Sustainable Restructuring
How to emerge stronger from the financial crisis

At frightening speed, a crisis in the U.S. real-estate market became a worldwide recession that shook the global economy to its foundations. Companies have responded primarily with short-term measures that seek to optimize costs and increase liquidity. But to ensure a sustained competitive edge and profitable growth after the economic crisis subsides, short-term decisions must be made as part of a long-term strategy. That’s why we encourage companies to undergo “sustainable restructuring.”

The current financial and economic crisis is the most serious the world has seen since the end of World War II. In terms of its speed and severity, this downturn has, within its first year, surpassed even the Great Depression of 1930. Although it remains to be seen how the situation will develop and what its ultimate extent will be, a quick recovery now appears unlikely.

Companies today are confronted with economic conditions in which their empirical data and previously held values no longer apply. Even once-thriving firms with effective corporate decision-making are in precarious financial situations, sometimes to the point of insolvency. Others are facing profitability and liquidity struggles in spite of well-positioned strategies, caused on one hand by restrictive lending and on the other by a lack of demand—both the result of a prevailing uncertainty that goes much deeper than in previous downturns. For the corporate sector, survival depends on acting swiftly and effectively, despite not knowing how or when the economic crisis will end.

Yet many firms appear to be “strategically paralyzed,” a new A.T. Kearney study finds. To maintain a sustained competitive edge and profitable growth and to emerge from the crisis even stronger, all short-term decisions, including operational measures to safeguard profitability and liquidity along the entire value chain, must be tied to a long-term strategy.

While the financial crisis continues, the majority of companies still have enough leeway to do more than react with short-term strategies (see figure 1 on the following page).

Strategic Paralysis
In our study of more than 1,200 cases of insolvency, we examined the most common reasons for corporate crises and analyzed the main countermeasures. More than half of all insolvencies are related to poor strategic
or investment decisions. Although the crisis is usually best handled at the strategic level, imperiled companies tend to react by adopting short-term, purely operational measures. According to our study, only 15 percent of all measures used in crisis are accompanied by a new, more effective strategic focus (see sidebar: Responding to a Crisis).

To help companies refocus during a downturn, we developed a “sustainable restructuring” approach—based on a comprehensive analysis of corporate crises and our experience working with troubled firms. It begins with a quick scan to determine a company’s potential while scrutinizing its liquidity, profitability and strategy. With this as a basis, a roadmap is developed, which identifies short- and medium-term measures that can be put in place immediately, as well as a longer-term strategic concept for sustainable restructuring (see figure 2). The focus is twofold—to survive the current crisis while also preparing for an eventual rebound.

Optimizing the Supply Chain

To trim costs and increase liquidity, companies almost always turn first to their procurement and purchasing organizations—usually their largest cost pools.

In this economic climate, as raw material prices drop and competition among suppliers picks up, the door is wide open for renegotiating contracts. It is possible to reduce material costs in the short term without placing an undue strain on relations with suppliers, especially those that are strategically important. Also, joint cost-optimization measures, such as a supplier-fitness program, can improve supply chain performance without an adverse effect on profit margins.

These tactics, combined with improved spending, can result in major cost savings and better liquidity within a short period of time. We have several examples that illustrate this, including steel price renegotiations in the automotive industry and supplier-fitness programs in consumer products. Machinery manufacturers often undertake supplier consolidation programs in order to offer financial support to strategic suppliers.

Sales is also a key focal point in a recession, as poor sales can have a severe impact on production. One challenge is reengineering processes and balancing fluctuations in capacity utilization. In the short term, capital resources can be released by downsizing stock, managing receivables and liabilities, and improving net current assets. In this way, net working capital can be reduced up to 35 percent.
quickly, particularly in manufacturing-intense industries such as steel and chemicals.

Sales and marketing can also contribute to a sustainable restructuring by keeping prices and sales volume as stable as possible, primarily by improving customer relations. The goal is to counteract price pressure while optimizing the customer and product portfolio.

A New Strategic Focus
Restructuring involves reexaming strategic focus against the backdrop of a rapidly changing business environment. Given the magnitude of today’s crisis, we recommend adapting the overall corporate strategy and tailoring short-term measures to ensure a sustainable restructuring. True long-term success depends on forging an approach that balances liquidity, profitability and strategy (see figure 3).

The approach begins at the business or industry level with an awareness that certain local or global trends among customers, competitors, suppliers and technologies may persist after the crisis, or they may develop into a new dynamic as a result of the structural interruptions. Outlining which scenarios may unfold in the future will lay the framework for

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Responding to a Crisis

The A.T. Kearney study reveals the most common causes of bankruptcy and identifies how companies typically respond to a business or economic crises.

Frequent causes of insolvency:
- Incorrect strategy or investment decisions: 54%
- Unbalanced cost structure: 39%
- Lack of liquidity: 38%
- Management’s belated or inconsistent response to the crisis: 34%
- Dependency on the value chain: 23%

Common responses to a serious crisis:
- Free up liquidity: 62%
- Coordinate more closely with customers and suppliers: 46%
- Reduce costs: 42%
- Deploy debt-equity measures: 34%
- Increase strategic focus: 33%

your company’s strategic focus, to which all short- and medium-term measures should be geared. For instance in the airline industry, the current shift in demand for low-cost tickets and economy travel will likely persist after the recovery. Thus, an airline undergoing sustainable restructuring must incorporate changes in customer demand into its business model.

A thorough review, and possible refocusing of your business strategy will ensure that all operational measures support strategic goals. At the same time, flexibility and the ability to respond swiftly to new developments are essential in times of economic uncertainty. A good example of this kind of strategic refocus is occurring with engineering companies, many of which are shifting to the after-sales and service business, not only to compensate for fewer orders but also to stabilize revenues and profits.

Mergers and acquisitions are another option in a crisis, as long as the proper weight is given to the logic of consolidation. An acquisition can be a lucrative proposition if the company is strong financially and the target firm is not. Young, innovative firms with inadequate reserves or companies that invested too much in expansion and now have less equity can be attractive candidates for takeover.

Hit the Ground Running

How will the crisis pan out? It is impossible to say right now. However, the range of possibilities goes from rapid recovery to a series of highs and lows to a slow, steady upturn. Thus far, most companies have focused on short-term measures to fight the downturn, since these promise immediate savings and can safeguard liquidity.

However, simply “slimming down” will produce an immediate impact, but the longer-term effect could be detrimental. In a downturn, it is important to stay flexible and leave room for growth, so you can hit the ground running once the crisis ends.

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