RESILIENCE report

strategy+business

7 Ways Forward

by Conrad Winkler, Kaj Grichnik, Arvind Kaushal, Richard Rawlinson, Edward Tse, Martin J. Bollinger, Karim Sabbagh, Roman Friedrich, Pierre Péladeau, Yoshiyuki Kishimoto, Hiroyuki Sawada, Chieko Matsuda, Justin Pettit, and Shumeet Banerji

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7 WAYS FORWARD

How to rebuild your capabilities for long-term growth in a time of turmoil.

IN MID-SEPTEMBER 2008, as the credit collapse accelerated into full-scale economic meltdown, the world's attention naturally turned to triage and recovery. Booz & Company, which publishes *strategy+business,* was the first major management consulting firm to respond.

The firm's experts quickly developed a set of guides for businesses making their way through the downturn, beginning with an article by CEO Shumeet Banerji ("Navigating through the Financial Crisis"), published on the Web on October 3.

It was already apparent that not all companies were equally affected. As Banerji wrote, "These times, though unnerving for some, will create great opportunity for many companies. Industry structure is fundamentally reshaped by discontinuity."

How, then, can a leader ensure that his or her company ends up among the winners? That's the question answered in the essays that follow. Adapted from Booz & Company reports on the downturn, each assesses long-term growth prospects from the perspective of an industry, function, or region. Together, they add up to a comprehensive view of the emerging post-meltdown economic landscape.

—Art Kleiner
Editor-in-Chief

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1.

Manufacturing: Diagnosing This Downturn

by Conrad Winkler, Kaj Grichnik, and Arvind Kaushal

For manufacturers, every economic downturn feels unique. The 1930s were marked by overcapacity, partially the result of aggressive factory investments and productivity improvements made during and after World War I. Manufacturers were buried in a vast inventory of unwanted products. With cash having dried up and disappeared after the banking system collapse, there was no easy route to recovery; it took until 1932 for the U.S. unemployment rate to reach its peak of 25 percent. In the late 1970s and early 1980s, stagflation and the recession that followed represented their own form of virulent uncertainty. The current crisis combines bursting bubbles in real estate, commodities, and the stock market — all in a toxic stew that is rapidly reducing consumer demand, freezing the credit that is necessary for manufacturers to restructure, and provoking massive layoffs. This could spiral into its own long, drawn-out deflation, just as the Great Depression did — or it could take another turn entirely.

Yet when one looks at the manufacturers who survived and positioned themselves well in past downturns, the most effective approaches were similar. Here are several time-tested survival strategies for manufacturers that could provide a bridge over short-term troubles and simultaneously build long-term competitive advantage.

- **Look beyond the crisis.** The most important part of a downturn strategy is to examine your current and future company and industry position, and your product mix in light of that position. Can you come out of this as the low-cost producer with advantages of scale? Which competitors, customers, or suppliers might fail, and what does this imply for where to expand or contract product lines? Investigate where you can cancel or delay product and manufacturing investments, versus where you need to play more aggressively to win. It will be impossible to know how to take some of the other necessary steps if you do not know where you can win.
- **Improve your product mix and profitability.** With reduced demand in many areas, some products that were profitable just became money-losers. Nonstrategic customers or those that have de-sourced you may be targets for hefty price increases during the transition. Conversely, if you have a market advantage, outpace your competitors by selling upgraded products at a slightly lower price than you would normally consider. This may also be the time to rationalize product lines and take out items that are complex to produce, especially if customers will no longer pay for them. Remember that complexity is often a driver of overhead costs.
- **Free up cash.** Cash costs have gone up dramatically. Postpone nonessential investments and cancel projects that are no longer viable. Adjust capacity and inventory levels for decreased demand, moving rapidly to analytical targets based on the newer, much lower, consumer demand. Ensure that accounts payable and receivable are in line with your industry's norms; track changes in customer credit. Consider making changes to employee pay schedules. Retailers and other business customers will most likely be willing to pay more for

Illustrations by Felix Sockwell

faster cycle times because their demand is also uncertain.

• **Rationalize overhead costs.** Match so-called fixed staffing needs to new workloads. For plants that have shrunk in size, combine senior-level job functions like plant management, HR, finance, and engineering across plants. Aggressively reduce materials handling, quality, and maintenance activity while retaining the most skilled maintenance people. The greatest gains can be achieved by reducing the number of layers between the CEO and the factory floor.

• **Reduce capacity.** This is one of the most difficult levers to pull, but it is essential for conserving cash. Eliminate shifts where slow sales have severely cut into production. In-source production to fill unused capacity. Consider combining some plants with those of competitors. But keep an eye on the most likely places for post-downturn demand; make sure that you retain productive factories there, prepared to fill the void left by competitors who will have exited the market or slashed production.

• **Improve productivity for direct and indirect labor.** Cross-train factory staff for increased flexibility in response to fluctuating demand. Use overtime and weekend schedules to substitute for unneeded full shifts.

• **Reduce wages, benefits, and raw materials costs.** Previous run-ups in labor costs may not have been justified, and many would rather keep their jobs at a lower wage than lose them. Remember the need for tremendous leadership as you embark on this path. Also, commodity prices are lower, which offers an opportunity to examine cost models and possibly rejigger raw material purchasing strategies. Renegotiate long-term contracts, readjust hedges, and switch to lower-cost materials that do not compromise product value.

All these critical measures involve judgment calls. They cannot be applied across the board. Some situations may call for cutting back some inventory but maintaining or improving service levels for the most profitable customers, or outsourcing in some areas and bringing operations in-house elsewhere. In each case, rapidly assess your situation, diagnose your problem, and then adopt a more frugal, adaptive, and resilient position — from which you can start planning for the upswing.

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2.

Consumer Products: Some Brands Win

by Richard Rawlinson

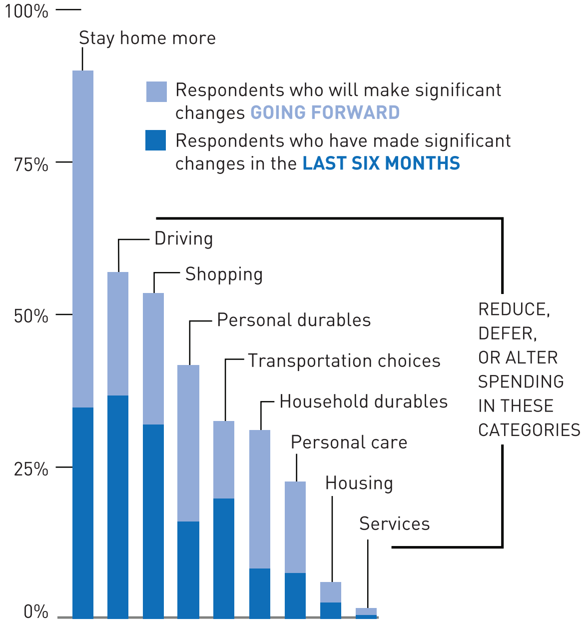
Consumer anxiety had been building throughout 2008, but only in the autumn did this anxiety show up in day-to-day buying habits. Perhaps that was because those first to feel the effects, in the spring and summer, were a relatively small group of consumers: bankers fearful of losing their jobs and homeowners unsure they would be able to refinance their mortgages. But later in the year, the broader consumer climate began to chill as unemployment levels rose.

In the U.S., the change in consumer behavior was evident in an in-depth survey of 1,000 households conducted in September by Booz & Company. It suggested that, in contrast to their behavior in many previous downturns, a large proportion of consumers were already cutting back in anticipation of income declines. They had begun shopping more frugally, driving less, and spending less on restaurants and entertainment outside the home. (See Exhibit 1.) And consumers expected to make even deeper cuts in their spending, given their gloomy outlook for the economy. But they had not switched brand loyalties or expectations. Indeed, in the months to come, as people spend more time at home, they will probably grow more attached to brands that provide the most perceived value at the lowest cost.

Companies that have successfully built up a distinctive combination of brand value, customer loyalty, and savvy pricing can now use their success as a launching pad for further growth. For example, in September, the Tesco PLC retail chain rolled out a product line called Discount Brands, more expensive than its Value brand and billed as "high quality you can afford." Now is the time to launch such second brands, provided they can

Exhibit 1: **Staying Home, Shopping Carefully**

A Booz & Company survey of 1,000 U.S. households revealed behavioral changes that respondents had made and expectations of more to come.



Source: Booz & Company

offer quality without the frothy advertising and aspirational pricing of their top-of-the-line siblings.

Marketers can also thrive by providing alternative, noneconomic reasons for consumers to trade down to less-expensive products. These might include environmentalism, health, and simplicity. Auto dealers can sell the Toyota Prius instead of the Lexus as a way for customers to "do their part to stop climate change," even though the price and fuel-cost savings ultimately drive the decision to switch.

Consumer concerns about health and wellness have inspired much product innovation during the past five years. The growth of organic food sales may be faltering, but this is probably not the end of popularity for organics and wellness-oriented products. Consumers will continue to age, and they will still want the benefits of health and physical well-being. But now they will seek out manufacturers and retailers who deliver those benefits at mainstream prices. This tension will stimulate innovation that should lead to a new synthesis between environmental and health concerns and pricing.

For luxury goods, the challenge is different. It is often said that spending by the superrich is immune to economic crisis. But luxury brand owners will still face losses among their mass affluent customers, the market segment in which many of the most prestigious brands achieve enough volume to remain profitable. Savile Row will carry on, but premium-branded factory "made to measure" clothiers will suffer. These companies need to find ways for their products to become palatable to more cost-conscious consumers while maintaining their image of high value and status.

The key is pricing. Manufacturers and retailers alike should feature just a few price points, clearly indicated, so that consumers know how to control and manage their spending. That fits the in-store behavior observed last autumn in the U.S. and Europe — where retailers report seeing more planning, more shopping lists, and more conscious management of price and value. The long years of the booming economy let many marketers cloud brand portfolio fundamentals; they now need to clearly differentiate their premium brands from those at the bottom of the pricing ladder.

Marketers need pricing that fits like a wetsuit, following the nooks and crannies of customer preference and spending constraints, stretching and bending as the economy shifts up and down. One consumer products manufacturer was caught off guard by a rapid shift in consumer interest from premium convenience packages to larger, better-value packages; the company discovered during the shift that the larger packages were not profitable. As they seek to prevent this kind of pricing surprise and to realize profits, manufacturers and retailers must work together more closely than ever before, minimizing the friction that raises prices and causes inefficiency.

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3.

China: Cautious Activists

by Edward Tse

For a long time, China's leaders have studied the development patterns of more developed countries — recognizing that their situation is unique but looking for models all the same. The United States has served as a key model. But the financial tsunami, as it is called in

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China, has caused Beijing to reconsider following the American example.

Because of the economic slowdown of China's major trading partners in North America and Europe, its exports have suffered. A large number of export-oriented businesses (mostly small and midsized enterprises) have gone bankrupt or significantly reduced their operations. China is now highly integrated with the rest of the world; it can no longer "decouple" itself from the West and return to being an isolated economy.

But exports constitute only about one-third of China's GDP. And China's financial and banking systems remained relatively stable and well regulated through the first few months of the crisis. This gave China a sound foundation compared with the U.S. and western Europe. China also benefited from its wealthy government (which maintained a surplus) and from the high savings rate and frugal culture of its population.

The rest of the world has expressed both hope and expectations that the Chinese, with their cash reserves, will take on a more activist role: helping the global economy transition out of crisis, making acquisitions, and being more assertive. But Chinese leaders recognize that they still lack experience as world leaders; they see this as an important time to learn.

In a speech welcoming U.K. Prime Minister Gordon Brown to China on October 14, 2008, Chinese Premier Wen Jiabao said, "China will continue to play an active role with a responsible attitude. [But] for China, what counts the most now is to successfully address its domestic affairs. China will adopt flexible and cautious macroeconomic policies to make the macro control more targeted and flexible. China will also maintain stability in its economy and capital market to promote steady, rapid economic growth. This will be our largest contribution to the world." Other senior leaders such as President Hu Jintao and Vice President Xi Jinping have made similar public remarks. The Chinese government has made it clear that it will continue investing in building infrastructure, such as railroads, to aid further GDP growth.

The financial crisis represents an opportunity for Chinese businesses and the government to increase their soft power. Leading Chinese enterprises, such as China Mobile Ltd. and Industrial and Commercial Bank of China Ltd., are developing alliances, investments, and closer relationships with other parts of the world. Leaders of multinational companies should take note of this trend: The Chinese company they compete against today could be their ally in the future, or vice versa.

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4.

Aerospace and Defense: Assault on Risk

by Martin J. Bollinger

The aerospace and defense industry is under great pressure. Order rates for new commercial aircraft have declined, and major defense programs around the world have been canceled or cut back. The last time this happened, in the early 1990s, the one strategy that did not succeed was hunkering down — attempting to outlast the fall in aerospace and defense demand by cutting costs and curtailing investment. In general, that approach exacerbates risk and performance problems. Executives try to "fill the factory" to keep people busy. They pursue work of marginal profitability and high risk, and they bring outsourced work back in-house even if the in-house facility is more costly. Ultimately, they find that they are managing a portfolio with the risk profile of a derivatives trader and the expected returns of government T-bills.

The alternative is for leaders, beginning with CEOs and CFOs, to become more adept at understanding and managing risk and reward across the business portfolio. This means addressing the full range of indirect cost categories: corporate allocations, people-related costs, site-related costs, information technology spend, and discretionary expenditure. And it means seeing markets as Marshal Ferdinand Foch saw the battlefield of the Marne in his legendary dispatch of 1914. Just before he turned the tide of the initial German offensive, Foch cabled: "My center is giving way and my right is in retreat. Situation excellent. I shall attack."

One good place to start is in improving risk management practices. In recent years, virtually every segment of the aerospace and defense industry has suffered calamitous difficulties in executing major projects. Large commercial aircraft, military spacecraft, naval surface combatants — none have been immune from expensive (and embarrassing) program failure. Many analysts attribute these failures to management errors, lack of customer self-discipline, systems integration issues, or shortages of skilled labor. But these factors, although they play a role, cannot explain why the problem is so widespread and so deep.

The underlying cause is the increasing obsolescence of this industry's traditional approaches to program management, especially in tracking and reducing risk. The industry's conventional project management tools and practices were developed decades ago, at a time when technically astute customers worked closely with just one vertically integrated contractor for any given project. The methods depended on a clear, unbiased, and easy exchange of data. Today, a typical contractor is a complex network of industry consortia, often spanning continents and sharing responsibility for managing costs, schedules, and risks. A teammate from another company, working on a shared project, could easily be a competitor tomorrow. The exchange of simple data on risks can become the basis for prolonged contract disputes or competitive disadvantage. There are too few positive incentives to volunteer relevant risk data in a timely manner.

Fortunately, new techniques are emerging that can pierce the veil. These include objective risk-scoring criteria that apply to all types of risk, whether technical or purely cost- or schedule-related; the use of computer-based simulations to assess how risks might correlate; and new forms of mitigation analysis. These have provided senior management with the information they need to direct remediation efforts, and to set financial goals that can cover the costs of an appropriate balance between risk and return.

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5.

Telecom: Exceeding Expectations

by Karim Sabbagh, Roman Friedrich, and Pierre Péladeau

Telecommunications companies are bracing for a long period of slow growth. Indeed, before the financial crisis hit, many telecom operators were already taking steps to streamline their business models; those initiatives are now likely to be accelerated. They will outsource more

When times are tough, purchases of high-end devices slow down, but people still want to talk on the phone, watch television, and use the Internet.

processes, pull back infrastructure expenditures, and rethink the pace of rolling out new technologies.

But they should be wary of cutting strategic technological investments that affect their ability to remain competitive — for example, mobile broadband infrastructure, next-generation networks, and fiber rollouts (including fiber-to-the-home, with which Verizon has had success in the U.S.). The industry can learn from the experience of 2001: The companies that stuck with their network infrastructure investments amid a general telecom crisis emerged with unassailable positions.

In general, telecom-service revenue is unlikely to be permanently hurt. The resilience of communications revenue is a function, in part, of the relative youth of the industry, but also of telecom's position as an essential service in mature economies. When times are tough, replacement cycles for handsets lengthen and purchases of high-end devices (like the iPhone) slow down. But people still turn to their existing devices to talk on the phone, watch television, and use the Internet.

Even in developing nations, where there may be a drop in subscriptions or revenue at first, most companies will continue to add subscribers, and some will emerge from the crisis stronger — as Turkey's Turkcell Iletisim Hizmetleri AS and Argentina's Telefónica de Argentina SA did after 2001. The increasing cost-consciousness of enterprise customers, including their desire to cut back on travel expenses, may finally create enough demand for communications services that support videoconferencing, telecommuting, and teleconferencing. As these customers look to get a better handle on their selling, general, and administrative (SG&A) costs, there may also be increased demand for new services like voice over IP, managed services, and process automation enabled by telecommunications. Although the turmoil puts pressure on costs and will force some vulnerable companies out of business, it will also create many opportunities in this sector for companies that have the requisite financial strength and foresight.

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Also contributing to this essay was Booz & Company Senior Associate Gabriel Catrina.

6.

Japan: Lessons from a Lost Decade

by Yoshiyuki Kishimoto, Hiroyuki Sawada, and Chieko Matsuda

Some experts have observed that the current global financial crisis resembles the collapse of Japan's bubble economy in the early 1990s. And indeed, the underlying behavior was the same: Financial institutions, looking for fast returns, provided financing without enough restraint. This capital in turn fueled sectors of the real economy, such as durable consumer goods, along with the housing boom, and caused them to overdevelop as they competed for customers. Before Japan could return to prosperity, its business community had to learn three critical lessons.

• **The dangers of excess supply.** From the 1950s through the 1970s, the Japanese economy grew largely through exports. Then, after a steep rise in the value of the yen in 1986, Japanese policymakers increased deregulation and added more government supports to business, actions aimed at stimulating domestic demand. The relaxation of constraints on financial activity spurred investment; industrial companies, as well as real estate developers, expanded their businesses by relying on their increased ability to borrow. This business growth, in turn, drove up the Nikkei stock index.

Only after the bubble collapsed in 1991 did the underlying problem with this growth strategy become evident: The consumer market in Japan was limited, and the perception of high demand was mistaken. But many companies had invested in anticipation of future demand, and now the country had too much supply capacity and too much debt. Many borrowers ended up with debts that exceeded the value of their collateral assets.

In our current economic crisis, the global financial community has fallen into the same set of traps. A surplus of financing drove the excess supply in the industrial sector, which drove fierce competition to fulfill future demand, leading to long-term overcapacity.

• **Customers as scarce resources.** After the collapse of the Japanese bubble, industrial companies had to recognize that customers are scarce resources. Among the first to see this were the Japanese automotive companies, for whom "follow the customer" has been a core strategy — especially valuable when the demand for new cars is declining. In their home market, Japanese auto companies emphasize downstream revenues, including insurance, loans, inspections, maintenance, parts, and accessories. Those revenues, stable even in recessionary times, are essential to keeping the dealer network alive. In overseas markets, Japanese automakers "follow the car," offering used high-quality vehicles as weapons against the cheap new automobiles being introduced by upstart Asian competitors. By building relationships with consumers through service and support, these moves create a market for the future.

Today's global companies are not necessarily doing a good job of following the customer or the car (or any other product). Throughout the early 2000s, they pursued the familiar business model of churning customers by focusing on new sales. Now they must redefine their global business models, changing the focus from making and selling to making, selling, and servicing — seeking more revenue from the same customer base rather than chasing new and uncertain growth. Making the most of an existing customer base is an effective strategy in a recession, and it will remain effective even in growing markets, especially for the long term.

• **Inevitable consolidation.** In Japan, after the Asian financial crisis in 1997, 13 banks merged into four groups. Something similar will happen in the U.S. and Europe during the next year or two — not just in financial services, but in all sectors. Large companies will have to consider consolidating their excess capacity by acquiring (or allying with) overseas companies and their potential customer bases.

In Japan, this was a particularly important lesson for the financial and industrial sectors; both had to solve excess capacity problems. But whereas the banking sector consolidated, Japanese industrial companies have been slow to follow suit. Instead, they have largely continued competing with one another. There are only a few models of constructive consolidation, such as the global alliance between Renault SA and Nissan Motor Company. The two parties jointly pursued real synergies (for example, in reducing sourcing costs) rather than one seeking full control of the other party (as Daimler-Benz AG sought with the Chrysler Corporation).

Some might argue that the Japanese consolidation was unique, because of the unusually close relationships between banks and borrowers. But even though that part of the context is different, multinational companies today face a similar challenge: excess supply caused not only by financial leverage, but also by excessive competition. Once again, consolidation is needed to provide stability. That consolidation will probably be driven by those with strong R&D leadership. Global access to R&D capabilities in, for example, energy or environmental innovation will drive demand in the future.

The global financial-services industry will also face consolidation, but geopolitical factors rather than innovation will determine the results. In the past, banks did not compete across state lines (in the U.S.), across national borders (in the E.U.), or across some prefecture and province boundaries elsewhere. But with the advancement of global economies, and increasing crossmarket competition among global players, banks no longer secure high enough profit margins in their home territories. Credit default swaps, high-risk solvency and leverage ratios, and other excesses were the products of a short-lived effort to compete through innovation, and they will all be regulated in the future. Banks and other financial-services firms will have to refine their business models: Low cost structures, global economies of scale, internal risk management capability (as opposed to risk transfer technology), and a sufficient capital base will be hallmarks of this new, more mature business model.

During the 1990s, many Japanese business leaders waited years for recovery. After all, the fundamentals of the world economy were solid. Productivity and quality were increasing, and global markets were expanding. Only a few companies took the measures that helped them rebuild: reducing supply, building a business based on repeat customers, and embracing consolidation. Many global companies, unwilling to forget the boom times, will make the mistake of waiting for recovery. Others will learn to be more proactive — and they will be the corporate leaders of the next decade.

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7.

Finance: Facing the Liquidity Challenge

by Justin Pettit

Back in early 2008, corporate lending was heading for a record year, toward US$700 billion in high-grade loans. But then the market came to a grinding halt. Economists may quibble about whether this downturn compares to that of the early 1980s, but by December 2008, the price of corporate credit risk had reached its highest levels since the Great Depression. As evidenced by the collapse of Lehman Brothers, a liquidity crisis can be a much faster route to death than operational challenges. And many of today's companies are facing both.

With stock prices testing new lows and risk appetite in ruins across the capital markets, where can corporations turn for their capital needs? For the immediate and foreseeable future, they will turn first to themselves. The importance of financial strength and strategic liquidity in today's market cannot be overstated. It provides buoyancy to boost enterprise value and helps maintain operations, enhance bargaining power, improve competitive position, and support investment during turbulent times. Companies that cannot easily gain access to credit will need to use their cash more deliberately. All this suggests some new financial imperatives:

- **Implement a better financial risk management program.** Companies cannot afford the cash-flow volatility imposed by commodity, currency, and interest rate fluctuations. But few companies have devoted enough attention to quantifying, analyzing, and managing their net exposures. Many financial managers (1) don't have a strong understanding of their exposures, (2) believe they are already naturally hedged, (3) feel that hedging is too expensive, or (4) relegate hedging to the arcane world of "financial engineering." That must change.
- **Build or buy strategic liquidity.** Closely related to risk management is the design of capital structure. For years, companies with high credit ratings and large amounts of cash were targets for gaggles of investment bankers pitching share repurchase programs and taking

on more debt. But now, cash is a strategic asset. Leading companies are retaining operating cash flow, selling idle assets, and drawing down their bank lines. They are exploring other vehicles for secondary liquidity: backup lines of credit, financing, securitizations of receivables and other assets, sale leasebacks, and more flexible purchasing and outsourcing contracts. Companies are reversing the trend toward larger share-repurchase programs and dividends. There is also a resurgence in creative methods to reduce leverage and bolster financial strength.

• **Manage your corporate portfolio for value, not performance.** When evaluating business units, most companies still rely on traditional financial performance metrics, such as margins, operating income, and return on capital employed. It is assumed that these are proxies for value. But in fact, this performance is already reflected in the market values of assets, and these metrics are inappropriate for your portfolio decisions. Instead, make decisions based on the value of expected income (discounted cash flow, or DCF) versus the value you would get if you disposed of the unit. The conventional approach of selling "dogs" (low-growth, low-return units) and acquiring "stars" (high-growth, high-return units) can be your most costly strategy, especially in a downturn. Hold assets, instead, when you think the DCF value is greater than the likely net proceeds of a sale.

• **Monitor your sources of value.** Today, more than ever before, strategies fail in the execution, not the vision. Quality execution requires that countless economic, value-based decisions be made at all levels within the company — including integrations, dispositions, closures, outsourcing, promotions, pricing changes, and value propositions. These decisions depend on a comprehensive economic fact base, yet most information systems remain geared to providing accounting data for the reporting needs of legal entities. If meaningful dashboards of customer, product, and stock keeping unit (SKU) profitability remain a distant dream at your company, it is time to wake up and start using them.

• **Move forward on your growth agenda, especially in emerging markets.** Corporate profits have become increasingly reliant on overseas demand, with international profits now accounting for roughly one-third of corporate profits. Your global strategy should be grounded in distinctive capabilities that you develop deliberately: through organic internal efforts, acquisitions chosen for the capabilities that would be gained through them, or collaborative arrangements.

• **Audit your defenses against takeovers.** Today's stock prices create a window of opportunity for buyers. It behooves executives to ensure they will have the requisite time to devise and execute a response to an acquisition bid. A high-level defense audit covers four basic topics: general state and corporate takeover laws, board of directors structure and policies, shareholder voting processes, and takeover provisions (including poison pills) within your own governance structures.

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Afterword: Toward Holistic Recovery

by Shumeet Banerji

This crisis has been a compound failure. It was created not just by managerial and governance lapses, but also by central banks, regulators, and "growth-first" government policies. Enabled by cheap credit, and by the light regulation of their risk and indebtedness, financial institutions have imploded. Very lax mortgage lending and securitization practices took risky assets off the balance sheets of the originating banks and spread the virus around the world. All of this was based on one immense correlated bet, on U.S. residential real estate. Investor appetites led to enormous pressure on managements to grow balance sheets, with asset purchases funded by leverage — raising debt-to-equity ratios of some banks as high as 40 to 1. At the same time, as they were aggressively forced to adopt "mark to market" accounting, a large number of banks ended up speculatively destroying the value of their own assets. Many financial-services institutions neglected basic principles of risk management. The scale of the problem dragged down all but the best banks, wiping out equity capital.

As I write this in January 2009, the stability of the banking system has yet to be restored. Similarly, many industrial and consumer companies have proven vulnerable. As the *Wall Street Journal* put it on December 9, 2008, in an article about the destruction of wealth: "The crisis has been particularly hard on executives who gambled badly with their business — they got into the wrong industry at the wrong time, took on risky investments, piled too much debt on their companies, or leveraged their own finances to a catastrophic degree."

Yet there are many exceptions: More conservative banks, and companies that have been managed for steady, long-term, capability-led, customer-focused growth, appear able to weather the storm. To be sure, they confront many challenges — for example, global shortages of credit and liquidity. Time is short, and the pressures are immense. Conventional remedies for surviving a downturn, such as restructuring underperforming assets or reducing working capital, will be inadequate this time.

As all seven of the preceding essays make clear, managers of surviving companies must take a holistic view: reviewing every facet of every business activity for potential efficiency improvements or aggressive change. They must assess their company's competitive position dispassionately, then act boldly: for example, exiting some segments and competing harder in others, including through acquisition of less well-managed competitors. They must be courageous in challenging the received wisdom of their industries.

There is no foolproof formula for risk mitigation. Managers will have to make many difficult judgment calls, and quickly. But there are clear options to reshape the very basis of competition. Discontinuity really does provide opportunity for managers who see it and seize it. Lastly, governments and regulators will hopefully not draw the wrong conclusion from the data. The dominant policies of the past two decades have led to an ascendancy of market mechanisms, a steady opening of world trade and a retreat from protectionism, lifting millions of people into the middle class around the world. No better solution has been proposed by the critics of these forces. Precisely because this crisis is a compound failure, there are lessons to be learned by all participants — not just corporate management, but governments, regulators, and commentators as well. We will all learn to value the contrarians of this world as we pick up the pieces in the coming months. +

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