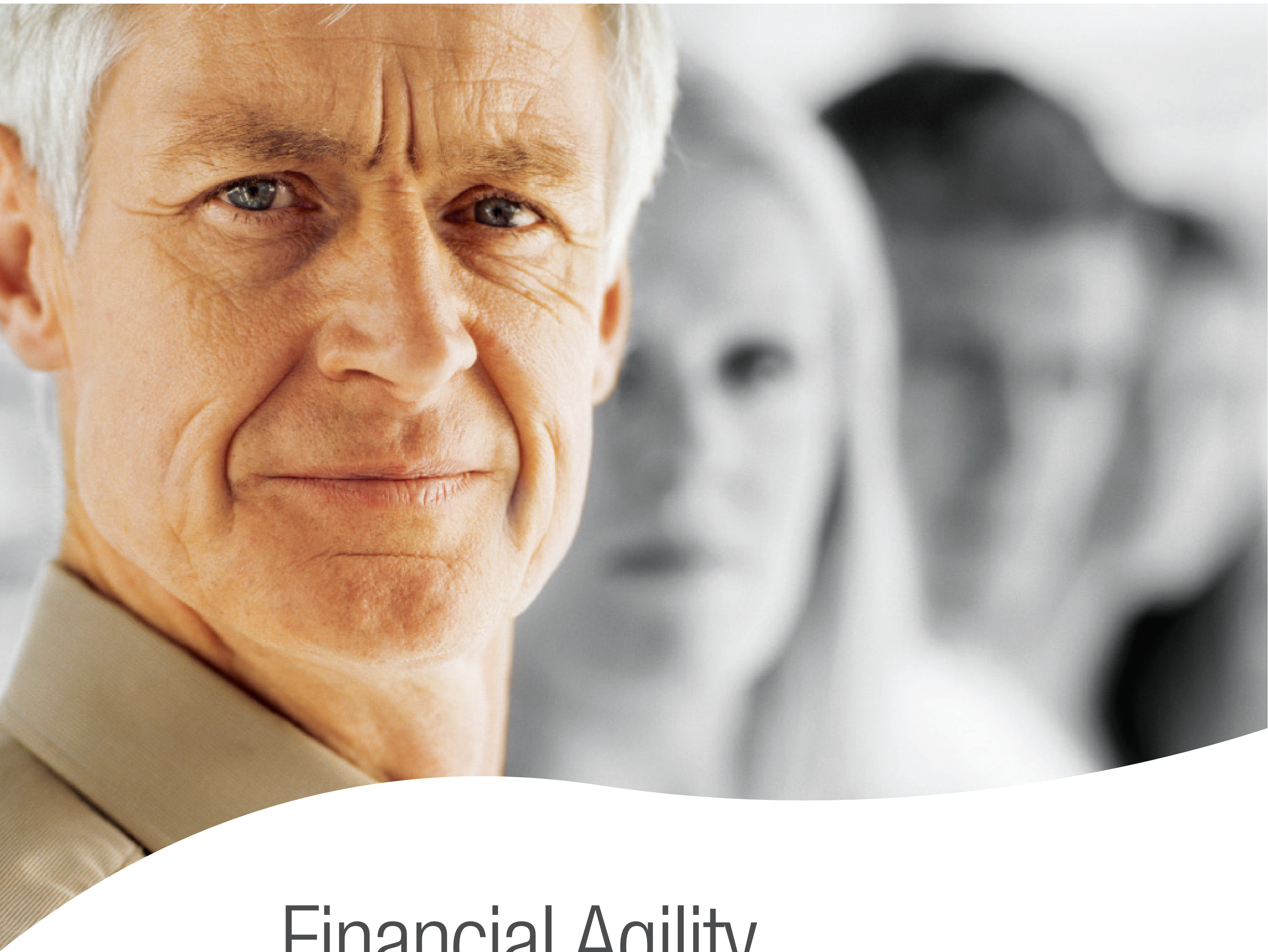

Financial Agility

The Four **Crucial Conversations** for Uncertain Economic Times

By **Joseph Grenny** & **David Maxfield**

VitalSmarts surveyed more than 2,000 managers and executives from more than 400 different companies to learn what it takes to be financially agile. The results were remarkable. We found four moments that happen in every organization that predict with incredible precision how well and how fast an organization responds to economic threats. Those who handled these four moments well were more than five times more likely to respond within days or weeks rather than letting responses drag on for months or even years. Furthermore, those who stepped up to these crucial moments effectively were more than ten times more likely to respond in a way that positioned the company for future success rather than making cuts that ultimately hurt its potential.

crucial conversations®

VitalSmarts®

Financial Agility

The Four **Crucial Conversations** for Uncertain Economic Times

The rollercoaster ups and downs of our recent economy are enough to make any executive dizzy—or even nauseous. The stock market, the capital market, and consumer spending are spiraling out of control. A leader's challenge is to bolt expenses to revenues during this wild ride—especially during the descents. If expenses don't drop as quickly as revenues, minor shortfalls turn into major cliffs. For example:

- In the second quarter of 2008, U.S. Steel achieved record profits. By November, the company's situation had changed so dramatically it was forced to lay off 675 workers and postpone a $450 million new plant[i].
- In July 2008, Beaumont Hospitals was doing so well that it revealed plans to build a new medical school, a proton-beam cancer center, and a suburban medical center. By November, the company had implemented layoffs, salary rollbacks, and a halt on new construction[ii].
- The Dow Jones average skyrocketed and crashed almost daily in the second half of 2008—rising more than 12,000 points if you add up all the good days—but plummeting more than 14,000 points if you add up the bad[iii].

Even with stories like these becoming more and more common, there are organizations that show a strong ability to respond to these changing financial conditions. The most agile respond faster and find millions of dollars more in savings than their peers. Less agile firms can take months longer to respond—and some suffer horribly because they never quite make the pivot.

VitalSmarts researchers wanted to discover exactly what set the more agile firms apart from the sluggish, so we asked more than 2,000 managers and executives from more than 400 different companies to reflect on their experiences with major financial retrenchments. Our hypothesis was that major financial adjustments were more of a human than a technical problem—that they didn't rely as much on the quality of data, processes, or policies as on behavior. We wanted to identify the crucial moments leaders face in fiscal challenges that profoundly predict the quality and speed of an organization's response.

The results were remarkable. **We found four moments that happen in every organization that predict with incredible precision how well and how fast an organization responds to economic threats.** Those who handled these four moments well were more than five times more likely to respond within days or weeks rather than letting responses drag on for months or even years. Furthermore, **those who stepped up to these crucial moments effectively were *more than ten times more likely* to respond in a way that positioned the company for future success** rather than making cuts that ultimately hurt its potential.

Mistrust Your Instincts

For example, in one insurance company, the CEO saw the organization's pool of investable capital dry up due to some financial shocks. In an emergency executive team meeting she announced that each division would see its capital allocation reduced by 15 percent for the coming year. After the CEO made the announcement, dejected VPs began shuffling out of the room. As they did, Sharon, a division VP, asked that they all reassemble. When they resumed their seats, she said, "Look, 15 percent across the board doesn't make sense to me." Each VP in the room suspected Sharon was making a defense of her own budget. But her statement took a surprising turn: "We all know the big growth opportunities this year are not in my division—they're in Alec's. If he's getting cut 15 percent, I'll shift some of my capital to him so we can leverage the market that's working."

The meeting went on another two hours as—for the first time—the executive team made enterprise-based decisions about capital deployment rather than arguing for their functions. But more importantly, they turned an imposed solution into an intelligent one. Their understanding of which cuts would cost and which would not enabled the team to develop a rapid and effective solution.

In the case study, Sharon's chance comment turned out to be a crucial moment. It was a moment when a small change in behavior led to a far more effective plan. It turned a dictum into dialogue and engaged far more intelligence in the response than the CEO was capable of applying.

Yet according to our study, Sharon's response was an anomaly. In most financial crises, senior leaders' instincts are to impose top-down solutions. Most leaders know this is not the best response, but after watching their troops mill around in the face of a looming crisis, they do the only thing they know how to do—they bark orders.

Our study found that when senior leaders follow their instincts and impose top-down solutions, the resulting plan has a fifty-fifty chance of damaging the company's long-term ability to thrive. Such plans are also two and a half times more likely to cost the firm millions of dollars in potential savings that lower-level managers could have helped identify.

But the options are not limited to dithering or dictating. Our study also showed that ***organizations respond faster and better to threatening conditions when leaders create candid and effective dialogue during four predictable moments.*** If cultural norms make it impossible to speak up during these four moments, opportunities will be missed, time will drag on, and peril will mount. If leaders invest in their team's willingness and ability to step up to these crucial conversations, their companies will react with agility that produces remarkable benefits in lean times.

The Four Crucial Moments

1. Debate, Dithering and Denial

The first crucial moment occurs when the team is confronted with financial data that may or may not signal a crisis. With all the unknowns that surface in these situations, teams often disagree over the urgency of the issues and how to handle them. Teams that are unable to discuss their differences effectively can delay action for weeks or even months, allowing the crisis to deepen. They are also five times more likely to have their boss ultimately pull decision-making power out of their hands.

However, teams that are able to discuss disagreements about the urgency of a financial issue are twice as likely to act on it within hours or days, and, as a result, are nine times more likely to resolve issues. Agile teams address these disagreements head on.

Our study showed that fewer than 40 percent of executives are capable of doing what Van Vranken did at Spectrum Health. Instead of pushing their teams to reach a common understanding of the crisis, they either impose their own action plan or do nothing. Ironically, both alternatives lead to delay and denial. Top-down solutions bog down as uncommitted lieutenants drag their feet; inevitably, doing nothing leads to nothing being done.

CASE STUDY:

Spectrum Health

When Matt Van Vranken, CEO of Spectrum Health Grand Rapids, faced an unparalleled drop in revenue, he compressed the problem-definition phase into a few intense days.

After the hospital's census plummeted, opinions from VPs differed on what to do. Some believed the census drop would end in the Fall. Others felt the census would worsen with the overall economy. Still others saw increased census in their own areas and wondered if the problem was being blown out of proportion.

The VPs dithered for three months, until Van Vranken confronted the situation head on. He and his CFO documented the census and staffing levels and then pushed the team to examine the shortfall. He asked his VPs to put their disagreements on the table where they could be examined against the data within a very tight timeframe. The team challenged each others' perspectives and decided to treat the census issue as a crisis. The situation was resolved within a few months.

2. Undiscussables

In this crucial moment, teams are hampered by the fact that some of the biggest opportunities for adjustment aren't "politically correct" to discuss. In many organizations, managers are aware of huge potential savings but just can't talk about them. These could include historical inefficiencies, costs resulting from powerful players' bad behaviors, leader's sacred cows, etc.

More than three-fourths of the leaders in our study cite times when the biggest barriers to cost savings were politically sensitive cultural practices; even more cite times when the barriers were leaders' pet policies or topics. More than half report that the inability to address these prickly issues delayed their response by weeks or months and more than a third said the entire effort was derailed by these taboos.

On the other hand, about one-fourth of managers said that while the issues were sensitive, they found a way to bring them up. ***These organizations were four and a half times more likely to act on a financial crisis within days instead of weeks or months, and nearly five times more likely to resolve it.*** Teams that were unable to discuss these differences were six and a half times more likely to have their bosses pull decision-making power out of their hands.

EXAMPLE:

Budget Undiscussables

In one pharmaceutical firm, leaders were scrambling to deal with a big budget gap. The investor relations department knew they could save $150,000 per year by reducing the number of non-value-added participants at their annual analysts' meeting by 75 percent. In addition, the HR department recognized they could save a great deal by cutting five low-value universities from their list of regular recruiting visits. The investor relations team never proposed the idea because they knew the executives who got "uninvited" would be offended. Likewise, the HR department never proposed the recruiting cuts because one of the five was the CEO's Alma Mater.

3. Silent Collusion

This crucial moment happens when decisions have been made, a plan has been put in place, and predictably, some team members go back on their agreements—and peers and bosses let them get away with it. Almost 80 percent of our study participants reported this problem hampering their financial agility.

The scenario often plays out like this. Everyone is asked to make tough decisions. But most are skeptical about whether their peers will really pony up. So they watch and wait—refusing to make hard choices until they see others dive in.

The implicit pact in this silent collusion is, "I won't confront you about your area and you won't confront me about mine." The result is that commitments slide, cynicism grows, and the organization suffers.

Only one in ten respondents said that peers were willing to hold each other accountable to their cost savings commitments. While it may not be a surprise to most readers that many fail to hold their peers accountable, what is surprising is that the silent collusion extends to almost three-fourths of bosses. Seventy-two percent of supervisors neglected to confront failed cost savings commitments. As a result, more than four out of five teams bogged down in their response to changing financial conditions.

Teams that hold each other accountable for commitments related to a financial crisis are six and half times more likely to take effective action quickly. However, teams that fail to hold each other accountable are seven times more likely to have their bosses pull the responsibility out of their hands.

EXAMPLE:

Silent Collusion in Singapore

In one of our study sites, leaders unanimously agreed to cancel all discretionary consulting contracts. The manager from Japan found out his peer in Malaysia went straight home from the big strategy meeting and extended a consulting contract rather than cancelling it. He waited to see whether the boss would call his peer on his actions. It never happened. He was disgusted. And he was silent. He said nothing to his boss. He said nothing to his peer. Instead, he concluded hypocrisy was being rewarded, so he also failed to execute on his commitments. Soon, his peer in Singapore saw his lack of commitment and checked out of the process as well.

4. Irrational Slashing

The final crucial moment is, in some ways, the result of failure to address the previous three. Senior leaders rose up through the ranks seeing failures in the previous three crucial conversations. They themselves often dithered rather than acted. They felt stifled in their ability to raise undiscussables when talking about sensitive cost-cutting options. They participated in silent collusion—forestalling tough decisions until they witnessed real accountability. And now, they are the ones in charge.

Senior leaders see (or simply expect) delaying. They feel they can't trust their lieutenants to make the hard calls and they fully expect disingenuous support from the organization.

This is a crucial moment because when leaders are driven by mistrust, they have two options. One option is to confront the trust issues and attempt to drive genuine agreements with their staff.

But fewer than 29 percent of leaders confront the trust issue head on. Rather than talking through their misgivings, they act them out. They do so by demanding across-the-board cuts rather than intelligent reductions. When they take this irrational approach, they tend to provoke more gaming than teaming. For example, mid-level managers might react to the implicit mistrust by cutting in places they know will cause pain—which gives them a more potent way to demand restoration of resources in the near term. Or, they might sandbag in advance by storing up unfilled positions they can pretend to "cut" when the uniform demands come down.

Leaders who exclude the team instead of confronting their concerns about the team's actions are nearly three times more likely to undermine their own purpose by either undercutting their mission, making ill-advised cuts, or resorting to uniform across-the-board cuts when a more tailored approach would have been more effective.

EXAMPLE:

Across-the-board Cuts

The senior executive of one telecom company sent out a decree demanding "15 percent across-the-board budget cuts." When we asked him to explain this rationale behind such demands, he walked across the room and closed his door. Returning to his seat, he said, "I've been here 20 years. I know every manager here has at least 15 percent in a slush fund for times like this. Dialogue is pointless—they'd never admit it anyway."

Unfortunately, these across-the-board cuts hit the small-business marketing campaign the hardest. Unaware of the unwritten budget padding policy, a newly minted manager had made the mistake of submitting only the budget she really needed. When the cuts came, they went to the bone in her area. During this period, the company's competitors saw growth in small business telecom services. Unfortunately, this organization did not due to delays in the marketing campaign as a result of non-targeted budget cuts.

What Leaders Can Do to Create Financially Agile Teams

The pattern is clear. Each of these crucial situations represents a pivot point between agility and a tar pit. Teams that step up to these conversations are not just a little more agile; they are many times more responsive and able to succeed in tough financial times. Our agile teams are 250 percent more likely to say they "may miss a few opportunities, but generally do okay." Our less agile teams are 360 percent more likely to say they miss hundreds of thousands, millions, or tens of millions of dollars in lost opportunities.

So here are five things leaders can do to take control:

1. Model and Teach Dialogue Skills.

Leaders must overtly foster the dialogue skills required to address these four crucial conversations. In the best organizations, leaders actually teach them.

If managers don't have the skills to raise these conflicts without leading to contention, they won't raise them. As managers gain confidence in practicing crucial conversations skills, every one of the positive results described above is enabled. Issues are brought up more quickly, are discussed more thoroughly, and are raised in a way that leads to consensus not conflict. In this atmosphere, leaders are able to make tough but wise decisions and see them implemented efficiently.

There is no workaround for an investment in skill. When leaders lack the confidence to raise tough issues, it is usually because they lack the competence. Consistent, intensive, and sincere investment in skill building is a crucial ingredient to promoting financial agility.

2. Schedule Regular Financial Workouts.

These are complex conversations that require dedicated time to play out. Leaders need to commit regular and substantial blocks of time to address the four topics we've discussed.

Let's face it—the era of fixed budgets is over. In this chaotic marketplace, leaders need to use current revenue, not budgets, to guide their spending. Most budgets just aren't responsive enough to changing financial conditions.

Agile firms replace these fixed budgets with financial workouts, scheduled quarterly or in response to unforeseen shocks. These workouts are led by the CEO or COO, and pit a wide range of initiatives against clear criteria, the firm's revenue, and strategy. The evaluation process needs to be clear and simple so that it highlights the difficult tradeoffs the team must make.

These workouts require both time and structure. When leaders try to squeeze them in as one more item on an overstuffed agenda, they drag on for months. Likewise, a series of one-hour discussions is not as effective as a single day-long discussion. A longer workout encourages the team to dig deeper into the financial situation and to take on tough topics that would otherwise be left hanging.

The most common mistake made in structuring these workouts is to evaluate each initiative on its own merits, instead of forcing initiatives to compete for priority. Individually, every initiative seems meritorious, so the crucial conversations are avoided. But, taken together, these excellent initiatives are likely to be unaffordable. Making them compete forces the tough conversations and tradeoffs.

3. Publicly Sacrifice a Sacred Cow.

Sacrifice breathes life into new values. When leaders openly demonstrate that fiscal stewardship is more important than pet projects or personal ego, cynical team members begin to "doubt their doubts." They begin to entertain the possibility that more is discussable than they previously assumed. A notable former CEO was recently vilified in the news because while his firm lost billions of dollars he spent more than a million dollars redecorating his office.

Contrast this with a wise executive who we watched gather with his top 200 managers to generate a financial adjustment plan. He asked them to generate ways he could reduce his own budget to support the company's needs. In other words, he publicly sacrificed his own ego. Some were timid in the exercise, but soon the inevitable happened. Because this executive had invested for years in fostering the skill and will in his team to raise tough issues, one manager took him at his word and suggested he start flying coach and eliminate redundant executive staff at his second office location.

When the idea came up, he paused and looked at the other 199 managers. With a bit of drama he then said, "That's the first really challenging idea I've heard. And it's spot on. Let's keep going."

At that moment the dialogue opened up completely. The remainder of this financial workout session was one of the most productive in months. Why? Because the team had the skills. Because they had the opportunity. And because the public sacrifice demonstrated that the only inviolable value was the goal they were mutually obligated to achieve.

4. Support Decisions that Favor Timeliness over Perfection.

Most managers believe their leaders expect perfection. While this tacit belief can create mischief in good times, it creates peril in bad. Normal indecision is magnified manifold as managers are asked to make extraordinarily consequential decisions that can affect staffing levels, production capacity, quality standards, and other sacrosanct values.

So, allow time for data gathering but candidly discuss and agree on the limited fidelity that will be used to make final decisions. These urgent financial decisions are always made under conditions of uncertainty. Fiscally agile leaders accept this inevitability and work to understand the nature of the uncertainties they face. Then they tailor their tactics to the nature of the uncertainty.

Sometimes uncertainties exist because leaders can't wait for complete information. For example, a Florida school system saw tax revenues plummet and knew they had to make dramatic budget cuts. At the same time, one of their community's largest employers, a chicken-processing firm, closed. As a result, leaders had very poor information on how many total students, how many Spanish-speaking students, and how many low-income students would arrive on the first day of school. Yet they had to act on this incomplete information. To deal with the uncertainty, they prepared three scenarios they could choose from, made incremental decisions they could easily revise, went after the most important missing data, and made plans to revisit their decisions as soon as complete data came in.

Similarly, uncertainty exists when leaders must select and reject options before the options have been fully defined. For example, a large food-service firm needed to cut costs, which meant cancelling as many as a third of the new products they had under development. To address the situation, they grouped products into categories based on development status, market segment, and manufacturing technology, then made decisions that would preserve their most important product platforms.

These agile leaders didn't allow denial or silent collusion, and they didn't engage in irrational slashing. Instead, they accepted that their team's information would never be perfect, helped them determine the nature of the uncertainties they faced, and encouraged them to tailor their decisions to the information they had.

5. Create Safe "Sub Dialogues."

It can be helpful to break the fiscal challenge into discrete problems and assign small cross-functional groups of peers to work in a time-bound way to generate solutions.

For example, the leaders of a stock photography firm needed to cut costs. They were quick to identify what was core and what was expendable within their archive business—the value was in their inventory. However, they also owned a creative agency, where the value was not in inventory but in relationships with Hollywood stars.

The leaders were not as familiar with that part of their business but had to make cuts anyway. So, they created a "sub dialogue" by assigning this problem to those who truly understood it. They gave clear instruction about how much needed to be reduced and the timeframe within which they needed to make decisions.

They did not delegate the final decision, but rather asked for recommendations and explanations. Furthermore, the senior team let them know the kind of cuts that would be made if a plan could not be proposed within the needed timeframe. The agency managers were motivated to be creative and make the deadlines because they understood the havoc the cuts their superiors would impose would create. The results were intelligent cuts proposed rapidly by those who truly understood and embraced the goals of the reduction.

Another type of sub dialogue has senior leaders partner up in teams of two or three to evaluate each others' areas. This forces them to question their peers' initiatives and break through the deference barriers that exist within most senior teams.

Conclusions

It turns out the greatest barrier to financial agility is not a lack of intelligence or a lack of time; it's a lack of focused and unified dialogue.

While the need for financial agility is greater today than at any time in recent memory, the capacity to engage an entire organization in candid, timely and wise deliberation pays returns in any season. The present study shows that quality and speed are not at odds. If leaders invest in the skills, time, and support required to allow people to hold the four crucial conversations outlined here, they can generate both profoundly wise (ten times higher quality solutions as judged by their own managers) and surprisingly rapid solutions to their financial challenges.

Next Steps

VitalSmarts has spent three decades studying what it takes to influence rapid, profound, and sustainable change in behavior. Our research shows that organizations with strong cultural norms of candor and dialogue invest substantial resources in training their employees to speak up skillfully during crucial moments.

As a result of our research, we have built world-class training products and advisory services that can help people in your organization change the way they step up to and handle crucial moments—moments that if handled well can lead to financial agility and long-term success.

To learn more about our Crucial Conversations Training programs, events and speeches, visit **www.vitalsmarts.com/crucialconversationstraining.aspx** or call to speak with a VitalSmarts training consultant at 1.800.449.5989.

About Joseph Grenny and David Maxfield—Coauthors of the *New York Times* bestsellers, *Crucial Conversations* (McGraw-Hill) and *Influencer* (McGraw-Hill), Joseph Grenny and David Maxfield are sought-after speakers, consultants, and cofounders of VitalSmarts, an innovator in corporate training and organizational performance.

About VitalSmarts—An innovator in corporate training and leadership development, VitalSmarts combines three decades of original research with 50 years of the best social science to help leaders and organizations change human behavior and achieve new levels of performance. We've identified four high-leverage skill sets that, when used in combination, create healthy corporate cultures. These skills are taught in our award-winning training programs and *New York Times* bestselling books of the same titles: *Crucial Conversations*, *Crucial Accountability*, *Influencer*, and *Change Anything*. VitalSmarts has worked with 300 of the Fortune 500 companies and trained more than one million people worldwide. **www.vitalsmarts.com**

VitalSmarts®

801.765.9600 • www.vitalsmarts.com
282 River Bend Lane Suite 100 Provo, Ut