



# No credit? Big problem.

## Focus on short-term cash or long-term growth?

The credit crisis and economic downturn have already pushed some companies to the brink of bankruptcy. Credit is tight and there's no end in sight. Should you hunker down and focus on cash? Or should you use the downturn as an opportunity to grab market share and drive long-term growth? In reality, both strategies have inherent risks to the business.

	Point	Counterpoint
<b>Focus on short-term cash.</b>  <i>"Do everything you can to generate and preserve cash. It's all about survival."</i>	Shift your focus from revenue and earnings per share to cash.	Easier said than done. Most business leaders have spent their entire careers focused on earnings and growth and don't know how to manage a business around cash flow. Cash isn't the language of day-to-day business performance.
	Reduce costs and conserve cash by freezing discretionary spending and implementing across-the-board cuts. Focus on activities that really matter and stop everything else.	Often the cash savings from these types of initiatives is relatively small and temporary. Cash levers must be pulled, but carefully. When you're trying to trim fat, it's easy to cut bone and muscle by mistake.
	Free up working capital by tightly managing payables and receivables, and by reducing inventory levels.	These actions can come back to bite you if not done right. Demanding faster payment can damage important customer relationships. Delaying payments to cash-strapped suppliers can lead to supply disruption (you might even lose your preferred customer status). Reducing inventories can lead to stock-outs.
	Rationalize assets by closing plants, streamlining your product portfolio, and trimming under-utilized assets.	These actions can actually make your cash crunch worse in the short term. It takes time and money to close facilities and sell assets. Plus, asset sales in a down market can easily turn into a short-sighted fire sale.

	Point	Counterpoint
<b>Think long term.</b>  <i>“Stick to your long-term strategy. A downturn is a great time to grab market share and strengthen your business position.”</i>	Stay committed to your long-term growth strategy.	It’s smart to focus on the long term. But some companies are in dire straits and don’t have that luxury; cash generation and retention may be critical to survival. The longer you wait to come to grips with the new reality, the more limited and unattractive your options may be.
	The economy will eventually recover. Companies that think long term will be in the best position to capitalize on the upturn.	If short-term cash problems drive you into bankruptcy — or severely weaken your market position — your long-term strategy is irrelevant.

## My take

**Don deCamara**  
Principal, Deloitte Consulting LLP

Everyone knows that in an economic crisis, cash is king. However, most business leaders and managers don’t have much experience managing a business around cash flow. They have spent their entire careers focused on earnings and growth, and often find it hard to switch gears. Here are some things to keep in mind during these difficult times:

**Realistically assess your financial condition.** It’s critical to understand whether your company is financially underperforming or distressed. This assessment should show how much cash you need to generate — and how quickly you need it. Generating a lot of cash fast is more likely to put the long-term health of your business at risk.

**Short-term cash requirements often trump long-term strategy.** In normal times, it’s smart to develop a sound long-term strategy and then stick with it. But these aren’t normal times. If a short-term cash crisis drives you out of business, your long-term strategy doesn’t really matter.

**Cash flow trumps earnings per share.** For a distressed business, the key to survival is cash flow. That’s a huge mental shift for most CFOs and managers, who are accustomed to focusing on earnings per share. Since companies don’t normally focus on cash, most do not have an easy way to determine what their cash position is, or how long their cash will last. Distressed companies might need to track and forecast cash flow weekly, or even daily. Earnings might be important to Wall Street, but cash keeps the lights on.

**Attack on all fronts.** To build a war chest of cash, you need all of your leaders to be on the same page in making cash a top priority for the company. All potential cash sources must be thoroughly examined. These sources include everything from stemming price leakage to reducing cost and working capital to selling underutilized assets.

**It’s about the portfolio.** Develop a portfolio of integrated programs to generate cash with an eye toward reinforcing the long-term viability of your business. Focus on cost and working capital “quick hits” to generate an immediate liquidity cushion and to fund longer term structural programs such as closing stores and selling off business units. A combination of activities can strengthen your balance sheet and help you capitalize on the upturn.

**Action trumps analysis.** In a crisis, you don’t have time for detailed analysis or deep reflection. The longer you wait, the more narrow your options. In normal times, the 80/20 rule can help you avoid analysis paralysis. But when your liquidity is drying up, you might need to shift to 60/40.

**Expect the unexpected.** Develop downside financial scenarios for your business and understand — in advance — what the key trigger points are (e.g., order book reductions), and what specific actions you will immediately take to preserve cash.

**Retrenching trumps growth.** Businesses usually focus on growth. But for distressed companies in a tough economy, the key is shrinking the business to a profitable core. That might mean closing plants, laying off staff, pulling out of shaky markets, reducing your product portfolio, liquidating underused assets, spinning off non-core businesses, and even turning your back on unprofitable customers. This contraction reduces cash erosion and generates new cash through asset sales.

Different companies have different needs and respond to a downturn in different ways. Companies with strong businesses and balance sheets can capitalize on the situation by gobbling up struggling competitors or poaching their competitors' best customers. These companies can afford to take a long-term view and position themselves to capitalize on the upturn — and they should. However, other companies will need to take dramatic action just to survive. For these companies, managing cash flow must be the top priority.

## A view from the retail sector

### Rod Sides

#### Principal, Deloitte Consulting LLP

The credit crisis is having a huge impact on retailers. "Trade credit" is the lifeblood of the retail industry; however, with retail defaults rising fast, many suppliers are nervous about extending more credit. At the same time, banks are cutting credit lines and the cost of interim financing is skyrocketing. A retailer that can't make its payments may quickly find itself in a death spiral where suppliers won't supply products, making it impossible for the retailer to generate sales and pay its debts.

To make matters worse, tighter credit standards are choking off consumer demand. For retailers, a large accumulation of unsold inventory can quickly erode even the strongest cash position. After a dismal holiday season, many sellers will likely have a lot of excess inventory and need to raise cash as quickly as possible.

**Selectively clear inventory and reduce buying levels.** To free up working capital, retailers need to clear seasonal merchandise quickly. Although this will cut into their margins, it will help generate the cash they need to fund ongoing operations. At the same time, retailers should reduce their buying levels to conserve working capital through the traditionally slower periods of the first and second quarter.

**Focus on price, not promotion.** For many retailers, "brand building" advertising is a luxury they just can't afford right now. In a downturn, price tends to be a bigger factor than brand as many consumers "trade down," so it probably makes sense to scale back on fancy advertising and focus more attention on keeping prices low on core items to drive more traffic through the door.

**Strategically reinvest in customer service.** Most retailers have already cut store staff and service levels to the bone, so there may not be much opportunity there. In fact, some retailers might benefit from strategically re-investing in customer service and staff. Our experience suggests that even a small increase in customer service (less than two minutes per customer) can drive as much as a 20 percent improvement in sales conversion and average transaction size.

In this environment, a company's balance sheet dictates its strategy. The handful of retailers with strong balance sheets can capitalize on easy opportunities to grab market share. On the other hand, those with unhealthy balance sheets may need to adopt a single-minded focus on cash just to survive.

# A view from reorganization services

**Sheila Smith**

**Principal, Reorganization Services, Deloitte Financial Advisory Services LLP**

When lenders stop lending, vendors stop shipping, and customers stop buying. This chain reaction is pushing many companies to the brink of insolvency. Here are a few alternatives distressed companies should consider as they work to avoid running out of cash:

**Map out cash needs.** When it comes to managing cash, a recession is the wrong time to fly by the seat of your pants. To stay in control, management should take time to carefully map out exact liquidity needs over the next three, six, and nine months.

**Prepare for major liquidity events.** After identifying ordinary short-term cash needs, management should consider turning its attention to extraordinary events such as seasonal build up of inventory, loan and credit line renewals, and balloon payments. Unless companies actively plan for these events, they may find themselves caught in a squeeze play.

**Plan for worse than the worst.** Identify a worst case scenario; then expect reality to be twice as bad as that. Until the economy shows clear signs of recovery, companies may want to assume things are going to get really, really tough.

Banks are lending less and charging more. At the same time, many vendors have stopped extending credit and are insisting on cash-in-advance or cash-on-delivery. Do you know where your cash is?

For more information, please visit: [www.deloitte.com/us/debates/nocredit](http://www.deloitte.com/us/debates/nocredit).

For further information about this debate, please contact:

**Don deCamara**

Principal  
Strategy & Operations  
Deloitte Consulting LLP  
[ddecamara@deloitte.com](mailto:ddecamara@deloitte.com)

**Rodney R. Sides**

Principal  
Deloitte Consulting LLP  
[rsides@deloitte.com](mailto:rsides@deloitte.com)

**Sheila T. Smith**

Principal  
Reorganization Services  
Deloitte Financial Advisory Services LLP  
[sheismith@deloitte.com](mailto:sheismith@deloitte.com)

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In this ChiefExecutive.com article, Don de Camara, Deloitte Consulting LLP principal, discusses common-sense strategies companies can use to gain a competitive advantage during a downturn.

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