

Strategy in an Age of Volatility: Step One – Be Prepared for the Unexpected

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An age of increased volatility

Advancing technologies and an increasingly interconnected global economy change established customer relationships and business models with unprecedented speed. Deregulation and new legislation add uncertainty and fundamentally shift the nature of competition in sudden and unexpected ways. Basic and once powerful industries such as airlines, long distance carriers and electric power producers move towards bankruptcy, joining a slew of companies already there from the wreckage of the Internet bubble.

Uncertainty for most businesses will continue to increase. Technological innovation is increasingly difficult to anticipate, but the rewards are alluring. Regulation and legislation have unwittingly opened the door for some events--such as litigation and corporate accounting scandals--and future efforts to regulate and legislate how business is conducted will likely create new crises. Meanwhile, changes in the geopolitical balance have added an element of fear to the mix.

Yet even in this volatile marketplace, standing still is not an option. And, as some have discovered, volatility isn't inherently bad. Each change in fortune for a company or an industry can bring unprecedented opportunities for those who are poised for action. Some visionary and wellcapitalized investors are buying companies and assets at prices that would have been unheard of earlier in the year. It's not just Warren Buffett and his legendary investment style; Southwest Airlines, for example, made an important decision to expand capacity after 9/11. Several firms have purchased gas pipeline assets, traditionally considered stable assets, from troubled energy ventures. And there has been an unprecedented wave of private placements of convertible and preferred stock.

**A clear message for leaders in all industries in this age of volatility:
Be prepared for the unexpected.**

Preparation means considering both the challenges and opportunities presented by rapidly changing circumstances. A surprising number of companies have been caught without the basics in place when a "surprise" has occurred.

Preparing for life in the age of volatility is a two-step process – first, it entails being prepared for a rapid response to an unforeseen event, in other words, having an emergency survival guide close at hand.

The second step is long-term strategic planning, a process that must be adapted to apply to a volatile marketplace.

With an eye on the basics, here are the key elements of the first step – a survival guide for the age of volatility to help you plan for the best-case as well as worst-case scenarios.

(1) Know yourself

- How well does your entire executive team understand the true sources of value in your organization?
- How consistently do you communicate your core messages externally?
- Which assets could you sell most quickly?
- What impact would that have on near-term and longer-term results?

The first step in any planning process is to make sure the leadership team is in agreement about the fundamentals of the business. An assessment of not only the assets and structure of your organization, but also the perceptions of its people may turn up some surprising contradictions.

Peril: Faced with an unprecedented opportunity – or challenge – the last thing you want to do is get into a prolonged debate about your company's focus and strategy. In many companies, strategic planning is an important, but completely separate process from rapid response.

Promise: A simple, shared understanding of the business, its differentiating qualities and true sources of value, will improve response to an unforeseen event – good or bad.

Revitalizing and focusing strategic planning will lead to success in the uncertain times ahead.

A clear and consistent focus will help you capture the right opportunities quickly and decline the ones that will pull you off course. It will also help identify unexpected opportunities. This applies to relationships with customers, suppliers, competitors and even potential employees.

(2) Keep a shopping list for key assets

A sudden swing in the wrong direction has forced many organizations to look at selling off choice assets to reduce debt or improve liquidity. In a few years, energy companies that have sold their “stable” pipeline assets may regret the loss of cash flow. Investors will recognize that those sales severely limit future growth.

Promise: Evaluate your competitors' assets to see which might complement your current holdings. This evaluation should focus on what it is worth to your operations - taking into consideration other upcoming capital expense priorities and factoring in the time it would take to build such an asset yourself – instead of focusing on market prices.

Peril: While no company plans to be on the wrong end of a fire sale, each organization could benefit from some careful structuring of assets. Assets may suddenly and briefly be available at a discount, but just because something is on sale doesn't automatically make it a good buy. Dynegy's purchase of Enron's pipeline business appeared to be a coup until the latter fell into bankruptcy.

While compiling your list, also think about partitioning your assets to insulate core holdings and increase flexibility to act (e.g. sell off peripheral components without disrupting the business).

(3) Remember that cash is king

Capital availability, unprecedented downgrading of debt, and dramatic interest rate swings challenge the assumption that you—or any company for that matter—will be able to rely on traditional sources of funding in times of crisis.

Peril: What you think of as a stable business may suddenly appear “toxic” to a lender. Companies who leveraged their strong assets to finance rapid growth have seen their cash evaporate as their credit rating drops. Industry giants like Williams are making quick deals just to raise cash. Good defense requires protecting both your assets and your credit rating.

Promise: Companies (or people) with strong cash are finding opportunities to either buy assets or lend money. Individual players are able to leverage their strong positions to reshape industries to their own competitive advantage. Several companies are beginning to roll-up assets in energy, telecommunications and technology markets.

While the first three steps are internally focused, there are steps to protect your position in the marketplace as well.

(4) Expand your customer focus

Promise: Prepare a customer acquisition approach for your competitor's most profitable customers, and have designated teams ready to approach each customer should the opportunity arise. Estimate the lifetime value of the customer, and any incremental sales or brand value created with the acquisition.

Peril: Prepare for the loss of your major customers, which could occur because of their own crisis or in response to a negative turn in your business. In addition to maintaining an awareness of the situation in the markets of your key customers, consider opportunities that may arise from the loss of a single customer. Could you approach a competitor of a lost customer once conflict of interest is a non-issue?

(5) Check the links in your supply chain

Awareness of supplier markets is often as critical as an awareness of customer markets. Formulate alternatives for the collapse of a single company (e.g. Andersen) or of an entire industry (e.g. power trading). Make sure you have documented your needs sufficiently to re-bid on short notice.

Peril: How would you respond to the loss or bankruptcy of a major supplier? Andersen as your auditor? Enron as your power marketer? WorldCom as your telecom supplier? United as your travel partner? Odds are that you've already experienced at least one of these challenges.

Promise: A dramatic change in price structure in an area such as telecom hardware may offer huge savings opportunities. Keep an eye on industries that affect your supply chain from beginning to end and push for deals when you can.

That completes the five elements. Your approach to this exercise can determine its success: our experience shows that leadership and timing are critical to results. Since each of these elements requires cross-functional input, it enables senior members of the leadership team to interact outside traditional reporting relationships. Also, setting a tight deadline, four to six weeks, will ensure this effort doesn't get lost amidst daily operations or other fire drills. Preparing for a sudden event is good practice for actually responding to one.

Once you've completed the steps outlined above, and are prepared to address unforeseen circumstances in the near term, you can turn your attention to longer-term strategy.

While increased volatility makes strategic planning more relevant than ever, most companies continue to approach planning as more of a bureaucracy or budgeting exercise – removed from these real-time decisions. What's truly needed now from strategic planning is strategic intelligence and superior response.

Completing the survival kit list of actions above, and revitalizing and focusing strategic planning will lead to success in the uncertain times ahead.

Bridge Strategy Group is an elite, experience-led general management consultancy committed to helping our clients rapidly improve their business performance.

For more information, please contact us at 312-357-6740 or visit us at: www.bridgestrategy.com

