

The Hidden Danger in the Credit Crisis

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The latest news on the international credit crisis is not good. U.S. President Obama, when asked by Jay Leno why the government's loans to banks haven't made it to down to Main Street, confessed that the banks "haven't started lending it yet."

For Canadians, the situation appears not so dire because our banks weren't caught up nearly so much in dodgy mortgages and derivatives gambling. But there's a hidden danger in the credit crisis that is starting to directly impact many Canadian businesses.

One problem with the so-called "credit" crisis is that it's misnamed. It's actually a crisis of "cash flow" for small- to medium-sized businesses. Essentially, it's now about solid, profitable businesses hitting the wall because their customers are suddenly delaying payment, not paying at all or going bankrupt. Customers see scary headlines and think, *We'd better conserve cash*, so they start stretching out payments to their suppliers. These days, big companies and little ones are holding back, finding all sorts of reasons to hoard cash.

Business Week noted recently that a February survey of 1,000 U.S. corporate credit managers by the Credit Research Foundation found that 78% have witnessed a slowdown in business-to-business payments. The ever-widening "cash gap" between when you pay out expenditures for employees and suppliers and revenue coming in from customers is stretching many businesses.

Here in B.C., one company we know was surprised to have a local government pay an unexpectedly small down-payment on a large contract, throwing a major monkey wrench into the company's cash flow management strategies. As customers "elongate" their payment plans up to 60 or 90 days and beyond, we're seeing a major increase in inquiries for our accounts receivable financing and consulting services. Collection agency use is up and some suppliers are demanding cash up front.

Others are finding that their new line of credit is no longer enough to operate in today's expanded cash-gap era and bank loans are harder to come by. Recent statistics confirm the emerging crunch: bank lending to Canadian businesses is down 19 percent from a year ago. Cash is getting scarce. We're getting even more referrals from our banking colleagues, simply because their clients no longer meet their criteria once they've handed in their year-end financials. Companies that are doing well may still require an increase in their lines of credit in order to stave off the effects of the cash crunch on their growth.

Since a cash-flow crisis can hurt healthy businesses, it is much more pervasive and pernicious than a credit crunch. The old adage has now become "cash flow is king" and strategizing and managing accounts receivables and collecting payments is now a vital area of expertise.

What can companies do? These days, “spray and pray” — whereby you simply send out your invoices and hope something comes back in the mail — is no longer enough. A more professional accounts receivable approach is now critical to your firm’s financial health.

Rapidly growing companies should not be penalized for their success in getting new contracts; as older companies lay off workers, these new growing businesses will put people back to work during the recession. In order to get out of troubled economic times, we have to help solid businesses not only stay financially strong, but also to grow rapidly. Therefore, now is the time for policymakers to pay close attention to keeping business financing moving, especially for rapidly growing firms.

It would be a shame if Canada were sucked into the global economic maelstrom because fear pulled even healthy companies down. What’s needed is boldness, creativity and, above all, speed by all concerned to solve this “crisis of cash flow” before it turns a recession into something much worse.