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Practically Speaking

Performance Improvement Guide

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You may be wondering how you can continue to grow your organization and remain competitive in today's business environment when the price of doing business shows few signs of easing. Inflation increased significantly in 2022 and remains high today, leaving many businesses struggling to manage costs. Additionally, the Bank of Canada raised interest rates to clamp down on inflation — limiting the ability of many businesses to access credit and driving investors to be far more discerning on return on capital.

According to a release from the Bank of Canada, inflation is not expected to return to its two percent target until the end of 2024. Results from its fourth-quarter 2022 Business Outlook Survey shows that rising inflation and high interest rates are having a significant impact across all industries:

- Almost 75 percent of businesses reported that rising interest rates are having unfavourable effects on their operations and decisions
- More than 25 percent of businesses expect to cut their capital spending over the next year
- Over 25 percent of businesses reported that financing conditions have tightened over the past three months

These statistics align with the experiences of our advisors here at MNP — the topics of resiliency, maintaining profitability, and sustaining growth through this period of high inflation and rising interest rates are cited as key concerns in conversations with clients.

This guide is designed to provide you with some practical ideas to help you develop or build upon all aspects of your organization's performance strategy. From acquisitions to business transformation, to preserving profitability in a high borrowing cost environment, we understand the obstacles you're facing in today's marketplace.

While the solutions will be as unique as your business, asking yourself the right questions will empower you to find new paths forward as you chart your course through turbulent economic headwinds.

Value creation strategy

Your goal as a leader is to maximize profits — and you want to ensure the revenue from your business outweighs the cost to produce your products and send them to market. However, your previously profitable and well-capitalized business may be facing fierce economic headwinds that are having a significant impact on your bottom line.

You must prioritize developing a value creation strategy in 2023 to remain competitive in your industry. Simply put, a value creation strategy asks what investments you will have to make to ensure your profitability continues to increase along with your enterprise value — even through periods of economic uncertainty.

For example, consider a technology company which invests a portion of its revenue to develop a new cloud services platform. While the investment may not result in immediate profits, it will pay off in the long-term if many businesses subscribe to its cloud services in the future.

Investing in a value creation strategy could pay off exponentially in the future. Still, many business leaders are hesitant to funnel hard-earned profits into ideas that may not provide immediate returns.

It's worth noting a study published by the Federal Government suggests that investments in research and development increase the growth of small to mid-sized Canadian businesses. Taking the steps towards developing a value creation strategy now will help you stand out in today's marketplace, offer unique value to your customers, and generate greater profits for your business in the future.

As you evaluate or develop a value creation strategy for your organization, ask yourself the following questions:

- **How much profit does my company generate today?** The value of your business is more than just a multiple of its worth and factors such as company culture, proprietary products, and customer diversity can significantly increase your company's valuation — or decrease it if not managed well.
- **What factors could increase the value of my company?** Value drivers include employee training, investments in new technology or infrastructure, and proprietary product development.
- **What factors are inhibiting the value of my company and its long-term profitability?** Value inhibitors include customer concentration, key person risk, and technology or infrastructure debt.
- **What investments have I made to ensure my business will continue to grow and scale in the long term?** These investments can include simplifying the process of running your company or taking steps to expand your customer base.

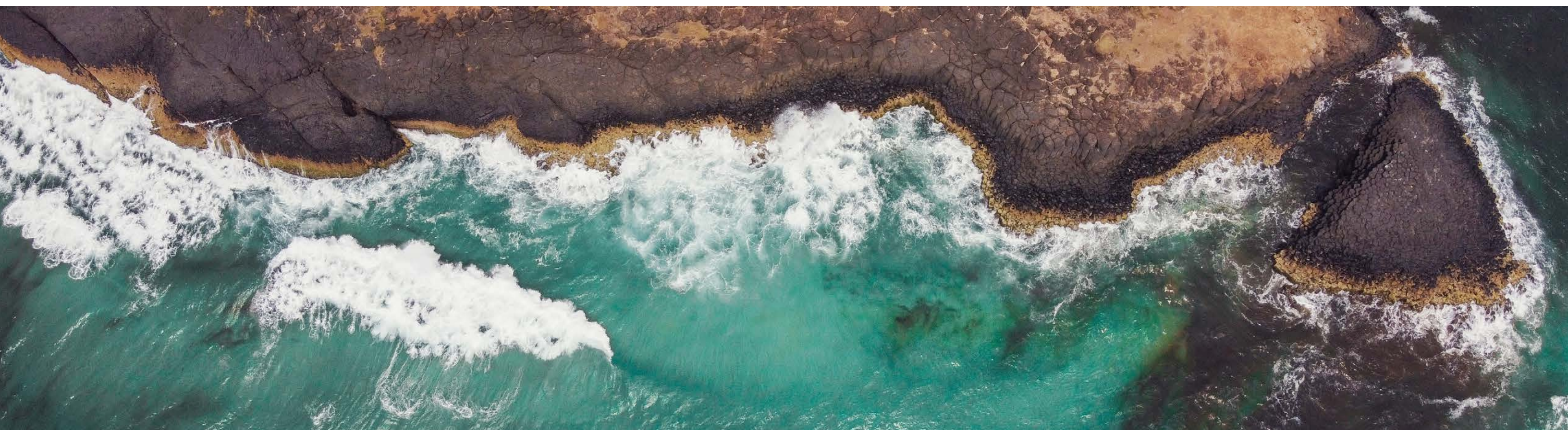
Answers to these questions will be as unique as your business and industry — each will require a customized strategy to drive up your enterprise value. While the process of developing a value creation strategy may be complex, those who don't plan for growth risk losing profitability in the future.

It's necessary to ask yourself each of these questions to understand the current position of your business in the Canadian mid-market. Once you determine where you stand, you can consider adjustments to increase the performance of your business, invest in long-term success, and overcome challenges on your journey from earning income to creating wealth.

Business resiliency

Businesses experienced unprecedented growth opportunities during the past few years — as your profits increased, your company scaled its capital and operations quickly. However, many businesses have struggled to remain resilient amid rising inflation and interest rates.

The Bank of Canada's overnight rate fell to 0.25 percent in 2020 and has increased to 4.5 percent as of March 2023. Your company may have more capital than it did prior to the pandemic but now your growth may have stagnated as the cost of servicing that capital has gone up significantly. For example, if your company owned $10 million in capital prior to the pandemic, you may have paid $25,000 in capital costs per year. In today's high-cost environment, your capital costs will have risen to $450,000, with severe consequences on the profitability of your business.



It is essential to develop a resiliency strategy to help your business weather periods of economic hardship. To begin the process of making your business more resilient, ask yourself the following four questions:

- **How can I maximize my revenue relative to my capital assets on hand?** Conduct an analysis to understand your return on assets and consider finding new homes for assets with a low return on value.
- **Where can I drive profitability?** Investing in new products and determining how to run your product development department on a restricted budget will help your business remain resilient in the long-term.
- **What risks are present in my business?** Create a strategic plan to manage potential risk issues such as customer concentration. Evaluating your business for potential risks helps you anticipate the problems you need to solve and identify potential new opportunities.
- **What acquisitions can I make to increase profitability?** Consider acquiring new talent, competitors, technology, or products to increase the profitability of your business. Look forward two to three years to ensure you have the right investments in place for success.

Developing a business resiliency plan will not only help your company remain profitable through challenging economic headwinds — it will also enable you to retain your competitive edge and stand out in the marketplace by investing in new technology and capitalizing on industry disruption.

One of your responsibilities as an organizational leader is making the right choices to ensure your business remains resilient both in times of economic hardship and times of unprecedented success. Keeping both eyes forward on the future of your industry will help you recognize opportunities, identify risks, and ensure you have the right strategy in place to remain resilient.

Maintaining profitability

The current high-cost environment is having significant consequences on the profitability of Canadian businesses. The rate of inflation is both increasing the cost of the materials you need to make your products and having a severe impact on your customer base.

RBC economists predict record-high inflation and higher debt servicing costs will shave nearly $3,000 from average purchasing power for households in 2023. According to Statistics Canada, almost 75 percent of Canadians reported that rising prices have affected their ability to meet day-to-day expenses, forcing them to adjust their spending habits and reducing demand across all industries.

High borrowing costs are also decreasing the ability of businesses to raise capital or leverage debt. Close to 20 percent of Canadian businesses reported that tighter financing conditions or uncertainty are holding back their capital expenditure plans according to the fourth-quarter 2022 Business Outlook Survey from the Bank of Canada.

Additionally, many companies took on short-term debt while borrowing costs were at or near record lows between 2008 and 2022. Now they need to determine how to pay down that debt as customer demand decreases and renewal rates rise, eroding already slim profit margins.

There's no single correct way to execute your profitability strategy — the solution will be as unique as your business. However, most solutions will include examining your cash flow, identifying areas where you can reduce costs, and managing your inventory to help maintain revenue. And your ability to negotiate lower prices, transfer costs, and standardize pricing will have an influence on your success.

According to Statistics Canada's February 2023 Consumer Price Index, the cost of meat has increased by 6.2 percent from February 2022 to February 2023. Many customers are now substituting meat for less expensive products to preserve their own savings. Likewise, your business must be creative and consider all opportunities to preserve your bottom line.

To begin thinking about how you can continue to maintain and grow your company's profitability in the current high-cost environment, ask yourself the following questions:

- **What is my operating cash flow?** Evaluate your operating cash flow to determine if you need more money to fund your business or if your cash flow is positive. This will help you determine where you currently stand and where to go from here.
- **Where can I reduce costs?** Examine your business for areas where you may be spending too much money and explore the concept of zero budgeting to reduce wasteful expenditures.
- **How can I reduce the money held in my business?** Review your accounts receivable to determine where payments might be delayed and consider adjustments you can make to ensure you receive your profits on time.
- **Where can I transfer my costs?** Consider diversifying your supply base to negotiate better costs for the materials to make your products.
- **How elastic is the demand in the marketplace?** Customer demand decreases when prices rise past a certain point. Determine the elasticity of demand for your products and consider changes you can make to retain customer interest.

Many business owners believe cutting costs or reducing labour is the key to success. Evaluating every aspect of your business will help you determine if that's the case or whether you can identify new opportunities to improve your position in the marketplace. You can take concrete steps to improve the performance of your business, and this investment may yield a myriad of benefits — such as improving efficiency, reducing supply chain delays, and increasing profitability.

Acquisitions and business transformation

Many business owners see mergers and acquisitions as an opportunity to transform their business, increase performance and invest in growth. While you may gain new talent, products, or technology, acquiring or merging with another company often fails to bring long-term value.

According to the Harvard Business Review, anywhere between 70 and 90 percent of acquisitions fail. Additionally, a study from the MIT Sloan School of Management shows that 33 percent of acquired employees will leave within the first year of their company's purchase.

In the face of such results, you may find yourself wondering how best to approach acquiring another company. You know how to run your own business and may have achieved great success in your industry — but have little experience with the acquisition process. It is essential to have a clear plan in place to help you identify the steps you need to take to integrate successfully and transform your business.

The most viable solution is an integration strategy that prioritizes clarity of purpose, governance, and engagement across all levels of the organization. This strategy will help you to clearly identify your objectives, plan out the transition to integrated operations, and ensure you have the right team in place to manage the transition with the necessary time commitments to maximize success.

Here are some examples of questions you should be asking yourself, and your team, throughout the complex process:

- **Have I done my due diligence?** Examine the business you intend to acquire with a critical lens to identify potential risks, determine success criteria, and outline strategic objectives.
- **What are my expectations for this acquisition?** Expectations may include increasing value, reducing risks, or accessing new resources. Once you have identified your expectations, you can create a tailored strategy to ensure your success.
- **Do I have the right team to manage the integration?** You need to have a specialized team in place to manage the integration in both the pre-close planning phase and the 100-day stabilization period.
- **What obstacles might delay the integration process?** Examples include a clash of company cultures, lack of clear communication, and inadequate tools to assist the transition.

Having a plan in place well ahead of the closing date will support the full integration of the acquired company and drive the value of your business forward. A focused integration strategy is an investment to increase your revenue, gain new talent, and enable the transformation of your company.

What comes next

The current high-cost environment is predicted to continue for some time and will have a significant impact on the growth of your business. Taking the steps toward refining or rethinking your growth and performance strategies today will enable your organization to weather economic uncertainty and support your future success.

Investing in performance improvement strategies over the next several years will help drive the value of your organization forward — during and after times of economic hardship. Companies that are best positioned to grow and remain competitive in the current economic landscape are those that invest in growth and business transformation, and make carefully considered decisions to maximize enterprise value, maintain resiliency, and increase the profitability of their business.

To learn more, sign up for our weekly Real Talk Tuesdays newsletter at mnp.ca/practicallyspeaking or view individual insights written by our top performance improvement advisors:

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