TIAS

SCHOOL FOR BUSINESS AND SOCIETY

# CFO Survey Europe

# Q3 2015


- *Optimism of European CFOs leveling out*
- *Tightening of labor markets: Companies find it difficult to fill key job openings*
- *Complacency about the risk of future economic stress*

*Photograph:" Jobs Help Wanted" by neetalparekh, used under CC BY / Desaturated from original.*

As part of the quarterly CFO Global Business Outlook survey, TIAS conducts CFO Survey Europe in collaboration with Duke's Fuqua School of Business, ACCA and CFO Publishing.

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# Contents

# *Introduction*

*Economic sentiment weakens after last quarter's record high*

During the third quarter of 2015, economic sentiment among CFOs worldwide has subdued. While the number of optimists among European CFOs reached a record high during the previous quarter, this number has now slightly decreased and is coupled with a decline in the average level of optimism from 61 to 58 on a scale of 100. CFO optimism in the US has weakened but remains strongest in the world. On a scale from 0 to 100, CFOs rate the outlook at 60, down from 63 last quarter.

*Could strong optimism about the own company be misguided by complacency about future economic stress?*

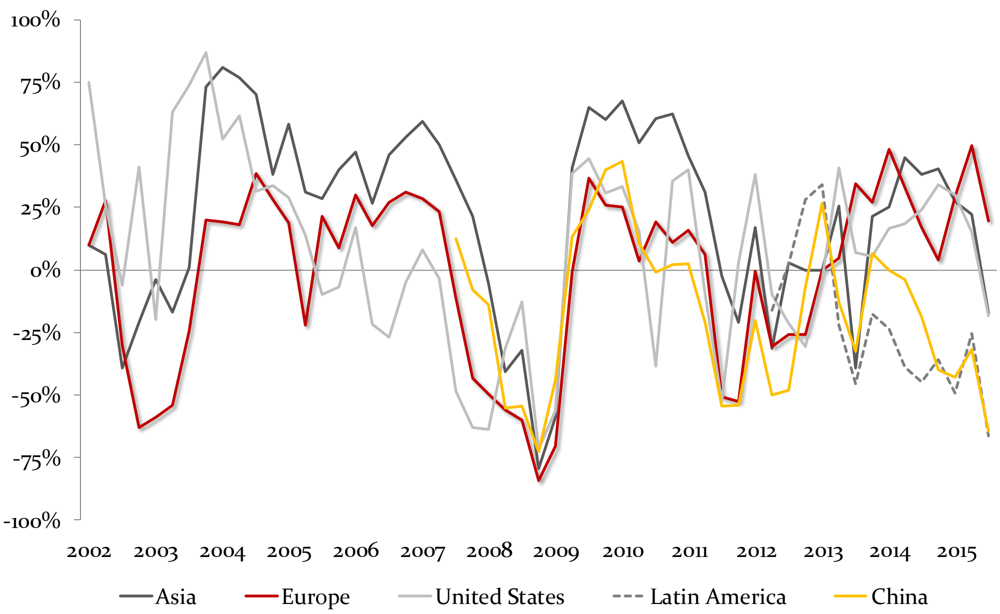
In Q3, 42% of European financial directors say they have a more positive economic outlook, while only 22% of CFOs are less confident about next year's economy. However, the number of optimists continues to outpace those with a negative outlook on the economy. Optimism about the own company also remains high. However, CFOs also believe that firms have become complacent about the threat of future economic stress and as such fail to successfully manage downside risk.

Increased business spending signals that companies are preparing for growth, something which will also be achieved via mergers and acquisitions as about a third of the companies indicate to have plans for the acquisition of (a part of) another company. Deals will be funded primarily by cash and debt.

*Wages and salaries are expected to improve in companies' bid to attract and retain personnel*

In a bid to find qualified and competent employees for key job openings, more than 50% of the companies in Europe say they have recently increased the wages and salaries of their primary employees (or plan to do so in the short term).

Figure 1. Optimism index for CFOs in Asia, Europe, US, Latin America and China (percentage of optimists -/- percentage of pessimists)

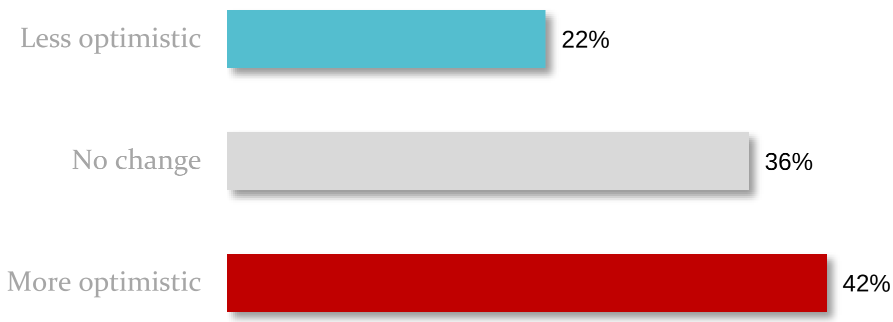


# CFO optimism & sentiment

*Economic sentiment has slightly deteriorated but optimists continue to outpace pessimists*

Compared to the previous quarter, the optimism in this third quarter has leveled off with now only 42% of the financial directors having a favorable economic outlook for the next twelve months. Correspondingly, the number of pessimists has increased to 22%, up from 12% in Q2. Overall, the average level of optimism has weakened from 60.4 to 57.9 on a scale of 100.

Figure 2. European CFO sentiment regarding economy of own country




The deterioration in economic sentiment across Europe is similar to that of other major regions in the world (see figure 3).

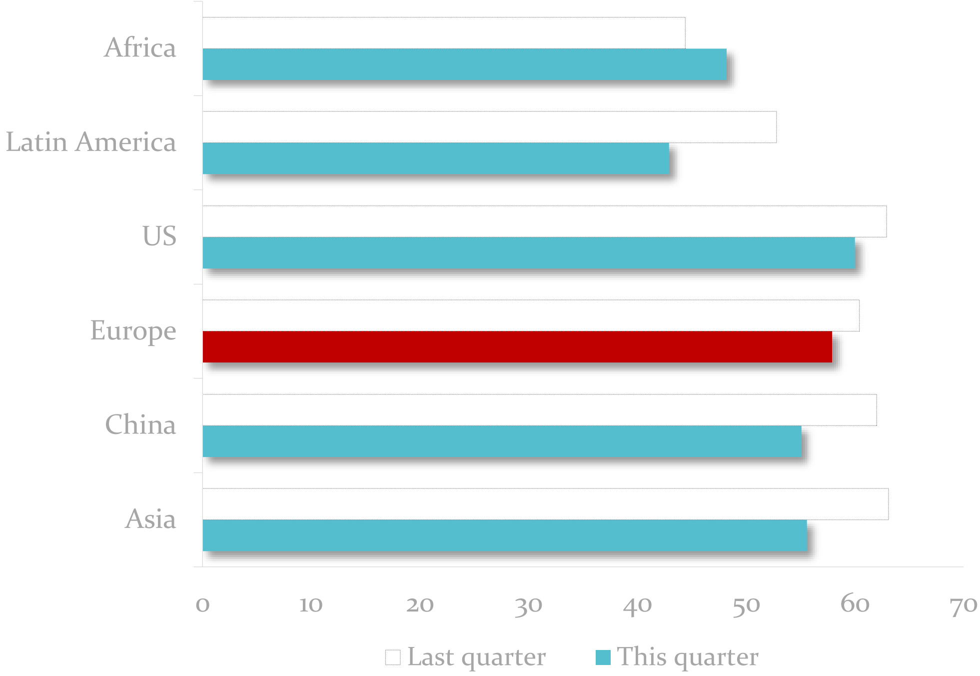
*Other major region across the globe also experience a decline in optimism*

- Although the number of optimists among CFOs on the African continent has inched upward to 22% (up from 14% during the previous quarter), the number of pessimists remains large (72%). The average optimism level has increased from 44 to 48 on a scale of 100.
- With only 7.3% of the financial directors having a positive outlook, and 74% a more pessimistic view, economic sentiment in the Latin American region has reached a record low. Correspondingly, the average level of optimism has dropped to a substantially lower level, from 53 in Q2 to 43 during this third quarter.
- The number of optimists in the US has decreased for the third consecutive quarter to 23% in Q3 (down from 37% in Q2), whereas the number of pessimists has increased significantly from 22% to 42%. The average optimism level in the US continues to outpace the rest of the world but was also subject to deterioration during Q3, currently standing at 60 on a scale of 100.

- Optimism among Asian CFOs has also received a blow during the third quarter of 2015. The number of optimists has declined to 29% while the number of pessimists has increased to almost 55%. The average level of optimism has dropped to 55 (from 63) on a scale of 100 and now trails that of the European and US regions.
- The average optimism level among financial executives in China has also experienced a significant drop to 55 on a scale of 100 (down from 62 during Q2). The number of optimists continues to linger around 12% whereas the number of pessimists has reached 77%.

*For the first time in at least a decade, optimism is lower in all emerging regions than in US and Europe.*

Figure 3. Optimism level about own country's economy




Top (macro-economic) concerns of European CFOs remain largely unchanged for the third quarter with economic uncertainty, currency risks and weak demand continuing to have the highest priority (table 1).

*Macroeconomic concerns remain largely unchanged*

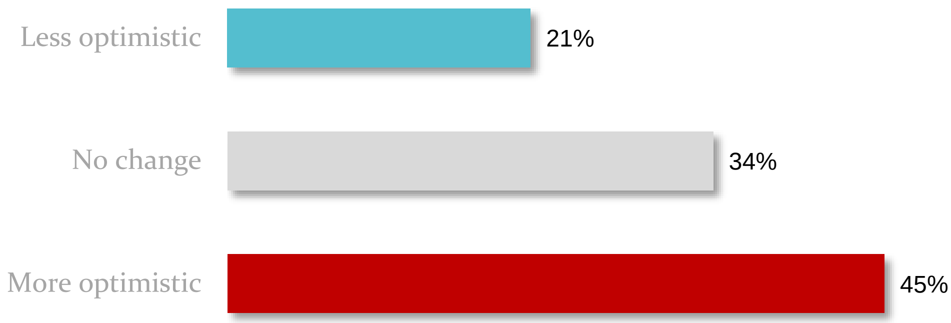
Table 1. Top 10 concerns on the agenda of European CFOs

| | This quarter | Previous quarter |
|---|---|---|
| 1 | Economic uncertainty | Economic Uncertainty |
| 2 | Currency risk | Currency risk |
| 3 | Weak demand for your products/services | Weak demand for your product/services |
| 4 | Attracting and retaining qualified employees | Government policy |
| 5 | Government policies | Access to capital |
| 6 | Regulatory requirements | Regulatory requirements |
| 7 | Employee productivity | Attracting and retaining qualified employees |
| 8 | Access to capital | Employee productivity |
| 9 | Employee morale | Raising wages and salaries |
| 10 | Geopolitical / health crises | Employee morale |

However, the macro-economic concerns of the European CFOs do not have a significant impact on the average sentiment regarding the financial prospects of their own company. With currently 45% of the CFOs more optimistic, and an average optimism level of 63.5 on a scale of 100, the European financial executives are clearly confident about the future performance of their respective companies (figure 4).

*European CFOs remain optimistic about the financial prospects of their own company…*

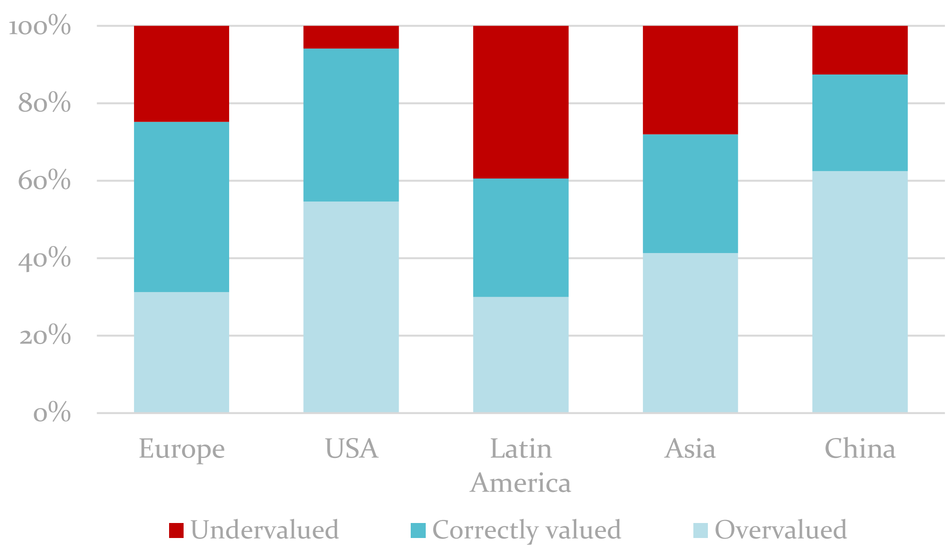
Figure 4. European CFO sentiment regarding financial prospects of own company in next twelve years




Nevertheless, around one third of the European CFOs also believe that the stock markets in their own countries are overvalued. More than half of their US colleagues believe that the US stock market is overvalued, while even more than 60% of the respondents in China believe that the Chinese stock market is overvalued.

*…but also believe that the stock market may be overvalued*

Figure 5. CFO's perceptions about stock market

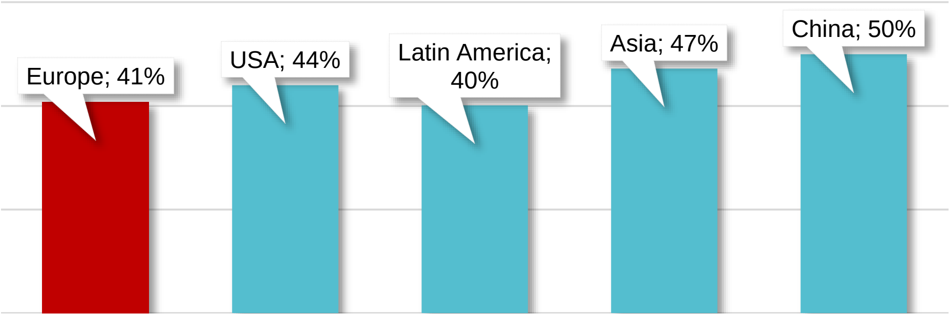



Continued worries about the economy in general, coupled with weak demand for products and services, may eventually lead to increased risk and potentially result in a sharp correction in the equity markets, consequently leading to much lower market valuations.

Moreover, CFOs are worried that companies are not adequately managing risk. In Europe, 41% of CFOs believe firms in their own industries have become complacent about managing downside risk (figure 6).

*Concern among CFOs about complacency in industry about future economic stress…*

Figure 6. Share of CFOs that believe that firms in their industry have become complacent about the threat of, and potential negative effects of, future economic stress

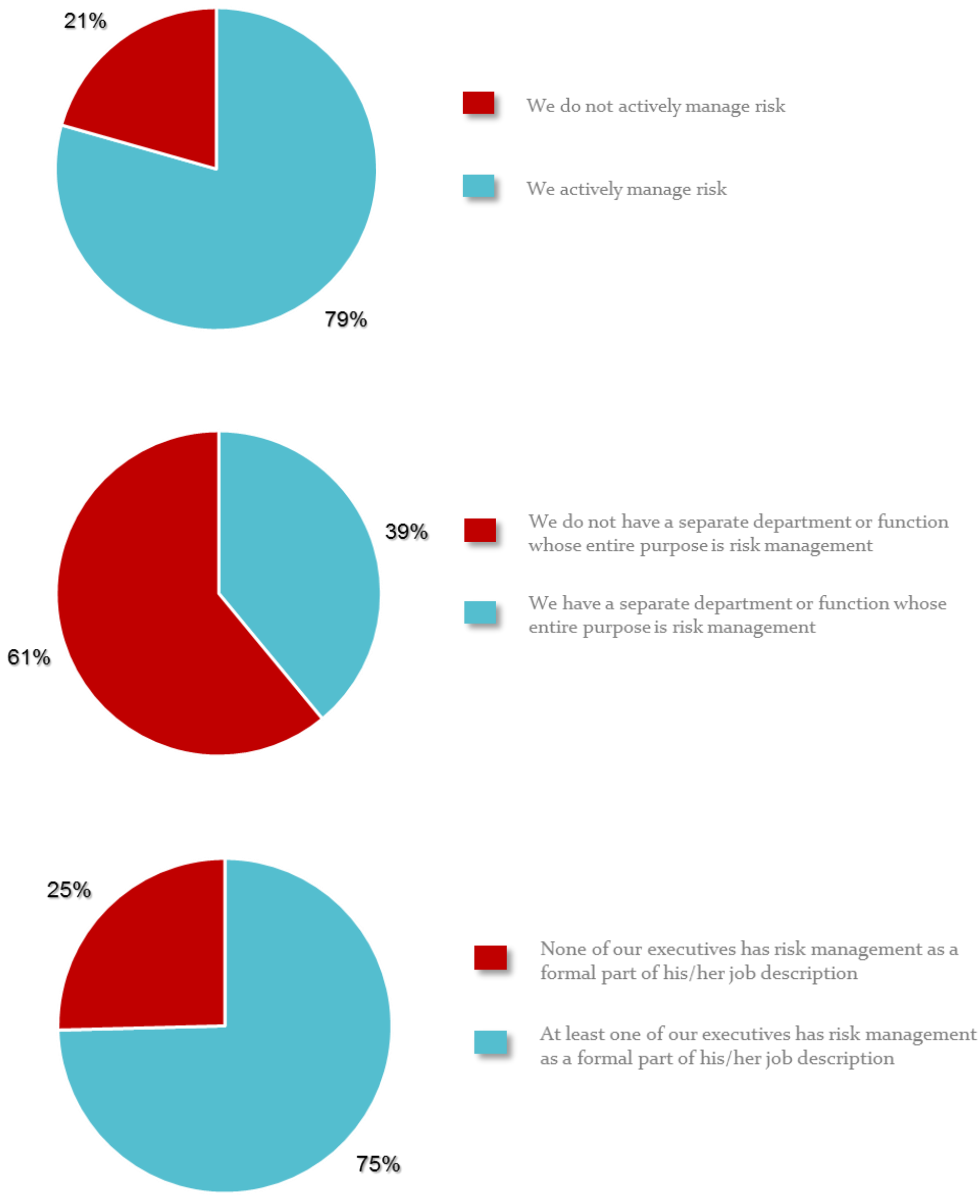



However, when asked about risk management, a vast majority (almost 80%) of European CFOs confirm to have such activity embedded in their organization, with three out of four indicating that this is an executive-level responsibility (figure 7).

*…even though risk management seems to be firmly embedded in European companies…*

*…at the executive level*

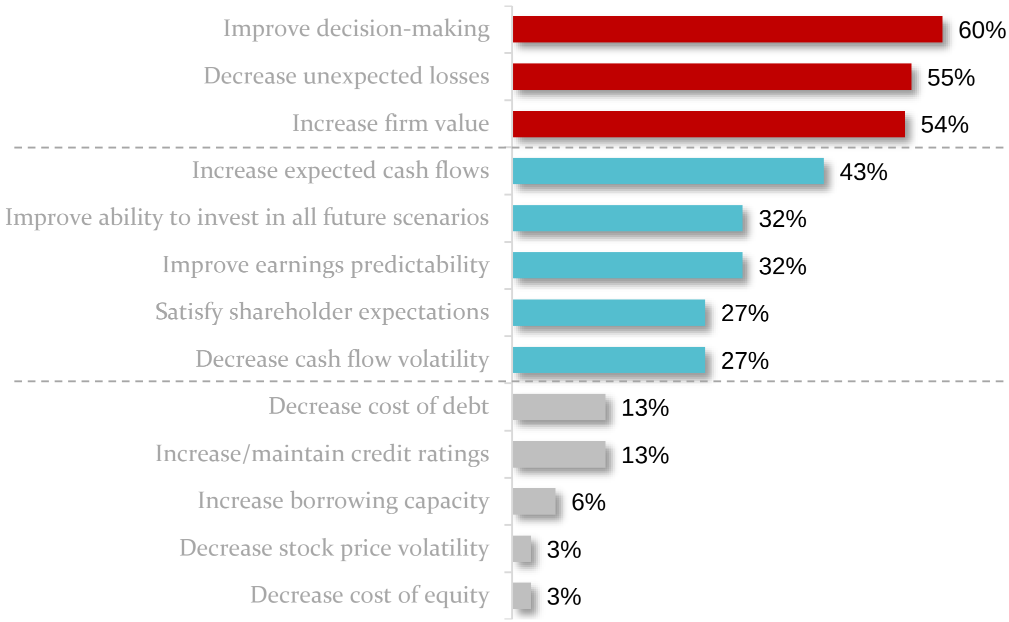
Figure 7. To what extent is risk management embedded in the organization?



More than half of the European financial directors see risk management as a way to potentially increase their company's value and decrease the chance of unexpected losses. The most important reason for managing risk is that it contributes to better decision-making altogether.

***Risk management is believed to contribute to improved decision-making, and helps to increase firm value and decrease unexpected losses***

Figure 8. What do you think are the most important reasons for your company to manage risk? (choose four most important)



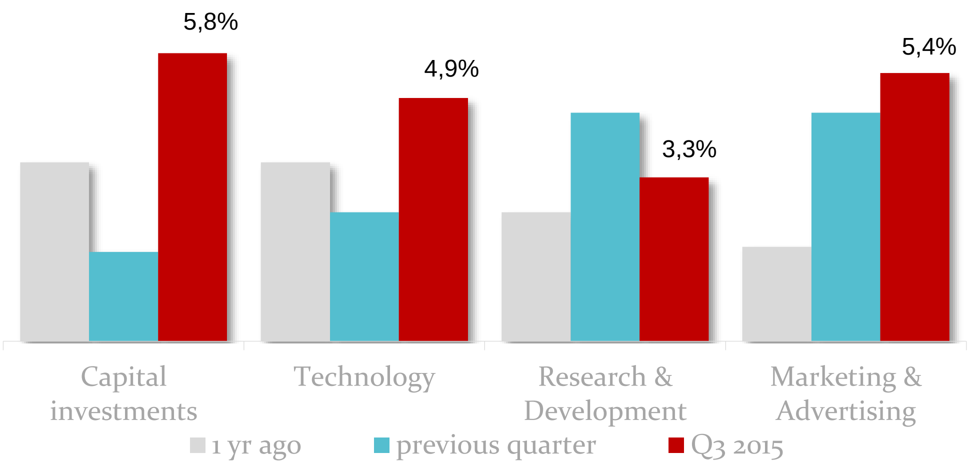
# *Finance & capital*

*Business spending is expected to increase in the next twelve months…*

With the exception of R&D expenditures, business spending is expected to grow across the board (figure 9). More than half of the European CFOs (58%) expects to increase capital investments during the next twelve months at an average growth rate of 5.8% (up from 1.8 % in the previous quarter). Around 70% of the companies intend to increase technology spending at an average rate of 4.9% (up from 2.6% in Q2). 64% of the European CFOs indicate that their company plans to increase marketing and advertising expenditures during the next twelve months, at an average rate of 5.4% (up from 4.6% during the last quarter).

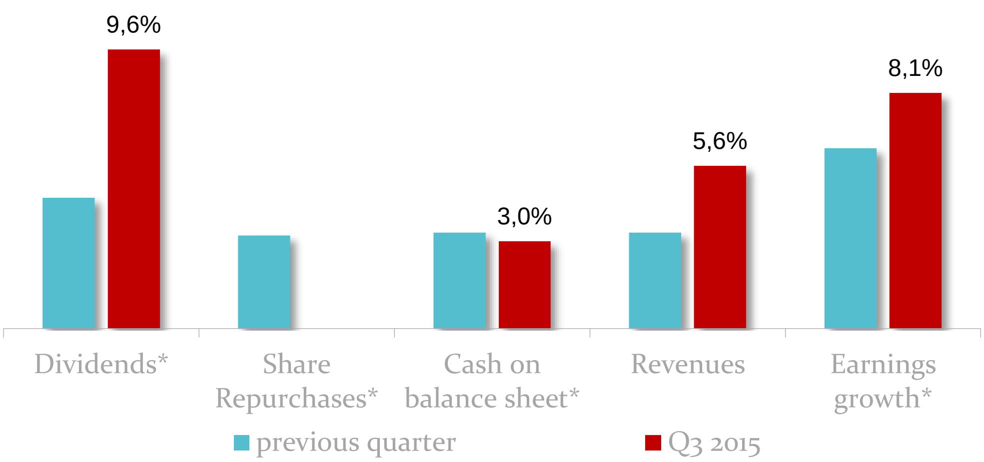
Figure 9. CFOs' expected growth in business spending for next 12 months

*…at much higher rates than previous quarters*




During the next twelve months, public firms are expected to realize growth in both revenues and earnings (figure 10).

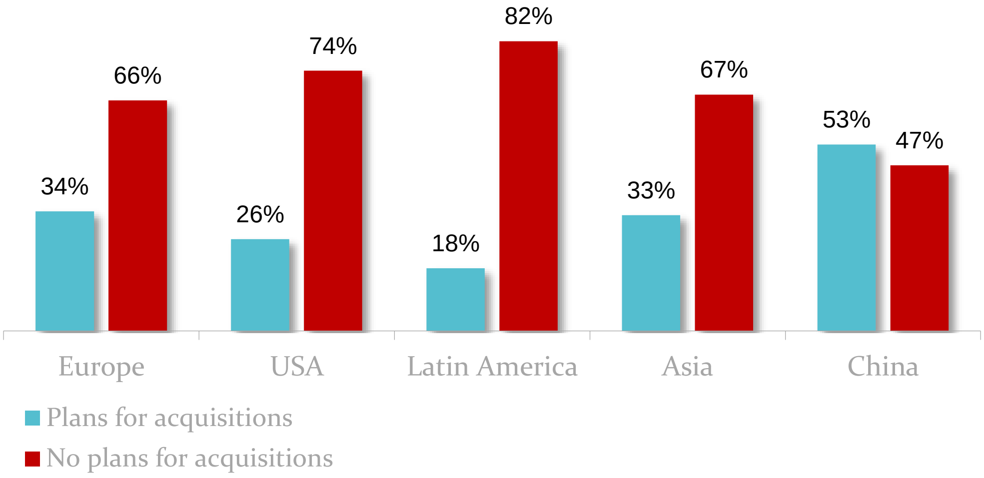
Figure 10. Anticipated balance sheet and P&L developments (public firms)



For the next twelve months, merger and acquisition activity is expected to continue the trend of earlier this year. In Europe, approximately one third of the companies is expected to acquire (part of) another company. During this same period, Latin American CFOs anticipate subdued M&A activity in their respective region, whereas for China more than half of the companies is expected to engage in M&A activity.

*M&A activity is expected to continue its pace of earlier this year…*

Figure 11. During the next year, does your company plan to acquire another (part of) company or companies?




Main motives driving the decisions of European companies to acquire another (part of a) company include: the potential to realize product diversification, achieving cost synergies and improving the company's position in the industry. See table 2 for a full overview of M&A motives.

*…with the aim of improving the company's overall industry position…*

*… and achieving synergy-effects in costs and revenues*

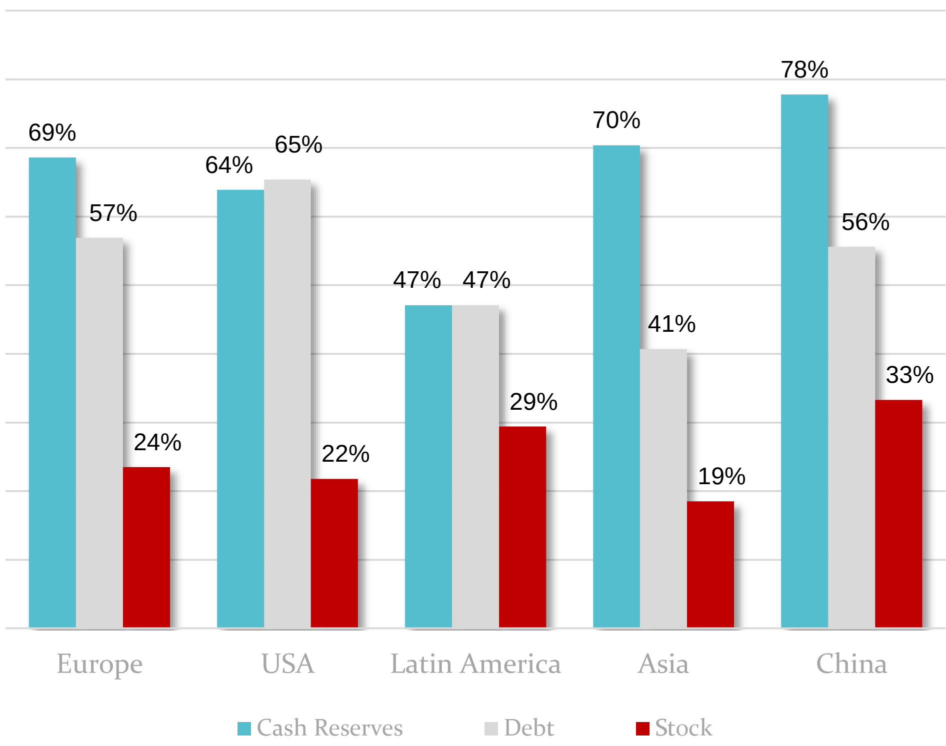
Table 2. Why is your firm making acquisition(s)? (Choose up to 3 reasons)

| | Europe | USA | Latin America | Asia | China |
|---|---|---|---|---|---|
| To improve our industry position | 49% | 41% | 50% | 48% | 22% |
| Cost synergies | 47% | 35% | 32% | 22% | 22% |
| Product diversification | 37% | 38% | 18% | 44% | 33% |
| Revenue synergies | 35% | 29% | 35% | 37% | 22% |
| Consolidation of industry | 29% | 30% | 44% | 19% | 33% |
| Geographic diversification | 26% | 29% | 41% | 41% | 33% |
| Acquire fast-growing assets | 10% | 14% | 9% | 11% | 22% |
| Attractive target valuation | 10% | 20% | 29% | 7% | 11% |
| Deploy cash reserves | 10% | 8% | 0% | 11% | 11% |
| Change in government regulation/programs | 0% | 2% | 3% | 4% | 11% |

To fund M&A activity, cash reserves remain the most favored source among companies worldwide. In Europe nearly 70% of the companies finance their acquisition with (at least) cash reserves, comparable to Asian companies (figure 13).

Figure 13. How will your firm fund the acquisition(s)? (check all that apply)?

*M&A activity primarily funded via cash and debt*

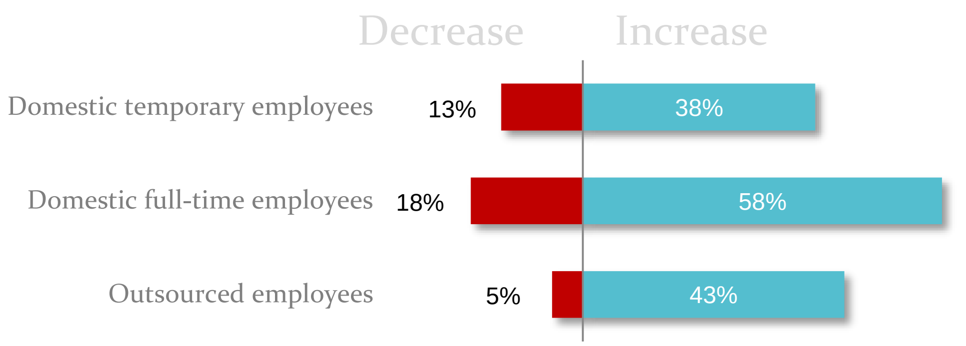


# Employment

*Employment (full time contracts) is expected to increase during the next twelve months…*

During the third quarter of 2015, more than half of the European companies (58%) is expected to step up fulltime hiring, whereas around 40% of the companies is expected to increase outsourcing (figure 12).

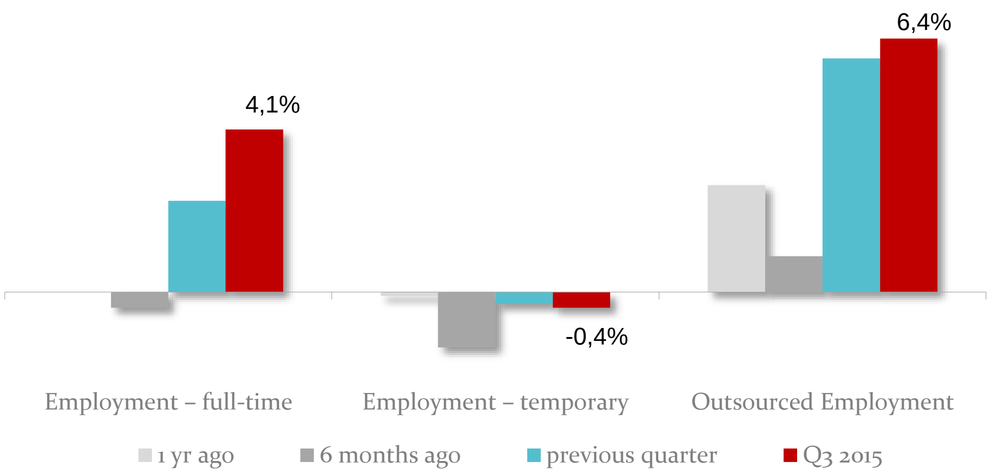
Figure 12. Relative to the previous twelve months, do you expect a positive (increase) or negative (decrease) change in the next twelve months for…?




The companies' plans to increase hiring are expected to translate into an average growth of full time employment of 4.1% during the next twelve months, up from 2.3% in the previous quarter (figure 13). Outsourced employment is anticipated to reach an average growth rate of 6.4%.

*…with fulltime employment and outsourcing contracts expected to benefit*

Figure 13. European CFOs expected growth for next 12 months in employee mix

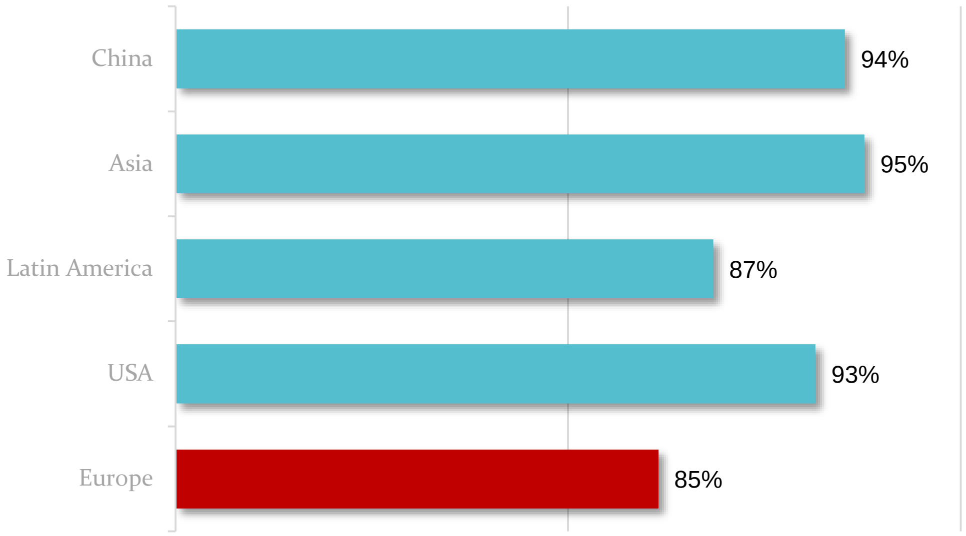



The steep improvement that is expected for employment is partly supported by the fact that 85% of the European companies are signaling that they currently have job openings for key positions (figure 14).

In other major regions such as the US and Asia, even nine out of ten companies say to have key positions available.

*On average, 9 out of 10 companies are looking to fill key job positions…*

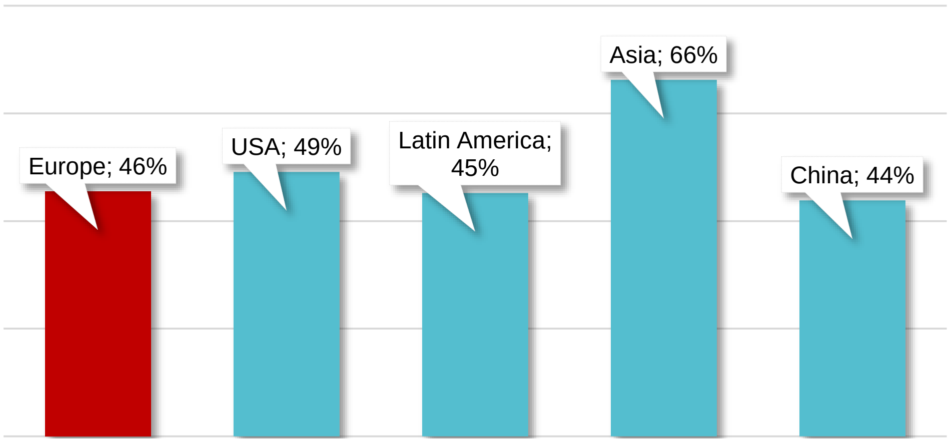
Figure 14. Share of companies that have job openings for key positions




Notwithstanding these encouraging developments, almost half of the European CFOs indicate that their company is experiencing difficulties in filling key positions (figure 15).

*…but almost half of the companies experience difficulty in attracting qualified and competent employees*

Figure 15. Share of companies that experience difficulty in filling key job openings




Unsurprisingly, the difficulty in attracting (or retaining) qualified and competent personnel is also one of the main reasons for companies in Europe to increase primary employees' wages and salaries. Keeping wages and salaries in line with those offered at peer companies in the industry is another main reason why companies in Europe would increase remuneration (table 3).

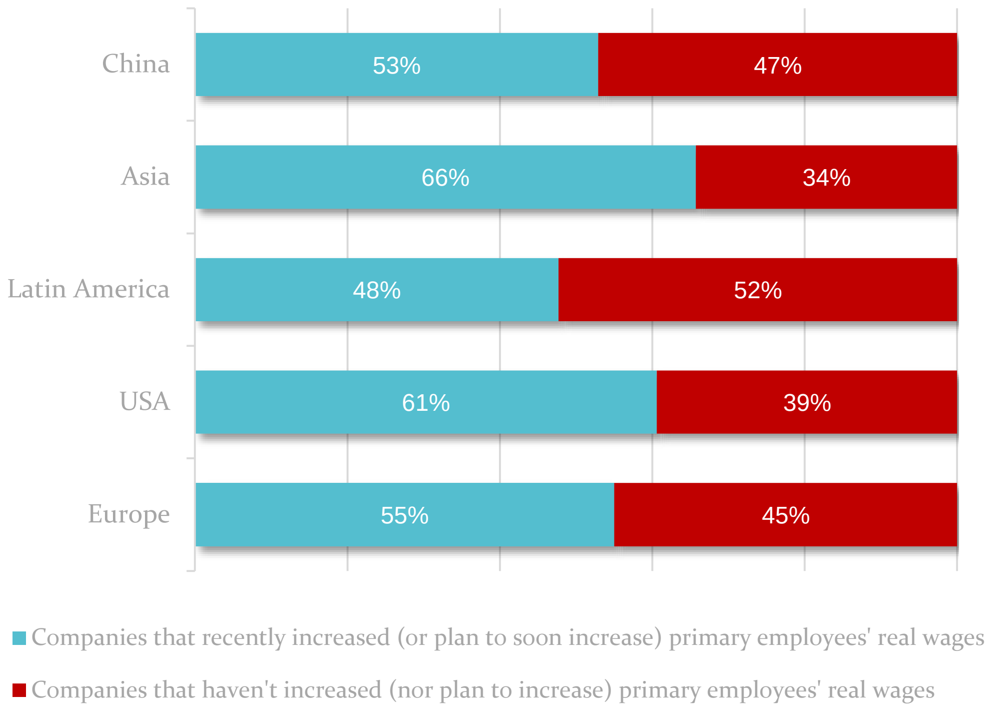
Table 3. Top reasons for firms to increase their primary employees' real wages and salaries

| | Europe | USA | Latin America | Asia | China |
|---|---|---|---|---|---|
| Difficulty attracting/retaining qualified employees | **34%** | **43%** | 30% | **37%** | 44% |
| To keep up with wages at our peer firms | 25% | 32% | **34%** | 30% | 33% |
| Company s financial performance has improved | 24% | 20% | 16% | 13% | 11% |
| Labor market pressures/conditions | 21% | 35% | 28% | 35% | **67%** |
| Pressure from employees or their representatives | 16% | 10% | 19% | 26% | 0% |
| Employees are stakeholders in the firm | 14% | 6% | 4% | 2% | 22% |
| Company altruism | 10% | 7% | 5% | 9% | 0% |

***Difficulties in recruitment is incentive for companies to raise wages and salaries***

Consequently, more than half of the companies in Europe has recently increased the wages and salaries of their primary employees (or plans to do so in the short term).

Figure 16. Has your firm recently increased (or plans to soon increase) your primary employees' real wages/salaries?




***In Europe, more than half of the companies has recently increased wages and salaries of their primary employees***

# 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 | 41.6% | 23.1% | 7.3% | 22.2% | 29.3% |
| Less optimistic | 22.1% | 41.6% | 73.8% | 72.2% | 54.5% |
| No change | 36.2% | 35.3% | 18.8% | 5.6% | 16.2% |
| Own country optimism level | **57.9** | **60.0** | **42.9** | **48.2** | **55.6** |
| *About own company* | | | | | |
| More optimistic | 45.3% | 39.3% | 25.1% | 61.1% | 42.4% |
| Less optimistic | 20.9% | 32.4% | 41.9% | 22.2% | 39.4% |
| No change | 33.8% | 28.3% | 33.0% | 16.7% | 18.2% |
| Own company optimism level | **63.5** | **65.8** | **58.9** | **67.4** | **62.6** |
| **Business spending** | | | | | |
| Capital spending | 5.8% | 2.4% | 0.5% | -10% | -0.6% |
| Technology spending | 4.9% | 4.3% | 3.3% | 1.7% | 4.4% |
| R&D spending | 3.3% | 1.6% | 3.9% | -5.6% | 2.7% |
| Advertising and marketing spending | 5.4% | 3.6% | -1.1% | 5.6% | 7.3% |
| **Employment** | | | | | |
| Employment – full-time | 4.1% | 1.4% | -0.8% | 1.0% | -1.3% |
| Employment – temporary | -0.4% | -1.0% | -1.0% | -5.2% | 0.7% |
| Outsourced Employment | 6.4% | 0.52% | -0.6% | 0.5% | 0.6% |
| Wages and Salaries | 3.0% | 3.3% | 5.5% | 8.3% | 5.2% |
| Health Care Costs | 1.4% | 7.5% | 9.4% | 6.6% | 0.7% |
| **Balance Sheet & P&L** | | | | | |
| Productivity | 3.5% | 3.2% | 1.6% | 2.6% | 2.0% |
| Inflation (own-firm products) | 0.6% | 0.9% | 7.5% | 0.6% | -5.0% |
| Revenue growth | 5.6% | 3.5% | 7.5% | 3.0% | 1.9% |
| Earnings growth* | 8.1% | 3.0% | 2.9% | 8.9% | 0.1% |
| Dividends* | 9.6% | 3.5% | -6.4% | 5.0% | 0% |
| Share Repurchases* | 0.0% | 2.2% | 0.0% | 0% | 0% |
| Cash on balance sheet* | 3.0% | 0.3% | -0.9% | 7.9% | 3.7% |
| Mergers and Acquisitions | 34.5% plan to acquire | 26.1% plan to acquire | 17.7% plan to acquire | 22.2%% plan to acquire | 36.4% plan to acquire |

*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 third quarter of 2015. The survey concluded September 5, 2015. Every quarter, CFOs in Europe, the US, Latin America, Asia (and China), and Africa are questioned about their economic expectations. Current records go back 78 quarters. The CFO Survey is conducted jointly by TIAS School for Business and Society (Tilburg, Netherlands), Duke University (Durham, North Carolina), ACCA Global and CFO Magazine.

**Note for the press**

Previous editions of the CFO Survey can be found at FinanceLab under the CFO Survey tab. For further information, please contact Mrs. Rian van Heur, TIAS School for Business and Society, tel.+31-(0)-134668637 or e-mail m.j.vanheur@tias.edu

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