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Unlocking cash from your balance sheet

Opportunities to free up cash may be hiding in plain sight. Here are six strategies for releasing cash from your balance sheet.

by Ojas Shah and Zachary Silverman

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A company's income statement is typically the first stop for management teams seeking ways to reduce debt-to-equity ratios, improve profitability, and increase resilience. That's for good reason: creating long-term value requires sustainable growth, as well as changes to margins and cost structure. Yet few companies give much thought to the assets and liabilities on a balance sheet that can unlock lucrative opportunities.[1] Here are six proven strategies to consider.

Analyze receivables and payables

Many companies treat working capital simply as the cost of doing business. In our experience, few consider the negative impact of extended customer terms, tight payment cycles, and high inventory levels on true economic value. That's why a thorough analysis of previous years' transactions usually reveals process gaps, unfavorable and unnecessary terms with customers and vendors, and other near-term opportunities to improve working capital.

By closing gaps caused by slow invoicing, weak collections policies, early payments to vendors, inefficient payment processes, and out-of-market terms, a company can typically reduce its cash-conversion cycle, freeing up cash to make investments, reduce debt, pay dividends, and fund mergers and acquisitions. For example, a global agricultural-products company conducted a transaction-level analysis as part of a broad effort to achieve best-in-class improvements in working capital. The results helped it design new product- and region-specific initiatives to transform its order-to-cash process, as well as various category-specific measures and process improvements to extend the procure-to-pay cycle.

Reimagine or divest underperforming long-term assets

Sizable opportunities to release cash may also exist further down the asset ledger. An analytical look at the returns generated by investments in property, plants, and equipment—among other long-term assets—can single out stranded or noncore assets that detract from performance. Those assets can then be sold or repurposed, improving results by freeing up cash through the deployment of assets to higher-value activities and delaying planned capital expenditures.

One North American distribution company eager to reduce its debt-to-equity ratio and deploy its capital investments in a way that would yield higher returns used an ROIC framework to determine which assets and business units were performing well and could deliver more, and which were not and should receive less investment or be divested. An analysis of the relative performance of businesses and assets indicated that there was a wide dispersion around the company's aggregate ROIC—some were performing better and some far worse. The company identified where to invest and prioritized its list of underperformers by assessing how easily each business could achieve its target ROIC, as well as the ways in which each divestment could adversely affect liquidity or the remaining businesses.

Recover 'trapped' cash and accelerate returns from partnerships

Companies often find that not every dollar on the balance sheet is equal; cash may be sitting in foreign jurisdictions without an operationally or tax-efficient way to deploy it. Regularly reviewing cash balances, requirements, and transfers globally may free this "trapped" cash and put it to productive uses, such as capital expenditure.

Similarly, companies may participate in joint ventures (JVs) or other partnerships that deliver cash dividends, but those dividends might not be sent in a timely manner. This is effectively the same as trapped cash: it is cash that belongs to the company but is not truly available. As part of a thorough review of its balance sheet, a global engineering and construction company identified a number of JVs that owed cash payments. Following the review, the company was able to capture the

[1] Christian Grube, Sun-You Park, and Jakob Rüden, "Moving from cash preservation to cash excellence for the next normal," September 29, 2020, McKinsey.com.

cash it was owed and also establish a regular cycle for collecting cash more quickly in the future.

In addition, better global cash management can reduce business complexity and urgent cash transfers. In a recent review of its global cash and bank account structure, one telecommunications provider realized that only about 50 percent of the cash on its balance sheet was truly accessible because of local account restrictions and other transaction frictions. The company reformed its cash-management practices and bank account structures globally, allowing it to have much greater access to this trapped cash, deploy it to profitable activities, and reduce the provider's reliance on external funding.

Manage credit support strategically

Many businesses require credit support—such as cash collateral, letters of credit, and surety bonds—on a regular basis for a wide range of commercial and regulatory purposes. However, while these tools often soak up precious liquidity, many companies pay little attention to them. A high-performing treasury function, often in conjunction with the legal function, can improve a company's liquidity position by providing strategic insights into credit support in multiple dimensions.

First, the company should review all credit-support requirements on a regular basis (at least quarterly) to determine if existing credit support is still required. For instance, if a project requiring cash collateral is now complete, the cash collateral should be returned. Second, for the credit support that is required, the company should identify the most capital-efficient way to provide it. For some, this can mean replacing cash collateral with a letter of credit that does not affect revolver availability; for others, it can mean replacing a letter of credit with a surety bond that does not require further collateral.

Recently, a large, independent power producer undertook such a review of its credit support. It had posted more than $250 million to commercial and regulatory counterparties, and due to ownership changes, credit support had not been a focus. The result of the review was significant: the company was able to recover more than $50 million in cash within weeks and another $50 million within six months.

Reduce long-term operating liabilities

Assets are not the only opportunities for releasing cash. A pool of cash to invest in high-performing business ventures or to distribute to shareholders can be amassed by reducing long-term liabilities, including environmental ones. While the actions required for environmental compliance do not change, a company may be able to reduce—or better manage—its liabilities by examining underlying assumptions. If credit support in the form of cash or letters of credit exists for a given liability, a company may also be able to improve liquidity.

During a recent review of environmental obligations, one US power producer discovered that its balance sheet included several oversize obligations and failed to account for completed reclamation and remediation work. The company worked with regulators to revise its environmental liabilities and then secured less costly credit support for them. A similar review of long-term, postemployment obligations would likely highlight additional opportunities to free up cash.

Companies that schedule robust, regular reviews of their balance sheets can increase working capital and convert underperforming assets and capital-consuming liabilities into accessible cash. Together, these changes can finance M&A, research and development, and capital expenditures; strengthen resilience; and increase distributions to shareholders.

Identify alternatives for funding of pension obligations

Many mature global companies have significant pension and employee-benefit obligations. Those with future defined-benefit obligations face uncertainty regarding the amount and timing of those obligations. These companies have a range of alternatives to the status quo, including liability-driven investing; modifying existing defined-benefit plans; freezing the defined-benefit plan and converting it to a defined-contribution plan; adopting a cash balance plan; or combining several of these options. Of course, these are major decisions that affect a range of stakeholders—not the least of which are employees and retirees. But companies have been successful in executing such transitions.

Recently, a large US retailer eliminated several billion dollars of pension liability for 30,000 employees by transferring the liability entirely to an annuity provider in conjunction with a plan termination. The retirees covered by this plan will receive the same pension benefit on the same schedule as they currently receive or that they expected to receive in the future. While the transaction did not provide cash to the retailer today, it eliminated future funding requirements and volatility. The annuity provider will seek to profit by earning a return on the pension assets in excess of its required payouts to the retirees.

These opportunities are proven strategies to release cash from the balance sheet in the right situations. If they're not sustained, however, companies can find themselves in the same position they were in before they released cash. In our experience, a robust capability-building program, in tandem with the cash-release execution, is critical to sustaining impact. Furthermore, this involves building the capabilities not just of the finance and treasury functions but also across the business so that the entire organization considers the balance sheet on a daily basis.

Ojas Shah is a partner in McKinsey's New Jersey office, and **Zachary Silverman** is a partner in the Atlanta office.