

# A practical guide to managing your business in a downturn.

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# A 10 point readiness check

The credit crunch is beginning to squeeze entrepreneurial businesses. Negative growth, weakened demand and reduced lending by the banks is compounding an already difficult situation in which commodity prices are rising rapidly. While some regions and sectors are proving more resilient than others, it is sensible to analyse your own business environment and to take decisive remedial action.

No doubt your plans for managing your business effectively through the downturn are already in play. However, our 10-point check provides a quick reminder of some of the areas to consider to improve your readiness and even turn conditions to your advantage.

Most of our tips and recommendations are essentially about good business practice. Management teams often forget to do the basics when the focus is on growth, but that emphasis needs to change. The coming months should be about instilling the right discipline in the business.

Entrepreneurial businesses that are well structured and well managed will see opportunity in uncertainty. By doing the right things quickly and decisively, you might even turn the crisis on its head.



# 01

## Cash is king

**“If you still have cash on the balance sheet, you’ve always got options and will have a greater degree of flexibility in your decision making.”**

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Paul Raleigh  
Managing Partner

What’s the issue?

The old adage stands – turnover is vanity, profit is sanity and cash is reality. In a tough market, it’s probable that everything will slow down. Debtors pay less quickly, turnover may fall, cash from profits reduces and your bank may be less inclined to lend. In short, cash is limited. This differs greatly from the recent experience of most Irish businesses. During the Celtic Tiger period many businesses did not keep such a close eye on their cash position, because they didn’t have to.

The critical issue in the near-term will relate to your ability to conserve and control cash, and management needs to be relentless in its attention to this.

What can you do?

- Undertake a critical analysis of the business at this point. Establish what the short-term cash requirements are and then forecast longer-term cash flows based on credible and realistic financial information. If you can’t produce this from your own management information, you should consider bringing in outside help. You need to get underneath the first layer of information to reveal the true picture.
- To generate cash more quickly, negotiate credit terms with suppliers that are as long as possible, and negotiate terms with your customers that are as short as possible.

- Focus strongly on the key metrics, such as debtor days and creditor days.
- Manage your stock cycles as efficiently as possible. Employ just-in-time stock replacement to keep levels to a minimum and clear out old stock to generate cash. In the short-term, profit may need to be sacrificed in order to generate cash.
- You could increase prices to increase profits (albeit with reduced volumes), which in turn should reduce your working capital requirements and hence cash usage. However, this needs to be judiciously operated with a keen eye on price elasticity. If you lose all your sales, you have no business.

**“Before taking on new customers, check their credit worthiness and strictly adhere to credit terms by chasing payments. Resolve issues on any invoices very quickly, as these can cause unwanted delays.”**

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**Paul McCann**  
Specialist Advisory Services Partner

#### What to avoid?

You might need to scrutinise the prospect of securing significant new contracts in a different light. While some contracts may appear to be low hanging fruit, you need to be mindful of their potential impact on your working capital cycle and working practices.



# 02

## Get closer to your bank

**“Cash flows and confidence are key in this market when dealing with your bank. Prepare your business plan and future cash flows diligently and deal proactively with your bank manager.”**

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**Michael Neary**  
Corporate Finance Partner

What's the issue?

The banks are facing a tough time too. They may be more cautious and concerned with bad debt, so will need greater persuasion to lend you more money if you need it. In many areas, new lending will be severely restricted and you may struggle to re-finance existing facilities. The banks will focus increasingly on the quality of their loan book, and their key concern will be loan recoverability.

What can you do?

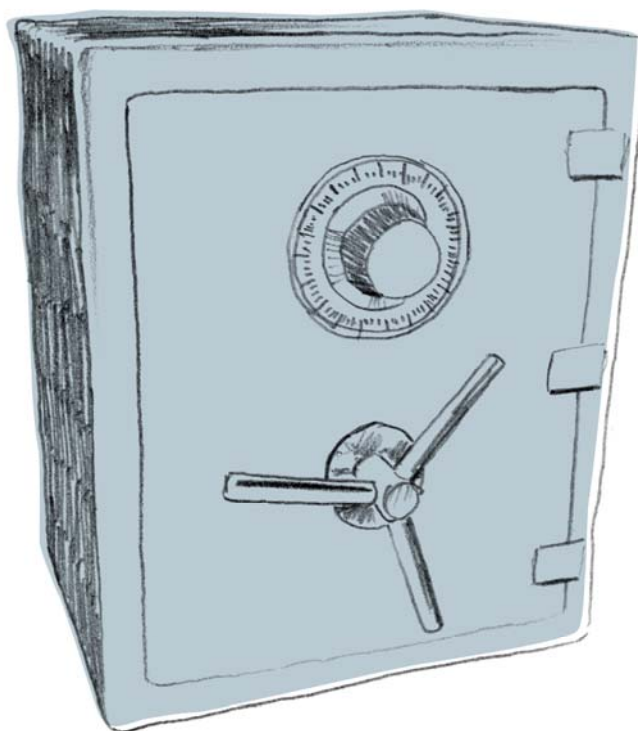
Treat your banker as a partner in the business. Keep them fully informed of what is going on and the decisions you are taking, and give them lots of notice if you need help. Banks only make money by lending money – they want you to prosper so they can continue to lend money to you. Proactively manage your relationship with them. The last thing a bank wants is to receive one week's notice that you need to double your overdraft facility.

If you do need to go back to the bank, discuss this with your advisers. Draw on their knowledge and independence to improve the credibility of your plans.

If you are looking to re-finance, also consider alternative sources of finance. An asset-based lender may enable you to leverage more funds out of existing assets. Invoice discounting or debtor factoring are options to increase cash flow.

What to avoid?

Don't fall into the trap of thinking that it is up to the bank to guide you through any issues or problems. If you talk to your bank early enough, they may work through the problem with you, but be very clear that the ultimate responsibility for resolving any issues falls squarely on management's shoulders.



# 03

## Be relentless on cost control

### What's the issue?

You will want to at least maintain your current level of profits, which will almost certainly require you to cut costs. In the good times, costs can escalate with little challenge. Tougher conditions will require much more focused cost management.

### What can you do?

There is a natural tendency to look at costs from a top-down approach, but a bottom-up approach may be best. Employ zero-based budgeting to review all costs very carefully in terms of their value to the business. What costs do you actually need to run your business? Leave no stone unturned and review every commitment. Some will be difficult to flex in the short-term, but others may offer scope for savings.

Carefully consider two major areas of cost: tax and people (see points 05 and 09).

Take the opportunity where possible to re-negotiate lease terms and capital equipment utilisation. Make the tough decisions before you have to. Pay attention to variable costs too, including reviewing of raw material and consumables costs.

Spot markets rise at times of cancelled contracts, which can add significantly to the bottom line in many industries. Take steps to guarantee supply though so that when the market opportunity comes you are able to respond.

### What to avoid?

Do not automatically cut marketing expenditure. While this is traditionally seen as easy to cut, doing so can have a significant impact on your competitive position, especially when market conditions begin to pick up. There is still a lot of business to be won in a downturn and it becomes a matter of having to try harder to grab the opportunities that are out there.

**“Look hard at discretionary spend, and investigate areas such as travel, general expenses, hospitality and entertaining.”**

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Aidan Connaughton  
Audit Partner

# 04

## Re-visit your strategy

What's the issue?

Tough trading conditions will demand a clear strategy, combined with focused and relentless management to implement that strategy. When market conditions change rapidly, you can't assume that your existing product and market strategy will continue to be successful. Changing market conditions can often be a catalyst for revisiting difficult strategic decisions.

This is not the time for your strategy to drift off course, but equally you may need to stop and think, and take a fresh look at your business.

What can you do?

You need a crystal clear understanding of your core capabilities, the strengths of the business and where your best opportunities exist. This clarity of focus will enhance your ability to take advantage of opportunities as they emerge.

Having the right business model to go forward may require the disposal of non-core assets and business streams. Non-core business streams can consume much needed working capital and the sale of non core assets will also generate cash.

Combine available market research with existing financial information on year-on-year performance and comparisons with budget. Determine which product lines, sectors and customers are likely to put pressure on your profitability, and which present the better

tactical opportunities in the short-term. There is no better time to review business performance in this way, as it will help you to focus your resources more effectively. If you have liquidity or access to investment funds, look at acquiring assets, expertise or a local competitor.

In uncertain times, trade barriers can retrench or relax depending upon the government, creating new opportunities that you may have discounted previously. Similarly, shifts in the currency markets can quickly create a better environment for exports.

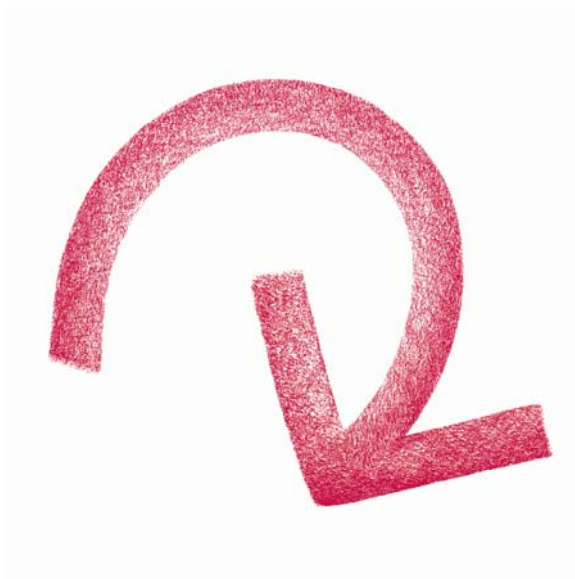
What to avoid?

Don't throw the baby out with the bathwater. Yes, it is important to test assumptions and re-visit strategy but don't feel you need to change the whole business model overnight. If your strategy is a good one, hold your nerve, manage effectively and keep the faith.

**“To be one of the successful businesses in these difficult times you need to adapt quickly to the changing environment and change direction, perhaps to a substantial extent, rather than merely react to events as they unfold.”**

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**Tony O'Brien**  
Head of Business Consulting



# 05

## Get smarter on tax

**“Ensure that you are aware of the opportunities available to reduce your tax liabilities. The benefits of this are twofold: reduced tax liabilities and improved cash flow.”**

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Frank Walsh  
Partner

What's the issue?

Tax, in its various forms, is usually one of the biggest overheads in the business and you need to look carefully at how to manage that cost and the cash flows.

What can you do?

A downturn in the economy does not mean all is lost. It provides the perfect platform to re-organise assets and investments to secure future advantage.

Asset portfolios

- dispose of assets and crystallise losses;
- beware of connected party rules for offsetting losses; and
- transfer assets to children while values are low and transfer taxes are comparatively low.

Utilisation of losses

Current year trading losses are firstly carried back to the prior period to be utilised against trading profits. Any excess losses can be set against other income and chargeable gains arising in the same period.

In light of the economic downturn, companies should review the carrying value of their trading stock e.g. land. Any write down should be tax deductible. This should reduce the corporation tax liability for the current year and, depending on the circumstances, may result in a tax refund for the previous year.

### Change of year-end

A change of year-end can be useful in group situations. Companies can shorten or lengthen their accounting period (subject to company law) to maximise the amount of losses being transferred from one company to another. Only contemporaneous losses can be surrendered and claims are limited to profits of a corresponding period. Where accounting periods are shortened, payment of tax liabilities may be accelerated. For seasonal businesses, it can be beneficial to choose a year-end date just before a seasonal surge in income and profitability. This gives the maximum delay between earning the profits and paying the tax.

### Early filing

If you are due a refund of tax e.g. over-payment of preliminary tax, you should look to file a tax return as soon as possible in order to obtain the refund at the earliest possible opportunity. Effectively this is an interest free loan to the Revenue Commissioners.

Relief for bad debts is given for tax purposes where it is shown to the satisfaction of the Inspector of Taxes that the debt is bad. A deduction is also available for doubtful debts to the extent that they are estimated to be bad i.e. a specific bad debt provision. Claims in respect of bad debts are made when filing the relevant corporation tax return.

A VAT refund in respect of a bad debt can be claimed where it can be demonstrated that the debt is not recoverable.

### Cash flow saving – review basis of VAT payments

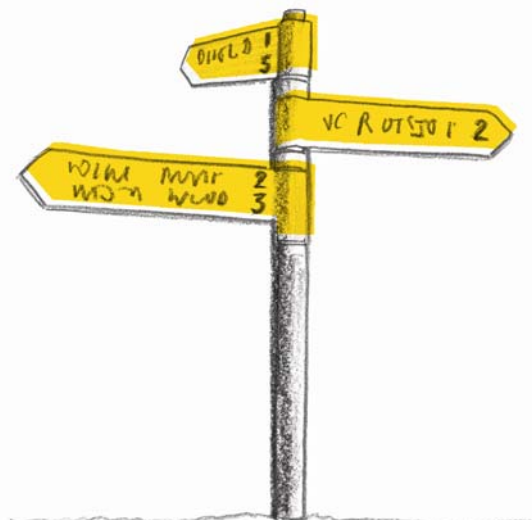
Under the invoice basis of accounting for VAT one must pay over VAT for the VAT period in which the invoice is raised. Under the cash receipts basis, one does not account for VAT until receipt of payment for the goods and services supplied. In a time where there is a longer delay in invoices being paid companies may consider changing to a cash receipts basis (subject to application to Revenue Commissioners).

The cash receipts basis applies where:

- Annual turnover does not exceed or is not likely to exceed €1,000,000.
- Supplies of goods or services are at least 90% made to unregistered persons or to persons who are not entitled to claim a full deduction of the tax chargeable on the supply to them.

### What to avoid?

The last thing that you should do is fall behind with your tax payments and compliance requirements. Substantial interest charges and other penalties can be applied in the event of late submission of tax returns and late payments of tax.



# 06

## Sanity check new investment plans

**“Consider carrying out cost benefit analysis on new asset investments. Such decisions should be based on the level of expected return. This is particularly pertinent when investment opportunities are competing for scarce resources.”**

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Patrick Burke  
Partner

What's the issue?

Investing in new assets in a downturn can bleed you of cash when you need it most. Carefully consider your investment plans, and question the proposed value and timing.

What can you do?

If it isn't business critical, consider deferring it. For a business critical asset, negotiate hard to acquire on favourable terms. But don't use all the cash – try to borrow.

What to avoid?

It used to be said that if there was a fountain in reception and a flagpole outside you were due to go bust. Avoid investing profits in status symbols.

# 07

## Keep an eye out for bargains

### What's the issue?

The mid-market is still fuelling M&A activity. Our experience over recent months has been that while the larger deals may be drying up, ambitious and well-funded companies continue to see the value of strategic acquisitions and are picking up bargains to supplement organic growth. An increasing number of private companies with access to funding see huge opportunities for expansion in the current climate. It is likely that there will still be funding available for the right proposition.

### What can you do?

Be alert to opportunities where business valuations are dropping and where business owners are looking for quick exits rather than trading through a more difficult economic period.

Take professional advice to ensure that any acquisitions are properly assessed and aligned to your strategic plans going forward.

### What to avoid?

This is not the time to become distracted. Remain absolutely focused on the day-to-day running of the business. Be mindful of debt capacity and don't overstretch yourself.



# 08

## Align performance and rewards

### What's the issue?

Align your people. Motivation can take a hammering when business is lean. Once you've defined your key objectives out of strategic planning and zero-based budgeting exercises, you need to make sure that staff understand your approach. Ensure your strategy is communicated and repeat it often. Align every aspect of staff reward to achievement of your goals.

### What can you do?

Think about the behaviours you want to encourage. Consider the 'golden thread' running from strategic objectives right down to individual objectives and remuneration. Think about rewarding sales teams based on profit per unit or speed of cash flows rather than simply on units sold. Alternatively, consider paying bonuses once minimum profits and minimum cash flows have been achieved.

### What to avoid?

If you have a bonus culture, and the cash simply isn't there to make bonus payments, you can't put your head in the sand. You have to be completely transparent and communicate effectively to explain the position. Consider alternatives, such as a deferred share arrangement to encourage staff to stick with you through the downturn.

**“Reevaluate your rewards structure and the objectives they mean to achieve. Revised structures may have a less immediate impact on cash flows than cuts but they should put you on sound footing in these challenging times and help to retain your key talent.”**

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Sinead Donovan  
Audit Partner



# 09

## Right size

### What's the issue?

Regrettably, as the major cost to most entrepreneurial businesses is labour, it is likely cuts will have to be made. This is never an easy thing to do, and it's important to do it as objectively as possible.

### What can you do?

A zero-based budgeting exercise will give you a strong steer as to what you need and at what level to support your strategic direction. Carefully consider the skills, commitment and capability you will need. Communicate well, retain integrity through the process but move quickly. Re-invigorate and re-motivate those that are left.

Lock in your key talent using incentives and personal development plans. Don't throw away talent unnecessarily, as this may prove to be a false economy when you consider the costs of recruitment and the loss of productivity and expertise. Make sure you take the appropriate advice, as these decisions are fraught with difficulty.

### What to avoid?

You can't allow emotion to rule your decision-making. You need reasonable and objective criteria to ensure that decisions are made in the best interests of the business and are not based on relationships or length of service.

**“Be decisive when making cuts. Develop a business plan to guide you through these challenging times. Be sure to keep your key people informed of changes and communicate your realigned business objectives.”**

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Michael McAteer  
Partner

# 10

## Protect your personal wealth

### What's the issue?

When business is thin on the ground, it is important to avoid being too reliant on the business. Also you need to have a clear view of how you separate your personal wealth from the finances of the business. Lenders will be asking for security, whether that is based on a business asset or on the business owner's personal property. Business owners need to be careful.

### What can you do?

If you've made good profits over recent years, consider how you can take the money out of the business (taking into consideration the associated tax implications of the method used to take the money out). If the worst happens, those funds are safe. If you do end up putting money back in to the business, make sure it is your decision to do so, rather than doing so just because you have money left in there. If, as individuals, you need to lend money to the company out of personal funds, rather than putting it in as an unsecured loan, consider cash backing the bank's additional advance or taking security under a second charge after the bank. In this way, if you do cease trading, you improve the prospects of recovering your funds.

### What to avoid?

Throwing good money after bad.



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## Appendix 1

# Questionnaire

Consider the following questions. An affirmative response to a number of questions could be indicative of a company experiencing financial and/or operational distress.

### Financial

1. Is a “going-concern” opinion at issue? Y/N
2. Has revenue decreased by more than five percent during the last 12 months? Y/N
3. Has gross margin decreased during the last 12 months? Y/N
4. Has the company’s operating cash flow (EBITDA less capital expenditures) decreased in the last 12 months? Y/N
5. Has the company’s cash collection cycle increased in the past 12 months? Y/N
6. Has the quotient of average inventory divided by annual sales increased by more than 10 percent during the last 12 months? Y/N
7. In the last 12 months, have vendors increasingly demanded cash on delivery or reduced credit terms? Y/N
8. Did utilisation on revolving credit exceed 85 percent of availability in the last 12 months? Y/N
9. Has the company violated the terms of its borrowing agreements or breached debt covenants in the last 12 months? Y/N  
Is the company highly leveraged relative to industry competitors? Y/N
10. Has the company’s debt credit rating been downgraded, or has its debt traded at a discount over the last 12 months? Y/N
11. Does the company expect to have difficulty meeting scheduled principal or interest payments? Y/N

### Management/Organisational

12. Has there been significant turnover among the senior management team? Y/N
13. Is management reactive rather than proactive in solving problems? Y/N
14. Has the company not produced a monthly financial plan (including projected income statement, balance sheet and cash flow statement) in the last 12 months? Y/N
15. Has the company prepared a strategic business plan in the last 12 months? Y/N

### Sales/Marketing

16. Did the company lose market share in the last 12 months? Y/N
17. Have any new entrants captured significant market share during the last 12 months? Y/N
18. Have there been major delays in launching new products? Y/N
19. Are the company’s sales highly concentrated among few customers? Y/N
20. Is it fair to say the company is not deeply familiar with the credit profiles of its major customers? Y/N

### Operations/Production

21. Is there over-capacity in the company or its industry? Y/N
22. Is the company’s technology lagging? Y/N
23. Have customers cited an increasing rise in quality problems in the last 12 months? Y/N



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