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CEO briefing 2009

for corporate pioneers

Economist Intelligence Unit
The Economist

CEO briefing 2009

for corporate pioneers

A NORTON ROSE GROUP REPORT IN COLLABORATION WITH
THE ECONOMIST INTELLIGENCE UNIT
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Norton Rose Group

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See also *A smart approach to sourcing*, Norton Rose LLP 2008.

For corporate pioneers

At Norton Rose Group we aim to find the right solution for our clients' business needs. On our behalf, the Economist Intelligence Unit approached over 900 senior executives across a range of industries and markets worldwide and spoke in depth with 19 CEOs and other senior executives to find out their take on the global economy following the fiscal and economic turmoil of 2008. We commissioned this report for two reasons. We wanted, naturally enough, to check firsthand how our clients are experiencing the recession and what their plans are over the next twelve months. We also saw this as an opportunity for us to act as a conduit and let our clients and other major corporates know what their peers are thinking.

One of the findings that came out of these conversations – one of the chinks of light – was the emphasis on maintaining confidence and on investing for the future (through R&D and other measures). Market confidence has certainly taken a beating in 2008 but there is reason to hope that 2009 will see it re-establish itself. The business landscape looks set to change, possibly in radical measure, with scope for new thinking, new models and new opportunities.

CEO briefing 2009 covers issues around the global marketplace, identifies opportunities and risks, looks in particular at the health of the M&A sector and examines prospects for the immediate future. We trust that it will make interesting reading and be of use to you.

Norton Rose LLP
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executive summary

Introduction

Companies have been taking the strain as first the credit crunch and then a full-scale global economic slowdown have hit their balance sheets and their profits. As the effects of this situation are felt across the world, *CEO Briefing* examines how damaging the downturn has been so far, its probable impact during 2009 and how companies can position themselves to both weather the crisis and emerge positioned for growth.

This report presents the findings of an executive confidence survey, conducted during October and November 2008, the latest Economist Intelligence Unit forecasts from January 2009, and current Norton Rose Group insights on the key issues.

Key findings

1. A steep fall in business confidence epitomises the transition to 2009.

CEO sentiment
At the start of 2007, nearly 90% of chief executives were confident about the outlook for their companies, but this plummeted to just over 50% by November 2008. Europeans were the most pessimistic about the outlook for the year ahead, with 28% expecting 2009 to be "bad" or "very bad", followed by 23% of respondents in North America. Sub-Saharan Africa has the most bullish outlook, with 83% of executives considering the prospects for 2009 as "good".

Economist Intelligence Unit forecast
The health of the global economy deteriorated sharply in November and December 2008. The Economist Intelligence Unit now expects that the global economy will contract in 2009 by 0.9%. Although growth will resume in 2010, the pick-up will still be slower compared with either of the two recent recessions in 1991 and 2001. At purchasing power parity (PPP), the world economy will expand by 0.2% in 2009, the slowest rate of increase since the early 1980s, and by 2.4% in 2010. See *Section 1: the global marketplace/EIU forecast* for more detailed information.

Norton Rose Group insight
The decline in confidence is hardly surprising given the unprecedented six months in Europe and the US. There is a real feeling of "what next?"; until this lifts, the gloom will continue, and uncertainty over which companies remain viable will continue to cloud the scene. In the weeks to come, auditors will be looking for robust evidence that the business is a going concern before they issue their audit opinion. It is clear that there is significant pain to come for all, but particularly for SMEs that rely upon credit lines from banks which will be instructed to prioritise tier one borrowers. Many will be lost. Many will have to sell core businesses to create the necessary cash to survive the crunch. This in itself will create opportunities. Growth in these distressed sales should highlight the bottom of the cycle.

We have already seen a pick-up in activity by Chinese and African institutions using the lack of traditional liquidity as an opportunity to build key banking relationships. Even with the massive drop in the price of base metals, China will continue to finance the development of key African countries.

2. Executives in financial services, transport and the retail and consumer goods sectors are most pessimistic.

CEO sentiment
From the companies surveyed, the retail and consumer goods sector, financial services firms and the transport industry are the most pessimistic, with 25%, 31% and 34% of respondents in those sectors, respectively, describing the outlook for 2009 as "bad" or "very bad". On the other hand, more than half of the respondents from technology companies (54%), as well as energy and infrastructure firms (57%), are relatively upbeat. Technology companies are likely to be optimistic on the back of greater prospects for automation as firms seek to cut costs, while the infrastructure sector will seek to benefit from a renewed focus on infrastructure spending as a source of job creation during a downturn.

Economist Intelligence Unit forecast
Financial markets remain largely frozen, notwithstanding a sharp decline in interbank rates in some countries, with credit markets still characterised by high levels of risk aversion. A "normalisation" of financial conditions is not expected until 2010 at the earliest – and will not mean a return to the lending environment that prevailed until the August 2007 crash. Beyond this, world trade is expected to contract by 2% in 2009, as import demand from the US, the euro area and Japan collapses. This will hurt shipping companies and others within transport and logistics, as well as retailers.

Norton Rose Group insight
Transport is a capital intensive business that relies heavily on both the debt and capital markets. Notwithstanding government intervention in many of the world's developed

economies, these markets are, on the whole, closed for business. The airline industry, which is very much consumer- and demand-driven, is going through a particularly challenging period. The shipping industry finds itself in an extremely difficult position, on the whole. Shipping companies have, in some sectors, seen a collapse in the earnings of their vessels amounting to over 90%.

However, there are areas of optimism. Activity in the rail sector, at least in the UK, remains buoyant – although this is largely due to existing Government commitments to develop and expand various rail networks. The shipping and airline industries are by their very nature global businesses, and there are many jurisdictions around the world with the money and the stated intent to grow these industries. Abu Dhabi, Oman and Qatar are obvious examples. It is also clear that there is likely to be important consolidation in the airline industry, which can only strengthen it.

3. Companies are wary of the risks of doing business in the US.

CEO sentiment
The US, the rock of the global free market economy for a century, is now viewed by the majority of respondents as the riskiest place to do business. Companies globally consider North America the greatest source of operational and financial risk. Asian companies are noticeably wary about the risks involved in doing business in North America, although concerns are highest among US companies themselves.

Economist Intelligence Unit forecast
The indications are that the current US downturn is shaping up to be one of the longest since the Great Depression. Recovery will not set in until the second half of 2009, buoyed by further fiscal stimulus measures. However, even then, the rate of expansion is likely to be sluggish, reflecting both ongoing adjustment in the housing sector and the slow rebuilding of household balance sheets. The sharp deterioration in labour market conditions since end-2007 also augurs ill for consumer sentiment.

Norton Rose Group insight
From a business perspective there are, however, some grounds for optimism. The start of Barack Obama's Presidency of the United States will, in all likelihood, herald an initial wave of optimism. This, coupled with fiscal and other measures, is likely to result in a more positive consumer sentiment, providing a short-term stimulus to the economy.

The strength of the US dollar means that western Europe is once again a comparatively cheap place for American companies to do business. On this basis, as liquidity returns to the banking sector during 2009, we are likely to see increasing investment from US businesses in Europe.

Although many of our respondents were concerned about the risks of doing business in the US, this is, in our view, unlikely to deter them from doing business there. As a new regulatory framework is assembled under the new administration, we expect to be busy continuing to advise our clients on how to interpret the new regulations and the practical implications for their businesses.

4. Cost control will be a key priority this year.

CEO sentiment
The way companies are being managed has changed dramatically inside a year. A focus on costs rather than top-line growth is the main priority of chief executives for 2009. By contrast, in 2007 few companies viewed good housekeeping as a prime consideration. Nearly one-quarter of chief executives will reduce their payrolls this year, while over one-half aim to conserve cash by streamlining internal processes. Nearly one-quarter will increase their use of IT to automate processes in a bid to bring costs down. One in four firms expect to make cuts in their levels of staffing.

Economist Intelligence Unit forecast
For many firms in developed markets, jobs will be the obvious source of cost cuts. In the US, unemployment will continue to rise sharply in early 2009 following the loss of more than half a million jobs in December, as the travails in the financial sector take their toll on the real economy. Employment in the UK has also started to fall, with the rate of unemployment expected to rise sharply, topping an average of 9% of the labour force in 2010.

Norton Rose Group insight
As businesses seek to drive costs down by reducing headcount, they will encounter various regulatory issues at a national and transnational level. Significant costs will be incurred by those businesses failing to comply with such regulations.

In addition, the manner in which headcount is reduced is often fraught with reputational risk. Notwithstanding the need to reduce costs in a short space of time in order to remain competitive, businesses must consider their future

requirements; how they are seen to treat the workforce now will affect their ability to increase headcount in a rising market when there is increased competition for talent. In the fight for talent which we have witnessed over the last decade or more, significant resources have been focused on employee engagement: these efforts will have been wasted if employers fail to manage effectively, and legally, the reduction of their workforce.

5. The value of M&A deals will decline sharply in 2009, but CEOs from stronger, cash-rich businesses will face good value M&A opportunities.

CEO sentiment

41% of companies polled had completed a deal in the past 12 months, with North America the least active region. But, perhaps in anticipation of cheaper assets this year, nearly one-half of the companies surveyed say they will be involved in M&A in the next 12 months and over one-fifth believe they will complete two to five deals.

Economist Intelligence Unit forecast

Mergers and acquisitions (M&As) have been hit hard by the lack of credit, declines in equity markets, the ever-worsening global economic outlook and plummeting confidence. Global M&As are expected to decline to about US$2 trillion in 2009, from an estimated US$3.1 trillion in 2008 and a record total of US$4.4 trillion in 2007. A few mitigating factors will help limit the drop, though. For example, companies with cash can take advantage of low equity valuations; aggressive interest rate reductions should ease the credit crunch to an extent; and consolidation trends in financial services, as well as energy, healthcare and media, are likely to continue. See *Section 3: mergers and acquisitions/EIU forecast* for more detailed information.

Norton Rose Group insight

2009 is likely to see some opportunistic M&A activity for those companies fortunate enough to have the characteristics identified by the Economist Intelligence Unit forecast. However, this will involve directors and shareholders making difficult judgement calls about the deployment of scarce capital. Calling the bottom of the market will also require steady nerves. 2009's opportunities will arise as companies in financial difficulties seek to shore up their balance sheets with non-core business disposals.

6. Most firms expect to continue investing.

CEO sentiment

Despite the difficult macroeconomic backdrop, many companies will continue to invest. A rising number of companies plan to invest in sales and marketing and R&D in 2009 compared with 2007, suggesting that they have ambitions beyond short-term survival. In terms of where the opportunities lie, they are convinced that Asia will continue its growth path and represents the best region for sales and profits growth in the future. Asia is singled out as the most popular destination for new investment in the next 12 months.

Economist Intelligence Unit forecast

Although Asia will remain the fastest-growing region, the pace of its slowdown will be pronounced. Growth in the region (excluding Japan) will decline sharply in 2009 to just over 3%, with only a moderate recovery to just under 5% in 2010. China and India will still grow rapidly, but at much lower rates than in recent years. Fundamentals for many countries in the region, such as bank lending growth, current-account balances and foreign-exchange reserve levels, have improved dramatically since the last financial and economic crisis in 1997–98, although this has not stopped many countries from being cut off from access to foreign capital. See *Section 1: the global marketplace/EIU forecast* for more detailed information.

Norton Rose Group insight

The current economic slowdown is likely to accelerate the long-term, generational shift in the world economic balance of power from West to East. Opportunities will undoubtedly arise for strategic and opportunistic investments and acquisitions in Asia at attractive long-term valuations. Careful structuring of such investments in jurisdictions which often have extensive foreign ownership restrictions or other regulatory hurdles is essential to achieve maximum value.

The world economy faces tough times ahead, with chief executives having to make the type of decisions they have not had to wrestle with for a generation. Without doubt, their mettle will be tested as they confront hard, unpalatable choices. There is light beckoning for some, however. Opportunities do exist for the right companies operating in the right markets – for those with strong stomachs and solid balance sheets. Corporate pioneers can exploit these.

1

the global marketplace

Business is a place for optimists. Few chief executives reach the summit of their companies with a gloomy outlook for their business, the markets in which they operate and the economy as a whole. So the depth of decline in their collective confidence level, revealed in this year's *CEO Briefing*, is quite something to behold. Just 12 short months ago, almost nine out of ten chief executives believed the prospects for their businesses were good for the coming year. That has dropped dramatically to 55% this year – the lowest level since 2002, when *CEO Briefing* polled executives for the first time. Close to one-quarter went as far to say prospects were actually "bad" or "very bad".

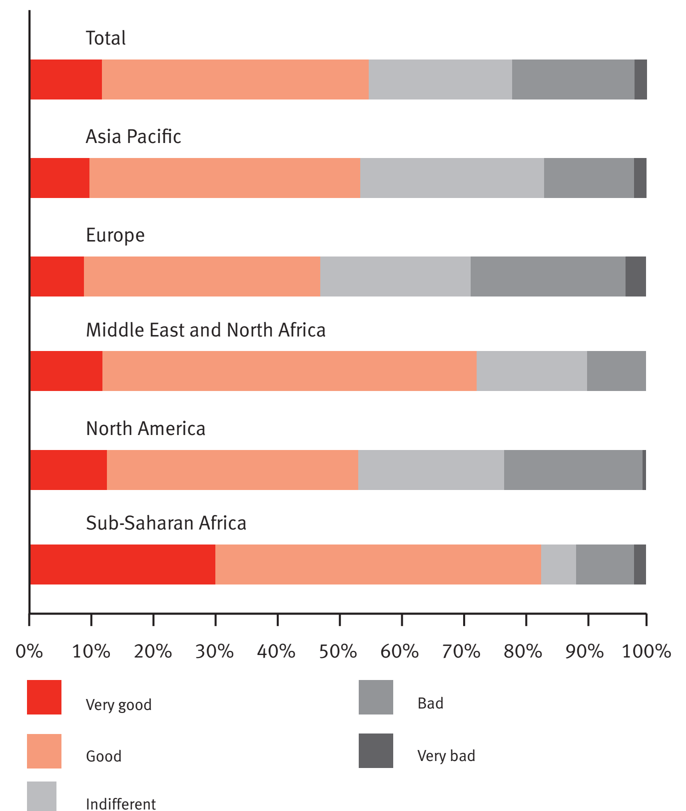
While companies are well aware of economic recession across much of the world, they have little way of knowing how deep that downturn will be, and that is causing them concern. Jürgen Hambrecht, chief executive of BASF, the world's largest chemicals company, says: "The way ahead is murky, and we are navigating by sight at the moment. While we cannot influence the overall economic picture, we can focus on those things we can control – particularly costs and cash." Hans Wijers, chief executive of AkzoNobel, the global specialty chemicals and coatings company, says: "We are as yet undecided whether this is a normal recessionary cycle, a deeper recession or even a systemic crisis."

Asian companies, which looked better placed to weather the downturn, are now less confident about the ability of the region's exports to cushion them from the storm. Just 54% of Asian companies are upbeat about prospects for this year, although the proportion that cite their prospects as "bad" is lower than the global average at 16%.

Many emerging market companies remain committed to expanding at historic rates. The Face Shop, a South Korean low-cost beauty products firm with 900 stores in 19 countries, says it will roll out its business as fast as it has done since the company was launched five years ago. Tommy Kim, chief operating officer until September, says: "The Face Shop remains committed to value pricing and this helps to scale the business even in today's soft economy." In 2009, the firm will focus on launching more department stores and other shopping mall outlets in China, the US and Japan.

The corporate mood is darkest in Western Europe, where just 45% of companies say their prospects over the next 12 months are good. Even in the US, which is widely deemed to have the biggest structural imbalances, companies are not this gloomy.

How do you view the prospects for your business over the coming 12 months? [by region]



Compared with the rest of the world, executives in the Middle East don't feel anywhere near as downbeat, despite a plummeting oil price in the final quarter of 2008. Nearly three-quarters (73%) of companies in the region believe their businesses will do well this year. Just 10% have a negative outlook. The optimism is based on the assumption that the commodities boom will resume and that the oil-rich economies of the Middle East will continue to grow and attract investment. John Griffith-Jones, chairman of KPMG Europe, Middle East and Asia, says: "You have to remember they have a huge amount of wealth. They are not exactly decoupled from the rest of the world, but I would expect the richer Mid-East countries to keep on building infrastructure, albeit at a slower pace." But optimism clearly needs to be tempered by recent evidence of a slowdown in real estate and infrastructure development, particularly in Dubai, which does not possess an oil industry. Investment in new real estate and infrastructure projects, including those unveiled

in October at the Dubai Cityscape convention, will be substantially reduced in 2009 and possibly also in 2010, owing to tight credit conditions.

The evidence from industrial groups is that demand from the Middle East for high-end products remains strong. Sappi, the world's largest producer of glossy paper, based in South Africa, has a strong order book in the Middle East for its coated fine paper. Ralph Boettger, Sappi's chief executive, says: "It is used in brochures, high-end magazines and the kind of advertising material that is in high demand in this fast-growing region where quality is the key differentiator."

Sectors affected to differing degrees

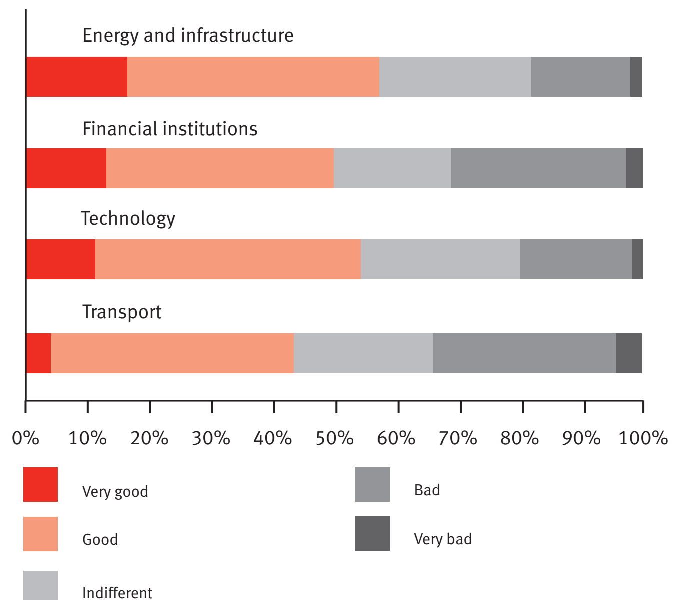
Just as the downturn is affecting the regions to different degrees, so each industrial sector has its own story to tell. Financial services firms, unsurprisingly, view the coming year with trepidation. Nearly one-third (32%) think prospects for their firms in 2009 are unreservedly "bad". However, the average hides wide-ranging views within the banking sector, depending on where the bank is based. While 32% of North American banks view the outlook for the year ahead as "bad", and 34% of banks in the Asia-Pacific region agree with them, a massive 72% of banks in Western Europe expressed negative views for their organisation over the next 12 months. By contrast, just 8% of banks in the Middle East view their prospects for 2009 negatively, and about two-thirds (67%) expect a good year.

Bankers' fears are significantly outweighed by those in the automotive sector where more than one-half (53%) say this will be a poor year. The signs of distress in this industry are most clearly in evidence at US carmakers General Motors, Chrysler and Ford, but are not confined to the US.

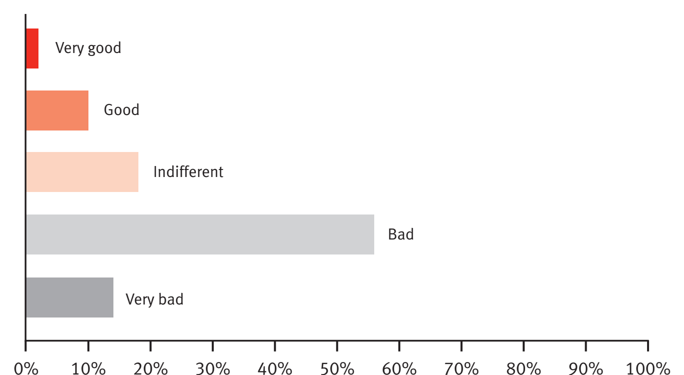
At the other end of the scale, technology companies are relatively bullish, with over half foreseeing a profitable year, although about one in five harbour a gloomy outlook. This perhaps relates to indications that, as unemployment accelerates, companies will replace some of their workforce with automated processes – see *Section 4: finding value in times of distress* for more on this trend.

While, overall, surprisingly few companies (22%) say prospects for their business in 2009 are bad, some 71% are negative about the economy as a whole. This comprises 56% who opine that the global economic outlook is "bad" and 14% who say it is "very bad". The implication is that – with their aforementioned propensity for optimism – a great many chief executives think their businesses will outperform the general economy and steer clear of trouble. It is clear they cannot all be right. But it is equally clear that some chief executives had the foresight to predict the coming storm and battened down the hatches in advance of it.

How do you view the prospects for your business over the coming 12 months? [by sector]



How does your organisation view the global economic outlook over the coming 12 months?



AkzoNobel is one that prepared early and could be well positioned for a period of economic austerity. Chief executive Hans Wijers says: “We have undergone a major transformation of our portfolio so two-thirds of our businesses are in leading positions in their markets – either number one or number two.” AkzoNobel has created a balance of products over the years so that 75% of them are in medium- to low-cyclical business, which is less impacted by discretionary spending cutbacks during a slowdown. And, in common with other global companies, AkzoNobel can reallocate resources to where they are most required in the world.

Financial instability at top of corporate agenda

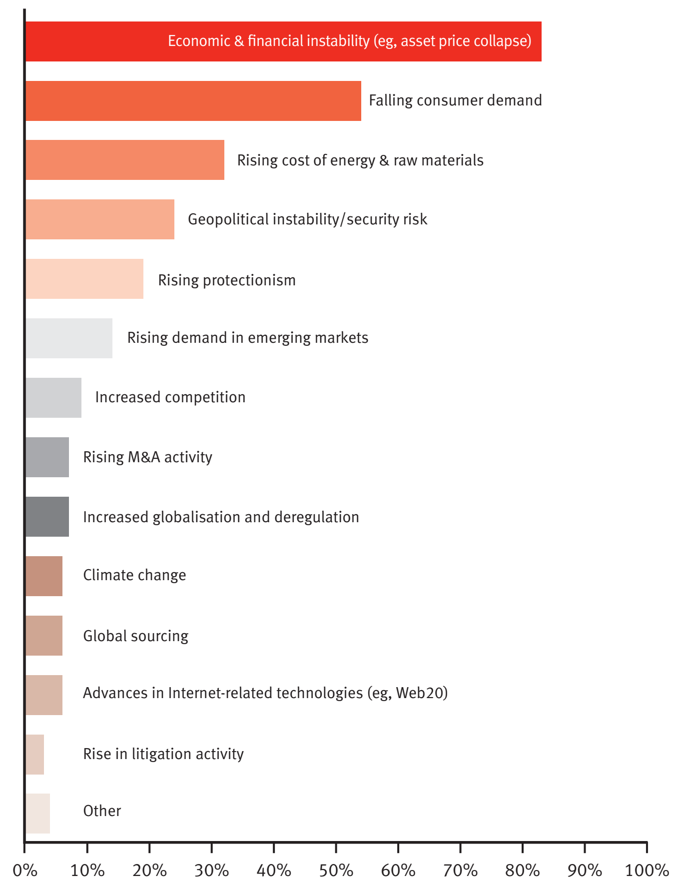
Yet, few can have predicted the incredible economic and financial instability witnessed in the latter half of 2008, with the collapse of Fannie Mae, AIG and Lehman Brothers within the space of weeks. Some 82% of companies say instability is their greatest fear for 2009, while 53% cite falling consumer demand and nearly one-third (32%) say the rising cost of energy and raw materials is their biggest challenge. Banks have greater than average fears about financial instability, with 86% of them citing worries in this regards. This rises to 92% for banks in Western Europe and the Middle East.

Corporate anxieties overall are in stark contrast to 2007, when chief executives were most concerned about rising demand in emerging markets, followed by global sourcing and geopolitical uncertainty. Just 15% mentioned economic and financial stability. This is clear evidence, were it needed, that prospects for a stable business environment have deteriorated enormously.

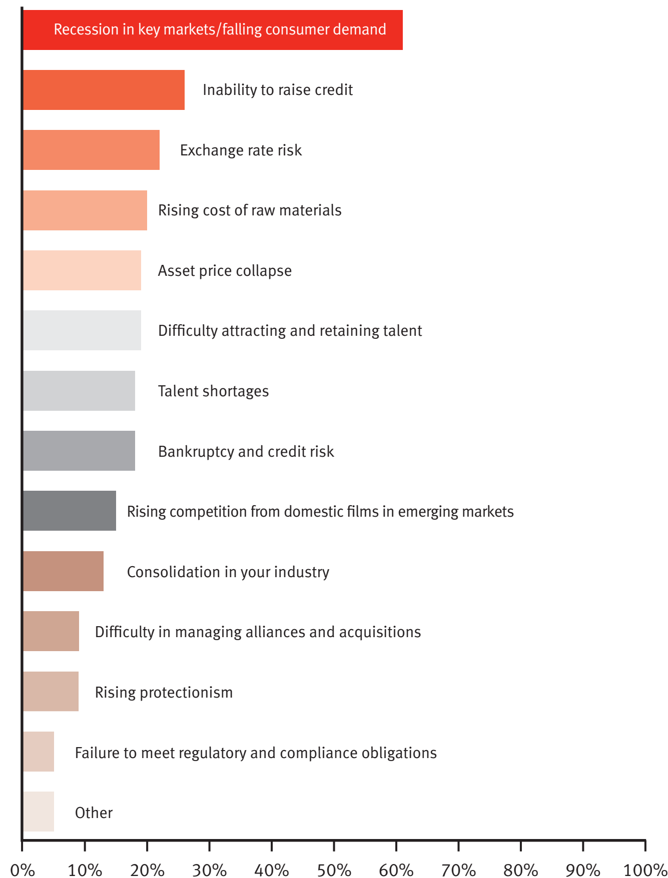
Instability even appears to be affecting areas of the world that are not highly interconnected with the global economy. GE India, a local arm of the US conglomerate, for instance, says although the domestic market is still officially forecast to grow by 7-7.5% next year, this is far slower than in the last three years. While India is not an export-led market and is relatively consumption-led, it has now been impacted by the global credit crisis. Tejpreet Chopra, chief executive of GE India, believes that infrastructure, a key part of India’s and GE’s growth, has slowed despite huge internal demand for better roads, airports, ports and telecommunication networks. Mr Chopra says: “It is too early to say if there is a definite trend towards lower infrastructure spending, but there is no doubt some projects will get squeezed.” Even aviation, one of GE India’s most buoyant business segment last year, is slowing. “Growth in aviation is certainly less dramatic than in 2005-07,” says Mr Chopra.

The volatility of commodity prices over the past 12 months is causing some executives to fret, particularly since the business model of many companies does not allow them to adjust their commodity inputs. The price of a barrel of Brent Crude, for example, has varied by over US$100 during the past 12 months. Mr Kim, of beauty products firm The Face Shop, says: “For some of our products, packaging is more

In your opinion, which of the following forces will have the greatest impact on the global economy over the coming 12 months? Please select up to three answers.



What are the greatest risks your company will face over the next 12 months? Please select up to three answers.



costly than our content. It is sourced from all round the world and raw materials have increased in price markedly. But we won't compromise on the quality of packaging because that is the customer's first contact with the product."

And others, such as Vattenfall, a Swedish power company with revenues in excess of US$20bn, are not convinced the commodities boom has yet run its course. Lars Josefsson, chief executive of Vattenfall, says: "We expect commodities to stay low for a while but then move up significantly once again."

Balance sheet concerns escalate

While outright recession is the predominant worry of most companies, one-quarter cite the inability to raise credit as the greatest obstacle to business this year. This is both a consequence of reduced cashflow leaving some companies struggling to meet interest and debt payments, and of the major banks' inability to lend to corporates as they seek to repair their own balance sheets.

Mr Griffith-Jones, chairman of KPMG EMEA, says: "Banks are unwilling to automatically extend facilities and where they do renew them they want more security and covenants. Some of these are meetable, but they can be tricky for companies facing P&L difficulties."

Indeed, the lending environment does not appear to have improved despite central banks around the world cutting interest rates to historic lows. The US Federal Reserve in December cut its target interest rate to between zero and 0.25% in an attempt to loosen credit, while the UK cut interest rates to 1.5% in January 2009, its lowest-ever level. The Fed has also said it will lend as much as US$200bn against highly rated asset-backed securities backed by car loans, student loans, credit-card debt and small-business loans in a bid to get banking moving again.

The balance sheet outlook is better for companies that had the foresight (or luck) to refinance before the credit crisis gained momentum. Sainsbury, the UK's third-biggest supermarket chain, is one company that has given itself some breathing space for some years to come. Darren Shapland, Sainsbury's chief financial officer, says: "We refinanced all our long-term debt in 2006, just at the right time really." Sainsbury will not have to refinance any long-term debt until 2018 and some of it only in 2031. "We are not immune to the credit crunch's impact but at least we need no further borrowing," Mr Shapland adds.

Few immune to effects of crisis

In Western Europe, 68% of companies say they are most worried about recession. This is a reflection of lower growth rates in the region, and the inability of more mature economies to bounce back as rapidly as faster-growing areas. By contrast, just 57% of Middle-Eastern companies are worried about the effects of a recession; instead, 36% say that a shortage of talent poses the greatest challenge.

Nevertheless, the problems emanating from the credit crisis are affecting all countries to some degree. No country is insulated and there is little evidence of emerging markets decoupling from Western markets. Companies are fighting fires on a host of fronts, including falling demand, higher funding costs and unprecedented market volatility. All of which means there are some difficult decisions to be made on investment versus cost-savings and short-term survival versus long-term outperformance.

Economist Intelligence Unit forecast

The outlook for the world economy in 2009

Many executives will no doubt be glad for the dawn of a new year, after a chaotic 2008 that saw several major banks, as many as 30 airlines and numerous other businesses collapse in the midst of economic conditions that for many will be the toughest ever experienced.

The condition of the global economy deteriorated markedly in November and December, with economic indicators in all major developed economies pointing towards a severe downward and broad-based real-economy adjustment. Emerging markets also continued to struggle, with even China and India now showing signs of stress. Financial markets also remain largely frozen, notwithstanding a sharp decline in interbank rates in some countries, with credit markets still characterised by high levels of risk aversion. Although macroeconomic policy in many countries is now strongly supportive of growth, the recent sharp weakening of the health of the global economy suggests that policy may have to become even more aggressive and unorthodox in 2009 before positive effects are felt.

Accordingly, the Economist Intelligence Unit now expects the world economy at purchasing power parity (PPP) to grow by just 0.2%, the slowest rate of expansion since the early 1980s, and by a relatively sluggish 2.4% in 2010. The picture is bleaker for GDP at market rates, which gives greater emphasis to richer countries and better reflects the exchange rates at which firms trade and repatriate profits. We now forecast a contraction of 0.9% in global GDP using this measure, the first such shrinkage since the end of the second world war. Recovery in 2010 will be slow – at just 1.4%, expansion will be slower than that seen in either the 1991 or 2001 global recessions.

Recent policy action to prevent the crisis from worsening further has been unprecedentedly aggressive. October 2008 saw a co-ordinated interest rate cut by major central banks in advanced economies. Policy rates have continued to fall since then. Introduction of quantitative easing in all the major developed economies also remains a distinct possibility. On the fiscal side, the US, the euro zone, Japan and the UK have all announced significant fiscal stimulus packages – the US government has since the onset of the crisis in August 2007 already committed around US$7trn of funds in the form of guarantees and bail-outs and the US president-elect, Barack Obama, is promising further fiscal support for the economy, possibly of the order of US$500bn-1trn. In December the EU unveiled a fiscal stimulus package worth around €200bn (US$266bn), or around 1.5% of the region’s GDP.

Risks remain

Despite this, key indicators of risk aversion remained high in late 2008, although this should ease more rapidly in 2009. But a number of triggers for renewed turmoil remain. The impact of the credit crisis is increasingly feeding through to the real economy in the US, which should lead to rising defaults on many types of loans. Bankruptcies among major non-financial companies could also cause a new panic. The weakening of countries other than the US, including emerging markets, could also send new shock waves through the international financial system.

Overall, the outlook for the developed world in the short term is poor, despite the tailwind of lower commodity prices. Hefty downgrades to forecasts to all industrialised countries are largely driving our expectations for a global economic contraction in 2009. In 2009 the US, the euro zone, the UK and Japan, all of which are now in recession, will experience outright full-year contractions in output in 2009 of 1 to 2% and post only a sluggish return to growth in 2010. In the US, the downturn in the housing market has further to run and house prices will continue to fall steeply, and financial market turmoil is now feeding through into the real economy as suggested by the recent severe weakening of the US labour market. The euro zone will struggle under a number of headwinds, most importantly much tighter financial conditions, a strong euro and a number of bursting asset bubbles, notably the housing busts in Spain and Ireland. Reflecting the importance of financial services in driving growth and the severe weakness of its housing market, the UK is forecast to experience the sharpest recession of the major developed economies

in 2009. In Japan, the generally weak growth trend, sharply lower exports on the back of recent yen strength, plummeting consumer and corporate confidence and monetary and fiscal policy constraints all portend a severe downturn for 2009.

Emerging markets under pressure too

Emerging markets have had a good run in recent years on the back of strong domestic demand and buoyant world trade growth. But the environment changed dramatically in 2008 and will deteriorate further in 2009, as financial conditions worsen and export demand weakens. Many emerging market countries are in a relatively strong position to weather the downturn. A large number have reduced external liabilities, implemented market-friendly reforms and tried to boost growth potential. Others will struggle.

Emerging Asia will remain the world's fastest-growing region in 2009, but its openness to trade will leave it highly exposed to the recession in the developed world. Although growth, by global standards, will hold up relatively well in Asia (excluding Japan) in 2009 and 2010, at around 5% on average, expansion will be sluggish in comparison with the blistering rates of around 8% notched up at the peak of the recent boom in 2006-07. The region’s performance will depend to a large extent on its most important economy, China. The real GDP forecast for China has been cut to around 6% in 2009 (from 8% previously), but should pick up slightly to 7.2% in 2010. But the outlook for 2009, in particular, assumes the government will play a key role in supporting economic activity. The Central and Eastern Europe region will be hit hard by the weakening of demand in the euro area. It could experience further economic crises in addition to those already seen in Hungary and Ukraine – the Baltics and the Balkans both look vulnerable. In the major oil-exporting countries of the Commonwealth of Independent States and throughout much of the Middle East and North Africa, the fall in oil prices will dampen domestic demand. Growth in sub-Saharan Africa will soften more moderately, as it is less integrated in the global financial and commercial system. Latin America will be adversely affected by the downturn in the US and the euro zone, but for the most part the region is not as vulnerable to financial crises, largely reflecting structural improvements made in Brazil, its largest economy, in recent years.

World Outlook

(%)	2006	2007	2008[a]	2009[b]	2010[b]
Real GDP growth (PPP exchange rates)					
World	5.0	4.9	3.4	0.2	2.4
OECD	3.1	2.7	1.3	-1.9	0.5
Non-OECD	8.1	8.4	6.7	3.1	4.8
Real GDP growth (market exchange rates)					
World	4.1	3.9	2.4	-0.4	1.5
North America	2.8	2.1	1.1	-1.8	0.7
Western Europe	3.1	2.8	1.1	-1.2	0.4
Transition economies	7.3	7.4	5.9	0.8	3.2
Asia & Australasia	5.5	5.8	3.7	1.2	3.0
Latin America	7.0	7.4	4.0	1.0	2.2
Middle East & North Africa	5.5	5.5	6.3	2.8	3.5
Sub-Saharan Africa	6.6	6.3	5.0	3.8	4.5
Inflation (av)					
World	3.2	3.4	5.1	2.2	2.5
OECD	2.2	2.1	3.4	0.1	1.0
Trade in goods					
World	9.1	7.4	4.9	-2.0	2.2
Developed countries	7.5	4.9	2.5	-0.1	1.8
Developing countries	12.0	11.8	8.8	-4.0	3.6

a Estimates. b Forecasts.

Source: Economist Intelligence Unit.

2
opportunities and risks

Chief executives, as outlined in Section 1, are desperately searching for the right analysis to help them fight the battles they know lie ahead. When they eventually reach their conclusions, they may well find they need new tools to turn analysis into a plan of action for their companies. In fact, it may not be too bold to assert that the global economy is entering a new era, where the risks and rewards bear little relation to those of previous decades.

Certainly, conventional thinking appears to have been turned on its head. Consider this key fact: the US is now named by respondents to this survey as the riskiest place on earth to do business. Companies see North America as the greatest source of operational risk (cited by 32%) and of financial risk (cited by 51%). Misgivings about the US are high among Asian companies, 57% of which think North America is the greatest source of financial risk. Tellingly, even 72% of North American companies believe the US is the riskiest place to do business.

A wide range of factors have engendered this perception. The US banking system effectively collapsed last year and there is no telling yet whether state support has drawn a line under the problems or whether they will worsen this year. With the government having injected vast amounts of capital into the banks and agreeing to underwrite some of their future risks, the US balance sheet appears stretched. Congress warned in January 2009 that the deficit will hit nearly US$1,200bn this year – a post-World War II record – even without the cost of the coming fiscal stimulus. The US may also be forced to provide further bailout money for the automobile and other industries. Pressure on the dollar may further increase during 2009 and unemployment, which soared by nearly 700,000 in December, is climbing. Any company wishing to enter the US market will have to consider these not inconsiderable macroeconomic risks. While these difficulties exist in many parts of the world, survey respondents believe the risk of further damage to the world's leading economy is greater given the imbalances of the recent past.

Novartis, the Swiss pharmaceuticals group with turnover of US$39.8bn in 2007, says US growth will slow considerably. But it is not just the state of US finances and the economy that present a risk. Joe Jimenez, chief executive of Novartis Pharma, the company's main operating business, says: "The new administration is likely to make pricing tougher and to be more sympathetic to the use of generic drugs, which undercuts branded products." On the other hand, Novartis sees double-digit growth this year in Russia, China, South Korea, Turkey and Brazil, in which combined sales amounted to US$2bn last year.

Paper and pulp producer Sappi is also relying increasingly on emerging markets for growth. Sappi sees growth in North America, its key market, at just 1.5% this year, compared with 2% for Western Europe and 3 to 5% for Eastern Europe. It has particularly high expectations of Asian markets – and it is seeing little sign that consumers are cutting out the luxuries. Chief executive Ralph Boettger says: "We are selling more and more chemical cellulose to Asia, which is used in the textile industry as a cotton substitute. For example, there is strong demand for a type of very expensive golf sweaters made from it."

Companies around the globe believe Asia will provide the best opportunity for growth this year. Chief executive of chemicals company BASF, Jürgen Hambrecht, says: "We expect Asia and China in particular to drive growth in our business in the coming year. As the Chinese economy is largely driven by domestic consumption and investment, we expect that domestic demand will be less affected by the present crisis."

Which region will offer the greatest opportunities, in terms of both revenue growth and sourcing, for your business over the next 12 months? And which will be the source of greatest operational and financial risk?

But not all companies are looking overseas to diversify their client base and grow the business. Many, such as Sainsbury, are content to find ways to maintain and expand revenues in their domestic markets. Darren Shapland, Sainsbury's chief financial officer, says: "Looking at next year, we think our core food business will remain robust. People need to eat and that won't change." But Sainsbury, which had a turnover of £19.3bn in 2007, is also shifting strategy to make sure revenues are sustained as the downturn in the UK bites. It has repositioned itself as an affordable supermarket through its "feed your family for a fiver" campaign, as well as its "switch and save" push to persuade customers to buy its own brands. Mr Shapland says: "Price is very important at times like these, but customers tell us they still want quality food."

Efforts to keep turnover high and encourage customers to keep shopping at its stores are the first plank of Sainsbury's strategy for the economic downturn. The second is to cut its operating costs, so that any drop in sales is counterbalanced by reduced expenditure and overheads. "We are accelerating efficiency programmes, including simplifying our supply chain," says Mr Shapland. It aims to cut down the miles travelled by its vehicle fleet and introduce a new type of scanner to process groceries more quickly. It is also reducing discretionary spending such as travel and encouraging greater use of video-conferencing. Where staff do travel, newly installed kiosks in Sainsbury's main offices will arrange the travel in-house with the aim of achieving lower prices.

Grace under pressure – AIG rebuilds

Case study

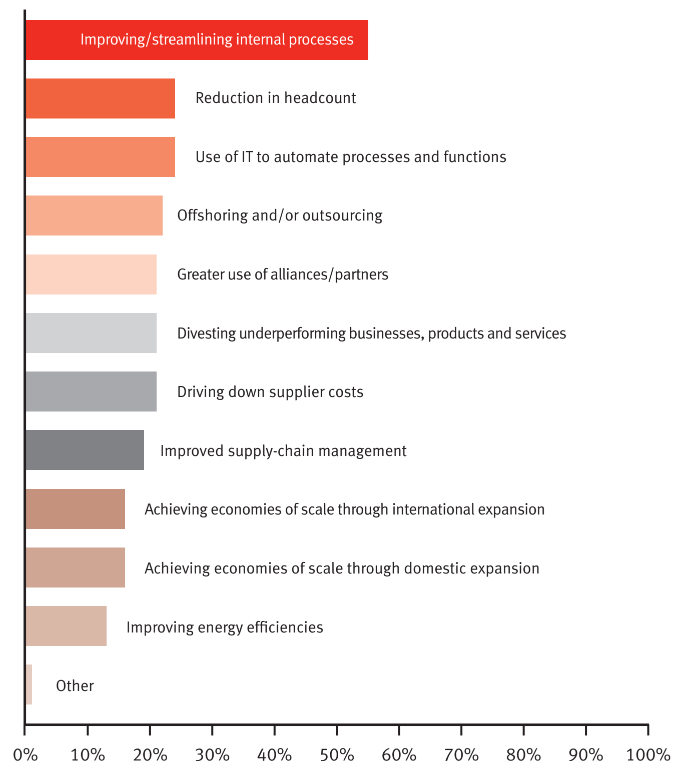
AIG represents perhaps the ultimate test of a company's ability to survive the credit crisis. Effectively nationalised in September after it revealed huge losses, the world's largest insurer faced a tough sell to convince customers and suppliers that it was still a force to be reckoned with. Karen Morris, chief innovation officer at AIG, says: "Our competitors see the parent company issues as a *carpe diem* opportunity. But this is when your mettle gets tested. We know that we will have to work hard to hold onto the trust and loyalty of our clients and that is exactly what we are doing." AIG's general insurance businesses are still the largest in the US and it still possesses a formidable talent pool and an enviable network of affiliates and associated companies. "We are taking nothing for granted and know that we will need to be resourceful, responsive and creative to maintain customer relationships," says Ms Morris. In fact, since September 16th when the US Federal Reserve announced a rescue plan for AIG, in the US alone AIG has launched 14 new products and services. "We are not slowing down," Ms Morris adds.

Cost-cutting takes precedence over growth

This kind of housekeeping is replicated at companies around the world. In fact, close to one-half (44%) say they will focus on costs rather than top-line growth this year as their main priority. By contrast, in 2007, a mere 24% said they would focus on costs.

Of course, the most obvious – and fastest – way to reduce costs is to cut staff numbers. KPMG says headcount has remained broadly steady, but it has reined in graduate recruitment, hiring just 750 graduates last year compared with 900 in 2007. However, graduate hiring rates will not be frozen altogether, says Mr Griffiths-Jones, chairman of KPMG EMEA: "We can't stop recruiting completely, because today's graduates are the qualified auditors of three years' time."

Which of the following will be most important for lowering costs at your organisation over the next 12 months? Please select up to three answers.



Nevertheless, 25% of companies say they will reduce headcount this year, while 55% will streamline internal processes and a further 23% will increase their use of IT to automate processes.

Chemicals company BASF has launched a project that will combine elements of all three cost-cutting approaches with the aim of generating €1bn in cost savings by 2012, with a large proportion of these by 2009 and 2010. The project, NEXT, is a "global excellence" programme consisting of more than 500 projects and processes designed to create greater value in every BASF function and business by simplifying processes and implementing new IT technologies.

The change in strategy by companies since last year is conspicuous. In 2007, the priority of most companies (48%) was in-house performance improvement, with economies of scale through international expansion cited by one-third. Not a single company in 2007's report had given a thought to downsizing.

The logical conclusion to draw is that risks are clearly outweighing opportunities in most spheres of activity. Whereas most companies were in full expansion mode in 2007, their overriding instinct now is to pull their horns in. And one of the major consequences of this caution is a steep drop-off in M&A, both in measured activity last year and in expected volumes this year.

Economist Intelligence Unit forecast

Currencies in 2009: a year of turbulence

2008 was marked by unprecedented turbulence in world foreign exchange markets. Strong directional trends in place for several years reversed as carry trades were unwound amid risk aversion and deleveraging. Volatility – which had been low for several years – surged.

Since peaking at €1:US$1.60 in July this year, the euro has lost around 20% of its value against the US currency. It has lost even more against a resurgent yen. Similarly, the currencies of commodity producers and of emerging market currencies – beneficiaries of the global upswing, abundant liquidity and risk appetite – have suffered large declines.

With the economic news set to remain dire and credit scarce and costly, the trends that have dominated currency markets in the second half of 2008 are likely to persist in 2009.

Deleveraging to benefit the yen and dollar

While a good deal of deleveraging has already taken place in currency markets, the process still has further to run. This will benefit the yen and the dollar, which have been used as funding currencies for investments in high-yielding and risky currencies. Hedging strategies by corporates, which in 2002–2007 reinforced dollar weakness, will be adapted to a strengthening dollar, in a self-reinforcing process.

Recession and interest differentials

As job losses and bankruptcies exert downward pressure on inflation and raise the risk of deflation in some countries, central banks will be cutting rates. But policy rates in the US (currently 1%) and Japan (0.3%) have little scope to fall further. Thus, interest differentials between these two countries and the euro zone, the UK and commodity producers, such as Australia, are set to narrow, which should benefit the dollar and the yen. Note that it is movements in interest differentials rather than interest differentials per se that explain currency movements.

However, the US Federal Reserve is already moving to a policy of quantitative easing in which it is expanding its balance sheet to provide assistance to mortgage providers (Fannie Mae and Freddie Mac), financial institutions and corporations. The expansion of the money supply that these operations entail could pose a threat to the dollar in the second half of 2009.

Fiscal stimulus

Where governments take an active approach to stimulating recovery through fiscal policy, the impact on their currencies will depend on their ability to attract funding, including from external sources. Credibility of fiscal management over the cycle will be important. Governments running large deficits in 2009 will need to explain how they plan to put the public finances on a sustainable footing in the medium term. Any concerns about sovereign creditworthiness would lead to downward pressure on currencies.

While the recession theme will dominate currency markets in the early part of 2009, if signs of recovery start to emerge in the second half of the year, markets will reward relative economic outperformance, bidding up currencies of countries that recover first and punishing those of laggards.

External financing constraints

Given constraints on financing, current account balances will have an important bearing on foreign exchange markets. The US will continue to run a hefty current account deficit in 2009, although it will be on a narrowing trend, as subdued domestic demand and lower oil prices reduce the import bill.

Large current account deficits will weigh on sterling and the Australian and New Zealand dollars. In these countries, banking systems are heavily dependent on external wholesale funding. For example, in the UK banks have a funding gap (credit exceeds their deposit base) by around £700bn. As UK banks struggle to roll over maturing external debts, this will exert downward pressure on sterling.

The currencies of emerging markets with large external financing needs – including much of Central and Eastern Europe, Turkey and South Africa – are likely to weaken unless their needs are covered by large loans from the IMF and official lenders. Commodity currencies will be under pressure as a result of lower prices, which will be reflected in smaller current account surpluses and deficits in some countries, such as Russia, Venezuela and Iran.

Table: The outlook for 2009
Exchange rates vs US$; annual averages

Unit		2006	2007	2008[a]
A$:US$	1.33	1.20	1.21	1.61
€:US$	0.80	0.73	0.67	0.74
¥:US$	116	118	104	97
£:US$	0.54	0.50	0.54	0.68

a Estimates. b Forecasts.

Source: Economist Intelligence Unit.

3

mergers and acquisitions

Deal-making is often the sign of a confident – some argue over-confident – and expanding economy. The value of total global M&A deals was forecast to reach about US$3.1trn during 2008, down by 30% from the record total of US$4.4trn in 2007 (see *EIU forecast* page 28).

Indeed, of the companies surveyed for *CEO Briefing*, just 42% had done any deals in the past 12 months and 20% had completed between two and five deals.

North America was the most barren M&A landscape with a mere 35% of companies in the region having completed a deal last year, reflecting both a lack of corporate confidence and a lack of finance capital from the under-pressure banking sector. This compares with 47% of companies in Western Europe dipping their toes in M&A, 41% in Asia and 44% in the Middle East.

Where M&A has taken place it has principally been for solidly-formed business reasons, based on in-depth due diligence and excellent strategic fit. Speculative mergers stand little chance of meeting the approval of shareholders given the risks they can pose to company balance sheets.

GE India, whose parent group in the US has been a very acquisitive force over the years, reinforces the point. Chief executive Tejpreet Chopra says the local Indian business is now much more careful when considering deals. “When we partner with someone it has to be a very good fit with the day-to-day core business,” he says. “We would take more time and do more analysis and due diligence in transactions now.”

Opportunities still exist

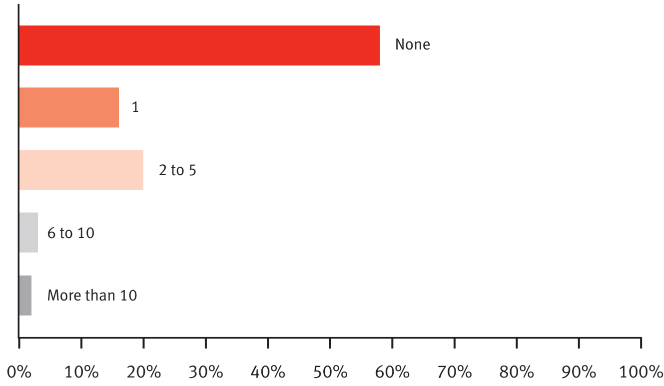
While most companies saw 2008 as an inappropriate time to invest in M&A, a trend that will persist in 2009, declining asset prices and a lack of confidence among managers has provided gilt-edged opportunities in certain sectors. The paper and pulp producer Sappi, for instance, made the decision to buy four European paper mills for €750m in September. They represented a compelling opportunity to strengthen Sappi’s business, according to Mr Boettger, Sappi’s chief executive. “Our European business has underperformed for several years because of over-capacity and fragmentation in the industry, but these deals have consolidated it and will increase our margins.”

According to survey respondents, the next 12 months might well see a number of companies taking advantage of the market environment to expand their franchise. Although most will pursue deals in order to expand abroad or snap up rivals, a significant minority (13% of those firms expecting to do a deal) believe their firm’s primary strategy for M&A will be the acquisition of a distressed business. Perhaps in anticipation of cheaper assets this year, nearly one-half of companies polled believe they will be involved in a merger in the next 12 months. Abertis, a Spanish infrastructure group that operates in 17 countries, sees a host of opportunities in its sector. It says investment funds, private equity and construction companies are suffering from excessive leverage and are looking to divest assets, of which Abertis plans to take full advantage. Salvador Alemany, chief executive of Abertis, says: “We consider that now is the time for consolidating our positions in the markets in which we are already present, and in projects and companies in which we already hold an interest.”

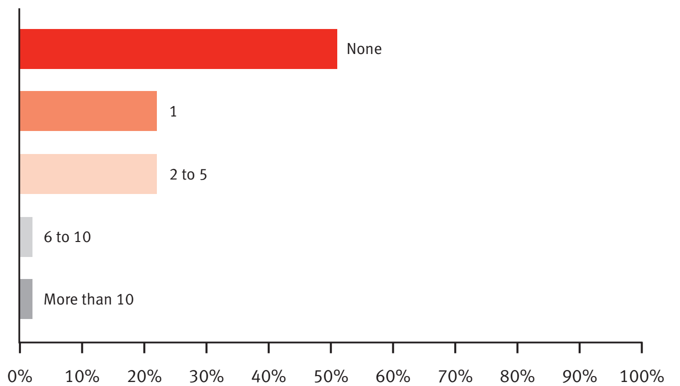
For chemicals company AkzoNobel, achieving scale was a prime consideration in the purchase of ICI, a UK paints and chemicals group, in a £8.1bn deal that completed in early 2008. AkzoNobel is still consolidating the acquisition and believes it will eventually provide €340m in cost savings. Chief executive Hans Wijers says: “We continue to look for bolt-on opportunities, particularly as multiples have come down.” With half of the value of AkzoNobel’s products in raw materials, scaling the business means it can negotiate harder because of the sheer size of each order it places. Not only do large purchases confer on it most-favoured-client status, but the reduced administrative and logistical costs of bulk buying allow it to obtain significant discounts. There are R&D benefits from making acquisitions too if acquired companies are developing technologies that can add to AkzoNobel’s range. “Products we develop in one country can be rolled out right across the globe,” says Mr Wijers.

Banks are particularly likely to conduct M&A this year, with 57% predicting they will be involved in at least one deal. It is also worth noting that 4% of banks say they will launch 10 or more mergers and takeovers in 2009. There is a clear belief that forced and distressed sellers will create attractive valuations for stronger banks that are looking to consolidate in their core markets and business lines. Current markets could offer a once-in-a-generation opportunity.

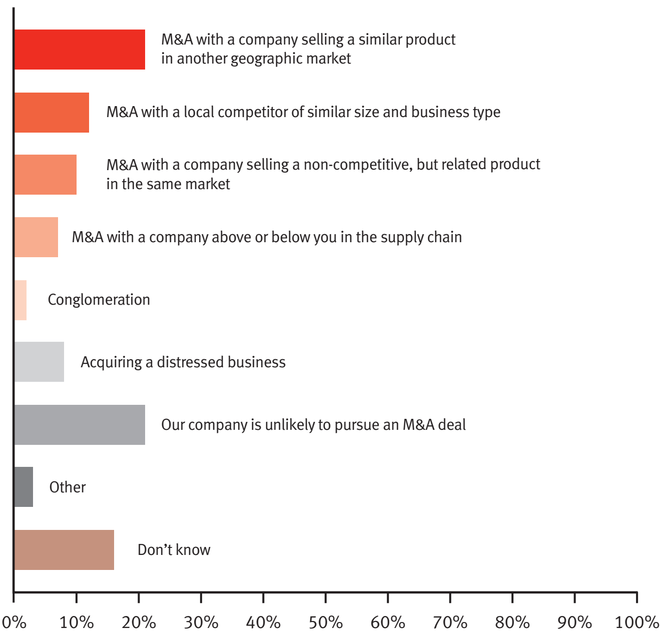
How many deals did your company complete over the past 12 months?



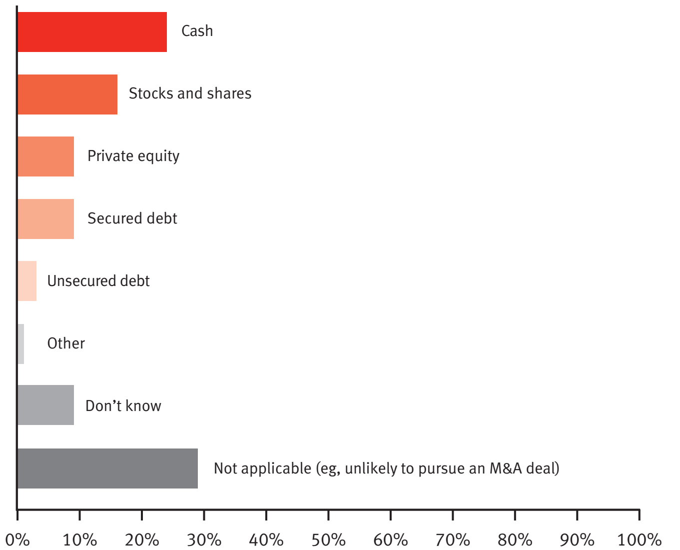
Over the next 12 months, how many mergers and acquisitions deals (M&A) is your company likely to conduct?



If your company does plan to pursue any M&A deals, what will its primary strategy be?



If your company does plan to pursue any M&A deals, how is it primarily likely to fund the bulk of them?



Nevertheless, while promising deals are likely to emerge during 2009, it is not easy for firms to complete deals in the current environment. The main impediment is funding, since debt-financed transactions are unlikely to be sanctioned by banks apart from deals involving the highest-quality assets. In fact, debt-financing is now so difficult to obtain that old-fashioned cash will be the most prevalent means of payment, according to survey respondents. This is followed by share-based transactions, with private equity deals bringing up the rear.

This last set of data is instructive. Expectations of private equity, which has driven M&A for the past half-decade, have tumbled to the extent that it ranks way behind cash and shares in transactions.

Private equity has been a major part of the corporate landscape for the past five years, helping to accelerate restructuring, speeding consolidation in crowded industries and even driving stock market valuations. But it seems, temporarily at least, to have become a bit-part actor. This sudden demise of private equity represents another plank pulled away from under the corporate world – in addition to dwindling bank funding and declining business and consumer confidence.

And yet, despite the difficulties and the worries, there are chinks of light emanating from all corners of the corporate world. There are a number of areas and strategies that will hold up well in the testing times to come and others that will rebound strongly as soon as the first glimpses of recovery appear.

Economist Intelligence Unit forecast

Global foreign direct investment in 2009

Global foreign direct investment (FDI) inflows reached a record total of US$1.9trn in 2007, the peak of a four-year boom in mergers and acquisitions (M&A) and FDI. Growth in FDI flows in 2007 represented the fourth consecutive year of a strong recovery that began in 2004. World FDI flows had experienced a sharp decline after 2000, in line with the global economic slowdown and end of the previous M&A boom, reaching a nadir in 2003.

Global FDI flows initially proved relatively resilient in the face of the financial and credit crisis that began in the second half of 2007. Despite the financial turmoil, key features of the global environment remained favourable for FDI into the second half of 2007. However, the situation changed significantly in 2008, especially after the dramatic events in mid-September. Under the impact of the intensifying global financial and economic crisis, global FDI inflows declined by an estimated 17% in 2008 in US dollar terms. They are set to drop sharply, by more than one-third, in 2009.

M&As and FDI

FDI flows are dominated by trends in cross-border M&As. Indeed, the correlation between global FDI inflows and the value of completed cross-border M&As is nearly perfect. This is not only because cross-border M&As make up a large share of FDI, but also because even non-M&A components of FDI are affected by similar forces that affect M&As.

M&As have been hit hard by the lack of credit, declines in equity markets, the ever-worsening global economic outlook and plummeting confidence. The value of total global M&As (domestic and cross-border) in 2008 is estimated at some US$3.1trn, down by 30% from the record total of US$4.4trn in 2007. The decline would have been even worse – by some 40% – if deals involving distressed financial institutions had not been stripped out. Cross-border M&As make up 35-40% of total M&As. The proportion has been increasing in recent years. Global cross-border M&As were worth some US$1.3trn in 2008, after a record US$1.7trn total in 2007.

Outlook for 2009

Private equity deals, which were a significant driver of M&As in 2007, declined by about 70% in 2008, and are not expected to recover any time soon. Large deals will be particularly scarce. Many announced deals are being withdrawn and M&A completion rates are down. Global M&As are expected to decline to about US$2trn in 2009. The volume of global cross-border M&As is projected to fall by about 35% in 2009, to US$800bn.

The FDI fall reflects the reduced availability of credit, sharply lower equity prices and a large-scale retreat from risk. The substantial headwinds facing M&A will not subside soon. The freezing of credit markets and sharp declines in equity markets have forced firms to rely largely on cash reserves to finance investment. Commodity prices are plummeting, which will limit FDI in natural resources. MNCs will repatriate rather than reinvest earnings to shore up balance sheets. There is also an increasing risk of protectionism.

Emerging market sovereign wealth funds (SWFs) are now worth about US$4trn. However, hopes that SWFs will boost significantly FDI are unlikely to be met. First of all, the sharp decline in commodity prices has affected many SWFs (for example, the Russian one). Furthermore, during the early stage of the global financial crisis, many SWFs made sizeable investments in troubled financial institutions in developed countries. However, they are likely to be much more prudent now after registering considerable losses.

The slump in M&As and FDI in 2008-09 is expected to be similar to the declines in 2001-02. Global cross-border M&As were down by some 25% in 2008 and are projected to drop by one-third in 2009. Global FDI inflows declined by 17% in 2008 and are forecast to drop by 35% in 2009.

Economic conditions are considerably worse now than in 2001–02. The reason that the decline in FDI is not expected to be worse now than in 2001–02 is because of several mitigating factors that should help limit the extent of the drop.

- Cash-rich Chinese and Japanese firms looking to expand abroad (although Japan is in deep recession and China is slowing)
- M&A dealmaking by corporations. Corporations with cash can take advantage of low equity valuations
- Pressure to privatise assets and external financing constraints in emerging markets
- Cost-cutting pressures on MNCs and investment in emerging markets
- Aggressive reductions in interest rates should ease the credit crunch to an extent
- Consolidation and deleveraging in the financial sector will continue to make up a large share of M&As, but most will be domestic deals
- Consolidation trends in other industries (energy, healthcare and media)

FDI inflows

(US$ bn unless otherwise stated)	2007	2008[a]	2009[b]
World total	1,922	1,591	1,033
% change	36.3	-17.2	-35.1
% of world GDP	3.6	2.6	1.6
Developed countries	1,210	943	576
Emerging markets	712	648	457
% share developed countries	63.0	59.3	55.8
% share emerging markets	37.0	40.7	44.2

a Estimates. b Forecasts.

Source: Economist Intelligence Unit.

The light at the end of the tunnel

The FDI outlook for 2009 is grim and there are few positives. Those of a more optimistic bent have to look to the medium term for a rosier perspective, probably beyond 2010. There are several reasons to be optimistic about the medium-term prospects for FDI. These include the global trend towards better business environments, technological change, the search for competitively-priced skills, and sharper global competition pushing companies to seek lower-cost destinations.

4

finding value in times of distress

Just as the difficulties facing the corporate world differ from sector to sector and from company to company, so the bright spots are distinct from one another in size, type and intensity. Some companies have hunkered down and are sitting on a strong balance sheet that enables them to take decisions based on rational behaviour rather than on fear. Others have shifted their models to position themselves for a new corporate and political reality. Perhaps the greatest number are well-run companies that have found themselves in a sweetspot where business and opportunities have virtually been presented to them by the crisis.

Spanish infrastructure group Abertis, for one, believes it will be able to pick and choose assets to buy and manage over the coming year or so. It sees major infrastructure shortfalls in most countries, coupled with limited public resources as many governments struggle with heavy debt burdens and face growing social demands. Chief executive Salvador Alemany says: "In this context, the market for public-private partnerships infrastructure offers numerous possibilities for mid- and long-term growth."

For many companies – other than those crippled by debt or in markets where sales are plunging across the board – the key to short- and medium-term success is likely to depend on maintaining confidence in the business model. The confidence to keep investing in products and people and staying positioned for better days is a rare but precious commodity.

Savvy companies invest for better times ahead

And, indeed, many business leaders do express a degree of confidence in their companies. Asked to say in which business areas they will invest most in 2009, sales and marketing is given highest priority (37% of respondents), while one-third cited R&D. This is an increase from the 2007 report, where 36% said they would make marketing and sales their highest priority and 26% cited R&D.

It is the planned increase in R&D that gives most cause for optimism, because it suggests that companies are still prepared to invest for the future despite the problems they are grappling with in the present.

Even though finding resources for R&D is more difficult at a time when internal company competition for the same funds is intensifying, some companies are adamant about investing for the future. Pharmaceuticals group Novartis, for example, has speeded up a restructuring process so it can continue to fund its R&D programme. Chief executive Joe Jimenez says: "We spend over 20% of our sales on R&D, which is at the high end for the pharmaceuticals industry, and we want to maintain that to pull ahead of our rivals." A year ago, Novartis announced a plan to save US$1.6bn over three years so it could intensify its efforts to find the blockbuster drugs of the future. "We saved US$700m last year so we are well on our way to meeting our targets," Mr Jimenez adds.

Dirty business, green policies

Case study

Sustainable business remains high on the corporate agenda, despite all the other business concerns. This is not surprising given the weight of scientific evidence that shows industry's effect on the planet and given the subsequent state-sponsored crackdown on the worst environmental offenders. The so-called "dirty" industries appear to have taken up the green cudgel with greater enthusiasm than cleaner industries, their enthusiasm no doubt galvanised by the interest taken by state regulators.

Consider GE India: its biggest revenue areas are derived from energy, water, aviation and other industries that throw off a lot of carbon waste. It has launched initiatives in poor, rural areas to develop sustainable energy, healthcare and water projects. It has, for instance, created a turbine that runs on cow dung instead of oil for use in villages. GE points out that this kind of project is becoming more common in a country that is a world leader in sustainable technology. Tejpreet Chopra, chief executive of GE India, says: "The High Court in Delhi decreed years ago that public buses must run on gas. And let's not forget that India has the world's fourth-largest wind market." He does not believe progress on the environment will be impeded by an economic downturn. "This has become less an economic issue and more about lifestyle," he says. "It will not go backwards from here."

Sappi, the South African paper producer, has also focused on sustainable business. Ralph Boettger, Sappi's chief executive, says: "Across all our operations we try to be more self-sufficient and efficient in energy terms." Among other initiatives, the company burns tyre chips to create energy for its power plants and recycles steam from its paper production. However, there are warnings that the corporate sustainability push in Europe is being hampered by regulators. Jürgen Hambrecht, chief executive of BASF, the German chemicals group, says: "The EU's solitary

plans regarding emission trading pose a massive threat to the global competitiveness of the region's energy-intensive industry." He believes a weakened European industry will not be in a position to innovate for future sustainable growth and for that reason the EU must reverse its policy.

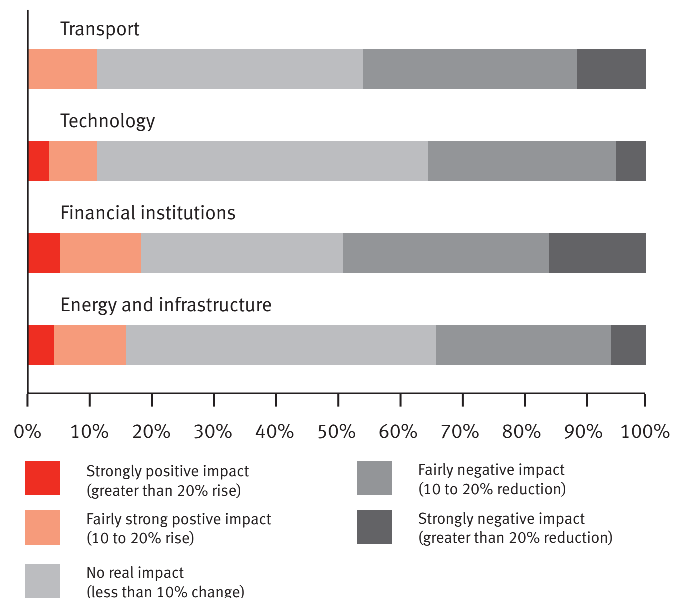
High-tech is bucking the trend

Investment in IT infrastructure is also predicted to rise, from 24% last year to 27% this year. This has made technology firms more bullish than most about their future prospects, more than half of those polled predicting a profitable year. One thing driving the optimism appears to be a supposition that some companies will replace parts of their workforces with automation. There is certainly evidence in the marketplace to support this theory.

Chi-X Europe, one of a number of new share trading platforms that have sprung up in Europe over the past two years, is one company that is using state-of-the-art technology to attract traders and attempt to wrest market share from its rivals, the incumbent stock exchanges. Peter Randall, chief executive of Chi-X Europe, argues that cost is the Achilles heel of the incumbent exchanges and leaner, more technology-focused platforms will prove attractive to investors. He says: "The challenge for incumbents is that Chi-X has just 27 staff and operates out of modest offices outside the City of London while the London Stock Exchange, for example, has a staff of 1,100." The new platforms offer lower costs and faster trading, since they have been created from scratch using the latest technology. The low-cost model has allowed Chi-X to offer trading in the shares of all 12 major European economies in less than two years since launch, and it is already the fourth-largest European exchange in the 750 stocks it offers, according to Federation of European Securities Exchanges data.

IT companies also appear more able to expand their business than companies in other sectors. Just 27% are worried about raising capital, compared with 32% across all sectors. They have become leaner after the high-tech bust eight years ago and are perhaps more prepared for this downturn than most. Their biggest worry, cited by 43%, is understanding customers in multiple territories. Their focus is clearly on sales and the selling process, not cost-cutting and conserving cash.

Measured by changes to forecast year-on-year revenue growth, what impact have current events in the financial services sector had on your business?



NeoNet, a Stockholm-based technology provider to the financial services industry, is one that foresees a relatively benign environment for its business. Its chief executive, Simon Nathanson, says: "We have no major problems in our business – we had an even better third quarter than the second quarter. Our risk management tools are in great demand because investment firms are unsure of the strength of their counterparties, particularly investment banks." NeoNet's plans for this year include continuing to invest in its salesforce and rolling out its services in more overseas markets.

No pulling back from emerging markets

Just as opportunities exist only in certain industries, so they can be found in selected geographies too. In this respect, there is a strong belief, unshaken by the sudden tempest in

emerging markets, that the growth trajectory of Asia will carry on where it left off once the global economic picture becomes a little clearer. Asia will be the destination for most new investment in the next 12 months, according to 44% of chief executives. This compares to 14% of companies that will invest in Central and Eastern Europe and 15% in North America. It is interesting to note that emerging Europe is seen as at least as promising a place to do business as the US and Canada.

For those companies with stable balance sheets and strong stomachs, riding the emerging markets rollercoaster, particularly in Asia, just might provide access to the highest revenue streams of the coming years.

Infrastructure group Abertis sees opportunity across the emerging market spectrum. Its target regions for this year include Chile and Mexico in Latin America, and some "BRIC" countries, such as India and Brazil, which have large-scale infrastructure development programmes based on private participation.

Nevertheless, it does not believe these potential revenue steams can be accessed without risk and is cautious about the challenges involved. Chief executive Salvador Alemany says: "In developing countries – and even in some first-world powers, such as the US – that have little tradition of private-initiative concessions, there are risks relating to the lack of benchmarks, legal framework development and even the whole culture of paying for use of infrastructure. However, we believe that it is just a matter of time before such realities become commonplace in these areas as well."

A winning formula for straitened times

Case study

The hackneyed phrase "win-win" is still used in many a sales pitch. But rarely has it been as appropriate as it is today. In extremely difficult times, business is only being done where there is a clear benefit for both customer and supplier. AkzoNobel, specialty chemicals and coatings company, believes it has hit on a formula that achieves just that aim. AkzoNobel has decided to focus much of its R&D efforts on low-energy solutions that save customers money while increasing its own margins. Hans Wijers, chief executive of AkzoNobel, says: "We have launched a number of successful products in the last couple of years that have eco-efficiency at their heart. These products have higher margins for us but provide significant energy savings for customers." In its marine division, for instance, it has developed Intersleek, an anti-fouling paint that when applied to vessels produces an ultra-smooth surface, allowing the boat to glide through the water with less resistance and saving the owner 4-6% in fuel costs a year. Meanwhile, in tandem with Home Depot, the US chainstore, AkzoNobel has developed a paint, Freshaire, that poses fewer health risks. In addition, it has created a technology for car bodyshops that uses ultraviolet light instead of heat to cure paint. Productivity in the bodyshop rises as it uses less energy and AkzoNobel's margins also rise. Finally, AkzoNobel has developed a lighter paint for the Airbus 380 aircraft so it can fly further using the same amount of fuel.

Banking on growth in emerging markets

Case study

Banking endured one of its most troubled years in living memory in 2008, as a lack of liquidity and unprecedented asset write-downs sparked a full-scale crisis in the industry. Most governments in the developed world were forced to take stakes in their banks or else provide guarantees to savers in order to shore up the system. But for the stronger franchises, the downturn has provided an opportunity to increase market share in the home market or in other markets in which they have a dominant position. Alpha Bank, one of the largest banks in Greece, founded in 1879, believes its longevity and branding as a cautious institution plays into its hands in troubled times. Michael Massourakis, group chief economist, says: "We have seen people shifting deposits from smaller banks to the bigger ones. They know we are stable and have the experience to help them if they are in difficulty."

Alpha Bank's conservative approach – it is not exposed to investment banking – has allowed it to continue an expansion programme that has seen it build a mini-empire in south-eastern Europe over a 15-year period. By the end of 2008, it had opened about 600 foreign branches, mainly in Romania, Bulgaria, Serbia and Cyprus, in addition to about 450 in its home market. Its target is to establish a total of 1,000 branches abroad, seizing a market share of above 10% in south-eastern Europe and 15% in the wider region, including Greece. If it is

successful, it believes 30% of total earnings will be derived from activities in south-eastern Europe. Mr Massourakis says: “Our expansion over the last two or three years has been based on rising incomes after many of these countries joined the European Union.”

The bank did not ease off the gas last year, establishing 225 new foreign branches to keep it on track for its 1,000-branch target. But the turmoil in markets, which has creates uncertainty and lack of visibility, has forced it to slow its plans for this year. “It is best to be a little cautious in this situation,” says Mr Massourakis. “We have had a very aggressive expansion in the last three years, but now funding difficulties means we are pausing to review the proposition. Our focus will be on improving productivity in our existing branches.”

The Middle East – cushioned from the blow?

Compared with other parts of the world, there is greater optimism within the Middle East for prospects within and outside the region for local companies. And this, in turn, provides reason to believe that overseas companies doing business in the Middle East could benefit from the relative stability of the region. As noted in Section 1, 73% of Middle-Eastern chief executives expect decent prospects for business over the next 12 months.

This is hardly surprising given the huge oil revenues that have flowed to the region in the past few years. But the Gulf Co-operation Council countries have done much more than merely hand over millions of barrels of oil in exchange for billions of dollars. They have been forward thinking: aware that their oil will not last forever, they have created ambitious infrastructure programmes to create a regional powerhouse in business, tourism, education and healthcare. However, OPEC cuts in oil production, feeble investment growth (as liquidity dries up) and weak expansion in services on the back of the global recession will lead to growth of just 1.5% in the United Arab Emirates in 2009 – implying a recession in Dubai – with a weak recovery in 2010.

The Dubai International Financial Centre (DIFC), an arm of the government of Dubai, was set up as one of many agents that are encouraging investment in the city and its many infrastructure projects. David Eldon, chairman of the DIFC, says although Dubai’s dramatic growth of recent years is now declining, expansion is strongly supported by the billions of dollars of oil reserves already accumulated. “The financial reserves will ensure that Dubai is reasonably well insulated,” says Mr Eldon, a former chairman of the Hongkong and Shanghai Banking Corporation. “It is clear that this environment will create a lot of opportunities over time.” But only those, such as Middle-East companies and governments, with large hoards of cash will be in a position to forge ahead when an upturn finally arrives. Whereas many countries and companies may have to call a complete halt to capital-intensive projects, Dubai will forge ahead, says Mr Eldon. “The truth is, it has to complete the projects it has started or it will have nothing to sell.”

And what of the US, the undisputed hub of capitalism? The simple fact is that confidence in the US – its financial institutions, its growth potential, its overall stability – is waning. Chief executives have indicated they are largely steering a course away from America and towards emerging markets.

Nevertheless, despite the fact that the US appears in worse shape than many other economies, there are those who believe that America may emerge from the downturn in better shape than is commonly envisaged. Karen Morris, chief innovation officer at AIG, the giant US insurer that was nationalised in September, explains why this might be the case. She points out that previous US downturns have spawned a clutch of great, innovative companies such as Microsoft, eBay and Google. “So we may now see some really new and exciting stuff. All those Oxford and Stanford MBAs who would have otherwise gone into hedge funds and investment banks may well now do something different with their talent and energy. This may help the US to recover more quickly than most people imagine.”

“It is the best of times and the worst of times for innovation,” says Ms Morris. “Of course, economic stress can stifle investments in experimentation and exploration; however, scarcity can also be a stimulus for ingenuity and creative problem solving. Rather than the recession hindering innovation, I prefer to think that innovation, the output of intellectual capital, will help hasten the recovery. Established organizations that have invested in a rigorous innovation infrastructure will be poised now to get a return on ideas.”

Certainly, those who have written off America’s ability to reinvent itself in the past have more than often been proved wrong.

Methodology

CEO Briefing 2009 is a Norton Rose Group report produced in collaboration with the Economist Intelligence Unit. The Economist Intelligence Unit's editorial team carried out the survey, conducted the interviews and wrote the report. Phil Davis was the author of the report. John Bowler, Robert Ward and Laza Kekic contributed additional economic forecasts. William Ridgers and James Watson edited the report. The findings do not necessarily reflect the views of Norton Rose Group.

The research drew on two main initiatives: a survey of 925 senior executives, representing a range of industries from Europe, North America, Asia Pacific and the Middle East, as well as other emerging markets; and in-depth interviews with 19 CEOs and other senior executives from around the world. The survey was carried out in October and November 2008. The report draws on and makes comparisons with the EIU's *CEO briefing 2007*.

The report also draws on a range of economic forecasts from the Economist Intelligence Unit. These provide a specific outlook for 2009 on a number of items – encompassing the global economy, major exchange rates and foreign direct investment – and are presented as standalone items in the report.

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Executive summaries are also available.

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CEO briefing 2009
for corporate pioneers

CEO Briefing 2009 presents the views of over 900 senior executives across a range of industries and markets worldwide. This report was produced in collaboration with the Economist Intelligence Unit.

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