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The law of unintended consequences

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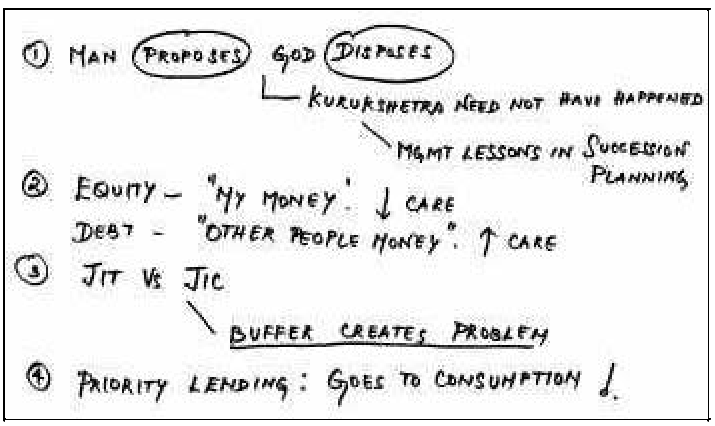

"MAN proposes, God disposes," said China sipping in his third cup of coke. Wafers scorned. She trusted no God; she believed that Religion and *Vasthu* were the *mantras* of insecure souls.

Muscles, studying to be a heart surgeon, interrupted her thoughts saying, "That's not what China means. What he means is that many of our actions have unintended consequences."

Muscles explained, "Look, things don't often happen the way we expect them to."

And he resorted to the epics to make his point. "You know," he said, "my take is that the Kurukshetra could have been avoided."

If there was one thing Wafers disliked more than Taxation, it was to have Muscles pontificate. When he did that he was unstoppable.

"In the Mahabarata, Bhishma made the younger son, Pandu, the king, instead of the older Dhritarashtra. The logic being that a blind Dhritarashtra would not be able to govern the kingdom effectively," said Muscles.

Wafers wasn't able to understand the significance.

But China cottoned on. "When Pandu died early and Dhritarashtra took over he had a one point agenda — to perpetuate his dynasty. And that deepened the animosity between the Pandavas and Kauravas , leading to the Kurukshetra", he said.

Muscles rubbed it in, "Had Dhritarashtra been anointed King to begin with, his confidence in planning the succession would have been high. Probably, he would have remained a titular head with the real powers vested with Pandu. Perhaps he would not have been unfair to the Pandavas."

China echoed Muscles, "Kurukshetra might not have happened." And this he defined as, "The law of unintended consequences".

Wafers was beginning to understand. She wondered to herself whether there was a certain analogy to this in finance, "Like, in Capital Structure. Managers often prefer equity to debt since equity is perceived to be cheaper. Debt involves mandatory principal and interest payments. With equity, there is no compulsion to pay dividends. And rarely is equity capital returned to investors. So managers take things easy with equity funds".

China read her mind to the tee. And remarked, "Yes. That's precisely why the dotcoms folded up in the early 2000s. They had access to easy venture capital funding, they never understood the importance of equity." Wafers was aghast. She cursed, "People read my mind like a book."

Of course, she kept her thoughts to herself.

China explained, "Debt is perceived to be risky, companies tend to be more careful with the debt money. And debt often brings in quite a bit of discipline and leads to better financial performance."

Muscles added, "Leveraged buyouts are based on this very same principle." Ha, the law of unintended consequences at work.

Wafers nodded. Only the other day her professor, who taught inventory control, had told the class about "just in time".

He had remarked, " While the Japanese follow JIT (just in time), Indians follow JIC (just in case)". She had smiled then. Now she understood.

Managers maintain inventory because it acts as a buffer against uncertainty. Inventory comes in handy if a supplier delays delivery.

In the JIT system, hardly any inventory is kept. The entire plant stops if something goes wrong. Hence, the risk.

But companies like Toyota, are aware of the consequences of things going wrong in a JIT system. So they ensure that suppliers always deliver on time.

On the other hand, companies like Titanic (the multi-million dollar company that Wafers audited), which hold huge inventory, quality control is slack and vendor management slips.

In short, holding inventory undermines the effectiveness of the plant. Instead of acting as a buffer, the inventory creates problems! The law of unintended consequences!

Knowing Wafers' weakness for business-oriented examples, China decided to volunteer an analogy with small-scale industries (SSI). "After independence, our political leaders decided to promote SSI. And so many areas were reserved exclusively for them and they were given special concessions. The results were disastrous. Today, most units in the SSI sector are sick. Given the scale at which they operate, few SSIs have the financial or marketing warewithal needed to survive. The healthy units have decided to go slow on growth so that they can remain within the ceilings prescribed, and continue to enjoy the SSI status." What a shame indeed.

Wafers recalled an editorial she had read in a financial daily. It read, "During the 1990s, successive Indian governments consciously lowered interest rates. The belief was that lower interest rates would boost investments. But what has happened is the opposite. Banks are unwilling to lend to industrial projects, as their risks are not covered by these low interest rates! Instead they have chosen to invest in government securities. At the same time, they have opted for consumer financing where the spreads are higher and the risks lower. The result — rise in consumption expenditure on consumer durables. Instead of boosting investment, lower interest rates have increased consumption."

Ha, the law of unintended consequences thought Wafers.

China volunteered a global example. "Germany and France, have imposed restrictions in the labour market in areas like firing and minimum wages. The aim — to protect workers. The outcome — reluctance by companies to recruit workers. Companies realise that once they hire workers, it will be difficult to retrench them. In short, labour legislation has ended up hurting their interests, instead of helping the worker!"

Wafers decided to make a mental note of what these tales revealed. That actions give a certain appearance on the surface but deep down, they are different. If we overlook the deeper issues, the most logical decisions will lead to unintended consequences! Some lesson indeed.

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