Managing Your Business

Growth Opportunities Increase During Economic Downturns

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It is a little counter-intuitive but research confirms that economic downturns are generally the best times to implement growth initiatives and create shareholder value. By the same token, the research also shows that the most effective business strategy during boom times is to divest assets or implement similar retrenchment activities. Unfortunately, and perhaps not surprising, most companies do the exact opposite!

Market Research Support

A recent McKinsey study based on a database of roughly 200 global companies tracked investment and divestment activities over several years for these companies and calculated total economic returns for each company during downturns and expansion periods as well as by strategy that was employed during these periods. The two key findings from this research showed that:

1. of the potential strategic moves companies can take to grow in a downturn—divest, acquire, or invest to gain share—effective acquisition strategies created the most significant added value for shareholders and,
2. during industry expansions, the most effective strategies were those involving divestments of assets and businesses. The research also showed that, despite these results, acquisitions are much less frequent during economic downturns and divestments are much less frequent during economic expansions.

While this research suggests that companies are not acting in a rational manner, the tendencies of companies to retrench in a downturn and expand in an upturn are not surprising. As revenues slow and margins get squeezed, management naturally switches its focus to cutting costs and maintaining earnings. Companies focus on protecting their balance sheets during tough times —an approach leading to the deferral of growth and of lower-priority investments, the shelving of large acquisitions, and the sale of assets.

Also, when the industry is contracting and profitability declines, it is more difficult to effectively implement acquisitions and share growth programs because there are more immediate priorities and often, like the situation today, a lack of credit and cash to get them done. This is consistent with other research that shows that most companies simply freeze during economic downturns and avoid making any strategic portfolio moves until the market returns to a more normal circumstance.

The Best Companies are Contrarians

The research shows, however, that the best growth companies do take a contrarian approach. They view a downturn as a time to increase their market positions and make acquisitions. With a combination of available credit, cash, and strategic resolve, they aggressively take advantage of rare opportunities that can result in fundamental changes in the competitive landscape. In most cases, high quality assets can be purchased at prices well below their actual worth as weaker competitors are forced to make desperate strategic moves to preserve their companies.

This is not to say that companies should go on a spending spree in a downturn and tighten their belts in an upturn. It is also understood that, from a practical standpoint, most companies are simply not in a financial position to exploit the opportunities downturns present. But for large numbers of healthy companies that would normally not consider a contrarian approach, there is clearly an opportunity to resist the natural tendency to retrench when the market declines and instead view this period as a time to make a strategic expansion move that will increase long-term shareholder value.

Best Advice – Look For and Take Advantage of Opportunities

In our industry, the smart companies with strong balance sheets and clear a well thought out growth strategy are keeping a close tab on the market and the competitive environment so that they can take advantage of competitive mistakes, distress sales, high quality employees who may suddenly be available, or affiliation / partnership opportunities that could result in a much stronger business when the market returns to a more normal level.

The companies that are able to take advantage of these rare opportunities are the ones that will be the new market leaders in the future US pulp and paper industry when the dust finally settles.

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