Client Article

May '09

## *Improving financial strength and strategic liquidity in the downturn*

The importance of financial strength and strategic liquidity in today's market cannot be overstated. It provides buoyancy to boost enterprise value and helps maintain operations, enhance bargaining power, improve competitive position, and support investment during turbulent times. Companies that cannot easily gain access to credit will need to use their cash more deliberately. All this suggests some new financial imperatives:

**Implement a better financial risk management program.** Companies cannot afford the cash-flow volatility imposed by commodity, currency, and interest rate fluctuations. But few companies have devoted enough attention to quantifying, analysing, and managing their net exposures. Many financial managers
(1) don't have a strong understanding of their exposures,
(2) believe they are already naturally hedged,
(3) feel that hedging is too expensive, or
(4) relegate hedging to the arcane world of "financial engineering." That must change.

**Build or buy strategic liquidity.** Closely related to risk management is the design of capital structure. For years, companies with high credit ratings and large amounts of cash were targets for gaggles of investment bankers pitching share repurchase programs and taking on more debt. But now, cash is a strategic asset. Leading companies are retaining operating cash flow, selling idle assets, and drawing down their bank lines. They are exploring other vehicles for secondary liquidity: backup lines of credit, financing, securitizations of receivables and other assets, sale leasebacks, and more flexible purchasing and outsourcing contracts. Companies are reversing the trend toward larger share-repurchase programs and dividends. There is also resurgence in creative methods to reduce leverage and bolster financial strength.

**Manage your corporate portfolio for value, not performance.** When evaluating business units, most companies still rely on traditional financial performance metrics, such as margins, operating income, and return on capital employed. It is assumed that these are proxies for value. But in fact, this performance is already reflected in the market values of assets, and these metrics are inappropriate for your portfolio decisions. Instead, make decisions based on the value of expected income (discounted cash flow, or DCF) versus the value you would get if you disposed of the unit. The conventional approach of selling "dogs" (low-growth, low-return units) and acquiring "stars" (high-growth, high-return units) can be your most costly strategy, especially in a downturn. Hold assets, instead, when you think the DCF value is greater than the likely net proceeds of a sale.

**Monitor your sources of value.** Today, more than ever before, strategies fail in the execution, not the vision. Quality execution requires that countless economic, value-based decisions be made at all levels within the company — including integrations, dispositions, closures, outsourcing, promotions, pricing changes, and value propositions. These decisions depend on a comprehensive economic fact base, yet most information systems remain geared to providing accounting data for the reporting needs of legal entities. If meaningful dashboards of customer, product, and stock keeping unit (SKU) profitability remain a distant dream at your company, it is time to wake up and start using them.

**Move forward on your growth agenda, especially in emerging markets.** Corporate profits have become increasingly reliant on overseas demand, with international profits now accounting for roughly one-third of corporate profits. Your global strategy should be grounded in distinctive capabilities that you develop deliberately: through organic internal efforts, acquisitions chosen for the capabilities that would be gained through them, or collaborative arrangements.

**Audit your defences against takeovers.** Today's stock prices create a window of opportunity for buyers. It behoves executives to ensure they will have the requisite time to devise and execute a response to an acquisition bid. A high-level defence audit covers four basic topics: general state and corporate takeover laws, board of directors' structure and policies, shareholder voting processes, and takeover provisions (including poison pills) within your own governance structures

***Deshel can help provide the interim support that a company to weather the downturn***

***Contact Alan Latham +61 415 296 960***