Cash and profit management during a downturn

Part 2 of 6

Are we doing all that we should for short-term operational sustainment?

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Headwinds

Profitability and more importantly cashflow routinely face several challenges, which become acute and critical for business sustainment during an economic downturn. This downturn may be market induced, due to an act of nature or more recently a viral pandemic. Ultimately it results in sales and sales productivity declines, layoffs, a significant supply disruption and increasing raw material costs.

For a successful turnaround or recovery a relentless focus on cash management is the main short-term priority. Essentially, this brings business back to its basics for success.

Simply said, is the business generating cash or burning it? More specifically, which investments, assets, and resources are generating or burning cash? Many businesses then rapidly start to look at their cash conversion cycle, implementing a net working capital excellence initiative.

Figure 1: Typical business phases during a downturn

Reduce lead-times and processing

Reduce non-critical expenditures

Segment & rationalize products & services

Improve receivables and collections

Cash management top activities

Improving working capital invariably requires enterprise-level, cross-functional alignment and cooperation, often difficult to achieve especially when functional incentives are misaligned. As an example, the need for new assets to capitalize on an area of growth would require significant capital outlays, however, operational leases may provide a lower overall cash outlay and easier budgeting for future expenditures. All value chain risks as well as all direct and indirect costs must be assessed and then prioritized for rapid cash release opportunities, including capital spending, operating costs and overhead.

Due to external factors there is often an increased delay in receivables. Compounding the problem, the typically complex internal delivery process from sales to invoicing artificially extends the order to cash cycle. Many companies move quickly to extend payment terms to suppliers without thoroughly assessing risk, reducing the non-sales generating expenses, focusing on variable costs and closely managing their working capital related to the needs for equipment or major capital repairs.

Another area of impact on cash many organizations consider is to explore the option for rebalancing the supply chain in order to optimize costs or alternative suppliers; evaluating margins by product and by customer to rationalize key products and or services for the reduction of negative profit segments.

Below are 10 recommended short-term operational actions to take which will address the cash challenges, based on past work with many clients who successfully overcame their financial struggles in similar situations.

Improving cash inflow:

1. Conduct customer credit checks and offer early payment incentives to improve the cash cycle
2. Improve internal cycle times related to the delivery and invoicing process
3. Focus on receivables collection and leverage electronic invoicing when possible
4. Build a buffer of cash reserves, typically 6-12 months of operating expenses

Improving cash outflow:

5. Permit only revenue generating expenses
6. Negotiate more favorable credit terms with lenders
7. Renegotiate and adjust the payment model and extend payment terms with key suppliers
8. Expand leasing of assets over purchases
9. Improve forecasting, planning and the inventory cycle (faster goods-to-sale)
10. Adjust the sales model, moving inventory and increasing pricing flexibility where feasible

In some asset intensive industries, like Oil and Gas as an example, there are additional levers for cash preservation and generation. Some other areas to consider include asset sales, the mothballing of key assets to reduce insurance and depreciation or selling participation in some projects through joint ventures.

Profit management top improvement activities

Similarly, many organizations employ a vast number of short-term activities to improve their overall profit margin. The most common actions include:

Improving operating costs:

1. *COGS - materials:* aggregate spending and negotiate rates with suppliers
2. *COGS – labor:* organizational rightsizing, shift restructuring/ overhead reduction
3. *COGS – maintenance:* defer non-essential repairs / servicing; rationalize the contractor base
4. *COGS – operating efficiencies:* increase process yield and reduce processing time
5. *COGS – logistics and distribution:* optimize the network, transportation, distribution costs
6. *COGS – inventory:* improve demand planning and scheduling, including inventory reductions
7. *SG&A costs:* Rebalance the sales function, including rationalizing customers and products
8. *R&D spend:* Defer non-essential programs and temporality reallocate/ redeploy resources

(COGS: cost of goods sold; SG&A: sales, general and administrative costs; R&D: research and development costs)

Improving non-operating costs:

9. *Interest expenses:* negotiate for more favorable credit terms with lenders
10. *Overhead:* Reduce overhead via organizational layer 'flattening' and tactical consolidations

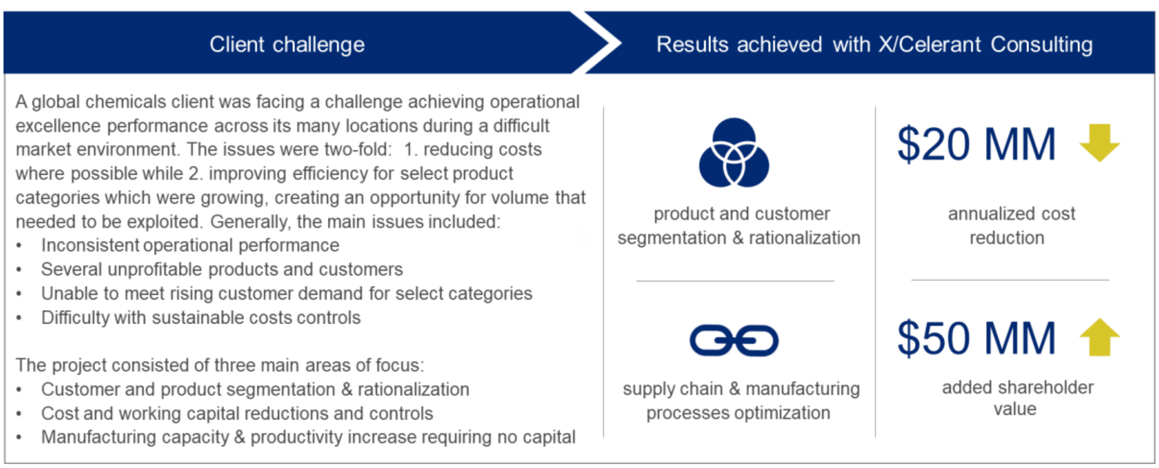

Figure 2: An example outcome of results, from a prior client engagement.

We have helped many clients over the past 30 years with rapid cash release and operational improvement, progressing through their business cycles from insolvency to overcapacity and sold-out demand. If you have questions or would like to discuss the approach and elements of this framework, feel free to reach out using the contact information below.

About the authors

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