Business Strategy during Crisis

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Abstract. *Drawing from a body of strategic management literature, we explore the approaches proposed by theory and available to business decision makers during crisis. We argue that there is no real theory of success of management during crisis but only broad principles that should be followed. In a certain sense, experience and intuition – what could be called soft skills – are as important as hardcore economics. Moreover, the metrics of measuring crisis and the impact of decisions during such circumstances are to be further explored and divided in a comprehensive taxonomy. Despite its popular use, crisis management is at the start of its development. The authors advance both an approach as well as a tool for supporting decisions during business crisis.*

Keywords: crisis, business, strategy, management, decision.

Introduction

Starting with mid-March, the vast majority of the governments in the major economies in the world, including all the countries of the European Union, have been confronted with a novel epidemic called COVID-19. According to the official understanding by World Health Organization, the virus originated in late 2019 in the city of Wuhan in the People Republic of China. It has later spread in an extraordinary manner around the world, surpassing in June 2020 nine million confirmed cases and more than 400,000 deaths. Because of the lack of any successful proven remedy and the controversy around it, governments have implemented a radical policy measure in order to attempt to prevent a major rise in the number of infected cases: lockdowns.

The 2020 health crisis have induced absolutely new public policy responses. Lockdowns are public policies that prevent people to freely transit and move. It translates into a significant lack of mobility for the vast majority of the population. Because of the medical fact that any gathering of people may generate the transmission of the virus, government measures have induced either:

1. the freezing of physical activities of companies as employees were prevented from getting together as well as the annulment of physical meetings with business partners (suppliers and customers);
2. the continuing operation of certain companies which were qualified as critically important for the functioning of the entire society. Such companies did not have the opportunity to stop their operation as they were deemed critical for the operation of society as in the case of energy, telecommunication, so on.

Literature review and economic context

The current economic crisis generated by the public policy measures occasioned by the COVID-19 pandemic have challenged both the business decision-makers and academic researchers alike (Xiarewama and Civelek, 2020). The core reason is that such an economic crisis is truly novel as compared to any other types of crisis the global and local economies have experienced till now.

The closest yardstick that people have thought of has been the 2007 global financial crisis. While most probably the core reasons for drawing a parallel between the two crises have been the timing (the 2007 global financial crisis is the most recent crisis) and their global character (as opposed, for example, with the more regional 1998 Asian financial crisis), there are significant limits in such a comparison.

A Brief Comparison between the 2007 Global Financial Crisis and the 2020 COVID-19 Pandemics		
Specific measures	Global Financial Crisis 2007 and following	COVID-19 Pandemic 2020 and following
lockdowns	no	yes
disruption of sourcing	no	yes
disruption of distribution	no	in some cases
access to finance	somehow	no
international trade	no	somehow
state aid	focused on banking / financial industry	focused on any type of company (SME and big), banking is still not a target
human resources	no really an impact	requalification and digitalization
Source: authors		

The 2007 global financial crisis has been, in a certain sense, a classical recession. While there are many competing theories about the causes and the impact of recessions, one of the key explanations consists in the so-called Austrian business cycle theory (Rothbard, 2000).

The Austrian theory perceives recessions as conditions of the economy when the overexpansion of the money supply from the previous period is finally revealed. Recessions are „corrections” and the economy reposition itself on a capital base which is more fit to the real demand of the population (Mises, 1980).

In a classical recession, after the expansionary monetary policies some kind of monetary contraction has to be implemented. That means a rise in the rate of interest which fundamentally leads to a rise in the cost of capital. Such a development in the financial sector as well as the malinvestments generated by the wrong perception of the availability of capital leads to a wave of bankruptcies and business failures which leads to unemployment, decrease in wages, foreclosures and other negative social phenomena. However, the vast majority of companies will succeed in keeping operations running. As opposed to the Great Depression, for example, the 2007 Global Financial Crisis has experienced open trade and the lack of barriers in the path of economic flows. It also has experienced some novel public policies such as quantitative easing and the refusal of monetary authorities worldwide to allow the rise in the rate of interest.

In the first 3 months after the outbreak of the COVID-19 pandemic, the lockdowns have translated in a major restriction in the business operation. Except the industries related to the basic goods and services of the population, as well as those serving governmental bodies, the vast majority suspended their physical operation and focused only on those tasks that could be performed from home by the employees. This has meant sometimes a total breakdown in the operation of supply chain for the vast majority of the companies dealing with consumer goods industries and their supply chains.

Business strategy during a classical recession

It is difficult for an economist who holds the right economic theory to advice business decision-makers about the right strategy to be followed during a recession (Schumpeter, 1954). A significant number of historical factors which cannot be easily taken into account may play a more relevant role than the core economic concepts underlined in the economics textbooks. But under the umbrella of the Austrian school of economics, several judgements can be made.

First of all, as recessions are periods in which the economy goes back to the fundamentals of the consumers, business decision makers should try to assess how the consumer will change and behave like after the recession. Any past experience may be useful but also constraining this liberty of judgement.

Second of all, as the Austrian theory of economics holds that the expansion is a period of malinvestments, that means a lot of investment projects in the corporate sphere were made based on wrong assumptions, like the time preference of the society as well as the ratio between saving and spending. Recession is a period when such malinvestments should be revealed (so a lot of business failures).

Third of all, during the expansion period, the prices of the factors of production skyrocketed and, in consequence, recession will readjust them. However, the key challenge is that classical economists were assuming that once the recession is revealed, policy makers will stop the “expansionary” policies (especially regarding the money and credit supply). This has not happened during the 2007 financial crisis so malinvestments have not been revealed and unsustainable businesses continued their operation.

Moreover, malinvestments during the expansion period are not particularly the ones that will discontinue their operation during the recession.

Malinvestments are not just new investments

Let us assume that we have a particular industry where the demand is covered in an efficient way by ten producers (let us assume they have equal market shares). Under a normal credit and money context (Mises, 1963), no new producer will succeed in raising enough capital in order to build a new facility and successfully contest the position of an already existing producer. However, because of the credit expansion and easy credit policy (which means an artificially lower cost of capital), a new venture may successfully raise the capital in order to start production and reach the market.

Under the new competitive structure of the market, it is obvious that on a medium term all the existing eleven producers have to adjust to the new fundamental of the sector. One of more of the former marginal producers (but viable under the “normal” scenario) may exit the market because they have not adjusted to the new (expansionary) context of the industry. For example, they have pursued a more conservative financial policy by avoiding debt while the new entrant massively relied on debt in order to upheave the sector (Hulsmann, 1998).

So, in a certain sense, credit expansion translates into a significant restructuring of almost any economic sector. The idea that, for example, during a recession, only new malinvestments will disappear is an oversimplification view and it ignores the dynamics of the market process. In fact, as the law and economics approach argue, any modification of the regulatory environment will lead to not only of reallocation of resources in the economy but also an alteration of the incentives of the market participants. So, for example, access to artificially lowered cost of capital will favor, according to the argument of Cantillon effects, those companies that, as a result of a certain risk profile, are ready to engage in a riskier financial strategy based on debt than companies with a more conservative approach (Rothbard, 2009). Such a distinction is not only relevant for the discussion in the financial field, but also in what regards the incentives of market participants to behave in a rational, profit maximizing way.

Methodology

In this paper, we employ the methodology of the Austrian School of Economics in order to explore the relation between economic theory and business (Mises, 2001). Austrian School of Economics is renowned for its *ex ante* reasoning, based on deductive approach and methodological individualism (Schumpeter, 1954).

It is highly important to stress that there is a demarcation between economic theory and entrepreneurial judgement (Topan, 2005). Fundamentally, this is the difference between theory and strategy. Theory is a body of knowledge structured in categorical statements about causality relations between economic concept. It is abstract and universally valid. For example, we may advance a theory of economic crisis through which we advance causality relations among economic concepts that explain why there is a universal cluster of errors in a society.

Entrepreneurial judgement is, however, a form of economic calculation through which individuals engage in action taking into account perceived costs and benefits (Mises, 1963). In a certain sense, the difference between theory and strategy is a difference between a systems' view and an agent's view. While an entrepreneur may master the economic theory, that does not insure him against making poor entrepreneurial judgments. This is because action and strategy must operate into a complex world with infinite factors and the relevance of these factors is subject to risk assumption, experience and risk profile. In other words, even if, as an agent, I may know the causality relations in an economic system, I may fail to assess how important is each of the factors in a certain context (Mitroff, 2000). This is because each of these factors may have an adverse causal impact which may be difficult to assess.

For example, everybody knows – not only from theory but also from empirical assessment – that if the demand decreases, the price should go down, *ceteris paribus*. This is a theoretical statement which has a universal validity. However, if the *ceteris paribus* condition does not hold (all other things do not remain equal), we cannot say that the price will go down. For example, the demand decreases but the supply also decreases so, in a certain historical context, even if the demand decreases, because the supply also decreased, the price went up. This is because the decrease in supply was more important than the decrease in demand. However, for an entrepreneur who masters the basics of the theory of supply and demand, it is obviously difficult to make a forecast because he / she may only perceive that both the supply and demand go down but cannot assess which move of the market is more important or has a more important impact on the price (Rosenthal & Pijnenburg, 1991). Entrepreneurs – and, in fact, all the market participants – do always operate in a state of incomplete knowledge and cannot correctly assess the decisions taken by other market participants as both reactions (“*normal*” or “*contrarian*”) are logical if a different

judgment of relevance is made. This is fundamentally the entrepreneurial risk that cannot be eliminated by mastering a “good” or valid theory.

This is how we could explain why two entrepreneurs who hold the same valid economic theory may take opposing decisions in a certain economic context. What is however important to highlight that this is not an invitation to theoretical relativism, that is, theory is irrelevant for entrepreneurial action. Obviously, if, in a certain context, an entrepreneur holds the wrong theory (he / she believes that a decrease in demand leads to an increase in price) but he / she makes also a wrong judgment of relevance (that the decrease in demand is less important than the decrease in supply), the correct forecast may emerge: the price increased.

But such a historical context cannot play the validating role of any theory of the price in a market economy. Entrepreneurial experience is so important for operational business decision-making but it should be no held as validated knowledge in the textbooks of economics. This section contains the research methods used by the author, the main research hypotheses, and the arguments for defining them. The author should explain the qualitative and quantitative methods used and how the research has been designed and performed.

Results and discussions

The current crisis has challenged theorists and practitioners alike by the novelty of the governmental policies and measures that has to be followed by the private sector. But some particularities can be already highlighted.

The “Procurst Bed”

The core characteristic of the lockdowns is that they put a hold on all the competitors in a market. Under such a condition, a certain levelling of the competitive conditions in such sectors may emerge which will favor the less competitive competitors and disfavor the more competitive ones. This is in a markedly manifest contrast with the conditions during the financial recessions, when the hypercompetitive producers will not be affected by the restructuring of the industry.

So, in a certain sense, lockdown may act as a role of a “reset” in the industry where all the participants are put under the same starting conditions. In a certain sense, during the period of the lockdown, it could be a focus on marketing that may uphold the competitive conditions in the economy and provide certain “pole positions” for the competitors that have focused on advertising and promotion during the cease of the operations. Consumers, especially under the assumption that they have been held “hostages” to their home and, in consequence, particularly sensitive to marketing, may have been more receptive during such a period.

Duplication of supply chains

One of the key arguments made during the contemporary covid-19 pandemic has been regarding the alleged overreliance on certain streamlined and lean supply chains at the global level. For example, the lockdown was first introduced in certain provinces in the People Republic of China. Such public policies affected the operation of the international supply chain that used manufacturing facilities in the Hubei province of this country. Moreover, the international trade has not been allowed to freely operate internationally as the mobility of the individuals (and, in consequence, companies) was severely limited.

Certain policy makers as well as business analysts deplored such an overreliance on Chinese suppliers or manufacturing facilities of the large transnational companies. The Chinese lockdown put such supply chains into freeze as the core wisdom in supply chain management in

the last three decades has been to avoid duplication and focus on efficiency. New strategic concepts such as „reshoring” (as opposed to „offshoring”, meaning the relocation of key manufacturing facilities in the home market of the company), „decoupling” (meaning a downgrade of American – Chinese economic relations, from the disinvestment of American companies in China to abandonment of the Chinese suppliers).

Chinese economy has been a key beneficiary of a revolution in strategic thinking starting with the 80s when American companies started to copy the Japanese thinking and implement its strategic management approach. Such approaches like „lean production”, „just-in-time delivery”, „zero inventories”, „mass customization” or „total-quality management” has meant the abandonment of traditional industrial management philosophy based on „mass production”, „just-in-case inventories”, standardization and scale economies (Lin and Hui, 1999).

The core idea was that inventories as well as returns were costs that should be avoided by another type of logistics and production systems. Companies worked mainly on demand, avoided inventories and perfected the architecture and quality management of the products in order to avoid returns. Massive increases in productivity and financial return have emerged while the opportunity costs consisted mainly in an overreliance on the supply chain. Due to its emergence as the destination of choice for the relocation decision starting in the 90s, Chinese economy has been the main beneficiary of such a streamlined production processes, together with other Asian economies such as Malaysia, Thailand or, later, Vietnam. Everybody was already discussing this issue in Japan, for example, about the challenges that emerge in the supply chain when on producer is out of production (due to natural events or hazards). But everybody ignored the potential risk of an event with global implication that may block international supply chains.

So today, a lot of business strategists call for a regionalization of supply chain, in the sense the globalization has meant a bet on only one solution. Through regionalization, global companies may develop alternative supply chains that compete inside the firm to complete orders and insure diversification of risk.

Politics will become more and more relevant for business

It should be noted that there are also calls for such a „decoupling” that have less to do with business logic and more with the political logic. The contemporary period has been marked by the increase in the political risk that international firms are facing while operating globally. It is, first of all, about the political and economic dispute between United States of America and the People Republic of China that may lead to significant barriers in the path of trade, investment and technology between the largest two economies in the world. So American companies but also third party (like Japanese or Korean) may incur a massive risk in the future while producing in China for export on the American market.

Moreover, European Union seems to be, at its turn, exposed to increases in both internal political turmoil but also in its relations with other major international players, such as United States of America, the Russian Federation as well as People Republic of China. While BREXIT has imposed a new challenge to the economic bloc, it may also spur increased efforts towards an even deeper integration. If the 2007 financial recession may offer an example, major reshaping in politics occurred in different European countries, especially in Greece and other Southern members (such as Spain or Italy). The electorate may react to economic hardships sometimes in an unpredictable way.

On medium term, it may be a big intellectual challenge to forecast whether such an increased political risk may lead to a deeper regionalization of trade and investment flows, reaching

the status of regional blocs that increasingly „create trade” inwards and „divert the trade” from outwards.

Digitalization

The industries or at least the subsectors that have been the least affected by the physical lockdowns and the barriers in the path of mobility have been obviously those based on Internet and other means of communication. In fact, the lack of mobility has led companies to switch online and implement strategies to keep the operation through a physical delocalization of the activities of their workforce. Anywhere such a decentralization of activities has been available, firms have opted for such a rethinking of their business and the transformation of the organization into a virtual workplace.

Such a process is not easy for a significant number of reasons. First of all, for a majority of employees, their home became a part of their office space but nonetheless the choice was simple: adapt or risk your job or your position inside the organization. Such a forced transition into the digital workplace may have a deep impact however of the way that business is conducted, at least in the case of small and medium enterprises (Mitroff, 2019). Decision makers will reassess the need for physical office space and the need to create a particular type of atmosphere in the workplace. Major reshuffles will emerge in the close future but obviously there are also many opportunities. Second of all, information technology and cybersecurity will take a new role as the virtual organization has to be held together by a robust platform and the security of data transfers between employees has to be permanently maintained.

Such a network company will raise significant challenges related to the legal framework but also for the corporate culture. A person working from home has more the profile of an independent contractor than that of an employee. Its contribution to the projects and task will be more easily to be identified and its reward may be more tightly related to his or her performance. Moreover, elements which are essential to the corporate cultures, such as personal interaction, common symbols and artefacts may be modified and adjusted. In such a social distancing environment, corporate culture has to adapt.

Less but more internationalization?

While some voices speak about an end of globalization and they expect less internationalization in the future, this may not be the case. Obviously, political risk and decoupling as well as digitalization will play strong roles in this respect. But, in fact, they may go in either direction. In fact, virtual organizations will more easily involve foreign „employees” and „contractors”. As Internet make distances disappear, this may also mean the emergence of the global network company whose legal status is extremely challenging. While companies have preferred to outsource some of their activities to other entities located in economies with a massive labor cost advantage, a company that creates a virtual workplace will more easily integrate foreign nationals in its teams.

In this respect, law and taxation will face formidable challenges in the close future as the legal status of such „foreign employees” will become increasingly difficult to assess. Why a company will need foreign affiliates when it could directly hire foreign nationals? Obviously, physical production and manufacturing will keep their present status but some industries – like software, business services and so on – will experience in the same time a less but more internationalization?

The “liquidity” trap

The problems that a company is facing will surely surface at one moment in the financial and accounting records of the company. However, simply looking at the financial data does not mean that the analyst is understanding the problems facing the company.

For a company that does not understand its demand, the problems in this regard may seem to be a liquidity problem. That is, the decrease in the demand that the company is facing may look like a temporary adjustment of the consumers that will be corrected when the “normal” market conditions will return. For example, a decrease of 20% in its order may be interpreted by the producer as a temporary challenge as consumers may have their own liquidity problems or their risk aversion will determine them to postpone their orders. Most probably, most companies will react by requiring their consumers to pay sooner (less probable) or pressuring their suppliers to accept a delay in their payments (most probable).

But such a worsening of the circle of payables is very difficult to assess whether it is temporary or a long-term restructuring of the demand and, in consequence of the sector. Creditors and banking institutions will have difficulties in formulating a correct assessment. In a certain sense, any malinvestment problem starts as a liquidity problem so it is not easy to assess the situation and to devise the right measures of restructuring.

Any company should distance itself from the problem and take a cool approach in assessing the new fundamentals of the market. In certain cases, it must preemptively take the right decisions in order to restructure its assets in order to reposition itself under the new conditions. This may translate in downsizing decisions which will raise challenges in the positioning of the company on the market as well as in what regards capital structure and human resources policies.

The “opportunity” trap of public policy schemes

The COVID-19 pandemic has generated some of the most radical distancing measures in public policy in the living memory. Even during the lockdowns, policy makers have come to realize that an economic crisis will follow after the relaxing of the measures. In consequence, some of the most encompassing measures of support have been announced in the major economies in the world.

Such schemes of state aid will surely impact the competitive structure of the markets and the restructuring process of the economy (Rothbard, 2009). While their intention cannot be qualified but only well, the impact may make it even harder for the companies to adjust to the new market conditions.

Such a conclusion may come as a result of two arguments. One of the arguments is that the public support schemes cannot really make a difference between the companies that are better positioned to survive and thrive under the new market fundamentals. So, in consequence, all the companies that will qualify for support (based on their past performance pre-COVID-19 crisis) will receive such support but a part of them (those who will not make it over the reality) will prolong their operations. That will mean a cost to the economy and will make it harder for the other companies to access the factors of production; moreover, such public policy schemes will keep high the costs of factors of production as these “walking dead” companies (which should be “dead” but are kept “alive” by support from the government) will also take part in the process of auctioning of the factors of production in the economy.

The other argument derives from the fact that the largest part of the schemes of public policy are tied to conditions regarding the workforce. That is, the government couples the objective to support producers with the objective to support workforce (and avoid unemployment), like preserving the number of employees in such companies. While the intentions could be qualified

again as good, the impact may be negative as a large number of companies receiving such support will avoid making later necessary restructuring conditions or make it without the necessary adjustment in the human resources, which will translate into an oversized workforce, a loss in productivity and even a restructuring trap that will later be borne most probably by the shareholders (in the case that the companies survive) or creditors (if the companies will go bankrupt). What it is interesting, in this scenario, is that the cost that the companies have to allocate towards the workforce will deprive them from auctioning other factors of production (that will be, *per a contrario*, cheaper) that will favor companies that will not register negative consequences of the pandemic (especially companies from the digital industries).

Conclusion

The 2020 COVID-19 pandemic has already generated, in the first months of the crisis, a massive negative impact on the economy. Some reports qualify it as being comparable with the Second World War in terms of decrease in economic activity. Business strategists are trying to assess such an impact and to make recommendations regarding the alteration and updating of the corporate strategies for the present but also for the future.

Lockdowns may become a more frequently used public policy and companies have to adapt so such challenges. As a general conclusion, risk diversification and especially political risk will become a key priority in the corporate agenda for the future. This is caused by both political events associated with the current pandemic but also with the attempt to avoid overreliance to a streamlined and mean supply chain. Digitalization is surely the other key development that will impact the relation between companies and their employees but also, as we have argued, their international presence.

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