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CFO Survey Europe

Q1 2016

- *Number of optimists has plummeted*
- *Taking into account a new recession?*
- *Employment under pressure*

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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Introduction

Economic sentiment deteriorates as CFOs anticipate a new recession

Among financial directors in Europe, only 18% remain positive about the economic prospects for the coming 12 months as nine out of ten CFOs expects another recession by the end of 2016, at an average probability of 30%. Next to risks related to the internal market (e.g. budget deficits, political risk, etc.), many CFOs consider the continuing slump in China to be a major cause for concern that may potentially lead up to a recession in Europe.

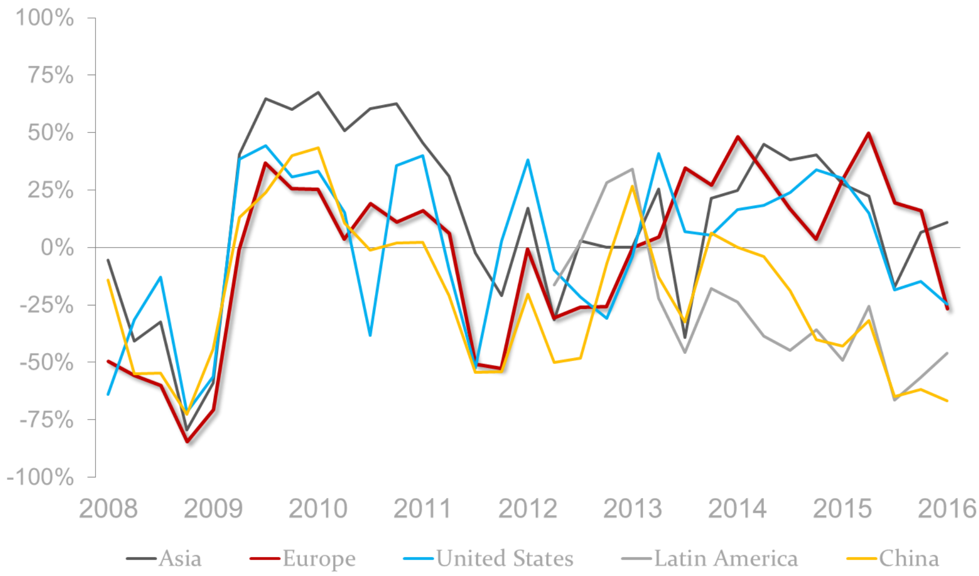
Could a hard landing in China trigger a recession in Europe?

The number of optimists in China has also fallen into significant decline. Only 9% of the respondents in China are more positive about the economic outlook of their country, whereas more than 75% are now more pessimistic about the next twelve months. An alarming situation because a hard landing in China would entail a major and unprecedented impact on the world economy. In such scenario, substantial price declines in raw materials, energy and imports cannot be ruled out and may cause (longer term) deflationary effects that could further undermine the already low European core inflation.

…current low (core) inflation climate in Europe is cause for concern

Approximately one third of the European financial directors indicate that a sustained period of low core inflation (under 1%) would have negative consequences for their company's financial performance. For instance, more than half of the CFOs say that they will not be able to keep price levels in pace with employment and production costs. In such deflationary climate, companies and consumers are compelled to continue postponing expenditures in anticipation of further sustained price decreases. This may lead to long-term fall in demand bringing about second-round-effects where companies are forced to cut costs, and a negative wage-price spiral would result in a new recession.

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

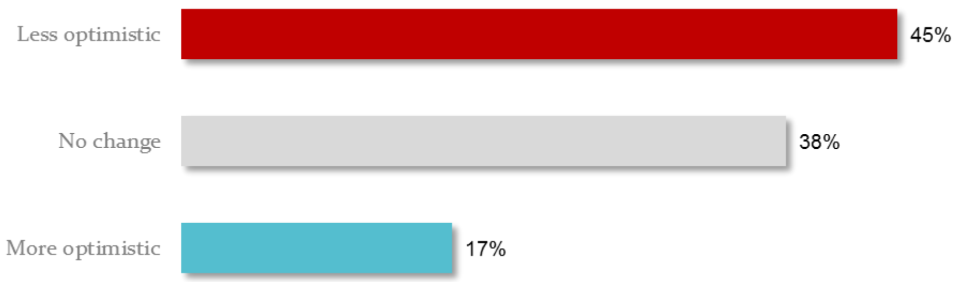


CFO optimism & sentiment

Dramatic decline in number of optimists…

The number of pessimists among European financial directors grew to 45%, the strongest hike since 2012. Only 17% of the CFOs remain more optimistic about their own country's economic outlook for the next twelve months (figure 2). The average level of optimism has also dropped significantly, from 58.4 (on a scale of 100) during the previous quarter, to 53 in this first quarter of 2016.

Figure 2. European CFO sentiment regarding economy of own country



The big drop in economic sentiment has pushed the level of optimism among European CFOs behind that of major economic regions such as the US, China and Asia (see figure 3).

…has pushed the level of optimism among European CFOs behind that of other major economic regions

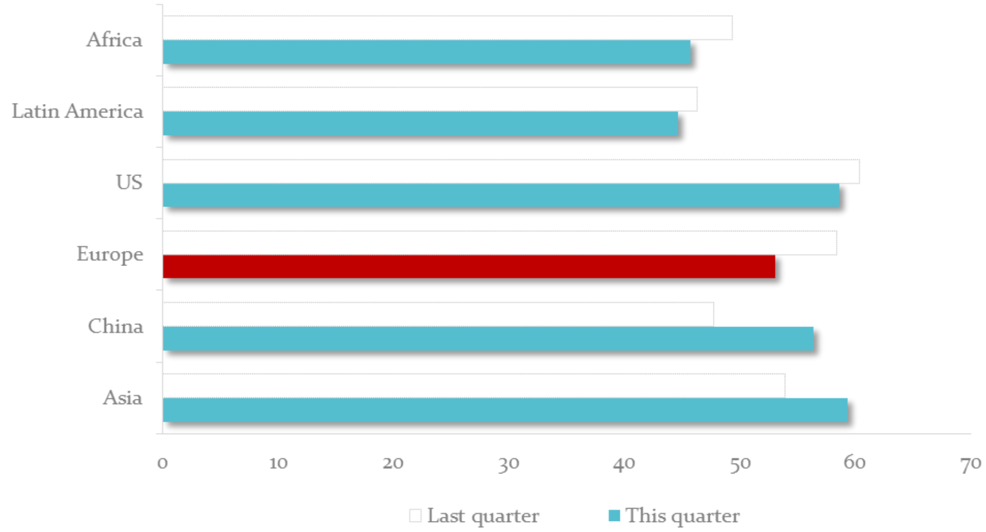
- The number of optimists among African financial directors has improved markedly from only 13% of the CFOs having a more positive outlook in Q4 2015 to 29% more optimistic during Q1 2016. The number of pessimists however, remains high at 64% and has dampened the average optimism level further from 49.3 to 45.7 on a scale of 100.
- After the marginal improvement in the number of optimists during the previous quarter, the number of CFOs in Latin America with a positive view on the economic outlook has again inched upwards from 10.4% to 13.6%. However, with still 60% of the CFOs more pessimistic, the average level of optimism has decreased further from 46.3 to 44.6 on a scale of 100 and remains at the lower end of all major economic regions.
- The optimism level in the US has decreased to 58.6 on a scale of 100 during Q1 2016. Whereas a little over 26% of the US financial directors had a positive outlook on the economy during the previous quarter, the number of optimists has now declined to 23% during this quarter. The average optimism level in the US has slid below the 60-marker and currently stands at 58.6 on a scale of 100.
- In Asia, the number of optimists and pessimists remains largely unaltered with 37.5% of the CFOs more optimistic and 44.4% more

pessimistic about their own country's economic prospects. The average level of optimism (measured on a scale of 100) however, has improved significantly to 59.3, up from 53.9 during Q4 2015.

- The number of financial executives in China that have a positive economic outlook for the next twelve months has dropped further to a mere 9.1% during this first quarter of 2016. The number of CFOs that has a pessimistic view on their economy remains unchanged at 76%. Notwithstanding this gloomy balance between optimists and pessimists, the average optimism level in China has improved substantially during Q1 2016 and currently reads 56.4 on a scale of 100 (up from 47.7).

Figure 3. Optimism level about own country's economy

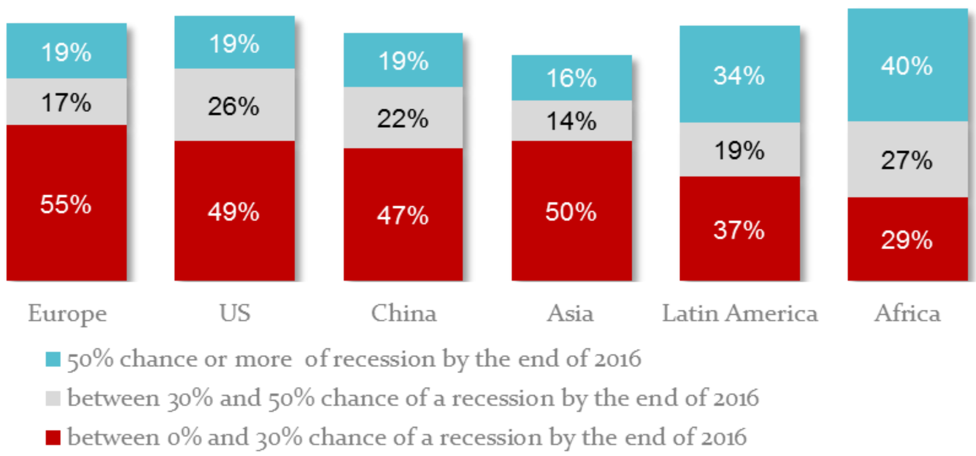
Europe is hit worst among worldwide decline in optimism.



The considerable deterioration in economic sentiment is also evidenced by CFOs' expectations regarding the occurrence of a. In Europe for example, no less than 9 out of 10 financial directors expects a recession to hit their economy by the end of 2016.

Figure 4. What do you think is the probability that your country's economy will be in recession at the end of 2016?

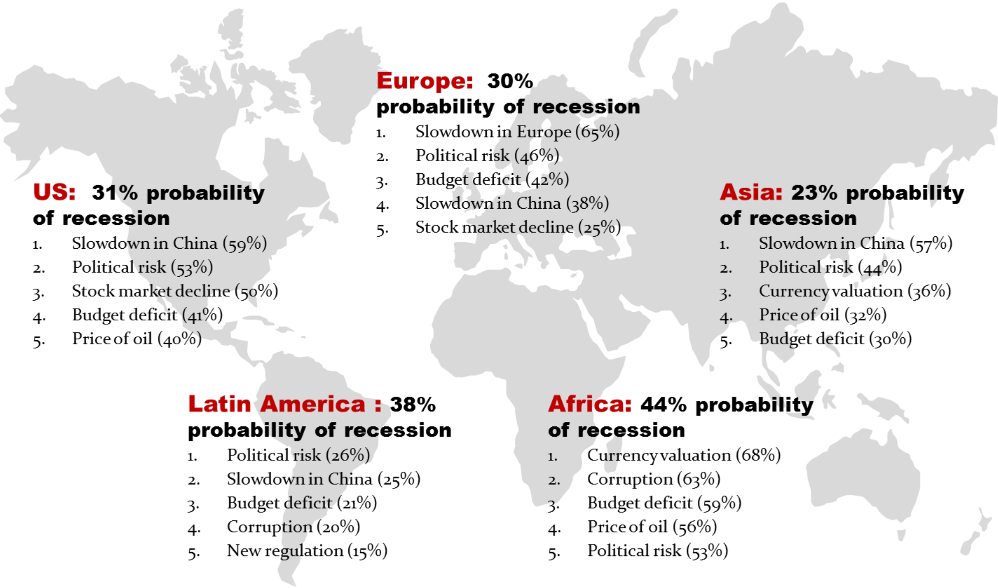
Nine out of ten CFOs in Europe expects another recession to hit their country…



In Europe, CFOs assign an average probability of 30% to a recession by the end of 2016. According to the financial executives, factors such a general slowdown in the European economy, political risk and budget deficits would be the major causes for such recession to occur.

Figure 5. Average of probabilities assigned by CFOs that the country's economy will be in recession at the end of 2016, including top 5 key risks that might lead to such recession.

…assigning an average probability of 30% that a recession will occur at the end of 2016



The real possibility of a recession (or at least the CFOs' perception thereof) may also explain why optimism about the financial performance of the own company (for the next twelve months) has deteriorated significantly. During Q1 2016, only 35% of the European CFOs remain optimistic about the prospects of their own company, down from 54.5% during the previous quarter (figure 6). The average level of optimism measured on a scale of 100 has also decreased from 65.2 to 62.5.

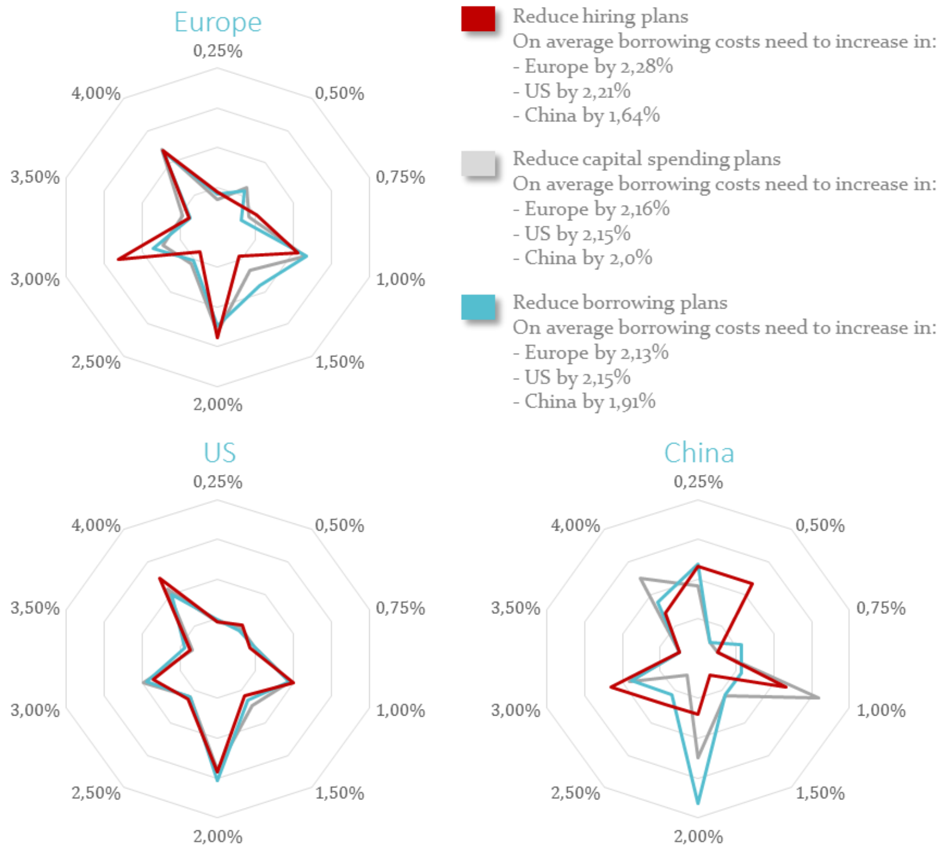
Figure 6. European CFO sentiment regarding financial prospects of own company in next twelve months

European financial directors are less optimistic about the financial prospects of their own company

Notwithstanding the fear of a new recession to hit the European countries, financial executives do not regard interest rates as much of a risk factor that could potentially lead to a recession. For European companies, interest rates would have to increase (on average) by more than 2% before they would consider reduce hiring, capital spending or borrowing altogether (figure 7).

Interest rates are not considered to be among the most important risk factors that lead up to a new recession

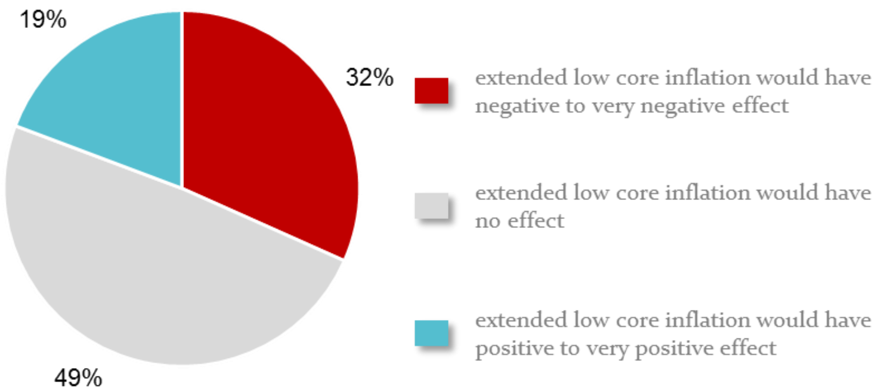
Figure 7. Compared to interest rates today, how much would your borrowing costs have to increase to cause your company to reduce capital spending, hiring and borrowing?



However, the current low (core) inflation climate in Europe does not bode well for the European economy. When asked, approximately one third of the European companies say that extended low core inflation would have a negative impact on the firm's financial performance (figure 8).

…whereas a sustained period of low (core) inflation would be of much more concern to European CFOs…

Figure 8. What effect would an extended low core inflation (0% - 1% each year for the foreseeable future) have on financial performance?

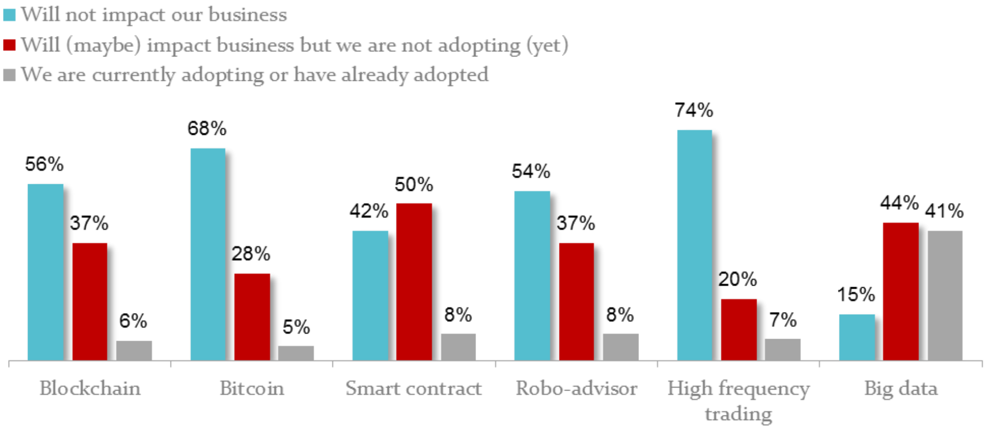


…as companies are much less able to inflate prices and meet profit targets

More than half of the financial directors indicate that under such circumstances, their company's ability to raise prices (in order to keep pace with rising labor and non-labor costs), would substantially diminish. 38% of the CFOs expect that the company's ability to meet profit targets would also come under pressure. Another 20% even believes that extended low (core) inflation would ultimately alter the competitive balance within their industry.

This competitive balance however, will also depend on the degree to which companies are able to pick up on new trends and innovative developments that will help them staying ahead of the curve. In this respect, innovations such as smart contracts and big data are believed to significantly impact operations in the next five years (figure 9).

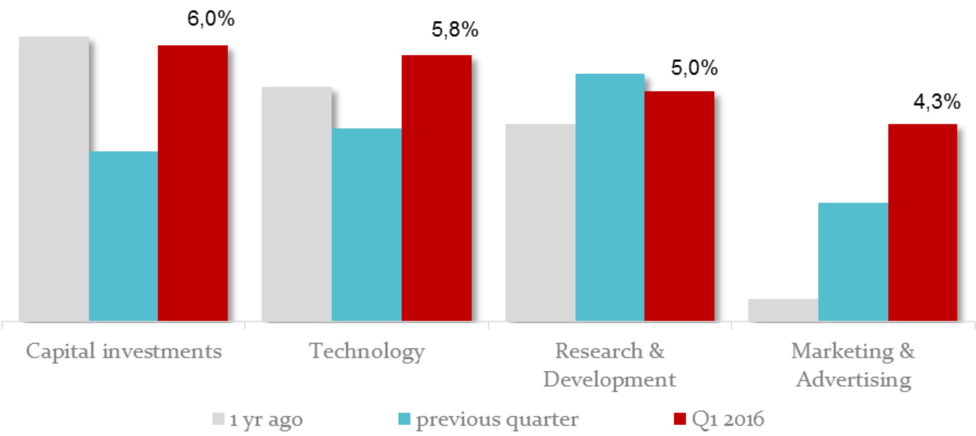
Figure 9. Which of the following innovations will affect your company and its operations in the next 5 years?



Finance & capital

Business spending during the next twelve months is expected to pick up momentum again with more than half of the European CFOs anticipating increases in R&D spending (at an average growth rate of 6%), technology spending (5.8%), and marketing & advertising (5.0%). Six out of ten financial directors expect to increase their capital investments (at an average growth rate of 6.0%) during the next twelve months (figure 10).

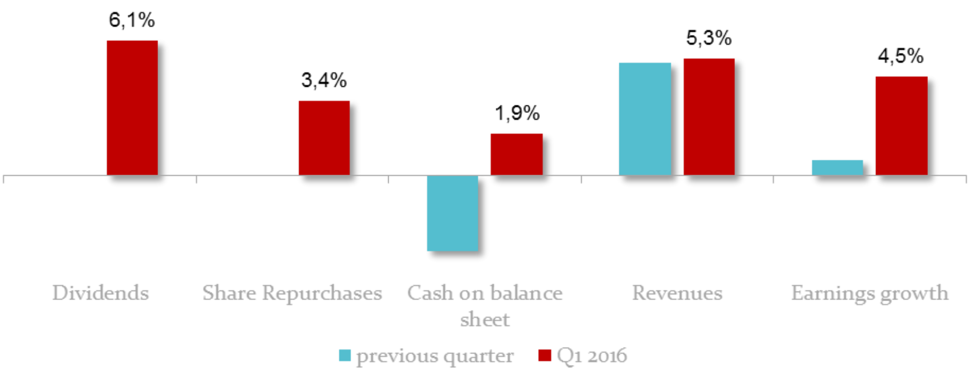
Figure 10. CFOs' expected growth in business spending for next 12 months



Despite fears of economic downturn, business spending is expected to continue its pace of previous quarters

Compared to the previous quarter, public companies are expected to improve their balance sheet and P&L during the next twelve months. Revenues and earnings are expected to increase on average by 5.3% and 4.5% respectively, whereas firms are also likely to improve their cash positions, albeit against a moderate growth rate of 1.9% on average (figure 11).

Figure 11. Anticipated balance sheet and P&L developments (public firms)



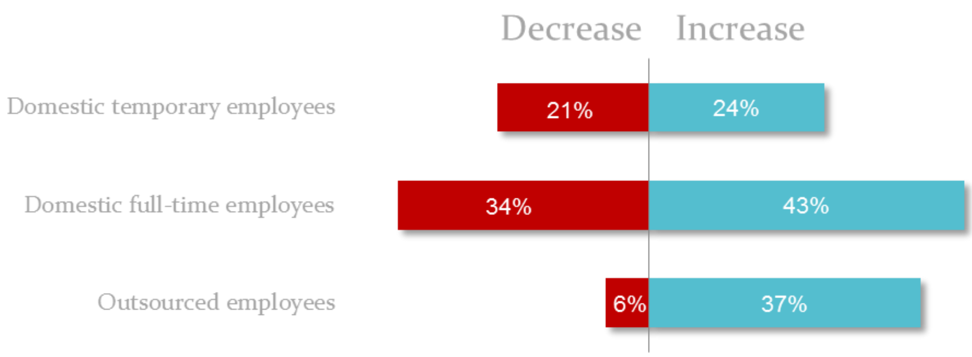
As public firms expect to increase revenues and earnings, they will also seek to improve their cash positions

Employment

Fulltime and temporary employment contracts are under pressure…

The overall employment picture remains bleak for the next twelve months. The number of CFOs who anticipate increases in both full time and temporary employment contracts is in large part offset by an equally large group of CFOs who expect to reduce temporary and fulltime contracts (figure 12). Overall, for the next twelve months outsourcing of employment also appears to remain the most preferred alternative to employers.

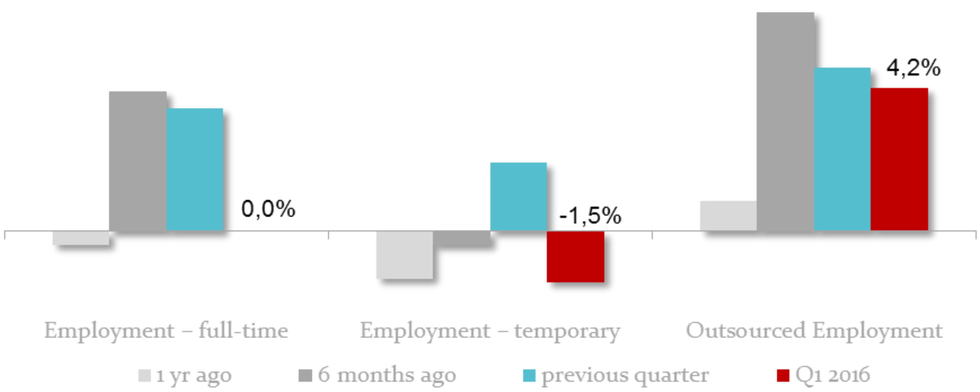
Figure 12. Relative to the previous twelve months, do you expect a positive (increase) or negative (decrease) change in the next twelve months for…?



Zooming in on the (average) employment growth rates, indeed we observe that CFOs (on average) do not expect to see any increases in the number of full-time contracts and even anticipate a further decline in temporary employment contracts. Growth in outsourcing of employment is expected to remain positive (4.2% on average) albeit at a slower rate than the previous two quarters, underscoring this quarter's bleak employment picture (figure 13).

…as growth in the next twelve months remains unlikely

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



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	17.8%	22.8%	13.6%	28.7%	37.5%
Less optimistic	44.4%	47.3%	59.7%	63.6%	44.4%
No change	37.9%	29.9%	26.7%	7.7%	18.1%
Own country optimism level	**53.0**	**58.6**	**44.6**	**45.7**	**59.3**
About own company					
More optimistic	34.5%	41.8%	31.4%	45.1%	46.5%
Less optimistic	26.8%	30.2%	30.0%	41.7%	33.1%
No change	38.7%	28.0%	38.6%	13.2%	20.4%
Own company optimism level	**62.5**	**66.0**	**58.0**	**58.7**	**63.2**
Business spending					
Capital spending	6.0%	2.0%	2.2%	1.7%	4.4%
Technology spending	5.8%	4.3%	2.9%	6.5%	5.9%
R&D spending	5.0%	1.2%	3.3%	4.0%	4.6%
Advertising and marketing spending	4.3%	2.8%	-1.1%	1.0%	5.0%
Employment					
Employment – full-time	0.0%	2.0%	-2.2%	-1.3%	-0.3%
Employment – temporary	-1.5%	-0.3%	-0.2%	-1.1%	-1.6%
Outsourced Employment	4.2%	1.1%	-1.2%	-0.7%	-0.6%
Wages and Salaries	1.4%	3.2%	2.1%	4.2%	4.5%
Health Care Costs	1.8%	7.1%	3.6%	5.4%	4.0%
Balance Sheet & P&L					
Productivity	3.5%	2.6%	3.4%	4.1%	3.3%
Inflation (own-firm products)	1.4%	0.8%	1.1%	4.5%	0.2%
Revenue growth	5.3%	3.7%	-1.0%	8.6%	0.1%
Earnings growth*	4.5%	1.6%	-0.3%	6.2%	-0.8%
Dividends*	6.1%	0.4%	2.2%	3.9%	-1.3%
Share Repurchases*	3.4%	2.1%	0.0%	0.7%	0%
Cash on balance sheet*	1.9%	3.2%	0.4%	4.6%	-1.8%
Mergers and Acquisitions	Not asked.	Not asked.	Not asked.	Not asked.	Not asked.

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 first quarter of 2016. The survey concluded March 4, 2016. Every quarter, CFOs in Europe, the US, Latin America, Asia (and China), and Africa are questioned about their economic expectations. Current records go back 80 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. Judith Slikker, TIAS School for Business and Society, tel.+31-(0)-134668622 or e-mail j.slikker@tias.edu

CFO Survey Europe team

Kees Koedijk
Professor Financial Management
Dean & Director TIAS School for Business & Society

Christian Staupe
Policy Advisor Dean's Office
Coordinator CFO Survey Europe

Judith Slikker (contactperson)
Brand manager
Corporate Marketing & External Relations
j.slikker@tias.edu
+31-(0)-13 466 8622