

Thinking about next downturn?

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Banking experts say businesses should develop strategy to set up rainy day fund

It is no secret that the federal Paycheck Protection Program helped many businesses of all sizes keep their doors open during the pandemic.

PPP loans provided a direct incentive for small businesses to keep their workers on payroll.

The U.S. Small Business Administration said it distributed more than \$500 billion in 2020, and Indiana received about \$9.5 billion of those dollars. Most of it went to full-service restaurants, religious organizations, insurance agencies, real estate agents and brokers, and dentist offices, respectively.

As individuals, people are told to set aside a portion of their earnings into savings accounts for a rainy day, in the event of an emergency.

Businesses should be no different. According to the SBA, there are several important reasons for a business to have a rainy day fund:

Growing a business debt free: It takes money to expand or hire new employees.

The unexpected: The pandemic has proven the challenges that come with unexpected events.

Retirement: Small business owners need to have retirement plans in place.

But how does a business go about doing this? Financial experts agree it's no easy task but not impossible.

'Hope is not a strategy' – Michael Schneider

Sometimes life throws a person or a business opportunities to put lessons learned during training into action. This was the case for First Financial Bank, which has yearly training modules that simulate pandemic conditions.

"I like to say that hope is not a strategy," said Michael Schneider, commercial market manager for Northwest Indiana at First Financial. "We have yearly training that includes simulations on what to do during pandemic conditions, such as when in-person work and transactions are not possible, (so) we have been through downturns before, but this pandemic was probably the most unique situation we have faced."

Schneider said there were two keys for First Financial to weather the pandemic: preparation and communication. In the banking industry, as is the case with many other industries, institutions are consistently creating plans and testing them for risk management.

"We took a multifaceted approach to communication during the pandemic, particularly in the early days," Schneider said. "We proactively reached out to clients and wanted to make sure they knew we were partners and advisers to help them weather this pandemic."

First Financial Bank launched a hardship-relief program at the beginning of the pandemic, through which business and commercial clients could request to make interest-only payments or defer payments.

Schneider said the pandemic and the associated economic downturn also provided an opportunity for First Financial to connect with the communities it serves.

“Our strategic intent is to be interwoven in our communities,” Schneider said. “We showed what we mean with this intent during the pandemic, (and) we jumped in with a good level of COVID support in our communities.”

For example, Schneider said the First Financial Foundation pledged more than \$1 million in the early stages of the pandemic. First Financial provided more than \$40,000 in relief to agencies across Northwest Indiana.

The institution and its foundation also provided support for minority-owned businesses in Gary and the surrounding areas.

Schneider said there are many ways for a business to start a rainy day fund. He said one important consideration is to not let day-to-day challenges get in the way of having money set aside for emergencies.

“One simple way to start could be having a small automatic debit come out each pay period,” Schneider said. “Business owners should be consistent and conscious, and talking to bankers ahead of time would be ideal.”

Diversify for success – Greg Bracco

The strategy of “not putting all of your eggs in one basket” holds true to sustaining a downturn. That’s the advice from Greg Bracco, senior vice president and chief business banking officer at Peoples Bank.

“Businesses should try to diversify across different industries, if possible,” Bracco said. “They can sustain a downturn in the economy if they are in a good financial position and have a diverse customer base well in advance of the slowdown.”

By retaining a portion of their net income, Bracco said, businesses will improve their cash and equity, increasing their ability to continue to pay their debt and fixed expenses despite a decline in sales. He said business owners also should have a good grasp of some key information that impacts their business’s cash flow, including:

- Profit centers and loss leaders
- Monthly fixed expenses
- Sales required to break even
- An acceptable level of accounts receivable
- Repayment terms for accounts payable.

“Knowing this information will allow the business to focus on the areas that have the greatest impact on the income statement, increasing their chances of success,” Bracco said. “Three good strategies for a business to weather a downturn in the economy are to be well capitalized, understand your business’s financials and diversify the customers and industries you serve.”

“The Small Business Administration’s Paycheck Protection Program, PPP, was an integral part of sustaining some businesses during the economic downturn,” Bracco said. “This forgivable loan provided qualified businesses funds to maintain employees and pay certain expenses, which allowed many businesses to remain in business during the slowdown.

Bracco said most banks provided temporary loan modifications to businesses that were negatively impacted by the pandemic.

“In many instances, the loans were modified to require interest only for a period of time to reduce the required payments,” Bracco said. “Most businesses that received these modifications were able to resume their original payments when the modification period expired.”

Give them a call – Craig Dwight

Pick up the phone and call. This was the top piece of advice from Craig Dwight, president of Horizon Bank. He says business owners will be amazed at the help they can receive if they simply call their bank or financial adviser.

“I experienced this first-hand with our business customers here at Horizon,” he said. “We really are a strategic partner for business and want to help in a variety of ways.”

Dwight said Horizon worked with thousands of businesses through the Payroll Protection Plan. He said those business owners who had a strong network may have fared better in the beginning of the pandemic.

“A key piece of advice I offer is for business owners to have a team of experts to call upon before they need help,” Dwight said. “This network should include banking experts, financial advisers, insurance attorneys and other key contacts. If you have this network in place and a crisis hits, you are much better prepared to deal with it and have experts in place who already know about your business.”

Dwight said the primary goals for a business during an economic downturn are the preservation of cash and capital.

“You want to focus on balance sheet management in a downturn and protect your business’s cash,” Dwight said. “You may be able to work with vendors to extend or change terms to protect your cash, increase long-term debt and lower costs, (so) you definitely want to try and avoid pulling out equity from the business during a downturn (because) that will hurt you in the long term.”

Dwight said the banking industry, with its regulations and backup systems and processes in place, was likely better prepared than others for responding to a pandemic. He said consumers also seemed to generally fair better during the pandemic than businesses.

“I think it was mostly a situation where businesses had very little time when the pandemic hit and had to make big changes quickly,” he said. “On the consumer side, we saw a lot of mortgage customers ask and receive extensions, but many just wanted that piece of mind of having received an extension and were able to continue making their regular payments.”

Temperature check – Michael Schrage

Businesses need to assess if the overall economy or their segment of business is getting overheated.

That's the advice from, Michael Schrage, chairman of the board and CEO of Centier Bank, who said business owners should prepare alternate business plans if things turn down.

"Businesses can financially prepare for downturns by not overextending or leveraging their finances," Schrage said. "It is easy and tempting to do when things are good. Always have a plan B available and ready if needed."

Schrage said Centier provided counseling during the pandemic to businesses, informing owners on what options and alternatives they might pursue for relief and support.

"Centier has always positioned ourselves as a trusted financial partner, helping businesses through every step of their journeys," Schrage said. "During the pandemic specifically, we assisted business clients through payment relief, including access to SBA government relief funds, (and) we also provided counseling, informing them on what options and alternatives they might pursue for relief and support."

Looking at cash – Andrea Short

Andrea Short, president and chief financial officer at 1st Source Bank, offered several strategies for businesses to deploy to help them prepare for and then weather an economic downturn. One suggested strategy is to build cash reserves and monitor cash flows.

"Making sure you understand where your cash is coming from and how it is being spent will help for quick adjustments," Short said. "Another strategy is to review inventory levels and making sure you are optimizing the amount of inventory you are keeping on hand. Reducing expenses and diversifying revenue sources are other strategies to consider."

Short said starting and building a rainy day fund takes commitment and is simple but not easy.

"First, you should set up a separate bank account where the rainy fund is maintained," Short said. "Separating the funds helps with the discipline not to spend the funds until they are truly needed, (and) once the account is established, work on setting aside extra cash each month, with a goal of building a reserve of three- to six-months' worth of expenses."

Banks have had to focus on their own businesses and colleagues while at the same time focusing on helping customers — business and consumer. Internally, Short said, banks followed CDC guidelines, changed workplaces to lower infection risk, moved high-risk colleagues to work remotely, learned to use video for meetings and outreach, and built credit reserves.

"We helped business clients with PPP applications — both round 1 and round 2 currently in process in 2021 and forgiveness applications for PPP round 1," Short said. "We worked with clients having payment problems due to coronavirus shutdowns to defer loan payments until better times."