

RECESSION: KEY QUESTIONS FOR BUSINESS SURVIVAL AND GROWTH

Quick Points: An overview in 60 seconds

In this executive briefing I will provide key pointers for business managers leading their organisations during a recession or economic downturn. The key pointers, designed to maximise growth opportunities, are:

POINTER #1: DON'T DO WHAT YOU DID BEFORE. It is over 16 years since the world economy went through a period of extended retrenchment. Customers, staff, marketplaces, business processes and organisational structures have changed dramatically during those 16 years. Don't look at what your organisation did during the last recession - it might not work this time.

POINTER #2: COSTS – DON'T SHOOT THE USUAL SUSPECTS. Don't make your first move a cut in sales, marketing and training. You just might create more problems than you may have envisaged.

POINTER #3: COSTS - ASK THE RIGHT QUESTIONS. Costs and expenses have to come under the spotlight when growth is challenging, but looking at the flexibility of your cost base, "frictional" costs and determining your minimum critical size may be the first areas to examine before thinking about cost-cutting.

POINTER #4: THINK OF RECESSION AS A TIME FOR INNOVATION. Perhaps surprisingly, a recession demands product and offering focused innovation - possibly at even greater rates than when an economy is growing.

POINTER #5: TALENT ACQUISITION. A period of retrenchment when competitors launch their job cutting programmes is a unique opportunity to acquire new talent that can take you into new product areas, new geographic markets and possibly most importantly help you accelerate away faster than the competition when the recovery appears.

POINTER #6: RECESSION ISN'T THE ONLY RISK THAT YOUR BUSINESS FACES. A quick look at the World Economic Forum's latest global risk report will reveal that there is more to focus on than just recession related threats.

Remember too that leading during a recession is probably the ultimate test for today's business leaders.

The Days Seem Darker

Breakfasts have become a less than relaxing experience.

I seem to get repeated 'bouts of indigestion. But the problem isn't with the cornflakes. It's the headlines that greet me at the breakfast table:

'Britain facing huge job losses' (Sunday Times February 9)
'America's economy risks the mother of all meltdowns' (FT February 19).

When these headlines first started to appear I hoped that they would go away. But they have not. I awoke on Wednesday 9th July to more disturbing headlines such as:

'UK not OK'
'Ireland's Banks hit buy fear of recession' and
'Fed ready to extend bank aid'.

With the compass needle turning towards a prolonged economic slowdown, it seems wise to focus on answering this question:

'How can we grow our businesses during an economic downturn?'

Faith in the System

Let us assume that we are not staring down into a chasm that spells the end of the capitalist system.

Some, as I do, regard recessionary periods as periods of adjustment – the global economic engine must go into the garage for some repair and reconditioning. It's got overheated. But, if we have faith that the economic system is not fundamentally flawed, the global engine will appear bright and sparkling at some point from the repair workshop and we will need, at the very least, to ensure that our businesses are in a fit state to jump on it and accelerate away as fast as possible.

But research tells us that we might be able to do more, much more, than put our businesses into mothballs, wait and just accept stagnating levels of growth or even decline. The consultants McKinsey and Bain have pointed to the fact that some businesses grow at surprising rates during an economic recession and that agile upstarts could knock established sector leaders off their perches.

So, instead of a time for retrenchment and inwards thinking, it is a time for planning for expansion and sector leadership whilst others adopt more inwards looking, pessimistic, glass half-full, perspectives. If you are a sector leader, the clear challenge is how to defend and extend that position as others just may be planning to chase your tail. On the other hand, if you're an aspiring leader, now may be the time to make your move.

As a business leader, managing a business through a recession may be the most difficult task that you will face. It will certainly be a period when, for the reasons I will explain below, your management credibility will really be put on the line.

Success in a Recession: Some Pointers

Now that recession is (subject to confirmation by the economists) a reality, it might be valuable to set out some pointers for consideration if you want to outgrow the competition.

I'm going to suggest 6 pointers for you to consider if you don't want to put your business in mothballs just yet.

POINTER #1: DON'T DO WHAT YOU DID BEFORE.

This is a piece of general advice to any business facing a crisis. We have an inbuilt instinct when things go badly wrong to seek the security of the tried and tested recipes. What worked in the past will work in the future.

The problem is that the world has changed considerably since the last recession – and I'm talking about the last real period of real economic contraction – which was experienced between 1988 and 1991. Your customers are different, their purchasing behaviour is different, your distribution channels will have changed, your employees certainly are different and have a new set of motivators. The dynamic behaviour of the cost base of your business is, or should be, substantially different.

Finally, in the late 1980's we were only just thinking about the new emerging economic markets such as India and China.

So going back and looking at what worked before might not be the best thing to do. You can be sure, however, that many of your competitors will do just this – look back to the past.

POINTER #2: COSTS – DON'T SHOOT THE USUAL SUSPECTS.

This is very much related to my last comment. Costs will, and should, come under the spotlight when growth gets more challenging. But be careful of shooting the usual suspects as your first move.

The 'usual suspects' for cost cutting are:

- (1) New product development, R & D
- (2) Marketing
- (3) Sales
- (4) Training and staff development
- (5) Hiring – imposition of the ubiquitous 'headcount' freeze or reduction target. I can almost hear the e-mails whizzing through cyber-space – *'No new hirings or promotions to be made without the personal approval of the Chief Executive'*.

Initially, these look like sensible moves that will help to guard the bottom line.

Yes, there may be some short-term gain and you can demonstrate that you are doing something, but the first four of the above cuts will reduce the ability of the business to at least hold its own in a deep recession. Remember, the last time that we had a real recession was probably in 1988 and real economic growth was not restored until 1992. How are you going to survive such a length of time – possibly up to four years - without new products and a stripped down marketing and sales capability?

The last recession also brought with it a new word into usage - "*downsizing*". But downsizing brings with it considerable risks. Research from the 1980's tells us that downsizing can be an uncertain process. For example, looking at research from the 1980's, about 1 in 3 firms that downsized experienced productivity reductions.

There are other problems too with across the board headcount reductions that include:

- (i) Decreases in employee motivation and commitment to the organisation.
- (ii) Decreased levels of work effort on the part of surviving employees.
- (iii) Working atmospheres or "cultures" characterised by low levels of trust and high levels of insecurity.
- (iv) The appearance of the "survivor sickness syndrome" where symptoms include decreased creativity, increased fatigue and importantly risk aversion.

So a quick fix could produce longer-term problems.

If we're looking to the past, then the 1990's was the decade that delivered a second new word into our business vocabulary – "*outsourcing*".

In a cost pressured environment, outsourcing may seem tempting – and could be a viable option. But ask yourself three questions before you take the outsourcing decision.

First, where in the value chain do you really deliver your competitive uniqueness? Chances are, that this will be in the customer interaction process.

The second question is – how do you get your ideas to innovate – where does your innovation trail start? As we will see, hard times are a period for innovation. So beware of outsourcing (a) the source of your uniqueness and (b) your source of new ideas.

But there is one final question to ask before you press either the outsourcing or downsizing buttons and that is *'Where is my organisation's memory?'* - a very serious question and not the joke that it may first appear to be.

My view, having worked with many organisations, is that when the costs are cut or outsourced, so is the organisation's memory – especially the experience gained in entering new markets and developing new products.

In the 1990's there was a view that middle management didn't do very much. It was only when these managers had gone that organisations recognised their real value – middle managers held the memory of past experiences and how things were done. In other words, middle management retained the understanding of how the organisation grew organically in the past. The last thing that you want, when the recession ends, is an organisation that is good at running a "tight ship" but that has forgotten how to innovate and grow organically.

This is a big trap and one that many organisations fell into in the early 2000's economic dip.

POINTER #3: COSTS – THE QUESTIONS TO ASK.

I will side with the Finance Director and agree that costs must be closely examined when times are difficult, but before sharpening the financial scalpel, consider these questions:

"What is our minimum critical size?" A key question for any business facing a tougher environment. It may be a lot higher than is commonly thought. Consider how it could be reduced without impacting the core capabilities of your organisation.

"How can we reduce the incremental costs of organic growth?" A fair few businesses don't know what the incremental cost of their business is – the additional costs associated with putting that one extra piece of business on the books - let alone how those costs could be minimised. The key issue to crack is just how to minimise these additional costs of doing business. The web has had a major impact or should have had a major impact on the cost structure of your organisation. Many insurance operations have used web technology to rid themselves of costly labour intensive processes, like issuing new policies, that don't add much in the way of differentiation from their competitors. The point is that in excising these processes, the incremental costs of growth have been reduced and the cost structure of these organisations has been made more flexible.

"What is our exposure to 'frictional costs'?" A favourite area of mine. My definition of frictional costs includes:

- (a) Costs associated with duplicated activities inside the organisation.
- (b) Costs associated with the same activities that take place in your business and elsewhere in the value chain. Look carefully at the processes that your suppliers and distributors undertake. Are there duplications?
- (c) Costs associated with processes and activities that were historically important but now don't add real value for key stakeholders. Think carefully about this one. The last decade is full of examples of how technology – and notably the web – has changed the importance of strategic investments. I call this the 'Amazon' effect. Traditionally, bookstores needed well-positioned, large and expensive retail outlets. Amazon changed all that – offering better pricing and vastly increased selection – rendering an expensive strategic asset – a chain of prime location retail outlets – into a strategic liability. Instead of cost reduction, the real question to ask is how could you change your competitors' strategic assets into strategic liabilities?

If your COO really understands your industry's value chain you should get a fast view of what your frictional cost exposure really is.

POINTER #4: THINK OF RECESSION AS A TIME FOR INNOVATION.

If we are to learn anything from research then it is that, paradoxically, a period of recession means that it is time to innovate and here I'm talking about customer focused innovation – not internal or cost focused innovation that we've just been talking about.

In terms of innovation, there are three inter-related questions to address:

- (1) *How can we broaden the range of products that we supply to our customers?* Recessions are a time for developing new and improved products. Your current customer base is "warm", they know you and you know them. A central first task is to try to broaden what you offer to your current customers. – and this means being good at product development.
- (2) *How can we broaden the range of customers that we deal with?* Can our products be marketed, possibly in their current or an altered state, to new customer segments or new geographic markets? Can we improve the way we reach out to customers? Are there new routes to the customer?
- (3) *Will our customers' needs change during a recession?* The current downturn has spawned a new phenomenon, called the "Aldi Effect". We can take a lesson here from the experiences of the UK's Marks and Spencer. Their retail food operation has just taken a hit in the current downturn. Cash strapped consumers are moving away from expensive ready cooked meals and thinking about buying the cheaper substitutes instead of the expensive, luxury ready prepared meal that is the mainstay of Marks and Spencer's offering. Marks and Spencer's competitors, particularly Tesco, offer a full range of raw ingredients and cheaper ready meal substitutes. Other operations that can help consumers "trade down" are benefiting too. Take the pizza takeaway chain Domino's. Reporting their 6 month results to the end of June 2008, Domino's notes that sales to its existing customers have contracted, but sales to totally new customers had risen by around 20%, as more affluent customers, that would usually have dined out regularly, adjust their spending habits.

Marks and Spencer don't have that flexibility currently to move their offerings. The result is loss of customers to competitors. Customers that might be hard to recover when economic times get better.

So, we need to be innovative to keep up with changing customer demands and needs. As we have seen, you can be sure that your customers' needs and buying behaviours will change during an economic recession. The challenge is not to lose your hard won customers to competitors who might just keep them for the long run.

POINTER #5: TALENT ACQUISITION

Research tells us that businesses that grow during a recession are good at spotting attractively priced potential acquisitions.

But there are other unique opportunities for acquisition during a recession. When competitors engage in headcount reduction programmes people - or talent - becomes available. Some see this as a rare opportunity to acquire the skills to:

- (a) Push into product areas where demand is growing, not contracting
- (b) Expand geographically and
- (c) Strengthen their position to move quickly, faster than the competition, when the economy recovers.

POINTER #6: RECESSION ISN'T THE ONLY RISK – THERE ARE BIGGER ONES.

Rather than look at the next economic forecast, take a look at the 2008 Global Risk Network report published in January by the World Economic Forum. When you've downloaded it, move to look at the illustration on page 23.

Now ask yourself - Did your organization consider these risks when preparing its business plan? Have you considered a scenario that embraces these factors? Merely taking a "monocular" view of risk and the outside world may prove to be the biggest future failing for many businesses. There are other threats out there to your business than just an impending recession.

One Last Point

Finally, we also have to consider the cultural impact of the moves that business leaders take during a recession and the question, I am afraid, of leadership credibility.

Employees will be worried about their future earning streams and whether or not their homes and families are safe. As is usual in times of crisis, employees will be looking to top-level leadership for hope and guidance.

Finally

I hope that you have enjoyed this briefing. In view of the importance of management and leadership during an economic recession, I have started a briefing series in my blog on this subject.

You can find more on the website or e-mail me using the link below. I enjoy personally helping businesses - some of the work I undertake includes:

- § Forward looking business scenarios – what are your future challenges?
- § Facilitating board level strategic reviews, with a particular emphasis upon the definition of tomorrow's competitive environment
- § Design and implementation of Balanced Scorecard performance measurement systems
- § Research to help identify what potential capital providers will look for in your business plan
- § Training: Strategic Thinking, Scenario Planning, Performance Measurement and Strategic Change Workshops.
- § Product portfolio assessment. Helping the business to define the optimal product portfolio – balancing future competitive conditions with the probability of achieving future planned performance
- § Communication programmes
- § Organisational audits – assessing the innovative capability of your organisation

Best regards,

Robert Davies