Outlook

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2009, Number 2

Dealing with the downturn

The road back

Capital markets
The customer
Risk management
The workforce
Private equity

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The Long View

William D. Green
Chairman & Chief Executive Officer
Accenture

High performance in navigating a downturn

The steep downturn in the global economy continues to dominate my conversations with CEOs and government leaders around the world. The effects of the downturn are far-reaching, touching virtually every person in every organization in some way.

Leaders today are challenged to adapt to an environment that seems to change on a daily basis, and seldom for the better. The pressure to reduce costs, operate more effectively and stay a step ahead of competitors is more intense than ever. For many organizations, where the immediate objective is simply to survive, the right response is, of course, anything but "business as usual."

This issue of *Outlook* addresses the downturn from a number of perspectives. We explore the future shape of capital markets in the wake of the credit crisis and the new role of private equity financing. We examine the recent failures of risk management and the changes required to avoid repeating mistakes down the road.

This issue also looks at key forces for economic recovery. One particularly timely article discusses recent consumer behavior and analyzes the changing dynamics of spending. Another article deals with workforce management in a slow economy and the importance of having the right talent in place to help ensure that a company emerges in a more competitive position.

At Accenture, we have forged our strongest client relationships not in easy times but in times of challenge. Therefore, our most important agenda item is to remain *relevant* and *responsive* to our clients as they chart their course for the future. For example, we are working closely with our clients on rapid and sustained cost management, customer acquisition and retention, operational excellence, and effective merger and acquisition planning and integration. And we are leveraging our experience, instincts and insights from previous economic cycles to help our clients make decisions, for today and tomorrow.

No one can predict how long the current downturn will last or what the economic landscape will look like in recovery. I am encouraged, however, that most leaders I speak with still have the horizon in their sights as they focus on opportunities to improve and innovate on behalf of their customers and stakeholders. In other words, they are continuing their pursuit of high performance.

I hope the ideas in this issue of *Outlook* resonate during your own journey and are also a source of inspiration as you continue to navigate through the downturn, and beyond to brighter days.

From the Editor's Desk

Transformation and globalization

We work from a broad editorial palette at *Outlook*. Each table of contents reflects our mission to identify and explore the most pressing issues facing today's business and government leaders across a range of topics—from strategy to talent management to information technology.

As this issue's table of contents began to take shape, I was struck by the fact that the 10 articles, selected and assigned separately, were, in fact, all key elements of two larger and interconnected themes: the transformative impact of the current economic downturn and the rapidly changing shape of globalization.

Take consumer behavior, for example. One of the articles offers an in-depth look at how the volatility in discretionary spending brought on by the downturn is forcing retailers around the world to rethink everything from marketing to pricing. Another article looks at ways companies can use the economic slump as an opportunity to refashion their organizations with the capabilities and people that can make their organizations more competitive. And two pieces—one on the capital markets, the other on private equity—examine the fallout from the financial crisis and how it will affect the way companies raise money in the future.

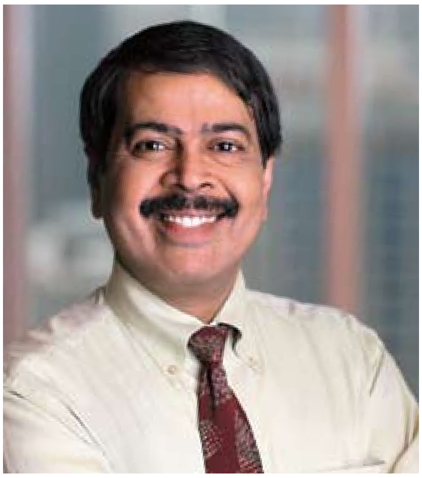
These changes and adjustments also represent integral parts of the latest phase of globalization, in which competition in a multi-polar world is being waged in a number of crucial arenas, including consumption, talent and capital. "High performers are writing a new playbook for globalization," note the authors of an article that outlines three broad strategies for withstanding the short-term disruption of the downturn while laying the groundwork for long-term growth.

Competing successfully and ultimately achieving high performance begins at the ground level with an effective global operating model, a subject addressed in a companion article. And as shown by another piece, perhaps no country illustrates these themes more starkly than China: Although its companies are being battered by the recession, the country remains a central player in the global economy.

These are not short-term responses to the downturn. From capital markets to risk management, from talent management to consumer spending, they herald permanent changes in the way the world does business.

David Cudaback
Editor-in-Chief, *Outlook*

Everything elastic



Kishore S. Swaminathan
Chief Scientist
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What if your business processes and capabilities—your IT, workforce, R&D—were in essence elastic, able to stretch, change and expand at will and weather just about any global economic storm? Now imagine the impact this could have on your company's performance.

Traditionally, organizations have been isolated islands, with fixed sets of business capabilities determined by what they can do on their own, within their own organizational boundaries. Expansion typically meant significant capital outlays for building new factories, entering new businesses or geographies, upgrading and expanding IT.

Such organizations are inherently reactive. Less demand? Factories reduce shifts, workers are furloughed and expensive capital equipment goes underutilized. A spurt in demand is often met by a shortage of products, disruption of services, unhappy customers, frantic hiring and impulsive capacity building. In fact, one could argue that any successful business today is by definition less than efficient, because its success is predicated on overcapacity to meet peak demand, which also means underutilization of resources—particularly capital—most of the rest of the time.

The invisible hand

Slowly but surely, the invisible hand of information technology has been blurring the boundaries between organizations to the point that business capabilities have now started to spill across organizational boundaries. To be sure, the phenomenon itself is not new. In the past, companies have shared business capabilities through various special arrangements such as alliances, trading agreements and industry consortia.

What's new is that IT is now making it possible for business capabilities to cross organizational boundaries at an *industrial scale*. This has enormous consequences for companies and indeed for the very fundamentals that govern the economics of business.

When organizations can effectively and efficiently share business capabilities, a series of things begin to happen. First, companies need to plan only for average demand and can offload excess demand to a third-party provider on an as-needed basis, with the hope and promise that the provider can gracefully and seamlessly augment the company's capabilities. Second, much of the unpredictable or variable demand moves from a fixed or capital cost to a variable or operational cost on the balance sheet.

Third, this industrial-strength sharing of capabilities enables companies to enter new businesses and markets with relatively little risk. If the new product or market turns out to be a dog, a company can wind down operations with little or no sunk costs. Alternatively, if the adventure is wildly successful, the company can rapidly scale up to meet demand.

Put another way, when business capabilities can be sourced effectively and efficiently, companies can pass on significant business risks to a provider.

So what's in this for the third-party providers? First, as more clients seek their services, they begin to specialize, and as the process becomes cost effective, they gain price advantage. This, in turn, enables them to provide the same service to multiple clients at lower cost and thereby achieve scale. Once they have scale—particularly across multiple clients from different industries and different business cycles—providers are in a position to load-balance across all of their clients, taking advantage of the clients' staggered business needs.

When the providers achieve enough scale, they can plan for average (as opposed to peak) demand and achieve high utilization rates by constantly repurposing capacity from one client to another. This enables them to hedge against the risks that are passed on to them by their clients.

When scale happens, elasticity follows.

Enter the Internet

IT and business process outsourcing are early examples of elasticity—sourcing people and certain simple business processes from outside the organization, with the provider taking some of the demand and utilization risks. The phenomenon began to gain momentum in 2001. Many observers attribute this to cost reduction necessitated by that year's recession. Others point to cost arbitrage between developed and emerging economies. Still others attribute the rise of outsourcing to the need for companies to focus on their "core competence."

But cost arbitrage, the need to focus on core competence and the pressure to reduce costs have all existed for years. So what changed? The surprisingly simple answer is "the Internet."

By around 2000, the Internet had evolved to the point that it could support inter-enterprise communication—email, instant messaging, Voice over IP—and provide access to applications and data across organizational and geographic boundaries. Although outsourcing was practiced well before the Internet, the dramatic increase in various forms of outsourcing was made possible by the cheap, *industrial-scale* communication that was enabled by the Internet.

Today, the operating goal of every outsourcing provider is to go from a "your-mess-for-less" model (operating a business process for a client per the client's specifications) to a "many-to-one" model (offering a menu of standardized business processes per the provider's specifications). Why? Because only with scale can providers offer standardized processes to multiple clients so that the same process, people and other resources can be repurposed across clients to cater to their changing business needs.

The latest technology trends—Internet computing; mobile computing; the convergence of communication, collaboration, communities and content—seem poised to create even more business elasticity.

Today, Internet computing—a.k.a. cloud computing—makes it possible to buy processing power, storage, software, even simple business processes on the fly, pay for what you use and scale up or down as needed. Internet computing provides elasticity to IT itself. Companies no longer need to commit to expensive (and often underutilized) capital equipment or software in their data centers, but can simply rent them when needed. A few Fortune 500 companies have started using cloud computing for core business functions, including drug development, CRM, ERP and procurement.

Perhaps more important, Internet computing also brings elasticity to business processes, enabling them to change or scale horizontally and vertically depending on business conditions.

How? Software as a service, software markets and integration standards provide companies with many more sourcing options and standard means of integrating hardware, software and process components. Business processes, therefore, need no longer be cookie-cutter affairs provided by large monolithic software packages but instead can be assembled and reassembled from a large set of third-party software suites.

And since the hardware and software are sourced from outside the enterprise firewall, it becomes much easier to integrate processes with those of providers (to expand business capacity horizontally) or those of industry partners (to expand business capabilities vertically). Moreover, the integration takes on an industrial scale: no more proprietary arrangements, lawyers or small-print documents.

If something as simple as email and VoIP could give rise to workforce elasticity in the form of business process outsourcing, recent developments in collaboration and mobile technologies may well call into question many of the assumptions underpinning today's global mega enterprises.

Companies and individuals today have access to an astonishing range of options for communication and collaboration, from IM, VoIP, blogs and wikis to 3G and 4G wireless networks to location-awareness and near-field technology. Add to this the so-called Millennials or Generation Y (including my lovely teenager), for whom mobile phones, IM, podcasting, Facebook and Twitter are like air and gravity. As these young people begin to enter the workforce in large numbers over the next five years, companies will not only have to revisit their different technological options; they will also need to rethink their workforce and workplace practices. (For more, see "Does your company have an IT generation gap?" *Outlook*, January 2009.)

For example, how can a company reduce the wear and tear on employees caused by travel and time zone differences and the time wasted in daily commutes? Better utilize or even eliminate office space? Or avoid the enormous stress on management and workers caused by large-scale hiring and layoffs in times of business volatility?

How does a company effectively deploy an expert across multiple projects and augment R&D with experts from the outside? Or use crowd-sourcing techniques internally as well as with customers to increase innovation?

Indeed, how does a company manage an elastic workforce that may consist of a core set of employees and a large number of free agents working for themselves or for other organizations?

Technology is already available that enables companies to source people on demand to solve a problem or aid a computer in solving a problem that requires human intelligence. To be sure, there's nothing new about engaging contractors for work. But what is new is that collaboration and mobile communication technologies are taking it to a new level: global sourcing of human expertise at scale and on the fly.

New frontier

Innovation elasticity is a particularly interesting new frontier. For example, today there are "open-innovation marketplaces" such as InnoCentive, where companies can pose complex scientific or business problems to a community of more than 100,000 researchers from various fields and pay only if a suitable solution is proposed. Procter & Gamble reports positive results through InnoCentive and is now actively experimenting with an R&D model called Connect + Develop. P&G's goal is to derive 50 percent of its innovation from outside the company in the future.

At the other end of the spectrum, companies such as Starbucks and Dell have developed web-based models for large-scale inclusion of their customers as an integral part of their innovation processes. As of March of this year, customers have contributed more than 60,000 ideas to mystarbucksidea.com (for example, "a free drink on your birthday") and 11,000 ideas to Dell's Ideastream ("Add the decibel level of your computer to the specifications," suggested one customer).

The relentless march of information technology is slowly carving out a new reality. Elastic processes. Elastic workforce. Elastic IT. Elastic innovation. And complimentary latte on your birthday. Is your company ready?

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Contents

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Special Report: Dealing with the Downturn

When people know that a foundation of risk controls is in place, they have a better sense of their limits but can still be appropriately venturesome.

Constructive tension (page 86)

Adapting to the multi-polar world

The new globalization playbook

By Mark Purdy, Matthew C. Robinson and Paul F. Nunes

The dynamics of global competition are rapidly moving away from the traditional mix of product exports, reliance on local partners and single-nation headquarters. High performers are adopting a new way of doing business that exploits the power of being simultaneously global and local.

It's highly unlikely that British shoppers will find live toads and turtles at their favorite Tesco stores anytime soon. But in China, where consumers are familiar with "wet" markets, the big UK-based grocer caters to local tastes by selling a range of live food in tanks.

Tesco is just one of a group of high performers that are overhauling their approach to business to more effectively address the opportunities and challenges presented by the multi-polar world. As well they must: The dynamics of global competition are rapidly moving away from the traditional mix of product exports, reliance on local partners and single-nation headquarters toward a new way of doing business that exploits the power of being simultaneously global and local.

Older strategies took a narrow view of the sources of consumption, talent, capital, resources and ideas—the five critical arenas where competition is being waged in the multi-polar world (see "Brave new world," *Outlook*, May 2008). The economic landscape has changed significantly in a short time. Companies from emerging markets now have the ambition, resources and operating models to actively shape globalization. Capital can come from Norway just as easily as it can from New York. Talent streams across borders. Ideas are no respecters of national frontiers either, as they are increasingly shared worldwide in an instant via the Internet.

To discover what companies must do to thrive in this world, Accenture conducted extensive research into the globalization strategies pursued by both high-performance businesses and less successful companies. As part of that research, we surveyed business leaders from 375 companies, representing all major industries and 53 developed and emerging markets. Respondents included executives from 45 high-performance businesses and 35 businesses whose performance ranked them at or near the bottom of their industries.

The survey confirmed that most executives have identified the benefits to be reaped in the multi-polar world and are rethinking their strategies accordingly. For example, 86 percent of respondents reported that they are looking to boost sales beyond their home markets.

However, what was most interesting was how executives plan to do this—and the stark differences in approach, industry by industry, between high-performance businesses and their lower-performing competitors.

High performers stand out in three ways. First, these companies move beyond parochial thinking and regional focus by taking a "superglobal" view of world. They actively and continually explore new geographic sources of value to create more options for where and how to compete. At the same time, they avoid insular corporate thinking by taking a "superlocal" view on the ground, recognizing market differences and weaving themselves into the local fabric. Finally, they invest in networking their organizations so that people and ideas can flow rapidly to the places they are most needed.

In doing so, high performers are writing a new playbook for globalization that will help businesses withstand short-term pressures while laying the groundwork for long-term growth.

Create geographic options

High-performance businesses continually look outward, exploring the larger business environment (and that of their value chain partners) and making deliberate choices about where to compete and with whom to engage. Knowing no two markets are the same, high performers realize they need to tap multiple geographies to find the resources they need, whether they are seeking talent, raw materials, components or capital.

Consider the importance of finding new sources of talent. In our survey, 44 percent of high performers told us that obtaining access to new talent pools drives their investments in foreign markets to a significant or great extent, compared with just 20 percent of low performers (see chart, page 16). Avon Products, the first firm to be granted a direct-selling license by the Chinese government, credits its successful recruitment drive in China—more than half a million "Avon ladies" enlisted since March 2006—with dramatically boosting revenue in the country.

Because high performers know that skill and expertise can be found virtually anywhere, they are alert to the possibilities offered by talent pools beyond their immediate operational boundaries. Fifty-seven percent of high performers reported that they actively recruit from markets where they have no operations or sales, compared with 39 percent of low performers.

All of the high-performance businesses we surveyed also build links with local universities and research institutes as sources of interns and new recruits, compared with just 59 percent of their competitors. And high performers are much more likely to use innovative, non-conventional recruiting methods, such as competitions and word-of-mouth strategies (89 percent versus 62 percent).

High performers also understand that reaching previously underserved customer groups requires new approaches, such as the use of seemingly unorthodox distribution and marketing channels.

Norwegian media company Schibsted, for example, has won new business in places once regarded

High performers realize that they need to tap multiple geographies to find the resources they need, whether they are seeking talent, raw materials, components or capital.

as peripheral markets, such as Italy, Austria, Singapore and Russia. Despite the dominance of television advertising in Russia—one of the world's fastest-growing media markets—Schibsted's efficiently distributed free publication, *Moi Rayon*, has created a new market for advertising that has helped it become St. Petersburg's most-read newspaper.

Innovation without borders

New ideas are no longer the special province of developed economies. Nor does it make sense for companies to place all their innovation bets in one geographic area (see chart, page 19).

High-performance businesses are clearly aware that there are now many more innovation hubs and untapped sources of expertise outside their home markets. Fifty-eight percent source innovation from more than one country, compared with 34 percent of low performers. The recent wild volatility in commodities markets points to another area where geographic options are critical. To reduce risks and control costs, high-performance businesses have more than one source of key raw materials. In our research, 44 percent of high performers reported that they diversify the geographic sources of these materials to a significant or great extent, compared with 28 percent of low performers.

For example, US-based industrial conglomerate Danaher Corp.

A changing leaderboard

By 2030, the make-up of the world's 10 biggest economies will be dramatically different than it is today.

Ranked by real GDP at purchasing-power parity

	1990	2008[e]	2030[f]
1.	United States	United States	China
2.	Japan	China	United States
3.	Russia	Japan	India
4.	Germany	India	Japan
5.	France	Germany	Brazil
6.	Italy	Russia	Russia
7.	United Kingdom	United Kingdom	Germany
8.	China	France	United Kingdom
9.	Brazil	Brazil	France
10.	India	Italy	Mexico

Source: Economist Intelligence Unit

Nokia's global brain trust: Encouraging the mobility of ideas

It is not surprising that mobile-phone leader Nokia teams up with leading international universities in search of the next great communications technology ideas. The Finnish company's research center in the United Kingdom works with the University of Cambridge to develop nanotechnologies for mobile communication and what is being called "ambient intelligence"—electronic environments that are sensitive and responsive to the presence of people. In Beijing, Nokia's research hub was set up to take advantage of China's top-level universities and to gather valuable local perspectives on communications trends and market potential.

But the other aspect of Nokia's open innovation model is far less conventional: its abundant use of the Internet to harvest new ideas. The progress of current projects is posted on company wikis. The Nokia Beta Labs website plays host to a legion of testers who provide feedback on new and potential applications. And Forum Nokia, a portal available in English, Chinese and Japanese, gives outside developers access to resources to help them design, test, certify, market and sell their own applications, content, services or websites to mobile users via Nokia devices.

By encouraging the mobility of ideas across its network and then exploiting them commercially, Nokia is able to succeed with an innovation strategy that represents the best of global and local approaches.

But Nokia's open-innovation thrust is by itself only part of a long-term innovation strategy aimed at supporting sustained expansion into markets outside the company's traditional European markets.

Venture capital investment is the other thrust. The company's Nokia Growth Partners, with offices in China, Finland, India and the United States, manages $350 million for direct investments and fund-of-fund investments in other venture capital players, primarily in the United States, Europe and Asia. One recent fund investment was in Madhouse, China's leading mobile advertisement network—a crucial driver for continued growth in mobile communications markets.

purchases raw materials and components—including steel, copper, cast iron, electronic components, aluminum, plastics and other petroleum-based products—from many independent sources around the world. Similarly, South Africa's Anglo Platinum searches for new sources of raw materials not only in the obvious places—such as that country's Bushveld Complex, where new exploration permits were granted in 2007—but also in southern China and in western Russia.

Access to capital is another area where top-performing companies actively pursue multiple options, including those beyond traditional financial hubs (see chart, opposite). They are "following the money," thus improving their access to capital and diversifying risk, as well as continuously updating knowledge, relationships and financing models to reflect the new map of global investment flows. In particular, they are well aware of the new breed of sovereign and private investors from emerging nations. Given the current turmoil in the international financial markets, their embrace of diversity is particularly prudent.

A good example of the multi-polar nature of financing: Not long ago, despite a dramatic slowdown in infrastructure lending, an Asian technology, engineering, construction and manufacturing conglomerate secured a loan that set records in the company's home country for the length of its term and the degree of leverage. The deal highlighted this emerging-market multinational's heightened standing in global debt markets. Half of the funding came from a major commercial bank in the Gulf.

Be authentically local

When companies enter new markets, the many differences in tastes and customs, as well as unfamiliar regulatory and political environments, often constitute major stumbling blocks. That's why, when it comes to operating in local markets, high performers don't just "switch the label on the can." Instead, they immerse themselves in the markets to become part of the local business and social fabric, adapting their strategies, operations and products to meet local conditions and tastes. They become *authentically* local. (For an example, see the Tesco sidebar, page 17. For a related article, see "A passage to India," *Outlook*, January 2009.)

One way to do so is to make an effort to relate to customers in new markets and to tailor offerings specifically to their needs. Norwegian telecom company Telenor Group is entering new markets with innovative mobile offerings that suit particular customer groups. For example, in a partnership with Citibank, Telenor's DiGiREMIT service allows migrant workers in Malaysia to transfer money securely to Bangladesh, Indonesia or the Philippines. In Pakistan, subscribers to Telenor TeleDoctor service receive easy access to experienced doctors who can provide medical advice and symptom diagnosis in eight languages to those who can't travel to an appointment.

Just as local talent is one of the keys to effectively exploiting geographic options, developing and employing talent is equally important to efforts to become authentically local. Talent pools in new and emerging markets can be shallower than they first appear, with business-ready skills often in short supply. In particular, knowledge-based skills can be hard to find. Increasingly, they demand not only technical proficiency but also a range of complementary softer skills, such as management experience, organizational ability and creativity.

A lack of senior management talent with international business experience often compounds the problem. Expatriates can fill the gap in the short term, but they seldom represent a sustainable model in terms of cultural insight, business stewardship and cost.

Narrowing the talent gap

High-performance businesses fully recognize those challenges and apply a range of responses to ensure that their workforces are equipped with the full complement of technical and managerial skills. Nearly nine out of 10 high performers—compared with fewer than six out of 10 low performers—establish their own academies to develop the people they need to compete in new markets. These institutions can help to augment technical skills, build management proficiencies, and emphasize less tangible aspects of performance, such as teamwork and creativity.

The new playbook

In a multi-polar world, high-performance businesses are those that successfully pursue three broad strategies across five key competitive battlegrounds.

	New consumers	Talent	Innovation	Resource sustainability	Capital
Create geographic options	Reach out to potential customers in overseas markets with new business models, channels and infrastructure investment that unlock otherwise latent demand	Source talent wherever it may exist geographically, as well as from sectors of the population that may have been overlooked previously, such as women and rural workforces	Identify emerging centers of excellence in different technologies, products and processes around the world	Build resource input security via term contracts, upstream acquisitions and investment in diversified geographic sources	Improve access to capital and diversify risk by updating knowledge, relationships and financing models to reflect the new map of global investment flows
Be authentically local	Identify critical local differences in consumer preferences and usage and, in response, tailor products and services to new consumer segments	Develop and mold local talent for today and tomorrow by investing across the skills spectrum	Embed innovation activities into the local research and development and consumer environment, working in tandem with industry peers and policymakers	Optimize resources strategy under differing economic, cultural and regulatory constraints across markets, and harness incentive regimes, such as carbon trading, for current and new business	Be willing to draw on a broad suite of investment models tailored to the characteristics of different markets
Network the organization	Create structured channels to allow rapid diffusion of ideas and know-how across geographic regions				
	Build a global backbone of standardized data, systems and processes				
	Ensure multi-polar leadership to cultivate a global mindset from the top down				

Source: Accenture analysis

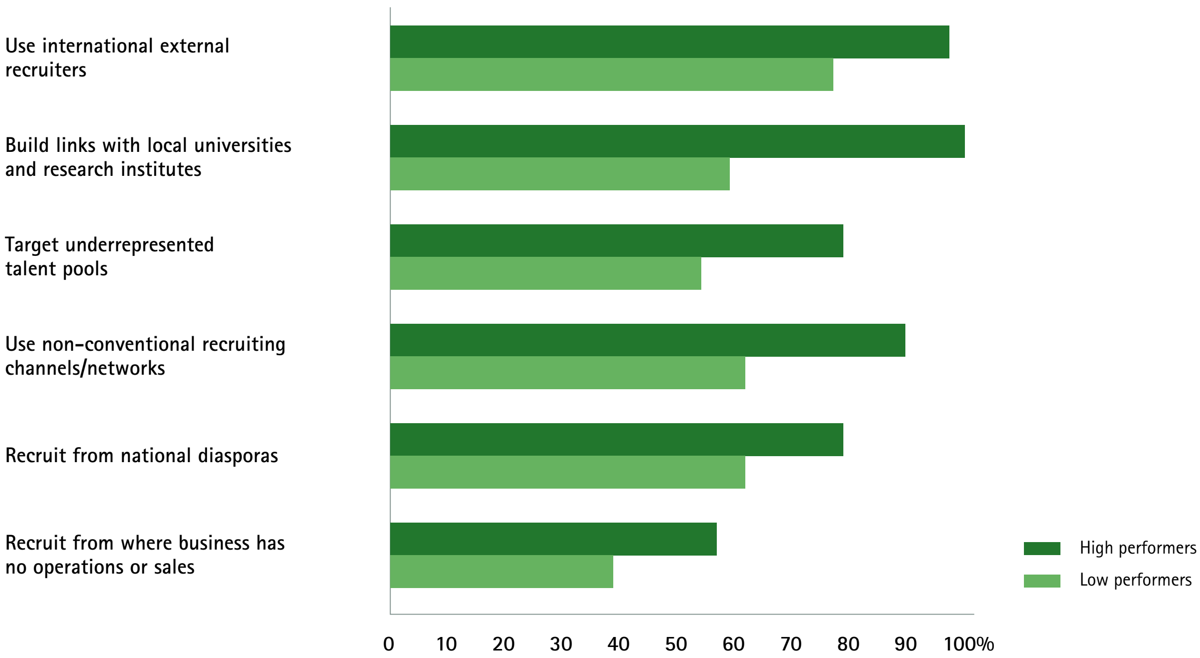
Cisco Systems, for example, has ramped up its Global Talent Acceleration Program, which now has hubs in Jordan, South Africa and India. The program aims to narrow the gap between the supply and demand of regional talent by creating next-generation consulting, engineering and sales expertise in emerging countries. The 37-week program offers two tracks: professional, for students with three to five years' work experience, and associate, for recent university graduates. All program graduates are expected to join Cisco as full-time employees.

High performers also become authentically local by formally encouraging innovation in locations close to emerging and future customers. Our survey showed that they are more likely than low performers—86 percent versus 63 percent—to locate research and development facilities near their customer bases in new markets (see chart, page 19).

Sometimes growth by acquisition is needed to enable effective participation in local innovation clusters, particularly when access to specific know-how or technology is critical. Our survey found that high-performance businesses are far more likely than their lower-performing counterparts to embed themselves more deeply with local innovation hubs such as universities or research institutions (85 percent versus 58 percent).

Help wanted

As part of our research into globalization strategies, Accenture asked business leaders which of the following steps they were taking in foreign markets where they aimed to expand their workforces.



Source: Accenture analysis

Tesco's toads:
Tailoring store experiences to local cultures

Tesco, the world's third-largest grocer, sells live toads and turtles from tanks in its Chinese stores, catering to consumers familiar with shopping in "wet" markets. In Japan, where the UK-headquartered retailer's research showed that shoppers prefer buying small amounts of fresh food each day, the company entered the market not by opening hypermarkets but by acquiring a discount supermarket operator.

Tesco is a master of the multi-polar world. Today the company, which made its first move abroad in 1994 when it entered Hungary, operates more than 3,900 stores in 14 countries. It is expanding rapidly in nations such as Turkey, Malaysia and South Korea. More than 60 percent of Tesco's sales space is now located outside the United Kingdom.

Tesco's strategy is to maintain its authentically local approach by being highly flexible about its retailing format and its means of entering markets. In 2004, it entered China's booming retail grocery market (which today is estimated to be worth roughly $285 billion and to be growing at a rate of 7 percent annually) through a joint venture with Taiwan's Ting Hsin International Group, of which it now owns 90 percent. Today, the company operates more than 60 stores in China, and much of what it sells there is made in China. Its global reach is key to its local effectiveness: Tesco believes that in China it can use the experience it has gained from operating around the world to offer a mix of products that will have greater local appeal than those sold by its two major rivals.

In India, Tesco has teamed up with local retailer Trent, a subsidiary of the Tata Group, to establish wholesale cash-and-carry stores for retailers, restaurants and caterers. The company is also sharing its know-how and technology to help Trent expand its Star Bazaar hypermarket chain.

Tesco's authentically local approach is enhanced by its commitment to using local talent. Today in China, 80 percent of its managers are local hires. Globally, it has recruited MBAs from India to staff the core function charged with deploying Tesco's new global operating model around the world.

At the same time, the company is rigorously global when it comes to the systems that support its different customer-facing approaches worldwide. All stores use the same technology and processes for billing, purchasing and general management. Tesco plans to centralize IT applications under a single network and voice contract and to standardize its main finance, human resources and sales applications. Standard reporting functions will allow executives to manage a store in Malaysia or Japan just as they would a store in the United Kingdom.

Network the organization

The appropriate balance of global activities and local focus will vary according to the times, the industry and the company. To find and maintain that balance, high performers are taking steps toward creating a global operating model that mirrors their multipolar business environment and enables them to reap the benefits of being both "superglobal" and "superlocal." (For a related article, see page 22.)

Worldwide consistency, standardization and a global culture are essential features of these models. In our research, we learned that high performers successfully network their organizations by concentrating on three specific networking activities.

Promote mobility

For high performers, mobility is the key to getting the most from their resources—especially their human and intangible resources. They actively seek and find ways to scale the benefits of local success to the organization at large. By creating companies that are permeable—both internally and externally—the high performers enable people, ideas and best practices to flow through the organization.

The high performers we surveyed undertake a variety of activities to promote mobility in their organizations. In the realm of talent, 51 percent, to a significant or great extent, equip employees with the skills and opportunities they need to work in different markets—offering language courses or job rotations, for instance—compared with 35 percent of low performers. More than half of the high performers, to a significant or great extent, also give their employees opportunities early in their careers to work abroad, compared with 31 percent of underperformers.

Making sure that ideas get communicated throughout their businesses is an important part of the networking agenda for high performers. Half of those we surveyed told us that they channel innovative ideas from employees via established processes to a significant or great extent, compared with 32 percent of lower performers. Businesses can also encourage employees to connect and share globally so that best practices can be transferred across the company.

Bob Willett, CIO of Best Buy and CEO of Best Buy International, describes the benefits of global interconnectedness this way: "From a shareholder perspective, it means we've got a balanced portfolio across the world of learning, of sourcing—and also, equally important in terms of development, of people and their careers. If you work internationally, it adds a completely new dimension to your experience that you bring back to the mothership, and you do a better job as a result in the way that you treat people, how you develop people."

Maintain strong core processes and structures

To operate successfully on a global scale, companies need to make the essential components of a global operating model—especially organizational architecture, information systems, business processes and data—consistent and standardized.

Global enterprise-resource-planning systems will continue to have an important role in this process. Maintaining a backbone of systems and common processes enables the mobility that allows a company to scale successfully.

Common processes and the active sharing of best practices help high performers successfully bring product and service innovations to multiple markets. For instance, Japanese automaker Suzuki Motor Corp. plans to use the lessons learned from its R&D for the Indian market to strengthen its approach to other emerging markets in South Asia, the Middle East and Africa. High performers are more than three times as likely as low performers to replicate successful innovations across different markets to a significant or great extent (57 percent versus 16 percent).

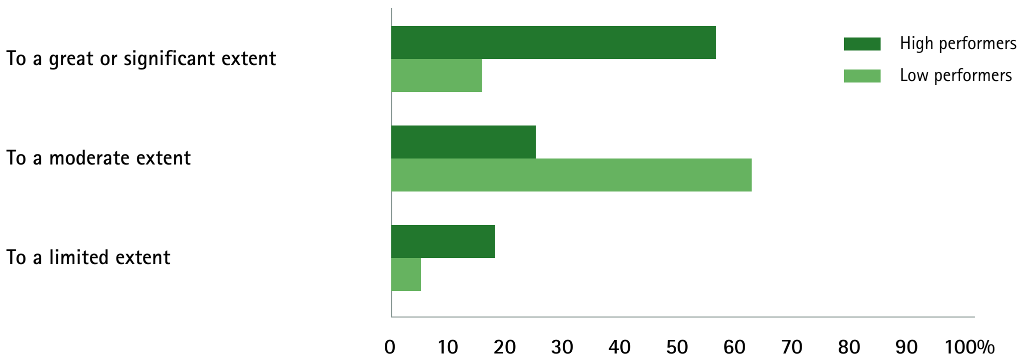
Foster multi-polar leadership

A global mindset starts at the top. The flow of ideas and know-how requires leaders who understand the nature of the multi-polar world. The effective creation of geographic options and valuable local links is more likely to come from a leadership team that reflects the company's current and future geographic footprint.

High performers are already out in front, forging multi-polar leadership teams (see chart, page 20). Eighty-two percent of the high performers we surveyed currently

Ideas without borders

Accenture also asked business leaders about the extent to which their companies were successfully replicating innovations across different markets where they aimed to expand R&D/innovation activities.



Source: Accenture analysis

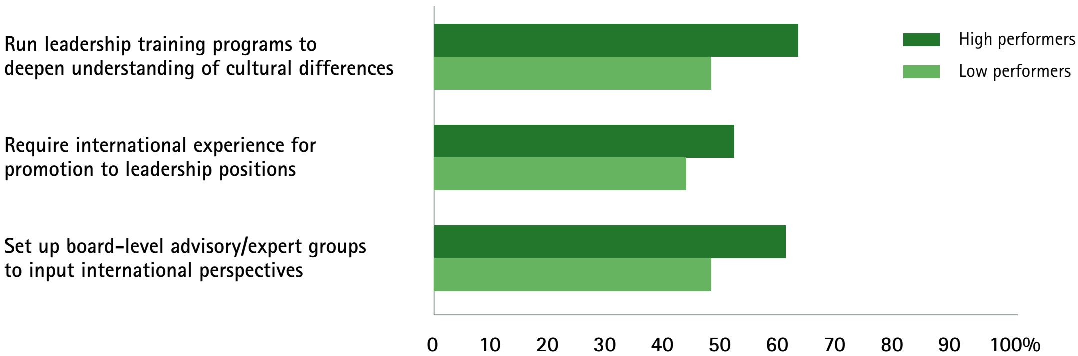
have foreign board members, and, based on their responses, that proportion should rise to 91 percent within three years. The comparable figures for low performers are 71 percent (now) and 77 percent (in three years). In addition, more high performers than low performers have set up board-level groups of advisors to gain international perspectives (61 percent versus 49 percent).

A global mindset can be inculcated in a variety of ways beyond the composition of the leadership team. For instance, nearly two-thirds of high performers—compared with fewer than half of low performers—run leadership training programs to deepen understanding of cultural differences.

As an offshoot of its "innovation academy," one major European insurer runs a one-year training course for 25 senior and middle managers. The program relies heavily on fieldwork—visits to NATO headquarters, for example, or the London Stock Exchange and major corporations—to enable the course participants to see firsthand how other organizations confront the kinds of challenges they face and to help them identify sources of value creation and begin to apply what they learn to opportunities for the company. The program also aims to foster critical and creative thinking at all levels of management across the group.

Global leadership

These business leaders also told us what changes their companies made to the composition, structure or operation of their leadership teams in response to globalization.



Source: Accenture analysis

Accenture's latest research confirms that high performers everywhere tackle globalization in very different ways than yesterday's multinationals. They don't think only in terms of product exports or the leverage of local partners. Rather, they deliberately create clear geographic options, embed themselves deeply in local business ecosystems, and build operating networks that enable people, processes and ideas to flow easily around their global operations.

There can be no one true path for success in a globalizing world, of course. But the contours of a new approach are now evident. The strategic playbook for globalization shows how to navigate those contours. It's now up to business leaders to read it.

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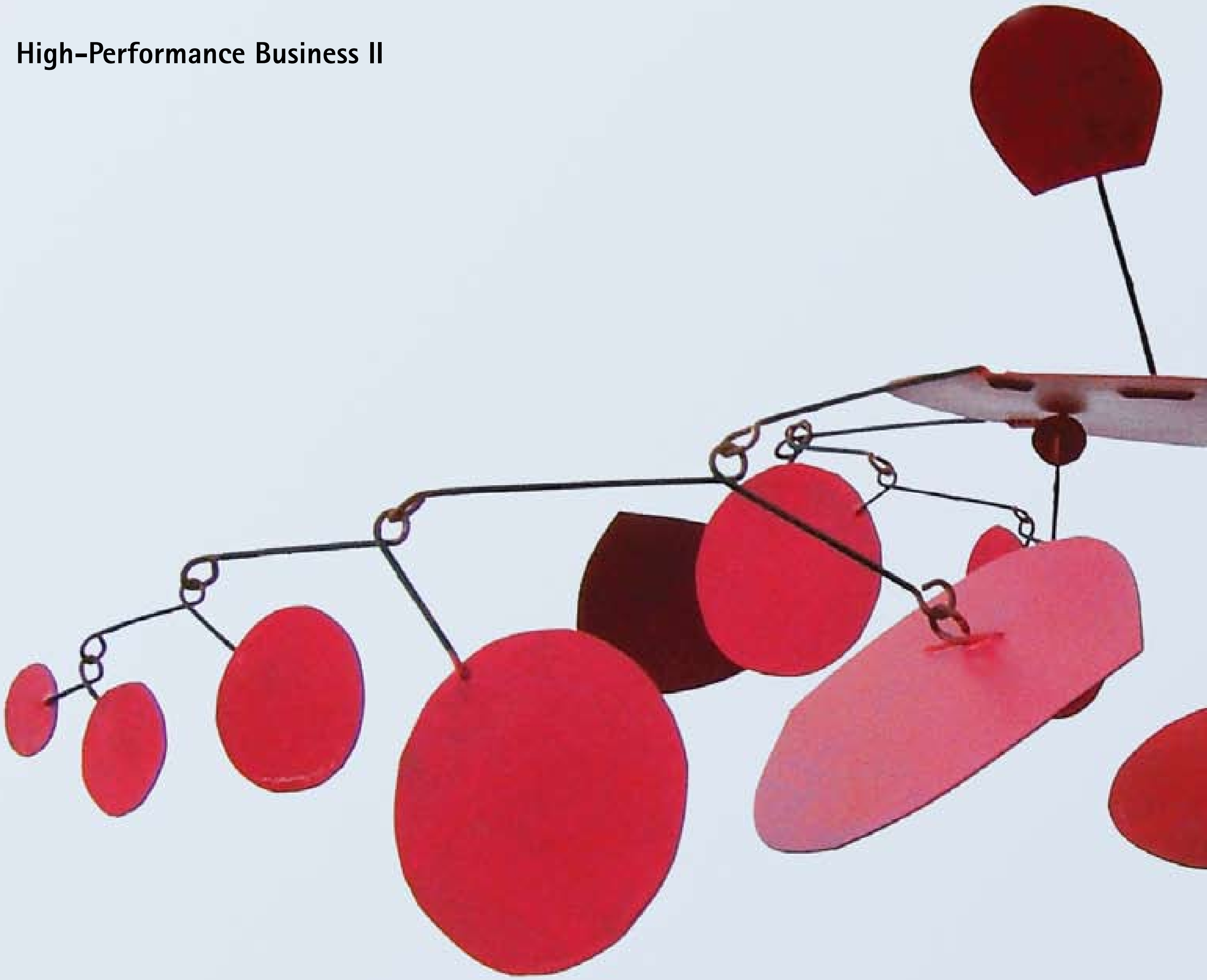


How to organize for the new realities

By Stéphane Girod, Michael V. Peterson and Joshua B. Bellin

A well-chosen global operating model is critical to growth in today's markets. What a model emphasizes, however, is likely to vary with a company's goals, experience and home-country origins. Here's how two successful emerging-market multinationals are executing their global strategies, with important insights for both developing- and developed-market companies.

"Are we properly organized and aligned to execute our strategy across geographic borders?"

"Do we have we the right mix of global scale and local responsiveness?"

These are among the difficult questions more and more executives are asking as they organize to meet the new realities of doing business in a multi-polar world. Indeed, a recent Accenture survey revealed that 95 percent of senior executives in multinationals headquartered in developed markets worry that their companies don't have the right recipe for managing (or extending) their global footprint.

In past decades, the prescription for going multinational was relatively straightforward: Grow from a solid foundation in one's home country and replicate well-established rules and processes across a larger geographic area. Adapt to local conditions but resolve conflicts in favor of the home-office culture. Reduce complexity by maintaining a relatively homogeneous leadership team.

More recently, however, the playing field has changed. Developed-market multinationals now find themselves competing with upstarts from emerging economies. Competition in many industries is now truly global. Emerging-market multinationals in automotive, IT and energy have gained a significant presence in developed economies. Established multinationals struggle to outfox nimble local competitors in the consumer products sectors of emerging economies.

There seems to be a consensus that an effective global operating model—the means by which executives coordinate a corporate center with geographic units as they pursue international growth—is critical to successful growth in a multi-polar world. (Accenture has developed a model consisting of four essential elements; see sidebar, pages 26–27.) Makes sense—but how do companies, from developed and developing economies alike, create the right combination of global coordination and local responsiveness?

In a search for answers, researchers at Accenture's Institute for High Performance and professionals in the field have launched an investigation into the practices adopted by emerging-market multinationals, asking, in effect, whether they have discovered a different organizational formula for the new global economy. In this article, we report on findings from extensive interviews with the top leaders in two successful companies (see "About the research," page 29). What we found suggests that there may be a new approach to global organization—one in which emerging-market multinationals have valuable lessons to teach to all global companies.

The new wave

At the heart of our research are the leadership teams from two companies regarded as exemplars of a new wave of emerging-market multinationals. One is an energy and chemicals company that has grown rapidly through successful joint ventures. The other is a telecommunications company that has expanded through a strategy focused on value-added services and international diversification. (At the request of both companies, we have changed their names for the purpose of this article.)

We found that despite differences in industry and strategy, both of these emerging-market multinationals seek to maintain flexibility and nimbleness even as they grow in revenue, product diversity and organizational complexity. They follow conventional wisdom, but only up to a point. For example, as they extend their reach to new and distant locations, they consciously introduce standardization in the form of business processes, technologies, organizational structure and metrics. However, despite conventional wisdom, they place a high priority on employee engagement, on collaborative networks and personal ties, and on active but dispersed leadership as keys to the successful management of geographic expansion.

EnerCo: Harnessing people power

EnerCo was founded as the national oil company of an emerging-market country nearly 60 years ago but has since been privatized. In recent years, it has sought to profit from its proprietary technology by expanding internationally; its preferred method has been the joint venture. The company has also developed a robust chemicals business. Meanwhile, its oil and gas and its chemicals business units have each sought out their own opportunities.

Extraordinary effort by its people and a bullish, long-term-oriented leadership are vital elements of EnerCo's story of growth and innovation on a global scale. Great pride is taken in the can-do spirit of its people—the optimism, technical competence, resourcefulness and resoluteness born of the home country's pioneer heritage.

In interviews, executives expressed this spirit in different ways. As one put it, "People in our country don't like to be defeated by anything." Another explained that "you can put our people in very difficult and remote places, and they will make things work." As soon as a need is identified, he added, "you will find people across the company who will start contributing or will make others available to go and fix it."

Despite the company's size and global footprint, an entrepreneurial ethos pervades the organization. According to a company veteran: "People go out there and set up something and get started. And it's mostly those who haven't done that before at all. Many don't have a full appreciation of business process systems or anything like that. And you see this ambitious engineer with an attitude of 'We can do anything.' "

Executives believe this attitude is a great selling point to potential partners because EnerCo doesn't hesitate to send its nationals abroad to imbue foreign operations with the same spirit and ethic. However, they stress that home-country expatriates must cultivate that spirit abroad, not impose it through centrally issued directives.

Building trust

At the leadership level, the company has built the trust with host governments and local partners that is essential to business success in a foreign country. EnerCo is also willing to go where others are reluctant to invest, and even to meet on partners' home turf. "We are prepared to invest where risk is very high," noted one executive. "Places like Mozambique, Iran, Nigeria and Papua New Guinea."

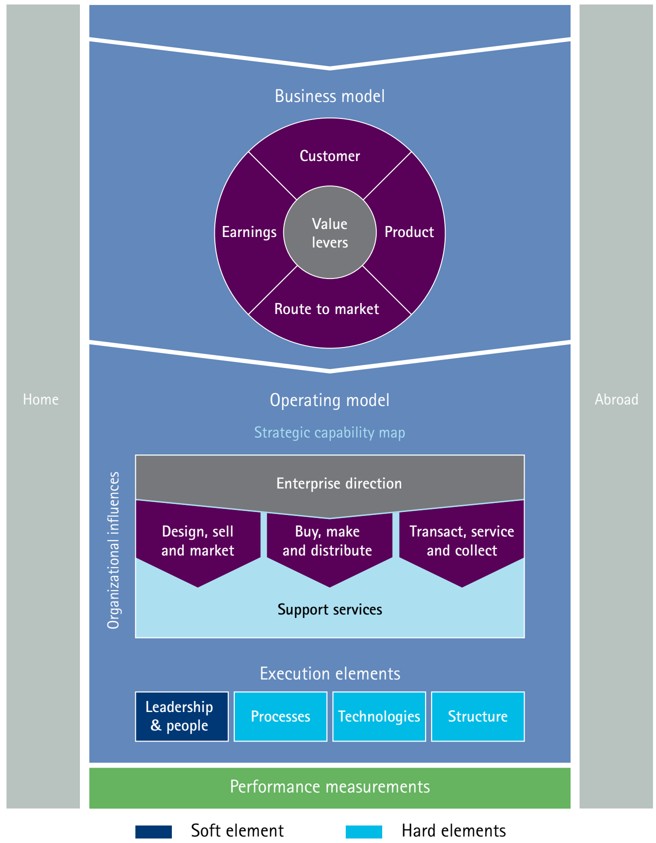
According to another EnerCo executive, a government minister once complained to him that "when I do business with Western companies, they don't come to my coun-

What is a global operating model?

A global operating model is the vehicle through which a company executes its business model and international growth strategy.

A core requirement of a global operating model is that it enables multinational executives to coordinate operations between the corporate center and the geographic business units and to form an end-to-end strategic value chain. Four organizational elements underpin these capabilities. One element (leadership and people) is more intangible—or "soft." The other three elements (organizational structure, processes and technologies) are more formal—or "hard." Performance measures tie all aspects of the operating model together (see chart at right).

Leadership and people. Leadership consists of the senior team that substantially influences the organization and serves as an example for how it should operate. Of particular importance to an operating model are an organization's leadership style, its degree of diversity and the way its leaders make decisions. As for people, the key aspects are the company's approach to talent management, its emphasis on employee engagement and the way it fosters networking. Also included is the organization's cultural dimension—the beliefs and shared values that bind its members together.



Source: Accenture analysis

try. I have to fly to another country to meet with them." And perhaps its own emerging-market roots give EnerCo an edge in these areas over developed-market competitors.

Executives recognize that their focus on people and leadership—the so-called "softer" elements of a global operating model—may be essential, but they also know it's not enough. For example, we were told about the growing sense that the company's energy and chemicals businesses lacked "coherence." They were expanding into new countries without coordination; once there, they operated autonomously. Worse, executives worried that the company was starting to lose the opportunity to learn from new operations. As one executive explained, "There's no way of bringing back the knowledge or the lessons learned after each process or project."

Executives sense that EnerCo's can-do spirit, while admirable, needs to be backed by more standardized and repeatable processes. Noted one: "We have to convince our people that when you start up a new business, you need at least things like payroll and sales and marketing." But even as they contemplate further expansion (and with it, greater need for standardization), they remain resolute in their belief that "soft-side" management needs to be the highest priority in EnerCo's global operating model.

Organizational structure. Within this element is the way responsibility, reporting and accountabilities are defined. It includes the structural and control mechanisms used both to integrate and differentiate units and businesses.

Processes. This element consists of the clusters of activities that produce measurable outputs. It includes all the management processes that help coordinate input-output activities in the value chain across geographic units. Some examples of processes are strategic planning, resource allocation, knowledge management, innovation management, customer relationship management and supply chain management.

Technologies. This includes the physical equipment, software and tools that underpin the processes. For example, enterprise-resource-planning software and intranet portals can help effect financial control, knowledge management and innovation processes.

Taken together, the content and the relative importance given to each organizational element characterize the global operating model configuration. Each element can be thought of as a dial that can be set at different levels; the configuration is the unique combination of these dial settings. To achieve high performance, the organizational elements need to work together in a good internal fit.

A small number of rules helps determine which processes, technologies and metrics should be standardized across geographic locations and which should be allowed to vary locally.

CommCo: The harmonization solution

CommCo is a 23-year-old emerging-market telecommunications company that, until recently, enjoyed a local monopoly and offered mostly voice services in its domestic market. After CommCo was privatized and lost its monopoly, it diversified into value-added services such as data and launched a series of acquisitions that dramatically expanded its ability to reach and serve large global enterprise customers. Today, the company operates multiple data centers in Europe, Asia and the United States. More than 50 percent of its sales come from overseas operations.

CommCo, like EnerCo, attributes its success in growing its international footprint to the strengths of its leadership and its people. For example, the executives we interviewed underscored the importance of having leaders who maintain a visible presence in each of the company's diverse geographic markets.

As one of them told us, "You want to be present in all your markets and set key directions. You want to show you are there, that you're supporting each of your overseas markets in the same way you do in your own home-country market. It's very demanding for the leadership team." He went on to argue that visible leadership is crucial to success in emerging markets, where processes are not as well developed: "You have to be there when they start their operation to help them build their own and to act as a true partner."

Three principles guide the approach CommCo's leaders take to their global operating model: an emphasis on harmonization over standardization; the importance of a geographically distributed leadership team; and "global-local" talent management.

Harmonization consists of a framework of simple rules about what should be local, what should be regional and what should be global in the operating model. CommCo executives insist that harmonization provides them with the benefits of standardization without the loss of flexibility.

In other words, a small number of rules helps determine which processes, technologies and metrics should be standardized across geographic locations and which should be allowed to vary locally. Harmonization does not necessarily mean that standards are based on home-country practices. It is possible (perhaps even probable) that the best processes, technologies and metrics will emerge from the network of foreign and domestic operations.

An example of harmonization through simple rules: Activities or decisions that have a direct impact on customers are left to business units rather than to the corporate center. So while the company has chosen a standardized framework for credit, within that framework different regions or countries can develop local processes, provided they are approved by the global comptroller.

The second key to CommCo's success internationally is its distributed leadership. There is no real headquarters; high-profile leaders collaborate from different places around the globe. One executive explained that "the top 50 people in the business . . . are distributed across 12 [world] cities. And less than one-third of them are from the home country." The purpose of this structure, he continued, is "to allow us to be as close to our customers and markets as possible. We hold

on to this structure very passionately because we believe that the mix of the people and their location reflect our thinking" about how best to serve customers in each market.

The dispersed nature of the top team, however, doesn't slow the company down. "Even though we are a large company with people around the globe," one leader told us, "the leadership team acts very fast. We can get together with 10 minutes' notice, we can get on the phone wherever we are, and we are there to take decisions."

The last distinctive property of CommCo's global operating model is its approach to talent management. Across the entire company, the importance of common values and employee engagement are emphasized; the human resource function (a shared service) has crafted a common induction process and a global program to train employees to improve virtual team working skills and virtual team management.

Still, the company depends on local teams to respond to customers effectively and quickly. According to one top manager, "The underlying principle is that you need local people to work effectively in local markets, and therefore we have been very strict about adhering to that and building a local talent base."

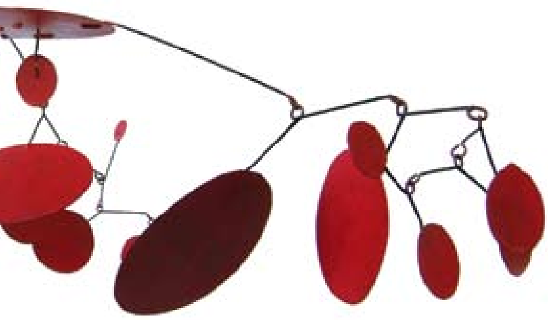
Control versus flexibility

Several valuable insights can be drawn from the experiences of these two companies.

About the research

Because little research has been done on the global operating models of emerging-market multinationals, Accenture devised a case study methodology to explore them in detail. We built the cases by triangulating three data sources: face-to-face interviews with top company executives, external experts' accounts and published material. Interviewees had either operational or central function responsibilities. We chose the oil and gas and the telecommunications industries because companies in both face similar pressures to achieve efficiency across borders while, at the same time, retaining a high degree of local adaptability.

At the request of both companies, we changed their names for the purposes of this article. "CommCo" and "EnerCo" were selected for their leadership positions within their industries and because their global footprints in emerging and developed markets place similar constraints on their global operating models.



Even as emerging-market multinationals seek a balanced global operating model, they put leadership and people first.

Most important, these case studies demonstrate that emerging-market multinationals can grow successfully by emphasizing the soft elements of a global operating model—leadership and people. Strong, visible leadership and an entrepreneurial workforce have served CommCo and EnerCo well at home but also have given them an advantage in adapting to the particular market conditions and customer traits often found in emerging markets.

Even as they expand into developed markets, executives in these emerging-market multinationals take pains to avoid stifling what brought the company success in the first place. A top EnerCo manager expressed it this way: "You need to drive standardization on its own merits without cutting back on the can-do culture." A colleague echoed this admonition: "[You need to] balance control versus flexibility, or else you will discourage innovation."

Indeed, too heavy a focus on standardization would undermine EnerCo's joint venture approach to internationalization. Since each venture has distinct goals, and therefore needs distinct management processes and metrics, flexibility is essential.

Looking ahead, top executives at both EnerCo and CommCo recognize that the "hard" elements of their respective global operating models need to be addressed to more effectively leverage their global scale across emerging and developed markets. CommCo, for example, wants to improve internal communications processes, which are essential to the durability of distributed leadership and employee empowerment across time zones. This has led executives to identify the lack of unified technology platforms and formal knowledge management processes as a potential constraint on their ability to leverage the talents of a globally distributed workforce.

Moreover, CommCo is working on clarifying lines of accountability and decision making. This isn't because conventional wisdom calls for greater formalization as a function of increased size but because the company discovered that in the absence of simple rules and common technology, customer-facing employees had begun to defer to managers halfway across the world, causing long response delays. (For a related article, see "Is this any way to make a decision?" *Outlook*, January 2009.) Once again, standardization—in this case, standardization of decision procedures and communication technology—is taken most seriously when it enables something essential to competitive success: flexible teams of people and empowered leaders.

This brings us to the third lesson these case studies present: Even as emerging-market multinationals seek a balanced global operating model, they put leadership and people first. To put it another way, the hard elements of the model—structure, processes, technology and metrics—should ultimately be seen as supporting those soft elements critical to the effectiveness of a global operating model. As one CommCo executive observed, "With the best processes in the world, if your management is not visionary, your best processes will not help you."

One important facet of visionary leadership is the ability to know when to standardize and when to disrupt the standards. The balance between formalization and flexibility is a dynamic one for these emerging-market multinationals. It is not static, at least not for long.

One thing is clear: If multinationals intend to operate in both developed and emerging markets, they can't lose sight of the potential for people and leadership to be critical drivers of success in a multi-polar world.

Operating models that focus on short-term performance, managing uncertainty and reducing complexity may be well tailored for competing in developed markets, but they may not be suitable for success in emerging economies. Developed-market multinationals may need to shift from a formalistic, standards-driven global operating model—one in which the strengths and potential of leadership and people are limited by an excessive emphasis on standardized and centralized processes, technologies and structure—and embrace a more flexible model.

Some companies will undoubtedly struggle to resolve this tension. In deference to the culture of the home-country market, they may attach too much value to the legacy elements of the model that brought them success in the past. The truth is that companies need not make this an either-or proposition.

Over time, emerging-market multinationals will begin to put more emphasis on the hard elements of the model: processes, technologies and organizational structure. They will also place a greater emphasis on performance metrics. Yet if the experiences of EnerCo and CommCo are any guide, the best emerging-market multinationals will ultimately prove to be both comfortable and adept at bringing a dynamic balance between the "hard" and the "soft" to their global operating models.

In fact, it's a lesson that all companies would be wise to learn: Those that emphasize the right balance of elements in their global operating model will be best positioned to execute successful multi-polar strategies.

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A tale of two Chinas

By Gong Li, Andrew Sleigh and Paul F. Nunes

The rise of a new economic superstructure in China—featuring companies that are already world-class—is one of two sides to the new China story. The other side is the extent to which many other Chinese companies are struggling.

Zhejiang province, with its entrepreneurial spirit and small businesses producing low-cost goods, has in many ways been emblematic of China's extraordinary economic growth. Following its own development model, the eastern coastal province became one of China's richest; in 2007, it boasted a GDP of about $255 billion and per capita disposal income for its urban residents of $2,800.

Then the global economy hit a wall.

Today, China's businesses stagger under the burden of rising costs, sinking demand, talent shortages and tougher regulations. As export activity sags and Beijing encourages the phasing out of "backward production practices," a major shakeout is well under way in many industries. And in once-booming Zhejiang in the second half of 2008, companies were shuttered at a rate of more than 200 a month.

China's companies find themselves caught in a kind of economic perfect storm. The world is sinking deeper into recession just as these enterprises are losing their traditional competitive advantages of low-cost labor, natural resources and capital.

However, recent Accenture research suggests that although no company in China will escape the effects of the downturn, some businesses are dramatically better positioned than others to weather this storm. During the past decade, the country's strongest companies began to open up noticeable leads over others in their industries (see "About the research," opposite).

Lately, their leads have widened. The research indicates that the choices that put these companies on a path to high performance before the crisis will also enable them to ride out the current turmoil and emerge even stronger.

The rise of this new economic superstructure in China—featuring companies that are already world-class in their successes today and their positioning for tomorrow—is one of two sides to the new China story. The other side is the extent to which many other Chinese companies are struggling.

The implications for global business leaders are profound. On the one hand, they need to recognize just how muscular China's top performers have become and adjust their strategies accordingly. Yet they must not generalize about Chinese competition; instead, they need to assess the myriad opportunities now being revealed as so many other Chinese companies lag behind.

China's leading companies are pulling ahead of their peers at an astonishing clip. Companies such as computer maker Lenovo, Gree Electric Appliances and China Mobile are achieving world-class levels of performance, moving smartly up the value chain with higher-priced, higher-quality products and services whose improved features appeal to carefully targeted customers. In fact, nearly 90 percent of China's high performers are prioritizing investments that will add more value to their products and services over the next three years (see chart, page 37).

By contrast, half of the low performers are still relying on the low-cost advantages that have served Chinese companies so well until recently.

About the research

To build up a comprehensive picture of high-performance business in China, Accenture applied its proprietary financial analysis to examine 13 industries in the country—the second year running that we have done so. The latest candidate pool included 30 additional companies that now meet the criterion of being publicly listed for five years or more. We created a detailed survey that was answered by nearly 100 senior executives from large, publicly listed Chinese companies. We also gathered valuable input by discussing our findings and theories with several board-level representatives of Chinese high-performance businesses.

Out of the pool of 200-plus companies, 36 met Accenture's definition of high performance—companies that are unequivocally outperforming their local peers in terms of returns to shareholders, revenue growth, profitability, consistency and positioning for the future.

The frailty of many Chinese businesses gives the country's solid companies new opportunities for growth.

At the same time, many of their local competitors are struggling now that the basis of competition has changed so dramatically. Earlier this decade, China's poorest performers, powered by their low-cost advantages, were growing nearly seven times faster than their global peers. But in the past few years, they have fallen behind them in revenue growth.

In terms of profitability—generating returns on invested capital higher than the cost of capital—the picture has been consistently gloomy. Measured over the long term, Chinese companies have achieved lower and even negative economic profits compared with their global counterparts. In the short term, China's high performers have made huge strides to narrow the profitability gap with the world's best companies. But the nation's average and low performers have actually destroyed economic value.

This widening performance gap has serious implications for competitors, Chinese and non-Chinese alike. By learning what propels China's most successful companies—the Grees and Lenovos as well as the next wave of strong players, such as Wuhan Iron and Steel Corp. and pharmaceuticals giant Yunnan Baiyao Group Co.—business leaders in the rest of the world will be better able to compete with them in global arenas.

At the same time, the frailty of many other Chinese businesses gives the country's solid companies new openings for growth. Understanding what creates high performance will help the average contenders to reach parity with the best Chinese companies and thereby allow them to tap into new opportunities afforded by the wide-ranging domestic stimulus package now being implemented by Beijing.

The downturn, coupled with the performance gap, has also revealed to non-Chinese companies opportunities in China that the country's blazing economic expansion has obscured until now. Those already with a presence there are well placed to capitalize on the push to boost domestic demand. Not only can they promptly gauge local customer needs—for example, assessing where the rural component of the government's stimulus and reforms will offer the most opportunities—but they already have the commercial and political links and the established distribution channels to quickly take advantage of those opportunities.

At the same time, they are positioned to decide which of China's weak performers are worth trying to acquire, or at least to acquire key assets from. Others that have yet to engage—perhaps in the belief that most opportunities were spoken for by tough domestic players—can now envision how to participate in China's next wave of growth, possibly through acquisitions or joint ventures.

Positioned for excellence

Just how have China's high performers excelled as rising costs have eliminated past advantages? And how have they positioned themselves to prevail in the face of global recession?

Accenture's research has isolated nine attributes mastered by China's top companies—traits that not only offer insight and example for other Chinese enterprises but that serve as important reminders for all business leaders of what it takes to excel in today's ferociously competitive climate—economic downturn or no. Here is how China's best companies have extended their industry leads—and why they promise to be highly competitive in global markets.

1. They are moving up and across the value chain.

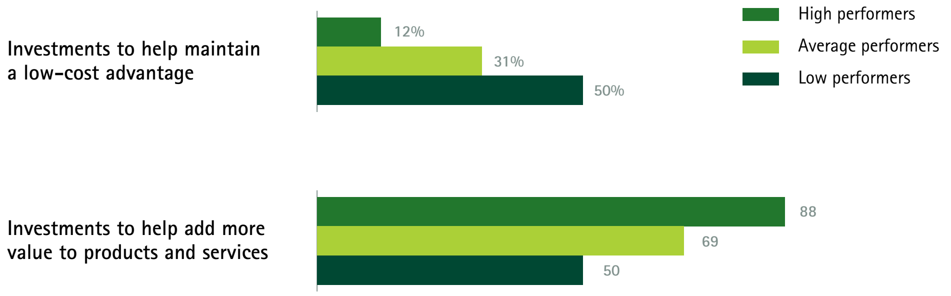
Chinese high performers are guided by the overriding need to add value to their products and services. They know that when customers instantly associate their brands with quality and service, they can expect to see substantial improvements in margins.

They also have a clear understanding of how to actually capture more of the source and flow of that value. They are building higher-end products that command higher price premiums and greater profit margins, and they are expertly capturing more value by taking greater control of other parts of their value chains—either upstream, on the supply side, or downstream, in their sales and distribution channels. An increasing number of leading companies are using mergers and acquisitions to realize these goals.

The Erdos Group, China's flagship cashmere producer, has made concerted moves to control its entire industry's value chain. The company, which accounts for 30 percent of global cashmere production, owns many farms from which it sources raw materials. It also runs its own product design, development and production

Investment priorities

Accenture recently surveyed a wide range of Chinese companies. They were asked what their most important investment priorities would be over the next three years.



Source: Accenture High Performance Business China survey, 2008

Chinese high performers look beyond the nation's borders to obtain the tools for profitable growth—talent, capital and innovative ideas.

centers, and it has built a national cashmere product engineering and technical research center.

The latest chapter in the Erdos growth story: The company has opened seven international sales companies and 30 branded retail stores in cities where the fashion industry is prominent and where overseas demand for cashmere products has been strongest—Los Angeles, London, Tokyo, Moscow, Köln, Hong Kong and Milan. At the same time, Erdos, like other Chinese cashmere producers, is shifting its reliance on exports to a greater emphasis on domestic sales. The company will invest nearly $118 million over five years to set up 100 flagship shops in China.

By contrast, Accenture's survey found that China's low performers are less likely to be diversifying or planning to diversify into other parts of their own industry value chain. Less than one in five low performers indicated any intention to move upstream within their own industry over the next three to five years.

2. They are globally aware and "super local."

More than three-quarters of the Chinese high performers surveyed already consider themselves global or at least regional companies. (Only a third of the low performers think of themselves that way.) But although many have robust sales outside China and some have a presence overseas, the key difference between Chinese high performers and their peers is that they have global mindsets. They look beyond the nation's borders to obtain the tools for profitable growth—talent, capital and even the innovative ideas that are the lifeblood of long-term growth and profitability (see chart, opposite).

At Baosteel Group Corp., a global mindset means that more than 1,000 of its employees have been trained in Japan, and the company has absorbed lessons from General Electric and other US companies about building a stronger and more predictable supply of experienced managers. At power generation equipment maker DongFang Electric Corp., getting involved in the global market means carrying out technology transfers with non-Chinese companies.

A global view of intellectual capital is called for as well. Pockets of specialized knowledge exist worldwide; for example, Chinese companies in the biotech business are able to forge close relationships with their counterparts in the centers of biotech research and clinical trials in Singapore.

The high performers' global outlook complements rather than conflicts with their sharp focus on domestic markets. Yantai Wanhua Polyurethanes Co. is proof of that. The polyurethane producer sees its efforts to attract international talent and management know-how as valuable for helping it grow at home, where its greatest opportunities currently lie.

However, China's best companies are careful to identify the domestic markets with the most immediate potential. Although the government is pouring stimulus incentives into poorer rural communities, nearly 90 percent of China's high performers identify metropolises such as Beijing and Shanghai as the heart of their business. So the bulk of their investments in new, higher value-added products and services are geared to China's larger cities.

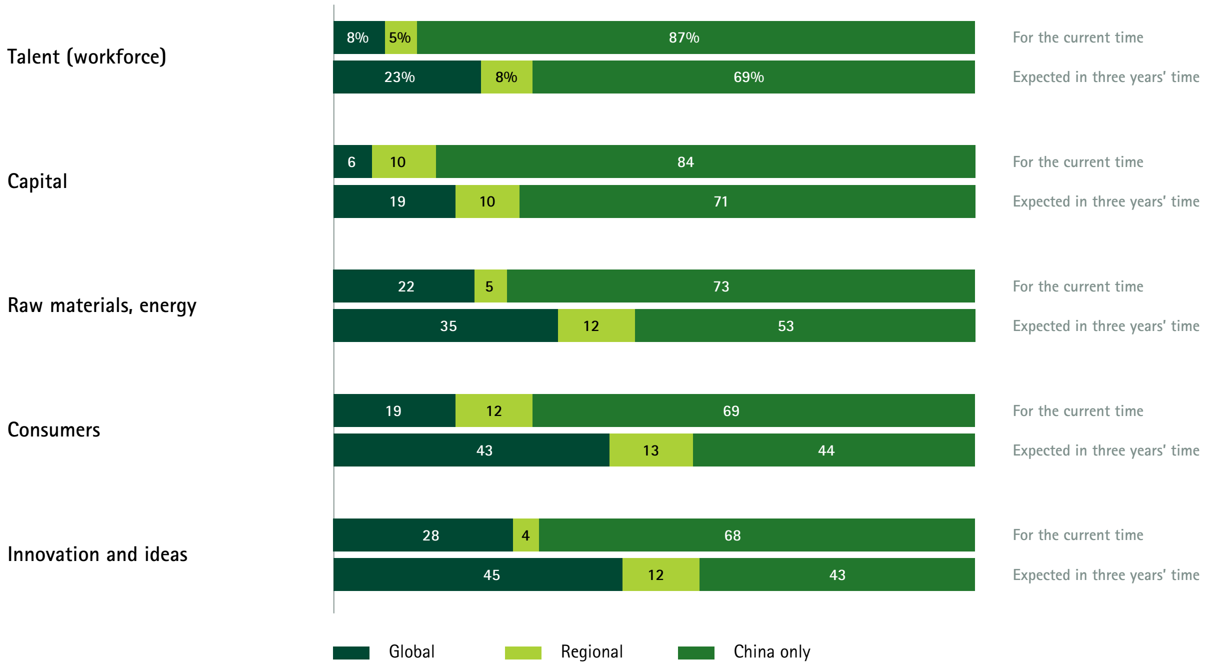
Beverages leader Yantai Changyu Pioneer Wine Company is a prime example. Most end customers for its wines and spirits are higher-income consumers in cities in China's coastal region. Sales of the company's higher-end products are growing rapidly.

3. They are implementing controlled and pragmatic growth.
There is a marked difference in approach between China's strongest and weakest performers when it comes to managing growth. Although there is still a widely shared concept in China that success means being the biggest in an industry, only the high performers have learned how to harness scale's real advantages. They realize that increased size brings opportunities such as economies of scale, distribution networks and negotiating power, and, unlike their peers, they have built processes and operating models to take advantage of those opportunities so they have greater control of their future growth.

The high performers are also particularly pragmatic about growth. To begin with, they work hard to ensure that their growth rewards a variety of stakeholders, not just shareholders (see chart, page 41). Rather than focusing solely on narrow financial metrics when developing strategy—tending chiefly to shareholders' near-term concerns, as most average and low performers

Global sourcing

Survey participants were asked to identify the primary geographic sources for five key resources (all companies).



Source: Accenture High Performance Business China survey, 2008

More companies are filing for patents, or suing to enforce patent rights, in China than anywhere else.

appear to do—China's high performers realize that the best way to deliver long-term value is by taking good care of their customers, their employees, and the communities and society within which they operate.

This perspective puts customers at the forefront of the high performers' mindset. China Mobile offers an example of customer consciousness in action. The company spends significantly to improve its service and promises customers that "if the bill is wrong, we return double." To back that promise, the telecommunications leader has invested in a differentiating technology—a sophisticated billing support system.

China Mobile is one of many high performers that also place a premium on meeting employees' needs. The rationale: Engaged and contented staff members are more productive, more attuned to customers' needs and more willing to "go the extra mile." At consumer electronics company Hisense, business leaders emphasize the importance of a culture of cohesion for improving employee retention. Companies like Hisense are unlikely to reduce investments in training or career development for the sake of improving results in the next financial period.

4. They put a premium on innovation in many forms.

The performance gap is readily apparent in terms of approaches to innovation. China's top companies want to extend their leads using new products and technologies fitted to their customers' needs; the poor performers tend to focus more on incremental improvements of existing products (see chart, page 43).

Nearly nine out of 10 of the high performers surveyed see investments designed to help add more value to products and services as their most important spending priority over the next three years. "A product's advantage is temporary," Li Chunbo, board chairman of Zhejiang Medicine Co., said recently. "If we want to lead the market, we have to have a keen passion for product quality and for R&D. In fact, the quality of our products reflects the company's overall quality and strength."

Superior distinctive capabilities, one of the building blocks of high-performance business, stem from innovation on many levels—not only in terms of new-product development but in business processes. China National Offshore Oil Corporation, known as CNOOC, is a case in point. In 2003, the company introduced an innovative new talent management process that gives all employees—for example, technicians as well as professional engineers—an opportunity to climb the career ladder.

The new approach circumvents the talent challenge often found in such companies, where technology staff and those from service functions are not on a defined "management track" and therefore are unable to reach senior positions. In addition, CNOOC staff are not restricted to conventional Chinese pay scales when they are located overseas. Now CNOOC can offer attractive expatriate compensation packages—as global rivals like ExxonMobil Corp. and Total do.

5. They build innovation systems.

Chinese high performers' approach is to make innovation repeatable, not accidental. So they foster processes and structures that signal the strategic importance of innovation, encourage knowledge sharing and collaboration, and provide the right kinds of incentives to their employees. One example: Seeking out top technology talent, Web search firm Baidu uses the Web itself to tap China's engineering savvy, sponsoring a yearly programming competition that asks entrants to create, for instance, a martial arts character using the fewest lines of computer code possible.

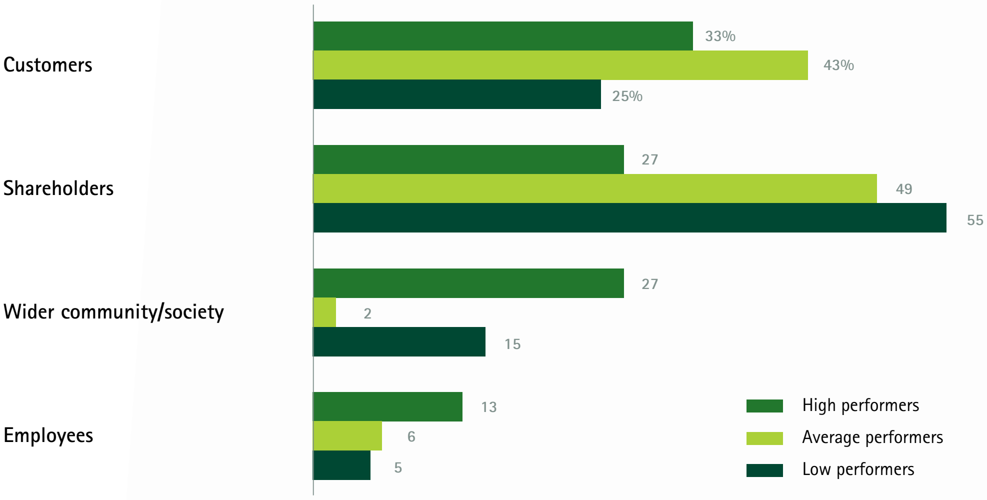
Further, the high performers do not limit their evaluation to incremental revenues from new products; they place enormous importance on the enduring value of a strong intellectual property portfolio. More companies are filing for patents, and suing to enforce patent rights, in China than anywhere else. News reports say that China's State Intellectual Property Office received nearly 700,000 patent applications in 2007, far greater than the number received in the United States. Chinese patent filings are climbing at more than 20 percent a year.

Says Yunshu Zhou, general manager of pharmaceuticals company Jiangsu Hengrui Medicine Co.: "Only when we have new drugs with intellectual property rights can we move beyond low-price competition."

Like any other business process, innovation must be monitored and measured if it is to be done properly. China's high-performance businesses understand the importance of quantitative measurements of their innovation activities. They

Multiple stakeholders

Survey participants were asked to indicate which stakeholders are given top priority when they formulate strategy.



Source: Accenture High Performance Business China survey, 2008

China's strongest corporations are expanding their involvement with the nation's education system to help ensure that future graduates have the necessary skills.

track metrics such as incremental revenue from recently developed products and the number of patents or trademarks granted. By contrast, almost half of the country's remaining companies do not carry out such activities.

6. They build businesses with the customer at their core.

This is another attribute where there is a stark difference between China's strongest companies and its poorest performers. The former prioritize investments that enhance customer satisfaction and loyalty; the latter continue to chase new customers (see chart, page 44).

The high performers know they can develop distinctive capabilities if they can ensure positive customer experiences at every point of interaction between company and customer. They understand that there is little point in developing higher-margin, value-added offerings if they can't provide equivalent levels of customer service to cope with the ever-rising expectations of their customers.

They are also becoming highly proficient at understanding and focusing on the needs of many different customer segments over a wide range of "touchpoints." China Mobile's GoTone service, aimed at its high-value customers, is a tiered loyalty and service program that includes a dedicated hotline for inquiries as well as access to VIP airport lounges across China and reduced membership rates at golf courses. The provider's M-Zone plan, targeting teens and twentysomethings, hosts special events for members, such as appearances by pop stars.

7. They are "talent powered."

China's high performers steadily acquire the skills and make the right investments in human capital that allow them to compete more easily in sophisticated markets and to extract more value from their products and services. One example: Meat processor Luohe Shuanghui Enterprise Group Co. now controls many aspects of its value chain, including 700 company-run retail stores. In a recent interview, Shuanghui CIO Liu Xiaobing explained his company's perspective: "If we can get appropriate talent—especially senior management—we will control every part of the value chain ourselves."

These globally minded companies are casting the talent net wide, reaching out to expatriates they hope will join the flow of *hai gui*, or "sea turtles"— returning Chinese who bring a wealth of global work experience.

Like their counterparts elsewhere, China's strongest corporations will continue to struggle not only with finding top talent but with retaining it. Besides rethinking compensation packages, they are expanding their involvement with the nation's education system to help ensure that future graduates have the necessary skills. For instance, appliance maker Gree, in an effort to identify the best talent for recruitment, has held a series of competitions in universities around the country to encourage students to come up with innovative new design ideas.

And whereas many of their rivals emphasize salary and benefits, the top performers think more broadly, in terms of talent development—a blend of factors, including well-defined career paths, training and education, knowledge sharing and an amicable working environment, that collectively can do much to improve retention and upgrade workforce skills.

8. They use IT as a source of competitive advantage.
Most Chinese companies can leapfrog several generations of hardware and software because, as a rule, they are not burdened by the legacy IT systems that their global counterparts struggle with. Many of the high performers are exploiting this advantage to the fullest, actively deploying enterprise resource planning systems—SAP and Oracle suites just like those used by global leaders elsewhere.

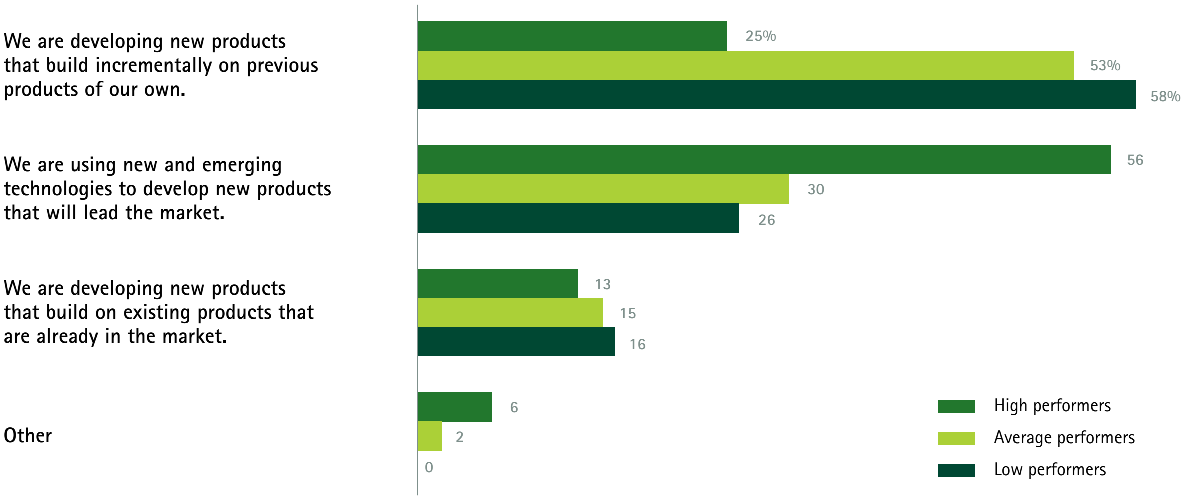
Although most high performers continue to use IT to keep a lid on costs, some are also moving to adopt new technologies that can help them transform the ways they work with their customers, suppliers and employees.

China Mobile views its IT function as a potential source of revenue. Its executives are looking at offering other corporations the technologies and services that the telecom company has developed to fulfill internal demand and improve its own competitiveness. The company is also constructing a B2B e-business platform that uses IT to integrate its supply chain, greatly lowering costs and risk for its business partners as well.

9. They practice sustainable growth.
More Chinese high performers see long-term benefit in serious efforts that reduce their impact on the environment. They know

New technologies, new products

Survey participants were asked to characterize their current R&D strategies.



Source: Accenture High Performance Business China survey, 2008

that consumers (and investors) will keep pushing for stronger "green" efforts from business. One 2007 poll revealed that nearly seven out of 10 Chinese consumers said they would prefer to buy products and services from green companies.

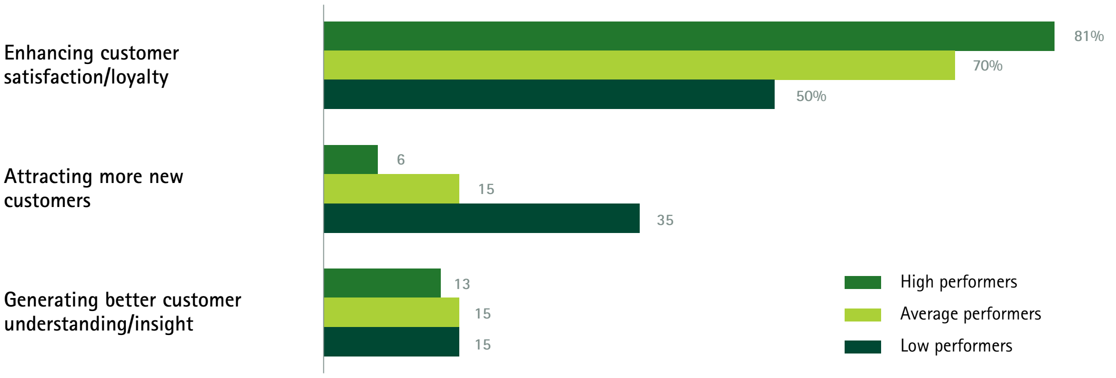
Sustainability efforts will be critical to those companies intent on competing in higher-margin markets outside China. For the companies focusing on markets inside the country, there are opportunities to appeal to the newly awakened environmental sensibilities of Chinese customers while staying ahead of China's increasingly active environmental regulators.

Companies in resource-intensive industries are leading the way. Wuhan Iron and Steel, once known as a major source of pollution, recently implemented a new system in a major coke plant that will recycle more than 95 percent of the water used at the plant, compared with just 47 percent previously. The company, which plans to achieve zero wastewater discharge of this year, is now devoting 10 percent of its fixed-asset investments to energy-saving and environmental-protection facilities, according to *China Daily*.

Elsewhere, Zhejiang Medicine Co. has won ISO 14001 certification—an internationally recognized benchmark signifying high levels of environmental management—verifying that its manufacturing operations meet the strictest environmental standards. And

Customer focus

Survey participants were asked to identify the highest priority for their company's current customer-related investments.



Source: Accenture High Performance Business China survey, 2008

Lenovo points to the high marks it received in 2007 from Greenpeace for its advanced practices in handling electronic waste.

So what does this new wave of Chinese high performers mean for business leaders inside and outside China?

Imagine the business world as it could be five years from now. Harbin Power Equipment Co. is on the short list to build a massive hydroelectric project in Chile. Automaker Chery's name flashes in lights in New York City's Times Square. And Gree wins a giant contract to supply "green" air conditioners for all municipal buildings in Atlanta—and to service them for 10 years.

The point is not whether these scenarios actually play out; it is that, judging by detailed analysis of the attributes of China's high performers, there can be little doubt that many of them will soon reach such milestones. Senior managers who think that China's most successful enterprises have succeeded largely thanks to their low-cost advantages must now accept that those companies have the mindsets, systems and capabilities to be ferocious global contenders from here on. If these companies have managed to compress into 30 years the development that took much of the rest of the world two centuries to achieve, what might they be able to do by 2040?

For the Chinese companies that rate as average performers—and for the non-Chinese companies that now have fresh opportunities to partner with them or even to acquire them—there is no better time than now to examine the three building blocks of high performance and identify the weaknesses that have so far prevented them from joining the ranks of the high performers.

But remember: Time is of the essence. The global economic slump means that many average players could quickly share the plight of the low performers—losing momentum and fighting for the remnants of dwindling markets. And where does that leave the underachievers? They, too, have customers and resources that, coupled with Beijing's efforts to stimulate domestic demand, could make them highly attractive partners or acquisition targets.

If there is one big idea that should come from a fresh look at China's economy, it is this: Last year's assumptions about the nation's competitiveness are long out of date. Global business leaders need to face up to the power and the positioning of China's top companies—and expect to go head-to-head with them from now on. But at the same time, they would be wise to assess the myriad opportunities now being revealed as so many other Chinese companies lag behind.

In other words, there are long-term business benefits to seeing both sides of the new China story.

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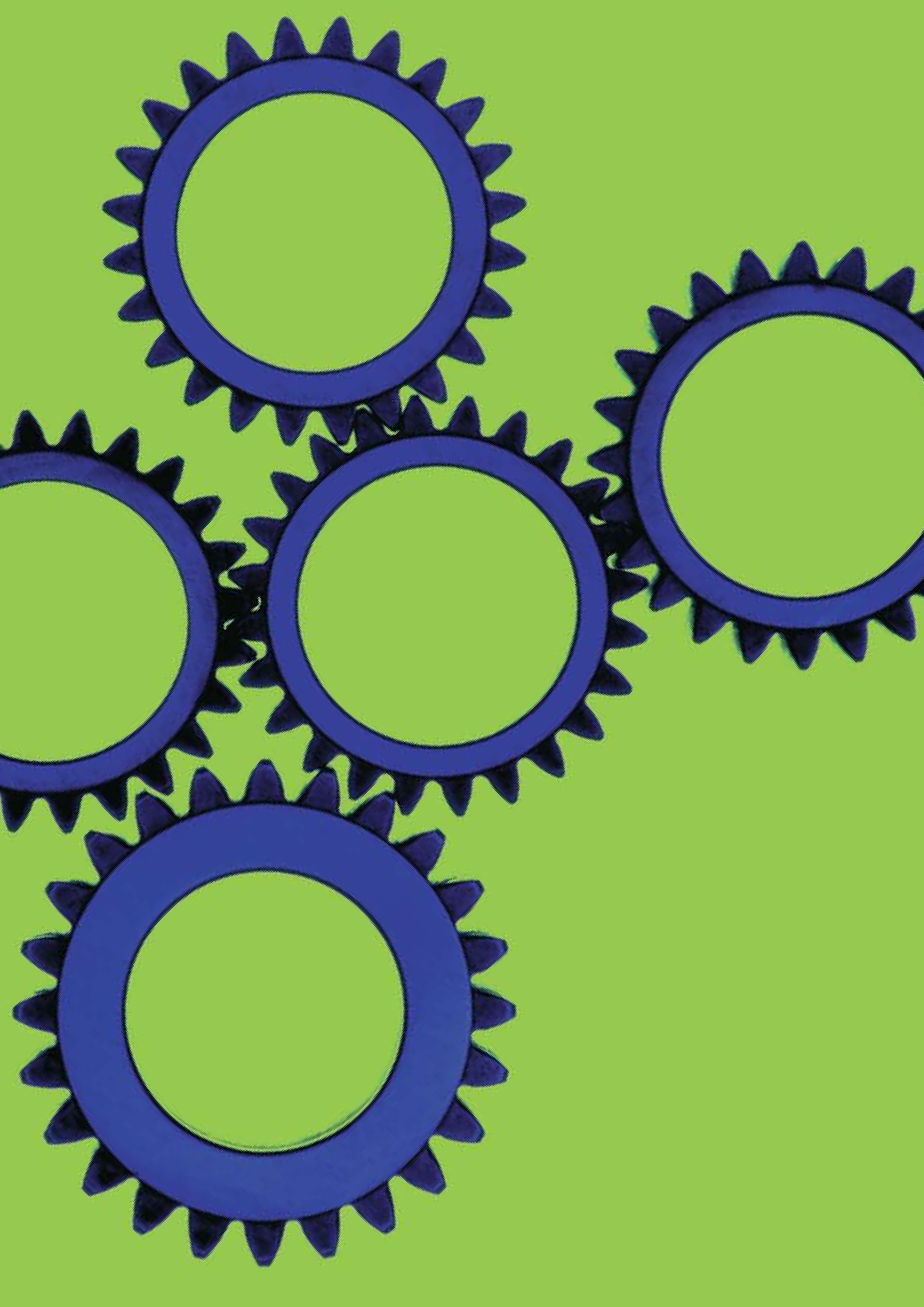
The bigger picture

By Juan Domenech and Greg Parston

In the face of economic turmoil, many public-sector leaders are thinking tactically, not strategically. As a result, they risk overlooking the long-term implications of trends associated with the multi-polar world. To respond successfully, governments must successfully address five critical areas as they develop new ways of working that emphasize creating public value.



Whether the current, more intense phase of globalization is something positive or negative can often be a matter of point of view.

For multinational companies, today's multi-polar world—with its vibrant emerging economies, global enterprises, increased economic openness, mobile populations, and ubiquitous connectivity and information flows—represents exciting new business opportunities.

To be sure, growth from trade and productivity gains benefits all. But for governments already struggling to protect and improve their citizens' quality of life against international terrorism, environmental degradation and worrisome demographic trends, these same developments can sometimes make their task more difficult.

What's good for companies is not always good for countries. Although many global corporations take a bullish view of the multi-polar world and its dynamic business environment, governments that do not adapt and prepare themselves adequately will be distinctly more bearish.

While the concerns of large corporations typically run to global matters—global markets, global sourcing, global hiring and global production—nations tend to focus most on issues that arise within their borders, such as immigration, education, living standards and unemployment levels. Unless addressed effectively, this global/local clash can interfere with the goals of public managers who seek to create public value for their citizens. Those same managers will also soon learn that the only certain thing in this newly uncertain age is that the tools and stratagems they used successfully in the past will be of little use in the future.

Accenture research suggests that in the multi-polar world, public-sector players, whether from the once-dominant Western economies or emerging markets, must successfully address five key areas if their countries are to thrive.

1. Developing national talent

A country's success and prosperity depend on the skills and capabilities of its people, and today's multi-polar reality demands that public managers find ways to attract and retain talented workers as well as the businesses that employ them. At the same time, governments—large employers of national talent in their own right—must examine new ways of working to ensure their own continued effectiveness and competitiveness. This is particularly important in light of current demographic trends, such as aging and shrinking populations and the need to retain older workers.

Globalization has intensified competition among nations as suppliers of talent. Emerging economies tout the rapidly rising skill levels of their workforces. Combined with their lower costs of doing business and their expanding consumer markets, this trend erodes the advantages developed nations have relied on to attract and retain employers and highly skilled employees. As a result, the competition for jobs is moving into high-value, high-skill industries—the rarefied domain formerly reserved for developed nations.

Governments should bring together the full range of agencies and policy-making bodies to develop a national talent management strategy and put it into play. Goals should include identifying the economy's current and future talent needs, using today's talent effectively and efficiently, and providing the training needed to shape the nation's workforce to meet the demands of the global economy, now and in the future.

In addition, countries should work to attract whatever talent they themselves cannot supply. India, for instance, has set up recruitment offices in a range of nations, including the United Kingdom and the United States, to target individuals with IT skills. The Portuguese government has used "nation branding"—running a $4.3 million media campaign that highlights the country's political, social and cultural advantages—to lure immigrant labor, especially Indians, whose resident community in Portugal now forms one of the largest non-English-speaking groups in Europe. This global search for talent is a good example of the interconnectedness and countervailing dynamics of the multi-polar world.

Our research further shows that to manage talent successfully, countries must nurture distinctive capabilities—one of the three building blocks of high performance—in the public as well as the private sector.

China, for example, has strategically targeted nanotechnology as an area of future success, investing more than $400 million in the sector and establishing the National Center for Nanoscience and Technology in Beijing and the National Engineering Center for Nanotechnology in Shanghai. India's federal government is investing $250 million in a similar national initiative to support nanotechnological research. As a result, China, India and several other emerging economies have begun to leapfrog developed countries in potentially lucrative new industries.

Countries that nurture and work to retain talent by offering attractive career opportunities create employment and wealth for their citizens. Those that don't will be on the losing side of the competition for investment and jobs.

The competition for jobs is moving into high-value, high-skill industries—the rarefied domain formerly reserved for developed nations.

2. Managing the movement of people and money

The rapid global flow of capital and the recent failures of the international banking system have forced governments to rethink the way they identify risk.

Governments must institute the right combination of social, economic and immigration policies to meet the needs of industry and enable the secure movement of people, capital and goods. The rise of multinational corporations compels governments to develop more sophisticated revenue systems, regulatory strategies and fiscal policies—often in collaboration with other nations—to address growing concerns over sustainability, security and the desirability of the foreign ownership of local assets.

The increasingly mobile masses of people looking for jobs and better opportunities—a key characteristic of the multi-polar world—are straining national immigration systems worldwide, a situation exacerbated by heightened security concerns and the economic downturn. This trend also puts serious stress on education and health systems and housing in the host countries.

Migration patterns have changed as well, with more people moving temporarily to do a job (often lured by companies that lack domestic talent) and then returning to their home countries. Thus immigration policies must emphasize flexibility as they enable and manage mobility to meet the needs of the nation. In 2008, for example, the United Kingdom started implementing a new points-based immigration system, similar to an Australian model, to control immigration and tackle abuse of foreign workers, while helping to identify and attract the most talented workers.

Companies operate in more complex ways across diverse locations in the multi-polar world, making it difficult for governments to determine appropriate taxation. In one response to this issue, the Irish government has established a Revenue On-Line Service through which individuals and firms can file tax returns, pay taxes and access their tax details.

Governments also should collaborate more to enable commercial mobility and meet the needs of businesses that work across borders. The EU, for example, established a VAT Information Exchange System, which makes it easier for firms to manage the value-added taxes they pay while reducing both charges and processing costs.

In addition to these improvements, the rapid global flow of capital—and the recent failures in the international banking systems that underpin that flow—has forced governments to rethink the way they identify risk, deal with international customers, and audit and regulate transactions.

Accelerated capital mobility—as well as the global fallout from the current downturn and the crisis in the financial system—is already leading to greater policy coordination across a wider range of governments. For example, the G8 countries launched the Heiligendamm Process in 2007 to establish an ongoing dialogue between developed countries and important emerging economies, including Brazil, China, India, Mexico and South Africa, on the biggest challenges facing the global economy today. One objective of the talks is to strengthen the freedom of investment by encouraging a more open investment climate.

Like businesses, nations compete for capital, so governments must consider strategies to attract investments. Something of a pioneer in this area, the Japanese government, for instance, has long used the Japan External Trade Organization, or JETRO, to seek out foreign capital investment and to help broker investment deals. The organization has recently enjoyed numerous successes in industries ranging from biotechnology, software and media to insurance, manufacturing and retailing.

With major increases in investments from abroad comes the question of foreign ownership of local assets. In some cases, the answer is a definite "no." For example, Air France-KLM's attempt to purchase a majority stake in Alitalia was blocked by Italian unions, which were emboldened by political hostility to the deal.

3. Enhancing social infrastructure

Individual citizens, businesses and even industries can easily be displaced by the massive and complex machinery that drives the global economy. That's why government agencies must find ways to help their citizens avoid being trampled beneath globalization's expanding influence.

Public managers face a number of challenges in this area. One involves finding ways to promote citizens' access to the labor market by helping them acquire flexible skills. In the United States, the North Carolina state government has successfully helped a significant number of workers from the fading textile and furniture industries retrain for high-tech and other employment by funding courses at community colleges and supporting any employers that create 15 new jobs for laid-off workers.

Governments should also act to adapt local public services to give immigrants access to health care, for example, and address the threat of global pandemics. Highly mobile workers can quickly spread diseases across borders, and governments should establish global disease-monitoring systems that can identify and help contain outbreaks, particularly in developing countries.

Likewise, volatile world markets present enormous challenges to governments that seek economic stability at home. The actions taken by multinational corporations when dealing with local or global financial crises, such as shutting plants, can lead to business failure and large-scale unemployment. This has a direct impact on the need for social infrastructure within individual countries as well as on government fiscal policies. In the face of the significant job losses resulting from the recent global economic crisis, for example, both the Chinese government's $586 billion stimulus package and the recently enacted US government program to save or create an estimated 3.5 million jobs over two years include significant spending on infrastructure.

4. Protecting national security

The desirable free flow of goods and capital across countries and regions can open the door to undesirable consequences. Countries must be prepared to act quickly to address emerging threats and ensure resource security—especially when their economies rely heavily on natural resources in the energy field from politically volatile areas. This can involve technical assistance and aid and, in extreme cases, military assistance.

Rising international trade flows and migration will force governments to improve their importation and transit security. But safer can mean slower, and the slower and more costly the process is, the harder it becomes for companies to compete. If countries cannot ensure security while enabling efficient movement, multinationals may seek alternative locations closer to their means of production or their customers. Threats include terrorism as well as the reemergence of maritime piracy.

Public managers also need to review their immigration security systems to address national and transnational security risks. New technologies such as identity management and security screening systems can help in this process, although their use can raise sensitive personal privacy issues in some countries.

In 2007, Portugal introduced multifunctional, biometric national ID cards—one card for each citizen—to replace the five separate ID cards citizens carried for basic identification, taxes, health services, social security and voting. These national ID cards, in addition to carrying information about an array of public services, conform to EU regulations protecting individual privacy (see "It's in the cards," *Outlook*, January 2008).

Environmental sustainability can be an area of competitive national advantage.

5. Ensuring environmental sustainability

Governments must be good stewards of national wealth and resources, but results to date have been mixed. While developed countries pursue carbon dioxide reductions, for example, some estimates indicate that in the next five years, China and India will construct coal-fired power plants that will produce emissions exceeding the reductions delivered by the Kyoto accords by five times. Public managers can promote sustainability in a number of ways, such as developing alternative fuels, regulating the ecological impact of businesses, encouraging research and building infrastructure that supports the use of renewable energy sources.

With an eye toward developing alternative energy sources, New Zealand has harnessed its abundant rivers to produce hydroelectric power, which now generates about 70 percent of the nation's electricity. Likewise, Iceland now heats 90 percent of all its housing using geothermal energy, while France relies on nuclear power to meet 77 percent of its electricity needs.

Examples of regulation focused on sustainability include the Dutch government's attempt to reduce consumers' carbon emissions through the way it taxes new vehicles. The program rewards drivers who choose smaller, less polluting vehicles while significantly raising the tax paid on cars that produce high emissions. The Spanish government has gone one step further and announced plans to lower the national speed limit to 50 miles per hour to help reduce fuel consumption.

In fact, environmental sustainability can be an area of competitive national advantage. Germany has become a world leader in solar energy, for example, because of its early experimentation with and investment in this technology. German companies have found success producing the photovoltaic panels used in solar energy, and today the industry employs an estimated 40,000 people.

But governments must also collaborate with each other to circumvent threats to the environment that are too large for any one nation to address. For example, US states and Canadian provinces that border the Great Lakes have established the Great Lakes Commission, which has developed a strategic plan to protect and sustain the regional environment.

Given the current state of economic turmoil, many government managers are thinking tactically, not strategically. As a result, they might overlook the long-term implications of trends associated with the multi-polar world and how they should respond. Ultimately, however, achieving success in the multi-polar world will require them to look beyond current tools and methods and develop new ways of working that emphasize creating public value—improving the health, safety, education and skill levels of their people.

Doing this effectively will require countries to step beyond the current status quo and begin to build bold and innovative co-productive relationships with a variety of stakeholders, including other governments, national and multinational businesses, and their citizens.

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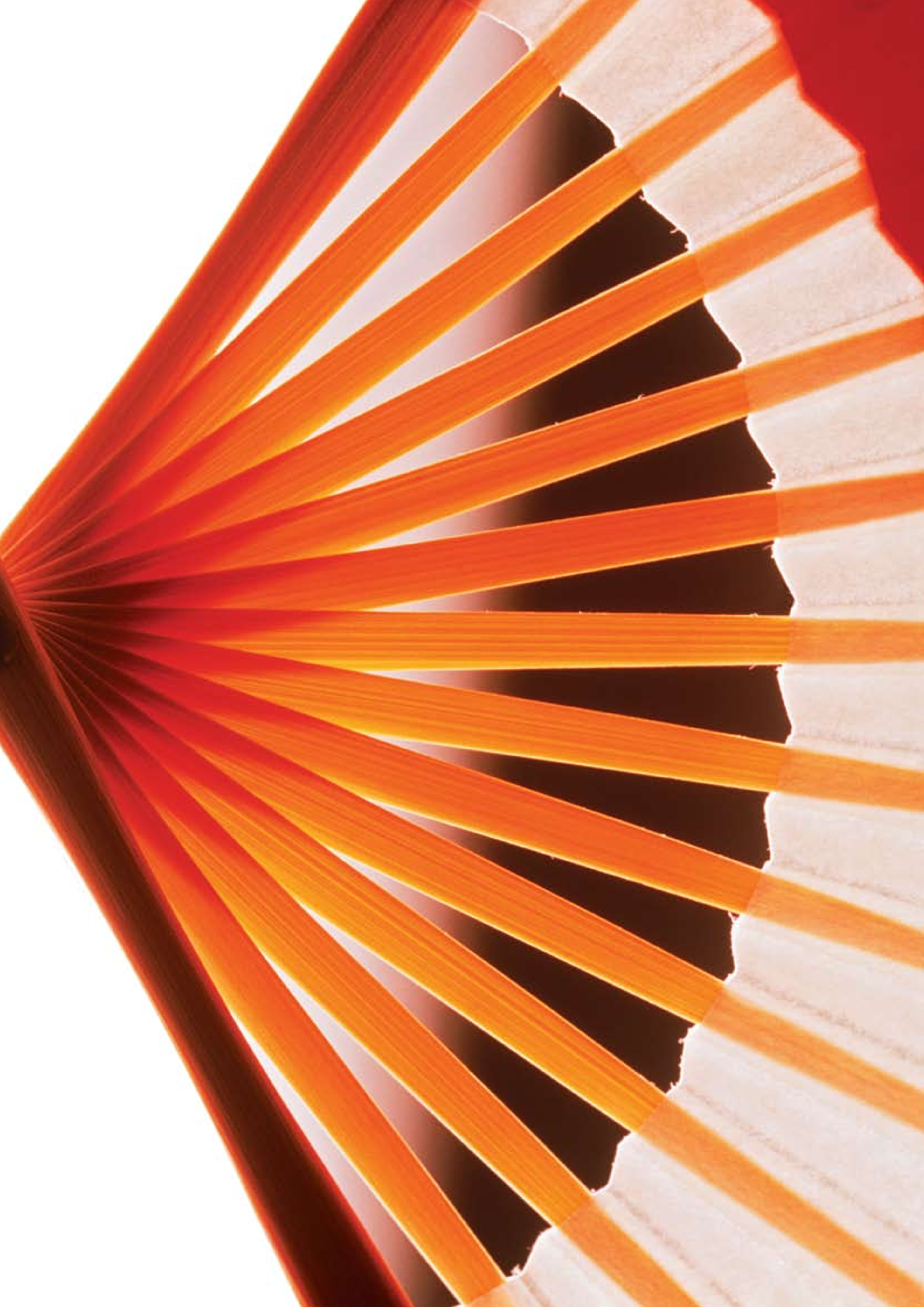
Meeting the mandate for global IT

By Nan J. Morrison

CIOs are coming under more and more pressure to control costs, recruit the best talent and serve both the company and its customers from a global perspective. Here's what many of them in North America are doing to meet the challenge of fully globalizing IT capabilities.



What does it mean to be a global IT organization?

At a US manufacturer of industrial equipment, IT supports the company's computer-aided design systems in Eastern Europe and ensures that the development teams receive performance data on the company's products from Australia to Patagonia. Meanwhile, a leading media services agency has rolled out global workflow solutions and worldwide systems for managing its creative assets so it can provide seamless product delivery to its global clients.

These are just two examples of ways companies are using IT operations globally. But are they evidence that IT is being used globally enough to meet the demands of a multi-polar world in which many companies' key business functions are dispersed throughout dozens of countries?

In fact, it is more likely that IT operating models are out of sync with the overall business direction. Although 85 percent of business managers who responded to a recent Accenture survey claimed that global operations were crucial to their organizations' business strategy, 94 percent of them said their companies' operating capabilities to support that strategy were not up to par.

Chief executives need to ask their IT leaders how much more efficiency they can gain and how much more business value IT can create with a more global approach (see sidebar, opposite). CEOs must be confident that IT is helping the company use its assets well no matter where they are located; that IT can roll out new tools or updates globally when needed, quickly and error-free; and that IT can support external customers as well as internal operations such as the global supply chain or worldwide brand management.

Of course, there is no universal blueprint for making IT "global enough." But in Accenture's view, the most important feature of a global IT operation is a single CIO with global enterprise responsibility—a highly experienced executive who sets overall IT priorities and heads a global IT governance steering committee.

That does not preclude many of the CIO's direct reports from having end-to-end responsibility for their domains worldwide—for example, an IT leader who "owns" enterprise architecture activities everywhere. But it does limit the ability of local or regional CIOs to make independent decisions that may not be best for the IT organization as a whole.

The CIO of a top global marketing firm puts the concept this way: "Having a global IT operation is about taking geography out of the equation. It's about doing work across many markets in a consistent, efficient way, with everyone having access to information and knowledge, regardless of location."

Accenture has been down this path itself. Our transformation to a global IT operating model began eight years ago with the decision, upon becoming a publicly traded company, to manage the business as a single global entity rather than through many separate country units. The business provided full support as Accenture's IT organization moved to one enterprise resource planning

Global realignment: The payoff

A global approach to IT will not only make an organization more efficient, it will also create more business value.

- Global connectivity and platforms allow employees to collaborate seamlessly, leverage assets across the business and work from anywhere without losing productivity. Such flexibility is especially valued by Gen X and Millennial professionals.
- Application costs, infrastructure costs and service costs are reduced through global rationalization.
- The business has "one version of the truth."
- Best practice local solutions can be more easily shared worldwide when there is a global IT management structure and governance model to facilitate information flow.
- Acquisitions can be integrated more quickly and less expensively.
- Best practice and scalable IT processes and service levels can by implemented, monitored and measured, improving quality and reducing the risk of local, undocumented or unproven processes.
- CIOs gain better visibility of the range of IT activities, allowing standard metrics to be implemented and used consistently, enabling quick responses to issues and more effective priority-setting.

platform and a unified infrastructure that enables global collaboration, cost reduction and a single view of operating data.

As our number of employees grew by 133 percent and revenue increased by 72 percent, the cost of IT as a percentage of revenue fell by half, IT expenditures decreased by 24 percent, and the total applications count was almost halved. Notably, during the same period, satisfaction levels for Accenture employees improved by 20 percent.

Stepping up

Creating a fully global IT operating model presents a range of opportunities to support the business—opportunities that can be grouped in two main categories.

Creating more value for the business. IT can help a company build stronger capabilities in areas such as collaboration, global operations, and business information and analytics—capabilities that make it easier to tailor products and services to customers' needs.

IT enables global collaboration through common tools and a connected infrastructure. For example, Accenture estimates that although workers in high-value roles—such as research and development, product development and marketing—typically spend 80 percent of their time working collaboratively, they rarely meet face to face. So for, say, a manufacturer of large industrial equipment, it is essential that IT supports collaborative product

Are you global enough?

It's increasingly likely that the CEO will ask whether IT is appropriately global. Here are some of the questions the CIO should be prepared to answer.

- Can our products be reviewed with customers, virtually and in real time, regardless of geography?
- Can our teams work seamlessly with one another no matter where they are based?
- Can IT provide the right level of support around the clock and at the right cost?
- Is IT managing its global infrastructure, applications portfolio and service delivery platform with the goal of reducing total cost of ownership worldwide?
- Is IT tapping into the right talent wherever staff is located?

design in the United States, India and China, allowing engineers worldwide to share ideas and design efficiently while accommodating local variations and product development lifecycles.

Collaboration also extends externally to customers, suppliers and partners. One advertising company CIO noted that since many of her firm's clients are global, content review must be global as well—from the first design concepts for an ad to approval by the client. In essence, collaboration allows IT to support the business wherever it is operating and wherever its customers are.

A global IT operating model enables local best practices to become more visible and to be shared globally, quickly. Explains one CIO: "Our internal express mail delivery system was developed in our Australian operations, and proved so valuable that we rolled it out globally." And by applying global data standards that align with worldwide business metrics, IT can help develop a common view of data—in essence, a "single version of the truth" that improves decision making in areas such as global supply chain, inventory management and customer relationship management programs.

Running IT more effectively and efficiently. Adopting a global IT operating model can also help companies reduce costs significantly. One CIO estimates that he drove costs down more than 35 percent by focusing on a global services footprint with rationalized and tiered service and support. He and his team rethought the sourcing of internal IT functions, moving operations that did not need to be close to the business—help desks, for example—to lower-cost company locations.

In Accenture's experience, the global management of systems and infrastructure also means that the IT investment portfolio can be managed more effectively. A global view of investment allows IT to work with the business side to focus dollars on the best internal platforms to build from, to take an aggressive approach to retiring applications as the global portfolio evolves, and to quickly roll out upgrades or manage emerging risks on current platforms.

With a global architecture standard (or at least with guiding principles in place), the business is better able to roll out new technologies. Global standards or principles also simplify the decisions made during an acquisition and reduce the amount of post-merger integration work required; this, in turn, speeds up delivery of synergies from the acquisition on both the IT and business sides. (For more on IT and post-merger integration, see "Reconcilable differences," *Outlook*, June 2005.)

By taking a global approach, IT leaders can also tap a broader talent pool as well as broaden career opportunities for their staffs. "Talent is location-agnostic," notes the CIO of a leading US industrial manufacturer with nearly 500 locations in 50 countries. Adds the CIO of an international brand-building firm: "With IT staff of necessity drawn from what used to be called the four corners of the globe, I've found the interaction within such a diverse group yields higher-quality solutions than when the old fraternity of American IT guys mirrored each other."

Roadblocks

Given the many benefits of a global IT model, why haven't more companies adopted it? Three roadblocks are most common:

Adopting a global IT operating model can help companies reduce costs significantly.

It is essential to have the executive team's wholehearted buy-in for the concept of a global IT model and what it will be designed to achieve.

the organization's limited global perspective; competing priorities; and general resistance to change.

If the business is operating with significant local autonomy, it is likely to consume IT resources accordingly and may not be amenable to taking global direction. In this case, IT leaders will have more success introducing global models if they focus first on internal IT changes, such as server consolidation, which usually require less business involvement. Explains the CIO of a large international marketing services company: "Too often, companies operate locally even when they have a global presence, a federated model with processes and workflows repeating in each market. IT cannot function truly globally in these circumstances."

Competing priorities are another impediment. When most initiatives are managed locally, or if there is no single global "burning platform," it is challenging to get the attention and focus needed to drive change from a global perspective.

And, as with any change effort, there is always resistance. This will be especially true in cases where individuals who have barely communicated suddenly need to work together in new ways, or where local IT managers see their spheres of influence shrinking.

Before such obstacles can be overcome, it is essential to have the executive team's wholehearted buy-in for the concept of a global IT model and what it will be designed to achieve. Their support of the changes required to get there is critical—to establish the communication and governance structures required for success, to secure funding and to position the transformation plan as not dependent on the CIO alone.

A clear business case primes the buy-in and establishes key metrics. In an exemplary case, one company's CEO clearly articulated a global IT perspective as part of his vision for global business, and today he meets regularly with the CIO and COO to measure progress.

Game plan

Moving IT to a global operating model involves many of the same challenges as executing a new IT strategy or managing the integration of IT functions during a big merger. Says the CIO of a major cable TV content provider, "The basics still hold: Align to company strategy, get the right people in the right jobs and communicate."

So what is the game plan?

1. Get ready to get going

The first step is to understand the business priorities and to gauge how a global IT operating model will help the organization meet those objectives. Once those considerations are clear, the CIO can start to think through the operating model design.

There are many design questions. What should the new organization structure look like? What will the global roles be? Where will those people reside? How much of the IT organization might still be controlled locally versus centrally, and what management needs to be in place in those locations? What changes must be made to existing governance processes now that decisions have a global impact? What specific skills and capabilities are needed to address emerging global business needs and to manage with a global span of control? How can these

How global IT redefined P&G's in-store promotions strategy

Procter & Gamble had a problem: The consumer goods leader's trade promotion management (TPM) capabilities had become inefficient.

In the retail business, TPM can be a significant expense category. It involves the processes and costs of special promotions paid by a producer to a retailer—for example, for a special one-week in-store display that includes a temporary price cut. For P&G, trade promotion management is essential for products as varied as Pampers, Tide, Crest and Duracell, and it must be managed across the 160-plus nations in which the company does business.

With such a significant investment worldwide, P&G needed a solution that would better measure the results of its promotions strategies. The solution had to be one that consistently identified the most profitable tactics or decisions that would optimize promotion spending in the future.

Procter & Gamble's primary challenge was coming up with a standardized, global way to manage, track and analyze trade promotion spending across its far-flung enterprise. Like many global consumer goods companies, P&G monitored its promotional activities on a country-by-country basis. In some regions, it used promotion management software tools; in others, promotions managers relied on complex spreadsheets. This disjointed approach was far more costly than it needed to be. In addition, management was not able to easily view promotion details across accounts in a standardized format—an impediment to crisp decision making.

The consumer goods leader set out to standardize its TPM capabilities worldwide. Specifically, its IT teams, working with P&G's promotion management teams from the United States to Indonesia, saw the value of building an application development capability that would streamline and unify the company's many TPM applications, improve productivity and lower P&G's total cost of application ownership.

Working with their external technology partners, P&G's IT teams designed, developed and rolled out a standardized platform for planning, funding, tracking and evaluating the company's trade promotion management activities worldwide. They paired their partners' top IT professionals in Bangalore, Manila, Milan and Monterrey with local P&G resources to identify region-specific integration needs, quantify the impact of the TPM system changes, forecast data volumes, and prepare the local business units for the new trade promotion management system and processes.

P&G's operations in Indonesia became the pilot for the project. The effort involved upgrading P&G's country-specific data repository and enhancing the TPM system and processes. The IT teams then oversaw changes to the core system's functional and technical design, transforming a regional application into a global, scalable solution.

So far, Procter & Gamble has rolled out six major releases of the global trade promotion management solution to more than 14 countries, and is set to distribute the new capability to thousands of users in more than 50 additional countries over the next three years. The improvements allow the company to not only manage its current promotions more efficiently but also to redirect promotion investments to higher-value activities and to plan yearly promotion activity more accurately.

As attention shifts to common digital applications and to Web 2.0 technologies, CIOs may find that infrastructure considerations are less important.

skills be acquired—built or bought—and what are the trade-offs of balancing internal know-how with external perspectives and skills? What metrics will best measure the value a global IT operating model is delivering against its targets?

The answers to those and many comparable questions can then be evaluated against the current baseline of IT assets and attributes—the applications and infrastructure footprint, the capabilities inherent in the organization, and the current organization structures and processes.

The resulting gap analysis drives both the business case and the implementation plan. It may reveal, for instance, that there are more data centers than are cost-effective for a fully global operation; that few managers have cross-border management experience; or that there is a significant "shadow IT" organization that will need to be brought into the fold if the full benefits of the new model are to be realized.

2. Build the case for change

Now, with a clearer view of the gap between where IT is and where it is going, the CIO must build the business case. This is crucial to engaging top management, to demonstrate business value and as an input to setting implementation priorities. It should include all relevant costs and investments, reflect both long-term and near-term priorities, and consider economic and other criteria—for example, supporting a "top three" business objective, improving time to market for key products or meeting the needs of the most important customers.

For example, if a company does not reconfigure its architecture to support common standards for digital media, it might not be able to share content across markets easily and create competitive advantage. Thus, the business case might identify several new sources of revenue available only if the company implements this capability.

3. Build a comprehensive, phased transformation plan

It will not be possible to effect massive changes in one fell swoop, so most CIOs pick their starting point based on the key business drivers, on ease of implementation and on the time it will take to start seeing benefits, as identified in the business case. Priorities will be refreshed over time.

One CIO notes that her group's transformation plan started with infrastructure, driven by Y2K demands and then moved along by the company's globalization and by growth in emerging markets, which called for much more extensive collaboration. Now, as attention has shifted to common digital applications and to Web 2.0 technologies, this CIO finds that infrastructure considerations are less important because the business value is generated elsewhere in her IT organization.

The transformation plan also has to be comprehensive—addressing not just the projects necessary to achieve target applications, infrastructure or information architectures but also the work needed to implement processes, develop new sourcing relationships, change the organization structure and build new capabilities. For example, it may be necessary to adopt new types of pilot processes. One CIO now pilots in at least three locations to achieve buy-in before launching global rollouts.

Note that while global governance processes will vary by company, having a process in place and adapting it over time are also critical to successfully managing the transformation plan.

4. Spend serious time on change management and communications

Frequent communication and strong change management skills are essential. As one CIO puts it: "You need to be like Mother Teresa to placate, like a kamikaze pilot to drive important initiatives and like Winston Churchill to negotiate the paths in a global world."

As with any major new initiative, it is not possible to simply "flip the switch." Most CIOs we know who have embarked on the transformation to a global IT model caution that it took longer than they expected, in part because of the many managerial subtleties and because of the myriad change and communications actions that had to be addressed.

CIOs who have been through big change programs know how important it is to take them step by step. Understanding that the highest hurdles are cultural and political, not rational, they invest time and effort early on in order to build thoughtful change campaigns that win strong support from those who will be affected.

Those CIOs also know there's no substitute for being there, and that bringing non-US operations into the fold requires on-the-ground time in those locations, assessing talent, understanding how things are working, figuring out which aspects of the culture or processes should be retained, gauging the risks of change and communicating the changes. Advises a Fortune 500 IT leader: "Be prepared that some regions may need to move more slowly. Flexibility in approach mitigates the risks of losing the benefits of good existing working relationships."

Implementing a truly global IT operating model is challenging, but it offers substantial rewards for both IT and the business. It requires continuous attention to managing the change, communicating success and keeping the transformation program relevant. IT must work to leverage its own scale, scope and global talent, and employ creative sourcing strategies to deliver value.

The reward comes when IT truly supports the global business. It means that IT has established secure global connectivity to enable collaboration and knowledge sharing internally and with customers. It is evident in standardized enterprise architecture that reduces costs and allows single views of data. And it shows up in the faster integration of acquisitions and the efficient rollout of new technologies to support the business. The CIOs who can drive this transformation will create opportunities for their IT organizations and help their companies compete more effectively in a multi-polar world.

About the author

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Can a new business model save investment banking?

By Robert P. Gach and James R. Sproule

Transparency, liquidity and increased oversight will be prominent features of the new capital markets landscape. The key to growth in this industry: customer-focused financial-product innovation that helps clients identify and manage risk.

The axiom is as simple as it is sobering: The current global economic downturn began with the sudden widening of credit spreads in August 2007, which precipitated a crisis that soon engulfed financial markets around the world. Until strength and stability return to those markets, there can be no sustained recovery.

The damage to the banking system has been staggering. As of the beginning of March 2009, banks worldwide had announced losses of $840 billion. Total damages could run as high as $1.4 trillion.

Capital markets and investment banking play a key role in the global financial system and the overall economy. They are an important source of the financing critical to the health of the economy, as well as the ultimate arbiters of where value is being created. This article focuses on that sector by exploring the five areas where the future shape of the capital markets will be determined.

1. Revenues

Revenues are being hit by the flight from complexity and a slowing economy. But new products will emerge that deliver transparency and reduce risk or offer the possibility of significant outperformance.

No amount of cost cutting or margin enhancement can compensate for steeply falling revenues in this sector. Yet robust revenues are essential to everything from innovation to the extraordinary returns that financial services have been able to generate over past decades.

At least in the longer term, Accenture remains optimistic. We believe that the demand for traditional financial products such as equities and bonds will continue its historic trend of running up to 3 percent ahead of the supply. This demand is driven by both global demographics and the clear need to save for retirement. Savings in 2008 alone totaled $5.8 trillion globally, and the trend will continue to support revenue growth as well as the creation of a host of new financial products and services.

Given their size, maintaining sales and trading revenues is crucial for investment banks' overall performance. Indeed, Accenture research has calculated that sales and trading accounted for 75 percent of investment banking revenues during the recent boom years. At the same time, traditional corporate advisory work fell to 20 percent of revenues (although advisory revenues rose to 40 percent of total revenues in 2008, in light of losses in the credit markets).

Before the credit crunch, the financial markets may well have reached a high point in terms of both margin and volume. But for management, this may not prove to be as controversial a notion as might be imagined.

As investment banks are absorbed into larger, traditionally more conservative retail banking operations, their ultimate parent organizations may be less willing to take on risk or pay out commensurate reward. In fact, some banks' managements may prefer lower but possibly more stable earnings. For an industry accustomed to rapid change and high profits, this would be a radical shift indeed.

Scope for recovery

Does this mean that a chastened industry will abandon the complex, high-margin products—entire new classes of securitized and monetized assets—that fueled the money-spinning trading operations before the credit crisis?

In analyzing what caused the house of complex financial products to collapse, two factors stand out: The potential for illiquidity should have been more carefully considered; and calculating liabilities for products was nearly impossible when those products had to move through multiple iterations to ultimately determine a valuation.

But Accenture believes that labeling all complex products as "excessively risky" is too sweeping a judgment. Although there have been clear failures across a wide range of new financial instruments, there is scope for recovery; it all depends on the product in question.

For products like collateralized debt obligations, the principle of diversification remains sound and relevant, and this alone points to an eventual rebound. Where a financial product's underlying principle or added value is less apparent—as is the case in a number of complex and illiquid over-the-counter instruments, such as credit default swaps—demand and, hence, revenues have fallen and will not soon recover.

Successful, profitable financial products will be those that address liquidity concerns, have transparent ultimate liability and still offer an attractive risk-to-return ratio. These are most likely to be based on cross-product complexity, the linking together of highly liquid financial instruments.

The high degree of liquidity would mean that each piece could be priced separately. At the same time, these products would tie the pieces together in such a way that they would offer investors attractive returns for risks undertaken. What margins these products will command remains to be seen. But if complexity is to be profitable again, it must be more transparent, more liquid and utilize a wide range of financial products.

Some banks' managements may prefer lower but possibly more stable earnings.

2. Risk and liquidity

Risk parameters have expanded to include liquidity. Efforts to increase liquidity and transparency will mean more on-exchange trading as well as new capital structures. At the same time, changes in accounting rules could promote the development of new structures that are capable of accepting illiquidity risks.

Although liquidity has always been vital to financial markets, the lack of it was seldom seen as a financial risk by investors and bankers—until the credit crisis. A combination of banks losing faith in counterparties that were assumed to be financially sound and a more general uncertainty about future losses as the economy slid into recession has led to a collapse in liquidity.

This collapse has already had a significant impact on bank balance sheets and will have a similar impact on future bank revenues and profits. Exact percentages naturally vary, but with some investment banks generating up to 50 percent of trading revenue from proprietary positions, it is clear that illiquidity can quickly impair assets necessarily held on a balance sheet as a natural part of business operations.

As a result, some more conservative retail bank managements and shareholders, even regulators, may seek to scale back investment banking operations that take significant proprietary positions. Clearly, there is a need for better reporting and pricing transparency, as well as for risk assessment and liquidity support. Ultimately, some capital markets firms may simply become less willing to accept risk than they were in the past.

Transferring risk

Where risks are known, informed judgments can be made about the wisdom of particular investments. The greatest danger comes, of course, where risks are unknown. Therefore, assuming that risks can be identified and assessed, an equally likely approach for other firms will be to transfer risk to new kinds of entities or to standalone divisions within more traditional existing institutions.

It is notable that funds simply write down the value of their investments rather than recapitalize their balance sheets. In a world where illiquidity risks are evaluated and these evaluations become an integral part of the calculations aimed at delivering outperformance, it may well be that fund-like structures become the most appropriate home for potentially illiquid financial products.

Concerns over liquidity are also going to have an impact on the once high-margin business of complex, custom-made derivatives. Banks are going to be increasingly unwilling to create illiquid over-the-counter financial products in light of investor reluctance to buy such products. This does not necessarily mean complex derivatives will disappear, but their use will increasingly shift to financial institutions that can better accommodate illiquidity risk.

For financial markets, the need for demonstrable transparency and liquidity is likely to lead to greater standardization and, thus, on-exchange trading. These moves will be further enhanced by the exchanges themselves, which will encourage liquidity providers to enter the market.

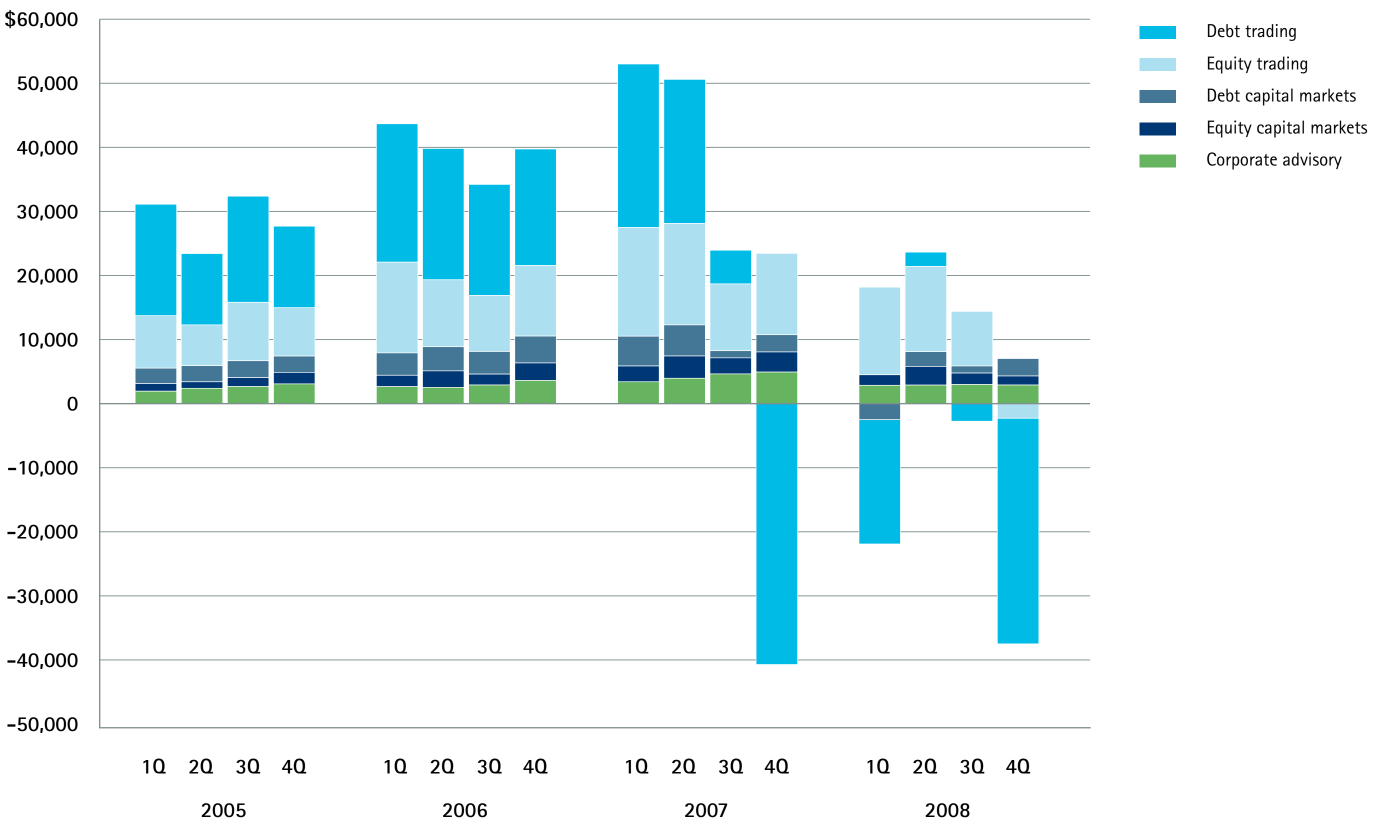
Once something approaching normalcy returns to the markets, so too will the desire for outperformance. When this happens, banks are likely to move away from structures where illiquidity and attendant capital requirements are an issue, and create new corporate structures better able to cope with significant market fluctuations.

In accommodating new illiquidity risks, banks and funds will be able to take advantage of new opportunities and a new route to outperformance. But the need for better transparency and reporting will be absolute. The premium on illiquid products is certainly likely to rise, giving higher potential returns to investors who are less constrained by immediate capital requirements. Hedge funds could be one of the principal investors to take on this risk as they look to maintain returns in a world of lower leverage.

The Great Collapse

Investment banking revenues rose significantly from the first quarter of 2005 through the second quarter of 2007, driven in particular by higher debt trading revenues. These revenues stalled in the third quarter of 2007 and then plummeted in the fourth quarter of 2007 as trading losses were accumulated and declared in year-end accounts.

Investment banking revenues, 2005–2008, $ millions



Source: Accenture research

3. Capital requirements

The rising cost of capital is likely to hit financial institutions' returns, and lending dependent on a deposit base is not going to be sufficient to fund long-term growth.

While arguments will certainly continue about the origins of the credit crisis, there is no doubt about its chief impact on the banking sector: Substantial write-downs of assets have left banks around the world in need of significant recapitalization.

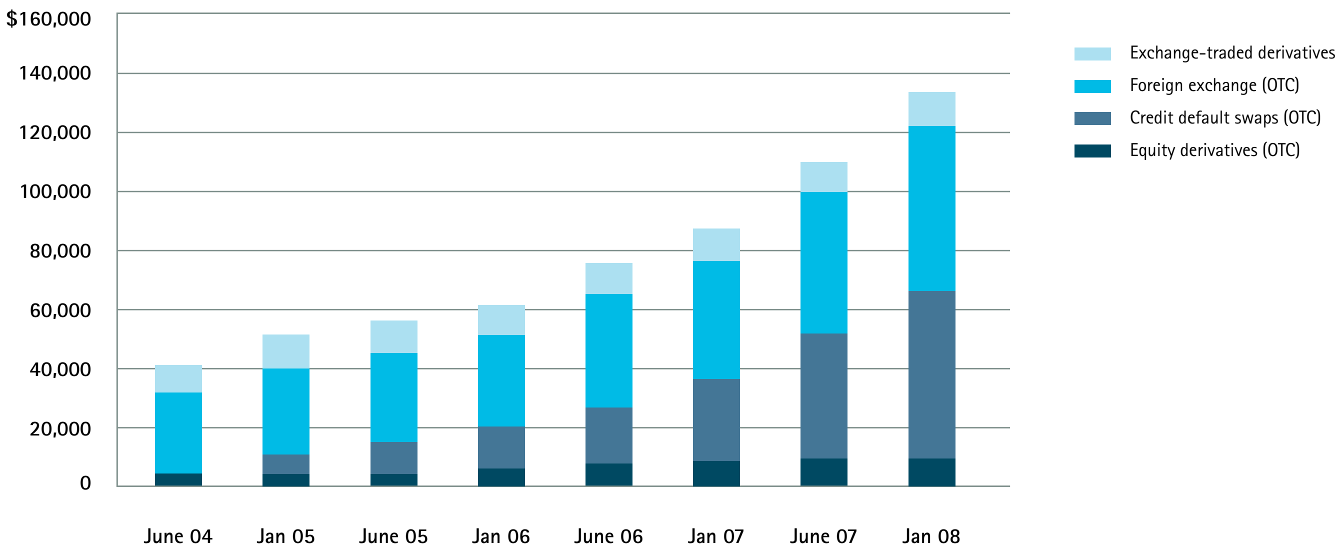
Part of the debate over bank solvency has focused on the application of fair-value accounting to complex financial instruments, something that becomes particularly complicated in illiquid markets. Prevailing rules have forced banks to "mark to market" products held on their trading books, resulting in valuations significantly lower than those implied by discounted future cash flow models. This undervaluation has amplified pressures on banks' capital reserves and has led to calls to recognize only realized losses and gains.

Proposed reforms include shifting a portion of trading-book assets to the banks' own accounts, essentially reverting to cost accounting and using the acquisition price and discounted future cash flows to determine an instrument's value.

A wealth of ideas

Banks and hedge funds drove the development and trading of innovative financial products over the past decade with the total value traded rising to $1.4 trillion in 2008.

Growth of financial products, $ billions



Source: BIS; Accenture research

Although this would ease solvency pressure, it would also mean less transparency for investors.

There is no clear and simple solution to this problem. But whatever the final outcome, capital adequacy will in all likelihood be the driving force in determining how firms and funds accommodate risks.

Revisiting leverage

Banks traditionally have had three principal sources of capital.

In the past, equity played a relatively minor role on banks' overall balance sheets—although this may well be changing with the injection of substantial government capital.

While banks will undoubtedly continue to use leverage, the higher cost of debt means leverage levels will fall, and banks will find it difficult to maintain their historic return on assets. A reduction in leverage from 95 percent of capital to 66 percent, for example, could reduce average ROE from approximately 15 percent to 10 percent.

Although there may be little risk of regulators stipulating leverage levels, more cautious integrated-bank shareholders will undoubtedly demand a curtailing of the appetite for the sort of high-risk business models traditionally favored by investment banks. Where governments have become shareholders, the appetite for risk is likely to be even lower.

Retail deposits have once again become a key source of funding, especially as a number of commercial banks absorb formerly independent investment banking operations and as former investment banks refashion themselves as bank holding companies.

Once established, a retail deposit base is a relatively low-cost source of financing and tends to be reasonably static. However, accumulating deposits is a slow and expensive process, and the most obvious way to attract more deposits—paying higher rates of interest—increases banks' cost of funding. In the medium term, growing an industry on a stable (even stagnant) depositor base is going to prove difficult.

For the moment, banks rightly remain focused on working through their current losses and assessing the length and depth of the global recession. In the medium term, however, banks will be unable to raise sufficient capital to accommodate future economic expansion unless they utilize the capital markets.

Banks, therefore, face two challenges. They need to reassure potential investors that in the future, they will not face the same risks that led to the present crisis. And they must find ways, without resorting to excessive leverage, to give investors an attractive return for the risks they are undertaking.

4. Innovation

There will continue to be a premium on financial-product innovation. But innovation will shift increasingly to the buy side. High fees will be dependent on demonstrable performance.

During the past decade, there has been a notable shift in power in the financial markets to the buy side, the end-consumer of most financial products. With this shift, sell-side investment banks no longer provide free research, control access to corporate clients, determine what financial products will be made available or, in many cases, even provide liquidity. This gradual change in the balance of power across financial markets has been accompanied by an equally important shift in the source of innovation.

Much of the recent innovation in financial markets has been driven by hedge funds. This does not mean, however, that fund managers are not feeling a good deal of pressure. Not only have their portfolios been decimated; even before the crisis, they were grappling with a number of challenges—the higher costs of doing their own research, a reduction in the number of brokers they could work with and significant competition from low-cost index funds.

The capital markets will nonetheless continue to see rapid innovation. But precisely where innovation will occur—and what sort of risks and rewards will be involved—shall be subject to a good deal of change in the future.

What is certain is that product innovation will be more focused on customer needs, such as liquidity and transparency, than it has in the recent past. This customer-focused innovation will ultimately include process innovation and other ways to help clients better understand and assess risk, including risk associated with products that have already been developed.

Adding value

The search for returns will force high-cost active fund managers, particularly at hedge funds, to look where few others have gone before. This will drive managers to increase their funds' presence in areas such as less liquid, small company stocks and to continue their expansion into private equity. Fees will become more closely tied to performance, which will reinforce the need for innovation. Firms that can build on this innovation—by adding value or allowing value to be effectively added by others—are going to be the industry's high performers of the future.

As for the growing sentiment that hedge funds are something of an endangered species, this is certainly a possibility. But if they do disappear, they will be replaced by actively managed, leveraged funds with broad mandates—in other words, a more highly evolved version of precisely the same thing.

Innovation may well require flexible capital structures. For products with an inherently high risk, it may well be that corporate entities that can accommodate illiquidity are more appropriate. These entities could be captives of larger integrated banks or completely independent.

As long as uncertainty grips the markets, large amounts of money will remain in cash or cash-equivalent instruments. Once this money reenters the market, there will be more than enough of it chasing top fund managers for them to maintain generous fee structures.

The rewards are potentially substantial. But more than ever before, they will fall to those who can deliver innovative instruments that offer a reasonable balance of risk and reward.

5. Regulation

Effective regulation will need to take a global, coordinated, flexible and holistic view of risk across all instruments and segments of the market.

The crisis in the financial markets has exposed two conflicting truths: Any regulatory scheme that does not seek to harmonize rules on an international scale is likely to be ineffective. But only a national government is going to have sufficient money and political clout to effectively underwrite a system in trouble.

What is needed today is a coordinated and structured global regulatory framework that actively identifies and manages shocks throughout the financial system. Moreover, any such global approach must strive to resolve a number of difficult and, at times, conflicting issues—including concerns over moral hazard and a culture of excessive risk taking; an increasingly interrelated and complex global financial system; and the lack of consistency across markets.

Clearly, reaching broadly based agreement on what such a system will look like and how it will function is going to be a slow and difficult process.

Emphasis on oversight

Regulatory regimes will continue to foster competition and support a technologically enabled market infrastructure. But there will be a new emphasis on repairing gaps in oversight. There has long been an appreciation that international regulation is both necessary and should have some sort of risk assessment at its heart. What is now also being appreciated is that regulation cannot separate financing into various constituent parts.

The Basel II accords basically addressed commercial bank capital adequacy with little consideration for what was going on in the wider debt capital market. While the system is an improvement on what preceded it, Basel II has put rating agencies at the core of its risk assessments. Risk weighting is undoubtedly to be welcomed, but there are serious questions about the ratings themselves as well as about whether the agencies were appropriately responsive to the credit crisis as it developed.

We believe regulators need to address five issues.

- **Accounting rules.** Fair-value, historic-value and mark-to-model systems all have advantages. Looking at where each system might be best employed and by whom has to be a pressing priority as banks rebuild their businesses. Strict guidance as to when each set of rules should be employed may be necessary, but a greater degree of flexibility certainly looks to be desirable.

- **Capital adequacy.** Rules for many complex financial instruments need to be reviewed. Transparency must be central to any solution, which obviously places a premium on the understanding of such instruments.

- **Emerging markets.** Countries such as India and China are already major players in the global capital markets. If these countries are to be financed rapidly, with minimum risk to investors and at minimum cost to local companies, new capital adequacy regimes will need to be created to draw them into new international agreements.

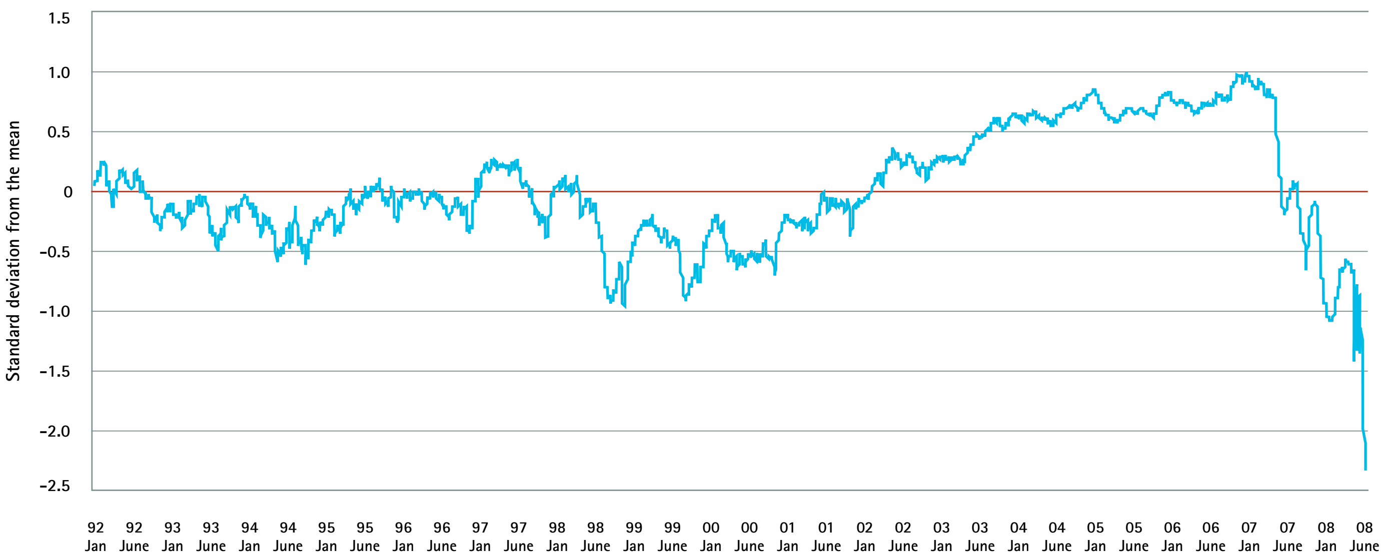
- **Regulatory scope.** Principles-based regulation will continue. However, regulators are going to take a much broader, more dynamic and interactive view of their role.

- **Transparency and liquidity.** Both must be improved, although how this will be achieved in full remains to be seen.

Cash strapped

The global liquidity index, which is based on nine different measures of liquidity that are then aggregated by the Bank of England, shows the total collapse of liquidity in the global financial system beginning with a severe contraction starting in August 2007.

Global liquidity index



Source: Bank of England

The real winners will be those who have been brave enough to use this downturn to acquire new market share at steeply discounted prices.

Looking to the future
Deriving a definitive forecast from these trends is not our intention. Rather, it is crucial to understand that each of the five factors listed above will be important—no matter which scenario we consider most likely.

Two important variables will determine the shape of financial markets in the immediate future: how the economy recovers and how those markets are regulated. These two factors are obviously intertwined. Overzealous financial regulation could hinder an economic recovery, for example, just as a quick economic recovery could cool the current enthusiasm for tougher regulation.

Looking ahead, Accenture envisions three plausible scenarios for capital markets, each with its own challenges.

1. Deep regulatory engagement
Governments around the world have invested unprecedented sums of taxpayer money in their banks, just when recession is biting deeply into the global economy. In the first scenario, in an attempt to protect these investments as well as to shield electorates from the worst ravages of the economic downturn, governments, through their regulators, take a highly active role in banking operations.

Under this scenario:

- **Regulators determine, or help to guide, broad levels of bank lending and terms of lending.** Historically, allowing political priorities to direct bank lending has seldom been successful. For the moment, there remains broad agreement that even where a government has invested considerable sums of taxpayer money, banks should be run at arm's length from politicians. However, this general agreement has not entirely muted calls for using the financial system for largely political ends.

The danger is that as recession progresses, political priorities overcome the best of government intentions to refrain from unduly influencing banking operations.

- **Businesses or activities deemed "too risky" by regulators are either discouraged or disallowed.** By stipulating what sorts of products are allowed, or by closely circumscribing products, regulators will discourage the kind of financial innovation and product creation that sustained margins and, at least in part, returns over the past decade. Yields would fall in the broader financial markets as demand drives up prices, and any economic recovery would be slowed by a lack of dynamic capital.

- **Regulators seek to influence, if not set, executive compensation.** The question of whether prevailing executive compensation schemes in the capital markets encourage disproportionate risk is a matter of considerable debate. For the moment, in those cases where no public money has been sought for a bailout, there is little regulators are proposing to do.

But where there has been a government injection of public funds, there will undoubtedly be some danger of the regulation of executive compensation. This may lead to a flight of talent to lightly regulated funds, where far higher compensation (for taking far higher risk) can be earned away from the glare of public oversight. Whatever the outcome, executive compensation will remain a highly incendiary political issue as long as taxpayer money is involved.

- **Regulatory compliance becomes a major expense and an effective barrier to entry into financial services.** Wide-ranging regulation would largely be dictated to the industry, which could become a serious burden. For example, regulatory compliance costs could rise considerably. As a consequence, competition would be reduced across capital markets as entrepreneurial firms would be discouraged from entering markets due to high initial costs and lower potential returns.

2. Ragged recovery

This scenario, which we consider the most likely, foresees a normal recovery in due course. A ragged recovery is, in many ways, proof that life is fair. Those financial institutions that were most excessive in their risk taking in the past would be punished. The survivors would be those that had been conservative in their lending, effective in their risk management, or large enough to withstand losses.

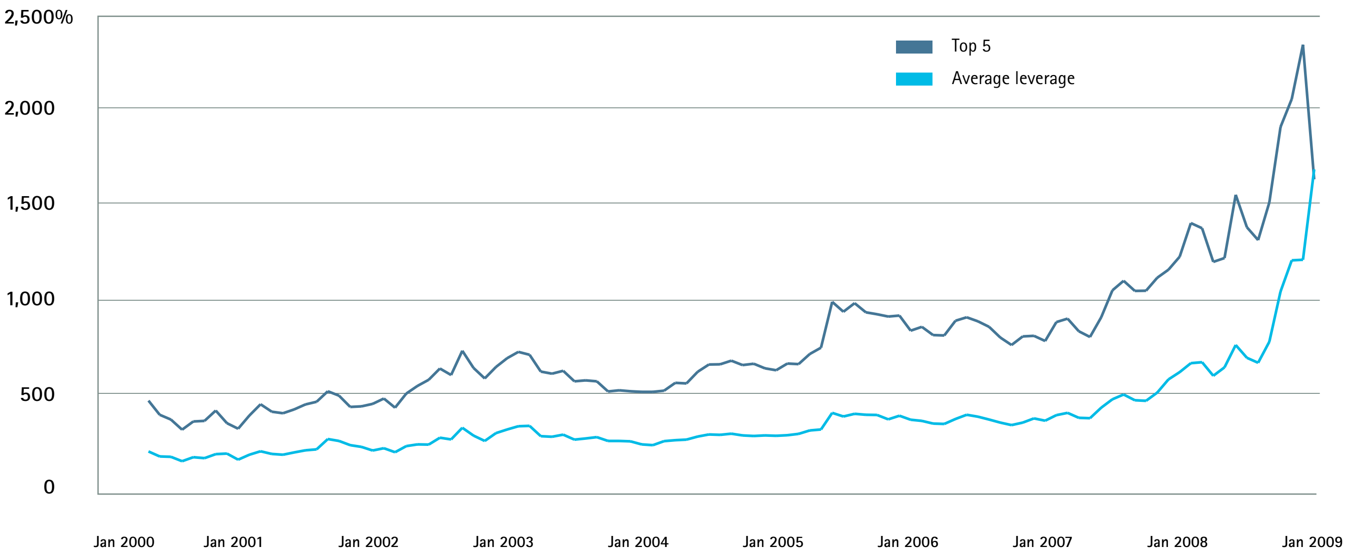
However, the real winners would be those who have been brave enough to use this downturn to acquire new market share at steeply discounted prices.

A renewed emphasis on transparency and liquidity is a certainty

Risky business

Leverage ratios at banks rose over the past decade and then began to spike in late 2007 as share prices fell. The five banks that had the highest leverage ratios since 2000 peaked at a ratio of 2,300 percent total debt-to-market capitalization.

Selected banks' leverage ratios



Source: Bloomberg; Accenture research

Innovation is likely to shift to products that transparently meet a specific need and to emerging-markets financial products where sustained outperformance is realistically possible.

and will be a feature of all three scenarios. But in a ragged recovery, once the financial markets begin to recover, so too will the desire for outperformance. For banks that have had difficulty coping with illiquid financial products on their balance sheets, the solution is not to abandon innovation but to move product innovation and complexity to new organizational structures that can cope with the changing marketplace.

The potential for financial product innovation is no more likely to fade than human ingenuity. In a ragged recovery, complex and potentially illiquid products are going to be manufactured, sold and held by entities that can cope with illiquidity. Furthermore, innovation is likely to shift from complex products to products that transparently meet a specific need and emerging-markets financial products where sustained outperformance is realistically possible.

As for regulation, under this scenario:

- Regulators take a supervisory and directing role only in those firms they have rescued.
- New dynamic risk measures are utilized by both investors and regulators.
- It is accepted that mistakes have been made by both firms and regulators, and that the concerned parties work together on the next generation of regulation.

Regulation would seek to be principles-based and flexible enough to respond to changing circumstances within the wider market. This will push regulators and the regulated to work cooperatively on an ongoing basis. The cost of regulation under this arrangement would rise and may, in the process, curtail new entrants into the market. But this will have only a marginal effect on overall competition.

3. Rapid recovery

Unlikely as this now might seem, the potential for the global economy to recover more rapidly than is being forecast must be considered. For the capital markets, the most important feature of this scenario would be a rapid return of those underlying factors that drove the business during the past few years: demand for financial products and the push into emerging markets.

Considerable amounts of investor capital have been withdrawn from markets over the course of 2007 and 2008. In a rapid recovery, this money would quickly reenter markets. This would not only automatically repair many balance sheets and boost pension funds, it would also provide capital for a renewed expansion.

While there would be a new regulatory regime, the expanding recovery would reduce the political pressure to use intrusive or draconian measures to punish bankers. Under this scenario:

- Regulators take a supervisory and directing role only in those banks they have rescued.
- New dynamic risk measures are utilized by both investors and regulators.
- Pressure for new regulations is lessened and international agreement becomes more difficult.

None of our scenarios foresees product complexity as it existed pre-crisis. However, a rapid recovery would quickly create demand for new products. This would lead to both a complexity of products drawn from across silos and a renewed interest in products from emerging markets.

This scenario would also take the pressure off politicians to act for the sake of acting, with the result that there would be relatively little regulatory change over the next few years. This would be particularly true for comprehensive international regulation, which, in the absence of an obvious imperative to act, becomes even more difficult to agree upon.

The danger of this scenario is that the lessons of the past few years are not absorbed, and that in the medium term, the imbalances that have led to the present difficulties will simply reemerge. And presumably, this is a path no one in the capital markets wants to go down again.

During the past seven years, financial markets were so buoyant that even capital markets firms with poorly conceived, undifferentiated strategies could prosper. But it is now clear that the business model that prevailed until the summer of 2007 was not sustainable. And any firm that seeks to resuscitate that model is bound to fail.

But turning their backs on the past is not enough. High performers in capital markets will be those who understand not only how the world has changed but also how, with the right market positioning, distinctive capabilities and performance anatomy, they can take advantage of those changes.

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How to make the most of the Great Consumer Trade Down

By Paul F. Nunes, Carolyn J. Polka and Larry Thomas

As discretionary spending all but disappears, companies must make adjustments in product mix, pricing, promotions and channel strategy to deliver the innovation today's customers value. By providing offerings with a clear range of desirable benefits and delivering them at the right price point, leading companies will be showing a clear way forward.

The global downturn has turned big spenders into penny-pinchers just about everywhere.

In Accenture's most recent global survey of cross-industry consumer sentiment, 67 percent of respondents said they believe it could take up to three years before they are confident enough to spend freely again. Until then, many said, they plan to shop at discount stores, avoid premium-priced products, postpone the purchase of big-ticket items like cars, eat at home more often and wait for the next sale.

These worldwide developments have left many in the retail and consumer products industries struggling to adapt. Not surprisingly, luxury and specialty goods companies have been gravely affected. But others are also feeling the squeeze—witness the bankruptcy of the popular mid-market US home furnishings company Linens 'n Things and the demise of the iconic Woolworths stores in the United Kingdom. Only discount chains and a few department stores seem to be holding their own—though even the recession-resistant are far from recession-proof.

Some managers might be inclined to take a long view, comparing recent events to previous downturns and looking at strategies that worked during troubles past for insight. Those strategies, however, are unlikely to be helpful.

It's a stretch to draw too close an analogy to the Great Depression, a time when consumer demand slumped so catastrophically and for so long that tens of millions of unemployed workers worldwide subsisted on handouts and meals from soup kitchens. Social safety nets across the developed world and high savings rates in many emerging markets should cushion consumers this time around. Besides, 80 years after the 1929 Crash, people spend very differently—with significant implications for industry.

Thanks to the relative decline in the real cost of most basic goods, and to the real growth in average wages in both developed and developing countries, shoppers in many markets now spend significantly more on once-discretionary categories like health care, education and transportation than they do on food and clothing. In many cases, they now spend nearly as much on categories like consumer electronics and entertainment as they do on necessities.

Coping with consumers' purchasing volatility—as recession-chastened shoppers continue to trade down and even out of many discretionary categories, at least temporarily—probably constitutes the biggest challenge for retailers and consumer goods companies. And it will remain so for some time if, as many expect, the quest for greater value at lower prices becomes a long-term trend. Meanwhile, ongoing uncertainty about consumers' real needs and desires will require companies to study their behavior and attitudes even more closely than usual.

Profound consequences

The consequences of the downturn are profound, not least for companies seeking to achieve or sustain high performance (see sidebar, below). It is important to note, however, that not all companies in all sectors are being hit with equal force. In a recession, how customers perceive cost-benefit trade-offs changes. They will start to value different elements of a product or service. In the current downturn, some retailers and manufacturers have actually benefited from this aspect of the trading-down trend.

Take the specialty-coffee drink sector. While sales of $4 lattes at premium outlets are slumping, drinks at less fashionable vendors, where a cup of coffee can cost at least 20 percent less, have been enjoying an upswing. It's a similar story in other food and restaurant sectors. Not only are consumers eating out less, they are favoring lower-priced establishments when they do. Indeed, shoppers in general seem to be seeking alternative sources for products and services that offer nearly the same benefit—particularly emotionally, like dining out with friends—but at a lower cost.

Still, many seem disinclined to give up life's little luxuries entirely, especially when treats like a night out can help lift the spirits. Chocolate appears to have particular staying power—especially if it's priced right. Chocoholics are eschewing premium truffles in favor of the good old-fashioned chocolate bar, giving the producers of more traditional, less expensive candy a much-needed sales boost.

At the high end of the income scale, the rich seem to be seeking solace in what some have dubbed "stealth wealth"—avoiding (or at least disguising) conspicuous consumption with a new emphasis on low-profile chic. In Beverly Hills, for instance, stores on Rodeo Drive report that customers are opting for less extravagant versions of must-have designer goods and are requesting plain white shopping bags for their purchases.

In some markets, luxury purchases have been holding up strikingly well. Sales at the French company LVMH, for example, which makes Louis Vuitton leather goods

Consumer behavior and high performance

Changes in consumer behavior and cuts in spending affect each of the five key measures that Accenture's High Performance Business methodology uses to define such companies—growth, profitability, positioning for the future, consistency and longevity. Declines in consumption can slow, halt and even reverse healthy revenue growth trends in leading companies that rely on discretionary spending. Profits are squeezed when consumers seek bargains and discounts. Future value—the portion of market capitalization above the value of current earnings in perpetuity—evaporates as shareholder confidence in future sales growth deteriorates, even for otherwise attractive offerings and business positions. Consistency flags as business performance becomes harder to predict and manage. And longevity of performance is threatened as consumers think twice about what—and where—they buy.

Even old offerings can look new when they are unbundled, although this tactic must be used with caution.

among other high-end products, are buoyant—especially in emerging markets, where the wealthy are less inclined to stealth and the company enjoys considerable cachet.

By 2015, wealthy consumers in Japan, China and Korea will account for 80 percent of total discretionary spending in Asia, according to a recent survey by MasterCard Worldwide. The number of affluent Asian consumers is expected to almost triple in the same period. Indeed, the burgeoning bourgeoisie in many emerging markets is helping keep consumer demand in these markets relatively robust. Hence, despite the downturn, leading global retailers, from Wal-Mart Stores to Sweden's H&M clothing stores, are still expanding in Asia.

Tactical adjustments

Rethinking what markets they choose to compete in will be an important strategic response for leading companies in these troubled times. But they will also make tactical adjustments to the kinds of products they sell, as well as to their marketing strategies, to help them achieve or sustain high performance.

By focusing on selling the right assortment of products (by minimizing those at the high end, for example), companies can boost margin and capture share. When one large home-improvement retailer reevaluated the assortment of lighting products it was selling, it found too many high-end items in some categories—a mix that was clearly out of alignment with consumers' increasingly frugal tastes. The company repositioned itself, emphasizing more basic styles and good or better price points, and selling the more expensive products only through special order. As a result, sales increased and so did overall category margin, allowing the retailer to make fewer markdowns.

New categories and products can also boost sales. One US department store chain tailors a portion of its merchandise to local tastes and conditions. By changing the clothing styles to suit the more conservative tastes of shoppers in certain parts of the country, the chain has been able to improve performance.

Or consider how Dollar Tree extended the range of food products that appeal to its thrifty customer base—introducing coolers and freezer cases in 150 locations to store more food, which has helped the discount retailer drive healthy sales growth.

Even old offerings can look new when they are unbundled, although this tactic must be used with caution and its effects frequently tested if customer expectations are to be managed. Still, if used correctly, it can be effective. Case in point: the move by most major airlines to impose à la carte pricing for the services customers use, including charging them for checked baggage. (Luggage handling is an expensive proposition for the airlines because it is so labor-intensive.) Although the move has not been exactly popular with passengers, they seem to have more or less accepted it—and it does appear to be helping the airlines' beleaguered bottom lines. One large US carrier, for example, has said it expects to collect about $275 million annually from first- and second-bag fees.

Meanwhile, adding pay-per-use options to services that are typically membership or subscription based, such as health clubs, can help make some consumers feel they are getting better value for their money—and attract new ones. So can reducing minimum-purchase requirements, as a number of luxury resorts now are doing by allowing shorter minimum stays.

Private labeling

The best-performing companies will also be swift to exploit the private-label opportunity the downturn presents. Accenture research shows that private-label products generate margins in excess of 15 percent more than a manufacturer's branded product. To be sure, companies that offer private-label goods may need to build and manage new sourcing and supply chain capabilities. But for many, the investment is worth it, especially because private label doesn't always have to be at the bottom of the value assortment. The key to success is to know the customer well enough to be able to identify specific opportunities; done this way, private label can be an important differentiator.

In Europe, where it's usually known as "own brand," the private-label concept is well established. For some years, the UK retailer Tesco has been leveraging the customer information gathered via its famous Clubcard loyalty card to divide its customers into distinct segments and create private-label products tailored to each one. The retailer's Finest range of relatively expensive own-brand food products, for example, caters to more affluent shoppers; its Value line, as the name suggests, targets families on tight budgets. Recently, as the UK recession has deepened and competition from deep discounters like Germany's Aldi has intensified, Tesco has recognized the change in customer preferences and introduced yet another range of own-brand discount products. (For more information on Tesco, see page 17.)

As cash-strapped US consumers modify their traditional loyalty to big-name brands, more stores have been introducing private-label lines as well. Even the upscale grocer Whole Foods Market has acknowledged its customers' increasing price sensitivity, offering a large number of private-label organic products. Non-food retailers have also been embracing the shift to store brands—witness Best Buy's Insignia brand of electronics and Home Depot's line of Hampton Bay ceiling fans.

Meanwhile, in an effort to lure customers away from more expensive department and specialty stores, retailer Kohl's now offers higher-end fashion lines such as Vera Wang. And in 2006, Target launched Go International, a designer line of limited-edition collections created exclusively for the retailer by brands such as Rogan, which is usually carried only at Barneys New York.

Old-fashioned practices

Many well-worn marketing practices are regaining favor during the current credit crunch, and the right ones, if used correctly, can help hard-pressed retailers and consumer goods companies stay profitable.

Anecdotal evidence suggests that haggling is back in fashion, for instance, and retailers should be prepared for it. They may need to train staff in the art of negotiation, or consider incorporating margin-based incentives into their compensation structure. Meanwhile, a once-popular form of "poor man's credit"—the layaway plan, which allows a buyer to select a piece of merchandise, leave it in storage and pay for it over a set period of time—is enjoying a revival among some retailers as a promotional tactic. Kmart made layaway the centerpiece of its holiday advertising,

Companies should be boosting their marketing budgets and exploiting the downturn to seize market share.

and soon after customer requests for layaway drove its sister store Sears to also offer the option.

A new firm, eLayaway, has updated the concept, allowing customers to choose products online from more than 1,000 retailers and arrange for monthly deductions from their bank accounts in return for a 1.9 percent service charge. Once payments are completed, the merchant ships the product to the consumer. The firm's customer base has grown tenfold in a year.

Discounting has also become widespread, even with high-end retailers. Saks Fifth Avenue abandoned a longstanding unwritten agreement between retailers and designers about when and by how much to cut prices when it slashed the cost of some of its designer goods a whopping 70 percent last November. The move was, of course, a prudent effort to get rid of clothing fast before the fashions changed.

Discounting may be an obvious way of trying to move unwanted inventory, but it can become a dangerous habit if customers get used to markdowns and start waiting for sales. And of course there are never any guarantees that it will produce the desired result: Despite Saks's steep price reduction, the store's January same-store sales still fell nearly 24 percent.

Coupons, by contrast, can encourage customers to try products and can raise the profiles of brand names. For example, Procter & Gamble, the largest advertiser in the United States, recently opened a retail version of P&GbrandSaver, the coupon booklets the company inserts in Sunday newspapers, in a temporary store in midtown Manhattan. There, visitors could receive advance copies of the P&GbrandSaver coupons, along with product samples and demonstrations for such brands as Clairol, Downy, Olay and Tide. In fact, 2007 was the first time since 1992 that coupon redemption rates in the United States did not decline from the previous year.

Tangible results

In a downturn, the power of sound pricing strategies increases appreciably. So, too, does the challenge of understanding its effects. Not enough companies analyze price changes after the fact to determine what worked and what didn't in terms of sales, margin or the speed at which a product moves off the shelf. As a result, they find it impossible to design better pricing and promotion strategies for the future. Leading companies, by contrast, recognize that pricing power does not weaken along with the economy. Resisting the temptation to give away pricing power, they instead take systematic steps to boost pricing efficiency (see "How to price smarter in uncertain times," *Outlook*, September 2008).

It's important to take a similar approach to promotions, which, if misused, can encourage customers to cherry-pick. And in the interests of preserving brand equity and earnings, successful companies will also resist the urge to cut advertising budgets in the downturn. In fact, if companies can afford it, they should be boosting their marketing budgets and exploiting the opportunity to seize market share—as the Japanese automakers did during the US recession of the 1980s.

Accenture research shows that advertisements are still the main source of product information for consumers. What's more, advertising boosts confidence in the brand, reassuring not only consumers but also the trade as a whole.

Capturing the attention of today's cautious consumers will be challenging. But leading companies are striving to make their messages relevant to the public's current mood—witness Hyundai's promise to take a car back if its purchaser loses his or her job. Leading companies are also carefully placing messages where today's customers are most likely to find them, and then systematically monitoring feedback.

Savvy companies will get ahead of the cash-strapped consumer's shift to multi-channel buying. Online sales have certainly soared since the downturn. Tesco, for one, is planning to launch a discount clothing section on its website to compete head-to-head with online discounter Asos, which has seized substantial market share in this rapidly growing segment.

Still, Accenture research shows that websites are less effective than either word of mouth or advertising as a source of product information for consumers. While cost-conscious companies should surely aim to boost their e-commerce capabilities—the Internet, for example, allows ever improving pay-for-performance marketing—they should also take care not to lose their focus on delivering a seamless and consistent customer experience from all channels: Web, catalog and store.

High performers know who their customers are and are able to establish and maintain a close and personal connection with them. In Europe's diverse markets, for example, leading retail grocers have benefited by adapting store formats to the communities they serve. Edeka's "50+" stores, for instance, appeal to older Germans by offering single-serving meals, places to sit, spacious aisles and shopping carts that attach to wheelchairs. Some of these features are popular with other demographics too. Younger single people like the meals, and shoppers with young children in tow appreciate the wider aisles.

As non-essential spending of all kinds shrinks, companies must look across the spectrum of their marketing efforts, making adjustments in product mix, pricing, promotion and channel strategy to deliver the innovation today's customers value. This sort of attention to detail may not resolve the big challenge of this downturn—the decline in discretionary spending. But by providing offerings with a clear range of desirable benefits, and by delivering them at the right price point, leading companies will show a clear way forward.

Indeed, for nimble companies with the right value proposition, the new frugality offers an important opportunity for growth.

About the authors

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Constructive tension

By Mark Foster, Daniel T. London and Eva Dewor

Enterprise risk management and enterprise performance management are really two sides of the same coin. To achieve balance between the two, companies must fully integrate risk management with their operating model, performance goals and decision-making frameworks—the layers of day-to-day accountability within the organization as well as the bigger rules and governance structures by which it operates.

The first truly global financial crisis has revealed the inherent weaknesses in the traditional approach to enterprise risk management, and the extent to which companies' current ERM processes and controls continue to place them in jeopardy.

Just as poorly planned and executed risk management capabilities contributed to the collapse, so now are they impeding the recovery. Effective risk management has always been about finding the right balance between prevention and proactive value generation. Risk management processes failed on both counts. Not only did they fail to prevent the snowballing economic crisis; once that crisis set in, the balance shifted too far in the other direction. From taking too many risks, companies decided to take none, and the credit markets essentially ceased to operate.

The goal of a new generation of ERM solutions must be the full integration of risk management with the operating model, performance goals and decision-making frameworks of a business—the layers of day-to-day accountability within the organization as well as the bigger rules and governance structures by which it operates. Enterprise *risk* management and enterprise *performance* management are really two sides of the same coin, and they need to be held together in a kind of constructive tension.

This tension frequently tests the limits of the entrepreneurial spirit each company needs to drive growth. To be sure, those limits must be firm and unambiguous. But there are times when a strong risk management capability should encourage a company to probe those limits. With closer integration, the risk and performance sides of the organization are kept in sync, working together toward a common goal.

What went wrong?

How and why did supposedly sophisticated risk management processes and systems fail so badly? There is no single explanation. Instead, a number of factors came into play.

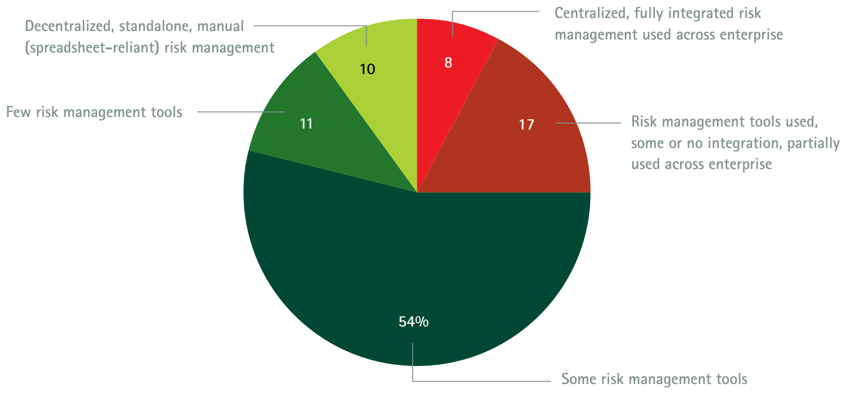
1. Complexity and speed
If there was anything unique and unprecedented about the market collapse of 2008, it was the speed at which events occurred, completely outpacing the ability of companies' internal systems and risk management capabilities to keep up. Companies tracked risk, to be sure. But like a home with old wiring, organizations with out-of-date risk management circuitry were overloaded by market events as the situation spun out of control.

2. Fragmented, incomplete information
An effective response to a certain kind of risk—market, credit, liquidity or operational—depends on rapidly gathering, aggregating and making sense of information from both internal and external sources. Most companies, however, struggle to derive insights from their internal information systems and to evaluate the impact of external events on their operations and business.

Leading organizations today are seeking ways to improve their ability to use internal information to drive more effective decision making and also to monitor external events to evaluate "contagion risk"—

A patchwork of tools and controls

According to Accenture research, most companies lack integrated risk management capabilities.



Source: Accenture analysis

If a company can't effectively manage performance, it can't adequately measure and manage the risks associated with that performance.

things happening with markets, business partners or other companies whose problems might then ripple into their own organization.

3. Non-integrated ERM capabilities
Fragmented information that impairs a company's ability to identify and mitigate risks in a timely manner is, in part, a reflection of the fact that few companies have truly integrated ERM capabilities.

Just 8 percent of the companies surveyed in the recently published Accenture High Performance Finance Study indicated they have a fully integrated risk management capability that is used uniformly across the enterprise. Slightly more than a fifth of them (21 percent) reported that their approach uses few risk management tools or a largely decentralized, standalone and manual process that relies primarily on spreadsheets (see chart, page 89).

One of the effects of a non-integrated ERM approach is redundancy, which leads to increased costs. Indeed, the expense of meeting risk management challenges is rising at a time when budgets are tight already. Respondents to a second recent Accenture ERM study—this one on enterprise risk management and based on a global survey of more than 250 CFOs, chief risk officers and other risk executives across multiple industries—feel that the costs of their risk management capabilities have increased dramatically. More than a quarter of the executives noted cost increases of between 25 percent and 50 percent; 14 percent cited increases of greater than 50 percent (see chart, page 92).

Companies need a more integrated approach to ERM—one that closely involves the business units in defining the risk management services that will enable better business decisions and support business strategies that are both bolder and less risky.

4. Inadequate enterprise performance management capabilities
Just as most companies have been slow to provide integrated ERM, so do they struggle to deliver effective and integrated enterprise performance management capabilities. Only 20 percent of respondents to Accenture's most recent High Performance Finance Study described their enterprise performance management capabilities as "advanced."

What that means from a risk perspective is that companies cannot adequately focus the risk management organization on what exactly it should be doing to drive better business performance. If a company can't effectively manage performance, it can't adequately measure and manage the risks associated with that performance.

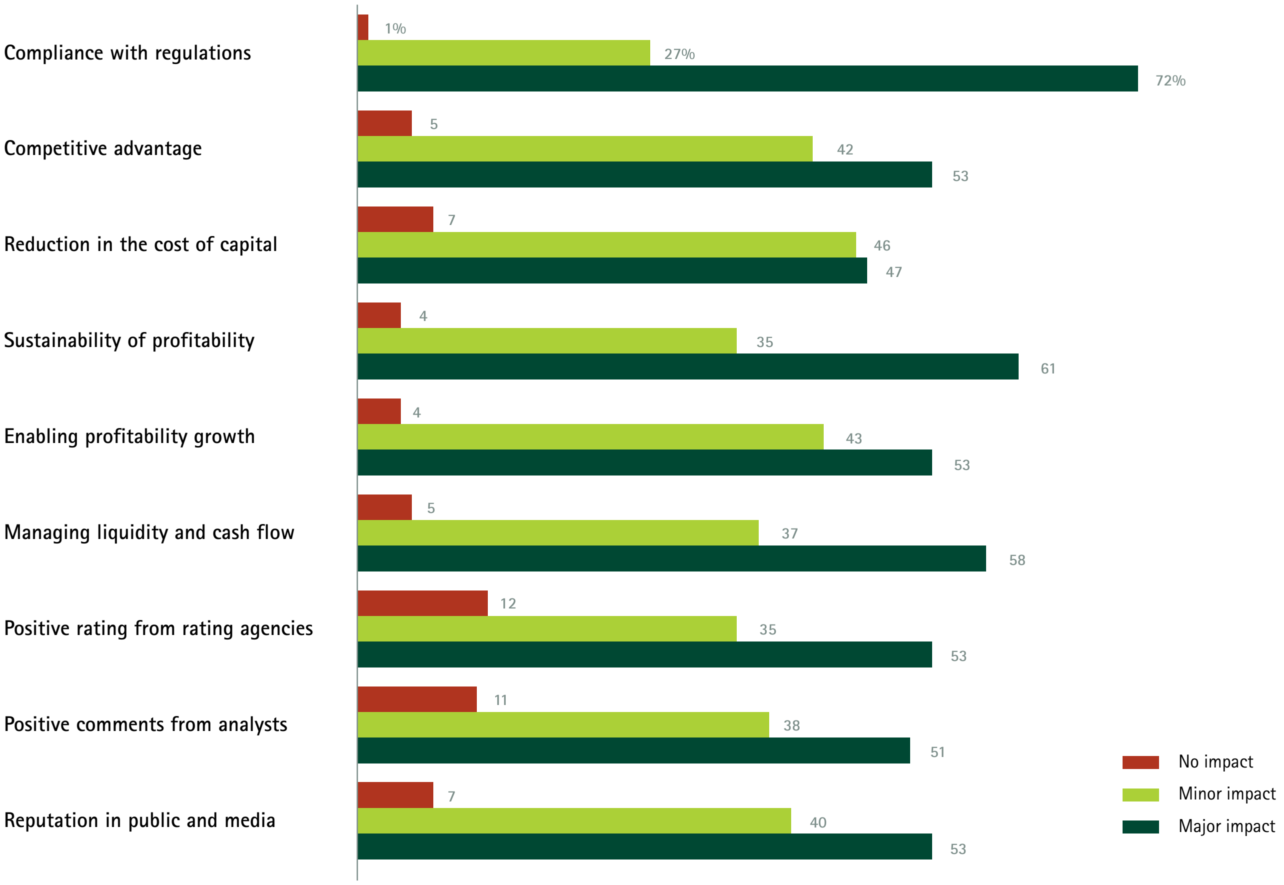
5. A compliance mindset
Regulatory compliance is certainly a critical component of good risk management. But if compliance becomes the only or dominant mindset of a company when it comes to risk management, it may compromise the company's ability to respond to today's marketplace risks. Accenture's ERM study shows that the vast majority of executives do indeed see the value of their risk management function primarily in terms of its impact on compliance (see chart, opposite).

But compliance alone cannot effectively define the risk management function or derive optimal value from it. Compliance tends to breed a top-down risk management environment and a merely reactive culture focused on ticking boxes on a checklist rather than proac-

Misdirected mindset

The vast majority of executives surveyed see the value of their risk management function primarily in terms of its impact on compliance.

Impact of the risk function on the business



Source: Accenture analysis

tively looking for ways to improve performance.

6. Inadequate governance structures and risk cultures
In a world of chronic volatility and data overload, it is not enough just to have information systems generating data. At the onset of the current economic crisis, the data was there. What was lacking was the judgment, governance and effective escalation processes capable of translating the data into action.

There must be management processes in place that establish effective controls and oversight so that risk mitigation is not the responsibility of just a few individuals, but actually expresses the will of the entire organization.

The new ERM

The risk management challenges facing companies around the world are clearly multifaceted. That means the solution must also be broad—covering not just an organization's processes and technology but also its leadership and culture.

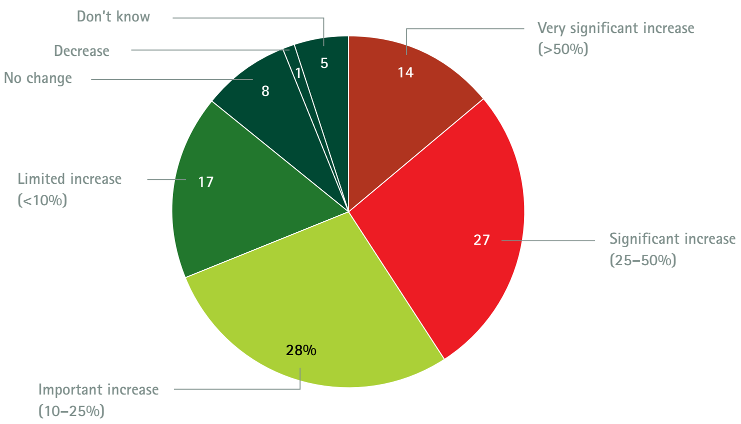
A new and more effective approach to risk management must be both comprehensive and cost efficient. It must have the kind of reach and specificity needed to restore public trust and enable business growth, while also delivering the cost savings that are critical during these challenging economic times. It must support the constructive tension needed to simultaneously set limits on entrepreneurial activities and encourage that sense of entrepreneurship—helping people take reasonable risks to fuel growth and better business performance.

1. Taking a more comprehensive view
In light of the lapses that contributed to the crisis of 2008, the best word to describe the new approach to risk management needed to protect and advance companies is perhaps *pervasive*.

Risk management must pervade the operating model of the business: into the kinds of meetings and reviews that are held and the questions that are asked; into governance and decision-making

An expensive proposition

Most executives believe that the cost of effective risk management has risen dramatically.



Source: Accenture analysis

How Vale centralized and integrated risk management

Vale, one of the largest private-sector companies in Latin America and the second-largest diversified metals and mining company in the world, has successfully implemented an integrated ERM program. Through an aggressive program of mergers and acquisitions, Vale altered its revenue composition and increased its total debt exposure from $4 billion in 2004 to $20 billion in 2007. The new ERM processes and systems were designed to address three areas in particular: market risk, credit risk and operational risk.

Market risk is managed by an effective governance structure involving the board of directors and an executive risk committee. This was a quick win that helped gain executive buy-in for the more difficult activities that were soon to come. Credit risk management was centralized, giving the function more control over company cash flow; a single tool to measure and monitor credit risk was also put in place.

Finally, to mitigate operational risk—the source of most risk for non-finance companies—Vale needed to improve its system for allocating and sharing resources across the enterprise and enhance its ability to monitor the risk exposures that might translate into financial losses within its operations. The solution was to align business strategy with operations, provide for a centralized allocation of capital to cover expected losses, define a corporate insurance policy, and control and monitor performance through an iterative and continuously improving system.

Vale's CFO was the primary sponsor of the centralized and integrated risk management program, which has enabled the company to manage multiple levels of risk under the same structure.

Its new ERM program has given Vale stronger compliance capabilities while enabling the company to avoid succumbing to a narrow compliance mentality. Improved, integrated risk management has bolstered Vale's operating performance, resulted in better capital allocation and enhanced the company's reputation and brand value.

One of the lessons of the subprime crisis is that many banks focused on a single performance measure—the firm's ultimate business performance—instead of how the company was performing across the various risk areas identified.

processes; into the training people receive, the management and leadership behaviors expected throughout the organization, and the rewards structures in place.

Effective enterprise risk management departs from the fragmented and compartmentalized solutions already in place at many companies. It offers a holistic view of the enterprise designed to identify and understand a variety of risks, and then feed that understanding into the growth engine of the company.

The new ERM embraces the two critical facets of any risk management activity: loss prevention and risk mitigation, the control-based aspect that focuses on negative events; and the strategic and entrepreneurial aspect, which focuses on aligning risk and reward to better evaluate risk in pursuit of business advantage.

Such a pervasive and integrated ERM approach is the exception today and not the rule. About 8 percent of the companies that responded to Accenture's ERM survey say they have attained such a goal. Information technology architectures are one significant constraint here. About 40 percent of the respondents use standalone technology solutions for risk management that are often mutually exclusive. Only 23 percent have a fully integrated IT architecture to help manage risk (see chart, opposite).

According to the Accenture High Performance Finance Study, an integrated ERM approach drives better business value. Companies that have successfully implemented this approach are more likely than their less-successful peers to say that their risk management capabilities have a high or extremely high positive impact on their enterprise's financial performance (35 percent versus 27 percent). These companies are also significantly more likely than laggards to be satisfied or very satisfied with their company's overall management of financial and non-financial risks (79 percent versus 33 percent).

2. Achieving better focus and specificity

One risk management strategy that sounds compelling is the effort to quantify risk through a metric or index, but this can take a company down the wrong path. Such an approach can decrease a company's risk management awareness because it does not provide the level of specificity needed to guide an organization toward specific risk areas. To know that your "risk management index" has risen 2 points may be interesting, but that kind of information is seldom actionable.

Indeed, one of the lessons of the subprime crisis is that many investment banks focused on a single performance measure—the firm's ultimate business performance—instead of on how the company was performing across the various risk areas identified. Companies need more transparency into their overall portfolio so they can diversify their risk capital needs and improve their performance.

One way to achieve this transparency is to use more diverse and sophisticated key performance indicators than just return on investment or return on equity. A series of risk-adjusted performance measures are also now critical to linking risk and performance. These measures help managers at the corporate and business-unit levels to act as shareholders by explicitly linking their decision making to value creation.

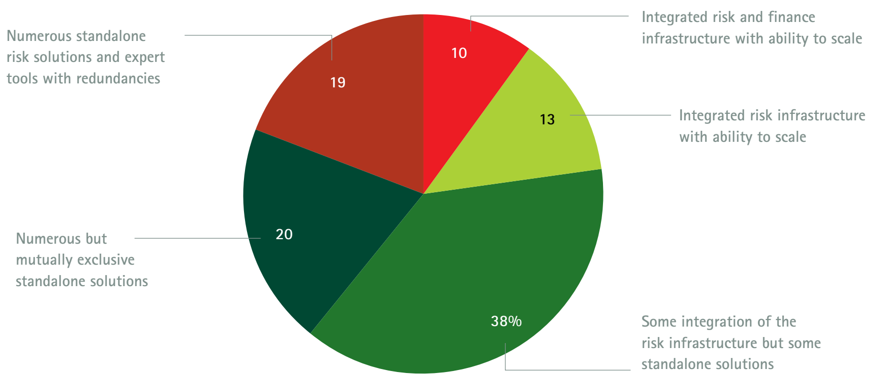
With a richer, more detailed risk profile, a chief risk officer can work with the business units to set priorities and, even more important, to put in place the staff and structures needed to work within the boundaries set by the risk identification process. Risk management must be articulated down to the actual behaviors required of relevant people in the organization.

Simply creating a risk inventory isn't enough. Risk management must be embedded in the organization's structures, roles and accountabilities. When it is, then a monitoring system or dashboard has meaning: One can look at various scores and take action, because they are at the necessary level of specificity.

3. Providing better data
All effective controls depend on the quality of the data provided: "Garbage in, garbage out," as the saying goes. In our experience, companies that have achieved risk management mastery have attained a high degree of granularity in their data. Again, this is in part a matter of operating according to the necessary level of specificity. Companies need the right information, in the right granularity, at the right moment to assess risks and take action.

IT impediments

Many companies report that they are constrained by an IT architecture that does not support a fully integrated risk management solution.



Source: Accenture analysis

The entire organizational culture must support the kind of detailed awareness needed to effectively manage risk.

One technique used by Accenture is what we call Continuous Controls Monitoring, or CCM, which uses information technology to mine the full range of a company's transactional data to assess risks and provide business insights. CCM improves compliance efficiency, but also can reduce costs and increase profitability by measuring the efficiency of internal processes and identifying such things as payment errors.

Continuous Controls Monitoring also improves overall risk management capabilities, because the monitoring process is based on 100 percent of transactional data instead of just a small sample. Typically, auditors—both internal and external—manually sample and review only a small portion of the total transactions and then use that data to project the overall results. CCM executes controls against the entire end-to-end business process. The result is a higher level of confidence and a reduced level of risk.

4. Creating a more effective risk management culture

A risk management organization is essential, and the work of the executive in charge—a chief risk officer or the equivalent—is now more important than ever. If risk management does not have a prominent place within the overall corporate agenda, and if it is not regularly reinforced at the highest levels of the company, it will not have sufficient power to drive the business in the appropriate direction. The chief risk officer should be a trusted and empowered member of the executive team.

At the same time, the market collapse of 2008 should also serve as a warning to companies that simply having a chief risk officer in place isn't nearly enough. The entire organizational culture must support the kind of detailed awareness needed to effectively manage risk. Successful risk management depends on an organization's people—all its people.

Companies must become much more rigorous in the analysis necessary to set a baseline cultural assessment and then measure progress toward a more effective risk culture. One asset at organizations' disposal is a more detailed framework for creating role-specific risk profiles.

This framework enables comparative assessment of the risks associated with any role—both the risk inherent in the role itself and the level and degree of risk managed. The risk assessment then helps identify those roles within the organization with which there is the greatest degree of risk associated, and therefore those for which controlling and remedial actions are most needed.

Another specific area to be addressed is the performance management structure, especially with regard to incentives. One pervasive problem in organizations is that performance targets are focused on the short term and thus do not encourage behaviors that create long-term, sustainable value.

The answer is to achieve a greater level of specificity—actually charting a new set of desired behaviors against the operating procedures needed to encourage those behaviors. The total rewards package can then be recalibrated to reflect a better balance of base and at-risk pay, lengthening the timescale over which deal quality is assessed and rewards paid out.

With a stronger culture and with better processes, technologies, controls and leadership in place, the chosen level of risk tolerance can be implemented consistently across the enterprise. When people know that a foundation of risk controls is in place, they have a better sense of their limits but can still be appropriately venturesome.

Effective risk management is more than simply a matter of mitigation, compliance and control, as important as these processes are. Risk and reward optimization must be embedded into the business lines and into the transaction and portfolio management processes so that companies can meet their long-term business goals.

By balancing risks and rewards—balancing enterprise risk management and enterprise performance management—companies link risk and profitability objectives, which can improve strategic capital decisions and increase shareholder returns. Companies can better coordinate risk measurement, capital allocation, performance assessment and management across the enterprise. Today, more than ever, organizations must be able to use the information derived from their risk management capabilities to make better decisions and drive high performance.

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The new talent equation

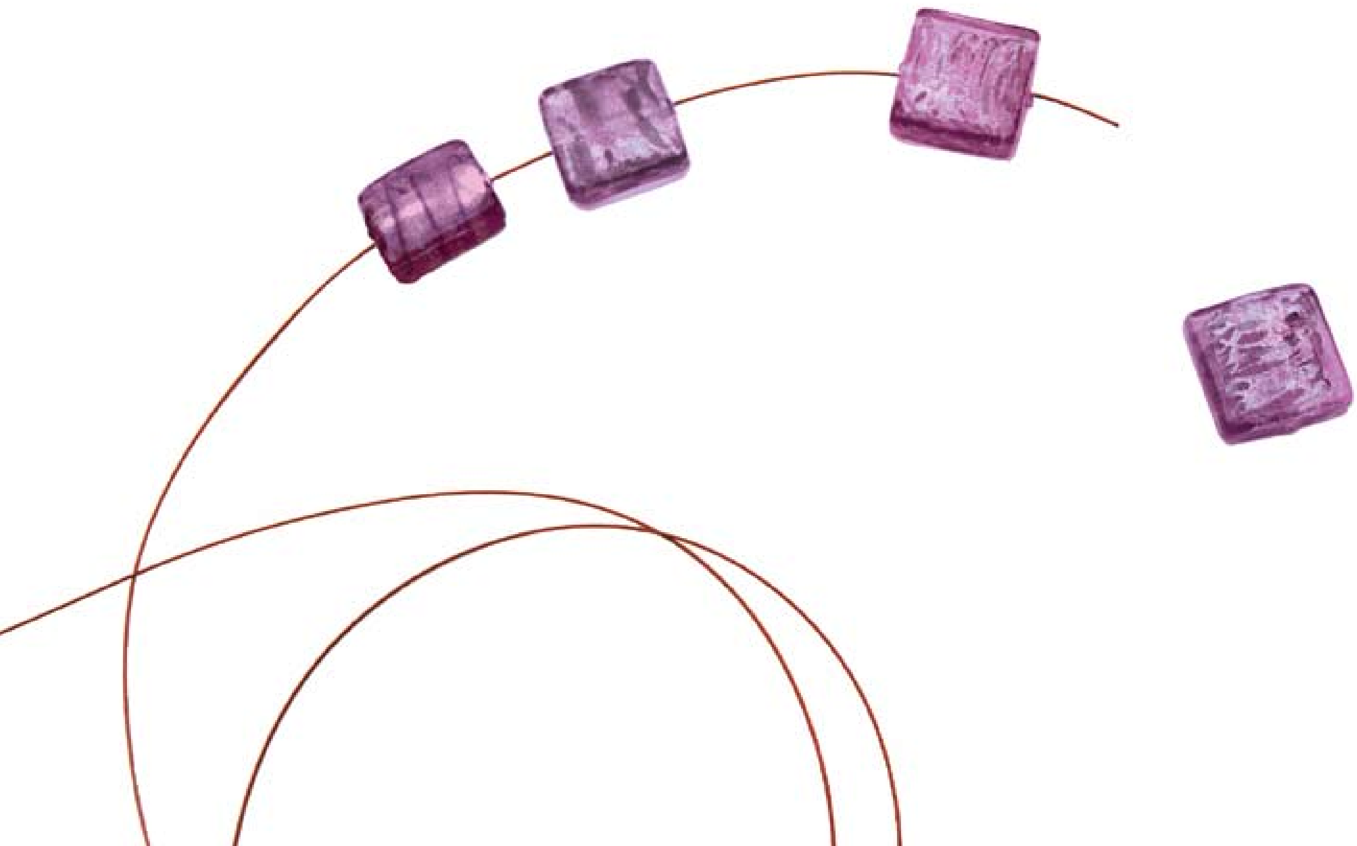
By Peter Cheese, Catherine S. Farley and Alan Gibbons

The objective at the heart of successful talent management in difficult times: to think ahead and to think more strategically about creating a workforce with the capabilities to outperform the competition as the economy turns around. A number of fresh approaches are available to help companies go beyond responses focused only on staff reductions.

These are anxious times for workers and the companies that employ them . . . or used to employ them. But for employers, it isn't only a matter of how to effectively manage workforce costs in the short term. Just as critical is finding ways to use the immediate economic crisis as an opportunity to refashion an organization with the people and capabilities that can create competitive advantage in the longer term.

For many companies, seizing on that opportunity is going to take some work. The current business and economic environment is exposing a host of weaknesses in the talent management practices of many organizations, as well as the lack of a comprehensive understanding of skills, capabilities, key workforces and top talent.

Indeed, in making decisions about the future of different jobs and roles, many companies are flying blind. Without a clear sense of which workforce capabilities are essential and which are secondary, what workforces are business-critical and what are not, who the top performers are and whose performance is average or worse, companies cannot make the right talent decisions.



The result can be the loss of high-potential talent along with critical capabilities, knowledge and relationships, and a diminished ability to perform and compete successfully. Given what appears to be the longer-term nature of this downturn, it is all the more important for organizations to get talent management right. And soon.

Fresh approaches

Talent strategy is, in fact, as important as any other part of an organization's overall strategy, regardless of the business conditions. Unfortunately, the harsh glare of the downturn has exposed the fact that the talent planning and management capabilities of many organizations are not equal to the challenges that lie ahead.

Once a first round of workforce reductions is complete, for example, then what? Such initial adjustments are relatively easy to make and are, for the most part, good for the company: Low performers are quickly identified, and the rest of the workforce rarely registers surprise at the choices made. But the next round of cuts, if necessary, is usually much harder, especially for companies with incomplete information about employee performance and capabilities. This kind of information is essential for achieving the objective at the heart of successful talent management in difficult times: to think ahead and to think more strategically about creating a workforce with the capabilities to outperform the competition as the economy turns around.

A number of actions and fresh approaches are available to companies to help ensure that their workforce capabilities and talent support their ability to stay competitive. With these approaches, companies can go beyond responses focused only on reductions. They can recalibrate jobs and salaries rather than simply cut positions or hours. They can identify the most strategically necessary roles, where hiring should continue even during a recession. They can support their workforce in new ways and increase opportunities for collaboration. They can identify the top performers who must be retained. They can finally act on the global sourcing strategies they've been considering to leverage talent in locations around the world.

Organizations can also do better long-term workforce planning, using this crisis as an opportunity to make changes they probably should have made years ago. And they can approach the downturn as an opportunity to develop a new generation of insightful and strong leadership.

Survival: Slashing jobs or slashing costs?

One mistake companies can make during a recession is to confuse eliminating jobs with eliminating costs.

Making across-the-board headcount reductions, without adequately taking strategic capability or areas for growth into account, can be damaging to longer-term positioning. One major retailer, for example, recently instituted a voluntary retirement program for its workforce without adequately specifying who was eligible. The result: the exit of hundreds of employees with a wealth of knowledge and experience that the company really didn't want to lose.

What organizations need is a more comprehensive approach to reducing workforce costs that does not compromise workforce quality.

Poorly informed cutbacks can weaken an organization in multiple ways. Such workforce reduction programs are damaging to the morale and goodwill of the company, and to the engagement and productivity of those workers who remain (see sidebar, opposite).

That damage can be long-lasting and especially insidious insofar as the extent of the problem may not be fully appreciated during the downturn. Temporary constraints on changing jobs may mean that voluntary attrition drops to near zero for a time. But high employee retention does not necessarily mean high levels of employee satisfaction.

For example, in a recent Accenture survey, the majority of more than 2,600 middle managers in 17 markets in North and South America, Europe, Africa and Asia Pacific said they were staying with their current companies only because they felt they had no choice. In addition to the 12 percent of respondents who are actively looking for a new job, another 60 percent said they would consider new employment but are not currently looking given current market conditions. Not a comforting statistic.

Indiscriminate workforce cuts can also weaken the ability of organizations to perform at competitive levels. Performance degradation can show up almost immediately in lower revenues and higher customer attrition. It also can damage the workforce in the longer run by taking out top talent that was simply unlucky enough to work for the wrong unit or location at the wrong time.

Some organizations are trying new, creative alternatives to reducing workforce costs—for example, reducing base pay or using variable pay scales linked to performance. Another approach is to cut hours for all employees or to require them to take unpaid vacation days.

In March, for example, California announced "self-directed furloughs" for state workers, requiring affected employees to take any two unpaid days of their choice per month. The state estimates this will save $1.3 billion through June 2010, at which time the furloughs will end. Only time will tell, however, what negative long-term effects such an approach—which amounts to about a 9 percent pay cut—might have on employee engagement and retention.

There are alternatives to cuts and layoffs of business-critical workforces. One major telecommunications company, for instance, has been actively seeking to lend its highly trained engineers to outside organizations on a temporary basis. The employees have the opportunity to work on fresh challenges at an equivalent salary, while the company is able to temporarily reduce headcount.

Such alternatives can be effective. But what organizations need in addition is a more comprehensive approach to reducing workforce costs that does not compromise workforce quality. To do this effectively, a company should do what Accenture calls a strategic role assessment—an evaluation of the entire workforce according to performance levels and the business value delivered by different individuals and roles (see sidebar, page 107).

How to identify strategic talent

Organizations have had varying degrees of success with a number of new approaches to cutting workforce costs (see story). But what they need in addition is a more comprehensive approach to reducing workforce costs without impairing workforce quality. To do this effectively, a company needs a better understanding of the different roles within its workforce and needs to conduct what we call strategic role assessment, or SRA.

The purpose of SRA is to identify strategic talent—individuals who are top performers relative to their peers and who perform roles that directly support an organization's strategic goals (see chart below). An assessment of the entire workforce, function by function and business area by business area, can be conducted, plotting people according to two spectrums: performance (from exceptional to low); and value (from mission-critical to nonessential).

This analysis then enables organizations to become far more nuanced and informed about how they invest in their workforce. Many organizations today routinely waste payroll budget by failing to set salary levels properly. The result: too much money paid to the wrong people and too little to the ones whose contribution is mission-critical. During these economic times, such waste is unacceptable, especially since payroll can represent from 40 percent to 70 percent or more of revenues for service or knowledge businesses.

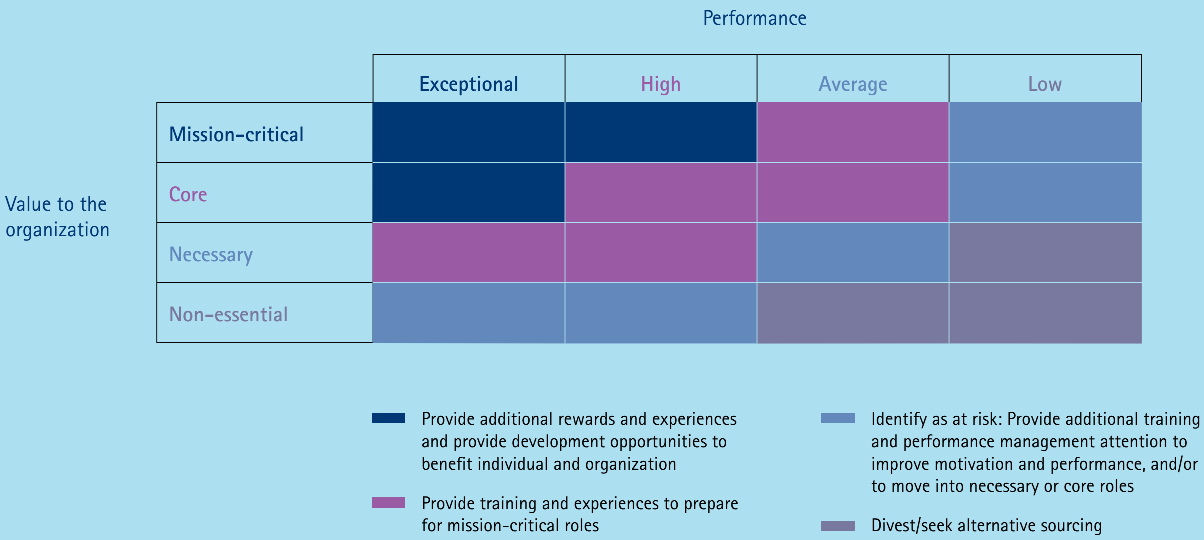
With the SRA approach, roles can be clearly segmented and reward decisions can then be made on a transparent and equitable basis, each job being paid according to its strategic value to the organization and market competitiveness. Base pay and total cash compensation levels can be set appropriately and then checked against local-market benchmark data.

One of the results of an SRA may seem counterintuitive during a recession: Some employees may actually need a pay *increase* because of their importance to the organization. This reinvestment is more than offset, however, by recalibrating the pay of "core" and "necessary" workers (depending on their performance grades) and by counseling low performers in nonessential roles out of the organization.

Of course, SRAs can also mean that some workers in fact receive salary reductions—perhaps back to levels from three to four years ago. Yet the assessment advantage from a cultural impact perspective is that the process is comprehensive and equitable. Management can say to the entire workforce, "We're going to use business-case data and workforce performance analysis to look at where strategic value is being created in the organization, and we're going to adjust pay scales in light of that assessment."

This approach also has the potential to encounter less resistance from labor unions. It does not unfairly target one location, factory or workforce segment over another. Its aim is simply to reallocate rewards where they will create the best return on investment.

The ultimate result of a strategic role assessment is a powerful compensation strategy that is tailored to the organization and thus difficult for its competitors to replicate. And the payoff can be significant: from 6 percent to 10 percent of total payroll costs over a one- or two-year period, with the added advantage of having a less negative effect on workforce morale and engagement. In fact, this is a strategy that can legitimately claim to protect jobs.



Source: Accenture analysis

Repositioning: Workforce planning that reinvents the organization

An economic downturn is actually a time to think much more boldly about what kind of talent is needed to drive an organization forward, how essential skills should be sourced, what an optimal culture would be and so forth. So in addition to addressing their most immediate workforce cost problems, companies must also engage in more comprehensive kinds of planning that can bolster their medium-term ability to reposition themselves. People are expecting change, and it's important not to let that opportunity go to waste.

Done well, workforce planning is a rigorous process in four phases. The first phase begins by getting a handle on the demand side of the workforce equation: What kind of workforce with what kinds of skills is needed to execute business strategy? What are the critical workforces that need to be filled with top talent—near term and long term?

In the second phase, attention shifts to the supply side. First, what's happening? What impact does the fact that people are generally less inclined to leave a job voluntarily during a downturn have on the overall workforce mix? Does it slow the advancement of some emerging talent? What impact do those who are leaving have on organizational knowledge and experience? Is the organization capturing the critical knowledge of top talent before they leave or retire?

Next, look at what's happening externally. It has become clear during the past few years that demographic changes and educational shortfalls are having a profound effect on the ability of companies to source and retain the kinds of workers needed to propel the business forward. Employees now entering the workforce—often called Generation Y or Millennials—are often less inclined to work on the terms long accepted by their parents; they're usually looking for a more balanced life, they have a strong focus on meaningful work and they want to work for companies with a social conscience.

The third phase of the planning process analyzes the gap between workforce demand and supply, which leads to the final phase: the development of the actual plan. The options available to companies at that point are especially important to repositioning the workforce for challenging economic times. They include the following.

Global sourcing and recruiting
A recent survey conducted by Accenture in collaboration with the Economist Intelligence Unit found that companies are increasingly turning to global sourcing and delivery in lower-cost countries not only as a means of reducing costs but also as a way to improve productivity, increase the pool of available talent and complete critical projects at a faster pace.

In the research, which surveyed executives across the Americas, Europe and Asia Pacific, 22 percent of respondents said they have seen direct business cost savings of more than 20 percent through global sourcing. Seventy percent have experienced increases in business productivity from global sourcing, and more than half have seen improvements in the quality of both business and IT performance.

This global perspective on the sourcing of work must also inform the way a company sources workforce talent in general. Companies need to be flexible in finding and recruiting talent wherever it exists. The shortage of leadership and of other critical skills has led to a much stronger focus on global talent sourcing in recent years, and the economic downturn makes that perspective all the more important.

Accenture's most recent study on the multi-polar world ("Strategies for achieving high performance in a multi-polar world: Global choices for global challenges," 2009) found that 51 percent of high performers (versus 34 percent of low performers) are likely to seek to expand their workforce in foreign markets, both by increasing the number of markets where they recruit and by expanding in markets where they already recruit.

Outsourcing and contingent labor
Using contingent workforces or temporary and contract labor is one way to shore up important capabilities without incurring the costs associated with long-term employment. But this approach carries risks. The longer-term loyalty of temporary workers and their alignment to a company's goals and strategy are more doubtful. How much to invest in their skills building and development is also a question, so bringing in these kinds of workers is usually done with specific skill areas in mind.

Shared services and outsourcing approaches are other ways to reap the benefits of a variable workforce. Today, as in previous downturns, there is growing interest in outsourcing, especially for particular types of jobs. Non-core activities, areas of the business where attracting and retaining talent may be harder, or more repetitive transactional or analytical tasks where it is important to reduce costs without losing quality can be appropriate for outsourcing or partnering options.

One grocery retailer found itself in a situation where it could not effectively retain salaried workers in the forecasting function—an essential job but one involving repetitive analytic and reporting responsibility. The company's solution was to find an outsourcing partner that could provide a reliable source of forecasting experience and knowledge.

According to the company's senior vice president for planning and merchandise control, "The forecasting group involves very technical kinds of skills and experience, and so I prefer having a resource that can provide me with the very best people on an ongoing basis and who have a bigger pool of talent to draw from."

Retraining and redeployment
For companies working to turn talent into business advantage, retraining and redeploying that talent is another critical part of medium-term repositioning. If a workforce analysis finds exceptional performers in jobs that must be eliminated, it is vital that companies find the means to retain those performers by matching them to more strategic roles.

Last year a global carmaker halted production of several models at a number of its US plants. But

The shortage of leadership and of other critical skills has led to a much stronger focus on global talent sourcing.

High-performance businesses ensure that their workforces are continuously equipped with the technical and managerial skills needed to respond to a changing global business environment.

instead of letting the 4,500 affected workers go, the company opted to retrain these workers for new tasks and roles. Training classes included productivity improvement, materials handling and workplace hazards, diversity and ethics. According to one of the company's managers, "This was the first chance we've really had to live out our values. We're not just keeping people on the payroll because we're nice. At the end of all this, our hope is that we'll end up with a more skilled North American workforce."

An organization's ability to share knowledge, to deliver effective learning at the right time, and to capture experience and critical knowledge has never been more important. Learning is an essential talent management capability, but it is often the target of cost cutting in tougher times.

Now is the time to embrace and employ some of the new ways of learning and sharing knowledge. Web 2.0 technologies can have a huge impact on how people connect and learn, at lower delivery costs. When almost every organization is cutting back on internal expenses, collaboration tools and Web 2.0 communication approaches represent a real opportunity to keep people connected and engaged.

Our research has found that high-performance businesses ensure that their workforces are continuously equipped with the technical and managerial skills needed to respond to a changing global business environment. Nearly nine out of 10 high performers—compared with fewer than six out of 10 low performers—have established an academy approach to learning, which more formally recognizes the key skill areas and learning programs they need to keep the capabilities of mission-critical workforces fresh and relevant.

Talent acquisition

A general slowing of the recruitment engine is inevitable during a recession, but smart companies will never turn it off completely. But isn't hiring during a severe downturn virtually unthinkable? In fact, skill shortages will remain and may even be aggravated in a downturn because the need cannot easily be masked. Many companies have discovered that they cannot entirely shut down university recruiting and then immediately restore it to full strength somewhere down the road. Some companies have taken years to reestablish a campus recruiting foothold after suspending their presence for an extended time.

Smart companies will also keep an eye out for skilled workers who in good times may have been too difficult or expensive to attract but who are now available thanks to workforce reductions in other companies.

Hewlett-Packard owes much to this mindset. Jim Collins, author of the bestselling books *Good to Great* and *Built to Last*, related in a recent interview that "if you go back in history, a few companies used difficult times to bolster their legions of talent. After World War II, all the government labs were shutting down, and engineers were streaming out. Hewlett-Packard was actually going through a layoff. But at the same time, Bill Hewlett and Dave Packard said the greatest opportunity they ever got wasn't technology; it was the opportunity to hire those engineers."

Keeping employees engaged in tough times

By Elizabeth Craig

During an economic downturn, keeping employees engaged—aligned with and invested in the company's current business strategy, and energized to overcome challenges—can be particularly daunting. But it can also make a critical difference in competitiveness.

Various studies have shown that highly engaged workforces produce better business results than disengaged workers—measured in terms such as higher productivity, improved customer satisfaction and better employee retention. But where do you start when you want to achieve those kinds of results?

Given the bewildering variety of approaches to raising engagement levels, many organizations may simply try to pull as many levers as possible—often in ways that do not really engage people or improve business performance. Without a deeper understanding of what inspires employees to engage, it is difficult for companies to set priorities for engagement initiatives, or to bring about substantial and lasting improvements in engagement.

One thing is important to note: Improving employee engagement is not necessarily expensive. Indeed, many of the things that really matter to a workforce don't cost anything at all.

To identify and understand the drivers of employee engagement and the appropriate organizational responses, the Accenture Institute for High Performance recently conducted a survey of more than 1,200 employees in large US companies across several industries. Our research highlights three keys to improving employee engagement.

Build a culture of trust and respect for the individual
Our survey found that people are four times more likely to be highly engaged in the success of their organization when leaders behave in trustworthy and predictable ways. When a company is downsizing, it needs to work particularly hard to retain employees' trust. It's usually not layoffs themselves that threaten engagement; it's the way they are handled. People are more likely to engage when critical business decisions are fair and transparent and are communicated by leaders in an open, honest and proactive way.

Trust and respect matter. People who perceive that fellow employees are treated with respect, dignity and attention to their positive self-regard are five times more likely to be highly engaged than people who report low trust in and respect for their organizations and leaders. Employees who do not feel respected are 17 times more likely to be highly disengaged than those who do feel respected. Simply letting employees know that their efforts are appreciated can boost engagement.

Create meaningful work and career opportunities
Leaders, particularly in uncertain times, must offer a clear and compelling direction and vision for the future and help employees understand how their work relates to the organization's goals. Individuals' sense of meaning and purpose in their work derives, in part, from an understanding of their roles and how they align with the objectives of the organization. Our research found that 72 percent of people who believe their work is significant are engaged, whereas only 24 percent of employees who see little significance in their work are engaged.

It is also crucial that employees have opportunities to develop themselves and advance their careers. Our research found that 60 percent of employees who report they are building skills and experience that will help them attain career goals are highly engaged, while just 7 percent of people without such opportunities are highly engaged. People without opportunities for career growth are 13 times more likely to disengage at work.

Support employees' well-being
Because stress is high in challenging times, maintaining the energy and well-being of the workforce is critical. Demanding long hours during the week and on weekends may deliver some results in the short term, but only at the expense of a long-term depletion of workforce energy. Our research indicates that when companies manage work demands so that people have opportunities to recover from stressful situations and overwork, employees are twice as likely to be engaged than when they have no chance to recover from their exertion.

Companies can also support engagement by providing critical resources, including information, additional training, increased autonomy, staff, and enabling tools and technologies.

When faced with budgetary constraints, organizations often first slash many of the resources that support employees. However, in our research, people who reported that they had the resources they needed to do their jobs effectively were nine times more likely to be highly engaged than those without them. Maintaining core training, connecting people across the organization to help them support one another, and encouraging knowledge sharing are all important measures to take to support employees.

By cultivating the three conditions explained here, companies lay the groundwork for employee engagement—inspiring their talent to help the organization survive these challenging times and achieve high performance.

Growth: The importance of leadership development

All of the actions discussed to this point—workforce assessments and planning, retraining, global sourcing of work and talent—contribute to an organization's ability to position itself for growth when the economy begins to turn around.

One last, crucial element in turning talent to business advantage during this recession, however, remains: leadership development. It is no exaggeration to say that today's economic crisis is a leadership training and testing ground, under the most stressful conditions. So every organization must step up and use the current economic situation to test and develop its next generation of leadership. At the same time, it must also make sure it is looking after its current leaders, communicating with them and supporting them.

Here, insights from our colleague Bob Thomas's recent book, *Crucibles of Leadership*, are especially appropriate. In the book, he argues that what matters most in leadership development is not just innate capabilities but what one makes of experience—particularly the traumatic and often unplanned crucible events that challenge one's identity as a leader. As Thomas writes, "The ability to find meaning and strength in adversity distinguishes leaders from nonleaders." (For a related article, see "Turning experience into leadership," *Outlook*, January 2008.)

The point is to turn the current economic situation into a learning experience that can benefit current leaders, as well as those who will form the next generation of leadership. Burt Tansky, CEO of Nieman Marcus, noted recently: "I've been telling many of our young people who have never been through this [kind of downturn] to study what's going on today, study the kind of things that are being put in place to minimize the stress, because as their careers develop, they're going to have to face some of this again."

The next step, then, would be for organizations to institutionalize those insights into what's happening today and use them to advance leadership capabilities throughout the organization.

Honda Motor Co., for example, has historically used work projects as the foundation for developing leaders. Honda project managers are expected not only to produce results but also to create a learning contract with the company around the leadership skills developed during the course of the project. Applied to a recessionary environment, that kind of project-based, experiential approach to leadership development can make young leaders attuned to what they are learning, and help them share experiences with their peers.

It is easy enough to say that companies that can rally their people will have a better chance to thrive during and after the economic downturn. But effective talent management is not simply a matter of exhortation or charisma. Close, comprehensive and scientific analysis of the capabilities needed to achieve high performance is vital.

If workforce cuts must be made, a scalpel and not a machete is in order. That is, the types of close analysis discussed here—strategic role assessment and comprehensive workforce planning—enable organizations to plot a path forward that is far more informed about what skills the company needs, who in the workforce has those skills, and how such skills can be sourced in the most cost-effective manner if they cannot be found or developed internally.

It's workforce talent that is feeling the effects of today's economic crisis most profoundly. At the same time, this crisis could well be the period when strategic talent management finally comes of age.

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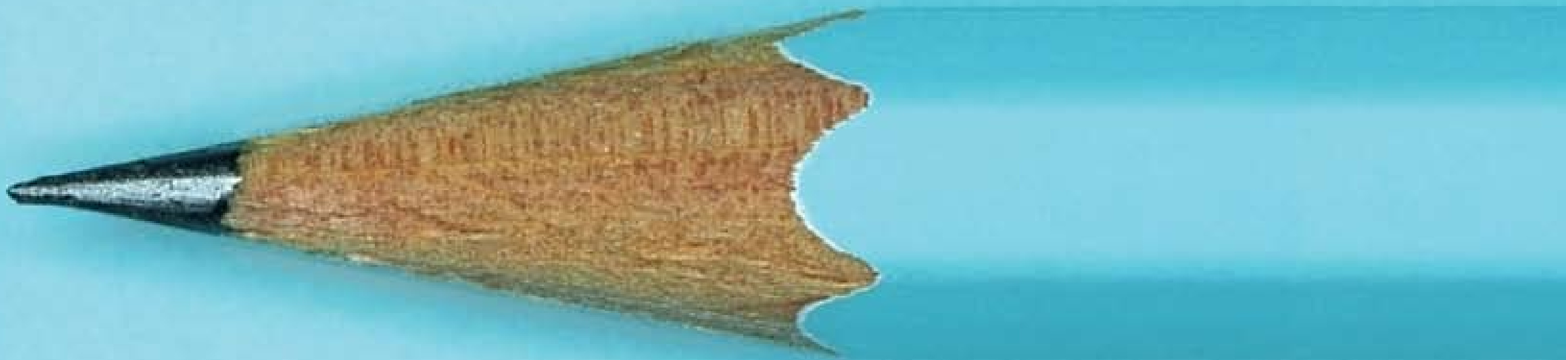


Private practices

By Andy Tinlin, Markus Rimner and Rajesh Sennik

The downturn is driving private equity firms away from an emphasis on deal making and toward a new focus on operational improvements—a shift with important implications for public companies.

It was deal making on an unprecedented scale: Between the start of the latest buyout boom in 2002 and the onset of the credit crunch five years later, private equity firms acquired and co-invested in $3 trillion worth of assets globally.

Inevitably, with so much money flowing in, competition for assets intensified during this period. And as more players acquired the financial engineering skills pioneered by private equity firms, assumptions about gains from balance sheet restructuring started to be built into bids. Indeed, by the time the credit markets ground to a halt in July 2007 (see page 73), it was not unusual to see a host of private equity firms bidding for the same asset. As a result, the sellers of the asset were in many cases getting more of the financial upside than the buyers.

So where does the private equity industry go from here?

Even before the credit crunch, some firms were shifting their focus from clinching new deals to the challenge of boosting returns from those already done. And during the past 18 months, prompted by the dearth of deal-making opportunities, others have joined them.

Leading firms, in fact, now work with a new value-creation toolbox, with a focus on effecting the operational improvements in their portfolio companies that can boost cash flow and fuel higher operating profits. To achieve this, they have strengthened their teams by recruiting seasoned executives and advisors who can support portfolio company management teams in identifying and driving those operational improvements.

Since portfolio companies are in a wide range of industries, the most effective approach for most private equity firms is to develop a toolbox that can be similarly effective across industries. Private equity firms, therefore, have been zeroing in on a few key operational areas.

This has broad implications for public companies. Significant operational improvements among companies owned by private equity firms could make them much more daunting competitors. At the same time, however, public companies can learn from the approach private equity players are taking.

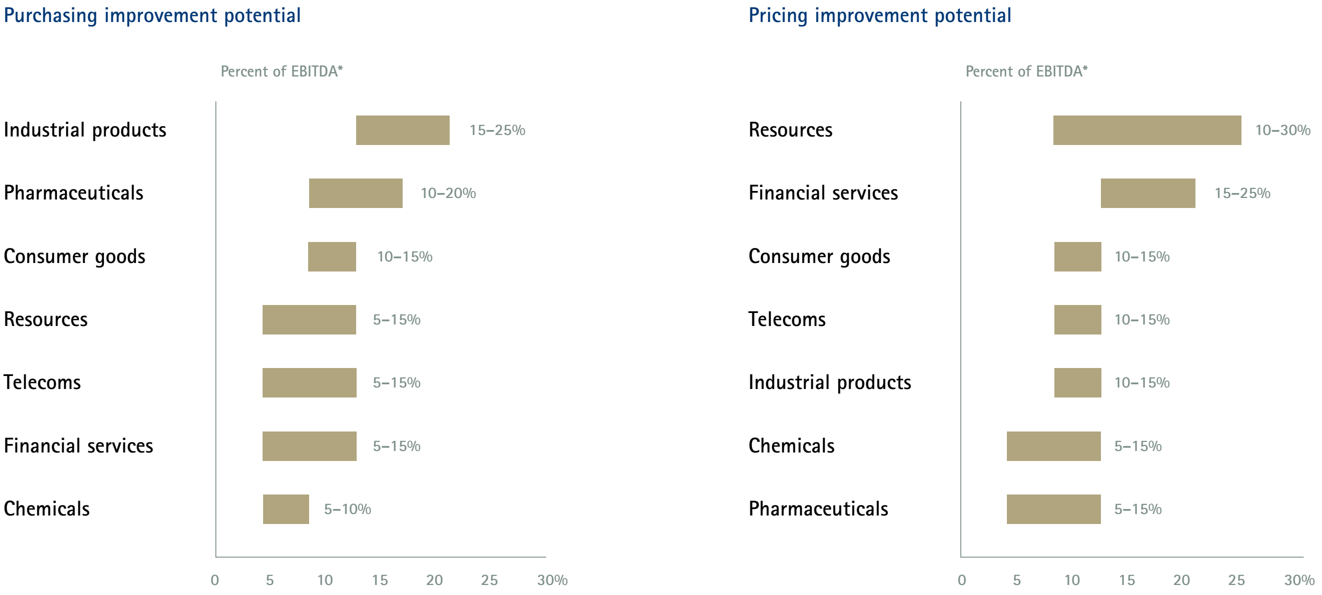
Improving cash flow

Accenture research suggests that improvements in supply chain efficiency and the introduction of pricing disciplines can each improve underlying cash flow by 25 percent to 30 percent—and that the basic tools for making these changes can be applied across most industries. Accenture's experience also indicates that the rationalization of back-office functions, including finance and accounting, IT and human resources, can improve cash flow by a further 5 percent to 10 percent.

In 2007, for example, the New York-based private equity firm Vestar Capital Partners implemented a supply chain improvement program at Solo Cup Co., which provides paper coffee cups to foodservice operators and distributors to leading chains like McDonald's and Starbucks Corp. The program, which

Big opportunities

Improvements in purchasing and pricing can have an important impact on cash flow across most industries, with the biggest gains from supply chain improvements in industrial products and the most potential from pricing improvements in resources.



* Earnings before interest, taxes, depreciation and amortization
Source: Accenture analysis

included boosting inventory turns to lower working capital requirements and the closure of peripheral manufacturing plants, increased cash flow by some 33 percent.

Meanwhile, when a leading family entertainment group that had recently come under private equity ownership raised prices at its attractions, it had no effect on attendance. To the contrary: Although prices were raised twice in 2008, by a total of 10 percent, visitor numbers rose by nearly 30 percent in the same period—a clear indication that the private equity owners had judged price elasticity correctly. Similarly, because the owners could offer visitors holding an annual pass for one of the group's most popular attractions access to other attractions as well, they were able to raise the price of the pass by 50 percent in the two years following the deal.

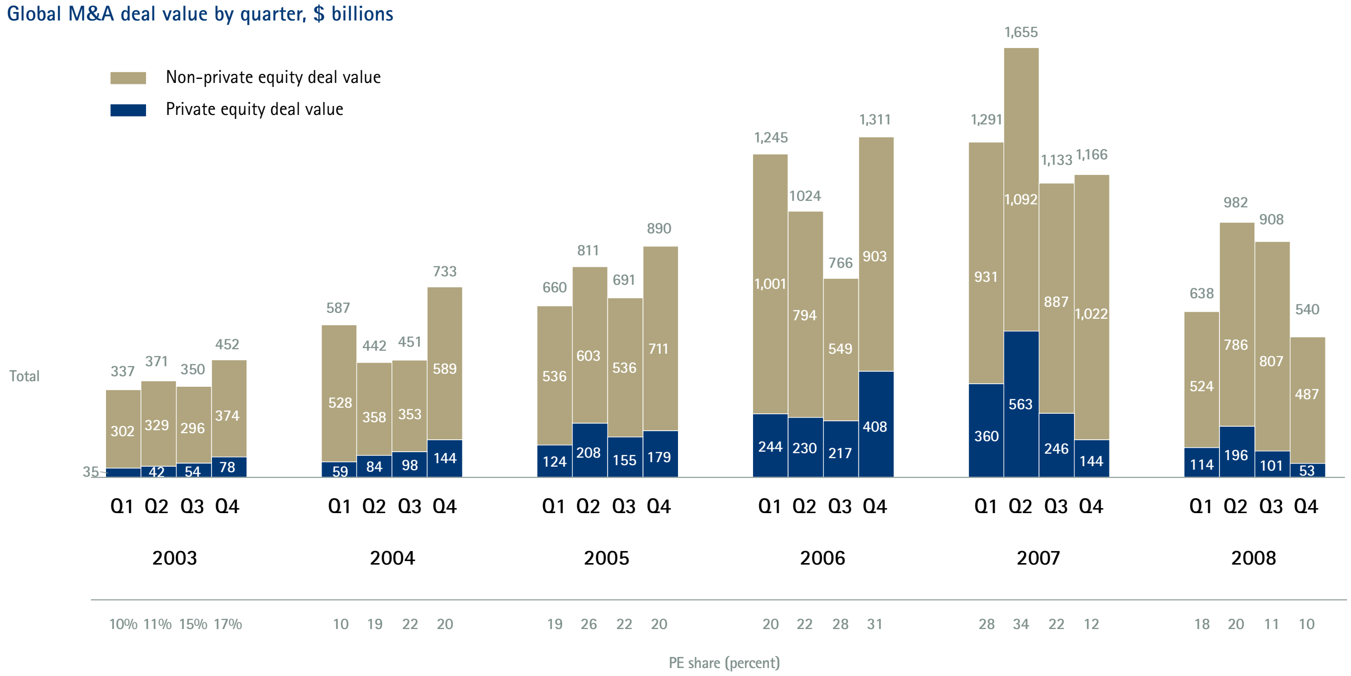
Value gap

Given the urgent need to plug what is by now a large value "gap"— $2 trillion must be created globally by 2011 if investors' expectations are to be satisfied—more and more private equity firms will seek to create value by driving such improvements. What's more, Accenture analysis suggests their efforts could bear significant fruit. A recent sample of private equity transactions shows that if the operational improvements outlined in their management plans were fully achieved across the entire sector, they could close almost half the current value gap.

The boom years

As the value of M&A deals globally skyrocketed during the past decade, so did the private equity share of deals, with both the total deal value and the private equity share peaking in the second quarter of 2007.

Global M&A deal value by quarter, $ billions



Source: Thomson Financial

LDC: A culture of ownership

For many in the private equity industry, deriving value from operational improvements in the companies they own is a relatively new strategy (see story). For Lloyds TSB Development Capital (LDC), however, it's pretty much business as usual.

LDC, which is a wholly owned subsidiary of Lloyds Banking Group, one of the United Kingdom's biggest banks, was founded in 1981 when the modern private equity industry was just taking off. At that time, pioneering firms could generate returns for investors up to two and a half times those available in the stock market, as well as handsome profits for themselves, just by buying low and selling high. Those days, of course, are long gone—and LDC was swifter than some to anticipate their passing.

The UK mid-market player shifted its focus in 2001. The bursting of the dot.com bubble prompted the firm to review its approach to new investments as well as its existing portfolio and concentrate on helping management teams grow shareholder value. LDC currently holds a portfolio of some 60 companies, across a range of sectors in the United Kingdom, with an aggregate value of around £2 billion. Each year, it invests in 10 to 20 new companies and sells roughly the same number of businesses. The key to success: a hands-on approach to ownership that involves investing a lot of time and energy in relationship building with existing management—even before a deal is done.

LDC's Value Enhancement Group, a team of strategists, industry and operational improvement specialists, is involved, alongside the transaction team, in the three- to six-month due diligence process leading up to deal completion. The aim, explains LDC deputy CEO Patrick Sellers, is for the group to formulate, with the management team, a 100-day plan aimed at identifying areas for improvement and focusing on "quick wins" that will boost profits and cash flows. Once the plan is completed, LDC continues to work alongside management teams on longer-term value-enhancing projects.

Because LDC prefers to work in partnership with existing management, the group pays particular attention to assessing the quality of management teams and understanding their strategy and ambitions. LDC may, where appropriate, bring in outside expertise to help in certain specific areas, but the firm would rather walk away from a deal than have to recruit a whole new team to run the business.

In fact, although LDC will act as a facilitator, it relies on existing management to implement its value-creation strategy for every company in its portfolio, so once an investment has been made, the firm maintains a continual dialogue with them. Differences are openly discussed at the board level, and rather than trying to unilaterally impose its point of view, LDC uses the power of persuasion to resolve disputes.

An outside, independent non-executive chairman is an especially important appointment in this regard. Sellers recalls the pivotal role played by one such director in convincing a management team to change its procurement policy. The company had historically sourced in the United Kingdom, a practice that was depressing its margins. But the board feared that sourcing abroad would diminish product quality. The non-executive chairman, who had many years' experience sourcing overseas in similar industries, was able to address these concerns and help the team successfully plan and execute the transition.

Procurement, indeed, is viewed as so important to value creation that LDC employs a specialist to help management teams identify and capture opportunities in sourcing, tendering and pricing strategies. As its model has evolved, LDC has continued to develop a longer-term view of operational improvement projects in general—a reflection of its deep conviction that only sustainable improvement will boost cash flow and profitability and thus contribute to an uplift in value when the business is sold.

All ultimately depends, of course, on the management team's conviction as well. And this is where LDC's hard work upfront really pays off. As Sellers observes, "One of the beauties of private equity is that the interests of shareholders and the management team can be so very closely aligned." By obtaining management's buy-in from the very beginning, LDC ensures that they are.

In the meantime, private equity's new focus on operational improvements has much broader implications. Sustainable value creation in any asset derives from its future cash flows. Accenture research shows that up to 70 percent of the value of any company—even a large, mature company— can be based on an expectation of future cash flow growth. That suggests that *any* management, whether of a privately held or publicly traded company, struggling to create value in the downturn and beyond could benefit by viewing the challenge through a private equity lens.

To be sure, when it comes to value creation via operational improvements, private equity firms have a built-in advantage. Thanks to their Wall Street origins, their mindset is overwhelmingly financial. Because they have an exceptionally clear view of the financial impact of change initiatives, they know exactly which ones will have the most positive impact on value.

Private equity owners select only a very limited number of change initiatives—those most likely to result in the kind of financially viable company they can sell for a profit a few years down the line. Moreover, leading firms pursue these projects with the exceptional rigor that characterizes just about every aspect of their approach—including the way they handle the commercial due diligence that identifies portfolio companies with potential in the first place (see sidebar, below).

The right target

If private equity firms are going to meet investors' expectations, they need to optimize cash flow (see story). And that means they can't afford to pack their portfolios with companies that will underperform. Picking the right target is essential.

It is the job of commercial—also known as strategic—due diligence to provide a view on the potential operating cash flow of a target company. Yet most commercial due diligence concentrates either on the market dynamics only or on validating the information that underpins existing—not future—cash flows. What's more, it tends to do so rather simplistically, leaving many acquirers with only a sketchy understanding of the assumptions underlying management plans.

Good commercial due diligence, by contrast, identifies the key performance drivers at the outset—and thoroughly tests them to provide a rigorously objective reality check on management forecasts. The devil, typically, is in the details.

A prospective private equity buyer recently pulled back from a deal with a major European media and entertainment company after doing some detailed analysis of the current management's forecast. The forecast was based on the assumption that 70 percent of revenue growth would be driven by annual advertising price increases. After analyzing the planned increases in light of historic pricing, market price elasticity and the ability of then current operational processes to support them, the prospective buyer decided the forecasts were too optimistic. It was clear, in fact, that future cash flows would be significantly lower than projected.

In this instance, future growth would have required substantial operational improvements—rewarding the sales force for increases in margin, not revenue, for example, to discourage rate discounting, as well as improved tracking and management reporting. All of which underscores the importance not only of commercial due diligence that addresses many of the post-deal improvement issues typically tackled in the first 100 days after an acquisition, but also the often complementary role of operational due diligence on those parts of the business most critical to meeting growth projections and capital expenditure plans.

When it comes to execution, private equity's commercial instincts can be especially effective. Having defined a value-creation target for the company and having identified those operational improvements most likely to lead to its realization, leading firms align the interests of all stakeholders around both immediate priorities and the end goal.

They hire managers—including outsiders with operational backgrounds—and motivate them through equity ownership to act like owners. They also track their progress relentlessly and take immediate corrective action when things go awry. (For an example of how private equity firms are becoming much more active on the boards of acquired companies, see sidebar, page 115.) The spread of performance-based pay for chief executives of public companies might be expected to limit the upside from incentive alignment when a company is taken private. But private equity owners still do much better than their public counterparts in this respect, in part due to taking a longer-term ownership approach to incentives.

Operational improvement initiatives can be disruptive for any company—private or public—especially when they involve outsiders. But as long as they are judged correctly in the first place and their implementation engages the portfolio company's management without disempowering them, they can also reap substantial rewards. That has certainly been the experience of many leading private equity firms.

Public companies seeking to drive higher operating profits and bolster competitive advantage could do worse than seek to emulate their example.

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Company Index

The following companies and organizations are referenced in this issue.

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