

CFO Survey Europe – Quarterly Report



Q4 2011

- *Crisis Spilling over to Real Economy*
- *Industry Conditions are Worsening*
- *Emergency Plans at the Ready*



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Introduction

The crisis that started within the financial system has spilled over to the real economy

At the end of 2011 CFO optimism remains low. Few financial executives on the European continent are positive about the economic prospects and several indicators point towards economic stagnation on the short term. The protracted crisis, at first predominantly limited to the financial markets, now seems to have spilled over to the real economy.

European CFOs observe deterioration within their respective industries. Many of them state that, compared to a year ago, demand for their products have dropped.

CFOs worry about another recession...

It is no surprise that weak consumer demand, price pressure from competitors and deterioration of credit market conditions fuel CFOs' anxieties about an emerging recession. Decline in expected investments and expenditures for the coming twelve months and stalling employment do not provide any comfort.

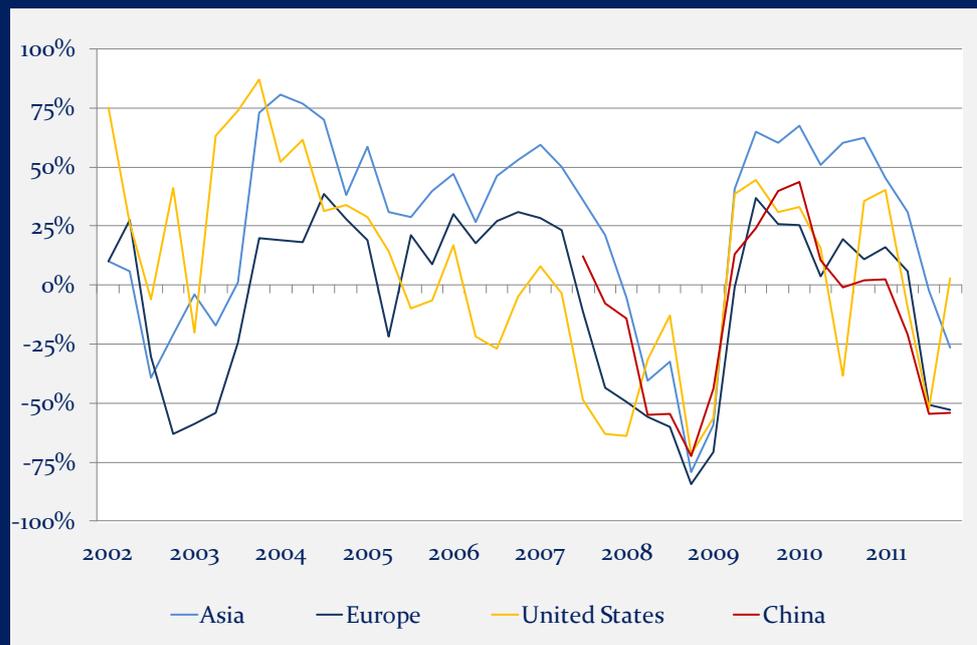
..and have taken serious precautions

Recovery is far from evident and the question remains whether Europe should prepare for another economic downturn. More than 60% of financial executives on the European continent state to be on the safe side and have prepared a contingency plan for emergencies.

What effect will these measures have on the long term?

Typically these plans entail drastic measures directly affecting employment and investment. This raises doubts on their effectiveness and whether or not these measures inhibit economic growth further. The competitiveness of individual companies and possibly entire industries on the long term could be severely impaired.

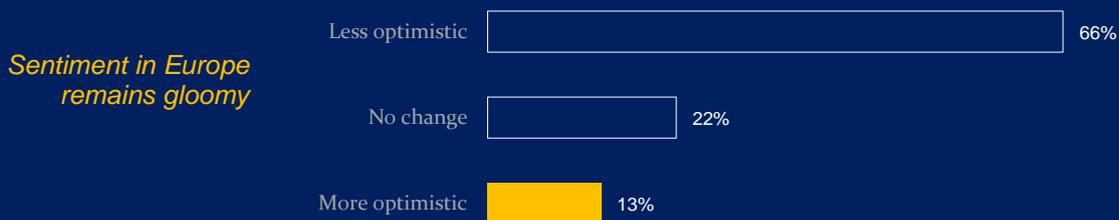
Figure 1. Optimism index for CFOs in Asia, Europe, US and China



CFO optimism & sentiment

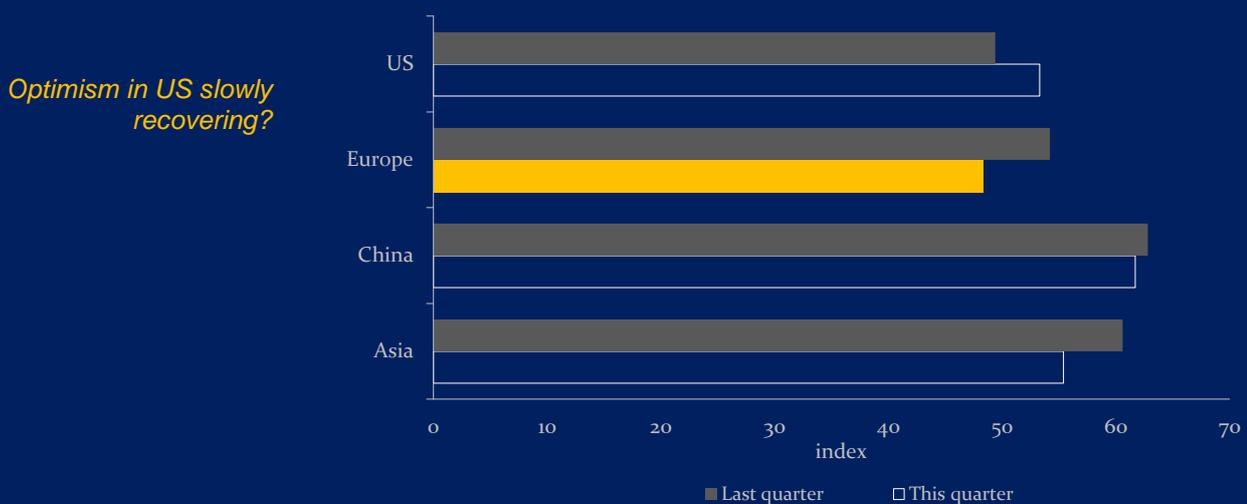
Two thirds of the European CFOs are less optimistic about the economic outlook of their own country. Continuing the trend of previous quarters, the average optimism index has dropped to a staggering low level of 48 (on a scale of 100) during the last quarter of 2011. Only 13% of the financial executives are more optimistic.

Figure 2. European CFO sentiment regarding economy of own country



The global economic outlook remains weak. Next to Europe, Asia has witnessed a strong decline during the last five quarters in optimism among financial executives: from 73 in December 2010 to 55 (on a scale of 100) during the fourth quarter of 2011. Although in the US a larger share of CFOs have indicated to be more positive about the country's economic prospects (compared to last quarter), the actual optimism level in the US has only seen piecemeal improvement pointing towards a slow recovery.

Figure 3. Optimism level about own country's economy

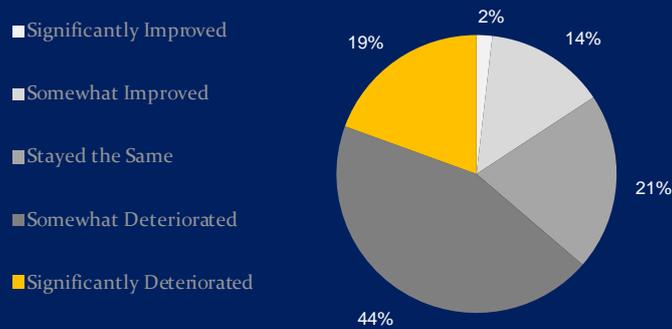


Crisis in Europe has profound and significant impact

The (financial) crisis does not leave many companies untouched. Nine out of ten European CFOs claim that their company is affected in some way. Half of them say that the effects are significant and thus impacts day-to-day business. More than 60% of European companies have experienced a deterioration of economic conditions within their specific industry over the last twelve months.

Figure 4. Over the last 12 months, have the economic conditions of the industry that you operate in improved or deteriorated?

on industry level..

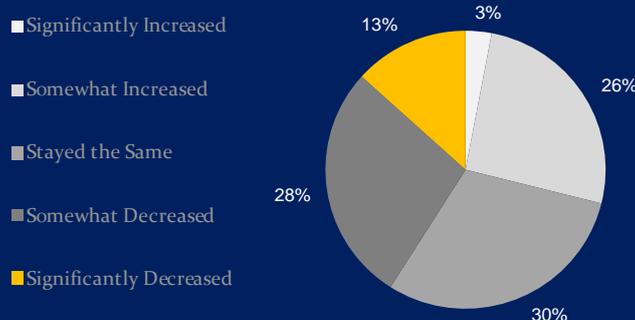


The worsening of the economic and industry specific conditions is also reflected in the production capacity of manufacturing companies. In 2010, the average production capacity utilization was 75%. At the beginning of the year the expected utilization for 2011 was estimated at 81%. During the first half of 2011 however, the manufacturing companies failed to reach this target and actual utilized capacity stuck at 74%. Although European CFOs have seen slight improvement during the second half of 2011 (79%) it remains to be seen whether this constitutes a structural improvement.

...and individual company level

Consumer demand and price pressure from competitors still remain major (macro) concerns for the CFOs. 40% of the companies in the survey have witnessed a decline of product demand by consumers, when compared to a year ago. The negative sentiment among European executives is therefore largely induced by a deterioration of demand-side dynamics. That what started as a crisis in the financial system seems to have spilled over to the real economy.

Figure 5. Compared to one year ago, has demand for your product increased, decreased, or stayed the same?



But economic recovery should come first and foremost from within Europe

Even though the U.S and Asia are generally considered to be the primary drivers of the global economy, the priority should be economic recovery on the European continent. As European companies primarily originate their sales turnover within Europe itself, this is the only solution to prevent further damage to European companies.

Figure 6. Geographical breakdown of sales revenue for European companies (average of all European countries in the survey)



...as Europe remains the dominant market for European companies

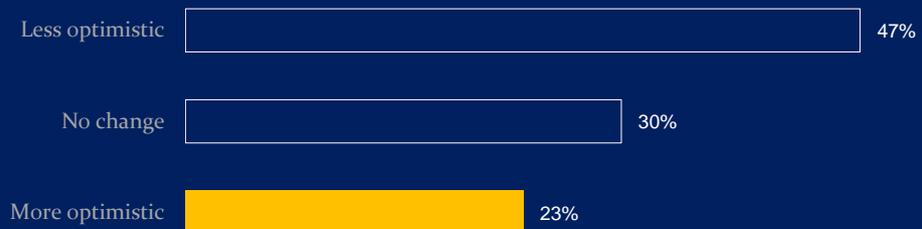
Demand-side concerns and tight credit markets fuel the fear of a recession

There is considerable fear among European CFOs for another recession to take place within the next 6 months. They estimate the chance at 50%. Besides demand side concerns, the executives are also worried about conditions in the credit markets. The ease of borrowing has not improved compared to a year ago.

As different factors seem to indicate that the real economy is adversely affected by the financial crisis, it should come as no surprise that the optimism regarding the (financial) prospects of the own company has deteriorated further during the fourth quarter of 2011. Besides that almost half of the European CFOs are more pessimistic, the actual optimism level has decreased to 57 (on a scale of 100).

Figure 7. European CFO sentiment regarding financial prospects of own company

...leading to negative sentiments regarding the outlook of individual companies



Top internal concerns for the Eurozone companies include:

1. Ability to maintain margins
2. Ability to forecast results
3. Adequate working capital management
4. Maintaining morale and productivity

On average, European companies seem to be somewhat prepared for different scenarios including a rise in the costs of key inputs and energy prices.

However, the deteriorating external and internal conditions (in combination with fear of a recession) increasingly necessitate CFOs to contemplate on detailed contingency planning.

More than 60% of the financial executives have indicated that they have an emergency plan in place to fall back on in case a recession would occur. These plans are quite comprehensive and include far reaching measures.

- On average, companies would let go almost 13% of the workforce through layoffs and/or voluntary separations.
- Of those CFOs that have a plan in place, more than 50% indicate that they will not dip into cash reserves to avoid layoffs or cut expenses.
- More than 25% of the budget for capital expenditures would be cut.
- Of those companies that have a plan in place, almost half of them would cut discretionary spending such as R&D.

Clearly these measures are rigorous and detrimental to the competitive position of individual companies (and possibly sectors and industries) on the long term as they inhibit economic growth.

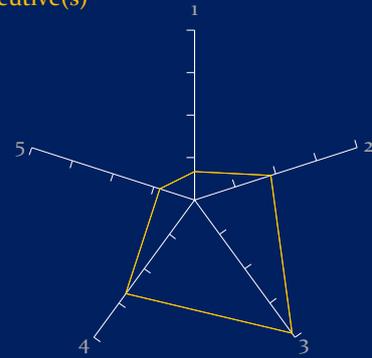
Contingency planning induced by fears over another recession

Entailing drastic measures

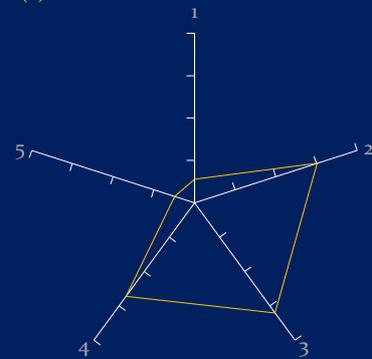
Possibly inhibiting future economic growth and competitiveness

Figure 8 . How well is your company prepared for: (1 = not prepared, 5 = very prepared)

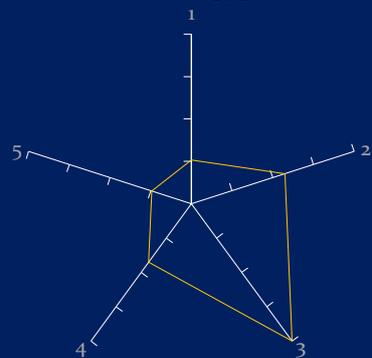
A. Departure of C-level executive(s)



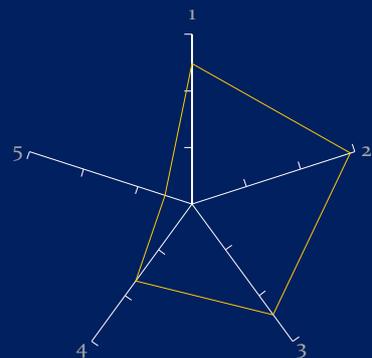
B. Dramatic rise in cost of key input(s)



C. Dramatic rise in energy prices



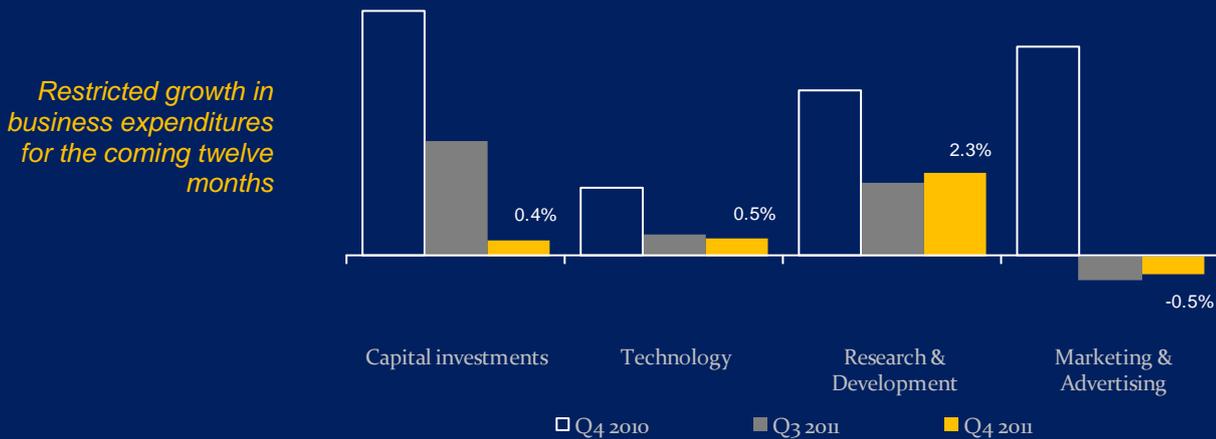
D. Natural disaster



Finance & capital

Over the year 2011 a significant decline could be observed across all major budget items. European companies remain strapped for cash and hardly expect any growth for 2012 in the primary business expenditures that are critical for maintaining a competitive position in the market.

Figure 9. CFOs' quarterly expected growth in spending for next 12 months



- Capital spending and investments are expected to increase at an average rate of around 0.4% (3.2% in previous quarter)
- R&D expenditure remains at a 2.3% expected growth rate
- After the sharp decline during last quarter the growth in technology expenditures is estimated at 0.5%
- Corporate spending on advertising and marketing is expected to decrease further on average with -0.5%

Possibly due to weak growth in earnings and cash reserves...

Weak growth in earnings and cash reserves lingers on and pushes companies to look for financial funds on the credit markets. However, financial institutions have become less eager to provide funds and apply more stringent conditions. European executives have indicated that the ease of borrowing has deteriorated.

Figure 10. Ease of borrowing for European companies (compared to a year ago)



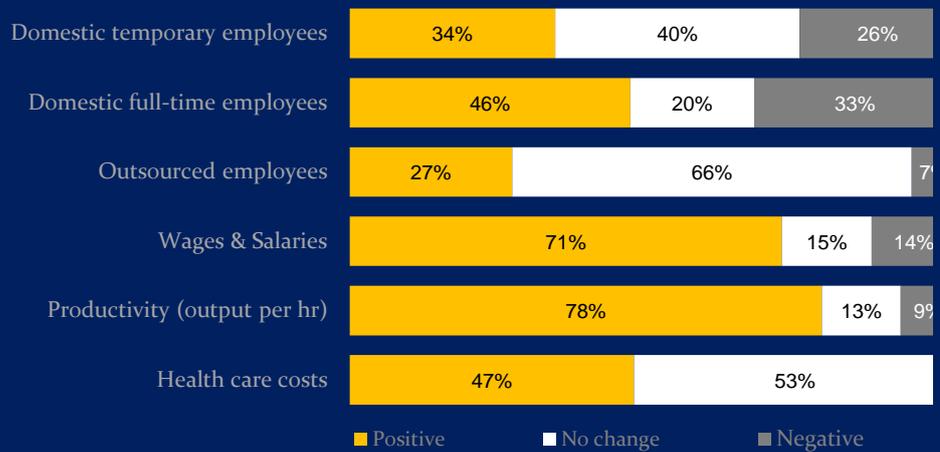
Employment

The change in employee mix expressed during Q3 is expected to continue

The fourth quarter of 2011 continues the trend of the previous quarter in terms of employment. The third quarter witnessed a change in the employee mix. During that period more than one third of the European companies pushed back their hiring plans due to weak macro economic dynamics. With full time and temporary employment in decline companies expected to outsource their activities and hence increase flexibility in HR management.

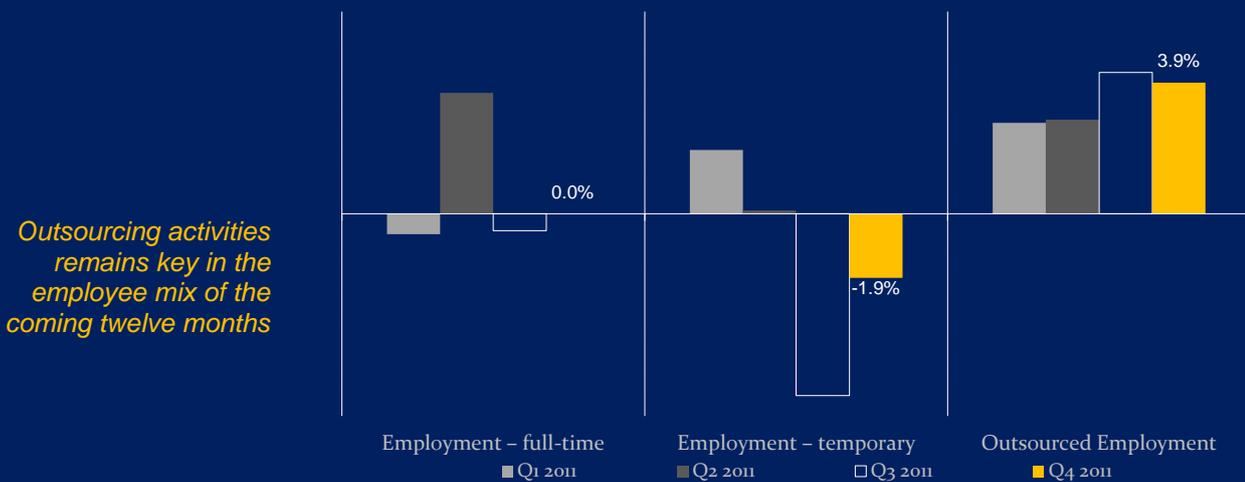
Employment across all contract types is expected to see a moderate but positive change. The underlying growth rates however, are not expected to have a significant impact on the current employee mix.

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 current fears for recession, and the emergency plans at the ready, companies are expected to maintain an employee mix in which outsourcing of activities takes a prominent place.

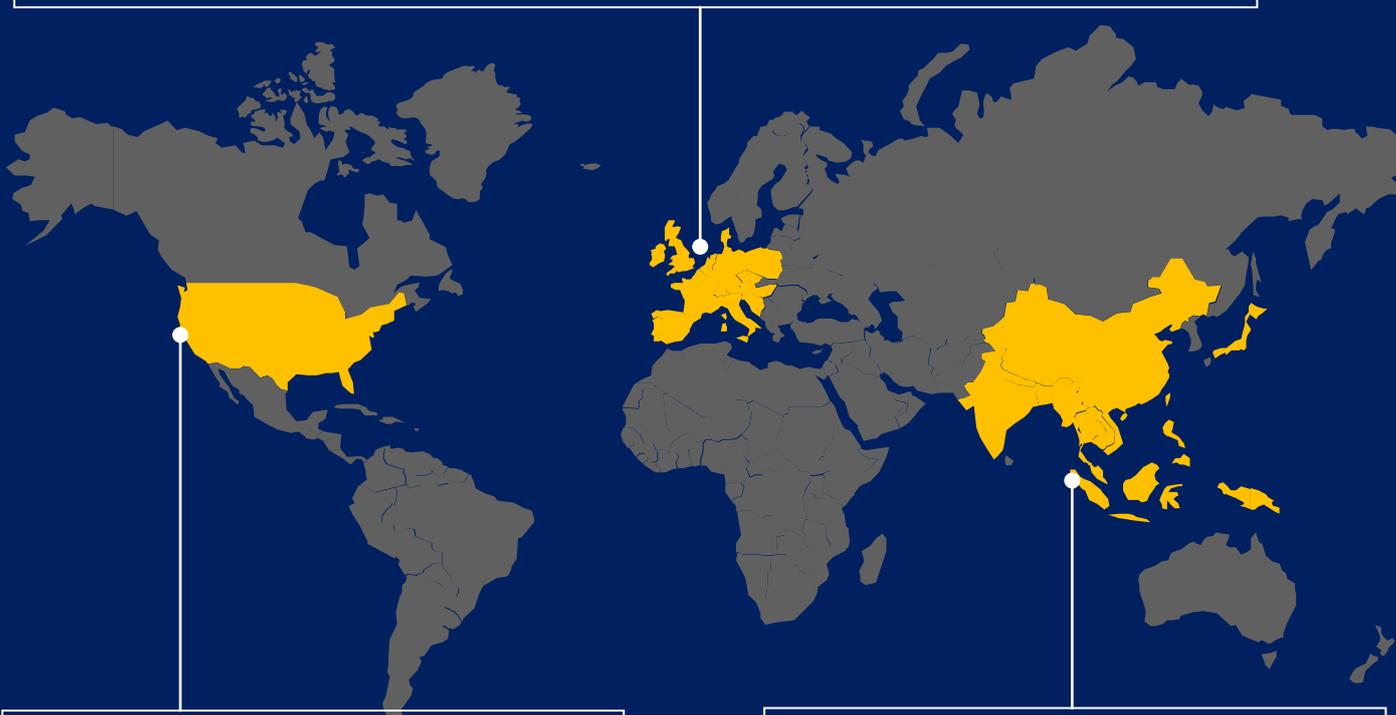
Figure 12. European CFOs expected growth for next 12 months in employee mix



Outsourcing activities remains key in the employee mix of the coming twelve months

Key results CFO Survey – Europe, US and Asia

Optimism about the country's economy	More opt: 12.9%	Employment – full-time	0.0%
	Less opt: 65.6%	Employment – temporary	-1.9%
	No chg: 21.5%	Outsourced Employment	3.9%
Country optimism level	48.3	Wages and Salaries	1.6%
	More opt: 23.3%	Productivity	4.2%
Optimism about own company	Less opt: 46.6%	Inflation (own-firm products)	-0.8%
	No chg: 30.1%	Earnings growth*	1.1%
Own company optimism level	57.5	Dividends*	2.9%
Capital spending	0.4%	Share Repurchases*	3.3%
Technology spending	0.5%	Cash on balance sheet*	1.2%
R&D spending	2.3%	Mergers and Acquisitions	Not asked
Advertising and marketing spending	-0.5%		



Optimism about the U.S. economy	More opt: 34.4%
	Less opt: 31.6%
	No chg: 34.0%
U. S. optimism level (0 to 100)	53.3
	More opt: 38.5%
Optimism about own company	Less opt: 28.0%
	No chg: 33.5%
Own company optimism level	63.1
Capital spending	7.8%
Technology spending	6.0%
R&D spending	2.9%
Advertising and marketing spending	2.3%
Employment – full-time	1.5%
Employment – temporary	0.2%
Outsourced Employment	1.8%
Wages and Salaries	2.4%
Productivity	2.7%
Inflation (own-firm products)	1.8%
Earnings growth*	7.7%
Dividends*	3.6%
Share Repurchases*	9.0%
Cash on balance sheet*	4.4%
Mergers and Acquisitions	Not asked

Optimism about the country's economy	More opt: 27.0%
	Less opt: 57.9%
	No chg: 15.2%
Country optimism level	57.3
	More opt: 38.7%
Optimism about own company	Less opt: 37.5%
	No chg: 23.9%
Own company optimism level	62.8
Capital spending	5.2%
Technology spending	3.8%
R&D spending	5.7%
Advertising and marketing spending	4.3%
Employment – full-time	5.4%
Employment – temporary	3.9%
Outsourced Employment	5.5%
Wages and Salaries	6.5%
Productivity	4.9%
Inflation (own-firm products)	0.1%
Earnings growth*	10.6%
Dividends*	10.7%
Share Repurchases*	0.1%
Cash on balance sheet*	5.1%
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 fourth quarter of 2011. The survey concluded December 9, 2011. Every quarter, CFOs in Europe, the US, Asia and China are questioned about their economic expectations. Current records go back 63 quarters. The CFO Survey is conducted jointly by Tilburg University, Duke University (Durham, North Carolina) and CFO Magazine.

Note for the Press

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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