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Top Priorities for **FINANCIAL SERVICES FIRMS** in 2023

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The Rise of BANKING *on* PURPOSE

CASH MANAGEMENT DURING BUSINESS TURNAROUND

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Alan Tilley, Chairman at BM&T European Restructuring Solutions, delves into the importance of cash flow management during a period of decline.

Businesses are in a state of constant flux. They are either moving forward or in decline. When a business is in decline, there are opportunities to turn things around at various stages of the decline curve. Taking action early can be done while funds are still available. Left too late, the turnaround must be done under liquidity and creditor pressure in the "zone of insolvency," where a liquidity event could trigger the need to file for insolvency protection. In most jurisdictions, this is a statutory obligation, usually defined as the inability to make payments as they fall due in the normal course of business. Although this may be a clear legal definition, in practice there can be some flexibility in this definition, particularly where a viable business exists and processes are in place to stabilise and rectify the adverse cash flow.

A well-managed turnaround is in the best interest of all stakeholders. However, priority must be given to ensuring that creditors are not put in a worse position than they would be in an insolvency. It is therefore imperative that cash collateral is not impaired during the process. To achieve this, a robust and effective cash flow management system is required.

The most effective tool for cash flow management is a 13-week cash flow model with sufficient detail to highlight the important receipts and payments. The model should build in critical payments and significant cash receipts, showing a weekly cash receipts total and a cash payments total, along with a net cash generation or deficit and a closing cash balance compared to funding facilities and a closing headroom. This should be positive across the period if insolvency is to be avoided. The report should be finalised before business closure at the week's end, and variations of actual to forecast challenged, with people held responsible for shortfalls in performance. A revised forecast should be issued with achievable objectives; no moving goalposts! Peaks and troughs should be levelled out by realistic management of creditor expectations. All senior management should be aware of their responsibilities. They should know that they are part of the turnaround process, that they have obligations to a changing level of stakeholders, and that for them, it is not "business as usual."

Most turnaround managers would focus early attention by taking management control of the cash forecasting and cash management process. Cash control is the number one priority at the initial stage of an engagement. Only when the cash burn is stopped, cash flow is stabilised, and accurate forecasting is in place, can essential decisions on business viability and operational improvements be made. Controlling payments is an obvious first step, but some payments are critical, such as payroll and essential services like telephone and utilities, which usually cannot be delayed. There will also be pressing creditors for critical goods in the production process that will need careful management. The calming presence or intervention of a turnaround manager will often help achieve an acceptable payment approach to what had probably already become a fractious relationship. These payments must be factored in as priorities in the cash forecasts and adhered to. Failure to honour agreements or other essential payments can precipitate a more critical situation.

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While most pressure comes from the creditor side, there can also be a positive cash flow benefit from challenging invoicing and billing processes or resolving other disputes or cash generation activities. On one assignment, a large company's invoice dispatch process was handled remotely from the team responsible for invoice calculation, resulting in a time gap of many days between work completion and invoice dispatch. Accelerating invoice preparation and dispatch generated a significant one-off cash bonus that alleviated creditor pressure. On another assignment, a long-outstanding and significant VAT receivable from an overseas customer had been left unresolved and filed in the "too difficult" folder. Diligent investigation by the turnaround manager resolved the issue positively. In another instance, a company was entitled to a large tax loss refund, but due to delinquent filing of accounts and tax returns, the refund had not been claimed. Addressing this issue helped alleviate creditor pressure. In another case, when a company's payroll was in jeopardy, a solution was found by selling a valuable but no longer business-critical license agreement to an overseas producer. Such situations are not uncommon in poorly managed businesses. By challenging accepted practices and thinking creatively, surprising benefits can be achieved.

From experience, it is often the case that accounts receivable collection has been neglected or handled at too low a level. Aggressive debt collection and payment inducement through fast pay discounts can uncover a treasure trove of low-hanging fruit that can buy time for more permanent solutions to be implemented. In some cases, customers whose suppliers fail may experience production disruptions and may be open to temporary "fast pay" processes while the turnaround is achieved. It is surprising that in such crisis situations, senior management often considers accounts receivable collection to be below their status level when, in fact, the survival of the business depends on it. Other short-term solutions may be available. Disputes and warranty issues can be resolved positively through senior-level involvement. Collections may be delayed due to disputes over only

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a portion of an invoice, and a small concession in such cases may unlock a larger payment. However, understanding the reason for the dispute can also be enlightening. Warranty claims and service level disputes may reveal underlying business and performance issues that are at the heart of business underperformance and are pointers to where operational changes are needed to restore the business to profitability and positive cash flow.

Cash pressure can have severe consequences in group companies, especially where there is inter-group trading. Local finance managers may become cash hoarders and hold onto cash for their local interests. In groups, cash flow needs to be managed on a consolidated basis, and a senior-level manager should have close control over the process, authorising and approving payments over a certain level. There may be a tendency to understate local cash availability in reports sent to head office, so vigilance should be exercised, and cash flow reports should be checked for accuracy against bank statements. A group approach to critical payments should be adopted to ensure that local subsidiaries are not prioritising non-critical payments ahead of group needs. Good practice is to allow local authorisation for small payments, making up the majority of the number but a small proportion of the value, while focusing control on the larger payments, which make up the majority of the value. Local sales subsidiaries should be aware that they depend on the manufacturing entities that have pressing supplier needs to maintain production. This can be particularly acute in industries that have significant seasonal variations or protracted plant vacation shutdowns.

As the turnaround process unfolds, cash flow management becomes routine, and business disciplines become embedded as better practices. Operational improvements revealed during the cash management process can be implemented. Opportunities for better asset-based funding may arise with improved cash management disciplines. The downward momentum on the decline curve will have been reversed, and the turnaround will be underway. However, continued vigilance on cash management is crucial. It is the foundation upon which the turnaround is built and should never be forgotten.