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Survival vs. Success

*How Companies Are
Responding to the
Recession, and Why
It's Not Enough*

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EXECUTIVE SUMMARY

Rather than doing too much, too soon, in response to the current recession, companies risk doing too little, too late. A targeted, in-depth study of the specific cost-cutting and revenue enhancement initiatives being implemented at Fortune 500 companies sheds light on a shell-shocked business community. In a wide range of industries, senior executives are engaged in across-the-board, tactical cost-cutting exercises to ensure survival, but surprisingly few appear to be truly overhauling their cost structures to get at the heart of escalating fixed costs and bloated balance sheets. Nor are the majority pursuing creative strategies for longer-term success. “Cauterize” seems to be the watchword on most executive floors. Without history as a guide or any visibility on how deep and long this recession will be, chief executives must forge ahead. Markets in the midst of a structural shift yield myriad opportunities for players with initiative and fortitude. The future promises rare and sustainable advantage for companies that get it right. But getting there will take prudence, discipline, and speed—as well as creativity and courage.

Contents

1 Executive Summary	11 <i>Exhibit 5 Capital Expenditures Are Drying Up</i>	19 <i>Exhibit 10 Functional Savings Targets Are Too Modest</i>
3 Key Findings		
3 Not Your Run-of-the-Mill Recession	13 Revenue Growth Takes a Backseat to Cost Reduction	19 <i>Exhibit 11 Companies Need to Speed Up the Savings</i>
5 Caught in the Headlights	13 <i>Exhibit 6 Cutting Costs or Capabilities?</i>	21 Too Much Delegation Diminishes Savings
5 <i>Exhibit 1 Companies Are Fighting Fires, Not Forging a Future</i>	14 <i>Exhibit 7 Missed Opportunities for Short-Term Revenue Growth</i>	21 <i>Exhibit 12 Top-Down Is Out</i>
6 Accelerated Cost Transformation	16 Emerging Markets— A Potentially Risky Bet	22 Urgent Memo to the CEO
7 Lopping Costs Tops To-Do List	16 <i>Exhibit 8 Emerging Markets Are a Questionable Investment Haven</i>	23 <i>Exhibit 13 Strategic Moves in a Crisis Environment</i>
7 <i>Exhibit 2 Short-Term Survival Is Priority 1</i>	17 Building a Capabilities- Driven Strategy	24 Moment of Truth
8 <i>Exhibit 3 Cost Leaders and Laggards Are Adopting the Same Short-Term Survival Tactics</i>	18 Savings Projections: Too Low and Too Slow	25 Research Methodology
10 <i>Exhibit 4 Companies Exaggerate Their Own Cost-Cutting Prowess</i>	18 <i>Exhibit 9 Cost Reduction Targets Are Underwhelming</i>	25 About the Authors
11 Capital Expenditures Are a Casualty		

Key Findings

- Volatile economic conditions are creating churn in business objectives, making planning and execution exceptionally difficult—companies feel as though they're flying blind.
- Short-term cost reduction reigns supreme. But executives worry that all of the obvious savings opportunities have been exhausted, and their single-digit savings targets reflect this concern.
- Meanwhile, executives still have not elevated the priority of some obvious measures—including compensation adjustments—that could help save their companies.
- Revenue-side opportunities and capability building have taken a clear backseat. This raises serious questions about companies' ability to compete once the economy starts to rebound.
- Companies are placing a possibly risky bet on emerging markets that are not immune to global economic risks.

NOT YOUR RUN-OF-THE-MILL RECESSION

Senior executives in every industry can agree on one thing: This recession is unlike any other in recent memory. Its force, speed, and impact are greater, and its scope more global. Even the savviest economists don't concur on where the bottom is, or when our interconnected economy will hit it, but there is every indication that this recession will last longer than the 10 to 18 months typical of those in the past half century.

This recession is not the product of a single market meltdown. Rather, it was spawned by the perfect storm of destructive economic conditions—

first the run-up in real estate values fueled by easy credit and extreme leverage, and then the consequent freezing of the financial infrastructure and the clampdown on credit. Both leaders and laggards in every industry profited from the euphoric consumption let loose by the speculative bubble. Now that it has burst, senior managers at every company need to dispassionately reassess where they stand competitively and financially.

While the outlook is distressingly uncertain, this much is clear: The global economy is not just contracting; it is undergoing a structural shift that will fundamentally and permanently alter the shape and fortunes of many, if not all, industries. Those business leaders who creatively and aggressively seize the consequent strategic opportunities will prosper. Those who limit their approach to indiscriminate cost-cutting and other reactionary moves may well perish.



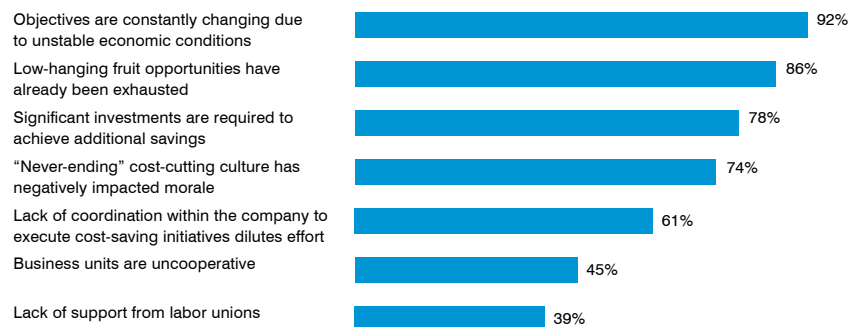
CAUGHT IN THE HEADLIGHTS

No matter the industry, no matter the region, C-suite executives echo the same lament: “We’re flying blind. We have no visibility.” Our survey results only confirm this sentiment. Ninety-two percent of senior respondents cited “objectives [that] are constantly changing due to unstable economic conditions” as a major challenge to achieving their cost reduction objectives (*see Exhibit 1*).

Unable to get their arms around the scope of this crisis, chief executives appear to be hunkering down to wait it out. They have rolled out the requisite across-the-board cuts, launched the initial rounds of layoffs, and conserved what cash they can. Now, many are at a loss as to what to do next. In fact, 86 percent of respondents report that “low-hanging fruit opportunities have already been

Exhibit 1
Companies Are Fighting Fires, Not Forging a Future

MAJOR OBSTACLES FACING COST-CUTTING INITIATIVES



Note: Companies citing issue as a “significant” or “reasonable” challenge.
Source: Booz & Company Recession Survey

Accelerated Cost Transformation

“Quick” and “considered” rarely describe the same process, but they can both apply to cost reduction campaigns. The trick is to identify and drive short- and medium-term savings opportunities that meet all the following criteria:

- They provide a significant payoff with minimal time and investment.
- They strike both quickly and deeply at the fat without cutting into the essential muscle—the core capabilities and processes of the business.
- They produce results that stick for the long haul, so that costs don’t bounce back.

If companies systematically uncover and exploit these opportunities, the savings over a six- to 12-month period can be significant—as much as 10 to 20 percent of the cost base. We call this process accelerated cost transformation, and it rests on three fundamental principles.

- **Clear separation of structural and nonstructural costs:** This is necessary to understand which costs are inherently rooted in the business model (e.g., distribution channels and geographic footprint) and which are independent of it (e.g., IT systems). Each requires a different strategy.
- **Rapid identification of both demand- and supply-side improvement areas:** “Demand” pertains to the business units’ internal consumption of goods and services (e.g., internal service levels), while “supply” describes external drivers of cost structure (e.g., negotiated supplier rates). Successful transformations hit both hard.
- **Sustainability:** Taking out lots of cost is painful, but it’s not hard. What’s hard is simultaneously knowing when to stop before cutting into muscle. Sustainability is also about ensuring that the right mechanisms are in place to perpetuate the cost transformation.

By applying the techniques of accelerated cost transformation, companies in all sectors can drive measurable and substantial results. Take, for example, a high-tech manufacturer that almost declared bankruptcy in the wake of a market-wide collapse in demand and liquidity. It immediately executed an aggressive, global program to raise cash by reducing inventory and accounts receivable levels consistent with service-level requirements, while simultaneously reducing working capital by 35 percent, which amounted to more than \$4 billion in savings in nine months. Another example is a consumer products company that faced a profit drop of 50 percent due to rapid volume declines and price wars with competitors. After executing an aggressive cost diagnostic that was akin to what a private equity firm might do and that left no stone unturned, it was able to reduce its run rate by 10 percent—\$400 million—in the first six months. Within two years, it was able to reduce costs by 30 percent across multiple functions.

Companies can rapidly retool their cost structure while preserving long-term viability, but it takes creativity, careful planning, and disciplined execution.

exhausted,” and nearly three-quarters note that the “‘never-ending’ cost-cutting culture has negatively impacted morale.” To achieve further savings would require structural change and “significant investments,” in the view of nearly four in five senior executives. Many are understandably loath to make those investments in a cash-strapped environment. Yet there is growing acknowledgment as the recession deepens that “business as usual” will not suffice. Novel and expedited approaches to deep cost reduction are needed (*see “Accelerated Cost Transformation”*).

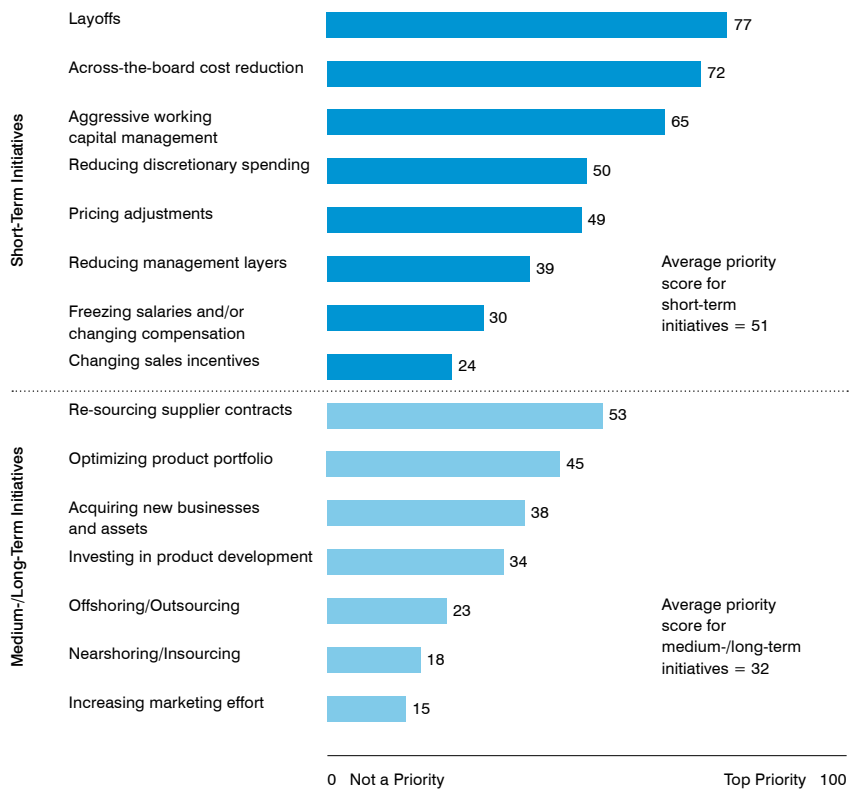
LOPPING COSTS TOPS TO-DO LIST

Among the cost reduction and revenue growth levers we itemized, survey respondents assigned higher priority, in general, to short-term cost control tactics, such as across-the-board cuts, layoffs, aggressive working capital management, and discretionary spend reductions (*see Exhibit 2*). This is not surprising, as these measures typically yield significant savings within six months; they are the default levers companies pull in any market downturn.

Companies manifest considerably less appetite for such long-term initiatives as strategic acquisitions, product and service development, offshoring, and insourcing. Interestingly, adjustments to compensation—salary freezes and incentive changes—are fairly low on most respondents' priority lists, despite the fact that these measures can deliver savings quickly. Given that it is precisely this reluctance to cap or cut salaries and bonuses that has aroused the public's indignation, this is surprising.

Exhibit 2
Short-Term Survival Is Priority 1

AVERAGE PRIORITY RANKING OF COST REDUCTION AND REVENUE GROWTH MEASURES



Source: Booz & Company Recession Survey

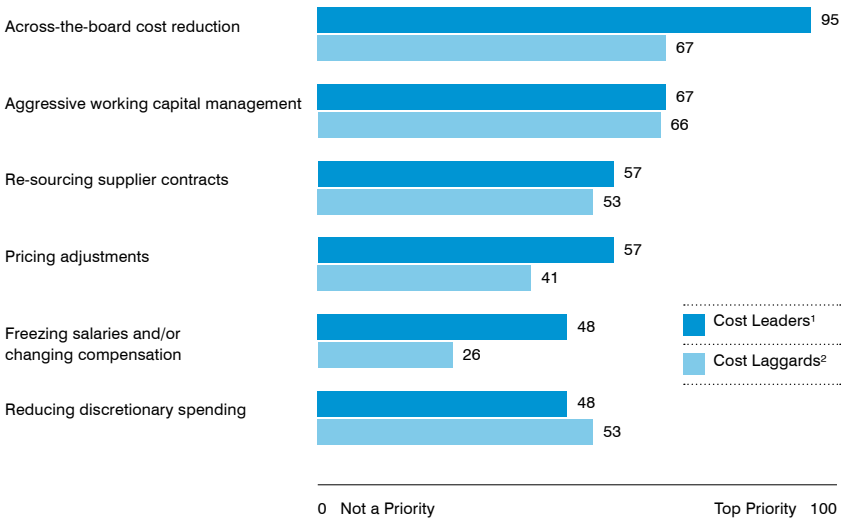
The emphasis on across-the-board cost cutting and layoffs communicates that companies are defaulting to standard downturn defenses and may be overly optimistic in assessing the magnitude of, and response required by, this recession. Even companies

that regard themselves as cost leaders are focused on the same short-term survival tactics, with one important difference: Self-described cost leaders are almost twice as willing to freeze salaries and reduce compensation (see Exhibit 3).

Companies tend to be quite generous in assessing their own competitive positioning on cost management. An astonishing 40 percent of our senior executive survey respondents believe they rank in the top 15 percent in their industry in terms of competitive

Exhibit 3
Cost Leaders and Laggards Are Adopting the Same Short-Term Survival Tactics

**RELATIVE PRIORITY OF COST REDUCTION LEVERS
(COST LEADERS VS. COST LAGGARDS)**



¹ Cost leaders are companies that ranked their cost structure as highly competitive (top 5%) compared with competitors.

² Cost laggards are companies that ranked their cost structure as not competitive (below average) or somewhat competitive (average) compared with competitors.

Source: Booz & Company Recession Survey

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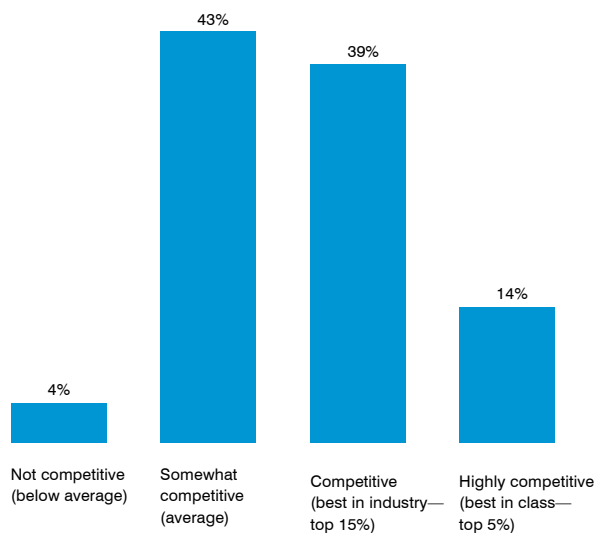
cost structure; 14 percent go so far as to describe themselves as “best in class,” or in the top 5 percent in their industry (see Exhibit 4). The fact that 14 percent describe themselves as in the top 5 percent reveals a disconnect between perception and reality; companies suffering from exaggerated optimism will struggle to map a strategy for managing this recession.

This emphasis on quick-hit cost reduction tactics is not surprising, but it is shortsighted. Given the magnitude of the structural break redefining the economy and most industries, there is every reason to assume that the weak will be culled before this recession is over; traditional survival strategies are simply not enough.

The good news is that those who take the big leap now are likely to set themselves apart moving forward. Smart companies will take the opportunity provided by this severe setback to gain some perspective on their competitive position, now and in various future scenarios. And they will take the steps today to build the platform for long-term success, not just short-term survival (see “Urgent Memo to the CEO,” page 22).

Exhibit 4
Companies Exaggerate Their Own Cost-Cutting Prowess

**SELF-REPORTED COMPETITIVENESS OF COST STRUCTURE
(PERCENTAGE OF ALL RESPONDENTS)**



Source: Booz & Company Recession Survey

CAPITAL EXPENDITURES ARE A CASUALTY

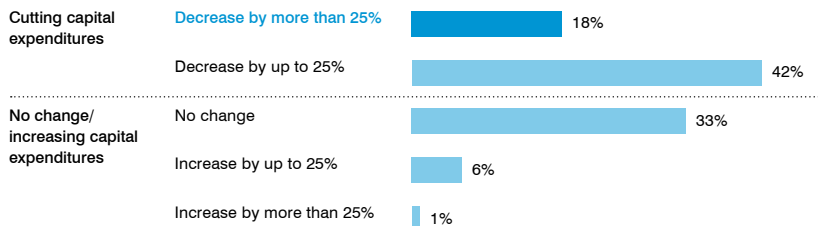
Consistent with an emphasis on short-term, survival mode strategies, most companies surveyed are slashing capital expenditures. Sixty percent of respondents indicated they are cutting these expenditures; nearly one in five are cutting them by 25 percent or more (see Exhibit 5).

Again, it's not unusual for companies to curtail capital expenditures in a cash- and credit-constrained recessionary environment. But a strategy overly focused on eliminating costs

and curbing investments will not position companies for growth when the economy ultimately rebounds. Companies need to use a nuanced approach in addressing the demand shocks rolling through their markets. They must simultaneously balance cost reductions with selective investments in new markets, new segments, or new capabilities, to offset losses and/or lock down and strengthen high-performing parts of the portfolio (see "Building a Capabilities-Driven Strategy," page 17).

Exhibit 5
Capital Expenditures Are Drying Up

**IMPACT OF RECESSION ON CAPITAL EXPENDITURES
(PERCENTAGE OF RESPONDENTS)**



Source: Booz & Company Recession Survey



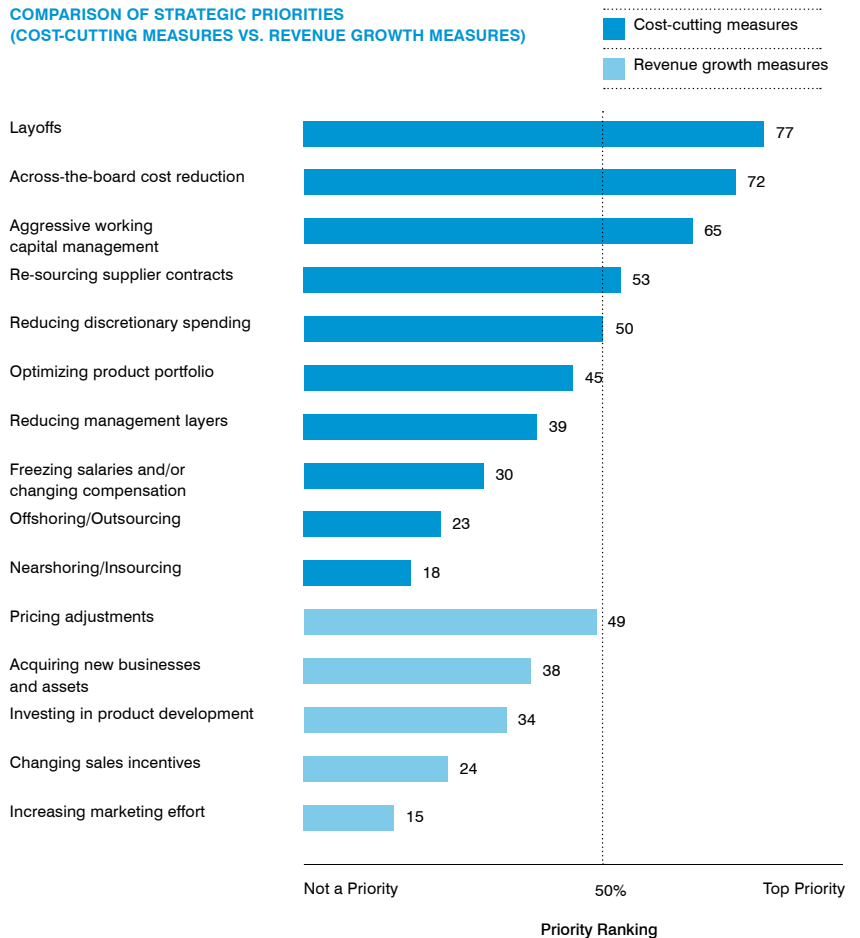
REVENUE GROWTH TAKES A BACKSEAT TO COST REDUCTION

While the majority (52 percent) of senior executives we surveyed report that they are both cutting costs and investing in new growth, a surprising 39 percent conceded they are engaged solely in cost-cutting initiatives. Moreover, cost-cutting programs far outweigh revenue enhancement measures on companies' priority lists (see Exhibit 6). This rationing of investment in revenue growth will quite possibly leave these companies without the competitively advantaged capabilities they will need to succeed

in the redefined industry structures that will emerge from this recession.

The overwhelming focus on cost reduction and the relatively short shrift given to revenue enhancement suggest an opportunity for greater creativity in addressing this crisis. Of the revenue growth measures being explored by respondents, several are long-term initiatives (e.g., acquisitions and new product development) that will take time to bear fruit (see Exhibit 7). Meanwhile,

Exhibit 6
Cutting Costs or Capabilities?



Source: Booz & Company Recession Survey

more immediate revenue generation tools (e.g., marketing and sales incentives) are being largely overlooked.

This is a lost opportunity that companies can ill afford in this climate. Companies need to look beyond the cost containment techniques they've leveraged in previous dips and demonstrate a whole new level of creativity in growing the top line.

Consider Hyundai's example. Confronted with a sharply depressed market for new car sales, Hyundai came up with an unprecedented promotion to alleviate consumer

anxiety created by uncertain economic conditions: The company is allowing buyers to return their new cars within a year of purchase if they lose their jobs. Just recently, it enhanced this promotion by offering to pay the vehicle loan or lease for 90 days while the owner looks for work. Owners who keep their cars need not reimburse the automaker for these payments. This marketing innovation appears to be paying off. While overall car sales were down more than 40 percent in February 2009 compared with the previous year, Hyundai's sales were down only 1.5 percent.

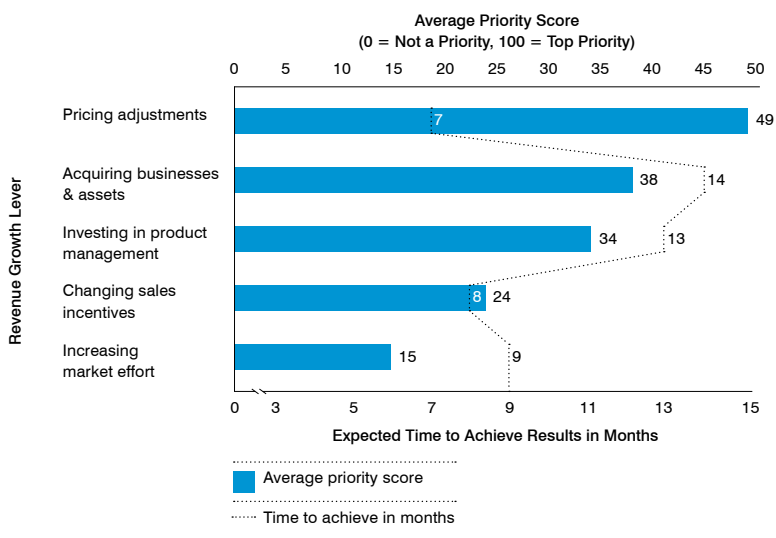
The company has creatively—and successfully—answered this question: “What will it take to get you into this car?”

Similarly, Amazon reported record revenues in the fourth quarter of 2008, largely by rolling out a series of aggressive yet tailored discounts and promotional offers during the holiday shopping season, while its retail competitors lamented their losses.

If there ever was a time for the sales and marketing departments to shine, this is it.

Exhibit 7
Missed Opportunities for Short-Term Revenue Growth

AVERAGE PRIORITY AND EXPECTED TIMING OF REVENUE GROWTH MEASURES



Source: Booz & Company Recession Survey

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focus on cost reduction
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EMERGING MARKETS— A POTENTIALLY RISKY BET

To the extent that companies are investing, they appear to be banking on the emerging markets, while pulling money out of the U.S. and, to a lesser degree, Europe. The majority of new investment dollars are flowing from U.S. companies to Asia and the Middle East, according to our research (*see Exhibit 8*).

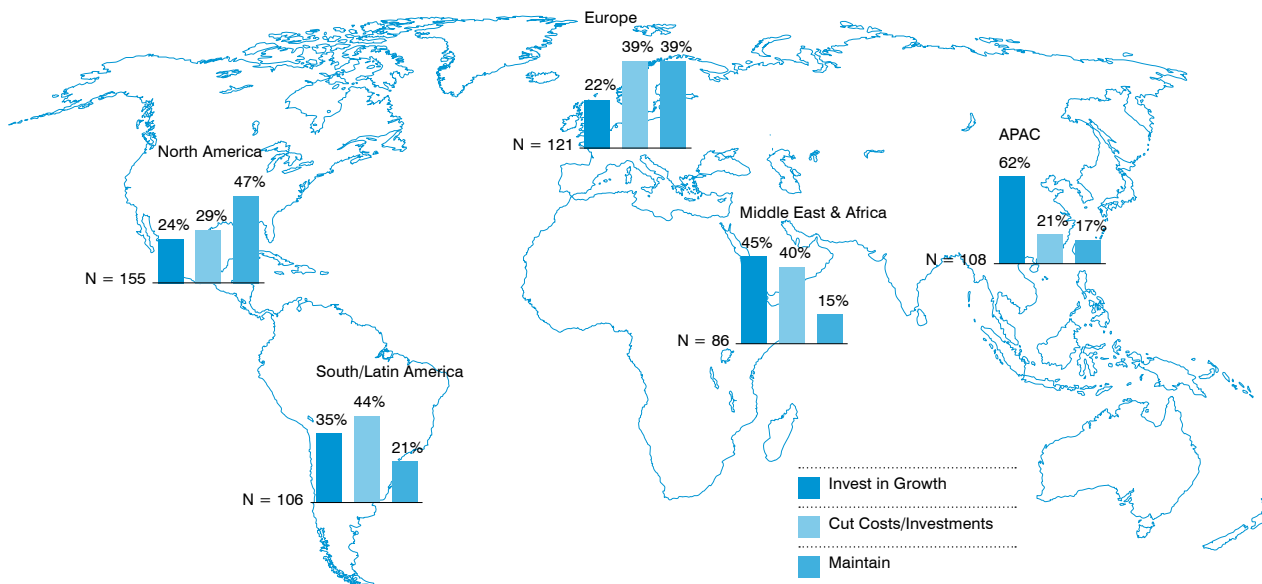
Emerging markets have experienced spectacular growth over the past decade, and it is true that the U.S. and European economies were the first to take the hit in the current recession. But this recession has quickly made its presence known throughout the world; there is no such thing as isolated economic pain in a global, interdependent economy. Indeed, China has already announced a stimulus package exceeding that of the U.S. as a proportion of GDP.

This drama is still unfolding, but preliminary evidence indicates that many of the world's growth economies are feeling the same recessionary chill, and that domestic demand may not act as a sufficient shock absorber for shrinking exports. To be sure, the situation does vary from country to country; for example, India, with its sizable and growing middle class and relatively low dependence on exports, is in a very different position from the more export-driven "tiger" economies.

There are additional considerations. For example, multinationals that have had a presence in these emerging markets for a decade or more, and have already tailored their business models to the local environment, will be better positioned to sustain or grow than those that have entered the

Exhibit 8
Emerging Markets are a Questionable Investment Haven

COMPARISON OF COST AND INVESTMENT STRATEGIES ACROSS REGIONS
(PERCENTAGE OF RESPONDENTS BY STRATEGY)



Source: Booz & Company Recession Survey

market within the last five years. And the profits—or perils—will depend on the type of industry as well; for example, demand for basic consumer products, a segment that is largely recession-proof, is unlikely to be affected.

All told, however, opportunities in emerging markets will have to be carefully sought out. Multinational companies should continue investing in countries such as China and India to the extent possible, but should not put blanket faith in these economies to offset massive slowdowns at home. Prudence and thoughtfulness are required to succeed.

Companies should also consider that the exodus of investment funds from North America and Europe could serve to lengthen the recession in both those regions. While it may be too soon to tell, most companies do not expect government intervention to provide them with sufficient reason to shift investments back to their home regions. Three-quarters of the companies responding to our survey report that government bailout packages will have no impact on their investment strategy.

Building a Capabilities-Driven Strategy

Strategies grounded in defensive, downturn-dictated thinking—cut costs, avoid risk—may improve an organization’s chances for survival, but they undermine long-term success. Winning companies will work to identify the sectors and businesses with the most potential, and invest now in capabilities that will best differentiate them from their competitors.

The term “capabilities” specifically refers to any combination of distinctive and actionable ideas, skills, or competencies that allow a company to consistently attract its primary customers and execute better than its competitors. Wal-Mart’s prowess in supply chain management, Southwest Airlines’ expertise in asset utilization, Toyota’s mastery of the automotive production system, and Procter & Gamble’s ability to broadly apply innovation across product categories are all examples of capabilities that confer and sustainably support a “right to win” in their respective industries.

In the current, constrained economic environment, in which scale is no guarantee of success, companies are increasingly relying on differentiated capabilities—in how they market, innovate, sell, or operate their supply chains—as a means to winning.

But it’s not enough anymore to have a portfolio of businesses, each with distinctive but different capabilities. Increasingly, companies are building a portfolio of complementary capabilities that cross business unit lines and distinguish the company as a whole. Moreover, certain leading companies are making decisions to acquire or divest businesses based on the extent to which they contribute to the coherence of this overall capabilities portfolio.

The challenge is in isolating those capabilities that drive success and then deliberately allocating disproportionate enterprise support to them. The latter is particularly important in an environment of economic constraint. It’s not necessarily sufficient for a company to figure out what it’s good at; it must discover where it truly excels, and dispense with the rest. Companies can do this not by looking inward and trying to discern their own strengths, but rather by looking outward at what their customers desire. By designing a portfolio of skills and tools needed to win customers, companies can accrue sustainable competitive advantage.

Winning companies in every industry will make portfolio decisions that (1) take advantage of the distinctive capabilities they already have, (2) add businesses that complement or extend those capabilities, and (3) divest businesses that require inconsistent capabilities, driving down costs in the process. Analyzing and measuring the coherence of a portfolio will become a necessity as companies face fiercer competition. Size no longer ensures survival, and participating in a high-growth segment may not ensure prosperity. In today’s global business environment, it’s not what companies do that matters, it’s how well they do it.¹

SAVINGS PROJECTIONS: TOO LOW AND TOO SLOW

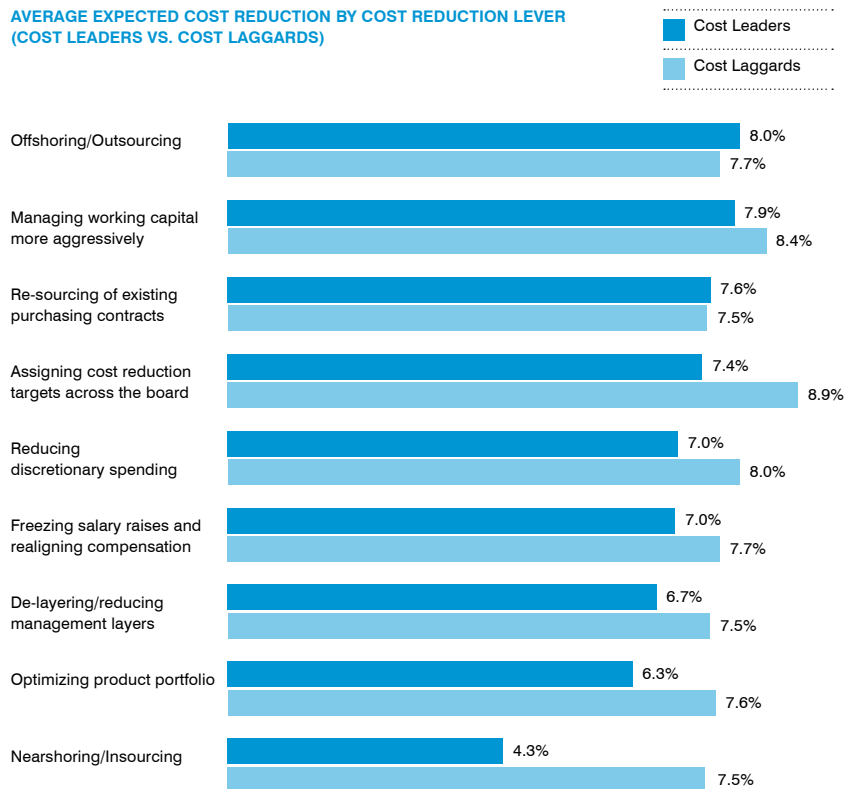
Perhaps the biggest gap between respondents' perceptions and the current reality is in the cost reduction targets needed. Companies anticipate savings of 4 to 10 percent across all of the various levers they are pulling, and across all of the functions being assessed (see Exhibits 9 and 10).

But marginal cuts such as these are not enough to spell success, or in some cases even survival, in this economy. Companies are not being ambitious or aggressive enough in laying the foundation for long-term competitiveness, and this is true of cost leaders as well as laggards. Our

experience suggests that with a carefully conceived plan and disciplined execution, companies could realize average program savings of between 10 and 20 percent.

Not only are savings targets too low—they are also too slow. In our experience, companies often deliver results that are more aggressive and impressive than senior executives in our survey are projecting (see Exhibit 11). And in this economy, speedy execution is more important than ever.

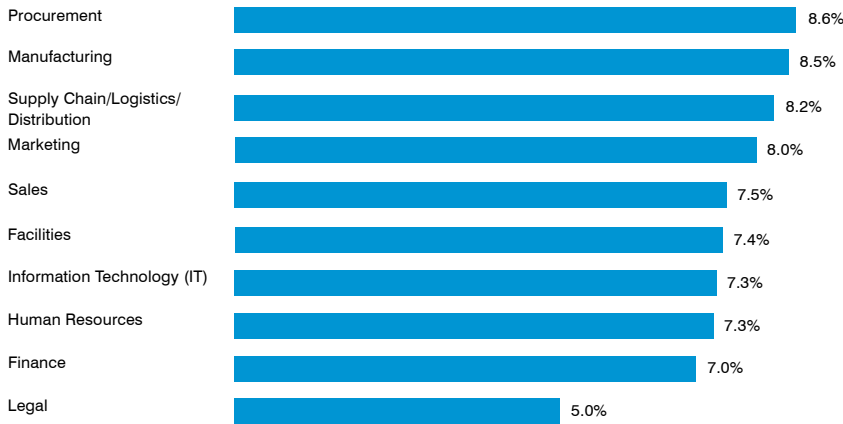
Exhibit 9
Cost Reduction Targets Are Underwhelming



Source: Booz & Company Recession Survey

Exhibit 10
Functional Savings Targets Are Too Modest

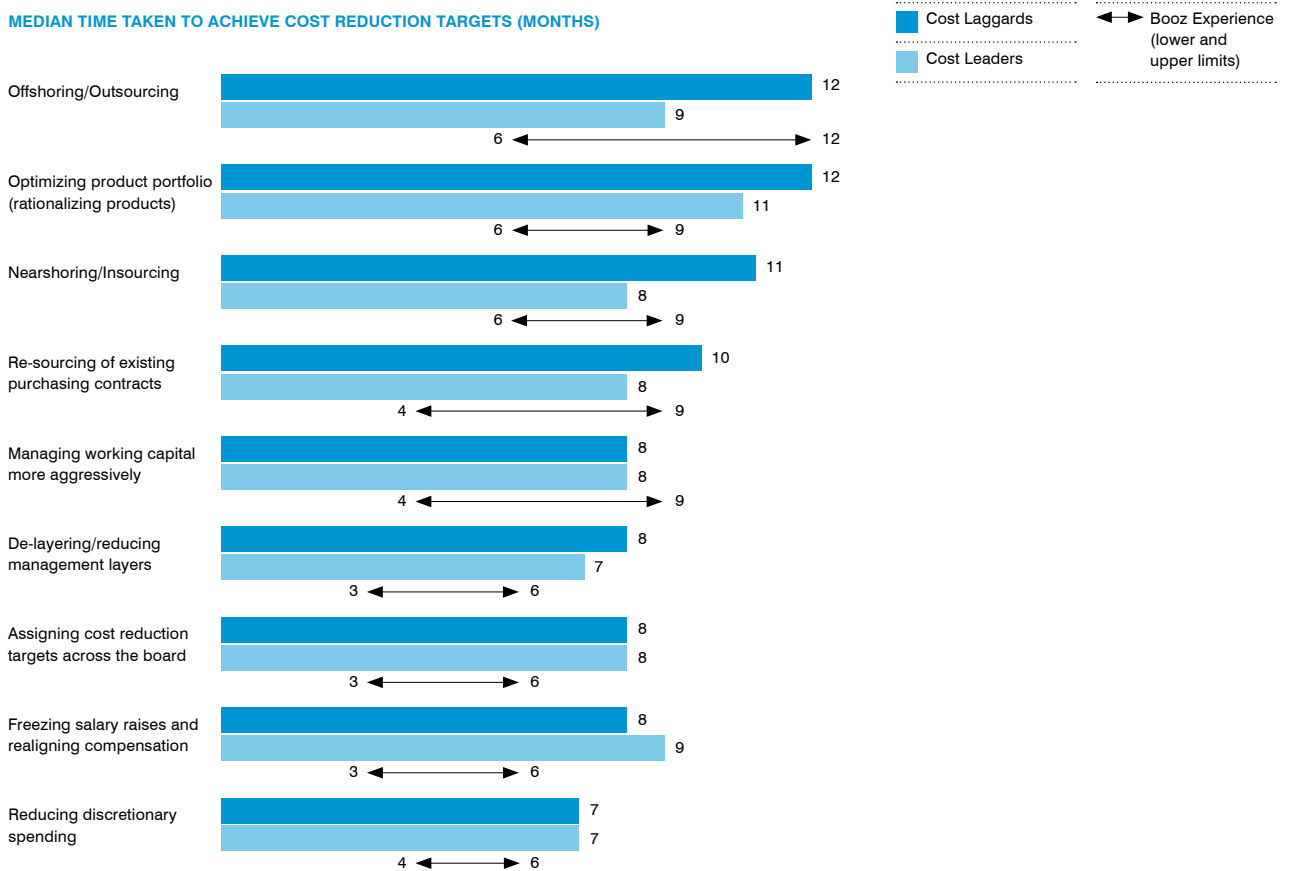
AVERAGE TARGETED SAVINGS PER FUNCTIONAL AREA



Source: Booz & Company Recession Survey

Exhibit 11
Companies Need to Speed Up the Savings

MEDIAN TIME TAKEN TO ACHIEVE COST REDUCTION TARGETS (MONTHS)



Source: Booz & Company Recession Survey

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TOO MUCH DELEGATION DIMINISHES SAVINGS

In fact, our survey results confirm that a formal, cross-functional, enterprise-wide approach to coordinating activities and tracking progress can deliver significantly higher savings. Nearly 40 percent of the companies

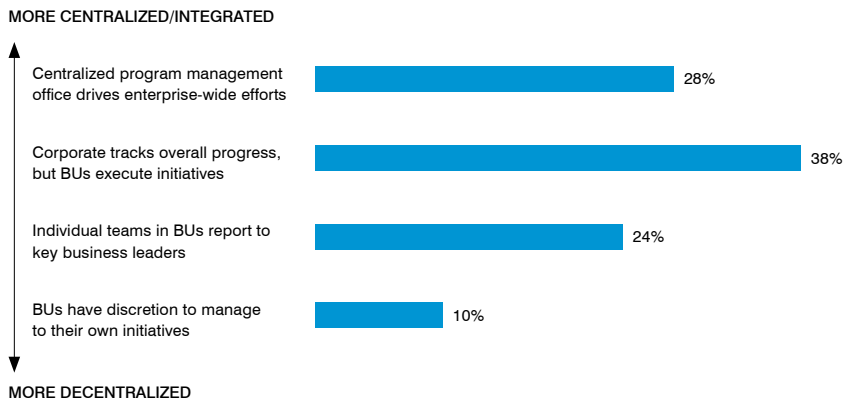
taking such a programmatic approach expect to achieve savings of 20 percent or more, compared with only 20 percent of companies leaving it to the business units.

Most companies appear to have offloaded authority and accountability for implementing cost-cutting measures onto the business units, rather than driving programmatic cost reduction efforts from headquarters. In fact, 72 percent of the senior executives responding to our survey have delegated all or most of the responsibility for executing recession-proofing initiatives to the individual business units and functions (see Exhibit 12).

While companies should avoid a purely top-down, headquarters-driven approach that would result in senior management micromanaging the process rather than focusing on outcomes, our experience strongly suggests that some level of enterprise integration is necessary to ensure that cuts are being made in the right places and with sufficient vigor and rigor.

Exhibit 12
Top-Down Is Out

COMPANIES' EXECUTION STRATEGY FOR RECESSION RESPONSE
(PERCENTAGE OF RESPONDENTS)



Source: Booz & Company Recession Survey



Urgent Memo to the CEO

If you are a chief executive officer, a business unit manager, or a line supervisor in any major company around the world, you need to adjust your mind-set to a future that looks very different than it did just a few months ago. During speculative bubbles, the pressure on the strong and the weak is the same: to ride the wave of growth, regardless of whether it's based on permanent value or transient speculation. But the bubble has burst, and now your first priority is to see market dynamics clearly—not as an investor, but as a decision maker with a company to steer.

Given the potential for discontinuous change in the structure of your industry, success hinges on your ability to adapt immediately to the unanticipated and seize strategic opportunities. These opportunities will likely present themselves sooner rather than later. That's why your preparation cannot be postponed. The prescriptions for the weak are different from those for the strong.

The challenge for the weak is to position assets and people to their best advantage and take the right steps to give every piece of the company its best chance to succeed, even if under different ownership.

For the strong—and those who can be strong—we recommend the following course.²

First, examine your portfolio of businesses and ask three fundamental questions about each.

1. Is this business core to your company's future value?
2. Can you envision it as the basis for a sustaining stream of growth opportunities?
3. Does it offer a path to building financial performance that is greater than what investors can earn elsewhere in their equity portfolios?

Concentrate your corporate strategy on those businesses that are a “yes” to all three questions—and monetize the rest. There will be too many good opportunities for you to build on this core to bother with anything else.

Focusing on your most valuable customers is just as important. These are the customers who recognize your product or service as the one that delivers the greatest surplus value relative to the next best alternative, regardless of its price or your profits.

The economy will not improve immediately. We are entering a period in which the value of being able to act strategically and decisively for the long term will increase enormously. Anticipate the future shape of your industry and place targeted, affordable bets that position you for advantage. This moment of opportunity is of paramount importance for your businesses’ positions for years to come.

Exhibit 13
Strategic Moves in a Crisis Environment

THEMES	STRATEGIC ACTIONS
FOCUS ON YOUR FUTURE	<ul style="list-style-type: none"> - Concentrate your portfolio of businesses on long-term winners - Target your most valuable customers
PREPARE TO WEATHER THE STORM	<ul style="list-style-type: none"> - Lower your breakeven to remain profitable under the worst-case scenario - Reduce capacity, complexity, and fixed costs - Husband your balance sheet
ANTICIPATE THE FUTURE INDUSTRY STRUCTURE	<ul style="list-style-type: none"> - Create a view on how your industry should restructure - Understand the impact of government intervention
RESOLVE YOUR GAME PLAN	<ul style="list-style-type: none"> - If the industry needs to consolidate, decide whether you are a buyer or a seller - Allow for selective share increases through smart pricing - Do not sacrifice R&D or capital expenditures; prioritize and use these investments offensively
PREPARE TO TAKE INTELLIGENT RISKS	<ul style="list-style-type: none"> - Get ready for the upturn - Watch and prepare for a rekindling of price increases, particularly on commodities - Prepare to recapitalize your debt if the stimulus packages overshoot

Source: Booz & Company



MOMENT OF TRUTH

For the strongest competitors in an industry, a recession is a terrible thing to waste. They have an opportunity to leapfrog less aggressive and creative competitors and pick up strategic assets on the cheap, but they must act quickly; fortune favors the bold and the swift. Meanwhile, the current climate has left executives more defensive than bold. It's difficult to navigate a multibillion-dollar enterprise through uncharted waters in the dark. Understandably, CEOs are not queuing up to become a cautionary tale.

But this is not the time to go into a hole and hibernate until the storm

passes; survival strategies are not success strategies. Companies need to develop action plans grounded in market realities and carefully developed strategic insight that address the following fundamental questions: Where should we cut deep and fast? And equally important, where should we invest to build a winning portfolio of differentiating capabilities?

Companies that take this opportunity to remodel their businesses to be viable not only *through* but also *after* the recession will rebound sooner, stronger, and with a markedly improved strategic position.

Research Methodology

Booz & Company surveyed 155 senior executives of Fortune 500 companies headquartered in the U.S. on the specific strategies and tactics their companies have implemented to address the recession. The survey was conducted anonymously in January 2009 by a third-party research firm. A quarter of the survey respondents were among the senior-most decision makers in their company (e.g., CEO, president, COO, CFO), while the remaining 75 percent were senior executives who report directly to the C-suite. A range of industries are represented in the survey, including automotive, chemicals, consumer products, energy, industrial manufacturing, media, professional services, technology, transportation, and utilities. The survey asked detailed questions on specific cost reduction and revenue enhancement measures, as well as targeted questions on the anticipated impact of congressional bailout packages.

¹ For further insight on how companies make this assessment and act on it, see "[Capabilities-Driven Strategy](#)."

² For a more detailed explanation of all five priorities set forth, see "[Rethink Your Strategy: An Urgent Memo to the CEO](#)."

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