Informita

10 things to do if you are running out of cash **March 2020**

Running out of cash: It's a one time thing

It has long been known that running out of cash is something that a company will only ever do once. The impact of COVID-19 has exposed the weakness of many corporates who have over-extended their balance sheets and are now busily retrenching to survive. For example, the US airline industry has spent billions in share buy-backs in the last decade. Now they are looking for a bail-out. If you are at this point of crisis, you have missed the opportunity to create a stable business structure that supports working capital. That will have to come some time later. So what are the things that you may need to do to survive the impasse?

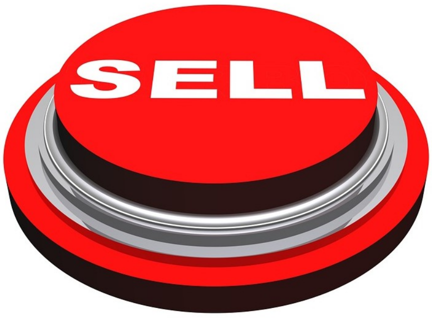
1: Model the worst case scenario

Many companies have never seriously stress-tested their balance sheet. If you haven't done so, now is the time to start. Some industries are expecting to be hit very hard in the coming six months. For example, international airline companies expect up to 80% drops in revenues in the coming weeks and no one is quite sure how long the contraction in trade will last. In other industries the hit is less likely to be as severe, but it is unlikely that no-one will be affected. So it is time to run your stress test model running the worst case scenario for your revenues and the subsequent impact on your balance sheet. Now, you will have some sense of whether there is a problem brewing where you will be short of funding.

2: Talk to your lenders

Many companies are afraid to talk to their lenders when they first get a sense that trouble is brewing. This is a big mistake. The earlier you talk to your lenders, the more they will be able or likely to help. In the current scenario, there is going to be a growing queue of companies talking to their lenders about distress, so it is better to be at the head of the queue. Lenders do not want to lose their shirts either, so they will appreciate the fact that you are approaching them at an early stage. That will give them an increased level of confidence in the ability of the corporate management team to weather the storm. This will help them to decide favourably about extending payment dates or providing additional liquidity.

3: Sell something

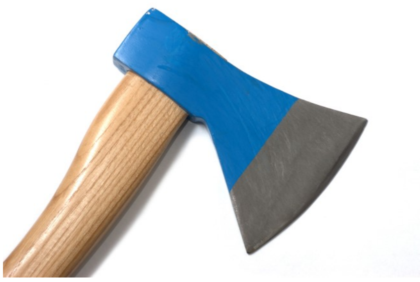


One of the quickest ways to generate a large amount of cash quickly is to sell a business. This will only be a useful option assuming that you have something that someone wants to buy and that the transaction can be done in a short timescale. You will probably need to sell to an already known suitor and expect to sell at a bargain price. It is important to have a realistic expectation of how much cash will be generated and how quickly the cash will be available to support liquidity. If you are in an industry where there may be competition concerns about any business sale, it is advisable to be in contact with the relevant regulators at the earliest possible stage so that any agreed sale will not be blocked in the closing stages of the transaction.

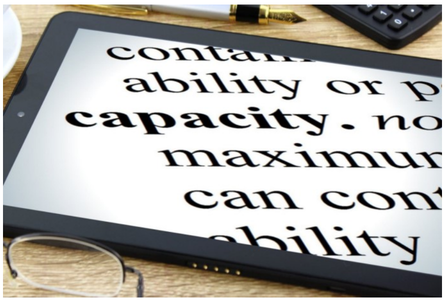
4: Reduce Operating Costs

In situations where customer demand has dropped very quickly it is imperative to reduce operating costs as quickly as possible. Get rid of all costs that can be cut in the short term that are not focused on conserving cash. Examples would be overtime bans, travel bans, working remotely and banning consulting spend. Some might consider that some of these short term cost reductions may end up being counter-productive. That may turn out to be true, but when survival is the priority, then everything else must take a back seat.

5: Slash capital spending



It is vital that capital spending of all kinds be curtailed. It doesn't matter how precious or how strategically correct the capital project might be, it must be stopped or at least postponed. This may mean that there are penalty clauses to be paid for. This needs to be balanced against the value of cash conserved in the short term. Often penalty clauses might be avoided if the project is delayed rather than abandoned. These are things to be considered. Also, all leases should be reviewed to see if termination can save on short term expenditure. This will definitely have to be balanced against termination payments, but should still be considered.



6: Reduce short term capacity

If customer demand has dropped, manufacturing capacity must be reduced as quickly as possible. There is always a time lag between the customer demand dropping and the signal being received by the manufacturer. Back in October 2008 many manufacturers supplying to the automobile industry saw demand drop by 30% in one month. The short term solutions were to temporarily close plants and that also allowed excess inventories to be run down.

7: Talk to your suppliers about payments

Many businesses that are in trouble end up paying suppliers late or not paying suppliers at all without any warning. This is a huge mistake on the part of management. If this happens, key suppliers will halt the fulfilment of orders and that may be the end of the business. It is much better to speak to key suppliers when it is clear that there is likely to be a problem rather than waiting for the worst to happen. This is a common practice in the aerospace industry where the cost of resourcing parts is very high. Therefore suppliers are more prepared to support the supply chain for a while rather than incur these additional costs and the disruption to their highly integrated supply chains.

8: Talk to your customers about receivables

Equally, you should be talking to your key customers. They may agree to pay invoices early for a period of time in order to support your company through this choppy period. In many cases it will be expensive for the customer to resource product in the short term. This can be particularly true for retailers. There is an old saying in retail that if it isn't on the shelf, then it is not for sale. So if they do not have your product then there is no sale for them to make to the consumer.

9: Talk to the taxman about payment deferrals

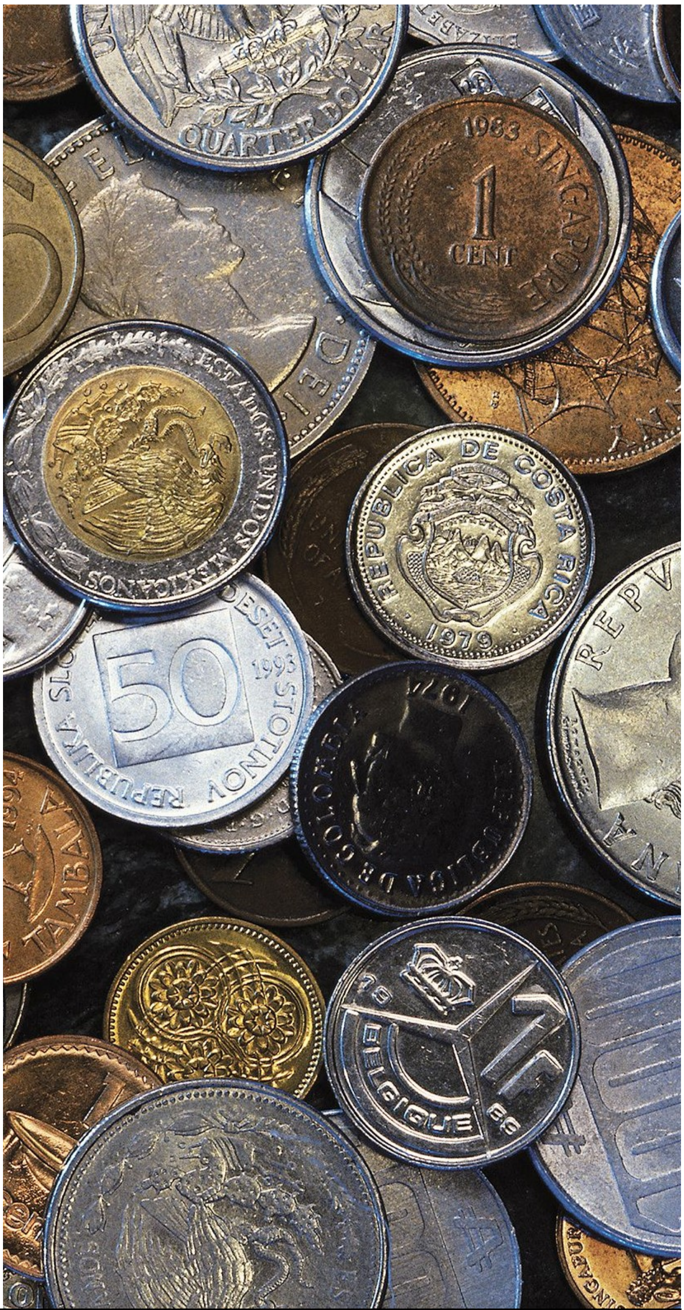
The taxman never likes it when they don't get paid. If you believe that paying your taxes is going to be a problem, it is always best to tell the taxman as soon as possible. That makes it more likely that they may agree to a deferral of tax payments. But it is important to act quickly. A recent example in the UK is Flybe. They ended up getting a tax deferral at the last minute, but it proved to be far too late to save the business.

10: Time to fold

If you have gone through all the steps above and you still are short of cash, it will be time to call in the insolvency experts. They might be able to save something of the company and protect at least some of those employed by the company. Again it is important to act quickly. Sadly this is rarely true. It is the difference between a business that can be rescued versus a business that will be liquidated.

Conclusion: All this could have been avoided

For too many companies working capital is a problem they deal with when cash suddenly becomes a problem. Dealing with the issue in that way may mean the end for some companies, but it doesn't have to be that way. Companies that manage working capital well manage most things in their business well. But the contrary is not necessarily so. In practice, that will mean that you need to consider working capital management as a core business strategy.



Agree to competitive terms with your customers and then get paid on time. Agree to competitive terms with your suppliers and then pay them on time. Understand how your trading pattern influences the amount of inventory you hold. Employ best practices in the management of receivables, payables and inventories. Incentivise non-financial managers to manage working capital well. These are all parts of having a business with a true cash culture. With all these elements in place, you give your company a much better opportunity to weather the storms that will inevitably occur and gain a competitive advantage over those who did not take these prudent steps.

The former chairman of what was British Aerospace, Sir Roland Smith, said that "you can only run out of cash once" back in the 1980s. It is a great pity that many have failed to take notice of this solid advice. Ultimately, the weakness of a company is not defined by a lack of profitability but by a lack of balance sheet strength. Companies go to the wall because they run out of cash, not because there was red ink on the P&L. But working capital is not just about having a defensive strategy. It has been shown many times over that great names have fallen from great heights because of reduced cash flows. The best recent example is GE, who have fallen out of the DOW 30 because they got stuck in businesses that bled cash. But cash is also binary. You either have cash or you do not. Back in 2001, Enron was still reporting huge profits. But they were false and it was the cash balance that caught them out in the end. In the end, it will always be true that revenue is vanity, profit is sanity and cash is reality.

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Website: www.informita.com

Twitter/Facebook: @informita

Email: info@informita.com
Phone: +351-911556662