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## HANGING TOUGH

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In the late nineteen-twenties, two companies—Kellogg and Post—dominated the market for packaged cereal. It was still a relatively new market: ready-to-eat cereal had been around for decades, but Americans didn't see it as a real alternative to oatmeal or cream of wheat until the twenties. So, when the Depression hit, no one knew what would happen to consumer demand. Post did the predictable thing: it reined in expenses and cut back on advertising. But Kellogg doubled its ad budget, moved aggressively into radio advertising, and heavily pushed its new cereal, Rice Krispies. (Snap, Crackle, and Pop first appeared in the thirties.) By 1933, even as the economy cratered, Kellogg's profits had risen almost thirty per cent and it had become what it remains today: the industry's dominant player.

You'd think that everyone would want to emulate Kellogg's success, but, when hard times hit, most companies end up behaving more like Post. They hunker down, cut spending, and wait for good times to return. They make fewer acquisitions, even though prices are cheaper. They cut advertising budgets. And often they invest less in research and development. They do all this to preserve what they have. But there's a trade-off: numerous studies have shown that companies that keep spending on acquisition, advertising, and R. & D. during recessions do significantly better than those which make big cuts. In 1927, the economist Roland Vaile found that firms that kept ad spending stable or increased it during the recession of 1921-22 saw their sales hold up significantly better than those which didn't. A study of advertising during the 1981-82 recession found that sales at firms that increased advertising or held steady grew precipitously in the next three years, compared with only slight increases at firms that had slashed their budgets. And a McKinsey study of the 1990-91 recession found that companies that remained

market leaders or became serious challengers during the downturn had increased their acquisition, R. & D., and ad budgets, while companies at the bottom of the pile had reduced them.

One way to read these studies is simply that recessions make the strong stronger and the weak weaker, since the strong can afford to keep investing while the weak have to devote all their energies to staying afloat. But although deep pockets help in a downturn, recessions nonetheless create more opportunity for challengers, not less. When everyone is advertising, for instance, it's hard to separate yourself from the pack; when ads are scarcer, the returns on investment seem to rise. That may be why during the 1990-91 recession, according to a Bain & Company study, twice as many companies leaped from the bottom of their industries to the top as did so in the years before and after.

Chrysler's fortunes in the Great Depression are a classic instance of this. Chrysler had been the third player in the U.S. auto industry, behind G.M. and Ford. But early in the downturn it gave a big push to a new brand—Plymouth—targeted at the low end of the market, and by 1933 it had surpassed Ford to become North America's second-biggest automaker. On a smaller scale, Hyundai has made huge gains in market share this year, thanks to a hefty advertising budget and a guarantee to take back cars from owners who have lost their jobs. Those gains may turn out to be temporary, but in fact the benefits from recession investment are often surprisingly long-lived, with companies maintaining their gains in market share and sales well into economic recovery.

Why, then, are companies so quick to cut back when trouble hits? The answer has something to do with a famous distinction that the economist Frank Knight made between risk and uncertainty. Risk describes a situation where you have a sense of the range and likelihood of possible outcomes. Uncertainty describes a situation where it's not even clear what might happen, let alone how likely the possible outcomes are. Uncertainty is always a part of business, but in a recession it dominates everything else: no one's sure how long the downturn will last, how shoppers will react, whether we'll go back to the way things were before or see permanent changes in consumer behavior. So it's natural to focus on what you can control: minimizing losses and improving short-term results. And cutting spending is a good way of doing this; a major study, by the Strategic Planning Institute, of corporate behavior during the past thirty years found that reducing ad spending during recessions did improve companies' return on capital. It also meant, though, that they grew less quickly in the years following recessions than more free-spending competitors did. But for many companies recessions are a time when short-term considerations trump long-term potential.

This is not irrational. It's true that the uncertainty of recessions creates an opportunity for serious profits, and the historical record is full of companies that made successful gambles in hard times: Kraft introduced Miracle Whip in 1933 and saw it become America's best-selling dressing in six months; Texas Instruments brought out the transistor radio in the 1954 recession; Apple launched the iPod in 2001. Then again, the record is also full of forgotten companies that gambled and failed. The academics Peter Dickson and Joseph Giglierano have argued that companies have to worry about two kinds of failure: "sinking the boat" (wrecking the company by making a bad bet) or "missing the boat" (letting a great opportunity pass). Today, most companies are far more worried about sinking the boat than about missing it. That's why the opportunity to do what Kellogg did exists. That's also why it's so nerve-racking to try it.

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