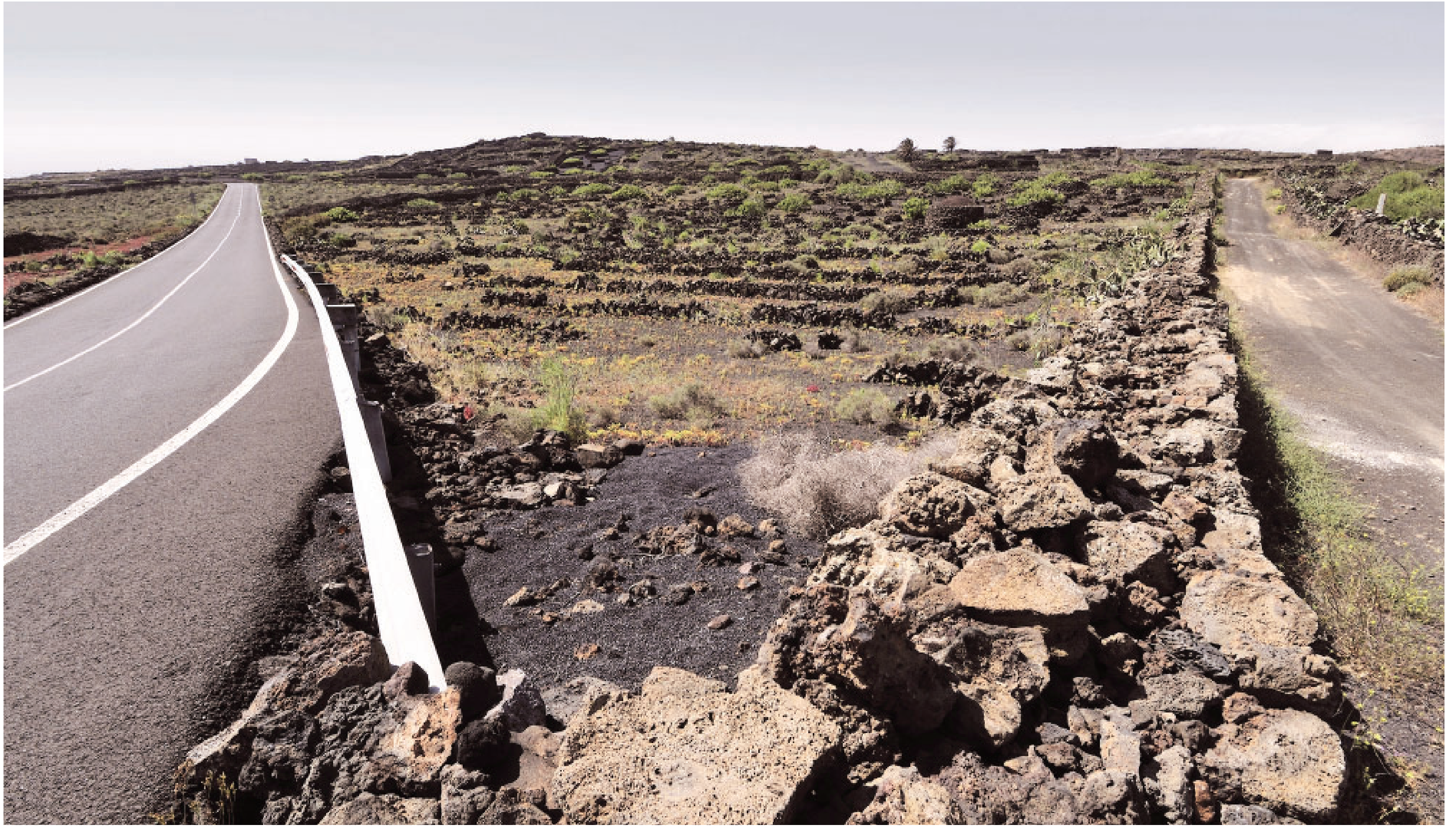

Using the Next Recession to Change the Game

The winners are laying bold plans now to turn a downturn to their advantage.

By Miguel Simoes de Melo, Thomas Kwasniok and James Hadley

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At a Glance

- Timing a recession is hard, but 10 years into the current recovery, a downturn is overdue.
- Bain research shows that the winners in any recession set themselves up *before* the slowdown to act aggressively when the storm hits.
- Now is the time to strengthen the core, align on strategy and prioritize the three or four initiatives that will enable the company to thrive as others flail.

How long can the good times last? As the postcrisis recovery stretches toward its tenth year, that's become a subject of spirited debate. The bulls suggest that favorable tax policy and aggressive US deregulation will spark growth indefinitely. The bears argue that fiscal restraint, a flattening yield curve and global trade tensions are signaling the expansion is waning.

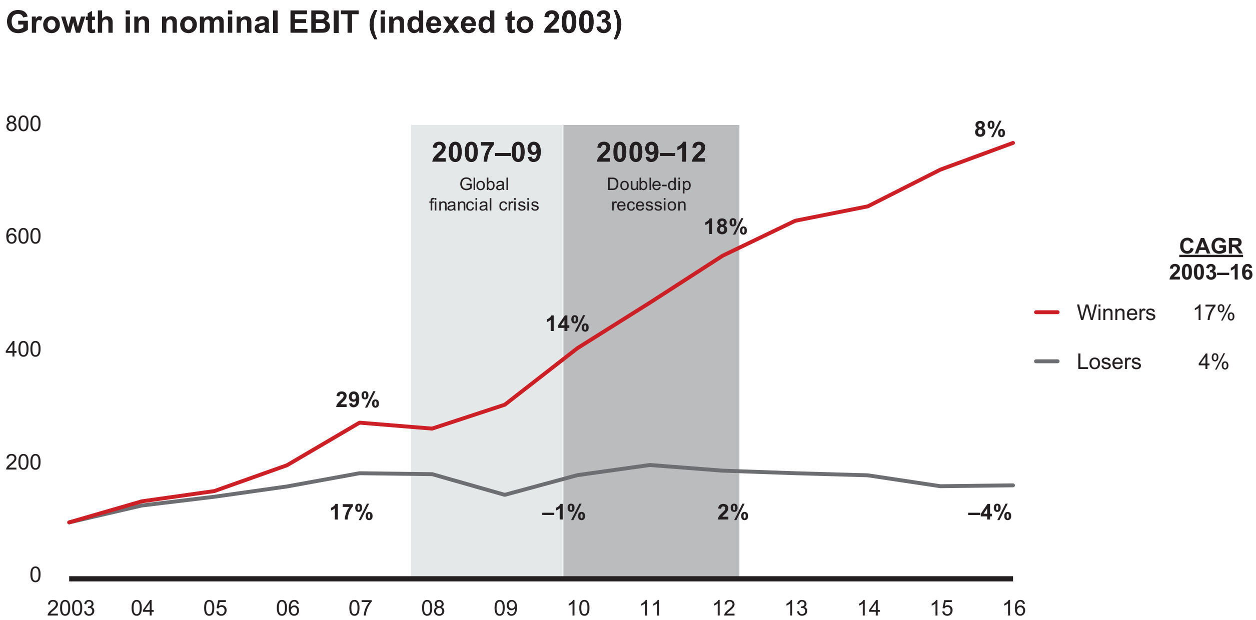
Timing a recession is notoriously hard, but two things are certain: A downturn *will* arrive eventually and this recovery is defying the odds already; only one recovery on record (from 1991-2001) has lasted as long as a decade, and most peter out within five years. We also know that for corporate leaders, the timing of the next downturn is probably less important than the answer to a couple of simple queries: Are we prepared for the inevitable downturn? And will we wish we had done something different when we still had the chance?

Our research suggests that the eventual winners in any downturn are companies that aggressively captured the opportunities unique to recessions. Playing offense, in other words, almost always trumps hunkering down or trying to weather through. The data shows that winners in a downturn actually make more dramatic gains than winners do during boom times, depending on the shape of the recession. These periods of tumult can be an important opportunity for strategic repositioning and very often prove to be inflection points, shifting profit pools and producing a new industry order.

The current cycle is a good example. Going into the global financial crisis, the eventual winners and losers in a group of 3,500 global companies both were experiencing double-digit earnings growth. But as soon as the storm hit, performance began to diverge sharply: the winners continued to grow, while the losers stalled out *(see Figure 1)*. The performance gap only widened during the recovery. This suggests that moves made before and during the crisis were key to determining a company's trajectory once the upturn arrived.

What made the difference? Preparation and alignment on strategy *before* the downturn hit were key factors. The CEOs and boards of the winners in our study had already done the hard work of defining their core competitive advantages and prioritizing the three or four initiatives that were central to executing strategy. Then, as the recession approached, winning teams laid careful plans for boldly taking

Figure 1: Winners and losers both grew before the global financial crisis, but winners accelerated through it while the losers stalled



Notes: 338 winners and 3,113 losers; percentages in the chart show CAGR during each period
Sources: S&P Capital IQ; Bain & Company

advantage of opportunities that might develop under different scenarios. They doubled down on their core initiatives to maintain momentum into the storm. They created strategic wish lists of potential acquisitions and primed their M&A engines. They considered which stars to recruit as others faltered. And they made the tough decisions to streamline the business and trim noncore activities to raise the "currency" to pay for their bold ambitions.

Losers did very little of this. They tended to be less clearly aligned on strategic intent at the outset and lulled into a sense of complacency by prerecession growth. Few made contingency plans or thought through alternative scenarios. When the downturn hit, they switched to survival mode, making deep cuts and reacting defensively. The results speak for themselves. Having lost momentum during the downturn, the losers struggled to bounce back once the recovery took hold. The winners emerged stronger, gaining momentum from the bold, strategic moves they made before and during the recession.

At Costco Wholesale Corp., preparing to profit from the global financial crisis meant recommitting to what it has always done best: simplifying its assortment and running stores more efficiently than others. It slashed the cost of running its in-store pharmacies by centralizing its prescription fill centers. It improved its already market-leading category management practices to limit SKUs and streamlined its supply chain. This flexibility allowed Costco to adapt its store offerings to make them more attractive to cash-strapped customers as the recession wore on. From a position of strength, the retail giant expanded its reach by 20 new warehouses during the recession and increased both revenues and margins. Indeed, while revenues dipped a modest 1.46% in fiscal 2009 as the company weathered the leading edge of the crisis, Costco roared back to double-digit revenue growth by 2011 and 2012.

So what are the likely winners in the next cycle doing now to position themselves for the coming downturn? In our experience, the most effective teams focus their planning in several important ways.

Stress-testing the business

As we've seen, companies that thrive in recessions enter periods of economic turmoil with a clear understanding of their core strengths—who they are and what differentiates them from others. Stress-testing begins with carefully reviewing this point of departure and gauging how well the existing company would do against the economic and business scenarios that are most likely to unfold over the next 12 to 24 months. This involves crisis planning, certainly. What's your degree of exposure to a sharp downturn? But it also means preparing to go on the offensive. Given the way the macro and industry environment may evolve, what opportunities is each scenario likely to present as we forge ahead aggressively on our journey to full potential?

Envisioning a winning formula

Taking this proactive approach positions leaders to envision how they'd win under any scenario. But executing on that vision requires an intentional plan for getting ready. This means precisely defining the key opportunities presented by each scenario and diagnosing the business capabilities the company would need to win. How proficient are we in the parts of the business that will really count as we move forward? Is our M&A capability up to the task? Do we have the right people in the right roles to take on the challenges this downturn will present? Do we have the financial underpinning that will allow us to move proactively?

A ruthless focus on your core objectives is a critical part of leadership here. That means stepping up efforts to simplify the core business by reducing complexity and creating efficiencies. Leaders have to ask the tough questions about outsourcing noncore activities or divesting noncore business while multiples are still attractive. Companies inevitably take more risks during the good times, betting on an emerging market, say, or testing a hot new technology. Now is the time to make a call on those bets (never easy) and exit any that are soaking up resources that should be funneled back into the core.

Drawing up the playbook

Winners focus on turning planning into action by writing a playbook for each scenario that's clearly tied to strategy. They ask, "What business levers will we need to pull under what conditions, and what are our priorities?" This starts with laying out the no-regret moves the company should make regardless of the scenario. If outsourcing a capability or closing a factory makes sense, it probably makes sense no matter what the next 12 to 24 months will bring. Winners then draw up scenario-specific action plans, being careful to define the key signposts they must monitor to gain early intelligence on which future is unfolding. This prepares leadership in advance with a full quiver of scenario-specific options and hedges and a clear mechanism for knowing when and where to put the right ones into play.

Trying to predict a recession with any precision is a risky game. Most often you'll be wrong. But winning companies recognize that sustained profit growth throughout an economic cycle depends on controlling what they can control. The companies that power into a downturn and accelerate out of it aren't complacent. They define the scenarios they're likely to confront and lay bold plans to profit from whatever they encounter.

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