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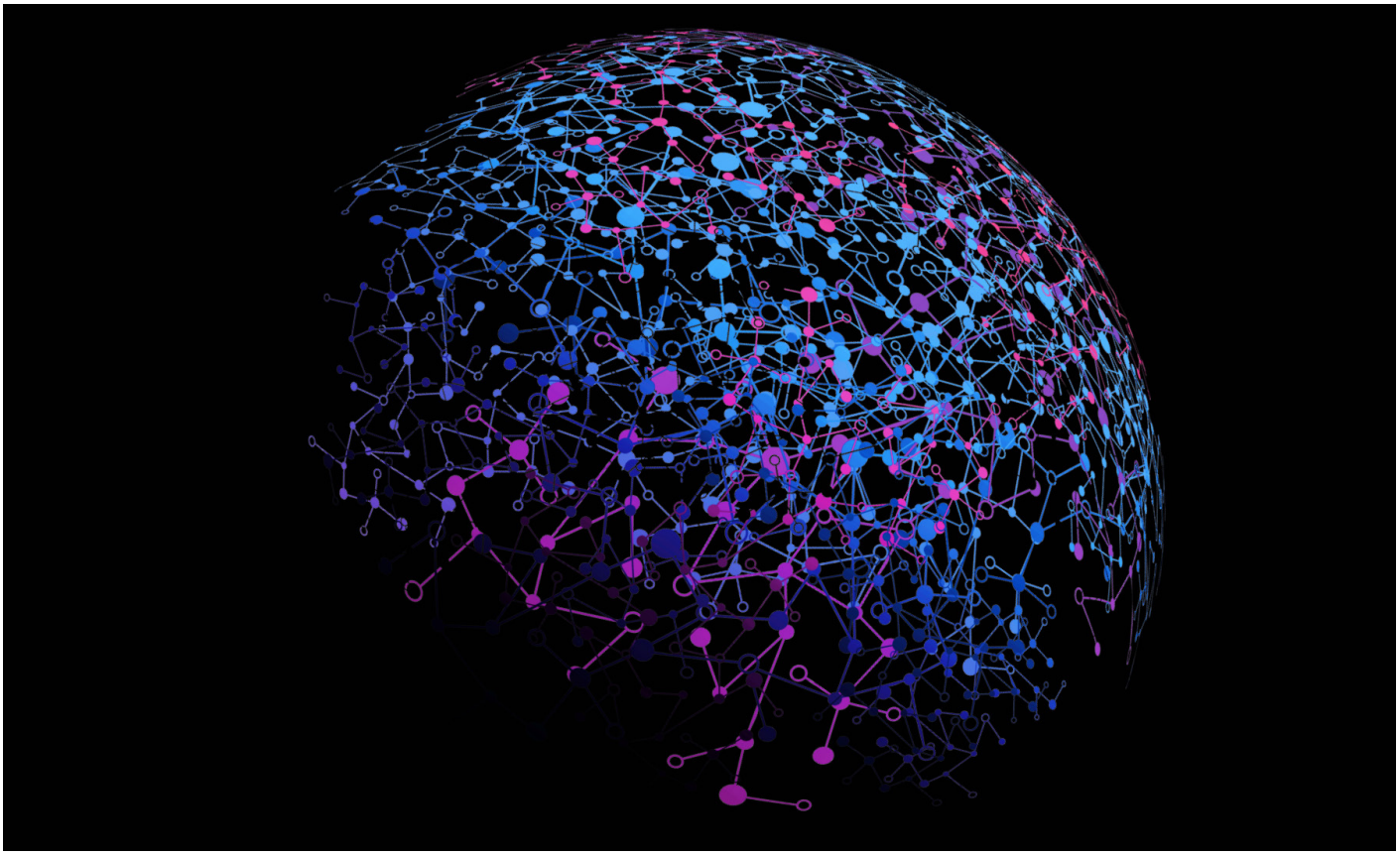


Managing Cash flow during a period of crisis

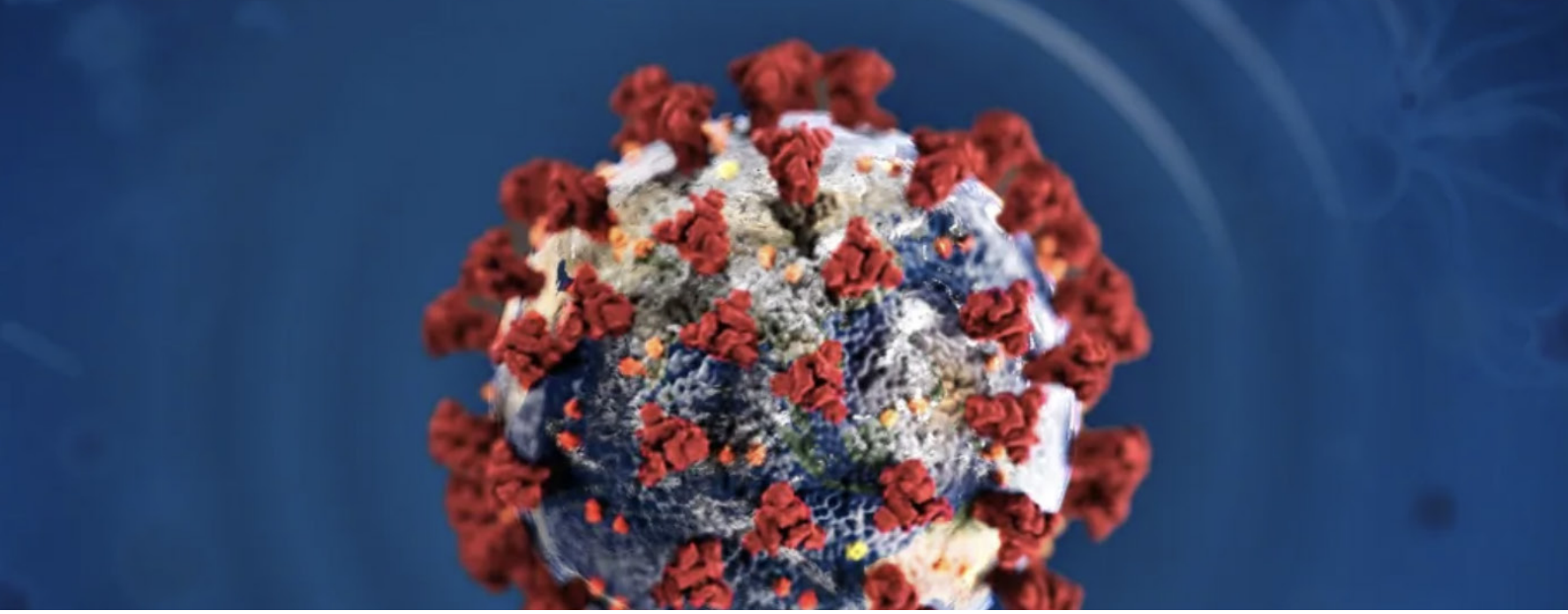
COVID-19

As a typical "black swan" event, COVID-19 took the world by complete surprise. This newly identified coronavirus was first seen in Wuhan, the capital of Hubei province in central China in December 2019. As at the middle of March 2020, the virus has infected over 160,000 people, and led to more than 6,000 deaths. More than 150 countries are now reporting positive cases of COVID-19 as the virus spreads globally, impacting communities, ecosystems, and supply chains far beyond China.

Ghana first reported two COVID-19 cases on 12 March 2020. Since then, over 20 more cases have been confirmed in Ghana. The President, as part of measures to tackle the situation, announced the release of USD 100 million to help fight the virus. Other measures introduced by the Government include, a suspension of all public gatherings for the next four weeks, closure of all schools until further notice, and a ban on the entry of non Ghanaian citizens into the country. These restrictions are likely to have adverse impact on businesses in Ghana especially the hospitality, air travel and tourism sectors. In addition, there is likely to be a sharp decline in demand for Ghanaian goods in Europe and Asia leading to a significant drop in sales and cash for businesses that produce for export.

The focus of most businesses now is on protecting employees, understanding the risks to their business, and managing the supply chain disruptions caused by the efforts to contain the spread of COVID-19. The full impact of this epidemic on businesses and supply chains is still unknown, with the most optimistic forecasts predicting that normalcy in China may return by April,1 with a full global recovery lagging depending on how other geographies are ultimately affected by the virus. However, one thing is certain: **this event will have global economic and financial ramifications that will be felt throughout global supply chains, from raw materials to finished products.**

This article will suggest ways organisations can mitigate damages to their business during this volatile event.



Businesses that will be hit the hardest

Businesses in sectors such as tourism, hospitality, entertainment and air transportation have been particularly hard-hit in the short term.

Businesses in consumer goods and retail may also be at higher-than-normal financial risk, especially those with a high exposure to China, and those in seasonal businesses where demand may be lost (as opposed to shifted), such as such perishable consumer goods and seasonal apparel.

Even commodity-oriented industries, such as metals and mining or oil and gas, are exposed as global demand shifts and pricing fluctuates.

Responding to the immediate challenge

1. Ensure you have a robust framework for managing supply chain risk.

Supply chain management is a complex challenge, and finance-related problems only add to the risk. Do you know if any of your customers are in trouble and might be unable to pay for the goods and services you deliver? If you manufacture a product and want to sell it to someone outside your borders, you typically require a letter of credit from a prime bank that proves the buyer can pay. This letter of credit not only provides a source of ultimate payment, it can also be used to secure inventory financing while the goods are in transit—so it's important to make sure these letters of credit are still reliable. Ensuring you understand the financial risks of your key trading partners, customers, and suppliers is a critical consideration in times like these.

2. Ensure your own financing remains viable.

In these circumstances, don't assume the financing options you previously had available to you will continue to be available. Undertake scenario planning to better understand how much cash you'll need and for how long. Use this opportunity to actively engage with your financing partners to ensure your available lines of credit remain available, and to explore new or additional options should you require them.

3. Focus on the cash-to-cash conversion cycle.

Under normal business conditions, companies primarily focus on the profit and losses–growing the top line while managing the bottom line. Routine back-office activities such as paying bills and turning receivables into cash are often taken for granted. In the current abnormal business conditions, smart companies are shifting their focus from the income statement to the balance sheet. Of the three elements of working capital–payables, receivables, and inventory, executives have a tendency to focus on inventory. But, in order to minimize working capital requirements during challenging times, it's important to apply a coordinated approach that addresses all three areas.

4. Think like a CFO, across the organization.

As managers step up to the challenges of disruption and inventory shortages, they generally spend their days thinking about operations and don't pay much attention to finance and treasury issues. More often than not, inventory levels and other critical business parameters are driven by customer service requirements and operational capabilities, not financial constraints. But what if the situation was reversed? What if working capital was the company's primary constraint on inventory, and managers were given the challenge of making it work? How would that affect your supply chain and inventory practices?

5. Revisit your variable costs.

Reducing your variable costs is often a quicker way to immediately reduce your cash outflows than focusing on your fixed costs. Of course, there are the typical variable cost-reduction levers, such as imposing travel bans and non-essential meeting restrictions (which might already be in place as a way to manage employee safety), imposing hiring freezes, and placing restrictions on discretionary spend like entertainment and training. When labour is a significant cost line in your business, consider avenues that might help reduce spend to avoid getting to a situation where layoffs are required. For example, look for opportunities to reduce contract labour and re-distribute work to your permanent workforce. And, if necessary, consider offering voluntary, or even involuntary, leave without pay to preserve cash.

6. Revisit capital investment plans.

With cash flow forecasts in mind, consider what's really necessary for the near term. What capital investments can be postponed until the situation improves? What capital investments should be reconsidered? What capital investments are required to position for the rebound and for creating competitive advantage?

7. Focus on inventory management.

Companies are at risk of experiencing supply chain disruptions due to shortages in raw material and component parts. Inventory safety stock parameters will most likely need to be updated to reflect the increased demand and supply-side volatility, which will have the effect of increasing overall inventory levels, assuming that's possible. At the same time, businesses will be thinking about securing additional inventory, or strategic stock, as a further buffer against the potential impact of a prolonged or much broader supply chain disruption. Also at the same time, from a cash flow perspective, companies may be considering actions to reduce finished goods inventories, especially in perishable products, where waste is an important consideration and markets remain difficult to access.

Balancing the demands for more buffer inventory and managing cash flow may not be as easy as it sounds. Companies that still use simplistic approaches to inventory management might be able to do a quick assessment and find some immediate opportunities to drive down inventory. However, many companies are likely to find that significant inventory cuts have an adverse effect on customer service and production. Sustainable savings will most likely require fundamental improvements in end-to-end supply chain inventory visibility, demand planning, inventory and safety stock policies, production planning and scheduling, lead-time compression, network-wide available-to-promise, and SKU (stock keeping unit) rationalization.

The way forward

Given the importance of cash flow in times like this, companies should immediately develop a treasury plan for cash management as part of their overall business risk and continuity plans. In doing so, it is essential to take a full ecosystem and end-to-end supply chain perspective, as the approaches you take to manage cash will have implications for not only your business but also for your customers.

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