

# Coping with Sudden Changes in Cash Needs & Availability



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CRISIS MANAGEMENT FOR LEADERS:  
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**HARVARD  
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# Coping with Sudden Changes in Cash Needs and Availability

The second program of HBS's series on Crisis Management for Leaders, led by professors Fritz Foley and Malcolm Baker, focused on coping with financial and liquidity challenges in the COVID-19 crisis. Alumni panelists from across the globe, from a wide range of industries and firms, shared their perspectives and experiences.

## The world has experienced an unprecedented shutdown of economic activity.

At stunning speed, global businesses have shut down. Extreme demand shocks have spread across the economy, with dramatic decreases in the demand for travel, transportation, oil, and retail products, as well as many other sectors. These demand shocks have reverberated throughout supply chains.

As this economic contagion has occurred, U.S. firms have drawn down more than \$150 billion from their credit lines. Unlike 2008, bank balance sheets are comparatively strong, but the high level of corporate debt is concerning. Global corporate debt totaled \$71 trillion in 2018 and has risen since. About 50% of investment-grade debt is rated BBB, which isn't far from a junk rating. Further, almost \$6 trillion in corporate debt is highly leveraged; these companies may face serious financial challenges.

## In coping with financial disruption, an iterative, agile, problem-solving process is essential.

In the previous program, Dutch Leonard emphasized that while there is no playbook for this crisis, the best course of action is an iterative, agile, problem-solving process. The process Leonard shared starts with defining the organization's goals and values, understanding the situation, developing options, predicting the outcomes for each option, choosing the best course of action, and executing. It is necessary to rapidly repeat this cycle, constantly iterating.

In HBS finance courses, the value-based management framework is taught. It involves:

- **Forecasting** incremental free cash flow.
- **Valuing** future cash flows and choosing options to maximize net present value.
- **Funding** all value-creating activities.
- **Considering the broader context** of the organization's goals, priorities, and values.

In times of crisis, however, this framework is challenged, as it is difficult to forecast and value cash flows, and funding can't be assumed. Right now, the focus needs to be less on long-term value creation and more on forecasting immediate funding needs and securing funding.

### MAIN IDEAS

- **Many businesses are already facing liquidity challenges or anticipate needing additional funding soon.**
- **An iterative, agile, problem-solving framework is invaluable in dealing with financial challenges during this crisis.**
- **Companies must urgently forecast their cash needs and identify all possible sources of funds.**

**“Demand shocks are propagating throughout the economy.”**

Malcolm Baker

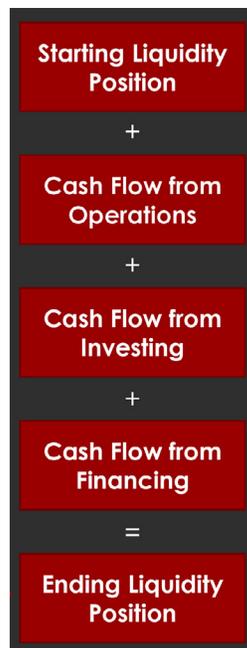
**“During the crisis, the long term just got much shorter.”**

Fritz Foley

**To understand cash needs, build a cash flow statement using the direct method.**

During normal times, businesses typically forecast cash flows for years. During a crisis, it is essential to project cash flow for days, weeks, and months. An intuitive approach to forecasting funding needs is the direct method. The steps are shown and discussed below.

- **Starting liquidity position** begins with an assessment of cash and cash equivalents as well as borrowing capacity through lines of credit.
- **Cash flow from operations** is cash proceeds from customers less cash paid to suppliers, cash interest, and cash taxes.
- **Cash flow from investing** includes cash proceeds from the sale of plant, property, equipment, and business units. These kinds of sales can be good sources of liquidity during normal times but are problematic during a broad liquidity crisis. Many firms have announced plans to cut capital investments, but maintenance can only be deferred for a limited time.
- **Cash flow from financing** covers proceeds from the issuance of debt or equity less cash paid to retire debt, repurchase shares, or pay dividends.
- **Ending liquidity position** is computed by taking the starting liquidity position and adding or subtracting cash flows from operations, investing, and financing.



**“Do the best you can to protect your most important relationships and the ones you are going to need on the other side [of the crisis].”**

A.J. Jones, Intermedia Capital Group (MBA 1987) (Panelist)

Panelists in all industries are forecasting their cash needs. They are looking at which decisions have the most important consequences and which relationships are most critical.

Scenario planning is a priority for panelists. They are anticipating scenarios for cash needs if the crisis lasts one, three, or six months, and are revising their forecasts and scenario plans weekly. One panelist suggested thinking along two dimensions: 1) an urgent “crisis mode” to forecast immediate cash needs; and 2) a “plan ahead mode” to forecast needs to thrive longer term.

**“Scenario planning is the most important thing because none of us has any idea what the duration, intensity, or severity will be.”**

Deborah Farrington, StarVest Partners, LP (MBA 1976) (Panelist)

**FORECASTING FUNDING NEEDS**  
 Program participants were polled about their current and anticipated cash needs.

- 20% are facing liquidity challenges right now
- 40% anticipate needing additional funds in 2020
- 40% have sufficient funds for 2020

**The same framework can help in fill funding gaps.**

Filling funding gaps involves assessing cash flow opportunities from operations, investing, and financing.

- **Finding cash from operations** involves looking at revenues to determine which receivables can be collected and to assess the possible impact of moving to a new social distancing sales

approach. On the cost side, it is important to determine which costs are variable (or might become variable) and to explore deferring or restructuring interest, lease, and tax payments.

- **Finding cash from investing** may be difficult as it is probably not the best time to sell assets. Options to consider include the sale/leaseback of assets and reducing capital expenditures.
- **Finding cash from financing** entails assessing drawing down credit lines, raising cash from new debt or equity, deferring or restructuring debt obligations, pursuing government loans, suspending share repurchases, and decreasing or eliminating dividends.

Panelists are using all of these tactics. They are drawing down all available credit lines to have cash in hand. Companies are moving quickly to take advantage of government funding programs, are renegotiating debt obligations, covenants, and rent, and are reducing or eliminating capital investments. They are prioritizing which suppliers to pay now and which to hold off until later, are reducing salaries—especially among executives, to show shared sacrifice—and are furloughing or laying off employees.

During this difficult time, open communication is critical, particularly with employees, lenders, and suppliers. Honest communication conveys “we are going to get through this together.”

Those with ample liquidity believe this crisis will produce attractive investment opportunities.

### **In navigating financial challenges, leadership matters immensely.**

Panelists who are bankers and investors—who see numerous companies and leaders—reiterated the importance of strong leadership. The best leaders grasp the key issues, prioritize what is most important, use a framework like the one discussed to explore all funding options, are creative, seek flexibility, and communicate openly and clearly to build trust and loyalty. They realize this crisis is a marathon, not a sprint, and continue to think strategically about the future.

### **Additional Resources**

- View the complete program lineup for [Crisis Management for Leaders](#)
- Download the [slides](#) from this program
- Download the [video](#) of this program

**“We immediately had to do everything we could to hold onto our cash.”**

Jed Webber, Webber Restaurant Group (Panelist)