# Recession:

## a practical guide for businesses in Thailand

2008 - 2009

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# Introduction

The credit crunch in the United States and Europe appears to be transforming into a global recession and starting to squeeze business across a wide range of industries. Slowing growth, weakening demand and reduced lending by banks, compound an already difficult environment in which key commodity prices are fluctuating rapidly. While some geographies and industries are proving more resilient than others, our general advice to clients is to take proactive steps to prepare for potentially challenging days ahead.

Year 2008 has been a rough ride for the economy and the financial sector. In the major economies, it seems that each week another major bank failure, economic crisis, or government bailout is grabbing the headlines. Keeping track of all of the events and understanding what impact they will have are discouraging. In this guide, Grant Thornton in Thailand provides an overview of the recent major economic events, a brief assessment of how they may affect the typical business, and a 10-point checklist of things to consider as you manage through this difficult time.

With careful planning, foresight and a touch of innovation, you might even be able to turn conditions to your advantage. Businesses that are well-capitalized, well-positioned, and well-managed should see opportunities.

Most of our suggestions are about good business practices. After years of focus on revenue growth, fuelled by easy credit and global demand, management teams often ignore the other fundamentals. But the emphasis will need to change now. The coming months should be about instilling rigor and discipline throughout your business.

In the appendix, we have included a simple diagnostic questionnaire to help you determine if your business or that of your suppliers or customers might be at risk of financial distress.

# OI Manage cash intensely

## What's the issue?

Cash is the lifeblood of any business. It matters more than earnings. In a slowing economy, understanding and managing cash flow are extremely important. Customers are likely to pay their bills more slowly, sales and profitability will likely decline, and banks are more cautious in lending and will require more collateral or may reduce existing facilities.  Liquidity can become constrained very rapidly.

## What can you do?

It is important that you strengthen your liquidity as much as possible and closely monitor the cash flow of your business.

Stress-test your business plan and understand the resulting impact on liquidity. Based on your financial projections, forecast your cash flow, including near to medium term receipts and payments, identify peaks in demand for cash, manage your receivable balances and improve your cash conversion cycle.

With your suppliers, bargain with them for the most favourable credit terms and balance the benefit of early payment discount against your need for credit. For inventory, sell-down aged inventory, reduce inventory levels, decrease investment in stock, improve stock management and employ just-in-time stock management to the extent that is practical in your industry.

## What should be avoided?

Growth always consumes cash. A significant sales opportunity that seems to be profitable may have dire consequences on a company's cash conversion cycle and its ability to finance it in this market. An increase in the duration of the cash conversion cycle is a negative signal. Thoroughly consider the implications to cash flow from increased sales that may require capital expenditure and a ramp-up period. Understand the worst-case scenario, and make decisions accordingly.

# 02 Steadily control cost

### What's the issue?

In tough business conditions with decreasing demand and fluctuating commodity prices, cost cutting and spending reduction may be necessary to maintain profitability. Escalating costs will cause margin compression and, in turn, put pressure on liquidity.

### What can you do?

Control costs across the board. Review all costs very carefully in terms of their value to the business. Identify the costs that you actually need to run the business. Avoid cutting costs that will affect your business operations.

Conduct relative risk and benchmarking analyses against competitors in the industry, and look for saving opportunities. Reduce fixed cost as much as possible, and hold managers accountable for all expenditures and cash outflows.

A cost database is important. Build a cost database and keep it updated. Employ a real-time cost database to enable multi-dimensional analysis improving cost-related decision making.

Understand your fixed and variable costs and don't overlook any outstanding liabilities that are not reflected on your balance sheet. Find opportunities for reducing costs, and reconsider any capital expenditure decisions. Institute policies that encourage and reward cost savings and cash conservation.

Carefully consider a major area of cost: people. Avoid increasing salaries, but increase incentives or variable pay instead. Negotiate salary or deferred salary as necessary.

Watch out for one of the often-undisclosed costs associated with downturns; increased fraud. With executives and employees under increasing personal financial pressure, some people may be tempted to stray from the straight and narrow. Remove fraud temptations by tightening controls over financial movements.

### What should be avoided?

Prioritise … do not automatically cut marketing costs or employees as it might impact on your competitive position, particularly when market conditions pick up. Think about your business and, more importantly, your strategy. Cost-cutting initiatives that risk diminishing value should not be undertaken. Don't over-react.

# 03 Evaluate customers and suppliers

## What's the issue?

The recent challenges in credit markets, as well as a general economic downturn, have put increased pressure on the purchasing power and creditworthiness of customers, resulting in a tightening of credit terms and product availability from suppliers.

## What can you do?

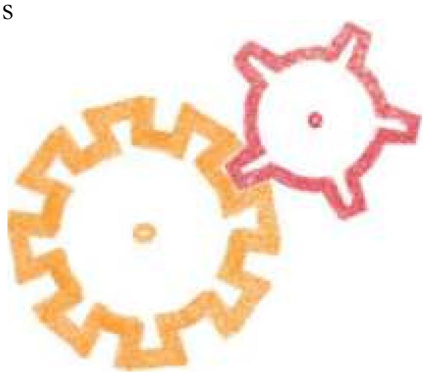
Re-evaluate credit terms with customers and negotiate the shortest reasonable terms. Carefully review the creditworthiness of each new and existing customer and set appropriate credit limits. Monitor the accounts receivable aging and quickly address any accounts that are past due. Request regular financial information from your largest customers to identify and evaluate risks. It is prudent to understand the credit profile of any customer that could severely impact your business if that customer runs into trouble. Also, encourage them to pay you earlier by offering early payment discounts.

In times of slowing sales, your competitors will be more aggressive in their efforts to win over your best customers. You must strengthen your relationship with all your key customers. Identify their needs and try to improve the quality of services, for example, by offering faster delivery times and thereby helping them reduce their stock levels without you having to reduce your prices. Customer relationship management initiatives are important.

In term of suppliers, bargain with them for the most favourable credit terms and faster deliveries. To maintain maximum flexibility also negotiate earlier payment discounts. Conduct a robust analysis and critically evaluate whether you need more or fewer suppliers. Expand your supplier base if some of your suppliers are financially weak.

## What should be avoided?

Do not assume your customers or suppliers are financially healthy. Failing to promptly collect receivables may result in a significant loss and cash flow shortfall that could materially hurt your business. Accordingly, extending generous credit terms to secure a sale may be a double-edged knife, to be handled with great care.



# 04 Review and reconsider your investment plan

## What's the issue?

Investing in new assets during a downturn can be an opportunity to buy more cheaply but can also bleed you of cash when you need it most. Carefully consider your capital investment plan, and question the proposed value and timing.

## What can you do?

Invest in assets with potential to generate high income in the short term. Re-focus away from longer term innovation but encourage innovation that may achieve shorter term expectations of increasing revenues and improving cash flow.

Take into account the timing of investments. Do not cancel an investment if it is vital to keep your business operating properly, but if it is not critical, consider delaying or deferring it. For mission critical-assets, negotiate to acquire them under the most favourable terms including discounts or deferred payments. To further preserve cash, consider the use of asset-financing or debt, to the extent that it is available.

It is essential to weigh the operating and tax benefits of the investment against the financing costs, especially in a lending environment that has become considerably more challenging. Incorporate increased borrowing costs into cash flow budgeting.

Understand changes to working capital that may result from a particular investment and incorporate them into cash flow budgeting. The project may result in an increase or decrease in cash, accounts receivable, accounts payable, or inventory.

## What should be avoided?

Do not just blindly stop all investing during difficult times. Failure to make necessary investments can put you on a slippery slope. If an investment is vital to keep your business operating properly, do not suspend or postpone the investment decision just because financing is more expensive and complicated.

# 05 Get closer to your banks

## What's the issue?

Given the current situation, banks have become more cautious and concerned about credit quality. As a result, they will become more restrictive in lending. Borrowing will likely come at higher prices and include more rigid conditions. Banks are increasingly focused on the quality of their loan portfolios; their key concern is loan recoverability.

## What can you do?

Treat your banks as a partner in the business. Keep them informed and help them understand your business, industry, and competitive dynamic. Make sure you give them prior notice if you need their help. Proactively manage your relationship with your lender.

If you need to go back to the bank for additional borrowing, discuss with your advisors. In many instances, getting your banks to work with you has a lot to do with how you ask for their help. Have a plan in hand. You will be better off if you are the one to tell the bank about any issues, rather than have them discover it themselves. In addition, understand prevailing financing structures and terms if you need additional borrowing.

Do your best to stay current on your debts. Try to ensure your company has the finance available to operate the business effectively. You will clearly want to avoid having your lines of credit restricted, demand loan called, finding your way into the bank's "special asset group", or being forced to enter into a restrictive and expensive forbearance agreement.

Make sure you understand the default provisions in your current borrowing agreements. Consider alternative ways of structuring your current credit facility. Potential sources of finance include subordinated debt, private equity and venture capital. These funding sources are generally longer in duration and often take more time to arrange.

## What should be avoided?

Do not automatically assume that your current lending relationships are going to stay in place. Avoid being in the position of not understanding your alternatives if you are forced to end the relationship with your bank, lender, or investors. Do not be left without a contingency plan.

# 06 Keep an eye out for bargains

## What's the issue?

As lending markets contract, some companies will have, or anticipate having, liquidity problems. A number of these companies will consider a sale transaction as a viable option due to a need to realise cash, a lack of confidence in a recovery or just to focus on their core business in these more challenging times. These situations create buying opportunities at attractive prices.

## What can you do?

The best buys are made in a down market. Well-funded companies looking to add market share, expand product/service offerings or recruit quality people might find it less expensive to acquire targets that fit this criteria than it would be to invest internally or to try to achieve these goals organically.

Limited access to capital may force other potential buyers onto the sidelines. The result will be less competition for attractive acquisition targets and thus, reduced pricing multiples on acquisitions. Working with a good professional advisor can increase awareness of such opportunities, while ensuring transactions are priced and executed in an effective, cost-efficient manner.

## What should be avoided?

Do not make an acquisition just because you can. A good acquisition should support your growth strategy and must be combined with careful transaction execution and post-acquisition integration.

Remain absolutely focused on the day-to-day running of the business. Do not become distracted. Be mindful of debt capacity and don't over-leverage the business.

# 07 Be strategic in workforce management

## What's the issue?

In the economic downturn, workforce management is critical to the success of the business. Some companies lay off employees to reduce costs in what is sometimes a knee-jerk reaction and may leave themselves without the right skill sets to manage the business through the crisis. Conversely, some companies purposefully carry excess resource to be well positioned for the anticipated upturn. So, what should be the right approach for workforce management?

## What can you do?

Be strategic. Focus on productivity and manage excess resource. Review staff performance. Look after key performing and loyal staff. If you must retain excess workforce, try to agree reduced or flexible hours and compensation. Consider using training programs to build their skills to make them more efficient and productive.

The Board of Directors should be more involved and give clear direction to the CEO. The Board of Directors should consider whether the current CEO has the right skills for this new business environment. If not, there are two options; get a new CEO with the right skills, or provide more hands-on leadership to support the CEO by appointing one of the directors or a consultant with the relevant experience as an advisor to the CEO.

Retention is vital in the downturn period. The CEO has to demonstrate that the company believes that people are the greatest asset of the company. Have retention strategies in place. Review compensation packages, and focus on transparency.

Keep staff informed more frequently than ever. Signals from the management are very important. Communicate to staff frequently about the company's plans, directions, and approaches to handle the situation.

## What should be avoided?

Don't just pay lip service to people issues. Take it seriously, and do it right away!

Avoid excessive micro-management of people. It is tempting to start micro-managing, to be seen to be 'doing something' about the crisis. Focus on the critical issues, give clear direction and let the management and people get on with their tasks.

# 08 Get smarter on tax

## What's the issue?

It is important to take appropriate advantage of any opportunities available to reduce your tax liabilities, such as utilizing available credits and deductions and making the right estimated tax payment.

## What can you do?

Focus on tax reduction and cash-flow improvement.  In terms of corporate income tax, businesses should take appropriate advantage of the available tax credits. In Thailand, depreciation is an underutilised area of tax management. For certain capital assets (e.g. machinery), an immediate deduction of 40 percent of the cost of the asset is available.

Companies should think about conducting a review of fixed and leasehold assets in order to ensure that each asset is depreciated over the correct timeframe for tax purposes. Often these cost segregation studies result in a reclassification of a significant number of assets and can result in substantial, immediate tax deductions.

## What should be avoided?

Do not miss required tax payments and filings as it can result in significant interest and penalties.

Don't seek sympathy and financial relief from the tax authorities.  In an economic downturn they suffer declining tax revenues and so are under significant pressure to collect all tax liabilities.  Manage your taxes proactively and seek the best tax advice.

# 09 Protect your personal wealth

## What's the issue?

The uncertain stock market clearly demonstrates the need for diversification. Diversification is equally important when considering additional investments in a business.

In an economic downturn, it is likely that businesses will have greater borrowing needs, and banks will be tighter on lending, asking for more security in the form of personal guarantees, additional collateral and more stringent debt covenants. Resolving business cash needs with personal assets will reduce the diversification of your overall personal net worth and increase your exposure.

## What can you do?

Think hard about your options before you agree to become more personally exposed for the sake of the business. Though you may be emotionally and financially tied to your business, make decisions objectively. Ask yourself the following questions; can the business survive a long-term recession? What will you do the next time the business needs cash?

Debt may not be the only source of cash. Consider bringing additional owners into your business. Equity financing may be a safer alternative and provide you with additional resources if the economy does not improve as quickly as you expect.

If you choose debt financing, try to avoid personal guarantees and pledges of personal assets to secure business debt. Understand the financial ratios of the business, and make sure there are no opportunities for technical default of the loan guarantees that will trigger a personal guarantee.

## What should be avoided?

Throwing good money after bad.

# 10 Worst-case scenario!

## What's the issue?

You have taken a hard look at your business and stress-tested your financial assumptions, but your fixed cost is still too high. Your balance sheet is highly leveraged relative to your competitors. Your credit is contracting. Your current outlook is negative. You foresee a serious liquidity crisis in the near term. Your future is uncertain.

## What can you do?

Do not panic. You are not alone as the economic downturn impacts businesses across almost every industry. Carefully consider strategic alternatives (e.g., debt restructuring, sales of non-core assets or subsidiary businesses, or raising equity).

Look at your business without its existing debt, and determine its debt capacity based on your current financial projections. There are two fundamental approaches to determining debt capacity: leverage multiples and coverage ratios. Lenders and debt investors also look at alternative exit strategies, including the liquidation value of collateral and tertiary sources of recovery such as personal guarantees. Understand your bargaining position and your views on value. Consider your fiduciary responsibility. If you are operating in the "Zone of Insolvency", your responsibility is to creditors, not to shareholders.

## What should be avoided?

Do not assume that the problem will go away by itself. And do not wait until you are almost out of cash.

Seek professional help early…. Restructuring and Recovery professionals are experienced in dealing with these issues and they can help you assess your options and quickly develop a plan then help proactively discuss it with your bankers and creditors.

Do not agree to provide additional collateral or personal guarantees in exchange for covenant waivers, until you have fully assessed your options.

# Appendix:

# Self-Assessment Questionnaire

**Consider the following questions for your own company.**
**An affirmative response to a number of these questions could be indicative that a company is experiencing financial and/or operational distress.**

- If you find a lot of affirmative answers, it may be time to seek some immediate advice.
- If you find mainly negative answers then you may be in good shape for now but, like everyone, you still need to carefully consider how you will manage over the next few months.
- If you find almost no affirmative answers and your company is cash rich, without taking excessive risks, this may be the best time to develop an acquisition strategy.

**If you need some help completing the questionnaire, Grant Thornton's team in Thailand can provide this service.**

**This questionnaire can also be used to evaluate your customers and suppliers.**

## Financial

| | | | |
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| **1** | Has the company's auditor discussed the need to consider giving a "going-concern" audit opinion? | **Y** | **N** |
| **2** | Has revenue decreased by more than five percent during the past 12 months? | **Y** | **N** |
| **3** | Has gross margin decreased during the last 12 months? | **Y** | **N** |
| **4** | Has the company's operating cash flow (EBITDA less capital expenditures) decreased during the past 12 months? | **Y** | **N** |
| **5** | Has the company's cash collection cycle increased in the past 12 months? | **Y** | **N** |
| **6** | Has the quotient of average inventory divided by annual sales increased by more than 10 percent during the last 12 months? | **Y** | **N** |
| **7** | In the last 12 months, have vendors reduced or refused credit terms / demanded cash on delivery? | **Y** | **N** |
| **8** | Did utilization on revolving credit exceed 85 percent of availability in the last 12 months? | **Y** | **N** |
| **9** | Has the company violated the terms of its borrowing agreements or breached debt covenants in the last 12 months? | **Y** | **N** |
| **10** | Is the company highly leveraged relative to industry competitors? | **Y** | **N** |
| **11** | Has the company's debt credit rating been downgraded, or has its debt traded at a discount over the last 12 months? | **Y** | **N** |
| **12** | Does the company expect to have difficulty meeting scheduled principal or interest payments? | **Y** | **N** |
| **13** | Has the company been avoiding paying tax liabilities? | **Y** | **N** |

## Management / Organization

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| **14** | Has there been significant turnover among the senior management team? | **Y** | **N** |
| **15** | Is management reactive rather than proactive in solving problems? | **Y** | **N** |
| **16** | Has the company failed to produce a monthly financial plan (including projected income statement, balance sheet and cash flow statement) in the last 12 months? | **Y** | **N** |
| **17** | Has the company failed to prepare a strategic business plan in the last 12 months? | **Y** | **N** |

## Sales / Marketing

| | | | |
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| **18** | Did the company lose market share in the last 12 months? | **Y** | **N** |
| **19** | Have any new entrants captured significant market share during the last 12 months? | **Y** | **N** |
| **20** | Have there been major delays in launching new products? | **Y** | **N** |
| **21** | Are the company's sales highly concentrated among few customers? | **Y** | **N** |
| **22** | Is it fair to say the company is not deeply familiar with the actual credit histories and profiles of its major customers? | **Y** | **N** |

## Operations / Production

| | | | |
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| **23** | Is there over-capacity in the company or its industry? | **Y** | **N** |
| **24** | Is the company's technology lagging? | **Y** | **N** |
| **25** | Have customers cited an increasing rise in quality problems in the last 12 months? | **Y** | **N** |

## About Grant Thornton in Thailand:

Grant Thornton in Thailand is well recognized by the business community as one of the leading professional service firms in Thailand and has been in Thailand since 1991. We helped many clients successfully navigate the Asian economic crisis of the late 1990s, applying a mixture of techniques, including debt restructuring, cost cutting and business plan revision. We have also helped many clients realise acquisition and expansion opportunities.

Our services include business consulting, external and internal auditing service, domestic and international tax planning, corporate finance advisory, restructuring and reorganization, merger and acquisition, executive recruitment, succession planning and remuneration planning.

To learn more about our firm, please visit our web site: www.grantthornton.co.th

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