Working capital management: Emerging topics and trends

PwC Malaysia’s 2021 Working Capital Study

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Foreword

Welcome to PwC Malaysia’s 5th annual Working Capital Study. This publication analyses the financial performance of over 400 listed companies across 14 different industries in Malaysia. The findings can be used as a guide to assess working capital performance and related key indicators.

Our latest report titled ‘Working capital management - Emerging topics and trends’ explores the need for a sharper focus on cash optimisation and liquidity strategies by businesses as they navigate the current climate amidst a subdued economy and persisting lockdown restrictions.

What’s the story at the end of year 2020?

As a whole, the Net Working Capital (NWC) days has improved slightly from 53 days in financial year 2019 (FY19) to 52 days in FY20. This is largely driven by the extension (improvement) in payable days by 7 days, from 48 days in FY19 to 55 days in FY20. Receivable and inventory days have declined in FY20 with an increase of 2 and 4 days respectively from FY19.

Our analysis revealed that larger and medium sized companies have improved in their NWC days in FY20 from FY19. This could be attributed to better operations management and focus on key working capital areas such as order-to-cash (receivables), procure-to-pay (payables) and forecast-to-fulfil (inventory). However, smaller companies told a different story with their NWC performance declining by 16 days in FY20 from FY19.

The change in economic conditions has resulted in dramatic and urgent shifts in priorities, requiring companies to conserve liquidity, increase cash visibility, protect balance sheets and establish agile and resilient supply chains as the business environment evolves.

In this study, we share our thoughts on several areas in working capital, including our perspectives on some of the emerging topics and trends, that could help companies conserve and manage their cash flow. We also share the opportunities available for businesses as environmental, social and governance (ESG) priorities and increasing digitalisation redefine the working capital management landscape as we know it. We hope you find our latest perspectives useful to your organisation.

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At a glance

Overall **1-day improvement** in **Net Working Capital days** in FY20

Overall **decline in revenue, EBITDA, net income and cash flow from operations** in FY20

8 out of 14 industries declined in their working capital performance

Digital analytics to drive an **agile and resilient supply chain**

Working capital overview

1

How have things changed from FY19 to FY20?

Did you know?

"Only 30% of Malaysian business leaders and owners polled in PwC's 2021 Act Now to Recover survey on business recovery, have carried out contingency planning in the past 12 months to establish a resilient and agile supply chain in their organisation. Read more about supply chain resilience and agility on page 14 of this report."

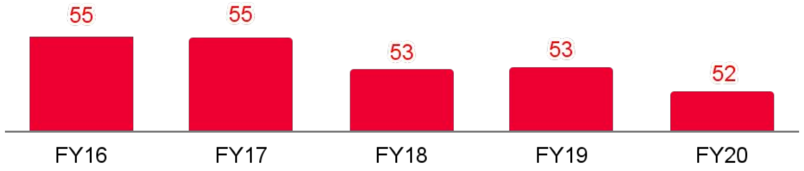
1 Improvement in Net Working Capital days
Net Working Capital (NWC) days of Malaysian companies improved marginally by 1 day in FY20 from FY19

2 Improvement primarily driven by longer payable days
Our analysis shows that overall payable days (DPO) were well managed with an increase of 7 days in FY20 from FY19. This underlines the fact that companies have extended their payment terms with their suppliers to better manage their internal cash flow

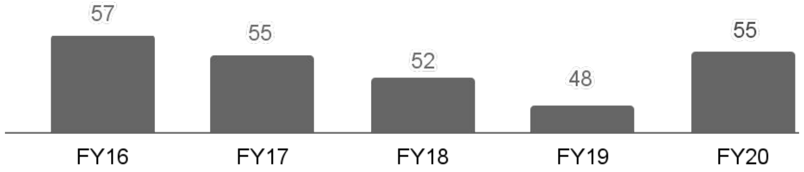
3 Increase in receivables and inventory days
Overall Malaysian companies are faced with longer receivable days (DSO) due to slower receivables collections (2-day increase in FY20 from FY19). Inventory days (DIO) have also increased by 4 days in FY20 from FY19, possibly driven by nationwide lockdowns which pushed sales figures lower

4 Overall improvement driven by larger players in Malaysia
Though an improvement is shown in the overall working capital performance of Malaysian companies, it is important to note that this is heavily influenced by the larger players. There is a wide gap between the small and large companies. As a group, smaller companies have declined in NWC days by 16 days in FY20 from FY19 (refer to page 9)

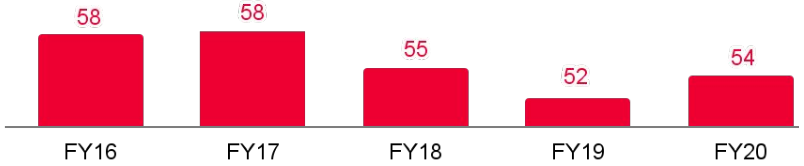
Net Working Capital (NWC) Days



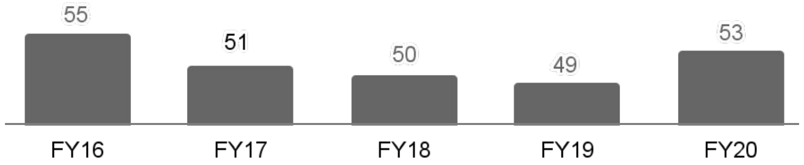
Days of Payables Outstanding (DPO)



Days of Sales Outstanding (DSO)



Days of Inventory Outstanding (DIO)

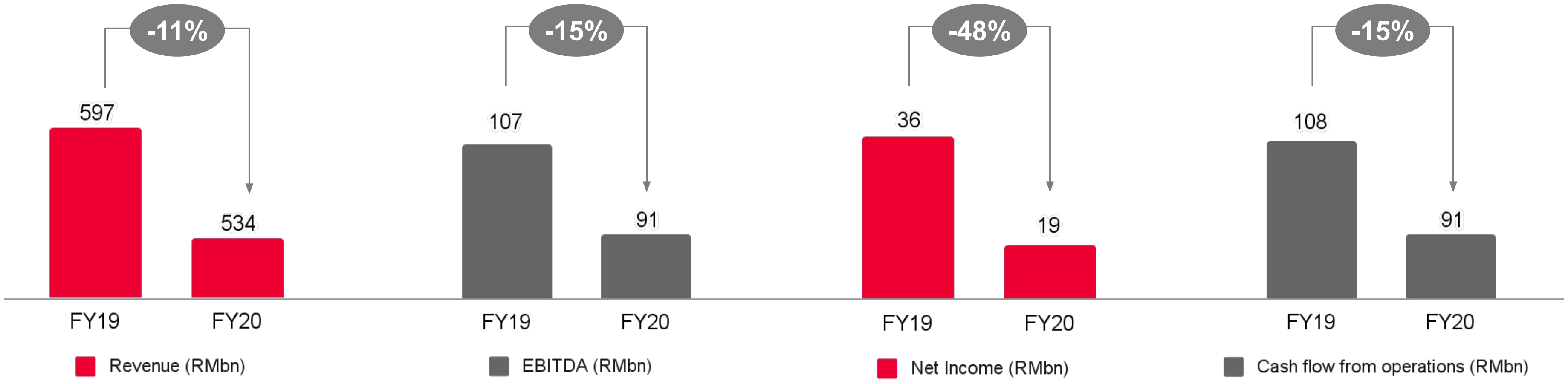


Note: Net Working Capital days is Days of Sales Outstanding + Days of Inventory Outstanding - Days of Payables Outstanding

Source: Capital IQ and PwC analysis

How have things changed from FY19 to FY20?

Overall revenue, EBITDA, net income and operating cash flow of Malaysian companies have declined as follows:



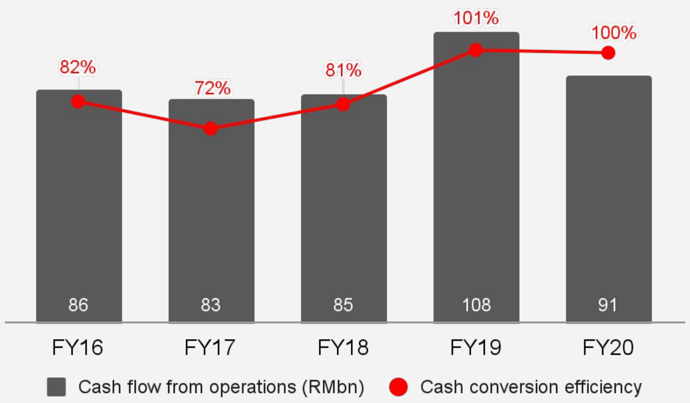
Good cash conversion efficiency (CCE) in FY19 and FY20 at c.100%

Despite the decline in absolute figures for sales, profitability and cash flow, CCE which is an indicator of how efficiently a company is able to convert profits into cash, has remained stable in FY20 at 100% (FY19: 101%)

This is possibly due to the improvement in NWC days driven by extended payable days. Companies are able to convert their profits into cash by delaying payments to suppliers. However, CCE could be further improved through digitalisation of working capital levers (receivables, inventory and payables) which enhances the efficiency and transparency of these processes (refer to page 13)

Cash Conversion Efficiency (CCE)*

(*CCE = Cash flow from operations/ EBITDA)



Source: Capital IQ and PwC analysis

Working capital performance of the various industries

8 out of 14 industries have longer Net Working Capital days in FY20 compared to FY19, mostly driven by the extended inventory holding or receivables collection period

Industry	Change in NWC days	Change in DPO	Change in DSO	Change in DIO
Apparel & luxury	+34	-10	-1	+25
Technology	+19	-1	+14	+4
Trading services	+12	+4	+5	+11
Industrial products	+8	+7	+7	+8
Healthcare	+7	+1	+1	+7
Oil & gas	+3	+1	+3	+1
Consumer products	+2	0	-1	+3
Plantation	+1	+1	+1	+1
Wood	-7	+1	+3	-9
Media & telco	-15	+8	-8	+1
Engineering	-18	+3	+1	-16
Energy & utilities	-19	+20	0	+1
Plastics & packaging	-22	+4	-8	-10
Transportation & logistics	-23	+51	+23	+5

Industries such as apparel and luxury, technology, trading services and industrial products have declined the most in their working capital performance

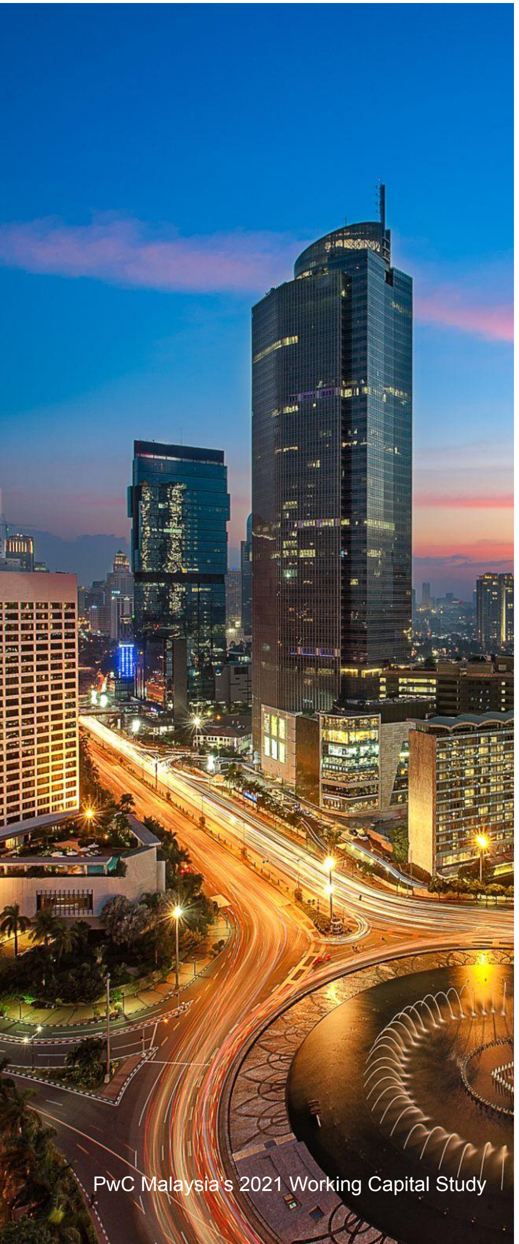
1. **Apparel and luxury, and trading services**
   70% of companies within these 2 industries have declined in their working capital performance. Inventory holding days have declined the most in these industries, signifying that large amounts of inventories are being held and not sold

2. **Technology**
   Our analysis reveals that companies in this industry have been faced with extended receivable days of up to 2 weeks and longer inventory holding days in FY20, resulting in an overall increase in NWC days by 19 days in FY20 from FY19

3. **Industrial products**
   Though companies in this industry were able to negotiate longer payment terms with suppliers, extended receivable and inventory days have increased their overall NWC days in FY20 by 8 days from FY19

Source: Capital IQ and PwC analysis

How have the smaller companies fared against the larger players?

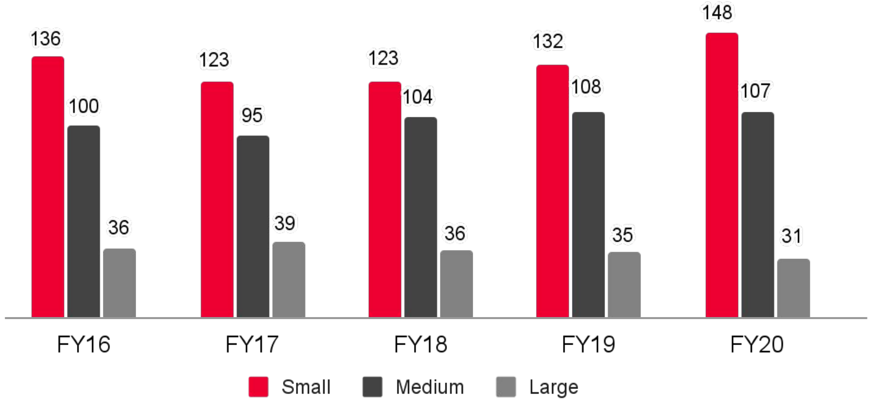


Smaller companies have significantly declined in their working capital performance when compared to medium and large sized companies

- When it comes to working capital, size remains an important factor, and the gap between the larger and smaller companies continues to widen year-on-year.
- Smaller companies represent 57% of the total companies analysed. Our analysis reveals that the increase of overall NWC days by 16 days is driven by the 9-day increase in receivables days (DSO) (108 in FY20 vs 99 in FY19) and 11-day increase in inventory days (DIO) (107 in FY20 and 96 in FY19).
- Larger companies (19% of total companies analysed) were able to mitigate their 2-day increase in receivable days (DSO) and 2-day increase in inventory days (DIO) with extension of payable days (DPO) by 8 days in FY20 from FY19. This resulted in an overall improvement in the working capital performance of larger companies.
- The NWC days by company size shows that smaller and medium sized companies have 3 to 5 times longer NWC days than larger companies. Therefore, there are ample opportunities for these companies to improve their working capital position.

* Large companies; RM1.5bn or more in revenue, Medium companies; more than RM500mn and less than RM1.5bn in revenue, Small companies; RM500mn or less in revenue

Net Working Capital Days by company size



Change in NWC, DPO, DSO and DIO in FY20 from FY19

Company size	Change in NWC days	DPO	DSO	DIO
Small (57%)	+16	+5	+9	+11
Medium (24%)	-1	+3	-3	+5
Large (19%)	-4	+8	+2	+2

Improvement in days   Decline in days

Source: Capital IQ and PwC analysis

Emerging topics

- Digitalisation and analytics
- Supply chain resilience and agility
- ESG and sustainable Supply Chain Finance

2

Digitalisation and analytics

Digital technologies are key for ensuring end-to-end visibility and transparency

"The lines are getting blurred between industries, competition, and customer segments with new entrants constantly bringing in new technologies to disrupt the business ecosystem. Companies will need to be clear about their digital strategy and how digitalisation will affect their current business model."

Amidst the pandemic, many companies experienced supply chain disruptions that impaired the flow of products and significantly affected sales and cash flow. As a result, optimising liquidity and working capital understandably remains as one of the top priorities for many businesses. Nevertheless, when triggered to take action as a result of the prolonged lockdown periods, many companies have realised some easy "cash" wins.

In most cases, a hypothesis driven **top-down approach** has been deployed to realise these 'easy' cash wins, which are mostly immediate remedies with short term focus. This approach typically identifies and realises up to ~40% of cash potential. The remaining cash potential is not fully identified and /or realised as it requires a more sophisticated data analytics capability.

For this, a data and analytics driven **bottom-up approach** is required, that utilises transactional data combined with emerging technologies, i.e. advanced data analytics and process mining, to identify and realise the additional cash potential.

Driving cash realisation across the value chain with digital analytics

- Availability of transaction data with timely and dynamic information made possible by digital analytics
- This also provides transparency of operational value chain
- And in turn, enables focus on associated key drivers and rapid cash realisation

Process mining as a foundation for digital transformation

In order to understand business processes and their current state, traditional methods used, until recently, were to interview stakeholders, examine systems, analyse documents and operational reports. These methods are time consuming and far from being accurate in reflecting on-ground process realities. In today's world, with the digitalisation of processes and data proliferation, there are better and more efficient ways of analysing business processes.

Process mining can help companies overcome the complexity and fragmentation of end-to-end operational processes by using event logs to provide a visualisation and analysis of the end-to-end business processes. This approach speeds up process discovery and provides a robust, data-driven baseline for continuous improvement initiatives. It also helps in creating granular visibility of the processes, prescriptive analytics to find (and resolve) root causes of inefficiencies and serves as an enabler for process excellence.

Process Mining steps

1. Collect
Collect data from source systems

2. Discover
Discover entire process with all deviations

3. Enhance
Suggest actions for process improvement

4. Monitor
Set KPIs and manage performance

4 ways to use process mining

Process standardisation
Analyse execution pattern to quantify process standardisation and understand outliers

Inefficiency identification
Identify bottlenecks, areas for rework, blockers and delays for informed root cause analysis

Automation assessment
Assess current automation utilisation and identify excessive or repetitive manual touchpoints

Compliance analysis
Recognise non-compliant executive patterns and reveal service level agreement (SLA) non-conformance

Click here to learn more about how PwC's Process mining services can help you

Supply chain resilience and agility

Building resilience in your supply chain

> 76% of the respondents in PwC's 2021 Act Now to Recover survey reported that they experienced supply chain disruptions in the past 12 months due to the pandemic. Retail and manufacturing were the sectors most impacted."

Organisations need to rethink their priorities around supply chain set-up and operations as their supply chains are increasingly exposed to risks from the pandemic. Building a resilient and agile supply chain is possible with the use of digital working capital platforms to be prepared for unexpected risk events in the future.

Immediate impact of COVID-19

- Diversified sources of supply
- Regionalisation and nearshoring of supply chain activities
- Review of make-or-buy decisions
- Capacity adjustments up to c.50% of volume
- New go-to-market approaches in response to different customer needs
- Adjusted product portfolios

Key capabilities for a resilient future supply chain

- Dynamic supply chain segmentation
- Closed loop integrated planning and execution
- Supply chain transparency and sustainability
- Smart logistics flows
- AI-driven supply chain management
- Future-ready organisation that deploys talent in agile and innovative ways

Key capabilities for a resilient future supply chain

"

Only 24% of the respondents in PwC's 2021 Act Now to Recover survey have used a digital tool to monitor their working capital in the past 12 months. The rest of the population are either unaware or have not utilised any such tools to track and monitor their working capital levels."

The increased focus on supply chain resilience and agility is enabling organisations to enhance their end-to-end supply chains. This is an opportunity to fully align their supply chains with business goals and increasing digital connection with suppliers and customers while improving their ability to bounce back after dealing with risks.

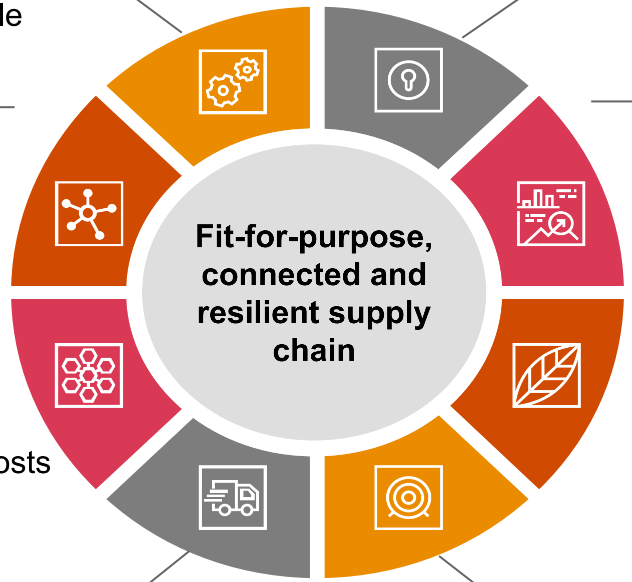
Key capabilities for a resilient future supply chain

Future-ready organisation
Supply chain organisations will need to upskill, reskill and redeploy talent in agile and innovative ways to remain resilient.

AI-driven supply chain management
AI accelerates supply chain improvements and enhances agility in dealing with disruptions or change.

Dynamic supply chain segmentation
Dynamic supply chain segmentation enhances customer centricity and continuously balances service levels, costs and margins.

Smart logistics flows
Smart logistics improve visibility and control along the supply chain.



The vision
Purpose built supply chains, moving beyond profit maximisation to value creation through ESG[1] practices

Working capital benefits
Investments in supply chain excellence pay off in cash, cost and service benefits.

Supply chain transparency and sustainability
Transparent supply chains provide visibility into the products and logistics, enabling real time decision making to manage sustainability risks more effectively

Closed loop and integrated planning
Supply chain planning is synchronised with execution in real time, integrates supply chain partners and enables continuous optimisation.

[1] Environmental, social and governance

ESG and sustainable Supply Chain Finance

How ESG will drive the next wave of transformation

“

PwC’s analysis[2] of global company reports, exploring how businesses are engaging with the United Nations’ Sustainable Development Goals (SDGs) revealed that:

73% of Malaysian companies mentioned the SDGs in their reporting

Only **20%** of Malaysian companies included the SDGs in their published business strategy

11% of Malaysian companies mentioned specific SDG targets”

The pandemic has brought renewed focus to environmental, social and governance (ESG) issues. The interconnected nature of supply chains for instance, could mean that unfair labour practices or corruption on one end of the supply chain may have a bearing on whether a business is trusted by its consumers or investors, affecting its bottom line.

Like digital, ESG has significant implications on how businesses strategise, invest or grow. Businesses may be asking questions like “where should we focus?”, “what opportunities can we identify to solve our issues and create value in new ways?” As companies ride the wave of the ESG revolution, they will find that these 3 things are critical: reporting needs to be reimagined to take into account broader non-financial metrics; the company will need to redefine or reinvent their strategy with ESG at its core, and business transformation will be key in managing redefined objectives and driving these changes.

Key factors driving the call for ESG[3]

Investors, governments and consumers are driving the ESG wave

- Institutional investors increasingly prioritise non-financial impacts, calling for corporates to disclose and address ESG risks
- Increased scrutiny is observed among regulators and policymakers who are putting pressure on businesses to measure and disclose their ESG risks, among other practices

Climate change accelerates ESG risks, yet there are also opportunities

Climate risk factors

- Malaysia, located near the equator, is at risk of higher rise in temperature and increased sea levels. This could result in food security issues such as rice production and potentially more volatile palm oil prices

Untapped ESG opportunities in Malaysia

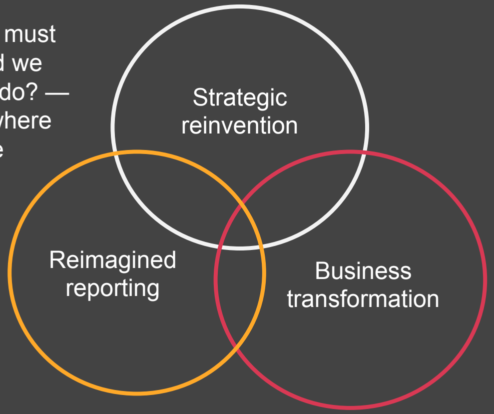
- Penetration of renewable energy is still far from the target; Electric vehicle (EV) sales and construction of green buildings are still very low

ESG has yet to be a core focus for companies

- Corporates need to put ESG at the forefront to future proof their business against increasing sustainability risks
- Boards need to consider ESG risks and strategies as part of its roles as provided by the Malaysian Code on Corporate Governance (MCCG) 2021

The three dimensions of the ESG revolution[4]

Translates ESG aspirations — What must we do? What should we do? What could we do? — into a blueprint for where and how to compete



Enables the measurement and management of ESG factors such as carbon emissions, workforce diversity and supply chain sustainability

Drives ESG strategy and reporting into the heart of the business, often building on ongoing digital transformation initiatives

[2] PwC SDG Challenge 2019 (Malaysia report), 2020
[3] Rethinking ESG in a post COVID-19 world, PwC, 2020
[4] Are you ready for the ESG revolution?, PwC, 2021

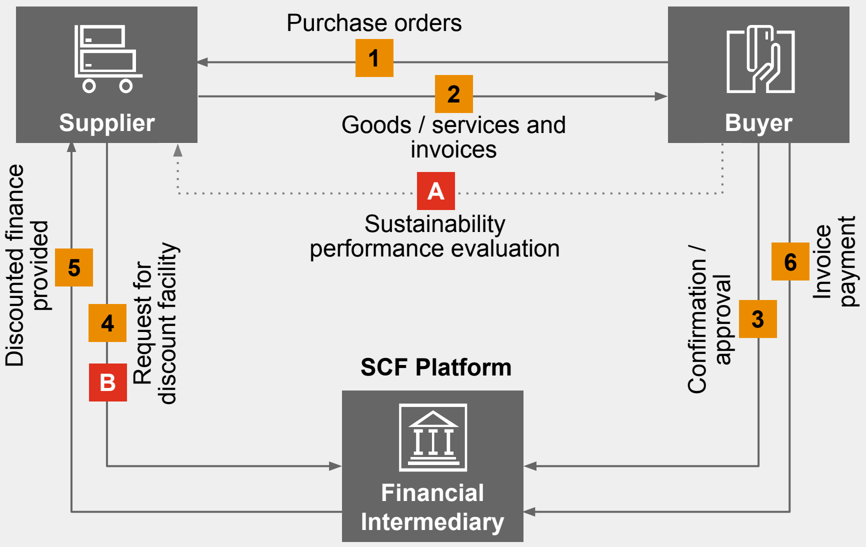
Integrating sustainability into Supply Chain Finance (SCF)

We observed that many organisations are facing cash management challenges with low cash reserves or unstable cash flow during the pandemic. As a result, demand for financing, including supply chain finance (SCF) has increased exponentially to address the working capital shortfall.

SCF is essentially the practice of placing an intermediary (usually a bank or Fintech provider) in the payment process between the buyer and the supplier. SCF provides short term credit, which can optimise cash flow by allowing buyers to lengthen their payment terms whilst providing suppliers with the option to receive payments earlier.

But the solution does not stop there. Most SCF providers go beyond organising payments. An example is integration of ESG performance criteria into a buyer-led supply chain finance programme, allowing buyers to reward suppliers (e.g. through favourable discounted rates) based on the supplier's ESG rating).

SCF Process Flow



A. The buyer or a third party evaluates the supplier's sustainability performance

B. The supplier who scores higher ESG rating obtains a more favourable discounted rate

Transaction Flow

1. The buyer places order with the supplier
2. The supplier fulfils the order and invoices the buyer
3. The buyer approves and confirms payment at maturity with the financial intermediary
4. The supplier sells (at a predetermined discounted rate) to the financial intermediary
5. The financial intermediary remits early payment to the supplier
6. The buyer pays the financial intermediary as agreed at maturity of invoice

Stakeholder	Benefits
Buyer	• Longer payment terms hence the opportunity to unlock working capital • Improved supplier relationships • Contributes to achievement of sustainability commitments and goals
Supplier	• Reduction of trade receivables and increase in cash position • No collateral required • Entitlement for more favourable financing rates with improved ESG rating serves as an incentive for sustainability investment
Financial Intermediary	• Increases the potential client's portfolio • Allows differentiation in product offerings • Contributes to achievement of sustainable finance goals and alignment to ESG targets

Improvement areas and how we can help

3

Where and how we can help you to release cash from working capital

Overall Working capital solutions

- **Online working capital maturity assessment**
- **Working capital governance design and set-up**

Accounts receivable

- Tailored, proactive collections
- Credit risk policies
- Aligned and optimised customer terms
- Timeliness and quality of billing
- Contract and milestone management
- Systematic dispute resolution
- Dispute root cause elimination
- Negotiation strategy and support

Inventory

- Lean and agile supply chain strategies
- Global footprint and coordination
- Forecasting techniques
- Demand and inventory planning
- Inventory tracking
- Balancing cost, cash and service level considerations
- Inventory parameters and controls defining target stock

Accounts payable

- Consolidated spending
- Increasing control with centre-led procurement
- Assistance in avoiding leakage with purchasing channels
- Payment terms harmonisation
- Supply chain finance benefits assessment, roll-out and ESG considerations
- Eradicating early payments
- Payment cycles and methods
- Negotiation strategy and support

- Data analytics and digital working capital solutions
- Working capital e-learning and training
- Trade finance solutions
- Process mining as a service

Our working capital improvement approach

Quick scan → **Solution design and quick wins** → **Implementation support**

Methodology

Metrics	Overview	Formula
Net Working Capital "NWC" days	NWC days measures the length of time that each net input dollar is tied up in the production and sales before it gets converted into cash received	DSO+DIO-DPO
Days Sales Outstanding "DSO"	DSO is a measure of the number of days that a company takes to collect cash after the goods or services have been delivered.	(Accounts Receivable/Sales) x 365
Days Payables Outstanding "DPO"	DPO is an indicator of the number of days for a company to pay its trade creditors.	(Accounts Payable/ Cost of Goods Sold) x 365
Days Inventories Outstanding "DIO"	DIO is a measure of the number of days for a company to hold its inventory before the sale.	(Inventories/ Cost of Goods Sold) x 365
Cash Conversion Efficiency "CCE"	CCE is an indicator of how efficient a company is in converting its profits into cash.	Cash from Operating Activities/ EBITDA

This study provides a view of working capital performance based on the data sourced from S&P Capital IQ, across 411 listed companies in Malaysia. Companies operating in the financial services, property developer, and construction industries were excluded from the study.

As the research is based on publicly available information, all figures are financial year-end figures. Due to the disproportionate efforts to improve working capital performance towards year-end, the real underlying working capital requirement within reporting periods might be higher. Also, off-balance sheet financing or the effect of asset securitisation have not been taken into account.

Our report also includes findings from the Act Now to Recover survey, conducted by PwC Malaysia in June and July 2021. The survey had 87 respondents comprising business owners/leaders from over 10 industries, such as retail and consumer, industrial manufacturing and services, financial services, healthcare, real estate, and technology, media and telecommunication among others.

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