HOW TO MANAGE IN A RECESSION

FORTUNE

This time it's going to be a lot different and, in many ways, tougher. Foreign competition, high debt, and the restructurings of the Eighties have changed the equation. Layoffs and plain-vanilla cost cutting won't be enough. Now you'll have to spend money to survive.

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AS BETTE DAVIS snapped in her Oscar-winning film All About Eve: "Fasten your seat belts. It's going to be a bumpy night." Sure, no one's officially declared a recession yet, but in boardrooms from Alcoa to Zenith managers are preparing for the worst -- just in case. Consider the reply of one FORTUNE 500 executive when approached for an interview: "We're too busy battening down the hatches to talk."

That beleaguered manager has good cause for concern. Whether it has already arrived, arrives next year, or comes years hence (see Fortune Forecast), the next recession promises to be very different from and in many ways harder to navigate than those that came before. It is possible, for one thing, that recession could hit the U.S. while missing Western Europe and Japan. Big foreign competitors could use the slump to hammer weakened Americans. For another, after the restructurings of the Eighties many U.S. companies are already running lean. For them, the obvious money-saving anodynes like massive layoffs and reduced travel are not an option.

Says David Nadler, president of New York's Delta Consulting Group: "Most of the things you can do without damaging your business have been done. There's little low-hanging fruit left." Instead, companies will have to struggle to be still more ingenious, devising new techniques to squeeze out money at the margins, maybe even radically redesigning the way people go about their work. The effort may entail innovative arrangements with labor, novel administrative systems, or yet further investment in technology. For example, Corning recently devised a recession plan that should reduce costs significantly without layoffs. Delta Air Lines has in place an unusual budget process that allows managers to cut costs the second a downturn hits.

Allegheny Ludlum is shifting around production of its stainless steel in a manner that drops costs 30%. Old reflexes that used to kick in when recession loomed will have to be rethought. Don't expect, for instance, to have the luxury of cutting back heavily on marketing and product development. The experts argue that smart companies will find the funds to increase advertising and new-product launches. Says Harvard business school professor John Kotter: "It's a different set of responses. You don't just say, 'It's tough times, let's cut.' You take risks and spend more." Why do things look so different this time around?

The main reason is competition from abroad. Try the old-fashioned remedy of slashing head count, product development, and marketing, and watch your foreign rivals, emboldened by continued growth in their home markets, launch new products, cut prices, boost advertising, and -- are you sweating yet? -- steal share that you may never regain.

Okay, you're thinking. Say I decide to turn on the turbos during bad times. Won't stockholders storm the gates as earnings and dividends shrink? Not necessarily. To many corporate chiefs, investors seem more patient today. Says + Ronald Allen, CEO of Delta Air Lines: "With the LBO and takeover craze behind us, I really feel it's easier today to manage long term."

Unlike previous recessions, where all companies tended to suffer together, in this one some will probably lose big while others emerge considerably stronger than before. The most likely candidates for trouble are companies entering hard times with more debt than ever. Some 26% of corporate cash flow currently goes to meet debt payments, compared with only 9% at the start of the 1974 recession and 18% going into the 1982 slump. Companies that didn't binge on debt, including foreign competitors, can turn up the heat and steal business.

Allegheny Ludlum has a strong balance sheet and CEO Robert Bozzone sounds almost eager for a downturn to hit. Says he: "We'll be a 500-pound gorilla with a great opportunity to gain share." Like a homeowner who tapes and boards his windows before a hurricane, managers should get ready now. Most CEOs, consultants, and business professors agree, though, that preparing for recession is more a matter of making adjustments in how you do things than of making major shifts in your strategy.

If you're a low-cost producer, get your costs down even more. If you're a customer-driven company, provide better service than ever. If your business is propelled by technology and its changes, launch as many new products as possible. Redouble efforts on all those up-to-date management tactics that should be second nature by now -- total quality, self-managed teams, just-in- time, and speed. If you haven't introduced such reforms yet, a recession could help you do so. Says Ray Stata, chief of Analog Devices, a Norwood, Massachusetts, maker of high-tech devices that link measuring instruments to computers: "When you're concerned about survival, people really get religion. The pressure is intense and the fear is mounting, so it's change or else." Stata, whose industry has been struggling through its own recession for the past two years, even was able to get his top managers to change their behavior.

He had long noticed that his executives often became excited about an idea but then, inexplicably, failed to act on it. The idea usually got shunted off to a committee, where it died. Last spring Stata asked his colleagues to borrow some management principles from quality sage W. E. Deming, a man more closely associated with improvements in the factory than in the executive suite. For one, Stata wanted ^ his top people to visit customers more. Deming's simple four steps -- plan, do, check, act -- forced the managers to do, rather than think about doing. Before long they were all getting out and helping improve business. NOT A MOMENT too soon.

In times of pending trouble, many seasoned managers find it pays to keep an extra-careful eye on demand to avoid that bugbear of past recessions, getting caught with inventories that could take painful months to work down. Says Corning group president Roger Ackerman: ''It's getting blind-sided that does the most damage.'' Corning has told its salespeople to look for recessionary signs: a slight drop in orders, a customer or supplier who suddenly starts haggling over prices, even something as seemingly innocuous as a customer's office in need of a new paint job.

The company is also using what has become a common manufacturing tool -- the just-in-time, or JIT, system of managing inventory -- to provide an early warning of recession and to lessen the threat it could pose. With JIT, customers order parts from Corning only as needed, and the company, thanks to an electronic ordering system, can supply them in a few days rather than the months it took under the old system. This allows Corning to track swings in demand much more closely. When Corning sees customers starting to pull back, it knows it's time to cut production and avoid a nasty buildup of inventory.

During recessions, the last thing you want to do is skimp on customer service, even though this may mean forgoing some cost savings. In the last slump, Delta Air Lines tried to save money by serving pretzels rather than peanuts. Passengers hated it. One told a stewardess, ''You're so cheap, you won't even spring for peanuts.'' It also sent the wrong signal to flight attendants, who assumed the airline was more interested in costs than service. Says CEO Allen: ''You've got to find ways to hold the line on costs without shaving service.''

The Home Depot chain of home improvement stores, one of the fastest-growing retailers in the country, works hard to fine-tune its service for hard times. It makes sure its sales force knows how to deal with the penny-pinching consumers. In September, for instance, CEO Bernard Marcus and President Arthur Blank appeared on their quarterly satellite broadcast to the troops, called Breakfast With Bernie and Arthur, to discuss how to deal with the psychology of recession.

THE MESSAGE they gave to their 20,000 employees, who watched the show on monitors in the stores: ''Since the consumer is stingy about spending money, you have to explain why he ought to spend and you have to fight like a spurned lover.'' Marcus suggested that his salespeople tell customers that it still pays to renovate even in this soft housing market. After all, real estate is cyclical and home prices will eventually bounce back. Or if you can't sell your house to buy a bigger one, why not turn the garage into a much needed bedroom? Says Marcus: ''We're getting our salespeople to look at a half-full glass, and we're going to increase sales no matter how bad times get.'' At 3M, some managers encourage salespeople to emphasize how products can help customers make it through a recession. Says Robert Hershock, a group vice president: ''I look at it as a real opportunity to go in and talk about the labor and cost-saving aspects of our products.''

SINCE COMPETITION from abroad won't allow you to slash costs across the board, it makes sense to divide up the elements of your business into two categories: those where it pays to increase spending (advertising, product development, and productivity improvements) and those where you can probably still get away with some careful pruning (maintenance, energy, outside contractors, and wages). Admittedly, to boost spending in a recession requires a killer instinct. Think murderous. Says Edward Lawler III, a professor of management at the University of Southern California: ''If you're strong, look at recession as an opportunity to deliver the death blow to some marginal players.'' In going on offense, one of the most potent weapons in a recession can be advertising.

That's in part because historically most managers have considered cutbacks in advertising the easiest and quickest way to reduce costs in a downturn. At the start of each of the last three recessions, the growth rate of ad spending slowed on average 27%. The trend continues. Today, in anticipation of a slowdown, ad spending growth is already flat, hurting many media companies, including Time Warner, parent of FORTUNE's publisher.

Some companies, like Delta Air Lines, Alberto-Culver, and Geico, play the ad game differently, finding that in tough times higher spending pays. In the last recession, for instance, Alberto-Culver raised its advertising and gained market share. Says President Howard Bernick: ''We've already had to tighten our spending this year, but we haven't cut a nickel from advertising.'' **|** In anticipation of recession, Delta Air Lines and Geico are already pumping up ad budgets. Delta, which has lost money in only one year -- 1983 -- since World War II, believes hesitant travelers need even more convincing during difficult times. Geico, one of the nation's leading auto insurers, is scanning markets nationwide to see where competitors are hurting most. Then it beefs up advertising and cuts prices in these regions.

The company says it is already gaining share. When faced with consumers who make

Ebenezer Scrooge look like Mother Teresa, it helps to shift your ad campaign from messages like luxury and status- enhancement to efficiency and value. Some car companies, including GM's Cadillac division, are now emphasizing miles per gallon. Until recently, Bertolli U.S.A., a division of Italy's SME Group, has been pushing the heritage and tradition of its olive oil -- peasants and silver olive trees and all. Worried about tight-fisted consumers changing to cheaper vegetable oils, the company will now stress olive oil's health benefits.

AFTER FINE-TUNING advertising and marketing, the most important thing a manager can do in a recession -- and one of the most counterintuitive -- is to fire off a broadside of new products. Customers are more fickle then ever in hard times, and they're not going to wait around while you, for cost reasons, keep your new products on hold, especially if the Japanese and Germans keep pumping out new stuff. But where will you get the bucks to launch all those new gizmos? Often the best source is triage on your R&D. If you take a hard-nosed look at all your projects, you can probably cut the number in half and still keep a lot of promising ones in the pipeline.

Says Philip Thomas, president of a Dallas trouble-shooting firm bearing his name: ''You can't let emotions get in the way. A lot of people stay in love with a project long after it's clear it's not going to be a success.'' But don't make the mistake of cutting projects simply because they're long term. ''If you get rid of the long-term projects,'' argues B.F. Goodrich CEO John Ong, ''you're mortgaging your future.'' Instead, it's better to ask which projects are most realistic both short and long term. Does the science behind them exist today, or do they depend on breakthroughs? Is there a market, or are you hoping one will materialize?

THOMAS RECOMMENDS focusing on evolutionary rather than revolutionary products. This means adding features to existing lines, a trick the Japanese % have perfected. You can get new products out more quickly this way, which translates into faster profits. The risk is a lot less too. Says Thomas: ''Home runs have a low probability of success, and in a recession I want to survive.'' Partly in anticipation of tough sledding for the auto industry, GM's Delco Electronics, which makes car audio systems and electronic engine controls for GM, Rolls-Royce, Toyota, and others, has sped up its new-product development time for integrated circuits from 42 months to 18 months. It has done this by making many small improvements in the product and by streamlining the design and manufacturing processes.

Improvements in productivity are another good place to invest during a recession. This isn't as much of a no-brainer as it sounds, because when you make manufacturing more efficient, you usually also increase capacity, which is the last thing you want when demand slackens. Says Harvard professor Steven Wheelwright:

"You need to make sure that the combination of better quality and lower cost pays for that extra capacity." That's just what Allegheny Ludlum, a Pittsburgh maker of specialty steel, is banking on. Though the company is already seeing signs of recession in its business, Allegheny is pushing ahead with an $85 million finishing mill that will increase capacity 30%.

That doesn't faze CEO Bozzone, who argues that the efficiency gains will let him deliver a better product quicker and gain market share. Says he: "Capital spending is a strategic focus, and the key is not to lose your focus and pull your horns in on everything." TJ International, a Boise, Idaho, maker of windows and specialty building materials, is taking a similar tack, investing millions in new processes to manufacture lumber products more efficiently. CEO Walt Minnick adds that a downturn is often the best time to tinker with your production facilities and work processes. You can't fiddle very much when a factory is running at full tilt, but in a recession there is plenty of idle machinery around for experimentation. Keep an eye out for cuts that look all too easy.

At Geico a manager wanted to trade in some of the company's fleet of 488 cars at 50,000 miles rather than the usual 40,000. The idea sounded like a money saver, but after looking more closely, managers found that holding on to the cars would actually cost more because of rising repair costs. Says Geico CEO William Snyder: "You have to ask yourself, 'If the idea is so good, why didn't you do it when times were good?' " With service such a high priority these days, companies that try to save by suddenly axing huge numbers of people will quickly find themselves at a competitive disadvantage.

There are ways, however, to lower payroll costs without big layoffs. Corning demonstrated this recently when it signed an unusual agreement with the union at its Blacksburg, Virginia, plant. The deal: When times get tough, outside contractors will go first. Idle Corning workers will clean the factory, manicure the grounds, and paint the halls. If the slump gets deeper, the company will move to shorter hours, then shorter workweeks, and finally, only if absolutely necessary, workers will be laid off. Says Corning's Ackerman: "We've spent a lot of time training these people. We don't want to lose them." He figures that eliminating contractors can reduce costs enough to equal the drop in sales he expects in a recession.

DELTA AIR LINES has a similar flight plan. The last time the company laid off a full-time worker was in 1957, partly because come good times or bad, the company never lets its head count grow faster than capacity. In addition, about 8% of Delta's work force is made up of employees who understand that their jobs are temporary. When turbulence hits, the company will furlough those workers rather than the ones whose positions are considered permanent. If that doesn't do the trick, Delta will still try to avoid layoffs. In one recession the company reassigned some of its pilots to handling baggage on the assumption that it can always use extra hands to improve service. Streamlining the work process can produce big savings, especially in the office. Says consultant Philip Thomas: "The administrative process is still sloppy and slow." A lot of paperwork doesn't contribute much value to your product or service.

At one FORTUNE 500 company the head of R&D held formal quarterly evaluations on all his projects. His scientists and engineers spent weeks preparing for them. After one session, Thomas asked the boss, "What did you add to your new products?" The chief sat back, thought a moment, and said, "Not much." After that he did away with reviews. If streamlining results in excess people, you can switch them to sales and marketing, whose ranks can always use strengthening.

RECESSION VETERANS like Delta CEO Allen insist that you must have a system that allows you to start cutting costs the moment a downturn hits. At Delta, managers work without an annual budget. Every expenditure over $5,000 -- jet fuel excepted -- must be approved by top management. Every Monday morning Allen and his top aides pore over a list of 40 or so expenditures. If times get tough they can immediately knock out a request for replacing an old Xerox machine or painting a terminal. The process sounds cumbersome, but it forces every manager in the field to think hard about what's really necessary before kicking a request up to the CEO.

Says C. D. Turner, a Delta manager who runs the baggage handlers, ticket takers, and others at the Atlanta hub: "If it's not something I absolutely need to run that old baggage tug, I don't ask for it." At Corning, group president Ackerman takes a different approach, dividing his budget into three major categories: expansion of business, productivity improvements, and maintenance. In a recession Ackerman will always try to cut maintenance before touching the other two. Do you really need to pave the parking lot or to put a new roof on your factory? Ask yourself if a patch job might not do just as well. Once you've squeezed all you can out of maintenance, you might find some marginal savings in energy.

As in the recession of the 1970s, it's probable that a downturn now would be aggravated by high energy prices. In response, use the same old commonsense drill. Brush off those energy savings plans that you hatched during the last OPEC crisis. Turn the thermostat down, encourage people to wear sweaters in the winter, and conserve power whenever possible.

IF YOU'RE UNFORTUNATE enough to be running a highly leveraged company, do yourself a favor and unload as much debt as possible before the maelstrom hits. One quick way to raise cash is to sell some businesses -- and soon. Says consultant Nadler: "Companies still waffling over marginal businesses should face up and dump them.'' You can't dither, for once a recession hits, prices of assets will plummet -- it's already happened in some industries like banking, autos, and real estate -- and then it's no time to sell. If you're on the other side of the equation, sitting pretty with a strong balance sheet, you can look at the recession as a great time to pick up cheap assets. But, warns Goodrich CEO Ong, ''the business you buy has to fit your long-term strategy tighter than a glove.'' And think about incorporating the possibility of recession into that strategy, even if it's a little late to start now.

Instead of merrily assuming healthy growth as most companies do, Delta Air Lines and TJ International, the Idaho lumber outfit, build assumptions of recession into their long-term plans. In its ten-year plan, Delta forecasts two sharp recessions, an exercise that forces it to keep debt low enough (currently 34% of capitalization) to allow it to continue to expand through a slump. Though the airline industry is already hurting, Delta is sticking to plans to fly to 11 new cities overseas, invest $300 million to expand its maintenance facilities at the Atlanta airport, and add 35 planes to its fleet this year alone.

Probably the worst thing you can do in a recession is to panic and, like some corporate lemming, lead your company off a cliff in the name of cost savings. The recession will end someday. If you've done little during the bad times to boost service, improve your products, or bring out new ones, you'll be way behind when the bright skies eventually dawn.

http://money.cnn.com/magazines/fortune/fortune_archive/1990/11/05/74313/index.htm