Ready for renewal?


COLIN FLETCHER AND **GILL RINGLAND** ENVISAGE A VERY DIFFERENT ECONOMIC ORDER COMING INTO OPERATION OVER THE NEXT 20 YEARS AND EXPLAIN HOW BUSINESSES CAN ADAPT SUCCESSFULLY.

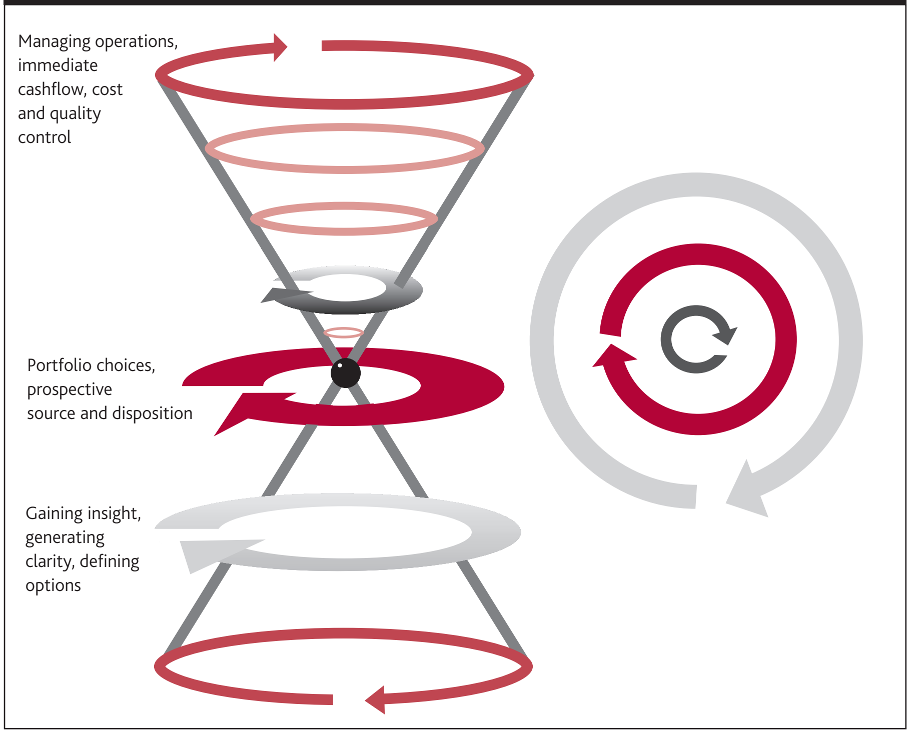
The last decades have witnessed some disruptive financial events: the Asian collapse of 1997, the dotcom boom and bust, and latterly, the global financial crisis and recession. Nevertheless, for an extended period, consistent growth and low interest rates provided a benign umbrella for businesses. The industrial countries showed steady growth and low inflation, commodity and wage costs remained relatively stable, and the populous countries of Asia were content to grow rapidly while taking in the low-skilled work of the wealthy world.

But it is now clear that even before the financial crisis broke all was not well with this model. Concerns were growing about energy depletion, environmental pollution, security, rising food prices, economic and financial imbalances, and asset price inflation. While central banks appeared to have general inflation under control, they drove a property and share price boom and an unsustainable mushrooming of debt, particularly among UK and US consumers. This, together with the monetary loosening after the dotcom collapse, was one deep root from which the financial crisis grew.

THE FINANCIAL CRISIS. The bursting of the financial bubble has highlighted the scale of build-up in private sector debt and levels of gearing and led to a surge in public sector indebtedness as governments took extraordinary steps to prevent a systemic banking collapse. The resulting levels of private and public sector debt, coupled with the scale of public sector deficits now faced by a number of the industrialised nations, will not only take time to work out of the system but the required actions will not be without risk and pain. The crisis that started with sub-prime mortgages in 2006 has revealed something very different beneath the tranquil surface of the last two decades.

The world ahead will be very different.

Figure 1: The three-ring circus



Demographic change and the growth in education will shift patterns of labour skill and cost. The older industrial nations (and China) face political, social and financial challenges as their workforce ages and retires. Skills once restricted to the industrialised nations are now widely available, further enhancing the shift in international competitiveness towards new entrants. Much the same can be said for technology, which continues its relentless expansion in depth and range.

The debt burden of the wealthy nations will make their recovery slower than that of the new competitor nations. Competition will be intense, and on new terms. Global issues – such as environmental change, but also international law and finance, access to raw materials and the management of intellectual property – all require the rich nations to sacrifice some power. This rebalancing of power and an institutional vacuum implies that the next decade will be a turbulent one.

Businesses will have to adapt to changes in the nature, structure and location of markets, in the relative and absolute costs of labour and capital, and in the security and economics of supply chains. Success is likely to require much greater focus on addressing future uncertainty, on corporate renewal, and on managing the associated risks and requirements for change.

MENTAL FRAMEWORKS. To make sense of the emerging world order, we have developed some frameworks for thinking about the short, medium and long term. The short run (possibly measured in years rather than months) is about finding the way out of the financial overhang, debt and unemployment situation in the West. The medium term depends on how the wealthy world comes to terms with the new economic and political conditions, and with new competitors. The longer term is constrained by events to date, subsequent developments over the short to medium term, and the world's capability to tackle global systemic challenges.

This has led us to develop three scenarios:

- **Low Road.** The crisis extends beyond the financial sector, Western unemployment remains high and global growth is low;
- **My Road.** The industrialised countries continue to suffer, while a billion new consumers in the cities of Asia, Africa and Latin America create a new style; and
- **High Road.** International mechanisms quickly drive the world out of the financial crisis and start to tackle the global systemic challenges.

All three timeframes will be turbulent for the economies and organisations of industrialised countries.

So how can organisations meet this challenge? Over the last decade, many large organisations have been managed with a common set of systems, tools and technologies, intensifying competition. Product lifecycles have accelerated and commoditisation has squeezed profits. The actions businesses take to evade this commoditisation will typically use the same measures that caused it, further accelerating a race that cannot be avoided.

RENEWAL. The cycle can only be broken by changing how things are done and what is done. Renewal needs to be purposeful, allowing the organisation to evade the forces of commoditisation. Renewal needs to match both its current situation and the changing environment.

To do this, the organisation has to be able to gain and analyse insight. It also needs a clear sense of its values, the choices it has made around often intangible issues such as brand positioning, staff relationships and the like. And it needs to relate its current activity and asset base to practical ways forward: its options. These three qualities are joined by the organisational narrative – the shared set of reflexes that knit the organisation together.

Box 1: Purposeful renewal in treasury

It is always helpful to stop and think if things could be done better, *writes Martin O'Donovan*. This time round it might be advisable for business planning to consider the High, Low and My Road scenarios discussed in the main article here. Scenarios could include fundamental demographic, environmental and political changes, perhaps even a wholesale shift of focus from the old economies to the new.

In previous planning rounds each business planning outcome may have been assumed to be financeable and so simply fed back to treasury to inform its own financing plan and to reflect any changed funding cost assumptions. This time round there is a good argument for saying that funding availability is more likely to be a constraint on the business plan options. The business plan may have to follow on from the treasury plan rather than the other way around.

In treasury planning, make use of the internal knowledge and insight of your finance people following the evolution and impact of the market crisis. Explore new sources of finance, reconsider your optimal capital structure, and check on the possibilities for internal liquidity or cashflows. Planning for an upturn is very like planning for a downturn. Cashflow can again come under pressure and lag behind any EBITDA recovery.

The qualities of insight, values, narrative and option generation are held together through the operation of a fifth quality: machinery (that is, the active and dynamic infrastructure, including staff and processes).

An organisation that uses these five qualities for renewal is what we call a "purposeful self-renewing organisation".

THE DOUBLE CONE. At the same time as an organisation engages in renewal, it has to continue to compete in its current lines of business. But how can two different cultures – of operational excellence, and the experimentation and innovation needed for renewal – be fitted into one business?

Figure 1 illustrates the conundrum as a double cone. In the lower cone, the activities are concerned with gaining insight and turning ideas into options. Where the cones meet, assets are allocated and projects approved. In the upper cone, radiating out from this, the organisation maintains its focus on meeting the current competition.

The three concentric circles on the right of Figure 1 represent processes with distinctive qualities. They are drawn as loops because they are iterative.

The inner cycle, circling the top cone, is about managing established operations and their financial and other control and reporting.

The middle loop represents the evolution of the asset portfolio in the medium term. It sets out to deliver concrete plans, discriminate between projects competing for resources. It typically assesses asset flows over a period of one to five years. It has a strong operational feel, employs many of the tools of finance and is home to resource flow planning, roadmapping and the assessment of volatility, discount rates, risk mitigation and related activities.

The outer loop is about how the operating environment works and may change. Some of the tools often deployed in this loop are scenario planning, competitive and stakeholder positioning, corporate and social responsibility and communications, HR development, succession planning and talent management. Long-range option generation and innovation are connected into and from this loop.

None of the mechanisms in the outer loop is revolutionary. The cost of applying them is extremely small, particularly in terms of the scale of the errors they avoid and the successful renewal they facilitate.

What makes the difference revolutionary is the integration of the processes in the three-ring circus and their engagement with sources of knowledge from across the organisation. The streamlining of organisations during the 1990s and 2000s stripped out much of the capacity that had once existed to do this, but it is the key to a purposeful self-renewing organisation.

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