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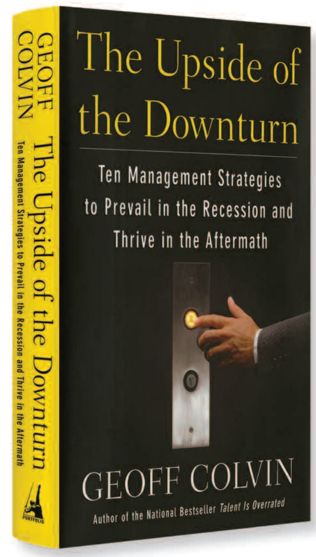


by Geoff Colvin

# The Upside of the Downturn

## Ten Management Strategies to Prevail in the Recession and Thrive in the Aftermath

### THE SUMMARY IN BRIEF

Some businesses — and some people — will emerge from this downturn stronger and more dominant than when it started. Others will weaken and fade. It all depends on critical choices they make right now. In *The Upside of the Downturn*, Geoff Colvin, respected business journalist and best-selling author, says even the scariest recession has an upside.

The best managers know that conventional thinking won't help them win in these tough times. They're taking smart, practical steps that will not only keep them strong, but will also distance them from the pack for years to come. The dozens of top-performing leaders Colvin interviewed reject the common view that slashing costs and firing employees are all that matter. They see the recession as a rich opportunity to reinvent their organizations and lay the groundwork for future growth.

Colvin's 10 solidly grounded strategies will increase your company's competitiveness and build its long-term value. He shows how these strategies really work, using examples of major companies that have applied them with inspiring results.

### IN THIS SUMMARY, YOU WILL LEARN:

- The structure of industries will change profoundly as various players disappear and others transform themselves.
- The six key categories that shape performance and viability are financial strength, competitive advantage, government intervention, the state of your customers, your reputation and your risks.
- The true costs of layoffs and whether they will actually get you the benefits you're counting on.
- One way to think through the matter of your strategy and business model in this recession is to answer three basic questions.

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# THE COMPLETE SUMMARY: **THE UPSIDE OF THE DOWNTURN**

**by Geoff Colvin**

**The author:** Geoff Colvin, *Fortune's* senior editor at large, writes the popular column "Value Driven." Colvin lectures widely and is the regular lead moderator for the Fortune Global Forum. He also offers daily business commentary on the CBS Radio Network. His first book, *Talent Is Overrated*, earned international acclaim and was a *Wall Street Journal, BusinessWeek* and *New York Times* business bestseller.

*The Upside of the Downturn* by Geoff Colvin. Copyright © 2009 by Geoff Colvin. Summarized with permission of the publisher, Portfolio, a member of Penguin Group (USA). 182 pages. $24.95. ISBN 978-1-59184-296-5.



## The Greatest Opportunity

It is easy to say that tough times are an opportunity, but much harder for most businesspeople to find anything attractive in trouble on today's scale. A global economic decline that in many nations is already the longest since the Depression, that has wiped out trillions of dollars of wealth, thrown millions of people out of jobs, caused hundreds of thousands of businesses to close, and is to most people just a mess, a curse, a plague.

But in fact, this historic downturn really does offer new, similarly scaled possibilities. The reasons are specific and hardheaded:

1. This downturn is worldwide, so your canvas of opportunity is huge.
2. This downturn is severe and painful, answering the prayers of every business leader who wants to make big changes in his or her organizations.
3. This downturn is deep, meaning it's affecting people's most fundamental economic behaviors — spending, saving, borrowing, investing — in ways that may last for years.
4. This downturn is long, which means that many companies won't survive it.
5. This downturn is novel, so most managers have never experienced anything like it and no one has an advantage in knowing how to manage for it.

### This Downturn Will Test You Personally

Times of crisis present genuinely great opportunities not just to demonstrate leadership but also to develop it — to build leadership capabilities beyond what you or others in your organization now possess. Scientific research on great performance has shown persuasively that high abilities of all kinds are developed; they don't occur naturally. The question of whether great leaders are born or made is settled: they're made.

Everyone is facing the opportunities that are present, though sometimes concealed, in the global downturn. Only a subset of businesspeople will recognize those opportunities. Of those people, only some will get past fear and defensiveness and try to take advantage of the opportunities. And of that group, only some will succeed.

## The New Normal

Seeing the downturn as a bunch of statistics is easy, tempting and almost useless. Seeing the recession as part of a story is our only hope of understanding it well enough to manage through it. And as fascinating as the story is, what we all really care about is our own narrative — what happens to me and my organization in this story?

It's also important to focus on the story's most important elements and, in the current portion of the world's economic saga, it's clear what they are. There are two: one is the behavior of American consumers; the other is risk and how economic players around the world have regarded it — a volatile love-hate relationship that is central to the story of the recession and what will come next.

### The Day the World Changed

The day the world changed, though no one knew it at the time, was June 13, 2007. These turning points are never clear except in retrospect and no one can say exactly why they happen when they do. But on that day, for whatever reason, investors started waking up to

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risk, and all the world-changing turmoil we're coping with today has followed from that.

Specifically, investors began to feel they weren't getting paid enough for making risky investments. At first the effects were barely noticeable, but by August they were unavoidable. That's when the subprime crisis began, for the simple reason that investors who had previously ignored the risks of subprime mortgages and the securities built from them were now demanding to be paid a more realistic — that is, higher — return. Just six months after investors came to their senses about risk, the recession had begun.

### Not Since Genesis

Every recession is unique, and this one is different in many ways, including the bizarre nature of the financial securities that got banks into trouble and its interconnected global complexity. But for people in business, the most important difference centers on the strange behavior of the protagonists of our story, consumers.

- Ever since Joseph decoded Pharaoh's dream about fat cows and thin ones, consumers have followed his policy response: Save in the fat years to survive in the thin ones.
- In good times they put away some of the abundance because they know they'll need it in bad times to come.
- Then, when the bad times hit, they spend some of what they've saved.

That's what consumers have always done because it's so obviously prudent. But it isn't what they did this time.

For the first time since Genesis, consumers did everything backward. During the expansion from 2002 through 2007, the savings rate of U.S. consumers fell rather than rose. In mid-2005 it even went negative, and it stayed below 1 percent for most of the period until late 2008.

Then, with the recession really taking hold, consumers again did the opposite of what they've usually done and increased their saving. That is the reverse of how consumers behaved during the Great Depression. That's how this strange story has led to a recession of historic proportions. Now businesspeople need to know what will happen in the story's next episode.

### The New Normal

Because this recession is so severe, and because of the unique way in which it happened, we can be sure that it will change the world in several big, long-lasting ways.

### Firefighting: The Most Dramatic Form of Responding to a Crisis

In this time of crisis it's worth considering what a group of psychological researchers learned when they studied firefighters. They investigated what two groups of firefighters, novices and veterans, actually saw when they looked at a burning building.

- The novices noticed the obvious features: the height and color of the flames, which parts of the building were involved.
- But the veterans, looking at the same fires, saw something different. They saw a story. They noticed the clues that told them how and where the fire had started, why it was burning as it was, and what it would likely do next.

By seeing the fire as a story, not just a collection of traits, they could create a plan for managing it. That's what made them effective firefighters. It's the same with the economy.

The changes are already happening. The structure of industries will change profoundly as various players disappear and others transform themselves. We don't have to wait for the recession to end to see the new world that it's creating, to glimpse the next episode in the story. Specifically:

1. The U.S. economy will become less consumer driven and consumer focused.
2. Social attitudes toward working, saving, spending and borrowing will shift.
3. The world economy will become less U.S.-centric.
4. Investors will remain spooked by risk for a long time.
5. Government will play a much larger role.

## Reset Priorities

Jamie Dimon is arguably the only major bank CEO who has come through the financial crisis looking good. As chief of JPMorgan Chase, he got the bank out of subprime mortgages in 2006 and kept it so financially strong that when other major institutions failed, notably Bear Stearns and Washington Mutual, Chase bought them and their still-valuable assets for minimal prices.

Now everyone wants to learn more about how Dimon manages and he's not bashful about explaining it. When a Harvard Business School professor asked him, in October 2008, how he was managing through the crisis, Dimon was perfectly clear about what was most important: "You have to prioritize. I am shocked by the number of people who are watching that train coming down the track" — meaning the recession — "and they're still worrying about their strategic plan for 2009. We canceled all that stuff — all of it — meetings, travel, you name it, to focus on the fact that we're in the middle of a real crisis."

### What's Your Specific New Reality?

The changes in your reality are probably much more extensive than you realize. To grasp them fully, examine how your company's world has changed in six key categories that shape performance — and viability:

1. Financial strength
2. Competitive advantage
3. Government intervention
4. The state of your customers
5. Your reputation
6. Your risks.

### Making Smart Decisions Under Stress

Understanding all the elements of your new reality is a big job, but the great thing about doing it is that it creates a picture — a rich overall view of your business in today's new environment. Looking at that big picture, you'll probably realize that many of your pre-recession goals just aren't realistic anymore. Abandoning such goals for now isn't failure, it's facing reality and protecting the business. In their place you'll create new goals:

- Increase market share.
- Lower breakeven points.
- Create new customer value propositions.

But in a way, this analysis, this assessment of the new reality and revising of goals, is the easy part. The hard part is responding — getting yourself and others to embrace the new reality, make decisions in a stressful, fast-changing and uncertain environment, and take action.

### How to Respond?

The best and clearest explanation comes from studies of the military, where stress is worst and the consequences most serious. Research by the World Health Organization has shown how soldiers avoid the harmful effects of the stress and uncertainty of combat. Note how each factor has a clear parallel in business.

- They feel in control.
- They have strong group cohesion.
- They trust their leaders.
- They have high motivation.
- They feel well armed and protected.
- They feel well trained.
- They have a reliable medical corps.

Overstressed decision makers are bad decision makers, so unless the stress problem is at least blunted, nothing else will turn out well.

## Protect Your Most Valuable Asset

Toyota has never laid off anyone. It's not that Toyota is selling as many cars and trucks in 2009 as it was in 2007. On the contrary, its sales were whacked more heavily than at any time in the company's history, though not nearly as badly as the Detroit Three's sales were hit. Nor is the company continuing to turn out millions of vehicles and storing them unsold on some vast parking lot. Instead, Toyota has been doing what it has always done in recessions, continuing to pay workers who continue to come to work every day.

If they aren't needed to make cars all day, which in this environment they often aren't, then they do other things. They take classes in workplace safety or how to handle materials; participate in exercises, developed at Toyota over many years on how to improve productivity; go to seminars on diversity or ethics; and go through assessment exercises to see how much they're learning.

Toyota doesn't promise its employees that it will never lay anyone off. Its policy of keeping employees on staff during recessions and giving them extra training means that when the economy turns up, those employees are in the plant, ready to go and probably far better prepared than the employees of any competitor.

### The New Importance of Human Capital

The best companies and the best leaders take a larger view of their people during a downturn. They avoid the reflexive responses that they may have grown up with and that may be traditional in their own company. When they stop and examine today's environment, they find that it's full of opportunities — to begin practices they always should have been using, to improve the quality of their people, to increase employees' loyalty and motivation, to build the culture.

### The True Costs of Layoffs

Maybe you've tried everything and concluded that you're in one of those companies that honestly cannot avoid layoffs. But before you pull the trigger, consider the true costs of layoffs and whether they will actually get you the benefits you're counting on:

- Layoffs are expensive in direct costs. Severance payments and other benefit costs that may be contractually required can add up to a substantial total, and most of those costs are immediate.
- Valuable knowledge will walk out the door.
- Your company will lose productivity before, during and after the layoff.
- Your company will damage its brand as an employer.
- Your leadership pipeline will suffer years from now.
- Even the survivors will pay a price.
- Wall Street's reaction may be the opposite of what you expect.

## Engage the Outside World

### Public Attitudes Are Changing

Today's crisis is no Great Depression, but it too will change business's world for decades. Finding opportunity in that shift may seem tough when public attitudes appear to be moving massively against business. But remember, your company isn't businesses, it's one company. As an analogy, it has been shown many times that most people don't like Congress but do like their own congressman. Indeed, there's no better time to look good than when the competition is despised.

### The New Relationship with Government

Only a few companies are big enough to influence government during this critical period. The challenge for most of us will be understanding what's coming, then thinking deeply about what it will mean for our businesses. Change is on the way in four broad categories:

1. New regulation of leverage, risk and risk markets.
2. Large-scale new regulatory frameworks.
3. Protectionism and other employment programs.
4. Greater government activism in areas less directly connected to resolving the crisis.

### Get Right with the Street

We all tend to keep quiet when we don't have answers — to "hunker in the bunker," as American Express CEO Ken Chenault put it, until we feel we have something definite to say. That's exactly the wrong approach. A company's constituencies don't expect you to have all the answers. They just want to hear your view of the world, to understand how you're approaching your situation and to know that you're thinking about them. In bad times they need to hear all this much, much more than when times are good.

## Reexamine Your Strategy and Business Model

Is our strategy going to work in this environment? What must we change — and what must we not change? Will the recession fundamentally change our industry and our place in it? Or will this downturn just throw us off the long-term trend line for a couple of years? Do we need a new business model?

Those are large and deep questions for any company, and reconsidering strategy can turn into a miasma that consumes endless time and yields nothing. Yet the process is manageable. One way to think through the matter of your strategy and business model in this recession is to answer three basic questions:

1. What is our core?
2. How is this recession changing our customers and their behavior?
3. Will this recession hasten — or even cause — a large-scale restructuring of our industry, and if so, how will it affect us?

### Three Multi-Industry Trends

Knowing which kind of future your industry faces — a world-changing, once-in-a-lifetime revolution or an era of major adaptation — is critical before you can form your response. A danger in a recession as deep as this one is that it may accelerate trends that will affect your business but that weren't even on your worry list. Three broad, multi-industry trends, already well under way, are especially worth watching because a bad recession could fuel them significantly:

- **Cocreation.** The idea is that most successful companies no longer invent new products and services on their own. They create them along with their customers, and they do it in a way that produces a unique experience for each customer. In cocreation, the choices are infinite and the company neither imagines nor delivers them all.
- **Brand building in developing economies.** It has been apparent for some time that the next great phase of business development in China and other developing economies will center on brand building, but it was slow going as long as the world clamored for low-cost manufacturing as fast as these countries could provide it. Motivated by the current slowdown, they may become brand power-houses far more quickly than many Western companies expect.
- **Imagination-based business models.** As living standards decline in Western economies, a conven-

tional response is to urge greater achievement in science and technology, long the foundation of economic dominance. The vision of the right-brain future is appealing in the developed world because it plays to the West's strengths today.

# Manage for Value

For every company, deciding how to measure itself in this recession is one of the most critically important decisions to be made. That's because the way you decide to measure your performance is the foundational decision. Once it is made, it guides virtually all of your other decisions. If it's wrong, it will lead to many bad decisions, which in this environment may be disastrous.

### Your Real Goal

Our system is called capitalism for a reason: it's all about capital. Yet that bedrock reality gets obscured in all kinds of ways as a result of accounting rules, corporate shorthand, media reports and other factors.

Every company's goal is to create value, which means using capital to build a business that's worth more than the capital itself. And the way this is done is to *earn a return on the capital that's greater than the cost of the capital*, a measure that financial economists call economic profit.

### Get to Know Your Capital

Many of the world's best-managed companies understand this rule and live by it, but many other companies don't. The resulting wrong decisions may be survivable in a growing economy, but they can be fatal in a deep recession. To understand exactly how, you must first explore two simple questions: How much capital is in our business? How much does our capital really cost?

### Making the Right Decisions the Right Way

The decisions managers are making now can be put into three major categories:

- **Deciding what to manage for.** In this recession, when cash seems so especially dear, managing for value may show the way to finding additional cash that wasn't available prerecession. As managers evaluate operations against the standard of a higher capital cost, they will likely find that some no longer meet the test and should be stopped, thus freeing up more cash.
- **Mergers and acquisitions.** Merger activity typically plunges in a recession, and that has been happening this time. Yet a historic downturn is a terrific opportunity for companies to buy other firms at bargain prices, and it can even work out well for sellers.
- **Dividends.** Most companies that pay dividends hate reducing them, yet that's what many have been doing. Yet it's possible that those companies have been forced into doing something smart. Paying a dividend achieves nothing for shareholders. It merely gives them some money that they already hold, embodied in the price of the stock. Every time a company pays a dividend, the price of its stock drops by the amount of the dividend.

A wonderful thing about the principles of finance is that they don't change. In a deep downturn, when every company must operate within much narrower margins of error, observing them becomes much more critical. Yet many managers, disoriented by the unfamiliar conditions, lose sight of the basic principles at just this crucial moment. The opportunity is to chart a course that may seem contrarian — to avoid cutting costs that others are cutting, to do deals that others won't do — secure in the knowledge that you're actually pointed in the right direction, and when the storm ends, you'll be far ahead of your competitors.

# Create New Solutions for Customers' New Problems

The most successful companies understand that through good times and bad, they're always creating complete experiences to meet their customers' changing wants and needs. The process doesn't start when a recession hits. Instead, these companies are constantly monitoring the state of their customers and are experimenting with new value propositions that could better serve customers.

### Getting Creative in Meeting New Needs

As companies create new value propositions for their customers' new recessionary wants and needs, they can do so on several dimensions, giving companies more options than many managers may realize. The simplest approach to creating a recession value proposition is devising a new product or service that offers the customer a reduced experience, carefully defined, at a lower price.

# Price with Courage

To say that price cuts aren't inevitable in a recession is an understatement. If you believe that you absolutely must do it, please consider fully all the potential dangers, which are much more extensive than many business people imagine:

- Price cuts rarely pay for themselves. They may even reduce profit more than holding prices steady.
- Price cuts can destroy brand equity that took years to

build and may take years to restore.

- Price cuts train customers to behave badly. Buyers of all kinds have a tendency to remember the lowest price they ever paid for your product or service.
- Customers hate price increases more than they like price cuts.

### How Much Pricing Power Do You Really Have?

Pricing is a continuing process through good times and bad. It's just that in good times you probably don't have to get it exactly right, while in a serious recession the stakes are much higher. For a business, even the most skillful pricing won't produce financial success if the company hasn't met the challenges of the recession on the inside. If its operations aren't competitive, if it isn't efficient, then it could still be crushed by the recession; while if it is, the recession can be a time of triumph.

## Get Fitter Faster

Reevaluating the economic value of customers — and of products, services, facilities and lines of business — is one of the most important steps a company can take in tough times. It's the nuts and bolts of business, the millions of day-to-day decisions that add up to productivity, efficiency and financial success. In a historically severe recession, they become more important than at any other time.

The most effective moves aren't always the ones that managers reflexively make. Sometimes they're exactly the opposite. The greatest rewards go to businesses that move fastest and best in the following ten practices:

1. Understand the new economic profitability of all your business's components.
2. Look at your world through a green lens.
3. Think twice before cutting the easy expenses.
4. Ask, what would we do if we had to sell this business?
5. Focus intensely on a few clear goals.
6. Make executive pay a help, not a hindrance.
7. Don't spread the cuts evenly.
8. Don't sacrifice cash just to improve reported earnings.
9. Take a fresh look at offshoring.
10. Ask the employees where the opportunities are.

### Operational Excellence

Operational excellence isn't every company's strength. An excellent book, *The Discipline of Market Leaders*, even argued that it shouldn't be — that every company needs to focus on just one of three possible strengths (the other two are product leadership and customer intimacy).

But in a deep recession, when every dollar of profit becomes far harder to earn, the value of operational excellence multiplies, and every company needs to get better at it.

The truth is that in operations and every other aspect of running a business, the stakes become much higher in a recession.

## Understand All Your Risks

Around the world, thousands of companies were analyzing their risks diligently, and plenty of them (not just in finance and real estate) believed they were well prepared. They just never considered the type of cascading systemic failure that actually occurred. Of course, now we'll all be preparing for that type of catastrophe, which means the greatest risk we face is something new that we haven't imagined.

### Seeing the Risk You Never Imagined

The enormously destructive power of this recession teaches five lessons that every company can apply for much better understanding and control of its risks.

1. **Turbocharge your imagination.** Because the events that do the worst damage are the ones you never conceived of, effective risk management begins with an eternal quest to imagine possibilities you hadn't even thought about before.
2. **Build scenarios.** Cold-war military strategists originated scenario planning, so by now the technique is well developed. Properly guided, it can help managers see important possible events they wouldn't have imagined, because it's all about thinking through possible sequences.
3. **Think in probabilities while realizing their limitations.** The strength of thinking in probabilities is that it forces us to bring to the surface and confront thoughts that we may not realize we're carrying around.
4. **Use the power of markets.** Prediction markets, in which real people bet real money on the likelihood of specific events, have been around for years and attracted lots of acclaim after correctly predicting the squeaker 2004 U.S. presidential election.
5. **Create an organization and culture that adapts quickly to new realities.** This recession is an unprecedented opportunity to begin such a change.

## Don't Forget to Grow Yourself

Crisis is the ultimate leadership opportunity, but not every leader rises to the challenge. A crisis like this recession demands five actions of a leader. They're simple to state and may seem simple to do, but they aren't. Finding the strength to do them will contribute significantly to any leader's growth.

1. Stand up and be seen.
2. Be calm and in control.
3. Be decisive.
4. Show fearlessness.
5. Explain the crisis in a larger context.

### Now Is the Time to Build All Abilities

Because a recession demands so much more of leaders, it offers them an opportunity to build their skills to much higher levels. So we all face more and richer opportunities to grow than we do in normal times. In fact, these opportunities are even greater than most people realize.

Psychologists have found that humans do not make progress at a steady, even pace. Instead, we follow a pattern of surge and recover. A severe recession is obviously not a time for us to recover. It is rather the very best time for us to surge, to push ourselves ahead and develop the new skills and abilities that will change us and stay with us forever.

## For Next Time

Even long recessions end and are followed by expansions, which eventually beget new recessions. The best managers never become so consumed by the present that they forget their place in the cycle. Just as Dimon was thinking of the inevitable bad times to come as the good times rolled, smart managers are planning now for what they'll do when economic growth returns. The landscape of possibilities is broad, so it's useful to think of them in distinct categories:

- **Engaging the outside world.** Good times are when you make the friends that you'll need in bad times.
- **Managing people.** The temptations to become lax on this critical issue are almost overwhelming during a boom. But in a world where human capital is every company's most valuable asset, it's one of the most critically important jobs.
- **Adjusting strategy and business model.** Just as every investing strategy works in a bull market, every business strategy may seem brilliant during an economic boom. That's the time to ask how well the strategy or business model would hold up in a recession.
- **Staying connected with customers.** The best companies never stop refining their customer value propositions — observing customer behavior, understanding how customer needs are changing and experimenting with hypotheses for new value propositions.
- **Managing capital.** When a company lands in a recession after years of poor capital management, the pain is extreme. All that misery can be avoided if a company manages capital rigorously when times are good.
- **Getting more efficient and productive.**
- **Adapting to changing risks.** For unsuccessful companies, risk is a hot topic at the depths of a recession. For great companies, it's a hot topic at the height of a boom.
- **Continuing to grow personally.**

### Good Times Preparation for the Bad

Managing intelligently during the next expansion, vital as it is, will be less a chance to clobber competitors than a way of preparing the organization for the make-or-break environment of the next recession. That way of thinking may seem strange. It feels backward. Good times seen merely as preparation for the bad? But it is the inescapable result of thinking about your company as an institution that, with luck, will last longer than your career or anyone else's, persisting through the elation and challenges of economic cycles that will never end.

We've forgotten how to think about business as progressing through a series of cycles. Yet that's what it is and will always be. Now that we've been powerfully reminded of that fact, we can again appreciate a larger truth about life in business. Good times are when you'll experience your greatest success. But bad times are your greatest opportunity.