Turning Crisis into Competitive Advantage:
Immediate Cost Management Techniques and Strategic Innovations

FEI Breakfast Seminar
April 2009
Recovery in global economy may not occur until 4Q2009 or later

Current Debt Levels Indicate Deleveraging Has Some Distance To Go

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<tbody>
<tr>
<td>Total</td>
<td>155.4%</td>
<td>230.0%</td>
<td>264.5%</td>
<td>345.9%</td>
</tr>
<tr>
<td>Household:</td>
<td>47.9%</td>
<td>61.5%</td>
<td>70.4%</td>
<td>96.5%</td>
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<tr>
<td>Mortgage</td>
<td>31.8</td>
<td>42.8</td>
<td>48.4</td>
<td>73.1</td>
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<tr>
<td>Other debt</td>
<td>16.1</td>
<td>18.7</td>
<td>22.0</td>
<td>23.4</td>
</tr>
<tr>
<td>Business:</td>
<td>70.5%</td>
<td>108.9%</td>
<td>148.0%</td>
<td>193.6%</td>
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<tr>
<td>Nonfinancial</td>
<td>50.7</td>
<td>64.2</td>
<td>66.2</td>
<td>76.4</td>
</tr>
<tr>
<td>Financial</td>
<td>19.8</td>
<td>44.7</td>
<td>81.8</td>
<td>117.2</td>
</tr>
<tr>
<td>Government</td>
<td>37.0%</td>
<td>59.6%</td>
<td>46.0%</td>
<td>55.9%</td>
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Three ways to recover from over-leveraging:

- File for bankruptcy
- Print money
- Increase productivity
Yet broader forces are at work

Our world has become...

- Smaller & Flatter
  - Pervasive connections and communications
  - Emerging markets
  - Open trade

- Riskier
  - Systems-level complexity
  - Viral spread of information
  - Widening gap between information available, and information effectively managed.

- Smarter
  - Instrumented
  - Interconnected
  - Intelligent

... And tomorrow's leaders will capitalize on the new opportunities created
We are Facing a Different Kind of Downturn Where Traditional Responses Won’t Suffice

Reality of New Environment

Long & Difficult
- Unprecedented constraints on access to credit and capital; Unwinding of over-leverage
- Falling demand, increased price sensitivity as consumers and enterprises cut back
- Disruptions in supply chains, partner and customer arrangements

Transformative
- Restructuring of industries: Firms fail, sold off overnight
- New regulatory regimes
- Stress on global inter-dependencies

Implications

Typical cost management will not be enough!
Need to:
- Examine working capital
  -- Reduce and preserve capital
  -- Streamline operations

Management Challenges

- Immediate cost takeout initiatives
- Manage costs and maximize capital to drive a focus on value
- Review and validate or reset the company strategy
- Position organization for sustainable profit improvement
- Drive a structured approach to increasing efficiency and enhancing effectiveness of organization
- Reprioritize projects/investments
- Take decisive actions
An analysis of early winners points to strategies for success

Top performers during 2008...

Exhibited three strategies

1. Focus on Value
   - Do more with less
   - Focus on the core

2. Exploit Opportunities
   - Capture share
   - Build future capabilities

3. Act Quickly
   - Leadership
   - Risk & transparency

Criteria for Top Performers:
- Market Cap >$1.4B
- 52 week stock price change >5.0%

Source: Google Finance, IBM S&C analysis. Performance period is 12/27/07 to 12/18/08
Transformation Continuum

Most organizations simply cut costs and fail to capitalize on transformational opportunities.

- **Status Quo**
  - Impairs ability to compete and survive
  - Limits enhancement of culture and skills

- **Cut Costs**
  - Minimal disruption and fast
  - Could destroy value

- **Cost Optimization**
  - Most effective at capturing near-term synergies
  - Most effective at encouraging upside potential

- **Best of Both**
  - Shift from operational productivity improvements
  - Spend more on innovation

- **Pros and Cons**

Driving cost out both tactically and strategically will help ensure success...and innovation
The typical response

Understanding behavior will help mitigate any drop in productivity throughout the transformation.

Early Denial
- "We can change if necessary"
- "Our company is well positioned"

Fear/Uncertainty
- "What does this mean for me?"
- "What are my priorities now?"

Paralysis
- "I can’t act with all this uncertainty"
- "My highest priority is to stay on top of the economic news"

Adaptation
- "The train is leaving, I better get on"
- "It’s hard, but we can do it"

Commitment to Execution!!
- "Decisive and bold"
- "We will succeed"

Withdrawal
- "I’ll do what is necessary to survive"

More responsibility has shifted to the CFO to lead their organization through the recovery
There are five critical focus areas for effectively executing on the cost reduction and innovation agenda

**Challenges**

1. How do you capture savings ... 
2. ...while maintaining systems and processes 
3. ...in a timely manner 
4. ...and building a strategic platform 
5. ...without negatively affecting customers or financial performance?

**Focus Areas**

1. Control the Program
2. Expand and Front Load Savings Capture
3. Plan for Issue-Free transformation and action
4. Design & Implement Innovation Strategy
5. Address Culture & Organization Design Immediately and Communicate Frequently
Framework for succeeding in the new economic environment

Success requires a holistic response to manage through the current downturn.
# Techniques for Success

Organizations must focus on cost management and innovation.

<table>
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<tr>
<th>Multi-Tier Approach</th>
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<tr>
<td><strong>FOCUS ON SHORT TERM 6-9 MONTHS PAYBACK</strong></td>
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<tr>
<td>Identify and take 20%-40% out of cost base (Max 4 weeks to implementation)</td>
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<tr>
<td>- Make intelligent decisions to reduce the cost base</td>
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<tr>
<td>- Reduce costs in operations and direct expenditure</td>
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| **INNOVATE BUSINESS MODEL AND GAIN SHARE** |
| - Selective acquisitions |
| - Disrupt weak competitors |
| - Turn IT into an enabler of business agility |

| **LONG TERM STABILITY AND INDUSTRY LEADERSHIP** |
| - Process improvements |
| - Strategic acquisitions and alliances |
| - Analytics to improve decision making |
| - Robust governance and risk management capabilities |
Reduce costs / risk and improve controls using multiple levers

<table>
<thead>
<tr>
<th>AREAS FOR IMPROVEMENT</th>
<th>SAVINGS POTENTIAL</th>
<th>BALANCE SHEET IMPACT</th>
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<tbody>
<tr>
<td><strong>PROCESSES</strong></td>
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<tr>
<td>Streamline work</td>
<td>5-15%</td>
<td>Cash conservation</td>
</tr>
<tr>
<td>Realize economies of scale</td>
<td></td>
<td>Working capital optimization</td>
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<tr>
<td><strong>TECHNOLOGY</strong></td>
<td></td>
<td></td>
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<tr>
<td>Consolidation, virtualization, automation</td>
<td>5-30%</td>
<td>Cash conservation</td>
</tr>
<tr>
<td>Variable cost model</td>
<td></td>
<td>Higher ROI/ROA</td>
</tr>
<tr>
<td><strong>OPERATING MODEL</strong></td>
<td></td>
<td></td>
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<tr>
<td>Focus on core processes – outsource other</td>
<td>20-35%</td>
<td>Cash conservation</td>
</tr>
<tr>
<td>Global Enterprise model</td>
<td></td>
<td>Improved controls</td>
</tr>
<tr>
<td><strong>OUTSOURCING</strong></td>
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<td></td>
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<tr>
<td>IT infrastructure &amp; applications</td>
<td>15-40%</td>
<td>Cash conservation</td>
</tr>
<tr>
<td>CRM, HR, F&amp;A</td>
<td></td>
<td>Cash generation</td>
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Some clients use all of these simultaneously to fundamentally change their business model.
IBM is working with the Government of Malta to build the world’s first national smart utility grid. This includes replacing a quarter-million conventional electric meters with Smart meters and upgrading its water system where it can be monitored and managed remotely.

Customers will be able to use the Internet to track their utility usage in real time, choose the best plan and pre-pay services.

Malta is the first country to green its national grid – serving as a test case to determine whether integrating smart technologies into both electricity and water systems can help mitigate the increasing effects of global warming on the island.
Our approach has delivered significant financial benefits for a variety of clients

<table>
<thead>
<tr>
<th>Client</th>
<th>Strategic Imperatives</th>
<th>IBM-Client Approach</th>
<th>Bottom-Line Results</th>
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</table>
| **Top-tier global bank**  
  - Universal Bank  
  (~ $1T assets) | ➢ Improve productivity dramatically  
  ➢ Target emerging markets for growth  
  ➢ Self-fund future investments | ➢ Advanced a strategic cost reduction initiative for the North American consumer Bank  
  ➢ Leveraged Component Business Modeling (CBM) to identify cross-consumer business opportunities:  
  ➢ Attributed $12B in operating costs across 88 components  
  ➢ Identified major savings opportunities | ➢ Identified over $110 million in short and medium term cost savings  
  ➢ Established longer-term improvements in customer service, marketing effectiveness and relationship management  
  ➢ Supported savings implementation |
| **Hydro Ottawa** | ➢ Need for stable, reliable customer information & billing systems  
  ➢ Improve risk management  
  ➢ Not viable through the legacy infrastructure | ➢ IBM developed and implemented a new Customer Information & Billing system  
  ➢ Solution optimizes the system and equates the cost of the services provided with the number of customer Hydro Ottawa invoices | ➢ Clear view of client purchases  
  ➢ Avoided capital expense of an internal solution and also traditional outsourced options  
  ➢ Robust solution that is high functioning, stable, extensible and flexible  
  ➢ Enabled to face competitive challenges and shifting business models (ie. Impact deregulation)  
  ➢ Reduction of overall IT costs |
| **Top 5 Canadian Wealth Management Company**  
  (CAD $510B assets) | ➢ Define a phased roadmap of improvement projects to achieve at least $12.5m annual net benefit in combined organization, process and technology costs | ➢ Leveraged Component Business Modeling (CBM) approach to establish a componentized view of the Wealth Management business and develop an investment roadmap of strategic initiatives to achieve business optimization goals | ➢ Identified total annual net benefit of $365m CAD  
  ➢ Identified 17 major cross-organizational opportunities to drive benefits |
Are you ready?

1. Focus on Value
- Cut costs strategically
- Know where the most value is
- Ruthlessly review and prioritize
- Define approaches for succeeding with most value-oriented customers

2. Exploit Opportunities
- Understand your competitive position
- Know what new business models could transform your market
- Be ready for the upturn and have a robust plan in place
- Have the right team in place

3. Act with Speed
- Apply change management processes and skills to every project
- Track the variables that give you an accurate view of your risks and vulnerabilities
Headlights on 2010 CFO Study

The primary survey hypothesis examines the smarter enterprise *

How does the CFO make the enterprise smarter in an era of increased uncertainty?

CONTEXT/SITUATION: Uncertainty
ROLE: Mission-critical
DATA: transparency
NEW INTELLIGENCE: Shaped by CFO
ORGANIZATIONAL AGILITY
TALENT: Tomorrow’s team

* Note: Hypothesis as of 10 April. The Survey hypotheses continue to evolve and change
- For more information please visit IBM’s CFO Website
Let’s build a smarter planet