



High performance. Delivered.

This article originally appeared
in the October 2009 issue of

Outlook

The journal of
high-performance business

High-Performance Business

Mastering change to achieve high performance

By Caroline Firstbrook

Global business reality has been fundamentally and permanently altered by economic and financial disruption. The nature and degree of the transformation will vary across industries. But as they consider their response, all executives must master five dimensions of change.

- Consulting • Technology • Outsourcing

Wall Street icon Lehman Brothers—the largest bankruptcy in history. Iceland, a developed world sovereign state—flirting with insolvency. Abu Dhabi's International Petroleum Investment Company—snapping up stakes in troubled energy, chemicals and construction companies in Spain, Germany and Canada.

What's going on here?

The credit crisis and accompanying global recession have fundamentally changed the business world. As a new economic and commercial reality emerges, executives must reexamine conventional wisdom about how to succeed and, in many cases, abandon it.

How will this new reality affect business in three areas critical to success—the customer, competitive dynamics and the prospects for growth? And what are the implications for how managers configure their businesses and lead their people?

The customer is king

Customer values and buying behavior have changed, often dramatically, across most industries. How permanent will these changes be, and what opportunities does this create to respond to these new needs and win market share away from the competition?

New buyer values

Frugality is cool. Examples abound of the newfound popularity of thrift, including non-cash bartering clubs, the return of do-it-yourself and the widespread phenomenon of trading down to more value-oriented retail formats and offers. Conversely, conspicuous consumption is no longer fashionable, as signaled by the growing anxiety in the luxury goods sector.

This fascination with thrift will likely persist for three to five years after the recovery, for several reasons. First, consumers who amassed mountains of debt, confident that the value of their homes and other investments would continue to rise, now need to reckon with their creditors; disposable cash will be tight. Second, as they retire, the increasing numbers of older consumers will have less money to spend. Finally, higher tax rates, lower asset values and the elimination of bonuses will constrain the spending of even the wealthiest consumers.

With less to spend, buyers will choose more judiciously. They will increasingly look for products and services that are more closely tailored to their needs. As a result, companies will have to invest in more sophisticated approaches to customer segmentation, and use this information to develop genuinely differentiated offerings.

Durability will also increase in importance, as customers hold on to products longer. For example, the average age of trade-ins for US cars rose to 76 months at the end of 2008, up from 68 months in the fourth quarter of 2006. While this has been caused in part by the shortage of credit for new vehicle purchases, it also reflects improved quality; cars once replaced at 100,000 miles can now remain on the road for 200,000 and more. Thus, instead of purchasing new cars every three to five years, customers may choose to extend ownership—perhaps even keeping vehicles until they're ready for the junkyard.

Values such as environmental sustainability and corporate social responsibility are likely to grow in importance as consumers reject the indiscriminate consumption patterns of the past.

Other values, such as environmental sustainability and corporate social responsibility, are likely to grow in importance as consumers reject the indiscriminate consumption patterns of the past and become more selective in their choices. A growing number of companies are already investing in developing their green credentials, and with activist groups determined to turn the spotlight on the worst offenders, this has become an increasingly visible measure of corporate performance. Meanwhile, growing opposition to exploiting fur-bearing animal species is hitting the already troubled luxury goods sector.

Similar changes will affect industrial buyers. The present, pervasive emphasis on cost management will lead to wider adoption of professional purchasing practices—reverse auctions and the use of specialized third-party procurement services, for instance—and persistently higher levels of price sensitivity across all industries. Continued tight credit for companies of all types may also lead to an increased interest in new ownership models, replacing outright ownership with, say, “pay-per-use” models.

For example, more and more airlines are using performance-based logistics—based on the “Power by the Hour” approach to aircraft-engine ownership pioneered by Rolls-Royce—which promises a fixed cost for engine flight hours over the life of the contract. Meanwhile, governments in the United States and the United Kingdom are contracting for military aircraft and other equipment on an availability basis, leaving manufacturers responsible for supplying spares and other services on demand.

Companies in a wide range of industries will also seek opportunities to share capital investment

costs and risks by creating third-party joint ventures that allow direct competitors to share common infrastructure at a lower cost. This is already happening in newspaper printing and mobile telephony, where common networks and infrastructures have increasingly become the norm.

Third-party suppliers of such services as billing and collections, now serving multiple competitors in the same industry, are likewise becoming more important players. As companies look to reduce costs, third-party suppliers are expected to provide a wider range of offerings, including sales, customer service and IT infrastructure, freeing up cash and leaving businesses to focus on their core strengths.

Tapping into emerging consumers

All countries and regions are not created equal when it comes to the impact or aftermath of the recession. Developed Western economies, coping with the consequences of the meltdown in financial markets, are likely to experience slower growth, for a longer period. Although the slowdown in global demand has constrained expansion in emerging markets, the continued growth of the middle class in India, Brazil, South Africa, China and other developing economies will provide an important source of new demand for multinational companies.

For example, retail sales in China have remained much stronger than those of other big economies this year, with robust spending coming not only from the traditional high-growth cities clustered around the Yangtze and Pearl River deltas but also from inland and lower-tier cities, as the country’s growing middle class continues to flex its economic muscle.

New competitive landscape

Entire industries will undergo wrenching and perhaps lasting changes as a result of the downturn. How might power shift between buyers and suppliers? Who will the new competitors be, and how will the rules of the game change?

Shifting power in the value chain

In many industries, imbalances in supply and demand (resulting from underinvestment during the recession) will create price volatility as demand returns. For example, the World Steel Association predicts a global drop in steel demand of 15 percent in 2009, driven by more than 25 percent declines in Europe and North America.

Such spikes will not be limited to commodity industries. Shipbuilding and aircraft manufacturing are just two industries where a slowdown in demand and a consequent reduction of manufacturing capacity is likely to create shortages and push up prices in the medium term. In the first quarter of 2009, Airbus, the commercial aerospace division of EADS, secured only eight net new orders (after cancellations), down from 395 net new orders in the same period in 2008. Although it has a substantial order backlog to deliver against, Airbus recently announced a modest reduction in output for later this year and predicted further cuts to come.

The specter of failure among suppliers may force downstream customers to buy them out in order to secure access to resources that are scarce or difficult to replicate. Supplier consolidation and bankruptcies could create additional problems for buyers, shifting the balance of power and nullifying established rules and agreements.

As part of its restructuring plans, Chrysler Group is canceling contracts with 800 of its 3,200 dealers in the United States, for example,

and General Motors Corp. has announced plans to end franchise agreements with 1,100 US dealers. In better times, this would have meant big payouts. When GM announced the closing of its Oldsmobile division in 2000, it had to pay more than \$1 billion in compensation to the dealers.

Looking downstream, changing customer circumstances will ripple back up supply chains, forcing otherwise healthy companies into difficulties from which many will not recover. For example, makers of electronic components have already felt the impact of reduced demand for consumer electronics, and a similar pattern has emerged upstream for automotive manufacturers. In the publishing industry, plunging advertising revenues have accelerated the decline in profitability for newspapers and magazines, bringing many to the brink of insolvency.

New competitors

Bankruptcies and financial distress will change the faces of many industries. In some cases, this will result in diminished capacity, potentially improving returns for those companies that remain in the market. However, capacity may also simply change hands, often at fire-sale prices that allow new entrants to compete from a much lower cost base.

Meanwhile, attractively priced acquisition opportunities will likely draw new investors into Western markets. Several emerging-market multinationals have already demonstrated their inten-

tion of using M&A as a basis to extend their footprint into the more profitable markets of the developed world.

China's Sichuan Tengzhong Heavy Industrial Machinery Co., for example, has tentatively agreed to purchase GM's Hummer brand of large sport utility vehicles and pickup trucks, while the Industrial and Commercial Bank of China is slated to buy a 70 percent stake in a Canadian subsidiary of The Bank of East Asia, giving it a valuable foothold in the Canadian market.

Investors in distressed debt also provide a mechanism for recycling troubled operations. Firms such as Apollo Investment Corporation, Oaktree Capital Management and Centerbridge in the United States, for example, can acquire companies at a fraction of their previous value, often for as little as 20 to 30 cents on the dollar, and then bring them back to market at a profit.

Accelerated consolidation is widely expected in many industries, including construction, energy, banking and retail, as the downturn forces companies to seek partners in order to survive, and depressed asset prices make deals more attractive for the strongest companies. This, too, will change the game for existing players, allowing the largest companies to pursue scale-based cost savings and offer benefits to customers that smaller players cannot hope to match.

New rules

Increased regulation will be part of the new reality for many industries, as governments seek a more active role in managing such key industries as banking, housing, manufacturing and health care. These range from proposed cap-and-trade rules designed to control the industrial emission of greenhouse gases to sector-specific actions such as carbon dioxide abatement measures in the auto industries of Western Europe and the United States. The end result will be added costs and new constraints on what companies can and cannot do.

On the positive side, the continued movement toward the harmonization of global regulatory standards in industries as varied as automotive (emissions controls and safety) and telecommunications should help reduce costs for global players.

Chronic volatility

Exchange rate fluctuations will continue as governments seek to fund substantial investment in economic bailouts. Prices of a wide range of commodities, as well as services such as shipping and transportation, will swing up and down as the market seeks a stable balance between supply and demand.

Investors will remain skittish, even as economies emerge from the downturn, and this will exacerbate higher volatility, resulting in faster and more extreme reactions to changes in key economic indicators and the continued erratic behavior of stock markets.

Prospects for growth

The heady days of ready cash and loose credit already seem like distant memories. How will companies sustain their ability to invest in growth and choose where and how to grow?

The ability to invest in growth and the choices of where and how to grow will widen the gap between winners and losers.

Organizations may need to consider different capital structures and find new sources of cash to fund innovations, new capacity, enhanced capabilities, geographic expansions or acquisitions. Managers must also revisit their plans and prospects for organic growth, and adjust these to fit with the new customer reality.

Beyond these fundamental questions, executives will need to reassess their portfolios of products and services, asking whether they still make sense in light of changing customer needs and competitive dynamics. This may reveal gaps that must be filled, or opportunities to divest businesses that are either not contributing to the company's core strategic thrust or failing to meet minimum performance requirements. With a smaller pool of investment cash, companies will need to make difficult choices about how to allocate spending between developed and emerging markets, and between organic growth and M&A.

The ability to invest in growth and the choices of where and how to grow will help widen the gap between winners and losers in the future. Winners will continue to invest in R&D through the downturn; have capital available to take advantage of M&A opportunities at fire-sale prices; respond to changing customer needs with innovative new offers; and establish early, strong positions in emerging markets. These investments will create disproportionate advantages for these companies, propelling them to stronger performance coming out of the downturn.

In the future, companies in capital-intensive industries like telecommu-

nications, industrial equipment and natural resources that lack sufficient credit or deep pockets will have to rely on more expensive equity capital to fund growth. The dramatic fall in the value of pension funds will also create a burden for retiree-heavy companies and constrain their ability to invest in new growth.

In one telling example, the UK telecom operator BT Group announced in May that it will nearly double the amount paid into its retirement scheme, from £280 million in 2008 to £525 million, for each of the next three years, in response to an expected £4 billion shortfall in its pension fund. These payments will consume almost a quarter of the company's projected free cash flow over that period.

To raise cash and pay down debt, some companies will have to sell off assets, creating opportunities for more financially secure players. The overall level of M&A activity should pick up in late 2009 and accelerate in 2010 as company valuations stabilize and financially secure competitors move to take advantage of low asset values.

A number of noteworthy deals have already emerged in 2009. In January, Pfizer announced plans to acquire Wyeth for \$68 billion, while in June, Fiat acquired key Chrysler assets in a deal brokered by the US government.

As a result of these and other changes, the average amount of leverage for all companies will drop, while favorable emerging-market growth rates will continue to attract investments away from slower-growing developed economies.

New business models

New challenges require new ways of operating. How will companies adapt to the new competitive reality, and what will this mean for business models, governance and skills?

These dramatic changes in customer behavior, the competitive environment and the outlook for growth will have a significant impact in two key areas: how companies operate and how they deploy talent at all levels of their organizations. As a result, companies will need to acquire new capabilities and rethink what activities they should undertake, and where.

In an environment where external funding continues to be in short supply, companies will need to consider new ways to preserve cash. Outsourcing and offshoring will likely experience strong growth as companies look to exploit labor cost differences and tap into the superior operating efficiency of specialist players. As an illustration, a recent survey of British multinationals revealed that more than 80 percent of them are considering moving at least one major business function overseas in the next five years to cut costs.

As companies expand across the globe, it will become increasingly critical for them to exploit scale more effectively, both in back-office activities such as human resources management, finance and purchasing and in front-office applications like package design, marketing analytics, and advertising and promotion. Rather than duplicating scarce skills in each region, global centers of excellence enabled by information technology will allow the most advanced players to deliver world-class capabilities to all geographies.

Other factors will influence the choice of business models. Increasing numbers of cross-border deals will create new challenges in integrating

across multiple cultures, customers and competitive environments. This is particularly true for companies straddling developed and emerging markets. More generally, as companies expand internationally, the need to exploit global scale while simultaneously customizing both offerings and governance to fit the needs of very different markets will require new structures, processes and skills.

Technology will continue to transform the way business is done, facilitating greater mobility and the geographic dispersion of activities. A growing skills shortage in the West and the relative abundance of those skills in emerging markets such as India and China will cause companies to move increasingly sophisticated activities offshore—including major segments of the R&D value chain.

Better risk management

The downturn will drive a need for new skills in risk management and regulatory compliance. For example, to avoid a repeat of the last crisis, banks will need to establish stronger and more objective governance policies regarding risk. Two Spanish banks, BBVA and Banco Santander, have led the way by establishing risk committees, which include strong representation by non-executive directors, to review new loans and discuss broader risks. Many observers have credited this process with sparing the institutions much of fallout from the credit crunch.

As volatility continues, more companies in more industries will need to embrace hedging and forward buying strategies for a range of commodities to manage these risks and protect future profits. And securing access

to scarce resources will become more important once growth returns.

As one example of new hedging strategies, China, South Korea and the Gulf States—countries with excess capital but insufficient agricultural capacity to meet

their needs—are buying or leasing farmland abroad. This protects them against future price volatility and, more important, guarantees the safety of their food supply in a world where the threat of export bans by producing countries has become much more real.

The talent agenda

The rapidly changing environment has presented new challenges to leadership and the talent agenda. How do leaders need to adapt to create greater responsiveness in the face of high volatility? How can critical talent be fostered through the downturn, and how can lost skills be rebuilt once growth returns?

Adapting to crisis-driven change will require companies to nimbly shift direction as needed, abandoning outdated plans and thinking and redirecting efforts into new and more promising areas. As a result, the quality of leadership will become more important than ever in determining an organization's survival. The downturn will pose difficult and often painful choices for leadership: how much should we cut and what should we preserve, where should we invest scarce resources for growth, which markets or activities do we walk away from, and how do we lead teams confidently through change?

Corporate boards should replace weak leaders who fail to make good choices or articulate a vision that their organizations find compelling. However, where leadership is doing a good job, companies will likely ask some CEOs and leadership teams due for retirement to stay on for an extended period to steer their organizations out of trouble.

This could create a challenge for the next generation of leaders, who might prefer to pursue new opportunities where they have a greater chance of promotion to the top. Succession planning in such situations

must therefore take into account the potential for a gap at the critical senior levels just below the CEO.

The competition for talent will reignite following the downturn as companies, eager to rebound, scramble to recruit needed skills and rebuild capacity lost to the recession. The challenges will be particularly intense in industries where specialist skills have been lost—the financial sector, for example—in some cases permanently, as workers have emigrated or changed career paths.

In Western Europe and Japan, an aging workforce has exacerbated the skills shortage, forcing governments to consider either increased immigration or outsourcing. Talent flight has also become a major problem in these regions. Germany, for example, is losing increasing numbers of skilled professionals as well as workers. In 2008, more than 3,000 doctors left the country, bringing the number of German doctors working abroad to almost 20,000.

Return of the Boomers

One phenomenon of the downturn has been the return of Baby Boomers to the workforce. Between December 2007 and May 2009, 5.7 million

For further reading

"Creating an agile organization," *Outlook*, October 2009

"Outsourcing: A new value proposition," *Outlook*, October 2009

"India: The innovation advantage," *Outlook*, October 2009

"How to make the most of the Great Consumer Trade Down," *Outlook*, June 2009

"How to organize for new realities," *Outlook*, June 2009

"Does your company have an IT generation gap?" *Outlook*, January 2009

"China rising," *Outlook*, May 2008

"A bold new look for global sourcing," *Outlook*, September 2007

"Why winning the wallets of China's consumers is harder than you think," *Outlook*, September 2007

jobs were lost in the United States, bringing total unemployment to 8.9 percent—at that point, the highest level in 25 years. However, from December 2007 to December 2008, the number of Americans 55 and older in the workforce rose by more than 870,000.

With deflated retirement accounts and lowered expectations for early retirement, more Boomers have decided to remain in the workforce. The return of growth may prompt many of these workers to leave the workforce, aggravating the skills shortage in some industries.

Companies that recruit top talent during the downturn can gain long-term advantages. With fewer opportunities available to them, new graduates have been widening their job searches. When recruiting in the City of London slumped in late 2008, some companies that traditionally struggled to attract the best graduates saw an opportunity. Aldi, the discount grocer, has seen a 280 percent rise in applications, and has increased its recruiting target by 50 percent to take advantage of the exceptional hiring market.

Longer term, even if the financial sector regains some of its lost luster and lures away some of these highfliers, employers such as Aldi will be better placed to market themselves on college campuses by leveraging these alumni.

Becoming a clear employer of choice will depend on honing an employee value proposition that appeals to the younger generation. In 2008, McDonald's became one of Britain's first employers authorized to award its own nationally recognized educational certifications. The company began offering courses in basic shift management that are the equivalent of the United Kingdom's A-levels (an

Advanced Level General Certificate of Education). More than 2,500 people have signed up for the course, including several hundred university graduates eager to undertake this hands-on training.

Companies will also need to explore new employment models to attract and retain the best and brightest younger workers, who often have different perspectives on careers and work than their parents. Research indicates that many so-called Millennials (those born between 1980 and 2000), for example, have a strong urge to achieve a work/life balance; as a result, they may choose more flexible job structures and benefits that differ from those traditionally offered. For instance, Accenture research shows that Millennials want to use consumer tech (smart phones, MP3 music players), social networking and open-source software while at work.

Haves and have-nots

Talent shortages will be felt most urgently among trained, educated and experienced knowledge-worker positions. In other industries, however, shifting economic power may lead to the permanent loss of jobs.

As of June 2009, the US manufacturing sector had accounted for more than 25 percent of the country's job losses since the beginning of the recession. Many of the losses were among automobile manufacturers and related suppliers. Without government incentives and other forms of intervention, many of these jobs may move to lower-cost locations, creating the threat of large-scale and long-term unemployment in those industries.

The gaps in contribution, productivity and pay between highly trained, educated and experienced knowledge workers and a rapidly expanding pool of available but largely unskilled

workers could drive greater labor unrest. This in turn could compel governments to act; possibly to introduce regulations that limit the differential treatment of employees, for example.

Finally, ultra-low-cost-labor countries—Laos, Cambodia, parts of Africa—will see significant business interest and growth as multinationals seek to manage labor costs when the global economy recovers.

The downturn has already precipitated major changes in buyer behavior, industry structure and competitive dynamics, and has opened a gap between winners and losers that is likely to grow substantially. Success in the eventual upturn will depend on leadership's ability to anticipate and react to these and succeeding changes and to make wise, often very difficult choices about how and where to invest, how to configure their operations, and how to preserve and rebuild key skills once growth returns.

About the author

Caroline Firstbrook is the managing director of Accenture Strategy in Europe, the Middle East, Africa and Latin America. Ms. Firstbrook has extensive experience in M&A strategy and target evaluation, merger negotiation, positioning for privatization and new market entry strategies across a wide range of industries. In addition to her consulting experience, she spent five years as an entrepreneur, setting up and later selling Easychem, an Internet retailer of crop inputs to farmers, and partnering with life sciences company Syngenta to explore biotech venturing opportunities. Ms. Firstbrook is based in London.

caroline.firstbrook@accenture.com

Outlook is published by Accenture.
© 2009 Accenture.
All rights reserved.

The views and opinions in this article should not be viewed as professional advice with respect to your business.

Accenture, its logo, and High Performance Delivered are trademarks of Accenture.

The use herein of trademarks that may be owned by others is not an assertion of ownership of such trademarks by Accenture nor intended to imply an association between Accenture and the lawful owners of such trademarks.

For more information about Accenture, please visit www.accenture.com