Are you ready for the new interest rate environment?

Smart working capital practices matter more than ever

By Rick Erickson, Global Director of Freight Payment Solutions, U.S. Bank

The art of working capital management has declined since the 2008 market crash. The lingering low or no interest rate environment gave organizations little incentive to be disciplined in managing cash flow. Many have plenty of cash on hand or are unconcerned about debt, so they have let their cash management strategy muscles atrophy. This will undoubtedly come back to haunt them now that interest rates are rising and markets are becoming less forgiving of careless working capital management.

Fact is, no matter the rate environment and no matter your cash position, it always pays to be disciplined in managing working capital. It is always a best practice to take maximum advantage of your cash. In the world of transportation, that advantage can reach both ends of the shipper-carrier pendulum through the application of extended term financing.

Orchestrating the end-to-end cash flow velocity and supporting transactions is critical to enhancing working capital, reducing risk and improving margins. In today's global supply chains with numerous partners — transportation providers and financial institutions — all stakeholders need visibility into the transactions, parameters and results. This is particularly germane when looking at logistics, freight and freight spend. Today's automated freight payment and audit systems offer businesses flexible tracking and financing programs which accelerate cash flow without impacting balance sheets.

Putting the right solutions in place

An integrated, fully electronic freight payment system can help businesses uncover cost savings, increase financial control and gain valuable insight into freight expenditures with more detailed information at a very fine level of granularity, helping to achieve your cost-to-serve goals.

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Shippers of goods always strive to strengthen their supply chain, reduce costs and increase efficiency. By providing greater control over the freight payment and audit process, an outsourced, electronic freight audit and payment system is designed to make more effective use of time and resources, lowering costs for shipping and improving relationships with partnering carriers.

For shippers, the Holy Grail is getting one system to process and pay all transactions while providing full visibility at all points in the process to both shipper and carrier. That journey starts with the basics: 100 percent auditing of transactions, ensuring comprehensive accuracy. Chances are, if shippers are processing paper transactions manually, they're not checking each invoice, thus leaving money on the table.

"The problem is real: invoices are rarely accurate," says Eric Johnson, Research Director and IT Editor, American Shipper. "We found that only one in 10 invoices is accurate. Ninety percent are wrong in some way." That requires a lot of staff time to reconcile manually. "Transportation and finance teams are spending too much time just trying to get something right rather than strategic things like better relationships with carriers," he says.

Shippers who use an outsourced, electronic freight audit and payment system reduce their overall cost-to-serve by:

- Increasing efficiency and enhancing control over freight payments
- Improving visibility into critical invoice and payment data
- Avoiding invoicing errors
- Eliminating rework
- Collaborating online with carriers to process, pay and quickly resolve exceptions

But becoming more efficient is only part of the equation. Companies who unlock working capital from their freight payment process not only keep their cost-to-serve down, they are implementing best practices that will keep costs down when interest rates begin to rise.

Leveraging innovative cash management solutions: Extended term financing

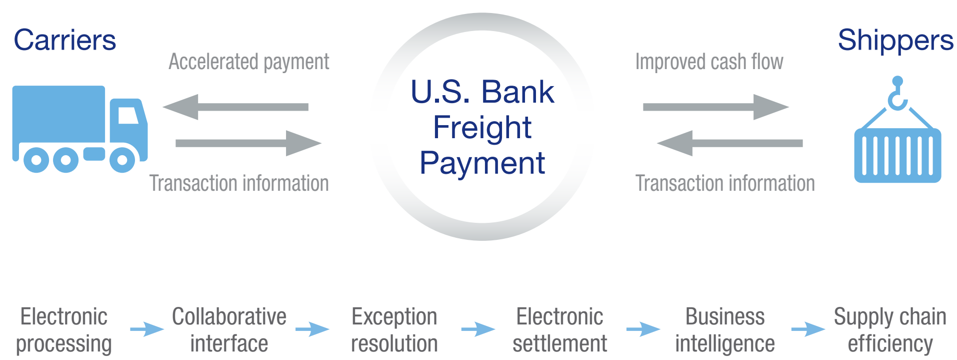
The old-school strategy for cash management calls for the shipper to extend payment terms as long as possible and drop the check in the mail just in the nick of time to meet the terms. Extending payment terms is not industry specific. A variety of sectors increasingly use this strategy, including automotive, electronics, food and beverage, manufacturing, retail and many others. Recently, several popular grocery store brands are asking suppliers to give them 120 days to pay their invoices.

While extending payment terms may satisfy the cash management needs of the shipper, it can lead to unhappy carrier partners. In today's carrier market where trucking capacity is so tight, carriers have the upper hand. With the ability to pick and choose their shipping partners, and faced with a long wait for payment, they may choose to walk away to haul for somebody who pays them more quickly.

New-school strategy looks to extended term financing through a financial institution to balance the scales. Carriers get paid right away upon invoice approval, and shippers hold onto their cash until they pay the bank at term (commonly 60 days). This allows both parties to better manage their cash, while enhancing the shipper-carrier relationship.

In a cash intensive transportation business, shippers often can't lean on carriers in order to meet their own working capital goals. Extended term financing can maintain carrier relationships by reducing Days Sales Outstanding (DSO) for that carrier, and shippers can extend their Days Payable Outstanding (DPO) and improve working capital cash flow.

Supply chain financing is not a loan in the traditional sense, nor is it factoring. It is an extension of the shipper's accounts payable, often referred to as "off balance sheet" funding. The best definition of supply chain finance is that it facilitates transactions between trading partners by providing financing and payment options that are negotiated to improve each trading partner's financial position.



Supply chain financing can be a true win-win solution for both trading partners. By extending payments to 45, 60, 75 or even 90 days, shippers have more cash for other projects — without negatively impacting their relationships. Preserved cash can then be leveraged to purchase assets, make acquisitions, manage restructuring efforts, reduce debt, repurchase stock, enhance earnings per share, or create increased liquidity.

"High performing supply chains minimize the number of days between the time you pay your suppliers (cash out) and the time you receive payment from your customers (cash in)," says Jane H. Malin, owner of Bridge Consulting, an industry expert on supply chain excellence.

"When Net 30 becomes Net 60 or greater, imagine how that positively impacts your cash-to-cash (C2C) cycle," says Malin. The bottom line: the shorter the C2C cycle, the more cash is accessible and more net working capital is available for investment. In today's business environment, it is critical to keep working capital healthy and flowing smoothly. This includes transportation spend.

Let's look at a simple example.

If you pay $100 million annually in transportation, consider the value of having access to that money for 60 to 90 days, compared to your typical 30. Assuming Weighted Average Cost of Capital (WACC) at 10 percent and 100 percent of your transportation payments extended:

- If you extend payments to 60 days, you have freed up $607,000 annually in working capital.
- If you extend them out to 90 days, you have now freed up over $1.1 million in working capital.

Why it's important now

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— John W. Mitchell, Ph.D., Economist

As we've seen, low interest rates can cause working capital complacency. But a period of changing policy arrived on December 16, 2015, when the Federal Reserve boosted its Federal Funds Rate ever so slightly. "Interest rate moves will likely be gradual," said economist John W. Mitchell, Ph.D., in a recent webinar presentation for American Shipper. "It appears the competitive environment will remain intense, with tightening labor markets, technology pressures and the dollar holding down the price of imports. That means there will be pressure on firms to reduce costs and look for things that will potentially give them an advantage." Smart management of the financial supply chain can have significant impact in this area.

As companies face increasingly complex global supply chains, the importance of disciplined working capital practices cannot be overstated. Even in a low interest rate environment, savvy organizations will examine the role finance tools can play in their success, and look for end-to-end visibility into the financial supply chain as a way to improve cash-to-cash cycle times. When interest rates begin to rise, these organizations will have the working capital management practices in place that will help them stay a step ahead.

Conclusion

Organizations that have allowed their cash management practices to slip in the low-interest rate environment are leaving money on the table. The higher that interest rates rise, the more that will be true, but higher rates aren't necessary for smart cash management to pay off. A shrewd first move toward optimizing your cash position is to implement an automated freight payment solution coupled with extended term financing. It will optimize your access to working capital in the supply chain while preserving good trading relationships with your suppliers. Don't wait to see where interest rates end up – the time to act is now.

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