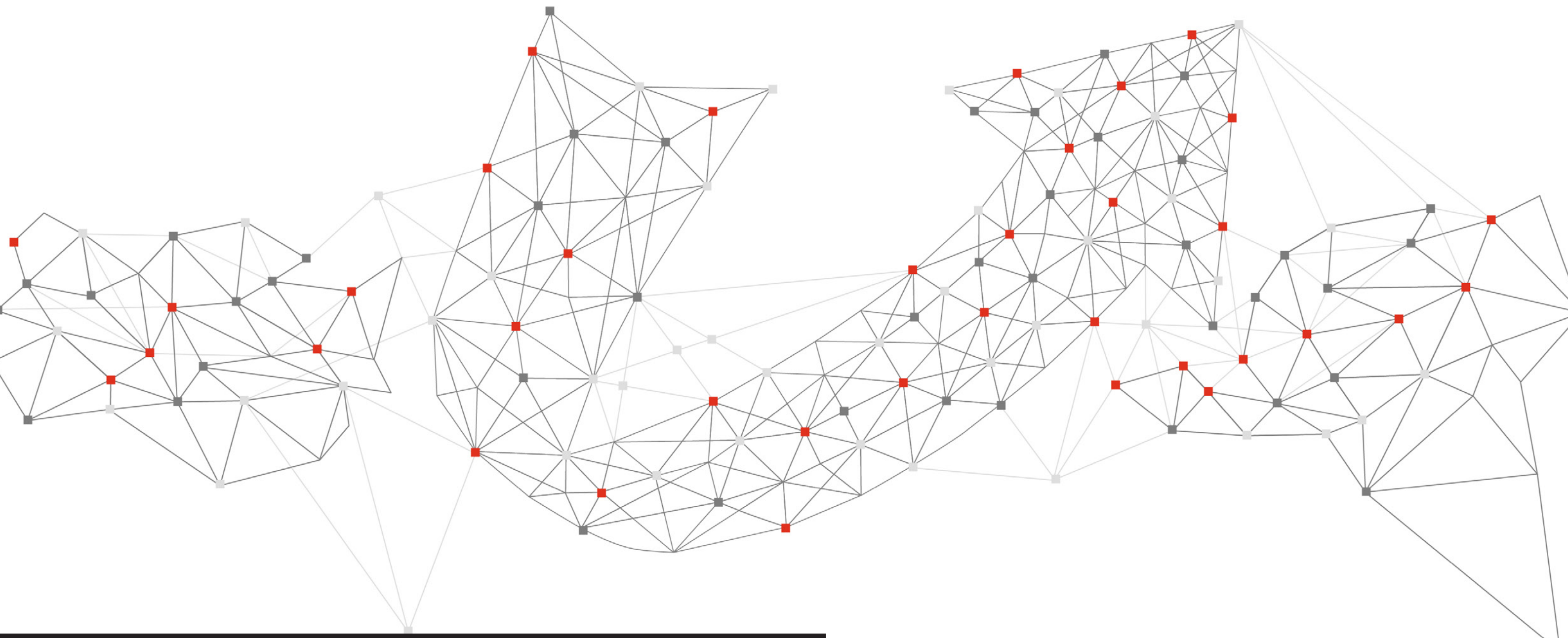

COVID-19: Dealing with financial and liquidity risks

The World Health Organization (WHO) has declared the COVID-19 outbreak a pandemic and a public health emergency of international concern. A slowdown in economic activities due to measures taken to contain the pandemic will have a direct impact on businesses worldwide. The interdependent nature of our widely interconnected global economy means that if there is an impact on a business, it causes a ripple effect on many others around it.

Responding to an economic slowdown requires sensitive management of finances, balancing the short-term requirements with the long-term plans by organisations. Rising uncertainties and increasing volatilities in global markets make financial risk management extremely complex but essential in day-to-day operations of organisations.

At present, the extent of the COVID-19 outbreak and by when it will be brought under control remains unknown. What is certain is that businesses worldwide will need to consider the impact of reduced economic activities and lockdowns on their financial health and stability.

What to do now?

At this hour of crisis, it is absolutely essential for businesses to plan for the present and the future. Complex business environments warrant more meticulous assessments of financial risks and planning using many different possibilities.

Cash flow and forecasting models: Companies should evaluate the impact of the COVID-19 outbreak on their cash flows by thoroughly reviewing their credit lines, debtors and creditors. Since business cycles would no longer be what they used to be, organisations must forecast different scenarios ranging from not optimistic to completely pessimistic to understand the new financial thresholds. This exercise becomes the base for developing any plan in the future and is an extremely critical initial step. Critical factors affecting cash conversion such as sales cycles, payment cycles and critical heads of outflow need to be factored in preparation of the cash flow forecasts.

Simulations and scenario analysis: Simulations and scenario analysis are necessary to set milestones, using which different levels of measures can be planned by organisations. They need to consider various scenarios from optimistic to pessimistic and understand their impact on the financial models developed. Some of the illustrative scenarios in the current COVID-19 crisis are:

- **Base scenario:** When the infection has spread to stage 2, i.e. local transmission from infected persons and some areas put under lockdown for approximately a month.

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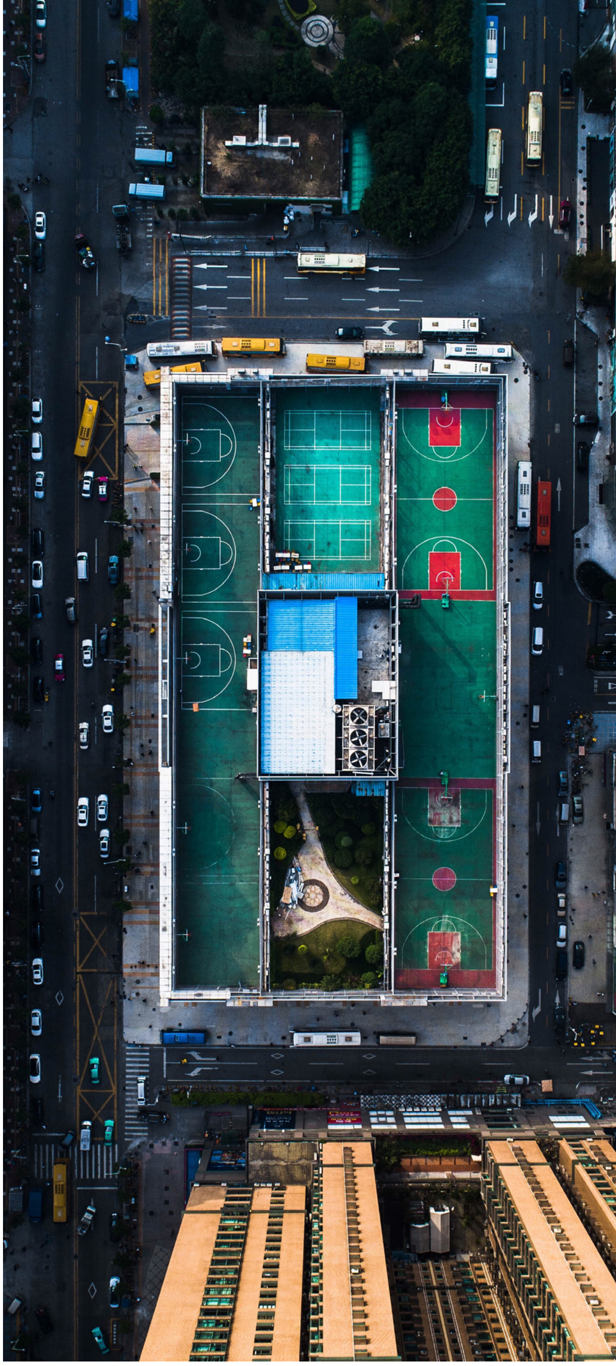
- **Medium scenario:** When the infection has spread to stage 3, i.e. community transmission resulting in countries being put under a lockdown of approximately three months or more.
- **Worst-case scenario:** The outbreak has been declared a pandemic and the global economy is on the brink of recession as countries have been put under lockdown for more than six months.

All of the above situations will have varying impact on global financial markets, depending on the extent of the effect on particular regions and how other countries/businesses are dependent on them. To add to the complexity, an organisation's own level of exposure to these macro-economic factors will play out very differently. Consequently, different situations across businesses would warrant different responses and strategies for them to bounce back.

Market volatility management: The COVID-19 outbreak has caused increased volatility in global financial markets, necessitating regular monitoring of market risk exposures and limits to avoid surprises. All financial exposures of a business as well as important investment decisions should be revalidated and retimed, based on the simulations, scenario analysis and forecasting models. Since there is little or no predictability in assessing the volatility in markets, most organisations will need to strategise for unfamiliar scenarios. Under such circumstances, planning for the most undesired outcome is a sound strategy.

Prioritising cash flows: Under such unusual circumstances when the future of global markets is uncertain, companies need to judiciously allocate existing resources to achieve mission-critical outcomes. Investment decisions and large outflows that can be deferred should be timed accordingly and communicated appropriately so that resources can be maximised. Most organisations would prioritise outflows such as raw materials, energy and labour costs as they are directly needed for business continuity.

Cutting the tail: Times like these give businesses an opportunity to reduce the amount of credit needed and maximise the credit available from their system. Organisations can right-size their operational costs during such crisis to ensure that there is no further disruption. A process of 'cash challenge' which allows various stakeholders to pose healthy challenges to the allocation of cash allows the innovative solutions and the right priorities to emerge through a mutually participative process.



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