

more  
than  
money



nab

# WORKING CAPITAL & SUPPLY CHAIN RESILIENCE

Shawn Treloar and Ashley Barratt | July 2020

# SUPPLY CHAIN RESILIENCE

There are currently more than 2 million small businesses operating in Australia, the engine room of the domestic economy. The COVID-19 pandemic and subsequent economic impact presents an unprecedented challenge for most, with businesses having been slowed, downsized, and many shut down. The Australian Government has responded with several stimulus measures, with support for the economy of around \$259 billion, representing 13.3 per cent of annual GDP.<sup>1</sup>

The pandemic has highlighted the importance of supply chain resilience for many Australian businesses. Supply chain concerns during this crisis (and beyond) can be roughly grouped into three categories:

- 1. Unanticipated heightened demand** (e.g. healthcare, grocery and foodstuff retail). Increased demand on supply chain with potential increased cost of supply leading to need for more working capital;
- 2. Those dealing with unforeseeable declines in demand** (e.g. travel and tourism, recruitment, education). Critical suppliers may be unable to survive due to cash flow crisis disrupting ability to meet even reduced demand; and
- 3. Those where demand is stable but business is impacted by freight and logistics.** Potential for cashflow impacts from a slower working capital cycle for both Corporates and their suppliers.

When supply chains are under pressure, their working capital requirements too become impacted.

These impacts may be felt well into the post COVID-19 recession and eventual recovery, and could also form the 'new normal'. Corporate management teams are now asking questions like:

- Should there be a shift to local suppliers and a more diversified supplier base? What will that do to our input costs?
- Should we place more emphasis on a diversifying our customer base to mitigate risk? What associated challenges does this bring to our invoicing and collections processes?
- Will a focus on just in time 'JIT' inventory management be replaced with an increased emphasis on holding more stock to protect against possible future shocks?
- Strategically, do I need to reconsider which parts of my value chain are outsourced to external suppliers' vs direct controlling via internal vertical integration?

## Cash Conversion

Prime Minister Scott Morrison recently said big business could take on some of the burden of those who can't afford to by fast tracking payments to suppliers<sup>2</sup>. This burden can be assumed to mean the responsibility of keeping liquidity within supply chains. And over the last few months of the crisis, we have seen some large Corporates and Government departments in Australia take immediate steps to ensure suppliers are paid more quickly, by simply accelerating supplier payments to deliver immediate benefit. It's true of course, that Corporates broadly have an opportunity to support many small businesses through this time and ensure the economic prosperity of all, so early payment in this context would seem just good corporate citizenry. And it is not just altruism and goodwill driving them – larger Corporates are in many cases providing cash flow acceleration support to avoid the disruption that could occur if long established and reliable supply chains fail under short term financial pressure. The issue of course, is finding a balance between their own liquidity and performance needs, against acts of corporate goodwill and shoring up suppliers facing short-term cyclical pressures.

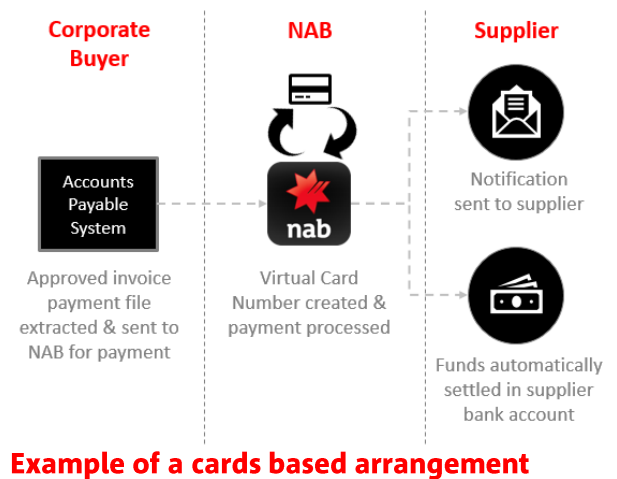
“...finding a balance between their own liquidity and performance needs, against acts of corporate goodwill and shoring up suppliers facing short-term cyclical pressures...”

The key issue for Corporates is understanding what additional supplier support means for their own liquidity? Triggering earlier payment for suppliers could appear to be a small effort to the Corporate buyer, delivering important benefit to the smaller supplier. Consider however that the average cash conversion cycle for Australian business in 2019 was 49 days. This varies significantly for different industries and businesses of course, but if a typical Corporate has a turnover of \$100m and gross profit margin of 25%, just a 5-day change to this cycle represents ~\$1m change in working capital. This is therefore not an insignificant consideration in the balance of business sustainability vs supplier health and goodwill. Couple this with other actions likely being taken, such as lengthening inventory holding periods, as Corporates move to mitigate additional shocks during the crisis, it becomes clear that liquidity can quickly become an issue for the Corporate buyer if extending supplier support is not well managed.

## Delivering support

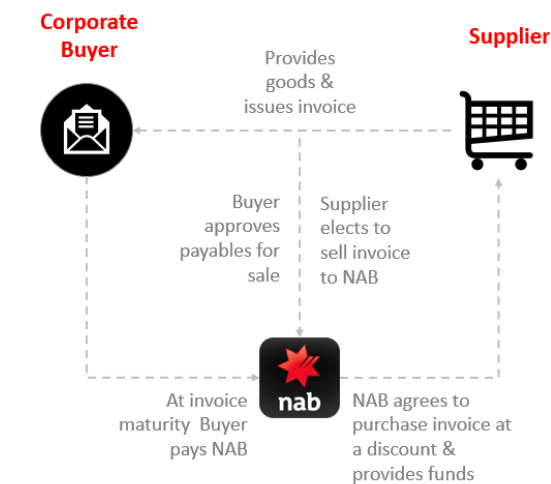
Banks can play a significant role in providing the liquidity to Corporates in managing a changing working capital cycle, and can be engaged to deliver solutions to assist over the current crisis (and ongoing). These can range in scale and complexity, depending on the requirement. For instance, prioritising speed and flexibility of implementation may be most important within the response to the current pandemic. A simple trade finance arrangement could therefore provide funding to suppliers on an agreed facility quite quickly. The parties can reach a commercial agreement where discounts may be provided to secure early payment, with the Corporate balancing the amount of discount versus the additional funding costs or even the cost of finding alternative supply if the supplier fails (This is a simplistic scenario and other issues such as the balance sheet impact of taking on additional debts or reducing headroom in borrowing capacity are amongst other likely concerns).

Some more bespoke solutions like Payables Finance would deliver effective support to suppliers. Again, this achieves the desired outcome of early payments but can be tailored to have less impact on the buyer. Structures can be customised to be off balance sheet from a debt perspective (trade creditor balance remains unchanged) via a sale of the receivable by the supplier to the bank in exchange for early payment. Arrangements can allow for costs to be borne by the supplier or shared between buyer and supplier. The supplier onboarding for Payables Financing facilities means however it is unlikely to be effective within the short term, and may be a better solution for recovery phase of this crisis or as a long term strategic working capital improvement option.



Under an AIP solution, the supplier can elect to accept an early payment of the invoice to improve their own cash flows and mitigate any future non-payment risk. The buyer's cash flows aren't impacted as they benefit from the interest free periods (up to 55 days) customary to Corporate Card facilities. The cost of accepting early payment under these solutions are borne by the supplier, but in an environment of tighter lending conditions as a result of economic uncertainty, many smaller suppliers benefit in this form of supply chain financing.

There is no one size fits all solution however, and Corporates do need to consider how a mix of financing and payment options work for their organisation and supplier base. For instance, Corporates with international suppliers face a range of additional complexity in longer supply chains with cross-border considerations. This can impact the payment solutions available



Automated card based payment solutions are increasingly emerging in Australia as viable options for Corporates. Using the existing card scheme networks, Corporates can support smaller suppliers, typically not the target of traditional supply chain finance solutions, by paying earlier with no adverse impact to their own cash flow.

NAB provides the capability to make early payments to suppliers via the Automated Invoice Payments "AIP" solution. AIP is a file based submission for automated processing internally by NAB, with minimal input required from the supplier.

Consider the impacts to the cash conversion cycle using AIP when compared to a standard scenario where buyer pays its supplier on the invoice due date (30 days) via a traditional funds transfer.

"Automated card based payment solutions are increasingly emerging in Australia as viable options for Corporates."

## A summary

Within a typical corporate's supplier base, there will be any number currently struggling with the challenge of reduced demand for their service/product, weakened trading conditions, and limited access to capital. Some of these suppliers will reach out for support, but the reality is that many won't. Corporates have the opportunity to be proactive with their whole supplier base over this time, not just to those that do reach out for assistance.

Over the extended period that this crisis will impact business for, any tools that can assist and ensure supply chain stability should be considered. Whether it's a Trade finance facility, Automated Card Payment facilities, Payables Finance or something more bespoke, Corporates should be exploring options available, as replacing existing suppliers following the immediate crisis has risks. A number of solutions can work in concert to address the range of needs across the supplier base of a typical Corporate.

NAB is available to support our Corporate clients in exploring the best options for their business. To explore options for your organisation both now and into the future, please contact your local NAB Transaction Solutions or Trading and Working Capital Specialist.

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1. <https://treasury.gov.au/coronavirus>
2. <https://www.smh.com.au/politics/federal/one-goal-in-2020-scott-morrison-asks-business-to-step-up-to-help-shield-economy-from-coronavirus-20200309-p548ch.html>



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Peter Lee Associates –  
Transaction Banking Survey  
2020. Ranking against the  
four major domestic banks.

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