The CEO’s Dilemma
Building Financial Resilience
November 2022
Introduction to this document

Recently, we are seeing general changes in energy prices, interest rates, foreign exchange movements, commodity price growth, broken supply chains, and the highest inflation since the 1970s crisis—the outlook in all these areas remains highly uncertain.

It is therefore imperative for businesses to optimize their financial resilience to stay afloat or create competitive advantage—72% of CFOs ranked improving flexibility of budgeting and forecasting as their number one focus for 2022.

The best organizations know how to turn uncertainty into opportunity. This document addresses how organizations can build financial resilience by focusing on cash, rebalancing trade-offs between expenses and flexibility, building agility into planning and reporting, and adapting financial policy and investor messaging.

Source: CFO dive, FutureCFO, Protiviti; BCG analysis
Recent global disruptions are leading to significant impacts across companies’ P&L and balance sheets—with varied effects by sector and region. Adaptability is vital.

C-suite members around the globe have ranked flexibility and resilience as their number one priority for 2022 and beyond. Moreover, refinancing is expected to be challenging in the near future, making it imperative to build financial resilience to mitigate negative impacts.

Executives can build financial resilience along four vectors:

- **Reassess cash management**: Create dynamic and in-depth visibility and pull all levers to mitigate liquidity risks (e.g., optimize margins, working capital, secure financing)
- **Reevaluate financial trade-offs**: Selectively invest in buffers (e.g., working capital, cash, leverage) and weigh trade-offs against cost reductions
- **Improve agility of financial steering**: Adjust short- and long-term planning and performance reporting to enable flexible decision making and mitigation
- **Adapt capital allocation and investor messaging**: Ensure transparency regarding impact of current situation, stay committed to dividends, consider M&A to build advantage and stay flexible on buybacks
Economic snapshot for October shows most recent developments across risk indicators

Why financial resilience matters now

How to achieve financial resilience
Refinancing will be challenging in the near term—companies need to build financial resilience to mitigate impacts

**Significantly higher financing cost** | Global corporate debt maturities peak in 2026; rising interest rates (and spreads) increase accumulated financing cost by $40B to $60B a year.

**Higher expected loan defaults** | European loan market defaults expected to rise toward 3% in 2023, with significant 2023 and 2024 maturities looming.

**Cautious private-equity financing** | The days of US private-equity shops leveraging firms at debt-to-total-value ratios of 85% are long gone. The US average debt-to-value ratio for private-equity deals last year was closer to 50%.

**Historic high-yield-bond volume drop** | Issuance stood at $207B on Oct 24, 2022, compared with $776B at the same time in 2021, a fall that surpasses the one recorded during the financial crisis. But maturity peaks in 2026 and 2029 provide breathing room.

**Higher risk from leveraged loans** | US leveraged loan borrowers face a wall of maturities in the next two to three years, and the number of such maturities has been growing fast.

**Experienced CFOs wanted** | Companies are increasingly searching for CFOs with experience in cost management and balance-sheet refinancing as they struggle for visibility on the direction of the economy.
Transparency on your starting point is key for building financial resilience

1. E.g., supply chains, labor pools, geopolitics, consumers, investors, rival moves; 2. E.g., profit volatility, free cash flows, debt levels, funding options, leadership readiness

Source: BCG analysis
AGENDA

- Why financial resilience matters now
- How to achieve financial resilience
Four key elements of building financial resilience

Where **to refocus** on creating buffers instead of minimizing costs

How to **adapt planning** to enable a quick response to unexpected changes

How to **track performance** in an increasingly dynamic environment

How to **ensure in-depth visibility** into near-term liquidity

What levers to pull to **ensure sufficient cash reserves**

**Cash focus**

**Financial trade-offs**

**Agile financial steering**

**Flexible capital allocation and transparent investor messaging**

What to **change** in capital allocation and investor messaging to adapt to the current environment

Source: BCG analysis
Cash focus | Cash is king… again, it’s time to pull all levers to manage liquidity

1. Improve visibility of cash situation
   - Forecast liquidity development on a rolling basis
   - Incorporate various scenario and sensitivity analyses in liquidity planning
   - Plan ahead and prepare for mitigation levers as needed

2. Optimize margins
   - Reassess pricing and sales management
   - Manage costs, i.e., raw materials, personnel, SG&A
   - Adapt approaches like ZBB (zero-based budgeting)

3. Improve working capital
   - Decrease inventory (e.g., via cycle time reduction)
   - Strengthen receivables management (e.g., invoicing cycles, reminders and dunning, terms)
   - Optimize accounts payable process (e.g., avoid early payments)

4. Reassess capital expenditures
   - Reevaluate segmentation of capital projects (e.g., replacement or growth project)
   - Assess countermeasures (e.g., postponement, prioritization) based on urgency or risk

5. Secure financing
   - Secure sufficient borrowing capacity
   - Review financing options (e.g., debt vs invest)
   - Optimize maturity structure of debt for inflation
   - Consider tax options/breaks for investments

6. Boost asset productivity
   - Outsource/lease
   - Reduce capex (e.g., simplified product portfolio)
   - Optimize asset capacity and downtimes

Source: BCG analysis
Example of a global medical technology and equipment provider

At the start of COVID-19, the company’s revenue dropped by over 60%. This put the business in a very vulnerable and cash-constrained position.

Key challenges

- Traditional planning methods ineffective due to changing environment
- Short time horizons to adapt strategy and slow cash burn rate

Concrete actions

- Evaluated cash balance under various scenarios
  - Developed a tool to create transparency in cash flows over evaluation period

- Protected net working capital by slowing cash burn
  - Identified noncritical expenses and functions
  - Reduced manufacturing capacity to limit cash burn
  - Leveraged demand forecast to balance ensuring inventory level and slowing cash burn

- Adjusted debt and refinancing based on scenarios
  - Created evidence base to convince investors and banks to refinance at lower interest rates and with longer payback periods

Significant impact

- OPEX savings identified across decision scenarios
  - $+150M

- Implemented effective measures to ensure survival at the time of crisis

- Enabled a real-time dynamic planning approach for the future

Source: BCG project experience
## Financial trade-offs | Trade-offs between managing costs and flexibility need rebalancing

<table>
<thead>
<tr>
<th>Working capital</th>
<th>Cash</th>
<th>Leverage</th>
<th>FX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimize to free up capital</td>
<td>Reduce cash to lower financing costs</td>
<td>Increase to benefit from low cost of debt</td>
<td>Accept FX risk</td>
</tr>
<tr>
<td>Allow buffers to secure supply chain</td>
<td>Increase cash reserve</td>
<td>Reduce to increase financial leeway</td>
<td>Accept hedging cost to lower FX risk</td>
</tr>
</tbody>
</table>

### From minimizing cost...
- Review nondiscretionary expenses
- Improve cash forecasting and stress testing, redefine liquidity buffers

### To enhancing flexibility...
- Renegotiate supplier/client terms
- Incentivize early payments and optimize dunning
- Focus on longer-term financing
- Reevaluate potential equity financing

### by...
- Review nondiscretionary expenses
- Improve cash forecasting and stress testing, redefine liquidity buffers
- Focus on longer-term financing
- Reevaluate potential equity financing

### Examples
- Renegotiate supplier/client terms
- Incentivize early payments and optimize dunning
- Review nondiscretionary expenses
- Improve cash forecasting and stress testing, redefine liquidity buffers
- Focus on longer-term financing
- Reevaluate potential equity financing
- Reassess FX exposure
- Boost hedging where relevant

Source: BCG analysis
Financial trade-offs | Assess risk appetite and financial trade-offs by actively managing balance sheet

Example of a global fleet management company

Given global uncertainty, leadership embarked on a balance sheet optimization program to develop a funding strategy, improve operational flexibility, and enhance financial resilience.

**Key challenges**
- Low visibility of current liquidity position
- Complex capital structure with expensive funding sources
- Elevated uncertainty due to macroeconomic situation

**Concrete actions**

**Rapid liquidity assessment for immediate visibility, followed by building of bespoke dashboard tool**
- Developed working capital control tower to provide real-time view and forecast of liquidity with 50+ data sources
- Modeled multiple custom stress scenarios
- Automated monitoring and forward-looking alerts for early warning

**Evolved balance sheet and treasury operating model**
- Conducted a deep dive into financial risk appetite
- Repositioned balance sheet to ensure all metrics stayed within risk appetite for potential stress scenarios
- Created dedicated forums for regular leadership review of operating metrics indicative of financial resilience

**Significant impact**

- +10% P&L impact, based on active balance sheet mgmt. (incl. T&C)
- Improved liquidity position and simplified funding strategy
- Reduced reporting burden and automated risk monitoring
- Enhanced forward visibility and decision support for executive team

---

1. Balance sheet optimization includes working capital, cash & liquidity, financing, capital structure, risk management & counterparty management (e.g., bank group)
2. Terms and conditions Source: BCG project experience

Copyright © 2022 by Boston Consulting Group. All rights reserved.
Agile financial steering | Executives need to increase agility in planning and reporting

**Long-term planning**

Set relative targets
- Absolute targets quickly become too easy or too hard in dynamic environments
- Targets relative to benchmarks provide a better bar to evaluate performance

Reassess portfolio moves
- Dynamically review as opportunities and risks change
- Evaluate diversification to minimize risk

**Short-term planning**

Descope budgeting
- Detailed budgets lead to more frequent planning errors rather than more control
- More aggregate budgets provide necessary flexibility during execution

Increase forecast frequency
- Frequent look-aheads becoming increasingly important
- Model/AI-based forecasting allows greater (monthly) frequency at reasonable effort

**Performance reporting**

Focus on relative reporting
- Actual vs. budget often is not indicative of performance anymore
- Refocus reporting on ratios and benchmarks instead of absolute numbers

Improve cash and cost tracking
- Environment requires greater transparency of cost and cash
- Reporting detail on these items and their drivers should be increased

Source: BCG analysis
Agile financial steering | AI-based forecasting improved the flexibility of decision making

Example of a global financial and mobility service provider

Management employed an **AI approach to forecast performance** for 50+ business entities to drive more flexible actions and forward-oriented performance discussions.

**Key challenges**

- Arduous task of ensuring high forecasting quality
- Organizational skepticism toward AI forecasting
- Potential last sluggish reaction as in prior financial crises

**Concrete actions**

**Developed AI algorithm to improve forecasting**

- Validates forecasts by comparing with past performance
- Selects best algorithm(s) for each KPI
- Detects outliers, automatically adjusts value

**Implemented AI forecasting with systematic change management**

- Pilot run in parallel with human-based forecast to prove efficacy
- Set up appealing dashboard to facilitate acceptance
- Allowed management to always weigh in to secure ownership

**Changed to a forward-looking steering approach**

- Switched reporting from actual vs. budget to last forecast vs. current forecast
- Allowed to validate if last actions need to be adapted
- Focused on actions to improve next forecast vs. current

**Significant impact**

- **Improved forecasting quality**
  - 70% AI forecasts more accurate vs. human forecasts

- **Quicker with lower effort**
  - Allowing monthly forecast in 1 instead of 10 days

- **Enabled dynamic decision making**
  - "What to change to improve next forecast?"

Source: BCG project experience
Capital allocation and investor messaging | Ensure transparency around impact on business, stay committed to dividends and flexible on buybacks

**Capital allocation**

*Exhibit strong commitment to strategic capital stewardship*

1. Ensure **clear understanding of strength and durability** of sources of cash

2. **Prepare to be flexible**, to manage cash situation in an uncertain environment

3. **Maintain commitment to dividends** as one of the top priorities, suspend only as last resort

4. **Assess M&A**, to secure assets at lower valuation and build long-term advantage

5. **Pursue buybacks**—after securing liquidity, backed by point of view on intrinsic vs market value

**Investor messaging**

*Clearly communicate impact on performance and investment thesis*

1. Provide **detailed view of impact** of current environment on business and investment thesis

2. Convey potential **risks, opportunities, and flexibilities**

3. Proactively offer clarity on **changes in short-term performance** expectations and mitigations

4. Focus on resilience of the business and **strength in the current environment**

5. **Highlight investments** and initiatives that will continue to build long-term health

Source: BCG analysis
The right tactics depend on your starting position

<table>
<thead>
<tr>
<th>Market stability¹</th>
<th>Financial stability²</th>
<th>Unprepared</th>
<th>Prepared</th>
<th>Fortress</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Low</td>
<td>Take action to <strong>protect cash</strong>; start piloting <strong>agile financial steering selectively</strong> (e.g., frequent forecasting)</td>
<td>Take immediate action to <strong>protect cash and strengthen balance sheet</strong></td>
<td>Invest to build <strong>agile financial steering</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Stay flexible in capital allocation</td>
<td></td>
<td>Review <strong>buybacks and M&amp;A especially</strong></td>
</tr>
</tbody>
</table>

**Act now to build financial resilience**

- Dynamically assess the impact and range of outcomes
- Develop clear visibility into liquidity situation and mitigate
- Pursue no-regret moves, e.g., challenge cost base and working capital, resecure financing, etc.
- Pivot toward short forecasting cycles and trimmed budgeting
- Adapt tracking indicators, enhance focus on cash and liquidity

---

1. E.g., supply chains, labor pools, geopolitics, consumers, investors, rival moves; 2. E.g., profit volatility, free cash flows, debt levels, funding options, leadership readiness. Source: BCG analysis
Connect with our Resilience, Transform, Risk & Compliance, and Center for CFO Excellence leadership team with any questions

Central Resilience Team

**Ryoji Kimura**
Global Leader - Corporate Finance & Strategy
Kimura.Ryoji@bcg.com
Tokyo

**Alexander Roos**
Global Co-Leader – Center for CFO Excellence
Roos.Alexander@bcg.com
Berlin

**Daniel Feldkamp**
Managing Director & Partner
Feldkamp.Daniel@bcg.com
Munich

Transform

**Tuukka Seppä**
Global Leader – BCG Transform
Seppa.Tuukka@bcg.com
Helsinki

Risk & Compliance

**Matteo Coppola**
Global Leader - Risk & Compliance
Coppola.Matteo@bcg.com
Milan

Center for CFO Excellence

**Juliet Grabowski**
Global Co-Leader – Center for CFO Excellence
Grabowski.Juliet@bcg.com
Boston

---

Click here for our latest publications in the CEO’s Dilemma Executive Perspectives series and additional Resilience insights
The services and materials provided by Boston Consulting Group (BCG) are subject to BCG’s Standard Terms (a copy of which is available upon request) or such other agreement as may have been previously executed by BCG. BCG does not provide legal, accounting, or tax advice. The Client is responsible for obtaining independent advice concerning these matters. This advice may affect the guidance given by BCG. Further, BCG has made no undertaking to update these materials after the date hereof, notwithstanding that such information may become outdated or inaccurate.

The materials contained in this presentation are designed for the sole use by the board of directors or senior management of the Client and solely for the limited purposes described in the presentation. The materials shall not be copied or given to any person or entity other than the Client (“Third Party”) without the prior written consent of BCG. These materials serve only as the focus for discussion; they are incomplete without the accompanying oral commentary and may not be relied on as a stand-alone document. Further, Third Parties may not, and it is unreasonable for any Third Party to, rely on these materials for any purpose whatsoever. To the fullest extent permitted by law (and except to the extent otherwise agreed in a signed writing by BCG), BCG shall have no liability whatsoever to any Third Party, and any Third Party hereby waives any rights and claims it may have at any time against BCG with regard to the services, this presentation, or other materials, including the accuracy or completeness thereof. Receipt and review of this document shall be deemed agreement with and consideration for the foregoing.

BCG does not provide fairness opinions or valuations of market transactions, and these materials should not be relied on or construed as such. Further, the financial evaluations, projected market and financial information, and conclusions contained in these materials are based upon standard valuation methodologies, are not definitive forecasts, and are not guaranteed by BCG. BCG has used public and/or confidential data and assumptions provided to BCG by the Client. BCG has not independently verified the data and assumptions used in these analyses. Changes in the underlying data or operating assumptions will clearly impact the analyses and conclusions.