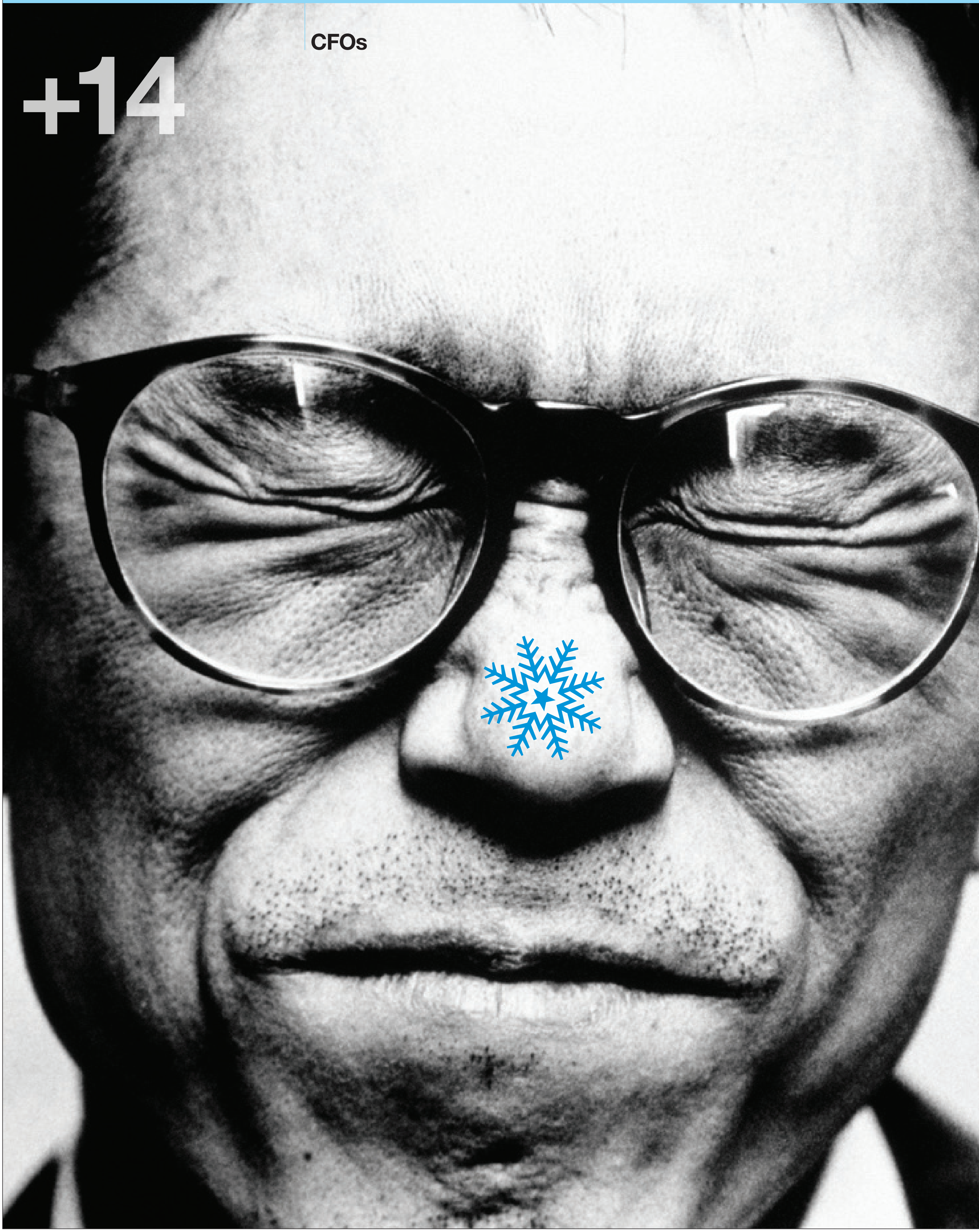
+14



Chilling times

Very few CFOs caught in the financial crisis have ever experienced anything like it, writes *Naomi Martig*

Additional reporting by Helen Luk

It's a cold winter for the world economy. Many chief financial officers are coping with what they say is the worst financial crisis in their career – one where a tiny misstep can bring them down.

Liquidity management is by far their top priority in the months and possibly years to come. "I think the problem for us and probably for a lot of other companies is even if you are profitable, even if your business plan is brilliant, if the cash isn't there, you're dead anyway," says Atul Khanna, CFO of AGSA Asia Ltd., a Swiss-owned group that designs and manufactures displays primarily for high-end watch brands in its Dongguan factories.

Khanna, who took up his post in 2005, says the company is expecting a decline in sales figures in the first quarter of this year and warns manufacturers who haven't yet experienced a head-on collision with the crisis to be prepared for it.

Most companies cannot afford to make cash management errors these days. "If sales makes a mistake, we manage; if production makes a mistake, we can still manage. Quality problems, supplier problems, non-delivery, counter-party risks, we can still manage to a certain degree. But with liquidity problems, if I make a mistake today, we can be dead within a week," Khanna says.

The last quarter of 2008 saw a slew of corporate liquidations in Hong Kong, including listed fashion retailer U-Right, toy manufacturer Smart Union and private electronics retailer Tai Lin Radio Service. Financial experts fear more winding-up orders can be expected as businesses run into liquidity problems as a result of weakening demand and rising costs.

Tough times call for tough decisions

In addition to knowing the nooks and crannies of every financial crack and crawlspace of their companies, CFOs must also improve the accuracy of business forecasts by taking a look at the current finances of their major consumers and suppliers, according to Andrew Lam, assurance partner with Grant Thornton in Hong Kong.

"It is all linked together," he says. "I've seen people with a very good plan, but they can't cope with the drastic change in the customers. For example, a sudden deterioration of a customer's finance leads to some bad debts or reduced orders, and they (the company) can't change their production quickly enough.

"On the other hand, I have also seen companies with a lot of orders and a very good customer base. But problems came up with the suppliers leading to the companies suffering a

Photo: Paul Thomas/Getty Images

lot of losses because they had some commitments or guarantees in their orders, which the suppliers couldn't fulfil," he says.

For AGSA's Khanna, this volatility has become increasingly difficult to predict, mainly because his company sells a large portion of showcase materials to luxury watch suppliers in the U.S. and Europe, regions hardest-hit by the financial crisis. And because AGSA serves companies that sell to the consumers, the knock-on effect can take months to develop, he says.

"For example, it doesn't faze me now if General Motors goes into bankruptcy," says Khanna. But GM employees "who are going to get thrown out are usually [customers of our customers]. If they cannot buy, then these brands will not buy our materials."

The U.S. Treasury recently granted General Motors US$9.3 billion after the struggling U.S. carmaker announced in November plans to suspend around 30 percent of its North American assembly plant volume and cut production by around 250,000 vehicles in the first quarter of 2009, according to *Dow Jones Newswire*. That same month, GM announced it would lay off 30,000 workers over the next three years.

If the bailout didn't materialize, Khanna says, his company would see the lag within six months. "So I need to prepare a six-month prediction that my customers will not buy. I need to warn my boss and we need to plan."

He is clearly not the only finance head whose priority is to ensure cash remains readily available. So where should they start?

Identify the non-essentials

Grant Thornton's Lam says CFOs have to make it as basic as figuring out the essentials from the non-essentials. "They need to be able to calculate the company's short-term cash requirements and forecast the long-term cash flows.

Management, pay heed

Here are a few tips from Grant Thornton's *The credit crunch: a practical guide on how to survive the downturn*:

1. Cash is king

- Calculate your short-term cash requirements and forecast your long-term cash flow.
- Negotiate longer credit terms with your suppliers and shorter terms with your customers.
- Focus on numbers that matter, such as debtor and creditor days.
- Manage stock cycles efficiently to generate cash.
- Don't take on new customers without considering the impact they may have on your capital cycle.

2. Get closer to your bank

- Keep your banker fully informed about what's going on in your business.
- Talk to your professional advisors about ways to improve a plan's credibility.
- Consider alternative sources of financing.
- Check the availability of trade or stock finance if you are importing.

3. Be relentless on cost control

- Review all your costs in terms of their value to your business.
- Consider two major cost areas – tax and people.
- Negotiate the terms of leases and the use of capital equipment.
- Pay attention to variable costs.
- Look out for cancelled contracts.
- Take steps to guarantee supplies.
- Don't automatically cut all your marketing expenditure.

4. Revisit your business strategy

- Identify your core capabilities and where your best opportunities exist.
- Dispose of non-core assets and business streams.
- Acquire assets, expertise or competitors if you have liquidity.
- Consider shifts in currency markets.
- Don't think you need to change your entire business model overnight.

5. Get smarter on tax

- Check your tax assessment and your eligibility for a holdover of tax provision.
- Schedule any revenue expenses and purchases of items to receive tax relief and/or allowances.
- Don't fall behind with tax payments and compliance requirements.

6. Reconsider investment plans

- Defer new plans if they are not critical to the business.
- Negotiate more favourable terms for critical assets.
- Try borrowing money instead of using all your cash.
- Check out possible tax relief and depreciation allowances.
- Don't invest your profits in status symbols.

> On a global scale, this is surely the worst financial crisis I have ever seen. No one clearly knows whether we have hit the bottom or not and the downturn may last two to three years.

They need internally to come up with plans, both operating and financial. Let the others know that 'if this happens,' this is what they will have to do for the next quarter, the next half year, the next year or even the next two years.

"And if things deteriorate further, you must have a plan B and one that you are prepared to execute if need be," he says.

Kenneth Lam, China CFO of Airbus, is bracing for the tough times ahead in the aviation industry, where orders are expected to slow as the operating environment for many airlines get rough.

"On a global scale, this is surely the worst financial crisis I have ever seen. No one clearly knows whether we have hit the bottom or not and the downturn may last two to three years," he says.

According to Lam, the airlines face two liquidity problems: reduced or delayed income from customers and exchange rate fluctuations that are increasing companies' currency exposure and putting pressure on their cash management.

Lam says his company is coming up with a plan to advise customers on getting financing, although the financial crisis hasn't hit Airbus' short-term revenue in China yet.

"We need to ensure our company's key customers and suppliers are not going bankrupt, which could seriously affect our financial and operating plans," he says. "The effect is delayed but I expect to see a slight downturn in orders this year."

Lam says companies should keep an eye on the long-term effect of short-term decisions, even during times of crisis. "Before going for layoffs or services cuts, we should study the business process to identify the slacks and streamline the processes," he says.

John Chiu, the Institute's CFO, agrees. "People mean money," he says. "If you have good staff that run certain divisions within any industry and you cut them on a short-term basis, when the market comes back, you may spend years training that new person."

That's why Chiu, when he was the Asia CFO of a U.K.-based property services firm, resorted to salary cuts to ride out the 1997 financial crisis.

"We did not lay off staff, but we did reduce everybody's salary from top to bottom by 10 percent. That put us all in the same boat," he says. "We then renegotiated our lease with the landlord. We cut all non-essential expenditures, non-essential entertaining and non-essential travelling."

Although a flurry of financial woes will likely blanket much of Hong Kong this year, Chiu says CPAs can take comfort in knowing that their skills are needed and the profession is respected. "Accountants are always in demand – maybe now it is for winding-up whereas before it was for IPOs."

Being a bank's best friend

Maintaining access to credit is tricky these days, since many banks have now become as high-risk as the companies requesting their help. CFOs can find themselves in uncomfortable positions, juggling open relationships with banks while at the same time being the bearer of bad news.

The good news is, even in light of the declining economy, banks still need to do business – CFOs simply need to work

7. Keep an eye out for bargains
- Be alert to opportunities when business valuations are dropping.
- Take professional advice to properly assess any acquisition.
- Don't lose focus on running your business.
- Don't overstretch debt capacity.

8. Align performance and rewards
- Reward your sales team according to profit per unit or the speed of cash flow.
- Pay bonuses when minimum profits and cash flows have been achieved.
- Use incentives and personal development plans to lock in key people.
- Don't pretend you have the cash to pay bonuses when you don't.

harder to convince banks they are worth the risk.

Cheng Kin-chung experienced first hand difficulties doing just that following the 2003 SARS crisis. At the time, he was CFO of Skyworth Digital Holding Ltd., a Hong Kong-listed company producing mainly high definition televisions, and banks were wary of Skyworth as customers got behind in payments and inventories piled up.

"The banks were very worried about the recoverability of their loans and tried to reduce the credit lines, and even asked for full settlement of the loan," says Cheng, who is now chief executive of Skyworth TTG Holdings Ltd., a joint venture set up by Skyworth Digital and Tripod Technology Group, a global IT services company, in September.

Skyworth Digital eventually turned to mainland banks – a good lesson for CFOs if their companies, like Skyworth, partially operate in the mainland, Cheng says. "Talk to both Hong Kong and mainland bankers to make sure they understand your business model, needs and risks," he says.

CFOs who don't have anywhere else to go for money have no choice but to maintain good relations with their banks. That often entails spilling the beans long before the mess begins.

"We just recently had a problem with one customer," says AGSA's Khanna. "And I didn't need to inform the bank for another three weeks. But I called them up and told them anyhow." He says he did that to prevent the bank from asking him a simple question – "When exactly did you find out?" – should the problem escalate in coming weeks.

"It was just a phone call," he says. "So the banks know that if anything goes wrong, I will always call them."

Bad spills spread fast

CFOs have different strategies depending on what industries they are in, be it manufacturing, property or finance.

"If you take the financial industry, it will be on its knees in terms of

Photo: Frank Walsh/Getty Images

corporate finance, IPOs and mortgage financing," says the Institute's Chiu. "They are not pursuing any new business, so they are consolidating what they have. And that gives the CFO a clear indicator of what to do with the staff."

Most bankers in Hong Kong and around the world remain on edge as nearly all top banks, including Citigroup, Goldman Sachs, Morgan Stanley and Merrill Lynch, announced massive layoffs in the last quarter of 2008.

In Hong Kong, properties are taking a beating. International property consultant Jones Lang LaSalle predicts capital values and rents will fall until the first half of 2010. In November 2008, home sales dropped to the lowest level in 17 years, worse than the real estate market's last big downturn during the SARS outbreak.

Once-vibrant property prices on the mainland, especially in Shanghai, Shenzhen and Guangzhou, are slumping despite government measures to boost sales. In Shanghai, real estate prices plunged nearly 20 percent in the third quarter of 2008 compared to the second quarter, according to *Bloomberg*. Property prices in Shenzhen shed 15 percent in November compared to a year earlier, *The Wall Street Journal* reported. Figures from China's National Bureau of Statistics showed home sales fell 20.6 percent in the first 11 months of 2008 from a year earlier.

"We are trying to turn out current projects or inventory into cash as quickly as possible, rather than having any expanding plans to acquire more companies," says Simon Fung, CFO of Baoye Group Co., which develops and sells residential properties in Shanghai, Hefei, Wuhan and Shaoxing. The company is offering "bigger discounts" to buyers in order to boost sales, he says.

Fung says Baoye's building material manufacturing business is hurting the most because the sector traditionally suffers from higher bad debts and now has to cope with rising raw material costs and dwindling demand.

And because customers still have three to six months to pay about 30 to 40 percent of the remaining costs once the goods are shipped, "we are now very careful with who we take on and have increased our credit checks on all customers," he says.

AGSA's Khanna, meanwhile, will lay off another 10 percent to 20 percent of his company's staff in Dongguan in the next two to three months. He already let go of 400 of its 850 workers in the area last year as domestic demand for goods weakened and exports declined. Figures announced in December 2008 showed that exports in China fell by 2.2 percent in November compared with a year

Lending for keeps

The world has turned upside down. Banks are stingy and companies are frustrated about getting credit.

Just a few months ago, lending to reputable companies was never a worry. "Now, even big names can be a problem," says Nixon Chan, senior executive for commercial banking at HSBC's Hong Kong office.

Tightened lending is hitting small and medium sized enterprises the hardest. Danny Lau, chairman of the Hong Kong SME Association, says up to 3,000 SMEs closed down between October and December, a rate that is 50 percent higher than the same period in 2007.

According to Lau, around 5,000 SMEs were in danger of going bust as of December. "They are running out of cash because banks are cutting their credit lines, customers are not paying on time, and suppliers and subcontractors are tightening up their credit to them," he says.

To help them out, HSBC has introduced a US$5 billion global loan fund, of which HK$4 billion is reserved for SMEs in Hong Kong. The government has also announced a HK$100 billion rescue plan in loan guarantees to businesses, including SMEs.

SMEs are showing their desperation: Around 1,500 SMEs submitted loan enquiries to HSBC in the two weeks after the new scheme was announced in December, up from around 200 enquiries the bank usually receives within a two-week time frame, according to Yvonne Chuang, a Hong Kong-based HSBC spokeswoman.

Total lending in Hong Kong fell 0.4 percent in October from September 2008, the first month-on-month decline since December 2007, according to the *South China Morning Post*. The decline comes as both HSBC and its competitors have strengthened checks on borrowers to ensure the companies' cash flow is healthy.

Senior executives looking to maintain or increase their credit should remember that these days, banks have as much vested in you as you do them. "The customer should treat the bank really just as a business partner," says Chan.

Because HSBC traditionally has been a conservative lender, it has not tightened requirements for loan applications. Still, the bank is asking its borrowers more detailed questions about their suppliers, customers and financial conditions, Chan says. He declined to provide actual monthly lending figures.

Struggling businesses, he says, should be open and communicate thoroughly with their banks. "It is up to the relationship manager and customer to talk to each other about aspirations, coming production or whatever, so that each can really plan ahead."

earlier, the first fall in exports in seven years, according to *The Economist*.

Rescue me, China

With Hong Kong suffering from its first recession since the SARS crisis, can the territory rely on the motherland to come to its rescue again?

Last time around, Hong Kong rebounded swiftly from the economic devastation brought on by SARS partly because of a surge in the number of individual tourists from the mainland after Beijing eased travel restrictions for them. Over the past four years, a slew of initial public offerings by big mainland state-owned enterprises also propelled the Hong Kong stock market to dizzying heights.

China, which is expected to record a high albeit slowing GDP growth of around 8 percent in 2009, will cushion Hong Kong but drastic relief measures for the territory are unlikely, the Institute's Chiu says.

"They (China) are also suffering. Their factories are closing down and they are introducing stimulus packages to try and stem the harm – cutting stamp duty, reducing interest rates, putting other stimulus packages into the marketplace," he says. "If you are reliant on China for everything, it is the wrong attitude to take."

Baoye's Fung agrees. "This time around it doesn't look like there is anything extra that mainland China can immediately provide," he says.

Indeed, 2009 will be a tough year for CFOs. According to *The Economist*, more CFOs were fired than chief executives following the dotcom crash in 2000. These days, 25 percent to 30 percent of them move on each year, nearly twice the rate in the 1990s. Last year, the CFO of a Fortune 1,000 company stayed in the job on average for just 30 months, the report says.

There is, however, a good side to all this: When the recession ends, the CFOs who survive will likely be showered with accolades.

"Being a CFO is probably one of the most important roles to play in financially difficult times," Chiu says. "They are the guys who mould the business so that it actually becomes financially strong. And if the CFOs can do that (now), then it is the most important prize of any organization in this financial market." A+

Photo: Smari/Getty Images