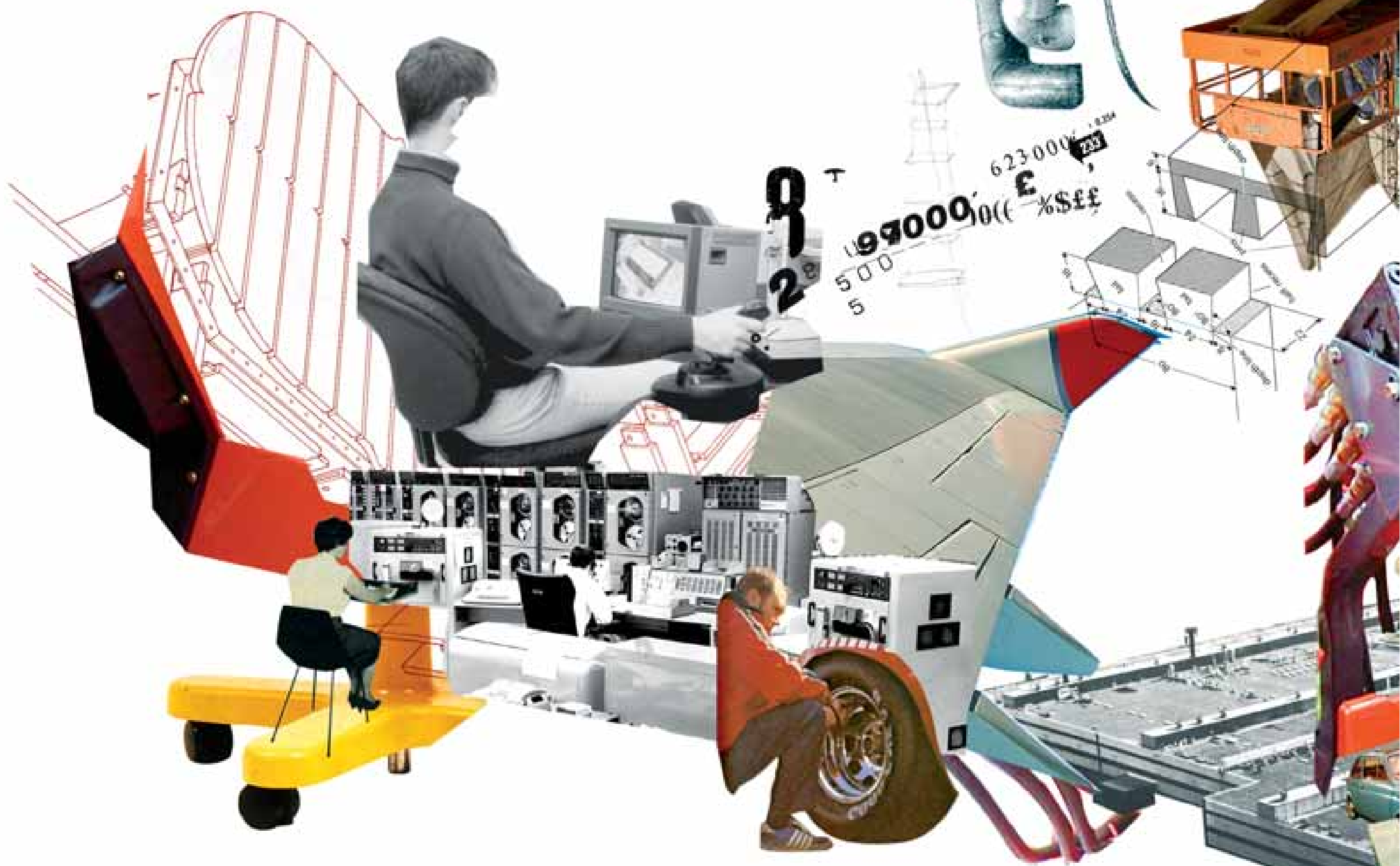
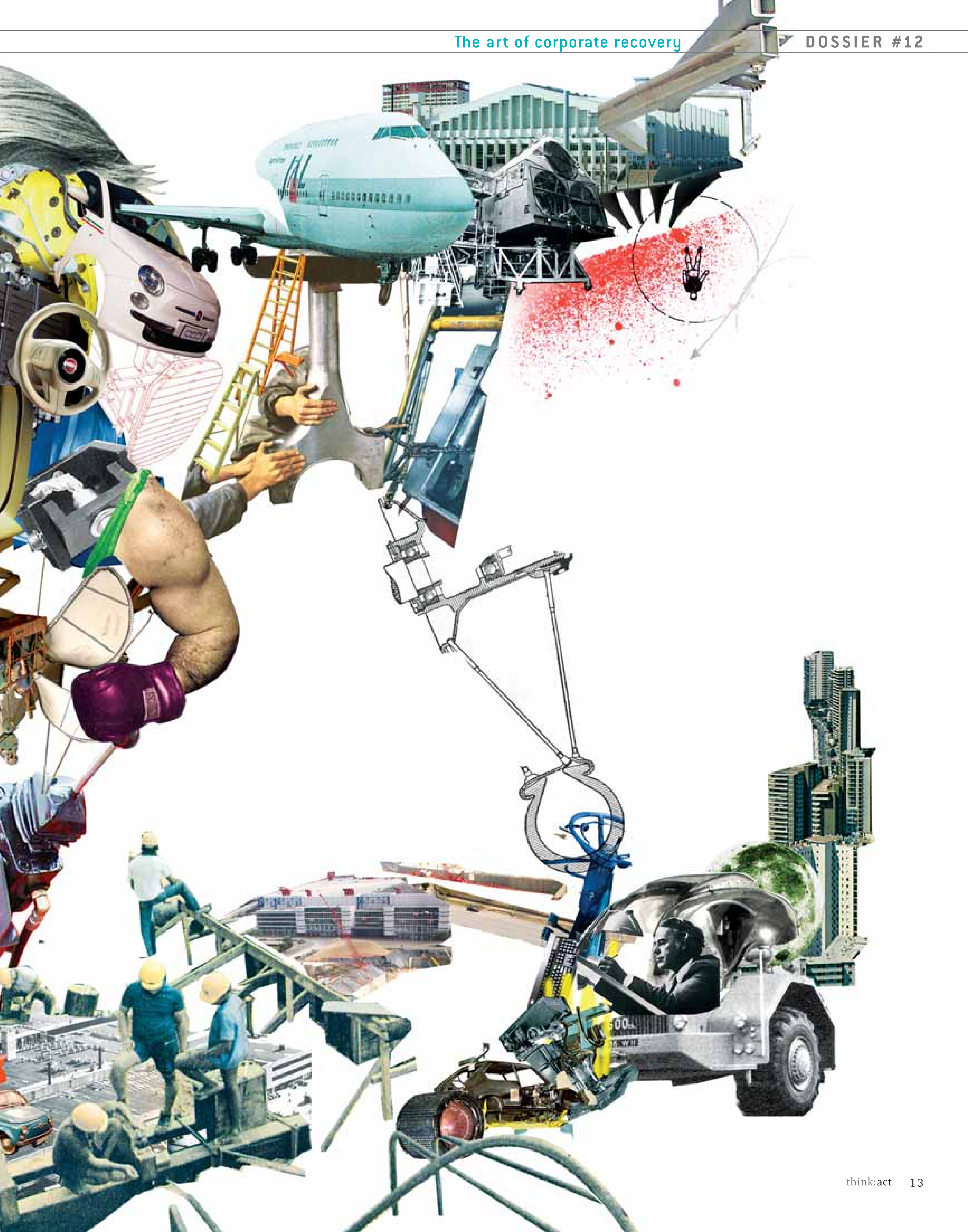
The art of corporate recovery

as seen by James Dawe

The business world depicted by artist James Dawe is a rather chaotic one; it is an environment where constant change is the norm. About his piece—which he created exclusively for think:act—he says, “I focused on the significance of evolution and transformation. These are essential factors for a company’s survival. I therefore intended to create a futuristic hybrid structure that reaches for the sky—or moves towards a new utopia.” In his collage, Dawe also integrates some singular elements contained in this dossier, such as the Fiat 500 and an airplane.





You can also listen to this article on our audio CD (page 63).

NORTHERN ROCK

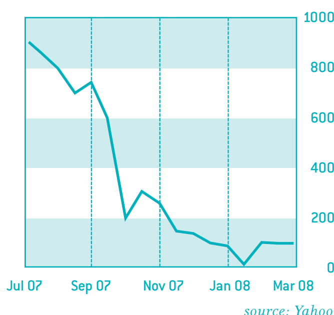
AFTER WHOLESALE CREDIT MARKETS SHUT DOWN, THE COMPANY WAS NATIONALIZED. IT NOW REDUCES ITS BALANCE SHEET BY REDEEMING MORTGAGES FASTER.

£4.1 billion is how much the company owes to the Bank of England.

"We remain firmly focused on our business priorities of repaying the government debt, releasing the guarantee arrangements and, in due course, returning Northern Rock to private ownership.

RON SANDLER, EXECUTIVE CHAIRMAN

SHARE PRICE: STABILIZED AFTER A STEEP FALL



source: Yahoo

Here's the CFO's recession

Times got tough in global business. The liquidity drain is a severe problem for many companies—even for those with a healthy market strategy. Often there is only one way out: restructuring for corporate recovery.

THE SIGNS TRICKLE through day by day. Coffee chain Starbucks issued a warning that its sales declined as consumers tightened their belts. Stir in retail sales that are declining overall, and sprinkle with rising sales for discounters. Add rampant foreclosures. The result is the consumer on ice and an economy with a unique concoction of unsettling factors—watched nervously around the world.

Businesses are feeling the pinch. Those in tight financial markets get squeezed from two sides: Even as consumers rein in their discretionary spending and large companies pay smaller companies with increasing delays, banks are less likely to provide loans for bridging bumpy periods or investing in new products or services. This all comes at a time when companies face record-high oil and commodity prices and European and Asian firms suffer exchange-rate risk.

IT'S ONLY NATURAL then that companies begin to hold on to their cash, just as banks have been doing in the aftermath of the subprime crisis. This pulls money out of the economy left and right and makes life difficult for companies that need cash, particularly those with non-stellar ratings. As companies search for funding, banks are busy trying to tally their own losses and keep those losses from mounting.

Analysts say it's time to face reality: The subprime crisis and the resulting liquidity strain are impacting the economy outside of the financial services industry. Politicians are more frequently using the "R" word. But what does it mean for company bosses? "If you thought your business was immune to such dramatic turbulence, think again," says Steve Francis, a partner in Roland Berger's Turnaround and Restructuring Practice. This rethinking "is not happening quickly everywhere. There will be a slow and reluctant realization in businesses across most of the economy that restructuring is required."

Crises can always become lethal if companies are ill-prepared. But in this downturn, the situation is special, since balance sheets tend to include higher debt levels and more complicated debt structures than in the past, and angst has taken deeper root.

"In every other downturn, banks have trusted each other. Right now banks don't trust one another even on routine transactions," says Francis. The financial-market-induced downturn seems to have snuck up on companies that had been happily focusing on growth after recovering from the Internet bubble. Many racked up debt since it was so readily available. Others sold out to private equity investors that raised the level of debt on balance sheets to unforeseen levels. By some estimates, a full 30 percent of the "real" economy is private-equity-owned. It's like being caught full sail in a storm: You take a battering if you proceed on course. But navigating an alternate route to liquidity is no fun either.

Instead of the CEO charting the course, this downturn may require whole new thinking about debt levels and structures. Given the liquidity squeeze, the CFO is more likely to see a tsunami coming before the CEO can recognize it. The CFO is, after all, the person who sits at the intersection of operations and liquidity—a position that provides a unique understanding of the threats brought on by the current market situation. "The normal recession is the CEO's recession. With the focus on liquidity, this is the CFO's recession," Francis says, adding, "CFOs live and die by liquidity. While CEOs may be able to talk themselves out of their strategic miscalculations and fudge on their CVs, CFOs do not survive the loss of a company's liquidity. It's black and white."

Companies typically face a crisis of existence after passing through three phases. First, a company makes strategic missteps and loses its competitive advantage. Somewhere down the line, this becomes

evident internally. Shortly thereafter, stakeholders and the media begin to hear about the company's dilemma via its worsening financial and operational results. Management reacts, but actions bring delayed impact, and banks begin to crack down on loan covenants, causing a crisis or even insolvency.

A protracted example is the fate of the US automotive industry. Decades ago, the big players failed to do their homework. They focused on large vehicles and the domestic market while Japanese and German automakers placed better bets on international markets and fuel-efficient technologies. Now, US players lag behind. But this doesn't mean that the worldwide liquidity crunch will leave European and Japanese automakers unscathed. They still face the dangers of decreased consumer demand, stricter environmental regulation and tighter financing regimes.

INDEED, THIS IS the hallmark of the "CFO's recession": The liquidity squeeze, with its widespread uncertainty about financial markets, may cause problems for otherwise healthy players. All of a sudden, a company has trouble paying its bills or finding money to invest in new technology or R&D. "A good company with a bad balance sheet ends up becoming a bad company," says Francis.

Companies inherently look to restructuring to help them manage their businesses amid the dangers of the market. Those that are leading in their markets but tight on cash may be candidates for financial restructuring, while companies that are both overleveraged and struggling may need to consider holistic restructuring that includes strategic, operational and financial reorganization. Most advisors will address all three areas in initial assessments before restructuring projects are defined.

Northern Rock was one of the first to slip in the UK as a result of the subprime crisis, and the bank is now restructuring in all three areas. The mortgage lender was nationalized in February and a new CEO was brought in to lead the restructuring, after wholesale credit markets effectively shut down amid the liquidity crunch and caused the bank's business model to falter. The bank is now set to repay its debts —£4.1 billion at the end of March 2008—to the Bank of England by 2010.

AS PART OF THE restructuring, Northern Rock is reducing its balance sheet by redeeming mortgages faster than in the past. It is trying to achieve a balanced mix between retail and non-retail sources of funding, and is reducing headcount by roughly 2,000. In May, Ron Sandler, the new executive chairman, said, "I am pleased to report that solid progress has been made against our business plan. The Bank of England loan facilities are reducing and the balance sheet is contracting as a result of planned mortgage redemptions. While arrears have increased, the credit quality of the loan book remains satisfactory and at a level assumed in the plan." Clearly the outlook for the UK mortgage market is uncertain, but "progress against our business plan to date is encouraging. We remain firmly focused on our business priorities of repaying the government debt, releasing the guarantee arrangements and, in due course, returning Northern Rock to private ownership," he said.

Most managers accept that restructuring, particularly operational restructuring, should be a long-term process. They also know that it must come fast and be minimally disruptive for customers. If not, banks will take over. "You end up playing chicken with banks, particularly if you benefit from 'covenant lite' lending conditions. If you lose, the banks get to run the business," says Francis. Richard Tett, restructuring specialist at Freshfields Bruckhaus Deringer, has already seen an uptick in business as some CEOs have heeded early warning signs forced into restructuring in the face of the credit squeeze that has become a consumer squeeze. "We're moving into an active phase in restructuring, as the credit crunch hits and liquidity dries up." Many businesses have only survived the past years because of the generosity of banks. "Some can recover with bridge financing, but others have been propped up. It has turned out that bridge financing has merely delayed restructuring. In the current tighter market, some companies that received bridge financing in the last few years would not be given the same liquidity today."

This was the story of the last years: extreme liquidity and the willingness of markets to provide financing and covenants with no fees. Now that the situation has reversed dramatically, the question is: How prepared are you to weather the storm?

SIGNS THAT A DOWNTURN HAS ARRIVED:

- ➔ Commercial property values down
- ➔ Retail spending slowing
- ➔ Rumors of problems for highly indebted companies
- ➔ Larger companies paying smaller companies more slowly

FIAT

THE ITALIAN CARMAKER HAS BEEN TURNED AROUND COMPLETELY. CEO SERGIO MARCHIONNE DECREASED DEBT, IMPROVED LIQUIDITY AND REFOCUSED THE AUTO DIVISION ON SMALLER CARS.

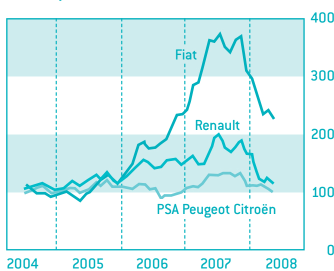
766 million euros was the Fiat Group's profit in the first quarter.

"The single most important thing was to dismantle the organizational structure of Fiat. We tore it apart in 60 days, removing a large number of leaders who had been there for a long time."

CEO SERGIO MARCHIONNE

THE MARCHIONNE EFFECT

Share price index, June 1st 2004=100



source: Thomson Datastream

Since 2004, the Fiat share price fared much better than those of its French competitors.

You can also listen to this article on our audio CD (page 63).

New strength in the storm

When companies rebuild their business, a lot can go wrong. But companies like Fiat show how reacting to crises works. Some hints: Clear analysis, spending discipline—and the willingness to cooperate long-term with one's banker.

GIVEN THE INCREASED COMPLEXITIES of restructuring, due to higher corporate debt levels and ever-growing hierarchies of debt ownership, the restructuring industry has become more savvy in how it helps clients solve problems. Though each firm at the table has its unique competitive advantages, restructuring professionals have identified some industry-wide best practices for restructuring.

"We believe that you cannot perform financial restructuring without operational restructuring," says Max Falckenberg, a partner at Roland Berger Strategy Consultants in Duesseldorf, "or you'll end up doing the operational restructuring anyway." Best practices are intended to help managers steer around the six most common reasons for failed restructuring cases: The first is unrealistic planning, such as neglecting to consider the customer's needs and ignoring market trends when setting the plan. Second, restructures can fizzle if plans are not detailed enough. In other words, plans need to assign responsibilities and specific actions clearly and define milestones clearly for reaching high-level goals.

Third, many restructurings focus too much on internal issues and hinder the company from catching up with competitors. Fourth, managers frequently suffer from a lack of confidence from the workforce given the missteps that brought on the restructuring case. Fifth, companies may stumble due to an opaque view of profit drivers. Some firms have not properly analyzed their product portfolios and have put too much emphasis on growth rather than on profitable growth. Finally, and perhaps most significantly, companies fail at restructuring because they are reluctant to change. "A slow drift into crisis does not create a sense of urgency," says Falckenberg. However, there are some companies that are currently succeeding in operational, strategic and financial restructuring—just in time for the liquidity crunch.

Take Italian automaker Fiat. The Agnelli family, Fiat's primary owners, brought in Sergio Marchionne to turn around the business in 2004. Marchionne restructured on multiple fronts and did it fast.

Marchionne says, "The single most important thing was to dismantle the organizational structure of Fiat. We tore it apart in 60 days, removing a large number of leaders who had been there for a long time and who represented an operating style that lay outside any proper understanding of market dynamics. We flattened out the structure and gave some relatively young people, in terms of both age and experience, a huge amount of scope."

Now the automaker's prospects are looking up, just as the overall economy is down. Marchionne decreased debt, improved liquidity, returned to the company's Italian design roots and refocused the auto division on smaller cars. Cult car Fiat 500 won the hearts of auto connoisseurs. The result of the whole process: In 2007, the company booked profits of €3.2 billion, 66 percent more than in 2006.

SIMILARLY, CHIEF EXECUTIVE Patrick Cescau of consumer goods company Unilever said that ongoing restructuring within the company was expected to drive 2008 sales growth toward the upper end of the previously predicted range of 3 to 5 percent.

In 2006, Japan Airlines stated that its medium-term business goals included improving profitability by restructuring international passenger operations and downsizing equipment, as well as reducing cost structures. About a year later, the airline's restructuring program had helped it report a steep jump in first-half profit. JAL said operating profit totaled ¥56.6 billion in the six months to September 30, up from ¥8.1 billion in the same period a year earlier.

Another case: Ford Motor Company narrowed its loss in the midst of a painful restructuring. It lost

$2.7 billion in 2007, far less than record losses in 2006 of $12.6 billion , and it reported quarterly net income of $100 million in April. The company plans to use its multi-year restructuring to turn a profit in North America in 2009. "We're going to be there when the market comes back with the right products that people really do want, with the cost structure that gives them the very best value," said Chief Executive Officer Alan Mulally.

HOWEVER, ALL FOUR COMPANIES waited until a crisis hit before they started the restructuring process—rather typical behavior. A recent Roland Berger survey on restructuring shows that 71 percent of companies do not respond until the strategic crisis has turned into an earnings or liquidity crisis.

The companies have other common characteristics, too: The projects had the support of top management, they followed a holistic concept, and they were implemented quickly. Most experts will tell managers to heed early warning signs and avoid crisis restructuring altogether by performing ongoing restructuring projects. That stated, experts also say that successful restructuring projects, particularly the debt restructuring cases that are on the rise, always begin with an open and honest analysis of the economic situation of the company.

TOOL 1: INSPIRE CONFIDENCE WITH SOLID ANALYSIS AND OUTSIDE PARTNERS

Considering the illiquid market, experts say that companies need a CFO who produces figures that are accurate and believable—figures which lenders can trust. Richard Tett, a restructuring specialist at law firm Freshfields Bruckhaus Deringer: "You have to give the lenders the feeling that they can have confidence in the business. The fact that you're in for a restructuring means that something has gone wrong. It may not be your fault, but something that people were expecting to happen has not happened. That engenders concern, nervousness and potentially distrust in figures." Experts also agree on the high value of bringing in a fresh pair of eyes when restructuring begins.

Unilever relied on outside consultants for parts of its One Unilever operational change program. Among other things, the program consolidated HR functions. It has already brought measurable benefits. CEO Patrick Cescau said, "The reshaping of the business and the acceleration of our change program are bringing real benefits. They make Unilever a more flexible and resilient company, better placed to meet the challenges of operating in a tougher economic and cost environment."

On financial restructuring cases, Tett reminds executives that within banks, restructuring projects are likely to be handed off from the relationship bankers to the workout bankers, another reason to bring in outside advisors who are experienced in crisis negotiations. "These people have a different mindset. The new bankers who deal with it will have lots of experience in restructures. The directors of the companies may never have been in a distressed situation, so the dynamic changes. Issues that are important to workout bankers may not be so important to the relationship bankers," says Tett. Maybe people will trust the management to get it right, Tett adds, but most people will draw comfort from those who have been in this situation before —those who come in knowing the kinds of things the banks are thinking about.

KEY FINDINGS FROM A RECENT ROLAND BERGER REPORT ON RESTRUCTURING:

- Management commitment is the most important success factor for restructuring projects
- Companies are slow in responding to crisis. Only 50 percent respond within 12 months.
- Early warning systems are deemed important but often not implemented.
- Some two-thirds of companies require additional liquid funds for restructuring.
- Reducing personnel expenses is the most important cost-cutting action.
- Restructuring is an ongoing task.

Source: Roland Berger Strategy Consultants

UNILEVER

UNILEVER USES A STRATEGY OF ONGOING RESTRUCTURING. THE COMPANY RELIED ON OUTSIDE CONSULTANTS FOR PARTS OF ITS ONE UNILEVER OPERATIONAL CHANGE PROGRAM.

Up to 5 percent could be the sales growth in 2008, partly due to ongoing restructuring.

"We feel confident that, in 2008, we'll be able to maintain growth at the upper end of our 3 to 5 percent range, despite a more challenging environment. We are now a fitter, leaner, more aggressive company."

CEO PATRICK CESCAU

OPERATING PROFIT WENT UP NEARLY 40 PERCENT

FIRST QUARTER 2008 (current rates)

	(in € million)	increase
Operating profit	1,815	39 %
Pre-tax profit	1,782	34 %
Net profit	1,407	34 %
EPS (in €)	0.47	35 %

source: Unilever

TOOL 2: HOLD ON TO CASH

In a financial-market-driven downturn, cash is king more than ever. Companies most focus on improving liquidity above all else. Some methods include selling off assets, transferring properties to banks to finance the restructuring and selling all properties not related to production . Another tool: reduce stock cycles. "We were able to increase liquidity for a machinery manufacturer by €10 million by reducing the raw materials kept in stock," says Falckenberg.

Other tricks: Reduce accounts receivable by stopping the practice of shopping against invoices. Or reduce accounts receivables by renegotiating the terms of payment from 45 days to 30 days.

TOOL 3: CREATE A ROLLING LIQUIDITY FORECAST

If restructuring focuses on financials, the analysis at the outset must also include rolling liquidity forecasts. A recent survey by Roland Berger Strategy Consultants showed that only 30 percent of companies with a liquidity crisis have implemented rolling liquidity forecasts.

In his years of experience with corporate turnarounds, Steve Francis, a partner in Roland Berger's Turnaround and Restructuring Practice in London, says he has learned that every business has huge amounts of cash sloshing around inside of it. "Know where it is and who is responsible for it," Francis says. At one company for which he served as the CRO, or the chief restructuring officer, Francis established a global daily report for each account. It showed what went in and what went out. He also ensured that no operating units had more cash than they needed, in order to enforce a culture of financial restraint. "If managers wanted to spend money, they had to ask for it," said Francis, adding, "If companies don't have a cash constraint, they don't apply toughest cash disciplines."

TOOL 4: SHOP AROUND FOR A RESTRUCTURING JURISDICTION

Restructuring professionals recommend that companies shop around for the best locations for their restructuring needs. German auto parts maker Schefenacker made a move that turned the heads of German politicians and prompted a round of soul searching about the country's insolvency laws. A holding company based in Germany, Schefenacker moved its headquarters to London and filed for bankruptcy there in 2007. Under the English process, which is more flexible than the German one, it was able to remain in business.

TOOL 5: PLAN TO WORK LONG-TERM WITH YOUR BANKERS

In the current illiquid market environment, companies that undergo financial restructuring may find that they have to work long-term with a particular set of bankers. Which set of bankers that is may not be clear at the outset, since a company's house bank may have sold the loan in question.

Richard Millward, managing director of restructuring at NM Rothschild in London, cautions executives: "You need to understand exactly what your loan documents say to know if your banks are allowed to sell loans without prior notification or if they need to get permission." Still, Millward recommends that CFOs focus on stable and strong relationships with their banks, many of which are in the awkward position of trying to reduce their exposure to a company while helping it succeed.

"You will be there longer than you might have thought," says Millward. He added, "The mood is focused on how to work constructively with existing banks."

TOOL 6: DEVELOP A COMMUNICATIONS STRATEGY

Given the long chain of debt ownership, the CFO must also consider the fact that banks may share information. Once communicated, the CFO no longer has full control of potentially damaging reports and charts.

"You need to think about what banks will do with the information," says Millward. "As long as they sign confidentiality agreements, banks may share the information if they are allowed." For instance, a hedge fund may walk away from the table after reviewing confidential information about a company and its loans. It bought no loan, but it learned some interesting things about a particular company.

The problem, of course, is that companies are often obliged to share proprietary information with their banks. That's why executives should also think through their communication strategy before breaking potentially bad news about underperformance or operational problems, Millward says.

TOOL 7: BE PREPARED FOR A NEW RESTRUCTURING ENVIRONMENT

Ten to 15 years ago, insolvency was the domain of banks and accounting firms. Banks would write down loans by 20 to 80 percent, waive interest for several years and then turn debt into equity stakes. If banks were successful, they could potentially recover a high percentage of their original loan or win on the deal, writing up the loan and taking a profit.

THE QUESTION WAS, "Should we stay and wait or should we write off the loan?" If a bank decided the latter, it called in the accounting firms to turn off the lights. Scroll forward to the turn of the century and the growth of the secondary and distressed debt market, with their multitude of debt levels. "Because it is traded, people will buy into debt at 60 cents on the euro or 20 cents on the euro on the basis that no matter how bad it is now, the situation can get better," says Francis. Witness recent auctions by Deutsche Bank and Citigroup of large parts of their leveraged loan portfolios at a discount.

Given higher overall corporate debt levels and the thriving secondary market, multiple parties now take an interest in a single company's business. This increases the collective will to keep companies afloat, particularly in Europe, where few companies actually survive insolvency. In the United States, with its more lenient Chapter 11 rules, companies have better chances of re-establishing themselves.

TWO DECADES AGO, if a company failed, the bank would get stuck with the debt. Now, dynamics are completely different, as many investors stand to lose.

But this doesn't mean that all investors will act as expected when a company sits down with its lenders and tries to gain consent from the majority for a new lending facility. "In some cases, people genuinely think the proposed move is something the company shouldn't do. Or, people buy into the debt and don't act reasonably because of their hidden agendas. They may use the holdout position as leverage," says Tett.

For example, a hedge fund might try to force the sale of an asset rather than restructure to keep the firm alive, while it is short-selling its unsecured debt and its equity, according to Henry Hu, a professor of law at the University of Texas, Austin. "When there are more restructurings and bankruptcies, there is a lot more potential for mischief," Hu told the Economist newspaper.

IN SHORT, the impact of non-bank institutions as holders of debt has made restructuring more complex and volatile. In the past, Millward says, companies could vary from their business plans by up to 30 percent before the bank became alarmed. "Now, that's maybe 20 to 25 percent," he says. Another point: Only a year ago, companies could run competitions for lending groups to get the best deals.

"TODAY, A STRONG, SENSIBLY LEVERAGED company would have far fewer competitive offers and therefore less room to maneuver. Companies that in the past had the chance to solve problems with short-term refinancing no longer have the option today," says Millward. It all adds up to a few simple points. In times of economic downturn, cash flow declines and managers have less time than usual to make critical decisions. That's why company bosses have to prepare by restructuring frequently—also in good times, with an eye to the future and potential turbulence. John F. Kennedy put it nicely: "The time to repair the roof is when the sun is shining."

BEST PRACTICES: WORKING WITH BANKS DURING FINANCIAL-MARKET-INDUCED RESTRUCTURING

- ➔ Identify the best partner for the long term.
- ➔ Consider how the bank views your company's credit.
- ➔ Examine the bank's total exposure to the company and consider if the bank is overexposed.
- ➔ Consider the decision process at the bank and the nature of contact with the bank. Are you dealing with the local branch or headquarters? Is your contact person capable of making decisions?

Source: Roland Berger Strategy Consultants

Times get rough? Great!

Crises are usually seen as something bad. But smart companies can actually use them, argues management author Morgen Witzel. The industries in case: steel and food. Here is how companies like Nestlé or Mittal reacted to the turbulences.

BENJAMIN DISRAELI, the British prime minister, famously remarked that "in a civilized society, the only constant is change." That was over 130 years ago, and little has happened since to prove Mr. Disraeli wrong. We know: Businesses that do not learn and adapt will be threatened by change. But others see change and indeed crises as an opportunity, a source of advantage. Those managers who understand the nature of change and particularly its cycles can use it to build competitive position, introduce new products and services, reconfigure their structure through acquisitions or alliances, and so position themselves to ride the wave of change and come out as winners.

TAKE TWO INDUSTRIES where change is indeed a constant: steel and food production. The steel industry has always been prone to a lot of turbulence. Demand fluctuates rapidly, and companies constantly struggle to find a balance between underproduction and overproduction. The food industry is more prone to shocks from the production side as commodities prices rise and fall, often at the mercy of the weather. However, also here, change is a constant element companies have to reckon with.

History shows us that in both these industries, the losers were the ones who could not adapt and meet the new demands placed on them. The winners rode with the tide.

FROM ANCIENT TIMES right up to the 19th century, steel production had been almost a cottage industry. The advent of new production processes like the Bessemer method changed that, and very large steel companies like Krupp and Carnegie rose rapidly. But demand for steel in the industrializing countries of Europe and North America rose more rapidly still. By the year 1900, the steel industry worldwide was highly fragmented.

IT WAS ALSO PRONE to economic shocks. A cyclical downturn in the economy reduced the demand for steel in markets such as construction and shipbuilding. Companies would be caught with high levels of inventory compounded by canceled orders. They would scale back, only to be wrong-footed again when the economy picked up and the demand for steel rose suddenly. In the US, the response was to scale up. The merger of several large companies including Carnegie into United States Steel was the result.

Today, we see the same process happening again. In the 1990s, you couldn't give steel away in world markets, but now demand is soaring. But will it last? Smart steel-makers know what happened before and are preparing to ride the trends. "In the coming years and decades, innovations and forward-looking products will increasingly be determined by global megatrends," says Ekkehard Schulz, chairman of the executive board of ThyssenKrupp. "The effects of climate change, resource shortages, population growth and urbanization, to name just a few of these megatrends, are constantly subject to debate."

THYSSENKRUPP'S SOLUTION is organic growth, investing in new plant capacity, but also hedging by investing in other market segments such as elevators, components for the aviation and car industry, even contributing to the building of the new flood barriers to protect the city of Venice. In this way, ThyssenKrupp hopes to be less prone to cyclical change.

Others are hoping to future-proof themselves in the manner of United States Steel, by scaling up. The takeovers of Arcelor by Mittal and Corus by fellow Indian firm Tata Steel are impressive examples of this. So is the series of strategic alliances negotiated by Shanghai-based Baosteel, with other Chinese steelmakers but also with Corus and most recently with

MORGEN WITZEL is Honorary Senior Fellow at the School of Business and Economics, University of Exeter. He writes for newspapers and journals including the Financial Times, Financial World, Finance and Management, Corporate Finance Review and The Smart Manager, India's leading management magazine. He lectures and teaches on the history of management methods and practices, and on business in Asia and business strategy. His books include *Doing Business in China*, *Managing in Virtual Organizations*, *Management: The Basics* and the recent *John Adair: Fundamentals of Leadership*.

Nippon Steel. These "Asian Tiger" firms are not just restructuring themselves. Indeed, they are reshaping their entire industry. Others will have to get bigger, too, in order to compete.

SIGNIFICANTLY, BOTH INDIAN FIRMS are part of larger diversified conglomerates, whose own internal demands for steel have played a role in these acquisitions: in effect, these are moves up the value chain, rather than just expansion in a single segment. And these are companies that know about change and know how to manage it. "Business changes almost every day," says Sunil Mittal of the Mittal Group. (He currently runs the group's telecom venture in India.) "You wake up in the morning and the ground has moved a few inches. Some days it is yards. You need to constantly learn and re-learn, or you will lose out." It is with this philosophy of change in mind that Mittal took the upheavals in the steel industry as an opportunity—and evolved from the changes stronger and bigger than before.

THERE ARE SOME INTERESTING similarities between the changes in the steel industry and those in a very different business: that of the big food corporations. The food industry is subject to periodic fluctuations, especially in commodity prices. Bad weather can wreck harvests; good weather can lead to bumper crops and a glut on the market, with prices plunging. Result: price fluctuations. The US food-product giant Heinz found a way to insulate itself from these vagaries. Way back in the 1890s, Heinz grabbed the market lead with the introduction of high-quality, imperishable tinned and bottled produce. Heinz's brands were more expensive than those of their rivals, but quality-conscious consumers did not care.

TODAY, THE FOOD INDUSTRY is in a crisis again. For example, coffee—a few years ago the price of coffee dropped sharply, leaving some Indian coffee growers on the brink of bankruptcy. In 2008, however, unseasonal rains in the south of India are damaging both coffee and tea harvests, promising to send prices soaring again. Food producers have to be constantly on the alert for such changes. Nestlé, for example, a leading maker of coffee products, hedges against risk and tries to predict cyclical swings in prices. Seeing the present crisis coming, it bought up stocks in advance.

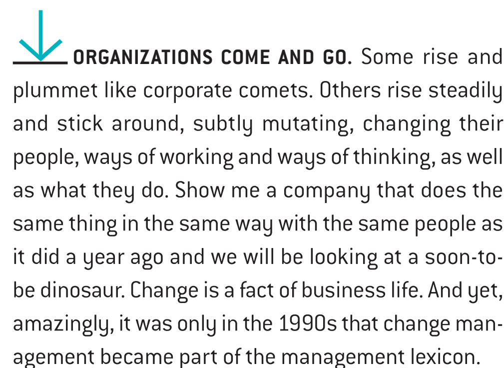
FOR NESTLÉ, QUALITY IS another important growth driver, in addition to the hedge strategy. The company expects to realize higher margins with its higher-value food ranges. US company Kraft did the same with its DiGiorno Ultimate range of high-quality frozen pizzas. The aim: challenge Domino's and other takeout pizza chains and grab a higher share of the North American pizza market. In Britain, the growth rate of supermarket chain Waitrose, despite above-average prices, is double that of lower-cost rivals—even the mighty Tesco. The Waitrose secret? High-quality products, including an extensive organic range, have captured the high ground in this particular market segment.

Other food companies have adopted different strategies, looking at the bottom of the pyramid. The one-dollar burger offered by McDonald's and the one-dollar cup of coffee to be introduced by Starbucks will appeal to the cash-strapped North American consumer. What is important though is that successful companies took the challenge of the crisis to rethink their business. They saw the structural changes a crisis would bring, and used them for their own good. Some steel companies are scaling up through acquisition; others are moving into boutique problems and choosing organic growth. In food, some are responding to high commodities prices by moving up to high-margin products; others are moving down to recapture the mass-market position with lower prices. What is best depends on the strengths of the individual company, its markets and the reputation and relationships it already has with customers. Starting from this analysis, a company has to ask itself where are valuable windows of opportunity.

In this context, it is important to remember continuity as well as change, and not throw the baby out with the bathwater. Established brands give leverage and will help open up new markets and new opportunities. But it is essential to understand the dynamics, the threats and opportunities in each market and how best to respond. Often it is a matter of timing. Managers must know what to do, and how to do it. But knowing when to do it might be the most important decision of all.

Forget the quick fix!

Corporate recovery is a slow-burning reality, argues management thinker Stuart Crainer. In order to get back to the top, a company has to be ready for change. And, most importantly: Change is not just about communication. Every change process needs a strategic plan.



ORGANIZATIONS COME AND GO. Some rise and plummet like corporate comets. Others rise steadily and stick around, subtly mutating, changing their people, ways of working and ways of thinking, as well as what they do. Show me a company that does the same thing in the same way with the same people as it did a year ago and we will be looking at a soon-to-be dinosaur. Change is a fact of business life. And yet, amazingly, it was only in the 1990s that change management became part of the management lexicon.

The reticence to embrace change is understandable. Organizations and individuals are attracted to the status quo. Every piece of research ever done into change suggests that change is ridden with difficulties. Whether you are subtly altering a product line, removing a tier of middle managers, restructuring your organization or merging with another organization, change is difficult and dangerous.

But it can be done. Witness the renaissance of IBM under Lou Gerstner; the revitalization of the retailer Marks & Spencer under Stuart Rose; the renaissance of the Olympic movement from near bankruptcy in the early 1980s to the multi-billion-dollar branding behemoth of today; and many other instances.

So, how should you approach the reality of change? How should you make change happen? The first step in understanding and implementing change is to appreciate that it happens continually. Change is never-ending. This was brought home to me talking to the current CEO of the US company Pitney Bowes and his predecessor. Now, Pitney Bowes is one of the bellwethers of the American corporate world. With 80 percent market share, it had little incentive to reinvent itself. Enter the Pitney Bowes headquarters in Stamford, Connecticut, and you feel you are near the comforting and comfortable heart of corporate America. With over two million customers, more than 3,500 active patents and sales in excess of $5.5 billion, the company was identified by management author Jim Collins in his best-seller *Good to Great* as one of his corporate paragons. Yet, over the last decade it has undergone a carefully calibrated transformation.

THE THING WHICH strikes you talking to current CEO Murray Martin and his predecessor, Michael Critelli, is how large change looms on their agendas. "I call it 'grow or go,'" says Martin. "You either grow as a business or you're going to go away as a business. We said, if we're sitting in one space at 80 percent, what are the adjacent spaces in which we have very small market share that we can leverage our capabilities, our knowledge and our people to expand? And that's what we have been doing." Hence, one can say that the company constantly redefines itself. This effectively means treating change as the constant reinvention of its competitive position.

This is not easy to do. One side effect: The company's market share plummeted overnight. From a position of dominance, its market share of this much larger marketplace was estimated in low-single-figure percentage points. "We don't think that you make use of radical change with something that is working well. It has been a migration to where we are," reflects Martin. "Evolution is not good if you're evolving from something that's not working." Despite its longevity and apparent comfort, Pitney Bowes has restless leaders. Martin is energetic and focused—so much so that he distilled down his five initial core messages on taking over as CEO to a mere three. The company's management and managerial succession is geared around change. Michael Critelli, CEO until 2007, calculated that during the first three years as CEO you're basically trying to get acclimatized. During the next five or six years you are a change agent, putting in place your programs and vision for the company, and in the last four years you are focused on succession planning,

ensuring the talent is there for the next generation. This can only happen in an organization where there is recognition that change is a necessary part of the organizational condition.

AS CRITELLI AND MARTIN suggest, change requires leadership. "Where does leadership begin? Where change begins," reflected James McGregor Burns. For him, the leader is not the completer of change, but its catalyst. This demands that the leader seizes the initiative and rewrites the agenda.

Knowledge about managing change processes has garnered increasing attention of top managers in recent years. One-third of European companies have already budgeted for a change project, and the systematic change of existing business models and organizations is seen by 85 percent of companies as important or very important. Given those figures, it is astonishing how little success most change projects have. Half of all the managers responsible for change projects admit that they have missed their change goals by a wide margin, and 80 percent of all change management projects are seen by the companies that undertook them as partial or complete failures. Why do they fail? "European companies plan to spend approximately 15 percent more on change management this year," says Torsten Oltmanns, Global Marketing Director of Roland Berger Strategy Consultants. "The lion's share of that spending goes toward communication with employees—and that's wrong." A Roland Berger team examined the rules for successful change management and came to the conclusion that most projects fail because management does not systematically solve the conflicts within its own ranks. "As a result," says Oltmanns, "there's no solid, realistic strategy. And yet the companies initiate costly programs for changing employee behavior. If the leadership questions are not resolved, you might as well throw the rest of the money out the window. Change management is a task for the top leadership."

Successful change requires the efforts of a critical mass of key individuals. According to Harvard change guru John Kotter, "a group of two to 50 people, depending on the size of the corporation we are considering—in order to move the organization in significantly different directions. If the minimum of critical mass is not reached in the first stages, nothing really important will happen." Change demands leadership, but change should not be considered merely an initiative or a program. Rather, it is a state of mind—one that requires long-term commitment.

Also, change is more than a matter of the right IT infrastructure. Oswaldo Lorenzo of Spain's IE Business School has looked at how companies spend billions of dollars on IT systems while senior managers often freely admit that their investments fail to live up to expectations. "With such large investments come equally large expectations," he says. Enterprise systems promise much, "but, in reality they are often highly complex and threaten the status quo of relationships in an organization." As a result, implementation is frequently fraught with difficulties. "Change management costs can mount as old systems are discarded or modified, staff are trained, old processes set aside, and new procedures adopted." Subsequently, organizations seek a rapid return on their investment and design a project plan that reduces risk to a minimum. "Organizations struggle to achieve results that meet their original expectations."

Lorenzo's research concludes that far from being a quick win, or providing a fast track to an order-of-magnitude improvement, enterprise systems (ES) are best utilized if they are seen as the focus of a slow, diligent learning process. They present employees with an opportunity to relearn daily tasks they had hitherto thought routine, to forge new bonds and to share new insights in the process. "It can take six years from the inception of an ES project to reach the point at which organizations report that they have fully mastered the technology and processes." This is the essence of change: it is not a short-term exercise, but a long-term process and way of thinking. It is not a quick fix, but a slow-burning reality.

STUART CRAINER is editor of *Business Strategy Review* and the first editorial fellow of London Business School. Together with his partner Des Dearlove, he is associate director of the Management Innovation Lab, creator of the Thinkers 50 ranking and editor of the bestselling *Financial Times Handbook of Management*.

Murray Martin, CEO of Pitney Bowes, thinks that permanent reinvention is the key to corporate success.

Kissing the right frogs

Hard times need tough managers—this idea seems to drive the current trend toward CROs (chief restructuring officers). These masters of disaster are expected to manage a corporate recovery process better than CEOs. But are they? Michael Jarrett is skeptical.

MICHAEL JARRETT is an adjunct professor in organizational behavior at London Business School. Michael's forthcoming book *Ready for Change: Unlocking the Secrets of Successful Change* will be published in autumn 2008.

THE THIRST FOR A CONQUERING HERO or heroine is universal across time, language and culture. The corporate world is no exception. So, it is no surprise that the title "corporate restructuring officer" has become the height of organizational fashion. It is the new black of organizational myth making, the latest in a long line of corporate saviors. The CRO is the magician, the superhuman executive who will turn 70 percent of transformational failure into success.

As you can tell, I am skeptical. I believe that CROs are being set up to fail. I can understand the allure of this archetypal myth of successful change. We all enjoy slaying the dragon, recovering lost treasure and the key character returning with gold—or good news for analysts. But, such a story, while appealing, is based on a poor understanding of how change works. I'd like to rewrite it. Research evidence shows that successful change is systemic. It forms part of the organization's DNA. As a result, it cannot be left simply in the hands of a single individual—even if they rejoice in a C-suite job title. Change is everyone's job or no one's.

MY RESEARCH OVER THE LAST DECADE has led me to conclude that there are four things required to make change stick. First, you need to be kissing the right frog. If there is one person that can make a difference it is the CEO. A transformational leader who sets a vision, resonates with his or her team and gets things done is the real prince or princess of this story. Such leaders make a real difference to the culture and performance of the organization. The competitive challenge facing Indra Nooyi, when appointed as CEO of Pepsi, meant she had to inspire the troops to move from just selling fizzy drinks to a wider portfolio of health snacks. She was able to rouse her team and staff. Her colleagues say she "brings her whole self" to the office. She inspires them. She has the qualities

of a transformational leader (without the CRO moniker). Second, you need to assemble a good band of travelers. Leaders are only as good as their management teams. Top management teams which are aligned with their leaders enhance the chances of successful change. If there is dissent or a lack of team congruence, then the leader's efforts, influence and success will be vastly diminished. When Xerox was on the cusp of collapse, it was making an annual loss of one-third of a billion dollars, debts were $17.1 billion, debt ratings were rapidly falling and share prices were an all-time low at $4.43. Anne Mulcahy, who took over as CEO, had a clear mandate for change and to take the flab out of the organization.

Mulcahy built an inner top-management team that operated as the head, heart and hands of the organization. CFO Larry Zimmerman worked the numbers with Jim Firestone, who ran the North American region. Ursula Burns was the hands, carefully implementing difficult cuts yet trying to build the new company. The CEO held the heart of the organization. Her motto was to stay close to the values of the company. Mulcahy states, "I've been with the company for 30 years ... I stayed because I became enthralled by a culture that broadly defined 'citizenship' to include how you treat your people, your customers, your suppliers, and the communities where we work and live ... Every decision I make is aligned with those values."

OUR OWN RESEARCH CONFIRMS these findings. We surveyed 5000 executives across a wide range of industries in countries as diverse as Austria to Zambia. In addition to the qualities of the top management team, we also found that organizations' strategic capabilities also made a significant difference. Third, you have to have the right rituals and culture to respond to change. Organizations successful in large-scale change had a level of internal fitness for change compared with those that found change more difficult. We found distinct change types. Change "avoiders" did not like change, were resistant and inert. "Analyzers" knew what they needed to do but spent too much time thinking about it. "Adaptors," on the other hand, had the internal capabilities to change. Not only did they change once. They are able to do it repeatedly. The secrets to their success were their innovative and collaborative cultures, the quality of their people and their structures that helped fluid execution of their goals.

Google demonstrates how this takes place. It innovates, has a collaborative culture and executes efficiently. These are the three capabilities for organizational fitness. They directly affect the success of change and organizational performance. Finally, strategies for change should align to environmental conditions. You have to tune in to the world in order to change it. CROs are not the villains in this story. But neither are they the new heroes. They carry the bag on behalf of the leader and the top management team. They are limited by the culture of the community. They are subject to the unexpected twists and dark corners of the forest of competition. They may be part of the solution, but they are the not the solution. Beware kissing false frogs.

Counterpoint: Sushil Khanna

THE PROFESSOR FOR STRATEGIC MANAGEMENT AT THE INDIAN INSTITUTE OF MANAGEMENT THINKS THAT IN POSTMERGER SITUATIONS, A CHIEF RESTRUCTURING OFFICER CAN DO A VALUABLE JOB.

"USUALLY, acquisitions and mergers require the bidding firm to pay a premium to acquire the target firm. This can be justified only because of the expected gains from the merger. These gains are strictly a function of synergies and savings that can generated through restructuring. Hence generating the necessary gains from changes in the organizational and operational parameters is the key task. Research shows that this is not easy; a reason why many mergers result in destruction of shareholder value.

IT IS UNLIKELY that a CEO will be able to devote adequate time for such detailed restructuring, though his support and mandate will be necessary. A CEO's main task is corporate-level strategy. Hence the merged firm will be better off appointing an independent corporate restructuring officer to plan and execute the key tasks that will help generate the synergies, as well as handle the organizational and human resistance that is inevitable."

Becoming a better leader

Corporate crises put a lot of mental stress on CEOs. David Chan, professor at Singapore Management University, thinks that psychology can help those at the top. One lesson: Don't fall in the regret trap. The good thing: Crises can make CEOs grow.

DAVID CHAN received his Ph.D. in industrial and organizational psychology from Michigan State University. He is currently professor of psychology and interim dean at the School of Social Sciences, Singapore Management University. Chan has published numerous articles and authored several handbook chapters and encyclopedias. He serves as senior editor of the Asia Pacific Journal of Management. Together with Nobel Laureate Daniel Kahneman, he serves on an international committee formed to develop measures of national well-being.

THINK:ACT Professor Chan, what's going on in the mind of a CEO when the company gets in a crisis?

DAVID CHAN *A crisis is foremost perceived as a stressful situation that threatens the survival of the company. As part of an automatic human survival response, the CEO will experience an increase in adrenaline and other stress hormones as well as a physiological activation of those parts of his nervous system to energize himself to prepare to fight or flee from the potentially threatening situation. This physiological activation is accompanied by emotions such as fear, anxiety and anger.*

Is the "fight or flee" alternative still enough?

The pattern of human reactions of fight or flight triggered by threatening situations could either enhance or inhibit effective crisis management. It is useful when it leads to heightened awareness, increased vigilance and preparedness to act quickly and decisively in situations that demand these predispositions.

But it might also be insufficient?

The pattern was certainly adaptive in evolutionary past when our physical personal survival was in actual danger. However, in today's world, some of the automatic reactions may be maladaptive. Fleeing a crisis situation is either not possible or not desirable if the goal is to help the company overcome the crisis. Some fighting reactions such as aggressive behaviors and hypervigilance are also counterproductive when calmness, restraint of impulsive actions or calculated risks are necessary.

Can CEOs prepare for tough times?

Yes. CEOs need to learn about and understand the basic normal human survival reactions to threatening crisis situations and be sensitive to potential blind spots and dangers. In addition to equipping themselves with stress coping skills such as techniques of anxiety reduction and impulse control, CEOs can enhance their skills in crisis management through development of leadership competencies: systems thinking, scenario thinking, prioritization, personal composure and impact under stress, decision making with incomplete information, ability to persuade, influence and motivate others, interpersonal sensitivity, situational awareness and practical intelligence. One of the greatest CEO weaknesses is the belief that he already possesses all the experience and skills needed for crisis management.

Which is bad?

Some top managers, by virtue of occupying leadership positions, mistakenly assume that their legitimate authority translates to leadership competency. They think there is no need for them to learn more about leadership. They are less likely to check their own assumptions on how to lead. For example, there are some basic psychological facts that are highly relevant when dealing with crisis situations but these are often unknown or ignored by CEOs.

Like what?

Consider research findings on negativity bias in human behaviors. Research has consistently shown that the power of the negative is stronger than the power of the positive. A loss of $100 is more negative than a gain of $100 is positive. One reprimand has a stronger and more lasting effect than one praise. Very often, leaders failed because they did not consider the human tendency towards negativity bias when they interact with others.

CEOs bear a lot of responsibility when their company is in trouble. How can psychology help them?

There are some well-established dos and don'ts in crisis management. Don't deny or ignore the crisis. Procrastinating or postponing decisions is likely to make things worse. Although it is important to identify and analyze your mistakes, don't dwell in regret, guilt and self-pity.

What can CEOs do then?

There are several problem-focused strategies that could help cope with the mental pressures from a crisis situation. You could perform a cognitive reappraisal of the situation to move away from negative emotions such as anxiety, fear, anger, regret, guilt and blame, and consider different and new perspectives directed at resolution of the crisis. Maintaining a sense of self-esteem is critical. As the CEO who is the commander-in-chief in the crisis situation, it is also important to have an appropriately high level of self-efficacy—the belief that you are able to effectively mobilize available resources to accomplish tasks directed at solving problems. Finally, social support from family and friends is critical.

How well are current CEOs prepared for a crisis?

Many CEOs, especially first-time CEOs or those without any previous experience of handling crisis situations, are probably not very well-prepared to deal effectively with crisis situations where the problems are ill-defined and the demands are novel. Things also get more complicated when the crisis occurs in a cultural, political and economic setting that is unfamiliar to the CEO. Finally, crisis situations involving integrity and ethical issues and those occurring in pre-existing hostile work environments or under great uncertainty such as a recent change in top leadership or a recent acquisition or merger are particularly difficult to deal with.

Should top managers use psychological help?

In prolonged crises, CEOs having severe adaptation problems may benefit from professional help in clinical psychology so that they can regain psychological health. However, in many crisis situations demanding immediate attention, it may not be possible to take regular and substantial time off from work to seek professional help. In such cases, applying basic techniques of stress management becomes important.

In a crisis, the CEO also has to strengthen employee confidence. But how?

You need to show that you are in control of the situation without trivializing it. Get the entire leadership team to show empathy and address the immediate needs and concerns of the employees! Help the employees see what is critical and why they need to focus on what is critical to overcome the crisis! This often requires more than merely presenting strong and clear arguments—you need to possess a sense of mission and an ability to create optimism and hope among employees and inspire them to action. What the CEO needs here are leadership competencies associated with person composure and impact, interpersonal sensitivity, situational awareness, and judgment effectiveness and the ability to motivate.

Is it good or bad for the CEO to show employees that he is also personally in a tough situation?

Employees are not predisposed to empathize and appreciate the personally tough situation that the CEO is going through; they are expecting to see a composed and dynamic leader who will solve their problems. In crisis situations, it is not unusual for employees to get more critical of the leadership. Hence, it is even more important for CEOs to understand the psychology of employees and react constructively.

Is it possible for a CEO to grow personally through a crisis?

Certainly. The experience of the crisis, especially when it was successfully overcome, provides the CEO the memory of a major work life event that he can draw on later. The crisis experience is like an unstructured real-life training. It also helps develop resilience in the CEO. Often, after a crisis experience, the CEO will enter a reflective phase where he takes stock of his values, attitudes, beliefs, actions, roles and social relationships. This may result in a positive reprioritization of goals, such as placing more importance on teamwork, employee well-being and talent management.

DOSSIER #12

THE ART OF CORPORATE RECOVERY

Key learnings

What to do when the crisis hits you? In this dossier, we offered some advice for companies whose business or industry is going through hard times. Here are some results:

- ➔ Don't concentrate only on financial restructuring! The organizational side also matters.
- ➔ Keep the market in focus! If you restructure internally without also improving your market position, you will lose.
- ➔ Get the numbers right first! A solid financial analysis helps the rebuilding of your business and gives lenders confidence.
- ➔ Talk—but in the right way! Lenders and investors share information. Hence, you need a strategy for what you want, or have, to convey.

Ghazanfar Ali (at left) and Wiqar Ali Khan from MTV Pakistan. While Ali manages the music TV franchise, Ali Khan fills the role of star host.

MTV Pakistan's studio team. The channel can't yet define its success in actual figures, as television in Pakistan is still lacking viewer ratings technology.

You can also listen to this article on our audio CD (page 63).

REPORT

"Pakistan is cool."

Pakistan goes pop: Young entrepreneurs aim at establishing the MTV brand on a national scale. Their objective is to integrate regional artists into the international concept—risky business in a land threatened by radical Muslim fundamentalists. A report from the fringes of pop culture.

● Mereweather Road, in downtown Karachi. ● This path down to the future of pop culture in the Islamic Republic of Pakistan leads through a dusty side street. Here the MTV studios represent the interface between this Third World nation and the pulse of the global music industry. As political unrest reverberates through the country, the arrival of the globally renowned music brand 16 months ago has resulted in a thriving pop-culture market with great potential. The economic basics for a growing leisure industry are more solid than ever. Pakistan's per-capita income has doubled since 2000, and the gross national product has risen approximately 50 percent over the past six years. Goldman Sachs considers Pakistan one of the "Next 11"—countries with the potential of catching up to the BRIC countries Brazil, Russia, India and China. US-based MTV has set its sights on this growth market. "MTV Pakistan is the nation's first locally produced international broadcasting station," says Indus Network Chairman Ghazanfar Ali of the joint venture between MTV International and his television company. After the country gained access to satellite television broadcasting in 2000, the 70-year-old entrepreneur was the first to recognize the potential of this market with 160 million people and consequently founded the first independent satellite station. Today, Ali is one of the most influential people in Pakistan's TV business. Moreover, Ali and MTV now share a major role for an additional segment of the media and music industry: the recording industry. It has been thriving since the liberalization of television broadcasting. MTV Pakistan has emerged as the most significant marketing tool for producers of music CDs, ahead of radio, the Internet, the media, concerts and tours. Pakistan's music industry is a market with very specific rules—along with astonishing contradictions. While radical Islamic fundamentalists murder CD retailers in Pakistan's northwestern provinces, MTV celebrity VJ Wiqar Ali Khan extols hedonistic values on his fashion and music show titled *Style Guru*. "The demand for pop culture is huge," says Khan. "Even though music doesn't play a major role in Islam, Pakistan has the highest number of national musicians on the charts of any country in the world."

WHILE CONSUMERS DEMAND MORE POP MUSIC, ISLAMISTS ARE BURNING DOWN CD STORES

Khan, who was raised in London, is well aware of the differences between the Western and Pakistani segments of the music business. "The sales chain here is very fragmented," he explains. "There are no noteworthy label structures, just distributors who purchase albums and all rights from the artists for a fixed sum regardless of the commercial outcome." Moreover, once a song is released, it is immediately pirated and burned on CD. According to the International Federation of the Phonographic Industry (IFPI), 230 million bootleg copies are produced in Pakistan annually—three times the number of CDs sold legitimately in the US during 2007.

MTV Pakistan is the country's first locally produced international channel.

Ali Khan and bodyguards. Security is all-important, since not all Pakistanis look favorably upon the activities of this pop culture mogul.

"We're trying to be as mass-oriented as possible."
Ghazanfar Ali

The deluge of pirated copies was also the reason why the major record labels EMI and HMV bade farewell to Pakistan in 1994. EMI returned once the government started to restrict, albeit somewhat tentatively, the black market in 2006. Ameed Riaz, the head of EMI Pakistan, still believes the price of €2.50 per CD, as recommended by UK-based EMI, is unrealistic. "We know that no one here would spend that much for a CD," he says. For €0.80 already buys bootleg copies of CDs featuring Madonna, the national music hero Nusrat Fateh Ali Khan, and other luminaries of the hit charts.

Despite the myriad problems, the pop music business in Pakistan ultimately functions, because major consumer-goods brands are sponsoring people's favorite musicians through contracts in the two-digit millions. Coca-Cola and Unilever, for example, created their own musical envoys with the group Junoon, which the UK's *Q* magazine called "one of the world's biggest rock bands" due to its enormous success throughout Southeast Asia. The rockers consume Coke in their video clips, while pitching toothpaste during the commercial breaks. "Every top artist has an image that is shaped by the consumer-goods industry," says music journalist Ziad Zafar, describing the influence of regionally prevalent music sponsorship deals. Western pop purists, of course, find this abhorrent. TV producer Ghazanfar Ali is decidedly less worried about a loss in artistic credibility. "We're trying to be as mass-oriented as possible," he says, explaining MTV Pakistan's strategy. It is indeed a win-win situation: While MTV Pakistan benefits from the power and visibility of the international brand, the US parent company has faith in the market potential of Pakistani musicians outside their own country. "MTV Pakistan is the perfect platform to present the wonderful culture of this country to the rest of the world. Pakistan is cool," said Bill Roedy, MTV's International Chairman on the occasion of the channel's launch in Karachi in December 2006.

Today, roughly 18 months later, pop products from Pakistan have evolved into "heavy rotators" on MTV India and MTV Arabia. It is anyone's guess as to how successful MTV Pakistan is domestically, however. "We currently reach about four million households via cable and satellite," says Ho Yan Mok, MTV's director of marketing for Asia. The market research methods intended to measure viewer numbers in Pakistan are still in their infancy, and for that reason Ghazanfar Ali measures the success of his joint venture using Web site traffic, which has increased dramatically. "Initially, we got 10,000 hits per day," he says, "and now we're up to 30,000." In comparison, MTV UK's Web site posts 9 million hits per day. This is outstanding, considering that the UK's per-capita private Internet access rate is 24 times higher than that of Pakistan.

APPROXIMATELY HALF OF PAKISTANIS ARE YOUNGER THAN 20—A TREMENDOUS POTENTIAL

Ali is hoping for more involvement from abroad, so that MTV Pakistan and the pop music industry can continue growing. "At its core, this country is a market like any other. The West, however, is currently leaving the business end to the Arabs because the Western media only covers the dangers in Pakistan, not the opportunities." Indeed, the potential of this market is tremendous: Half of Pakistan's population has not even reached the age of 20. It remains an open question whether the current growth of MTV Pakistan will result in a consolidated Pakistani pop market. For a more conservative government might suddenly clip the burgeoning growth at any time. Still, Ali remains optimistic: "We will also come to terms with future changes—just as we've come to terms with shifts in the past." ●

Pakistan is an equal blend of the traditional and the modern. The population's demand for pop culture is "huge," says Wiqar Ali Khan.

Wiqar Ali Khan is the star of MTV Pakistan. His show, *Style Guru*, openly propagates hedonistic—and thereby distinctly Western—values.