Grant Thornton

An instinct for growth™

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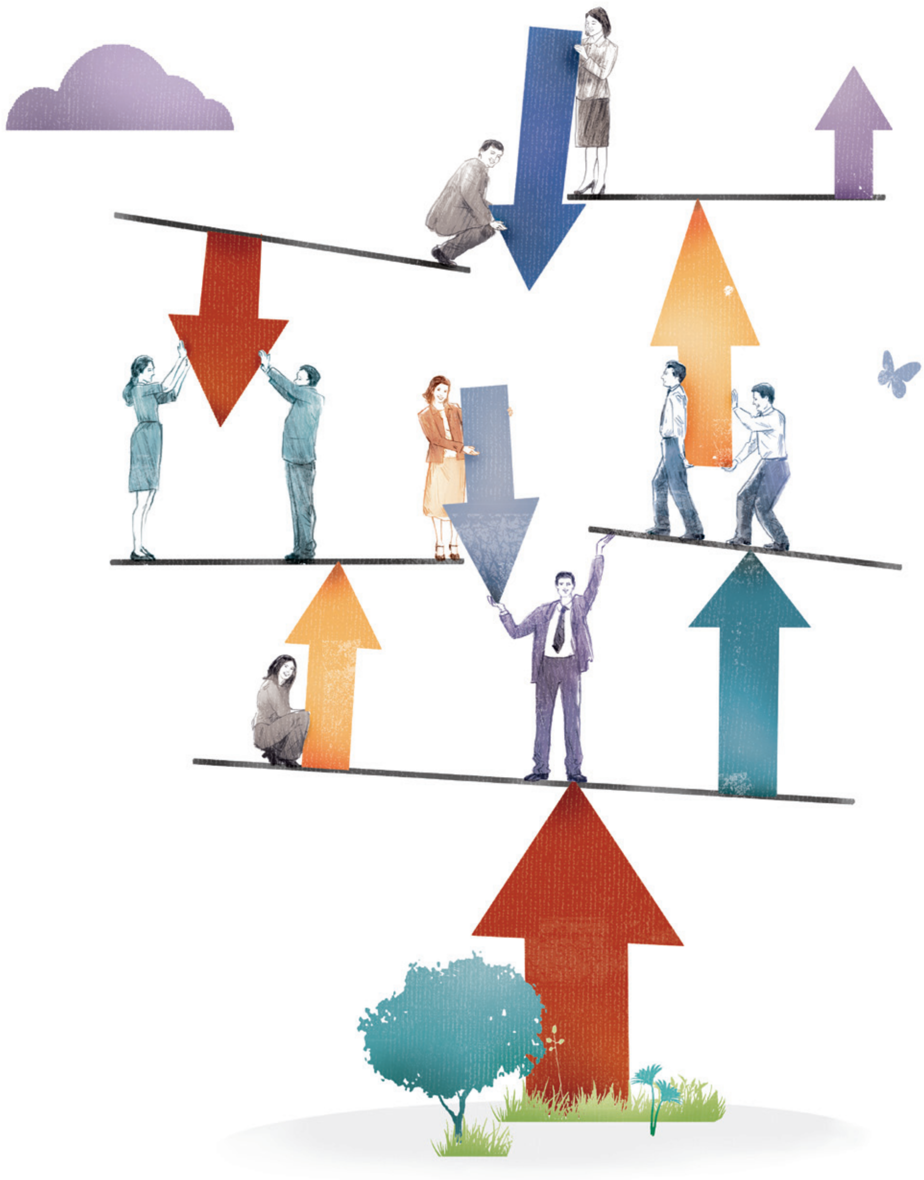
Growth in a difficult economic climate:
A practical guide



“The global economic landscape has changed considerably over the past few years with the GFC continuing to impact economies around the world. Governments are considering new reforms and legislation, whilst businesses are learning from past experiences and moving quickly to capture new opportunities and advantages.

Australia, less impacted than the majority of major economies, is now in a more forward looking position. Now is a time for entrepreneurs to gather their learnings and embed sound practices into their businesses. For Australian operators wishing to expand overseas, ensuring that your home base has a solid foundation is critical. While some regions and sectors are proving more resilient than others, it is prudent to consider all your options to strengthen your business.

With uncertainty comes opportunity. Our 10 point check provides some quick reminders that may help you to improve your readiness to capitalise on them.”

Michael Pittendrigh
National Head of Privately Held Business

A 10 point readiness check

Cash is king
Get closer to your bank
Be relentless on cost control
Re-visit your strategy
Get smarter on tax
Sanity check new investment plans
Keep an eye out for bargains
Align performance and rewards
Retain your talent
Protect your personal wealth

Cash is king

> "If you still have cash on the balance sheet, you've always got somewhere to go, and will have a greater degree of flexibility in your decision making."
>
> **Michael Pittendrigh**
> National Head of Privately Held Business

What is the issue?

The old adage stands – turnover is vanity, profit is sanity and cash is reality. In a tough market, it's probable that everything will remain slow. Debtors can pay less quickly, turnover can be flat and margins are pressured. Banks become less inclined to lend. In short, cash is limited.

Your ability to conserve and control cash, will be critical and management needs to be relentless in its focus on this.

What can you do?

"Undertake a critical analysis of the business at this point. Establish what the short-term cash requirements are and then forecast longer-term cash flows based on credible and realistic financial information. If you can't produce this from the information you have, bring in outside help. You need to get underneath the first layer of information to reveal the true picture," suggests Paul Billingham, National Head of Financal Advisory.

Importantly, you need to monitor performance against projections and your forecasts need to be fluid. To generate cash more quickly, negotiate longer credit terms with suppliers and shorter terms with customers. Focus on the key metrics, such as debtor days, creditor days and stock turns.

It costs money to hold stock. Manage your stock cycles as efficiently as possible by employing just-in-time stock replacement to keep levels to a minimum and by clearing out old dead stock to generate cash. In the short-term, profit may need to be sacrificed in order to generate cash.

"You could increase prices to reduce volumes and increase profits, which in turn will reduce your working capital requirements and hence cash usage. Of course, this needs to be judiciously operated with a keen eye on price elasticity. If you lose all your sales you have no business," says Michael Pittendrigh, National Head of Privately Held Business.

What to avoid?

"Shortcuts. Be disciplined and do the hard work in evaluating whether a new business opportunity has a positive impact on your working capital position. Make sure your instinct is supported by a strong business case," comments Craig Lawson, Partner, Privately Held Business.

Before taking on new customers check their credit worthiness and strictly apply credit terms by strongly chasing payments. Resolve queries on any invoices very quickly, as these can cause unwanted delays.

2 Get closer to your bank

"Take a hard look at your reporting and accounting systems. If these are weak and do not quite show what you and the bank need to know, think seriously about improving them, quickly."

Tony Markwell
Partner, Privately Held Business
Brisbane

What's the issue?

Banks continue to be cautious and concerned with bad debt in the current environment, so will need greater persuasion to lend you more money if you need it. In many areas, new lending will be severely restricted and you may struggle to re-finance existing facilities. The banks will focus increasingly on the quality of their loan book, and their key concern will be loan recoverability.

What can you do?

Treat your banker as a partner in the business. Keep them fully informed of what is going on and the decisions you are taking and give them lots of notice if you need help. Banks only make money by lending money – they want you to prosper so they can continue to lend money to you. Proactively manage your relationship with them. The last thing a bank wants is to receive one week's notice that you need to double your overdraft facility.

If you do need to go back to the bank, discuss this with your advisers. Draw on their knowledge and independence to improve the credibility of you plans.

If you are looking to re-finance, also consider alternative sources of finance. An asset based lender may enable you to leverage more funds out of existing assets. If you are importing, there may be trade finance, or stock finance available.

What to avoid?

Don't fall into the trap of thinking that it is up to the bank to guide you through any issues or problems. If you talk to your bank early enough, they may work through the problem with you, but be very clear that the ultimate responsibility for resolving any issues falls squarely on management's shoulders.

3

Be relentless on cost control

> “Look hard at discretionary spend, and pick off the easy wins in areas such as travel, general expenses, hospitality and entertaining.”
>
> **Dale Ryan**
> Partner, Privately Held Business
> Adelaide

What's the issue?

You will want to at least maintain your current level of profit, which may require you to review how you cut costs. Whilst we are now in a more forward looking environment always remember in the good times, costs can escalate with little challenge.

What can you do?

There is a natural tendency to look at costs from a top-down approach, but a bottom-up approach may be best. Employ zero-based budgeting to review all costs very carefully in terms of their value to the business. What costs do you actually need to run this business? And run it well?

Leave no stone unturned and review every commitment. Some will be difficult to flex in the short-term, but others may offer scope for savings.

Carefully consider two major areas of cost: tax and people (see points 5 and 9).

Take the opportunity where possible to re-negotiate lease terms and capital equipment utilisation.

Pay attention to variable costs too, including reviews of raw material and consumables costs.

Spot markets rise at times of cancelled contracts, which can add significantly to the bottom line in many industries. Take steps to guarantee supply so that when the market opportunity comes you are able to respond.

What to avoid?

“Understand and manage your marketing expenditure. While this is traditionally seen as easy to limit or restrict, doing so can have a significant impact on your competitive position, especially when market conditions begin to pick up. It can become a matter of having to try harder to grab the business,” remarks Michael Pittendrigh.

4 Re-visit your strategy

What's the issue?

Tough trading conditions will demand a clear strategy combined with focused and relentless management to implement that strategy. When market conditions change rapidly, you can't assume that your existing product and market strategy will continue to be successful. Changing market conditions are often a catalyst for revisiting difficult strategic decisions.

This is not the time for your strategy to drift off course, but equally you may need to stop and think, and take a fresh look at your business.

What can you do?

"You need a crystal clear understanding of your core capabilities, the strengths of the business and where your best opportunities exist. This clarity of focus will enhance your ability to take advantage of opportunities as they emerge," says Tony Markwell.

Be selective in the acquisition of assets and management of surplus, non-core assets. Non-core business streams can consume much needed working capital and the sale will also generate cash.

Combine available market research with existing financial information on year-on-year performance and comparisons with budget. Determine which product lines, sectors and customers are likely to put pressure on your profitability, and which present the better tactical opportunities in the short term. There is no better time to review business performance in this way, as it will help you to focus your resources more effectively.

If you have liquidity or access to investment funds, look at acquiring assets, expertise or a local competitor.

"In uncertain times, trade barriers can retrench or relax depending upon the government, creating new opportunities that you may have discounted previously. Similarly, shifts in the currency markets can quickly create a better environment for exports," comments Michael Pittendrigh.

What to avoid?

"Yes, it is important to test assumptions and re-visit strategy but don't feel you need to change the whole business model overnight. If your strategy is a good one, hold your nerve, manage effectively and keep the faith," says Bill Shew, a Sydney based Partner of Privately Held Business.

5

Get smarter on tax

What's the issue?

Tax, in its various forms, is usually one of the biggest overheads in the business and you need to look carefully at how to manage that cost.

What can you do?

The accounting method you choose for GST has a large impact on the cash flow of your business.

If the turnover of your business does not exceed $2m per year, you are able to account for GST on a cash basis, meaning that you only remit GST on income you have actually received and only claim GST on expenses that you have actually paid. This is particularly relevant for those businesses with a delay between invoicing and receiving payment for an invoice.

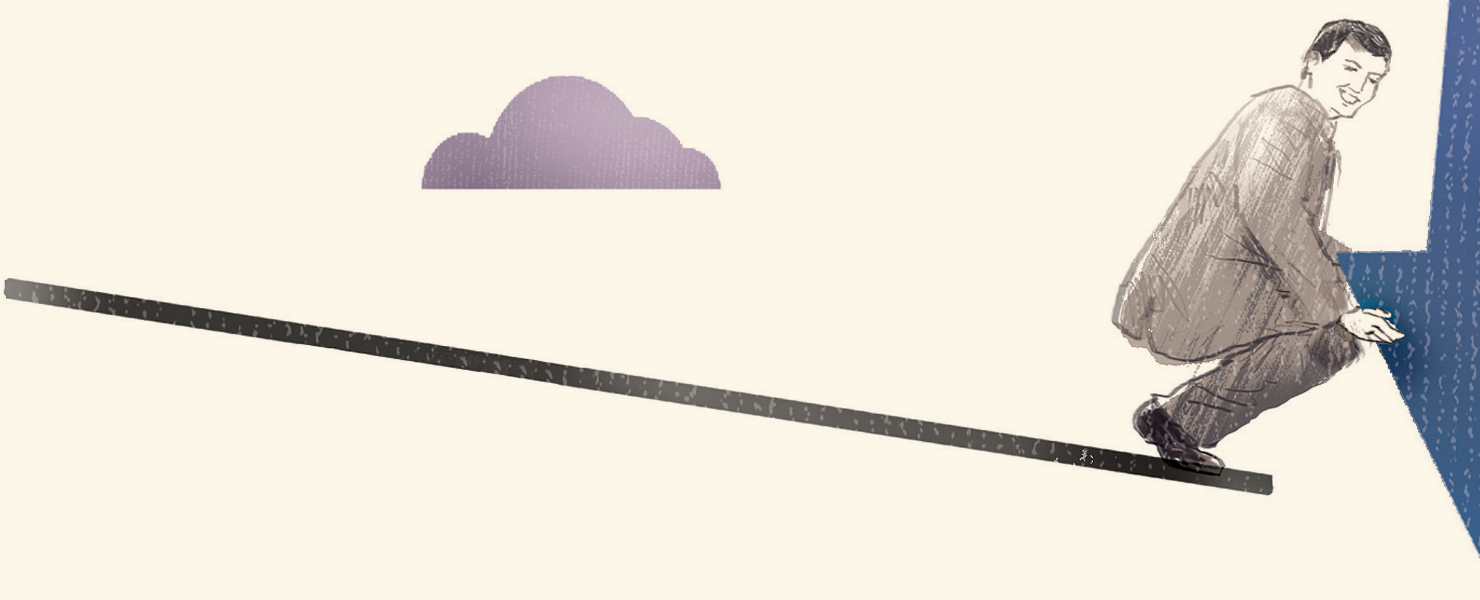
Make sure you maximise depreciation and capital allowance claims, particularly for new acquisitions – including property acquisitions.

Consider the way that you remunerate yourself as the business owner. You may be able to achieve direct and indirect tax savings.

As a business owner, consider your superannuation strategies. As your business grows, consider whether your existing structure is still optimal.

What to avoid?

The last thing that you should do is fall behind with your tax payments and compliance requirements. Substantial penalties can be applied in the event of late payments and late lodgements. Continue to make payments to the bank and manage this relationship accordingly.



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Sanity check new investment plans

What's the issue?

Investing in new assets can sometimes bleed you of cash when you need it most. Carefully consider your investment plans, and question the proposed value and timing. Consider discounted cash flow analysis where warranted.

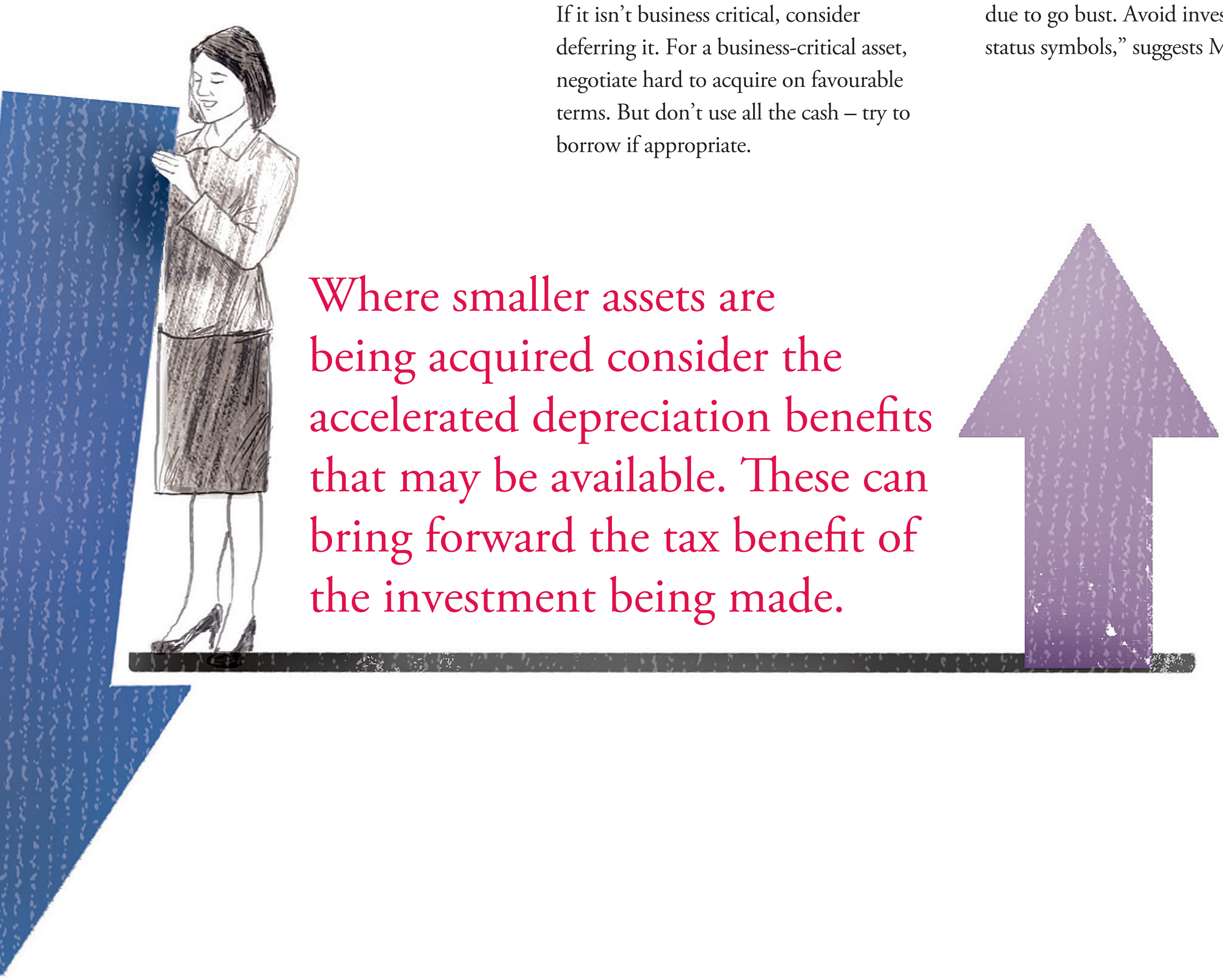
What can you do?

If it isn't business critical, consider deferring it. For a business-critical asset, negotiate hard to acquire on favourable terms. But don't use all the cash – try to borrow if appropriate.

For smaller investments, "low cost" assets acquired can be pooled for depreciation purposes, which are eligible for higher depreciation rates than would be available if the asset did not form part of the pool.

What to avoid?

"It used to be said that if there was a fountain in reception and flagpole outside you were due to go bust. Avoid investing profits in status symbols," suggests Michael Pittendrigh.



Where smaller assets are being acquired consider the accelerated depreciation benefits that may be available. These can bring forward the tax benefit of the investment being made.

7

Keep an eye out for bargains

What is the issue?
The mid-market is still fuelling M&A activity. A recent survey of 600 owners and managers of privately-held businesses by Grant Thornton UK showed that, while the mega deals may be drying up, ambitious and well-funded companies continue to see the value of strategic acquisitions and are picking up bargains to supplement organic growth. An increasing number of private companies with access to funding see huge opportunities for expansion in the current climate. It is likely that there will still be funding available for the right proposition.

What can you do?
"Be alert to opportunities where business valuations are dropping and where business owners are looking for quick exits rather than trading through a more difficult economic period. However, ensure the opportunity fits within your defined market space and has a sustainable business model," says Paul Gooley, Partner, Corporate Finance.

What to avoid?
This is not the time to become distracted. Remain absolutely focused on the day-to-day running of the business. Be mindful of debt capacity and don't overstretch yourself.

Align performance and rewards

Changing rewards structures is clearly a slower burn than immediate cuts, but it can strengthen a longer-term position and can demonstrate that management is taking positive action.

What's the issue?

Look after your people. Trust that they are aligned with your goals. Motivation can take a hammering when business is lean. Once you've defined your key objectives out of strategic planning and zero-based budgeting exercises, you need to make sure staff understand and are rewarded for achieving those objectives. Ensure everyone knows the strategy and repeat it often. Align every aspect of reward to achievement of your goals.

What can you do?

Think about the behaviours you want to encourage. Consider the "golden thread" running from strategic objectives right down to individual objectives and remuneration.

Think about rewarding sales teams based on profit per unit or speed of cash flows rather than simply on units sold. Consider only paying bonuses once minimum profits and minimum cash flows have been achieved.

What to avoid?

"If you have a bonus culture, and the cash simply isn't there to make bonus payments you can't put your head in the sand. You have to be completely transparent and communicate effectively to explain the position. Consider alternatives, such as a deferred share arrangement to encourage staff to stick with you through a downturn," comments John O'Donnell, Partner, Privately Held Business in Sydney.

9 Retain your talent

> “The cost of replacing staff is high. Do what you can to retain your talent.”
>
> **Gail Curtis**
> Partner, Privately Held Business
> Perth

What’s the issue?

The major cost to many entrepreneurial businesses is labour. Cuts may have to be made. This is never an easy thing to do, and it’s important to do it as objectively as possible. At the same time you need to maintain some growth capacity and retain your talent.

What can you do?

A zero-based budgeting exercise will give you a strong steer as to what you need and at what level to support your strategic direction. Carefully consider the skills commitment and capability you will need.

Communicate well, retain integrity through the process but move quickly. Re-invigorate and re-motivate those that remain.

“Lock in your key talent using incentives and personal development plans. Don’t throw away talent unnecessarily as this may prove to be a false economy when you consider the costs of recruitment and the loss of productivity and expertise,” suggests Tony Markwell.

Make sure you take the appropriate advice, as these decisions are fraught with difficulty.

What to avoid?

You can’t allow emotion to rule your decision-making. You need reasonable and objective criteria to ensure that decisions are made that are best for the business and are not based on relationships or length of service.

10

Protect your personal wealth

What's the issue?

You need to have a clear view of how you separate your personal wealth from the finances of the business. Lenders will be asking for security, whether that is based on a business asset or on the business owner's personal property. Business owners need to be careful.

What can you do?

If you've made good profits over the years, consider how you can extract wealth out of the business (of course, consideration of the associated tax implications will be required). Careful planning is necessary – seek advice.

If you end up putting money back into the business, make sure it is your decision to do so, rather than just doing so because you have money left in there.

If you need to lend money to the business out of personal funds, rather than putting it in as an unsecured loan, consider cash backing a bank advance or taking security under a second charge after the bank. This could improve the prospects of recovering your funds if the need arises.

What to avoid?

Throwing good money after bad.

Contacts

Further advice

We are here to help. For further information and advice based on the specific issues facing your business, please contact your local Grant Thornton office.

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