McKinney Rogers

Ready for the recovery

Foreword from Damian McKinney

The world's economy has been hit by a recession of rare severity, and every sector has suffered. Happily, fears of a repeat of the Great Depression were not realized and, at the time of writing, the debate is now more about the prospect of green shoots and whether they have appeared.

As performance and leadership consultants, McKinney Rogers is interested in whether, faced with such dramatic chaos in the global economy, business directors were able to react quickly, review priorities and implement effective measures.

Of even more interest is, having implemented strong measures and deep cuts, are businesses well-placed to react rapidly when the recovery starts.

Our experience is that executives at many large businesses are bullish about the future – they have taken strong measures: they are surviving and some are even thriving. Many have put in place plans to realize exciting ambitions when the recovery happens and are proceeding with them.

For many businesses, when the upturn happens it will still be a very different and tougher market - characterized in the West by chastened banks, indebted governments, wary investors and poorer customers. Competition from emerging markets will continue to become ever-more sophisticated, while opportunities there will continue to grow rapidly.

Many markets will have been dramatically changed by the recession. Their challenge is to make sure their plans are effectively implemented, so that they can capitalize on the opportunities they have identified.

We hope this white paper emboldens their directors in maintaining the difficult task of delivering the numbers today while finding the resources to invest for the future.

This white paper is also intended as an alarm call to those businesses who feel they have successfully hunkered down - cutting costs, sweating existing assets, and scaling back investments - and are waiting for the storm to pass before getting back to their old strategy. They are confusing "surviving the recession" with "being ready for the recovery". They will emerge in 2010 surprised to find stronger competitors with improved offerings - to avoid this they must take steps now to already be on the front foot when the recovery happens.

Yours faithfully

Damian McKinney
Chief Executive
McKinney Rogers

Executive summary

Hasty cuts as recession brought panic in boardrooms

Most firms did not spot the recession until it was upon them and, according to our research, for many the initial response was to immediately implement cuts before considering their business's strategy.

We often see this cut first, plan later approach to problems. But the de-linking of actions and the corporate plan can often mean that the easiest cuts are made rather than the important ones. It also often means that when businesses do return to revise their strategy they find they have cut areas they wished they hadn't.

Why did many firms look to cut first and plan second? Our view is that this is because planning in many businesses is a bureaucratic corporate exercise, rather than a meaningful 'route map' which governs every turn they make. Corporate plans should be dynamic and updated as the situation changes. Certainly during a recession, or indeed in any crisis, it should be reviewed on a regular basis.

Whilst many sectors have certainly taken a battering, our research shows that the bleak tales of redundancies and insolvencies do not tell the whole story. For instance, our research in the manufacturing sector found that many have in fact taken a thoughtful and front-footed approach to tackling the recession and its aftermath, with many expecting to emerge from the recession in a much stronger position.

Acquisitions set to make a comeback – but handle with care

Some firms expect to be able to grow through acquiring competitors from 2010. However, we caution executives to be selective and not simply buy distressed companies because they appear cheap – turning round a poorly performing company takes a lot of financial and management resource, and finance is going to be in short supply for a long time to come. Investors are also very wary of companies doing anything other than reducing their leverage.

In the current environment the value from mergers should be viewed with even greater skepticism. Low leverage, cash generation and, wherever possible, exposure to emerging markets are what investors in the stock market are rewarding. Attempting to buy and integrate a struggling business may well simply import a lot of extra problems to the distraction of achieving other, more important goals, in the rest of the business.

Can management teams deliver the plans?

Our research suggests that while many firms are confident in their plans and approach to the recession, many had concerns about their ability to execute these effectively to take advantage of the upturn.

It is certainly our experience that the ability to implement plans quickly is what distinguishes high-performers from the rest. Where businesses are slow to act, chief executives must tackle the cultural and structural issues that lead to such operational lethargy.

Part of this is encouraging entrepreneurial skills to be as highly regarded as traditional management skills such as finance, marketing and project management. Entrepreneurialism and the ability to innovate will be even more important as companies in many sectors find themselves facing increasingly sophisticated competition from China and other emerging markets.

Particularly important for CEOs is having a vision of where they want the business to be and to have identified the really key areas where their business needs to make a breakthrough to achieve success. Is it a successful product innovation, a break-through idea, a new market or a successful take-over? Achieving and exploiting the key break-outs should be the focus for you and your A-Team at the moment. In the same way that great generals leave the current battle in the hands of their deputies and are already planning how to win the next, this applies to business leaders too. Leave fighting the last months of the recession to your trusted deputies, while you and some of your best people set about winning the recovery too

The response to the recession

Most companies did not realize a recession was coming until it was upon them, with nearly two-thirds of those we researched not spotting it was imminent until the summer of 2008. For many, it meant a dramatic and unexpected reversal of fortunes, but they were not alone in being caught out by the sudden recognition of a severe recession – policymakers were still publicly in denial about its severity well into the autumn.

Because of the panic in many businesses when the recession appeared with such suddenness and force, many firms have bitten too far into the bone with their cuts, and may well find they have compromised their ability to expand again as the market improves. Indeed, we have received comments from CEOs that the last thing they want is a strong recovery as they downsized so much they will not be able to rebuild sufficiently quickly.

Research shows that executives consistently highlight how important product development is for them, yet many have cut back on R&D.

For many businesses, cutting back on R&D will have been a panic measure that will damage their ability to be on the front foot when the recovery happens and will be strongly regretted later.

In fact, at businesses we researched, the area with the least cuts was senior management – yet this is the area where big savings can be made because of their comparative expense. Action here also presents a timely opportunity to move on underperforming executives!

Intellectual property specialists CPA Global analysed 240 companies over 10 years found a surprisingly strong statistical link between R&D expenditure and net income. In sectors analysed - including machinery, electronics, precision instruments, semiconductors and medical devices – as least 52% of industry income was explained by R&D expenditure, and in many cases much more. They concluded "The linkage between innovation and profitability is critical, yet one which is not well understood beyond general intuition. We can say that along the innovation value chain, R&D is clearly one of the most, if not the most, important activities".

CPA Global "Closing the innovation gap" white paper – March 2008

When the recovery starts (and at the time of writing it seemed to already be on the way for fall 2009), the vital elements that will help a company grow rapidly are the skilled workers and talented managers in its core areas. Deep cuts in these core areas will severely hamper the ability to recover, and businesses that have made such cuts need to ensure their plans to rebuild are realistic and have been thought through in detail.

If HR is still implementing redundancies, you should evaluate whether they are needed at all. In some areas skilled people laid off may still be in the job market and available for hire in fall 2009 and possibly into the following year. However, firms looking to re-employ skilled people they have laid off may well be disappointed.

The recession represents a great opportunity to seek out talented executives and technicians to fill skills gaps. For example, this approach has been taken by many of the smaller banks (who avoided the credit crisis troubles of their bigger rivals) to pick off high-performing executives and teams from their troubled rivals. There is definitely an opportunity to hunt out the best talent at the moment for your team!

Recent research suggests that the recession has created a revolution in industrial relations and working practices. For instance, a survey by the UK's Confederation of British Industry showed that more than 60% of firms have reappraised their management guidelines to adapt to a challenging climate. Flexible working hours, extra holiday, cuts in paid overtime and even extended shut-downs are becoming a matter of course for businesses in every sector.

Having a "flexible labour market has proved a huge asset during these testing times", CBI Deputy Director-General John Cridland said. "This has been a particularly bruising recession, but one of its most positive and striking aspects has been the commitment of many businesses and their staff to work together to try to trim costs and save jobs."

CBI: "*Recession creates new employment landscape*", June 2009.

Immediate reactions to the recession have not all been about making cuts. Substantial numbers of businesses have responded positively with measures to grow market share and new markets. Our research suggests that the vast majority of executives felt that the recession in fact offered significant opportunities to improve the way their business operates, with broad opportunities being seen in investment and new markets.

For instance, following research earlier this year we were pleasantly surprised by how bullish many firms were about their prospects, particularly given the severity of market conditions they were enduring and the cuts many had made due to market turmoil, and many had responded by seeking new markets and actively increasing product innovation.

Merger and acquisition opportunities expected (but handle with care)

Many companies seem optimistic about the prospect of acquiring struggling rivals in a climate which will not favor organic growth. However, while not looking to deter businesses from opportunistically getting bargains that further their strategy, we certainly wish to raise a number of red warning flags with regard to potential M&A deals.

Recent research suggests M&A opportunities exist in many sectors. Deloitte's most recent survey of activity in the insurance field suggested scope for huge growth in the latter quarter of 2009, as firms seek to raise capital by selling off assets and buyers from emerging markets move into untapped sectors.

Firms were most likely to merge in five situations, the study noted: after financial struggles have crippled balance sheets; before market values begin to escalate once again; if prices look set to remain weak and there is an opportunity to acquire a rival cheaply; in response to new regulatory demands; and when investment return are persistently low.

Deloitte: "*The 2009 Insurance M&A Outlook: Opportunity in an Uncertain Environment*." June 2009.

Previously, when credit was cheap, it made good business sense to buy a company (typically with debt featuring strongly in the mix) and then re-sell it at higher value to another buyer – also financing the purchase with large elements of debt. However, this is no longer the case.

Following the credit crunch, finance is in short supply and may not ever return to its recent availability, so many businesses will have to look to their own resources to pay for the deal as well as handle the subsequent costs coming from the merger and integration. For listed companies, the equity markets would once have rewarded such strategies, but now are taking a much more risk-averse view. The same applies to trade purchasers and private equity finance too.

A related point is that in the current climate, which may turn out to be with us for quite some time, it is going to be hard to achieve value from rising asset prices, except where they have been gained at a genuine bargain price. The equity markets are rewarding businesses that are cash generative and reducing debt, not those that are acquisitive. In this market, small mergers that can be quickly and successfully integrated, probably bringing valuable intellectual property or reach, are much more likely to meet the approval of investors than large, costly mergers that engulf huge amounts of time and resources to digest.

> In spite of increased activity in the capital markets, industry figures have urged caution when approaching big deals. Dieter Turowski, European head of M&A at Morgan Stanley, argues that the market faces at least 18-24 months of quieter activity based on past cycles. "We have reached the bottom, but recovery will be slow and fragile" he said, although the fundamentals of the market now appeared stronger. "One encouraging sign is that we have incredibly open bond and equity markets. That means investment-grade companies can finance their deals and even resurrect some of those which were put on hold because of the turmoil in capital markets."
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> Dealogic, "*Global M&A in H1 2009*", June 2009.

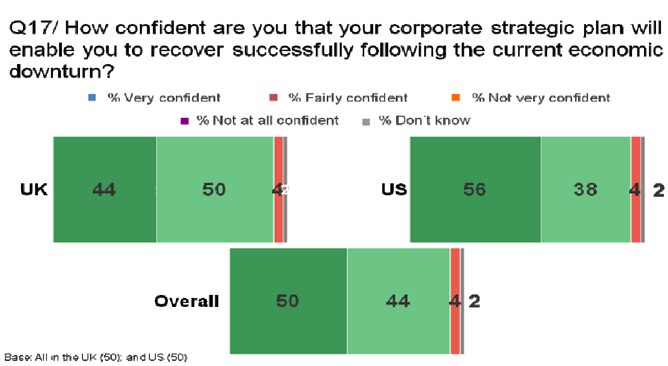
Corporate strategic plans – big ambitions for the recovery

The recession has certainly provided a major impetus to strategic thinking for many firms – only two percent of businesses surveyed in the manufacturing sector had not given their corporate strategic plan a significant review in the previous year. The typical plan looked forward three or five years, and was either under review (30 percent) or recently revised (45 percent had completed a review in the past six months).

Our experience is that a clear determinant of whether a business succeeds is "is there a clear plan, is the leadership team committed to achieving it, do people at every level of the organization understand what they need to do to achieve it?".

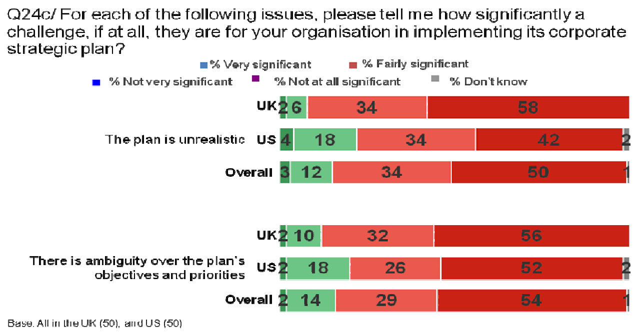
Plans that are long, complex and/or overly detailed are much harder to operationalise. Length and complexity provide plenty of opportunity for misunderstanding over intent and priorities.

For instance, recent research for MR by Ipsos MORI revealed that while executives at large manufacturers were typically happy with the corporate plan, there was concern over whether it would work if economic conditions continued to get worse. Equally, many of these senior executives were concerned about the ability of their organizations to execute the plans effectively.



Base: senior leadership team members in 50 American and 50 British large & mid-sized manufacturers. Research conducted by Ipsos MORI for McKinney Rogers earlier in 2009.

We find operational lethargy usually comes from a cultural issue within the company, and there is a clear tell-tale sign for the CEO – their company struggles to do anything at all with pace! This is generally accompanied by staff having the belief that “we can’t make decisions quickly here” - which ends up being a self-fulfilling prophecy. Another sign to look for is confusion around new products, with such companies launching products or services that haven’t been properly communicated throughout the organization: for instance marketing has done all the literature, the product is ready and launched, but the sales staff have not been trained.



The tell-tale signs of a lack of clarity about the plan typically show themselves through functions taking a different interpretation over what is meant and the priorities. Misalignment due to competition between organizational silos is another strong sign of a lack of clear direction and focus from the senior leaders, and example indicators of this are ‘pet projects’ being furthered even though they are clearly not supporting the plan’s priorities and direction.

What can the chief executive do about such intractable problems? One approach that we find works well in similar circumstances where we have been involved – both to get areas cooperating and to instill the willingness to make (the right!) decisions amongst employees - is taking more of a ‘campaign planning’ approach. Here the CEO starts with end state they desire and then works back from there – involving all the relevant stakeholders from an early stage to ensure engagement and buy-in.

Can management deliver the plans for the recovery?

There is no doubt given the financial data and sentiment of CEOs the McKinney Rogers team have spoken to recently that the recovery will start soon, so now is the time for business leaders to act if they are to win the recovery too. Those that wait for the recovery to be irrefutable will already have lost their share of the opportunities the next 18 months will present.

Great generals and great business leaders think about the future battles and leave the current ones to their deputies to win. Business leaders, whether running FTSE giants or family firms, need to trust their deputies to get them through the last legs of this recession while they set about planning on how to “win the recovery”: many don’t trust their managers, which is a failing in their own leadership!

Before a major assault, generals rest their troops, train them for the mission ahead and plan how they will achieve victory. The same applies with businesses, where there is now an austere culture of long hours, weekend working and penny-pinching to reflect the crisis we have endured.

However, you need refreshed, motivated and energetic executives for success, not the tired and scarred.
Make sure they had a holiday this summer; retrain them when they return; pull some of your best people out of the current battle; don't call meetings at weekends, and have a break yourself!
Make sure you are recruiting the very best talent now while these people are still available.

Most of all you need a fresh and clear vision of what future success *is* for your business, supported by your top team, that can be clearly communicated in a way that excites and energises your people. The next 18 months will be critical, and having a clear vision for where you want to be in five years will allow you to be confident about what needs to happen between now and Christmas next year.

Particularly important is identifying the really key areas where your business needs to make a breakthrough to achieve its success. Is it a successful product innovation, a break-through idea, a new market or a successful take-over? Achieving and exploiting the key break-outs should be the focus for you and your A-Team at the moment.

About McKinney Rogers
McKinney Rogers is a global consultancy with a proven track record for transforming performance. We are a team of highly experienced leaders who are passionate about delivering extraordinary results – taking a unique approach to turning strategy into action by embedding clarity and alignment throughout the client organization.

We do this through Mission Leadership®, which is a combination of practical tools and technology that focus on behaviors, process and performance.

Our ability to transform performance has been recognized by such global clients as Diageo, Gröhe, Pfizer, and Wal-Mart.

www.mckinneyrogers.com
Email: enquiries@mckinneyrogers.com
