COUNTERPOINT

† David Crawford is the Partner in Charge of the Reconstruction and Insolvency Division of KPMG Peat Marwick. Some of the administrations that he has handled include International Harvester Australia Ltd., The Trustees Executors & Agency Co. Ltd., Ariadne Australia Ltd., Bond Brewing Holdings Ltd., and the Victorian Economic Development Corp. He is currently involved in the administration of Quintex Australia Ltd. and the restructuring of the Adelaide Steamship Group. This paper was first delivered at the 1991 Manufacturing Outlook Conference.

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Corporate Strategies for Survival and Growth

David Crawford †

1. Introduction

As an Insolvency Practitioner I naturally come across a great many companies which have missed the boat as far as corporate strategies for survival and growth are concerned. There is obviously potential to learn some lessons from analysis of the reasons for those companies' failure. What is possibly of more interest, however, is the category of companies which have not yet failed, which have financial and management problems (or perhaps just mediocre preformance), and which have the potential for survival and growth if only management is capable of recognising and dealing with the problems.

In these opening comments I would like to comment briefly on the Australian commercial environment as a whole, and then concentrate on what individual company managements can do to enhance their prospects of survival and growth.

2. Australian Commercial Environment

We Australians in general have, I think, been fairly slow to accept that other countries have been improving their standards of living at a faster rate than we have, and that we face the real prospect of permanent reductions in our standard of living as a result of lack of attention to our international competitiveness. There is only a very slow understanding of the fact that, whether we as individuals work in export industries or not, our standard of living is affected by the performance of our export industries, which is in turn affected by the performance of all industry in Australia. In the past some people have had their favourite hobby horses when it came to apportioning the blame for any perceived lack of competitiveness in Australia. Management would typically blame government regulation, union militancy, too many holidays, slovenly or lazy work practices, and high wage rates. These factors have great emotional appeal to management and there may well be

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some truth in the allegations. Any dispassionate analysis, however, would have to concede that production costs and competitiveness are significantly influenced by the performance of management, and by capital productivity as well as labour productivity.

There are, of course, a great many variables and hindrances to efficient production in the Australian economy which are beyond the control of individual company managements. The Manufacturing Outlook Conference is obviously keenly interested in as much reform as possible in all those external factors which currently hinder competitive performance by company management. The other half of the picture is the action which management can take within their own organisations to improve performance and ensure survival and growth, and this is the area to which I would like to address the rest of my remarks.

3. Corporate Strategies for Survival and Growth

Analysis of company failures from the late 1980s is instructive in that it reveals the significant extent to which individual corporate failure is caused by management rather than external factors.

Commentators, depending on their allegiances, place different weightings on the various factors which appear to have caused Australia's corporate problems. Factors blamed include:

- deregulation of the banking system and the subsequent over-supply of available money for lending;
- widespread community expectations of continuing inflation in asset prices encouraging speculation rather than production;
- the bias towards higher gearing ratios caused by the tax deductibility of interest and asset price speculation;
- more favourable treatment of capital gains as opposed to income by the taxation system;
- poor bank-lending practices;
- bad management on the part of borrowers;
- inadequate corporate regulation and poor corporate morality; and
- government management of macro-economic policy.

There is little doubt that each of these factors contributed to an environment in which we could expect a higher-than-normal company failure rate. But they do not explain why some companies fail while others do not.

The inability of a particular company to withstand major setbacks without becoming insolvent can usually be traced back to the quality of management. Most of the high-profile corporate failures in Australia in the last two or three

years have involved bad management, either in the sense of a flawed business strategy, inappropriate speculation with borrowed funds or a lack of business morality in acting as custodian of shareholders' interests. Many of them have involved a high-profile, domineering chief executive—which is itself a warning signal of potential management problems—or a board where there is a majority of executive directors.

Some of the corporate failures have had within their structures some very successful and well managed business. Examples are Hooker Corporation, which had very successful Australian businesses, and the Linter Group, which produced a stream of the best known brand names in the clothing industry. Both groups failed, not through losses suffered in core trading businesses, but through an inability to meet debt-servicing costs on borrowed funds utilised on projects which could not generate sufficient income to be self-sufficient. The risk of failure implicit in the overall business strategy is often compounded by lack of attention to detail in planning, and budgeting (profit and cash flow), and by a failure to recognise problems in time to take corrective action.

During the 1980s, there may have been too much liquidity in the system, and banks may have made some poor lending decisions, but it was company managements who adopted business strategies that failed.

4. Lessons for Management

4.1 The Importance of Planning

From an individual company's point of view the first basic lesson from the failures of the 1980s is in relation to the importance of planning. Success sometimes occurs in spite of lack of planning, but normally in any commercial enterprise the only way to ensure success is to draw up plans based on achievable assumptions about turnover, et cetera, and to work those plans through to make sure that if everything goes according to plan, the results will be satisfactory. This does not mean that every business strategy should be profitable in the short term. It may be that a discounting period is a justified management decision, but before making the decision, management should be aware of the expected impact on cash flow and profit. Management can only be sure of this by using financial budgeting. Plans or budgets should be produced by management (or consultants, if necessary) and then ratified by the board as being budgets with which, if they were achieved, the board (and, presumably, the shareholders) would be pleased.

The planning process also involves business risk assessment. All businesses are subject to risks due to variables beyond their control, but many of those risks can actually be identified. For example, speculators in the property industry in the 1980s were subject to the risk that asset prices would level off or actually decline. It is up to speculators to decide whether to accept that risk in view of their assessment of the potential for gain.

In a company's case, the planning adopted by a board of directors should not expose the company to failure merely because a quite identifiable risk moves against the company. Directors need to ask themselves "What if" questions relevant to their particular business. Examples are "What if interest rates remain high?", "What if exchange rates move against us?", "What if budgeted turnover is not achieved?", "What if property prices fall?", et cetera, and if the answers are that the business would not survive, the business plans need to be adjusted to reduce the company's exposure to the particular risk involved.

4.2 The Need for a Strong Financial Function

The second lesson from the 1980s is in relation to the need for good financial reporting systems. There is a tendency for those of us trained in financial management to assume that business managers have some basic understanding of finance and accounting skills, which we can presume without further explanation. We are wrong to make that assumption. There are a variety of other skills involved in running a business successfully, including selling skills, marketing skills, administrative ability and personnel management. Good technical skills (for example, actuarial) often result in promotion to senior management, but they do not guarantee good management skills.

Some successful business people are able to combine all of their necessary skills and run a business personally. A more common occurrence, however, is that successful business people do not hold all the necessary skills personally, but instead make judicious use of their own skills and the skills of others (whether employees or outside consultants) as the need arises.

The lack of finance and accounting skills is obvious in many corporate failures. Some of our more flamboyant Australian directors apparently believed that it is possible to run a business with scant regard to conventional financial practice. Typical examples are the total inability to distinguish between cash and profit, failure to use budgeting as a planning tool, and failure to use regular reporting of actual results to adjust business strategies. Even worse, and surprisingly common, is the failure to keep proper books and records. How can directors expect to make good planning decisions if they are unable to determine their company's current position, or the effect that previous decisions have had? The lesson for directors is that they must ensure that their company has a strong financial function, capable of producing up-to-date financial reports and forward budgets on a timely basis, and the directors must make use of an analysis of those reports to enable them to monitor and assess the success of the company's various activities.

Monthly reporting is almost universally accepted as good business practice, and many larger businesses in fact now report more frequently. Monthly reports allow management to assess how their plans and budgets are in fact working out, and to take whatever remedial action appears to be necessary before problems become critical. Of course, in order for the monthly reports to be useful, they must

be analysed and compared with the expected results. Financial trends need to be explained, particularly if they are unfavourable. The only reason for taking no action would then be because the unfavourable trend has been explained and accepted as a temporary aberration.

Some readers might think this is all terribly basic, but it is ignored surprisingly often. Insolvency practitioners often take charge of companies with turnover measured in millions, where the company records show no sign of monthly budgeting or cash flow planning, and where financial reports were only available to the board on an annual basis.

5. Goal-Setting for Competitive Performance

Good planning and reporting systems are not only essential for survival, they are also essential for competitive performance and growth. There is a very readable discussion of the various factors involved in a booklet prepared for the Business Council of Australia by Access Economics and The Allen Consulting Group entitled *Developing Australia's National Competitiveness*.[1] The booklet provides a good starting point for debate about strategies which Australia should adopt to ensure the long-term survival and growth of our businesses. I would like to paraphrase a few points which are relevant to individual businesses:

- Future survival depends on being able to match the competition.
- Cost efficiency is a necessary but not sufficient condition for competitiveness. The aim must be to improve product quality, reliability, service, customer awareness, innovation and technology.
- Our standards of quality and service are below the OECD average.
- Average productivity levels in Australian manufacturing are 10% below best Australian performance, and 20–25% below best international performance.
- Management and employees must change their goals to aim at world-best performance.

The general thrust of the report is that Australia as a whole needs to raise its sights and aim for best currently achievable performance.

This point was echoed in an "action program" released by a number of prominent businessmen on 29 July this year.[2] The action program basically

1. Access Economics and The Allen Consulting Group Pty. Ltd., 1991, *Developing Australia's National Competitiveness* (Melbourne, Business Council of Australia).
2. M. Deeley, J. Prescott, J. Ralph, I. Burgess, W. Bailey, I. Webber, I. Deveson, B. Vaughn, R. Wilson, 29 July 1991, *Statement and Action Program*, published by the authors.

consisted of ten suggestions to improve Australia's long-run economic performance. Paragraph 3 was as follows:

> In the past we have focused on improving past performance as our standard. In order to be truly competitive this is no longer good enough. Australia will need to perform at the best international standards in all we do. Governments, businesses and unions need to systematically establish and pursue world-best performance standards in all their undertakings so as to achieve these within three to five years.

6. Conclusion

It is easy for individual businesses in Australia to point to the various factors which inhibit their performance and which are beyond their control. But, as the Business Council of Australia report highlights, many businesses in Australia perform well below their industry best within our current Australian system. Whilst all participants have a responsibility to improve the Australian business environment, individual company managements need to ensure that their own performance is the best that can be achieved within the current constraints. This is unlikely to occur under hit-and-miss crisis management.

The insolvency lessons of the 1980s—and my own experiences in consulting for companies experiencing difficulty—suggest that there is still a significant proportion of Australian company management which does not pay sufficient attention to setting goals and measuring performance in an effort to ensure that they meet the needs and expectations of their customers at a competitive price, whilst still remaining profitable. The survivors of corporate Australia in the 1990s will be those who place a high priority on planning and business risk assessment, who ensure that their company has strong financial budgeting and reporting systems, and who use their reporting systems for earlier identification and resolution of problems.