

Protecting Liquidity: Smart Strategies for Tough Times

In a market characterized by severe economic downturn and pervasive uncertainty, liquidity issues have become a serious risk to all companies regardless of industry sector. No one is immune. Assuming “business as usual” with your lenders can spell disaster. Few among today’s top management teams have faced a challenge of this magnitude and some are shocked by how quickly slowing revenue and frozen credit can blossom into a full-blown crisis. Surviving in this environment requires a thoughtful, proactive approach that anticipates problems and devises solutions before liquidity problems reach a crisis state.

THE WARNING SIGNS

Today’s borrowers face unprecedented obstacles that include slow receivables and diminishing collateral values. Banks have less tolerance for borrowers with issues, and loan renewals are by no means automatic. A debt covenant waiver or an over-advance can prove fatal; the cost of waivers has sky rocketed from the price of lunch to an increase in several points, assuming your existing lenders will even work with you. Take nothing for granted. Until you have a closed deal and truly available dollars you have nothing. What you experienced 30 days ago is different than reality today. The lending market is extremely volatile and unfortunately, none of the volatility has worked in the borrower’s favor.

LENDERS IN TURMOIL

Remember that borrowers are not the only entities in turmoil. Many lenders are facing their own liquidity management issues. Adding to the volatility is the significant number of bank mergers in the recent past.

With impaired balance sheets and less available total credit, lenders are concerned about their future, both professionally and personally. Moving an account to work out, increasing reserves on their portfolio is substantially riskier today for a loan officer than it has been in the past. And because the TARP was not targeted to commercial lending, commercial lenders are getting no relief.

If your lender is in turmoil, the decision process may no longer be in the hands of your loan officer or relationship manager. Your credit may well be controlled by the risk officer and credit committee. If you have an issue, their response may not be consistent with past behaviors.

A NEW APPROACH TO LIQUIDITY PROTECTION

Both banks and borrowers have a stake in avoiding covenant waivers. Now is the time to be aggressive about protecting liquidity.

STAY ALERT AND FORECAST POTENTIAL PROBLEMS NOW

First, remain alert to situations that indicate the need to act quickly. Ensure the key drivers of the business are understood and monitored on a very timely basis. The ability to forecast and plan is keen. As difficult as it is to do in this market, forecasting and planning needs to be a core competency across the organization. Involve all critical disciplines, not just finance. A foundation of objective information and rigorous forecasting practices is imperative for you to anticipate problems and devise solutions. Fact-based, forward-looking analysis and projections based on real data rather than optimistic estimates must be your starting point.

Project operations at least four quarters ahead using run rates as much as possible. Next, carefully assess your base case projections – do they exceed liquidity/compliance minimums? Are there potential debt covenant issues? If so, ask yourself what has to change to preserve working capital without crippling your business.

It’s also critical to understand your worst case scenario, including the impact of lower asset appraisals and the reduced availability of credit. Document your assumptions and estimates so you can challenge them as circumstances change. This analysis is time sensitive and needs to be based on a hard look at market conditions, including the impact of these conditions on your customer base. Consider bringing in external help to assist what is likely to be an overextended financial team. A third party perspective helps bring the organization real time market data and objectivity.

REMEMBER: CASH IS KING

Not only is cash king, it now reigns supreme. Be sure your financial team is focused on cash and working capital. Understanding your current cash position and where it is going over the next several quarters is critical. Financing options are limited and costly.

Until the credit crunch abates, preserving and improving liquidity must take precedence over earnings. Given the uncertainty of credit, survival may depend on self-generated cash.

STRENGTHEN YOUR CORE

Find the profitable, cash flow-positive core of your business and cut away at everything else. That means analyzing your business in detail in order to understand the real drivers of profit. If you can't do this quickly and accurately, it makes sense to bring in outside resources. Be sure that you understand your cost structure and profitability so that you can make informed decisions in a timely manner.

Once you determine your core business, there are usually several options. Close unprofitable units, liquidate slow-moving inventory, and monitor accounts receivable closely. Shrink your costs to activities that customers will pay for and that ultimately generate cash. Identify and cut unprofitable customers.

BE STRATEGIC

This is not a time when cutting costs will lead to survival. Be strategic in addressing short and long term liquidity needs and be sure your team is appropriately focused on these initiatives.

OBTAIN VALUE FROM PAST INVESTMENTS

Reschedule or cut new projects unless the ROI aligns to your liquidity needs. Focus instead on trying to realize some incremental value from the dollars you have already spent. For example, many companies can realize incremental value from their existing technology without investing significant dollars, if any. Be sure you have fixed any unsound IT governance and management practices before additional dollars are spent.

FIND "HIDDEN" LIQUIDITY

Scour balance sheet for assets you can sell or liabilities you can extend. To identify these opportunities, utilize benchmarks that identify the most efficient businesses in your industry and compare them with your performance. To contribute to working capital, every balance sheet dollar has to be turned over faster. Maximize cash flow by matching inventories to sales, collecting from customers faster and negotiating favorable terms with your suppliers. Review in depth the components of your cash to cash cycle, realizing the impact on liquidity of even small improvements.

COMMUNICATION IS KEY

Intensify communication with your stakeholders, e.g. your employees, Board members, lenders, shareholders and auditors. Ensure they understand how you are responding to the market and why. When you offer an honest assessment of where the company stands, you build stakeholder confidence.

Also, communicate early and often with your lenders, particularly prior to approaching renewals or requesting waivers or modifications. Give them information and business plans that instill confidence that you can address your working capital needs. Include credible forecasts, actions and contingency plans in every discussion, and use an independent third party to lead this process. It adds to your credibility, as lenders may significantly discount management projections.

LOOK FOR ALTERNATIVE FINANCING NOW

Don't wait until you need it – assume you will. Searching for alternatives now enables your organization to negotiate from a position of strength. There is still money out there, but it takes time and persistence to find appropriate sources.

Avoid believing that you can raise more capital to “get over the hump;” the odds of that happening are probably limited. Ensure you understand the cause-and-effect that drives your business model. The ability to forecast and plan is paramount. Look at the process behind the numbers, question assumptions and model what-if scenarios and alternative business strategies.

As you undertake the above steps, remember the process may be painful, but it will generate results. It can be difficult for Board members and CEOs to admit that the company has a looming liquidity issue. But you must be decisive. Create a sense of urgency as to how illiquidity can spiral out of control if not contained early.

ABOUT THE AUTHOR

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