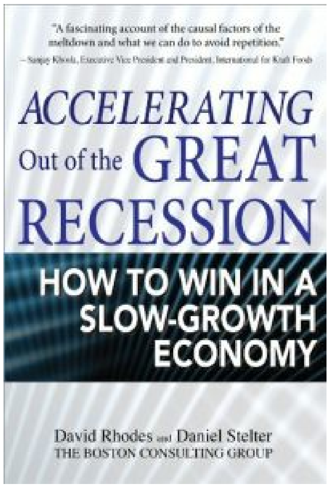

Book Accelerating Out of the Great Recession

How to Win in a Slow-Growth Economy

David Rhodes and Daniel Stelter
McGraw-Hill, 2010

Recommendation

Boring history and economic lessons can drop some students into zonked-out slumber. Fortunately, this book will rouse them. International consultants David Rhodes and Daniel Stelter deliver a mix of entertainment and education that is enhanced by engaging examples and an appealing style. They solidly package business and historical lessons from the Depression era and apply them to the "Great Recession." Their text is concise, albeit with occasional bouts of redundancy. Although the authors have attempted to create a politically neutral analysis, an astute reader might detect an apparent but not intrusive preference for conservative fiscal politics. That's because the writers highlight the shortfalls and downsides of Democratic-administration interventions at some length and offer only minimal criticism of Republican deregulatory policies, without deeply analyzing their role in opening the door to securities crises, Ponzi schemes and the mortgage market meltdown. However, the text's benefits outweigh any political oversights especially since modern literary evenhandedness often amounts to little more than a "plague on both your houses" anyway. The authors go beyond just diagnosing economic problems. They supply concrete, evidence-based solutions for executives who are trying to generate profits in a rigorous fiscal environment. *BooksInShort* recommends this book to corporate leaders, strategists and managers who want to spur sales and excitement in a period of slow business growth.

Take-Aways

- The post-2009 economy is in the deepest financial doldrums since the Depression.
- Companies that succeeded in the 1930s offer lessons for contemporary businesses.
- The ones that thrived, such as General Motors and IBM, played offense and defense, with investments, cost controls, price reductions and innovation.
- Despite the economic rebound, signs of long-term trouble remain. Ailing banks and tapped-out consumers face a lengthy healing process.
- Industry and government analysts downplay the severity of economic problems, employment uncertainty, debt levels and falling property values.
- Consumers have powered past recoveries, but now are spending less to reduce debt.
- As during the Depression, economic revival efforts could spark dramatic changes in trade, fiscal policy and industrial realities.
- Governments will enact protectionist rules and policies and will intervene in business.
- Corporations that don't falter during recessions find greater profits by quickly adjusting their business plans to meet the challenges of difficult times.
- They network, practice savvy politics, and strive for authenticity and differentiation.

Summary

Crisis Averted?

The "Great Recession" did not develop into the Great Depression, part II, and signs have emerged that an economic rebound is under way. But here's the other side of the coin: Governments and central banks from around the globe had to provide an "unprecedented" level of intervention to prevent a worldwide economic meltdown. Experts estimate that governments from different countries spent some $18 trillion to create stability in the financial industry and spent an additional $2.5 trillion to jump-start economic production and consumption.

> "The Great Recession might be over, but the global economy will remain damaged for many years to come."

Despite that massive level of intervention, underlying economic problems remain in place. It could be years before damaged companies and weakened financial institutions rebound. Meanwhile, the world faces the sharpest economic decline in decades.

The drop in production is real and severe. The International Monetary Fund (IMF) reports that the global economy fell 1.1%, with "advanced" countries posting the greatest retreat, a decline of 3.4% in 2009. For the two-year period ending in 2009, international trade and production slipped faster than they did during the Depression.

Anatomy of Decline

Dramatic spikes in home prices set the stage for the economic crisis. The sharp rise began in 1997, and by 2006 home prices had doubled on an inflation-adjusted basis. Easy credit, falling interest rates and aggressive lending standards drove growth in real estate prices and home ownership rates. This scenario was built on three assumptions, which proved to be inaccurate:

1. **Most borrowers seemed to be good credit risks** – That assumption was false. Lower interest rates and softer lending standards made weak borrowers appear stronger than they really were. The situation became even more precarious when homeowners used their houses for more borrowing through risky home equity loans. With that access to easily borrowed money, the family house turned into a cash machine.
2. **Capital markets investors were shrewd players** – Despite access to volumes of data and analysis, this time the putative experts were wrong.
3. **Lending risk was globally diverse and not dangerously concentrated** –This supposition was off-target. Banks retained a large portion of the lending risk.

> "The damaged economy opens up some opportunities for game-changing strategies."

The precipitous drop in U.S. real estate prices led to a crisis in subprime securities, and that sparked a global liquidity crunch in the financial sector, especially in the banking industry. Ailing banks extended fewer loans, which meant diminished business activity and increased layoffs. The cycle continued to spin into economic disaster, as business and consumer loan defaults escalated.

Difficult Rebound

The banking sector faces a lengthy recovery process, especially given its estimated losses of $3.4 trillion from 2007 through 2010. What's more, the IMF predicts that banks in the U.S. and Europe have not fully acknowledged the extent of their potential losses, so more trouble is still to come. Many institutions will require capital infusions to stay afloat, and governments will need to shore up their financial systems. Unfortunately, industry and government analysts have downplayed the severity and complexity of these continuing problems.

> "Financial market structure and regulatory reforms will not be sufficient to address issues that emanate from the real economy. So there is a very real risk that the next bubble will build up and, in doing so, present a renewed danger for the real economy."

Consumers are also tapped out, and that reality is another wound for the banking industry. The uncertain job market, high debt levels and falling homes prices are an unhealthy financial mix for consumers, who normally fuel economic growth. The poor fiscal health of U.S. consumers, who are linked to nearly 20% of global gross domestic product, is a negative factor for the world marketplace. To reduce personal deficits, consumers are likely to sell their possessions, shop for value and save more of their money as they either pay off or default on their debts.

> "Today, the margin for error for business leaders is smaller than it has been for a very long time."

To offset shoppers' diminished spending, governments can swap private debt for public debt, and use it to recapitalize problem banks. This scenario shifts the weight of bad personal loans to taxpayers. Or officials could introduce policies to increase inflation, a move that could drop the level of debt and make it easier for borrowers to repay. However, this is a risky option.

New Economic Pictures

Repairing the financial system will translate into dramatic changes in many areas, including trade, fiscal policy and industrial realities. Governments in the U.S. and abroad are likely to intercede. This new era of interventionist policies reverses a global trend ushered in during the 1980s by former U.K. Prime Minister Margaret Thatcher and former U.S. President Ronald Reagan. Privatization and deregulation – which set the stage for financial excesses – were the order of the day and drove economic development. Other unfolding economic scenarios include:

- **Reindustrialization** – From 2000 to 2010, Europe and the U.S. have lost millions of jobs – mostly industrial positions – to emerging countries, including India and China. The service industry now dominates U.S. employment. This one-dimensional economy is problematic. To create a new balance between industrial and service jobs, government officials in the U.S. and Europe are likely to stimulate their manufacturing sectors.
- **Protectionism** – To shield their domestic economies, local governments probably will enact defensive fiscal policies, as they did during past recessions. Regional and national campaigns such as "Buy American" or "Buy Australian" will become common.
- **Increased regulation** – Health care, finance and energy are the most likely targets for additional legislation and regulations.

Victors in Sluggish Times

Historically, periods of lackluster economic growth restructure corporate landscapes. Some companies falter and fold during recessions, but others capture greater profits and market dominance. Business activity during the Great Depression illustrates that point. New car sales dropped 75% for the three-year period ending in 1932, and the automobile industry posted a total loss of nearly $200 million in 1932 alone. That loss translates into nearly $3 billion at current values. However, these auto companies outperformed their competitors during the 1930s:

- **General Motors** – In the environment of the Depression, 50% of the automotive industry shut down. General Motors (GM), however, posted impressive annual profits during that time and dramatically increased its market share. Flexible but disciplined systems enabled GM to earn money. It lowered its costs and scaled back the production of mid-range and high-end cars. What's more, GM redeployed its resources – manufacturing, sales and marketing – to make and market lower-priced cars that customers welcomed.
- **Chrysler** – The Depression represented a major turning point for Chrysler. During that period, it catapulted from a struggling start-up to a significant "Big Three" player in the auto industry. The dramatic rise occurred because Chrysler improved its assembly-line efficiency, produced more budget cars, launched new dealerships and created a broader marketing outreach.

Play Strong Defense

Depression-era survivors thrived with solid fiscal defense plans – the most important step for dealing with a "damaged economy." Successful companies acted quickly and firmly to alter their business blueprints. An effective defense involves the following elements:

- **Financial controls** – Guard your liquidity and create a solid plan for managing your cash flow. Strategies include reworking vendor contracts to incorporate concessions from suppliers, delaying optional expenses, tracking inventory more closely and reducing debt.
- **Business basics** – Weak economies require far-reaching, cost-cutting strategies, preferably early in the down cycle. Management needs the flexibility to be able to respond quickly to opportunities and challenges.
- **Revenue stream** – To maintain and attract customers, firms that are doing all right often lower or contain product prices during sluggish markets. For example, McDonald's lowered its costs in the 1970s, enabling it to cut menu prices in 1978. Inflation forced Wendy's, a fast-food competitor, to increase prices 14% that year.

Playing Offense: Winning Strategies for Hard Times

Of course, successful companies also go on the offense to gain market share, even in hard times. A winning strategy should include innovation, smart marketing, investments and "game-changing strategies." Take International Business Machines (IBM) – which flourished during the Depression – as a textbook case about how strong firms can thrive during sluggish economic periods. From 1929 through 1932, the business machine market took a huge hit as production slid 60% and many companies failed. But Thomas J. Watson, IBM's founder, moved decisively in 1929 to implement an effective long-term plan based on innovation and investment. IBM developed state-of-the-art accounting equipment and lowered prices to draw buyers at a time when "only 5% of business accounting functions were automated." It also launched a pioneering machine-leasing program to attract customers who could not afford to purchase its equipment. Even during the height of the Depression, IBM put substantial resources into research and development. This investment paid long-term dividends, and this strategy "is just as relevant today."

New Management Rules

Using the model of companies that survived the Depression, savvy executives understand that their businesses cannot operate as usual in the current difficult economic climate. Leaders must scrutinize their corporate cultures and management styles. Here are a few new rules:

- **Take center stage** – During the Depression, successful business executives made sure to remain visible and accessible to all their employees. Richard Deupree of Procter & Gamble visited his company's manufacturing plants to explain the firm's challenges to employees and to outline its strategic plan. Turbulent times increase workers' appetites for information, insight and direction.
- **Rethink globalization** – A worldwide reach can offer new opportunities, such as "producing more in developing countries in order to serve the local domestic market."
- **Be real** – Authenticity and sincerity carry a lot of weight when corporate leaders deliver information to employees and try to inspire them. Executives should establish realistic expectations about benchmarks, performance measurement and internal standards.
- **Network professionally** – Managers should not operate in a void. Expand your leadership team to include expertise from a broad range of staffers, specialties and talents. An inclusive executive culture sets up a spirit of cooperation through the ranks.
- **Manage governmental relations** – Corporations must polish their "political skills" to take advantage of "the heightened involvement – and intervention – of government in day-to-day business affairs."
- **Differentiate** – The way to trump a weak economy is to make your company distinctive. This requires strategic thinking, focus, decisiveness and the ability to move quickly.

About the Authors

David Rhodes and **Daniel Stelter** are senior partners in The Boston Consulting Group, an international consultancy. Rhodes, based in London, is an expert on corporate strategy and organization, and Stelter, based in Berlin, focuses on corporate finance and strategic direction.