INSEAD

The Business School for the World®

KNOWLEDGE

Steering a new course in unchartered waters

With credit getting tighter, companies are going to have to change the way they do business and manage their cash. Laurence Danon, executive board member of Edmond de Rothschild Corporate Finance in France, says we are likely to see companies implementing huge cost-savings plans, probably with significant layoffs and dramatic changes to capital expenditure and development programmes.

Speaking during a panel discussion at the Women's Forum here recently, Danon described the crisis as unprecedented, global and of historic proportion, adding that we are in uncharted waters.

There will be much less credit coming from the banking system and companies are going to have to find money elseswhere - from private equity firms, for example. For small companies, Danon expects to see the government play a bigger role. "They will have to find new vehicles to finance them, bypassing the banking system."

Danon believes that, after the crisis, the values of entrepreneurship – growth, innovation, new products and services – will be predominant again.

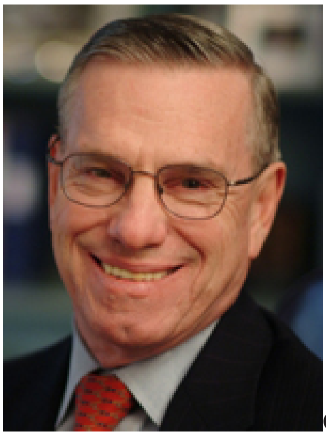
She also sees a rebalancing of economies, with emerging Asian countries such as China and India – as well as Africa with consistent six per cent growth for the last five years – leading the pack. Growth in Europe, however, will remain flat, and regulation will be key for the shrinking US economy.

"I'm sure the governments are not going to own the banks forever," Danon says. "All the senior bankers who pushed for a solution are going to push for a way out as soon as they can breathe easy."

**Jean-Michel Steg**, Citigroup's head of banking in France says less credit will be available for corporations and the government will be more involved in what you do day to day. Whichever industry you look at, especially the financial services, there will be bigger but fewer companies, and inflation will rise. "The financial crisis as we see it today is deep, intense. (It) will not and cannot last a long time," Steg says. "It is a big spasm and very painful, but within months it will be done."

For now, countries will have to tackle the economic downturn. Democracies don't like economic cycles, says Steg, as they have a hard time dealing with the populist sentiment against the lack of constant growth and prosperity. But cycles exist and are difficult to erase.

The bubbles burst

**Clyde Prestowitz**, founder and president of the US-based Economic Strategy Institute, says the crisis was the result of a huge amount of leveraging over the past 20 years, with tremendous growth in credit creation, which led to an enormous amount of capital sloshing around.

"There were very attractive conditions for speculation and risky investment especially in the US where interest rates were very low. The result is several enormous bubbles which are now breaking with tremendous consequences."

The 'Reaganomics' era - the notion that markets are self-adjusting – is dead, he adds.

Recapitalising banks

What the governments and regulators now have to do is get the systems started again so that their economies can function.

According to Prestowitz, the technical fix which is being practised is to inject money into the banks to unlock credit, so that liquidity begins to flow again. Regulators are investing by taking shares in the banks and getting warrants, and guaranteeing lending between banks for a set period of time.

Alluding to Sweden's 'tough love' policy in the 1990s to recapitalise its banking system, Prestowitz says: "Sweden went through immense pain, with some 14 per cent drop in GDP. But it recovered and recovered tremendously."

The outlook

Danon says she doesn't expect much to change in the coming months. "Prices will not ease. Some parts of the world like Brazil, which is doing very well, are untouched by the crisis. The world is global today so I think it's going to worsen and probably spread to places like Brazil and Asia in the coming months."

Prestowitz believes we are heading for a global recession. US manufacturing production has shrunk 34 per cent. Europe is also in recession. China is still being forecast by IMF to grow at 9 per cent but he feels that both China and India will probably grow by around 4-5 per cent.

Will China and India be able to pull the rest of the world out of recession? The short answer is no. "At $3 trillion and $1 trillion respectively, those economies are not big enough," he says.

Another big problem is that the US has been a major consumer of goods from around the world. But US consumption is shrinking and savings are rising.

**Maria Livanos Cattaui**, who is on the board of Petroplus Holdings in Switzerland, takes the view that it is through the emerging economies countries that some of the solutions will emerge.

"If I had to make a prediction, unlike the Second World War which is a catastrophic event, to bring growth in the US it is perhaps the addressing of poverty and of marginalised countries and the stimulus to them to grow that may be, in this particular cycle, something we should look on as a direction that will give us again a great deal more hope."

The Women's Forum for the Economy and Society held its fourth Global Meeting in Deauville on 16-18 October 2008.

Find article at
https://knowledge.insead.edu/economics/steering-a-new-course-in-unchartered-waters-1772