



Surviving creative destruction

The world is going through a major economic transition in which capitalism must evolve. **Michael Townsend** considers the 'strategic icebergs' on the horizon – and how businesses should respond

"No amount of orthodox strategy, innovation, or competition – all premised on economic harm – can help businesses, countries, economies, or the world reignite prosperity in the 21st century."

Umair Haque

(New Capitalist Manifesto, 2011)

We are most of the way through 2011, over three years since the onset of the global financial crisis. On a bad day the stock markets are in complete turmoil. On a good day, they are simply volatile. Investor confidence is low, unsurprisingly. This is not the best environment within which capitalism, business, or the transition to a green economy can easily flourish. Just look at the spate of solar companies going to the wall in the US in recent weeks.

There are fundamental shifts occurring at the macro economic level that will have a massive impact on business in general, as well as those striving to become more sustainable. Adapting to these changes could make the difference between prosperity and survival. Some large, apparently 'bullet-proof' names may yet be among the casualties. One cannot assume that just because a business has customers today, that want, and can afford its goods and services, that they will be able to do so in the very near future. Sustainability leaders and boards everywhere need to be alert to the strategic icebergs on the horizon.

West to East: there is an inexorable shift in wealth from West to East. This has been coming on for some years, aided by strong economic planning, the availability of natural resources and a low cost base, plus the western propensity for transferring assets and capability through business strategies designed for short-term economic gain. China is now the world's second largest economy and is anticipated to replace the US as top dog within ten years. This shift will have a major impact on the relative wealth and power position of your customers and suppliers.

No more growth? The economic growth of the previous 20 years has been fuelled by debt. This approach to growth has had its day. Furthermore, we do need to ask the strategic question, concerning whether it is possible, or even desirable to aim for long-term growth in the West, or do we need to adapt to a different economic model? How would your business cope with this new reality?

More discerning customer spend: at the micro-level, as we de-leverage our economies away from debt, we experience the real impact of austerity measures and declining wages, along with inflation, all resulting in less disposable income. How many of your products and services may be affected by this, either directly or indirectly?

A rebalanced economy: the policy response in the UK and other countries sees a greater emphasis on manufacturing and export, and a

move away from financial services, retail and real estate development. This looks good on first inspection, although output is dropping as the global economy continues to struggle. Every business reliant on exports will be working hard to make sure its products and services are both desirable and affordable in markets abroad. In the developed economies, suffering similar troubles to UK, there are some doubts here. In the developing economies, we need to compete with equally attractive, but potentially less expensive rivals. Can your business really export and prosper?

Rising energy prices: anything linked to rising fossil fuel energy prices is likely to become inherently unaffordable. If your model is predicated on sending products (powered by fossil fuels) around the world, you will need to consider the sensitivity of increasingly competitive prices against rising input costs. Beware of a tipping point, caused by interaction of market, customer and price dynamics, where demand for your products could effectively fall off a cliff, literally overnight. The IMF recently considered likely scenarios for oil price increases of +60% in the short-term, and +200-600% within 20 years. The question is not about will, but when oil becomes unaffordable. How vulnerable will your customers, suppliers and your own business be to this key factor?

Climate change economics: one cannot forget about climate change, and adaptation to

the increased frequency, intensity and impact of environmental disasters takes on greater significance. Apparently 80% of businesses affected by the floods in Gloucestershire a few years ago have since gone into liquidation. What hit them hardest was not necessarily the direct impact of the event, but the hidden impacts like the gradual loss of customers and staff over the extended periods through which the businesses were unable to trade. One wonders at the further impacts to be experienced by businesses in the US as result of Hurricane Irene; it could take years for the full effects to become visible. How would your business cope with the direct and indirect impacts of increasingly severe environmental events?

So it feels like we are in a time of 'peak everything'. It is highly likely that the combined impact of these strategic factors will be massive. For many of us, it can almost feel too big to get our heads around, at times. But we have to be aware and avoid the tendency for 'wilful blindness', and resist the vain hope that it will all go away and BAU will somehow return.

But that is not all. The next financial crisis is already predicted, mainly because we have not addressed the fundamental weaknesses in our global economy. Will it be as soon as Christmas 2011, as Paul B Farrell predicts, or perhaps 2015, as others suggest? Either way, as Umair Haque writes: "Ultimately the failure to create authentic economic value catches up with every company, country and economy". It appears to be a question of when, rather than if we reach this point.

When we do hit the wall there is little fat, resources or resilience left in the system to cope with another major event. The next crisis could sweep through economies and businesses like a tsunami. If we see investors panic in response to perceived weaknesses, we will see the value of stocks tumble. In the old paradigm, investment will only recover if there are confident expectations of growth in earnings. If share prices get too low, there may be no return for many businesses. And what of their dependent suppliers?

Perhaps we will see a great re-structuring. Many commentators, including Farrell, Gilding, Haque, Kortzen, Porritt, Stiglitz, Wolf, the New Economics Foundation, and others identify the need to restructure our economies: based on need, rather than consumption; on the generation of real wealth, rather than speculation; involving fair exchange, rather than abuse of power; and with new institutions to ensure our markets work properly. In short, a more sustainable approach for the greater good.

This would mean a huge change to the way

in which our economies would work. Some might say it would be getting back to the 'roots' of capitalism, with more emphasis on free trade, local economies, re-localised production, owner-managed businesses, and less about rigged markets and unhealthy corporate domination. Whatever the outcome, these dynamics and the next crisis will have a profound impact on our economies, along with the goods and services we all decide we want, and how much we can afford to pay for them.

As well as affecting the demand side, a restructuring of our economies will impact on the supply side. But with such change, there also comes opportunity; it is not all about downside risk. In a re-localised economy there could be a wealth of opportunities, especially for new business start-ups and for SMEs. There may be less emphasis on the virtual, and more on real needs. Not to put too fine a point on it, when faced with the dilemma of whether to buy food, heating, a new car, or even the latest video game, the answer for 99% of the population will be painfully easy to reach.

"Review the business model. Previous assumptions over what you did and how you made money may no longer be valid"

This unprecedented combination of events means we are in new territory, and the ability to deal with all this needs vision, leadership, and courage; to be able to look beyond the current system, beyond the difficulties, and to take on the real challenge of transformation, to take our businesses to a better place, another model.

We need the politicians to do their bit, but what can we do as business professionals? Can we make an impact, or is this game perhaps just too big, and too out of control for us to make a real difference?

In reality, there is much we can, and must do. First of all, sustainability professionals and business leaders need to get brutally strategic and honest, about what is really coming up and the likely impacts on the business, its customers and how money is to be made. It is time to look at that big picture, think the unthinkable, and consider the real impacts (however painful) on our business models and operations, and start developing some creative solutions.

Simply following the green agenda is not necessarily a guarantee of success, either. It is entirely possible to be making great strides in

carbon, energy and waste reduction, but still go out of business. Aligning sustainability with operational cost reduction is still a good idea, but it is not necessarily sufficient.

No. The icebergs on the horizon raise too many questions about the efficacy of our products and services, and how we will continue to make money in the 21st century economy. We need to understand these dynamics, and identify how the business model may need to evolve, or in some cases even radically change, to make sure we are still around and earning reasonable returns. We need to ensure our products are both economically and environmentally sustainable.

Approaching this challenge requires all of us to look through a new lens, as conventional fixes are shown to be lacking. This is where circular economy principles can help, not just in terms of optimising the level of resources we retain in productive use, but also in terms of the flow of money in a productive economy. There is much to be done here, and we will explore this opportunity more fully in future articles.

In delivering sustainable business, it may also be necessary to review our ownership models. If we are too heavily reliant on external shareholders, not only are we constrained in our ability to take long-term decisions, we could also be fatally exposed when a further stock market crisis hits. When shares are in free-fall, the descent can be rapid and terminal. Is the PLC format adequate, with its relentless expectations on short-term profit only? I'm not so sure. Alternative formats, such as worker-owned cooperatives could offer greater flexibility, resilience and a more equitable distribution of real wealth.

There is no doubt we are going through a major economic transition, and what comes out the other side may not look much like the economy we have, on the whole, enjoyed over the last few decades. Whether we like it or not, capitalism will need to evolve, either by design or by the impact of events, and this will have direct consequences for all businesses.

Whether we have a smooth transition, or something akin to Gilding's 'great disruption', will largely be down to our collective response. Time will tell. As businesses aspiring to become more sustainable, we need to make sure our business models are sustainable first, and then to deal with operational delivery of this. This is a time to be bold.

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