

Spotlight CPD Quiz

Managing in a Downturn

Question 1

John Maynard Keynes coined a term; “the paradox of thrift.” What situation was he describing?

- (a) trying to save cash often results in greater expenditure
- (b) trying to conserve cash results in a general slowdown
- (c) conserving cash to cope with a slowdown hurts the economy. This then harms the cash conservers along with everyone else.
- (d) trying to spend your way out of a recession leads to increasing debt
- (e) don't know

Answer

The right answer is (c) conserving cash to cope with a slowdown hurts the economy. This then harms the cash conservers along with everyone else.

The Economist, November 22nd 2008, All you need is cash.

Question 2

What is meant by “liquidity” in a recession?

- (a) having a current ratio over 3.0
- (b) having an Acid Test ratio over 2.0
- (c) having a cash flow that has been strongly positive in recent years
- (d) having cash invested that is sufficient for a year of depressed operations plus significant undrawn credit facilities with an ‘undoubted’ bank
- (e) don't know

Answer

The right answer is (d) having cash invested that is sufficient for several years of operations plus significant undrawn credit facilities with an ‘undoubted’ bank.

With the downturn being forecast as being very severe, recent strong cash flows may not be a guide to the future situation. Current ratio and the ‘acid test’ ratio (or quick ratio) may rely on debtors performing on their obligations. Of these debtors, many may be less than desirable credit risks.

Question 3

As treasurer of a group with a syndicated loan, you have invested time in finding out who now holds your debt. Which of the following might cause you most concern?

- (a) current debt holders may not be willing to offer support if your group experiences minor difficulties
- (b) current debt holders may have bought credit derivatives to cover their exposure to your group and would therefore be “insured” against any loss
- (c) current debt holders may be unable to perform under any future drawdown under the agreement
- (d) all of the above
- (e) don't know

Answer

The right answer is (d) all of the above.

Under normal circumstances it is possible to replace an existing lender who fails to perform or who is uncooperative. Current circumstances, though, dictate that replacing a lender may be difficult. As worrying is the thought that the lender may have no vested interest in your survival due to the credit protection he has taken.

Briefing Note: Contingency Planning for a Downturn in the Economy, ACT May 2008

<http://www.treasurers.org/contingencyplanning>

Question 4

You have invested time in trying to ensure that your company's working capital requirement is as small as it reasonably can be. At the same time your finance director has mandated advisors to sell a key business division.

What risks might be inherent in these actions?

- (a) the downturn might be less severe than feared and the action might prove unnecessary
- (b) the fees of the advisors might be enough to cause a cash shortfall elsewhere
- (c) counterparties, including lenders, might be alarmed that your situation is worse than they thought
- (d) minimising the working capital investment might prove counter-productive, particularly if you reduce credit given
- (e) don't know

Answer

The right answer is (c) counterparties, including lenders, might be alarmed that your situation is worse than they thought.

Creditors are generally watchful for companies making "last throws of the dice" and thus simply weakening the position of lenders. Running down working capital (as opposed to managing it more efficiently), selling off crown jewels and so on might be seen in such a light.

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The risks identified in (a) and (d) are also valid concerns so depending on the circumstances could be deemed right answers as well.

Question 5

In anticipation of reduced profitability in the coming months you have been asked to consider the staffing levels and organisation within treasury. If you feel that flexibility is vital, which of the following would be your preferred means of maintaining the quality of service without incurring long term fixed cost?

- (a) use temps or interim executives to fill vacancies rather than new permanent staff
- (b) invest in treasury systems to avoid the need for as many staff
- (c) outsource the major processing activities within treasury
- (d) authorise temporary staff to cover vacancies in dealing or moving funds
- (e) don't know

Answer

The right answer is (a) use temps or interim executives to fill vacancies rather than new permanent staff.

Answer (b) would almost certainly require an upfront investment – unlikely to be attractive when cash is at such a premium. Answer (c) would almost certainly require a long term commitment of fixed cost. Answer (d) would be highly risky without appropriate vetting.

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Question 6

You have an imminent meeting with one of your company's core relationship banks when a senior financial executive of your company suggests that you make the meeting easier by using a revised set of forecasts that he has just prepared. You are slightly uneasy about the assumptions underlying these new forecasts, but are very aware that they will make it much more likely to obtain the necessary rollover finance.

What should you do?

- (a) use the revised forecasts on the grounds that they have been prepared by a senior finance executive and you have no evidence to refute their veracity
- (b) use the revised forecasts – if they are wrong it is not your problem
- (c) use the revised forecasts because it is your job to negotiate the rollover finance and this gives the best chance of achieving that
- (d) do not use the forecasts because you need time to satisfy yourself that they really do reflect the best estimates of what is likely to happen
- (e) don't know

Answer

The right answer is (d) do not use the forecasts because you need time to satisfy yourself that they really do reflect the best estimates of what is likely to happen.

Aside from obligations under general, company and financial services law and regulation, the treasurer's credibility is an important asset both personally and for the company. You must have good grounds for believing what you put forward. Treasurers can come under pressure from colleagues in times of uncertainty, but that pressure must be resisted; a good treasurer must retain his integrity and credibility both inside and outside the company.

It may be a good idea to keep your own contemporaneous notes of meetings in a bound notebook. From the perspective of a personal career as well as the credibility of the company, the treasurer's integrity is not easily repairable.

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