Managing Uncertainty:
Navigating the Minefield

International survey of how business leaders have responded to major uncertainty

by PA Consulting Group
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with a foreword by Sir John Banham, former Chairman, Johnson Matthey and Senior Independent Director at Invesco
Foreword

This is a time of extraordinary uncertainty for everybody – governments, individuals, families and businesses. But while uncertainty brings huge problems, it also offers great opportunities. During the global financial crisis of 2008, businesses and governments in general reacted too slowly. Many thought the crisis would blow over and adopted a very passive approach – failing to remember the phrase ‘you should never waste a good crisis’.

The PA Consulting Group (PA) ‘Managing Uncertainty’ survey sets out some very timely lessons that companies can learn from this experience. They should begin by securing defensive capital, for example having a well-financed pension fund, and making sure assets are in good repair. At the same time they must invest for the long term.

Companies should also address any weaknesses in their portfolios. They should not take on any new businesses that will not contribute to overall performance, and they should dispose of existing underperforming businesses as these will soon become unsupportable.

Companies should cut costs, but carefully, so as not to damage their long-term health. And they should remodel their business for a totally new world – the world after the financial crisis that is currently forming will be as different as the world that followed the crisis of 2008. Companies need to be looking at the future rather than past.

During the previous crisis, when I was chairman of Johnson Matthey, the company actually increased investment in capital and R&D, and as a result came out of the downturn stronger than it went in.
One of the oldest lessons in business is that good companies prosper in terrible markets. The key is to focus effort on strengthening competitive position. But speed is crucial; delay can be very damaging. Companies that press on with plans that are already in hand (even though circumstances have changed), because they lack the flexibility required to change course, will come out of this tough time in very bad shape.

PA's survey is something that every CEO should read – and act on. Doing so may make the difference between winning and losing in the coming crisis.

Many companies have still not learnt the lessons of three years ago, never mind the lessons of tomorrow. It is unforgivable to commit the same mistake twice. Once is quite enough.

Sir John Banham is former Chairman, Johnson Matthey (Coutts & Co Large-Cap Business of the Year) and Senior Independent Director at Invesco.
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In 2010, Michel Syrett and Marion Devine of The Economist began researching their book, Managing Uncertainty: Strategies for Surviving and Thriving in Turbulent Times. During their investigation, they came across Mark Thomas’s publication, The Zombie Economy, and contacted him to ask if PA would run a survey to provide evidence they could draw on.

Early in 2011, Mark and his colleague, Mel Albury, worked with Michel and Marion to design a survey that could help establish how organisations respond to uncertainty and which strategies are most successful. Both teams saw this as an opportunity to identify practical steps that would help businesses gain a better understanding of how to manage uncertainty, an area so far largely unexplored.

These issues were timely at the beginning of the collaboration, but the subject matter has grown increasingly relevant month by month with the unfolding political and economic situation across Europe and beyond. The findings are even more relevant and valuable than anticipated at the outset of the project.

Conducting the research, analysing the results and interviewing many of the respondents has provided an exciting opportunity to work with respected researchers and gain a new depth of insight into one of the crucial questions on executives’ minds at present – how do we manage our businesses in these uncertain times, and can we turn the dangers into opportunities?
Acknowledgements

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Mark Thomas and Mel Albury, Survey leads, PA Consulting Group.
Introduction
“What we know about the global financial crisis is that we don’t know very much.”

Paul A Samuelson, Nobel laureate and eminent US economist
Introduction

As business leaders set about formulating strategy for the next few years, they face enormous uncertainty. The fallout from the global financial crisis of 2008 is continuing to have a deep and wide-ranging effect in world markets, and this will not change in the foreseeable future. Moreover, the recent recession has characteristics that we have never seen before – many of the old rules no longer apply, making it even more difficult to know how to react.

But while this uncertainty creates formidable challenges, it also yields a wealth of opportunities. It is not just a matter of survival – the recession and its aftermath have created new chances for companies to build competitive advantage and get ahead of those less able to respond and adapt. Companies that can react positively have the potential to outmanoeuvre their rivals and emerge with a sustainably higher market share than they had at the beginning of the crisis.

The winning companies will be those that take steps now to derive advantage from coming dislocations by looking for opportunities to restructure, develop new products and services, target different markets and even make acquisitions to build market share. But to flourish in this unpredictable global environment requires a different set of tools and a new approach.

It was with the goal of identifying successful strategies and tools for the uncertain years ahead that PA embarked on its Managing Uncertainty research. We asked 200 business leaders worldwide how they had responded to the financial crisis, what their experience had been in the intervening period and how they are positioned to meet the challenges ahead. We analysed their responses by comparing them against total shareholder return (TSR), which looks at the value the market places on a company’s stocks and shares over time.
Our results produce a fascinating blueprint for how to survive and thrive in a climate of continued economic uncertainty. One of our key discoveries was that the most common response, cautiously battening down the hatches, is not a formula for success. The highest-performing companies took a different approach: they identified the crisis early and responded quickly. They had a moderate approach to cost reduction, and they looked beyond this to focus on the opportunities to get ahead.

**Key recommendations**

- Make sure you respond faster than your competitors  
  – see Recommendation I

- Remove inefficiency but protect competitive advantage  
  – see Recommendation II

- Come out with a sustainably higher market share than you went in with – see Recommendation III.

Our report provides analysis of the survey findings to derive lessons from the experience of companies in the four years since the recession began. We show the consequence of taking certain courses of action, and the evidence as to which strategies put companies ahead. We also provide practical step-by-step advice on actions to take, and outline various scenarios to plan for.
The PA Managing Uncertainty survey – key results from our research

The predominant message to emerge from the PA survey is that the global financial crisis has created challenges different from those of a normal recession, and the normal response – battening down the hatches and waiting for a return to business as usual – is inadequate. In their response to the global financial crisis, most companies were too slow, too cost focused and too passive. As we enter the next stage in the global financial crisis, they cannot afford the same response again.

• Most companies were slow to respond: it took them one year to understand that the global financial crisis would have a fundamental effect on their business, and a further six months to act.

• They were also too cost focused. Although cost is a key issue, it is a mistake to apply cuts indiscriminately across the business. Many companies have taken remarkable steps to survive, reducing costs harder and faster than ever before. Yet for most, this kind of cost cutting is not sustainable over the long term. Nor can more than one company be the lowest-cost producer in the market. The others must compete on a different basis.

• Finally, companies have been too passive in their response to the financial crisis: only one-third saw it as a time of potential opportunity. Change is not easy, but reinvention and transformation will help organisations emerge strong, healthy and fit for the future.

Many companies have still not understood the need to look at this recession in a different way. They need to plan more consciously to adopt a more flexible approach. Our research and analysis of financial performance showed that the companies that recovered fastest were those that acted quickly, controlled costs moderately and responded actively to market opportunities created by the crisis.
Living with uncertainty

We have now had four years of living in an uncertain climate, from the toxic loans of the US subprime mortgages and the run on Northern Rock in 2007, through the Lehman Brothers collapse in September 2008, to the more recent crisis in Greece and problems elsewhere in the eurozone. Unlike previous recessions, the effect of this has been to create a climate of severe financial constraint simultaneously across all four key components of the global economy: banks, companies, governments and consumers.

The result has been a self-reinforcing spiral of downward pressure. Weakness in bank balance sheets restricts their ability to lend to companies, constraining growth and causing insolvency and restructuring. This in turn leads to stubbornly high unemployment and reduced consumer demand, increasing pressure on governments to provide stimulus and support packages for consumers and banks.

The effects of the crisis are still unfolding. There is a large amount of residual risk in global markets. Banks, for example, continue to hold high levels of toxic assets, many of which are not ‘marked to market’, and governments, which unleashed stimulus and support packages totalling around 25% of global GDP in the aftermath of the fall of Lehman Brothers, are cutting spending to reduce debt. Millions of consumers in Europe and the US are now unwilling to spend and unable to borrow, and growth in consumer spending in the so-called BRICs (Brazil, Russia, India and China) is not enough to counteract this.
In our survey, it was clear that respondents are extremely concerned about these issues.

Respondents recognised that what started as an economic crisis is now a complex knot of economic, political and regulatory issues (see figure 1). The combination of these risks makes it imperative for businesses to become better at managing uncertainty. To succeed now, most companies need to be well prepared for a range of outcomes.
Recommendation I: Make sure you respond faster than your competitors
“Customer feedback is vital. What they think, how they plan to react and how they actually react needs careful monitoring.”
Recommendation I:

Make sure you respond faster than your competitors

Survey findings: The highest-performing companies identified the crisis early and responded quickly. But most took 18 months to react – 12 to understand how serious it was, and 6 to decide what to do (see figure 2).

In February 2007, HSBC wrote down its holdings of subprime-related mortgage bonds by $10 billion. In July that year, investment bank Bear Stearns told investors they would get back little, if any, of the money invested in two of its hedge funds tied to subprime mortgages in the US, after rival banks refused to help.

There were plenty of problems in Europe too. In August, BNP Paribas told investors they would not be able to take money out of two of its funds because it could not value the assets in them, owing to a ‘complete evaporation of liquidity’ in the market. Meanwhile, the German regional bank Sachsen LB was sold to Germany’s biggest regional bank, Landesbank Baden-Württemberg, having come close to collapse under its exposure to subprime debt. It received a €17 billion lifeline. In September that year, the UK’s Northern Rock sought and received liquidity support from the Bank of England. As this was the first run on a UK bank in 136 years, companies should have recognised the scale of the problem then.
**Figure 2: The global financial crisis began in early 2007**

- **Aug 2007**: Sachsen LB rescued after €17 billion lifeline.
  - Short-term credit markets freeze-up.
  - Countrywide rescued in US.

- **Sep 2007**: Northern Rock sought and received a liquidity support facility from the Bank of England.

- **Dec 2007**: The US officially enters into a recession.

- **Feb 2007**: HSBC wrote down its holdings of subprime-related mortgage bonds by $10 billion.

- **Early 2008**: Scale of subprime lending becomes clear as Fannie Mae and Freddie Mac experience problems.

- **Sep 2008**: Collapse of Lehman Brothers – the point we consider the ‘precipice’ of the crisis.

- **Aug 2007**: Sachsen LB rescued after €17 billion lifeline.
  - Short-term credit markets freeze-up.
  - Countrywide rescued in US.

- **Late 2008**: US and global government interventions.

- **Early 2009**: OECD composite leading indicators begin to turn up.

- **Mid 2009**: First indications from OECD that situation is stabilising.

- **May 2010**: Greek bailout.

- **Late 2010**: Bailout of Irish banks.
**Figure 3:** Most companies were a year too late in believing the situation was serious

![Chart showing awareness of impact of financial crisis over time.](image)

Source: PA analysis

**Figure 4:** Companies took a further six months on average to react

![Chart showing number of months to respond vs respondents citing a quick response.](image)

Source: PA analysis
By October 2007, Swiss bank UBS had become the world’s first top-flight bank to announce losses, $3.4 billion, from subprime-related investments, causing the chairman and chief executive to step down. Later, banking giant Citigroup unveiled a subprime-related loss of $3.1 billion. A fortnight on, Citigroup was forced to write down a further $5.9 billion. Within six months, its stated losses amounted to $40 billion. In December, the US officially entered recession, and early in 2008 the scale of subprime lending became clear with the problems of the US mortgage corporations, Fannie Mae and Freddie Mac.

Yet it was not until the collapse of Lehman Brothers in September 2008 that most companies realised the full scale of the economic crisis (see figure 3). Why did it take so long? The answer is that people were neither observing what was happening nor taking steps to orientate themselves in the new financial landscape. Admittedly, most were unaware of the $1 trillion subprime lending in the US. But even had they known, they lacked a frame of reference, so when they decided action was necessary they had to go back to first principles. So daunting was this task that, not surprisingly, it caused paralysis. Even the quickest to act still took more than four months on average (see figure 4).
Figure 5: People who thought they made the right decisions tended to do so quickly. By contrast, those who thought they made the wrong decisions took longer to decide on a response.

Requiring one year to realise there was a problem, and six months to react, it took most companies, in total, 18 months to respond.

Our survey results show a clear correlation between speed and success in decision making (see figure 5). Companies that responded faster were far happier with their decisions, despite having had less time to make them. Companies that took longer to decide on a course of action were less happy with the decisions they made. This is explained, we believe, by the difficulty managers had in orientating themselves to an unfamiliar crisis – a balance sheet recession rather than a conventional inventory cycle one. Many managers only responded when the inventory cycle recession began, and did so as if it was another conventional recession.
How to act faster: the OODA loop

The ‘OODA loop’, which has its origins in the US Air Force, provides companies with a strategy for understanding how they can move quickly to gain an advantage over competitors even as the field of engagement is in flux (see figure 6).

The term OODA (observe, orient, decide, act) was coined by US Air Force pilot and Pentagon consultant Colonel John Boyd to assist combat pilots. He had a standing bet that, from an initial position of disadvantage, he could manoeuvre his plane into a position to defeat any opposing pilot in air combat within 40 seconds. He reputedly never lost the bet. Colonel Boyd argued that the ability to cycle rapidly through the OODA loop is more critical to success than individual faculties such as good eyesight or fast reactions.

**Observe.** This is crucial. If organisations do not observe, they cannot react. Agile companies supplement traditional market research with qualitative studies, questioning their customers, suppliers and employees about unusual trends and behaviours they may have noticed recently. Technology, such as social media, means that data are now available from new sources and can be analysed in new ways.

**Orient.** Orientation is the area where there is the greatest danger of misjudgement, not least because of the tendency to make data fit expectations. Companies can avoid this mistake by ensuring they have a diverse management team supplemented by external views, and by consciously striving to eliminate complacency. As Intel’s Andy Grove said: “Success breeds complacency. Complacency breeds failure. Only the paranoid survive.”

Four years on from the beginning of the financial crisis, there is a danger of complacency. ‘Black swan’ fatigue, a form of lethargy towards unlikely
events, or ‘known unknowns’, may threaten companies that are weary of the idea that another extremely unlikely event could happen and cause havoc in markets. Companies should not run their business on the basis that all will be perfect. Some landmines will explode and companies must plan for these.

**Decide.** The right decision will be determined by successful orientation. It must also be timely, not too late. Good decision making requires strong governance with robust processes at all levels and a cohesive leadership group. To make fully informed decisions, people must have the right information.

Often it makes sense to devolve decision making and empower employees to make their own decisions, rather than requiring decisions to be constantly validated by management. There is frequently a strong case for acting fast to see if a change works, for example testing a new retail format on a small scale, and deciding afterwards whether to roll it out more widely.
Act. Swift action is essential. Without speed, companies cannot be agile even if they complete the first three stages of OODA successfully. There can often be a disconnect between the ‘decide’ and ‘act’ stages of the loop. As with decision making, decentralisation can increase companies’ ability to act fast. Useful approaches to get away from the silo mindset that can paralyse large companies include encouraging an entrepreneurial atmosphere and fostering informal networks that link people across different functions.

Spotting the risks

It is now more difficult than ever for business leaders to orientate themselves due to the number and variety of risks they are exposed to. The large amount of residual risk can be categorised in four areas: consumer, corporate, banking, government. Among the many events that could be the next landmine for the global economy are: default, inflation, austerity, social unrest, protectionism and commodity shocks. Banks and governments are the most exposed. However, timescales are difficult to determine – some analysts warned about US subprime lending and property prices in Spain years before the crisis happened.

Survey respondents identified risks in descending order of uncertainty and impact: as figure 1 shows, they rated political, legal and economic factors as being characterised by the greatest degree of uncertainty, while judging technological, environmental and social factors as slightly less uncertain. The position of these factors in the hierarchy might fluctuate, for example in the UK our research predated the August riots, but they nevertheless still indicate the extent of uncertainty that companies are aware of as having a potentially damaging effect on business.

The range of challenges is bewildering – but they share a common root cause: debt. Debt is also at the root of the property bubble, which is why Japan faltered at the end of the 1980s; it contributed to companies’ problems at the end of the 1990s and to those of banks in the past decade. Companies, consumers and banks have all had debt problems. Now it is the turn of governments: PIIGS (Portugal, Italy, Ireland, Greece and Spain) first, but also the US, the UK, Japan, Germany, France and even China, where a significant bubble may have formed. This is why our evidence is so important, and why it is crucial to act on our recommendations and view the crisis as an opportunity.
Recommendation II: Remove inefficiency but protect competitive advantage
“We are getting back to being customer focused. In a crisis, people become really insular: you look inside, at costs and risk. We are trying to balance that now; risk and cost management remains important, but we need to refocus on the customer and create opportunities for growth.”

Don Schneider, Group HR Director, Old Mutual
Recommendation II: **Remove inefficiency but protect competitive advantage**

**Survey findings:** The highest-performing companies had a scientific approach to cost reduction and shrinkage.

Cost reduction is the traditional response to an inventory cycle recession, so it was not surprising that it was the single most common action taken by the companies that participated in the PA survey. Some 82% of respondents cut costs, as shown in figure 7. However, the simple fact of cost cutting was not a differentiator between those who thought they made the right decisions and those who did not. Indeed, the highest-performing companies (as measured by TSR) had a carefully judged approach to cost reduction.

Our results showed that medium-term performance, as measured by TSR, correlated strongly with a moderate degree of cost reduction: those who did little and those who did a great deal performed worse.
Figure 7: Companies adopted a wide range of responses to the financial crisis.

Source: PA analysis
The most successful companies were measured and focused: they did not cut excessively (see figure 8), they tried to preserve staff and they avoided fire sales of businesses at the lowest point of the economic cycle.

Cuts, such as headcount reductions, which reduce capacity, especially in areas where skills take time to build, should be very carefully targeted at those businesses for which medium-term overcapacity exists. Our survey results showed clearly the negative correlation between depth of staff cuts and medium-term TSR (see figure 9).
How to get cost reduction right

What is the difference between a ‘good’ approach to cost cutting and a ‘bad’ one?

A bad approach has three characteristics:

• It is indiscriminate: good businesses are cut just as much as failing businesses; costs are targeted based on category of spend rather than whether they are creating value

• It damages long-term capacity or competitiveness

• It restricts the company’s ability to deliver high levels of customer service or product quality.

As an example of indiscriminate cuts, the memo (see figure 10), loosely based on those we have seen in the market, shows how across-the-board cost reduction remains a natural response for some managers.

Similarly, cuts that reduce the attractiveness of products or services to customers, for example reduction in marketing spend, service levels or product quantity, can be very damaging.

Good cost reduction, by contrast, is focused on:

• Businesses, products or markets for which growth is either unlikely (for example because the market is in long-term decline) or that are unlikely to create value (because the returns are below the cost of capital)

• Functions, activities or projects whose outputs are neither essential to the sustainability of the business (unlike essential areas like sound financial controls) nor highly valued by customers (and since customer needs are changing, there may be new opportunities to reduce costs here).

Even ‘good’ cost cutting cannot be the whole answer for most businesses. In each sector, one company will be the lowest-cost provider: this is the basis of its competitive advantage, and all its efforts should be devoted to maintaining or extending this advantage; for this business, cost reduction is all. For its competitors, however, price-based competition is a game they
can only lose: these companies must find a different way of meeting the developing needs of customers and consumers. Ways of doing this are described in Recommendation III.

Cost cutting in moderation is helpful to TSR, but too much of it can be a bad thing because it damages long-term competitiveness. Making cost cutting the only strategy is dangerous – companies need to look for other ways to gain competitive advantage and differentiate themselves in the market.

**Figure 10:** An example of indiscriminate approach to cost cutting

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Subject: cost reduction

_Dear Colleagues_

As we head into the last quarter, there is a need to further tighten and minimise spend on non-staff costs at all levels. The following changes will be implemented immediately:

1. **Technology:** _Freeze on hardware and software spend._

2. **Consultants, contractors and technical specialists:** _All spend to be pre-approved, with in-flight consulting engagements and planned spend submitted for revalidation. Contractors and technical specialists to take a mandatory two-week Christmas holiday._

3. **Travel:** _International travel for internal purposes is to cease. The existing policy that allows employees taxis after 9.00pm will be amended to after 10.00pm._

4. **Entertainment and off-sites:** _No staff entertainment for remainder of year, and no end-of-year party subsidy. No off-sites until further notice._

5. **Marketing and communications:** _External spend to be re-reviewed. Internal communications spend to cease for remainder of year, eg brochures for internal use, internal communications videos._

6. **Training:** _No new external training to be booked for remainder of year._

7. **Telecoms:** _No new approvals (BlackBerry, headsets etc)._ 

Please cascade the above to your leadership teams.
Recommendation III: Come out of the crisis stronger than you went in
“Yes, this is a moment of challenge... but each generation has found the capacity to not only endure but to prosper – to discover great opportunity in the midst of a crisis.”

Barack Obama, US President
Recommendation III:

**Come out of the crisis stronger than you went in**

_Survey findings:_ The highest-performing companies viewed the crisis as an opportunity rather than a threat.

Two-thirds of respondents saw the crisis as a threat and sought solely to ride it out. But this represents a huge opportunity for those with a more positive approach. They have the chance to build market share and acquire erstwhile competitors. The PA Managing Uncertainty survey highlights a number of potentially winning strategies.

“We have to look at it as an opportunity. Even though everyone will need medicine, governments are running out of money and so they are going to change what they are prepared to fund. For Boehringer, it’s about: how can we respond, how can we help them achieve what they are trying to do and how can we as a company create some form of competitive advantage? The system is in chaos, so if we can be the ones who go in and help sort out that chaos by changing our business model that will make us very successful.”

_Gifford Tanser, HR Director, Boehringer Ingelheim_
The key drivers of success

The most important finding relates to overall mindset: around two-thirds of companies saw the crisis as a time of threat, and planned defensively; one-third saw it as a time of opportunity and planned to beat their rivals. The second group had a far higher TSR than the former (see figure 11).

**Figure 11:** The highest-performing companies viewed the crisis as an opportunity rather than a threat

The key tactics that enabled companies with a positive approach to outperform their rivals were:

- Better planning: consciously putting in place flexible planning – moving from budgets to rolling forecasts and from forecasts to scenario planning – and being aware of competitor moves
- Better management: strengthening governance, empowering staff
- Bold strategic moves: such as acquiring new businesses.
Our survey shows that companies that implemented flexible planning tools such as scenario planning were happier with the quality of their decisions and had a higher TSR (see figure 12).

Those that strengthened leadership and governance, and engaged staff were also happier with the quality of their decisions and showed a higher TSR over the period (see figure 13).

Just as companies that sold businesses during the crisis performed worse than average, those that had amassed the financial strength to buy businesses outperformed their competitors in TSR terms (see figures 14 and 15).

Source: PA analysis
“For a few years now, I have felt that leadership is about managing ambiguity in an uncertain world; that’s one of the mantras I’ve had when looking for good leaders and identifying good leaders – people who can manage the ambiguity. Leadership is about being able to do that, and in such a way that more often than not, you are successful in managing through ambiguity.”

Virginia Rothwell, Group HR Director, Phoenix

Source: PA analysis
ABN AMRO sees the financial crisis as a buying opportunity

In an interview with the Financial Times (FT) in October, Gerrit Zalm, the former Dutch finance minister who is now chief executive of ABN AMRO, explained how the Dutch bank is preparing to take advantage of the coming crisis by using ‘offensive capital’. The bank is on a mission to re-emerge as a force in the sector and has promised to be a buyer of eurozone financial assets that capital-stretched banks are preparing to sell. Mr Zalm told the FT that the bank is very well capitalised and not in a position to have to shrink its balance sheet. The plan for portfolio acquisitions is part ABN’s strategy to rebuild its identity as an international bank. It recently moved back into the US oil and gas market and plans to open offices in Moscow and Shanghai. The bank’s growth, including its foreign build-up, will focus sharply on niche areas of strength, says Mr Zalm. It only wants to undertake international activities in areas where it thinks it can beat the top banks in the world.

Scenario development: a Greek example

A Greek default may seem like a marginal event on the fringes of Europe that is unlikely to have much impact on the majority of global businesses. But thinking about the implications and outcomes if it happened is an instructive exercise and highlights how complex and interrelated today’s global market can be (see figure 16). Although the Greek economy is small (about $310 billion), a default could change the economic landscape of Europe, if not the world.

The 200% yield on one-year Greek government bonds, at the time of writing, appears to let investors more than treble their money, but this reflects the perceived high risk. A Greek government default could trigger 2008 all over again. The IMF estimated total system losses at €300 billion, and there would be a knock-on effect potentially including Ireland, Portugal, Spain and Italy.
Companies with exposure to any part of the eurozone ought to develop contingency plans. Depending on the location of your customers, competitors and suppliers, this scenario could present a wide range of challenges and opportunities. The most successful companies plan to deal with both.

The most proactive companies already have well-developed contingency plans to respond to such a scenario – indeed, there are companies that are already acting on these plans: German travel company TUI, for example, was widely reported as having sent notices to Greek hotels with which it regularly does business, asking them to accept payments in drachma in the event of an exit from the euro. Clearly, having such contractual provisions in place before a change would both protect TUI against problems and potentially give a period of significant competitive advantage.

At the time of writing, the scenario above is a future possibility only; but it is clear that events in the eurozone are developing fast, and this scenario – or others – may be playing out as you read.
“No battle was ever won according to plan, but no battle was ever won without one.”

Planning for various scenarios is crucial

One of the key findings in the PA Managing Uncertainty survey was that companies can benefit significantly from planning how they would respond to a range of scenarios, and from adopting a flexible approach that allows them to respond fast. Improving capability in these two areas positions companies much more strongly to turn economic uncertainty to positive advantage.

In order to be able to formulate a rapid and informed response, companies must think through a range of scenarios based on what they believe could happen and decide how they would respond if it did.

A typical scenario plan follows the stages shown here:

1. Define what scenarios to look at, for example
   - Double-dip recession in US
   - Generic plan if China blows
   - Greek default and eurozone fragmentation

2. Determine impact on your own business
3. Trace the sequence of events
4. Assess the impact on customers, suppliers, competitors and your own operations
5. Work out whether it would be good or bad news – company specific
6. Identify options to defend against or take advantage of the situation
7. Select what specific actions to take
8. Decide what triggers to look out for and who will do the monitoring

Source: PA analysis
Taking advantage of the changes

In the current economic climate, many consumers are postponing major expenditure, prioritising what they believe is really worth paying for, and often trading down, for example choosing a ‘staycation’ rather than holidaying abroad. They are paring down, reducing waste, buying less and pouncing on bargains. These changes in behaviour are more marked and rapid than the normal development of consumer needs over time. They are also semi-permanent and will endure for several years, the lifespan of many products and services. This creates opportunities for dynamic companies to compete in new ways.

The combination of these factors creates opportunities for those prepared to hold their nerve and invest. It is by far the cheapest time to take market share, buy businesses, take share organically from failing companies and position to meet the needs of half-dead, half-alive ‘zombie’ consumers who have lost the ability to function normally, gaining an even bigger slice of the market.

Berkshire Hathaway makes acquisitions

Berkshire Hathaway is one capital-rich company that has exploited market turmoil to make advantageous acquisitions.

In 2008, Berkshire Hathaway bought Baltimore-based Constellation Energy Group for $4.7 billion and immediately injected $1 billion. At a time when others were keeping their wallets closed, Warren Buffett, Berkshire Hathaway’s chairman, chief executive and major shareholder, was prepared to write multibillion-dollar cheques. The same year, he also spent $14.5 billion buying preferred shares of three blue-chip American companies, Wrigley, General Electric and Goldman Sachs. In November 2009,
Berkshire Hathaway bought the 77.4% of Burlington Northern Santa Fe, a railway company based in Fort Worth, Texas, it did not already own for $26 billion in cash and stock – the largest deal in Berkshire history. As Mr Buffett likes to say, he is “fearful when others are greedy, and greedy when others are fearful.”

Energy companies take strategic decisions

The energy sector is one in which companies are exhibiting very different risk appetites in the face of uncertainty: some are withdrawing from risky investments, while others are taking a bold stance that these investments will in time provide attractive returns.

Investing in nuclear energy is expensive and long term. A nuclear power station costs hundreds of millions of dollars, takes 10 years to build and operates for 50–60 years, a timeframe likely to encompass several economic boom-to-bust cycles. In the early 2000s, the nuclear energy industry underwent a renaissance, with many seeing it as a green and cost-effective answer to the world’s fast-growing power requirements. But that changed significantly following the global financial crisis, the earthquake and tidal wave in Japan’s Fukushima and the tapping of shale gas, a new, plentiful and cheaper source of power.

Many countries are now re-examining their nuclear power strategy. Deterred by toughened regulation, tight finances and formidable operational challenges, countries such as Switzerland, Germany and Italy have decided not to pursue nuclear power investment, perceiving the risks to outweigh the benefits. Others are taking a different view. Tennessee Valley Authority, which decided 10 years ago to focus on nuclear power as part of its core business, has stuck with this decision throughout the recent economic turmoil, believing that the fundamental arguments for nuclear remain strong and will be validated in due course.
Governments invest in research and development

Our survey shows that economic turmoil has created opportunities for proactive businesses to seize competitive advantage. Similarly, it has presented governments with an opportunity to take a more proactive approach to helping business and industry thrive. Markets have shown that, left to their own devices, they are often unable/unwilling to self-regulate. So governments in Europe and the US have risen to the challenge, spending billions of dollars on research, development and innovation to help business and industry recover from the impact of market failure. They are now behaving much more like their counterparts in countries such as China, investing in the public sector, building consortia and helping them win major contracts. Many are maintaining funding at its pre-crisis level – a much higher percentage of GDP than five years ago. Now that we know that markets can fail, government intervention, regulation and investment in innovation are here to stay.
Next steps
“Our actions during and after the crisis are not typical, but reflect the fact that our company experienced successful transformation before the crisis, so we were lean and strategically settled when the crisis began. This gave us the opportunity to be expansive during the crisis, which has led to massive gains in our market share.”

Survey respondent
Next steps

If you are a manager looking for ways to address current and future uncertainty, what can you learn from our survey respondents' experiences of the recent crisis?

• Make sure you respond faster than your competitors
  There is a strong correlation between speed and subsequent satisfaction with decisions. The highest-performing companies spotted and responded fastest to the global financial crisis. So seek to establish an early-warning system to highlight potential problems on the horizon. Most companies did not believe the situation was serious until the fall of Lehman Brothers, approximately one year after they should have known. They then took a further six months to respond, an 18-month delay from observation to action.

• Remove inefficiency but protect competitive advantage
  Cost cutting is a natural and correct response to uncertainty, but avoid panic reactions: aim to remove genuine inefficiency without slashing staff costs, which can seriously damage customer service. Identify cost-cutting measures that do not damage long-term performance and avoid selling assets at the lowest point in the economic cycle.

• Plan to come out with a sustainably higher market share than you went in with
  Keep abreast of competitor actions and look out for opportunities to buy businesses, supplies, staff and advertising. Empower staff and strengthen governance. Plan flexibly, for example moving from budgets to scenarios, with concrete actions to improve positioning. Avoid paralysis and be ready to mobilise when the opportunity arises.

How can you act on these key recommendations in practice? Figure 17 sets out four steps that any business can take, starting today. The first two steps are the necessary preparation; the last two represent the anchors that will ensure your company comes out as one of the winners.
Figure 17: Concrete steps for business leaders to take

Four steps to success

Prepare for the crisis
- Ensure your balance sheet is strong
  - Develop scenario plans and build early warning system
  - Establish ‘defensive liquidity’
  - Build ‘offensive liquidity’ if possible

Respond as a winner
- Strengthen your business
  - Sell poor businesses before the crisis breaks
  - Retain the cash
  - Strengthen governance and leadership
  - Create high-quality plans to derive value from the crisis

- Reshape your business for the post-crisis world
  - Cut costs carefully
  - Meet changed needs of customers
  - Engage staff

- Seize market opportunities
  - Buy businesses
  - Take market share
  - Attack weakened competitors

Source: PA analysis
Conclusion

As it becomes clearer that we are again heading for a period of major turmoil, companies must do all they can to ensure that they are positioned to emerge from the turmoil as winners.

The lessons from the survey are clear: do not treat the coming crisis as another ‘normal’ recession:

• Prepare so that you can respond more quickly than your competitors
• Cut costs scientifically but protect competitive advantage
• Plan to come out with a sustainably higher market share than you went in with.
Appendix: a note on methodology

PA surveyed 205 c-level and director-level representatives of companies over a range of geographies.

The analysis has been produced using the survey data and also by comparing responses against total shareholder return (TSR) for listed respondents (92 in total). As TSR looks at the value the market places on a company’s stocks and shares over time, we have used this measure as a proxy for performance. We have used data from the period 2007 to 2010 to cover the main timeline of the financial crisis.

This survey has not been fully able to prove causality between actions and performance. To help overcome questions around causality in comparisons between actions and performance, we have used ‘delta TSR’. This is the difference between a company’s TSR and the average for its sector, so avoiding skewing results based on the overall success of a particular sector, and showing a respondent’s performance relative to its peers. We have also looked at ‘delta TSR’ over a three-year period, giving a higher likelihood that a respondent’s actions would have impacted TSR during that time.

The key results have been tested for statistical validity and were found to be significant to a minimum of the 90% level, and in some cases to the 95% level.
To find out more about PA’s survey or how to manage uncertainty in your business, visit:

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Try our online benchmarking tool to see how you compare

Scan.
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Get in touch.
Managing Uncertainty: Navigating the Minefield
International survey of how business leaders have responded to major uncertainty

PA’s survey is something that every CEO should read – and act on. Doing so may make the difference between winning and losing in the coming crisis.

Many companies have still not learnt the lessons of three years ago, never mind the lessons of tomorrow. It is unforgivable to commit the same mistake twice. Once is quite enough.

*From the foreword by Sir John Banham*
former Chairman of Johnson Matthey
(Coutts & Co Large-Cap Business of the Year)
and Senior Independent Director at Invesco.