

## MANAGING DURING THE DOWNTURN

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### ***Abstract***

The Global financial meltdown fueled by the sub prime crisis have made the global economy as a whole to sail through a highly turbulent times in such that no one knows what will be the exact size of the impact and when will the economy get its recovery. In this context, this paper makes an attempt to offer a list of doable for the stakeholders [Stake holders of Indian economy includes the Government of India, the Reserve Bank of India, Companies, Households and Individuals] of Indian Economy in their efforts to manage the downturn.

***Key Words: Global financial meltdown, sub prime crisis, stakeholders of Indian Economy and list of doable***

## **1. Introduction to the “R” Factor**

The Federal Reserve, the central bank of the United States of America [US] during early 2000, had started reducing its bench mark lending rates to the Commercial Banks operating in America. This made availability of credit easier for the borrowers which in turn resulted in a situation where commercial banks started lending to sub prime borrowers who are known as NINJAs [No Income, No Job and No Assets]. Here, the commercial banks did not bother about the credit worthiness of the sub prime borrowers as these loans were pooled together under asset securitization mode. Such securities known as Collateralized Debt Obligations [CDOs] were traded among the banks, financial institutions, Hedge funds and other players in the financial markets. These CDOs were credit rated by leading rating agencies in the US and are insured by Insurers like the American International Group [AIG] using another complex product namely the Credit Default Swaps [CDS]. The availability of easy credit without collaterals led to the boom in housing market such that the value of houses had given the confidence to the sub prime lenders, which encouraged them to lend more and more sub prime loans which means more and more business in the CDOs and CDS markets. All these came to an end when the NINJAs started defaulting in their loan cum interest repayments. They could not repay the installments as the Federal Reserve hiked its rates to a higher level in order to cool down the inflationary pressures and housing bubble prevailed during 2006-07 and 2007-08. The bigger names in the Wall Street started filing for bankruptcy one after the other as victims of the sub prime contagion [Fannie Mae, Freddie Mac, Lehman Brothers, Washington Mutual. AIG are some of the many victims of SPC].

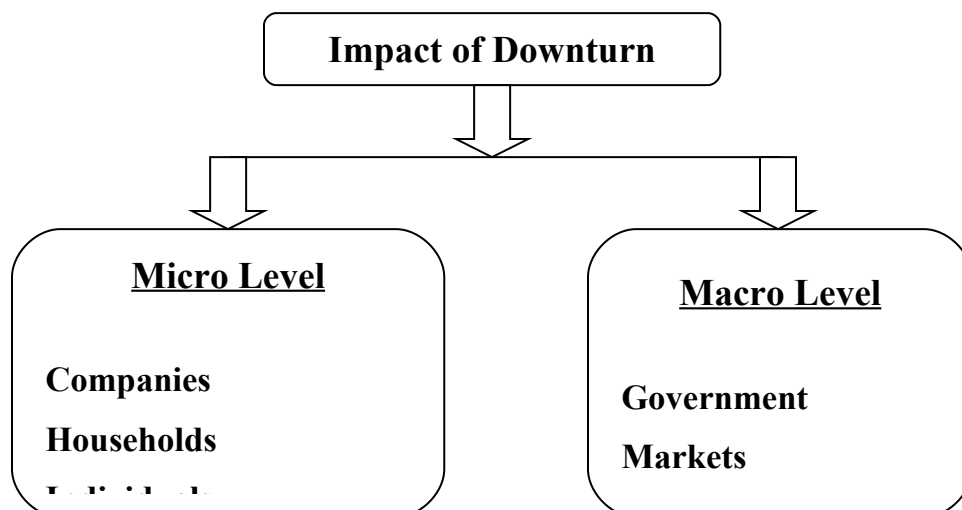
The coupling theory had spread the sub prime effect throughout the globe such that the global Gross Domestic Product growth is estimated to be less than 1%[0.5%] for the FY 2009-2010. As far as India is concerned, the picture is quite confusing as the GDP growth estimates differ among various official reports. The Central Statistical Organization estimates the GDP growth rate of Indian economy for the FY 2009-2010 at 7.1%, International Monetary Fund estimates the number at 6%, while it is 7.4% by CMIE, RBI's number is at 6.8% and the estimate by Goldman Sachs and Citigroup

foresee the growth rate between 5.5% and 6%. One similarity among all these estimates is that Indian Economy's growth rate has fallen down from the 9% range to 5.5% - 6% range. The "R" factor is evident for the Indian Economy from its highly fluctuating Index of Industrial Production numbers [Negative in 2 months and fluctuating in the past few months]. In addition to IIP indicators, the top line and bottom line figures of India Inc for the last 3 quarters are in the declining trend on a year on year basis. [ 93 out of 500 CNX 500 companies have reported negative Net Profit margin in the December 2008 quarter]. Further, ASSOCHAM's Eco plus Study conducted during February 2009 among 222 companies from 11 sectors reveal that demand growth got hit across sectors. According to the study, the average demand of the sample companies dropped by 10% in the third quarter of FY 2008-2009. The decline in demand growth rates range from 18% to 50%. . Steel, Auto, Auto components and Textiles are the worst hit sectors.

## 2. Impact of Downturn on the stakeholders

The stakeholders of Indian Economy consist of Government of India and Reserve Bank of India, the central bank of the country at the macro level and the companies, house holds and individuals at the micro level. The slowdown at the macro level is measured by the GDP, IIP, unemployment, poor credit off take and decreasing gross capital formation numbers. While fall in sales, declining profits, piling up of inventories, declining salary levels etc are the yardsticks to measure the impact of slowdown on the stakeholders at micro level.

Figure: Impact of Downturn on Indian Economy



### **3. Roadmap for Managing the Downturn**

The following are the road map for the above mentioned stakeholders in their efforts towards managing downturn.

**3.1: What should the Government do?** The government has two options in dealing with the economic slowdown

**A. Increase spending:** According to JM Keynes, the aggregate demand in an economy is computed by summing up the demand of individual households, companies and government along with its net exports [excess of exports over its imports]. If this is true, the prevailing slowdown in the economy can be managed by increasing the spending of the government in infrastructure in the form of roads, ports, railway tracks, power projects, coal, mines and other infrastructure items. Apart from that the government can also increase its spending in employment oriented schemes such as the National Rural Employment Guarantee Schemes [NREGS] and Bharat Nirman [The Finance Minister has announced a reasonable amount towards these schemes in the interim budget]. The US and European governments have announced their bail out packages amounting to trillion US \$. Though these measures lead to higher fiscal deficit [in the range of 11% plus] these are expected to increase the money circulation in the economy which will lead to increased consumption/demand. Increased demand for consumer and capital goods will remove the temporary blocks in the recovery of the economy.

**B. Reduce Taxes:** Reducing taxes both direct and indirect is another alternative for the government in managing the economic slowdown. But Dr. Bimal Jalan, the former governor of RBI is of the opinion that taxes are levied only on the non essential goods hence cutting taxes is not the right alternative in this context. Reduction in income tax rate may not bring the expected result [increase in

consumption] if the propensity to save gets increased instead of the propensity to consume.

**Tighten the Regulation:** It is the duty of the government to monitor the activities of the regulators such as SEBI, IRDA, RBI, MCA..etc. The regulatory bodies are responsible for corporate scams in the likes of Satyam in India. Credit rating agencies should be more alert in their rating exercises. Any crisis in the name of what so ever collapses the economy even during boom. In that case, the impact of scams, system failures have the last mile impact on the economy during slowdown. Hence there is greater need from the government to monitor and facilitate the activities of the regulatory bodies such that no such crisis takes place in the economy.

### ***What should the RBI do?***

The Reserve Bank of India, being the central bank of the country takes the onus for managing the monetary policies of the economy. The RBI has done its best in reducing the impact of the sub prime crisis on Indian economy by its prudent policies and justifiable regulations. It had to fight with the double digit inflation in the first 3 quarters of the FY 2008-2009. In fact its efforts had brought down the inflation rate from 12% plus during last year to less than 4% in the latest report [Though the primary reason for the fall in inflation is the softening commodity prices].However the present scenario is a strange situation to the central bank where the companies find it difficult to avail credit from the commercial banks. In dealing with the slowdown, it has released so far

Rs. 3, 85,000 crores by reducing its rates as follows:

Table 1: Policy Rates [ FY 2009-2010]

Policy rate	Peak rate [ %]	Present rate [%] [February 2009]
Bank rate	6	6
Repo rate	9	5.50
Reverse Repo rate	6	4
CRR	9	5
SLR	25	24
PLR	13.75-14.25	12.75-13.25
SB rate	4	3.5
Deposit rate	9-10	7.5-9.6
Forex reserve	300 Billion Dollars	260 Billion Dollars

Source: Compiled from Business Line

In spite of the reduction in the key lending rates, the credit off stake of the commercial banks is not in line with the expectations of the central bank. Hence the central bank can think of making use of Quantitative easing as a tool to deal with the reluctance of the commercial banks in lending to business houses on the ground of poor credit worthiness of the business houses. However the central bank can also think of encouraging the CBs to increase their credit off take to India Inc. In this context the efforts of the central bank by opening a refinance window for sectors such as MSME, housing and other priority sectors is the step in the right direction. Therefore the problem is not about liquidity but about sanctioning of the loans by CBs to the business houses. It is also suggested that the RBI reduces the policy rates up to a level which is good enough to encourage the business houses to move out of the downturn. Federal Reserve, Bank of Japan and European Central Bank and other central banks in western countries have moved towards zero interest rates scenario.

***What should companies do?***

The corporate sector needs to do the following in order to keep their business going.

**A. Impact Review:** The first thing, business houses need to do is to conduct a thorough impact review of the economic down turn on their businesses. It calls for tracing out answers for the following questions: whether there is drop in turn over? If so, what are the products that have shown declining sales volume? How about the sales trends across different segments? What about the trends in costs? How about the inventory levels? Are they normal or abnormal? What about competitor's performance? Is it on the same line or different from that of their numbers? Is there any obstacle in managing the working capital needs of the business? If yes, how does the business manages the problem? Is the approach rational?

**B. Redrafting Functional Strategies:** The impact review offers light on the need to redraft the functional strategies such that the company is able to overcome the negative impact of the economic downturn.

### ***Marketing***

- Computation of the market share of the company in different products and different segments.
- Forecast of future demand [for next 4 quarters] on Best, Normal and Worst case scenarios for the entire industry, and there from, the demand for the company can be forecasted.
- Cutting down prices is the immediate strategy of many business units during the slowdown. But the rational strategy is to adjust the quantity of the product and not the price of the product. For instance if a customer can pay Rs.5 instead of Rs.15 for a soft drink/Beverage, the company can think of introducing a new package with a reduced quantity in such that the new package offers value for the money the customer is willing to pay for it.
- Cutting down the advertisement expenditure seems to be a correct strategy under the cost leadership framework. But the studies conducted during the

previous downturns reveal that companies which had maintained their advt. budget were successful in terms of increased market share after the slowdown. Hence it is the right time for a business unit to maintain the ad budget and thereby increasing its market share. For instance, AIRCEL has been building its brand by communicating to the customers that it is number one among the cellular service providers in the state of Tamilnadu to reach the milestone of 1,00,000,00customers. State Bank of India is another live example for concentrating on promotion strategies during slowdown.

- Innovation in strategies may increase the business volumes during the unfortunate times. For example, Realty companies in India are offering EMI Holidays for the buyers for two years. Union Bank of India has come out with an innovative RD scheme with varying pay INS and time periods.UTI mutual fund is employing Dabbawallas in Mumbai as a channel for distribution of its mutual fund schemes. The company has identified a new distribution channel for marketers in India.

### ***Production***

- Based on the forecast of company demand, the business unit should realign its production strategies. For example, an organization can change its number of production shifts based on the market demand for its products.
- Reducing Material costs by superior negotiation with the suppliers is the need of the hour. For instance, Ashok Layland had reduced the material cost by negotiations which resulted in 300-400 basis point improvement in prices of its vehicles.
- Cutting down the production level is an optimum strategy if the costs of not producing the product are lower compared to the cost of producing the product. For instance, Ashok Layland had reduced its production of LCVs at its Uttarakhand plant to 50000 units from 1,50,000 units, which is expected to save Rs 700-800 crores. The cost savings is due to savings in terms of lower inventory costs, production overheads and other cost heads.

- Outsourcing of components may also reduce the costs provided the quality of the product is maintained and there exist good and reliable suppliers for the products/services

### ***Human Resources***

- People management is a Key Result Area in delivering success for a business unit during the downturn. It is obvious to adopt lay off as a strategy in achieving the cost minimization strategy. But alternatives such as seeking voluntary reduction in salaries and incentives, flexible work hours and improvement in productivity are worth enough to try during the slowdown. These strategies reduce the costs besides improving the efficiency of the organization.
- Downturn also offers opportunities to recruit talented workforce at reduced salaries.
- Multi tasking is a possible option for companies to engage its employees during downturn. For instance, HI Tech aria Limited, a Madurai based company had called for its workforce for a meeting for communicating the impact of slowdown on its business. The Managing Director had invited ideas for managing slowdown from his employees. His initiative had resulted in the employees contributing more than 200 ideas which if implemented will result in Rs 40 lakhs per year.

### ***Finance***

- Cost reduction is the way of life for companies during the downturn. So companies need to reduce costs as Austerity measures. For instance, Ashok Layland plans to reduce the costs to the extent of Rs.50 crores by a regiment cost reduction system.
- It is the time to reduce the indirect costs such as traveling costs, Perquisites, Administration costs,etc.
- Every rupee spent by the company should contribute to its return on investment as one rupee saved is one rupee earned during the slowdown.

- Companies need to realize the importance of the adage” Cash is King” during the downturn. Many companies find it difficult to generate cash profits during the slowdown. Hence, there is a compelling need for companies to accelerate their cash inflows and decelerate their cash out flows by way of the time tested strategies. For example, Subhiksha is in news for its liquidity problems.

### ***C. Make use of Opportunities***

- It is the right time to buy core assets at reduced prices .For instance, assets such as real estates are sold at their cheapest value now
- Listed companies can take this as an opportunity to buy back their shares which are available at their lowest. Such a move increases the confidence of the investors there by leading to increased valuation of the companies in the market
- Downturn also provides an opportunity for companies to explore the Mergers& Acquisition option. Perhaps this is the best time for companies to acquire smaller companies, which results in increased synergies for the acquirer in the long run.

### ***D. Stakeholder Management***

- Finally, companies should maintain their relationship with all the stakeholders by being transparent with the disclosure of information about all their activities. Stakeholders can make all the difference during the slowdown provided they are well taken care by the companies.

### ***3.4 What should Households and Individuals do?***

- The Households and Individuals have realized the need to save from their present disposable income for managing their life during the hard times. This calls for proper investment planning in such a way that their life does not get stuck for want of funds.
- Sticking to the current job is the rational behaviour of an individual during recession. Because job market, becomes sellers market during the downturn.

#### **4. Conclusion**

No body expects slowdown to take place. However we need to accept the fact that prosperity and slowdown are the two sides of the same coin. The present slowdown is the outcome of the failure of the system to foresee the future. And the magnitude of the impact of the crisis still remains an enigma. However the economy and its stakeholders have no other option except to cope with the economic downturn. This calls for a collective action from all the stakeholders because downturn is everyone's problem.

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