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Luxembourg Business Compass

LBC: modest increase of expectations from **1.0** to **1.3**

Spring 2011

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Luxembourg Business Compass
by KPMG and Luxemburger Wort

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Contents

Introduction

It is my pleasure to introduce you to the 3rd edition of the Luxembourg Business Compass. This 3rd edition is again to catch the latest developments of the Luxembourg economy and to help all of us make appropriate decisions in the Luxembourg economy and political sphere, which, as we all know, are inextricably linked.

Whereas the 1st and 2nd editions came out in times of financial and economic turmoil worldwide, the current edition comes out in times of financial and economic turmoil europewide. Indeed, what will the financial and economic Europe look like in the years to come? Will there be further integration or disintegration? What will the position of Luxembourg be?
In addition, due to the financial and economic crisis worldwide, the balance of power has started to shift worldwide from the conventional developed countries to the rising developing countries or so-called BRICS countries. The role of Luxembourg is no longer easily foreseeable.

Your answers to our questions are quintessential to shape Luxembourg's future into the right direction. From your answers it looks like we are already on the right track. Let me thank all of you for your contribution and let me express special thanks to Minister Frieden and all panelists for their support.

Karin Riehl
Managing Partner
KPMG in Luxembourg

I am very proud to present you the 3rd edition of the Luxembourg Business Compass (LBC). The LBC has quickly become a reference in the Luxembourg economy.

In fact, the LBC has been a great success since its 1st edition in 2009. It has managed to become a necessary tool to evaluate the climate of the Luxembourg and international entrepreneurs based in the Grand Duchy of Luxembourg. KPMG and Luxemburger Wort have worked hard on it, encouraged by the business leaders who participate each year in the research or the discussions on the entrepreneurial climate in Luxembourg.

"Un homme averti en vaut deux!" - Luxemburger Wort has informed the different actors of the Luxembourg population for some 163 years. The provision of information is foremost a profession, but also allows orientation and choice on the basis of analyzing essential news. As every business leader is concerned by it on a daily basis, Luxemburger Wort has developed the economic section for some years and has positioned itself as the actor for the provision of economic information in Luxembourg.

By joining their efforts, KPMG and Luxemburger Wort, with the help of the business leaders and political leaders in Luxembourg, are able to provide an overview of the entrepreneurial climate and economic trend in Luxembourg on an annual basis. Also, I would like to thank all those who have contributed to this edition of the LBC and I hope I see you back next year.

Paul Lenert
Director General
Saint-Paul Luxembourg

Message by Mr Pierre Gramegna

A timid boost in business confidence goes along with a number of unanswered questions…

The Luxembourg Business Compass (LBC) is by now an established tool of economic intelligence. First published in spring 2009, in the midst of the most severe, non-war related economic slump since the Great Depression in the 1930's, the LBC results now underpin a timid improvement of key Luxembourg economic decision makers' confidence. This is, without any doubt, positive news. However, one should not be tempted to jump to the conclusion that the dark clouds in the economic sky have lifted altogether. Indeed, the key risk factors, as duly identified by the respondents to this edition of the LBC, are not only numerous, but also significant.

In reality, the road to a sustainable economic recovery in Luxembourg is winding and bumpy, and challenges are local, European and global in their scope. A number of key domestic economic sectors are still directly struggling with the effects of the crisis, and Luxembourg's export-oriented economic model remains truly incompatible with the slow, continuous and unsustainable degradation of the national cost- and price related competitiveness. The 2010 economic recovery had been supported by negative baseline effects and by industrial restocking. Now that this process has touched to an end, Luxembourg's economic foundations have to be solidified in order to ensure the competitiveness of its goods and services on the global marketplace. The still rather lacklustre evolution of private investment activity illustrates the on-going widespread reluctance of economic decision makers to make significant commitments for the future. This, in turn, is directly slowing down Luxembourg's medium- and long term

growth potential. Indeed, albeit their apparent optimism, business leaders can see the potential storm that may lay ahead, and which can only be tackled by an ambitious structural reform agenda.

Luxembourg, as founding member, a convinced protagonist and a true advocate of both the EU and the common European currency, is extremely dependant on developments on the Old Continent. The sovereign debt crisis is deeply affecting Europe, in general, and some of its Member States, in particular, putting under tremendous pressure the single most important common accomplishment since the achievement of the Common market and the borderless Schengen area, i.e. the Euro. Far from advocating a doom scenario of bringing to an end the single currency project and reintroducing inefficient local currencies and their related trade barriers, the political uproar, the unhealthy scepticism regarding our ability to resolve this crisis, the endless discussions and the Europe-wide rumours and contradictions definitely bear the potential of slowing down the timid economic recovery in Europe, which Luxembourg is so exceptionally dependant on.

On the global scale, geopolitical tensions are on the rise, with soaring prices for petrol and other raw materials. These global trends may well be amplified by the backward looking wage indexation system operated – in full isolation - by our country. Indeed, why do Luxembourg companies, for events they cannot change or even influence, have to pay a much higher toll than their competitors?

The raw materials induced rise of global inflation rates might also trigger a rapid and severe tightening of monetary policy, which can also slow down the cyclical uptick in the global economy. The ECB's sole mandate being the safeguarding of the price stability, one can expect this tightening to be more pronounced in Europe than in most other parts of the world.

On a national scale, Luxembourg's fate is very closely linked to the success of its financial sector. Can we resolve the tricky equation of consolidating positive growth rates in this sector - which will undoubtedly be below historic trends even in the most optimistic scenario - whilst operating in a more and more strongly regulated environment where legal and regulatory opportunities are brought to an end or are at least challenged?
Can Luxembourg achieve sound public finances, which are of utmost importance in order to reinforce the economic growth potential, which has deeply suffered by the financial and economic crisis, whilst maintaining a high level of public investments for both tangible and intangible infrastructures? Is this even possible if structural reforms are not sufficiently embraced and if the yield of the key ingredient to public finances – the taxes paid by the financial sector in its broadest sense – is challenged?

In order for economic recovery to gain solid ground in Luxembourg, key economic decision markers postulate a true embracement of the necessary structural reforms by their political counterparts. If the latter continue to hesitate, to put off reforms and to adopt a piecemeal approach as opposed to an inclusive and integral policy effort, Luxembourg's economy might as well hit an iceberg, sooner or later, on its way to a safe haven.
An ambitious reform agenda must lay the groundwork for the necessary restoration of economic competiveness, sound public finances, long term sustainability of the age-related public spending, a diversified economy which can resist to external and sectoral shocks, and – last but not least and according to Europe's 2020 strategy for a smart, sustainable and inclusive growth – a borderless and open labour market where nationals, foreigners and cross-border workers can work side by side in order to prepare the future of Luxembourg, both in the private and in the public sector.

All in all, the compass points into the right direction. However, now it's up to the political actors to make sure the way is clear.

Since 2009, the Chamber of Commerce has fully supported the KPMG / Luxemburger Wort initiative of the Luxembourg Business Compass, whose first goal is to gather opinions, challenges, priorities and concerns of Luxembourg's economic decisions makers. The LBC survey is truly a very useful complement to the benchmark studies and the economic surveys already carried out, among other institutions, by the Luxembourg Chamber of Commerce. In this context, it is worth pointing out that all these studies – be it Eurochambers' annual economic survey, the "Global Competiveness Report" published by the World Economic Forum or the Institute for Management Development's "World Competitiveness Yearbook" – are confirming the main messages of the LBC: the recovery is there, but it is fragile and a number of key challenges must be met in order to achieve a sustainable economic growth for Luxembourg.

Let me take the opportunity to express my gratitude to all the respondents to the LBC – survey and to congratulate once again its initiators – KPMG and the Luxemburger Wort – for the excellent new tool of economic intelligence that they have provided us.

Pierre Gramegna
Director General of the Luxembourg Chamber of Commerce

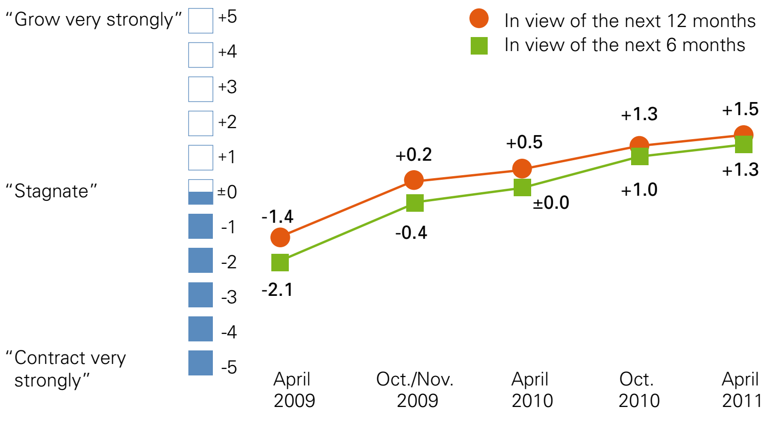
Executive Summary

1. Expectations for the Luxembourg economy continue to show a clearly positive trend

Over the course of the next 6 months, Luxembourg entrepreneurs generally expect to see moderate economic growth. Similarly, expectations for the next 12 months have continued to improve. Luxembourg entrepreneurs confirm the positive expectations already expressed in the prior survey: in their view, the worst stage of the crisis has been surmounted and the situation is now starting to turn around.

Short-Term Expectations for the Luxembourg Economy Continue to Develop Positively

On a scale of +5 to -5, average step chosen by respondents to indicate how they expect the Luxembourg economy will develop -



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, April 2010, Oct. 2010, April 2011)
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2. Luxembourg's competitiveness as a business location has slightly improved, but only few entrepreneurs rate it as "very good"

3. Luxembourg business leaders also clearly anticipate a positive trend at their own companies

4. Tendency towards increased investment budgets in all areas of operations, with more money being allocated to marketing and sales, training, IT

5. Current hot topics relating to economic policy and the public sector:

- **Opinions are divided among Luxembourg business leaders with regard to the proposed pensions reform; and**
- **The introduction of a legally binding quota for women in executive positions was clearly rejected; and**
- **Luxembourg business leaders favor reducing entry wages and the implementation of a performance evaluation system for public sector employees.**

Conference at a glance














Luxemburger Wort



Findings

Expectations for the Luxembourg economy continue to show a clearly positive trend

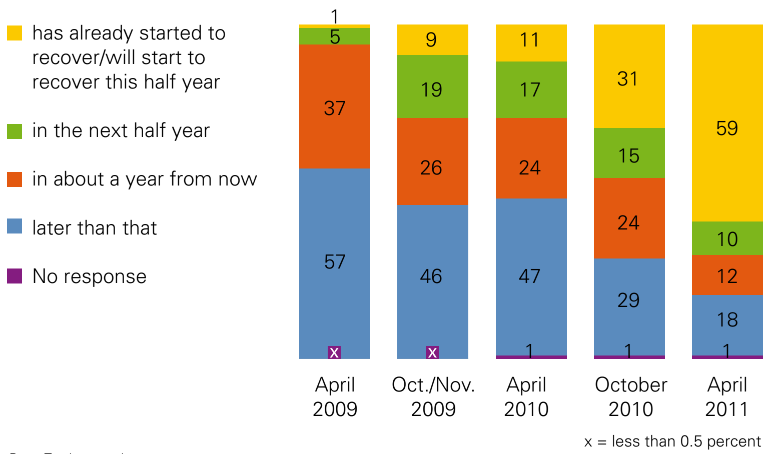
The growing optimism since the middle of last year is unmistakable

Developments anticipated by the business leaders in their company in the next 6 months

- Compared to April 2009, Luxembourg entrepreneurs now anticipate that other companies in their line of business will implement less cost-cutting measures
- Similarly, a smaller number of entrepreneurs now expect that companies scale down their activities, close or reduce facilities
- The expectation expressed most frequently by Luxembourg business leaders, is that companies will focus on innovations and developing new products and services

When Will the Economy Start Recovering Again?
Luxembourg Entrepreneurs Are Clearly More Optimistic

The Luxembourg economy (%) –



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, April 2010, Oct. 2010, April 2011)

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50%

of Luxembourg entrepreneurs are convinced that the Luxembourg economy has already recovered

Nevertheless, about one third of the business leaders interviewed are more pessimistic and do not anticipate an economic recovery until 2012 or even later.

Index of Expectations for the Luxembourg Economy in View of the Next 6 Months

On a scale of +5 to -5, step chosen by respondents to indicate how they expect the Luxembourg economy will develop -

		April 2009		April 2010		April 2011	
"Grow very strongly"	+5	x		x		x	
	+4	x		x		x	
	+3	x	5	1	44	10	81
	+2	x		11		31	
	+1	5		32		40	
"Stagnate"	±0	10		24		18	
	-1	15		12		1	
	-2	27		14		x	
	-3	30	84	6	32	x	1
	-4	9		x		x	
"Contract very strongly"	-5	3		x		x	
No response		1		x		x	
		100		100		100	
On average		-2.09		±0.00		+1.3	

x = less than 0.5 percent

Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort
(April 2009, April 2010, April 2011)

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Trends expected for the next 6 months

- The results obtained are the clear opposite of the results in April 2009
- None of the entrepreneurs anticipate very strong economic growth over the next 6 months

88%

of the business leaders interviewed expect that the Luxembourg economy will grow over the course of the year

Index of Expectations for the Luxembourg Economy in View of the Next 12 Months

On a scale of +5 to -5, step chosen by respondents to indicate how they expect the Luxembourg economy will develop -

		April 2009		April 2010		April 2011	
"Grow very strongly"	+5	x		x		x	
	+4	x		2		x	
	+3	x	11	1	61	24	88
	+2	4		29		25	
	+1	7		29		39	
"Stagnate"	±0	17		14		8	
	-1	24		9		1	
	-2	23		8		1	
	-3	15	72	5	25	x	3
	-4	6		2		x	
"Contract very strongly"	-5	4		1		1	
No response		x		x		1	
		100		100		100	
On average		-1.4		+0.5		+1.5	

x = less than 0.5 percent

Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxembourger Wort (April 2009, April 2010, April 2011)

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Forecasts for the next 12 months

The findings are generally similar, albeit somewhat more positive than expectations over the next 6 months.

Luxembourg's competitveness as a business location

In comparison to the last survey wave, the business leaders interviewed tend to assess Luxembourg's competitiveness as a business location somewhat better, although their overall assessment is still « only » slightly above average

Factors most cited that ensure Luxembourg's competitiveness as a business location

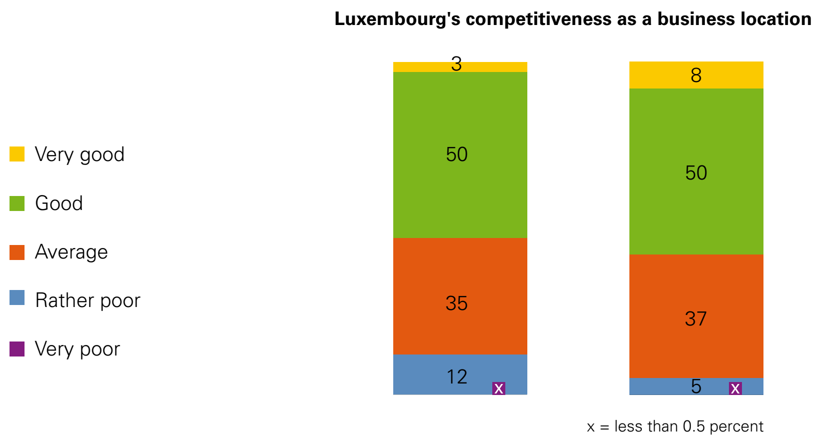
Luxembourg entrepreneurs emphasize on:

- The pragmatic and flexible regulatory environment
- The availability of high quality, well-trained workforce
- Competitive labor costs

New products, services and markets, as well as a stable and political environment, are seen by the Luxembourg entrepreneurs as less important factors (in relative terms compared to the above).

Entrepreneurs Tend to Assess Luxembourg's Competitiveness as a Business Location More Positively

"How do you assess the competitiveness of Luxembourg as a business location?"



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (October 2010, April 2011) *© IfD-Allensbach*

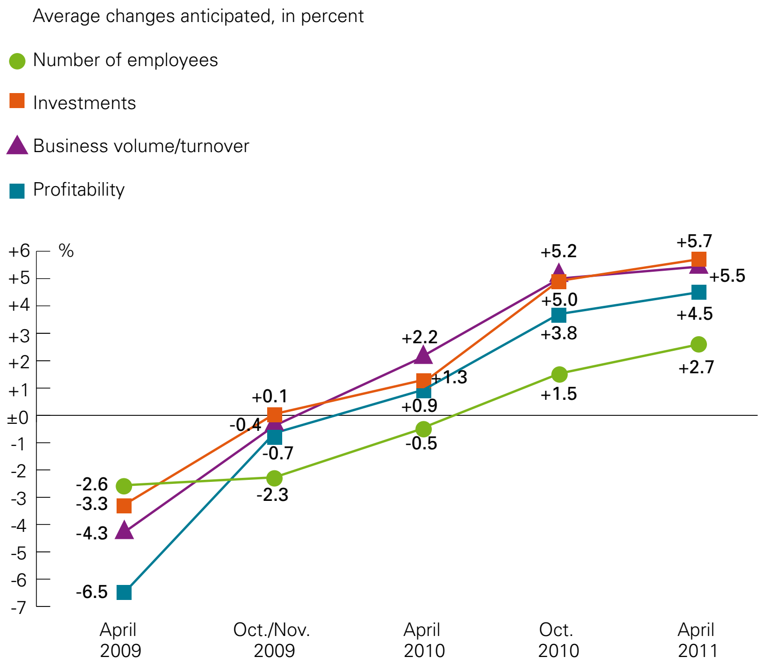
Luxembourg business leaders clearly anticipate a positive trend at their own companies

Trends observed over the next 6 months

- A majority of business leaders expects moderate to substantial increases in turnover, profitability and the number of employees, along with unchanged to moderate investment growth.
- Only a minority anticipate negative development at their companies with regard to these indicators.
- The greatest disparity is found with regard to profitability. Whereas 69 percent of the entrepreneurs interviewed anticipate growing profitability at their companies – including 16 percent who expect an increase of 10 percent or more – 11 percent predict that profits will decline over the same period of time.

Expectations for Entrepreneurs' Own Companies: Increases in Turnover, Investments, Profitability and in the Number of Employees

Question: "How do you expect the following areas or indicators will develop at your Luxembourg company over the next 6 months?"



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, April 2010, Oct. 2010, April 2011)

51%

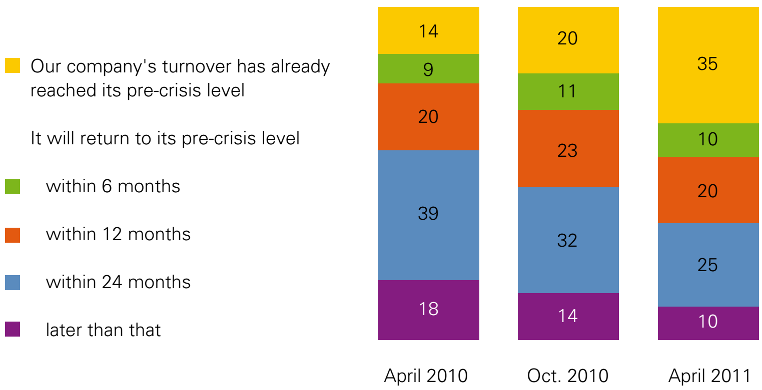
of Luxembourg entrepreneurs say that turnover was not affected by the crisis (25 percent) or has already reached pre-crisis level (26 percent)

49%

of Luxembourg entrepreneurs say that turnover has not yet returned to pre-crisis levels

When Will Turnover Return to Pre-Crisis Levels?
Clearly Improved Expectations among Affected Companies

Question: "When do you expect your company's turnover will return to its pre-crisis level?"



Base: Companies whose turnover declined during the financial and economic crisis
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2010, Oct. 2010, April 2011) *© IfD-Allensbach*

The results shown in the graph are adjusted for the 25% of Luxembourg entrepreneurs whose turnover was not affected by the crisis

Tendancy towards increased budgets in all areas of operations

50%

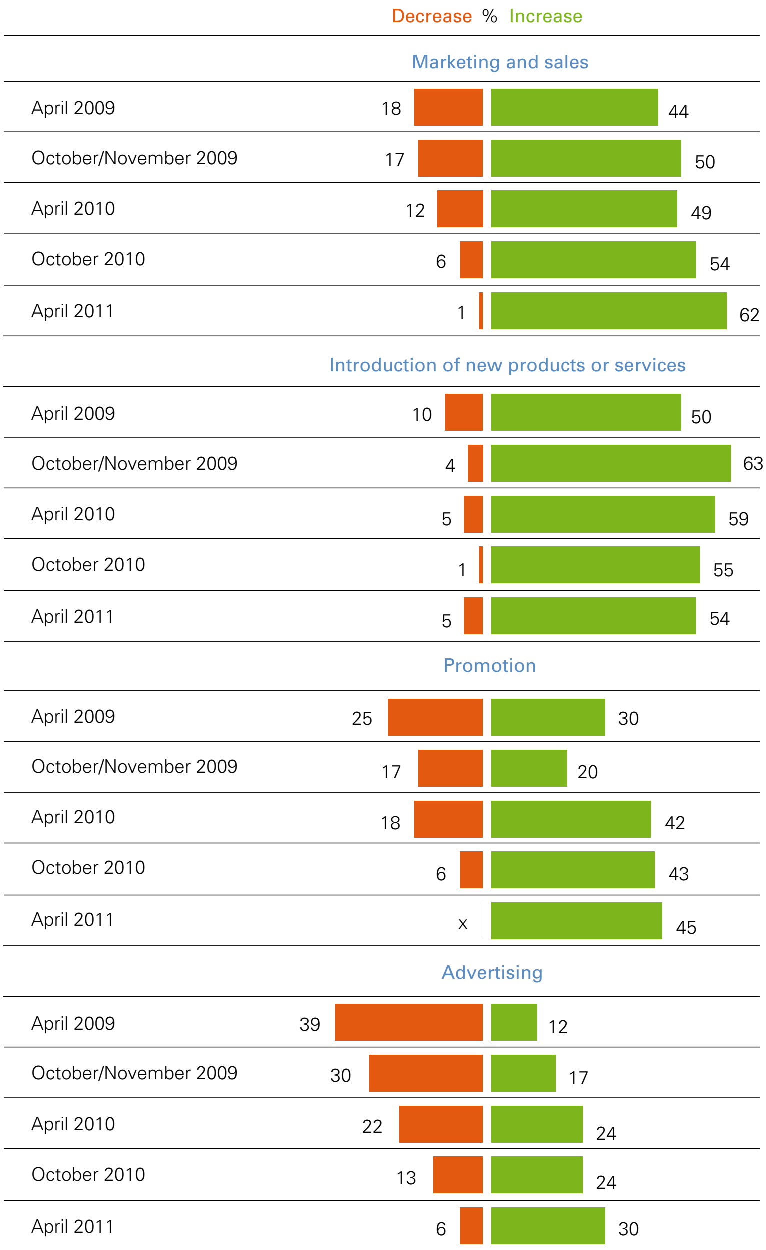
of Luxembourg companies are planning to increase their staffing expenditure

Investment plans:

- More funds will be allocated to marketing and sales, as well as to advertising and promotion, and IT.
- The companies' decisions to hire new staff are more frequently based on the growing demand for their products or services rather than the general economic conditions.
- A growing share of companies is also planning to invest more in research and development, as well as e-commerce.

Changes in Companies' Planned Expenditures – I:
Companies Continue to Raise Budgets for Boosting Sales

Question: "In which of the following areas will your Luxembourg company increase or, respectively, reduce its expenditures in the next 6 months?"



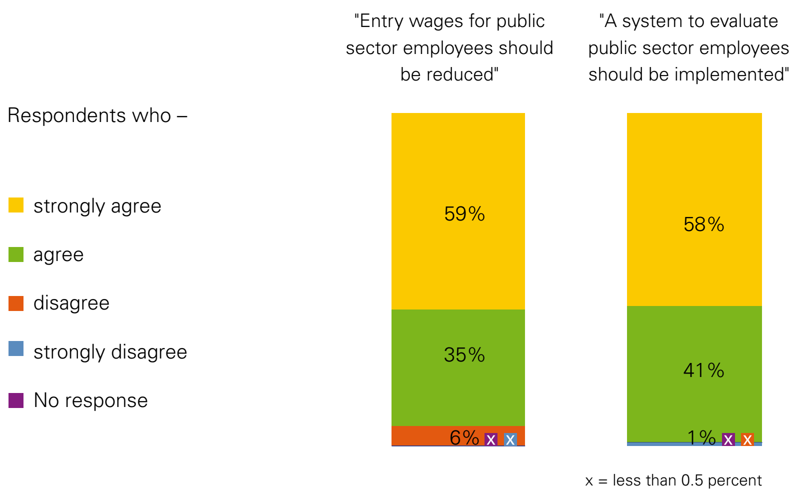
x = less than 0.5 percent

Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, April 2010, Oct. 2010, April 2011)

Current issues relating to the public sector and economic policy

Stimulating the economy or reducing the national debt?
Opinions are divided among entrepreneurs: 56% favour stimulating the economy, whereas 43% prioritise reducing national debt

Entrepreneurs Favor Reducing Entry Wages and Establishing an Evaluation System for Public Sector Employees



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2011)
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Homework for the public sector

Three quarters of entrepreneurs believe expenditures for the government and administration in Luxembourg are too high. Also, as was already observed in the previous surveys, Luxembourg entrepreneurs do not view the government and public administration as particularly efficient.

100%

of the decision-makers interviewed reject the idea of introducing a legally binding quota for women in executive positions

74%

of the decision-makers interviewed believe that every company should decide for itself whether and how they want to increase the share of women in executive positions

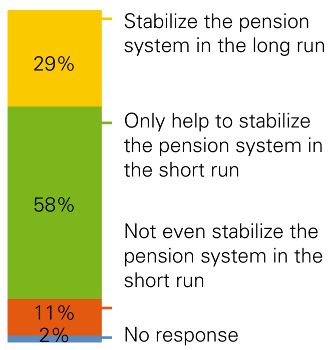
26%

of the decision-makers interviewed believe that companies should voluntarily pledge to fill a certain share of executive positions with women

Skeptical Assessments of the Proposals to Reform the Retirement Pension System

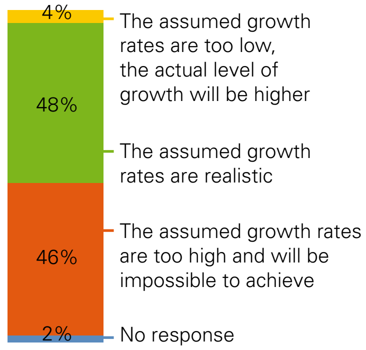
Question:
"Ministers Frieden and di Bartolomeo are planning to reform the retirement pension system. In essence, the 40-year contribution period would remain unchanged but retirement benefits would be reduced by 15%. The reduction in retirement benefits could be offset by working an additional three years."

These measures would –



Question:
"In order to be successful, the planned reform of the retirement pension system is based on the assumption that GDP will grow at a rate of 3% p.a. and employment growth will be 1.5% p.a. How do you assess these underlying assumptions?"

These measures would –



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2011)

About the survey

In April 2009, top decision-makers at the largest companies in Luxembourg, as defined by the number of employees, were interviewed for the first time within the framework of the "Luxembourg Business Compass." Using this instrument, the aim was to establish an economic indicator - for the first time ever - that could be employed to ascertain Luxembourg business leaders' expectations regarding the future economic trend in Luxembourg at regular intervals. The survey focuses particularly on how business leaders expect the Luxembourg economy will develop in the next six or, respectively, 12 months, along with their expectations and plans for their own companies' future development. These core questions are supplemented by varying questions pertaining to business or politics.

In April 2011, the survey for the "Luxembourg Business Compass" was repeated for the fifth time. As with the prior survey waves, the INSTITUT FÜR DEMOSKOPIE ALLENSBACH was commissioned by KPMG S.A.R.L. to design the survey methodologically, develop the questionnaire in cooperation with the client,confidentially process the anonymous data collected and compile a report on the findings. After being notified about the survey in writing or by telephone, a total of 80 top decision-makers were interviewed using an online questionnaire in English in the time from April 1 to 20, 2011. As in the previous survey waves, it was also possible to draw a top-notch sample for the present survey. In 15 percent of the cases, the interview was completed by the company owner him- or herself, while more than two thirds of the respondents hold the position of CEO/CFO or COO at their companies (69 percent), and an additional 15 percent hold other executive positions.[1]

The companies were selected based on the STATEC directory, "Les principaux employeurs au Luxembourg d'après l'effectif classés par branche d'activité économique de la NACE Rév.2, Situation au 1er janvier 2009 (édition juin 2009)."

1 One respondent did not indicate his/her position at the company.

In drawing the sample, companies were selected from the different business sectors in line with these sectors' share of the gross domestic product in Luxembourg. Within the different economic sectors, the largest companies - as determined by the number of employees - were included in the investigation.

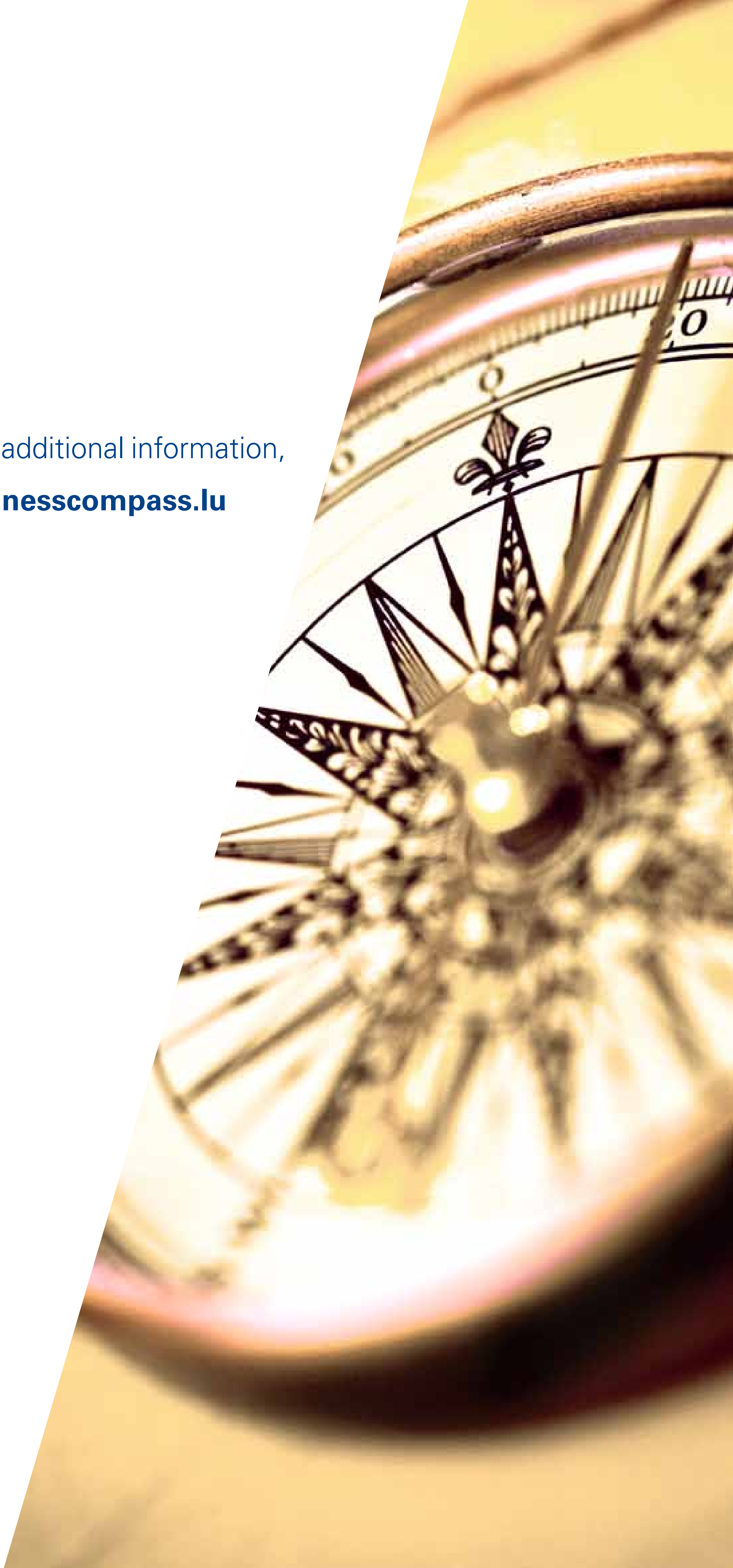
At the time when the first survey wave was conducted, the Luxembourg economy was still firmly in the grip of the global economic and financial crisis. The current findings show that the Luxembourg economy is clearly on the path towards recovery, with Luxembourg business leaders assessing both the general state of the economy and the situation at their own companies more optimistically than in any of the previous four survey waves.
The core questions on the economic trend are augmented in the present survey by differentiated trend questions on Luxembourg's competitiveness and on the various developments entrepreneurs anticipate in their own line of business or economic sector. In addition, several questions pertaining to current political issues or economic policies are included: specifically, questions on introducing quotas for women in executive positions, on the evaluation and remuneration of public sector employees, and on the proposed reform of the retirement pension system in Luxembourg.

The present report summarizes the most important findings of the study and presents them in graphic form. The report is supplemented by a basic volume of tables showing the responses to all questions in tabular form.

Allensbach on Lake Constance, INSTITUT FÜR DEMOSKOPIE ALLENSBACH
May 12, 2011

For the entire report and additional information,

www.luxembourgbusinesscompass.lu



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