

# The Boardroom Report

## Weathering tough times

The worst thing Australian directors could do during the harsh conditions they might face over the next year is batten down the hatches and just try to survive, warns Michael Finland, group managing director of Vantage Performance.

He says signs of economic slowdown in China, combined with a predicted poor retail result over Christmas and concerns over the carbon tax's effects, mean 2012 will be incredibly challenging for many businesses.

"The worst thing a business can do is approach this period with a 'bunker down' attitude. You need to treat tough times as an opportunity and be doing something different to stand out from the competition so you can continue to grow and source capital to fund the business," he says.

"The herd will panic and start cost cutting and laying off staff like they always do. Those more likely to come through the tough conditions in better shape will be the ones tightly managing their working capital, continuing with research and development and innovation, showcasing their demonstrable unique selling propositions and standing out from the crowd. These are the businesses that will win the competition for hard-to-find credit."

Finland's six tips on surviving an economic downturn include:

1. Don't just compete on price when things get tough. "The trouble with relying on discounting is you don't know your competitors' cash reserves. Don't blindly go down this path not knowing if you can outlast your competitor," he says.
2. Be unique and have a real point of difference (think Peter Alexander). "Who would you rather be coming out of the next downturn – the business still discounting its old products or the one introducing new products at a higher margin to the market? Keep the focus on innovation through the downturn."
3. Aggressively manage accounts receivable, inventory and payables and seriously consider selling non-core assets, divisions or surplus assets.
4. Seriously consider sale and leaseback options for property and other assets to bolster cash flow.
5. Consider a merger in order to not only survive, but to come through the next period in better shape than your competitors.
6. Focus right now on stress testing your business.

Finland says tough economic conditions have dramatically increased the speed at which business conditions can change, forcing astute directors to rely more than ever on risk management strategies to protect their businesses.

"Regardless of the position your business is in, it's essential to be undertaking detailed financial modelling and 'what if' scenario testing to gauge how various sudden changes in market conditions will affect your business and, more importantly, what initiatives management can deploy to combat these challenges," he says.

"It's all about analysing base case and worst case revenue, margin and working capital scenarios. This sort of stress testing can help businesses decide on a range of initiatives to deploy in case market conditions deteriorate any further."

Finland says stress testing forces management to ask the "what if" and to create strategies to deal with given scenarios to minimise risks and maximise opportunities. This allows the business to react quickly if conditions change suddenly.

Key questions posed in an effective stress testing program include:

1. What is the new break even level for the business and how does it change from the previous level?
2. What would be the impact on revenue and earnings if we lost a major customer?
3. How would cash flow be affected if debtors took an extra 10 days to settle accounts?
4. Could there be a breach of banking covenants and if so, how would we respond to our financiers' concerns?
5. What changes will we require to our banking facilities and what would be our banks' attitude to an increase in lending, if required?
6. What overheads will we reduce and what capital expansion plans must go on hold to preserve cash?
7. Are sales or production levels too low to remain viable and is a merger or strategic partnership needed to maintain critical mass? Who would we approach?
8. What plans do we have to meet Australian Taxation Office requests?

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