Business Process Improvement
Sailing In Troubled Waters -*February 11, 2001*
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Looking at the current economic environment, most observers would probably agree that we are heading toward difficult times, reminiscent of some in the past. With lightning speed, fiscal and monetary policies are shifting from controlling an overheated economy with worrisome signs of inflation to stimulating an economy heading for a soft landing or possibly even to a recession. Even the federal government is revising downward the budget surplus estimates.

We are being flooded with bad news. Many new economy companies have drowned in a sea of red ink and this has submerged the NASDAQ market. These were the first strong signals that quickly led to troubles in the other markets, began to erode confidence and started a quick turnaround in spending habits. The consumer, the linchpin of the unprecedented economic boom we have experienced for nearly a decade, appears to have had enough and decided to pull back. Retail sales continue to falter, as do sales of autos, computers, luxury items, housing and related materials.

Industry is showing the effects of all the bad news. Earnings reports have been grim. Capital spending has retreated and venture capital is tough to find, particularly for dot-com and smaller telecommunications-related businesses that have been providing the underpinning for employment and advertising growth. Bankruptcies and downsizings have also taken a toll. Recent announcements of bankruptcies at Montgomery Ward, Outboard Marine, TWA and others have been accompanied by a host of announcements of companies contracting, for example Sears closing stores, GM dumping its Olds line and advertising agencies cutting creative staff.

All of this ill-wind is being felt especially by the banking community, as daily pronouncements are made of increasing problem loan levels and mixed earnings results as a growing number of lenders are being forced to boost their reserves and write off billions in loan assets. This leading indicator of shoals ahead means many companies are finding revenue growth difficult to sustain, thus deteriorating debt service capability. And unlike past recessions, where bad loans were concentrated in the real estate sector, today's problems are more widespread, occurring in consumer finance companies, movie theater chains, and even utility companies.

Where does this bad news lead? No one really knows. The Fed recently took aggressive action to stem the tide, cutting interest rates by a half point without following the usual pattern of waiting for a scheduled meeting. Will this do the trick?

Will the proposed Bush tax cut, if approved, provide the needed stimulus? Will the consumer resume spending and will individuals again turn around depressed stock markets? We'll have to wait and see; however, early indications are not good.

Although there are new uncertainties and negatives to deal with in the coming months, corporate boards and executive management should act now to manage the impact of the current difficult times and even more severe troubles that may be on the horizon. This is exactly the environment in which top notch managers in a company with good corporate governance can show their mettle. Protecting and enhancing shareholder value is relatively easy in good times but in troubled times only the best prepared companies can flourish. Crews who are not prepared to batten down all hatches may suffer troubled waters or even sail off course and disappear altogether.

What can be done? The first step should be to create an awareness throughout the organization that external factors are changing so that the crew is prepared for new policies. At the same time, a risk profile needs to be considered to identify potential threats and decide how they can be dealt with. This action is critical and should involve board members and particularly the audit committee, so that board support for future actions comes quickly when needed. For a start, areas to be considered include: a thorough review of business plans and especially the near term operating budget and capital development phasing as it relates to revenue growth. Assumptions made last year in the course of a normal budget cycle probably need to be revised. Hard reviews mean discussion of sensitive items such as capital spending reductions, pricing changes, review of strategic alliances, firming-up of bank credit facilities, and lastly may even take the very difficult direction for management of plant closings and/or sales of subsidiary operations. The point is that early problem detection and contingency plans are the keys to survival in a storm. After all, that is why good sailors make sure their sails have good reef points already in the sails even though they may never be used. Once established, the risk profile needs to be monitored and updated when necessary. Obviously, the earlier problem areas are identified and dealt with the more the impact can be controlled and altered. This is best accomplished with proper tools to monitor the value drivers of the company. The keys in this situation are good internal controls and a cash monitoring system that gives early warnings of components in trouble.

Now is definitely the time to make sure your company doesn't get pushed off its desired course by the incoming tide of problems. Tune up your corporate oversight tools starting with the audit committee and see that it is staffed with the right people that ask the right questions and can assess the impact of major strategic and tactical initiatives. Also make sure that the audit committee is kept informed and agrees with sensitive announcements regarding finances and business prospects. Your company must speak with one voice and be scrupulously honest in getting out the facts quickly and to every one of its constituencies.

Internal controls, while always important, are even more critical in these times. It is absolutely essential that management gets proper and timely data to monitor the company's health and there can be no hint of a serious breakdown in proper controls. Internal audit should be charged with evaluating these processes and have regular meetings with the audit committee to keep them informed and to help the committee focus on hot spots. The audit committee must take the role of an effective watchdog without usurping management's authority. Good corporate transparency is a continuing need, especially in troubled waters.

Monitoring tools must be in place that focus on the key value drivers of the firm. There are usually not that many and understanding them and determining how each affects cash flow will provide a chart for relatively smooth sailing in the most turbulent waters. Staying on course will be difficult, but by monitoring how each of the value drivers are meeting their cash targets it can be done. Midcourse corrections can be made quickly when problems are surfaced and dealt with promptly and effectively.

Effective corporate governance will permit sailing in troubled waters.

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