

think:act CONTENT

Fresh thinking for decision makers

What now?

think:act CONTENT: Special edition

three scenarios
on the current crisis | Are we
on the brink of a recovery,
recession or depression? |
We'll show you what's up
ahead | We'll also tell you
how to steer your company
safely through the crisis |

GROWTH OUTLOOK EVAPORATES
IMF World GDP growth projections for 2009



+3.0% **+2.2%**
October 08 November 08

Source: IMF World Economic Outlook

WHAT NOW? THREE SCENARIOS ON THE CURRENT CRISIS

Three scenarios on which way the world economy could go

The current crisis on the international financial markets has in recent weeks led governments, central banks and businesses to take action that would have seemed unthinkable even a short while ago. What can we expect next? And what can and must businesses do now?

To give some guidance, we have condensed the wide range of possible developments into three scenarios. In scenario 1, the economy recovers relatively quickly (we think this is still possible). Scenario 2 assumes a recession is coming (which is how most people are currently thinking). Scenario 3 is a depression (which we think is not very likely).

Business needs to be prepared for all three scenarios. This article therefore shows what businesses should do to deal with the crisis while at the same time leveraging the many opportunities the coming months will offer.

GDP GROWTH RATES [%]

	2007	2008	2009
WORLD	5.0	3.7	2.2
EU	3.1	1.5	-0.2
USA	2.0	1.4	-0.7
JAPAN	2.1	0.5	-0.2
EMERGING ASIAN ECONOMIES	10.0	8.3	7.1

Source: IMF World Economic Outlook

FALLING COMMODITY PRICES WILL BENEFIT THE WORLD

Price for crude oil per barrel



Source: FT

SCENARIO 1: RAPID RECOVERY (ONE-DIMENSIONAL CRISIS)

a) **HOW LONG WILL THE CRISIS LAST?** Another six to twelve months.

b) **HOW BAD WILL IT BE?** Some economies will see negative growth for several quarters. The stock and commodities markets will remain very volatile. There will be a loss of confidence, but the economy will not remain weak for long. Global economic growth will fall to 2.2% in 2009. Yet it will keep growing thanks to only slightly weakened expansion in the BRIC states (Brazil, Russia, India and China).

c) **WHAT WILL IT BE LIKE?** The financial crisis will have a knock-on effect on the real economy, but this won't last too long or be too bad. Different areas of the world will be hit very differently: Europe's economies will suffer very little, and even the BRIC states will avoid the worst of the fallout. The US will suffer worse. They too will nevertheless recover relatively quickly again thanks to massive state intervention. Falling commodity prices will benefit the world. The economy and society will wake up to the recent discovery that the state and the international community have a major and positive role to play in the market economy.

d) HOW MUCH CAN THE POLITICIANS DO? National and international rescue packages (guarantees, cash injections, government holdings) and emergency action by the central banks (cutting interest rates, increasing the money supply and injecting cash) will be effective. So yes, the crisis can be overcome on a political level. Politicians acting quickly and in concert will soon restore confidence among the players in different markets – savers, consumers, investors and businesses. Only a few countries will resort to protectionism. (Such trends are visible in France and – depending on what the new administration does in office – in the US).

e) WHAT ABOUT THE ECONOMY? Apart from the dip in growth in gross domestic product (GDP), the damage to the economy is containable. Unemployment worldwide will rise only slightly. In some countries that are heavily affected by the crisis and where labor markets are flexible (such as the US), unemployment will increase somewhat more strongly. Economies such as China and India, whose growth rates are only marginally lower than before the crisis, will make up for poor growth in developed regions. The finance industry will see more insolvencies, more consolidation and more concentration. Only the fittest will survive. Confidence in the financial markets will soon be restored as they become more transparent and better regulated.

f) AND WHAT ABOUT BUSINESS? The stock markets will tumble. Cashflow bottlenecks and financing problems will present companies with major challenges, but ones they can solve – thanks in no small measure to government aid. Many companies in the finance industry will have to fight for their lives. And it will become apparent that certain business models and highly complex financial products have no future. Cash-rich companies will be in a good position to buy, however, while business in general – and utility and haulage companies in particular – will benefit from falling energy and commodity prices. Stricter government regulation in the wake of the financial crisis will temporarily lead to moderate realignment expenses. Underperformers will be weeded out in the banking sector and, to a much lesser extent, in other industries too. Businesses in Europe, the BRIC states and emerging economies will suffer less than those in the US. Consumption in the former countries will be largely unaffected. Having done their homework, European companies will be innovative and produce extremely efficiently. Meanwhile, the middle classes are growing in the BRIC countries and emerging nations – and European companies are making precisely what these consumers want. Businesses in the BRIC states and emerging nations will continue to invest heavily as these countries still need a great deal of infrastructure, capital and consumer goods.

SCENARIO 2: RECESSION (TWO-DIMENSIONAL CRISIS)

a) HOW LONG WILL IT LAST? Another year or two, but definitely the whole of 2009. Recession is usually defined as GDP shrinking for two consecutive quarters.

b) HOW BAD WILL IT BE? Global GDP will decline by 1-2% overall, affecting all the industrialized nations, all the emerging and developing countries (albeit to a significantly lesser extent) and virtually all industries.

CHINESE ECONOMIC RECOVERY PROGRAM, NOVEMBER 9, 2008

600.
000.
000.
000 \$

Source: FTI

ECONOMIC STIMULUS PACKAGES IN JAPAN



Source: The Japan Times

c) **WHAT WILL IT BE LIKE?** The financial crisis will be accompanied by a real economic crisis (the second dimension). In other words, the financial crisis will have major repercussions for the real economy. Once again, the picture varies. This two-dimensional crisis will have a massive impact on the US. GDP will contract sharply there and the US will recover only slowly. Europe's economies will shrink slightly while the BRIC states will keep on growing strongly, although less so than in previous years. As in scenario 1, the relationship between state and market will shift in favor of the state, which will regulate the financial markets more tightly. Many people will thus see the government as playing a necessary, positive role in the market economy.

d) **HOW MUCH CAN THE POLITICIANS DO?** New rules for a reformed world financial system will be agreed at international level, but will be a long time coming. Besides launching short-term state and monetary policy rescue packages, many governments will try to support their national economies with economic booster programs. Though these can soften the negative effects of the crisis, there is a limit to how much they can do. Moreover, the favorable effects tend to evaporate relatively quickly given the prevailing mood (lack of confidence and a reluctance to consume/invest), as the economy will remain mired in recession despite state intervention. Savers, consumers, investors and companies will regain their confidence only very slowly. Some major economies will revert to protectionist tendencies that risk limiting financial freedoms significantly in the longer term. As the relationship between state and the economy will shift in the state's favor governments will thus become more self-confident. Further privatization and deregulation programs will be postponed or dropped altogether.

e) **WHAT ABOUT THE ECONOMY?** Unemployment will rise – especially in the USA, with its relatively flexible labor markets. Consumer confidence will be eroded and people will start to save more again. "Safe saving" will be especially popular in many Western nations. As the value of real estate and private pensions declines, many people will have little choice but to rely on more government assistance, thereby driving up government debt.

f) **AND WHAT ABOUT BUSINESS?** Besides the financing problems they are facing, many companies will also struggle with falling turnover and sales. They will thus be forced to cut costs and restructure accordingly. As in any recession (and for the same reasons), more businesses will go bankrupt and consolidation will be widespread. As in scenario 1, businesses in Europe, the BRIC countries and emerging nations will be less affected by this process of natural selection than those in the US. The crisis will present huge opportunities to well managed, cash-rich companies.

SCENARIO 3: DEPRESSION (THREE-DIMENSIONAL CRISIS)

a) **HOW LONG WILL IT LAST?** Another three to five years. The term "depression" is usually taken to mean when the economy slumps for several years in a row, and is often used in connection with the world economic crisis in the late 1920s.

b) **HOW BAD WILL IT BE?** The whole world economy will be hit badly. Global GDP will shrink for several years in succession, sometimes in double digits. No industry or country in the

world will come off lightly. It may not be a rerun of the Great Depression after 1929. Even so, the symptoms of crisis will be much worse than any global economic crisis in the past seventy years.

c) WHAT WILL IT BE LIKE? The financial crisis will be accompanied by a real economic crisis and a systemic crisis (the three dimensions referred to above). It will be a long time before the banking sector gets back on its feet as it was before the financial crisis. Governments will take over a major proportion of the banks, but will have to be very restrictive about granting loans itself, as they too will be strapped for cash. Huge financial problems will be rife in the real economy. Many companies will go bust, sparking off a vicious circle of insolvencies, mass unemployment, depressed purchasing power, imploding demand collapses and further insolvencies.

d) HOW MUCH CAN THE POLITICIANS DO? Not much. Even the central banks will soon have little room to maneuver. Economic programs will be announced but will have little effect. As time goes on, governments will have no money left to support the economy. Some infrastructure projects will be left unfinished – all of which will trigger a massive loss of confidence in the political establishment (and, with it, in the state as a financial player). Internationally coordinated emergency laws will drastically restrict the market's freedom to respond. National governments will nationalize many companies. Large-scale protectionism will undermine the international community of states. Organizations such as the European Union will come under heavy pressure from nation states. Some countries will even drop out of the EU and/or the single currency agreement.

e) WHAT ABOUT THE ECONOMY? Worldwide, unemployment will double or even triple over what it was in 2008. Disposable income will be slashed, confidence will be at rock bottom and the mood will be bad. Deflation (falling prices) will prevail. Many other key indicators will point downward. Numerous countries will turn protectionist and restrict economic freedom. Social tensions will soar, sparking off conflicts (some of them violent) in many countries. In many areas of the world, the market economy will have a massive credibility problem, as many people see Western-style capitalism as the cause of the depression. Many people withdraw from social involvement. The black market will flourish. It will be a very long time before savers, consumers, investors and businesses regain any confidence at all – and even then only in part.

f) AND WHAT ABOUT BUSINESS? A wave of insolvencies will sweep over all industries, provoking sometimes chaotic business conditions around the globe. Domino effects will put even healthy businesses under huge pressure as their markets fail and their main suppliers topple. Even businesses in the BRIC states and emerging nations will invest much less than they used to. Growth rates in these countries will thus collapse between 2009 and 2013. Raising capital will become a complex, expensive business. Expected returns will be much lower in the long run. Caution and mistrust will be the order of the day. The entrepreneurial spirit will grind to a halt. "Play safe" will be the watchword – an attitude that only makes the crisis worse, however.

BAIL-OUT MEASURES IN % OF GDP

US
5%

UK
18%

GERMANY
21%

SOUTH KOREA
80%

Source: Uni Credit

OVERVIEW: THREE CRISIS SCENARIOS

SCENARIO	1) RAPID RECOVERY	2) RECESSION	3) DEPRESSION
How long will the crisis last?	Six to twelve months	One or two years	Three to five years
How bad will it be?	The economy will dip slightly	The global economy will shrink significantly	The global economy will contract hugely and for a long time
What will it be like?	One-dimensional crisis (financial crisis)	Two-dimensional crisis (financial crisis plus real economic crisis)	Three-dimensional crisis (financial crisis, real economic crisis and systemic crisis)
How much can the politicians do?	Rescue packages will stabilize matters and encourage confidence	Rescue packages and economic programs can help, but to a limited extent only	Government and monetary policy interventions will have little useful impact
What about the economy?	Won't affect unemployment, inflation or consumer confidence much	Unemployment will rise sharply, inflation will fall, people will save more, government debt will increase	Unemployment will soar, the economy will deflate, confidence will be lost, protectionist tendencies and social tensions will ensue
And what about business?	Value will erode, liquidity and refinancing problems will arise but can be solved; cash-rich companies can exploit opportunities	Sales and profits will collapse, restructuring will be necessary; many companies will become insolvent; cash-rich companies can exploit opportunities	Waves of insolvencies will strike; business conditions will be chaotic; investment will dry up; the economy will collapse
Who will it affect?	Mainly the financial industry	Most industries and regions of the world (although countries like China and India will keep the global economy going)	All industries and regions of the world

WHAT'S MOST LIKELY TO HAPPEN? WATCH OUT FOR THESE INDICATORS

There are three questions we need to bear in mind in the coming weeks and months, because the answers will give a good indication of which of the three scenarios will actually unfold:

FINANCE: Will the financial markets soon have enough liquidity again, and will financial players start trusting one another again? Or will even more billions disappear into the financial sector's seemingly bottomless pit? If the latter transpires, scenarios 2 and 3 will become even more likely.

POLITICS: How massively will the politicians intervene in the economy? Will other nations follow France's example, for instance, by protecting key industries against the acquisitive but unwanted attentions of certain other governments? Will the markets welcome this state intervention or think it goes too far? Are we heading for protectionism once again? If governments go too far on this score, that could make managing the crisis even harder, as well as making it last longer. Worse still, politicians could find their hands tied if states teeter on the verge of bankruptcy.

REAL ECONOMY: How will individual industries and service sectors fare? Will more companies plunge into severe difficulties? Or have the steps they have taken to make themselves more flexible and cut costs in recent years made them more crisis-proof? Will sales collapse (Christmas trade and industry order books are good indicators here)? And will the BRIC states still bolster growth? Or will these economies too find themselves in increasingly deep water? The rule of thumb is that the less unusual the course of events in this domain, the more likely scenario 1 will be.

However things turn out, companies must prepare for what's coming, and must do it fast.

WHAT TO DO IN THE CRISIS? RECOMMENDATIONS ON HOW BUSINESSES SHOULD ACT

What companies should do to make the best of the crisis in the coming months depends mainly on two factors: their financial strength and their industry environment. For well-resourced companies, this is the ideal time to look at growth strategies. And not all industries are affected to the same extent, of course. While the crisis is simply speeding up the structural problems in the automotive industry, for example, other industries, such as the environmental industry, are continuing to grow.

There's one thing we can say for all businesses, though: You need to act now! What's essential here is to respond to the crisis both strategically and financially at the same time. Because one thing is clear: The traditional V curve – the belief that a company must first shrink down to a healthy size and then grow again afterward – no longer applies. Even in a crisis, you must still boost productivity and invest in growth. If you don't, you will risk falling behind in the long run.

BIGGEST DROP EVER: Consumer Confidence Index US



Source: Conference Board

BUT THE OUTLOOK FOR 2010 IS SOMEWHAT BRIGHTER AGAIN:

GDP growth projections

 **+2.0% POINTS**
High income countries

 **+1.7% POINTS**
Developing countries

Source: World Bank

The priorities in tackling these strategic and financial challenges depend on which camp businesses are in:

- For cash-rich companies, the current crisis offers an excellent opportunity to make themselves more competitive. Backed by suitably flexible strategic planning, these businesses can concentrate on consistently spotting potential opportunities in the market. Investment and product portfolios should be managed aggressively and good M&A opportunities seized immediately. All these activities should be flanked by constant action to improve productivity, allowing these companies to exploit their strategic leeway to the full.
- On the other hand, companies with virtually empty pockets must give urgent priority to getting back on a sound financial footing. Stable liquidity planning, strict cost-cutting programs and streamlined portfolios are imperative to give these companies sufficient breathing space to even think about aggressive strategic action. Many businesses will have to engage in thorough restructuring exercises.

LET US NOW DRILL DOWN INTO THE DETAILS OF WHAT MUST BE DONE:

DRAW UP SCENARIO PLANS: Working on the basis of macroeconomic scenarios, companies must develop their own scenarios and identify a number of alternative courses of action. These individual scenarios should take due account of both the company's specific competitive position and the situation in their industry. Given good scenarios, companies can prepare themselves well for different developments and contingencies, deducing what to do specifically on a case-by-case basis.

OBTAIN SECURE FUNDING: Creating adequate liquidity reserves is critical here. Long-term financing that covers the company's needs as they arise, tight receivables management and optimized working capital give a business room to breathe. Covenants should be managed consistently and proactively, and should be designed to be as flexible as possible. Moves to optimize the structure of capital – by buying back loans cheaply if all goes well, or by restructuring debt if it doesn't – must figure high on the corporate agenda.

REVIEW YOUR INVESTMENT PROGRAMS: All investments, without exception, must be critically examined in light of your capital situation. Focused, strategic investment programs are naturally a must. And they help protect your competitive position in the long term.

MANAGE YOUR COSTS TIGHTLY: Other operating expenses in particular can be reduced very quickly. Any programs you have already ratified should be brought forward or speeded up. Purchasing must be made more cost-conscious than ever. The efficiency of all your processes must be examined honestly.

EXPAND OR STREAMLINE PORTFOLIOS: Key questions to answer here: Which business segments enjoy the best growth prospects? What segments are not relevant for the business strategy, but, instead, can be sold off to strengthen the cash position?

Which products are key in generating sales and which produce poor margins – and will probably keep doing so in the future? The current financial crisis is the ultimate wakeup call to adjust your product portfolio.

RESTRUCTURE WHERE NECESSARY: Businesses that are hit hard by the crisis must safeguard liquidity at any cost, sharply reduce their other operating expenses, trim their workforce and take other, often painful, measures to ensure they survive. Once again, though, simply slashing costs is not enough. On the contrary, the turnaround must lay the foundations for profitable growth in future.

LAST BUT NOT LEAST, MANAGING VALUE: It is not just a question of economics. Healthy companies focus on performance, confidence, integrity and sound optimism – thereby gaining their employees' trust. This also includes a healthy dose of open communication – both outside and within the company.

Clearly, a whole raft of measures is essential to deal with the short-term impact of the crisis while at the same time exploiting the opportunities that any economic downturn presents. If you get it right now, you will come through the crisis stronger in the long term.

IF YOU HAVE FURTHER QUESTIONS, PLEASE
FEEL FREE TO CONTACT US AT ANY TIME:

Prof. Dr. Burkhard Schwenker, CEO
+49 (40) 37631 4232
news@rolandberger.com

think:act CONTENT

Publishers: Burkhard Schwenker, António Bernardo

Overall responsibility: Torsten Oltmanns

Project management: Dr. Katherine Nöling

Roland Berger Strategy Consultants

Am Sandtorkai 41

20457 Hamburg

+49 (40) 37631 4421

news@rolandberger.com

WHAT NEEDS TO BE DONE

How to guide your company safely through the crisis

1. Draft scenarios
2. Secure financing
3. Review investments
4. Tighten costs
5. Streamline portfolio
6. Check restructuring
7. Managing value

