Thinking Strategically during the Global Downturn

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The global recession has likely created a structural break in the global economy. Businesses thus need to reassess their strategies for operating in a highly integrated global economy. Initial reactions have often been defensive, including downsizing and calls for government support. However, times of crisis are also times of opportunity. In the short-term, opportunities arise for instance in 'value for money' segments. However, for long term opportunities, businesses have to develop foresight to use the economic downturn to position themselves for the next upswing.

The current public debate largely focuses on the origins of the crisis,[1] yet it is time to look forward to ask, ***how can businesses survive the crisis, and position themselves for the recovery whenever it may come?*** I aim to initiate this forward-looking debate. My main focus thus is on generating ideas, rather than to provide definitive answers. I thus hope to stimulate discussions in the AIB community, and I shall share my view as the crisis evolves on my blog at www.klausmeyer.co.uk/blog (you may also find this blog useful to complement your teaching of international business during these volatile times).

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Some Stylized Trends

The financial crisis originated from the financial sector in the USA and the UK. At the core appear to have been unsound lending practices by financial institutions, notably in the private mortgage lending sector, and unsatisfactory risk management practices (Haldane, 2009). In 2008, the contagion spread worldwide, causing an unprecedented credit squeeze as inter-bank lending came to a virtual hold. In consequence, businesses faced liquidity squeezes and consumers cut back their expenses. Worldwide GDP growth has slowed from 5.0% in 2007 to 3.7% in 2008, and in July 2009, the IMF predicted a drop (!) of 1.4% over the year 2009 (-3.8% in advanced economies and +1.5% in emerging and developing economies).[2] At the risk of oversimplification, we can summarize the crisis as follows:

1. The collapse of parts of the financial sector has created an intensive credit squeeze in autumn of 2008 that drastically reduced credit available to the real economy.
2. Asset prices have declined sharply as the burst of the housing market bubble in the USA and some other countries reduced the nominal wealth of private individuals.
3. The decline of stock markets reinforced the decline in the value of privately held assets.
4. Falling (nominal) wealth and uncertainty regarding job security depressed consumer spending, especially in the advanced economies, yet with widely varying impact across industries.
5. Exchange rates shifted considerably during 2008, including a dramatic depreciation of for instance the British pound and several East European currencies, a continuously strong Euro, and a US$ recovering from a period of relative weakness.
6. Commodity prices have declined from all time highs in 2008, providing a (probably temporary) relief of demand pressures that saw prices climb to unprecedented heights in 2008.
7. Businesses are laying off staff, resulting in rising unemployment, and anxiety among the remaining workforce. In conjunction with an emergent capitalism, critique might lead to stronger pressures from trade unions and other NGOs on economic policies.

The contagion appears to be world-wide. News commentators around the world seem to believe their own country to be less affected than most, yet this is often self-delusion. Specific effects may have a stronger effect on some countries than others, yet no-one seems to have escaped the crunch entirely.

Critical for the halting or continuation of the crisis are the ***expectations*** of consumers and decision makers in business. Any economic decision is shaped by the decision makers' expectation of future states of the world. In 2009, these expectations are characterized by a high degree of uncertainty. Key economic variables are more volatile and thus increase economic risk measures, while the awareness of the possibility of events not captured by conventional risk measures has been amplified, thus further increasing ***perceived*** uncertainty. Moreover, expectations appear to have a downward bias as a general 'sense of fear' is pervading society, nourished by dramatizing accounts in the media, which might create a self-fulfilling prophecy.

Public policy has reacted to these dramatic developments by very large fiscal stimulus policies, while monetary policy has been expansionary, lowering interest rates to historically low levels. These policy responses are fundamentally different from, for instance, the responses in 1929 when tight fiscal and monetary policy magnified the impact of the financial crisis (Galbraith, 1955; Krugman, 2008; von Mehren, 2009).

Further important policy initiatives are expected to redesign the regulation of the financial sector. In essence, such regulation must establish that those taking decisions to bear risk, such as assessing a client's credit worthiness and approving a loan, also bear the costs should the loan not be repaid. Successful redesign of the financial sector regulation and restructuring of the sector are essential to re-establish trust in banks, and to ease the credit squeeze (Johnson, 2009). A third area of public policy that might have an important impact are policies affecting international trade. Although political leaders are publicly committed to free trade, considerable concerns exist regarding the credibility of such commitments.

Business Strategies for the Crisis

How can businesses handle the imminent threats of the downturn? In the short-run, survival strategies have to address immediate threats, and may exploit temporary opportunities. In the long-run, companies have to position themselves strategically for an upswing in a 'new economy' that may be very different than the recent economic boom (Table 1).

Table 1: Opportunities of the Crisis: Key markets

Markets	Survival Strategies (short-run)	Strategic Positioning (long-run)	Challenging decisions
Finance	Retain cash flow to enhance flexibility. Sell peripheral businesses to increase financial resources.	Opportunities for those with cash reserves to acquire businesses with liquidity constraints.	Trade-offs between short-term liquidity constraints and long-term strategic investments.
Real estate and housing	Avoid high leverage to reduce risk of negative equity.	Acquire real estate at much lower prices.	Will housing prices drop further? When is the right time to buy?
Corporate assets	Avoid high leverage to reduce risk of bankruptcy.	Implement strategic change that had been inhibited by organizational inertia. Acquire assets at much lower prices.	Will share prices drop further? When is the right time to buy?
Consumer goods and services	Opportunities in niches likely to be resilient during the crisis (see Table 3).	Position in segments with long run growth potential. Develop new business models for the new economy.	Trade-offs between short- and long-term market positioning
Currencies	Flexibly shift operations to countries with devalued currencies.	Retain operational flexibility to react to future exchange rate re-alignments.	How much to base investment decisions on current exchange rates?
Natural resources	Smoothen the phase-out of energy and resource intensive technologies.	Continue to adapt to in the long-run likely higher resource costs.	How much advantages are to be gained by energy and resource saving technologies?
Labour	Downsize non-essential labour.	Retain labour that is essential for long term strategies. Train and engage staff to build a loyal workforce.	How to afford keeping people on the pay-roll when demand is low?
Public policy	a) Opportunities for sectors targeted in stimulus programmes or subsidies b) Lower interest rate create opportunities to raise capital c) Financial re-regulation should reduce costs of capital d) Protectionism may create opportunities to enter protected segments.	a) Build capabilities for long-term competitive advantages b) Invest in real assets protected from the threat of inflation c) Build solid banks using 'old-fashioned' banking principles d) Don't expect long-term prosperity in niches creates solely by protectionism.	How to predict what governments will do next?

Thinking Strategically

First priority for many businesses is to secure their cash flow, to reduce creditor risk, and to retain liquid assets. Yet, at the same time, cash-rich firms may face unexpected opportunities to acquire other businesses at depressed share prices, notably businesses facing liquidity problems. A critical decision for businesses contemplating M&As as well as individuals contemplating buying a home is the timing of their investment. Ideally, they would want to buy at the bottom of the market. However, there is no way of knowing when this bottom is reached. In fact, when a consensus suggests that the bottom has been reached, this will impact expectations and drive up prices again.

Market growth is likely to be slow in many industry segments that are affected by falling consumer spending and business purchasing, as I briefly discuss later. In the longer run, the next upswing is likely to be associated with new technologies and business models.

Exchange rate movements may in the short run trigger relocation of activities. Yet, in the long term, the US$ may not remain as strong given the US' twin deficits (trade and budget), dependence on imported raw materials and a shaky banking sector, while the Chinese Yuan in particular may appreciate due to the relative weakness of its main trading partners. Thus, exchange rates remain highly instable and difficult to forecast. Long-run strategies should thus create operational flexibility to readjust to future exchange rate movements.

Lower commodity prices benefit businesses by easing the pressures to restructure. Yet, some prices remain high, notably precious metals. Long-run strategies thus need to consider the fundamental pressures that drove up prices in the first place, such as environmental costs and the increased demand from India and China. Businesses thus have to continue to adapt to what in the long-term will likely be higher resource costs, and develop technologies to economize on these scarce resources.

With respect to labour, many businesses face challenging decisions. On the one hand, financial constraints and falling demand suggest downsizing the workforce. This may be an opportunity to streamline the organization and cut excessive slack. However, for many companies their workforce is (one of) their most valuable resource, and once dismissed, the human capital may be lost forever, which would undermine their long-term competitiveness. Hence, companies ought to think forward and retain and in fact upgrade the workforce that shall carry the company into the new economy.

Government policy intervention is creating specific opportunities for sectors favoured in fiscal stimulus programmes or protection. In many cases, increased government investment may benefit for example the construction sector, 'climate change' causes or vocational training; elsewhere subsidies may help politically influential but declining industries. Yet, if businesses in these sectors expand, they need to be aware of their dependency on government spending, which is likely to be reduced once budgets are tightened again. Recall the German recession of the mid 1990s when the construction industry suffered from its overexpansion during the government-spending driven post-unification construction boom in Eastern Germany.

Table 2: Market Opportunities During the Recession

Opportunity	Examples	Challenging Decisions
Low cost retail	Discount supermarkets for food and clothing	Is it worthwhile going downmarket, thus taking the risk of downgrading the brand?
Basic need goods	Non-branded consumer goods, foods	How can we innovate to deliver essentials at lower costs?
Help customers save costs	IT system providers, energy saving technologies	How can we convince customers that now is a good time to invest?
Help customers manage uncertainties	Risk sharing contracts	How can we assume risk on behalf of customers when credit is scarce?
Career breaks	Education, especially post-experience programmes, gap year travel, social work	How can we invest in new programmes when budgets are tight?
Entertainment	Domestic tourism, home entertainment, take-away food, sports	How can we develop budget services that fit current budget constraints but can go upmarket when the economy picks up?

Market Opportunities during the Recession

Identifying markets that are likely to be resilient and potentially growing during the recession requires analyzing what people and businesses are likely to do ***more*** during the recession. This leads to several general ideas that may be applicable to a wide range of businesses (Table 2).

The most evident growth potential exists in the low price segment as many consumers shift from premium brands to budget substitutes. Consumers will always need to satisfy their basic needs, and during the recession they do so with tighter budgets. Evidence of successful value-for-money strategies exists in the low price section of the retail sector. For instance, in the UK, ASDA, Primark and the German newcomers Aldi and Lidl have been reporting substantial sales growth. Similarly, in the USA, 'dollar stores' have been reporting substantial revenue and profit growth in 2008.

Manufacturers may likewise adopt strategies of 'value for money' with low costs based on scale economies. This may involve innovations that aim not at advancing new technologies, but at modifying products, production processes and business models to deliver almost the same level of benefit to customers at much lower costs. However, many of the companies serving this segment are either sourcing from emerging economies, or originating from emerging economies. In fact, emerging economies like China, India and Brazil have recently seen fast growth of mass consumer markets with comparatively standardized products at low prices. Local businesses and some MNEs, such as Unilever, have developed business models specifically for this segment. Willamson and Zeng (2009) thus recommend that businesses in Europe or North America partner with businesses in emerging economies, but not, as was traditionally the case, to target emerging economy markets, but to join forces in targeting the budget segment in mature market economies.

Business-to-business markets are likewise affected by tighter budget constraints, as the credit crunch induces cuts in non-essential purchases. This has grave consequences for service providers such as external consultants. If, for example, IT budgets are cut by 25%, while 70% of the budget is spent on maintenance, then only 5% of the budget is available for new acquisitions of hardware or software. Thus, IT service providers have to offer services that help their customers to save IT maintenance costs, or costs elsewhere in the organization. Unsurprisingly, Microsoft reported record losses in summer of 2009. However, the cost-saving motive has enabled some service providers to report brisk business as more firms accelerate outsourcing.

An additional obstacle to major purchases is often the risk that adverse events during the life time of the item may affect its value, or the buyer's ability to pay for it. For example, people worried about losing their job are likely to postpone buying a new car, especially if they need to finance it with a bank loan. If sellers can help manage this risk, this may ease purchasing decisions. For example, Hyundai USA generated considerable attention —and sales— by offering to buy back cars if customers lost their job within a year of the purchase. Effectively, Hyundai offered an insurance policy along with the purchase of a car. While this needs to be factored into the purchase price, this approach helps customers managing the investment risk. More generally, the principle of sharing risk with customers may provide opportunities for business, though it needs to be balanced with the credit risk thus assumed on behalf of the customer.

An industry that tends to be fairly resilient to economic downturns is entertainment. People may spend less on long distance travel and expensive days out, a tendency that is likely to be reinforced by the flu epidemic. Yet they substitute such activities by domestic travel and stay-at-home entertainment. This creates opportunities for local and regional tourism destinations, as well as all businesses that provide for an enjoyable day at home. A wide range of industries may try to tap into this opportunity, including sports, video games, children's toys, take-away and ready-to-eat meals (substituting for days eating out).

Many people wish to use their involuntary career break (less fashionably known as unemployment) in a useful way. Thus, reportedly, exotic locations around the world see large numbers of city traders enjoying a modern form of gap year. Business opportunities thus arise for those who can facilitate such travels as travel agents or tour operators. Others may wish to invest in their own future and enroll for further education, such as MBA. Those offering higher education thus face considerable opportunities to upgrade and upscale their programmes. However, they would have to react flexibly and un-bureaucratically to design and implement new programmes, which creates formidable opportunities for non-traditional institutions.

Long term restructuring: In search of the new economy

The global crisis represents a 'structural break', that is, a moment in time when the basic trends and patterns of the business environment are likely to change in many industries. This creates both challenges and opportunities for businesses to create new strategies and business models based on a comprehensive reassessment of all strategic parameters (Rumelt, 2009). The successful design of a new strategy however requires a vision of what the new economy may look like, and where the business ought to be positioned within this new economy. Businesses may thus employ scenario techniques to develop an understanding of possible future states of the world (Shoemaker, 1995).

Which industries are worthwhile to be in? This question is hardest to predict of all, and whoever get its right is likely to earn handsome returns. Based on mostly informal brainstorming in various groups of students and executives, I suggest the following growth of the new, post-recession economy:

- *Green energy*, which includes for instance energy saving technologies in businesses and home as well as alternative energy generation technologies such as wind energy, solar panels and tidal wave power plants.
- *Heath and social care*, which includes services as diverse as hospitals, beauty treatment, child care, and care for the elderly as well as equipment manufacturers supporting these services, including new technologies such as biotechnology.
- *Nutrition and foods* helping a healthy lifestyle, for instance organic foods and new forms of delivering fresh foods to households and restaurants.
- *Entertainment* in a broad sense including for instance movies and theme parks as well as various forms of home entertainment such as video games, and entertainment delivered via the Internet.
- *Education* in a broad sense, including pre-school, primary, vocational, and higher education, as well as training in specialized professional skills and foreign languages.
- *Cost-efficient provision of basic needs*, especially to the 'base of the pyramid' but – at least during the crisis – also in some mature market economies.
- *Consultancy*, especially those helping businesses with new financial regulation, with organizational change, and with cost oriented process re-engineering.

A common theme in many of these industries is the confluence of manufacturing and services. Traditionally, manufacturing and services were quite distinct, yet in the last decade many manufacturing companies found themselves earning more money from associated services and replacement parts. This shift is driven by innovations of business models, which may have become more important in driving change than technological change alone. Experimentation with new business models may thus be an important way to advance ahead of competitors into the new economy.

Conclusion

The financial crisis of 2008 had a disruptive effect on many industries, and it is likely that we are experiencing a structural break with the emergence of a new economy that is driven by new business models and industries. In this crisis, businesses need two kinds of strategy, a survival strategy and a strategy of positioning for the new economy. The survival strategy may focus on segments likely to be resilient during the downturn, and it needs to be very cost and cash conscious. The strategic positioning needs creative thinking and experimentation with new business models, and the ability to recognize what forms of restructuring may be implemented during the crisis. If business leaders manage to adapt a forward looking approach, they should be able to lead out of the downturn before long.

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Endnotes

1 The contemporary discussion and analysis of the origins and spread of the crisis can be followed in *The Economist*, see for instance: "Finance and Economics: Mortgage Lending (16 December 2006), "Briefing: Securisation" (22 September 2007), "Briefing: Northern Rock" (20 October 2007), "Economic Focus: Same as it ever was" (12 January 2008), "Economic Focus: Chain of Fools" (9 February 2008), "Briefing: Wall Street's crisis" (22 March 2008), "Briefing: A short history of modern finance" (18 October 2008).

2 International Monetary Fund (2009): *World Economic Outlook Update: Contractionary Forces Receding But Weak Recovery Ahead* (July 9, 2009), www.imf.org/external/pubs/ft/weo/2009/update/02/.

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