Exogenous Shocks

Exogenous shocks are unexpected or unpredictable events that occur outside an industry or country, but can have a dramatic effect on the performance or markets within an industry or country. A sudden hike in interest rates, Britain leaving the Exchange Rate Mechanism in 1992, the Far East Currency Crisis of 1997, the hurricanes of 2006 the credit crunch of 2008, and terrorist atrocities are all examples of exogenous shocks.

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The great problem for businesses in the 70s and 80s was that although exogenous shocks were specifically unpredictable, it still seemed likely that they were going to occur and their impacts were predictable. A large shock would push up prices, deflate demand and of course reduce profitability. This all meant that firms were loath to expose themselves to the impact of these shocks wherever they might arise. So firms played it safe, concentrated on markets that they knew, and limited investment and risk.

Over the last 15 years the economy has become more robust, the effects of shocks in general have become less catastrophic, and as a result firms are less dictated to by the unknown, or unquantifiable.

Even so exogenous shocks do still occur and their consequences can be dramatic for sections of the economy. To see what can occur we can examine the example of the Foot and Mouth outbreak of 2001

The 2001 Foot and Mouth Disease outbreak had a devastating effect on farming, food production and tourism, and wide side-effects on other parts of the economy. Millions of animals were killed, creating enormous problems of disposal and compensation.

On 18 March 2001 the *Sunday Times* reported that the Foot and Mouth outbreak could;

> "cost the economy £9 billion and deprive the chancellor of nearly £3 billion in tax revenues".

The calculations, which were undertaken by the Centre for Economics and Business Research, indicated that the losses for tourism alone could be £8 billion (£2.7 billion from domestic tourism and £5.2 billion from overseas visitors). According to the same survey, farming and related industries might be affected by up to £3.6 billion. With some of the domestic tourism spending being diverted to other parts of the economy the CEBR estimated that the **net** effect on the economy was £9 billion.

The Institute of Directors carried out surveys that showed that the Foot and Mouth outbreak had a major impact on many member businesses – and not just farming. According to the 2001survey of 600 IoD (Institute of Directors) members, the tourist industry and transport, in particular, suffered the most. Around a third of members of the said that their businesses were being significantly affected with losses incurred averaging over £50,000.

The most heavily affected sectors were

- Agriculture—animals could not be taken from the farm for slaughter, so leading to lost profits. Entire herds were culled—destroying long term investment in breading stock. Many farmers quit the industry after the outbreak.
- Hotels, restaurants—limitations on movements within the effected areas also applied to people. So large areas of the countryside were simply out of bounds. People booking walking holidays, or involved in countryside pursuits etc. simply cancelled bookings. There was also a large fall in bookings from overseas.
- Distribution, and transport. With no animals to transport hauliers were short of work.

The most heavily affected areas included the North East and Wales with the South East (including London) the least affected. .

There was of course the other side to the coin, after all every cloud has a silver lining. Retailers did particularly well during the months of the Foot and Mouth Outbreak, as residents - and indeed tourists - locked out of the countryside went on shopping sprees in the towns instead. Retail sales in May 2001 grew at their fastest annual rate since July 1997.

Notes.