

RECESSION

# Avoid Making This Strategic Mistake in a Recession

by [Michael Greiner](#) and [Scott Julian](#)

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Illustration by Israel G. Vargas

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We are currently in the midst of the most severe economic crisis since the Great Depression. The unemployment rate has hit a record high, and the International Monetary Fund is predicting a drop in our GDP of nearly 6 percent this year. If this is purely a supply shock, then our economy should recover quickly once restrictions on economic activity are lifted. On the other hand, according to a report from the Becker Friedman Institute of the University of Chicago, 42 percent of the jobs lost so far in this crisis could be permanent losses. If that is the case, then this supply shock will turn into a demand crisis much like the Great Recession of 2008, and recovery will be much slower. With so much uncertainty, what should a strategist do?

We looked at data from the period right before the 2008 recession addressing how 5,278 publicly-traded firms fared based on their generic strategy of being either pure differentiators or pure cost leaders, according to Michael Porter's theories. Differentiators compete based on a variety of factors, such as quality or service, rather than prioritizing low prices. Cost leaders, on the other hand, focus their strategy on reducing costs thus enabling them to offer the product for the lowest possible price. Porter says either strategy will be successful, as long as the strategic orientation is pure. But in our analysis, differentiators were significantly more likely to suffer reduced revenues than cost leaders in the Great Recession and were significantly more likely to go out of business.

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In light of this, a thoughtful strategist might think it wise to change strategies by moving toward cost leadership. After all, moving from differentiation toward cost leadership makes a certain sense; everyone tightens their belts in a recession, particularly a severe one. Consumers reduce their spending and look for cheaper suppliers.

Businesses seek to reduce their expenses to weather the storm. Especially in an environment as unpredictable as we had in 2008 (or as we have now), cutting costs becomes a central focus of most businesses' efforts. However, our data do not support

changing strategies to become a cost leader during a recession. We found that when differentiators moved toward a cost leadership strategy such efforts did not help them. In fact, we found that changing strategy did not increase firm chances of surviving the recession, nor did it improve the firm's revenues or its finances.

This is the lesson of the Great Recession for strategists: cost leaders have a head start. As both kinds of firms seek to reduce costs to survive and reduce prices to attract more cost-conscious customers, cost leaders have the advantage because they are structured for such an approach. This is exactly the problem to which Porter pointed. In a competition to become more of a cost leader, the cost leader always wins. So, what should a differentiator do? Our research does point to some concrete lessons for strategists at differentiator firms during recessions.

First, do not try to change strategies. A differentiator will never out-cost leader a cost leader. As a result, differentiators are better off focusing, and trying to build, on their strengths. Next, reduce costs quickly, to a point. When faced with uncertain demand, firms need to lower costs as quickly as possible in an effort to marshal resources for a long fight back. Waiting to reduce costs in the hope that the recovery comes quickly will put a firm in a difficult position if that gamble turns out to be wrong. At the same time, the firm must be careful that these cuts do not jeopardize its ability to deliver a differentiated product or service. Finally, know that there is no easy solution. Simply reducing prices will not solve the problem. Unless you are the industry's low-cost leader, there will always be someone who can provide your goods or services at a lower price. Therefore, you need to mine the entrepreneurial fire that helped build your firm in the first place. Focus on your strengths. The advantages that made your product or service worth more than what the cost leaders offer still apply. You just need to make that case to your customers.

The good news is that most firms did survive the 2008 Great Recession. You might lead one of those firms. If that is the case, you know exactly what kind of hard work is required to survive a crisis of this magnitude. Imagining the grass to be greener for those following a strategy very different from yours, however, is not a viable solution.

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