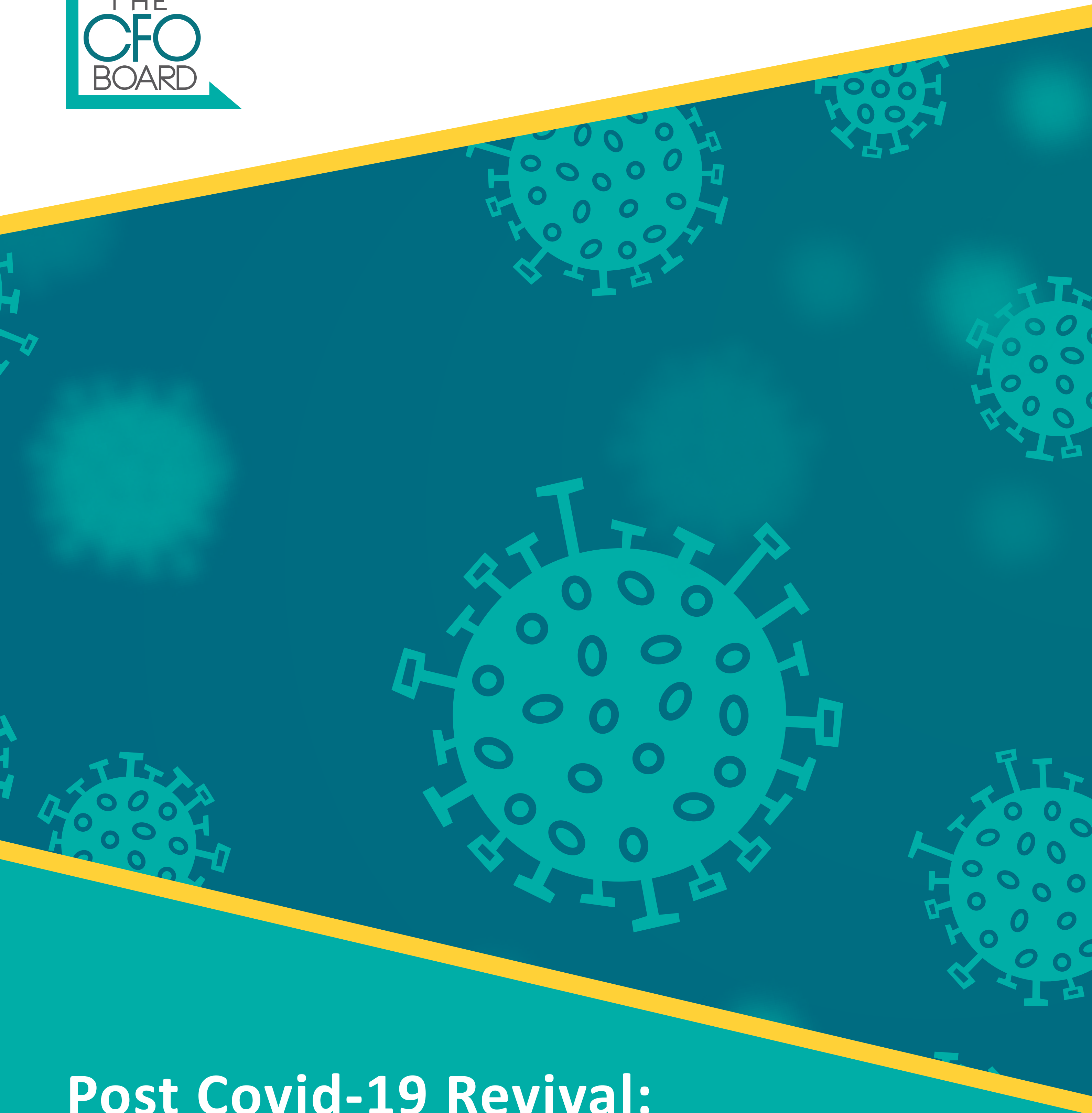

Post Covid-19 Revival: Action points for CFOs

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For further queries, please contact secretariat@cfoboard.com.

INTRODUCTION

Much has been discussed about the changing role of the CFO. And now, amidst the Covid-19 pandemic, it is time for finance leadership to demonstrate their skills and expertise not only in keeping the company running but also prepare it for the post pandemic effects.

There are three steps that corporates must take in overcoming this crisis:

1. Address the immediate concerns of safety and survival (till lockdown is lifted)
2. Stabilise the business over the next 6 months to one year post the pandemic (till vaccine is found)
3. Position the company on the path to recovery and growth in the next phase.

When Wuhan happened, it started as a supply chain crisis for Indian companies who source lot of equipment and spare parts from China. But as it developed into a pandemic, and lockdowns were imposed across continents, sales almost came to a standstill with corporates losing as much as 50-75% of revenues. It reminded us of the 2008 financial crisis and the actions that we took then for survival. But the difference this time is that it has an added dimension- the human dimension!

STAGE 1:

What are the urgent and immediate actions in this uncertain business environment?

First, let us look at the **business environment**. There has been collateral damage. Capital, liquidity and confidence - the three pillars of the financial system have been badly battered. The global financial landscape is changing every day not only irrevocably, but at breakneck speed. Broader forces at work in the global economy mean underlying economics of strategies could continue to shift with unprecedented speed and scale. And like in 2008, we are seeing the symptoms of a synchronised global recession. As the virus spreads and lockdowns are extended, the spectra of unemployment, salary cuts and food shortage loom large.

The priority then is to **optimise cash reserves** since the magnitude and duration of the crisis remain unclear. A centralised **"cash war room"** should be launched as was done by a leading organisation during the 2008 crisis. This will ensure that decisions are fast as sometimes people can get unnerved by the situation. Re-think all assumptions on liquidity including worst case scenarios depending on the potential paths of the virus' spread.

What percentage of your total credit lines do you believe would be available if you were to draw upon it now? What changes have you made to your money market fund investments? Seek waiver on debt covenants as early as possible to strengthen the balance sheet. Examine all financing documents and seek amendments to loan agreements. Proactively communicate with lenders.

Setting up the "cash war room" helps in implementing aggressive curbs on spending throughout the organisation. An initiative called ADAPT (Action for Downturn Alleviation and Profitability in Turbulence) was undertaken by a leading organization in 2008-09. Liquidity was tracked in real time across units of the company in all geographies.

Rolling forecasts based on macro-economic and company specific data should identify EBIDTA risk. The forecasts should also identify events and risks such as supply chain disruption, employee dislocation, sources of cash leakage. Liquidity concerns of customers, availability of short-term funding, supplier bankruptcies etc. Weekly rolling business forecasts and daily cash forecasts become the norm during this period. More granular and more regular reviews also become sine qua non.

Communication: There must be over communication with employees, customers, vendors and the larger eco system. There should be no room available for people to give rise to gossip. CEOs and CFOs must share transparently all that is available to them immediately rather than later. The empathy shown to employees must also get translated to customers as the customers (whom you would want to keep) will also be going through similar pain. Rather than fulfilling what they desire, we should try to meet their current needs compassionately. A communications plan should also be developed with finance leaders stressing the cash culture throughout the organisation. It is also necessary to communicate proactively with the board and convince them of the actions being taken to protect the business, the liquidity position and any changes to earnings forecasts.

Investors would expect companies to take drastic action and be prepared to discuss with them the liquidity situation, the use of and ability to generate cash as well as cost cutting measures. The frequency of interaction with investors should be increased.

Legal: The first thing to consider is whether COVID-19 constitutes a force majeure under existing contracts and to include a force majeure clause in those currently under negotiation. (See Annexure-1 for detailed actions on contractual obligations during COVID-19)

Reputation: The company should also not lose sight of its values in this situation. It is very easy to let go but very difficult to rebuild the reputation because in future, this reputation will earn them business.

STAGE 2:

In the second stage, when the pandemic starts showing a flattening curve and cash preservation concerns are addressed, it is necessary to position the company so that it operates effectively in the new normal. The company should start looking at new ways of working. The world, post COVID-19 will not be the same. Work from home, remote working, lesser real estate, enhanced cyber security will become the norm. This is the time when relationships with all need to become stronger. Evaluation of targets, cash position being a help, for growth should be evaluated. New normals will be drawn for pretty much all facets of the business. CFOs who can lead change, their companies will survive, the rest will be looking to go belly up. With increasing digitisation, more and more data will become available. There will be a surfeit of data. This will mean more use of machine learning, artificial intelligence and data scientists to make sense of the available data and to drive profitable growth.

Business: The first excercise is in gathering ground level intelligence i.e. gathering and sharing information on industry, markets, competition and customers; also, customer standing on competitor's response to the crisis. Traditional approach to budgeting should be replaced by zero- based budgeting and JIT budgeting in a volatile economy. Challenge assumptions ask uncomfortable questions. Analyse the structural changes which are likely to persist beyond the pandemic. Reallocate resources to businesses with strong existing revenue streams and optimise use of alternative sales and delivery channels such as e-commerce.

Finance: Deleverage! Expectation to self-fund growth over the next 12-18 months. Revisit insurance contracts. Focus on working capital as a source of liquidity. Invest time in banking relationship management. Develop a strategy on money market fund investments. And don't ignore counter-party risks.

Use this period of crisis to conduct a deep diagnostic of the balance sheet—refinance debt, reduce inventory, accounts payable and accounts receivable terms. Use this opportunity to also optimise the company's investment portfolio as it is likely that ROIs may have changed significantly as a result of the pandemic. Human and financial resources need to be shifted to high yielding projects and initiatives most valuable to the company. The finance department should also develop a few key metrics to monitor and manage key performance indicators in the form of a cockpit dashboard.

Supply chain: Review commodity or index linked pricing on contracts. Revisit payment terms policy in the light of the new credit environment. Assess the supplier base for criticality and solvency.

Drawing scenarios

Modelling of various business scenarios to prepare for dramatic drop in volumes and revenues and a plan on how the company will cope with the fall out of such drop will be very necessary so that if such an eventuality were to rise, the company was well prepared to handle this crisis. Take a big picture approach-a flexible approach- to reducing costs.

Draw out scenarios- if the pandemic (and recession) lasts one, two or three years, can the business service? Is it prepared for bankruptcy of its major customers? Can it cut its capital expenditure to one fourth or half?

Customers: Review the sales and marketing organisation KPIs in terms of inventory, debtors and customers. Is the customer viable? What to expect from your key customers? Increasing or decreasing orders? Ability of customers to pay timely. Likelihood whether customer will emerge stronger or worse from the downturn.

Adopt flexible pricing mechanisms. Customers (and their customers) will look to see whether price reflects the lower cost of inputs. Decreasing volumes will have impact of fixed cost spread over lower volumes, lower cash flow from operations unless price increase is sustained.

Think counter-cyclically, keep competitors off-guard by avoiding the obvious. e.g. instead of tightening customer payment terms and increasing collection efforts, consider more lenient payment terms to your key profitable customers to capture more of their business while making terms stricter for less attractive customers.

Capex: Do you continue or abandon projects? Base your decision on incremental cash investment and desired ROI- not on sunk costs. Use Sources and Uses of Fund statements to see how much cash generated is going towards capex. Choose projects which become operational in 12-18 months and choose strategic and customer centered projects. Assess if capex should be limited to depreciation for each business.

But don't postpone maintenance spending, and expenses pertaining to safety and regulation!

STAGE 3:

In the third stage, we look at corporates positioning themselves for recovery and growth. As companies shift attention from fire-fighting the crisis to getting the most from the recovery:

- What shape will recovery take? What should be expected as normal after the crisis and set appropriate performance targets
- Have you restructured enough? The weak economy makes it easier to implement unpopular changes and divestitures.

In the new normal phase, only the investment on human capital, change management, adhering to mission and vision and being honest to the strategy would see CFOs leading the companies into a trajectory of growth whilst many other companies may not have lived to tell the tale.

Offices and stores are closed. Telecommuting has become the normal. Consumers are buying as much as possible online. When the crisis ends, as all crises' must, will companies want to spend money on offices or will employees accept daily commuting to and from office, or will consumers make their purchases in physical stores? Corporates must think now about the possible strategic structural shifts that can take place and to build their business models accordingly. It does appear that COVID-19 is pushing towards e-commerce, telecommuting and the digital economy as the main trends.

Adopting a transformational mindset

Adopt a transformation mindset when allocating resources and shelve the incremental approach.

Talent: There will be global talent available because of possible redundancies and closures, and corporates must keep track of hiring fresh talent.

Mergers and acquisitions: Can mergers and acquisitions / divestitures improve the portfolio? This is the opportune time to restructure your business, get rid of bad businesses and acquisitions, and reallocate capital to high priority needs. Assets will be available cheap and it may be a good idea to adopt a step approach to acquisitions like Godrej has done over a period of time.

This is the first time that a crisis has forced large parts of the global workforce to work from home. Remote working means it makes digital collaboration tools essential to business functioning. Seize this moment to push digital initiatives through. BPOs who run critical processes for corporates worldwide are throttled by lockdowns. This gives opportunities to corporates to digitise and automate key business processes and reduce disruption and dependence on BPOs.

The human dimension: Perhaps the most important aspect has been kept for the last. Employees will be worst affected. They will be concerned about their health, their family and their ability to continue earning- their lives and livelihoods. Leadership must demonstrate empathy- whether by providing medical attention to the needy or ensuring their salaries and wages continue to be paid in this crisis. It is important their morale is kept high with continuous communication showing empathy with optimism that good days shall return.

CONCLUSION

It is uncertain how long this pandemic will last, but it is certain that CFOs can play a key role in not merely survival of the company but also see it thrive when the time comes. Austerity measures may have to be continued over the next 2-3 years as we see pressure on margins from cost inflation and margin reduction. But for now: CASH IS AGAIN KING.

ANNEXURE-1

COVID-19 and contractual obligations

In recent times, non-economic shocks- whether they are due to intensifying trade disputes like the US-China trade war, political upheavals like Brexit or high cost natural disasters like Hurricane IRMA in USA or the earthquake cum tsunami in Japan- have raised the questions on contract enforcement. Now, the COVID-19 pandemic has once again brought to focus on what corporates should do amidst this mayhem.

While this is by no means an exhaustive list, it tries to put forth a few areas which corporates need to concentrate on.

General: a) The first thing to consider is whether COVID-19 constitutes a force majeure under existing contracts and to include a force majeure clause currently under negotiation. b) Consider the consequences of declaring a force majeure event e.g. mitigation requirements, termination of exclusivity etc. c) Examine the consequences of postponement of products from virus hit countries and the impact on health emergencies, pandemics and travel restrictions. d) assess whether the impact of COVID-19 will affect the company's ability to meet its outstanding obligations- whether due to a direct impact or outside supplier obligations- and draw contingency plans.

Insurance: Analyse in totality all insurance policies to ensure the company is covered for damages resulting from the pandemic. Examine Property and Casualty (P&C), business interruption, business income, employees, general liability, D&O (Director and Officer) liability, cyber security, and specific disease related policies.

Mergers and acquisitions: a) Be realistic in your approach and timing in reviewing and closing potential transactions. Consider travel restrictions and quarantines. Consider the target entities' ability to suspend or terminate agreements under force majeure and insurance policies related to pandemics b) carefully review Material Adverse Change Clause to include COVID-19, adequacy of warranties and indemnities, standstill obligations and long stop date wherever applicable.

Supply chain- a) Reassess supply chain risks to make them more resilient to any kind of disruption- multi-sourcing strategies, supplier audits as a part of business practice- inventory buildup for critical components by increasing safety stocks. b) review commodity or index linked contracts

Financial system: a) Examine all financing documents to assess how COVID-19 will impact your ability to sustain your business currently and in future. Prepare for potential effects on interest rates, borrowing costs, property and asset values. b) contract modification for additional funding needs, amending terms of existing loan agreements or seeking waivers if unable to satisfy loan covenants. Proactively communicate with lenders and investors.

Litigation: Proactively seek extension of deadlines

Employees: Place signages in all common areas to maintain hygiene- encourage stay and work from home- issue guidelines for employees returning from abroad. Above all, be lenient in paying salaries and emphasise prevention and control of spreading the virus.

Cyber security: With employers and governments insisting on work from home it has become harder to a) maintain security and business continuity b) Maintaining confidentiality, integrity and availability of consumer facing networks as volumes spike. Information Technology and Legal will have to work together to safeguard their organisations.

Future contracts: Recognising that there is only that much one can do to existing contracts except following a collaborative approach to renegotiate the clauses, it is necessary to review the following clauses in future contracts in the light of the pandemic : Force Majeure, Client Responsibility to secure their own travel insurance, Inclement weather policies, Cancellation and Rescheduling, Safe working environment, Indemnification clause, Limitation of Liability, Failure of company to perform services etc.

Onerous contracts: Recognise onerous contracts, lease agreements and ongoing and future revenue contracts.

ASSOCIATION OF CFO WELFARE INDIA
216-241, 2nd Floor, Block – F, International Trade Tower,
Nehru Place, New Delhi – 110049

Website: **www.cfoboard.com**

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