Exploring the Changing Global Landscape for UK Companies

An RBS report prepared in co-operation with Economist Intelligence Unit The Economist

RBS
The Royal Bank of Scotland

Contents

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Foreword

We believe it is vitally important to keep abreast of issues that affect the international landscape. Why, because global trading conditions and trends affect almost all companies operating in the UK. This applies particularly to businesses with fully fledged international operations and also to those looking to expand overseas for the first time.

So, we asked the Economist Intelligence Unit to survey senior executives from a wide range of UK organisations on where they saw the challenges and opportunities of doing business internationally over the next three years. The report offers some insights into the key issues and we believe it makes essential reading for those keen to understand the changing international environment.

Perhaps surprisingly, even though companies are experiencing challenging times, a key finding is that they do not want to cut back on their international operations. In fact, a significant number are planning to expand into new markets to access additional customers and take advantage of outsourcing opportunities. Whatever the motivation for international expansion, RBS is committed to supporting businesses as they look to develop these opportunities.

We have experienced teams across the UK, comprehensive products and a global network to support your export sales, international outsourcing or international investments in protection.

The EIU received 331 responses to the survey representing a broad range of industries, including manufacturing, financial services, professional services, energy, media and information technology. About one half of respondents were from companies with annual revenues below £100m, while the remainder had revenues above that threshold. Approximately one half of respondents were CEOs, CFOs, managing directors and other board level executives.

The Economist's editorial team conducted the survey and compiled the accompanying report. The author was Andrei Postelnicu and the editor was Iain Scott. Our thanks go to the research team and the survey respondents and interviewees for their time and insights.

We hope you find this report informative and a valuable addition to your business thinking.

Mark Catton
Chief Executive
UK Corporate Banking

John Lyons
Head of Global Transaction
Services UK

March 2009

Please note that the survey and this paper are sponsored by The Royal Bank of Scotland Group plc although the findings expressed do not necessarily reflect our views.

Executive summary

Few executives expect that there will be any quick improvement in the external environment. UK companies that trade internationally express considerable concern about the prospects for the economic and market conditions over the next three years. Most notably, just 17% expect an improvement in the availability of capital over this period, with almost half expecting further deterioration. There is also concern about the cost of doing business. Despite recent volatility in oil and commodity prices, there is a strong consensus that transport, energy and raw materials will, on average, become more costly over the next three years. The availability of talent, however, is expected to improve, although this probably reflects employers' sentiment that job losses will reduce competition in labour markets.

International trade remains an essential strategic priority. Despite their gloomy assessment of the external environment, survey respondents recognise that they must not simply batten down the hatches and pull back from international trade. If anything, they indicate that they should increase their trading activity. Almost 60% think that the opportunities for geographic expansion will improve over the next three years and more than half say that their company plans to enter a new geographic market over the next year. Furthermore, three-quarters of respondents say that they have increased the number of overseas markets in which their company markets products and services over the past three years. In terms of strategic priorities, it is clear that companies favour a deepening and broadening of their geographic reach, both to diversify risk and revenue streams, and to offset the decline in a domestic market that has entered recession.

UK companies see more economic challenges at home than abroad in the next three years.

British executives expect to face economic challenges in whichever region they do business in the next three years, but they predict that those challenges will be tougher at home than abroad. However, they see fewer trade and investment barriers in the UK than in other regions over the same period.

There is a shift in the perception of emerging markets. Although growth in China, India and other key emerging markets is forecast to slow over the next year, respondents to our survey continue to see these countries as those most likely to present new opportunities. Half of the respondents said that they would invest more time and money in emerging markets than in developed markets over the next three years. China leads the pack as offering the best prospects for revenue growth, followed by India and Central and Eastern Europe. These findings represent a definite shift in the trading patterns of UK companies. Historically, UK companies saw emerging markets primarily as sources of labour, resources and raw materials. Today, however, the primary motivation for those that trade with overseas developing markets – by a considerable margin – is to access new customers, perhaps a reflection on the growing middle classes in such markets.

Bottom-line improvements will help to fund international expansion. The enthusiasm with which UK companies are embracing international market expansion begs the question as to how they will fund this investment in an environment of tighter, more expensive credit than in recent times. The survey suggests that the approach taken by many companies will be to focus on the balance sheet and pay close attention to the bottom line. In-house performance improvement and process innovation are seen by respondents as the most important tools to cut costs, with the use of alliances and partnerships, and outsourcing and offshoring, following close behind. By keeping costs down and freeing up cash, companies clearly hope that they can retain their focus on their international trading priorities.

Companies will seek to broaden their outsourcing relationships. The motivation behind companies' outsourcing arrangements is now firmly on their ability to reduce expenditure. Asked about the considerations when choosing a location for an outsourcing provider, respondents point to cost as by far the most important factor ahead of the ability to access specialist expertise. The survey also suggests that there will be a broadening of supplier relationships among UK companies over the next few years. Almost half say that they will increase the overall number of supplier and partner relationships, with just 11% predicting a decrease.

Testing times for trade

Until Summer 2008, many UK companies outside of the banking sector could have been forgiven for thinking that they would only feel ripples from the credit crisis. But as major investment banks failed, as governments stepped in to shore up major institutions, and as share prices around the world went into free-fall, it quickly became clear that the real economy would also feel the full force of economic uncertainty. Moreover, it was apparent that the crisis had global implications and the argument that emerging markets would somehow "decouple" from the crisis in the US and Europe was one that held little water.

UK companies that trade internationally now face a testing time. Access to credit has become more difficult. Unprecedented interest rate cuts by the Bank of England have been slow to make an impact on the supply of credit to the corporate sector. Revenues are in decline as consumers and businesses around the world tighten their belts. In the third quarter of 2008, household consumption contracted by 0.2% and fixed investment fell by 2.4%. The latest purchasing managers' indices, compiled by the Chartered Institute of Purchasing and Supply for the construction, manufacturing and services sectors, fell to record lows.

"There is no doubt that [going into 2009] there is a reduction in the flow of consumer goods," says Martyn Pellew, group development director for PD Ports. "In particular, we are seeing 10% to 15% declines in container volumes [at UK ports]. That is after a decade in which there have been steady increases."

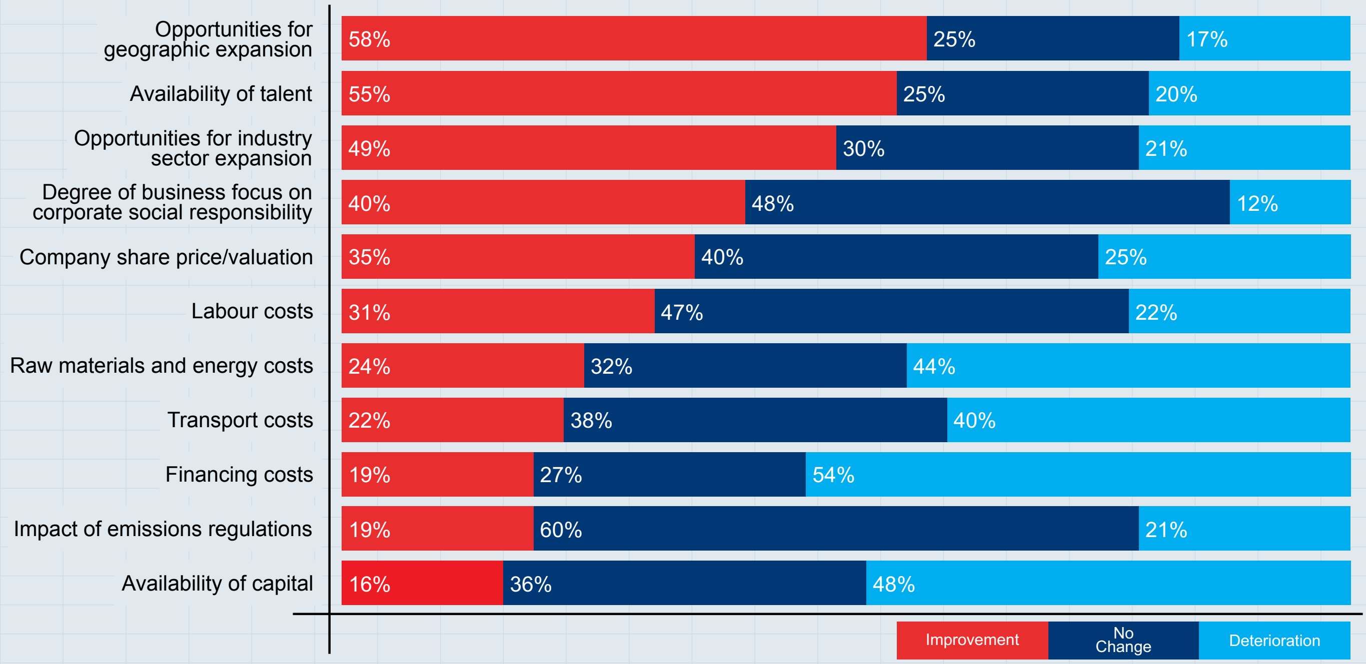
Financial markets remain volatile, as investors around the world struggle to understand the implications of major economic dislocation. Moreover, the economic outlook for the UK continues to deteriorate. Real GDP in the UK is now forecast to contract by 2.5% in 2009 and 0.9% in 2010, according to Economist Intelligence Unit (EIU) research published in December 2008. Sterling has weakened sharply in recent months, falling to a record low against the euro and plunging against a surprisingly resilient dollar.

But while the scale and reach of the economic crisis may have caught some companies unawares, others have been preparing for the worst for some time. "We spent this year restructuring our companies to adapt to the new environment," says Brian Davies, the chairman of Sanders Polyfilms, a plastics manufacturer. "I kept telling staff in Romania, 'It's coming, it's coming!' and in September I got the call from our Romanian plant telling me we had virtually no sales that month."

UK executives surveyed for this report point to the decreased availability and higher cost of capital as among the biggest challenges that they will face as they look to an uncertain future (see Table 1). Just 16% say that they expect the availability of capital to improve over the next three years, while fewer than 20% expect financing costs to improve over the same period.

Geographic expansion opportunities and the availability of talent are the main improvements expected over the next three years

Table 1. Over the next three years, what change does your organisation expect to the following aspects of your business?



Even with major cuts in interest rates, companies may not feel the benefit. "A large industrial client told us it's irrelevant where interest rates are," says Robin Johnson, a partner at Eversheds, the law firm. "When all is said and done, their cost of capital is 10%, including uncertainties, insurance and other costs. That's the reality of the situation."

The shrinking access to debt is felt most acutely in capital-intensive sectors such as infrastructure, but as Mr Davies of Sanders Polyfilms explains, a credit crunch leads to a reorganisation of priorities. "Businesses are not going to invest in capital, that's how you preserve your cash," he says. "You'll say: 'I have cash reserves; if I spend it on capital, then it's a speculative occupation and it is a time to be risk-averse'. We want to preserve as much cash as we can so that if [2009] is going to be as bad as we think it's going to be, we'll be able to go all the way through the year without having to organise additional cash facilities."

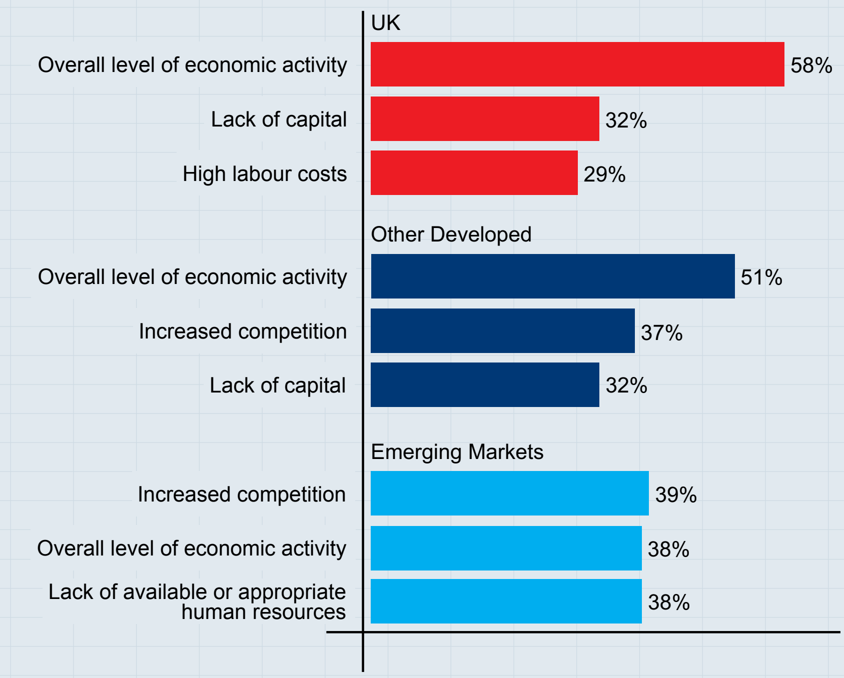
Curtailed access to capital is not the only challenge cited by survey respondents. Despite the volatility in oil prices since the summer of 2008, many anticipate increased raw material costs, as well as higher transport costs over the next three years. In reality, this is unlikely to be entirely borne out. While the Economist Intelligence Unit's overall commodity price index rose by 17% in 2008, a fall of 21.1% is forecast for 2009, and growth of just 0.5% for 2010, owing to weaker global commodity demand and less global liquidity for investing in commodities as an asset class.

More than half of respondents to our survey said that their companies had increased headcount in the previous year, but a quarter of them said that they had cut employee numbers, and the prospect for further large-scale job cuts in many developed countries seems certain. The latest UK data, from December 2008, showed unemployment rising to 6%.

The extent to which respondents expect challenges from their external business environment over the next three years varies, depending on which region they are being asked to consider. The overall level of economic activity is seen as considerably more challenging in the UK than in other developed and emerging markets, as are concerns about high taxes and high labour costs. But the UK is seen as presenting far fewer challenges than other markets when it comes to trade and investment barriers.

The level of economic activity represents the greatest challenge

Table 2. Over the next three years, which of the following do you expect to present the greatest challenges for your business?



Respondents to this question were asked to indicate the magnitude of a range of challenges to their businesses. Only the top three challenges for each region are displayed above.

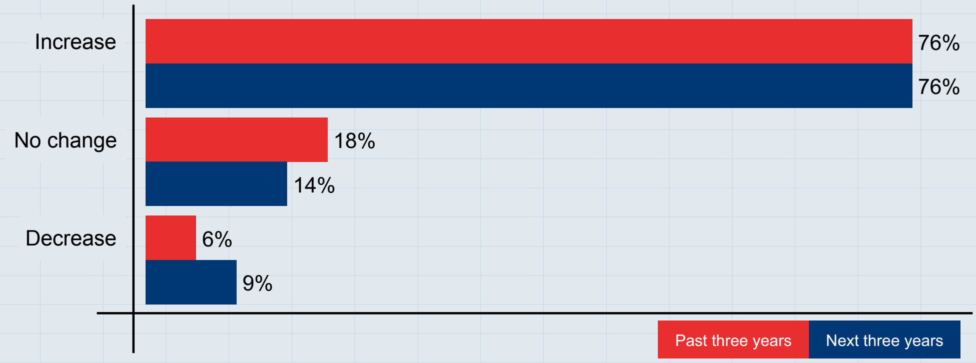
The impact of the downturn presents opportunity for entry into new markets

‘Executives are quick to recognise the importance of maintaining momentum in international trade’

Despite a gloomy outlook on the economic environment, the executives surveyed for this report were quick to recognise the importance of maintaining momentum in international trade. All represent companies that trade internationally, and many appear determined to expand on their cross-border business in the near future. Almost 60% say that they expect an improvement in the opportunities for geographic expansion in the next three years (see Table 1), and 55% say that they plan to enter a new geographic market (see Table 4). More than three-quarters say that they expect to increase the number of overseas countries in which they market their products and services over the same period (see Table 3). More than half the respondents agreed with the statement that they would invest more time and money in emerging markets than in developed markets over the next three years (see Table 11).

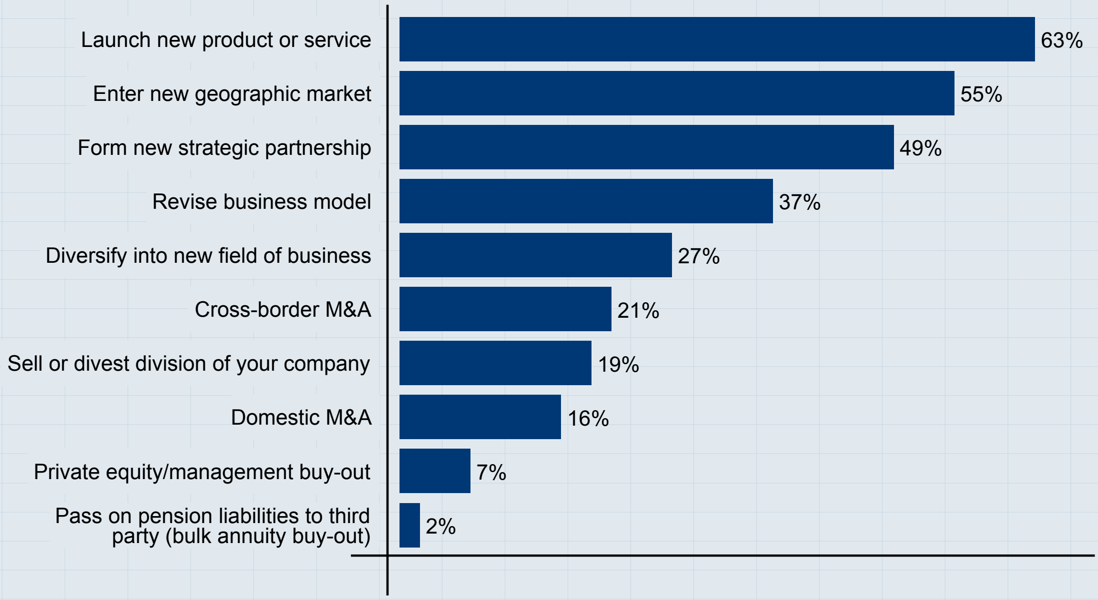
Over 75% of respondents expect past geographic expansion to continue

Table 3. What change has there been to the number of overseas countries in which your organisation markets its products and services in the past three years, and what change do you expect in the next three years?



Product launches and new market entry lead plans for the next 12 months

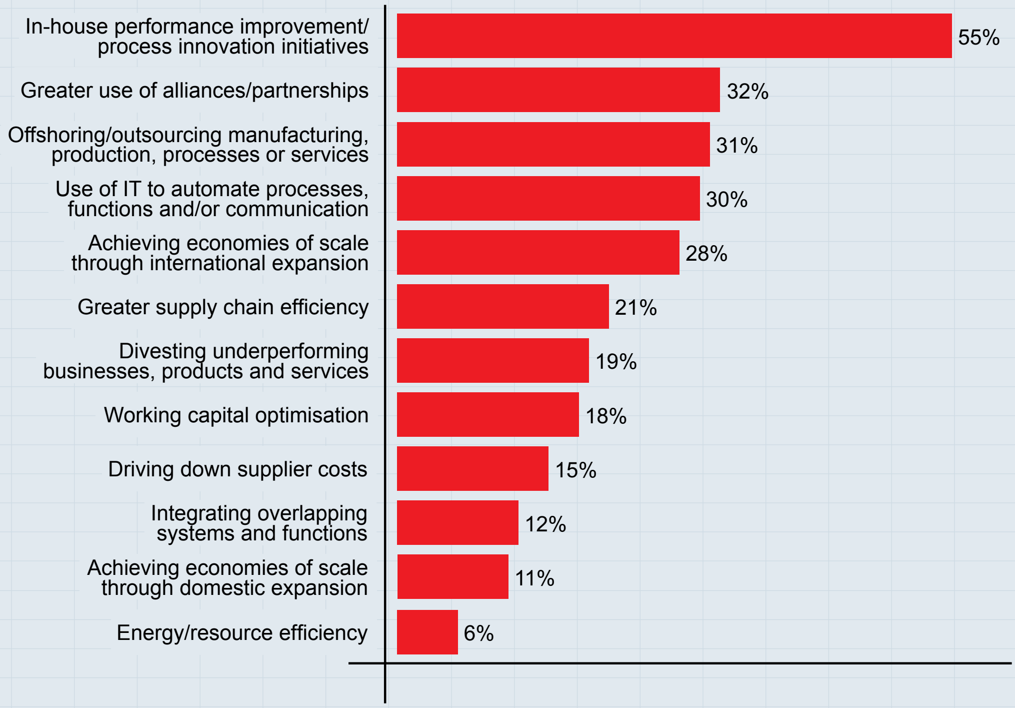
Table 4. Over the next year, which of the following strategic activities do you expect your organisation will execute?



At first glance, this bullish assessment of the opportunities for international expansion and growth may seem incongruous. Given that most companies expect the economic situation to deteriorate over the medium term and have low expectations of the availability of capital, it might be possible to question the wisdom of a continued programme of market and geographic expansion. Would companies not be better off retrenching and waiting for a more benign environment before ramping up their investment?

In-house improvements are seen as the leading solution to reducing costs

Table 5. Which of the following will be most important for reducing costs at your organisation over the next three to five years?



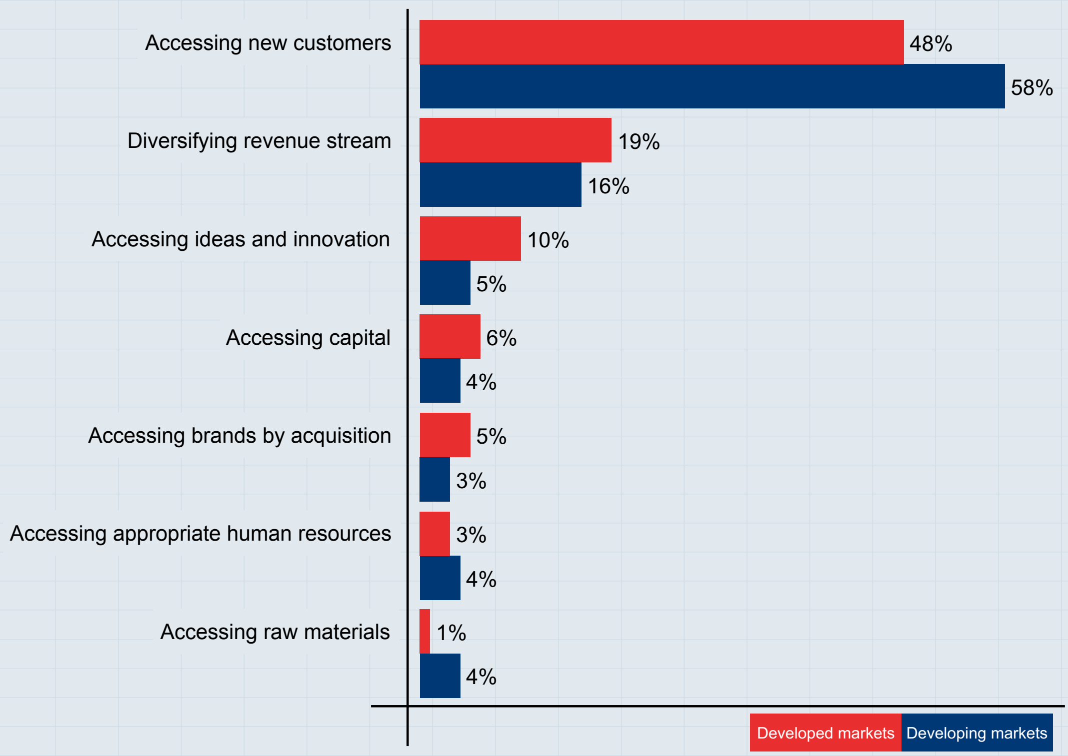
There are numerous reasons why companies may be keen to maintain their levels of international investment, or embark on it for the first time. First, UK companies face declining revenues in their domestic market and the prospect of flat economic growth for a year or more. Although growth is slowing in the key emerging markets of China, India and elsewhere, these economies are still motoring at a healthy rate. For example, China is forecast by the Economist Intelligence Unit to grow at 7% in 2009, compared with a contraction of 1.2% in the Euro area. In January, China's National Bureau of Statistics said the country's economy expanded by 13% in 2008, overtaking Germany to become the world's third largest after the US and Japan.

'Investment in emerging markets represents a rare opportunity for growth'

As a result, investment in emerging markets, with their fast-growing middle classes, represents a rare opportunity for growth and the most promising way of offsetting declining revenues at home. Asked about the motivations for their activities in developing countries, survey respondents cite access to new customers as being by far the most important factor. Other, more traditional motivations, such as gaining access to labour or natural resources, are far behind in the list of priorities (see Table 6).

Accessing new customers – the rationale for overseas expansion

Table 6. If your firm does plan to expand its activities in overseas markets over the next three years, what will be its primary motivations?



A second reason for the need to maintain activity levels is that these investments already have momentum. The recognition that countries such as China and India represent promising new markets for products and services is nothing new, and many companies will already have made substantial investments to tap into this rising demand. According to the Economist Intelligence Unit, trade and retail data in China continues to be strong, despite global economic gloom. Retail sales increased by 22% year-on-year in October 2008, and rural retail spending continued to grow dramatically, rising by 21.9% year-on-year in October.

‘Companies reason that they need to follow commitments through, however challenging the external conditions’

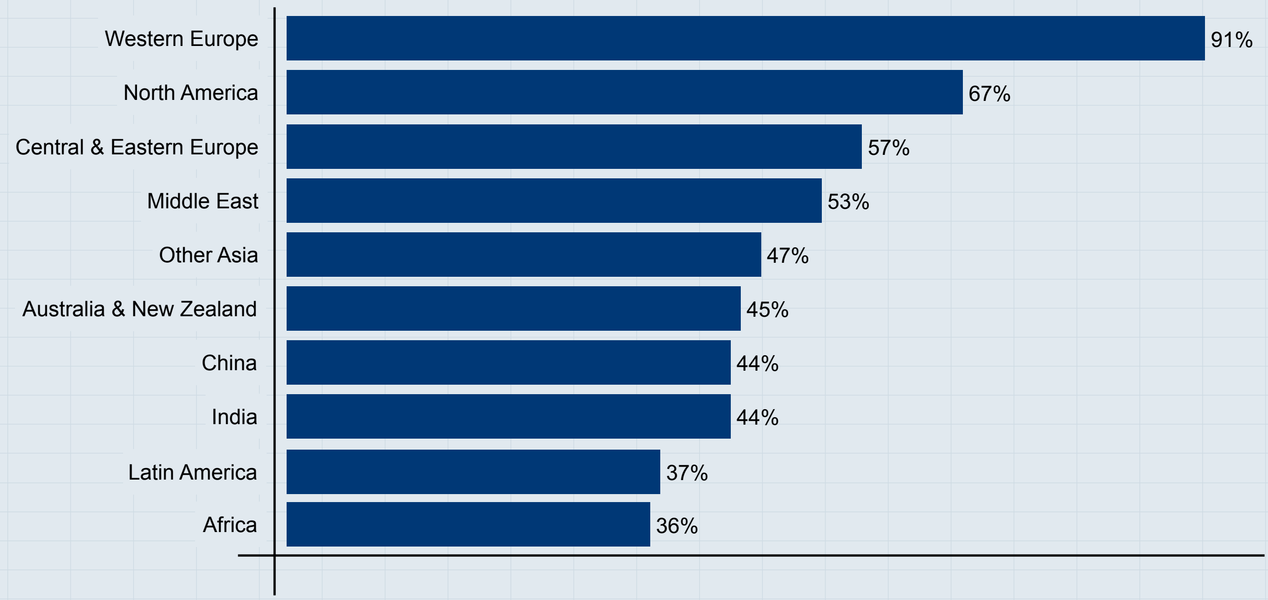
“Manufacturers only reduce the size of an operation as a last resort,” says Mr Davies, of Sanders Polyfilms. “It’s not done as a first cut because there is a serious cost to rebuilding the operation afterwards.”

The extent to which companies have already made investments in emerging markets is reflected in the survey findings. For example, three-quarters of respondents say that, in the past three years, they have increased the number of overseas countries in which their company markets its products and services (see Table 3). To withdraw now, or to slow down this process, would hugely damage companies’ long-term prospects as well as causing major waste and expense. In other words, the commitment has already been made and companies reason that they need to follow through, however challenging the external conditions. Companies, it seems, are taking a long-term view with their overseas investments.

The survey finds that companies are taking a broader view on their future markets. Asked where they currently market their products and services, Western Europe and North America lead the pack (see Table 7a). But when asked about the countries that offered the greatest opportunities for revenue growth over the next three years, the leading responses were China, India, Central and Eastern Europe and the Middle East, with Western Europe and North America in fifth and sixth position respectively (see Table 7b).

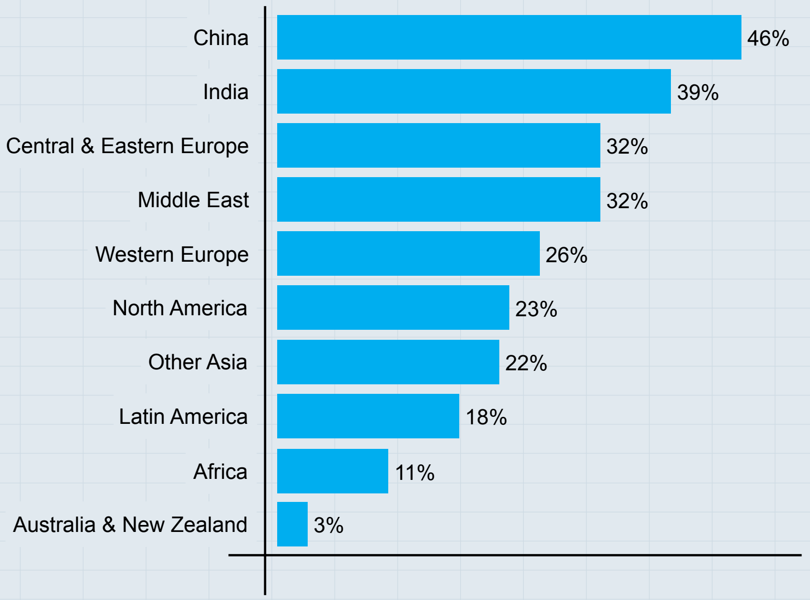
Europe and North America are currently the main markets

Table 7a. In which of the following regions and countries do you currently market your products and services?



The greatest opportunities are not just in the BRIC countries

Table 7b. In your opinion, which of the following regions and countries will offer the greatest opportunities for revenue growth over the next three years?



The growth in importance of emerging markets is not restricted to the traditional BRIC countries (Brazil, Russia, India and China). Andrew Cahn, chief executive of UK Trade & Investment (UKTI), points to research indicating a much broader penetration of new markets by UK businesses. "We found the most potential in Vietnam, Ukraine and the Gulf countries," he says.

'America will always be a market British companies are comfortable with'

However, Cahn says, the economic environment has created new opportunities for UK companies trading with more traditional markets. UKTI's US team, he says, "has never been busier with British companies wanting to export to the States. Sterling has weakened and suddenly (UK) companies find themselves with a competitively-priced product or service. America will always be a market British companies are comfortable with."

When companies select an overseas investment destination, the size of the market should not be their only concern. The regulatory environment, availability of human capital and political environment should all be taken into consideration – and monitored on an ongoing basis. Rising labour costs and changing regulations can erode the benefits of investment in a particular country and companies therefore benefit from diversification to ensure that disadvantages in one jurisdiction can be offset elsewhere. Nicolas Georghiades, chief operating officer of Alison Hayes, a garment manufacturer and supplier to UK department stores such as Debenhams, says that he does not even want to think about what would have happened if the company had not secured new production capacity in Vietnam and Egypt, following greater difficulty in recruiting and retaining workers in Romania.

'Rising labour costs and changing regulations can erode the benefits of investment in a particular country.'

Robin Johnson, partner at global law firm Eversheds, says his clients are seeing emerging markets in a new light amid the downturn. “When it comes to strategic opportunities I have heard a constant theme that there is an opportunity to invest heavily in developing countries,” he says. “Obviously, corporates are doing this all the time – historically, they have done it through acquisitions, but with cash at a premium and counterparty risk high on a board’s priorities, maybe now they can do it through strategic investments in their supply chains. Those investments could take on a more complex form that allows corporates to become more aware of a local partner’s financial and compliance position without taking a controlling interest, and ensuring that any red lights are communicated at an earlier stage.”

‘I have heard a constant theme that there is opportunity in developing countries’

However, not everyone is optimistic about expanding into emerging economies. “This is not the time when companies are going to send armies of people around the planet,” says Mr Davies of Sanders Polyfilms. “They tend to retreat from overseas markets first and focus on business at home. People will invest in safe, proven markets. What people won’t do at the moment is go looking for new, unproven markets because all such countries are having their difficulties. We are seeing Europe as our core market. If we develop significant sales in another part of Europe, we might consider investing locally. We are not looking beyond Europe.”

Those companies that are expanding into unfamiliar markets over a period of years are seeing an impact on their management teams. Asked if they thought that their management would become more international in composition as a result of continuing international expansion, around 40% agreed (see Table 11). The trend towards a deeper international presence is also expected to have an impact on the way in which companies structure themselves. Asked how they thought their company’s operations should be structured worldwide in three years’ time, only one-third thought that control would be centralised in the corporate headquarters – the remainder expected a high degree of decentralisation in one form or another, with one-quarter expecting that regions would be fairly autonomous.

Survey respondents identify a shortage of qualified labour as the most significant challenge that their companies face in developing countries, a factor that helps to explain their expectation that labour costs will continue to increase in the next few years. In China, according to December 2008 EIU data, average real wages are forecast to grow by 10.7% in 2009. Mr Cahn notes that his organisation is affected by high rates of staff churn among its 100-strong teams in China and India, where he concedes that attracting and keeping the best people is a struggle. His view is supported by a recent survey from Hewitt Associates, a human resources consultancy, which found that the average turnover rate in China increased from 8.3% in 2001 to 14.7% in 2007.

Outsourcing opportunities can be the key towards coping with the downturn

The strategic imperative to maintain, or even ramp up, international expansion would seem to conflict with the difficulties that companies face with the current financing environment. How can companies fund international adventures – a costly proposition at the best of times – when credit is in short supply?

There is no easy answer, but one approach that companies can take is to develop an obsessive focus on the bottom line and cash generation, as well as on securing efficient cash management and payment systems. This may not solve all their problems, but it can help to fund operations and investments that are already underway.

In a context of scarce liquidity and mounting costs for the foreseeable future, many businesses are concentrating on streamlining operations and preserving cash. Mr Davies of Sanders Polyfilms echoes this view, saying that his company has no plans to commit capital to investments until there is a pick-up in economic activity, which he estimates will not happen until the middle of 2010. To reset its operations for the downturn, Sanders has decreased capacity by 25% at its plants in both the UK and Romania.

A key priority among survey respondents in terms of cost-cutting is performance improvement and process innovation. This is likely to involve a laser-like focus on cash inflow, cash management systems, working capital optimisation and tighter trade credit conditions.

A second, vital cost-cutting approach is the use of outsourcing and offshoring. Among respondents to our survey, around 40% say that they expect to outsource more non-core functions and around half say that they expect to increase the overall number of their supplier and outsourcing relationships. However, some functions look to be mostly immune from outsourcing pressures – large numbers of respondents said they would not consider outsourcing sales and marketing (70%), risk management (62%), finance (60%) and research and development (55%).

In recent years, outsourcing providers have made the argument that outsourcing arrangements give companies access to specialist expertise that they would not be able to find in-house, as well as allowing them to keep down costs. But in a downturn it is clear that, from the customer perspective, the impetus shifts to being one of trying to save money above all other considerations. Almost two-thirds of respondents say that cost is the most important consideration when choosing a location for an overseas outsourcing provider, while half indicate that specialist expertise is the key factor. And asked about the benefits that their company foresees from its outsourcing activities, reduced staff costs and greater flexibility in the cost base are seen as most important (see Table 8).

It is interesting to note a distinction in appetites among respondents for outsourcing core functions, such as research and development and risk management, and non-core functions, such as administration and some aspects of human resources. In general, despite an overall push towards greater use of outsourcing, most companies see a clear line between core and non-core, and remain insistent that they should maintain the former in-house. As a result, the most likely candidates for outsourcing remain administration, information technology services and supply chain management.

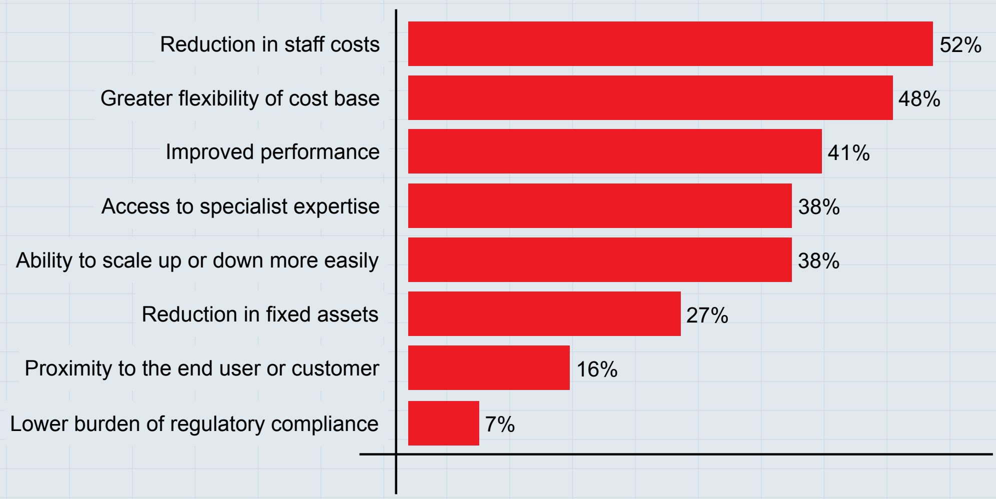
> ‘The most likely candidates for outsourcing remain administration, information technology services and supply chain management’

The trend towards more widespread use of outsourcing and offshoring, in combination with a sharpened focus on cost, could raise concerns that some companies may lose sight of the need to monitor ethical guidelines and practices at outsourced manufacturers and other providers. For example, if a company pushes its suppliers on costs, does it follow that the supplier will cut pay for staff or fail to upgrade working conditions? And does the desire to keep costs to a minimum mean that companies may conduct initial due diligence on their suppliers, but fail to monitor standards on an ongoing basis? Mr Georghiades of Alison Hayes says that this is not the case, and points out that textile manufacturers engage in audits of working practices both at the outset of an outsourcing contract and throughout its lifespan. “After we start we do ethical audits either yearly or twice a year,” he says. “This is certainly not a one-off.”

Meanwhile, Mr Davies, of Sanders Polyfilms, who is also involved with a bilateral chamber of commerce, suggests that certain labour standards have become requirements imposed on outsourcers by clients, similar to the standards that his company has to meet in order to be able to sell to British supermarkets.

Reduced staff costs and greater cost base flexibility lead the rationale for outsourcing

Table 8. Which of the following benefits to your company do you foresee from outsourcing activities in the next three years?



The availability of credit insurance

As the downturn continues to bite, some insurance firms are moving to reduce the level of cover they offer. The insurers' clampdown began early in the recession, but has become so serious that at the time this report went to press the UK government was formulating plans to underpin supply-chain insurance with a multi-billion pound guarantee scheme.

"There is a lot of apprehension around – a lot of concern about accessing credit and accessing trade insurance," says Andrew Cahn, of UK Trade & Investment.

The plastics industry is one sector that has come under pressure from insurers' decision to withdraw cover from suppliers, according to Brian Davies, chairman of Sanders Polyfilms.

"Because of the oil price fluctuations, a number of credit insurance companies have looked at plastics and said: 'We're going to reduce insurance cover'," says Mr Davies. "That has an immediate impact on companies' ability to raise credit. It seems to be a sector-wide approach, rather than one targeted at a particular company."

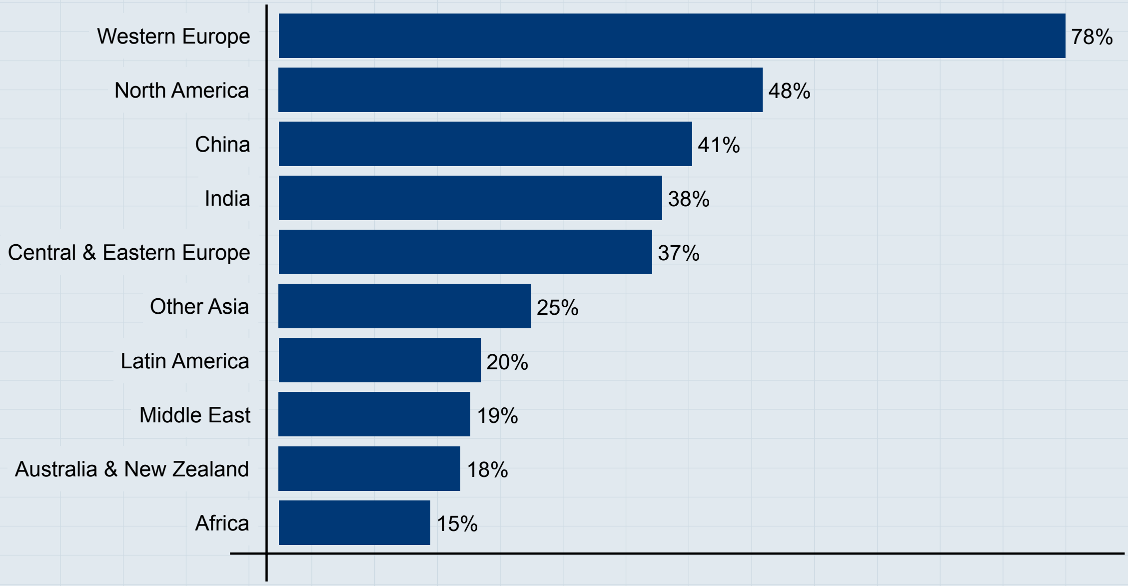
He adds that Sanders Polyfilms has two major customers whose credit limits have been cut by the insurers, in one case to zero. The problems experienced by Mr Davies are symptomatic of the experience of companies from a wide range of different sectors. During a more benign economic environment, many companies would be more willing to carry uninsured debt on their balance sheet. But in today's difficult environment, when the risk of insolvency among companies from a wide range of sectors is much greater, few will be prepared to take that risk.

"You have to ask long, hard questions about carrying this [uninsured debt]," says Mr Davies. "If our customers go bust, that would have a knock-on effect on our business."

He adds that, in the current environment, credit insurers wield considerable power over the future of many companies, possibly even driving some into bankruptcy. "If you're a company whose credit insurance rating has been cut, and you are unable to source all of your requirements, that can become a self-fulfilling prophecy in terms of going bust or not," he says. "People start saying: 'Can you pay me sooner? Can you pay me cash?' and everything becomes more difficult to fund."

Western Europe is the dominant outsourcing partner for UK companies

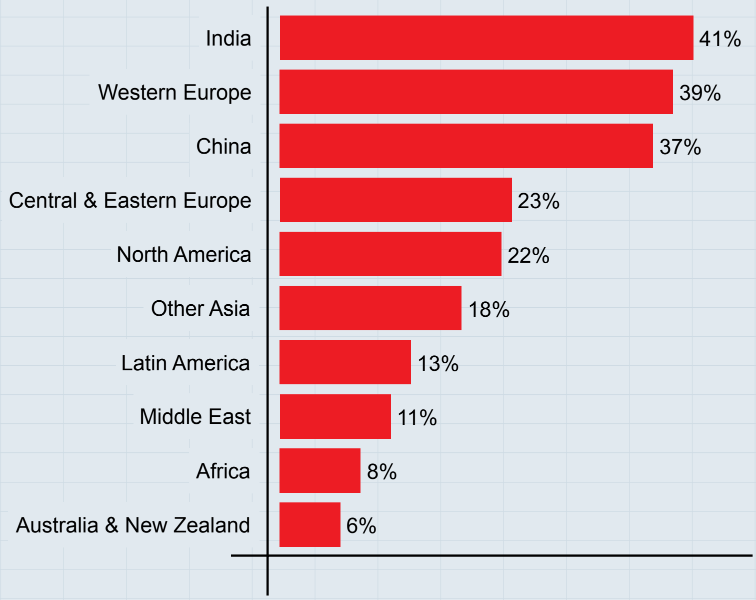
Table 9a. From which of the following regions and countries do you currently source products or services?



In the same way that companies are shifting their centre of gravity from developed to developing countries when it comes to marketing their products and services, so too there is a continuing trend towards emerging markets in outsourcing arrangements. For UK companies in the survey, Western Europe and North America are currently the most important sourcing partners, but looking ahead to the next three years, India leapfrogs Western Europe to take top spot, with China in third place.

India and Western Europe set to overtake China in terms of outsourcing potential

Table 9b. From which of the following regions and countries do you expect to offer the greatest sourcing opportunities for your organisation over the next three years?



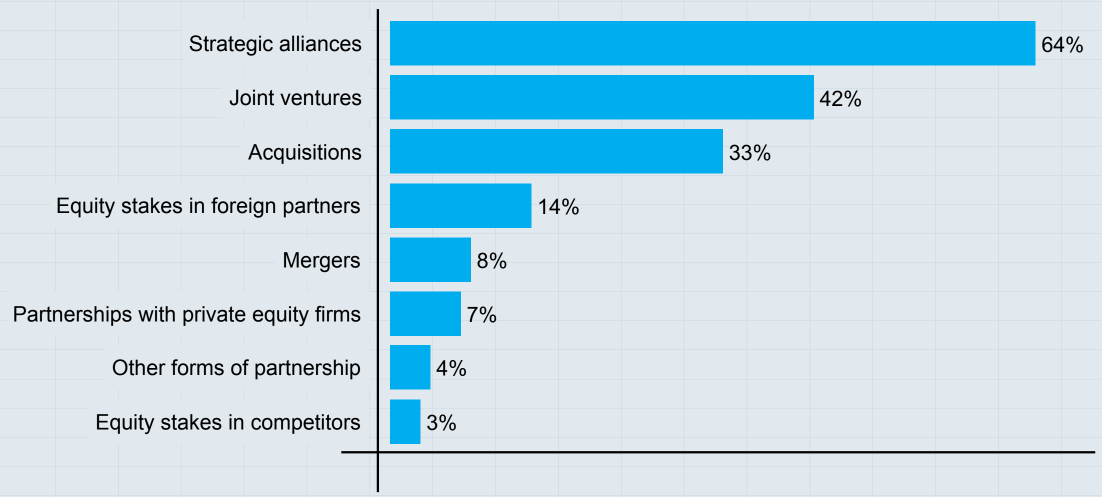
‘More than 60% of the survey respondents indicate that they plan to form a new strategic alliance over the next three years’

Companies also point to the use of alliances and partnerships as a way of cutting costs (see Table 10). This may involve sharing back-office operations, joint investments with the objective of sharing risk (and revenues), and the combination of strengths and resources in order to derive economies of scale. More than 60% of the survey respondents indicate that they plan to form a new strategic alliance over the next three years, and the greater use of alliances and partnerships is also identified as being an important method for reducing costs. Asked which categories of supplier relationship they hoped to establish in the next 12 months, 34% of respondents named distribution partners, 29% said shared service centres, 25% said R&D partners, 23% opted for financing partners, and 22% for manufacturing partners. When asked about which outsourcing partnerships they hoped to form, 25% said data or information technology, and 22% opted for customer service.

This is a trend that Mr Johnson at Eversheds says he is already seeing among his own clients. “We are involved in several projects that are aimed at sharing risk between organisations,” he says. “Depending on the sector, there are a lot of joint ventures being discussed, especially to help with sharing R&D or manufacturing costs.”

Working with others abroad will underpin expansion of activities

Table 10. In the next three years, which of the following do you plan to use to expand your business activities abroad?



There are, of course, risks associated with transactions such as joint ventures. Often popular during a downturn because of their capacity for reducing exposure to risk and unwanted costs, joint ventures quickly go out of fashion as soon as there is a pick-up in economic activity, according to Mr Johnson. “They are a bit like a shotgun marriage,” he says. “They achieve their purpose in the short run, but ultimately there is virtually always a falling out.”

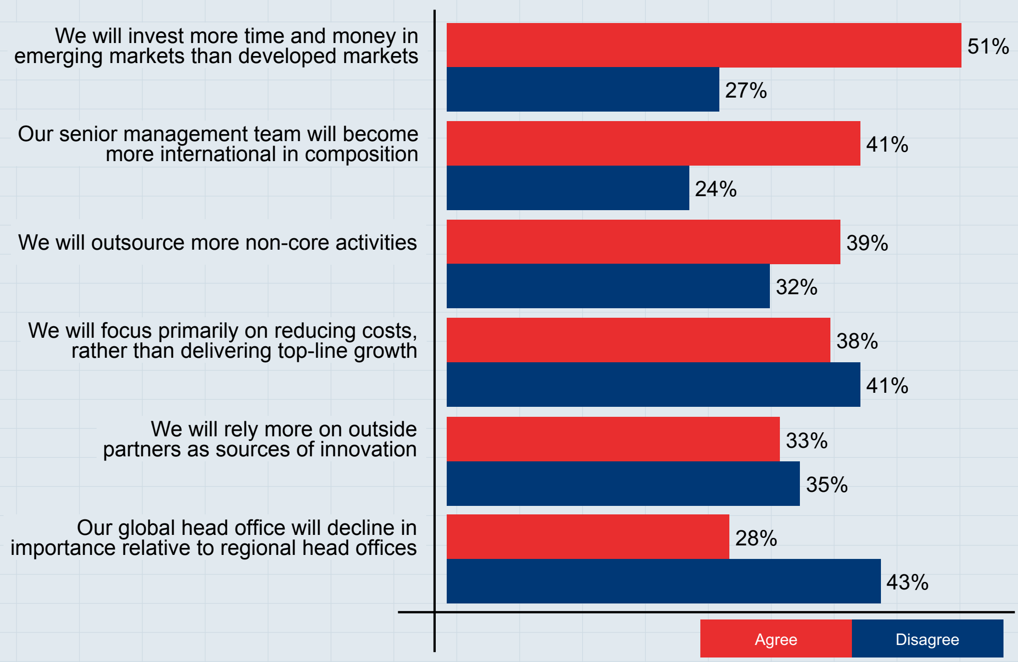
Mr Georghiades says that strategic alliances at Alison Hayes have not involved reaching out to competitors, but rather forming closer co-operations with suppliers and other vendors, such as transport companies.

Although strategic alliances and joint ventures may be among the most popular transactions in the current environment, this does not entirely rule out opportunities for mergers and acquisitions. Just fewer than 40% of survey respondents said that they will seek to capitalise on cheaper valuations to execute M&A deals, suggesting that we may see a wave of consolidation in some sectors. Executives interviewed for this paper also highlight the opportunity to acquire assets at attractive prices during a downturn. “During times like these, things become cheap, and when things become cheap, that’s an opportunity for a business person,” says Mr Davies.

It is interesting to note that few survey respondents expect to reduce expenses by driving down supplier costs. While there may be some mileage in squeezing suppliers or agreeing better terms to cope with a downturn, there is a real danger of piling on too much pressure and causing suppliers to enter financial difficulty and even bankruptcy. In an era of ultra-lean supply chains, when companies rely on a small number of key suppliers, such an approach can be counter-productive, and forward-thinking companies will seek instead to collaborate with their suppliers in order to achieve common goals as efficiently as possible.

Emerging markets and more international management will underpin business evolution

Table 11. Please indicate whether you agree or disagree with the following statements regarding how your business will evolve over the next three years.



Case study

The EIU spoke to PD Ports and discovered that one of the keys to planning in a downturn is making sure the urgent doesn't crowd out the important

PD Ports is a leading UK ports business offering end to end supply chain solutions. With headquarters based in the North East of England, PD Ports operates at many key UK ports and logistics centres with a growing European presence.

For infrastructure companies such as PD Ports, planning for the downturn and eventual recovery means being able to strike a balance between avoiding diversions from longer-term investments, and keeping momentum going. "We hope not to get diverted from our mission, which is to deliver a £300 million capital project for the Northern Gateway in the shape of a modern container terminal at Teesport," says Martyn Pellew, PD Ports' group development director. "The way you might get diverted is by delaying up-front expenses, such as not setting up the legal processes that allow contracts to be let out for contractors because you're trying to save money on legal fees, which is a discretionary spend in the short term. Or, because you're not doing the necessary advance marketing to persuade shipping lines to come to a northern port – that is, you fail to generate the demand that will justify the capital expenditure."

PD Ports hopes to start construction for the new terminal in 2010 and open it two years later. Mr Pellew indicates that other expenditure will be necessary before the terminal can be opened, including training – also a discretionary spending item.

Besides the new container terminal, PD Ports is waiting for a prospective tenant to secure approval for a wood-burning power plant. "While these things are on hold and we're talking about a multi-year process, there's always a risk that investors find something else they'd like to do with their money," Mr Pellew says. The objective in times of crisis, he adds, is not letting the urgent crowd out the important.

Conclusions

The effects of the economic downturn are making their presence felt, resulting in a more challenging environment for businesses that engage in trade across borders.

But the negative assessment of current conditions appears not to have reduced the appetite of UK companies for international expansion. Most companies in our survey see considerable opportunity in geographic and market expansion, and are confident that this strategy will help them to offset declines in domestic revenues. Pursuing such a strategy is by no means easy, but companies appear to recognise that a withdrawal from international commitments is an absolute last resort. The competitive environment is too fierce, and the long-term opportunities simply too great for companies to cut back on current investment priorities. The same message may also apply to companies that have not yet begun trading globally, but are waiting for conditions to improve before they do so.

‘Companies recognise that withdrawal from international commitments is a last resort’

Although it cannot replace credit in terms of its scale, a more careful focus on cash and the bottom line, as well as supply chains and payment systems, is seen as a valuable means of helping companies to maintain momentum with their international investments. Increased use of outsourcing and strategic partnerships is viewed as a way to increase flexibility and reduce risk, but the single most important way of cutting costs is perceived to be performance improvement and process innovation. To free up cash, it seems, companies need to look within the business first.

The need to maintain levels of international investment at the same time as keeping costs to a minimum is a tough balancing act in such a challenging economic and financing environment. Yet to succeed and grow, companies need to build their international presence in order to take advantage of long-term demographic and economic trends, particularly in emerging markets. This will require discipline, creativity and a strong nerve. But for those companies that can keep their balance, the rewards will be considerable.

‘The good executives see the opportunities that exist in a crisis’

Mr Cahn, of UKTI, says he was not surprised that many of the survey respondents seemed optimistic about new opportunities. “The good executives see the opportunities that exist in a crisis,” he says. “Historically, times like these are times of opportunity for the better companies to come out on top. Obviously there is a lot of concern, but the best are seeing opportunities and grabbing them.”