Winning in a Downturn
Six Actions to Take Now
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According to many indicators, a recession is either looming or already here. Yet because the business landscape has changed so much since the last recession, in 2001, the defensive and offensive tactics that worked then may not work as well this time around.

For example, emerging low-cost competitors from China, India, and other rapidly developing economies are now in a position to gain market share and acquire assets from cost-heavy incumbents. Moreover, many companies that were burned in the last recession are savvier today, and their behavior may be tougher to predict in a new downturn.

Now is the time to get ready. In today’s global economy, the ripple effects of a downturn will be widely felt—whether the economic crunch occurs on one’s home turf or not. Also, a major downturn can fundamentally change the dynamics of an industry. Analysis by The Boston Consulting Group shows that after the last recession, 30 percent of the companies that had been among the top ten players in their respective sectors dropped off that list, and fewer than 10 percent of those that dropped off ever made it back. The reason is simple: a downturn magnifies relative strengths and weaknesses.

In bad times, the bar rises and only the fittest can clear it—so being healthy at the beginning of a downturn is important. Moreover, strong companies bounce back from tough times more quickly. Surprisingly, in spite of the warning signs, most companies don’t adequately plan ahead, often reacting to a downturn by embarking on a costly, damaging cycle of doing too much, too late, and too randomly. By avoiding this cyclical overshooting, companies can prevent harmful, excessive cuts during a downturn—and useless and costly spending in an upturn.

Companies that survive and thrive during tough economic times build advantages in three critical areas: mindset, preparation, and execution. First, although they grasp the potential downside of a downturn, they focus instead on the opportunity for major competitive gains. This positive mindset sets them apart. Second, they prepare by planning and prioritizing specific offensive and defensive measures. As a downturn emerges, this thoughtful preparation paves the way for quicker and more effective execution—the third critical area of advantage. If achieved, these three advantages can lead to a long-term competitive edge.

**A Winning Mindset**

When confronted with a downturn, most companies limit themselves by lowering their expectations and implementing defensive measures aimed at cutting costs. Their goal is simply to survive the downturn—or at most to safeguard current earnings and growth. For ambitious, forward-looking companies, however, a downturn presents not a threat but an opportunity. (See the exhibit “To Win in a Downturn, Companies Must Climb the Pyramid of Ambition.”) Such companies look for ways to make strategic maneuvers and to better position themselves in key markets. They look for weaknesses in their competitors and seek opportunities to make inroads against them. Their goal is to emerge from the downturn even stronger than before.

Companies with a winning mindset cut the prices of certain products or services in order to increase market share—or they even selectively increase prices to boost profit margins.

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Instead of maintaining the status quo, they look for ways to leverage their core capabilities in new fields, industries, or market segments. What’s more, they plan these maneuvers in advance of a downturn to gain an advantage over their competitors. They realize that while a downturn may create short-term pain, it also offers opportunities for long-term gain.

During the 2001 recession, a company in the health care industry showed the difference that an ambitious mindset can make. The company was already in good shape at the start of the downturn, after restructuring to reduce costs and creating a more balanced product portfolio. As the economy soured, the company maintained R&D spending and further enhanced its product offerings, gaining market share during the recession and strongly outperforming its peer group in terms of market capitalization. Monitoring the landscape for other opportunities, the company then used its strong financial position to acquire a competitor that had been weakened by the downturn.

**Winning Preparation**

For companies in cyclical businesses, preparing for a downturn is essential. But virtually every company should be ready when the economy weakens. It’s critical to have a game plan to follow—one that has been developed thoughtfully in advance rather than cobbled together in a panic. Of course, the best time to prepare is before a downturn hits—ideally during the good times. But it’s better to start late than not at all.

Preparation has two dimensions: how to minimize damage to revenue growth and margins, and how to capitalize on opportunities to make inroads against the competition. Companies should start by defining their strategic goals for the downturn on the basis of their long-term strategy.

A case in point: a major industrial-goods manufacturer prepared for the 2001 recession on several fronts. It improved operations before the downturn, cutting purchasing costs by 20 percent, streamlining production, and boosting capacity utilization by 25 percent. As a result, operating margins grew from about 5 percent in 2000 to 11 percent in 2002, so that profits increased even as revenues shrank. During the same period, the company boosted its R&D spending by 25 percent and its engineering head count by 10 percent. Because of this unwavering focus on innovation in the midst of a downturn—in keeping with the long-term strategic plan—the company’s 2002 product launch was exceptionally strong. Even more impressive, the company sharply increased its industry ranking from the ninth largest in terms of market capitalization to a top-three position.

The key is to improve operating efficiency, strengthen the core business, and build a sustainable market position. Armed with stable growth and earnings, companies gain the freedom to make bolder, more strategic moves during a downturn. And companies that invest in their core business emerge from tough times more rapidly.

**Winning Execution**

Thoughtful, detailed preparation makes it possible for companies to take faster, more focused, and more effective action when a downturn arrives. Staying one step ahead of industry peers through skilled execution can lead to long-term competitive gains. But successfully implementing a downturn plan takes discipline, rigor, and oversight—as
does any major program-management effort.

During the last recession, a fast-food chain turned in its strongest-ever financial performance by flawlessly executing its downturn plan. A strong balance sheet and a low debt-to-equity ratio provided strategic flexibility, which the company capitalized on by investing in new stores, increasing revenues, and launching new products. The company maintained its commitment to high quality throughout the downturn and continued to pay a premium for superior ingredients. Throughout the tough times, its focus on work force satisfaction and customer loyalty never wavered. The advantage it gained through its winning execution paid off: the company doubled its market capitalization during the downturn, while its competitors lost half their value.

Companies must pay explicit attention to both the operational and people aspects of a downturn plan. Difficult times tend to sap the vitality of an organization, so executives should look for ways to create an energizing environment that says, “We’ll get through this together.” The best ways to achieve this goal are to communicate clearly and often, involve everyone in managing the downturn, and encourage problem solving and out-of-the-box thinking. Most important, companies should celebrate every victory, especially when they are few and far between.

A fearful environment is counterproductive, gives rise to rumormongering, and encourages your best people to polish their résumés. Succeeding in a downturn together, however, can foster a sustainable sense of pride, a loyal work force, and a powerful culture—and create tremendous momentum as the market rebounds.

The commitment to communication should extend beyond employees to external stakeholders, too. Recent studies show that analysts and investors tend to view companies with badly managed investor communications less favorably—especially when markets are expecting a downturn.

Be open about what you’re doing. Generally, the stock market responds well to companies with advantages in mindset, preparation, and execution. Wall Street knows that these companies are more likely to come out ahead in a recession.

Six Winning Actions

Many executives believe that their companies are better equipped to tackle tough times than they actually are. In a recent BCG survey, the majority of executives who expected a downturn within the next 12 months said that they viewed their companies as better prepared than their competitors were, even though fewer than half of the respondents said that they had taken any measures beyond basic cost cutting.¹

Such complacency is risky. As noted earlier, BCG analysis shows that when companies lose their leadership position during a recession, fewer than 10 percent manage to get back on top. A downturn changes the business landscape forever. Most companies that succeed do so by focusing on six actions: assessing their risk, sharpening their downturn radar, getting in shape, creating a prioritized action plan, thinking countercyclically, and being ready for the unexpected.

Assess your risk. Start by analyzing how susceptible to a downturn your company would be, and the likely effect on sales, costs, and margins. How cyclical is your business? Is the degree of cyclicity changing? Have you diversified your product lines, customer base, and target regions to balance out these fluctuations? Answering these questions will help identify and prioritize the actions you’ll take if the economy sours.

To determine where potential risks lie, examine your different lines of business, the company as a whole, the links of the value chain, and the resilience of your suppliers and customers. In essence, a company is a portfolio of products, industries, regions, markets, currencies, customers, and suppliers. Each of these components may affect the others—in positive or negative ways. Companies must analyze the impact of a downturn on each component and on the portfolio as a whole.

Distinguish between businesses with a clear competitive advantage and those that thrive only during an

¹. The BCG survey of business leaders polled more than 200 executives working at U.S. and German companies with annual revenues of more than $500 million.
upturn—when the tide lifts all boats. Marginal businesses can be a huge cash drain when the economy falters, so fix or sell them before a downturn hits.

Create a series of downturn scenarios based on historical patterns and projections for the future. Which businesses or products would be hardest hit by a downturn? What impact would a downturn have on your company’s input costs, asset productivity, growth, and innovation?

Assess your company’s strengths and vulnerabilities. Are your production facilities efficient enough to be profitable in a downturn? What impact would a lower utilization rate have? How asset-intensive are your operations—and how flexible? How global is your customer base? How vulnerable are you to exchange rate fluctuations? Have you matched the needs of your global customers with a global network of suppliers?

Evaluating your competitors is important, too. Analyze how well prepared they are for a downturn and how much relevant experience they have. Investigate key issues such as how sophisticated their planning approaches are, how much cash they have on hand to pursue opportunities that arise, how susceptible their business portfolios are to a downturn, how vulnerable they are to changes in supply or demand, and how diversified they are overall. In the last downturn, how did they fare relative to you? Who would be your strongest competitor in a recession? What moves would that rival be likely to make? And which of your competitors are your prime targets for capturing market share, undervalued assets, and talent?

Sharpen your downturn radar. Too often, companies ignore the first signs of a downturn, such as slower customer payments or rising inventory levels. When they finally realize that the economy is in trouble, it’s often too late to craft an effective strategy.

An early-warning system can help you get a jump on the competition. By systematically monitoring the landscape for danger signs and establishing triggers for specific actions, companies can stay one step ahead of the competition. For example, one industrial goods company regularly reviews the level of activity on the credit lines it extends to customers. By carefully analyzing these data, the company gains insight into the relative strength of various markets and customer segments. Another company learned of industrywide problems among its suppliers and set up favorable contracts to ensure that it would continue to receive critical inputs without interruption. As a result, the company has fared far better than its competitors.

On a regular basis, companies should monitor both domestic and global macroeconomic data, industry-specific indices, utilization and operating rates in downstream industries, and changes in the prices of raw materials. The key here is not to analyze every data point but to identify the information that really matters for your business or industry—and to interpret it correctly.

Closely observe the steps your competitors are taking. Be alert to changes in customer behavior patterns that might indicate a problem, such as requests for more lenient payment terms, increases in late payments or claim activity, the relocation of plants or facilities, or a change in communication patterns. Also take note of bankruptcy claims or other signs of financial distress among your competitors, suppliers, or customers.

Don’t be lulled into a false sense of security if your industry is late to feel the impact of a downturn. Instead, understand the signals so that you can better time the actions you take—and better leverage the downturn as an opportunity.

Get in shape—now. Flabby, inefficient companies face the greatest risk during tough economic times—and are slower to recover. That’s why winning companies adopt a lean mindset even in times of plenty. Such companies ask: Where can we trim operations, cut costs, release cash, and add value? Can we outsource any processes to low-cost countries in order to reduce costs and diversify country and currency risks? Can we de-layer levels of management or personnel in order to create a leaner, more agile organization?

Take a big-picture approach to reducing costs rather than simply tinkering with your cost structure as
it is currently configured. Develop collaborative partnerships, licensing agreements, and outsourcing relationships. These actions reduce risk, streamline your cost structure, add flexibility, and lead to new opportunities.

But getting in shape is more than just cutting costs. It is also building or reinforcing critical capabilities to better position the company for strategic wins. This may mean adding costs in some areas and cutting back on resources in other areas—with an eye toward the company’s overall cost structure and capabilities.

Most of these actions should be business as usual—they apply in good times as well as bad. But when a downturn is on the horizon, a tighter handle on these actions is critical. Companies should shed nonstrategic assets and focus on strengthening the core business, optimizing processes that directly affect revenue generation and cost to serve, and finding ways to get closer to customers and enhance their satisfaction.

One company conducted extensive research in advance of the last downturn in order to better understand its customers. When the industry began to suffer, the company was prepared. It used its findings to change its business model, distribution channels, and the overall customer experience. These actions helped stabilize earnings while competitors lost ground.

**Create a prioritized action plan.** Companies in strong operational and financial shape have greater freedom to make strategic moves when times get tough. But those that succeed don’t try to do everything at once. Instead, they identify and prioritize areas for improvement, focusing on actions that will strengthen their core business and deliver the greatest payback as rapidly as possible.

Your company’s level of risk and your objectives for the next downturn will shape your action plan. Formulate in advance the steps you’ll take in order to minimize the impact of the tougher economy and to realize competitive wins. Actions that create value quickly should become top priorities, because your response time will be a critical success factor. Also, learn to develop a capability for more rapid change—for instance, aim to complete a project within weeks instead of months.

After assessing your risk, for example, you might decide that you are most vulnerable to a slump in demand for one of your critical products, price reductions by a Chinese competitor seeking to gain share, a cost increase in several key raw materials, forced budget cuts for R&D, and increases in bad debt and inventories. With this scenario in mind, you could then devise a prioritized set of action steps for dealing with these issues so that your company will be ready to act swiftly when it needs to.

Companies should carefully balance the time, cost, effort, and relative benefits of each action. Be very clear about what you’ll do—and what you won’t do. Make sure that management is aligned around the plan and that roles and responsibilities are clearly defined.

**Think countercyclically.** Keep competitors off guard by avoiding the obvious. For instance, the usual reaction in a downturn is to tighten customer payment terms and increase collection efforts in order to boost cash flow. Instead, consider giving your most profitable customers or target accounts more lenient payment terms in order to capture more of their business. Make terms stricter for less attractive accounts. You’ll likely find that the net impact on income will be neutral at worst—or perhaps even positive—and you’ll see a boost on the upturn. Given that customer accounts offer different levels of profitability and growth potential, one size really does not fit all.

Moreover, be prepared to go after your competitors’ best, most profitable customers. While others are cutting back on customer service to reduce costs, strengthen your commitment to this critical area in order to make competitive inroads.

Another counterintuitive but worthwhile move is to increase investment in marketing or R&D during the downturn instead of cutting back—the knee-jerk reaction of most companies. Still another approach is to identify and accelerate the projects that will deliver the biggest payback when the economy starts to recover.

At the same time, keep an eye out for talented people who have been let go by your competitors, and increase your recruitment efforts. Know in advance which areas would succeed don’t try to do everything at once. Instead, they identify and prioritize areas for improvement, focusing on actions that will strengthen their core business and deliver the greatest payback as rapidly as possible.

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M&A activity also presents opportunities during a downturn. Divest strategically—when the economy is strong and you’re likely to get a better price. Identify marginal lines of business that have acceptable profits and growth in stable economic times but that are more vulnerable than the market leaders when the economy softens. By divesting these weaker links during good times, you can concentrate on investing to improve market position and cost leadership in your strongest lines of business.

Plan to buy when others are selling—that is, buy in a buyer’s market. Reducing debt and improving your cash position in advance will help ensure that you can take advantage of bargains when the economy softens. During the last recession, for example, a large European company capitalized on “distress sale” pricing to snap up a close competitor—and realized a major return on shareholder value. Recent BCG research supports this approach. We have found that downturn deals create about 15 percent more value on average than deals made during an upturn.2 Companies that invest during tough economic times can avoid overpaying in boom times.

Be ready for the unexpected. Finally, stay flexible—both defensively and offensively. Don’t be a slave to your plan. No matter how well prepared you are, the unexpected is bound to occur. Your competitors may make unanticipated moves that challenge your assumptions or threaten your strategy. Be ready to change course and move quickly as conditions change. To further enhance strategic flexibility, try to maintain a reserve of unallocated funds or improve working capital management to free up cash.

Be alert and willing to seize new opportunities as they present themselves. For instance, you’ll want to be able to bring on key talent in the event of layoffs by competitors, customers, or suppliers. When competitors that are pinched for cash are forced to sell valuable assets or lines of business, you’ll want to be able to bargain hunt.

You can’t plan for unexpected opportunities and competitive moves. But if you’ve done your basic homework in advance—your operations are lean, you have an action plan in place, and you’ve managed to get a head start on the downturn—you’ll be able to respond effectively and come out ahead. The key to winning in a downturn is to act sooner rather than later, before the narrow window of opportunity closes. With the right mindset, preparation, and execution, you’ll be able to minimize the pain and focus on the gains that may await when the economy improves.

Downturns create opportunities. Find and capture them now.

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