Difficult economic times bring rare and valuable opportunities to drive lasting change in your company.

Recession Opportunities

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Recession. Is this the worst of times or the best of times?

The answer is both. Difficult times bring difficult problems to all managers, but they also create rare opportunities for renewing change.

Consider cost-cutting. In recession, revenues fall, cash is depleted, and stock prices plummet. In most companies, the instinctive reaction is "all hands on deck" cutting costs. The problem with cost-cutting, however, is two-fold: managers often do it wrong, and cost-cutting is not enough.

Managers charged with cost-cutting in recessionary times all too often focus inordinately on short-term incremental gains, and miss major strategic opportunities.

In the first of my *Harvard Business School Working Knowledge* columns, I described a pattern of profitability within companies that I had observed in research and consulting across a dozen or more industries. The column is *Who's Managing Profitability?*, and here's the opening paragraph I wrote in 2002:

> "The most important issue facing most managers in this difficult economy is making more money from the existing business without costly new initiatives. In my research and work with companies ranging from distribution to telecom, I have been fascinated to find that at least 30 percent of each company's business by any measure (accounts, products, transactions) is unprofitable, but that this is offset by a few islands of high profitability. This sounds amazing, but it's true."

When I published this column, many managers wrote to agree that this described their companies. This article has been reprinted widely and read by thousands of managers, and to this day, no manager has disagreed.

What are the implications for cost-cutting? It means that there is a bad way and a good way to cut costs. The bad way is to cut across the board ("let's get inventory and travel expenses down…").

The good way is to look very carefully at your company and identify the winners and losers in terms of profitability and growth potential. The key is to shift resources systematically from the losers to the winners. This will enable you to lock in and nurture the profitable portion of your business, and to find and land more high-potential business. In the vernacular, you should "shoot one, promote one."

Opportunity for change

It turns out that economic difficulties present a critical opportunity to drive progressive change in a company. When my readers confirmed that the profitability pattern I wrote about was so widespread, I called a number of top executives to ask a simple question, "Why aren't you doing anything about it?"

The answer varied a bit from individual to individual, but the essence was the same: it's too hard to move a company to change when it's doing well. This was a dilemma. It was very hard for executives to execute fundamental change, even when they knew that it would create major lasting improvements.

Recession changes all of this. It is ironic that difficult economic times present one of the most important opportunities to drive renewing change in a company. In difficult times, with the company in jeopardy, managers throughout the company are very worried. It is precisely at this time that they will be most receptive to initiatives and change. Importantly, the same is true for customers and suppliers.

The essential question for a manager is how best to take advantage of this rare opportunity. In my experience working with companies in hard economic times, there are four major areas of opportunity.

Manage profitability

The profitability pattern that I see in company after company is one in which 20-30% of the company (measured by accounts/products/orders/lines) is very profitable, 30-40% is unprofitable by any measure, and the rest is marginal. Often over half of the gains from the highly-profitable portion of the business is going to cross-subsidize the unprofitable part. Rapid improvements in profitability and cash flow of 25-40% are often obtainable.

The current recession underscores that now is the time to analyze and actively manage your own company's profitability. This is the number one source of cash and resources to secure and grow the best parts of your business.

I described the process of profitability analysis, or profit mapping, in *The Hunt for Profits.* In my experience, two managers with a PC can do this analysis in about 2-3 months. The key is to do the analysis at "70% accuracy," which is sufficient for most major decisions. You'll quickly see where the company is making money, and where it is not. You can sharpen your pencil in the few places where additional accuracy will change a decision.

With this analysis, you can double down on the best parts of your business, target and secure more business with the potential for high profitability, improve your marginal business, and phase out the unprofitable parts of the business. This will enable you to redeploy resources, and rapidly increase your profitability and cash flow.

Two points are important here. First, it is critical to refocus your sales force to sell into high-potential underpenetrated accounts using your own systematized best practice account penetration process. I described this in two articles, *Use Best Practice to Fire Up Your Sales Team*, and *New Management Tool: Potential-Based Sales Forecasting*. This will quickly generate profitable new revenues to more than replace any fall-off in sales from phased-out unprofitable accounts.

The second point concerns the process of phasing out the unprofitable customers. In many cases, customers are unprofitable for reasons that may not be apparent to them. For example, erratic order patterns require you to carry high levels of safety stock, disrupt warehouse operations, and incur costly delivery charges. One company had the insight to explain to its unprofitable customers what they would have to do in order for the company to continue supplying them. In most cases, the customers were happy to comply.

Enhance customer and supplier profitability

Today, customers and suppliers are desperate for improvements in their own profitability and cash flow. In these tough times, they will be unusually receptive to new ways of doing things. This creates a unique and valuable opportunity for managers to lock in high value-added relationships with the best partners.

Supply chain partnerships can have a huge impact on customer and supplier profitability and cash flow. For your best customers, offering intercompany operations like vendor-managed inventory can greatly increase their asset productivity on their handling of your products. At the same time, you can gain control of their order pattern, and through this process significantly lower your own cost of operations. The benefits of these operating partnerships are so strong that sales often increase by 30-40% even in highly-penetrated accounts.

For your suppliers, the same partnership benefits are available. You can invite key suppliers to suggest ways that they could improve your company's profitability. Most suppliers implicitly assume that their customers are not open to serious operational innovations, and the most capable suppliers will jump at the chance to work closely with a customer that is open to innovative arrangements.

In addition, you can proactively analyze your own order pattern to your suppliers, and the lead times and delivery frequency that results. It is relatively easy to figure out ways to reduce both the suppliers' costs and your own costs at the same time. Gain-sharing is a natural next step.

You will seldom have this strong an opportunity to drive permanent innovations upstream and downstream in your supply chain. If you act now, you will reap the rewards for years, and it is likely that most of your competitors will be paralyzed by their obsession with unfocused cost-cutting.

Drive customer innovations

Recessionary times present an important opportunity to greatly improve the value proposition that you offer to your customers. In the previous section, I described how a supplier can increase a customer's profitability through operating partnerships. But the opportunity to improve a company's value proposition goes beyond this.

A supplier typically has very deep and detailed information on its products and their markets. This often includes very valuable information on customer best practices across a range of non-competing customers. In good times, when demand is strong, customers can achieve good levels of sales using only the sort of routine product and market information that is traditionally provided by suppliers.

In difficult times, however, customers need as much help as they can get. The problem is two-fold: (1) customer-supplier relationships are often implicitly adversarial, and (2) customers may not know what helpful information the supplier has within its organization (and this information may in fact be "buried" within the supplier's own organization, and not be readily available to the sales and marketing managers who normally interface with the customer).

There is great value for a supplier to proactively approach its good customers (and high-potential under-penetrated customers) with the proposition that both supplier and customer have a lot to gain by jointly rethinking the way the customer is using the products or bringing the products to market. Often, it quickly becomes apparent that the supplier has detailed information that can fundamentally improve the customer's own value proposition.

For example, one supplier worked with its best distributors to create special catalogs and customer intranet websites which focused on helping the distributors' customers to select the right products for particular applications, and to use them correctly. This had tremendous value for the ultimate consumers, and drove large sales increases through the whole channel.

Create strategic innovations

When is the best time to innovate? The answer, surprisingly, is when you don't need to. Think about the situation of GE's aircraft engine business. In the months after 9/11, airline traffic dropped precipitously, and orders fell off a cliff.

At the time, the company was developing a new generation of fuel-efficient engines. Could the timing have been worse? Not really. It took some time to complete the development cycle, and the engines were brought to market when the airlines were emerging from the slump, the market was strengthening, and jet fuel costs were rising.

In most companies, the lead time for the development of new products and business initiatives is 1-3 years. The current recession is predicted to be long and deep, lasting perhaps 1-2 years. Given the lead time for innovation, now is precisely the right time to invest in major initiatives that will come to fruition when markets finally strengthen.

Timing is everything

All this is profoundly counterintuitive. In a recession, the instinct is to hunker down and to focus on short-term measures to minimize the pain. This is exactly the wrong thing to do.

Insightful managers will realize that the difficult business conditions create a rare and valuable opportunity to renew and change their companies. Now is the time to be proactive and creative. Not only will you re-energize your organization, but you will reap the rewards for years to come.

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