VIEW POINT

CASH IS KING; NOW MORE THAN EVER

Abstract

With the disruptions brought about by the global pandemic, as well as by major demographic, technology, and market trends, retail and grocery chains are struggling to conserve cash and liquidity. This paper talks about these current challenges and presents several strategies to tackle them successfully.

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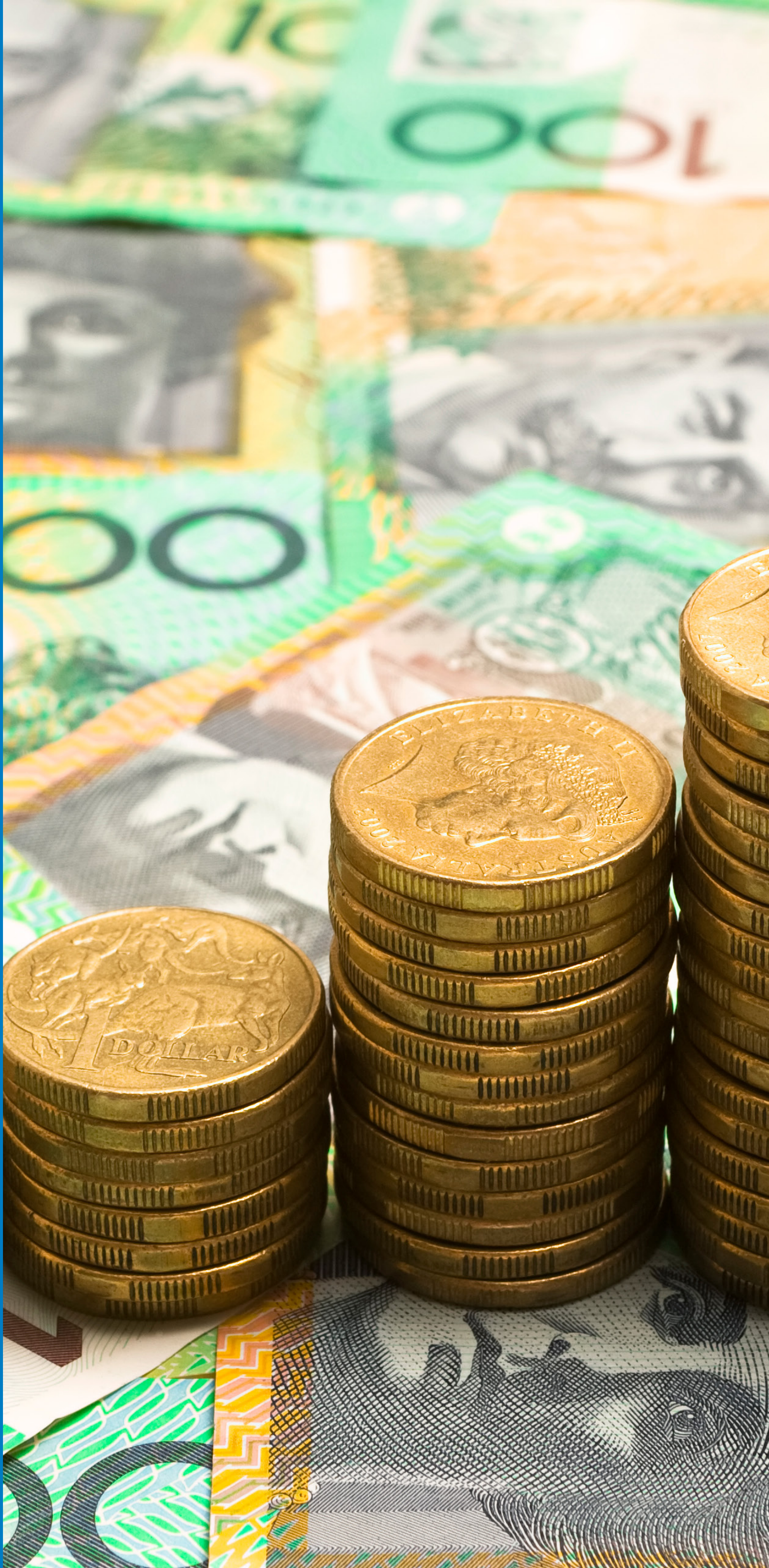
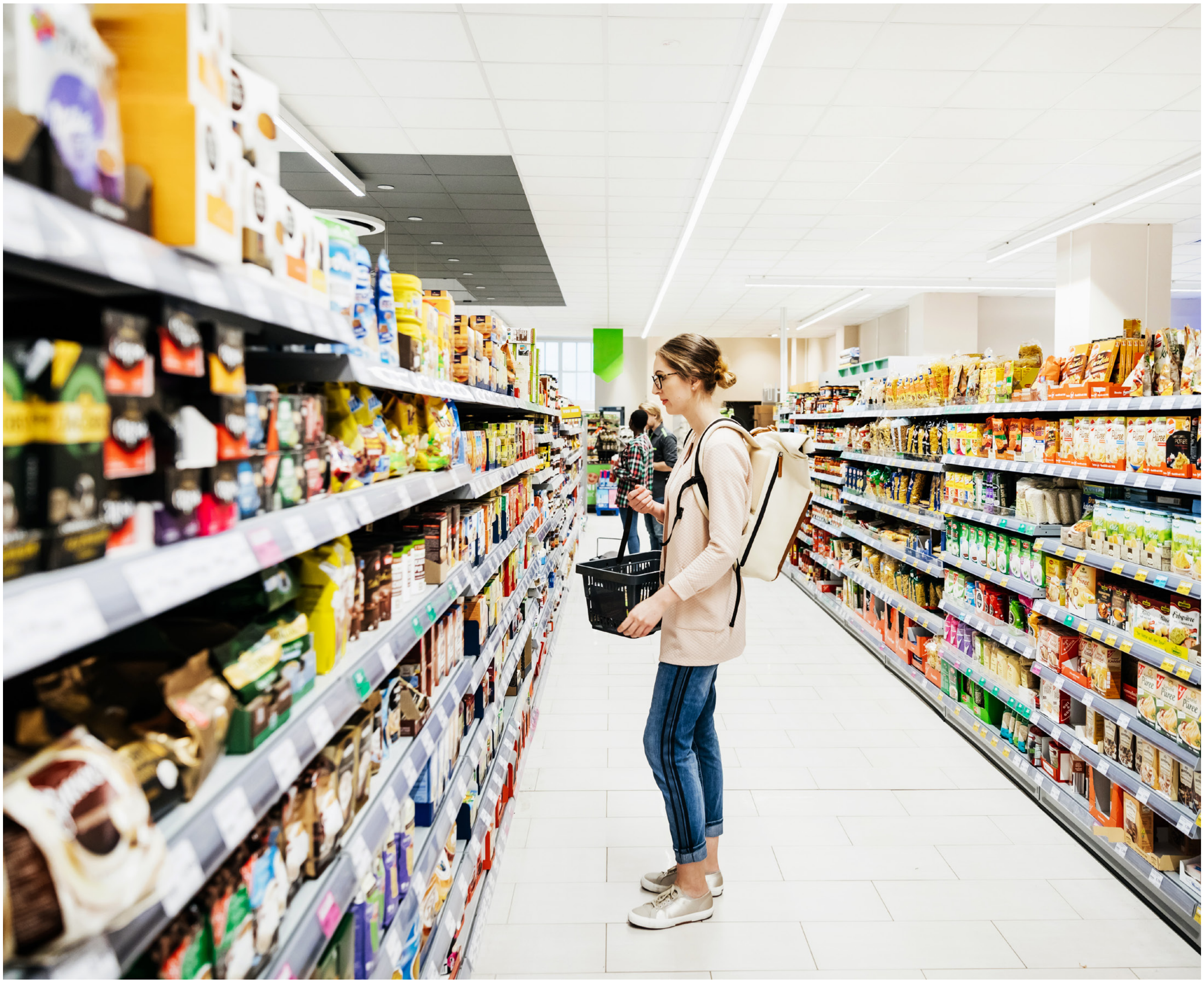
Liquidity to centerstage

The global pandemic has caused unprecedented and widespread disruption to the world economy, affecting business operations worldwide with significant impact on trade, business growth, and profitability. The cascading effects of a supply vacuum, instinctive reduction of shipping capacity by global carriers, and consequent over-reliance on airfreight have greatly increased organizations' logistics costs.

Even as the situation stabilizes and the world limps its way to a new normal, many companies' financial resources have been severely depleted by increased employee health-related expenditures, higher input costs, and fuels prices. The pandemic has also brought about immense churn in the job markets, causing shortage of critical skills, and leading to increased talent acquisition costs for employers.

Thus, in such uncertain times the key concerns of business are around conserving cash and liquidity, recovering from revenue shocks, and stabilizing supply chains. This means that organizations need to manage their working capital effectively while simultaneously striking a balance between liquidity and profitability.





Challenging times for retail

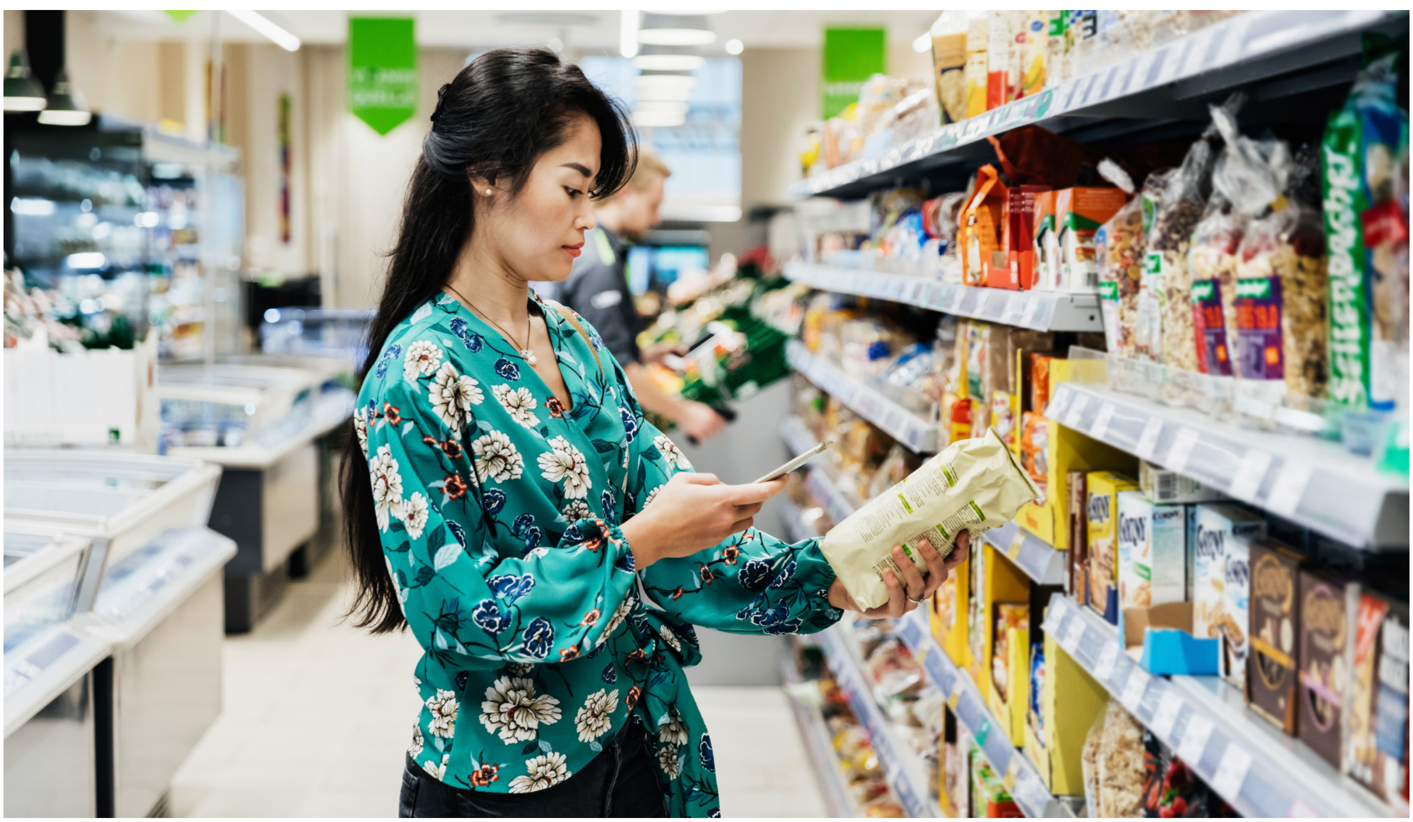
The retail industry is no exception, witnessing the same challenges detailed above. It has witnessed negative growth in Year 2020 on account of the economic crisis, and while Year 2021 has shown early signs of recovery, there has still been a significant impact on organizations' working capital. This can be explained by several factors:

- Slowdown in sales and higher operating expense caused by sudden operational disruptions
- Upsurge in e-commerce leading to huge losses to traditional retail set ups and limited operational sales windows
- Global supply chain disruptions leading to higher inventory carrying costs
- Longer cash operating cycles and a lack of synchronization in AP & AR pay terms

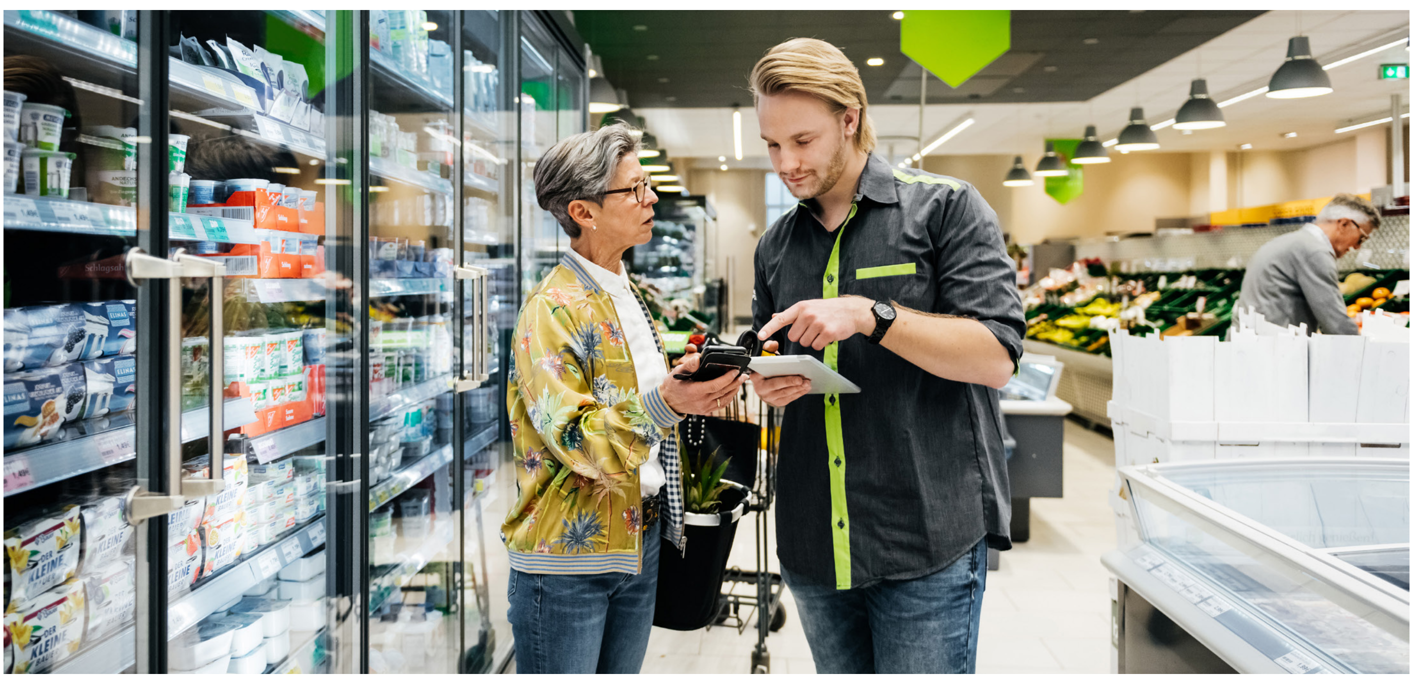
Cash flows in the retail industry are significantly a function of inventory and payables, as it should be. Retail chains typically focus on reducing inventories as the key lever for improving cash flow, sometimes missing opportunities to manage their payables in a smarter way. This also involves a delicate trade-off between loss of sales due to no stocks, margins on products, and the real estate available to carry inventory.

For an example, let's compare Kroger's net working capital trends with three of its peers — Target, Costco, and Rite Aid — over a four-year period, to get an understanding of Kroger's working capital situation. At a high level it is quite visible that Kroger carries a conservative inventory level which is lower than Costco or Target, and there appears to be some scope to extract more cash while managing payables. We believe that potentially there may be scope to improve net working capital (NWC) by 1-2 days which could release about $500 Mn of cash into the balance sheet, if not more, over the medium term.

Kroger[1]	30-Jan-21	30-Jan-20	30-Jan-19	30-Jan-18	Target[2]	30-Jan-21	30-Jan-20	30-Jan-19	30-Jan-18
Revenue (US$ bn)	132.5	122.2	121.1	122.6	Revenue (US$ bn)	93.6	78.1	75.4	71.9
Receivables (US$ bn)	1.8	1.7	1.6	1.6	Receivables (US$ bn)	1.1	1.0	1.1	0.9
Inventory (US$ bn)	7.1	7.1	6.8	6.5	Inventory (US$ bn)	10.7	9.0	9.5	8.7
Payables (US$ bn)	8.1	7.5	7.3	7.0	Payables (US$ bn)	15.9	11.9	11.6	10.8
NWC	0.8	1.3	1.1	1.2	NWC	(4.1)	(1.9)	(1.0)	(1.2)
In Days Sales					In Days Sales				
Receivables	4.9	5.1	4.8	4.9	Receivables	4.4	4.5	5.3	4.7
Inventory	19.5	21.2	20.6	19.4	Inventory	41.6	42.0	46.0	44.0
Payables	22.3	22.5	22.0	20.7	Payables	62.0	55.4	56.2	54.8
NWC	2.1	3.8	3.5	3.6	NWC	(16.0)	(8.9)	(4.8)	(6.1)



Costco[3]	30-Aug-20	30-Aug-19	30-Aug-18	30-Aug-17	Rite Aid [4]	27-Feb-21	27-Feb-20	27-Feb-19	27-Feb-18
Revenue (US$ bn)	166.8	152.7	141.6	129.0	Revenue (US$ bn)	24.0	21.9	21.6	21.5
Receivables (US$ bn)	1.6	1.5	1.7	1.4	Receivables (US$ bn)	1.5	1.3	1.8	1.9
Inventory (US$ bn)	12.2	11.4	11.0	9.8	Inventory (US$ bn)	1.9	1.9	1.9	1.8
Payables (US$ bn)	14.2	11.7	11.2	9.6	Payables (US$ bn)	2.1	2.2	2.4	2.9
NWC	(0.4)	1.3	1.5	1.7	NWC	1.2	1.0	1.2	0.8
In Days Sales					In Days Sales				
Receivables	4.3	4.6	5.0	4.3	Receivables	5.7	6.0	8.7	9.5
Inventory	33.7	34.0	33.3	29.3	Inventory	7.3	9.0	9.1	9.1
Payables	39.0	34.9	33.9	28.6	Payables	8.1	10.4	11.8	14.6
NWC	(1.0)	3.7	4.4	4.9	NWC	4.9	4.6	6.0	4.0



[1] https://finance.yahoo.com/quote/KR/financials?p=KR

[2] https://finance.yahoo.com/quote/TGT/financials?p=TGT

[3] https://finance.yahoo.com/quote/COST/financials?p=COST

[4] https://finance.yahoo.com/quote/RAD/financials?p=RAD

Trends in the grocery category

For grocery chains in developed markets, both growth and profitability have been on a downward trajectory due to higher costs, falling productivity, and race-to-the-bottom pricing. The speed and magnitude of the change driven by consumers' changing habits and preferences, intensifying competition, and new technologies, have caught most grocers off guard. Millennials who form a rising proportion of grocery customers, want healthier food, from sustainable sources, and deals and discounts too. Seamless online shopping is another key ask. Prior to the pandemic, people were also less inclined to cook, which could resume once the Covid waves settle down. And then, even as e-commerce through Amazon and even Walmart's have become bigger channels of sales, CPG companies are also queering the pitch through direct sales.

To counter these challenges, retail/grocery chains are aggressively adopting digital solutions, advanced analytics, artificial intelligence (AI), and the Internet of Things (IOT) to manage demand prediction, inventory levels, and to boost sales and margins. The focus is on convenience to customers with longer working hours, express checkouts, and door deliveries. In addition, educational and entertainment themes are being thrown in to enhance customer experience, with personalization and subscription-based selling models the other ideas used to enhance customer stickiness.

Fine-tuning inventories

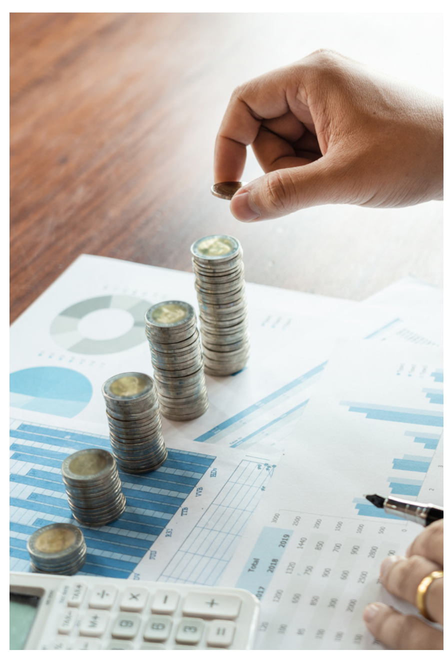
Even as these drastic shifts threaten to impact retail and grocery chains, they also underscore the growing need to better manage inventory levels through rethinking other aspects such as operations, logistics, and technology. Here are some recommendations:

- Use a control tower concept to create end-to-end visibility of inventory
- Enhance demand forecasting accuracy; reduce shrinkage, wastage, and out of stock scenarios; and reduce markdowns
- Continuously finetune inventory levels using advanced analytics
- Collaborate with CPG companies to optimize delivery schedules and locations
- Improve store space usage, extend shelf life, and increase revenue / square feet
- Help improve logistics, last mile challenges for home deliveries
- Enhance back-office efficiency and costs through head count optimization and location advantages
- Improve upstream operations – cold chains, in-bound quality, and speed of delivery through use of data and analytics
- Help innovate faster through best practices, technology interventions, and right-skilling people

Fine-tuning cash flows

While the inventory will always remain the primary focus for managing working capital, we believe that there also exists scope to complement inventory optimization by managing payment terms in a smarter way. Infosys has experience in helping clients do this through the following methods:

- Keeping vendor master data updated and ensuring payment terms as per vendor master are adhered to through reducing expedited, immediate, and early payments. Capturing discounts and ensuring all appropriate cash discount terms are also used
- Reducing the number of payment terms and moving towards a smaller set of optimized payment terms, thereby improving DPO
- Consolidating vendors wherever possible, so that better terms of trade can be obtained. This will also facilitate a lesser number of invoices to be processed and thereby an improved back office. Using e-auctions, and other price discovery mechanisms will also help optimize payment terms and costs. This can also be further enhanced through an aggressive use of spend analytics



Getting the strategy right

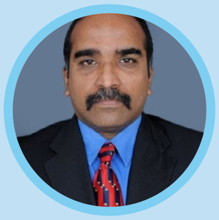
While making relevant strategies to optimize the working capital requirements in the changing business environment, here are key aspects organizations need to relook:

- Understand risks and establish a controlled environment for governance of working capital components
- Enhance monitoring and visibility of key critical components (near real-time intuitive dashboards)
- Leverage AI, ML, Market intelligence and digital technologies for data-driven decision making and to generate operational efficiencies
- Implement efficient vendor payment strategies (EPD) & payment term rationalization
- Minimize inventory cycle by practicing economic order quantity (EOQ) and establishing accurate demand forecasts with respect to cyclical and seasonal fluctuations
- Ensure liquidity is not increased at the cost of organization profitability; make wise investment decisions based on data backed forecasts and predictions

The way ahead

There is little doubt that the response to global tragedies presents retail and grocery chains with cash flow challenges. While the road ahead may be rough and rocky, the journey will be less fraught with peril if these challenges are alleviated by efficient and governed working capital management practices as detailed earlier. While doing this it is important to remain laser focused on maintaining liquidity and efficiently utilizing cash. After all, cash is king, now more than ever.

About the Authors



Ravishankar P

AVP & Business Head, Digital Transformation Services, Infosys BPM

Ravishankar P (Ravi) is globally responsible for driving Digital Transformation across the BPM Operations floors. This includes bringing all transformation levers right from process standardization, implementing process-based organizational structures, and bringing process mining and Lean-Six Sigma, analytics, AI/ML based solutions, and digital solutions like chatbots, portals, etc.

Ravi has been with Infosys BPM since 2005 and has played leadership roles in setting up the KPO business, the Analytics practice, etc. He also has robust experience in running large transformation projects, including the setup of the Income Tax Centralised Processing Centre in 2009.

Ravi is a qualified Chartered Accountant, Cost Accountant from the ICAI and ICWAI by profession, and his 14-year long experience as an Equity Analyst prior to joining Infosys BPM, helps bring a unique ROI-driven perspective to the business value he brings in for clients.

Biswadip Lahiri

Senior Consultant, Infosys BPM

Biswadip is a Senior Consultant with Infosys BPM's Digital Transformation Services and is responsible for finance and accounting digital solution design. He helps clients in their business process and digital transformation journey along with consulting and subject matter expertise across finance processes.

Biswadip is an MBA, Lean and Machine Learning certified with expertise in Finance & Accounting domain, and holds experience in operating model design, finance process and digital consulting, business process reengineering, finance service delivery, project management and technology implementation.

Prior to Infosys, Biswadip had been with Genpact, Capgemini, Accenture, E&Y across a variety of roles with an exposure to work with global stakeholders across geographies (Americas, EMEA & APAC).