CHAPTER 1

The Challenge of Managing in a Toxic Environment

Management challenges don't come any bigger than this. It's not just your business or industry that is in a downturn; the entire global economic system has been wounded. The liquidity crisis that erupted in September 2008 with the collapse of a few U.S. investment banks spread to businesses and consumers everywhere with a speed that left people as stunned as the victims of an automobile accident. By November virtually every major developed country in the world was either in recession or suffering from a wrenching slowdown in growth. Other countries whose economies are still growing also have felt the effects. Even India's enviable 7 percent GDP growth rate is down considerably from its previous levels of around 9 percent, driving home the irrefutable point that the world is connected as never before, sometimes in unpredictable ways.

Projections and estimates in these circumstances are little more than guesses. In August 2008 who would have predicted that Wall Street as we knew it for 50 years would simply disappear? Accustomed as we were to the easy availability of capital, who would have imagined that credit would simply dry up on a global scale? Going forward, who can say how much capital will be available for expansion? Which countries and markets will contract, and at what rates? How long will the contraction last—or could it become a depression? Will disinflation give way to deflation, followed by a surge of inflation? We will not know when we have turned the corner, and we cannot envision the shape and scope of the world that will emerge. What we *can* be sure of is that this is a time of tumultuous change, and with change come both danger and opportunity.

The financial tsunami was a long time in the making, and its consequences inevitably will be with us for a long time. How long depends on how smart the various players around the world in government, finance, and business are in rebuilding the system. Credit is the oil of the economic engine, and credit ultimately is a creation of confidence. Until all players are confident about the intentions and strength of the others, there can only be stagnation.

The economic peace of the past generation is over. We're in a war for survival, beset by fear, uncertainty, and doubt. As on any battlefield, conditions demand a seriously different kind of leadership from that which is appropriate in peacetime. Leaders must be prepared to make strategic, structural, financial, and operational changes—many of them drastic—in a hurry and with information that is at best incomplete.

As I wrote this in December 2008, most of the business leaders I was talking with were either deeply worried or frankly scared. Bewildered CEOs and directors were saying things such as "Things are going over a cliff in no time" and "No one has ever seen such a vortex before." The most pessimistic foresaw a catastrophe on the order of the Great Depression. Some said it would take one year for the global economy to normalize; others said it could take up to three. However, I also found leaders who already had begun reshaping their businesses to carry on through whatever hard times lie ahead. They are making changes now to emerge in better shape than ever, ready for the growth that ultimately will come. Some are pouncing on the opportunity to move faster than their peers and serve customers in different ways. These are the companies that will be among the game changers in the next expansion.

One Word: Cash

In the face of a downturn that is deeper, more widespread, and more sustained than anything you have experienced before, you have to adjust your most fundamental thoughts about what your business will look like and how it will be run. The immediate challenge is to act quickly and decisively to prepare for the worst possible scenario. Unless you already had plans and processes in place for a crisis, like Chad Holliday of DuPont, that is more difficult than one might expect. People tend to overestimate how well their company will fare because that is what they want to believe. Such misplaced optimism can lead to inaction or indecision, with dire consequences. If you conscientiously prepare for the worst, chances are that you will encounter something less bad than that and come out ahead when it is all over. If you don't prepare for the worst, you will put both your company and your career at risk.

Your focus must shift from the income statement to the balance sheet. Protecting cash flow is the most important challenge almost all companies face today whether they realize it or not. Before the crisis struck, your company's indicators of success were increasing earnings per share and growing revenues by gaining market share. The most critical metric now is cash. Pursuit of revenue growth must give way to understanding the cash implications of everything your company does. You absolutely must have sufficient cash or credible access to it to weather the storm. And, given today's information technology, you can and should know your company's cash position every single day.

Cash has three internal sources: earnings from operations, working capital (inventories and receivables), and the sale of assets. All three must be pursued vigorously. Every sale must be weighed against not just how attractive the margin is but how much cash will be tied up in inventories and receivables and for how long. Projects that once were evaluated on the basis of their return on investment now must be judged in terms of how much cash they consume and can generate and how soon they can bring in cash.

To understand why the generation of cash is so important, one need look no farther than the American automobile industry's reckoning during fall 2008. Not only had consumers shifted from demanding highly profitable SUVs to wanting fuel-efficient cars, they also had fallen victim to the credit crunch. Auto and truck sales plunged even as the companies were working feverishly to develop new models that would appeal to consumers. The reversal was so swift that General Motors announced in November that its available cash would last less than a year in the absence of a government rescue. None of the three automakers had a comfortable margin of cash on hand. With dismal sales, they were not generating much cash, and a lot of that cash essentially was locked up in inventory. They couldn't borrow substantial amounts because of their credit risk, and by that time they had sold most of their presumed nonessential assets.

Problems in the auto industry had been accumulating, but lack of liquidity can bring the mighty to their knees in less than two weeks. Witness the case of General Electric. A fundamentally solid company with a triple-A rating, it was nevertheless hammered by two weeks of volatility in March 2008 and again the following September, requiring the CEO to get external capital at exorbitant rates. Management had to divert its attention from running the business to managing issues of liquidity.

Because lack of liquidity will be an ever-present lethal threat, you will have to manage conservatively, lowering your *cash breakeven point* as rapidly as possible for the worst-case scenario. Breakeven points calculated on a cash basis will tell you what you need to do, whether it is discontinuing a product line, taking down a plant, or eliminating a distribution channel to survive the worst situation you can imagine.

Don't underestimate how bad that scenario may be. For example, how might the most severe downturn you can imagine affect your debt repayment? Could you be in violation of your loan covenants? Today many businesspeople feel that they have no real problem because they don't have to refinance until the middle of 2010. What if that line of credit dries up? Also, don't forget that plummeting stock prices have turned many pension surpluses into liabilities that must be funded. You have to factor all these possibilities into your cash equation.

Consider also that hard times may last longer than you think. The collapse of U.S. retailing in September 2008, called by some a hundred-year flood, signaled a fundamental shift in consumer behavior. Spreading around the globe, it portends a long period in which demand will continue to decline or remain low as cash-short consumers forgo or stretch out purchases. Stay focused on liquidity as you calculate your cash breakeven one, two, and maybe three years out. One company I advise is planning for a 10 percent reduction in unit volume and a 12 percent reduction in revenue in 2009 and again in 2010. The CEO and CFO are thinking ahead now about what that means if credit and market conditions remain severely impaired in 2010, when the company has to refinance debt.

Rethinking Growth

After spending their careers in a single-minded pursuit of growth, business leaders have to adjust their mentality. Some CEOs are telling their people that they should go for market share against competitors whose conditions could be unraveling. You should pursue that kind of growth only if it is profitable and cash-efficient. *Cash efficiency* means that gains in market share do not consume disproportionate amounts of cash in the form of more inventory, extended duration of accounts receivable, or increased complexity. The cash efficiency of new market share is extremely important. (This reality apparently was lost on Detroit's Big Three. Even as their scant resources were dwindling and while they were awaiting government help, industry executives were talking about plans to regain market share! That was pure fantasy, and to pursue that goal would have been deadly. Instead, what they desperately needed to do was reduce their overall market shares, cut product lines, prune the customer base, and try to gain share in cash-efficient and profitable segments.)

Protecting against a sudden liquidity crunch can mean thinking the previously unthinkable, such as deliberately giving up increases in revenue and in market share. As Rich Noll, CEO of Hanesbrands Inc., puts it, "You have to be more willing to leave a little bit of upside on the table to protect yourself for the downside."

One CEO I know surrendered 8 percent of his volume when he raised prices, but the new prices stuck and the result was the security of improved cash flow. It was a risky move. I recommend that in this environment you only raise prices on your least profitable customers. Even then, be prepared to walk away from those customers if they balk. Credit card companies have been raising rates on customers' credit balances aggressively.

The new reality is that barring acquisitions, your company will be smaller two years from now than it is today. Cash-strapped private equity firms have been unloading some of their companies for as little as a dollar! In an environment of falling demand and liquidity risk, most companies have no choice but to shrink. Your cash breakeven will tell you that you have to reduce your workforce and capacity. Bitter and painful as it is, you will have to face that reality, because survival depends on cutting costs and raising cash. You can turn that necessity to your advantage by being selective about the cuts you make. This is a time to narrow your focus and concentrate on the core of the business: the invaluable assets you can't afford to lose. Choose the market segments and even the particular customers you will continue to serve, the products you will continue to make, and the suppliers you will continue to buy from and eliminate the rest. Shrinking will present opportunities to simplify your processes and reduce the layers of management. In the end you will have fewer customers, fewer products, fewer facilities, fewer people, fewer suppliers—and a stronger company.

Using the necessity for cost reduction and liquidity to reshape and refocus the business puts you on the offensive. It turns a bad situation into an opportunity to build a company that will emerge from the storm stronger, better, more flexible, and better positioned than the competition.

A New Intensity of Management

Many leaders will have to make a huge change in how they manage day-to-day. Succeeding in a volatile environment requires frequent adjustments at the operational level of the business as well as an occasional disruptive shift. It demands what I call *management intensity*: a deep immersion in the operational details of the business and the outside world combined with hands-on involvement and followthrough. It's not enough to sit in your office, read reports, and issue directives. You need a granular understanding of what is happening outside your company, with customers, and in your own operations. Diverse parts of the business must be coupled to one another more tightly and linked to the outside world. Plans and progress must be revisited almost daily. Big picture, longer-term, strategic-level thinking cannot be abandoned, but every leader has to be involved, visible, and in daily communication. Your new guiding principle must be this: hands on, head in.

An important part of management intensity is a thorough understanding of changes in a volatile environment that can affect your business. You need information that is detailed, up to date, and unfiltered, obtained quickly and at the source. This is what I call *ground-level intelligence.* The most important type of ground-level intelligence has to do with consumers. Take, for instance, Wal-Mart's observation that for the first time ever its sales of baby formula were coinciding with twice-monthly pay periods, indicating that consumers were under severe stress and living from paycheck to paycheck. That's ground-level intelligence.

You should have a granular understanding of how the effects of the slowdown, such as tight credit and the threat of job losses, are changing consumer behavior. How are customers and suppliers adjusting or failing to adjust to the new reality? How are their financial condition and competitiveness changing? If, for example, your company makes personal computers, the person who buys your product usually will be an information technology executive, but the end users, or consumers, are the employees on whose desks those computers are placed. If your customer is reducing the number of employees, you should prepare for lower sales to that company.

Get out into the field and observe, like the retailer whose leaders visit consumers shopping through different channels, including farmers' markets, to see how their habits are changing. At the very least, get down with your own people who are close to customers. Although you may have to discount their natural optimism, the sales force is also an important source of ground-level intelligence, especially if they are business-savvy and have cultivated relationships with the customer's factory managers and sales and marketing executives.

The need for ground-level intelligence extends to your suppliers and partners. You should probe carefully to learn what they are doing, how they are feeling, and what they are seeing. They will be particularly valuable sources of information about credit availability and the prices of their own inputs and their own financial health.

Internally, detailed information on activities that directly affect the company's financial health and liquidity—things such as cash, inventories, and receivables—have to be monitored every day. Quarterly or monthly reports cannot be considered ground intelligence. Knowing that the inventory of a product line is building daily lets you act before it consumes more cash.

All this information needs to be shared, pooled, and then pored over in an effort to extract key facts and patterns that are beginning to emerge. You may see sales of certain products trending in different directions in different parts of the country, or you may discover that a competitor is doing better with one product than with another. When you see those trends emerging, you can act on them immediately, say, by changing advertising in different regions. Most important, you need to see the big picture that is emerging so that when one of your largest customers slashes orders to your company by 40 percent, it won't come as a surprise and you will be prepared to take swift countermeasures to protect your company. One major supplier to the U.S. auto industry discovered that the forecast it got from one of its automaker customers was downright wrong against the ground-level intelligence the supplier itself had gathered. The supplier spared itself a lot of excess inventory and cash usage by relying on its own information.

Conversations have to cut across silos so that you know what others in your business are picking up on and they know what is happening in your area. That way, your efforts are coordinated and your company can respond faster. Think of the situation you and your company face as being akin to a basketball game. Players on the team constantly make instant decisions about the way the competition is shaping itself and intuitively pass the ball to a teammate to counter the defense, never worrying about who gets the credit. Basketball is a game of speed, urgency, and flexibility that demands a high level of synchronization. In this environment, any lack of focus, speed, urgency, or flexibility will hurt the company because the lack of liquidity pushes a company over the cliff faster than anything else can. Only by synchronizing people as a companywide team can you obtain *focus*, *speed*, *urgency*, and *flexibility*, making and executing decisions faster.

Controlling in Real Time

Most companies have operated with annual targets and have measured progress toward those targets on a quarterly basis. In the current environment, that's too long to wait to see whether a company is on track. Conditions are changing so quickly that an annual target can be hopelessly unattainable only a week or two after it is set. You have to increase your *frequency of control,* setting targets on a quarterly, monthly, or even weekly basis. You have to revisit your goals and key performance indicators, tracking progress toward them and taking corrective actions more often. If you've been monitoring capacity versus actual production quarterly, for example, you may want to do it monthly. This will give you the agility to make modifications as conditions change.

Volatility shortens the life span of a business model and strategy. Yours may become obsolete sooner than you think. In fact, your company may have to change its strategy more than once before things return to normal. Flexibility may well be your strategy, and conservation of cash may be your goal until the clouds clear up. Staying in close touch with your people and digging into the numbers more often will help you pick up early warning signals that your strategy, business model, tactics, or execution is not working. There's no time to lose in sorting through those possibilities. You have to stay on top of things to see that your shorter-range plans and targets are being acted on. Follow-through must be weekly if not daily. Urgency comes when you ask questions and help people overcome any obstacles they may have encountered today, not tomorrow.

Budgets also must be compressed in time. They usually are set in place for a full year, using straight-line projections. Any company that does budgeting the usual way is almost certain to be disappointed. For example, many companies' budgets for 2008 were shot by the third quarter. At that point, the chances of making up losses were slim, and the budgets became meaningless. Yet planning, compensation, and a host of other processes were built around them. The kind of flexibility you need requires that all your people with input to the budget be able to sit down together to create it in a matter of days and then revisit and revise it monthly. Reducing the number of line items will simplify the process.

Management intensity means watching the horizon and the periphery even as you move decisively to ensure that the business survives the next six months. Use your ground intelligence to detect the forces that are changing the world both during the downturn and after it ends. Determining where things are headed won't be easy. Even in the best of times the future is often foggy, but an unyielding focus on the future coupled with a pragmatic approach to preparing the company for the worst will produce high returns. It lets you go on the offensive, detecting possible new rays of light. In November 2008, for instance, the domestic auto industry still was reeling from the drastic tumble in sales. Yet Ford, noting that the price of oil had dropped to $60 a barrel, added a shift to truck production to take advantage of the latest demand, which had been obscured when oil prices were well over $100 a barrel. (Of course, this might not be enough to save it from forthcoming strong headwinds.) Similarly, detecting a permanent shift toward buyer preferences for cheaper products may tell you to let go of a market segment rather than try to hold on to market share and lose cash.

Building a Confident Organization

This will be a time with many tough decisions, including choosing which people will stay (the real change agents) and which will go, whose budgets will be cut by how much, and which plants will be shut down and which will survive. Part of your management intensity entails making decisions swiftly. You won't always have time to answer every question and look at things from every angle. You must use your ground intelligence and have the guts to act. Also, you must be prepared to reverse earlier decisions that no longer make sense. One company had won board approval for a wholesale reconfiguration of its supply chain in early summer 2008, which required a huge capital investment over the next two years. When sales suddenly dropped 10 percent in one month that fall, the board urged the company to postpone the supply chain effort. They were willing to forgo the upside to husband their cash resources. At the same time, they felt that the new configuration of the supply chain would be different from the one that was planned.

Be decisive about the future too. Yes, forecasts and predictions seem all but meaningless at the moment. However, at some point there will be a recovery, and you need to prepare for it by making the best assumptions you can about your markets and your competitors. On the basis of that view, determine where to invest managerial energy and even some money in innovation, strategic acquisitions, new customers, new products, or new distribution channels. This is where your conservation efforts elsewhere allow you to seize the initiative and leave your more defensive competitors behind.

Aggressive measures and decisive actions build optimism and confidence—your own and others'. Spotting opportunities and pursuing them aggressively will inspire people and change their psychology from fear to realistic optimism. Your actions as well as your words will align the minds, the physical energy, and the hearts and souls of the people around you.

Your presence on the front line is also important in energizing people and transforming their fear into confidence. It must be the right kind of presence, though. Authenticity—the combination of rock-solid integrity, intellectual honesty, straightforwardness, and the ability to confront reality—is always important, but now it is absolutely critical. You have to instill courage and optimism in others by putting reality on the table and addressing it decisively. You need to show a path forward that is credible and concrete and enroll other change agents who have the courage to make tough calls without sacrificing values. If you tell half-truths, sugarcoat bad news, or fail to understand the realities of the toxic environment, people won't trust you. Worse, they will miss the urgency.

Your Job Now

This is the broad view of how your company can overcome the hardships imposed on it by the economic tsunami that has swept the world. The next eight chapters deal with specific actions each functional area of the business can take. Certainly you will want to read first about your own area of responsibility, but please take the time to read about all the other functions too. Never has it been more important for everyone in a company to understand the stresses and strains on colleagues in other jobs. The more you know about their situation, the more you will be able to work with them as team members for the good of the entire organization.

As has been noted, your company most likely will emerge from the battle smaller. You will have fewer customers, you will sell fewer products, you will have fewer suppliers, and you will have fewer layers of management. However, all this trimming, honing, and focusing also means that your processes will become simpler and more efficient and your company will become stronger. Even more important, you and your people will have a shared legacy of emerging victorious from a terrible war, prepared to take your company to a new level in a much better future.

THE SIX ESSENTIAL LEADERSHIP TRAITS FOR HARD TIMES

Which among the many important behaviors and traits that characterize a good leader are most important for managing in this downturn of downturns? Following are the six I consider essential, along with the reasons why.

Honesty and credibility. This is no simple challenge. Nobody can be certain about the business environment and its direction. How can you tell people what you believe when you can't be confident that it is right? You can't fake it or bluff—anybody can test your ideas by googling. The only answer is intellectual honesty and humility. Your authority derives not from omniscience but from your ability to facilitate understanding and solutions. Level with people: tell them how you see the world, acknowledge the limits of your understanding, and ask them for their own views. Doing this may take courage, but together you can piece together better probabilities than any one person can.

The ability to inspire. Always important, it is critical today. Most people are anxious. The tsunami came so suddenly, destroying their hard-earned savings and putting their jobs at risk, that they don't trust what they hear, see, or read. Worst, they don't see what will turn things around; many are close to losing hope. What can you do?

Start with your own team—it is they who will have to inspire the rest of the organization. Work with them to toughen their resolve to get through the storm successfully. Then help them to develop one or two realistically optimistic pictures of what can lie ahead. This is vital: they need a vision that will turn their lightbulbs on, generating creativity and ideas. Inspire your team to focus on the new priorities by doing so yourself, fearlessly. Inspiration will also come from making decisions that produce incremental successes. These are high energizers that build further successes.

Real-time connection with reality. In this volatile and uncertain environment, reality is a moving target. You have to keep updating your picture of it, continuously monitoring change and impending change through ground-level intelligence. Have your team do the same. Put all of your concrete external information on the table, however bad it may be, and discuss it among yourselves. Gather it from unconventional sources. Don't get locked into one view of things. Allow the picture to change as you gather new information.

Realism tempered with optimism. Unadulterated pessimism is no more realistic than unbridled optimism. While the first order of a realistic assessment is to understand and accept the magnitude of a problem, the fact is that few problems are insoluble. Focus your people on a vision of what is possible, and energize them to search for the actions that will realize the vision. This is where leadership becomes a performing art, introducing that touch of optimism that taps psychological reserves to deal with bad news and transform fear into action.

Managing with intensity. Your hands-on participation is essential in these times. You must dig into the right details with much higher frequency than ever before. Only through deep personal involvement can you acquire ground-level intelligence, share and discuss it with your team, and act with the speed that is required in a volatile environment.

Importantly, your people need you to be present with them in the foxhole. Your grasp of reality is useless if you can't bring the rest of your organization to understand it and act on it, and you cannot do this with memos and proclamations alone. You have to be interactive—listening as well as explaining, answering questions, taking the conversation to the next level, and then doing it again and again. Your people will be inspired not by stirring words as much as by seeing firsthand that you have put reality on the table and have a plan for addressing it decisively, as a team.

Boldness in building for the future. Facing the necessity of conserving cash and surviving in the short run, you may feel pressured to shortchange the future. Resist this pressure. It will take imagination and guts to place strategic bets with no guaranteed payoffs when there's so little money available and so much uncertainty about the assumptions your plan is based on. Yet such bets are critical: what good will it do if you limp to the finish line and find nothing there?