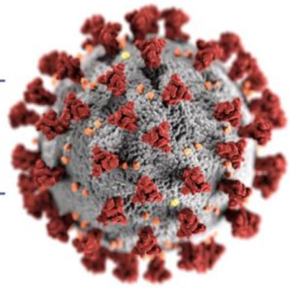
COVID-19: BAF II briefing notes



Pivot, prepare and position

These BAF II Covid-19 briefing notes are intended to help companies in Laos do three things:

- ***Pivot*** your existing business model to survive the current Covid-19 crisis;
- ***Prepare*** to withstand the challenges of a global economic downturn; and
- ***Position*** yourself for the economic recovery.

This fifth briefing note in the series provides some suggestions and recommendations on ways to adjust your finances that should help your business weather the current Covid-19 'storm', as well as the economic downturn that is widely expected to follow in 2020-21, and possibly beyond.

Briefing note 5: Financial planning

Cash is king. Most companies are experiencing a sharp and unwelcome drop in their revenues (sales) and earnings (profits), as a result of Covid-19 and the economic impact the virus has caused. As you know all too well, without those cash flows coming into the company it can be hard to keep all aspects of the business going. Suppliers still need to be paid, employees' salaries still need to be paid, loans and rent payments still need to be serviced, etc. If the supply of incoming money dries up, but outgoing money continues to flow, then this will slowly use up a company's capital reserves. For small businesses in particular, which tend to have fewer liquid assets, and therefore even more dependent on maintaining cash flows, such a situation is not sustainable in the long run. Solutions have to be found.

So what should a business do to try and stay 'cash flow positive', or at least prevent outgoing cash flows eating through your capital reserves ? The first thing to do is get a control over your cash flows. The second is to be highly disciplined about your costs and other financial outgoings, and be willing to cut where necessary. The third thing to do is revisit your financial plans and cash flow projections, and see if they need adjusting for the months ahead. And in the vast majority of cases, they probably will need adjusting.

There are probably four stages that businesses can work through in an attempt to improve their financial position during the current health crisis and sharp economic downturn:

Stage 1: The first stage is to make an honest and realistic assessment of your cash flows in the coming weeks, compared with before Covid-19. Split your total costs into fixed expenses that cannot be reduced, and those variable expenses that you may be able to fully or partially cut. By comparing your expected cash flows with your fixed and non-fixed costs, you will have a clearer sense of how much financial cutting you will need to do.

You may also want to explore any 'quick wins' that could be turned into cash generation in the next few months, and offering discounts to clients and customers willing to pay now for future services or products, as a way of increasing short-term cash flows. Focus on preserving working capital.

Stage 2: The second stage is to pursue ways of immediately reducing some of your expenses, however temporarily. To do this, focus on:

- what non-essential activities can be cut;
- what activities might be 'put on hold' for a later date to reduce costs, such as delaying a product launch or a new shop opening, or a hiring freeze for new staff; and

- what variable expenses, such as performance bonuses or commissions, can be cut. Reducing overtime or even normal working hours are other possibilities to consider, thereby cutting labour costs without actually laying off employees.

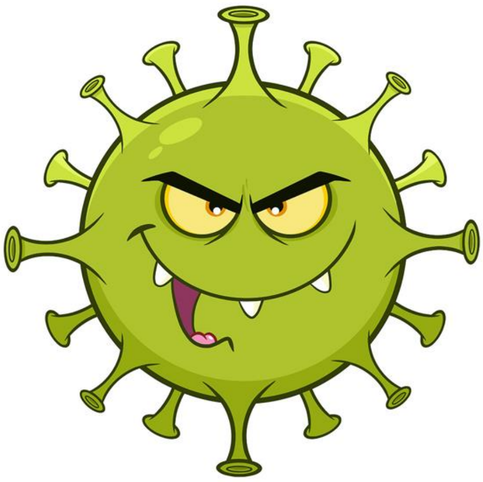
Stage 3: The third stage is to look at ways you can make your company's operations more efficient in the medium term, so as to further reduce operating costs. For this, you may want to review:

- the capacity of your senior staff to see whether they are fully utilized, and if not, think about consolidating some positions;
- the capacity of your various departments to see whether there is any unnecessary duplication of effort, or areas where activities can be merged for efficiency gains; and
- the overall efficiency of the business as a whole, and whether it can be made more efficient. For example, can you reduce your inventory costs ? Can you renegotiate your various contracts and credit terms with your main suppliers ? The same goes for things like shop or office rent, interest payments on bank loans and other debt obligations your company has – can they be renegotiated, at least for a limited time ?

Stage 4: The fourth stage is look at long-term structural changes in the business. For this, you may want to review:

- your employee headcount, and whether some positions can be merged or removed;
- whether some aspects of your business could be out-sourced to reduce costs;
- whether some parts of the business are under-performing, and should be closed down or sold off; and
- whether new market trends mean that more exciting business opportunities are starting to open up, including ones that offer better profit margins and higher risk-adjusted rates of return.

We would recommend that the kinds of defensive cost-cutting typically done in stages 3 and 4 should only be explored after all avenues in stages 1 and 2 have been exhausted. Be creative and inventive in your thinking, and do not hesitate to use your unique knowledge of your business and the market to come up with imaginative solutions, some of which may actually evolve into more long-term business strategies for growth.

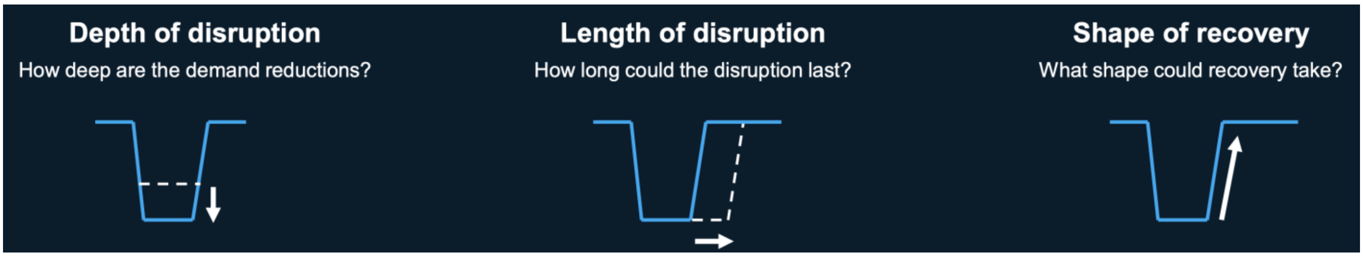


'Necessity is the mother of invention' (an old English proverb). When things are progressing satisfactorily, it is easy to become quite complacent, and allow various inefficiencies to develop. But a moment of crisis is good at shaking people and companies out of their comfort zones, and prompting them to look at their business through fresh eyes. Inefficiencies that were previously considered minor luxuries are exposed as a drain on a company's productivity and competitiveness, and potentially be removed. Also, company owners, managers and employees can all become much more creative and imaginative during a crisis, as the urgency of the situation prompts them to explore options that would have previously been ignored.

A useful 'financial resilience' check-list (adapted from Boston Consulting Group) includes the following recommended steps:

- Forecast your future cash flows and try to reduce all non-critical uses of cash;
- Prepare for changes in the cash conversion cycle (eg. changes in the payment terms with both suppliers and clients);
- Adjust working capital to focus on essential or high priority products and services;
- Reach out to your lenders (eg. banks) and other providers of credit, including landlords, to see if you can renegotiate your payment terms;
- Explore the potential of using 'accounts receivables' (also known as 'factoring') and other means of accelerating cash flows for working capital needs;
- Postpone all non-critical capital expenditure, and consider rationalizing short- and medium-term spending;
- Reduce discretionary spending, and keep a strict control over all procurement; and
- Conduct financial planning for various future economic and market scenarios.

Part of the challenge at the moment is that no one knows how long the current crisis will continue, how bad things might get, how long the recovery will take, and precisely when things might ultimately get back to some kind of normality. Will it be 2021, or 2022 ? Or maybe not until 2025 ? Right now, it is anyone's guess. So you may want to think about three or more scenarios for the economy and your particular market, and then apply these scenarios to your financial projections (and particularly your costs and revenue forecasts) to see what the likely impact would be. Such scenario planning does not guarantee a solution, but it does mean you are better prepared for whatever happens, and will have some idea about how to react.



Source: McKinsey & Co.

For example, one scenario might be that a vaccine is developed quite soon, and Covid-19 is brought under control in late 2020, that the economic recovery starts in 2021, and your market rapidly regains momentum. A second scenario might be that Covid-19 remains a health risk well into 2021, and that the economy remains depressed for a number of years, with a slower rate of market recovery. A third scenario might be that a second wave of Covid-19 (or another virus strain) occurs in 2021, triggering a second pandemic alert, setting back an economic and market recovery by several years.

These so-called 'stress tests' help you plan for a range of possible future prospects. McKinsey & Co. suggest there are three things to think about when looking at future scenarios:

- How ***deep*** will the scale of the Covid-9 economic crisis be for your business and your market ?
- How ***long*** will the Covid-19 economic crisis be for your business and your market ?
- What ***shape*** will the economic recovery take, when it comes ? For example: will the recovery trajectory be rapid or more gradual, be a straight line or a wobbly line, will it be economy-wide or different for each sector and market ?

Is it time to go digital ? We anticipate that the use of digital payments and e-commerce will steadily increase, particularly in the retail sector, and the use of cash payments and physical shopping will become less popular. This trend was already apparent long before Covid-19 struck, for various reasons around business efficiency and consumer convenience. But we expect that this trend will now accelerate, as people become more reluctant to hold paper money, and more hesitate to go shopping in conventional shops. But this trend is not confined to retail trade. B2B clients are also shifting more towards the use of on-line ordering and digital payment systems. Should your company be doing the same ? And if so, perhaps now a good time to start making that change, while normal business activity is slow.

Raising cash. It could be that, despite reducing costs to the very minimum, your business still needs to raise more cash for working capital. One option is to try and get a bank loan or a rolling overdraft facility, although it is important not to take on too many debt obligations that you will subsequently struggle to service – paying the monthly interest, as well as finally paying back the amount that was lent. It is also worth noting that many banks are also facing liquidity constraints during the economic crisis, and may be reluctant or unable to make many new loans (unless pressured to do so by the central bank).

In this context, look out for alternative sources of debt funding, such as various 'fintech' ventures and other innovators in the financial sector who do not have large pre-existing loan portfolios to worry about. Another option is to look at raising finance from outside investors, such as selling a share in your business, or agreeing to a 'convertible loan'.[1] And if you already have outside investors, it may be possible to request additional financing

[1] A convertible loan is like a normal (debt) loan, but can be converted into shares (equity) of the borrower, according to the terms set out in the convertible loan agreement.

from them, or for them to provide collateral that can used as security for a new bank loan. Using accounts receivables (also known as 'factoring') is another option to explore.[2]

Keep abreast of government policies to support businesses during Covid-19. Look out for announcements by government agencies and others on relief being offered to companies badly affected by the crisis. For example, temporary reductions or lifting of some administrative fees, deferred and reduced taxation, etc. A good place to start is the ILO's (regularly up-dated) database of country policy responses, which span:

- stimulating the economy and employment;
- supporting enterprises, jobs and incomes;
- protecting workers in the workplace; and
- activities of employers' and workers' organisations, etc.[3]

Here in Laos, Prime Minister's Decision No. 31/PM, issued on 29th March 2020, details specific policies and measures to mitigate the impact of Covid-19 on the economy. This includes a number of measures to support businesses, including:

- an exemption on payroll tax for employees earning less than Kip 5m per month;
- an exemption on corporate income tax for micro-enterprises;
- deferral of tax for tourism operators;
- deferral of social security payments for business affected by Covid-19; and
- working with commercial banks to explore making changes to loan repayment terms, interest rates on loans, etc.

BDS resources to consider

BAF II provides matching grants to companies that need to hire a third party 'business development service' (BDS) provider to help improve their business performance in some way. In the context of financial planning during the current crisis, if you think your business needs help, then contact BAF II to discuss this matter with our Business Advisors. The first step is to register on the BAF II website.

Also, check out the links to various useful Covid-19 materials provided on our website, on the 'Resources' page.

"We are all in this together." BAF II is here to help your business pivot, prepare and position.
Please contact us at: info@baflaos.com or tel: 020-55542658. Or visit us website at: www.baflaos.com

[2] Accounts receivables (or factoring) is a mechanism whereby a company offers its future earnings (as evidenced by current contracts it has with existing customers or clients) as collateral to support a loan or cash advance. It is often used as a way for smaller companies in particular to get cash income more quickly than having to wait for a (legally binding) contract to be completed and for the customer or client to pay.

[3] The Laos country page can be found here: https://www.ilo.org/global/topics/coronavirus/country-responses/lang--en/index.htm#LA