Steer your business to safety: Heed early financial warning signs

Management issue paper

A few years ago, a hosiery manufacturer recognized signs of serious trouble with its business. The problems were many and varied. The number of retailers selling hosiery was declining due to consolidation and the influence of large chain stores who were dominating the market.

Profit margins were falling for the manufacturer because the chains wanted bigger discounts and inventory held in stock for them for later shipping. As well, the manufacturer's low-end product was facing alarming competition from Asian suppliers with much cheaper labour costs. Profits were therefore disappearing while assets were being tied up for longer periods of time. Commitments and payments to suppliers had to be made well in advance, while turnover of receivables and inventory slowed considerably. Things looked very grim, but the managers made one wise decision: they called for outside help.

Spotting the danger signs in time is critical to saving a faltering business. Although there are many ways in which a company can experience trouble, there seem to be three broad areas to watch: finances, operations and strategic planning. A business obviously has to be profitable, but early financial warning signs include:

- reductions in working capital and cash flow,
- increases in fixed and variable expenses,
- dropping gross margins,
- significant differences between actual and projected results,
- poor return on investment; and
- lack of action on negative variances from budgets.

The operations area covers management and personnel as well as processing, whether manufacturing or distribution. Are competent managers making effective decisions in all necessary areas of the business? Lack of delegation and one-man rule could be a problem. Lack of controls on spending, budgeting, and accountability along with inefficiency, a low-level of equipment maintenance, poor collections and weak employee relationships can signal trouble. Is obsolete inventory taking up space without moving out? Is outdated equipment keeping costs high? Is technological change needed? These can be warnings from the processing side.

If you're not sure you're focusing on the right products for the right market at the right price with the right kind of service, you may lack effective strategic planning. Your strategic plan may be covering all the right things internally, yet your business can be blind-sided by such unforeseen external competitive forces as advances in technology and cheap foreign sources for raw materials or processing, that destroy your competitive advantage. Strategic plans that are not kept current in response to all market challenges are ineffective.

These are all warning signs to beware of. There are, however, steps you can take to turn things around before it's too late. First, get the right kind of internal financial information on a timely basis. Second, make sure you have the proper people in the proper places. Third, gain control of costing, spending, budgeting and cash flow. Fourth, keep revising your strategic plans relative to the risks and opportunities presented by external forces, making reasonable changes when indicated. Fifth, hire an outside, objective consultant to ensure that all the necessary steps are being taken.

Steering a troubled business to safety often involves four stages: stabilizing the situation by reducing cash losses and increasing cash flow, analyzing the business and/or strategic plan to determine how business objectives can be met, repositioning the company through financial restructuring, and strengthening the firm through organizational restructuring.

The hosiery manufacturer sought expert help in time to work through these stages. Grant Thornton's advisers immediately recognized a couple of points that were in the company's favour: it owned its building, and had kept its initial profits within the company in the form of inventory. To improve the current difficulties, the turnaround experts recommended stopping the manufacture of the low-end product, since it no longer made sense to attempt to compete with the Asian goods. They also suggested investing in equipment that decreased labour and its variable costs. Suppliers were approached to provide longer terms for the payment of raw materials, and a more sophisticated product was developed that had less competition and could find niche markets in the U.S. (through the use of an experienced U.S.-based marketing executive). The manufacturer's small size allowed it to offer faster delivery and better customer service than its competition.

The improvement did not happen overnight. The beneficial changes took about a year to implement, but now, the manufacturer is still in business and still profitable, although the market remains a tough challenge.

If your business is not as profitable as it used to be and you can't seem to identify the causes and solutions, Grant Thornton's turnaround management team of experts and specialists can work with you to identify the issues and understand your short- and long-term needs. A review of your current corporate structures and the organization as a whole would be done to identify the areas that can or need to be changed. The team can suggest alternative solutions and make projections from various models in order to assess probable results and determine the best approach, helping you steer a new course toward success.

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