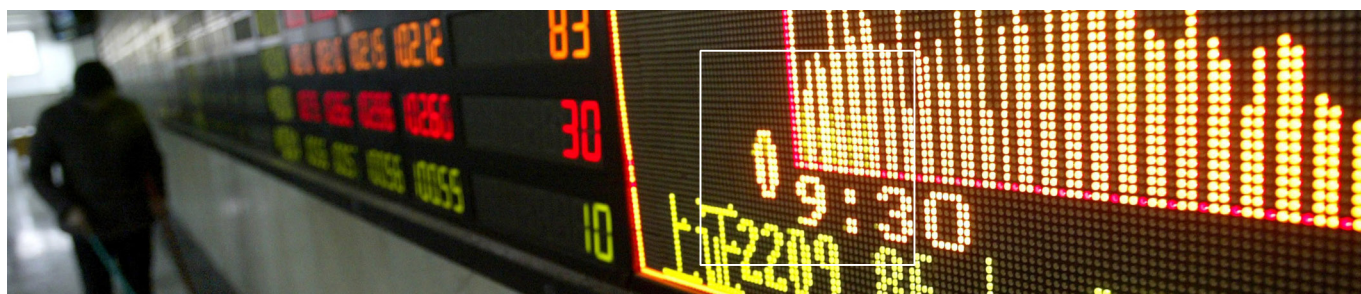


Waking up in a new world

Results of Arthur D. Little's global survey on the economic crisis



If only it was just a nightmare. Unfortunately the harsh reality is that virtually all economies and all sectors worldwide are simultaneously going through a brutal downturn. The speed and depth of the fall over the precipice have caught us all by surprise. But six months into the financial and economic crisis, let's no longer dwell on the pain it is inflicting. Let's rather focus on what the crisis means to business and how business can prepare for the time beyond the downturn.

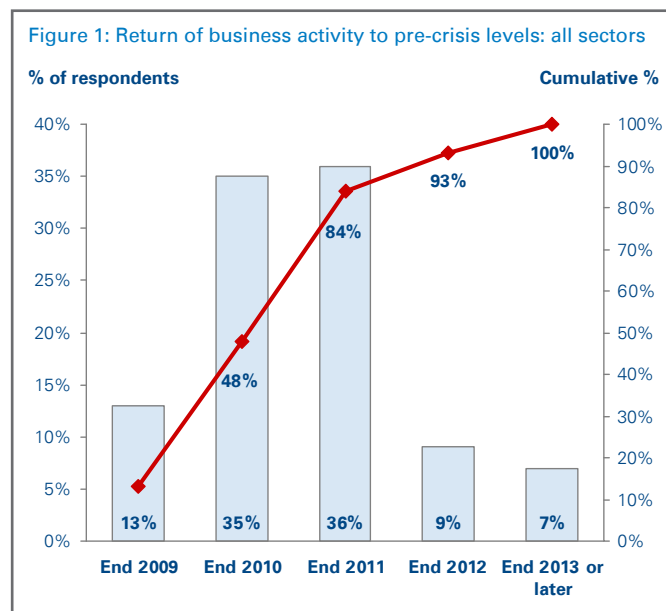
To that end, Arthur D. Little has conducted a global survey among senior executives of companies of all sizes and across all industries (see insert for more details about how the survey was done). This report provides a summary of the findings. In short our conclusions are:

- The large majority of executives (84 per cent) expect business to have returned to pre-crisis levels by the end of 2011 at the latest. This is a rather positive outlook given the depth of the downturn so far.
- Almost three quarters of respondents (73 per cent) say that this crisis is not so much a cyclical downturn as a fundamental questioning of the way businesses are run. In particular, it is expected to lead to a clearing-out of weaker competitors, and government is expected to play a much more active role in business.
- While almost all respondents are taking the unavoidable short-term cost-reduction measures to cope with the collapse in demand, a large number are simultaneously taking actions to prepare for the new world to come beyond the downturn.
- For example, in the midst of the downturn close to 60 per cent of respondents are giving very high or high priority to rethinking the company's medium-term business vision. Likewise, more than 40 per cent of respondents are still giving very high or high priority to preparing for the low-carbon economy. And more than 70 per cent are giving very high or high priority to improving their company's risk-management capabilities.

Let's look at each of these findings in more detail.

Back to pre-crisis activity levels by the end of 2011

One interesting question is when the downturn will have hit bottom. An even more interesting question is when business activity will have returned to pre-crisis levels. Almost half of respondents (48 per cent) think business activity will have returned to pre-crisis levels by the end of 2010. Only a minority of 16 per cent think this will not happen before the end of 2011. In other words, 84 per cent see a return to pre-crisis levels by the end of 2011 (see Figure 1).



About the survey

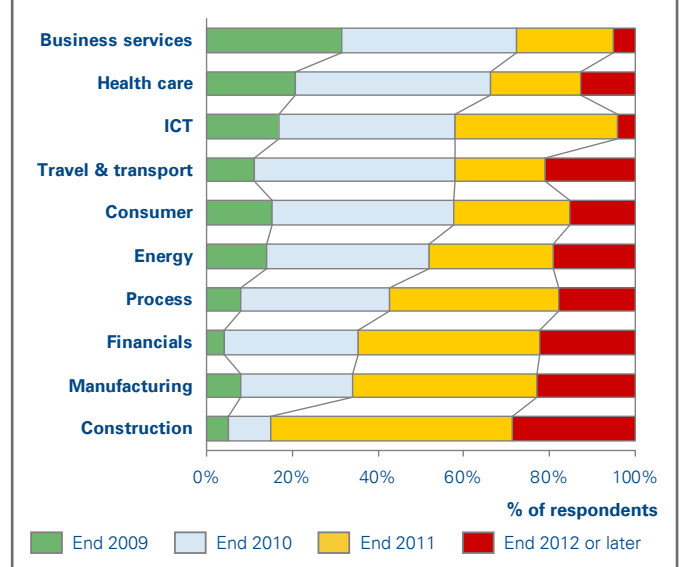
Arthur D. Little's global survey on priorities in the economic crisis was conducted during the first half of March 2009. A total of 363 senior company executives participated. The survey covered companies of all sizes in terms of revenues: less than US\$100 million (22 per cent of respondents), between \$100 million and \$1 billion (32 per cent), between \$1 billion and \$10 billion (27 per cent) and more than \$10 billion (19 per cent). The companies were more or less equally split between stock-market listed (47 per cent of respondents) and non-listed (53 per cent). The companies represented 29 industries that we grouped into 10 sectors: ICT (19 per cent of respondents), manufacturing (15 per cent), financials (12 per cent), energy (12 per cent), process (11 per cent), health care (7 per cent), consumer (7 per cent), construction (6 per cent), business services (6 per cent) and travel and transport (5 per cent). The majority of respondents were based in Europe (77 per cent), with the remainder in Japan (9 per cent) and the rest of the world (14 per cent).

We invited the survey participants by e-mail to respond via a website with controlled access. We purposefully designed a short survey, consisting of closed-ended questions, each with an ordinal scale (e.g. from "very high priority" to "very low priority"). The questions addressed four topics: the nature of the crisis, the impact of the crisis, the priority actions in response to the crisis and the duration of the crisis.

This may be considered a rather positive development. Many industries and companies report or forecast a brutal peak-to-bottom drop in sales by 30 per cent or even 50 per cent. Mathematically speaking, returning to normal then means a steep pick-up by 50 per cent to 100 per cent in two years' time.

Of course, there are significant differences between sectors (see Figure 2). Less cyclical sectors such as business services and health care are the most optimistic, with three quarters of respondents expecting a return to pre-crisis levels by the end of 2010. In more cyclical sectors such as construction, manufacturing and process industries, three quarters of respondents see such a return only by the end of 2011. The financial sector, while not traditionally cyclical, clearly suffers from a different systemic issue.

Figure 2: Return of business activity to pre-crisis levels: by sector



A fundamental questioning of the way businesses are run

It is one thing to consider that business activity will have returned to pre-crisis levels by the end of 2011 at the latest. It is quite another to assume that this means that business will be business as usual. In fact, survey respondents expect the world to look quite different beyond the downturn.

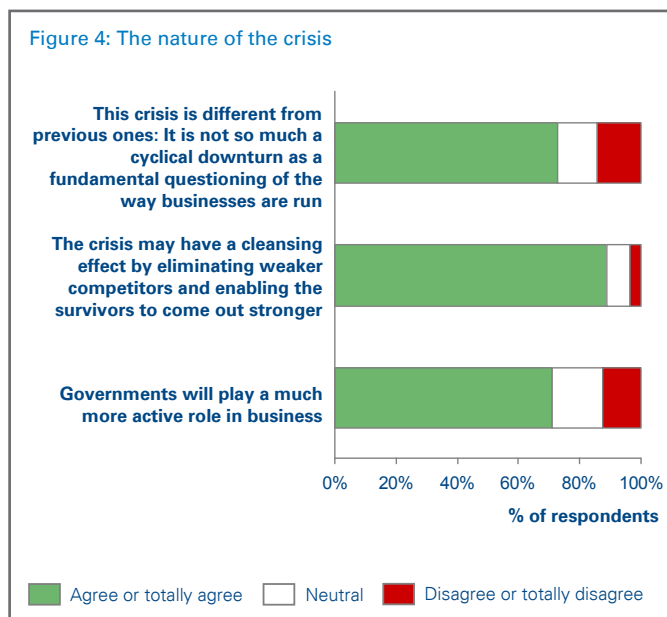
In order to see why, let's go back to the nature of the crisis. There is little doubt that we are witnessing an often-dramatic collapse in demand, which in turn leads to pressure on prices. We are not witnessing a supply shock, with a strong increase in input prices of materials and goods – quite the contrary. The one cost that has risen is, unsurprisingly, financing costs (see Figure 3).

Figure 3: The impact of the crisis on business



There lies the kernel of this crisis. What began as a banking crisis has ended in an implosion of business-to-business confidence across industries. Uncertainty about future sales levels has led companies to run down inventories, postpone capital expenditures and restrain investments, triggering a self-sustaining collapse of demand across value chains. The rise of financing costs has exacerbated the dismal situation.

Of course, credit scarcity will ease and confidence will come back at some point, as it has done after previous downturns. Therefore you might argue that this downturn, even though far more severe, is no different from previous turns in the business cycle. However, that is not what most executives think though. Almost three quarters of respondents (73 per cent) say that this crisis is not so much a cyclical downturn as a fundamental questioning of the way businesses are run. The consequences of this crisis will reverberate long after the upturn has come (see Figure 4).



Two effects stand out. First, almost all respondents (89 per cent) think that the crisis may have a cleansing effect by eliminating weaker rivals and enabling the survivors to come out stronger. The vexing issue for each company owner and executive should be: if my company cannot afford to be part of the hunting pack, when is the best time to surrender, and to whom? And, vice versa, if my company is strong enough to hunt, when is the best time to strike, and at whom?

Second, more than seven out of 10 respondents (71 per cent) think that government will play a much more active role in business in the years to come. It will not only establish the boundaries and steer business traffic but may also be in a driver's seat on the economic highway. The implications for business

are considerable, especially on the regulatory front. Tomorrow's executives will have to engage with government and go beyond conventional compliance. They will have to anticipate the moves of a government that at times is at once referee and a player in the game.

Preparing for the world to come beyond the downturn

If we expect the world beyond the downturn to be quite different from yesterday's, now is the time to prepare for it, and executives are taking a diverse set of actions (see Figure 5). We can put these in three categories which we have labeled "hygiene", "fitness" and "muscle building."

Actions that fit within the "hygiene" category are those that are essential to cope short-term with the implosion of confidence and collapse of demand. Almost no business can avoid rationalising operations and cutting overhead costs: 80-90 per cent of respondents are giving these actions very high or high priority.

Advice on rationalising operations

By Carsten Vollrath, Global Head of Arthur D. Little's Operations Management Practice

In dire economic times, companies should focus not only on survival but also on plans to leverage opportunities for gaining advantage across the entire value chain. The old adage "only the fittest survive" should be rewritten into "the fit will survive but the smart will prosper." This means taking operational improvements well beyond simple "stop the bleeding" downsizing approaches: when re-thinking your global operations strategy and footprint, apply innovative new approaches that lead both to immediate cost reductions and a sustainable competitive advantage. This includes initial capacities adjustments, shop-floor in-sourcing of value-added activities, and optimising processes and organisational set-up. But you should also engage with other players across your value chain to apply common best practices for the benefit of all.

Actions within the "fitness" category are those that aim at preserving in good shape the platform that makes up both the company's heritage and the core of any future growth. Keeping talent on board is a very high or high priority for 82 per cent of respondents. Maintaining R&D and innovation expenditures is a very high or high priority for 67 per cent of respondents. While it is relatively easy to cut costs in those two domains, so far executives by and large appear to have resisted the temptation.

Advice on maintaining innovation expenditures

By Per I. Nilsson, Global Head of Arthur D. Little's Technology & Innovation Management Practice

In a downturn as brutal as this one, customer and consumer needs change. As a consequence, your product strategy and product plan are no longer optimal, either in content or timing. That is why we recommend that you “restructure and reinvest.” “Restructure” means refocusing the product portfolio so that it fits with the changed conditions while reducing R&D spending by about 10 per cent. “Reinvest” means spending the savings from reduced R&D spending on actions that will increase competitiveness during the downturn and in the coming upturn. Such actions include: reducing time-to-cash (being able to develop new products more quickly and efficiently), reducing product costs (increasing profitability) and starting an innovation and growth programme (exploiting windfall opportunities related to technology and talent).

Advice on rethinking the medium-term business vision

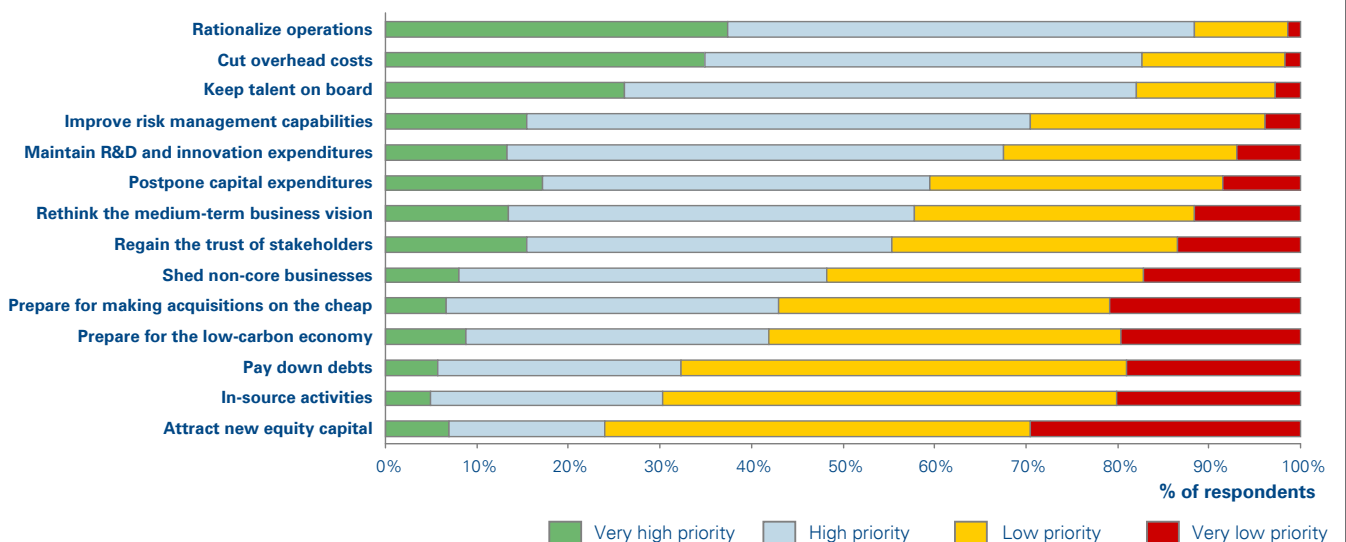
By Petter Kilefors, Global Head of Arthur D. Little's Strategy & Organization Practice

An economic downturn, no matter how brutal, does not change the essence of how to set strategy. Business leaders still need to answer three questions: what is our current position, what is the position we want, and what strategy will bridge the distance? There is one thing, however, that makes strategy-setting more challenging during a downturn: both the current and wanted positions are more volatile than in normal times. As a consequence, companies need humble yet determined leadership. While financial conditions may impose restrictions on short-term actions, necessity is the mother of invention and courage the father of business vision. Those who dare to take this moment of truth to rethink their medium-term vision, update their strategy and invest selectively are bound to outperform competitors caught by downsizing and paralysis.

Actions that fit within the “muscle building” category are those that aim firmly at preparing for the world to come beyond the downturn. It is striking that in the midst of the downturn close to 60 per cent of respondents are giving very high or high priority to rethinking the company's medium-term business vision. Likewise, more than 40 per cent of respondents are still giving very high or high priority to preparing for the low-carbon economy.

Finally, two other actions stand out. More than 70 per cent of respondents are giving very high or high priority to improving their company's risk-management capabilities. The speed and depth of the downturn have clearly been a brutal wake-up call for many companies. They want to spot signals of impending trouble earlier and strengthen their response capability. That is probably one of the more effective ways to shore up their reputation and regain the trust of stakeholders, an action to which about 55 per cent of respondents are giving very high or high priority (see Figure 5)

Figure 5: Priority actions in response to the crisis



Advice on preparing for the low-carbon economy

By Richard Clarke, Global Head of Arthur D. Little's Sustainability & Risk Practice

If nothing else, the events of 2008 showed us with great clarity how short-term our thinking has been. But can we, or are we willing to, learn from our mistakes to refrain from making short-term claims and focus on long-term action? Companies now have the opportunity to position themselves to take advantage of the post-downturn economy. And if we are to avoid charging into a different crisis - one of a dangerously altered climate - we believe we must also be a low-carbon economy. To emerge as sustainable leaders, companies need to develop a carbon and clean-technology strategy that (1) considers the complex (and changeable in the current economic climate) interactions with partners, suppliers and communities; (2) prioritises investments in carbon and clean technology based on a robust business case rather than an attempt to gain brand value, and (3) maximises opportunities to build the issue of carbon into innovation strategy.

Conclusion

Despite the brutal nature of the downturn, our survey has revealed that executives, after all, have a fairly composed view of the current situation and the way forward. They realise that the downturn is giving rise to a fundamental questioning of the way businesses are run, and they are taking action to prepare now for the new world to come beyond the downturn. Given the implosion of confidence that has tugged the economy down, it is no surprise that one of the highest-priority actions is to improve their company's risk-management capability. This will help to achieve one of the other top priorities: regaining the trust of stakeholders. Clearly, the upside of the downturn is that there is no escape from preparing for the upturn.

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Arthur D. Little

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