Euler Hermes report: Capital-constrained companies stretch payment terms to fund business growth

DSO's in South Africa are significantly below the global average

JOHANNESBURG – 16 JULY 2015: The global payments chain is coming under increasing pressure due to the increase in the number of days it takes to be paid for goods and services, and the challenges of economic slowdown in emerging markets and expansion in advanced economies, according to Euler Hermes, the worldwide leader in trade-credit insurance.

The company has analysed the gap between delivering goods and being paid for them, called Days Sales Outstanding (DSO). DSO is a widely recognised leading indicator of the health of firms and potential financial stress on businesses further down the supply chain.

The Euler Hermes research "Payment Behaviour – Who's Paying The Piper" anticipates that the global average DSO in 2015 will remain unchanged at 66 days for the fourth consecutive year, but that there are marked differences between the developed and emerging markets, and across individual sectors and companies.

"The data suggests companies continue to rely on extended credit terms as we see no reduction in payment periods globally," said Ludovic Subran, chief economist, Euler Hermes. "Companies in emerging markets are paid five days later than those in advanced economies, when they used to be paid 10 days ahead of them in 2007. Firms need to take extra care to look for signs of financial stress amongst their customers in the emerging world."

Overall, DSO in emerging markets will increase to 69 days in 2015. Russia, China and Brazil lead this increase in past-dues. In China, typical DSO increased significantly (+22 days between 2007 and 2015). Three main drivers explain this change in the payments behaviour of Chinese firms:

- Chinese companies have been chasing international clients and offering them supplier credit to win new business;
- Chinese firms are suffering from the country's economic slowdown and passing on payment pressures to their own suppliers and clients;
- Intercompany credit has become one of the main alternative sources of finance as access to bank credit and shadow banking has been reduced in the past year.

By contrast, the average DSO in advanced economies is expected to decline slightly to 64 days in 2015, down from 65 days in 2014, as economic recovery means that companies in these markets are once again generating more cash, enabling bills to be paid faster.

With the exception of oil and gas, every sector has been suffering from the rapid DSO increase in emerging markets. This evolution is most striking in technology, industrial goods and automotive, key sectors for these markets. The first two sectors are also showing the highest level of DSO at 91 and 75 days respectively.

The oil and gas exception can be explained by excessive cash accumulation within major firms. This excess liquidity enables oil and gas firms in advanced economies to be more flexible about the payment timing of their clients. This situation is not likely to last in the long run as declining oil prices and the need for new investments raise liquidity constraints.

The Euler Hermes research also finds that Italian companies continue to be paid very slowly, with an average 99 days DSO, 33 days above the global average. Italian DSO further stretches to 148 days in the chemicals sector and to 149 days in the technology sector. By contrast, Chinese and Indian companies are paid in an average 74 and 77 days, respectively, while Dutch companies are paid the quickest with an average 47 days DSO.

B2B activities continue to experience longer DSO on average than B2C businesses, as companies that are directly in contact with the final client are paid much faster than those involved in intercompany credit.

DSO's in South Africa significantly below the global average. In 2015 DSO's expected to slightly increase at 50 days

DSO in South Africa has been clearly below the global DSO average for five years in a row. We explain it by mainly two reasons: South Africa's businesses have experienced strong commercial links with a few Western countries whose DSOs have always been very low such as UK and above all the Netherlands; South Africa posted a fifth consecutive year of decrease in insolvencies last year showing an improved business climate. Greg Nosworthy, Euler Hermes South Africa Country Manager, said: "We expect the South African DSO as a whole to bounce back by 2 days at 50 days in 2015, especially due to the softening declining trend of South Africa's insolvencies as a whole and from the fact that some sectors already started registering a rebound in insolvencies, like the mining industry."