

SCENE STILL BAD, BUT STABLE

Economic conditions snapshot: March

Company executives forecast continuing economic gloom but, for the second quarter in a row, the good news is that the percentage of respondents who think the situation is worsening hasn't increased, according to a McKinsey quarterly survey. A gloomy economic stasis has taken hold, responses to the survey conducted from 10 March to 16 March—indicate. The percentage of the executives who say economic conditions have gotten worse at the national level hasn't increased, but fewer than a third expect an upturn this year.

Executives overall are confident with how their companies are managing the crisis, though 53% expect profit to drop in the first half of 2009, and the number expecting to shed workers has jumped 8 percentage points in six weeks. Companies that executives describe as well managed are more likely than others to reduce both operating costs and capital spending—and perhaps not weaken operations a great deal, because these companies are also more likely than others to be improving productivity. The survey shows that most companies are not actively seeking more cash. Respondents thought "bad banks"—institutions created to hold bad loans of banks—are a good idea, disagree on whether chief executive officers are paid too much, overwhelmingly said the public trusts business less than it did before the crisis—and laid the blame at the doors of financial firms. The survey garnered 1,630 responses from executives across a range of regions, industries, and functional specialties.

At companies that executives regarded as well managed during the crisis, nearly one-third of respondents expect profits to increase in the first half of 2009, and 15% expect to increase the size of the workforce

Reprinted with permission, ©2009/McKinsey & Co. The article was originally published in 'The McKinsey Quarterly' and can be found on its website, www.mckinseyquarterly.com

Graphics by SANDEEP BHATNAGAR/MINT

MCKINSEY GLOBAL SURVEY RESULTS

Big questions

There is no ambiguity among respondents about whether trust in business has fallen as a result of the crisis: 85% say it has—and by a wide margin—they blame the decline mostly on financial firms' misunderstanding of risk.

That response holds even among executives at financial firms. Among respondents who selected "other," many specified "greed". There is much less consensus among the respondents on whether CEO compensation is excessive in their industries: 43% say it is, and 47% say it isn't. Perhaps not surprising, nearly 60% of respondents in finance say yes, as do 49% of respondents at very large companies (those with annual revenue of \$1 billion or more).

Another area of intense public debate is how to restore liquidity and stability to markets. One option is for governments to buy the financial institutions' toxic assets and consolidate them into a "bad bank" to restore liquidity to the rest of the system (a plan similar to that proposed by the US government on 23 March). Fifty-four per cent of all respondents—and 61% of those in financial services—say that creating a bad bank would help restore liquidity. Executives across Asia are the most likely to hold this view. When we asked respondents which one action would do most to restore market stability, the responses express a clear focus on liquidity, with various ways to achieve it. The paths mentioned by many respondents are: lowering taxes for businesses, consumers, or both; increasing consumer confidence and spending; focusing on global responses in regulation, currency management, and confidence building (what one executive calls "sincere cooperation of all nations"); and cogent, long-term leadership, described by another respondent as "pick a plan, stick with it, communicate tactics, be clear".

Respondents also call for government actions of all sorts, as well as the reverse: "Leave the banks and companies alone. Let the bad fail and the good will thrive—this will set our globe back into balance." Perhaps the most hopeful note comes from an executive who writes, "Have patience. Confidence and risk tolerance will improve naturally, as it is part of human nature."

Stasis, with a few signs of hope

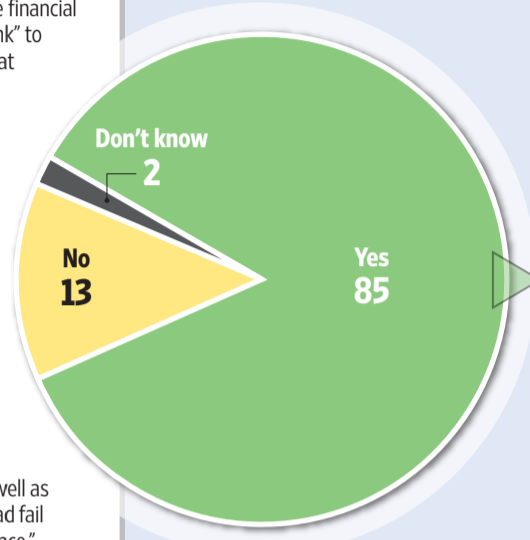
Patience will indeed be needed. Overall, executives say their national economies are in very poor shape—almost 90% say conditions have declined since September—but haven't got worse in the past six weeks. Similarly, the proportion of respondents expecting their nations' GDPs to drop stands at three-quarters, as it did six weeks ago. The proportion of executives expecting an economic upturn this year has dropped from 40% to 30%, suggesting that respondents expect the current situation to continue for some time.

Executives' responses about their companies indicate that, over the past six weeks, they have settled into the expectation that poor conditions will continue for some time. Half of all respondents expect their companies to shed workers in the first half of 2009—an 8 percentage point increase from just six weeks ago, when more expected an upturn to occur this year. And more respondents to this survey than to earlier ones offer a prediction for their companies' near-term profits: 53% expect profits to be lower in the first half of 2009 than in the second half of 2008, and these are mostly the same respondents who expect their companies to shed workers. Only 6% are unsure. Finally, the executives' expectations about how the crisis will change their industries haven't shifted notably since November. Roughly two-thirds expect lower growth, and as in November smaller percentages expect consolidation and a lower tolerance of risk. Although only 14% of respondents expect their countries' economic conditions to improve in the first half of 2009, that's more than twice the percentage that, six weeks ago, expected an improvement. The proportion of hopeful executives has increased most in Europe and North America. Further, most companies' finances still aren't on the edge, according to these respondents. Only a minority say their companies are seeking external funding (as has been the case since we began asking in October). More companies are seeking funds for new initiatives than for any other purpose. These responses indicate that growth is still on the agendas of some companies, particularly in high-tech and telecommunications. Among the other reasons for seeking funds, increasing available cash has decreased in importance since December. Our findings may suggest that although some companies are having trouble meeting everyday expenses, most companies are less focused on building a large pool of ready cash than they were a few months ago. Since interest payments regularly cut into cash, that conclusion may be supported by the finding that only 39% of all respondents say their companies have actively sought to decrease debt since last September (though 16% of the respondents don't know). There are some differences by region and industry, but only in manufacturing do a majority of respondents—a bare 51%—say that their companies have sought to reduce their debt. It must be noted that over the past six weeks, the number of companies seeking funds has jumped to 30% from 24%—the first big change since October. The increase comes from financial companies and from companies in Europe and in Latin America and other developing economies.

The risks of poor judgement

Has the public's trust in business diminished as a result of the global economic turmoil?

% of respondents, n = 1,630



Factors responsible for the decline

% of respondents who believe the public's trust in business has declined for given reason*, n = 1,392

Financial firms' misunderstanding of risk and its potential effects on the real economy

56

Job losses

33

Executive compensation levels

29

Declines in investment value

25

Predatory lending practices

25

Reduced availability of credit

12

Foreclosures

6

Other

6

*Respondents who answered "don't know" are not shown.

Expecting to shrink

% of respondents Mar 2009, n = 1,630 Jan 2009, n = 1,820

Profit

Expected change in first half of 2009 compared with second half of 2008*

Increase

25

24

No change

16

21

Decrease

53

47

Jobs

Expected change in size of workforce in first half of 2009*

Increase

11

11

Stay the same

38

45

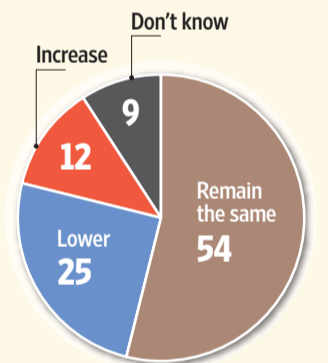
Decrease

50

42

Prices

Expected change in first half of 2009, n = 1,630



*Respondents who answered "don't know" are not shown.

More hopeful than in January

% of respondents

Substantially worse Moderately worse The same Moderately/substantially better

How are current economic conditions in your country compared with conditions in early September?

March, n = 1,630

49 40 6 5

January*, n = 1,820

46 45 6 3

How do you expect your country's economy to be in the first half of 2009?

March, n = 1,630

20 41 25 14

January*, n = 1,820

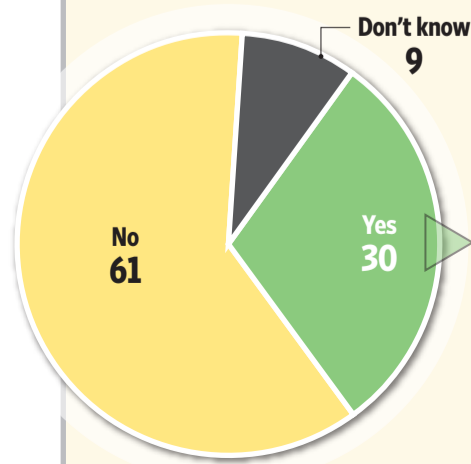
21 50 23 7

*Question asked about expectations at the end of the first quarter of 2009

New funds for new initiatives

Since mid-September, has your company sought external funding?

% of respondents, n = 1,630



For what purpose did you seek funding?

% of respondents whose companies sought funding* March, n = 1,630 January, n = 1,820

To pay for new initiatives (e.g., geographic expansion, innovation)

37

32

To refinance existing debt

34

33

To increase our available cash

30

40

To pay regular operating expenses

25

16

Other

13

12

*Respondents who answered "don't know" are not shown.

Continued on Page 16...