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Managing in a downturn

A four-part weekly series

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Fortune favours the well-prepared

Managing risk means being able and ready to adapt, not just following mathematical models and industry best practice. By **Russell Walker**

Traditionally, organisations have viewed risk management as a corporate requirement, and have often grouped it with audit and regulatory functions. Some have even empowered and titled corporate groups to "manage risk" along these lines. This has often centred on managing insurance policies and reviewing reports from rating agencies, which suggests that risk management was viewed more as the hedging of certain risks and the overall outsourcing of critical risk analysis, especially as related to credit risk.

The recent economic downturn has shown a new face and place for risk management. The strongest companies in this downturn are those that integrated risk management as a more comprehensive part of corporate strategy. The weaker companies depended on the traditional risk management school of thought mentioned above almost entirely. This is true in financial services and extends to nearly all industries reliant on credit, market, and operational risk management.

As a result, a few key behaviours of risk management as a driver of corporate strategy have emerged. First and foremost, sound risk management requires executive involvement and ownership. Next, a culture and climate must exist for openly communicating risk in the organisation. Additionally, communication of risk must have an emphasis on data-driven decisions. Last, but perhaps most critically, the organisation must have a "ready response" to a known risk.

Let us look first at how executive involvement in risk management helps to make it part of corporate strategy. A good example is US bank JPMorgan Chase, which has avoided the worst woes afflicting its competitors and has brilliantly executed a strategy that is rooted in understanding its risk and adapting as required. Witness its buying of Bear Stearns, the US investment bank, at $10 a share and its purchase of Washington Mutual, formerly the largest savings and loans operator in the US.

Unlike many of his peers, Jamie Dimon, JPMorgan chairman and chief executive, takes an active role in regular risk briefings. Not only does he ask for detailed risk reports, he also recognises the need to set a direction for the company in reaction to these risk outlooks rather than delegating the risk decisions. When the investment banking industry was moving towards greater real-estate investments and larger collateralised debt obligations purchases, he looked to data from the JPMorgan retail banks that showed that mortgage defaults were on the rise, and then provided his team the direction (based on data) to move against the herd by selling real-estate backed securities. It is hard to fathom that any organisation would make such a drastic decision about risk without the direct involvement of its senior leadership. So, just as executive involvement is important in setting corporate strategy, it is equally important in risk decisions.

To be effective as an organisation, there must be honesty and openness in communicating risks. It is clear that the international real-estate bubble was in part fuelled by a field of mortgages that were, in various forms, deceitful, incomplete or otherwise untraditional. Indeed, the classically trained credit risk managers signalled these mortgages as high risks. For many organisations that were focused on short-term earnings and felt a need to outpace the industry in bookings, this communication of risk was dismissed, or worse, silenced.

In the case of JPMorgan, it was the retail banking division that shared data with the investment bank on the escalations in mortgage delinquencies. This sharing of data across business lines allowed Mr Dimon and his corporate team to change strategy on the investment side. For many organisations, sharing information that challenges accepted norms or questions unconventional wisdom is not welcomed. Other banks could have done the same as JPMorgan, but the practice of communicating risks and data across business lines was absent. The lesson, of course, is that an enterprise must be willing to communicate about risk, especially when things are going well and the risk has yet to be realised. Given the interconnectedness of risk within an organisation, all lines should take the time to learn what other lines are doing.

The importance of information in risk management should not be missed. In recent months, many risk managers have pondered how the traditional risk management models failed to predict the crisis. After all, a great deal of thought has gone into the development of the models and techniques that are used to conventionally manage risk. But it is in the convention that the problem resides.

Conventional risk management techniques use historical data to make projections about "worse cases" or statistical anomalies that might arise. However, future negative outcomes are unknown to the models and future "failure paths" are not incorporated into the models. Most of the risk models used are not good at incorporating new information and even worse at new types or sources of information, such as changes observed in a tangential business line, observations from front-line staff or traders, or alternations in market behaviour due to phenomena such as reduced availability of capital.

When JPMorgan saw signs in its mortgage accounts, it incorporated information on mortgage payments that was unconventional for the evaluation of portfolios of mortgages by the investment bank. Its success came from identifying such novel information and realising that it challenged conventional thinking. In such conditions, relying on conventional risk models is highly questionable – some would even say harmful. So, the focus of a risk manager should not be strictly quantification, but the identification and incorporation of information, especially of new types and new sources, in order to determine direction and the changes that drive risk. Risk management is inherently a process of investigation and learning that is rooted in unravelling the complexity of the unknown.

The risks facing organisations are more complex and tightly connected than ever before. This complexity is largely driven by the ongoing globalisation of business and the increased speed of business activity, as enabled by technological advances. Using data to make decisions is key; it enables verification, and provides a means of breaking

JPMorgan's success came from identifying novel data and realising that it challenged conventional thinking

Your guide to **Managing in a downturn**

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- Japan's hubris
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accepted
credit
of a counterparty that was buying a swap or credit risk transfer, or the direction of commodity or real estate prices. For example, it is clear that the US automobile industry was not prepared for the recent volatility in oil prices. The "Big Three" US manufacturers were largely working on a view that oil would remain inexpensive to US consumers. Meanwhile, the likes of Toyota and Honda were making calculated investments in hybrid cars and other high-efficiency vehicles to position themselves for an upswing in oil prices. In many ways, the Japanese carmakers had already "readied their response" to the risk posed by higher oil prices and the

sewn a few years ago, during more prosperous times, when companies dispersed excess cash through dividends and share

The emphasis is on 'readying the response', in the same way that armies conduct simulations of yet-unseen wars

buy-backs, and undertook a wave of high-priced mergers. Indeed, shareholders clamoured for this sharing of wealth and punished those companies that held "excessive cash reserves." However, today those organisations that hoarded cash can better protect themselves against "liquidity risk" and can purchase competitor assets at significant discounts.

Warren Buffett's Berkshire Hathaway is a good example of this. Its policy of not paying a dividend drew naysayers in the past, but it means that the company now has cash when it is most needed. It has allowed Mr Buffett to follow a strategy of long-

Brett Ryder

term value for investors. The implicit risk decision was tied to strategy.
The current economic situation has altered many assump-
about business and markets, and we have a massive invest-
by governments in corporations. This will bring new risks
corporations and governments alike, which
different strategies and
Although we can more
agree that corporations
to return profits to
the role of govern-
major shareholders in
mortgage-holding compa-
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Frank Wright said
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management is not an exer-
but rather an ap-
understanding uncertainty,
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educated investments.
executive involvement, an
making data-driven de-
communication and the
think through scenarios
responses. A great many of the winners coming out of the current economic crisis will be those that not only held a bit more cash, but had a bit more information than their competitors and were able to seize a window of opportunity.

These lessons show that risk management is really about the identification of key information and its use in the decision-making process. It is not about guidelines or the execution of conventional mathematical models. Preparing for the unknown requires having the best information, not the industry accepted "best practice". The risk management team belongs on the corporate strategy team, not on the phone with insurance brokers. ■

Further reading

In a previous series of Mastering Management, published in 2006, Benoit Mandelbrot and Nassim Nicholas Taleb argued that traditional risk management tools were ineffectual because they focused too narrowly on normal conditions while failing to properly consider the role of extreme events. To read the article, visit **www.ft.com/managingdownturn**

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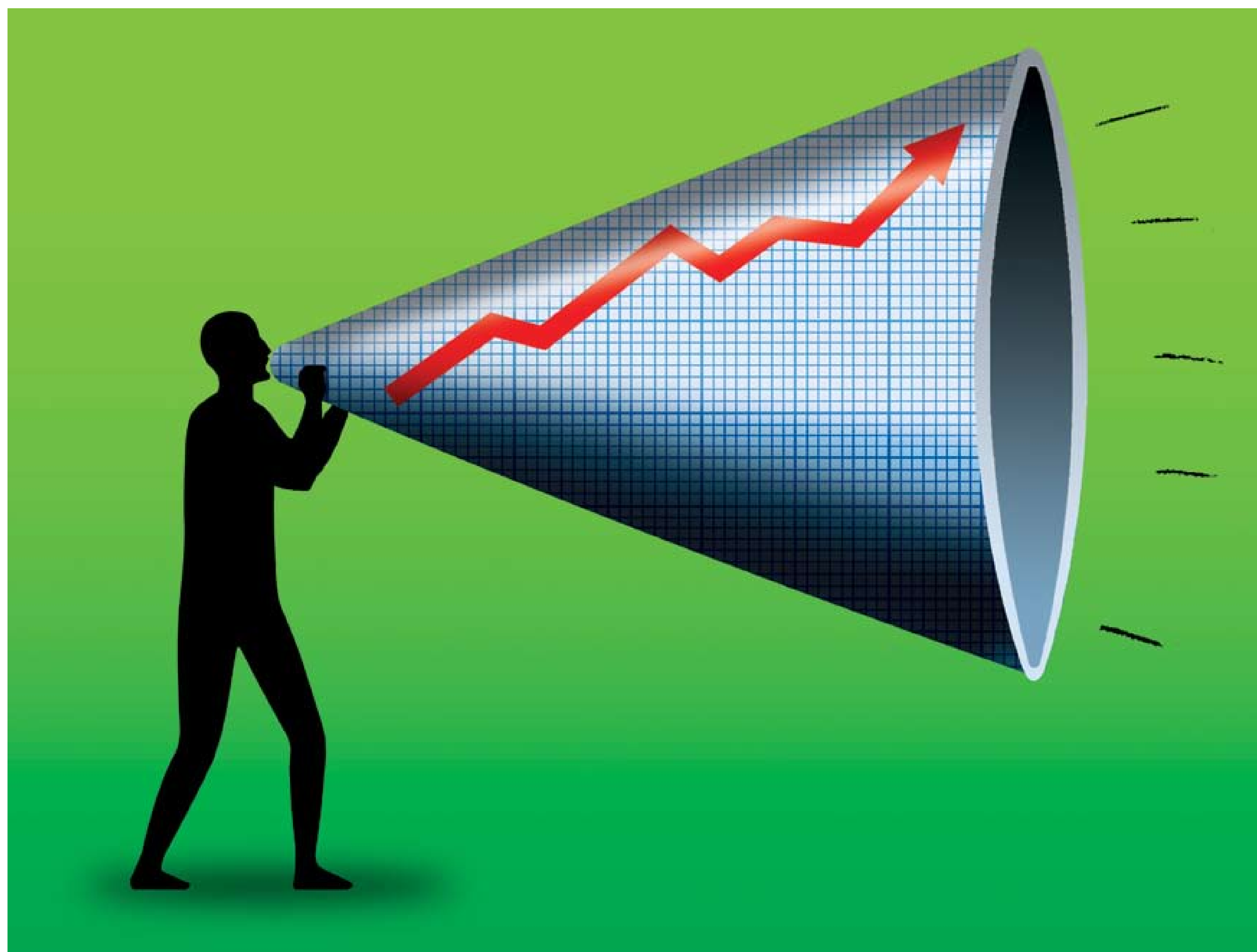
How to talk your way through a downturn

Whether or not your company is directly hit by a crisis, it is imperative to send out the right message to internal and external stakeholders. By **Paul A. Argenti**



Nick Lowndes/Eastwing

Distress has presented itself in spades in the past year with an extraordinary crisis rocking global capital markets. Stocks are fluctuating wildly and investors have watched life savings evaporate, crippling people's trust in financial institutions and, in many cases, big business as a whole.

While public scepticism and negative emotions have run high, such a time of crisis has also meant that, unlike during times of calm, companies have had an eager audience that is willing to absorb corporate messages. While filled with doubt, people have yearned to be spoken to and reassured.

During times of crisis, many companies flail by failing to act or by taking the wrong kind of action when communicating with distressed stakeholders. But in these circumstances, a crisp and transparent communication strategy can set a company apart from the competition by fortifying employee relationships, showcasing superior client/customer focus, and strengthening a company's reputation for transparency, reliability and integrity with members of the wider public. By acting quickly and communicating thoughtfully, a company can build reputational capital and weather the storm to come out on the other side perceived as a long-term leader. Below are some suggestions.

During times of economic downturn, all organisations should be aware that they are vulnerable, regardless of how much or how little they are directly implicated in the predicament. Reputation by association can all too easily cause companies in the right to be lumped in with the perpetrators who are wrong. Public fear – compounded by persistent media coverage – can further chip away at trust in a business sector, or even big business as a whole.

Beware of guilt by association

Reputational risks have intensified during the past year, with the credit crisis yielding real-life villains such as Bernard Madoff, the New York money manager and former Nasdaq chairman whose alleged $50bn fraud served as the *pièce de résistance* in the

shattering of trust in financial institutions in the US. Or B. Ramalinga Raju, founder and former chairman of Satyam Computer Services, the Indian outsourcing company, who resigned after admitting he had manipulated the company's books for many years including the creation of a fictitious cash balance worth more than $1bn.

Poor communication strategies or tactics make organisations or individuals likelier targets, even if they are well-meaning and innocent. Hank Paulson, former US Treasury secretary, serves as a prime example of how not to communicate during a downturn. In recent months, his missteps turned him into a household name. Never a spin-doctor, Mr Paulson forgot that the communication of his economic recovery plan would be just as important as its actual substance. Crucially, he did not effectively market his Troubled Assets Relief Plan (Tarp) as a rescue instead of a bail-out. Instead, his ineffective and soft-spined communications allowed the media to grab the reins and position the Treasury's efforts as a highly questionable $700bn bail-out of greedy banks. Making matters worse, in interviews and public communications Mr Paulson switched gears a number of times, signalling indecisiveness and even helplessness in the face of the financial storm.

Communicate early, often and clearly

Being aware of a corporation's vulnerability during a downturn is only the first step. The second, perhaps most critical step is to place more emphasis than ever on communicating clearly and consistently in such a precarious environment. During downturns, cutting communications teams as a non-revenue-generating area of an organisation may seem like an easy way to slash budgets but companies do so at their own peril. During a crisis, shareholders instinctively grasp for any shred of knowledge to hang on to and often misinterpret information. Stakeholders can end up feeling abandoned, confused or distrustful, and this can do long-term damage to a company's reputation.

Companies must also be sure to focus on employees, who, all too often, are the last to receive information. As the first point of contact for many external stakeholders, employees should be well informed and, therefore, able to project an air of confidence and stability to angst-ridden consumers and investors.

In the wake of the credit crisis, Bank of America enhanced its intranet site with news flash features to keep employees up to date with the stories relating to the bank that consumers were reading. The company also supplied employees with communication tools such as talking points, enabling them to more effectively address potential customer concerns over news items and the highly volatile financial services landscape.

Employee anxiety, unrest or mistrust can permeate beyond company walls to be picked up by the public. In November 2008, when Citigroup's share price plummeted to close to $3, from about $33 a year earlier, over concerns about its financial health, the bank struggled with employee leaks, allegations of in-fighting among its board of directors and a spin-off of Smith Barney, its brokerage arm. On a call to employees, Vikram Pandit, Citigroup chief executive, insisted that the company's capital position remained strong while "rumour mongering [was] at the heart of [the] problems."

Communication crib sheet for crisis times

During a crisis, companies can uncover opportunity by adhering to a few simple guidelines when communicating with investors, employees, the press and the general public.

- **Do not hide:** not hearing from you will breed additional suspicion and mistrust among stakeholders
- **Gather relevant information and stick to your story:** be as informed as possible to reassure stakeholders that you are in control and in the know. Switching gears or waffling signals insecurity
- **Communicate early and often:** both internally and externally. Keeping employees well informed is a vital step to keeping your organisation on message with all stakeholders
- **Centralise communications:** sending conflicting messages from different areas of a company signals disorganisation and undermines stakeholder confidence
- **Get inside the media's head:** anticipate how the press might spin first-hand or second-hand information
- **Choose communication channels thoughtfully:** how and where you say something is as crucial as what you are saying. During a period of distress, scrutiny of corporate communications is higher than ever as stakeholders clamour for information
- **Communicate directly with affected constituencies:** during times of instability and uncertainty, people want to be reassured by hearing information straight from the horse's mouth
- **Keep the business running:** even in the face of upheaval, remind stakeholders that you have not taken your eye off your primary purpose as a for-profit corporation that drives returns for investors
- **Keep values and character centre-stage:** in a period of crisis, maintaining trust is paramount. Adhering to corporate values, and using them as a navigational compass to guide corporate strategy and communications, will demonstrate stability and reliability, assuring stakeholders your head and heart are in the right place.

Learn to say sorry

Candid corporate communication means publicly recognising any missteps, as well as relating lessons learnt that will help to deliver future improvements once storms have been weathered. Failure to do so during and following a period of crisis can make a company seem complacent or, worse, arrogant. Consider the opening remarks made by Jeffrey Immelt, chairman and chief executive of General Electric, during the company's annual investor outlook call in December 2008. Mr Immelt diplomatically underscored the lessons learnt during a year of earnings disappointments: "So, we come through this I'd say having learned a lot, having navigated through some really challenging times. And, like anything else, we use it as a learning experience to get better."

Contrast this with another Citigroup communications oversight: in an interview with US broadcaster Charlie Rose, Mr Pandit positioned Citi as far-removed from the root of crisis, failing to acknowledge past missteps or assume responsibility for risk management failings and the resulting investor losses. "I can completely understand how people on Main Street, people who are not close to this industry would be furious at what's happened and furious at kind of where we've gotten to..." he said. "If you start throwing everybody under the bus, we're going to need a very large bus. Given what we have gone through, the most important thing is who can do the job going forward."

Employee anxiety, unrest or mistrust can permeate beyond company walls to be picked up by the public

While presenting a forward-moving plan is indeed critical, preserving goodwill with stakeholders can only happen if organisations are open and honest about their own role in and responsibility for a crisis, however small or indirect.

Use the Web 2.0 opportunity

As discussed earlier, a crisis can be an opportunity to demonstrate to your stakeholders just how strong you are as an organisation. Social media and digital communications create unlimited possibilities for corporations to have candid and personal conversations with their stakeholders. From internal and corporate blogs to websites complete with videos from management and tools such as Twitter, this is the first time that social media have played a big role in the dissemination of information during a crisis. Companies such as IBM, Dell and Ford, which faces widespread negative perceptions about itself and US automakers in general, are seizing the Web 2.0 opportunity to re-establish relationships with their stakeholders and to set the standard for transparency.

Ford's chief blogger and community manager, Scott Monty has done a great job of positioning the ailing automobile company for future success through Twitter pages, multiple posts and interviews, and a general level of savvy about Web 2.0 that most companies have not yet acquired. However, as Mr Monty said in a recent interview: "The tools don't matter a fig. They'll change, ebb, flow and go away. But you have to approach social media from a holistic viewpoint: how is this going to touch and affect what I'm doing across the board, and what do we want to accomplish?" In other words, don't forget that goal-setting is part of strategy.

Continuity, not re-invention

While invigorating a corporate communication game plan is critical during times of distress, be aware that radical new tacks in communication strategies can breed unwanted suspicion.

In the past year, investors have been severely burnt by false promises from senior executives, most notably from Lehman Brothers, which is under US federal investigation for potentially misleading comments to investors concerning the company's financial health by Richard Fuld, former chief executive. Investors have paid the price through depleted 401k retirement saving plans and mistrust of corporate communications has increased. As a result, sudden and unexpected communications – even those with the best of intentions – can heighten public fears.

Consider GE's shares slumping 10 per cent on December 1, when the company announced an unscheduled update. The announcement turned out to be positive – reiterating the company's strong credit rating and dividend commitment – but this example demonstrates how actions perceived as "unusual" can provoke harmful knee-jerk reactions from jittery investors, even when a company communicates well.

Increasing communication is essential, but developing a coherent communication strategy and selecting channels, timing and messages thoughtfully will be most important to avoid giving off alarmist signals. Similarly, maintaining a distinct sense of identity and focusing on corporate values becomes more essential in turbulent periods to reiterate corporate consistency and a willingness to stay focused on stakeholders' best interests.

Communication as crucial to financial risk management

The current crisis underscores how vital communication is to a company's financial risk management strategy. For a corporation to attract and retain investors, it must convey its financial and organisational picture in a clear, cohesive and trustworthy manner. Failing to do so can easily dent a financial reputation, particularly during times of crisis, when investors and consumers demand more – and even more timely – information, including why the crisis happened, how they will be affected, and what will be done to rectify the situation.

When the going gets tough, a corporation has an opportunity to showcase its mettle and position itself as an entity to be trusted through thick and thin. Such trust is built over the long term, through thoughtful words backed by action to build an authentic corporate character that stakeholders can genuinely believe in.

As J.P. Morgan, the famous industrialist, rightly explained in 1912: "The first thing is character... before money or anything else. Money cannot buy it... because a man I do not trust could not get money from me on all the bonds in Christendom." ■

Further reading

Business media are part of the communication story and their inability to foresee the credit crunch is raising a lot of questions. On FT.com, Insead's Matthew Fraser and Soumitra Dutta ask if the media missed the story. To read their analysis, visit **www.ft.com/managingdownturn**

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Getting staff on your side

During a downturn, listening to employees and setting realistic goals helps to maintain trust and dedication. By **Michael Gibbs**

Alastair Taylor/Inkshed

These are tough times. Most industries are in recession; many companies are at risk of failing. Fear of lay-offs pervades the workplace as negative economic news accumulates and it can be difficult to motivate staff – but this is when you need them most.

In tough times, the best managers stand out even more. Moreover, handling staff well now can pay high dividends when good times return. My research and experience suggests ways to make incentive systems work effectively even in this economic climate. Below are some suggestions of how to think through goal setting and evaluation.

What to emphasise?

Every incentive plan evaluates employee performance in some way, and most make use of goals as thresholds for earning rewards or to set expectations for performance. The business climate has changed dramatically, and there are different pressures on business now, so goals and evaluation may need to change. What should be emphasised?

Usually, incentive plans are criticised for being too short-term oriented. That is because they tend to focus on things that are easy to measure, whereas the effect an employee's performance has on the future is difficult to quantify.

In today's environment, however, a short-term orientation is often appropriate. Given the weak credit market, many companies need to manage for cash, and are concerned about the inability of customers to pay receivables. Incentives for better management of receivables, cost cutting, or temporary reductions in areas of discretionary spending, can be a good idea. However, implementation must be carefully monitored, as overly aggressive incentives to manage for cash can lead employees to manipulate numbers, damage relationships with clients, defer essential maintenance, and so on.

In this economy, most managers are compelled to give less emphasis to strategy and more to tactics. Doing so means tapping into the creativity and initiative of employees, who often have many ideas about ways to improve operations and cut costs. To motivate this creativity, you must give broader discretion to staff over methods. Focus on broadly stated goals ("cut costs" or "increase revenue"). Then measure outcomes instead of specific inputs (total revenue instead of number of new customers). This gives your employees latitude to try different methods and see what works best to achieve your objectives.

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Determining the right level of expected performance is never easy, but it is even more difficult in 2009. There is great volatility and uncertainty about the future, and performance in recent years is less likely to be a good indicator than in more stable years. Even if you can be relatively confident about expected performance, the highly volatile economy means that actual performance may well overshoot or undershoot expectations by a wide margin. If the employee finds the goal too easy or too difficult to achieve, poor motivation may result. How can you set goals in such an environment?

Set meaningful goals

Consider using shorter time horizons. Instead of stating goals for the entire year, set goals on a quarterly basis. Predictions over a shorter horizon are more likely to be accurate. An additional benefit is that your staff have a better idea of where they stand and what level of compensation they can expect. The tie between their actions and their rewards is stronger. Finally, a shorter horizon allows you to change expectations or criteria more quickly as the economic situation unfolds.

In highly volatile times, it makes sense to set easier-to-achieve goals than during more stable times. Goals may not be met because the employee was ineffective, or because of events beyond their control. It does not make sense to punish employees for factors beyond their control, especially when they are already nervous about their jobs and compensation. In the current downturn, there is greater risk that uncontrollable events will result in poor performance. It is appropriate to take some of this risk of failure away from employees by recognising that such risk is beyond their control.

Many companies use growth-based targets or performance measures. For example, a salesman might be rewarded based on the percentage increase in sales compared with last year. This approach has some downsides, but provides automatic goal setting. Growth-based targets may make sense when last year's performance is easily replicated this year compared with bringing in new business. However, they are problematic when the economy slows rapidly. This year it will be difficult to increase performance compared with last year; in fact, the economic performance of many companies will be negative. Great care must be used in implementing growth-based incentives. If your company uses them, give serious thought to eliminating the practice in the short-term.

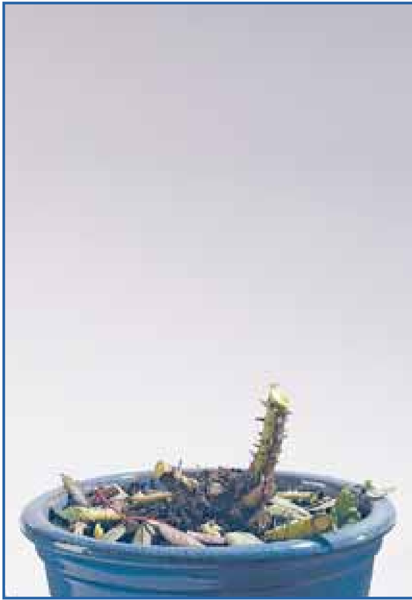
In a year when it is hard to know what performance is reasonable to expect, one tool that may help is benchmarking: holding employees accountable for performance relative to some comparison group. Individual salespeople could be evaluated compared with average sales (or average growth) across all salespeople. A chief executive could be evaluated on the company's earnings per share compared with competitors in the same industry. Even in a volatile year, as long as the volatility has a similar effect on the employee and the comparison group, benchmarking can improve the accuracy of evaluation.

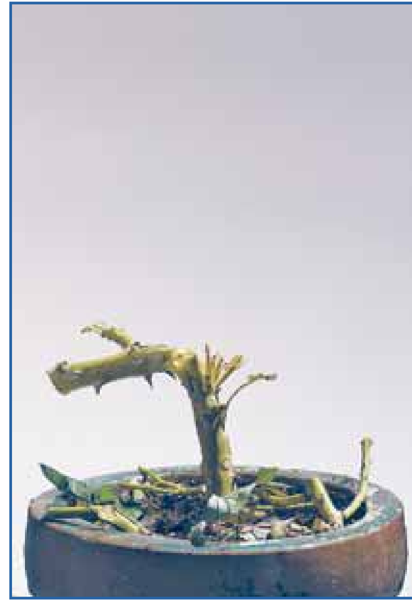
However, access to a good comparison group is critical. If the group the employee is measured against is not working in similar circumstances, benchmarking will only add more error to the evaluation. Consider our example of a specific salesperson measured against other salespeople. If sales territories vary widely in size, type of customer, economic conditions or other factors, benchmarking will hold the salesperson to a standard that does not reflect his or her job.

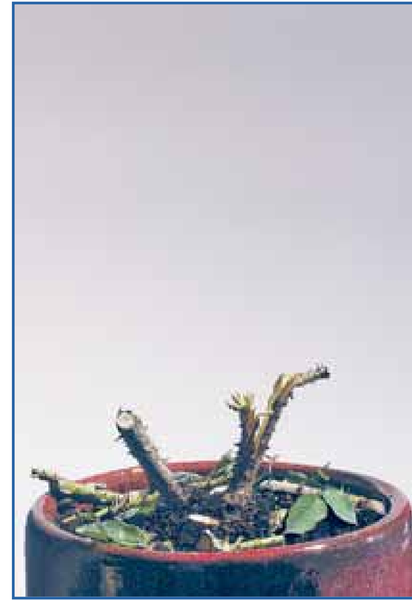
Finally, an important part of virtually any incentive plan is good judgment, especially in 2009. There is simply too much complexity and uncertainty to expect that even the best-designed incentive plan will fit the circumstances adequately. Good judgment can have multiple benefits. Consider using subjectively determined goals and performance evaluation rather than reliance only on numbers. Business conditions are changing rapidly. You may need to reassign people to different jobs, or reallocate tasks.

What you think will be important may turn out to be irrelevant; unexpected situations are likely to arise. Stating qualitative goals and expectations about performance may ➔

How do you cut costs without killing the business?







It's not just about too little or too much. It's about how and where to cut. Cut too close to the customer and you could lose them. Cut too much talent and you may not have a business to grow in the future. Cut knowledgeably, however, and sustained business performance can be achieved. KPMG firms can help you do this. With accurate and insightful information on what's driving which costs, we can help you cut waste without laying waste to the organization. We can help streamline and simplify the business, and help build a cost culture, from boardroom to washroom. In fact, help you prune so your business can blossom. To start, cut along to **kpmg.com/succeeding**.

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work better than tying rewards to explicit performance metrics. This gives you the flexibility to adapt those goals over time, much like the effect of using shorter time horizons, and to incorporate input from staff.

Also, reserve the right to change the incentive system at any time. You may not need to, but by making clear that you might, less conflict will arise if you do. If you use careful judgment, and establish trust with your employees, adapting poorly designed incentives will be preferable to leaving the system unaltered.

Collaborate

Economists, psychologists and human resource practitioners tend to agree that the job characteristic that employees value most is feeling that they can trust their supervisor. In tough times, with companies implementing lay-offs, it is even more of an issue.

What can you do to improve trust? Broadly speaking, collaborate with your employees on goal setting and evaluation, and in addressing the problems that your business faces. Sit down with each employee, discuss the current situation, and describe the kind of behaviour you are looking for (such as the creativity and initiative mentioned above). Using their input in goal setting and evaluation makes goals more realistic and relevant, and reduces employee risk. It provides buy-in and builds trust. Meet regularly to re-assess goals as the situation evolves. Of course, this is simply Peter Drucker's "Management by Objectives" approach. That method is often very effective but is particularly well suited to volatile times such as these.

Regular discussion about subjective goals has an additional advantage: manipulation is more likely when the economy is weak and employees are under high pressure. A collaborative approach to evaluation and monitoring makes it easier to detect, and thus deter, manipulation. In addition, manipulation tends to be easier when performance is based on pre-set metrics rather than retrospective judgment.

Communicate and listen. Be open about the challenges facing the business. In many cases, providing real-time data on the company's economic situation will be helpful. The environment is already risky enough, so listening and responding to employee feedback about the incentive system is important. If your employees believe that you are trying to treat them fairly and provide the tools they need to succeed, they are more likely to respond by working hard and creatively to improve the company's prospects.

Rise to the occasion

Managers face great challenges in 2009. But this is also an excellent time to improve your abilities as a leader. Self-reflection and continuous improvement in your management style now will make you a better manager for the rest of your career. In addition, by asking your staff to help you address a difficult economic situation, and then carefully listening and incorporating their concerns and ideas, you will increase your reputation as a manager who is trusted and good to work for. That is an excellent foundation for growth when the recession inevitably ends. ■

Optimists have a bright future

Leaders who see opportunity where others see gloom, and maintain focus and integrity, will win out. By **Peter Lorange**

There is much doomsday talk amid the global economic slowdown but managers should look at turbulent times for what they are: opportunities. There needs to be a fundamental change of mindset in how business leaders approach tumultuous times. Semantics do matter, so let's begin by eliminating the term "crisis management" and replace it with "unexpected opportunity management".

Leading in turbulent times requires optimism. The world is constantly changing during good and bad economic times and managers need to have an appetite for rapid change. Managers who lack that mindset should be doing something other than leading a business unit within an organisation.

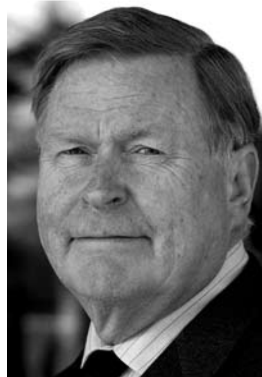
Both good and bad economic times are short-lived, but many leaders fail to understand business cycles. Markets always swing, so being comfortable with "in/out", "long/short" and "turning point" decisions is essential to leadership. It is important to keep in mind, particularly during a downturn, that markets will always come back. It is when the markets are down that undervalued assets can, and should, be picked up. To "play on the market movements" requires high focus on free cash flows – particularly critical in turbulent times.

Stay positive

Numerous investors made their fortunes by strategically investing during a downturn. Warren Buffett once famously said: "Be fearful when others are greedy and greedy only when others are fearful." This attitude requires a positive mindset.

A leader must never talk about damages, but should instead focus on opportunities. A realistic, but optimistic, approach will be far more beneficial for an organisation than one that is realistic and pessimistic. Anxiety and fear do not move an organisation forward when the going gets tough. Risks need to be looked at with optimism.

Perhaps no one exemplifies this better than Carlos Ghosn. He joined Nissan in 1999 as chief operating officer, became president in 2000 and was named chief executive a year later. At the time, Nissan was in dire straits, with ballooning debt and financial losses. While many were convinced of the company's ultimate demise, Mr Ghosn was so confident that his business strategy would succeed that he vowed to resign if certain objectives were not met within a determined time frame. This approach was so successful that it helped lead Nissan to improbable profitability.



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Think pragmatically

No manager can predict future economic conditions with 100 per cent accuracy, but a smart leader can prepare his or her team for difficult times ahead. The number one way they can do this is by ensuring that the team is able to think pragmatically. If this is in place, the organisation will be able to react.

This implies a shift from away from extensive systematic prior analysis, testing and planning towards earlier implementation followed by subsequent adjustment. Learning through doing is a key part of this. Plans and budgets need to be much less deterministic and much less extensive. Instead, the emphasis is to get it right through "trial and error" while avoiding analysis to paralysis.

This means understanding the relevant underlying critical success factors, effective human resource management, respecting competitive limits and focusing on a smaller set of key strategies. The result is a clear tendency towards simplifying things – to gain more in-depth focus – and thus higher speed. Leaders have to reckon more with their own cognitive limits and realise that strategy is a choice.

One might assume, for example, that Singapore Airlines was in dire straits in the late 1990s, given that much of Asia was in the grip of a major economic crisis. However, the management team at Singapore Airlines was flexible and quick in meeting the demands of the time. Consequently, the airline further established itself as one of the most profitable in the world and as one of Asia's biggest brands.

Management teams must find a meeting place – preferably away from the main office – where they can freely debate and generate new ideas. This allows managers to share competencies, implement co-ordinated change more rapidly and develop or renew strategies and/or prepare execution plans for implementation. Business schools can be effective in this capacity by focusing on "action learning", which blends academic expertise and relevant research with practical discussions among executives, who return to work with execution plans.

During periods of stability, the tendency is to focus on serving the interests of one particular stakeholder group: the shareholders. A finance-driven focus often prevails.

One major dilemma facing business leaders during periods of extreme turbulence is how to maintain credibility with owners and investors (internal) while focusing on external stakeholders. All major stakeholder groups must back the strategy, from the employees of the organisation (including upper/top management), banks, suppliers and stockholders. Thus, management stability is essential in order to avoid friction among non-cooperating stakeholders groups.

With the recent excesses in management bonus packages based on companies' financial performance, this bias in stakeholder focus has become highlighted. Huge pay differences between workers and top management also indicate imbalances. This creates unnecessary friction. In times of crisis, stakeholders need to be aligned to avoid a finger-pointing, me-versus-you attitude. Organisations must work more than ever with labour unions to create harmony. For example, it will be difficult for the US auto bail-out to work unless the automakers, unions and government are all on the same page. Swiss Air suffered because of its inability to collaborate in an effective manner with the Pilots Union.

Last but not least, leaders must demonstrate integrity in their actions. They must maintain trust while offering direction. One of the major reasons for the current financial crisis is that bankers stopped trusting each other, the inter-bank money flows dried up and default became prevalent. Consequently, trade slowed, resulting in tumbling stock markets, a reduction in manufacturing output, bankruptcies, government interventions and the cutting of interest rates.

The fact that executives have cashed in on lucrative bonuses while ordinary people have lost their homes has only worsened the image of banks. Hopefully, this will serve as a lesson that will lead to a new form of responsible leadership that focuses on getting positive results in the right way. Leaders must find the right balance between short- and long-term demands and focus on businesses that they truly understand.

The above described leadership qualities of optimism, speed, alignment and integrity are the recipe for succeeding in these turbulent times. The leaders of organisations which establish these attributes as best practice will no doubt seize opportunities and come out as the winners. A very different fate awaits the negative, slow, unaligned and irresponsible. ■

Huge pay differences between workers and top management indicate imbalances and create unnecessary friction

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Succeeding in Turbulent Times

Timothy P. Flynn, Chairman, KPMG International.

"We are living in extraordinary times. The events that have roiled the global economy in recent months will have a real and lasting impact on every business in every industry," says Timothy P. Flynn, Chairman, KPMG International. "The economic crisis gives organizations an opportunity to examine every aspect of their business model and lay the foundation for sustainable growth and improved competitive advantage."

As companies worldwide develop their plans to manage through these turbulent times, many CEOs are preparing for the worst. For distressed companies that are intent upon survival, their primary focus is on conserving cash—usually by slashing discretionary spending and aggressively reducing headcount.

"This approach is certainly understandable, but cost-cutting alone is not likely to deliver lasting results," Flynn cautions. "Organizations should think beyond short-term issues and look more broadly at cost optimization and cash management."

"The ability to effectively manage cash and working capital can provide a competitive advantage that can mean the difference between market leadership and mediocrity."

Cash is king

Confronted with a global credit crunch, companies are painfully aware that cash is king. It provides the ability to make acquisitions, invest in new plants and machinery, and develop new products and services. It gives companies the capacity to absorb defaults by customers and exposure to bad debt. And, it enables organizations to stabilize or even raise credit ratings and gain improved credit terms from suppliers.

However, according to a recent KPMG survey of more than 550 companies in the United States and Europe, 67 percent of senior financial executives said their company's working capital is flat or has deteriorated as compared to three years ago, with little relief in sight.

And while 83 percent of executives said managing working capital was the highest or a high priority at their companies, only 37 percent of those surveyed had a working capital improvement program in place during the past five years.

"There's no doubt that market events have compelled companies to become laser focused on cash management," says Flynn. "The ability to effectively manage cash and working capital can provide a competitive advantage that can mean the difference between market leadership and mediocrity. Unfortunately, some companies are often unable to apply a disciplined approach due to insufficient visibility into cash flow, inaccurate forecasting, disjointed initiatives and insufficient governance."

Even well-managed companies can benefit from a working capital improvement exercise across the business. And, he says, it's critical to include both finance and operations, which typically approach the issue from a different angle.

Optimizing costs

Businesses are under tremendous pressure today to reduce costs. Yet, nine out of 10 cost reduction programs fail to achieve their targets, and gains that are achieved are typically short-lived, according to another KPMG survey of more than 400 companies worldwide. Why? Our research shows that drivers are not clear, cost strategies are too cautious and cost discipline is not embedded in the culture.

As companies seek to reduce costs and free cash from the business, a holistic look at optimizing costs provides a platform to question entrenched approaches, drive greater efficiencies and create a "cost culture" within the organization.

"The most successful companies will re-examine the ways they develop, sell, market and deliver their products and services to optimize their cost structures and better serve their customers," Flynn says. He suggests three key areas of focus:

1) **Challenge complexity in the business model:** To drive change, companies should aim to reduce complexity and consider alternative business models. Consolidating functions into shared services can promote standardization and consolidation, but not necessarily optimization across processes and tasks. To realize savings that are truly sustainable, organizations should take an enterprise-wide view, redesigning processes within a service center, ensuring connectivity with core business processes, and continually evolving their model. Process optimization is the objective, with sustainable cost savings the result.

2) **Transform your supply chain:** The evolution to an international economy has led to increasingly complex global supply chains. Strategic supply chain management means re-evaluating end-to-end processes, and redesigning processes to deliver improved working capital, increased efficiencies and reduced taxes.

3) **Sustainability programs:** Environmental and sustainability programs are not just about good citizenship. "Green" programs can yield real cost savings through supply chain improvements that require less materials and energy to produce and ship products; effective use of energy, particularly around data centers and IT management; recycling benefits; and operations improvements that help to reduce the carbon footprint and enhance efficiencies.

Thinking beyond

Emerging successfully from these troubled times will require a commitment to thinking beyond business as usual, Flynn says. He says that recent market events have permanently changed the way that the capital markets work and how businesses operate. "Business leaders must accept these new realities and think beyond classic cost cutting to address their issues. Times of turmoil are also times of opportunity. Enterprises should get creative and think beyond managing from day-to-day—or quarter-to-quarter—to build more resilient and robust business models for long term success."

For more information on succeeding in turbulent times, visit: **kpmg.com/succeeding**

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Rethinking links in the global supply chain

New methods of partnering for product development can help companies profit from demand shifts. By **ManMohan S. Sodhi** and **Christopher S. Tang**

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When you have a real lemon on your hands, like the present economic downturn, you should think lemonade. This bitter and difficult financial crisis provides an opportunity to rethink an entire business and, more specifically, its supply chain.

This is a good time not only to look at initiatives to improve the company cash flow in the near term but also to think about long-term issues such as being in markets with zero growth. In the short term, there is a need to lower operating costs, for instance by outsourcing supply chain functions with demonstrable savings or by shedding projects whose incremental benefits cannot justify incremental costs in the near term.

The following ideas will help in meeting goals with regards to cutting costs, preparing for supply chain disruption, and improving your standing as a corporate citizen.

Combine lean and green

Lean means less waste and less waste means using fewer resources. Any company can make small improvements in its supply chain that collectively can lower costs and improve supply chain sustainability significantly.

Marks and Spencer, the UK retailer, has taken a leadership role in sustainability among its peers with its "Plan A", which is intended to reduce energy consumption by 25 per cent for all its operations by 2012. The implementation comprises many small efforts including replacing 90-watt light bulbs with 75-watt bulbs in its food stores in the UK. This not only reduces energy consumption by 17 per cent for lighting but also reduces refrigeration and air conditioning needs.

Packaging is another area to explore. Tetley Tea developed new packaging materials to increase the density per pallet of its products by 50 per cent, thereby reducing the number of vehicle loads between factory and warehouse by 28 per cent.

Planned obsolescence can make sense in rapidly innovating industries such as consumer electronics but in the wake of the downturn, the industry may have to make products with significantly longer lives. Doing so will result in reduced use of resources and less need for recycling, a burden that is likely to fall on manufacturers themselves in the coming years.

Tie pricing to supply chains

This is important to improve margins, not only in the present economic downturn but even more so in the long term, when developed markets face the prospect of zero growth for an uncertain period of time. Airlines and hotels, for example, use dynamic pricing to their advantage for individual customers. Similarly, manufacturing companies can use dynamic pricing by customising and delivering bundles of products and services for individual customers with different prices.

Dell, the computer manufacturer, adjusts prices dynamically to influence customers' product selection. When it faced a supply shortage of certain components from its Taiwanese suppliers after an earthquake in 1999, the company offered special price incentives to induce online customers to buy computers that utilised components from other countries.

Amazon, the online retailer, offers discounts to customers willing to reserve new products in advance. By using early sales data, Amazon can develop more accurate demand forecasts.

Companies can also rethink what they are selling. Bundling products and services enables organisations to differentiate themselves: for example, IBM's acquisition of PwC's consulting division in 2002 helped the IT group to further transform its business model from selling computing products to offering business solutions.

Companies can also develop in-house capabilities for services. Best Buy, the US electronics and home appliance retailer, moved to selling bundles of products and after-sales services provided by its "Geek Squad Agents". This strategy increases revenues and profits, and boosts customer satisfaction long after point-of-sale. General Electric customises its services bundle for each customer when selling turbines or medical equipment. Using such bundling, companies can implement "value-based pricing" at the individual customer level, but doing so requires adapting the supply chain to streamline the delivery of these bundles, including services, and improving their understanding of how customers use (or re-sell) their products.

Nick Lowndes/Eastwing

When developing the iPod, Apple provided up-front payment to entice integrated circuit manufacturers

Shorten supply chains

Shortening supply chains means not only moving manufacturing or sourcing closer to existing markets but also developing markets in the low-cost countries where manufacturing or sourcing take place. Shorter supply chains mean more agility, more robustness against disruption, lower exchange rate risk and, in the long run, lower costs. While many apparel makers source from low-cost countries such as China and India, Zara, the Spanish clothing retailer, has banked on its European plants to create and respond quickly to new market trends in Europe with a design-to-shelf time of only two weeks. Having European plants means it has lower transportation costs to its markets in Europe.

In Japan, some electronics manufacturers have moved core manufacturing back to high-cost Japan, giving them greater agility in responding to demand as well as better intellectual property protection. Sourcing closer to home can also help companies to gain recognition as good corporate citizens.

Today's low-cost sources are tomorrow's markets and western companies with a well-established global brand image can demand a price premium. For example, Shanghai GM, a joint venture between General Motors and the Shanghai Automotive Indus-

try Corporation, produces and sells Buicks in China at a premium despite having lower costs of production than in other markets.

Selling in China and India means having different types of supply chains for different market segments. The best example is Hindustan Unilever Limited (HUL), the largest fast-moving-consumer-goods company in India. The company's brands span the affordability spectrum, from top-end cosmetics to low-priced shampoo sachets. The HUL supply chain has adapted itself to meet customised requirements at the top end while driving cost-focused efficiencies to deliver and sell several billion sachets a year.

Reassess outsourcing and external partnerships

Companies are becoming more open to ideas and solutions from external parties. Procter and Gamble's so-called "Connect + Develop" business innovation model, which was launched in 2002, reduces the time and cost of product development by reaching out to other companies and academia for ideas for new products. For example, when P&G wanted to print text and images on Pringles potato crisps, it partnered with an Italian professor who had developed the relevant technology. This approach to innovation has enabled P&G to achieve phenomenal double-digit growth in sales and profit over the period since 2003.

In China, Hong Kong-based trading company Li and Fung provides supply chain management services to customers such as Kohl's, the US department store chain. Li and Fung uses its network of more than 6,000 suppliers across Asia to provide services ranging from design, sourcing, supply management, and quality inspection to logistics for its global customers.

However, outsourcing and partnerships require simple and transparent ways to share the pain and the gain. For example, when developing the iPod, Apple provided up-front payment to share the development costs of specialised chips in order to entice integrated circuit manufacturers such as Samsung and Micron. Toyota also provided similar incentives for Matsushita to develop the battery for the Prius hybrid car.

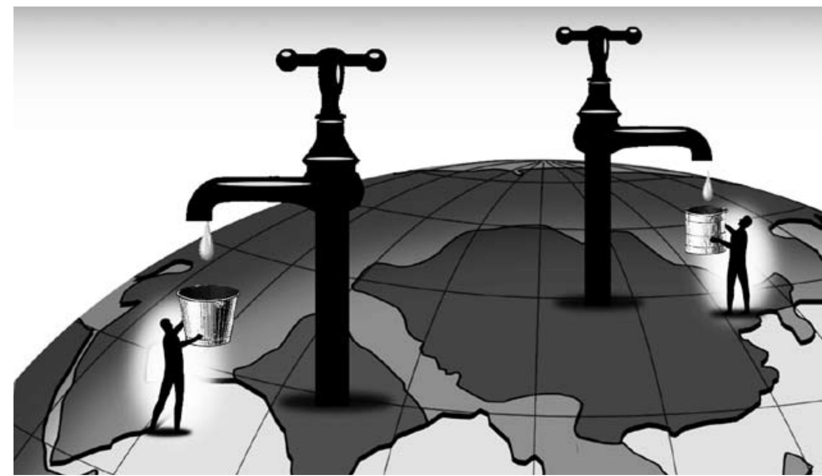
Conclusion

Cost-cutting can only go so far. Companies also need to seek additional revenues and higher profit margins. Being lean and green can generate additional profits in the long term. Just as Tetley's trucks now carry loads for their customers rather than coming back empty, there may be revenue opportunities in cost-reduction initiatives as consumers become more willing to pay a premium for eco-friendly products. Shorter supply chains and new methods of partnering for product development will make companies better positioned to take advantage of changing demand. Dynamic pricing means higher average prices – this is especially important when revenues are not growing – but companies must better understand what generates value for their customers.

The present downturn poses a long list of uncertainties in the year ahead. Nevertheless, if you squeeze the downturn lemon right, you should be able to enjoy lemonade for a long time to come. ■

Looking long term on the passage to 'Chindia'

How can companies leverage operations in China and India during the downturn? By **Jayashankar M. Swaminathan**



Nick Lowndes/Eastwing

Numerous companies such as Google, Microsoft, Toyota, Sony and Nokia have benefited from global operations during the past decade. A central component of this success has been the expansion of their supply chains into a number of emerging economies, particularly China and India. These countries serve as inexpensive bases for the production of goods and services on the supply side and have also become important markets for finished products on the demand side.

When the current downturn began, it was tempting to believe that the rapid growth of their internal markets would insulate China and India. The realisation is rapidly dawning, however, that in a highly interconnected business and financial world no country will be completely immune. Most recently, China has reported a growth rate of 6.8 per cent for the fourth quarter of 2008 while India has predicted a growth rate of 7 per cent for 2009. Both these figures are much lower than the growth in previous years.

Multinationals are beginning to rethink their "Chindia" strategy and many are contemplating a range of defensive actions. These include planning for a temporary shutdown of facilities in these countries to match supply and demand, or even contemplating an early exit from them. Such reactions may provide quick short-term solutions. For long-term success, however, a more nuanced response is required. Here are five suggestions that can help companies design a strategy.

Focus on the sector, not the economy

The impact of the downturn in China and India will vary sharply across the economic sphere. Businesses in the manufacturing and consumer products sectors are likely to be significantly affected as consumers become cautious in their spending, but companies involved in infrastructural development are less likely to be affected.

National and local governments in China and India are aware of the bottleneck that poor infrastructure places on growth. This infrastructure gap in particularly acute in India. In addition, spending on infrastructure provides the government with an appealing means of economic growth going. It is no surprise, for example, that for 2009 Lafarge, a world leader in building materials, has projected growth in China and India.

Reassess offshoring

For many businesses, offshoring has become an end in itself during the past decade, leading to the notion that anything that can be offshored, must be. As unemployment rises in developed economies, companies will be under growing pressure to reassess their offshoring practices and to keep more jobs at home. This pressure might be a blessing in disguise because it provides businesses with an opportunity to critically re-examine the type and degree of offshoring they pursue.

Companies must use this opportunity to carefully consider the short-, medium- and long-term implications of offshoring. They must also evaluate whether any of their offshoring initiatives have diluted their core competencies or hampered their ability to build and leverage intellectual capital. This is a good time to adjust the boundary between the activities that the company outsources and those that it does itself.

At the least, companies should consider renegotiating their offshoring contracts with service providers in China and India who are now less busy than in the recent past. In addition, strong local companies in China and India that do not have the resources to survive the downturn may provide interesting acquisition opportunities for multinationals with cash.

Prepare for supply chain risks

After years of heady growth, providers in China and India are witnessing a sharp slowdown. For the outsourcing industry, this is the time that the wheat will be separated from the chaff.

Companies should renegotiate offshoring contracts with service providers who are now less busy

While we may only be at the leading edge of the downturn, Satyam Computers, a major India-based software services provider, has already been in the news for financial misstatements and other irregularities.

As business slows down for some of these providers, there are greater chances that they may violate global compliance rules, which could lead to complications such as contamination (in manufacturing) and security risks (in services). It is important that multinationals pay more attention to protect themselves from such global supply chain risks during this downturn.

Improve the workforce

For multinationals who have captive operations in China and India, the downturn presents an opportunity for improving the quality of the workforce. During the past decade, many multinationals who initiated operations in these countries quickly realised that productive employees were difficult to attract and retain. This is a good time to take advantage of the weaker labour market to recruit and retain top-notch managerial talent. After all, an important benefit of running an operation in these countries is the opportunity to tap into their large pool of brainpower.

Innovate from China and India

The economic downturn will slow the rapid transition of the masses into the middle and upper middle classes in China and India. Correspondingly, the demand for high-end products and services will not grow as fast as projected. This shrinkage of the market is a challenge on the one hand, but it also offers companies the opportunity to accelerate development of affordable and robust products, designed for emerging markets. More importantly, such products could be attractive for customer segments in developed economies as well. ■

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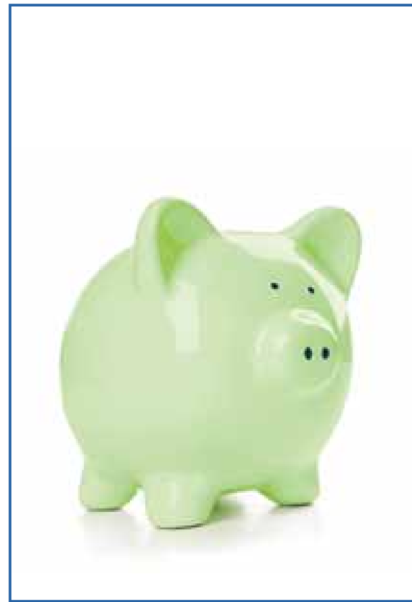
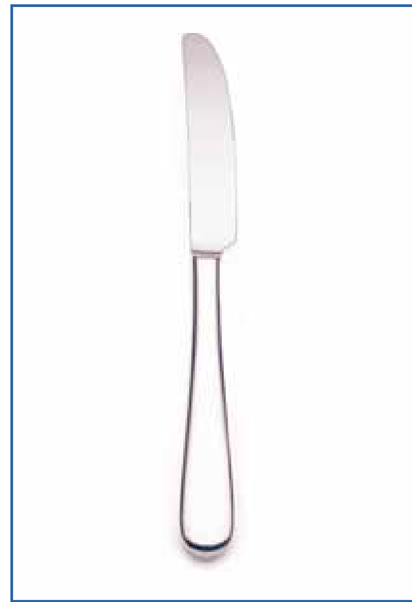
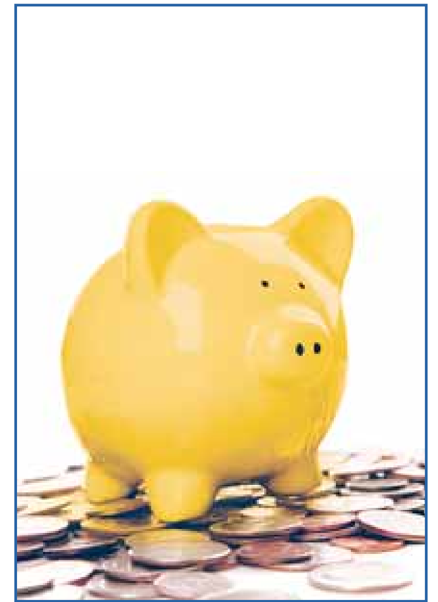
Your cash may be right there. But how do you get at it?







Chances are, the cash you need could be right there in your company. Lying unseen in cash management and treasury. Undiscovered in currency on the other side of the world. Hidden in receivables and inventory. Leaking out in payments processes. The fact is, there could be sources of cash in all these places and more. KPMG firms can help you gather it in. With tools that can help you see your cash situation more clearly. That can provide more control over your cash flows. And perhaps most important of all, help deliver sustainable operational improvement. Take two initial steps. First, put cash at the top of the boardroom agenda. Second, find out more at **kpmg.com/succeeding**.

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