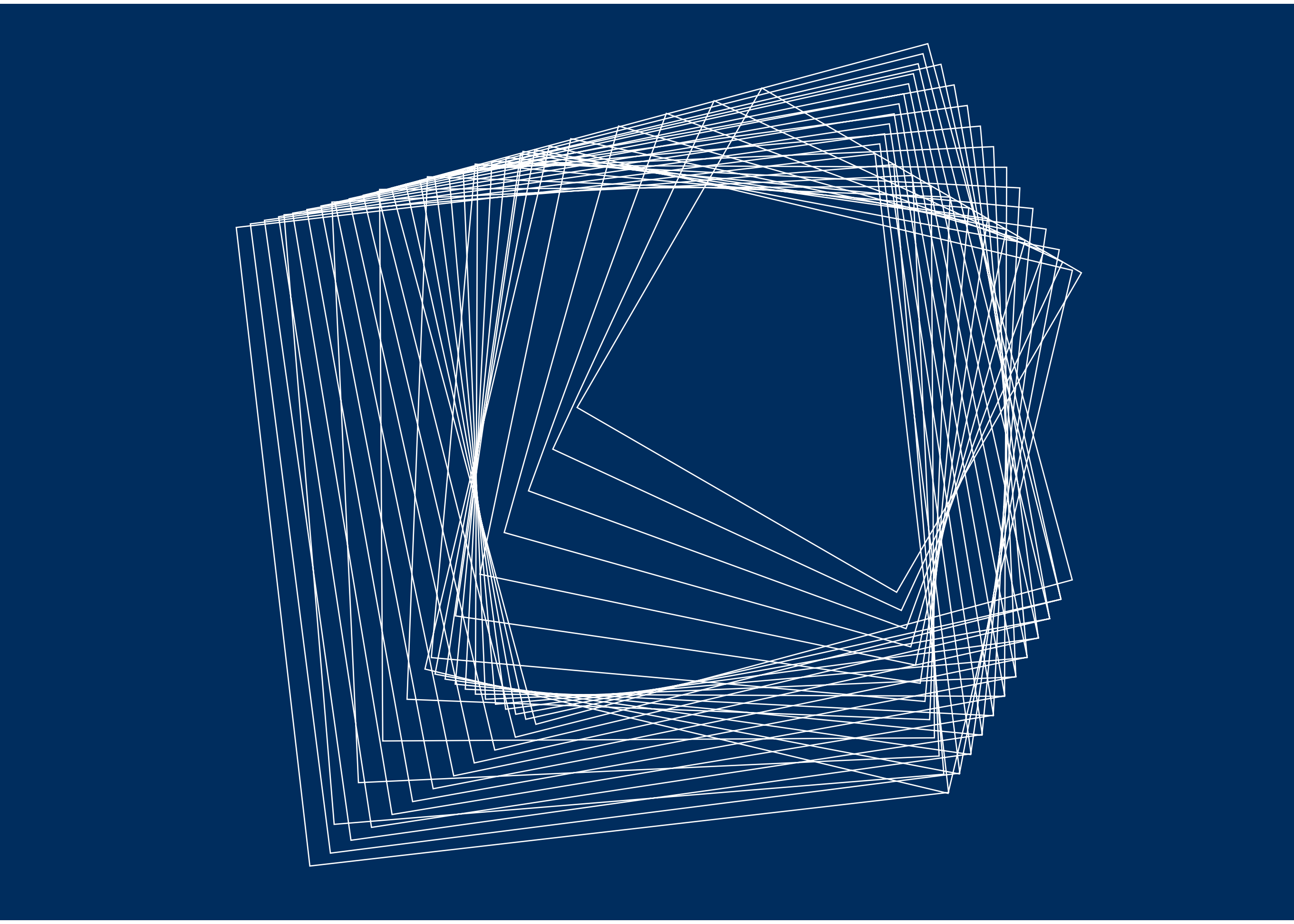
THINK ACT

BEYOND MAINSTREAM



SMART EFFICIENCY

The fast way for companies to become lean and agile

FEBRUARY 2015

Roland Berger
Strategy Consultants

THE BIG 3

1 0.8%

is all the growth that the IMF still expects of the euro area in 2014. Is crisis looming? Or is this merely a temporary adjustment? Companies should act now to prepare themselves.
p. 3

2 2

dimensions – efficiency and elasticity – characterize our innovative approach, which focuses on precisely those areas firms must work on to ensure they can respond swiftly to changing conditions.
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weeks is how long it takes to perform a 360-degree analysis that identifies the most important actions – and thus tangibly improves corporate performance.
p. 7

Adjustment or crisis?
p. 4

Volatility is the new normal. Constant uncertainty presents a stiff challenge to global players. Traditional economic indicators no longer provide reliable orientation. Today's companies are called on to be both lean and flexible.

Growth in Europe and Japan seems unable to gather momentum, and even the boom in emerging countries such as China and India has eased off noticeably. How these markets will fare in the long term depends on many political imponderables. The economic sanctions imposed on Russia as a consequence of the ongoing Ukraine crisis are a cause of concern for many European exporters. Nor are these the only questions firms must answer, as the price of oil and gold heads south and unrest escalates in countries such as Libya and Syria.

Volatility – accompanied by uncertainty, complexity and ambiguous developments – is the new normal. The VUCA world in which we live seems bereft of any truly reliable indicators that enable companies and their managers to plan for the long term. Corrections to forecasts are the rule rather than the exception A: The World Economic Outlook published by the International Monetary Fund (IMF) is only one of many examples. The IMF has lately corrected its projections for global economic development virtually across the board: Its November 2014 forecast puts growth in the euro area at just 1.2 percent, down from 1.7 in June 2014. Expected development in Japan has likewise been cut to [1] 0.9 percent in 2014 and 0.8 percent in 2015. As recently as June, the Fund's experts expected the US economy to expand by 2.8 percent in 2014 and 3.0 percent in 2015. Yet these figures too were adjusted in November, to 2.2 percent and 3.1 percent respectively. Nor is the latter projection the only upward correction: Spain's growth in 2014 is now expected to be 0.4 percent higher than was thought in June, while projected growth in 2015 is fully 0.7 percent higher than the forecast six months ago B.

Many blue chips still enjoy an earnings position that is largely stable. Even so, uncertainty is spreading – witness the graph plotted for the World Economic Climate C. This curve has been all over the place for about the past three years, with the result that no clear trend is discernible.

Should companies therefore rush to slim down? Or should they wait and see? While that is a tough one to call, many corporate groups have already decided to adopt countermeasures D. Take Germany, for example, where 22 out of 30 DAX companies and 22 of the 50 midcaps listed on the MDAX index are currently running programs to raise efficiency or cut costs.

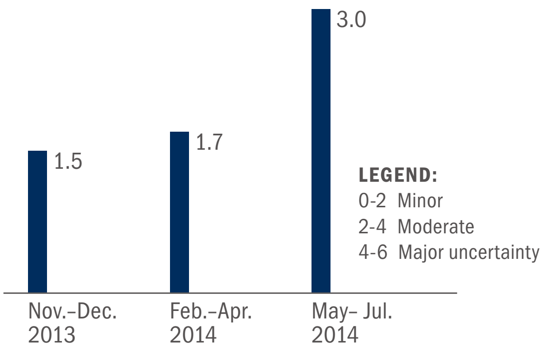
Businesses in other regions have initialized similar courses of action. These "early movers" include companies that are in the best of economic health. Among these players in particular, top executives seem increasingly uncertain about what to do. After all, you

TEMPORARY ADJUSTMENT? OR LOOMING CRISIS?

A

GROWING UNCERTAINTY

[Roland Berger Uncertainty Index[1)]]



1) Combines ten indicators, including the spread between and dynamics of economic forecasts, the mood barometer published by the Center for European Economic Research, and real economic data such as the development of exports and lending

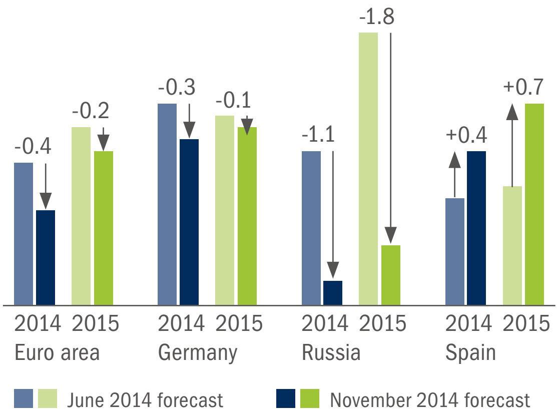
Source: Roland Berger

B

NO MORE DECISION SUPPORT

Corrections are the rule for economic forecasts

[GDP growth and difference between forecasts, in %]

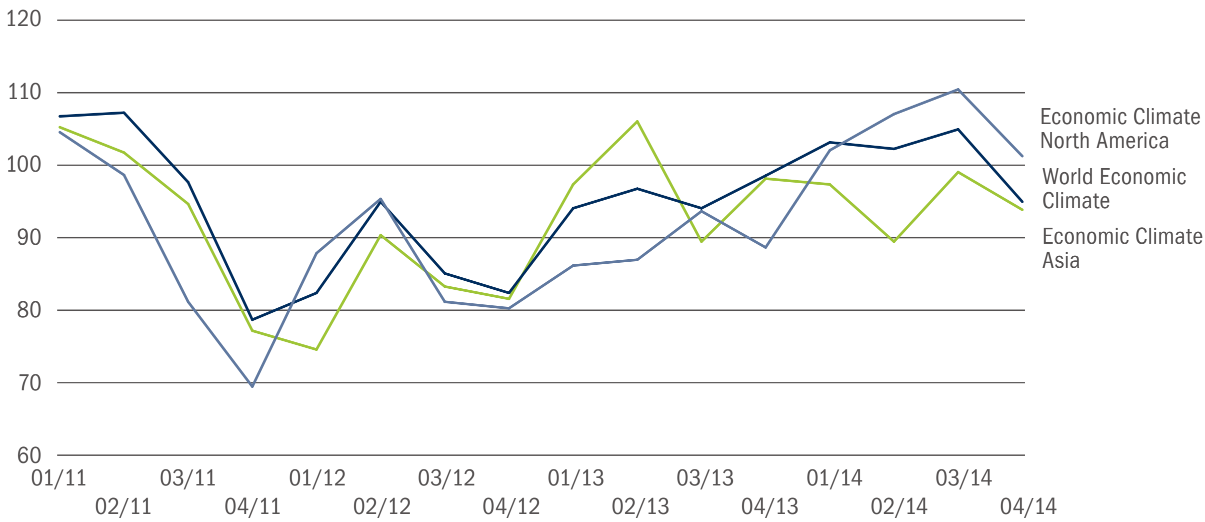


Source: IWF

C

ROLLER COASTER RIDE

No clear trend for either the World Economic Climate or the Economic Climate Asia/North America [Index, 2005 = 100]



Source: CES-ifo Group Munich

don't pare back a flourishing branch unless you really have to. Precisely for this situation, we have developed a method that we call Smart Efficiency. In the given context, we see two aspects to the concept of "smart":

Acting with strategic vision. We apply the logic of Smart Efficiency only to companies that are in good shape. This gives management plenty of room to maneuver – room that they should boldly exploit.

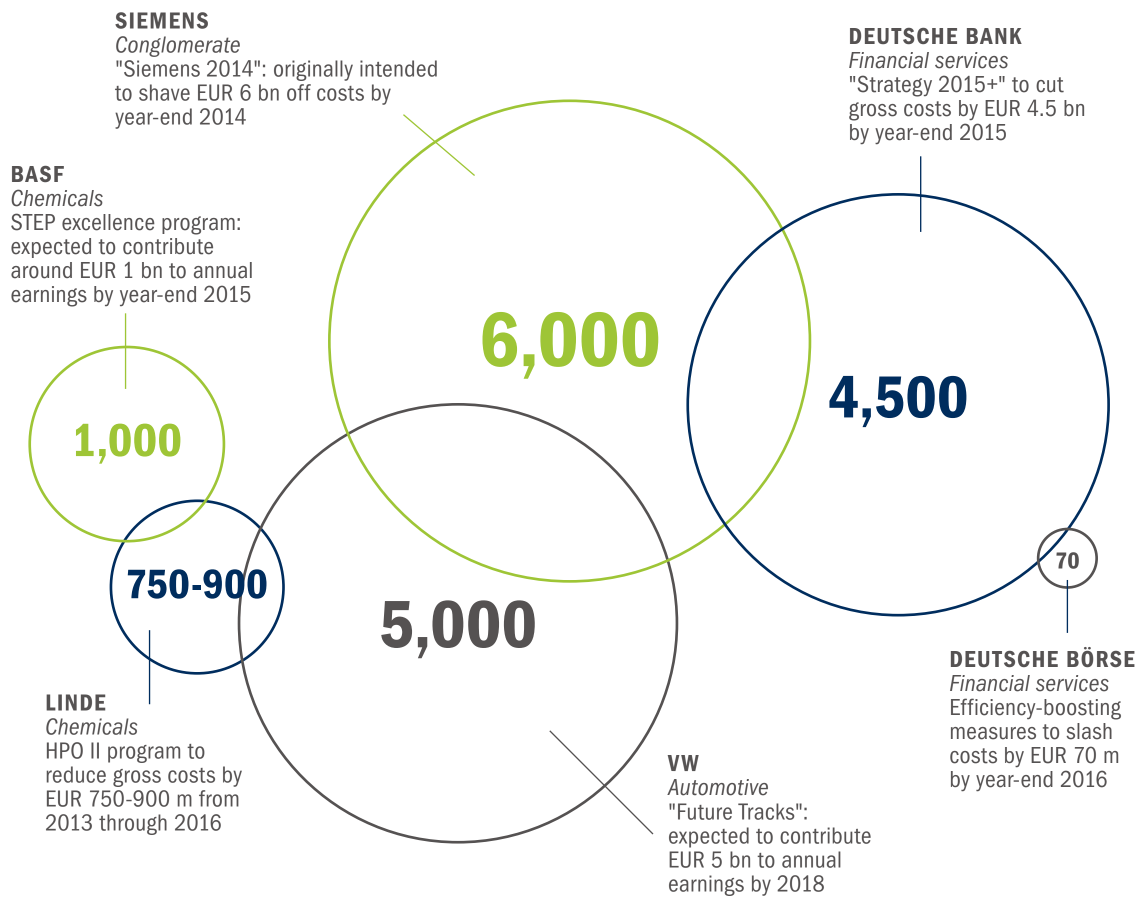
Combining efficiency and elasticity. We believe that concentrating on efficiency alone is too short-sighted. Addressing both dimensions in parallel is of crucial importance at the present time. Therefore, to model how flexible and agile companies are at present and will be in the event of volatile market developments, we have introduced elasticity as a new parameter.

This combination means that Smart Efficiency simultaneously improves the profitability and adaptability of a firm's core business – in both the short and medium terms.

D

ACTION, NOT REACTION

Examples of efficiency programs at healthy companies [EUR m]



Source: Manager Magazin, Handelsblatt, Roland Berger

Sniffing out the critical weak points. We investigate efficiency and elasticity. In just four weeks, our 360-degree quick check shows where companies would be vulnerable in the event of a crisis.

In the current market situation, it is important to take action to boost performance without delay. Three things about our method are new: First, we have bundled our expertise in corporate efficiency enhancement, our skills in corporate finance issues and our experience of all key industries, including automotive engineering, capital goods, pharmaceuticals, chemicals and IT. Our approach to this analysis is that of an outside partner who thinks from the inside – a fellow entrepreneur who co-owns the client's challenges. Second, the 360-degree quick check simultaneously examines the client's agility and efficiency. Third, the analysis takes no more than four weeks.

Looking under the hood

The first phase of a Smart Efficiency program involves sweeping a company's core business with a kind of 360-degree radar. Working in concert with the client, this lets us identify areas that need attention and action. Our quick check can very swiftly kick the tires of the company's key functions, measuring the findings against the benchmarks set by very good rivals and top players in other industries E. The core of our analysis is a financial model in which we screen the company's efficiency and elasticity in light of various business and capacity utilization scenarios. To this end, we explore the traditional links in the value chain, as well as analyzing overhead units such as IT and HR. At the same time, we conduct a detailed evaluation of the company's finances. Does the firm have sufficient cash reserves as a safety buffer, or to allow room to maneuver on acquisitions, for example? Is it also taking advantage of special forms of financing? A number of contextual factors – including governance, organizational structures, the corporate culture and the management system – likewise command our attention. Our experience shows that extreme variants of all these factors can have a substantial influence on programs to boost performance. We also analyze the business model, excluding strategic considerations for the time being.

Elasticity – a new dimension

To identify which solutions make sense in the current market situation and then prioritize them accordingly, we build on the concept of organizational resilience[1]. This concept describes companies' ability to anticipate upheavals in the market and adapt appropriately in good time. From a top management perspective, resilience is about addressing the cognitive, strategic, political and ideological challenges that organizations

1) "The Quest for Resilience", Harvard Business Review, September 2003

E

3 THE SMART EFFICIENCY QUICK CHECK

SWEEPING EACH COMPANY WITH 360-DEGREE RADAR

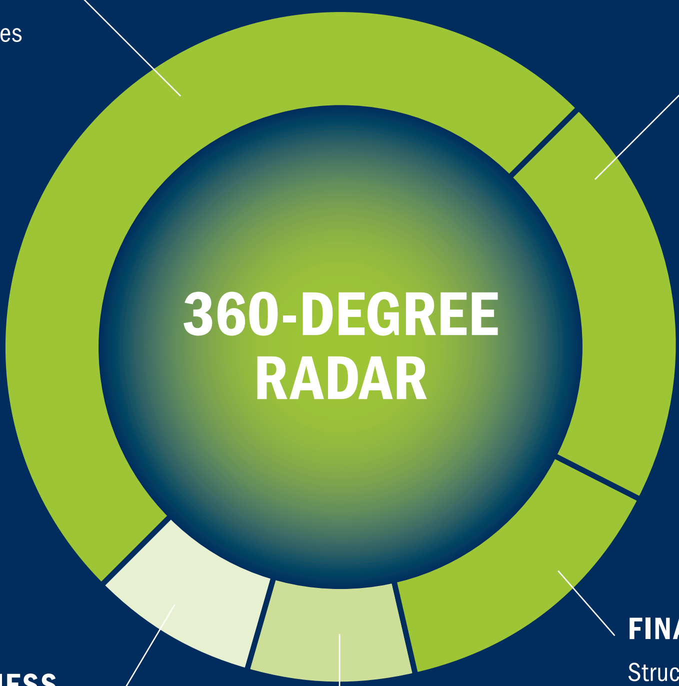
Our analysis covers every aspect of the company, focusing on the value chain, overhead and finance, but also screening management and the business model.

VALUE CHAIN

R&D
Marketing/sales
Purchasing
Supply chain
Production
Aftermarket/service

CONTROLLING

HR
IT
Administration



BUSINESS MODEL

Product/market positioning
Regional portfolio of products/customers
Value creation model

MANAGEMENT

Organizational structure
People management system
Corporate culture

FINANCES

Structure
Maturities
Flexibility

Source: Roland Berger

must master again and again if they are to stand their ground in the marketplace. We apply the concept at the operational level, seeking out areas where it can be put to good use in the short to medium term. Accordingly, we focus on the question of how adaptability can be measured immediately in the context of core business and what can be done to improve it.

Two parameters provide a sound starting point here: The first is profitability – the traditional measure of efficiency. Second, we use the break-even point as the measure of what we refer to as elasticity: an organization's ability to flexibly adjust its core business in response to fluctuations and crises. Specifically, we concern ourselves with considerations such as how well protected a company is – how much leeway (and what reserves, if any) a company has for itself, its finances and its contractual obligations. For example, a company that has signed lots of inflexible delivery agreements with minimum purchase volumes and/or long-term commitments may not have sufficient leeway to roll back production if demand slackens. Low levels of temporary staffing and having large volumes of capital tied up in real estate are further factors that can impair a firm's agility.

Striking the right balance

The objective of a 360-degree analysis is to tap reserves of efficiency and help the company avoid painful cutbacks later by preparing appropriately now. The quick check paints a clear picture of what needs to be done. Where do reserves of efficiency exist that can be tapped without spreading fear and uncertainty among the workforce and management? At what points would a lack of elasticity first cause operating earnings to suffer significantly in the event of a downturn? Where does the company need to prepare now for the eventuality of a crisis? Break-even – the point below which a market collapse would plunge the business unit concerned (and hence, ultimately, the entire company) into the red – lends much-needed transparency. Efficiency can be understood as target profitability for the unit(s) concerned. The corridor between break-even and targeted profitability then shows how much room the company has to maneuver.

Setting priorities

The issue now is to lower the break-even point as far as possible minimizing the risks to which targeted profitability is exposed. To illustrate what this means, we have developed a matrix F. The matrix shows where a company can take action to positively influence earnings without impairing elasticity, and vice versa. This can, for example, be done by bundling its procurement volumes and exploiting volume discounts to reduce the cost of materials. Optimized processes likewise diminish costs without pushing up the break-even point.

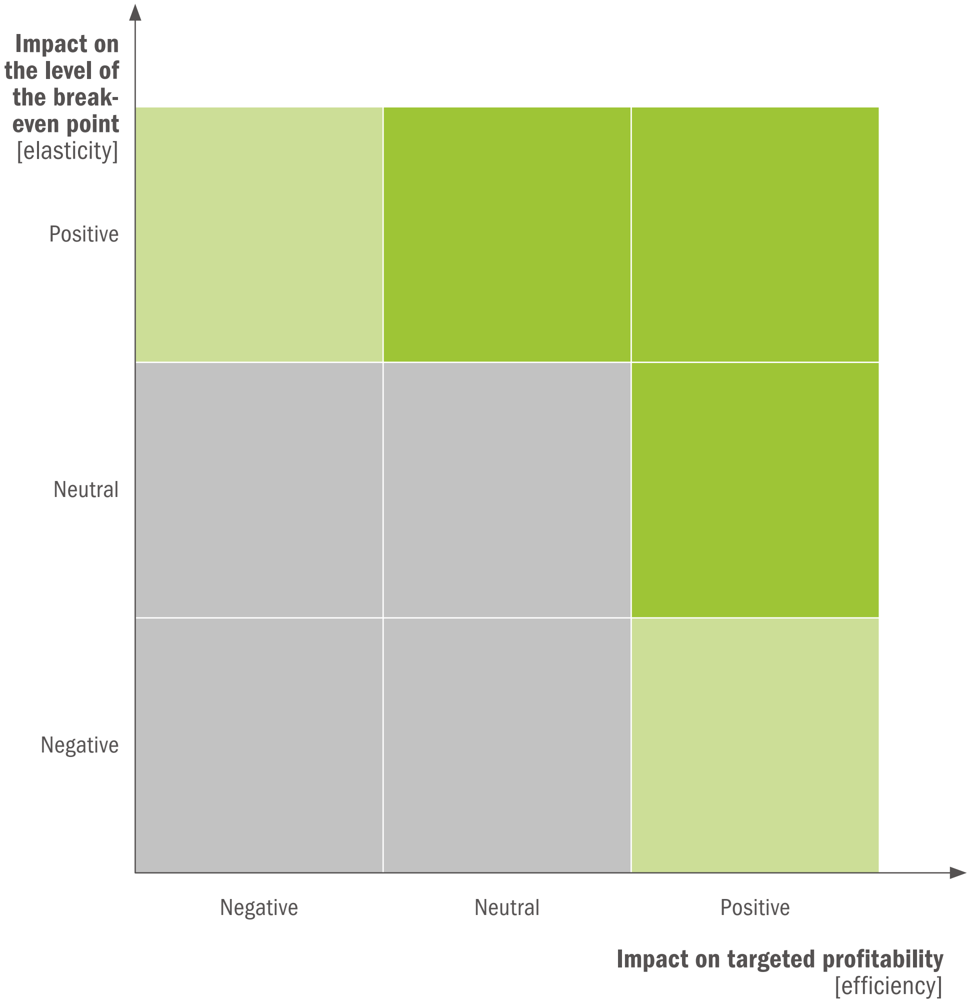
Nevertheless, a conflict of interests can sometimes occur between elasticity and efficiency. The purchase price normally declines (and profits increase), for instance, when a company agrees minimum purchase volumes with its suppliers. Yet by signing such agreements, the company inherently forfeits some of its elasticity: In the event of a slump, it may no longer be able to adjust its purchase volumes fully in line with its own shrinking business volume. There is no one-size-fits-all solution to such conflicts. What is needed is an entrepreneurial mindset, solid experience and a knowledge of the industry. We factor in the client's needs and identify specific considerations regarding potential areas for action.

F

THE FIVE FOCAL POINTS OF THE SMART EFFICIENCY APPROACH

MATRIX TO CLUSTER ACTIONS

Any action that can lower the break-even point without detracting from profitability – or vice versa – makes sense, without reservation (see the three dark green spaces on the matrix). Where conflicts of interests arise, we sit down with the client to work out a tailor-made solution (see the two light green spaces).



- Actions for which there is no conflict of interests between efficiency and elasticity
- Actions for which there are conflicts of interests between efficiency and elasticity
- Unattractive actions

Realizing quick wins is compulsory. Even more important is improving efficiency and elasticity in the short and medium term without causing the organization to lose its stride.

Hard numbers are the main way to see whether a performance boosting program has been executed successfully or otherwise. Yet our Smart Efficiency approach adds an extra component: The program should never cause the company to lose momentum. This tricky feat can be achieved only if unrest and anxiety within the organization can be kept to a minimum. Many of our projects have shown that change can be effected more agreeably for the people and units concerned if it is prepared thoroughly, organized in good time and communicated clearly. We proceed as follows:

First, we recommend that quick wins which stakeholders will barely perceive be realized to boost efficiency and/or elasticity. These are the classic low-hanging fruits, such as realizing better prices in material management (see above) and cutting costs by optimizing processes.

The second wave involves actions to improve elasticity in the medium term. Here, we help companies "grow into elasticity" by acting today in order to gain greater leeway in the future. One possibility is to introduce flexible working time accounts. It also makes sense to safeguard favorable financing conditions – for instance by arranging syndicated financing in what is known as a "club deal". This guarantees that borrowing terms remain favorable in the long term, while also ensuring that none of the partners can unilaterally terminate credit lines at the same time. Another instrument, borrowing base financing, is a relatively new one that adds flexibility by linking the scope of financing to the development of working capital. This means that more credit lines are automatically available during growth phases than when the business is shrinking.

During a third wave, we stake out prophylactic action packages that only need to be implemented when times get tough. This, too, gives companies greater flexibility, because everything has been thought through and is in place before the downturn materializes: All that is then needed is a green light to go ahead with implementation. Many of these actions will take an organization out of its comfort zone. Having said that, they need only be applied for as long as the downturn lasts. We sit down with the client to define suitable thresholds and set up control mechanisms that take effect as soon as a given threshold is reached. One package, for example, might cap the marketing budget, suspend voluntary fringe benefits and tighten up travel expense guidelines if sales fall below a critical threshold.

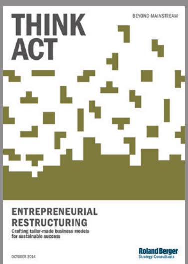
Our Smart Efficiency approach gives companies more breathing space. When the economy is booming, their competitive position scarcely changes: They simply optimize profitability and lose none of their momentum. The real benefits, however, are felt when a smoldering crisis flares up: When times get tough, you can quickly see who has carefully put their house – and their resources – in order. Lean and flexible companies can survive economic lulls without suffering serious damage. They are agile enough to quickly reposition themselves in forward-looking business spaces. ◆

ABOUT US

Roland Berger Strategy Consultants

Roland Berger Strategy Consultants, founded in 1967, is the only leading global consultancy of German heritage and European origin. With 2,400 employees working from 36 countries, we have successful operations in all major international markets. Our 50 offices are located in the key global business hubs. The consultancy is an independent partnership owned exclusively by 220 Partners. **WWW.ROLANDBERGER.COM**

Further reading

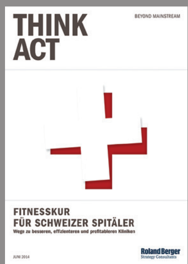


ENTREPRENEURIAL RESTRUCTURING
Crafting tailor-made business models for sustainable success

Successful restructuring means quickly coming up with a new business model that is convincing and sustainable. Roland Berger approaches the task from a strictly entrepreneurial perspective. On behalf of our clients, we moderate what are often conflicting demands. We also manage the transformation process as though we were handling our own business. Responsible, energetic and rigorous decision-making is at the heart of this "entrepreneurial restructuring" approach.

BOOSTING COMPANY PERFORMANCE
Supply chain risk steering and working capital as success drivers

What factors of influence drive operational excellence and thus boost a company's performance? A Roland Berger study analyzes data from 274 leading production companies and more than 20 interviews with top managers. Scientific support was provided by Universität Hohenheim and the Swiss Federal Institute of Technology Zurich. The findings? Companies that actively manage their supply chain risks can outperform comparable rivals by as much as 14%.



THE CURE FOR SWISS HOSPITALS
Toward hospitals that are better, more efficient and more profitable

Competition in the healthcare sector is growing ever more fierce. A Roland Berger study takes a close look at the Swiss hospital market, showing how clinics can prepare for the future. The study identifies four key areas of action: Hospitals must professionalize their purchasing management, improve their performance, manage new construction projects professionally and adopt a more strategic approach to acquisitions.

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