ESCAPING BANKRUPTCY

THE PANDEMIC SEEMS LIKE IT IS HERE TO STAY, BUT HOW CAN WE MAKE SURE IT'S EFFECTS AREN'T?

MAY 2021

MESSAGE FROM THE EDITORIAL BOARD

Welcome readers, to the May 2021 issue of Elevate, the monthly SL@100 newsletter. Our April issue's lead article "Customer Retention Amidst a Crisis" focused on how companies can work to retain customers, increasing penetration within their existing customer base and pivoting business strategy to stay relevant. Sri Lanka is currently battling a third wave of the Covid-19 pandemic with a rising number of cases causing a strain on the healthcare system and significant disruption of economic activity. Our lead article in this issue discusses a timely and relevant theme of "Escaping Bankruptcy" with practical, actionable steps that companies and SMEs can take to mitigate the negative impact from loss of business.

We also hosted a very successful webinar last month, and followed up with a successful workshop on the 5th of May, conducted by Paul D. Roberts - Partner at Be Courageous Innovation and Faculty member of Singularity University. Unfortunately, we were compelled to postpone our second Capacity Building & Networking Event, that was scheduled to be conducted in partnership with the Hambantota District Chamber of Commerce, on the 6th of May.

We will be making some changes to the format of the newsletter to reach many more readers. So please watch this space or visit our website for more exciting news on this.

We look forward to partnering with you on your company's growth journey, and would be happy to receive suggestions on what content you would like to see in future issues.

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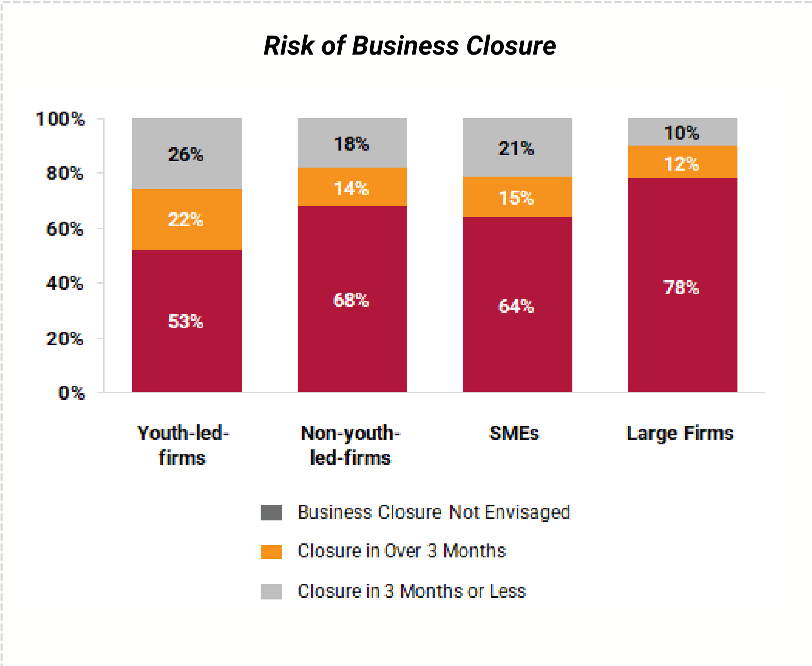
ECONOMIC DOWNTURNS HAVE CAUSED CASH FLOW IMPLICATIONS ACROSS THE EXTENDED SUPPLY CHAIN.

With almost all major economies of the world coming to a standstill due to stringent lockdown and social-distancing measures, most organizations are reeling for cash. To avert crisis, organizations are immediately switching to a survival mode to take care of their own finances, transferring pressure from supplier to customer or vice versa. This has led to the tremors of disruption being felt across the entire supply chain.

SO, EVENTUALLY WHO ALONG THE SUPPLY CHAIN TAKES THE BRUNT OF TIGHTER FINANCING NEEDS?

In the short term, as firms tighten working capital policies, the pressure of financing needs is transferred to more vulnerable partners along the supply chain. Survival has depended on financial resilience of trading partners, giving larger organizations the ability to withstand the pressure of the pandemic. Given that SMEs have fewer resources - lower cash reserves/cash buffer (in days), unstable cashflows and struggle for profitability - when compared to their larger counterparts, they are more often than not more vulnerable and end up having to be the ones that face liquidity shortages and bankruptcies. This condition is further aggravated by the unwillingness of banks to lend to non-reputed firms during times of crisis.



Source: "COVID-19: The Great Lockdown and its Impact on Small Business", ITC, June 2020.

HALF OF SMALL BUSINESSES ONLY HAVE A LARGE ENOUGH CASH BUFFER TO ALLOW THEM TO KEEP BUSINESS GOING FOR 27 DAYS. THOSE WITHIN LABOR INTENSIVE INDUSTRIES, HAVE EVEN LESS OF A BUFFER, WITH RESTAURANTS ONLY HAVING 16 BUFFER DAYS ON MEDIAN. HENCE, SMES AND YOUTH-LED FIRMS ARE AT A HIGHER RISK OF PERMANENTLY SHUTTING DOWN IN COMING MONTHS.

Cash Buffer Days

Restaurants	16 Days	Metal & Machinery	28 Days
Repair & Maintenance	18 Days	Healthcare Services	30 Days
Retail	19 Days	High-Tech Manufacturing	32 Days
Construction	20 Days	Other Prof. Services	33 Days
Personal Services	21 Days	High-Tech Services	33 Days
Wholesalers	23 Days	Real Estate	47 Days

Source: "Cash is King: Flows, Balances, and Buffer Days", JPMorgan Chase & Co., September 2016.

In order to mitigate liquidity shortages and avoid unnecessary bankruptcies in the nearest future, less-resilient organizations can adopt a range of temporary measures from – sustaining demand to working capital management and cost and capital restructuring. To read up on sustaining demand amidst crisis, look up our article on CUSTOMER RETENTION. In this article, we explore:

1

Working capital management tactics that can be deployed to bridge short-term financing gaps and weather off the effects of rising financial pressure from the more powerful upstream and downstream supply chain partners.

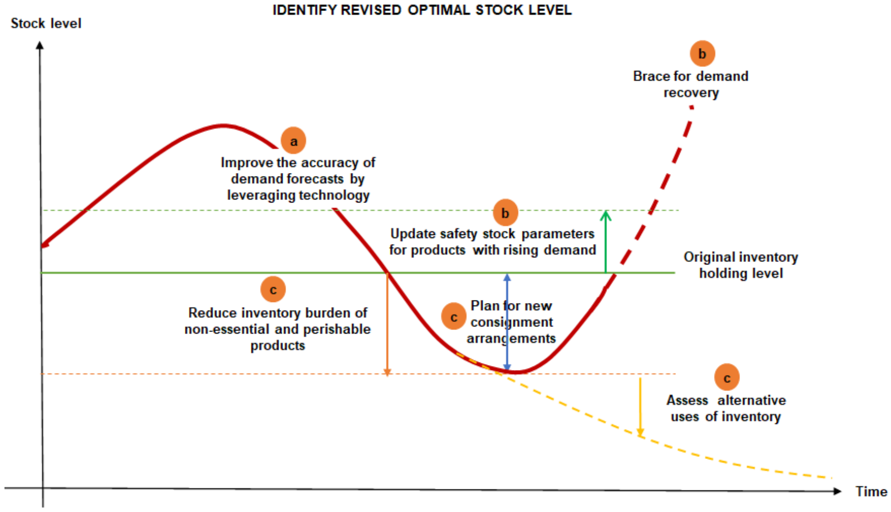
2

Cost and capital restructuring to ensure firms are not incurring expenses in the absence of business. Reducing variable costs, fixed costs as well as revisiting capital reinvestment plans are some of the tactics we explore.

1. MANAGING DAY TO DAY WORKING CAPITAL FINANCES IS ONE OF THE MOST CRUCIAL STEPS TO TIDE OVER THE CRISIS, WHILST BEARING IN MIND, ITS EFFECTS ON THE EXTENDED SUPPLY CHAIN.

As cashflow becomes the need of the hour and takes precedence over profitability, businesses are having to shift focus from the income statement to the balance sheet, deploying measures to release cash tied up in **inventory**, **receivables** **and** **payables.**

INVENTORY: Revisit demand plans and identify optimal stock buffer to avoid dislocation of inventory – an excess results in a cashflow struggle and a shortage leads to lost business.



A. IMPROVE THE ACCURACY OF DEMAND FORECASTS BY LEVERAGING TECHNOLOGY

I. Improve fill rates

Accurate demand forecasts enable early identification of optimal stock levels, re-order points and lead times. Having the required stock in time drives more revenue through improved fill rates and service levels, whilst keeping inventory holding costs down. It avoids the loss of business caused by an unavailability of products.

On the other hand, multiple firms that relied on outdated forecasts expecting usual inventory turnover in order to drive revenue and create space for new products have ended up closing locations owing to plummeting sales leading to inventory backlogs while additional inventory is en-route to them through vast supply chains.

For example, local independent grocery stores that carefully predicted the increase in demand owing to the pandemic have managed to restock the right products (mostly shelf food and sanitary products) at unprecedented speeds and drive revenue up.

B. FOR PRODUCTS WITH RISING DEMAND, UPDATE SAFETY STOCK PARAMETERS AND BRACE FOR RECOVERY MODE

I. Update safety stock parameters

In the short-term, as consumer demand shifts from wants to needs, essential products experience a surge in demand. Some of these products are at a risk of facing raw material/product shortages due to import restrictions, plant outages and lockdowns. Hence, inventory safety stock parameters need to be revised to reflect increased demand as well as supply-side volatility.

In addition to the product itself, other mission critical items that enable continuity in operations should also be stocked up - crucial raw materials for production (even if small volumes), personal protective equipment, such as masks, gloves, and gowns and key replacement parts and maintenance products, such as food-grade lubricants for critical plant equipment.

For instance, Sri Lankan consumers have begun to hoard medical supplies, resulting in massive shifts in demand for pharmacy retailers. However, countries from which such medicines are largely imported, such as India are facing spikes in infections and are likely to shutdown supply. Hence, retailers will need to look at securing additional inventory faster prior to shutdowns, or look for alternate suppliers in other regions or explore the potential of local pharmaceutical manufacturing (subject to availability of lab facilities, non-patent drugs, clinical trials and timelines) to ensure undisrupted product availability.

II. Brace for recovery mode

Failure post COVID for some has mainly owed to an overestimation of sustained impact, both systemically and cyclically, as the intensity of the shock fueled widespread economic pessimism, breaking many records (negative) in the process.

However, as evident from historical pandemics, economies and demand eventually stabilize at some point and the ones that emerge as winners are those that brace themselves for transformative recovery.

For example, a local spice manufacturer states that COVID certainly had an adverse impact on them; however, business picked up relatively soon after even amidst curfew restrictions as their product was an essential. Competitors who had overly downsized operations by closing plants and laying off employees, were unable to take advantage of the positive spike, whilst they, who prepared for recovery were able to bring supply chains and inventory back into balance much faster than those who waited to see signs of recovery to act on it.

C. FOR DEMAND CHOKED PRODUCTS REDUCE INVENTORY BURDEN

I. Return excesses, avoid further inventory creation and wastage

Where inventory hasn't contributed to margins, SMEs should collaborate with suppliers to explore the possibility of, returning shipments/loads of raw material that haven't reached ports/warehouses, returning unused raw material sitting in warehouses, hold off automatic material requisitions for the future and avoid dispatching into manufacturing lines for further production to avoid adding more inventory burden (both raw material and finished goods).

For more perishable products, inventory levels need to be adjusted to suit revised demand as waste is a prominent cause of cost where markets remain difficult to access.

For example, a local retailer selling imported gourmet prep food such as smoked salmon, overseas grown fruits, faced severe wastage given the shorter expiry periods and high purchase cost of such products. As consumers switch to be more conscious, they are purchasing more long lasting and affordable products.

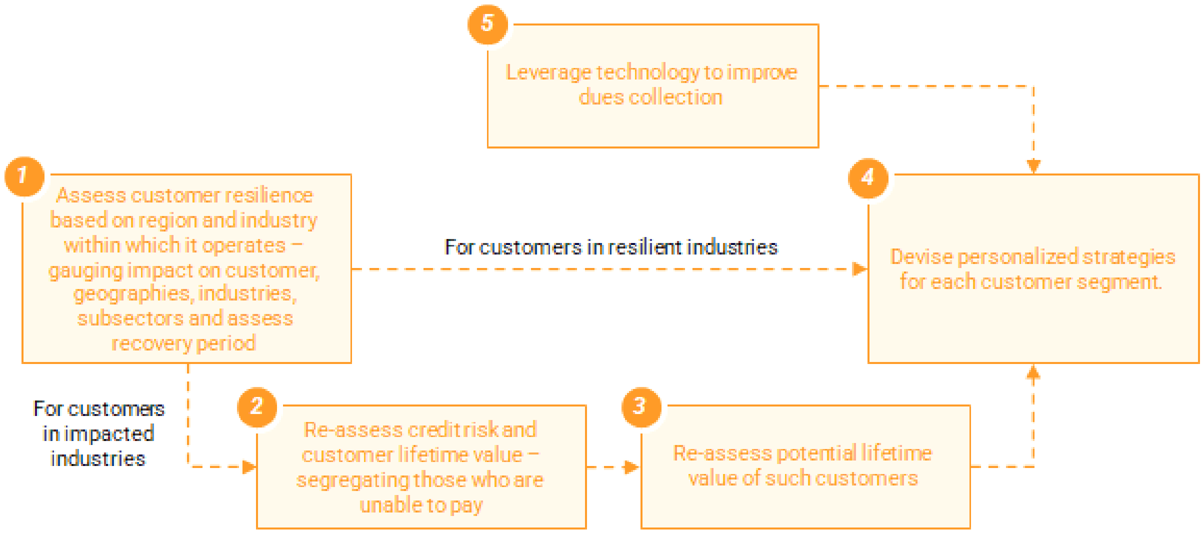
II. Assess alternative uses of inventory

- Finished goods inventory – assess the possibility of selling it in other regions. For example, if international markets are the main focus, redirect to domestic markets or to less affected geographies.
- Raw material inventory – assess products facing a surge in demand and evaluate the possibility of creating it with our raw materials. For example, alcohol be used to make sanitizers.
- Direct channels to reach consumer – if inventory is trapped in physical stores, review the possibility of advertising and selling online.

III. Consider new consignment arrangements

Approach key customers to identify if they are able to hold inventory on our behalf, or if vendors are willing to put supplies in our plants on consignment. This could be a win-win, so each party has a protective buffer in the event of a disruption while keeping inventory holding cost a minimal.

RECEIVABLES: Generate faster cash flow from receivables – a pre-earned cash source.



A. ASSESS CUSTOMER RESILIENCE BASED ON REGION AND INDUSTRY WITHIN WHICH IT OPERATES

Gauge impact on customer geographies, industries, subsectors and assess recovery period
It is not uncommon to find businesses at both ends of the spectrum. For those that are badly affected, assess the long-term impact of the outbreak: while some industries might take a longer time to come out of the crisis and the ensuing recession, others may bounce back quickly. Subsectors could also behave differently within an industry. For instance, automotive subsectors might follow very different recovery trajectories: the maintenance and repair of vehicles could recover more quickly, than their manufacture or sale.

For example, some industries like healthcare and essential supplies experience minimal or positive impact, while others like airlines and capital goods have been badly affected.

B. FOR CUSTOMERS IN IMPACTED INDUSTRIES, RE-ASSESS CREDIT RISK AND CUSTOMER LIFETIME VALUE

Segregating those who are unable to pay from those who are able to pay
Re-assess customer credit risk based on past credit history, the COVID-19 impact on their business, government support and delinquency risk.

Leverage advanced analytics tools that can use inputs such as past payment behaviors and company revised financial health to predict a company's likelihood of paying overdues.

For instance, this could be an opportune time to focus specifically on clients who have benefitted from government stimulus packages.

C. RE-ASSESS POTENTIAL LIFETIME VALUE OF CUSTOMERS

Identifying the potential business a company would receive from a customer
Identify loyal (one-time or recurring) and key customers (could their decisions disrupt us financially), how much business they currently account for (percentage of overall revenue), and the future of their business with the company.

Does a single customer account for greater than 25% of our business?

D. DEVISE PERSONALIZED STRATEGIES FOR EACH CUSTOMER SEGMENT

A one size fits all approach often results in longer Days Sales Outstanding. Hence, a personalized strategy for each customer segment is recommended.

PERSONALIZED STRATEGIES FOR RECEIVABLES

CUSTOMERS WHO ARE RESILIENT

Firms could offer dynamic discounts for early collection, with varying percentages based on customer lifetime value. With this technique, the company is essentially paying customers for short-term financing. While the cost may be substantial, if government loans or bank credits are not available, this might be one of the few available options as it reduces the risk of nonpayment or late payment.

LOYAL CUSTOMERS UNABLE TO PAY

For loyal customers (with high lifetime value), that are unable to pay, offer more time for settlement, late-fee waivers, work together to identify revised credit periods but discontinue further production or service to them until payment is received.

CUSTOMERS THAT DO NOT PAY

For the rest of the customers that show no signs of payment, organizations could charge late payment fees, and in worst cases, deploy more aggressive techniques such as factoring receivables and collection agencies to improve cash flow quickly, although it is a relatively expensive approach that can hurt relationships.

E. LEVERAGE TECHNOLOGY TO IMPROVE DUES COLLECTION

Digitize payments to ensure customers can pay you from wherever they are - SMEs are forced to use their agility to be more responsive to the crisis, as they do not have built-in resilience to fall back on. Taking leap frog approaches is essential to help them stay alive and digitization of payments is essentially one of them.

Improved visibility to cashflow decision makers - Ensure that all decentralized information is made available on a single dashboard with KPIs to monitor (pre-COVID versus post-COVID KPIs: current ratio, acid test ratio, inventory turnover, cash conversion cycle, receivable turnover).

For example, a B2B company consistently faced a high level of overdues on website orders due to a discrepancy in volumes. This was caused by a lack of information and clarity among responsible teams - IT, Sales and Collection teams. Establishing a centralized information system increased visibility across all three teams and helped the company with a significant reduction in overdue accounts. This also boosted morale among collection team members by reducing the time they spent working repeatedly on the same issues.

SUPPLIERS - Collaborate with suppliers to establish optimal revised credit terms and reschedule payments accordingly.

A. MAP SUPPLIER RESILIENCE AND HOW CRUCIAL THEY ARE TO OUR BUSINESS TO TAILOR PAYMENT STRATEGIES

Review vendor profiles to assess their resilience based on region, industry and subsector within which it operates. Then conduct a supplier risk analysis to evaluate their ability to react quickly and maintain supply continuity. Supplier cruciality would depend on level of diversification of supplier base, our level of reliance on them and their replaceability. Then create a payment strategy tailored to each of them.

PERSONALIZED STRATEGIES FOR SUPPLIERS

For critical suppliers who are resilient, negotiate for revised credit terms:

Target more financially stable suppliers, ideally who already share a long-term relationship, and firms you know need your business as they are more likely to compromise. Whilst large corporate suppliers would be imposing pressure on smaller players to expedite payments, cooperating with them and communicating about cash constraints owing to the pandemic may convince them to grant temporary relief in the form of extended credit or payments in instalments rather than lumpsums.

For critical suppliers who are vulnerable, prioritize and accelerate payments:

There are situations where companies would need to accelerate payables for a critical supplier that is on the brink of failure in order to preserve supply chain resilience and prevent a critical disruption. Such vendors are most likely to call for speedier collections. Hence, organizations should prioritize payments to support failing suppliers rather than settling them in the order of falling due or receipt of invoices. If the firm does not have adequate funds to settle outstanding balances, they should aim to rely on emergency government assistance, such as Sri Lanka's loan moratoriums and 4% concessionary loans. This is crucial to avoid permanently losing a key supplier.

For non-critical suppliers, work towards terms for delayed payments:

A unilateral decision to delay payments and force the extension on suppliers is likely to deprive supply chain partners of the cash they need to maintain their operations. This could also lead to late deliveries and quality problems, never mind the added strain to supply relationships. While this can be practiced when it comes to non-critical suppliers, firms should exercise caution and only resort to it as a last means, as their credit worthiness would be impacted.

B. LEVERAGE TECHNOLOGY TO ENSURE INVOICES ARE FOOLPROOF - PAYING ONLY FOR SERVICES YOU USED

- Simple automation of the payable process from recording and auditing purchase orders, invoices, requesting approvals and flagging missing documents helps reduce staff burden and chances for human error.
- Reviewing raw material stock for quality issues such as damages/expiry or non-required supplies that are still within the return period can also help reduce total bill.
- Identify what alternate suppliers are offering as concessions in times of pandemic and negotiate for similar terms, or inform suppliers of the inclination to switch.

2. COST AND CAPITAL RESTRUCTURING TO AVOID HAVING TO PAY FOR EXPENSES THAT FALL DUE DESPITE A LACK OF BUSINESS.

COST RESTRUCTURING - Firms should focus on both variable and fixed costs

A. REDUCE CURRENT VARIABLE COST SPEND

- When labour is a significant cost line, consider avenues that might help reduce spend to avoid getting to a situation where layoffs are required.
- Firms should look for opportunities to reduce contract labour and re-distribute work to the permanent workforce.
- Encourage employees to take available leave balances to reduce liabilities on the balance sheet and, if necessary, consider offering voluntary, or even involuntary, leave without pay to preserve cash.

For example, while there are 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 is essential.

B. REDUCE OVERALL FIXED COST SPEND

- If rental agreements are approaching renewal, look for cheaper and smaller locations and encourage employees to work from home to reduce rental, electricity and other corporate level expenses.
- In times of uncertainty, firms should aim to swap fixed costs to variable costs wherever possible—preserving core business while increasing flexibility on fringes.

Selling assets and leasing them back, expanding the use of contract manufacturing, transportation fleet leasing and third-party warehousing are some of the ways to raise emergency cash.

CAPITAL RESTRUCTURING - With cashflow forecasts in mind, firms should consider what's really necessary for the near term.

A. REVISIT CAPITAL INVESTMENT PLANS

- It is crucial to identify capital investments that can be postponed until the situation improves, investments that need to be entirely reconsidered and capital investments that are essential for rebound or for creating competitive advantage.

For example, most firms are cutting down non-critical expenses like research and development whilst investing on technology and digitization platforms.

IN THE MORE MEDIUM TERM, ORGANIZATIONS WOULD NEED TO BUILD RESILIENCE BY LOOKING BEYOND ITS OWN ENTERPRISE - COLLABORATING WITH KEY TRADING PARTNERS TO TRANSFORM THE EXTENDED SUPPLY CHAIN TO A MORE AGILE AND TRANSPARENT VALUE CHAIN. IN DOING SO, BUSINESSES WILL HAVE TO SAFEGUARD THE INTERESTS OF PARTNERS AS WELL AS ITS OWN EMPLOYEES. TO READ MORE, AWAIT OUR NEXT ISSUE.

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ABOUT THE AUTHOR

Seyeda Mowhiba is a Consultant at Stax and has been with us since 2016. As a holder of ACMA, CGMA, UK and four world awards in Financial Management and Strategy, she has led multiple projects assisting companies across diverse industries on business strategy formulation, process improvement, and financial modeling. Prior to her role at Stax, she worked at Moody's Analytics and Dilmah.

SRI LANKA@100 PLATFORM NEWS

SRI LANKA@100 HOSTS EXPONENTIAL THINKING WEBINAR WITH INNOVATION EXPERT PAUL D. ROBERTS

The U.S.-supported Sri Lanka@100 (SL@100) hosted a public webinar featuring Paul D. Roberts, partner at Be Courageous Innovation and faculty member at Singularity University. As a partner at Be Courageous Innovation, a growth consultancy firm, Paul is a sought-after speaker and has delivered 260+ talks and 80 programs to organizations and global audiences on various topics including innovation and exponential growth. Exponential growth or exponential thinking is a concept introduced by Ray Kurzweil and Peter Diamandis of Singularity University; at its core exponential thinking encourages companies and entrepreneurs to leverage evolving technologies such as artificial intelligence to drive accelerated growth.

The session, which was attended by nearly 300 participants, focused on helping the audience understand the emerging technologies that will shape the future, the rapidly volatile environment that companies operate in, how companies can fortify their businesses against potential future risks and capitalize on opportunities to drive growth.

“This concept of exponential growth is critical in helping Sri Lanka achieve high-income status so it can better compete on the world stage. With initiatives like Sri Lanka@100, we are helping Sri Lankan firms to effectively navigate the current challenges, become more resilient, and increase profits and employment,” said Debra Mosel, United States Agency for International Development (USAID) Deputy Mission Director for Sri Lanka and Maldives. “We hope that this and subsequent webinars in this series will provide useful and practical ideas that can be used to drive exponential growth for individuals, businesses, and ultimately, for Sri Lanka.”

SL@100 co-founder and Stax Managing Director Ruwindhu Peiris emphasized the vital importance of programs such as this to help build Sri Lanka’s future: “Encouraging an exponential mindset and an essentially optimistic way of thinking about the future is fundamental to what we stand for at Sri Lanka@100. It’s only when a large share of companies and individuals in our country start thinking in this way and acting accordingly that we will start to see transformational growth.”

SL@100 is a private sector-led business development platform that was launched in 2020 with support from the U.S. Government’s development arm, USAID. Its goal is to play an impactful part in making Sri Lanka a high-income country by 2048, i.e., within 100 years of independence. This initiative helps high potential small and medium enterprises (SMEs) to optimize internal operations, enhance product portfolios, access new markets, attract smart capital, and create next-generation businesses. SL@100 also conducts capacity-building events, such as this webinar, which are open to a broader audience of SMEs, entrepreneurs, and young leaders.

The webinar was supported by leading Sri Lankan organizations and businesses including NDB Bank, SLASSCOM, AMCHAM, Daily FT, and the CFA Society of Sri Lanka.

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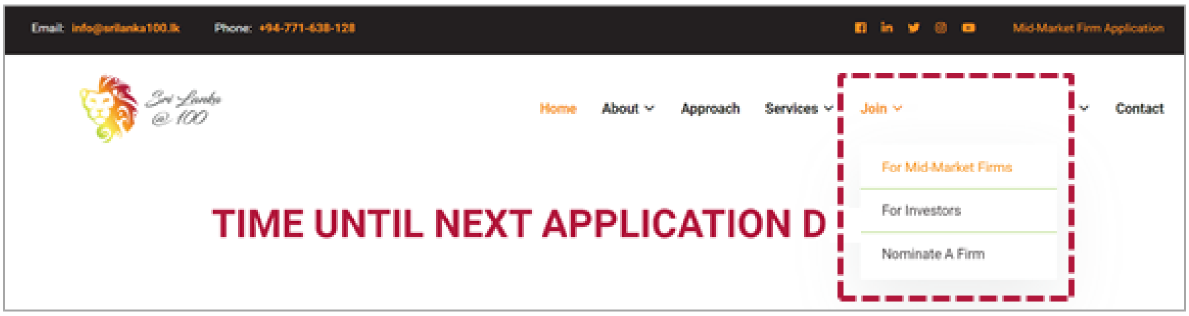

SRI LANKA@100—WHY, HOW, WHAT?

A Diamond from the Rough

1. WHY?

Why Does this Platform Exist?

PURPOSE: To make Sri Lanka a High-Income Country within 100 Years of Independence (2048)—with equitable and inclusive growth enabling all Sri Lankans to realize their aspirations.

3. WHAT?

What Exactly Is This Platform?

AN ECOSYSTEM: Where mid-market firms can thrive and create value by focusing on:

1. Building Next-Gen Businesses
2. Operations Optimization
3. Revenue Growth
4. Smart Capital

2. HOW?

How Will We Get There?

BY: Powering the Growth of Mid-market Firms and Adhering to the Values of INCLUSIVITY & EXCELLENCE

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