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COVID-19: Cash is Still King

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It cannot be emphasized enough: we are going through unprecedent times. The Covid-19 pandemic that has engulfed the world is putting to test our resilience – both from a personal and professional perspective – to deal with social distancing, home schooling, home office, and the uncertainty of not knowing when 'business as usual' will return. One of the fallouts of the crisis is the impending necessity of managing scarcer resources and, in this article, we shed light on the issue from the standpoint of one of the tenets of financial management: **cash is king**. Although you probably have heard this term a hundred times, its full implications have never been as important as they are now with Covid-19. In what follows, we advocate that firms will be in a better position to sail through stormy waters caused by the pandemic by adhering to working capital management that is cognizant of the importance of cash to their businesses. As a corollary, we hint at the importance of financial literacy for those occupying managerial positions, particularly so in times of crisis.

What has Covid-19 caused? According to the Australian Bureau of Statistics[1] *(Australian Bureau of Statistics [ABS] 2020)*, two thirds of Australian businesses (66%) faced a drop in cash flow resulting from either a reduction in demand for products or services (64%) and/or government restrictions on operations (48%). In spite of that, businesses are still liable to pay bills arising from fixed (e.g., employees' salaries, property rent, utilities) and variable costs (e.g., raw materials and other inputs required in the production process). How can this be managed?

The answer lies in the management of *working capital*: the amount of liquid assets (i.e., those can be easily converted into cash plus cash itself) that firms set aside to pay short-term liabilities. Businesses that can anticipate accounts receivables and reduce/postpone accounts payables are in a better cash position to absorb the pandemic shock. This is indeed what's being promoted in recent reports by Deloitte and PwC *(Deloitte 2020, PwC 2020)* and, in turn, corroborated by the findings of the ABS survey aforementioned: businesses are not only changing their processes (e.g., delivery of products and services) but also seeking new financial arrangements (38% renegotiated property rent/lease agreements, 24% deferred loan payments, and 16% changed paying terms with customers).

In effect, the measures above shorten what financial management textbooks call the *operating and cash conversion cycles*: the former, the time it takes to convert inventory into cash and, the latter, the time period between paying suppliers and collecting proceeds from sales. Reducing both cycles allows businesses to decrease the capital required to keep operations running and, therefore, can make a huge

difference in terms of whether an organization can survive an event of the magnitude of the one we are experiencing now.

All in all, it is fair to say that Covid-19 has brought to the fore the importance of understanding the cash flows associated with your business. If bankers tend to focus on the balance sheet (indicating the capacity of the company to pay off a loan) and investors on the income statement (portraying how profitable the business is), for managers it is even more urgent to understand how their decisions affect the cash position of the organization. For instance, accumulating excessive inventories, seeking capital expenditure in wrong times, and promoting marketing campaigns that unwarrantedly extend credit periods go against what's called *financial intelligence (Berman & Knight 2013).* We hope that this kind of literacy – financial if you like – has come to stay, the same way as more stringent hygienic practices.

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Footnote:

[1] At the time of this writing.