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THE TIME TO TRANSFORM IS NOW

FINNISH COMPANIES ARE UNPREPARED FOR A FUTURE DOWNTURN

By Mikko Nieminen and Otso Ojanen

EVERY DAY WE ARE presented with newer and more abundant evidence that economic troubles lie ahead. After a period of consistent and considerable growth, consensus is growing among business leaders and experts that the global economy is approaching a time of stagnation or even contraction. Weakening consumer confidence, shrinking appetites for investment, decreasing global trade, and increasing debt levels are but a few of the present indicators suggesting an impending global downturn. With the successes and failures of national economies ever more deeply entwined, no country is immune to these global trends, least of all Finland. Given the strong correlation between global economic growth and Finland's own economic performance, the impacts of a global downturn on Finland would be significant.

Issues are beginning to emerge in the Finnish economy

Unfortunately, there is reason to believe that Finland's companies are already demonstrating the symptoms of a cooling global economy. Even though the International Monetary Fund (IMF) forecasted a reasonable 1.9% real GDP growth for Finland in 2019, this is a 0.4 percentage point decline from 2018. Similarly, though the profitability of Finland's companies has steadily increased since 2013, stock market valuations have gone down since 2017. And with exports and investments driving Finland's postcrisis growth, the sharp contraction of Finnish exports since 2018 is yet another worrying sign. Thus, while analysts still claim to see domestic growth potential in Finland, ongoing consumer uncertainty threatens its realization.

Performance of Finnish companies is on the decline

These developments raise two critical questions: (1) are Finland's companies in a strong enough position to face a downturn, and (2) presented with this prospect, what preparations can they make to ensure long-term success?

To understand the first question, we analyzed the development of median total shareholder returns (TSR) of Finland's listed companies over the last five years. Because TSR measures the return of all cash flows to investors in a given period, it is a good indicator of a company's overall health. We believe that companies performing well before a downturn will have established competitive advantages that make them more resistant to economic fluctuations; therefore, TSR can also indicate a company's level of preparation for an economic slowdown. In short, we believe that companies with strong TSRs are more likely to succeed during, and after, a downturn. As the results of the analysis show, Finnish companies have no time to lose.

Finnish companies' one-year TSR was more than 16 percentage points lower than their five-year annualized TSR. (See Exhibit 1.) Over this five-year period, the contraction has accelerated and, crucially, has been driven by a decline in all three components of TSR: multiple change, financing impact, and operational improvements. This is particularly worrying, as both operational performance and market mood can be expected to weaken considerably in a downturn, thereby creating additional pressure on already slim returns.

These declines are seen across Finnish sectors, though there are significant differences in magnitude. (See Exhibit 2.) The five-year contractions are most pronounced in industrial goods (down 23 percentage points) and financial institutions (down 22 percentage points), whereas technology, media, and telecommunications (TMT) stands alone as the only sector maintaining positive one-year TSR (though even this has decreased considerably). Though this variance between industries is to be expected, what is most worrying is the industries' development in relation to global benchmarks. Finnish companies are considerably below the global performance of S&P 500 companies in each sector. (See Exhibit 2.) These TSR results indicate that Finnish companies are no longer following their global peers: they are already falling behind. It is therefore imperative that Finnish companies seek to improve their performance as quickly as possible.

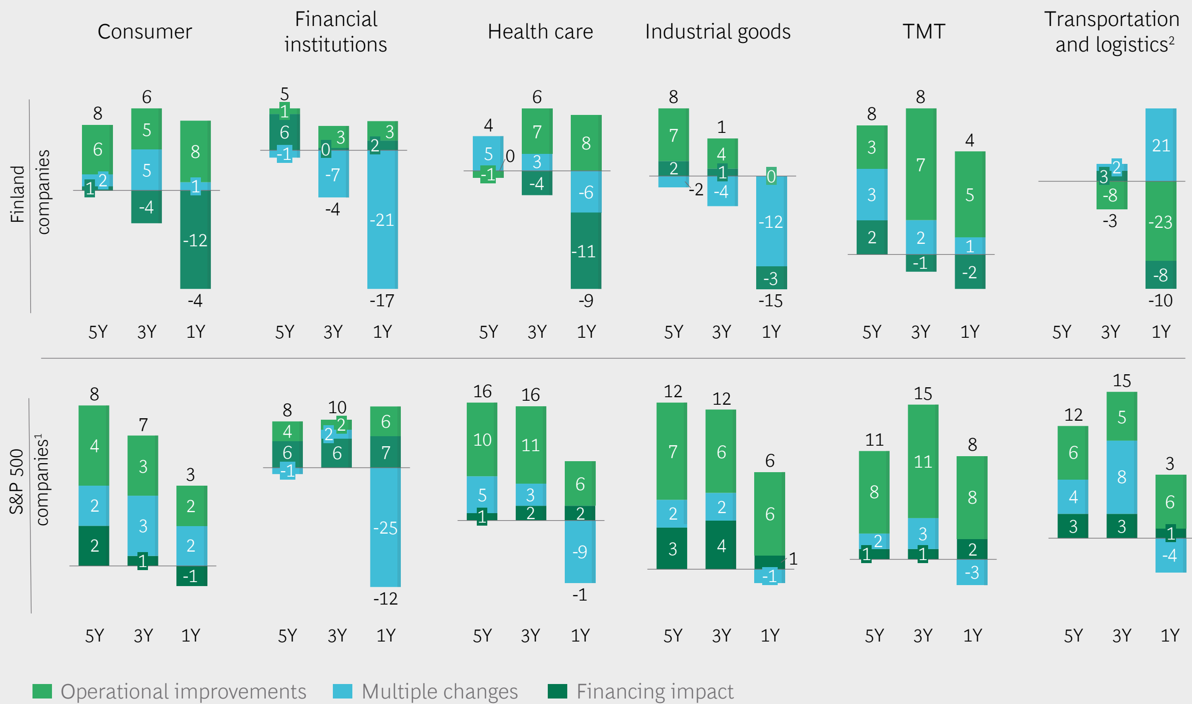
The time to act is now: Preemptive transformation

The quickest and most efficient way for a Finnish company to prepare itself is by initiating a business transformation. BCG's analysis of hundreds of transformations involving restructuring found that preemptive change generates significantly higher long-

EXHIBIT 1 | Finnish Companies' One-Year TSR Is Much Lower Than Their Five-Year Annualized TSR

Sources: S&P Capital IQ; BCG ValueScience analysis.
Note: Median of 147 listed Finnish companies.
[1]Because of median calculation, the sum of the parts might not add up to the median TSR.

EXHIBIT 2 | Finnish Companies Lag Behind Their Global Peers in All Sectors



Sources: S&P Capital IQ; BCG ValueScience analysis.
Note: Median of 147 listed Finnish companies.
[1]Based on median of S&P 500 companies.
[2]Only one company included here.

term value than reactive change. Because preemptive transformations take less time, cost less, and increase leadership stability more, companies that undertake them outperform their peers both in the aggregate and across most industries. The effects of preemptive actions are continuous, and the earlier a transformation is initiated, the better the outcomes. (See Exhibit 3.)

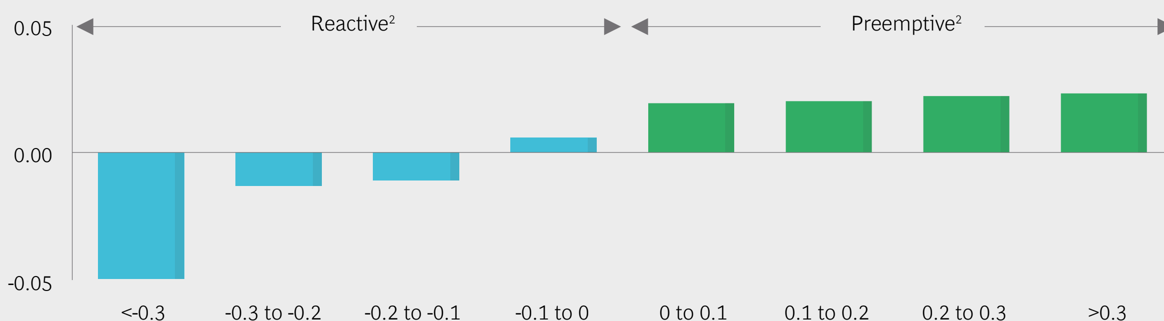
With this in mind, Finnish companies should immediately assess their levels of preparation, focusing on the fact that a timely transformation significantly increases the likelihood of long-term success. Through a holistic view of both growth and margin improvements, preemptive transformations realize quick wins, which act as cushions to absorb the impacts of an economic slowdown while also building a foundation for sustained performance in the long run.

Though the purpose of a preemptive transformation may be straightforward, successful implementation requires critical commitment and dedicated resources. A company must establish a clear view of its current strengths and weaknesses and define its ambitions, both immediate and in the long term. Only then can its focus shift from planning to implementation. This will begin with a Triage/Rapid Assessment in conjunction with no-regret moves—initiatives that are relatively easy to implement in the first 100 days, generating results in 3 to 12 months. Together these will close performance gaps, reduce costs, improve top- and bottom-line performance, and free up cash to drive longer-term initiatives. At the same time, a company will need to launch broader initiatives to reinvent itself for the future by focusing on innovation, growth, and continuing value creation.

For a more in-depth analysis of preemptive transformation, including success factors and a six-step approach to success, please refer to the BCG paper *Preemptive Transformation—Fix It Before It Breaks*.

Exhibit 3 | The Earlier a Company Transforms, the Better Its Future Performance

Average three-year relative TSR posttransformation[1]



One-year relative TSR pretransformation[1]

Sources: Compustat; S&P Capital IQ; BCG Henderson Institute.
[1]Performance measured as TSR relative to the industry average.
[2]Reactive transformation defined as negative TSR relative to the industry in the year prior to start of a transformation. Preemptive transformation defined as positive TSR relative to the industry in the year prior to start of a transformation.

About the Authors

Mikko Nieminen is a partner and managing director in BCG's Helsinki office. You can reach him at nieminen.mikko@bcg.com.

Otso Ojanen is a partner and associate director in BCG's Helsinki office. You can reach him at ojanen.otso@bcg.com.

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