CFO Survey Europe – Quarterly Report

DUKE THE FUQUA SCHOOL OF BUSINESS

TiasNimbas Business School

TILBURG UNIVERSITY

In association with: Eindhoven University of Technology

CFO Europe

Q2 2013

- *42% of European CFOs More Optimistic About own Company*
- *Cash Reserves for Investment and Acquisitions*
- *CSR & Sustainability: "It's the Right Thing to do", but Difficult to Measure*

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Introduction

Optimism in Europe unchanged. Rest of world shows mixed picture

The economic outlook among Chief Financial Officers in major regions shows a somewhat mixed picture during the second quarter of 2013. One third of the European financial executives are more optimistic about the economic outlook for the next twelve month, which is about the same as the number of optimists during the first quarter of this year.

While in Asia almost half of the financial directors are more optimistic (up from 43% during Q1), the number of CFOs in China and Latin America with a positive outlook on the economy has drastically decreased to 30% and 24% respectively. Both regions witnessed a great number of optimists during previous quarter; more than half of the CFOs in each region had a positive view towards their economy during Q1.

Strong uptick in US sentiment early sign of recovery?

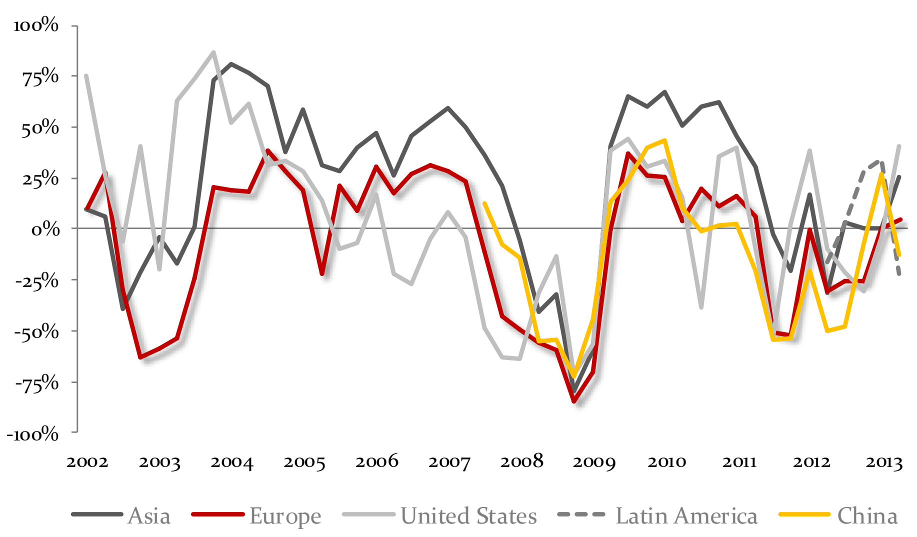
The big surprise is the US where optimism among CFOs has rebounded and is now above the long-run average for only the second time since 2007. Almost 54% (up from 31% during the previous quarter) of the financial executives are now more optimistic about the economic outlook for the US.

…what will be the effect on European sentiment?

In Europe, the piecemeal improvement in sentiment shows that it still has a long way to go. The strong growth in optimism in the US is therefore encouraging as it might signal slow economic recovery strong enough to fuel recovery on the European continent.

European companies have the lowest (relative) level of cash reserves compared to companies in the other world regions. Nevertheless, almost half of the European respondents indicate that they plan to deploy their cash reserves during the next twelve months. Financing of capital investments and acquisitions are on top of their lists.

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



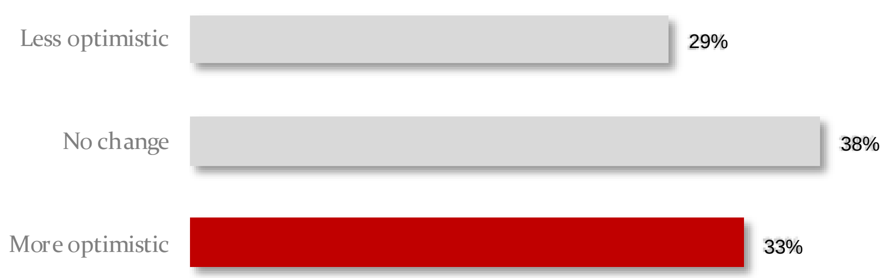
CFO optimism & sentiment

For the first time since 2011 the optimists outnumber the pessimists as optimism among European CFOs continues the positive trend of previous quarters. In this second quarter the average optimism level has climbed just above 53 (on a scale of 100), inching back to the level of one year ago.

This piecemeal improvement in optimism is also reflected by the small increase in the number of optimists combined with a decrease in the number of pessimists. Whereas the number of optimists and pessimist among European financial executives during the previous quarter was equally distributed and stood at 30.5%, this quarter the number of optimists has slightly increased to above 33% (figure 2).

Number of optimist and pessimists remains unchanged

Figure 2. European CFO sentiment regarding economy of own country



Most European CFOs (38%) however, do not expect to see any economic growth on the short term. Main reasons include low levels of consumer demand, price pressure resulting from strong competition, government policy and worldwide financial instability (table 1).

CFOs do not foresee any economic growth in the short term

The very moderate macroeconomic sentiment in Europe puts pressure on margins and makes it difficult for companies to forecast results. Under these circumstances, European CFOs also see it as a challenge to maintain morale and productivity among employees.

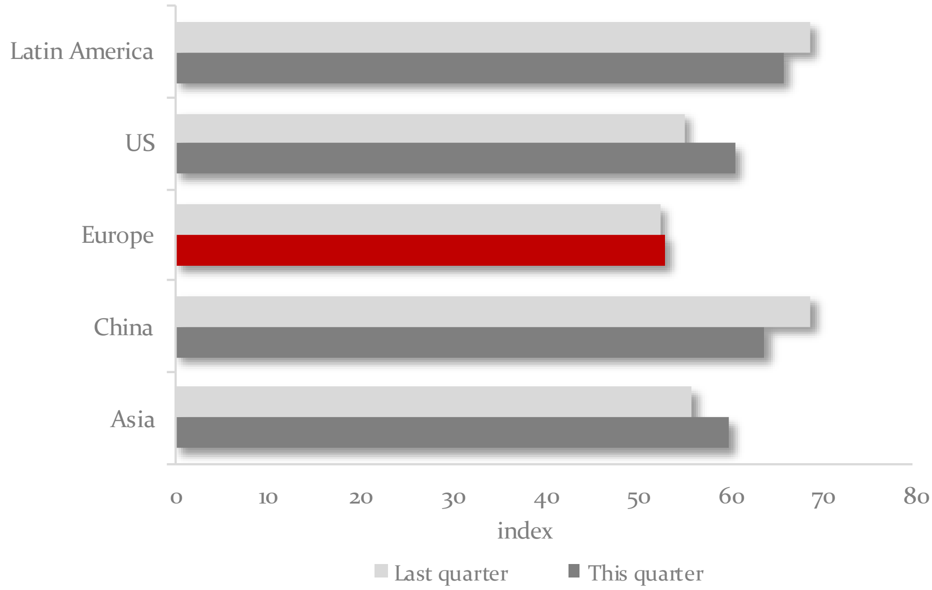
Table 1. Macro and internal concerns of European CFOs

Macro concerns	Internal concerns
➢ Consumer demand	➢ Ability to maintain margins
➢ Price pressure from competitors	➢ Ability to forecast results
➢ Global financial instability	➢ Working capital management
➢ National government policies	➢ Maintaining morale and productivity

It is noteworthy that economic sentiment among CFOs in the US has rebounded during Q2 and is now above the long-run average for only the second time since 2007. The U.S. Optimism Index rebounded to 61 on a scale from 0 to 100, well above last quarter's reading of 55 and also above the long-run average Index value of 59.

Economic sentiment in Europe continues to trail that of rest of world…

Figure 3. Optimism level about own country's economy



CFO Survey expands to the African continent

The economic outlook indices for the other regions also remain positive (figure 3):

- Latin American CFOs are the most optimistic in the world with the index at 66 on a scale of 100 (down from 69 last quarter)
- Asian optimism is up from previous quarter and stands at 62.
- China witnessed a decrease to 64 down from 69 during the previous quarter.
- This second quarter African economic sentiment was measured for the first time and stand at 56 on a scale of 100 (not included in figure 3)

Figure 4. How big a risk factor is business corruption in the country where you are located and what are the top 3 major effects? (scale of 1 to 5, 1 = not significant, 5 = very significant).

Major effects of business corruption inhibit economic growth

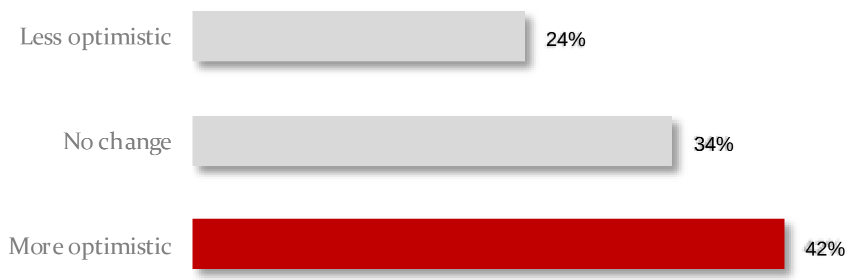
Business corruption perceived to be highest in Africa and lowest in the US

Business corruption, like fraud or bribery for example, hinders economic growth in many developing economies. 51% of CFOs in Africa say that corruption is a significant risk to economic development, as do more than 33% of Asian and Latin American financial executives. An additional one-third of CFOs in these developing regions say corruption is a moderate problem. In contrast, 16% of European CFOs and 6% percent of U.S. executives say that business corruption is a significant risk factor.

Pervasive corruption increases business costs both directly and indirectly, ultimately leading to lower investment and employment (figure 4). Corruption harms business development in fundamental ways:

- by increasing prices, reducing product quality, and reducing tax revenues collected by the government.
- by hindering expansion, hurting a company's reputation, and contributing to poor employee morale.
- Foreign companies are less likely to do business in a country that is known for having higher business corruption, also harming economic growth.

Figure 5. European CFO sentiment regarding financial prospects of own company



More optimists than pessimists among European CFOs

Traditionally, European CFOs' sentiment regarding the financial prospects of the own company has been more positive than their sentiment with respect to the (macro)economy. In Q2 2013 the optimism index regarding the financial outlook of the own company stands at 61, indicating a relatively high level of confidence in company performance.

Europe slowly turning into recovery mode?

42% of the European financial directors indicate to be more optimistic about the future prospects of the company this quarter (figure 5). This level has not been observed since the first quarter of 2011. The number of pessimists also has decreased substantially to a level just a little above 23% (down from almost 28.5% in the previous quarter). This combined trend supports our premise during Q1 2013 when we stated that we may have seen the worst of the crisis and that the economy is slowly turning into recovery mode.

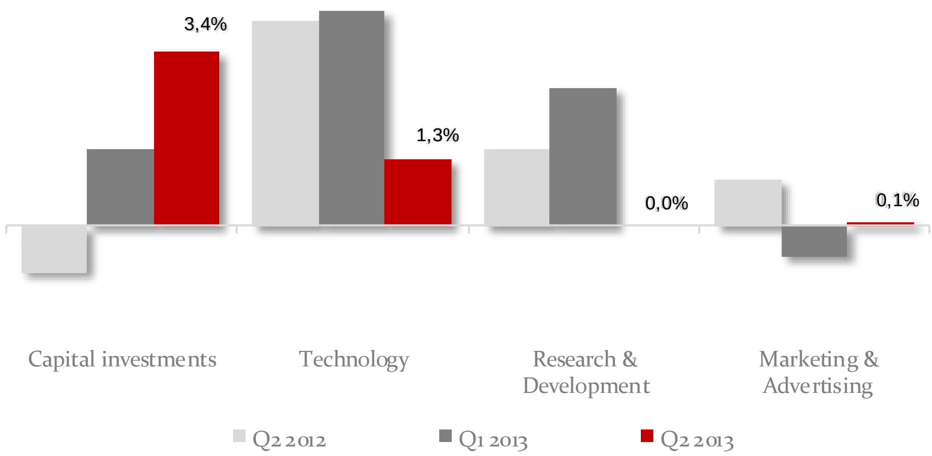
Finance & capital

Capacity utilization and productivity expected to increase

Three quarters of the European CFOs expect to witness an increase in productivity (measured by output per hour) over the next twelve months. This supports our data on planned manufacturing capacity utilization (for production companies) during the remainder of 2013, which is expected to reach 87%. If we compare this with the capacity that was actually utilized in the second half of 2012 one year ago (74.5%), we can expect to see a significant improvement of more than 12%.

The expected increase in productivity and capacity utilization rates may also explain why we observe an increase in expected capital investments while spending on all other major business items is expected to fall back drastically in the next twelve months (figure 6).

Figure 6. CFOs' quarterly expected growth in spending for next 12 months



Fueled by capital investments

- Capital spending and investments for the next twelve months are expected to increase at an average rate of 3.4% compared to a rate of 1.5% during the previous quarter
- Technology spending is fall back to a growth rate of 1.3% on average, down from 4.2% during the previous quarter.
- Whereas in the first quarter of this year R&D spending was still expected to grow at an average rate of 2.7%, this quarter R&D spending for the next twelve months is expected to remain flat.
- During Q1 2013 spending on marketing and advertising was anticipated to contract. This quarter expected growth in marketing and advertising expenditures remains flat at 0.1%.

Other business spending remains flat

Almost half of the European CFOs indicate that they will deploy their cash reserves during the next twelve months. Figure 7 shows that 40% of this group will allocate its cash reserves to capital spending and investments while another 31% will use its cash reserves to finance acquisitions. Even though cash remains an important source to finance capital investments, there is a relatively large group of European CFOs

Figure 7. Is it likely that your firm will begin to deploy its cash reserves during the next 12 months?

Cash reserves deployed for investment and acquisition

47% YES

Top 5 reasons for companies to deploy their cash reserves in the next twelve months

40%	Capital spending or investment
31%	Acquisitions
27%	Cover operating losses
27%	Pay down debt / line of credit
14%	Purchase inventory

But economic and financial uncertainty also stimulates cash hoarding

53% NO

Top 5 reasons for companies to not deploy their cash reserves in the next twelve months

Holding cash to save for potential future liabilities	31%
Do not need cash reserves as a source of funds	29%
Need cash as liquidity buffer (e.g., in case credit markets tighten)	26%
Currently have few attractive investment opportunities	22%
Holding cash until economic uncertainty declines	21%

who do not deploy their cash reserves because they do not need it as a source of funds. This may either indicate that: a) they do not intend to make any capital investments at all, or b) that they attract financial funds from other (external) sources.

Although 47% of European and 48% of US companies expect to deploy their cash reserves during the next twelve months, European and US firms still trail their counterparts in other major economic regions. For example, around two thirds of the companies in Africa and Asia are expected to deploy their cash reserves (figure 8).

Companies in emerging markets tend to have higher cash reserves than in European firms

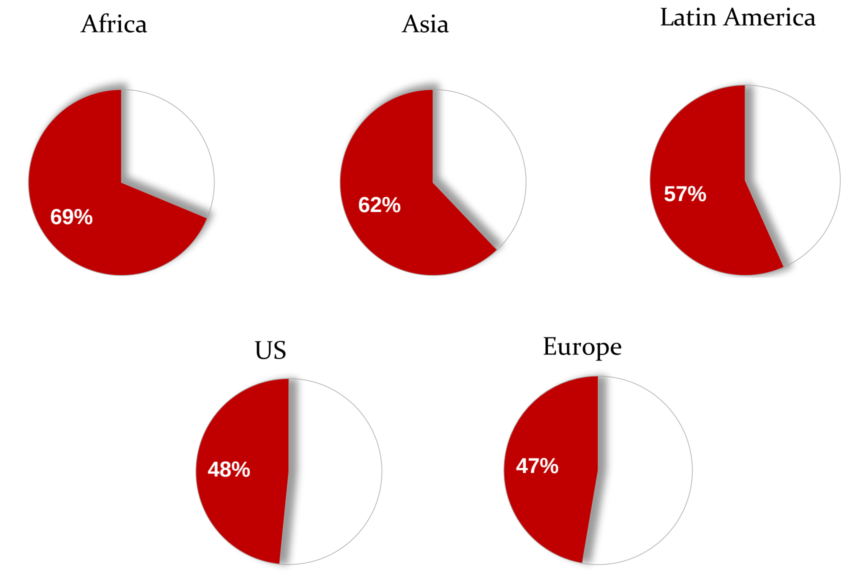
It is no surprise that corporations in these emerging market regions (Latin America and Asia) do well and consequently have the highest levels of cash reserves while European companies have the lowest levels of reserves. In case of the latter, the enduring crisis has clearly put a strain on their profitability and, consequently, their ability to hoard large cash reserves.

Worldwide, companies typically unleash cash for capital spending, acquisitions and paying down debt. However, Asian firms will also use cash to fund research and development, while U.S. firms will use cash to increase payout to shareholders. European companies on the other hand will use it to cover operating losses. Among those that will not begin to spend their cash, the most common reasons are due to concern about credit markets potentially tightening, extreme economic uncertainty and a lack of attractive investment opportunities.

Figure 8. Breakdown of company cash reserves and regional comparison

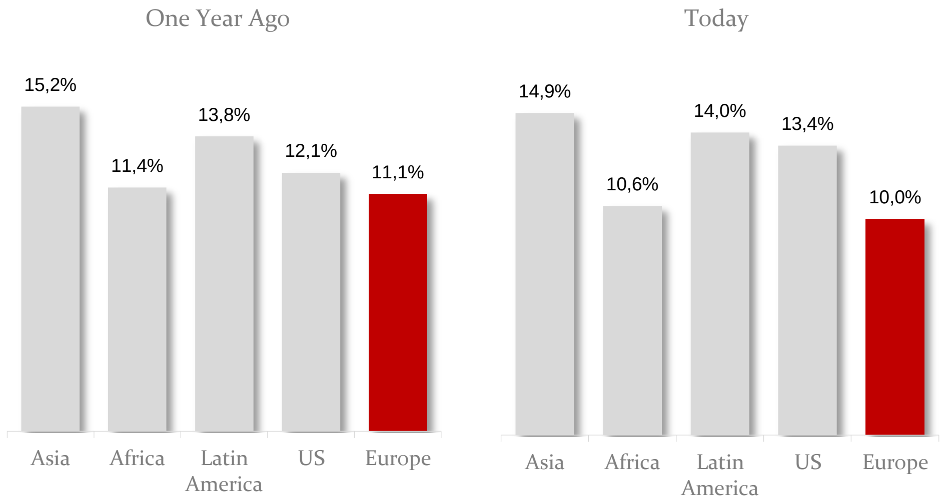
European CFOs precautious in deploying cash reserves?

a) Percentage of firms likely to deploy their cash reserves during the next 12 months



Or are European cash reserves simply too low?

b) How much cash and marketable securities does your firm hold (% of total assets)?



c) Percentage of cash held outside of your headquarter country

Asia	Africa	Latin America	US	Europe
11,4%	7,5%	7%	8,3%	**17,9%**

CSR and sustainability are important corporate objectives for European CFOs

In Europe, Corporate Social Responsibility (CSR) and sustainability are considered important aspects to integrate into corporate objectives. 63% of the European financial directors rate CSR and sustainability as moderately important or very important.

Corporate social responsibility and sustainability is even higher on the agenda in emerging market regions. In Asia for example, 67% of the respondents say that this is important or very important, while in South America 76% and in Africa even 83% of the respondents say that integrating CSR and sustainability into corporate objectives is moderately important or very important.

…but much less for their colleagues in the US

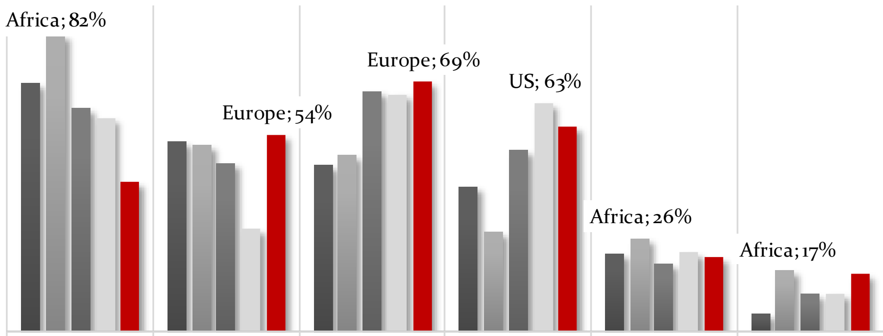
The US trails the rest of the world in terms of prioritizing CSR and sustainability among corporate objectives. A little less than one-half of US CFOs rate CSR and sustainability as moderately important or very important items in their business strategies.

Figure 9 shows that around the world, CSR and sustainability commitments are predominantly focused on:

- Community, which is highest on the African agenda compared to other regions
- Environment, where Europe leads the way closely followed by Asia and Africa
- Employees & management, where Europe is at the forefront closely followed by the US and Latin America
- Customers, where US is leading

In all regions the focus of CSR and sustainability efforts is much less on shareholders/owners and suppliers.

Figure 9. On which stakeholders are your company's CSR and sustainability commitments focused?



	Community	Environment	Employees & Management	Customers	Shareholders or owners	Suppliers
Asia	68%	52%	46%	40%	21%	5%
Africa	82%	52%	49%	27%	26%	17%
Latin America	62%	46%	66%	50%	19%	10%
US	59%	29%	65%	63%	22%	11%
Europe	41%	54%	69%	57%	21%	16%

CSR is "the right thing to do" and helps to boost reputation and image

As to why firms adopt CSR objectives, 69% of the European CFOs say that their company engages in CSR to improve external reputation, brand and image. Around 59% say that engaging in CSR "is the right thing to do". Around 35% of the European companies engaged in CSR say that improving employee morale, hiring and retention and overall internal goodwill is also considered as one of the top three reasons. Only 18% of the European companies that are engaged in CSR, state that they do so to increase customer demand. Another 19% believes that it will drive innovation.

But is much less a driver for innovation

Overall, the motivations to engage in CSR do not seem to have a direct (measurable) link with operating result or profitability. There is only a small group of companies that actually integrates CSR and

Even fewer companies use CSR to improve bottom line or efficiency

sustainability into their corporate objectives to improve the bottom line; only 7% does so. Another 11% does so to achieve cost efficiencies.

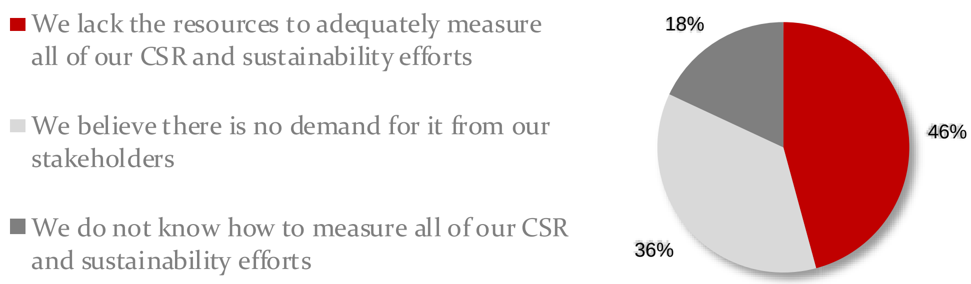
It is therefore no surprise that currently only 44% of the European respondents state that their company actively tracks its CSR efforts. However, among those companies that track CSR:

- 62% tracks well beyond the minimum legal or regulatory requirements
- 55% reports well beyond the minimum legal requirements
- 48% even audits the CSR and sustainability efforts well beyond the minimum legal or regulatory requirements

Among European firms that do not track CSR, the most common explanations are that the firms lack the resources to track and measure all their efforts, and they do not sense that there is demand from stakeholders to track and report specific CSR achievements (figure 10).

Figure 10. For European firms: To the degree that you to don't you track certain CSR or sustainability activities, why not?

Lack of resources limits companies to effectively measure CSR efforts

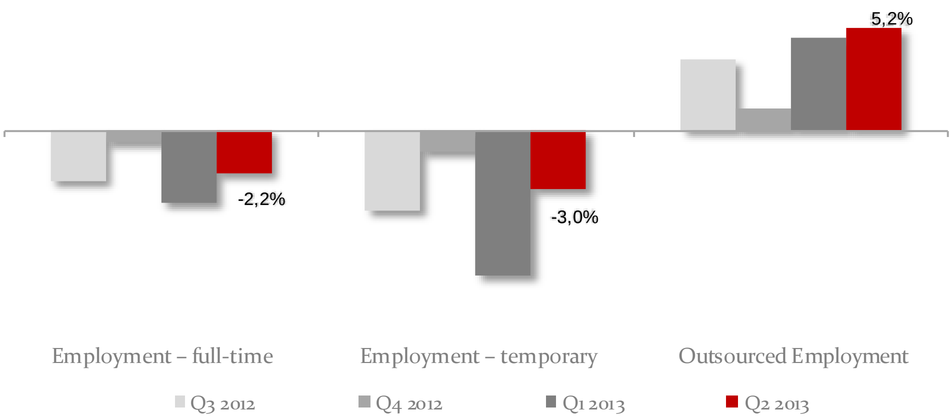


Employment

For the fourth quarter in a row we are likely to witness a fall in fulltime and temporary employment. European CFOs indicate that for the next twelve months they expect to reduce full-time employment with 2.2% and temporary contracts with 3.0% on average. Although this contraction is less severe than the expected fallback during the previous quarter, the outlook on employment remains bleak (figure 11).

Employment expected to contract further

Figure 11. European CFOs expected growth for next 12 months in employee mix



Productivity and wage increases likely during the next 12 months

The cut in fulltime employment is likely to take place in about 43% of the companies in Europe, while in 30% of the European companies temporary employment will be reduced (figure 12). 75% of the European CFOs expect to see increases in wages and salaries as well as productivity gains (measured as output per hour).

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

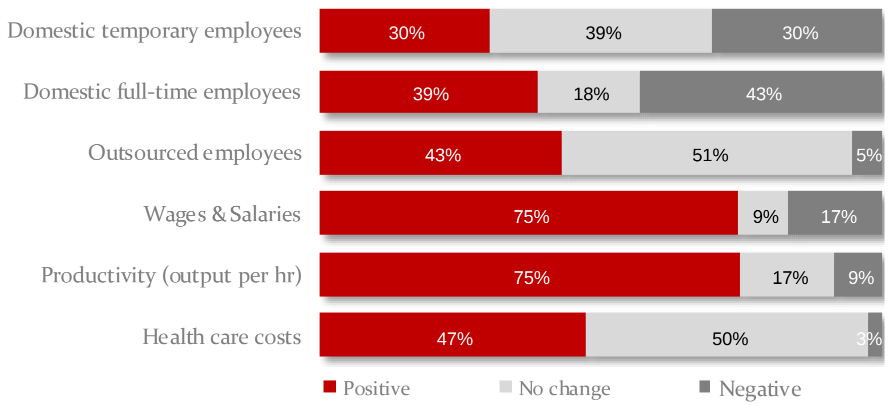
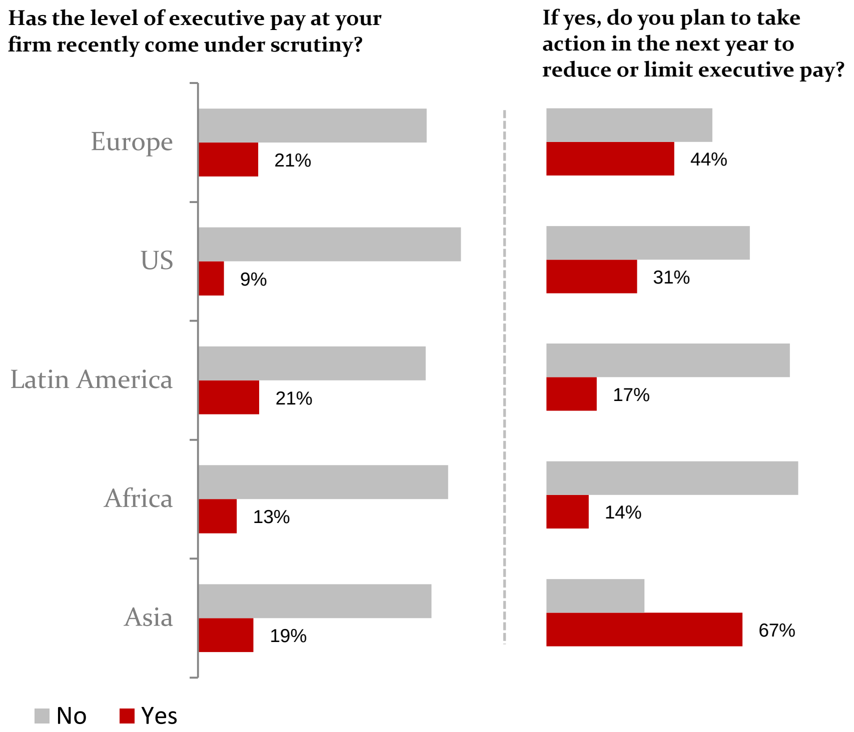


Figure 13.Has the level of executive pay at your firm recently come under scrutiny?



Approximately one-in-five European, Asian, and Latin American firms report that they have felt external pressure to reduce executive pay. In contrast, only one-in-ten U.S. and African firms have felt executive compensation pressure.

In those regions most affected, scrutiny of executive pay comes primarily from shareholders and boards of directors and only secondarily from regulators (figure 14).

Figure 14. Who has scrutinized executive pay at your firm? (choose top 3)

	Asia	Africa	Latin America	US	Europe
Shareholders / owners	**56%**	**33%**	**36%**	19%	**58%**
Board of directors	**36%**	11%	**59%**	**39%**	**52%**
Consultants	24%	0%	29%	16%	13%
Analysts	20%	11%	12%	7%	10%
Unions or other employees	20%	22%	3%	13%	7%
Regulators	12%	**33%**	5%	**23%**	26%
Press	8%	11%	3%	16%	10%

Key results CFO Survey – Europe, US, Latin America, Africa and Asia

Key Indicator	Europe	US	Latin America	Africa	Asia
Economic sentiment					
About economy of own country					
More optimistic	33.3%	53.7%	24.3%	29.4 %	51.5 %
Less optimistic	28.8%	12.8%	46.4%	47.1 %	26.1%
No change	37.9%	33.5%	29.3%	23.5 %	22.4 %
Country optimism level	**53.2**	**60.8**	**66.1**	**55.6**	**60.2**
About own company					
More optimistic	42.1%	42.3%	42.9%	54.4 %	48.1 %
Less optimistic	23.7%	24.1%	25.7%	29.4 %	31.9 %
No change	34.2%	33.5%	31.4%	16.2 %	20.0 %
Own company optimism level	**61.1**	**64.2**	**71.6**	**69.7**	**60.9**
Business spending					
Capital spending	3.4%	6.1%	4.3%	29.4%	6.4%
Technology spending	1.3%	6.1%	8.3%	7.2%	4.3%
R&D spending	0.0%	3.2%	6.9%	5.0%	1.0%
Advertising and marketing spending	0.1%	3.2%	9.6%	9.2%	0.1%
Employment					
Employment – full-time	-2.2%	0.8%	4.8%	2.0%	-1.2%
Employment – temporary	-3.0%	0.4%	2.7%	-5.5%	-6.3%
Outsourced Employment	5.2%	3.8%	3.1%	2.2%	-1.9%
Wages and Salaries	2.0%	2.5%	6.5%	7.8%	3.0%
Health Care Costs	1.8%	7.4%	6.3%	9.0%	2.1%
Balance Sheet and P&L					
Productivity	2.5%	3.1%	4.8%	5.1%	1.8%
Inflation (own-firm products)	0.8%	1.5%	2.5%	4.6%	-0.2%
Revenue growth	2.9%	5.0%	11.2%	9.8%	5.6%
Earnings growth*	4.6%	7.5%	11.5%	11.1%	2.2%
Dividends*	0.5%	9.4%	5.4%	15.2%	3.3%
Share Repurchases*	5.2%	1.7%	0.0%	2.2%	0.6%
Cash on balance sheet*	1.3%	8.3%	-3.3%	-1.9%	-0.4%
Mergers and Acquisitions	Not asked in Q2	Not asked in Q2	Not asked in Q2	Not asked in Q2	Not asked in Q2

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

About CFO Survey

The figures quoted above are taken from the Global CFO Survey for the second quarter of 2013. The survey concluded May 31, 2013. Every quarter, CFOs in Europe, the US, Asia and China are questioned about their economic expectations. Current records go back 69 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 mrs. Rian van Heur, TiasNimbas Business School, tel.+31-(0)-134668637 or e-mail m.j.vanheur@tiasnimbas.edu

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