

2010 Is All About 2011 (and Beyond)

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Chair: Charlie Wagstaff, Managing Director, Criticaleye

An unstable economy breeds uncertainty. To create momentum for growth, leaders must manage this uncertainty and 'get on with business'. Dominic Swords, Business Economist at Henley Business School, shared his insights on the current state of the economy with Members and guests at this Criticaleye Discussion Group.

The following are excerpts from Dominic's talk:

Dominant mindsets – Dominant Western mindsets have been framing how the world has operated over the last 25 years. The world has been driven by assumptions about globalisation being a key driver of business opportunities and integration around the world. This is being challenged.

Shifting power – The world's power base is shifting. The big unknown is whether it will become a bipolar world, a regionalised world or one dominated by China or the Far East in the way that it has been dominated by the USA in the past.

Bubble growth – The seven years leading up to the recession were clearly made up of bubble growth. Too many resources were being allocated to unsustainable practices. This did not create real value and has ultimately caused more pain than the short-term benefit.

Volatility - The volatility of the financial markets and the importance of sentiment towards these markets are troubling. The markets, despite direct actions and interventions made by governments to stimulate positive activity, can stifle any attempt at growth.

There is a notable dislocation between financial markets and 'real world' activity. Financial markets speculation has created stability over the past 25 years. This speculation created a discipline that if companies, individuals, businesses or governments get 'out of line', steps can be taken to expose that inefficiency within the system and force them to change. The increasing instability of markets is a major source of volatility and uncertainty beyond what fundamentals imply. We have to plan for this continuing over the short and medium term and hedge against volatility.

Organisations don't like uncertainty in the markets just as people like to eliminate risk and, in times of uncertainty, are attracted to certainty. The presence of risk naturally results in less investment in particular assets.

UK Budget – The budget is being watched by the market causing the latter to switch from being concerned that the UK has not been taking decisive control of our finances to being worrying that the UK is overdoing it.

Repaying the deficit: This is a key focus for the next 5 years.

Current deficit: £166 billion

Required reduction to cut the deficit by 50%: £88 billion

Restatement of deficit from last tax year: £11 billion – which means that the deficit will be closer to £155 billion

Amount already being taken out this year: £6 billion

The amount to be taken out over the course of the Coalition Government: approx £75 billion

Growth: 2 per cent compound growth over 4 or 5 years, meaning 8 to 9 per cent, amounting to some £35 billion over 5 years.

Leaving the Coalition Government needing to cut some £40 billion over the course of its time in power.

The concerns for the budget are twofold: One is that cuts will be too aggressive in the short-term. If the government goes beyond £40 billion in cuts, there are some downside risks to growth. Further cuts will also move beyond simple efficiency measures and cutting into activities. In the long term this may prove to be a new and more successful approach to managing the mix of public/private sector activity. The more important question is about what measures the government can introduce to encourage private sector based activity as the engine for new economic growth.

Values – Successful businesses of the future will be based more on values than on shareholder value. Although the need to create shareholder value will not disappear, there will be more emphasis on the underlining values of organisations. It's about understanding what the genuine customer needs are, how to meet them, how to communicate them in an honest, open and convincing way and how to align businesses and attract individuals to businesses that underpin those values.

Reputation – The cost of having a good reputation is ever increasing. Most organisations haven't come to terms with the speed of new media, meaning they are quickly losing ground. Organisations need to learn how to use social media, such as Twitter, to help respond to crises.

Latest update: The report by the Office for Budget Responsibility (OBR) downgraded the Budget forecasts to 1.3 per cent for this year followed by 2.6 per cent, 2.8 per cent, 2.8 per cent and 2.6 per cent until 2014/15. This is in line with our estimates discussed at our event. It underlines the need to assess the Budget on the basis of how far the cuts strike a balance between repairing the deficit and sparking off private sector re-generation. Too much of the former and insufficient of the latter risks under-achieving the new growth forecasts and further damaging the deficit. The markets will be watching this judgement closely.