CFO Survey Europe – Quarterly Report

DUKE THE FUQUA SCHOOL OF BUSINESS

TILBURG UNIVERSITY

Understanding Society

CFO Europe

Q3 2012

- *European CFOs see Greek Exit as Imminent*
- *Interest Rate Cuts Ineffective Measure to Stimulate Investment*

Contents

Introduction

CFO sentiment and economic outlook continues in negative territory

Optimism among CFOs worldwide remains troublesome. Although the emerging market regions including Latin America and Asia (excluding China) have witnessed piecemeal improvement, the situation in the US and Europe has not improved and remains weak.

Around 20% of the American financial executives are now optimistic about the economic climate. In the US, the number of pessimists has increased with almost 10% compared with the previous quarter and has reached now more than 43%. In Europe, the number of pessimists may have decreased but still remains at 46%.

For the US and Europe the prospects about one's own company have also deteriorated. European financial executives are confronted with market risks, strategic risks and financial risks. It's within this context that European companies are experiencing the adverse effects of the current economic climate.

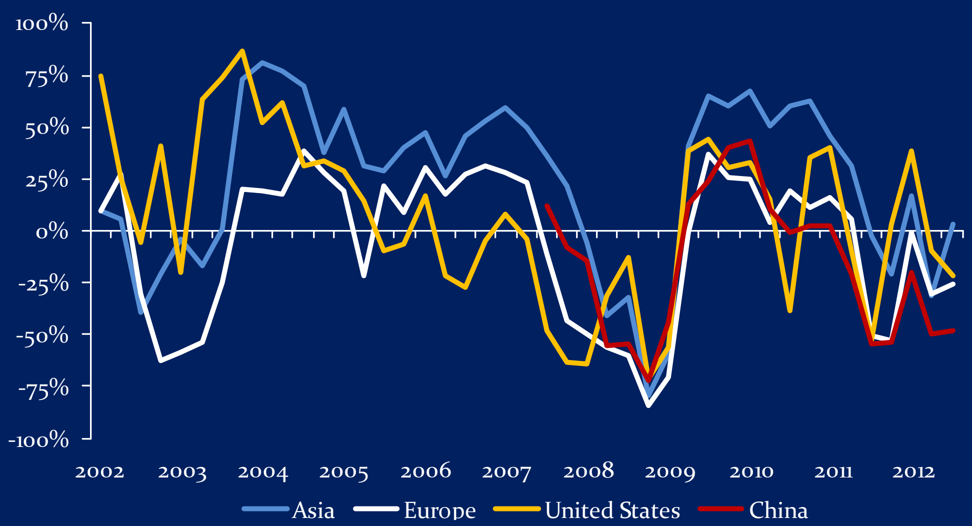
Eurozone breakup has very negative effect on European companies

If the Eurozone were to unravel, with one or more countries exiting, European CFOs expect that their own company will be affected even more adversely.

Decreasing interest rates to stimulate corporate investment is ineffective

Effectiveness of measures taken by the ECB to support economic recovery by lowering interest rates remains ambiguous at best. Most financial executives indicate that a further decrease of interest rates does not change their investment plans.

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

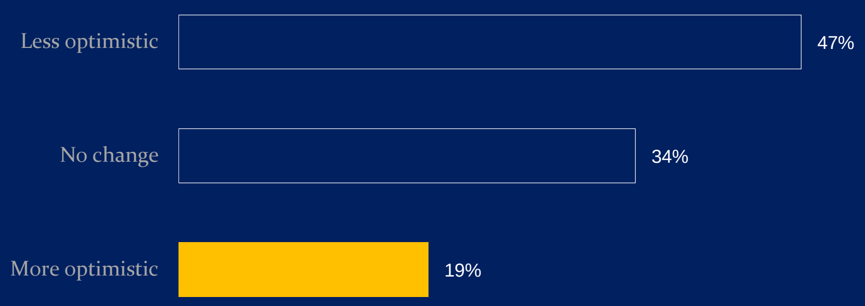


CFO optimism & sentiment

For a third quarter in a row, economic sentiment among European CFOs has deteriorated. Optimism is heading for the lower level that could be witnessed at the end of last year. Even though the number of pessimists has slightly decreased (from almost 52 % last quarter to 46% this quarter), the number of CFO's that haven't changed their view on the economic prospects has increased slightly compared to Q2 this year. This indicates that the poor economic prospects of last quarter remain largely intact this last quarter. Almost half of the financial executives indicate that they are less optimistic about the economic prospect for the coming 12 months (figure 2). The average optimism index has dropped further from 52 to 49 (on a scale of 100) pointing out a decreasing confidence in both the current economy and its recovery on the short term.

Figure 2. European CFO sentiment regarding economy of own country

European sentiment about the economy remains weak

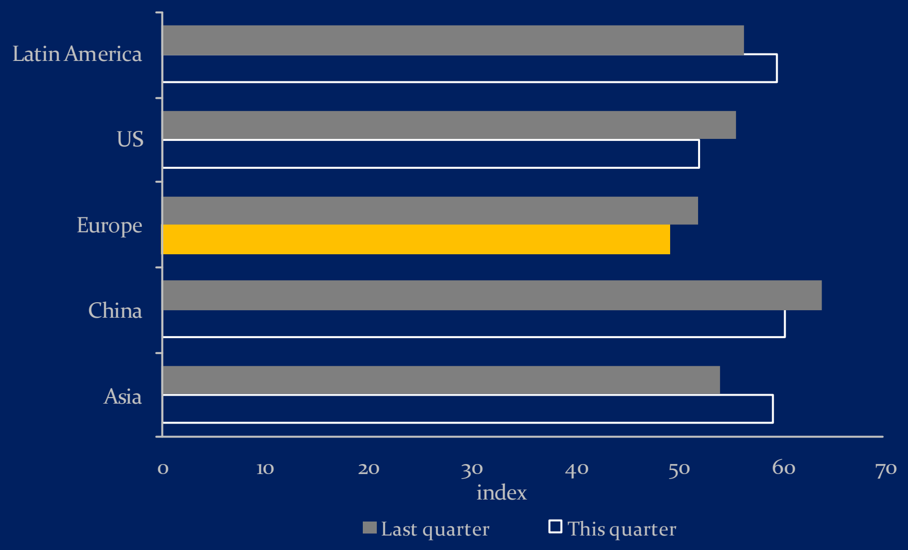


Together with Europe, the US has also witnessed deterioration in economic sentiment among CFOs (figure 3).

Figure 3. Optimism level about own country's economy

Emerging market regions see uptick in economic sentiment….

..while Europe,US and China experience another deterioration



Regions that are considered as emerging markets such as Latin America and Asia (with the exception of China) show strong uptick in their economic confidence levels (from 56 and 54 respectively, to almost 60 on a scale of 100 for both regions).

In Europe, the distribution among optimists and pessimists regarding the financial prospects of the own company remains largely unchanged compared with last quarter (figure 4). The actual level of optimism however, has decreased to the lower end as witnessed in Q4 2011. Standing at 57 on a scale of 100, the sentiment with respect to financials of the own company has experienced a significant negative downturn.

Outlook for own company remains weak and in line with previous quarter

Figure 4. European CFO sentiment regarding financial prospects of own company

This deterioration in sentiment among financial executives is reflected in the concerns that they express regarding the macro environment and the effect on the companies' internal operations (see table 1).

Macro and internal concerns remain unchanged

Table 1. Macro and internal concerns of European CFOs

Macro concerns	*Internal concerns*
➢ Consumer demand	➢ Ability to maintain margins
➢ Global financial instability	➢ Ability to forecast results
➢ National budget deficit	➢ Working capital management
➢ Credit markets and interest rates	➢ Maintaining morale and productivity

Two of the most important macro concerns that European executives are facing at the moment include consumer demand and global financial instability. Both are intimately connected with each other and are likely to continue to provide a challenge to CFOs on the European continent. Next to the current climate in Europe, a slowing growth in Asia or an unraveling of the Eurozone could implicate matters further.

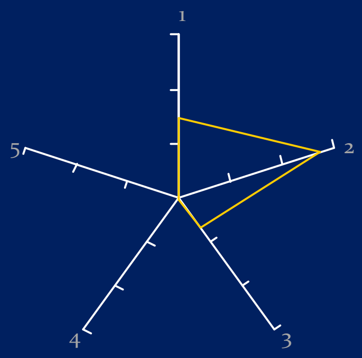
Figure 5. Impact of events on company
(1 = very negative, 5 = very positive)

Current economic climate in Europe is still affecting companies negatively...

Current climate in Europe

Unsurprisingly, European financial executives generally indicate that the current (economic) climate in Europe has a negative effect on their company. More than half of the CFOs say the effect is negative. Almost 30% of the executives say that the current climate has a very negative impact on their operations.

A. Current climate in Europe

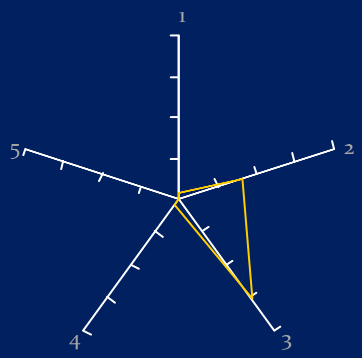


..while the impact of slowing growth in Asia on European companies is less severe

Slowing growth in Asia

More surprising is that European CFOs indicate that global financial instability and consumer demand are topping their list of macro concerns but that a slowing growth in Asia has a moderate effect on their companies. More than 60 percent of the CFOs remain neutral on the impact that a slowing Asian economy may have on their company. Only about one third of them consider such economic slowdown as negative to their operations.

B. Slowing growth in Asia

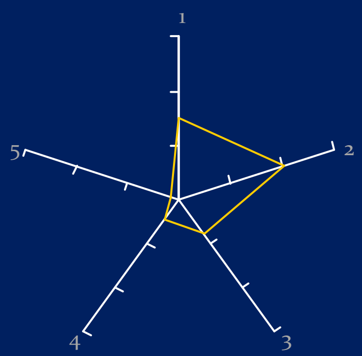


An unraveling of the Eurozone would be disastrous to many European companies

Unraveling of Europe

In the event that the Eurozone may fall apart or continues in another form, the impact on the European company is on average negative to very negative. More than 40% of the European executives believe such an event would have a negative effect on the company. Another 30% even regards such an occurrence to have very negative consequences to the company's operations.

C. In case Europe unravels



The fact that the current climate is (on average) regarded as having a negative effect on European companies while at the same time a slowing growth of the Asian economy only has a moderate impact on their operations, indicates that most European companies source their revenue from the internal European market. In our survey from Q4 2011, 61% of the CFOs already stated that they generate revenues from activities within the European market. Most likely this is also the big reason why European CFOs expect that an unraveling of the Eurozone will adversely impact their companies.

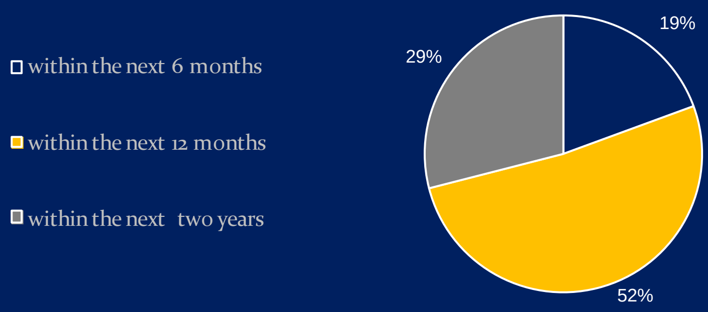
The question then remains whether the Eurozone will indeed survive in its current form. The current economic crisis in the Eurozone and in the peripheral countries in particular, has deepened severely over the last two years. Whereas at the onset of the crisis a Eurozone breakup was unmentionable, now this seems to have become a scenario open for discussion. Although in the political scene such a breakup is still being downplayed prominent economists and corporate leaders for long regarded this as a realistic outcome that needs to be considered in discussions. Some even see it as an unavoidable result.

European financial executives have indicated that such unraveling would implicate their business and operations. In the current context and considering the economic state that they are in, Greece and Spain are the first and foremost candidates that could herald the end of the Eurozone in its current form. 56% of the CFOs expect that a Greek exit is imminent. They estimate the probability of such exit at 49%.

Almost 20% of those that believe that a Greek exit is likely, believe that this will happen within the next 6 months (see figure 6).

Figure 6. Estimate of timeframe of Greece exiting the Eurozone from those CFO's that believe a Greek exit is probable

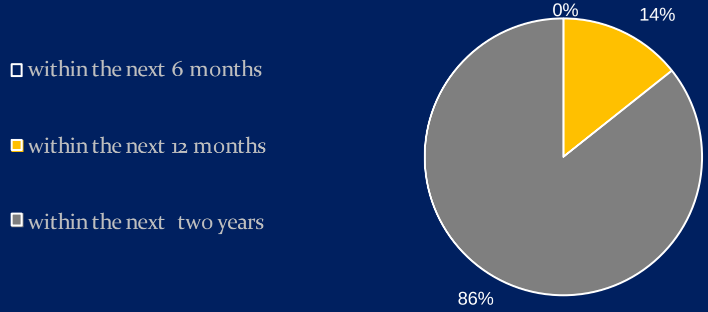
A Greek exit is imminent and will probably take place within the next 12 months



An exit of Spain from the Eurozone is of course potentially of a much greater magnitude. Impact of such an event would likely have a disastrous effect on many European companies. However, the vast majority of European CFOs, more than 90%, consider a Spanish exit unlikely. The remaining 9% who consider such exit as probable put a chance of 56% to this event. Furthermore, they believe this would occur within the next two years (figure 7).

Figure 7. Estimate of timeframe of Spain exiting the Eurozone from those CFO's that believe a Spanish exit is probable

Spain exiting the Eurozone is much less likely, but if it would occur it will be in the next two years



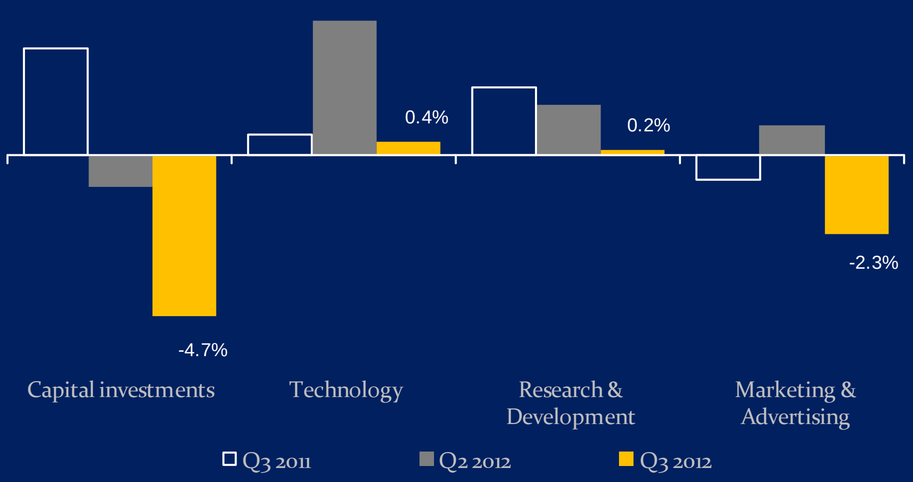
Finance & capital

Expenditures on major business components are all down compared to last quarter. Whereas spending on technology and R&D is expected to increase only very moderately, capital investments and marketing expenditures are likely to witness cutbacks within the next twelve months (figure 8). Compared to one year ago, the business expenditures have experienced a dramatic decline.

In the wake of the across-the-board decline in expenditures, European CFOs seem to brace for a further worsening of the economic climate as evidenced by the expected growth of cash reserves pointing towards cash hoarding. For publicly listed companies an average growth of 7.8% in cash on balance sheet is expected over the next twelve months.

Business expenditures over the next twelve months are expected to be down across the board

Figure 8. CFOs' quarterly expected growth in spending for next 12 months

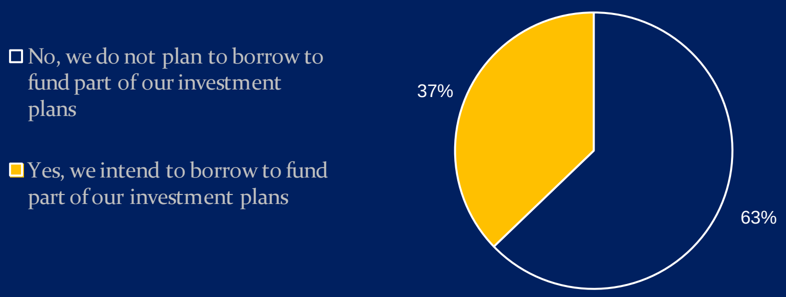


- Capital spending and investments are expected to decrease at an average rate of around -4.7% compared to -0.9% during the previous quarter
- Technology spending is expected to increase with a slight 0.4%, a significant decline from the expected 4.0% increase from last quarter
- R&D remains weak at a growth rate of 0.2%, down from 1.5% in Q2 2012
- Expenditures on Marketing & Advertising is expected to decrease at a rate of -2.3%, down from a expected growth of 0.9% in the previous quarter

Borrowing money to fund investments is not likely

The fact that capital investments are expected to decrease drastically over the next twelve months might indicate a shortage of financial funds. Borrowing money would offer an alternative to overcome such shortage. However, more than 60% of the financial executives do not intend to borrow and subsequently finance (part of) their investment plans with these funds(see figure 9).

Figure 9. Do you plan to borrow (issue debt, term loan, credit line, etc.) to fund at least part of your investment plans in the next year?



ECB measures to lower interest rates and stimulate economic growth through corporate investing are will prove to be ineffective…

In July of this year the ECB cut its main interest rate to a historic low of less than 1% in an attempt to support economic recovery in the Eurozone. Whether or not this measure will prove effective on the short and mid term remains to be seen: almost 60% of the European CFOs indicate that their investment plans are (currently) not influenced by a decrease in borrowing rates (see figure 10A).

Figure 10A. By how much would your borrowing costs have to decrease to cause you to initiate, accelerate or increase investment projects in the next year?

…because companies in general do not change their investment plans when borrowing rates decrease

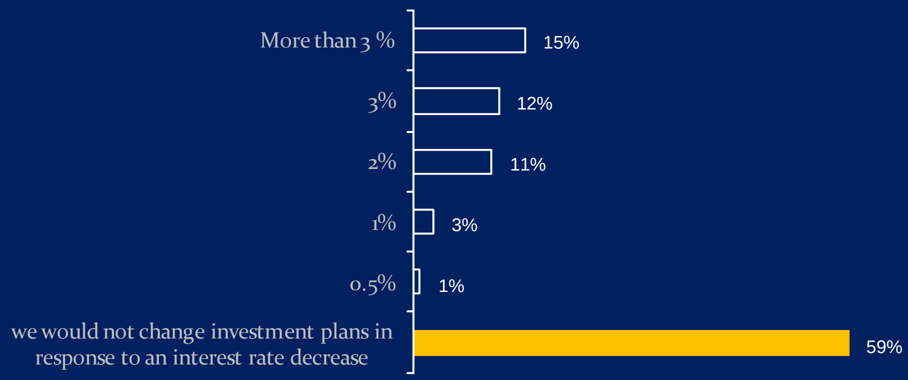
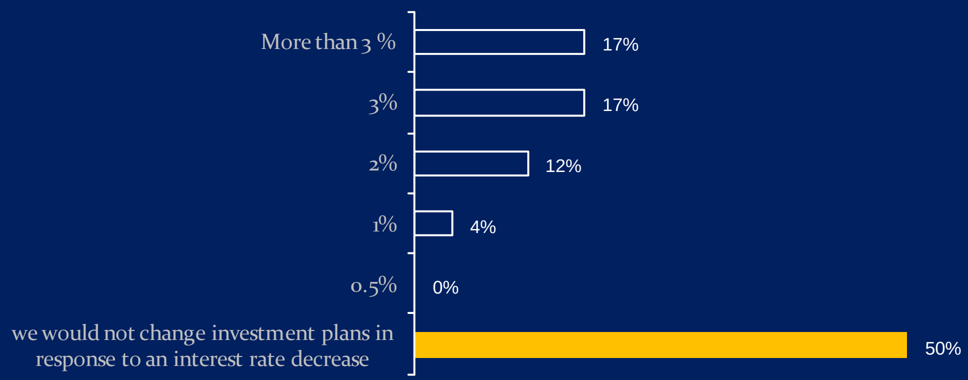


Figure 10B. By how much would your borrowing costs have to decrease to cause you to initiate, accelerate or increase investment projects in the next year? (Only for those who plan to borrow to fund investment plans]

..and those looking to borrow money to fund investments do not change their investment strategies neither on basis of a (further) decrease

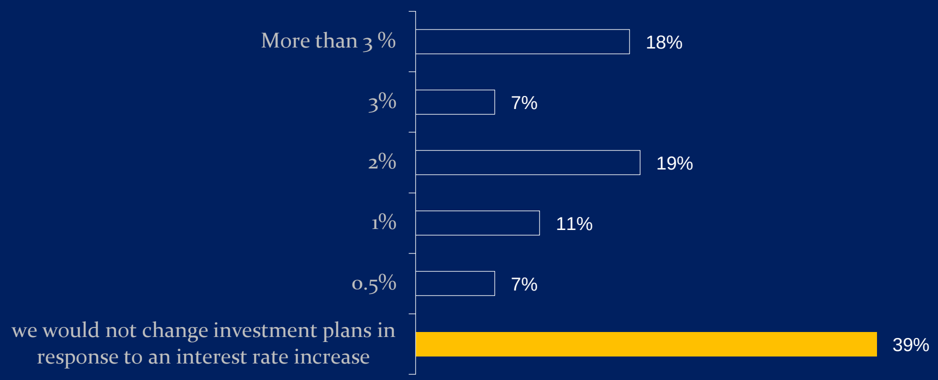


50% of those CFOs that do have the intention to borrow and fund their investment plans indicate that an interest rate decrease would not have any effect on their investment plans (see figure 10B).

For potential increases in the borrowing rate, the picture is slightly different. Only 39% of the financial executives indicate that an increase of borrowing rates would not influence their investment plans (figure 11A). However, if interest rates were to climb with 1% or more then more than half of the CFOs would change their investment strategy.

Figure 11A. By how much would your borrowing costs have to increase to cause you to delay or stop investment projects in the next year?

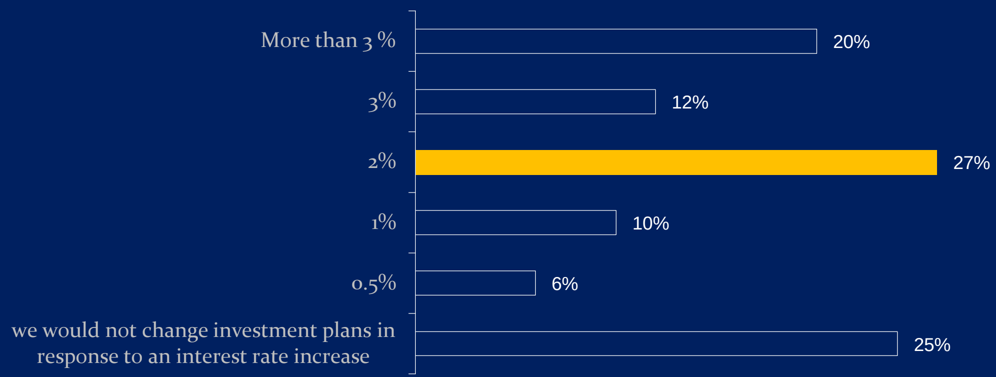
Increases in interest rates show a slightly different picture



The group of CFOs that would actually borrow money to fund their investment plans next year are relatively more sensitive to an interest rate change. Only 25% of them would not change their investment strategy when the borrowing rate would increase. However, almost 70% of this group would reconsider their investment plans if the interest rate would increase by 1% or more (figure 11B).

Figure 11B. By how much would your borrowing costs have to increase to cause you to delay or stop investment projects in the next year? Only for those who plan to borrow to fund investment plans

And those CFOs that plan to borrow money and fund their investment are more sensitive to interest rate hikes

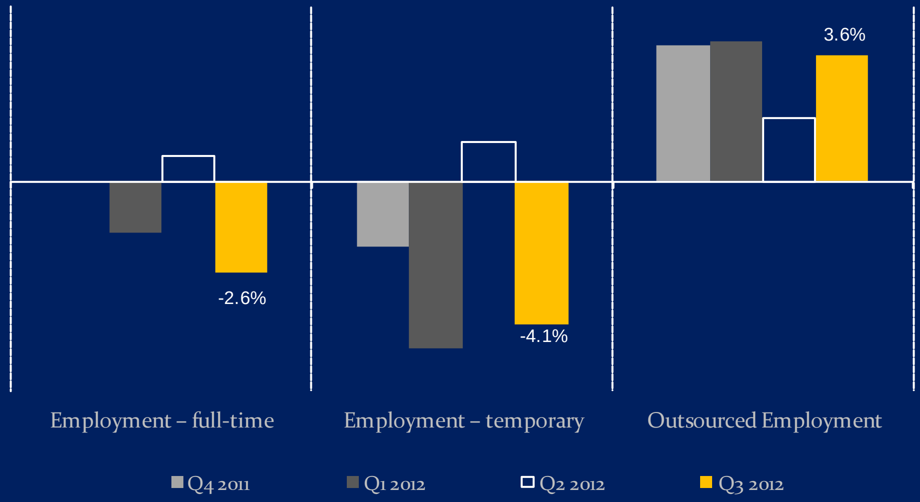


Employment

Employment picture remains bleak

The slight improvement in employment figures during the previous quarter could not be sustained during Q3 2012. Both full time employment as well as temporary employment is expected to decrease over the next twelve months with -2.6% and -4.1% respectively (figure 12). The average increase in outsourced employment is likely to make up for this fallback.

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

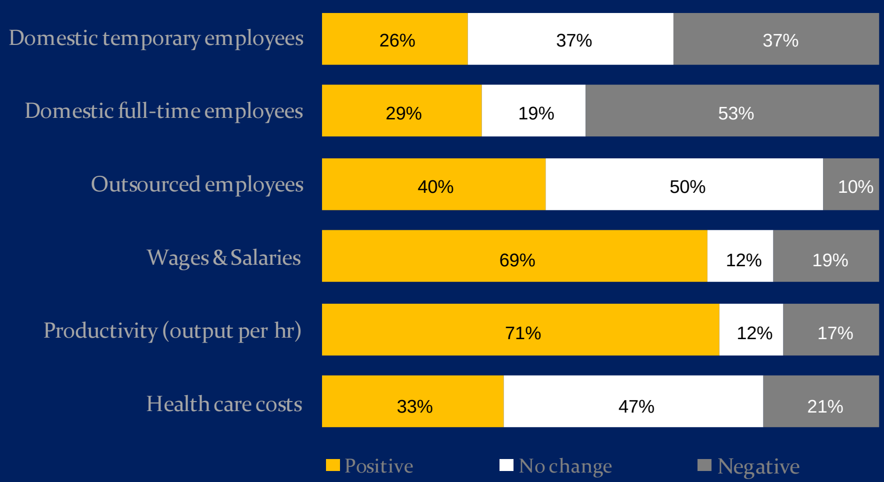


The increase in wages and salaries is likely due to the relatively higher costs from outsourcing employment (figure 10). However, the rise in salaries and wages is likely to be offset by an expected increase in productivity. More than 70% of the European companies expect to see such increase to take place in the next twelve months.

Wages are expected to rise…

..but will likely be offset by a rise in productivity output of employees

Figure 13. Relative to the previous 12 months, do you expect a positive or a negative change for your company in the following items?



Zooming in on the CFO-function, we see that respondents are (on average) predominantly occupied with activities that cover financial planning, analysis, reporting and accounting. Corporate strategy is another important aspect of the day-to-day agenda (figure 14).

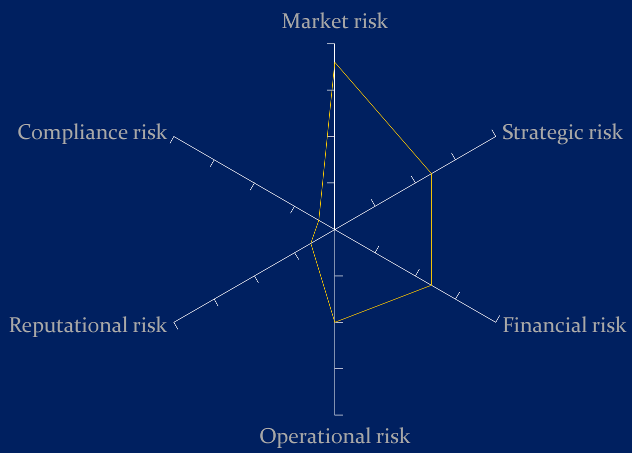
The CFO-function is well balanced across primary responsibilities

Figure 14. How do CFO's currently allocate their time across activities and departments?

Placing the CFO-function in the context of the company's priorities, there seems to be a good balance between that what is required from the financial executive (in term of activities and efforts measured by individual risk categories), and to how the CFO actually allocates his or her time across activities and departments. Market risk, strategic risk and financial risk top the CFOs list of risks that are most worrisome (figure 15).

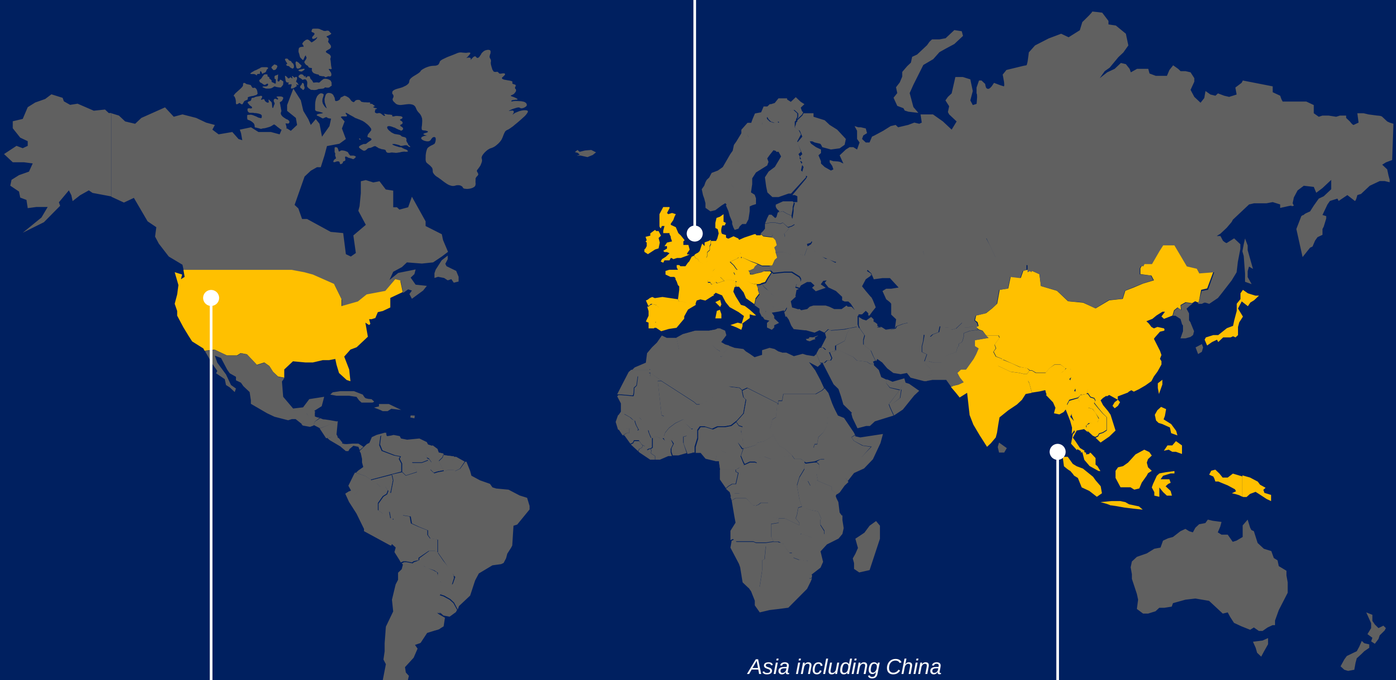
..and aligned with company priorities

Figure 15. Which risk categories are most worrisome to CFO's?



Key results CFO Survey – Europe, US and Asia

Optimism about the country's economy	More opt: 19.9% Less opt: 45.8% No chg: 34.3%	Employment – full-time	-2.6%
		Employment – temporary	-4.1%
		Outsourced Employment	3.6%
Country optimism level	49.1	Wages and Salaries	0.9%
Optimism about own company	More opt: 20.8% Less opt: 51.5% No chg: 27.7%	Productivity	1.7%
		Inflation (own-firm products)	0.8%
Own company optimism level	57.6	Earnings growth*	4.5%
		Dividends*	5.6%
Capital spending	-4.7%	Share Repurchases*	0.0%
Technology spending	0.4%	Cash on balance sheet*	8.2%
R&D spending	0.2%	Mergers and Acquisitions	Not asked.
Advertising and marketing spending	-2.3%		



Optimism about the U.S. economy	More opt: 22.1% Less opt: 43.5% No chg: 34.4%
U. S. optimism level (0 to 100)	52.1
Optimism about own company	More opt: 36.6% Less opt: 34.5 % No chg: 28.9%
Own company optimism level	62.0
Capital spending	3.7%
Technology spending	4.2%
R&D spending	2.6%
Advertising and marketing spending	3.2%
Employment – full-time	1.5%
Employment – temporary	0.9%
Outsourced Employment	2.9%
Wages and Salaries	2.6%
Productivity	2.9%
Inflation (own-firm products)	2.1%
Earnings growth*	6.0%
Dividends*	2.0%
Share Repurchases*	5.3%
Cash on balance sheet*	1.6%
Mergers and Acquisitions	Not asked.

Optimism about the country's economy	More opt: 32.7% Less opt: 46.5% No chg: 20.9%
Country optimism level	59.7
Optimism about own company	More opt: 43.7% Less opt: 33.5% No chg: 22.8%
Own company optimism level	64.4
Capital spending	7.5%
Technology spending	13.7%
R&D spending	4.6%
Advertising and marketing spending	1.8%
Employment – full-time	2.6%
Employment – temporary	3.2%
Outsourced Employment	8.1%
Wages and Salaries	7.2%
Productivity	3.9%
Inflation (own-firm products)	2.5%
Earnings growth*	4.7%
Dividends*	4.2%
Share Repurchases*	15.1%
Cash on balance sheet*	-5.2%
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 second quarter of 2012. The survey concluded May 31, 2012. Every quarter, CFOs in Europe, the US, Asia and China are questioned about their economic expectations. Current records go back 66 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 Reggy van den Bosch, Tilburg School of Economics and Management, tel.+31-(0)-134668923 or e-mail r.vandenbosch@tilburguniversity.edu

CFO Survey Europe team

Kees Koedijk
Professor Financial Management
Dean Tilburg School of Economics & Management

Reggy van den Bosch (contactperson)
Science Communications Officer
r.vandenbosch@tilburguniversity.edu
+31-(0)-13 466 8923

Christian Staupe
Research and Policy Officer
c.p.staupe@uvt.nl