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Rule Number One: Keep your eye on the ball

Conventional wisdom holds that at any given time a golfer should have no more than 3,000 pointers on the perfect swing in mind while trying to hit the ball. Similarly, CEOs, company directors and management teams have literally thousands of concepts, warning signs, key performance indicators, duties and obligations to bear in mind every second of every day – this is more focused in the current economic climate.

Maintaining a focus on all of these issues – in addition to actually running a business, managing a workforce and staying on top of compliance – is increasingly difficult.

This edition of *Ferriers Focus*, attempts to distil the many issues into a handful of manageable concepts and provide a roadmap for responsible management in these times of heightened concern over financial health.



In any economy, business failure is inevitable for a certain percentage of the corporate sector. The commercial landscape is a competitive and frequently changing environment which inevitably leads to business models, products and at times entire industries being rendered unsustainable. This is even more pronounced during times of economic uncertainty when management teams are challenged in new ways. It is during times like these that business management skills can make the difference.

There are a number of common characteristics of businesses that minimise the risk of failure. These themes separate the businesses that fail from those that not only survive but have an opportunity to thrive. While nothing can replace strong and decisive management, there are some additional factors which can help to reduce the risk of business failure.

To avoid financial distress:

- Be in business for a valid reason.
- Know how you are, where you are and where you're going.
- Communicate effectively and appropriately.

Be in business for a valid reason

A business needs to be innovative, outwardly focused and aware of its environment in order to anticipate change – this is how a business puts itself in a position to remain relevant to the market. Directors and management should continually challenge what their business is doing and its relevance to the marketplace. Take the example of a typewriter manufacturer facing the fallout from the switch to computers. An outward-looking business would have at the early signs of market

change been exploring options that would embrace change such as using the business's existing machinery, skills and people with a slightly different business model to suit the new digital environment.

In an upwardly-moving economic cycle, management constantly makes adjustments to its business to take advantage of opportunities and remain competitive. In a downward cycle businesses need to be doing exactly the same thing. Management has to frequently and aggressively challenge the business model before the market does it for you.

Remain relevant:

- Be responsive to an actual/perceived need.
- Continually assess, improve and refine your business model. Challenge your business before circumstances do.
- Maintain awareness of the marketplace, competitors and customer needs.
- Remember that business is not lifestyle support.
- Protect the intellectual property you have developed.
- Engage in continual improvement, upgrading and monitoring.

Know how you are, where you are and where you are going

Directors and management must understand the state of the business – its performance and financial position – on a real-time basis. This means implementing, maintaining and using good management information systems that management can easily access and understand. Key items that must be readily accessible are the cash position and short-term cash flow, creditor and debtor positions, capital expenditure budget and financial commitments, as well as sales, gross and net profit.

Successful businesses are forward looking and aim to see beyond the economic cycles, their own industry or market cycles and plan for them. By adopting this approach as a matter of habit, it is easier to weather the inevitable business cycles.

As an example, over the last ten years the credit environment has been extremely benign. Asset

prices have steadily risen and stock market returns have been high. In this environment, the concept of “lazy assets” became relevant. If a manufacturing business owned a building worth \$1 million, rather than carry that asset on the balance sheet and it generating no return, the building may be sold, and the proceeds invested to reduce debt and provide working capital or simply to invest. This seems logical, except that if the stock market falls and sales decline the business might not generate sufficient revenue to allow it to pay the rent. Such a short-term strategy leaves the business poorly placed to manage a change in circumstances.

Management needs to know where its business is going. This can only be achieved by being forward focussed rather than backward looking.

Plan ahead:

- Have a strategy that is achievable and a business model that is sustainable. If required, seek professional input.
- Actively engage in budgeting, planning and cash flow forecasting.
- Ensure sufficient working capital to keep the business running.
- Recognise the importance of quality financial information and management information systems. Look for completeness, validity and accuracy.
- Set clear medium and long-term plans with achievable milestones and targets.
- Keep up to date with the mundane – BAS returns, accounts, bank reconciliations – these are critical if there is to be effective use of budgeting, planning and forecasting and are frequently the difference between success and failure.

Communicate effectively and appropriately

Having effective communication engenders trust from key stakeholders, employees, suppliers, trade creditors and financiers. Trust builds support, and if the people you employ, buy from and sell to, borrow from or deal with on a day-to-day basis believe that they know what is going on with your business because you would tell them if you had a problem, they will be more likely to provide support when you need it.

This means discussing difficult issues and being prepared to implement difficult changes: reducing headcount due to poor performance or telling suppliers that you need extended trading terms due to poor cash flow. For your employees communication is critical – they know when a business is in difficulty and it is better to let them know why you are taking action rather than let them become demotivated, or potentially destructive to your business.

Communicate and engage:

- Be open, honest and straightforward.
- Develop and maintain established channels.
- Take care of your customers and suppliers.
- Take care of your employees – establish plans to involve, empower and reward staff.
- Identify stakeholders important to your business and communicate with them habitually.

Addressing financial distress: Key factors

There are many reasons businesses find themselves in financial distress. Sometimes it is due to management's lack of focus on key business drivers, a failure to pay proper regard to margins, incorrect or inadequate systems for managing working capital, or simply inappropriate financing structures.

But the most important thing for directors who have identified the warning signs is to respond appropriately. In our experience, there are some easily identifiable response characteristics that separate the survivors from victims.

Addressing financial distress:

- Walk towards the pain.
- Don't restructure yourself out of business: design sustainable restructures.
- Communicate effectively: remain straightforward and honest.
- Get advice and consider all options.

Walk towards the pain

It is important you don't try to hide the fact the business is facing challenges – acknowledge the challenges and engender support by facing them

pro-actively. This will be appreciated by your customers, suppliers and financiers.

It is critical that management does not leave it too late to seek assistance. If you think you may have an issue, call in professionals for a corporate health check. Like your own health, early diagnosis of any issue increases the chances of recovery. Ultimately, if management is pro-active it controls the process rather than allowing external parties take control (eg: by taking legal action for the recovery of a debt).

Open and honest communication can facilitate this. Management must not shy away from having the tough conversations. If supplier accounts cannot be paid, tell them why and work with them to find a mutual solution. If business performance is flagging, let employees know, tell them what you are doing about it and turn the situation into a challenge to be overcome with a clear strategy, action plan and goals. Remember: when you are communicating with your stakeholders you are in control of the message, which avoids the damage of rumours.

Sustainable restructuring

When formulating a restructuring plan, it is important to differentiate between stabilisation/damage control, and long-term goals. For example, in order to stabilise a distressed business, management may temporarily negotiate 120-day terms with suppliers or dramatically reduce headcount. This may be useful in the short-term, but it may not be a realistic long-term solution: suppliers won't continue to support the business and it will be understaffed. Any restructuring plan or business rescue package needs to recognise this: restructuring needs to be designed to be realistic and sustainable.

Be sustainable:

- Retain key talent.
- Set realistic cash flows and forecasts based on achievable results.
- Consider all stakeholders, and build a business plan stakeholders can believe in.
- Set reasonable trading terms.

Get advice and consider all options

Anyone able to bring all these concepts together will be armed with the right tools to deal with financial stress. Stabilising a distressed business requires disciplined planning, financial and analytical skills applied under pressure together with strong communication skills. Getting assistance from experienced professionals may be the key to effectively managing a turnaround plan.

Action plan:

- Stabilise the business.
- Identify underlying problems.
- Develop a restructuring plan.
- Implement the plan.

In some cases, a more formal approach is required and Voluntary Administration may need to be considered as part of an overall strategy. Entering administration allows the directors to put everything on hold while an experienced and independent practitioner assesses whether the business can be saved and the form that this may take.

For people in positions of financial stress, it is important to remember that professional advisers should not be regarded as a cost but as an investment in the future potential of the company. The right professional adviser should add value by assisting people and companies to navigate through the difficult waters of financial distress.



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