

## Financial Survival in 2009: New Disciplines for Weathering the Storm

*Many entrepreneurs can be likened to a skipper of a ship — without a navigator. With troubled waters expected ahead in 2009, charting course and weathering storms will necessitate a dynamic, comprehensive plan based on the best intelligence, with contingency plans ready to go if conditions worsen. The process of developing and maintaining an integrated financial planning model with detailed cash forecasting offers greater discipline, combined with better forecasting, to chart a successful course, enable course corrections and propel the business forward.*

By Bruce Mallory, Managing Partner  
Platinum Group

What are you doing to prepare for a tough year? It may be the toughest year yet for many businesses.

It's not unusual that entrepreneurs see themselves as the skippers of their boats and solo navigators of business decisions. With rough waters ahead in 2009, resolve to develop new disciplines to chart a successful course and make course corrections in advance of looming dangers. Survival depends upon timely information and discipline in order to map out comprehensive financial projections.

The problem most entrepreneurial skippers have is reliance upon sales figures only to build a budget and measure their performance. Yet, predicting revenue and income is only one-third of the equation. An integrated financial planning model ties together three essential forecasts to generate a map or plan: income statement, balance sheet and cash flow statement.

A good financial planning model presents a new discipline that goes beyond thinking that 2009 sales will be flat or merely down by 10 or 20 percent. It's a tool for making decisions before the storm hits.

### **Trends, Assumptions**

A computer-based planning model — tailored to each business — is built around a series of assumptions and allows for tracking actual results against these assumptions, thereby providing timely feedback to make more solid decisions and to weather extreme marketplace changes. Assumptions should be based on factual data and take into account recent trends in the business. For example, if customer payments are slowing in a tough economy, the assumption for “number of days’ sales in receivables” will need to be increased in the model.

The planning model also incorporates a series of “what ifs” for developing both a Plan A and Plan B in rough waters. What if customers pay 10 days slower than last year? What if vendors tighten credit terms? What if inventory turns more slowly as customer orders decline? Businesses that are more exposed to industries where the end product is a “consumer discretionary item” need to take note of all of these assumptions and more.

One area in need of attention in many companies comes from buying habits that impact inventory levels. People in the purchasing function receive computer alerts to order more inventory when levels are low, based on an assumed sales rate. However, if an item is being sold or used less frequently in today's market, there may be excess ordering if someone has not gone into the computer to change the assumptions that are driving the purchasing behavior. Without the discipline to review assumptions, inventory levels will climb at a faster rate than needed to support revenue and can cause a strain with cash flow, vendor relationships and the bank lines of credit.

"Cash is king" in these conditions; it is critical to review the dynamic correlation between the income statement, cash flow and balance sheet changes and a good planning model can do this automatically.

### **Deeper Due Diligence**

What can be done to prepare for these challenging times? Ideas can come from a deeper level of due diligence, such as:

- Visit customers — Discover what is going to impact the business of your top 20 customers in 2009. This cannot be done in a vacuum through guesswork. You need to look customers in the eye, ask how they see 2009 and whether or not your assumptions are correct. Stay close to see how their promises compare to actual results.
- Rank vendors — Tighten up critical vendor relationships by consciously reducing the number of vendors in 2009. By working with your most important vendors, it offers assurance of future business to them and shows that "we're all in this boat together." These key vendors will want to support you with additional credit in these tough times. Then be proactive by going to selected vendors early in the year and asking for notes payable for greater buying time and cash flow. (Don't wait until vendors are hounding you with collection calls.) This can provide cash by spreading the payables over the course of the year (with interest) versus using bank credit to pay vendors. This is a key strategy to avoid tapping out your bank line and building credibility with your vendors.
- Reduce offerings — As a result of reducing vendors, also plan to reduce the number of product offerings in 2009 based on the 80/20 rule of best sellers. With fewer products, inventory dollar investment and banking needs are reduced. This can get businesses out of a cash bind.

### **First-Quarter Exercise**

An integrated monthly financial planning model, combined with a 13-week cash flow model, enforces discipline on the skipper for reviewing reports and forecasts on a weekly basis and measuring actual results to performance. This depth of current information offers more

insight and comfort that there's smooth sailing ahead, or a need to talk to your financing sources proactively, instead of reactively.

A critical first-quarter exercise is to ask: "What cost reductions may need to be found for a break-even cash flow?" Entrepreneurs are eternal optimists. Many skippers are hoping that 2009 will be the same as 2008 — not worse. But if sales are 20 percent off from 2008, how is the business going to survive? The model can help determine what to cut now and what additional cuts need to be made if "hoped for milestones" are not achieved by March 31.

One company that practiced a disciplined weekly review for constantly revising projections by 30% percent found savings through changing compensation plans, taking payroll deductions, stopping a 401K match, and closing a location.

Another company found over a \$1MM of cash flow improvement and reduction of fixed costs by \$200K through improved inventory management, reducing inventory levels greatly and abandoning two rented warehouses.

Key business trends to watch in 2009, especially in the first quarter, include the average days outstanding in A/R, inventory levels, customer returns, and order backlog level. Any significant changes in these key indicators versus plans are "red flags" that a "Plan B" is likely needed to be implemented soon.

### **More Hands on Deck**

Navigation via an integrated financial planning model is possible with a CFO on deck that has the experience to build a good computer model based on constantly monitored assumptions. Not many in the bookkeeper or even Controller role are adequately experienced to develop and adjust such planning tools. Skippers who have access to monthly numbers that take four weeks to close are at a disadvantage for making timely course corrections.

An example of how a financial planning model works is a business that fell victim to the housing market downturn and dropped 10 percent in 2006 and 2007 revenues. In this case, a well meaning Controller provided monthly financial statements that allowed the CEO (skipper) to react to monthly numbers. He was looking behind instead of ahead, which did not allow for planning or course corrections. What's more, both had little understanding of the dynamics of cash flow under asset based lending or of fixed versus variable costs.

Platinum Group came on deck in at the end of 2007 to develop a multi-location financial planning model that rolled up to a total business view, which allowed us to review various "what if?" scenarios for individual cost changes at the nine locations. The model identified fixed versus variable costs and properly related these to sales in order to predict income more accurately based on various revenue assumptions for the different categories of retail, homebuilder and commercial sales.

With this forward-looking information, a 15 percent fixed cost reduction was identified for achieving a break-even point, which was critical to know to stay afloat, a surprise to the management team. The modeling allowed us to see how various changes — a combination of raising specific prices to improve margins and reducing certain fixed costs — would achieve the 15 percent reduction.

Fixed costs that could be reduced in 2008 included major changes in the compensation program for salespeople, plus reductions in staff and some discretionary expenses. When combined with more predictable income from various revenue assumptions and raising prices on selected products, the business improved its gross margin by 1.5 percent to achieve break even. What's more, a full year of cash flow benefits were reaped by negotiating vendor notes; monthly on-time note payments over the past year raised the credibility of this business with its vendors, which will continue to be a benefit in this tough economy. With the increased credibility gained through the successful 2008 program, the vendors have signed up for new notes in 2009 to again help with the cash flow in difficult times.

The challenge for skippers in 2009 is to go beyond an income statement/annual budget forecast by taking a more disciplined approach and building a complete financial projection with 13 week rolling cash projections with the CFO or experienced advisor. Once developed, these tools can be used year after year to develop plans and navigate change.

Without a good navigator and these navigational tools, even the best of skippers may run aground or be lost at sea in these stormy times.

###

Bruce Mallory is managing partner of Platinum Group, an interim management, consulting and investment group that leads privately held companies through critical transitions. The firm has invested in, managed and/or advised more than 500 companies in the Upper Midwest. Platinum Group was awarded the "Transaction of the Year" award in 2008 by the Upper Midwest Chapter of the Turnaround Management Association. For more information, visit [www.theplatinumgrp.com](http://www.theplatinumgrp.com) or email [bruce@pllc.com](mailto:bruce@pllc.com)