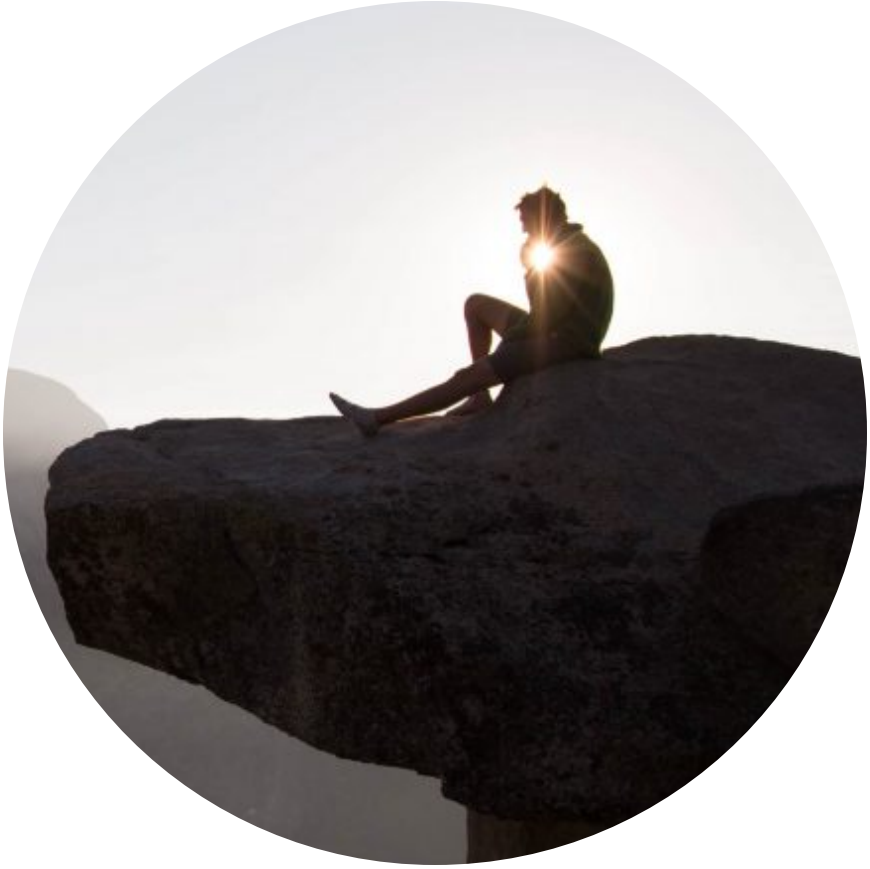
CFO's DOMAIN

2020 Year of Chaos

"A Guide to Financial Planning in the era of COVID-19"



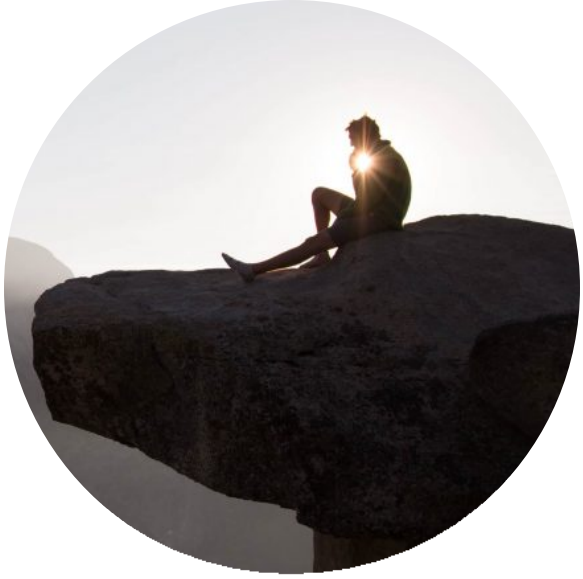
2020 has truly been the year of chaos and disruption, and for everyone!

In fact, none of us have seen times like this in our lives. It has been unprecedented and unexpected.

Today, more than ever before, organizations under the leadership and action of their Boards of Directors and Executive Management Teams must adopt a new approach towards people and planning. Empathetically, yet rapidly, plans need to be made and executed to ensure company resilience through a culture of adaptation and evolution.

Planning is not an easy task, and COVID-19 isn't making things any easier. Finance professionals who seek consistency, accuracy, and predictable planning cycles, must now struggle with the uncertainties surrounding the economy and anticipate the length of this pandemic's long term impact. That five-year plan that was a staple in every company board report around the country is now out the window.

So, how do you plan in the current environment, especially when no one has a true idea of what exactly is occurring from a timeline perspective?



First things first: your current plans and assumptions must be revised due to the fast-changing global health situation, which is causing uneven economic effects in all sectors. So, lets dig into it.

COVID-19's Economic Impact

The Coronavirus affects the nation's economy in three main ways:

- Lockdowns and Social Distancing has businesses operating at reduced capacities
- Supply chain interruption
- Capital market disruption and irregularity

However, most of the economic impact will depend on how consumers and enterprises react to the disease over the long term.

The COVID-19 pandemic's toll on economic activity in recent months is only the beginning of the story. While the rapid and unprecedented collapse of production, trade, and employment may be reversed as the pandemic eases, historical data suggest that long-term economic consequences could persist for a generation or more. One thing is for sure, we aren't going back to 'normal,' and the pandemic is likely the single biggest catalyst for enterprises to seek additional ways to find efficiencies through automation and outsourcing.

Among these effects is a prolonged period of depressed real interest rates that may linger for a decade or more. Typically, sustained periods of low borrowing costs are associated with higher real wages and create ample room for governments to finance stimulus measures to counteract economic damage – this concept, like the 5 year plan from yesterday, could also be out the window.

It is important to understand what the economic landscape will look like in the years and decades to come. That landscape will shape monetary and fiscal policy in ways that are not yet fully understood.

The Role of Financial-Planning Teams in Helping Businesses Navigate the Coronavirus Crisis

Ordinarily, a financial planning team would use a variety of tried-and-tested models for forecasting, budgeting, and carrying out root-cause analysis. All finance professionals have created standard financial reports.

However, very few finance teams have encountered the uncertainty they are currently experiencing. Notwithstanding, it is the finance team's role to come up with a crystal ball solution in a matter of weeks and one that addresses critical organization decisions.

Under this period of turmoil, financial planning requires a systematic, novel approach, that allows the CFO and finance team to lead with viable options.

In particular, the financial-planning group should focus on:

- Getting a clear view of the organizations current standing (especially from a cash runway perspective)
- Building a fact base for developing different scenarios
- A close examination of second order consequences resulting from the pandemic
- Relevant changes in consumer habits that may linger on after the pandemic ceases
- An opportunity discussion around positive byproducts in the current environment such as low borrowing costs
- A risk adjusted view of vendors, suppliers, and customers that may have a material impact on the future
- Changes in productivity and output resulting from a distributed workforce
- Identification of possible trigger points that require business adjustment and changes in forecasts

During the pandemic, businesses everywhere have faced excessive liquidity and risk tolerance levels. Regardless of where you decide to start, your company can utilize the information in this guide to overcome the uncertainty and make informed decisions.

Planning helps guide organizations through the crisis. Once all of this has passed, the CFO and finance team can use the crisis as the launchpad for in-depth conversations about "the new normal" that needs to be adopted.

Get a Clear View of the Organization's Current Standing

Every company must have a clear view of its financial position during the pandemic.

To achieve this, you need a financial-planning team that includes experts in sales and supply chains. Together, the team can build a fact base that tells a complete story about the history and current standing of the market and financial trends. The base will also provide possible future indicators.

A good starting point is a financial plan your company had rolled out at the beginning of 2020 since it helped establish assumptions that have changed in light of the pandemic.

A revenue to cash driver-based model that investigates weekly or monthly liquidity can help identify possible risks.

A driver-based model should compare trends and critical operational drivers in the business – these are inputs that are likely to have the most impact. Compare the operational drivers from before the pandemic to significant drivers since the start of the crisis.

- What has changed?
- Are there possible liquidity risks that are emerging?
- Are your drivers sensitive to the uncertainties surrounding your market?

At the same time, do not discount the value of looking at business drivers in your industry, including geographies, customers, and vendors. Compare the business drivers and see what has changed.

The outcome from this investigation will provide the baseline facts for comparing against future scenarios. Such scenarios are now the north star for the FP&A team and critical points of your budget/forecast for the coming two years.

Use a Fact Base for Developing Different Scenarios

Once you have identified a reliable base of facts, the next step for the financial-planning team is modeling three to four scenarios of how the Coronavirus pandemic may play out in your industry.

These scenarios are:

- An optimistic best-case scenario
- A pessimistic worst-case scenario
- A scenario where the current trajectory continues
- A most-likely case scenario

Each of the scenarios identified should be based on decline depth, duration, and time that would be needed for a recovery.

Further, all the scenarios should reflect the organization's exact starting point. For instance, a business experiencing a slight sales decline due to COVID-19 might only require small, non-structural changes to help it weather through the crisis.

On the other hand, an organization that has lost half of its sales volume should plan for revamping its cost structure and possibly the entire business model. Therefore, the worst and best cases are unique for different businesses, even if they are in the same sector.

Your financial forecasts should ideally exclude upside scenarios or investments from strategic initiatives. Financial planning should then make stress-test projections and run the initial business assumptions against the scenarios.

Time horizons to consider should start at three months out, then extend to 12 and then 18 months. During the modeling phase, the financial-planning team should depend on conservative assumptions and estimates without being overly precise.

Modeling provides the team a chance to build an overview of possible capacity and capital constraints due to the pandemic. One of the questions modeling helps answer includes what strategic initiatives should be canceled, deferred, slowed, or accelerated?

Companies in a strong cash position might opt for accelerating their opportunities by shoring up the supply chain – via the purchase of more raw materials or paying in advance to ensure critical resources are available. Conversely, an organization facing liquidity problems might choose to pursue payment term extensions with their suppliers or even defer some initiatives until after the crisis. Another option may be to take advantage of current interest rates by trying to raise debt.

Align the Financial Plan with the Most Sensible Path

After creating and pressure testing the fact base with different scenarios, the next step is working with the executive leadership team to decide which situations are most sensible for further action.

Depending on the level of disruption, the most sensible path may be sustaining the current business and looking into options of how to restore operations as fast as possible or restructuring your organization to meet the current environment. Other options include shifting your business model to address changing customer behavior or reshaping into an entirely new business.

Whatever the case, the financial-planning team needs to clarify how the organization handles cash conservation in a "coronavirus world", which includes near and mid-term cash flow evaluations. Such a plan is most effective if it is communicated across all critical departments, including marketing, sales, and operations. Companies should focus on how to maximize cash flow for sustaining the business and not the overall revenues or company size.

Internally, a financial-planning team might want to re-investigate performance plans with an emphasis on initiatives and not financial results. This is necessary due to previous compensation rewards linked to targets that are no longer viable due to pandemic's effects. Revisiting performance plans is also critical because new initiatives require embracing new activities.

Identify the Best Actions and Moves to Make

Now that you have your scenarios and a path forward, the financial-planning team must now collaborate with senior leadership to identify how to move forward. This collaboration will help:

- Create a set of coherent initiatives
- Determine the best way of executing initiatives
- Establish a means of tracking performance

Together, the team can also come up with the right mix of big bets, conservative based moves, and medium risk actions. These moves will either be built into your financial plan for 2020, considered in planning but not included in the business plan, or part of your crisis planning initiative.

Based on the scenarios above, for example, midsize industrial leaders may decide to shift resources from products that are dropping in sales due to the pandemic and focus on products that are holding steady. The same company may also choose to invest in converting some of their production machinery for making personal protective gear, which is urgently needed.

Senior leaders of a retail business in distress can work with the financial-planning team to create priority initiatives and map the working capital, costs, capital expenditures, and other levers required to carry them out successfully. A deep-dive of services and products associated with the initiatives and expected long-term and near-term sales ensure priorities and resources will need to be appropriately allocated. With this information available, it is easier for senior company leaders to revise their preferences, defer some of them or cancel a few.

Identify Potential Trigger Points

In times of crisis, the financial-planning team must keep a close eye on the business' liquidity and earnings potential. The team should identify the most relevant trigger points or indicators among the operational and business drivers that influence financial results. For many companies, these include sales and cash figures, but may also include sales-pipeline metrics and customer retention rates.

A dashboard built by the financial-planning team should be reviewed daily for changes and identification of interventions required. In its initial stages, the dashboard may be bootstrapped using standard software like Excel but should be ideally updated and live in a Business Intelligence tool that key stakeholders have access to for the latest, most reliable information.

Further, the trigger points should include KPI's that signals when a business moves from the crisis phase and enters the new normal. Early recovery from a downturn usually results in outsizing company gains in the market.

Four Key Questions

CFO Daily News identified four questions all CFOs should be asking right now, regardless of their size or the industry they're in, to make sure they're as ready as they can be for the COVID-19 crisis. We wanted to share them with you:

Question 1: Is your response being handled in silos?

If each individual department at your company is handling its own part (procurement tackling supply chain response, marketing reaching out to customers, etc.) you might not be getting a strategy that's properly aligned across your entire organization. As CFO you want to be making sure that each piece of the org chart isn't responding in a way that could make expensive headaches for another group.

Question 2: Could your current policies be putting your employees at greater risk?

If you haven't committed to an all-workforce remote work arrangement, you may be flooding your office with more people than usual, whether that's employees or additional visitors to your office.

And since we're learning that many people spreading the virus are asymptomatic, the increase in volume alone could be driving up the chances one of your employees falls ill to the coronavirus.

Question 3: What will you do about compensation?

Some industries and positions lend themselves better to remote work than others. Companies have already had to lay off people; others are offering to pay their salaries (for now). Consider salespeople who depend largely on commissions and will not be able to make that money if they can't travel due to COVID-19.

As CFO you're in the best position to do some scenario planning and map out the options for supporting your workforce while not jeopardizing the financial health of your company as a whole.

Question 4: Are you being overly optimistic?

CFOs are known for being realists, which is what's very much needed right now. But this pandemic may be a large scale and even catastrophic problem that extends way beyond the third quarter of this year. Many companies – your own and your trading partners included – are being too positive about when demand will return to normal. And that can be dangerous.

It turns out the companies in the worst current financial shape tend to be the ones that think we'll bounce back way faster than we actually will.

So, you need to ask the tough question of your suppliers, your customers, and even within your own company. If you plan for a deeper recession now, you may have better and more attractive options than if you're surprised come fall when things haven't bounced back.

At the End of the Day

COVID-19 is a public-health crisis with tragic global consequences. However, it does not have to signal an economic disaster for your organization. As a finance executive, you have an obligation to help your company navigate through this pandemic with a steady will and firm hand to rebound effectively and ultimately, achieve success.

Questions? Please Contact CFOs Domain today at **clientservices@cfosdomain.com**