

## **In chaos lies opportunity**

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Lehman Brothers' headlong pitch into bankruptcy protection, Merrill Lynch's dramatic sale to Bank of America and the U.S. government's rescue of AIG have battered financial markets. But in the turbulence lies opportunity.

Like dangerous curves on a racetrack, economic downturns create more opportunities for companies to move from the middle of the pack into leadership positions than any other time in business.

Unlike straight-aways where leaders can thrive on raw power alone, steep curves require strategic finesse. That often results in dramatic differences in performance as leaders steer out of the curve.

Consider how Southwest Airlines surged ahead during the 2001 recession. With a clean balance sheet, a clear cost advantage and adroitly hedged fuel costs, the discount carrier grew at the expense of rivals. As others eliminated capacity and jobs, Southwest lowered fares to gain market share. It boosted advertising to trumpet its price advantage and built solid relations with labor by avoiding layoffs.

Southwest is not unique. About 24 percent more firms moved from the back of the pack to the front in the 2001 downturn compared with the subsequent period of economic calm, according to an eight-year study by Bain & Company that analyzed the net profit margins and sales growth of more than 2,500 companies. Meanwhile, about one-fifth of all leadership companies—those in the top quartile of financial performance in their industry—fell to the bottom quartile. By comparison only three-quarters as many companies made such dramatic gains or losses after the recession.

Recessions hit some industries harder than others, so staying alert matters. The variations get amplified in a globalizing, interdependent economy. That adds both opportunity and complexity. The opportunity is to shift focus to economically healthier regions, as Johnson & Johnson, GE and IBM did in the second quarter of 2008, reporting solid performance outside the U.S. The complexity arises from having to make long-term investments in global operations with less certainty than ever about where you will be exposed when the next downturn hits.

Many industry leaders fall from the top during recessions because they assume that a strong market position is an insurance policy against trouble. That approach breeds overconfidence. Executives postpone taking precautions or reach for the same levers they pulled in the past -- like hedging their bets by diversifying. When the downturn hits hard they usually over-react. They slash costs and staff indiscriminately, cut capital expenditures, squeeze suppliers, and avoid strategic acquisitions. Then when

conditions improve, they must spend heavily to regain momentum.

The better approach: slow in, fast out-like a good driver heading into a sharp curve. Winners in recessions tend to brake quickly heading into a downturn by managing costs carefully and consistently. It's like downshifting to a lower gear to slow momentum and increase responsiveness. They focus on what the company does best, reinforcing the core business and spending to gain share. They aggressively monitor the competition to ensure they have the best possible line through the curve. That sets them up to accelerate at the apex of the curve, when the economy starts to improve. The farther you can see and the quicker you can turn, the faster you can safely corner.

In the 2001 recession, Intel Corp. timed its acceleration effectively to pull away from Advanced Micro Devices Inc., its scrappy rival in the chip business. Heading into the recession, AMD's heavy investment in product design was paying off, with AMD's revenues growing three times faster than Intel's.

Then the recession hit, catching the entire industry with too much capacity. As AMD's lack of profitability prevented it from investing in new production facilities, Intel seized the advantage. It invested in new facilities with state-of-the-art production capability and spent heavily to advertise its P4 processors. In the ensuing years, Intel's relative cost position improved dramatically and AMD had to slash 15 percent of its workforce. The momentum AMD had built quickly evaporated and a re-energized Intel remained the industry leader.

Another characteristic of companies adept in a downturn: they make bargain acquisitions to build up their core, even when it means taking calculated financial risks. As markets improve, they are well-positioned to accelerate. The latest example: Bank of America's planned acquisition of Merrill Lynch, which may turn out to be "the strategic opportunity of a lifetime," in the words of Ken Lewis, Bank of America's CEO.

For most industries, the optimal time to hit the brakes and downshift was months ago. The questions to be asking now are: Where is the apex of the curve, and how hard should we accelerate to take advantage of competitor mistakes? Who is in trouble and dumping valuable assets in order to survive? Can we add great people who are now available?

The companies with the right answers to those questions will have the inside track coming out of this downturn.

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