As seen in WASHINGTON BUSINESS JOURNAL ACG National Capital

REPRINTED FROM THE WASHINGTON BUSINESS JOURNAL, CORPORATE GROWTH SUPPLEMENT May 13, 2005

Maintaining Business Growth In The Face Of Cash Flow Difficulities – The Need To Consider The Disposal Of Non-Income Producing Assets

THE ISSUE

Businesses may face cash flow difficulties from several factors, which may force the business owner to focus too much on restoring cash flow, and thereby ignoring crucial business operations. Potential causes of cash flow difficulties include:

- Economic downturns
- Interest rate increases
- Decreases in sales due to market conditions or competition
- Collection problems
- Carrying cost of non-productive assets
- Inability of management to prepare for a crisis.

THE EFFECTS OF THE ISSUE

When cash flow shortages first arise, the typical owner may be forced to react to that need without focusing on the long range effects. Putting off one bill to pay another seems at first a simple solution to the problem and satisfies the immediate need. Initially, the owner thinks very little of the problem, reacts on a simple basis, expecting that the problem is short-lived. Most owners do not realize the long term effects of such actions. Accounts payable are no longer paid on a timely basis, bank payments become late, tax payments are delayed, payrolls are not timely made, and the resulting catch up becomes more and more difficult.

Suddenly, the owner is deluged with letters, telephone calls, demands from vendors, requests for COD payment, loss of credit standing, and even serious employee morale problems. More importantly, the owner can no longer effectively manage the day-to-day business operations, and faces personal exhaustion and a loss of his morale. Before long, the owner is pre-occupied with daily crises. Unreasonable demands are made, and reactions are based on merely keeping the business alive. The business is no longer operated in a planned method for steady growth and expansion. Lastly, employees are left in the dark and find it difficult to function in their positions.

OPTIONS AVAILABLE

The available options for the owner start to narrow. How does one plan and operate the business in the face of disaster and daily crises? How does one keep daily operations flowing with limited cash? There are numerous strategies available which include debt restructuring, finding new sources of capital, simply doing nothing with the hope that revenues will increase, selling the business at a loss, reducing expenses, or finding an asset to sell that generates cash or reduces debt and periodic payment of obligations. The final option above is the primary focus of this Article.

PLAN OF ACTION

The best move for the owner is to step back, meet with its business professional advisors, develop a plan to curb the daily cash demands, and program the payment of debts and bills. But, without the ability to generate cash, this becomes a difficult task, which can lead to legal ramifications against the business.

In the best situation, a business may find that it has valuable non-income producing assets that could create a solid cash reserve and reduce its cash outflow. The most significant of such assets, if available, may be the owned real estate in which the business operates. While it is true that, after a sale to an outside owner, rents still need to be paid in order to operate in the space, the elimination of payments for mortgages and taxes may be offset by the value realized on the sale of such assets. This would be particularly true, for example, if the business had borrowed against the real estate and had fallen behind in the payment of its debt. The best result then may be to secure the services of a competent real estate broker to list and sell the real estate. This can even be done in the face of adverse circumstances, including a threatened foreclosure or forced Chapter 11 Bankruptcy Proceeding. Additionally, the owner can refinance the real estate if there is sufficient equity and take some cash out of the real estate to pay down high interest debt, purchase new inventory to support sales or to support turn around strategies.

HERBERT S. EZRIN

INTENDED RESULTS

The intended result of a planned action to sell or refinance non-productive assets may have the effect of reducing the monthly cash outflow of the business, allowing the business to make a Plan with its creditors for the orderly payment of its debts, create new arrangements with vendors for ongoing merchandise needs, and, finally, to allow the owner and key employees to effectively focus again on the daily business needs and corporate growth.

EXAMPLE

Company A, a manufacturing company, had for years increased annual revenues, reduced non-core expenses and effected nominal, but steady cash flow increases. Company A rents its location from the Company owners who own the real estate in a General Partnership. Monthly rental (which included taxes, maintenance and insurance) covered the mortgage on the real estate. Company A occupied approximately two-thirds of the property, and the General Partnership had leased out the remainder. When the remaining one-third tenant moved from the premises and the General Partnership failed to locate another tenant, it suddenly found it necessary to increase the rent paid by Company A in order to keep mortgage payments current. The increased cash drain on Company A was like a downhill spiral. Company A missed vendor and tax payments, fell behind in payroll, could not deliver merchandise to its customers, and saw its sales drop dramatically. At the same time, the General partnership fell behind in its mortgage payments. Company A was forced into a Chapter 11 Bankruptcy Proceeding and the General Partnership faced foreclosure on the real estate.

Company A and the General Partnership then engaged a professional firm to guide it in a process of staving off foreclosure, aiding Company A in coming out of the Chapter 11, and helping with ongoing operations. The Plan put in place was to create the sale of the real estate, create additional cash for the business, reduce the cash outflow and concentrate on business operations and marketing.

A sale of the real estate was accomplished coupled with a lease to Company A which included a reduction in the size of the premises and a reasonable amount of annual rental payments. More importantly, the lease to Company A created a six month moratorium on rental payments, effectively creating cash for Company A. At the same time, Company A created a Plan for the payment of debt so that the cash flow crises could be avoided. This also included a short deferral period for the commencement of vendor payments. The sale of the real estate further enabled the General Partnership to pay-off the debts on the property and to eliminate the cash drain on Company A.

The result of the above turn-around strategy enabled the owner to again focus on growth and its business operations.

CONCLUSION

The ability of a business owner to devote full time and attention to daily operations and internal growth issues is most vital for the success and future growth of the business. Distractions from that time are very costly, consume time in areas that owners should avoid, and are major distractions and interruptions to the daily business flow. Time and again there are case studies demonstrating the disastrous effects to businesses when distractions occur. The success of an owner to effectively oversee its business during stressful periods depends upon the ability of the owner to delegate responsibility and to have the capacity to deal with the stressful demands. The owner must wisely choose not only staff members, but also outside advisors who have the knowledge and the skill sets that match the project. The example given here is one wherein the owner did choose a capable advisor who was able to sort through the issues, create legal barriers to business destruction, and develop the means by which a sale of non-income producing property was utilized to save the business, inject working cash in the business, and generate the time for the owner to effectively operate and manage the business. Growth of the business then became possible through the guidance of the owner.

Herbert S. Ezrin, is President of the Potomac Business Group, Inc., of Potomac, Maryland. He has over thirty-five (35) years of experience in a wide range of business, law, accounting and management consulting. Over the past twelve (12) years, he has focused on equity and M&A transactions, business growth and business turn-around situations. He can be reached at 301-983-0699 (office), 301-938-6378 (mobile) or at hezrin@potomacbizgroup.com (email). at hezrin@potomacbizgroup.com (email).

This article appeared in the ACG Special Advertising Supplement in Washington Business Journal. It has been reprinted by Washington Business Journal and futher reproduction by any other party is strictly prohibited. © 2005 by Washington Business Journal, 1555 Wilson Blvd., Suite 400, Arlington, VA 22209. 703-875-2200.