The Four-Pillar Turnaround System

A field guide for "Successfully Navigating the Downturn"

By the Staff at Second Wind Consultants, Inc.

Second Wind
Consultants

136 West Street, Suite 01
Northampton, MA 01060

T (888) 712-1993
F (800) 485-7853

www.secondwindconsultants.com

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1. Introduction

This guide is derived from many years of experience and designed based on today's realities, our current economy and business environment. It works. We know this because we have implemented it successfully and have tested its effect on the ground with our small business clients, where it matters.

Our commitment

Learning what works and what doesn't work in the front lines of hand-to-hand small business combat. ~Don Todrin

Much of this you can implement yourself. To this end, this is a guide, a road map, a battle plan.

Some of it must be directed by a seasoned professional, one of Second Wind Consultants' experts, as we are on the front lines fighting for our clients, leading the way showing them how to do it. Our mission is clear:

Your survival, your emergence, your growth and development into a profitable business organization.

We offer you this plan and our support to help you succeed.

Our Vision

It can be done. We do it every day.

Onward through the fog…to victory.

2. Your Corporate Structure: Before You Start

Creating a business entity properly is a relatively simple process and offers many benefits. Not doing this leaves you exposed to personal liability from the operations of your business. If you are not currently running your business out of an entity registered with the state, you cannot start this process soon enough.

Some may argue "I have no home or any assets to protect and therefore I see no reason of incurring the cost associated with incorporation or the creation of a Limited Liability Company (LLC)." While this may be true at the moment, a corporation or an LLC will offer you a corporate shield, which will protect you if the business fails.

Presumably, there will be a time in which you accumulate assets worthy of protection. When that day comes, having this corporate shield in place to protect you from the debts and liabilities of your business will be priceless. If the business fails and has incurred debt that it cannot pay, not having an LLC or corporation in place will leave you liable for those debts, which could result in judgments or event bankruptcy.

Simply stated, there is no valid reason not to register your business as a corporation or an LLC. Once you have created an LLC or corporation you have an entity, which can sue or be sued, have credit and do business on its own.

Additionally, when organized as an LLC or corporation, your presentation and perception to the business world is upgraded. It demonstrates a more committed and legitimate organization and ownership and is often given more credibility, especially when it comes to financing, credit and entering into contracts.

An important note: Creating a business entity facilitates the separation of business and personal expenses for tax purposes. In order to enjoy the advantages of the corporate shield, you must separate your living expenses from your business expenses and not co-mingle them. They are separate entities: you and your business must be run separately. This means taking payroll, draws or distributions from your business and then using them for personal expenses, rather than running all personal expenses directly through the business. If personal and business expenses are merged together, you may lose the benefits of the corporate shield altogether and find it far more difficult to take appropriate deductions for tax purposes.

Additionally, if you do not run the business separately from your personal matters, the business could be deemed as an “alter-ego” and any inappropriate actions you take or debts the business incurs could become personal.

Finally, there are some businesses which will require incorporation or creation of an LLC in order to maintain compliance with state and federal standards, rules and regulations. An example would be a medical practice of any sort requiring a professional corporation as opposed to another type of entity structure, depending on the state in which it operates.

Yes, this requires you to file an additional tax return and pay certain fees in addition to your own tax return, but if you intend to run a committed, long-term business, this is a small and ultimately affordable expense compared to the benefits received.

The next step is choosing which type of entity to use. The most commonly used entities for small-to-medium sized business are the S corporation and the Limited Liability Company. Other entity types include Limited Partnerships, C Corporations and Professional Corporations.

An LLC and an S Corporation are both very similar from a tax standpoint; however, the LLC offers additional flexibility.

We normally recommend an LLC for the reasons listed below:

1. An LLC offers more flexibility than organizations such as corporations, in that you can have disproportionate distributions of profits and losses, different than that of ownership percentages. This allows for a number of strategic nuances.
2. Adding and removing members is much simpler, as is redistribution of ownership percentages. This process can be more private through an LLC as well.
3. There is flexibility in taxation. You can elect to have the business taxed as a corporation, where the business is responsible for any tax liability. You can also elect to have the entity taxed as a partnership, where the liability will “pass-through” to the owners’ personal tax returns. Each option has its own advantages, depending on a number of variables.

4. Authority can be vested disproportionally to ownership, profit sharing or equity position. This may facilitate investor relationships more effectively than with a corporation.

Consult with your accountant in order to come to a conclusion on which entity and tax structure is in your best interest based on the facts surrounding your particular business.

Ownership Percentages and Chain of Command: Avoid the 50/50

In an effort to be as clear as possible, *under no circumstances should there ever be a 50/50% ownership between two owners. EVER.* Someone must have ultimate authority, the tiebreaker decision. This can be handled in many ways. In an LLC you can share profits and losses equally but allocate decision making differently. In a corporation, this is a more cumbersome process but still possible.

The problem is that for emotional reasons, people believe that a 50/50 is fair and equitable and, thus, more relationships are created under this mistaken understanding. Unfortunately, when disagreements occur under these circumstances the business is crippled.

Mission Statement

To some, this sounds like a waste of time. It isn't. It is a very important task to develop, create and utilize a mission statement. It answers the important question "What is the purpose of this business?" The answer should not be "to sell widgets and make a profit." Elevate your context and think higher, broader. Ask yourself about your goals, objectives, motivations, vision for your employees, your customers, your vendors, your community, the world and even mankind.

Don't stop there – what is motivating you to follow this path? What are your goals and objectives? What is your vision and your values? Vision, mission and values: this is where the soul of your business is defined.

It is worth the time to determine this now and then revisit it from time-to-time to make certain that you have not wandered far off your track. This is not to say that you can't make adjustments or change your plan to evolve into something different. Doing so, however, will require you to change your mission statement and make you reconsider what you have and where you are headed.

The mission statement is a key benchmark, a standard that you can check yourself against, helping to hold you to your vision. We see many small business owners wander away from their mission only to fall on their faces because they did not stay focused and committed to their mission. Create one, live it and stay with it. Change your mission statement only after careful consideration.

Partnership Agreement / Bylaws / Operating Agreement

Please do not let your lawyer prepare the basic, vanilla, boilerplate corporate bylaws or operating agreement. You might as well avoid the time and expense and have nothing at all, because that is all these documents are worth if not well thought out and specific to your business.

The point of this document is to describe how your business will run, essentially defining the rules of the game. In the beginning, everyone is friends and they all agree. In the middle or near the end, everyone will disagree and nobody will be friends. While the business is successful, you will argue about revenue sharing, profit sharing and who deserves more. In defeat, you will argue over debt and decision-making.

Here is the mandate. Figure out everything in advance when there are no differences between you and everyone agrees. When things get rough, like it or not, these decisions are already made and well documented. For example:

1. How compensation is figured.
2. Areas of responsibility. Who does what? Make sure there is no overlap and there are clear lines of responsibility and authority now, before disagreements arise. All partners can have input at the Board of Directors level, but each partner must have clear operational control over their area of responsibility. Invite an additional trusted person to be a board member to break deadlocks regarding such issues.
3. How personal investments of time and money are repaid.
4. Vacation policy and working commitment (how long?).
5. How someone gets in (or out) of the business. Divorce and separation.
6. How material decisions are made at the highest level, including borrowing, buying, merging, selling and liquidating.

7. How one partner can buy out another, including valuation of assets upon buyout.

Do all of this in advance and you will have a far better chance of long-term survival, growth and development. Do not accept the attorneys' or accountants' prepackaged documents; instead, pay to have customized documents designed and made for you. It will be the best investment you can possibly make. Create your own culture and environment, your rules to live by, and you will have guidelines and standards when you need them to guide you through difficult times.

Members/Officers

In a Limited Liability Company, the members are similar in nature to stockholders. However, members of an LLC can be vested with authority superseding the Managing Director, which is the equivalent position of a President/CEO of a corporation. This is a huge decision that will have great impact. Seek professional help in order to determine which situation is best for your circumstances.

In short, answer the question "Who do you want to control the business?" What is most important is not necessarily the title of Managing Director or Member, but rather the responsibility, control and decision-making authority and chain of command that are assigned to those titles. This is what helps a business operate successfully. Without these responsibilities being clearly defined, there is chaos.

Job Descriptions

This may also be considered minutia, but investing the time now will allow you to reap the benefits later. Every job should have a job description, which will allow you to hold partners and employees responsible for success against a clear set of guidelines for their particular role. Without a job description, how can you reward success or hold someone accountable for failure?

A well thought out job description is a very valuable document. Take the time to write job descriptions for all of the jobs in the company. It forces you to determine exactly what the responsibility is for each job and what the lines of communication and authority are.

Employee Contracts

This is a big decision and one that should be approached with caution. With an employee contract, you are bound to perform, as is the employee. If you want this level of control, have the contract carefully drafted with performance standards and separation criteria, as well as with non-competes, non-circumvention and non-disclosure covenants. These are enforceable and act as a huge deterrent to breach such covenants.

Even without an employee contract, you may want to include non-competes, etc. as a requirement of employment.

Employee Benefits Package

Be careful here. Start slow and build with success. The list of possible employee benefits is long and expensive, including some of the most common benefits:

1. Health Insurance: Determine the amount of coverage, deductible amount and a premium split between the company and employee.
2. Vacation Policy and Sick Days: Clearly define a vacation policy based on an accurate understanding of the expense of vacation days.
3. 401Ks: What will the business contribute? Setting up a 401K contribution has tax benefits to both employees and the business. Seek professional assistance when instituting such a policy. Do not embark on this avenue until the business has experience at least a year or two of success.

Checkbook Authority and Savings

The checkbook controls your business. If it is mismanaged, the consequences could be fatal. We advise that only owners maintain check-writing authority for a few years before considering adding staff. When staff members are added, controls must be in place to ensure the owners are informed of every financial transaction. When you do decide to give such responsibility, employ tactics such as daily checks of all expenses that you verify through online banking. Institute policies that require your approval for all significant expenses. Secure these systems by having your financial institution require dual signatures for checks over $5,000 (or whatever amount you choose). These controls can always be changed or relaxed, but having them in place initially is essential.

Create a savings account as soon as possible. Work with your bank to create a weekly or bi-weekly savings transfer to ensure the business maintains a sufficient level of cash.

Cash is the lifeblood of your business. Failure to create a system to ensure sufficient cash is extremely foolhardy.

Notes / UCCs on Business Assets

Borrowing is a basic part of business. When entering into a borrowing relationship with a creditor, however, it is extremely important to use caution and to minimize or eliminate personal exposure. Failure to do so can result in extremely expensive outcomes that can devastate you financially.

Here is a list of general guidelines to reviewing creditor security agreements:

1. Understand who is required to sign a note. Are you required to sign personally, on behalf of the business or both?
2. Avoid signing on a personal guaranty unless absolutely necessary to obtain required financing. Once you offer your personal guaranty, your personal assets then become at risk if the business fails to perform on the loan. If you do this, you should protect your personal assets first.
3. NEVER have your spouse sign anything. No exceptions.
4. A UCC is a security instrument that is similar to a lien that will be attached to your business assets for any secured debt. Try not to give overlapping UCCs to multiple creditors. Read the language on the security agreement and UCCs – they may be all encompassing, which is dangerous to your future well-being.
5. Do not give your landlord a UCC on your business assets. Landlords have significant power over your business as-is. Giving them a UCC on your business assets gives them far too much control over you and your business.
6. Limit the language included on the UCC. After acquired equipment, phrases such as “all accounts receivable,” “all intangible assets” and other restrictions can potentially be very damaging.

If the bank will not lend under these conditions, change banks. Find a lender who will lend with reasonable security. It may be difficult to find such funding but it is well worth the search. If banks were left to their own, they would secure their loan against every asset you own. This is unnecessary – learn to be cautious and avoid this.

Appropriate Insurances

Make sure you have all of the necessary insurances and don't think twice about it. Speak with an insurance broker and consider everything from general liability insurance, casualty insurance and, without question, workman's compensation (it's the law). Pay for it and don't complain. When you need it, you'll be glad you have it. Put these expenses in your business projections and cash flow pro forma and recognize them as a necessity.

Registering a Doing Business As (DBA)

A DBA will allow your business to operate, produce, perform and invoice under a name other than the name the business was registered under. This allows your business to operate with a trade name, something more marketable. A DBA can deliver many advantages; however, each town or city will have different filing requirements. You can find these requirements and register at the Town or City Hall.

Projected Financial Requirements for Success

Before you embark on any business venture, put forth a cash flow pro forma depicting what you believe will take place financially. Do not underestimate revenue and overestimate expenses just to be conservative. Doing so will create a false impression. Put the numbers down that you believe will occur. If necessary, do market research in order to ensure you have a realistic understanding of the business' potential. You can adjust to reality as events unfold.

This will afford you the opportunity to determine before you start how much capital you will need and what level your sales must be to succeed. *What by when* is the question to be answered and it will prove to be very revealing and very important. This process is explained in more detail later on.

Capital Equipment

Every business has capital equipment needs, be they as simple as telephones and computers or as extensive as printing presses or other large, specialized and expensive machines. Equipment may be purchased or leased; either way, if they are required so is the investment or cash flow to support such acquisitions. Make certain you plan effectively and accurately in your start up plan.

You may want to consider holding such valuable assets in a separate corporation or LLC. This can protect these assets in the event of a lawsuit or if a default on a debt occurs, as well as allowing for various specialized tax planning.

Your Business Plan

You must have a written plan. If you don't have a written plan, the business is merely a dream. While powerful, dreams do not drive success – plans do. Your plan does not have to be an exhaustive study of the entire marketplace, but it does require a specific outline of your strategy for success and how you are going to implement that strategy.

The plan should include the following three sections:

1. Finance: How much capital you have and how it is going to be spent.
2. Sales and marketing.
3. Operations.

Most important is the absolutely necessary and critical component: a cash flow pro forma that merges these three sections into one cash flow projection over time. This tells you whether or not your plan will succeed based on the amount of capital you have and the time flow of revenue and profitability. It will also tell you how much more you need to succeed or will identify what changes must be made.

If you cannot do this, hire someone to help you. It is fundamentally necessary. With this pro forma, a brief description of the three sections and the above-noted requirements, you are ready to proceed.

One final thought: Have a higher purpose, enroll your employees to embrace that purpose and good things will happen. A business with a higher purpose will be more profitable than a business whose purpose is solely profit.

Everyone in your business must be involved for it to work. Carry the context of your higher purpose throughout your company and watch the results. Everyone in the business will be happier; not only will you be paying back for your blessings, you'll be receiving rewards as well.

Conclusion

The past section represents the skeleton/body of the business, its structure and the operating components it requires to simply begin the venture. Once prepared, it is ready to implement your business plan. It has its marching orders.

3. Pillar One: Management By The Numbers

This is a must. There are no excuses. Know your numbers.

It's simple. Numbers are the language of business, and you must learn this language. You must become conversational with a few arithmetic concepts and numbers. It is impossible to effectively and successfully run a business for long in today's environment without understanding and using financial reports and numbers to guide your management decisions. No longer can you just "wing it," no longer can you use the excuse "I am not a numbers guy," and no longer can you say "My accountant knows" or "My bookkeeper knows" or "I find out when I get my tax return."

It is time that you take responsibility for your own destiny and manage by carefully watching the numbers. You can be trained to do this; you don't have to do it alone. We can guide you and teach you but you have to make the leap and commit to a new way of doing business, the way it ought to be done, with a close eye on the numbers – the language of business.

Here is what you need to understand:

1. **Cash Flow Pro Forma**

This is critical to forcing profitability and understanding your business. The Cash Flow Pro Forma is perhaps the most important tool you can use for supporting success and avoiding disaster.

This is your crystal ball, it will tell you if you can succeed or fail with your current parameters. It is also your road map, your guide to success.

It also tells you where you must make adjustments. This can include more cash, greater sales, less payroll, or lower overhead. It will all become very apparent once it is completed and will also give you your guidelines to make the necessary changes you need to succeed. It should be reviewed and updated as frequently as possible (at least monthly). It is your road map to profitability, informing you what you need to pay attention to in order to succeed.

In the appendix of this manual, there is a template that you can use for your business. Pay attention to the cash balance, total cash outflows, total cash inflows and your largest expense items. Watch timing; just because you make sales in one month doesn't mean you will be paid in that month. You may receive payment many months later.

2. **Profit and Loss Statements**

Read these monthly and respond accordingly. If you are using QuickBooks, which just about everyone does, a report is available with the click of a mouse button. Learn how to access this information and read it. If you are not making adequate profit, there is no sense in fighting the battle, as you will ultimately lose the war. It isn't about gross revenue; rather, the only thing that matters is net profit.

Figure out how to generate these reports and read them, learn from them, and respond to what they tell you. The information doesn't matter if you don't make the required adjustments to assure success. An example of a profit and loss statement, along with a template that you can use for your business, is included in the appendix of this manual. Go through the exercise of preparing this report, either with the sample information provided or with your actual data from QuickBooks.

The results of these reports are eye-opening. Frequently reviewing these statements is critical to your management success and ultimate business success. There is no advanced accounting degree needed to read these documents. They simply list your revenue against your expenses and show what profit or loss you experienced.

3. **Accounts Payable and Accounts Receivable**

What are these numbers telling you? How long does it take you to get paid? This is a critical factor in managing your business. Managing your cash flow successfully can make or break you.

- Are your customers purchasing while owing you? If so, this must stop.
- How old are you allowing your receivables to get before you cut customers off and send them into collection?
- Are you giving everyone terms or just those who pay on time? It's better not to sell than it is to sell and not get paid.
- Are you checking credit before you extend terms?
- Why are you giving terms at all to anyone, ever?

We often hear "It is an industry standard to allow 30-60 days." If you are providing valuable goods and services, you are entitled to be paid for them. We challenge the giving of terms just because it is expected. Is it not preferable to sell less and be paid on delivery than it is to sell more and be paid in 30, 60, 90 days, or not be paid at all?

Think about it. If you give net-30 terms and customers frequently pay in net-45 or net-60 days, it means that you must have at least 60 days of payroll and overhead cash to support providing terms. Since many small businesses don't have this kind of capital, it isn't wise to "be the bank" just to meet industry standards. Stop this drain of cash – it is crippling!

You must create a collection system. For example, we send out reminders every week for next week's receivables. If a client doesn't pay on the day the receivable is due, they get an email and a call asking why. We ask for a plan to resolve the payment delay and then monitor the plan. If the plan fails, we put them on the "back burner," meaning no work is done on their behalf until we are paid. This would be the equivalent of not allowing customers to continue ordering from your business when they have a past-due balance but not yet sending them to collections.

If this situation persists for over 30 days, we sever our relationship completely and put the client into collections. This system results in over 90% collection success every month and allows us to monitor the clients who can't comply. At the same time, we work with our clients who are having trouble while training them to communicate and keep their word.

This works. Create and implement a similar system based on communication, cooperation and constant monitoring to assure success.

4. **Sales Revenue Trends**

By watching your numbers every month, you will start to see trends. After three months of a number moving in the same direction (up or down), you have an official trend and must respond to it by changing something that will affect the outcome.

Seeing trends before they become catastrophic is critical to long-term success. Making adjustments based upon trends is an important management skill. First, you must identify the trend and then figure out how to respond. By month two of a growing trend, adjustments should be made. These can consist of increasing or reducing payroll to meet production demand, increasing or decreasing inventory levels, or the expansion or contraction of the product line.

If you are wrong and the building trend readjusts itself, your adjustments can still be powerful, beneficial and, if need be, reversible with little harm done. If the building trend reaches its third month with the same increasing or decreasing revenue and you have not made adjustments, the results could mean failure due to excess strain on cash flow in a revenue downturn, or failure to meet demand and loss of potential business during a revenue upswing.

5. **Cash Controls, a bill-paying system**

You need a payment system that will serve your needs.

It goes as follows: write checks Monday through Friday but do not mail them out. After payroll and payroll taxes are paid on Friday, see what available funds you have remaining and determine which payables are the most important. Use your available cash to pay the most important payables until you have paid them all off, are out of cash or have reached a point where you want to preserve the remaining cash.

Save the ones not mailed for the next week and repeat this process. By doing so, you will make certain that you don't pay a lower-priority payable and not have adequate cash for a more important payable. This approach lends order and control to your payable system. It prevents paying the wrong bill at the cost of another, more important bill. It allows you, not your creditors, to control your cash flow. The squeaky wheel issue usually works for the creditor (he who collects hardest gets paid the fastest). This system prevents the wrong wheel from getting the grease simply because it is being the loudest.

Another safeguard method is to make payables twice per month on the first and on the fifteenth, allowing you to see how much cash you have and allocate resources effectively. You can teach your vendors to understand your system, and they will work with you. This keeps you in control.

Too many businesses either pay the vendor screaming the loudest or use all of their cash until they run out in anticipation of more receivables coming in. When they don't arrive as planned, important bills remain unpaid. This must be avoided at all costs!

6. **Ratios: Payroll, Overhead, Debt, Leases**

You need to keep everything in proportion.

Your rent must not be too great a percentage of your gross revenue. The same applies to payroll. Your cost of goods must also be within certain ranges of your revenue and pricing. Your profitability must be a certain percentage of your revenue to earn you enough to cover your overhead and leave some available cash for retained earnings.

These standards change industry to industry, but there are general parameters you can follow:

- Payroll should not be more than 30% if you are making or selling a product. If selling a service, payroll can be as high as 40-50%.
- Rent should be 7-10% of gross revenue.
- Cost of goods should be less than 30%.
- Profitability should be 10-20% NET, higher if possible.
- Retained earnings should be 10% of revenues.

These are basic guidelines – each business has its own ratios to follow. Higher revenue, greater margins and greater competition can all affect the resulting ratios. Calculate your percentages from your profit and loss statements. Any expenses that are above these standards need to be decreased immediately, as they are causing unnecessary financial strain on the company.

7. **Install Key Indicator Systems**

These systems should be installed everywhere, measuring performance and providing incentives, two very important management strategies.

The best way to control your company and provide valuable incentive rewards is with measurable key indicators. These will be about a half-dozen numbers measuring key aspects of your business (the pulse of your business), such as amount of product made or services delivered, product shipped, new customers acquired, contract proposals submitted, consultations or presentations made, dollars received, back-order in days, in dollars, in widgets, in services, turns per table, number of overall customers, number of defects, etc. The list goes on and on.

It depends on your particular business as to what key indicators are measured, but this is one excellent way to determine what your company is doing and how it is progressing, where the bottlenecks are and where you must improve. It also allows you to control and measure productivity at the individual level, the team level or for the entire business.

It also demonstrates how to pay for increased productivity. Incentives can be based on the key indicators by individual, by team, by department or by the entire company's performance. You can design it as you choose – it's an excellent way to see and reward success while also preempting potential problems.

8. **Productivity – Measure It.**

At one time you figured out how to price your service or widget based on how much time and payroll it took to deliver it or make it. That's productivity when measured per employee man-hour. This number must be checked frequently to make certain your standards are being met. This is where profit is made or lost.

There is nothing more devastating for a business than to have figured it takes ten hours to produce a result when, in reality, it takes 15 hours. There is no way to make a profit when that happens. Many business owners priced product and services long ago and, since then, material costs, time to produce, payroll cost, and overhead have gone up. This must be measured frequently and pricing needs to be adjusted to maintain profitability.

9. **Work Backlog**

How many days of production are on order? Based on your predictable new order flow, will you always be in production? If not, reduce your employee-base and increase productivity to support peaks and valleys.

This is another critical factor that can destroy profitability. Being over-employed based on a reduced back order amount will result in a normal slowdown. This results in a huge overhead imbalance and loss of profits. This is a crucial area of analysis and must be watched carefully; either increase sales or decrease employee-base to balance.

10. **Cash on Hand**

You must have adequate cash and a cushion for the unknown at all times. Peaks and valleys occur, emergencies happen, holidays come and weather interrupts. Life happens – absenteeism, vacations or interruptions for any reason can cause a need for temporary support for your cash flow.

If you are constantly putting cash away automatically without consideration, you will have a cushion for the day you need it. When used, be certain to return it when you can, if you can. This also serves as your retained earnings and your bonus money (or growth money, etc.). It is your own bank – use it carefully and sparingly and never go below a base amount if you can help it.

Conclusion

Every day, week, month and quarter check your numbers. Recognize your trends and identify if you are hitting your goals. If you aren't reaching those goals, make adjustments. There should be no surprises at year-end, be constantly reviewing and reading the numbers – they are your report card, your road map, your crystal ball. They tell you where you were, where you are and where you are headed.

Know your numbers and study your reports. They are the language of business. Manage by reading what they tell you and respond accordingly. That way, there is never a need to guess what to do or where your business stands.

Track, monitor and control – these are the operative words for a manager. Track your key indicators, review them constantly and make adjustments as a direct result of what they are telling you.

Downsize – Lose the emotion
An important part of managing by the numbers

If you have been operating for a few years or more and are now faced with reduced revenues, you must downsize (sometimes deeply). You will most likely need to downsize deeper than you want to or think you can, but you must. Failure to do this can be fatal to your business. It is mostly about payroll, as that is likely your biggest issue and has the most impact.

There are many other areas that you can downsize, however, including inventory, space, insurance, equipment, vehicles, advertising, marketing, employee benefits, workman's comp insurance and overtime, to name a few. These items individually may be small, but collectively they are meaningful.

How to do it

A beginning note: Every job must be systemized and the systems must be written down so new employees can be trained the way you want them to be trained. This will help make downsizing much easier, as no one has the expertise you need to carry on, or train unless you have it all in the systems. There are many strategies you can employ to emerge successful again if you are currently operating a business that has reduced revenues, thus making your cash flow challenged. Perhaps one of the first and most powerful is on the cost side of your business equation: meaningfully downsize payroll.

Nobody wants to do this. If done, most often a payroll reduction is not done deeply enough, and thus the equation is still not balanced. The job is not done. We understand small business owners' reluctance to fire their loyal help. The simple truth is that if you don't balance the equation, soon everyone at your company will be out of work. It is necessary to lose a few to save the rest, or even lose many to save the core. If you succeed in your emergence plan, you will have the opportunity to rehire.

Who Goes and Who Stays? A Strategy That Works

You must preserve the integrity of the business by reducing each department a little, leaving the core business operational. Do not simply cut out entire departments that are deemed less necessary than others. Cross training can also become extremely valuable when downsizing, where people can perform many jobs, not just one.

Staff positions can also be eliminated with greater ease as people can handle their own staff requirements. These are tough times and we must all learn compromise.

As a secret to success, productivity must go up to support the deep cuts being made. Productivity must increase, more widgets, more revenue, more of everything per person, per hour, per day with reduced manpower and no overtime. There are many ways to accomplish this seemingly impossible feat; if done properly, it is a natural outcome.

There have been hundreds of productivity studies over the years. These studies point to the fact that overall, productivity is much lower than anyone understands or believes. When we test productivity, we most often compute it at 30-50%! Occasionally it can be higher, but this is very seldom. Most of the results were between 30-40%. This means that 18-24 minutes out of every hour were productive on the average. Yes, this is hard to believe but very true.

Equally true is that the good employee and the trusting employer believe that the employee is doing the best he/she can and is not purposefully underperforming. We believe this to be true. We also believe that the numbers speak the higher truth and the reality is that, with proper training, proper incentives and proper communication of expectations, productivity numbers can increase dramatically.

The first major mistake employers and managers make is to deny their employees the critical information of what is expected, allowing the employee to simply work “at his/her own pace,” or “as hard as they can.” It is impossible for the employee to meet expectations; it just will not happen if they don’t know what the expectations are.

Conversely, if an employee is told that they are expected to get a specific job done in two hours, they will do their best to reach that goal. Tell them that they will receive a bonus of some kind if the job is done in 1.5 hours, they will find a way to do so, thus the cost per project goes down, profit goes up and the employee earns more for their work. This is a win-win for the employee and the business. It works like magic.

Create key indicators with an incentive reward system so your remaining employees will earn more for greater productivity, as will the business. This works extremely well and should always be used, even when the business is not experiencing a downturn.

Eliminate all overtime and make it up with increased productivity and incentive rewards for achieving more. Watch your profit go up while your overhead goes down. This should apply to sales and marketing, production – pretty much everything. Everyone wins with increased productivity.

How and What to Say to Your Workforce

Explain to your workforce exactly what is happening and why. They see the downturn and are extremely worried about their jobs. If you act quickly and decisively, you will preserve your core employees. If you delay and don't communicate effectively, they will migrate quickly to safer jobs, with more security even if they are offered less pay. Stability is frequently more important than a bigger paycheck.

You must be empathetic with your employees, as they are frightened by the prospect of the business' failure. You must understand their fear and give them hope for the future. You can do this by explaining your plan for survival and emergence. Explain that you will have to lose some people to save the business and remaining employees, but that you are hopeful that you can rehire as the business grows again. You must also report progress to your employees so they feel and believe that it will all work out as projected. If delays or reversals occur, report this also. Your employees will appreciate the honesty and respect your effort. They will still follow you to victory if you remain honest and open with them.

How you treat those you are letting go is just as critical, as your remaining help will be watching carefully and taking note. They understand how you handle letting people go is how they will be treated if the time comes to let them go. How you are demonstrating care and concern for your employees transfers to how they respect and follow you.

You must also explain to them what you are doing to share the loss, such as reducing your payroll, taking your wife off the payroll, invading your savings, selling your Mercedes, etc. Whatever sacrifice you are making you must share with the employees so they understand you are in it with them. Tell them the truth – they will appreciate your efforts.

You must be as generous and considerate as you can for your help that will be let go. Support their transition as best as you can. While money counts, it is scarce; offer service, respect and emotional support in whatever forms possible. This kind of consideration counts a lot in such turbulent times.

You have an opportunity to be either a champ or a chump; it's your choice. Be upbeat but honest. Give your employees time lines for how long you think it will take to achieve your reemergence plan. Restore their benefits, if removed, as quickly as possible. Most important, report your progress often and clearly.

If you demonstrate that you believe you will emerge, your employees will follow you anywhere. Be honest, be positive, be firm, be empathetic, be supportive and be their leader. Again – they will follow you.

When faced with these conditions, empathy is the key to success, to both those fired and those remaining to share the burden. Have a plan and communicate often.

How to Determine How Deep to Go (Remember to manage by the numbers)

Using your cash flow pro forma and profit and loss statements, you must determine productivity requirements for the new level of revenue the business is facing. It's arithmetic friends – do the math and make the cuts to expenses to keep them at, or below, the acceptable percentages. If revenue returns to previous levels, then you can begin to rebuild. Make cuts until the business is profitable, then cut deeper and make it up with increase productivity based on incentive rewards. Do it all at one time, not in stages, as a staged approach creates uncertainty. Figure it out, go deeper and don't do it again.

Remember, no overtime, increased productivity, and offer incentives. Overtime is wasteful and does not increase productivity; it only increases your costs and reduces your profit. Increase productivity and win! Use a key indicator system to implement incentive-based rewards and monitor your productivity. Resist using dollars as a benchmark. Use something measurable that is associated with the person's work so they can immediately understand how to gain a larger incentive. Whether it is the number of calls per hour, number of widgets per hour, number of visits per day, or number of contracts sent out per month, it should be the most meaningful measure to that particular job that allows you to measure productivity and reward success.

If possible, build teams. Have team incentives and rewards. Team success is much more powerful and productive than individual success. If you have enough people to form teams, do it and measure incentives based on team efforts. Measure individual effort as well so you can make certain you have appropriate activity from each team member, but offer rewards based upon team success. This works best and also creates individual support between team members with your better employees helping the less-effective employees to become more productive and get better at their jobs.

Inventory

Business owners love their inventory. It gives them a sense of security and a belief that it assures sales by always having what the customer needs on hand. Unfortunately, it's a very expensive security blanket, and the few individual sales it may support are hardly worth the huge investment in holding a large inventory. Consider the following soft-costs associated with holding a large inventory of product:

- Spoilage.
- Warehouse space and utilities.
- Out of style product (resulting in worthless inventory).
- The wrong sizes, colors or styles (the unpopular ones you couldn't sell when it was in style).
- Shrinkage.
- Insurance.
- Manpower to manage.
- The big one: **cash tied up in inventory that would be better used elsewhere.**

Get rid of your inventory. Figure out how to operate with just what you need. It is OK to lose and occasional sale if you don't have some obscure request on hand. Special order it and charge more.

If you have inventory, sell it with as deep a discount as you need to convert it to cash, which can be used to further your mission now. Forget the investment and forget the potential return. Sell it for pennies on the dollar if you have to and turn it into cash. Follow that by downsizing your imprint and experience overhead reduction as well. More cash and decreased overhead is a great combination! This is an important part of downsizing.

Barriers to be Careful About

- **Sense of loyalty by owner to the released employees:** This is an emotional issue that is very challenging. Remember, if you fail in this strategy, everyone will soon be out of work.

- **Your failures to cross-train your employees on multiple tasks:** Failure to cross-train becomes very important during downsizing. You may end up requiring more people than you should have originally required to run your business.
- **Failure to have written systems to pass on "the way it is done":** If everything is retained through oral legacy and employees train employees "on the fly," you could be in for a problem or it could take longer than necessary to implement downsizing, as the employees scheduled to be let go must remain to cross-train those remaining.
- **Loss of expertise, goodwill:** This is always a problem but one that must be overcome. Plan from the beginning to spread such goodwill out and never let one employee control your important relationships.
- **Fear in the hearts of those remaining:** If your transition is not done with adequate empathy, communication and rapid turnaround efforts, you will lose even more critical help. This could prove to be devastating.
- **Belief that you need everyone onboard:** You don't. Increased productivity is the answer.
- **Belief that you need your inventory.**
- **Belief that your employees are doing their best:** Your employees may think that they are doing their best until you install an incentive-based reward system. Once you do so, watch productivity fly! You must become non-emotional and make business decisions. This is what a leader must do – show empathy but cut deeply.

4. Pillar Two: Reinvention

What is reinvention?

Simply put, it is changing your business model to maximize profits, not gross revenues. It is better meeting the needs of today's marketplace and effectively creating a competitive advantage. It is disengaging from your history and moving into the future.

Reinvention requires vertical expansion or contraction of manufacturing, distribution, wholesaling, retailing, internet sales direct to the customer and mail order sales. It takes expanding or retracting up and down the chain. Figure out where the most profit is and go there, eliminating the least profitable aspects of your operation. Reinvent yourself and go where the profit is. Stop pursuing gross revenue.

It also requires horizontal expansion or contraction by opening or closing stores, offices or warehouses. Again, remember profit and forget gross revenue.

Operational changes will be necessary as well, such as sub-contracting, importing instead of manufacturing and buying machinery instead of using labor. Change your business to create lower overhead and higher net profit.

Make financial adjustments, change your terms and increase your pricing. Do all of this with the aim of decreasing costs or increasing profit, as well as becoming more attractive to your client base. Getting smaller but more profitable is a fine objective.

Track and react to market adjustments. Redefine your target market to aim your marketing efforts at the most profitable sector, not everyone on the planet.

Focus on product selection. Feature handmade or custom made products, the broadest selection or the most obscure one. It's about becoming specialized and operating in a niche market. Find a way to own a genre, specialize and be special. This will support higher prices and create greater demand from those willing to spend on such a selection. This is an important area for reinvention and can support real change and great results.

Another huge opportunity to reinvent y our business is service, service and more service. Service is addicting for a customer and supports charging higher prices for your products. Whatever you are doing, figure out how to deliver stunning service and outdo your competition to secure your share of the market. It's probably the single most significant area for reinvention to help expand your business.

Service comes in different ways; for example, having very knowledgeable sales people who really know what they are doing. It can be educating the public, having extensive guaranties, quality financing, pickup and delivery, free assembly or free installation – whatever you can think of to captivate the market's imagination and support profitable sales.

Another view is to change your strategies (how you plan on implementing your plan). Rewrite the playbook, reconsider options you may have never considered in the past or may have rejected as not appropriate at the time. Be inventive and creative. Joint ventures, direct marketing and vertical or horizontal expansion are all strategy adjustments.

Then there are the real creative marketing innovations and reinvention. For example, wine tastings, single-sitting dinners, entertainment, food, clowns, "try before you buy," unlimited guaranties, and on it goes. Embrace your marketplace and create competitive advantages. Consider the following:

- A chiropractor expands hours to cover late Friday and weekend nights, until midnight, serving the working public. The business is now flourishing.
- A restaurant that featured expensive business dining changes to less-expensive power lunches, increasing revenues dramatically through volume.

When banks began to stay open on Saturdays and Sundays and in the evenings, that was reinvention! Gas stations now having convenience stores is an example of reinvention. Hair salons featuring clothing boutiques is just another example of reinvention.

Use your imagination and expand and intensify your efforts to focus on profit and originality, service and creativity. Stop discounting, stop putting loss leaders out, stop being "everything to everyone" and stop being "ho-hum" as usual. Become specialized, unique and add value. Perceived value is the benchmark.

How do you do this? Locate a profitable niche within your market and exploit it. A local insurance agency specializes in small airplane insurance and does very well. Why? Because they are close to a busy local airport and flight school.

Find your sweet spot. Figure out where your highest profits are and what you can specialize in. If you don't have a sweet spot – invent one!

Ask yourself: "Why should anyone buy from me?" What is your competitive advantage? Identify this and adjust your strategies accordingly.

No one wants to change; everyone must. Free yourself from your history and discover the future. Reinvent your business and succeed. It is no longer how it used to be done; it is now how it needs to be done today.

5. Pillar Three: Internet Marketing

Everyone knows of Internet marketing, but far too few small business owners are using the Internet to effectively market their services and sell their products. One misunderstanding is that you cannot market on the Internet on a local basis, which is not true at all.

Marketing online is an equalizer and a game changer. It puts you on the world map (or the local map) and allows you to compete with the best. If it is done correctly, it can be an extremely affordable tool that every business can use. It is a must to successfully compete in today's market.

If you don't believe it yet or are still saying "It's not for me," here are two facts to consider:

- Facebook reported 845 million monthly average users as of Dec. 31, 2011.
- YouTube has over 1.5 billion views per day.

Honestly, how can this not be for you?

Unfortunately, many small business owners jumped on the bandwagon and created a mediocre (or worse) web site as part of their initial Internet marketing efforts. This doesn't sell products nor does it add value in any way. Yet, these business owners feel that they have done their job and are not satisfied with the results. In the end, they neglect the Internet and ignore its potential.

There is a lot more to Internet marketing than just having a website that does little more than announce your existence. At one point, that was adequate, but not any longer. The Internet has evolved into something greater, requiring a different type of effort to realize its full potential. You must do this today to compete effectively and emerge profitably.

Are you one of the business owners with a website that isn't doing anything for you? Remember, your online presence must be used effectively; it is a marketing strategy, not a placeholder. Consider the following tips:

- Your website must be a good one. It must be well designed and give pertinent information (at a minimum). Many websites don't satisfy even this requirement, and it's just the beginning.

- Support your website with social media: blogs, YouTube, Facebook, Twitter, LinkedIn, etc.
- Create a social network using the methods above with which you can drive your product or service to heights never considered possible before. This can be done internationally, nationally or locally. You can compete with the best, the biggest and the most…and win. The playing field has been leveled and entry into this arena is available to anyone who chooses to engage.

Marketing online is affordable and so powerful that it is a strategy that must be employed. Due to the depth of the recession we are currently experiencing, more traditional advertising tools do not work anywhere near as effectively and are far more expensive. It is critical to gain a competitive edge without a huge budget. The Internet is the way to accomplish this!

One thing that you have to realize is that it's no longer about just advertising. It is about creating a relationship with the marketplace and, once accomplished, it is a virtually unbreakable bond, an understanding, a community and a culture. Try doing that with a newspaper ad. Those days are over, dying with a fight, but over. The Internet is the new arena, and regardless of your age and your comfort with it, you must learn how to use it or you will fail to emerge. Your competition will leave you behind, scrambling for the left-over crumbs and competing with price only.

This is setting the stage for an influx of people wanting what you have to offer. Once you begin writing blog posts, adding video, and communicating on Facebook and Twitter, you can then begin an outreach program using a newsletter on the Internet. Capture the information of people who reached out to you via comments on your blog posts, requests for information, calling in for any reason, prospects that did not become customers, and even current customers. Use this information to build a newsletter list that shares a common interest in your goods and services. These people become your community.

Create a strategy around this and you will begin to develop a larger and larger community of followers. It takes time but it works; this is what social networking is all about. You are creating dialogue; this is far more powerful than traditional advertising.

Many business owners forget to harvest their most valuable asset: their customer list. These are people who already purchases from you and already believe in your services and products. They will spread the word and possibly come back to buy again. Even though they are existing customers, they must constantly be reminded that you exist. Make them a part of your Internet community; they will bring you referrals and repeat business. They too will help spread the word.

If you need help, hire your own local, experienced webmaster. The important thing is to get this done. A good website is a must to emerge from this economic and business downturn; this is part of your reinvention.

Further exploitation of the Internet is the use of Google Adwords, a huge resource that is extremely cost efficient. It draws people to you, again with the goal of getting them into your community of interaction and communication. This is part of search engine optimization (SEO) and assures that people find your company when searching the web for the products or services you offer. Google Adwords can be applied locally, regionally or nationally and it is an extremely powerful traffic-generating tool.

There are similar opportunities with Facebook, LinkedIn and various other popular sites/platforms. These should be experimented with using minimal funds to see if they work for you and your product or service. Constantly growing your online community is the objective. It's not specifically selling, but creating dialogue, a flow of information and relationships online. This is the new way of advertising. It's what works today.

There are more opportunities out there for those who know what to look for. Seek out chat rooms, groups of people with similar interests, products or ideas. When you find these groups, become engaged in their conversations. Your job is to involve yourself in the dialogue, putting yourself and your website out there to be read and discovered. You can further post your blog entries on other websites, allowing others to discover and read your material.

The potential is endless. This all drives eyes to your website so you continue to be discovered, growing your community, readers and participants who will purchase your goods and services. It happens every day.

Another type of success can be fostered through community service projects. This develops a relationship between your business and your community by giving back to it. This can also be supported by your Internet presence and continues to create relationships with your marketplace. This is extremely powerful and provides a wonderful experience for you, your employees and the community you are serving while also creating goodwill, which translates into increase revenue and profit.

These are some changes you must make to reinvent and grow your business. While a lot of this is difficult to do without guidance, much of it can be done on your own with effort and a willingness to learn. We urge you to ask for help. It is available and we can guide you to where you need to be and provide you with the expertise required to succeed. You can now compete with anyone and win, all while doing it on an affordable budget.

THE WORLD'S CHANGED, GET ON BOARD! It's a roller coaster ride with victory in sight.

6. Pillar Four: The Workout

Decreasing revenues, increasing overhead, pinched profit margins, changing customer habits and fierce competition – all of this means supporting yesterday's loans on today's cash flow. In a word: impossible.

This is perhaps the most important pillar of all. Even with the effective implementation of the other three pillars, a small business can't survive the pressure of bone crushing debt service that robs the business of all available cash flow and prevents effective operations. Furthermore, once a small business is in default, all that remains is liquidation by foreclosure and auction, effectively ending the existence of the business.

Following this, the personal guaranties will be called and the small business owner, now without the business, will be forced into personal bankruptcy, as there is no viable way to handle the personal guaranty.

Fortunately, there are other areas of debt to be worked out as well. The above scenario describes the first position secured bank debt, either traditional secured bank debt or SBA guaranteed debt, but always in a first position and thus in control of everything, including the business, its assets, the receivables equipment, inventory and the personal net worth of the owner/guarantor.

Everything is at risk. If the spouse has signed the loan, then the family home and his/her assets are also at risk. In a word, it's "all in."

After the first level of secured debt, there may be second levels of bank debt, such as lines of credit. These are very susceptible to workout; as we all know and understand unless the first priority gets paid, the second priority gets nothing.

The list grows:

- Seller take-backs, second to the bank. Sometimes they are secured with subordinate UCCs, but are still second priorities.
- Landlord.
- Vendors, with or without personal guaranties.
- Tax obligations, including 941 payroll taxes unpaid and dangerous.
- Credit card debt, whether personal or not, that are all a direct result of the

business.
- Mortgage debt on commercial buildings used for the business.
- Lawsuits, even with judgments pending.

Everything can be worked out. This is the point. Everything.

The workout must be done, as it is simply impossible for small business to be able to service debt taken when the business was doing 20-50% more revenue when it took on the debt than it is now, due to the economic downturn or for whatever other reason.

You can't wait it out, as this downturn will last for a long, long time. This is the economy that we must operate in, and you can't afford to pay, as you will end up in liquidation and left with no options other than self-destruction.

If you see this train wreck coming, implement your debt workouts as soon as possible. You are wasting important resources and getting weaker every day. Do it now – don't wait.

7. Conclusion

Change is uncomfortable – this we all know. However, change is critical for survival, this too we all know. Our economy has changed and, therefore, our business models must change to reflect what is happening.

The Four Pillar system is a guide, a map to support the changes you must make. It requires your input to work. You understand your business better than anyone; it is you who must take ownership of the changes you must make.

You must lead the way, as your employees will also push back against change. This is natural – your leadership is critical.

One final thought: change the context and the results change. You must put these changes into a positive context that supports growth, development and success, as opposed to a survival plan.

It is a new day, there is a new road to take and **successful emergence** is the context. Own this and you will succeed.

The Four Pillar system is your guide to this new context: **expand and intensify**, that is your mission. Lead your team to that place. This guide will help you; you must interpret and apply the system, but you must first deliver the new context. That is your job.

Good luck. We are here to help you.

The Second Wind Consultants team.

8. Addendum

1. P&L profit and loss statement

EXAMPLE:

Business Name

Business Address

Suburb

Profit & Loss Statement

For the period 1 January 2009 to 31 December 2009

Income	
Sales	$120,200.00
Services	$55,000.00
Other Income	$2520.00
Total Income	**$177,720.00**
Expenses	
Accounting	$2,500.00
Advertising	$7,500.00
Assets – Small	$100.00
Bank Charges	$962.40
Cost of Goods Sold	$22,500.00
Depreciation	$2,385.00
Electricity	$2,994.90
Hire of Equipment	$4,200.00
Insurance	$1,221.00
Interest	$2,401.66
Motor Vehicle	$1,203.50
Office Supplies	$962.11
Postage & Printing	$725.00
Rent	$15,610.00
Repairs & Maintenance	$1,082.00
Stationery	$660.00
Subscriptions	$3,690.00
Telephone	$2,165.00
Training / Seminars	$2,200.00
Wages & Oncosts	$65,000.00
Total Expenses	**$140,062.57**
Profit / (Loss)	**$37,657.43**

TEMPLATE: See enclosed Excel Workbook

2. **Cash Flow Pro Forma (see included spreadsheet)**

3. **Break Even Analysis Formula**

P x X = TFC + V x X

P = Product Price

X = Product Quantity Sold

TFC = Total Fixed Cost

V = Variable Cost Per Unit

The left side of this equation is relatively simple. It represents gross revenue: the price of your product or service multiplied by the quantity sold.

The right side of the equation is where many get confused. Your Total Fixed Costs (TFC) is all costs that occur regardless of the level of production or sales. If one more or one less widget is made and sold, these costs will not fluctuate. These costs can include loan payments, administrative salaries, rent expenses and lease payments, amongst others.

Your Variable Cost Per Unit (V) represents the expenses that are incurred with each unit sold or produced: the cost of producing one more widget. Examples of these costs are direct labor hours, direct materials, and shipping and freight expenses, amongst others.

Essentially, this equation allows you to assure that your base-level expenses and overhead (TFC) and cost of goods (V) are accounted for and weighed against your total revenue. If your business can't at the very least balance this equation, you are fighting a losing battle and will experience consistent losses. If this is your reality, you must change something about your equation by increasing prices, decreasing fixed costs or variable costs, if possible.

The goal is to have the left side of the equation outweigh the right, meaning revenue that exceeds all expenses. This is profit; without it, you can't survive.

UCC terms to be avoided

Following is an example of language used in what is known as a "Blanket UCC," a security instrument that encompasses all assets of a business. As stated before, it is important to take actions to prevent banks from using such language. This language is extremely dangerous for a business operating during economic distress.

> *All of the Debtor's rights, title and interest now existing or hereafter acquired in all assets, including but not limited to; accounts, inventory, furniture, fixtures, equipment, general intangibles, insurance proceeds, instruments, documents, and chattel paper and all proceeds and products therof and further including all amounts payable under any policies of insurance with respect thereto and any proceeds.*

Language such as "all assets," "now existing or hereafter acquired," "general intangibles" and "insurance policies" are all more than necessary and will cripple the business if a bank were to decide to collect on them. Please don't allow your creditors to put you in such a predicament. They will have a stranglehold on your business and will control your financial future. Find a lender who will do business without such terms.