO and CCC
- Increase Net WC and Cash Flow from Operating Activities (CFOA)
- Improve reported leverage (Net Debt:EBITDA) by increasing cash with no matching liability
- Improve Weighted Average Cost of Capital (WACC)

The structure provides risk mitigation on either specific obligors or a portfolio of obligors, which is especially important for companies with a significant amount of concentration in their receivables base. It can also help drive sales growth by companies negotiating contracts with new prospects (or renewing existing contracts) where the other party requests extended terms by building the cost of that financing into the commercial contract.

Historically, operating a receivables finance program was manually intensive. However, according to Omisore, any company can benefit from implementing a technology-based receivables finance solution, particularly if it has multiple billing entities across different jurisdictions and currencies.

Several key pieces of data need to be extracted, standardized, aggregated and submitted to the purchase of the receivables at the time of each trade, as well as settlement.

Because of acquisitions, companies with multiple ERP systems typically experience difficulty extracting data in a timely manner and have extensive manual cash application reconciliation and other processes.

In addition, many organizations have a dedicated resource that spends significant time managing the program. So, the goal is to achieve an automated process, which can be accomplished through technology integration involving a two-way flow of data between the seller's ERP system and the purchaser's technology platform.

Ade Omisore, Head of Structuring, Receivables Finance, Taulia

"An important feature of any receivables finance platform is the ability to provide insightful analytics," says Omisore. "That includes the ability to benchmark against industry peers, not just based on publicly available data but on millions of anonymized proprietary data points that certain organizations are able to gather and track over time."

"It is also important to run AI-driven working capital scenarios to understand the ramifications of certain decisions to be able to deploy the cash strategy that delivers the desired working capital outcome and to measure the effectiveness of the plan vis-a-vis the initial scenario, which helps drive accountability", he adds.

With appropriate planning buy-in from stakeholders and ongoing measurement against objectives, receivables finance - on the right platform – significantly reduce DSO and the cash conversion cycle.

With that in mind, Omisore offers several key factors to consider when evaluating a receivables finance provider:

- The availability of a holistic working capital platform that covers receivables, payables and inventory – ideally on a single platform
- The ability to fully integrate across various ERP systems, thereby automating the end-to-end receivables sales process
- An extensive multi-funded network of investors providing diversification and enhanced price competition
- The ability to provide transformational insights and analytics

Summary of an AR set-up

01 Underlying supplier-buyer relationship between the supplier **"A/R Seller"** and its customer (i.e., **"Obligor"** or **"Debtor"**)

02 Sale of goods and services creates a payment obligation known as a **"Receivable"**

03 An invoice documents the payment obligation

04 A commercial contract or Purchase Order governs the terms of payment

05 Supplier subsequently sells, assigns or discounts the Receivable on a **True Sale, Non-Recourse or Limited Recourse basis** to a purchaser of the Receivables (the **"A/R Purchaser"**).

06 A **Receivables Purchase Agreement** (**"RPA"**) governs the sale. The sale typically qualifies for a **Legal True Sale Opinion** to bolster the off-balance sheet treatment (under US GAAP or IFRS).

TAKE AWAYS:

"Think carefully about whether you want to drive cash or working capital performance"

– Jakob Rudden

"Benchmark working capital metrics against your peer group, leverage available financial tools to drive the benefit of a receivables finance program, and utilize technology to simplify the operational processes"

– Ade Omisore

Webinar Participants

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This report is based on the second in a series of educational webinars produced by the Working Capital Forum in partnership with Taulia. A recording of the webinar can be accessed online at https://taulia.com/resources/ondemand-webinars/a-treasurers-guide-to-receivables-finance/

For more information on the topics covered in this report, visit www.taulia.com

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