Illustration 12.4
Are the Giants Subject to the Ups and Downs of the Markets?

In August 1997, executives from huge industrial firms, such as Mobil and Union Carbide, were in conference with a team of management consultants and, as reported in *The Wall Street Journal,* the mood was surprisingly somber.* “It's a fine summer day, the stock market is booming, and some of the companies represented here are posting stronger-than-expected profits. . . . They ought to be euphoric.”

The director of the consultant group and the host of the meeting welcomed the executives by saying, “I feel like the prophet of doom. It’s our belief that the downturn has started.” For two days, the executives and their advisers had discussed what they expected in their industries over the next two years: “growing overcapacity, world-wide product gluts, price wars, shakeouts and consolidations.” The problems seemed to stem from the investment, perhaps overinvestment, during the expansion, which appeared to many to have resulted in overcapacity.

The problem extended beyond the oil, chemical, paper, and other industries that process raw materials: “The global auto and airline industries are building capacity rapidly, and some experts expect shakeouts in them, too, by 1999. Already, U.S. retail space and semiconductor-manufacturing capacity are widely acknowledged to far exceed demand.” A Union Carbide vice president cited a basic problem in chemicals: “The profitability that the industry sees in the good times has always led to overinvesting, and it has this time.”

There was a new twist in this cycle, according to the *WSJ*: “More than in past cycles, this one is increasingly global.” New factories were going up everywhere, especially in the emerging nations of Asia and Latin America. This was especially true in automaking: Latin America’s auto production was expected to double between 1995 and 2000, and nearly double in Asia outside of Japan and South Korea. Industry experts expected a shakeout by the end of the century. The two largest airplane producers, Boeing and Europe’s Airbus, responding to a record number of aircraft orders, were increasing production rates and “producing more than the market can absorb.” Similar overinvestment was occurring in other industries.

The *WSJ* wondered, “Why don’t many executives see capacity problems building up? One reason is ego. Companies figure that when the bloodbath is over, *they* will emerge the winners. Another reason is me-tooism, the hard mentality: When cash is strong the fad is to spend it.” We might suggest an additional reason: They do see their own possible capacity problems building up, but they worry that if they are wrong and the boom continues, they may get left behind if they don’t continue expanding.

The management consultants suggested some possible solutions at the meeting. Investments timed to match changes in demand, better management of working capital, and strong industrial marketing. All were rather nebulous. The head of strategic planning at Shell International Petroleum Corporation noted, “If we repeat some of the behaviors of the past, we might wind up giving it away to the marketplace again.”

We would agree. We also believe the answer to the question in the title of this illustration is, “Yes.”

*“Same Old Cycles: In Some Industries Executives Foresee Tough Times Ahead,” *The Wall Street Journal,* Aug. 7, 1997.