NEWS Think Tank | Quarterly

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Dear readers

In our last newsletter we introduced you to our new thematic focal point “Controlling in Times of Crisis” (a working title). It explained how controlling and management can grow together better in a crisis, and what companies can learn from critical situations. In this context, we illustrated for you some tips for dealing with crises.

In this edition of our quarterly newsletter we would like to provide companies with thought-provoking assistance in dealing with a critical situation. To do that, we present and systematise lessons learned from companies that have already successfully dealt with such predicaments. Daniel Kittelberger (Consultant at Horváth & Partners) in an interview also provides useful tips from a management consulting perspective on how to deal with a crisis. Finally, we turn our focus to crisis management and explain the theoretical foundations.

We hope you enjoy this issue and wish you a good start to 2020.

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Reading tips

The research paper **Wertorientierte Steuerung in der Krise? Perspektiven für eine Neuausrichtung der Controllingarbeit** (Value-based Controlling in the Crisis? Perspectives for a Realignment of Controlling’s Work) by Dr B. E. Weißenberger (Zeitschrift für Controlling, 2011, Issue 1) uses the financial crisis of 2008/2009 as a starting point to analyse how a crisis affects controlling. The author concludes that companies must return to a holistic approach to management control. Otherwise they themselves might become the trigger for the next crisis.

In his work **Handbuch Krisenmanagement** (Crisis Management Handbook), A. Thießen provides corporate executives and managers with numerous tools and aids to overcome critical situations in the best manner possible. In addition to articles by 30 researchers, the author focuses in particular on the foundations and structures of modern crisis management and its communication. Its limits are discussed as well. Crisis management is seen here as a part of corporate management.

What is the right strategy to overcome a crisis? | Lessons learned from companies that fended off critical situations

Companies in crisis are often staring into the abyss: cost-cutting programmes keep necessary investments on the back burner, headcount is reduced, niche areas are scaled back; focusing on the core business is usually the right way forward.

The companies Lanxess AG, OSRAM Licht AG and Rheinmetall AG faced a similar abyss. Yet all shared a common fate: each was able to fend off the predicament that threatened its future. How did they accomplish this? In this article we examine more closely and summarise the successful strategies of the *survivors*. We do this by starting with a Boston Consulting Group (BCG) study from 2017.

Crises surprise entire industries time and again – many German mechanical engineering companies are currently in the midst of a crisis (F.A.Z. 2019). In principle, different approaches exist to achieve the desired turnaround (see Fig. 1). These strategies, however, are not meant to be a panacea. Their applicability must naturally be checked in advance, and they are almost always dependent on the situation, company and not least the industry.

Disinvest, **expand** and **grow** – these strategies initially contradict each other when a company is in dire straits. But markets and their framework conditions change in crises too. This is why many companies look to expand their areas of expertise. This frequently also involves growth opportunities that can be realised only through structural market changes. Examples of such possibilities include expanding the product portfolio or acquiring stakes in other companies. Lanxess AG, for example, founded a joint venture with Saudi Aramco, which enabled a substantial inflow of funds. This inflow then promoted debt relief and fostered strategic growth.

But companies are not always lucky enough to find the right partner at the right time for an inflow of funds. That is why many companies **disinvest** in the crisis. The capital tied up in tangible assets will be released to create additional financial means.

It is also helpful to scale back unprofitable secondary activities significantly in order to **focus on the company's core business**. This strategy goes hand in hand with expansion and growth because growth almost always means simultaneously minimising unprofitable business areas. This frees up capital at the same time.

All companies in the study used a wide variety of **cost-cutting and savings programmes**. As already mentioned in the last newsletter, controlling and management must always coordinate in advance any savings measures and take into consideration any subsequent risks.

As a rule, these strategies aim to achieve a **strategic realignment**. This new strategy then becomes the foundation to derive operational measures that should generate long-term competitive advantages and reinforce the company's positioning.

Figure 1: Five strategies for creating value in a crisis (BCG 2017)

Spotlight: Crisis management | Keeping the chaos under control

Once companies are affected by a crisis, good crisis management is needed. How do you deal with employees and what can controlling do to help contain the causes of the trouble?

Crises repeatedly shake entire industries. Companies that aim to survive them must be well equipped. The extent of the 2008 financial meltdown has shown the potential magnitude that economic slumps can have on entire economies. But what exactly is a classic crisis?

In a business context, a crisis has several characteristics. It is (1) **unexpected**, which makes it difficult to anticipate. Crises also often have far-reaching consequences that can lead to an (2) **existential development** for companies. This can usually impact individual subsegments or even entire divisions. As a rule, the achievement of the company's objectives is at risk. These challenging developments must usually be mastered amid some (3) **time pressure**. Top management and controlling must work intensely and hand in hand to initiate adequate countermeasures within a tight time frame, otherwise the situation could escalate. Finally, crises are (4) **ambiguous**, i.e. their causes cannot be attributed to individual triggers. That is also the reason why **crisis prevention** is so difficult. Controlling can often be based only on individual warning signals (Thießen 2013).

Fig. 2 provides a summary of the definitions, causes and forms of crises (Weißenberger et al. 2011). It becomes clear that exogenous corporate crises are especially difficult to anticipate.

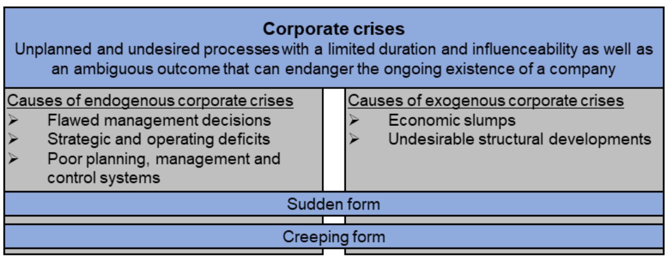

Figure 2: Definitions, types and forms of corporate crises (based on Weißenberger et al. 2011)

Small and medium-sized companies in particular frequently have problems taking countermeasures in these situations because they often have only a limited impact on the economy. We take this opportunity to encourage such companies to send representatives (for example, from controlling) to participate in research and expert groups. In contrast, endogenous corporate crises are much easier to identify and remedy. But here, too, problems become clear. Flawed management decisions are difficult to detect unless a corresponding control apparatus is in place. It becomes clear that controlling can provide crucial support, particularly concerning the causes of endogenous corporate crises. It can take on management's control function, if none is available, and also counteract poor planning.

The **crisis management process** is usually divided into three phases: (1) pre-crisis phase, (2) imminent-crisis phase and the (3) post-crisis phase (Crandall et al. 2010, s.a. Thießen 2013). Fundamentally, companies must differentiate between operational and strategic crisis management. While operational measures are intended to alleviate the direct effects of the emergency situation, strategic measures are aimed at prevention, i.e. to prevent a recurrence of similar situations. Reber et al. (2011) propose in this respect the establishment of a crisis-management team, which takes responsibility for the establishment of structures and processes if a crisis occurs.

Managers as well as top management generally have problems if the critical situation has been identified but not yet communicated to the rest of the workforce. They want not only to **avoid any unrest** and **ease concerns**, but also to **motivate employees** (emotional level). Admittedly, this is much easier said than

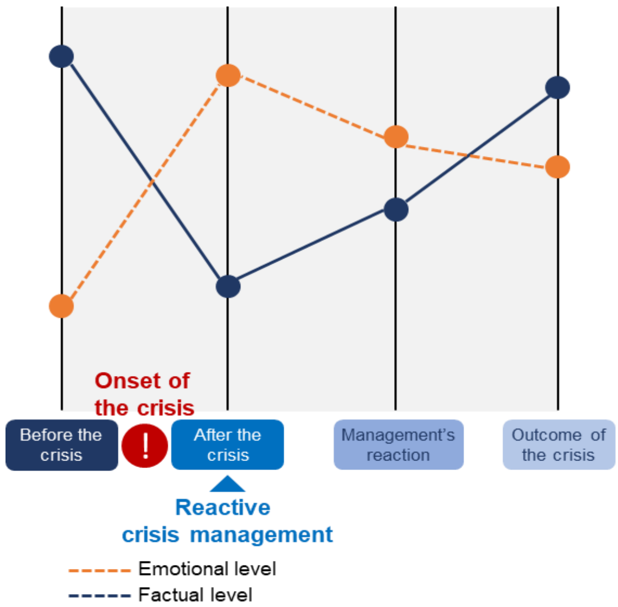

Figure 3: The factual and emotional level in the event of a crisis (based on Töpfer 2006).

done. Töpfer (2006) provides useful aids in this regard for **communicating to contain a crisis** (see Fig. 3). After apologising for the situation arising from the trouble, management must fully inform all employees (factual level) and then explain the process for everyone, including a detailed description of the most important countermeasures. Finally, management should present a plan setting out how such a situation can be prevented in the future.

Preparing for a crisis | Interview with Daniel Kittelberger

Once the onset of the crisis is certain, preparations are important. In an interview, Daniel Kittelberger (Consultant at Horváth & Partners, a management consultancy) has given us useful tips for preparing and planning for dealing with critical situations.

ICV: Mr Kittelberger, what has changed since the last economic crisis?

Kittelberger: Most companies used the economic upturn to invest in their growth – for example, to internationalise their sales markets, develop new customer groups or expand their own business model – often in tandem with digitisation measures. But all of this has made the companies more complex, and has increased their fixed cost ratios, too.

ICV: Are the signs of a coming crisis already noticeable?

Kittelberger: I would say not in terms of the economy as a whole, but clear signs of an economic downturn are apparent in individual sectors, for example in mechanical engineering and in the automation industry. Following record sales in the past, we are now increasingly seeing declines in EBIT margins. The German Mechanical Engineering Industry Association (VDMA) has confirmed this impression once again: order intake in the first four months of this year is on average ten per cent lower compared with the previous year.

ICV: What could the next few months look like in this industry?

Kittelberger: Companies exhibit not only lower order intake, but also overcapacity in production. This combination will lead to mounting price and margin pressure in the markets. The extent of the downturn is difficult to forecast, however, because it depends in part on the reaction of the affected industry.

ICV: How should companies react?

Kittelberger: Companies should initially differentiate between their core business and secondary activities. This differentiation then provides a basis to derive efficiency measures, which can be used for growth once the downturn has been overcome. Overcoming the crisis is just the first step; the subsequent growth is the second. In addition, top management should work with controlling to perform multiple scenario analyses and then prepare measures for these cases. Being caught out in the cold by a crisis also means a lagging response. At that point, most competitors are already one step ahead. Regardless of the state of the industry, companies should develop these scenarios today so that they have them ready when they are needed.

ICV: And what can companies do that are currently in dire straits?

Kittelberger: The first step is to identify meaningful savings potential in company functions (e.g. in production: reduce capacity, make production more flexible through short-time working models). Regardless of where savings are to be made, controlling should discuss with management the effectiveness and ease of implementation of the individual measures. Once all measures have been defined, the company must determine the starting points for the individual activities and assign responsibilities. To do this, it usually makes sense to establish a new unit to manage the programme. Controlling and top management should definitely be part of these committees. After the crisis, the efficiency programmes must then be evaluated for future critical situations. For further information, please refer to our White Paper (2019).

ICV: Thank you for the interview, Mr Kittelberger.

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