

# >>> What If They Don't Come Back?

Business prepares  
for consumers  
without confidence.

By Steve Lawrence

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## ou may have heard

the Economics 101 theory, pushed by that old Austrian Joseph Schumpeter, that the “creative destruction” of wrenching economic change brings valuable new perspective. Recession may be tough, but it can teach important lessons and transform the ways we do business and spend our money. From this, Schumpeter argued, the economy emerges stronger in fresh and unexpected ways.

No telling how he might have reconciled the downturn of 2008-09 with his notion of good things created by bad times. Certainly the American consumer has been learning to spend money in a different and diminished way. But at the same time, there is disturbing evidence from corporate boardrooms to Main Street’s small businesses that the new way of doing business in America may not look so different from the old way—just more confused and slowed down.

A few forward-looking companies are giving planning and budgeting a makeover in an attempt to respond to the economy’s incredible ambiguity. But managing for the short term, with its emphasis on high risk, quick profits, and hitting those next-quarter numbers, still prevails. Never mind that this is exactly the sort of tunnel-vision strategizing that got us into this mess, a trend with indisputably damaging effects. In September 2009, Warren Buffett joined twenty-six other top executives, academics, and investors, via the Aspen Institute, to declare: “We believe that short-term objectives have eroded faith in corporations continuing to be the foundation of the American free enterprise system.”

Even so, wide swaths of business in America, encouraged by small stirrings of growth, seems to have bought the line that the Great Recession is over and all we have to do now is wait for everyone to start spending money again. This is called whistling past the graveyard. All those consumers, whose lavish spending is supposed to lift the economy, are smiling thinly.

Any congressperson fresh from visiting voters will tell you that the public is convinced that their recession-panicked lawmakers bailed out Wall Street and the big banks and left the rest of the country with little to show for it. The public’s cynicism, doubt, fear, and anger are not at all good for the economy. Growth and prosperity in America depend on happy shoppers. But shaken consumers do not spend money.

**I**t will be a major challenge for corporations big and small to figure out not only how to respond but how to rebuild an economy using fewer consumer dollars. Consumers now save what they can, pay down what debt they can, try desperately

to keep foreclosure signs off their lawns. If they have jobs, their hours and pay have probably been cut. If they’re unemployed, the odds of their landing good full-time jobs is little better than their chances of getting admitted to Harvard University. This is the stuff of which the United States is made these days.

Still, Americans keep hearing that the Great Recession is over, though they understand that this mainly means that things are either not getting worse or are just getting worse more slowly. They watch President Obama and his recovery team describe the purportedly wonderful things that a \$700 billion stimulus package is doing for the economy. They are unimpressed. Wall Street’s enthusiasm is not contagious this time.

Official unemployment numbers, sad as they are, don’t tell the full story. The jobless rate in November, for instance, was put at 10 percent, slightly below the 10.7 percent at the peak of the 1982 recession. But that’s an average. This time around, jobless rates for workers at every education level exceed those in ‘82. (Because there are far more college graduates in the workforce these days, their comparatively low unemployment rate—4.9 percent—improves the average jobless number.) At the same time, the government’s official measure of worker underutilization, the Bureau of Labor Statistics’ U6 gauge, more than doubled in this recession’s first two years, to an October peak of 17.5 percent. In other words, more than one in six working-age Americans is either unemployed, working part-time, or “marginally attached.” The U6 does not take into account all those wildly overqualified folks who now hold one or two jobs at half what they earned before they got fired.

No surprise that the Census Bureau confirms that middle-class wages and income have fallen in the last decade and that the 2008 poverty rate was the highest in a dozen years. Free-food depots are now haunted by the formerly middle class, with the use of food stamps (now dubbed “nutritional aid”) across the United States hitting record highs. Thirty-six million people were using food stamps, a 33 percent increase over the last two years. Those few laid-off workers who are being called back are, according to one study, taking pay cuts averaging 40 percent.

### NO SAVINGS, NO SPENDING

In spite of all this, America remains a consumer-driven country. Its prosperity and growth, 71.5 percent of GDP, are still dependent on snappy auto sales, packed shopping malls, and the proposition that too much is never enough. But Americans in debt, without jobs or money, are not happy consumers. They are hardly consumers at all. If they still have credit cards, they’re anxious about using them, facing higher rates and the fear that next year’s household income won’t be high enough to pay off this year’s debt. The debit card is the new credit card, as people try to manage their money in a more realistic, cash-and-carry way.

“People are working to bring down their debt levels,” says Bill Seyfried, an economist who studies consumer trends at

the Rollins College Crummer Graduate School of Business. “But without jobs, and without savings, that’s pretty hard to do. And it doesn’t leave a lot of money for more general consumer spending. Nationally, the debt-to-income ratio in 2009 has been around 118 percent. In 2000, it was 80 or 90 percent. So just to get back to levels of ten years ago, we’d have to drop that ratio by more than 10 percent. People are going to be deleveraging. But they don’t have savings to tap into. And if you are paying down debt, you are not spending.”

Little wonder that executives, economists, and recession-watchers are deeply concerned about how consumers have changed and whether that change is permanent. Certainly, for now, there is plenty of evidence that frugality is the new cool, that value is in and luxury is out, that deep discounting is here for a long while. After all, as they say in sales, once you give ‘em that discount, you never get ‘em to pay full price again.



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But the bigger question is whether business can still count on the American consumer to drive the economy—in the United States and elsewhere—to growth and prosperity. Have we been frightened into saving more and making permanent changes in our buying habits? And if consumer spending will no longer be 70-plus percent of GDP, what will replace it if we are to remain the world’s most prosperous country?

“This was a searing recession for consumers,” says Comerica chief economist Dana Johnson. “They have suffered an unprecedented decline in household net worth. Twenty-four percent is bigger than anything we’ve seen since the Great Depression. In the recession in the ‘80s, it was 13 percent. So the most important source of uncertainty about the economy is just that: the

recovery of consumer spending.” Consumer bankruptcies were up nearly 28 percent in October 2009 compared to the year before. And the American Bankruptcy Institute expects the surge to continue.

Gallup, McKinsey, ARG, and others who have been polling consumers see significant percentages spending far less than they were with no immediate plans to change that pattern. McKinsey’s findings are typical: 90 percent of respondents were cutting back; half anticipated keeping their wallets closed even after the outlook brightens.

Federal figures show the same pattern. In the previous three recessions, personal consumption began picking up noticeably by the sixth quarter of the downturn. This was not happening as the year ended and we moved past the official two-year mark of the recession’s start: Household savings rates leaped from just over 1 percent in early 2008 to 5 percent in the second quarter of 2009, signaling even more hesitancy to spend.

Millions of consumers used their homes as ATMs during the boom, pumping up the economy, but those days are gone for the time being: Few predict a robust return of the nation’s housing market. Arthur C. Nelson, director of the University of Utah’s Metropolitan Research Center, sees a major shift toward renting as the population ages and credit remains tight. Yes, real estate is a highly local phenomenon, and there remain hotspots in housing, but more than 3.5 million homes remain on the U.S. market, about an eight-month supply. And an estimated seven million homes are headed for foreclosure over the next few years—about a full year’s worth of sales in a decent market.

“In Florida, something like 50 percent of mortgages are underwater,” Seyfried says. In Nevada it is 65 percent. “Nationally, it is between 20 and 30 percent, depending on where you look. There was all this aggressive marketing from banks and mortgage lenders. So now people’s attitude is more cautious, if only because the access to that easy mortgage money has evaporated.”

### FROM LUXURIES TO BASICS

Admittedly, it is never safe to bet against the American consumer’s urge to splurge. None of the economists, investment advisers, and analysts interviewed for this article believe that the new frugal consumer is a permanent phenomenon. “There is not going to be a new economy,” said Michael Szenberg, an economist at Pace University’s Lubin School of Business. “It would require a drastic revolutionary, cultural change, and I just don’t see that. Given the framework of our economy, it is just not going to happen. Our culture is not based on simplicity. We like to show off our wealth.”

All the same, it's hard to see much push for the economy from the suburban mall anytime soon. "Eventually consumer spending will likely get down below 70 percent of GDP," Seyfried predicts. "In the '90s, it was around 60 percent."

Consumers talk a lot about how frugal they are these days; retailers are wary of what they are calling "shopper's guilt" and "luxury shame." Most seem to believe that upgraded online retailing is the way to overcome shoppers' reluctance to be seen with a trunkful of stuffed shopping bags. Saks has been trying out online "private sale events" for selected customers. And Neiman Marcus has been working its posh-list customers in the same manner. With the United States generally accounting for about one-third of luxury-goods sales worldwide, retailers are especially anxious to kick-start that sector.

But hailing success in retailing these days is very much like pronouncing the recession over. Things are bad, but at a slower pace. Witness one evaluation from one of consultant Bain & Co.'s newsletters to retailers near the end of 2009. First the good news: "The number of online buyers in the third quarter was up significantly—19.6% over last year—as value-conscious consumers increasingly turned to the Web for easy comparison shopping and the best deals." Then the bad: "This growth was not enough, however, to offset the average number and size of transactions: 16.4% fewer transactions per buyer and 2.4% smaller transactions than last year." The few high spots—Kindles, iPhones, Blu-Ray players—aren't enough.

"Even my wealthy clients are cutting back," says Dean Barber, president of Lenexa, Kan.-based Barber Financial Group. "They have all lost a tremendous amount of money, and their debt has not gone down. They've got to pay off that debt now. So I don't see where these rosy predictions of retail sales are coming from."



In supermarket aisles, it is strictly back to basics. From Whole Foods to Wal-Mart, discounted private-label and house brands are the new choice. And with consumers cooking at home more, supermarkets are moving more lower-priced staples. Brand names such as Kraft, Heinz, General Mills, and Campbell Soup are responding with special offers and other discounts. All this, of course, means that shoppers are spend-

ing less money. Even clip-and-savers are back: Though coupons will likely never hit their 1992 end-of-recession peak, they're up for the first time since 2006, with a 23 percent increase in the first half of 2009.

For virtually every spending level and category, then, there are major structural changes under way in the American economy that are certain to ripple out for many years. "I also expect that durable goods will have a longer shelf life in our homes," Rodriguez says. "Cars and computers just won't be replaced as quickly. But the biggest effect we may see will be from young people, those who have not yet begun to chart their spending patterns. Unemployment is a coarse measurement, but for any young person with less than a college education, the employment rate is more than twice the national average. These are awfully lean times for kids. Even for those graduating with business degrees, it used to be they could expect fairly rapid progress in their careers, bonuses, raises, and that is not going to happen either." So much for those 18-to-25-year-olds whom advertisers are said to crave.

The Obama administration would have us believe that tough times will begin to melt this year as the remaining 60 percent or so of its stimulus package seeps into the economy. No doubt more spending on roads, bridges, and other infrastructure will not hurt; certainly, beefing up the nation's electric grid is a great idea. No doubt, too, that once those roads are repaired and bridges built, the men and women who did the work will again be looking for jobs. "I continue to be fairly positive about the stimulus," says Jim Haughey, chief economist at survey firm Reed Construction Data. "It seems to be generally doing its job. But a lot of it is not really stimulus in the sense that it will create something and be sustainable over time. Ten years from now, we'll look back on this and say, 'Well, we spent a lot of money, but it didn't generate anything sustainable.'"

None of this is to argue that the business cycle has been repealed and that the United States—along with the rest of the advanced economies—will not eventually emerge from this recession. It is just not at all clear exactly how that will happen with jobs gone, consumers disaffected, and little on the horizon to take their place.

As business and the government look at this sorry economy, they seem to be captivated—in thrall almost—by a new kind of magical thinking: *Something* will happen to pull us out of this. Just have patience. Capturing this attitude perfectly, *Washington Post* political cartoonist Tom Toles drew a self-satisfied executive talking to one of his employees. "We're laying you off because of the economy," the exec says. Then he advises: "We can't rehire you until you start spending." Then he cautions: "But don't do that until you pay down your debt and rebuild your savings." Then he shrugs: "In any case, you'll be unemployed a long time because it will be a jobless recovery."

Taken aback, the employee says, "I don't see how I'm sup-

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posed . . .” He is interrupted by the exec, who says, “Shhhh!” And then commands: “Surprise us.”

## **ARE THEY WILLING TO CHANGE?**

Clearly, business today must do more than wait for that surprise. “What’s troubling is, I don’t perceive corporations doing anything substantial to change how they do business,” says Peter L. Rodriguez, director of Tayloe Murphy International Center at the University of Virginia’s Darden School of Business. “There is some belt-tightening and minor reappraisal, but nothing much more.”

Rodriguez is hardly alone in that assessment. But it may be a bit harsh. “You can see companies responding,” Seyfried insists. “They have been getting their costs under control, which has helped earnings. And I see high-end retailers announcing permanently lower prices, changing their marketing philosophies.” He sees a strategic move toward exports.

“We are already seeing a shift in the makeup of some boards,” says Robert Pozen, author of *Too Big to Save?: How to Fix the U.S. Financial System* and chairman of MFS Investment Management, which manages over \$150 billion in assets for more than five million investors worldwide. “Boards are getting smaller, more independent, and they are spending more time on governance and risk issues,” he says. “And all that is good. But I don’t see these institutions backing away from their old internal risk models, and that is troubling. It’s not clear they are willing to do that.”

Even if many companies have retained those old ways of doing business, they are certainly operating more cautiously, even more self-consciously, out of choice and necessity. “Corporations are sitting on a lot of money but, more important, on enormous excess capacity,” says Comerica Bank’s Johnson. “In general, companies have plenty of ability to produce more. But there is still a lot of skepticism about how fast this recession is going away, so it’s not surprising they are holding back on capital spending.”

Still, he does see a recovery beginning. “The economy will get a lot of support from exports,” he explains. “The dollar is weak, and exports will continue upward. And there has been improvement in the credit markets: It is getting easier to borrow and to issue bonds, and look at the M&A activity we are seeing. Getting financing for good deals is getting easier.”

McKinsey, Accenture, and others, in fact, see corporations using mergers and acquisitions as a primary means of growth

in a recovering economy. These new combines may be especially attractive now because assets of all types are so relatively cheap. But this strategy brings its own peril: These same consultants estimate that M&A is so poorly done these days that about 70 percent disappoint. Companies misjudge everything from the value of potential synergies in joining firms to the often-vast cultural differences that can make a combine untenable. So while mergers are seen as a sign of economic optimism and opportunity, they too often fail to produce the anticipated result.

## **THE TERRIBLE, NO GOOD, HORRIBLE, VERY BAD YEAR**

On a more optimistic note, though, there does seem to be a growing awareness that this economy calls for a sharp reappraisal of planning, budgeting, and corporate strategizing. “You know, usually you do your budget and then you don’t change much over the course of the year,” Estée Lauder chief strategy officer Peter Jueptner recently told *McKinsey Quarterly*. “Now we’re basically changing quarterly and adjusting quarterly.”

But how can corporations cope with unprecedented economic ambiguity? Obviously, there are almost as many answers as there are businesses and executives. But those answers might be a bit easier if not for the nagging uncertainty and doubts about exactly how, and how fast, real recovery will happen.

A part of that doubt centers on the gnawing suspicion that the administration and the Congress struggling to fix the economy are far too enmeshed with the Wall Street, banking, and other financial wizards who created this disaster in the first place. Tough, bold, imaginative, and confidence-inspiring solutions for pushing the country back from the brink have not so far emerged from Capitol Hill or the White House.

And the people leading corporate America today seem every bit as unprepared as the politicians to muscle this country into a high-impact recovery. “We have a generation of people in leadership positions who had never experienced a major crisis,” Rodriguez said. “They did not have an enduring sense of skepticism. From 1983 to 2007, we had twenty-five years when there were modest recessions with no more than four to five quarters of shrinking GDP.”

These days, he points out, when government officials and the country’s top executives meet to discuss solutions, they are seriously limited in the options they consider because, “No one in the room ever had a bad year.”

Until now. ■