Managing in a Deflationary Economy – A View From Malaysia

Today's economic news features descriptions of our stalled economy, punctuated by concerns that we may slip into deflation. Most U.S. managers have not had direct experience with managing in a deflationary economy. This economic environment creates extraordinary challenges and requires a completely different way of managing.

In my last post, I related the experiences of Tenglum Low, a top Malaysian executive (and former executive student), in managing mergers and reorganizations in Malaysia. Tenglum also has successfully guided his company through a series of severe deflationary episodes that accompanied the Southeast Asian economic crises that took place over the decade of the 1990s.

In 1999, Tenglum wrote a letter to me about managing in an economic crisis that I read to my class every year. I reproduce the letter below (with some minor editing). Tenglum wrote:

> It has been a long time since we last met and corresponded. The Asian crisis has been going on for almost two years. The initial stage was a lot of arguments between IMF medicine (i.e., International Monetary Fund mandated belt-tightening) and Keynesian theory.
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> Under the IMF package, we see the recovery of Korea. Until the restructuring of our bankruptcy law, we have yet to see a major shakeout. Indonesia is still going through chaos, because the tightening affects the poor more. One school of thought is that unless there is military power, peace would be a long way off because of the breakdown in law and order. Malaysia is already near the bottom, and has not shown signs of further decline. Meanwhile, the banking sector is undergoing major restructuring, and major M&A is just beginning. However, we think foreign direct investment will still be slow until investors see stability in long term government policy.
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> Meanwhile, we are beginning to feel a breakdown in the international trade system due to more protectionism everywhere – like don't export your problem away.
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> As for me, this is the second recession I have gone through in Malaysia during the past ten years. The last one was milder because it did not hit all Asia. This round is much tougher because it is a combination of financial and economic crises. Further, I was made responsible for what used to be a US$200 million company, which has plummeted to US$80 million.
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> Probably, I have learned my lesson well. There are many things we needed to do which can now be summarized into newly conventional wisdom (which seemed to be lacking at the beginning of the crisis, or perhaps we could not swallow our pride and face reality or overcome denial).

1. The first step is to clear all inventories, because selling prices will drop very fast, and demand will shrink even faster. Two months stock will turn into nine months stock.

2. Next, go on just-in-time to reduce financial risk, and focus on making only the manufacturing margin (variable cost), otherwise you will be too rigid to sell at all.

3. When you are in a difficult time, still allocate time and money for new products.

4. Strengthen your strategic alliances with your best customers, and be prepared to drop your fringe customers because you cannot count on everyone to be able to make it.

5. Further, it helps to see clearly beyond the current distortions to determine whether you can be an ultimate world player with sound competitive advantages.

6. The weak foreign exchange rate will help you to export, but the bigger question is whether you can create productivity improvements over the next few years that will enable you to sustain business growth when economic order returns.

Tenglum's letter closes with these six points of essential management advice. It is clear that a deflationary economic crisis removes all the safety nets and margin for error that prosperity provides.

The essential question for managers is to what extent these six principles should guide our actions today.