Lessons from S&P Recession Survivors

Larry Mallak

The recession of 2008-2009 humbled many firms and individuals.

Unemployment topped 10%, millions of homeowners faced foreclosure, the housing and mortgage industry led the way to a long, painful, "Great Recession." Although these events were not "black swans," in Taleb's terms[1], they are painful and their effects reach like tentacles through a broad swath of global economic activities. Black swans, you may recall, are events that are unexpected, have widespread consequences, and we build rational explanations for them post hoc.

Fast Company, *BusinessWeek*, *Harvard Business Review*, and other popular outlets have published many articles extolling the virtues of taking decisive action during such a recession. These actions may make a difference when the recession ends and orders start piling back up. However, we should take a moment to examine the activities of firms who weathered the last recession and performed well in the past decade as a result. What can we learn from them to apply to our own organizations?

The S&P 500 is often used as a representative measure of the health of the U.S. economy. However, 40% of the companies in the S&P 500 in 1999 were no longer on the list in 2009. Some were victims of mergers, but many others fell off the list because their businesses slipped.

Investors have heard many decry the decade of the 2000s as the "lost decade." A dollar invested in the S&P 500 on the first trading day of 1999 saw it worth just 65 cents a decade later (3/31/09 is our cutoff point). This "underperformance" is seen by many as a failure of the U.S. economic engine. If we look at the Top 20 performers of the S&P 500 during that same time period, we see a vastly different story. Instead of a 35% loss during that time, the Top 20 earned an average *426% return* in stock price, excluding dividends. What accounted for this differential performance during this "lost decade?" This manifesto offers some insights based on an analysis of the Top 20's business environment and strategies deployed during the 2000s. Then, we recount some lessons that any firm can use to build a solid economic future.

[1] See Taleb's ChangeThis manifesto at http://changethis.com/manifesto/show/33.04.FewFar

Top 20 Analysis

Rank	Company	Industry	Reason for Growth
1	QualComm, Inc.	IT	Growth in cell phone penetration, CDMA technology.
2	Apple Inc.	IT	iPod + iTunes, Airbook, iMac, return of Steve Jobs.
3	Occidental Petroleum Corporation	Energy	Able to extract oil & gas at higher profits when oil prices rose.
4	Apache Corp.	Energy	Able to extract oil & gas at higher profits when oil prices rose.
5	EOG Resources Inc.	Energy	Able to extract oil & gas at higher profits when oil prices rose.
6	St. Jude Medical Inc.	Healthcare	Grew international sales, developed niche in cardiac products—a major growth area
7	AutoZone Inc.	Retail	Cars kept on road longer, increasing demand for auto parts and service
8	Paccar Inc.	Manufacturing	Increased demand for trucking followed implementation of Six Sigma, thereby growing margins
9	Praxair, Inc.	Manufacturing	Grew 15% during 2008 recession, moved into medical gases market, earned status of "most admired company" which reduced hiring costs
10	Ball Corporation	Manufacturing	Alumi-Tek bottle innovation introduced in 2000s bucked the trends and produced a 30% profit advantage over its rivals
11	Nucor Corporation	Manufacturing	Largest scrap metal recycler in US, weak dollar, and the ability to ramp up and down based on demand. Also on the list of "most admired companies."
12	Freeport-McMoRan Copper & Gold Inc.	Mining	Price of gold tripled while costs remained steady—recipe for big profits.

Rank	Company	Industry	Reason for Growth
13	CR Bard Inc.	Healthcare	Targeted growth in baby boomer disease areas—dialysis catheters (from diabetes and cancer) and cardio products.
14	Unitedhealth Group Inc.	Healthcare	Kept costs in line while riding major increases in healthcare costs (revenues to them).
15	Adobe Systems Inc.	IT	Ubiquity of Acrobat (pdf format) and the verb "PhotoShop."
16	Entergy Corp.	Energy	Grew through acquisitions, including nuclear power, to meet the increased US electricity demand
17	Allergan Inc.	Healthcare	Botox sales nearly tripled with only 41% more employees.
18	Darden Restaurants Inc.	Retail	Foresaw the slowdown in boomer spending and reduced cost structure prior to downturn. Also able to ramp up or down based on demand through use of part-time employees.
19	Sempra Energy	Energy	Meeting the increased demand for US electricity while their business model is geared to operate clean and renewable power sources, esp. as mandated by legislation in California.
20	Devon Energy	Energy	Strategic acquisition (Mitchell Energy) doubled Devon's size, while riding the oil price boom to record profits.

Our analysis of the Top 20 firms showed several insights into their outperformance during the decade of the 2000s. These insights have implications for firms today who want to lead in the current decade.

INSIGHT #1. *Your industry bucked trends and your firm learned how to capitalize on this.*

Some industries are typically identified as "recession-proof." Well, nothing is truly "recession-proof," as many hospital administrators saw their revenues and admissions decline during the Great Recession, necessitating layoffs and downsizing of services. The fact is: if you have less money (and no access to credit), you will spend less money. The credit crunch made sure of that in this recession.

Healthcare

U.S. expenditures on health went from $1.44 trillion in 2001 to $2.20 trillion in 2007. Current estimates are $2.6 trillion (2009), representing a slower growth rate than experienced in the early part of the decade. The point is that the healthcare sector is still growing; it's just not growing as fast as it used to. This is good news when viewed as a percent of a country's GNP, but not so good news if you run a firm that relies on revenues from increasing healthcare spending.

The second part of insight #1 is that the firm must learn how to capitalize on the trend. Just because you are in a rising tide doesn't mean that your boat will get lifted. Your boat must be capable of facing the tide and not get rolled over. The healthcare firms on our Top 20 list found ways to do just that.

St. Jude Medical (#6) grew sales not just in the United States, but across the globe. They developed new products for cardiac patients, which just happens to be one of the leading causes of death in the developed world. CR Bard is the market leader in dialysis catheters, a growing segment of the healthcare sector as the rate of diabetic population surges in the United States and those patients begin experiencing organ failure. Bard was well positioned to profit from this unfortunate health trend. UnitedHealth, as an insurer, earns its revenues as a percent of healthcare spending. So, as their subscriber base spends more on healthcare, United earns more revenues. Of course, United needs to run its business so it makes a profit on those increased revenues. The fourth healthcare firm in the Top 20, Allergan, built its growth story not on contact lens care, but as the patent holder to Botox. Botox went from a $308 million product in 2001 to a $1.3 billion product in 2008, a 322% increase in sales on that one product.

IT (Information Technology)

The big internet shakeout that followed the internet bubble and related recession of 2000-01 left some mighty players standing. And, it left behind a legendary IT infrastructure and a stoked appetite for better, faster, and smaller devices to access information. This "information" was not just news, sport, stock quotes, and weather. It was music, video, instant messaging, and the birth of social networks. Now, news junkies, programmers, and academics were not the only ones demanding more out of their devices—it was hair stylists in Hong Kong, eye technicians in Iran, safari drivers in South Africa, and a whole generation of youth who would obtain and play music without ever visiting a CD shop (or paying for those downloads). This demand for entertainment and communication over the internet meant firms that could capitalize on this trend and profit from it could do quite well, assuming they survived the "dot-com" crash.

Qual-Comm was a survivor. Okay, that's an understatement. A very gross understatement. After a meteoric rise during the internet bubble, QCOM's stock went up 10x during our 2000-2009 study period. Their success bucked the trend in telecom because they made the CDMA chips and technology that drove the cell phone industry and their business is anchored in IT, not telecom. (See more under insight #3.) Apple was more than a survivor. They bucked the trends for many reasons. (See insights #2 and #3.) Adobe's portable document format (pdf) and Photoshop need no introduction. The web would not be the same without these landmark developments. (See insight #3.) These three IT firms outperformed in the 2000s. They bucked the trends. But, they did so much more that they will be profiled for deeper in later insights.

Just because you are in a rising tide doesn't mean that your boat will get lifted. Your boat must be capable of facing the tide and not get rolled over.

Energy

When you go from world demand for oil of 76.7 million BBL in 2000 to 84.0 million BBL in 2009,[2] you know you have a rising tide to ride, despite all our efforts to reduce consumption and be more sustainable. (However, U.S. consumption dropped during this period, from 19.7 to 18.7 million BBL—a 5% decrease.) Six of our Top 20 firms rode this trend very well. See more in insight #4.

[2] Source: http://www.eia.doe.gov/ipm/demand.html [Accessed 5/12/10]

INSIGHT #2. *You have a strategic advantage or you created one.*

When your firm has a strategic advantage in the marketplace, you can price accordingly or build market share more rapidly than your competitors. As the late Grateful Dead frontman Jerry Garcia once said, "You do not merely want to be the best of the best. You want to be considered the only ones who do what you do." When you're the only one who does what you do, people will flock to you. Just as Deadheads followed the group around the country for extended periods of time, iPod-heads (or today, iPhone-heads) look to Apple for the Next Big Thing. "His Steveness" has such an influence on the company that Apple's stock price fluctuates with his health. One could argue that Apple's strategic advantage is Steve Jobs and its design-centric products and flashy product launches. Apple can command premium prices for its products because its products are highly differentiated for the competition.

Nucor's strategic advantage was created as the firm matured. Nucor is now the largest recycler of scrap steel in the U.S., recycling more than 13.4 million tons of steel in 2009. As a provider of infrastructure materials to the world, the buildout in emerging countries and the rising economics of those markets has increased demand for Nucor's steel products. Nucor eschews inventory, preferring to build to order and thereby avoiding expensive holding costs of large, heavy product. Nucor's work culture is flat, lean, and decentralized. In addition, the average employee earns nearly $100,000 in salary and bonuses. Bonuses are directly linked with company profits. Nucor's work environment and incentives motivate the workforce to be productive and produce quality output, while taking responsibility for what they produce and having the authority to make decisions on the line that their counterparts in other organizations would require a manager to make.

INSIGHT #3. *You sell ubiquity.*

Having a ubiquitous product or a product whose name enters the global vocabulary produces heavy demand and further stimulates demand among those who do not have the product. ("Oh, you have one of *those* smartphones, not an iPhone.") Just as Kleenex became synonymous with tissues and as JELL-O did with gelatin, Google and Adobe have their own ubiquitous products. (Google was not in the S&P 500 in 2000; they did not make the list until March 31, 2006 and is therefore not considered in this analysis.)

If you want to view a file on the web, chances are you need Adobe's Acrobat Reader. Without Acrobat (or a rival's pdf viewer), you won't be able to view pdf files—the standard for retaining format and security features in a shared document. Doctored-up photos appearing in magazines, blogs, and in your photo album were likely produced using Adobe's Photoshop. Photoshop is now so ubiquitous that it is used as a verb—"Did you photoshop the image to remove the former VP of Marketing?"

If you want to add a music file to your mp3 player, chances are you'll visit Apple's iTunes store. And, you'll likely play that file on your iPod or iPhone (or maybe your iPad). Although Google did not make the list for our study period, the fact that "google" is also a verb ("Did you google that?") tells you how powerful their product is. You can't just use any search engine—you have to use Google. They'll likely make this list for the current decade.

Qualcomm deals with ubiquity. Most cell phone users won't have discussions about their CDMA chip providers or who developed this technology. But, if your company is responsible for a key component in an industry that has 4.1 billion units in use[3] and if you can produce your product at a profit and sell at a price the customer will pay, then you will rise with this tide.

[3] Source: http://en.wikipedia.org/wiki/List_of_countries_by_number_of_mobile_phones_in_use [Accessed 5/5/10]

INSIGHT #4. *Global demand for energy fueled growth in your industry.*

During our study period, the price of a barrel of oil went from $16.56 to $53.48,[4] a 223% increase, with a spike to $140. Demand increased during that time, as well. Global demand went up 9.5%, but U.S. demand went down 5% during the same time period. U.S. demand for electricity increased 12% from 1999-2008 (latest date that electricity usage is available).

Six of our Top 20 firms rode this trend very well—Occidental Petroleum, Apache, EOG Resources, and Devon Energy operate in the oil and gas space. Entergy and Sempra Energy operate in the energy utility markets. Using the price of oil as the key driver of energy costs, these six energy firms in our Top 20 rode the commodity pricing power to produce their profits. The size and scope of the oil & gas companies, along with their success in locating and extracting and distributing these commodities in a cost-effective manner, has led them to produce top growth during our study period. In addition, Devon made several strategic acquisitions in the 2000s that were accretive to their bottom line. One acquisition alone—Mitchell Energy—doubled the size of Devon overnight.

Although not technically midcap firms,[5] Entergy and Sempra are smaller large cap firms ($14.5 and $11.6 billion, respectively), which enables higher percentage growth rates. By size, the midcap and smaller large cap firms hold the advantage because it is very difficult for a firm the size of ExxonMobil (market cap of $300 billion), for example, to grow 20% per year. This is why you don't see ExxonMobil and its peers in our Top 20. The oil & gas firms in our Top 20 have the ability to achieve sizable growth and manage that growth to produce profits while retaining cost effectiveness.

[4] Source: http://inflationdata.com/inflation/inflation_rate/historical_oil_prices_table.asp [Accessed 5/5/10]

[5] Midcap firms are defined by inclusion in the S&P Midcap 400 as those have market capitalizations between $200 million and $5 billion.

INSIGHT #5. *Your firm has the flexibility to ramp up and down with the business cycle.*

One of two retail firms on our list, Darden Restaurants, also bucked the trends and produced a 214% return during our study period. How did they do it? Darden, operator of Red Lobster, Olive Garden, Smoky Bones, and a few other chains, owns or operates all but three of their 1773 stores in the U.S. and Canada. Darden leadership foresaw a slowdown in growth in 2004 and began implementing cost reduction steps that were invisible to the customer. In this manner, when the slowdown would come, Darden could still produce similar margins. Service is very important during a slowdown—if you go out to eat less often, you have little tolerance for poor service. Darden redoubled its efforts to train and deliver high quality service at its restaurants.

Service is very important during a slowdown.

Darden's productivity tells the story of growth—they grew sales 81% during our study period and they did this with only 40% more employees. This led to EPS growth of 141% during the study period. Most of Darden's restaurant employees are part-time, allowing each site to schedule hours to match local demand. This allows the firm to ramp up and down with demand, making effective use of labor.

AutoZone seems an unlikely growth story. But, when you have tough economic times, people hold on to their cars longer. This drives sales of auto parts and AutoZone was structured to take advantage of this trend by opening new stores to meet this demand.

Nucor, noted earlier for its recycling dominance, also has the ability to ramp up and down with its business cycles. Production worker pay is tied directly to production, keeping labor costs in check when sales are down and providing unlimited pay potential when sales are up. This ramp up/down strategy has worked well for several of our Top 20—Freeport moves its mining equipment around to areas where it can produce the best productivity and Ball Corporation opens and closes plants as needed.

INSIGHT #6. *You have a firm that found a niche and ran with it.*

Five of our Top 20 firms earn their keep on the front lines—manufacturing and mining. These include Paccar, Praxair, Ball Corp., Nucor, and Freeport-McMorRan Copper & Gold. Paccar makes Peterbilt and Kenworth trucks. Trucks carry goods to stores and factories. We buy these goods. More trucks carry goods to stores and factories. We buy a little more of these goods. Now, we need more trucks—get it? How did Paccar outperform? They not only implemented Six Sigma in their plants, but required it for all their suppliers. And, they did this in 2002, so they had most of the decade to reap the rewards as demand for trucking increased.

Praxair produces industrial gases, not exactly where one thinks “growth.” They expanded into medical gases during the 2000s, hooking into the healthcare growth. In 2008, when most firms’ sales numbers took a huge hit, Praxair was hitting 15% sales growth. This is a *Fortune* and *Forbes* “most admired company” which typically translates into the ability to be more selective in hiring and to experience higher employee retention rates, which saves the company lots of money and avoids lost productivity due to learning curves.

Ball Corp., yes *that* one—the one that sells canning jars to your grandmother, was a growth story in the 2000s. When the Dow Jones packaging index went down 38.5% in the recession of 2008, Ball suffered only a 6.5% drop. What did they do? Been to a baseball game or a bar lately? Ball produced the innovative Alumi-Tek bottle (looks like glass, made of aluminum) for Miller beer (and others). These bottles are everywhere, they use fewer resources to manufacture, and they are 100% recyclable. From a user perspective, the container "drinks like a bottle and cools like a can." The Alumi-Tek is also 50% lighter than the average aluminum bottle and resealable. So, that's their niche.

Nucor is a manufacturer, but acts more like an innovative human resource lab that happens to produce steel. Their "niche" is innovative human resource and manufacturing strategies that best match their markets (labor and customers) and provide well for their employees. You read their story earlier (if not, go back and do that).

Freeport-McMoRan Copper & Gold rode the commodity pricing boom in gold. They also were able to effectively allocate their equipment and personnel to adjust their mining capacity based on spot prices for copper and gold and forecasts of mining production. Again, when the spot price for gold goes from $290 to $1100 and your cost structure remains essentially unchanged, you have instant profits.

"You do not merely want to be the best of the best. You want to be considered the only ones who do what you do." —JERRY GARCIA

Lessons for Leading in the 2010s

1. Know your industry and know where you can exploit opportunity.

Knowledge of your industry—not just now, but where it is headed—should feed ideas of where the new opportunities will be. They will probably be in the disruptive innovation category, rather than incremental improvements to existing products and services. Understanding your industry (and those like yours, think hospitality and hospitals), will help your leadership team to make the intuitive leaps toward big breakthroughs. The firms in our Top 20 rode commodity pricing booms, the increase in healthcare spending, and Botox.

2. Manage forward and predict the actual future (not necessarily the desired future). You need a staunch view of reality to be a survivor—whether a disaster victim or a start-up or an established business.

Rosy corporate future planning processes often paint a picture that is good for short-term, quarter-to-quarter, managers—they'll be gone by the time the plan's time horizon comes into view. To survive as an organization, *leaders* must take a staunch view of their own reality. What can go wrong? How would we survive a disruptive innovation that drops prices by 50% overnight? How can we develop a product or service having niche (or ubiquitous) properties? Darden Restaurants, in our Top 20, foresaw the slowdown in boomer spending ahead of the curve and made proactive changes so they still made profits when demand slowed.

3. Know your market and what your customers will be doing 3-5 years down the road.

What will they be buying or not buying? What current changes will affect their purchasing decisions? For example, the 2008-2009 banking crisis has slowed cash flowing into equity investments. If you were marketing a new mutual fund, you'd have a hard time attracting cash, but if you were selling gold, you'd likely have some takers (even at $1100 per ounce). What unarticulated needs of your customers are not being met? Get comfortable with empathic design and ethnographic techniques to surface these needs before your competitors do. For example, Intel sends its researchers into people's homes to see how they use information technology devices. They feed their results back into chip design and to the firms they supply to design products that consumers never said they needed, but their behaviors indicate they needed. One major implication for Intel was to develop better chips to support wireless computing. This allowed the "family computer" to be unwired and move around the house, just as the occupants of the house do. Intel found that families tended to hang out together, but using the computer meant going to the isolated part of the house where the computer was located.

4. Understand how the major global trends may affect all aspects of your supply chain—your business, your industry, your employees, your products, your suppliers, your customers.

The trends facing your industry, company, and country have effects across the entire supply chain. Organizations reduce uncertainty (and costs) when they manage their supply chains well. Trends that affect your suppliers, customers, and commodities will work their way into your business operations. Firms that recognize and manage the supply chain are more likely to be positioned properly to profit when the trends manifest themselves. Some strategies of our Top 20 include the ability to ramp up and down according to demand, selling a niche product or a ubiquitous product, or developing products to serve a market that grows despite a recession, like medical areas of cardiac services and diabetes. And, some just profited because they ran profitable operations in an oil patch.

Business cycles will continue to punish the unprepared. Take time to discern what your firm (and you) need to do to be successful in light of these powerful external forces.

info

ABOUT THE AUTHOR

Dr. Larry Mallak is a Professor on the Industrial and Manufacturing Engineering faculty at Western Michigan University. As founding principal their Engineering Management Research Lab, Larry works with organizations to manage culture and develop innovative leadership. He has worked with various healthcare systems, Fortune 500 firms, the U.S. Department of Energy, Westinghouse and the U.S. Army on culture and leadership initiatives. He as also an Associate Editor of the *Engineering Management Journal*. You can visit him on the web at drmallak.com.

SEND THIS

Pass along a copy of this manifesto to others.

SUBSCRIBE

Sign up for our free e-newsletter to learn about our latest manifestos as soon as they are available.

BORN ON DATE

This document was created on August 3, 2011 and is based on the best information available at that time.

ABOUT CHANGETHIS

ChangeThis is a vehicle, not a publisher. We make it easy for big ideas to spread. While the authors we work with are responsible for their own work, they don't necessarily agree with everything available in ChangeThis format. But you knew that already.

ChangeThis is supported by the love and tender care of 800-CEO-READ. Visit us at 800-CEO-READ or at our daily blog.

COPYRIGHT INFO

Cover image from iStockphoto®

WHAT YOU CAN DO

You are given the unlimited right to print this manifesto and to distribute it electronically (via email, your website, or any other means). You can print out pages and put them in your favorite coffee shop's windows or your doctor's waiting room. You can transcribe the author's words onto the sidewalk, or you can hand out copies to everyone you meet. You may not alter this manifesto in any way, though, and you may not charge for it.