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A Dozen Ways Businesses Can Stay Liquid in a Freezing Economy

by Steve Tanner, Editor
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With no end in sight for the continued decimation of global stock indices, triggered by a credit-freezing crisis of confidence and other negative economic indicators, optimism is in short supply. But what's a business owner to do? How should a company weather the storm knowing that revenues and profits will fall?

In such turbulent economic times, small businesses can react in a few ways to hopefully ensure perpetuity of their operations.

"They can stick their heads in the ground and hope for the best, dramatically cut all expenses and risk future growth, or they can somehow use the downturn to make their business more effective," says Dave Stephens, co-founder and CEO of San Mateo-based Coupa Software Inc.

Stephens advocates the third approach, of course, since neither denial nor panic lends itself to moving forward. We offer a dozen suggestions for improving your odds of remaining solvent, culled from numerous recent discussions with executives, bankers, consultants and other business and finance experts.

1. Make Balance Sheets Look "Plain Vanilla"
At least through 2010, business lenders will be very reluctant to make specialized loans and instead will only back companies with conservative, "plain vanilla" balance sheets, says Bill Conerly, principal of Conerly Consulting LLC. The best way to do this, he adds, is to make your balance sheet and funding requirements match your industry.

"If you have to go through all of this explanation, the banker might jack up your terms," says Conerly, based in Lake Oswego, Oregon. "It's kind of like if you're designing a product and need some screws, it's going to be easier to get an off-the-shelf screw."

Also, bankers will not look favorably on a business if its balance sheet shows that the owners are siphoning off equity, indicating a general unwillingness of the owners to invest in their own venture, says New York-based consultant Jonathan Gassman.

2. Draft a New Business Plan In Line With the New Economic Reality
Let's face it, most products and services that do well in a stable economy fare much worse during a severe recession. So why would a lender feel confident backing a business owner who hands them yesterday's business plan? This should include a reassessment of collateral – "They really don't want to own your furniture and computers should the business go belly-up" – and a clear path of how the loan will be paid down, Gassman says.

But an updated business plan will do much more than just improve your chances of securing credit, says Christopher Hurn, president and CEO of Mercantile Commercial Capital LLC, a business lender based in Altamonte Springs, Florida.

"The simple act of preparing this will help force tough decisions and get your creative juices flowing for new, related opportunities for your business," Hurn says. "Get your partners and employees involved in this too, so you have their buy-in as well."

Continued on page 2.

3. Plan Some Face Time With Your Lender

Relationships simply matter more in a down market sparked by a crisis of confidence, sources say. Similar to the job interview process, potential lenders – like potential employers – will get a much better sense of your value once they meet you in person and get beyond the paperwork.

"I think the most important thing for a business owner is to have a one-on-one relationship with the final decision-maker in the bank," says Brian Horton, president of 1st Enterprise Bank Inc. in Los Angeles.

Horton and others say this is much easier to do with a smaller community bank, where the decision-maker lives in the same community as the businesses his or her institution backs. Conerly says that with an updated business plan and a simplified balance sheet in hand, it is much easier to personally plead one's case for credit.

4. Consider Factoring and Other Alternatives

Business owners can look elsewhere when the loan officer shows you the door, which will happen more often in this environment. One such option becoming more popular is asset-based lending, which includes factoring (wherein lenders advance roughly 80% of the value of a company's accounts receivable and charge a slightly higher interest rate).

Typically, distressed companies unable to secure traditional loans will seek out asset-based loans, but the credit crisis has made factoring a viable option for otherwise-healthy companies, says Andrej Suskavcevic, whose New York-based organization represents asset-based lenders.

"So they'll go to an asset based lender who does a lot more due diligence. The lender will do a physical examination of the inventory and will take into account what it will take for them to sell it," says Suskavcevic, CEO of Commercial Finance Association.

Asset-based lenders will consider anything that has real value, including physical inventory, other hard assets, accounts receivable (factoring) and even intellectual property.

Another option is the use of peer-to-peer lending Websites such as Prosper.com, maintained by San Francisco-based Prosper Marketplace Inc. Prosper.com allows small business owners and budding entrepreneurs to post loan requests online, and then lenders bid for their business.

5. Check Your Bank's Condition Report

While the recently passed $700 billion bailout package includes an increase in the amount of deposited bank funds the Federal Deposit Insurance Corporation (FDIC) will insure from $100,000 to $250,000, businesses often exceed the limit, says Sam Thacker, small business finance and credit expert for AllBusiness.com Inc.

Thacker recommends that any business over the $250,000 threshold check the bank's latest condition report, available online through the Federal Financial Institutions Examination Council. After accessing the report, Thacker says, borrowers should look at the section titled "Schedule RC-R (regulatory capital)" and specifically line 33, titled "Total Risk-Based Capital Ratio."

"The higher the ratio, the stronger the bank is and the less likely the bank will have difficulties meeting its obligations," Thacker says. "If the ratio is less than 10, the bank is minimally capitalized and unless it is a brand new bank, one should consider moving deposits in excess of $250,000 per depositor to another unaffiliated institution."

6. Adhere to a Budget and Trim Waste

Staying within a budget and getting rid of wasteful spending is always a good idea, but can mean the difference

Continued on page 3.

between survival and bankruptcy these days. Stephens suggests separating strategies into those that control expenses and those that maintain growth, stressing the importance of not throwing the baby out with the bathwater. "I think treating your employees well and providing health benefits are all good business practices," Stephens says. "But you just have to get rid of things like association memberships, free food in the break rooms, things can be considered non-core expenditures."

The largest competitor to any small business is Waste Inc., says Paul Rauseo, managing director of George S. May International Co., a business consultancy based right outside of Chicago.

"We have to be cognizant that the largest opportunity for small businesses is the ability to cut waste," Rauseo, who oversees clients in the western United States. "When you're looking at a 2% interest rate increase but cut 10% in waste, then you're 8% ahead of the curve."

7. Be Careful Not to Jeopardize Future Growth
A scalpel is much better than an axe when cutting expenses, since broad and tactical spending cuts can inadvertently hurt the ability to grow, sources agree. Conventional wisdom, Birol says, is to cut everything and see what your competitors are doing; but he says a better approach is to first get a handle on what your industry needs the most and how you plan to generate future revenue.

Responding with a knee-jerk reaction – i.e., cutting payroll or marketing, or abandoning promising projects that have yet to generate revenue – simply is not a recipe for success, Hurn says.

"This is not how these folks will survive the recession," Hurn says. "Smart business owners should continue [or increase] their marketing, get rid of their weakest link employees, thoroughly examine their business model for new opportunities and generally go back to the things that made them successful in the first place."

8. Look For Opportunities to Barter
Bartering with other organizations is great way to get what you need when cash is tight. Birol says face-to-face interactions, perhaps through chamber of commerce mixers or other business events, help facilitate bartering deals. Weblogs, or blogs, also allow this kind of interaction, he adds.

Birol says three-way barters exponentially open up even more opportunities.

"I need something you know how to get; you have something that I know someone else needs. So we do a three-way barter," he says.

9. Restructure Payment Plans
Anything a business can do to encourage customers and supply chain partners to pay sooner – ideally, before paying others – will help that business stay liquid, Birol says. Two examples are prepayment for services and the pay-as-you-go model. And although large corporations typically make their small business partners wait for payment, he says that should no longer be considered acceptable.
"Small companies have to step up and say they can't do business with larger companies like that anymore," Birol says, suggesting a rule that both customers and business partners pay within a 30-day window. "This would probably accelerate the multiplier effect to the point where we would never be in a recession again."

10. Form Strategic Alliances
San Diego-based author and business advisor Sheila Holm recommends strategic alliances as a way for business partners and businesses with similar interests to leverage one another. Holm tells her client companies to set up alliances with at least seven other businesses.

Continued on page 4.

"You make an outline of your business, looking at everyone you purchase from, sell to, and everyone in sales and distribution – so everyone making money from you and everyone you depend on," says Holm, who says the goal is to run more efficiently in a way that is beneficial to everyone who is interdependent on one another.

She says the trust and knowledge-sharing that comes from sitting down with customers, distributors and partners will help guide decisions that ultimately keep the wheels turning. Stephens says now is the time to perhaps solicit suppliers for advice and ask them how a product or service can be improved or modified in order to lower cost.

11. Refocus on Core Competencies

Companies that do well in a generally healthy market often branch out into new areas, but businesses might be better off focusing on what they do best, and ultimately that which generates the most revenue. This is not to say that businesses should go back to their old business plan, but rather rediscover what makes them unique and then find out what their industry really needs from them right now, Birol says.

"I believe a company in bad times, as much as ever, should focus on their best and highest use – what a business is good at doing, likes doing, and what the market will pay for," Birol says.

For example: If you operate a hamburger stand and have become famous for your double cheeseburgers, but began selling espresso drinks just because everyone else did – then perhaps it's time to get back to the meat of your business and cut out the fancy coffee. As Birol says, this is the time for executives and managers to ask themselves what their customers value the most about their business.

12. Be Creative and Extend Reach

While it may sound contradictory to the previous point, businesses must become creative in order to survive and set themselves apart from the competition, Rauseo says. Businesses should stay focused on core competencies, he says, but must also look for creative new ways to apply those competencies to an ever-tightening marketplace. "As many clients as we see choking, there are answers for those that are creative," Rauseo says. "The only companies that are going to survive are those that will shift gears right now. We're seeing that over and over."

Rauseo also says now is a good time for businesses to consider extending their geographic and/or demographic reach to take advantage of market vacuums left as competitors leave the marketplace.

While he and other sources offer valuable tips for staying alive in a frighteningly turbulent economy, Rauseo does not sugar coat the situation. Bottom line: You're on your own. Good luck.

"We'll continue to see a decrease in real estate because foreclosures are continuing to increase. Businesses will continue to contract," Rauseo says. "Not to be the picture of doom and gloom, but small business owners [need to] hunker down because there is no $700 billion bailout package for them." ■