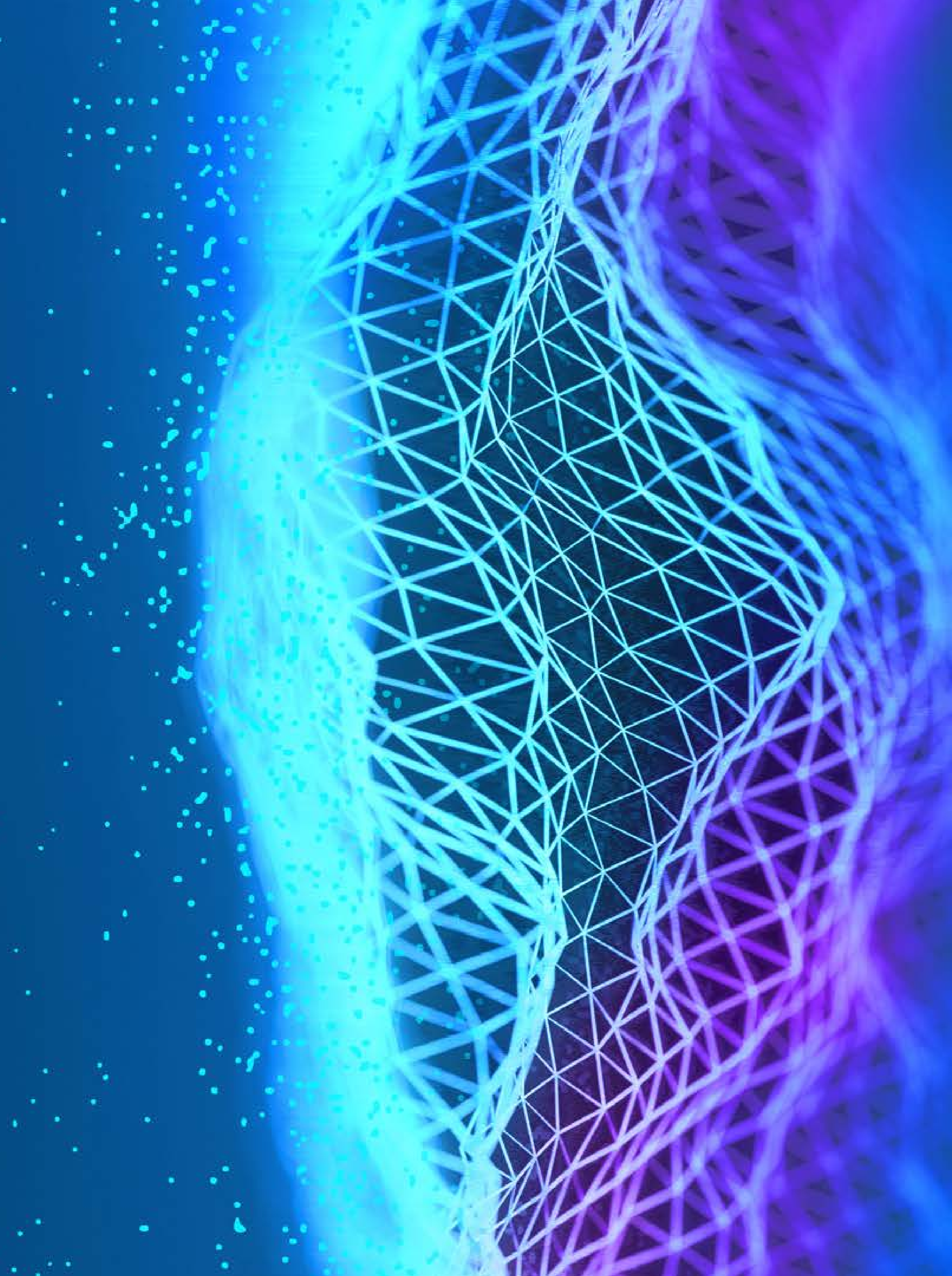
KPMG

Managing cash in the ‘New Reality’ economy



COVID-19 has placed huge operational and financial pressures on businesses. Many have been supported by government schemes and legislative changes, such as the Job Retention Scheme (JRS) and rent moratoriums, which have reduced cash burn rates during the acute phase of the crisis. While some of the support programmes require funds to be repaid in the medium and longer terms - such as HMRC VAT deferrals and Coronavirus Business Interruption Loan Scheme/ Coronavirus Large Business Interruption Loan Scheme (CBILS/CLBILS) - many of the temporary measures are coming to an end. This means that cash flow and cash management have the potential to become even-greater challenges.

Businesses are starting to understand and analyse the long-term impact on revenue streams and operations and realise they need to re-focus and adapt. This often requires cash to help finance the changes, such as rightsizing workforces or closing/moving operations. Knowing how much cash you have and when there may be a problem in the future, helps to focus management attention on improving controls and taking mitigating action to improve liquidity. Lenders are also increasingly keen to ensure that cash is being controlled effectively before providing additional funding.

With our help and support, clients regularly achieve cash benefits of up to 5% of their annual turnover, releasing trapped cash and improving business performance. And it's not just for organisations that are stressed or distressed. Stable businesses can also benefit from freeing up cash, as there are still plenty of market opportunities around if they have funds available to feed and accelerate their growth ambitions. Our deep sector experience - across the likes of retail, consumer, industrials, healthcare and services – along with our global reach, means we know what best looks like.

We asked our cash flow and working capital experts for some practical considerations and guidance to help businesses manage their cash, as they build recovery and growth plans.

Their advice and insight focus on 4 important areas:

1 **Common assumptions and pitfalls**

2 **Where to start**

3 **Making changes**

4 **Sustaining the gain**

> Most businesses have never experienced such acute cashflow pressures and often haven't got the capacity to deal with them effectively.

Mark Raddan, Advisory Partner, Restructuring

Common assumptions and pitfalls

Controls and governance structures around cash may be limited and a focus on working capital may not have been a priority in the past. There may also be a general lack of understanding of how increased product range and complexity can tie up working capital and the impact of not enforcing trading terms.

It's an issue for smaller owner-managed businesses and large corporates alike. While the level of complexity may vary, the challenges and principles underpinning potential solutions are very similar. Neither should be complacent in thinking robust cash forecasting and management does not apply to them.

Management often think they have it covered in the cash forecast they create as part of their monthly P&L and month end reporting activities. However, these indirect forecasts are often not 'fit-for-purpose' with insufficient day-to-day detail to identify issues ahead. Where businesses do create short-term receipts & payments cash forecasting (a direct cashflow forecast) it needs to be regularly validated against actual performance. Learning from errors and inaccuracies is a critical part of the cash forecasting feedback loop.

Businesses can rush to make kneejerk 'crisis' changes that only have a short-term impact. Avoiding a pinch point at month end, for example, might simply delay the issue for a few weeks. It may be necessary in some cases, but for others it could exacerbate the situation and have a long-term detrimental impact on the business as it looks to recover.

Even businesses that are relatively comfortable from a cash perspective may be impacted by the actions of a key supplier or customer. If either were to change their own cash practices, such as payment terms for example, or enter insolvency proceedings, other businesses with significant exposure may be left unexpectedly vulnerable. Building headroom and balance sheet resilience is a prudent step to take, even if the immediate outlook appears relatively comfortable.

Where to start

Make cash forecasting a priority. It's often a secondary exercise, undertaken on an irregular or incomplete basis and providing insufficient granularity. We suggest all clients build a rolling 13 or 17 week short term cash flow forecast, that reconciles both to the opening balance sheet position and cash at bank. This will help businesses to spot upcoming pinch points and identify areas of cash leakage.

Sensitise your forecasts. Run various scenarios to predict and understand outcomes, for example how might cash be impacted by a further national lockdown or change in consumer behaviour? This should also reconcile to longer-term cash forecasts produced as part of strategic planning and forecasting exercises. These should be refreshed on a regular basis, because current circumstances are changing so rapidly, and used to build a long-term view.

Keep monitoring your customer and supplier behaviours. Have these changed during lockdown to create a different working capital profile? Take a long look at your stock profiles including levels, mix and safety stocks. Changing customer and supplier circumstances may result in higher or lower inventory levels being required as part of your day-to-day operations.

Review all cash movements in and out of a business. Can these be influenced or changed to your advantage? For example, agreeing with your landlord to pay rent monthly, rather than quarterly, is one way of reducing a major cash pinch point.

> "Getting a handle on your current day-to-day cash position is the critical first step."

Jane Hurst, Advisory Partner, Restructuring

> There is rarely a silver bullet to addressing cash issues – it's often about incremental changes and identifying a series of marginal gains.

Kenny McKay, Advisory Partner, Restructuring

Making changes

Managing cash effectively is about understanding the cash value of time and that small changes can have surprisingly significant impact when implemented at scale. As an example, if a business turns over £100m a year and it were possible to reduce customer payment terms by just a week, nearly £2m of working capital benefit could be achieved.

Change must be led from the top and be engrained within the DNA and culture of the business. In good times management focus on revenue and profit growth. When life is more challenging, the business needs to be run for cash and liquidity to ensure survival.

It's important to understand the timing difference of implementing certain measures. Some quick wins can be implemented relatively easily – for example, paying suppliers when the invoice is due rather than ahead of time. Others, such as reducing product lines and rationalising SKUs to release working capital held in slow-moving stock, will require more detailed analysis, factoring in product margins, customer requirements and wider business review.

Sustaining the gain

Sustaining long-term cash management is often the hardest issue for businesses to overcome. If actions were undertaken as a manual or 'one-off' exercise, the benefits are likely to be short-lived and might create unanticipated side effects. For example, delaying payments beyond agreed terms could damage supplier relationships or decrease your negotiating position during pricing conversations, removing SKUs may result in a loss of custom.

Implement effective control systems that support a wholesale change in the approach to cash management. Businesses need to embed these controls in new processes and make people accountable for delivering and sustaining the benefits - one option could be to link remuneration packages with cash and working capital targets. The objective is to have clear and continuous visibility of the cash and working capital position, with clear unambiguous performance metrics to aid performance.

Building a working capital dashboard is a key part of sustainability. Managing working capital shouldn't be relegated to a line in month end MI reports, because by then it can be too late to mitigate unanticipated issues.

Many finance systems will now provide outputs to show your current working capital position in real time.

Effective cash transparency and reporting is paramount. A robust short-term cash flow forecast (at least 13 weeks) on a receipts and payments basis must be in place, as well as tracking of other operational KPIs.

"When it comes to cash management, COVID-19 has been a catalyst for change for many businesses. The big question is how to restore cash balances and make lasting performance improvements."

Lee Swinerd, Managing Director, Restructuring

How we can help

Whether it's workshops for smaller organisations or deploying our tech applications for more sophisticated corporate set-ups, we can help businesses:

- Get to grips with their cashflow and understand liquidity drivers
- Quickly uncover their working capital opportunity and support it with granular evidence
- Build a robust forecast to underpin decision-making
- Identify a range of measures to preserve or generate cash
- Analyse the potential impact of any changes
- Foster stakeholder buy-in
- Devise processes, controls and metrics that drive accountability
- Implement cash performance improvements in a fast and sustainable way

Contact us

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