



## **Financial Sustainability**

Customer sensing and financial monitoring

March 2020

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# Background

## Financial Sustainability – Bespoke Credit Risk Monitoring Solutions

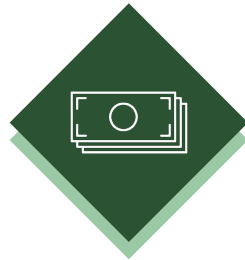
### 1. C-19 impact on customers

Large consumer corporates have a relatively short window to prepare for the impact of Covid-19 on the financial resilience of their distribution and customer networks.



### 2. Financial challenges

Many of these businesses will not qualify for government relief and may seek some form of financial support from their major suppliers, by way of extended credit terms and / or working capital loans to allow them to trade through some form of hibernation period.



### 3. Evolving landscape

Given the rapidly evolving environment that C-19 has created, the immediate focus for many corporates is on establishing an active flow of monitoring data, as quickly as possible to be able to identify and monitor the critical third parties that are most likely to require support



### 4. Clear protocol required

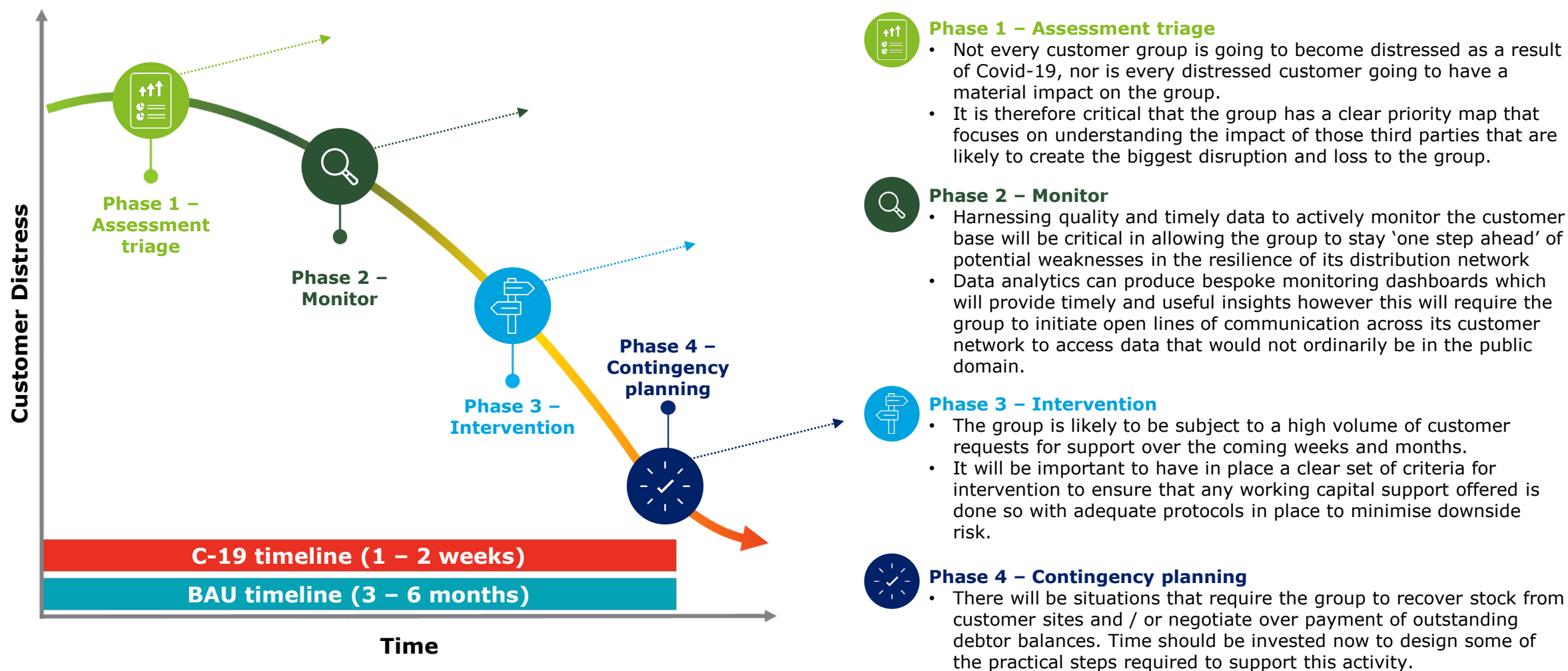
Most corporates will need to agree a clear commercial rationale to govern forthcoming requests for financial support and ensure an appropriate diligence protocol is in place to underpin such decisions and prepare for stakeholder negotiations.



**This document sets out some high level considerations to help plan for the impact of Covid-19 on distribution networks.**

# Financial considerations on customer resilience driven by Covid-19

The pace at which Covid-19 is crippling business models requires an acceleration of robust monitoring to be in place and a clear protocol to be established to govern intervention



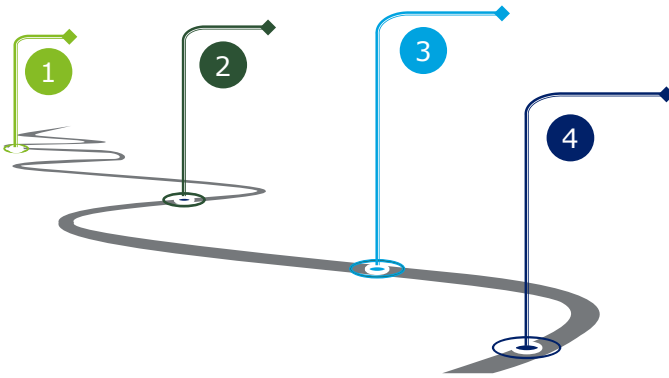
# Phase 1 – Assessment triage

It is vital that the customer base is clearly mapped in order of priority. The focus should be on supporting business critical customers who are identified as vulnerable and have a strategic importance to the group



## Business Critical Customers

Identify the customers that are critical to the group based on your business relationship



- 1 Identify sole route to market customers
- 2 Identify strategic partnerships
- 3 Identify debtors of significant size
- 4 Identify other customers of major influence

Internal group data utilised



## Assess Vulnerability

Identify which of those critical customers are likely to be vulnerable based on macro-economic factors:

- **Sectoral factors** e.g. hospitality industry is unable to get to market in many areas.
- **Geographic factors** e.g. those distributing in markets that are 'locked down' vs. those that are able to access a greater range of routes to market.

Or less resilient based on what is known about them already:

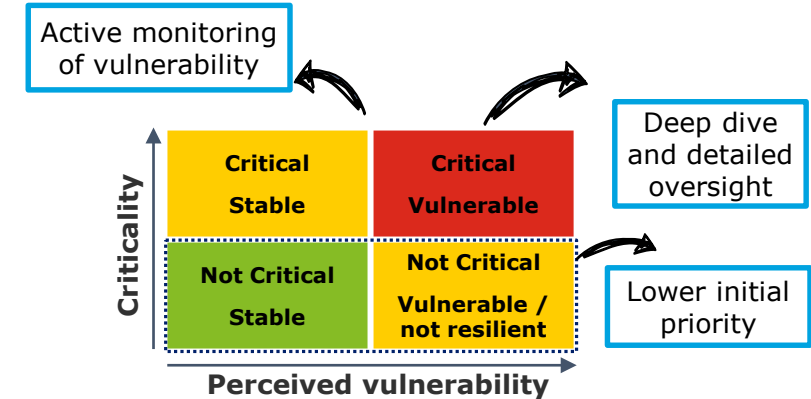
- **Publicly available financial health data** such as ratings – though not suited to a dynamic environment they may give an idea of historic financial strength and help identify customers of heightened risk
- **Recent public indicators** such as news of large scale layoffs, inability to deliver product, etc.

Sector expertise and externally available data utilised



## Prioritise

Prioritise customers based on criticality vs perceived vulnerability matrix



And create proportionate oversight plan...

**Critical customers** are prioritised for oversight and direct customer engagement, including planning support and deep dive reviews for vulnerable customers.

**Non-critical customers** will be less of a priority, but a framework for reactively assessing support requests will be required.

Customer engagement for critical customers

# Phase 2 - Monitor

Harnessing operational data is helpful but there is no substitute for open channels of communication with key customer groups at this time to allow the group to monitor financial health against recent performance

## Key challenge/opportunity

## Key Considerations



### Can you harness existing operational data?

- Review what data is already captured as part of the day to day operations and that can provide critical insights into how the customer network is performing.
- For instance, some merchant service provider clients are tracking the daily sales data on a 'last twelve months basis' to get an up to date snap shot on demand trends.
- There are also risk sensing tools available that utilise government, media, satellite and other proprietary data to enable continuous updating of the criticality-vulnerability matrix to identify customers where increased vulnerability means additional oversight is required. The set up time for such a risk sensing tool can be as little as 72 hours.
- An example of leveraging existing data could be to focus on sell-out/stock-in trade data to help to understand inventory and depletion levels providing an early warning of demand and potential inventory builds. This could then potentially result in working capital or returns implications as well as ongoing sales pipeline sustainability issues.



### Accessing better quality and timely performance stats from your customer network?

- A common weakness in corporates' ability to monitor financial stress in their customer and supplier networks is not being able to access timely performance data. External credit rating agencies all rely on audited information that is out of date and offers no real time insight into seasonality or how the business is performing at the current time. This is particularly relevant for the situation we find ourselves in now with the impact of Covid-19 on leisure and hospitality being impacted with immediate effect.
- Corporates should be proactive in opening up the lines of communication with critical customer groups to gain access to their latest performance stats to help flag signs of distress in order to respond as early as practically possible.



### Resource/capability

- Monitoring real time risk is time intensive and it is important that the data captured can be processed quickly to produce meaningful insights that can drive business decisions.
- The task force combining data analytics, credit control and customer relationship managers will enable the team automate the data feed as much as possible whilst ensuring that a strong focus is creating on outputs versus inputs.
- For instance, some corporates will measure this data against a tailored suite of covenants and in doing so will create their own their own 'red-flag' system which can be an efficient way of rapidly identifying any areas of focus that require business input.

# Phase 3 - Intervention

Over the coming days, the group should agree a clear commercial rationale to govern requests for financial support and ensure an appropriate diligence protocol is in place to underpin such decisions

## Example of main criteria for intervention



Any planned intervention will likely require significant time and resource from the group's team to assess the request for support and navigate stakeholder negotiations around the form of that support.

From our experience, formal intervention would typically be restricted to those customers that are providing a business critical service that, if stopped would create further financial, operational and reputational impact on the group.

Otherwise, there should be a clear economic rationale that intervention is likely to result in a materially better economic return than would otherwise be gained should the customer be unable to continue trading? (see final point below).

This economic rationale should also reflect the position of any third party stakeholders such as credit insurance companies who may require a level of intervention as part of their criteria.

What self-help measures has the customer already secured to improve the liquidity position of its business? This should include taking steps to draw availability liquidity, reduce costs and restructure overheads etc.

Who are the financial stakeholders in the business and what support have they committed? This should include but not be limited to parent company guarantees; key equity holders; and lenders.

Who are the other major suppliers into the customer and what support has been requested of them? Has this been secured?

Has the customer shared a turnaround P&L and cash flow forecast for the business that reflects how the combined 'rescue' support from its collective stakeholders will result in a stable trading platform for the medium to longer term?

Clear oversight as to how management plan to prevent further deterioration should downside risks continue to evolve.

Any request for support should be measured against a best estimate of recovery should the business cease to trade. This is often referred to as 'an estimated outcome statement' and is typically prepared by an Insolvency Practitioner who will apply their judgement as to the likely recovery of assets to the creditors in the event of an insolvency.

In most insolvent scenarios in the UK, the group should have the right to take back any unsold stock that has retention of title, however, the cost of doing this will fall to the group and the net recovery may be significantly impaired.

Alternatives may include selling the stock at a discount to a third party but this will need to be assessed on a individual basis.

Any unpaid debtor balance will likely fall to be an unsecured claim against the insolvent business and hence the 'estimated outcome statement' becomes an important tool to drive stakeholder behaviour in a restructuring scenario.

# Phase 4 – Contingency planning

Time should be invested now to design some of the practical steps required to support the recovery of stock from customer sites, where required

## Stock recovery

- Work with legal counsel to validate if the ROT is enforceable from a legal perspective?
- As long as most goods are branded and therefore easily identifiable, no further labelling should be required.
- Logistically, how would they pick up the stock, in terms of haulage, people and access?
- Where would the stock be recovered from? In practice, most large corporates would only consider collecting stock from large customers' DCs, rather than small single sites.
- Where would the recovered stock be stored by the group – are there capacity constraints?
- The decision to collect depends on whether a deal could be reached with the administrator that is economically and operationally better than collection and resale to another (solvent) customer

## Recovery Considerations

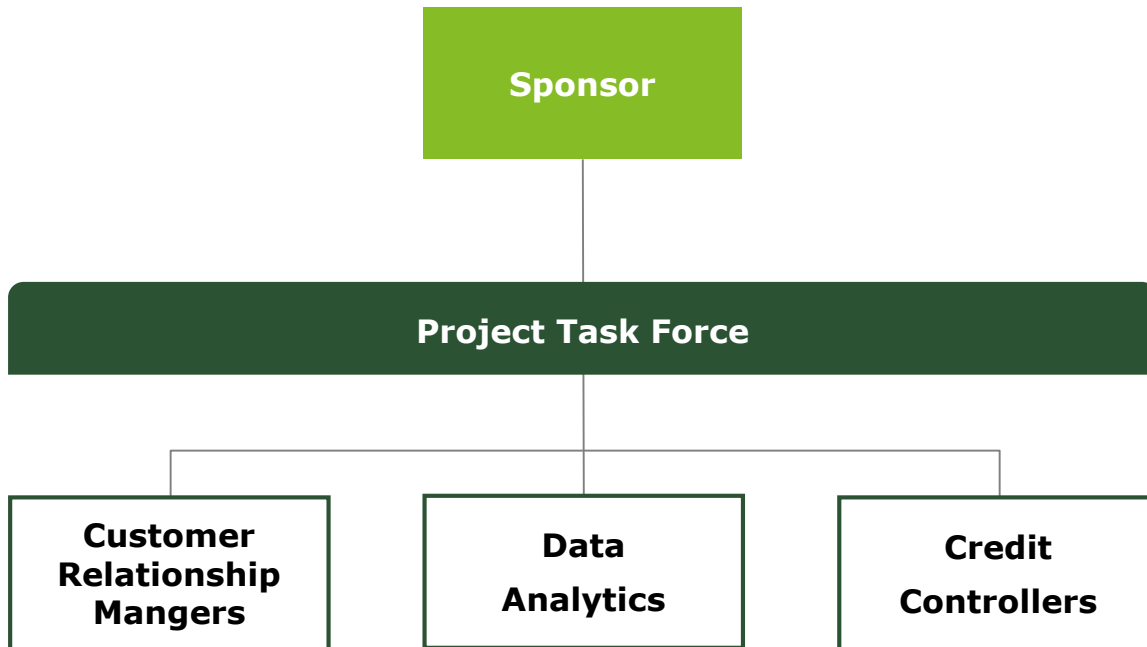
## Debtor recovery

- Is there sufficient credit insurance in place for bad debts?
- A sale of the customer's business from administration can provide a helpful ransom position for the group with the buyer of the business, to improve book debt recovery and amend go forward payment terms and pricing. Albeit, it is uncertain in the current market whether a business sale could be achieved by an administrator of the customer.
- Brands – is there any contractual control over who can distribute the brand that could mean an administrator of a customer would need the group's approval to sell or trade the business? This may lead to a scenario whereby the group could exert control over the admin strategy?
- Is there any appetite for the group to acquire customers through an insolvency process to protect your route to market?



# Next steps

Given the rapidly evolving environment that C-19 has created, the immediate focus for many corporates is on establishing an active flow of monitoring data, as quickly as possible



## Indicative next steps

Day 1	By end of week 1	By end of week 2
<p>Form task force to develop and oversee customer resilience plan</p>	<p>Map customer network and identify a list of priority critical customers that are considered at risk</p> <p>Identify a set of internal operational data and desk top data feeds to monitor customer performance trends.</p> <p>Design and activate a desk top monitoring tool.</p> <p>Open direct communication channel with priority critical customer group and design and implement bespoke covenant monitoring</p>	<p>Design a detailed decision tree / commercial protocol to support intervention decisions</p> <p>Roll out upskilling workshops to all relationships managers to educate them to deal with requests for support.</p> <p>Design infrastructure / practical steps required to facilitate stock recoveries, where required</p>



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