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Guidelines to Maximize Liquidity and Support a Cash-Centric Organization During Market Uncertainty

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The economic impact of COVID-19 requires leaders in every industry to make critical business decisions during this time of market uncertainty. Knowing your current cash status and managing liquidity — cash in the bank and borrowing capacity — are vital elements in this process. Optimizing your liquidity while maintaining your business is a balancing act, and chief financial officers (CFOs) must ask themselves these important questions:

- What liquidity tools are currently in place?
- Do these liquidity tools provide the necessary and critical information that management needs to provide proper direction to executives, the board and capital structure participants?

A more thorough approach to managing liquidity helps financial leaders anticipate near- and longer-term decisions, allowing companies to:

- Track every dollar coming into and leaving the business, creating stronger financial discipline and revealing the true drivers of liquidity success in the company.
- Quickly tackle issues that could affect the viability of the business (e.g., loss of revenue and ensuing cash receipts or rising costs that you cannot pass through to and/or recoup from customers).
- Use real-time data to communicate future liquidity needs to any constituent.

Effective liquidity management requires having an actionable plan to preserve funds and maximize borrowing capabilities based on updated forecasting and relaying any difficult but necessary decisions and realities to employees, capital structure constituents, management and boards. To manage cash flow and financial obligations, financial leaders will need to evaluate their current liquidity management practices by:

- Assessing liquidity requirements during a turbulent time.
- Communicating that information to boards, lenders, vendors and other stakeholders to

have a productive conversation about what needs to happen to fix the current state.

- Driving liquidity tools into the organization and institutionalizing this process.

Necessary Elements to Manage Liquidity

Simply stated, liquidity is cash in the bank and a business's availability to borrow as detailed under its capital structure credit facilities. Borrowing limits are typically driven by working capital or a borrowing base tied to collateral and financial covenants. Successfully managing cash and liquidity requires:

- **A cash culture:** An awareness of how cash should drive company behavior is essential. For many middle market businesses, day-to-day decisions should be based on cash instead of other more traditional accounting criteria.
- **A reliable and accurate cash and borrowing base forecast model:** Once developed, this forecast can be used week after week to predict cash flow and borrowing availability. This includes the development of baseline assumptions and then pressure testing the assumptions with conservative and optimistic alternative scenarios. By focusing on strategic modeling and 13-week cash flow plans, organizations can prepare themselves today for variable market outcomes.
- **Robust, periodic communication with all interested parties:** Parties not involved in daily business operations, such as boards of directors and lenders, will take great comfort in receiving regular, clear updates from management. Transparency is key to maintaining confidence and support.

Next Steps: How to Optimize Liquidity Management

In order to ensure efficient liquidity management practices during market instability, financial leaders should:

1. **Conduct a current-state liquidity assessment:** Taking the time to thoroughly review the state of the company's current cash position as well as its historic cash level and trends is vital to developing a plan for liquidity management. This evaluation should identify:
   - **Current resources:** Gauge whether the necessary staff, tools and skills are readily available to manage an effective plan and identify how you will address any gaps.
   - **Borrowing base availability:** Determine how much you can borrow based on realistic outlooks for collateral assets.
   - **The company's ability to satisfy its obligations:** Ensure data is up to date on all current and forthcoming expenditures and days payable outstanding trends, including operating and nonoperating cash levels.
2. **Assess your company's cash culture:** Successful liquidity management requires a constant eye on actual cash on a daily and weekly basis. High-performing organizations have the resources to track detailed cash reporting, illustrate how and why cash expenditure decisions are made, and enforce adequate cash control measures.
3. **Open communication:** Honest conversations with board members, sponsors, lenders and vendors is essential. Heightening their awareness into the plans for managing near-term liquidity, and most importantly the rationale for why, strengthens trust and transparency across the organization. This also reinforces the mentality that proactive liquidity management needs to be a standard and consistent company practice.

There is no one-size-fits-all framework for managing liquidity. In many ways, every organization is unique. But by leveraging current liquidity management tools and ensuring the necessary people and communication structures are also in place, leaders can position their organizations for near-term sustainability and long-term growth with a proper liquidity road map.

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Key Takeaways

Proactive liquidity management is essential, particularly during market volatility. Effective management will require leadership to:

Think Differently.

Institutionalize liquidity management within your organization; make it part of your company culture and make decisions based on it.

Plan Differently.

Assess your existing resources and tools for liquidity management and develop a plan for improvement that can be shared with your management team, board and/or all capital structure constituents.

Act Differently.

Ensure your plan contains a focus on cash culture, a reliable cash and borrowing base forecast model, direct communication with internal stakeholders and lenders and, most importantly, actionable steps based on forecasted scenarios.