

## SHOPPING IN YOUR CLOSET

Conspicuous saving has replaced conspicuous consumption in the United States. From the plunge in retail sales to the explosion in the savings rate to the lowest consumer confidence levels ever recorded, Americans have turned off spending. They are shopping in their closets and their garages.

Consumers drive the American economy. Obviously, no silver bullet unlocks pocketbooks. Stability in house prices, however, is part of the answer. We will know when that moment occurs only in hindsight.

Businesses can't wait for the stability, particularly when the recovery may be equally challenging. Economists' projections are speculative and even their predictions of the multiplier effect of the stimulus bill are historical, not predictive. The plunge in economic activity may be followed by a roaring inflation created by the flood of money printed by the Federal Reserve. Stagflation is, for those of us who lived through the 1970s, an unpleasant condition.

How might chief executives manage the financial strategies of their enterprises in a chaotic world? In particular, what actions do consumer-oriented companies need to take now?

First and most importantly, companies must conserve cash. Forget fancy phrases like "liquidity". The job of today's CEO is to be sure everyday that the company has enough cash to survive.

Second, be skeptical about all capital expenditure proposals. Retailers, in particular, should stop opening stores. Chasing "comp store" increases to please security analysts has been a trap for years. Virtually every store opened by a retailer over the past 15 years — no matter the category, size or geography — has cost more, started at lower volumes and grown more slowly than the previous year's stores. Even in good times, consumption was not growing as fast as the amount of new square feet, not to mention the appeal of internet shopping. Bankrupt retailers disappear today, not only because there is no DIP financing, but because no consumer cares. They can get the goods from numbers of other outlets.

Returns on investment have declined steadily. To overcome this disagreeable fact, managements have piled on leverage.

Third, successful managers will manage cash flow – not earnings. With so many stocks trading in single digits – for example, 77 of the S&P 500 – most stocks are trading on option value. Investors expect lower earnings. They are rating the survival prospects of each company and comparing their chances with those of their competitors. They hope executives will manage their balance sheets and cash flows to be winners at the end of turmoil.

Fourth, managements cannot rely on their traditional lenders. Make no mistake, the late 20th century financial system has collapsed. We are propping up banking institutions that demonstrably lack the management talent and disciplines to provide long-term stability. A new generation of banking leadership will have to emerge before business can rely on traditional credit sources. No amount of taxpayer assistance or compensation caps will erase decades of bad practices. The few banks left most assuredly will use their oligopolistic power to the disadvantage of their clients.

Business would be wise to diversify the sources of its capital. There is ample capital today but it is shell-shocked. When panic abates and the world is flush with the currency created by the central banks, capital will be available from many financial sources.

Fifth, we are nearing a moment when there will be extraordinary opportunities to acquire deflated assets. After all, the psychology of competitors is depressed along with their deflated stock prices. Managements have aged, chronologically and emotionally, over the past year. The strongest managements armed with the deepest and most balanced capitalizations will prosper.

Finally, there is a warning for boards of directors. The combination of flattened stock prices and the public opprobrium regarding executive pay has put managements at risk. Only a few companies, Google being one, have re-set options to reflect present stock prices. Without some agreement on re-doing executive compensation, there will be few incentives for incumbent managements to stay in place. We may be on the cusp of a massive merry-go-round with executives leaving their jobs for greener pastures where new contracts can be written.

It's time for business to prepare for a decade of economic unpredictability. It may not happen but the winners will plan for it.

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