



# Managing in a Downturn

Strategies for master  
navigators

**Inflation, the strong Canadian dollar, a weakened US economy and a shrinking Canadian one, dropping consumer confidence, job losses in the manufacturing sector: it's getting tough out there for Canadian businesses.**

How many of them are prepared and equipped to weather the storm, given that only a year ago, Canada's private companies were coasting on the strength of the Canadian economy, feeling confident, profitable and achieving great success, according to PwC's *Business Insights® 2007 Survey of Canadian Private Companies*? Even then, with the US slowdown already underway, the vast majority remained optimistic and unaffected. Now, many of the country's business leaders are scrambling for ways to make sure their companies are among the survivors should the current downturn continue. The good news is that there are strategies for managing in a downturn. In a worst case scenario—because realism is key—these strategies can ensure your company's survival, positioning it so that when the economy picks up, it's out of the gates right away. At best—because positive realism is also key—it can

help you take advantage of the opportunities downturns offer and come out even stronger.

"During a downturn, don't cross your fingers and count on tomorrow being a better day," says John McKenna, a partner and senior vice president in the Corporate Restructuring and Advisory practice of PricewaterhouseCoopers. "You have to be proactive and make positive changes to deal with the new economic realities we are currently experiencing." This means companies have to assess themselves with brutal honesty and detail. They need to keep a vigilant eye on the horizon, ready to identify possible coming threats and have contingency plans in place. It also means they have to have an eagle eye on internal details, constantly analyzing and reviewing what's happening—and planning for new problems that might occur. These strategies help companies remain agile

and resilient, navigating the storm with confidence, with the ability to change course quickly if necessary. “Being proactive with all parts of your business is vital. If you’re just reacting to everything, you can ‘get by’ when times are good, but in my view, you’ll ultimately end up losing when times get tougher,” says McKenna.

## **Top six long-term strategies for navigating the storm**

### **1. Know your core strategic advantages and focus on them**

- “What is it that you do best and that keeps your customers coming back to you? What drives the majority of your profitability?” asks McKenna.
- Figuring this out requires stepping out of ingrained biases and tackling sacred cows—and it doesn’t always confirm what you thought your core operations were. Whether it’s outsourcing opportunities, new technologies, or globalization, the business landscape is changing. As a result, your company’s competitive advantage from five years ago may no longer apply.
- During a downturn, core operations often continue to make money but they can be jeopardized by the non-core operations. Either shed the costly non-cores, or invest and modify them to turn them into core operations.

### **2. Know your key customers—and their risks to you**

- Identify your key customers not by who buys the most, but by which ones contribute the majority of your profits.
- Identify your risk of losing these key customers. Are they in a discretionary industry that’s typically hard hit during a recession? “If two-thirds of your key customers are exposed to the recession, then you may have a problem, and you need to plan for it,” says McKenna.
- Also try classifying them. In McKenna’s opinion, there are three main types of customers: the Loyalists, who are your best customers; the Negotiators/Demanders, who are constantly “chipping away” at you by demanding price cuts or other concessions; and the Potential Exits who, for whatever reason, may not be your customers in a year’s time. If a high percentage of key customers are Potential Exits, you need to develop strategies to deal with the risk that they might all go.

### **3. Prepare for the actions of your competitors**

- More than ever, your competitors will be targeting your business during a downturn.
- It goes without saying that you need to keep your existing customers happy by continuing to provide your goods/services as required. But it is also crucial that you increase your dialogue with

your key clients so that not only do you know what’s happening in their business, but they are aware of what is happening in your business. Keep it open and honest and if you’re dealing with problems, to the extent you can, let them know what’s happening and how you’re addressing it. “You are trying to build your customer’s confidence that you are a reliable supplier that has a future. The last thing you want is for them to have a kneejerk reaction to rumours,” says McKenna.

- Consider protecting your key employees from being snatched by competitors by creating special incentive plans that reward loyalty and seniority. Make sure your general employee incentive plans are based on the new economic realities and attainable targets: if achieving last year’s sales is the realistic goal, don’t keep your incentive goals based on doubling revenue every year.
- Increase dialogue with employees so that it’s truly a two-way flow of information, rather than just a one-way flow of instructions. Be honest with them, even if you are having problems (they likely know about them anyway). Tell them how you are dealing with these issues and how it will improve the company’s prospects. Genuine communication will strengthen their trust in the company and again should help to prevent kneejerk reactions to rumours/offers from competitors.

- Prepare for possible price cuts by your competitors to protect their market share. Do you cut your prices or can you make other changes to protect your profitability by reducing costs (e.g. reducing packaging, producing lower specification products) to facilitate a price reduction, or providing additional value with minimal incremental costs to you (e.g. extended warranty)?

#### 4. Develop a detailed budget model and update it frequently

- It is essential that you have a financial model that lets you budget your results for at least the next 12 months. Creating and updating it should not be a once-a-year event—practice makes perfect and for many companies that have made this a regular event, it's a painless process to update the budget on a monthly basis. This model must be detailed enough to model all key inputs, but flexible enough to allow scenario analysis, so you can determine exactly what the impact of financial challenges brought on by the volatile economy and marketplace will be. "You may still have a really tough problem to deal with, but having more time improves your chances of devising a solution that will work," says McKenna.

- It is essential that the model is also linked to your cash flow statement and borrowing base, so you can also assess the impact of these changes on your cash or liquidity position.

#### 5. Use a systematic approach to identify potential cost-cutting areas

- When times are good, companies can be lazy when it comes to controlling costs, but they quickly re-focus on this area when things get tougher. Avoid "across-the-board" straight percentage cost reductions, as these penalize departments that are "lean" already and often don't trim "fat" departments enough. There are a number of systematic approaches to identify potential cost-cutting areas, whether by cost type, activity or SKU. Conducting a detailed, thorough cost analysis will reveal areas for further management review and action where real sustainable savings can be extracted.
- Precise and methodical cutting leaves a company stronger and more efficient rather than struggling with missing muscle. "The long-term payback can be quite significant," says McKenna.

#### 6. Protect your liquidity

- It goes without saying that preserving liquidity (i.e. cash, unused loan facilities, the ability to raise equity or access to capital) is essential during a recession.

Be pre-emptive. If you wait until you're losing money, you're going to have a far harder time building and maintaining your liquidity.

- With your financial model and scenario analysis, you should be able to identify what additional liquidity you might need. If you know six months ahead of time that you're going to be hitting a rough patch and will need extra cash, go to your financiers now, demonstrate that you have a plan and show them how the provision of additional liquidity will safeguard their existing investments.
- As an aside, all borrowers need to recognize that the capital markets are now different. Until recently, it was a borrower's market, with lenders and other stakeholders being more lenient with respect to covenant breaches, terms and conditions and pricing—but that's no longer the case. If you have a loan maturing, or you have breached one of your financial covenants, you need to develop alternatives to deal with these less amenable stakeholders.
- Having liquidity allows you to cushion the hard hits, but it also lets you take advantage of opportunities—from purchasing new equipment at downturn prices, to buying a competitor who is in distress or has gone under.

## Top three short-term strategies

### 1. Seller beware!

- Be cautious with new customers making large orders. In a downturn, there will be companies that switch from supplier to supplier—without paying their bills. Do your homework: perform a credit history search and keep credit to a level that would not be fatal to you.
- Even if an existing customer wants a big or custom run—protect yourself. Take deposits, or progress payments to minimize your financial exposure.

### 2. Actively monitor your existing customers' accounts receivable balances

- Perform periodic reviews of your major customers' financial conditions. Update these customers' credit limits accordingly and most importantly, enforce these new limits.
- Transfer collection for overdue accounts away from sales personnel. It's very difficult to make another sale, if the same person is trying to be the "tough guy" to collect a prior sale (particularly when the sales person will make a commission on the new sale).

- Reduce your credit risk without losing customers by offering early or enhanced early settlement discounts to riskier customers. That way, you're still getting paid and you are maintaining your market share.

### 3. Prepare weekly cash flow forecasts

- Monthly financial models are useful for identifying looming big-picture issues and performing scenario analysis. But you need a more detailed weekly cash flow forecast to identify upcoming cash crunches. As a result, you should also develop a weekly cash flow forecast that covers up to a 13-week period. Every week, review and update it, investigating reasons for forecast to actual differences. "It takes time to be able to forecast cash flows accurately, but if you do it regularly, it can really help you spot problems way in advance," says McKenna.

Finally, if you do get into financial difficulty, don't ignore it. Identify and deal with issues head on as soon as you can. Problems never get better by themselves.

If you're struggling to identify the issues or how to solve them, seek professional help from advisors who specialize in restructuring and turnarounds. "You rarely get a second chance to restructure," McKenna adds.

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"Rarely is there nothing you can do. It's just that a lot of times if you leave it too late, your options are severely limited."