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Collateral Damage: Function Focus

Leaders Have Made the Quick Cuts—Now What?

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Over the past several months, companies have aggressively moved to cut costs and preserve cash, among other relatively quick—and reversible—measures. But layoffs, salary caps, suspended retirement contributions, and cuts in travel and training don't fundamentally reshape a company.

Moreover, the economy is not rebounding quickly. So executives have started to contemplate a more fundamental initiative: creating a new organization and business model founded on lower revenue and profit levels.

Building on the framework of the earlier flagship Collateral Damage papers, this publication outlines a series of organizational and people moves that will sustain companies through the duration of the recession and strengthen them afterward.¹

What Keeps You Awake at Night?

Top executives today collectively face organizational and people challenges that have not been confronted in more than 70 years. Each company, of course, has a unique set of concerns. But in our conversations with executives, three common themes that transcend industry, region, and situation have emerged:

- ◇ I've made a series of staff reductions. What now? How do I act boldly to secure an even stronger future?
- ◇ How do I maintain motivation when employees don't see a light at the end of the tunnel and their stock options are underwater?
- ◇ How do I quickly drive the changes I know I need to make and ensure that they last?

The economy is stuck. Most companies have already lowered their costs through such measures as freezing salaries, stopping hiring, and suspending retirement fund contributions. There is nothing wrong with any of these steps. But as conditions have continued to deteriorate, companies have been forced to make more and deeper cuts. And by opting for the quick cuts, companies are draining morale and weakening their economic foundation. Instead, they need to make the right fixes—fundamental changes in their organization, processes, and even business models.

This new reality represents a marked change from the conventional wisdom of just a few months ago. In late 2008, The Boston Consulting Group and the European Association for People Management surveyed 883 executives about cost and work force actions. The three most popular actions were cutting back recruiting (69 percent), curtailing company events (54 percent), and reducing bonuses based on corporate performance (45 percent)—all stopgap measures that could quickly be overturned. In addition, one-third of those executives were planning layoffs of full-time employees.

Today, few executives expect a quick reversal. They have already followed the textbook approach to getting through a recession—and it's not working. It's time to turn the page—or create a new one. Executives need to make the difficult decisions that lingered in the back of their minds—and that they knew needed making—prior to the onset of the recession. They should be choosing which businesses to exit and which activities to outsource. They should be flattening their organizations and killing sacred cows.

1. See *Creating People Advantage in Times of Crisis: How to Address HR Challenges in the Recession*, BCG and EAPM White Paper, March 2009; and *Collateral Damage, Part 6: Underestimating the Crisis*, BCG White Paper, April 2009.

In good times, inertia can frequently stall fundamental organizational redesign and thwart good intentions. Today, executives have a once-in-a-lifetime opportunity to make the choices that are all too easy to sweep under the rug during more robust economic times. As Rahm Emanuel, U.S. President Obama's chief of staff, has said, "You never want a serious crisis to go to waste. . . [It gives you] an opportunity to do things you thought you could not do before."

Acting Boldly and Preserving the Future

So what kind of bold moves should companies be making that will actually motivate their people and strengthen their futures? We have identified three primary actions: fundamental redesign, delaying, and outsourcing and offshoring. A parallel fourth step—creating a flexible work force—is central to these moves.

Fundamental Redesign. Executives frequently say that their actions merely mirror the short-term focus of their investors. But investors have written off 2009 and are taking the long view these days. BCG recently interviewed 25 institutional investors and surveyed 135 others. We found that, over the next 12 to 24 months, these investors do not want companies to chase short-term profit. Instead, they expect companies to strengthen their competitiveness, organizational capabilities, and strategic positioning. Nearly 40 percent of investors believe that companies with strong cash flow and balance sheets are not acting urgently to exploit current economic conditions, and 72 percent say that companies should be making investments in long-term growth, even if they miss quarterly earnings targets.

In fact, all companies can use the current economic environment to fundamentally redesign their business models, organizations, and processes. Consider the example of a retailer that did just that. A few years ago, the retailer was confronted with the entry of a larger company into its market and was experiencing difficulties with distribution and products. A new chief executive recognized the competitive threat as an opportunity to reshape the company around speed, scale, and lower costs. Within six months, the CEO had pulled merchandising, promotion, and other regional activities into the center. The exercise did not simply rearrange boxes on an organization chart but created new processes and jobs. And the company devoted more than 15,000 hours to educating employees about the new merchandising processes. The reorganization reduced head count by 15 percent, saved hundreds of millions of dollars, and enabled a national pricing strategy, new store formats, and new brands.

This retailer needed to blow up its regional structure and merchandising processes and start anew—continual, incremental changes in operations would not have worked. Today's economy will require other companies to take similar, courageous steps.

Consider companies in rapidly developing economies (RDEs), which are now catching their breath and taking the steps that breakneck growth prevented in the past. In their rush to expand globally, they historically have not fully integrated many of their global acquisitions. One company, a perennial on our list of active RDE acquirers since 2006, has used the past six months to radically improve the integration and lower the cost structure of its global acquisitions.²

Other RDE companies are strengthening their bench of talent. When they were in hypergrowth mode, many had been hiring and promoting people so quickly that some found themselves with the wrong people in the wrong places. A few are using the global slowdown to recruit selectively outside of their home markets and to move people into more suitable jobs.

Delaying. Even after all the job cuts in recent months—and sometimes because of them—many organizations are still out of shape. The management pyramid is fat in the middle, with too many layers and narrow spans of control. A company with more than eight layers and fewer than eight spans of control will typically be sluggish and bureaucratic.

2. See *The 2009 BCG 100 New Global Challengers: How Companies from Rapidly Developing Economies Are Contending for Global Leadership*, BCG report, January 2009.

Delaying speeds up both information flows and decision making. With leaner managerial ranks and a focus on work rather than coordination, activities that don't deliver value get eliminated. Delaying is not a new idea, but it can be difficult to implement, requiring discipline, a willingness to confront sacred cows, and a fast and fair cascading process.

Properly executed, delaying enables executives throughout an organization to reshape the company. Senior executives first agree on key guiding principles and then design the layer immediately below them. Each succeeding layer of managers designs and staffs the layer below it. Executives assume collective responsibility for the future and are able to address many lurking organizational issues exposed through this cascading process. Delaying should remove 20 percent of management costs and at the same time create an organization that is more effective.

Outsourcing and Offshoring. Few companies have fully exploited the ability to create a radically different cost structure and business model through outsourcing. Although rising protectionism and currency moves could conceivably forestall this option, especially in the short term, we think that the larger obstacle is fear—companies worry that they will lose control of their intellectual property, the quality of their products or services, or their overall brand image.

Speed trumped these concerns for Apple in 2001 when it created the groundbreaking iPod portable music player. In order to hit the market in time for the holiday shopping season, the company was willing to relinquish its customary tight control. Apple executives turned to PortalPlayer, a semiconductor company, for the underlying software and chip that powers the device, and to another company, Pixo, to help with the user interface. The rest is retail history. Launched in the dark days after 9/11 and the collapse of the technology bubble, the iPod quickly became the fastest-selling music player of all time and fundamentally changed the strategic trajectory of the computer maker.

Pharmaceutical companies are also turning to outsourcing to boost their competitive edge. Eli Lilly plans to achieve a 1:1 ratio of fixed to variable costs in its R&D organization as a way to decrease the overall cost of drug launches. The variable spending is focused on global outsourcing and other partnerships that amplify and leverage Lilly's portfolio and increase its chances of finding breakthroughs. Several of these partnerships are located in India and China. The partners frequently share both the risks and the rewards of the ventures. "It's a transformation of the R&D enterprise," Robert W. Armstrong, Lilly's vice president for global external research and development, told *BusinessWeek* last year. "We have to think in a totally different mode."

A Flexible Work Force. Many companies need to create work forces whose size and compensation levels can ebb and flow with demand. Flexibility and variability can be difficult to achieve in the short term, but they are essential long-term goals. As companies redesign, delay, and outsource operations, they have the opportunity to create greater agility.

There are no magic bullets. Companies need to hire a greater mix of contractors and temporary and part-time employees, delay benefit coverage, and offer meaningful sabbatical options. They should also start to track and measure the flexibility and variability of work forces through an employee metric that is linked to the cost of goods sold. If volume declines by 15 percent, business leaders need to be held accountable for ensuring a comparable decline in work force costs.

One often-overlooked source of flexibility is a company's former employees. Many companies handle layoffs clumsily. They show employees their severance package—and then the door. But there is an opportunity to build ties with these employees, who were once valued and could eventually return as contractors, freelancers, or even full-time employees. Some companies have been creating alumni networks in order to maintain those ties and preserve the HR brand in the market.

Maintaining Motivation amid Uncertainty and Loss

Many people are in a funk at work. They have lost close colleagues—not to mention a large part of their savings. Some have lost confidence in their companies—and even in the foundations of a market economy.

Many are angry and depressed.

Even senior leaders, generally the most motivated employees, are feeling the effects of the downturn. The share of senior executives who say they are giving discretionary effort to their jobs has dropped from 29 percent in the second half of 2006 to 13 percent in the second half of 2008, according to a survey of more than 60 companies conducted by the Corporate Executive Board.

We see three opportunities to engage employees: customer service and competition, leadership, and compensation.

Customer Service and Competition. In the short run, how can companies get their people motivated about their work when there is so little news to celebrate? Companies can focus on getting people excited about serving customers and beating the competition.

Delivering customer satisfaction can be an enormous intangible employee benefit. Most employees find it tremendously rewarding to represent their company and to serve their customers. But in a recession, front-line employees are frequently responsible for delivering corporate decisions relating to pricing, service, and support to customers, without having been adequately briefed on the changes. To maintain the motivation of these employees and communicate effectively with customers, companies should be educating the frontline about the changes and the best way to convey them to customers.

In these trying times, it is especially important to celebrate victories in head-to-head sales efforts and anything else that will fire the competitive spirit. People want to win. Even if a company is struggling financially, executives can instill excitement about new customers, greater penetration, and key wins. Market share can be the new mantra, while growth in revenues and profits are in hibernation.

Leadership. It is a truism that leadership is a key to driving change. But what does that really mean? In order to have credibility, leaders need to acknowledge that the economy is bad. Yet to be effective, they also need to express confidence in the company. Leaders may be experiencing tremendous uncertainty internally—but outwardly feel the need to convey strength. We recognize that this is a difficult balancing act: be too optimistic, and people will dismiss what you say; be too pessimistic, and people will lose confidence.

Over the longer run, it will be easier to build motivation if employees can see concrete actions being taken—actions that will eventually create a stronger company. A collateral benefit of making bold moves is that they give employees a rallying cry. They send a strong signal to the organization and build confidence. If employees believe that management has guts, perseverance, skill, and the right plan, they will be willing to hang in there.

Although today's economic environment may be unique in modern economic history, many companies have emerged stronger from tough times. From these examples, we draw five practical steps that companies can apply today.

Mobilizing the Extended Leadership Team. Leaders cannot pilot through the recession on their own. They need to bring in their broader leadership group, which will provide complementary skills and multiply the manpower and brainpower available to tackle critical issues. There is strength in numbers.

Middle managers are frequently the most important leaders in times like these. They have often been with the organization longer than more senior leaders. Many are capable of brilliantly navigating their teams through turbulence. By respecting, trusting, and properly engaging these managers, leaders can set a positive example for how managers should treat one another and their customers—whose loyalty is crucial in difficult times.

Companies should devote a day or even two days of thoughtfully planned, formal training with each leadership level to help them learn how to help their people. The payoff in employee engagement will be worth the expense. (See the sidebar “Leading Through the Valley.”)

Leading Through the Valley

In addition to tackling tall business challenges, companies must also address the feelings of fear and uncertainty harbored by some of their employees. Although many companies choose to ignore the emotional side of change, Credit Suisse has created a workshop that they call *Managing Through Difficult Times*, which helps leaders help their people. The workshop, which can be a half or full day, combines traditional leadership training with an open exchange of personal experiences

among leaders. The main objectives of the workshop are to raise the awareness of the behaviors that employees might exhibit, improve communication, and increase employee engagement and effectiveness. Credit Suisse is offering the workshop at all managerial levels and expects 800 managers from all operating regions around the world to attend a workshop by midyear. Local managers and leadership experts jointly run the sessions, which have been well received.

Setting Clear Expectations. Employees respond more positively if they are given firm expectations. Leaders need to define the measures of success, both for the short term and for the future. They need to provide clarity about what is most important in this environment. They should kill or postpone nonessential projects and give employees the freedom to defer or reduce noncore and discretionary responsibilities.

Keeping It Real. Employees want to know that their leaders have a heart. People will rarely go the extra mile for someone who is all logic and no emotion. Leaders should be prepared to openly share what the recession means for them personally. This requires an honest evaluation of their feelings and the willingness—even the courage—to let their guard down. Tone and delivery can and will influence how people interpret and internalize events, so it is important to pay attention to both the content and the context of messages.

It is also important for leaders to try to make sure that their own batteries are reasonably charged. They should not try to be superheroes. It is difficult for leaders to offer employees hope when they are feeling hopeless or to energize people when they are not energized themselves.

Driving Results. Running day-to-day business operations can be a significant challenge during a recession. Initiatives need clearly established milestones and metrics—and unambiguous ownership. Leaders need to rigorously track progress against those metrics and milestones, intervene when necessary, and communicate both successes and course corrections.

At the same time, leaders need to celebrate success and recognize the contributions of individual team members who have achieved results. Testimonials from customers and employees that demonstrate a company's values and strengths can be amazingly powerful and effective. Some executives think video clips and small rewards can be gimmicky. Perhaps—but they work.

Understanding Employee Grief. Leaders should also be aware of their people's emotional reactions, such as shock, fear, loss of confidence, and grief. Many people are experiencing the emotions that accompany a significant loss and are going through the same reactions as those who confront a terminal illness or the death of a friend or family member. This analogy is more valid than it may initially seem. From a psychological perspective, the response to all significant losses is similar. Along the five stages of grief—denial, bargaining, anger, depression, and acceptance—many employees are somewhere between anger and acceptance in coming to terms with their losses, although others may be lagging behind.

People are hungry for information and leadership. In an information vacuum, they will connect the dots in the worst ways imaginable. Leaders should encourage people to talk about what they're feeling and listen with empathy. They should be holding team and one-on-one meetings to acknowledge the concerns of employees.

Finally, to help gauge confidence and engagement, companies should institute regular pulse checks. They can do this formally through surveys or informally through casual conversations and meetings. These checks can help identify concerns early so that those concerns can be addressed quickly and effectively.

Compensation. The days of wine and roses are over. For years, even midlevel executives were able to generate significant wealth by exercising their stock options in a rising stock market. But today, most options are out of the money. In this environment, how can companies keep their stars and maintain overall employee motivation? This question is nagging chief executives who have lost one of their most compelling retention and motivation tools.

Companies need to reframe the terms of engagement with key employees. While the bull market that lasted from 1982 through 2007 is unlikely to recur, equity levels should allow new options to generate value over time. Companies need to view themselves as start-ups and excite and entice their stars with incentives based on sustainable future performance. This is a time to re-recruit in-house talent and to point out the risks of leaving for another company. Strong companies may have an opportunity to pick up key talent from their competitors. As one chief executive said recently, “We’re finding great candidates in the market who will work for a fraction” of what they would have demanded a few years ago.

A key lesson of the financial collapse will surely be that tightly linking compensation to short-term results creates perverse incentives. As a senior executive of a global bank said, “You know you’re in a world of hurt when everyone seems to qualify for their bonuses, yet the company’s results are abysmal.”

UBS recently reviewed its compensation schemes and reoriented both the variable cash and variable equity components of top executives’ pay to long-term performance. These individuals will be required to forfeit prior bonuses if ongoing performance is inadequate. Although the contours of future compensation will be in flux for some time, the UBS model may serve as a rough draft for companies reviewing their compensation models.

Driving Change

The recession has forced many companies into a reactive fighter’s crouch. They are prepared to absorb the economic blows right in front of them but are not necessarily ready to face the future. Although that stance made sense several months ago when the duration and depth of the recession were unknown, it is no longer sufficient. Companies should be meaningfully rethinking and reshaping their strategies, structures, priorities, and processes. Piecemeal change will not work. Incremental change will not work. Delegated change will not work.

General Electric popularized the idea of continuous improvement. But while continuous improvement is a valuable way to improve functioning operations and processes, it cannot create deep and fast organizational change. Big, bold moves—initiated, driven, and monitored from the top—are required.

The most effective way to institute permanent change is through the cascading process. Imagine a multi-level architectural fountain with water tumbling from layer to layer, powered by the force of gravity and elegant design. Organizations should introduce change in the same way.

Top executives cannot merely lay out a broad framework and leave implementation to others. Rather, they need to be committed to the change and to actively design the new roles and responsibilities at the next level. They need to assign people to roles and communicate thoroughly and frequently throughout the process, tracking progress against deadlines and deliverables. Once that sequence has been completed, the second layer reprises it with the third level, and so on.

This is not top-down management by another name. In cascading change, the middle of the organization has a meaningful role in designing what happens below it. The middle is not merely a conduit for commands from Mount Olympus.

In the recent merger of two European banks, this approach was deployed successfully in order to introduce a new set of expectations regarding how people should behave and lead. One bank was skilled in direct sales, whereas the other focused on traditional branch banking. The success of the merger hinged on the ability to integrate these two different cultures.

Organizational Health Checklist

- ◇ Is your organization focused on those activities that drive value? Do people clearly know their roles and responsibilities?
- ◇ Do you have fewer than eight layers, and do you have wide managerial spans, particularly in the middle?
- ◇ Are support activities consolidated to capture scale?
- ◇ Are noncore parts of your business outsourced to capture value? Can you push the definition of “noncore” even further?
- ◇ Do your key employees know your vision and competitive strengths? Are you celebrating competitive wins and superior customer service?
- ◇ Have you engaged with your key employees, solicited their advice, and listened to their concerns?
- ◇ Do you have a process in place that systematically drives change from the top to the bottom?
- ◇ Are your goals and incentives tied to strategic, and not just financial, goals?

Employees received training in how to get their staff in layers below them to exhibit the new behaviors. The training was tailored to the specific challenges of each level of the organization. Altogether, the changes touched 14,000 employees. In order to ensure that the changes took root, behavioral expectations were built into performance reviews. The bank has tracked both employee engagement and customer attrition since the merger, and scores in both domains are strong.

This approach of cascading change has four notable characteristics that set it apart from less successful efforts. First, it delivers sustained, measurable results because execution is not delegated. Second, it embeds permanent behavioral change within the organization—the process of design and implementation creates excitement and momentum. Third, it creates both confidence and capabilities, as people see the fruits of their efforts. Fourth, it leaves the organization performing at a higher level than before, with a more motivated and engaged work force.

Companies have started to confront the financial constraints of a new era, but many have not yet embraced the organizational implications. The shape and size of many companies will change radically over the next several years. Chief executives must be the main architects of this transformation. (To get a quick read on your organization, see the sidebar “Organizational Health Checklist.”)

The success of companies—and the very survival of some of them—will hinge on the ability of chief executives to reshape their organizations to the new reality. Fortunately, they don’t need to concoct new organizational models or theories. What works is the stuff that has always worked. The tools themselves are not new, but the urgency and the opportunity have never been greater. As Dorothy says in *The Wizard of Oz*, “If I ever go looking for my heart’s desire again, I won’t look any further than my own backyard.” Leadership converts opportunity into action—and ultimately into advantage.

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