NEWS Think Tank | Quarterly

Crises – Special Edition 1 | May 2020

Dear readers

Now is the time to act! Hundreds of thousands of companies are struggling to survive in the face of very special challenges. The coronavirus pandemic shows us, first, that our economy, with its global networks, is quickly reaching its limits, and that its set-up, even after many years of optimisation, is subject to constant changes. Second, the extent of the shock cannot be absorbed easily, no matter how flexible the organisation. The slumps in the various industries are too immense and lasting to do that.

A small team from the ICV's Think Tank therefore set out to describe the current and looming situation, and to show which phases of crisis management we are currently experiencing and those we will soon face. We show what characterises the individual phases and which roles controllers can play when working through the phases in their companies.

On April 24th we discussed our ideas in a multi-hour online conference with a dozen top managers and controllers from different companies. These participants exchange ideas several times a year with Prof. Gleich in an Operational Excellence working group. This was an opportunity for us to receive valuable suggestions that we incorporated directly into what you are about to read.

The team of authors hopes you enjoy the newsletter:

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Reading tips

It is not that easy at the moment to give the right literature tips. A recipe book on how to keep your company on course or get it back on track is not yet on the market. That is exactly what motivated us to develop these remarks.

We nevertheless would like to provide a few recommendations.

A book that is particularly topical is the new controlling-consultant **Modern Cost Management – Flexible – Customised – Sustainable** (ed. R. Gleich, Haufe-Verlag 2020). It contains some interesting and appropriate articles from business and consulting practice, including implementation tips and proven recommendations.

A comprehensive, very practical manual on **Cost Management** was published last year by UVK-Verlag, written by Prof. Dr. Birgit Friedl. It contains many starting points, including for cost management in times of crisis. This book is also worth reading and can provide help.

We are also happy to recommend the short article written by the WHU professors and ICV Board of Trustees members Jürgen Weber and Utz Schäffer, and published in the current edition of Controller Magazin. Its title is **Coronavirus Crisis: A Crucial Moment for Controllers.**

Management of the current crisis | The special role of controllers

What we are currently experiencing, in terms of the unfolding crisis in society and the economy, is completely unprecedented in its form and radical nature. None of the managers and controllers presently responsible for the fate of their companies have ever dealt with anything like it before. As a result, reference points and company-specific experience for coping with this critical moment are lacking. The following ideas from the ICV Think Tank aim to help you determine the positioning of your company and show you ways out of the crisis.

The likely evolution of the current or looming predicament facing our European economy and also the global economy is uncharted territory for managers and controllers with crisis management experience. The current critical situation cannot be understood and managed using the means we have applied in the past. We at the ICV Think Tank have therefore attempted to develop templates that might help a traditional industrial or service company to deal with this unprecedented moment. We initially differentiated between the possible phases of the crisis. Then we characterised these phases and defined, in particular, the role of the controller in the respective phase.
These templates should also help to create stability and provide an anchor and reference point, because nothing is worse than panic mode without perspective. This perspective is exactly what we aim to convey.
We have decided to differentiate between four phases of crisis management (see Fig. 1):

- **Phase 1** aims to help the company survive after an unexpected exogenous (coronavirus) shock. For many companies, this phase will probably extend from mid-March to mid-June 2020.
- **Phase 2** involves stabilising the company and business based on the new circumstances, which are usually radically different versus the past. Here, too, we expect the duration of this phase is about three months, i.e. for many companies, it will extend from July to around September of this year.
- **Phase 3** focuses on the realignment of the company's business models, which is necessary in most cases. In other words, the company is now looking ahead again and trying to identify and utilise new opportunities. Ideally, the company starts this phase in parallel to Phase 2. We expect this phase will last for about six months.
- **Phase 4** is dedicated to the actual restart of the company after or at the end of the crisis. Here, too, a longer start-up phase extending for several months will be needed until the company's added value functions as desired. In our opinion, the speed of the market players at restarting is the absolute trump card in the competition on the market.

While it is certainly still a bit speculative to elaborate on these phases – as we have done below – because of the uncertainty that admittedly prevails from today's perspective, we have decided to take the risk at this time. We will then take up and address this risk again in future quarterly newsletters when new insights become apparent. That means our model will "live".
In the following we describe the individual phases in a little more detail while highlighting controlling's special role in each phase.

In **Phase 1 of the crisis**, the main focus, as outlined, is on ensuring the company's survival. The critical situation is still relatively new and business as usual prevails at many companies (i.e., as could be observed in many companies in March 2020, when revenues were still being generated in line with previous years or the company's planning). The severe downturn, however, is apparent from the decline in incoming orders. The first crisis project teams should be established, or are now under consideration.
While some sectors are booming – still or now even more than

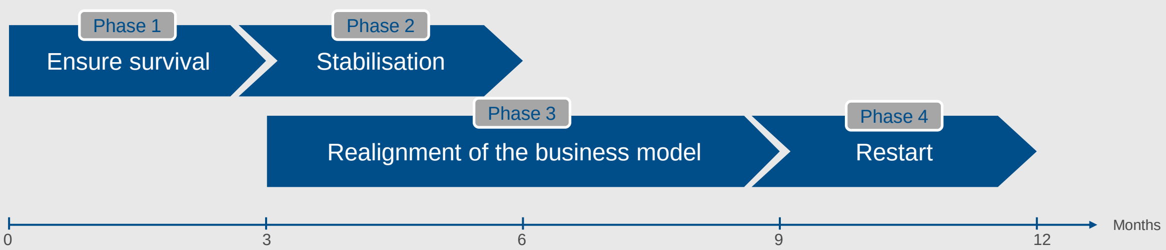


Figure 1: Phases of crisis management

ever (e.g. the construction and pharmaceutical industries) – others are facing the complete standstill of all their commercial activities. These beleaguered industries include gastronomy, tourism and aviation. The industries that are still booming, such as the pharmaceutical sector, are explicitly not addressed here.

In the current coronavirus crisis, considerations that play an especially important role are the health aspects and the right form of communication with employees and other stakeholders, as well as the motivation of employees. This phase also requires that the responsible company managers investigate the potential use of government aid programmes, and additionally create the prerequisites for their possible use (e.g. reduction of overtime as a preparatory measure for applying for short-time work). At this point in the crisis, the key business metric is liquidity; its availability ensures the company's survival. This core premise could be called "cash safeguarding".

In Phase 1, controllers should ensure the required liquidity transparency and prepare regular forecasts for the next few days, weeks and months (see Fig. 2). They must ensure the quality of data in the new context. An example of this is validating the plausibility of incoming orders. We have observed, for example, that ordering systems in the automotive industry still intensively ordered parts from suppliers, even though almost all manufacturers had long since stopped production. Controllers should track down such (and other) revenue risks that jeopardise liquidity or planning. They must likewise establish fast and robust reporting for the critical situation. Here we see the tendency that the reporting will be much more frequent and different, i.e. reports tailored to the crisis and its specific phase, and will include different focal points.

Controllers, in their role as **business partners**, should also actively participate in the development of scenarios for the coming months of the crisis and derive conclusions from them. These, in turn, must lead to action plans. In addition, the company's previous risk position should be scrutinised and supplemented to reflect the current circumstances. Other important immediate measures, such as retaining key people or establishing important cooperation partners, could also be initiated via controlling.

Phase 2, which focuses on **stabilising the company**, is initially characterised by the fact that the crisis has or will become part of the daily routine. At the moment we see that many companies are now rapidly taking things for granted during the crisis that were previously not considered "normal", such as home office work or online video conferencing. One example illustrates this: a well-known IOT consultancy of a major German corporation is currently providing remote support – without any significant overall loss of revenue compared to plan – for around 95% of its current customer projects. Just a few months ago, the market would not have accepted such an approach.

Phase 2 will nevertheless be bitter for many companies and in individual cases will threaten their existence. Revenue and order intake will fall sharply. In many industries, this can result in

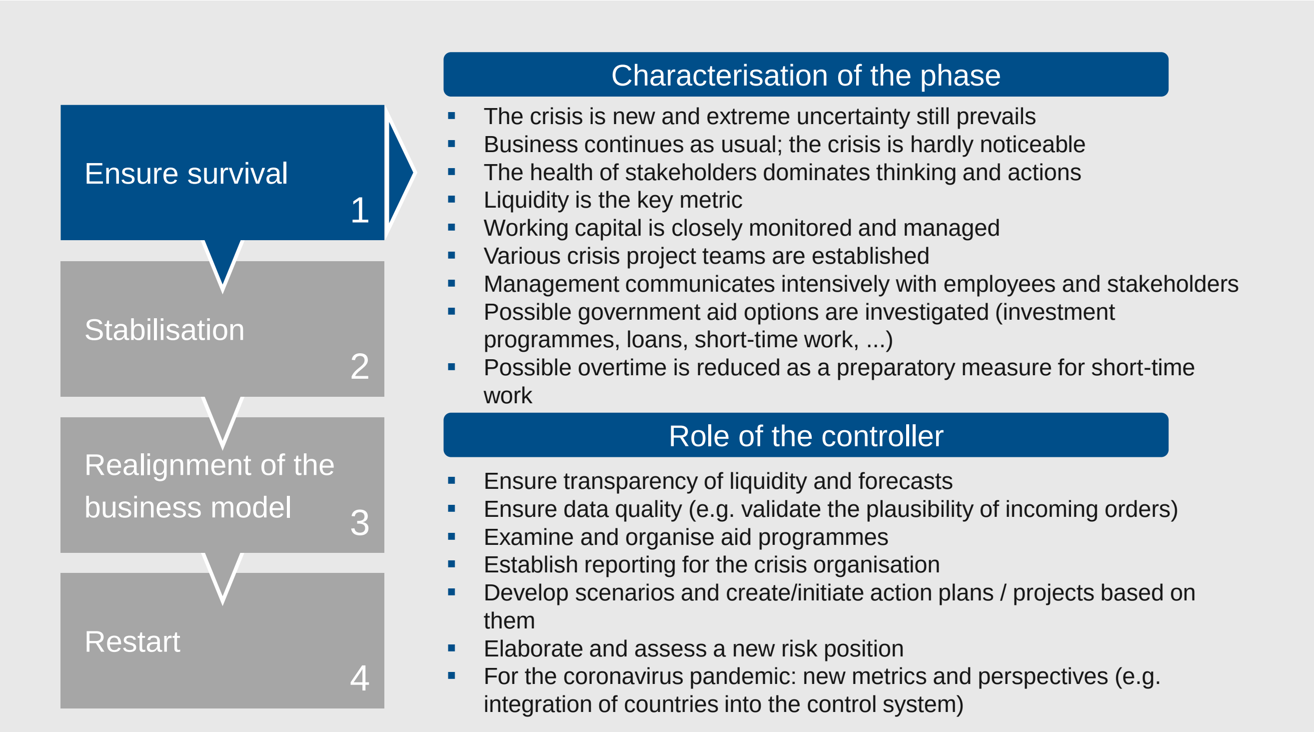


Figure 2: Phase 1 - Ensuring survival

declines of up to 50% or more of the previous “normal” monthly revenue. Extrapolated for 2020 as a whole, massive revenue declines among “non-crisis winners” (such as the automotive industry or the B2B logistics sector) are easy to anticipate. Six months in 2020 with 40% less-than-planned revenue makes 20% less-than-budgeted revenue for the year as a whole. This means the planned operating profit is already extremely endangered or eliminated, and the liquidity position is at least weakened.

In addition, many companies will also be forced to re-assess acquisitions or subsidiaries. This, too, will have a further negative impact on earnings.

Severe downturns are estimated to become existential only when revenue decreases by 40% on a comparable period in the previous year.

Liquidity therefore remains crucial for stabilising the business in severe downturns. Management must thus focus initially on liquidity, then also on profitability, and launch crisis project teams that work explicitly on these priorities. A key question will be how to deal with planned investments. Replacement or expansion investments must be carefully examined in Phases 1 and 2; contracts may need to be suspended or renegotiated if necessary. Rationalisation investments should be seriously considered in Phase 3.

We believe that investments in innovation, sustainability and digitalisation should be given special protection where feasible, since many companies’ important strategic goals are closely linked to them.

One of the world’s leading factory logistics companies even sees the need in the current crisis to make its factories absolutely crisis-proof, which means possible investments in the next step towards automation, i.e. a factory without people who could be infected.

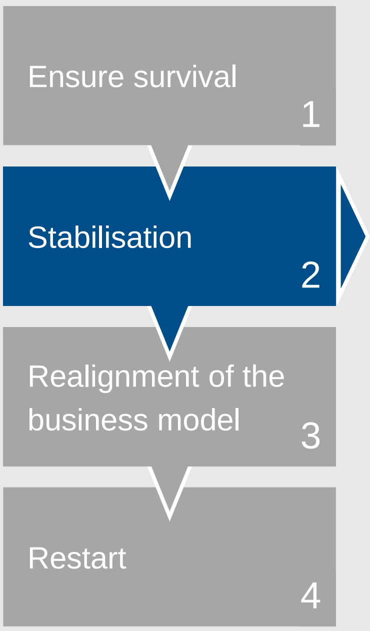
The COO of an automotive supplier is currently taking a different approach, and is instead emphasising investments in several of the company’s own factories. In his opinion, now is the time to achieve unprecedented favourable contract and purchase terms.

In this phase every company must find its own way. In the case of the latter, his approach will definitely require robust liquidity.

The situation will be particularly difficult for companies that are currently unable to carry out business activities and are therefore not generating any revenue. What we have outlined here as possibilities will be feasible only if the company’s financial situation is very stable.

Also in this phase, in which many changes are taking shape, extensive communication is important to inform employees and other stakeholders (e.g. also lenders) in order to get, retain or strengthen their backing.

In **Phase 2** (see Fig. 3), the **controller** should also work to ensure liquidity is transparent and that forecasts are constantly updated. If possible, the controller should help to “bunker” cash. While this can happen in Phase 1, depending on the cash situation Phase 2 is also sufficient. This means, among



Characterisation of the phase

- The crisis becomes part of the “daily routine”
- Incoming orders and revenue decrease noticeably; costs cannot be reduced by the same amount
- The action plans drawn up are gradually escalated
- Liquidity remains the dominant metric
- The crisis project teams are working first on solutions, e.g. with regard to increasing efficiency, reducing costs, as well as prioritising investments, value chains and core business areas
- Management communicates intensively with employees and stakeholders

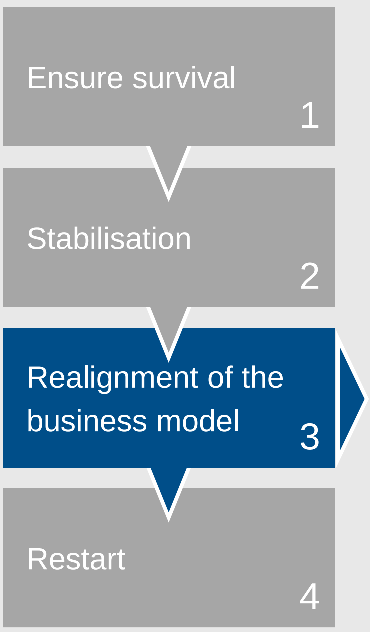
Role of the controller

- Ensure transparency of liquidity and forecasts
- Efficiency improvement programmes are started; cost reduction team continues to monitor closely and implement results quickly
- Scenarios and action plans / projects based on them are enhanced
- Profitability-oriented portfolio management with regard to products/investments/locations is established and implemented
- For the coronavirus pandemic: business continuity plans are developed

Figure 3: Phase 2 - Stabilisation

other things, that credit lines with existing banking partners must be renegotiated in order to have a liquidity buffer. Alternatively, other fast forms of financing may be used (provided that government options have been exhausted).
Controllers must closely control the action plans and efficiency improvement programmes that have been launched (as well as the investment considerations mentioned above). They must additionally support the rapid implementation of the insights and the results.
One guiding premise in this regard could be, for example, to reduce costs significantly in order to lower the break-even point for as many products and services as possible.
We think that profitable portfolio management also fits well in this phase. Such management involves evaluating all products, processes, investments and international subsidiaries against rigorous financial criteria. As a result, nice-to-have solutions must be systematically identified and, if necessary, eliminated. In "normal" times, this might often be frowned upon because it frequently involves traditional products, beloved suppliers or a shareholder's favourite projects.
In the current coronavirus crisis, controllers should also develop business continuity plans to help safeguard the continued existence of the company.

The **realignment of the business models** is the focus of **Phase 3** (see Fig. 4) of our crisis concept. In this phase, the company is planning and acting more strongly towards the medium term, with a planning horizon of three years at most. Ideally the company will also emphasise forecasts and foresight scenarios.
An intensive examination of the future design of the business model and the value chains will take place in this phase. The international diversification of business and the global breakdown of work will probably change a little, but not fundamentally, because otherwise a portion of our prosperity would be endangered. Insourcing a large part of the added value to Germany is illusory and uneconomical. We will nevertheless experience changes and, for example, witness the return of inventories, even though this should not be done when taking solely working capital considerations and profitability-oriented reasons into account. Strong arguments nevertheless speak in favour of this specific step, including having a stable delivery capability, which can also be supported, for example, by strengthening regional locations in Europe. The security of the supply chain is an important consideration, too. This is precisely what many manufacturing companies in crisis mode are already currently working on. In addition, many COOs have recognised the need to seriously question the justification for lean supply chains due to reasons of stability and security, and that individual dependencies on suppliers should be scaled back. For many, "2 plus x" suppliers is the order of the day; and whenever possible, one of these suppliers should not be located 7,000 km or more away.
Further strategic adjustments will undoubtedly occur. For instance, many existing multi-year revenue plans must be modified, and the implementation strategies that have already been



Characterisation of the phase

- Value chains and the business model are analysed
- Based on this, a strategic adjustment or realignment is carried out
- The organisation and resources are adapted to the new circumstances
- A special focus is placed on the organisation's agility and resilience, and the possibilities available to it from digitalisation
- Liquidity, profitability and growth potential, in this sequence, are planned and managed
- Management communicates closely with employees and stakeholders regarding the new structure
- The company's new risk profile is created

Role of the controller

- New or modified business models and value chains are assessed based on the criteria: liquidity/profitability/growth/resilience/risk
- Measures to control the agreed cost-cutting projects/actions from Phase 1 and 2 are carried out
- New strategic controlling is established
- New future-relevant controller competencies are established
- For the coronavirus pandemic: controlling models for digital transactions are developed; resources are reallocated

Figure 4: Phase 3 - Realignment of the business model

adopted, and the planned resource allocations, have to be aligned to the new realities. This will be essential, especially if a delayed economic recovery occurs as the crisis unfolds (in the meantime, forecasters refer to a protracted U-shaped trend for the recovery). This is where an organisation's resilience and agility come into play. Companies must focus on this in particular when modifying their business models. Going forward, organisational structures that are as flexible as possible should be a matter of course, as volatility will certainly not decrease in many industries. Organisations must therefore be able to cope with rapid growth just as easily as with sudden declines in demand. By the way, this is where traditional optimisation models will also prove to be lacking.

In Phase 3, controllers will be closely involved in evaluating the new or adjusted business models, as well as the newly created or modified value chains. The assessment criteria in the review models should include not only the "classics" of liquidity, profitability and growth potential, but also the resilience of an organisation or supply chain, and its risk profile. Furthermore, controllers must continue to closely monitor the measures agreed in Phases 1 and 2. Overall, the controller should redesign the strategic controlling mechanisms, perhaps by implementing a corresponding balanced scorecard or another adequate performance measurement and management system. New digital transactions in particular should be controllable by controllers. We are convinced the coronavirus pandemic will result in a large increase in this type of activity. This means controllers must prepare for this growth by, for example, expanding their skills so that they can develop the right solutions.

We think that controllers should also have a critical role in the back-to-normal considerations. Related questions could be:

- How many business trips are really needed?
- How much security is absolutely necessary in terms of the organisation and resources?
- What do our customers really need at the moment?
- At its core, how stable must a flexible organisation be?

The actual restart of the company, which we call **Phase 4** (see Fig. 5), begins after the realignment of the company, based on the considerations defined in Phase 3. It is important in this regard to get the most out of the new circumstances, and to implement new or modified strategies, business models and value chains. Companies can operate profitably again, even if revenues are lower compared to pre-crisis times, if their strategic and organisational structures have been changed. Ultimately, speed will be crucial to the success of Phase 4, i.e. speed in the development and implementation of new solutions. This can go hand in hand with a pioneering role in the "new market", which is often associated with a profitable market positioning of the company. Companies must absolutely avoid taking a wait-and-see approach, and deliberately or hesitantly positioning themselves as "late followers". This costs profit, revenue and market share, and can endanger the company.

Phase-specific change management, which should start in

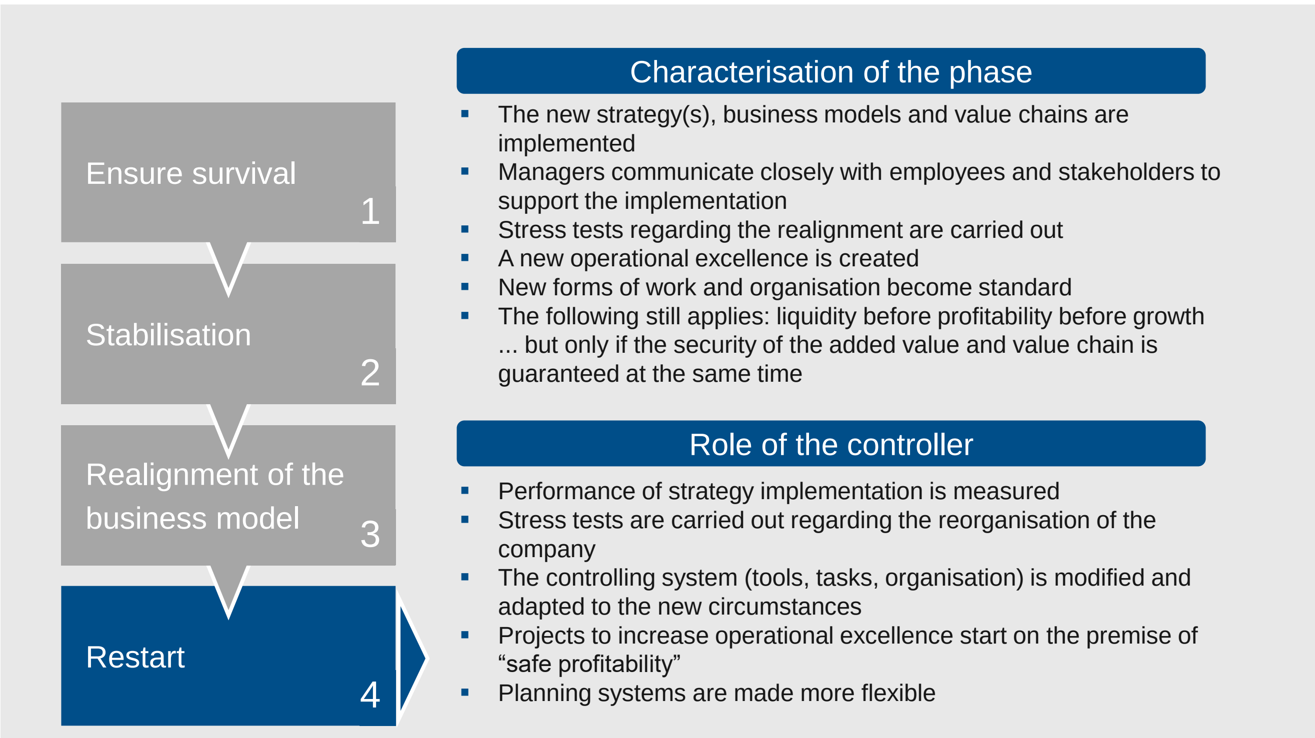


Figure 5: Phase 4 – Restart

Phase 3, requires further close communication with all stakeholders because a lot will change. The pandemic is accelerating the implementation of new – including digital – forms of work and organisation faster than was recently expected, and safety will be an even more important premise for sustainable corporate success.
Controllers should repeatedly challenge the new organisations with stress tests and, as main criteria, test safety issues in addition to the aspects mentioned in Phase 3. Overall, controlling will also have to adapt and probably rearrange its own tools, tasks and organisational structure, and become more flexible and agile. This can also be achieved with regard to its own areas of responsibility. We are thinking, for example, of more flexible planning and forecasting systems, combined with corresponding reporting that is just as adaptable, using all of the new digital and technological possibilities at our disposal.

What is our summary? We believe a rapid and rigorous assessment of the situation, and then action, are the top priorities. This can happen only if controllers and managers collaborate. In order to establish themselves sustainably as business partners, controllers can now “score” and, using their business expertise to support management, help reveal the right path to a successful future. To that end we have summarised our thoughts in Fig. 6. It depicts for each phase the importance of specific controlling metrics for coping with the crisis.

We recommend that controllers act very proactively in an environment shaped by crisis management. Otherwise the purpose of controlling, and the commercial benefit of controllers themselves, will likely be questioned, and probably not just in times of crisis.

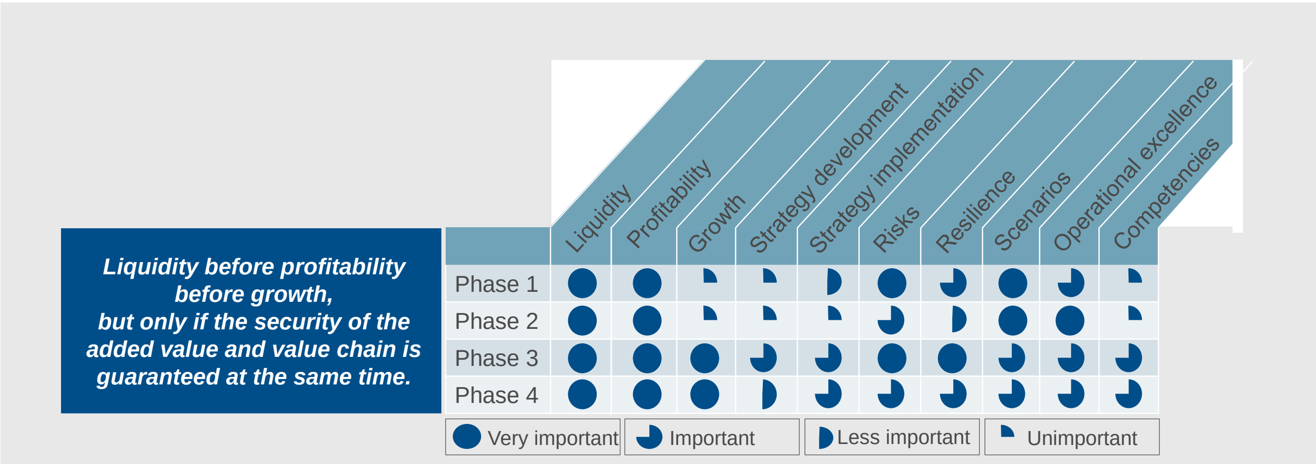


Figure 6: Overview of phase-related focus for controllers

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