

Large companies: Working Capital Requirement hit its worst level since 2012 at 70 days

Corporates to correct their inventories and show stronger discipline in payment in 2019

- **Global Working Capital Requirement (WCR)¹ deteriorated by +1 day to 70 days in 2018, coming back to its highest and thus worst level since 2012.** For 2019, Euler Hermes expects a correction in inventories and a stronger discipline in payment for corporates.
- **WCR rose in three out of five countries** in 2018, mostly due to a noticeable inventory accumulation (+4 days on average). Emerging markets are on average less efficient than advanced economies in adjusting their payment behavior.
- **WCR is one month longer for European SMEs compared to large companies.**
- Although half of the sectors registered an increase in inventories in 2018, **three out of five sectors still managed to stabilize or even improve their WCR.**

Paris, July 17 2019 – [A new study, jointly produced by Euler Hermes Economic Research and Euler Hermes Rating, focuses on Working Capital](#) as a key indicator of the financial situation and behavior of corporates. It complements previous studies that pointed out [the reactivating of self-discipline of corporates in their Days Sale Outstanding \(DSO\)](#), and [the unusual accumulation of inventories by corporates](#), giving an enlarged view on the financial situation and behavior of corporates.

Correcting the record high global WCR

In 2018, Global Working Capital Requirement hit its worst level since 2012 (+1 day, 70 days). The evolution of WCR indicates which businesses have improved, or in this case, deteriorated, their capacity to maintain operating cash flow and internal funding for investment.

The deterioration mainly comes from the increase in inventories (+3 days), which are currently between 20% and 30% above what is considered a normal level. Companies tried to offset this rise by adjusting their payment behaviors through a decrease of their DSO (-1 day) and an increase in their Days Payable Outstanding (DPO) (+1 day).

Still, the WCR rise represents **USD820bn or a 12% rise** of additional financial resources consumed by working capital in 2018. *“A rise in WCR usually means fewer financial resources for corporates to pursue other objectives such as new product development, geographical expansion, acquisitions, modernization or debt reduction and could therefore lead to an economic slowdown”*, explains **Maxime Lemerle, Head of Sector and Insolvency Research at Euler Hermes.**

In reaction to lower global growth and higher global uncertainty, Euler Hermes expects large corporates to adopt a cautious approach in 2019 and correct their inventories, while showing a stronger discipline in payment. Consequently, **the WCR of large companies should decline by 2 days (to 68 days) in 2019**, along with a stabilization in value terms to the expected increase in turnover.

¹ The Working Capital Requirement (WCR) of a company is a financial metric whose components are accounts receivable (also known as DSO for Days Sales Outstanding), inventory (aka DIO for Days Inventory Outstanding) and accounts payable (aka DPO for Days Payable Outstanding). It is calculated according to the following formula: $WCR=DSO+DIO-DPO$. A rise (drop) in WCR comes either from a higher (lower) DSO, a higher (lower) DIO or from a lower (higher) DPO.

Emerging markets have greater difficulties in adjusting their payment behavior

WCR rose in three out of five countries in 2018. The top increases in emerging markets were seen in Brazil (+9 days), South Africa (+8 days) and Chile (+5 days) while deteriorations in Central and Eastern Europe (Russia, Bulgaria) and Asia (India, South Korea and Hong Kong) were also recorded. Several advanced economies also registered an increase in WCR: the Nordics (+4 days), Germany (+3 days), and the US (+1 day). For all of those countries, the rise was triggered by an important inventory accumulation (+4 days in average). Overall, emerging markets tend to have more difficulties than advanced economies when it comes to adjusting their payment behavior to the rise in inventories.

Countries which managed to stabilize or even decrease their WCR despite the rise in inventories mostly did it through a decrease in DSO. Surprisingly, Mediterranean countries – Portugal, France and Italy – where companies have a bad habit of getting paid late by their customers and therefore stood out with important increases in DSO in 2018, still managed to decrease their WCR to respectively 57 days (-6 days), 66 days (-1 day) and 70 days (-4 days).

“Looking at Western Europe, SMEs posted better performance in WCR than large companies in 2018. In Italy, SMEs reduced their WCR by -14 days (-4 days for large companies). In Spain, SMEs recorded a -7 days decrease in WCR while large companies posted a +3 days rebound. WCR also slightly improved for French SMEs (-1 day) while it remained stable for large companies”, said **Kai Gerdes, Head of Analysis at Euler Hermes Rating.**

A less widespread sectorial WCR deterioration

Although half of the sectors registered an increase in inventories in 2018, the deterioration in WCR is much less widespread since 3 out of 5 sectors managed to stabilize or even improve theirs in 2018.

It is worth noting that the five sectors – Aeronautics, Machinery, Electronics, Pharmaceuticals and Leisure goods – with the highest level of WCR, which all go beyond 100 days, all managed to reduce their WCR in 2018. On the other hand, the Paper, Automotive, Agrifood, Utilities and Household Equipment sectors suffered a rise in WCR due to an increase in inventories.

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Press contact

EULER HERMES GROUP

Jean-Baptiste Mounier
+33 (0)1 84 11 51 14
jean-baptiste.mounier@eulerhermes.com

FOOTPRINT CONSULTANTS


Cécile Jacquet
+33 (0)1 80 48 14 80
cjacquet@footprintconsultants.fr

Quentin Giudicelli
+33 (0)1 80 48 14 80
qgiudicelli@footprintconsultants.fr

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