Gaining Competitive Advantage in the New Normal

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ABSTRACT

The financial crisis that started in mid-2008 has led to a subsequent economic recession. Although officially declared over, global financial degradation may result in a “double-dip” recession with no substantive relief in the near future. Consequently, fundamental shifts within global forestry and the forest industry sectors have taken place with disruptions, dislocations, and uncertainties felt through the entire chain from the forest to markets. This is the worst downturn for forest products markets since the first oil crisis in the 1970s. Manifestations have included decreased demand, fluctuating prices and changed exchange rates, increased competition, overcapacity, low profitability, wood supply problems, and competition for raw materials exacerbated by the emerging bio-based energy sector. Although the ability of the forest sector as a whole to experience strong growth during the recession and when recovery begins is doubtful, there are many actions that individual companies can take to create competitive opportunities during the crisis and solidify position when markets strengthen. This article presents specific actions that can be taken to create or maintain competitive advantage across the forest sector supply chain in this time of crisis.

INTRODUCTION

The macroenvironment surrounding the global forest products industry has undergone drastic changes in the recent past. The emergence of low-cost producers, changing trade flows, and increasing pressure from social and environmental stakeholders have pushed forest sector companies away from being oriented toward resource extraction and commodity production focus to embrace a new position that aligns them better with these new challenges. At the turn of the century, it became widely understood that the global forest products sector would operate under what would later be called a "green economy," and that the industry would move from an extraction paradigm to a sustainability or conservation-based paradigm. This shift—at least the direction of the shift—is attested to by observable changes in both corporate action and communication wherein forest certification, corporate social responsibility, carbon markets, and ecosystem services have increasingly entered the common lexicon. This new, conservation-leaning paradigm, however, does not supplant the ever-existing need for forest sector companies to continuously improve and make their production and management techniques more efficient; in fact, it only makes this need even more imperative and complex in nature. Indeed, companies are now faced with a dual challenge of achieving operational efficiency (related to profitability) and stakeholder effectiveness (related to social and environmental performance). Balancing these two dimensions has been a bumpy road for a great many companies even during normal economic times. While companies were searching for "win–win" solutions, the advent of the Great Recession in late 2007 to early 2008 made the road bumpier and cast a fog over the view forward.

The Great Recession is officially over (Huffington Post staff 2010) but continues to reverberate through the global economy. Many fear that a W-shaped recession is possible, or that an L-shaped prolonged downturn with little growth might be the ultimate path of the economy in the near term (Olson 2010). The Great Recession has negatively affected nearly all business operations across a majority of industries, forcing most companies around the world to lower their inventories, cut technology spending, scale-down core processes, face reduced demand for their products, and live with limited financial flexibility to invest (Olson 2010). In most cases, their ability to find innovative solutions that are much needed for thriving, or even surviving, in a changed marketplace were halted or jolted. However, we do not intend to focus on the myriad ways that the economic recession has impacted companies in the forest sector. Rather, our focus is on proposing a path forward that, we hope, will help forest sector companies as they prepare themselves for the short- and long-term future.

Recessionary periods are germane to the free-market economic system. We have learned from previous recessions that the long-term success of companies depends on their ability to maintain or quickly develop competitive advantage after a recessionary phase. It is, however, noteworthy that the seeds of this competitive advantage are sown long before a recession is over. It is almost embarrassingly obvious to say that economic recessions push many companies to seek survival strategies, yet it is much needed to emphasize that companies must not remain frozen in a difficult economic climate and forego the opportunities that occur during a period of downturn. Recessions create both organic and inorganic growth opportunities for companies that are different from those arising during boom times. In the case of the recent Great Recession, for example, some companies are finding opportunities in the aftermath, by entering markets where competitors have been weakened and hiring talent that would otherwise not have been available (McKinsey and Company 2009). Many companies that acted proactively in autumn 2008 or before were able to cushion themselves against the adverse effects of recession, and although they may have sustained lower short-term earnings, they are better positioned for harnessing postrecession opportunities relative to their peers. Farsighted companies have learned that it is imperative to craft and hone postrecession strategies before the recession is over, and this is precisely why they mesh their postrecession vision with business decisions made during the recession.

Moving past the Great Recession, companies seek to create competitive advantages, and in so doing they adopt different strategic postures. Although the future of the sector remains unclear, it also presents an opportunity to pause and develop a big picture of the path forward. We believe it is important to magnify some key areas not only in the context of economic recession, but also in the context of long-term competitiveness of the forest sector vis-à-vis competing industries. We begin with a suggestion for companies to develop in-house business cycle forecasting capabilities that may prepare them better for economic shocks. We then draw from previous research and briefly outline how various strategic choices that companies make during a recession can affect their postrecession performance. Further, we focus on the leadership and organizational culture aspects that may erect architecture for companies' postrecession success. We then focus on industry sophistication and argue that companies need to make significant efforts to align themselves with a changed world. We close this article by urging forest sector companies to make the best they can out of the economic crisis.

DEVELOPING A BUSINESS CYCLE ORIENTATION: PREPARING FOR A DOWNTURN

As opposed to a traditional view suggesting that business cycles cannot be predicted, an emerging research area focuses on developing tools and strategies for advancing business-cycle management (Navarro 2004, 2009). This literature suggests that companies must focus on developing and deploying forecasting capabilities, rather than leaving business cycle forecasting to outside economists. Now, managers can forecast business cycles by monitoring gross domestic product forecasting equations, stock market trends, and shapes of bond-market yield curves. Together, these three tools have a well-researched predictive power for business cycle forecasting. In addition, Economic Cycle Research Institute's Weekly Leading Index and The Conference Board's Composite Index of Leading Indicators have provided signals for previous recessions.

Given the importance of the housing market to the forest products sector's overall economic health, developing business cycle orientation may be an even more logical proposition for forest sector companies. In fact, a recent study emphasizes that credit markets have been better predictors of economic downturns than equity markets (Koller 2010). This study argues that globally most major economic downturns have been driven by some kind of credit crisis. For example, the study links the US economic downturn of 1980 with the Federal Reserve Board Inflation Crackdown; the downturn of 1990 with the savings and loan, junk bond crisis; and the recent 2007 downturn with the US subprime-mortgage crisis.

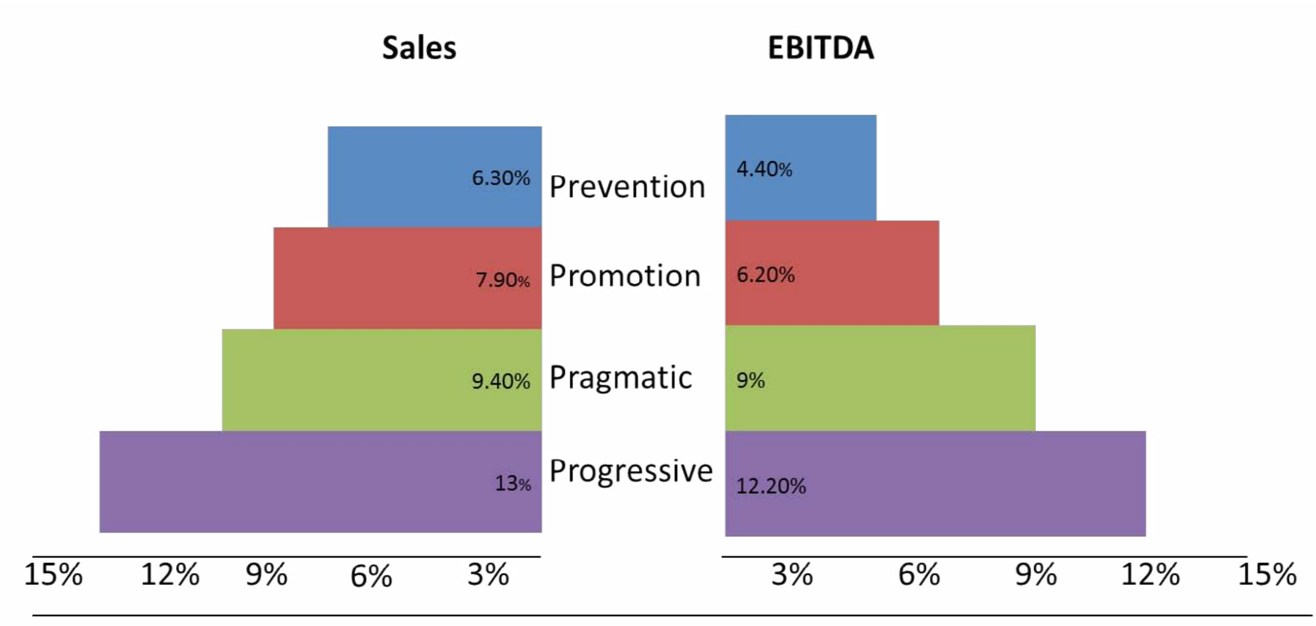
In order to develop a business cycle orientation within their companies, managers of forest products companies must proactively engage in following macroeconomic developments and focus on improving financial and credit market knowledge. We strongly recommend forest sector companies to expose their nonfinancial managers to these financial aspects through, for example, continuing education programs. After all, a business cycle orientation entails a companywide understanding of and sensitivity to business cycles. In other words, it is important to develop a culture in which all personnel in the company are constantly aware of the dynamics of the business cycle, not just top management.

MAKING DOWNTURN STRATEGIES: EYEING THE UPTURN

Companies respond differently to economic downturns and pursue different strategies to deal with challenges of navigating through an economic downturn and remaining competitive. Based on companies' in-recession strategies, Gulati et al. (2010) classify them into four distinct types:

1. Prevention-focused companies—those making primarily defensive moves, more

Figure 1. A comparative illustration of the postrecession sales and earnings before interest, taxes, depreciation, and amortization (EBITDA) of the four company types (adapted from Gulati et al. 2010).



concerned about avoiding losses and minimizing downside risks.

2. Promotion-focused companies—those investing more than their peers in offensive or aggressive moves.

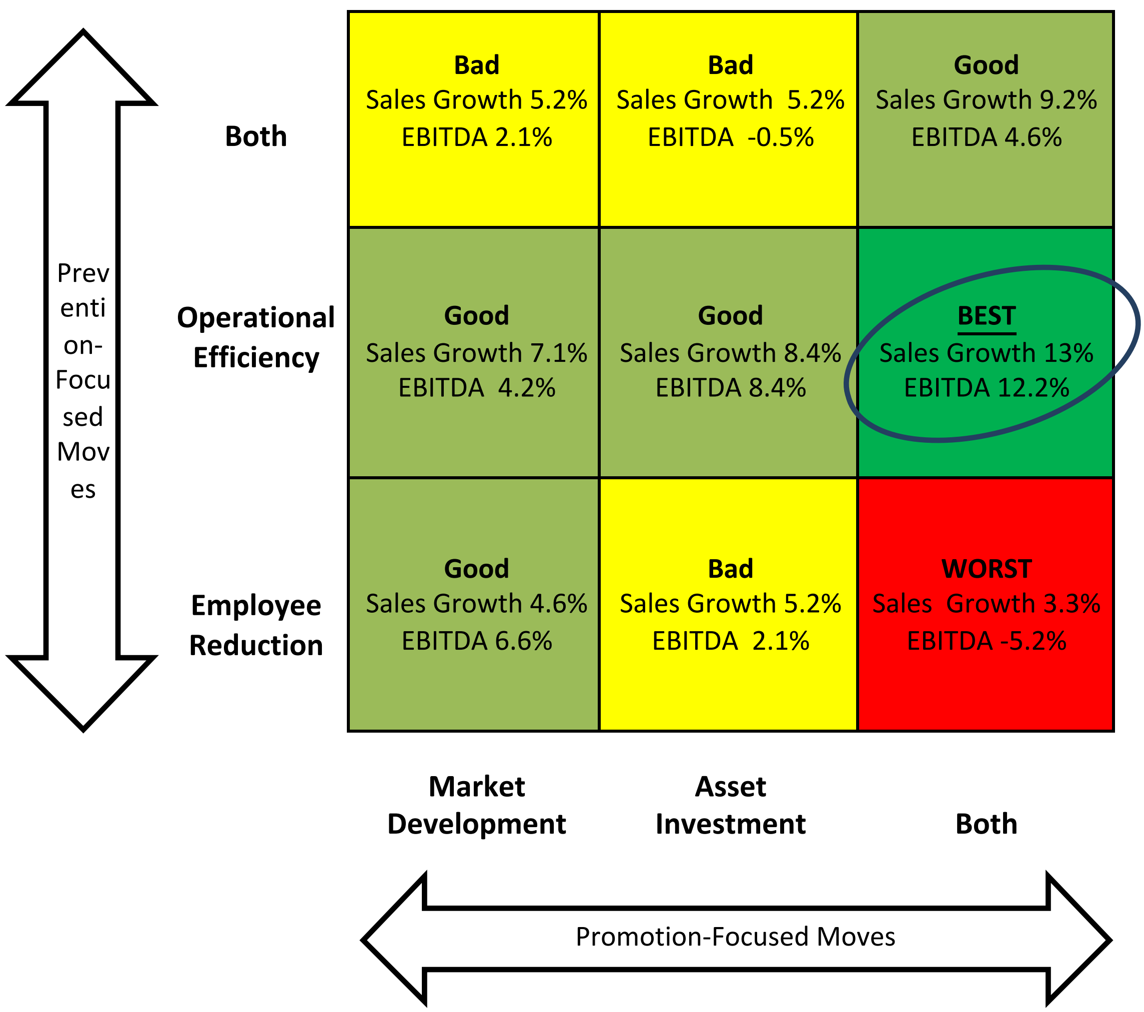
3. Pragmatic companies—those combining defensive and offensive moves.

4. Progressive companies—those deploying an optimal combination of defense and offense.

Based on an analysis of 4,700 public companies' in-recession strategies and postrecession financial performance during the past three global recessions, this study concludes that only about 9 percent of companies come out of a recession stronger than their pre-recession levels. Figure 1 summarizes postrecession financial performance of the four different types of companies.

Progressive companies—those that deploy an optimal combination of prevention and promotion moves—fare better than companies that are prevention-focused or promotion-focused, or those that combine prevention- and promotion-focused approaches (pragmatic). To provide a specific characterization of progressive companies, Gulati et al. (2010) distilled the prevention and promotion strategies into three different combinations of two factors each. Prevention-focused moves may include an exclusive focus on either employee reduction or operational efficiency, or a combination of both. Similarly, promotion-focused moves may include an exclusive focus on either market development or asset investment, or a combination of both. A combination of preventive and promotion-focused moves provides a matrix of nine strategic choices as shown in Figure 2. It may be noted from the figure that the optimal combination of prevention and promotion approaches is achieved when a company focuses on increasing its operational efficiency while simultaneously developing new markets and enlarging its asset base. The cited study outlines several examples that may help understand the core message. For example, the study argues that during the 2000 slowdown, Sony significantly reduced its workforce, research and development (R & D) expenditures, and capital expenditures. These measures led to a short-term increase in its profit but led to long-term continuous decline in sales. The other extreme, promotion focus, cost Hewlett Packard a profitability level decline after it heavily invested in acquisition, R & D, branding,

Figure 2. Postrecession financial performance associated with different combinations of companies' in-recession strategies (adapted from Gulati et al. 2010).



and global expansion at the height of the 2000 downturn.

LEADING YOUR COMPANY: DEVELOPING A CULTURE OF TRUST IS THE KEY

Reeves and Deimler (2009) emphasize that typical responses of most companies during an economic recession include shrinking production capacity, downsizing labor force, reducing discretionary spending, and conserving cash. This "hibernating" reaction, they argue, is a time-tested proposition and works well if the recession is short in duration. However, recessions may persist. For example, there is a growing consensus among economists, business leaders, and governments that suggests the current downturn may be of unpredictable duration and that even when the upturn comes, the postcrisis strategic and operating environment will almost certainly be quite different.

In the same vein, Heifetz et al. (2009) suggest that the economic recession must not be viewed simply as a rough spell that is over. While the "emergency" phase of recession is over, during which companies essentially needed to buy time while striving to stabilize their situation vis-à-vis the external environment, what lies ahead is an "adaptive" phase of the crisis wherein companies must address the underlying causes of the crisis and at the same time build the capacity to thrive in a new reality. Survival strategies, such as shrinking production capacity, downsizing the labor force, reducing discretionary spending, and conserving cash, may help companies buy time, but they are not likely to foster future sustainable competitive advantage.

In essence, it is argued that organizations will not automatically return to normal in the postrecession period. The leadership within organizations instead must strategically steer their organizations out of crisis. This will require leaders with three fundamental skills: (1) fostering adaptation within their organizations by helping employees identify and develop new practices needed to move forward in the new context; (2) creating a sense of urgency among employees while simultaneously managing their anxiety so that they do not fight, flee, or freeze; and (3) encouraging people at all levels of organization to lead experiments that will help the organization adapt to changing times (Heifetz et al. 2009). Also, as recovery continues to be slow, it is important to develop an organizational culture that fosters trust between management and employees and among employees.

Owners and CEOs of forest companies must focus on honing their adaptive leadership skills. A reactive posture of waiting for an organizational situation to improve with an improvement in economic conditions will not help organizations out of the crisis. Business managers and owners must recognize that economic crises bring a point of inflection in the global economy—the world after rarely resembles the one before. It is all the more certain in the case of the current crisis: business leaders must adapt to lead their organizations in the "new normal" and focus on keeping their employees' and partners' morale and confidence unshaken yet realistic, with trust in their organizations intact. Also, it is important that organizations train their people to embrace changes in the external environment. These changes may include consumer behavior, customer financial situations, newly emerged partnerships, and even changed ways of doing business. The sooner an organization, and its people, become one with these new realities, the better off they will be. We strongly recommend forest sector companies devise mechanisms to sensitize their entire workforce to help them see the world and their business in light of a changed environment. The last thing a firm needs is fragmented opinions among its employees about the new reality.

INDUSTRY SOPHISTICATION: FINDING NEWER PATHWAYS TO COMPETITIVENESS

Economic recessions change much for companies but what generally remains unchanged is a continued necessity to focus on understanding the changes taking place in supply and customer chains, identifying new sources of competition, understanding factors that shape purchase decisions, and learning how to become a source of value to customers (Brown 2009). Postrecession, companies are confronted with the need to find new rules for seeking economies of scale, reducing development-to-market cycle times, and improving customized product servicing. It is striking that in 1950, there was a 71 percent probability that the top five market-share leaders in a sector were also among the top five for operating margin. By 2007, that likelihood had dropped to 31 percent (Reeves and Deimler 2009). Sophistication and various company capabilities have thus generally become more broadly diffused, but we suspect this is not true for forest sector companies.

For forest sector companies, continuous improvements in manufacturing and support system technologies must remain at the core of business sophistication. Investing in advanced manufacturing technology (the application of computer-enhanced science to a firm's production system) allows companies to respond to rapid market change and adapt to shorter product life cycles. Producing high-quality, custom-designed products using a manufacturing technology platform can also help companies achieve economies of scale (Vonderembse et al. 1995).

Also, forest sector companies, especially those in lumber and plywood, have focused on improving recovery and increasing production volume. This is evident from an average 22 percent increment that has happened in sawmill recovery between 1970 and 2006. This increment was largely a result of process improvements in chipping technology, thinner kerf saws, curve sawing, and computerized scanning and "optimization" technology, which have led to better recovery of higher value coproducts (Meil et al. 2007). Today, as the competition for saw logs and peeler logs is getting fiercer and raw material costs are beginning to rise, focus on value recovery has become ever more important for lumber and plywood mills.

A sole focus on volume is unlikely to reap competitive advantage. Even traditional commodity sectors of the industry can learn from the lessons provided by the contrast between the US furniture and cabinet sectors over the last decades. While the furniture industry relied on producing standardized, stock furniture and was decimated by Chinese competition, the cabinet sector chose to offer made-to-order (mass-customized) cabinets to the market. In 2009, 69 percent of US consumption of nonupholstered furniture was imported. In contrast, the equivalent number for cabinets was 4 percent (Buehlmann and Schuler 2013). We speculate that successful firms will develop sophisticated integrated information management systems that aggregate customer preferences, technological adaptation, production economies, delivery schedules, servicing, and end-use improvisations, thus leveraging the benefits of mass customization.

In addition, supply chain sophistication is important. Many companies have already deployed logistics information technology (LIT) for better planning, implementation, and control of procedures for transportation and storage of goods throughout the value chain. However, because of the various inherent inter- and intraorganizational interdependencies required for the effective transportation and storage of goods, adoption of LIT seldom automatically translates to improved supply-chain operations. One key imperative is technology integration; for example, a concurrent adoption of LIT with radio frequency identification might provide better results than selecting one or the other. Moreover, tech-adoption for improving supply-chain efficiency seldom provides the hoped-for results unless buyer–seller relationships are strong (Hazen and Byrd 2012) and they provide both a platform and motivations for technological compatibilities between them. Despite the fact that across segments, technological improvement and automation in the forest products sector has been steady, resultant efficiencies have not revolutionized the basic architecture of forest sector operations. Bill Gates once said, "The first rule of any technology used in a business is that automation applied to an efficient operation will magnify the efficiency. The second is that automation applied to an inefficient operation will magnify the inefficiency." Indeed, automation is not a panacea and not even viable if not well integrated with overall operations. It is important that companies avoid ad hoc technology adoption and instead develop a well-thought-out strategic map for technology adoption. Companies should also conduct an audit to assess the preparedness of its employees for tech-adoption and process change. It is the people at work, after all, who make a new process or technology succeed for a company.

SO, WHAT IS THE MESSAGE?

Essentially, we have argued that forest sector companies must be more proactive in monitoring the business environment. A few progressive companies are of course taking the lead, but overall the sector remains largely characterized by traditional thinking. Rooted in the history and traditions of the forest sector, most companies have focused more on process-related improvement. Focus on product improvement and new product development has remained a secondary priority. Business systems improvements have, however, received very little attention among a great many forest sector companies. Consequently, the culture of the sector has remained largely unchanged.

It is within the context of this traditional mind-set that we challenge forest sector companies to deal with the new normal. It is time for them to start thinking about business system innovations. Developing a culture of business cycle orientation, a culture that encourages a farsighted view during economic downturn, and a culture that fosters organizational aligning with the new normal are just three key imperatives we have identified here. Opportunities are boundless. The newer marketplace realities necessitate a fresh look at where companies focus their innovation efforts. For example, companies may consider introducing new services, such as financing, that could enhance their value proposition for budget-strapped customers (and final consumers). In practice, making these cultural changes happen will require both a shift in top management mind-set and also a significant investment in employee training and competence development. Many small and midsized companies may find such investments prohibitive. A potential way to address this challenge is through developing multi-agency clusters that Hansen (2010) notes could provide models for enhancing industry's innovation capacity in a clustered and institutionalized fashion.

But, one may ask why should the sector really change? Why must the traditional capabilities of the sector—producing and selling—not be focused on? The answer is because traditional capabilities have a flip side too; they may become core rigidities in a changed context and hamper growth both at company and industry levels. Companies must remain vigilant and adaptive so as not to allow their capabilities to turn into rigidities.

CONCLUSIONS

The recent recession may be technically over, yet its remnants continue to challenge forest sector companies globally and will for some time to come. Additionally, the business climate remains dynamic and stakeholder pressures pronounced. Forest sector companies will need to be even more innovative and strategic in managing internal and external business affairs. We also believe that this recession has hastened the decline of ineffective business models and prompted companies to reexamine their business strategies. Noted economist and entrepreneur Paul Romer said, "a crisis is a terrible thing to waste." Companies that use the crisis to get beyond their past will be the winners in the postrecession forest sector. They will have fine-tuned their business systems and operations and be prepared for long-term competitive advantage.

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