A survey report by

visual insight™
Predictive Business Intelligence™

The business cost of the banking crisis

January 2009

John Lowry has had a 43-year career in the IT, communications and related technology industries.

For 25 years, he worked for and was trained by many of the world's premier companies, including General Electric Company, ICI, Ford Motor Company, IBM, Unilever, Thorn EMI, and Andersen Consulting (Accenture).

Following this career with premier companies, he has spent 18 years in the start-up, turn-round, restructuring, refinancing, merger and acquisition of technology businesses with turnovers from £2 million to £250 million in Europe and the USA acting as interim Chief Executive, Executive Chairman or Chief Restructuring Officer.

In 2006 he was one of a number of turnaround experts engaged by NHS Trusts to recover them to balanced budgets. He acted as Director of Recovery of a Primary Care Trust and a 3-hospital Acute Trust.

A Fellow of the Institute for Turnaround, Member of the Association of Business Recovery Professionals, Member of the PricewaterhouseCoopers Turnaround Director Panel and Member of the British Computer Society.

Foreword by John Lowry, chairman of Visual Insight Limited

I warmly endorse this initiative by Visual Insight to understand how directors are responding to the threats from the banking crisis. In many respects the results should act as something of a wake-up call to those businesses that still think the banks will be able to support them in time to avoid disaster.

In my view expecting the banks to support a business that has not husbanded its cash carefully shows a somewhat cavalier attitude by directors. Every step possible should be taken to keep the fortunes of the business within the control of directors and not the changing lending policy of a bank.

I think it is a very positive sign that non-executive directors are taking their fiduciary responsibilities seriously and are bringing a healthy level of scrutiny to the boardroom - as well as creative thinking about alternative sources of cash. British businesses need this injection of know-how at a time when many directors will only have experienced a growth economy.

My greatest anxiety is that too many good businesses will fail – not because their bank declines to provide the oxygen of cash (although this may be a contributory factor) but because directors fail to adjust their behaviour to very different economic conditions.

This survey has identified that too many businesses operate on best guesses when it comes to bookings, revenue and cash planning. In an economy starved of liquidity, operating on best guesses when the safety blanket of a growing economy has been removed could be deemed irresponsible by shareholders and banks. In a downturn accurate forecasting is critical.

I believe that boards of directors must substantially improve the management science they use to ensure a greater predictability of income. Armed with the assurance that this will provide, directors will be able to make the effective decisions necessary to ensure that their companies emerge from this downturn stronger and more successful. The banks will only support those companies in whose forecasts they have confidence.

Introduction

Everyday Visual Insight helps companies who are challenged by the gap between sales forecasted and revenue achieved. After 15 years of economic growth, many companies have learnt to accept this inaccuracy as a function of doing business. But in a downturn this gulf between a salesperson's best guess and business reality can represent a drain on a business's most precious resource – cash.

As a result Visual Insight decided to commission a survey to help directors to see how their peers are responding to the credit crunch and to identify if the attitudes to cash management are consistent throughout the Boardroom.

The survey was carried out online by Onva Consulting Limited and was circulated to directors in UK companies by a variety of organisations including: The FD Centre, Haywards LLP, Liverpool Ventures, and Strategic Software Partners. It was active for one week and 111 directors responded - 47% of which were CEOs.

Executive summary

The results of the survey uncover some interesting trends and anomalies:

Cash management is king but revenue consistently fails to match forecasts

- While two thirds of directors (64%) rank cash management as their number one priority, over eight out of ten (83%) feel that they cannot trust the sales forecasts they are given – making cash management much more challenging
- This challenge (and the reason for the distrust) is confirmed by the fact that revenues consistently come in lower than forecasted. Two thirds (65%) of directors feel that forecasts have hyped revenue expectations at least once in the last three months. In fact one in five (21%) directors believes that sales forecasts have exceeded revenue every month for the last three months

Cash resources are under threat by inaccuracies in sales forecasts

- The threat this gap between promised and real income provides to businesses is highlighted by the fact that less than half of directors (47%) think they have the financial resources to manage just a 10% shortfall for three months
- The significance of this gap is brought home by the fact that 72% of directors apply a discount factor to sales forecasts of between 5% and 90% and, a massive 80% of these directors discount by over 10%! In fact, almost four out of ten directors discount forecasts by 50% or more
- One in 10 directors think that they would burst their bank facility if revenues miss forecast by just 10% for three months

Mixed views about the likelihood of support by banks – but demands could be high

- There is an equal split between directors who think banks will advance further credit if needed and those than think they will not. Slightly more directors (9%) believe there is absolutely no chance of extra support than those that think it is guaranteed (7%)
- If extra banks support is available, directors expect it to come at a price. Half of directors expect to provide directors guarantees to secure more credit; one in 14 expect the bank to demand a debenture or other physical assets as security; only three out of ten (29%) do not think the bank would demand any extra security

Non-executive directors lead the way with a prudent cash view

- Not only do NXDs lead the chart for giving cash management the highest priority (83%) but they also have the lowest levels of trust in the forecasts provided to them - 17% complete distrust and 87% partial distrust
- If sales miss forecast by 10% for three months NXDs would expect redundancies and a third would expect the firm to go into administration
- If more cash is needed, NXDs would look to alternative sources of private equity rather than approach directors or shareholders which are the preferred routes of other directors

Chairmen seem less concerned by cash implications of shortfalls in revenue

- Perhaps surprisingly, as the chairman is the guardian of shareholder interests, only 50% of chairmen assign cash management the highest priority. In fact chairmen have the highest levels of trust in the forecasts with 21% trusting them completely. However, if they have cause not to trust the forecast, they then apply the highest average discount factor at 46%. This may be because nearly all chairmen (83%) believe they have sufficient cash resources to ride a 10% shortfall in sales for three months and, 70% believe they have a very high probability of being advanced further credit by their bank if needed

CFOs will look for redundancies to balance the books

- 60% of CFOs will expect redundancies if revenue misses forecast by 10% for three months – twice as high as NXDs and five time the rate for CEOs at 12%.

CEOs share distrust levels and lead cynicism about bank support

- Almost eight out of ten CEOs discount sales forecasts by an average of 34%. Only four out of ten believe they have the cash resources to survive a 10% shortfall for three months with 23% expecting to cut costs and draw on a bank overdraft facility. One in ten would expect to burst this facility
- One in eight believe the banks would not advance further credit with 60% ranking this as highly unlikely (1-5 on ten point probability scale)

Results Overview

The survey contained nine questions as follows:

Q1. Where does cash generation rank in your business priorities?

64% of directors placed cash management as the #1 priority with 31% ranking it as priority two or three. One in twenty (5%) put cash management at number four or five.

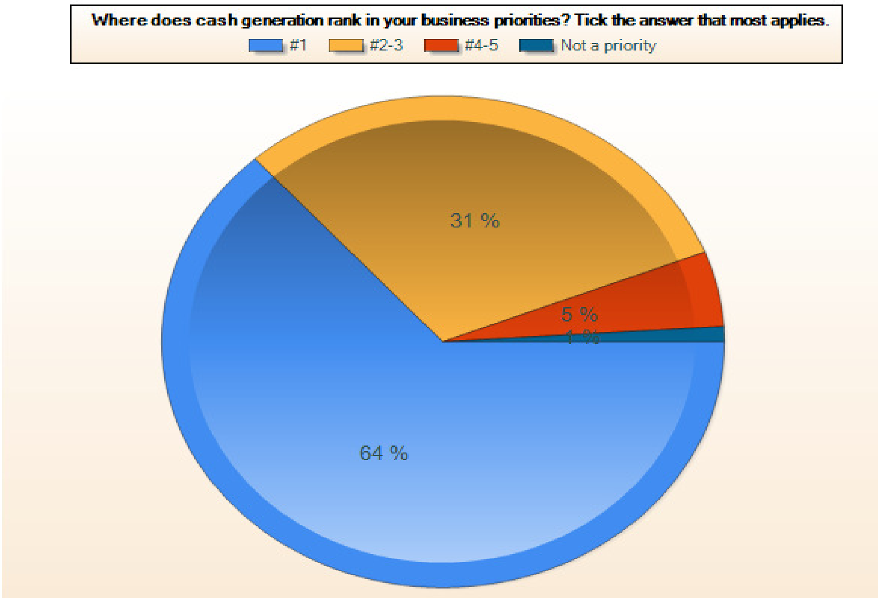

Figure 1 – The importance of cash generation

Q2. What importance do your fellow directors give to cash generation?

Three quarters (73%) of directors think that their board colleagues assign cash management the same priority. One in 10 think other directors regard it as more important and one in six (17%) think other directors view it as less important.

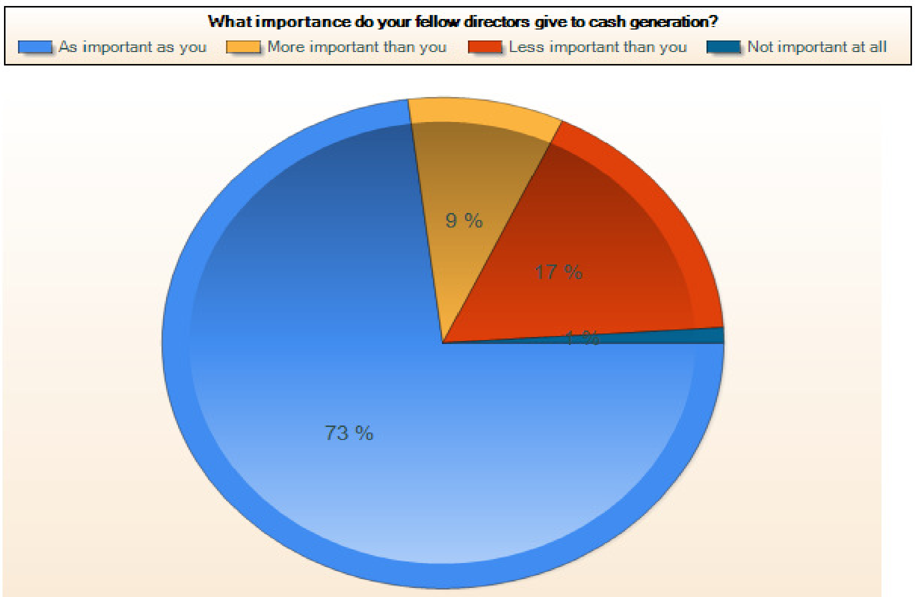

Figure 2 – The importance of cash generation to other direc-

Results Overview

The survey contained nine questions as follows:

Q3. How much do you trust the accuracy of the sales forecast you are provided?

One in six directors (17%) completely trust the sales forecasts presented to them while one in nine don't trust them at all. Almost three quarters of directors apply a discount factor with a range of between 5% and 90%.

21% of those who only partially trust the forecast did not specify a discount factor. One in five (19%) discount forecasts by between 5% and 15%; one third (35%) apply a discount factor of between 20% and 45%; 11% discount by half and one in seven (14%) discount by 60% or more. Almost four out of ten directors discount forecasts by 50% or more – demonstrating very low levels of trust in the forecasts presented to them.

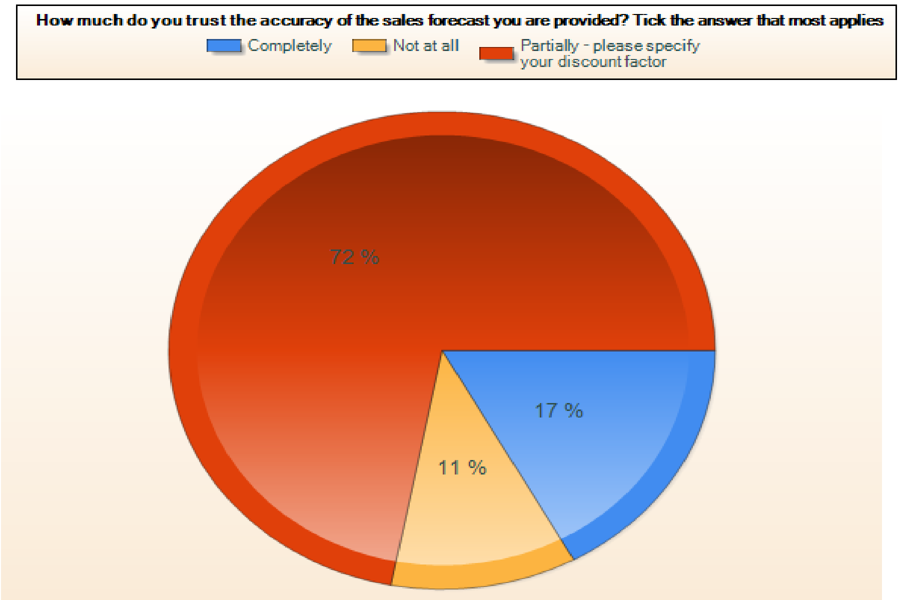

Figure 3 – Trust levels in sales forecasts

Q4. If your sales forecasts were wrong by a factor of 10% for one month, what would be the impact on your business?

Almost eight out of ten directors (78%) believe that they have sufficient resources to cope with forecasts being out by 10% for one month only. One in eight would cut costs (12%); one in nine (11%) would need to draw on a bank facility and for one in 20 (5%) this fluctuation would mean they would exceed their bank overdraft.

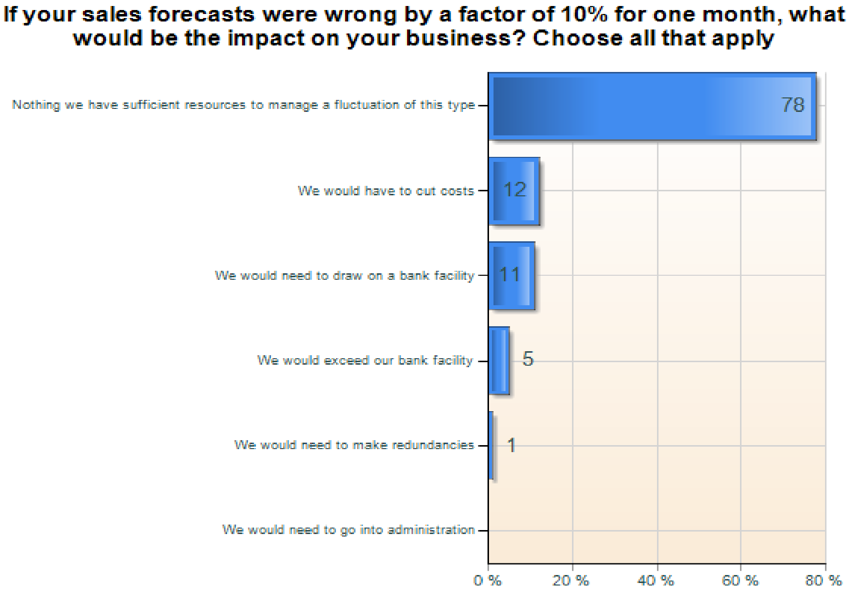

Figure 4 – Implications of a 10% shortfall for one month

Results Overview

The survey contained nine questions as follows:

Q5. If your sales forecasts were wrong by a factor of 10% for three months, what would be the impact on your business?

If forecasts were out by just 10% for three months the impact on businesses would be markedly different. Less than half of directors (47%) believe they have the resources to cope with this level of fluctuation. The number cutting costs increases by two and a half times to 31%; the number drawing on a bank facility almost doubles (19%); the number exceeding their overdraft doubles to (10%); one in eight directors would expect to make redundancies and one in 50 directors would expect their organisation to go into administration.

If your sales forecasts were wrong by a factor of 10% for three months, what would be the impact on your business? Choose all that apply

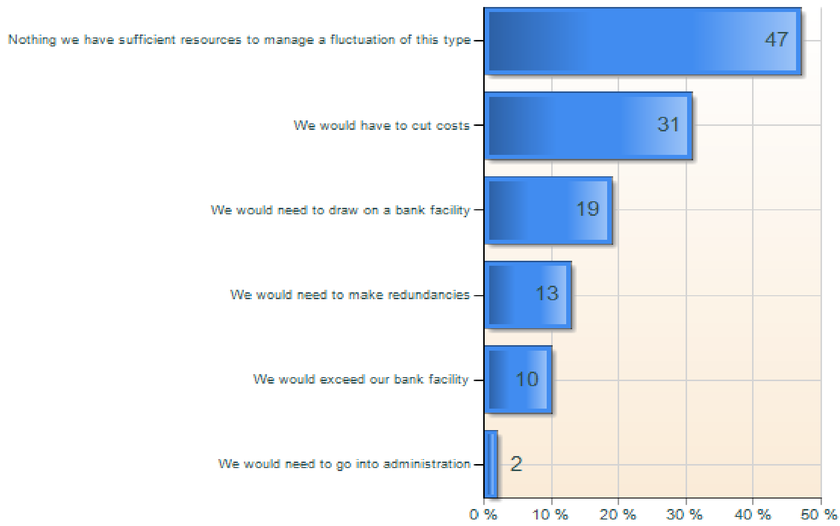

Figure 5 – Implications of a 10% shortfall for three months

Q6. How many times in the last three months have the sales forecasts provided to you been higher than the revenue secured?

Two thirds of directors have seen their sales forecasts exceed revenue in the last three months. Of these one third (32%) have seen revenue miss the forecast every month; one in four (26%) have missed the forecast in two out of the three months and four out of ten (42%) missed on one occasion.

How many times in the last three months have the sales forecasts provided to you been higher than the revenue secured?

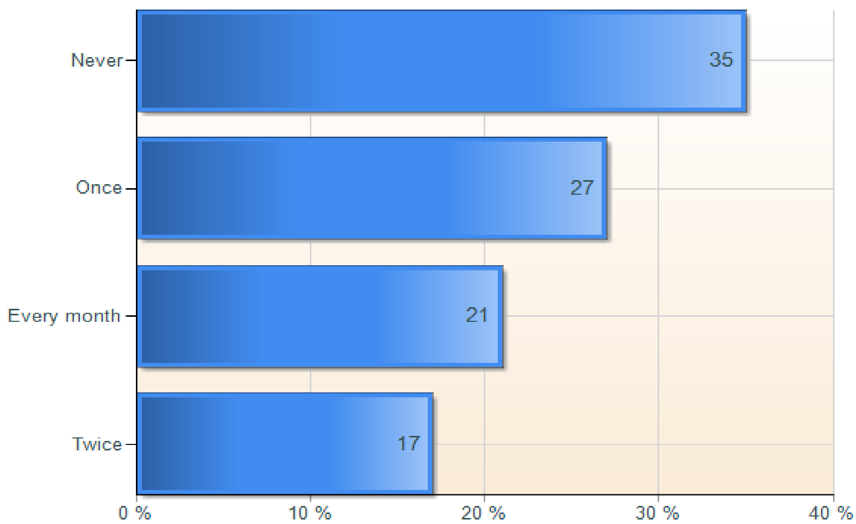

Figure 6 – Frequency of a gap between forecast and actual revenue

Results Overview

The survey contained nine questions as follows:

Q7. If you needed to find a cash injection quickly, how likely on a scale of 1 to10 is it that your bank would give you extra credit? (Where 1 = no chance and 10 = it's a certainty)

One in 11 directors think there is no chance their bank will provide extra credit; only one in 14 believe it is a certainty. 50% of directors rank their chances at five or less and 50% at six or more.

Comments by directors on banks include:

What support? They support their bonuses and their friends. They care nothing for the rest of us - we're just fodder. Still, now none of them trust any other bankers - at least they've got that right.

Perfectly good businesses will go to the wall just because banks took bad risks with people with no capacity to meet their repayments. It is galling that there seems no appetite for the people who caused this mess to pay with their jobs.

Although this does not affect us directly at the moment, we see many clients being made to jump through hoops to get any assistance from the banks.

Over the past three years banks have withdrawn/tightened offered facilities at every opportunity. This trend will continue/worsen and bite into the functionality of many SME's. Cash will be King for the foreseeable future.

These are clearly exceptional times. The sooner banks have the confidence to act as bankers again, the better.

Building up the courage to invest in business winning activity is a big call at present - especially as others will be going through the same mental turmoil. The next two years (at least) will be a truly defining period as far as risk assessment and business projection is concerned. It will be a brave person who attempts to forecast this one!

All support appears to be for the banks from the government - I see nothing to help us

If you needed to find a cash injection quickly, how likely on a scale of 1 to10 is it that your bank would give you extra credit? (Where 1 = no chance and 10 = it's a certainty)

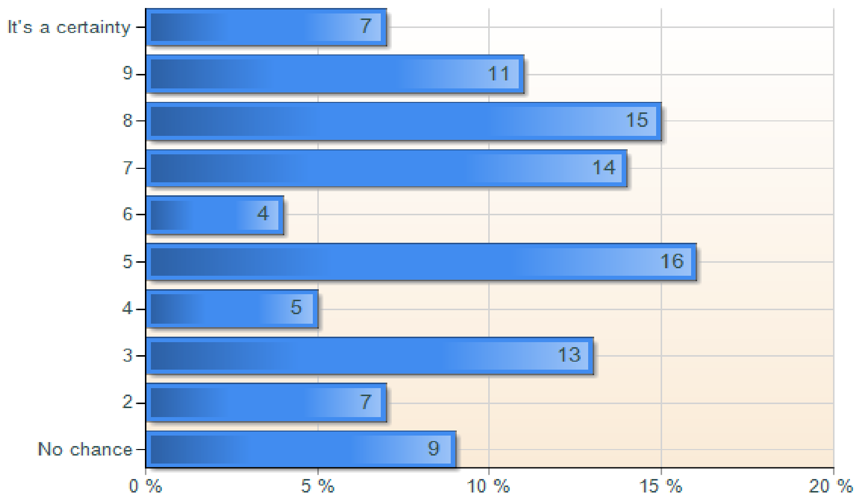

Figure 7 – Likelihood of additional bank funding

Additional comments by directors on banks ...

There's a general shortage of funds available from the banks which is restricting investment by SMEs

It would be useful if the banks knew their customers.

Banks don't even provide helpful advice - they are the source of the liquidity problems in the market that will see decent businesses denied essential cash resources.

Cash is clearly the only criteria right now. But we wouldn't even bother asking our bank. We would use our own resources

Banks are being cooperative, same as usual, but we have strong relationship.

Staggeringly we secured £250,000 in DTI Small Firms Loans in 2003/2004 at a time when our business was infinitely less developed and greater in terms of risk. Now we would not even get a £10,000 facility without directors guarantees

Results Overview

The survey contained nine questions as follows:

Q8. What security would the bank expect from you if they provided extra cash support?

Half of directors expect to provide directors guarantees to secure more credit; one in 14 expect the bank to demand a debenture or other physical assets as security; three out of ten (29%) do not think the bank would demand any extra security and half that number (14%) believe the banks will not extend further credit.

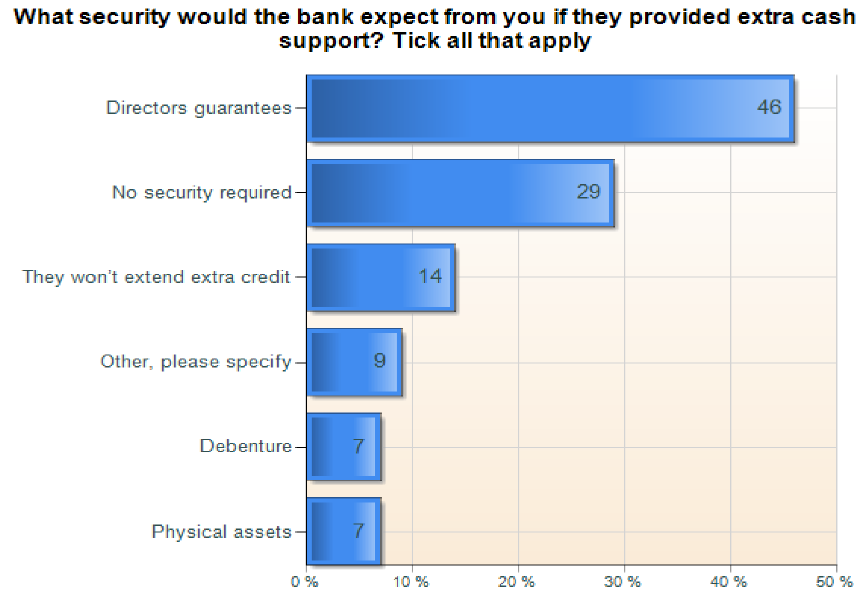

Figure 8 – Additional security demanded by banks

Q9. Where else would you look to find cash if your bank will not provide it?

Almost half of directors (45%) would expect directors to fund extra cash resources; one in four (38%) would look to shareholders to do so; one in six would turn to venture capital and twice that number (35%) would approach other private equity sources. One in eight would look elsewhere, including: friends, family, a trade sale or merger and factoring.

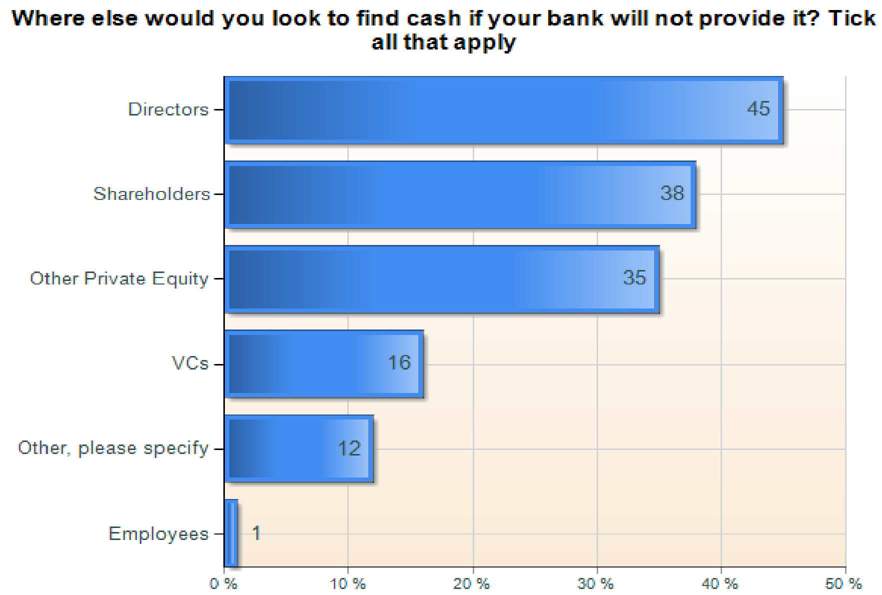

Figure 9 – Alternative sources of cash

Results Overview

When the results are analysed by Board role a different picture appears.

Q1. Where does cash generation rank in your business priorities?

83% of non-executive directors assign the highest priority to cash management compared with only 50% of chairman. In fact one in 14 chairmen do not think cash management is a priority at all. Perhaps surprisingly, one in 15 CFOs rank cash management at number four or five on the priority list.

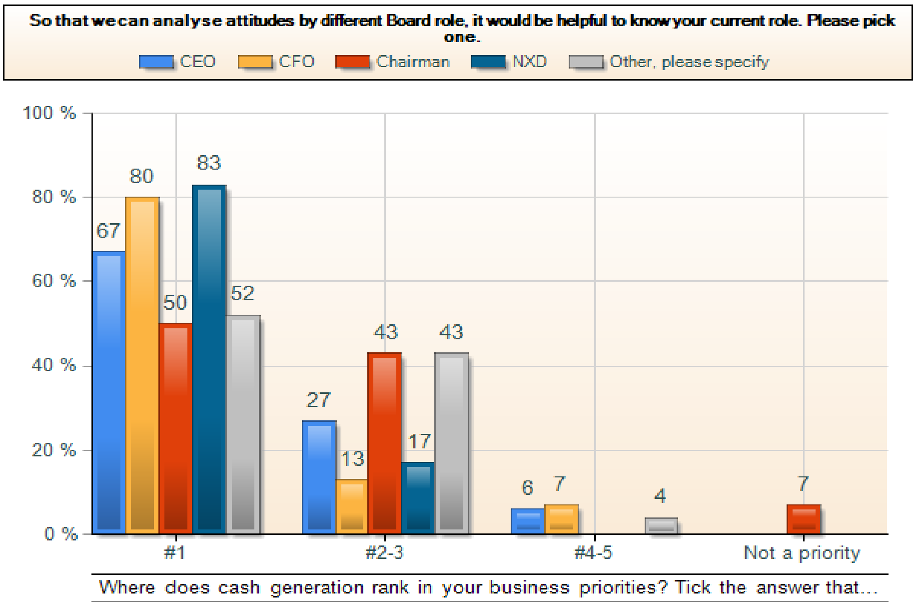

Figure 10 – The importance of cash generation – by board role

Q2. What importance do your fellow directors give to cash generation?

Most directors think other directors assign cash management the same level of priority – between 65% and 87% depending on the role. One in five CEOs and on in six CFOs and NXDs think others see it as less important.

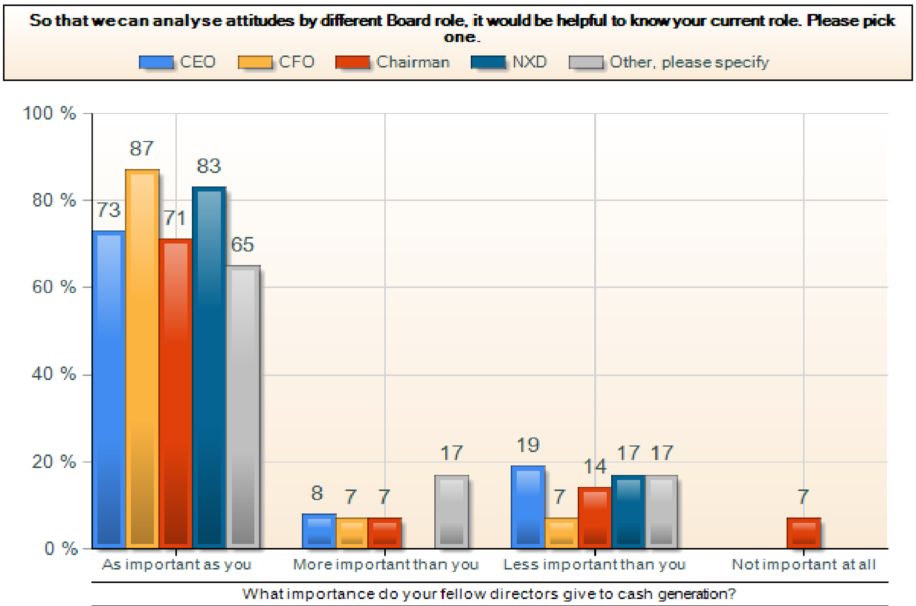

Figure 11 – The importance of cash generation to other directors – by board role

Results Overview

When the results are analysed by Board role a different picture appears.

Q3. How much do you trust the accuracy of the sales forecast you are provided?

NXDs have the least trust in the forecast presented to them with 17% distrusting them completely and 83% partially. One in five chairmen trust them completely and the same number not all with the balance, 57% applying a discount factor. Only one in six CEOs trust the forecasts completely.

Chairmen and CFOs apply the highest discount factors – 46% and 44% on average respectively. CEOs and NXDs apply a discount factor of 34% and 30% respectively.

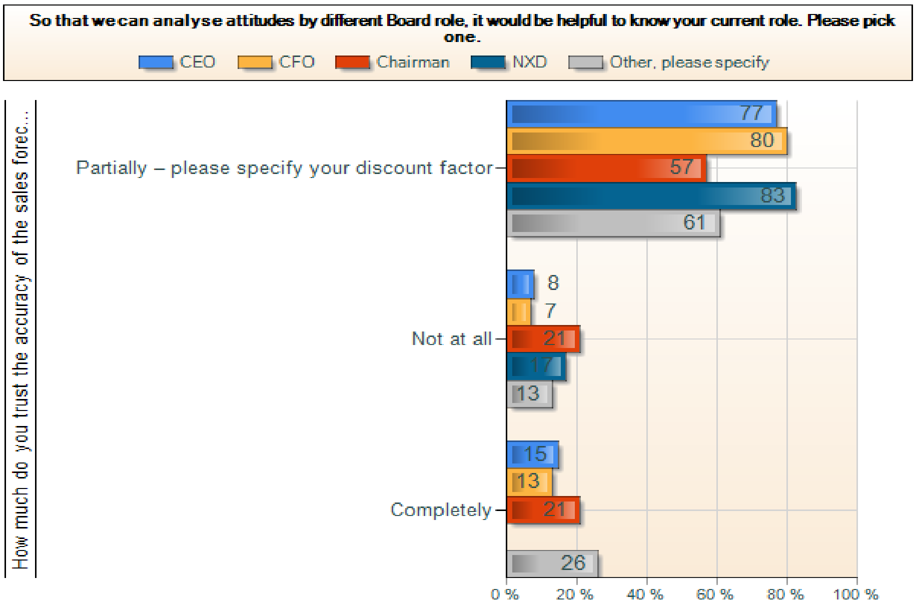

Figure 12 – Trust levels in sales forecasts – by board role

Q4. If your sales forecasts were wrong by a factor of 10% for one month, what would be the impact on your business?

Nearly all chairmen believe they have sufficient resources to ride a 10% difference in revenue to sales forecast in one month, compared to only 67% of NXDs.

Only CEOs think it would be necessary to draw on a bank facility (13%) and to cut costs 10% but only 2% think they would exceed their bank facility compared with one in eight CFOs and one in six NXDs. A third of NXDs (33%) and one in eight (13%) CFOs would expect to make redundancies compared with only 2% of CEOs.

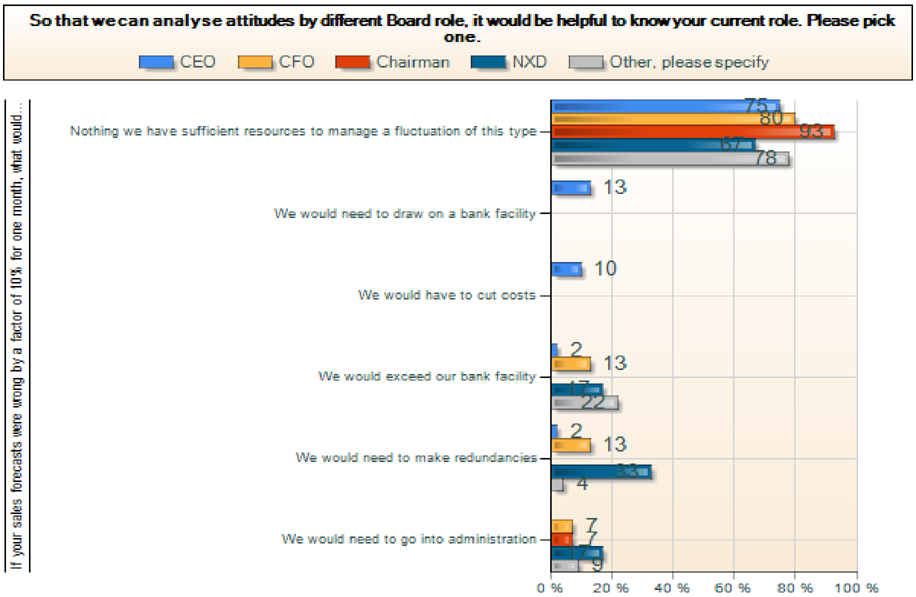

Figure 13 – Implications of a 10% shortfall for one month – by board role

The business cost of the banking crisis

How directors are approaching the challenges of a cash-starved economy

A survey report by visual insight

Results Overview

When the results are analysed by Board role a different picture appears.

Q5. If your sales forecasts were wrong by a factor of 10% for three months, what would be the impact on your business?

If forecasts were out by just 10% for three months the views of most directors change quite dramatically. Only chairmen at (86%) remain confident that they would have sufficient resources to manage this fluctuation – compared to only a third of CFOs and NXDs and four in ten CEOs. Almost a quarter of CEOs (23%) would expect to cut costs.

However, many more directors would expect to make redundancies than if the shortfall was for one month only – with 60% of CFOs and 33% of NXDs looking for this kind of saving.

One third of NXDs would expect the firm to go into administration.

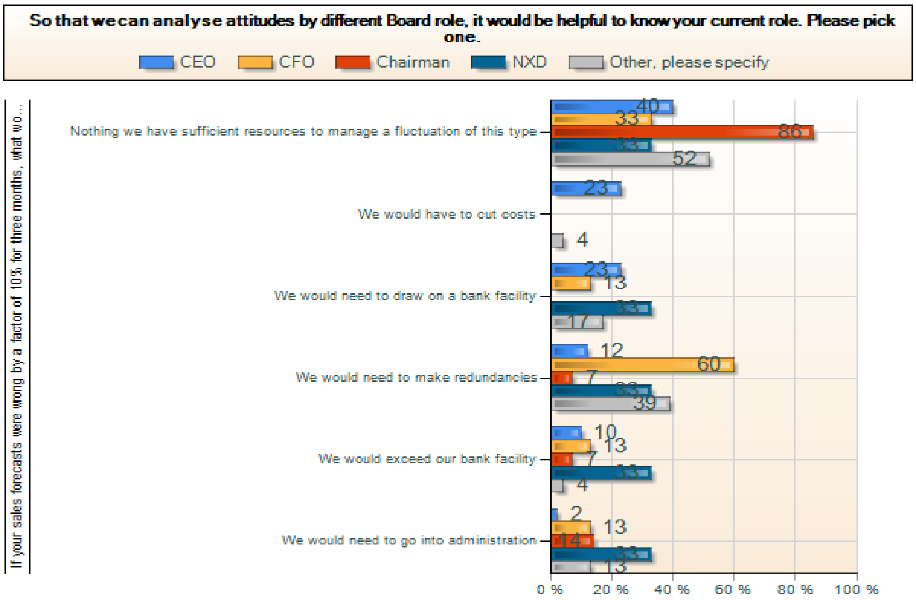

Figure 14 – Implications of a 10% shortfall for three months – by board role

Q6. How many times in the last three months have the sales forecasts provided to you been higher than the revenue secured?

There is a huge range of view on the frequency with which revenue is lower than the forecasted sales. 27% of CEOs believe this occurred once in the last three months compared to 50% of chairmen and 67% of NXDs. Almost one in three CEOs believe this happens every month compared to only 13% of CFOs.

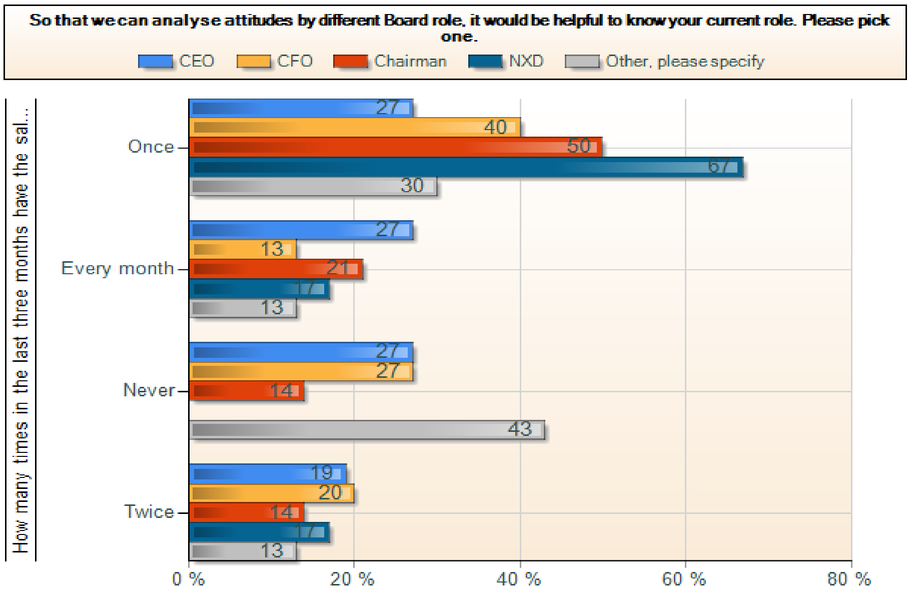

Figure 15 – Frequency of a gap between forecast and actual revenue – by board role

Results Overview

When the results are analysed by Board role a different picture appears.

Q7. If you needed to find a cash injection quickly, how likely on a scale of 1 to10 is it that your bank would give you extra credit? (Where 1 = no chance and 10 = it's a certainty)

CEOs have the most cynicism about the likelihood of receiving extra cash with one in eight believing there is no chance. Chairmen seem to have the most confidence in bank support with 70% ranking the chances at between seven and ten.

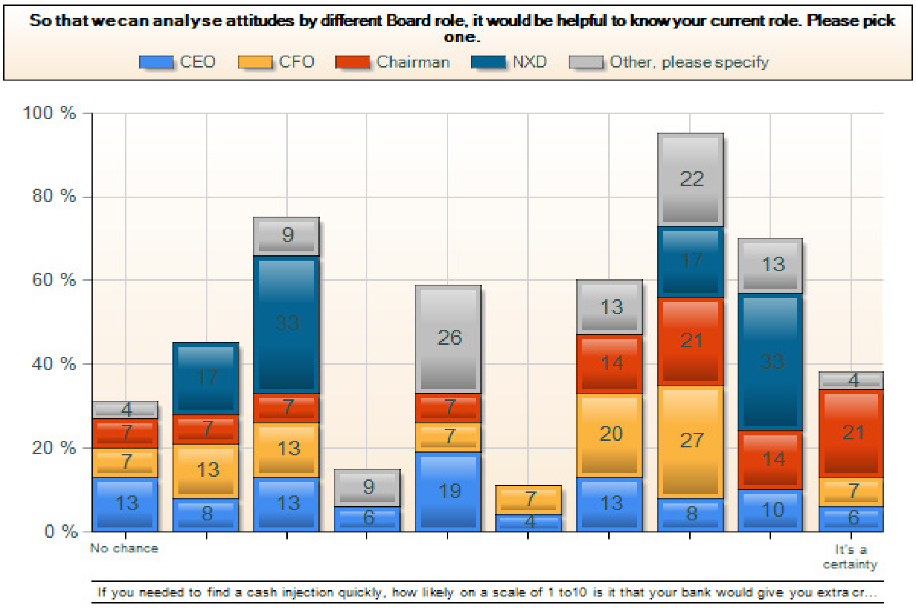

Figure 16 – Likelihood of additional bank funding – by board role

Q8. What security would the bank expect from you if they provided extra cash support?

Chairmen (50%) and CFOs (40%) have the highest levels of belief that the bank would not require security for extra cash support. CEOs (60%) and NXDs (50%) would expect to provide directors guarantees. One in five CFOs and one in six CEOs and NXDs believe that extra credit will not be granted.

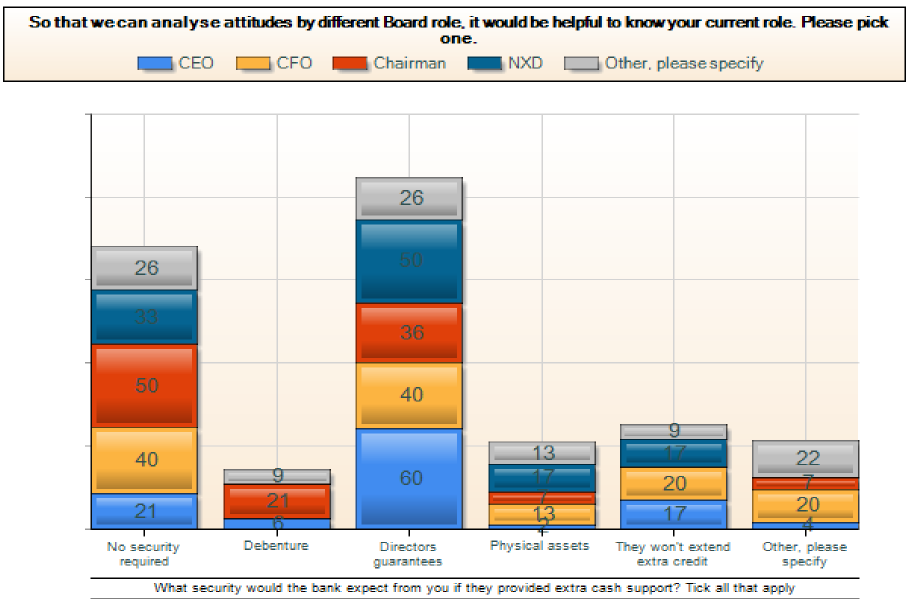

Figure 17 – Additional security demanded by banks – by board role

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Results Overview

When the results are analysed by Board role a different picture appears.

Q9. Where else would you look to find cash if your bank will not provide it?

The preferred source for CEOs is directors (48%) and shareholders (42%). This view is shared by chairmen and CFOs. However, NXDs would look further afield with 67% looking to other private equity sources for cash.

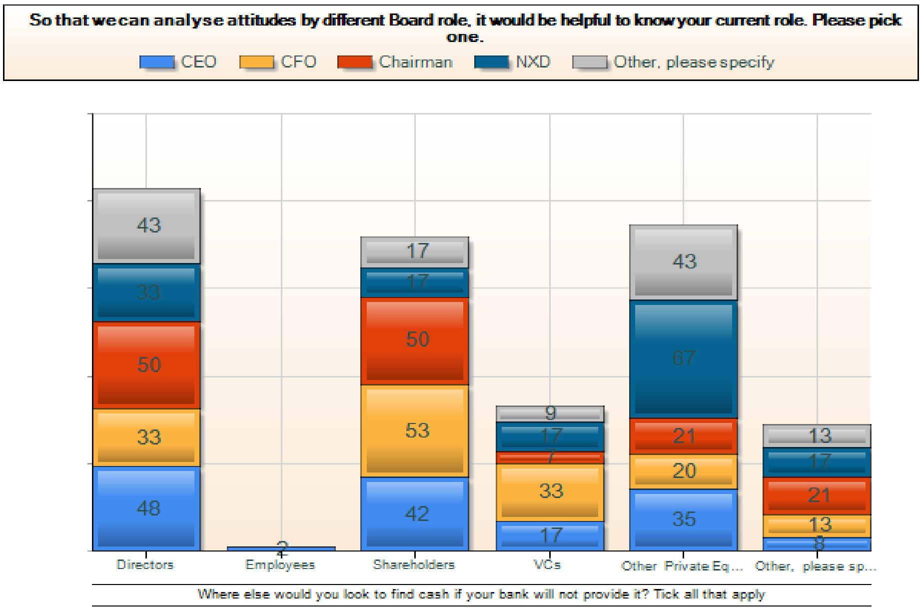

Figure 18 – Alternative sources of cash – by board role

Checklist for action

Because cash is the life blood of any business, we believe this survey has highlighted the need for directors to identify the following:

- The quality and accuracy of the revenue pipeline for the next three months
- The steps necessary to survive a shortfall in revenue
- The level of support available from their bank – and at what cost
- A Plan B for a cash injection if the bank is unlikely to extend any/further credit