

Four Cs are keys to surviving the recession

By **JEFFREY C. JONES**

A year and a half ago, I wrote an article (“It’s time to prepare for the coming storm,” RBJ, 8/31/2007) warning that a tidal wave of liquidity in the economy was burying risk and giving too many businesses a false sense of security. The article provided a “hurricane checklist” to help businesses ready themselves for a downturn.

Well, this storm has turned out to be a doozy. The free flow of credit has slowed to a trickle, and by every economic measure the trough our economy has entered will be deep. The only thing certain as 2008 comes to a close is that no one knows exactly what will happen—how low the stock market will go, how long the recession will last, how much money the federal government will spend bailing out companies in trouble.

The federal bailouts of banks, insurance companies and likely the auto industry add a new layer of uncertainty. Firms that receive federal aid, as well as the suppliers and customers who depend on them, have additional variables to consider. When will the money come, and with what restrictions? How much will it be? And will the government’s support truly make things right again, or just delay the inevitable?

All of this means it is past time to prepare your checklist. The name of the game now is survival, and the rules can be summarized by four Cs:

- Confronting the challenge
- Contingency planning
- Conserving cash
- Cultivating credit

Confronting the problem sounds like a no-brainer. In one sense, we can’t escape it. Bad financial news seems to hit us in the face every time we click open the RBJ Daily Report, turn on CNBC or read our 401(k) statements. But too many of the CEOs and managers my firm works with remain in a state of denial regarding their own organi-

zations. Things aren’t too bad at the moment, and with any luck the economy will start turning around soon, so why not put off any significant changes until the picture becomes clearer?

The answer is simple: Waiting until the bad times hit is bad for your business. With very few exceptions, there are only two kinds of employers in the world today—those who are already being squeezed hard by this recession, and those who are about to be. If you manage a firm or a department, the sooner you start dealing with it, the better off you *and* your employees will be in the long run.



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That leads to the second rule of survival, contingency planning. Suppose you’re looking at a 5 percent decline in year-to-date sales over the past three months. That’s likely not a calamity. But what will you do if that decline becomes 15 percent over the next three months, or 50 percent three months after that? Managers need to think through their options and have a plan in place to address a wide range of scenarios. Ideally, you’ll have spent some intensive hours developing strategies that never need to be used. But if the worst happens, you will be in far better shape adjusting a plan that’s already developed, rather than making it up on the fly while you’re under intense pressure.

As part of the plan, managers should be sure to think about vendors and suppliers as well as customers. Do you know how their businesses are faring? If a key supplier goes under, how will it affect your ability to deliver your product or service? A good contingency plan will identify alternate sources in case they’re needed. Investing in key suppliers, in exchange for cost concessions, is another option to consider.

Rule No. 3 builds on one of the oldest axioms in business: Cash is king, and never more so than during a recession. Given the uncertainties of credit, businesses need to manage their operations on a cash

basis to the greatest extent possible. That makes cash flow modeling and liquidity forecasting more important than ever. It also requires firms to manage working capital, defined as inventory and receivables minus payables, more aggressively than ever before.

That can be a challenge for manufacturing businesses, where inventories naturally climb whenever sales start to decline. At first, it may not seem like a big deal, or even like a good idea—a little extra inventory will make it easy to respond quickly when the economy turns around. We encourage businesses to take the opposite view and to see every piece of unused inventory as a little pile of wasted cash, sitting on a shelf instead of helping to pay the bills and keep the operation healthy.

The same rule applies to service firms, where the inventory is primarily human capital. Managers need to make sure that the number of employees matches the volume of business. As painful as layoffs are, remember that losing a few people today to keep the business healthy is better than letting the whole business fail tomorrow, putting more people out of work.

Along with keeping inventory lean, optimizing working capital requires businesses to be more aggressive than ever in collecting receivables. Bill promptly, follow up frequently and enforce payment terms. Your business is not a bank, and you don’t need to extend customers free credit by allowing them not to pay their bills on time. On the payables side, delay sending cash out as long as possible without incurring penalties or risking vendor relationships.

As your business works to improve cash flow, rule No. 3 recognizes that credit is a resource that can be cultivated, even when financial markets are struggling. As the saying goes, “In good times my banker takes me to lunch; in hard times, I take my banker to lunch.” It’s important for current creditors to understand your business, and to have a relationship that will help you to navigate troubled times more easily.

Another credit-cultivation tool is to evaluate your existing bank covenants based on

your business forecasts, rather than past performance. If your business is likely to blow a covenant based on forecasts, talk to the bank now, and try to get the covenant changed. Similarly, it's a good idea to initiate renewal of credit facilities early, perhaps 12 to 18 months ahead of the current term elapsing. That will give you time to prepare for new covenants and restrictions, and to find alternate sources of credit if

needed. Many community banks and credit unions, for example, have more resources available as worried consumers invest their savings closer to home.

As 2008 draws to a close, it appears certain that the economy will get worse before it gets better. More people will be laid off, more businesses will suffer losses, and many won't make it through this steep downturn. But as surely as winter turns to

spring, times will get better. Businesses that understand the four Cs have the opportunity not only to survive, but to come out stronger when the sun shines again.

Jeffrey C. Jones is president and CEO of JC Jones & Associates LLC, which assists firms in profit improvement and turnaround, business restructuring, mergers and acquisitions, information technology and compliance services.