Management Tool Kit

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Restructuring in 2009

Understanding and Responding to the Crisis

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EXECUTIVE SUMMARY

As senior managers get past the strategic paralysis they suffered in the first stage of the financial crisis, they will need to respond in an appropriate and structured way. They will also need to figure out which changes to make first. In this environment, companies may need to address challenges related to costs, revenues, and their balance sheets. Moreover, these issues generally can't wait; they must be dealt with quickly.

We describe a robust, three-step approach to change that companies should take during the crisis: understanding immediate needs, setting priorities, and implementing restructuring. We include an overview of 25 key management tools across five key focus areas that can help ensure success in companies' restructuring efforts. In each of these areas, a set of specific improvement actions can help weak companies survive and strong companies take advantage of their position.

THE IMPACT OF THE GLOBAL CRISIS ON EUROPEAN COMPANIES

It may have started elsewhere, but the global downturn is hitting European companies particularly hard. This is not surprising; most European countries have grown increasingly reliant on exports. Germany and France, Europe's number one and number two economies, derive 40 and 21 percent of their gross domestic product, respectively, from exports. (The United Kingdom, the third-biggest European economy, derives 16 percent of GDP from exports.) The percentages are even higher in other European countries, such as the Netherlands (71 percent export-dependent) and Hungary (68 percent export-dependent). Their outward focus means companies in Europe all face an enormous challenge.

What should European companies be doing in response to the crisis? For that matter, what are they—and companies everywhere—doing now? In many cases, the answer to the second question, unfortunately, is that companies are not doing the right things. In a December 2008 survey of 828 senior managers around the world, Booz & Company found a startling disconnect between what should be commonsense reactions to the crisis, such as accelerating one's cash-generation initiatives, and actual behavior, such as doing nothing new to generate cash. In a recent article, "Rethink Your Strategy: An Urgent Memo to the CEO,"[1] Booz & Company made the case that the depth of this crisis calls for nothing less than an all-out reevaluation of corporate strategy and creates an opportunity for companies to restructure their businesses.

This document builds on "Rethink Your Strategy" by segmenting the options for response according to a company's circumstances and by providing a framework, and a snapshot of the tools, that can help. It is a tactical "how-to" to follow up "What now?"—the question that managers began puzzling over late in 2008.

RESTRUCTURING OPTIONS: IT ALL DEPENDS ON A COMPANY'S FUNDAMENTAL POSITIONING

Given the depth and the extent of the problems, there is no one-size-fits-all response to the crisis. Instead, the moves that companies should make will depend on the answers to a few fundamental questions:

Could your company survive the worst downturn in volumes and prices since World War II? If so, for how long?

How well is your company positioned? If your business went away, would others be able to fill the gap?

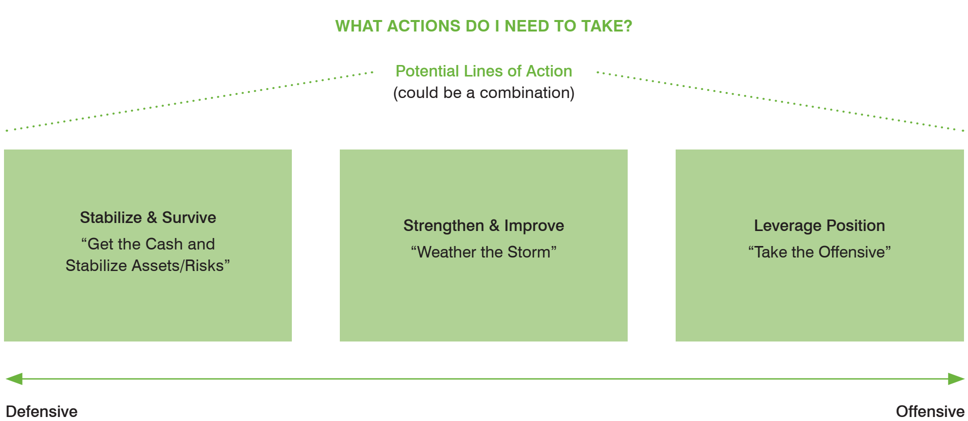
How will capacity be rationalized in your industry? Who is the marginal player? Is it you?

Given the way things are now, in which of your businesses would you invest your own money?

Executives' answers to these questions will determine where their company falls on the continuum of potential actions—whether their company should be defensive and just try to stay alive, or move forward aggressively, perhaps by making opportunistic acquisitions. Indeed, some companies will likely want to combine different actions, being defensive in some areas and going on the offensive in others *(see Exhibit 1)*.

These potential lines of action also apply to four basic company clusters

Exhibit 1
Continuum of Actions



Source: Booz & Company

that Booz & Company identified in conducting its December 2008 survey (see sidebar, "From Strong to Failing: What Four Company Clusters Mean"). The cluster that a company falls into will largely determine whether the company should focus on survival, should look for ways to strengthen itself with adjacent next steps, or should embrace a wider range of opportunities because it is in a position to shoulder the attendant risk. As noted above, whatever they should be doing in this crisis, many companies aren't yet doing it, which speaks to the suddenness and unpredictability of the economic downturn.

1. *Stabilize and survive.* Companies that are failing and whose self-assessment yields the most troubling prognoses should focus on securing funding and ensuring their cash flow—that is to say, surviving. These companies should exit underperforming businesses, cut costs wherever possible, pare their working capital, and reduce their exposure to operational and nonoperational risk factors. With the confidence of their stakeholders wavering, they should engage with suppliers, customers, investors, and employees, and might even ask employees to accept temporary wage reductions, whether directly or indirectly through shortened workweeks. In some cases, companies will be living on borrowed time as they hunt for a buyer.

   Of the companies that described themselves as financially weak in Booz & Company's December 2008 survey, between 67 and 75 percent said they were accelerating such cost-cutting efforts. But plenty of financially strong companies are doing the same—and no one can blame them. Germany's carmakers temporarily closed some factories in late 2008, and the country's chemical giant, BASF SE, reduced working hours for 20,000 workers. ArcelorMittal, the Luxembourg-based steel maker, also cut hours for workers. During the recent holiday season, computer maker Dell Inc. and car manufacturer Honda were among the companies asking workers to accept mandatory unpaid holidays.

2. *Strengthen and improve.* Companies whose core businesses aren't threatened should nevertheless reassess their product portfolios and engage in process enhancements and strategic cost-cutting initiatives. One way to do this is to restructure the supply chain. One European manufacturer has sold off factories that were producing subcomponents—backing away from its longtime practice of vertical integration but,

Companies whose core businesses aren't threatened should nevertheless reassess their product portfolios.

more important, removing the factories from its balance sheet and shedding billions in euro-based wages at a time when exchange rates are working against it. The sell-off has allowed the manufacturer to get around the fact that layoffs are an almost impossible tactic in the worker-friendly European Union. Although the company embarked on this initiative several years ago in response to issues it was going through at the time, it is a tactic that could produce benefits for many manufacturers during today's broader crisis.

Other companies, as part of their improvement tactics, are redeploying workers away from units or regions where business has softened to regions where it is holding up better. Some are also reducing their working capital through improved inventory management.

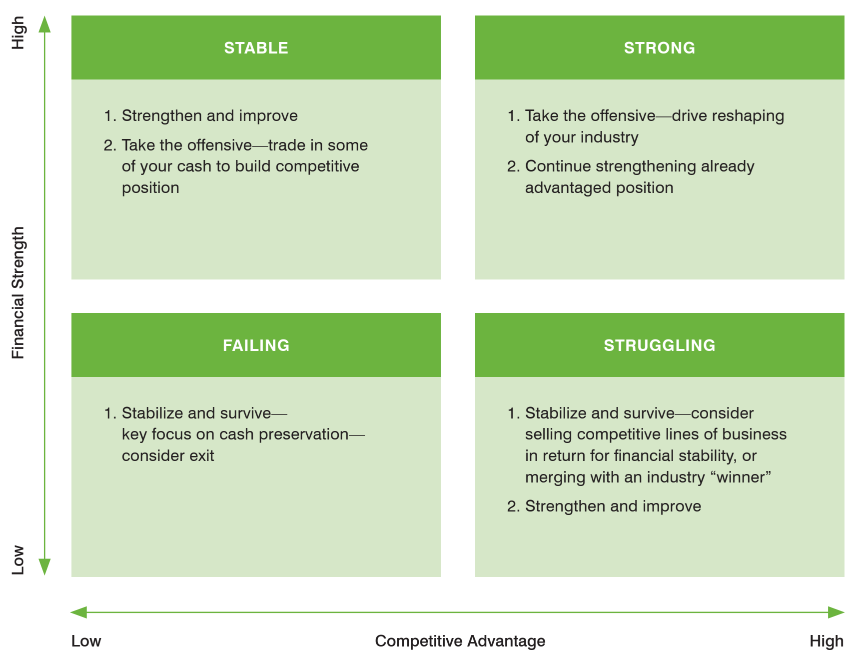
From Strong to Failing: What Four Company Clusters Mean

The cluster into which companies fit was determined by respondents' self-assessments along two dimensions: financial strength and competitive advantage. Companies that said they needed no immediate external financial support were categorized as financially strong; those that said they did need external financial support were categorized as financially weak *(see Exhibit A)*.

Competitive advantage was determined by whether companies said they performed better or worse than rivals along five dimensions: cost, product/brand positioning, technology/capabilities, leadership/management, and ability to influence/collaborate with regulatory authorities. Companies that said they performed better than their rivals on three or more of those dimensions ranked high on competitive advantage; those that said they performed better than rivals on two or fewer dimensions ranked low.

The answers made it possible to identify four basic clusters: **strong companies** (characterized by both financial and competitive strength), **stable companies** (strong financially but weak competitively), **struggling companies** (weak financially but strong competitively), and **failing companies** (weak in both areas).

Exhibit A
Priority Lines of Action for Business Clusters



Financial strength Based on response to "My company is financially strong today and is not in immediate need of external financial support"; High includes respondents who agreed; Low includes respondents who neither agreed nor disagreed.
Competitive advantage Five competitive dimensions tested: 1. Cost, 2. Product/positioning, 3. Technology/capabilities, 4. Leadership/management, 5. Ability to influence/collaborate with regulatory authorities.
Source: Booz & Company

Not as many fundamentally healthy companies as one might expect are increasing the pace of their growth initiatives.

3. *Leverage position.* And then there are the best-positioned companies—those with the balance-sheet strength and cash flow necessary to take advantage of emerging opportunities and build for the long term. These companies should use this period to fine-tune their portfolio of businesses, pursuing coveted assets that become available in the market and selling or deemphasizing noncore assets. They should also spend some time determining where their industry is headed and figuring out which new capabilities they want to develop, which products they want to introduce, and which emerging markets they want to enter.

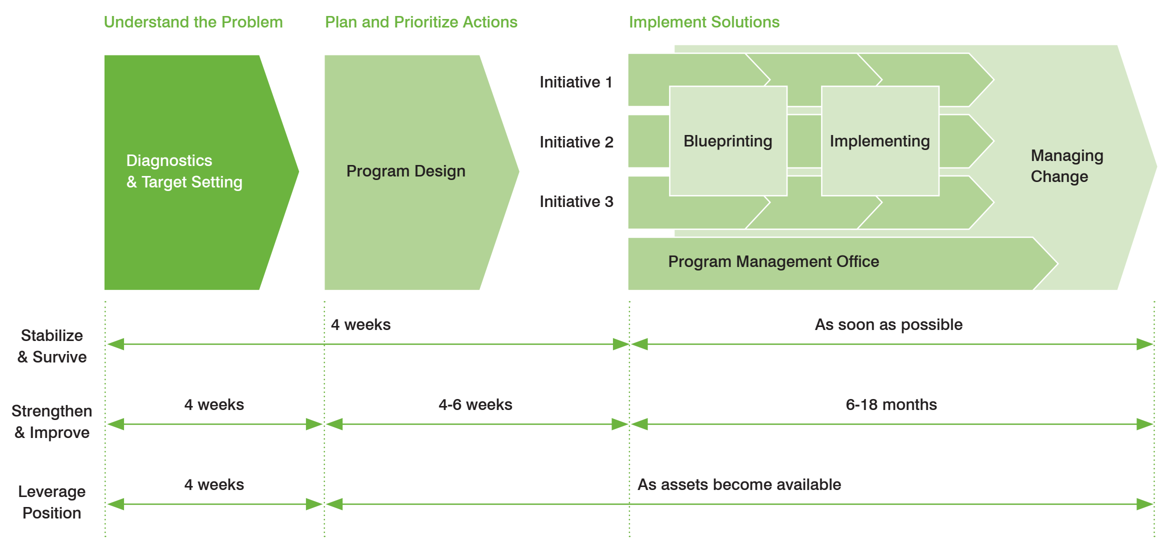
This is what one major beverage manufacturer has been doing. Instead of retrenching or focusing strictly on cash retention, the company is expanding aggressively into one particularly promising emerging market by looking for local distributors and bottlers it can buy. These distribution channels are essential to success in its target market, and the beverage maker rightly perceives an opportunity during the downturn to pick up some properties that could help it at a good price.

Still, not as many fundamentally healthy companies as one might expect are increasing the pace of their growth initiatives. Sixty-six percent of strong companies, for instance, are either slowing their expansion into emerging markets or going at the same pace as previously, versus the 34 percent that are doing more. The Booz & Company survey also showed that just 40 percent of strong companies are increasing the pace at which they invest in new products. Forty-five percent are going at the same pace, and 15 percent have decelerated their new product investments.

MAKING RESTRUCTURING WORK: A THREE-STEP APPROACH AND 25 KEY TOOLS

No matter where companies fall on the line-of-action continuum, it is important to use a robust approach to implementing change *(see Exhibit 2)*. In our three-step approach, Step 1 is to undertake a diagnostic to understand the immediate needs of the company and set targets; Step 2 is to design and plan the program and prioritize the actions; and Step 3 is to implement the restructuring, often with the help of a program management office, because communication is key during this step. The timing and requirements of each step will differ, of course, depending on the situation in which a company finds itself; also varying are the tools the company will use to implement its change program (more

Exhibit 2
A 3-Step Approach to Restructuring



Source: Booz & Company

on this in a minute). What is vital is that there be a structured approach to the program.

Every company also needs to decide which tools or levers will be the focus of its restructuring initiative. We have identified 25 different tools that can improve the company's competitive position and enable success in the restructuring *(see Exhibit 3)*.

Improvement activities have three potential focuses: the balance sheet, costs, and revenue protection and growth. Some tools take the form of enablers—managing people in new ways, for instance, or altering the company's strategy.

The unprecedented nature of the worldwide economic crisis calls for the innovative application of these seemingly familiar tools and levers. Each of the five areas offers, in effect, a set of new paradigms and an associated set of actions that could go a long way toward ensuring the success of companies' restructuring efforts. Here's a closer look at some of those paradigms and what's needed to address them:

Improving the Balance Sheet
New paradigm: Balance-sheet

Exhibit 3
25 Tools of Restructuring

	Focus Area					
Improvement Activities	Improving/Leveraging Balance Sheet	Funding and capital management	Working capital reduction	Nonperforming asset sell-off/divestments	Risk management	Investor mgmt/ share price protection
Improvement Activities	Cost Reduction	Labor cost management	Supply base restructuring/sourcing	Network optimization	Operations/process improvement (incl lean, R&D, IT)	Overhead reduction
Improvement Activities	Revenue Protection & Growth	Consumer insight	Customer, brand, and product portfolio optimization	Pricing	Sales force effectiveness and efficiency	Marketing effectiveness and efficiency
Enablers	Making It Happen	Leadership and program management	Stakeholder management incl crisis governance model	Change management	Talent management/ retention	Performance management
Enablers	Strategy & Operating Model	Industry structure and competitor dynamics	Business/strategy review	Corporate strategy and portfolio review incl capability-driven strategy	M&A/PMI, alliances and partnerships	Target operating model (incl IT)

Source: Booz & Company

strength is no longer a nice-to-have; it's an essential characteristic of winning companies.
How to address the paradigm: Companies should get rid of their dogs by monetizing all noncore businesses and assets. If selling now is too difficult, they should run these noncore businesses for cash only. By strengthening their balance sheets, companies will be creating their own investment capital—and thus ensuring their strategic flexibility. Balance-sheet strength will give struggling and failing companies a better chance to survive, and will give strong companies the flexibility to leverage their positions.

Cost Reduction
New paradigm: Companies should be exhaustive in evaluating costs—the proper attitude is that there is no longer any such thing as a fixed cost.
How to address the paradigm:

- In the supply chain, the focus must be on resilience. Companies struggling to survive should emphasize cash and payment terms over margin. Stronger companies should immediately look for ways to restructure their supply bases. And all companies need to understand that prices related to raw materials are potentially more volatile than ever. In certain cases, companies should even explore their suppliers' appetites for investing in them, for taking over certain assets, or for hiring some of their key employees.

- To get a handle on labor costs, companies should negotiate the entire package with labor representatives. This is a time when companies struggling to survive should be doing all they can to minimize layoff costs and to lobby for government support. For stronger companies, it is a time to exact concessions from labor representatives in return for employment guarantees.

- Even R&D and capital expenditures should be earmarked for cuts; in an environment like this, the idea that they are fixed costs should be discarded. Indeed, the right move for companies in danger of failing may be to slash R&D spending to the bare minimum and focus the organization on maximizing cash by eliminating nonessential product specifications. By contrast, strong companies should invest heavily in products and segments that will be the winners of the future, taking advantage of market conditions to strategically reposition their innovation pipelines.

Revenue Protection and Growth
New paradigm: Companies should focus on their most valuable customers, and should address and serve them accordingly.
How to address the paradigm: Shedding marginal customers will be just as important as shedding marginal businesses. Companies that are strong and that can focus will always see opportunities to serve their most valuable customers better and to gain share. This is a time for companies to improve their consumer insight and to optimize their portfolios to remove complexity in their customer segmentations and service offerings. As they do so, they will need to shift their marketing efforts accordingly.

Making It Happen
New paradigm: Companies must work with all their stakeholders and hold on to their talent.
How to address the paradigm: Early and regular engagement with the full range of stakeholders (including government) is more critical than ever, especially for companies that are fighting to survive. It's particularly important not to forget about internal stakeholders, who play such a decisive role in implementation. The goals should be to nurture the most talented employees, to keep lines of communication open, and to be as forthright as circumstances allow.

Strategy and Operating Model
New paradigm: Companies should build their strategies on their capabilities.
How to address the paradigm: The design and delivery of a coherent portfolio of skills and tools will drive the value of the company. The shifts that emerge from any such repositioning do not need to increase cost, since investments that do not help the company will be eliminated.

The design and delivery of a coherent portfolio of skills and tools will drive the value of the company.

SUMMING UP: THE SIX KEY SUCCESS FACTORS

For all the differences that companies may have, there are a number of things every one of them must do well in order to come through the crisis in as good shape as possible.

1. *Impartial self-assessment.* No restructuring program will be successful if it is biased or influenced by overly optimistic thinking. The fact that more than half of all respondents to Booz & Company's December 2008 survey said their companies would come through the crisis stronger shows there may be plenty of wishful thinking going on. Instead, any new direction should be analytically based, built on a fact-based view for step change. It's particularly important for companies to separate out the structural and nonstructural parts of their business models, so they can understand how to modify those models if necessary.

2. *Leadership.* The executive board and the supervisory board must commit significant time to driving the program. Those executives should also discard any preference they might have for consensus building. Executives at a European bank on the receiving end of a government bailout huddled together during the first 60 days—quantifying their exposure to toxic assets, formulating strategies, designing a new governance model, and securing financing. This exemplifies the need for leadership at these times. Had that bank invited input on its problems from lower-level managers, it would never have been able to answer the fundamental question—"What now?"—quickly enough. With significant change looming for many industries and companies, top-down decision making is essential.

3. *Radical solutions.* Companies need to be open to new ideas and counterintuitive measures, more so than they were in the past. One example of a counterintuitive measure: entering into alliances, or at least discussions, with rivals. Another example: in-sourcing work. This possibility is particularly worth exploring in Europe, where laws relating to trade unions and work councils make it just about impossible to fire workers quickly. Of course, in-sourcing is feasible only among companies that still have the in-house competency to handle the outsourced work. Automobile makers are a logical group to pursue in-sourcing; they could handle the manufacture of engine parts at factories that have been forced to cut shifts during the crisis but that, at least in Europe, are still having to pay factory employees the bulk of their wages.

4. *Faster action.* In a time of high uncertainty and rapidly changing external factors, improved responsiveness will become a competitive advantage. It may have been possible, in an earlier era, to formulate strategy during retreats that served as the jumping-off point for months of blue-sky executive e-mails, board meetings, and committee group recommendations. That is a luxury most companies can no longer afford. These days, it's more likely that companies will have to make rapid diagnostic self-health checks—in some cases, in as little as a week or two. Out of those, ideally, should come some quick wins—the divestment of unprofitable assets, wage concessions, renegotiated contracts with suppliers, and the like.

5. *Effective program structures.* Cross-functional coordination and effective change management are vital enablers to optimize results and ensure their sustainability. As initiatives overlap and increase in complexity, and as more stakeholders take an interest in those initiatives, a programmatic approach becomes essential. Companies in the midst of such urgent restructurings, like the European bank that received a government investment, instinctively understand the need for—and embrace—the involvement of a program management office.

6. *Stakeholder management.* The crisis is affecting customers, investors, the government, suppliers, and employees/work councils. There must be plans for managing all of these constituencies. Indeed, the crisis, if played right, can give companies a new chance to lobby for advantages their workers or regulators had previously rejected.

   As for the government, perhaps it can be persuaded to back protectionist policies that no longer seem so ill-advised, or look past the risks of a merger that no longer appears detrimental to competition and bad for consumers. Stakeholder management is all about getting people to help with initiatives that benefit you and your shareholders. That this is possible now is one of the silver linings in the awfully dark cloud that lingers overhead.

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Endnotes

[1] "Rethink Your Strategy: An Urgent Memo to the CEO," by Paul Branstad, Bill Jackson, and Shumeet Banerji. Booz & Company, December 2008, http://www.booz.com/media/uploads/Rethink_Your_Strategy.pdf

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