Bevan Buckland LLP
Chartered accountants, tax and financial planners

BEATING THE ODDS

Helping your business to succeed in challenging times

GUS WILLIAMS
CHIEF EXECUTIVE OFFICER

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Who are we?

Bevan Buckland LLP

As Wales's largest independent accountancy firm with more than 120 years of experience in supporting SMEs, our exceptional team is fully equipped to deliver the full range of accountancy services, to the highest standard.

From core functions such as bookkeeping and tax returns to practical advice on how to develop your business, everything we do is based on a deep knowledge and commitment to do the very best for our clients and ultimately to help them grow their businesses.

INTRODUCTION

SURVIVING A RECESSION

On average in the UK, 10% of companies cease trading each year. That includes businesses going bankrupt, firms where the owner just retires and shuts up shop, and those companies which have never really got off the ground.

This 10% rate of failure is not an issue when times are good and new businesses start up at a rate of around 12%.

In a recession, the risk of your businesses ceasing to trade could double to around 1 in 5.
Our mission at Bevan Buckland is simple. We want our clients to beat those odds. We want to make sure that our clients do not make up part of the 100% who fail.

It is not just about preventing failure. 10% of businesses will actually grow and thrive in a recession.

This is our guide to survival and success in challenging times.

10%

of companies cease trading each financial year.

ONE MONTH

Research shows SMES look for new financing only one month before they need the cash, too late for many.

Cash is King

Evidence suggests that on average SMEs only try to find new financing one month before they need the cash. In times when banks are lending and credit is good this is not a problem, but in a recession that approach does not work.

If you do not have a cashflow forecast, then your chances of failing rise exponentially. Smaller businesses and sole traders need two cashflow forecasts, your business forecast and your personal cashflow needs. There is no point having a business cashflow only to find out you cannot pay your personal mortgage. If you do nothing else right now you should sit down with your accountant and put together a cashflow forecast.

"If you do not have a cashflow forecast, then your chances of failing rise exponentially."

Never planning ahead means waking up on a Monday and realising that you cannot pay your obligations on a Friday. Understanding what your outgoing payments are and when they are due is business advice that every good accountant should be able to provide.

Embrace the Stress

You should also stress test your cashflows. Understand how your cash balance will look under a worst-case scenario. Understand under what circumstances you will become insolvent so you can plan ahead and reduce the risk of it ever happening.

Balance Sheet is Strength

Once you understand your cashflow it is time to look at your balance sheet. The more leveraged your balance sheet is, the greater the risk that your business will fail in a recession. Businesses fail first because they run out of cashflow, they fail secondly because they cannot refinance an already highly leveraged balance sheet when the availability of credit worsens.

> ***"Businesses fail first because they run out of cashflow, they fail secondly because they cannot refinance"***

Strengthening your balance sheet means paying down short term or variable rate debt and increasing your equity by reducing withdrawals or bringing in new capital while capital is still relatively cheap and accessible.

Working Capital lets you carry on working

There is nothing more crushing than seeing a good business fail because its cash is tied up in working capital. Your business may look good on paper because you have lots of inventory and lots of receivables.

A fire sale of valuable inventory is the last thing you want to see after your business has failed. Likewise, you do not want to see a debt recovery company getting rich because they have bought up your receivables at a fraction of what they are worth.

Understand your working capital, optimise inventory, and manage your receivables. Consider working capital financing options.

Balance Sheet is Strength

If you sell on invoice or credit, then make sure you have effective processes in place to manage bad debtor risk. This is even more important If your sales are concentrated in a few buyers. Do you understand the credit risk of your customers? If your payment terms are 30 days and a client pays you after 60 days, do you know why? Should you continue selling to a customer who has breached payment terms? When it comes to bad debtors, having the common attitude that “well they paid eventually last time” is not enough of a control in a recession when cashflow and credit availability disappears.

Be wary of discounting...

When sales fall, it is tempting to think of using discounting and exclusive offers to try to maintain sales volume. If you are a supermarket, then discounting can be a good tactic, but I have seen many other businesses accumulate losses through bad discounting.

Do you know the price elasticity of demand for your product? Discounting and exclusive offers work for supermarkets, because we all need to buy food, we tend to shop where the staples are cheapest, and buy more if we (usually mistakenly) think we are getting a good deal.

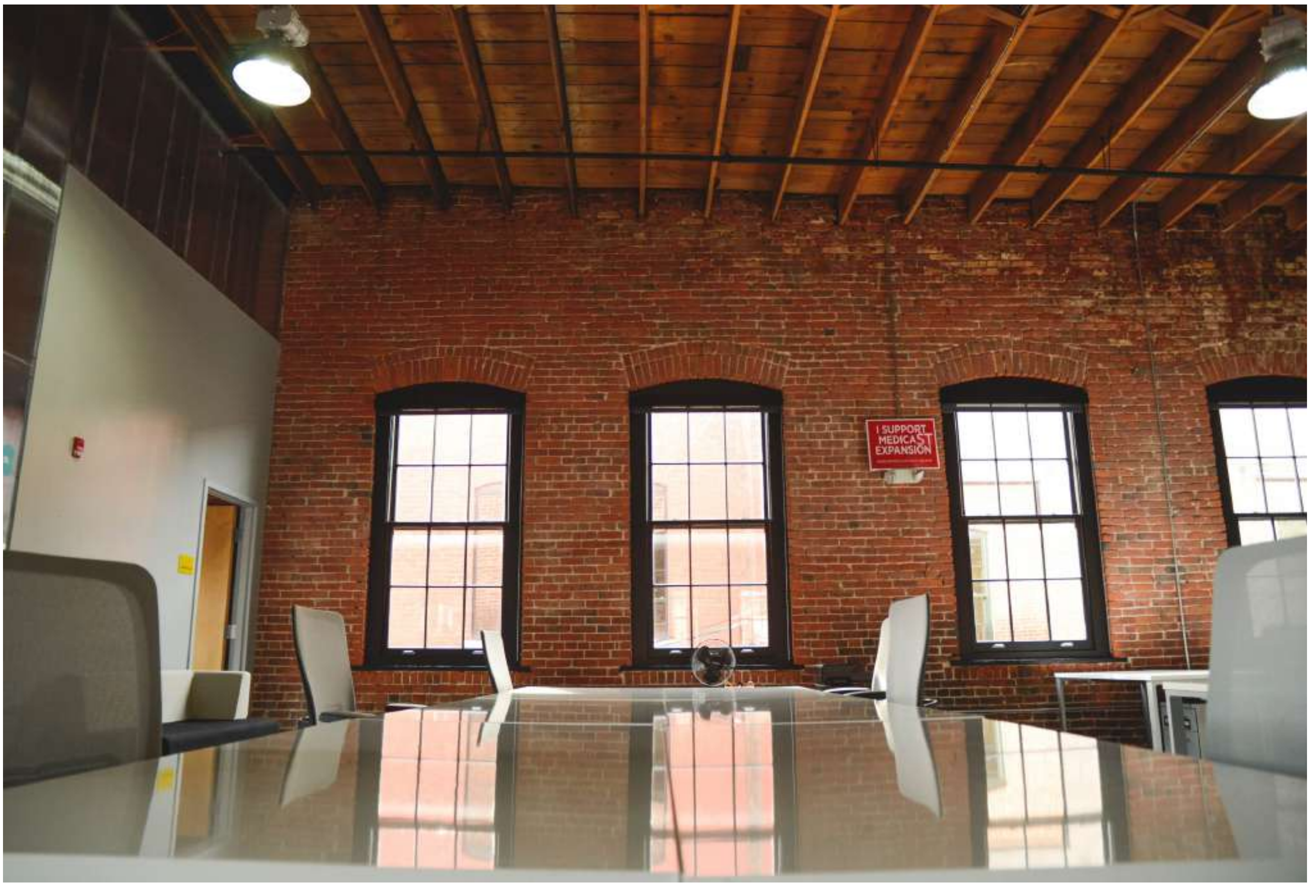
Necessity items where there is no alternative have a low-price elasticity of demand. Every day non-substitutable consumables have a low-price elasticity of demand (bread, bananas, and milk).

However, these items are easily available and found at many places – people need to buy them, but they can buy them at many places. People will travel an additional 10 miles to buy petrol 1p cheaper than their nearest petrol station. This is probably cost neutral overall if you add in the cost of driving the 10 miles, but that is the way consumers behave. Supermarkets discount petrol, bread, milk, and bananas because everyone buys them, and they can make up the loss by persuading customers to spend more on other items.

Discounting works if it brings in new customers that would otherwise go elsewhere and ties them in to spending money on higher margin products.

If you are selling a specialist product, where there is no substitute alternative, and there is little competition, then discounting can destroy your profits. Take the example of a company that sells 1000 units a year in normal times. 750 of those customers are loyal customers who love and value your product and will continue buying during a recession. 250 of those customers are one off impulse buyers. In a recession your sales fall from 1000 to 750 so to try and increase sales back to 1000 you give everyone 10% off.

The 750 customers who would have bought at full value are now only paying 90% of what they were willing to pay you. The 250 impulse customers are not attracted back by the 10% discount. In this scenario you have just given away 10% of your profits for nothing.



You cannot make good decisions if you do not have good data

We all like to think that we can make good decisions based on intuition and guesswork. In life you might get away with those 50/50 odds. If you are running a business during a recession, you need your decisions to be evidence based. Good data is good evidence. Good data does two things, it gives you a better basis on which to make decisions, but more importantly it tells you when you are wrong. If you cannot measure it, you cannot manage it.

A simple example is If you have 5 products and are making enough profit to be happy, you probably don't care about anything other than the bottoms line and how much tax you pay. However, it is unlikely those 5 products all make the same profit.

When that bottom line number falls, you will want to know which of your 5 products are profitable and which make a loss.

If you do not have good data, then you need to spend time making sure you do. Split your products or processes into value chains. Understand how your business adds value to those products or processes. Every product or service is the result of a process of delivery that adds varying degrees of value to your customer.

To maximise your profitability, minimise costs on the low value add parts of the process and maximise the profit on your high value and to do that you need to be able to monitor your business processes, to do that you need good data.

Your competition is your biggest threat and your biggest opportunity

If overall demand for your product is growing, then you probably don't care too much about your competition. There is enough pie for everyone to take a slice. In a recession where there is falling demand then who you are competing against and what they are doing becomes far more important.

The more susceptible your industry is to recession, the more important it is to know what your competition is doing and the more important it is to beat them.

If you run a restaurant and there are 2 other restaurants on your street. In a recession the chances are two of those restaurants will fail and one will succeed. The one that succeeds will be the one that has better food, better service, better atmosphere, better value, and better understands what the customers want.

Put simply, the better you understand your customers and give them what they want, the better managed your business is, then the better your chance of success. This is stating the obvious. The better managed your business, the better you are than your competitors, the greater your chance of success. In a recession this makes all the difference. Know your competition and beat them at delivering what your customers want and are willing to pay for.

It is not just about reducing your costs; it is how you manage them

The response of most business owners to a recession is to reduce costs as much as possible. There is a reason we haven't put this at the top of the list of things to do. Well-managed businesses should be doing this anyway. If your business is poorly managed, then the first thing to do is cut excess costs. For well-managed businesses it is not about cutting costs, it is about prioritising spending.

If your first instinct is to cut costs then you will likely do the following one by one: cut marketing costs; cut administrative costs; cut customer service costs; cut input costs, cut the quality of your product or service; cut staff.

If all you do is cut costs, starting with the easiest to cut and working your way down, then you might just be increasing the risk that your business fails.

Indiscriminately cutting costs may improve short term profitability, but you may also be destroying the long-term value of your business. Cost cutting can reduce the quality of your product or service, and may drive customers away, accelerating your decline. If your competitor is dramatically cutting costs and quality, then you should rejoice. Cut costs where you can but be careful about reducing the value of the product or service that you deliver to your customers.

Keep Your Staff if You Can

For many businesses staffing is the main cost. When profit falls, many look first to cutting staff.

If you need to reduce production or capacity due to falling demand. Think carefully about how just cutting staff will impact your business.

Redundancy can be expensive, so the first thing to consider is whether you can cut staffing costs in other ways. Can you reduce hours rather than staff? Can you shift salaries to a more flexible incentive or profit-based pay structure, such as guaranteeing bonuses if productivity and profit targets are met? Good HR and employment law advice may be cheaper than redundancies.

The temptation is always to cut those staff who are cheapest to cut, normally those who are young and haven't been there very long. COVID provides us with a good example of how rushing to cut staff on a last in first out basis can create problems. If you cut all your trainees, your young keen and ambitious employees, and then your experienced staff retire, you could end up with no one to replace them and be left scrambling to re hire. A lot of the value of your business is in your human capital, sacrificing your human capital for short term profits can destroy the long-term value of your business.

Value Creation or Value Protection?

At Bevan Buckland we often say revenue is vanity, profit is sanity. In a recession it is not always just about profits.

In a recession the priority may not be profitability. In Wales particularly, one of the problems with past recessions, was not the impact on corporate profits, but that we made bad decisions which destroyed the long-term value of our industries. Business owners should not be afraid to sacrifice short term profits in order to maintain the long term, inherent value of their business.

Invest Where you can

The graveyard of successful businesses who failed during a recession is littered with businesses who failed to invest. In a short recession, cutting short term investment may help cashflow. In a sustained recession, cutting investment may ultimately leave your services and products obsolete in a world driven by technology and rising customer expectations.

Those businesses who structure themselves and their finances in a way that allows ongoing investment are often the ones who emerge from recessions in a better position than when they went in.

Investing in technology that drives productivity and quality is one of the best ways you can survive and also thrive in tougher times.

GET GOOD TAX ADVICE

At Bevan Buckland we come across many businesses that are paying the wrong amount of tax. In a recession, you cannot afford to give away profits. Getting good tax advice and paying the right amount is something every successful business does. You also need to consider how you structure your affairs. How certain are you that in a recession you can offset potential losses against other profits or future tax liabilities?

CASHFLOW & BALANCE SHEET

We finish up by going back to where we started, if you manage your cashflow and have a strong balance sheet then not only do you increase your chances of survival, but you also give yourself the opportunity to thrive.

Businesses who prepare in this way may even find opportunity to purchase assets cheaply and grow market share as the competition struggles. To do this you need a strong balance sheet and liquidity before the recession bites. Start planning now.

SURVIVAL OF THE FITTEST

All of the above filter into the fact that it is the best managed companies who make up the 10% of businesses who will thrive in the coming recession.

Of the businesses that fail, the first to fail will be those that were poorly managed before the recession started. The next to fail will be those businesses who do nothing. After that will be those businesses who do something but do it too late.

There will be no excuse for a lack of preparation and planning and inactivity will be punished.

A lesson from the past

The dotcom bubble and the resulting recession of 2000 sent more businesses into bankruptcy, and more quickly, than any other recession. In the bubble of the 90s many businesses leveraged themselves to the hilt in the belief that revenue growth was everything and that capital was cheap and freely available. When growth stopped, the cash ran out, and there was no new capital to be had. Businesses went under. It wasn't the business ideas that were bad, it was their cashflow and balance sheets that were bad.

One company in particular was the winner from this over leverage. Amazon raised $700m in capital one month before the dot.com bubble burst.

"It wasn't the business ideas that were bad, it was their cashflow and balance sheets that were bad".

That was mostly luck, but it meant Amazon had the cash and the balance sheet strength to survive the chaos, enabled it to invest while its rivals failed, and it benefitted from acquiring its failed rivals assets on the cheap. The rest is history.

Make sure your business comes out of the other side of any coming recession on the right side of history.

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Contact Us

If you would like to find out more about how we can help you or your business, please get in touch

01792 410100

mail@bevanbuckland.co.uk

www.bevanbuckland.co.uk

Offices in Swansea, Cowbridge, Haverfordwest, Pembroke & Carmarthen