Crunch conditions

IN THE LAST IN A SERIES ON THE PROBLEM OF LATE PAYMENT, **GRAHAM BUCK** LOOKS AT THE TREASURER'S OPTIONS AND TACTICS WHEN THE COMPANY IS STRAPPED FOR CASH.

Executive summary

- As treasurers are expert at managing liquidity risk, a company with cashflow difficulties benefits from giving the treasurer the final say on making payments.
- Commercial reality and ethics are as much a guide as the law in deciding how a company should proceed with its suppliers. Seeking legal remedy can sour a commercial relationship.
- When a company begins to fall behind with its payments, it enters a cycle from which it is difficult to break free. The support of the bank in such circumstances varies across national boundaries.

One treasurer of a company with cashflow difficulties, who asks not to be identified, offers a personal experience of the dilemmas created by such a position: "As regularly happens at my group, you're confronted with the question, 'Do we pay the wages or do we pay our suppliers?' It's the hard choice you're regularly faced with when you're in a cash-restrained position.

"No treasurer enjoys paying an invoice late, even if there are a few accountants who regard it as clever. But they don't have the experience of being on the other end of the phone from their supplier, who is either berating you or begging you for payment when you simply don't have the cash to comply."

He believes that any company in serious financial distress benefits from having a properly qualified treasurer as part of the team. He or she will be in the position of having the final say on all payments, and able to override colleagues – a power that may need to be exercised on some occasions.

The ultimate decision rests on assessing the respective interests of all parties – creditors, shareholders, employees – and deciding a course of action that best serves each of them.

What is ethically the right thing to do? An action that helps to keep the company afloat may be possible to justify, even if it results in keeping creditors waiting. Likewise, while downright lying can never be condoned there may be legitimate arguments for a cash-restrained company to hold back the release of sensitive corporate information by a day or two.

"Treasurers are well placed to deal with these moral and ethical conundrums," suggests the treasurer. "These considerations may be the drivers that lie behind making a payment late, when the reason appears to others to be sheer tightfistedness. The golden rule for any of us is liquidity. It's the biggest risk that we have to manage."

ETHICS ON A DAILY BASIS So the treasurer of a cash-constrained company has to refer to ethics on a daily basis in deciding the right thing to do. In this situation, commercial reality and ethics are as much a guide as legislation – and the payment plans the company enters into can reflect a balance of all three.

The plan may involve making part-payment, or spreading it over several months. As another treasurer observes: "If we go bust, we may well take several of our suppliers with us, so it's in their interests to play along."

It also demands regular communication with the companies to which money is owed and careful consideration of the words to be used. "Saying that you can't pay will spark panic, but if your company is cash-constrained you will need to explain it."

Treasurers also have to review their company's working capital cycle. The treasurer of a major US software group based in the UK says its customer terms are lengthier than its supplier terms. The department has to conduct a monthly check of its supplier agreements so that any contract falling outside these standard payment terms can be monitored for working capital efficiency.

"When the screw tightens and liquidity follows, it can make for an untenable situation," says the treasurer. "The US company recognises this and insists that all non-standard terms must be vetted by treasury."

When a company begins to fall behind with its payments, it enters a cycle from which it is difficult to break free, he adds. Although not

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too many treasurers have found themselves in this unenviable situation, it is likely to become more common over the next few years and will test their ingenuity.

LEGISLATION HAS LITTLE IMPACT Recent surveys indicate that companies are already waiting longer for payment – and in some cases not being paid at all. The issue of late payment is particularly acute in sectors such as food where, although the major retailers escaped serious censure in the recent Competition Commission report, they can deploy considerable muscle against the supply chain.

Late payment seems little affected by legislation such as the Late Payment of Commercial Debts (Interest) Act 1998, and treasurers confirm that it is employed only in the very last resort.

"You don't want to use it unless you really have to as it sours the commercial relationship," says Jonathan Clarke, former Director of Treasury at food group RHM prior to its acquisition by Premier Foods. Nor should it be the government's role to legislate on commercial transactions, he adds.

As someone who has worked for public companies and private equity-owned companies, Clarke says that, in his experience, delaying payment for as long as possible is an integral part of cash management.

"Private equity will try and maximise the delay in making payment on the basis that the survival of the company is of greater importance than any ethical considerations," he adds.

On the supplier side, predictably it is the larger companies that are best able to adopt a tough line on the date by which they require payment than smaller companies, which lack commercial clout.

As Clarke observes, a supplier that is also a global company or multinational is in the best position to lay down its payment terms. The respective strength of the buyer versus the seller will establish how long payment can be delayed.

The issue of a company's ability to demand tighter payment terms has moved higher up the corporate agenda as pressure on the balance sheet has increased. The summer's credit crunch means that finance directors are closely scrutinising working capital levels.

"Treasury is getting more involved in the control and measurement of working capital, flagging key performance indicators such as payment days," Clarke says.

"It's a straightforward trade-off. You either use working capital or cash. It's almost a function of the increased attention on working capital and the closer scrutiny of cash generation."

BANK SUPPORT Have conditions in the UK made late payment more of a problem than in neighbouring countries? The treasurer of a cash-strapped company suggests that a company that has experienced financial distress but manages to turn around its fortunes will still find it hard to attract bank support in Britain. By contrast, in countries such as Sweden the banks would regard a corporate recovery story as an incentive.

For instance, in Scandinavia there is generally little understanding of concepts other than that of same-day value. He believes that UK clearing banks are less likely to support businesses with liquidity problems than is the case elsewhere in Europe. The fallout from this lack of support tends to land on suppliers instead. In contrast to the UK experience, the US bankruptcy code is often cited – the US Chapter 11 arrangement allows US companies a breathing space in which to reorganise their finances and, in theory at least, share the pain equally between the various parties.

"Late payment is very much an Anglo-Saxon concept, although in Germany the relationship between companies and their banks is particularly close," he adds. "Local banks will do a great deal to prevent a company from going under."

And the experience of his own company? "We built up huge arrears in PAYE and VAT payments, but managed to repay the lot. We don't want to fall back into the same situation after getting up to date with our payments, but one of our lenders effectively penalised us for doing the right thing and getting back up to date.

"Non-bank lenders, such as US hedge funds, have proven particularly unsupportive. On the continent, banks will be closer to the day-to-day running of the business, so they will be more generous and flexible in their lending, but as a *quid pro quo* they will also practically sit on your board."

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The late late show, September 2007, page 28.
Balance of power, October 2007, page 40.