

## WHAT IF THIS DOWNTURN LASTS LONGER THAN YOU EXPECT?

One of the very few things you can predict with certainty right now is that almost every day will bring sunny media stories declaring that the current economic slump will soon end. Stories saying that the bad news flow will slow sharply in the next few months. That as we turn into 2010, car sales will be rising, the property market will be in good shape, consumers will be gaining confidence, businesses will be investing, and GDP growth will be on the up. That's what we want to hear – and it's what we need to hear.

But check the assumptions underpinning these sunny forecasts, and another picture looks more likely. There are dark times ahead. How long they'll last – and how tough things will be – is anyone's guess.

Executives basing their strategies on a quick end to recession are courting trouble. One risk is psychological. Because they anticipate better conditions soon, they'll block out information suggesting otherwise and home in on good news stories that confirm what they already think. This in turn will lead them to either *not* adjust to harsh short term conditions, or do too little, too late. It'll take them too long to get costs out, lock-in important customers, and fix their operational shortcomings. At best, this will drive them into an earnings slump. At worst, it will put their very survival in jeopardy.

At the same time, they'll fail to think hard enough about the long term. They'll be less realistic, radical, and creative than necessary. Seeing this downturn as just another normal hiccup in the business cycle – albeit a pretty deep one – they'll underestimate the transformational nature of what's going on and stay in “business as usual” mode when that's the opposite of what's needed.

Of course, it's a lot easier to do nothing, or at best to make a few minor tweaks to a business, than it is to do anything extreme. And no one in her right mind would think it sensible to turn a business model on its head, retrench a lot of people, slash investments in R&D or marketing, or put expansion plans on hold if things will be back to normal in a short time.

Executives always need to balance stability and change. Too much of either can be the kiss of death. They also need to manage with their minds on both the present and the future.

Becoming good at something that matters takes time, effort, and persistence. But there's always the danger of becoming too good at things that no longer matter. Producing excellent LP records – or even CDs – in an era when music lovers use MP3 players and download tunes from the internet is fruitless. There's little point in promoting desktop PCs when the market is shifting rapidly towards notebooks or

netbooks. No amount of extraordinary craftsmanship will persuade customers to splurge on luxury goods when frugality becomes a value.

Investment gurus tell us that the stock market is forward looking. They also assure us that when tens of thousands of investors take a view on the future, “the wisdom of crowds” is likely to make their expectations quite accurate. But to rely on the stock market as an indicator of what’s ahead is to take a very simplistic – and potentially deceiving – view of the state of the world. After all, a lot of supposedly very smart punters failed to see these bad times coming, and lost their shirts. (As they’ve done in every previous slump.)

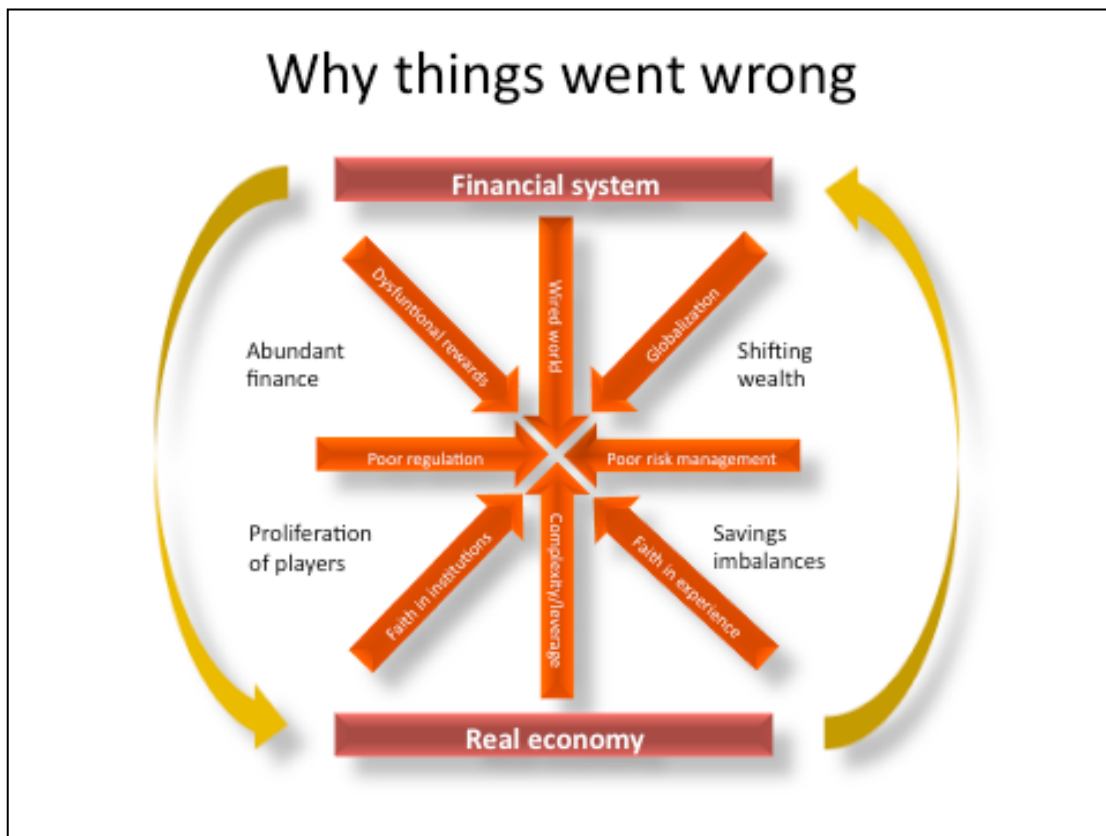
While there may be glimmers of hope in some parts of the global economy, and in some parts of local economies, the current downturn is unusually coordinated and widespread. Most industries are in the same leaky boat, and feeding each other’s woes.

Watch what’s happening all around us. National growth rates are plunging into negative territory everywhere. Japan’s output fell by more than 20% in the first quarter; exports in March plunged by 49.6%. Every new report on the UK economy paints a bleaker picture – and with the Brown government in crisis, there’s sure to be much worse news ahead. In March, the European Central Bank forecast a contraction of 3.2% in Eurozone GDP in 2009; on June 4, this was revised to a fall of 4.1% – 5.1%. Countries in Central and Eastern Europe are in appalling shape, and there’s a growing risk that they’ll pull developed economies down with them.

Mineral sales have sagged. Factories making just about everything from machine tools to airliners, from TV sets to mobile phones, are being closed. Ships are standing idle and airfreight companies are flying with shrinking loads. Airlines are losing money hand over fist (except for a few low-cost operators like Southwest and Ryanair). Hotels are taking fewer bookings – more of them at the last minute and for steeply discounted rates. Pubs and shops are closing their doors. Sales of diamonds and other luxury goods are in a swoon. Consumers are buying less and saving more, shopping around for low prices, holding on to their ageing cars and shoes, and postponing visits to their plastic surgeons and dentists. Firms are chopping their use of lawyers and management consultants. Banks are tight with credit, and clients are not asking for it. And of course, job losses are soaring.

There is still a huge amount of stock in the US housing market, so home prices, new building permits, and new home starts continue to fall. Come the end of 2009, many US homeowners are going to be hit by yet another round of trouble when their adjustable rate mortgages are hiked upwards. At the same time, a credit card bomb is waiting to go off. In the world’s biggest economy, where consumers account for more than two-thirds of GDP, these are ominous signs for everyone.

What began as a financial crisis has rapidly become an economic crisis. Contraction in the real economy, in turn, is hurting the financial sector. The symbiotic relationship between Wall Street and Main Street has become toxic embrace (see the chart below). The notion of mutually assured destruction (MAD) that defined politics in the cold war now defines the world of money.



Fearful governments are lobbying massive stimulus packages at the problem, but no one knows if they'll work – or when. Soothing sounds from the March G20 summit in London have largely been drowned out by the ongoing difficulties that countries, companies, and individuals face. So a growing number of prominent economists are warning that recent efforts to save the world will trigger unanticipated consequences that will be very unpleasant and long-lasting.

Amid the clatter and clutter, there are undoubtedly snippets of good news. Some things are getting less worse more slowly. Inventories have been wound down and soon will have to be replenished. Purchasing managers indices are less gloomy than they were at the beginning of the year. It is important to acknowledge these signals. But it is equally important not to be fooled by them, to keep looking at the big picture, and to deal in facts.

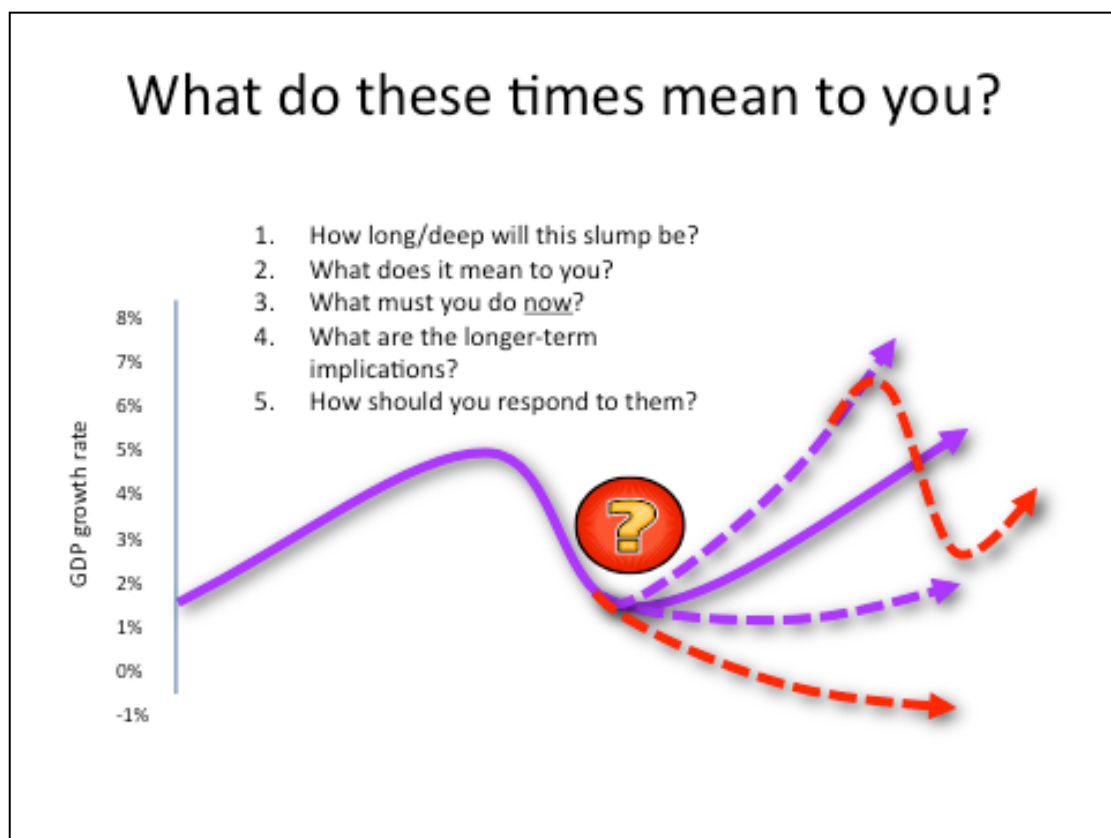
Just because some things might look slightly rosier does not mean that all is well. In fact, there is more than enough evidence and opinion that we are a long, long way from the "beginning of the end." And a great deal of confusion is being created by global leaders who are trying to fix this mess. That favourite ambiguity of economists – "on the one hand ... and on the other hand" – is being used to very bad effect.

A closing communiqué after the first session of the G7 finance minister's meeting on April 24 assured us, "Recent data suggest that the pace of decline in our economies has slowed and some signs of stabilization are emerging."

Consider:

- Speaking at the G7 finance minister's meeting on April 24, US Treasury Secretary Tim Geithner said, "We are right to be somewhat encouraged, but we would be wrong to conclude that we are close to emerging from the darkness that descended on the global economy early last fall." And Japanese Finance Minister Kaoru Yosano said "signs of stabilization" were "an expression with a question mark."
- An editorial in the *New York Times* (April 23) cites a view from Moody's.com that 3.4 million homeowners will default on their mortgages in 2009 and 2.1 million will lose their homes, but warns, "Those projections may prove too rosy because they assume that the Obama plan will be largely successful. That's far from assured."

The scope and complexity of the mess we're in are enormous. Some aspects are cyclical: things will get "back to normal," or close to it. But many are structural which means they are permanent and irreversible. Accordingly, executives need to long and hard about the crucial questions in the chart below.



There is no question that we are at what former Intel Chairman Andy Grove called a "strategic inflection point." This is a time of great danger – and great opportunity. Getting through it successfully will not happen to anyone expecting to get through it easily.