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BY JOHN S. MCCALLUM

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As the economy turns: 10 questions for executives

BY JOHN S. MCCALLUM

For executives of Canadian enterprises, the economic environment of the last few years has been about as good as it gets. The situation underscores the fact that an enterprise has to be really unlucky or really inept not to perform well when the economy is booming, and interest rates, the dollar and inflation are low. But there is a downside. Performance that comes too easily because of the good times can distract an executive from preparing for the bad times.

How well an enterprise rides out the bad times very much depends on the preparatory steps it has taken during the good times. A good economy should provide an enterprise with both the resources and breathing room needed to get ready for a slowdown. When our economy goes sour, as it inevitably will, my guess is that many executives will wish they had spent less time looking in the mirror admiring their own performance and more time focusing on the nitty-gritty of proper management practice. New Economy executives should be under no illusion: The business cycle is alive and well; what goes up, also goes down.

"The business cycle is alive and well; what goes up, also goes down"

A serious slowdown may not be far off. Regardless, right now is always the best time for executives to make preparations, and objectively answering 10 questions should aid in that task. Lamenting what was not done when times were ideal takes an executive nowhere. Prosperity always lies in doing what can be done now. Gardening enthusiasts say the best time to plant a tree is 20 years ago; the next best time is now. That analogy applies to the practice of management.

It is useful to consider just where we are in the business cycle. The only thing that is clear is where we have been. 1997 to 1999 were good, and things just kept getting better in 2000: almost five-percent real growth, with stable prices, a falling unemployment rate, aggressive business investment in equipment and machinery, strong consumer spending, and surpluses in both the current and government spending accounts. It is not often that the stars line up so perfectly! Reasons for our good fortune include the longest and strongest expansion in U.S. history (over one-third of our GDP is U.S. exports), a low dollar, low interest rates, technological revolution, rising productivity, a high level of pent-up consumer demand coming out of the much weaker early and middle years of the 1990s, low energy prices, deregulation, globalization and financial innovation.

With apologies to William Shakespeare (King Henry VI, Part III), the Canadian economic worm is turning. Seemingly overnight, the U.S. has gone from boom to slowdown. Moreover, U.S. interest rates could push the Canadian dollar significantly higher, putting our export sector at considerable risk. The technology sector is an earnings/demand/stock market wreck, and consumers are up to the gunnels in everything from cars to computer equipment. Energy prices are through the roof; poverty, labour, environmental and fairness problems are taking the sheen off globalization; and financial market turmoil is creating havoc for consumers and businesses. Add executive suites that in many instances have little or no experience with slowdown—let alone recession, persistently low commodity prices, and hugely indebted consumer and government sectors, and the potential is certainly there for things to get very ugly in Canada. The current economic malaise may be only a harbinger. We are clearly late in a business cycle with our best days behind us.

My guess is executives will soon be longing for the good old days of 2000. But regardless of what the economy does, executives have no control over it. What they do have control over is their own actions, how they position their enterprises. However late we are in the up part of the business cycle, there is purpose in asking the following questions.

1. IS THE STRUCTURE RIGHT?

To Alfred Pritchard Sloane Jr., the legendary architect of General Motors, the key to business success lay in getting people and other resources properly organized. Borrowing from the economist's jargon, the proper organization structure may not be a sufficient condition for enterprise success, but it certainly is a necessary condition. To Sloane, strategy followed structure. To add to Sloane, execution follows strategy, and performance follows execution. Over time, getting the structure right is crucial; only luck can save the chronically poorly structured.

Sloane's "decentralized operational management with central policy control driven by return on investment" surely belongs in the pantheon of contributions to management thinking. Every executive will find at least some value in Sloane's *My Years With General Motors*. Aficionados are referred to Sloane's lesser-known book, *Adventures of a White Collar Man*. Sloane was either president, CEO or chairman of General Motors from 1923 to 1956.

Structure is crucial, but it is rarely critical. As a consequence, it is easy to put off restructuring for another day. The trouble is that days become years. Enterprises can easily sleepwalk their way into becoming a structural relic that seriously impacts competitiveness and profitability and threatens survival. Fixing structure takes time, and it is best done in small bites after regular review. It should be on every executive's agenda. Structure is ideally tackled without the distraction of slowdown, falling stock prices, declining earnings, cutbacks and layoffs. Ideally, it is even tackled today.

2. IS THE BUSINESS MODEL SUSTAINABLE?

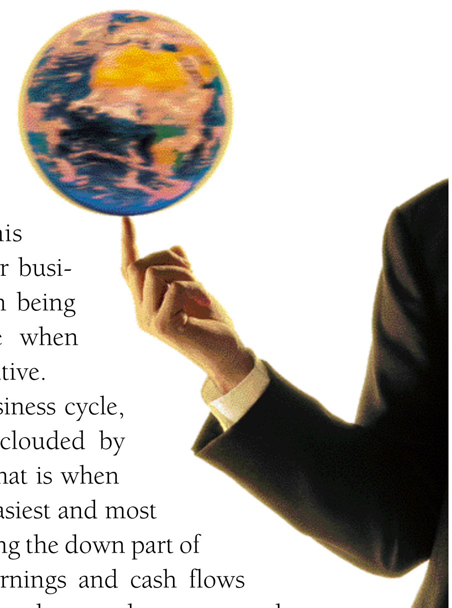
The business model is an enterprise's core strategy. It must be sustainable in the sense that it will indefinitely deliver competitive financial returns across the entire business cycle. Strategy that works over part or even most of the cycle is fatally flawed; the only issue is timing. No quality of the business model should be more important than its sustainability.

The business model should be continually tested and reviewed. For most enterprises, the greatest vulnerability is during the down part of the business cycle. That is precisely the worst time to find out that the business model does not work; options will be fewest and pressures will be greatest. Before slowdown is when executives should be asking if their business model is sustainable through slowdown. Testing a business model for cross-cycle sustainability is no easy task; even a good try is far better than no try at all. Experience, judgment, "what if" games, quantitative analysis and computer simulation are all useful business-model testing approaches.

Like a 10-step treatment program for a substance addict, fixing an unsustainable business model begins when the executive looks in the mirror and frankly admits that his/her model is unsustainable. Understanding and admitting that what you are doing is not sustainable is a precondition for fixing things. Such an admission may be hard on the ego, but it is surely good for the enterprise.

3. DO YOU WANT TO BE IN THE BUSINESS YOU ARE IN?

According to *U.S. News & World Report* (May 8, 2000), the legendary management thinker and adviser Peter F. Drucker asked Jack Welch this question shortly after he became CEO of General Electric in 1980. Drucker's specific question was: "If you weren't already in this business, would you choose to get into it now?" Every CEO should be continually asking this question about every major business line. Prosperity lies in being unemotional and decisive when the answers are in the negative.



In the up part of the business cycle, judgment is likely to be clouded by how good things are. Yet that is when exiting a business will be easiest and most rewarding financially. During the down part of the cycle, pressures on earnings and cash flows can lead to hasty decisions that are later regretted. Perhaps Drucker's greatest strength is his ability to get to the core of an issue in just a few words.

4. IS EXECUTIVE SUCCESS IN PLACE?

In a slowdown, executives can be forgiven for thinking they have been singled out for a special application of Murphy's Law. With everything else going wrong, and seemingly at once, enterprises do not need the added burden and risk of abruptly replacing senior people in a no-succession-plan vacuum. Enterprises that have not thought about their next generation of management, at least to the point of the options available, usually find that slowdown brings those chickens home to roost, and hard. For example, decisions may be made too quickly, expectations of new executives may be excessive, integrating new executives fast may win out over doing it properly, and the executive team may fragment as individuals focus on their own interests that may or may not be the enterprise's.

All executives are important, but the most important by far is the CEO. The job of CEO is special. It is where vision, strategy, decision-making and execution come together. No enterprise can indefinitely survive bad leadership from its ▶

CEO. Slowdown heightens the already enormous pressures on the CEO and, hence, raises the chances of either resignation or termination. Enterprises will not regret the time and resources they devote to the CEO succession exercise. It is not an exercise best embarked upon in the down part of the business cycle. Thinking about the next CEO should begin on the current CEO's first day—the CEO job is that important. Poorly planned CEO succession inevitably disintegrates into a superstar search frenzy, something that is fertile ground for mistake.

5. DO YOU KNOW YOUR CUSTOMERS?

An enterprise's most important asset is its customers. They provide the revenues and, hence, the profits. In a very real sense, customers are the glue that holds an enterprise together. The problem today is that customer needs, wants, choices, characteristics and capacities are changing at a breathtaking pace, making the prospects bleak for enterprises that do not stay at the cutting edge of everything worth knowing about their customers.

"Customers are the glue that holds an enterprise together"

You may not know your customers well, but you can be sure someone else does and is ready to pounce on them. This is particularly the case during slowdown, when overcapacity is highest and the chances of stealing customers are especially good. The science of customer research is developing as fast as any broad area of business inquiry, so it would not be surprising to find that an enterprise might have slipped on this important success dimension. The time to get serious about knowing your customer is not during slowdown, when the customer is cutting back and becoming increasingly price- and choice-sensitive. Executives who think knowing the customer is too costly should consider the cost of not knowing the customer.

6. ARE THE COSTS RIGHT?

Controlling costs is a vital executive function. Costs cannot get too far out of line without taking competitiveness with them; lose control of your costs and you lose control of pricing and profits. Costs are far more likely to get away from an enterprise during the good times, when the distractions are many and the consequences of being casual on costs seem minor. The more attention paid to costs during the good times, the less gut-wrenching and disruptive the cost-rationalizing-driven cutbacks and layoffs in the bad times. The "good guy" executive who lets costs go in the good times is not a good guy at all. That stark reality often only hits home when the economy goes bad. Controlling costs is a matter of continually comparing them with competitors', constant analysis and innovation, strong discipline and a relentless willingness to say no.

7. IS THE PRODUCT RIGHT?

The reason for knowing the customer and controlling costs (No. 5 & 6) is to have the right product available at the right price. In the process of asking about the customer and costs, executives should be asking about the product. Doing everything else right, and then seriously missing on the product, is not even a partial victory. Poor product management in the up part of the business cycle usually comes back to haunt enterprises in the down part.

8. DO YOU KNOW YOUR COMPETITION?

The competition is what beats you, and with globalization, technological change and deregulation, it has arguably never been so fierce. Not knowing what your competitors are up to is as dangerous as not knowing your customers. What your competitors are usually up to is finding ways to take your customers. The good times, when revenues and profits are easier, is when it is easiest to forget about the competition. Those who fall into that trap inevitably pay for it when things turn down. Slowdown is a bad time to discover that you do not know your competition. Knowing the competition involves everything from their products and customers to their policies and options. Corporate intelligence has never been more important.

9. IS THE BALANCE SHEET RIGHT?

Nothing exposes a too heavily indebted and/or too poorly matched balance sheet more than slowdown. Revenues needed to service providers of capital come under pressure during slowdown, and capital becomes more difficult to attract as lenders and investors raise standards. The best time to ask if the balance sheet is right, and fix it if it is not, is in the up part of the business cycle when confidence is high, the financial markets are buoyant and credit is easy. Those with too weak a balance sheet sometimes do not even make it out of slowdown. Key balance sheet issues are the debt/equity ratio, the debt maturity schedule, secure lines of credit and the regard in which the enterprise is held by the financial community.

10. WHERE ARE YOU ON TECHNOLOGY?

Slowdown is the worst part of the business cycle in which to be substantially behind the competition on technology. The reason is that slowdown diverts resources from technological competitiveness to the apparently more pressing needs of the day to day. If you are behind on technology going into slowdown, you will be the exception if you do not come out of slowdown even farther behind. Executives should commit to being technologically competitive across the business cycle. For executives today, the pace of workplace and product technological change is unprecedented. The faster the pace of technological change, the greater the consequences for the enterprise that lags. A cautionary note: Enterprises that are already cutting back on IT spending because they expect the economy to slip would do well to revisit their decision. After the fact, they may be glad they did.

Executives should use what is left of the up part of this business cycle to get ready for slowdown. The questions posed here will provide a focus in that regard. Executives should not misread their successes during the good times. A booming economy, low interest rates and a low dollar probably explain more than their own executive genius. A little humility in the good times will pay off in the bad times. Preparation will pay off even more. ■

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