

# Ideas



April 2008 - Supplement

## The Importance of Liquidity in Today's Economy

### 10 Steps to Build a Liquidity Cushion

In business, cash is king, particularly during tough economic times or when the markets are turbulent. Without cash, your company cannot pay its bills nor carry out growth plans, and it may find it difficult to get credit or take advantage of business opportunities.

Maintaining and improving liquidity is one of the lessons to be learned from the recent collapse of Bear Stearns. While the investment bank's structure and industry may be far different from your business, many of the same rules apply.

Here are ten steps toward boosting and maintaining your company's liquidity:

Take time to ascertain your company's position. The key is knowing that your business can generate enough cash from its operations and liquid assets to provide fuel for survival and growth. A profitable company with significant value is of little use if it has no cash to pay creditors.

Consult with your accountants about your company's liquidity or working capital ratio, which is examined by creditors.

If your company has too much cash tied up in assets, it may be hurting from unnecessary interest payments, bad debts from receivables or excess inventory. Consider securing an emergency line of credit so that you can avoid paying high interest rates, from sources such as credit cards, when you need cash in a hurry.

Get payment, retainers or deposits from customers the moment sales are made.

Perform credit checks on new customers, particularly if they place significant orders.

Monitor accounts receivables to ensure that your company is collecting promptly. Cash is your company's lifeline. If receivables are high, they can drain cash and lead to failure.

If possible, negotiate longer payment terms with vendors, in order to hold onto cash for a longer period of time.

Sweep excess cash balances into an interest-bearing account when the funds aren't being used and sweep them back to your operating account when your company needs the money.

Review overhead costs, which directly affect your business's profitability and look for opportunities to decrease them. Overhead expenses include rent, advertising, office supplies, as well as insurance, auto and truck expenses. Also eliminate unnecessary utility costs.

Dump unproductive assets that your business is storing and not using. Generally, the only reason to spend money on such fixed assets as buildings, equipment and vehicles is to generate revenue.

Monitor the money that's being taken out of the business for items such as sports tickets, costly last-minute airline tickets, unauthorized overtime, expensive conventions, etc. Examine the cost and use of business vehicles by employees. Non-essential and non-

business expenditures unnecessarily drain cash from your organization.

Review the profitability of your products and services. Determine where your company can increase prices to boost profits. Consider eliminating unprofitable products and services.

Improving liquidity is about delaying outlays as long as possible while collecting cash quickly from customers, operating efficiently, and arranging for capital infusions before they are needed.

But for security and survival, that's not enough. You must also have contingency plans.

#### Plan for Possible Financial Situations in the Future

Consider some of the following situations that could leave your business in a serious cash crunch. What would your company do if one or more of the following happens:

- Customer buying habits change.
- Sales turn flat or even decline by 20 or 30 percent.
- Your company faces 60 to 90 days without receiving payments from several large customers.
- Accounts receivable collections slow by five or 10 or 20 days.
- Lenders increase rates by one, two or three per cent or decrease your borrowing limits.
- Your largest customer fails.
- Existing creditors are unwilling to lend your business money or renew its credit. Keep in mind that the value and marketability of collateral, pledged to secure a loan, often dwindles during tough economic times.
- Competitors actively go after your accounts.

Contingency planning tests the financial prudence of each part of your organization. So starting now, when the economy is faltering, and continuing every year or so, even when the economy recovers, ask each department head for an action plan that maintains and even improves corporate results in the event

of conditions that could hurt your company's receivables and liquidity.

In doing this, managers will likely realize there are areas in their departments that need improvement. That is likely to prompt them to start making the changes now rather than waiting for a crisis situation to occur.

## The Lessons of Bear Stearns



### Available Cash = Acquisition Opportunities

Bear Stearns insisted that it didn't actually have a liquidity crisis. It fell victim to rumors that it was in a cash crunch.

*March 10, 2008: In a press release, Bear Stearns denied market rumors regarding the firm's liquidity, stating there was "absolutely no truth" to them. President and CEO Alan Schwartz said: "Bear Stearns' balance sheet, liquidity and capital remain strong."*

Some observers suggest that with a liquidity ratio of 171 percent, the bank should have been able to continue financing its operations for another 20 months. That ratio is a company's total dollar value of cash and marketable assets divided by its current liabilities -- in other words, the extent to which a company can quickly liquidate assets to cover short-term liabilities.

But investor panic caused a run on the company's prime brokerage unit, which left the financial giant without enough cash to continue operating.

Meanwhile, JP Morgan Chase & Co. had the liquidity to step in and acquire Bear Stearns at a distressed price.

*March 17, 2008: In announcing that it was acquiring Bear Stearns, JP Morgan stated that it was pleased to be obtaining "an attractive set of businesses." Chairman and CEO Jamie Dimon said: "The transaction will provide*

*good long-term value for JP Morgan Chase shareholders. This acquisition meets our key criteria: we are taking reasonable risk, we have built in an appropriate margin for error, it strengthens our business, and we have a clear ability to execute."*

Bear Stearns' cash shortage prompted the Federal Reserve Bank to intervene and negotiate a \$2-a-share bid by JP Morgan. But that astonishing low bid didn't sit

well with shareholders, so Morgan increased its bid to \$10 a share, valuing Bear Stearns at about \$2.4 billion.

How did JP Morgan, with assistance from the Fed, have the liquidity to take quick advantage of its rival's problems? Analysts say Morgan proactively built liquidity in the early stages of the credit market crisis. Moreover, the company has remained disciplined in reducing holdings and suspending equity repurchases.

## Upcoming AMR Workshops & Network Meetings

|                |  |                |
|----------------|--|----------------|
| April 9-10     | Marketing Resources Network                  | Scottsdale, AZ |
| April 21-22    | AE BootCamp                                  | Chicago, IL    |
| April 23-24    | Financial Firepower Management Roundtable    | Chicago, IL    |
| May 2-3        | Alliance of Marketing Communication Agencies | Carmel, CA     |
| May 15-16      | Roundtable of Agency Management Principals   | Santa Fe, NM   |
| Sept 18-19     | AEBootCamp                                   | Baltimore, MD  |
| Oct 31 / Nov 1 | AMR-1<br>Two Days in a Pressure Cooker       | Scottsdale, AZ |

If you would like a program brochure that includes meeting information, an agenda and a registration form, go to the AMR website and download the PDF brochure for the meeting. You'll find the link on the home page, and on the appropriate workshop page. [www.agencyroundtable.com](http://www.agencyroundtable.com)

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