

Project investment in uncertain economic times (by Michelle Thomas)

Does the GFC prevent companies from undertaking strategic organisational change due lack of available funding or does it present an opportunity? Will shrewd companies make investments in these uncertain economic times that clearly differentiate them from their competitors when the eventual economic upturn arrives?

Introduction

Much has been written about the global financial crisis ("GFC") and its impact on business. The financial situation continues to unfold, and new developments are reported daily.

In difficult economic times, businesses are deterred from undertaking key investments and incurring capital expenditure, due in part from declining returns but also, as has been widely reported, from difficulties in obtaining finance.

This paper considers the key project planning, implementation and review decisions faced by managerial teams, and the way in which the decision making process has now changed.

Financing and capital management

Clearly the ability of a business to obtain funds is a key issue when considering whether a particular project is viable. If sufficient funds are not available, or cannot be sourced at acceptable terms, then the project is unlikely to move beyond the boardroom.

The possibility that finance may not be available is a relatively new business consideration. Until very recently, credit was readily available, and companies with "lazy balance sheets" or low share prices relative to asset values were often viewed as potential takeover targets. Many of these companies sought to leverage their positions as a defensive tactic, and so while capital management strategies were key business consideration, the availability of credit (and the fact that it might not be) did not generally enter the equation.

However this situation changed very quickly in 2008, and suddenly those companies which were highly leveraged were put under the spotlight for being overly leveraged, rather than under-leveraged. There continues to be a greater level of scrutiny on those companies with excess debt, and many stories have emerged (and continue to emerge) of the difficulties faced where high debt levels need to be serviced in the current economic climate.

So what do these changes mean to those companies who now need to

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raise funds? The reality for those companies with strong business models and viable business proposals is that, in the medium to long term at least, probably very little has changed. Economists are predicting that external financing will become more readily available in the medium term, particularly where it can be shown that the project requiring funding is projected to improve business profitability and where sufficient cash can be generated to meet debt obligations.

Financial institutions are likely to scrutinise business plans and projections in greater detail than in the past, and this will mean that the planning and information gathering process will be more involved. However this additional work is likely to be needed for internal purposes also, as boardrooms and investors are likely to scrutinise projections to a greater level than may have occurred in the past.

In a similar fashion, sourcing funds through the issue of equity is likely to be a more involved process in the future, as potential shareholders will need to be convinced of the financial benefits of investing before committing funds (assuming funds are available), and it is likely that a smaller pool of equity funds will be available due to the impact of the GFC on shareholders' wealth.

For those fortunate enough to have sufficient funds to allow projects to be financed without raising funds externally, little will have changed. However because of the economic landscape, management will need to have a very accurate understanding of what the project will mean in a financial and economic sense, and will need to be able to convince stakeholders of its merits.

Profitability and cash flow

Managing costs is a key priority for businesses at the moment, and discretionary spending is being cut wherever possible.

Regardless of the state of the economy, cash flow problems are the main source of business failure, and in difficult economic times, cash flow management becomes more important than ever. It is important that in the current economic environment, a business has the cash available to service debt obligations and other cash outflows. Reported profitability is important, but in order to stay afloat a business needs sufficient cash levels.

Because of this, it is vital that a business weigh up the cash flow impact of investment proposals. Stakeholders evaluating the performance of a business are also more likely to judge business decisions on cash flow performance and arguably a business can influence the judgment of stakeholders by focusing on the cash flow impacts of particular decisions. Those projects which are cash flow positive may be seen positively by stakeholders, notwithstanding the impact of the project on reported profits.

Revenues and expenses which do not have a cash flow impact (such as depreciation) may not be as relevant to decision making as would otherwise be the case.

Businesses should seek to understand tax implications of particular proposals, and the possibility of reducing cash tax payments in the future as a result of the proposals by claiming particular amounts as tax deductible.

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It is also vital that systems and processes are in place to ensure that reliable and timely financial information is available. It may be timely for businesses to reassess the types of financial and managerial information which is generated – whether too much or too little is gathered, whether the most valuable information is gathered, and what is done with the information. It is a good time to revisit many aspects of information gathering and utilisation in order to ensure the business runs as efficiently and effectively as possible.

Taking advantage of difficult economic times

Many businesses are taking advantage of cheaper credit (where available!) to expand their own operations, by purchasing assets from distressed businesses or taking equity interests in other companies at cheaper prices. Others are taking complete stock of the way in which they operate and are examining whether there ways in which their operations can be improved when the upturn begins, in an attempt to take a step ahead of competitors.

The organisations which will emerge strongest from the current downturn are those which have a deep understanding of their own value chain and who are able to enhance the value from key products, processes and services, and perhaps refocus away from those which are less value adding. Many businesses are positioning themselves to emerge from the global downturn in a stronger and more sustainable position.

Although many businesses are now deferring project expenditure, those businesses which have the financing and which are prepared to invest in strong and viable activities are likely to emerge from the current environment ahead of competitors.

Employee retention

Redundancy is a major concern for many employees in the current economic climate – from a period of high employment and difficulties in finding and retaining staff, there is now a situation of rising unemployment and excess labour supply. Redundancy is a real possibility for employees in firms and small businesses which now need to cut costs quickly.

In current times, it is more important than ever that businesses are able to engage with key employees to ensure that they remain motivated and committed to the business. It may also be a time to consider recruiting new employees with particular skills and experience who are now available, and whose skills will benefit the business.

Consider whether your business could engage employees at all levels in the managerial decision making process, by perhaps rewarding suggestions for ways in which efficiency could be increased. All businesses should keep open lines of communication with staff in relation to business performance and projections to ensure that redundancies are managed in a dignified way and those staff members who continue to be employed remain committed and focused on the business.

Where there is under-utilisation of particular staff members, it may be possible to engage those staff members in project assessment and implementation in order to control project costs and to provide new opportunities for employees.

Ensuring Performance

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Summary

In business Change is a constant. The only variable is the rate at which the change occurs. With the GFC we are currently in a period of rapid change. Smart companies will capitalise on this by continuing to invest in strategic projects. Projects that when executed will provide clear competitive advantage when the upturn arrives. However this must be balanced by the potential downside risk that any prolonged recession may bring. A company must examine all currently committed expenditure. Does this expenditure still make sense in the current economic environment? Does the business case still provide a positive return and do the variables continue to stack up? All companies should review their project portfolio now and reprioritise the projects in light of the current economic trading conditions.

How wired can help?

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