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A McKinsey Quarterly Reader

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Introduction

To thank you for serving on the McKinsey Online Executive Panel, we're offering this collection of some of the surveys we've conducted so far this year.

In addition to posing broad, global questions on topics such as economic confidence, the role of business in society, organizational change, and significant business trends, *The McKinsey Quarterly* has conducted surveys on the role of employee benefits, the significance of earnings guidance, and what directors actually know about their companies.

We hope that you'll find the collection interesting and will continue to participate in McKinsey surveys.

McKinsey Survey of Business Executives

The McKinsey Quarterly

Weighing the pros and cons of earnings guidance

Most companies plan to continue providing investors with frequent earnings guidance, though executives disagree about its costs and benefits.

A number of major companies, including Berkshire Hathaway, Citigroup, Ford Motor, and Google, have chosen not to issue frequent earnings guidance to investors. Nonetheless, the vast majority of executives responding to the latest *McKinsey Quarterly* survey¹ whose companies issue guidance—some 83 percent of them—say that their companies have no current plans to alter their approach. Yet the executives disagree about the benefits and costs of issuing guidance, the greatest sources of pressure to provide it, and the possible effects of curtailing or discontinuing it.

The survey findings suggest that most executives continue to issue earnings guidance—the comments management provides about how a company will perform in the future—in the absence of any clear consensus on its contribution to company value and largely at the insistence of brokerage house analysts.²

Detailed responses to the survey appear on the following pages.

¹The *McKinsey Quarterly* conducted the survey in January 2006 and received 124 responses from a worldwide representative sample of CFOs, CEOs, and board members of publicly held companies.

²The practice of issuing earnings guidance took root in the 1970s, when many companies began privately communicating their forecasts to large investors, and grew during the stock-market boom of the 1990s, when the US Congress protected companies from liability for their statements about projected performance. More recently, growth of the practice has slowed as some companies have ceased issuing guidance, citing among other factors the negative effect of forcing management into a short-term focus.

Staying the course

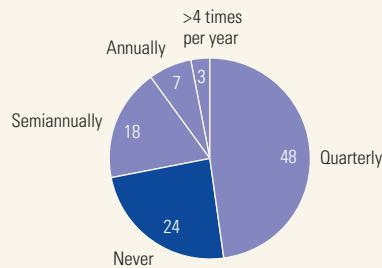
More than three-quarters of the survey respondents say that their companies issue earnings guidance to investors, with 48 percent providing it on a quarterly basis (Exhibit 1). Some two-thirds of the surveyed executives report that their companies haven't changed the frequency of earnings guidance during the past three years—but fully one-fourth say their companies have increased its frequency during that time. A large majority report that their companies have no plans to change current practices; only 12 percent expect their companies to issue guidance less frequently and 5 percent more frequently (Exhibit 2).

EXHIBIT 1

Frequency of earnings guidance

% of respondents¹

In 2005 how often did your company issue earnings guidance to investors and analysts?



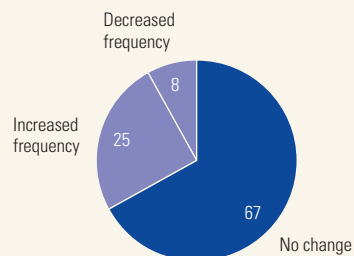
¹All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions.

EXHIBIT 2

Stable and unlikely to change

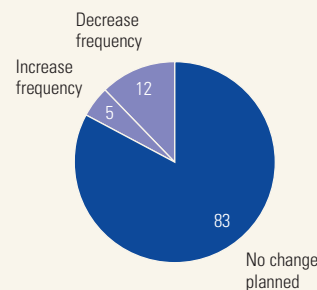
How, if at all, has your company changed the frequency of its earnings guidance during the past 3 years?

% of respondents¹



How, if at all, does your company plan to change the frequency of its earnings guidance in the future?

% of respondents currently providing guidance at least once a year¹



¹All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions.

A lack of consensus

More than three-quarters of the respondents whose companies currently provide earnings guidance say that the practice helps to satisfy requests from investors and analysts. Just slightly fewer attribute the same value to maintaining a channel of communication with investors. Just over half believe that issuing guidance intensifies management's focus on achieving financial targets.

Consensus is elusive, however, on all other questions regarding the benefits associated with earnings guidance—including moderating share price volatility, raising valuations, building a wider base of shareholders, and increasing liquidity (Exhibit 3).

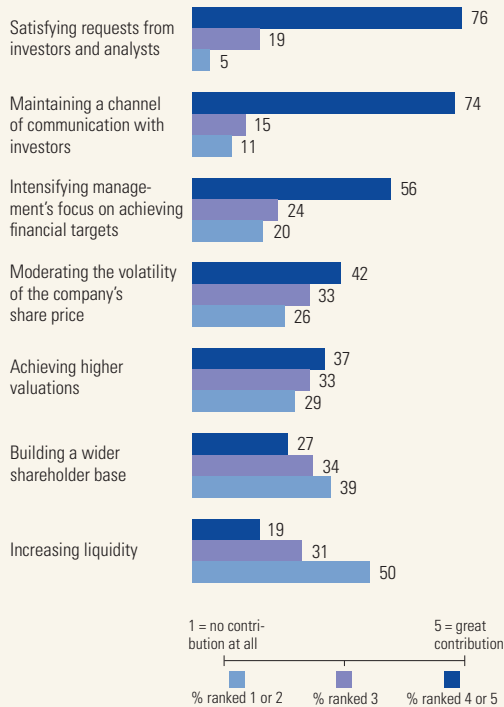
The panel is similarly split on the costs of providing earnings guidance. A scant majority say that guidance is costly in the time that management spends on the effort. On other possible costs—particularly employee time devoted to issuing guidance and a company focus on short-term earnings—the response is mixed.

EXHIBIT 3

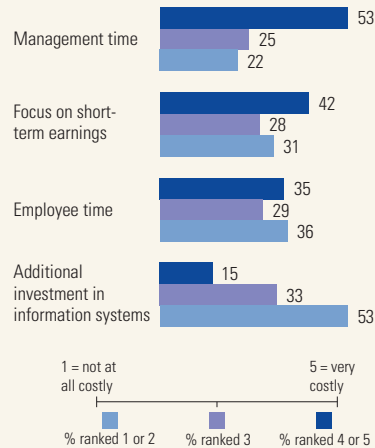
Perceived benefits and costs of issuing guidance

% of respondents currently providing guidance¹

Contribution toward possible results of providing earnings guidance



Cost to companies of selected factors associated with providing earnings guidance



¹ All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures may not sum to 100%, because of rounding.

Don't you want to tell me something?

Half of the executives we surveyed indicate that sell-side analysts demand earnings guidance more insistently than any other group does. On the remaining sources of pressure to provide guidance, the executives are split (Exhibit 4).

Hedge funds, whose large movements of capital in and out of companies have made them a force for market volatility, do not strike many executives as a strong source of pressure for earnings guidance: just 29 percent of the respondents characterize hedge funds as insistent in demanding it.

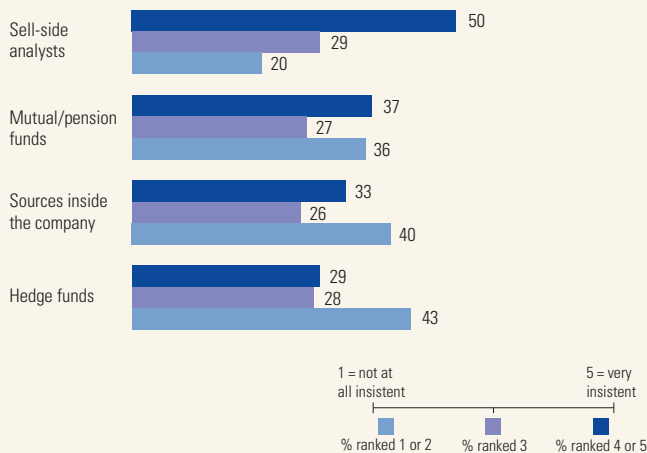
Regarding the activity of hedge funds more generally, most executives say that when the funds make frequent and sizable trades of their company's stock, only short-term share prices and share price volatility—not long-term share prices—are affected (Exhibit 5).

EXHIBIT 4

Who's demanding guidance?

% of respondents¹

Insistency of demand for earnings guidance by:



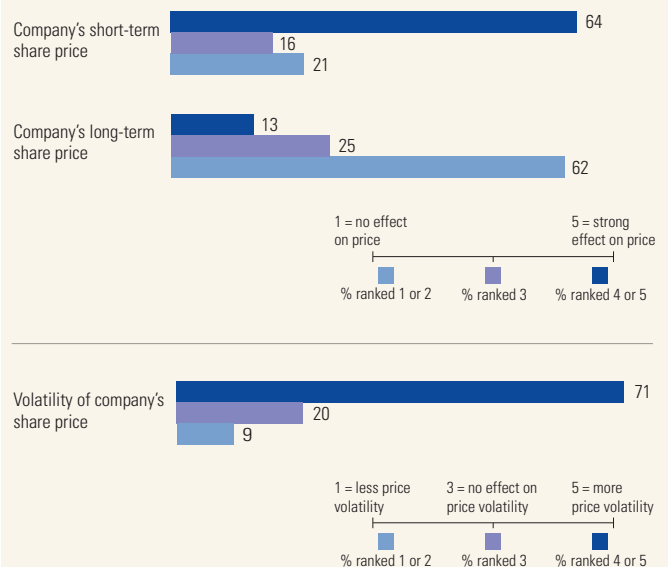
¹ All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures may not sum to 100%, because of rounding.

EXHIBIT 5

The role of hedge funds

% of respondents at companies with hedge-fund activity¹

Effect of frequent, sizable trades by hedge funds of your company's stock on:



¹ All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures may not sum to 100% because of rounding.

Doing without

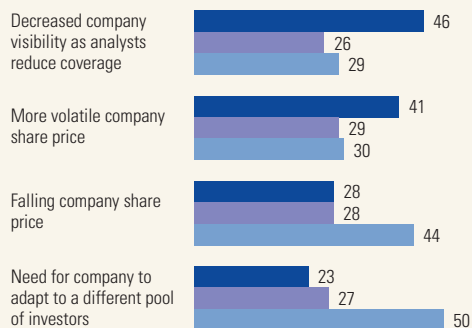
Executives also share little common ground regarding the risks of reducing or discontinuing guidance. However, a plurality of the respondents whose companies currently provide guidance agree that a company's visibility would decrease as analysts reduced coverage. On the other hand, half doubt that the company would have to adapt to a different pool of investors. On the remaining consequences, the distribution of responses is more dispersed (Exhibit 6). *Q*

EXHIBIT 6

Fear of consequences of reducing frequency

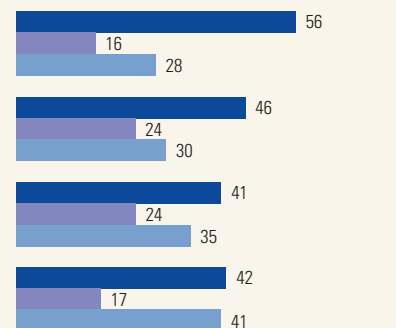
If earnings guidance were issued less frequently, the likelihood of:

% of respondents currently providing guidance more than once a year¹



If earnings guidance were eliminated altogether, the likelihood of:

% of respondents currently providing guidance at least once a year¹



1 = not at all likely
5 = very likely
% ranked 1 or 2 % ranked 3 % ranked 4 or 5

¹All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures may not sum to 100%, because of rounding.

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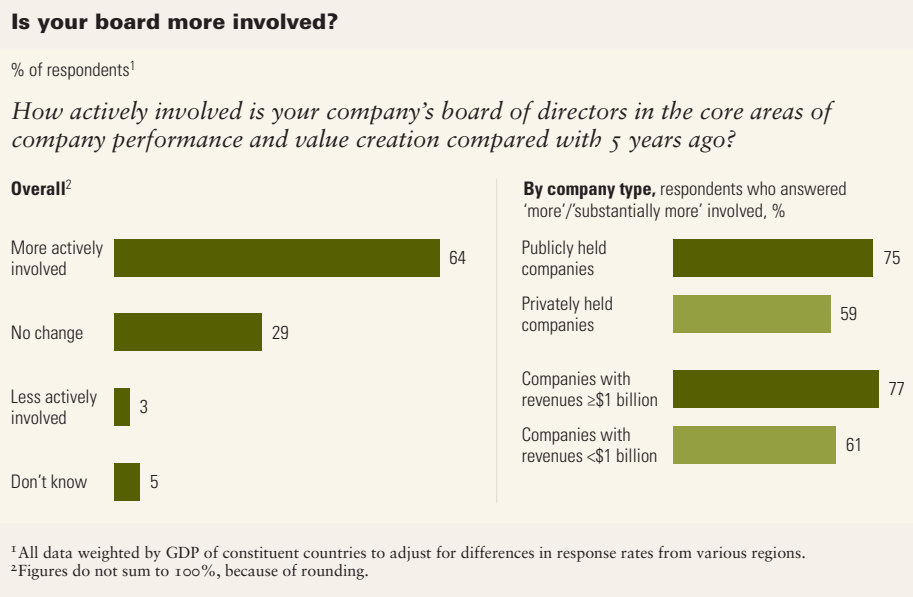
What directors know about their companies

Corporate board members are more actively involved than they have been, and they are often—but not always—knowledgeable.

Boards of directors are becoming much more knowledgeable about and actively involved in their companies' core performance and value-creating activities, according to the executives who responded to the latest *McKinsey Quarterly* survey.¹ However, in one controversial area of corporate governance—compensating executives with stock options and bonuses tied to earnings growth—these more active board members have effected relatively little change.

In a previous survey, conducted in early 2005, directors expressed an eagerness to spend more time on topics such as their companies' talent, skills, and current performance.² Directors appear to have made significant progress: nearly two-thirds of all respondents to the current survey say that boards have become more actively involved in strategy, finance, and other core areas of corporate performance and in value creation than they were five years ago. Further, the proportion of boards that are more active varies little from region to region, even though reforms in corporate-governance regulation have differed significantly around the world. Larger companies and publicly held ones are somewhat more likely to have more active boards (Exhibit 1).

EXHIBIT 1



¹ *The McKinsey Quarterly* conducted the survey in February 2006 and received 1,468 responses from a worldwide representative sample of business executives from publicly and privately held businesses across a full range of industries.

² Robert F. Felton and Pamela Keenan Fritz, "The view from the boardroom," *The McKinsey Quarterly*, 2005 special edition: Value and performance, pp. 48–61 (www.mckinseyquarterly.com/links/23020).

McKinsey Survey of Business Executives

Notably, CEOs, CFOs, and other “C-level” executives, who have the closest contact with the board—indeed, many are on it—see less dramatic change in the directors’ roles in the past five years than other executives do: a third say that no change has taken place in the board’s level of activity, a view held by only 20 percent of other executives (Exhibit 2). In addition, C-level executives are less likely than others to say that board members fully understand their companies’ strategies, financial position, and risks (Exhibit 3). Although the survey did not probe this issue more deeply, several possible reasons could explain the disparity. One might be a difference in perceptions between C-level executives, who may think that boards were more actively involved in the past, and other respondents. It is also possible that the changes are more rhetoric than reality.

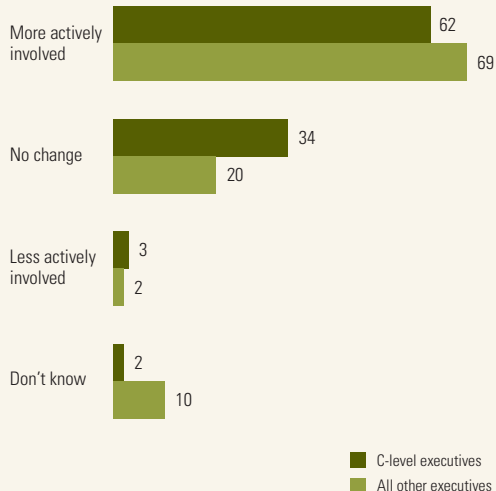
EXHIBIT 2

Differing perspectives on the board

% of respondents¹

How actively involved is your company’s board of directors in the core areas of company performance and value creation compared with 5 years ago?

By type of executive



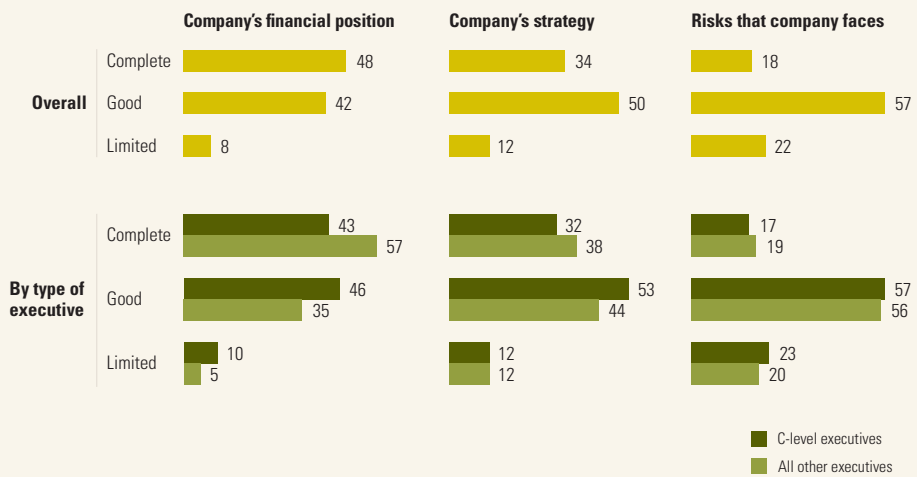
¹ All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because of rounding.

McKinsey Survey of Business Executives

EXHIBIT 3

The knowledgeable and the not so knowledgeable

% of respondents who describe board's understanding of given issue as 'complete,' 'good,' or 'limited'¹



¹All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because respondents who answered "no understanding" or "don't know" are not shown.

Even so, executives at all levels say that directors have made real progress in learning more about their companies' strategies, financial position, and risks. Last year, 63 percent of board members said they had a good or complete understanding of the risks facing their companies; this year, 75 percent of respondents say so. On the board's understanding of corporate strategy, the share reporting a solid understanding has risen to 84 percent, from 73 percent. Nine out of ten respondents to the current survey say that their boards have a good or complete understanding of the financial position of their companies.

McKinsey Survey of Business Executives

The biggest knowledge gap for boards continues to be about risk: while 34 percent of the respondents say that the directors have a complete knowledge of strategy, only 18 percent credit them with the same command of risk. One year ago, the figure was 11 percent in both categories. Some 48 percent of the respondents say that their boards have a complete grasp of their companies' finances.

Directors don't seem to be putting their newfound knowledge to work by addressing controversial pay practices such as stock options, stock grants, and bonuses tied to earnings growth. Two-thirds of the executives say that their companies' use of such pay practices has not diminished in the past five years. Companies in North America are the least likely to have changed: only 15 percent did so. Companies in the developed countries of the Asia-Pacific region, at 25 percent, are the likeliest to have changed pay practices (Exhibit 4). *Q*

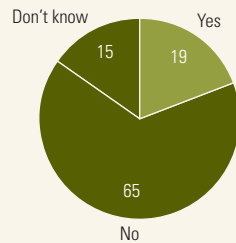
EXHIBIT 4

Few have abandoned pay for performance

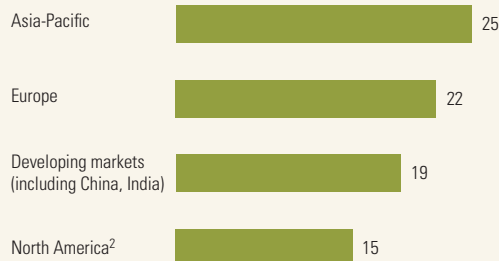
% of respondents¹

Regarding the pay of top executives, in the past 5 years has your company decreased the use of pay-for-performance approaches?

Overall



Company has diminished use of pay for performance, by region



¹All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because of rounding.

²Bermuda, Canada, Greenland, United States.

An executive perspective on employee benefits: **A McKinsey Survey**



The vast majority of US executives see employee benefits as important to their company's competitiveness, according to the latest *McKinsey Quarterly* survey.

Fully 88 percent of the respondents name human-resources concerns—particularly attracting and retaining talent plus meeting responsibilities to employees—as the main reasons for offering benefits.

Despite this motivation, many companies haven't learned what their employees really want from benefit programs, and few actually measure the performance of (or return on investment from) their benefit offerings.

An executive perspective on employee benefits: **A McKinsey Survey**

Executives say employee benefits help companies compete but have an incomplete understanding of benefits and how they perform.

US executives overwhelmingly see employee benefits as important for competing effectively, particularly as a means to attract and retain talent, according to the latest *McKinsey Quarterly* survey.¹ Yet many companies don't understand what benefits employees prefer, and few explicitly measure the performance of their benefit offerings.

With health care costs continuing to rise at an annual rate of 7 to 9 percent (after years of double-digit percentage increases), many US companies have been forced to reconsider their role as providers of benefits for current and retired employees. Most respondents place the cost of benefits among the three most important factors affecting their company's finances.

Many of the surveyed executives also view consumer-driven health care programs as a long-term way to create a financially sustainable benefit offering for current employees.

Detailed survey results appear on the following pages.

¹The *McKinsey Quarterly* conducted the survey in April 2006 and received 152 responses from a representative sample of CEOs and other C-level executives and board members of privately and publicly held US companies with more than 100 employees.

The cost of health benefits

Nearly every executive who responded to the survey says that his or her company offers health care benefits to current employees, and 68 percent also offer some type of retirement benefit (Exhibit 1).

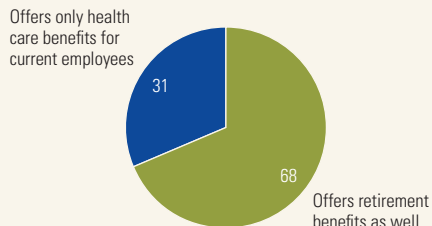
The respondents acknowledge that employee benefits have a significant impact on company finances. Sixty-three percent of the executives whose companies offer both health care and retirement benefits view health care benefits for current employees as being more critical to a company's long-term financial health. Despite the massive financial liabilities some US companies have accumulated for pensions and other retirement benefits, only 17 percent of the surveyed executives say that retirement benefits have a greater impact than health benefits do on their company's long-term finances. An additional 21 percent said that health care for current employees and retirement benefits have equal impact.

EXHIBIT 1

Employee benefit offerings

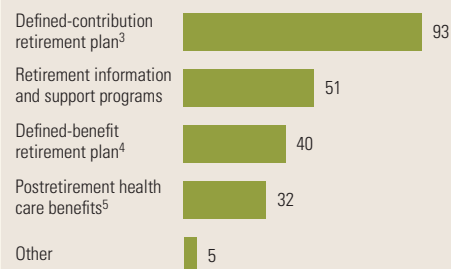
What types of benefits does your company offer its employees?

% of total respondents¹



What types of retirement benefits does your company offer?

% of respondents whose companies offer retirement benefits (n = 104)²



¹ Figures do not sum to 100%, because respondents answering "neither of the above" are not shown.

² Respondents could select more than one answer.

³ Such as 401(k) plans or profit sharing.

⁴ Such as traditional pension plans or cash balance pension plans.

⁵ Such as major-medical or prescription-drug coverage.

Source: April 2006 McKinsey Quarterly survey of US executives

The competitive advantage

Whatever the cost of benefits, it is clear that executives think investing in them is worthwhile, even crucial. An overwhelming majority—89 percent—say that providing benefits is either “somewhat important” or “extremely important” to their company’s ability to compete effectively (Exhibit 2).

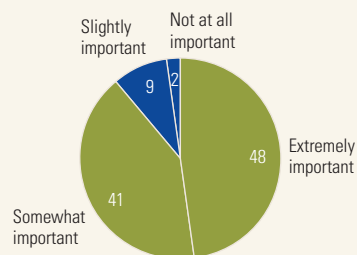
In particular, survey respondents cite benefits as a way to win the competition for talented workers. Fifty-eight percent say that attracting and retaining talent is the main reason for offering benefits. An additional 30 percent say the most important reason their company offers employee benefits is to meet its responsibilities to employees.

EXHIBIT 2

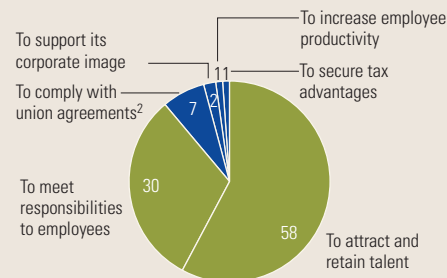
Attracting and retaining the talent to compete

% of respondents whose companies offer health care or retirement benefits (n = 151)

How important a role do these employee benefits play in your company’s ability to compete effectively?



What is the most important reason your company offers these benefits to its employees?¹



¹ Figures do not sum to 100%, because respondents who answered “don’t know” are not shown.

² 26% of respondents are from a company with a workforce that is partially or completely unionized.

Source: April 2006 McKinsey Quarterly survey of US executives

What executives don't know

Although executives cite employee benefits as critical to their company's competitiveness, our results suggest that they haven't taken steps to learn what employees want from benefit offerings or to assess explicitly the performance of their benefit strategy.

Forty-three percent of respondents state that their companies understand the benefit-related preferences of employees only "somewhat" or "not at all" (Exhibit 3). Just 13 percent say their companies understand employee preferences "extremely well." Further, the vast majority don't measure performance against benefit objectives. Nearly six out of ten of those executives who say their companies don't measure performance admit that they've never even considered measuring it.

This situation is unfortunate. Our data suggest that when executives better understand their employees' benefit preferences, executives are more likely to say that their company receives an adequate return on its benefit investments. More than half of all the respondents claim to understand their employees' benefit preferences "well" or "extremely well." Of those, 68 percent say they receive an adequate return on investment; in contrast, only 38 percent of those who admit to understanding their employees' preferences less well consider the ROI to be adequate.

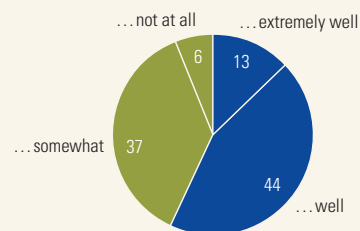
EXHIBIT 3

Don't know much about benefits

How well does your company understand the benefit-related preferences of its employees?

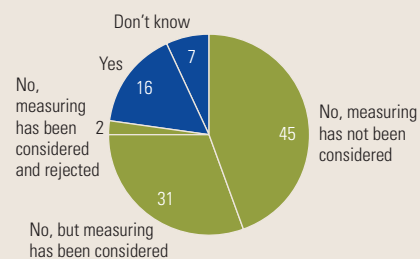
% of respondents

Understands employee preferences ...



Does your company explicitly measure the performance of its investment in these employee benefits?

% of respondents whose companies offer health care or retirement benefits (n = 151)¹



¹ Figures do not sum to 100%, because of rounding.

Source: April 2006 McKinsey Quarterly survey of US executives

Employees of a certain age

Given the importance executives place on benefits as a means to attract and retain talent, the survey suggests that companies could make more effective use of the benefits they offer.

In particular, companies might better use retirement benefits to create an attractive value proposition for talented workers.

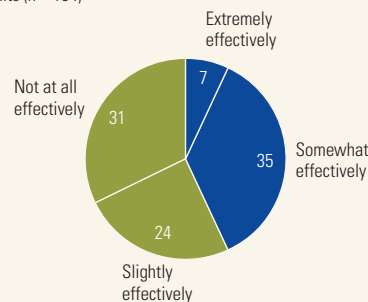
Some retirement experts believe that 50 is a critical age for employees to begin planning their transition to a self-sufficient retirement. However, 55 percent of respondents characterized their company's retirement programs as "slightly" or "not at all" effective in helping employees start the transition to retirement by age 50 (Exhibit 4).

EXHIBIT 4

Preparing for retirement

How effectively do your company's current retirement offerings start preparing employees by age 50 to make the transition to retirement?

% of respondents whose companies offer retirement benefits (n = 104)¹



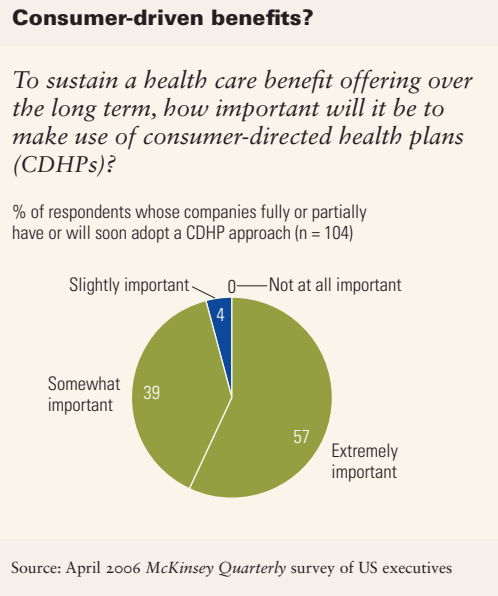
¹ Figures do not sum to 100%, because respondents who answered "don't know" are not shown.

Source: April 2006 *McKinsey Quarterly* survey of US executives

Shifting responsibility to employees

To balance the cost and value of providing benefits to their employees, some companies have been working to change the economics of how benefits are provided. Many have turned to consumer-directed health plans (CDHPs), which seek to reduce costs by giving consumers more responsibility for managing their own health care spending. Seventy-four percent of survey respondents report that they either plan to adopt or have adopted some form of a CDHP. Of these respondents, 96 percent believe that CDHPs are “extremely important” or “somewhat important” to their company’s ability to sustain a health care benefit over the long term (Exhibit 5).

EXHIBIT 5



Contributors to this survey’s development and analysis include **Gene Kuo**, a consultant in McKinsey’s Houston office, and **Paul Mango**, a director in the Pittsburgh office.

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