

Surviving the Credit Crunch

Why Cash Management Alone Is Not Enough For Business Success Today

The current economic situation has led to a plethora of articles in newspapers and magazines about how businesses should manage cash flow better, in order to survive such difficult times. Financial advisers and, in particular corporate restructuring specialists, are very keen to promote the cash management philosophy and it has been repeated so many times, that I imagine most business people have got the message that profit is merely an accounting concept and that 'Cash is King'!

Often the 'look after your cash' message focuses upon working capital management: the reduction of stock and debtors; extending payment terms to suppliers; as well as cutting base costs and reviewing the possibilities for outsourcing all but the most essential internal processes.

Of course, we have heard and read all this before and whilst there IS merit in continuing to practise good cash management; it should not be regarded as a panacea in today's unusually difficult times. There are three main objections to the overriding assertion that Cash is King.

Firstly: cash management, especially working capital management, is a zero sum game. If one company extends its creditors to improve its cash position, then the supplier to that company is worse off. In turn, that supplier may delay payments to its own creditors. Taken in the round, there will be winners and losers in this game of 'pass the parcel' but overall, the economic system has not changed. On average, nobody is really better off.

The second objection is that in this Credit Crunch, liquidity is being forced out of businesses as the banks strive to rebuild their own balance sheets. Cash is moving from corporate balance sheets to the banks, who are seeking to reduce leverage and improve their Tier One capital. Therefore, whilst the business tries to improve its liquidity through cash management, there are greater external forces at work which undo their best efforts by removing cash from circulation.

The final reason to treat with caution the advice that 'cash management cures all', is that much has been done already. In a recent edition of The Economist, an article entitled "Managing in the Downturn" warned that those firms attempting to squeeze suppliers should think again - as supply chains now stretch across continents and work on a 'just-in-time' basis. The slightest glitch can cause chaos! The Financial Times adds that some larger companies are so concerned about the state of play with their suppliers that they are bending over backwards to help...even going so far as paying them early! - not the normal actions of a business where Cash is King!

So yes, cash management is - and always will be - necessary – but cash management ALONE is not a sufficient condition for business survival in the current circumstances.

But if Cash is not always King.....what is??....

The answer is simple to articulate but difficult to execute: Build Better Businesses!

Over the past 25 years, there have been a number of books that describe the traits of successful businesses. 'In Search of Excellence' by Peters and Waterman and 'Good to Great' by Jim Collins to name but two. Many of the companies highlighted in these books have subsequently floundered, not because the research was flawed but because the external environment has changed radically

and these businesses were unable to adapt. You only have to think of IBM, Hanson and BTR and more recently Fannie Mae to realise that many of the successful companies of twenty years ago are not now what they used to be.

Recent research by the London Business School has looked at why these companies have declined. Also: what are the characteristics of the current climate that will affect the success of the new breed of corporations? The conclusions show that the current commercial environment is fundamentally volatile and is dominated by three major factors: -

Firstly: the impact of Private Equity on corporate life, leading to rapid changes in company ownership, high levels of leverage and astronomical company valuations. All this activity is beginning to unwind in the Credit Crunch, but the World is still suffering from the 'indigestion' caused by the last 10 years of Private Equity. Valuations remain high; investee companies are burdened by a high level of debt on their balance sheets and profits are being hammered by the costs of servicing such large debts.

The second factor is the rapid speed of change that any company faces in its immediate environment - especially in relation to Technology. Advances are so swift and pervasive that technologies may be obsolete as soon as they are purchased. It is becoming impossible to predict with any sort of accuracy what the next blockbuster product will be or how it will impact across business and society.

The third and arguably the biggest change is the complexity of conducting business in what is, today, a global business system. Customers and suppliers are no longer local to each other. A medium sized business based in the UK, could well buy its raw materials from China; buy its manufactured components from Eastern Europe on a just-in-time basis; outsource its IT support to India and sell its finished products across the world. This business is locked into commitments that cannot be changed easily or quickly. Just imagine trying to impose a 'Cash is King' philosophy here, when your major stakeholders are thousands of miles away and you have already mitigated much of the risk with cash deposits from customers and arranged letters of credit for your supplies on the high seas!

The London Business School has identified that the companies that adapt best to a volatile environment are those that can absorb shocks and yet remain agile in changing circumstances. A business can absorb these shocks in a number of ways such as:

- being big enough to have a dominant market share
- having diversified cash flows, i.e is not dependent upon one sector
- benefitting from a low fixed cost base
- having customers contracted in to long term relationships.

Many of these characteristics are associated with larger businesses and whilst a large corporation may not be as efficient as many smaller concerns, size does give a business time to address inefficiencies through the sale of assets, reduction of costs and investment of cash surpluses back in to the company.

A smaller company, on the other hand, will not have the 'wool on its back' to absorb the shocks generated in an ever-changing environment. To become successful, small businesses need to be fleet of foot and agile. They must make decisions quickly and adapt their plans to suit continually changing circumstances. The London Business School research has found that business agility is derived from the use of critical information to make decisions and the presence of a flat hierarchical structure that promotes an open culture.

The key to benefitting from critical information is to be able to generate real time granular data that provides an accurate insight to business performance i.e. to get to the nitty gritty of any problem fast! In my experience, those businesses best placed to succeed, are those which generate this performance data outside the formal management accounts system. If a CEO knows how his business is performing from up to date data rather than relying on six week old profit and loss account, then he is much better placed to make the business succeed. I know of one business in financial services that has both its actual cash collection and sales systems updated every 20 minutes and published on the firm's intranet. With this level of real time data, it is no wonder that the business is able to make quick decisions to adapt to changing influences.

Another important use of data is the treatment of Key Performance Indicators (KPIs). There is a great tendency, especially in Private Equity deals, to generate more and more information and more and more KPIs. Often these KPIs are based upon historic data and provide a view of the business from every possible angle – not all of them relevant. In reality, businesses have only a small number of levers that can be pulled to alter performance. Therefore success is more likely through an emphasis on a small number of truly relevant KPI's rather than a plethora of indicators that dilute the main messages.

Once the agile company has identified and has access to the real time data and the critical KPI's to move forward, this information must be discussed, debated and implemented. An agile company will promote an open environment where dissent and challenge are widely encouraged and previous mistakes are discussed openly to make sure that key objectives are understood. Such debate should not be mistaken for consensual leadership and a slow bureaucratic process. There is still a requirement for leaders to lead, but the behaviour of leaders may need to change to facilitate discussions and enable the necessary processes to be undertaken.

For example, if a business is revising its plans or trying to make sense of today's economic situation, the CEO should encourage debate, engage others, be open to ideas and adopt some intellectual humility. However, when that same business is making choices regarding how to go ahead and *execute* its revised plans, then there is a need for a decisive, trustworthy and inspiring approach to encourage others to succeed. There should be a sense of urgency at all times, similar to any start-up situation where decisions must be made quickly.

In essence, an agile company is a business that:

- makes fast decisions possible
- accelerates the decision making process
- retains the ability to make high-quality, strategic choices

The company achieves this goal by putting in place the ability to:

- track real time information
- develop a deep and intuitive grasp of the business
- develop multiple options during the decision making process and analyse them quickly
- involve everyone and depend upon one or two principal counsellors
- make a quick decision without needing a full consensus
- remember that delaying a decision can be as bad as making the wrong choice

The current economic downturn is going to see the failure of many businesses. There are some, such as Woolworths, that business analysts have predicted would fail, because they are managed poorly, have no competitive advantage or in the case of Woolworths, have high fixed costs. There are other businesses which will adopt sensible strategies around cash management, are able to reduce costs and will do all they can to get their house in order... but which will also fail.

Those that survive will do so because they can adapt, think quickly and put in place recovery strategies as well as looking after their cash en route. This is a time for major changes in business and the flexible, adaptable, agile company will emerge the strongest.

Ian Brown

Ian Brown is an independent consultant who has 25 years experience working for both private equity and banks. He has successfully managed a number of corporate turnarounds and exits. He is a Director of Interim Portfolio Management, a business that specialises in assisting stakeholders in leveraged situations.