



## Finance

*Get your business back on solid financial basis by working systematically through incoming and outgoing cash flows, working capital and business model*

*The lack of business and sales during lock down period stopped your business income whilst some expenses continued. This caused a cash crunch in your business. Scrutinize and prioritize your ongoing and planned expenses and incomes to stabilize the cash flows of your business. Explore whether you need additional working capital and how you could mobilize such. Review your business model to make it more agile and profitable for the future.*

### Background

MSMEs provide a backbone to the economy and society. In India, for example, MSMEs create employment for over 120 million, contribute 6.1% of manufacturing GDP and 24.6% of service GDP, providing 33.4% of manufacturing output and up to 45% of exports. This is achieved by 65.03 million micro-enterprises, 300,000 small enterprises and 5,000 medium enterprises. Despite their economic significance, it is widely recognized that MSMEs underperform large scale enterprises, in regard to productivity, innovation, working conditions, technology and innovation, energy and environment, management and finances. This undermines the ability of MSMEs to bounce back from a crisis. Many MSMEs operate exclusively on cash flow basis, with relatively few assets, making banks and other financial institutions (including non-banking financial institutions) wary to extend affordable loans or other financial services to MSME segment.

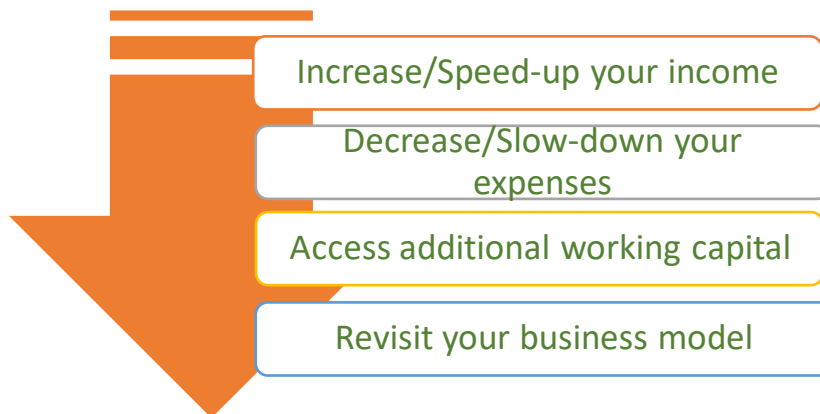
### Approach

Finance is already one of the biggest challenges to MSMEs in India (and elsewhere), and this has worsened seriously since the onset of COVID-19 pandemic. Many MSMEs find themselves on the brink of staying solvent amidst lockdown and upon gradual lifting of restrictions, and the high uncertainties moving forward. Markets are stalled with disruptions in both upstream and downstream supply-chains. There are serious cashflow implications on businesses, such that the full impacts will only be understood in months to come.

As money is tight, prioritizing is a must. Make sure to spend on things that matter most for sustaining business in an incremental manner in the immediate future. A four-pronged approach is possible. Increase and speed up your income, while simultaneously decreasing and slowing down expenses to alleviate the immediate

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cash flow crunch. And look into options to leverage more finances into your business, by a fresh injection of working capital or changes in the business model. These four are elaborated here, and further suggestions are provided in the accompanying [Finance Checklist](#).



### *Speed Up your Income*

The international and national movement restrictions and lock down have a major impact on the income of any company, i.e., revenue and cash-flow receipts from the sales of goods and services are harder or fewer. At the same time MSMEs may be faced with deferred payments from customers who themselves are struggling with cashflow crisis. Hence MSMEs should urgently take up cashflow forecasting to understand how the company will be able to sustain in the coming months

#### How much money do you have?

*“MSME businesses are usually a month-to-month operation, with little reserves for the future. A disruption like this [COVID] might just mean restarting everything ...*

This probably is the case with most MSMEs, especially those manufacturing units with low cash reserves or unstable/seasonal cash flows. There are a few examples of MSMEs that always survived on cashflows and managed to stay debt free, and are confident about paying salary for the next few months. Many though are particularly vulnerable and have already lost weeks or even months' worth of sales and are looking at limited incoming cash during the restart and recovery period, with continuing uncertainty on development of the pandemic and national and international policy responses.



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### **MSMEs resuming operations will benefit from detailed**

#### **Monthly Cashflow Forecast Statement<sup>(1)</sup>**

It is good practice to prepare cashflow forecast to examine existing or potential cash flow problems and project the finances for the coming months. The cash flow forecasting should be done for a period of 3-months, 6-months and 12-months to understand what business activities will affect your cash reserves. This will help you take key business decisions.

Hence to understand the state of your cashflow for resuming activities in a comprehensive manner is necessary. This calls for quickly taking stock of receivables to understand the cash available to the business, to plan the expenses in resuming your business activities. It means converting receivables into cash and ensuring bills are paid. Also moving to cash-sale cycles will ensure cash inflow and also shifting your business focus on customers where sales-cycles are shorter will be prudent.

*MSMEs could align their activity so as to maintain at least 5% of their entire sources in the form of 'cash' or 'near cash items' ...*

A cash flow analysis will help you not only evaluate your revenues, expenses, and credit transactions, you can also evaluate non-cash items and services when calculating cash flow from operations. With a clearer understanding of the operational requirements, you can choose to control the key aspects of your business to conserve and generate cash. This will enable you to take key decisions on the company's liquidity and working capital requirements.

### ***Slow down your expenses***

The cashflow forecasting also provides the reference point to scrutinize your company's expenses. It is prudent to recalibrate planned expenses to forecasted income of the company. Fixed expenses like wages, salaries, rent and utilities (and others) are to be paid on regular intervals. Deferring (maybe partially) some of these expenses for a short period of time is probably possible, but not over a month or two. However, the variable expenses (adverts, professional services etc.) can be cancelled towards improving the company's balance sheet so that your key business operations can be resumed.

#### **How much will it cost to reopen?**



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*“Finance officers of MSMEs are ensuring that the priority expenditures like capital expenditures are lowered to secure liquidity for prolonged periods ...”*

Government is developing and announcing recovery packages for example in regard to loan support, wage subsidies, tax deferrals, moratorium on utility payments, and possibly other fiscal and/or financial relief to MSMEs. The modalities of accessing them are yet to be clear, nor the necessary obligations these may carry. Hence shoring-up business from drying up all financial resources requires cutting down capital and other expenses urgently.

Reduction of capital expenditures is the most critical decision for companies to survive the lean period. Reviving the business while minimizing working capital requirements hence calls for examining payables, receivables, and inventory for thorough scrutiny. While immediate investment plans will have to be postponed, a few could be dropped-off from the near future of the company. The checklist hence will be useful in identifying those *“expenditures that can be deferred”* and *“budgeting to resume business activities”*. The *“Expense Matrix”* can be populated with items from the checklist to evaluate if those expenses are expendable or not.

Business can try to quickly empty the finished-goods inventories by focusing on selling products or billing customers for a technology or a service offered. This will generate cash inflows to aid the business recovery. However, those offering B2B products or services need to evaluate the demand-supply scenarios - are your customers still solvent? The state of logistics across the country is in a disarray, while suppliers/vendors are also recovering from the lockdown. Hence, prioritizing products and processes for cancellation, reduction or deferment can sustain the company's balance sheet.

Resuming business with limited cashflow might force MSMEs to cherry-pick business activities that are necessary to sustain the company in the interim. Even though when these may come with a small increased price tag (due to for example additional hygiene or sanitization requirements or increased transport costs) it may still be worth doing to secure some incoming cash flows. Overall, it is needed to evaluate and budget for the necessary resources, including technicians and laborers. Only then you can estimate the cost for enabling the return of workers and recommencing work in a safe work environment. MSMEs should strive to keep key technical staff and laborers who are highly skilled at niche jobs, as these are necessary for the restart and recovery of business. This will call for the company to plan benefits and incentives to increase employee return and avoid attrition.

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Expense Matrix					
Expenditure Items  (see <a href="#">finance checklist</a> for more items)	Decision criteria for expenditure	Cost			
		low	med	high	NA
Labour	<ul style="list-style-type: none"><li>- Volume of workforce required (waged, salaried)</li><li>- Funds available for payroll?</li><li>- How many months?</li></ul>				
Safe working condition	<ul style="list-style-type: none"><li>- Investments for safe distancing, protective equip., workforce commute</li></ul>				
Raw Materials/Inventory	<ul style="list-style-type: none"><li>- Sufficient inventory/excess</li></ul>				
Production	<ul style="list-style-type: none"><li>- Operating costs, maintenance, cost of hiring technicians?</li></ul>				
Supply-chain	<ul style="list-style-type: none"><li>- Vendors still available? New supply-chain?</li></ul>				
Credit available?	<ul style="list-style-type: none"><li>- Collaterals based?</li><li>- Interest rate?</li></ul>				
Consumers	<ul style="list-style-type: none"><li>- B2B customers yet operational?</li></ul>				
Logistics/movements	<ul style="list-style-type: none"><li>- Regions (cities/towns/villages) still under COVID restrictions</li></ul>				
Distributors/Retailers					
Exports (if any)					
Other					

## ACCESSING FRESH WORKING CAPITAL

### Potential facilitation in accessing working capital

Many companies, especially start-ups and MSMEs may not have fixed holdings that can be used as collateral to take a loan. Hence strengthen your cashflow statements that can offer important proofs to validate the ability of your MSME to generate revenues. Banks in India already accept cashflow-based borrowing for lending to MSMEs (cash flow-based loans are more prevalent among MSMEs).

### Communicating to your investors and other stakeholders

Responding to the crises-led credit crunch, public-sector banks in India have opened emergency lines to their existing clients. Hence it is important for MSMEs to quickly



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engage their existing financing partners (banks, Nonbanking Finance Companies, equity providers and others) to ensure that their available lines of credit are still viable. Investors are acutely wary of the current risks but are keen to help you ensure their loan does not go bad. This means it is in the interest of your investor or lender that your business stays safe and solvent. Cashflow projections will be useful in these communications. Thus, reaching out to your partners, customers, creditors, banks, private investors, tax authorities or government with clear communications supported by up-to-date financial statements, invoices, payment receipts and other documentations and proofs, is crucial.

Given the current credit crunch you might not be able to make a few payments that are due. Hence the deferment should be communicated to your lenders. The lender could even help you restructure your loan. Thus, buying stakeholder trust and negotiating for viable extensions can give companies a breather. This requires urgent and priority communications to your stakeholder by offering updates with necessary detailing about the following 4 key aspects of your business.

**Impact on your  
product  
portfolio  
OR  
the entire  
business**

**Impact of cash  
cycle delays on  
the financial  
health of your  
company**

**Impact on the  
debt capacity  
of your  
company**

**Impact of  
supply chain  
disruption on  
your production**

These communications should also offer key major decisions like the closures of business units and the resultant termination of services cancellations (including employees, contractors, suppliers) should be informed. For some businesses, now might be the best time to get better terms and pricing from some vendors

### Who is offering private equity?

Fund-raise cycles will take time as investors rely on due diligence. Given the various disruptions and travel challenges, investors will be more cautious and slower to respond in taking decisions on new investment rounds. However, investors might be open to bridge capital rounds and follow-on funding. The cash flow forecasts can help you present your business activities for the next 12 months to your existing investors and invite their interests for the proposed business continuity strategies. Insights and updates about your current customer base and operational business modules will play decisive roles in sustaining investor confidence.





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For startups still bootstrapped, this might be the time to relook at your business with fresh perspective given the economic conditions, that will attract investor interests. Reset the business to align to the new business environment could also attract investors interests. Startups should also actively tap in to the various pro-bono advisories as many senior experts are keen to offer mentoring.

### **REVISING YOUR BUSINESS MODEL**

#### **Diversifying and staying solvent in the long run**

Cutting costs, and re-organizing your internal resources and funds could help you to fine-tune and tailor to the currently turbulent market. However, in the post-lockdown era the company will need to analyze if the product and service offerings are still valid. Are there shift in business focus - only to you or to the entire MSME sector? You may consider building alliances with other MSMEs to join forces. MSME associations can take a leadership role to respond to new market dynamics, and prepare the grounds for decisive shifts in the business objectives.

#### **New business models**

Businesses also recognize that priorities imposed during lockdowns could have long-lasting effects on the ways of working and business models. Businesses will be forced to evaluate the extended risks that continue post-lockdown. For instance, rare-earth material dependency on limited geographies, especially for permanent magnets has now forced the Indian manufacturing industry to look elsewhere or revisit legacy technologies with an objective of improving efficiency. This could propel indigenous innovations and potentially create a new shift in the material use.

Further, the conduct of MSMEs may change. The Indian industry which is heavily dependent on migrant workforces, now scattered, will affect the revival of MSMEs in the country. With delayed recovery time frames various interim measures are being put into place, for instance, can you move operations to the regions with labour is available? These aspects of business might persist and the cost viability of these measures will define business action.

#### **Longer forecasts necessary with revised objectives**

An MSME should assess the upstream and downstream impact of its interim actions and as well evaluate its logistics and supply-chain service providers. Before scaling up operations to a before-COVID-19 era, it is prudent to conduct high-level financial risk



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assessments to ensure suppliers and other vendors have sufficiently recovered and demand continues to exist.

Over some next 9 - 12 months, cashflows cannot be sustained only through payables and receivables. Further, squeezing the inventory out of operations will not yield results as the company would be completely shifting the risk burden either to suppliers or customers. Hence, experts recommend that

*while the recovery of the business is critical to an MSME in the immediate future, an organization should focus beyond its operations and inventory levels and focus about the entire ecosystem and supply chain.*

### Future-proofing Businesses

*Digitalization of finance:* in 2018, of the total MSME credit demand in the country, about INR 25 lakh crore was met through formal channels (borrowing done in the entity's or proprietor's name), while as much as INR 20 lakh crore was financed through informal channels. These informal lenders demand interest rates that are at least twice as high as the formal market. Digitalization processes can help 'formalization' of smaller MSMEs, by prioritizing refinancing based on MSME borrower classification. This will also improve the credit history of such companies and their opportunities to access various government schemes and relief measures.

*Automation of processes:* the uncertainties associated with the pandemic have brought attention to the need for productivity improvements (lower production costs) and also reduce worker density (social distancing). While resuming operations, businesses will now have to prioritize safe working spaces and the slow return of migrant labourers could affect the production cycles. These challenges are poised to trigger the market for *industrial automation in India*, including through use of Internet of Things (IoT). It is well established that automation enables and supports lean manufacturing with more efficient use of resources including raw materials, energy, water etc. and remotely controlled operations (that are fully automated).

## Annexure 1: Monthly Cash Flow Statement Template

Monthly Cash Flow Statement												
In INR	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21
Opening Cash												
Cash in Bank												
Mutual Funds/Liqui												





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d Investments												
Total Opening Cash	0	0	0	0	0	0	0	0	0	0	0	0
<b>Expected Inflows:</b>												
Cash Sales												
Payments from Debtors												
Any Other Receipts (Tax Refund etc)												
<b>Expected Payments:</b>												
<b>Expenses Linked to Sales</b>												
Raw Material												
Labour Costs												
Salaries												
Utilities (Electricity, Water, Gas, Hot water)												
Rent												
<b>Other Expenses</b>												
Insurance												
Tech/Data												
Marketing Expenses												
Other Admin Costs												
Supplies (office & operations)												
Repairs & maintenance												
Advertising												
Car, delivery & travel												
Accounting & legal												
Rent												
Telephone												



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e												
Professional Charges												
Insurance												
Taxes (real estate, etc.)												
Interest												
Other expenses (specify)												
<b>Statutory Payments</b>												
GST												
Income Tax												
<b>Loan Repayments</b>												
<b>Capital Expenditure /Asset Purchase</b>												
<b>Total Payments</b>	0	0	0	0	0	0	0	0	0	0	0	0
Ending Cash Balance	0	0	0	0	0	0	0	0	0	0	0	0
<b>If Ending Balance &lt;0, funded by:</b>												
Equity												
Debt												