# 40 years on: How do companies respond to the CBI's Industrial Trends Survey?

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With concern mounting for the UK economic outlook and the state of manufacturing, the CBI's Industrial Trends Survey (ITS) – now 40 years old – is playing an increasingly important role in informing the current economic debate.

It is nonetheless vital for the correct interpretation of the Survey's results to have a clear understanding of the basis on which respondents reply. From time to time, the CBI investigates the answering practices of its respondent companies by carrying out special surveys. So far, four such "questionnaires on the questionnaire" have been undertaken – in 1967[1], 1976[2], 1982[3] and 1989[4].

This report gives an overview of the latest special survey which was conducted between 28th July and 19th August 1998 and seeks to clarify the interpretation and improve the understanding of the Survey's results. (The results are given in the Statistical Update section).

After briefly discussing the methodology followed, the report identifies the extent to which the Survey accurately reflects the views of industrialists. The special survey's findings are then examined, highlighting the main issues to which it provides valuable insights.

1. How do companies assess business confidence and optimism about export prospects? These are vitally important indicators of the likely trends in manufacturing industry.

2. What is meant by 'capacity'?

3. What are the main constraints on export orders?

4. What factors enter companies' assessment of average costs? Can they, for example, take account of productivity improvements?

5. There are a number of matters fundamental to the correct interpretation of Survey data. What do firms mean, for example, by 'up', 'down' or 'the same' when assessing trends in economic variables? What precisely do companies mean by 'normal' when judging their order books? What determines 'normality' and does it change over time? What do companies regard as 'falling' export orders?

6. How useful are the Survey results themselves to businesses?

## Methodology

The special enquiry was conducted using the normal ITS procedures. 658 companies responded.

The good response to the special enquiry suggests that the findings are broadly representative of companies regularly participating in the regular Trends Surveys. Further evidence that the views of senior businessmen are indeed reflected was provided when we asked companies to indicate who filled the Survey questionnaire on a regular basis. Over 90% of those replying confirmed that the Survey was completed at a senior level – the Chairman, Managing Director, Functional Director or General Manager. The results of this special survey into answering practices can therefore be regarded as firmly based upon the views of senior industrialists.

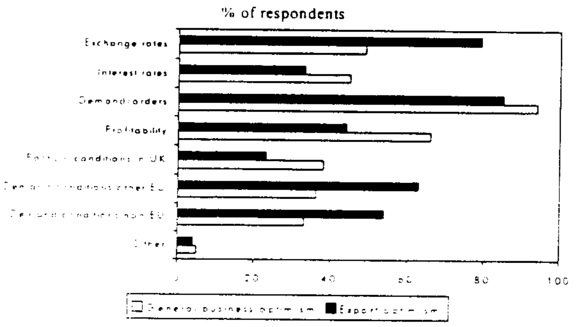
## Optimism

Business confidence and export optimism are important indicators because they can give advance warning of likely trends in manufacturing industry. Although the question in the quarterly survey is framed in terms of changes in the level of optimism (cited by 54% of respondents), previous enquires have indicated a significant minority answering in terms of levels. This survey confirms that just over a third of respondents answered the optimism questions in terms of levels, broadly in line with the results of the earlier enquiries. The stability in response practices over time is encouraging as it allows valid inferences to be drawn from trends in the balance over time.

Let us first consider what are the main determinants of general business optimism and how they are ranked in order of importance. Companies identified four key factors influencing their assessment of business confidence (see Chart 1). Demand or orders was by far the most influential – specified by 94% of all companies. This result helps to explain the fall in business confidence reported by the ITS since the beginning of 1998 as demand for manufacturing industry's products has weakened. Profitability was ranked second on average, and was cited by two-thirds of all respondents. Exchange rates were ranked as third in importance, by nearly a half of respondent firms, followed closely by interest rates.

Turning to the main factors governing companies' views of export prospects, the survey indicated that while demand still ranked as the leading influence, it was only specified by 85% of firms. Exchange rates, meanwhile, were now the second most important influence followed by demand conditions in other EU markets and profitability of exporters. This result is similar to that in the 1989 survey when 79% of firms ranked demand as the leading influence on export prospects. Although exchange rates were the next most important factor, they were cited by only 54% of respondents.

**Chart 1: Determinants of business and export optimism**




Source Answering Practices in the CBI Industrial Trends Survey, August 1998

## Capacity

How is the issue of 'capacity working' treated in the ITS? Respondents were asked if in defining full capacity they only measured current output solely against physical capacity or whether other factors were considered.

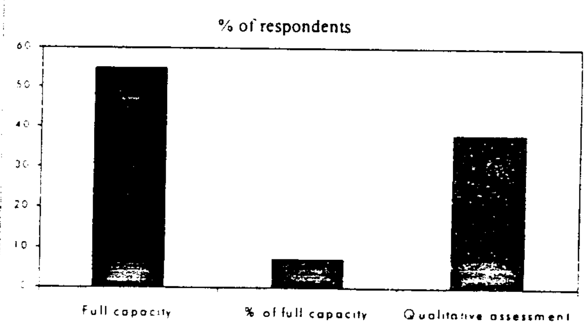
Almost two-thirds of the companies surveyed had physical capacity (buildings, plant and machinery) in mind, the remainder, some 35% also considered other factors. Of these utilisation of labour was by far the main influence, mentioned by nine out of ten companies. In the 1989 special survey, only 55% of companies mentioned that current output was measured against physical capacity.

The special survey also asked firms how they judged whether a given degree of utilisation was 'satisfactory'. Just less than a third of respondents based their assessment on 'full capacity', with over a half treating it as a percentage of full capacity and one-fifth relying on a qualitative judgement (see Chart 2). These findings are similar to those in the 1989 special survey.

Companies were then asked whether the percentage rate of operation currently regarded as satisfactory differed from the position five years ago. 59% of those equating 'satisfactory' with a percentage of full capacity said that this proportion had changed since 1993, with the vast majority of these companies indicating that utilisation rates were now higher. This differs from the response in the 1989 special survey when only a quarter of respondents said utilisation rates were higher than in 1984. 59% of respondents, in this survey, also said that they were now working closer to full capacity than they used to in 1993.

This result means importantly that the ITS responses cannot simply be interpreted as a direct measure of capacity utilisation in manufacturing industry. The response of companies can either reflect capacity changes and/or, as the special survey shows, changes in the benchmark for assessing a 'satisfactory' full rate of operation.

**Chart 2: Capacity: What do you regard as a 'satisfactory' rate of operation?**



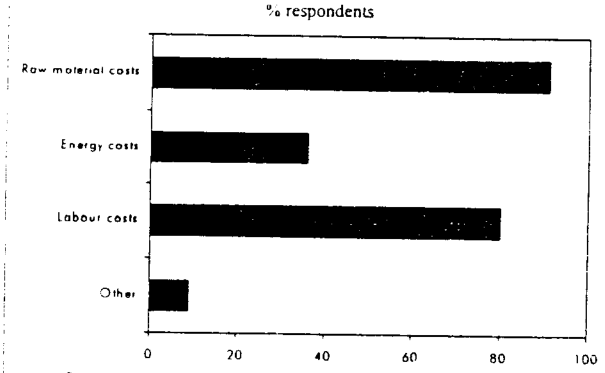

Source Answering Practices in the CBI Industrial Trends Survey, August 1998

## Costs

The special survey investigated how companies view past and expected trends in their average costs per unit of output. What are the most important influences affecting the response of firms to this question?

Raw material costs (at 91%), closely followed by labour costs (at 80%) were uppermost in the minds of respondents. Energy costs were ranked third in significance by around one-third of firms. Three-quarters of all firms, meanwhile, were also able to

**Chart 3: Factors influencing average costs**



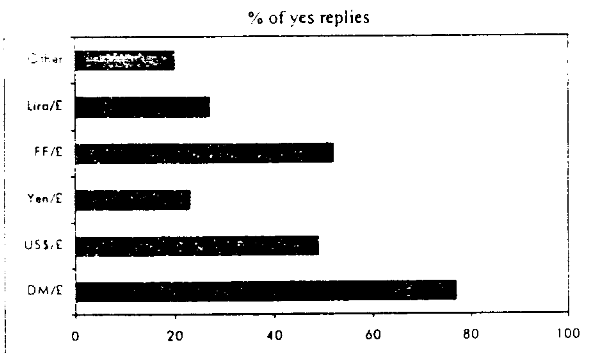

Source Answering Practices in the CBI Industrial Trends Survey, August 1998 take into account productivity improvements when considering trends in their average costs of production (see Chart 3). These findings are similar to those in the 1989 special survey.

## Constraints on exports

The special enquiry investigated two main factors likely to limit companies' ability to obtain export orders – 'prices' (compared with overseas competition) and 'political or economic conditions abroad'.

Firstly, when citing the constraint 'prices', 60% of respondents did this with reference to a specific exchange rate. Of these, around three-quarters mentioned the Deutschemark/Sterling rate, with the French Franc/Sterling and US dollar/Sterling being mentioned by 50% of these respondents (see Chart 4). Interestingly, the largest firms (employing more than 5000 staff) cited the $/£ and Yen/£ as their second and third most important constraints, highlighting the global nature of their business.

**Chart 4: Factor limiting export orders - 'prices' (exchange rate)**



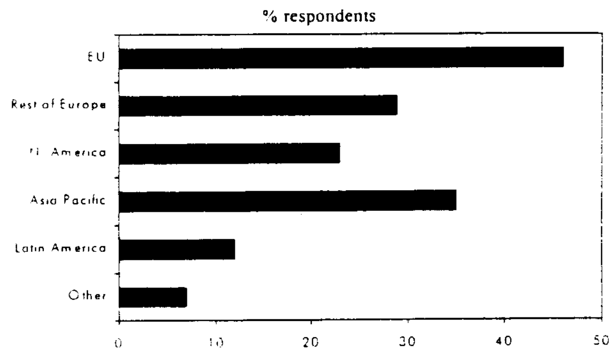

Source: Answering Practices in the CBI Industrial Trends Survey, August 1998

Companies were then asked over what period their view of the exchange rate was based on. Here there was quite an even split between three of the responses among those companies citing a specific exchange rate. Just under 40% of these respondents assessed an exchange rate average over the previous four months, closely followed by expectations over the next four months and the level of the exchange rate at the time of answering. This finding is of particular interest in the current environment of volatile exchange rate movements.

Secondly, when citing the constraint 'political or economic conditions abroad' as a constraint on export orders, nearly half cited conditions in the EU as concern. Surprisingly, a further third of respondents identified Asia Pacific - perhaps reflecting the impact of turmoil in these markets over the last year - followed by the rest of Europe and North America. Conditions in Latin America were of only minor concern to respondents (see Chart 5). The largest firms, however, viewed North America as their second most important market.

This finding has an important bearing on the analysis of the ITS. It provides a clear picture of the main markets which affect trading conditions for those companies who answer the ITS.

**Chart 5: Factor limiting export orders - 'political or economic conditions abroad'**




Source: Answering Practices in the CBI Industrial Trends Survey, August 1998

## Constraint on output

With skill shortages still apparent in certain pockets of the economy, companies were asked to make an assessment of how they identify this constraint on output.

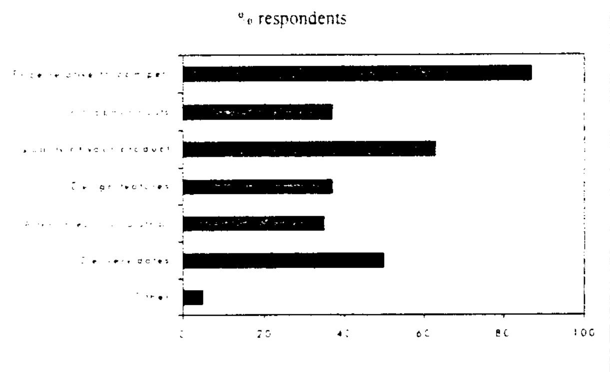
Nearly 60% of companies thought that skilled labour as a constraint on output reflected their difficulties in recruiting the right skilled labour. 45% saw this as a problem in relation to their current workforce. Most companies found that the skilled labour constraint referred to a combination of their production line workers and managerial/technical skilled staff.

## Competitiveness

Companies were asked what were the most important factors influencing their response to their competitiveness in the UK, other EU, and non-EU markets. The vast majority (87%) said the price of goods relative to their competitors was the most important factor. Almost two-thirds of respondents identified the quality of their products, with delivery dates being mentioned by a half of respondents (see Chart 6). These results refer to companies responses in relation to the UK market, but the findings are broadly replicated in relation to other EU and non-EU markets.

The largest firms expressed design features, along with the quality of their products as the second most important factor, with delivery dates coming down the ranking order.

**Chart 6: Factors influencing competitiveness**




Source: Answering Practices in the CBI Industrial Trends Survey, August 1998

## Interpreting survey data

In the special survey we also investigated a number of issues of fundamental importance to the correct interpretation of Survey data. There are five aspects which are particularly important: the first two refer to the interesting issue of 'normality' and companies' assessment of total order books covered in Questions 5a and 5b of the ITS, while the other three relate to Questions 6 to 12.

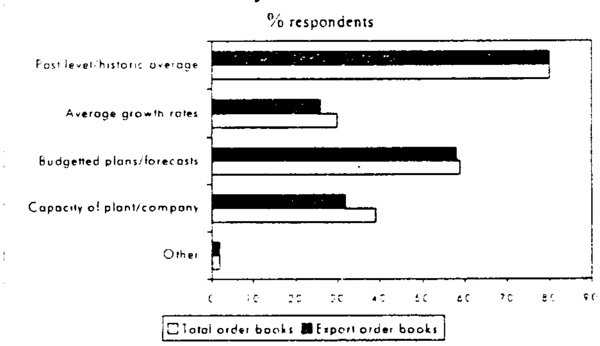
1. On what basis do firms assess the 'normality' of their order books expressed on a volume basis?
2. How do companies combine domestic and export order books to arrive at total order books?
3. What do companies mean by the 'trend over the past four months and the expected trend over the next four?
4. What do companies mean by 'up', 'down' or 'the same' in relation to economic variables?
5. How significant is seasonal variation and how do companies allow for this in their responses?

## Normality

How do firms assess whether or not their total and export order books are 'normal' in volume terms? The analysis concentrates upon the results for total order books, as the findings are broadly applicable to export order books. Companies were asked what benchmark was used to judge the normality of their order books. Out of the four options specified, the past level of orders or a historic average proved to be the most significant, cited by 80% of all respondents. Budgeted plans or forecasts were ranked second in importance, mentioned by 59% of companies. Plant capacity and average growth rates were, however, the least important factors influencing normality (see chart 7).

Companies were then asked whether their assessment of normal order books changed over time. Of those who used the past level of orders or some historical average as a benchmark, the majority (two-thirds of all respondents) confirmed that their view of 'normality' did shift over time. In the 1989 special survey, 61% of all respondents did so. It also appeared that for a significant minority of companies this assessment had altered in the past twelve months, while for others, this had occurred over the past five years. This result suggests that the strength of demand in 1996 and 1997 led a number of companies to change their perception of 'normality'. It is important to bear this in mind when interpreting the ITS evidence of a marked weakening of order books over the past year. These findings also confirm that the ITS data on the 'normality of companies' order books need to be interpreted with some care. They suggest that shorter term comparisons have the greater validity, while we should perhaps pay less attention to comparisons made over a longer time horizon.

**Chart 7: Benchmark used to assess the 'normality' of order books**




Source: Answering Practices in the CBI Industrial Trends Survey, August 1998

## Assessing total order books

A new question was asked in the special survey which tried to assess how companies combine their domestic and export order books to arrive at a figure for total order books. The vast majority (86%) said they made a direct assessment of total order books. Only 13% of respondents attached any weights to domestic and export order books according to their importance to their business.

Companies were asked a further question on whether they produce a heterogeneous range of products when they answer the questions on orders, output and stocks. Those who did, 49%, said they assessed volumes in a subjective manner, with the rest using an established quantitative procedure.

## Trends in economic variables

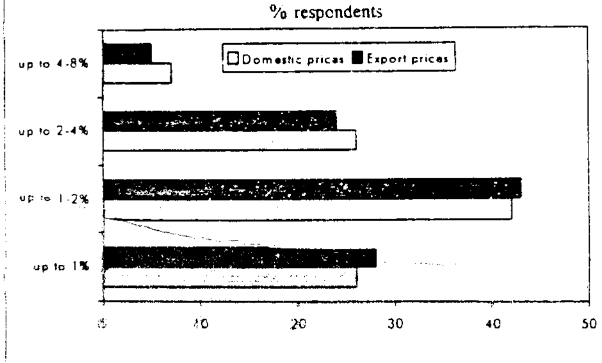
It is very important when interpreting the Survey results to know what time period respondents have in mind when replying. Moreover, the Survey questions themselves are potentially ambiguous since they refer only to the 'trend over the past four months' and the 'expected trend over the next four months'. The special survey indicated that nearly two-thirds of all respondents took this to mean 'the four months as a whole compared with the previous four months'. A fifth of companies, meanwhile, defined the time period as applying 'from beginning to end of the four month period', while 7% compared 'the four months as a whole with the same period a year ago'.

A significant minority, some 11% of respondents, employed some combination of these three options. It is important, therefore, that any analysis of the relationship of Survey data to official figures takes into account the ambiguities present. This result, though it makes the task of analysis more difficult, is nonetheless, broadly in line with the findings of earlier special surveys into answering practices. This suggests that the consistency of responses over time may not be seriously affected.

## 'Up, down, the same'

The special survey indicated that the overwhelming majority – around 90% of all respondents – answered the Survey questions in terms of the change in the level of the variable concerned, and not its rate of change. This finding is not only consistent with a priori expectations, but is also suggested by the relationships identified between Survey data and corresponding official figures. The main exception to this conclusion is, as we have already seen, the question on optimism.

**Chart 8: Range of movement regarded as the 'same'**



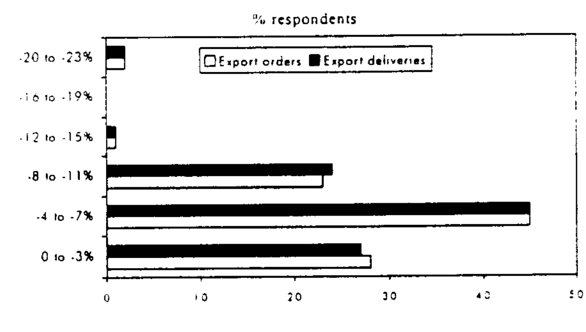

Source: Answering Practices in the CBI Industrial Trends Survey, August 1998

Much of the analysis of the Survey data has tended to focus on the 'balance' statistic, measuring the (weighted) percentage of respondents replying 'up' minus those replying 'down'. It is clear, however, that this approach traditionally used by the CBI does involve some loss of information. A significant proportion of respondents, for example, experience fairly large changes in the variable concerned and yet still reply 'the same'. The special enquiry lent some support to this view, indicating that close to a half of all respondents classified a range of movement up to 2-4% as falling within the reply 'the same' (see Chart 8). Interestingly, those respondents classifying a range of movement up to 4-8% as falling within the reply 'the same' has gone down from previous special enquiries (from 27% of all respondents in 1989 to 18% in 1998).

A further question was also asked on what range of movement do companies regard as indicating 'falling' export volumes. Unsurprisingly, a significant proportion of respondents (over two-thirds) classified a range of movement between -4 to -11% as indicating 'falling' export volumes (see Chart 9).

Overall, these results suggest that while the 'balance' remains useful as a summary statistic, econometric research is likely to be more productive if it uses the individual survey responses.

**Chart 9: Range of movement regarded as 'falling' export volumes**




Source: Answering Practices in the CBI Industrial Trends Survey, August 1998

## Seasonal variation

How significant is seasonal variation and how do respondents attempt to adjust for it? The special survey indicated that around a half of companies made no attempt to adjust for seasonality because it was not significant, while the other half took account of seasonal variation, primarily on a subjective basis. Taken together, these results suggest that the Survey data should be largely free from seasonal influences. Even in the case of factory gate prices, where the ITS points to a seasonal pattern – linked to the revision of price lists at the turn of the year – only a small minority of companies expressed any problems in assessing expected trends.

## How companies regard and use the survey results

The special survey also investigated companies' assessment and use of the ITS results. In general, the total trade results were regarded as of some help, although the more disaggregated sectoral and industry data appeared particularly useful to respondents.

Firms, meanwhile, indicated that Survey data were mainly used on a periodic basis when preparing operating plans or budgets. A minority, around a fifth of all companies said, however, that survey information was regularly used for business planning purposes.

## Conclusion

There are four main messages coming out of this special survey which should always be borne in mind when considering the ITS results.

1. The optimism questions need to be interpreted carefully, as a significant minority of companies continue to reply in terms of levels of confidence and not the changes in business mood specified by the ITS. Demand and profitability, meanwhile, are the main influences on business confidence, although exchange rates proved to be a highly significant determinant of optimism about export prospects.

2. The ITS question on capacity working has a number of dimensions and is not restricted to physical capacity, with labour utilisation also clearly a significant factor entering the assessment. This means that the responses cannot just be interpreted as a direct measure of capacity utilisation. The replies of companies can either reflect capacity changes and/or changes in the benchmark for assessing a 'satisfactory' full rate of operation.

3. While companies judge their competitiveness by the price of goods relative to their competitors, the quality of their products and delivery dates, the largest firms also view design features as important in their assessment of competitiveness.

4. The most striking result is on how companies judge the 'normality' of their order books. It is clear that companies' assessment of normality does change over time and the ITS results should be evaluated carefully. This implies that more attention should be paid to shorter term comparisons.

[1] Glynn, D.R. – "The CBI Industrial Trends Survey", Applied Economics (1969), Vol 1, No.3, pp183-196.
[2] Price, R.H. – "The CBI Survey – an insight into answering practices", CBI Review, Summer 1997. Reprinted in "Twenty years of 'ups' and 'downs'".
[3] Ballance, D.C. & Burton, C.P.H. – "Answering Practices in the CBI Industrial Trends Survey", "Twenty five years of 'ups' and 'downs', CBI, October 1983.
[4] Junankar, S.N. – "How do companies respond to the CBI's Industrial Trends Survey?", CBI Economic Situation Report, January 1990.

*Acknowledgement: The authors would like to thank Jonathan Wood, Head of Business Survey Unit for his assistance in the formulation of the special survey.*