

## The Recession Talk Your Board Should Have

Don't waste valuable time discussing the nuts and bolts of cost-cutting. Your board should be asking if a recession presents any opportunities for growth

By [Kevin P. Coyne](#)

Given the increasing likelihood of a recession, board meetings in the next few weeks are certain to include discussions about course corrections to stave off potential earnings hits. Such discussions are likely to irritate many management teams, who have seen little time pass since completing their multimonth budgeting process. But there is a much larger issue than how management will react to such talks: Are boards having the right recession-related discussions?

For most boards, the answer is no. In fact, surveys taken during the last recession by management consultants suggest that as many as 70% of boards will make two classic errors: They will hold discussions they shouldn't, while not holding the discussion they should.

### DEBATING A STEP-UP STRATEGY

With regard to the first error, boards waste their valuable time and management's patience when they choose to discuss the operational details of belt-tightening and tactical cost reduction. Whether the remedy is cutting discretionary expenditures, avoiding or delaying investments, implementing hiring freezes, or other "standard" actions, management already knows the options and the consequences better than the board. (After all, every one of these alternatives was probably discussed at length in developing the budget just presented.)

The board's role here should be limited to discussing the key issue: How would the shareholders want management to balance the two competing objectives of minimizing the hit to profits should a recession occur and capturing maximum growth should it not? Once the board has chosen its objective, it should then allow management to work out the details.

The first error, although it wastes valuable time and unnecessarily stirs up emotion, is less egregious than the second, which wastes something far more precious—strategic opportunity. The failure to debate whether the company should, in fact, step up its activities and use the recession as a chance to gain position and advantage can be a grave mistake. Studies of previous recessions have shown that a company has almost twice as much chance to dramatically improve its position in an industry during a recession compared to normal times—and that most (but not all) of the companies that did step up held their gains in subsequent economic recoveries.

How can your board and management determine whether a step-up strategy is right for your company? They should consider three major questions:

**1. Are there truly tangible consequences of missing the next year's earnings forecast?** I wish I could tell you that stepping up can be achieved without incurring additional expenses and might not lead to lower earnings, but that is probably not realistic. And it is certainly possible, though not certain, that your stock price will be adversely affected if you announce that you are lowering your forecast to invest in the future.

However, the real concern of the board should be not whether the stock will go down, but whether there are any consequences of a temporary decline. The board's job is not to protect the stock price at every moment, but to create shareholder wealth over the long run. Therefore, a short-term/long-term trade-off may well be worth it. Unless there are one-time merger-and-acquisition opportunities you will miss, predators are waiting to pounce on your company, or you need external funding, the board should at least engage in a discussion of the step-up alternative.

**2. In your industry, do "temporary" gains tend to become permanent?** Recessions provide an ideal time to gain on competitors, precisely because most of them tend to be stepping back. They postpone investments, cut research and development and advertising, and demoralize their companies through layoffs. The strategic question becomes whether a different strategy by your company, i.e., stepping up, will lead to a permanent shift in your relative position, as opposed to the status quo being restored when all players return to their normal patterns.

So ask yourself: Do organic market-share gains tend to stick over time? Do one-time advancements in product innovation vs. those of competitors lead to permanent product superiority? Are there key distributors that have previously resisted your attempts to gain entry that might be willing to open their doors if offered incentives during difficult times? What other one-time changes tend to permanently alter the strategic balance? The answers to these types of questions can reveal the upside to be weighed against the pain of a temporarily lower stock price.

**3. What is the potential downside if you simply take a defensive posture?** The board must look at the recession strategy dynamically, not just statically. What would happen to the company if your competitors chose to invest while you chose to retrench to protect earnings? In contrast to some companies gaining ground during recessions, many others lose ground. One consulting firm's study claims that fewer than one-third of those losing ground regain it during the subsequent years.

Therefore, the board needs to ask itself: Would you learn of your adversary's step-up actions quickly enough to respond? What would the long-run damage be? Even if you could respond, would it be doubly expensive? With that in mind, how does the trade-off between protecting earnings and investing look?

No one claims that there will be easy answers to the above questions. It would take a lot of effort and courage to tailor a step-up strategy to the company's specific situation. But then again, unthinkingly adopting a strategy of retrenchment would be every bit as hard, unpleasant, and possibly dangerous. It's important for the board to hold the right discussion, even if the decision ends in favor of retrenchment. And if the decision is to step up, so much the better.

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