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THE NEW ECONOMY: The Great Recession is Ending – NOW WHAT?

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INTRODUCTION

Thomas Harris, author of the Hannibal Lecter series of thrillers, wrote "how seldom we recognize the sound when the bolt of our fate slides home." As family and closely held business leaders, we are generally focused on the task at hand and may not have fully recognized that permanent life- or business-altering events have recently taken place. There is quite a bit of thinking these days that in the recovery following "The Great Recession" things won't transpire as they have in other recoveries. The ground has moved under our feet, and the change in fundamentals may well be permanent. The purpose of this paper is to challenge family and closely held business owners to think differently about their businesses and their futures, and, most importantly, what to do in the New Economy to assure success.

Leading economic indicators are trending upward showing that, while the economy is not yet what anyone would call robust, it is at least digging out of its hole. Single family home starts have now risen for five straight months – up 37% from the bottom according to the Associated Press. The New York Federal Reserve Bank reported that manufacturing is growing for the first time since April, 2008. The stock market has rebounded from its low of around 6500 in March, 2009, to over 9000 today, an increase of over 40%. *Newsweek* reports that the economy is currently expanding at a 2.5% annual rate in the third quarter, and consumer confidence is finally starting to come around again.

If the Great Recession is truly coming to a close, what will the recovery look like? What are the factors that will cause this recovery to be fundamentally different from others in the last 25 years? Why would this recovery be more challenging, and what do we as business owners do about it? Why are some people referring to this recovery as "the new normal," "the permanent recession," or "the era of low expectations?"

FIVE FOUNDTATIONAL AREAS OF IMPACT

The following is a brief discussion of five foundational areas which will have enormous impact on our economy's ability to recover and help explain why the new economy will look considerably different from the recent past.

1. **<u>Consumption</u>**

Just as the Great Depression shaped our parents' and grandparents' notions of consumption versus thrift, so the Great Recession may shape ours. The financial meltdown of the Autumn of 2008, the nationalization of General Motors and Chrysler in addition to money center banks, and the 50% drop in the stock market all shattered the beliefs that the American economy had somehow become recession proof and the Federal Reserve magically managed macro-economic factors to keep us on a continuous upward glide path. Consumption is not likely to come around soon because of a number of different factors.

- **Persistent unemployment**. This is the only recession since the Great Depression to wipe out all of the job growth from the previous expansion. The current unemployment rate is 9.4%, and the Federal Reserve expects it to exceed 10% in the near future. That is up from 4.8% in only 16 months! The economy has shed about

5% of its total jobs so far, far outstripping the 3% that the economy lost in the early 1980s. The Bureau of Labor Statistics reports that new hiring is the lowest it has ever been in the history of their survey.

- **Length of unemployment.** The average length of unemployment is 24.5 weeks – the longest since the government started tracking this statistic in 1948. Of the vaunted "stimulus" money, less than 10% of the $787 billion was to be spent on infrastructure in the first place, and comparatively little has hit the marketplace. So much for "shovel ready" projects to jump start employment.
- **Average work week.** The average work week is down to 33 hours, the shortest ever recorded. Therefore, as the economy recovers, companies are far more likely to give additional work time to existing employees – many of who have involuntarily become part-time workers – rather than hire new ones.
- **Falling wages**. Even state governments (California for example) have had to cut back on employee pay. It's possible that the United States could see negative wage growth in the near future as employers continue to tighten their belts.
- **Psychological stress**. Consumers lost $14 trillion, or 22% of their total wealth in The Great Recession. They are not likely to forget that pain anytime soon. Savings, not consumption, is today's mantra.

Consumption, which drives about 70% of our economy, isn't likely to increase until employment increases and wages grow. This recovery is likely to be characterized by persistent unemployment.

2. <u>Government</u>

Government intervention in the economy is expanding at a rate not seen since FDR in the 1930s. It has become increasingly difficult to distinguish between the two major political parties; both seem to have an appetite for ever bigger and more active (intrusive?) government. Confidence in government is decreasing. Town hall meetings around the nation show that "Joe the Plumber" type constituents are horrified about the idea of government run health care and the new taxes and fees necessary to pay for it.

Government officials have continually been embroiled in scandals. The governors of North Carolina, South Carolina, and New York have all had tremendous scandals surround them. In New Jersey, local politicians and religious leaders have been caught up in a web of political and financial corruption. A former member of congress from Louisiana was caught with almost $100,000 in cash stashed away in his freezer; he was recently convicted. And Timothy Geithner, Tom Daschle, and Charles Rangel, all political notables, have had humiliating episodes of failure to pay their taxes.

The $787 billion stimulus package, a product of both political parties, has unsettled many family and closely held business owners who don't believe in government bailouts of corporations – large or small – which happen to find themselves in trouble. President Bush's comment about having to act against his free market principles in order to save the free market simply failed to resonate in the family business community.

Business owners are uncertain and afraid of what is to come from government in the near future. They don't really know what their payroll taxes will look like next year; they expect income and corporate taxes to go up. They expect that they will somehow be required to pay for the burden of government run health care or "cap and trade" legislation. *Newsweek* magazine says the Obama administration economic strategy "rests on what some might call industrial policy or excessive government intervention – or even creeping socialism", and many family business owners agree. And last but not least, our annual deficit of about $1.5 trillion is 10% of GDP, a number not approached since the Great Depression of the 1930s. Five more years of those 10% of GDP deficits will increase America's debt to a level greater than 100% of GDP, a level that many economists and analysts recognize as a point of no return.

The relationship between government, individual citizens, and family and closely held businesses may have been altered permanently – and it scares the wits out of most family business owners who don't see positive outcomes for them as a result.

3. Technology

Technology is continuing to change at a rapid pace. The internet has become the primary source for news and information for a vast number of people. Traditional daily newspaper circulation is plummeting, and television and radio are experiencing precipitous declines in viewership and listenership as well. The buzz these days is all about Twitter and Facebook. According to some analysts, the internet will revolutionize how businesses reach out to their potential customers – but most family and closely held business owners don't yet know how they'll use technology to make this so, and they also fear that once they master Twitter, for example, something new, better, and faster will come along. Partly because new technology can be expensive – especially early in its product life cycle – family business owners have been reluctant to fully embrace technology as a way to market, communicate, and increase efficiencies. As a result, they have fallen behind the learning curve and are at a severe disadvantage to larger, better financed competitors – and risk permanently being on the backside of the technology learning curve.

4. Leverage & Finance

McKinsey reports that "the future will reveal significantly lower levels of leverage (and higher prices for risk) than we had come to expect." Therefore, businesses that rely on leverage – that means virtually all real estate and development related businesses – will suffer years of lower or even negative returns. Banks, which 18 months ago seemed to be willing to loan money to anyone for anything at any time, now are reluctant to loan money to even their best customers. One successful family business owner saw the recession as an opportunity to buy distressed real estate and businesses and, along with four other successful businessmen, pooled about $10 million of cash. They then approached banks to borrow an additional sum in order to give them a venture capital pool of about $30 million. These five businessmen, men who had always been able to borrow on favorable terms and who had always repaid loans on time, could barely get bankers to speak to them. Banks simply weren't loaning money.

In the past, the Federal Reserve had sought to stimulate the economy during recessions by lowering its key interest rate. That's not going to happen again; the Fed lending rate is now zero! Banks and investment firms, due to the financial crises and the Bernie Madoff scandal of late 2008, are in an environment where they are being regulated and scrutinized more tightly than ever. In fact, the full scope of the scrutiny isn't even known at this time. Therefore, the presence of leverage in the economy is simply not likely in the short run.

Another strategy used to stimulate economic growth is tax cuts. The current environment in which politicians are proposing to spend money like drunken sailors while government tax revenues at all levels are declining renders the possibility of tax cuts absolutely zero. In fact, many states have already enacted tax increases to balance their budgets. Taken together with the stimulus package which has failed to stimulate, there is not much politicians and regulators can do to fuel economic growth.

5. Demographics

Demographics will play a key factor in determining the pace of economic growth in the new economy. Several factors which allowed and even encouraged economic growth in the past are no more: 1. Immigration is slowing, 2. the historic entry of women into the workforce has basically run its course, and 3. the increase in the number of college graduates is slowing.

The fact is that America is "graying." The percentage of adults now working is about 59.5% down from 64% in 2000. The massive wave of post-World War II babies has run its course, and today's families simply aren't having as many children. The U.S. fertility rate – that is, the rate at which the current population is having babies – is at about 2.11, exactly the rate necessary to replace ourselves with zero future population growth. Illegal immigration is slowing due to the Great Recession and the trend towards stricter enforcement of immigration laws, and legal immigration is fixed. The U.S. is not growing in terms of population, and most developed Western nations are actually experiencing population decline.

There is a cost to the graying of America above and beyond simply the potential lack of skilled workers. The Congressional Budget Office says that federal spending for Social Security, Medicare, and Medicaid will increase annually by 6% over the next 20 years. These three programs represent an approximate $40 trillion liability that the government will be required to pay. That is a ticking demographic and financial time bomb with which we must reckon.

WHAT DO FAMILY BUSINESS OWNERS DO ABOUT THE NEW ECONOMY?

This recovery isn't going to feel like recent recoveries. You might say that we are now entering an era of lower expectations. The "future normal" is likely to be more cyclical than the post-1982 period. The low of the Great Recession was so low because our economic highs had become so high. The high tech bubble burst in 2002. The stock market bubble burst in 2008 after reaching its peak in August. The housing bubble burst in late 2008. Unless there is another bubble (and who in his right mind wants to perpetuate that cycle?), we can expect slow growth and a return to more frequent – if less severe and frightening – recessions as we had previously experienced throughout our economic history.

What then should family and closely held business leaders focus on in the New Economy to assure their survival and prosperity? Here are ten timely tips:

Tip #1: Focus on customers. With respect to your customers, find out what has changed for them as a result of the Great Recession. What can you do to help them shore up gaps? What has remained the same for them and doesn't require new services, products, or technology? Improve your customer Quality Assurance, convene focus groups of your customers, or undertake Voice of the Customer research in order to learn how to serve them better. Make sure you're devoting sufficient tender loving care to your existing customers; sometimes this is referred to as "super-pleasing." Super-pleasing existing customers and going back to former customers with whom you haven't done business in some time represents both a must and an opportunity in the New Economy.

Tip #2: Rethink business development. In the last seven or eight years, many companies haven't given much thought to their marketing plans. As one family business owner said, "We were like monkeys swinging from trees overloaded with bananas. Now that we're out of bananas, we have to get on the ground to find food only to find out that there are tigers and other dangers there." Finding abundant "bananas" isn't so easy today.

A good marketing plan is based on formal or informal customer research. Analyze current market outreach – including your website – for return on investment (ROI). The highest quality, the best products, and the best service don't matter a hill of beans if no one knows you're out there. For someone to enjoy your wonderful quality and terrific products they have to know about you first, and they must know that your product or service will help them solve a problem or create an opportunity. During the go-go era since 1982, business development for many companies has been comparatively easy. Those days are gone, and a renewed focus on the business development function is an absolute must to thrive in the New Economy.

Tip #3: Focus on how you spend executive time. In our newest book, *The Top Nine Reasons Family Businesses Fail and the Eight Building Blocks for Creating a SUSTAINABLE Closely Held Company* (http://www.familybusinessinstitute.com/index.php/Books-and-Publications/vmchk.html), we devote an enormous amount of space to the seemingly simple concept of time management. Experts estimate that most executives spend 40% to 50% of their time doing things which other people in the organization could do just as well, better, or at a lower cost. In the New Economy it will be incumbent on executives to exhibit leadership and focus like a laser beam on their highest payoff activities. The luxuries of getting out onto the shop floor and operating equipment or running company errands like picking up the mail or making bank deposits is a foolish expenditure of time for executives who should be focused on business development and other high payoff activities. Rationalizing low payoff behavior because "that's the way we've always done it here" can be a death sentence. Examine how you spend your time, and make sure you're doing high return activities instead of activities which should be done by someone else.

Tip #4: Build a better, more effective team by getting the right people on your bus. In *The Top Nine Reasons Family Businesses Fail and the Eight Building Blocks for Creating a SUSTAINABLE Closely Held Company* (http://www.familybusinessinstitute.com/index.php/Books-and-Publications/vmchk.html), we write: "Without great people, an entrepreneur or a family can only go so far. Since, as we've established, most entrepreneurs manage tasks and activities, they rarely focus on hiring the right kind of people or managing them for maximum performance." The Great Recession has produced an interesting byproduct – there are as many talented people searching for work now as there has been in our lifetimes!

Given the tight conditions and the prospect of low growth in the near future, we're NOT advocating increasing your head count. Rather, we're talking about a rigorous, dispassionate evaluation of your current team against the skills and talents of job seekers. One talented additional employee can do the work of two to three poor performers! As hard as family and closely held business owners work, don't they owe it to themselves to find other committed, talented people to share (or relieve some of) the load?

A barrier to getting the right people on your bus has been the simple lack of time and "how to" knowledge. *The Top Nine Reasons Family Businesses Fail and the Eight Building Blocks for Creating a SUSTAINABLE Closely Held Company* (http://www.familybusinessinstitute.com/index.php/Books-and-Publications/vmchk.html) devotes an entire chapter to help business leaders help themselves by offering methodology on hiring, retaining, and evaluating employees.

Tip #5: Periodically undertake expense audits or expense benchmarking. It is often difficult for closely held business leaders to know exactly where and how much to cut. It is awfully tempting to say, "There's absolutely no fat in my budget," but the facts contradict this claim. During the fall of 2008, a business owner called. He had a vague, unsettled feeling that he was probably spending more on his internal accounting team then he really should have. However, he didn't have a measuring stick against which to compare his expenditures. We were able to provide him with a standard, and, sure enough, his entrepreneurial instinct was correct. He had an overstaffed accounting department which was costing him far more money than departments in companies of similar size. To compound the problem, since there really wasn't enough work to keep everyone in the department fully occupied, their productivity had dropped so that work could be stretched out over all the people over the course of an entire work week. In other words, he had five people doing the work of three.

Expense audits can help you see clearly where you have costs out of line or, conversely, low productivity departments or functions which could stand to be shaken up. Know your costs – REALLY KNOW THEM. Most executives are in pretty good shape below the gross margin line (regarding their understanding of "support" costs), but a lot of them struggle above the line, which is where the real strategic decision making takes place. Whether it's construction, the funeral industry, manufacturing, etc., if you're producing 20% gross profit, that means 80 cents of every dollar is spent directly generating revenue. If a company is looking to reduce costs, it's likely to find more in that 80% than the residual 20%. Large numbers of family business executives really don't get that math or understand how to drive margin.

Whether you take a percentage or absolute view of contribution margin, inaccurate cost of goods information leads to poor service/product mix which will drive a business into the ground a lot faster than something aberrant below the line. Family business leaders have to do a better job of leveraging information and systems to get timely, relevant data regarding gross margin drivers to improve decision making.

Tip #6: Educate and train your people. In a recent KPMG survey, a large majority of young people rated training and development more important than even job security or salary. Everyone has tightened their belts during the Great Recession. Now, in the New Economy, there is an extreme reluctance to add new employees only to have to let them go again during the next recession. That means you're going to have to do more with less. One way to do that is to train and educate your employees. The training doesn't have to be expensive; for example it can be done in-house simply by having key managers share and pool internal best practices. Training also has the characteristic of increasing employee loyalty and morale; if you invest time and money in them, that's a clear signal that you are optimistic about the role they play as well as optimistic about the future of your company.

Tip #7: Increase your orientation towards technology. If in the New Economy we are going to be expected to do more with less – and we will be – then embracing technology is going to be increasingly important. Technology can now be used to have virtual meetings with customers and suppliers, communicate instantaneously with employees, push out promotional information about your company to thousands of people rather than a few dozen, and increase your visibility light years beyond where it was just a few short years ago. Irrespective of industry, you can rest assured that before people do business with you, they check the internet and visit your website; if you don't think this is true, simply ask your newest customers or employees. A family or closely held business today which finds itself resisting new technological opportunities is embracing the status quo versus embracing a better future.

Tip #8: Avoid the temptation to do nothing and be complacent about changing current conditions. We can't tell you over the years how many times we've heard the statement "that's the way we've always done it here." If in the New Economy a family business is stuck in the status quo and TTWWADIH thinking, it could be a death sentence. Shake out of that "do nothing thinking," and make sure that you get outside your comfort zones and do the things necessary to assure the survival of your closely held company.

Tip #9: Undertake comprehensive business planning. Comprehensive, 21st century business planning is simply *the best known tool to exist for producing both business success and family harmony.* If you don't know anything else about business planning, understand this: Companies that plan make more money than companies that don't! Steven Covey writes:

> *Planning is predetermining a course of events – working through what must happen if a desired result is to be brought to pass. Writing your plan is vital to actually seeing it happen. Until you produce a written plan, your profound thoughts too often will remain in the "someday stage" of development. A written plan on the other hand seems to produce a power and commitment that jump starts the "doing part of the effort."*

Tip #10: Take a proactive approach to politics. Write, call, and see your elected representatives. Join a trade association (if you haven't already done so) so that your voice can be united with others in your industry. Most family business owners have taken a hands-off attitude to politics; it's a messy game. However, in this new environment of bigger government, its going to be essential that your voice be heard. Something over 40% of Americans pay no federal income taxes at all. If that number were ever to exceed 50%, you can imagine that there would be an increased demand for transfer payments from those who are considered "wealthy" to those considered to be "disadvantaged." As small business owners and employers, we no longer have the luxury of being a part of the silent majority.

CONCLUSION

Planning – a process of formal consideration of an organization's future course resulting in an actionable, written plan – will pay off in spades by creating a clearer vision for everyone in your company, better teamwork, better needs anticipation, improved communication, and other benefits.

Roger McNamee, Silicon Valley deal maker, said, "Forget everything that you've learned about time (faster is better), money (capital is free), and leadership (no experience required). Everything takes longer in the New Economy. Longer is better than never, but it requires a different frame of reference. Wealth is no longer an entitlement; vision isn't a template in PowerPoint. Patience will once again be a virtue of great consequence. The trick is to get real about the new set of challenges we face and what it takes to win in an environment where there are no shortcuts. That will be the reality of the New Economy."

One closing thought; while this paper may paint a bleak picture of our prospects for success over the next few years, we remain resolutely upbeat and optimistic. The Great Recession has shaken us in so many ways; what is shaken most is our confidence. The New Economy will have its challenges, but remember that the pessimist has always – always – been wrong over the long haul when betting against the American entrepreneur. In spite of the odds, entrepreneurial family and closely held business owners find a way.