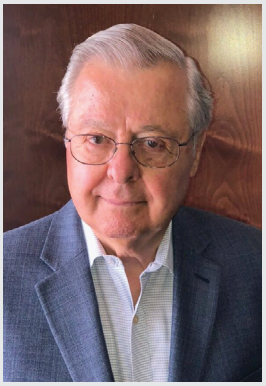
ISSUE 8 | JULY / AUGUST 2020

The Horsch *Business Report*

Helping you grow your career and your company



LARRY HORSCH

INTRODUCTION

As we move into the second half of 2020, the U.S. is opening up from the coronavirus lockdown and coping with the aftermath of the George Floyd murder in Minneapolis. We will be learning the eventual outcomes of each of these factors in the next few months.

We continue to seek your reaction to the Report and suggest you refer your friends to our website for the Report listed below.

THE ECONOMY OVERVIEW

Having reached a peak of 19% (the corrected figure) unemployment in the U.S., we are now seeing the rehiring process begin particularly in the hard-hit hospitality industry. While some believe that there could be a quick economic recovery with the aid of the Federal Reserve and U.S. Treasury action, it seems more likely that a more gradual recovery will occur that will accelerate when an effective vaccine may be discovered in 2021.

The premature opening in several states is causing a spike in the virus, which only prolongs the semi-lockdown situation. Until the public believes it is safe to engage in certain activities, it is really a waste to open up those activities.

While there is a delicate balance between more federal assistance and the size of the federal budget deficit, it is likely that more assistance will be needed to help the states, or they will be curtailing some public services.

As we have said before, there is no playbook for business executives or government officials to address the virus-induced sharp recession. Everyone's skill in improvising is being tested.

While consumer confidence has begun to recover from an earlier collapse, many unemployed workers are getting state and federal unemployment benefits that exceed their normal pay. At the moment, the federal $600 per week payment ends on July 31, if it is not extended. If not extended, the harsh reality of job loss will set in.

WASHINGTON SCENE

In a weakened economy, President Trump is continuing to cause controversy by firing inspectors general in various federal agencies and is experiencing high turnover in the executive branch. These factors are assisting Joe Biden in the polls regarding the November election. He had a four-point lead several weeks ago, which expanded to a nine-point lead a few weeks ago, and he now has a 14-point lead with four months left until the general election. While President Trump's campaign has significantly more money on hand than Biden's campaign, he is missing an effective theme for the campaign. John Bolton's book is also not helping President Trump, as Bolton lays out his arguments that lead to his conclusion that President Trump is woefully lacking in skills needed for the office of the President of the U.S.

As Joe Biden is reviewing Vice Presidential candidates, it seems likely he will pick a Black woman, but, at his age, it is critical to have someone with experience on the national and international scene ready to be President if Biden's health fails.[1]

MANAGEMENT

Management Challenges

The basic challenges in management today are:

- For tech companies, the challenge continues to be the creation of interesting new products to propel growth (as usual), while dealing with China as a troublesome large supplier, along with some likely monopoly lawsuits on the horizon.
- For hospitality companies and cyclical companies, the challenge is survival as we see an 80% dip or more in revenue for airlines, restaurants, and catering businesses, while cyclical companies are reforecasting the balance of 2020 downward and hoping for the best in 2021.
- For the large, well-financed, noncyclical, slower-growth companies, the challenge is reorganizing the normal work routine between formal offices and working at home, while tightening expenses for some revenue losses near term. Many latecomers to the Internet are having to play catchup to stimulate their internet sales that are growing much faster than any other sales channel.

The China Challenge

U.S. businesses doing a large volume in imported Chinese manufactured goods are struggling with tougher U.S. policies towards China as China flexes its muscle in Hong Kong and the South China Sea. Vast supply networks have been established over many years but are of questionable long-term value if China continues to flaunt world opinion on both domestic and international issues.

The Company Offices

While Congress ponders giving businesses partial immunity from virus lawsuits brought by their employees, employers are asking employees to return to their former offices and sign papers reducing their right to sue the company on matters relating to the virus. Many large companies are not planning to request employees to return to their formal offices until 2021.

If public schools (K – 12) do not open physically this fall, many families are faced with one or two adults trying to conduct their business from home while attending to the educational needs and other needs of their children, adding a certain level of confusion.

Management and Shareholder Interests

Management of U.S. corporations often get pressure from shareholders who are short-term oriented to do things that increases short-term earning power but may not be in the best interest of the organization long term.[2] One solution to this problem is to get the shareholders on the same page as management. This involves viewing the company as a three years investment, which is the minimum planning cycle for most significant businesses. To accomplish this, we would do the following:

- Change the long-term capital gains tax for taxable entities from a minimum of a one-year holding to a minimum of a three-year holding to qualify for long-term capital gains treatment.
- For non-taxable entities, such as pension funds, the tax rules would allow them to be taxed if they fail to hold their investment for a minimum of three years.

While some will say the short-term outside pressure helps to keep management on its toes, the negative influences more than offset those ideas.

Of the many corporate raiders that attempt to influence short-term results, only a minority have people on their staff that understand managing the business under consideration. Most are into "financial engineering," which more often than not involves increasing the corporate debt to boost shareholder results. Many of the companies today dealing with bankruptcy have basic businesses that are OK but have large amounts of debt that cannot be serviced.

The Human Resource Department

The human resource function in the U.S. ranges from the low-end organizations involving former English majors who keep the management group abreast of the law regarding employment. At the high end, the human resources departments employ professionals who are highly skilled in assisting top management in important training ideas, career development and promotion ideas, remedial action items, as well as employment law.

In the middle of these activities is the concept of confidentiality. If a company uses a 360-degree reporting concept where subordinates grade out their boss, there are two different outcomes depending on how the human resources department is positioned on the concept of confidentiality.

- At disorganized companies, this 360-degree review is almost useless, because the person being judged will discover who voted against him or her and will seek retribution.
- At advanced companies, the 360-degree review will be an important way for a manager to improve through confidential feedback that will help his or her long-term performance.

INVESTING

Current Speculating

We currently have millions of amateur investors suddenly finding that trading the stock market may be more interesting than doing normal hard work. The current flood of new speculative traders is being driven by:

- Unemployment – people with time on their hands
- Internet trading sites that have zero commission rates
- The absence of sports betting

- The quick spread of information and rumors that are communicated through the Internet in minutes

THIS TYPE OF SPECULATION ALWAYS ENDS BADLY.

Return on Equity

One of the most basic financial tools to judge potential investments is the company's profit return on the stock investment, which is more commonly known as return on equity (ROE). While it is most useful when the balance sheet has only modest amounts of debt, it really indicates how profitable the company is able to use shareholder funds.

High ROE can be created by low-profit margins and high-equity turnover (example Costco) or high-profit margins and low equity turnover (example: drug companies). Either way, management is using the shareholders' funds wisely.

While many investors get mesmerized by watching which stocks are moving up, the simple fact is if you don't know the ROE of the company under consideration, you really don't know much about the company and its ability to use capital wisely, including your capital.

A PARTING SHOT

Most creative people will tell you that their most creative time during the day is early in the morning. At the same time, on a worldwide basis, employees are spending almost one hour each way commuting to their jobs in major metropolitan areas. During the pandemic, a growing number of employees have seen the advantage of working at home and some employers are more open to the idea as a permanent concept.

Could it be that the pandemic will allow more people to trade the tension and frustration of driving to work and back for a more interesting interlude where the change is creating more new ideas?

Respectfully Submitted,

Larry Horsch

Larry Horsch
Founder and Editor
Minneapolis, MN
July 8, 2020©

[1] Being a mayor of a major city or a member of state government would probably not qualify a candidate for the Vice President's job.

[2] Costco has often been challenged to get rid of their fulltime employees with medical benefits in favor of part-time employees with no medical benefits to improve their short-term performance despite their excellent long-term results. Target has been pressured to sell all its real estate and lease it back to generate excess cash, much of which would be used to buy its shares back. Consultants hired by Target advised against this.

Published by the EM&F Communications Division of Eagle Management and Financial Corp. founded in 1988.