Preparing for and Handling “Hard Times”

Introduction

As Geoffrey Blainey (1993) suggests that the Australian economic history has been a series of “Booms and Bursts”. The reality is that every bubble bursts but the accurate prediction of when will it occur, how long it will last, how will we look when we come out, etc is the hard part. Furthermore, every boom has a predominant but different theme from the previous one, eg

“... in the early 1950s, it was retail and hire purchase; in the late 1960s, mining shares like Poseidon; in the late 1980s, debt-driven conglomerates like Bond Corp and Quintex; in the early 1990s, property; in the late 1990s, dot-com companies in 2000’s;..” until 2008 “... it was a stock market boom with higher leveraged property and financial engineering companies like Centro, MFS, Allco, Opes Prime...”

David Hains (Portland House) as quoted by Andrew Cornell, 2009

Human beings are creatures of habit and prefer to stay in their zones of comfort. As a result we are not good at handling the unexpected and uncertainty that lie outside our ‘tunnel of possibilities’. Usually the unexpected and unknown events are rare, have an extremely high impact and are low in predictability; although they appear retrospectively predictable. We need to adjust to handle them. Usually the problem lies not in the nature of the events but in the way we perceive them.

Furthermore,

“...you must never forget that every change ushers in unforeseen consequences. This applies as much to welcome change as unwelcome ones......obviously, you cannot plan for the unexpected. All you can really do is never let your guard down...”

Richard Branson, 2008

Linked with a preference to stay in your zone of comfort is a fixed mindset (Catherine Fox, 2009). A fixed mindset is a simple framework for gaining self-esteem and judging others. It encourages stereotyping by using preliminary information to decide on a fixed view. Fortunately, a brain continues to change throughout our lives. This gives us a chance to update information for better decision-making. We need to encourage a culture where we learn from our mistakes. Furthermore, when we are willing to learn, we are more receptive to feedback or criticism. Thus success depends upon effort, persistence and being prepared to move out of your comfort zone rather than innate talent.

Remember: people do not act in rational ways. Therefore, predicting behaviours and reactions is not easy.

According to Nassim Taleb (2007), there are 5 main reasons we fail to see unexpected events:

i) errors of confirmation (we focus on experience and preselected observations, and then generalize from them to the unseen; our tendency to look at what confirms that knowledge)

ii) narrative fallacy (we believe that stories will display distinct patterns; we fool ourselves with stories and anecdotes)

iii) human nature (we are programmed to handle the expected rather than the unexpected; how our emotions get in the way of logical)

iv) distortion of solid or silent evidence (we see what we want to see, ie these mis-perceptions become our reality; how we are selective in our understanding of history)

v) tunnel vision (we focus on a narrow range of well-defined sources of uncertainty; the difference between what people actually know and how much they think they know; the neglect of outside/external sources of uncertainty)

In spite of our exponentially increasing knowledge base, the future is becoming less predictable.

Some initial incorrect reaction to volatile times can be around “seige mentality” as shown by

- inaction (a very risky response)

- rising anxiety (how much worse can things get?)

- “just do something” (uncoordinated actions can target the wrong problem or overshoot the right one), eg extreme cost cutting, including staff (see above section on downsizing) and/or reduced capital expenditure. Need to be careful not to overdo cost cutting and regret this when the economy improves, ie you do not have the resources to take advantage of the up-turn. It is very difficult to predict, with any degree of accuracy, when a recovery will happen; you need to be ready for it and not be playing “catch-up footie”. Also, in a down-turn, opportunities will arise that require adequate staff and other resources in order to be realised.

In hard times, some organisations will revert to a command-and-control approach rather than continuing to nurture people, as the organisations grapple with short-term financial pressures and survival.

As the current crisis started as a financial crisis, it is expected that many of the private equity businesses/portfolios will not make it through the crisis because of their financial leverage, ie they have borrowed too much money.

“...Any business which expands rapidly during a boom using high leverage can be vulnerable when the bubble bursts...”

David Hains (Portland House) as quoted by Andrew Cornell, 2009
•Indicators of volatile times include

iii) Economic - stock markets, exchange rate, commodity prices (oil, copper & iron ore, etc), interest rates, government debt, etc

- stock markets (Aust. index - peaked over 5,000; fell to around 3,000 and is now oscillating above 5,000+)

- exchange rate (re $A v. $US ? peaked at over parity; fell to mid 60s and now around parity)

- oil prices (fell from $US 150 per barrel to under $32 in 2009 and now is around $100)

- copper prices (fell from over $US 4 to 1.25 per lb & surged to $US 4.65 in early 2011)

- iron ore ($US 80 to 180 per tonne & fell to below 100)

- interest rates (Australian Reserve Bank’s cash rate fell from 7.25 to 3%)

- government debt (surpluses to deficits)

- firm failures - in 2011, a record number of Australian firms failed (10,481)

iv) Others, eg simultaneous bushfires and floods in Australia, levels of urban water storage, earthquakes, tsunamis, cyclones, hurricanes, volcanic ash, etc

Impact of Volatile Times On Change

- Stability is no longer the norm; yet much of organisational development theory is based on stability

- Past success is no guarantee for future success

- Uncertain world with very few definitive answers, ie many shades of grey

- Need to be flexible to handle many “unintended consequences”or “unplanned events”

- Change is a journey, not a destination; it is on-going

- “Business as usual” less likely to be a sustainable option
•The aim is to survive the “hard times” and be in a suitable shape to thrive once the good times return. This is more than financial. It involves talent management plus identifying suitable markets, reviewing processes, etc. Furthermore, the status quo is under challenge and the world has always emerged very differently after each downturn.
•Research (David Rhodes et al, 2009) has suggested that organisations whose early responses to an economic downturn are tentative will typically overreact later on. This results in an expensive recovery when the economy recovers
•Many organisations fail to see the opportunities hidden in an economic downturn. To take advantage of these opportunities, the first prioroty is to do a thorough but rapid assessment of your vulnerabilities and then move decisively to minimise them. This will position you to seize future sources of competitive advantage, whether from investments in product/services development or transformative acquisitions.

What to Consider in “Hard Times”
•Minimizing your organisation’s vulnerabilities includes considering

a) financial fundamentals - as liquidity or cash is paramount to immediate survival and to handling the future, such as investments, you need to

i) monitor and maximize your cash position by

- calculating expected cash inflows and outflows to identify areas where spending can be reduced or postponed

- producing regular weekly or monthly cash reports (detailing expected near-term payments and receipts) depending on the volatility of the business,

- centralising or pooling data and cash to provide company-wide data and enables pooling of cash across business units

NB How much spending you allow depends on your assumptions about the severity of the downturn and to what degree such spending is discretionary

ii) improve cash flow by tightly managing customer credit by

- segmenting customers based on credit risk

- offering finance only to creditworthy or strategic customers

- assessing trade-offs between credit risks and marginal sales

- focusing sales incentives on the speed of getting sales paid for

NB In the current economic environment, buyers will seek credit more frequently. This will expose you to more risk.

iii) aggressively manage working capital (difference between current assets and liabilities) by

- reducing inventory by monitoring production and sourcing

- reducing receivables by actively managing customer credit

iv) optimize your financial structure and financing options by

- reducing debt and other liabilities

- securing access to lines of credit

- securing access to equity capital by tapping non-market sources, such as superannuation funds

NB Look for ways to strengthen balance sheets by reducing debt and other liabilities, such as operating leases or pension obligations

b) the current business (loosely-run operations, sluggish unit sales and over-extended organisations are vulnerable to economic shocks)

i) reduce costs and increase efficiency by

- discontinuing long-standing activities that add little business value

- reviving earlier efficiency initiatives too controversial to fully implement in better times

- streamlining the organisation by reducing levels of organisational hierarchy, consolidating or centralising key functions, etc

- analysing current supplies and buying practices by reviewing supply chains, standardizing components, etc

- re-examining the economics of going offshore

NB Need to be careful of purely reactive action, such as slashing marketing and/or core research and development, etc which could have a negative impact on your performance when the recovery comes.

ii) as cash becomes critically important, aggressively manage the top line by

- revitalizing customer retention initiatives (so that existing revenues are protect) and identifying ways to generate additional revenue from your current business

- realigning sales force utilization and deploying incentives to generate additional short-term revenue

- reallocating marketing spending toward immediate revenue generation

- considering more generous financial terms for customers in return for higher prices

iii) as purchasing behaviours change in a recession, rethink your product/service mix and pricing strategy by

- offering lower-priced versions of existing products

- identifying products for which customers are still willing to pay full price

- considering creative strategies such as result-based or subscription pricing

- unbundling services and adopting "a la carte" pricing

NB Determine how the needs, preferences and spending patterns of your customers, whether individuals or corporates, are impacted by the downturn.

iv) reduce planned investments and sell assets by

- establishing stringent capital allocation guidelines

- shedding unproductive assets that were difficult to dispose of in good times

- selling non-core businesses (including peripheral or poorly-performing operations) and focus on core businesses

NB At the same time be prepared

to invest in activities, such as marketing, R& D, product development, technology, etc that are best for the long-term future of the organisation

to be opportunistic about potentially good investments/consolidation, etc as history shows that the best deals occur during a downturn

to rethink your business model

c) share price (a strong market valuation relative to rivals is important in raising capital and acting on acquisition opportunities. Markets reward strong balance sheets with low debt and secured access to capital)

i) inform investors and analysts of your recession preparedness

ii) consider opting for dividend payments rather than share buybacks

Once the above analysis is done, then rapid implementation is important. Some obstacles to implementation include

- insufficient understanding and appreciation of the evolving crisis

- senior management's lack of appreciation and commitment

- failure to see how individual initiatives are part of a comprehensive plan

- lack of attention to the human element.

In preparing for a slowing of the economy, there is a better approach than the 'slash and burn' approach that has been used in the past. You need to review your business and understanding of products/services by asking:

- how has our business performed relative to our competitors?

- why do customers prefer to deal with us?

- what do we have to do to make a profit?

- what costs need reducing?

(Some suggestions for reducing costs include reducing internal overheads - back-office or warehouse - lowering inventory levels, non-core assets and/or under-utilised assets can be cashed in and/or outsourced, hiring casuals instead of permanent staff, delaying major capital expenditure, increasing the repair and maintenance of old equipment so that it lasts longer)

Continue to conduct the appropriate "naval gazing" activities

Innovation in the past has focused on growth opportunities, such as new products and services, marketing innovation, acquisitions, etc. In the current crisis there will be more innovative focus on operational issues fundamental to business health.

Some Other Suggestions

Review your customers' records to determine segments, sub-segments or individual accounts that will be impacted by the downturn in the economy

Rank your customers by size, profitability, recession resilience and loyalty

Increase communication with customers

Reassess your product/service ranges

Focus on value with products and services (including additional services)

Simplify your range of products and services

Guard against employee defection by calibrating non-financial benefits to staff, such as career enhancement, comradeship, challenges and recognition

Prepare the offensive strategies for competitors' price cuts (including reviewing of advertising and marketing spending. Remember: brands which reduce advertising expenditure can lose market share)

Focus on micro trends in particular markets

Prepare strategies for an upturn, including recapturing business lost to low-priced competitors

Summary

In summary you need

"...the three big ideas are awareness, resilience and flexibility...... awareness because things can move very quickly, resilience, which is to plan for the worst and the best case, and flexibility - you need to be ready to act..."

Michael Rennie as quoted by Peter Roberts, 2009

(sources: Jason Daniels, 2008; David Rhodes et a, 2009; Peter Roberts, 2009; Glenn Mumford, 2008 ; Stephen Wyatt, 2012)