

The state of working capital for  
small and midsize enterprises:

# challenges and opportunities for the global economy

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# Executive Summary

## ***For 2018 ahead, new challenges for small and midsize enterprises (SMEs) accompany economic recovery***

The third annual C2FO Working Capital Outlook Survey reveals a convergence of trends across the globe, bringing a shared set of opportunities and challenges for international small and midsize enterprises (SMEs) as well as their corporate customers. Overall, the need for liquidity increases and funding options are diversifying, allowing SMEs to access working capital outside of traditional cash flow sources, a positive trend that can help reduce supply chain financial risk.

With improved access to funding, barriers such as cost are the primary concern for SMEs, especially those in regions where interest rates are high or rising. Compared to large enterprises, SMEs still suffer from credit availability and cost gaps that inhibit growth. Interest rate spreads for SMEs continue to lag behind their pre-financial crisis levels. This finding underscores the tenet that if funding is not affordable, access does not matter. There is a significant opportunity for corporate customers to support their SME suppliers with lower-cost funding alternatives.

The 2017 survey data was notable for an “uncertainty paradox,” where positive signs of economic recovery, and SMEs’ improved access to funding and potential growth are countered by SMEs reporting uncertainty; both geopolitical and from a lack of confidence in customer relationships. The survey findings highlight other such contradictory trends including delays in payment and challenging payment terms on the rise despite new regulations designed to facilitate prompt payment by large enterprises to their SME suppliers.

The good news, aside from clear signals of economic recovery, is that for every challenge SMEs face, there is an opportunity for corporates to improve supply chain relationships and stability while increasing margin, complying with new regulations, and enhancing cash management strategies.

## ***This year’s survey was expanded to include India and China, as well as more midsize participants***

The survey expanded for 2017, adding businesses in China and India to those previously surveyed in the United States, United Kingdom, France, Germany, and Italy. The expanded set of respondents paints a more nuanced and robust picture of the state of working capital at year end for 2017. The expansion in the survey participants also resulted in larger average company size, as more owners, CFOs, and financial directors of midsize firms engaged in the survey this year.

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## CHALLENGE

# Small & midsize enterprise demand for liquidity is increasing

*From midsize global enterprises to single-owner small businesses, most SMEs surveyed agree that their need for liquidity has increased from last year. Larger SMEs reflected confidence, as well, in their ability to access sufficient cash flow.*

*These trends align with positive indicators for the global economy, denoting better access to funding, improved financial stability for supply chains, and the ability to invest in growth. The optimism should continue, provided the growing demand for liquidity can be met with access to affordable working capital.*

## KEY FINDINGS

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Two-thirds of SMEs indicate an increase in need for liquidity from 2016 to 2017

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Larger SMEs have stronger confidence in access to liquidity than smaller companies, particularly those in regions where interest rates are rising

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India and China reflect the highest demand for liquidity, fueled by their rapidly growing economies

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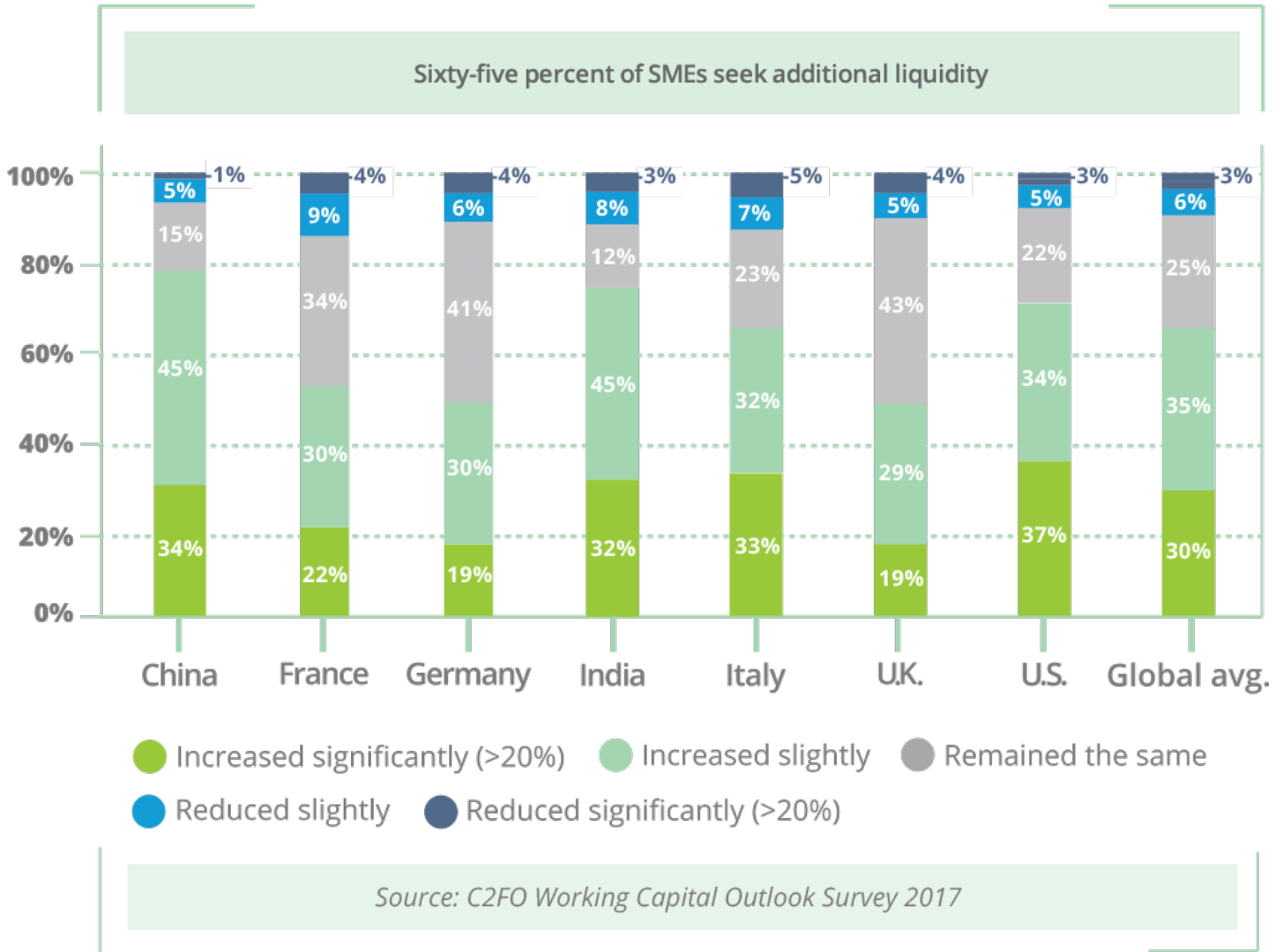
As the economy recovers, SMEs may be entering a new era of high growth; their need for liquidity may outpace access to funding especially as rates increase

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Alternative sources of financing from fintech companies will be critical to meet increasing demand for affordable funding

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## Small & midsize enterprise demand for liquidity is increasing



### Liquidity appetite expands most for larger SMEs

The Working Capital Outlook Survey results for this year reflect economic recovery and anticipated growth when compared to previous years' responses. Overall, SMEs report increased needs for liquidity, with two-thirds noting an increased need for liquidity over 2016. More than one-third of SMEs indicate that their liquidity needs have escalated significantly.

Amid this rise in the need for liquidity, the good news is that most of the larger SMEs surveyed believe they have sufficient access to cash flow to run their businesses. Organizations with 100 to 500 employees expressed very strong confidence that

they had ample liquidity to meet their current operational needs. Whether confidence regarding access to liquidity fully reflects the increasing demand for liquidity is open to question, especially with a global economy that is kicking into full gear and increased access to alternative sources of funding. SMEs in China and India, developing nations that both have rapidly growing economies, indicate a correspondingly high demand for liquidity.

Smaller SMEs, particularly SMEs in the U.S. and U.K., which both face the prospect of rising interest rates, express less confidence in adequate liquidity than larger SMEs in the survey.

## Small & midsize enterprise demand for liquidity is increasing

The C2FO survey revealed these smaller SMEs — specifically those with one to 10 employees — are less confident regarding their access to liquidity than larger businesses. For the smallest companies, cost of capital remains higher, and access to funding is more of a challenge. For example, only 50 percent of Italian SMEs with one to 10 employees believed that they had access to all the cash flow they needed to operate their businesses successfully. In the U.S., 24 percent of the smallest SMEs were not confident in their ability to access sufficient cash flow. For corporates, the findings for these smaller SMEs underscore the presence of more financial risk with smallest, deep-tier suppliers.

### Liquidity for SMEs provides economic stimulus

SMEs, companies with 250 employees or less, represent more than 95 percent of registered firms globally, accounting for more than 50 percent of jobs. SMEs contribute more than 35 percent of Gross Domestic Product (GDP) in many emerging markets, a number that swells to over 50 percent for developed countries.<sup>1</sup> In the top 10 cities of the U.K. alone, SMEs are projected to contribute £241bn to the U.K. economy by 2025. SMEs are the backbone of rapidly growing economies such as China and India which have the largest and second largest number of SMEs in the world. With this kind of scale, SME growth is critical to global economic growth.

With additional liquidity in hand, SMEs are clear on their priorities. In contrast to last year's survey results, SMEs are not as focused on expanding their R&D efforts. Instead, their top priorities for employing additional cash flow include:

- Purchase more inventory or equipment
- Expand operations, such as exporting to new markets or opening new locations
- Create contingency plans to deal with unexpected events
- Invest in employees through hiring, wages and benefits

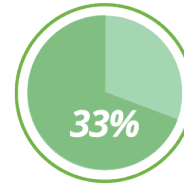
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*Small and medium-sized businesses (SMEs) and entrepreneurs have emerged as a driving force for more inclusive and prosperous societies. Fostering these firms' contributions can ensure that the benefits of growth are shared broadly.*

— Organization for Economic Cooperation and Development<sup>2</sup>

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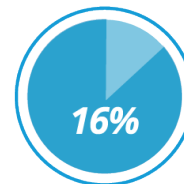
### Spending priority for SMEs with access to liquidity (global average)



**Purchase more inventory and/or equipment**



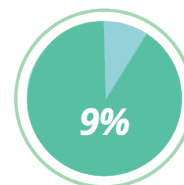
**Expand operations**  
(opening a new location, export to new countries, etc.)



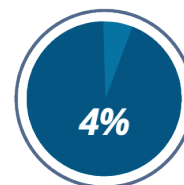
**Meet existing obligations**  
(e.g. payroll, leasing re-payments, supplier invoices)



**Invest in employees**  
(hiring, wages, insurances, etc.)



**Invest in R&D**



**Contingency planning**  
(unexpected flooding, equipment malfunctions, etc.)

Source: C2FO Working Capital Outlook Survey 2017

## Small & midsize enterprise demand for liquidity is increasing

### ***Growing pains: new challenges for SMEs accompany economic recovery***

As the global economy finally takes off after the long recovery from the financial crisis, SMEs may find themselves in waters uncharted for nearly a decade: funding growth as demand for their products and services rises.

Research reveals that SMEs are responsible for as much as half of overall GDP in most countries. As overall GDP rises, the SME contribution to GDP is very likely to expand or grow.<sup>4</sup> SMEs may be entering a new era of high growth, one in which they will need to free up as much cash that is tied up in accounts receivable as possible.

A thriving global economy with rising rates may put SMEs in a tight spot, needing even more liquidity than anticipated, but without the necessary access to the liquidity, they need to fund growth while still meeting increasing customer demand.

According to our survey data, SMEs are relying more on alternative sources of funding than in previous years, which may account for their confidence in their ability to access enough liquidity to successfully run their businesses. As demand for liquidity and growth increase, cost and consistency of funding will increase in importance too.

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***The global upswing in economic activity is strengthening, with global growth projected to rise to 3.6 percent in 2017 and 3.7 percent in 2018.<sup>3</sup>***

– The International Monetary Fund

”

Alternative sources of financing from fintech companies will be critical to provide competitively-priced access that SMEs need for capital requirements and funding growth. Fintech options include dynamic discounting, which provides one of the most affordable sources of liquidity for SMEs through a direct and transparent relationship with their customers instead of financial intermediaries.

Rising rates have already compromised the ability of SMEs in the U.S. and Italy to access the liquidity they require. The U.K. may also be at risk as inflation and rates increase there as well.<sup>5</sup>

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***Small and medium enterprises (SMEs) are the economic backbone of virtually every economy in the world.<sup>2</sup>***

– Ceyla Pazabasioglu-Duz,  
Senior Director, World Bank

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OPPORTUNITY

# Meet increasing demand for liquidity through trade finance innovation

*Fintech alternatives to trade finance, such as C2FO, offer SMEs an affordable source of funding that does not build debt, helps them diversify sources of working capital, and meets their increasing need for liquidity. For corporates, these solutions offer financial stability for all tiers of suppliers and cost reduction.*

## The benefits of trade finance innovation

SMEs	Corporates	The global economy
<ul style="list-style-type: none"><li>• Helps meet increasing cash flow needs and fund potential high growth by unlocking liquidity trapped in invoices that are due</li><li>• Provides a lower cost alternative to factoring and traditional financing, especially with high or rising interest rates in some geographic areas</li><li>• Works as part of a mix of funding options to meet increasing liquidity demands</li></ul>	<ul style="list-style-type: none"><li>• Provides cost reductions</li><li>• Offers SMEs consistent, affordable access to financing to sustain growth, operations, and meet customer demand effectively</li><li>• Protects the smallest SMEs in supply chains which may face a rising cost of capital as the economy grows and need for liquidity increases</li></ul>	<ul style="list-style-type: none"><li>• Unlocks global liquidity trapped in invoices across all SMEs to stimulate shared economic growth and the growth of SMEs</li><li>• Access to liquidity for SMEs offers economic growth by increasing investment in equipment, facilities and employee headcount</li><li>• Meets the increasing need for liquidity for India and China, where there is rapid economic growth</li></ul>



## CHALLENGE

# The cost of borrowing is limiting factor even as funding sources diversify

*Compared to previous survey results, cost — not access — is the limiting factor when it comes to funding for SMEs. Overall, SMEs indicate easier access to capital from both traditional and alternative sources. Among these alternatives, adoption of trade finance offerings is on the rise as SMEs seek alternative and lower cost options, especially for short-term needs.*

## KEY FINDINGS

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Compared to large enterprises, SMEs still suffer from credit availability and cost gaps that inhibit growth

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There is a significant opportunity for corporate customers to support SME suppliers with access to low-cost funding, especially in regions with rising interest rates

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SMEs use of funding sources other than cash flow rose by 40 percent from 2016 to 2017; they increasingly using alternative finance options

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SMEs cited finding competitive financing is their biggest challenge, with 31 percent noting high interest rates, not access, as their barrier

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One in five SMEs still reports difficulty in obtaining a loan from traditional banking partners

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Access to competitive borrowing rates has decreased slightly in the U.S. and significantly in Italy

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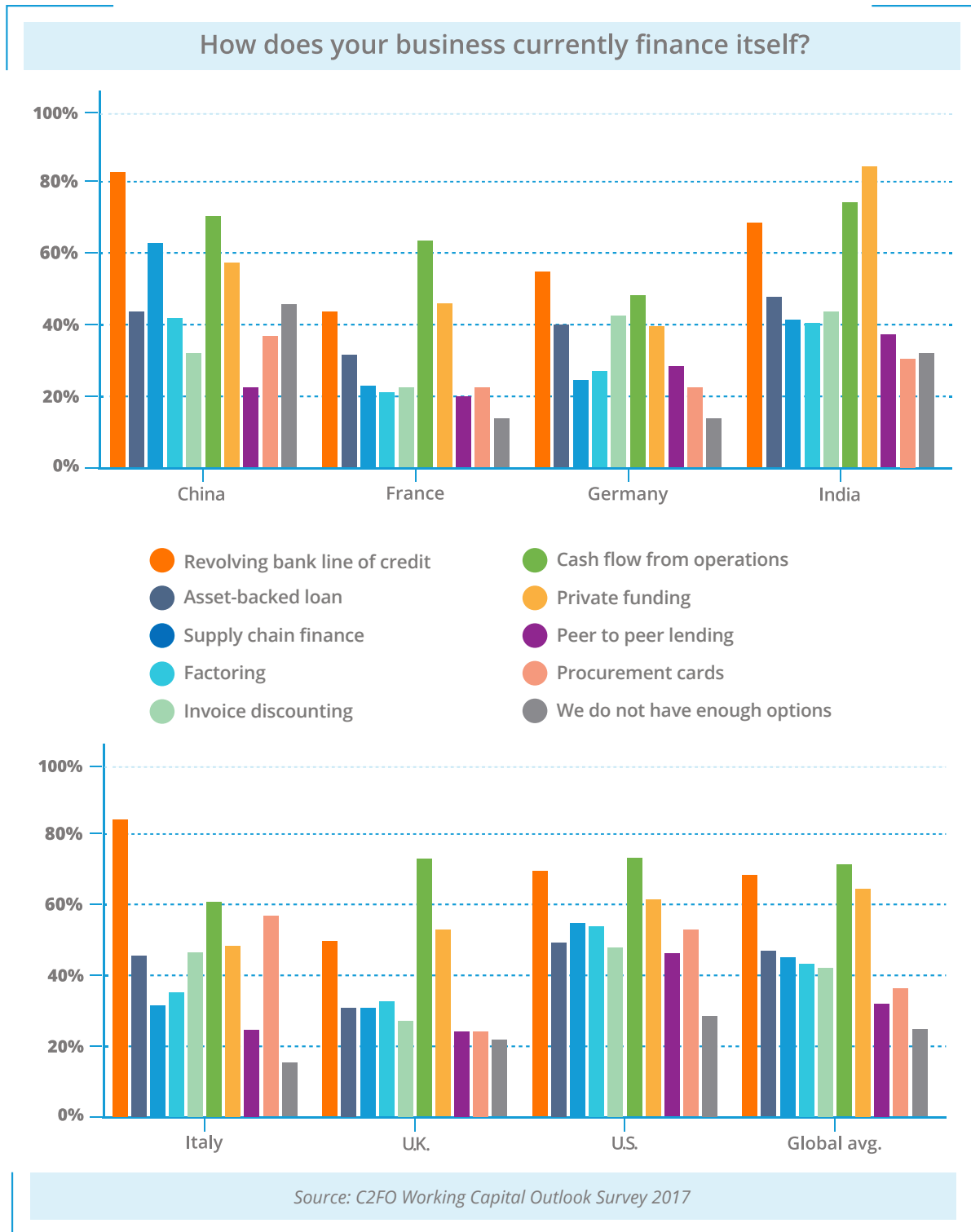
More than 45 percent of those surveyed in India reported short-term rates above 10 percent

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In China, nearly 20 percent of SMEs are paying rates above 10 percent for short-term borrowing

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The cost of borrowing is limiting factor even as funding sources diversify



The cost of borrowing is limiting factor even as funding sources diversify

### **SMEs look beyond cash flow to more diverse sources of funding**

In their search for alternatives to operational cash flow, SMEs diversified their use of financing sources, both traditional and alternative. Compared with last year, use of all funding sources, except operating cash flow, is up at least 40 percent. SMEs are acting on their desire for more cash to bolster their balance sheets, expand operations, or purchase inventory and are paying higher prices for it.

Increasingly, SMEs are financing themselves in a variety of traditional and alternative ways. The biggest changes between 2016 and 2017 occurred in asset-backed lending, supply chain financing, factoring, and invoice discounting, all of which jumped by at least 100 percent over their indicated usage in the year prior. Procurement cards are an addition to the survey this year, which were used heavily by companies in Italy and the U.S. The trend points to potential increases in supplier demand and adoption of trade finance programs as well as a strong desire to get paid faster than stated terms.

The expansion in the types of companies and countries included in the survey likely account for some of this change, as more companies that employed between 50-100 people were included in 2017 over 2016. SMEs also reported a significant change in their usage of traditional bank finance, up nearly 100 percent, which is likely accounted for by the inclusion of larger companies in the survey.

However, the self-reported changes in funding were too widespread and significant to ascribe to these factors alone. As their need for cash accelerates, SMEs are no longer content to confine themselves to organic sources of funds such as increases in operational cash flow. Instead, they are tapping as many sources as possible to grow their businesses and avoid over-reliance on internal funding sources.

### **Cost, not access, limits borrowing especially for emerging markets**

The challenge of finding competitive financing is the biggest one cited by SMEs surveyed, with 31 percent noting high interest rates, not access, as their most significant challenge. One in five SMEs still reports difficulty in obtaining a loan from traditional banking partners, while 16 percent report time-consuming and inflexible processes are a barrier to obtaining financing for their businesses. On a positive note, 18 percent of those surveyed by C2FO do not find it difficult to secure financing for their business.

While the willingness and ability to borrow are important, the rate at which those funds are available is no less important. High rates bring increased interest costs, which drain more cash from a SME over time. In the 2017 C2FO survey, the global average for borrowing rate was between eight to 10 percent, with only 17 percent of SMEs surveyed noting the ability to borrow at that rate.

Global median interest rates are 50%+ higher for loans to SMEs versus enterprises since the financial crisis.

**YEAR RATE SPREAD**

2007 **0.81%**

2008 **0.82%**

2009 **1.21%**

2010 **1.24%**

2011 **1.33%**

2012 **1.50%**

2013 **1.40%**

2014 **1.60%**

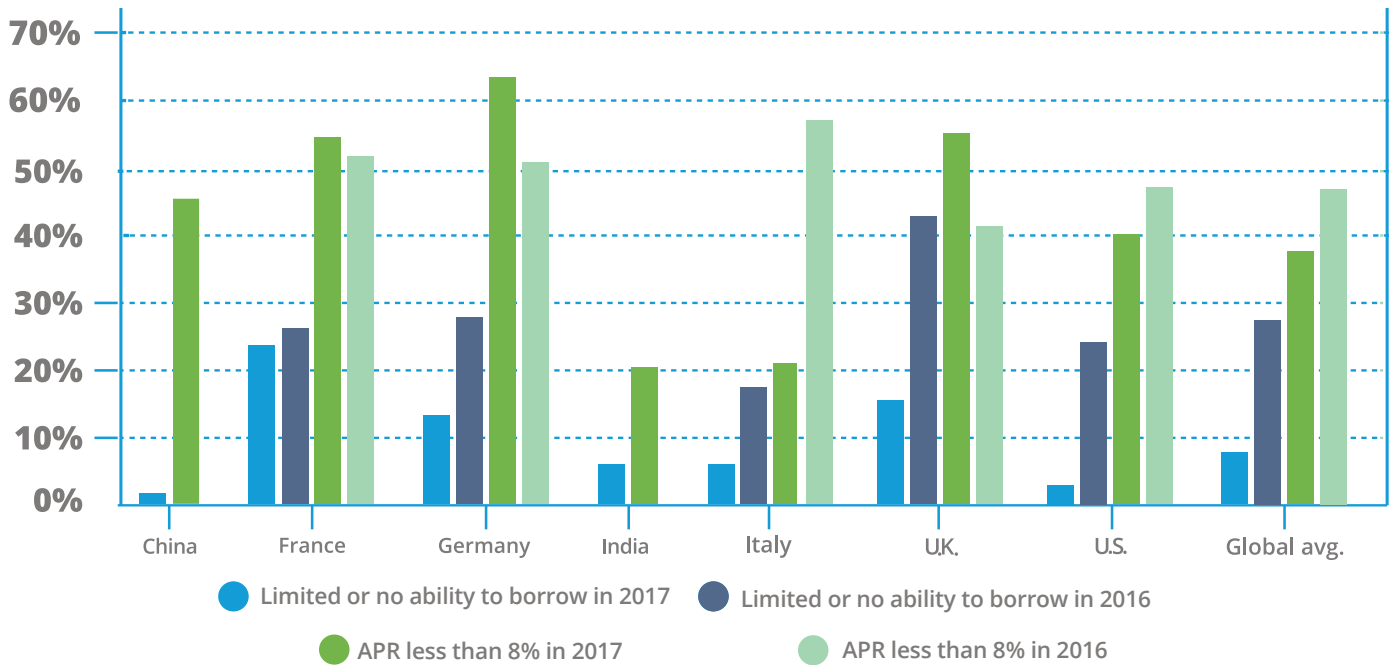
2015\* **1.40%**

\* Most recent data available

Source: Organization for Economic Cooperation and Development<sup>5</sup>

The cost of borrowing is limiting factor even as funding sources diversify

About sixty percent of SMEs globally have either limited or no access to borrowing, or borrow at rates of greater than eight percent APR



Source: C2FO Working Capital Outlook Survey 2017

### Credit cost gap for SMEs remains pronounced

Compared to large enterprises (more than 500 employees), SMEs suffer from a credit availability and cost gap that inhibits growth. While the global economy has recovered from the financial crisis, interest rate spreads continue to lag their pre-financial crisis levels.

### Geographic differences for access to funding and the cost of capital

Compared to 2016, globally, more SMEs reported the ability to borrow. This stems in part from the fact that a higher number of midsize companies participated in this year's survey versus 2016. While access to lending has improved overall, access to borrowing at competitive rates varies depending on geographical location.

Corporates with a multinational supply chain will need to consider these differences when assessing financial risk for suppliers.

Compared to 2016, SMEs in France, Germany, and the U.K. demonstrate an increased ability to borrow capital at less than eight percent. However, the Bank of England increased rates in November 2017 for the first time in 10 years to ward off rising inflation, increasing rates.<sup>6</sup>

Access to competitive borrowing rates has decreased slightly in the U.S. and significantly in Italy. The decline in access in the U.S. is linked to rising rates, which are projected to continue their slow climb under the new Federal Reserve Board Chairman, Jerome Powell.

The cost of borrowing is limiting factor even as funding sources diversify

### Global developing market SME credit snapshot (in billions)

	East Asia & Pacific	Middle East & North Africa	Latin America & the Caribbean	Europe & Central Asia	South Asia	Sub Saharan Africa	Total
<b>Credit Outstanding</b>	\$4,067	\$496	\$671	\$1,631	\$368	\$15	\$7,248
<b>Credit Gap</b>	\$706	\$359	\$620	\$358	\$207	\$132	\$2,382
<b>Total</b>	<b>\$4,774</b>	<b>\$855</b>	<b>\$1,291</b>	<b>\$1,989</b>	<b>\$575</b>	<b>\$146</b>	<b>\$9,630</b>

Source: Global Partnership for Financial Inclusion<sup>7</sup>

It's likely that U.S. SME access to financing may be constrained as rates continue to increase, especially financing through traditional lending sources. Alternative funding, including trade finance options, could provide lower cost funding options, especially for short-term needs.

In emerging markets, SMEs grapple with far higher rates. A prime example is India, where more than 45 percent of those surveyed reported short-term rates above 10 percent, while six percent report limited or no ability to borrow in 2017. In China, only two percent report a limited or no ability to borrow, with nearly 20 percent paying rates above 10 percent for short-term borrowing.

#### **Rising rates in U.S. could affect SME cash flow negatively in several ways:**

- Payments on variable rate financing already in place will automatically increase, as indexes tied to loans tend to increase when baseline rates such as the Federal Funds Rate go up. This means financing gets more expensive immediately, or whenever your loan agreement includes a trigger point
- Rates on virtually all types of new financing, especially traditional sources of financing, will rise along with the Federal Funds Rate
- Real estate will get more expensive, as the costs involved in getting loans necessary to finance the purchase of new facilities will rise

**\$2.1T – \$2.6T**  
**total unmet credit needs for**  
**200 million underfunded**  
**global SMEs<sup>8</sup>**

The cost of borrowing is limiting factor even as funding sources diversify

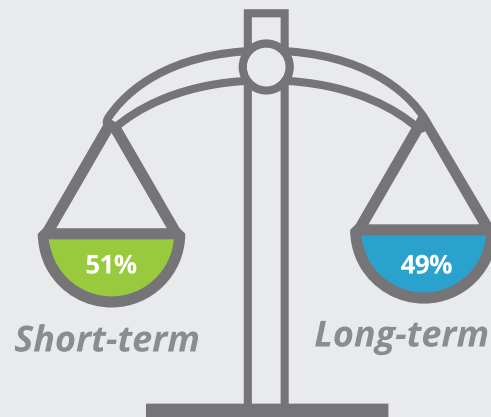
### **Short-term finance concerns grow for most SMEs**

SMEs views on the utility of long versus short-term loans have shifted in the past year. In 2016, SMEs were overwhelmingly concerned with long-term financing over short-term financing. However, in 2017, concerns about long- and short-term financing were nearly equal, a major change from the previous year.

This trend was most marked in the United States, where 57 percent of those surveyed cited concerns about short-term financing. This trend likely stems from the ongoing efforts of the U.S. Federal Reserve to increase short-term rates while paring down its \$4.5 billion balance sheet. Any increase in short-term rates possesses the potential to raise already high rates on SMEs, which tend to receive the least favorable rates in the system.

In part, this concern over short-term financing may explain the increase in SME adoption of funding options including invoice financing, factoring, and trade finance.

**Globally, SMEs are equally concerned with short-term funding for growth as they are long-term**



## OPPORTUNITY

# A “working capital mix” strategy solves finance gaps across entire the supply chain

*Both SMEs and corporates considering trade finance should pivot their strategy toward a working capital mix that offers flexibility and options for SME funding.*

### Working capital mix for SMEs

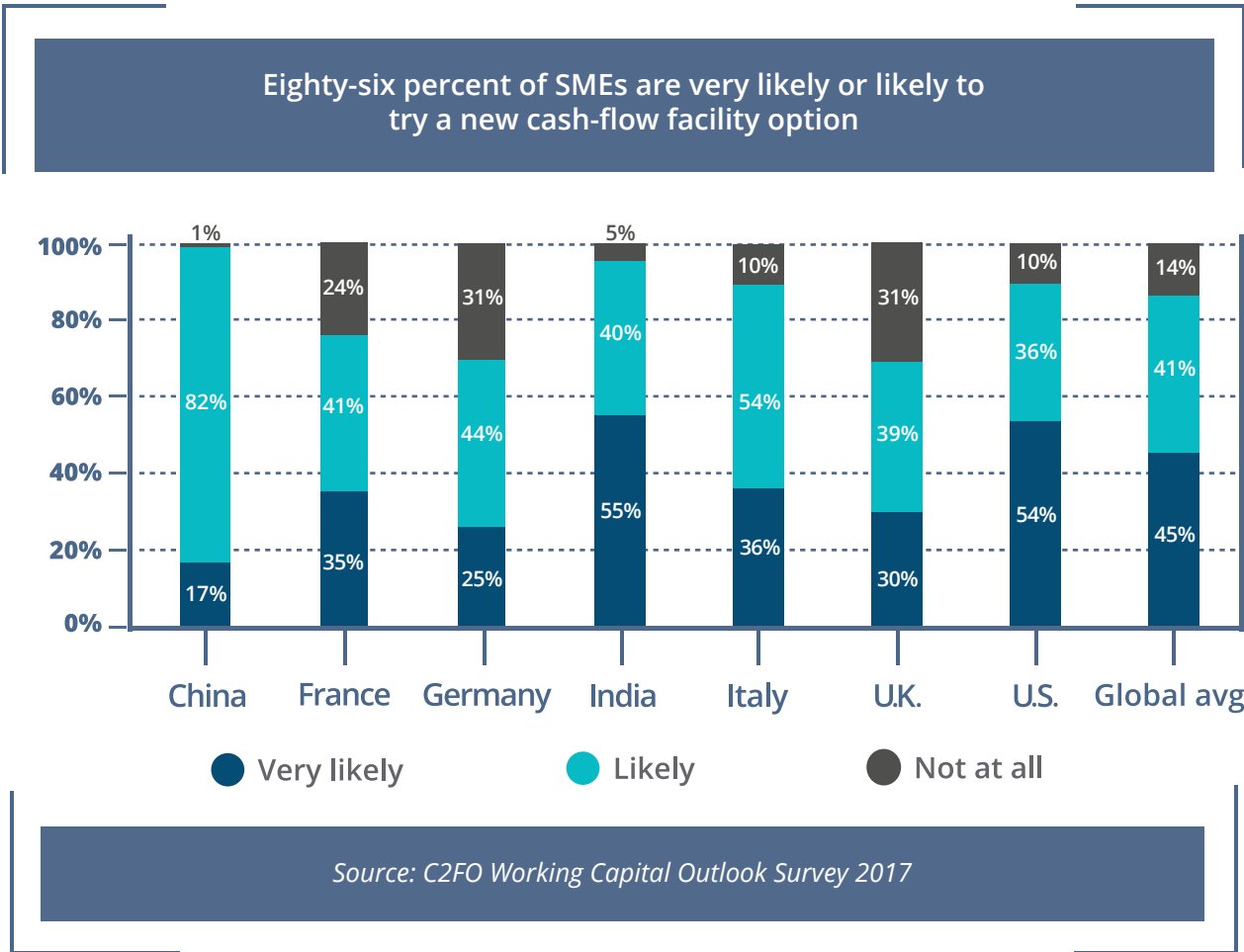
- Alternatives such as trade finance complement traditional funding sources such as a line of credit or asset-backed lending
- Lower cost, short-term capital without fees helps pay down higher cost debt
- Accelerated, on-demand payments on invoices offers control of cash flow and decreases reliance on line of credit
- Provides short-term access to additional working capital during temporary or seasonal peaks without adding to your debt
- Secondary finance option leaves more capacity on your bank line of credit for funding longer-term needs
- Access to trade finance options such as dynamic discounting offers a lower cost alternative to factoring and invoice financing with more flexibility and no fees

### Corporates benefit by offering a mix of trade finance options to suppliers

- Facilitating access to credit at a cost that is in line with or lower than their suppliers' cost of borrowing in exchange for a discount supports SME suppliers who may not have access to supply chain finance programs
- Early payment of approved invoices adds no risk for the buyer and contributes to supply chain health, particularly in support of smallest suppliers with limited or no ability to borrow affordably
- With dynamic discounting, corporates can strategically leverage their supply chains for cash management and gross margin improvements while reducing financial supply chain risk
- Supply chain finance (SCF) and p-cards also support early payment for suppliers and supply chain strength, but do not provide gross margin improvements. Thus, customers' value is limited with SCF and p-cards, as third-party financial providers realize this benefit instead

# The growth of alternative financing

*As alternative lending gains traction, SMEs have more options and flexibility in their funding sources than ever before. The expansion of the alternative lending universe and SME willingness to avail themselves of newer funding types are a virtuous circle that is reinforcing itself, helping alternative financing organizations, SMEs, and their buyers prosper.*



*SMEs in China, India, Italy and the U.S. are the most willing to avail themselves of alternatives such as dynamic discounting or early payment of invoices from a customer.*



## How SMEs choose funding (features ranked in importance)



### 1. Interest rates

Obviously, cost beats all — if alternative sources of funding include rates that are competitive with or better than current funding options, SMEs want to know about them. Because SMEs tend to be disadvantaged when it comes to types and cost of funding, they are open to additional sources of funding that provide increased cash flow and access to capital. Funding sources with competitive rates have an advantage when it comes to securing SME business, as SMEs in all countries surveyed ranked interest rates as the top deciding factor when trying a new source of cash.



### 2. Flexibility and transparency of terms

In an era where business, political, and economic conditions turn on a dime, flexibility and transparency of funding sources are vital. Keeping the cash flowing requires flexibility from funding sources so that SMEs can access capital when and how they need it. Transparency is also important so that they understand all the terms involved and can fit it in with the other funding facilities they have available.



### 3. Amount of available funds

As reported earlier in this survey, SMEs are united in their need for increased liquidity. They prefer funding sources that are in line with their needs today and in the future so that they can grow their businesses without worrying about the impact of economic factors and customer payment terms. Funding sources that can scale with their growth are preferable so that they don't continually have to seek additional funding sources.



### 4. Ease of use

The opportunity cost of time-consuming applications, financial reporting, calls, and meetings involved in securing traditional financing predisposes SMEs towards financing options that are easy to use. Too many SMEs have been burned by spending hours working on loan applications and assembling finance documents only to be turned down for the funding they so desperately need. Providers of financing must do their due diligence. However, this due diligence when aided by technology can be much more convenient and quicker than traditional loan applications.



### 5. Provider trust and reputation

SMEs in China ranked provider trust and reputation slightly higher than ease of use, while SMEs in every other country ranked ease of use higher. Trust is a vital factor in financial transactions. No matter how much an SME needs cash, they don't want to do business with companies or entities that they believe aren't trustworthy. Alternative financing sources wishing to do business with SMEs must do the hard work of establishing themselves as viable funding options and build trust so that when SMEs need funds, they know where to turn. Reputation goes hand in hand with trust, so funding sources should guard their reputations carefully, especially in this era of the 24-hour news cycle and social media.



### 6. Personal connection with provider

This factor ranked last in the survey, but was most important to SMEs in India, the U.K., and the U.S. Personal connections can be powerful when you have them, but SMEs in the C2FO survey demonstrate that other, more objective factors, are far more important.

## How SME funding sources fit with their priorities

### *Traditional lending and legacy trade finance options*



#### Traditional banking

Traditional banking, including revolving bank credit lines and asset-backed loans, tends to be less user-friendly because of long lead times and the headaches involved in assembling documentation. However, banks, savings and loans, and credit unions are usually seen as trusted sources of funding. Rates vary according to SME credit rating and include fees that increase the cost of borrowing.



#### Supply chain financing

Supply chain financing, also known as reverse factoring, involves third parties funding early payment to SMEs on invoices to large corporates in exchange for a fee. The ultimate corporate customer pays the third party when the invoice is due. Funding can scale depending on the SMEs receivables and once a supply chain finance system is set up, SMEs can access it as needed.



#### Procurement cards

Procurement cards allow large corporates to make faster payments to the smallest of their SME suppliers, even those that don't typically accept credit cards. The utility of procurement cards is limited to small suppliers who agree to participate in a specific card network. Procurement cards don't offer any potential for discount income generation, instead they offer an annual rebate to customers.

# 20.7%

*Alternative lending companies share of the U.S. small business market by 2020<sup>10</sup>*

## How SME funding sources fit with their priorities

### *Financing alternatives and fintech trade finance options*



#### Factoring and invoice finance

Factoring and invoice finance occurs when SMEs sell their receivables to a third party at a discount in exchange for immediate cash. Because it scales based on the size of receivables and quality of customers, it is attractive to SMEs with large amounts of account receivables. Factoring is a relatively easy source of funding with a short lead time. Interest rates are less competitive, there are generally fees, and a factoring company may require volume limits and ownership of the customer relationship.



#### Invoice discounting

Invoice discounting transactions, which occur directly between SMEs and their customers via fintech platforms such as C2FO, carry competitive interest rates. This is because suppliers are merely accessing funds they are already owed. The C2FO working capital marketplace is also flexible because the SME can choose which invoices to accelerate, the amount of the discount and the speed of the discounted payment. This allows for a direct, transparent relationship between SMEs and their customers without a financial intermediary.



#### Private funding

Private funding covers a variety of types of transactions, from personal loans from friends and relatives to funding rounds via venture capital and investors. Securing private loans can be time-consuming and rates can be high. Private funding isn't as reliable as other sources of funding for ongoing operations and expansion that SMEs need due to its long lead time.



#### Peer-to-peer lending

Peer-to-peer lending is more suitable for specific, one time projects than ongoing financing needs as most platforms require lending applications for each specific funding request. Funding can be quicker than traditional lending. Rates depend on the SME, their financing needs, and the interested investors.

**Compound annual growth of alternative SME lending**  
Includes: Peer-to-peer lending, Balance sheet lending, Invoice financing

COUNTRY	2013	2014	2015	GROWTH BY %
U.K.	\$0.44B	\$1.59B	\$1.78B	60%
U.S.	\$0.83B	\$2.09B	\$4.83B	80%
China	\$1.47B	\$8.44B	\$41.66B	205%
Canada	\$6.9M	\$15.1M	\$42.6M	83%
LAC Region*	\$11.8M	\$39.9M	\$55.5M	68%
Australia	\$9.9M	\$39.6M	\$232.7M	186%
Asia Pacific Region (excl. China/Australia)	\$80M	\$116.6M	\$360.4M	65%
Europe	\$52.4M	\$127.7M	\$376.8M	93%

*Source: Global Partnership for Financial Inclusion,<sup>11</sup> LAC is Latin America and Caribbean*

## CHALLENGE

# The “uncertainty paradox”

*Past Working Capital Outlook Surveys highlighted a “liquidity paradox,” where corporates held significant cash on their balance sheets while SMEs struggled for access to funding. This year’s survey highlights a different kind of paradox, one of uncertainty in business despite the rise in stock markets across the globe, and economic optimism.*

## KEY FINDINGS

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Despite positive economic signals, SMEs surveyed cited political uncertainty and lack of confidence in customer relationships as the largest potential obstacles to growth

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Difficult relationships between buyers and sellers, difficulty in adapting to market conditions, and inability to secure funding are top concerns for SMEs in China

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For 2017, one-quarter of SMEs report an expansion in the number of customers imposing longer payment terms despite new regulations for the EU

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More than 80 percent of SMEs surveyed indicated a preference for doing business with companies that offer supplier-friendly accelerated payment options, including dynamic discounting

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## The “uncertainty paradox”

### **Beyond geopolitical and economic uncertainty, SMEs concerned over customer relationships**

C2FO’s data reveals that SMEs in every country surveyed except China identify overall economic and political uncertainty as the largest potential growth obstacle. Not far behind is uncertainty regarding customer contracts. While the global economy has stabilized, SMEs relate a lack of confidence in the stability of their relationships with their customers.

Lack of confidence in the economic and political situation fosters uncertainty on the part of businesses. Across the countries that C2FO surveyed, SMEs regard exchange rate volatility as a top concern. Issues close behind include Brexit, economic growth, interest rates, inflation, government policies, wages, and tax reform.

In China, specifically, SMEs note that difficult relationships between buyers and sellers, difficulty in adapting to market conditions, and inability to secure funding are top concerns.

### **Uncertainty and cash stockpiling contradict rise in global markets**

Uncertainty is not conducive to business growth, especially for SMEs. In uncertain times, cash, funding, and access to cash often decline for all but the largest, most stable corporations.

Conversely, stock markets didn’t reflect this lack of confidence. Through mid-November, virtually all developed and emerging markets rose significantly, with emerging markets leading the way. Even the early February market dip reflects the paradox. The decline was not due to crisis, but in part, anticipation of inflation and rising interest rates.

Despite overall optimism, corporate cash hoards continue to increase, with U.S. companies leading the way with an estimated \$3.1 trillion stockpiled overseas.<sup>16</sup>

Stockpiling cash isn’t limited to the United States. While the U.S. dominated the Global Finance 2017 Global Cash 25, a list of the top 25 global public companies holding the most in cash and cash equivalents, 44 percent of the top 25 is

## Top Global Economic Issues of 2017<sup>12 13 14</sup>

- Global interest rate policies
- Trade protectionism and populism
- Stable Chinese growth rates
- U.S. tax, regulatory, and healthcare reform
- Rising terrorism
- Rogue states nuclear weapons development
- Exchange rates
- Productivity slowdown
- Income inequality
- Climate change

## 17.8%+ increase in the MSCI All Country Index through Nov. 16, 2017<sup>17</sup>

- MSCI All Country Index +17.8%
- MSCI Emerging Markets +30.5%
- MSCI EMU +23.7%
- MSCI Japan +18.4%
- MSCI U.K. +9.9%
- MSCI U.S. 15.6%
- MSCI France +23.9%
- MSCI Germany +23.4%
- MSCI Italy +24.6%
- MSCI China +50.5%
- MSCI India +28.6%

*Source: Yardeni Research, percentage change computed in U.S. dollars, MSCI is independent provider of research-driven insights and tools for institutional investors*

## The “uncertainty paradox”

held by companies outside of the United States, according to Global Finance Magazine.<sup>18</sup> Three Japanese companies are on that list.

Several factors may explain this contradiction. Memories of the financial crisis are still fresh, reinforced by global geopolitical and economic uncertainty. In addition, high levels of cash keep credit ratings solid, a situation that corporate treasurers are unwilling to disrupt. The prospect of rising interest rates dampens appetite for spending, as treasurers continue to keep a close eye on debt levels to avoid the potential for borrowing in the future when rates will likely be higher. Finally, executives are reluctant to repatriate cash to spend and expose it to taxation, unless, as for the U.S., there is a tax holiday. Multinational companies need low-risk options to put that cash to work, both in regions where it is held or if the cash is repatriated.

In many regions, interest rates were artificially low during economic recovery. As global fed functions by country start to unwind financial support for economies, borrowing costs will increase. Corporates may now shift strategy to using more of their own cash for investments.

### ***Payment terms, late payments increase despite regulatory pressure***

During the past year, SMEs report an expansion in the number of customers imposing longer payment terms. On average, more than a quarter of SME clients have extended payment terms. In the U.S. and U.K., the number of clients imposing longer payment terms on their SME suppliers doubled in the past year.

Not only have payment terms been extended in ways that negatively impact SME supplier cash flow, but many large corporates are also delaying actual payments. SMEs in the C2FO survey reported that payment delays have increased in Germany, the U.K., and the U.S. However, SME executives in China and Italy report even more significant payment delays than their counterparts in the U.S., U.K., and Germany.

## Top issues SMEs cite as a barrier to growth by region

<b>U.K.</b>	Increase in business taxes and directives
<b>U.S.</b>	Wage or tax reform
<b>Germany</b>	Tax increases
<b>France</b>	Special constraints related to current regulations
<b>Italy</b>	Increased bureaucracy and corporate taxes
<b>India</b>	Business difficulties, including ease of enforcing contracts, paying taxes, paying across borders
<b>China</b>	Production overcapacity

Source: C2FO Working Capital Outlook Survey 2017

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***“Prompt payment can make all the difference to small businesses, boosting their cash flow and allowing them to invest in growth for the future.”<sup>20</sup>***

– Margot James, U.K. Minister for Small Business, Consumers and Corporate Responsibility

”

## The “uncertainty paradox”

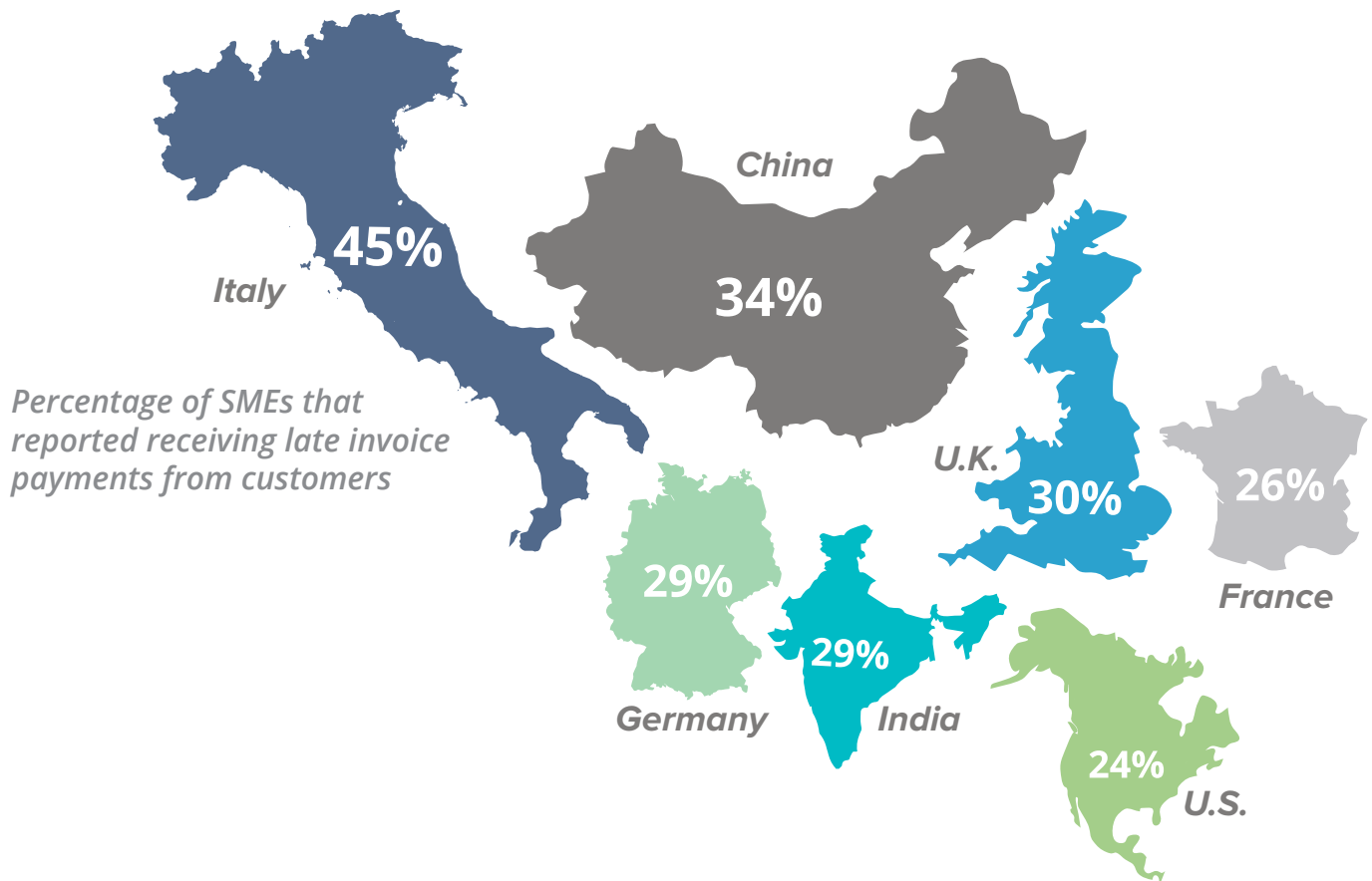
### **Twenty-eight percent of SMEs report that customers often pay their invoices late**

Delay in payments have increased in Germany (29%), U.K. (30%), and in the U.S. (24%). However, China (34%) and Italy (45%) have the latest payments of the countries surveyed.

At the same time, a number of jurisdictions, including the U.K. and the EU, have moved to implement regulations that encourage large corporates to publicly report details on how promptly they pay their SME suppliers. The Prompt Payment Code<sup>19</sup> (PPC), administrated by the Chartered Institute of Credit Management in the U.K., reached more than 2000 companies as signatories, including nearly 75 percent of U.K.'s FTSE100, an index of large British companies.

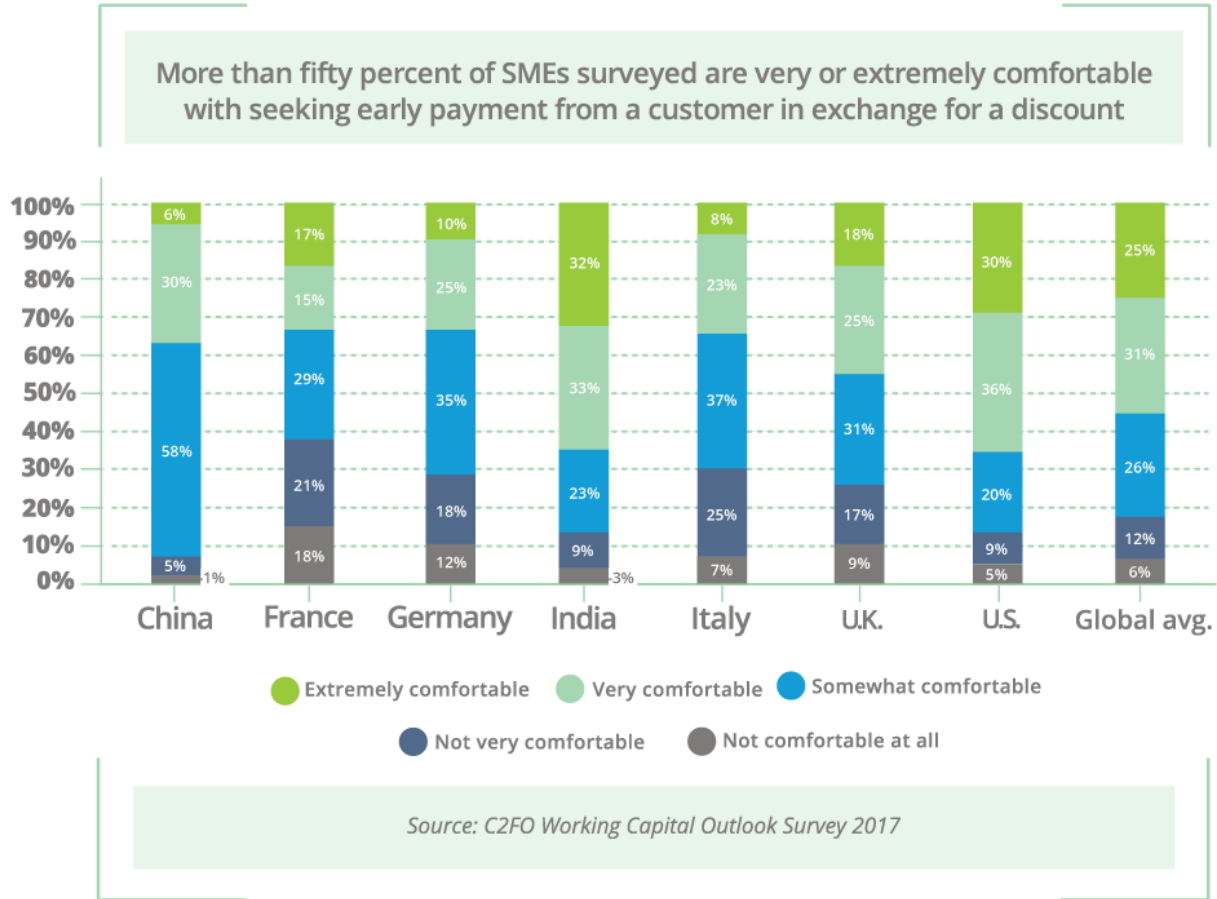
The code acknowledges that late payments and delayed payment terms have become a normalized part of the payments landscape during and since the financial crisis. It is a reality in today's financial landscape that large corporates, eager to maximize and maintain their cash positions, are unlikely to change their payment postures soon. As a result, SMEs are increasingly open to alternative sources of financing.

The PPC and other initiatives, such as those undertaken by the United Kingdom and the European Union, are laudable attempts to advance a solution. In the interim, alternative financing, including C2FO, serves the needs of both SME suppliers and their large corporate customers, cutting to the core of the problem with an answer that meets the requirements of both parties.





## The “uncertainty paradox”



The SME suppliers in the C2FO survey demonstrate increasing openness to such solutions. In fact, 75 percent of those surveyed were at least somewhat comfortable with the concept of asking their large corporate customers for early payment in exchange for a discount.

SMEs, eager to grow their business by accelerating their cash flow, increasingly demonstrate a preference for doing business with companies that are amenable to offering supplier-friendly accelerated payment options. More than 80 percent of SMEs surveyed agreed with the statement that “when deciding which customers to do business with, it is very or extremely important that your customers offer supplier friendly accelerated payment options.” Alternative financing sources that include accelerated payments in return for a discount are increasingly appealing to SMEs.

“We were not forced into this program by [customer] Leggett & Platt,” says Alan Ramsey, financial officer and

co-owner of Embassy Powdered Metals, describing the C2FO dynamic discounting program. “They merely suggested that it was an available tool. I’d recommend C2FO for any company that wants to control its cash,” he adds. “It’s easy to use, easy to understand. It gives me some flexibility in managing our growth, and it takes away some of the risk.”

Large corporates interested in protecting and securing their supply chain gain a demonstrable advantage with their suppliers when adopting innovative payment strategies. Further, as dynamic discounting payment is advanced directly to suppliers from the corporate customer, unlike supply chain finance, this program supports compliance with the Prompt Payment Code and other regulatory efforts such as Duty to Report (DtR) in the U.K.

Supply chain finance and p-cards do not impact the payment date by the corporate customer and payment is made from a third-party finance company, thus neither of these trade finance options support compliance with Duty to Report (DtR).

## OPPORTUNITY

# Technology and working capital management offer options to build better supplier relationships, provide lower-cost and consistent supplier funding, and yield a no-risk return for corporates

*There is no single panacea for uncertainty, particularly the geopolitical volatility that marked 2017. Still, corporates can embrace growing fintech solutions that offer stability for many of these SME concerns as well as reducing short-term investment risk.*

### Reducing uncertainty for SMEs

- Fintech solutions like C2FO and P2P automation have the potential to improve payment terms
- SMEs and their large corporate suppliers mutually benefit from collaborative, innovative payment solutions to alleviate uncertainty around payments, contracts, and market conditions
- SMEs, increasingly comfortable with invoice discounting in exchange for early payment, report improved relationships with customers offering this option
- Dynamic discounting offers suppliers flexible access to affordable working capital in regions where interest rates are high or rising

### Strategic options for corporates

- Improving access to cash ensures that SMEs can grow and invest in their operations without increasing supply chain risk for their customers
- Corporates can earn a no-risk yield on short-term investment
- Multinationals can put funds to work in region where needed or turn repatriated funds into margin with a dynamic discounting program
- Dynamic discounting, with its direct payment to suppliers from corporates, improves payment term reporting for regulatory measures such as the Prompt Payment Code and Duty to Report

# Conclusion

This year's survey participants reflect a broader range of participants from company size to more regions across the globe, specifically India and China. Despite the increased range of perspectives, SMEs overall share many of the same challenges and perspectives including the need for affordable financing from diverse sources. Increasingly, these sources include alternative funding. Globally, SMEs also share concerns over payment terms and customer relationships.

For most of the challenges SMEs indicated in the 2017 survey, there are fintech and strategic options to mitigate supply chain risks, build better supplier relationships, provide lower-cost and consistent supplier funding. These options help offset risks such as pressure to grow in a post-recovery economy, fluctuations in markets, interest rates, regulations, and geopolitical uncertainty.

## **Methodology**

A total of 2,672 CEOs/CFOs/Owners of SMEs in Europe, China, India, and the United States were surveyed during August and September 2017. Annual business revenue ranged in size, some upwards of \$70 million. Company size ranged from one to ten employees to 100-500 employees, with more midsize companies represented in the results than previous years.

Survey participants were asked a series of questions related to how they currently finance their growth, deploy capital and preferences related to working with their buyers, and their economic concerns. The purpose of this survey was to elicit responses that would uncover current perceptions around working capital financing and the impact of political and economic factors on funding, growth, and business relationships.

This is the third year in a row that C2FO has conducted a survey focused on SME working capital needs, providing a comparative look at year-over-year trends. The 2017 survey respondents from Europe include Germany, France, and Italy in addition to businesses in the U.K. For the first time, businesses from India and China participated in the survey.

## **Questions about the 2017 Working Capital Outlook Survey or C2FO?**

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For more C2FO expert commentary, visit [c2fo.com](http://c2fo.com).

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