RIF LOGISTICS Ltd RIF EUROPE B.V. RIF WORLDWIDE Plc RIF FX Ltd

Foreign Exchange and Cash Management

Accounts Payable Metric (DPO)

Days Payable Outstanding (DPO) refers to the average number of days it takes a company to pay back its accounts payable. Therefore, days payable outstanding measures how well a company is managing its accounts payable function. A DPO of 20 means that on average, it takes a company 20 days to pay back its suppliers, similarly a DPO of 5, means that it takes 5 days on average for a company to pay suppliers.

A high DPO is preferable for the company, as it means it takes longer to pay suppliers, therefore the unused cash can be used to fund short term investment activity or diverted to other business areas. Also, if the company has a longer sales cycle than average it can mean cash is not tied up in working capital for longer than necessary.

Whilst a high DPO is typically preferable, and normally indicates that the company will have better credit terms than competitors, this should not occur at the expense of sacrificing supplier relationships.

How can I work out my DPO?

Days Payable Outstanding = (Average Accounts Payable / Cost of Goods Sold) x Number of Days in Accounting Period

RTR Trading import goods from China and are invoiced in USD, a snapshot for this particular part of their accounts payable is as follows:

	30-Mar-19	30-Jun-19
	$	$
Current Liabilities		
Trade Payables	9000	12,000
Cost of Goods	90,000	150,000

$$\text{DPO} = \frac{(9{,}000 + 12{,}000 / 2)}{150000} \times 90$$

DPO = **6.3 days**

Over a 90 day period this company takes 6.3 days to its supplier.

So, the conundrum is what is the best DPO for your business? The answer is not fixed and will vary between industries and will depend heavily on what is financially viable for your business and supply chain, plus the ability of the accounts team to manage payments actively.

FX and International Payments

Importers, particularly SME's may not actively manage their foreign exchange exposure. Time constraints and lack of expertise tend to be main reasons. This however is a risky strategy, considering that if you're an UK company importing goods from China, then you are exposed to GBPUSD volatility which has had a range of nearly 8% in 3 months.

For instance, if you import two containers per month and the cost of goods are $25,000 then your cost of purchasing may be £20,128 (20th Sep 19) or £20,485 (27th Sep 19) depending on when you executed the conversion during a two-week period in September 2019.

Date	Contract Type	CCY Pair	Rate	Selling (GBP)	Buying (USD)
20/09/2019	Spot	GBPUSD	1.2420	£20,128.82	$25,000.00
27/09/2019	Spot	GBPUSD	1.2225	£20,449.90	$25,000.00
			Difference	£321.07	

If the FX risk has not been managed correctly, then when this type of transaction is extrapolated over a 6-12 month period your cost of goods could end up significantly higher (or lower) than you expected. Unless you can pass on these extra costs to your customers then FX risk is an area which should be addressed sooner rather than later to ensure your cashflows are predictable.

This type of volatility is not uncommon for GBPUSD considering the political landscape in both countries the past couple of years and if you're a company operating on tight margins then you cannot risk the possibility your costs could end up 10% higher than budgeted, you need to mitigate the FX risk..

So what can be done?

Foreign Exchange and Days Payable Outstanding – The unlikely marriage

Scenario 1

- RTR Trading imports 2 containers of electronics per month from Shenzhen.
- Payments are required in USD 30 days from Invoice date.
- Cost of goods on average are $25,000 per container.
- Upon invoice they pay the USD within 6 days.

Invoice Date	Contract Type	Currency Pair	Rate	Selling (GBP)	Buying (USD)
27-Sep-19	Spot	GBPUSD	1.2204	40,970.17	$50,000.00

Scenario 2

- RTR Trading imports 2 containers of electronics per month from Shenzhen
- Payments are required in USD 30 days from Invoice date
- Cost of goods on average are $25,000 per container
- Upon invoice they execute a FX Forward to buy $50,000 for 30 days.

Invoice Date	Contract Type	Currency Pair	Rate	Selling	Buying
27-Sep-19	Forward (30 Days)	GBPUSD	1.2225	£40,899.80	$50,000.00

Forward Rate adjustment = £70.37 improvement

By taking full advantage of the credit terms, an additional 24 days, RTR Trading will also improve their liquidity position because they keep hold of their cash for longer.

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Increasing Payables Days = Improvement in Cash & Liquidity

Existing DPO	=	6 Days
Proposal to extend to full term	=	30 days
Days Improvement	=	24 days
Cash & liquidity improvement	=	$\frac{\text{days improvement}}{\text{days in period}}$ x purchases in period
		$\frac{24}{30}$ x 50,000

RTR Trading would improve their cash & liquidity by $40,000

- **Improvement in DPO – Cash remains with company for longer**
- **FX rate achieved may be better than spot if buying forward**
- **FX Hedging – Reducing income volatility and smoother cost of goods across the period**

Balance is the key, as businesses cannot risk souring the relationship with suppliers, equally analysis should be carried out to what extent improvements can be made within the confines of their agreements to aid decision making.

If you would like to understand more about this strategy contact us directly

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