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OLIVER WYMAN

Corporate Finance
Development Services

Managing Profitability During a Downturn: From Triage to Treatment

The global economy is in the hospital, and it would not be surprising if your business should need to make a visit as well. But do you have the information necessary to quickly and accurately perform triage (i.e., determine the severity and urgency of the problem), diagnose the causes, select the right treatment, and position yourself for recovery? Without this information, you are at risk of mismatching the treatment to the illness – the business equivalent of applying a bandage to a broken leg at one extreme or performing surgery to cure a cold at the other.

As discussed herein, business triage involves locating your company on the "crisis slope" that runs from strategic downturn, through profitability erosion, to an all-out liquidity crisis. Once you understand where and why you have landed on the crisis slope, undertaking actions to improve business planning, financial forecasting, and cash management, while also embarking on a comprehensive performance improvement agenda, can set your company on the road back to business health.

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Triage *tri•age [tree-ahzh]*: the determination of priorities for action in an emergency. During the Napoleonic war, French doctors were overwhelmed with casualties arriving at their battlefield hospitals and were forced to create a process called "triage," in which they divided patients up depending on the severity of their problems. Today, every emergency room in the world treats patients in three phases:

1. **Triage:** estimate the severity and urgency of the problem

2. **Diagnose:** collect information to determine the cause of the problem

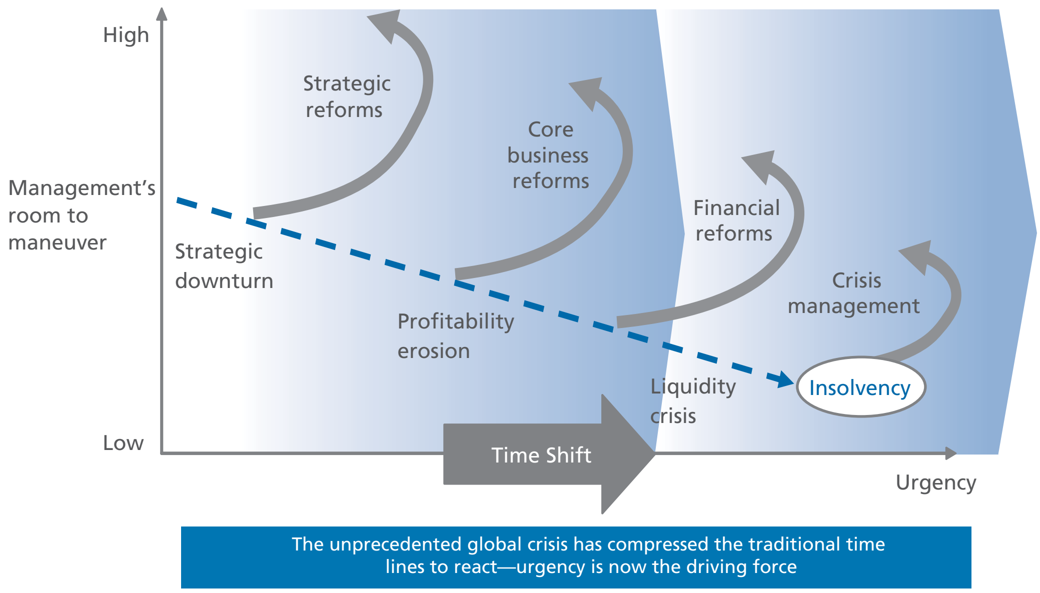
3. **Treat:** take action to address the problem

Such a process is just as necessary in the business world today. Firms often choose the wrong reforms because they are not attuned to the urgency or nature of the situation. But with rapid triage and a timely diagnosis, your senior management can take swift and targeted actions to remedy an affliction before it causes serious harm to your operations. Most critically, leadership teams that have been built to manage growth must be aware of the need to attune their capabilities to navigate the rapid value destruction that can occur in a down cycle.

Step 1: Triage—Locating your Company on the Crisis Slope

Based on our broad experience helping to manage companies through economic downturns, Oliver Wyman has developed the "crisis slope" (Exhibit 1) to aid in performing effective triage, by pinpointing the severity of a company's situation and the reforms it must undertake.

Exhibit 1 **The crisis slope**



When faced with life-threatening situations, companies vary in their ability to reassess their business models to refocus on customers, competitors, and company performance. It is critical to know where your company sits on the crisis slope—those that understand and take decisive action may prosper in the recovery, while those who misjudge their position are likely to falter quickly and continue to slide.

Case Example: Continental Airlines

Continental Airlines was one of the worst-performing US airlines when it entered the major recession of the early 1990's. The future looked bleak as oil prices skyrocketed and customer demand dropped significantly in the wake of economic turmoil. With financial strains mounting, losses increasing, and liquidity tightening, Continental's management team embarked on a turnaround to rescue the company.

Their decisive action, the "Go Forward Plan," is now recognized as one of the best worst-to-first stories in business. Continental redesigned the business to focus on the customer, worked proactively with all key stakeholders to restructure the company, deployed new management processes, and implemented financial capabilities to enhance profitability and liquidity. Not only did Continental survive the downturn, it became the industry leader during the recovery.

Case Example: Polaroid

Polaroid is an example of another kind. A wildly innovative company founded by a technological genius, Polaroid brought its first instant camera to the market in 1948, and created an iconic approach to photography that characterized a generation. In 1986, it defeated Kodak in a patent battle and had the instant photography market all to itself, or so the management team believed. Unfortunately, they had failed to see a strategic disruption on the horizon: digital photography.

As company after company refocused its efforts on digital (including Kodak), Polaroid stubbornly continued to focus on chemical-based film. It slid rapidly down the crisis slope, losing profitability, market share, and ultimately its liquidity. It filed for bankruptcy in 2001 and subsequently all of its assets, including the brand, were sold off.

Step 2: Diagnose—Determine the Problem

Every CEO and leadership team should consider assessing their company immediately. To help you perform this diagnosis, Oliver Wyman has developed a set of questions listed in Exhibit 2. The answers can act as an acid test to indicate your company's position on the crisis slope and the causes. Where does your company stand?

Exhibit 2 **The diagnostic checklist**

Liquidity crisis	• Are you in violation of any debt covenants? • Are you in danger of missing payment obligations? • Do you have trouble forecasting weekly cash flows to ensure the ability to meet payment obligations? • Are your accounts receivable inflating? • Is your operating margin eroding? • Are revenues declining faster than costs?
Profitability erosion	• Is your financial forecasting accurate and are you achieving your budget? • Do business units have trouble producing timely and accurate reporting updates? • Does your management team lack individuals who have led through a previous downturn? • Is your management team unaligned about what direction to go?
Strategic downturn	• Do you have strategic assets that are not providing a profitable return? • Do you need to change current corporate strategy and business plans for today's market? • Are your value proposition and customer base challenged by the new economic situation?

Stop with your first "yes" answer

Step 3: Treat—Take the Right Actions

Once you know where you are on the crisis slope, and have diagnosed the situation carefully, it's time to move on to instituting "reform." We use the term reform because it is likely you will need to re-form your strategy, your asset base, or your business model. Based on triage and diagnosis, you will know what type of reform is your top priority and what set of techniques you will need to apply. With these tools in hand, you can focus the leadership team and set the entire organization in motion.

No two reform programs are the same. The tools found in the corporate reform toolkit (Exhibit 3) each strike at different parts of the organization, have different objectives, and different timelines. Similarly, the management team needed to lead through each type of reform requires a different set of skills. A critical role for senior management is enlisting the right leader for the right initiative.

Exhibit 3 **Corporate reform techniques—the toolkit**

Strategic reform	Core business reform	Financial reform
• Business strategy and design • Enterprise performance management • Revenue stimulation programs • Organizational structure redesign • Leadership effectiveness	• Sales and marketing effectiveness • Operational transformation • Supply chain and sourcing • Overhead and cost structure • Labor costs and productivity • Outsourcing	• Financial forecasting • Cash flow management • Working capital • Asset sales • Capital structure • Debt refinancing and restructuring • Recapitalization

Strategic Reform

In this environment, companies must have comprehensive business planning and management capabilities to successfully execute strategies and improve financial performance. The economic crisis should have all leadership teams in a state of strategic review. Even the best strategies formulated before the crisis require a thorough reassessment, and, in some cases, may require a complete revamping.

A top priority for a leadership team is to reevaluate the company's business strategy in light of the new market realities. As market demand and customer priorities have been altered by the recent economic turmoil, the business design may require redefinition. Indeed, the companies that produced robust returns in the past likely may not achieve required returns in the future. A structured and objective approach should be deployed to assess continued strategic choices, business redesign options, and required improvement actions.

Enterprise performance management (EPM) is an approach for companies to successfully execute their business strategies (Exhibit 4). It is a well defined, coordinated, and integrated process incorporating short- and long-term views of the business environment, with corporate strategies tied to performance targets. It aligns strategic planning, annual planning, and financial forecasting/budgeting processes within the company; allows managers to achieve strategic goals through actionable plans; and accurately measures and predicts the performance of those plans.

Exhibit 4 **Enterprise performance management**

EPM is successful when development time has been devoted to both planning and reporting. Planning processes are focused, integrated, and streamlined, defining the tactics and targets required to meet business objectives. Reporting focuses on volatile and material changes in measures (exception based) and tracks goals, key success factors, and drivers of the business.

The cornerstone of performance reporting is a "leadership scorecard." It is a set of measures—both non-financial and financial—that help the leadership team assess how well it is executing strategies and how effective their strategy is in achieving goals. A scorecard that provides frequent updates serves as a critical technique for monitoring the implementation of reforms and target achievement. It can highlight new areas of the firm where core business tools may need to be applied and can provide senior management with timely visibility on implementation obstacles.

Core Business Reform

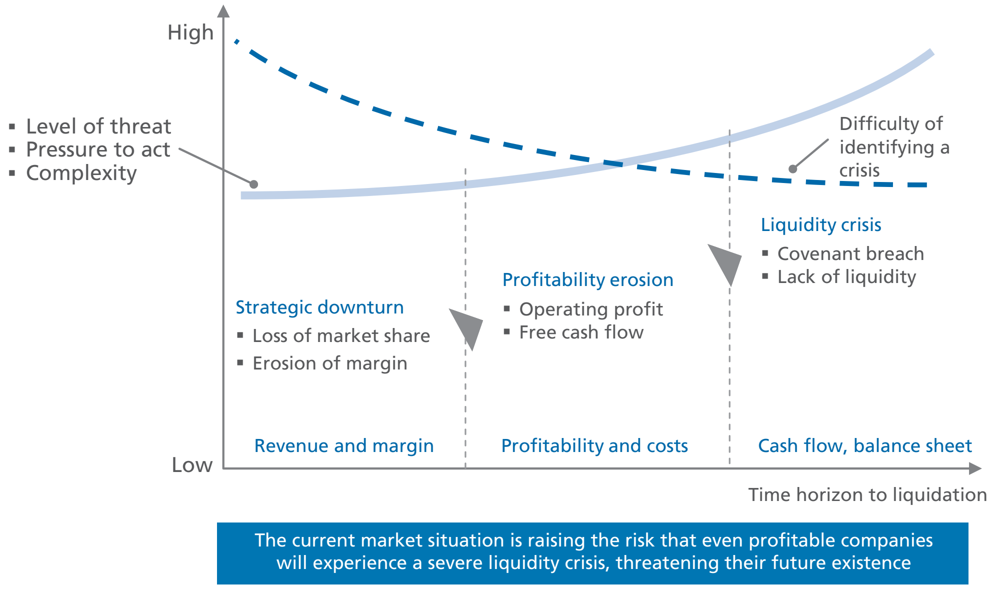
Core business reform gets under the skin of the organization and makes adjustments to the way a firm enhances revenues and controls costs through performance improvements. To effectively enact core business reform, senior executives must align closely with strongly committed middle managers who hear the daily heartbeat of the firm. If properly empowered to enact change, these middle managers have the capability to capture the imagination and energy of their workforce and turn the fear of "we're doing it wrong" into the hope of "we're making it right."

Core business reform is aimed at fast and effective actions to improve operations, cash flow, and return on investment. Such reform fosters the customers, products, and processes that are profitable and redevelops or relinquishes those that are not. Depending on the speed at which performance is deteriorating, more aggressive actions may be warranted.

The ability to create value is the primary criteria for prioritizing and applying resources to improvement efforts. Once selected, initiatives should focus on rapidly reducing costs and moving from fixed cost models to variable cost models. Speed to implementation should remain the critical driver of each workstream.

In some cases, however, where a company's expected performance does not provide acceptable returns, more structural and urgent restructuring actions may be warranted. The overnight deterioration of capital markets is making refinancing more difficult and further investment from existing shareholders may not be attainable. In addition, market demand shortfalls, excess fixed cost base, and higher operational risks arising from customer default and supplier terms may cause a company's strategic and profitability issues to lead to an all-out liquidity crisis (Exhibit 5).

Exhibit 5 **Timeline to a liquidity crisis**



Companies that normally would have time to ponder measures to resolve strategic and profitability issues are finding that timelines to act are greatly compressed and pressure to make fast decisions intensified. With little room to maneuver, company managers can find themselves quickly overwhelmed by a crisis. They must focus on putting out fires and calming panicky stakeholders, which averts their attention and support from critical reforms.

Financial Reform

You don't drive a car by only looking in the rearview mirror. Similarly, you cannot steer a business by only relying on historic results as a predictor of future performance. Financial reform allows managers to proactively address shortfalls and avoid liquidity issues by providing a clearer view of how current results relate to what lies ahead. With this knowledge, managers have a better understanding of future financial performance and cash flows and can revise financial forecasts to refocus profitability targets and maintain adequate liquidity.

Forecasting based on an annual budgeting process only provides managers with a static, and often out-of-date view. A better tool is a rolling forecast that is updated on a quarterly basis, providing a continuous view of both the current situation and the short-term outlook, and helping decision makers to recognize trends and adapt accordingly.

Additionally, a well defined and coordinated cash management program is essential. Cash flow needs to be accurately understood on a weekly, and, in many cases, a daily basis. Understanding cash receipts and disbursements—in addition to working capital requirements and debt service levels—are critical requirements. Cash is king and the ability to proactively manage cash flow and balances with customers, suppliers, and creditors may likely determine a company's ability to survive a downturn.

Financial and cash flow management combines a view of business as usual with anticipated "events" and facilitates the development of actions required to stay on course. By developing a transparent view of the company, managers can be forward-looking financial planners, able to quickly assess when it may be necessary to adjust tactics and goals.

Managing Your Reform Program

Specific leadership capabilities are required to successfully implement and manage reform programs. A leadership team that was focused on growth may need to be augmented or retooled to establish a reform agenda for the downturn. The leadership must unify their attention around the most pressing strategic matters. Once the right information is available and in use, a highly aligned leadership team is the single most important differentiator between success and failure.

To achieve success, your leadership team must set clear targets and responsibilities for improvement measures. To reach these targets, senior managers must instill a culture of openness throughout the organization, allowing all employees to speak candidly about reform needs and unearthing related root causes. The top team also must seek to eradicate any vestiges of bureaucracy and procedures that slow down decision making

Developing such a culture requires intensive communication among the leadership team and with all stakeholders. Communication also must be transparent so that all implementation obstacles can be identified and mitigated as soon as possible.

Ultimately, empowerment must flow from the top of the organization to the middle managers who provide hands-on management across the company. If all decision-making authority is retained at the top, your company simply will not be able to respond to the issues at hand. These middle managers must have the ability to quickly apply new tools and release the dormant potential of the organization.

A company's management team must also be cognizant of the changes the organization may need to embark on in order for reforms to take hold. Leaders must proactively prepare and manage for significant change. It may be necessary to couple reforms with a new vision and new values to capture the firm's commitment to reform.

Conclusion: It's Time to Get Healthy

Now is the time to pay attention to any symptoms of economic illness appearing in your company and keep them from getting worse. For triage to be effective and timely, it must be followed by accurate diagnosis and treatment. Relying on "what has always worked" to carry you through will only narrow the responses and the tools management can apply to remain profitable and navigate the economic situation ahead.

Today, every company executive should be focused on performing business triage and then designing the treatment process and tools that will drive change within their organization. By using the right tools with the right people at the right time, the CEO and executive team will be well prepared for the future, whether the overall economy is ill or well. ❖

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About Oliver Wyman

Oliver Wyman is an international consulting firm with over 2,900 professionals in over 40 offices in the Americas, Asia, Europe, and Middle East. We combine deep industry knowledge with specialized expertise in strategy, finance, operations, risk management, organizational transformation, and leadership development.

Oliver Wyman has been locally serving the MENA consulting market for over five years and currently serves the marketplace with more than 30 partners and over 100 professionals from its Dubai office. Oliver Wyman is particularly strong in selected core sectors in the MENA region: asset-intensive industries including aviation, aerospace, construction, energy, manufacturing, and transport; telecom and media industries including communications, media, and technology; and financial service industries including banking and insurance.

Oliver Wyman's Corporate Finance Practice

Our Corporate Finance capabilities span a range of services to support companies and investment firms in developing business plans to improve business performance, profitability, and cash flow. Corporate Finance Practice partners have in-depth expertise across business planning, performance improvement, restructuring, and capital markets. We have more than 30 years of helping improve business performance with a focus on implementation and hands-on execution.

Oliver Wyman's Development Services

At Oliver Wyman, we understand that in difficult times your advisor must not only help you diagnose and remedy problems, but work with you to drive the necessary change through your organization. Whether the problem requires a rethinking of strategy, creation of better alignment at the top, or a broad restructuring at every level, we can work with you to accomplish the task.

For more information on Oliver Wyman's Corporate Finance Practice or Development Services, please contact your Oliver Wyman account partner or one of the following partners:

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