



Accelerating Out of the Great Recession

How to Win in a Slow-Growth Economy

May 2010

THE BOSTON CONSULTING GROUP

Introduction

Who is BCG?

A leading global management consulting firm operating since 1963

- Advising senior management at the world's largest companies
- Deriving most of our business from continuing client relationships
- Working with strategy, organization, operations, and corporate development

BCG has worldwide presence with 69 offices in 40 countries

>2.5B USD in revenues (2008)

BCG Nordic established in 1989 and now consists of >200 people

- Stockholm (1989)
- Helsinki (1994)
- Oslo (1995)
- Copenhagen (1998)

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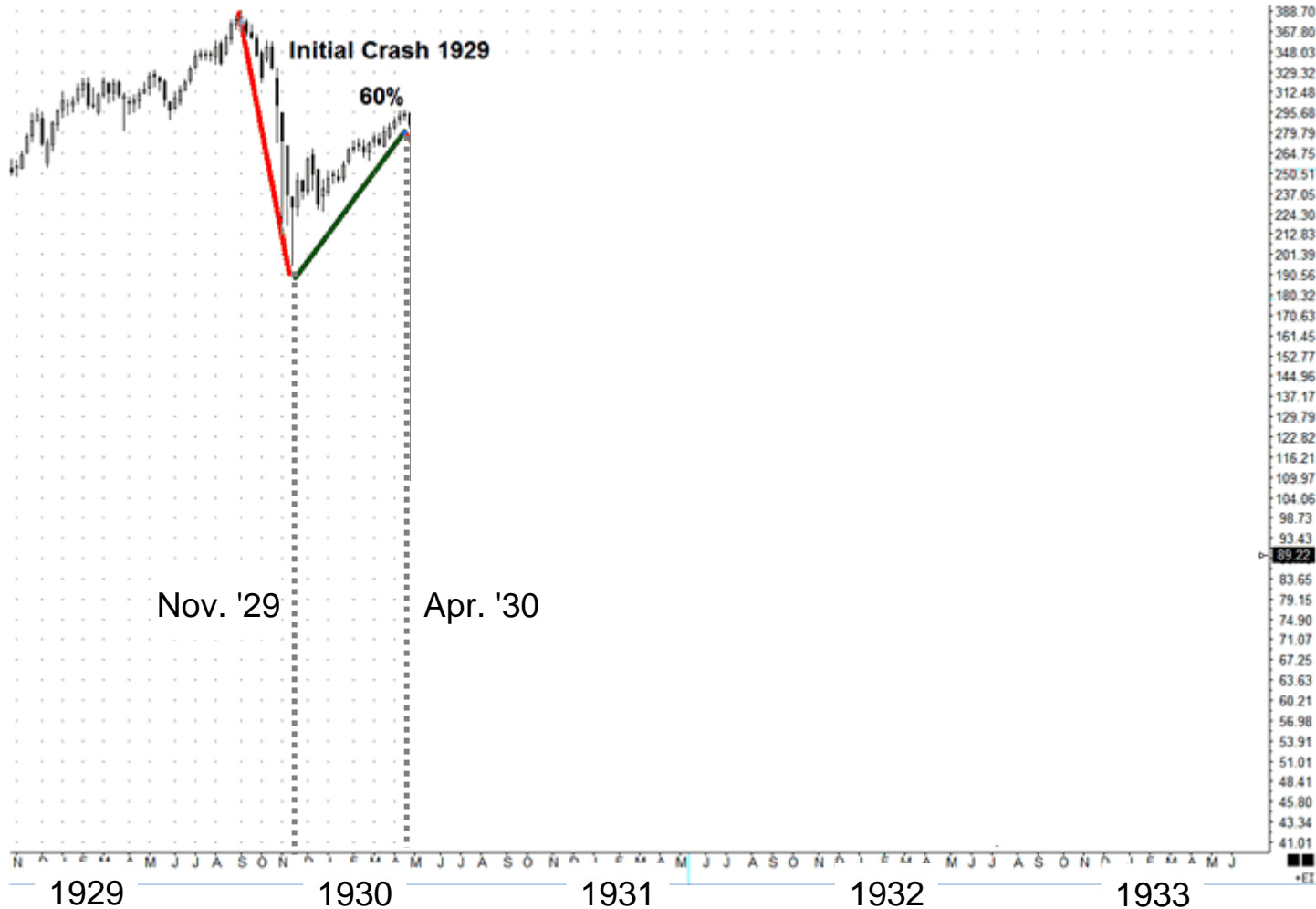
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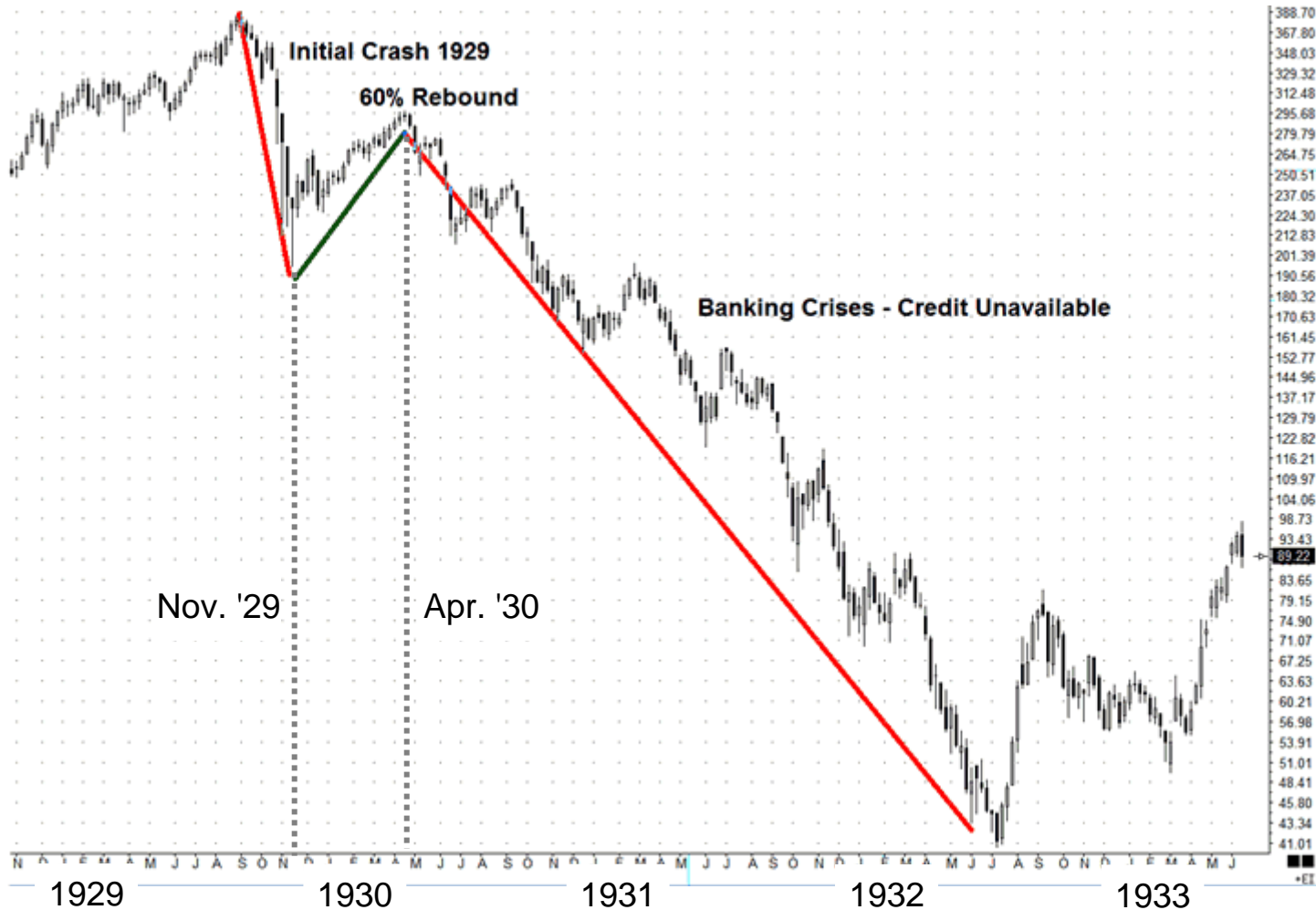
"Gentlemen, you have come too late ..."



Remember: Stocks gained 60% in 1930 ...



... only to drop much further

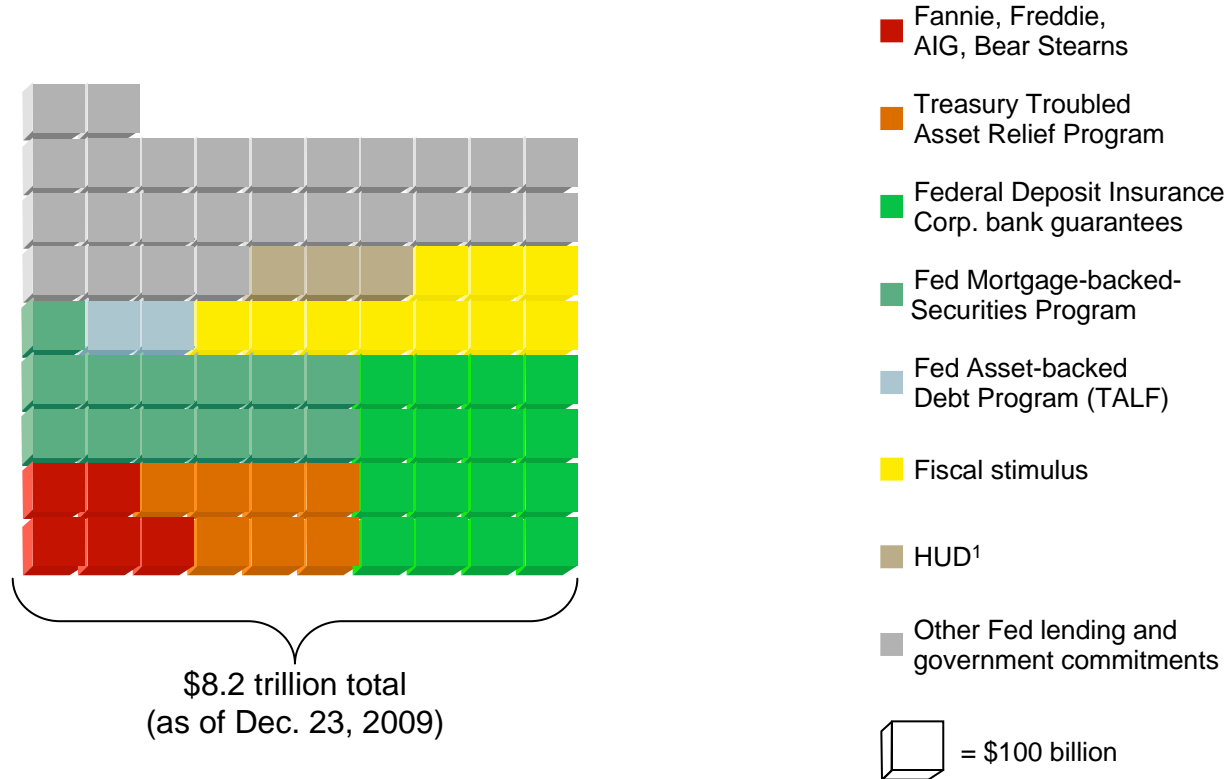


Unprecedented stimulus (I)



Unprecedented stimulus (II)

Total US government bailout exposure is \$8.2 trillion (Dec. 2009)



In June 2009 bailout and stimulus peaked at \$13.2 trillion

1. U.S. Department of Housing and Urban Development
 Note: Consists of government investments, loans, loan programs, debt guarantees, and securities purchases
 Source: Bloomberg estimate, December 23, 2009

Seems to work



THE  TIMES

“ Yes, the recession is over.



“ Tuesday's figures...mean that the UK is now out of recession.



“ Is the global recession really over?
Absolutely!



“ The recession is over.



“ I believe that the worst is over.

Börsen-Zeitung
Zeitung für die Finanzmärkte

“ Euro area left the recession behind.

Note: 5 statements made in February 2010, 1 made in December 2009 (Börsenzeitung)

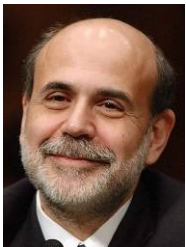
Source: Press research

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Who is right?

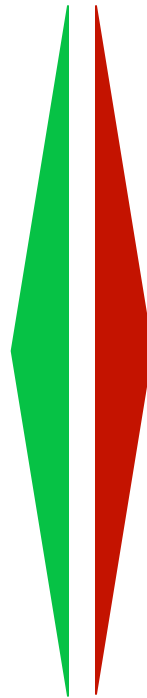
Positive news have arrived ...

- 1 Several economies officially out of recession
- 2 Leading economic indicators point to recovery
- 3 Stock markets rally as some investors regain confidence
- 4 Some banks report quarterly profits approaching pre-crisis levels



"Even though [...] the recession is very likely over at this point, it is still going to feel like a very weak economy for some time as many people still find their job security and their employment status is not what they wish it was."

Ben Bernanke



... but potential problems lurking

- 1 Consumers will focus on reducing debt for near future instead of spending
- 2 "Bear rally" likely—past recessions tell tale of caution
- 3 Unemployment will remain high or rise even further—"jobless recovery" threatens sustained growth
- 4 Trade rebalancing under way and threats of protectionism increasing
- 5 Deflation or excessive inflation possible

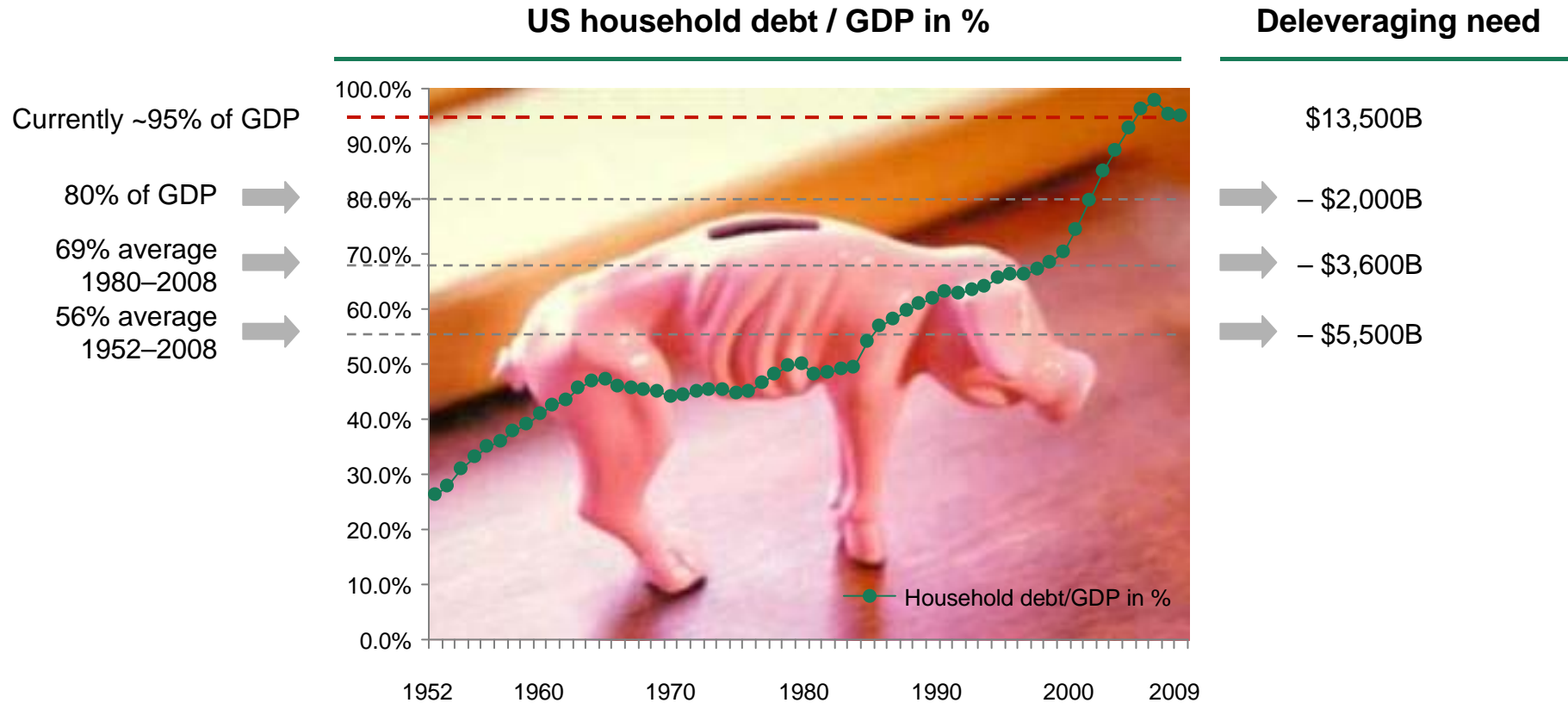


"Either you're in hell or you're in heaven. And the trouble is we're actually in purgatory."

Paul Krugman

Start feeding the pig

Reverting US household debt to long-term averages means decrease of ~ \$2–5,5T in debt



US consumption share of world GDP is 19%, while China's GDP is merely 7% of global GDP¹

1. Year end 2008 when using average market exchange rates

Source: Thomson Financial Datastream; Federal Reserve; Bureau of Economic Analysis; Barron's; Elliot Wave International, The Gabelli Mathers Fund, Financial Times, BCG estimate

OECD: "We need a plan B to curb the debt headwinds"

Deleveraging has not yet started



1. William White (Chair of OECD Economic and Development Review Committee) in Financial Times, 03 March 2010

Source: Federal Reserve Board, Bureau of Economic Analysis

Banks: The new healthy (I)

THE LEX COLUMN

Thursday June 11 2009

Banks: the new healthy

As an investor, would you touch the following bank with a cattle prod?

Its total assets dwarf common equity by 25 times to one – higher than the average for US banks over the past decade. Think of this another way: just a 4 per cent hit to the balance sheet and wave goodbye to shareholders' equity. Even comparing tier one capital with risk-weighted assets reveals that its gearing is 14 times.

What about those assets then?

Barely at the start of a household deleveraging process that will last for years, two-thirds of its outstanding loans are to consumers, with mortgages accounting for a quarter and credit cards for 10 per cent. Yet its non-performing loan ratio of 12 per cent for mortgages in the first quarter, for example, was the highest of all the banks that are covered by Barclays Capital. That ratio increased by almost 250 basis points versus the previous quarter, and there are few signs that house prices have stopped falling yet.

Then there are its off-balance sheet investment vehicles. This bank still has a \$93bn exposure – eclipsing common equity – a third of which relates to conduits that purchase securities funded by commercial paper. True, outside investors are technically first in line to take any hit. But if things get really bad, banks usually have to step up. What is more, it has so-called “level three” assets equivalent to 126 per cent of tangible common equity. These are assets which cannot be valued using observable inputs such as market prices – you just have to trust the bank's internal calculations.

Finally, like all banks, its past earnings power will be diminished due to lower economic growth and rising regulation. Unlike others, however, it is now free from the troubled asset relief programme. It is also considered by far the healthiest of the big US banks.

Banks: The new healthy (II)

Some habits seem to die hard



June, 1st, 2009

Dear Timmy,

we are happy to be able to pay back the \$25 billion you lent us. We hope you enjoyed the experience as much as we did (...)

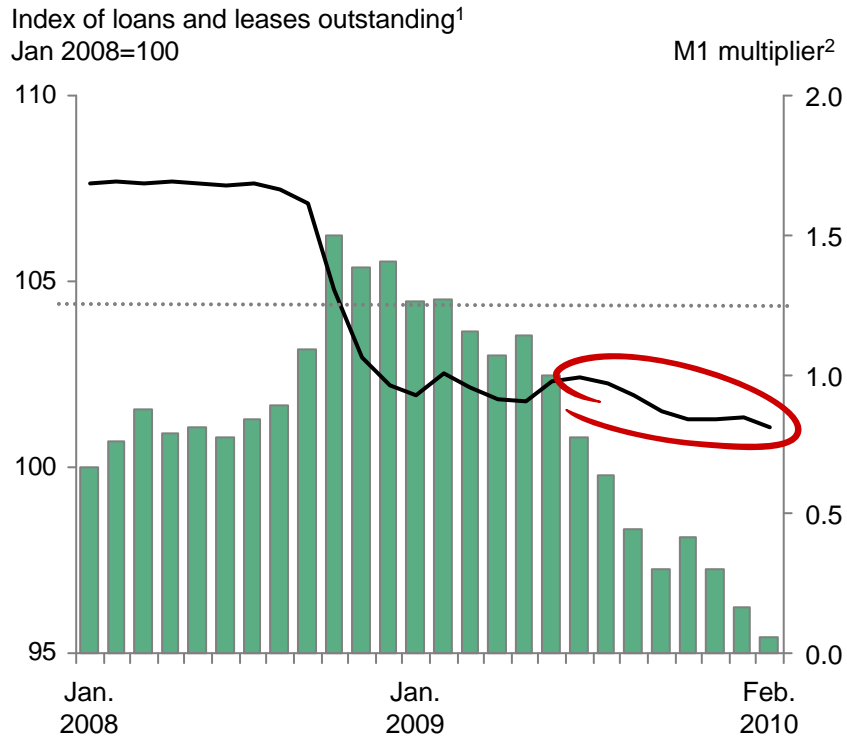
- Mock letter to Timothy Geithner, by Jamie Dimon, CEO of JPMorgan, read before the Annual NYU Internat. Hospitality Industry Invest. Conference -

Facts and Figures

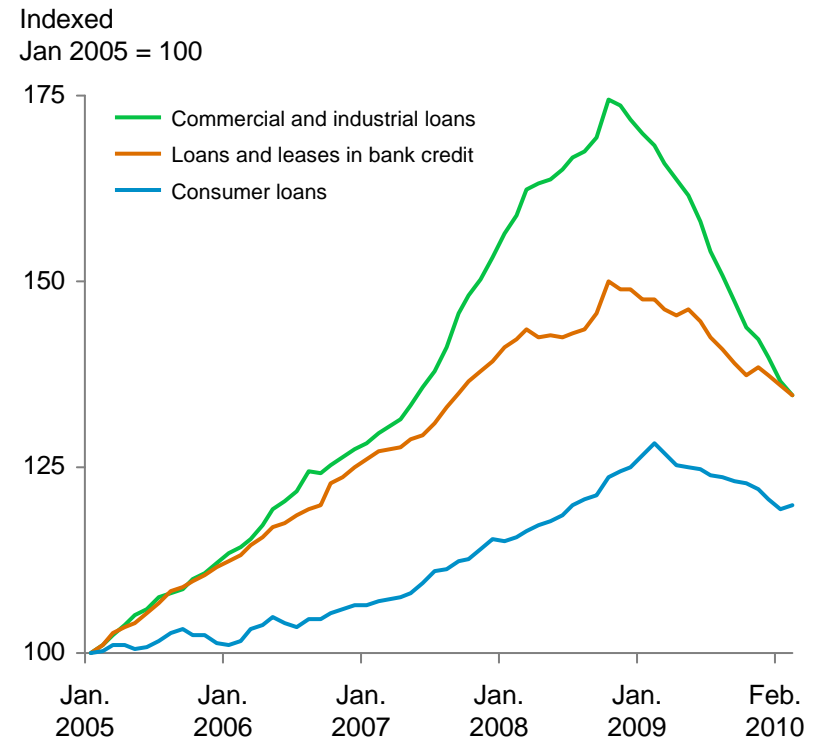
- Common equity to total assets: 4 %
- Tier 1 capital to RWA: 7 %
- Two-thirds of outstanding loans are to consumers, mortgages accounting for 25, credit cards for 10 %
- NPL ratio of 12 % for mortgages, increased by almost 250 bp versus previous quarter
- Off-balance sheet risk:
 - \$93bn exposure to off-balance sheet invest. vehicles, eclipsing common equity
 - "Level three" assets – cannot be valued using observable inputs – are equivalent to 126% of tangible common equity

No wonder credit is shrinking

Decreasing M1 multipliers leading to a lower outstanding credit volume



Credit declining in all sectors



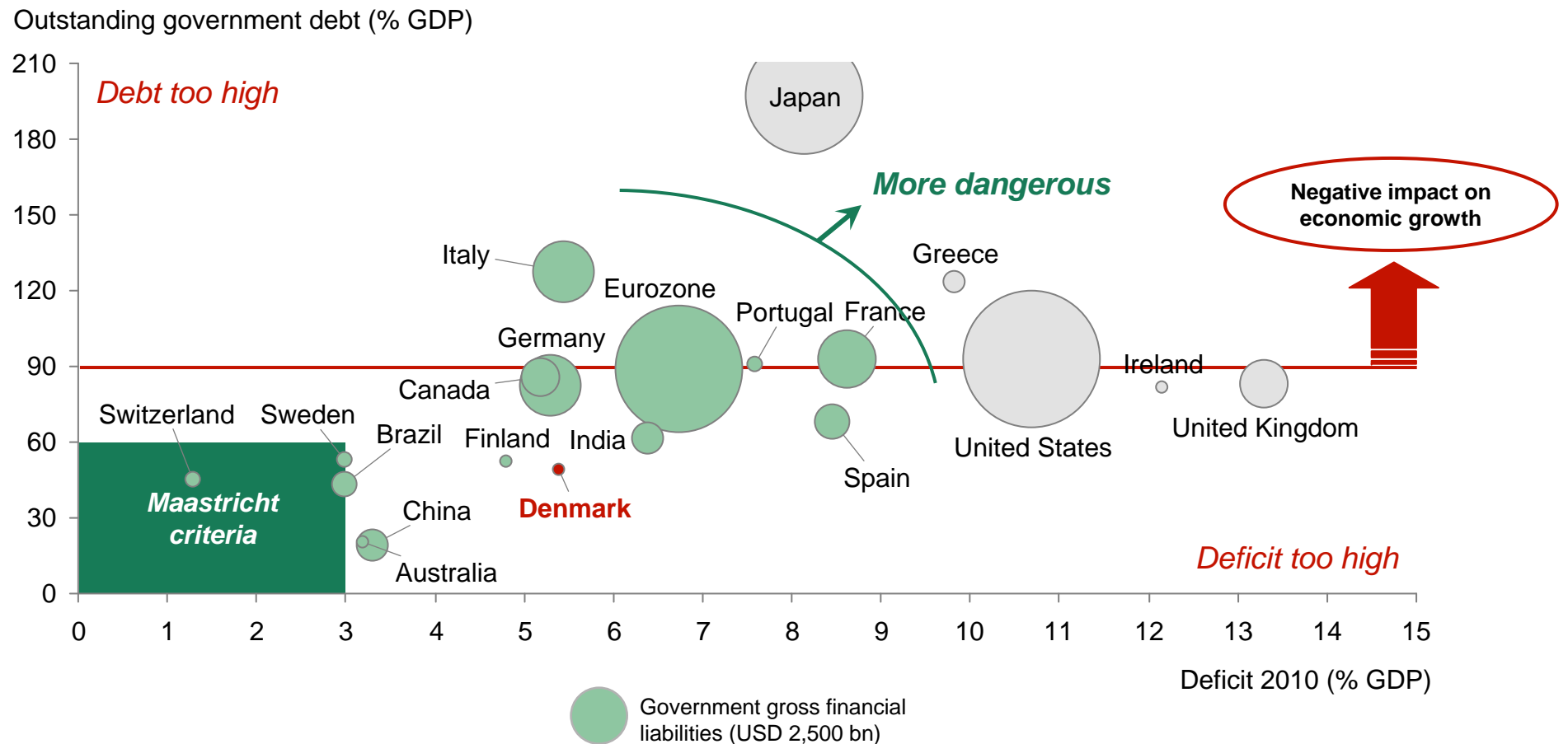
1. Loans and leases to consumers and non-financial corporations 2. M1 as a fraction of the monetary base M0, which is directly controlled by the central bank

Source: US Federal Reserve; ECB; BCG analysis

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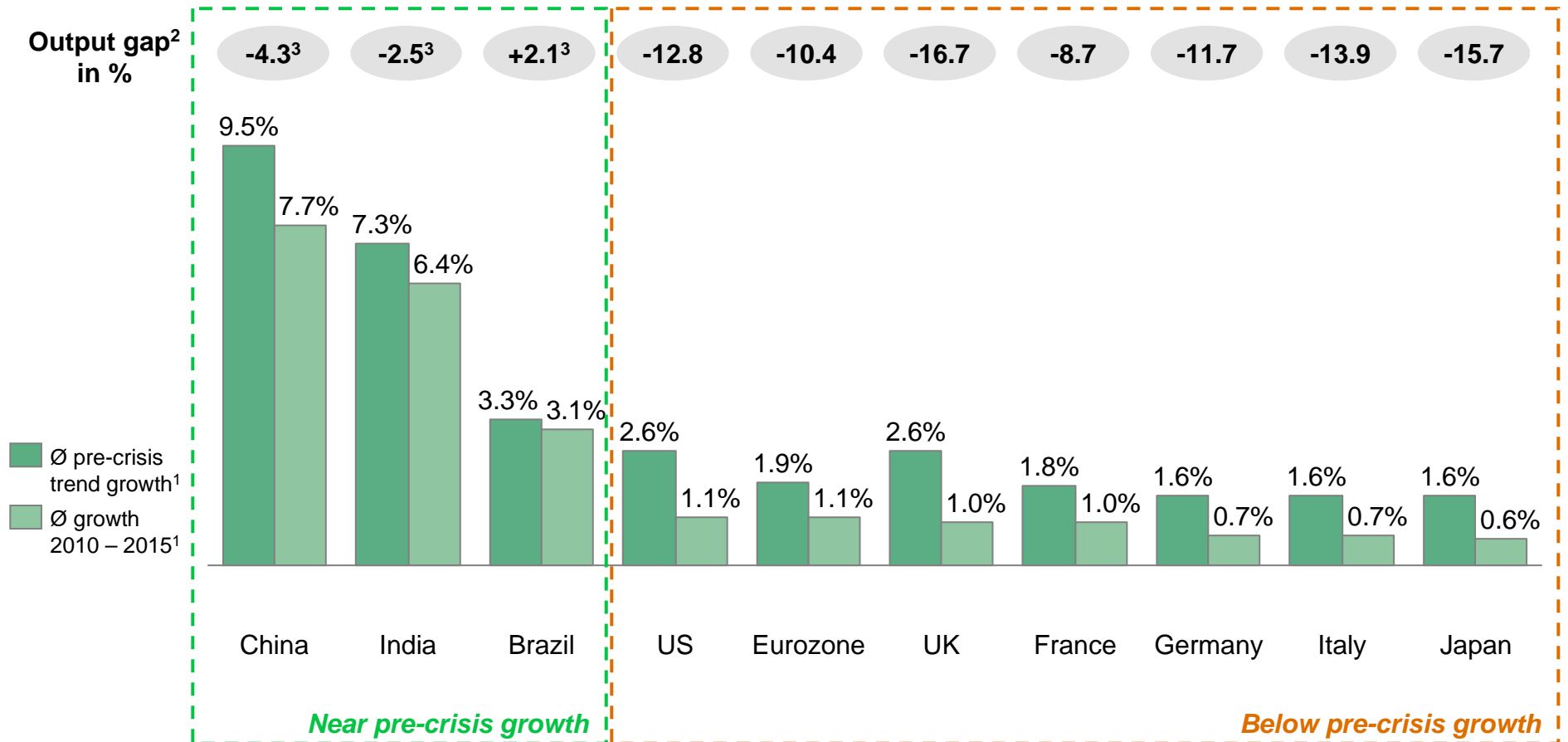
From financial and economic to sovereign crisis?

Overview of public debt and deficits



A two-speed world emerging

Simulation of future growth based on IMF research



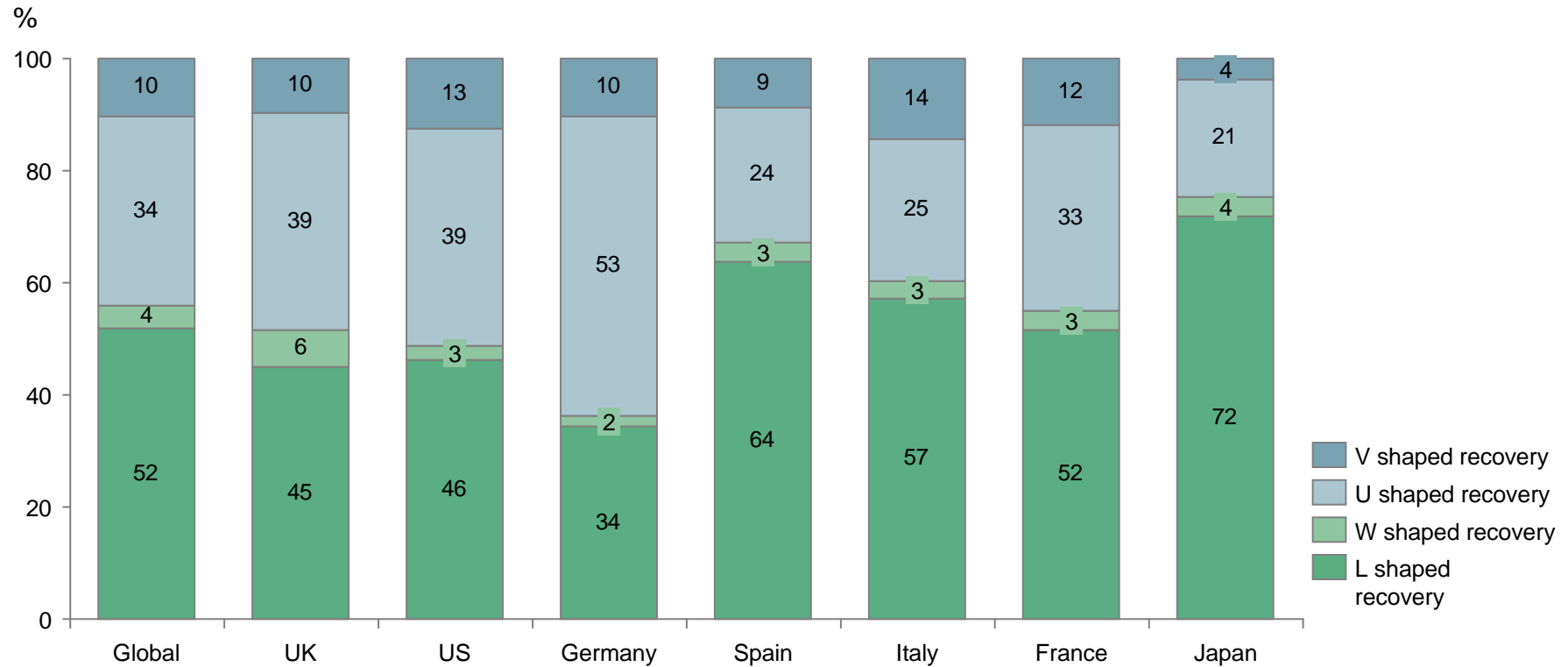
1. CAGR 2. Post-crisis GDP / GDP calculated as an extrapolation of pre-crisis trend growth 3. Cushioned by positive output gaps in 2008

Note: Trend calculated as a various-length OLS regression spanning at least ten years before the crisis

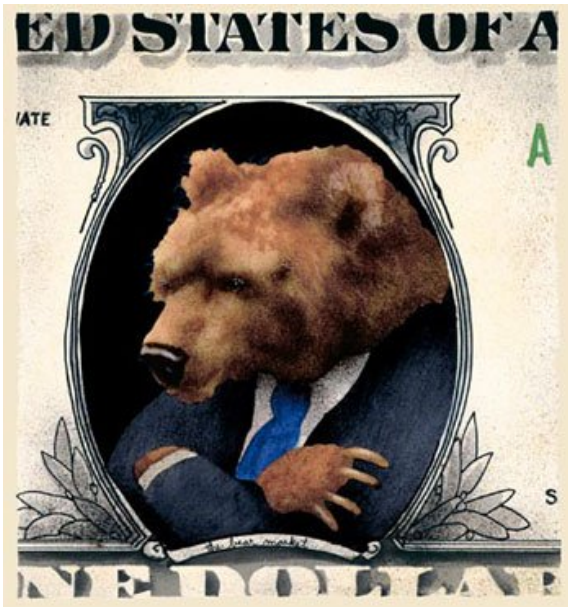
Source: Economist Intelligence Unit; Bloomberg; IMF; OECD, BCG analysis

Executives are skeptical

Forecast for shape of recovery (440 managers surveyed in March 2010)



A new global economic order (I)



Sluggish GDP growth

Expected by % of surveyed managers

Less debt turbo charging

73%

Rebalanced trade flows

73%

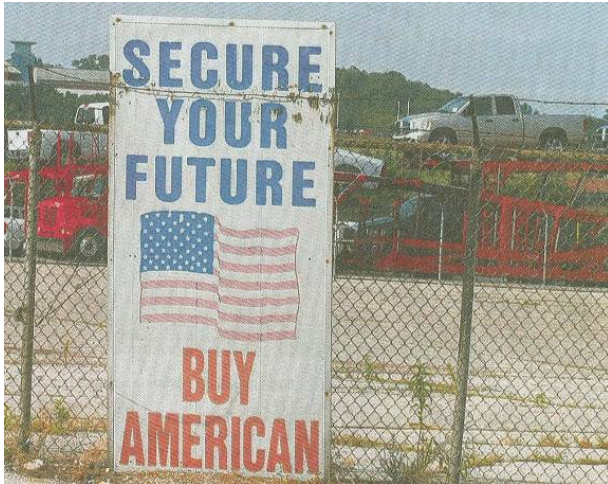
Slowdown in globalization

69%

BRIC countries will become important source of competitors

68%

A new global economic order (II)



Governments step in

Re-regulation

Protectionism

Fiscal stimulus packages

Stronger intervention,
ownership of business

Expected by % of
surveyed managers

82%

76%

73%

66%



"If you build a Renault plant in India to sell Renaults to Indians, that's justified, but if you build a factory, without saying the company's name, in the Czech Republic to sell cars in France, that's not justified."

Nicolas Sarkozy, February 2009

Protecting climate or industries?

New US law on maximum fuel consumption



Calculation of thresholds based on wheel base and track width

Formulas are calibrated in a way that large US manufacturers exactly meet the guidelines

Porsche achieved special approval until 2015

Until then Porsche needs to increase cruising range from 27 miles per gallon to 41.1 miles per gallon



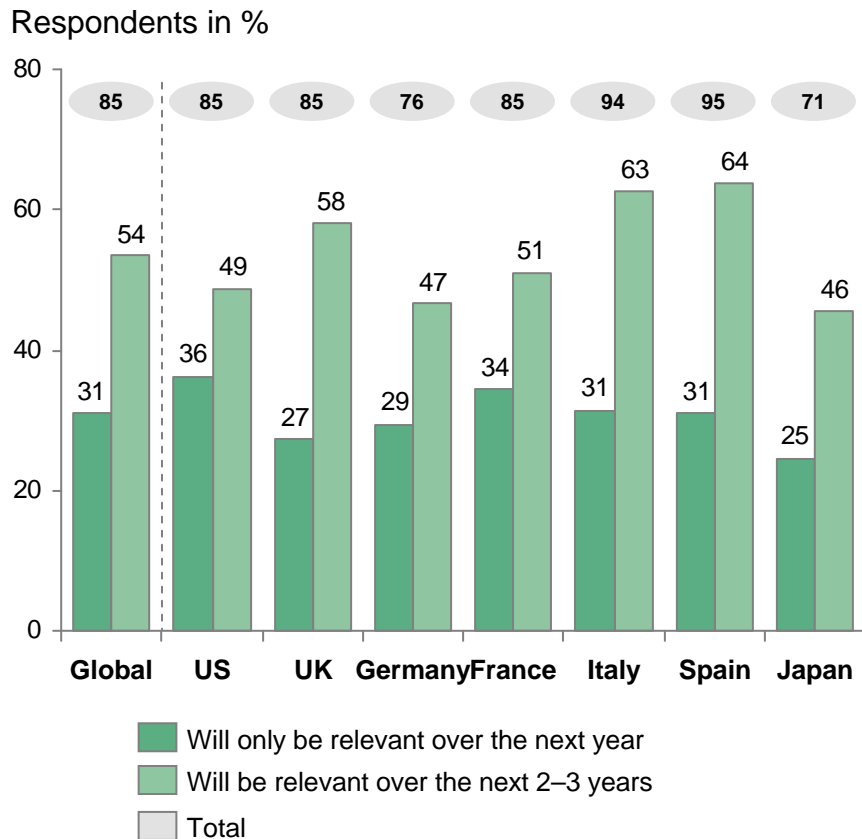
This is close to economic warfare!

Michael Macht, Porsche CEO

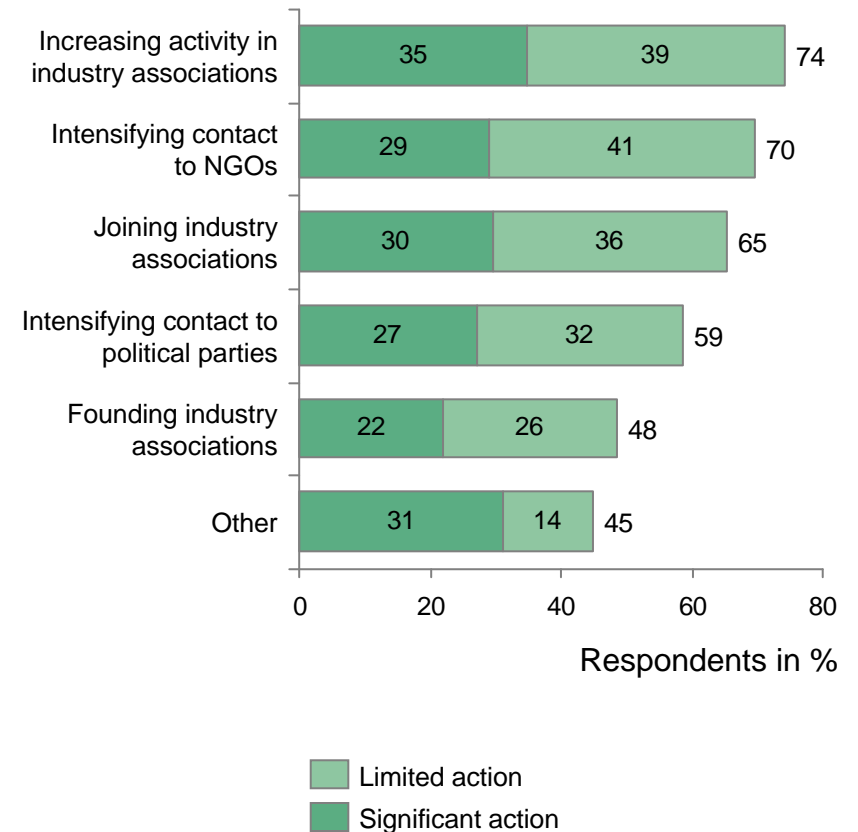


Companies assign high importance to lobbying – focus on activity in industry associations and contact to NGOs

Intensity of measures taken to prepare for government activity in business



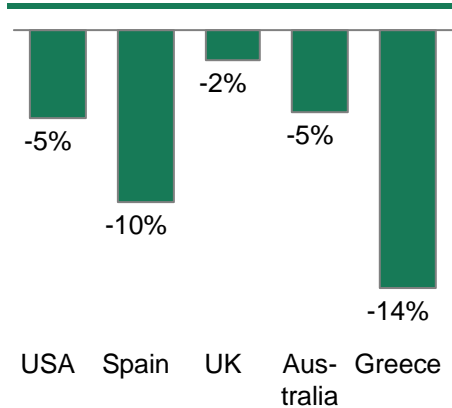
Measures taken by companies



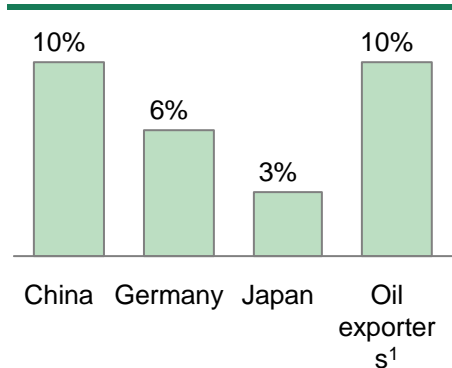
Is "rebalancing" possible?

Required surplus of deficit countries entirely allocated to surplus countries by relative size of GDP

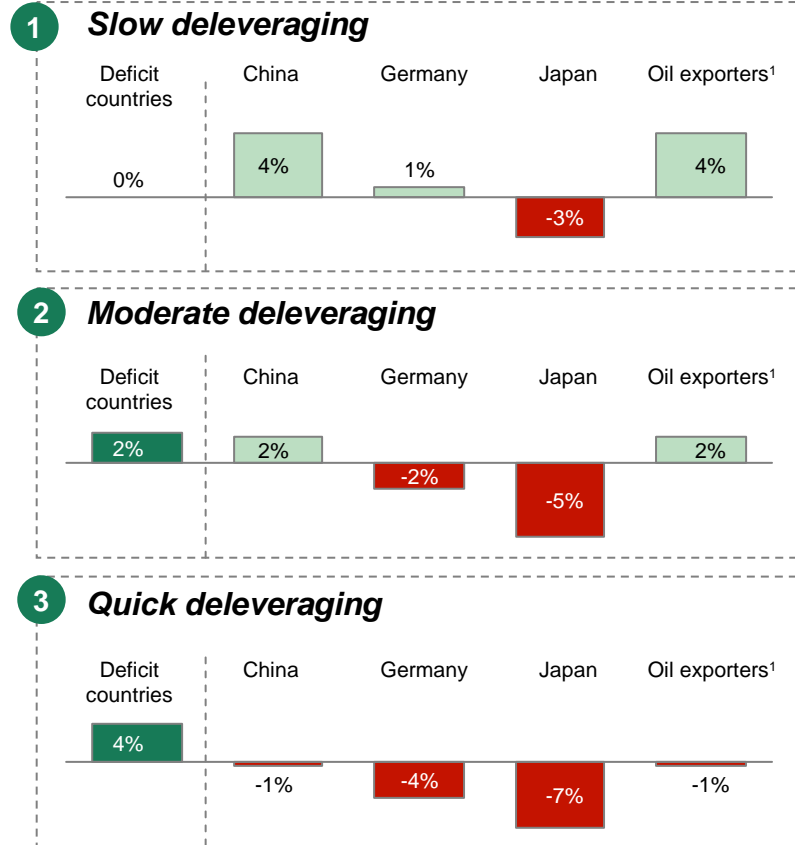
Deficit countries¹



Surplus countries¹



Alternative scenarios for deleveraging of deficit countries¹



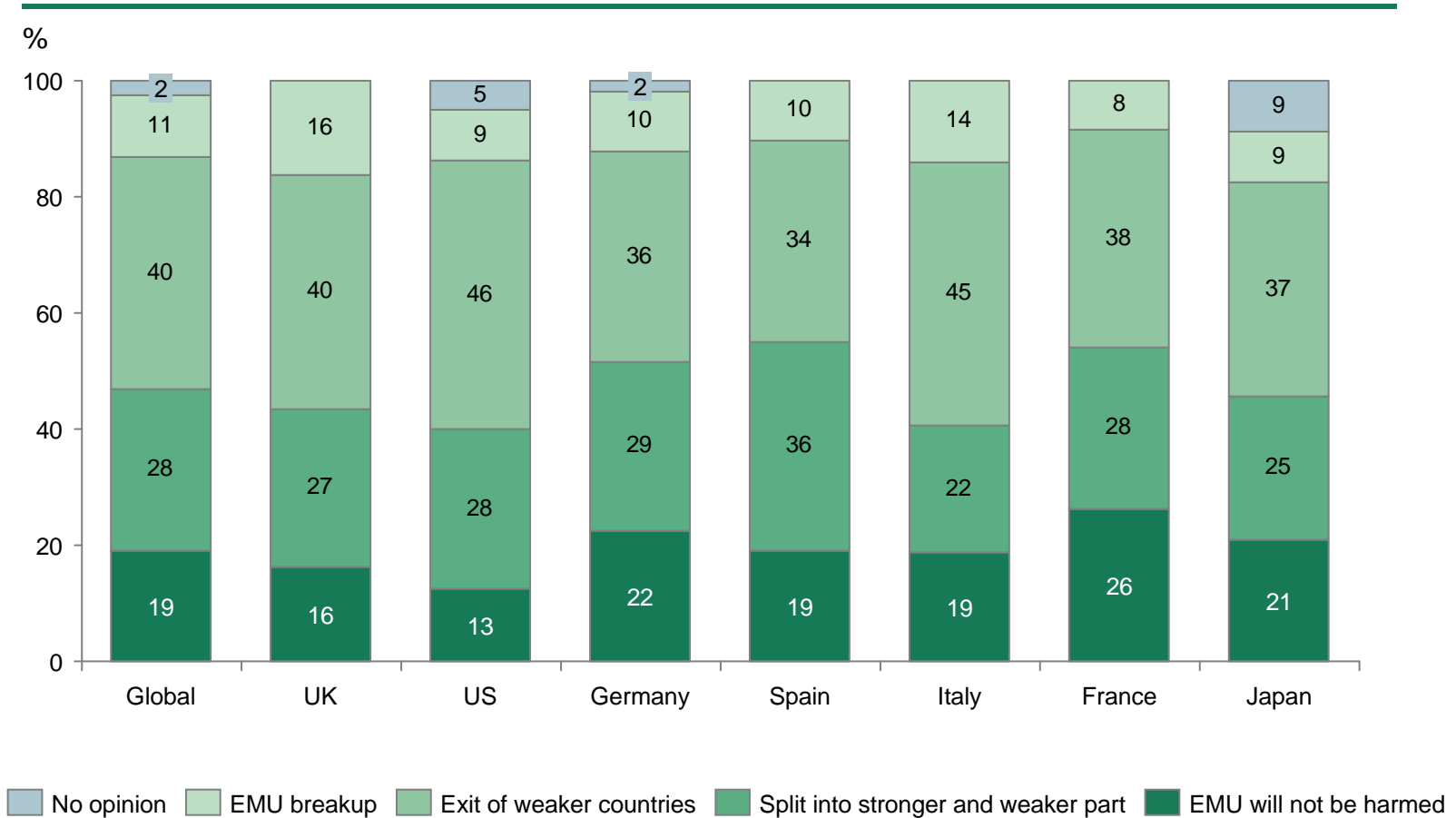
Implications

- Japan only surplus country that turns negative
- Deficit countries deleverage with rate of inflation
- Germany's current account balance turns negative as well
- Deficit countries deleverage with 2% current account surplus + inflation
- All surplus countries' current account balances turn negative
- Deficit countries deleverage with 4% current account surplus + inflation

1. All figures in charts represent current account balances as percentage of GDP per 2008. 2. Incl. Saudi Arabia, Russia, United Arab Emirates, Canada, Norway, Kuwait
Source: EIU, IMF, BCG analysis

Executives are skeptical about coherence of European Monetary Union

Expectations about EMU breakup



Source: BCG survey "Companies in the Downturn: Expectations, Actions and Preparedness", March 2010, N = 440

A new global economic order (III)

Changing mindsets: investors, consumers

Expected by % of surveyed managers

Lower appetite for risk

83%

Increased importance of
dividends

83%

Increase in consumers' price
sensitivity

89%

Less consumption—increase
of personal savings rate

79%

Anti-capitalist? Social
unrest?

74%



In a slow growth environment ...



Competitive intensity rises disproportionately



Pressure on profitability and costs



Growing generally means gaining share



Uncompetitive cost bases do not get rescued by growing with the market

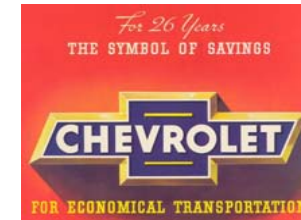
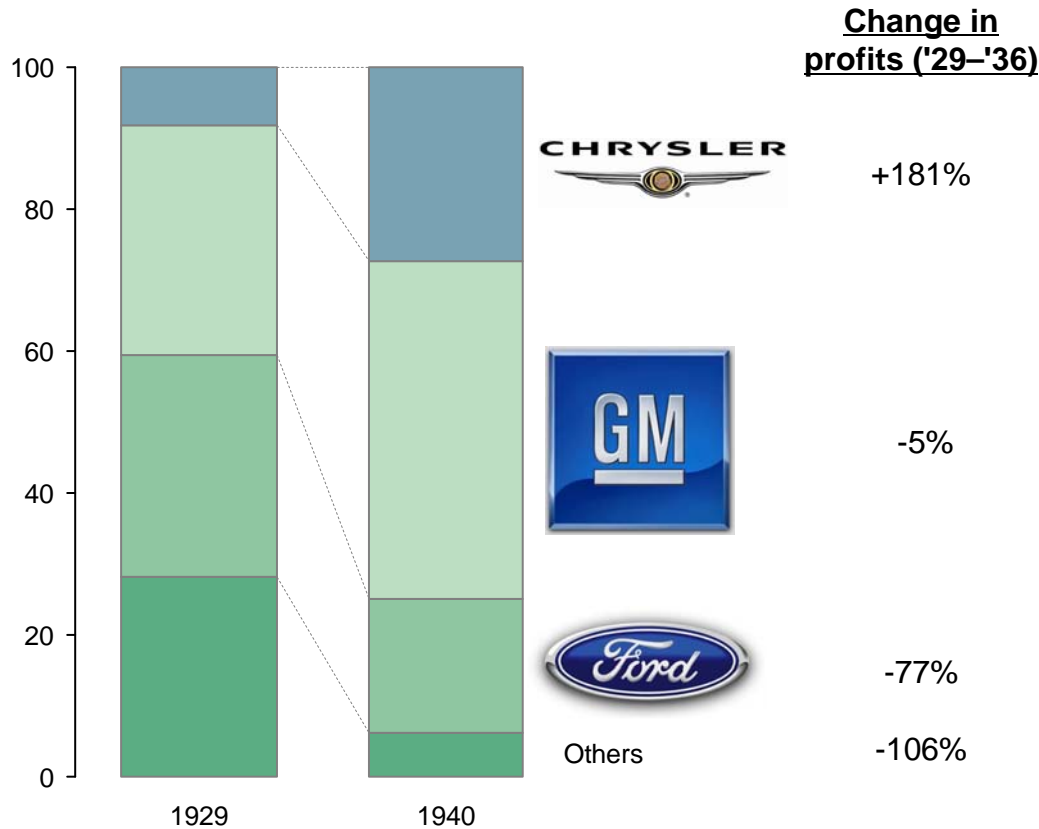


Broken business models get found out

Unique opportunity to change the pecking order

Example: US auto industry in the 30s

Market share in US auto industry



Rapid cost cutting, efficiency, flexibility



Focus on value, changing customer behaviors



Invested in the future



Successful companies see downturns as opportunities



Go for the attack!



Focus on innovation



Capitalize on changes in the external environment



Unleash advertising and marketing power



Take the fight to your competitors



Invest in the future



Employ game-changing strategies

A new managerial mind-set

Mobilize for growth

Rethink globalization

Hone political skills

Revisit the social contract

Challenge the shareholder value mantra

Redesign compensation systems

Redefine corporate governance

Change perspective on ethics

Lead from the front

Leadership makes the difference!



Walter P. Chrysler
Chrysler founder and
President 1925–36



Alfred P. Sloan
GM President 1923–37,
GM Chairman 1937–56



Thomas J. Watson
IBM President 1914–49



Richard R. Deupree
P&G President 1930–48

The years ahead

