IBM

Seven strategies

Weathering the economic downturn… while moving ahead

Introduction

Profit margins in the U.S. have sunk to an eight-year low.[1] Consumer confidence is teetering. Month after month, business executives around the world eagerly scan The Conference Board's latest report on economic indicators and search for good news. Lately, they've been disappointed.

While the economic downturn has hit some sectors and geographies harder than others, almost every business has felt its impact. At the same time, economic uncertainty elicits different reactions from different firms. Some organizations are simply treading water and attempting to ride out the storm; others are swimming upstream, intent on moving ahead of their competitors.

As executives rethink their business strategies, they should consider a variety of approaches — including some that are not immediately obvious given today's uncertain economic climate.

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Tactics in a tight economy

Although most people are confident that the economy will rebound, no one, including leading economists, can pinpoint exactly when or how that will happen. Instinctively, most businesses recognize the inherent danger in standing still; even in challenging times, strong competitors can easily pass a stalled opponent. Fortunately, there are tactics companies can put in place today that will help them emerge stronger and more competitive when the economic upturn arrives.

For businesses under pressure to react to marketplace dynamics, it's easy to forget that today's actions can sometimes produce unintended consequences. Cost cutting, in particular, must be approached cautiously; short-term gains may cause long-term pain. One study that analyzed the strategies and performance of U.S. firms from 1987 to 1992 found that two-thirds of the companies that used cost cutting as their primary means of survival during the last major downturn failed to show profitable revenue growth during the following five-year period.[2] Forward-thinking initiatives that concentrate on lowering an organization's ongoing cost structure are more effective than blanket budget cuts.

Based on consulting work with clients in various industries and geographies, IBM has assembled seven strategic themes to help business executives identify potential methods for improving their companies' position during a downturn. The tactics focus equally on efficiency and expansion, since businesses keen on moving ahead should always consider both perspectives. In fact, when corporate coffers are clamped shut, companies must rely on efficiency gains to fund expansion initiatives.

Market share at risk

Company	Consumer packaged goods company[3]
Problem	In a highly competitive environment, the company found itself consistently lagging behind its chief competitors. Brand profit margins were in most cases four percentage points below the opposition. And competitors' growth rates were often double the brand's meager top-line increases. The challenge was daunting, but clear: Catch up or be left out of the running altogether. How could the company effectively close in on competitors that were charging full speed ahead?

Focus

In boom times, the proverbial strategy is to let a thousand flowers bloom. However, when the financial picture darkens, it's often appropriate to do some pruning. An economic downturn is an ideal time to focus the corporation's scarce resources — both marketing and manufacturing dollars — on the most popular, promising or profitable products and brands. In other words, invest in the best and ignore the rest. Savings from consolidation efforts can then be applied to further support selected focus areas.

Market share at risk - the rest of the story

Company Consumer packaged goods company[3]

Action The business adopted a two-pronged strategy:

- Increase revenue growth by consolidating the brand portfolio, capitalizing on consumer insights and embracing new channels
- Improve margins by simplifying the business and driving efficiencies throughout the supply chain.

In attempts to appeal to local markets, the company had allowed brands to proliferate rather than develop a strong global presence. To get back on track, the business chose to focus exclusively on the top 25 percent of its brands (which incidentally produced almost 90 percent of the corporation's profits). At the same time, the company had no intention of losing ground locally; instead, it found new ways to remain regionally relevant while leveraging advantages afforded by its global brands. All resources — from marketing to manufacturing — rallied behind these selected brands. In a time of rapidly changing tastes, the company also recognized the need to segment its markets into more discrete groups and fully understand each segment's wants and needs. To accurately pinpoint what products to offer to whom, and quickly ascertain and adapt to market reactions, the business could not rely on syndicated data alone — competitors had access to most of that information. The real advantage, company executives determined, was from learning how to organize and use consumer data. Through innovative use of market intelligence (derived from proprietary, syndicated and public information on the Web) the business began to gain new insights about the relationship between its brands and its customers. To expand its reach, the company decided to pursue targeted marketing and sales channels — particularly online ventures.

While bolstering its top line, the company also focused on prudent cost reductions. The permeating mindset was simplification: Why do we need 24 shades of blue when two will do? Brand consolidation paved the way for eliminating one quarter of the company's manufacturing sites, while providing the impetus to streamline the supply chain and improve knowledge management for important product lines. Seventy-five percent of the cost savings flowed directly to the bottom line; the remaining 25 percent was reinvested in market-leadership activities.

Although its turn-around strategy is still underway, the company is already starting to see results. The first year of its four-year strategy ended with significant improvements in both sales and operating profits.

Similarly, businesses should concentrate on acquiring and retaining the most profitable customer sets: How?

- Forego expensive mass-marketing efforts; instead, market directly to carefully targeted prospects
- Focus efforts on serving top accounts better than ever. Understand customer cost and revenue drivers to determine the real "top accounts," then consider e-commerce and self-service solutions that can increase satisfaction while lowering costs.
- Learn to effectively use information that is already available in-house to build revenues from your existing customer base. By combining in-house information with proprietary market data, you can start to understand the "why" of customer preferences and build a stronger competitive advantage.

Shop for bargains

Considering today's lower market valuations and depressed price tags, now might be an opportune time to acquire capital assets, patented intellectual property—or entire companies. Businesses should assess their current capabilities in light of future aspirations and search for ways to fill expected gaps while target acquisitions are most affordable. Strategic hiring can also be a smart move, since compensation packages are generally more reasonable in tenuous times.

Ease points of pain

When revenues are climbing continuously, inefficiencies are easy to ignore; declines in per-unit margins can be made up through volume. But when growth stalls, margins come under tremendous scrutiny, forcing companies to inspect every aspect of their business for possible improvements. Rarely can a business simply stop performing a function; instead, it must find a way to accomplish the task differently. This often requires the help of technology.

Surplus inventory, high work-in-process and supply-and-demand discrepancies are more costly than ever. By digitally linking the entire supply chain and collaborating electronically with suppliers and customers, companies can potentially lower costs in the short term and improve market responsiveness over time. A serious commitment to integration—across Enterprise Resource Planning, Supply Chain Management, Product Lifecycle Management, Employee Self-Service, Business Intelligence, e-commerce and Customer Relationship Management systems, for example—can help companies gain speed, insights and strategic advantage. Customer acquisition costs remain

high for many large corporations because they pay to acquire the same customer again and again across every line of business. With a consolidated customer relationship strategy and an integrated view of the customer, businesses can reduce the overall cost of support without sacrificing service quality. Private exchanges may provide new benchmarks for efficiency and effectiveness by serving as an alternative or complementary avenue for supplier and customer interaction.

Contrary to what one might think, enabling process improvement through technology does not always involve huge capital outlays. For example, "e-sourcing" and business process outsourcing — models that enable a business to basically "rent" the technology infrastructure or business capability it needs — present lower-cost alternatives.

Grab share

Compare your performance to others — both competitors and leaders in other industries. Where you lag, close gaps. Where you lead, widen the distance. In some areas, a "fast follower" strategy may prove to be the most economical approach. First movers have learned expensive lessons and, in some cases, have charted a viable course. Quick studies may be able to follow closely behind and emulate best practices at lower cost.

Improving differentiating capabilities makes sense, too; your advances will be worth more if the economy grinds your competition to a standstill. It might be time to raise some competitive barriers to entry — increase scale or sway industry standards in your favor — while competitors are distracted.

Also, rather than eliminate advertising as part of broad-based cutbacks, you may want to consider more aggressive marketing strategies. Mindshare is crucial, particularly if a business wants to emerge from the downturn more competitively positioned. Today's corporations — even those that could never afford major marketing efforts — may find they can have more impact with less investment. Plus, with less advertising "noise" being heard, customers might actually listen to your company's marketing message.

Share costs

It's not surprising that when margins are squeezed, firms search out and eliminate redundancy. Internal and external best practices implemented through shared or common business models across the enterprise can dramatically lower costs while increasing competitiveness. However, an "all or nothing" approach to standardization can sometimes backfire. When implementation teams look beneath the surface of "common functions", they often discover legitimate needs for variance. Before too long, the cost of processing exceptions outweighs the anticipated synergy savings. An effective shared services strategy requires a deeper analysis up front — pursuing similar parts, not necessarily the whole function. Rather than forcing each function — regardless of line of business — into a standard mold, look for naturally occurring affinities, pinpoint specific areas of similarity, and combine those particular pieces.

Margins at risk

Company	Mortgage company[3]
Problem	Throughout the past few years, a competitive business environment had placed tremendous pressure on the firm to reduce costs. The latest round of economic challenges was the proverbial last straw. Having already taken advantage of more traditional efficiency improvements, the company knew a major shift would be required to reduce costs any further. Also, to encourage growth, the firm wanted to expand into new types of services — a strategy limited by its aging application infrastructure. How could the company reduce costs and increase flexibility simultaneously?

Success comes from striking a balance between the cost savings afforded by centralization and standardization, and the flexibility required by each line of business.

Once your organization has mastered the implementation of shared services models across lines of business, you could consider offering your "shared service" to external firms. But what if the processes involved are unrivaled in the marketplace? Would you really want to offer them to competitors? It depends. Today's differentiators may be standard fare tomorrow. The bottom line is that a shared service may be worth more to your business as a new revenue stream than as an operational cost advantage. As an aside, for those businesses pursuing scale, this same expertise could help you rapidly assimilate new organizations from mergers and acquisitions.

Margins at risk - the rest of the story

Company Mortgage company[3]

Action In an attempt to find creative costing-cutting measures, the leadership team began to look more closely at other firms within their holding company that also had mortgage businesses.

What they found was a sister organization whose primary functions overlapped with as much as 70 percent of their own. When the team studied how the company processed loans, produced statements and managed payments, the synergies became even more obvious.

What began as a search for improved business practices quickly blossomed into a much larger opportunity. The two firms decided to establish a third entity to manage the common business processes they jointly identified. By outsourcing these functions to the new spin-off, each business expects to save over US $80 million per year. In addition, their pooled resources allow higher levels of strategic IT investment—and greater benefits—than either company could afford independently. With lower operational costs and greater flexibility, each business is now able to focus on unique areas of expansion. One has launched a new venture—trading on loan risk; the other is diversifying into related financial services such as homeowners insurance. The new company created from this shared services vision has aspirations, too. In the near future, it will begin marketing its services to organizations outside its holding structure.

Enter new markets

Cost reductions can only relieve margin pressure to a certain degree. At some point, companies must have steady top-line growth to sustain their market capitalization. When confined to current markets, revenue growth also faces practical limits. For some businesses, continued growth comes only from new markets. Although expansion investments might impact earnings in the near term, Wall Street may be more forgiving in times of lowered expectations.

New markets can take many forms. Here are a few models to consider:

- **Go global…or local.** Among other advantages, a global presence offers businesses the ability to juggle operations, inventories and resources among various geographic regions to take advantage of more favorable economic conditions. On the other hand, by looking closer at local markets, it's also possible to find a niche that is being ignored or under-served.
- **Ignore industry boundaries.** Leverage your core capabilities or unique assets in another industry. For example, instead of simply renting out ATM space to a financial organization, a convenience store leveraged its easy-to-access locations and high customer traffic to enter the electronic banking business—establishing a separate, wholly owned financial institution to clear in-store banking transactions.

Products at risk

Company	Medical equipment and supplies manufacturer[3]
Problem	During past years, as per-unit margins on diagnostic equipment grew slimmer, the company compensated by taking share. In fact, its flagship product controlled an admirable 75 percent of the market. While things were looking good, the company's executive leadership team had an eye on the future; they quickly recognized that medical science and emerging technology were making greater strides each year, and that continued reliance on a few, large diagnostic products could place the firm in a precarious position. With new cures on the horizon, it was easily conceivable that their company's leading products, regardless of technological innovation, could someday become completely unnecessary—maybe sooner than later.

- **Commercialize IP.** Don't underestimate the value of your intellectual assets. Be proactive about patenting ideas, processes and technologies. Don't limit R&D returns to your own product innovations; actively search out supplementary sources of income from all intellectual property generated.
- **Shift to services.** Rather than buck the trend toward a services-oriented economy, find a way to participate. For the past four decades, services' share of the U.S. gross domestic product has continued to rise, while contributions from goods-producing industries have steadily declined.

Percentage of U.S. Gross Domestic Product (GDP)	1959[4]	1999[5]
Private services-producing industries	49%	65%
Private goods-producing industries	39%	23%

Products at risk - the rest of the story

Company	Medical equipment and supplies manufacturer[3]
Action	Inspired in part by the transformation of IBM into a leading services company, executive leaders began searching for viable service opportunities in their field of expertise. Within a few months, teams had identified over 100 potential service opportunities across three lines of business. To cull through the host of options and select a small, high-potential subset, the services strategy team relied on two primary criteria: What can we implement quickly and—a close corollary—what best fits our current capabilities? Several services were marketable, but strayed too far from the company's core competencies. Other alternatives promised high returns, but could not offer quick payback (within 18 months) or fast startup (nine months or less). Ideas ranged from medical practice consulting to managed diagnostic services. After a complete analysis, four initiatives were recommended and approved. Based on initial three-year projections, these new services will produce a return equal to 30 times the amount invested up front. While these forays into services will not eliminate the company's reliance on product revenues any time soon, they do pave the path to a more balanced—and less risky—offering portfolio.

Revisit abandoned ideas

A difficult economic environment is often a time for serious reflection. It may, in fact, cause executives to rethink initiatives that were once too hard, too risky or simply too controversial to tackle. In more favorable financial situations, businesses often reject changes such as restructuring, outsourcing or divesting. Such adjustments, while strategically sound, were not considered worth the organizational risk (and resistance) involved. However, during difficult times, positions and motivations change. If the business rationale remains valid, an organizational adjustment of this type might now be more palatable — or at least more plausible.

Business flexibility at risk

Company	Electronics manufacturer[3]
Problem	Headquartered in Japan, this global firm encountered the economic chill first. With over 75 percent of its business coming solely from Asia, the company felt somewhat exposed. If it could find a way to strengthen its market position in other parts of the world, the business would have to share resources globally and develop the flexibility to go where the market was better at any given time. Instinctively, the CEO felt that e-business could be both a catalyst and an accelerator for his company's globalization strategy. He also knew that significant corporate cultural change and geographic sensitivity would be required for success. But where to begin?

For many of the same reasons, potential alliances and partnerships may have been dismissed. With more economic "incentives" to partner these days, those alliances could now be easier to arrange. And considering recent tests of financial staying power, businesses have a better picture of their potential partners' strengths and weaknesses.

A company's view of its competition may shift as well. "Coopetition"—a model in which companies compete in one area while cooperating in another—may become more pervasive as businesses team up to provide greater customer value in a constricted market. Advances in intercompany governance and the ability to link organizational systems will dramatically increase alliance and partnership activity.

Business flexibility at risk - the rest of the story

Company	Electronics manufacturer[3]
Action	The leadership team decided to focus on areas that could significantly improve their company's competitive position: • The ability to leverage worldwide learning • Collaboration on product engineering and maintenance issues • Global information dissemination • Electronic procurement. Geography by geography, the team analyzed globalization risks across four impact areas: brand, organization, process and technology. Based on their findings, they mapped out detailed risk-mitigation and rollout plans. Even in times of economic retrenchment, their goal was to have their company become a more competitive player—worldwide. Rather than view globalization as a centralization effort, the team found it far more important to let all geographies have worldwide visibility. This would allow each locale to be more responsive to their customers' needs, and bring worldwide resources to bear on a local issue. For example, while demand was accelerating in California, surplus inventory sat idle in Korea. Rather than pay higher shipping costs and delay response to the customer, the company could transfer the necessary inventory to California, where the local organization could respond quicker and cheaper. Learning and collaboration were considered important contributors to competitive positioning—and cost reduction. Besides allowing the organization to provide routine employee education more cost-effectively, "e-learning" would also serve as a key enabler for putting the company's new business strategies into practice. In an electronic collaboration environment, engineers around the world could work together on challenging design issues and team up on customer problems reported in remote geographies. With its initial implementations in place, the company is now growing faster than its competitors in markets outside Japan. Its bottom line is improving as well, thanks to an 80 percent reduction in training costs and the ability to resolve customer problems in half the time.

Mid-course adjustments at IBM—an example

In 1993, the IBM Microelectronics Division moved IBM technology into the open marketplace. In addition to providing technology for IBM products, the business unit now supplies chips for a host of other companies' electronics products, including those of a few competitors. Over the last three years, the division has enjoyed steady growth and has been a regular contributor to IBM revenues.

In 2001, everything changed. Economic slumps overtook the telecommunications and networking industries, driving down demand. After reporting a 27 percent revenue increase during the first half of 2001, IBM expected chip sales to plunge as much as 20 percent in the second half of the year. In a predominately fixed-cost business, revenue drops fall straight through to the bottom line. Faced with such a drastic downturn, one might wonder how IBM would respond.

The IBM plan follows two parallel paths—cutting back and moving full steam ahead.

Cutting back:

- *Slow spending in mature product lines—Reduce budgets earmarked for making chips from materials such as aluminum, or chips designed for older routers and switches.*

Moving ahead:

- *Keep production in step with innovation—IBM leads the industry in patents, and more than one third are related to chip and packaging technology. To help turn those R&D advances into revenue, the company will continue investing in worldwide manufacturing capacity. The current US$5 billion investment plan—the largest capital investment in the company's history—includes plans to expand existing capabilities in Vermont, Japan and France, and construct a new state-of-the-art facility in New York. These advanced facilities will also lower the cost of chip production.*

- *Pursue new markets—As the number-one supplier of custom application-specific integrated circuit chips (ASIC), IBM is attempting to grow share in other high-tech markets such as wireless and digital home electronics devices. The Nintendo Gamecube, for instance, will be fueled by an IBM PowerPC® processor, custom-designed and manufactured by IBM.*

- *Expand brand presence—Introduce a new logo imprinted on the packaging of consumer electronics products that use technology or intellectual property from IBM. The new mark will be applied on a variety of devices—from PDAs and cell phones to game consoles and set-top boxes.*

Treading water or gaining ground?

The current economic crisis has certainly given executives a reason to assess their business performance and reexamine their organization's strategy. As you analyze and evaluate your current business plans, it might be helpful to ask yourself some of the following questions:

- How do our selling, general and administrative (SG&A) expenses compare to that of chief competitors and industry leaders? Are we really improving our cost structure for the long-term, or simply cutting costs to feel temporary relief?
- How are we identifying which business and technology initiatives to accelerate, maintain, merge or terminate? Could now be the right time to institute a more disciplined portfolio management process—one that will continue to pay dividends even after a favorable economy returns?
- Where can we incorporate the strategic positioning improvements we want or need… with the efficiency changes we must implement?
- Are our business results diluted because our attention is divided among too many products, brands or market segments?
- Do we have the process and technology infrastructure in place to quickly assimilate newly acquired or merged businesses and simultaneously meet the demands of an economic recovery?
- Which organizational "to do's" have we procrastinated about for too long?
- Do we have a clear vision of where we want to be when the economy stabilizes?

Navigating through an economic downswing is never easy; neither is organizational change. However, many executives are facing both challenges simultaneously. At IBM, we have weathered many economic cycles; during a few, we managed to transform our business in the process. Our strategy and change consultants would welcome the opportunity to help you study strategic alternatives and map out business plans that can help your organization be better positioned when "good times" return. To discuss how we can put our pragmatic thinking to work for you, please contact us at *insights@us.ibm.com*. To browse through other resources for business executives, we invite you to visit our Web site at:

ibm.com/services/insights

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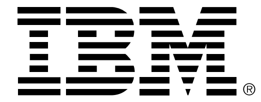

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Somers, NY 10589
U.S.A.

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10-01
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G510-1642-00