August 2019

Slow Patch or Next Recession? Contingency Planning for Business Owners

Create Opportunities

If you've been through a couple economic contractions, you've learned that contingency planning dramatically increases your odds of survival.

Recessions are normal events in our economy, so it makes sense to be prepared for the next one. And just as you have spent a great deal of time and effort building your organization, you should consider ways to avoid becoming an undesirable statistic if the economy slows down.

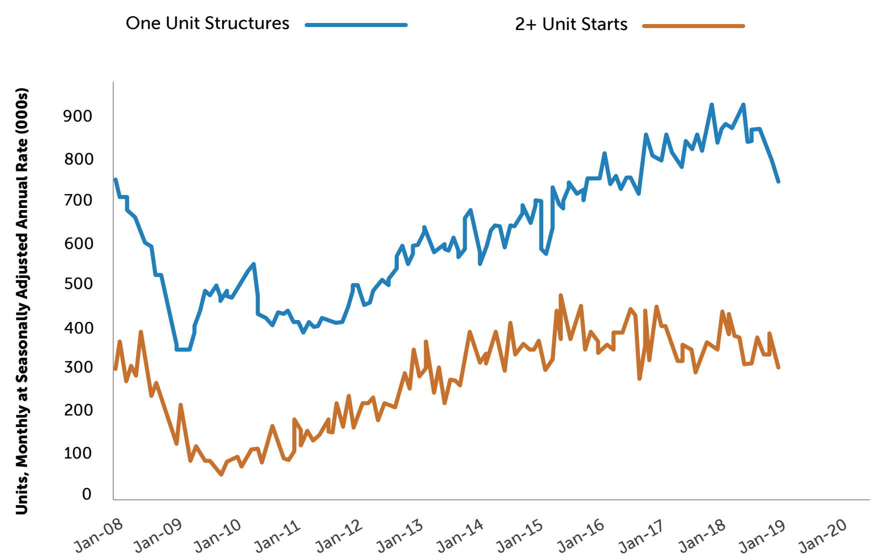
If owners have prepared for a downturn, often they find themselves in a better market position when the economy rebounds. You can prepare your business by developing a contingency plan to help you quickly respond to the changing environment.

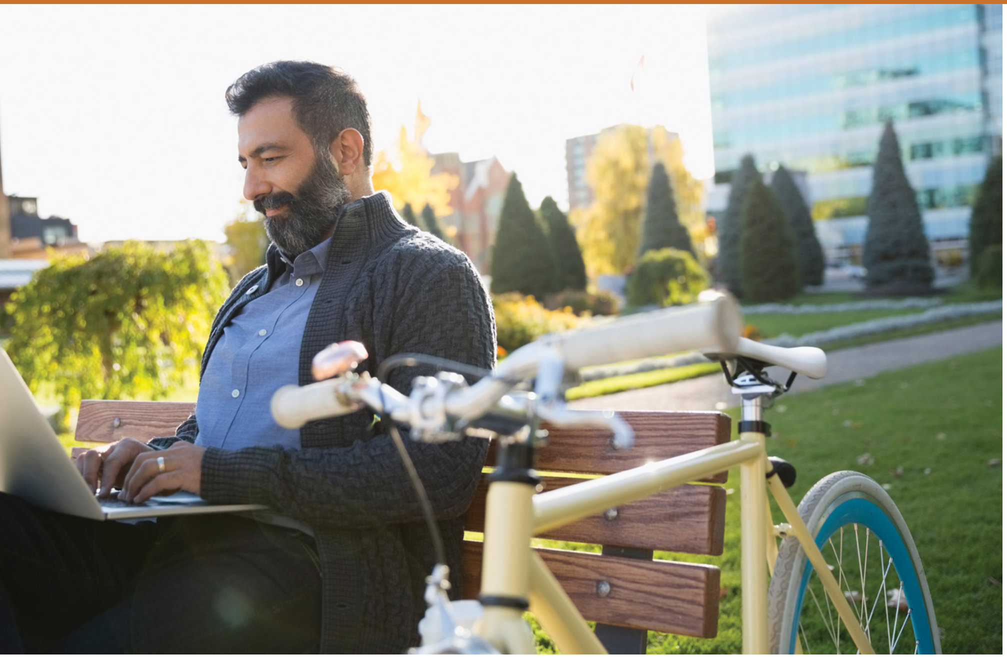
Is a recession on the horizon?

It is difficult to forecast exactly when the next recession will occur. The S&P 500 still looks strong this year. Unemployment is at 3.6 percent, the lowest since 1969. We have seen 104 months of consecutive jobs growth, the longest stretch ever. Finally, we are approaching the longest U.S. economic expansion in history. Although economic data is more mixed than in recent years, there are many positives underpinning the markets. U.S. consumer sentiment rose strongly in June, which bodes well for spending, the largest component of the economy. And perhaps most significantly, monetary policy and low taxes favor a continuation of the bull market.

However, the probability remains that we are [nearer the end of the bull market than the beginning](), and [investors must be prepared](). Fluctuations in interest rates, a divisive political climate, geo-political threats, and trade conflicts are all ingredients for economic stress. And while slow patches and recessions can be scary — you just have to do the work to prepare for them in order to still have a valuable and sustainable business when they pass.

Housing Starts, Single and 2+ Unit Structures





Develop a plan before you need it

During the dot.com era, many people saw the changing conditions, but didn't have a contingency plan. The stress of downsizing, letting employees go, and moving to smaller facilities, taught a lot of professionals invaluable lessons. Looking ahead while in a state of calm is a whole lot easier than coming up with creative options in the middle of a crisis. The benefits of thinking ahead are plentiful.

During the dot.com era, many people saw the changing conditions, but didn't have a contingency plan.

- A stable environment allows time for thorough consideration of difficult topics without the stress of financial pressure.
- Bringing your leaders together in a period of stability allows them to develop action steps that align with your long-term strategies.
- With little time pressure, your team can explore your organization's priorities and determine the sequences of events that trigger actions.
- Assignments and execution can be thoroughly discussed and mapped out.
- A clear communication plan for all stakeholders can be prepared in advance in a way that inspires confidence even in the midst of difficult news.

Ask the hard questions

Are you prepared for some financial stress? Ask yourself some questions, and think hard about your answers:

- Have I created an implementable contingency plan in the event of market stress?
- Do I know the key stressors on my organization?
- Do I know the economic factors that affect my organization's operations and profitability?
- Do I have processes in place to mitigate risks in a volatile economy?
- Have I delegated decision-making authority to the right members of my team?
- Have I documented the strategies to respond to worst-case and best-case scenarios during a recession?

If you answered no to any of the above questions, you will find the following guidelines helpful in developing a plan to improve your odds of surviving a recession and possibly expanding your market share and profitability when the economy recovers.

Do your homework

While there's a lot of upfront work — when you have some safeguards in place you won't get blindsided. Your strategic goals guide your decisions that form your contingency plan. Often, the impact of a single action may be minor by itself, but the cumulative effect can be greater when added to other actions. At every stage, all the actions you take will be to safeguard your assets and stabilize your operations.

Before you begin, you'll first need to spend some significant time on research and analysis. Your research should be focused on why, how, and when you will take action. Your analysis will address the following:

- Why are we doing this (e.g., preserve cash)?
- How are we doing this (e.g., identify the steps to be executed in sequential order)?
- When are we doing this (e.g., an economic indicator or key performance indicator [KPI] like 15 percent decrease in backlog)?

Although those three questions appear to be simple, the analysis involved in answering them will consider cash, accounts receivable, accounts payable, sales, covenant ratios, KPIs, gross profits, and net profits. It may also include operational costs, discretionary spending, employee benefits, contract obligations, asset divestitures, capital expenditures, credit sources, materials purchases, and vendors.

Gathering all of this information will form the foundation of the next phase of your preparations.

Build a realistic financial forecasting model

In the early 80s, when the prime lending rate hovered around 17 percent, trying to negotiate large real estate transactions would have been a challenge. It would be tough to make those numbers work, but that was the environment, and with a large amount of high quality information it was workable.

If you do the necessary research and analysis, your financial forecasting model can help you make decisions based on the information you have (and maybe a little gut instinct). Your forecasting model should be based on normal business activity in a normal business environment. At a minimum, the model should report a rolling 12 months and include a balance sheet, income statement, statement of cash, headcount, sales, and general and administrative expenses.

The financial model must be flexible enough to create "what if" situations and allow for immediate feedback based on predetermined metrics and "what if" data you input. Your research and analysis stage provides the groundwork for developing a sequence of events and defines optimistic, realistic, or worst case scenarios. Your forecasting model should provide concrete options for decision makers in each case.

Contingency planning is an ongoing process, but your strategic objectives and goal of sustainability are your unchanging guides.

Determine sequential actions

A contingency plan requires project teams that will communicate and implement it.

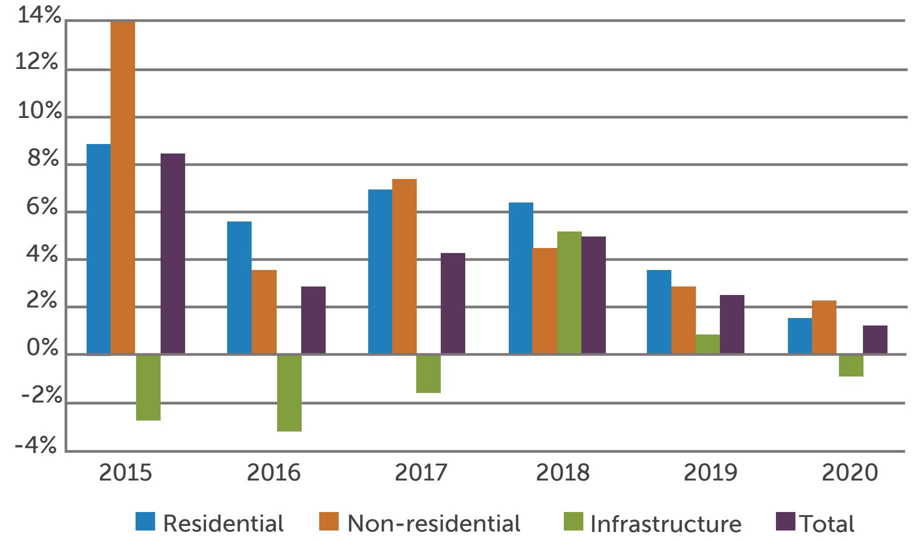
A strong plan articulates priorities. You must consider how certain actions at specific points in time will affect not just cash, but also sales, job performance, profitability, and metrics or covenants required by creditors and sureties. The actions you take will ripple across your operation — and they are intended to. However, thoroughly vetting your responses as you develop your contingency plan will prevent unforeseen and undesirable consequences that will be felt even more intensely during a crisis.

For example, eliminating marketing or advertising will enhance your cash situation, but how will that decision affect your sales pipeline? Delaying material vendor payments will maintain cash, but will it also lead to delays in material shipments to job sites and affect job performance, billings, completion, and trigger escalation clauses?

Consider creating a workflow that methodically phases in your action plans. The workflow identifies who is assigned which actions and who is responsible for communicating to others.

Growth rates for major U.S. construction market segments

(Percent change, real (2010) U.S. $)



Review, adjust, and monitor

Contingency planning is an ongoing process, but your strategic objectives and goal of sustainability are your unchanging guides. Upon completion of your formal plan, spend time reviewing and adjusting it. As your business evolves and your strategies change, your plan should too. Adding new debt or new contracts and their related risks, will require adjustments. Your strategy may now include downsizing or adding new locations or divisions. Your teams must revise their action plans to keep them current.

Most organizations monitor certain KPIs on a regular basis. Once you have reviewed yours, use them as a benchmark and compare them regularly to actual activity. When there is slippage from your baseline, identify the cause and if necessary, execute the sequence of steps you previously developed to address the problem. Don't wait.

The best time to prepare for a crisis is when you are in a stable environment.

How we can help

The best time to prepare for a crisis is when you are in a stable environment. And contingency planning is applicable to all kinds of business stressors from security breaches to power outages. Any disruption is easier to handle when you have prepared for it by imagining your response to it. Thinking through all the various scenarios positions you well when the next crisis arrives. And if your competition failed to prepare, you may find unique opportunities to expand market share, acquire needed assets, and find available skilled workers.

A solid plan increases the chances that your business will come out of the downturn better positioned for expansion and profitability when the economy returns to a growth cycle. And though contingency planning may seem like a lot of work, one of the most important benefits it will provide is peace of mind.

No one can predict the future, but proactive planning can help you thrive during uncertain times. With CLA, you can face the challenges on the horizon and see them as opportunities. You don't have to do this alone.

Contacts

For information on contingency planning, contact Marc Mallory. Marc Mallory has more than 15 years of accounting and finance experience in a wide range of industries. As a managing principal at CLA, he oversees client development for the outsourcing business line. He helps clients improve their financial operations and decision making ability through customized outsourcing services, so they can focus on managing their organizations. His experience includes CFO services, development of management reports, process improvements, accounting policy and procedures, cash flow forecasting, and budgeting models.

Marc Mallory
Principal
612-397-3263
marc.mallory@CLAconnect.com

For information on our wealth advisory services, contact Clayton Bland. Clayton Bland is a managing principal with CliftonLarsonAllen Wealth Advisors, LLC (CLA Wealth Advisors). He specializes in holistic consultative advice for a range of business owners, individuals, executives, retirees, foundations, and endowments. Clayton has more than 20 years of experience in the financial services industry. He was also a member of CLA's future innovations team (FIT).

Clayton Bland
Managing Principal, CLA Wealth Advisors
425-250-6034
clayton.bland@CLAconnect.com

About CLA

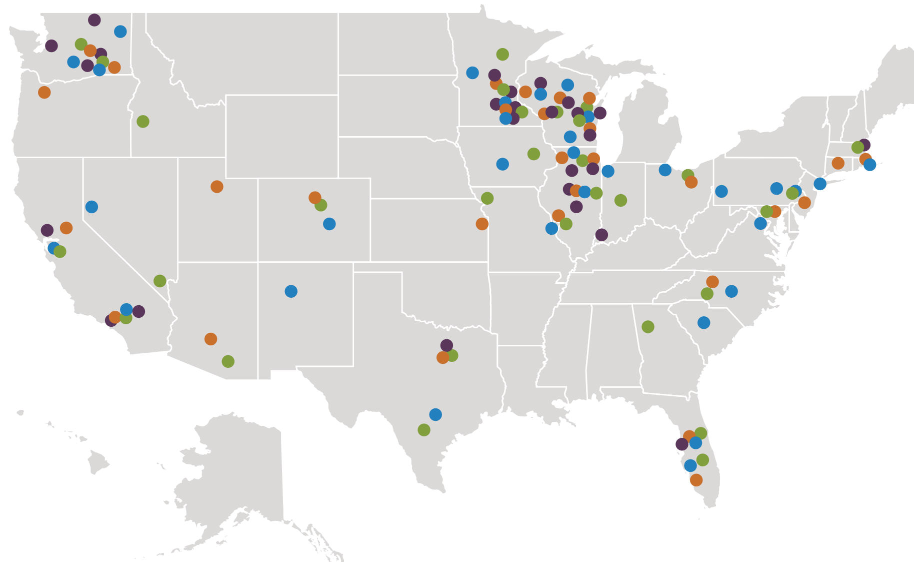
CLA exists to create opportunities for our clients, our people, and our communities through industry-focused wealth advisory, outsourcing, audit, tax, and consulting services. With more than 6,100 people, 120 U.S. locations and a global affiliation, we promise to know you and help you. For more information visit CLAconnect.com.

More than **6,100** people

More than **120** U.S. locations

Our **global** affiliation

A member of Nexia International



CLAconnect.com

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

A member of Nexia International