Time for a checkup

How to analyze operations and focus on strengths during an economic downturn

Interviewed by Kristen Hampshire

There is no better time than now to perform a wellness checkup of your business — take the pulse, determine your organization's strengths and weaknesses and determine what processes, products, people and other factors could inhibit your success in the coming year. Companies that fine-tune operations and focus on their core competencies will weather the economic storm.

"If you are investing in areas of your business where there are opportunities, your company will do well now and on the other side of this economic downturn when some of the competition will not be there," says Barry H. Worth, member, turnaround services, Brown Smith Wallace LLC. "The survivors will have stronger processes, products and more cohesive management teams."

A vast market correction like the one we are experiencing now is a golden opportunity for businesses to get an edge on the competition, to develop and refine internal processes, improve products and services, and strengthen their balance sheets.

Smart Business discussed how to conduct an internal checkup and why the economic downturn presents opportunities for proactive companies at a round table with Worth; Bill Willbrand, member, tax and accounting; Robin Bell, member, tax and accounting; and Ted Flom, member, risk services.

Barry H. Worth
Member
Brown Smith Wallace LLC

Bill Willbrand
Member
Brown Smith Wallace LLC

How can a market correction actually help strengthen a business?

We don't want to discount the tough road ahead. But, these times present opportunities for companies to become better managed and positioned now and for the future. Over the years, many companies have become complacent, growing the business without looking at internal processes. A downturn like this forces a 'clean piece of paper' approach to management, enabling companies to identify strengths and weaknesses and start fresh. A market correction forces businesses to reassess and recommit to goals and accept change.

What mistakes do companies tend to make during tough economic times?

Many companies err by not spending the necessary time or resources to identify and address underlying business problems. During tough times, these issues often become worse and can ultimately present a big risk to companies. Businesses today need increased attention and commitment. Managers must step up to understand problems, reassess risks and identify solutions immediately, before they get out of hand. The biggest mistake is ignoring operational inefficiencies and taking a 'wait and see' approach in a challenging economy.

Another key mistake is immediate cost cutting without proper analysis. Many businesses trim marketing or human resources first. But without marketing, a business is not positioned to gain market share and build its prospect list. When the economy rebounds, the company should be positioned to move full force, ahead of the competition. Assuming that the organization is lean, eliminating even more people will discourage the existing work force and could compel valuable employees — workers you want to keep — to look elsewhere for jobs. Be very careful when trimming these costs.

Instead, evaluate your customer base and product lines. Evaluate profit margins to ensure your pricing is adequate and all products are profitable. Are there customers that cost more to keep than they return to your bottom line? Are there product lines that should be discontinued? Review outstanding accounts receivables and determine whether a customer is too risky for you to continue serving. Recognize that uncollected accounts receivable is money you are loaning out to customers for free. And the older the invoice, the less likely a customer is to pay. Don't forget about effectively managing inventory levels. Every dollar of inventory is a dollar that could be invested elsewhere to help revitalize your business.

What are some of the early signs of a troubled company?

If your company is experiencing these 'symptoms,' stop and take a close look at your operations. Signs of trouble include: tightening cash flow, increasing and longer aging of receivables, building inventories, dwindling credit lines, declining debt/equity ratio, decreasing profit margins, diminishing sales and missed sales forecasts, lost clients and market share, increasing overhead costs, and declining quick and current ratios.

What strategies will position a business for success when the market improves down the road?

If you only focus on survival, you will most likely miss opportunities to capitalize on the upswing. This is a time when companies need to critically analyze their operations and put together a plan to position themselves to manage risks and capitalize on opportunities. A strong balance sheet can help a company capitalize on opportunities.

After identifying risks, areas for improvement and opportunities, call a meeting with managers and key operating employees to discuss findings and form a task force of individuals who are committed and will implement the plan. This task force should include management and key operating employees as well as trusted advisers, e.g., bankers and CPAs.

Your plan should address cash flow. Prepare a forecast at least 90 days out and keep it rolling one quarter ahead. Analyze assets that can be converted to cash, such as accounts receivables, dead or slow-moving inventory, and nonproducing property and equipment. Analyze debt and, if needed, contact key creditors to begin working out extended payment schedules and terms for current purchases. Keep lines of credit. This is challenging in today's banking environment, but take steps to preserve your lending relationship and share this plan with your banker. Finally, determine whether your company will need to access new capital to work the plan. Will you need a partner to get you through this period? Some options may include bringing on an individual investor (active or passive), venture capitalist, private equity group or bank SBIC.

How should businesses preserve and nurture relationships with lenders?

Keep lenders informed about the health of your business and share your operating plan with them. Identify the weak spots in your organization that you will improve, share with lenders what critical success factors will drive your business forward in this economy, and explain to them where cash flow opportunities exist. Ultimately, lenders want to know that the lines of credit they extend will be paid back. Assure them that your company is capable of doing so by involving them in the development of your plan. Bankers can be valuable advisers.

What planning is critical as businesses close out 2008 and prepare for the challenges that lie ahead?

First and foremost, businesses need to perform a thorough self-assessment — look at your strengths, weaknesses, opportunities and threats using a tool such as our 'Business Health Checkup.' Using this assessment, management can establish goals and a plan to move the company forward and position it for the future. Management must be brutally honest in this exercise. Bringing in an outside adviser can help bring objectivity as well as expertise to this effort. Putting together an effective plan will be the foundation of your company's long-term success.

Robin Bell
Member
Brown Smith Wallace LLC

Ted Flom
Member
Brown Smith Wallace LLC

What items should managers address as part of a business health checkup?

Critically evaluate how the downturn impacts your business. Look for risks and opportunities, review strategic priorities and reassess your commitment to them.

Some of the steps we recommend are to:

- Assess revenue streams for risks and opportunities. What happens to revenue if you change nothing? Where can margins be improved? What products/services should be discontinued? Which customer relationships should be reassessed? What opportunities would add market share through marketing, geographic expansion, etc.? What opportunities will arise due to situations with competitors (cheap acquisition, bad customer service, etc.)?
- Evaluate debt and capital structure.
- Analyze the quality of your assets.
- Assess working capital structure and identify ways to improve ratios.
- Examine relationships with customers, manage receivables, and exit unprofitable customer relationships.
- Analyze cost structure and determine where there are opportunities to tighten expenditures; consider the implications of budget reductions.
- Look for opportunities to renegotiate contracts to more favorable terms.
- Examine and strengthen budgeting, planning and forecasting practices.
- Consider tax planning opportunities and implications.
- Evaluate the effectiveness and efficiency of existing processes.
- Identify the company's critical success factors, and put in place tools to measure whether those are being achieved.
- Understand critical business risks, and put in place contingency plans when appropriate (e.g., what if you lose your largest customer or product sales drop dramatically?).
- Evaluate your team to determine if everyone can contribute to the success of the company. Consider whether there may be opportunities to attract top talent to your organization.

What's next, and how long will this economic downturn last?

If only we had a crystal ball. The fact of the matter is businesses should not concentrate on when the economy will rebound. They should concentrate on fine-tuning operations and doing what's best for their business now. Certainly, we are in uncharted waters, and we are going through some times now that economists with decades of experience have never seen. We cannot predict when the economy will rebound, but it's safe to say that we have a long road ahead of us.

With that in mind, businesses must focus on the long term. Relying on reports that the economy will improve by the fourth quarter or second quarter or several months from now causes some businesses to 'wait and see' and not give their organizations the attention needed to weather the economic storm. Do not put planning on hold in hopes of good times ahead. Certainly, the economy will make a comeback. Companies that prepare for that during challenging times will come out of this time stronger, leaner and positioned for success. Seek help from the outside for financial, planning and analytical expertise — and gain an objective opinion while assessing operations and data. Most of all, don't wait to start this process. Now is the time to take action so you can fully embrace current and future opportunities. <<

BARRY H. WORTH is a member at Brown Smith Wallace LLC. Reach him at (314) 983-1202 or bworth@bswllc.com. **BILL WILLBRAND** is a member at Brown Smith Wallace LLC. Reach him at (636) 754-0200 or billw@bswllc.com. **ROBIN BELL** is a member at Brown Smith Wallace LLC. Reach her at (314) 983-1217 or RBell@bswllc.com. **TED FLOM** is a member at Brown Smith Wallace LLC. Reach him at (314) 983-1294 or TFlom@bswllc.com.