

Restructuring is more than just cost-cutting

Restructuring is making a comeback in the wake of the economic crisis that has developed out of the financial crisis. For despite the prevailing mood of uncertainty, one thing is clear to most corporate executives: unlike Germany's 2003 recession, this time round the Austrian economy will also be hit just as hard, despite – or rather because of – the country's close ties with Central and Eastern Europe.

By and large we are therefore seeing a relatively swift reaction from Austrian executives. They seem to be neither paralyzed with fear nor in denial of reality. The key question they are asking is: "What's the best way for me to react?" The initial reflex tends to be to cut costs and, in the same context, to cut jobs.

This is too short-sighted in our view, however. In the following, we make six recommendations on how companies can (or should) **react intelligently and far-sightedly in a sudden economic crisis**.

1. Check the management model

In the last five years, Austrian companies have **considerably decentralized their decision-making structures** – a typical development during growth phases, when market proximity and entrepreneurial freedoms are decisive factors. In a sudden economic downturn, however, this organizational form has four marked disadvantages:

- First, **local assessments** on further market development **tend to be too positive**, which evidently has to do with the temperament of decentralized national CEOs. Yet especially in the current situation, it will be crucial to assess economic developments in 2009 realistically and, above all, uniformly across an entire region.
- Second, short-term **budget deviations**, both in results and in incoming orders, are frequently **offset** by "adroit" decentralized managers releasing these hidden reserves or delaying postings. This prevents news of deviations from reaching headquarters quickly.
- Third, in a situation where very rapid reactions are required, **much time is lost** to the built-in discussion and coordination process in highly decentralized structures. At the same time, uniform actions may be interpreted or implemented differently in the various countries.
- Fourth, **central risk management** with swift and unbureaucratic channels of communication is especially important at such a time. Yet RM is very rudimentary in many industries, following the positive developments of the last few years (for example, in construction or plant engineering).

Against the background of these four factors, a group executive board's first step in the current situation must be to keep a tighter rein on things and to switch very quickly to a more centralized decision-making structure. Since a fundamental group reorganization usually requires supervisory board approval, we do not recommend

complete restructuring, which would take too long anyway. Instead, we recommend **centralizing only individual processes**, as well as tightening the company's rules of procedure and decision-making guidelines, creating greater transparency in controlling departments and installing a central risk management system.

Central control while retaining a basically decentralized organizational model also makes it possible to **maintain momentum, local market orientation** and the motivation of the recently built second and third levels of management – despite the crisis.

2. Secure the home market

A **stable home market** is one of the most important success factors of fast-expanding, international or even global corporations. Market shares are usually higher in the home market, so that the **margins are typically better**, the legal and regulatory environment is better known, there is no (or little) currency risk, the rate of **capacity utilization** tends to be **higher** and the **cash flow** therefore **better**.

The world's 500 largest companies, for example, generate 60 to 80% of their business volume in their home market (be it the US, the EU or Japan). This usually represents an important basis for international success.

The definition of the term "home market" has changed for most Austrian companies over the last decade: it is no longer limited to Austria, but increasingly extends to Central Europe. In the current crisis, and in anticipation of what looks like a difficult year in 2009, it is crucial for Austrian companies to secure both their market position in their home market and the **income reserves** resulting from it. From a strategic point of view, securing these markets is much more important than securing distant export markets where market shares have been built up only in recent years – albeit at great cost in some cases.

This doesn't mean that companies in overseas markets should be rashly sold or closed down, only that top management should sharpen its focus. **Securing the home market** relates both to market share (and hence absolute volume) and to the **margin and price situation**. High strategic priority must be placed on avoiding a price war and a potentially permanent erosion of the price level in the home market.

3. Organize key account management

Getting the structure of the sales division right in terms of key account management is especially important for larger B2B companies that are organized in business units, divisions or largely independent national companies (usually with their own production). The automotive industry is a typical example, but this also applies to many producers of components and machines. In this field, too, the growth period of the last few years has largely led to a **reduction in internal coordination** or, to put a more positive gloss on it, to a decentralized entrepreneurial structure. Furthermore, large groups typically focus less on internal coordination, guidelines, processes and communication after a boom phase.

This can have very dangerous consequences in an economic crisis, however, for the first thing big customers do is to try to cut their material costs. They are also very

quick to launch internal projects to optimize their purchasing. Moreover, customers tend to have a better and more streamlined organization in their purchasing divisions than (selling) companies in their sales divisions. This can cause information asymmetry and very quickly lead to **disadvantageous negotiation outcomes**.

Therefore, a **meaningful structure for effective key account management** has to be found in times of economic slowdown. Each company must then judge in each individual case whether to centralize responsibility for customers ("one face to the customer") or only to coordinate it internally in the background ("one voice to the customer").

For this reason, greater key account orientation is also strategically significant because it can **prevent the customer portfolio from fragmenting**. Such fragmentation can occur if, after a sudden drop in capacity utilization in the sales division, attempts are made to win small contracts, even at marginal cost, to offset short-term capacity fluctuations. This approach can become highly problematic, however, because it significantly reduces process efficiency. Moreover, the sales division becomes distracted from its most important customers, opening the door to the competition.

4. Optimize decentralized value structures

Over the last few years, many companies have expanded not only organically, but also by taking over entire production and sales structures. However, many corporations have postponed **restructuring the value chain** within individual regions or across entire groups – arguing that they don't want to disturb healthy, newly acquired companies.

Looking on the positive side, this creates opportunities to **quickly leverage earnings and thus value** in many cases. Furthermore, this is based on an externally justified argument which can typically increase the pressure to implement actions and therefore succeed. Yet our main concern is not to centralize tasks, but primarily to coordinate tasks between national companies: for example, setting up regional shared service centers, optimizing the decentralized logistics network, defining the value structure, merging individual areas of production or getting individual locations to specialize in manufacturing technologies.

5. Strategically optimize central functions

The question of staff cuts in the holding company or corporate headquarters itself comes up in every cost-cutting project – and it is often at the top of the list. Although it goes without saying that the headquarters, too, has to be lean and efficient, we warn against overly hasty cuts in central tasks and functions. The argument against this step is not the idea of "holding onto resources for better times" or a "long-term orientation." Although both of these are fundamentally desirable, they are often not very helpful in a short-term income crisis.

Rather, our argument is that certain **central functions make the advantages of a group structure possible** in the first place. The background here is simple: over the last ten years, Austrian companies in particular have consolidated a fragmented, highly regionalized business across Europe, even worldwide in many industries (e.g.

in the construction, construction components and packaging industries). As a result, some of them have even become market leaders while much of the competition has remained medium-sized. **Medium-sized competitors**, however, also mean better market knowledge, greater customer loyalty and a leaner structure – leading to a more favorable cost structure (typical example: "no SAP").

If they react correctly in terms of strategy, these medium-sized competitors will also follow our recommendations 2 and 3 in times of crisis, i.e. securing their home market and strengthening their key account management. This, of course, makes life much more difficult for large groups.

The strategic logic behind consolidating a fragmented industry can only be that a **group structure** is better at value creation than a medium-sized structure. This **value added** is based, for example, on technical standardization, efficiency improvements, uniform product development, uniform branding, the bundling of R&D resources, and no longer having to duplicate technological expertise at every location. However, this strategic group logic must not be abandoned when times get tough. Otherwise the question of selling individual sites, companies or national organizations will be raised very quickly, and the overall logic of the group will be called into question.

When optimizing the overhead costs at headquarters, therefore, it is important to decide which functions fundamentally support the group's strategy (or make it possible in the first place) and which functions (usually purely administrative) could be provided more cheaply or more efficiently in some other way.

A second argument for a strategic approach is the need to **track planned synergies** after takeovers. In recent years, high premiums have typically been paid in the wake of acquisitions based on supposed synergies that were quantified with varying degrees of accuracy during the due diligence process. Only the corporate headquarters can follow this up and verify that these synergies really are realized in subsequent years, and that value has therefore not been destroyed by the individual acquisitions. However, this requires highly qualified, usually technical experts who must therefore not be dismissed out of short-term cost considerations.

In this context, we would especially like to emphasize the **importance of research and development** and of innovation. In several studies, we have already empirically demonstrated the direct link between innovation on the one hand and **sales and earnings growth** on the other. This relationship remains valid in times of crisis. Accordingly, businesses must not turn their back on this innovation orientation, even over the next 12 months. This applies especially to companies with a high proportion of exports, for example, in the Austrian metal-working and engineered products industries. A big cut in central R&D resources would seriously impair short- and medium-term competitiveness and must therefore be rejected.

6. Use growth opportunities

Despite all the discussions on the financial and economic crisis, to say nothing of cost focus and restructuring, it is also important not to lose sight of **selective growth targets**. Especially in the current stock market environment, well-capitalized companies have many opportunities for **takeovers** at comparatively favorable

multiples that would have been unthinkable eight months ago. 2009 will also see a structural change in the competitive landscape, for example in the automotive components-supplying industry.

Sticking to targeted growth strategies also has an important psychological effect on management: **ambitious targets** make it possible to increasingly **mobilize staff**. Companies that cut back their budgets too sharply, however, won't be taking sufficient advantage of internal reserves and won't achieve the leverage needed to win market share in times of crisis.

Conclusion

The imminent situation of a sudden economic slump will create special challenges for Austrian companies. Our recommendation is to resist the direct reflex of simply cutting costs and to start by thinking about the strategic ideas mentioned here. Our experience from countless projects shows that a restructuring plan based on these six pillars contributes much **more effectively** and **sustainably** to **securing the company's competitiveness and ability to survive**.