Gartner Research

Resilience during disruption: Managing Cash Flow Will Be the Key Enabler for Tech CEOs to Navigate a Downturn

Gaurav Gupta, VP Analyst
Martin Reynolds, Distinguished VP Analyst

5 November 2019

Gartner

Gartner

Resilience during disruption: Managing Cash Flow Will Be the Key Enabler for Tech CEOs to Navigate a Downturn

Published: 5 November 2019 **ID: G00463714**

Analyst(s): Gaurav Gupta, Martin Reynolds

Tech CEOs must prepare now to deal with a downturn by developing plans that focus on cash flow and maintaining cash flow flexibility.

Key Challenges

- The majority of tech CEOs measure revenue growth and profitability,[1] but only 30% currently measure cash burn rate and only 16% of tech CEOs believe cash burn rate is one of the top three KPIs they should measure. The lack of focus on cash burn rate could lead to cash flow problems in an economic downturn and leave many tech CEOs at a disadvantage.
- Tech CEOs must be aware that customers' liquidity may drop in a downturn, and customers may lose the ability to make payments on time.

Recommendations

Tech CEOs who seek to optimize cost and cash management to improve business performance management in an economic downturn must:

- Proactively manage cash flow and working capital by measuring cash management KPIs, including burn rate as an essential KPI.
- Protect cash flow by segmenting customers by ability to pay during difficult times.

Table of Contents

List of Tables

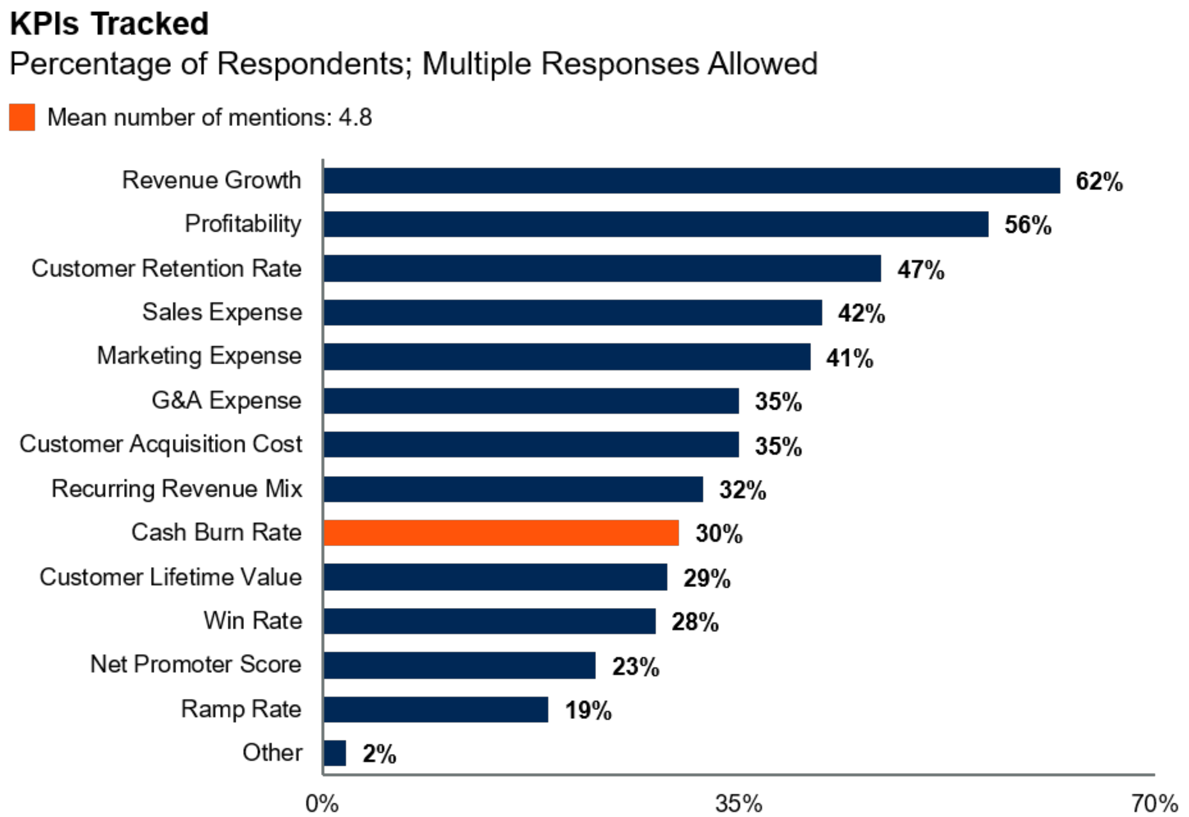
List of Figures

Introduction

Economic uncertainty was a common concern among Gartner clients entering 2019 and is expected to continue entering 2020. Economic downturns present a unique challenge since cash flow can be in crisis and cash liquidity can drop. In a downturn, maintaining optimum cash levels is extremely vital.

However, according to Gartner's 2019 KPIs for Tech CEOs survey among 507 tech CEOs and leaders of high-tech companies,[1] cash burn rate is not a metric that tech CEOs commonly track. Only 30% of tech CEOs currently measure cash burn rate (see Figure 1). Gartner calculates cash burn rate as (annual revenue divided by 12) minus monthly operating costs.

Figure 1. KPIs Tracked by Tech CEOs

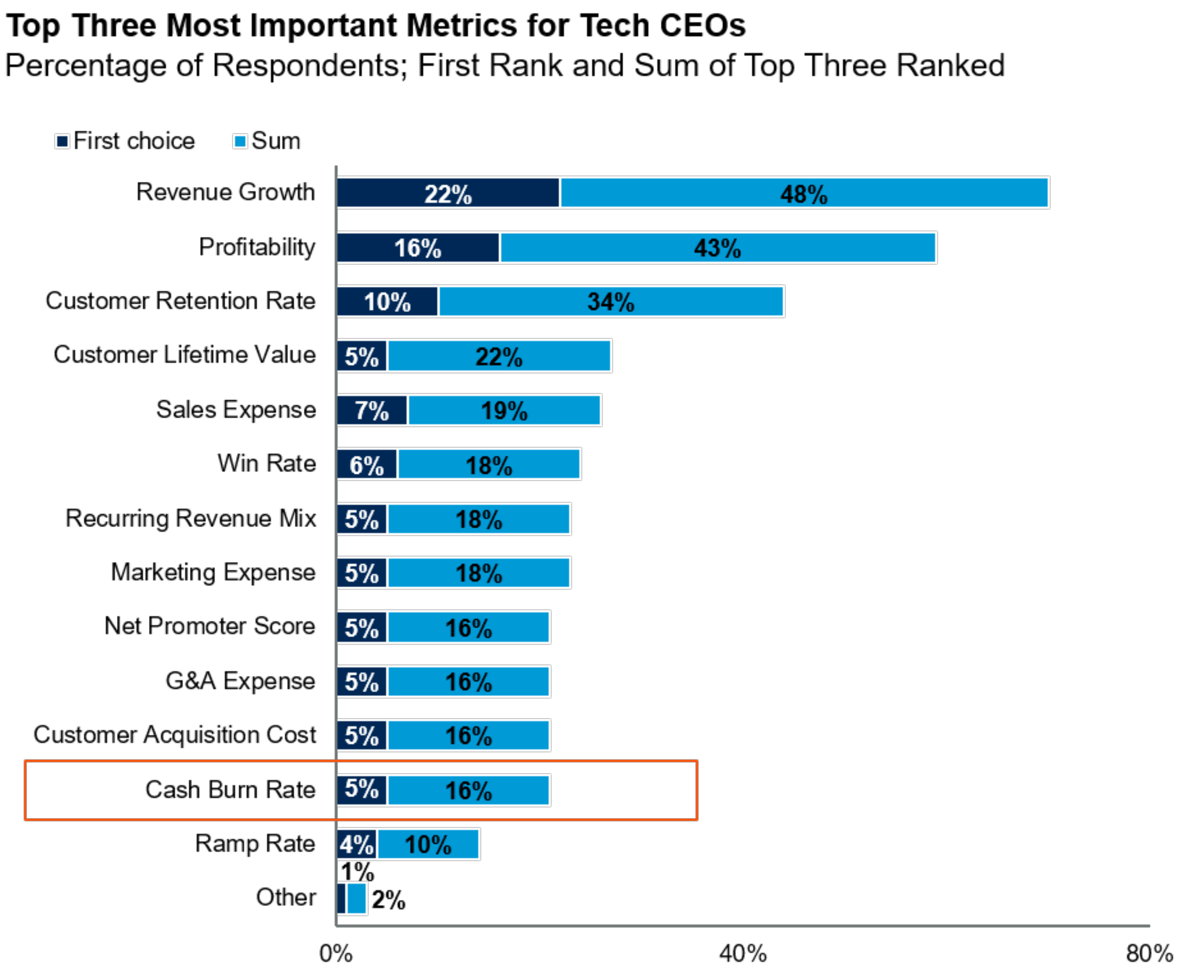


n = 507
Base: Total respondents
Source: Gartner's KPIs for Tech CEOs survey (July 2019)
A03. Which of the following KPIs does your organization track?
ID: 463714

As illustrated in Figure 1, tech CEOs are focused on revenue and profitability, but fewer measure cash burn rate. Balance sheet and a cash flow statement are the health report for a company. With negative cash flow, the company will go out of business unless the tech CEO takes corrective action quickly.

Figure 2 illustrates the top three most important metrics that tech CEOs said they believe they should track. Only 16% of tech CEOs chose cash burn rate as one of the top three metrics they should track. The lack of focus on cash burn rate could leave many tech CEOs at a disadvantage in an economic downturn.

Figure 2. Ranking of KPIs Tracked by Tech CEOs



Tech CEOs; n = 460

Base: Total respondents for each question, excluding "Not Sure/None"

Source: Gartner's KPIs for Tech CEOs survey (July 2019)

A03A. In your opinion, which of the following are the top 3 most important metrics your organization SHOULD track? Which does the board/private equity/leadership team think are the most important?

ID: 463714

Analysis

Focus on Cash Flow and Working Capital Management

In an economic downturn, cash flow can become very unpredictable. Clients may delay payments, suppliers demand cash upfront, and lenders can call loans, squeezing the company's cash balance and liquidity.

An economic downturn will create cash flow problems for tech CEOs. Without cash on hand, a company may be forced to pay bills late, curtail operations, and delay salary payments to employees. Financial difficulties lower the valuation of a company's debt and bonds and impair its ability to obtain financing.

In an economic downturn, without proper preparation, a company could be forced to drastically downsize its operations, cutting back investments in future product and service development and in marketing and sales. On the other hand, a competitor with better cash flow management will exit the recession with a stronger customer base and better prospects.

Therefore, the timing, amount and predictability of future cash flows should be an essential component of the budgeting and planning process at all companies, especially in a weak economy. Gartner's report "Tech CEOs: Establish Real-Time KPI Performance Dashboards for Your Business" emphasizes use of KPIs, including cash flow and cash burn rate, to measure the health of the business. Incorporating cash KPIs into a real-time dashboard will display results for the tech CEO to incorporate into action plans for improving business performance.

In addition to monitoring KPIs for managing cash, tech CEOs should improve business performance management through cost optimization, refining marketing campaigns, improving sales effectiveness, improving sales ramp, removing discounting, and going after market segments with the highest differentiation (highest chance to win at lowest customer acquisition costs).

If the business depends on rolling credit lines, a liquidity squeeze could result in lenders cutting back credit — or calling loans entirely. *Tech CEOs must review terms of credit facility to confirm access to these lines when most needed.*

Last, going into a market downturn, tech CEOs should consider raising additional equity capital to strengthen the balance sheet and improve working capital, thereby reducing the impact and risks of cash flow interruptions.

Segment Customers by Ability to Pay During Market Downturns

Typically, customers' liquidity drops in a downturn, and some customers' payment patterns may change. A recession will likely increase a company's accounts receivable as customers that owe the company money may make payments slower, later, or not at all. If the customer also has reduced revenue, the affected company may be forced to pay its own bills slower, later, or in smaller increments than the original credit agreement required. Note: Not all customers will experience reduced revenue in an economic downturn. Some customers may realize increased revenue as the result of an economic downturn.

Making late or delinquent payments will reduce the valuation of a corporation's debt and bonds and hinder its ability to obtain financing, as well as endanger critical supplier relationships. *Thus, it is critical for tech CEOs to focus on the best customers by understanding which customers might drop orders, have difficulty paying on time, or emerge weakened from recession.*

Tech CEOs need to maintain a positive cash flow, which might imply dropping some of the worst customers that may consume cash with late payments. Additionally, tech CEOs must improve cash and margins by encouraging upfront payments using alternative business models, such as a payment acceleration discount strategy.

Tech CEOs must segment their clients based on their ability to pay.

Clients and prospects can be broadly classified into three categories:

1. Red — The most risky customers, which won't pay on time, will negotiate till the last penny, and may go out of business. These are the customers that could pull the business down.
2. Amber — The customers that will pay, but whose payments will be delayed and that require a strategy to retain them.
3. Green — The customers that continue to pay cash on time as their businesses are resilient to downturns.

Table 1 can be used as a guide to help tech CEOs segment clients by industry. Gartner used an industry segmentation to provide some ideas and guidelines; however, if customer concentration is an issue for a young company, tech CEOs should *assess companies by name and have a recession plan for each.* This should be done on an ongoing basis, and there should be clear policies regarding when a customer is put on a "watch list" for days sales outstanding (DSO) and the escalation procedure between your company and your customer. Then in recession, it will require more frequent reviews. Slow payers with small profit margins are key targets for red classification. Gartner's report "Winning in the Turns: Crucial Cost and Cash Strategies for Tech CEOs" stresses the importance of focusing on the best customer market segments during turns based on their profitability and value.

Red companies present a possible threat to cash flow.

Amber companies need to be evaluated and sorted as red or watch.

Green companies have good cash flow and might be amenable to an early-payment discount, bolstering cash flow.

Table 1. Customer Mapping/Segmenting Guide by Industry

Industry	Key Possible DSO Characteristics During Economic Downturns	Action Plan
Financial services (banks)	Well experienced with liquidity crises after 2009.	Check banking customers for a strong asset base with limited exposure to segments. Further, one of the biggest risks that rises during a recession (particularly in insurance) is risk from fraud (such as fraudulent claims). The risk stance of the organization may be an indicator and needs to be checked.
Manufacturing and construction	Two sectors that are badly hit during recession.	Maintain firm prices; don't get into price wars; negotiate receivable days.
Technology	Leading companies have strong cash flows. But fast-growing emerging companies may face difficulties sustaining growth and making payments on time.	Be selective and maintain a healthy mix of established and early-stage customers.
Automotive	Likely to be cash-squeezed and will extend payment terms.	Profitable business, but extended payments are troublesome. Use pricing models that provide incentives for multiyear contracts paid upfront.
Hospitality and transportation	Travel budget is the first casualty, and during the worst times, sales will drop. Consumers take fewer vacations, and business travelers get squeezed.	Likely to be leveraged on their properties, and can go bankrupt. Some of the companies here can be red.
Retail	Customers hold off making purchases, exposing high debt service costs.	Flag retailers with excessive debt and inventory.
Education; state and local government	Budget/funding cuts will impact them negatively.	Reliable, but slow, payers. Protect if you can stretch cash.
Federal government	They will pay bills but might be delayed.	Protect. The only client that prints its own money.
Energy and utilities (power and water)	People don't give up electricity/water during a recession.	Good cash flow, but watch out for excessive debt.
Telecommunications	Good cash flow.	Payment acceleration discount strategy
Pharmaceutical and healthcare	Relatively inelastic demand.	Focus on keeping payments constant, or negotiate early-payment discounts.

Source: Gartner (November 2019)

Tech CEOs can utilize this table to track clients' expected ability to pay during turns. There will be exceptions to the criteria based on past experience with the clients, but this table acts as a good starting point. Segmenting clients will assist in understanding the client base or portfolio that exists today and the risk that the clients may present during a recession.

Gartner Recommended Reading

Some documents may not be available as part of your current Gartner subscription.

"Winning in the Turns: A Tech CEO Action Guide"

"How Tech CEOs Can Visualize Their Business Model"

"How Tech CEOs Should Select the Right Software Pricing Model"

"How Tech CEOs Can Make Software Pricing a Competitive Advantage"

"3 Ways for Tech CEOs to Increase Pricing Power in an Increasingly Competitive Landscape"

"Survey Data: Gartner KPIs for Tech CEOs Survey, 2019"

Evidence

[1] Gartner's KPIs for Tech CEOs survey explores the KPIs that startups and emerging companies measure, the perceptions about the importance of KPIs, and how startups and emerging providers use KPIs to effect change in the organization. The survey was conducted online by an external partner between April and June 2019.

In total, 507 respondents were interviewed in their native languages across North America (40%, n = 202; countries including the U.S. and Canada), Western Europe (30%, n = 153; countries including France, Germany, Spain, Italy and the U.K.), Asia/Pacific (30%, n = 152; countries including Australia, China, India and Singapore). Percentages may not add to 100% due to rounding. Interpret small base sizes (n < 30) with caution.

In order to enable the comparison and contrasting of key trends, quotas were established on key organizational and respondent characteristics:

- Qualifying organizations operate in the high-tech industry (applications/software, communications services, hardware, IT services and semiconductors), with anticipated enterprisewide annual revenue for 2019 of up to $250 million in U.S. dollars or the equivalent. All organizations focus on businesses and government/nonprofits as their primary customers (including B2B, business-to-business-to-consumer [B2B2C], business-to-business-to-business [B2B2B] and government/nonprofit). Companies had to be less than 25 years old and had to track KPIs in at least one area of their business.
- Qualified participants have the title of CEO/managing director (59%, n = 300), owner (18%, n = 93) or COO/C-level executive of operations or equivalent (23%, n = 114).

The survey was developed collaboratively by a team of Gartner analysts who follow these markets, and was reviewed, tested and administered by Gartner's Research Data and Analytics team.

Disclaimer: Results of this study *do not represent "global" findings or the market as a whole* but are a simple average of results for the targeted countries, industries and company-size segments covered in this survey.

GARTNER HEADQUARTERS

Corporate Headquarters
56 Top Gallant Road
Stamford, CT 06902-7700
USA
+1 203 964 0096

Regional Headquarters
AUSTRALIA
BRAZIL
JAPAN
UNITED KINGDOM

For a complete list of worldwide locations,
visit http://www.gartner.com/technology/about.jsp

This complimentary research is part of Gartner's ongoing coverage of the business impact of the coronavirus (COVID-19).

Access additional free content and coverage at gartner.com/smarterwithgartner and gartner.com.

Become a Client

Get access to this level of insight all year long — plus contextualized support for your strategic priorities — by becoming a client.

About Gartner

Gartner, Inc. (NYSE: IT) is the world's leading research and advisory company and a member of the S&P 500. We equip business leaders with indispensable insights, advice and tools to achieve their mission-critical priorities today and build the successful organizations of tomorrow.

Our unmatched combination of expert-led, practitioner-sourced and data-driven research steers clients toward the right decisions on the issues that matter most. We are a trusted advisor and an objective resource for more than 15,000 enterprises in more than 100 countries — across all major functions, in every industry and enterprise size.

To learn more about how we help decision makers fuel the future of business, visit **gartner.com.**