Growth Strategies in Turbulent Times

Presented at:
The 10th Nikkei Global Management Forum
Tokyo, Japan
October 27, 2008

Andrew N. Liveris
Chairman & CEO
The Dow Chemical Company

Good Morning.

Thank you, Nomura san, for those nice words and for inviting me here today.

This conference is very timely. It has an incredible assembly of speakers and a great set of program topics. As the day progresses, however, I believe each of the speakers today – regardless of their topic – will have to address current world events, and the ramification on their business and their strategies.

These are tumultuous times. Everyone in this room – and outside this room – has the same questions as they look at the volatility of the stock markets and markets in general as they stumble, weaken and even crash … as they watch governments come to the rescue with an array of different answers to unfreeze credit, to calm markets, restore confidence and to stimulate their economies.

Everyone is asking: How long will this last? How bad will this get? Is my company safe?

It's a good time to step back from the day-to-day worries and remind ourselves of the one major psychological weakness of our species. We Homo sapiens are eternal optimists when times are good … but manic depressives when times are bad.

Mr. Greenspan several years ago warned of "irrational exuberance" at the height of the Internet bubble. Perhaps what we need now is someone of his stature to warn us "excessive desperation" in the middle of this crash.

There is an old proverb we should do well to remember during times like this: "This too shall pass."

Having framed these times with a degree of sanguine optimism, let me return us to the reality of the moment.

The correction in the markets is very severe. It will have lasting consequences.

Countries will change their competitive positions. Instead of putting all of their hard-earned savings into one economy – the U.S. – they will diversify their portfolios to other instruments and to other geographies.

Financial centers will change their centers of gravity. New York will likely become less powerful. The UK must and will rethink its heavy reliance on financial services.

At the same time, petro-dollar economies are using their trillion-plus dollars in annual wealth transfers from other countries to build different value-add sectors to diversity their economies.

And the list goes on and on.

The point is this: in moments of great change, change will occur. And change has everyone feeling nervous.

In fact, I thought the mood was captured wonderfully by the front cover of a US business magazine recently. It simply asked the question: Is it safe yet?

Of course, the question implies that there **is** a safe time for businesses. You and I know differently.

If you've been in business long enough, you develop a sixth sense that tends to divide things into two categories: Risky times … and even riskier times.

But it's rarely safe, even when the global economy is good and business is booming.

I remember a story about legendary CEO Jack Welch who recalled a period when GE was winning in every aspect of its strategy. Record profits. Magnificent cash reserves and cash flow. No problems anywhere in the company.

Jack said he looked at all of that and concluded that, instead of smooth sailing, GE was sitting on the most comfortable chair on the Titanic.

The fact is that even good times carry their own risks. And times like these can be extremely frightening.

Two points are worth remembering here. First, there is very little any of us can do to change and even predict the external environment. It is what it is and it will be this way for at least the next six to nine months, or possibly much longer.

Secondly, if we can't change the external environment, then there is really only one option left.

As the Austrian psychiatrist Victor Frankl noted: "When we are no longer able to change a situation, we are challenged to change ourselves."

The really good companies know this. They are the ones that see opportunity in both good and bad times.

So what I'd like to do today is first, give you a wide picture of how we at Dow view the current economic crisis … how it compares to others in history, and what lessons we can learn from taking a broad view.

Then I'd like to put the crisis into a business context.

Do we see this as a crisis or an opportunity? If an opportunity, how do we seize the offensive without increasing our vulnerabilities?

As the CEO of a company that operates more than 500 plants at 250 sites in 175 countries, I hope I can offer a broad view of the current situation. Clearly we don't have all the answers, but neither do the many, many economists studying the problem.

In fact, after listening to the economists talk and talk and talk, you would be forgiven if you felt even more confused now than before.

On the one hand, they are predicting that we are already in the middle of a recession and are probably heading on the way out.

On the other hand, they say the events of the past several months are unprecedented and they're sure that this will be along and protracted recession unlike any other that we have ever seen.

All of the wavering and uncertainty and competing theories by our economic experts just goes to prove the point first made by the Irish playwright George Bernard Shaw who said: If all the economists were laid end to end, they would never reach a conclusion.

Sometimes I think economists were only created to make weather forecasters look good.

To their defense, this is a uniquely modern problem. The breadth and volatility of our current crisis has never been seen before. We have never been as global and as connected as we now are.

But I would submit that this financial crisis is not necessarily unique in terms of history.

In fact, history is full of similar financial crises.

Ever since there have been tradable goods, there have been ups and downs in the market.

We can go back to the days of ancient Egypt and find recorded evidence of economic cycles due to unpredictable wheat harvests.

And there have been bubbles, too. Think Amsterdam in the 1600s when the mania over tulip bulbs raged for 12 years before it collapsed.

At one point, single tulip bulbs were valued the same as entire country estates! Some were valued at twice the amount of Rembrandt's paintings.

Unrestrained exuberance … herding behavior … a lack of risk management discipline … greed without fear … followed by fear and anxiety and the black holes of the inevitable crash.

We've been here before. In fact, there have been at least 30 such economic cycles over the past 150 years. So we shouldn't be surprised.

But as Milton Friedman, the Nobel laureate in economics once pointed out, the one thing we learn from history … is that we don't learn from history.

Oftentimes, each generation has to relearn the mistakes of the past.

In truth, there are really only three things that separates today's economic troubles from those of the past.

One is that it's here before we expected. The frequency of the boom/bust cycle is coming quicker and quicker.

The second aspect is that this crisis truly is global and pandemic. So much for the de-coupling theory.

The third item that makes this cycle different is that the amplitude is unprecedented. Massive amounts of capital are flowing around the world today.

The amount of capital flowing around the world – relative to global GDP – has quadrupled over the past 10 years and continues to flow quickly from place to place in unprecedented amounts.

The sudden rush of money into ... and out of … a country is debilitating, especially for those that don't have financial or physical hedges as a buffer.

These countries look at their sudden wealth brought about by huge capital inflows and begin pouring money into massive infrastructure projects that don't equate to their productivity – and they suffer greatly when the money rushes out again.

This is a fairly new phenomenon, of course. None of us are used to – or quite know how to react to – these wild, finance-induced swings to our economies.

One very powerful physical hedge I have promoted is manufacturing. For many years I've encouraged countries to remember manufacturers when they consider their economic development plans.

Making things – real things – still matter. I'm afraid we've lost track of that in our collective rush to develop and build the services sectors – like the financial and retail and entertainment sectors.

There is a U.S. based writer – Kevin Phillips – who captured this quite clearly in a book last year in which he warned about the global crisis we're now in. His premise was that the over-reliance on the risky money of the financial sector was pushing the good, hard money of manufacturing out of the markets.

"Moving money around instead of making things," Phillips wrote, "is always dicey."

This is just one reason it distresses me to see countries – like the UK, like the U.S. and even like Japan – lose manufacturing jobs and manufacturing capacity and all the many positives that accrue from that.

Countries that build productive capacity – that produce physical goods and not just services – are more prone to having collateral during times of financial stress.

Manufacturing not only provides another layer of good-paying jobs, it's an overall value-add to the economy.

This country knows perhaps as well as any what the multiplying effect of manufacturing is. How it can take natural resources and change them into consumer goods like cars and computers and TV's that people around the world want and value.

Japan was the first non-Western country to industrialize and take advantage of that multiplying power. And for years the phrase – Made in Japan – has been an iconic statement of innovation and quality. And yet only one other country has lost more manufacturing jobs on a percentage basis than Japan over the past 20 years: the UK.

I'm sure Japan does not want to copy the UK economic model which has no physical hedge whatsoever against the current crisis. The UK completely lost its manufacturing base over the last several decades, and now is totally exposed to the financial services sector.

The bottom line is this: with Japanese banks in relatively strong positions, with the other Asian economies still in relative growth mode, with your history of innovation and proven ability to serve the entire world with cutting-edge products, you have an opportunity to accelerate your leadership position after the lost decade of the '90s.

I don't think it's a matter of having to choose, by the way, between short-term measures and long-term success. It's not an either/or proposition. Build for the long-term but execute relentlessly on short-term objectives.

I firmly believe that's not just good advice for a country, it's solid advice for companies. Individual companies. Regardless of the global economic outlook.

Or, perhaps a better way to say it is: precisely because of the economic outlook, now is the best time for activity on the macro and micro levels.

Let me explain.

Ask any school child to pick between either one chocolate sweet today or three tomorrow … and tomorrow doesn't stand a chance. Ask most managers to choose either long-term growth or making the next quarterly numbers, and you get a similar response. There is a strong predisposition to the here and now, especially so in the U.S.

My philosophy is that we're often asking managers the wrong question. It's not an either/or proposition.

Companies today must have both: a long-term outlook coupled with near-term execution that builds a sustainable enterprise. And I underline the word – sustainable.

And there are two broad areas here we need to think about. One is guarding the core of our business and protecting against losses.

That's the normal reaction in times like these. But it's not enough. In fact, if you are only in a defensive mode, you run the risk of paralyzing the entire company.

The other – and I would submit more powerful – area is looking for opportunity. Let me take this one first and begin with the results of a study completed by Bain & Company.

This group did an 8-year, 2,500 company study and found that economic turmoil, contrary to popular belief, actually created vast opportunities for companies to move into leadership positions. During the last great economic downturn in 2001, for example, 24 percent more firms moved from laggards to leaders than in the economically calm period earlier.

In fact, the companies that made acquisitions during a downturn generated triple the returns of companies that made acquisitions during the boom cycle.

This reconfirms a lesson from the Great Depression which gripped the U.S. 80 years ago. There were more millionaires created during the Great Depression than at any other time in U.S. history.

In both cases, individuals and companies saw opportunity. More importantly, they acted on those opportunities.

The fact is that the current crisis is taking its toll on companies with shaky balance sheets. Add to that the very real reaction most have to crises like these: to shed businesses and retrench in terms of products, services and geographies.

Assuming your balance sheet is healthy at the beginning of a crisis – more on that in a moment – this is an excellent time to accelerate the implementation of your strategy.

That is what we are doing at Dow.

We are moving quickly forward to fulfill the transformation of our company, a strategy that we announced several years ago.

Many of you may have heard, for example, of Dow's ground-breaking joint venture with the Kuwait Petrochemicals Corporation. We announced the deal last December to put much of our petrochemical business into a joint venture with them.

We are very close to closing that win-win deal.

The deal makes sense on two fronts.

First, it merges our petrochemical rich businesses with a first-class company, PIC, which has access to the raw materials for those products. That ensures those businesses will have a competitive cost position going forward.

Remember what I said about petro-dollar economies diversifying their sectors.

Secondly, it frees up cash we can use to grow the less cyclical part of our business: advanced materials and specialty chemicals.

And, in fact, we're doing that with the acquisition of Rohm and Haas we announced earlier this year. Rohm and Haas has a great platform, great technology and is a great compliment to our own specialty products which have great growth potential.

When combined, Rohm and Haas and Dow will be one of the largest advanced materials companies in the world with an R&D budget of over $1.6 Billion geared to growth markets like electronics, water purification, healthcare, infrastructure and transportation.

It's important to take care of our near-term fiscal challenges. But let's not forget that between now and 2050, we will be joined by some three billion additional people on this planet. And every one of them will be demanding the kind of quality of life you and I enjoy today.

These are the people who will be buying their first refrigerators, their first televisions and MP3 players and their first homes. Earlier this year the International Monetary Fund projected the number of automobiles by themselves will increase some 2.3 billion by 2050.

The good news for Japan – which already makes some of the best automobiles in the world – is that somebody will have to manufacture all those cars.

But keep in mind that those people will also need clean energy to fuel all of those cars. They'll expect much higher levels of health and nutrition than are available to them today.

The emerging economies in particular – China, India, Russia and Brazil as well as Southeast Asia – will be building new infrastructure to support this growing population.

Those represent real market opportunities. They represent areas where innovation will play a heavy role.

They're there – today – for the right companies to take advantage of them.

So my advice, first and foremost, is that we look for ways to strengthen our core businesses and fill the gaps in either products, geographies – or even people – who can help reach those new markets.

There have been some major examples of that in the news just recently.

In the U.S., Bank of America's acquisition of Merrill Lynch may turn out to be one of the best strategic acquisitions in modern history.

One company with a strong balance sheet. One in distress but with very attractive valuations. It's a good strategic fit and a very good investment.

Other examples? Eli Lilly just announced a bid to buy Imclone and just two months ago HP completed its buyout of EDS. Great examples of companies seizing opportunity when it arises.

Investments during this time period aren't limited to hard assets, by the way.

Now is also a great time to invest in those things that will return the most when the economy turns back to the good. Those include, by the way, investing in ethics – especially in periods of stress like these.

But it also means not abandoning the communities where we operate. Look for ways to make investments – either in time, money or in-kind gifts – that will help them cope, too.

And, finally, we have to continue investing in R&D. I said it earlier but I'm a firm believer that innovation is the driver. And while it's tempting to cut R&D today, you'll pay for it tomorrow.

That's why Dow's R&D spending has increased by about 30 percent in real dollars over the past decade. And it's why 35 percent of Dow's sales last year were from products introduced in the past five years and we have a pipeline of more than 300 major R&D projects.

Now, what I've been describing is your long-term strategy, right?

But we know that when the economy turns bad like it has today, those five-year plans we have jotted down on a piece of paper somewhere are no longer very static. They become dynamic and we must address – constantly and immediately – the external realities of the day.

I mean, Dow itself is not immune to near-death experiences. We've struggled, too, in our 111 year history.

But a near-death experience <u>can</u> be a catalyst for change. As the saying goes, there is nothing quite so invigorating than to be shot at and missed.

So we've learned the hard way that if we want to be able to take advantage of growth opportunities, we first have to manage the day-to-day finances of the business.

It's absolutely become ingrained in our culture because we don't want to repeat those painful episodes of the past.

This is business school 101 that many of us are forced to re-learn from time to time … beginning first and foremost with an almost obsession with financial discipline.

A study by McKinsey and Company found that the companies that tended to do best when the economic cycle bottomed out were the ones that made the hard decisions early in the cycle to improve their balance sheets. They didn't hesitate to cut discretionary spending, build cash and focus on the core.

Turbulence like this has a tendency to uncover the weak spots in any organization. Listen very carefully to what your operations say about the external realities. Constantly review where value is created in your operation, support those areas and cut the non-productive areas quickly.

The key is to maintain a long-term vision and direction … to stay the course on strategy and to be nimble and agile enough to change your tactics as the waters get rougher.

Remaining financially disciplined at all times means you earn the right to implement your strategy. Knowing where the "extra weight" on your ship is … knowing if it's "dead weight" or ballast, if you will, is critical.

Knowing when you need it and when you don't. Adjusting your compass based on the conditions of the here and now but being unwavering in your direction.

Remember what I said earlier about human nature. In times like this, it's natural for us to assume the worst.

And the tendency for all of us is to tie our ships of commerce tight against the docks and wait the storm out. But let me remind you of an old saying: Ships are safe in harbor, but that's not what ships are for.

Instead, we should – each of us – take up the challenge issued by American author and humorist Mark Twain.

"Twenty years from now," Twain said, "you will be more disappointed by the things that you didn't do than by the ones you did. So throw off the bowlines. Sail away from the safe harbor (and) catch the trade winds in your sails."

We at Dow have been living up to Twain's words with our own mantra: "Embrace reality. Make choices. Lead change."

We have made ourselves financially fit and have stayed fit as an organization and as an enterprise.

We have understood the storms the world has thrown at us and made our course adjustments. And, finally, we have followed three simple rules that help us survive tumultuous times like these.

I'd like to close my talk by leaving you the three rules we live by:

1. We reinforce strategy, discipline, ethics, and become more agile to seize opportunities.

2. We don't listen to consultants or economists.

3. We tone down the panic and anxiety and go about the day-to-day business of restoring confidence and optimism.

Maybe everyone should do the same?

Thank you.

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