

Special Report

Preparing for “Black Swan” Events*

** The Black Swan theory refers to large-impact, hard to predict, rare events and their dominant role in history.*

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Terrorism, global warming, a worldwide recession, pandemics, the Taliban's advances in nuclear-armed Pakistan, wild swings in oil prices, business scandals—all have occurred in recent months. Be certain that more phenomena, perhaps worse, will occur, leaving us in a “Black Swan” world.

Everyone will be tested—from business leaders and government officials, to consumers. Plans will need to be adjusted, money re-allocated and personal pursuits changed as nations and individuals struggle to cope.

We are in the early moments of dramatic change. No one knows how long it will last or where it will take us. Life will be constantly in flux. Anyone who chooses to do business as usual will be left behind.

But despite recent negative events and new challenges, we will continue to make progress. History teaches us there are too many positive factors occurring every day to stop progress. All of us need to be alert, resilient and prepared for a dramatically altered future from what we once expected.

Here we offer a glimpse of what we might expect in the interest of helping you prepare your business and yourself for tomorrow. After the dramatic changes of the past 18 months, it may seem risky to predict what the world will look like 18 months from now. We believe enough clues are emerging to make some soothsaying worthwhile. Our point: Do not expect calm waters ahead. We face a long period of turmoil.

This Report offers concepts we believe may be helpful in dealing with “Black Swan” events.

In Crisis, People Hunger For Strong Leadership & Good Judgment

How people at all levels in all walks of life step up and lead with positive ideas is a key for the future. It remains to be seen if men and women in large numbers will respond to this leadership challenge.

The difficulties we face today are not a result of sub-prime mortgages, credit default swaps or failed economic policies.

People who knew better in many cases made all this happen. They failed to be responsible leaders.

The common good and vision are the keys here. Those who are in leadership positions, or who aspire to be, should recognize the great challenges that have been thrust in front of us. If one is leading others, one must think about the consequences of one's acts upon others, not only about oneself.

Accountability may be a leader's main role. Those who step forward, exercise strong leadership based on good judgment, communicate their thinking clearly and face unflinchingly the tests that come will be the ones who earn and keep the top positions in the future. More than ever, true leadership will be rewarded.

There is a lesson that leaders may draw from President Obama's current popularity in public opinion polls. Obama is riding high not because the nation necessarily thinks that everything he is doing is right, but because people see him projecting thoughtful, forceful leadership on a wide variety of fronts—from the economy to health care to foreign policy.

The President conveys a sense that his leadership is balanced. He explains his decisions in clear, common sense language. He comes across as a responsible leader who exercises good judgment and is accountable to the nation.

Moral Leadership is Imperative

The yearning for strong moral leadership extends to every field of endeavor, intensified by a widespread feeling that today's economic and social problems are a direct result of a period of ignoring emerging problems. Sub-prime mortgages, credit default swaps and other toxic assets are symptoms of a failure of imagination and moral leadership.

That is especially true about the world of business. For most of the past decade, Americans have been exposed to a series of business scandals, from Enron to multibillion-dollar bank bailouts. The sense is that greed overwhelmed good judgment and selfishness swamped the public interest.

Error-free judgment is not what people expect. They do demand leaders be flexible, caring and experienced. The arrogant leader will not survive in a “Black Swan” world.

Good leadership also requires taking good ideas that stand the test of time and driving them forward with courage and determination. As we have noted before in these reports, one executive we know always asked his colleagues in tough situations: “What do you think?” He got good ideas and was seen as an interactive, hands-on, charismatic leader.

The New Economic Landscape

The current recession marks the end of one chapter in the economic life of America and the beginning of a very different one. The nation is entering a new era and a new way of life. Some areas will emerge stronger and more dynamic, especially regional centers such as New York, Chicago, Los Angeles, San Francisco and the Pacific Northwest corridor, which will flourish because of their large populations of talented, experienced, innovative people.

Other parts of the nation are likely to take more time to recover because they were dependent on industries that have run their course. These cities and regions must reinvent themselves—not an easy task.

Two regions, particularly, seem destined to languish in this unhappy category. One is the Rust Belt, from Buffalo to St. Louis, where the manufacturing base has been in decline for at least four decades. Detroit, in particular, faces a bleak future, but look for some determined efforts to change this.

It is true that the populations of these hard-hit cities have not dropped as much as the jobs losses would indicate, but that may be because it is difficult to sell houses and take a gamble jobs are easier to get elsewhere. The challenge for these cities will be to manage population decline without becoming blighted. This is a huge requirement for new, innovative urban leadership. Right now few are emerging.

The other region in danger is the Sun Belt, or more specifically those parts of the Sun Belt where growth was almost entirely dependent on a real estate boom—development that came from development. One writer called it “a housing Ponzi scheme.” Las Vegas is a prime example. So is Arizona, where average home prices have fallen a staggering 50% since their peak in 2006. For these areas, the recession has brought an abrupt end to an era of illusory wealth fueled by borrowed foreign capital.

Did You Know?

With 13 million people unemployed, there are still approximately 3 million jobs that employers are actively recruiting for, but have so far been unable to fill.

Adaptability

If there is one quality that is certain to be valued more in the executive leader of tomorrow, it is adaptability. Inflexible leadership has not worked for quite awhile, but it has taken the current economic climate to bring that home.

A combination of competence, pragmatism and performance will be the new gold standard for top managers. Yesterday’s flashy CEO will be seen as suspect.

CEOs and executives working their way up the ladder will have to be able to change direction quickly to please their boards as well as the public. The most valued CEOs will be those who

are able to shift business practices, personnel and policies to adapt to the changing economic scene. Look for a new dynamic between employees and top managers and for new forms of governance. The days of insider games on Wall Street are a thing of the past. Transparency is the new name of the game. Executives are not as likely to shift from company to company as they have done in the past. (Headhunters already have pared down their operations.)

The New Value of Entrepreneurship

There is great potential for small businesses and entrepreneurs to lead the way out of the mess we are in. Government will need to recognize this and provide incentives.

Risk-taking, hard-working people with brilliant ideas will emerge from the wreckage of the economy, while the business careers of many who are in charge now will be over, gone, along with seven-figure compensation.

Overall, the nation will see a shift away from (although not a complete abandonment of) manufacturing and a move toward idea-driven and creative industries—especially finance, high-tech, alternative energy sources, media and entertainment. Whether one is speaking of an individual, an organization or an entire region, those who best adapt to this new environment will flourish.

Did You Know?

- The Antarctic Peninsula has warmed 3°C over 50 years.
 - Sea level would rise 7 meters if Greenland's ice sheet melts.
 - A 70-meter rise would occur if both East and West Antarctic ice sheets melt.
 - 70% of Arctic winter ice is thin seasonal ice.
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New Standards Of Competence

Journalists have become the canaries in the mine

shaft, forced by newsroom layoffs to report, write, broadcast, opine about and analyze what is happening as well as post on-line videos, all at a fraction of what yesterday's journalists earned. So, too, will business leaders have to master a variety of skills, from engineering to management to finance. Delegating will not be as widespread because there will be fewer junior executives to handle the tasks.

The managers who are best at coaxing creativity and innovation from their workers will emerge as the next generation of leaders in an economy that depends less on moving goods and more on generating and transmitting ideas.

The average age of CEOs will decrease, possibly dramatically. (The Economist recently called Yahoo's new CEO strikingly old at 60.) With fewer slots available, there will be a move to executives who are young, strong on new technology and adept at cutting costs without losing productivity.

The shift from print to multimedia is irrevocable. CEOs will have to be adept in all forms of communication. (The idea of a CEO not having the latest Blackberry or its equivalent or being computer illiterate will be laughable.) Sophisticated video games will help train everyone, including business leaders.

Know Your Company

CEOs will have to know their companies from the bottom up and the top down to be able to adapt to environmental crises, new regulations, technological breakthroughs, changing workplace standards, competitors and global challenges. Colleges and universities will have to recruit the best and brightest ex-CEOs to teach their business students with practical, not theoretical, applications, how to keep up with the pace.

It will be harder than ever to stay on top after a mistake. Boards are going to be far less willing to forgive errors of judgment, let alone out-and-out mistakes or public relations disasters. Loyalty will continue to be a fading virtue.

There is a possibility—needed in our view—of a return to a higher level of ethical and moral conduct. If the breakdown of standards is seen as a chief reason for the fix we are in, we can expect a new and refreshing focus on this. If it does not happen, we have serious questions about the future. Corporations will do well to replace some of their legal staff with an ethicist or two.

Transparency Will Reign

Transparency in corporations will dovetail with the open government movement. Technology will make it increasingly difficult to keep a lid on corporate secrets. (Some think that technological advancements will mean that within a few years all conversations will be recorded and retained.) Many think corporations will be increasingly pressured to make ethics, environmentalism and diversity part of their everyday culture. They will need to disclose publicly such procedures as animal testing, their hiring of minorities, the extent of charitable giving and other forms of philanthropy.

Every corporation will be scrutinized by an Internet watchdog group or blogger tracking each move the CEO and other top managers make. This may result in even tighter security measures for top managers, such as full-time bodyguards, the hiring of security experts, more sophisticated alarm systems and, potentially, less freedom of movement for controversial senior managers. If there is one trend that looks irreversible in the current climate it is the loss of trust among Americans in once-sacrosanct institutions, whether it is the church, government, major league baseball or employers who no longer reward loyalty with loyalty.

Some predict a newly emergent power-to-the-people movement. Business leaders tomorrow will have to be able to prove that what they say is true. Because of the greed of some, tomorrow's top managers may well find to their dismay that they are unreasonably distrusted and discounted. A company that is found to have misled about claims for its product will be in serious trouble, even more so than in the past.

Recruiting From Abroad

There will be pressure to lift the current restrictions on the permanent immigration of top foreign scholars because of the growing alarm in the scientific and engineering community over the number of promising overseas students who must leave U.S. schools to return home. Unless it keeps its technological edge, the United States will lose its status as the last superpower. Keeping America competitive will become the new battle cry. There will be new business courses for students to major in, including entrepreneurship, sustainable business practices and strategic intelligence.

Leaders of businesses that work across borders will be expected to know different cultures, languages and traditions. CEOs will increasingly want to hire managers with wide travel experience, especially in Asia and Europe. But that won't be hard to do. The number of international travelers is expected to double worldwide from 842 million in 2006 to 1.6 billion within a decade.

Did You Know?

Online addressing systems are running out of digits, but Social Security numbers are still far from reaching their upper limit of nearly one billion.

The Burgeoning Green Movement

Despite the uncertain economic outlook, interest will continue to grow in the greening the planet movement as more people adopt state-of-the-art environmental practices. Americans are not likely to return to an age when fuel-efficiency was not a major consideration in buying a car or energy costs not a factor in buying a house. Buyers of new cars, for example, will want to believe they can save money on gas while helping to save the planet. So-called green products will be sought after; tax credits for solar products will proliferate.

Politically speaking, it is easier to make the case for such environmentalism in a down market than

to ask people to change when all is going well. President Obama has equated the creation of new green companies with more jobs.

CEOs who make public commitments to reducing pollution will be in demand as speakers, role models and trend-setters (witness Al Gore). It will become unpopular, even untenable, for CEOs to deny global climate change, which many still do.

Nanotechnology Will Be Ascendant

As nanotechnology becomes more widespread, there will be a big push for corporations to exploit it. Many CEOs will hire managers to supervise robots, instead of people, as nanotechnology improves. Retooling to prevent cyber-attacks and even bio-attacks from engineered bacteria and viruses will become another new focus for many CEOs.

Retraining Will Be Routine

CEOs will find that re-educating their workforces on a regular basis is imperative. Just as computers are often out-of-date almost as soon as they are installed, knowledge can be obsolete almost before the ink on the diploma is dry. Workers in successful companies will spend almost as much time re-training as they will on the job. CEOs, too, will have to go back to school to keep up-to-date.

Education beyond high school will become an almost universal job requirement. But the big push will be for technical and vocational training, and community colleges will play an increasingly important role in the American education system.

Smaller, Smarter Cars & Less Business Travel

Americans may never go back to planned obsolescence—the practice of trading in a car every year or two. Keeping a vehicle for several years will become the norm. Used cars will be in greater demand. Consumers will want vehicles that last longer and require less maintenance, that

are environmentally friendly, fuel efficient and safe. Zip (on-the-spot rentals) and Smart cars will become common in big cities. (It's noteworthy that 60% of the world's people will soon live in urban areas.)

Small will be a watchword in the coming years: smaller cars, smaller houses, smaller mortgages, smaller debt, smaller environmental footprints.

Meetings increasingly will be conducted online and business travel will decline. Company cars will shrink in number. Urbanization will make parking cars much more expensive, even out of reach for many. But the demand for electric cars will grow. More than eight out of every ten people in the world will have access to electricity in two decades. At the same time, the environmental problems of the developing nations will become an immense global challenge. Businesses that help solve such problems will thrive.

Did You Know?

59% of Americans opposed the government loans to GM and Chrysler, according to a Gallup Poll. Almost every survey finds a majority opposes auto bailouts.

Regulation Is A Booming Field

There will be movements to streamline regulations across national boundaries and to make laws of different countries more consistent. This is already happening among democratic countries in such fields as media law. Corporations once fought to make business laws in all 50 states compatible. Now, for better or worse, such convergence will happen globally.

In Washington, many lawmakers have vowed to tighten regulations on everything from Wall Street to tobacco to drugs to wildlife habitats and clean water. The new rallying cry is that never again should the government allow a business to become “too big to fail.”

Less Retail Therapy

A woman interviewed on television recently showed the camera crew her crowded closet that included a \$495 handbag she had used three times and several pairs of shoes (none designed for work) that cost more than \$500 each. She was clearly contrite and disgusted with herself and her \$13,000 credit-card debt. Such behavior, she said firmly, was over.

Americans are seriously rethinking their shopping habits, expensive restaurant meals (except for special occasions) and careless spending in general. Baby boomers often dismissed the Depression-era psychology of their parents. Now, they are undergoing a catharsis of their own. The key phrases for shoppers will be durable, efficient, lasts longer, costs less, more bang for the buck, on sale and healthful.

Consumers are in serious pursuit of better health, hence the growth in popularity of organic foods. It is debatable whether organic foods are really better for consumers and/or the environment, but the perception is that they are, so they will continue to sell well despite higher costs.

Did You Know?

74% of those surveyed in a recent Harris Poll said they were going to spend less on eating out and entertainment.

Delayed Retirement

Retiring early with benefits will no longer be part of the American Dream. The exception may be senior managers, and even they may undertake second careers, including starting spin-offs, motivational speaking, teaching and consulting. Two-thirds of middle-income Americans say they expect to continue working past age 65, but probably in a different line of work. There is a widespread lack of trust in pensions and a concomitant fear that Social Security won't be available.

Nonetheless, most younger Americans like their jobs; want to work; and expect to be healthier than their parents well into their 80s—if not always as well off. Some expect to start their own businesses. America's faith in entrepreneurship remains unscathed by the recession. Saving money will again become a virtue to be cherished and pursued. Knowing how to teach people to find bargains, locate rental homes, avoid foreclosure and make do with less will be valuable skills.

Home Ownership Reassessed

The American love affair with home ownership will undergo a change. The long-held belief that real estate values will always rise and therefore buying a home is a wise investment has been dealt a heavy blow. According to one estimate, about \$500 billion worth of homes are under water—the owner owes more than the house is worth—and the total may eventually soar close to \$1 trillion.

Moreover, the current recession has revealed the hidden liability of home ownership: The owner loses mobility. In the Rust Belt, for example, the unemployed can't look for work elsewhere until they sell their homes—but there are no buyers. What they thought was their most valuable possession has become a ball and chain.

The percentage of renters will increase significantly. Meanwhile, federal policies, dating back to the early 1950s, that encouraged home ownership and fostered the growth of the suburbs (e.g., the tax deductibility of mortgage interest), will come under scrutiny.

The Hope Of The Future

Even in a bad economy, there are always success stories of people risking all to start new companies based on new ideas. Witness the success of Netflix, quick-prepare meals for one or two people, solar-powered everything, environmental consulting firms, rollerators for mobility-challenged seniors, new devices to fight hearing

loss, in-home senior care services, Medicare and prescription-drug advisers for seniors, in-home computer consultants, start-ups that teach people new skills such as how to be the executor of a will or do a home energy audit. The list goes on. Despite the pain so many are suffering, the financial crisis will ultimately help America re-energize its creative powers and re-invigorate its economy in new and dynamic ways.

Implications For Business

Strategic planning will remain the indispensable key for any successful business leader. Unfortunately, planning has rarely been as difficult as it is today, thanks to one of the most turbulent, shifting economic environments since the Great Depression.

This rapidly changing landscape requires executives to prepare for a broad array of post-recession issues. Consider, for starters, labor supply, worker re-training, brain drains, new environmental constraints, relocation, the disappearance of credit-driven consumerism, higher taxes and a new automobile and home-ownership culture. Adaptability will be the core requirement for executive success in this new era. Small business-people and entrepreneurs, especially, should be prepared to exploit new opportunities.

For better or worse, there will be no more unfettered free markets, easy credit, look-the-other-way regulators, autocratic corporate chieftains or astronomical compensation packages.

To cope productively with such formidable challenges, the watchwords in the corner office will be accountability, flexibility, competence, innovation, pragmatism, transparency and performance. And let's not forget digital literacy, which will be a must for savvy senior managers. Strong communicators will be able to rocket to the top much sooner than in an earlier era, while language skills will be a big plus in an increasingly globalized business arena.

Closing Quote

“There is nothing to fear except the persistent refusal to find out the truth, the persistent refusal to analyze the causes of happenings.”

Dorothy Thompson
American Journalist and Author
(1894-1961)