Financial Architecture – The Art of Tiding Over A Business Crisis

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The term "Financial Architecture" that I often use is to ensure it's easy to understand while emphasising on the importance of the 360⁰ management of business and finances. Always see a business as an organism where the finances are the bloodline, and where a proper flow/circulation of this blood (read finances) will help the organism i.e., the business to grow healthy. Given the existential crisis that many businesses are facing today because of the pandemic, the art of crafting the financial ecosystem within a business makes the business smarter, efficient, and helps to tide over a crisis.

Financial Architecture starts at the planning stage i.e., Budgeting. Keeping the on-going pandemic in view, a business cannot afford to go on a long cash conversion cycle, since it has to ensure liquidity at all times. Therefore, not only evaluating expansion strategies and accordingly planning manpower costs and other related investments, but also revisiting areas that impacts working capital, and hence liquidity would be the need of hour for any business – small, medium or big.

So, what impacts the working capital and what you should do? The first and the foremost is Accounts Receivable i.e., your debtors' balance. If the debtors' balance keeps soaring, you will certainly show sales in the books but you will not have the cash in hand. Therefore, it's just about time that businesses should revisit their client contracts and negotiate a shorter credit period. Remember, your creditors/suppliers i.e., Accounts Payable would also be tightening the credit period with you, and, therefore, you as a business cannot afford to have a longer credit period with your customers since that will prolong the cash conversion cycle. The next in line is Inventory, where any move toward reducing the inventory cost at an optimum – ordering and carrying cost, purchase cost, logistics, and warehousing – without impacting the business continuity would release liquidity in the system.

The next stage in Financial Architecture is Cost Restructuring – Operational. This has to be carefully designed keeping in mind the medium-term goal of the company i.e., for the next 2-3 years. Usually a business has a tendency to first rationalise the manpower cost before they touch any other stream, which I don't think is the right approach. Therefore, in Operational Restructuring, the utmost importance should be placed on optimising the processes that leads to increase in productivity. In other words, a business has to emerge as cost efficient. Optimising processes for those who are in manufacturing and trading would mean optimising the Supply Chain – from first mile sourcing and warehousing to last mile delivery – using the Critical Path Method, but of course with contingency buffers.

For those who are in services, process optimisation would mean business process automation, virtual work systems, and reduced dependency on fixed infrastructure, which will lead to rationalisation of fixed recurring costs such as rent/lease, utilities, maintenance, etc. Once the processes are rightly optimised, align it with the medium-term goal to determine the manpower requirement, which will then help draw the manpower cost budget.

Once the budgeting exercise is complete as explained above, it then gives the business a proper idea on the quantum of fund requirement. Depending on the capital structure, the strategy for the funding route can be worked out – whether all Equity, mix of Equity/Debt, all Debt, or any other structured routes that bring in liquidity depending on the needs of the business. This has to be in sync with the last stage of Financial Architecture i.e., Financial Restructuring. The primary objective of Financial Restructuring is to reduce the leverage cost and improve profitability. If a business is sitting with high-to-very high cost of debt, it will erode much of the gains that it would have achieved at an operational level. In such a situation, Debt Swapping becomes imperative that allows a business to replace its high cost debt with low cost funds. The low cost funds can be tapped through domestic institution or through foreign routes i.e., External Commercial Borrowings (ECB) depending on the eligibility criteria. The benefit of ECB is that the funds can be tapped with interest rate (pre-hedging cost) as low as in the 3-4% range. That changes the profitability dynamics and enhances viability of the business. ◆

'The views expressed in the column are of the author, and may or may not be endorsed by the publication.'

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