

The Finance Director in 2010

What will the financial leaders of UK SMEs be doing this year?



As the economy crawls out of recession, the business community in the UK is faced with challenges of a variety and severity rarely seen. This paper will examine the issues facing finance directors of SMEs and the skills and tools that will be needed to meet those issues successfully. We will discuss holding things together in a crisis and preparing for the better times to come.

Get the information you need to manage cash effectively

The statistics may tell us that we are no longer technically in recession, but the economy remains decidedly weak. Availability of finance is patchy and companies (and therefore FDs) must, above all, be focused on cash. As ever, though, the FD needs a tight grip on all aspects of the business and a realistic plan. So management information must be available on demand and focused on the key drivers, and the business must have a flexible and robust model to enable it to understand the impact of decisions.

Protect your key resources

With the right information and realistic expectations, the company can then cut its cloth according to its means and successfully manage its way through and out of the downturn. But nobody should lose sight of the fact that things will eventually get better, and when they do companies will look to our staff to drive growth. Looking after staff is just as important when times are bad as when times are good. Good people understand that pay, benefits and so on are likely to be squeezed when demand is weak. Honesty and openness – about bad news as well as good – will help to maintain and build trust and confidence, making it more likely that they will stick around when things get better.

And protect yourself

Finally, all directors (but especially the FD) must be familiar with their legal responsibilities to creditors, and the risks (which include fines and disqualification) of failing to put creditors' interests first if the company is in danger of insolvency.

Adapt the model to the shifting environment

There are always opportunities out there, even in the depths of recession, and once you're sure of short term survival, you can start looking for and grasping them. They will include opportunities to reduce costs, grab market share and develop new product offers. Recessions are hugely disruptive. Competitors disappeared, new business models will have emerged. The old ways of doing things will no longer cut it.

During the tough times of the past couple of years, organisations have looked to the FD to secure their survival. As things get better, FDs will need to change their agenda to enable them to spot opportunities and to develop their influencing skills to ensure that they continue to hold their position centre-stage. An intimate understanding of the business and its drivers, supported by accurate information and a robust planning model are essential to the FD – now more than ever.

Take every opportunity to change the landscape

So the FD must be thinking about the business model and be ready to challenge the orthodoxy and slay sacred cows. How can technology be used to cut costs? Will the Cloud work for you?

Suppliers should be challenged too: take the opportunity to renegotiate contracts now so that they achieve the optimal balance of price, payment terms, quality and flexibility. And what applies to upstream relationships applies downstream as well. Revisit your pricing policy and your customer contracts.

Make sure funds are in place for growth

History suggests that more companies go out of business in the months after a recession than during the recession itself. Working capital needs will increase sharply as demand picks up and many businesses will not have access to the funds they need. So the FD should be using his or her robust and flexible forecasting model to understand the needs of the company in a range of scenarios and approaching funders to ensure that cash will be available if and when needed.

Be persuasive as well as analytical

The downturn has played to the classic strengths of the FD: analytical skills and cold, rational judgment. Recovery, and exploiting the opportunities that go with it, will require different traits, particularly creativity and the ability to persuade. Now is the time to start working on those skills, perhaps by using a mentor. When everyone knows that cash is tight it is easy to win arguments about cutting expenditure. To win arguments about which projects deserve investment and which don't, the FD needs excellent influencing skills. Presentation – both written and verbal – becomes vital. Take the time to work on your reports.

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Cash management is the key to survival

In an economic crisis, survival becomes the short-term imperative. The first question keeping business leaders awake at night should be: “Have I got enough cash to pay this month’s salaries?” The FD is the person to whom everyone turns for answers so he or she needs to have a tight grip on all aspects of the business. In other words, FD must have all the facts at their disposal.

Armed with up to date management information, an FD can keep the rest of the business informed and guide decision making. Transparency, honesty and incisive analysis (traits associated with successful FDs) will never be prized more. Don’t pull punches or dilute difficult messages. Make sure the organisation knows how long it can survive on its cash and get involved in significant decisions to work out the effect of pursuing the options the business is facing.

More than a year into the credit crunch, cash management remains the most important task of the FD, yet too many organisations are not devoting enough time or effort to it. Philip Davidson (chairman of the Institute for Turnaround and Head of Restructuring for KPMG Europe) says that he finds it

“incredible when we go into large companies that there is no one managing cash”.

Davidson notes that directors “are losing large amounts of revenue and have credit problems, but have never had to deal with these things before” because many are too young to have worked through a recession or were in junior positions in the early 1990s. They need help, and it falls to the FD to provide it.

What will the revenues be?

Survival starts with a realistic plan. Work out what sales the organisation can generate by focusing on the market and demand. Don’t be tempted to work out what your team **could** achieve if demand was there.

What does the business need to look like to achieve them?

Having established what revenues can be achieved, the next job is to assess what structure and resources will be required to deliver them, and how much that will cost. Can the business afford it? If not, think again.

And if you have more resources than you need to deliver the revenues, there are choices to make: cut back to the level you need and maximise profits, or

hold on to people and infrastructure you’ve invested in as you wait for times to get better? The answer will depend on your circumstances: how confident are you that things are about to get better? How costly will it be to replace any people, locations, kit that you shed?

What cost can be eliminated?

The truth is that the organisation (led by the FD) should *always* be looking for opportunities to perform more efficiently. In a downturn that is imperative. For most businesses, efficiency gains mean reducing the salary bill and few, if any, of us relish having the difficult conversations with staff to ‘let them go’.

The difficult economic environment may provide a financial justification for redundancies. But it is also true to say that most businesses have some under-performing employees with the resultant lost productivity. An organisation may be able to absorb poor performers when times are good, but when the pressure’s on, this is rarely the case.

See “How to cut costs and save money without damaging your business” by Paul Pascan at FD Solutions for real-life advice and assistance on how to view and control this exercise.

The auditor’s perspective David Blacher, an audit partner in Baker Tilly’s London office writes:

“The role of the FD has never been more important in these difficult times. An important area for finance teams to focus on is to look at the organisation objectively and ask how it should be run in terms of practices and procedures. At the same time, an honest and critical appraisal of its income streams should be undertaken so that everyone is clear about which parts of the business are the most profitable, where the best future opportunities lie in terms of growth, and therefore which areas should be geared up to ensure that the company can maximise its impact on the markets when things eventually pick up.”

Your workforce: *time for some housekeeping?*

Failure to deal with under-performing staff has serious implications for a business in any circumstances. Apart from the inevitable loss of efficiency and profit that poor performance causes, the long-term health of a business will be undermined because its best staff will become disenchanted if they feel they are carrying laggards.

Staff probably won't risk changing jobs in a recession, when unemployment is rising, but this doesn't mean they'll put up with poor management. In fact, if they are living through the loss of job security, reduced bonuses, pay freezes and longer hours that many companies suffer during difficult times, they are likely to resent poor management more than usual. The result will be poor morale – which will weigh further on the effectiveness of the organisation – and, when the economy and job market improve – staff turnover. The latest CIPD employee survey indicates that 34% of all employees will seek to change jobs within the next year

and a further 12% may do. The first to leave are those best able to find another job: your best performers. So make sure you're looking after them.

All organisations need a robust performance management system through which staff receive regular feedback on their performance; training and development needs are identified; training is delivered and staff feel valued and recognised. It may still be necessary to manage under-performers out of the business but at least they have been made aware of the problem, given the opportunity and support to enable them to improve.

This is good from the employee's point of view but also crucial for minimising the risk to the company of finding itself on the wrong end of an unfair dismissal judgement. GE's "20-70-10" system – which methodically manages out the bottom 10% of employees each year – has always been controversial, but Jack Welch emphatically defended it.

"You need to use the same rigour to evaluate your people that you use to evaluate your financial statements. You should take the top 20% of employees and make them feel loved," Welch advised. "Take the middle 70% and tell them what they need to do to get into the top 20%." Managing out the bottom 10 percent of performers is necessary not only for the organization's continued success but also for the sake of employees affected by the rigorous appraisal system. "People need to know where they stand," Welch said. "Failing to differentiate among employees—and holding on to bottom-tier performers—is actually the cruellest form of management there is."

Aiming to fire 10% of employees every year may be a step too far for most businesses, but the discipline and energy devoted to identifying and fostering good performance and identifying and rectifying poor performance are essential.

What happens if it all goes wrong? *Dealing with insolvency*

Even well managed businesses can find themselves in danger of insolvency. As the financial eyes and ears of the board, the FD must understand the consequences of business failure and the options which an organisation faces if it is slipping towards collapse.

Under the Companies Act 2006, section 172, directors have a duty to promote the success of the company. If a business is struggling to meet its obligations, however, this duty switches to protection of the company's creditors. We describe this period when the company is not in a formal insolvency but is in danger of becoming insolvent the *twilight zone* and it is characterised by uncertainty and anxiety for all

directors but especially the FD. It is particularly difficult for those who have not faced the prospect of insolvency before. If your business is trading in the twilight zone you and fellow directors must put interests of the creditors first. Failure to do so may result in sanctions (such as fines or disqualification) against all the directors. It is no defence to say that you were unaware of a problem: it is the responsibility of all directors to be informed about the company and its prospects.

Ensure that opportunities are explored for potential routes to obtaining new funds such as HMRC deferrals, Enterprise Finance Guarantee scheme and bank support. Regarding the HMRC deferral scheme, Steve

Clancy at MCR Tax Arrears Solutions says "despite the scheme still being available, we have seen HMRC tighten up on the procedure considerably since August 2009".

Be proactive. Engage with your creditors and explain to them the situation. Most organisations would prefer to work with a debtor to find a solution rather than push the debtor into administration or liquidation.

All being well, careful management of a business in the twilight zone will end with a return to health and normal trading. Alternatively, a sale, break up or winding up of all or part of the business may be possible without entering a formal insolvency arrangement.

Holding it together – dealing with insolvency

But if you feel that none of these options is possible, you should take the advice of an insolvency practitioner: in all likelihood the directors will be obliged to put the company into an insolvency procedure.

Increasingly, companies in difficulties are entering into collective agreements with their largest creditors which may involve long-term payment plans, write off of part of the debt or debt for equity swaps. At the moment, the prevailing philosophy of the courts is that if a company in difficulties has a viable business within it, everything should be done to make sure that part of the company is safe. Hence the growth of the so-called pre-pack where, with the prior agreement of the main creditors, a company is put into administration and immediately afterwards its viable business is sold to a new legal entity. This enables employees' jobs and customers' and suppliers' businesses to be safeguarded whilst leaving the unmanageable debts of the company behind. In theory, the proceeds of the sale of the viable

business will fund the settlement of the debts left behind, though in practice this will generally involve substantial write offs for those creditors or, possibly, result in them taking a substantial equity stake in the new entity. Whilst it may seem harsh on them, the end result is that jobs have been saved and trading partners have maintained a customer or supplier. And those creditors who have suffered a write off will almost certainly have received a larger payout than they would have received if the company had simply been wound up.

Insolvency need not be the end of the world. Many businesses emerge from insolvency smaller but fitter than they went into it. The reputations of managers and directors, including the FD, can be enhanced by the turnaround of an ailing business. Legal sanctions against the directors are only likely to be made if it can be shown that they behaved improperly. But the behaviour of the directors, and the FD in particular, of a company in the run up to insolvency will come under intense scrutiny during (and, retrospectively, in the run

up to) insolvency. So it is vital that directors are seen to be acting in the best interests of creditors whilst they are in the twilight zone.

Fenton Burgin, a Partner in Deloitte's insolvency practice, notes that "many FDs don't have the right skill set or experience to move from an environment where their company has been set up for growth and borrowing to fund expansion, to a market where sales fell off a cliff, creditors are pursuing payment, bank facilities have been breached and cash is running out." If your business is struggling to meet its obligations you must act decisively in the best interests of the company and yourself. Experienced business advisers with a track record of working through a turnaround can be invaluable – either in a hands-on role, hired to manage the business out of difficulty or in an advisory or mentoring capacity helping you and your colleagues to work through the problems you face. See later in this document for more thoughts on how a mentor can help the FD to be more effective.

Look after yourself and your fellow directors

If you are concerned that the company may not be able to meet its obligations either now or in the future you should make sure that:

- a reliable cash flow forecast is prepared;
- the board meets to discuss the company's financial position and that discussions are minuted;
- all creditors are treated equally, except that if the board feels (and has minuted) that failure to pay a particular creditor would cause the business to fail priority may be given to that creditor;
- consult an insolvency practitioner.

Improving efficiency

In good times and in bad the FD should, of course, be asking awkward questions of the organisation. What are the sacred cows? Under what circumstances would the business be ready to sacrifice them? Jim Collins in his bestseller *Good to Great* makes the point that the best companies do what they **can** be great at not what they would like to be great at. Be honest about your strengths and weaknesses as an organisation and play to the strengths. It seems obvious, but the truth is that few organisations really understand what makes them special.

This is as relevant to your back office as it is to the products and services that you provide to your customers have you looked at outsourcing services (or bringing them back in-house)? What opportunities for automation are there? Be honest with yourself about your company's abilities and be the best.

A revolution in IT

There are few businesses of more than a handful of staff which are not thoroughly dependent on the effectiveness of their IT systems. And pretty much every business has opportunities to use IT to improve productivity. You know what those opportunities are (or if you don't you should find out) and in most cases they are specific to your business. But there three linked developments which all organisations that use IT should be considering.

Hosting of IT infrastructure is becoming commonplace. You may well be using it already (in which case please skip ahead to the next paragraph), but if not you should at least be thinking about it. It's not right for everyone (it's unlikely to work if

you have more than a handful of users and you don't have a reliable high speed internet connection), but all organisations should be considering hosting of their file storage and email. Very small organisations and organisations with a significant number of mobile users will almost certainly benefit from hosting both in terms of cost and service.

One step beyond hosting is '**Software as a Service**' (or SaaS – pronounced 'sass') which allows users to access the applications they need (from spreadsheets to accounting to CRM and beyond) when they need them on a remote server. Paid for by a monthly fee (usually per user) and with no capital cost, it can result in substantial savings, reduce risk and improve responsiveness. If you haven't already done so, look into it.

The logical extension of hosting and SaaS is '**the Cloud**' which describes a means of delivering full computing services over the internet to end users who access them using a web browser. Again using the Cloud can dramatically reduce cost and risk, and improve flexibility and simplify the end user's experience. If you would like an FD's view of how hosting, SaaS and the Cloud could work for your business, please contact Tim Parfitt of FD Solutions.

Renegotiate supply prices

It may be more prosaic than the mysteries of technology, but if you're suffering why not talk to your supply chain about sharing the pain? The chances are that your clients have already (or will soon) be asking for you to share their pain. What will you do? Most businesses will do what they can to help a key client through difficulties, so why wouldn't your suppliers do the same with you? At the very least have a chat with them,

talk to them about price and payment terms.

Look at your pricing strategy

And whilst you're looking at your upstream terms of business, have a look at your downstream terms as well. Is there an opportunity to protect or grow market share by cutting your prices. Would your customers appreciate your taking the initiative in addressing the pain they may be suffering? Even if you don't want to initiate the discussion make sure you know how much you can afford to give to your key clients in terms of price and payment terms because they're almost certainly going to ask.

But maybe the right approach for you is to hold fast on your prices. The answer comes down to whether you think you can:

- a) change your business model to enable you to make permanent and substantial savings in your cost base (for example through process automation or finding low cost suppliers in Asia);
- b) push prices back to pre-crisis levels once things start to get better (if for example you offer a product or service with a short shelf life in a market where price responds quickly to demand, such as travel or premium restaurants); or
- c) hold your prices, cut costs to preserve margins as volumes fall, and wait for volumes to start rising again when recovery kicks (for example a creative agency with a highly differentiated offering).

If a) or b) apply then cutting prices may be the right approach. If c) then you'll probably be better to keep prices high.

Preparing for better times – access to the funds you need

Securing the funds you need

Do you know how much funding you need? Have you got a planning model which tells you your cash requirement over the medium term? If not, see later. And do you have an accurate and reliable short term cash forecasting model? There's no point seeking additional funding, or negotiating renewal of a facility, if you don't know how much you need, so get your forecasts right first.

Once the model's told you how much you need, test the assumptions. How can you reduce working capital levels? Is all the capex necessary? Most of all, remember that the recessions of the 1980s and 1990s tell us that more businesses fail coming out of a recession than going into or through it. Why? Because as demand picks up, your working capital needs, and as a result the danger of overtrading, will rise dramatically. Be ready for the increase in your cash outflow to acquire the additional resources you'll need to meet increasing activity. Make sure you have the ability to spot when it will happen and to cover it.

Do you really need to spend all that capex?

Look hard at all your capex. Can you squeeze another few months, a year or more out of your assets? Would you be better to delay an investment and accept higher unit costs in the short term? Are there any redundant assets? Is sale and lease back an option? Have you sold the company jet (or yacht) yet? On the other hand, are there opportunities to acquire assets now at significant discount which you were intending to purchase in a year or two?

Credit control: do the simple things well

There's no mystery to good credit control but the most common fault is to treat it simply as debt collection rather than credit control. Like so many other things it's about doing the simple things well and regularly. Do you issue statements every month? Do you ring your customers before invoices fall due to make sure they have the invoice and remind them

that payment should be imminent? Do you systematically withhold deliveries from slow payers? Do you monitor the state of your key customers' finances? Do you talk to them regularly – and especially if you spot any changes to their payment patterns? And if things get difficult, do you have a debt recovery firm lined up?

Inventory: make sure sales, production and purchasing are aligned

Not every business has stock to finance, but if you do you need to be sure that your sales, buying and production teams are talking to each other. If you have a full MRP system (and it's properly configured with meaningful sales forecasts) the system will be looking after the co-ordination. But most SMEs don't have a single system to look after their supply chain, so in these cash-constrained times they need to be extra careful that purchasing and manufacturing plans are consistent with sales forecasts.

Even if you do have an effective integrated system, you should still be looking for opportunities to reduce stock cover. Are your safety stock levels too high? Do you buy on a consignment stock basis? Do you work on a just-in-time basis?

Suppliers: be honest - tell them what you want

There's always a balance to be struck between price and payment terms. If your suppliers are in a strong cash position they may well be prepared to extend your payment terms in return for an increase in price (or vice versa – see above). So have a chat with them. Find out what they're thinking. Be honest with them and do what you say you're going to do. Don't let them down and find that supply has been withheld and your relationship has been lost, but do remember that just as your clients are pressing you for better terms, so you are perfectly within your rights to seek to pass some of that pressure on to your suppliers.

Why the banks prefer confidential invoice discounting (CID)

So now you know how much cash you need, where are you going to go? There's no getting away from the fact that the banks are less willing to lend now than they were two years ago. And when they do lend it's on far less favourable terms. But that's not to say that they won't lend, so what's the best route to securing funding from a bank? Generally speaking, security will go a long way to providing the comfort the

lender needs. If you own a property then a mortgage may be an option for you. But most businesses don't own property and even those that do will find that the uncertainty in the property market has undermined the banks' confidence in mortgages. The best chance of secured finance at the moment is to be found in debtor-based lending, probably in the form of confidential invoice discounting (CID). Banks prefer this to overdraft and

term loans – even with full personal guarantees – because it protects their capital ratios. From the borrower's point of view, it provides cash when needed, flexes with activity and usually requires far less in terms of personal guarantees (PGs) from the directors of the business. It is a sign of the times though, that some lenders are demanding PGs despite the comfort of the security provided by the debtor book. And like all other

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forms of finance, spreads and fees have increased sharply over the last eighteen months or so. That is not to say that all other lending has dried up because it hasn't.

Lenders will advance funds against inventory, and fixed asset financing (including traditional HP, sale and lease back, lease, split ownership or simple cash flow loans) are available

but are often more restrictive than would have been the case a couple of years ago.

**WARNING:
read the small print**

Whatever form of debt finance you obtain, you are likely to come under much more intense scrutiny from the provider than a couple of years ago. Small print is being applied rigorously, so make sure that you are in a position to deliver all the obligations placed on you in the agreement, and that you meet all those obligations. For example, if it says you should provide the bank with monthly management accounts within 21 days of month end, make sure you do.

Private equity swimming in cash?

Despite the talk of collapsing asset values and lack of liquidity in the global financial markets, there are plenty of investors with cash to invest. Private equity seems to have been very quiet over the last two years, and may not seem an obvious source of funding in the current climate. But there is no shortage of funds ready to invest. What has changed is the

private equity community's appetite for risk. With the banks no longer willing to lend huge sums to enable deals to be leveraged, rates of return for private equity are likely to be much lower over the coming years than over the last ten years or so. And with anticipated returns lower, appetite for risk has inevitably fallen as well.

So if you are interested in issuing shares to get access to cash, it may well be possible. But you are going to have to work harder for that cash and demonstrate a robust business model with real prospects for growth.

The private equity perspective Mark Ledger-Beadell of Meta Corporate Finance writes:

"Partly due to the way in which Private Equity houses raise their cash they too have a cycle in which cash is readily available or lean and/or the fund life determines when they are more in buy mode or sale mode. A lot of houses at the moment, irrespective of their liquidity position, are looking inwards and "fixing" or restabilising their existing investments. Those that had their exit peak just pre recession are sitting pretty with little or no portfolio problems and cash to spend. Some houses, indeed, have the major embarrassment of too much cash and nowhere to get a return on it. No surprise then that these are not turning to the banks but doing the Term or Mezzanine on their own and then possibly refinancing with a bank post deal. So is the banking position driving the private equity market? Well of course to some extent... but the fund managers have mouths to feed too so they will find a way to transact for the right deal. Banks will follow equity even if it is personal from a group of angels or investing NED; bankers are to some extent just keeping their heads down or the publicity spend has been cut, but deals are getting done.

What is true even pre recession is that Private Equity due diligence ("DD") processes have got more robust and deeper. The recession of course has not changed this. There are funds, the Government backed Capital for Enterprise, largely managed by Octopus and Maven, for example, can be accessed with what is being termed "light touch" due diligence. This is still probably more than the 80s or 90s though! Otherwise DD has probably got tougher. I will limit my comments to two key issues: firstly management DD – if the team is not prepared to subject themselves to 360 degree reviews don't start the process; secondly, management in a recession and the consequent focus on cash flow requires a different breed of manager. The FD component of a leveraged deal has always been important but now the interface between a strong MD and FD team is paramount."

Preparing for better times – getting the business into shape

Is this the time to exit? *How positive do you feel?*

Although logic would suggest that the bottom of the business cycle is not the best time to sell your business, the reality is that this is a very good time to be thinking about exit. If you are concerned that your business won't make it through the downturn, that it will emerge far weaker (and so less valuable) than it is now, or that you don't have the energy to see it through, you should be looking for

potential acquirers. Recessions are marked by periods of consolidation in most sectors: do you know who the consolidators are? Are you talking to them?

Do you know what your shareholders' want? Many investors are looking for arbitrage opportunities: disinvesting from parts of their portfolio to enable them to take advantage plunging values elsewhere. This will lead to

growing numbers of MBO's in the SME sector over the coming year.

On the other hand, if you are feeling confident about the prospects for your business then have you considered leading the consolidation of your sector? Which of your competitors (or suppliers, or customers) could you integrate into your business to build scale and value (or to stop someone else)?

The M&A perspective: Keith Hunt, Managing Partner of specialist M&A firm Results International writes:

"In early 2009, companies had little visibility and even less confidence so M&A ground to a halt. But now the confidence has returned and public and private companies alike are looking for opportunities to improve their service offerings and geographic reach through M&A activity. There is a window of opportunity for smarter companies to decide who to combine with whether by acquisition, sale or merger to position themselves in a lead position for the upturn. Those who leave it too late may find the best partners have been snapped up and they are left facing tough competition from new combinations with exciting offerings for their clients."

Preparing for better times: *Spotting opportunities*

The strategies that protect the organisation through the recession might enable you to grow profits (or at least maintain them) in the short term, but cost cutting will not support long term growth. Assuming that your objective is to increase the value of your business, sooner or later you will have to get back to top line growth.

At some point things are going to get better, so how can the FD – hero in the tough times – still be the hero as the recession ends? What are the skills you need to help your company thrive as it starts to grow again? There are opportunities out there even now. Are you able to anticipate them and act before the competition?

An effective FD knows what's going on in all corners of the organisation. He or she is in control. So the keys to success as an FD are access to information and the ability to use that information to drive decision making.

Investment

If your organisation is going to thrive through the recovery, it will need to be ready. What skills will be needed to grow? Have you lost them through cost cutting? Do you need to bring in new people, and/or replace existing staff? If you have decided to hold on to your staff during the downturn, make sure you use their idle time for training, to develop new capabilities or to improve processes.

Is the recruitment market awash with good people who have lost their jobs? This is a great time to recruit if you have the resources. If you can demonstrate that you have a healthy business, perhaps there are opportunities to acquire tempt key staff away from competitors? Can you use your financial strength to hurt competitors? Can you afford to cut prices below them to gain share?

Can you afford to maintain or improve quality when they are cutting corners? Or can you make a bold statement about your strength and integrity by refusing to cut prices?

Are there distressed businesses with desirable products, customers or people which are available for acquisition?

Whatever the opportunity, you can't make the right decision unless you have access to the information you need.

Your key drivers

Do you understand your business? What are the key drivers of success and the constraints or obstacles? Are you measuring them? Are you monitoring your competitors? What's your market share? Is it going up or down? What is driving your customers' purchasing behaviour?

All organisations should be focussing on a handful of indicators which are measured regularly and communicated to decision makers. Whilst their nature will change from business to business, they should include a mixture of forward, backward, inward and outward looking measures, and you should be able to drill down to more detailed analysis which explains trends and patterns. Your focus should be on identifying and then influencing the key measure of the success of your business: what, in *Good to Great*, Jim Collins calls **profit per x**. 'X' may be your most constrained resource: so a professional services business might measure the profit per hour of staff time; or 'X' may be a measure of how you deliver your product: profit per customer or per unit sold. Information is useful only insofar as it is acted upon, so the FD must take the

Preparing for better times – getting the business into shape

time to discuss the measures with his or her colleagues, get their buy-in to the measures being used, identify patterns and trends, and deliver insight to make sure the audience understands how the business is performing.

Managing risk

Identify risks: as you establish what your key drivers of success are you should identify what the main risks relating to those drivers are. *For example, if you operate a just-in-time inventory policy, the strength and diversity of your suppliers is a key risk.* Having worked out what the risks are, you need to set up **controls** to limit their probability and/or impact. *So continuing the example, our just-in-time manufacturer could insist that its supplier puts in place an insurance backed bonded supply and provides*

regular management information to demonstrate its financial strength. Controls cannot be 100% effective in preventing risks from materialising, so you also need to **mitigate** their effect. Do you have a disaster recovery plan in place? *For example: ensuring that there are at least two active suppliers of all goods or pre negotiating rates and terms with alternative suppliers ready for activation if the main supplier defaults.* You may be able to **share** risks, for example by insuring against a loss or by finding a development partner to split costs and returns on a project. You need to use your regular reporting routines (whether daily, weekly, monthly, quarterly) to **monitor** your processes and environment to give you prior warning of impending problems. So keep a close eye on your suppliers' delivery performance. Occasional late,

incomplete or incorrect deliveries may be a signal of cash or operational problems and so an increased risk of loss of supply. Finally is there someone independent who you can review your businesses actions with an unbiased eye to help avoid the snowball risk of a decision getting swept along. An effective non-executive director will make an excellent sounding board and adviser to a company's board. Mentors (see later) can also provide individual directors and senior managers with support and guidance. An independent NED or mentor should help you to see things through a different perspective and help to identify risks and opportunities that you might otherwise have missed. Finally, remember that the Combine Code on Corporate Governance applies to small businesses just as much as it does to large corporate

Planning a robust model brings it all together

You know what your key drivers and constraints are. You understand your environment and the risks and opportunities that you face. All you need to do now is model those variables so you can map out your options.

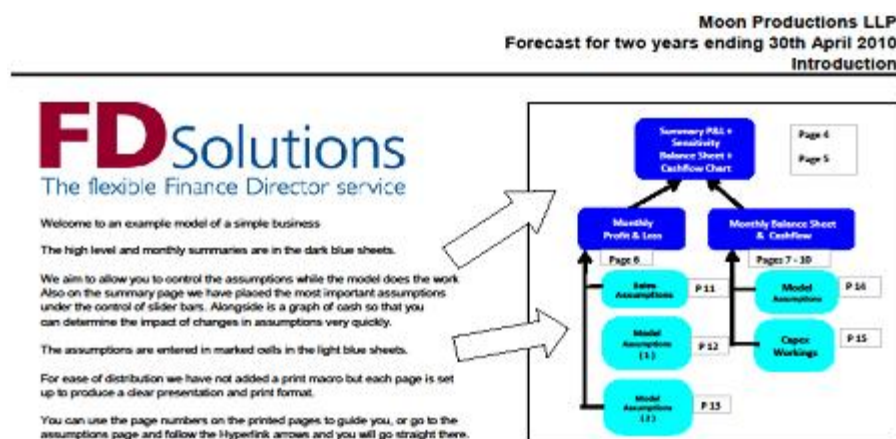
Few SMEs have the resources to invest in purpose built modelling software such as Cognos or Business Objects, but we all have access to Excel which, if used properly, is a

powerful and flexible modelling tool capable of building sophisticated yet easy-to-use business plans. The merits of modelling with Excel will be covered by a separate paper. This document will outline the features of a robust Excel model and the benefits it brings to a business.

Businesses which use a flexible planning model are able quickly to assess the impact of decisions and market developments and so choose

the best options available to them. An effective model is an accurate representation of the business and enables a user to change the key assumptions (which will reflect the key drivers of success) so as to explore a range of scenarios and outcomes. The model will summarise the key measures and track changes as they are made.

If your forecast model doesn't provide all this, look at the example on our website www.fdsolutions.uk.com.



Preparing for better times – getting the business into shape

Moon Productions LLP Forecast for two years ending 30th April 2010 Summary Profit & Loss and Sensitivities (All figures are £000)

	Year	Year	Year	Sensitivity	Original Value per month	Sensitivity per month	Revised per month
	Apr-08 draft	Apr-09 forecast	Apr-10 forecast				
Fees	1,643	946	960	Impact on model of:	80.0	-	80.0
Direct costs	374	357	377	Fees income	28.2	-	28.2
Gross Profit	1,269	589	583	Fee earners	-	-	-
Gross Profit %	77%	62%	61%	Share sales receipts	10.9	-	10.9
People Costs	264	206	204	Premises costs	18.8	-	18.8
Premises Costs	160	225	256	Legal fee costs	8.3	-	8.3
General Costs	775	420	465	Version Control	Y/E 4/08	Y/E 4/09	Y/E 4/10
Finance	457	25	27	Base PBIT	(387)	(286)	(369)
PBIT	(387)	(286)	(369)	IMPACT of Changes (re. above)	-	-	-
Interest Income / (Expense)	9	(17)	(60)				
Corporation Tax		-	-				
PAT	(378)	(303)	(429)				
Headcount @ Year End	16	16	17				

What skills do you need? *The ability to influence*

The FD is celebrated in the downturn for his or her clarity of thinking, analytical prowess and cold, rational judgment. All those characteristics will continue to be important as the organisation returns to growth, but to be a hero on the way up the FD will also need to demonstrate creativity and empathy with the rest of the organisation.

Spotting opportunities, rather than just the risk-spotting we are famous for, demands an ability to think laterally. Devising strategies to exploit those opportunities demands creativity. More importantly, convincing his or her colleagues to act on those opportunities and risks

requires a talent for both oral and written communication. It all comes down to an ability to influence the behaviour of those around us by building rapport and guiding our audience to the right conclusion. The oral skills are rarely innate but can be learned using techniques such as neuro-linguistic programming (or NLP). For ideas on how to improve your communication skills have a look at the FD Mentors' programme.

Few FDs think carefully about how they present information on paper or in a formal presentation. Reports are all too often long and impenetrable blocks of text. Presentations are a

succession of bullet points. Keep your reports brief. Make them easy on the eye. In western societies we have been trained to read across a page from left to right, so position your arguments from left (headline) to right (detail). Don't overdo the use of charts. Keep charts simple and relevant. People like tables of relevant numbers (think of the football results and tables) – don't be afraid to use them to break up text. For ideas on how you can improve your reports read *How to make an impact* by Jon Moon or visit his website at www.jmoon.co.uk. Your readers will notice the difference, your reports will gain credence and you will gain influence.

Conclusion

As we emerge (officially at least) from the worst recession in living memory, businesses are likely to find that growth brings with it as many risks as opportunities. The pick-up in activity will bring new stresses which will require a different approach. More businesses are expected to fail in the 12 months after the end of the recession than during the recession itself, so the finance director will need to remain vigilant even as he or she finds the resources to enable the organisation to exploit its growth opportunities. The successful finance director, who has led the way through the downturn, is ideally placed to lead the organisation through the new period of growth.

Contact details

If you would like to discuss any of the issues raised in this paper please contact Richard Brooks one of our Directors

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The flexible Finance Director service

