Five ways smart companies maintain growth and profitability.

The economy is relatively healthy, but history has taught us that growth cycles don't last forever. It's not if there will be an economic downturn — it's when.

Knowing that there's a cyclical pattern to many markets, savvy owners and executives figure out how to take advantage of business cycles to create a continuing growth trajectory and boost profitability.

Over the next three months, we will be taking a look at five action items that are critical to middle-market companies for maximizing growth, profitability, and value — in any economy, including:

1. Develop a strategic plan

2. Grow your customer base

3. Make better decisions through data analytics

4. Take a flexible approach to real estate

5. Maximize value when selling your business

This month, let's take a look at the first two:

1. Develop a strategic plan

Companies that withstand the ups and downs of the economy share several qualities that consistently drive value. These companies offer compelling products and services, from both the strategic and customer perspectives. They have healthy equity positions and strong balance sheets. They maintain a flexible cost structure. And they plan ahead to identify new opportunities and can quickly deploy resources to seize those opportunities.

The main enabler for all of the above? High-level planning that informs strategic directions.

Conduct a financial stress test

To begin planning ahead, glance backward. Consider how previous recessions affected your company, your industry, your customer base. How much did revenue decline? How much were your margins compressed? How long did the effects last — were they short and sharp, or longer and more gradual?

A key tool for planning is an assumption-driven integrated financial model that includes a forecasted income statement, balance sheet, cash flows and, where applicable, borrowing base calculation. This model can be used to stress test how your company would perform if a future recession has the same impact on total revenue and profit margins as past downturns. Run different scenarios in the model to see the effects of changes in fixed and variable costs, revenue, pricing, margins, and other parameters. Ask yourself this: How would the company fare if history were to repeat itself? Use the answers to prepare now for the next downturn.

Unfortunately, we don't see as many middle-market companies doing this type of financial modeling as we'd like — especially considering that it doesn't require a large investment of dollars or time. Remember, you can keep it high level and still draw insightful, actionable information.

Dig deeper for growth opportunities

If your stress test results come back positive, great. Still, look for less obvious issues beneath the surface. Survey the ecosystem around you. Who are your key suppliers and customers? Which are your most profitable products? How does this compare to your competitors? How will the health of particular customers, suppliers, and competitors affect your business in a downturn? Most importantly, what threats and opportunities can you discern?

We saw several clients enter the Great Recession with the financial strength not just to survive, but to also take advantage of opportunities because they used alternative cost reduction techniques. Some made acquisitions of weaker competitors or assets at distressed prices. Other clients saw opportunities to grow their customer base. They had production and support capacity to step in when other suppliers stumbled. As a result, they gained market share and penetrated new accounts.

When it comes to R&D, we counsel clients much the same way. Smart companies continue to innovate while others are crouched defensively. On the talent side, sharp people working for distressed companies often get concerned and look for alternatives. Again, rather than pull back on talent, be on the offensive to invest. At the same time, engage your talent in discussions about the company's future, and their future with the company, so you don't lose capable staff.

Strengthen your balance sheet to enable strategic moves

Companies often ask us how to do this. The short, but not easy answer, is this: Perform well, consistently. Some companies lose discipline when times are good and business is highly profitable. Based on the results of your financial modeling, ask yourself: What would you do in an actual downturn? Then do some of those things now, before a downturn occurs — that's the foundation of a sound profitability strategy. Practice better working capital management; sell excess assets; lock in favorable interest rates and lease terms (more on that shortly); spend or expand only when there's a clear-cut opportunity that promises good yield and strong impact.

When those well-aligned strategic opportunities — be it an acquisition, an innovation, a talented new hire — do arise, you'll have cash available to react.

With the many distractions middle-market executives face, it's hard to know where to focus your efforts. Asking hard questions and putting the company through its financial paces can point you to the right strategic initiatives to solidify profits and cash flow. Is it an exact science? Of course not. But begin working your way forward, and be prepared to course correct as you go.

2. Grow your customer base

It's more expensive to acquire new customers than to retain them — we've all heard that maxim before and, most of the time, we remember it. But sometimes we get spooked — after all, aren't more customers better than fewer customers? Not necessarily.

When it comes to high-value customer growth, top-performing companies do a few things consistently, in both good times and bad. First, they take a structured approach. We use a customer strategy framework with our clients to help them deepen their customer relationships. The framework guides companies, first, to articulate a vision for serving customers. Next, businesses look at how they must perform to achieve that vision. They then establish a baseline to assess how well they're doing in terms of capabilities, plans, and current customer relationships.

Often, the assessment doesn't align with the vision, revealing gaps to address. This should lead to important strategic discussions about your core competencies as they relate to customer needs and how you want to differentiate your business from competitors in the marketplace. How are you positioned against them? All of these answers should be synthesized into your overarching strategy and tactical plans for moving forward.

The last step of the framework is to monitor progress. Are you making headway? Are you making inroads with that particular high-value customer you've targeted? At a minimum, you should be assessing progress quarterly. It's critical to hold internal discussions and solicit feedback from customers; we wish we saw more middle-market companies doing both — formally and frequently.

Know your customers better

Top-performing companies seek new opportunities with existing customers. Use the framework to explore current customer relationships further. From a strategic and sales perspective, can you see where growth is going to come from? Are there other divisions within the business that your company could penetrate?

On the tactical side, make sure your company has more than one point of contact within the business. Engage those individuals in a discussion. What do they see in the marketplace? Who in the customer's organization interacts with its customer base? Gain a more robust understanding of your customers, who they're selling to, how strong demand is for your products and services and, ultimately, where your products and services are going.

Likewise, your company's "relationship team" should be just that: a team. For example, involve engineering, finance, and management when dealing with a key strategic customer. If you have a direct sales force, salespeople should be well-versed in your products, so they add real value, and their incentives should reward retention and new business from existing customers.

But here's an important caveat: Not all customers are good for your business. Some customers are more profitable or more strategic in value than others. Are you able to discern which are which? How do your customers' profit margins compare? How easy are they to work with? How important are they for future business? The extra time you spend on care and feeding of low-margin or high-maintenance customers is time not spent finding others who might be a better strategic fit for your company. The opportunity costs of "bad customers" can be quite high.

Create a memorable customer experience

Top-performing companies create memorable customer experiences to build loyalty, often by solving customer challenges. Tesla, with a loyalty rate of 85 percent, developed a more affordable Model 3 to broaden its base. Pre-orders alone brought $400 million in cash to the company.

In the middle market, we helped a client who was struggling because it had few "very good" customers. Management was concerned it had tapped out its customer base. The company developed a new strategy around helping customers solve problems. Our client developed new relationships with its key customers, broadening its interface beyond purchasing, and proactively learned about the customer's challenges. When meetings were held, the client came prepared with solutions. At that point, the customer saw our client in a new light, no longer a commodity but a strategic business partner.

Next month we'll take a look at action items 3 & 4. Stay tuned!

Source: plantemoran.com - TIM WEED, DARON GIFFORD, DENNIS BAGLEY, RON GANTNER, PLANTE MORAN CRESA, PHIL GILBERT