

RECESSION IN MANUFACTURING SECTOR AND STRATEGIC OPTIONS IN FRONT OF INDUSTRY – AN INDIAN PERSPECTIVE.

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ABSTRACT

The word 'recession' sends a shocking wave among people, more prominently business fraternity. Recession is an economic phenomenon of decline in macro economic factors of demand for goods and services, production levels, research and development budgets, marketing promotions and so on.

This paper looks into the aspects of impact of recession in manufacturing sector in India and how companies have viewed it from strategic angle. The basic question is whether the recession has really set-in, and if so, what actions industry has contemplated to face it and mitigate the challenges posed. There is no doubt that recession has set in, but, the magnitude of recession impact as felt differs from one sector to another. Normally, companies re-look into their manufacturing operations, product line, operational expenses and other budgets to face the economic decline. Many companies have advocated the strategies of lean manufacturing, cutting down manpower, freezing of salaries and other employee benefits, focusing on products with market potential and higher profit margin etc. to stay in business and remain competitive to face the recessionary trends in the market. A few companies also have considered the option of entering international markets where recession is not much.

The paper brings out some of the reactions to recession shared by corporate bosses in terms of how they intend to tackle this economic crisis and what strategies they have in their mind to come out. Finally, the paper presents in brief the findings of a study of 16 manufacturing industries in Hubli-Dharwad area of north Karnataka with respect to the approach they have followed to face the recession and the strategic initiatives taken. A conclusion is drawn at the end in terms of how companies have shown an inclination to face the economic decline and march towards the future.

Introduction:

Economists and industry analysts in the past have spoken about the vicious circle of economic activity, which stated that each economy moves in the sequential stages of growth, maturity and decline and the cycle repeats. But, then, it was not possible to precisely predict how many years the economy will be in growth stage, in maturity stage and in decline stage. Also, many companies attempted to predict the on-set of recession but could not meet with much success as to the accuracy of their prediction. This was more true in case of industrial products (engineering goods), not consumer products.

Economic growth of different economies in the world is guided by different factors – local, international, and global. Hence, the rate of economic growth has been showing wide variation between countries for years. India, of-late, had shown a consistent economic growth rate in recent years which has been envied by many nations, particularly developed countries. India, along with China and a few South East Asian countries, has been considered as 'emerging' economies with a lot of growth potential in view of lower levels of penetration of various products and services as well as vast size of population.

The seeds for the disastrous collapse of the economic boom were sown during the first phase of the historic boom in global growth that started in 2004. The first phase was driven by strong global growth

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of 5 per cent during 2004-07 with global trade growing at around 8 per cent during 2003-07 and capital witnessing strong flows between emerging markets and developed countries. Consumers and investors benefited from the credit and asset booms, poverty declined and globalization advanced. The BRIC (Brazil, Russia, India and China) and other emerging markets attracted foreign investors. The role of developing countries, per se, on global issues like the climate change negotiations, and in institutions such as United Nations, the G-20 and the World Trade Organization (WTO), increased. Governments in developed countries and some emerging markets put aside their doubts about liberalized markets, letting private sector play a greater role and markets to regulate themselves.¹

The present recession has been traced to 2nd quarter of the financial year 2008 as per the business and economic reports appearing in media. Some refer to it as a backlash of what has happened in large economies like USA, the Europe, Japan etc. where many of the financial institutions (mostly banks) have collapsed due to sub-prime problems. The governments in these countries have come up with different initiatives to protect the economy and industry, popularly referred to as stimulus package. Indian government also came up with similar “financial stimulus” package of around Rs. 30,000 crore by means of lowering taxes, reducing interest rates, increasing money supply, export promotion incentives, investments in infrastructure and other projects so that Indian industry shall not be affected much.⁹ The economic reports indicate this stimulus package has helped corporate world to reduce the damage and be on recovery path.

Definition of Recession :

Recession is an economic phenomenon of decline in macro economic factors of demand for goods and services, production levels, research and development budgets, marketing promotions and so on.

In economics, a recession is a business cycle contraction, a general slowdown in economic activity over a period of time. During recessions, many macroeconomic indicators vary in a similar way. Production as measured by gross domestic product (GDP), employment, investment spending, capacity utilization, household incomes, business profits and inflation all fall during recessions; bankruptcies and unemployment rate rises. Recessions are generally believed to be caused by a drop in spending. Governments usually respond to recessions by adopting expansionary macroeconomic policies, such as increasing money supply, increasing government spending and decreasing taxation.²

Many professionals and experts around the world believe that a true economic recession can only be confirmed if GDP (Gross Domestic Product) growth is negative for a period of two or more consecutive quarters. The agency that is officially in charge of declaring a recession in the United States is known as the National Bureau of Economic Research, or NBER. The NBER defines a recession as a “significant decline in economic activity lasting more than a few months.” Recession (or contraction) is a natural result of the economic cycle and will adjust for changes in consumer spending and consumption or increasing and decreasing prices of goods and labor.³

The basic question faced by many people is: 'How recession creeps-in?' But, the generally accepted answer offered by economists is, an economy which grows over a period of time tends to slow down the growth as a part of the normal economic cycle. A recession normally takes place when consumers lose confidence in the growth of the economy and spends less. This leads to a decreased demand for goods and services, which in turn leads to a decrease in production, lay-offs and a sharp rise in unemployment. Investors spend less as they fear stocks values will fall and thus stock markets fall on negative sentiment.⁴

Reaction to recession:

As soon as an economy and the industries there in receive some indications of economic decline they become cautious in their approach and start evaluating on the aspects of how soon it is coming, how long it may stay, what impact it will have on demand and supply forces, how it will affect the performance of an economy and the major corporations. The on-setting of recession has two broad reactions from corporate world. The first one is conservative i.e. defensive in nature. The companies who believe this ideology think in terms of cutting down costs, reducing manpower, reducing production, coming out of business (at the other extreme). The other reaction is positive, indicating here companies consider the recession as an opportunity to try some innovative methods to combat the effect of recession and look for growth in long term by initiating some bold and well thought-out strategies.

The reaction to recession by marketers can be traced in different ways. Faced with slowing demand, cost reduction, and negative sentiments, some marketers react to downturn by withdrawing to a shell. On the contrary there are marketers who become aggressive during these tough times. They come with new ambitious products and offers trying their level best to provoke the customers who postpone their purchases. It is interesting to see how Indian marketers responded to recession. Although there is a perception that Indian marketing practitioners are conservative, this recession proved the skeptics wrong. Many Indian brands reacted aggressively to the downturn determined to ride the storm rather than hiding in a safe place. The possible steps could be introducing new products, new segments, increasing promotional spends, reinforcing best selling brands and repricing.⁵

Possible Strategic Solutions to beat recession:

Lean manufacturing is one of the strategies advocated by many experts. They believe that, 'a crisis is the best time for a paradigm change in thinking, culture, strategy and hence, results.' The very process of implementing lean manufacturing has a very organized and inbuilt method of seeing non-value adding costs and reducing them. One must also look at the potential for lean through the value streams. The value stream manager will have to gain an agreement to do the right things for the entire value stream from the various departmental functions that will be involved. Companies that have not worked and achieved lean results may have lost the benefit of gaining advantage over competitors at this time. But before you know it, the next demand slump will be around in 2015-16, and companies that work on becoming lean from now will hold the advantage then.⁶

Though some companies embarked upon the strategy of **manpower reduction** to contest recession stiffly, others have viewed this move as poor vision. The second group feels rather than manpower reduction, we should look at manpower management. They advocate using recession period to harness the skills of employees and then reallocate the work in a manner which gives optimum results in terms of efficiency and productivity. 'The common thread running across the disparate corporate lessons is employee engagement, CEO after CEO drove home the point that no amount of capital and business vision can make you a winner in the downturn if your people aren't with you – with their hearts and their minds.'⁶

It is said the leader shows the path and the followers tread it. People working in the companies look up to their leaders to create confidence in them and guide them in achieving best possible results. **Leadership** style and qualities also decide the strategic outlook for companies planning to face recession. 'A leadership that is based on honesty in purpose, clarity in vision and transparency in action will not only outlast any downturn, but will even benefit from it. If this downturn helps corporate India identify and acquire the kind of leadership it needs to claim the place it deserves in the global economy, we will have lots to thank the Lehman Brothers for.'¹⁷

Strategies of Indian giants:

The strategies followed by corporate chiefs in India gives a divergent view. It goes with how you look into economic situation and its impact on performance of one's own company. Some of Indian manufacturing giants have come out with innovative strategies to meet the challenges posed by economic downturn. They show wide variation and depth of thinking process undergone by corporate chiefs to stand tall in the volatile situation of recovery and recession. The media has reported following views expressed by corporate bigwigs in terms of how they plan to face the economic situation.

Mr. Harsh Mariwala, Chairman and Managing Director, Marico Industries suggests, "Communicate widely and deeply." He says managing employee expectations is a tough task, especially in a downturn. It helped that Marico employees always had a strong sense of ownership. He has advocated three distinct strategies :

1. During tough times, have two parallel teams working – one warding off threats and the other looking at opportunities.
2. Treat employees as generals in their own right rather than just hired soldiers.
3. Strike the golden mean between positivity and action.

Mr. D. Shivakumar, Vice President and Managing Director, Nokia India says, "Don't cut down on marketing, innovation." He felt enhanced levels of communication – both internal and external – and innovation saw Nokia India through the downturn. He recommends:

1. Accept, analyze and respond to the situation.
2. Communicate openly, honestly and frequently.
3. Don't layoff arbitrarily.

Mr. Pawan Munjal, Managing Director, Hero Honda Motors mentions, "Don't skimp on ads, investments." Keep the big picture in mind, don't take hasty decisions.

Mr. Azim Premji, Chairman, Wipro Limited, says "The time to build frugality is when there is no need to." The recession taught Wipro the importance of innovation, optimizing resources and being the best-cost partner of its clients.

Mr. Venu Srinivasan, President CII and Chairman, TVS Motor Company, feels "Don't push profits at the cost of stability." Keep business operations simple and nimble in a world where companies have diversified across geographies and currencies.

Finally, Mr. Dinesh Hinduja, Executive Director, Gokaldas Exports, shares, "Slowdown gave us a chance to tweak our business model." Reeling under the double-whammy of a stronger rupee and a recession, the garments exporter widened its product mix and went lean. He further suggests:

1. Enter new segments and expand in others like suitings and industrial garments.
2. Take up lean management initiatives to cut costs and increase productivity.
3. Expand manufacturing to towns where labor is cheap and easily available.⁸

Research and the findings:

The impact of recession varies from country to country, industry to industry, market to market and company to company. Hence, it was felt essential to undertake a small research study of some 15-20 companies in Hubli-Dharwad area in north Karnataka to understand how these companies have understood the recession, its impact on their operations, and the strategies they pursued to face it and beat it, if possible.

This research covers sixteen companies of different sizes (small, medium and large) in manufacturing sector located in Hubli-Dharwad region of north Karnataka, established between 1961 and 2004. A simple questionnaire was prepared containing 12 questions to elicit response of company people and then measure the impact of recession on the companies under study. The questionnaire was personally administered among chief executives or managers in these organizations by the researcher and their response was obtained. These responses were then analyzed to bring out salient findings on the subject under study.

The major findings of the study are as under:

1. 88% of the companies confirmed that the recession has affected their performance. These companies have reported lower sales, reduced order booking, pressure on profit margins.
2. 38% of the companies export their products to other countries and 19% said their exports are affected because of recession.
3. 94% of the companies reported that their domestic sales are affected due to recession. These companies have mentioned about their customers' dependence on overseas markets, which have faced the crisis and hence have affected their off-take from Indian suppliers.
4. 75% of the companies mentioned that they have initiated material cost cutting initiatives to beat the decline. These companies have looked at possibility of using alternate material resources without affecting quality. Also, they have looked at possibility of cutting material cost by bulk purchases and better inventory management methods.
5. 82% of the companies looked at manpower reduction to face the challenges posed by recession. These companies have looked at reducing the usage of temporary workers, optimum utilization of existing workers and multi-skilling them so that they can overlook fresh recruitments.
6. 56% of the companies have resorted to reducing production to beat the recession. Other 44% companies have not felt the need to reduce production. This is resorted to by only those companies who find that blocking of funds in immovable inventories bring pressure on their fund management.
7. Hardly 31% of the companies felt the need to remove some non-profitable or non-saleable products. 69% of the companies continued with same product mix. Very few companies have looked at the need to identify the products which are not moving or moving very slow to market. They feel almost all products are having similar impact of recessionary trends.
8. 94% of the companies have looked at austerity measures like cutting down wastages and unwanted expenses to beat recession.
9. 88% of the companies have shared their concern about recession with managers and employees. They mention that managers and employees are now educated and aware of situation in the external world, hence, accept the management initiatives to tackle the economic situation.
10. 69% of the companies have confirmed that their efforts to beat the recession have given some tangible results. These companies have reported increased sales but with lower profit margins.
11. The companies selected for study have also shared the concern of recession with other stakeholders like customers (69%), suppliers (94%), dealers and intermediaries (69%) and partners / shareholders (56%).
12. 44% of the companies have confirmed that recession has affected their competitive position in the market and they have resorted to steps like price-cut, discounts, better delivery-terms and other customer-friendly initiative to remain competitive.

(Some of the bar charts depicting above findings are enclosed at the end.)

The study shows 7 firms have actually achieved higher sales during 2008-09 as compared to 2007-08 in spite of the recession. When asked, these organizations informed that though sales figures have increased, the profitability has come down considerably in view of various initiatives undertaken to

tackle the recession like price cuts, discounts, higher level of services, enhanced warranty periods and some CRM initiatives.

Participants' comments noted during the study:

One company mentioned about intense competition from low-price products from China has compelled them to come out of the export market. They stated their inability to go down on prices to the Chinese level and hence preferred to cater to domestic market.

Another company manager mentioned that they have recently received a large order from one of the Gulf countries and hence they are not feeling the heat of recession. If that order had not come, perhaps their answers to questions would have been significantly different.

Finally, one company CEO mentioned that he does not believe in manpower cutting. He commented; "As far as possible, do not resort to dispensing with your manpower. This is an asset in which the company invests lot of money. It is not available immediately after the recession is receded, if you remove these people." He further added, "machine tools industry is the first to be affected by recession and last to come out of it." He also advised to check up whether the companies are prepared to initiate same steps to fight the recession, if unfortunately, another recession comes in?

Conclusion:

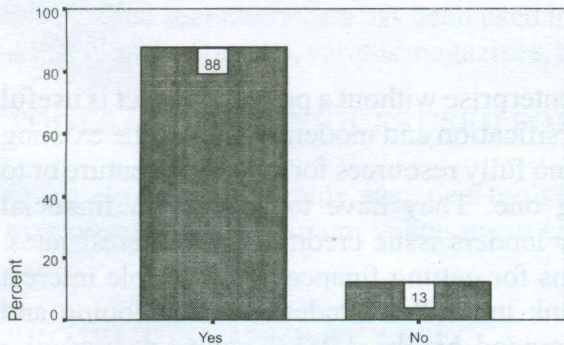
One thing is clear that recession is not for some, but for all. Almost all companies in manufacturing sector have shown that they are impacted by recession. The degree to which the impact is felt varies from one firm to another depending on different factors, both internal and external. Some organizations have taken recession as an opportunity to reengineer and improvise, while others have played safe with defensive tactics. While first group of companies have taken some bold steps to launch new products, diversify into new product-market segments, innovate, improvise operations and develop multiple skills in employees, the latter group has thought it fit to cut man power, reduce production, move out of some markets etc. But, the recession has given one lesson to all, that things can not be taken for granted and one has to have in advance a diverse set of strategic alternatives so that an appropriate strategy can be chosen to handle economic upheavals firmly and boldly.

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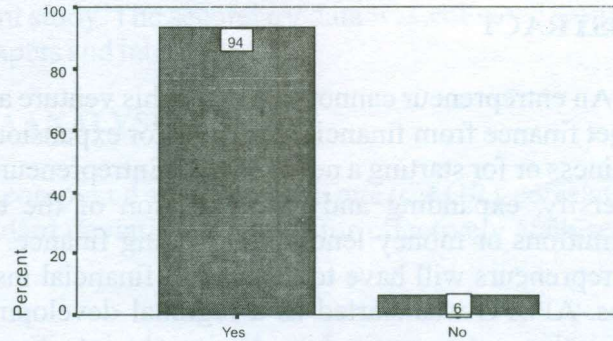
Some analysis details :

Has recession affected your company's business performance?



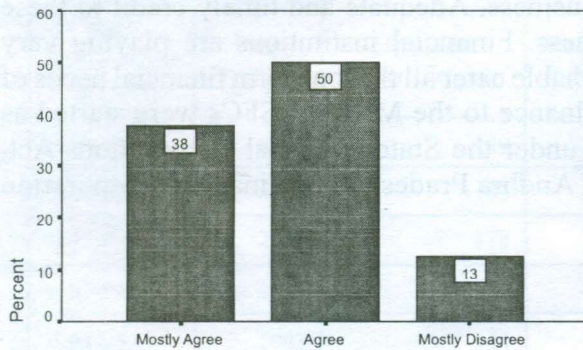
Affect of recession on company's performance

Are your company's domestic sales affected due to ongoing recession?



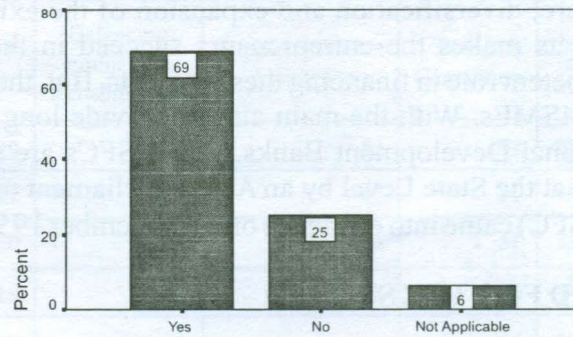
Effect of recession on company's domestic sales

Have you shared your concern of recession with your employees and managers?



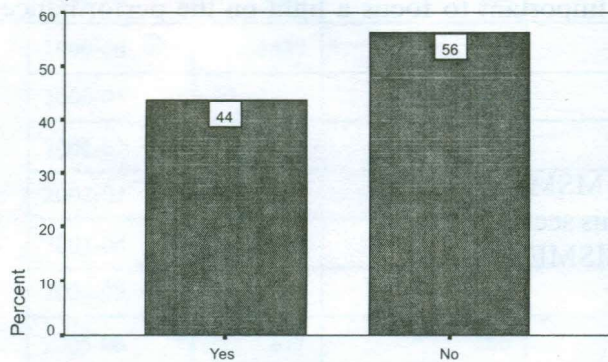
Sharing concern with employees & managers

You shared your concern of recession affecting your business with customers?



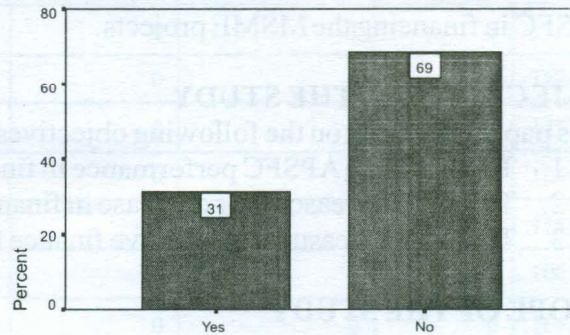
Sharing concern of recession with customers

Has recession affected competitive position in the market?



Effect of recession on the competitive position of the company

Do you have any formal mechanism to predict possibility of arrival of recession?



Do you have any formal mechanism to predict possibility of arrival of re