Five Ways to Build a Fortress Balance Sheet

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When the last recession came swooping in with a vengeance, marketers with strong balance sheets, those who had stockpiled cash and had low debt, were the clear winners. While Wall Street kept touting leverage and other people's money even as the financial wheels came off, marketers who had kept debt low and cash high had built the fortress so strongly they came away with only a few scars, no fatalities.

Most petroleum marketers have experienced good years since then, with fat margins and healthy profits other than a few sector glitches like the oil patch. Experiencing a few good years in a row, however, it's way too easy to get complacent about balance sheet best practices. Complacency can be deadly. Now is the time to build your own balance fortress using these five techniques.

1. Stockpile cash by keeping inventory and receivables under tight control. Do you know and track your inventory days' supply on hand to be sure it's not ballooning up? We've been sharing with our M-Power™ clients gutsy inventory moves that entail reducing high-velocity SKUs (that's not a typo — yes, eliminating really hot-selling products!) with phenomenal profit results. In addition, with supplier terms generally getting shorter, we strongly advise taking a hard look at your terms and customer payment trends. Be ruthless about good-quality customers unless you are specifically skilled in high-risk accounts. It doesn't take many dealers going bad to wipe out an entire year of profit.

2. Borrow 75 percent or less. Whether you are borrowing for a sizeable acquisition or just a small piece of equipment, the 75 percent rule of borrowing will keep your debt in check. Marketers who took it in the chin the worst during the last recession were doing crazy leverage moves, like borrowing even more than asset cost. Those who did that 110 percent borrowing thing over and over again got themselves in serious trouble! Some are out of business and not even reading this article today. If you borrow 75 percent and then find you have a banner year, prepay. That means also avoid accepting prepayment clauses from your lenders.

3. Match the loan term to the asset life, never longer. Marketers who used 25- and 30-year mortgages for stores ended up in a world of hurt when deflation struck and store properties were worth less than what was owed. A good rule of thumb is to ask for a loan term no longer than the life of the asset. If you want to be superconservative, think of what year will be the first time it will need an overhaul, and be sure your loan term is short of that mark. For instance, if you buy tractors for your fuel hauling and expect them to last five years, don't ask for a seven-year loan just to have lower payments.

4. Rid yourself of nonperforming assets. Whether it's a store that's a loser, a piece of land you thought was a good idea at the time but development fill-in is going far slower than you thought, or rarely used equipment sitting out in your yard, get rid of it! A nonperforming asset may even be a whole division that is sucking your cash, time and energy. Be ruthless about all assets needing to perform using specific return on asset as a measure (that's where the money that asset generates is compared to its current market value). Successful marketers often use a 15 percent hurdle rate for all asset performance. Come in less than that over time, and the asset will be cut (sold, disposed, whatever).

5. Hold one person accountable for the fortress. Too many marketers treat their balance sheet like a forgotten stepchild, and even fewer have metrics, goals and accountability attached to all balance sheet items. Be the exception to the rule! Ideally, every asset on your balance sheet should have an accountable owner with return on asset (ROA) metrics and a target to hit and achieve. When it comes to balance sheet accountability, analysis should be happening monthly, and corrective actions immediately.

The argument you will hear is building a "balance sheet fortress" doesn't maximize profits. Frankly, I think this objection is bunk. In the words of Greg Brenneman, who masterminded the Continental Airlines turnaround and saved the company, "Make sure you have adequate time to execute your plan by having plenty of liquidity (cash)." He also relates this to personal freedom by saying, "Manage your personal lifestyle and financial resources so that money becomes your faithful servant and not your relentless master." Can I get an "amen" to that?