ACTIVE COST MANAGEMENT

ACTIVATE

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Ensuring your continued success

Relatively low interest rates, a strengthening Australian dollar, low unemployment, record housing prices in locations across the country….Australia has sipped a sweet cocktail of great economic prosperity in recent years.

But are we heading for a bitter turn?

Volatility in world markets just a short time ago signaled an economic slowdown and market corrections for shares, debt, commodities and currencies could be lurking around the corner.

Worrying signals are emerging - investors lost billions of dollars of share value when a wave of uncertainty washed into unsettled stock exchanges. The S&P ASX200 dropped 8% in August, but broke new records in October. The Australian dollar lost 13.5% from July to August, and then hit 89 cents US in October.

This volatility in asset markets, reflects fear and uncertainly in wholesale debt markets. Banks are still afraid to lend to other banks or major clients because they do not know how safe their money will be. The liquidity squeeze is already affecting Australians' ability to access credit. If tighter credit persists business and consumer spending will reduce. If interest rates are slashed in response, inflation and cost increases may follow.

In this second edition of Activate, bought to you by Active Cost Management, we'll investigate the potential effects of a credit crunch on business.

There's good news - prudent planning can put your business in the best position for continued success.

Learn how cost management strategies could strengthen your operations and ease the credit squeeze.

Contact us to find out more about how we can partner with you to put these into practice.

Yours in good business!
The Active Cost Management Team

Feeling the bite of the credit crunch

With the USA in the grip of a credit crunch, jitters have been felt in stock exchanges across the globe.

As the US housing market cools, many borrowers with low incomes have defaulted on repayments and their repossessed homes have undercut the property market. 1.2 million homebuyers have been forced to default or foreclose this year because they haven't been able to sell their homes or end up owing more than their home is worth. Forecasts say repossessions will swallow over 2 million more American homes in the coming year.

The impact has rocked the US home loan industry, particularly 'sub-prime' lenders - institutions that loaned money to homebuyers who couldn't provide the documentation to meet banks' standards, or who had past credit problems.

Significant losses in share values have forced many lenders to cut jobs, sell assets, reduce borrowings, write down the value of home loans on their books, and tighten credit guidelines.

In the flow-on effect as shares are dumped to gain liquidity, wild swings in the stock market have damaged hedge funds, mortgage lenders, money-market funds, and art prices.

Australian businesses also felt the effects, including Adelaide Bank and the RAMS Home Loans group.

Understanding what impact a credit crunch could have in Australia is vital.

We could see these possible outcomes:

Interest rates increase:
- Competition for funds mean that debt costs and equity ratios required for borrowing rise.
- Consumer credit card debt multiplies.
- Consumers and businesses divert surplus cash to repay debt, decreasing their ability to spend on items such as retail consumer goods or business services.
- Home borrowers experiencing mortgage stress default. Mortgagee sales cause housing values to decrease generally – eroding equity margins and leading to more defaults.

Unsettling of the stock market:
- Yield expectations increase and share prices fall, leading to margin calls.
- Confidence in investing drops and trading slows.
- Returns to shareholders reduce as customers conserve cash.
- Companies in a weak financial position are forced to cut jobs, slash low profit product lines, and clear inventories.
- Company takeovers may be postponed or cancelled.

Strengthening of the Australian dollar:
- Higher interest rates attract foreign deposits, but the Australian dollar values of exports fall while import competition increases.
- Imports displace Australian manufacturers and jobs for everyday essentials such as groceries and hardware through to appliances, electronics, steel and motor vehicles.
- Overseas travel becomes cheaper, hitting local tourism.

Wise businesses are working now to mitigate the impact of any future market downturns. By controlling elements within their scope of control, such as cash flow, they'll be in the best position for success.

Quick facts

The number of Australian households suffering ‘mortgage stress’ has nearly doubled in just five years (those paying more than 30 percent of their income towards mortgage repayments), according to Census figures.

The number of renters suffering from financial stress is forecast to jump nearly 50 percent over the next three years as tenants face spending a growing slice of their income on housing.

The widespread housing slump being experienced across the USA is considered to be the worst in 16 years. Some predict that US home prices will fall this year in the first annual decline since the Great Depression of the 1930s.

In the USA, more than 30 percent of banks have tightened standards for sub-prime mortgages. Over 14 percent of banks have tightened standards on higher quality mortgages.

Easing the credit squeeze

Now is the time to plan how to tackle the impact of any credit squeeze. Take steps today to strengthen your cash flow:

Manage your debtors
- get on top of your debtors – reduce days debtors ratio (debtors/sales x 365).

Plan your payments
- review payment terms and ensure your payments are made on time, not early
- check you’re not making capital payments until contractual completion
- negotiate discounts for prompt payment, if not already in place.

Streamline sales terms
- review sales terms offered to your customers; offer discounts for prompt payment
- make customer payment terms a strategic issue - not a sales department decision
- choose now who you want to keep as long term customers if funds are rationed - favoring strong payers.

Be strategic about stock
- be realistic about slow-moving stock and obsolete plant - clear it now, before markets slow
- review stock purchasing plans against sales at least twice as regularly as you have been used to.

Get serious about supply
- review delivery times, both inward and outwards - is a slow supply chain inflating your inventory?
- review supply arrangements with Active Cost Management, to ensure your non-strategic buying arrangements are at least as good as your competitors’.

Review your relationships
- talk to key suppliers - would they, or could they, carry you for a while if cash flow slowed?
- shore up customer relations and ensure the major customers are welded to you
- meet your bank and update your relationship. Ensure you have more than adequate emergency facilities in place - and that they are bomb-proof.
- review your customers’ profitability and credit risk
- make sure your staff is reviewed and recognised – ensure key players know how important they are, even in the midst of rocky periods . Let them know they are the solution, not the problem – you will need them!

Ensure your premises are paying off
- schedule all lease expiries and start to plan now if you think you may need smaller premises or fewer distribution points.

Ask us for more information – we’re here to protect your bottom line.

Bring precision to your profitability

Make a dramatic difference to your profitability - reduce costs by efficiently managing your purchasing supply contracts.

Active Cost Management’s advisors and practitioners help clients reach their cost management goals in:

Telecoms and data, freight and couriers, office supplies, printing, catering, advertising, packaging, cleaning, waste management, document storage and more.

Telephone: 1300 300 969
Email: info@activecost.com.au

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The Cycle