

## Recession Planning: Turning Fog Lamps on the Current Uncertainty

By Peter J. Kennedy, Jr. and Patrick B. Marren

*The article below went to press in August 2008, when the economic turmoil of the moment seemed almost manageable. Six weeks later, all hell has broken loose. Elements of worst-case conditions suggested in the article appear to be coming true. A postscript added on September 26, 2008 tries to put the more recent events in a longer-term strategic perspective.*

The U.S. is at an uncertain and potentially dangerous economic juncture – this much we know, but beyond that fairly obvious observation, not much at all is certain. There’s definitely no clear roadmap for sustained recovery and growth. And yet, life (and corporate decisions) do not wait for the clouds to lift. And that is why firms need practical steps to manage this uncertainty and guide today’s decisions.

The real risk for business right now is, as someone said 75 years ago, fear itself. Fear often translates into paralysis, which leads either to inadequate preparation for risks not already on the horizon, or to overly cautious management that overlooks upside opportunities. Uncertain times demand the imagination and courage to explore an expansive range of market “futures” that might plausibly present themselves over the next 18 to 48 months.

For, as hard as it is for some to believe, today’s wounded markets, too, will revive, perhaps sooner than later. Modest though they are right now, there are some hopeful signs. The latest GDP figures for the second quarter of 2008 showed unexpectedly strong growth of 3.3%, not a contraction. Exports, behind the weak dollar, continue to surge. Also, by the end of August, light crude oil prices were down some 30% from their peak and many analysts were expecting further price falls, perhaps back into double digits. If sustained, oil price moderation would have a hugely uplifting impact on markets – and consumers – grown twitchy over the prospect of persistent inflation. This would also help uplift the battered dollar.

On the housing front, there’s also modest room for optimism, albeit longer term, with the federal government’s decision to take over Fannie Mae and Freddie Mac. No one doubts that stability in the real estate sec-

tor is a critical pre-condition for sustained U.S. economic recovery.

On the opposite extreme, we may indeed be looking at something rather awful, especially if the asset price collapse turns out to be more pervasive and stubborn than we would like to think about. In the real estate domain, no one knows what will be the full impact of the Fannie Mae and Freddie Mac disasters. It’s one thing if real estate’s recovery is slow and painful; it’s another if the credit markets are so seized up by recent shocks that businesses cannot get loans.

And what about another financial shock, such as a chain of hedge fund failures? This is the kind of event that could lead to contagious panic, setting in motion a range of financial, economic, and political actions and reactions that could spur a full-blown global economic crisis. This is the economic doomsday possibility, not that far-fetched considering the plausible triggers (e.g., a new oil shock, a new Middle East war, a terrorist event) that could spark such a nasty chain reaction of economic events. One cannot also help but wonder what knock-on effects the Russian invasion of Georgia will spark.

### THE ILLUSION OF A “MOST LIKELY CASE”

What then is the strategic take-away from these two extremes? Don’t bet the farm on either scenario happening. Neither one will, in exact detail. And don’t bet on some arbitrary intermediate case, either. The future is never adequately captured by a “best/expected/worst case” analysis. It’s always richer and, at the same time, messier, an amalgam of the expected and the shocking. Betting your all on a “most likely” case is quite possibly the most dangerous course your organization could possibly take.

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Executives would be wise to face up to the impossibility of predicting the actual course of truly unpredictable events. Instead, focus on conditions that create big, strategic risks in your particular world of work. These might include, for example: a prolonged weakness in U.S. consumer demand; disruptions in supply chains originating in China; a persistently weak dollar; or double-digit U.S. interest rates.

Do not neglect to throw favorable elements into the mix: an export-led manufacturing rebound; lower benefit costs because of a national health policy; the possibility of higher H1B immigration quotas for technical employees; or new regulations that create favorable competitive conditions.

Think also of “wild card” events, which can occur suddenly, and quite independently of the business cycle. These might include environmental catastrophes (related or unconnected to global climate change); a disruptive technological breakthrough; or even a successful attack on the U.S. (and the world’s) cyber infrastructure.

### ANTICIPATING THE EVENTUAL RECOVERY – NOW

Finally, assemble a cross section of left- and right-brain people from across your organization to think through the strategic implications of these risk factors. This can be done in an informal “what-if” manner, or in a more structured (e.g., multiple strategic-scenario) framework. The important thing is for business leaders to invest the time in exploring alternative business conditions that could plausibly occur, and then to have the courage and resolve to adjust current plans and decisions on the basis of the new insights that emerge.

Turning the fog lights on the current uncertainty is no guarantee that all the right calls will be made. But it’s one of the best bets against big mistakes and being blindsided by an event or set of conditions that was either missed or otherwise deemed unlikely. The winners of tomorrow will be those who do not allow the current panic to drive them into tunnel vision, and who avoid failures of imagination.

Five or so years from now, case studies will be written about the prescient business leaders who, way back in 2008, made the right strategic moves at a time of extraordinary market uncertainty. Some will be brilliant; some will just be darned lucky. But, in any case, the odds of success will be maximized by a thoughtful and serious investment in “dress rehearsal” of organiza-

tional decisions matched not against some “most likely future,” but against multiple scenarios of both recession and recovery.

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### (POSTSCRIPT: SEPTEMBER 26, 2008)

As always seems to be the case in this decade, reality has outstripped bad fiction. The past two weeks have seen change and disruption on Wall Street, the disappearance of several household names in the world of finance, and a proposed government bailout of such gargantuan proportions that even we hardened writers of corporate non-fiction would have been laughed out of town if we had written it into a client scenario.

Although some of its particulars have been overtaken by events, the basic message of the article above has been validated: anyone betting on a “most likely scenario” in this current economic storm is probably wearing a barrel right about now.

As the article might have suggested, it has been a very bad millennium so far for the “conventional wisdom” in almost every sphere of human endeavor. A quick survey:

- 2001: Almost everyone agrees that terrorism is a serious problem and that steps must be taken within the decade, if not within a few years, to prevent another USS Cole or 1993 World Trade Center bombing.
- 2003: Almost everyone agrees that Saddam Hussein has weapons of mass destruction, though not everyone agrees on what to do about it.
- 2003: Almost everyone agrees that the U.S. victory in Iraq will be swift and relatively painless, on the order of the 1991 war.
- 2005: Almost everyone agrees that the Iraq War is lost and that the “Surge” cannot possibly be followed by improved conditions on the ground in Iraq.
- 2007: Almost everyone hails the upswing on Wall Street and anticipates another long boom like the 1990s, now that the stagnation of 2000-2006 is over.
- 2007: Almost everyone tabs Hillary Clinton as the winner of the Democratic presidential nomination.

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- 2007: Almost everyone dismisses the John McCain campaign as absolutely dead in the water.
- 2007: Almost everyone proclaims the 2008 election will be “a referendum on Iraq.”
- Summer 2008: Almost everyone admits that the economy is in recession (just before the announcement of second quarter GDP growth of 3.3 percent).
- September 2008: Almost everyone on Wall Street believes the government bailout of Fannie and Freddie has just about solved the mortgage crisis.
- Later September 2008: The Secretary of the Treasury insists on sweeping unreviewable power to buy up as much as \$700 billion in bad assets on behalf of taxpayers, or else... some things will happen that he does not quite specify. Experts are, for once, divided on what might happen if we do, and even more on what might happen if we don't.

In times like these, “thinking out of the box” may not be enough. In order to capture the actual gigantic range of plausible futures, we may have to think right out of our known universes. The Congressional-Bush administration plan may be adopted essentially as is, and work perfectly – or flop; it may be adopted with significant revisions, and work or flop; it may not be adopted at all, as lawmakers revolt against the bailout of “rich Wall Street screwups,” and the result might be disaster... or nothing much at all. (Remember Y2K?)

Whether a bailout package is passed or not, the crisis may be contained to a few Wall Street insiders; it might merely have significant ramifications for short-to mid-term growth in the “real” economy; or it might be a second worldwide depression.

The examples given above show how badly one-dimensional conventional wisdom can lead us astray in reasonably stable times. The one upside of the chaos of this past week might be that for once, there *is* no conventional wisdom, and we *have* to imagine gigantically different possible outcomes simply to function.

The deep dark secret, though, is that even in times of relative stability, the experts are often wrong about what is coming around the corner.

In fact, *experts being wrong is the source of most crises in the world*. When experts are right, things are predictable, and crises don't occur. It's only when they are wrong, and obviously wrong, that fundamental uncertainty and real crisis take hold.

Which is why, as the article states, a rigorous approach to examining the broadest possible array of potential future conditions is a good idea even in the best of times... which these clearly are not.

Stay tuned...

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