



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

ICAEW BUSINESS OPINION

September 2009

MANAGING BUSINESS IN UNCERTAIN ECONOMIC TIMES

Research report



WELCOME

Our most recent *Business Confidence Monitor*, published in Q3 2009, cautiously predicted an end to recession in the UK, based on the rising confidence of the ICAEW's members in business. This special report explores the measures businesses have taken to make it through this far, and how they plan to capitalise on any future recovery.

The report is a snapshot of how UK enterprises are dealing with the combined impact of an unforeseen credit crunch and an unparalleled recession. It contains valuable lessons for businesses of all sizes and sectors, and for policy-makers looking to support the economy out of the downturn.

Improved financial management has been crucial for survival. Nearly four out of every five members cited it as a key measure in significantly helping their business to respond to the downturn. The severity of the downturn has stimulated interest in greater financial management, demanding that businesses pay closer attention than ever before to how resources are managed.

We remain cautious – any recovery is likely to be fragile. Yet it is now clear that our members are beginning to see past the recession into an eventual recovery. Measures taken by businesses to survive the recession may well ensure that they emerge leaner, fitter and ready to profit from any recovery.



Michael D M Izza
Chief Executive
The Institute of Chartered Accountants in England and Wales



FOREWORD

Charles Davis, Economist, cebr
ICAEW Economic Partner

It looks likely that the UK economy will return to growth in the third quarter of 2009 – as shown by the *ICAEW Business Confidence Monitor* – moving into positive territory for the first time since 2007. However, we cannot underestimate how severe the recession has been and the many challenges that remain ahead for the UK economy. The credit crunch became the most severe financial crisis since the Great Depression and led to a deep contraction of the UK economy. Economic output shrank by 5.5% from a peak in the first quarter of 2008 to the second quarter of 2009. The overall contraction in the economy in 2009 is likely to be the largest since post-war demilitarisation which resulted in a 4.5% reduction in economic activity in 1945.

UK households face higher unemployment, reduced earnings growth, lower house prices and restricted bank lending. Moreover, consumers and the UK government have something in common – a debt mountain. While Bank of England data showed that the level of consumer debt fell in July for the first time since records began in 1993, in the government's case, debt continues to proliferate. Her Majesty's Government will record the largest peacetime borrowing on record in 2009–10. The necessary fiscal adjustment that this requires will be a major drag on the UK economy as it pulls out of recession in 2010 and beyond. As the public sector is forced to adjust, some clear lessons could be taken from how private sector businesses weathered a savage economic storm over the last two years.

Firms have had to take proactive, tough decisions to stay afloat. This ICAEW Business Opinion report vividly illustrates the types of actions that businesses have taken during the downturn. Key has been improved financial management and a stern look at cost bases. Almost four in every five respondents report improved financial management as a key measure in responding to the downturn.

More than half of respondents in the survey cited renegotiation of supply contracts or reducing staff numbers as key measures in responding effectively to the economic downturn. Firms have had to scrutinise human resource requirements carefully. However, noticeable in this recession has been the extent to which businesses have been able to implement pay restraint, and in some cases reduced working weeks, to avoid redundancies.

Hence, the private sector has relied mainly on its own measures: the majority of ICAEW members identify cost cutting or improving internal operations as key. These findings could add to the debate over which parts of public sector involvement in the economy are most effective, given that major cut-backs will be necessary to rein in the mounting public sector debt. The report also offers some steer for the public sector by showing how the private sector has improved efficiency and weathered the recessionary storm.

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INTRODUCTION

It is nearly a year since the collapse of Lehman Brothers signalled a new phase of the credit crunch, precipitating the failures of US and European banks, and governments' attempts to restore stability to the financial system. The knock-on effects on consumer and business confidence have been severe, resulting in the worst downturn in living memory.

In light of this, we undertook a short survey to understand how businesses have coped in these uncertain economic times. We hope this report will help those involved in supporting businesses through the crisis, giving them a better understanding of business concerns in order to prioritise resources and build policy understanding of business reaction to the downturn.

A total of 1,000 ICAEW members in industry and commerce were interviewed between 13 May 2009 and 3 August 2009. The interviews were carried out as part of the Institute's *UK Business Confidence Monitor*. We asked them which steps and measures had significantly helped them to respond to the current economic crisis, as well as what would help them over the coming 12 months. In addition we asked them if they had any concerns over the potential insolvency of their supply chain and what actions they took.

It is clear that the downturn has required greater focus on financial management as well as internal and external cost reduction programmes, which should leave businesses fitter and better equipped for an upturn.

The latest ICAEW *UK Business Confidence Monitor* (published in August 2009) shows that businesses are reporting a more positive outlook for the first time in more than 18 months. The findings in this report show signs that some firms are becoming engaged in preparing their businesses for an upturn in the economy.

Increased availability of finance is reported as one of the factors that would help business prepare for the economic upturn, in addition to improved market conditions. In other recent ICAEW research (*SME Access to Finance*, published in July 2009) senior partners in accountancy firms reported that SMEs are finding it harder to access capital.

The individuals interviewed came from a broad range of companies across all regions of the UK and all industry sectors. When reading the results, bear in mind that the ICAEW membership is biased towards larger businesses, so the sample is not strictly representative of businesses in the UK, but of organisations employing our members. You can find information about the profile of the organisations covered in this research in the technical details section on page 15.

The ICAEW works in the public interest to promote enterprise, innovation and sustainable growth in a socially responsible business environment. Our strength and knowledge is drawn from the expertise of over 132,000 members worldwide who hold world-class finance qualifications. Their experience gives us a detailed understanding of the dynamics which drive our economy.

EXECUTIVE SUMMARY

- In response to the economic crisis, over the last 12 months businesses have undertaken a wide range of actions to cope with the economic downturn. By far the most widespread has been improvement of their financial management, cited by three-quarters of firms.
- Cutting the running cost of the business has also been crucial. Measures taken include renegotiation with suppliers and cutting staff costs through reduction of staff numbers, pay levels, working hours, and training expenditure.
- Applying for access to finance from government-assisted schemes was particularly relevant to the Banking, Finance & Insurance sector (25%), and to a lesser extent to other sectors as well.
- Four in ten firms have at least some concerns regarding their supply chain. These are most notable among those more traditionally associated with a physical supply chain such as Construction, Manufacturing and Retail. Measures which would assist businesses in the supply chain include financial information from potential suppliers and customers that is easy to understand, affordable access to credit ratings and affordable credit insurance.
- In addition to a general improvement in market confidence, specific actions that will help businesses in the next 12 months are continued cost management and availability of finance. There may be some evidence of a more positive outlook (also reflected in the ICAEW *Business Confidence Monitor*) as firms report planned business development and investment in human capital as helping their preparation for economic growth.

FINDINGS

I RESPONDING TO THE CURRENT CRISIS

We asked the ICAEW members about the measures they have found **significantly** helpful in response to the economic downturn in the last 12 months (Fig 1). Having been given a fairly comprehensive list of choices it appears that businesses have undertaken a variety of steps and many (24%) still had more to add, demonstrating their determination to make it through the crisis.

Easily the most widespread action businesses have taken in responding to the economic situation was the improvement of their financial management (including cash flow and improved management information on assets, debts and credit risk). This was implemented by the majority of businesses (78%). A recent ICAEW research report (*SME Access to Finance*, released July 2009) also found that improved financial management was important for SMEs in managing the downturn.

Cutting the running costs of business was the second major step taken. Over half of firms renegotiated their supply contracts (55%) in order to cut direct costs.

Many companies have been actively implementing actions to reduce staff costs to ensure their businesses can survive. Over half reported reducing employee numbers (53%), one in four reduced their staff training spend (25%), one in five cut staff pay (20%) and one in eight (13%) reduced the working week for their staff. Cutting headcount is still often seen as unavoidable when a company's financial viability is threatened, as reflected by the recent waves of increasing unemployment.

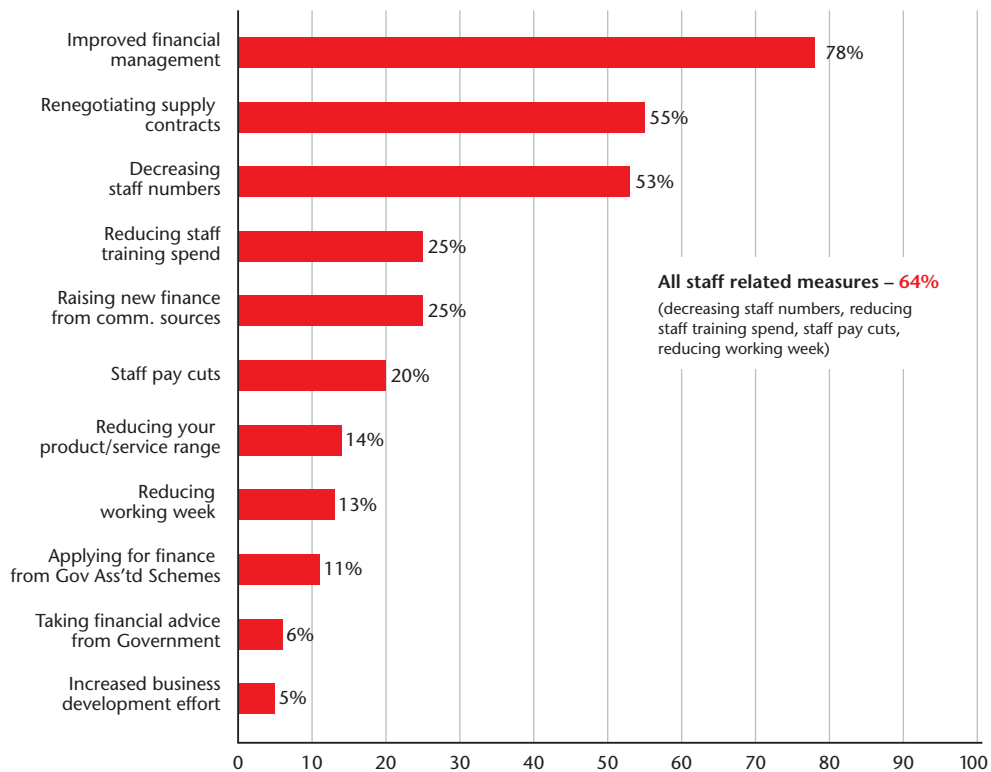
Difficulties with cash flow arising from reduced sales and increased working capital requirements meant that some businesses needed to inject finance into their business to keep afloat. A quarter (25%) raised new finance from commercial sources, and 11% applied for finance through government-assisted schemes.

Other measures taken included: narrowing the range of services or products (14%) to maximise profits from the available resources of staff and working capital by focusing on core competencies; and taking financial advice from Business Link or the Regional Development Agencies (6%). Driving business development actively was a measure taken by only a few (5%).

Fig. 1 Key measures in responding to the economic downturn

Which of the following helped your business significantly in responding to the effects of the economic downturn? *(Prompted)*

Please tell us what else has significantly helped your business? *(Spontaneous)*



Base: all respondents (1,000). Mentions of fewer than 5% not shown

Comparing activities undertaken over the last 12 months by sector, certain measures, such as renegotiating the supply chain, are far more relevant to core businesses in sectors such as Manufacturing, Construction or Hotels & Catering. Those sectors which have taken the greatest variety of measures are those which have been most affected in the recent crisis, i.e. Manufacturing and Construction. The two sectors showed above average activity for the greatest range of measures, as shown in Fig 2. Both these sectors reduced staff numbers, pay and working hours at an above average level in order to maintain a viable business.

Fig. 2 Key measures in responding to the economic downturn – by sector

Which of the following helped your business significantly in responding to the effects of the economic downturn? (Prompted)

| Showing % for each column | Banking, Finance & Insurance | Business Services | Communications | Construction | Health & educ. | Hotels & Catering | IT | Manufact. & Engineer. | Other services | Primary services ** | Property | Retail & Wholesale | Transport & Storage |
|-----------------------------------|------------------------------|-------------------|----------------|--------------|----------------|-------------------|----|-----------------------|----------------|---------------------|----------|--------------------|---------------------|
| Improved financial man. | 83 | 77 | 62 | 87 | 72 | 84 | 68 | 82 | 64 | 76 | 84 | 72 | 78 |
| Renegotiating supply chains | 44 | 44 | 62 | 67 | 47 | 70 | 45 | 59 | 43 | 53 | 52 | 62 | 66 |
| Decreasing staff numbers | 63 | 47 | 54 | 66 | 37 | 70 | 52 | 62 | 42 | 34 | 47 | 47 | 64 |
| Reduce staff training spend | 34 | 17 | 28 | 36 | 21 | 13 | 21 | 30 | 19 | 15 | 29 | 21 | 28 |
| Raising new commercial finance | 28 | 28 | 21 | 29 | 15 | 23 | 12 | 19 | 26 | 27 | 37 | 19 | 26 |
| Staff pay cuts | 20 | 13 | 33 | 25 | 14 | 7 | 22 | 30 | 13 | 5 | 23 | 10 | 30 |
| Reduce product / service range | 28 | 9 | 23 | 9 | 6 | 20 | 2 | 17 | 5 | none | 10 | 16 | 18 |
| Reduce working week | 4 | 8 | 11 | 18 | 8 | 10 | 11 | 30 | 15 | 2 | 8 | 7 | 15 |
| Raise Gov. assisted finance | 25 | 12 | 7 | 12 | 18 | 8 | 10 | 11 | 10 | 11 | 9 | 6 | 2 |
| Financial advice from Gov. bodies | 3 | 9 | 10 | 5 | 3 | 2 | 6 | 7 | 7 | 4 | 6 | 5 | 2 |

** Primary services include agriculture, fishing, energy, water and mining. Base: all respondents in each sector

Raising new finance from commercial sources is seen as a significant help by businesses in most sectors, in particular the Property sector (37%).

A reduction of the product or service range is not an option for every business, but it has been common in service-led sectors. Banking, Finance & Insurance (28%), alongside Communications (23%) and the leisure sector (Hotels & Catering, 20%) have focused more than others on their core business to increase efficiency and profitability.

Government-assisted finance has most helped the Banking sector. This is not surprising given the government's focus in rebuilding the financial sector in the last 12 months. Across all sectors, there has been relatively little use of consultative and support facilities such as the Regional Development Agencies.

Fig. 3 Key measures in responding to the economic downturn – by size

Which of the following helped your business significantly in responding to the effects of the economic downturn? (*Prompted*)

| Showing % for each column | Micro (<9) | Small (10-49) | Medium (50-249) | SME (up to 249) | Large (250+) | Very large** (1,000+) |
|-----------------------------------|---------------|------------------|--------------------|--------------------|-----------------|--------------------------|
| Improved financial man. | 52 | 77 | 82 | 73 | 83 | 84 |
| Renegotiating supply chains | 23 | 51 | 56 | 46 | 62 | 63 |
| Decreasing staff numbers | 18 | 45 | 52 | 41 | 64 | 66 |
| Reduce staff training spend | 8 | 22 | 31 | 22 | 28 | 29 |
| Raising new commercial finance | 24 | 27 | 21 | 24 | 25 | 28 |
| Staff pay cuts | 6 | 19 | 27 | 18 | 21 | 18 |
| Reduce product / service range | 10 | 15 | 9 | 12 | 15 | 16 |
| Reduce working week | 6 | 12 | 18 | 13 | 12 | 13 |
| Raise Gov. assisted finance | 11 | 14 | 8 | 12 | 10 | 13 |
| Financial advice from Gov. bodies | 6 | 12 | 4 | 8 | 4 | 4 |

** Very large is a sub-set of Large companies. Base: all respondents in each size category

Company size and sector do, at least to some extent, go hand in hand, yet it is interesting to compare the behaviour of companies of different sizes when faced with an economic crisis of the current scale. The largest companies are likely to have the biggest supply chains and most complex financial management systems, and improvements in these two areas are likely to have the greatest impact for companies at this end of the size spectrum.

Overall, the very smallest (micro) companies seem to have taken the fewest measures, although they may, of course, simply be unable to make any genuinely transformative changes – reliance on certain suppliers for credit terms, owner management and much lower levels of required investment in staff development decrease the relevance of these measures. Yet more might be done to help the smallest businesses make the most of what they have, as they are less confident about the economic prospects facing their organisation over the next 12 months compared to others, according to the latest ICAEW *Business Confidence Monitor*. Small companies (with between 10 and 49 employees) make the most use of advice available from governmental bodies such as Business Link and the Regional Development Agencies, but this still amounts to fewer than one in eight.

The largest companies have been most likely to cut staff numbers, as they are most able to cut at least some staff without significantly impacting their core operations (as shown in Fig. 3). By comparison, medium sized companies have made the most use of other staff cost reduction measures, such as cutting training spending, working hours and staff pay, in order to retain their existing workforce.

Fig. 4 Key measures in responding to the economic downturn – by region

Which of the following helped your business significantly in responding to the effects of the economic downturn? (*Prompted*)

| Showing % for each column | London | South East (excl London) | South West | East England | East Midlands | West Midlands | North West | Northern England | Yorks & Humber | Scotland | Wales |
|-----------------------------------|--------|--------------------------------|---------------|-----------------|------------------|------------------|---------------|---------------------|-------------------|----------|-------|
| Improved financial man. | 72 | 74 | 77 | 78 | 78 | 85 | 78 | 81 | 75 | 90 | 84 |
| Renegotiating supply chains | 49 | 51 | 54 | 55 | 65 | 67 | 53 | 52 | 64 | 50 | 54 |
| Decreasing staff numbers | 51 | 50 | 63 | 49 | 61 | 66 | 48 | 54 | 57 | 49 | 50 |
| Reduce staff training spend | 23 | 28 | 25 | 22 | 35 | 20 | 22 | 30 | 21 | 31 | 25 |
| Raising new commercial finance | 24 | 23 | 26 | 23 | 36 | 30 | 24 | 8 | 21 | 31 | 20 |
| Staff pay cuts | 21 | 21 | 16 | 17 | 16 | 19 | 19 | 18 | 22 | 15 | 35 |
| Reduce product / service range | 17 | 10 | 13 | 13 | 23 | 10 | 10 | 8 | 15 | 15 | 16 |
| Reduce working week | 6 | 14 | 17 | 9 | 15 | 16 | 7 | 24 | 18 | 10 | 22 |
| Raise Gov. assisted finance | 12 | 3 | 10 | 6 | 14 | 18 | 10 | 8 | 9 | 21 | 23 |
| Financial advice from Gov. bodies | 2 | 6 | 4 | 6 | 7 | 8 | 8 | 6 | 3 | 11 | 11 |

Base: all respondents in each region.

In addition to differences between the sectors there are some regional differences in the activities taken to respond to the current economic crisis. In Scotland and Wales, businesses have made more use of support available from government organisations compared to other UK regions – around one in ten businesses report taking advice from central and regional government, while more than one in five firms has benefited from accessing government-assisted finance.

Firms in the Midlands (East and West) have used a wider range of measures to avert the effects of the crisis. This is probably a reflection of the pronounced impact of the economic downturn on the manufacturing sector.

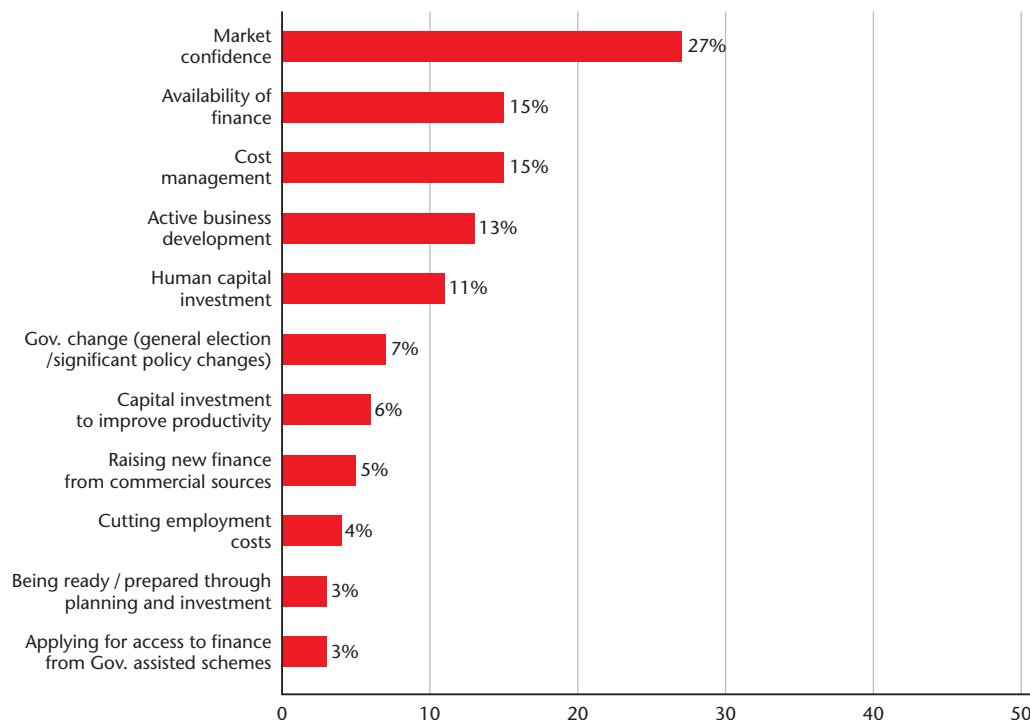
II GETTING READY – HOW TO PREPARE FOR THE ECONOMIC UPTURN

After discussing which activities had helped their business over the last 12 months, we asked members for their spontaneous thoughts on what would help them most to prepare their businesses for the economic upturn over the next 12 months.

Increased market confidence – among consumers, businesses and finance providers – is the most commonly mentioned factor that would help their business most in the next 12 months. There is also evidence of businesses taking more forward-looking steps – continuing to manage their costs (15%), planning business development (13%) and investing in human capital (11%). A small number of businesses thought that significant policy changes were required, and a general election or significant change in government policy was mentioned by 7%.

Fig. 5 Getting ready for the economic upturn

What do you think will help your business most over the next 12 months in readiness for the economic upturn? (*Spontaneous*)



Base: all respondents (1,000). Mentions of fewer than 2% not shown

Looking at variation by sector, it is in the hard-hit Retail & Wholesale sector where the greatest number of factors is rated as significantly helpful in preparing businesses for recovery. Active cost management (26%), business development (20%) and human capital investment (18%) highlight this sector's impetus to make the most of the coming economic upturn.

The IT sector, currently one of the most confident in the UK according to the latest ICAEW *Business Confidence Monitor*, is most convinced that 'being ready' through planning and appropriate investment (10%) is the most important part of preparing for increased demand. The Property sector suffers most from a lack of available finance, with 40% stressing the need for banks to lend so that their businesses can recover.

Comparing key activities by region, market confidence returning for both customers and the business community as a whole is an issue for all. This was most evident in the East of England (34%) and Scotland (32%), where dependence on the tourist industry and the production of food, fast moving consumer goods and other consumer goods is likely to be partly responsible.

Cost management was cited more often than average in London (24%) and West Midlands (23%). The availability of affordable finance was more commonly raised by respondents in Scotland (29%) the North West (23%) and West Midlands (22%) compared to other regions.

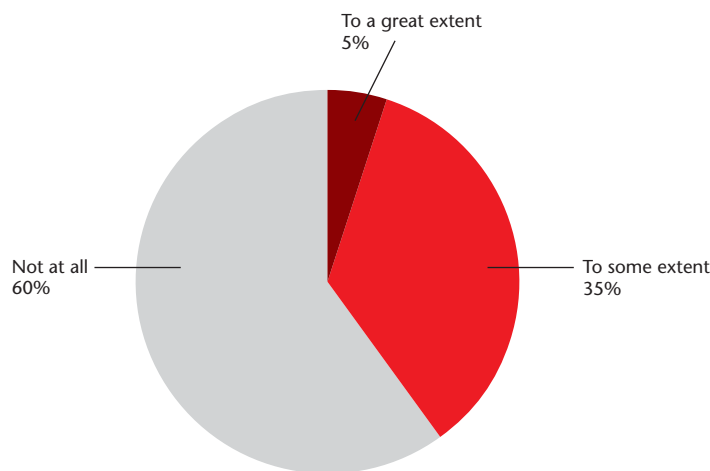
Both Wales and London are more likely than others to identify greater business development activity as a means of getting ready for the economic upturn (21% and 18% respectively). London is also more likely than other regions to look to invest in human capital (20%).

III SUPPLY CHAIN INSOLVENCY – A CONCERN FOR UK BUSINESSES?

A significant minority expressed some concerns over the insolvency of their supply chain – four in ten had at least some concerns in the last 12 months.

Fig. 6 Concerns over insolvency of the supply chain

To what extent have you had any insolvency concerns with respect to your supply chain in the last 12 months?



Base: all respondents (1,000)

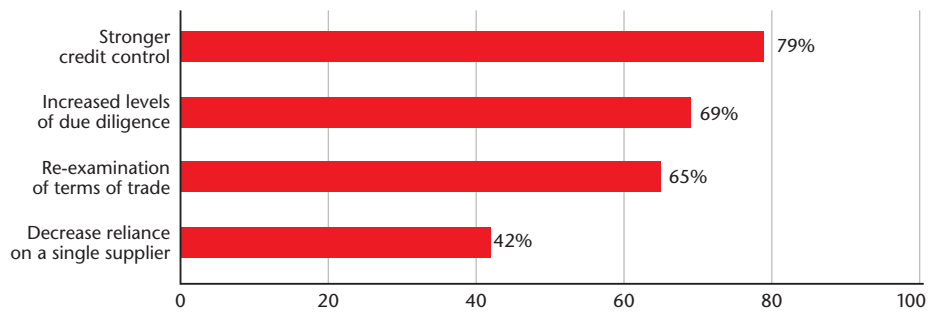
Concerns about the supply chain are most pronounced in sectors which are reliant on a physical supply chain such as Construction (54% concerned to some or a great extent), Manufacturing & Engineering (53%) and Retail & Wholesale (49%). This is in contrast with those in the IT sector (19%), Health & Education (21%) and Banking, Finance & Insurance (23%).

In Transport & Storage, opinions are divided – 10% are concerned to a great extent, but an above average proportion (66%) is not concerned at all.

Measures taken by those with concerns over their supply chain are: stronger credit control (79%); increased levels of due diligence before trading with new suppliers or customers (69%); and a re-examination of their terms of trade (65%).

Fig. 7 Effect of concerns over supply chain insolvency

In which of the following ways have these concerns affected your business in the last 12 months?

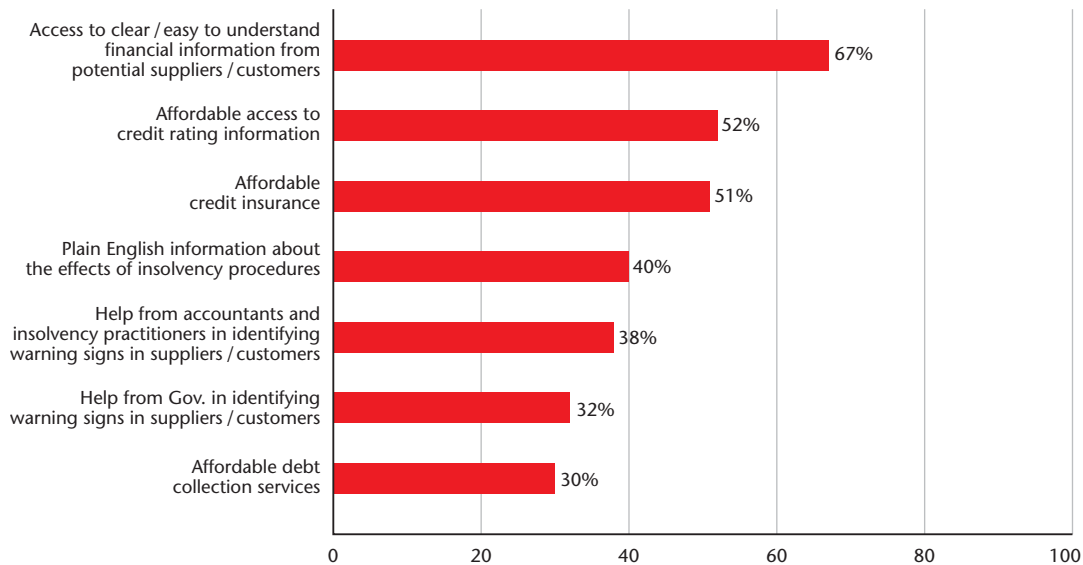


Base: respondents who have had concerns over the solvency of their supply chain in the last 12 months (407)

The importance of due diligence before trading with new suppliers or customers grows in direct proportion to company size, from the smallest (micro, 50%) to the largest (81%). This may be a consequence of smaller companies not always having the leverage or resources to challenge new suppliers in this way.

Fig. 8 Minimising concerns over supply chain insolvency

Which of the following would help minimise your concerns in the future?



Base: all respondents who have had concerns over the solvency of their supply chain in the last 12 months (407)

Access to clear financial information, such as cash flows from potential suppliers or customers, is most commonly identified as a potential way to help minimise future concerns about insolvency risk (67%), followed by affordable credit rating information (52%) and affordable credit insurance (51%).

Other activities identified by a significant minority as potentially helping alleviate insolvency concerns are: clearly worded guidance on the effects of insolvency procedures (40%); and support from qualified advisers, such as accountants (38%) or the Government (32%) in identifying risky customers or suppliers. Affordable debt collection would also help to ease some concerns (30%).

TECHNICAL DETAILS

This research was conducted by The Institute of Chartered Accountants in England and Wales (ICAEW).

During the period of 13 May 2009 to 3 August 2009, we interviewed 1,000 ICAEW members who work in industry and commerce (ie, outside accountancy practice), to find out about their companies' response to the current crisis.

The interviews were carried out as part of the Institute's UK *Business Confidence Monitor*, and conducted by telephone.

We asked those taking part what had helped them to respond to the economic downturn so far, what would help them over the next 12 months, and the extent to which concerns over the insolvency of their supply chain were having an effect on their business.

Those interviewed are from companies of all sizes, located across the UK and based in a broad range of industry sectors. Just under half (477) are from small and medium-sized enterprises (up to 249 employees); the other 523 represent companies of 250 or more employees.

This sample of SMEs compared to large businesses is not in line with the incidence of sizes of business in the UK as a whole. You should bear in mind that, due to the types of firms in which ICAEW members tend to be employed, the companies covered have a natural emphasis towards the larger end of SME (those with 50–249 employees).

The tables to the right describe the profile of the businesses contacted in this survey.

Please note: the sample has been weighted to ensure the profile of the survey sample accurately represents the UK economy (by value) for company size (no. of employees), regional locations and industry sector. All findings are based on these weighted figures. To illustrate the actual participation in the study, the figures quoted to the right show the actual number of participants in each category.

| REGION | No of interviews |
|--------------------------|---------------------|
| London | 150 |
| South East (excl London) | 140 |
| South West | 80 |
| East England | 90 |
| East Midlands | 70 |
| West Midlands | 80 |
| North West | 100 |
| Northern England | 70 |
| Yorks & Humber | 82 |
| Scotland | 67 |
| Wales | 70 |
| Northern Ireland | <i>not included</i> |
| TOTAL | 1,000 |

| SECTOR | No of interviews |
|------------------------------|------------------|
| Primary services* | 73 |
| Banking, finance & insurance | 105 |
| Business services | 73 |
| Communications | 41 |
| Construction | 81 |
| Health & Education | 52 |
| Hotels & Catering | 30 |
| IT | 75 |
| Manufacturing & Engineering | 152 |
| Property | 85 |
| Retail & Wholesale | 126 |
| Other service activities | 54 |
| Transport & Storage | 53 |
| TOTAL | 1,000 |

* Primary services include agriculture, fisheries, energy, water and mining

| SIZE (EMPLOYEES) | No of interviews |
|--|------------------|
| Micro & Small (up to 49) | 276 |
| Medium (50–249) | 201 |
| Large (250+) | 523 |
| <i>(of which: Very large (1,000+))</i> | 349 |
| TOTAL | 1,000 |

*included in 'Large' category

FURTHER INFORMATION

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