



BY MICHAEL FINGLAND

# Never Waste a Good Crisis

## — Stress Testing your Business for 2012

AS WE ENTER 2012, CEOs WILL HAVE LITTLE TIME TO EASE THEMSELVES INTO THE NEW YEAR BECAUSE ALL SIGNS INDICATE IT WILL BE A TOUGH YEAR FOR MANY BUSINESSES.

The economic slowdown in China, combined with a poor Christmas retail result and concerns over the carbon tax impact, mean 2012 will, for many, be tougher than the original GFC aftermath.

Each month, I'll be addressing ways CEOs can improve their business's performance. First up: the battle for credit, and the role stress testing can play in helping you achieve this.

Bank finance is becoming tight again. CEOs need to work out how their businesses can stand out from the crowd.

The worst thing management teams can do is 'bunker down'. Treat tough times as an opportunity, and do something different to stand out from the competition so you can source capital and continue to grow.

Rather than panicking with the herd and using the perennial stopgaps of cost cutting and laying off staff, smart CEOs will come through difficult trading conditions by tightly managing working capital, showcasing or developing their unique point of difference, and investing in R&D and innovation.

It's important to not just compete on price when things get tough – you don't know your competitors' cash reserves, so don't blindly discount without knowing you can outlast them!

Aggressively manage accounts receivable, inventory and payables. Undertake a strategic review of your supply chain to identify cost savings or efficiency gains; seriously consider selling non-core assets/divisions or surplus assets; and consider sale-and-leaseback options for property and other assets to strengthen your balance sheet.

Of the more than 16,000 Australian companies likely to become insolvent in 2012 (based on FY2011 ASIC stats of 14,566), a significant number could have been saved if they had sought the right help early enough.

That's why it's important to focus now on stress testing your business.

Stress testing helps you decide on a range of initiatives to minimise risk and maximise opportunity. It involves analysing base and worst-case revenue, margin and working capital scenarios. This allows the business to react quickly if conditions change suddenly.

Stress testing also provides clarification around short- to medium-term capital requirements and puts management in a stronger position if they need to negotiate with financiers, by showing they are prepared for and able to handle challenges.

In our experience, only 5–10 per cent of management teams will be prepared with detailed action plans developed using the stress test process – and they will be in prime position to take serious market share off their competitors over the next 18 months. •

### KEY STRESS TESTING QUESTIONS FOR CEOs

- What if credit markets seize up (again) and you're unable to roll over your banking facilities?
- If China continues to slow, what impact will that have on your revenue, and what's your new break-even level?
- For businesses with customer concentration, what is the impact on revenue and earnings if you lose a major customer?
- How is cashflow impacted if your customers take an extra 10–15 days to settle?
- Could there be a breach of banking covenants, and how would you respond to financiers' concerns?
- What changes will you require for your banking facilities, and what would be your bank's attitude to an increase in lending?
- What overheads will you reduce, and what capex plans must go on hold to preserve cash?
- Are sales or production levels too low to remain viable, and is a merger/strategic partnership needed to maintain critical mass? Who would you approach? Is your business ready for such a process or will you need six months to prepare?
- Are you able or willing to approach private equity as a means to strengthen your balance sheet or to fund a merger/acquisition?

The key to stress testing is to use the financial modelling outcomes to develop a clear and 'pre-approved' action plan so management teams can act nimbly when the unexpected happens. This means management can make prudent (sometimes lifesaving) decisions very quickly.

Those able to adapt to change are the ones that will prosper in the future.

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