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OPERATIONS PRACTICE

McKinsey conversations with global leaders: Jim Owens of Caterpillar

Caterpillar's former chairman and CEO reflects on an unconventional career path, organizational change, and how and where to stay competitive over the long term.



During his 38-year tenure at Caterpillar, Jim Owens saw the construction-equipment company recover from the financial brink to become an industry archetype in today's emerging-market growth story. In this video, the latest in our interview series *McKinsey conversations with global leaders*, Owens—who retired as chairman on October 31—talks about that evolution, his own journey, and the role business leaders play in rebalancing new economic realities. Hans-Werner Kaas, a director in McKinsey's Detroit office, conducted the interview in September 2010.

Managing in the downturn: The game has changed

The Quarterly: Jim, unlike most CEOs, you are an economist by training. How has that unique background shaped your views on the global economic crisis?

Jim Owens: In terms of the economic side of it all, here at Caterpillar, we think about scenarios. And so, we kind of set those trend levels, if you will, and then the high-lows that we will have to deal with. And really, within the firm, we break that down into the sub-elements of our business, because the assets to support the business are tied to that. And so, we've gone through, in our strategic planning process at Caterpillar over the years, we've really worked on that high-low mentality with a lot of emphasis, because everybody is inclined to be optimistic.

In many of the industries we serve, be it global oil and gas industry, mining industry—certainly construction, housing—these industries are highly cyclical. And the capital goods dimension, you know, fluctuates even more than the macroeconomic, GDP-type dollars associated with it. So, we just have to be prepared for those kinds of extremes.

The Quarterly: And has the economic crisis shifted any of the more fundamental strategic priorities, directions of Caterpillar?

Jim Owens: No. You know, I think, interestingly enough, we put together our Vision 2020, our long-term strategy, back in 2004, 2005. I think it's stood the test of time very well. We knew there was a megatrend afoot in the global economy, of emerging markets growing at two to three times as fast as the OECD¹ countries, a mass urbanization there. We felt they were driving commodity markets, so a lot of that was embedded in our strategy, as was the need to be prepared for extreme fluctuations and a trough scenario of a deep global recession.

Now, it turns out that the deep global recession of 2009 was considerably worse than we expected. I mean, the worst since 1938. I wouldn't be facetious enough to say we put

¹Organisation for Economic Co-operation and Development.

that into our plan back in 2004, but we did put a deep world recession in there, and we forced all of our business units to think about how we would deal with that if it occurred simultaneously globally.

And that served us very well, you know, as we went through the trough. Now, I think we have to keep in mind and be mindful of the fact we're likely going to have a longer period at below trend levels of sales in many of the industries we serve. But we're also likely to see a correction back to that trend level that'll be rather abrupt when it does occur.

The Quarterly: From a personal standpoint, the lessons learned during the economic crisis—has it changed the way you have been leading the organization?

Jim Owens: Not really. I got a lot of my management training, if you will, in the economic crisis of the early 1980s—a very painful lesson for us corporately because we went through a period of almost three years of losing a million dollars a day.

And it was seared in my mind, certainly from the financial side of the company, that Caterpillar had gone through 50 years of the Depression, and world wars, and sustained profitability, and we had now allowed ourselves to get into a position where we couldn't sustain profitability in the early '80s crisis.

It was a tough decade. But I came out of that with a great resolve that we would build in flexibility that would allow the company to sustain profitability and, ideally, cover the cost of capital in the worst-case scenario. And I think, you know, this is not a cyclical or a quarterly thing; this is a long-term journey and positioning ourselves to do that. And I am actually very proud of what we delivered in the global financial crisis of '09. We were able to take about 30 percent out of our—what accountants would have called our period cost structure inside of four months.

We encouraged a significant inventory reduction because we didn't want things building up in the wrong places that we'd have to discount. We radically reduced production. All those built-in mechanisms for cost flexibility that we thought we had, we were able to exercise and execute on. And we actually never had a quarter even of operating loss. We sustained profitability for the year, near the target levels that we had for just a normal deep, worldwide recession.

So if I learned anything, it's that staying focused on the long-term horizon—where you want to go—and having a solid plan to deal with the extreme edges of what you may have to deal with in terms of the macroeconomic environment.

The Quarterly: Which remaining uncertainty, Jim, do you still see in the global economic recovery?

Jim Owens: Well, I don't think it's a steady path. And I think we've got to kind of rebalance the world economy. We've got to come back to, in the western world, a fiscal discipline—at least over the course of the business cycle. We've got to get back to—in the United States, certainly—to significantly more savings, more investment in our future. We've got to improve our trade balance by increasing our exports—not by becoming protectionists, but by staying open to the world market and aggressively working on [the] global competitiveness of our economy.

It's hard for most US citizens to come to grips with the reality that we're 5 percent of the world's population. I think we're going to be dealing in a world in the future that's—in terms of its economic centers of gravity—is going to be very multipolar. The emerging—market theater now has more than 50 percent of GDP globally. They're growing much faster. So, the game has changed. The need to think about global competitiveness is ever greater.

In the industry: Harnessing megatrends

The Quarterly: Talking about the great rebalancing between emerging economies, developed economies—in terms of absolute GDP but also GDP growth—what implications does that have for Caterpillar?

Jim Owens: It's very beneficial to Caterpillar in the sense that the—this megatrend, the emerging market country growth and the large population Asian countries, particularly India and China, [are] now at a stage of economic development where their middle class is greater than most any European country, and that middle class is growing quite rapidly in those countries, a trend toward mass urbanization, both of which drive demand for commodities. We think that trend is going to continue, and that reasonably higher growth rate, at least two times the OECD world for another decade or two. That tends to keep commodity prices at a high level.

So, the higher prices drive economic wealth in those countries. That wealth enables them to invest in creating development of the natural resource base as well as infrastructure. And then, the demand—consumer demand for housing and other things that follows on. So, it's kind of a virtuous circle. Very good thing for Caterpillar because the oil and gas industry—energy, in general—is one of our most important industries worldwide. Global mining is one of our most important industries worldwide. And of course, big infrastructure development and housing are all our sweet spots.

At the same time, we recognize our big manufacturing operations have been in the United States and Western Europe. And even though we started a move to the emerging-market theater 50 years ago with—we've been in Brazil now for 55 years, we're domestically a leader there. And we've been investing in China and India for a while, but it's at relatively modest levels. Over the last five or six years, we've put about another billion dollars of investment in new plant and equipment in those countries and there's more on the table coming right now.

We recognize we've got to create a competitive manufacturing base to compete effectively in those countries, and we've got to aggressively develop our dealer infrastructure. We have relatively lower market share in those countries, though we're a good participant. And we're very much focused, strategically, on being sure we end up with a leadership position across the emerging-market theater.

The Quarterly: What are the challenges you see or the concerns you have to really execute that holistic business model?

Jim Owens: Probably the big risk, if you will, is the evolution of the customer base. And by that I mean, we're used to serving large, sophisticated contractors who look at total owning and operating cost over the life cycle of a project, who understand that very well, who understand owning and operating cost, who understand what the uptime of equipment—you know, the value of having 24-hour parts availability and getting it fixed on the weekend and being sure it's always producing.

I worry in a place like China, sometimes, that—the way contracting is done, there are, you know, contractors and subs and subs and subs. And by the time you get down to the owner of the machine, he's a very small businessman who maybe is overly focused on just the initial price of the equipment, and he kind of can't see his way through to residual values and owning and operating cost and a lot of things that are important to our business model.

That's changing in most of these key developing countries. You know, I've spent a lot of time in a place like Indonesia, where I've seen the emergence of a very strong customer base that does buy into the concepts of our business model. And we need to help that emerge in other places.

The Quarterly: Jim, what role do you see for manufacturing, especially in our developed economies?

Jim Owens: I think from—in an economic context, manufacturing's a little misunderstood. The US is still the largest manufacturing economy in the world, and we're

still one of the leading exporters of manufactured products in the world. As a percent of GDP and certainly of the labor force, it's radically reduced from what it used to be.

On the other hand, you know, a company like Caterpillar—we used to count the cafeteria workers and the lawn-care workers and everything else as "manufacturing employees." Today, they've been outsourced, and they now work for a service company that provides that service for us instead of us doing it directly, and this is true across all manufacturing employers in the country.

And of course, there's also been incredible productivity growth. All the information technology that's come along that we've leveraged into enhanced manufacturing capabilities. Quite frankly, you cannot produce the quality of products that we, in many cases, are producing—the machining tolerances, et cetera—without very sophisticated, automated machining capabilities. It can't be done by hand anymore. So, we've taken a lot of blue-collar work and made it white-collar work.

Leadership: Walk the talk

The Quarterly: How would you define your own personal leadership style?

Jim Owens: You know, I was asked by a group of students recently if I had a lot of management training prior to coming here, and, quite frankly, my training was more in the textile engineering, and in economics and econometrics. And I think there's certain values you learn even as a youth, you know, be it from scouting or whatever other activities—team sports—that you're involved in, about how to get teams working well together.

I very much believe in teamwork and I think a values-based management style that really is as simple as the golden rule. You want to treat people as you'd like to be treated. And if you keep that in mind, and really value and respect other people's opinions, then you can get the kind of teamwork, I think, that it takes to be successful over time in the economy we're competing in today.

To me, any great company—it's not about a great individual leader; it's about a leadership culture within the company. And it's about establishing a leadership culture that does value people. And that draws out the best in, literally, a cast of—a company the size of Caterpillar—thousands of leaders around the world who are making decisions every day. So, it's about getting that kind of passion and enthusiasm for winning brought out in people all across your enterprise.

The Quarterly: Every CEO, once he takes over his new role, has a plan for his first 100, first 200 days. Did you have a plan for your last 100 days?

Jim Owens: We had a lot of discussion about that between myself and the board. The last two transitions at Caterpillar, we had a relatively abrupt transition between the time that the new, incoming chairman knew that he was going to get the job, and when he actually had the job. In my case, literally, I found out at 10:00 at night that I was going to be the next chairman and CEO. It was announced the next morning, and, you know, ten days later, my [predecessor]—I mean, ten work days—was kind of moving aside. And he didn't want to be a lame duck, and that's an understandable reaction.

But I thought that this isn't really about what I want and what I'm comfortable with, but really about what's the best thing for the enterprise. And having spent 12 to 18 months on strategy once I got settled into the job, I felt it would be extremely beneficial to the enterprise if the person who was going to replace me knew it at least 9, 10 months ahead of time so that he could work on refreshing the strategy.

And then we would transition by when he was ready to roll out the strategy at midyear. He would roll out the strategy to our global supply chain, so our employees, our dealers, and our key suppliers would get the rollout message from the chairman elect and new CEO, and he would become CEO at the end of June. And quite frankly, you know, by the time we get to June, I had pretty much handed over all the reins. So, it is a little bit—it's not as much fun to be leaving as it is arriving. On the other hand, it's not so much about fun for the outgoing CEO as it is about a seamless transition and having an enterprise that has traction with the new strategy right out of the box.

So, there's not time wasted, there's no big shifting of gears down the road. And I think that's, as I look back on it, I feel—and I told the board, this is art more than science. We'll kind of look back in a couple of years and say, did that work better than our previous transitions? And a lot depends on the people and how they work the transition. As the outgoing CEO, you've got to stay engaged long enough, but you've got to know when you need to get out of the way and let the new team take over. And I think the organization can only look at one leader at a time.

The Quarterly: What do you want your legacy at Caterpillar to be?

Jim Owens: I think I will probably be most remembered for the performance of the company in the most difficult and severe recession since 1938. What I'd like to be most remembered for, of course, is the people side of the equation. Great communications, values-based management, walking the talk on our values in action, and a highly ethical company, you know, are the kind[s] of things that I'm probably proudest of. Not probably—I am proudest of.

Management lessons: Organization first

The Quarterly: If you think back over your career, what was the most important key lesson you learned as an executive, as a manager?

Jim Owens: You know, if I had to cite one that was particularly searing and impactful on maybe changing me, the two years that I came back from Europe as an economist and went into accounting, but I was charged with working across the company and forging a make-buy strategy at a time when we were under intense global competitive pressure. We knew we had a cost problem. This was the period of time we were losing a lot of money. And we had to really change our mindset from a sort of a functional discipline to a real business discipline.

And I didn't have anybody working directly for me, but I had division managers—from manufacturing, engineering, purchasing, accounting, and our parts and service group—on a committee that I chaired that reported to a group of officers of the company. And working through that dilemma and thinking about how to reposition Caterpillar—and really having to lead with just the power of ideas, because none of these people worked directly for me—was a period of stress and one that I learned a tremendous amount in. And I think, in the end, we got a lot done. And so, you begin to take a lot of pride at what you can get done with leadership without position power.

The Quarterly: What corporate culture have you built over the years at Caterpillar, and if you look back, would you change anything?

Jim Owens: You know, I don't want to sound facetious here, but probably not. I think Caterpillar has a very rich culture that's been built up over many, many years. We tend to attract and retain employees that join the company right out of college or within the first ten years of their working career. And most we tend to keep and retain over time.

Over the recent years I have been very concerned about—we've had some we-they-isms in the culture, particularly when it comes to production workforce and management workforce, union versus non-union, in some of our facilities. And one of the things I really emphasized and recognized is [that] united teams win, divided teams lose.

Early on I felt, from a people dimension, the only way to get from being a good company to a great company is just to go to uncommonly high levels of engagement with all of your people. We wanted to go from sort of good-average on safety to one of the very best in the world. And this is back to that we-they attitude. I didn't want this to be something that we did jointly with the union or something. They're Caterpillar employees. We needed to go out and stake out the ground that we were going to look after everybody all day. And we're going to look after our fellow employee workers, and it's a joint initiative. And we held

management accountable for delivering steady improvement in safety performance and for moving Caterpillar to one of the best in the industrial world.

And I'm very proud to say we got that done. But it sent a very loud message to our employees about how much we cared about them. And it helped us purge that we-they-ism that was residual in some of our operations. We also said, you know, we want to set an expectation that we do walk the talk with our values in action. And through our employee survey, we're going to measure how well our leadership team does at engaging employees.

How do you expect employees to help you deliver on your goals and to move you to your future vision if they don't understand what that vision is? If they don't understand what their unit has to do to contribute to achieving that vision? If they don't feel that their manager walks the talk day in and day out on values-based management? If they wouldn't recommend it as a place to work to a friend or colleague? So, you know, when we started rolling out our strategy, the outside groups that we consulted with said, "You know, if you could get to 65 with positive feedback on your employee survey, that would be approaching really outstanding company status." We set 90 as our goal. We said, "How can you be a great company if at least 90 percent of the people don't understand what you want do, how you're going to get there, and what role they have to play in helping you get there? And they're enthusiastic about you as an employer."

And I'm very proud of the fact that over the last seven years, we improved every single year. We were at 82 at the end of '09 in the most horrific business conditions you can imagine. You know, people were rolling up their sleeves and thinking about how I can make this company better.

The Quarterly: What has been the most important lesson you have learned to engage people and lead people?

Jim Owens: I think it takes very intense communications, and it takes them—and very transparent communications, honest communications, that are delivered by the seniormost leaders with conviction on a regular basis. When we got into the global financial economic crisis I delivered that initial, very difficult message that all of our employees need to understand and the difficult decisions that we were having to take.

I then put on an officer of the company, one of the group presidents, every single month for an all-employee, town hall-type meeting to talk about the state of play, where we were, what was happening—our successes and what we needed to do better.

And I think that was immensely helpful to our people. None of us liked the fact that we had to downsize the workforce. But I think the candor and honesty that we dealt with it was

extraordinarily helpful in helping keeping everybody on board, rowing together, to keep our boat sailing through these very turbulent waters.

The Quarterly: You're nearing the end of a remarkable and exceptional career at Caterpillar. What advice would you have for other executives within your company or institution but also beyond?

Jim Owens: I've been asked a lot lately, you know, did you come to Caterpillar back in 1972 aspiring to be the CEO? And not surprisingly, the answer was no. I mean, in fact, I came to Caterpillar, I didn't even know what a CEO was hardly.

I came aspiring to be a great business economist and to really learn the tricks of the trade and how to leverage the energy I put into getting my doctorate in economics, and the econometric tools that I had developed, and how to apply those in a business setting. And along the way, you know, I took the opportunities that presented themselves. And I think at each step of the ladder, I looked for ways to do my job uncommonly well, and for what—how I could expand, sort of, the scope of my job and do more things for the company as I began to think about my success as organizational success. How can I make the organization more successful?

I never really thought about chairing the company, at least [not] until I was CFO of the company. And by then, I'm over 20 years into the company and into my job. So I think I very much believe in, sort of, the Jim Collins mantra of really putting the organization first and thinking always about what you can do to make the organization successful, and thinking in terms of we, not I, all along the way.

Business in society: To the forefront

The Quarterly: Business leaders play important roles in advancing the welfare, and also the thinking, of societies. What is or should be the role of the CEO in advancing societies?

Jim Owens: I think business leaders, you know, sort of in the post-Enron world and all of the issues around maybe excessive compensation, business leaders have kind of stepped to the background. What I worry about is: we don't want to address the difficult issues, and we've become politically polarized to where we can't have an adult conversation about some of the things that we need to do better as a country in terms of economic policy.

I think the business community just has to get more engaged in helping educate the public. The CEO gets one vote, but we have an opportunity to enhance economic understanding about good economic policy that will promote growth and economic prosperity in our countries—not only in the United States, but around the world.

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So, how do we go about doing that? I mean, in the United States right now we've got big issues around the—we have a large fiscal deficit right now that's driven by a severe recession that we will recover from. But we have a long-term structural deficit because we don't have a tax revenue base that's going to cover the entitlement programs that are basically in place, and the baby boom generation that's coming.

So, we need to thoughtfully sit down with our government leaders and think about how we're going to get the economic policies in place to do what needs to be done to have a sustainable economy. And the longer we wait and the closer we get to the train wreck, the harder it is to deal with.

The Quarterly: You're a member of the president's economic advisory board. In that role, Jim, can you influence economic policies better than not being on that board?

Jim Owens: You know, I think the PERAB, the President's Economic Recovery Advisory Board, includes such an eclectic group of special interest groups. I mean, there are business people, two, there are labor unions, two, there are academics, there are investment professionals, there are entrepreneurs from Silicon Valley, there are Council Economic Advisor's Chair from the Democratic and Republican administrations.

And it's really hard to get a consensus on an economic recommendation. I mean, a good example might be: I'm a very strong advocate for trade agreements. So, I'd like to see—if we're going to export, I'd like to see the three FTAs passed, the US moving forward with the Doha Round of trade negotiations, because I think we need an international framework for WTO.² And I think there's a real win—win proposition for the United States and [the] rest of [the] world—and economic prosperity in the world—by getting that done. The labor union groups involved with the PERAB are vehemently opposed to virtually any trade agreement. So, you know, we're not making the kind of forward progress I'd like. •

 $^2\!$ World Trade Organization.

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