

# BULLETIN

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## Are You One Bad Spring Away From Bankruptcy?

by Charles R. Hall

In times of economic downturn, the financial weaknesses of any greenhouse business become more acute, and these weaknesses start to express themselves exponentially. Problems that are minor during periods of economic prosperity can quickly change to tsunamis in a crisis. In addition, there are many decisions that demand your hourly attention in a greenhouse business; thus it is all too easy to overlook the signs that would indicate the company may be at risk of being insolvent.

However, this situation can be avoided if you have a timely benchmarking system in place that regularly analyzes financial metrics regarding specific key areas of your business. I would suggest that during these difficult economic times, senior managers should make special efforts to ask themselves the

following “red flag” questions to determine if their business might face trouble in the future:

1. Are you having difficulty meeting your bills in a timely manner, indicating cash flow problems?
2. Are you experiencing a shrinking market for your product? (Figure 1 page 7)
3. Are you frequently losing customer sales?
4. Is there an increase in customer complaints, revealing that your business is failing to meet their needs?
5. Do you find that inventory levels are climbing faster than sales, and you are building up more inventory than sales warrant?



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## Perennial Problem: Clearance or Carry-Over

by Kate Terrell

Fall is here and the mums are flying out the door along with pumpkins, corn stalks, and all the other harvest-time trimmings.

While brightly colored mums may now be the stars of the show, summer’s perennial crop is going out of bloom and looking more tired every day. Customers are expecting it to go on sale and growers start to struggle with the idea of discounting product or getting it ready to go to bed for the winter and then bringing it back in the spring.

There are several approaches that can help maximize profitability without wasting labor and resources. I spoke with several area grower/retailers to learn how they handle the problem.

### Making Sales Work

One approach is to have sales throughout the whole season instead of one big clearance at the end. This approach can encourage customers to come back throughout the season to see what is on sale now (Figure 1 page 9). Charlie Cole from Cole Gardens in Concord, New Hampshire, likes to get rid of his product. “We like to put perennials on sale after the plant begins to go out of season,” he said. “For example, we sell ground or creeping phlox once it begins to go out of color, not in the fall when they look awful and no one cares about them.”

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**Figure 1.** Track your sales closely. Consistently shrinking sales is a sure sign that you are headed for financial troubles.

6. Is your company highly leveraged and thinly capitalized? Does your bank have more at stake in your business than you do?
  7. Do you have essentially a one-person management team? Is your company overly dependent upon any one person?
  8. Is your business suffering from poor management communications? Are decisions not being disseminated down from the top?
  9. Are you making decisions based on poor managerial information (e.g., inadequate information on sales levels, growth and aging of accounts receivables, inventory levels and turns, etc.)?
  10. Is your company very late in producing financial statements? This is a sure sign of poor financial planning.
  11. Are you experiencing sales growth but no growth in net income?
  12. Do you have a tight grip on expenditures, or is your company committing to expenditures before cash is in hand?
- I should mention that these “red flag” questions are not listed in order of importance, nor necessarily in terms of the sequence in which they should be addressed. Nonetheless, if you answered “yes” to any of these questions, then your business should conduct an immediate assessment to determine the underlying causes.
- The following short list of “to do” items might be a good starting place. Some of these steps are radical, while others are a milder form of defense. Implement them according to the conditions you are experiencing in your market area.
- ### To Do List
1. Conserve your cash. Don’t spend a dime on anything that isn’t absolutely necessary to the strategic vision of your operation. Examine every personal expense you have to find alternatives to any spending patterns.
  2. Refinance anything and everything you can. Stretch out the payments because getting cash later on will be difficult as more people will apply for loans and banks become very picky.
  3. Work out a *worst-case scenario* cash flow projection that assumes a decrease in sales. As part of this, determine what expenses will be unavoidable. Look through your cash disbursements. Pre-plan a less expensive alternative to as many expense categories as possible.
  4. Know your costs well because poor pricing can put you out of business faster. Assume that cost-side pressures caused by a recession will last about two years after a recession is over.
  5. Beef up your advertising/marketing. Everyone else is cutting back. Now is the time to gain “mind share.”
  6. Slowdowns mean layoffs. Therefore, new hires become available and are sometimes available at a lower rate of pay than your current rate. Take advantage of that.
  7. If part of your fleet is going to be idle for some time, try to store unused vehicles and get a reduced rate of insurance due to non-use.
  8. Selling off assets during a recession is difficult. Nevertheless, selling off unused equipment reduces insurance, registration costs, and property taxes. Convert anything you don’t need into cash well ahead of any signals that your area will be hard hit.
  9. Apply for credit long before you need it. You may have to “borrow” your future, and banks will raise interest rates on high-risk loans as conditions worsen.
  10. Look deeper in your own markets. Can you offer your current customer base a more diversified line of products and/or services?
  11. Review your business insurance to make sure your premiums have been adjusted for the depreciated value of your vehicles and equipment.
  12. Take a look at your estimated tax payments made to the IRS. Decreased earnings call for decreased estimated tax payments.
- Cash is “king” during economic slowdowns no matter how mild or severe. Expect your customers to also feel the effect, which means they will pay you at a much slower rate than during the good times (Figure 2 page 8). That’s precisely the reason that you’ll need additional working capital to finance your receivables, if nothing else.
- In periods of economic expansion, managers often focus so intently on revenue and earnings growth that they ignore other, less obvious methods of value creation, such as working-capital

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**Figure 2.** As cash dries up for your customers, you can expect the same; do everything possible to preserve your on-hand cash.

management – the process of optimizing net current assets relative to business volume. But companies that manage their working capital effectively can generate cash, streamline their operations, and improve their cost position. When the economy is expanding, the impact of reduced working capital can be the critical difference between success and failure in a takeover bid or between funding a strategic project with cash on hand and funding it through a debt offering.

The payoff for effective working-capital management can be even greater during an economic contraction, when reduced access to external funding and sharp decreases in sales can greatly limit available cash. Although companies with liquidity issues face particular challenges in a downturn, all businesses can benefit from a renewed focus on working capital. Those with short-term liquidity problems can reduce inventories and optimize receivables and payables to free up cash quickly; businesses with strong balance sheets but decreasing demand for their products can reduce inventories to offset falling sales so that working-capital ratios don't worsen; and companies whose performance remains strong can use working-capital strategies to solidify their financial position and attack competitors weakened by the crisis.

An excellent exercise is to run a cash flow working-capital projection using 60 days, 90 days, 120 days, and even up to 6 months to be paid from some of your customers. How much cash do you need to survive? It's imperative to find the answer to that question. Working capital is an important source of cash

throughout the business cycle, but it is especially critical during a downturn.

If firms do find themselves in a working capital shortage, they have several options (thanks to Barry Sturdivant of the Bank of The West for the tips):

1. Sell off any fixed assets you can afford to do without and use the cash to pay creditors or invest in additional trading assets.
2. Incur additional term debt. This option simply moves short-term debt to the long-term section of the balance sheet. To do this you must have term-debt borrowing capacity, which is determined by profitability, cash flow, collateral, and net worth position.
3. Increase your net worth. Net worth can be increased by selling part of your company to an investor, injecting your own cash, or by generating additional earnings.
4. Decrease your working capital requirement. This is done by lowering your investment in trading assets. In other words, instead of building your working capital level, you lower your working capital requirement to meet your level by either increasing inventory turnover or increasing accounts receivables collections.

There are a few last tips on working capital to remember. First, a lack of cash will get you into trouble before a lack of earnings. Although you should take trade discounts, be careful not to do so at the expense of not having cash when you need it most. Banks are less likely these days to bail you out during the production and shipping season with an increase (even temporary) to your line. If banks do come to your aid, it will likely involve hefty fees and possibly a rate increase.

If you do find yourself in dire financial conditions, communicate with your bankers often; let them know what you are doing. Convince them that you are thinking about their interest as well and that you will do whatever it takes to make sure their loans are repaid. The biggest mistake companies make with bankers is not staying in constant communication with them and then at the last minute surprising them with bad news. Debt will be difficult to obtain; make sure your credibility and communications are in place so that you will be in line to get your share. Keep your loans in good repair, and by all means, do not bust any loan covenants.

Hopefully, this article has prompted you to ask the hard questions regarding the financial situation of your greenhouse business. While we may be in the midst of economic recovery, this one will be a lot slower than we have seen historically, and there will likely be several more bumps in the road. But as it has been said, proper prior preparation prevents poor performance!

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