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Managing in a downturn

Jean Pousson offers some suggestions to organisations as the economy slows down

Jean Pousson

How quickly things change. A year ago the phrase credit crunch could have been mistaken for a particular type of cereal.

Today a Google search delivers 7.3 million hits.Economists for once agree on one thing, the economy is slowing! As a result the dynamics of industries will change. Businesses will have to do things differently. Executives and managers will have to make do with an even more uncertain business landscape.

Some hints and tips:
Relook at the strategic/business plan:
The assumptions which underpinned strategic options over a year ago may no longer be relevant. Is the current strategy still robust? Never before has past success been such a poor proxy for future performance. Every single assumption behind the strategy will need revisiting.

Customers' and suppliers' solvency will need to be re-examined as well.
Competitors have been known to behave irrationally in times of distress. What is the craziest thing that your competitor could do? Are you prepared for that? Is your source of competitive advantage still relevant?

Finances:
Financially what are the pressure points? Could you fight a price war? What level of revenues drop could you afford? Could you sustain your clients slowing down their payment patterns? Don't focus on aggressive cost cutting as the panacea of all panaceas. Cost cutting is like surgery; it corrects a wrong — no more! Although some frugality may be required please ensure that this activity does not consume people's time.

Cost cutting is not strategy. Do not destroy the fabric of the business with indiscriminate and frenzied attempts to reduce the cost base at the exclusion of everything else.

Although I firmly subscribe to the: "don't need it don't spent it" view, soft and easy areas of cost containment like advertising and management training should be resisted.

Focus on cash. Monitor cash flows far more than usual. Make sure that the sources and uses of cash are well understood. Forecasts need to be finessed and regularly watched. There can be no surprises there. Don't be scared to consider the worst case scenario and stress test the impact.

Risks:
Re-assess the risk profile of your business. The dynamics have changed. Distressed economic conditions and new business models bring about new and different types of business risks.Are the risks fully understood? Is the impact understood as well? Monetise the risks ie calculate impact on profitability, cash flows and solvency levels. Are mitigation actions sufficient?
Risk is often viewed as a containment exercise only. Think about the strategic opportunities that economic slowdowns tend to bring.

Banks:
Communicate far more than usual with your banks. Make sure that loan covenants are ok. Flood them with information about your business. You need to make sure that they fully understand your business, its risks, and that they are assured of your continued success (or survival!)

Go and fetch them to come and have a look at you. Let them have a wonder and see for themselves by chatting to any staff member. Give them financial information quickly and efficiently.

Banks are nervous too so don't add to their nervousness by withholding information from them.

Diagnosis:
Einsten once famously remarked: "current problems cannot be solved by current thinking because in all probability current thinking is the reason behind current problems!"

Therefore get fresh and objective perspectives as to the issues facing your business. There are a million reasons as to why executives and managers may be too close and too involved to identify the real problems. Good consultants and independent non executive directors can be very valuable assets in times like these.

Good luck!

Legislation is no substitute for good credit management

In about 1993 I attended an Institute of Credit Management conference in London. One of the speakers, Stan Mendham of the Forum of Private Businesses, was preaching the need for legislation to compel big companies to pay small suppliers promptly. I thought it a waste of time and that small businesses would be too timid to use it.

Question time came at the end of the speech and I asked "what benefit is it to me in accumulating interest on an overdue account when I need cash flow – to be paid?" Stan Mendham brushed aside my scepticism.

Five years later The Late Payment of Commercial Debts (Interest) Act 1998 was introduced. Predictably it has helped very few small businesses improve their cash flow.

According to Bacs, the organisation owned by leading banks and building societies, 80pc of small and medium-sized businesses are failing to use the legislation. Well blow me down. How ungrateful of them.

It has been reported that Trade bodies think tougher measures should be introduced. One idea is for government inspectors to carry out spot checks on big companies to see if bills have been paid on time. Can you believe it?

From where will these inspectors come? Will they be carefully selected from the current hundreds of thousands of civil servants? Will the government have a recruitment drive? I can picture the job advertisement headline in the newspaper: "Reciprocal Fiscal Interchange Facilitators".

Bruce Bosworth

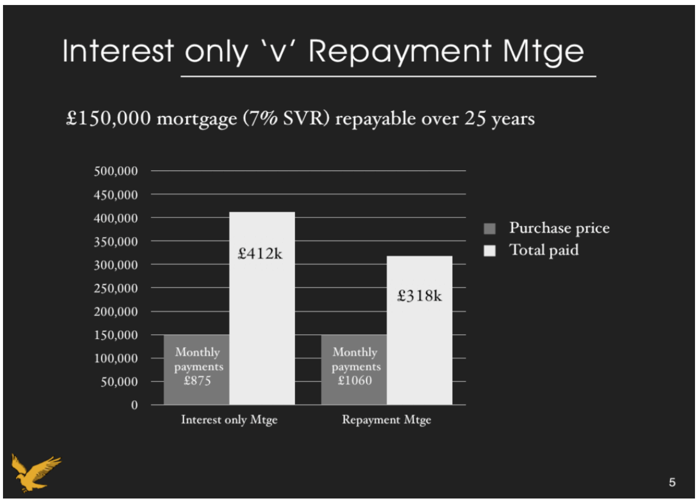
And what will the government inspectors do if they find an overdue account. Will they do a debt collection job on behalf of the supplier? Will they sort out the dispute that is causing the delay? Will they examine the conditions of sale and purchase of the buyer and seller and act as arbitrators? Perhaps they will issue a slow payment fine against the debtor.

Small businesses already have the laws and advice necessary to support them in their credit control procedures. If they cannot do good business no civil servant will be able to improve their prospects.

… and so to the next financial crisis

The next consumer financial crisis will occur about 2025 - 2030. Why? Because a slump historically occurs every 10 - 15 years. Also that is when many interest only mortgages will mature and many householders will not have the means to repay the capital amount when the mortgage term ends. During this current financial debacle many mortgage holders cannot afford to pay their monthly repayment mortgage. To reduce their monthly mortgage payments they are changing to interest only. The intention of course is to resort to a full repayment mortgage as soon as times improve; but how many people will?

In 2002 there were 531,800 first-time buyers of which 6pc (32,000) were interest only mortgages. In 2007 there were 357,500 first-time buyers of which 20pc (72,600) were interest only mortgages. These statistics are easily found but figures that are not available are the number of people converting existing repayment mortgages to interest only mortgages to avoid court action against them.



The chart shows how much more costly a repayment mortgage is compared with a repayment mortgage. The monthly interest payments over 25 years amount to £262,500. Then you need to find another £150,000 to repay the capital amount. Don't spend the next two decades kidding yourself you bought a house for £150.000.

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