

The Horsch *Business Report*



Helping you grow your career and your company



LARRY HORSCH

INTRODUCTION

We continue to be impressed by the growth of the readership of the Report both in the U.S. and internationally.

We have a winner in our blog challenge addressing the question of “Bad Bosses” and what to do about it. The winner is Erik located in Florida whose response is on our website. It’s exceptional and you’d do well to review it. He’ll receive our custom cap with our logo shortly.

If you have friends or business acquaintances who would enjoy the free Report, include them by giving them our website address listed below. While our primary mission is to help you grow your career and your company, our secondary mission is to increase economic, financial, and business literacy, which is essential to the functioning of a free enterprise / democratic society.

ECONOMICS

General Overview

The trouble with China continues in a modified way with China agreeing to buy U.S. farm products and President Trump backing down on increasing tariffs already in place. This still leaves very basic disagreements on China’s stealing technology and subsidizing government-owned companies. They have also been slow in opening up their markets in accordance with WTO rules.

While Wall Street waits anxiously for the next Federal Reserve reduction in interest rates of $\frac{1}{4}$ percent, the trade war is many times more important. It has slowed trade throughout the world as business spending is being reduced in a time of cloudy outlook.

Canary in the Coal Mine

For those not familiar with the phrase, “canary in the coal mine,” it refers to coal miners who have a canary in a cage to indicate if stray poisonous gases are creeping into the mine that would kill the miners. The canary dying quickly would indicate that it’s time to leave the mine. So it is with economic indicators.

While business capital expenditures are much smaller than consumer spending or government spending, they are the most volatile and they are the canary in the coal mine. It is the indicator to be aware of in assessing the risks ahead. It is volatile because businessmen can lose interest in buying long-lived equipment when the business outlook appears cloudy or gloomy. When this outlook actually begins to happen, layoffs occur in the employment sector and consumer confidence begins to fade as consumers wonder about the future of their jobs.

Business spending is already fading, and consumer confidence will fall as the layoffs occur. While some of the business spending reductions are a function of the China/U.S. trade fight, some of it is also part of the ending of a 10-year expansion of the business cycle.

Historically, business cycles have expansion phases lasting several years and contraction phases lasting several months. Since the current cycle has lasted for 10 years in the expansion phase, the math has gotten somewhat distorted. Part of this extra expansion occurred because of the caution that existed coming out of the Great Recession. The excesses this time did not build up quickly, so the expansion continued. Now, we are entering the first stage of the contraction phase. While we never know in advance the depth or duration of a recession, it is unlikely to equal the Great Recession when a major part of home financing was plagued by fraud (fraudulent appraisals and fraudulent income disclosures by buyers).

THE WASHINGTON SCENE

Big Problems versus Small Problems

Anyone who’s had the opportunity to travel abroad to less developed countries will experience a lot of different problems affecting these countries including chronic unemployment, corruption, drug gangs, voting fraud, and sometimes a general disregard for the public good by those in power. For example, today, if you were to look south of the U.S. border into Mexico, Central America and South America, it’s hard to find a country that’s not sinking from one of the problems listed above.

With the above in mind, when we discuss the problems confronting the United States, including immigration, wealth inequality, healthcare costs, public education underperformance, gun violence, or the tribal nature of Washington politics, these problems are much more solvable than those observed in foreign travel. We have the wealth and the know-how to address these problems once we get beyond gridlock in Washington. While the gridlock has deepened in the last year, reasonable people will rise up to solve it because the American public will demand it.

President Trump’s Implosion

The hope that many had in the election of President Trump to the presidency was that he’d “drain the swamp.” This is being sidelined by his confusing management methods that succeeded in the New York real estate market with that needed to be a successful president of the United States. His historic management style has consisted of a one-man band, surrounded by relatives, ready to counterpunch if slighted in any way and highly impulsive decisions. This apparently has worked well for him in his real estate career based on various personal wealth estimates.

Today, this same approach as president has weakened our link with our traditional allies, caused very high turnover in the executive

branch of government, and encouraged his flaunting the rules of law which restrict his playing field. He is giving the impeachment investigation new evidence periodically in his inability to adjust to the government laws and the Constitution versus New York real estate customs. If he had a top adviser or a talented older relative who could guide him, it might get him back on track. However, that's unlikely with his history, age, and wealth. So, in some ways, we're watching the President of the United States implode before our eyes.¹ The pullout in Syria is the most recent example of this decision making.

The strategy of violating rules and laws and tying it all up in a delaying tactic through the court system will slow things but this pattern of action seems to be causing independent voters to agree with the Democrats as the national polls show voters favoring impeachment by over 50%. If this continues Senate Republicans will have to reassess support for the president. Six or more Republican Senators are already wavering.

The Democratic Situation

On the Democratic side, Elizabeth Warren and Joe Biden seem to be in a category by themselves pursuing the presidency. Bernie Sanders being sidelined with a health issue will only help Warren who shares many of Sander's ideas.

MANAGEMENT

There's a fork in the road ahead of you when you're promoted to a higher position in business. If you go to the right, you think that you deserve this promotion, which is mostly ego. If you go to the left, you will think more of your growing responsibilities.

In going to the right, you're comfortable living isolated from your subordinates in a walled community, traveling on corporate jets, shopping at exclusive shops and knowing you deserve this. If you go to the left to the responsibility trail, you feel an obligation to perform going forward for the good of the company and all of those under you who are doing a lot

of the heavy lifting so that the future will be rewarding for all.

You can enjoy the fruits of your past labor and connect with your subordinates if you get your head in the game in realizing how important they are in your success and giving them lots of TLC. Smaller company execs have a major advantage here because they most often know the names of most or all their employees and can personalize this process.

We said it before in our website quote of April 29, 2019, but it merits repeating:

"After leveraged buyouts, outsourcing, downsizing and rightsizing in American corporations, starting in the mid-1980s, employees were too often treated like commodities. It is amazing what employees will do for a company if they believe they are valued."

INVESTING

Current Markets

Equities in the U.S. are at or near peak levels even with mixed 3rd quarter earnings reports.

Measuring Business Financial Success

One of the most basic measures to gauge a company's success financially is to review the percentage return on equity invested in the business. In many successful companies in growth industries, return on equity is above 20% using modest levels of long-term debt.

While there are exceptions, most successful companies have a high-gross profit margin (above 50%) which enables them to cover their expenses and make a decent profit.² Within the covering of expenses, there is a key expenditure which is the dollars spent on research and development for new products and services. Without significant expenditures for new ideas,

¹ Psychologists and psychiatrists would have a fine-tuned clinical definition of this condition, but we'll use implosion for our purposes.

² The companies that are successful with lower gross profit margins usually have the advantage of large economies of scale.

companies have lower gross profit margins and little funding for new ideas which seals their fate.

Simply stated, that which is easily done doesn't pay much. So, if a company chooses to offer ordinary products and services, it usually gets ordinary results. Compounding this problem is that many employees in R&D are more comfortable working on ordinary products and services and avoiding the risks of attempting to accomplish tasks that are much more difficult.

Creativity

Creativity is the heart of creating better products and services. Creativity is always in short supply. To manage the process, it usually requires more flexibility to handle odd requests such as not working normal business hours. If you have employees that have high creativity, they have to be protected a bit because they can be very valuable in contributing to the company's future success.

While it is only one example, our most successful venture capital backed technology company had 105 R&D engineers and it was determined that only three were capable of truly original thought, but they made all the difference in building the company into a world-class competitor. Unfortunately, this skill is mostly in place at birth where the wiring in the brain is different. Training won't improve it much for those not blessed with this unique brain wiring.

The moral of the story: Invest in companies with unique products and services that have developed skills in attracting and retaining creative employees.

A PARTING SHOT

Whenever you get too full of yourself, you might do well to reflect on the following questions and observation.

- Where would you be today if you were born into a large family in an under-developed country where family income is less than \$1,000 per year?
- Where would you be today if your country was torn apart by war, drought and disease?
- Where would you be today if your schooling only went to ninth grade and your education was over?
- In addition to the above, realize that you had no influence whatsoever on establishing your IQ.

Keep working hard and have a good plan, but add a little humility to the process and be thankful for your blessings. Gratefulness is a powerful factor in your outlook on life.

Wishing you an early Happy Holiday Season.

Respectfully Submitted,



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