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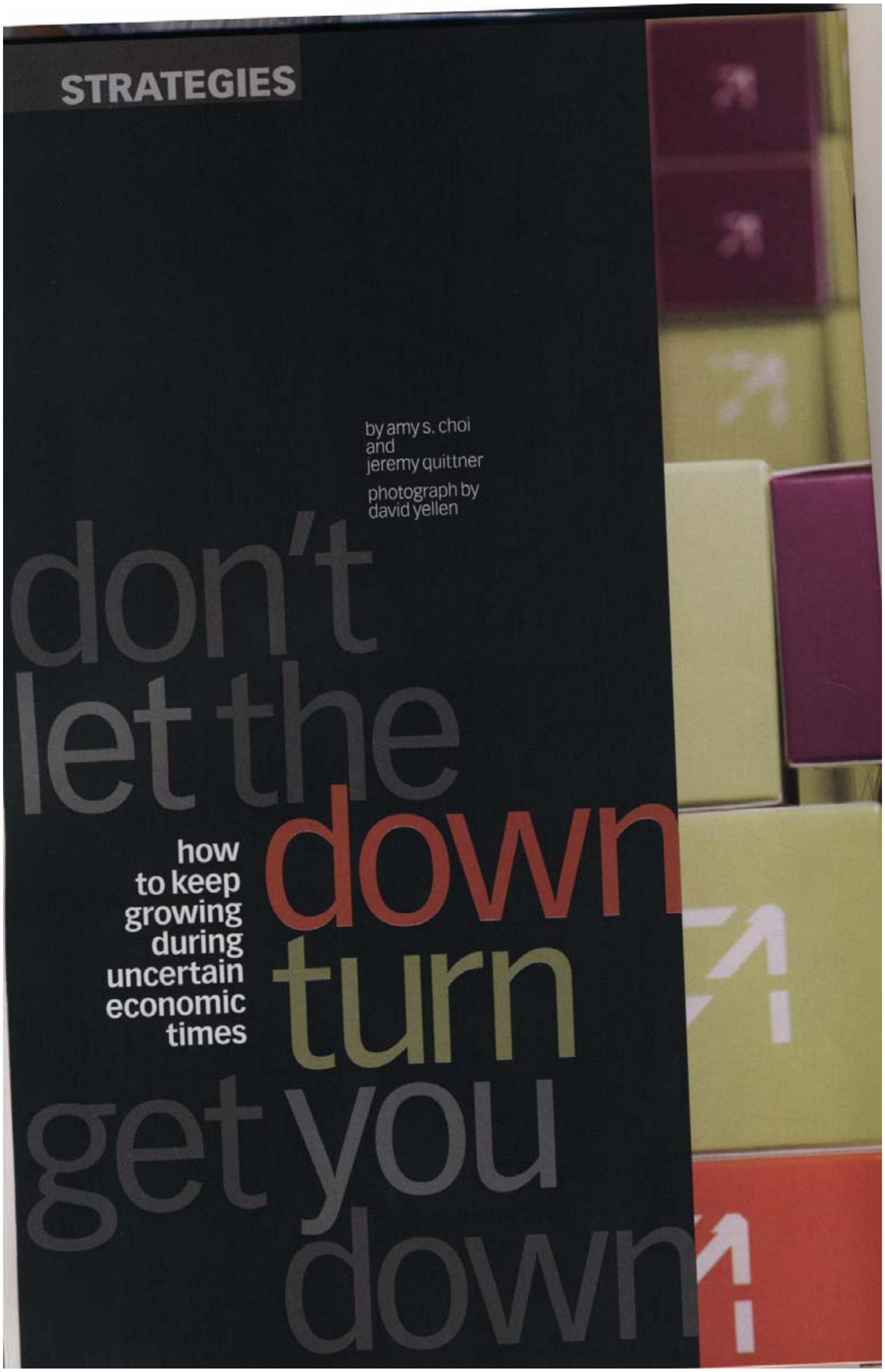
ALCHIMIE FOREVER



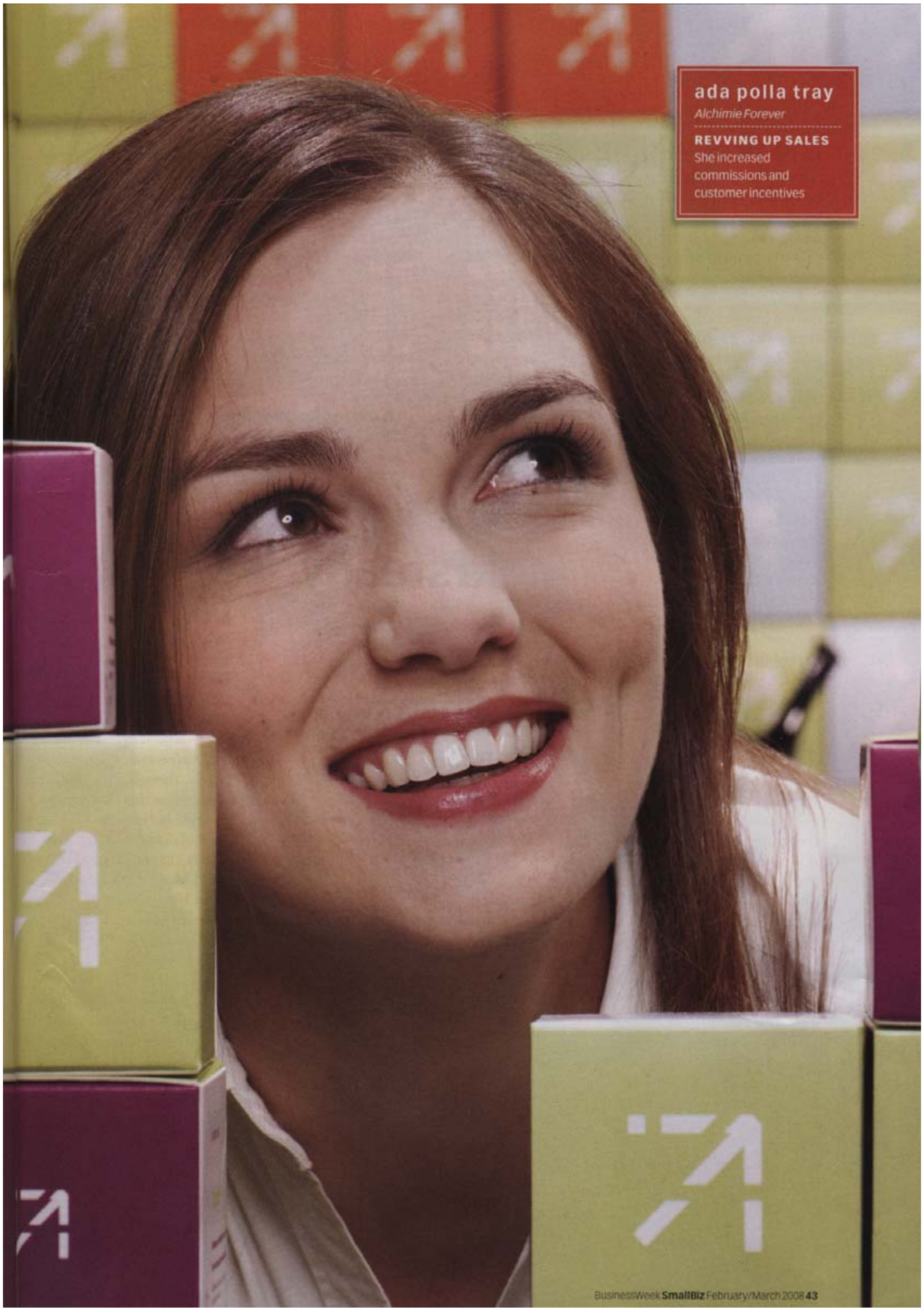
STRATEGIES

by amy s. choi and jeremy quittner

photograph by david yellen

don't let the downturn get you down

how to keep growing during uncertain economic times



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STRATEGIES

the first inkling of trouble

came late last August. Every summer, sales at Alchimie Forever of Washington, D.C., ramp up as spas and beauty salons build their holiday supply of the company's luxury face creams and lotions. But this year, orders were on pace to grow only 10%, a mere blip compared with the usual 24% third-quarter bump.

Founder Ada Polla Tray got busy. She upped the commissions of her four salespeople to 13% from 8%. She gave spa managers $100 gift cards for every $1,000 of products they sold. She offered a free tube of a new exfoliation cream to customers who bought six at $39 a pop. And she started slashing costs throughout the eight-employee, $1 million company. Her moves helped soften the blow: Sales rose 12% over the same quarter in 2006.

How quickly the good times seem to have screeched to a halt. Entrepreneurs like Polla Tray are getting a crash course in managing during tricky economic times. "The environment has gotten much more difficult for entrepreneurs," says Glenn Okun, clinical professor of management and entrepreneurship at New York University's Stern School of Business. "In the last few years, it was in their favor with lots of capital, both debt and equity, on very favorable terms, but now the pendulum has swung in the other direction."

Difficult may be an understatement. Banks have tightened their lending standards, and credit-card defaults are up. Home values continue to fall, ending many entrepreneurs' plans to use home equity lines of credit for quick cash. Energy prices are sky-high. And although the Federal Reserve slashed interest rates twice in January and an economic stimulus package is on the way, how much those changes will help small companies—and when—remains to be seen.

In the meantime, cutting costs is imperative. You'll want to cast a sharp eye on your company's spending. Not just for big-ticket items such as real estate and staffing, but for everyday needs such as office supplies and cell phones.

But there is more you can do, and some of it might surprise you.

A period of economic uncertainty is exactly the time to assess both the finances and the future of your business. Indeed, companies that buckle down can do as well—even continuing to grow—as most companies do during boom years. Here's one measure: About 26% of small businesses operating during the recession of 2000 and 2001 added employees, not much less than the 29% that did during the last year of the tech bubble in 1999, according to an October, 2007, study by the Small Business Administration's Office of Advocacy. So look hard at your balance sheet and business model. Assessing your customers and your market will help you decide where to cut back and, yes, where to invest.

no expense too small

You may think of yourself as the visionary behind your company, but now is the time to be an eagle-eyed accountant, ready to attack the tiniest prey. In 2007, Polla Tray sent $30 bottles of champagne to customers as holiday gifts, rather than the $45 box of chocolates she gave the year before. She asked her sales staff to stay with friends and relatives when they traveled and to book flights during off-peak times. Those changes helped Alchimie slash its $20,000 annual travel budget by 15%. Says Polla Tray: "No expense is a small expense, especially in a downturn."

Don't economize indiscriminately, though. "It's important to cut items that may affect your lifestyle, but not items that affect your customers," says Matthew Kelley, CEO of financial advisory Gold Medal Waters in Boulder, Colo. If you run a coffee shop and go from three baristas to two, you may save money, but you'll lose customers who don't want to wait on a long line for their java.

It may sound counterintuitive, but lean times may call for you to boost some of your outlays. "Sales is the lifeblood of the business, and you should often consider adding to sales and marketing during economic downturns," says Steven Hauck, president of Steven Hauck & Associates, a turnaround management consulting company in Arroyo Grande, Calif. You could raise commissions, as Pol-

MATTHEW MAHON

pricing

hold steady

As tempting as it may be to cut prices during a downturn, hang on. Doing so may temporarily boost business, but it can spell trouble in the long run, particularly if you get caught in a price war. "Dropping prices during a downturn is almost always the wrong thing to do because it undermines your value proposition," says Reed Holden, founder of pricing consultant Holden Advisors, based in Concord, Mass. **"When the market turns around, you'll be stuck with more price-sensitive salespeople and customers and less profit."**

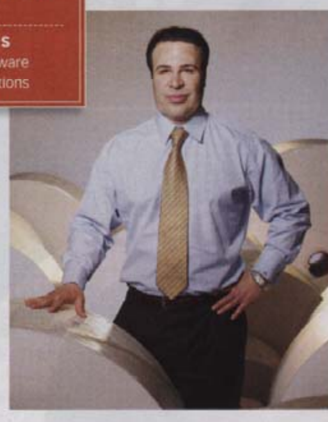
Are competitors already dropping their prices? Instead of following, consider adding options for your customers that don't cost your company much overhead but justify your current pricing structure, says Frank Luby, a partner at pricing consultant Simon Kucher & Partners in Cambridge, Mass. "The goal in a recession is to maintain as much pricing power in the relationship as you can," says Luby. If your customer service line is open from 9 to 5, for example, try keeping it open a few more hours. Or extend the length of your warranties or offer more convenient delivery times than the competition.

Or try selling alternatives to your existing line. Put together different packages of products and services that you can sell at lower prices. In addition to your customary 24-hour maintenance package, say, offer a lower-priced version that operates only during business hours. That allows you to maintain your premium pricing while still driving enough business to keep you afloat, says Holden. Even if customers flock to the lower-cost products for a time, your brand will emerge untarnished when the economy rebounds. —*A.S.C.*

la Tray did. Or you could emulate Joseph Greco, CEO of PSC InfoGroup, a 181-person, $160 million statement processing company who gives his top performers gifts he knows each will appreciate, such as tickets to a sporting event. He also tries to hook customers by offering them discounts for 6 to 12 months, hoping they'll stay for the long run.

Whether you're paring costs or judiciously investing, the best tool for staying abreast of spending is a detailed financial report, produced daily, weekly, or monthly. Check it regularly, and fluctuations in even small expenditures will jump out. In December, while perusing the weekly reports for Hospitality Holdings, a 100-employee, $12 million New York owner and operator of restaurants and bars, CEO Mark Grossich noticed that linen cleaning costs had spiked 15% at one of his venues. He visited and found a busboy mopping the kitchen floor with fresh linens, instead of soiled ones or a mop. "More often than not, if expenses increase there's a reasonable explanation," says Grossich. Bill Cox, CEO of 65-employee, $6.5 million Cox Manufacturing, a San Antonio maker of specialty machine components, uses his weekly line-by-line report to track the cost of everything from tools to lunchroom supplies to labor, and compares those expenses with output. If his budgeted ratios get out of whack, Cox can easily spot the problem.

joseph greco
PSC InfoGroup
KEEPING TABS
He designed software to monitor collections



DAVID YELLEN

Don't spend too much of your life counting pennies. Until a year ago, Steven Boal, CEO of Coupons Inc., a $45 million online promotions company in Mountain View, Calif., required that any check over $5,000 be signed by both him and his controller. But he realized that the task was distracting and frequently kept him from doing other business for his 85-person company. So he doubled the limit to $10,000 and scheduled 15 minutes a week for signing checks. "If you have a growing business, you have to question whether it's appropriate to spend your day writing checks," he says. "But you need to have the right financial controls in place to make sure that you're never blindsided by your expenses."

Tough times demand that you pay particularly close attention to the cash flowing into your company as well. "The collection of receivables tends to become a higher risk for businesses operating through a recession," says Okun. He recommends doing a credit analysis of your customers. You can ask new customers for a Dun & Bradstreet credit report or some other substantiation of their creditworthiness.

Or you can develop your own measures. In 2005, Greco of PSC designed a software program that compares each customer's payments over the previous three months to the trends over the past three years. The software alerts Greco if, say, a customer who typically paid in 33 days slips to 40 days. "This tells us they are struggling with cash management," he says. Then he'll give the client a ring, offering to renegotiate terms and gently asking when PSC can expect payment. In the last few months, Greco and his staff have had to make a lot of calls: The average collection time has nudged up from about 35 days to 39 days.

A friendly phone call or two can also help you build rapport with your suppliers, which can be crucial when your own customers are slow to pay. "With vendors and key partners, the closer you get to them, the more comfortable they are and the less likely they will get aggressive with you," says Hauck. Late last summer, Polla Tray asked her printer to lengthen her payment cycle from 30 days to 90. "There is a camaraderie with small businesses," she says. "If you are feeling it, they are feeling it." This fall, Scott Bray, whose four-person, $1 million company, Scott Bray Design Associates, spends close to $6,000 a month on rent, asked the owner of his building if he could pay every 45 days instead. "My landlord has been very understanding," says Bray.

Keep the phone lines open to your bank, too. If you don't already have a strong credit history there, take out some small loans and pay them back on schedule. "You need to establish credibility with your banks and anybody else who is extending you credit," says Robert Friedbauer, a Teaneck (N.J.)-based CPA. Keep in mind that commercial bank loans often come with covenants, or requirements that you meet certain financial benchmarks—a ceiling on the ratio of debt to equity, say. If you run into trouble during a downturn and trip a covenant, you may have to repay the entire loan. Before that happens, talk to your banker about striking more lenient terms. "With your bank, there should never be a surprise," says Hauck.

narrower vision

If you're an entrepreneur, you are what you make. A downturn is a perfect time to take a close look at your products to see which are worth keeping and which you ought to sacrifice. Give a quick hook to money-losers, of course. But even some profitable products might not bring in enough to justify the effort of making and selling them. Elaine Romanelli, an associate professor of strategy and entrepreneurship at Georgetown University's McDonough School of Business, says small companies with a tight focus may thrive during economic downturns. Often it is better to give a narrow group

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of customers something you know they want or need than to pursue a wider group you don't really understand. "The more specialized firm will retain customers and target them fairly efficiently during tough times," says Romanelli. Specialization has another benefit: Your business will likely spend less on product development.

One way to assess the value of your product line is through a technocratic-sounding procedure called an activity-based cost analysis, which tallies everything you spend to make each of your products and to serve each set of customers. Oracle and SAS both sell cost analysis software. A standardized industry checklist can help, too. In the end, you'll know the fixed and variable costs associated with everything your company does. You'll also see how those costs compare with the associated profit margins. You will know, for example, if your fixed costs are rising for a particular client, customer group, or product line, helping you decide which product lines to eliminate and which customers you'd be better off not serving.

After performing a cost analysis, Bill Cox decided to wean Cox Manufacturing from the auto industry. "Even though it's an incredibly high volume of business, the margins are squeezed down so much it's no longer a good choice for us," he says. "We always choose to focus where the sunshine is." Similarly, after office remodeling contracts began to dry up last spring, interior designer Bray decided to focus more attention on his furniture procurement operation, which distributes about 200 lines of office furniture. Procurement provides about 40% of Bray's revenues, but because the business has no storage costs, its share of profits is significantly higher.

As important as the numbers are, use common sense as well. In 2001, Greco saw the unit selling business forms, which had a margin of 7%, was bringing down profits, and he thought about killing it. A closer look revealed that the problem was the high cost of warehousing the forms. Greco cut the square footage allotted to storage, and the unit's margins jumped to 23%. Today the line contributes $1.2 million to revenues.

You may also want to diversify customers to hedge your bets. In 1982 an oil company that accounted for 50% of Cox Manufacturing's sales went under. "It was one phone call that nearly put us out of business," says Cox. "We had to stop production and lay off a shift of workers." The company now won't give more than 20% of its business to a single customer.

mark grossich
Hospitality Holdings
WATCH THE BOOKS
He studies weekly reports for stray expenses

A period of slack revenues should get you thinking about adding to your product line, too. Small business owners "could look into half-step diversifications," says Eric Siegel, a lecturer in management at the University of Pennsylvania's Wharton School. Consider products that are closely related to what you do best and that get you into slightly different markets. This past October, Polla Tray launched a new facial scrub, and she is looking to add a line of sunscreens. Although she'll be taking on big competitors and will have to spend $50,000 to develop the line, she believes that expansion is far less risky than sitting back and hoping to hang onto what she's got. "We have to keep it new and interesting for clients," she says.

To look at the world a little ruthlessly, the good news about bad times is that some of your rivals will fold, giving you a chance to scoop up their customers, enter a new niche, or simply find some bargains. When business cooled after the September 11 terror attacks, Cox bought three used Swiss precision cutting machines from a competitor for $70,000 apiece, $30,000 less than the typical sticker price for a used machine and about half the price of a new machine.

During bad patches in his industry, Steven Boal gobbles up staff. Coupons Inc. grew more slowly through the tech boom than many of its Silicon Valley peers, but the leisurely pace worked in its favor when the bubble burst. "A lot of companies had overinvested early to generate immediate profits and didn't have the resources to withstand the bust," says Boal. "We were able to pick up a lot of talent, and it was a great time to show our perseverance to potential clients who might have experimented with some of our competitors." In tough times, an eye for a good bet can separate the entrepreneurs who make it from the ones who fail. SB

cost-cutting

easy savers

- » Replace your phone service with a free VOIP provider such as Skype.
- » Purge excess inventory with a fire sale.
- » Keep payroll to 40% of fixed costs.
- » Create a bonus pool that ties everyone in your company to the business' profitability. This will provide an incentive to keep down expenses.
- » Pay vendors on a biweekly rather than weekly cycle.
- » Maximize your float through Zip Code management. Vendors in Zip Codes far away from your business may wait longer to receive—and cash—their checks, temporarily freeing up funds.

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