Surviving A Recession

Understanding how you can ride out the recession and seize new opportunities

In good times business owners ought to be able to run a successful business that is in great shape. Nevertheless, good times hide a business's real weaknesses and also hide underlying strengths. When the tough times come, both the strengths and weaknesses are revealed.

A recession is a time when the business landscape is washed clean. This economic cycle presents an opportunity to lay the base to build your bottom line by addressing issues you should have been doing right irrespective of economic conditions. For already well run businesses, it's a time to reinforce their advantage by focusing even harder on the things that have made them successful.

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Economic downturns present opportunities for companies prepared to look. Recessions reshuffle the decks more than boom times and research shows that gains made during challenging times tend to endure.

Do you know what impact the recession will have?

Understanding the facts of the situation does not have to be challenging. The alternative – failing to take the time to understand the implications and considering the challenging questions for your business could be the falsest economy of all.

So, what should you be doing?

Review your pricing strategy

Normally people think nothing goes to the bottom line unless it first goes through the top line. That line of thinking leads to the mistaken belief that revenue is a major profit driver and price reduction allows you to hold or even grow market share and thereby maintain profitability.

Price reduction only makes sense if you are in a market where price elasticity is high.

If you are in a market where price elasticity is high, or at least rising because of the recession, then some price reduction might make sense. However, if you try this and don't see an increase in sales then market demand may not be as elastic as you think - don't continue with it.
Furthermore, in tough times customers tend to have smaller-sized orders meaning your cost of supplying the order is relatively higher and if you discount your price, you shrink the margin even more.

Rather than dropping your price, look at ways to bring together a lower-priced alternative to your main service or product with some "value" removed. In other words, maintain your margin on your main lines and introduce a lower-priced alternative to service your price-sensitive customers.

Consider the impact that a price reduction has on the need for additional sales to maintain gross profit. E.g. if your GP% is 30% a price reduction of 10% (a common discount used) will require a 50% increase in sales to maintain your gross profit.

Identifying your very best customers and most profitable products and/or services

If you do an analysis of your customer base you will normally find that between 10-30% are unprofitable for you. The "Pareto analysis" states that 20% of your customers contribute 80% of your revenue.

Concentrate on your top 20% of customers

When you know who these customers are, concentrate on them. Don't give much attention, or even get rid of the low profit contributors. Your immediate profitability will improve because you are generating quality revenue by ridding yourself of unprofitable business and not spending wasted time on customers that are not generating the profits.

Get closer to your top 20% of clients, make sure you understand how you can better meet their needs. Look to maintain your competitive advantage and margins by improving your offering.

Build strength in your balance sheet

Many businesses have too much debt that is incorrectly structured i.e. too heavily weighted to short term. Often shareholder distributions/drawings are too high and debtors and inventory are poorly managed.

Look at selling unused or under-utilised assets and if those assets are required for some aspect of your operations, maybe look at out-sourcing that service.

Improve the quality of your reporting and financial management processes

A business should be able to produce a full set of financial statements that are accurate and available within 7 -10 days of the end of the month. A monthly review focussing on the key results is critical as is addressing any areas of concern.

Identify the KPIs needed to properly manage your business

You can only manage what you measure. Timely and accurate reporting of performance is more critical than ever. Identify the Key Performance Indicators (KPIs) needed to properly manage your business. Some of the most common KPIs are: turnover, margin and customer satisfaction. A weekly report showing sales, receivables, payables, cash, potential sales and orders on hand can also be invaluable. The KPIs will depend on the business in question.

Manage discretionary expenses

Manage your discretionary spending.

A discretionary expense is one over which management has discretion in the sense that it can be cut, increased or eliminated (e.g. entertainment, kitchen supplies). In contrast, non-discretionary expenses are those expenses the business is either contractually obligated to or are absolutely necessary to “keep the doors open” (e.g. rent, suppliers).

It is important not to cut expenses that directly impact the strength of the relationship you have with your profitable customers or the investment made in developing and delivering profitable products and services. However, consider reducing nonprofitable products and customers and review the non-discretionary expenses.

The key here is to undertake a customer and product line profitability analysis in conjunction with a rate of return review on expense items and seek out better suppliers who will offer better service at lower prices.

Working with your suppliers to find ways to lower the cost of servicing

Consider negiotiating better terms with suppliers.

Naturally, one way to achieve cost reduction would be to put pressure on suppliers to lower prices and/or offer better payment terms. Having a good relationship with suppliers is critical to continued success when the economy improves.

Keep the team in the loop

Staff are the key to your success. In a recession people always worry about their job and the last thing a business wants is for the best people to start jumping ship and joining another organisation.

The major cost to most business is labour, but staff cuts may prove to be a false economy. New recruitment, when it becomes necessary, is costly. Motivation of remaining staff can also be difficult. If cuts are necessary, communicate well, act with integrity, and move quickly to re-motivate your staff.

Finding the upside to a downturn

Surviving a business downturn provides an opportunity to show decisive, astute leadership.

Remain entrepreneurial, look for opportunities and underlying profits, and rediscover drive and qualities that built the business in the first place e.g. common sense, analysis. Take personal responsibility in your business and decide the correct strategy to achieve.

Think “outside the box”.

Use innovation and alertness to succeed. If a business is asked if their current operating environment has changed from this time last year invariably they say ‘yes’. Asked what they are doing differently, the response is often ‘nothing’. A willingness to be agile, to think innovatively and refocus resources on the true value drivers of the business during the economic downturn can provide opportunities for your business to prosper. It is a mistake to believe that simply tweaking an existing product or approach will deliver the rescue. More radical thinking may be needed and this also carries with it the need to manage and minimise risk.

The following are some practical steps that can be taken when faced with intensifying competition or a marked downturn:

Develop the right strategy

A strategy has three essential elements – development, implementation and selling. Behind all three of these is "choice" - the need to choose a distinctive, competitive position on three dimensions:

- Who to target as customers (and who to avoid targeting)?
- What products to offer?
- How to undertake related activities?

Focus on the most profitable areas

Concentrating on products and services with the best margin will increase profitability. This might mean redirecting sales and advertising activities.

Strengthen customer focus

This is how businesses retain and sell more to existing customers, and attract new business and customers.

Increase sales revenue

Businesses need to increase the effectiveness of pricing, sales teams, sales process, sales activities and channels – or a combination of all five. A vital component here is measurement.

Manage the money

Control costs, analyse short- and long-term cash needs and review debt structure.

Cash management, costs, revenue and investment. Control costs, reduce them wherever possible and manage cash by controlling payment terms with suppliers and customers. Analyse cash needs in the short and longer term based on realistic financial information. Review debt structure and determine if financing is appropriate and priced correctly. Some of the basics of cash flow management are also important, like negotiating better credit terms with customers and suppliers.

Develop profitable new products

While it may be risky to develop new products in a downturn, inaction may be more risky – the momentum of innovation is what carries business beyond the downturn. If you stay the same during a period of increased competition and falling demand, you will fall even further and faster behind your competitors.

Build closer relationships with your bank

Keep your bank fully informed of the decisions you are taking and give them lots of notice if you need help. Banks only make money by lending money. However, they are likely to give priority to businesses that demonstrate they are on top of their issues. Go to the bank with solutions not problems. If you are looking to refinance consider alternative sources such as an asset-based lender.

Act decisively

Strong companies will not sit back and wait for the challenging times to pass. The winners will be those who act decisively, make tough decisions and position themselves to take advantage of the upturn. Businesses who benefitted from previous economic downturns are those that acted proactively and decisively.