Managing effectively in a downturn, turning challenges into opportunities

Both the USA and Europe are facing a serious downturn if not a recession caused by the Credit Crisis. These are significant markets for Indonesian exports. The downturns in global Commodity Prices and Markets also have serious consequences to the Indonesian Economy. The Indonesian Government has already taken a number of actions to increase liquidity in the Indonesia banking sector and to help support the serious fall in the Indonesian Stock Markets. The Government has already downgraded its GDP growth. There is a possibility that there will be a serious downturn in Indonesia caused by Global problems.

Indonesian businesses and their executives therefore face considerable challenges – and managing in a downturn. Although Indonesian businesses only recently came out of the Asian Crisis in 2002 – 2003, these experiences are still relevant; however there is a need to remind everyone of the challenges that may arise.

Effective managers – whether or not they have the benefit of the experience of a previous recession – must consider the effects of the downturn and what it means for their business and its survival. Then they should address the key questions – what do we need to do differently, what do we need to do better? Often, the secret of survival will be getting the simple things right rather than embarking on wholesale radical change in every aspect of the operation. Many practical steps can be taken to minimise the effect of the downturn and position the business to emerge strongly when economic conditions improve.

1. Understand the true impact of the downturn on your business

When assessing how the downturn will impact your business you should pose these questions to yourself and your colleagues:

- **How will our customers behave** – will they trade down to the cheapest model in the range, purchase the same product less often, or seek a substitute product or service?
- **How will our competitors react** – will they work with customers to re-engineer their products, seek to maintain volumes by cutting prices, or seek alliances to reduce market competition?
- **What do we need to do well to minimise the impact of the downturn on us** – play to the strength of our existing customer base rather than seek to expand, focus on those customers most likely to thrive in difficult times, suspend product development in favour of supporting existing brands, revisit our pricing policies?

You need to assess how different segments of your customer base will behave in the downturn, how price sensitive they are and how loyal they are to your product or service. You should also assess how strong your competitors are –

will they see the slowdown as a threat or an opportunity? You then need to adapt your strategy to the changed conditions and assess whether the new strategy has implications in other areas such as, for example, supply chain, production capacity or financing requirements.

Given the volatility which exists in current markets it makes sense to subject your assessment of the impact of the downturn on your business to stress testing and scenario planning. Only when you have considered the potential range of future outcomes can you determine the optimum course of action to take. When conditions are difficult, the most successful businesses are the ones that react quickest – those that take the tough decisions early and lead rather than follow. Once you have defined your new strategy, share it with management and drive it. Make your key people accountable for targets which are consistent with your revised strategy.

2. Identify unprofitable products and customers

When resources are limited it is critically important to be aware of the profitability of individual customers and products. Profitable customers and products need and deserve investment – not least because they will be at risk of loss to competitors – whilst unprofitable customers and products require detailed analysis to determine whether or not the position can be rectified. It makes no sense to have scarce resources, in the form of financial investment or management time, tied up in delivering products or services at nil or negligible profit unless a rapid improvement can be achieved. Establishing product, customer and segment profitability requires a thorough analysis to ensure that all direct and indirect costs are considered. When this is done, corrective action for non-performing products or customers can include price increases, cost reduction, amendments to terms of trade and in some cases removal from your portfolio.

Once you have identified your profitable products and customers you should invest the time and resources to stay close to them. You need to understand how they are impacted by the downturn and convince them of the benefits of your product or service.

3. Cost reduction

Cost control is a necessary obsession for any business. In good times however, it is frequently subordinated to the imperatives of growth and development. In a downturn, cost control and cost reduction must be a prime focus of management who should start with a blank sheet. Sustainable cost reduction involves moving from your current cost base to a lower cost model. This will involve a fundamental reappraisal of the business model in all its aspects, and will require sustained management commitment over a considerable time.

In the short term, the quickest route to cost reduction is to target discretionary expenditure – segregate the essential from the desirable and limit outgoings accordingly.

In the medium term, cost reduction must come from examination of the present cost base and an assessment of the value derived from each significant cost category. This review should consider the level of cost in all areas of the business and then seek to identify where savings are possible. Take a hard look at procurement, at inefficient work practices, at waste.

A key action at this stage is to increase cost consciousness throughout the business, get people involved and reward measurable contributions.

In the longer term, cost reduction will involve driving down the business break-even point to as low a level as possible – making costs variable rather than fixed in order to minimise vulnerability to a downturn. This will involve examining just about everything – the market the business should be targeting, the product or service offering, the opportunities for outsourcing or sub-contracting manufacture, the desirability of centralising or outsourcing support functions, reworking the management information system, redesigning remuneration policies. This kind of change cannot be achieved in weeks or months, but the threats presented by the downturn will persuade all stakeholders of the need for regular reinvention.

4. Effective working capital management

When ‘cash is king’ everyone in the business should be focused on minimising investment in working capital. Effective working capital management will limit reliance on lenders, contain financing costs, and reduce the risk of loss through stock obsolescence or bad debts. Individual strategies to deal with levels of debtors, creditors and stocks are required, for example:

- Cash collection should be proactively managed – perhaps by deploying additional resources to the credit control function, or offering customer incentives such as early payment discounts. Ensure that you process invoices on time and stay close to who pays you.
- Consider incentivising your sales team at cash collec tion point rather than when the sale is made.
- Suppliers should be paid in accordance with agreed credit terms and not before due, unless attractive settlement discounts are on offer.
- Inventory balances should be maintained at the mini mum level consistent with agreed customer service levels.

Effective working capital management in a downturn will require close contact with customers and logistics providers, ongoing review of your sales pipeline, the recalibration of inventory stocking levels and re-order points, and, potentially, streamlining product ranges.

5. Effective performance management and forecasting

The function of management information systems can no longer be limited to measurement of past financial performance. Focused reporting and effective forecasting are critical to both effective planning and day-to-day management, particularly in a downturn. Timely, benchmarked, feedback is essential for sound decision making.

In the short term, a focus on a limited number of key performance indicators is required. These measures should be transparent, unambiguous and easily understood. The KPIs, which should have a focus on cash generation, should be formally communicated and managers should be encouraged through, for example, incentivisation, to deliver on them.

The medium term perspective requires a strong financial forecasting capability. Rolling forecasts, which are produced as a matter of routine directly from the management information system, will provide management with the necessary flexibility plan for likely developments in the marketplace on a timely basis.

6. An experienced and well resourced finance team

A downturn produces new challenges for all parts of an organisation, but the finance function will come under particular pressure to meet increasing demands for information to support initiatives throughout the business. The resource needs in this area – in terms of people, experience and IT support must be a priority for senior management. Short term needs can be met by contractors or secondees while the longer term requirements of the business are assessed.

7. Appropriate financing arrangements

Inappropriate financing arrangements can mean that borrowings are unnecessarily expensive or that your business has insufficient flexibility when cash flows are tight. In the current environment it might be thought that the chances of refinancing bank debt are slim. Banks are currently panicking and looking to increase funding casts on roll-overs or exit the relationships. This is a short term strategy and they may lose customers. In fact debt funding is still available to companies with a well thought out plan and robust cash generation capability. There is still competition in the market for such refinancing and this can mean that more attractive terms may be available to you. Furthermore, you may be in a position to consider alternative sources of finance such as, for example, asset based finance and/or leasing.

Key to getting the right debt financing for your business is to understand what is available in the market, to identify the structure that best suits your business, to consider any tax impacts of refinancing and to negotiate effectively with your lenders.

8. Strategic M&A activity

Lessons learnt from previous downturns have shown that merger and acquisition opportunities will present themselves in most industries. The key to availing of these opportunities, which tend to be more favourably priced than in a booming economy, is having the financial and operating flexibility to move quickly. There are particular skillsets required in acquiring distressed businesses and experience shows that if deals are effectively managed in a downturn there is the potential to generate above average returns once trading conditions return to normal.

9. Careful tax planning

It is important not to lose sight of the importance of careful tax planning while dealing with the new management challenges presented by the downturn. While still ensuring that your organisation remains fully tax compliant, it should be possible to improve your cash flow position by reducing or deferring tax payments to the Tax Office. Opportunities here would include making maximum use of losses in calculating Preliminary Tax Payments and ensuring that all available deductions are being claimed.

At a more strategic level, falling asset values can also be taken advantage of for crystallising losses and tax effective succession planning.

From a human resource perspective tax efficient remuneration strategies is more important than ever; likewise, the tax implications of any workforce reduction which proves necessary – for both the business and the individuals concerned – should be closely examined.

10. Communicate with stakeholders

Managing the stakeholders in a business is critical, especially in difficult times. The key to effective management

of all relationships (whether with shareholders, employees, customers, the tax authorities or providers of finance) is timely and honest communication. Withholding information or springing surprises is likely to unnerve people and erode their confidence in your ability to manage the business.
It is important that you keep all stakeholders informed about the threats and opportunities that a downturn brings to the business and about the actions that you are taking to manage them. While the required communication can be very time-consuming, particularly when there are many other challenges to be addressed, it is a vitally important investment.

11. Manage key talent effectively

The 2008 PwC Global CEO survey highlighted that concerns over people and talent far outweighed fears of recession. Engage with your people and be open with them. Ensure you motivate and develop high-performers. Watch for pressure points but also be aware that key talent may be more readily available for recruitment than was the case in the boom times. It is also likely that recruitment costs and packages will be more competitive in a downturn and this can present opportunities for your business.

Challenge as opportunity

In a downturn, numerous difficulties present themselves – all important, all urgent. A natural response may be to “batten down the hatches” and focus solely on today’s problems. Prudent management is of course necessary, but it is important also to recognise the opportunities presented – to challenge old ways of doing things, to take advantage of weaker competitors, to plan for the changed marketplace that will emerge. Effective management will help ensure your business is best placed to come through the bad times re-energised and fit for the future.

Thriving in a downturn requires greater diligence and skill than during more favourable economic times. However, the rewards can be greater as businesses that adapt quickly with the right strategies can not only grow, but position themselves strongly for the inevitable upturn that will emerge.

Addressing the points above will help ensure your business is best placed to come through the bad times re-energised and fit for the future.

PricewaterhouseCoopers Indonesia has extensive experience of helping organisations in all industries to address the challenges of a downturn. To discuss how we can apply our experience to help you, please contact:

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