One solution doesn't have to mean one strategy.

Proactive and reactive—take all the right steps to manage the health of your business.

A Grant Thornton white paper for manufacturing and distribution

The ability to maintain a healthy balance sheet is key to the short- and long-term success of any business, helping to ensure continued access to existing and incremental financing while providing much-needed flexibility in dealing with current creditors. Access to capital, should the right opportunity arise, and creditor patience in tough times are critical not only to growth, but to survival.

The challenges posed by the recent global economic climate, however, have some Canadian businesses balancing on the bubble. Many who are facing an ongoing erosion of their profit margins are wondering what steps they can take to make sure relationships with lenders remain strong. Or perhaps they've recently been experiencing losses and have begun to fear the negative impact an unforeseen business event could have on their financials, particularly the balance sheet. Other businesses have already seen the bubble break and are looking for ways to stay afloat, hoping to reinvigorate their business and bolster their access to future credit.

No matter which case applies, we're talking about rebuilding the overall health of your business, and there are several strategic approaches you can take. The first is simply to keep the lines of communication open with your lender, providing them with timely, forthright

explanations for any anomalies on the balance sheet or in the business overall. This immediately enhances your credibility. When the balance sheet suggests that there may be problems now or right around the corner, the answer is not to avoid your lender, but to get closer. Reasons, explanations, expectations, recovery plans: these will only improve relationships and foster opportunities.

Once you've made sure your lender is in the loop, the implementation of both financial and operational health checks within your company is a further key to maintaining—or rebuilding—the health of your balance sheet, as well as demonstrating to creditors that you're committed to taking positive and proactive action. The most efficient, comprehensive outcomes will be achieved when financial and operational specialists work in concert—not necessarily side-by-side, but in ways that allow their mutual, specialized skill sets and knowledge bases to inform, interact with and improve the results of the other.

Financial checks

Cash flow and working capital

Start here at the first hint of trouble. A thorough analysis of cash flow and working capital allows you to project how your company's health will hold up in the coming months. A sluggish economy can create a perfect storm aimed directly at unwary businesses: your sales slow and your suppliers, whose sales have also slowed, simultaneously demand timely payment, often on much more aggressive terms—so not only have your profits decreased, your need for working capital has increased. If you find yourself increasingly reliant on your customers to pay on or near their due dates so you can pay on yours, you're in a dangerous cycle. Understand your cash flow; prepare detailed forecasts and compare results. Stabilizing your cash flow will stabilize your working capital as well, and that's something lenders will want to see. If you find you've already slipped into trouble, there are a number of options available depending on your particular circumstances. You may be able to

- try to match payments with receipts—if systems and resources allow, set up payments to suppliers to occur after the majority of receipts normally come in;
- use natural hedging if you operate in multiple currencies, e.g., use US$ revenue to pay US$ expenses to minimize financing costs as well as exposure to currency fluctuation;
- examine inventory levels, liquidating old stock and reducing new where possible, and consider implementing LEAN and JIT (just-in-time) production;
- explore alternative working capital financing options such as export insurance (if applicable), receivable factoring and asset-based lending;
- consider simple refinancing options such as principal payment holidays and term loans against fixed assets;
- try to achieve discipline and flexibility in fixed asset management—analyze your CAPEX requirements over the next two years by
  - performing a present value lease-vs.-buy analysis of assets to assess the best financing option, and
  - building flexibility into methods of asset acquisition and deployment;
- look at commodity hedging to minimize the downside risk of raw materials costs; and
- review costs at every level, including human resource costs: consider every opportunity—big and small—to reduce and contain costs. Not only is this critical to the long-term sustainability of the business, it sends a very strong message to lenders about your continued commitment to the business despite the challenges it is currently experiencing.

The balance sheet

It's hard to keep something working right if you don't tend to all the parts. To this end, it's time well-spent for business owners to regularly familiarize themselves with the state of the balance sheet. As a snapshot of your company's net worth, it's highly indicative of the overall health of your business, and it's one of the first things a lender will want to see if you apply for new credit or a credit extension. What are your short- and long-term credit obligations? Are you likely to meet them? Do you have assets that can quickly be turned into cash if necessary? If these answers aren't clear, the balance sheet deserves another look.

> "All businesses face challenges in a turbulent economy. Businesses should think about contracting rather than expanding during uncertain times. Reducing the scope of operations and limiting commitments can help stressed businesses to stabilize financials and improve their long-term outlook."

Stanley Julien
National Director, Special Accounts Management Unit
Bank of Montreal

Fixed assets

No matter what it says, the balance sheet may not reflect the true, reasonable value of fixed assets. For instance, the carrying value of real estate is often substantially below fair market value (FMV), providing the possibility of revaluation and refinancing to increase or secure cash flow. At the same time, the carrying value of equipment is often higher than its FMV, so beware of overestimating how much your cash flow would increase if you liquidated this type of asset. Also consider whether the cost of replacing technologically superior equipment will be outweighed by new efficiencies and whether you have enough working capital set aside to make such expenditures when justified or required.

Personal circumstances

If you're the owner of a privately held business, you're probably drawing a regular income, and if you're facing financial issues, you may be considering scaling back to invest further in the company, especially if third party funding isn't available to you. Be certain there's a strong business reason for doing this, and don't throw good money after bad. Consider all possible funding options first.

The simplest sign of trouble for any business is an ongoing position of negative working capital, i.e., the business is not able to meet its short-term obligations. Such a business can't survive on a self-sustaining basis for an extended period of time without the injection of outside capital. Obviously, this is a difficult position for both company and lender. And often it's when a contradiction like this comes into play—you need capital to stay afloat but lenders are hesitant because your ability to repay appears severely compromised—that the complementary value of a parallel initiative like productivity improvement becomes evident. Your financial adviser has helped you apply the above checks, implemented some strategic solutions designed to appease your creditors and pressure your debtors, and provided a comprehensive assessment of your business. Now let's see what operations and productivity improvement steps you can take.

> "We have seen the benefits of implementing proactive productivity improvement measures in conjunction with financial checks firsthand. Also, accessing the experiences of other businesses through third party sources can provide insights that may be more objective and help owners make decisions which might otherwise be influenced by emotion or tradition."

Craig Thompson
Area Vice President, Atlantic Region
Commercial Banking, Scotiabank

Operational checks

While the implementation of financial checks is usually the result of an unstable balance sheet, it's the income statement—evidence of ongoing losses or a steady decline of the profit margin—that usually suggests the need for operational checks and the involvement of productivity improvement specialists. These checks focus on improving operational and selling performance and can directly impact the income statement, as well as key balance sheet accounts.

Moving from analysis to implementation to long-term support, successful productivity improvement projects employ a participatory but highly systematic approach, applying multiple checks in three categories across the organization:

Process	Systems	People
process mapping	volume forecasting	supervisory model
methods analysis	resource planning	active supervision
activity lists	cycle controls	management style
observations	daily production meeting/s	managing emotional response
planning guidelines	operating report	
problem solving	process feedback mechanisms	
"Lean" and statistical tools	weekly production meeting/s management reporting	

By improving on-site processes, providing a system that allows supervisors to work more effectively, and coaching for lasting behavioural change, your productivity improvement specialists should attain clear results and sustainable improvement in productivity, margins and profitability. Typical benefits include reductions in lead time, inventory, changeover time, unit costs and space requirements, as well as improvements in throughput and supervisory capability.

Lender attitudes have changed—business attitudes should too.

Stressed businesses must remember that, due to the same forces pressuring them, lenders are facing powerful pressures of their own—from stakeholders, regulators, investors, and internal decision makers—to be more cautious about new creditor reliability and stricter with existing customers who are in default of their loans. At the same time, government and society at large expect these institutions to help stimulate the economy and support business by continuing to lend and by not forcing businesses into bankruptcy. This results in a situation that can be of mutual benefit to businesses, service providers and the lenders themselves.

While lenders may on one hand be stricter with new loans and tougher on those with current credit, they are also demonstrating more patience with businesses that are prepared to ask for help. Too often, businesses shy away from productivity engagements simply due to the size of the project and the perceived expense. There are, however, several good reasons why these are bad reasons. If the working capital is available, companies should carefully evaluate how much and how quickly the savings that can be achieved through productivity improvement will offset the initial cost. For those companies that do not have the working capital, there are funding sources available that specifically cover these kinds of initiatives. Your adviser should be able to direct you accordingly.

Finally, to reiterate, lender attitudes have changed. In recent years, efficiency and productivity have become significantly higher focus areas for lenders as part of their ongoing credit reviews, risk assessments and due diligence. As a result, their willingness to be open to—even encourage—productivity improvement initiatives has expanded, and is likely to continue. Lender scepticism can be changed too, which should be a powerful incentive for all companies to consider—or reconsider—the value of a productivity improvement initiative.

When it cuts both ways, it just means you have two edges.

It's fairly clear that there are a number of specific financial and operational checks that pressured businesses can implement to restore or reinforce corporate health. Unfortunately, what often happens when a business goes looking for these types of solutions is that they find compartmentalized service platforms that offer one or the other—or, more often, that offer both without taking into account how complementary and symbiotic these services are.

It's often the case, regardless of whether finance or operations specialists are first into a stressed organization, that the information developed by the lead group both suggests the involvement of the other, and informs the actions of the other when they do become involved. Without question, the task will be easier for a financial team looking to secure financing for an organization if the organization can show a clear improvement in productivity and provide the lender with specific data on how these improvements were achieved. Conversely, a productivity improvement project can be more quickly and accurately tailored to an organization's specific needs if there is solid, extensive, analytical balance sheet data coming from the finance side.

At first glance, it may appear that finance and operations service providers are, indeed, a world apart—number-crunching bean counters on one hand, who provide various accounting and audit services while studying the books from afar; and process-oriented project managers on the other, who are hands-on with the business, understanding it—and helping improve it—from the inside out. This is an unfair simplification of the skills and approach of each. Good accounting demands applied business knowledge—the ability and willingness to dig into the operations of a company and really understand what the numbers mean. Likewise, operations specialists, whose activities are often conducted in industrial environments, are not just industry-centric project drivers who shy away from the books. To do their jobs, they must fully understand the financial underpinnings of the companies they help.

The work of one group can critically shape and augment the work of the other, depending on the specific needs and issues an individual business has. And the potential results speak for themselves: strengthen your relationship with your lender, expand current credit flexibility and increase future financing options. It's a potent combination of services that delivers a powerful set of solutions.

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