Focus on the Future: Companies Fail Because They Don't Change

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by James V. McTevia
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It seems to me that the radio spot that depicts a tragedy when the stock of a Hi Tech company drops in value because the company reported earnings, then increases in value when losses are reported, is a clear indictment of the weak foundation of our society's investment judgment and a testimony to the potential disaster our economy could ultimately face.

Economists Quarterly Forecasts, in its first quarter issue, included opinions on the five major events that could trigger a serious downturn in the economy-a stock market decline, a Federal Reserve mistake, inflation, an oil price increase or an international crisis. It is notable that none of the concerns deal with the fiscal health of the business community.

In the real financial world, this is described as a paradox, and what a paradox it is. Will the strong economy continue forever? No. Should businesses be concerned? Yes. When will the economy begin to slip? No one seems to know and that's the trillion-dollar question.

Economists predict gross domestic products dropping from 4.7 percent in the first quarter of 2000 to 3 percent in the first quarter of 2001. They also predict that consumer spending (or the steam that drives our economic machine) will drop from 4.1 percent in 2000 to 3.2 percent in 2001 and that corporate profits will drop from 7.3 percent to 3.3 percent during the same period.

Many highly regarded economists are pointing to these and other key indicators, predicting that the economic outlook for the 2000s is that the economy will not be as strong as in the past several years. Real gross national product is expected to decline and there are predictions of lower auto sales, high unemployment and a drop in real disposal income.

Based on economists' predictions, it certainly appears our economy is headed for trouble in mid or late 2001, at least, by virtue of declining consumer spending and lower corporate profits, even if none of the other five trigger points is activated. Therefore, now is the time to begin to prepare for what appears to be a downturn looming in our economy.

This is not to suggest that the decline will be as severe as the Great Depression or the Recession of the 1970s. Many businesses will, nevertheless, encounter problems serious enough to endanger continuing in business as they struggle to compete over the next few years.

Never before in the history of the country has there been such a level of sustained expansion of the business economy. Most companies have enjoyed a strong level of economic activity that enabled them and their owners to enjoy continued growth in a thriving business environment. Because of these prolonged good times, many principals and chief executive officers who are guiding companies today have never experienced the challenges of a severe business downturn.

Operating a business is risky and difficult under any circumstances. Management must devote a tremendous amount of energy and time to the operation of a company on a day to day basis. However, it's important they allocate some time to future planning and be able to forecast changes in the business environment.

Owners and managers should always develop projections and business plans. Continuous changes are required as the company operates month after month, year after year. Principals must be aware of fluctuations in the economic environment and in the trends of their particular industry. They must be willing to incorporate the necessary changes, regardless of how painful the changes may be. The failure or inability to recognize the need for change, and more importantly, the unwillingness to take corrective action, are overwhelming reasons why a majority of once successful companies encounter difficulties, which ultimately lead to serious financial problems and eventual failure.

In some instances, the company's backlog of orders may begin to drop, resulting in a decrease in future volume. The company, nevertheless, continues to operate at the same level of expenses. Businesses, like individuals, easily become accustomed to supporting an image, and owners often simply refuse to react to obvious signals that dictate immediate adjustments. The companies and principals continue to live in the manner in which they have become accustomed, without regard to changed circumstances.

In a number of our engagements, we have found that many companies that have experienced a drop in volume refuse to make the adjustments in overhead and have even incurred debt in an attempt to maintain unrealistic levels of wages, benefits and standards. We have even seen situations where companies have actually borrowed to expand their operations during down cycles in their industry.

If you are fortunate enough to be a principal of a successful business today, I strongly recommend that over the next few months, you take a very hard look at the company's future and prepare a plan to implement changes, when necessary.

When a company plans for its future, it should prepare projections, at a minimum, on an annual basis. The projections should incorporate the results of the company's previous history, its present operation, and the company's best estimates on what will happen in its industry over the next 12 months. Operation, and the company's best - If sales are increasing, smart executives on what will happen in its industry know that working capital require-over the next 12 months.

Whether senior management develops the projections internally or an outside firm is engaged to assist, if the assumptions incorporated into the plan are not realistic, it will be a road map to disaster rather than a useful tool to guide the company through a difficult period. The most important and often elusive ingredient in the development of projections is always what the company's level of sales activity and working capital requirements will be.

Sales activity projections should be developed through meetings with sales and marketing managers, who are then responsible for supporting the results. If they are prepared properly on a conservative basis, areas of expense expressed as a percentage of those levels measured by the company's previous and present operating experience will be more meaningful, resulting in a more accurate set of projections.

Working capital requirements can then be backed into a firm operating budget, which is an extremely useful tool for the company's future planning. I believe those businesses that have not already developed next year's budget by this time are in for a rude awakening.

Once the projections or budget have been prepared, they are worthless documents unless closely monitored and strictly adhered to. The projections of profit and loss and cash flow should be compared on a monthly basis with actual operating results.

If sales are increasing, smart executives know that working capital requirements must also increase. If the sales increase is short-term in nature, the short-term operating expenses must necessarily increase. Thus these increases will also be short-term and probably won't require an expansion of facilities.

On the other hand, if midway through the year, substantial unprojected orders are received that dramatically alter the company's operation; a completely new set of projections should then be constructed. The company cannot be expected to operate over the next several moths using a budget that was developed on information that no longer represents actual circumstances.

I am now convinced in my more than 40 years of experience, which includes a number of downturns in the business economy, that a number of business that are, or appear to be thriving today will, in fact, fall on very difficult times over the next 12 months. Some will even go out of business because principals simply refuse to take the time to look into the future.

Businesses fail because principals fail to recognize the signs, which always appear to herald a change in the future economic environment. There are signals, which are almost universal in every industry. They are found through articles in trade journals and newspapers, through meetings and participation in trade associations. Quite simply, we must all recognize that the ultimate responsibility for developing realistic projections lies with today's owners and managers. For many businesses over the next several months, there will be no second chances.