CFO Survey Europe – Quarterly Report

Tilburg University
Understanding Society

Q3 2011

- *Persistent Decline in Optimism*
- *Production, Hiring and Expected Earnings All Down*
- *Indicators of Looming Recession?*

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Introduction

CFO optimism plunges worldwide

CFO optimism has plummeted in the third quarter of 2011 continuing the negative trend of the second quarter. Major regions such as the US and Asia exhibit a strong decline in the number of optimists. Two thirds of European financial executives are less optimistic about the economic prospects of their country.

Eurobonds as answer to Euro crisis?

With the debt crisis lingering on and without real prospects of significant improvement any time soon, more than half of the European CFOs consider the creation of Eurobonds as desirable. A precursor to such a jointly issued and guaranteed bond by all EU member states would likely be (further) fiscal integration and more stringent budgetary supervision and control.

The deterioration in CFO sentiment is not limited to the macro economy but also extends to the financial prospects of the individual firms. The number of executives that are more pessimistic has increased considerably for the Eurozone and has remained significant for the US in comparison with the second quarter of this year.

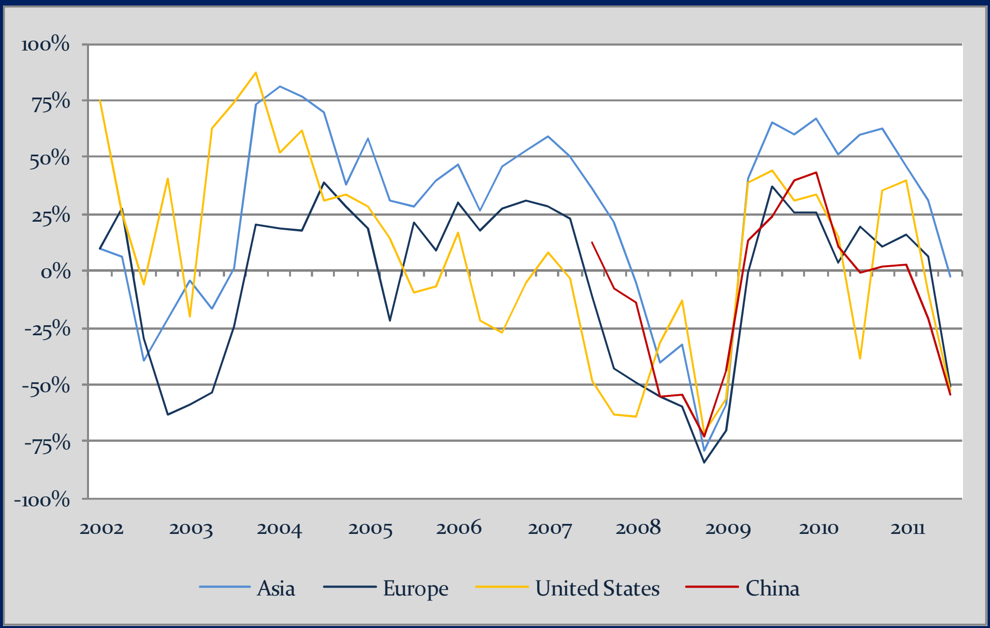
In Europe corporate spending is in decline to say the least. Companies express their concerns about consumer demand, global financial instability, price pressure and the difficulty for them to maintain margins.

CFOs' concerns affect day-to-day business…

These worries translate into negative expectations for both earnings growth and capital expenditures. With production capacity just above 70% and growth in employee hiring expected to drop into negative territory the question arises whether we are on the eve of another Europe wide recession.

…indicating a recession?

Figure 1. Optimism index for CFOs in Asia, Europe, US and China

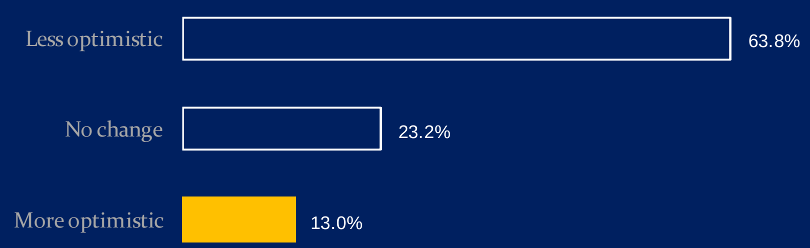


CFO optimism & sentiment

CFOs turn pessimistic in Europe

Optimism among European CFOs has plunged during the third quarter of 2011. Almost two out of three of the financial executives are less optimistic about the economic outlook of their own country. The average optimism index has dropped to 54.2 (on a scale of 100) from 58.5 during previous quarter. A mere 13% of the European CFOs is more optimistic.

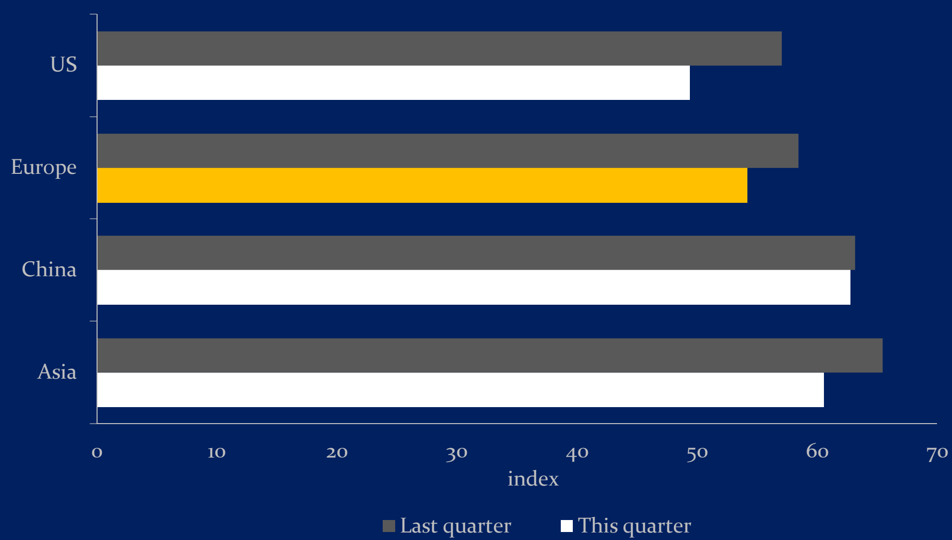
Figure 1. European CFO sentiment regarding economy of own country



With the US and Asia not showing any better results

Worldwide, optimism has decreased significantly across the board. Not only has the European continent witnessed deterioration of economic sentiment, regions such as the US and Asia too are experiencing steep decline in optimism. In Asia the optimism level has decreased from 65.5 to 60.6 (on a scale of 100) and in the US the level has dropped to 49.4 from 57.1 during the previous quarter. These steep declines may signal the possibility of the current global economic downturn to develop into a recession, across Europe and the US in particular.

Figure 2. Optimism level about own country's economy



Worries indicate the possibility of constrained growth in Europe

Similar to previous quarter, concerns topping the European CFO's agenda include:

- Consumer demand
- Global financial instability
- Price pressure from competitors
- Credit markets and interest rate developments

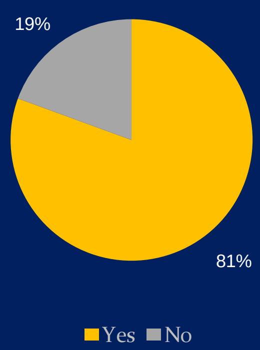
Likely to result in a recession within the next year?

These worries add to the uncertainty about the economic development in major regions. CFOs from both Europe and the US have expressed their concerns about a possible recession hitting their own country within the next year. Almost 60% of the European CFOs and 65% of American CFOs show moderate to serious concern of such an event to take place.

7% of European financial executives and 11% of their American colleagues consider their own economy to be already in the midst of a recession. Even though the underlying problems and dynamics differ among the two regions, the level of concern for a recession to hit the economy is more or less the same.

According to more than 80% of the European financial executives, the chance of a Europe-wide recession is not entirely isolated but is also exacerbated by the occurrence of a US recession.

Figure 3. Would a US recession instigate a Europe-wide recession?



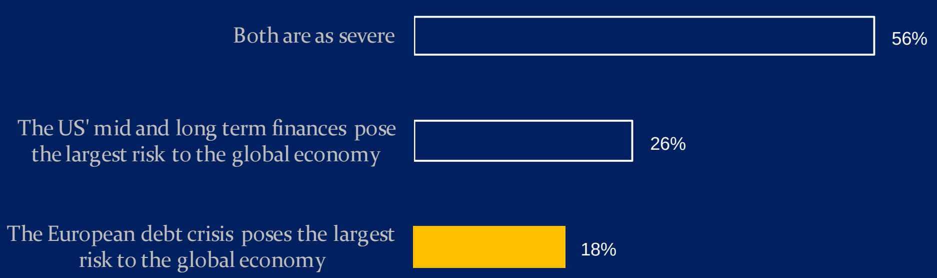
What if the US economy would fall into recession first?

If indeed the US were first to fall into recession, the probability of a Eurozone recession is estimated at 60%. This of course begs the question how severe the economic situations in both markets are regarded.

Subsequently, European CFOs were asked which market (and underlying dynamics) they think poses the largest threat to the global economy. Apparently, more than halve of the executives consider the economic situation of both markets to be as severe. One out of four regards the mid and long term financial situation in the US to be in the worst state and therefore pose the largest threat to the global economy. Less than 20% thinks the European debt crisis is the primary reason for concern.

Figure 4. Which market is in the worst state?

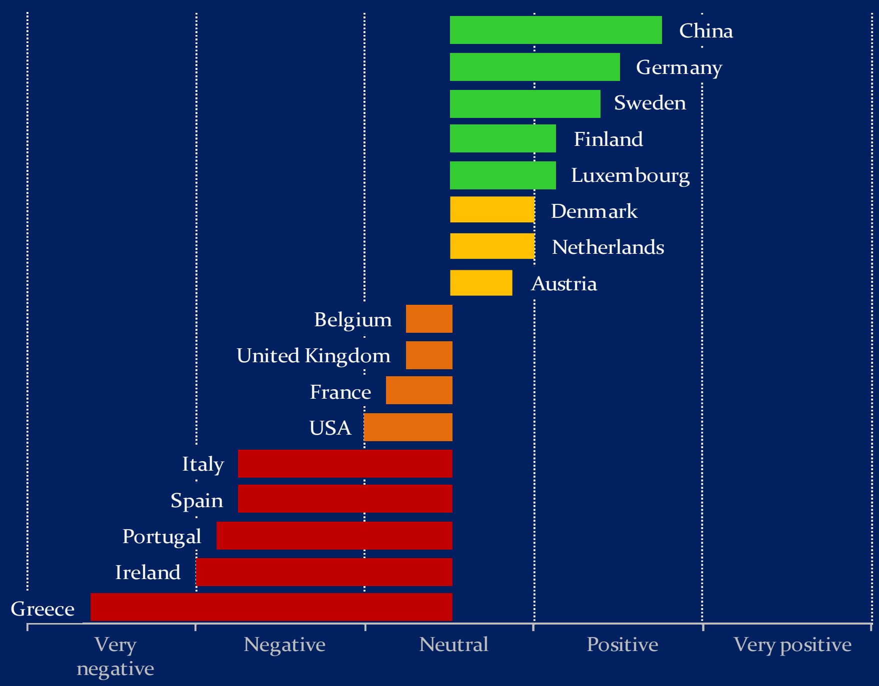
How do European CFOs rate the US and European economies?



In a further country-by-country breakdown, European CFOs were asked to rate each individual country on basis of its fiscal, budgetary and economic developments on a scale of 1 to 5 (1 being very negative and 5 being very positive).

US economic prospects and developments rated worse than most European countries

Figure 5. European CFO's rating for individual countries



The financial executives clearly view the US economy in a slightly more negative way compared with most European countries. It should therefore come as no surprise that the majority of the CFOs (60%) considers the recent S&P's-downgrade of the US triple-A status to be justified.

Gross of European CFOs regard US downgrade by S&P justified

Figure 6. Do you consider the S&P's US-downgrade to be justified?

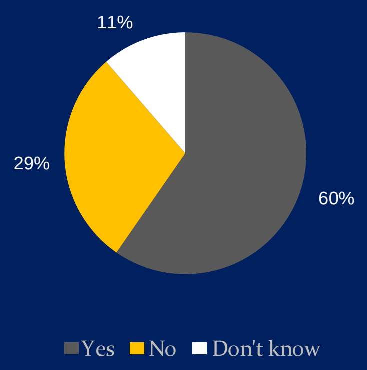
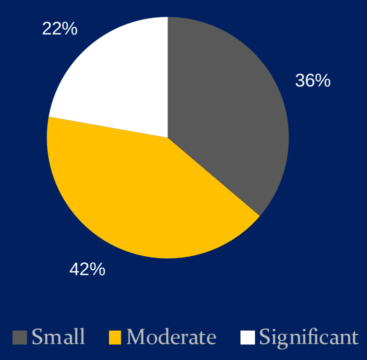


Figure 7. What will be the impact of the downgrade on the global economy?



Although the impact will not be severe

However, according to the CFOs, the impact of this downgrade should not be very significant. It is simply regarded as a confirmation of what was already known for a long time. The market has discounted this information accordingly. Moreover, the role of the US in the global economy together with the fact that the dollar is the world's reserve currency will likely soften any major adverse effects of the downgrade.

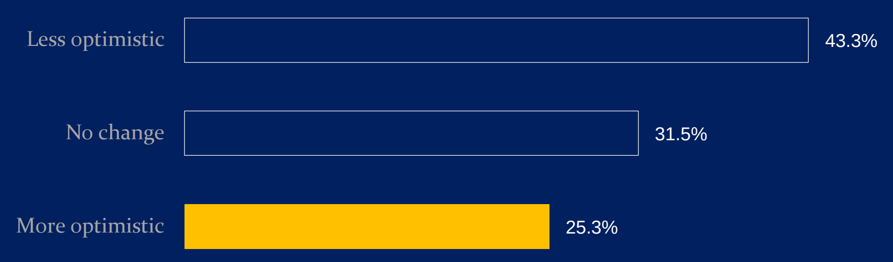
Optimism in Europe about financial prospects of the own company has weakened

Optimism regarding the (financial) prospects of the own company has also weakened during the third quarter of 2011. Although the actual optimism level remains at around 63 on a scale of 100 (the same as previous quarter), the decline in optimism is caused primarily by a substantial increase in the number of pessimists. Whereas in the previous quarter almost 17% of European CFOs were more pessimistic about the own company, this quarter the number of pessimists has increased to 43%, leaving only one out of four CFOs being more optimistic.

Worries continue to drive down CFO's sentiment

Top internal concerns for the Eurozone companies include:
1. Ability to maintain margins
2. Ability to forecast results
3. Attracting and retaining qualified employees
4. Adequate working capital management

Figure 8. European CFO sentiment regarding financial prospects of own company



Possibly turning executives apprehensive in their pursuit of investment opportunities

One third of the companies indicate that they will not necessarily (be able to) pursue all investment opportunities that have a positive NPV. CFOs mention several reasons for this that may also have contributed to the growing number of pessimists. These reasons include:
- 61% of the CFOs indicate that there is too much uncertainty about some projects
- 57% mention a shortage of funding
- 43% perceives the risks of projects as too high
- 43% claim to have a shortage of management time and expertise
- 27% indicate to have a shortage of employees

Figure 9. Does your company pursue all investment projects with positive NPV, during normal economic times?

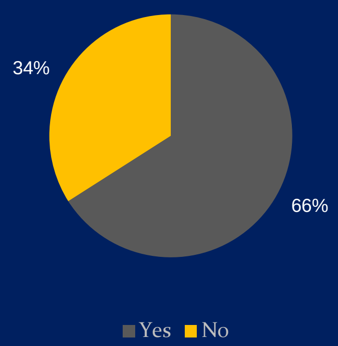
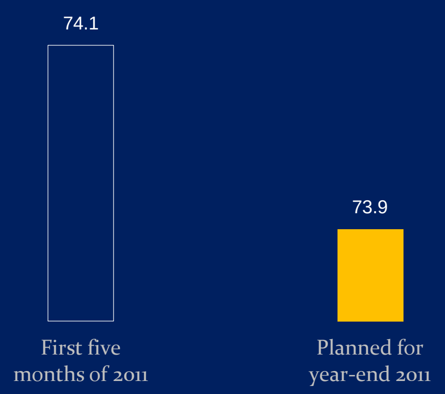


Figure 10. Capacity utilization in 2011 (%)



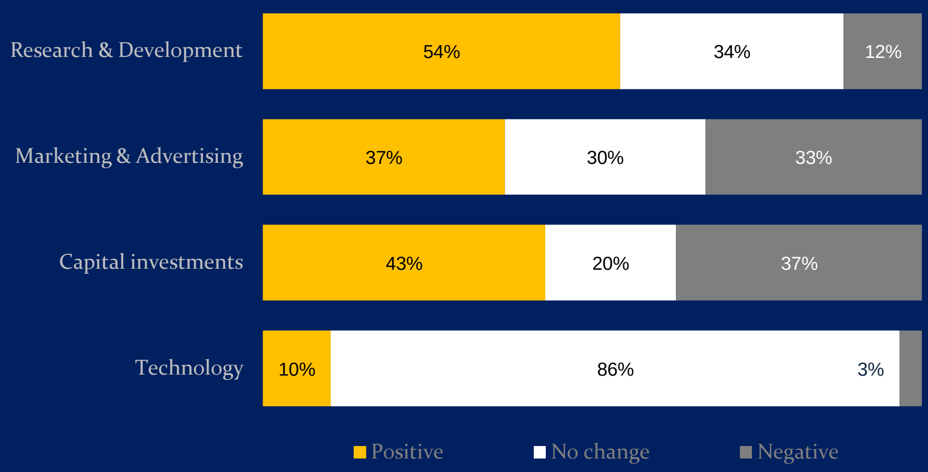
Capacity utilization another indicator for economic slowdown?

The capacity utilized within the European production companies during this quarter remained almost the same as at the end of 2010, at 74%. No improvement in utilization is foreseen in the months ahead. The forecast for utilization of production capacity at year-end was in the first quarter still 80.6%. This forecast was adjusted in the second and third quarters down to 78.9% and 73.9%, respectively. This may indicate a further delay in economic recovery.

Outlook for corporate spending less favorable than previous quarter

The anticipated slowdown is translated into corporate spending plans. In comparison with the first two quarters of this year, the number of companies planning to spend more on the major corporate spending items has decreased during this third quarter.

Figure 11. Relative to the previous 12 months, do you expect a positive or a negative change for your company in the following items?



With technology and marketing & advertising expenditures taking the biggest cuts

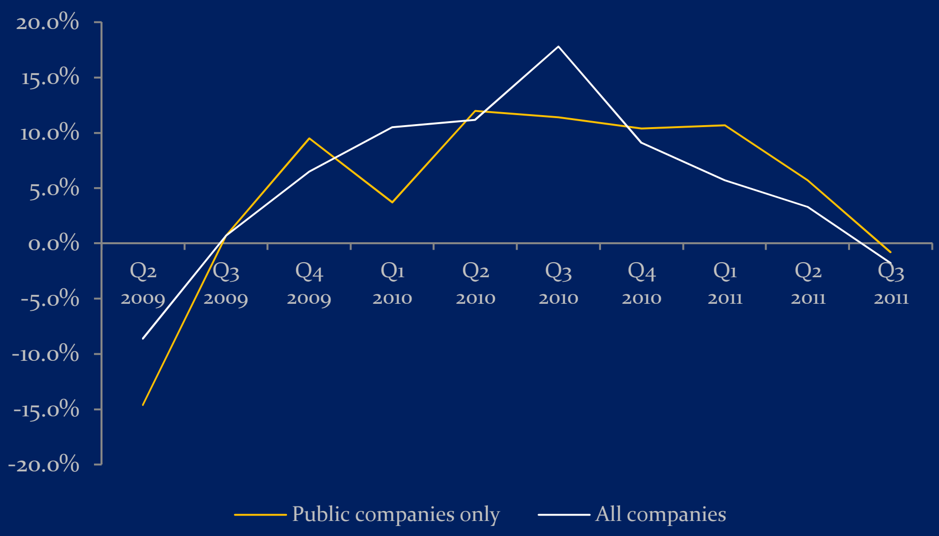
- Capital spending and investments is expected to increase at an average rate of around 3.2%, down from 3.5% last quarter
- R&D expenditure is estimated to increase by a moderate 2.0%, down from almost 4% last quarter
- Technology expenditures fall back to a growth rate of 0.6% (down from almost 4% in Q2 2011)
- Corporate spending on advertising and marketing is expected to decrease on average with -0.7% down from 2.0% last quarter

Finance & capital

Until recently, CFOs in Europe remained very positive about their own firms' profit forecasts. After a tumultuous 2008, which was accompanied by extremely negative profit forecasts, sentiment improved considerably from mid 2009. There's remarkably little of this improvement left today.

Earnings growth continues the downward dive which had set in last year

Figure 12. Quarterly expected earningsgrowth for next 12 months



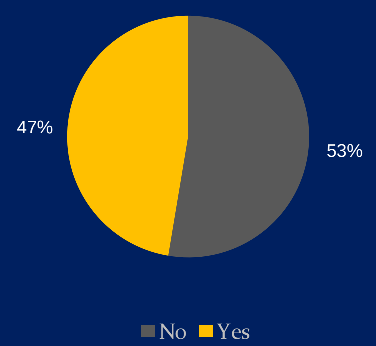
Whereas for the last two years the predicted (average) growth in profit has remained in positive territory, this quarter's expectations on growth in earnings were negative.

Possibly stimulating companies to hoard cash

Lack of earnings may have contributed to CFO's restraint with respect to cash reserve deployment. Almost halve of the companies indicate that they will hold on to their cash reserves in the next twelve months.

Also the economic uncertainty and difficult credit markets are causing firms to accumulate massive financial reserves. This could be at the expense of potential economic growth.

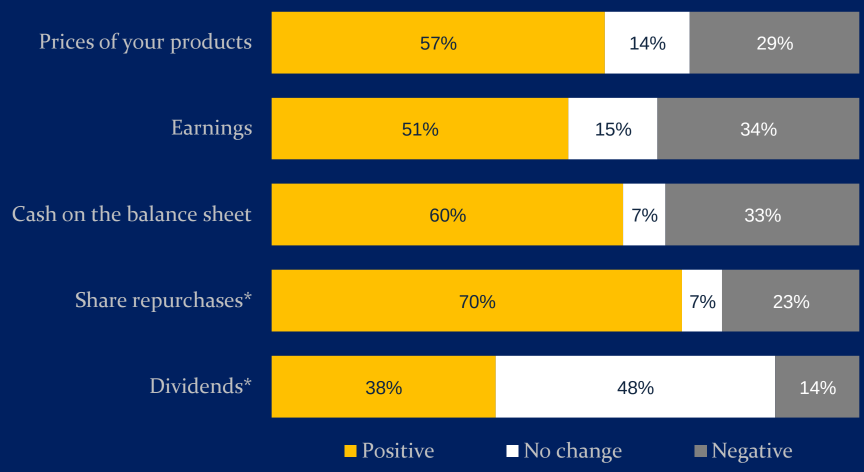
Figure 13. Will you deploy your cash reserves during the next 12 months?



Motivations to hoard cash include:
- Need for cash as a liquidity buffer (42%)
- Hold cash until economic uncertainty declines (28%)
- Few attractive investment opportunities available (25%)
- Lack of excess cash (22%)

In the previous quarter more than two thirds of the CFOs indicated that they expected to see a positive change in earnings. This quarter just over half of the executives believes this is the case. In line with the anticipated cash hoarding, 60% of the companies are expected to see growth in their cash (on the balance sheet).

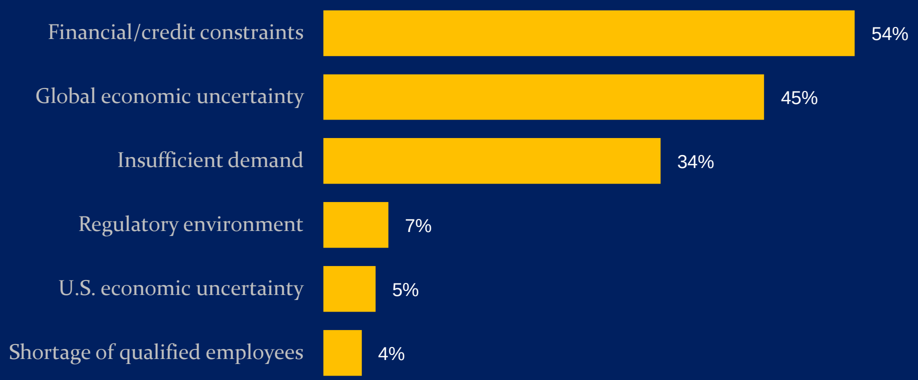
Figure 14. Relative to the previous 12 months, do you expect a positive or a negative change for your company in the following items?



Four out of ten European financial executives indicate that they also have pushed back the company's capital expenditure plans. With more than halve of the respondents blaming financial credit constraints and 45% stating that the global economic uncertainty is restraining capital expenditure, this may further indicate that economic growth is likely to be impeded for quite a while longer.

Financial and credit constraints and global economic uncertainty put a cap on capital expenditures

Figure 15 . Motivations for those companies that have pushed back capital expenditure plans



Employment

Macro economic concerns affect companies' hiring plans

During the third quarter of 2011 more than one third of the European companies have pushed back their hiring plans. Again, primary reasons for this include insufficient consumer demand, the global economic uncertainty, and financial and credit constraints.

With the risk of inhibiting growth opportunities

This may have implications for a firm's growth opportunities. For example, companies explain an inability to initiate investment projects by pointing, among other things, to shortages of staff, time to manage the project, and a lack of expertise.

Figure 16. In the last three months, have you pushed back your hiring plans?

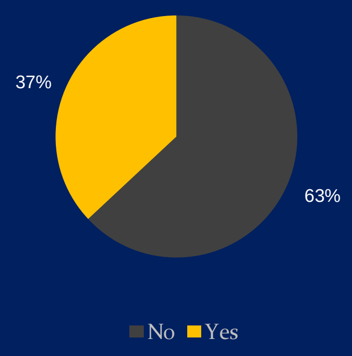
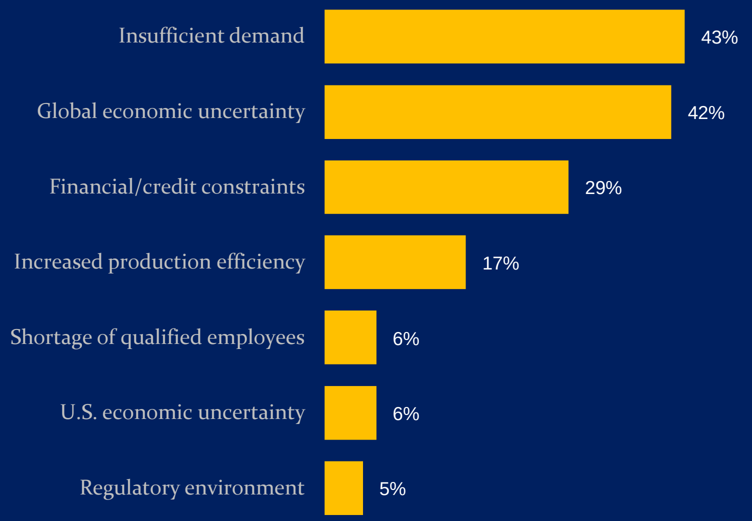


Figure 17. Motivations for those companies that have pushed back hiring plans

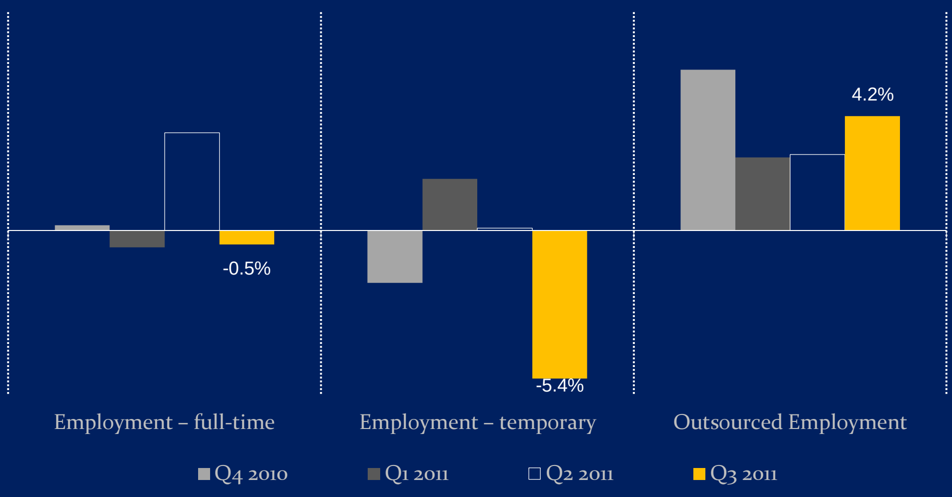


A change in the employee mix is foreseen…

The combination of weak macro economic dynamics and a cutback in hiring will likely result in a change in the employee mix. During the previous quarter average (expected) growth rates were highest for full time employment while growth in temporary employment remained neutral. This quarter's expected growth in full-time employees and temporary employees for the coming twelve months is -0.5% and -5.4%, respectively.

Figure 18. European CFOs expected growth for next 12 months in employee mix

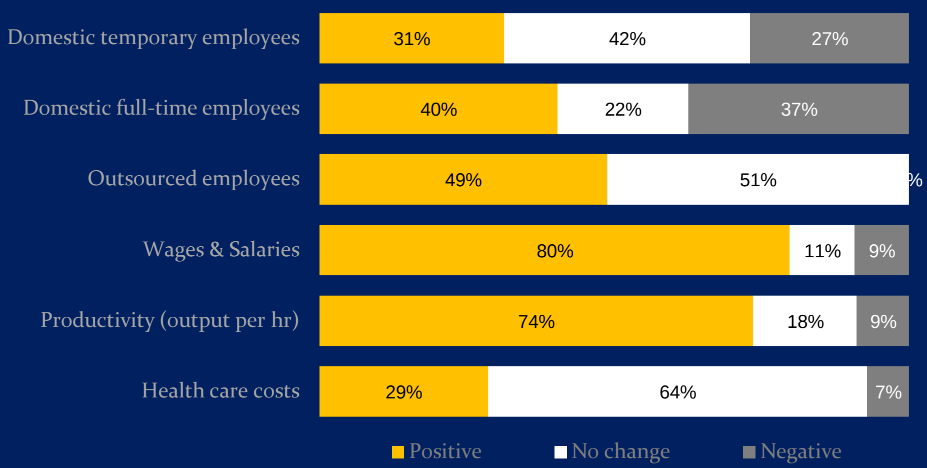
…with outsourcing of employment possibly becoming the preferred method of hiring…



With full time and temporary employment in decline, it is expected that companies will increasingly outsource activities over the next twelve months. Almost half of the companies indicate that they will do so (compared with only 30% in Q2 2011). Although 40% of the CFOs indicate that they still plan to increase full time hiring, this is significantly less compared to the previous quarter where around 60% stated to increase full time hiring.

Figure 19. Relative to the previous 12 months, do you expect a positive or a negative change for your company in the following items?

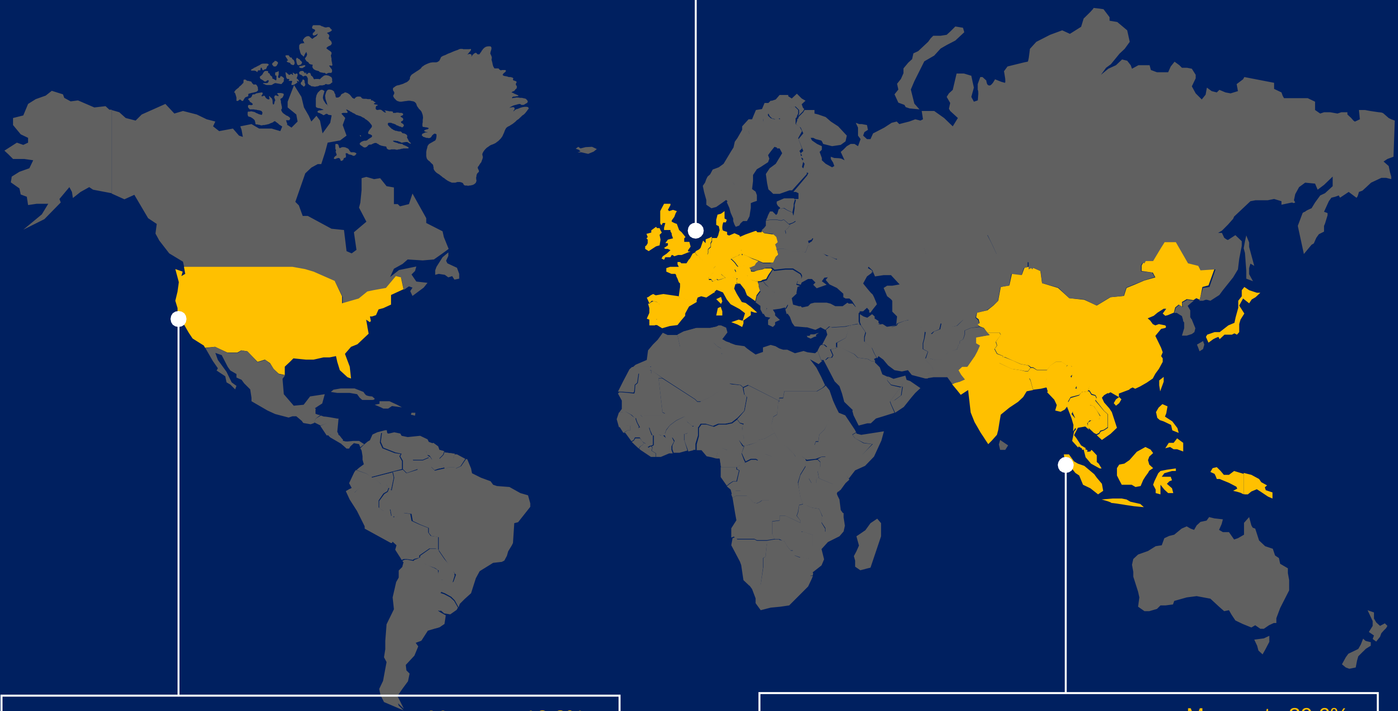
…resulting in expected increases in wages and salaries



The rise in outsourced employment may also explain why financial executives expect wages and salaries to increase over the next twelve months.

Key results CFO Survey – Europe, US and Asia

Optimism about the country's economy	More opt: 13.0% Less opt: 63.8% No chg: 23.2%	Employment – full-time	-0.5%
		Employment – temporary	-5.4%
		Outsourced Employment	4.2%
Country optimism level	54.2	Wages and Salaries	3.0%
Optimism about own company	More opt: 25.3% Less opt: 43.3% No chg: 31.5%	Productivity	3.5%
		Inflation (own-firm products)	0.5%
Own company optimism level	63.9	Earnings growth*	-0.8%
		Dividends*	-0.8%
Capital spending	3.2%	Share Repurchases*	4.5%
Technology spending	0.6%	Cash on balance sheet*	3.4%
R&D spending	2.0%	Mergers and Acquisitions	Not asked
Advertising and marketing spending	-0.7%		



Optimism about the U.S. economy	More opt: 12.2% Less opt: 64.8% No chg: 23.0%
U. S. optimism level (0 to 100)	49.4
Optimism about own company	More opt: 29.4% Less opt: 36.4% No chg: 34.2%
Own company optimism level	63.1
Capital spending	4.5%
Technology spending	4.3%
R&D spending	2.8%
Advertising and marketing spending	2.1%
Employment – full-time	0.9%
Employment – temporary	-0.4%
Outsourced Employment	2.2%
Wages and Salaries	2.3%
Productivity	3.0%
Inflation (own-firm products)	2.5%
Earnings growth*	9.4%
Dividends*	12.4%
Share Repurchases*	3.4%
Cash on balance sheet*	-1.8%
Mergers and Acquisitions	Not asked

Optimism about the country's economy	More opt: 39.6% Less opt: 41.9% No chg: 18.5%
Country optimism level	60.6
Optimism about own company	More opt: 47.1% Less opt: 36.9% No chg: 16.0%
Own company optimism level	62.7
Capital spending	13.2%
Technology spending	12.9%
R&D spending	7.2%
Advertising and marketing spending	5.5%
Employment – full-time	6.8%
Employment – temporary	2.9%
Outsourced Employment	3.0%
Wages and Salaries	8.0%
Productivity	6.5%
Inflation (own-firm products)	4.1%
Earnings growth*	7.4%
Dividends*	4.0%
Share Repurchases*	0.2%
Cash on balance sheet*	6.4%
Mergers and Acquisitions	Not asked.

Percentages indicate this quarter's expected growth rates for the next twelve months
** Indicates public firms only*

About CFO Survey

All the figures quoted above are taken from the Global CFO Survey for the third quarter of 2011. The survey concluded September 9, 2011. Every quarter, CFOs in Europe, the US, Asia and China are questioned about their economic expectations. Current records go back 62 quarters. The CFO Survey is conducted jointly by Tilburg University, Duke University (Durham, North Carolina) and CFO Magazine.

Note for the Press

The full results, including summary tables and previous editions of the CFO Survey can be found at www.cfosurveyeurope.org. For further information, please contact Margreet Punt, Tilburg School of Economics and Management, tel. +31-(0)13-4663765 or e-mail margreet.punt@uvt.nl

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