U. P. D. E. S. H

INDIAN MANAGERS EXHIBITED EXCESSIVE OPTIMISM A YEAR AGO, SAYS PANKAJ GHEMAWAT — NOW THEY NEED TO WATCH OUT AGAINST SUCCUMBING TO EXTREME PESSIMISM INSTEAD

THE SCORECARD ON Indian globalisation that I issued last year in these pages attracted a fair amount of commentary, most of it critical: one reader even dubbed me “Professor Pessimist.” How out of touch I was with the spirit of the times became clearer later that month, at Davos. The financial crisis was gathering steam, and most of the Western participants seemed subdued, at least until they hit the receptions. But the Asians seemed to be in a better mood, and the large Indian contingent struck me as particularly ebullient, even by day. There was much talk, as I recall, of decoupling that would allow emerging economies to keep up their growth momentum even as advanced economies slowed down.

What a difference a year makes. FDI into India was running at twice the levels of the previous year’s through September, but has since lagged, and outbound FDI has collapsed, in line with the global financial crisis. Given redemptions by portfolio investors and repayments of loans that aren’t being rolled over, the large capital account surplus in 2007-08 is expected to disappear, almost. Exports are still predicted to grow marginally, but that may not happen given how fast world trade is dropping. And in terms of overall economic output, the mid-year review of the economy cautions that growth may be as low as 7% for the year, down significantly from the 8.7% forecast in the pre-budget economic survey (and 9.6% a year earlier). So much for decoupling!

But enough of the macroeconomic gloom and doom. What should Indian businesses do to deal with the global downturn? Here are half a dozen themes for 2009 that can conveniently be remembered with the acronym of UPDESH:

Uncertainty: The focus on single-point forecasts of growth, even if they have to be revised frequently, is common in Indian business as well as in government, and is symptomatic of a broader tendency to suppress uncertainty. The recent turbulence should remind us, if anything can, that this is a bad idea. Allow for a range of growth rates. And try to at least think through dynamics other than straight line trends. For instance, try to allow for cycles by building lean years as well as fat ones into long-range planning. Or try to model the effects of various kinds of shocks before they actually occur. The broader point here is to envision qualitatively different states of the world instead of simply trying to predict the next bump or shock to it. I think here of an avian flu simulation that I prepared for a client: while the client couldn’t predict, let alone prevent, an occurrence, it could prepare to respond more effectively by thinking through possible responses ahead of time.

Profits (and Capital):
The focus on growth forecasts is also indicative of a fixation on the topline as opposed to the bottom line — which companies were able to get away with against a backdrop of
low interest rates and rising asset prices. And some really dumb deals were done as a result. As Warren Buffett observed about the dotcom bubble, nothing sedates rationality like large doses of effortless money. But with asset prices mired in what looks as if it will be a long slump and capital costs that have increased sharply — effectively to infinity for companies that no longer have access to capital markets — earning an adequate return on capital employed becomes a priority. And liquidity a formidable competitive weapon.

Drive: Improving profitability to a meaningful extent is going to require driving the core businesses hard. What this means is going to vary based on a business or group’s history. Businesses that have, for instance, grown severalfold in the last few years through acquisitions are going to have to accelerate their efforts to integrate their operations — or to find some other way to rationalise them. Extensively diversified groups may need to focus their operational improvement initiatives on a core handful of businesses, and so on. But whatever the specific challenges and opportunities, a common requirement is focused hands-on management. Less time will be available, as a result, for pursuits ranging from pontificating in public fora to engaging in “hobby businesses” to simply taking it easy. 2009 is not going to be an easy year.

Employees: The drive to improve profitability, is likely to lead, at least in the short run, to headcount reductions (although there are exceptions, such as the financial institution that is aggressively recruiting investment bankers). Even where there is no avoiding such reductions, how they are accomplished has a huge impact on the quality and morale of the remaining employees and, as a result, on organisational effectiveness in the longer-run. While this may seem obvious, one of the silliest possible ways of reducing headcount — uniform across-the-board cuts — also seems to be one of the ones most frequently employed.

Strategy: Initiatives to improve profitability or streamline employment remain purely operational unless integrated with a strategic conception of how a business is going to compete. Given how much the external environment has shifted in the last year or so, most businesses will need to review their strategies — although whether that exercise is likely to indicate that change is needed and, if so, in which direction, will depend once again on company context. This particular point is worth emphasising because otherwise, operational exigencies often crowd out strategic thinking during crises — even though that is when a strategic rethink is arguably most likely to be useful.

Horizons: Unless your strategic review indicates that your best option is to wind up your business, the relevant horizon for strategic decision making is going to stretch out quite some time into the future. That raises questions about the observation from previous business downturns: based on US data, investment has tended to decline two to four times as fast as output during them. It is hard to rationalise such large cutbacks as value-maximising, which is why John Maynard Keynes ended up invoking volatile “animal spirits” to explain them. And herd behaviour just reinforces such tendencies. Given this historical record, guard to the extent possible against letting short-to-medium run developments overshadow longer-term intent.

More broadly, while Indian managers may have exhibited excessive optimism a year ago, they now need to watch out against overreacting to the global downturn by succumbing to extreme pessimism instead. Such whiplash is, based on the historical record, quite common. It is also extremely costly. A downturn is not an excuse to forget about the future. That is the overarching point of UPDESH.
Author’s Note: For additional details on strategy during a downturn, see my article The Risk of Not Investing in a Recession in the Winter 1993 issue of the Sloan Management Review (to be reissued there with updated commentary by me this spring).

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