WHAT HARD TIMES

by Joseph Sullivan

The sun is beginning to shine on the electrical distribution industry again—or perhaps it would be more accurate to say that formerly gray skies are now only partly cloudy. Anyway, it's better now—let's enjoy it, and let's hope to never go back. But by all means, let's look back and take stock of the hard lessons of the downturn. Doing so can mean better, more profitable businesses moving forward, and stronger companies that weather future storms more easily.

In the downturn, everyone suffered, but some went bankrupt or are today in a gravely weakened condition. What made the difference? We asked leading bankruptcy and credit lawyer Joseph Coleman, of Kane, Russell, Coleman & Logan, for his insights. He has 18 years of experience working with troubled companies and is counsel for the Official Committee of Unsecured Creditors in the ongoing Warren Electric Company bankruptcy. He identified four general characteristics that lead to dangerous business difficulties:

1. The "We can sell our way out of it" mentality. It almost never works, and it keeps management from looking reality in the face and making the tough changes necessary for survival.

2. Inadequate management information—because meaningful performance and business metrics and reports are not being used, or because the quality of information is bad, or even because it is delayed to the point that it is too stale to guide decisions.

3. Management weakness in one or more of several areas:

- ✓ A dominant CEO surrounded by toadies and yes-people,
- ✓ Inability to change, and/or
- ✓ Brain drain of the best managers due to low morale or the lack of clear and challenging career paths.

4. Lack of proactive management—due to excessive optimism or a head-in-the-sand attitude.

These are the big business wreckers Coleman has witnessed over and over again, across many industries—and all of them apply to electrical distribution. For example, a Midwestern distributorship experiencing small losses doubled its sales territories in 2001, based on the promises of the salespeople added. Over the next year the additional expenses outran any additional sales.

In another case, a Southwestern distributorship made several acquisitions over time, never adequately integrating them into a system. Business and financial reporting was increasingly late, inadequate, and inaccurate. An atmosphere of chaos and domineering management lead to a serious brain and talent drain, just as the company most needed brains and talent. Losses racked up and cash went from short to critical. An unstoppable downward spiral accelerated into bankruptcy.

The company in the first example still exists, and is in pretty good shape for the shape it's in. In that case, management responded vigorously when it finally recog-

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nized its predicament. The second company was liquidated. It was short on management, short on reliable information to drive decisions, short on cash, and long on debt.

Why did the first company survive? By doing some things that all distributors should do at all times:

• Paying as much attention to cash flow as to sales. Build a spreadsheet that looks forward at cash 12 months, month by month, and manage business in such a way as to have enough cash on hand to pay the bills. The key word here is cash, not profit. Cash is the actual money available to pay bills at any given time. It is possible to be profitable and not have cash; it is also possible to go broke making a profit.

• Pull the entire management team together into one room and look disaster squarely in the face (in the form of a screen projection of the cash flow spreadsheet full of red ink). Rather than take a chance with poor communication, turf wars, and the protection of sacred cows, look at the same information at the same time and then develop a highly accountable joint plan that works.

• Reassess each month in just the same way—everyone looking at the latest information, everyone accountable, everyone a part of the solution.

• Focus sales on the customer base that fits an ideal profile.

• Eliminate peripheral operations that are not contributing, but rather diverting time and attention from the core business.

In short, become—and remain—a focused and tightly run company. Even with a lingering debt burden, businesses that do this will be around for many years to come.

How-to of cash management

Managing cash flow is a fine concept, but how is it done? First, it must be visible. A company must be able to see what its cash balances are probably going to be one, two, or 12 months in advance on a best-informed-guess basis. Excel or Quattro Pro spreadsheets are the place to start. Go through the check registers and look at what actually comes in and what is actually paid, and when. Put this information into a month-to-month timeline that computes starting and ending balances, and voilá—the result is exactly the kind of spreadsheet used by the surviving company mentioned above. Check to see whether forecast cash balances are positive, and that there is a decent-sized (20% ▶

or so) cash cushion (or that amount in available credit at all times).

At the end of each month, take a hard look at the forecast as it compares to actual experience. Redo the forecast for 12 months forward on a rolling basis, taking into account any material new information. If things don't look favorable, if prospects for cash are tight and scary, act immediately. Try to match payments and collections by negotiating—or just taking—longer payment terms and by speeding collections. Often discounts can be negotiated on longer terms simply by asking—as can collections.

Many distributors do not have a system in place to track and flag receivables and make a graduated, immediate collection effort. But a few friendly, early calls can really pay off. If that fails with some customers, get more aggressive on a graduated response basis. Aggressive inventory management, done right, is immensely valuable in cash flow management. Global purchasing cutbacks, however, are a recipe for disaster.

Companies should take pains to be sure that they are getting useful management information, and getting it on time. Accountants should not be allowed to drag things out so they can work up financial statement perfection—today's decisions can't be made based on what happened weeks ago. Furthermore, the monthly financial statement is simply not an effective tool for decision making. Measure performance in all important areas, and push accountants to learn how to do it—they weren't hired to be historians.

Bringing all key people into the information and decision process goes far toward overcoming Coleman's third business wrecker. It is important to have a team. Good money is being paid for the talent in a company; how silly is it to overlook and disempower it? If the talent is not good, it should be rearranged or replaced, and then the company structured to take advantage of what it has.

These are the lessons of the downturn. No distributor can change the economy. However, even those facing the toughest challenges can radically reduce risk and damage by using the techniques we have discussed. Frankly, if they do the same in good times, they can build very strong, formidably competitive businesses. ■■■

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Time to take action

Now, suppose you are a bit behind the curve. You are still in business, but the downturn burned through your assets and left behind bigger debts. You are headed for trouble with the bank and the vendors. What are your options? What can you do beyond the basics in this article? Again we turned to Joseph Coleman, of Kane, Russell, Coleman & Logan, for insight:

1. **Now, more than ever, you need a reputation for integrity, and you need allies. Be open and honest with vendors and creditors.**
2. **Bring in some fresh objectivity—new and forthright members of the management team or a reputable crisis manager.**
3. **Reach out to the bank and make it part of the solution. Note—a bank workout officer recently reported that her (major) bank would not make major concessions unless an acceptable crisis manager is on the job; this is not at all unusual.**
4. **None of the vendors wants to lose sales, so work out arrangements with each in order of their importance. Consider terms or notes for old balances.**
5. **Do not delay in cutting costs. Things probably will not get better, and a dollar lost is a dollar lost.**

Additionally, there are some practices that many of the best distributors focused on even more than usual during the downturn. It's not too late to follow their lead. Here are a few:

- **Use of a matrix in sales management, with prospects ranked by potential and salespeople ranked by call efficiency and achievement of the potential in their territories.**
- **Development of geographically compact sales territories to reduce windshield time.**
- **Adopt the strict use of a customer pricing matrix.**
- **Add credit risk to the criteria used in locating a customer in the pricing matrix (charge risky or slow-paying customers more).**
- **Use IDX2, and the Industry Data Warehouse, both from IDEA, to improve product information flow and radically cut the costs of order placement, invoicing, and other communications with vendors.**

—J.S.

When all else fails...

If the situation is looking like bankruptcy consider first an unofficial creditor's committee. This is done by retaining a knowledgeable accountant or lawyer, who, working on the company's behalf, organizes the committee. It provides a structured environment for negotiations, and can often get the many of the benefits of bankruptcy at a fraction of the cost and uncertainty. At the same time, the threat of bankruptcy helps keep the committee honest. Finally, there is the bankruptcy option. Here are the pros and cons:

Pros	Cons
• Cleanses the balance sheet thoroughly and efficiently	• Very expensive (companies pay their own lawyers and advisors, and those of the bank and creditors)
• Gets rid of unprofitable operations	• Demanding of time and attention to the extent that management can be diverted from the business
• Possibly reduces bank debt	• Extremely unpredictable due to competing interests
• Jettisons unprofitable leases and contracts	• Owners rarely retain ownership without investing significant additional funds