

Trapped Cash in the Manufacturing Sector

London and the South East

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Contents

1. Why is good cash flow important?	4
2. The impact of late payments – the poor cash flow	6
3. Cash flow in London and the South East	7
4. Invoice Finance as a cash flow enabler	8
5. Conclusion	10





Management Summary

- Late payments are detrimental to cash flow, which is important for the health of a business as it enables it to make investments, overcome financial challenges and, ultimately, grow.
- Our previous research shows that SMEs are missing out on £250 billion of liquid cash flow because of slow and late payments.¹
- Late payments are a particular problem for SMEs in London and the South East with 67% of small businesses in the South East and 70% in London reporting late payment problems.²
- The manufacturing sector in London and the South East makes a significant contribution to the UK economy. It is the largest manufacturing regional economy in the UK, and there were 32,190 manufacturing enterprises in the region in 2017.³ Manufacturing is largely made up of SMEs which operate within a complex supply chain involving firms across the UK and the world.
- This paper uses a conservative research model which estimates that £2.5bn could be freed up for SMEs in the manufacturing sector in London and the South East through the use of invoice finance.
- This significant sum could improve manufacturers' cash flow, be reinvested into the sector and contribute to the success of manufacturing in the region



Why is good cash flow important?

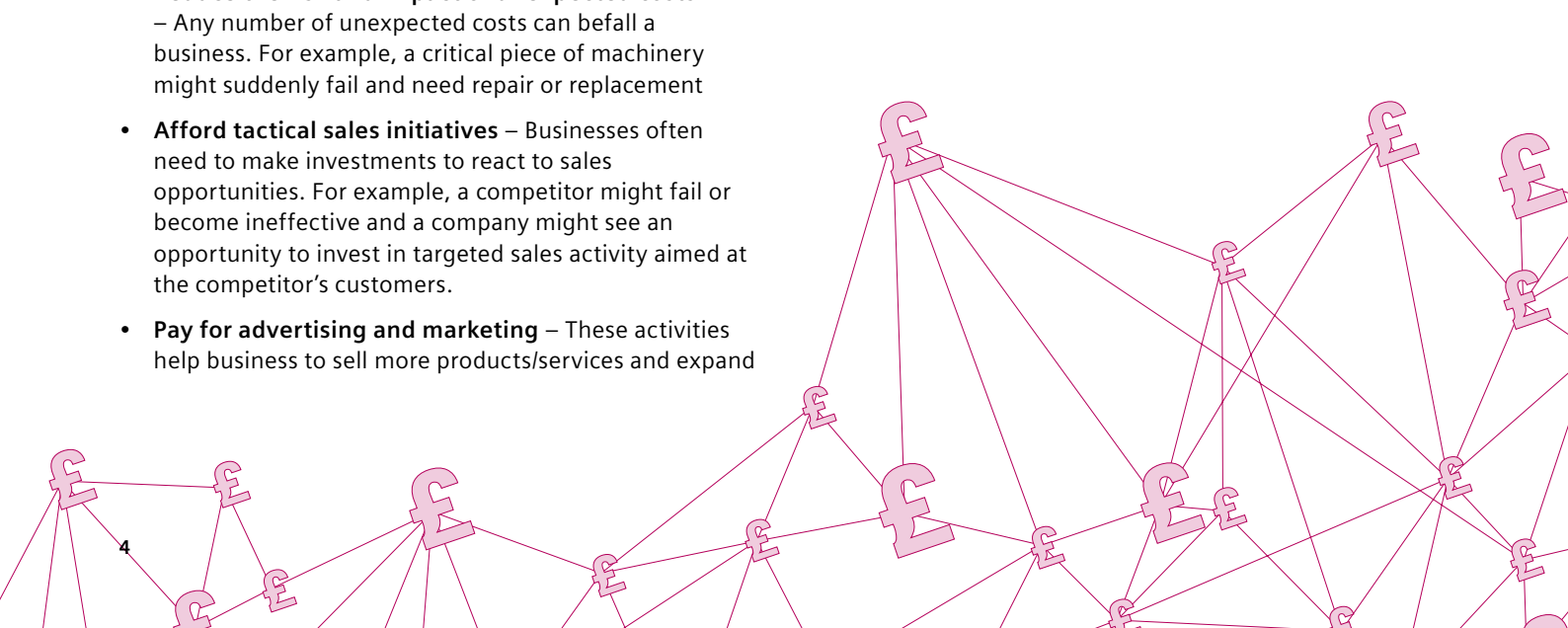
Generating positive cash flow is a sign of a company's financial health and means it can settle debts, reinvest in its business, pay expenses and provide a buffer against future financial challenges.⁴ Cash flow management is important to any business because ultimately it determines a company's ability to create value for its shareholders.

Businesses can use cash flow to:-

- **Fund new product/service development** – Expanding into new areas requires upfront investment to make it happen
- **Order more inventory or raw materials** – A sudden influx of orders is welcome, but to satisfy them quickly the components need to be purchased
- **Avoid problems with the costs of growth** – Growth brings a number of possible costs including recruitment fees, extra salaries and employee benefits, purchase of materials and equipment, and potentially larger premises all of which need to be covered often before the financial benefits of being a bigger business are realised
- **Reduce the risk and impact of unexpected costs** – Any number of unexpected costs can befall a business. For example, a critical piece of machinery might suddenly fail and need repair or replacement
- **Afford tactical sales initiatives** – Businesses often need to make investments to react to sales opportunities. For example, a competitor might fail or become ineffective and a company might see an opportunity to invest in targeted sales activity aimed at the competitor's customers.
- **Pay for advertising and marketing** – These activities help business to sell more products/services and expand

All of these applications of cash flow have a common aim of helping the company to grow and generate more profit. But they all require investment before that growth is realised. A company with good cash flow has competitive advantage because it is able to deploy funds for upfront investment in these activities. Companies which have poorer cash flow lack the working capital and therefore the resources to achieve these things. Or they may find they can't react to opportunities quickly because they need to keep a tighter rein on their finances in order to pay key suppliers on time.

So it's easy to see why small business owners place a great deal of importance in preserving their cash flow. In fact, over 70% of small business owners agree that poor cash flow poses the greatest risk to their company.⁵



“...over 70% of small business owners agree that poor cash flow poses the greatest risk to their company”



The impact of late payments – the poor cash flow cycle

Late payments are detrimental to cash flow because not receiving invoice settlements on time means companies have less cash available to them.

38% of UK businesses say that they receive most invoice payments out of terms⁶ and our previous research shows that SMEs are missing out on £250 billion of liquid cash flow because of slow and late payments.⁷ Late payments cost businesses time and resources to track and chase, but chronic late payments can become a more serious problem and threaten the resilience of the business. Around 50,000 businesses fail each year due to late payments and this amounts to a £2.5bn shortfall for the UK economy to withstand.⁸

We've already seen that cash flow can be used to fund activities that contribute to company growth. In addition, good cash flow management allows a business to build up a 'float' to cover payments before they arrive. Even a timely payment will come 30, 60 or 90 days after the product or service is delivered, depending on the terms. The longer payments take to arrive, the more of a cash 'float' a company needs, but the less cash they have available. Therefore, an increasing proportion of the business' cash is tied up 'plugging' the payment gap and is unavailable to invest in fostering growth.

Cash flow in London and the South East

There are 1.9m SMEs in London and the South East,⁹ many of which are in the manufacturing sector. SMEs are vital to UK manufacturing which operates within a highly complex supply chain. Nationally, the vast majority of manufacturing companies are small businesses.¹⁰

Manufacturing only accounts for a small proportion of London and the South East's jobs and output,¹¹ nevertheless it is still the largest regional manufacturing economy in the UK.¹² In 2017, the South East and London accounted for just under a quarter (24.8%) of all UK manufactured exports, the largest of any region.¹³

The strength of the region's manufacturing sector is particularly underpinned by the high degree of manufacturers serving the food and drink sector. The steady demand of food and drink products means demand offers relative stability, even through economic uncertainty.¹⁴ The region's second largest sector – 'other

transport'¹⁵ – and in particular the export-focused aerospace sector, is built upon strong global demand.¹⁶ This, in turn, boosts the metal and electronics sectors, both of which have a large presence in the region.¹⁷

Yet, despite this success, SMEs in London and the South East are among those most affected by late payments,¹⁸ impacting their ability to grow. ¹⁹ Given the sector's significance to the UK economy, it's important that manufacturing SMEs in London and the South East are able to overcome the challenges they incur as a result of being paid late.

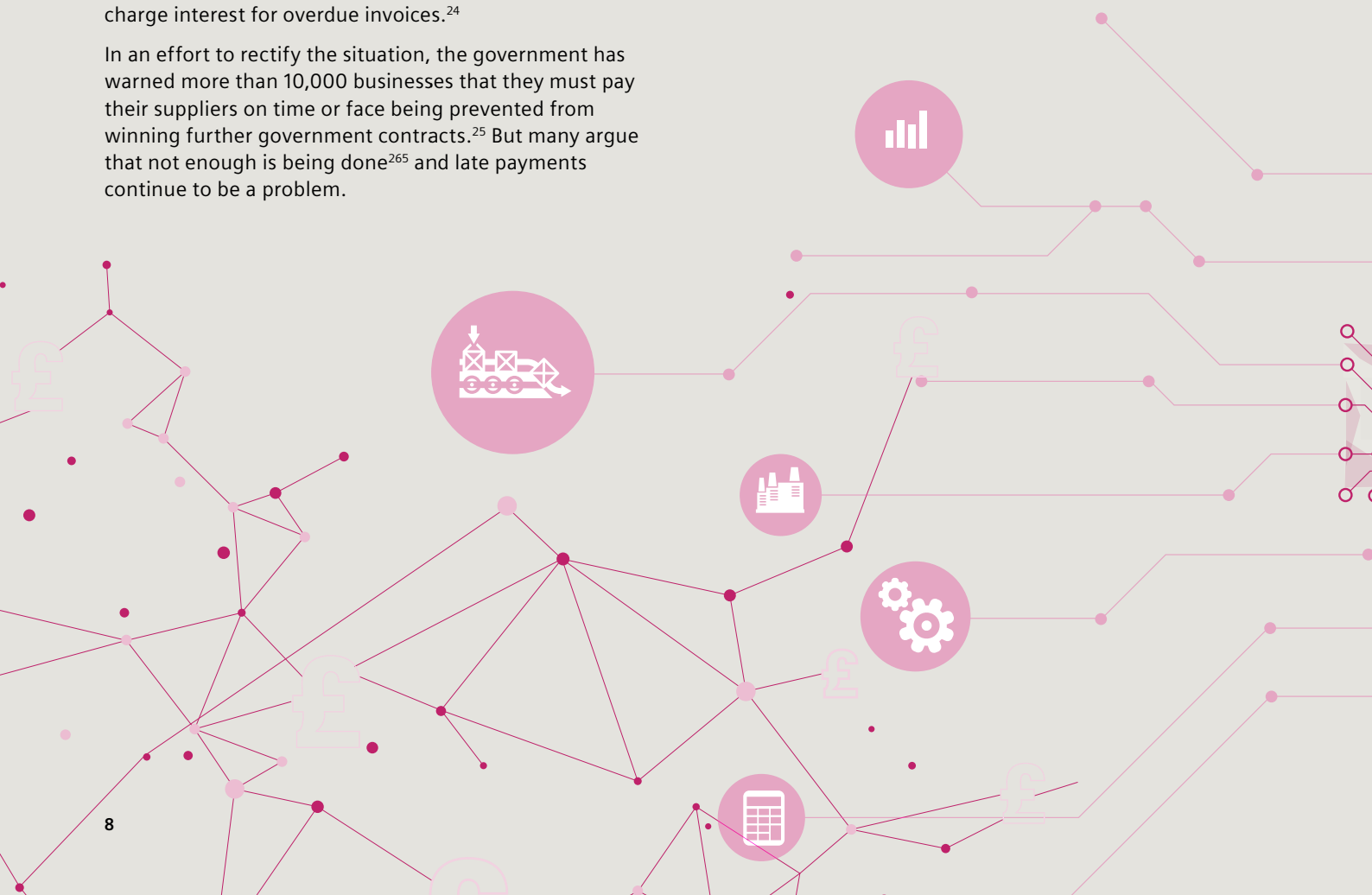
Invoice Finance as a cash flow enabler

SMEs need to be paid on time in order to maintain their cash flow. However, despite repeated calls for invoices to be settled more promptly,²⁰ businesses – and particularly SMEs – still suffer from the effects of late payments.

As a result, 37% of small businesses run into cash flow difficulties, 30% have been forced into taking out an overdraft, while 20% suffered a slowdown in profit growth as a result.²¹ Manufacturing is a sector that operates on tight profit margins; an average of 15.7%²² and in a survey by The Manufacturer, 40% of manufacturers said they were unsure of where their future profits would come from.²³ Furthermore, 61% of small businesses are paid late by big businesses, but conversely, 79% of small businesses don't charge interest for overdue invoices.²⁴

In an effort to rectify the situation, the government has warned more than 10,000 businesses that they must pay their suppliers on time or face being prevented from winning further government contracts.²⁵ But many argue that not enough is being done²⁶ and late payments continue to be a problem.

Therefore, many SME manufacturers are turning to invoice finance to bolster their cash flow. By using invoice finance, when a company invoices their customer, up to 90% of the approved invoice total is immediately advanced by the finance provider, with the remaining 10% paid once their customer settles the balance. This provides the company with essential working capital so it can then invest in expanding its business without having to wait for bills to be paid.



Invoice finance continues to grow in popularity; 21% of UK businesses with a turnover over £1m per year use invoice finance.²⁷ The tool is becoming particularly important to the manufacturing sector with manufacturers accounting for 25% of companies using invoice finance.²⁸

As we've seen, manufacturers play an important role in the economy of London and the South East. It's therefore important that these businesses receive the financial support that enables them to grow and continue to contribute to the prosperity of the region.

Siemens Financial Services has calculated how much cash could be freed up for the manufacturing sector in London and the South East through the use of invoice finance. By taking the average manufacturing DSO and applying this to the turnover of manufacturers in the region we can estimate the value of payments left outstanding. The proportion of companies not eligible for invoice finance has then been removed. This figure is then multiplied by 90% for the amount advanced through invoice finance, and halved to eliminate any exaggeration due to, for example, ineligible invoices and current invoice finance marketing penetration.

Based on this conservative model, £2.5bn could be freed up for SMEs in the manufacturing sector in London and the South East through the use of invoice finance.

Conclusion

Manufacturing in London and the South East makes an important contribution to the UK economy. The vast majority of these manufacturers are SMEs all of which have an important role to play in the complex supply chain of the sector, not just in the local region but nationally and internationally.

Good cash flow is important for any business, but particularly for SMEs which lack the capital resources of their larger counterparts and often operate on tight margins. It's long been acknowledged that late payments cause a significant problem for SMEs but those awaiting a solution have been left wanting.

By utilising invoice finance, SME manufacturers in London and the South East of England can access the cash flow needed to develop new products, approach new customers and ensure they have the resources available to meet any unforeseen costs. As this research shows, the sums available to the manufacturing sector in London and the South East through invoice finance are considerable. By freeing this 'trapped' cash, SMEs can look forward to realising their growth ambitions and further contributing to the economy.

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