

The impact of the Global Financial Crisis

Some say the global financial crisis (GFC) has yet to fully hit Australia with all eyes on the first quarter results due in the next couple of months. Regardless of what you believe, companies are being cautious with their spending and costs are being cut across the board. In December 2008 and January 2009 the Inside Story asked some of Australia's most senior and respected business journalists what they thought of the challenges facing Australian businesses....

How is the GFC impacting Australia?

The GFC is likened by many journalists to a tsunami – taking the world by surprise by its size, its impact and speed. A wide range of issues have arisen as a result of the crisis and journalists believe that only those companies who had sound business practices prior to now will be able to survive and ride the storm through.

"The speed has taken everyone by surprise. Even mid-year they thought 'Oh yes, we'll bail out one more company in the US, one more bank or one more investment bank and confidence will be restored.' Well it just hasn't; the share prices keep sliding, companies keep failing, deals are off, now the retailers are being hit by people shutting their purses. So I think people just don't know where it's going to end."

Australia is seeing a reduction in demand for its exports, in particular to China which in turn is seeing a reduction in demand for its goods from Europe and the Americas. This in turn is expected to impact jobs across a wide range of industries in Australia:

"The mining sector has carried the economy here probably for the past couple of years, so now there's signs of that slowing down and that's going to have a big impact."

At a glance summary

- The extent and speed of the GFC has taken people by surprise - early signs were ignored
- The Government is expected to boost consumer confidence domestically
- Worse expected to come
- Overhaul of business practices needed in future
- Shareholders challenging board decisions
- Opportunities for the strong – including R&D and marketing activities

"...it's the old case of America sneezes and the world catches a cold, as much as we like to think we're probably as insulated as possible against these things, there's certainly no way that we're going to avoid the repercussions which have impacted elsewhere."

The decision by BHP Billiton to put the Rio Tinto purchase on hold was seen to be a major indicator of how the financial situation is pressurising companies in the Australian environment.

The biggest issue is the amount of debt companies were (and are) carrying. This has left them in difficulties.

Those companies owing large sums are finding it increasingly difficult to refinance and journalists note that investors are pulling away from debt ridden companies:

"I think the challenge for all businesses though is just trying to get bank funding for your operations and your capital expenditure and whatever at the moment. The banks are just still pretty shy in terms of who they lend to and they charge you a lot when they do."

The impact of the Global Financial Crisis

"We've got a lot of people telling us that they wouldn't invest in a company which has significant debt levels."

Companies wishing to expand their businesses are having to fund growth through use of profits – profits which are already falling due to the overall economic slowdown. It is believed this hasn't happened in the past:

"The two previous recessions weren't nearly as heavy-hitting in terms of not being able to get credit for instance, not being able to borrow money as a business..."

Some are managing to raise capital through the issuing of more shares, this in itself resulting in potential long term impacts for the business and shareholders.

What has been the response?

Journalists believe there has been little creativity in most businesses' approach to the crisis, with the reduction of overheads the primary focus:

"Making sure that they're lean and mean and are able to extract whatever efficiencies they can from their business."

Not all businesses are seen to be tackling issues through the laying off of staff. Journalists believe the organisations who are able to minimise redundancies and cut costs elsewhere are going to fare better in the long run. Examples include:

- Companies reducing staff hours – eg introducing part time working hours
- Cutting bonuses eg Macquarie Bank
- Selling off non core assets
- Scaling back projects
- Recruitment freezes

The majority of companies are not thought to be thinking long term at present, rather focusing on getting through the next six to twelve months.

How are investors responding?

Having emerged from a lengthy year bull market in Australia, shareholders and investors had largely taken a back seat. This is thought to be changing.

The bout of annual general meetings towards the end of 2008 was thought to involve far more interaction from shareholders than in the past, demonstrating to journalists that they are starting to take more interest and control of their investments and those running them.

Areas of contention include executive bonuses. In some cases changes have been put in place to ensure bonuses are paid as a result of performance rather than as a matter of course:

"...they're extending them out over a longer period so the executives can't get cash in hand straight up, they're having to do more for their money."

However, there is not yet suggestion that CEO salary capping will be introduced in Australia.

"People thought that the economy would keep going forever and debt wasn't a problem. Ultimately those assumptions were wrong. I think they got a bit complacent."

The impact of the Global Financial Crisis

Which companies are coping better?

Certain industries are felt to be largely recession proof and therefore impacted far less than others. These include pharmaceutical and health, superannuation, takeaway food outlets and supermarkets.

The banks are perceived to have fared comparatively well, with the structure and regulation of the Australian banking system emerging as a strength compared to other countries. Australia's banks stand out because:

- They can't merge or be taken over by foreign banks - gives them a stronger foothold, protected by the four pillars
- There is a minimum amount of cash they have to hold against their deposits
- There has not been the same level of exposure to sub prime market as in America – less exposure to Ninja (no income, no job and no assets) loans

Journalists suggest the open and honest approach of Australia's banks in admitting the levels of debt early on has allowed them to take a hit, then immediately begin regaining their reputations:

"The banking industry [has] ridden through an almost perfect storm yet our major banks are in very robust shape and in fact one of the strongest, Commonwealth Bank, was able to pick up an absolute bargain by buying BankWest before the government put in the guarantee for a knock-down price; Westpac was able to buy St George...they're in reasonable shape."

"...because they've been transparent with the market and they've told the market exactly what's happening, their shares often rebound a lot faster; where it's the other ones where investors aren't sure just how much debt they have on their books because they're not saying, they're the ones that seem to run into more trouble."

Macquarie Bank is one company which is thought to have begun tackling issues internally long before other businesses:

"I think they started battening down the hatches for this easily more than a year ago ...their previous chief executive, Alan Moss was quite proactive in shoring up their balance sheet a long time before any of us knew that there was really a problem."

It is thought Macquarie would have fared far worse in the crisis had it not taken action early.

Could companies have been better prepared?

Retrospectively, journalists believe Australian companies could have been better prepared for the GFC, with signs mid 2007 that the bubble was about to burst:

"There were signs back in July [2007] that something was happening and certainly a number of investors and companies did start preparing...but certainly no one knew it was going to come down to what's actually happened and that's quite evident by what governments around the world are having to do; the Treasury departments didn't realise what was going to occur even when it was occurring."

The fact that early warnings were made so long ago is thought to have contributed to the issues. People saw nothing happening and continued as usual:

The impact of the Global Financial Crisis

"...because nothing actually happened people were just conscious of making money while they could."

Certain business models such as that of investment company Babcock and Brown are thought to have been highly risky, over exposed to debt that proved unsustainable in the current environment:

"Business like Allco, Babcock & Brown, a lot of these financial engineered structures probably should have been recognising a lot earlier that once the tap turned off they were in deep trouble, and they didn't and now they've paid the price..."

Journalists believe a great many companies blinkered themselves to the potential issues, instead concentrating on getting the edge on competitors, regardless of the risks involved:

"Businesses could have...put away some money for a rainy day; or even at least put together some contingency plans that would look at how they would deal if the boom finally came to an end."

"Some of the companies may have been looking at their risk management but you just can't stop in the middle of a boom; all your competitors are moving ahead so you've got to stay with them or obviously you fall behind...it's a bit of a catch 22 I suspect."

Government's role in the economic downturn

In times of crisis it is often the government to whom people turn for help and guidance. It responded late last year with stimulus payments to encourage spending around Christmas time, boosting the domestic economy.

Journalists believe this should be the key role of government, encouraging consumer confidence to ensure continued spending.

Government regulation as a result of the recession in the early 1990s is thought to have aided the insurance and banking industry in remaining strong now:

"...In the early '90s when [Westpac Bank] almost went out backwards and two weren't that far behind because of their high risk corporate lending practices. I think regulators came in and closed a lot of that down..."

Guaranteeing consumer bank deposits is thought to have also boosted confidence in Australia's banks:

"The Government's maybe got their foot in front of that concern in the first place by guaranteeing bank deposits for consumers."

The collapse of ABC Learning Centres has placed a lot of pressure on the Government to find childcare placements for around 100,000 young children.

It is felt that business always asks for as much as it can get but at the same time it wants Government to leave it alone as much as possible.

Journalists recognise the federal Government may have to bail out specific industries in order to save the wider economy:

"If a government takes that view then obviously the money...should be spent on cushioning the inevitable impact of those corporate collapses on the employees and so forth because you'll obviously have an enormous number of people out of work so you'll need more money for unemployment benefits and training..."

The impact of the Global Financial Crisis

Journalists are expecting to see the following from state governments:

- Continue to support and encourage consumer spending and confidence
- Employment levels – keeping a close watch on unemployment, encouraging and helping with reemployment
- Continue spending on long term infrastructure projects – keeping up investment:

"Their responsibility is to ensure their spending at this time is in the right areas - minimise the hemorrhaging."

"Public transport is just a key thing that needs to be addressed....hospitals...schools, all those sorts of I suppose softer infrastructure issues haven't really been addressed."

The general perception is that the federal Government has done a good job thus far, acting early enough to tackle solutions and working hard to avoid a recession.

The future – next 12-18 months

Journalists admit they are all "...crystal ball gazing..." when it comes to the economy but there is a general belief things will worsen before getting better. This is backed up by predictions from economists and experts in banking and broking houses.

The majority of journalists believe Australia will go into a technical recession at some stage:

"..have a couple of periods of flat to negative growth."

"I expect that growth will either plateau or come back below 2%."

"We will probably see close to a recession, if not negative change to Australia's GDP in the next 12 months."

"...it's huge, it's ugly, it's global... there's just no spark to turn it around for the time being. The whole system is pretty rotten."

Since the interviews concluded we have seen a further cut in interest rates, something journalists believe we will be seeing more of, encouraged by a reduction in inflation:

"I think there'll be further interest rate cuts. Things like the falling fuel prices will take an edge off of inflation which will free up the RBA's hand to cut interest rates further."

It is thought that by April 2009 there will be a clearer picture of how the economy is truly faring – by then the quarter one results will have been reported and include the post Christmas spending figures.

The year ahead is generally expected to be difficult:

"I think the outlook for the year ahead is it's going to be really tough. I think there'll be more companies that could go under, particularly those that have significant debt; I think that's inevitable."

Journalists are predicting the following impacts to various industries:

- Retail - 12-18 months of pain for the retail sector, in particular impacting clothing shops, luxury goods, high fashion, giftware
- Motor industry – expecting major restructures due to American ownership – potentially bought out by Asian manufacturers. Again 12-18 month timeframe

The impact of the Global Financial Crisis

- Property market – first home buyers are expected to be buoyed by the low interest rates and government grant, however existing home owners are thought to be concentrating on reducing their debt levels
- Exporters – are expected to benefit from the lower Australian dollar, however profit levels will not equal the boom of recent years
- Public service – a perception there will be multiple job cuts as state governments balance budgets
- Companies reliant on exporting to China (such as those in the resources sector) are thought to be at highest risk as the ripple from America hits and in turn impacts the economy here.

Change needed within core business models

Journalists believe there is a fundamental review of business required to ensure that the vulnerable position we see today is avoided in the future.

They perceive there are plenty of case studies being created for future business students to learn from and boards also need to be taking stock of the mistakes made and review business practices in the future.

Along with the aforementioned reviews to executive salary and bonus payments journalists believe there should be further investigations made.

It is expected there will be more attention paid to board members and pressure from investors to ensure appropriate people are present:

"There'll be a lot of hard questions from shareholders asking these directors whether they are qualified to continue their careers as company directors with so many black marks against their names. I think we've just recently seen Rod Eddington, he's been appointed the new chairman of ANZ yet he's still on the board of Alcoa which has gone into administration."

Many journalists would like to see the end of the 'boy's club' attitude to being a board member and the recruitment of appropriate skills, something they see as being simple good governance:

"We are seeing a lot of pay rises for company directors despite the reality for their shareholders and the loss of value in their companies, and we're also seeing a lot of directors with black marks against their names getting coveted positions on other boards. ...There's still a lot of clubbishness which goes on with company directors and I can't see that cracking."

There is speculation that businesses will think twice before becoming reliant on debt (rather than profit) to pay dividends and reimbursements:

"I think that business model, I don't know whether it's dead but it's definitely being reviewed and I think that's something that will take place I guess over the next 18 months, two years."

Some suggest a much more dramatic overhaul of traditional thinking is required by boards and investors, encouraging businesses to make investments for long term sustainable success rather than focusing on short term gains and targets.

"If companies are going to survive we need to start valuing stability over greed and short term profits."

The impact of the Global Financial Crisis

Opportunities for the strong

Those companies which are better managed are expected to shine in this environment. Better management is thought to be about:

- Making strong, concise decisions – based on evidence:

"Monitoring demand very closely, staying close to your customers, monitoring trends."

- Ensuring balance sheets are robust – financially sound:

"Companies that have conserved cash through the good times are now in a position where they can a) ride through these times, but b) also be opportunistic in terms of being able to make acquisitions at the bottom of the market. So I suppose having a very strong financial position is pretty critical in the current environment."

"I think everybody is going to do it tough [this] year but I think there'll be real opportunities for those companies that position themselves for the downturn."

- Continuing spending on research and development:

"When things pick up, companies need to be in a position to have new products to go with new strategies and new services."

- Keeping up marketing activity - at present journalists suggest companies are in shock mode, with advertising down displayed in a thinning of magazines and newspapers:

"If you stop the publicity it looks like you have given up – you've got to stay out there and keep your product in front of people..."

The companies which are in a financially sound position are expected to emerge from the crisis as altogether stronger organisations:

"The companies that survive will be much stronger in their respective [fields]..."

It is believed there will be much more consolidation with bargains to be found for those companies able to put their hands on funds.

Any overseas investments are expected to be minimised with investor comfort found in domestic markets:

"Initially they'll look domestically because that's what investors want; people are too scared about the whole international situation so they want transparency on anything a company is doing...people understand if you're buying some operation over in Europe or the US it's a lot harder for local investors to understand that operation and back it."

Above all journalists recommend companies are open and honest about their position, allow the market to absorb the situation and take on board the strategies in place to move the business forward. While journalists are not expecting ambitious strategies, sound plans are expected to be communicated.

"There's been downturns before, there's been recoveries before, a lot of people that work in finance are saying they've never seen a climate like this at the moment."

INSIDE REPUTATION BULLETIN



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About the Inside Story

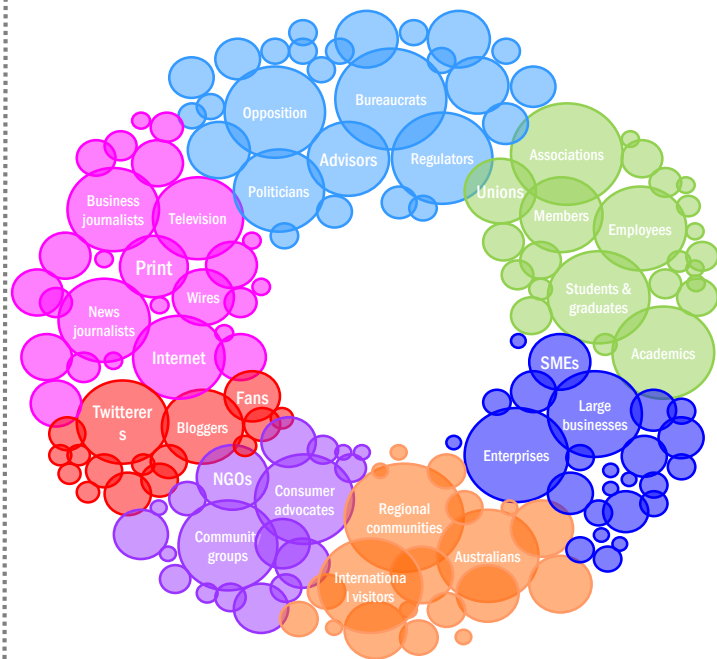
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