

Economic outlook at the end of 2009

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The global situation:

The period after an earthquake is often responsible for more fatalities than the shock itself. Fires, disease, toppling buildings and even flood water cause greater damage - but less visibly - as each subsequent little incident occurs in its own time and place.

So it is now with the global economy and indeed New Zealand itself – the seismograph has stopped rumbling but hundreds of individual tragedies will continue to play themselves out over the coming months despite the green shoots that may surround them. As will be returned to later, the tragedy for NZ with many of its marginal businesses (and overseas with many of their financial institutions), may well be that those lingering cripples impede the recovery of their marketplace.

To continue the earthquake analogy, it is only temporary emergency government support which has preserved even the level of economic activity that exists in many countries. **This life support is not indefinite and comes at a high price.** Like the wound under the emergency field dressing, only when the protection is removed later will it become apparent whether the underlying flesh has begun to heal, has become gangrenous or has merely festered, neither improving nor worsening.

One thing that is certain is that **governments are the ones bankrupted** by the recession of 2008/9. If many first-world governments were businesses, their levels of debt would force them into bankruptcy – think of Japan nearing 200% of GDP. Speculation on actual government collapse is irrelevant to this Outlook (though credit must go to Msr Strauss-Kahn and the IMF, and many of the G20) – but what is of concern is that just to regain their 2007 positions most of those governments will have to persist with high taxes for the next decade and reduce their spending substantially.

The impact on the demand side – by emptying people's pockets – is apparent enough, but it is the supply side where the impact is subtle yet substantial. Given the inexorable rise in compliance costs, governments will not be able to sacrifice bureaucrats and advisers so the proportion of GDP they return to spending which is productive to the broader economy – buying new fire engines, building bridges and schools, running police cars etc. – will be a lot less.

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This substantial reduction in domestic demand will be amplified by the fact that the **first world affordability crisis** has not been resolved by the events of the last 18 months. In the UK for instance, house prices are still 150% above their 1997 level but wages have only increased by half that amount – 79%. In most old economies those consumers are also just about to start shouldering the burden of supporting the baby-boomers whose houses they cannot afford to buy from them! In short, less workers with less money and less jobs for them will have to support more and more people with more and more needs. Whichever way you cook the books, the people working – directly or through government debt – will have to shoulder that burden. Additionally, this will reduce their global competitiveness creating a further vicious circle of less work and less buying power.

Ultimately those consumers purchase the products that NZ provides which pay for us to then purchase our oil, televisions and industrial raw materials. If they do not buy enough, we cannot buy enough either.

Geographical area	% of NZ Exports, 2008
Australia	23.3%
North-East Asia	20.9%
North-West Europe	11.6%
North America	11.4%
South-East Asia	10.9%
N Africa & Middle East	5.9%

Source: Statistics NZ Global New Zealand Report for the year ending Dec 2008

So, will no quick recovery in the old world mean the same for the New World? Only partially. The proportion of export destinations in the above table which are dead in the water is less than you might think – the value of trade to Asia continues to grow and clearly primary industries like farming or forestry will show a recovery more than manufacturers of washing machines. What this does mean is that some areas of the NZ economy will substantially outstrip the others by far more than is immediately apparent. This will lead to hefty change in many dependant markets.

And here in New Zealand:

Is New Zealand seeing a false dawn therefore? No – just a long, grey morning. The world works again (and is already forgetting the lessons of the recent past) but there is just not enough traction for growth to resume at a reasonable rate.

What does that really mean? It means Directors lack the sustained healthy activity that gives them the certainty to employ more staff, or the confidence to improve equipment, or the cashflow to buy more economically, or the committed business to underwrite expansion. Like a ship in the fog they know they are alright right now, but not what's coming next.

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Structural unemployment is an underlying issue which will be a drag on recovery. A lack of skills (or to be blunt the right mentality to learn skills needed for the modern work-place) sits along with geographical stickiness of labour, the long-term prevalence of benefit dependancy and the unattractiveness of many wage levels to mean we will soon return to a point where there are shortages in some areas and a glut of people unsuited or unwilling to take the employment available.

Consolidation is a silent force which now needs to be recognised. The NZ marketplace is undergoing a subtle reshaping of greater impact than the loosening of trade controls. Franchise chains, buying groups and the consolidation of industries mean that the independent operators for which NZ has been conspicuous will soon be a thing of the past. The geographical isolation which allowed smaller businesses to flourish for a century is now far less relevant as so little work needs to be done on or near the farm to support it. The local engineer no longer machines the part – it is ordered in. This leads to centralisation, powerful dealer chains and support by freight not support by production. Our children will have less opportunities as a result, but this is not a force which can be stopped, it is a simple consequence of some economies of scale becoming available where before they could not be applied.

One other factor slowing recovery globally and in New Zealand is that, despite what the IT industry and others might say, there are **diminishing returns from innovation**. Everyone's got the internet now and there aren't really any more substantial improvements to be made in many areas. Every small gain in efficiency tends to be cancelled out by time wasted because of traffic or regulation or infrastructure or IT failure (to name just a few).

Unfortunately operating at less than full capacity is often inefficient and worse still often leads to complacency. This makes margin preservation even harder, especially when staff are aware that there is spare capacity. Necessity is the mother of invention and without an economy running hot, there are less ideas coming out of the boiler room. Capacity management is a slow-burning fuse and when demand does increase expect many organisations to fail to perceive it, believe it, anticipate it or meet it!

Over-capitalised industries are one of two lame ducks which will hamper a recovery in New Zealand. Too much recycled and secondhand machinery (think of the screen print industry) depresses margins and wastes resources. A good recession would seep a lot of this excess capacity away but unfortunately this has not happened yet - and the consequences will act as a drag on recovery.

The other ugly sister in NZ's cupboard is the number of businesses with what can only be known as **commercial negative equity**. They have struggled on with declining margins and minimal profit on the strength of freehold buildings, former glories or particular long-term customers. They too depress margins and are a haven of inefficiency but the owners are often trapped by now being unable to realise the value for the business that they require to settle debts or achieve the long-awaited retirement. With or without ownership of their premises, they continue along – often at

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a gentle loss – in the desperate hope that former profitability might return and an exit arise.

What is the Government doing about all this? While it has taken people a while to remember that good government often means doing nothing at all (as opposed to the ethos of socialism which believes in incessant interference by the state), this government has yet to seize a lot of opportunities to make more change than it has done. It has shown great skill in laying the groundwork for winning the next election but has done little yet for the smaller businesses who cannot stand up to the likes of Telecom, power companies or banks.

One healthy consequence of the change of government and the recession is that the **pendulum swung back to employers** in a big way. It had a long way to go to get back to normal after the previous decade but now is an ideal time for employers to reorganise businesses, establish new working habits and make the changes they had been wary of in the past.

The effect on the marketplace

Like tectonic plates, markets shift slowly but powerfully and dangerously. Expect them to change with subtle undercurrents, and do not rely on pigeonholes, segmentations or assumptions that held good up to this year - they are probably out of date. Assume its all new, and look at it afresh.

The effect on the business

You cannot run the marathon if you cannot keep motivated - 2010 is shaping up to demand the same resilience. You will not do badly, if you take the situation seriously. The economy has not recovered enough and some markets and businesses cannot survive. Get out of there; do not be one. It's time to be strong, fast and sure.

What you should do

1. Leadership

Now is the time for a concentrated, thematic and honest look at leadership in your organisation. In a period of flat growth, your ability to lead will make the difference between success or the subtle decay of failure. Now is the time to lead by example, to demand high standards and initiative. Now is the time to share your vision, to foster communication and to inspire with your confidence. Now is the time to lead your company.

2. Now's the time to widen the net

Broaden the CMGs (Customer Market Groups) and PSGs (Product & Service Groups) that you target. Normally we say looking at other greener grass is a sign of a failure of your own – and sort your own knitting out first - BUT this is a period when some markets will lose their appeal (permanently even) and new ones slowly arise. Encourage looking sideways by your sales staff and never say no.

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3. Pick growth markets

Easier said than done – but if your market is stagnant, you will not grow. Move into markets with more activity even if they do not appear very profitable.

4. Find people who can commit

Customers who can commit are like holding gold rather than paper currency. Actively court, encourage and prioritise customer groups who are in a position to be more certain about their buying authority. These are also often the people who may pay on time in full.

5. Go for certainty not margin

Enough certainty generates margin through efficiency. It allows you to employ capital more efficiently, order more efficiently, even beat your supplier's prices down. Pursue those groups, that type of work and price for certainty – all of these strategies will help you create certainty in your production.

6. Go for margin once you have got the job

Make efficiency your religion in 2010. Do not waste a scrap of material or a minute of time. Running at 90% efficiency makes most staff complacent. Use that 10% spare to make everything as tight as possible. Your example, your consistency, your explanation of how important every tiny action can be - is critical.

7. Revisit your sales strategy

If you found it hard to imagine where or how you could pursue points 2-7 you need to look at your market, your value chain and your whole environment. It has changed, and now you need to know it more intimately than ever before. Book a day with your staff and work out where you are going to go.

8. Restructuring

Change now while staff are pliable. They are still grateful for a job and recognise that your business may not function the way it has done. Strong leadership, a focus on new types of sale and a religion for efficiency (as above) will all set the scene in which changing people's jobs will seem more appropriate and less threatening. You can do this by re-training, shifting departmental responsibilities, introducing checking and supervising levels for instance. But, don't chicken out – if you can't get it done now, you never will, and if you know your organisation is holding itself back and you don't get it done now, that is admitting failure. Be honest.

8. Cashflow

Be blunt and realistic about what you can achieve! Do not let nagging cashflow worries deflate your other efforts – create a working system of assessing forward cashflow weekly, then forget about it for the other 6 days a week and concentrate on the other points above.

The January shark

One between the 4th and the 10th and another in the following week.