Economic Update

When china sneezes, the global markets go for self quarantine measures

As at 18th March 2020

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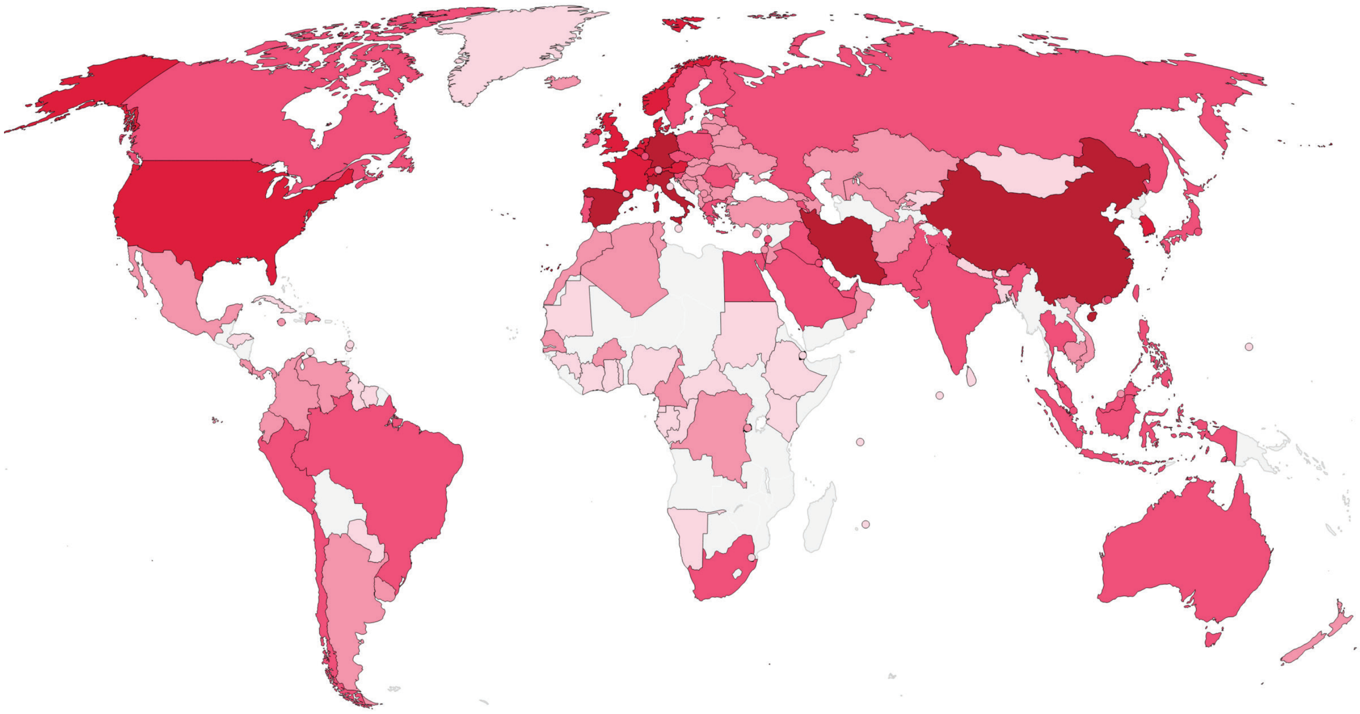
Overview of events

Covid-19 and its penetration

Jurisdictions with confirmed cases as of 18th March 2020



Source: Mapping the Coronavirus Outbreak Across the World, Bloomberg

Dealing with the pandemic

<u>Measures:</u>

- Part/full travel restrictions
- Closure of borders
- Lockdowns
- Closure of education institutions
- Working from home
- Expansionary monetary policy

<u>Impact:</u>

- Shut down of one of the largest global manufacturing hubs (Hubei province has been under lockdown since 23rd January 2020)
- Movement of ghost planes as the tourism industry has been negatively impacted globally
- Panic buying (increased demand for staple goods)
- Flight to safety
- Closure of businesses in other areas of quarantine/lockdown
- Fed Rate cuts
- Quantitative easing

Impact on the global Economy

With the WHO stating that 146 countries have recorded cases of COVID-19, there is no doubt that the global economy is being affected negatively.

As locations are being kept under lockdown, non-essential businesses in some of the major global economies have had to either keep shut, reduce their working hours or encourage a remote working environment..

Slow down in global trade leading to supply issues.


Increased panic across the globe has led to excess demand for essential goods and services which is likely to lead to supply shortages and increase in prices. Furthermore, trade between nations has been limited with nations stemming the flow of goods being manufactured in China (which accounts for the largest industrial output, c. USD 4 trillion in 2018).

Global financial cities under lockdown affecting the world's capital markets.

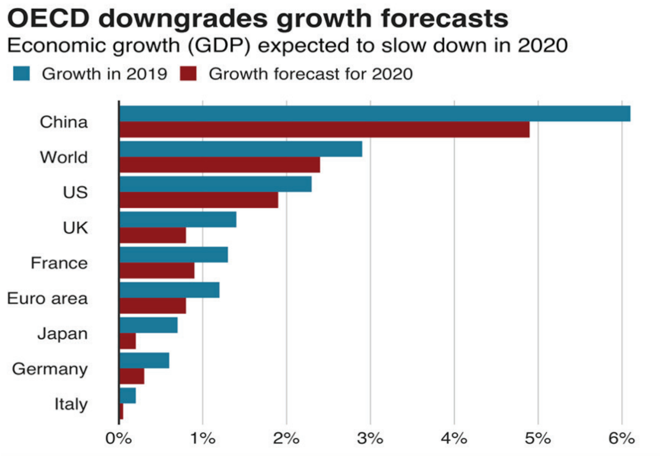
Governments under immense pressure to stop the spread of the pandemic leaving little time to focus on other issues affecting their economies.

Global growth

Stagnating economic growth

According to OECD, the global economy is likely to grow at 2.4% in 2020, down from the initial prospect of 2.9%. (The slowest growth rate since the 2008/2009 financial crisis)

Longer lasting and more intensive outbreak of the virus could cut global growth rates to 1.5% as factories suspend operations and workers stay at home to stop the spread.



Source: Coronavirus: 8 charts on how it has shaken economies, BBC

Industries

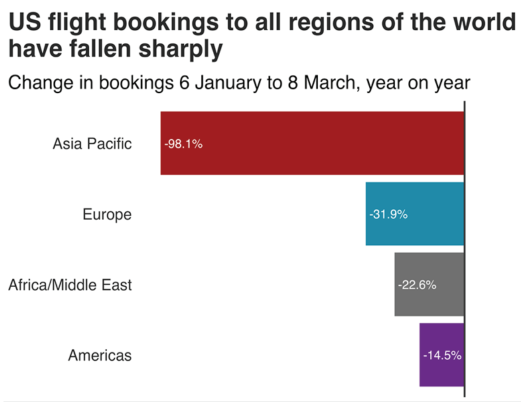
Travel among the hardest hit

Travel restrictions and fear of the spread of the virus has led to airlines suspending flights and tourists canceling business trips and holidays.

Up to 8th March, flights booked from the US were behind by 37% as compared to the same period last year.

Chinese tourists staying home means lower income for host countries as the Chinese spend three times more on average.

Cancellation of large scale events and additional flights is likely to have a bigger impact on the industry.



Source: Coronavirus: 8 charts on how it has shaken economies, BBC

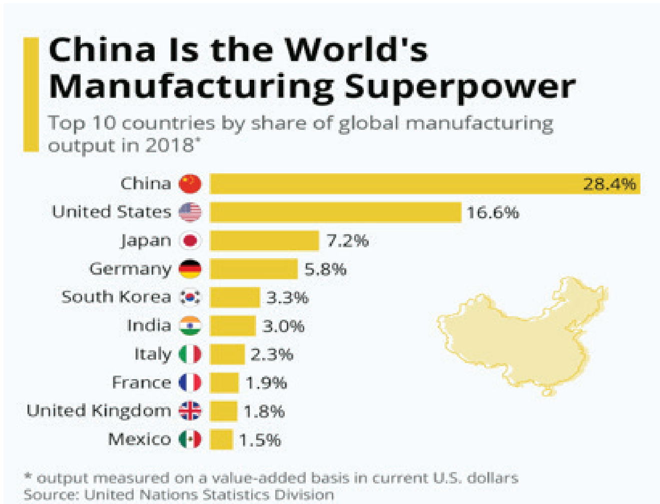
Factories slowing down

China makes up a third of the global manufacturing and is the world's largest exporter of goods.

NASA's pollution monitoring satellites have seen a significant drop in the nitrogen dioxide levels over China as factory activity in the "workshop of the world" has been paused to contain the spread of the virus.

Restrictions have also affected the supply chains of large global companies which rely on Chinese production and migrant workers.

The Eurozone on the other hand relies significantly on the export of manufactured capital goods to China. With major European economies taking on lockdown measures, movement of these capital goods are also restricted leading to lower sales volumes.



Source: Statista

Majority of the world's manufacturing superpowers have been severely affected by the pandemic, highlighting the extent of the impact COVID-19 is likely to have on global trade.

Source: Coronavirus: 8 charts on how it has shaken economies, BBC

Customers buying less of non-essential items

People are avoiding activities that would expose themselves to the virus, such as shopping.

Restaurants, car dealerships and shops have recorded a fall in consumer demand across the world.

In the initial phases, smartphone sales are also going to have a big impact as large smartphone factories (such a Apple) based in China have closed operations. With China also being a larger market for smartphone sales, restrictions will see a drop in sales.

Global financial markets

Global shares take a hit

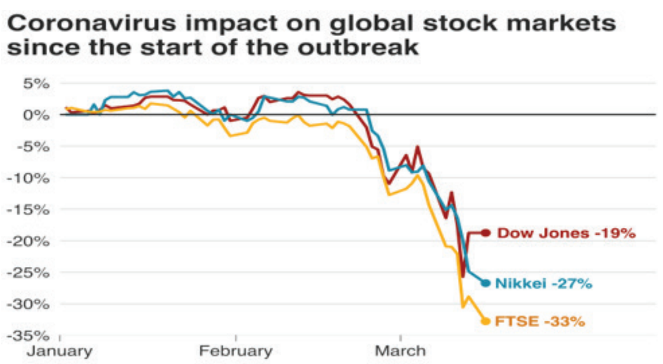
Besides the trade war between the US and China, COVID-19 has worried investors across the world leading significant drops to the world's largest stock markets.

In the second week of March, the Dow Jones saw it's biggest one day decline since 1987.

All the measures put in place by various countries to stop the outbreak has meant that various businesses are not operating at optimal levels signaling that business profits are going to be much lower this year. The knock-on effect of lower profits on investments returns in the stock markets has led to investors taking "flight to safety".

Increased volatility of the stock markets is being felt across the world as investors offload their equity investments.

It is estimated that USD 9 trillion was wiped out of global stock markets over a nine day period. The Nairobi Securities Exchange saw KES 573 billion being wiped out over a two month period as a result of the virus and other economic headwinds led to exits by foreign investors



Source: Coronavirus: 8 charts on how it has shaken economies, BBC

However, all of the volatility is not entirely due to the virus outbreak. Implosion of an alliance between OPEC and Russia has also caused a crash in global crude oil prices. A price war initiated by Saudi Arabia after Russia refused to go along with the OPEC plans of rescuing the oil markets from a plunge in global oil demand as a result of COVID-19.

Oil prices have nosedived by over 23% to prices below USD 30 per barrel. At one particular point, the price of a barrel of oil was costing as much as the price of 16 piece KFC bucket.

Source: WTI Crude Oil Prices – 10 Year Chart

On 16th March, Asian stocks also sank deeper into the red despite coordination from global central banks stepping in to restore investor confidence in the stock markets.

Stock futures, financial instruments that are used to trade in the stock markets at a predefined future date, also nosedived on 16th March despite efforts by governments and central banks to boost economic expansion by cushioning economies against the ill effects of the coronavirus pandemic.

Some measures taken include cutting Federal Reserve rates, US purchasing large quantities of crude oil in order to increase storage volumes and support US oil shales from the drop in global crude oil prices.

European and Asian economies have also faced the same impact. From the onset, governments and central banks are bracing for a recession as a result of the virus spread and oil market chaos.

A move back in time

Federal reserve actions

In a bold, emergency action to support the US economy from the ill effects of COVID-19, the Federal Reserve on Sunday 15th March 2020 announced that it would cut interest rates to near zero (target rates of 0% to 0.25%, a cut from interest rate of 2.5% in 2019 and 1.25% in early 2020).

The rate cut is expected to prevent a credit crunch and financial market disruptions that were experienced in 2008/2009.

With the stock markets entering a nosedive last week, the Federal Reserve had to step in to cut rates much earlier than expected since the world has been gripped with fear that the global economy could stumble into a recession far sooner than expected as a result of the motions of normal life come to a halt over the attempts by governments to stop the spread of COVID-19.

Source: Macrotrends – Federal Fund Rate

Besides the rate cuts, the Federal Reserve has also begun quantitative easing by using USD 700 billion to buy back treasury bonds and mortgage-backed securities in order to stimulate the economy and cushion the stock markets against the nosedive in equity prices.

The Federal Reserve also struck a deal with five other foreign central banks to cut their interest rates on currency back financial instruments in order to keep global financial markets to run normally.

These measures were first seen after the 2008/2009 financial crisis pointing to the assumption that the global economy is likely to enter into recession mode as a result of the coronavirus outbreak.

Quantitative easing is the term used by economists to describe the purchase of treasury bonds and bills by the government itself in order to cushion the citizens from bankruptcy. The government would "print money" to buy these bonds back from the public. Currently, China (USD 1.07 trillion) is the second largest holder of US treasuries after Japan.

However, the impact of the federal rate cut has, up to 18th March 2020, had no positive impact on the stock markets and it is likely that the current actions of the central banks will bear fruit much later in the future.

Nonetheless, action by the Federal Reserve to cut interest rates should be good news for businesses who will now be able to borrow at cheaper interest rates in order to increase production after the pandemic quietens down.

One of the world's most important short-term interest rates followed suit to catch up with the actions of the central banks causing the Libor rates to drop below 1%.

The cheap lending options will allow governments and central banks to stimulate the economy at a time of severe global distress.

The futures market

In times of uncertainty, Gold has always been considered a safe haven. This was the case in February when gold prices hit a 7 year high of USD 1,682.35 per ounce in February. However, gold has been on a gradual decline over the past week as investors rush to hoard cash.

The decline in interest rates and a plunge of the stock markets are key factors that are making investors risk averse in order to focus on hoarding of cash.

Even though as per history, gold should continue to remain a safe haven for investors at such a time.

Additionally, the futures price for precious metals (markets making assumptions on what prices of metals will be in the near future) has been falling on the backdrop of weak global cues from the industrial sectors, especially the slump in the demand from the Chinese manufacturing industries.

Impact on Kenya

Kenya's Economy

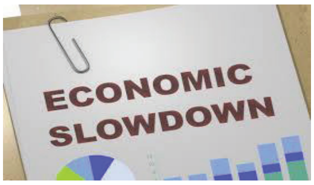
- Tourism is also a major engine of the Kenyan economy.
- Travel restrictions and closure of borders will impact the sector severely as discussed by Hon. Najib Balala.
- The knock on effect of the travel bans will also affect other sectors of the leisure industry as has been the case in most of the other nations that are on lock down.
- The impact of this will also affect FX rate with limited inflows of the green buck.
- Kenya's economy is largely dependent (26%) on the agriculture, especially the export of tea and coffee.
- With the threat of border's being shut down across Europe and Asia, there could be a direct impact on Kenya's economy arising from the slump in agriculture exports.
- Nevertheless, as seen with US restrictions on the Eurozone, trade may not likely be affected unless there are severe impacts on the modes of transportation.
- It is estimated that the travel restrictions from countries affected by COVID-19 will lock out 88% (2.8 million) of foreign travelers.
- Although the ban is only for 30 days, prolonged spread of the virus will see the ban increasing, further affecting the tourism industry for majority of the year.
- The knock on effect will be felt by the already struggling aviation and hotel industries.
- Kenya Airways is the most likely to face the brunt of the travel restrictions as a majority of its current routes are affected leading to suspension of routes and grounding of aircrafts.
- The country's bed night occupancy is also likely to be hurt by the travel restrictions which will expect the annual rates for 2020 to drop below the past 5 years annual average of 32%.

Trade

- With over 3 dozen ships cancelling their arrival at the Port of Mombasa and the fate of another 102 ships unknown, economic disruption is likely to worsen.
- With supply of goods likely to run low, businesses are already bracing for an economic hit whilst consumers can expect inflation to rise as a result of the mismatch between demand and supply.
- Kenya not only imports manufactured goods, but the drop in import of raw materials will be a cause for concern for various other local industries.
- Lower production as a result of the weak raw material supply will also see Kenya's export volumes drop.
- Lower imports at the Port of Mombasa will also have a knock-on effect on logistics within East Africa. Trucking businesses are likely to see low volumes for transportation which will negatively affect their revenues since majority of these businesses price their services based on volumes transported.
- The effect on the lower volumes being transported by the SGR will have additional implications on the nations debt repayments to foreign lenders.

Economic risks

1. Economic Slow Down



2. Strain on Healthcare

Consumer spending

Unemployment

Banking Crisis

FX Depreciation

Flight to Safety

Government Stimulus

Economic risk

Impact

The two main impacts envisioned by COVID-19 are the slow down in the economy and the increased pressure on the already fragile healthcare system.

- As with the rest of the globe, real GDP forecasts have been revised downwards in 2020, especially for the near term future.
- As already discussed, the impact on the key drivers of the economy is inevitable and has already been felt throughout the nation.
- However, the impact global economic slowdown will be enhanced as a result of it's direct implication on the livelihoods of people.
- The lockdowns initiated by governments have caused businesses to slow down operations leaving employees to in a dilemma of either taking unpaid leaves or becoming redundant (Business Daily, 2020).
- This has a massive impact on consumer spending in the economy as people focus on utilizing their limited income on goods and services that are determined to be most important to their survival.
- Poor business performance and lower incomes will further affect the banking industry in terms of repayments of loans. Business and personal loan defaults are likely to become common as the hard times will prevent banking clients from servicing their debt obligations.
- The global impact of the pandemic has also meant that analysts foresee diaspora remittances in to Kenya slowing down over 2020. Diaspora remittances into Kenya stood at USD 2.8 billion in 2019 (Daily Nation, 2020).
- Diaspora remittances coupled with the "flight to safety" from international investors, which has already seen the Nairobi Securities Exchange lose over half a trillion Kenya Shillings over the past two months (Business Daily, 2020), causes a concern for the depreciation of the local currency. This could make borrowing in foreign currencies expensive for the business environment that is already struggling.
- Whilst the Government continues to stay focused on limiting the spread of the coronavirus, the Government also needs to put in place expansionary measures to boost the economy and cushion it from any negative impacts arising from the virus.
- However, a balance will need to be struck between boosting the economy and supporting the strain that is likely to be felt by the healthcare system. Thus, it can be expected that fiscal measures will be put in place for fighting the pandemic whilst the monetary policies will be put in to prevent any severe economic disruption.

Mitigating factors

- Traders have been warned against inflating the prices of basic essential goods in the wake of the coronavirus pandemic.
- Panic buying and disruption to trading will lead to low supplies in the market. Taking criminal action against business that will artificially raise prices of essential goods will allow the country to safeguard citizens against inflationary pressures.
- Nonetheless, the success of this will be determined by the effectiveness of the authorities to stem unfavorable practices.

- Safaricom was the first to waive off transaction fees for it's M-Pesa services which will allow businesses to minimize on their finance costs whilst ensuring the safety of their employees.
- Safaricom announced on 17th March 2020 that it had agreed to waive off fees for transactions below KES 1,000, double the amount being transacted at one particular time and increase the daily transacted amount to KES 300,000.
- The Banks on Tuesday 18th March 2020 also announced that they will facilitate the increase of mobile digital platforms, waive of balance inquiry charges and eliminate charges for transfers from mobile money wallets to bank accounts.

- Banks on Tuesday 18th March 2020 announced measures to offer relief to borrowers.
- Some of the measures put forward to assist businesses and the general public to keep a float during the pandemic are listed below (Press Release, CBK).
  - Provide relief for personal loans based on individual circumstances;
  - Review requests for the extension of personal loans for a period up to a year;
  - Corporates and SMEs to contact their banks for restructuring options based on circumstances;
  - Banks to meet the costs of extending or restructuring the loans;

- The conflict between OPEC and Russia will probably prove to be an angel in disguise for consumer, albeit at a later date in the future.
- The drop in global oil prices in March signals that consumers can look forward to lower fuel expenses after the initial lag period, boosting hopes for struggling industries to continue remaining a float during the pandemic.
- The drop in oil prices will help logistic companies to lower their fuel expenses after the lag period so as to support them from a fall in demand for their services as a result of ship cancellations at the Port of Mombasa.
- Aviation industries will also be able to weather the current storm by taking part in acquiring fuel at lower rates for future use over the derivatives market.
- Nonetheless, losses will be felt across the oil industry after the lag period for the benefit of the consumers.

- Since November 2019, the Central Bank of Kenya has cut it's lending rates from 9% to the current rate of 8.25% in order to support borrowers in the wake of economic headwinds.
- The Central Bank of Kenya's Monetary Policy Committee is scheduled to meet next week on the 28th of March 2020 where analysts predict that the lending rates will be cut further by 0.25% to 0.5% to cushion businesses as a result of the ill effects of the coronavirus pandemic. This follows the measures undertaken by the Federal Reserve in slashing interest rates to assist economies to return back to potential levels.
- The Central Bank of Kenya has also indicated a plan to purchase USD 400 million from Banks over a 90 day period up to June in order to increase dollar reserves. Amid growing global uncertainty, this will stabilize the local currency against the green buck.

- The additional strain put on the healthcare system as a result of the pandemic is likely to lead to additional borrowing from the public markets via treasury bonds.
- With the possibility of interest rates being cut further, analysts expect the issue of the financial securities to be purchased at a discounted value (purchase price of the bonds will be lower than the par value) providing an opportunity for investors to capture higher yields.
- Given the current turmoil in the global capital markets (lower interest rates in the US and plunging stock markets), the local currency could mitigate the risk of large depreciations against the dollar as foreign investors return to purchase local bonds.

Covid-19: respond and restore

Some leadership considerations in the era of covid-19

Business leaders now find themselves on the front lines of the COVID-19 outbreak. While there is uncertainty in many aspects of this health crisis, for business the implications are clear: resiliency, agility, planning, empathy, and preparedness are all important factors, today and in the future.

Here are some considerations for leaders in the COVID-19 era.

1. The critical basics: your people. Active and open communication, sick policy flexibility, enabling social distancing, remote work planning and technology enablement where possible, decontamination/ sanitization of facilities and offices are all essential steps. Importantly, so is listening to your people.

2. Consider information carefully. Guidance from authorities. Filter news and reporting for facts. Apply critical thinking to experts and forecasts. Relentlessly update current thinking in a time of rapid change.

3. Thoughtfulness around your customer. Thinking ahead about implications for your customers and how you can serve them in a different time. Communicate in a planned and active way with your customers, potentially through multiple channels.

4. Agile decisionmaking. Create means to take decisions rapidly. Eliminate red tape.

5. Know your vulnerabilities and try to contain risk. Quantification and seasonalization/timing of risk can be important – people, financials, strategy, cashflow, amongst others.

6. Capitalize on innovation. Use times of change to innovate in ways that contemplate and plan for a new way of working. Consider short-term mitigation plans and investments in light of potential future advantages to be gained.

7. Document and create policies now, in real time, where they did not exist. Prepare for a next crisis. And plan for a changed climate in the wake of this one.

Is your supply chain ready for covid-19 disruption?

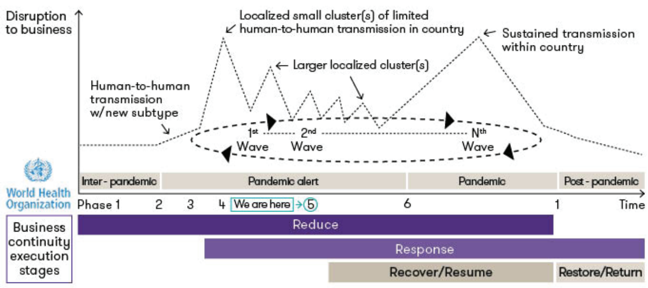
8 Lessons for strengthening your supply chain today

The COVID-19 pandemic is upending the carefully calibrated logistics of global shipping and highlighting long-standing concerns. Plunging exports from China and congestion at Chinese ports are disrupting the trade of American goods. US farm products destined for Asian markets are stuck at Chinese ports, creating a traffic jam that is driving up prices for US exporters and sowing additional turmoil on top of a not-yet-resolved trade war. Factory shutdowns have crippled China's industrial production. As a result, shipping volumes out of China have fallen. A record 2 million containers of ocean-going cargo stalled in February, per Alphaliner – a Paris based marine data provider. That February number is higher than the 1.5 million in cargo idled in 2009 during the height of the Great Recession. Delivery issues; rising concerns around product availability, cost, and quality; and decreased manufacturing capacity stemming from plant closures and workforce shortages are all disrupting supply chains. While the ultimate effects of the COVID-19 crisis can't be known yet, there is no question COVID-19 threatens the supply chains of both small and large organizations around the globe.

In the March 4, 2020 edition of Grant Thornton's Economic Currents, Grant Thornton Chief Economist Diane Swonk discussed how COVID-19, combined with business investment decline, corporate debt levels, and low unemployment figures, could drop global GDP into recession. COVID-19 is directly suppressing growth on a global scale at sufficient magnitude to drive down GDP forecasts. Declines in travel and consumer spending support that projection.

Organizations need to act now to improve supply chain resilience and mitigate evolving constraints and related financial performance issues. They must focus organizational resources on the most important value protection and cash management efforts and determine whether this is the time to implement their business continuity plans and crisis management teams. They need to define the immediate, critical resiliency responses required to boost corporate performance, viability and sustainability. Supply chain disruptions increase the likelihood of logistical, financial, and solvency concerns, especially in the absence of substantial working capital or ready access to credit. A lack of organizational resiliency presents an essential modern day challenge for today's business leaders. Many organizations are not prepared for a pandemic event.

What a pandemic means for global supply chains



On March 11, 2020 the World Health Organization declared COVID-19 a full-blown global pandemic, with sustained transmission of COVID-19 within most, if not all, countries and widespread community transmission between individual persons. This will mean even greater business disruption and financial losses, along with rapid setbacks to global GDP forecasts. This pandemic may also cause sizeable workforce availability constraints, as employees stay home to protect themselves, care for family members or are placed under local health quarantine.

The COVID-19 crisis presents today's business leaders with a challenge the global economy has not faced since the Spanish Flu pandemic, which occurred between 1918-20. The Spanish Flu infected up to one third of the world population, with a mortality rate of approximately 3%, killing many young adults in the prime of their lives. Over the subsequent 100 years, the growth engines driving business ecosystems have changed, becoming broadly global and dependent on trade across far-flung supply chains. These supply changes are finely tuned to manage raw material and production costs and to deliver competitively priced products to consumers. The time and cost variances of a pandemic shock would severely affect already fragile supply chains. Such a crisis heightens the need for organizations to be able to access, quantify and respond to supply chain risks in real time. Otherwise, supply chain disruptions increase the likelihood of logistical, financial and solvency concerns, especially in the absence of substantial working capital or ready access to credit. The lack of organizational resiliency in the face of a pandemic presents an essential challenge for today's business leaders.

Following are eight supply chain lessons organizations can apply today to better understand, prepare for and combat the disruptions of the COVID-19 pandemic.

8 Lessons for Mitigating Supply Chain Disruptions

- Lesson 1: Build a supply chain risk management governance framework and link underlying processes and key risk triggers to a business continuity plan

  - Governance framework should be documented with clear roles and responsibilities
  - Scope and objectives and desired outputs should be clearly defined
  - Resiliency planning and business continuity must be included and tested
  - The cadence for executive level review should be firm and the results documented

- Lesson 2: Collect internal data on disruptions

  - Data on prior events or disruptions is valuable. It can help predict results for future events
  - The necessary data often has to be built rather than extracted from internal systems
  - Challenge employees to identify events and train them on inputting and generating the kind of data that is needed
  - Catalog the data for quick reference and better usability within qualitative and quantitative analysis and reporting
- Lesson 3: Leverage external data and models

  - External data is equally important and useful for augmenting internal data
  - Industry specific data is often available and offers an added filter
  - Cross industry or customer consortiums offer unique data that adds context
  - External models exist and can help validate internal data and findings

- Lesson 4: Identify the most prevalent supply chain risks

  - Brainstorm with your internal thought leaders to identify the most obvious risk factors
  - Consider the industry and competitors to identify other potential risk factors
  - Subscribe to academic studies on risk factors in specific industries or geographies
  - Think about risk factors that occur less frequently (e.g., natural disasters, trade wars, COVID-19)
  - Imagine the art of the possible and run a few scenarios to see what happens

- Lesson 5: Conduct a supply chain risk assessment to understand the business impact of supply chain disruptions both upstream, internal and downstream, across various supplier groups and product lines

  - Use the risk factors you identify to brainstorm the possible failure modes. For example, consider order and sources of potential disruptions, cost of parts, products and other variable costs, workforce stoppage costs due to supplier non-performance, or non-performance due to supplier workforce stoppage or slowdown.
  - Allow all key stakeholders to build their own risk-based view driven by their first-hand view of possible failures and root cause analysis'
  - Consider denial of use or premises in the risk assessment. Apply varying time durations
  - Socialize and reach consensus on the possible root causes and impact zones
  - Complete quantitative scoring of the impact models

- Lesson 6: Use quantitative modeling that evaluates supply chain risks based on conditional probabilities

  - Build quantitative models that can learn from valid data you collect and maintain
  - Integrate your risk assessment and cost analysis into the risk modeling
  - Use scenario modeling, root cause analysis, and correlations to test the impact zones for unrelated events across different manufacturing, delivery and quality aspects of your supply chain
  - Use algorithms tuned to evaluate emerging and atypical risks and adjust accordingly

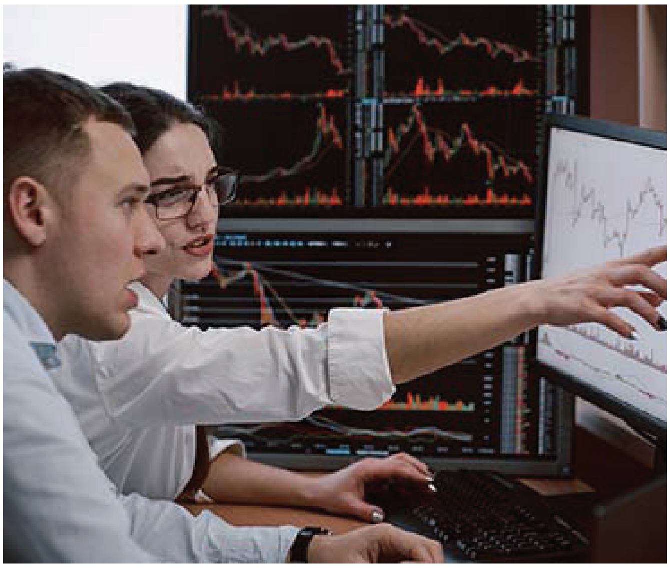
- Lesson 7: Develop and iterate on your resiliency plans including a disaster recovery plan with business rules the determine when these plans go into effect

  - Always understand the financial exposure you assume with your supply chain subject to the likelihood such exposure actually occurs
  - Align resources with the most critical resiliency plans that also protect your working capital
  - Build detailed resiliency plans as part of your supply chain risk governance framework
  - Maintain disaster recovery plans with clear initiation triggers and guidelines

- Lesson 8: Demand that your suppliers, contract manufacturers, 3PL providers, and other have sophisticated supply chain risk management and resiliency planning capabilities
  - Your upstream and downstream trading partners also have supply chain risks
  - Ensure risk management and resiliency planning are part of your supplier management strategy
  - Integrated supplier performance data into your risk modeling efforts
  - Proactively search the relationships between variables

Focus on cash flow and liquidity for covid-19 resilience

With recession looming, 4 ways to act now



The COVID-19 pandemic is roiling financial markets, threatening businesses and challenging management teams. In these uncertain times and with a possible recession looming, the cash and liquidity needs of a business are paramount. Focus on these four areas now to position your business for what's coming next.

1. Cash is king - understand your cash and working capital needs

Cash is the lifeblood of any business. In a volatile and slowing economy, getting an immediate handle on your daily cash needs is essential. Take a critical view of operations, review existing cash flow forecasting processes and understand how potential disruptions to operations may affect liquidity.

- Run scenario analyses on your financial and cash forecast and understand how that interacts with short-term liquidity needs. This exercise may also highlight any borrowing base or covenant beaches that you could be facing and can help shape any short-term management decisions.
- Look for opportunities to build a war chest of cash and investigate whether drawing down on credit facilities could be prudent for safeguarding your business.
- Strategically manage working capital, potentially selling inventory or minimizing new inventory purchases to generate cash. Take a critical look at working capital KPIs such as days payable outstanding and days sales outstanding and understand impact of stretching these days in either direction. Assess capital expenditure requirements and defer non-essential spending if possible.

2. Cost optimization - be relentless on cost control

Maintaining your current or historical levels of profitability in an environment where supply and demand fundamentals are decreasing simultaneously can be difficult without closely analyzing spending.

- Develop a strategy: do not execute cost-cutting initiatives at the risk of compromising revenue generating capabilities or diminishing value.
- Review fixed and variable costs carefully and determine what costs you actually need to run the business.
- Develop and monitor cost reduction initiatives, such as rationalizing SG&A, taking a close look at headcount and instituting policies that encourage and reward cost savings and conservation.

3. Evaluate customers and suppliers

In times of economic uncertainty, businesses could see increased pressure on the purchasing power and credit-worthiness of customers while also facing tighter credit terms and product availability from suppliers.

- Do not assume your customers are financially healthy. Re-evaluate credit terms with current customers, negotiate the shortest reasonable terms, and carefully review the credit-worthiness of each new customer before extending credit.
- Continuously monitor accounts. Failing to collect receivables timely (or even on an accelerated basis) may result in a cash flow shortfall that could have an immediate impact on all areas of your business.
- Negotiate for the most favorable credit terms with suppliers and critically evaluate your supplier base to determine if your current agreement is still the most favorable for your business.

4. Communicate early and often with your lenders

Your existing lenders will likely know you and your business best. Communicate with them early and often, explaining any situations that may arise and the actions you propose to address them. Transparency and open communication will serve you both well. Your existing lender could be your fastest source of additional liquidity.

- Evaluate potential covenant breaches based on the outcome of various scenario analyses impacting your financial forecast.
- Conduct detailed modeling of your working capital facilities, particularly with asset-based loans, which can change their availability formulas due to updated net orderly liquidation values via new appraisals.
- Stay current on your debt if possible and assess capital structure concerns, including whether you should consider refinancing or recapitalization alternatives.
- Engaging in key stakeholder and lender discussions early can provide you the time and liquidity to address your immediate potential financial challenges.

The COVID-19 pandemic presents novel challenges and a chaotic business environment. By focusing now on cash flow and liquidity, you can provide your business with the financial cushion and flexibility to weather the storm.

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