Five Challenges for the Next Five Years

Thomas A. Stewart
Booz & Company’s mission is to serve the senior agenda of the world’s leading institutions

We will be known for the relevance of our ideas, the practical impact of our contributions, the collaborative spirit of our people, and the intrinsically global nature of our firm.

We aim to be the people called upon by leading businesses, governments and other institutions to help deal with their toughest challenges.

We will succeed by being integral and essential to our clients’ success--a company that people want to work with and work for.
Challenge #1: Surviving the meltdown

Challenge #2: Adapting to a carbon-constrained world

Challenge #3: Picking up the pace

Challenge #4: Establishing your right to win

Challenge #5: Leading in uncertainty
Executives lack confidence in their own companies’ plans for the crisis

“My company’s senior leadership has defined a credible plan for navigating through the crisis”

All respondents

- Agree: 60%
- Neutral: 26%
- Disagree: 14%

40% of all respondents express doubts about their company’s plan

CEO & CXO level respondents only

- Agree: 66%
- Neutral: 24%
- Disagree: 10%

Even among CEO/CXO who presumably created the plan, 34% express doubt in plan’s credibility
Companies struggle to cope simultaneously with cost and strategy

- SG&A costs
- Materials and sourcing
- Rightsizing
- Reducing complexity

- Industry logic
- Portfolio choices
- Investment decisions
You can cut costs *and* grow stronger by strategically defining where to invest, and where not to.

### Most Companies Are Cutting Costs Ineffectively

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<tr>
<th>Wrong Focus</th>
<th>Sub-Optimal Outcome</th>
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<tr>
<td>Cut across the board</td>
<td>Competitive position weakens as valuable activities are cut to boost short-term financials</td>
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<td>Target the biggest cost categories first</td>
<td>Strategic differentiation decreases</td>
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<td>Overreliance on using benchmarks by mechanically cutting to “best-in-class” levels irrespective of differences in strategy</td>
<td>Costs creep back over time</td>
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<td>Give priority to short-term cost reduction</td>
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### You Can Cut Costs *and* Grow Stronger

<table>
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<th>Strategic Cost Management</th>
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<td>Most costs are your discretionary investments and should directly reflect your strategy</td>
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<td>Taking costs out is a strategic opportunity to make clear decisions about where to focus your business</td>
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<td>Sustainable cost cutting is about choosing your strengths and using them more effectively</td>
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A carbon-constrained world could affect a business in innumerable ways

- Global growth rates?
- Industry impacts?
- Increasing risk of calamitous events (floods, etc.)?
- Impact on asset values?…
- Effect on government relations?
- Cost of energy / carbon?
- Impact on corporate culture?
- A carbon tax would cost us …
- Opportunity for new products will be …
- Effect on current product / service lines will be …

To understand how to respond, every board should ask--and every CEO should be able to answer--five questions
Question 1: What impact will a carbon-constrained world have on our income statement--our revenue, our ability to grow, etc?

**Forms in which carbon constraint could manifest itself**
- Change in energy costs
  - Price increases
  - Price volatility
- Change in energy production mix (electrification, renewables, etc)
- Change in energy consumption mix (transportation, etc)
- Change in regulatory environment
  - Carbon taxes
  - Market mechanisms (cap & trade)
  - Regulations (emissions standards, green building laws, etc.)
  - Customer requirements--e.g., Wal-Mart

**Impact on income statement and growth potential**
- Macroeconomic
  - Global
  - Regional
  - National
  - Local
- Industry and sector
- Market segments
- Product lines
Question 2: What impact will a carbon constrained world have on our balance sheet and risk profile?

- **Balance sheet risks**
  - Does the value of our assets change
    - That ski resort in Vail?
    - Our air-conditioning patent?
  - In a carbon-trading scheme, are we a buyer or a seller?
  - Are we affected by increasing risk of calamitous events?

- **Nonfinancial risks**
  - Reputational risk
  - Political risk
  - Operational risk: stability of key customers or suppliers
  - etc

Has our risk premium changed?
Question 3: What new opportunities do we have in a carbon-constrained world?
In a low carbon economy, there will be new winners and losers

Revenues from GE’s ecomagination initiative grew 21% last year

In 2003, World Resources Institute and Sustainable Asset Management presciently forecast the impact of carbon constraint on automakers

**FIGURE A. QUANTIFICATION OF THE RISKS (Value Exposure) AND OPPORTUNITIES (Management Quality) OF CARBON CONSTRAINTS**

*Note: The lines indicate industry averages in each category.*
Question 4: What impact will a carbon-constrained world have on our stakeholders?
Question 5: How can we take carbon out of our value chain?

Reduce carbon use in our operations

- Develop designs and new materials that are inherently carbon-neutral or sustainable, following “Biosphere Rules”
  - Use a parsimonious palette
  - Recycle and cycle UP
  - Exploit platforms
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Speed is everywhere

- Product innovation
- Customers
- Communications
- Capital
- Speed to scale
As the rate of change increases, companies need to be able to duck a punch--and to take a punch

Source: Donald Sull, “How to Thrive in Turbulent Markets,” HBR February 2009
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**Challenge #4: Establishing your right to win**

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A company’s right to win depends on its unique intellectual capital

What do we sell that is unique and valuable?

Uniqueness

Value

WHAT DO CUSTOMERS PAY US FOR?
Intellectual Capital is found in people and capabilities; asset-based strategies are dated and, ultimately, doomed.
Companies that focus on capability systems have created superior value

The Importance of Coherence

Degree to which a company leverages a common set of capabilities across its different businesses

Sources: Booz & Company; Capital IQ, Bloomberg
The key message: focus your investments on those capabilities essential to your advantage – cut the rest

**Capabilities-Driven Strategy**

- Asset-based strategies are dated and, ultimately, doomed
- Essential advantage lies in coherent systems of capabilities
- Interconnected people, knowledge, systems, tools and processes that allow companies to consistently out-execute the competition
- Winning companies start from what they do exceptionally well and focus on leveraging these capabilities
- Capabilities drive most or all worthwhile discretionary costs

**Strategic Implications**

- Identify clearly the **3-6 capabilities that are essential** for you to win in the marketplace
- Focus your discretionary costs **around clusters of essential capabilities**
- Cut other expenses that do not directly support them
- Ask not what you should cut, but what you should keep--and leverage across your business
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Cause and Effect

- Known

- Knowable
  (complicated)

- Non-existent
  (chaotic)

- Emergent
  (complex)
Cause and effect

- Known
  - Rules (best practices)

- Knowable (complicated)
  - Experts (research)

- Non-existent (chaotic)
  - First movers (actions)

- Emergent (complex)
  - Leaders (nurture or repress)