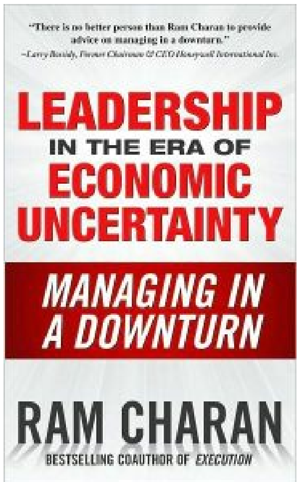

Book Leadership in the Era of Economic Uncertainty

Managing in a Downturn

Ram Charan
McGraw-Hill, 2008

Recommendation

This short, pointed book by one of America's leading management thinkers offers a checklist of to-do steps for managers who are coping with the economic crisis. Ram Charan covers all the bases: the board of directors, chief officers, operations, sales, research and development, and more. He offers direct, unambiguous, actionable advice for managing at each level, including: manage for cash, watch the numbers, know which customers to fire and recognize that annual targets make no sense when demand is unpredictable. Charan's record as a coach to CEOs and as an author of best-selling business books speaks for itself. In this book, *BooksInShort* finds that he more than lives up to his reputation, avoiding jargon, generalizations and lofty theoretical pronouncements to focus on what managers must do now for their companies to survive.

Take-Aways

- Cash is king, especially in a crisis.
- Consider getting rid of some customers and some product lines to reduce complexity, increase efficiency, and conserve cash.
- Be realistic, but be optimistic – fear is paralyzing.
- Let sales and marketing intelligence inform your research and development.
- Crisis creates opportunity because your competitors may falter or fail to invest for the long term.
- Consider setting new sales targets that fit the times.
- The CFO should keep the CEO and other executives aware of how various business scenarios affect the financials.
- Boards of directors need a granular understanding of their companies' cash-focused business metrics and risk management programs.
- CEOs and business unit managers need to manage metrics in near real time.
- Companies that survive the current economic crisis will emerge from it stronger than when they entered it.

Summary

When Crisis Strikes, Covet Cash

In the midst of an economic downturn, monitoring and managing cash are among your most important responsibilities. Know your company's liquidity level every day. Track your daily cash flow and weekly changes in working capital. Make sure that every executive who needs such information can get it. Calculate your cash break-even point and try to lower it. Centralization or decentralization of operations may help, depending on your company's needs. If need be, cut your employee headcount prudently but expeditiously; don't wait for a steep decline in revenue before commencing layoffs.

> "Management challenges don't come any bigger than this. It's not just your business or industry that is in a downturn; the entire global economic system has been wounded."

In the global slump that began in 2007, cash is king; managers confront an unprecedented lack of liquidity. The fate of the American auto industry should be instructive: Major carmakers basically ran out of money. Avoid that kind of wreck. Carefully manage working capital, considering ideas for asset sales and other means of generating cash.

Crisis Leadership

Boldness is a virtue not to be underestimated. Opportunities always exist in economic downturns. Take time to identify and protect your core businesses, customers and assets. Continue to delegate, but stay close and stay informed.

> "Leaders who are realistic about their external environment but still positive and reinforcing in responding to the difficulties will more than likely be successful."

Top managers need to spend more time on the operational details of their businesses. Cut back on outside activities and public events, and spend more time with the suppliers, customers and managers you rely on most. Recognize the strain on your people and prepare to manage such stress-related employee behavior as refusal to share information. Be visible within your company. Hold staff meetings at least once a week and talk to some salespeople daily – not the same ones but different ones each day.

> "In this volatile and uncertain environment, reality is a moving target."

Short-term survival takes top priority in a dangerous economic downturn. Crisis management may require stepping away from existing long-term strategies and instituting shorter business cycles. If no one knows what will happen over the next 12 months, yearly targets are meaningless. Strive for "management intensity," which refers to the depth of your immersion in the nitty-gritty of your business. Managers must grasp operational details in times of crisis and know the facts on the ground: How are consumers reacting, what is happening to suppliers and how does it mesh?

"Six Essential Leadership Traits"

Hard times test even the best managers. CEOs and business unit managers know that the buck stops on their desks. Seeing things as they really are is always difficult, never more so than when circumstances are frightening. Denial is as dangerous as the paralysis of fear. The challenge for top managers is to impress upon their organizations the severity of the crisis while still providing a vision that justifies hope. Be sure you display the following six essential leadership traits for hard times:

1. **"Honesty and credibility"** – Dishonesty dilutes courage, humility and other leadership qualities. Be humble, straightforward, courageous and on the level.
2. **"The ability to inspire"** – Know how to rally your team and, through them, the organization at large.
3. **"Real-time connection with reality"** – This is hard when reality itself is changing rapidly. Gather as much intelligence as you can. Learn new facts and new perspectives.
4. **"Realism tempered with optimism"** – Don't let bad news sink you in pessimism. Keep your focus on possibility and opportunity.
5. **"Managing with intensity"** – Listen to your employees, get in the trenches, show that you are facing facts and work as a team.
6. **"Boldness in building for the future"** – Invest appropriately in the future to prepare your company for the next upturn in the economy.

Sales Force Requirements

Be realistic but disciplined about sales targets and consider setting new targets that are sensitive to the current situation. One company set targets that encouraged its sales force to call customers and press for payments due. The move boosted its cash flow despite a sales slowdown.

> "Annual targets are all but pointless when no one can forecast demand a year out."

Salespeople should be the eyes and ears of your company, evaluating every customer's potential cost or benefit. Handle the termination of business with a customer diplomatically to leave the door open for a possible future relationship.

Growth can be a mixed blessing. Companies need efficient, affordable growth that assures adequate cash flow. On the other hand, companies in contraction can gain strength by ridding themselves of weak, cash-consuming product lines and facilities. Dropping low-performing customers or products can improve cash flow by simplifying operations. Analyze how your customer base and product portfolio affect your company's need for cash.

> "Protecting against a sudden liquidity crunch can mean thinking the previously unthinkable, such as deliberately giving up increases in revenue and market share."

Sales and marketing personnel need to communicate with their colleagues in research and product development. Market intelligence can lead to successful efforts to achieve profitable innovations. One Wal-Mart supplier came up with new packaging, increased Wal-Mart's sales and revenues, and, therefore, could charge higher prices for its products.

"What the CFO Needs to Know"

Chief financial officers routinely communicate their companies' financial condition both internally and externally, but the task is hardly routine in a recession. As the voice of the company in the external financial world, the CFO must communicate clearly, honestly and repeatedly to keep investors and lenders apprised of the company's condition, including its rate of cash accumulation or dissipation.

> "To judge which customers to keep and which to drop, you must have a detailed understanding of how each one affects your business and different parts of your value chain."

Internally, the CFO must tell your corporate managers exactly what is happening with cash and what needs to happen. CFOs guide boards of directors through crises by demonstrating what changes are needed and delivering progress reports frequently. Farsighted CFOs have prepared their co-workers for an economic crisis that may persist for years. Even nonfinancial managers need to understand "how various scenarios would affect the balance sheet, including the potential consequences of a credit rating downgrade."

"You have two major responsibilities that must be met through communication: information flow and motivation."

Operational and capital budgeting processes are subject to change in a deep recession. Stale approaches to executive compensation may need refreshment, too. Cut intelligently if you must trim payroll. Don't vacate positions you may have to refill soon. Make sure the ax falls only once: Recurring layoffs kill morale. Carefully controlling pay and benefits may put your company on a sounder financial footing. With a new focus on cash conservation, the company may find it easier to alter salaries, incentive pay and benefits. Hire staff members for your service business according to demand in order to meet customers' needs. Find cash-wise ways to reward staffers whose morale has suffered the impact of lagging 401(k) plans and fear of unemployment.

Investment and Innovation

Calculate and lower your company's cash break-even point before your revenues slide. Think systemically about the impact of your decisions and actions in each area of your operations, both in terms of your company and its various constituencies. Consider your policies in these areas:

- **Maintenance** – Keep spending on regular maintenance; deferred maintenance can be costlier.
- **Capital investment** – Think twice before capping capital investment, a tempting target for cost reduction. Before cutting planned capital projects, re-evaluate them in the context of their long-term value. The downturn won't last forever, after all. You may be in a stronger competitive position if you invest in new technologies and your competitors, practicing false economies, do not.
- **Retail and wholesale** – Product line simplification is a possible source of positive cash flow for companies that sell a wide array of merchandise. Half of your products probably produce no more than 5% of your sales, so reducing your product line can increase your efficiency. Consider outsourcing operations that are not competitively critical.
- **Manufacturing** – Investigate how closing plants, subcontracting, automating and the like would affect your overall cash position.
- **Branding** – Protect your brand. Adjust prices carefully to conform to its strategic positioning. If you must cut promotional expenditures, do so thoughtfully.
- **Research and development (R&D)** – Revisit and rebalance your R&D agenda. Cut the budget carefully. Identify projects that really matter for the long term. You may need to set new priorities. Treat your research projects as a dynamic portfolio, subject to the same rebalancing discipline that investors use to remix their stock portfolios.
- **Innovation** – Keep seeking disruptive innovations that could reshape your industry. If your competitors focus only on survival, your company can gain an advantage through prudent investment in innovation. Consider forming research partnerships abroad, such as allying with an Asian or Brazilian firm that seeks an American partner, but protect your intellectual property rights.

Suppliers and Other Outsiders

Manage the timing of material purchases and customer deliveries to conserve cash. Shorten reaction times to new orders from customers by forming closer connections with your upstream and downstream supply-chain partners. Accelerate your access to information about trends within your industry. While information technology can help, recognize that some intelligence is available only from face-to-face conversations, not online.

"This is a great time to spot leadership talent by observing how leaders are handling their jobs in different conditions."

Valuable information flows from having solid links with your supply-chain partners. Form collaborative relationships with your suppliers, treat them as partners and try to make the partnership mutually beneficial. Cooperation can help each participant in your company's supply chain meet the common challenge of sustaining adequate cash flow. Find ways to make your company a better business partner by reducing your red tape burden on suppliers and customers. Be transparent and trustworthy. Having respectful relationships with your investors, the news media and government regulators will contribute to your firm's credibility. Inform your investor relations staff about any performance indicators that reflect the firm's new focus on cash.

Direction for Directors

Company performance targets aren't what they used to be. Forget revenue. The cash break-even point is more important now. Directors also should pay close attention to risk factors and how they are managed. Boards need to use new performance metrics because so many older ones no longer apply. The economic situation is so fluid that no targets are likely to hold firm for long. Nevertheless, if management fails to achieve a target, the board must know why.

"Your integrity, impartiality, and objectivity will be tested here. Play no favorites."

Boards can improve cash flow simply by cutting executive pay, but restructuring pay packages may prove wiser. Executive compensation that is largely dependent on a company's stock price going up might make little sense when the stock market is flat. Reconsider such compensation schemes. Because a widespread stock market slide is beyond the control of any management team, expecting them to take less pay as a result is arguably unfair.

"If you're a capable leader, you will have a stronger business after the downturn than you did before."

Directors need contact with their companies' middle managers to know what they are thinking and feeling. That type of feedback can guide the board's decisions about the CEO position, now and in the future. The board should stand behind a CEO as long as he or she has what it takes to steer the company through an extraordinarily difficult period. At the same time, having a CEO succession plan in place is imperative.

About the Author

Ram Charan is the co-author of Execution and Confronting Reality, and the author of What the CEO Wants You to Know. A noted expert on business strategy, he has coached some of the world's most successful CEOs.