CFO

COVID-19 Aftermath: Moving Beyond Quick Fixes to Sustainable Value Creation

What else can companies do to help drive their businesses' short-term cash flows and fund their long-term ambitions? **By Greg W. Schooley**

Most companies have exhausted their first set of actions in response to COVID-19 — "low-hanging fruit," so to speak — to stabilize cash flows, increase liquidity, and manage their business through the pandemic. The question now is what else can companies do to help drive their business's short-term cash flows and fund their long-term ambitions?

At the onset of the COVID-19 crisis, many companies acted fast to increase liquidity and protect their businesses. However, those actions are often only temporary fixes. Companies now face the task of balancing competing goals: improving cash flow and implementing sustainable value creation strategies, while simultaneously ramping up for increased business activity.

CFO's can lead the focus on several areas to achieve longer-term stability:

- Reducing indirect taxes, which can represent up to 25% of total personnel costs
- Cutting third-party spend by launching sourcing programs
- Reviewing real estate footprint, leases, and facility management services
- Outsourcing back-office ac tivities to reduce cost and shift to variable cost structures
- Optimizing working capital to release cash in accounts payable, accounts receivable, inventory and other areas

Cost of Goods Sold (COGS)

COGS typically represent the largest portion of operating expenses for most businesses, and they are an important area for reductions and optimizations. Some of these costs, such as manufacturing, can be complex because they involve executing Lean Six Sigma practices across diverse manufacturing sites. The biggest expense for many companies is purchased components and materials. Companies can address it by reducing purchasing costs through sourcing programs that consolidate spend with fewer, more aggressive suppliers.

Indirect Taxes

Most executives are surprised to learn that indirect taxes are a major cost area, particularly in the post-COVID-19 environment. The total indirect tax burden of most companies is roughly 25% of their total personnel expenses. Indirect tax costs reside in many areas of an organization, including procurement, research and development, labor expenses, and manufacturing. By taking a holistic review and establishing a program focused on indirect taxes, companies can reduce these costs by 10% to 20%. These savings can be realized within three to four months. Often these savings also have "look-back" provisions, meaning businesses can claim savings on past tax payments as well.

Real Estate

Real estate costs represent about 3% to 5% of a company's overall revenue. The COVID-19 pandemic has prompted many companies to review their real estate footprint, leases, and facility management services to significantly reduce expenses, better align with changing customer behavior, and evolve their workplace strategy. Real estate costs can be reduced through rooftop consolidations, reducing vacancies, improving lease terms, and reviewing facility management services, such as cleaning and repairs. Lease restructuring reviews can identify ways to reduce rent or terminate leases as we face imminent declines in real estate values and rents for a number of years. Developing an overarching workplace strategy can help enhance productivity and engagement while highlighting offices that can be shed, or that may need improvements for continued use.

Customer and Product Optimization

Pricing is one of the most powerful levers available for improving margins and driving quick profit growth. Investing in pricing tools and new strategies powered by big data and analytics can help to increase gross margins. Rationalizing products can also drive significant profit growth by focusing on more profitable segments. Most companies have experienced a dramatic product or SKU proliferation. For example, grocery stores that carried 7,000 SKUs in 1970 now have 40,000. More SKUs often lead to increased complexity, higher inventory levels, larger store footprints, and ultimately higher operating expenses. Companies may also look to grow their more profitable customers while assessing pricing changes among their low- or no-margin customers.

Labor Productivity

Labor is a large component of a company's operating expenses in both in terms of selling, general, and administrative (SG&A) functions, as well as supply chain. Actions to address labor productivity include enhancing workflows for increased efficiency, utilizing automation for improved productivity, shifting some operations offshore to capitalize on lower-cost labor, and possibly outsourcing non-strategic functions like accounts payable. These strategies can often deliver savings of 20% to 30% even for larger, "lean" companies.

Working Capital

Companies typically carry too much working capital in the range of 5% of revenues. In good times, when capital is plentiful and cheap, working capital may not be a strategic focus. In economic crises, companies need to carefully manage cash to survive and grow. Companies should assess the supply base to understand which suppliers are not providing market-competitive terms. While some suppliers are "mission-critical" and should be handled with care, most are not. Many suppliers would be willing to extend terms in exchange for continued business. Similarly, companies can assess their AP processes to understand where opportunities exist to leverage AP more strategically to release cash. Accounts receivable processes also deserve a close look to understand which customers can improve payments with additional attention and incentives.

Cash Management Office (CMO)

Establishing a CMO can help focus efforts that may increase the odds of success for a value creation program. A CMO typically involves several elements, including the use of analytics to determine achievement levels. Once opportunities have been qualified and prioritized, common project charters can be established. This often helps provide accountability for the agreed-upon changes and results.

Another element involves a realignment of key performance indicators, metrics, and incentives. To instill a cash culture within an organization, teams may need to understand the role they play and understand how to make effective decisions. A final element is cash forecasting to seek benefit from changes implemented and so that cash can be deployed effectively in the future.

The COVID-19 pandemic and subsequent shutdown of the global economy represents the biggest collective challenge faced by companies in the past century. In these extraordinary times, companies must take decisive actions quickly to provide for survival and future viability.

The views reflected in this article are those of the author and do not necessarily reflect the views of the global EY organization or its member firms. CFO

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