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Managing in volatile times

The five business dimensions organizations should pay attention to during a downturn

The current economic downturn has forced organizations to actively reassess their business and its priorities. Volatile times challenge managers to make decisions that balance risks and rewards in the face of great uncertainty. By making appropriate financial, operational, governance, and risk management changes now, you can better position your organization to maintain cash flow and to effectively weather the current economic storm. More importantly, by adapting now, you have the opportunity to lay the foundation for renewed growth and greater competitive advantage when the economy rebounds.

Today's volatile times call for your attention in key business practice areas. Adjustments made in these areas can help you to assess, plan, and stay ahead of the game — ultimately providing the opportunity for enhanced performance when the economic environment stabilizes. There are five business dimensions that organizations should pay particular attention to managing effectively:

- Revenue
- Cost
- Assets
- Expectations
- Foundations

Revenue	Cost	Assets	Expectations
• Pricing • Growth • Customer insights • Revenue assurance • Sales force optimization	• Cost reduction • Contract compliance • Tax planning and optimization • Sourcing/procurement and supplier reviews • Supply chain • People cost	• Cash generation and conservation • Fair value accounting/ due diligence • Treasury risk management • Cash forecasting and modeling • Capital management • Debt advisory and turnaround • Portfolio strategy and execution	• Issue and crisis management • Communication in an uncertain economy • M&A strategy and execution • Business and scenario planning

Foundations		
• Board and executive reporting and governance • Enterprise risk management	• Talent management • Performance-based remuneration and reward	• Fraud risk management and forensic review

Revenue

Pricing
Utilize pricing as a powerful lever for improving financial performance.

- Pricing practices may vary widely as demand falters and conditions get tough. Differences between list and pocket price can be significant due to price leakage.
- Global currency translation and exchange effects offer opportunities to hone margins and ignite demand.
- Most organizations pay little attention to price setting, price administration, and price capture. Flexibility with pricing strategies can help sustain demand.
- Based on Deloitte's experience, fewer than 3% of organizations effectively manage, communicate, and enforce pricing strategies.
- Based on Deloitte's experience with publicly traded companies, a 3 – 5% margin improvement from eliminating price leakage alone is achievable.
- To more effectively formulate and execute pricing strategies, organizations should enhance their planning and forecasting capabilities to integrate demand elasticity into revenue models.

Growth
Provide a rigorous framework for developing a growth strategy, even in challenging times.

- Organizations gain better insight into growth performance and potential when they decompose the sources of growth (M&A, market share, or momentum).
- Challenging economic conditions can create opportunities for targeted growth. Sorting out the right priorities and options is key.
- Organizations should adapt growth frameworks to filter all opportunities against a consistent set of financial and operational factors in all market conditions.
- Portfolio options, at all levels, should be evaluated and challenged to take full advantage of market conditions and sustain the business.
- Implementing a common framework to rationalize product and service offerings can help focus the portfolio and liberate limited resources.

Customer insights
When executed properly, customer insights will help your organization retain and up-sell existing customers, win new profitable customers, and enhance earnings.

- Customer segmentation can be a powerful means to identify unmet customer needs and should be the first step in creating a meaningful dialogue with key customers.
- It is more effective when a company tailors offerings to segments that are the most profitable and targets them where the company has a distinct competitive advantage.
- Based on Deloitte's experience, 3 – 7 times improvement in retention and targeting is not unusual.
- Based on Deloitte's experience, the estimated level of effort to secure a new customer is 10 times that to retain an existing one.

Revenue assurance
Ensure that all revenue and monies owed to the organization are identified, quantified, and ultimately collected.

- Collections can become increasingly challenging during a period of economic uncertainty.
- Organizations that utilize partnerships or joint ventures to "extend the enterprise" should effectively manage contracts to ensure that entitled revenue is being properly collected.
- Risk increases with the increase in the number of customers, systems of record, transactions, adjustments, and refunds.
- Anomalies arise when there is either complex or changing pricing or royalty arrangements with customers.

Sales force optimization
Make sure that your sales force is protecting current revenue streams while generating new revenue sources.

- Sales compensation structures should be evaluated to make sure they are driving the right behaviors for the current environment.
- The organization structure and make-up of the sales force should be evaluated to make sure you have the right talent to face off against available opportunities in every market.
- Sales incentives should be structured in a way that drives your sales force to diversify your revenue stream by cross-selling all of your products and services.
- Learning and training programs may be needed to ensure that your best sales people are better positioned to deliver against these new requirements.

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Cost

Cost reduction

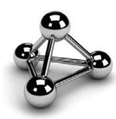
Cost management becomes a critical management lever as market uncertainty increases. Despite top line impacts, earnings can be maintained through controllable and sustainable cost reduction and process efficiency improvements.

- Streamlining the business configuration (products, customers, channels, etc.) can help drive margin improvement.
- Rationalizing the service delivery model for staff functions and shifting fixed costs to variable costs using outsourcing can improve operating flexibility, yielding significant and sustainable structural cost savings.
- Right-sizing the infrastructure footprint should help reduce operating costs and improve asset efficiency. For example, based on Deloitte's experience, ERP consolidation can reduce support and maintenance costs by 20 – 45%.
- Eliminating unnecessary business activities may be needed to permanently reduce spending.
- Preventing avoidable losses by tightening controls in the areas of fraud, waste, and abuse can help capture margin leakage.

Contract compliance

Manage the risks of the extended enterprise to ensure that incurred costs are reflective of contractual agreements.

- Increased contract management rigor is essential to effective cost containment.
- Improve data reliability and integrity through enhanced controls and information monitoring processes.
- Conditions for rebates and discounts are often poorly controlled.
- Evaluating contract administration and compliance can often surface cost and working capital savings, as well as enhance negotiated outcomes.



Tax planning and optimization

Take advantage of a number of tax planning opportunities to effectively manage risk and to maximize shareholder value.

- Tax strategies must be evaluated and adapted to the current business climate.
- Internal debt restructuring, cross border financing and/or cash repatriation, and business restructuring are a few of the management actions than can create tax consequences.
- Utilization and management of losses can often result in recovering some of last year's payments.
- Assessing tax challenges and strategies is essential to reducing the overall impact of taxes on the organization in a downturn scenario.

Sourcing/procurement and supplier reviews

Understand and mitigate against financial stress in your supply base. Evaluate sourcing and accounts payable practices to identify opportunities to reduce cost, improve spend management, and improve cash management.

- Significant opportunities usually exist for organizations with many vendors, contract arrangements, and transactions. Opportunities usually increase proportionate to the number of divisions, systems, internal teams, and locations involved in procurement.
- Management of terms, conditions, and compliance is often inconsistent.
- Based on Deloitte's experience, financial recoveries of 5 – 10 times fees and identification of procurement opportunities of 10 – 15 times fees are not unusual.
- While many organizations do credit checks on customers, based on Deloitte's experience, few understand the true financial health of key suppliers.
- Financial failure of a key supplier can halt your supply chain, causing business interruption, lost sales, and damage to your business reputation. It's critical to anticipate supplier performance challenges and take action to manage potential risk to the business.

Supply chain

Improved supply chain strategy and execution across procurement, manufacturing, and distribution can help cut costs, increase service levels, and increase cash flow.

- Overall supply chain performance can deteriorate with uncertainty and disruptions in demand and supply.
- Inventory management is challenged as uncertainty increases and forecasting becomes difficult, creating even greater working capital challenges.
- Understanding supply chain performance and cost is critical to helping manage order fulfillment, optimize plant and facility utilization, reduce working capital requirements, and minimize operating risk.

People cost

Your compensation and benefits costs are typically one of your largest Profit & Loss expenses, and carry significant risk as well.

- Transformational approaches to health care can yield significant cost savings while maintaining competitive benefit levels.
- In addition, current opportunities in disease management and pharmacy benefits have good potential for cost savings, again without impacting quality.
- Realigning compensation and benefits structures to meet current realities can also be a source of short-term savings, although care must be taken to not create a negative impact on corporate culture.
- Risk mitigation strategies for large liabilities, such as defined benefit retirement and self-funded health plans, can have a positive impact on the predictability of future costs.
- Retention and reduction in force strategies can be significantly enhanced with the right compensation and benefits strategies to support them.

Assets

Cash generation and conservation
Improve cash flow by freeing up working capital and improving disciplines around cash management.

- Cash management and generation is an essential discipline, even more so as liquidity deteriorates.
- Cash-efficient organizations have a heavy weighting on cash management and the management KPIs.
- Actions must be taken to aggressively liquidate underutilized assets, manage/forecast cash on a weekly basis, repatriate earnings from abroad, focus on compressing the working capital cash conversion cycle, and ensure line of credit availability.
- Re-enforcing cash management disciplines should be a critical priority.

Fair value accounting/due diligence
Determine fair value as it relates to goodwill impairment testing, financial instruments, and investments. Establish risk management policies around valuations and review the impact of changes to accounting standards.

- Valuations should be revisited due to current volatility in the capital markets.
- Process of determining fair value should be defensible and include corroborative valuation approaches, analysis of inputs, burden of proof to forego fundamental analysis, stress and sensitivity analysis, and model testing.
- Fair value policies in financial reporting processes should give consideration to changes in accounting standards.

Treasury risk management
Evaluation of risk management policy, financial instruments pricing and valuation, and treasury board reporting.

- Lack of relevant and/or reliable information linking risks to anticipated benefits may result in poor investment decisions.
- Lack of relevant and reliable information that enables management to effectively prioritize its investment portfolios or balance its business in a strategic context may preclude a diversified organization from optimizing its financial assets.
- Failure to align financial asset investment objectives and valuation measures with enterprise-wide and/or operating unit objectives and strategies may result in conflicting, uncoordinated activities throughout the organization.
- Boards want an understanding of how earnings may be impacted by market volatility and the impact of fair value accounting on the balance sheet.

Cash forecasting and modeling
Model key business drivers and decisions to forecast cash flows and/or earnings and measure financial outcomes and assess risk.

- Staying on top of the cash position by monitoring current and forecasted cash positions is essential.
- Conduct a scenario analysis to assess the impact of changing business drivers.
- Vendors stop shipping on terms, customers buy less, and lenders tighten credit.
- Quantify the forecast range of cash earnings and develop contingency plans for rapid execution.

Capital management
Develop an approach to capital management which incorporates key risk areas, including capital calculations, capital enhancements, and enterprise risk management.

- The amount of capital held and how these assets are structured and/or valued is vital in helping to prevent severe financial distress and/or failure.
- Growing economic uncertainty and the complexity of financial instruments has increased the importance of capital management and heightened the need to gain a greater understanding of risk.
- Failure to estimate and determine the timing and amount of funds potentially required may result in failure to meet capital requirements in a timely manner.
- Organizations can quantify and better manage risk by utilizing a structured framework to evaluate and prioritize capital sourcing and allocation.

Debt advisory and turnaround
Develop credible operational and financial restructuring plans to gain support of existing or new financiers.

- Assess and monitor impact of market challenges on financial structures, including leverage levels, maturity schedules, fixed vs. floating rates, covenant compliance, etc.
- Develop a credible turnaround plan that addresses critical business viability, financial leverage, and liquidity challenges.
- Develop financial restructuring alternatives that maximize value for all parties.
- Proactively engage lenders and creditors.

Portfolio strategy and execution
Assist corporate executives with evaluating their portfolio to ascertain where the opportunities lie to unlock value by taking both a valuation and market assessment view.

- Asset sales may be essential to freeing up capital and focusing the business on mission-critical objectives.
- Portfolio analysis should challenge relative value contribution of each business unit/product/asset and divest accordingly.
- An unbalanced portfolio may result in market penalties, such as underperforming stock prices or a hostile takeover.
- Consideration should be given to the degree of business separation to properly anticipate and plan for the pending asset sales and accelerate structural cost overhang.

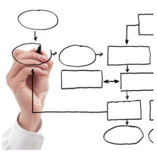
Expectations

Issue and crisis management
Identify, understand, escalate, and manage issues that arise within your organization.

- Forensic analytic technology can assist in understanding how critical issues are being managed.
- In today's complex litigation and investigative environment, companies need a continuum of discovery services – from readiness to collecting, processing, hosting, reviewing, and production.
- Investigations and dispute services can help accelerate the issue and shorten the dispute resolution process.

Communication in an uncertain economy
Prepare to respond to continuous disclosure triggers that are accentuated by the current environment.

- Forecasting the business outlook and managing expectations is now more challenging, if not impossible.
- Develop management processes that quickly identify changes in conditions that may increase the likelihood that a profit downgrade is critical.
- The current environment is impacting the market for certain assets and securities, potentially triggering disclosure events associated with asset-carrying values.
- Board and audit committees should understand parameters for continuous disclosure, trigger events, and associated timetables for going to market with a disclosure.
- The credit crisis will impact some organizations' ability to meet covenants or refinance debt, potentially triggering a disclosure event.
- An independent perspective can provide new thinking and enhance the decision process of management and the board.



M&A strategy and execution
Develop an M&A strategy to take advantage of market opportunities and build internal capability to execute on it.

- Transaction opportunities usually increase as valuations fall and/or organizations look to trim their portfolios.
- Aggressive assessment and pursuit of portfolio options can help create competitive advantage and exploit opportunistic situations.
- Developing clear M&A objectives can help facilitate strategic alignment and protect against poor decision making in volatile times.
- M&A capability must be appropriately staffed and armed with a playbook structuring the evaluation of mergers, acquisitions, and divestitures.
- Poor IT integration is the dominant cause of failure to achieve M&A financial objectives; adequate IT due diligence and detailed post-merger integration planning are essential.

Business and scenario planning
Boards and management need to understand and quantify their organization's potential exposure to volatility and change, and evaluate against their current portfolio.

- Scenario planning is essential to understanding the potential impact of economic conditions on the business; both good and bad.
- Plan for the worst and hope for the best to provide management insight and perspective.
- Develop a range of potential economic scenarios and understand how to respond to competitors, customers, suppliers, lenders, and shareholders. Consider further erosion in the business, as well as potential upturn scenarios to frame the realm of the possible.
- Develop early warning systems, trigger points, and contingency plans.
- Tighten alignment between strategy, business planning, and annual operating plans.
- Improve management understanding and consensus for the course of action.

Foundations

Board and executive reporting and governance
Assess the information the board and senior management receives for accuracy, reliability, timeliness, and action-ability.

- You must be comfortable with the information you are receiving in terms of timeliness, horizon, and quality.
- Management needs a "line of sight" between board-level reporting and the underlying systems.
- Core key performance indicators must be evaluated and changed to meet market conditions and be properly aligned with incentives.
- Board governance structure must be effective in anticipating and responding to market turbulence.

Enterprise risk management
Understand the enterprise risk at all levels to anticipate, plan, and respond to conditions that could jeopardize the business.

- The rapidly changing market conditions and volatility can exacerbate current business risks and surface new risks for the business to manage.
- Organizations who understand their "Risk IQ" are better positioned to take action to manage and/or mitigate risk and help meet long- and short-term goals.
- Risk scenario planning can define the circumstances, options, and range of management response to help react to market conditions on short notice.
- An integrated approach to risk management is not only more effective, it can also create new efficiencies.

Talent management
Confirm the organization's talent priorities, risks, and actions for supporting the business.

- In volatile times, it is more critical than ever to define and manage talent important to sustaining the business.
- The downturn can create new challenges to retaining critical talent and capabilities and to preventing organizational knowledge from walking out the door.
- Copying your competitors' talent practices won't work, as organizations have unique business, customer, and product strategies.
- Talent management begins with creating a fact base that qualifies critical business needs and capabilities against the changing business outlook.

Performance-based remuneration and reward
With new regulation and increased scrutiny around executive compensation, corporations must have an effective and defensible remuneration system in place.

- Managing a compensation program in a dynamically changing business environment creates unique challenges.
- Managing executive reward expectations, motivation, and retention through the economic downturn is key to retaining critical employees and keeping them motivated.
- Opportunities usually exist to better support the Board Remuneration Committee with governance, disclosure and executive employment matters, remuneration governance advisory, performance analytics, remuneration benchmarking, and performance-based reward plans.

Fraud risk management and forensic review
Identify and respond to fraud, conflicts of interest, and potential corporate code-of-conduct violations.

- Current business trends, such as supply chain globalization and further reliance on information technology, coupled with economic instability, have increased both the pressures and the opportunities for fraud to occur.
- Management must continually improve the design, implementation, and assessment of antifraud programs and controls.
- Forensic assessments of quantitative and qualitative information can help isolate damages and provide a clear understanding of the impact on the organization.
- Evaluating and quantifying real or potential losses can help minimize the risk of fraud, facilitate resolution of commercial disputes, and identify the potential for financial litigation.
- Automated pattern-recognition programs can be used to scan transaction streams to identify patterns of fraudulent behavior and flag potentially fraudulent transactions.

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