Accelerating Out of the Great Recession
How to Win in a Slow-Growth Economy

May 2010
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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"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)

- Fannie, Freddie, AIG, Bear Stearns
- Treasury Troubled Asset Relief Program
- Federal Deposit Insurance Corp. bank guarantees
- Fed Mortgage-backed Securities Program
- Fed Asset-backed Debt Program (TALF)
- Fiscal stimulus
- HUD
- Other Fed lending and government commitments

$8.2 trillion total (as of Dec. 23, 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

"Yes, the recession is over."

FT Financial Times

"The recession is over."

"The recession is over."

Moody's

"Is the global recession really over? Absolutely!"

BBC World

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

"The recession is over."

Börsen-Zeitung

"Euro area left the recession behind."

"I believe that the worst is over."

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

… 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

"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

"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 GDP

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 $3bn 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.
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

Source: FT Lex Column, 11 June 2009; NY Times, Wall Street Journal
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
From financial and economic to sovereign crisis?

Overview of public debt and deficits

Outstanding government debt (% GDP)

Debt too high

More dangerous

Deficit too high

Negative impact on economic growth

Government gross financial liabilities (USD 2,500 bn)

Source: OECD

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THE BOSTON CONSULTING GROUP
A two-speed world emerging

Simulation of future growth based on IMF research

Output gap² in %

<table>
<thead>
<tr>
<th>Country</th>
<th>Near pre-crisis growth</th>
<th>Below pre-crisis growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>9.5%</td>
<td>-4.3³</td>
</tr>
<tr>
<td>India</td>
<td>7.7%</td>
<td>-2.5³</td>
</tr>
<tr>
<td>Brazil</td>
<td>7.3%</td>
<td>+2.1³</td>
</tr>
<tr>
<td>US</td>
<td>3.3%</td>
<td>-12.8</td>
</tr>
<tr>
<td>Eurozone</td>
<td>3.1%</td>
<td>-10.4</td>
</tr>
<tr>
<td>UK</td>
<td>2.6%</td>
<td>-16.7</td>
</tr>
<tr>
<td>France</td>
<td>1.9%</td>
<td>-8.7</td>
</tr>
<tr>
<td>Germany</td>
<td>1.8%</td>
<td>-11.7</td>
</tr>
<tr>
<td>Italy</td>
<td>1.0%</td>
<td>-13.9</td>
</tr>
<tr>
<td>Japan</td>
<td>1.0%</td>
<td>-15.7</td>
</tr>
<tr>
<td>China</td>
<td>1.6%</td>
<td>9.5%</td>
</tr>
<tr>
<td>India</td>
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<tr>
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<td>1.0%</td>
<td>2.6%</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.1%</td>
<td>1.9%</td>
</tr>
<tr>
<td>UK</td>
<td>1.0%</td>
<td>2.6%</td>
</tr>
<tr>
<td>France</td>
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<td>Italy</td>
<td>0.7%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Japan</td>
<td>0.6%</td>
<td>1.6%</td>
</tr>
</tbody>
</table>

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

BCG-Winning in slow growth economy-30Apr10-CPH.ppt
Executives are skeptical

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

A new global economic order (I)

Sluggish GDP growth

- Less debt turbo charging
- Rebalanced trade flows
- Slowdown in globalization
- BRIC countries will become important source of competitors

Expected by % of surveyed managers

- 73%
- 73%
- 69%
- 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 lobbyism – focus on activity in industry associations and contact to NGOs

Intensity of measures taken to prepare for government activity in business

Respondents in %

Measures taken by companies

<table>
<thead>
<tr>
<th>Measure</th>
<th>Limited action</th>
<th>Significant action</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing activity in industry associations</td>
<td></td>
<td></td>
<td>74</td>
</tr>
<tr>
<td>Intensifying contact to NGOs</td>
<td>29</td>
<td>41</td>
<td>70</td>
</tr>
<tr>
<td>Joining industry associations</td>
<td>30</td>
<td>36</td>
<td>65</td>
</tr>
<tr>
<td>Intensifying contact to political parties</td>
<td>27</td>
<td>32</td>
<td>59</td>
</tr>
<tr>
<td>Founding industry associations</td>
<td>22</td>
<td>26</td>
<td>48</td>
</tr>
<tr>
<td>Other</td>
<td>31</td>
<td>14</td>
<td>45</td>
</tr>
</tbody>
</table>

Is "rebalancing" possible?
Required surplus of deficit countries entirely allocated to surplus countries by relative size of GDP

Deficit countries¹

<table>
<thead>
<tr>
<th>Country</th>
<th>Current Account Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>-5%</td>
</tr>
<tr>
<td>Spain</td>
<td>-10%</td>
</tr>
<tr>
<td>UK</td>
<td>-2%</td>
</tr>
<tr>
<td>Australia</td>
<td>-14%</td>
</tr>
<tr>
<td>Greece</td>
<td>-14%</td>
</tr>
</tbody>
</table>

Surplus countries¹

<table>
<thead>
<tr>
<th>Country</th>
<th>Current Account Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>10%</td>
</tr>
<tr>
<td>Germany</td>
<td>6%</td>
</tr>
<tr>
<td>Japan</td>
<td>3%</td>
</tr>
<tr>
<td>Oil exporters¹</td>
<td>10%</td>
</tr>
</tbody>
</table>

Alternative scenarios for deleveraging of deficit countries¹

1. **Slow deleveraging**

<table>
<thead>
<tr>
<th>Deficit countries</th>
<th>China</th>
<th>Germany</th>
<th>Japan</th>
<th>Oil exporters¹</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0%</td>
<td>4%</td>
<td>1%</td>
<td>-3%</td>
</tr>
</tbody>
</table>

Implications:
- Japan only surplus country that turns negative
- Deficit countries deleverage with rate of inflation

2. **Moderate deleveraging**

<table>
<thead>
<tr>
<th>Deficit countries</th>
<th>China</th>
<th>Germany</th>
<th>Japan</th>
<th>Oil exporters¹</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2%</td>
<td>2%</td>
<td>-2%</td>
<td>-5%</td>
</tr>
</tbody>
</table>

Implications:
- Germany's current account balance turns negative as well
- Deficit countries deleverage with 2% current account surplus + inflation

3. **Quick deleveraging**

<table>
<thead>
<tr>
<th>Deficit countries</th>
<th>China</th>
<th>Germany</th>
<th>Japan</th>
<th>Oil exporters¹</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4%</td>
<td>-1%</td>
<td>-4%</td>
<td>-7%</td>
</tr>
</tbody>
</table>

Implications:
- All surplus countries' current account balances turn negative
- Deficit countries deleverage with 4% current account surplus + inflation

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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

## A new global economic order (III)

### Changing mindsets: investors, consumers

<table>
<thead>
<tr>
<th>Phenomenon</th>
<th>Expected by % of surveyed managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower appetite for risk</td>
<td>83%</td>
</tr>
<tr>
<td>Increased importance of dividends</td>
<td>83%</td>
</tr>
<tr>
<td>Increase in consumers' price sensitivity</td>
<td>89%</td>
</tr>
<tr>
<td>Less consumption—increase of personal savings rate</td>
<td>79%</td>
</tr>
<tr>
<td>Anti-capitalist? Social unrest?</td>
<td>74%</td>
</tr>
</tbody>
</table>

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*

- **GM**: +181%
- **Chrysler**: +181%
- **Ford**: -5%
- **Others**: -77%
- **Others**: -106%

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