View metadata, citation and similar papers at core.ac.uk brought to you by CORE
provided by Research Papers in Economics

CORPORATE STRATEGIES DURING THE GLOBAL CRISIS

Prof. Marilen PIRTEA, PhD
Assist. Prof. Cristina NICOLESCU, PhD Student
Junior Assist. Claudiu BOŢOC, PhD Student
West University of Timişoara

The financial crisis has created a structural break that shifts many of the competitive parameters that the corporate strategies were build on. Hence, companies have to comprehensively reassess and often redesign their strategies, both to survive the crisis, and to benefit from the next economic upswing.

The financial crisis originated from problems in the financial sector in the U.S.A. and the U.K. The contagion spread through the global financial sector affecting banks in numerous other countries, and causing an unprecedented credit squeeze as inter-bank lending came to a virtual hold. This in turn affected the real economy as businesses faced liquidity squeezes and consumers cut back their expenses. To assess the likely impact on the real economy, and strategies that business may adopt during the crisis, we need to understand what is happening in the key markets in which businesses operate. They vary across industries, and decision makers thus may want to do a similar analysis with the markets and moderators that are most relevant for their industry.

We will present the likely trends, threats and opportunities in key markets: finance, real estate and housing, corporate assets, consumer goods and services, currencies, natural resources and labour. The emerging trends are: for the financial sector: disintermediation in the banking sector created an intensive credit squeeze (less availability and higher costs); this is reinforced by fewer internally generated funds due to decreased company profits, for real estate and housing: substantive decrease in real estate prices in some countries; for corporate assets: large decrease in the value of share prices; for consumer goods and services: slower world economic growth affecting in particular premium segments, consumer durables and international trade; for currencies: exchange rate realignments, and higher perceived exchange rate risks; for natural resources: prices of natural resources, notably energy, have fallen from all time high, yet precious metals remain expensive and for labour: increased unemployment weakens individual bargaining position, yet organized labour unions may gain influence.

The consequences for Business in the Real Economy consist in: financial constraints on investments, especially for firms with higher financial leverage and reduced wealth lowers spending (financial sector), reduced private wealth reduces spending (real estate and housing), ability to raise finance reduced, but opportunities to acquire businesses at reduced prices (corporate assets), reduced demand and greater cost-consciousness of customers (consumer goods and services), Growth opportunities for countries with devalued currencies, changes in pressures for offshoring, advantages for those who can react flexibly, increased costs and reduced availability of hedging instruments (currencies), temporary relief from a much anticipated crisis (natural resources), availability of labour

increases, yet social issues associated with unemployment may cause disruptions (labour).

The crisis in the financial sector has created an intensive credit squeeze in autumn of 2008 that drastically reduced credit available to the real economy. This credit squeeze has reduced the access to bank finance and thus ability of businesses to invest. Lower profits reinforce this shortage of financial resources as they reduce the ability to finance investments internally. The effects of the squeeze vary considerably across firm depending on their finance structure. Particularly hit are businesses that relying to a large extend on banks for their financing, namely small and medium-size privately held companies; some of whom have seen their working capital credit lines cut and thus had to reduce the scope of their business, or even shut down. The credit squeeze also affects entrepreneurs considering setting up a new business as all sources of new finance – both bank loans and venture capital – are more difficult to obtain.

Secondly, asset prices have declined sharply. Initially the burst of the housing market bubble in the U.S.A. and some other countries reduced the perceived wealth of private individuals. The decline of these assets reduced the value of investment and pension funds, and thus private savings. These effects combine to reduce the wealth held by private individuals, and thus their consumption. However, they also generate opportunities for those with cash reserves to acquire businesses at much reduced prices.

Fourth, falling (nominal) wealth and depresses consumer spending and thus market demand. Worldwide GDP growth has slowed from 5.0% in 2007 to 3.7% in 2008, and the IMF has predicted a further drop to 2.2% in 2009. Many advanced economies entered recession in 2008, and forecasts for 2009 suggest negative growth for OECD countries as a whole.

This slowing of demand is likely to affect some industries more than others. During severe recessions, consumers focus on their basic needs, while cutting expenses for products and services higher up on Maslow's 'needs pyramid'. Thus businesses providing for example food and household goods at value for money prices are likely to find their demand to be fairly resilient, while recession is likely to hit in particular: premium brands (consumers switch to lower cost segments), consumer durables, such as cars (purchases are often made on credit and can easily be postponed), and export oriented businesses that suffer from a decline of international trade.

Fifth, exchange rates have moved considerably during 2008, including a rapid depreciation of for instance the British pound and several East European currencies vis-à- vis their main trading partners in the Euro area. At the same time, the Euro remained strong, while the US$ recovered from its recent weakness. These changes are presumably driven by perceived investment risk, but they might help the export performance of countries with devalued currencies.

Sixth, commodity prices have declined from all time highs in 2008, which may provide a (probably temporary) relief of demand pressures in recent years that saw prices climb to unprecedented. At the same time, however, prices of precious metals like gold and titanium remain high as they are perceived to be stores of value in uncertain times. More fundamentally, the volatility of commodity prices illuminates the difficulties of predicting key economic variables even in the medium term, and thus the risks inherent in long-term investment decisions.

Finally, labour markets are affected indirectly. The credit crunch induced businesses in the real economy to lay-off staff, which resulted in substantial increases in unemployment. It also caused considerable anxiety among the remaining workforce.

All of these markets are subject to expectations of the market participants. Any economic decision is shaped by the

decision makers' expectation of future states of the world.

Over the past two decades, many companies have shifted the scope of their operations towards global niche strategies.

The phenomenon is equally common among medium-size companies, especially in business-to-business markets.

Conglomerates have become focused but highly international organizations that resourced their international growth in part been the sale of other business units. Thus, globalization has changed corporate strategies. In the 1980s, firms may have had a choice between being a domestic, diversified powerhouse and a global niche player. At the onset of the 21st century, they no longer had that choice. Globalisation has created an integrated competitive landscape, where (almost) every firm competes with any other firm that happens to offer similar products or services.

Global strategies enable MNEs to create and exploit competences that provide competitive advantages over domestic firms. These opportunities arise from the exposure to a diversity of markets, resources and regulatory regimes.

Greater economies of scale can be attained by supplying multiple national markets from one site, thus reducing costs of, for instance, product development, production and distribution networks. Global scale moreover enhances bargaining power vis-à-vis suppliers and other business partners. If the economic crisis shifts consumer demand to value-for-money products and services, cost savings from scale economies, they would become even more important.

Firms can exploit comparative cost advantages across locations by disaggregating production and sourcing operations across different locations. This allows them to arbitrage even small differences in costs, especially for labour and raw materials. It may also enhance flexibility allowing smooth shifts between alternative sites for production and for sourcing. Both of these capabilities are likely to be even more important in price-driven competition.

Integration of research and development (R&D) sites round the world allow access to a diversity of talent and knowledge clusters, and interaction with the most innovative customers, suppliers and researchers.

The exchange of operational knowledge, experience and competences linkages across operations and locations are a potential source for innovations and new competencies. By creating and sharing databases and human capital across operations firms thus create a global knowledge pool that can support each individual operation. For example, creative ideas on how to address the challenges of the economic crisis may quickly be transmitted and redeployed around the world.

Businesses serving other businesses often work with customers that themselves have a global scope of operation, and expect delivery of the same product or service at multiple sites. Firms with global distribution networks and production sites in many business hubs are often better positioned to supply these key account customers, for example in the automotive sector.

Single country operations cannot realistically replicate the cost and dynamic advantages of an operation integrating multiple locations.

Principally, these advantages of a global operation continue to apply during the recession. The first two advantages, in fact, are likely to become more important when competition shifts from brand image to cost effectiveness. Both, scale economies and efficient global supply chains enhance an organization's ability to withstand intensified cost pressures. The resource-constraints of the recession may limit firms ability to build new global capabilities, yet firms that have build such capabilities are now in a good position to exploit them. Hence, certain costs and risks may increase, yet

the fundamental arguments for a global strategy remain in place.

In the 1990s and 2000s, the globalization of corporate strategies has accelerated. This process had been driven by complementary external and internal forces: technological advances, market liberalization, financial markets, and managerial leadership.

From a strategic management perspective, the global crisis represents a 'structural break', that is a moment in time when the basic trends and patterns of the business environment are likely to change in many industries. This creates both challenges and opportunities for businesses to create new strategies and business models based on a comprehensive reassessment of all strategic parameters.

In the short-run, survival strategies have to address immediate threats, and may exploit temporary opportunities.

In the long-run, companies have to positioning themselves strategically for an upswing in a 'new economy' that may be very different than the recent economic boom.

Regarding the financial sector, survival strategies (short-run) refer to: retain cash flow to enhance flexibility and sell peripheral businesses to increase financial resources and the strategic positioning (long-run) refer to: opportunities for those with cash reserves to acquire other businesses.

Regarding the real estate and housing sector, survival strategies (short-run) refer to: avoid high leverage to reduce risk of negative equity and the strategic positioning (long-run) refer to: acquire real estate at much lower prices.

Regarding corporate assets, survival strategies (short-run) refer to: avoid high leverage to reduce risk of bankruptcy and the strategic positioning (long-run) refer to: implement strategic change that had been inhibited by organizational inertia before the crisis and acquire assets at much lower prices.

For consumer goods and services, survival strategies (short-run) refer to: opportunities in niches likely to be resilient during the crisis and the strategic positioning (long-run) refer to: position the business in segments with growth potential in the long run and develop new business models for the new economy.

Regarding currencies, survival strategies (short-run) refer to: flexibly shift operations to countries with devalued currencies and the strategic positioning (long-run) refer to: retain operational flexibility to react to future exchange rate re-alignments.

Regarding natural resources, survival strategies (short-run) refer to: smoothen the phase-out of energy and resource intensive technologies and the strategic positioning (long-run) refer to: continue to adapt to in the long-run likely higher resource costs.

On the labour market, survival strategies (short-run) refer to: downsize non-essential labour and the strategic positioning (long-run) refer to: retain labour that is essential for long term strategies, train and engage staff to build a loyal workforce for the next upswing.

The shifts in the business environment suggest that we see a structural break in the global economy. Yet, the nature of this structural break is not yet known, and it is almost impossible to forecast.

However, three major themes emerge from the discussion of the consequences for business strategies, and they merit further exploration: opportunities in niche markets likely to be resilient to the crisis, strategic and organizational flexibility to react to changes in the environment, and opportunities for restructuring to position the firm for the new economy evolving after the 'structural break'.

The rapidly changing and hard to forecast environment favors those who can react flexibly to changing trends. The first pre-condition for being able to react flexibly is to retain cash reserves that can be invested when opportunities arise. Moreover, in this downturn, the lack of liquidity appears to be a more common cause for companies to fail than lack of profitability. This creates challenges to

balance the need for cash flow with retaining resources and investing in new opportunities. Difficult choices arise, for example, for decisions such as paying dividends and share buy-backs. The imperative of retaining cash flow suggests not to pay dividends or to buy back shares at this time, when if the business is profitable.

Financial analysts may interpret a lack of dividends as sign of weakness and thus advise to the contrary. However, given the economy-wide shortage of credit, I would suggest that keeping cash in-house shows foresight in view of opportunities in a rapidly evolving business environment, and financial analysts ought to rethink what provides an organization with a basis for survival and sustainable growth at this time.

A structural break presents an opportunity for strategists to design entirely new strategies. The successful design of a new strategy however requires a vision of what the new economy may look like, and where the business ought to be positioned within this new economy. The financial crisis of 2008 had a disruptive effect on many but by far not all industries, and it is likely that we are experiencing a structural break with the emergence of a new economy that is driven by new business models and industries.

Yet, the crisis leaves the basic logic of global strategies in tact; globally oriented businesses will also in the future attain substantive competitive advantages over their purely domestic competitors, based on their global supply chains, global market access, or global product development.

In this crisis, businesses need two kinds of strategy, a survival strategy and a strategy of positioning for the new economy.

REFERENCES

Courtney, H.	*Crafting strategy in an uncertain world*, Harvard Business School Press, 2001
Ghemawat, P.	*Redefining global strategy*, Boston: Harvard Business School Press 2007
Khanna, T. & Yafeh, Y	*Business groups in emerging markets: Paragon or parasites?,* Journal of Economic Literature, 65, pag. 331-372, 2007
Maslow, A.H.	*Towards a psychology of being*, 3rd ed., Wiley, 1998
Meyer, K.E.	*Globalfocusing: From domestic conglomerates to global specialists,* Journal of Management Studies 43(5): pag. 1109-1144, 2006
Newman, K.	*Organizational transformation during institutional upheaval,* Academy of Management Review 25: pag. 602-619, 2000
Rugman M. Alan, Verbeke Alain	*Global corporate strategy and trade policy*, Routledge,1990