Most leaders are seeing “perfect storm” conditions that have set their companies back. Oren Harari offers a blueprint of extreme measures that can propel beleaguered companies toward success.

A BLUEPRINT FOR BOUNCING BACK
Today, the economic seas are roiling under the perfect-storm collision of a sub-prime mortgage meltdown, the collapse of securities tied to those mortgages, a global credit freeze, a wildly gyrating equities market and, for good measure, a steep decline in industrial production, commodity prices, retail sales and jobs. Despite massive government interventions worldwide, the global economy is mired in a deep recession, the impact of which is expected to last for several years. In view of the fact that the entire economy of Iceland has flirted with total breakdown, it is fitting that the Icelandic word for “financial crisis” best describes today’s market realities: kreppe.

And yet, as Carlos Baradello, a retired Motorola executive, points out, “A crisis is a terrible thing to waste.” Today’s challenges represent a significant strategic opportunity for leaders of individual firms. They are an opportunity to reposition and renovate any company for success in the rough waters ahead and to prepare for domination when the seas begin to calm. Today – when all the rules seem to be in flux and markets are in disarray – is precisely the time to launch genuine transformations in your business.

Stephen Privett, President of the University of San Francisco, would agree. In an October 6, 2008, memo urging faculty and staff to help the university respond to the economic crisis, he wrote: “There is a Latin adage to the effect that in extremely challenging circumstances, one must take extreme measures to ensure the well-being of all concerned: in extremis, extrema tentantur.”

Of course, it’s easy to talk about extrema tentantur, extreme measures, than to actually take extreme measures. Leaders have long touted the need for change. But, often, their declarations have had more of an intellectual flavour than an aggressive “must do” imperative. Often, “change” has translated more into incremental thinking and cautious tinkering at the edges than into bold transformations. Now, however, things are different. A new sense of urgency is in the air. After all, when credit, debt and equity markets around the world are in dire straits, “change” is not an abstract concept. As a leader, if you don’t feel a sense of urgency about the need for big change now, when will you feel it? And if you’re waiting for a time in which it’ll be easier to “get people on board” for big change, when will you find an easier time than right now?

An extreme blueprint?
It’s time to consider a blueprint for capitalizing on today’s economic realities to reposition organizations for sustained cost reductions, liquidity and competitive advantage. This blueprint will revolve primarily around what I call the organization’s “underground”. To define terms, an organization’s “above ground” represents what the market sees and customers experience directly – such as products, services, promotions and sales efforts. In contrast, the hidden underground represents the root foundations that customers don’t see (for example, cost structures and operational systems) but nevertheless are vital for the organization’s financial health, and ultimately, the customer experience. Key segments of the underground include inventory management, administration, procurement, cost accounting, information systems, logistics, sales support, supply chain and distribution management, the “organization chart” and all operational processes.

Typically, innovation is applied to above-ground factors such as products and customer care. While that should always remain a business priority, I propose that the key to extrema tentantur in today’s unstable environment is to take innovation underground. From the outset, let me be clear that taking innovation underground is not simply about such clichéd concepts as reducing expenditures, improving current operations and reorganizing. Astute leaders have always been on the prowl for cost-cutting opportunities; and, in today’s environment, such efforts must be accelerated. Organizations I currently work with are doing whatever they can to lower costs and improve liquidity. They’re slicing departmental budgets, making people redundant, reducing capital expenditures, shrinking marketing initiatives, postponing new construction, shutting down facilities, tightening up on accounts receivables, seeking new tax deductions, renegotiating terms with creditors, cancelling overtime opportunities and urging employees to drastically decrease their usage of everything from photocopying to electricity. (Even Google is tightening its belt, literally, by eliminating free Tuesday afternoon tea, slimming down free food selections and shortening cafeteria hours.)

On the whole, these are justifiable steps. Fiscally and symbolically, it is important to show resolve when it comes to cost reduction in today’s environment. But be aware of three facts: one, many conventional cost-cutting initiatives are so scattered and marginal that they have minimal long-term impact on the company’s financial health. Two, many deeper cost-cutting initiatives are ultimately self-defeating because they’re not strategic; they cut too little of the wrong things and too much of the right things. Three, a glaring problem with many conventional cost-cutting actions is that there’s not a drop of imagination in any of them.

Taking innovation underground resolves these three problems because the leader’s focus is not on episodic, marginal cost-cutting actions. Rather, the focus is on applying re-imagination and reinvention to the sources of organizational waste, cost...
overruns and operational sluggishness. By taking innovation underground, leaders reconstruct the entire organization for speed, agility, responsiveness and internal efficiency. They remove toxic assets – cash-sucking, value-detracting, bloat-enhancing and attention-distracting units, processes, legacies and structures – from the company’s balance sheet. Most importantly, they optimize their company’s standing on the “4 Cs” that my colleague, Vistage International CEO Rafael Pastor, defines as the most important challenges facing executives today: costs, cash, credit and customers.

Over the past few years – even in today’s difficult times – companies as diverse as vintner Bronco Wine, retailer Zara, and electronic commerce purveyor Amazon have boasted enviable profit margins and customer loyalty metrics. Leaders of these companies credit much of their successes to innovative technologies, processes, supply chains, logistics, and other underground factors – which have, in turn, allowed the companies to slash costs, free up capital for product innovation, boost speed to market, and apply resources for greater customer responsiveness.

You’re not going to turn a leaden organization into a Bronco, Zara or Amazon overnight. But what can you learn from them as you cope with today’s challenging environment? Imagine the power of mobilizing people (exciting them, in fact!) to take innovation underground in the midst of a lousy economy. While your competitors are passively wringing hands, episodically nibbling at fat, compulsively plunging into slash-and-burn tactics or going to government for a bailout, your management team can be systematically rebuilding your organization for thriving in the future. By taking innovation underground, you will be driving down your actual cost of doing business, liberating resources for potent above-ground activities, creating a leaner, more agile organization and reaping the benefits of sustained margin and cash flow – even if you need to lower prices. That’s how you capitalize on the realities of kreppe. Here’s my 12-step blueprint for turning hard times into better times.

1. Commit to profit and cash flow, not just sales and market share. First and foremost, a leader must manage with the premise that in today’s environment, profit and cash flow are the key drivers of corporate health. This means that innovating on the cost end is as important as innovating on the revenue end. At Toyota, leaders do not divorce profit from discussions of sales growth, which means they are as obsessive about production and distribution efficiencies as they are about building revenue and market share. They are as obsessive at reducing the amount of working capital tied to day-to-day operations as they are with increasing the flair of new product designs. When companies (or executive planning sessions) trumpet sales and market share but gloss over profitability and cash flow, you know there’s something amiss underground.

2. Set audacious goals. This is the operational heart and soul of taking innovation underground. Years ago, Colin Gilmore, an operations manager at United Airlines, told me how he managed to achieve exceptional efficiencies at a United repair and maintenance facility. “I set impossible goals. I pointed to certain cycle times and told my people, ‘I want 80 per cent reduction.’ They said ‘That’s impossible.’ I said ‘You’re right – as long as we do things the old way. We’ll form into groups, examine every step in the process, every line in the budget, and then eliminate and reinvent. Anything is fair game except quality.’ As it turns out, we usually didn’t achieve 80 per cent, but we often got to 40 per cent and 50 per cent, which is a lot more than had I asked for a five per cent improvement.” Gilmore’s philosophy is institutionalized at Dell. Ex-CEO Kevin Rollins described it this way: “Michael [Dell] and I set irrational goals to encourage our team so they don’t think of conventional solutions.... If we asked for a 10 per cent or 15 per cent increase in productivity, we’d get conventional solutions. But if we ask them to double their productivity, then they have to rethink everything.”

3. Don’t stop drilling down. Taking innovation underground is not a one-shot or temporary process, even after the first positive returns roll in. It is an ongoing commitment. In contrast to their competitors, leaders at Bronco Wine, Toyota and IKEA are relentless in their obsessions because they

These are the kinds of companies you and your teams should be visiting and benchmarking during these difficult times, even if your firm’s products, services and price points are higher-end.
know there are yet more rewards to be unearthed from underground improvements. For example, furniture retailer IKEA has focused on developing new algorithms and systems in logistics, inventory management and materials management so as to continually redesign one of the company’s best-selling mugs. The goal of these efforts is to squeeze more units onto a single pallet, at last count going from 864 to more than 2,000. When spread over 25 million mugs sold each year, the cost savings drops millions of dollars straight to the bottom line and allows the company to boost margins even on can’t-be-beat pricing. And this obsession is only about mugs. Ponder the total return on investment as these obsessions are institutionalized across the entire product line of the IKEA organization.

4. Make technology your lifeline. The challenge here is to drill down into the organization with innovative technologies that will radically reduce what Michael Dell calls “friction”, that is, the organizational forces that bottle up or slow down the flow of information and ideas. Consider the Rand finding that digitalizing medical records alone could reduce health care costs in the US by over $140 billion annually. Then consider Indiana Heart Hospital, which has digitalized all documents, connected clinicians, administrators and data via wireless laptops and PDAs; it has thereby documented sizable gains in productivity, quality, speed and physician morale. As any good CIO or CTO realizes, the optimal impact of this step can only be realized when it is request for a proposal. For example, Virgin Atlantic has worked closely with technology supplier EDS for 25 years on underground innovations, such as the recent overhaul of Virgin’s entire global reservation systems. EDS staff not only initiate ideas and projects but work intimately with Virgin staff to regularly “co-create” new underground value. To reinforce collaboration and to improve the value-added in your company’s supply chain, it’s also to your advantage to help your suppliers innovate in their own undergrounds. Toyota sponsors regular joint programmes between its own employees and those of suppliers to figure out ways to help both parties radically cut the number of steps needed to make cars and parts. This step alone, according to Toyota, has generated multibillion-dollar savings, enhanced productive efficiencies and boosted goodwill immensely.

6. View outsourcing as liberation. Some costs your firm simply shouldn’t be carrying – period. Dean Singleton, the head of MediaNews Group, one of the few profitable newspaper chains (55 newspapers) in the US, says: “If you need to offshore it, offshore it. In today’s world, whether your desk is down the hall or around the world, from a computer standpoint, it doesn’t matter.” MediaNews Group has cut preproduction costs by 65 per cent by outsourcing the work to Indian firms. From manufacturing (outsourced by Ericsson) to document management (outsourced by Goldman Sachs), any function or task – but especially those peripheral to the core

accompanied by cultural changes towards more open, transparent and collaborative decision-making processes. Implementing this technology-culture interface will require investment, to be sure; but as Zara and Indiana Heart Hospital have shown, the returns on the right investments will be exponential. At Cisco Systems, the recent investment in seamless social networking systems has trimmed operating expenses and boosted profits by two to four per cent.

5. Seek suppliers who can help you improve your underground while you help them improve theirs. Be more selective in choosing suppliers by considering factors such as talent, innovation, trust and collaborative capacity as selection criteria, not just price. It’s to your advantage to grow relationships with (very) selected suppliers who can proactively help you reinvent your underground, not simply meet the terms of a contract or respond to a

value-add of the company – ought to be fair game for outsourcing. Many organizations bestow in-house monopoly status on non-revenue, cost-draining tasks and functions that do not directly contribute to the company’s growth nor add value to its core mission. No company should outsource everything, but a judicious, carefully calibrated focus on outsourcing can be a powerful weapon in stopping the organization from subsidizing non-essential activities, thereby freeing up critical resources for above-ground activities. Outsourcing routine, commodity and non-value-adding work will not only lower direct costs but will also clear up the debris that makes organizations fat and sluggish and distracts leaders from focusing on growing the business.

If you want innovation to happen underground, you must take command of the effort yourself.

7. Organizationally, keep it simple, lean and uncluttered. Approach your business with the following mantra: lateral pass-offs, vertical
management layers, and central corporate staffs are all potential sources of substantial costs; and even worse, they are often counterproductive. Therefore, creatively eliminate as much of them as you can and replace them with enlightened technologies and management systems. (The consultancy Hackett Group estimates that a hypothetical $20 billion company could save as much as $1 billion a year just by cross-disciplinary collaboration between sales, procurement and production.) Virgin CEO Richard Branson’s personal obsession is to “keep headquarters to a minimum” – a small handful for a multi-billion-dollar global empire – in order to push down brand innovation and profit-and-loss accountability. Remember Peter Drucker’s advice that, in organizations, there is nothing as stupid as making more efficient what shouldn’t be done at all.

8. Measure the underground obsessively. What gets measured gets done, as the saying goes. Ken Olevson, a turnaround expert in the manufacturing sector, has also found that what gets measured, publicized and discussed gets people excited to achieve. On some plant floors, he instigated some exceptional increases in productivity and morale with the most low-tech methods, like posting monthly and weekly goals along with daily progress towards those goals, on huge sheets of paper tacked on walls – and then rewarding achievement accordingly. At Whole Foods Markets, metrics such as inventory turns and margins are publicly posted per store versus across stores and per industry average. Dell concentrates on issues such as days in inventory, cash-conversion cycles, time to build a product and supplier performance. Medtronic carefully benchmarks supply chain processes with those of proven leaders like Wal-Mart, and then tracks its own accordingly. Dell concentrates on issues such as days in inventory, cash-conversion cycles, time to build a product and supplier performance. Medtronic carefully benchmarks supply chain processes with those of proven leaders like Wal-Mart, and then tracks its own accordingly. If it’s important, you measure it, you post it and you manage by it.

9. Hire innovative people for the underground. All too often, the most imaginative people work above-ground while the grim “green visor” folks rigidly control the underground “by the book”. Change that: hire creative irreverent iconoclasts who are burning to take charge and free them to accomplish the impossible in the underground. Give them some non-negotiable ethical, financial and performance standards, as well as attractive career incentives and then let them loose. Nike acknowledges that its revenues and margins dramatically improved when underground issues such as systems integration and inventory management became as “cool” as product design and engineering – and when innovative people were hired to do some cool things with those functions.

A blueprint for bouncing back

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- Set audacious goals.
- Don’t stop drilling down.
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- Seek suppliers who can help you improve your underground while you help them improve theirs.
- View outsourcing as liberation.
- Organizationally, keep it simple, lean and uncluttered.
- Measure the underground obsessively.
- Hire innovative people for the underground.
- Learn from companies that “get it”.
- Make it personal.
- Surgically remove “bad business” from your books.

10. Learn from companies that “get it”. Consider IKEA, Emerson, Wal-Mart, Costco, ING Direct, Southwest Airlines, Ryanair, Go! Airlines, indiOne Hotels, Dell, ExxonMobil, Tata Motors and the entire Easy Group empire. What do these companies have in common? The answer is that each of them is ruthlessly committed to continuously innovating (not just “continuously improving”) their underground as a strategic priority in order to generate profitable growth and strong brands with rock-bottom pricing. These are the kinds of companies you and your teams should be visiting and benchmarking during these difficult times, even if your firm’s products, services and price points are higher-end. You don’t need to be in the auto industry to find great value in learning how Tata Motors in India can actually make a legitimate $2,500 car, and, even more remarkably, expect to profit from it. In developing the Nano car, Tata has been helped by low labour costs, to be sure. But the company has also poured innovation into materials management, supplier selection, radical outsourcing, modular assembly, draconian reduction of parts, tubeless tire development, engine miniaturization and other processes that have generated over 30 patents. How can Tata’s innovations be applied to your own organization? Don’t limit your benchmarking to firms whose performance is incrementally better than yours. There is nothing that will educate or inspire people as much as personally learning from companies who are doing something that conventional wisdom says is impossible. This is as true with the underground as it is with the above ground.
11. **Make it personal.** If you want innovation to happen underground, you must take command of the effort yourself. You don’t need to become an efficiency expert, nor should you micro-manage, but you must demonstrate that you’re engaged and passionate about the underground. “I’ve not seen an effective leader who can’t spend time down in the trenches,” says Amazon CEO Jeff Bezos, who spends a lot of time there. And when he does, he gets down and dirty, like on his knees with warehouse equipment. He peppers people with questions about operations speed, the number of customer contacts per order, the average time spent per customer contact, the breakdown of email versus phone contacts and the total cost of each. He wants to know how the system can get better and what he as a CEO needs to do to help the process. He’s personally engaged in the underground. To take this principle a step further, you need to “literally” live the message personally.

Bronco CEO Fred Franzia is rich, but his office is inside a barebones trailer and when he travels he stays in cheap motels – and everyone knows it and thereby understands the corporate priorities. You don’t need to emulate Franzia’s ascetic lifestyle; but as a leader you’re a visible role model and to some extent you must role model the message, especially during trying times.

12. **Surgically remove “bad business” from your books.** Many company leaders implicitly define any revenue source (products, markets, assets or customers) as good business if it raises sales and market share. This is erroneous. Good business also spurs growth in profit margins, brand differentiation, investor excitement and market buzz. Bad business does not. Jan Carlzon, explaining his impressive 1980s turnaround of Scandinavian Airlines (SAS Group), contrasted the two types of business best when he said: “The secret of good business is knowing the bad business to turn away.” Leaders must acknowledge that some business will provide revenues and market share and also keep a company stuck in high-cost, declining-growth, here’s-what-we’ve-always-done-and-who-we’ve-always-served quicksand. Too many resources get drained and too many leaders get distracted by attending to those kinds of bad business, products and services that have become chronic low-margin commodities and ought to be let go, low-growth saturated markets that ought to be abandoned, customers who generate a poor return on investment and literally ought to be fired, poorly performing or poorly fitting (with core strategy) divisions that may have been lucrative in the past but now ought to be divested. The more bad business is on the books, the more costly and sclerotic will be the underground that has to support it, and, obviously, the more challenging it will be to realize the powerful returns from the prior 11 steps described above. Surgically removing bad business not only helps clean out the underground, but it also releases insights and resources that build good business.

**Taking innovation underground**

Thinking about this blueprint, you may ask why more attention has not been paid to things like products and customer service. Aren’t they important too? My reply is this: I’ve focused on the underground because in a prolonged economic downturn, you can’t go wrong by concentrating on costs and cash flow. But the beauty of taking innovation underground is that it stimulates innovation in products and services too. At Zara, the global real-time communications cycle between store managers and designers is essential for cool product development. The paperless environment at Indiana Heart Hospital has freed the organization to concentrate on the most cutting-edge medical interventions and personalized clinical care. The organizational and technological networks at Cisco Systems have generated literally a tenfold increase in new projects (several boasting multimillion dollar revenue streams within months) and a double-digit decline in time to market. Taking innovation underground is the critical engine for achieving success in a lousy economy and for preparing for domination in an improved economy.