FINANCIAL MANAGEMENT DISRUPTION

A practical guide for CFOs managing companies through disruptive times

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FINANCIAL
MANAGEMENT
THROUGH
DISRUPTION

…there are fundamental measures **CFOs should** take in order to **equip themselves and their organizations** to weather any further disruptions.

FINANCIAL MANAGEMENT DURING AN ECONOMIC DOWNTURN

During the COVID-19 pandemic and its aftermath, CFOs and their organizations have had to confront a variety of unanticipated challenges, including erratic customer demand, supply chain disruptions, volatile commodity prices and wage inflation, rising interest rates, and labor shortfalls, while trying to manage remote and onsite workforces. The worst economic effects of the COVID-19 episode may be mostly behind us but we foresee more challenges ahead, with many economists predicting a recession in the next twelve months as the Fed continues to hike interest rates aggressively.[1] From a finance leadership perspective, a recession would likely result in, among other things, diminished spending by customers and unpredictable demand signals, leading to wide-ranging impacts on business performance, investment strategy and hiring plans.

Given these widespread and ongoing challenges, there are fundamental measures CFOs should take in order to equip themselves and their organizations to weather any further disruptions. FTI has identified four critical areas of focus that will help CFOs navigate challenging times ahead while exploiting competitive advantages and improving operational efficiencies.

PRO TIP: Craft an Effective Communication Plan

A period of economic disruption can often lead to substantial change for an organization, which raises the importance of maintaining a dialogue with all key internal and external stakeholders. Finance leaders will want to build a reputation for transparency and be sure to vet decisions internally before communicating them to other teams or outside stakeholders. Crafting an organizational narrative around ongoing/upcoming changes, being specific about actions and articulating an ongoing commitment to stakeholders will help to increase buy-in and reception of execution plans.

[1] https://www.bloomberg.com/news/articles/2022-06-16/consumers-are-running-out-of-steam-and-market-isn-t-ready-for-it

Driver-Based Integrated Forecast:

In periods of economic uncertainty, it is critical for organizations to quickly monitor financial performance and have the ability to run driver-based scenario planning. An integrated three-statement model forecast aligns corporate strategy to business drivers and key performance indicators (KPIs), and allows CFOs to test scenarios for the forecasted financial statements, liquidity, KPIs and macro trends that can impact the business. Having an integrated three-statement model further provides timely, accurate and reliable financial projections aligned to business strategy. Developing rolling financial forecasts, either 6-8 quarterly forecasts or 18 monthly forecasts, provides management with a playbook needed to effectively manage through volatility.

Understand Liquidity Runway:

CFOs require clear visibility into their organizations' liquidity runway over the short- and medium-term to adequately prepare and adjust to economic fluctuations. During periods of disruption when "cash is king", having a comprehensive understanding of liquidity, working capital drivers and operating cash usage is essential to building a resilient financial strategy. Closely managing an optimal capital structure, debt service capabilities, and cash flow on a weekly basis, or daily, if possible, is critical to ensuring adequate liquidity during a downturn.

Defined Strategic Initiatives:

Disciplined executive leadership is required to define, execute and monitor strategic initiatives during a period of change. Opportunities can arise from attractively priced acquisition targets, cost optimization, workforce planning, product/segment optimization, and capital strategy. A disciplined and coordinated approach is required to successfully execute these strategic initiatives, as they will require cross-functional collaboration with limited and often stressed personnel. Leading these enterprise initiatives, the CFO is best positioned to ensure maximizing profitability and enterprise value.

Right-Sizing the Capital Structure:

Finance leaders need to stress-test the balance sheet to ensure the enterprise has a sustainable and resilient capital structure. In times of disruption, free cash flow, interest payments and cost of capital can experience volatile swings, and CFOs must ensure financial obligations can be met. However, there are also potential M&A opportunities that can arise, specifically acquisition targets with distressed valuations, where excess capital can be put to work to provide further market gains while competitors might not be in the same advantageous position. Companies with the strongest balance sheets most often are the winners in a downturn by taking advantage of long term growth opportunities, either investing organically or via acquisition.

KEY BENEFITS & CONSIDERATIONS

DRIVER-BASED INTEGRATED FORECAST:

KEY BENEFITS

- Ability to run real-time forecast scenario and analysis across P&L, Balance Sheet and Cash Flow
- Defined KPIs and Business drivers aligned to corporate strategy
- Leadership dashboard with KPIs predict plan shortfalls and needed actions to address drives actionability and enterprise performance
- Reporting that focuses on metrics that matter, high impact measures that are material and volatile are constantly managed

KEY CONSIDERATIONS

- Requires clearly defined corporate forecast drivers, assumptions, and data sources
- Automate systematic process for obtaining KPI/forecast data and actualizing leading forecast drivers
- Ensure master data structure facilitates analytical outputs

UNDERSTAND LIQUIDITY RUNWAY:

KEY BENEFITS

- Clear visibility into liquidity runway and any potential shortfalls
- Ensure projected P&L performance and B/S structure enables a sustainable liquidity profile
- Real-time transparency into working capital, operating expenses, debt service and capital expenditures
- Ability to test debt covenant and floating interest rate terms, ensuring compliance with covenants per debt agreements

KEY CONSIDERATIONS

- Direct bottom-up rolling weekly cash flow reporting that provides the most timely and accurate insight into liquidity
- Direct cash flow should be aligned to the forecast assumptions in the indirect cash flow as part of the three-statement forecast
- Critical to run variance reporting to refine forecast accuracy and accountability

DEFINED STRATEGIC INITIATIVES:

KEY BENEFITS

- Clearly defined strategic initiatives during a period of economic disruption provides disciplined executive leadership and focuses the organization
- Organizations with clear strategic priorities are best positioned to quickly capitalize on opportunities across M&A, product strategy, cost reduction, and workforce planning
- Defined initiatives create accountability for execution and continuous monitoring during a period of change

KEY CONSIDERATIONS

- A streamlined focus on a few well-defined initiatives creates a better framework for execution
- There ultimately needs to be individual accountability for strategic initiatives to develop leadership and agile decision making
- Ambitions need to be realistic within framework of limited and often stretched resources

RIGHT-SIZING CAPITAL STRUCTURE:

KEY BENEFITS

- Stress testing the balance sheet helps ensure a sustainable and resilient capital structure is in place
- Ability to closely monitor debt service capabilities with rising/falling interest rates during periods of disruption and determine if a strategy adjustment is required
- Potential for realignment of debt/equity capital structure appropriate to market conditions
- Excess capital can be efficiently utilized during periods of distressed economic valuations

KEY CONSIDERATIONS

- Important to ensure all financial obligations can be met over the forecast horizon, including critical debt covenant and interest obligations
- Early and proactive communications with lenders is required in the event of potential capital structure stress
- Monitoring capital market conditions and sentiment in the industry helps improve timing for capital events, including opportunistic realignment of debt/equity mix

CRITICAL INDICATORS TO MONITOR

A Helpful List Of Business Trends That CFO's Should Keep An Eye On During A Downturn

2022 has presented businesses and CFOs with a unique and challenging set of circumstances. As impacts from the COVID-19 pandemic evolve, the resulting economic disruptions have combined to create a particularly difficult time for finance leaders. Below are five macro trends that CFOs should proactively monitor, and how these trends may impact your business.

CUSTOMER DEMAND —
Forecast Demand Through Relationships

Your clients and customers are the best source of truth to anticipate upcoming demand. Establishing consistent communication touch points with executives of key customers can provide demand signals needed to make informed and prudent adjustments to financial strategy.

INFLATION —
Rising Inflation Has Been Severely Impacting Consumers and Business During Q3 of 2022

With the resulting decrease in purchasing power, businesses need to manage pricing and costs accordingly to hedge against long-term inflation potentially on the horizon.

CONSUMER SPENDING — Declining Consumer Spending is a Leading Indicator of Financial Downturns

Consumers are starting to increase savings, often a predictor of a decline in consumer spending. A recent Barclays report showed that credit card spending declined from 20% monthly spending growth in May 2021 to 10% in May 2022.[1] This highlights that confidence in the economy is starting to fade, and could result in a decrease in consumer spending that could potentially accelerate a financial downturn. While as of this writing consumer spending hasn't slowed, it is worth continuing to monitor.

ENTERPRISE CAPEX — Capital Expenditures Could Possibly Start to Tighten During The Annual Planning Process

Assess your capital projects regularly to reevaluate the investments your firm is making. Wasteful or mismanaged projects eliminate any capital advantages you might hold during periods of distress. Ensure those investments are meaningful to accomplishing your financial strategy.

SALES — Closely Track the Sales Backlog, Sales Pipeline, Customer Retention, and New Prospects

Sales cycles elongating are the first indication of pending downturn in orders and revenue. Working closely with the sales team can help you understand in real-time if the approvals and closing length of sales contracts are starting to extend. This is a solid indication that there is some friction in the market and that sales might start to weaken.

[1] https://www.bloomberg.com/news/articles/2022-06-16/consumers-are-running-out-of-steam-and-market-isn-t-ready-for-it

If you have questions, please reach out to:

GINA GUTZEIT

Leader, Office of the CFO Solutions

+1.212.499.3670 T | +1.917.690.6590 M

gina.gutzeit@fticonsulting.com

DAVID WHITE

West Leader, Office of the CFO Solutions

+1.424.313.3112

david.white@fticonsulting.com

Contributors:

JAMES WOLF

Senior Managing Director

Office of the CFO, Corporate Finance

+1.704.777.7483

james.wolf@fticonsulting.com

THOMAS GRIGG

Managing Director

Office of the CFO, Corporate Finance

+1.213.379.3841

thomas.grigg@fticonsulting.com

STEPHEN HAWORTH

Director

Office of the CFO, Corporate Finance

+1.832.491.5151

stephen.haworth@fticonsulting.com

OMAR ELLIS

Senior Manager, Marketing

CF - Office of the CFO, Corporate Finance

+1.503.701.1630

omar.ellis@fticonsulting.com

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