

WHEN FLAT IS THE NEW UP

# Cash Management in Distressed Organizations

BY TOMMY M. ONICH, CTP, MANAGING DIRECTOR, TCM

**D**istressed organizations and their stakeholders face an extraordinary operating environment, one that is harsh, unforgiving, ambiguous, and exigent.

The time available for management to make decisions is substantively determined by available cash. Poor financial performance usually impairs financial resources. And if threats from any of numerous constituents become elevated, available time effectively is reduced to zero with the onset of a full-blown crisis.

Typically management information systems are adversely affected by extraordinary demands for all resources. The ability to deliver useful information is further impaired by human nature. Denial is often pervasive, and the result is a paucity of critical thinking and reluctance by anyone to be the harbinger of bad news.

A distressed organization also is likely to have experienced an erosion of corporate discipline. As a result, information that is produced may not be timely, relevant, or reliable, and control may be poor to nonexistent.

In a distressed setting cash is king. It is lifeblood. It pays for needed goods and services to ensure that the organization can continue to operate while addressing its problems. It is also used to manage risks that appear rapidly and in multivariate form in distressed situations. Cash is also necessary to execute and implement a plan to reverse the company's fortunes. It is always scarce, and obtaining more is problematic.

The necessity and scarcity of cash jointly determine the goals of cash management: to control and conserve, and to find new sources.

Thus, cash management in a distressed setting first involves husbanding all resources and then allocating them by priority in a disciplined manner. With conservation and control in mind, this requires establishing a narrow band of authority for determining priority and authorizing disbursements. The definition of "narrow" varies by the size of an organization, but in any case means as few people as possible. Payment priority is a zero sum game. Therefore, priorities are based on absolute necessity or legal requirement.

## The Tools

The primary tools of control and conservation are the daily cash report and the weekly forecast. Both must be prepared keeping in mind the nature of the distressed environment and the quality of information available.

An organization in extreme distress may have experienced a serious breakdown in its MIS and accounting systems. Of necessity initial reports may be very limited in both content and the projected period forward.

The mantra of the turnaround profession has become the 13-week cash projection. This is a laudable goal, but unfortunately it may not be possible to project that far into the future given that accuracy is paramount. The availability of quality information may necessitate that only simple reports can be prepared while more accurate and detailed information is being prepared. There is absolutely no point in creating a financial model as a tool using data that is mere fantasy. This will certainly make matters worse.

**Daily Cash Report.** As its name indicates, this report is produced each day. In clear detail, it:

- States the available cash position
- Shows changes in key cash drivers
- Confirms margin or loan formula compliance and loan availability
- Acts as an early warning mechanism
- Meshes with the weekly cash flow report and other accounting tools, such as the disbursement record

The sample report shown in **Figure 1** contains three sections that address these goals: cash, sales, and current assets and liabilities.

At a glance, this report provides an accurate and current cash position of the company, specifying exactly what cash is on hand on the day of the report. It integrates availability for operating loans with actual cash availability. As a safeguard, it confirms compliance with any covenant concerning lending margins. Used in conjunction with the weekly report, it provides insight concerning projections.

Sales are the ultimate cash driver. At a glance, the report provides the metrics that the manager needs to determine the current level of sales compared to a monthly target. From this report, it is also apparent immediately if a backlog has developed.

Because they are affected by sales and represent a source or use of cash, it is important to understand just how current assets and liabilities change over the month. Thus, the metrics provided in the daily cash report include accounts receivable (A/R), accounts payable (A/P), and inventory from the beginning of the month and a daily change. This information can also be used to ensure covenant compliance as applicable.

**Weekly Cash Report.** In terms of a planning horizon it is useful for this report to look a few months into the future. It should be very accurate, so the projected horizon should not exceed the ability to deliver accuracy. Any distressed organization is extremely vulnerable to a variety of threats, and a failure in cash planning can easily result in the beginning of a downward spiral.

The weekly report is designed to provide salient information concerning cash in the organization. It is about cash and not sales performance, accruals, depreciation, or other matters. The report:

- Provides an early warning system in terms of expected financial performance.
- Provides a basic platform that rolls forward every week to manage the disbursement of funds by identifying cash availability.
- Assists in risk management by identifying all obligations and their priority, including legal matters and potential threats.
- Is used or integrated with other information, such as sales reports or disbursement records, to track performance and enhance control.
- Meshes or combines with the daily report to ensure operating loan compliance with margins and anticipate any changes.

**Figure 2** (see page 18) is a useful template in a simple and intuitively understood format. At a glance, it quickly answers these explicit questions: What is available? What needs to be spent? Implicitly it also answers these additional questions: Have priorities been established and met? Have threats been addressed?

### Finding More Cash

Finding additional cash is always a problem for a distressed organization. At least in the short run increasing sales is likely difficult or impossible. To make matters worse, current economic conditions have dramatically reduced credit availability, and asset values have plummeted.

Whatever the challenges, additional cash is essential for recovery. In fact the troika required for recovery has three parameters: quality management, a viable core product, and financial resources.

Time is also of the essence and speed is therefore essential. In a distressed environment, conditions tend to deteriorate and get much worse very quickly. Sources of cash must be found quickly, and all alternatives must be explored. It is unlikely that any single

**Figure 1: Daily Cash Report**

<b>CASH AVAILABLE TODAY</b>	XXXX		
<b>OPERATING LOAN</b>		<b>TERM LOAN(S)</b>	
Balance Forward	XXXX	Principal Loan #!	XXX
Advances	XXXX	Arrears	nil
Payments	XXXX	Payment Interest Due?	XX
		Payment Principal Due?	XX
Balance	XXXX		
Allowable by Formula	XXXX		
Available	XXXX		
		<b>COMPLIANCE</b>	
		Operating loan is 1M based upon 75% of A/R less over 90 days plus 25% inventory to a max of 250K This based upon monthly report submitted XXX	
<b>CASH AVAILABLE</b>			
Cash net of float all accts	XXXX		
Loan Available	XXXX		
Total	XXXX		
<b>SALES</b>			
Sales month to date	XXXX	Billing days in month	XXXX
Sales budget month to date	XXXX	Billing days elapsed	XXXX
Over/Under	XXX		
<b>BOOKINGS SHIPMENTS &amp; BACKLOG</b>			
	TODAY	MTD	
BEGINNING BACKLOG	XXXX	XXXX	
BOOKINGS	XXXX	XXXX	
ADJUSTMENTS	XXXX	XXXX	
NET BOOKING	XXXX	XXXX	
SHIPMENTS	XXXX	XXXX	
ENDING BACKLOG	XXXX	XXXX	
<b>CURRENT A&amp;L</b>			
A/R Begin Month	XXXX	A/P Begin Month	XXXX
TODAY	XXXX	TODAY	XXXX
Change	XXXX	Change	XXXX
Inventory Begin Month	XXX		
Today	XXX		
Change	XXX		

source will be sufficient, and success may be determined at the margin.

A negative change in assets or a positive change in liabilities is a source of funds. Keeping this in mind, the balance sheet should be viewed with a skeptical eye, if not downright disbelief. These steps are useful in evaluating potential sources of additional cash:

- Visual inspection and inventory of all tangible assets at all locations, including plants, equipment, vehicles, real estate, and inventory.
- Inventory of all intangible assets, including A/R, patents, trademarks, leases, and interests in other entities.

- Professional valuation of assets under two scenarios: liquidation under distress and liquidation as a going concern

- Confirmation from the sources of current balances for all loans, mortgages, and financial liabilities, with particular attention paid to those that are less obvious, such as third-party liabilities and contingent liabilities

- Verification by competent legal counsel of all encumbrances, liens, or mortgages on company assets.

## CASH MANAGEMENT

This creates a reliable balance sheet, one in which assets are based on a recoverable value under current conditions and liabilities are based on what is currently owed. This exercise is very useful in turnaround planning. The information provided sets the stage in the search for funds. The first principal of this search is for management to be honest, and straightforward with stakeholders. With that in mind, the following should be reviewed:

**Sales/Margins.** A dramatic increase in the level of sales is unlikely. However, it is also true that a distressed organization often is selling at low margins and, in some cases, perhaps below cost. Management often takes the view that getting business is the most important goal, ignoring margins. This is may be further exacerbated by poor quality of information, a lack of internal discipline, and customers seeking advantage. Ultimately this results in an adverse effect on cash.

As soon as possible, a review of margins should be conducted. On no account should negative margins be permitted or even what is believed to be cost/price breakeven. The latter is often just a manifestation of management weakness and probably masks margins that are actually negative.

**Secured Lenders.** The current credit environment is so tight that there may be no other lenders to approach. Although obtaining a large increase to credit facilities is unlikely, marginal changes can be very important. These may take the form of a reduction in payments, allowing some carve-outs, or even a sale/lease-back. In conjunction with other sources of cash, these may be sufficient.

**Noncore or nonperforming assets.** The standard balance sheet often masks underperforming or little-used assets. A physical inventory and inspection may reveal a great deal, including equipment that is rusting and unused, inventory gathering dust, or a plant that obviously is operating below capacity.

Figure 2: Weekly Report

	LW	BUDGET	DIFFER	WK1	WK2	WK3	WK4	ETC
<b>RECEIPTS</b>								
From sales	XXXXX	XXX	XXX	XXXXX	XXXX	XXX	XXX	
From A/R	XXX	XXX	XXX	XXXXX	XXXX	XXX	XXX	
From asset sale	XXXX	XXX	XXX	XXXXX	XXXX	XXX	XXX	
From other	XXX	XXX	XXX	XXXXX	XXXX	XXX	XXX	
<b>TOTAL CASH RECEIPTS</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXX</b>	<b>XXX</b>	
<b>DISBURSEMENTS</b>								
<b>LABOR</b>								
Payroll	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Worker Comp	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Medical ins	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Dental Ins	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
<b>TOTAL LABOR BURDEN</b>	<b>XXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>			
<b>UTILITIES</b>								
Telephone	XXXX	XXXX	XXXXX	XXXX	XXXX	XXXX	XXXX	
Electric	XXXX	XXXX	XXXXX	XXXX	XXXX	XXXX	XXXX	
Gas	XXXX	XXXX	XXXXX	XXXX	XXXX	XXXX	XXXX	
Water	XXXX	XXXX	XXXXX	XXXX	XXXX	XXXX	XXXX	
<b>TOTAL UTILITIES</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	
<b>SALES</b>								
Commissions/Royalties	XXXXX	XXXXX	XXXXX	XXXX	XXXX	XXXX	XXX	
Travel	XXXXX	XXXXX	XXXXX	XXXX	XXXX	XXXX	XXX	
Promo	XXXXX	XXXXX	XXXXX	XXXX	XXXX	XXXX	XXX	
Entertain	XXXXX	XXXXX	XXXXX	XXXX	XXXX	XXXX	XXX	
<b>TOTAL SALES EXPENSE</b>	<b>XXXXX</b>	<b>XXXXX</b>	<b>XXXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXX</b>	
<b>LEASES AND RENTAL</b>								
Warehouse	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Equipment Plant	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Equipment Office	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Vehicles	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
<b>TOTAL LEASES &amp; RENTAL</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	
<b>OTHER</b>								
Professional fees	XXXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Property tax	XXXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Data processing	XXXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Security	XXXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Interest	XXXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
Legal settlement	XXXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	
<b>TOTAL OTHER</b>	<b>XXXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	
<b>TOTAL CASH RECEIPTS</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	
<b>TOTAL DISBURSEMENTS</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	
<b>DIFFERENCE</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	
<b>OPERATING LINE</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	
<b>CASH</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	<b>XXXX</b>	

A comprehensive review may also reveal intangible assets that can be sold or leveraged. These may include patents, trademarks, or other intellectual property. All assets should be reviewed with a cold, hard eye, and anything not likely to be of use for 18 months or more should be sold.

***Changes to Working Capital Components.***

These include A/R, A/P, and inventory. An extension of credit terms can result in a significant one-time cash infusion, as can lowering collection time on receivables. Excess inventory is a common cash trap, and additional resources often can be realized through inventory reductions.

***Government.*** Appealing to governments at various levels is often a lengthy and arduous task. However, governmental entities also are possible sources of financing and other support. The process can be started quickly at a local level and expanded even while a turnaround plan is being developed.

**A Real Chance of Recovery**

In a distressed organization, the importance of cash is huge. A good argument can be made that it is the *sine qua non* of a turnaround, for cash is sustenance, a resource to


meet threats, and fuel for recovery. It is also likely scarce.

The characteristics of necessity and scarcity set the platform for cash management in a distressed organization. Husbanding resources and controlling disbursement are supported by daily and weekly cash reports. The daily report provides on-the-spot information concerning cash availability. The weekly report encompasses a projected period that ideally includes a few months forward.

Above all, both reports must contain accurate information. This may be a challenge initially because information deficiencies characterize troubled organizations. The accuracy of information is of obvious importance to management, but it also supports open and honest communication with constituents and provides a positive framework to encourage their cooperation.

New sources of cash must be sought from every possible venue. The task is always difficult, but it is possible to incrementally win the necessary resources. Creating a balance sheet that provides a current and accurate picture of both assets and liabilities reveals opportunities for financial restructuring, refinancing, or divestiture.

Concurrently, an objective review of sales and margins and the elimination of low margin accounts should occur. Finally, the arduous process of appealing to various levels of government should begin. This may result in a source of funds, and it will certainly result in additional support of some kind.

The process of cash management renews corporate discipline, reveals much about the balance sheet and operations, conserves resources, and seeks additional sources of capital. Taken together, these measures provide a real chance to achieve corporate recovery. 

---

*Tommy M. Onich, CTP, is a managing director with TCMI and specializes in interim and crisis management of underperforming and distressed companies. He has assisted companies as an advisor and interim CEO. Onich holds an Honors Bachelor of Business Administration from Brock University and was the second Canadian to complete all CTP requirements.*



REPRINTED WITH PERMISSION FROM  
 THE JOURNAL OF **CORPORATE  
 RENEWAL**

© The Journal of Corporate Renewal, 2009