

STRATEGY & RECESSION: WHY THE OLD QUESTIONS DON'T WORK

Quick Points: An overview in 60 seconds

Now that at least the developed economies are entering a period of recession a new series of questions is required. This briefing holds that as we progress through a recession and emerge into a new period of growth we may find that our target customers, their needs and buying behaviours may have changed significantly.

Notably, this briefing points to the possibility that developed, services based, economies could undergo a structural shift during recession just as, for example, the UK's economy did in the late 1970s as it shifted from a manufacturing to services.

To examine these shifts it is suggested that different questions and issues must be examined in three separate time periods:

Period 1: *Managing the Present*: The next 6 months.

Period 2: *Surviving the Middle Years*: 12 to 48 months out and

Period 3: *The Long View - New Strategies for New Markets*: The 5 year view

Overview

At the time of writing this briefing we are probably all deep into the annual planning process.

But this time the challenges are different and therefore the questions that we should address must change. An era of uninterrupted economic growth has come to an abrupt halt. The hopes emanating from last year's planning cycle, that the world would experience just a temporary economic slowdown, have been dashed at least for those of us in the developed economies.

The one uncomfortable fact that we must now face is that no one knows, with any degree of confidence, what the business environment will look like next year, let alone in five years time. We are entering a true period of uncertainty.

The future shape of the world and therefore the competitive strategies that we must craft to survive and flourish will be formed by a complex confluence of global, national and socio-demographic forces. I will explore these forces, their interaction and, most importantly, future global formative events that could have a material impact upon the structure of our business environment later in this briefing series.

But now onto some suggested questions that you should now be considering as part of your current business planning process.

The New Questions

Whilst the future is clouded, there is a range of questions that must be addressed during this year's planning process. To help you, I am going to suggest that we divide or categorise our questions into three different time periods:

Period 1: *Managing the Present*: The next 6 months.

Period 2: *Surviving the Middle Years*: 12 to 48 months out.

Period 3: *The Long View - New Strategies for New Markets*: The 5 year view.

Each of these periods will have different challenges and therefore different questions must be presented and answered.

Period 1: Managing the Present

The short-term focus is making sure that the business is in a fit state to survive, grow and potentially out-manoeuvre more inwards thinking competitors. The issues to consider have been dealt with in my earlier briefing [Recession: Key Questions for Business Survival and Growth](#), but the central message was do not take actions that would make contraction and decline a self-fulfilling prophecy for your business.

Three of the key questions that could help you in the immediate future are:

(i) *How are our customers' needs and decision making criteria changing in the short-term?*

In past briefings I have referred to this as the "Aldi Effect". Customers' needs, or more importantly, decision criteria will change more than once during the cycle of this downturn. Customers will make certain immediate changes to their decision criteria. One simple example is that "eating in is the new eating out" - as restaurants empty, takeaway pizza operations flourish. The first task is to identify how customers are now changing what they buy and how they make up their minds. This is as much true for business to business markets as it is for consumer markets. In business markets the perceived risk agenda will be changing as will the decision making process and the composition of the key people involved in that decision making process. This is a question that must be answered now, as it will have significant implications for your offerings and management of target customers over the next 12 months.

(ii) *How can we reduce and manage costs creatively?*

Rather than opting straight away for across the board headcount reductions or freezes, consider carefully your exposure to frictional costs. By frictional costs I mean the costs related to:

- (a) Activities that are duplicated either in your organisation or elsewhere in your value chain for example similar processes, activities and decisions made both in your organisation and in distributors' organisations.
- (b) Activities that have historically been carried out but in today's changed environment add little value.

Remember that the consultants McKinsey have calculated that most organisations can deliver substantial process cost savings by conducting a ground up review of processes - for example up to 30% gains in direct labour productivity, lower material costs and reductions in establishment expenditure.

(iii) *How should we manage the survivors?*

It is an unfortunate fact that employment levels may have to be reduced. Few organisations will be totally insulated from a contracting economy. If you do have to make staff redundant, consider carefully how you manage and motivate the survivors. They too will still feel insecure and threatened and Human Resource policies must change accordingly.

Period 2: Surviving the Middle Years

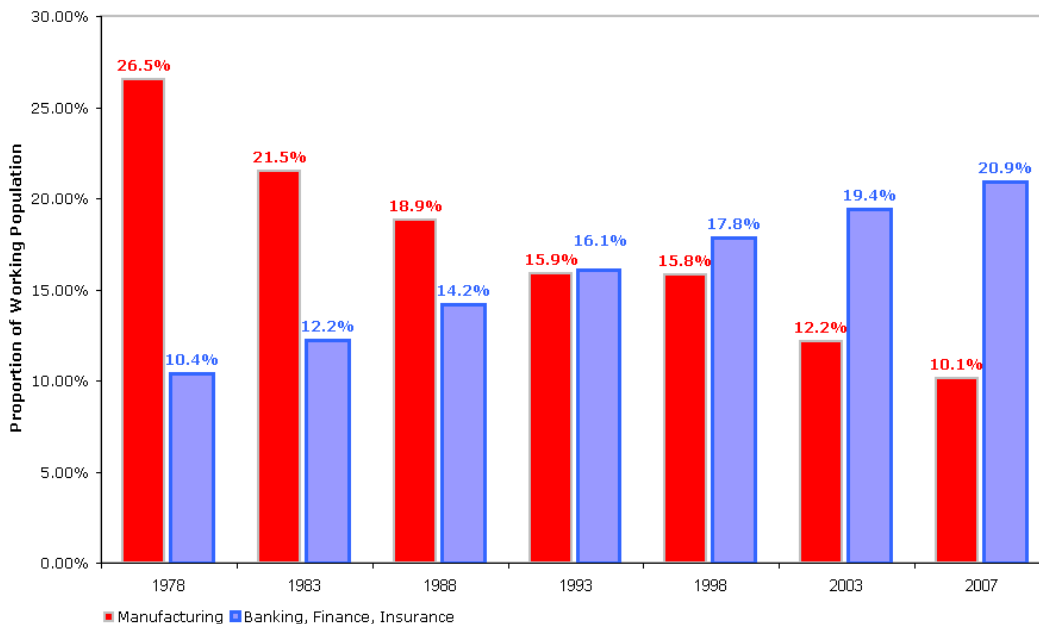
Some interesting forecasts have started to appear focusing upon the immediate impact of the "melt down" in the banking and broader financial services sectors.

Some forecasts point to, in London alone, 60,000 job losses in financial services[1]. To put this in perspective, there are some 230,000 people employed in this sector in London and the South East of England[2]. Broadly up to 1 in 4 employees could lose their jobs. This statistic, together with broader global developments, points towards a potential structural shift in the economies of the developed world.

The last time that we witnessed a structural shift in the developed economies was in the late 1970s when, as an example, the UK's economy made a transition from manufacturing to services. This transition, in employment terms, is illustrated below and it can be clearly seen that the financial services sector came to the rescue.

UK Employment Trends: Quo Vadis?

UK Employment Trends: Quo Vadis?



Source: Office for National Statistics. Workforce jobs by industry: United Kingdom, Thousands, Seasonally adjusted.

The issue that we must consider is “What the financial services sector gave, will it in turn take away?”

There is no guarantee that the employment structure in developed economies will be the same after the recession as it was before.

Critically, we need to consider if there will be a post services based economy and what form it could take.

There are a number of forces that could dampen a post-recession resurgence in employment within financial services including:

- § **Regulation.** Regulation will prove to be a key shaping force in a post recessionary world and I will cover this issue in more depth in a subsequent briefing. It looks however currently that at least in the banking sector innovation in new “products” will be more tightly monitored.
- § **The Emerging Economies.** Arguably, when referring to the BRICs (Brazil, Russia, India and China), we should now use the term “emerged economies”. One of the next challenges for the newly emerged economies, and China in particular, will be continue to boost employment growth. We have seen massive investment, within China, in heavy industry. The one problem is that heavy industry is not a significant generator of jobs. But the financial services sector has just that potential[3]. We can therefore expect further inwards and outwards investment in financial services that, in turn, places financial services organisations in the developed economies under pressure. As indigenous financial services organisations grow in the emerged economies they will become acquisitive looking, amongst things, for the ability to travel up the learning curve at maximum possible speed. In this scenario, one of the problems faced within the developed economies is that it is relatively easy to migrate employment within the financial services sector, as the recent trend towards outsourcing has demonstrated. So when organisations are acquired, the employees to service the business could be located anywhere globally.

However, the hallmark of the current crisis is that we are at a complex road junction. It is impossible to know which route the world will take.

Critical Update

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An alternative argument to that articulated above is that the collapse of Sterling, for example, rewrites the economics of the outsourcing equation and that more jobs eventually could come home. Governments too could take a more protective stance in employment terms in respect of financial services organisations where they have acquired financial interests.

Another buoyant perspective is that increased demand from the new middle classes in the emerged economies could eventually lead to resurgence in the manufacturing sectors of developed economies creating new sources of employment.

What we can be reasonably sure of is that certain sectors of the economy, such as financial services, will probably shed jobs and contract as we progress into recession.

The immediate challenge is to look at the transition period, as shown in the illustration above, and address this question:

"Which of our customer sectors are most exposed to decline and which, in turn, may prove to be the most resilient?"

Considering three dimensions – industry sector, geographic area and firm size may be a good way to approach this question in your business. The answer may reveal that significant changes are required in respect of the definition of target customer segments, the products and services that are provided and the distribution channels that are used.

Period 3: The Long View - New Strategies for New Markets: The 5 year view

The argument presented in the last section, that the pre and post recession structures of economies in the developed world may be significantly different, forms the foundation for the most challenging question of all:

"What form will a post recession economy take?"

There is some emerging evidence that economies at least in the developed world may undergo a structural change, just as we witnessed in the 1970s and 1980s.

It may therefore be dangerous to assume that, post recession, things will be exactly as they were before.

References

[1] I. Dey, "Goodbye To The City ... And Hello To The Life As A Teacher or Gardener.," The Sunday Times, Nov. 2008, p. 7.

[2] "NGRF - LMI Future Trends - Regional / national dimension (Sector: Financial Services)," NGRF; <http://www.guidance-research.org/future-trends/banking/regional>.

[3] G. Dyer, "Comment - How the financial crisis is changing China," FT.com, Oct. 2008; <http://www.ft.com/cms/s/0/e5d48044-a04c-11dd-80a0-000077b07658.html>.

Finally

I hope that you have enjoyed this briefing.

You can find more on the website or e-mail me using the link below. I enjoy personally helping businesses - some of the work I undertake includes:

- § Forward looking business scenarios – what are your future challenges?
- § Facilitating board level strategic reviews, with a particular emphasis upon the definition of tomorrow's competitive environment
- § Design and implementation of Balanced Scorecard performance measurement systems
- § Research to help identify what potential capital providers will look for in your business plan
- § Training: Strategic Thinking, Scenario Planning, Performance Measurement and Strategic Change Workshops.
- § Product portfolio assessment. Helping the business to define the optimal product portfolio – balancing future competitive conditions with the probability of achieving future planned performance
- § Communication programmes
- § Organisational audits – assessing the innovative capability of your organisation

Best regards,

Robert Davies