

MEMO TO THE CEO

Winning in Turbulence

Clarify Strategy

BY

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HELP YOU LEARN HOW TO MANAGE IN A DOWNTURN

Harvard Business Press
Boston, Massachusetts

ISBN-13: 978-1-4221-6677-2
6678BC

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Clarify Strategy

Choose Where and How to Win

WHEN A PERSON'S LIFE is threatened, the body adapts superbly for fight or flight. Blood flow is diverted to the lungs and other critical areas. The pupils dilate to improve vision, and hearing is sharper. Breathing, heart rates, and response times accelerate. The odds of survival improve.

If only a company could respond so brilliantly to the dangers of a downturn. Instead, executives often struggle to distinguish between core activities and less-vital functions. They look inward rather than outward. Their decisions are hampered by loss of concentration, diminished creativity, and an inability to perceive and learn from new information. When that happens, the odds of survival deteriorate.

The goal of strategy in a downturn is to help you end up on the right side of the mortality tables—not just surviving but poised for growth, as Darwinian forces eliminate weaker competitors. To build that strategy, you need to

know exactly where you will compete, how you plan to win, and how you will mobilize the organization to implement the strategy.

Where to Compete: Defining the Core

In good times, companies expand their operations. They add product lines, expand into new geographic areas and customer segments, and even experiment with new business models. Then comes a downturn. The company can no longer do everything it once did, and the decisions about where to focus can be agonizing. Traditional strongholds may be profitable, but can they deliver sufficient growth? New business arenas are growing, but they are proving far more challenging than expected. Besides, we launched them with such fanfare—won't we look ridiculous if we cut them back so soon?

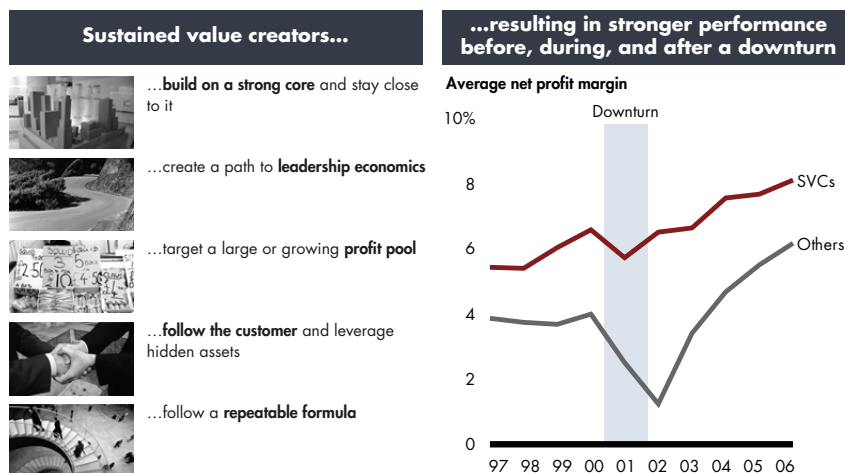
Bain's analysis shows that concentrating on a company's core business dramatically improves the odds of success in a downturn. About 95 percent of the companies that we call sustained value creators—those that maintained at least a 5.5 percent real growth rate in revenue and profit over ten years while earning back their cost of capital—are leaders in their core businesses. Strong cores also helped this group perform better and recover faster in the last downturn: average net profit margins bounced back to 6.5 percent in 2002, only slightly below pre-recession levels in 2000. Their competitors fared much worse, with average net profit margins falling to around 1 percent during the same period, a drop of about 3 percentage points. Again, it's like the human body: faced with threats, it relies on the fundamental systems at its core that afford the best chance of survival (figure 1).

But deciding to focus on the core is much easier than finding it and developing its full potential.

Defining the core begins with an outside-in view: delineating the markets you operate in, assessing what is happening in those markets, and defining the company's strategic position in each one. How are customers' needs changing? Where might competitors be newly vulnerable? This is not an exercise in listening for what you want to hear, with conclusions that flatter your accomplishments; it's based on a robust definition of the boundaries between markets and a realistic assessment of competitive position. And it's a critically important step in a downturn, because the wrong market definition can lead to strategic missteps even when times are good. In the late 1990s, for example, Gillette decided to view its core business as "checkout purchases" and thus diversified into batteries and writing instruments. But these

FIGURE 1

Clarify your strategy: Invest to gain share in core business(es)



Source: WorldScope; Bain analysis, 2008

businesses had little in common with Gillette's razor business, so synergies were few. The company struggled, and its stock price fell by more than 60 percent between 1998 and 2001.

The outside-in view, in turn, sets the context for a thorough inside-out analysis. Where is the company generating the best results, measured by profitability and growth? Which product lines, which markets, which customer segments? With this fundamental data in hand, you can ask two critical questions that managers often miss.

- Who are the customers that we love the most—and that love us the most? Imagine a grid showing the profitability of different customer segments on one axis and the loyalty of customers in those segments on the other. In the upper right-hand corner are the customers who generate the most profits, and who can scarcely get enough of what you offer them. They are your “profitable promoters”—the ones who will buy from you repeatedly, sing your praises to their friends, and make money for you. They are at the heart of your business.

- *What unique advantages do we have?* A company's unique capabilities can be as important as its best customers. It may have exceptional engineering skills, like Intel, or marketing abilities, like Nike. It may have created a distinctive set of relationships with customers. Singapore-based Olam International, a leader in the business of supplying agricultural commodities from emerging markets to large food processors in the developed world, got its start by developing exceptional skills in managing the price and foreign-currency risks that are endemic to the business. Companies may also have a distinctive set of assets, such as De Beers's diamond mines or Disney's cartoon characters, or a dominant share of particular markets. All these can give them an economic advantage that no one else has, at least for a while.

Such advantages help companies decide where to compete, and in a downturn they're more important than ever. Procter & Gamble, for instance, has always owned a strong set of brands with loyal customers in many segments. In recent years it has reinforced those all-important customer relationships through continuous innovation designed to deliver specific benefits to customers. As a result, P&G can compete effectively—and retain more of its customers—in any area where it decides to focus these capabilities.

How to Win: The Repeatable, Adaptable Model

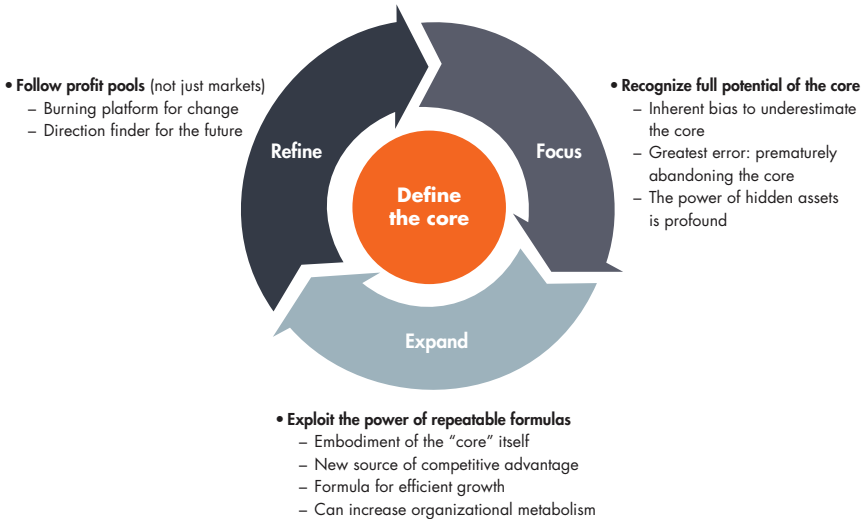
How do you know if your core business can compete successfully? Short-term financial measures don't always provide reliable insights into the health of a core or what may be required for it to succeed. There is simply too much noise in the signal—too many variables that affect performance—to have confidence in the message. A 20 percent drop in revenue, for instance, may reflect the immediate impact of a downturn or it may signify a troubled core.

Repeatability

The key to a strong core business is a *repeatable formula* that allows the company to reinforce and expand the core in ways that won't later require retrenchment. The formula defines how the company intends to win. Its repeatability conditions the organization to move quickly and instinctively, the way years of practice help great athletes develop the muscle memory that enables them to compete at the highest levels (figure 2).

FIGURE 2

Clarify your strategy: Three pillars of strategy under turbulence



Source: Bain analysis

Compare the histories of Nike and Reebok, for example. In 1987, Nike’s operating profits were \$164 million to Reebok’s \$309 million, and Nike’s market valuation was half that of Reebok’s. Fifteen years (and two downturns) later, the situation was reversed: by then, Nike’s profits were \$1.1 billion while Reebok’s had declined to \$247 million. The difference was that Nike had developed the repeatable model that enabled it to expand its core business systematically from jogging to volleyball to tennis to basketball to soccer, and so on. Nike executives told us that this model was built on four core capabilities that remained constant throughout the company’s history: world-class brand management, an ability to develop sports stars as brand icons, superior R&D capabilities in shoes, and a strong apparel supply chain. Reebok, meanwhile, veered from one business to the next with no clear plan. Unrelated investments such as the acquisition of the Boston Whaler boat company sapped the company’s strength just as its core shoe business came under attack.

In our experience, most successful strategies are based on some kind of repeatable model that strengthens and expands the core. The power of a

repeatable model is its simplicity. Everyone in the organization, in effect, knows the business's priorities, and has the skills and capabilities to make the core as strong as it can be. They can move fast when opportunities arise. In a slow economy, all that is invaluable.

Adaptability

Repeatable, however, doesn't mean *unchanging*. In fact, Darwin would say that adaptability is at least as important as fitness for survival. Recessions have a way of accelerating Darwinian shakeouts. The reason, of course, is that nothing holds steady in a downturn. Companies must make tough choices about which markets they can compete in most effectively and then revisit those choices as new information becomes available. They must make hard decisions about where they will develop world-class capabilities and assets and where they will be satisfied with "good enough" for now. Those decisions, too, need to be revisited regularly.

To react quickly and effectively to what's happening in their markets and industries, companies need a system for gathering and acting on feedback from the front lines of the business. The human body constantly scans the environment for changes in temperature, food supply, competitive threats, and other vital factors. Changes in the environment trigger immediate adaptations in metabolic rates, adrenaline levels, even perspiration. Companies can learn to do the same. For example, they can do a quick Net Promoter® Score (NPS) survey of customers after every transaction, asking how likely it is that the customers would recommend the company or the product to a friend or colleague. Answers to this question—scored on a 0–10 scale—correlate closely with customer loyalty and can serve as an early warning of incipient dissatisfaction or defection. The brokerage firm Charles Schwab, for example, used the Net Promoter system to reverse declines in revenue and profits and recover its market position. Schwab cut its prices to reestablish its position as a value leader. It also eliminated "nuisance" fees and invested in service improvements at every level. Schwab constantly monitored its NPS survey scores during these moves, using its client feedback loops to keep the organization focused on clients and make sure its new strategy was on the right track.

Rigorous feedback loops are invaluable in a downturn, as companies try to determine whether customer priorities are changing and if the specific economic advantages of their repeatable model continues to apply. U.K. retailer Tesco's repeatable model is its ability to open store after store and to cater

effectively to different customer segments with different store formats. As the current recession took hold in the United Kingdom, Tesco saw that its customers were looking for value-priced products, and so began emphasizing value rather than premium lines.

Often, the keys to adapting a company's repeatable model are found within the company's existing business. Unilever, for example, has responded to recessionary trends in the United States and Europe by expanding an innovative rural distribution model led by women's self-help groups to several emerging markets. Hindustan Unilever's *Shakti* program, which enables unemployed rural women in India to set themselves up in business as direct-to-home distributors of Unilever's consumer products, is being adapted to Sri Lanka, Vietnam, and Bangladesh. The women sell the products—usually in small, inexpensive packages—in rural villages not reached by other distribution channels. Unilever aims to use the low-cost distribution network to tap fresh avenues of growth in Asian, African, and Latin American markets.

Strengthening the Core

Companies with a formula built into the organization's muscle memory can often invest to strengthen it, even during a slowdown. They naturally tailor investment levels to the economic climate and available financial resources and they emphasize adaptability as well as repeatability. But they don't let up, and that steady persistence helps them pull away from competitors. Southwest Airlines is a prime example. During the 2001–2002 downturn it discounted fares heavily, boosting demand and reinforcing its positioning as the leading low-fare airline. It invested only modestly in capacity growth, less than it might have in normal times but still enough to hone its repeatable model of expanding into new regional markets. It also launched an aggressive advertising campaign to build its base of loyal customers. Thanks to these moves, Southwest emerged from the downturn with greater market share.

Sometimes the best way to strengthen the core is to refocus it, selling off businesses that are less closely related so the company can grow around a more tightly defined core. General Dynamics pursued this strategy in the early 1990s. Facing a prolonged slowdown in the defense industry, the organization began divesting companies in aerospace and missile systems, where it had no chance of establishing leadership. Revenue declined, but profitability increased. The company then began reinvesting in a better-defined core, bolstering its marine systems business through acquisitions and building a new, related core in electronics and defense information systems. By

2005 its revenue and profit growth marked it as the best-performing defense company in the United States during this period.

How to Mobilize: The Change Model

In a downturn a company must respond quickly to threats. The strategy often shifts from expansion to reinforcing the core. Changes like these can be unsettling to people in an organization—one reason for the slowness and confusion that often characterize companies' responses to a recession. The challenge is to help people understand the new direction and enable them to work in concert rather than at cross-purposes. We call this *mobilization*, and it's an essential part of a strategy designed to strengthen the core.

Mobilization spells out the *what*, *who*, and *when* of change, but it particularly focuses on the *why* and the *how*. Both are essential in a recession. Understanding the reasons for change is critical, because people must believe they will emerge from the turbulence as winners. If they believe they are relying on a bad business model, they won't engage. The *how* of change is equally important. Companies habitually expect more of their employees in a recession, often because they have reduced headcount. But you can't engage people by asking them to do the same things at, say, 20 percent less cost. They need to believe that what they are doing now—implementing the new strategy—will lead to a better future.

Mobilization starts early, as soon as the strategy itself is being determined. In the first phase of a change effort, managers naturally focus on assembling the fact base and creating alternatives. But companies preparing for mobilization will already be assessing the challenge of rallying the entire organization behind the strategy. In the second phase, most attention focuses on making strategic choices; companies should also weigh the practical requirements of implementing each option. The third phase then focuses on mobilization itself. Change leaders must create a compelling vision and communicate it all the way through to the front line. They must define clear roles for implementing the change and launch the right initiatives to get it started. They must set up effective project management capabilities, complete with contingency plans and well-defined accountabilities.

A downturn tests the core. When you mobilize to strengthen it, you find out how strong your repeatable model is, and how adaptable. It's a moment of truth, and a vital measure of your company's ability to fight in segments where it has decided to compete, flee other segments, and emerge from the trauma stronger than before.