Credit Risk Ready Podcast

Host Linda Keith CPA With Joel Block

Focus on Finance: Key Strategy Questions for Your Business Borrowers

Hi, this is Linda Keith CPA with Credit Risk Ready, a podcast where we interview senior credit and lending professionals from community financial institutions across the United States, their regulators, and banking advisors to better understand and mitigate credit risk.

Today, we're going to learn what our most successful business clients are, or should be, considering now to solidify their successful transition or to recover from the challenges of the pandemic recession. For each point, we'll provide you the key strategy question that will unlock the insights to getting it right in this ever-changing and increasingly complex business environment. Use these questions in your conversation with your business borrowers and prospects to understand their plans as they're moving forward. And, perhaps, to help them by giving them some food for thought.

Our guide on this journey is Joel Block, a longtime venture capitalist hedge fund manager, which he says is gobbledygook for professional investor, who lives in a shark tank world like on TV. Since selling his publishing company to a Fortune 500, Joel keynotes and consults on disruption-resistant success strategies. What I appreciate about Joel is that he can apply these ideas from Wall Street right to Main Street.

So, Joel, welcome to the podcast.

Joel Block:

Hey, Linda. How are you? Thanks for having me.

Linda Keith:

I'm doing really well. I have got to say, the time is certainly ripe for disruption-resistant success strategies, as I don't believe I've seen greater disruption to businesses in my lifetime than the pandemic recession. How about you?

Joel Block:

I don't think anybody has. I mean, not in any of our lifetimes. The world has changed 20 or 30 years almost overnight, and a lot of people are having a hard time coping with that. It's been a very difficult thing for them.

Linda Keith:

You know, it has, and on the other hand it's also turned out amazingly well for some people. So that's part of what we're going to get at here is how these questions can help us figure out who's doing well, who isn't, and maybe help the ones who need to look at it a little differently. I must admit that even if somebody's doing well, the kinds of key strategy questions we're suggesting will help them do even better.

So, first, let me tell our listeners that the insights and questions for this episode are coming directly from Joel's report *Competing on Capital: 29 Business Trends for 2021 and Beyond*. I have a link to request this free report in the show notes. I highly recommend you read it and then send it to your business clients, because providing useful resources is one of those key ways to bring value to that relationship. Right now, this resource is one of the good ones.

Joel Block:

I'd like to first say why I thought it was so important to break this into buckets. And that is that, listen, I'm in the money business, you're in the money business, your clients are in the money business, so many of us… That's financial capital.

But you know, that's not the only capital that runs the place. One of the things that we all have to pay attention to is that, you know, a carpenter doesn't just use a hammer or a saw. Those people are masters at all different kinds of tools and know exactly which tool to use exactly when. That's what business people have to do, too. We have to be really, really good at knowing when to use what tool. If we get really good at that, then our businesses are going to do better. That's the reason that we broke it there.

There are many different kinds of capital: financial, human capital, intellectual capital, and physical capital. Those are the kind of categories that we produce these trends in. So, we look for trends and, by the way, that would help engage all different kinds of professionals from inside of every company. There was something for everybody inside of these companies. These are trends that typically are coming straight from Wall Street that we look at.

Linda Keith:

Many people who get into business, especially small to midsize businesses, they don't have all these perspectives. They're good at baking, so they start a bakery. Right? Or heck, I got into being a CPA because I needed a class Monday, Wednesday, and Friday from 2:00-3:00. I called out to my dorm and somebody says, "Oh, write down BA 230," and that ended up being accounting. If I started a CPA firm, that wouldn't be because I understood sales, marketing, and all these other things. The nice thing about the report you've created is that it brings these various buckets together. Wherever your weak spot is, it gives you something strong to latch on to.

Joel Block:

Exactly.

Linda Keith:

In this episode, let's focus on the monetary and financial resources, which you describe as the gasoline that powers the business engine. Because financial, so many businesses just don't, don't, don't understand it. So, how about this one: “Fixed costs are a boat anchor.” What do you mean by that?

Joel Block:

Well, a lot of companies have an awful lot of costs that are built in that they can't really get out from under. I've been in the startup business and around the startup business for a lot of my career. One of the great advantages that younger companies have is that they don't have the accumulation of legacy costs like older companies. That could be equipment. It could be leases. It could be long-term contracts. It could be pensions. Littler companies just don't have that. I would tell companies, especially very established ones, that in order to maintain the maximum amount of nimbleness, if that's even a word…

Linda Keith:

It is now.

Joel Block:

….they really have to lighten their load and try to reduce the number of long-term legacy type of contracts and burden that they're carrying. Because that burden is really what will ultimately take them down in the long run. This isn't revolutionary kind of information. But it's really important, especially at a time like now when we have uncertainty about cash. Uncertainty about all different kinds of things in the way money is moving. We don't know how our customers are all doing. There's just a lot of uncertainty. The more we can unburden ourselves, the better off we're all going to be.

Linda Keith:

I remember before the Great Recession, business was really good. I knew there were some expenses that if we looked at them more closely we could probably cut them back. But when business is good, it even feels like the time necessary to even identify those things… It's just, we should just be spending that time working with our customers because it's so good. It wasn't until the Great Recession that we actually sat down, really looked at some of those costs, and said, “All right, this really is something we could shave off.”

In some ways, recessions and setbacks are opportunities to streamline what you're doing and find those anchors that you just don't need anymore.

Joel Block:

That's so important, because this whole pandemic has really forced us to relook at a lot of things. There are companies that have 50 floors of buildings in New York City that are probably going to be giving up 46 of their floors.

Linda Keith:

Yeah.

Joel Block:

Imagine how much of their overhead they're going to unravel, which causes other problems that we can talk about later on. But they're going to be releasing an enormous amount of their overhead. Because of the way that companies operate, the way business operates going forward has changed, and our needs are just not the same. If you don't lighten your load as much as you can, you're going to have less options. You're going to be less desirable to suitors. You're going to be less desirable to lenders. Companies really need to do the best they can to position themselves to be light on their feet so that they can move in a moment's notice, if that's possible.

Linda Keith:

Well, and I agree completely. If I am the lender to that organization and, in my conversations and checking back in, I can see that they're doing this kind of behavior – they're lightening the load; they're really looking at cost; they're looking at what's profitable, what isn't – they are mitigating their risk. Every time one of my borrowers mitigates their risk, they are mitigating my risk as the lender. So, it's an extremely positive move on the part of our business borrowers.

Joel Block:

For sure. For sure.

Linda Keith:

So, your key strategy question for this one was, "What fixed and overhead costs can we reduce or restructure?"

Obviously, that question is a question the business would ask themselves. But, again, the business lender can think about those questions in terms of, "What can I observe that my business borrowers are doing to reduce fixed costs and restructure?"

Joel Block:

Yeah. Part of the reason why this is a good report to put in the hands of the borrowers, from the perspective of the lenders, is these are important exercises for companies to do. They need to sit around their conference tables in their boardrooms, or wherever they are, and they need to be asking these kinds of questions. Whether they report back to the lender or not, the lender needs to know they're thinking about these things. They need to know they're taking action. They need to know that they're not being stubborn. And they need to know that the customer is not just sitting back and just hoping that nothing happens with their head in the sand.

Linda Keith:

That's right.

Joel Block:

The world is moving. The world is changing. Lenders need to know that their business borrowers are moving and changing along with the times.

Linda Keith:

One of the interviews I did in 2018 in a study my company did on credit risk writing was with a CEO of a business bank. He said, “You know, Linda, the borrowers I'm actually more worried about are the ones who have never been through a downturn. They've just been sailing along. The ones who have been through tough times and come out of it, and have shown me what they will do when they are in tough times, I have a much better sense of whether they are credit worthy or not.”

Joel Block:

Listen, that's a really interesting point. Because if somebody's been through the war, they kind of know what's coming.

Linda Keith:

Yeah.

Joel Block:

If you haven't been through it, you don't know what's coming. You're in for potentially a big surprise and surprises are better for birthdays than they are for business.

Linda Keith:

I love that. All right, well, let's move on to our next one.

The second point I want to spend some time on is what you titled The Ownership Shuffle. Assets are going on sale. And, as you know, my focus and credit training is the frontline folks. I regularly remind them it is a big mistake to think all businesses are negatively impacted by the recession. But it's also a mistake to assume that most have not been impacted. If a business is in that stronger-than-ever category, both in profitability and in liquidity, there could be some great opportunities out there.

Joel Block:

The number of opportunities that are starting to present themselves is extraordinary. Just this weekend, it was announced the Tropicana Hotel in Las Vegas is for sale. Caesar’s is about to put Planet Hollywood up for sale. These properties are at deep discounts. These companies need to get rid of them. They have whatever internal reason they want to move them. They are not holding out for the top dollar. So, there really are opportunities for potential suitors to come in and make hundreds of millions of dollars in a heartbeat.

But not every deal is hundreds of millions of dollars. There are small ones too. People are running low on cash. People just can't keep going for 6, 12, 18 months with limited cash resources. Hertz has gone through the mill with this. Dunkin Donuts: they closed 600 stores and they still weren't doing right because their traffic in the morning are parents of children who go to school. They drop off the kids, and then they go and have coffee and a doughnut and that traffic was reduced. It was interrupted. Dunkin put itself up for sale and Arby's acquired them.

This is going to be happening. How long can a company keep going before, eventually, all those assets just start to have reduced value in the hands of a company that doesn't have cash? Then what ends up happening is that some other company is going to come along and they're going to buy the entire company for some much-reduced price. Much less than the aggregate value of the assets. They're going to buy everything at just some reduced cost. That's on the horizon. People who were in the fund business like I am, the venture business, they are gathering assets so that they can start buying, because assets are going on sale. We always talk about buy low, sell high. Well, asset prices are going lower as we speak and people who have cash are in really strong position.

Linda Keith:
When you think about small-to-midsize businesses, a bunch of them have gotten super liquid just because they didn't know what was going to happen. Right? Then it turns out their business is doing well and they have all this extra cash, because they were being careful. They are potentially really well positioned, not only for stepping in and buying a company that has struggled, but there's a whole other group that I'm thinking of. Business owners who were close to retirement or had a plan that maybe in the next five years they would look at selling their business. Then things go the way things are going now, and some of them are thinking, "The amount of money I'd need to put from my retirement assets into this business to make it for the next year, I could maybe just go ahead and find a buyer now, and exit, and not work for the next five years to try to recoup what I lost this year."

Your key strategy question for this one in your report is, "What businesses are suffering that could make a good acquisition target for us?" I think that's a great question for lenders to be asking their business borrowers. Maybe not with those words, but just, "Do you have your eye on any acquisitions that you want to make?" It could be because the target is in trouble. But it also could be that they know that the CPA has been planning retire for a while and and it would be a good practice to pick up. Maybe they should start that conversation, or come back to the conversation if they've actually had it before and it just didn't go anywhere.

Joel Block:

It also says to me that there's going to be some consolidation inside of industries. Bigger or more healthy companies are going to buy other companies that are not doing as well. By the way, it could be a smaller one buying a bigger one if the smaller one is better managed. I think there's going to be consolidation inside of industries.

There's going to be a lot of changing. Buildings are going to be changed. People aren't paying rent, so different owners are going to come in that are capitalized in different ways. Restaurants have been terribly devastated. This is really sad, but what's going to happen with restaurants, which is clear to me, is that restaurants are going to go out of business. Really through no fault of their own, because they just haven't any customers in a year or they've had a really reduced number of customers in a year. So, then they fold down the restaurant. But all of us consumers who live near those restaurants, we still want a restaurant. So, somebody else comes in who's going to pay rent to the landlord. They get a beautiful shell that's ready to go. Then what ends up happening is that the new restaurateur comes in. Customers are ready. They're coming in at a lower basis, a lower price than they might have otherwise come in. That person is going to get an extra sweet deal. Then the customers come back because they want to restaurant. There's just sort of an unfair evolution that's happening right now. I don't say fair in the kindergarten sense. But it just looks unfair and it's unfortunately how it works. But, that's kind of where we're at right now. Things are changing and they're changing fast.

Linda Keith:

And there are losers and winners.

Joel Block:

There are losers and there are winners. Sometimes, that's the part that's not fair. Sometimes you lose because you're a knucklehead. You're running bad business. But this is not one of those situations.

Linda Keith:

Right.

Joel Block:

This is a situation where people who are doing a good job running a good business, have a good clientele, pay their bills, and have a good team are wiped out of business because this tsunami came along through no fault of anyone. It's not anyone's fault. But that being said, a lot of these things are just not inside of any of our control and people are going to be negatively affected because of it.

Linda Keith:

Well, and let me talk about the losers for a moment. Because some of those losers have business loans with someone listening to us right now. One of the best things that a banker can do is help someone recognize that they're going to lose sooner than they could come to that conclusion by themselves. While they still can maybe get something out of the assets, or find a buyer, or not put all of their retirement money into something that's just never going to make it. It's part of our responsibility as lending and credit professionals, actually, to help our borrower unwind in a way that's not harmful to the bank. When it's just going to get worse for the bank the longer a person who is going to lose anyway struggles.

Well, we've gone through the time and we've only covered two of the five items in your report. Just in this one little bucket, you've got asset utilization, which I love. The question on that one is, "What underutilized assets does this business have that's negatively impacting their business and what can they do about it?" Because, just like consumers, particularly the millennials, which we'll have to give them some credit for this one, are saying, "We don't need to own everything." Well, maybe this business needs to step back and go, "Do we actually need to own all the assets we currently have and is there a better way to do this?"

Joel Block:

You know, Linda, what a lot of this comes down to is there's a new way of thinking. The world has changed. Young people think differently than us old folks.

Linda Keith:

Speak for yourself, Joel. I'm not old!

Joel Block:

I'm not talking to you. I'm talking only about myself, by the way.

Linda Keith:

Well, this is not my first, second, third, fourth, or even my fifth recession. So, I got to admit it.

Joel Block:

That's right. We've all been through the rodeo a few times. That's part of what a few gray hairs is worth. But the world thinks in a little different way and we all need to think in a different way. Part of this report is designed to help businesses think in a different way.

Linda Keith:

Absolutely. Well, again, I want to point out to our listeners we've got the link in the show notes to Joel's report *Competing on Capital: 29 Business Trends for 2021 and Beyond*. We're also going to link to his podcast Profit From the Inside: Straight Talk on Business and Profits With Insiders in the Know. I believe that if you are in lending and credit, and businesses or business owners are in your wheelhouse, then understanding business better is definitely a credit risk mitigator.

So, Joel, thank you so much for helping us out today.

Joel Block:

Happy to help. Thanks, Linda.

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Linda Keith:
Thanks for joining us on the Credit Risk Ready podcast. Subscribe, comment, or share on social media to stay connected and spread the word. Join me next time as we bring our bank, our customers, and our communities through the recession safe and sound.

Take care.

Resources

Winners take the Inside Track. Here's the intel you need to join them...

- The Business Trend Report for 2021:
  Competing on Capital: 29 Business Trends for 2021 and Beyond
  http://bit.ly/Bullseye-Trend2021

- Podcast:
  Profit From the Inside: Straight Talk on Business and Profits With Insiders in the Know
  https://bullseyecap.com/index.php/blog/

About Joel Block

Joel's a futurist and longtime venture capitalist/hedge fund manager (gobbledygook for professional investor) who lives in a Shark Tank world like on TV. Since selling his publishing company to a Fortune 500 company, Joel's cage-rattling keynotes expose Wall Street insights and the inside track on high-velocity innovation, empowering business executives and their teams to "Disrupt Their Competitors' Future."

Savvy industry leaders come to Joel for the high-impact advisory services that drive our disruption-resistant success strategies. His unique approach to innovative business model development helps structure, implement, and enable sustained results.

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About Linda Keith

Linda Keith, CPA, draws on her 30-plus years of experience consulting with and training lending institutions; background in public accounting; 15-plus years as CFO of the family residential construction company; and experience as an examiner with the Washington State Auditor's Office and as adjunct faculty in Accounting Principles and Managerial Accounting to help lending and credit professionals say “yes” to good loans.

Of course, you know those are not consecutive years or she'd be over 100 by now!

Linda is known by her clients to be both practical and funny. In fact, there is a movement afoot to change the 'P' in CPA to stand for 'Playful'. The fact is, people absorb ideas and learn better when they are having a little bit of fun. So, Linda brings the fun along with her practical knowledge and depth of understanding to provide credit analysis training and presentations that make a difference.

She is the founder of Lenders Online Training, a virtual classroom approach to improving tax return and financial statement analysis capabilities; the host of the Credit Risk Ready Podcast; and a consultant/trainer on credit risk to banks and credit unions across the country.

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