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# Signals for the Coming Year

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# Signals for the Coming Year

Change may be certain, but for a business decision maker, some changes have more impact than others. Here are eight trends that will make the greatest difference in 2008.

**by Art Kleiner**

Decision makers are inundated these days with possibilities. There are myriad opportunities to seize, hundreds of competitive threats to avoid, and the constant awareness that any relevant trend — the price of oil, the popularity of a new interactive medium, the viability of an overseas market — may shift dramatically at any time. That's why the first step of an effective strategy is separating signal from noise: recognizing the most telling indicators of the trends that will have real impact in the coming year. Fortunately, some signals have extra clarity and resonance right now, even amidst the cacophony.

At *strategy+business*, which is published by the management consultancy Booz Allen Hamilton, we continually seek insight from industry experts at our firm: people with years of experience working with automotive, financial-services, consumer products, energy, industrials, media, oil and gas, health-care, and high-tech companies. We have learned that the most significant trends in any one industry tend to cross over to others as well. Right now, for instance, the credit collapse affecting the financial-services industry has ramifications for many sectors around the globe. Similarly, if the trend we see toward IT regaining relevance is borne out, it could not just influence individual industries, but have a benign, and largely unanticipated, macroeconomic effect.

We think eight critical trends will be most important in the coming year that apply to every sector. They're not sending the most obvious signals — indeed, they're important precisely because many leaders are overlooking them. But we think they deserve attention.

**1. Faster, more frequent bubbles.** Although the effects of the housing bubble deflation will continue to play out during 2008, there remains a surplus of capital around the world that requires places to invest. But many of the favored places seem suddenly uncertain. Another bubble may be about to burst around credit cards; unsecured consumer debt is higher than the underlying fundamentals of employment and wages would support, particularly as overtime dries up in many industries. The emerging economies within the BRIC (Brazil, Russia, India, China) nations and elsewhere continue to grow, but the amount of growth is uncertain. Competition from companies based in those emerging nations is heating up and will grow far more dramatically in the next year — symbolized, perhaps, by Tata Motors' introduction of its US$2,500 automobile in early January. Private equity capital will be increasingly vulnerable if the cost of debt rises — at least that part of it that expects to get returns through speculation on corporate assets. And it's not clear how far the value of the dollar will drop.

These uncertainties will all exacerbate one another, and they will be reinforced by the increased velocity of

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capital. There were periods of similar financial turbulence, for example, in the 1970s and '80s, but money was still constrained at that time by the fact that an investor had to call a broker to place an order. Today, as soon as an opportunity is perceived to have potential, billions could flow there instantly.

The result, as Booz Allen's financial-services experts put it, will be "more frequent bubbles" appearing at an ever-faster pace. The definition of a bubble is simple: a state in which asset prices are inflated beyond the support of underlying cash flow. As some bubbles pop, other sectors will attract sudden speculative investment (for example, export-focused services and high tech this year) and then they may also become vulnerable.

Unfortunately, when bubbles burst, the capital markets tend to overreact. That's why an economy of faster, more frequent bubbles could be difficult to live in. And this situation could last a while, perhaps as long as five years or more. If the downturn of 2001 was like the economy catching a cold, this year will seem more like having the flu: debilitating, longer-lasting, and making it hard to keep up day-to-day activity. Yet people cope with the flu, and many corporations will find they can operate effectively, perhaps even masterfully, in a time of high uncertainty.

Hunkering down and waiting for the turbulence to end will not be a successful strategy. Instead, there will be a renewed interest in having a balanced corporate portfolio, deliberately hedging against local or sector-specific downturns. Some companies, like HSBC, are already learning to develop truly global managers, cultivating employees who can move during the course of their careers through a dozen regions (and who are willing to make personal sacrifices to do so; for example, putting their children in boarding school). Corporations have paid lip service to global activity; now they will be forced to make it a core focus, even if that's difficult at first.

**2. The cost of energy complexity.** Energy has been in a state of turbulence for a year now, with dramatic price increases, a more serious emphasis on climate change, and a growing consensus that the energy mix must shift…eventually. In power generation, coal is out (too many greenhouse gases) except in China (for the moment), nuclear is coming back (but not yet having an impact), renewables are rhetorically satisfying but not yet viable (too small, too uncertain, too unscalable), and demand is poised to rise. This makes natural gas the default fuel for the moment. In transportation fuels, the conflict between biofuels and food production will be with us for some time, and so will the challenge of building out the kind of infrastructure needed to run motor vehicles on electricity or hydrogen (hydrogen could take decades).

From a strategic perspective, the most important underlying trend is not the move toward any particular fuel or option, not even hybrids, but the ambiguity of choice. This will affect business practices, subtly but pervasively, throughout the world this year. For as energy sources proliferate, complexity increases. Complexity adds cost. And most companies have not yet figured out ways in which they can focus their energy bets on a limited number of technologies. They can expect their costs to escalate.

Unfortunately, there is no way to avoid complexity and uncertainty in making choices about energy. There will be no obvious single solution; like decisions about expanding into new markets, the best options will vary for each industry and location. And although flexibility will be paramount, few companies can be infinitely flexible.

Ambiguity has one beneficial consequence: It tends to spur innovation. The energy industry will increasingly resemble the early years of the Internet, marked with both fruitful and failed experimentation, yielding many unexpected successes — and quite a few visible failures. Who will be the energy-oriented equivalents of Amazon, eBay, Yahoo, and Google? We may get some leading indicators during the coming year.

**3. Participative risk.** Financial institutions, central banks, governments, and insurance companies, all learning to survive in a more volatile economy, are thinking differently about risk than they used to. They are enlisting their customers to assume partial responsibility for reducing the risks they face, not just insuring against them.

This trend will be amplified by the generational shift that begins this year, bringing about a tidal wave of financial and medical need in the U.S. as the baby boom generation starts to enter its 60s. Some of these people are well-prepared for their retirement years, and wealth-related industries are emerging to meet them. But many are not. A large number of people also are ill-prepared for the increasing frequency of storms, fires, and other natural catastrophes. And food safety, product safety, and energy safety scares will continue, as will the threat of financial disasters.

Insurance companies in health care and other fields have already begun to rethink the relationships among the costs of care, the costs of insurance, and the level of awareness of their customers. (This is the basic premise of the influential consumer-driven health-care model.) Some government leaders are also becoming interested. Who will educate the public on sound financial practice, on preventative health care, and on wise consumer choices in general? That question has not yet been fully answered, but there may be a wave of activity in the private sector this year, as health-care and financial-services firms continue their innovation in consumer-oriented services.

**4. Strategic sourcing.** This will be the year in which procurement of supplies, machines, components, materials, and services takes on a strategic importance it never had before. One driver of this trend is scarcity. In their forthcoming book, *Make or Break: How Manufacturers Can Leap from Decline to Revitalization* (McGraw-Hill, 2008), Booz Allen Hamilton Vice Presidents Kaj Grichnik and Conrad Winkler note that, "For the first time since World War II, companies face growing shortages in key raw materials — everything from once commonplace supplies, such as steel and aluminum, to high-value elements, such as gold, silver, copper, and platinum. Even recycled materials are increasingly scarce. In general, these shortages are primarily due to the inability of mining and processing facilities to keep up with ballooning economic growth in emerging countries like China, India, and Brazil."

The most farsighted companies have already begun to respond by rethinking the operating model underlying their procurement. They are abandoning the traditional adversarial efforts to divide and conquer suppliers through price-based competition; instead, they are seeking more collaborative, capable, information-rich partnerships with their suppliers. This means changes in practices and in procedures (often abetted by new ways of using information technology), and changes in corporate culture. They are also developing complex, multitiered, global supply networks. All of this signifies a broader and more incisive role for the chief purchasing officer in many companies. Increasing preference for green products (particularly those with low carbon footprints) and problems with product safety (exemplified by the lead paint in inexpensive toys and concerns about food impurities) will make the quality of sourcing ever-more important.

**5. Excellence as a differentiator.** Three trends from previous years are continuing to affect corporations, and they are also interacting with one another in unexpected ways. The first is cost pressure. Global competition continues to accelerate; expanding markets and technological uncertainties demand increasing investment; and mergers, acquisitions, and private equity deals add pressure, as well.

Second, the task of reducing cost is growing more difficult every year. Much of the "low-hanging fruit" has already been taken out of marketing expenses, SG&A (sales, general, and administrative expense), and HR. Outsourcing, once seen as a relatively quick and easy way to arbitrage labor costs, is maturing into a source of capability — higher value, but more expensive.

The third trend is labor scarcity and a rise in labor demand. In the last few years, shortages of skilled workers have begun to constrain new operations in energy, transportation, and manufacturing. Now, even in countries with immense populations like China and India, companies need talent (and governments do, too). There aren't enough highly skilled people to go around. Meanwhile, as the millennial generation (those born since 1980) enters the workforce en masse, qualities that once seemed novel — in-depth familiarity with the Internet and technology; casual acceptance of diversity in race, gender, and sexual orientation; and appreciation for informality — will become the norm. Millennials also appear to be more interested in social causes than their predecessors, but are also extremely pragmatic: They don't want to waste their time without seeing results.

Together, these trends seem to be sparking a small but potent cultural shift, both inside corporations and in society at large. We see it in the ever-growing demand for science education, and in an renewed interest in various forms of participative management, operational excellence, and more results-oriented organizational practices and structures. The craft of management will be seen as a differentiator, even in high-growth environments like China and India, between companies that succeed and companies that fail.

Employers will increasingly attract people through learning and development, corporate culture, and operational excellence. After years of being downplayed, practices like lean production, metrics-based marketing, focused priorities (instead of dozens of strategic initiatives that lead nowhere), and in-depth executive succession practices will be taken more seriously.

There are many reasons to look forward to this shift, despite the demands it will place on executive and HR strategists. According to recent research on strategic leadership, companies that are "great places to work" already outperform the S&P 500 by a factor of more than two-to-one; this may be the year that other companies start to understand the reason for their success.

**6. Green technology as the ìnew Y2K.î** Back in the late 1990s, when it was not clear precisely what it would require to reconstruct enterprise computers in advance of the date change at the turn of the millennium, the financial-services and corporate worlds bit the bullet and redesigned their technologies.

The global Y2K effort may or may not have prevented global computer collapse; we'll never know. But its effect was immense either way. It spurred innovation, it promoted cleaner housekeeping, and it may well have lessened the impact of disasters such as the September 11, 2001, attacks — if only by making the financial-services community more aware of its capacity for safeguarding against breakdown and recovering from it.

With the threat of climate change, the governments and corporations of the world face a new Y2K-style challenge. Whatever the actual threat of human-created greenhouse gases may be, the perceived threat — and the urgency among groups like the Intergovernmental Panel on Climate Change — is going to drive both governmental and corporate activity for the forthcoming years. This will lead to a wave of housekeeping and innovation that, like Y2K, will have unexpected effects. We will probably see some of those effects emerging this year. This does not necessarily mean that conventional wisdom (for example, about the immediate returns from energy-efficient technologies) is right. But capital investment priorities will change, many companies will develop innovation or alliance skills that they otherwise would not, and waiting for government mandates will probably not be the most effective strategy.

**7. ITís Relevant Renaissance.** Remember when information technology used to be considered a center of power for organizations? Remember when personal computers used to be fun — and fun was a source of productivity? Those times may be coming back. At the same time that companies recognize the viability of much lower IT spending — the idea that information technologies can consume less of a company's overall budget than they have in the past — we are also seeing a rekindling of interest, enthusiasm, even excitement over the potential of information technology to revitalize a business. IT is returning as a subject of strategic interest in the executive suite, rather than merely as infrastructure that is taken for granted.

Partly, this renewed interest is driven by the cost pressures and new workforce already discussed, and partly by a new wave of IT productivity. Moore's Law continues to hold, so computer power per dollar continues to increase. And the new wave of technological and social advances loosely known as Web 2.0, in which people use Web-based applications for a finer-grained, more participative interchange, continues to play a role. As enterprise technology evolves, each of the industry sectors will adapt in its own way, including consumer products, where point-of-sale data is suddenly available to marketers and retailers in real time; oil, where the "digital oilfield" is helping to resolve some labor shortages in exploration and production; power generation, which may require smart grid innovations to make the most of advances in nuclear power and renewable technologies; and health care, which may finally embrace the information technology revolution in full force during the next year or two.

**8. The Digital Marketing Imperative.** Booz Allen's research during the past year — with the Association of National Advertisers (ANA), the Interactive Advertising Bureau (IAB), and the American Association of Advertising Agencies (AAAA) — has confirmed what many marketers have grasped intuitively: The game has shifted. New media have not just increased opportunities for advertising and drawn consumers away from broadcast TV and mainstream print; they have changed the culture, the required skill set, and the strategic value of the marketing function. As Booz Allen Vice President Christopher Vollmer notes in his forthcoming book *Always On: Advertising, Marketing and Media in an Era of Consumer Control* (McGraw-Hill, 2008), "We are now at the beginning of a consumer-centric digital age, in which the traditional ways of marketing products and services are no longer viable. The corporate demand for marketing accountability and return on investment has reached a crescendo. And, the previous exclusive relationships between marketers, ad agencies, and media companies are being configured in new ways."

We have seen this in many sectors, most prominently in consumer products. Companies such as Procter & Gamble, Nike, and Unilever are reinventing themselves as they did at the start of the mass media era, into generators of marketing innovation and creators of business models.

For marketers, the greatest challenge and opportunity is the new imperative of metrics. Based in part on the rich availability of data about online consumer activity (but also related to new insights about the impact of television and other legacy media on consumer behavior), marketers are learning new ways of judging the effectiveness of their work, and building new real-time efforts to create responsive, generative advertising. Although new media have been around for a dozen years, it's only since 2006 that the trend of customer-centric, insight-rich marketing has broken through into the mainstream. Most consumer-oriented companies will never be the same.

All of these trends favor companies that can be more internally capable and resilient. Our experience and our observations suggest that this is happening — at least in the best companies we work with. And as the examples of the leaders become more visible, we think others may follow.

In every industry, there is at least one company that has shown its ability to master these challenges. We hope this is a good year for you, and that you will be able to master your own challenges in good time to enjoy a prosperous 2008. +

## Resources

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