

MANAGING IN HARD TIMES – 2009 AND BEYOND

the first of a series in corporate survival

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Imagine one of these happening to your company:

- your sales rapidly drop by more than 25%
- your top customer shuts down and files for bankruptcy
- more than 50% of your accounts receivable suddenly become past due
- market prices of your products plunge by at least 20%
- your bank does not renew your main credit line
- your main bank is closed down, more than 40% of your company's cash and investments are trapped inside
- more than 50% of the value of your company's investments in securities and other instruments vanish overnight

The recession is not a question of if or when, but how it will hurt or destroy your business and industry. Are you ready for the inevitable? Will you take these lying down as they start to wreck your business, or will your management remain in blissful denial stage (“these can’t happen to us because they have not happened before” or “we’re too big to fail” attitude)? I recently asked the marketing head of major firm if she is willing to present to management a forecast of a 25% decrease in sales. She said “never”. I asked why. “I’ll get fired for doing so” was her frank response. It seems that self-preservation and mutual destruction are two sides of the same coin.

You cannot stop an economic crisis, but you can stop it from causing a corporate crisis. The economy will always change from bad to better – the question is that will your company be still around when it does. It’s time for defensive management, to quickly prepare and execute plans under the worst scenarios. Don’t waste time listening to others analyze what went wrong with the global economy and who’s to blame. When the silent tsunami makes landfall, the least prepared and those still in denial will be washed away with their illusions of invincibility and good management. The point is to survive the

bottom of the economic cycle and wait out the storm. Economic downswings are usually rapid, and the upswings are slow. Staying power is therefore key.

My first job after college was turning around a small company after a classmate convinced me it was a better option and learning experience than joining a big firm, working up the ladder while ministering to your boss, growing in age and pay but not wisdom, and eventually retiring into oblivion. My first book “Quality Means Survival” (Prentice-Hall, 1997) was a turnaround book about how to deal with the Japanese threat using their own weapon – Quality. Japan was causing a global crisis from the 70’s to the 90’s by grabbing markets until then dominated by established companies and countries caught sleeping with bad quality. My second book “Turnaround Management – Best Practices from the Indonesian Experience” (Asian Institute of Management, 2005) talks about successful turnaround lessons from Indonesian firms which survived the 1997 Asian Financial Crisis. It’s tempting to write a turnaround book about the ongoing 2009 global recession, but in the interest of timely relevance, I decided to write a series of articles on the subject while the economic bloodbath is still raging and worsening worldwide.

Media and politicians are now focusing on how to bail out Wall Street and Main Street or their counterparts in other countries undergoing recession. In the limelight are big financial institutions, select industries with lobby power, and homeowners. But nobody is talking about helping legions of similarly threatened and distressed companies and industries around the world – big and small – which are not high-profile and whose demise has no immediate or obvious political and social consequence to those in power. Many are now at a loss on how to swim in uncharted waters. Who will help them? Actually no one but themselves. Right now they are just waiting to be clobbered or hoping the asteroid that hit faraway Wall Street will not affect them. Flying boulders will not, but the dark dust clouds that are spreading rapidly from this impact point will, as they cool and stifle economies world wide, spreading gloom and doom. This article is for businesses, big and small, which will never get bailout money and will never be in the news except as part of statistics of casualties.

Traditional strategic planning models will not be very useful and relevant during a recession, wherein companies fight for survival in two fronts: dwindling demand and sales, and dwindling cash – both thanks to dwindling credit. Conventional competitive strategy and analysis teach how to steal market share from competitors and outflank them

with so called differentiating and niche strategies, or leaving them behind to decimate each other, as you swim to your pristine blue ocean. During hard times however, oceans of all colors, red or blue, dry up with the evaporation of spending power. In a recession when the total industry pie is shrinking rapidly, maintaining as well as increasing market share or share of the pie won't do much to maintain sales at profitable or even break-even levels. Therefore, the only way to maintain profitability and have your heads above water, is not by attempting to increase current sales but by quickly reducing break even point and slashing fixed costs or looking for other salable things to sell during hard times. Exceptions are businesses luckily positioned at the low end of the market, which survive with increased sales as consumers trade down from high-end to low-end products and services (e.g. McDonald's, Wal-Mart). As companies scramble for cash and prop up liquidity, serious threats would come more from creditors and customers, than from the traditionally feared competitors. Companies used to sparring only with competitors during good times, will find it difficult to spar this time with creditors and customers for survival. Creditors like banks may limit and stop credit lines and customers may stop or delay payments to conserve cash. Highly leveraged corporate borrowers and cash-strapped suppliers, particularly those at the bottom of the supply chain or food chain, suddenly become endangered species.

Balanced scorecards would be ineffective roadmaps in a recession, if not a luxury. Postpone your balancing act for a while and focus on your weakest link and biggest leaks. Thomas Edison once said "Show me a thoroughly satisfied man and I will show you a failure." In times of crisis, we can restate this profound thought as "Show me a thoroughly balanced company and I will show you a failure (waiting to happen)." Redo your SWOT (strengths, weaknesses, opportunities, and threats) analysis. Recession changes the rules and playing field. Your current major strengths may become irrelevant, while your minor strength may turn out to be your life saver. Some of your lingering weaknesses may be magnified and mortally cripple your company (e.g. over-leveraging, bloated receivables, spiraling health care costs, overstaffing). Threats you normally take for granted may suddenly become real and wipe out your business while opportunities may take new forms.

This article will examine these important survival strategies:

- Cut the right cost
- Conserve and protect your cash

- Keep your clients and core business
- Ask all stakeholders to help save the company

CUT THE RIGHT COST

Reduce break-even sales. Big companies increase their risk by raising their breakeven sales through reckless expansion, thinking that the economy will never falter. If your break even sales is more than 75% of your current sales, you are a bankruptcy waiting to happen in an economic meltdown. Warren Buffet warns us of this weakness of seemingly powerful companies: “It's only when the tide goes out that you learn who's been swimming naked.” Initial recession data show that sales slump across industries range from 20% - 50% decrease, and worsening as news of pay and hiring freeze, layoffs, shutdowns, closures, bankruptcy filings mount. If you are not confident your company can survive this dismal level for at least a year, its time to switch gears to survival mode. To cut break-even sales, cut costs, but not any cost. Cut fixed costs but not variable cost which you can and must do later. When sales drop, variable costs – high and low - also drop, but not fixed costs. In a crunch, fixed costs are much more relevant and threatening than variable costs and are often the root cause of liquidity problems that lead to bankruptcy. But don't cut any fixed cost mindlessly - cut only the unnecessary fixed costs. Cut the right costs with the right amount. For example, don't cut fixed costs that may reduce sales and alienate your few remaining liquid customers - e.g. front-liners and customer service facilities. Don't cut fixed costs that assure the quality that defines your product, services, and brand. The last thing you want do is shoot yourself in the foot by cutting costs and losing more sales as a consequence. The few remaining viable customers and buyers want great respect and almost royal attention when they knock on your doors, visit your showroom, call you or send you an email. They know their bargaining power in times of crisis and will not be amused when you send them shoddy goods or when nobody pays instant attention to their needs and inquiries because you have dramatically downsized your frontline personnel.

Convert as much fixed costs as you legally and strategically can to variable costs, primarily by purchasing from outside or outsourcing. But outsource carefully, selectively, and intelligently. Make sure none of your critical BPO providers do not go belly up during the recession. Remember the cost structure of BPO's is almost pure fixed costs (high break-even). They themselves do not outsource in order to capture all the value at

the bottom of the supply chain. All the fixed costs their clients pass on to BPO's become their gigantic fixed costs – rent, depreciation, manpower, health care, equipment, and infrastructure. BPO's wonderful growth-oriented business model is most vulnerable to declining sales due to recession. The loss of a single big account by your BPO provider may jeopardize its servicing of your account.

Downsize, cut capacity. Close underperforming branches and stores and perennially subsidized businesses. Normally, in downsizing, we release the new employees first using the LIFO principle (Last in First out) and/or those at the bottom of the competency list. Any list will always have a bottom, so it is just a question which names will unfortunately be pushed down there. By convention, we actually reward loyal and productive people by letting them keep their jobs. You may also want to consider an alternative strategy: letting go of the good employees first. This may sound counterintuitive but actually it makes a lot of sense from my experience in studying an assembly plant in Asia that opened my eyes to this technique. In the first place, why keep these over-qualified highly paid people do mostly boring and repetitive work remaining in a trimmed down company. Why not let the less qualified, less competent ones do these routine tasks? Now what you want to do is set up a new company with a new value proposition that these displaced talents can profitably run and manage. They can partner with their original employer in setting up this venture. So you shoot two birds with one stone by firing the good guys: you significantly cut the manpower cost of the company, and increase its sales and profits, courtesy of the newly formed affiliate run by former employees. The director of the assembly plant I mentioned trimmed its workforce not by reducing the semi-skilled assembly workers but by letting go its highly skilled mechanics in its mould making department. The company then helped these mechanics set up a new mould making venture that eventually supplied moulds to the assembly plant and third parties as customers.

Cut waste and be a firm believer this time in doing so, and not just a casual reader of those Toyota books. Better yet, be paranoid about wastes. Andy Grove's battle cry was "Only the Paranoid Survives" when he was turning around Intel during its mid-80's crisis due to Japanese competition. To survive the recession, companies must become lean –fast – like the boxer who must shed pounds quickly to qualify for a match category or else lose by default on fight night. All forms of waste must be identified and eliminated – low hanging or otherwise. We are not just talking about operational wastefulness, but also strategic wastefulness. Operational wastes include excess people,

inventory, equipment, and excessive use of resources that are hidden by high sales during boom times. Strategic wastes are unprofitable products, divisions, business units, ventures, investments, and affiliates that are hidden by subsidies coming from high sales of core businesses. Companies guilty of strategic wastefulness are those which over-diversify, over-expand, over-invest without much thought and deliberation because being cash rich, they think they can always afford to make expensive mistakes from these ventures and adventures. They unwittingly increase their break even sales which would eventually haunt them when sales subside. When there is a two-digit drop in sales, as in a recession, these mistakes are quickly exposed. Toyota uses the water analogy to explain this unmasking principle: Only when the level of water in a stream comes down can you see the rocks. Water here is sales, and rocks are the hidden wastes primarily in the form of excess production, inventory, or investments. This reminds us of Warren Buffet's "swimming naked" metaphor and the old saying "Anybody can steer a ship in calm waters."

During an economic downturn, it is usually too late to create and demand a waste-conscious culture from all since this means a fast drastic change in life-style and way of thinking by management and employees alike. A wasteful organization led by a wasteful management cannot change overnight after having been pampered by uninterrupted years of prosperity, high growth, wage hikes, bonuses, and dividends. But as they say, it is better late than never. Waste elimination and prevention should not be considered just a project and program for the duration of the crisis. It should continue and develop into a permanent culture or way of life even after recession is over and the economy has recovered. A sustainable waste-conscious culture serves to crisis-proof your organization against the impact of future economic downturns. It is your insurance. Lean companies are recession proof or, at the very least, recession resistant. Lean companies would most likely weather the recession. Keep in mind that lean times demand lean thinking and lean living.

CONSERVE AND PROTECT YOUR CASH

Conserve cash. Cash is king in good and bad times. Maximize use of resources. Try to get as much from your idle resources without spending anything. Shut down subsidized businesses that burn cash. Let go of so called "strategic businesses" that have yet to show results, and pull the plug off "incubating businesses" that burn cash. Drop

cash draining loss leaders, missionary routes, and pure cost centers. Do not de-leverage. Don't pre-terminate your loan if your account is current. Interest rates dramatically come down close to nil in a recession or depression. De-leveraging or reduction of debt/equity ratio is only for banks and other ailing companies begging for government bailout money as a pre-condition. So don't unnecessarily solve the liquidity problem of your creditors unless they legitimately call your loan. Conserve your meager cash for day-to-day operations to pay for your essential fixed costs to survive.

Protect your cash. Move assets to more stable, more liquid though lower earning instruments. Don't put all your eggs in one basket. "Let the investor / depositor beware" could be a principle as life-saving as "Let the buyer beware" during these uncertain times. Spread and diversify your investments and deposits among several trusted banks. Make sure you have around four for five so that if one gets into trouble and locks in your company's funds indefinitely, you are not operationally crippled. Recent events demonstrate that size, reputation, track record, history, nor brand equity do not matter in determining the trustworthiness and stability of modern-day financial institutions – investment as well as commercial banks. Even established financial and accounting institutions have imploded, liquidated, broken apart, or sought refuge not only during this current recession but in the past decades. The reason, I believe, is that management, greedy to fatten their pockets, has put aside the values and traditions of the company's original founders. The track record of a financial institution may have been flawless for decades or even hundreds of years, but top managements have short tenure, short memory, and short term goals. They could not care less about the bank's great, accomplishments in the past and what happens to it and its clients' money long after they have exited with their golden parachutes. The actions of financial institutions are subject to the laws of binomial probability, the same that governs the outcomes of tossing coins. Toss a coin. Head or tail will always have an equal chance of coming out, regardless of the outcomes or patterns of outcomes in previous tosses. This probabilistic amnesia also decides whether your next child will be a boy or girl, or whether your bank will collapse or not next month even after decades of uninterrupted profitability and industry leadership. So where do you keep your company's hard earned cash and funds? Since past data are unreliable and financial institutions have no memories, you should also erase any positive or previous image of these companies from your memory.

Do your own homework and due diligence from the start as if you don't know these institutions. Since the bank's size, reputation, and history do not matter, do not just

assess the bank, but also its current managements (not past managements) for trustworthiness. Remember that banking and finance service is based on trust. Once that trust is betrayed, it is never recovered. Avoid banks whose current management has a track record of investing in toxic assets and papers and risking your money with maverick, irresponsible practices. Do not rely on the puny insurance that will not help you any if your bank is liquidated. Don't trust credit rating agencies to blow their whistles and warn you. Don't rely on regulatory agencies to watch over your deposits and investments. They are only good in investigation after the fact but not preventing financial disasters and scams. Check or demand to know your bank's current capital adequacy ratios and other critical indicators of stability and sound practice. Make sure they are way above the required regulatory minimums. Avoid those banks which just play around or near these legal minimums. Avoid banks with huge and questionable off-balance sheet accounts and assets, and those which divert funds from its core business. Off-balance sheet businesses have proven to be the Achilles heels of many well-established banks. Mistrust banks with sizeable loans to the bank's directors, officers, stockholders and related interests like affiliates and subsidiaries – even if within the maximum regulatory limits. The business of the banks' affiliates and subsidiaries would likely be hit by the recession. The unwritten rule in a crisis is that banks would protect and prioritize their own affiliates ahead of their clients and minority shareholders. Finally to protect your cash, day-to-day guarding and collection of accounts receivables are essential – making sure they remain current during the recession.

KEEP YOUR CLIENTS AND CORE BUSINESS

Keep and take good care of good clients, and let go of all the bad ones. In a crunch, customers, stakeholders who are normally helpful allies and partners, become threats the moment they develop their own liquidity problems. To save themselves, they may not pay you on time or at all and may keep your money indefinitely – some hoping you fold up before they do. A report most companies do not have in spite of overstuffed IT and accounting departments, comes in handy. It's called client or account profitability analysis report which tells us, as the names implies, how much total profit each client brings to the company every year after buying its goods and services. In a growing economy and times of prosperity, this report is deemed by many as irrelevant and a luxury (costly and complex) to prepare. What only matters is that all customers together, regardless of individual contribution, deliver the fat bottom line or net profit after tax

which make top management glow and gloat, and shareholders contended with uninterrupted dividends. In a downturn however, this blindness will only serve to delay the quick weeding out of losing accounts to make a turnaround or rescue plan succeed. Unprofitable accounts may steal your profits, cash (by not paying on time), and capital (by not paying at all). Try to keep and get clients from industries that are recession-proof or recession-resistant. Past due account receivables in an economic downturn may be an industry problem, and not client specific. An industry sector badly hit by the recession may cause severe liquidity problems in all its players – regardless of their track record of prompt payments.

Protect your core business. Don't starve it by having it subsidize unprofitable non-core businesses. However, if your core business gets a direct hit from the recession, (e.g. discretionary, high ticket merchandise), quickly find and nurture a sustainable non-core business into your next core business or cash generator. Meanwhile, until your core market recovers, creatively develop crisis-products you can sell during the recession to offset the lower demand for your core products. For example, come out with low-end, affordable products and services if your current products and services are pricey and discretionary in nature. Develop and sell a new service that will support or complement the products your customers now have and can't afford to buy more of.

ASK ALL STAKEHOLDERS TO HELP

Prepare employees for the worst. Admonish those who will remain to make supreme but constructive sacrifices for the company. Tell them "this is not a drill" and that the party's over. Everybody must do his part, and not be a drag. In a leaking boat, everybody must either row to reach the shore or scoop water out. Excess baggage, analysts and observers are jettisoned. Those who choose or were chosen to remain, regardless of rank or tenure, must do door-to-door selling, collection of current and past due receivables, or find ways and means for the company to save money. Remember employees and managers agreeing to pay cuts or pay freeze are still a drag to the company if they cannot and do not do constructive, rehabilitative work to keep the company afloat. Letting them sweep the floor is also unproductive unless you can cut outsourced housekeeping costs. Keep in mind that unproductive assets, however cheap, are still wastes.

Partner with competitors and forge non-aggression pacts during these hard times. Band together to save your industry. Fight your common threats rather than each other at least until the crisis is over. Protect your shared supply chain from buckling. Partner with suppliers. Surprisingly, suppliers, who you have pitted against each other to get the lowest price deal and squeezed and starved with slow, stretched payments, can be life-saving allies in an economic crunch. Find new strengths, new savings and new value streams across your supply chain.

Finally make your board work. Your board should be a working board, a thinking board, and sounding board of management. The board should not just nod at everything management has done and plans to do. For instance, the CEO together with the CFO would more likely defend management's past actions, and assure all that the ongoing economic crisis won't adversely affect the company because the strategies and safeguards they have put in place. A thinking board would always take these self-serving pronouncements with a grain of salt, and grill the two officers. The board's independent directors in particular should be more active in protecting the interest of all shareholders especially the minority shareholders, clients, and society at large from the inimical acts and plans of management. Had they been doing their jobs and discharging their oversight responsibility, the sour and scam investments of many companies would have been uncovered earlier and perhaps prevented. Independent directors, having the heaviest social responsibility in the board, should not be yes-men of management and the majority directors. They should not just hop from one board meeting to another, collecting per diem envelopes. In the end, bad management can only come from a bad board.

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