

## **Covid-19 - Light at the end of the tunnel? What next?**



As we head towards the end of what has been a very eventful 2020, the news of vaccine success has brought a bit of cheer to people and the prospect of a return to normal life at some point in 2021. Much has been written about what the “new normal” might look like and it will not be a return to exactly how things were before Covid19. There is much talk about an accelerating digital revolution and also a green recovery. Whilst such things may well become reality, many businesses face more immediate and pressing problems. Two recent reports highlight these issues.

McKinsey surveyed 2,200 SME’s in the five largest European countries and found a bleak picture<sup>1</sup>. “One in five was concerned they might default on loans and have to lay off employees, while 28 percent feared they would have to cancel growth projects. In aggregate, more than half felt their businesses may not survive longer than 12 months - despite the fact that 20 percent of those surveyed had already taken advantage of the various forms of government assistance.”

Deloitte have looked at the UK insolvency statistics<sup>2</sup>. “We expect corporate insolvencies could be much higher in the first half of 2021 compared with previous years. They could potentially be even higher than the average 60% increase experienced at the height of the global financial crisis in 2009. Automotive, retail and food service are expected to be the most impacted.”

Businesses could well be asking if that light at the end of the tunnel is the proverbial train coming the other way. Clearly, government assistance is going to come to an end at some point and loans will need to be repaid. Amidst all the noise, the forecasts and strategic advice, how does an SME management team prepare its business for life post-Covid? Waiting until everything becomes much more certain is not the answer. By then it could be

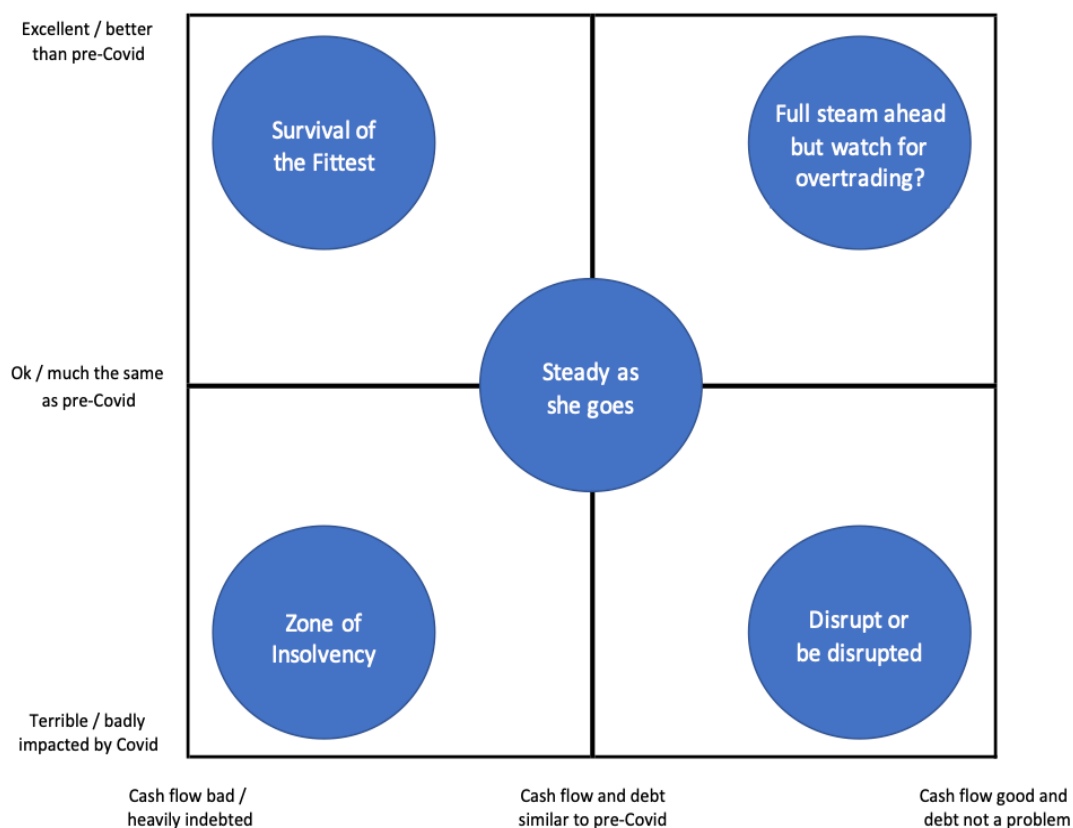
too late. Time spent now will enable a business to be prepared for the likely scenario with plans for how to react if things turn out differently.

With such levels of uncertainty, it is a good idea to start out with simple analysis that can then be further developed for the specifics of the business. A good start point would be to look at your markets / customers and at your financial situation. You know how your markets have been impacted by Covid and it should be possible to make some estimates of how they will look post-Covid. Have they changed completely, or will they recover to something close where they were? Will the level of business be better or worse than before? No business planning exercise can be undertaken that doesn't start with the top line, sales.

Similarly, you know what the financial impact of Covid has been. Has cashflow dried up or has it improved? What level of debt do you have? Do you have access to further capital?

Getting external help to do this should ensure the assessment of market position and finances is accurate. We all have unconscious biases and independent involvement in the analysis, or a review after an initial analysis can help counter this.

If you start from a simplistic analysis like this, you then start to look at what sort of challenges you face and can develop those and potential responses in more detail for your own business situation. The classic business school 2x2 matrix can be a good way to look at this. It can help guide your thinking but does not provide answers. Consider this:



### **Steady as she goes**

It could be that the business will emerge in much the same position as before Covid. There will be some who have survived relatively unscathed and can carry on as before.

### **Full steam ahead**

This is a great position to be in. But high growth can have its problems. Increased working capital requirements can soon exhaust cash reserves and available financing facilities. Then there are all the resource issues, getting the right people, maintaining the culture, etc. It is also likely that businesses in high growth sectors can grow faster by means of acquisitions, including buying up those in distress. Detailed analysis of the competitive landscape will help identify potential opportunities ahead of the “new normal”. They need careful planning and good post-acquisition implementation is critical to realise the benefits.

### **Survival of the fittest**

Those that find themselves in high growth markets but that remain in a poor financial position risk seeing well financed competitors racing ahead. Maybe they were in a poor financial position pre-Covid and just haven't been able to recover. Detailed cash flow forecasting and analysis can help identify where the problems lie and it is surprising how often cash flow can be improved. Beyond that it can help identify the impact on investment, whether restructuring debt may be possible, whether re-financing is an option, and whether new equity investment could be a solution. All of these take time and action needs to be taken well before we enter any sort of normality. Failure to do so risks carrying on with a financial ball & chain around your ankle, missing opportunities, a deteriorating competitive position and a slide towards the zone of insolvency as competitors eat your lunch.

### **Disrupt or be disrupted**

In fast changing markets that have been disrupted by Covid and will continue to be, it is important to recognise what those changes are. Some may be hard to quantify. For example, how much will people continue to work from home? If hybrid working becomes the norm how will that look? Change tends to happen faster than people expect. If finances are not under pressure it is easy to be complacent. Don't continue to invest in business that is declining but instead look to pivot and invest where the market is heading. There may well be M&A opportunities to diversify, access new technology, and to enter new markets or geographies. But make sure you get it right. Healthy cash resources dwindle fast if poor investment decisions are taken.

### **Zone of Insolvency**

This is the worst place to find yourself. As mentioned at the start of this article there is a high probability that the number of insolvencies is going to increase rapidly in

2021. For some there will be no chance of recovering and insolvency is inevitable. For others there could be a chance to recover. A proper turnaround, both operationally and financially can restore a business to health. There could be a whole raft of things that can be done, and it needs an experienced turnaround professional to help assess the situation, identify the options and help the management team create and deliver a robust turnaround plan that is supported by all stakeholders.

Hopefully the simplistic analysis above may help clarify thinking and help a busy management team start to think about where they are and what they have to do. Many businesses have been stuck in survival mode since the pandemic hit in March 2020. The prospect of a return to some sort of normal is welcome but just waiting to see how that pans out is leaving your business a hostage to fortune.

What needs to be done will be unique to your business but almost everything needs to be thought through and planned. Whether you are investing in new products or markets, acquiring a company, re-jigging your supply chain, worried about a potentially insolvent customer, closing part of your business, making redundancies, refinancing, restructuring debt, selling your business, hiring new people or maybe contemplating insolvency, there is a need to act now. The inherent uncertainty of the Covid-19 pandemic should not be an excuse to just wait and see.

Planning and forecasting are without a doubt more difficult than ever due to the amount of uncertainty and it is harder for stakeholders to accept and agree those plans and forecasts. But it has never been more necessary.

In the current situation it is essential to consider and prepare plans for various scenarios. Whichever reality most closely resembles at each checkpoint (quarterly perhaps for the next 2 years) can be brought to the fore, updated and implemented. Future options planning can then be adjusted in line with that too. Nobody would pretend that it is easy but most worthwhile tasks aren't.

Similarly, asking for help is not a sign of weakness. It is a sign of strength. Many management teams will never have been through anything like this before. Many are also busy fighting fires every day and don't have the time to plan much beyond the next week. Recognising that you don't have the knowledge and experience or that you simply don't have the bandwidth, or both, should be applauded not criticised. We would urge businesses to grasp the nettle before it is too late.

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Acknowledgements:

1. <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/covid-19-and-european-small-and-medium-size-enterprises-how-they-are-weathering-the-storm?>
2. <https://www2.deloitte.com/uk/en/pages/corporate-finance/articles/another-storm-on-the-horizon-the-outlook-for-insolvencies-in-2021.html>