THE ONLY WAY IS UP

Just because the world is in a business downturn, it doesn’t mean that you and your business can’t be up about your future prospects. Don Sull has specialized on the upside of turbulence.

Don Sull is a multi-faceted talent in the business world. After graduating from Harvard University, he worked as a consultant with McKinsey & Company and as a management investor in a leveraged buyout firm. He then earned his MBA and doctorate from Harvard Business School and taught there before joining the London Business School faculty, where he is Professor of Management Practice in Strategic and International Management and Faculty Director of Executive Education. Recognized as a global authority on how organizations can succeed in turbulent times, he has published four books and over 100 case studies, book chapters, and articles. His new book, The Upside of Turbulence, is forthcoming in October.

In addition to the printed word, Sull embraces the virtual world of podcasts and blogs. His blog for the Financial Times can be found at blogs.ft.com/donsullblog, and his podcasts and videos are accessible at www.donsull.com. Sull talked upside to Georgina Peters.

Your blog is titled “Leading in turbulent times”. Why did you like that phrase as a theme for your commentaries?
Most business executives these days would agree that companies operate in an era of exceptional turbulence. Lehman Brothers, they might point out, weathered the US civil war, several recessions, four financial panics, two world wars, depressions, oil shocks, and the terror attacks of 9/11, yet could not survive the current financial crisis.

Studies of the global economy tell a different story. Macroeconomists refer to a “great moderation”, based on a reduction in cyclical fluctuations in gross domestic product in recent decades in most high-income countries. How can we reconcile the boardroom perception of growing turbulence with evidence of stability?

Part of the explanation lies in the timing of the latter studies, which predated the present economic crisis. A more fundamental explanation: stock market indices and GDP can mask increased volatility at the company level. Greater turbulence puts an individual company’s survival at risk. The average life expectancy of a company listed on the S&P index has decreased from 90 years during the 1930s to under 25 years by the late 1990s, while the probability that a public firm would disappear in any given 10-year period more than doubled from the 1960s to the 1990s. The odds that a high-performing firm would be dethroned from industry leadership tripled between the 1970s and the 1990s.

My own sense is that, when the data points are taken for the first decade of this century, we’ll see some staggering shifts in corporate stability. For me, the central challenge for any executive right now is to lead in these turbulent times.
Your blog offers more than commentary; it also puts forth strategies and tactics that executives can use to deal with the turbulence. What are the essential things for an executive to keep in mind?

One of my entries talked about “How to seize the upside of the downturn”, and I received a lot of positive response to that posting. In a recession, companies can accelerate organizational change, take share from rivals, acquire resources cheaply and outmanoeuvre rivals. My core advice:

- **Explore anomalies to identify opportunities.** Unexpected events signal a gap between strategy and competitive realities. By exploring anomalies, managers can spot opportunities others miss.

- **Collect “rush” data.** Compile information that is real-time, unfiltered, shared across the organization and holistic enough to provide a multifaceted view of a complex situation – to spot threats and opportunities.

- **Be agile.** Rather than trying to predict an unknowable future, build an organization capable of seizing unexpected opportunities as they arise.

- **Execute by commitments.** At its heart, an organization is a dynamic network of commitments up and down the chain of command, across units and to external stakeholders. Cultivate and coordinate commitments to execute in a systematic way.

- **Use simple rules for a complex world.** Rather than match market complexity with complicated strategy, apply a small number of heuristics to critical processes.

**Good points, but is there a risk of making surviving in turbulent times seem too easy?**

Of course. I offer the above as compass points, not any kind of prescription. Turbulence poses daunting questions for business leaders. How to lead when a dense fog of uncertainty obscures vision into the future? How to balance stability and flexibility? How to spot opportunities that emerge outside the established course of business? How to balance a portfolio to exploit existing businesses while nurturing promising new opportunities?

Many people assume that leaders such as Bill Gates or Sir Richard Branson possess some genetic endowment that allows them to succeed in a turbulent world. Decades of research, however, have failed to uncover any meaningful link between enduring personality traits and the successful pursuit of opportunity. Entrepreneurs and managers seize the upside of turbulence not because of who they are but because of what they do.

**You once listed five myths about business failure. They were compelling.**

Many companies are suffering in the current recession, and their leaders blame their struggles on the financial crisis. Many of these explanations are too simplistic. Leaders should be careful that they are not lapsing into believing any of these five myths about business failure in a downturn:

**Myth 1: The downturn caused our problems.** For most industries facing serious problems right now, including big losers like automobiles and print media, the recession is not the ultimate cause of their suffering. Instead the downturn reveals (and aggravates) fundamental flaws in their business model. When the tide goes out, as Warren Buffett famously observed, you find out who has been swimming naked. These business models were broken long before Lehman filed for bankruptcy and will remain broken unless executives use the downturn to begin fixing them. Take General Motors. The automaker’s problems certainly did not originate with the current drop in consumer demand or higher retiree and medical costs. GM’s problems arise from the company’s inability, over decades, to make cars people wanted to buy. US car and light truck registrations more than doubled between 1970 (104 million) and 2006 (235 million). At the same time, GM’s market share collapsed from nearly 45 per cent in 1970 to under 20 per cent in 2009.

**Myth 2: Companies fail quickly.** Companies make the news when they abruptly file for bankruptcy. While firms file quickly, they fail slowly. As a junior consultant at McKinsey 20 years ago, I remember a presentation to a Detroit automaker highlighting many of the problems that plague the industry today, including poor product quality, high cost
structure, and slow response to shifting consumer trends. The executives did not respond with indignation or denial, but indifference. One manager dismissed the report by saying “there is nothing new here.” That was in 1988. Some companies do fail quickly, particularly trading firms such as Lehman Brothers or Long Term Capital Management, that rely on their ability to raise short-term funds. When counterparties lose confidence and withhold cash, they fuel a vicious downward circle. Most companies fail like GM, however, not Lehman. Slow decline is both good news and bad news for leaders. It provides them with the time to experiment with new business models and implement change but can also sap the urgency needed for change.

Myth 3: No one saw it coming. If by “it” people mean the current recession, this is true. But the downturn is the proximate rather than the ultimate cause of most business failures. The newspaper industry, for example, responded with dismay when the Tribune company, owner of the Chicago Tribune and the Los Angeles Times, filed for bankruptcy late last year. When might they have seen the fallout of digital technology coming? Maybe in 1995, when the Nieman foundation hosted a conference on the “online era” that included Arthur Sulzberger, Jr., the publisher of The New York Times? Or in 1981, when the Thomson Corporation, which then published over 100 newspapers in North America, bought a medical information business and sold The Times newspaper, beginning its transformation into a digital media powerhouse that culminated in its 2007 acquisition of Reuters? Or might print executives have noticed the signs in 1978, when Knight Ridder recognized the imminent emergence of digital media and launched videotex, which loaded news over a dedicated telephone connection? The reality is that the newspaper industry has had at least three decades of clues that their business model was at risk. The problem wasn’t that they couldn’t see the writing on the wall, but that executives at most newspapers failed to experiment creatively or drive transformation aggressively.

Myth 4: Things will return to normal after the downturn. Successive cohorts of executives in the automobile and airline industries, among others, have consoled themselves and appeased their investors with this myth. In many realities, the situation is likely to be worse, and stay worse, after the downturn. Consumers and corporations do not stop spending altogether in a recession, but they do seek out value for money. As a result, they are more likely to move away from companies that offer poor value for money and experiment with alternatives. Shoppers at ASDA, for example, are increasingly turning to the company’s George budget clothing line and, if they are satisfied with the quality, may not return to higher-priced brands. Homeowners who cut out real estate agents to save costs may find the process of buying or selling a house without a middleman is not only cheaper, but more straightforward and quicker. Consumers who try alternatives are unlikely to flock back to business models that do not add value after the recession.

Myth 5: It couldn’t happen to us. Some executives resort to Schadenfreude to lift their spirits in a downturn. To feel better about the woes in their industry, book publishers snicker at newspapers, and even print executives can look down on their unfortunate counterparts in the music industry. In reality, leading companies in many industries, including law firms, pharmaceuticals, fast moving consumer goods and executive education, are persisting in very flawed business models, even if the severity of their problems is not yet apparent to everyone. The best way to ensure corporate failure is to assume it could never happen to you.

In a recession, companies can accelerate organizational change, take share from rivals, acquire resources cheaply and outmanoeuvre rivals.
The good For many companies, the downturn is the root cause of declining financial performance. These companies are executing well against a sound business model, but they still experience profits and cash flow declines in the face of tough market conditions. The downturn has been particularly hard on firms exposed to the US real estate market (such as banks, construction firms, real estate developers) as well as well-run operations, like Cemex, that borrowed too much during the boom. Good firms facing hard times should weather the downturn with minimum damage and position themselves to thrive when the economy rebounds. I’m thinking here of companies like Carnival Cruise Lines, Toyota, Tesco, Johnson & Johnson, Southwest Airlines, Wal-Mart, P&G, IBM, Accenture, Standard Chartered Bank, Banco Santander, Telefonica, Royal Bank of Canada, Reckitt Benckiser, Samsung, Goldman Sachs, ArcelorMittal and Nokia.

The bad These companies struggle because of poor execution of a sound business model. GM pursued the same strategy as Toyota but did so very poorly. GM founded Saturn in 1985 to produce high-quality small cars that could compete with offerings from Toyota and Honda – a sound strategic decision marred by dreadful execution. The downturn is proving particularly painful for companies that were struggling with execution during the boom. The good news is that leaders can use the downturn to make difficult organizational changes that can help their company to execute more effectively. I’d list these companies in this category: Motorola, Sony Ericsson, Nortel, Gap, Kodak, Unisys, Thomson, Office Depot, Philips, Telecom Italia, BT, UBS, Sears, K-Mart, Circuit City, Sun Microsystems and Heineken.

The ugly Firms in this category face the most daunting challenge of all, because their business model can no longer create value. No amount of good execution can compensate for a broken business model, although it may ensure that a well-run company is among the last to fail. Business models typically go bad over extended periods of time, as a firm’s ability to create value erodes gradually, culminating in a sudden collapse. By the time a business model has collapsed, it is easy to identify as broken but almost impossible to fix. Obviously broken business models include legacy airlines, newspapers, music labels, book retailers and Internet service firms (for example, Razorfish, Scient, Viant, C-bridge, Zefer).

How does a manager know whether his company is "good" by your definition – and how should he or she steer the company accordingly? You know if your company is good if it is among the leaders in your industry by multiple measures (for example, revenue growth, profitability, value creation, low costs). You can also tell if your sector has multiple healthy competitors.

And, if you’re in this position, my basic advice for using this downturn is to seize market opportunities that less well-run competitors cannot, make ongoing operational improvements, invest for the long term, look for bargain acquisitions, inject urgency to make necessary changes, prune costs that sprouted like weeds and don’t panic.

And what of the manager in a “bad” company? My sense is that managers can tell if they’re in a bad company category if those competitors following the same business model are successful; if you’re losing global market share over time; if there is a large gap between your firm’s performance and leading rivals on operational, financial, innovation, brand and other measures; if your company is repeatedly too late in seizing market opportunities; or if top management switches from one strategic initiative to another without effectively implementing any of them.

But even a bad company can take positive steps, no? Such companies can use the downturn to initiate or accelerate transformation to improve execution, force hard choices throughout the organization to increase focus, instil processes to ensure ongoing cost discipline, link layoffs to individual performance to cull underperformers, forge key managers to work as cohorts to improve execution, simplify operations to ease execution, cull corporate priorities to a handful to guarantee execution on those, improve how work is done (for example,
process improvement or commitment-based management), build IT infrastructure to monitor execution and change compensation systems to reward performance.

And the signs to look for if your company is “ugly”? How do you know if your company is ugly? Look for these signs: all companies in your industry are in serious trouble, there are widespread bankruptcies, your competitors are resorting to desperate actions, or government intervention in your business has become the new norm. Unfortunately, your choices of what to do are slim. You can just manage to survive the downturn and live to fight another day, declare bankruptcy, shrink drastically to a defendable core or seek government aid.

Anything else? Pray.

Opportunity knocks
Your blog may be about survival, but it seems to resonate many times with optimism. You wrote a great post about opportunity.

That’s because I do think that companies and leaders can become too down, personally, during a downturn. In the midst of the present economic crisis, many managers fixate on the risks to their core business – slowing demand, falling prices, and scarce credit. Exclusive focus on the abundant bad news obscures a counter-intuitive but crucial truth about downturns – the worst of times for the economy as a whole can be the best of times for individual firms to create value in the long run. If your business is good, bad – and maybe even ugly – there are usually opportunities that you would be wise to consider. Let me list the major types of opportunities I’m thinking of:

- **Market opportunities** Firms can increase revenues in a downturn by responding to customers’ shifting demands, inducing trial of new products, or poaching clients from struggling rivals.

- **Resource opportunities** To raise cash, many companies must sell tangible and intangible assets at low prices, creating opportunities for firms that have the wherewithal to acquire in a downturn.

- **Operational opportunities** Executives can use the downturn to improve work practices and hone existing processes to reduce costs in the short term and increase efficiency going forward.

- **Portfolio opportunities** Executives can use the economic crisis to force hard choices on a company’s portfolio of business units, products and customers. These choices include clear decisions on what to do, what not to do and, most importantly, what to stop doing.

- **Transformation opportunities** An economic crisis provides the ideal occasion for executives to step back and rethink their business model, begin a transformation process to position the firm to compete in the future or accelerate an ongoing change initiative.

Are there examples of companies demonstrating how such opportunities can lead to success? There are many. In past downturns, firms including Toyota, Nokia, Cisco and Carnival Cruise Lines emerged from an economic crisis stronger than when they entered. Like the mythical Libyan wrestler, Antaeus (who regained his vitality when thrown to the ground), these companies derived competitive strength from economic hard times, even as their competitors languished or failed. Several factors influence a firm’s ability to seize the opportunities presented by a downturn, including their strength entering a recession and the organization’s agility in spotting and exploiting changes in the market.

A critical difference between firms that thrive or stumble in a downturn is how well executives understand the range of opportunities that arise during a recession, and what it takes to seize that opportunity and convert it to newfound success.