

Economic Outlook

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Professor Lord Eatwell

Issue 1 – April 2009

Introduction

This Economic Outlook is the first of the Chartered Management Institute's new series of research papers examining managers' views on the economy. It presents the findings of the Institute's new Economic Outlook Survey, which will be conducted on a six-monthly basis to provide insights into the impact of the economy on UK organisations, managers' expectations of future economic performance, and the actions being taken by managers to steer their organisations through the challenges they face.

This paper has been written by Professor Lord Eatwell, Chief Economic Adviser to the Chartered Management Institute.

Methodology

The Chartered Management Institute invited 15,000 of its members to complete an online survey during March 2009. A total of 811 responses were received from across the UK, drawn from industry sectors across the economy and from managers at a range of levels of seniority up to directors and chief executives.

Where reference is made to net percentage points, for example net level of business optimism, this figure is calculated by subtracting the percentage of those who are not optimistic from the percentage of the those who are optimistic.

Biography

Professor Lord Eatwell became the Chartered Management Institute's Chief Economic Adviser at the start of 2009. He is President of Queens' College, University of Cambridge and Professor of Financial Policy. He is also Director of the Cambridge Endowment for Research in Finance (CERF). He has been a Visiting Professor at Columbia University, the University of Massachusetts at Amherst, the University of Amsterdam and a teaching fellow at Harvard University.

John Eatwell was previously an economic adviser to Neil Kinnock, the then-leader of the Labour Party. He was made a life peer in 1992 and from 1993 to 1997 was Principal Opposition Spokesman in the House of Lords on Treasury and Economic Affairs. He is currently a non-executive director of SAV Credit and adviser to the private equity firms Warburg Pincus & Company International Ltd and Palamon Capital Partners. He is also Chairman of the Classic FM Consumer Panel.

Foreword



A persistent theme of the G20 summit held in London at the start of April 2009 was that “the world has changed”. There will be no “return to normal”, we were told – where normal is deemed to be something like, say, 2006. But it is not at all clear exactly what this means. Something must be done, but what? The debate over what was actually achieved at the summit will no doubt rumble on as the strengths and weaknesses of the measures agreed are revealed over time. But what are the principles that are to guide this new world?

An important new book by the distinguished American economists, George Akerlof and Robert Shiller¹, presents a provocative view derived from J.M. Keynes:

“Keynes’ view of the government’s role in the economy was very much like what we are told in the parenting advice books. On the one hand, they warn us not to be too authoritarian. The children will be superficially obedient, but when they become teenagers they will rebel. On the other hand these books tell us not to be too permissive. In this case they have not been taught to set proper limits for themselves... The proper role of the parent is to set limits so that the child does not overindulge her animal spirits. But those limits should also allow the child the independence to learn and to be creative... This corresponds exactly to Keynes’ position regarding the proper role of government. Capitalist societies... can be tremendously creative. Government should interfere as little as possible with that creativity. But on the other hand, *left to their own devices*, capitalist economies will pursue excess, as current times bear witness. There will be *manias*. The manias will be followed by *panics*.”

Akerlof and Shiller go on to chart a new approach to economic policy grounded in human behaviour, taking full account of the diversity of human motivations, from fear and greed to compassion and a commitment to fairness. They also suggest a need, particularly in times of stress, to feed into economic policy-making the views of key economic actors – what do they think is going on? What do they think is of importance? What do they expect to happen and what are they going to do about it?

This is exactly what the Chartered Management Institute’s Economic Outlook Survey seeks to do. The survey seeks not just the opinions of Britain’s managers and an insight into how they see the world, but also a perspective on what they intend to do to tackle the challenges of the current economic and financial turmoil.

Their responses also provide some insight into what managers see as the proper role of government.

Professor Lord Eatwell
Chief Economic Adviser
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¹ George A. Akerlof and Robert J. Shiller, *Animal Spirits: How Human Psychology Drives the Economy and Why It Matters for Global Capitalism*. Princeton University Press, Princeton, New Jersey, 2009.

Summary of Findings

The UK economy

- **Impact of the current state of the UK economy** – 80 per cent of respondents believe the current state of the UK economy is having a negative impact on their organisation (33 per cent report a significantly negative impact; 47 per cent report a slightly negative impact). However, 10 per cent of managers are experiencing a positive impact.
- **Anticipated length of the recession** – just 10 per cent of organisations believe the current economic recession will last less than a year. The majority (61 per cent) believe it will last two years.
- **Economic performance over the next 12 months** – 84 per cent of respondents believe that the United Kingdom's GDP will fall over the next 12 months. Consumer spending (78 per cent); investment in research and development (72 per cent) and the level of employment (69 per cent) are also predicted to fall by a significant majority of respondents.
- **Availability of finance** – 56 per cent of managers perceive availability of finance for long-term investment to be worse than it was six months ago. In addition, the availability of finance for 'work in progress' and short term needs is deemed to have deteriorated by 50 per cent.

Policy responses

- **The role of Government** – managers expect Government to take action in response to the recession. Only 22 per cent agree that Government can do little to affect the downturn; a far bigger number (61 per cent) disagree.
- **Tax breaks for investment in skills development** – 85 per cent of respondents agree/strongly agree that Government should provide tax breaks for employer investment in skills development as a policy response to the economic downturn. This was the most popular policy consulted on in this survey and support is very strong throughout the public, private and charitable sectors.
- **Accelerating regulatory reform** – 59 per cent of managers want measures to reduce business regulation to be accelerated.
- **Cutting business taxes** – 61 per cent of respondents agree/strongly agree that business taxes should be cut.

UK organisations

- **Business optimism** – the net level of optimism about business prospects over the next six months has fallen to -4 percentage points, from a positive score of 23 in September 2008. However, considering their organisations' prospects over the next 12 months, managers are more optimistic, with a net level of 16 (albeit down from 31 percentage points). Net optimism about the outlook over the next three years remains steady, at 56 percentage points.
- **Falling investment in management development** – 38 per cent of respondents predict that their organisation's management development will decrease over the next six months.

- **Most damaging economic factors** – 62 per cent of managers believe the level of Government debt will have a damaging impact on their organisations over the next six months. The cost of energy (60 per cent); levels of personal debt (42 per cent) and pension liabilities (40 per cent) are also major concerns.
- **Drop in recruitment** – 49 per cent of respondents predict that their organisation's budget for recruitment will significantly decrease/decrease over the next six months. A majority of firms (other than the very small) have already introduced a recruitment freeze, and all are working hard to cut overheads.
- **Job security** – despite the prevailing economic conditions, 62 per cent of respondents report to feel very secure/secure in their jobs. Twenty-seven per cent claimed to feel insecure, and 10 per cent very insecure. There was no significant difference in job security when distinguished by age (61 per cent of under-40s and 63 per cent of over-40s felt secure).

Sector differences

Whilst there are some differences between the perceptions of managers in the private, public and charitable/not-for-profit sectors, on the whole it is striking how similar their views are of the problems ahead.

- **Impact of the recession** – the proportion of managers expecting the recession to have a significantly negative impact on their activities is higher in the private sector (40 per cent) than in the public sector (20 per cent). However, when "significant" and "slight" are combined the proportions are exactly the same, at 79 per cent.
- **Length of the recession** – whilst the predominant view is that the recession will last two years, the private sector is slightly more optimistic than the public sector. Organisations with more employees (1000+) tend to be more pessimistic than smaller enterprises.
- **Regulation** – regulatory reform is a particularly important issue for managers in private limited companies. Managers working in charities are less enthusiastic.
- **Job security** – those working in the public sector and for charities are significantly more secure in their jobs than those in public or private companies.

Gender differences

- **The impact of the recession** – although the numbers are quite small, rather more women than men (13 per cent to 8 per cent) have a positive view of the recession. Perhaps this is because more men (81 per cent) are seeing a negative impact on their organisation than women (75 per cent).
- **Business optimism** – female managers are markedly more optimistic about the next six months than men, with a business optimism net level of 24 percentage points compared to -12 percentage points for men. A difference continues to exist in outlook on the next 12 months (business optimism net level of 33 percentage points to 11 percentage points). Men, however, tend to be more optimistic about prospects over the next three years (net level of business optimism of 56 percentage points, as opposed to 48 percentage points for women).
- **Job security** – female managers currently feel slightly more secure in their employment (66 per cent) than men (61 per cent).

Commentary on Findings

The Chartered Management Institute's Economic Outlook Survey, conducted in March 2009, provides insights into how managers' reactions have changed as the scale of the recession has become evident. The latest survey can be compared with data from a previous survey conducted by the Institute, in September 2008, to assess how circumstances have changed over the past six months.

It has been a miserable six months. The number of managers experiencing a negative impact from the current state of the economy has grown substantially, from 66 to 80 per cent. Eighty four per cent of managers expect UK GDP to fall over the next twelve months.

A majority of managers expect the recession to last at least two years, with a small but rising proportion (10 per cent, up from 8 per cent) expecting a recession of more than three years.

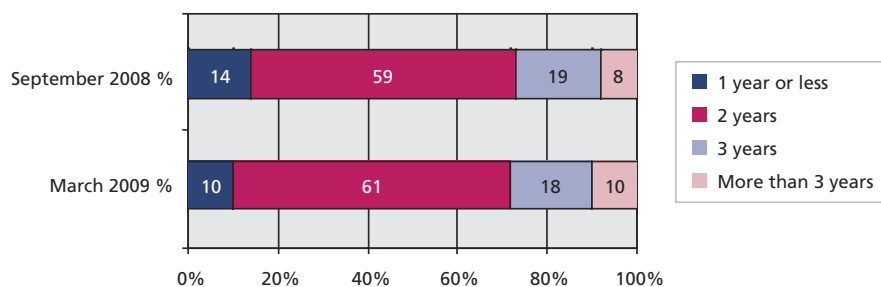


Chart 1: Expected length of the recession

The survey also examined how optimistic managers are about their organisations' prospects over a range of time-scales: the next six months, the next 12 months, and the next three years. The short-term outlook has fallen drastically, from a net level of 23 to -4 percentage points, as shown in Chart 2 below. Optimism for the coming year has also fallen sharply (31 to 16 percentage points net optimism). Yet whilst managers think the next six months will be awful, the net level of business optimism is at 56 percentage points when considering the next three years – a figure unchanged from 6 months ago.

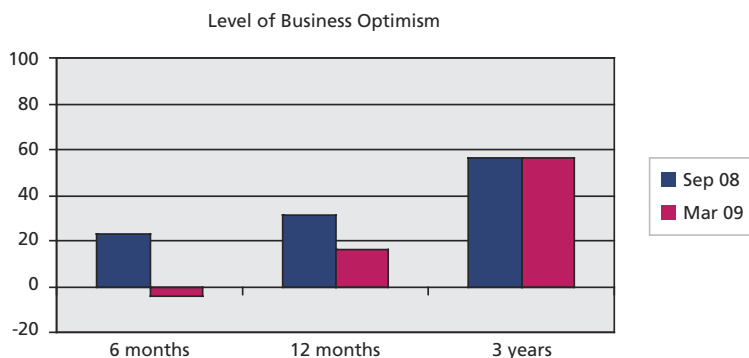


Chart 2: Net levels of business optimism, September 2008 and March 2009

It is clear that the overall economic situation has deteriorated and conditions are expected to remain difficult. However, there are some important trends in the survey evidence. One of the clear factors to emerge from the Institute's surveys is the commitment of management to their staff. Our recent employment survey indicated that managers would attempt to maintain employment by a variety of temporary measures with redundancy a last resort².

In September 2008, the commitment to staff was manifest in a majority intention to sustain or even increase investment in skills. That majority intention has not survived the experience of the last six months, with the majority intention now being to cut investment in skills and in management development (and to cut investment in plant and machinery too). Even though managers recognise that this will diminish the productive potential in the future, they have no choice given the severe deterioration in credit and demand. It is clear that investment in people has been a victim of the severity of the downturn. Yet lack of managerial skill is still expected by many (34 per cent – see Table 3, page 8) to have a significant negative impact on future performance. Managers are keenly aware of the importance of skills and are eager for Government support in this area (see Table 2 overleaf).

	September 2008 %	March 2009 %
Reduced business overheads	-	49
Recruitment freeze	32	47
Improved cash flow management	49	36
Frozen pay levels	13	33
Compulsory redundancies	-	31
Improved customer responsiveness	61	30
Voluntary redundancies	-	28
Introduced new products/services	48	26
Diversified into new markets	27	23
Focused on developing core internal staff	44	22

Table 1: The ten most common responses to the downturn

² See *Redeployment doubles in 12 months as employees seek alternative to redundancy*, CMI Press Release, 31 March 2009.

Policy responses

A significant majority of managers continue to believe that Government policies can have a beneficial impact on the economy – but the majority is falling. Fiscal incentives for investments in skills receive the greatest support among possible Government policies, as shown in Table 2 below. Opinion in favour of cuts in business taxes has grown, although opposition to any reduction in public spending is also growing. Managers also want the cut in VAT extended beyond December 2009. No further cuts in interest rates are called for (hardly surprising with the bank rate at 0.5 per cent). The small majority in favour of re-examining the case for joining the Euro which existed in September 2008 has gone, perhaps as memories of the Icelandic collapse fade.

	September 2008 %	March 2009 %
Government should provide tax breaks for employer investment in skills development	74	85
Business taxes should be cut	51	61
Measures to reduce business regulation should be accelerated	54	59
The lower rate of VAT should be extended beyond December 2009	-	52
Government should restrict international labour movements	-	47
The possibility of joining the Euro should be re-examined	39	37
Import controls to protect Britain from foreign competition	-	34
Public spending should be cut	57	34
Increase the supply of money (quantitative easing)	-	30
Government can do little to affect the downturn	15	22
Interest rates should be cut	62	20

Table 2: Agreement levels with possible policy responses to the economic downturn

As to the economic environment, Government debt is perceived as having a negative impact on business over the next 6 months (more important even than the lack of availability of credit). Managers also expect a significant negative impact from energy costs (somewhat surprising this, since energy costs are likely to be depressed at least in the short term, by the worldwide fall in demand), personal debt levels, labour disputes, and pension liabilities, together with skill shortages – as shown in Table 3 below.

It is rather worrying that the fall in the exchange rate is not seen as a competitive opportunity, but as a negative factor for the future.

	March 2009 %
Levels of Government debt	62
Cost of energy	60
Levels of personal debt	42
Pension liabilities	40
Changes in value of pound	38
Availability of credit	36
Management skill shortages	34
Employment disputes	32
Labour shortages	29
Reducing carbon emissions	21

Table 3: Factors impacting on business over the next six months: % damaging impact

Of course, organisations are suffering from the deterioration in the availability of finance. Fifty per cent of managers of firms both large and small testify to a worsening of financing for work in progress; 56 per cent find that funding conditions for long-term investment have deteriorated. Lack of finance is undermining the short-term viability and the long-term competitiveness of British business.

Recommendations – What is to be done?

Whilst this survey clearly charts a severely worsening economic climate, it also suggests that UK managers hold a number of clear views on what is to be done.

- They are overwhelmingly committed to investment in people, and deem skills, both management skills and workforce skills, as the key to competitive success.
- They believe that Government can make a difference if it is sensitive to the real needs of business, hence the call for aid in skill investment and for regulatory compliance to be made less onerous.
- They are optimistic by nature – but realistic too, facing up to the reality of investment cuts today even though this will harm competitiveness tomorrow.

These three characteristics pose direct challenges for Government in general and the Chancellor of the Exchequer in particular. Getting the balance right is not easy. However, six essential ingredients are:

- 1 The Government must reinforce British management's commitment to investment in skills, and support the preservation – as far as may be possible – of labour forces intact. If there are to be increases in Government expenditure in the Budget, then some of that increase should be targeted at skills, and the cost of keeping people in work must be cut. Both would be investments for a more competitive future.
- 2 Skills investment is top of the list, but investment in new plant and equipment should not be forgotten. There is a significant risk that cuts in investment will "overshoot", limiting future competitiveness.
- 3 The Government must make the case that the fall in the exchange rate is a valuable opportunity for British business. Of course there will be some sectors reliant on imports that will suffer, but taking British business as a whole, this is a valuable opportunity to increase market share at home and abroad.
- 4 At a time when creating new structures for financial regulation is likely to be at the forefront, the Government must not neglect the increasing costs of regulatory compliance all across British industry and commerce. The point is not to have no regulation. What must be done is to simplify necessary regulation, with a view to achieving desired goals whilst reducing the costs of regulatory compliance. The old Department of Trade and Industry is now called the Department for Business, Enterprise and Regulatory Reform. It's about time it lived up to its name.
- 5 The optimistic, can-do approach of British management is an attitude to be cherished. They need the tools to do the job. One of the essential tools is finance. Ensuring that business has the financial resources it needs must be the first priority for the banks and for the Government. Prosperous firms make for prosperous customers and prosperous taxpayers.
- 6 It is vital that the Government injects clarity into economic policy. Business needs to know what Government intends to do, in finance, in taxation, in policy toward business, and so on. Everyone knows that Government and business are facing unique problems, and that no-one is 100 per cent certain as to what the best policy might be. But it is important that the *direction* of Government thinking should be clear: if the economic rules of the game are to be changed, what are the principles on which the new rules will be based?

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First published 2009

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British Library Cataloguing in Publication Data

A CIP catalogue record for this report is available from the British Library

ISBN 0-85946-412-1

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Registered charity number 1091035
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ISBN 0-85946-412-1

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