Leyendecker & Associates

Consultants In Executive Search

ARMCHAIR ECONOMIC PERSPECTIVE
Back to the Future
August 2009

It is natural to compare today's economic circumstances to those from history. It is most natural to compare things to our personal history, our personal experience. We only really know what we know from personal experience. Personal experience is the lens we look through every day.

Not long ago a good friend sent me an e-mail containing information that seemed unreal. According to his e-mail, the United States has 20 sq ft of retail space per capita, that's 20 sq ft for every living man, woman and child. This information wasn't so shocking until he compared it to Europe, where they supposedly have 2 sq ft of retail space per capita.

"Could this be?" I thought. That seemed outrageous. The US has 10X retail per capita compared to Europe, an economic environment of comparable size and with comparable population. Of course I had to ask my search engine. Sure enough, there it was in an article in the definitive retail trade magazine, Shopping Centers Today. 10X capacity is real, oh my gosh!

After throwing these stats around with some friends who humor my economic ranting I settled down to consider that yes, there are conditional differences. Europeans live in much higher density cities and in much smaller homes. Higher density cities provide less available free space for malls and WalMart anchored shopping centers. Smaller homes require less stuff. But do Europeans live in homes 1/10 the size of Americans? Back to Mr. Search Engine.

From rummaging around the Internet I saw several references to the average US home size in 2006 being about 2,300 sq ft. Then from a 2006 report by the EUPC, Europe's homebuilder trade association, I was able to determine that the average European home was about 900 sq ft. This suggests that Americans live in houses about 2.5 times the size of Europeans. So do we need 10X retail per capita if we only live in 2.5X larger homes? On the basis of this comparison it would appear we need about 5 sq ft of retail space to reach equilibrium with Europe.

This is obviously a cocktail napkin analysis, which is what you should expect from the Armchair. Time will eventually tell if we need to go from 20 sq ft to 15, 10 or 5, but the bottom line seems to be we need to shrink significantly.

Consumers are going to spend less money. Millions of personal balance sheets need fixing. Millions of baby boomers do not have adequate savings for retirement. In addition, Washington is pushing policy more and more towards European standards with nationalized health care, carbon policy, larger social safety net programs, more regulation and bigger government. Washington's "fix" is only going to mean higher taxes, higher fees and a higher cost of living. Stretched personal balance sheets plus a higher cost of living do not add up to robust retail spending.

Supporting that 20 sq ft of retail space are consumer products, media and advertising, warehouses, transportation systems, retail developers, construction products, construction companies, landscapers, maintenance workers, power generation facilities and all sort of service professionals. Not only do we have over capacity in retail but we also have over capacity in everything that supports retail. Guess what? Jobs are going to disappear in all of these industries.

Armchair Economic Perspective
Back to the Future
August 2009

Now let's go Back to the Future.

I started in the recruiting business in Houston in 1979. The local energy based economy was booming. Inspired by the 1970's OPEC oil embargos, the price of oil rose from around $3.50 to about $35 a barrel between 1973 and 1981. That 10X increase in the price of oil drove massive amounts of capital into oil and gas exploration. In 1981, the peak year for oil prices during that cycle period, the number of drilling rigs searching for oil and gas in the US reached as high as 4,530. For the next five years the number of drilling rigs free fell all the way down to 663 in July of 1986. Rig usage then "recovered" to a range between 700 and 1,000 for the next nine years.

What happens when you have the capacity of 4,500 drilling rigs and the "new normal" might be 1,000, an 88% decrease? What happens when you have retail capacity of 20 sq ft and the "new normal" might be 5 sq ft, a 75% decrease?

Given our massive over capacity in the oil patch, the Houston and Texas economy did not seem to recover until the mid 1990's. Peak year was 1981. Recovery point was mid 1990's. It took about 15 years to work off the excess capacity of drilling rigs, support equipment and support services for 4,500 rigs. Taking this analogy, and given the massive amount of retail built to support a consumer based economy it would seem the US economy has several more years before it finds a "new normal".

For the US this means we have to shrink assets and people supporting our 20 sq ft of retail per capita down to meet the future "new normal" demand. During this shrinking phase there will be lots of bankruptcies, loan write offs and employment losses. Asset values everywhere are going to follow asset values of homes…down. In addition, you can't control prices and gross margins when there is excess capacity. The financially weakest companies always set price at surviving one more day, so profits for many companies will be elusive for many years.

This is our foreseeable future, our back to the future. We have to contract many things in the US to meet the "new normal.

During every stage of the economic cycle there is opportunity. Many of the greatest companies are founded during the deep dark depths of depression. Over the next few years Wal-Mart's and Microsoft's of the future will likely be started. But also during this period we are going to see the destruction of many well-known and well-regarded companies as well as thousands of smaller enterprises. Back to the future we will find that "new normal", but as my personal experience suggests the adjustment period could be more years than you have fingers.

Douglas A. Leyendecker
713-862-3030
doug@leyendecker.com