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Thriving Under Adversity

Strategies for Growth in the Crisis and Beyond

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May 2009

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Thriving Under Adversity

Strategies for Growth in the Crisis and Beyond

Faced with the worst recession since the 1930s, many companies are reacting as bears do to winter—by hibernating. They are shrinking production capacity, downsizing their labor force, reducing discretionary spending, and conserving cash until—they hope—the economy picks up again.

This is a tried and tested strategy—and it works if a recession is short, if the external world returns largely to its former state, and if competitors also take refuge from the economic winter by “hibernating.” But these conditions are becoming less likely by the day: the consensus is growing among economists, business leaders, and governments that the world is in the midst of a prolonged winter of unpredictable duration and that even when the upturn comes, the postcrisis strategic and operating environment will almost certainly be quite different.

Companies will have to—if they have not already done so—come to terms with new competitive realities.¹ Today’s recession will hasten the downfall of ineffective business models, accelerating the restructuring of entire industries. Consumer and investor behavior may be altered for an entire generation. The historically high consumer indebtedness and financial institution leverage that drove the last boom are unlikely to be seen again. And governments will loom larger in shaping the business landscape through their unprecedented fiscal-stimulus programs, the introduction of new regulations, and various forms of subtle protectionism.

In this environment, inaction is not an option. So the question is this: what course of action makes the most sense? Clearly, the first task is to ensure a company’s short-term survival. But hibernating—taking refuge from the economic winter—is only a defensive move. In order to thrive—and not just survive—senior executives should consider two other moves. First, they should develop a range of short- to medium-term recession-specific strategies designed to drive growth and ensure that their company emerges from this downturn *competitively advantaged*. Second, given the likelihood that the strategic environment will remain uncertain even after the recovery, they should institutionalize the lessons learned during the downturn in order to enter the upturn *more resilient*.

Survival: Necessary but Not Sufficient

There can be no question that the first task of senior executives in a downturn of this magnitude is to protect the business. Given that only a healthy company with at least some resources to spare can aspire for more than survival, they must insist on greater efficiency through thoughtful cost reduction, cash and working-capital management, organization redesign, and process improvements. And they must mitigate risks by investing in customer retention, managing credit, exercising prudence in capital investment, divesting noncore assets, and securing lines of credit and additional equity capital.²

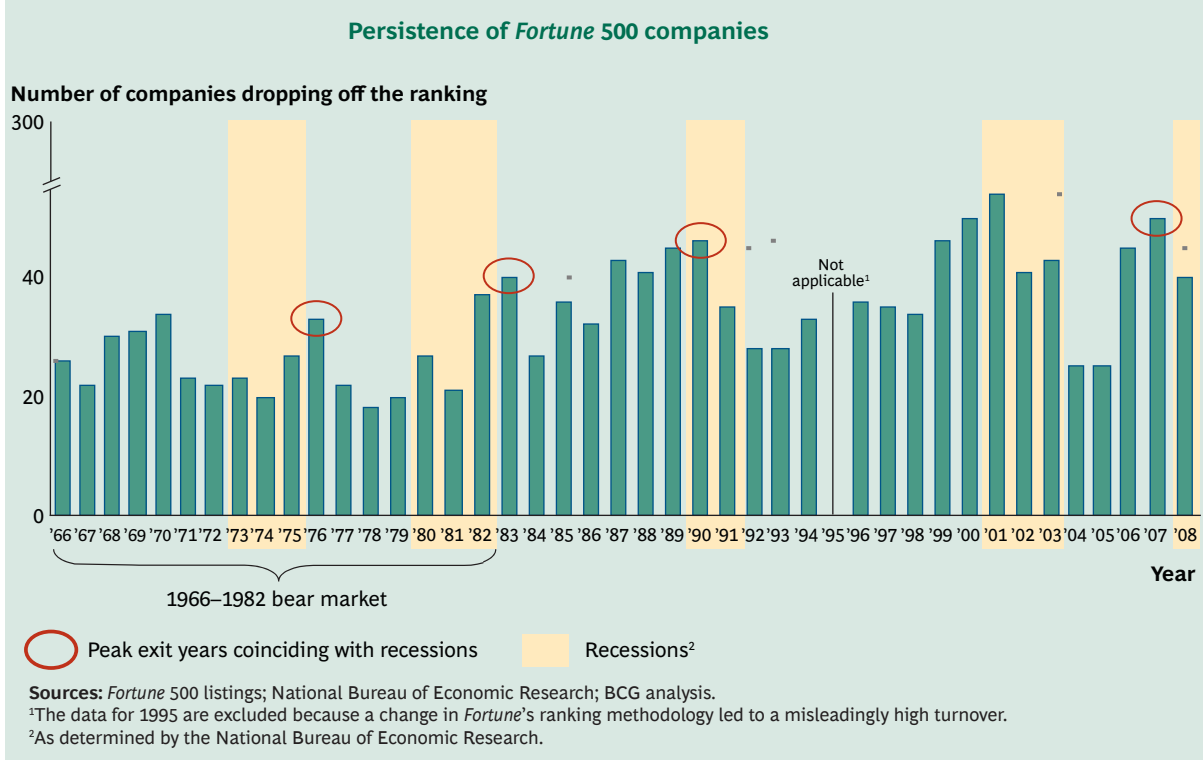
The risks of failing to plan properly for survival are very clear. History shows us that the number of companies that fall off the *Fortune* 500 in a given year goes up significantly in recessionary periods. Each of the five recessions since 1965 was associated with a peak in the number of companies falling off *Fortune*’s ranking. (See Exhibit 1.)

But if survival buys time, it does not guarantee sustainable competitive advantage. And although a relative cost advantage is an important dimension of competitiveness, history suggests that focusing solely

1. See *Collateral Damage, Part 5: Confronting the New Realities of a World in Crisis*, BCG White Paper, March 2009.

2. For a more detailed discussion of the survival “to do” list, see David Rhodes and Daniel Stelter, “Seize Advantage in a Downturn,” *Harvard Business Review*, February 2009.

Exhibit 1. Recessions Threaten the Survival of Leading Companies



on cost reduction during a downturn is unlikely to drive superior long-term performance. In the long bear market from 1966 to 1982, the lion’s share of companies that outperformed their peers on total shareholder return (TSR) saw higher growth in sales than in either EBIT or dividends. (See Exhibit 2.) And the connection between sales growth and superior relative TSR held not only over the full cycle but in each of the “decline” and “bottom” phases of that downturn as well.

Once a company has taken the defensive measures needed to survive during the downturn, it is then in a position to contemplate the future and to take the measures needed to thrive during the upturn.

Sustainable Competitive Advantage: Thriving Through the Downturn

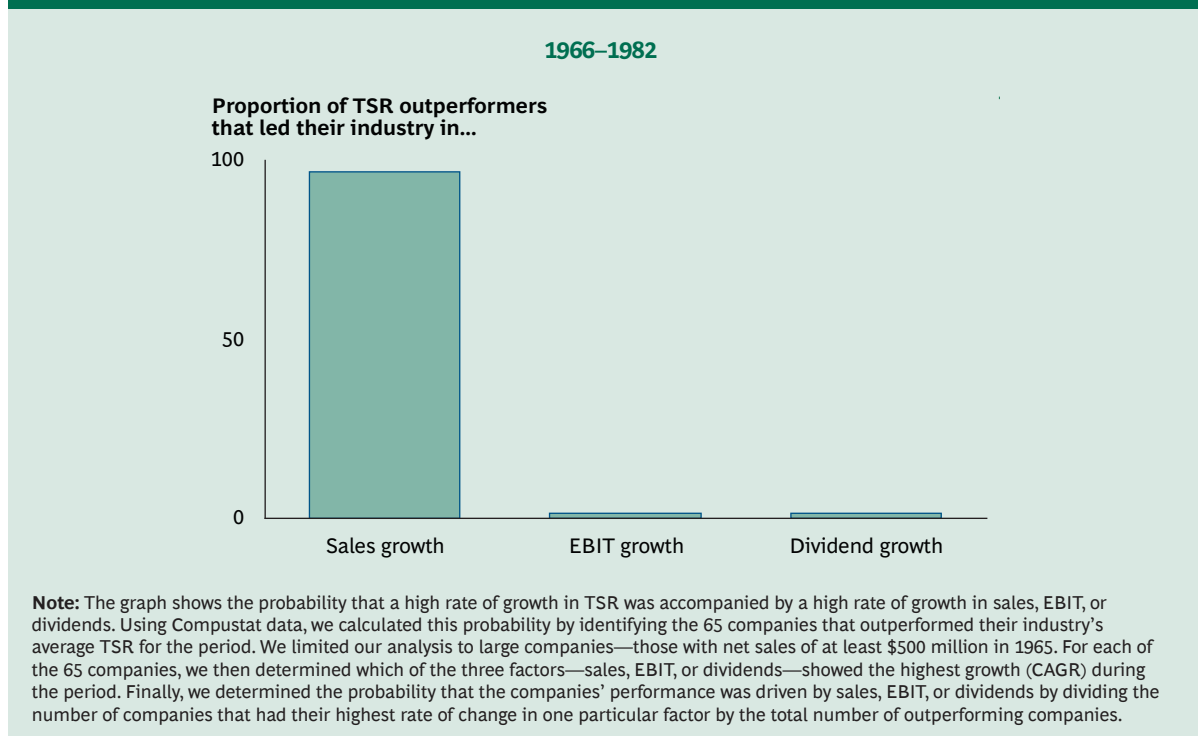
If the hibernating bear provides one of nature’s adaptive responses to a harsh or changing environment, there are many others. And, in 2009, as we mark the 200th anniversary of Charles Darwin’s birth, biological analogies—offering a powerful, comprehensive, and engaging framework to help chief executives brainstorm and refine their strategic options in a recession—seem particularly appropriate. Beyond hibernation, a metabolic strategy, nature offers four broad alternatives: behavioral strategies, social strategies, reproductive strategies, and evolutionary strategies.

Behavioral Strategies

Animals frequently adapt to environmental changes by altering their behavior. With critical foodstuffs in short or declining supply, they change their diet, expand their hunting range, or alter their hunting tactics. Businesses, too, can use a variety of behavioral strategies.

Adjusting the Customer Offering. This is all about changing *what* you hunt. Are there new services, such as financing, that enhance the value proposition for budget-strapped customers? Can you introduce new sizes that make a product appear to have better value in a recessionary environment, or reduce the number of base product features (while adding attractive new optional ones)?

Exhibit 2. In the Last Long Bear Market, Superior Growth in Total Shareholder Return Was Accompanied by Superior Growth in Sales



In the 1989–1992 recession, U-Haul, the North American truck-rental business, was facing increased price competition. Consumers were extremely cost conscious and there was little room to differentiate on service or capital improvement. Instead, U-Haul met the competition through low rental charges—but found a lucrative adjacent market selling high-margin add-ons such as cardboard boxes, tape, twine, and other packing materials. With this broader offering, U-Haul achieved profit leadership, boasting a 10 percent operating margin compared with the industry average of 3 percent.

In the 1990s, BAA, the U.K.-based airport-management company, faced a recession in its domestic market. At the same time, it faced a significant strategic challenge from an upcoming regulatory shift: the company feared that its lucrative duty-free-shopping business at Heathrow and other airports could collapse when customs barriers within the European Union were lifted in 1999. But, instead of cutting back, BAA chose to increase its retail space by 50 percent and shift its retail mix toward branded luxury boutiques. The moves paid off. Retail revenues grew nearly 18 percent between 1998 and 1999, largely with the same customer base—setting the company on a solid trajectory of growth.

Exploring New Pricing Models. Pricing and contracting can represent powerful ways to change the way the company does business—or, to continue the biological metaphor, *how* it hunts. Are there ways to reduce mutual uncertainty through long-term contracts or to reduce customers' risk through outcome-based pricing regimes? In the 1980s, Rolls-Royce and, soon after, General Electric radically changed the way they sold aircraft engines. They started to sell engine “power by the hour,” instead of separately selling engines plus financing plus maintenance plus spare parts. The airlines, which paid nothing up front, paid on the basis of their planes' utilization. Rolls-Royce and GE not only won share in the engine market, they also increased revenue per client (by bundling together equipment, financing, and service) and extracted a premium—better margins—at the same time.

Entering New Markets and Exiting Old Ones. This is all about deciding *where* to hunt. Where are the opportunities for growth, given different potential offerings? What are the best ways to change business operations to reflect changing consumer demand? The recession of the early 1990s hit luxury carmakers hard. In 1996, Porsche, seeking to return to growth, introduced the Boxster series. At two-thirds the price of (and 40 percent parts commonality with) Porsche's flagship 911, the Boxster was a great success and

helped drive 46 percent growth in revenues for the company between 1996 and 1997.

Making Opportunistic Moves to Boost Competitive Advantage. This is about the honing of predatory skills. Can you capture key customers from competitors? Can you secure other scarce assets from them (for example, talented staff, intellectual property, or brands)? Are there attractive M&A opportunities (friendly or hostile) among recession-wounded competitors? Arrow Electronics, a U.S.-based distributor of electronics to equipment makers, value-added resellers, and contract manufacturers, saw the multiyear slump in the components business in the late 1980s as an opportunity to seize industry leadership. Although the number two company, Arrow was half the size of its larger competitor. In 1988, it began buying and integrating smaller competitors. By the time the sector rebounded, Arrow had become the market share leader. Between 1991 and 1994, its operating income increased at a rate of 96 percent per year (outstripping its sales growth of 64.5 percent), owing to its expanded scale and supplier power.

Social Strategies

Sometimes animals thrive in a challenging environment by banding together through cooperative or symbiotic relationships. In the same way, companies can deploy social strategies. For example:

- ◇ *Partnering with Suppliers or Customers.* Are there ways to work together to remove direct, inventory, or transaction costs from the system for mutual benefit?
- ◇ *Partnering with Competitors.* Does the downturn offer opportunities for competitors to come together? Are there opportunities to share services, capabilities, or assets? Are there opportunities to lower costs and spur growth by using open-source innovation models?
- ◇ *Shaping the Environment Itself.* Is there an opportunity to argue for favorable changes to regulatory regimes—either independent of or in concert with competitors?

Two cases illustrate the power of partnering strategies:

The Airlines' Response to the Threat of Internet Distribution. By the late 1990s, dot-com travel sites such as Travelocity and Expedia constituted a significant new threat to the profitability of airlines. Having only recently gained more control over travel agency commissions, the airlines found themselves facing a new, far more concentrated channel with the potential to demand steep fees for the most advantageous positions in search results. The threat prompted a collective response: five major U.S. airlines—American, Continental, Delta, Northwest, and United—joined together to create Orbitz. Launched in June 2001, Orbitz offered the best available fares, utilizing a breakthrough search technology in a clear and consumer-friendly user interface. It was a big hit. The airlines were pleased, for two reasons. First, in exchange for committing to offer “most favored nation” pricing to Orbitz, they had met consumers’ desire for one-stop shopping for the lowest price—and had secured reasonable online distribution costs for themselves. And second, they earned a tidy return on their approximately \$215 million equity investment—at first through an initial public offering in 2003, and then, the following year, when Cendant Corporation, a U.S.-based holding company with significant travel and tourism investments, purchased Orbitz for \$1.25 billion.

Technology Companies' Collaboration on Enterprise Linux. In the 1990s, major hardware and software companies incurred significant costs in testing and certifying their enterprise products for the many different variants of the Unix operating system because competitive rivalry prevented any single vendor's Unix from becoming the de facto standard. The diplomacy of Red Hat—coupled with the enlightened self-interest of a coalition of companies including Dell, Hewlett-Packard, IBM, Oracle, and Veritas—led to Red Hat's version of Linux becoming the “standard” for enterprise Linux. Consequently, the costs of all these companies have decreased, and the business market for Linux has grown significantly—to the benefit of all.

Reproductive Strategies

In nature, two fundamentally different reproductive strategies confer advantage: survival through the *quantity* of offspring and survival through the *quality* and nurture of offspring. In business, many companies have used the rapid expansion of franchising or “store within a store” activities during tough times (the quantity approach) to ensure continued rapid growth while putting little capital at risk. By contrast,

The Body Shop, a U.K.-based retailer, pursued the quality approach in response to the 1998–2000 recession in its domestic market—buying back franchises, as well as investing in store refurbishment and new products—and refocused the consumer’s image of the brand at a higher quality point. Those investments helped the company return to double-digit growth.

Reproductive strategies in business typically entail carefully managing the portfolio of “business experiments.” Approaches to consider include the following:

- ◇ *Rapid Prototyping.* Are there business models that can be quickly “mocked up” and tested with customers?
- ◇ *Incubation.* Some high-investment initiatives might drive future competitive advantage. How can they best be protected and nurtured during their gestation at a time when investments as a whole are being curtailed?

Virgin, the U.K.-based conglomerate, has leveraged its brand to launch more than 360 different ventures and has achieved leadership positions across a diverse range of industries: Virgin Atlantic is the second-largest airline in the U.K. market; Virgin Direct (now called Virgin Money), a financial services venture, amassed £1.6 billion in deposits and more than 275,000 customers within three months of its launch in 1995. The Virgin Group has an operating model focused on innovation and a risk-embracing, venture-capital-like hunger for growth. It regularly investigates and enters (as well as exits) businesses. All new ventures harness the powerful Virgin brand; but, more important, they also typically leverage the capabilities of partner companies in order to increase the speed of entry to the market and lower the size of the group’s investment. In effect, what Virgin is doing is placing many small bets on many different-size opportunities around the world—eager to harvest big successes but not afraid of losing some of its offspring.

Evolutionary Strategies

Sometimes the environment changes so much that the only way to adapt successfully is to evolve into another form. Darwin’s finches evolved, in a process known as adaptive radiation, from a common ancestor into 13 distinct species, each well adapted to the ecology of a specific island within the Galápagos chain.

In business, evolutionary strategies typically revolve around business model innovation. Successful new models are well adapted to their business environment. In the early phases of a business model’s life cycle, multiple models—some start-ups and some incumbents—compete for supremacy. Eventually, out of this diversity, only the fittest will survive, leaving the others to fade away. When the environment changes sufficiently, a new battle for dominance emerges.

Evolutionary strategies are the most challenging for incumbent companies. But challenging does not mean impossible. Think of Intel’s transformation from a commodity manufacturer of DRAM memory chips into a premium, branded microprocessor maker; or IBM’s transformation from a product company into a service company; or Nokia’s striking shift from paper maker to a leading manufacturer of telecom equipment.

In the natural world, evolutionary strategies are available only to *species*, not to *individual organisms*. Not every finch will have the qualities necessary to survive on a new island—but some will, and finches as a whole will evolve successfully and survive the transition. So, to make use of this metaphor, companies need to think of managing a series of business model experiments with some deliberate degree of redundancy. This approach is important because there may be hidden value in traits that seem extraneous today: they may offer “preadaptation” to unexpected shifts in the environment.

For this reason, short-term-survival strategies—for example, recessionary cost-reduction and efficiency initiatives—should be undertaken carefully, lest they risk eliminating critical preadaptive business models or capabilities. It is essential to distinguish between what is strategic and what is superfluous. Clearly, without survival there is no possibility of sustainable competitive advantage. But without diversity, experimentation, and even some degree of redundancy, there can be no resilience in the face of change.

Resilience: Making Adaptation a Way of Life

It seems likely that even after the eventual economic recovery, heightened uncertainty and volatility will remain permanent features of the business environment. As a result, *resilience*—the ongoing ability to anticipate and adapt to critical strategic shifts—will become an increasingly important driver of future competitive advantage.

Consider some of the challenges that senior executives have had to face in recent years:

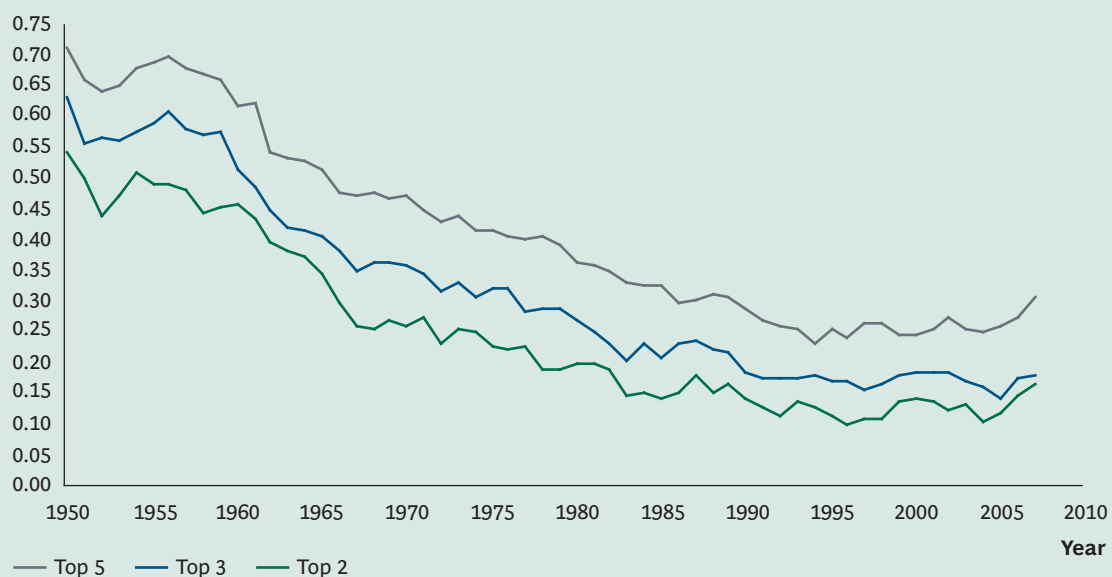
- ◇ The rise of rapidly developing economies (RDEs) such as China and India
- ◇ The evolution of globalization from what was initially a sourcing phenomenon into a competitive one as well, with the emergence of new RDE-based global challengers
- ◇ The exponential growth of information technology, including improvements in bandwidth, ubiquitous connectivity, and the related innovations associated with the Internet
- ◇ Concerns about climate change and sustainability
- ◇ Growing geopolitical tensions and risks

There is another challenge: some of the traditional ways in which companies have gained competitive advantage—for instance, focusing on scale—have been losing their edge. In 1950, there was a 71 percent probability that the top five market-share leaders in a sector were also among the top five for operating margin. By 2007, that likelihood had dropped to 31 percent. (See Exhibit 3.)

Furthermore, companies can no longer count on market share to guarantee *future profitability*. And even those at the top of their industries cannot expect to stay there as long as they once did. Exhibit 4 shows the average change in rank per year for publicly traded companies in 69 industries. Whether you look at leadership as measured by sales, income, or market capitalization, the data show a dramatic increase in volatility over the last few decades.

Exhibit 3. Market Share No Longer Guarantees Profitability

Probability that the top share leaders are also the most profitable companies (sales versus operating margin)



Source: BCG analysis.

Exhibit 4. Leadership Volatility Has Been Increasing



Source: BCG analysis.

¹Average unweighted change in rank per year of publicly traded companies across 69 industries.

Resilience enables a company to better navigate these and other challenges. A resilient company perceives opportunities and risks more clearly—and responds to them both more effectively and more rapidly. Such an organization has several characteristics.

Foresight. This quality entails actively monitoring the key megatrends and events that could create opportunities and risks. Executives develop a shared internal view of the trends of greatest importance; then they define the “trigger events” that may enable or require action; and then, for each trigger event, they prepare a playbook of potential strategic moves to mitigate risk or to make the most of new opportunities. The increasingly connected nature of business and society makes it necessary for companies to look well beyond their own industry—and even outside the business world—to identify critical trends.

In 2002, United Parcel Service (UPS), the U.S.-based transportation and logistics company, conducted its first formal long-term scenario-planning exercise. It has since repeated the exercise in order to explore potential changes in its strategic vision. UPS has also established a monitoring process to detect weak signals and new trends that could challenge the company’s assumptions. Since the introduction of this process, UPS has successfully anticipated—and taken advantage of—industry consolidation and the growth of the Internet.

Agility. Companies must foster the willingness, preparedness, and ability to adapt rapidly in response to, or in anticipation of, disruptive events. In some cases, they can agree on conditional moves keyed to specific trigger events, thus ensuring a rapid response.

Flexibility. It is critical to ensure that the company has the staying power and human and financial resources to survive unexpected changes—or to take advantage of unexpected opportunities. No matter how good your foresight or how agile your company, there will be events—both external and internal—that will take you by surprise. Having the flexibility to enable your company to absorb or react decisively to these shocks is a critical ingredient for strategic resilience.

Entrepreneurialism. In stable times, companies thrive by optimizing and scaling their existing business models. In changing times, they thrive by exploring, designing, and scaling new business models. This sort of innovation requires specific capabilities and processes quite distinct from those of product development in a stable market. It also requires a strategic embrace of redundancy—a readiness to invest in more

innovations than are strictly necessary for survival in order to develop a portfolio of capabilities and business models that may offer “preadaptation” to tomorrow’s markets.

Qantas, the Australian airline, needed to fend off a strong challenge in its core national market from start-up Virgin Blue, part of the U.K.-based Virgin Group. Virgin Blue had entered the market in late 2000 with a business model combining low fares with the “Virgin experience” and was soon taking market share from Qantas on a number of its busiest and most profitable routes. Given its cost structure, Qantas realized that it could not sustainably compete with Virgin Blue directly, so it decided to set up a new low-cost business model. Rather than simply copying Virgin Blue’s model, Qantas chose to outdo it by creating Jetstar, an ultra-low-cost airline designed from the outset to be lower-cost than Virgin Blue. Jetstar launched in the first half of 2004, offering new planes and rock-bottom fares. It also boasted the lowest cost structure in the market and has since lowered costs further. Jetstar’s business-model evolution continued when it initiated international service in 2006, making it the world’s first low-cost long-haul airline. It pioneered a revolutionary à la carte pricing approach that enabled consumers to customize their onboard experience with different options for food, comfort, and entertainment. While Jetstar has replaced Qantas on some leisure routes, its launch has been particularly effective in slowing Virgin Blue’s growth plans. Virgin Blue found itself squeezed in a pincer, with strong competition from Qantas in the leisure and business markets. In 2007, Virgin Blue abandoned its discount positioning and shifted its focus to business travelers.

Diversity. A company’s creativity in adapting to an unknown future will be shaped by the diversity of perspectives it can bring to bear—and these will be determined by the diversity of its employees and culture. The degree to which a company can foster and maintain such diversity, even in the face of a recession, is a key determinant of its future resilience.

Ability to Shape the Competitive Environment. Resilient companies counter volatility and uncertainty by working to shape the regulations, the standards, and even the structure of their industries. Following the attacks of September 11, 2001, U.S. airlines buffered the tragedy’s impact on their industry by successfully lobbying the government for immediate cash relief and loan guarantees—as well as initiating a longer-term dialogue with regulators about the need for industry consolidation and lower taxes.

Companies able to survive and thrive during a downturn are heavily favored for future advantage. And with growth opportunities likely to come in all sizes and shapes, the ability to shift seamlessly and rapidly from insight to action may well make the difference between winning and losing during and after the downturn. So business leaders are well advised to adopt a balanced focus on the three themes set out in this paper—survival, advantage, and resilience—and to reflect on the strategic lessons from the natural world.

Of course, this is easier said than done: for most companies, the hardest challenges in fostering resilience will not be analytical, they will be organizational. And for many, becoming a resilient company will require significant cultural change, skill building, and leadership. But the suddenness and the seriousness of this economic winter can be a catalyst for change because most employees now viscerally understand that “business as usual” does not make sense in unusual times. A crisis, after all, is a terrible thing to waste.

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Acknowledgments

The authors would like to thank Sumit Sahni, Dana Hughes, and Matt Stack for their contributions to this paper, as well as Gary Callahan, Matthew Clark, Angela DiBattista, Sharon Slodki, and Simon Targett for their editorial and production support.

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