

TATA STRATEGIC MANAGEMENT GROUP

Business in the time of economic crises

As the debt crisis in the developed world escalates, Indian companies have to prepare for a period of uncertainty, make selective, risk-factored moves, and avoid the danger of paralysis in decision-making, says **Raju Bhinge**

Each passing day brings more evidence of the escalating crisis of sovereign debt in the developed world. In the US, slow growth (1-2 per cent per annum), compounded by reduced government spending, could lead to a recession. In Europe, Greece, Ireland and Portugal are already in a debt crisis; Italy and Spain are also under pressure. These countries will soon have to restructure their debt or else default, which would lead to a chain reaction impacting lenders and other European Union (EU) nations. The next global financial crisis is likely to emerge from a sovereign default in Europe. The break-up of the EU is no longer being ruled out. The alternative is a tighter fiscal union.

Either choice would put enormous stress on Eurozone's component political systems.

What does this imply for Indian firms? They have to prepare for a period of uncertainty and volatility, and prepare for several alternative futures that may unfold. *Table 1* outlines a range of scenarios depending on what happens in the developed world.

A RESILIENT ECONOMY

India's economy is driven by domestic consumption (67 per cent) and investment (35 per cent) with the external sector having a negative contribution. Most investment is funded by domestic savings, the gap being about 2-3 per cent of gross domestic product (GDP). This makes our economy more resilient to external shocks. At present, India is experiencing high inflation and a high fiscal deficit. Monetary tightening measures have been instituted to control inflation. Economic growth is likely to



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Table 1: Macro-economic scenarios

SCENARIO		OPTIMISTIC	LIKELY	CONSERVATIVE	CRISIS
USA	GDP growth	>2%	1-2%	-ve: two quarters	-ve: > four quarters
Eurozone (Portugal, Italy, Ireland, Greece and Spain)		As is (holding operation)	Loan restructuring	Orderly exit from the euro	Disorderly exit from the euro
	GDP growth	>2%	1-2%	-ve: two quarters	-ve: > four quarters
Crude oil	\$ per barrel	110	100	80	60
India	Monetary easing	Q1 2012	Mid-2012	Q1 2012	Early 2012

slow moderately to about 7.5 per cent in 2011-12 and 2012-13. As inflation declines to an acceptable level and interest rates are reduced by the Reserve Bank of India, growth will rebound to over eight per cent in 2013-14.

A global financial crisis would have an adverse impact through reduced growth in exports and significant decrease in foreign currency flows. This will be partly offset by the benefit of lower prices of crude oil and other commodities. The net effect would be a downside risk of GDP growth reducing to about 6-7 per cent in 2012-13. This is consistent with the 2008-09 scenario, when GDP growth dropped to 6.8 per cent. The likely GDP growth in India for the macro scenarios drawn above is shown in *Figure 1*.

OPTIONS FOR CORPORATE INDIA

Firms operating in India will have to respond to dramatic swings in business conditions. At the time of the announcement of the union budget in February 2011, expectations were that GDP growth would be more than eight per cent in 2011-12 and over nine per cent per annum in the 12th Plan period (2012-17). Most business plans incorporated aggressive revenue growth, capacity expansions,

head-count ramp-ups and large capex programmes, along with ambitious resource raising initiatives.

How should firms respond to the global uncertainties and risks that are increasingly manifesting themselves? First, they must identify the macro-economic scenario(s) appropriate for their business(es). Next they need to distinguish the industry trends — especially market growth, but also changes ▶▶

Figure 1: India's economic growth in various global scenarios

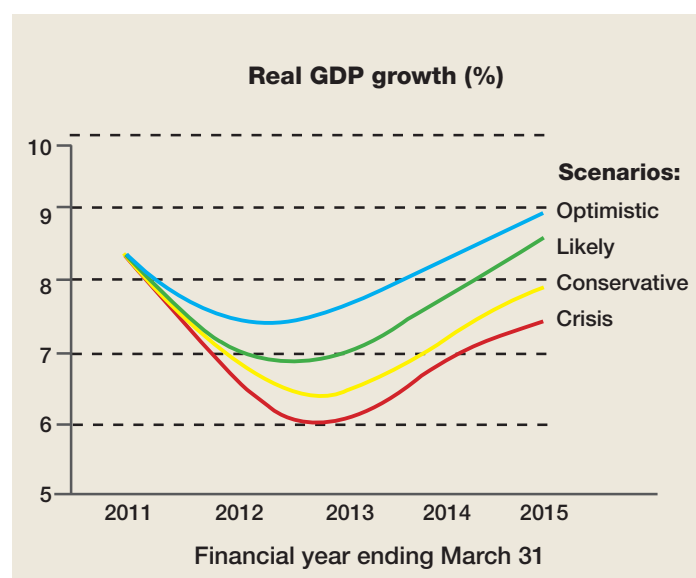
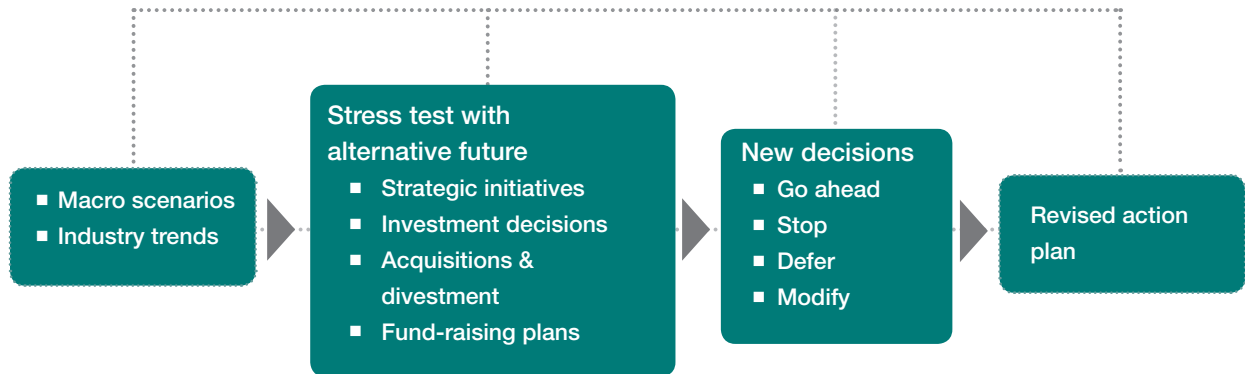


Figure 2: Review of strategic decisions



in regulations, new competition and technology shifts — as applicable to them. Companies need to assess the likely swings in demand for their products / services over the next few years. After the 2008 crisis, for instance, some sectors, like automobiles and capital goods, experienced negative growth for several months, even quarters. Others, like consumer staples, saw reduced growth rates and a shift in consumer buying of value brands. Sectors like power generation were unaffected.

Finally, using this set of alternative scenarios and assumptions, companies should evaluate, in stress tests, all major decisions that are in the pipeline (Figure 2), such as:

- **Strategic initiatives:** New product launches, entry into new market segments, technology upgrade, etc.
- **Investments:** Capacity additions, greenfield locations, new manufacturing processes, etc.
- **Acquisitions and divestments:** Rationale, cash flows, valuation range, benefit potential, etc.
- **Fund-raising plans:** Equity issues, ECB (external commercial

borrowings), FCCB (foreign currency commercial borrowings), etc.

Decisions or initiatives that can be justified even in the crisis scenario should be actively pursued. Others may have to be deferred, modified and, in some cases, abandoned. This will result in a fresh selection of moves and an action plan which will yield value even in an adverse set of circumstances.

PLAN FOR THE UPTURN

It is critical for firms to avoid the danger of paralysis in decision-making. In the given scenario, they should make selective, premeditated moves factoring in the current risks and uncertainties. Only this would enable them to ride out the slowdown arising from the current global economic storm and be well positioned to reap the opportunities that the subsequent upturn will bring. The outlook for growth in 2011-12 is getting re-rated each week. Fiscal 2012-13 promises to be a turbulent year, the extent of volatility depending on which macro scenario plays out.

However, beyond 2013, India's economy is likely to bounce back to over eight per cent growth. Indications are that, relative to the developed economies, especially Japan and Europe, India is likely to become the third largest economy in purchasing power parity terms by 2012. In nominal terms, India is expected to be the fifth largest economy by 2015 and the third largest by 2020. □

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