

# Growing through crises (2)

by

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Valuations are at their highest. Economic growth is strong (except in Europe). Companies are investing. Interest rates are beginning to rise. Hence, the next crisis is coming.

When? Probably in the next eighteen months. Why? It does not matter; there are numerous possible triggers: a poorly managed Brexit, an excessively quick rise in protectionism, a growth crisis in China, a transitory adjustment of the Internet bubble, a surge in key interest rates... The global economy is structurally cyclical, with a major crisis every ten years since 1945 (the last one occurred in 2008/2009) and one or two minor crises in the interval (see table).

The real question is: what needs to be done today to get through the next crisis and be even stronger when it ends?

Relevant strategies remain the same <sup>(1)</sup>:

- Differentiate investments and actions as much as possible between sectors, value steps, geographies... assessing which ones are critical and which ones are not.
- Slow down investments immediately in all non-critical sectors.
- Accelerate asset sales if some of them had to be conducted anyway (including assets under management in private equity funds).
- Invert the time horizons on commitments for purchases (shorten) and sales (lengthen) in businesses where it is possible to do so.
- Reduce all costs which are not strategic development costs (commercial costs, R & D...) and maximize cash flows.
- Identify relevant acquisition targets which will be destabilized within 12 to 24 months and prepare to approach them when the time comes.
- Refocus management actions on what matters most.
- Already prepare a plan for market share gains and investments when the crisis ends in order to initiate it before other competitors and consolidate the industry.

Many companies anticipate crises and analyze them in hindsight to justify their results. Few act accordingly, that is to say *before* (slowdown and differentiation of investments, focus of actions, maximization of cash); *during* (preparation of the end for a stronger recovery than competitors; orders for equipment and raw materials requiring a long cycle of production or supply); *and after* (maximum deployment of growth investments and market share gains; repurchase of competitors).

Getting through a crisis requires much more than laying low until the storm is over. It is a critical exercise requiring to change the pace and to focus in the course of business in order to take advantage of it. The involvement of the CEO, or even the shareholder, is critical for making the main decisions and ensuring their implementation at the right pace.

During crises, timing is crucial. A company which will implement the right levers in three years instead of eighteen months makes a major mistake. It will suffer from a disastrous decline of

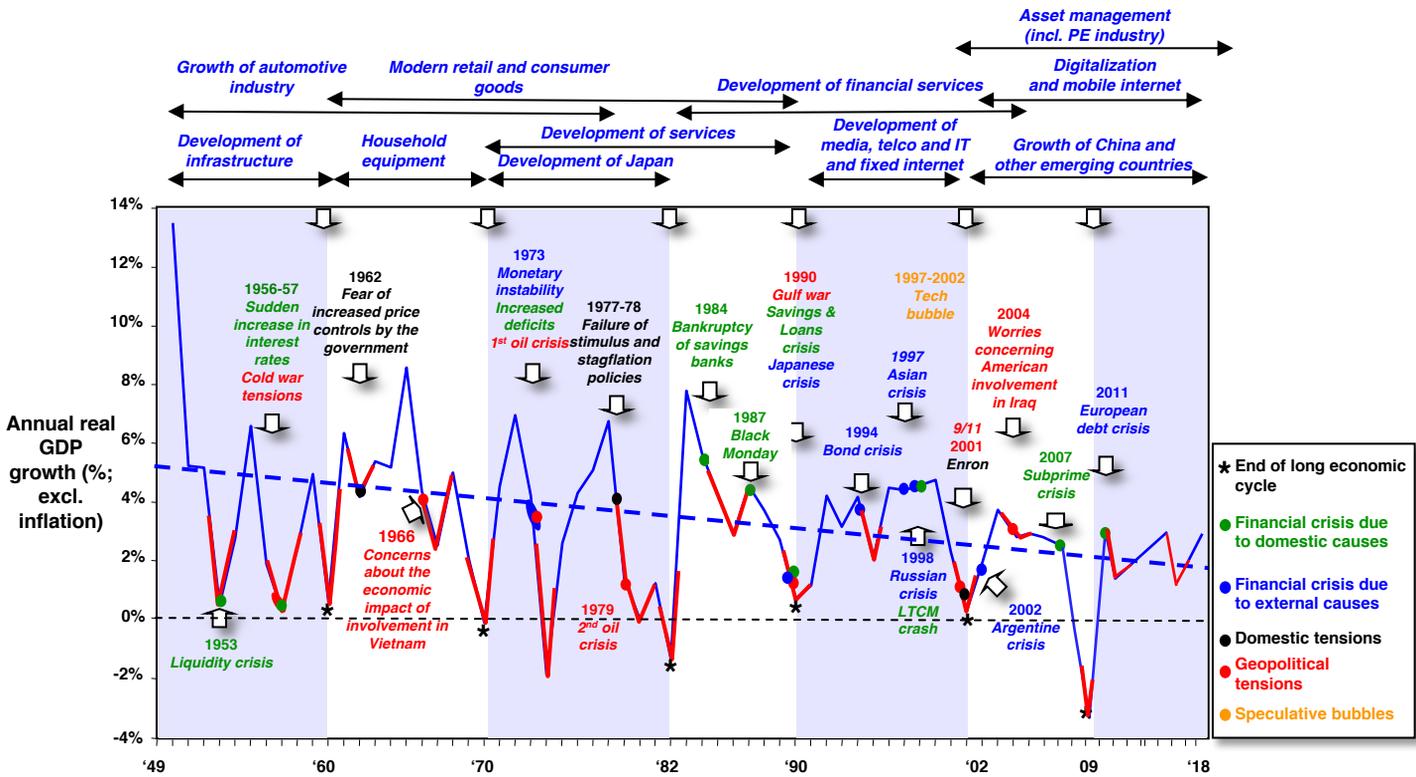
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<sup>1</sup> See the following articles: "Growing through crises", June 2008 and "Should crises be planned?", October 2010.

- Table -

The Western economy goes through a major crisis every ten years

- Example of the USA -



Sources:IMF, BEA, Bloomberg, Shiller, Estin & Co analyses and estimates

its performance in the middle of the crisis and will still be cutting costs and capacities during the recovery instead of gaining market share.

What is the risk of triggering these actions too early and be off by 6 to 12 months in the timing of this new crisis? It is low; the company will simply have accelerated a necessary refocus of its most critical activities and action levers and stopped investments which were dilutive anyway.

Long-term growth is built through cycles and crises. Thanks to the wherewithal given by financial valuations during the expansionary phase of the cycle; thanks to the cash flows available at the bottom of the cycle. Crisis exits are most of the time the best opportunity to consolidate the industry, provided there is a clear vision of attractive investment sectors and relevant targets for the company.

The world in the aftermath of a major crisis is never the same as before:

- Some industries which were on a path of endless growth become mature all of a sudden and no longer offer the same potential for value creation (end of the long-term growth of the automotive industry after 1970, of hypermarkets after 1990, of financial services and telecommunications networks after 2000...)<sup>(2)</sup>.
- The hierarchy of competitors within an activity has changed and there has been concentration; emblematic major leaders go bankrupt, sell important parts of their activity or are absorbed by their competitors (Chrysler, Boussac... in the 70s, Usinor, Continental Airlines... in the 80s, Euromarché, Promodes, Crédit Lyonnais, Commodore, TWA, Swissair ... in the 90s, General Motors, Chrysler (again!), Pechiney, Compaq, Kmart, Montgomery Ward, Marconi, Alcatel, Westinghouse, WorldCom, Saatchi & Saatchi, Enron, Calpine, Pacific Gas and Electric... in the 2000s; Lehman Brothers, RBS, Dexia, American Airlines, Areva, Alstom, Carillion, Alcatel Lucent, Broadcom, Nortel, Technip, Seadrill... in 2008 and the following years).
- New competitors and business models appear (Asian competitors, low cost models, vertical integrations, uberisation, online models...).
- Government responses to the crisis change the allocation of resources and fiscal policy across the economy, modify the relative attractiveness of sectors (support to struggling sectors, regulations, liquidity injections...) and in doing so, create the conditions for the next crisis.

Major decennial crises are not mere jolts in the trajectory of companies. They induce or reflect disruptions and strong opportunities in industry dynamics and competitive systems.

How do you see your industry in 2020-2025, in the aftermath of the next crisis? And what are you doing to prepare for it?

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*Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists CEOs and senior executives of European, North American and Asian corporations in the formulation and implementation of growth strategies, as well as managers of private equity funds in the analysis and valuation of their investments.*

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<sup>2</sup> All these ends in the Western economy only (excluding emerging countries).

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