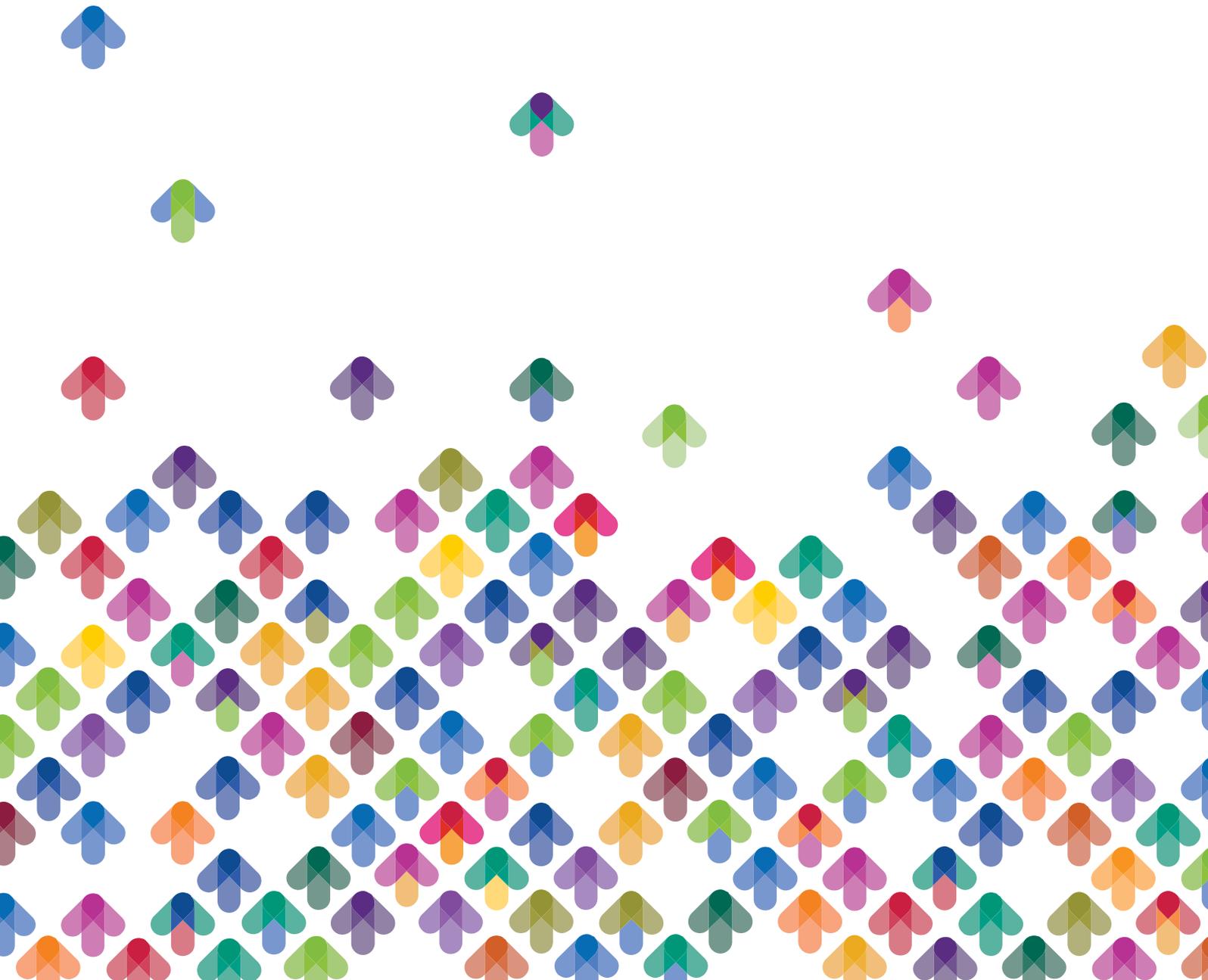


The UK's cash conundrum

Business Consulting

September 2016





The UK faces a conundrum in redistributing cash to support the growth aspirations of dynamic businesses

In the UK, total cash on hand has risen by 14% since 2010. The majority of this cash sits in the bank accounts of a relatively small number of corporates. Could a better distribution of cash to support the working capital requirements of fast-growth, dynamic organisations improve the growth prospects for the UK economy?

Why hold cash?

Since the global financial crisis began in 2007/8, major global economies have experienced a mix of recession and sluggish growth. There has also been significant uncertainty and volatility in financial markets, exemplified by the foreign exchange fluctuations in the immediate aftermath of the UK's vote to leave the European Union.

As a result, many corporates have pursued strategies focused on cash flow and have actively built cash reserves to act as a 'buffer' against potentially volatile market conditions. This is despite the fact that interest rates have been at historically low levels and recently reduced to 0.25%, with some major banks warning that they may start charging companies to hold cash.

The cash conundrum

Our annual cash and working capital research study of 2,929 public and private UK companies highlights a liquidity imbalance, which threatens to starve dynamic, fast growth companies of the working capital needed to accelerate growth in the UK economy.

Of the £244 billion in cash currently sitting on the balance sheet of UK corporates, a staggering 30% is held by just ten companies, with a similar trend in the US as well.

To put it into context, £244 billion is equivalent to 13.5% of UK GDP in 2015. Releasing (or redistributing) some of this cash to support the requirements of fast-growth, dynamic corporates has the potential to super-charge UK economic growth.

No 'silver bullet'

The one thing for certain is that there is no easy fix, despite the increase in the number of commentators who recognise the problem.

There are also a range of new financing products seeking to address the challenge. However, their success in truly addressing the UK's cash conundrum has been limited to-date.

At Grant Thornton, we will be seeking to engage stakeholders in a debate and investigation into potential structural and sustainable ways of redistributing cash to support accelerated UK economic growth.

In the meantime, the overriding conclusion of our study is that the onus is on companies to focus on the self-help available by targeting improvements in working capital performance. There remains significant levels of excess cash tied up on the balance sheets of UK corporates that can be released to support immediate growth aspirations.



Grant Thornton's take:

As a firm, we are seeking to create a Vibrant Economy - one which realises the shared potential of companies, cities, people and communities across the UK.

A critical element in achieving this will be the ability of the UK economy to deliver liquidity to those companies best placed to create economic growth.

Our study highlights the superior trading performance of those companies targeting year on year (YoY) working capital improvements, as they release cash and invest in delivering revenue and profit growth.

If we can effectively and efficiently distribute cash towards dynamic organisations, we believe it can have a significant impact on UK growth, in pursuit of a Vibrant Economy.



£244bn

CASH SPREAD ACROSS UK'S LARGEST 2,929 COMPANIES





Our study: results at a glance



Cash reserves have grown significantly over the last five years but are not distributed in an optimal manner for driving growth

- Cash on hand is up by 5% from last year, and 14% from 5 years ago
- Just 10 companies hold 30% of the cash on hand, while the remaining 2,919 hold the rest - the UK's cash conundrum
- The increase in cash on hand is driven by a combination of higher debt levels (currently at a 5 year high, totalling £1.1 trillion) and net YoY working capital improvements of 2.1%, releasing £17.2 billion.

When companies sustainably unlock cash from operations, they outperform their peers

- Only 10% of the companies in our study achieved three consecutive years of working capital improvement
- Those companies significantly outperformed the remainder of the population in trading terms too, delivering;
 - revenue growth of 3% (versus 1% for the rest of the population), and
 - 11% improvement in EBIT margin % (versus -2% for the rest)
- Therefore if more UK corporates were able to unlock better cash flow, it would be reinvested to drive improved rates of growth across the economy.



Despite improvements in working capital, £135 billion of cash is still available if corporates can improve performance

- There is no easy fix to the current liquidity imbalance, although the topic is clearly a focus for government and commentators alike
- In the short-term dynamic companies should focus on releasing some of the £135 billion excess cash tied up in working capital across our study group
- To this end we note that medium sized companies continue to feel the squeeze and underperform on working capital, whilst within sectors there remains very material differences in performance between upper and bottom quartiles.



Embedding best practice working capital management delivers more than just cash flow benefits

Only 10% of the companies in our study achieved three consecutive years of working capital improvement; those companies also significantly outperformed the rest of the population in terms of EBIT margin % improvement



% REVENUE GROWTH
(last 3 years)

Top 10% performers	Remaining 90%
3%↑	1%↑



% IMPROVEMENT IN EBIT MARGIN %
(last 3 years)

Top 10% performers	Remaining 90%
11%↑	-2%↓



% INCREASE IN TOTAL DEBT
(last 3 years)

Top 10% performers	Remaining 90%
9%↑	12%↑

The danger of short-term initiatives

As our research highlights, only 10% of companies in our study demonstrated three years of continuous working capital improvement. Unfortunately many companies still view working capital improvement as a 'project' focused on a short-term outcome; whether that be massaging a balance sheet or to meet an interest or debt repayment.

These projects are often tactical in nature. Examples being blind reductions on safety stocks, offering discounts for early customer payments and the most common of all – holding back supplier payments. Whilst they might achieve a short-term goal, they create long-term damage to the business through their impact on customers and suppliers perceptions of the business.

Benefits of embedding a continuous improvement cash culture

The contrast with those companies focusing on embedding best practice working capital practices across the end-to-end supply chain could not be more stark. Those companies achieving three continuous years of working capital improvement also achieved superior revenue and EBIT margin % growth over the same period, whilst their debt increased by a much lower percentage.

If more UK corporates were able to follow the example of the top performing companies in our study, the inference has to be that it would result in increased levels of revenue and profitability, driving growth, investment and employment. Working collaboratively with customers and suppliers can often unlock mutual opportunities for value creation, as exemplified in the case study below.



Case study: unlocking the route to a 'win-win' situation

A UK facility services company was targeting improvements in cash collection with a major customer, **who on average paid 36 days late**. Senior finance team members had been required to meet several times over a 12 month period to review individual matters in order to unlock payment.

Analysis of the time spent by the customers' Accounts Payable (AP) and senior finance team in resolving issues identified a material business case for resolution. The business case was presented to the customer and as a result, a joint team was established to quickly address the existing process challenges.

Within two months the issues were resolved and **all invoices were subsequently paid on time driving a £0.2 million cash flow improvement** for this customer alone; whilst the customer benefited from a significant reduction in AP process costs.



UK companies continue to focus on working capital performance

There are positive signs in terms of the overall improvement in working capital performance across companies included in the study over a five year period, however, there is a risk that this potentially masks other underlying trends

Recent trends in working capital

The positive news is that trends in working capital performance across the UK economy over the past five years indicate that the message is getting through.

Over that time, C2C days (Cash to Cash days, a measure of the cash conversion cycle relative to sales) has improved from 31.7 days to 28.7 days in our latest study.

The improvement of 0.6 days in the last 12 months alone delivered an exceptional £17.2 billion release of net working capital.

Receivables

Following two years of relatively static performance, receivables showed a 0.7% improvement in the most recent study. However, with average terms in the UK of around 45 days, we see significant further improvement opportunity with the right level of focus.

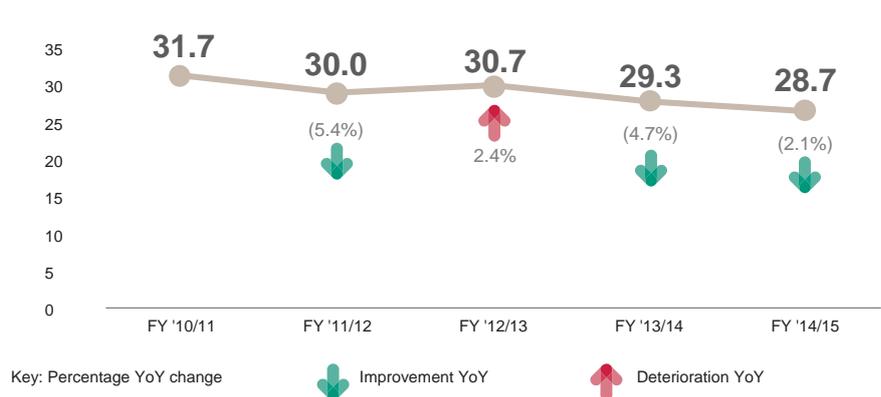
Inventory

Reductions to inventory holdings delivered the most significant YoY benefit and improved for a fourth consecutive year. For those companies delivering sustainable improvements, a focus on better use of data and increased focus on supply chain agility has been critical to the success achieved.

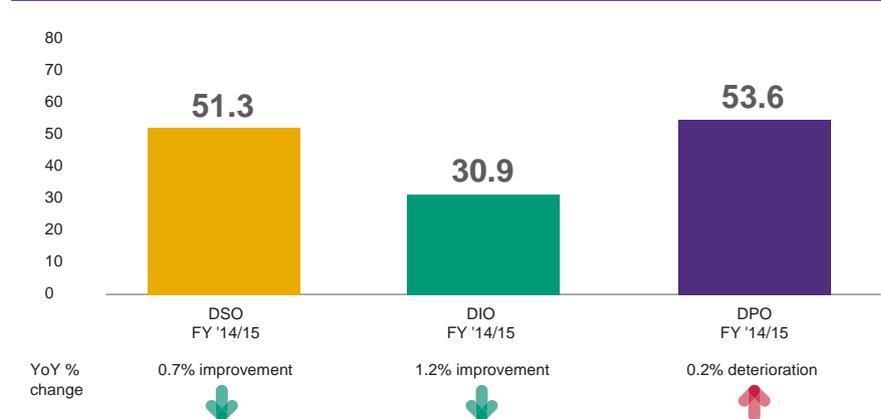
Payables

Payables has remained relatively static year on year, showing a small 0.2% deterioration. Coming after several years of improvement, this may suggest that, for many companies, the 'low hanging fruit' available through optimisation of the Procure-to-Pay (PTP) process has already been delivered.

UK five year trend in C2C days



Most recent year breakdown by DSO, DIO and DPO days





Grant Thornton's take:

The significant improvement in the overall UK C2C cycle over the past five years is a positive sign. However, the fact only 10% of companies delivered three continuous years improvement suggests many are still engaged in year-end tactics.

For the improvements noted above to have a positive impact on growth across the UK economy, a closer look at performance by size of company and sector is needed.



Mid-sized businesses continue to feel the squeeze on working capital

UK economic prosperity is intrinsically linked to the performance of mid-sized businesses, however, our data highlights the squeeze on the performance of both working capital and profitability

Trends by company size

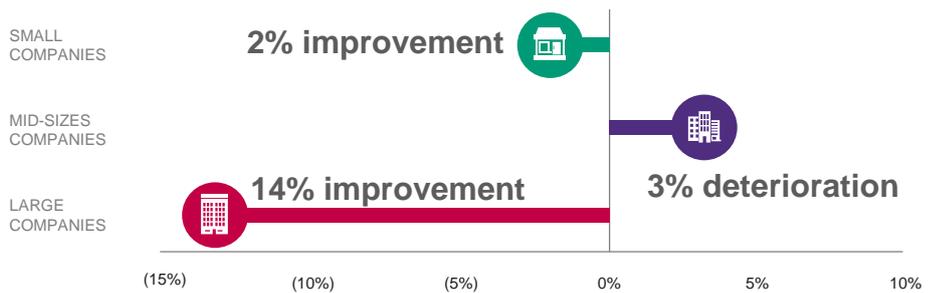
The chart opposite clearly shows that large companies have been the driving factor in YoY working capital improvements. Large companies have become skilled in implementing working capital best practices, utilising the additional resources at their disposal to optimise their C2C cycle.

Meanwhile, small companies have continued to seek out much smaller improvements. In many cases, this will be driven by the need to control cash flow carefully, for risk of over-trading based on limited resources. In small companies, there are much greater instances of Managing or Finance Directors playing an active role in working capital management.

However, the trend for mid-sized businesses has continued to deteriorate (this was identified in last year's study published as part of Grant Thornton's "Capital Thinking" series).

This deterioration has fed through to profitability as well, where mid-sized companies in our study suffered a 2.9 percentage points reduction in EBIT margin %, compared to small and large corporates who suffered negligible decreases.

YoY % change in C2C days



YoY change in EBIT margin % (percentage points)



Grant Thornton's take:

If the UK is to unlock the growth potential of dynamic mid-sized companies, then action needs to be taken to improve working capital performance across this group.

In this segment alone, an improvement in working capital matching the 2% YoY for small companies would have delivered a cash flow improvement of nearly £1 billion, alongside better EBIT performance.



De-bunking the myths around sector working capital requirements

Of course, the sector will impact "what good looks like" when it comes to working capital management, however, our data highlights that regardless of sector there are large differences between top and bottom quartile performers

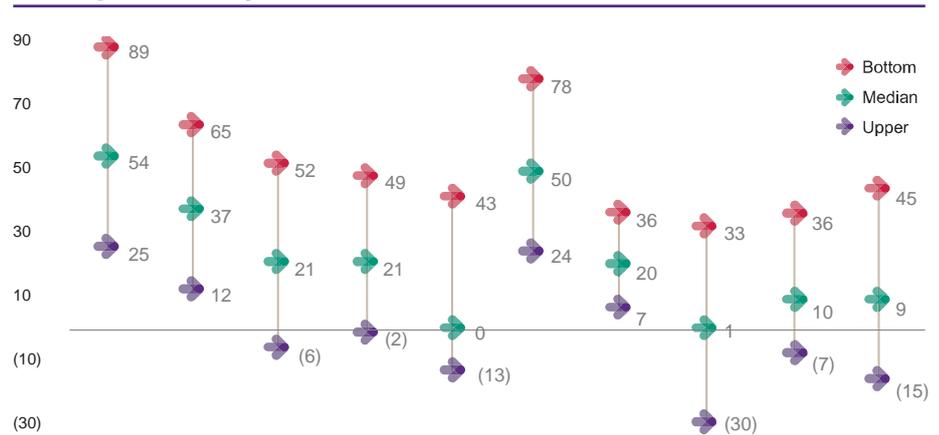
It's not what you do, it's the way that you do it...

In interviews with company directors and finance teams, 'sector' is by far the most commonly cited reason why working capital performance cannot be improved.

Across all sectors presented opposite there is an average 53 day gap between upper quartile and bottom quartile performance. Only one sector (Utilities) shows anything like a 'sector-based' trend with the gap from top to bottom quartile at only 29 days.

Take the traditionally working capital intensive Industrial Products sector for example. Note that its top performers are operating with lower levels of working capital than the median for Business Services or Utilities, which are typically much less intensive.

C2C quartiles by sector



YoY	6.0	0.8	0.3	(0.3)	(0.6)	(0.7)	(1.2)	(3.2)	(3.8)	(8.3)
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Pharmaceuticals
Industrial Products
Business Services
Consumer Products and Services
Public Sector, Health and Education
Mining
Utilities
Telecoms, Media and Technology
Oil and Gas
Construction

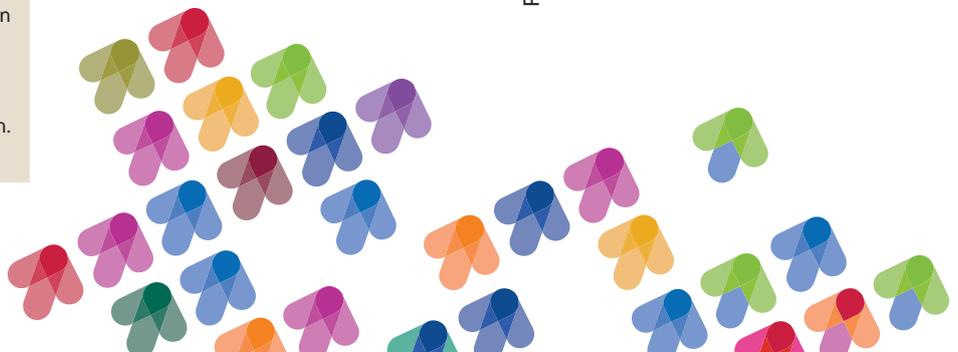


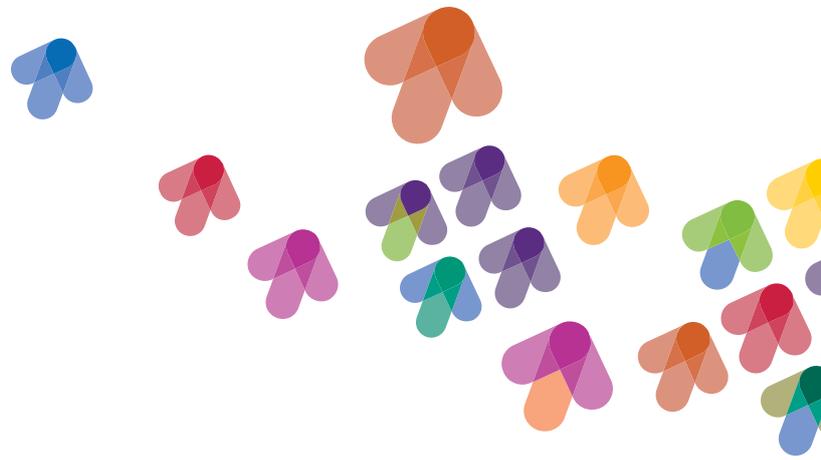
Grant Thornton's take:

The message for companies here is clear – if you are not focused on improving your working capital performance as a means of achieving competitive advantage and superior growth, then your competitors almost certainly are!

Too many companies take comfort on being somewhere close to the average performance for their sector and assume that little more can be done to improve.

As illustrated as part of our study, companies are missing out on significant potential EBIT as a result of their reliance on this assumption.





Our methodology

Our analysis reviewed the year-end working capital of 2,929 companies with revenue of at least £100 million as per their latest statutory accounts, based on data extracted from the Fame database over the past five years. We employ a rigorous data screening process to remove anomalies to ensure the integrity of the analysis and findings

Specifically:

- The overall review excludes financial services companies
- Performance trends are shown at an industry and size level. Each company has been allocated to an industry and a company size using latest sales as an indicator of size
- The overall analysis is based on the latest publically available annual financial statements
- The calculations have been pro-rated where necessary to reflect shorter/longer accounting periods

One inherent limitation of the analysis is that it is undertaken at a single point in time (ie year-end) rather than reflecting average working capital performance. Ratios can, therefore, be impacted by certain factors (e.g. seasonality and in-year M&A activity). However, using a dataset covering 2,929 companies on a non-weighted basis provides comfort in the robustness of the overall findings at both the size and sector level.

Working capital performance is a function of three main variables. How long does it take to collect cash due, how much inventory is tied up in servicing demand and how long does it take to pay suppliers? We look to measure the number of days of sales tied up in inventories and receivables (billed and unbilled) and the number of days of sales funding provided in the form of trade creditors and accruals. The basis of these calculations is set out at the bottom of this page.

Impact of Brexit

It is worth noting that the research in this study was largely undertaken pre-Brexit, but following the result, cash, and how we stimulate growth, are even more pertinent topics. We purposefully haven't focused on the direct impact of Brexit throughout the study, as the findings still hold true, but if you would like to know more about Grant Thornton's views on Brexit please visit <http://www.grantthornton.co.uk/en/insights/brexit-planning-the-future-shaping-the-debate/>

Metric definitions

Days Sales Outstanding (DSO):
(Trade Receivables + Prepayments & Accrued Income)/Sales x 365

Days Inventory Outstanding (DIO):
Inventory/Sales x 365

Days Payables Outstanding (DPO):
(Trade Payables + Accruals & Deferred Income)/Sales x 365

Cash to Cash (C2C):
DSO + DIO – DPO

Our analysis considered



Historical

TRENDS
OVER TIME



Size

- Large **Over £1 billion**
 Medium **£500 million – £1 billion**
 Small **£100 – £500 million**

Across
10

KEY SECTORS





How we can help

Working Capital Advisory

Our specialist Working Capital Advisory Services practice, along with our wider Business Consulting team, combines deep technical capability with sector experience and an understanding of how to drive value across the organisational structure

Grant Thornton's experience and focus can help you achieve these objectives and you can expect us to deliver:

- A typical cash release equivalent to between 10%-20% of gross working capital
- 50% of identified benefits often delivered in the first 6-12 months
- An organisational cash culture across sales, operations and finance
- Up-skilling of the management team to allow them to own and drive the improvements

As a result, the cash flow improvements we deliver are:

Larger + Faster + Sustained + Owned

We bring an external and independent view of what best practice looks like across the end-to-end process, and go far beyond delivering a list of recommended initiatives.

Procure to pay



Forecast to fulfil



Order to cash





Why Grant Thornton?

Experience – Our senior team not only have many years of leadership experience but also have considerable, hands-on project expertise that allows them to be efficient, effective and successful in working with you. Our senior advisors bring a point of view to your situation based on significant experience, ensuring a high level of challenge and insight, whilst being sensitive to topics that require care.

Focus on outcomes – Our approach is collaborative and agile. We have accelerators, benchmarks and toolkits; however, first and foremost we focus on the desired outcomes rather than carrying out a process, ensuring value for you throughout the engagement.

Delivering change – We work with the executive and leadership team, through to the management and operational teams to deliver achievable solutions, while helping you obtain the organisational buy-in to enable and facilitate change.



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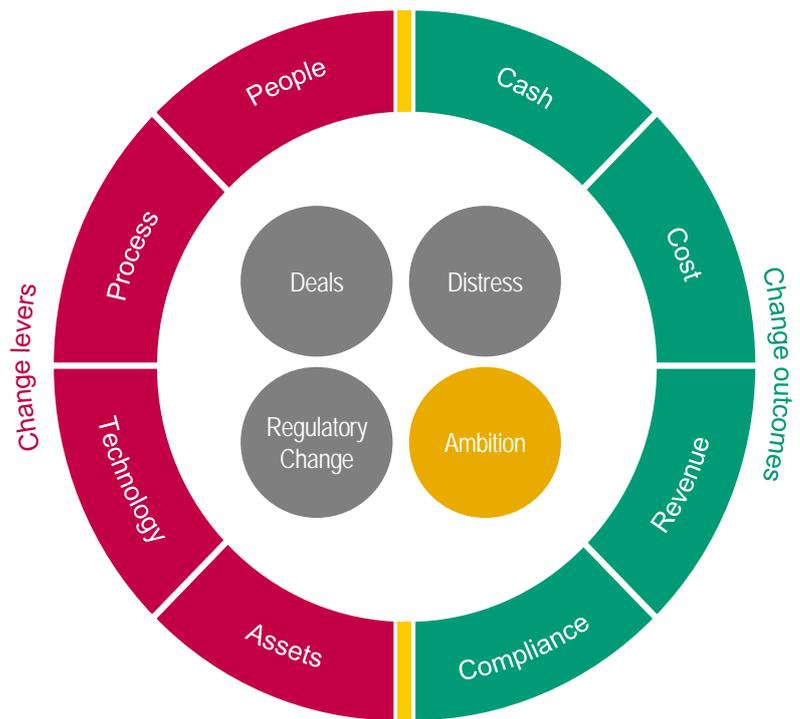
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How we can help

Business Consulting

Business Consulting is about delivering business change in all of its forms across all channels and sectors

Whether the change you're planning is event or intent driven, we give particular prominence to the people and leadership dimension of change. We seamlessly bring together the different levers for change that enable you to achieve your desired outcomes.



We work across five core areas within business change and transformation

Finance and working capital

- Finance Transformation
- Working Capital Optimisation
- Revenue and Cost Assurance
- Enterprise Performance Management
- Shared Services

Deals

- Enterprise Due Diligence
- IT Due Diligence
- Separation
- Integration
- Exit Readiness

Operations

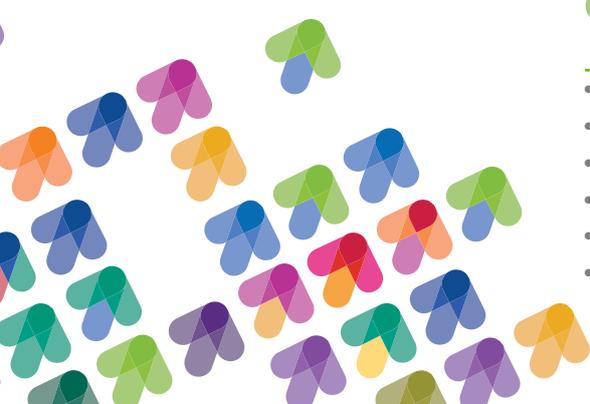
- Supply Chain Efficiency and Effectiveness
- Cost Reduction
- Shop Floor Optimisation
- Procurement Effectiveness

Technology

- Strategy and Architecture
- Digital
- Enterprise Application
- IT Sourcing Advisory
- IT Function Transformation
- IT Infrastructure, Security and Risk

Leadership, People and Culture

- Leadership Development
- Visioning, Strategy and Team Effectiveness
- Culture Change
- HR Function
- Employee Value Proposition
- Organisational Capability





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