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GAINING STRENGTH IN A WEAK ECONOMY: CEO RULES FOR SURVIVAL IN 2009

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The year 2009 has not begun on a happy note for America's mid-market companies. Even the most upbeat CEOs could be disheartened by the daily cascade of negative economic news and forecasts. There's a pervasive lack of what economist John Maynard Keynes called "animal spirits," the expansive optimism that produces risk taking and investment.[i]

The extreme pessimists are probably wrong -- but so probably are the strongest optimists. Recessions usually last longer than anticipated. Nothing in 2009 will be easy.

As CEO of a leading executive services firm, I speak to leaders of mid-market companies grappling with declining revenues and margins, excess capacity, anxious employees and restless investors. Conversations with hundreds of clients and nearly 1,000 of Tatum's business leaders who serve those clients have convinced me that the deepest recession in a generation calls for a stronger response than many companies have mustered to date.

Hunkering down, hoping to ride out the recession and accelerate past competitors once the economy recovers won't work. Only a series of bold steps will help your company survive the financial quarters ahead and get in position for the recovery. You need a new mindset suited to a future that looks very different than it did a year ago. Here's what we recommend.

RETHINK PROFIT

Anticipate Declining Revenues

Acknowledge the assumptions that have guided your decision making may not fit today's realities. Unless you're in a "recession proof" industry like health care or energy, your revenues are probably shrinking. A 10 percent decline in revenue may wipe out the entire bottom line that you were counting on. Make sure you can survive the next few quarters by focusing on marginal, short-term profit.

- Develop forecasts based on optimistic, realistic and worst-case revenue scenarios.
- Formulate contingency plans. Make sure your top managers are on-board with the plans, and are ready to act quickly if revenues decline.
- Identify and monitor your "early warning signals," such as a shrinking back log, a downturn in customer-market indices, or a worsening sales pipeline.
- Be willing to adjust the budget at more frequent intervals than in stable times; for example, quarterly, or even on a rolling basis.

- Keep bankers and investors appropriately informed, and take action quickly when needed.

Identify and Maintain Your Strengths, and Your Best Customers

Identify the strengths that have enabled your success to date, and those that will be important in the future. Which capabilities and skills are most critical? What distinguishes your ability to serve customers effectively?

Identify your highest-margin customers, and understand what you are "doing right" for them. Develop a game plan to protect and build on the strengths that have allowed you to be indispensible to these customers. Rather than cutting costs across the board, think about how you can shift resources to retain these high-margin customers, and attract more customers like them.

At the same time, be creative in how you can add value to the existing offering without increasing cost. For example, one professional services firm I know has added regular briefings to client executives to monetize its intellectual capital.

Decide What You Can Stop Doing, while Systematically Attacking Costs

Companies that create enduring value typically excel at discontinuing what no longer adds value. Make changes in cost structure that will least damage your strengths, and which will hone your value proposition down to what customers really value. Everything must be on the table as you redefine how to provide a good deal for your customers, at a profit to you.

For example, Dell was able to cut prices and gain share by dropping free after-sale customer support.[ii] Customers are now able to pay for the level of support they desire, and no more.

Comb through your cost structure seeking out what's inefficient; what's nice to have but dispensable; what's there because of history, inertia or wishful thinking; what may have worked in the past but doesn't anymore; and what isn't creating value as it used to. Reschedule or cut projects with dubious prospects. Scrutinize everything by asking: will customers pay for this?

Realize the challenges you will face in cutting costs. Most organizations aren't adept at taking costs out quickly as revenues decline, and margins suffer. Even your most hard-headed managers will try to protect their own people first. As your company has grown, your operations have probably become more complex. Take a knife to any complexity that isn't compliance-required or value-adding.

Manage Liquidity As Hard As Profitability

Your company may be dealing not only with negative growth but also with liquidity constraints. During good times you may not have obtained sufficient lines of credit to sustain your company through economic adversity. Trying to maintain liquidity on a smaller revenue base can be crippling.

Every balance sheet dollar has to be turned over faster to contribute to working capital. Maximize cash flow by matching inventories to sales and collecting from customers faster. Take advantage of increased supplier willingness to share risk and to provide favorable terms.

CAPTURE MARKET SHARE

Address New Opportunities Created by the Recession

Recessions reshape industries faster than good times do, creating opportunities for those with the vision and ability to seize them quickly. Studies have shown that companies have twice the opportunity to change their relative position in an industry during a recession compared to growth times.[iii]

For example, as you are cutting costs, think about how you might apply what you are learning to help other companies do so. For example, making compensation more performance-based requires complex computations and tracking. If you have developed this system, could you sell it to others? If you have outsourced payroll to a payroll service, could you negotiate lower rates in return for acting as an advocate or channel partner to help them sell their services to other businesses?

Keep an eye on competitors, and stand ready to capture market share as other players allow cost cutting to damage their service and quality, or fail outright.

New opportunities may also exist to gain new alliance partners, to move into adjacent markets, to adopt new pricing models, or to enter new channels. Some of these opportunities may be created by the failure of competitors, and some may be created by a new customer appetite for solutions that show measurable return on investment or reduce risk.

Acquire Opportunistically

Market valuations are down for strong and weak companies alike, and companies with resources to acquire complementary rivals will earn higher returns than they can with internal, organic growth. Of course, acquire only companies that support your ability to be the best in the world at you do, and work aggressively to capture synergies.

LEAD PEOPLE

Manage Cost and Motivate with Variable Compensation

The prospect of lower, less predictable revenue requires converting as much fixed cost to variable as you can. If you do this right, you'll maintain employee loyalty, manage profitability and spare yourself future hiring and training charges.

Tie compensation to individual or company performance. For example, define an attainable EBITDA target and commit to share a generous piece of it with your employees. If the volatile economic environment causes budget revisions, be sure to rebase compensation as well.

Avoid layoffs with measures such as shorter workweeks, unpaid vacations, voluntary or enforced furloughs, wage freezes, pension cuts and flexible work schedules. Employees whose friends and neighbors are losing their jobs will appreciate these approaches, and will stay motivated.

Imagine the conversations that General Motors and Chrysler are having with their suppliers, putting in play payment terms and contract flexibility issues that were once unthinkable. You may need to do the equivalent with your work force. Making pay for performance work will test your culture, but handled properly, will maintain trust and create the labor cost flexibility to help you weather the storm.

Keep Core Activities In-House, and Outsource Everything Else

Build and protect those "core" capabilities that differentiate you, while aggressively outsourcing anything non-core. Depending on your business, non-core activities may include IT maintenance, human resources administration, benefits and payroll, accounts receivable and payable, manufacturing, distribution or sales. You'll get the benefit of service provider expertise and economies of scale, and will pay only for services you need. The biggest benefit of outsourcing, however, is that it shifts your focus, resources and capital toward serving your clients' higher value needs and building your competitive advantage.

Retain Top Performers

Bear down on return on investment for any billable employees and cut the low performers. Don't make across-the-board cuts. Retain as many of your top performers as possible — those who really add marginal profitability. These are the creative producers who can capture opportunities created by the current economy, the ones you'll rely on to accelerate out of the downturn a winner.

Rethink Customer-Facing Resources

The sales resources that you added to attack a new market opportunity a few years back may now be superfluous, given contracting revenues. Evaluate which sales people are most needed given likely revenue scenarios. Do away with the others, or convert them to commission-only compensation. Convert your definition of operating profit to be sales minus cost of sales minus incentive compensation.

Similarly, the marketing, customer service, and technical support people that you selected to grow revenues may not be the same people you need to take share away from your competitors in a shrinking market. Evaluate return on investment for each position, and adjust resources and skills to fit the new environment.

FIND THE RIGHT VOICE

Create New Metrics
The crisis will challenge your financial management capabilities and your ability to keep a close eye on your key performance measures. Tight economics put a premium on your ability to understand and model the relationships between revenues, costs and margins. As you make changes to your operating model you'll need accurate metrics, for example, to track the performance of sales people who have taken over accounts from those who have departed.

Reenergize an Uncertain Workforce
A downturn is a scary time. Frequent and honest communication will go a long way toward maintaining a calm and motivated workforce. Create regularly scheduled forums to listen to concerns, and to update employees on the state of the company and on their roles in achieving new company objectives. Studies show that employees are motivated far more by a sense of shared purpose than by compensation. Create that shared purpose and reinforce it daily.

Idea banks can be a very effective way of engaging employees to meet corporate objectives. Home Depot did this very effectively in their "Aprons on the Floor" contest. The initiative challenged employees to take $180 million in cost out of the business, with the promise that savings would be poured back into increasing store labor, something that employees knew the company badly needed to do.[iv]

When there is bad news, don't shoot the messengers. It's key for your team to feel that that with creativity, tenacity and hard work, both they and the company can be successful.

Communicate Honestly And Strategically To All Constituencies

Identify your key constituencies and communicate candidly about the tough times ahead, but also paint a picture of the favorable prospects your company will enjoy after you've weathered the current storm.

This is a unique opportunity to review and renegotiate expectations with all stakeholders, including investors. By keeping targets realistic and communicating frequently, you'll manage expectations and build critical trust.

Put It All Together

During the growth years you ran as fast as you could to grow and capture share. The coming months will require clear-eyed expectations, fearless contingency planning and intelligent risk taking. Leading with the right balance of frugality and bold innovation will ensure your survival through the downturn and your emergence stronger than ever.

About the Author

Richard D'Amaro is Chairman and CEO of Tatum, LLC, where he has successfully completed tactical mergers and acquisitions, raised private equity funding, changed the firm's market positioning and developed new service lines to help clients tackle the challenge of executive burnout, turnover and change.

End Notes

[i] **The General Theory of Employment, Interest and Money, John Maynard Keynes, Rowman & Littlefield Publishers, Inc., February 1936.**

[ii] ***Dear Dell: Customer Service Should be Free*, Don Reisinger, CNET (http://news.cnet.com/8301-13506_3-10121992-17.html), December 12, 2008.**

[iii] ***Recessions Call for More Creativity, Not Less*, Kevin P. Coyne and Shawn T. Coyne, Harvard Business Publishing Online, January 31, 2008.**

[iv] **Rallying the Home Team, Jessica Marquez, Workforce Management (http://www.workforce.com/section/09/feature/25/67/25/index.html), July 24, 2008.**