

Moving on



The past 18 months have been a trying time for businesses, but for many the toughest challenge is the effect of a global recession. Successful strategies are needed for survival with cashflow/working capital being fundamental. The current economic climate is making it very difficult for businesses to forecast and control this – however, it is possible.

In recent weeks the Government has attempted to re-open capital and liquidity channels which have been severely constrained. Yet the system is still in the grip of a paradox. The banks insist they are open for business, but businesses are finding it fundamentally tougher to raise finance. What is the reality?

An altered landscape

Even before the financial crisis, small and medium sized businesses had difficulties gaining access to finance to support their development at key stages. However, we are now seeing evidence to suggest that larger business lending requirements are receiving similar treatment, i.e. greater scrutiny. Larger businesses are no longer considered to be immune to the major changes in the global economic climate.

Lenders are, however, still in business to lend money. The key difference now is that when risk and credit are approved the margins on mid- and long-term finance are increasingly linked to LIBOR (London Interbank Offered Rate), as opposed to base rate, and security requirements are much greater. The recent base rate cuts are starting to have a positive effect and with further cuts expected there is anticipation that LIBOR will continue to fall as well.

Funding against property has also fallen to loan-to-value levels of 60-65% and valuations on plant and machinery have also reduced, resulting in lower residual values. With the introduction of Basle II, traditional overdraft facilities will become more difficult to obtain compared to invoice finance or factoring, due to the associated capital requirements, which provide lenders with more control and transparency.

Essentially many lenders, which were previously chasing market share at any cost, now only want custom from the best clients. As the old competitive pressures no longer hold sway, lending criteria are becoming more refined and will potentially be even tighter in the months ahead.

Coping with the change

Many businesses may now find themselves in an awkward position. Contingency plans are needed to address the impact of this crisis and any possible

reduction in financial support, particularly if:

- finance facilities are due for renewal – banks may have already reviewed and re-priced these
- assets have diminished in value to a point where they no longer support the facility
- the business operates in an industry sector that is no longer attractive to finance e.g. property.

Problems for business can arise in a number of different forms. A business may have limited choice if its current finance partner is unwilling to provide support by renewing or approving additional facilities. There may be a need to review current finance facilities, to ensure there is capacity to support needs in the short to medium term. If there is a need to find a new facility or raise additional funds, the exhaustive scrutiny of each application will lead to increasing timescales: in some instances, a proposition that is acceptable at the outset of negotiations may become unacceptable in the time it takes to approve.

Nonetheless, businesses need finance. Many will thus need to make a tough decision now, as the cost of moving finance may be less than the ultimate cost of remaining where they are.

Strengthening your position

Understanding the cashflow requirements of the business as a whole, and of each individual project, is critical to survival. Financial projections should be reviewed and revised on a regular basis, with detailed performance variance analysis being incorporated into the revisions.

If financial projections are not kept up to date, they are unlikely to reflect the current performance and cash

requirements. Financing costs will have clearly increased, as well as energy costs, base materials and transport/distribution costs. It is therefore increasingly critical that businesses review their pricing and trading terms with both their clients and suppliers to ensure profitability. Such control will allow increases to be passed on, or confirm that margins remain sufficient to offset any impact while identifying the best option in terms of service, cost and cashflow implications.

Those that do not address any increases will start to face cashflow management issues. This will make the business vulnerable if its bankers are unsure of the ability to service debt – banks carefully monitor performance against target data provided initially, alongside historic information and covenants included as part of the facility agreement.

It is better to identify the issue as soon as possible, and to be able to justify the need for increased facilities or performance volatility. By looking at the bigger picture and carefully considering potential problems, or where savings can be made, you will be in a stronger position. At the moment banks certainly do not want surprises, and will act swiftly and ruthlessly to minimise their own exposure.

Similarly, in approaching new sources of finance, control and effective financial management must be demonstrated. The ability to identify business impacts will provide confidence and further underline the quality of the business.

By understanding needs, and demonstrating the serviceability of debt through strong and robust performance and cash management, a business can continue to flourish. Even in the current conditions, a business that can demonstrate its strength will receive financial support and grow.

Focusing attention

There are a number of critical areas which businesses should consider when managing through a recession. These can be divided into three categories: operational, financial and managerial.

Operational

- Assess impact of staff turnover and changes in management which could have a negative effect on the business.
- With 80% of turnover usually coming from 20% of the client base it is important that relationships are managed and quality of work/service is maintained, particularly for the top 20%.
- Review credit limits; check that insured debts are within allowed limits.
- Obtain credit references on any major customer/supplier.
- Review terms of trade and make sure they include a robust, 'all monies' retention of title clause.
- Look out for changes in payment patterns, or 'round sum' payments.
- Review operation of internal controls and fraud management action plans.

Financial

- Look for significant declines in sales, increased pressure on running costs, increased gearing, hardcore overdraft, negative cashflow/working capital.
- Be extra vigilant in monitoring banking covenants. Falls in asset values may affect reported profits and asset related covenants. Impairments may also need to be recognised in relation to goodwill, with consequent effects on reported profits and net assets.
- If expecting to make a trading loss in the current period, make a provisional loss carry-back claim to offset profits earned in the previous year. Provided appropriate evidence can be given to HMRC it may be possible to defer tax payments or obtain repayments. All businesses should review their provisioning policies to ensure provisions for trade debtors reflect likely cash recoveries. This will speed up tax deductions and ensure tax is not paid earlier than necessary. Falls in asset values may trigger impairment losses that can be claimed in a similar way.
- Ensure tax compliance is correct. Making mistakes or cutting corners can prove expensive. If considering redundancies or changing the way you work with contractors, take professional advice before implementing changes. Make sure tax returns and payments are made on time to avoid penalties.
- Timings of investments should be considered. For example, if a building project involves land remediation work to remove Japanese knotweed or to clear a site that has been derelict since March 1998, delaying the start until April 2009 may have tax benefits as it is proposed that costs for such work will then qualify for 150% land remediation relief.
- Lower values for property assets may offer the opportunity for assets to be transferred to the business owner at no or low tax cost.
- Maximise tax claims for any R&D work carried out.
- Share options to reward and motivate employees are often cheaper than bonus schemes or pay rises.
- Consider paying VAT electronically to HMRC, for example by CHAPS or BACS, as this will give a seven-day extension for the submission and payment of the VAT returns.
- If you are in a net repayment position (the VAT to be recovered is usually more than any VAT to pay) then it is worth considering filing your VAT returns on a monthly rather than quarterly basis to improve cashflow.
- Review arrangements for partial exemption to ensure recovery of full entitlements.
- Review invoice timing. It may be possible to delay accounting for some VAT by up to 14 days.
- Ensure your VAT return captures all VAT which you are entitled to recover in that VAT return period. Where possible seek agreement for a tax accrual method with HMRC for a one-off cash injection.
- Review method by which employee contributions are deducted to fund pension schemes.
- Review costs of employee benefits and source alternative suppliers where possible.

Managerial

- Appraise the management information system to ensure it is providing the information required for measuring performance against sales targets, overruns etc. This way you can be alerted to any variances at the earliest possible point.
- Appraise senior management and the board of directors to identify any latent weaknesses or shortfalls in experience and abilities required to trade through a recession, and where appropriate train or recruit as necessary.

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