COMMERCIAL BANKING

How to make your cash reserves last the distance

£200bn

the potential cash shortfall companies face as forecast by the Bank of England this autumn.

1 in 5 ?

businesses **do not** know how long their cash reserves will last

(Source: Office for National Statistics survey results released 13 August 2020)

Lloyds Bank have been providing support to companies running short of cash through Covid-19.

So far*, Lloyds Banking Group have lent more than

£10bn

to over **260,000** businesses.

* As at 25 August 2020

Preparing regular and accurate cash forecasts will be critical to identify and manage potential funding requirements in the coming weeks and months. Lloyds Bank has identified crucial steps to consider, split across three main themes.

- Prepare regular cash flow forecasts, including scenario planning
- Review customer invoicing and collection processes
- Evaluate international trade terms to optimise cash flow

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By the side of business

LLOYDS BANK

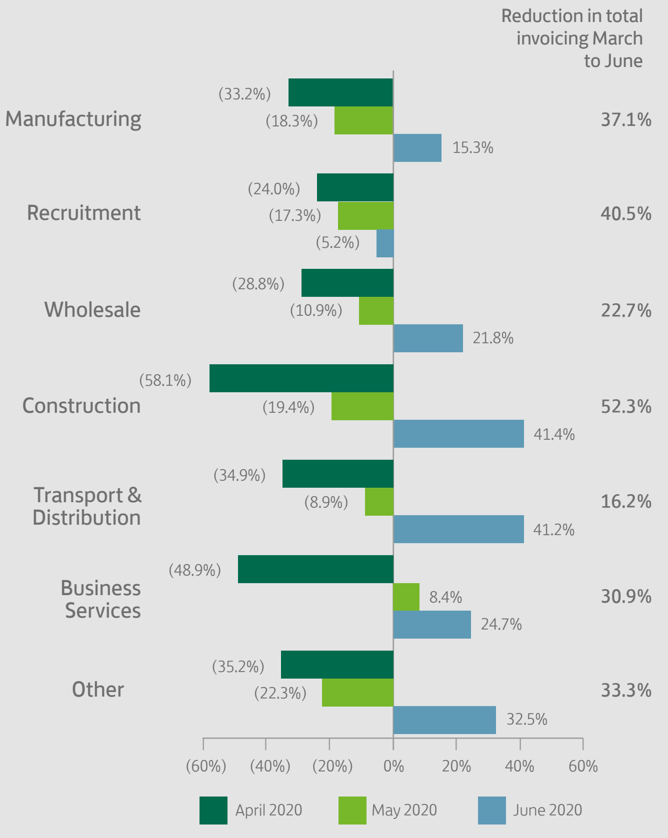
How to make your cash reserves last the distance?

The global impact of the pandemic and the unprecedented actions to contain its spread has resulted in a very sharp economic contraction in the first half of 2020. Recent data showed the UK economy contracted by 20.4% in the first half of this year.

Analysis of invoicing across our invoice finance portfolio supports this view with a reduction in the total value of invoices issued by our clients of 33% in April and a further fall of 13.6% across May.

Percentage change in total value of monthly invoicing

Source: Lloyds Bank

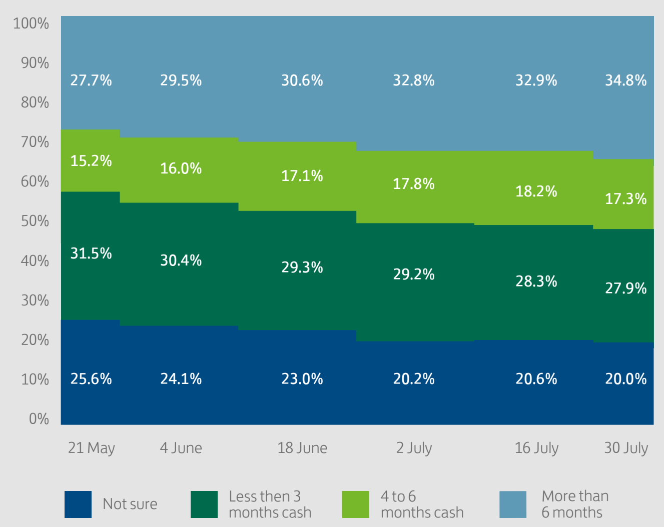


Whilst we are starting to see some signs of recovery, with total invoicing values increasing by 20.2% in June compared to May, it was still some 30.4% lower than pre-lockdown totals. The outlook for the UK and global economy remains unusually uncertain.

This considerable uncertainty regarding future trading has left many businesses with concerns regarding how long their cash reserves will last. Andrew Bailey, Governor of the Bank of England, highlighted recently that businesses face a potential cash shortfall of £200 billion this autumn. The Office for National Statistics' Business Impacts of Covid-19 survey has been reporting since the beginning of May that approximately 47% of businesses believe their cash reserves will last less than six months. In addition to this, around 30% of businesses have less than three months of cash reserves and 1 in 5 businesses are not sure how long their cash reserves will last. As a result, reducing costs and increasing cash flow have been among the top corporate priorities over the last few months.

Length of cash reserves

Source: ONS Business Impacts of Covid-19 survey



Additional support has been required by many companies to help them manage their liquidity and finance themselves through the shock. Whilst it is estimated that UK companies already have around £275 billion of debt maturing this year, much of which will need to be refinanced, a significant number of companies will enter the recovery phase with more leveraged balance sheets.

This is at a time when they will be faced with a series of cash flow challenges as some of the various support initiatives are phased out and the potential implications of UK-EU trade arrangements become clearer.

How will businesses manage the additional liabilities and challenges when significant uncertainty about the length and shape of any recovery period persists, particularly with significant mandatory restrictions and voluntary restraints still in place? In this note we highlight a number of important considerations to review as the economy continues its transition from lockdown to recovery:

Key highlights:

- UK companies face increased pressure on cash flow as financial support schemes start to phase out during a time when there is considerable economic and demand uncertainty
- Focusing on working capital will help to improve liquidity and enable businesses to better manage the uncertainty
- Robust cash flow forecast and scenario planning will be important to understand the impact of the withdrawal of official financial support
- New UK-EU trade arrangements may lead to a number of trade and distribution challenges that could result in additional costs, duties and tariffs that impact profit margins and cash flow

Providing access to additional cash and preserving existing reserves has been central to the government response. To date, schemes to provide funding in the form of grants, loans and guarantees have been provided alongside reliefs and payment deferrals for tax liabilities.

Central to this have been efforts to protect jobs. The Coronavirus Job Protection Scheme has allowed businesses to furlough employees and provide government funding to cover the cost of up to 80% of salaries. As of 5 July, 79% of trading businesses have applied for funding encompassing more than 9 million people, one third of the UK workforce, at a cost of £27.4 billion[1]. This scheme, with the share of wages paid by the Government reducing incrementally from August, will end in October and is projected to cost, net of tax receipts, £49.4 billion[1].

Other loan schemes, all part of the Coronavirus business interruption loan scheme, have been made available to firms across the spectrum. As at the end of June in excess of one million facilities had been approved with a combined total loan value of £42.9bn[1]. This additional funding, advanced over terms of between three and six years will need to be paid back.

These measures have been supported by other programmes including business rate relief for retail, hospitality and leisure sectors (costing c.£11bn), statutory sick pay relief (costing c.£2bn) and a business grant scheme estimated to have benefited 860,000 businesses at an estimated cost of £10.6bn[1].

In addition, deferments in the payments for tax, business rates and VAT have further eased the burden, for now, on hard-pressed businesses. As at 12 June, HMRC reports payments with a value of £27.5 billion had been deferred[2].

1 Office for Budget Responsibility Fiscal sustainability report – July 2020.
2 Office for Budget Responsibility Coronavirus policy monitoring database – 14 July 2020.

UK companies will experience significant pressure on cash flow in the coming months as financial support measures are phased out

All of these schemes in combination have contributed many billions to the expected shortfalls in the cash positions of UK firms sustaining them through the crisis. All the schemes will end, and in the case of loans, repayment will be expected to be funded by the hoped-for return of more normal trading conditions as the UK and the global economies recover.

What happens when these external schemes and other payment deferrals are phased out before business confidence and activity returns to anywhere near pre-Covid-19 levels?

> Understanding the cash profile of your business is critical. Available liquidity can change rapidly as your business faces a range of operational challenges and pressures. A key activity will be ensuring the business maintains an updated view of its forecast cash position.

Ed Thurman
Managing Director, Head of Global Transaction Banking,
Lloyds Bank Commercial Banking

Accurate and timely cash flow information will be critical in the months ahead

The ability of businesses to determine and monitor their liquidity in the months ahead is a critical task and needs to be performed regularly by management. Whilst forecasting cash flow accurately can be a difficult task during 'normal' trading periods, planning for future scenarios and the associated cash flow impact will be harder in the current pandemic. There are still a number of uncertainties regarding the easing of lockdown, returning to work, assessing customer demand and the shape of any recovery that will be hard to manage and predict for any business right now.

Despite these challenges, preparing a short term cash flow forecast lays the foundation on which other controls and actions will be based. This will provide a baseline cash position from which the impact of the cash pressures highlighted above can be assessed. Any resulting funding gap will require management to document and prioritise mitigating actions, including when to implement, given the size of any cash requirement and its impact on the business.

Lloyds Bank believes businesses should focus on the following to develop a robust cash flow forecast in order to assess and monitor the impact of cash flow risks:

1. **Understand the drivers of cash flow in your business:** Understand and document the sources of income and costs of your business, including the information needed to develop the forecast and any underlying assumptions. For example, whilst sales receipts in the retail sector may be based on like-for-like sales, further analysis on receipts split by method of payment may be required to improve forecast accuracy.

2. **Prepare a simple receipts and payments forecast to provide a more granular analysis of the cash flows of the business:** Forecast for a period of at least 13 or 17 weeks to cover the impact of the next cycle of quarterly rent and VAT. Review intra-month cash flows to understand the timing of any peak cash requirements – cash flow difficulties can emerge at any point of the month.

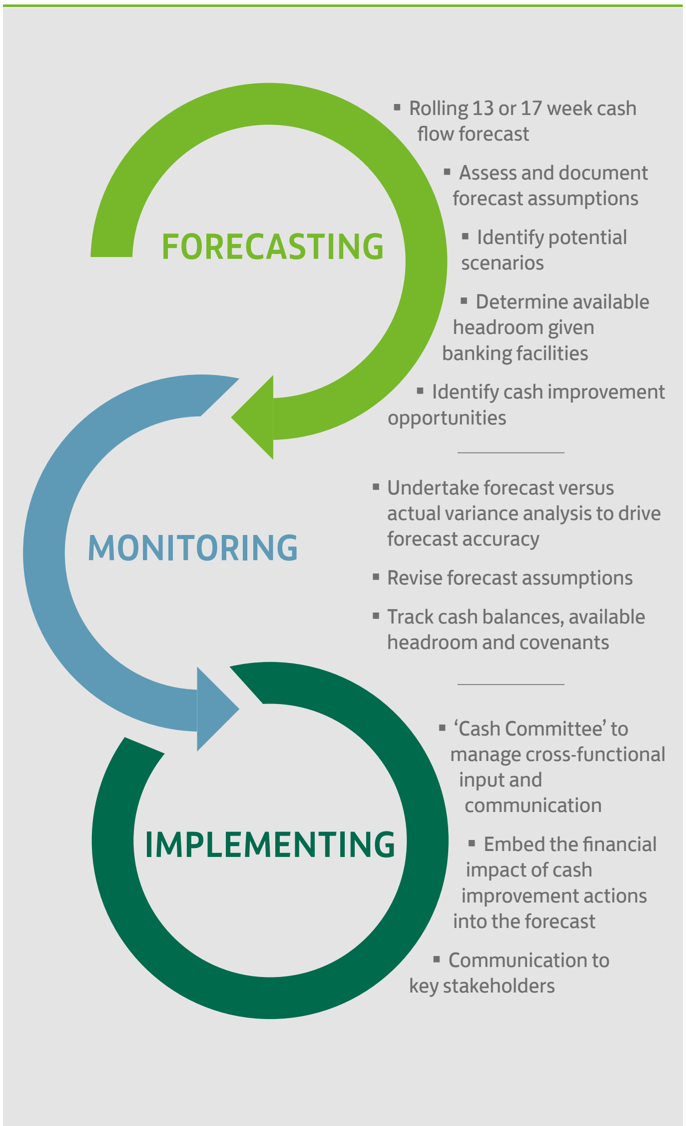
3 **Develop a standardised approach, including forecasting template and documenting assumptions:** This will allow you to incorporate variance analysis to review forecast accuracy and assess the appropriateness of underlying assumptions.

4 **Identify and prioritise cash improvement actions:** Understand what actions, including tactical changes, can be implemented to improve cash flow (e.g. consider refinancing any recent capital expenditure to help manage peak cash requirements).

5 **Cross-functional input may be required to improve forecast accuracy:** Whilst finance and treasury staff may have a large role in preparing the cash flow forecast, larger businesses may need input from departments that understand and control a particular cash flow (e.g. commercial teams may provide sales forecasts on which cash receipts are based).

6 **Cash flow reporting:** A cash flow forecast is only useful if its inputs and implications are fully understood. Cash flow forecasts should be accompanied by assumptions, commentary, variance analysis comparing to actual performance and changes from previous forecasts.

7 **Communication:** Talk to your customers and suppliers so they know your plans and you know what their plans are, and if they might affect your own plans and your trading relationship enough to revise operational plans and resulting forecasts.



Over the next few months businesses will also face increased pressure on cash flow from the working capital requirements of re-commencing trade

As firms do restart, the demand for cash will rise as they begin to purchase inventory and rely once again on their individual cash conversion cycles. Analysis has highlighted, however, that cash cycles are lengthening as trade receivable ageing profiles and collection periods have deteriorated since March. In particular, the total value of ageing invoices was 84.1% higher in June than in March across our client portfolios.

The payment terms businesses are able trade on with their suppliers and customers will be crucial to their ability to sustain themselves. Longer payment periods, as companies try to hold on to their cash, tightens liquidity and creates challenges throughout supply chains. For those companies that now find customer payment periods to be longer than supplier payment terms, there will be a funding gap in your cash flow that needs to be managed carefully.

In addition to this, given the greater impact of slow payments or bad debts on liquidity at the present moment in time, **Lloyds Bank recommends reviewing end-to-end customer order and invoicing processes**. Agreeing and documenting payment terms with customers is critical and will provide clarity over invoice due dates.

During negotiations check payment practice data to see if your potential customer files payment data with the Department for Business, Energy & Industrial Strategy. This data source will provide details of their standard and maximum contract terms, along with how quickly they pay their suppliers and the percentage of late payments. This will enable you to determine if they are asking for longer terms than their standard payment terms.

Ensure invoicing is accurately prepared as disputes and credit notes take time to be resolved. Ask customers what they need on their invoice in order for it to be approved simply and quickly. Incorporate processes for proactively following up invoices to ensure there are no issues that need to be resolved and that might delay payment. Where a dispute is identified, deal with the issues as quickly as possible so the reason for non-payment is removed.

Collection strategies should be based on a segmentation of customers' revenue and collection period. To improve cash flow quickly, focus on larger customers that pay more than seven days later than agreed payment terms.

Accounts receivables: Common risks

- No standard credit terms offered to customers;
- Uncertainties regarding authority limits, setting credit amounts, amending credit terms and accepting orders;
- Sales are able to override credit policies and limits and suffering bad debts;
- Not paying sufficient attention to the accuracy of invoices or credit terms;
- Insufficient efforts to follow up with customers in a timely manner when payments are past due;
- Application of cash targets to concentrate cash collection activity;
- Limited measurement and reporting of debtors, including KPIs (e.g. days sales outstanding, aged analysis, overdues and disputes, forecast cash receipts).

Brexit has a number of potential impacts that could increase lead times and extend cash conversion cycles at a time when pressure on working capital is increasing

Trade and distribution challenges could lead to additional costs, duties and tariffs that impact profit margins and cash flow

Whilst negotiations regarding a trade agreement with the EU are continuing, there are a number of implications for businesses and their international trade activity that impact cash flow at a time when liquidity needs to be managed carefully.

Border friction may increase. The removal of friction-free borders between the EU and the UK will create a range of challenges that will impact working capital. Increasing costs, longer payment times and the need to hold more inventory as border delays increase lead times are some of the potential outcomes of increased friction at borders.

Costs may increase as imported goods may become more expensive as tariffs are imposed. Unless these additional costs can be passed on, lower margins will lead to lower cash generation and higher levels of payables and inventory. Importers may need to pay customs duty from January next year. Given this, it would be sensible for businesses to identify ways to manage any customs liability and when to pay it in order to manage cash flow.

Who bears the cost of the duty depends on the contractual terms agreed between the importer and the seller. Therefore, it is sensible to consider which International Commercial Terms ("Incoterms"), as defined by the International Chamber of Commerce, for cross-border trade are incorporated into agreements. Incoterms determine who is responsible for both the import and export issues, including the payment of duty. Depending on the volume of imports, it may be worth investigating duty deferment accounts with HMRC as this enables payment of customs duty to the 15th of the following month after import. For HMRC to grant duty deferment facilities, businesses may need to provide adequate security in the form of a guarantee from a financial institution. The guarantee must be enough to cover all deferrable liabilities for a calendar month.

Toiletry Sales Ltd ("TSL") are a well established supplier of medical and associated products to major retailers and discounters in the UK. As with many businesses supplying the retail sector, TSL have been impacted by the pandemic experiencing a risk to the core business. Amid the Covid-19 outbreak, the business has been exploring how they could diversify their existing product range and introduce PPE and face masks in order to supply major retailers and the NHS.

TSL utilised its position as a long term customer to certified China suppliers (using their own Chinese technical team) to secure face mask supply. As a trusted supplier to major retailers and the NHS, TSL were able to quickly adapt and secure certified sales and supply in a rapidly changing market place.

Due to the global demand for PPE and face masks, TSL were faced with a change in terms of suppliers, which put short term pressure on the TSL cashflow. A solution was quickly agreed with Lloyds Bank, which enabled TSL to fund its face mask business, secure additional sales and meet customer expectations.

In addition, as the demand for face masks is continuing in the longer term, Lloyds Bank is providing an asset finance facility to enable TSL to purchase two machines so that face masks can be manufactured in the UK, reducing the need to import masks from China and exposing the customers and TSL to volatile airfreight costs. This will enable UK customers to purchase face masks at a competitive price without having to hold large amounts of stock, omitting the risk of any future price spikes or supply issues from China.

As businesses react to the impacts of duties and tariffs, it may lead to an increase in trade from outside the EU. Where businesses move to trade in new markets, increased shipping and transport times may drive a longer cash conversion cycle creating additional pressure on working capital. In addition, new markets may mean different regulations that require an increase in stock lines and greater overall inventory requirements. Alongside this, forecasting sales in new markets may be more challenging given the lack of trading history. Extended credit terms may be required as part of conforming to local payment practices.

If businesses seek alternative suppliers outside the EU, this may lead to longer supply chains and greater risk at a time when supply chain resilience is being reviewed in light of the Covid-19 pandemic. Identifying new suitable suppliers can take time, particularly in more complex supply chains. Identifying and contracting with new suppliers may lead to greater variations and uncertainty in supplier performance (i.e. on time and complete deliveries). Increased inventory may be required to be held to manage any supplier uncertainty.

New suppliers in different regions may lead to longer transport times and a greater mismatch between payment terms and transport, leading to goods being paid for before they arrive. Exposure to new markets may mean additional exchange rate risk to manage, given that currency rates can fluctuate significantly.

Conclusion

Controlling the risks associated with working capital will help to mitigate additional cash flow pressures associated with the phasing out of Government and other support schemes and the implications of Brexit

Managing liquidity will remain a corporate priority whilst the impacts of Covid-19 remain unclear. Pressure on cash flow will increase in the coming months as working capital requirements grow from increased trading and the phasing out of financial support measures.

Whilst trading negotiations with the EU continue, there is a risk that further costs and burdens are placed on businesses if frictionless trade comes to an end. Managing the potential cash flow implications of Brexit could cause cash and working capital challenges during normal trading conditions. When these challenges compound those being faced by businesses as a result of a period of lockdown and an uncertain economic environment, it will be crucial for businesses to manage the cash and working capital impacts of all of trading contracts, particularly those relating to international trade where potential risk is greater.

Lloyds Bank is here to support you to improve the management of your working capital and reduce the risk associated with international trade.

We have set out here some key actions that you can take within your business:

- Focus on cash and cost control;
- Make regular cash flow forecasting and scenario planning the centre of you cash management;
- Document your end-to-end cash flows given current supplier transit times and payment periods and customer collection profiles to identify any working capital funding gaps;
- Communicate with customers and suppliers regularly to understand how their business decisions impact your business;
- Review contractual terms within international trade agreements to minimise the impact of importer issues, including duties; and
- Explore duty deferment schemes with HMRC to optimise cash flow.

Our working capital solutions

Our teams across Lloyds Bank Commercial Banking can provide the following support:

Invoice Finance can be used to release working capital to support your investment and purchasing needs.

Our **Trade** solutions can help you to access funding and mitigate risks of non-payment or non-receipt of goods using Letter of Credit, Bills of Exchange as well as Bonds and Guarantees including Duty Deferment Guarantees.

Asset Finance can protect and release working capital by using Hire Purchase to both fund new assets and refinance of recent asset purchases.

Our **Payments solutions** can help digitise your payments with access to digital signatures and increased transactions limits alongside the ability to process cheques via your mobile.

We can help you receive card payments, including use of card holder not present and online payment methods to support e-commerce, through our card acquiring business, **Cardnet**.

Liquidity solutions are available to help optimise returns and retain ready access to cash reserves.

Treasury Services can help you to manage the risk associated with exposure to foreign currencies as a result of international trade.

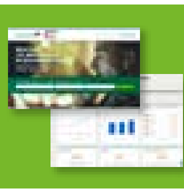
We can also help you access funding through the **UK Government backed schemes** including **CBILS, CLBILS and Bounce Back Loans** (lending criteria varies between the schemes and may be subject to status and eligibility).

Details of our solutions can be found here and both your Relationship Manager and our specialist teams will be happy to speak to you to help you access the support you need.

Support is also available through our Online Tools:

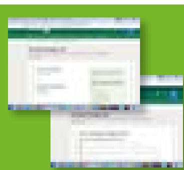
International Trade Portal

A key information resource for businesses at all stage of their trade journey. The ITP is now free and unlimited to all UK businesses.



Savings Strategy Tool

Make your money work harder by matching your cash forecasts against Lloyds Bank deposit products.



Our service promise

If you experience a problem, we will always try to resolve it as quickly as possible. Please bring it to the attention of any member of staff. Our complaints procedures for businesses with an annual turnover of up to £25m are published at **lloydsbank.com/business/contactus** and for businesses with an annual turnover of £25m or more they can found at **commercialbanking.lloydsbanking.com/contact-us/**

Go to:
lloydsbank.com/help-guidance/coronavirus

If you would like to know more, please speak to your Relationship Manager

Please contact us if you would like this information in an alternative format such as Braille, large print or audio.

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Eligible deposits with us are protected by the Financial Services Compensation Scheme (FSCS). We are covered by the Financial Ombudsman Service (FOS). Please note that due to FSCS and FOS eligibility criteria not all business customers will be covered.

Lloyds Banking Group is a financial services group that incorporates a number of brands including Lloyds Bank. More information on Lloyds Banking Group can be found at lloydsbankinggroup.com

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(08/20)