

EUROPEAN EDITION

*AT*KEARNEY

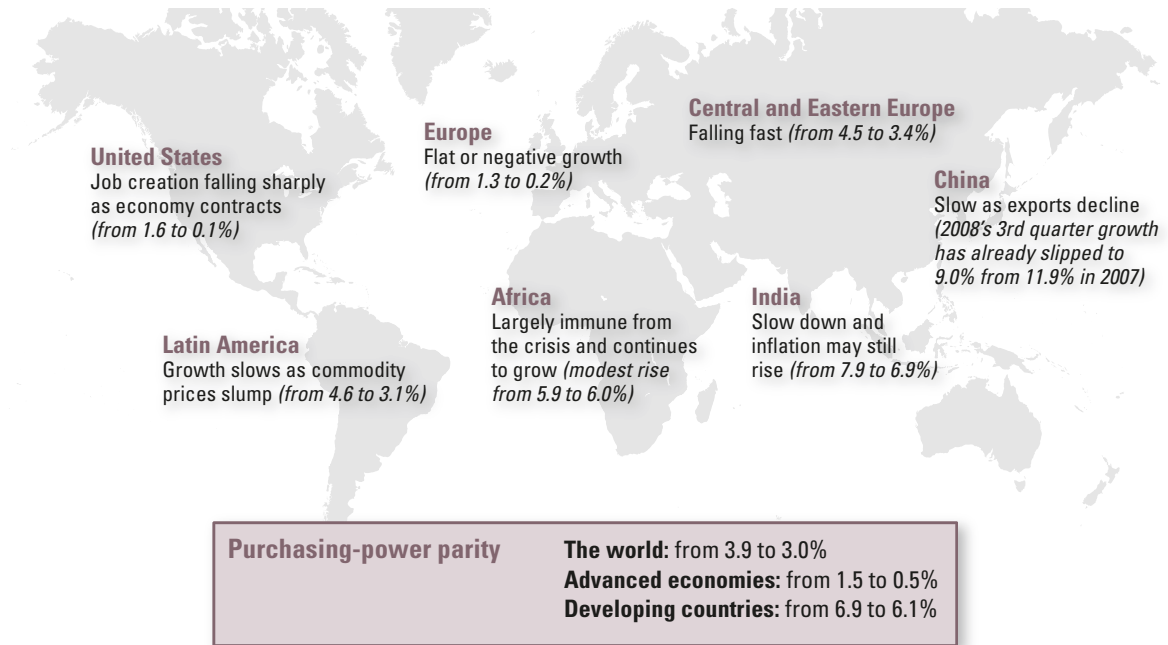
The Crash of 2008

Managing through volatility to success



IN OCTOBER 2008, some of the world's leading business executives, economists and policy experts gathered in Chicago for the annual CEO Retreat of A.T. Kearney's Global Business Policy Council. Since its founding in 1992, the Global Business Policy Council has helped senior business executives and government leaders monitor and capitalize on macroeconomic, geopolitical, sociodemographic and technological change worldwide. This paper provides a macro view of the economic consensus that emerged from the Chicago meeting and a micro view consisting of A.T. Kearney's perspective on smart decisions for managing your business in troubling times. The particular impact on Europe's economy is discussed in detail in the Appendix.

Figure 1
Forecasts for 2009



Notes: Estimates based on purchasing-power parity; world growth based on market exchange rates is forecast to drop from 2.7 percent in 2008 to 1.9 percent in 2009
Sources: Global Business Policy Council; International Monetary Fund's October 2008 World Economic Outlook; Chinese National Bureau of Statistics; A.T. Kearney analysis

Figure 2
The "what ifs" in a down economy

Risk	Potential impact	Likelihood
The nonbank financial system is outside the purview of the regulators	A meltdown of nonbank intermediaries and funds with nonliquid positions	High
Protectionism	Countries retrench and trade decreases as a result of popular opposition to free trade and foreign direct investment	Moderate
Credit crisis does not improve for small businesses	Slashed lines of credit for small businesses persists and many cannot make payroll	Moderate
U.S. economy does not respond to stimuli immediately	Aggressive fiscal and monetary policies produce too much liquidity and hyperinflation	Low to moderate

Note: CDS market estimate is based on notional value
Sources: Global Business Policy Council; Financial Times; International Swaps and Derivatives Association

THE MACRO VIEW

Amid tumbling share prices and bank rescues, participants at A.T. Kearney's Global Business Policy Council's 17th annual CEO Retreat concluded, after three days, that although a modern-day Great Depression was extremely unlikely, a prolonged and severe global recession was under way.

Having learned from the 1930s what not to do, policymakers were relatively quick to take action to preserve the main pillars of the banking system, with bold and coordinated inter-

national efforts to cut interest rates and provide liquidity. They were also expected to firmly resist any populist political attempts to repeat the kind of protectionist mistakes of the 1930 Smoot-Hawley Act, which exacerbated that era's economic downturn.

"A fatal heart attack had been avoided, but the patient is weak and will need a long recovery," commented one participant. But there were several patients in different stages of illness.

THE MICRO VIEW

What Matters to Corporate Executives: Developing Strategies for the Here and Now

Despite the global financial crisis, executives still have businesses to run. There's no time to wait for the economy to work its way out of this crisis. So, as business leaders consider the macro perspectives, they also face a number of crucial micro-level issues as they guide their organizations through these stormy times.

But where to start? What should be done first? Does the order matter? Or should everything be done at once? While some strategies might be right for your company today, unforeseen negative consequences could have a lasting impact, depending on how the crisis plays out. Devising the best approach requires a measure of tenacity—planning for short-term wins to cut costs and improve efficiency, while scanning the environment for opportunities to improve and grow the top line. Armed with the macro perspective from the CEO Retreat and the Global Business Policy Council's ongoing strategic analysis, we recommend a re-examination of strategies to identify opportunities for top-line growth and cost control across your organization.

Here are 12 suggested areas of focus that can yield powerful results in the current economic climate (*see figure 3*).

Figure 3

Twelve areas that can yield powerful results

1. Become a selective acquirer
2. Get smart with your marketing spending
3. Break the classic rules of pricing
4. Get creative with customer interactions
5. Gain control of out-of-control complexity
6. Streamline R&D without stifling innovation
7. Cut direct material costs: Kumbaya with your suppliers
8. Slash demand and indirect materials costs
9. Take a tough approach to manufacturing
10. Avoid the "whack-a-mole" approach to G&A cost cutting
11. Unlock millions (billions!) of dollars in cash flow
12. Design a leveraged organization

Source: A.T. Kearney

THE MACRO VIEW *(continued)*

The financial crisis initially seemed to be the problem of G-7 advanced industrial nations, which all face recession or, at best, stagnation in 2009. But its impact quickly spread to the \$1 trillion-plus BRIC countries of Brazil, Russia, India and China (*see figure 1 on page 2*). Each appeared vulnerable to the shrinking export markets in Japan, Europe and North America. They would also suffer from the sharp decline of energy and commodity prices and the loss of foreign direct investment, as Western

investors repatriated cash. The International Monetary Fund's (IMF) September forecast that BRIC countries would grow at 6 to 7 percent in 2009 was considered overly optimistic. The next layer of sizeable emerging markets are the so-called "MATTISK" countries (Mexico, Australia, Taiwan, Turkey, Indonesia and South Korea). These significant, if somewhat smaller, economies are also starting to suffer from the impact of the G-7 recession, and their growth rates are expected to drop

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Become a Selective Acquirer

Deals made in downturns create more value than those made in upturns. Yet success still relies on old-school tactics: identifying solid acquisition targets and confirming that those targets fit with your strategy and business model. An acquisition process that improves the top- and bottom-line performance of the acquired business will result in a significantly higher valuation multiple with the integrated business compared to its stand-alone value. Valuations have come down substantially, now favoring acquirers with strong balance sheets and cash flows. Deals can be made at more favorable prices, although equity stakes are higher and financing is more expensive. Still, the trade-offs can be beneficial to wise acquirers.

See Build Your Own Acquisitions Factory at www.atkearney.com.

Get Smart with Your Marketing Spending

Like it or not, marketing makes the commercial world go round—and it's increasingly becoming a very expensive rotation. The key to controlling this expense is simple: Effective stewardship of marketing expenditures can easily save 10 to 15 percent of

a company's total marketing budget—and that's enough to fund a lot of exciting activities or make a healthy contribution to the bottom line.

The timing for a structured approach to marketing couldn't be better. As the economy slows, the principal laws of marketing have been turned on their head and consumer sentiment is fundamentally affected by current economic conditions. Historically, companies cut advertising spending in a recession. But such moves are almost always made in a panicked search for in-quarter earnings. They are ill-timed, poorly targeted and occasionally damaging to core brands. As Professor John Quelch, Harvard Business School faculty member, explains, companies "can improve market share and return on investment at lower cost during a recession than during good economic times."

Smarter, more efficient spending on advertising can drive costs from marketing without compromising marketing objectives. Smart marketing begins in three areas:

Examine your entire marketing spending. A fact-based, clear-eyed review of the effectiveness of each marketing euro (do not forget the digital

well below the IMF's forecast of 5 percent.

The briefly fashionable theory of decoupling, where the BRIC countries were thought to be sufficiently well developed that they could withstand a slowdown in the West and continue to grow anyway, is now looking hollow. At best, we might expect a partial decoupling, in which G-7 growth stagnates while BRIC growth rates fall by a third or as much as half. In the context of raised public expectations in the BRIC countries, even

such a decline in growth rates could have profound social and political repercussions.

Clearly, this slowdown is going to be longer and deeper than the eight-month recessions of 1991 and 2001. This one may resemble the recession of 1981–82, which lasted 24 months; or 1974–75, which lasted almost as long and carried a long and deeply damaging inflationary tail. But the gloom is expected to lift eventually. There are already signs that the credit crunch and interbank

ones) and tight monitoring of financial commitments over time are key to making the right trade-offs between brands, segments and media.

Win on the customer front. Increasingly, impulse buyers and bargain shoppers are won at the point of sale or consumption. Making these sales requires excellence in execution, savvy and innovative field marketing, and masterful promotions; forget those lush TV ad campaigns.

Extract more value from media agency partners. It is possible to improve the joint processes that lead to creating and delivering great advertising, while also optimizing commercial production expenses. Agencies are more willing than ever to listen, so companies should start talking.

See *Keep Your Eye on the I* at www.atkearney.com.

Break the Classic Rules of Pricing

Are you focusing on your customers' *ability to pay* rather than *willingness to pay*? Are you comparing your prices to competitors or how your products are viewed in the eye of the customer? If so, you're not alone. Market research and traditional go-to-market analyses are popular ways to measure

ability to pay (via consumers' wealth) and price ladders. Willingness to pay and "price image" are rarely assessed because they are driven by more intangible factors, such as limitations in access to the product or channel, and psychological factors, such as the urgency of the need.

During times of economic downturn, reading your customers' minds is crucial. Setting prices for the "average" customer can hurt profitability. Despite a poor economy, certain microsegments of the business continue to have a high willingness to pay. One consumer-products company identified such microsegments and increased prices by 40 percent without any customer defection. The result was a 10 percent increase in earnings in three months.

Discounting remains a good method for price discrimination, but without a clear strategy, discipline and controls, potential benefits are often replaced by lost revenue. At an industrial services company, we recently redefined the discounting strategy and allowances to increase revenues by 3 percent in a period of four months.

A good pricing methodology should be neither complex nor academic, but rather a

THE MACRO VIEW *(continued)*

lending rates are starting to ease. Slight increases in new mortgages and home sales in the United States are seen as the first hint that the housing crisis could be over within a year, likely the first indication that the global economy will have bottomed out.

Ending the recession would require more of the coordinated fiscal stimulus that the G-7 countries and China had provided immediately after the IMF's October 12 summit. Fortunately, with government debt as a proportion of GDP

below 50 percent in the United Kingdom and below 65 percent in France, Canada and Germany, there is room for vigorous deficit financing. The effect would be that G-7 nations could start to look like Japan and Italy, with debt above 100 percent of GDP, a process that is likely to lead to more inflation in future years. But that is a problem for the future.

What President-elect Obama called “the fierce urgency of now” is upon us. (Figure 2 on page

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structured way of thinking strategically about practical issues, identifying opportunities to raise prices by deliberately breaking the classic rules of pricing. And what better time to break the rules than in a global financial meltdown?

See Pricing: An Eternity of Frustration? at www.atkearney.com.

Get Creative with Customer Interactions

In a world with few distinctions among products, quality and prices, customer interaction, from sales through service, is fast becoming a source of differentiation. Field forces are a frequent early target to cut costs fast. While they might produce a short-term margin lift, the improved margins come at the expense of long-term growth and shareholder value. The outcome is not often positive, as customer relationships crumble and field intelligence deteriorates.

By improving the deployment and effectiveness of field resources, you can reach growth targets without slashing field forces. But not across the board. All efforts, at least temporarily, should be ruthlessly strategic: Target your most attractive customer segments, acquire the high

potential (large and profitable) customers within those segments and serve them through the right channels—doing all of this while also keeping cost-to-serve at an appropriate level.

The top- and bottom-line advantages can be significant, ranging from a 10 to 30 percent increase in revenues to double-digit earnings growth, all within just six to 12 months.

Better customer service is guided by key questions: Which interactions will make or break the relationship with key customers? How can these touch points be revamped cost-effectively? What new processes must be forged to deliver on customers' expectations? What new roles and organizational capabilities will help support these processes and create “customer advocates”? What metrics (retention, revenue, tenure of relationship, product growth) will ensure that strategies are achieving projected benefits?

The right answers can result in significant wins: A retail bank increased customer retention rates from 1.5 to 3.6 percent, representing more than \$500 million in loan balances. A global hardware manufacturer increased overall growth in annual revenues, including \$30 million a year

2 outlines some of the major risks and potential impact.) The new U.S. Presidency has a clear opportunity to provide a fiscal stimulus as a reaction to the glaring need for major investments in the United States' dilapidated infrastructure. The American Association of Civil Engineers identified a need for \$1.6 trillion in urgent spending to repair bridges, roads, ports, airfields, sewage and water supplies, and the electric grid. Council attendees see a stimulus package of some \$500

billion to be deployed over the first two years of the next administration, starting in the first 100 days with investment in a "smart" national grid. Senior advisers to both Senators McCain and Obama, while differing on the scale and timing of the package needed, agreed in principle that it would be required.

There are two main problems with this idea. The first is the absorptive capacity of the U.S. economy, with possible shortages of skilled

in additional revenues from one key customer. A large pharmaceutical retailer reduced wait times for acute prescriptions by 80 percent, labor by 30 percent, and working capital requirements by 16 percent.

See Do Your Customers Value Their Experience? at www.atkearney.com.

Gain Control of Out-of-Control Complexity

Although the good times may be behind us for now, companies have had ample opportunities to grow. Globalization brought new and exciting markets within reach. Supply chains extended to all corners of the world. Consumers were anxious to absorb every new product or service even as they scrambled for better customized offers.

It should be no surprise then that many companies have paid a high price for this growth: excessive, extensive and out-of-control complexity. Product and service portfolios are exploding, processes and systems are proliferating, and organizational structures and interfaces are becoming increasingly convoluted and problematic.

Complexity must be controlled so companies have a clear path to the next growth frontier. Now is the time to take a step back and deal with those complexity challenges by:

- Adopting a strategic view on complexity—don't just cut the SKU tail but optimize the overall product portfolio based on customer needs
- Creating the appropriate transparency on revenue and the cost impact of complexity
- Taking a comprehensive value chain perspective
- Installing the right processes and governance to ensure sustainable results

See Taking Control of Complexity at www.atkearney.com.

Streamline Research and Development without Stifling Innovation

Innovation and R&D go hand-in-hand, and never more so than when the economy falters. In a recent study, we found that innovation leaders achieve roughly 70 percent higher earnings over a four-year period than companies without an explicit innovation focus.¹

¹ A.T. Kearney study of 200 companies in the European services sector, 2008; numbers based on earnings before interest and taxes.

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labor and engineering capabilities. The second is the need for national-level strategic planning. Current plans for port and railroad modernization in North America suffer because a large proportion of freight rail traffic still has to pass through the bottleneck of Chicago. This is an agenda, though fraught with some political complications, the new President will likely want to tackle early on in his term. Private and public investment in alternative energy supplies is also

confidently expected through a policy of “Green Keynesianism.” As a candidate, Mr. Obama was committed to “cap and trade” systems to control greenhouse gas emissions and in principle supported a Kyoto2 agreement.

Some relief for the global economy is at hand from the sharp fall in oil, food and other commodity prices. One of the reasons for the sharp psychological impact of the Crash of 2008 is that there has been a triple blow—a coinciding

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Success depends on rescoping or rationalizing a significant number of R&D projects without affecting growth and future profitability. Companies should also refocus on their core competencies—not only to capture cost savings, but also to sustain a competitive advantage through technology and product leadership. When noncore activities are sent to competent third parties in low-cost locations, the latest advancements in collaboration technology allow for a seamless integration of product development centers around the world.

See Innovation Management: Strategies for Success and Leadership at www.atkearney.com.

Cut Direct Material Costs: Kumbaya with Your Suppliers

In tough times, companies often attempt to squeeze the “last penny” out of their suppliers, thus opening the door to years-long confrontations. Smart companies, however, avoid the conflicts and instead try to understand their suppliers. They leverage powerful cost models (cost regression analysis) to understand how their suppliers compare to world-class competitors in apples-to-

apples price comparisons for items with totally different specifications in the same category.

For example, we helped a large global consumer packaged goods company, which annually buys more than 10,000 variations of primary paper packaging, make valid price comparisons on hundreds of items with different specifications simultaneously. The analysis identified a one-time savings potential of more than 15 percent in the category, addressed on a supplier-by-supplier basis.

When both parties—buyer and supplier—engage in open and transparent analyses it spurs collaborative behavior in reducing overall price.

See Restoring Cost Transparency at www.atkearney.com.

Slash Demand and Indirect Materials Costs

When the economy sinks, so do costs. But instead of focusing primarily on suppliers and their prices, we recommend company-wide initiatives in “demand management”—a proven approach to take costs out of an organization without further reducing its capacity to perform.

Using this approach, companies can cut 10

of food, fuel and financial crises. But food and fuel prices have halved since their peaks and with demand depressed are unlikely to soar again anytime soon. Moreover, severe droughts in Australia and Ukraine reduced food stocks to historically low levels in early 2008, but grain output is on track to be 5 percent higher than 2007's. Western investments in Russian and Ukrainian farms are expected to increase yields in the future. In the longer term, better water resource management

and better exploitation of poorly farmed areas in Africa could ease the problem, although climate change and the loss of arable land to development in China and India would pose severe challenges.

International trade, growing from \$3.3 trillion in 1990 to \$6.7 trillion in 2000 and to \$11.8 trillion in 2006, had been the key to globalization and global growth. Trade could continue to play this role in the future and the priority would be to prevent any recession-fueled moves toward

to 20 percent off their addressable spending in certain categories; savings can begin in as little as three months. With demand management, organizations address the underlying drivers of their external spending, align their purchases to their business needs and eliminate unnecessary consumption. Companies gain a better understanding of the rationale behind their purchases. Unlike traditional sourcing efforts, it targets the quantity of products purchased from suppliers—not just the price paid. Demand management fundamentally changes the way organizations acquire their goods and services.

Consider this: One company applied demand management to its technology spending, discovering that it had little control over the purchase of small, nonessential peripheral items. While most of the items cost less than \$200, together they represented half a million dollars per year in spending. By educating its workforce and implementing proper controls, demand for these nonessential items nearly vanished.

See Demand Management: Changing the Way Organizations Acquire Goods and Services at www.atkearney.com.

Take a Tough Approach to Manufacturing

For companies that have already made significant progress in implementing lean manufacturing and applying Six Sigma tools, this economic downturn presents even tougher questions: Do we have the right manufacturing footprint? Should we consolidate facilities? Can we reallocate production to lower-cost production sites? Should we be in the business of manufacturing at all?

There are approaches for improving business performance that leverage many of the tools and techniques made popular by Lean and Six Sigma. The focus is on achieving tangible results quickly, rather than losing valuable time putting an elaborate program in place. For example, a Next Generation Six Sigma approach helps reinvigorate existing continuous improvement efforts and Lean Six Sigma infrastructures, and helps refocus efforts and attention away from “program” parameters (for example, number of training sessions or how many certified black belts are in the organization) toward efforts that will have a tangible impact on the bottom line. This way, manufacturers not only weather

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protectionism. But this would require far more effective mechanisms to retrain and help those made unemployed by globalization if political support was to be maintained.

President-elect Obama's call, during his campaign, for a review of NAFTA and his public skepticism for existing free trade agreements were sobering, but policy advisers insisted that he was misunderstood; the then presidential candidate was a free trader, but one who would enforce the

existing rules on dumping and unfair practices. He supported the Doha round in principle as an important development tool. He would work to improve trade agreements, existing and future, within the context of his wider foreign policies that would be more consultative and internationalist.

A transatlantic free trade agreement (TAFTA), as proposed by German Chancellor Angela Merkel, could be a useful stimulus for freer trade in services and the adoption of common health and

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a downturn, but also are positioned for growth when new opportunities arise.

See the podcast "Next Generation Six Sigma: Capturing More Value with Less Effort" at www.atkearney.com.

Avoid the "Whack-a-Mole" Approach to G&A Cost Cutting

Companies often view back-office functions such as finance, IT, human resources and legal as non-value-added areas and ideal for cost cutting. This short-term approach to cost cutting almost always resembles the classic arcade game of "whack-a-mole" as cost reductions in one area show up as increases elsewhere. When the economy is in a nosedive, a more appropriate response is to transform the entire general and administrative (G&A) set of functions—not only focusing on short-term cost reductions, but also on long-term performance improvements. Balancing the need for near-term savings with the desire for deep and long-lasting results requires the following:

Simplify and automate processes. Standardize, simplify, automate and provide self-serve

web-based approaches—all result in lower overall costs.

Develop an outsourcing and offshoring strategy. Companies that simply outsource back-office functions to reduce costs without a comprehensive strategy have a higher dissatisfaction rate and end up in-sourcing at a later date.

Source vendors aggressively. Aggressively negotiating contracts with suppliers is a good opportunity for both short- and long-term cost reductions.

Manage demand. Defining what services these functions should provide, finding the appropriate charge-back mechanism, and controlling demand are all actions that can reduce total costs.

Redesign and consolidate. A measured review of both organization and process structures will determine the optimal design, control costs, and ensure appropriate accountability and oversight.

See The 3 As of Integrated G&A Management at www.atkearney.com.

Unlock Millions (Billions!) of Dollars in Cash Flow

Conserving cash and managing the balance sheet

safety standards, but it would have to be open to all countries agreeing to abide by its rules. Serious progress in multilateral trade would hinge on a reduction in the annual \$300 billion in G-7 agricultural subsidies, and as ever this would be politically difficult.

The overwhelming theme of this year's CEO Retreat is that the Crash of 2008 will leave few countries untouched. Participants in the global economy are all in this together and, when recov-

ery eventually comes in 2010 or so, the governance mechanisms and regulatory systems of the post-Crash order would also have to become global in scope, in participation and in decision making. This is now a multipolar economy, beyond the traditional dominance of the G-7, and a greater role for the BRIC and probably for the MATTISK countries is expected and desirable as the new rules are drafted.

This might not go as far as the one-nation,

are two actions that take on more importance during a downturn. Companies can unlock millions of dollars in cash flow—delivering immediate and substantial bottom-line benefits—by systematically identifying gaps and problems in the complete order-to-cash cycle. It not only releases immediate cash, but also reduces inventories and creates shareholder value. One client generated more than \$1.7 billion in total cash flow using this approach.

A working capital reduction effort focuses on addressing longer-term problems to ensure that those lofty levels of working capital never return. By improving existing processes, policies, organizations and information systems, companies can release more cash for growth and investment, reduce interest expense associated with not having to borrow, decrease the risk of bad debt, improve customer service and dispute resolution, and ultimately increase shareholder value.

See Improving Working Capital Performance at www.atkearney.com.

Design a Leveraged Organization

The best companies today are modular, where joint ventures, alliances, pooling, shared services,

offshoring and outsourcing are common tactics. Growth no longer requires optimally managing a firm's resources, but rather having access to competitive resources, internal or external, exclusive or shared. In an economic downturn, survival will depend on maximizing a wide range of opportunities for every piece of the value chain. If you do not consider optimization step changes—scaling up individual processes, relocating them, and fundamentally reengineering the configuration in which they operate—you may be denying your company competitive advantage.

There are three dimensions to what we call a leveraged organization:

Work smarter. Improve fundamental processes to address work systems, resources and IT enablement

Work cheaper. Optimize costs through better locations while considering factor costs and pools of expertise

Work bigger. Build economies of scale through improved processes, increase critical mass through specialized processes and shared investments

See Designing the Leveraged Organization at www.atkearney.com.

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one-vote rule of the World Trade Organization, and the process is unlikely to be smooth, but the trend of greater participation leading to greater responsibility is clear. In this context, China's decision to cut its interest rates in coordination with the G-7 countries after the October 12 IMF summit is highly significant; the Beijing leadership seems to have taken a strategic decision to

play the role of responsible stakeholder in the global economy. It may well be that the Crash of 2008 will be cathartic for the global policy needed to address the governance mechanisms judged necessary for effective policymaking in a post-globalization world.

THE MICRO VIEW *(continued)*

Conclusion

The successful business leader in a world of continuous, disruptive change must manage both the strategic and operational dynamics of a business. It is no longer enough to “stick to the knitting” without having good strategic insight into how fundamentally the business paradigm might be changing. Nor is it possible to identify and seize

strategic opportunities without the right kind of effective performance platform necessary to sustain new growth and profitability. The combination of new strategic foresight and operational rigor will define who wins and who loses in today's challenging environment. The smart, nimble and quick actors will emerge from this downturn stronger and more competitive than ever.

APPENDIX — THE IMPACT ON EUROPE

The financial crisis may have started in the United States, but it swiftly hit Europe. The first casualties of the disintegrating subprime mortgage market were two Bear Stearns funds in June 2007. In the following month, three Oddo funds were closed in France and on August 7 BNP Paribas halted withdrawals from three investment funds with assets of more than \$2 billion. The German government launched a rescue plan for IKB Deutsche Industriebank AG to guarantee obligations of \$11 billion, more than five times IKB's stock market value. Then came the run on Britain's Northern Rock bank, and the close integration of the transatlantic economies meant that Europe's own echo of the American crisis was under way.

The problems were complicated by the divergent policies of the U.S. Federal Reserve, which began cutting interest rates, and the European Central Bank (ECB), which kept interest rates high for fear of inflation, triggered largely by the rise in oil prices. As a result, the dollar fell against the euro. In July 2008, the ECB even raised interest rates from 5 percent to 5.25 percent for the eurozone, which further increased European export prices and spread the impact of the financial crisis into European industry. The euro-dollar currency gyrations were remarkable. In June 2001, the euro had been worth \$0.85. In October 2005, it was worth \$1.20 and in July 2008, it had risen to \$1.58, almost double the euro's value seven years earlier, although economic fundamentals gave no justification for such dramatic shifts. The high value of the euro both encouraged imports and discouraged exports. The economies of the eurozone, the 13 countries that now use the euro currency, shrank by 0.2 percent in both the second and the third quarters of 2008, the first eurozone recession since the new currency was launched in 1999.

As with the United States, the crisis in Europe came to a head in the week of October 6–10. Global markets were reeling after the bankruptcy of Lehman Brothers in September. But the trigger for the panic was the initial refusal of the U.S. Congress to approve the worryingly vague U.S. Treasury plan for a \$700 billion package to tackle the mortgage crisis. The plan was to buy sufficient toxic credit instruments to reestablish a market. Few economists thought this would work fast enough to save the toppling banking system, and the immediate need was to recapitalize the banks. Britain was the first to respond in Europe with a state-backed £500 billion (\$820 billion) guarantee for its banks on October 7. On October 13, France and Germany followed suit, with a €360 billion (\$530 billion) package of guarantees and loans from President Sarkozy and a €480 billion (\$700 billion) guarantee from Chancellor Angela Merkel. That meant the Europeans alone were standing behind the banking system to the tune of \$2 trillion or more. This decisive action, along with the coordinated G7 interest rate cuts and the G7 finance ministers' firm pledge at the October 11 International Monetary Fund (IMF) summit in Washington that a systemic failure would not be permitted, stopped the panic. But it did little to alleviate the recession. Although all of the major EU economies suffered, the recession arrived in different ways, with different impacts, and for different reasons.

The British Recession

In Britain, the end of 15 years of uninterrupted growth came with the collapse in the housing bubble. According to the widely recognized Nationwide survey, the average house sale price in 1996 was £66,000, almost tripling to £186,000 in 2007, and tumbling to just under £160,000 in

July 2008. British consumers were by far the most indebted in Europe, with household debt reaching 160 percent of GDP in 2007. On October 7, in what was to become both the worst week of the worldwide banking crisis and the occasion for the coordinated response of the G7 finance ministers at the Washington summit, Prime Minister Gordon Brown in effect offered to nationalize Britain's banks with a massive £500 billion guarantee in return for preferred shares.

As the financial crisis deepened, Britain also paid the price for its reliance on the battered financial sector in the City of London, which most estimates saw delivering more than 10 percent of GDP. Job losses in the City after the fall of Bear Stearns and Lehman Brothers were expected to exceed 100,000. The Oxford Economics group reported that London and the southeast lost 60,000 jobs in finance and business alone during the recession of the early 1990s, and 85,000 in the 2002–2003 slowdown. This recession was expected to be far more damaging after the Bank of England's Governor Mervyn King slashed interest rates from 5 percent to 3 percent between October 8 and November 6, to the lowest level in the United Kingdom in more than 50 years.

The French Recession

In France, as President Nicolas Sarkozy volubly complained to the ECB, the high euro damaged French exports, which account for 21 percent of GDP, although it did provide some protection against rising energy prices. But France, with unemployment at 8 percent (compared to 5.8 percent in the United Kingdom) had only sluggishly recovered from the slowdown in the first half of this decade. France had not suffered as much from the housing bubble, its prices rising

by 73 percent over the five years to 2007, compared to 90 percent in Britain and 105 percent in Spain. In the second quarter of 2008, the French economy contracted by 0.3 percent. Although the French economy then unexpectedly recovered slightly to grow by 0.1 percent in the third quarter, thus avoiding two successive quarters of negative growth (the usual definition of recession), the Bank of France forecast a recession starting in the fourth quarter and going into 2009. The situation led President Sarkozy to declare that "Laissez-faire is finished." Sarkozy, who occupied the rotating chair of the EU, was unable to rally his EU partners behind his call for coordinated economic governance at the EU level. But he successfully joined with Britain's Prime Minister Gordon Brown in calling for the global financial summit, which took place in Washington, D.C., on November 15 with the G20 group of nations.

Germany's Setback

Germany had seen modest growth from 2005 to 2007 thanks to earlier labor market reforms and thriving exports, which account for a remarkably high 41 percent of GDP and which delivered a \$150 billion trade surplus in the first half of 2008. But the rise of the euro hit the industrial sector hard this year. GDP fell by 0.2 percent in the second quarter and by 0.5 percent in the third quarter. German industrial orders fell by 8 percent in October. Germany had entirely escaped the housing bubble, and its consumers were among the least indebted in Europe. But its banks were vulnerable. Some Landesbanks, the regional lenders that are owned by Germany's 16 state banks, had been exposed to the subprime crisis, and on October 8, Berlin mounted a €50 billion rescue of Hypo Real Estate, the country's fourth

biggest bank. Some of the largest German banks were suspected of fragility because of the loans they had been able to keep off their balance sheets thanks to credit default swaps.

Blogs and media reports contributed to the mood of panic, after the RGE Monitor website of Nouriel Roubini, a New York-based economist whose predictions of such a banking crisis had made him into a celebrity, was widely quoted suggesting that “the largest European banks have become not only too big to fail, but also too big to be saved.” This was supported by his claim that “the total liabilities of Deutsche Bank (leverage ratio over 50) amount to about €2,000 billion (more than Fannie Mae) or more than 80 percent of the gross domestic product of Germany. This is simply too much for the Bundesbank or even the German state.” True or not, alarmism on the blogs and the evident drama of the crisis helped force European governments into their decisive response to save the banking system.

What Lies Ahead

The worst of the recession still lies ahead for Europe, with the new EU member states of eastern Europe looking particularly vulnerable. But the crisis was also severe for long-standing members Spain and Italy. Spain’s industrial production fell by 8.8 percent in October alone and 200,000 Spaniards registered for unemployment, almost as many as in the United States with its far larger population. Italy, whose economy had been sluggish since it joined the euro (after some dubious accounting to meet the credentials for joining) and had to forego its traditional practice of devaluation to remain competitive, faced the special problem of a level of government debt of 105 percent of GDP. By contrast, the debt-to-GDP ratio stood at 43 percent in Britain, at 64 percent in France and at 62 percent in Germany. This helped foster a further problem, an ominously widening spread in the interest rates demanded of euro bonds issued in Italy compared to those issued in Germany, a development which threatened the cohesion of the eurozone.

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