Strategic Recovery

Kim Warren – May 2003

It seems there are very few sectors right now where most firms are not struggling to survive in the aftermath of the 2000 market reversal, 9/11 and continued international difficulties from the Iraq war and SARS. Conventional efforts to protect profitability, such as down-sizing and expenditure cuts, cause substantial damage to the core business, and often leave firms substantially weakened – having cut back once, they just find themselves still less able to cope, and have to cut again. It need not be like this.

Case example

A high-value financial service firm I worked with last summer is typical. The stock market crash had killed their investment returns, and fee income was on the floor. They had built many investment products during the confidence of the late 1990s, and professional staff to support them. Naturally, the combination of falling income and higher costs left them in trouble, and they reckoned they needed to take out at least 15% of their cost base – some £3m.

All the usual suspects had been looked at – deferring the long-needed upgrade to their information systems (which would increase efficiency and cut costs, but only too late), cutting back-office staff, and economising on the car scheme, pension contributions and business-class travel! Problem was, this didn't add up to anything like enough savings, and the year ahead promised still-worse trouble.

The new HR director, the Finance Director and the CEO were not too happy with this unsatisfactory answer, so asked their senior team to take a look at the business to see if there was something fundamental needing to be done.

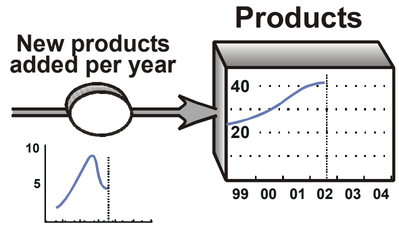
A new look at the problem

The strategic architecture of these financial service firms is not too complex. Clients invest money, buying products that are developed and managed by the firm's professional staff. The capital is invested in stocks and bonds, and any investment gains are added to the funds. The back-office staff and systems ensure that transactions are dealt with accurately and efficiently, though there was at the time some manual processing.

The basic resources of the firm, then, are clients, investment funds, products, professional and other staff, plus the many independent financial advisors through whom the firm reached their ultimate clients. In addition, they were concerned to sustain three critical 'intangibles' – their reputation with clients and the advisors, the motivation of their staff, and the strong investment capability they had built up over recent years. The team was especially worried about these soft factors, since crude redundancies would cause serious damage to all of them, risking a serious melt-down from an already serious position.

The optimism of the investment boom had encouraged people to launch numerous attractive new products, sell to many new clients, and develop more channels for selling these products to investors – all of which had entailed fighting hard in the market for the few skilled professionals who could do these sophisticated tasks. Figure 1 shows the product range as a 'bathtub' into which new products had been 'pumped' rapidly through the pipe entering from the left.

Figure 1: Rapid expansion of products in the boom.



Trouble under the surface

Apart from the people, though, the team found that most of these resources were in rather poor shape. Most of the investment products were performing badly, there were many small clients who cost more to serve than they were worth, and lots of intermediaries with rather dubious access to the market were causing still more work. Three more things surprised the team.

- The quality of these resources had been bad for a long time – well back into the boom period. Indeed, many products and clients had *never* been worthwhile. This problem had been hidden, though, while the solid core business made money.
- The growth of these resources had all been mutually reinforcing. As new products were added, they needed new people to support them, who then wanted to launch still *more* products. Moreover, with established clients fully provided with the investment products they wanted, still more clients had to be found to take up the extra offerings!
- Not only were the resources (products, clients, intermediaries) themselves in bad shape, the performance outcomes had been poor for some time too. Uptake for each new product had been declining, so average product holdings by clients had been low for many quarters. Client-acquisition and new relationships with advisors was proving very poor for the amount of effort that had gone into it. Nor did the problems stop there. All these marginal products, clients and relationships were generating a complex range of administrative and transaction-processing tasks, which put a disproportionate burden on the firm's systems and back-office staff.

This sounds alarming, but may be disturbingly familiar. Very many firms we talk with today face their own version of such difficulties, to a lesser or (more often) greater degree.

But in this case, as in most others, it turned out that a solid core business remained, on which a recovery could be built.

A healthy core architecture

The firm's core products were still performing as well as any in the market, given investment conditions at the time, and were widely held by clients. Many of the most marginal clients had already disinvested, and amongst the rest, many valuable clients remained, accessed either directly, or through some good advisors. Good professionals remained with the firm, sustaining its capabilities in product and client management. Even more reassuring, the firm's reputation was holding up, and morale was remarkably buoyant, thanks to some great leadership.

Better still, when the team looked into the architecture some more, they found that the best quality resources were tightly coupled – the best people were looking after the best clients, holding the best products, managed by more of the best people.

Consolidating back to a sustainable core

This good news made it possible for the team to devise a comprehensive program of rationalisation back towards a solid core of business that they were confident would function well. This would provide a platform for renewed growth, whenever more favourable conditions returned. (They hoped this would be during 2003, but it looks increasingly unlikely!)

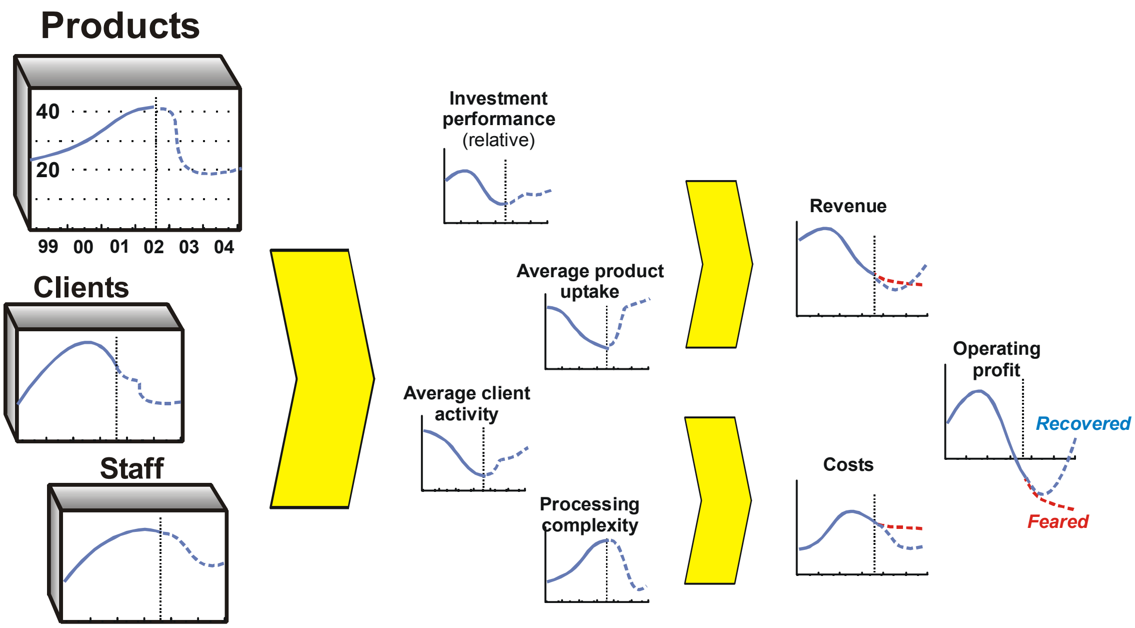
It would be crucial, though, to get everything properly balanced and timed – ***what to do, when and how much, with what likely impact on the rest of the system?*** And, of course, it had to protect staff motivation and the firm's reputation in the market! The plan went as follows:

- Identify the products that were not working, and remove them. This was easier said than done! You can't just discontinue investment products without managing investors onto alternatives, so that migration had to be planned in too.
- This would of course require fewer professionals, but to protect morale, the plan included the transfer of some products *along with the associated staff* to rival providers who were known to be more successful in specialist sectors.
- Marginal clients had to be rationalised too, and of course, some went with the marginal products. For the rest, rather than simply cut them off, efforts were made to find ways to make at least some of them more worthwhile, e.g. consolidating several small investments into one, and offering service that required less support.

Figure 2 shows some of the key components of this recovery. On the left are the resources, being rationalised by the right amount, at the right rate, in the right order. If changes happened too fast in one part of the organisation, other parts would not be ready in time to cope. Conversely, if certain changes were too slow, costs would continue to arise with no business to support them. If the team could just get the timing and scale of change right, they could get back to levels and qualities that were strong in their own right, and strongly supportive of each other. In the middle of Figure 2 are some of the internal performance improvements, and on the right the expected financial outcomes.

Important side-benefits of this rationalisation were spotted immediately. Simply removing the complexity would actually cut error-rates and delays, and actually *improve* service. This alone would boost the firm's reputation with clients and advisors. In addition, the product rationalisation was turned into a reputation advantage, by telling the customers how it was actually in their interests – investment performance would be protected and costs reduced. There was also a significant simplification of the support and transactional activity in the business, so that back-office costs could be reduced, but only *after* the business had been safely simplified.

Figure 2: Strategic recovery



The architecture that the team worked with was naturally more complex than Figure 2, and included three important additional features. First, the changes to resource-levels at left arise through actions to 'pump' them out of the business, and the confidence in the sustainable levels resulted from a strong, and *quantitative* managerial appreciation of how they had supported each other back in the days before the complexity had been added. Secondly, the intermediate consequences and financial outcomes were worked through in detail, not merely guessed. Lastly, the team's architecture included thoroughly thought-through estimates of what would likely happen to the softer factors too.

In addition, the team were able to use the architecture as a living 'control-panel', on which they could track each month's progress towards their better future, making adjustments if things worked out better or worse than expected. Like many firms today, they already employed a balanced score-card system to track many of these factors – data that could be dropped straight onto the architecture.

Lessons for strategic recovery

Many features of this situation are to be found in firms struggling to survive current troubles. Most can expect to discover the roots of their difficulties in historical developments undertaken in a very different trading environment. Fortunately, this very history may leave them with the chance of strategic recovery.

First, as firms scrambled not to miss the boat as markets boomed, a headlong rush ensued to capture every conceivable piece of new business. In the process, much *poor* business was signed up, which only became apparent when the bottom fell out of the market. You may well find such sludge in the bottom of your tank. Problem is, it's a tough call to shut down business at exactly the time when you seem to need every piece of it you can get. That's why it has to be linked to a coherent plan for improving other resources in parallel.

While sales were booming, almost anything seemed to sell, especially if it was 'new'. An explosion of novel products and services mushroomed, faster than anyone could really have time to check if the *last* great idea was really working. This too has left companies in market after market with slow-moving products, and rationalising these provides the second opportunity.

Regrettably, of course, the corollary of bringing business back to a sustainable core is a reduction in the staff needed to run a slimmer business. But as in our example, efforts can be made to find more secure futures for people, such as by passing products or customer-segments to other firms who can make better use of them. Furthermore, by not acting, everyone else is put at risk – and a strategically sound re-basing of the business is going to be substantially less troubling than the unfortunately common practice of indiscriminate and continuing cuts.

Manage expectations better than during the boom

The over-expansion of products and customers that led up to today's troubles was exacerbated by inevitable side-effects on managerial and professional mind-sets. Because everything was going so well, taking on people and spending lots of cash to build products and customers still faster was obviously the right thing to do. This was compounded by irresponsible hype from many quarters about the 'new economy' in which all the old rules would no longer apply. Unfortunately, the old rules about providing goods and services people wanted, at a price they could afford and at which you could make a margin, never *did* go away. It has now bitten back, and the pain has not gone away.

A further unfortunate pressure on management during the boom arose from ill-informed investor pressure. Because everyone else was growing like crazy, anyone who didn't was criticised for poor leadership and bullied into following the herd – Marconi springs to mind. In cases where *real* growth was not available, phantom earnings growth was often pursued by damaging, rather than over building resources. Marks & Spencer is one of the best-known examples.

The recovery of our case-example, though, should provide some reassurance. A sound, fact-based picture of the business architecture, building in the quantities and qualities of relevant resources, shows *why* performance is heading in the direction it is. The clear, quantitative and unambiguous picture that emerges gives a team a sound foundation on which they can work through possible rescue plans. Except in the most dire situations, it is likely that a sound (if smaller) core of quality resources can be consolidated into a newly sustainable business model.

An important trick now, though, will be to show investors that you actually *do* know what you are doing, and that they, from their distant viewpoint, are not likely to better-guess what you should be doing. There is a risk that they will see some alarming signs – serious cuts in business and in revenues, for example – but their ultimate interest is in sustainable future earnings, and crude top-line financials tell them (and you!) very little about that.

… and an optimistic note to end on.

Once this rescue is achieved, further opportunities may become apparent. Less skilled rivals will be in trouble, and you can save them the heartache of struggling on, either by acquiring them in their entirety, or else taking on any quality resources they do posses – good customers and staff, for example, and finish them off. As a newly-robust business, enjoying the foundation of a sound underlying architecture, you will be amongst the strongest players left on the field when markets recover, able to deploy some of the new cash-flows from that recovery into building new products and markets for the future – but do take care to build quality, not just quantity, next time!
