Managing cash flow in the wake of COVID-19 and how to prepare for the next big disruption

Extraordinary circumstances, such as the COVID-19 outbreak, force us to revisit and question past behaviors and business approaches. Our everyday inefficiencies, usually kept at bay by strategically placed buffers and manual workarounds, are relentlessly brought to surface as markets plummet and supply chains disrupt. This was captured well by Warren Buffet, in his quote:" *Only when the tide goes out do you discover who's been swimming naked*".

However, first order of business in crisis management will not be long term and sustainable solutions, but rather to ensure survival here and now. Adapting to whatever normal looks like post-COVID-19 will have to come later. Liquidity and cash will play a vital role in this, placing the balance sheet and short-term Working Capital improvements in focus, as demand and revenues continue to decline in parallel with banks willingness to fund. Companies who do not already have a short-term cash flow forecasting model in place do well in installing this, to ensure increased transparency on operational level, allowing for early warnings, scenario assessments and timely implementation of available rapid cash measures.

Whoever manages to survive this ongoing ordeal must be prepared to deal with the new reality. As the tide turns, we can either choose to accept good enough - - hoping our previous buffers and workarounds still hold, or, take this opportunity to go from good to great.

Why bother to improve, if good enough has worked before? We can think of at least two reasons to focus on improvements. First and foremost, we live in an era where disruption is intensifying. Powerful global forces change how we live and operate, not only through pandemics and/or environmental catastrophes, but through the continued rise of emerging economies, changing demographics and technological breakthroughs.

Secondly, it is axiomatic that if a company does not improve, its competitors will. The ever-growing list of COVID-19 bankruptcies is further proof there is no such thing as "too big to fail". Just look at Hertz. This world-acclaimed brand recently filed for Chapter 11 and is now selling off much of its fleet in a bid to meet demands from creditors.

There are few, if any, one-size-fits-all solutions. However, Nordstrom Advisory strongly advocates that any improvement journey would do well to include the following strategic and operational considerations:

1. **Keep your balance sheet as lean as your P/L** – Focus on cash, not instead of sales and profitability, but additionally. We often find the balance sheet and cash-flow underrepresented on management agendas, with incentive structures geared towards optimizing P&L only.
   Cash conversion and working capital ratios are great indicators on how efficiently a company is managing its processes and therefore mandate a larger focus. Also, we often find companies who excel at managing their working capital experience higher EBITDA as a direct result.
   Why is this important? Lean working capital, with emphasis on balancing supply chain risk, right-sizing buffers while minimizing lead-times and waste, will not only release capital, but also place your company in a stronger and more agile position for whatever next disruption to come. Also, increased availability of (free) capital reduces the need for expensive short-term funding, and lets you invest in e.g., growth, innovation and/or dividends.

2. **Be holistic and agile in your planning and target setting** – The ability to plan and re-plan swiftly across functions and entities will play an important role going forward, allowing companies to make timely and informed decisions even in times of crisis and change.
   Also, no matter the area, companies should ensure their plans have an end-to-end process focus with clear cross functional consideration. We often see functional campaigns with a narrow focus turn into a game of whack-a-mole, where parts of -- or all outcomes would create issues somewhere else in the organization: e.g.,

   - A sales organization plans to realize its volume target by promising shorter lead times and increased availability of goods, while
   - An inventory manager has been instructed to reduce stock levels; and
   - The purchasing department is pushing for supplier discounts by committing to larger volumes.

   These individual activities could be relevant by themselves. However, together they contradict each other, driving inefficiencies where at least one area of the organization would miss its

targets. Understanding these cross-functional implications and aligning targets across the organization is critical if you want to ensure sustainable and long-term results, without having to sacrifice any part of the overall business targets, e.g., working capital for topline or profitability (or vice-versa).
Keeping all of this together is one of the more challenging tasks for any company, and requires high level of transparency, supported by robust processes and control hubs. Also, we have in recent years seen innovative information management software surface, allowing companies to efficiently visualize and manage across functions. Companies would do well in reviewing these options as part of their digitalization strategies.

3. **View your suppliers and customers as an extended integrated value chain** – Management handbooks have taught us to leverage our comparative strengths. Most companies interpret this as freedom to push their own agendas on suppliers, be it availability, price, terms or something else. As attractive as this approach can look short term, it is Nordstrom Advisory's experience that the long-term negative effects outweigh the benefits, as well as put the supply chain at risk.

    - Any supplier will try to find a way to adjust its prices and cost-to-deliver to compensate for forced discounts and/or increased terms or seek alternative customers.
    - In the meantime, suppliers must find alternative ways to manage their businesses and cash-flows, often at higher cost, making them vulnerable to market changes.
    - This behavior breeds little loyalty among suppliers, removing any incentive to drive joint continuous improvement initiatives.
    - Even in cases where you find substitute suppliers easily, changing suppliers can be a costly matter from an operational standpoint (quality risk, product testing, system and BOM updates, etc.)

We know from experience that companies should use their comparative strengths to build stronger relationships and explore ways to reach true long-term win-win situations. The strongest foundation for long term prosperity is when the whole value chain collaborates. Several tools, notably supply chain financing (SCF), are designed with this in mind.

In Summary: Companies will have to balance short term survival with preparing for post-COVID-19. Near term, short term cash flow forecasting and control will be crucial. Companies should review their toolbox of rapid cash release activities, to prepare for any further unforeseen events.

Long term, companies should prepare for the next big disruption. Cash management and forecasting plays an important role even here, as do agile and well-balanced supply chains. Organizations should strive to enhance cross-functional planning and decision making, in a rapidly changing environment, preferably supported by relevant tools and/or system support.