

Putting the Focus Back Where it Belongs – on Business

Results of Arthur D. Little's 2010 global survey on the economic crisis



It is close to two years since the financial and economic crisis erupted with the dramatic collapse of Lehman Brothers, the impact of which has been felt across nearly all sectors and economies worldwide. As our 2009 global survey revealed, companies have made unavoidable short-term cost reductions to cope with the collapse in demand, but they have also taken actions to prepare for business beyond the downturn. It is now time to focus on the effectiveness of these measures. What actions taken during the crisis have resulted in enduring benefits? What factors are still holding back growth? And most importantly, what are businesses doing to outpace competitors in the post-crisis world?

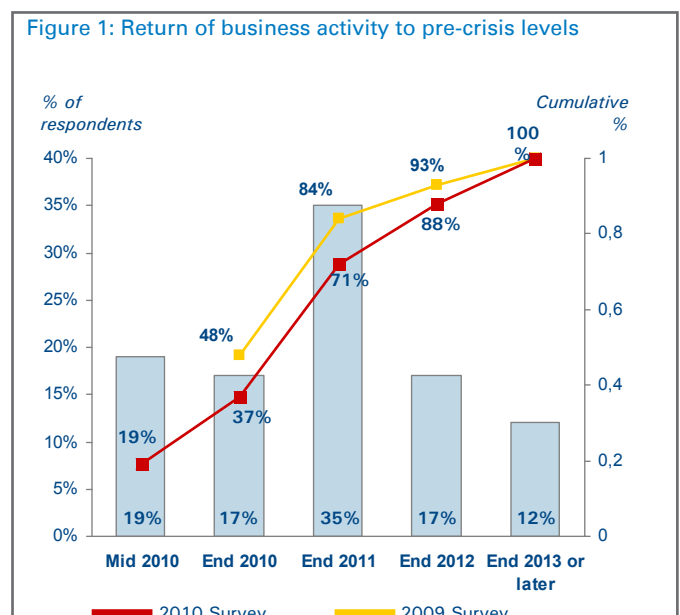
To that end, Arthur D. Little has conducted a global survey among senior executives from companies of many different sizes and across all industries (please see insert for more about how the survey was conducted). This report provides a summary of the findings. In short, our conclusions are:

- A large majority of executives (71 percent) expect business will return to pre-crisis levels by the end of 2011, at the latest. This is a more prudent outlook compared to last year, when 84 percent of executives predicted such a result.
- The notion of “new normal” has few adherents. Only a minority of executives (25 percent) estimates that future growth will be structurally lower than it was before the outbreak of the crisis.
- In-crisis measures related to a company’s core operations are expected to have the most enduring benefits: lower working capital, higher productivity through lay-offs, re-engineered processes, higher capacity utilization through cutbacks, and a rationalized manufacturing and logistics footprint.
- By far the most important factor holding back growth is hesitant consumer demand. Another major concern is the negative impact of government budget deficits on demand generated through public investments.
- Executives clearly see innovation as the most important tool for outperforming competitors. Benefiting from a structurally stronger footing, the battlefield is once again where it should be — concentrating on customers.

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

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

As with our 2009 survey, we inquired about the expected duration of the crisis. Most respondents (71 percent) think that business activity will return to pre-crisis levels by the end of 2011 at the latest, i.e. a full three years after the outbreak of the financial crisis (see Figure 1). Executives appear to be somewhat more prudent than they were a year ago. At that time, 84



About the survey

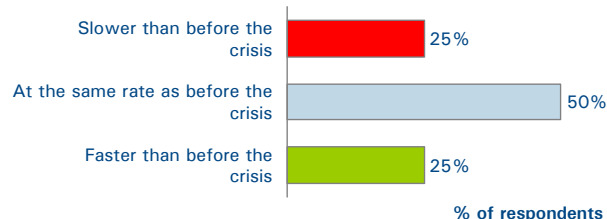
Arthur D. Little's global survey on "Priorities to outpace competitors in the post-crisis world" was conducted during the second half of April 2010. A total of 338 senior company executives participated. The survey covered companies of all sizes in terms of revenues: less than US\$ 100 million (20 percent of respondents), between US\$ 100 million and 1 billion (35 percent), between US\$ 1 billion and 10 billion (27 percent) and more than US\$ 10 billion (18 percent). The companies were more or less equally split between stock market listed (47 percent of respondents) and non-listed (53 percent). The companies represent 29 industries that we grouped into 10 sectors: ICT (23 percent of respondents), manufacturing (14 percent), process (13 percent), energy (11 percent), consumer (10 percent), health care (8 percent), financials (7 percent), construction (6 percent), business services (5 percent), and travel and transport (3 percent). The majority of respondents were based in Europe (80 percent), with the remainder in the Americas (8 percent) and the rest of the world (12 percent).

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 benefits from in-crisis measures; growth expectations; barriers to growth; and actions to outperform competitors.

percent of respondents predicted a return to pre-crisis levels by the end of 2011.

While executives may have become a bit more prudent, only a minority of them (25 percent) adhere to the notion of a "new normal," i.e. that even after the return to pre-crisis business activity levels, growth will be structurally lower than before the outbreak of the crisis. In fact, the very same proportion of respondents (25 percent) projects faster, not slower, growth (see Figure 2).

Figure 2: Growth rate when activity is back at pre-crisis level



Shifting to a "healthy normal"

Executives' optimism, even if it is prudent, may be linked to the fact that many of them expect enduring benefits from the harsh cost reduction measures they were forced to take during the downturn. Indeed, if there is one upside to the downturn, it is that it forced executives to take an integrated look — instead of piecemeal measures — at their core operations (e.g. addressing real operating costs as opposed to financing) and reduce costs structurally (e.g. no one-off effects). The resultant enduring benefits relate to lower working capital, higher productivity through lay-offs, re-engineered processes, higher capacity utilization through cutbacks, and a rationalized manufacturing and logistics footprint (see Figure 3, overleaf). In other words, executives went back to the nuts and bolts of their business for a wholesale makeover that should translate into strong profitability as growth picks up.

Similarly, wholesome effects are visible at the strategic level. The downturn has provided executives with the context to do some serious introspection about their core business, capabilities, and R&D priorities. They are wisely looking for solutions inside their own perimeter rather than outside (e.g. counting on competitor weaknesses or on favorable government policies).

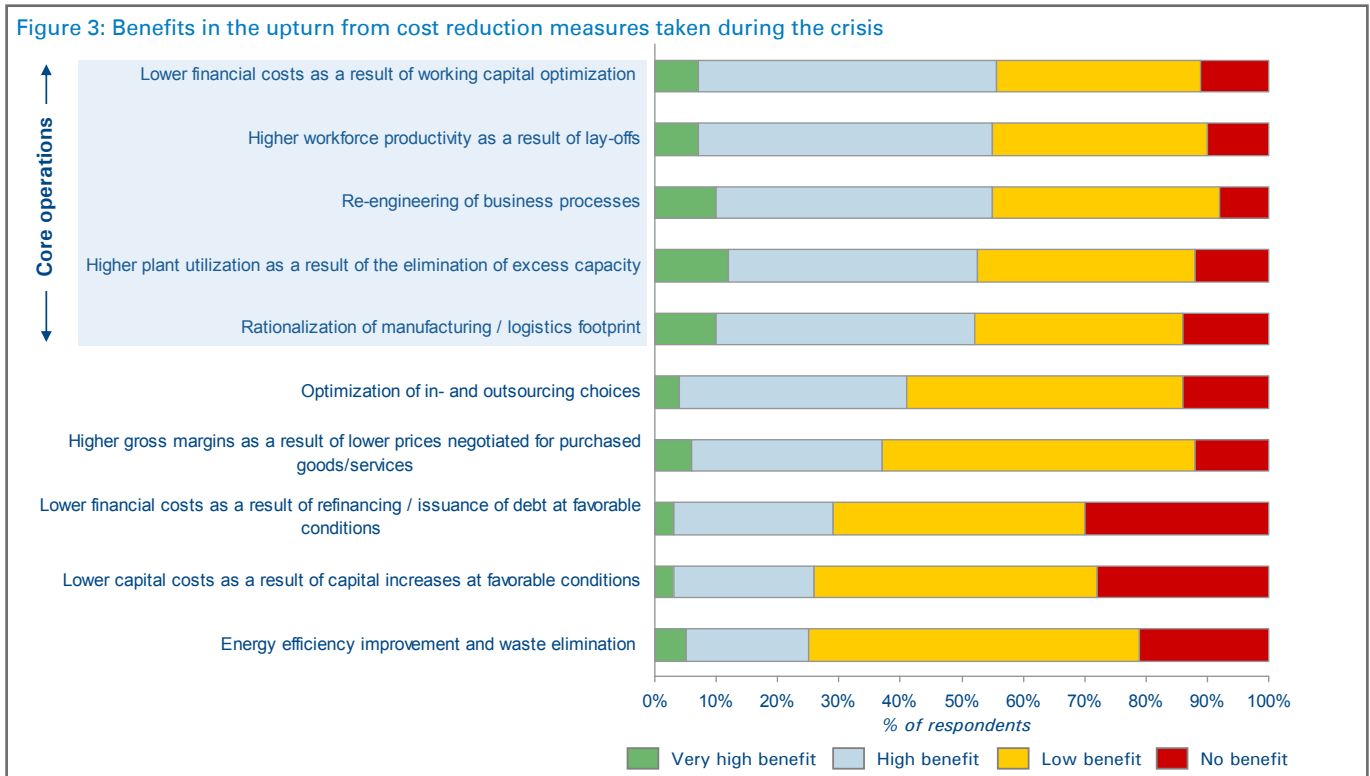
Especially striking is the importance executives have attached to retaining and strengthening their talent pool despite an often-calamitous drop in revenues. While lay-offs have been necessary, especially among lesser-qualified staff, it appears that companies have pursued various initiatives (temporary unemployment, reduced working hours, etc.) to hang on to human talent (see Figure 4, overleaf). Through the survey, business leaders appear to say: "We can blame others — say, bankers — for having gotten us *into* the crisis; but we will only have to blame ourselves for not getting *out* of the crisis."

Reaching out to customers from a healthy core

While the internal makeover has strengthened company foundations, executives are still prudent about their financial outlook. By far the most important factor underpinning this prudence is hesitant consumer demand. Executives also fear the negative impact of government budget deficits on demand generated through public investments. Interestingly, hesitant demand is seen as the consequence primarily of macro-economic uncertainty rather than the lack of innovations that meet customer needs (see Figure 5, overleaf).

Executives are also worried about increases in non-operating costs. Companies have tackled their internal operating costs, as explained above, but increases in the cost of capital, the

Figure 3: Benefits in the upturn from cost reduction measures taken during the crisis



cost of compliance and, to a lesser extent, corporate tax rates could dampen the resurgence of profits. Third in line are price and margin squeezes, be it the result of low-cost competitors, rising commodity prices or lingering industry over-capacity. Least worrisome are external factors such as the cost of carbon or the resurgence of trade barriers.

If consumer demand is still hesitant, executives clearly see innovation as the most important lever for taking a lead on competitors. Responding to unmet customer needs effectively

and increasing new product launch frequency are more important than entry into new segments or new geographic markets. These in turn are far more important than making acquisitions.

Consequently, the heat is on for companies to leverage their "core" that was restored to health during the crisis, and innovate their way back to the customer. The three side texts overleaf provide some advice from our global industry practice leaders.

Figure 4: Benefits in the upturn from strategic measures taken during the crisis



Advice to executives in the energy and chemicals industry

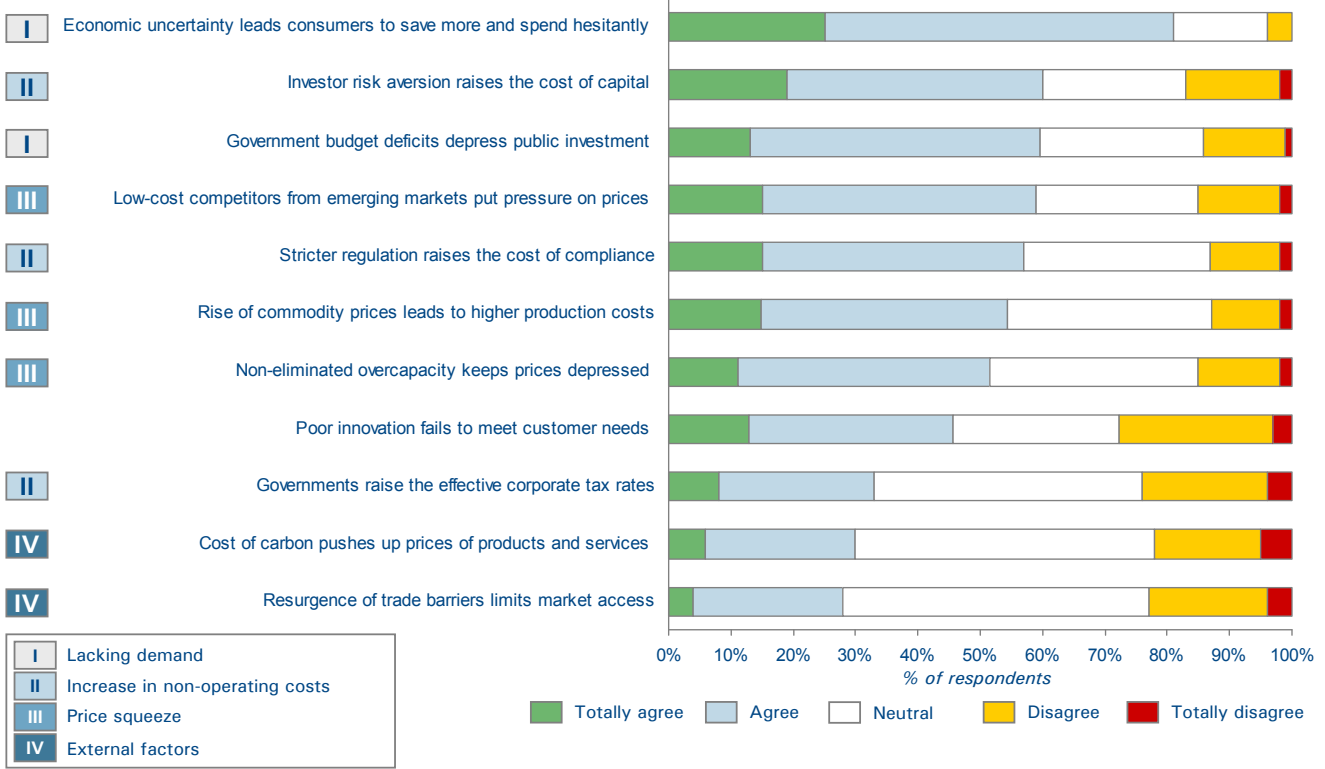
The financial and economic crisis struck fast and deep. The fall in demand triggered a commodity price decline with a dramatic effect on inventory. Process industries executives acted quickly, shuttering capacity and halting capital spending through much of the crisis. The recent demand rebound has tightened supply conditions across many segments and improved financial performance. Moving forward, executives will need to focus on repositioning and industry shaping, in response to the changed industrial demand profile worldwide, as well as shifting geographic footprints. Cross-border transactions will play an important role in shaping the industry and allowing new growth-centric sovereign players to diversify their commercial portfolios. As the industry evolves, participants will need to reflect on their portfolios and consider new sources of growth and new business models to ensure competitiveness and consistent value generation. Alternative energy, "smart" power, and bio-based chemistry all present new and dramatic growth avenues for our industries.

Advice to executives in the telecommunications and media industry

By Klaus von den Hoff, global practice leader

To succeed in coming years, the telecoms sector must achieve a totally new level of "lean & agile." On one hand, operators will need to opt out of certain business areas, outsourcing larger parts of their operations and adapting to a much lower cost level. Their strategies should include reductions of OPEX and postponing of CAPEX through consolidation of fixed & wireless networks, network sharing co-operations, and offloading mobile data traffic. To ensure survival in the future telecoms market, their goal must be to produce the cheapest and most cost-effective traffic. On the other hand, operators should explore new business opportunities in adjacent markets such as car telematics, media distribution, energy sector solutions, and efficiency-improving e-health offerings. This will require innovative and advanced solutions by verticals — and a completely new market approach.

Figure 5: Factors holding back growth



Advice to executives in the automotive and manufacturing industry

The economic crisis hit the automotive and manufacturing industries very hard. Executives have taken measures to streamline operations, cut costs and re-focus on core competencies — but they must go further. They need to anticipate trends and challenges, and align their company strategies accordingly. Automotive executives should recognize and act on the shift towards emerging markets, the e-mobility challenge, the new competitive landscape, and changing customer requirements. Similarly, manufacturing executives should bring their strategies in line with opportunities linked to emerging markets, energy efficiency and renewables. Having fortified their base during the crisis, executives should now focus on technology and business model innovations to remain competitive in a changing business environment.

Conclusion

Clearly, business leaders would have preferred the downturn hadn't happened. But at least it forced them to take a fundamental look at the core of their business, and thus put it on a structurally stronger footing. As a result, the battlefield is once again where it should be — with customers. The immediate challenge is to find innovative ways to persuade still-hesitant consumers to open their wallets.

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Arthur D. Little

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