

Contingency Planning --- Now is the Time

by Dr. Rick Johnson

Now is Not the Time to Panic

Yes, there are economic problems, but there are also opportunities! Leadership during these tough economic times is about not panicking, and that's exactly the message I want to get across... don't panic! Panic causes knee jerk reactions, and they are rarely correct. This *Economic Panic that could be caused by "Media Sensationalism"* can create a knee jerk reaction that negates effective leadership.

Panic Creates Fear, & Fear...

- *Paralyzes Potential*
- *Punishes Productivity*
- *Ruins Relationships*
- *Sabotages Success*
- *Inhibits Initiative*

We must understand the difference between panic and caution:

Panic - (noun) *a sudden overwhelming fear, with or without cause that produces hysterical or irrational behavior that often spreads.*

Caution - (noun) *a prudent forethought to minimize risk : a warning, a precaution.*

Deliberate Leadership, clear thinking and contingency planning leads to success in any economy. *Panic leads to failure.* As leaders we need to be deliberate, thoughtful, and take the actions necessary to stabilize the future of our individual businesses. So, Contingency Planning can prepare you and your company for both the opportunities of a recessionary economy as well as the potential pitfalls.

Developing the Contingency Plan

A Contingency Plan is a plan developed for a specific situation when things could go wrong. Contingency plans include selective strategies and actions to deal with specific variances to assumptions resulting in a particular problem, emergency or state of affairs. They also include a monitoring process and "triggers" for initiating planned actions. They are required to help businesses recover from serious incidents in the minimum time with minimum cost and disruption. Contingency Planning is a management process that identifies potential impacts that threaten an organization and provides a framework for building resilience and the capability for an effective response and possible recovery if required. They can also put you in a position to take advantage of opportunities that are a result of external influences.

Once the initial contingency planning session is complete, ownership must decide exactly who will be part of the contingency planning team to execute the plan. Additionally, how will meetings be run (e.g. pure status reporting up front), who will record the notes, etc.

- Frequency and agenda for team meetings
- Operating principles while the plan is in effect (e.g. team approval of expenditures over \$X)

MULTIPLE BUDGETS

The platform for contingency planning due to an economic crisis is the multiple budget process. This budgeting process should not be taken lightly. It should not be entered into with a haphazard approach. Objectives include.

- Gross margin improvement
- Increased market share
- Decreased overhead
- Cost containment
- Stable customer service
- Supply chain management
- Death by a Thousand Cuts (closing the GAP between profitability & costs)
- Potential Retrenchment

The three budgets you need to prepare are called "The Catastrophic Budget", "The Realistic Budget," and "The Optimistic Budget."

So Where Do We Start?

Step #1

All budgets generally start with a sales forecast. Go back to the Vice President of sales and request a new, realistic forecast. By the way, the V.P. of Sales is intimately involved in this process.

Chances are the new realistic forecast received from the sales force is going to be highly optimistic. It is by nature difficult for any salesperson to forecast anything other than solid growth regardless of conditions.

This is especially true if their incentive is based on revenue growth. The CFO, (Chief Financial Officer), takes that forecast and using historical percentages creates a proforma (A projected Profit and Loss statement based on the forecast). Unless your sales force is unique and turned in a forecast showing no growth or a revenue decline, this forecast and proforma becomes a basis for your "Optimistic Budget." This budget includes all your past sins prior to incorporating any of your contingency planning initiatives and adjustments.

Step # 2

The next step is to take the current year's actual performance and extend it through year end and determine the profitability or the extent of loss expected. Additionally, take the prior year's actual Profit and Loss statement and post it openly in the "War Room." I mention "War Room" because you must have a convenient, confidential place for your Contingency Planning Team to meet regularly and develop your plan. It's called a war room because there could be a lot of blood shedding involved in a situation where the company faces tremendous economic pressure.

Usually in these types of situations it isn't just a one year anomaly. You create a proforma for a realistic forecast and a catastrophic forecast just as you did for the optimistic forecast. These three proforma's become the platforms you build your three new budgets on. "The Optimistic," "The Realistic," and "The Catastrophic" budgets. If you are in the first half of the year, you use last year's actual numbers as a basis for determining your three new budgets. If you are in the latter half of the current year and can accurately predict year end results without the impact of any of the changes discussed in your assessment process then use that proforma as your basis point.

Operational Strategy

Red Light—Yellow Light—Green Light

How do you know when to initiate specific identified cost reductions, when to relax and when to be on guard. In a turbulent economic situation, you must be able to act and react quickly. You will be observing numerous indicators. Interpretation and understanding of these measurement tools is critical. These indicators may include among others:

INTERNAL

- Cash to cash cycle
- Operating profit
- DSO-accounts receivable
- Payables ageing-trend line
- Gross margin %
- Gross margin \$
- Quote activity
- Backlog
- Book to ship ratios
- Head count
- Specific initiatives
- Budget analysis
- Book to quote ratios

EXTERNAL

- Interest rates
- Backlog
- Purchasing managers index
- Business publication reports

The red light, yellow light, green light scenario establishes what mode you should be operating in. It is based on the key indicators you have established.

RED LIGHT ----- Catastrophic Plan

YELLOW LIGHT --- Realistic Plan

GREEN LIGHT ----- Optimistic Plan

In a turbulent economic situation you automatically implement the realistic plan in a precautionary status. You are in the yellow light mode. You determine when and if you move to either the red or green mode by tracking your indicators.

If you need help with your contingency planning, e-mail rick@ceostrategist.com and set up a phone conference to discuss your needs.

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