Working capital management remains mission-critical for businesses

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Although economic conditions are showing signs of improvement, these are still very challenging times for businesses.

Inflation has fallen significantly from the double-digit highs seen towards the end of last year - but the interest rate increases the Bank of England introduced to bring inflation under control have not yet started to be reversed. The cost of finance therefore remains high, while other costs have increased too such as a 10% rise in the National Living Wage and a 6.7% uplift in business rates that became effective from April.

As a result, margin squeeze is still a reality for many organisations - meaning that a strong focus on cash and liquidity management is essential. Improvements in the working capital position minimise the need for external financing and provide headroom for business activity and growth.

What can we expect in the months ahead?

Inflation has finally hit the Bank of England's 2% target, according to May's data. This is a welcome landmark, but the fact remains that the Monetary Policy Committee has repeatedly signalled it will take a cautious approach to rate reduction to prevent a bounce-back and ensure the 2% target is met sustainably in the medium term.

KPMG economists have forecast interest rates to fall from their present level of 5.25% to 4.25% during 2024, before settling at 3.0% during 2025.

Consumer spotlight: squeezed households present a continuing challenge

If this sounds encouraging, sectors reliant on consumer spending such as retail, consumer goods, casual dining, travel and leisure continue to face into a difficult market. We need to remember that the peak impact of increased interest rates is yet to be seen, with around 3 million households set to see their mortgage payments rise in the next two years, according to the Bank of England - with 400,000 households due to see "very large" rises (50% or more) as fixed rate deals come to an end. This will hit disposable incomes even as economic conditions apparently improve, and will come on top of existing, continuing cost of living pressures.

Recent trading statements from consumer goods and retail businesses indicate that consumer demand has been weakened by the high base rate. As more households move onto higher rate borrowing, there will be continued downward pressure on demand.

What does this mean for businesses?

Looking ahead, we see a challenging mix of factors that every organisation will need to work through individually to fully understand and assess.

On the one hand, the decline in inflation could lead to improved margins as increases to prices become greater than the relative increases in costs. As the rate of change for both variables stabilises, so should gross margins, as suppliers gradually pass costs onto consumers to reflect the true price.

On the other hand, other costs have risen. Labour costs loom large, especially for those businesses that employ significant numbers of lower paid staff. The 10% increase in the National Living Wage means that affected labour intensive businesses will have to find efficiencies and optimise their performance to prevent staff costs eating up margins. Meanwhile, the housing market and related industries are likely going to see decreased levels of activity until interest rates decline and mortgage affordability improves.

Add to this the ongoing geopolitical tensions that stalk many regions of the world, supply chain disruptions, a change of UK government, the looming US election in November - and there are numerous variables that businesses need to navigate.

How KPMG can help

In any period of uncertainty, and particularly in a high interest rate environment, it is important to create financial flexibility to be able to ride out and capitalise on unforeseen events. Optimising your working capital should be a priority. We have seen an increase in focus on this by our clients, whether to support acquisition and growth, to reduce financing costs or to fund technology and AI programmes. And this is a focus not limited to that of the CFO, it spans C-Suites, operations and Boards alike.

Our Cash & Working Capital team works with businesses globally and in the UK to advise on the optimal Receivable, Payables and Inventory processes and release cash tied up on the balance sheet, often the cheapest form of funding. Our rapid diagnostic assessments leverage data analytics, process walkthroughs and external and proprietary benchmarks to identify areas of improvement and quantify the corresponding opportunity. We frequently find a number of ‘quick wins’ that can be rapidly put in place, while longer-term sustainable benefits can be realised in the medium term. Our detailed implementation roadmaps take into consideration all the skills, capabilities and processes needed to realise benefits sustainably.

For more information on how to manage working capital, get in touch with our dedicated specialists.