

## **The Road Ahead – Part 4** ***A Redux of Nixon-Carter?***

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There are many parallels between the economic “malaise” of the 70’s and what we face today.

In this final part of our series, I draw parallels from my 40 years in workouts, turnarounds, startups, etc. Experience dragged me, then lead me, to the consideration of economics for small business.

It finally brought me to this conclusion for practical and harried owners:

“economics is what is next before it is seen.”



# **The Road Ahead – Part 4**

## ***(inside the Business Cycle)***

### **a micro look**

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### **What companies do**

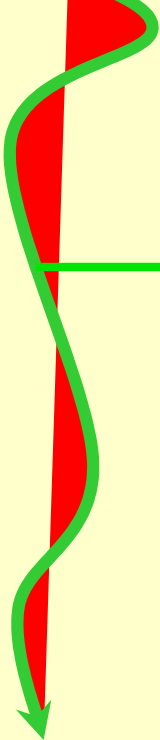
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The business cycle begins with

- startups including those who start by acquiring a company;
- followed by Keynesian Sector Pump;
- then the Keynesian General Pump;
- concluding with recovery.

A Keynesian pump is an agreement to fix something in the economy. The sector pump delivers a fix for one part where general is intended to benefit all.

At each stage I give a description, a model, and the internal characteristic of small business.



# Startup, Acquisition

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- description -- **Survival**
- model -- **Idea of What My Company should Be**
- internal -- **Independent**

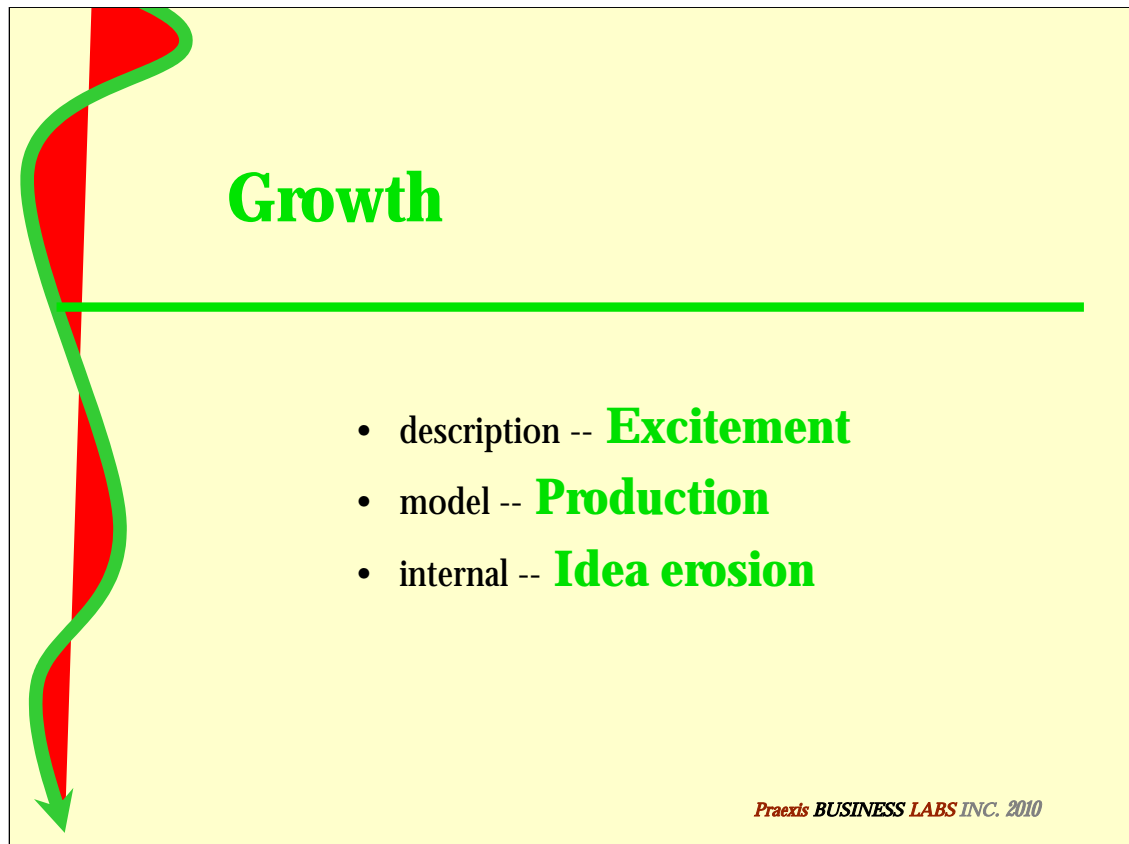
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These people are healthy, alive, vibrant; they are in survival. They are independent, which is to say free or freed from all kinds of constraints about what is and how things are supposed to be done.

At this stage, there are lots of problems, but they are all best understood as merely the sensations of problems. What appears chaotic, messy, inarticulate is merely the signs of life.

Most positive is their grip on economic reality: their model is their idea of what their company should be. It is positive because it runs directly back to the soundest economic rationale for their presumption of success in small business.

As one writer properly stated it, the economic justification for small companies is *efficiency of innovation*.



Past startup, the survival mode, the firm begins to prosper.

It feels good; vindication usually does. So does positive cash flow, and even more so the preservation of the initial investment. Time, capital, and personnel are still scarce.

Meeting the demands of growth shifts the emphasis from thinking and adjusting to simply doing: producing the thing or providing the service.

The model and the internal reality change subtly at this point. It is a natural evolution, but by itself it not yet a problem.



## 2 - Growth

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- description -- **Selling**
- model -- **Managing**
- internal -- **Idea nearly gone**

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That the idea is nearly gone seems not to matter.

It does matter.

It is the near loss of economic rationale.

That is not to say the loss of *business* rationale. By business measures, the company is on track. Only the owner's passing thoughts about what he intended for the company vs. how it is actually going raise doubt. Profits and cash are the measures of success.

Economic reality is another matter.



## 3 - Growth

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- description -- **Selling**
- model -- **Managing**
- internal -- **Idea gone**

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The continuation of positive results slides next to a subtle but critical change from the preceding growth phase.

The founding idea is gone.

It is not just that it no longer matters, but it is no longer a matter of even passing attention.

**Growth**

**[A weakened company, and susceptible to being misled and mis-investing]**

- description – survival, excitement, selling
- model – should be, production, managing
- internal -- independent, erosion, nearly gone, idea gone

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The founder's idea gives the owner the highest returns, lowest risk, and greatest satisfaction.

But if this is so why is it abandoned? The simplest explanation is accepted business practices produces better results in the short run.

Movement away from the founding model weakens the company because founders in moving away from deep skill finds themselves with a company they no longer understand.

The economic explanation is this: *the owner once occupied with the future is now occupied with the present. This shift in sight makes the owner susceptible to being misled.*



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## **Keynesian Sector Pump** **(credit, interest, taxes, trade)**

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This is an effort initiated by a consortium of trade industry, maybe union, and sometimes a community achieved through political action.

It delivers, variously, preferences in credit supply, interest rates, taxes, and trade to a single sector or industry.



## Keynesian Sector Pump (credit, interest, taxes, trade)

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- description -- **Rising sales, margins and profits**
- model -- **None**
- internal – **Sales-driven investment \*; diverted capital and attention**

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Nothing could be better than the effect for the sector. This is why there is no model. Just try to inject some criticism, some warning, and you will quickly hear, “we don’t need no stinking model.”

I admit it is a fun time. The euphoria is delightful, and blinding. With business booming, money the pressure for making fixed investments in productive capacity is overwhelming. Success and tax bills divert the owner’s attention and divert some capital away from the business. Keep track of the asterisk above (\*).

As James Surowiecki wrote in Wisdom of Crowds, “During boom times, it’s rare to hear a discordant voice suggesting that disaster is nigh, while when things are going bad, it is hard to find someone who suggests that panic is a mistake.”

The effect of sector spreads across the economy.



## Keynesian Sector Pump

credit, interest, taxes, trade

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- description -- Rising sales, margins and profits
- model -- None
- initial -- Sales driven investment; diverted capital and attention

**[In my view, oblivious to Keynesian deception, they believe they created success.] \***

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Of course, people believe they created the boom time.

Surely these companies do contribute, but no so much as is believed.

As George Santana said, "The empiricist [most managers] thinks he only believes what he sees but he is much better at believing than seeing."



## 2- Keynesian: Sector Pump (credit, interest, taxes, trade)

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- description -- **Profits erode**
- model -- **By-the-numbers**
- internal -- **Cost cutting 1; temporary recovery**

***Recession Begins***

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The drop in profits redoubles attention to the numbers.

It results in cost cutting, although this cutting is merely finding ways to spend less. Profits recover, but the effect is temporary.

The recession begins.




# Keynesian General Pump

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- description -- **Sales plummet**
- model – **Wisdom of Crowds**
- internal -- **Cost cutting 2\***

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Sales drop alarmingly.

Now the model shifts. By-the-numbers control is out of its element. There is too much uncertainty. People decide what to do is found by watching what others are doing. What are they doing? They are making deep cuts.

This is the third asterisk (\*). This slide begins an arrow that terminates in the final slide.

## 2- Keynesian General Pump

### Recovery

- description -- **Uncertainty**
- model -- **Crowd, alone together**
- internal -- **Inaction**

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And the final act of Keynesian Macro?

Description: inaction, nothing new. Model: continue following the herd--alone together. Those of us that are still around, that is. Internal: uncertainty of what to do -- the founding idea is gone, all we have is numbers of what once was.

It is sad to say that it isn't until established firms have fallen, failed, or huddled together in stasis that a recovery begins.

# Keynesian General Pump

## Recovery

- description -- Uncertainty
- model -- Crowd, alone together
- internal -- Inaction

**It ain't pretty!**

Pathology, Keynesian pump, track the \*

1. Sales-driven investment
2. Oblivious to immediate driver of results
3. Added fixed costs led to cost cut "2".
4. The affect of the final \* is on the next slide

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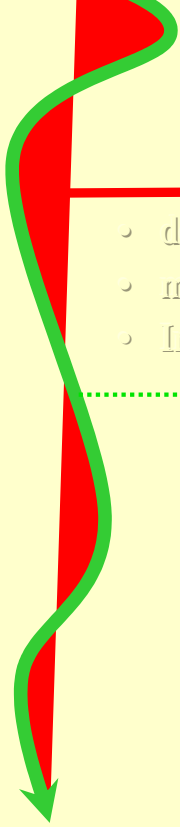
There is little to be said other than the overlay.

The box, the pathology of the decline, recounts all the asterisks(\*).

Why sales-driven investment arising from a sector pump contributes heavily to the decline is a matter of economic theory.

The reasons are unfamiliar. I'll offer one: the investments are not wise in efficiency or in timing. But the traceable effect, though rarely understood, is heavy mistimed, misplace investments are fixed costs, so other costs face a dulled axe.

The result, and as the final piece for recovery, are on the last slide. Follow the arrow.



## Keynesian General Pump Recovery

- description -- Uncertainty, "it ain't pretty"
- model -- Crowd, alone together
- Internal -- Inaction

(ran off or run off by pay plan \*) ←

### ***Disruptive Competition***

- description -- **Survival**
- model -- **Idea of what my company should be**
- internal -- **Independent**

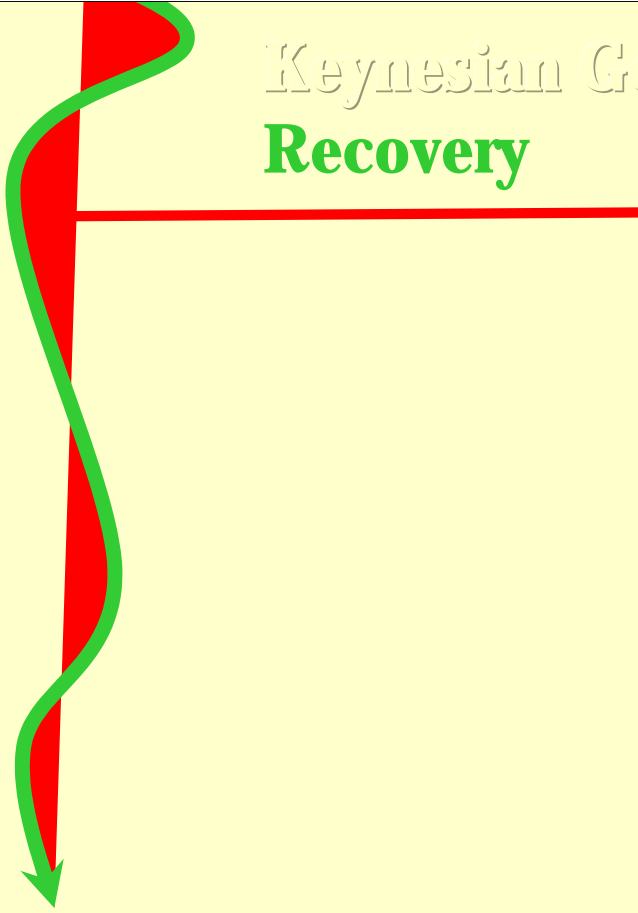
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We return to startups and acquisitions.

What gets cut in cost 2 is people—high value people from the core of the company.

They have ideas. They are become competitors. Their disruption is highly positive for the economy, consumers, and sometimes even for those firms they disrupt most.

# Keynesian General Pump Recovery



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The diagnostic challenge is that ultimate results are not immediate results. Because the effect is not immediate, the cause is rarely correctly identified. It is far easier to see what appears to be an immediate cause than the remote cause shown on the slides.

This delay between cause and effect is the answer as to why intelligent, motivated owners and those around them are misled, then blindsided.