Family Business

SURVIVAL STRATEGIES TO NAVIGATE YOUR FAMILY BUSINESS THROUGH THE PANDEMIC

By George A. Isaac
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Family businesses are the backbone of our U.S. economy. Yet many are in serious jeopardy due to the unprecedented coronavirus pandemic. Most businesses are now experiencing significant revenue decreases. While some companies may be seeing volume increases, the overall impacts of the crisis are staggering. Virtually all family businesses must now adapt in order to survive.

Even with the newly announced government programs of financial support, family businesses must take immediate steps to change their management focus in order to navigate safely through this cataclysm.

Management teams have traditionally used financial metrics of profitability, return on investment and risk to manage their businesses. Under normal circumstances, these metrics provide companies with a sound roadmap for success. However, under current conditions, a profoundly different roadmap must be adopted as rapidly as possible.

Cash and cash flow are king
Simply stated, profitability is no longer your goal! Businesses fail from running out of cash, regardless of profits. Business leadership must reorient their primary focus to cash balances and cash flows. This is a big transition, given decades of successful business experience (and cemented paradigms) using traditional financial metrics. A cash focus leads to different decisions, which are counterintuitive to many management teams.

Analysis, planning and forecasting
The starting point is a deep financial analysis of your business to determine the drivers of cash generation and cash consumption, and the timing of each by activity. This will help provide your

best roadmap for survival. The first step is to establish a project team to gather, analyze and produce this critical information.

Sources and uses of cash

The project team must define how each activity in your business impacts cash. Sales and related cost transactions have a daily effect on cash flow. Management of working capital impacts cash on a periodic or one-time basis. Dividing the business into four components allows different team members to simultaneously evaluate the effect of each activity on cash.

1. Working capital management. Sales and purchase cash flow cycles are a company's lifeline. Start with analyzing your key working capital accounts — accounts receivable, accounts payable and inventories.

> • *Accounts receivable.* Determine your major customers' payment cycles in terms of the number of days after shipment until you receive cash. Once determined, develop strategies to shorten the payment cycle. Possible actions include more aggressive collection follow-up, faster invoicing, shorter negotiated payment terms and collection of deposits upon receipt of a sales order. The key is to bring the cash in faster.
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> This is particularly important because the cash necessary for operations (payroll, vendor payments, administrative costs, financing costs, etc.) often is laid out before you receive payments from your customers.
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> Both increases and decreases in sales will have a direct impact on your cash balances, depending on your customer payment practices. So will the likelihood of slower payment cycles from customers due to financial distress. These changes can create a serious liquidity crisis for your company, so careful planning and receivables management is essential.
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> • *Accounts payable.* Analyze accounts payable by similarly evaluating each major vendor's impact on cash. Improve cash flow by renegotiating longer payment terms, eliminating early payment discounts, requesting purchase price discounts and extending payments until your supplier refuses to ship.
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> • *Inventories*. Inventories consume cash and provide minimal collateral value for borrowing money via working capital loans. Businesses should evaluate each component of inventory in terms of cash consumption — raw materials, work-in-progress and finished goods. The objective is to increase inventory turnover and sell slow-moving and obsolete inventories as quickly as possible to generate cash.

2. Debt and capital management. *Immediately* restructure your debts and other obligations with your banks, other lenders and landlords to slow down cash outflows. Actions include making interest-only payments for existing debt, negotiating rent concessions or delays in payment, and using any other appropriate methods that keep cash in the business.

Negotiate additional credit facilities through working capital, fixed asset and mortgage loans. Draw cash from these loans to generate additional reserves for your business. Remember, once cash is gone and you really need more, you will not be able to get it!

Projects with a greater than 180-day payback should be placed on hold, unless your business is not distressed and has excessive capital. The current business environment is too turbulent to justify spending cash, even for good projects, when the time horizon for payback could jeopardize the survival of the business.

3. Sales analysis. Examine the impact on cash of significant sales transactions. There are two issues to consider: (a) Are sales generating or consuming cash? (b) Will the cash received from a sale arrive before the business must pay for the variable costs required to produce the product?

The first management action is to change the focus from customer "profitability" to the sales transaction's "variable cash contribution margin." This metric is calculated by subtracting variable costs of goods sold and any other variable administrative costs from revenues. The metric provides a good estimate of the cash generation or consumption associated with key sales transactions. When the number is positive, cash is eventually generated with each sale. If the number is negative, it is a permanent drain of cash and must be remedied or the business eliminated.

The second test calculates the actual timing of receipts and disbursement of cash associated with a sale. Cash must be received prior to the business paying for its costs if the sale is to generate a positive cash flow. If the transaction from a variable cash contribution margin is positive but cash is received after the payment of costs, the transaction becomes cash consuming for all such increases in sales, and cash generating for decreases in those sales. This is a totally different metric and counterintuitive to many, but accurate in understanding cash flow and its impact on your business.

Two solutions are to negotiate better payment terms with your vendors and customers to generate net cash flow from each sales transaction, and to establish a working capital line of credit to finance the timing shortfall between receipt and payment of cash. Amazon has been creating cash flow for years by paying vendors in 60 days on average while collecting cash via credit cards from customers on the day of shipment (no account receivables). If a customer's sale results in a significant cash drain, you must consider whether to temporarily stop the business to protect your company's cash.

4. Operating activities analysis. Another critical step is to evaluate your operating activities to determine if they are optimized from a cash generation and consumption perspective. Analyze all major functions of your business.

The following questions are a good starting point:

- Is the operation efficient? Are there opportunities to reduce waste or improve productivity and thereby generate additional cash flow?
- Could operations be consolidated to reduce the cash requirements of maintaining multiple plants, warehouses, machines, trucks, administrative offices, etc.?
- Could a present activity or operation be outsourced to a lower cash "cost" supplier?
- Are all activities essential during the current business cycle (e.g., administrative activities)?
- Are there underutilized assets that could be sold to generate a one-time influx of cash?
- Can assets such as a warehouse or truck fleet be sold and leased back to generate cash?

Interim management reporting system

The final step is to provide real-time cash information to management to support day-to-day decision making. A typical approach is to forecast cash daily for the first two weeks and weekly for the following 10 weeks to provide a rolling 12-week forecast. Update the forecasting system daily based on new information such as daily cash receipts and disbursements.

There is ample literature available on building cash flow forecasting models. These should be constructed on a detailed level — certainly for major customers and expenditures — and can readily be produced on Excel spreadsheets.

While history is a good starting point to initially forecast cash payment and receipt cycles, it is extremely difficult to accurately project cash needs 60 or 90 days into the future. Historical payment patterns are not good predictors of cash flow during times of distress. For example, a significant payment from your largest customer that normally arrives in 30 days might get stretched to 45 or 60 days.

Communication and transparency

Once management has shifted from a profit orientation to a cash flow orientation, business leadership has better tools to keep the company afloat. Proactive management of cash must become your key metric. Of course, you will need to continue to produce traditional financial statements, but your day-to-day management decisions must be driven by your new cash flow forecasting system.

With current cash flow information at their fingertips, your business leadership can better negotiate with bankers, landlords, customers, vendors, owners and others who rely upon your company's longevity and financial well-being.

These are very challenging times. Taking immediate steps *today* to generate and protect your cash positions is a vital step for surviving to enjoy better times *tomorrow*.

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