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CFO Survey Europe

Q2 2016

- *Brexit may prompt similar referenda across EU*
- *Political uncertainty leads to more caution in spending, hiring and acquisitions*
- *Trade alliances are generally regarded as very positive*

Photograph:" Poll Card EU referendum" by Abi Begum, 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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Introduction

The number of optimists among European financial directors has improved markedly compared to the previous quarter. Also, during the second quarter of 2016 the optimism index (figure 1) reveals a promising upward trend in optimism across all major regions.

Rebound in number of optimists translates in only a moderate improvement in economic sentiment

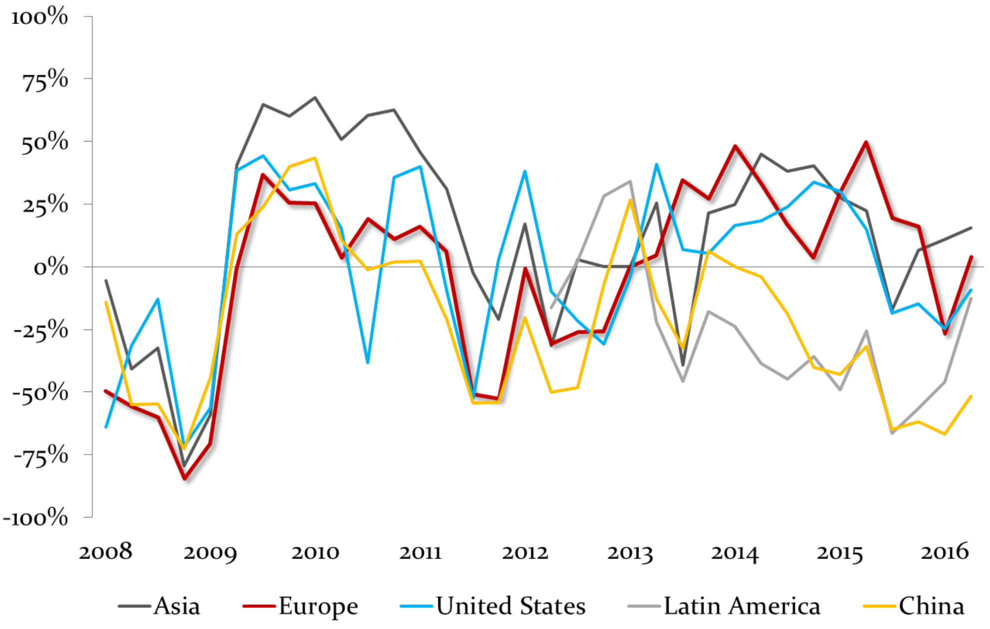
However, despite the notable rebound in the number of optimists among European CFOs, their (average) level of optimism has actually improved only moderately. One of the main reasons for the subdued sentiment is the current political climate as many companies have voiced their concern about the overall functioning of their respective governments.

…as political uncertainty leads to more caution in business spending plans

As a consequence of such political uncertainty, more than 60% of companies are now more reluctant with respect to their (business and capital) expenditures. Similarly, more than a third of the companies even claim to reconsider their plans for acquisitions.

Although at the moment political and economic uncertainty may seem to have the upper hand, European financial directors still expect to see a substantial productivity increase during the next twelve months, at an average growth rate of 11%. More importantly, they also anticipate gradual recovery in employment, for both temporary and fulltime contracts.

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



CFO optimism & sentiment

As number of optimists and pessimists is more evenly distributed in Europe…

Compared to previous quarters, the number of optimists and pessimists among European financial directors is now more evenly distributed, with 34% of CFOs more optimistic and 30% more pessimistic about the economic outlook (figure 2). The average level of optimism has inched upwards, from 53 (on a scale of 100) during the previous quarter, to 55.3 in this second quarter of 2016.

Figure 2. European CFO sentiment regarding economy of own country

We observe similar improvements in economic sentiment across the other major world regions (see figure 3).

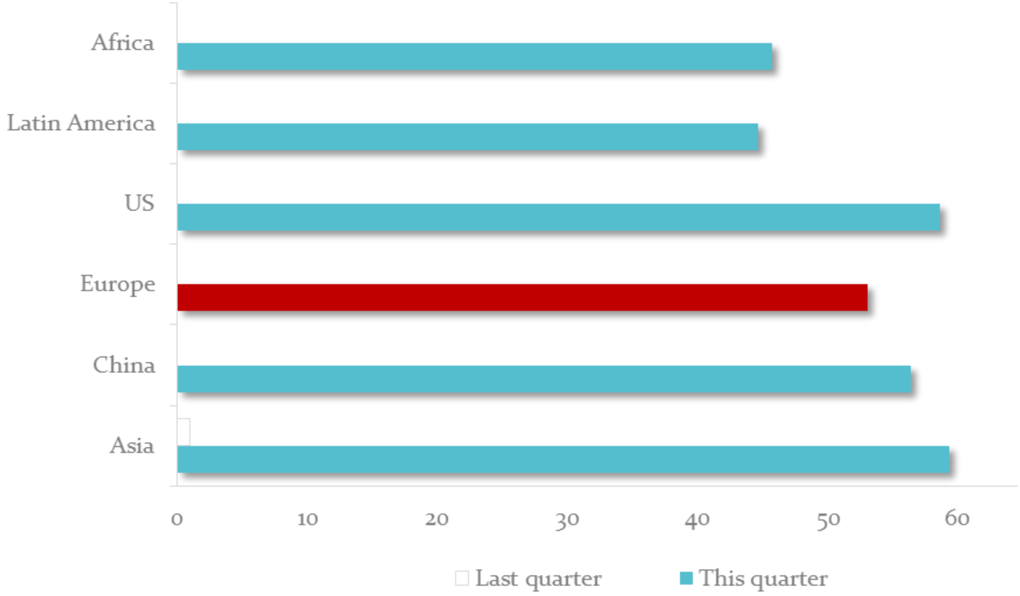
… economic sentiment among CFOs across other major regions has significantly improved during Q2

- The recovery in number of optimists among African financial directors has continued throughout this second quarter of 2016 with now more than one third of the CFOs more optimistic (compared to 28% during Q1). The number of pessimists has also eased off from 64% to 59%, while the overall level of optimism has improved slightly to 47.4 on a scale of 100.
- After three quarters of subdued optimism in Latin America, we now witness a relatively strong uptick in the number of CFOs who maintain a positive outlook on the economy, from 13.6% during Q1 to 31.1% this quarter. The average level of optimism has improved significantly from 44.6 to 52.9 on a scale of 100. Optimism, however, remains at the lower end compared to all other major economic regions.
- Economic sentiment and the number of optimists in the US are back at the same level observed during the second half of 2015. While now 26.7% of the US CFOs more optimistic and 35.9% less positive, the average optimism level (at 59.4 on a scale of 100) remains strongest among all of the major regions.
- For the third quarter in a row, the number of optimists in Asia has increased. Despite this improvement, with 42.5% of the CFOs now having a more positive view on the economic prospects, the actual level of optimism has slightly deteriorated from 59.3 during the previous quarter, to 58.7 during Q2 2016.

- After having dropped to its lowest level (9.1%) during Q1, this second quarter of 2016 sees a moderate rebound (13.5%) in the number of optimists among Chinese CFOs. Also, the number of financial directors with a negative economic outlook has decreased from 76% during Q1, to 64.9% in Q2. Although slightly lower, the average optimism level (55 on a scale of 100) in China remains relatively strong during Q2, compared to that in other regions.

European sentiment 'stuck in the middle'…

Figure 3. Optimism level about own country's economy



…as CFOs view the political uncertainty and risk as considerable…

Approximately half of the European CFOs has rated the degree of political uncertainty as 'large', whereas another 44% says political uncertainty poses a 'moderate' risk. Those political uncertainties that cause most concern among European CFOs, include: proposed regulations, government gridlock or dysfunction, potential for tax reform, and the upcoming elections. As a direct result of these uncertainties, companies say they are more cautious in (capital) spending, hiring and acquisitions (figure 4).

…leading to more caution in spending, hiring, and acquisition plans

Figure 4. Effects of political uncertainty

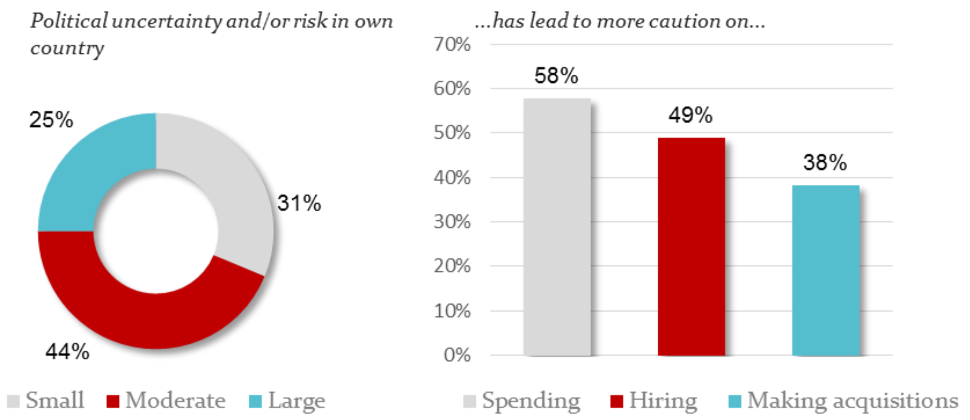
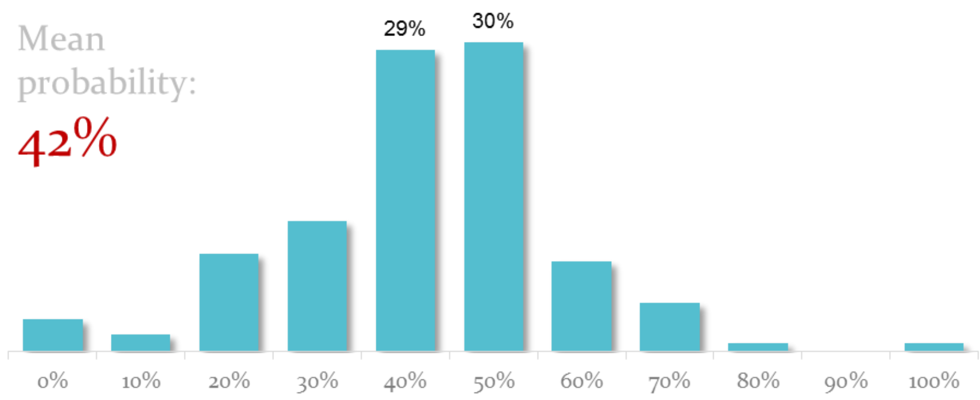


Figure 5. How have the European CFOs estimated the chances of a Brexit?

With the current outcome of the recent Brexit vote…



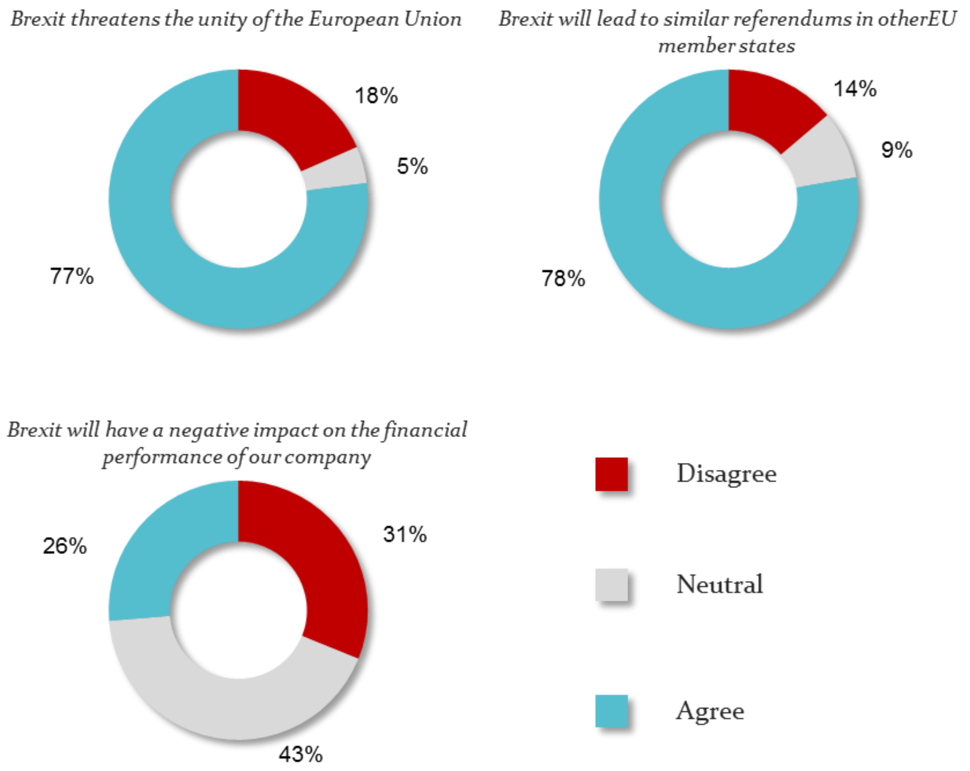
European CFOs assigned a 42% chance of a Brexit to occur (figure 5). Now, with the Brexit referendum behind us, and the U.K.'s divorce from the EU in the making, the main question is what the actual impact and effects of the Brexit will be. More than 75% of the European CFOs believe that the British referendum will lead to similar calls for voting in other EU countries. More importantly, 1 out of 4 companies anticipates a negative impact on its financial performance as a result from the Brexit (figure 6).

Figure 6. In your opinion, what would be the impact of a Brexit?

…many are now contemplating on the potential impact and effects that the Brexit may bring about

According to the majority, the unity of the European Union is at stake…

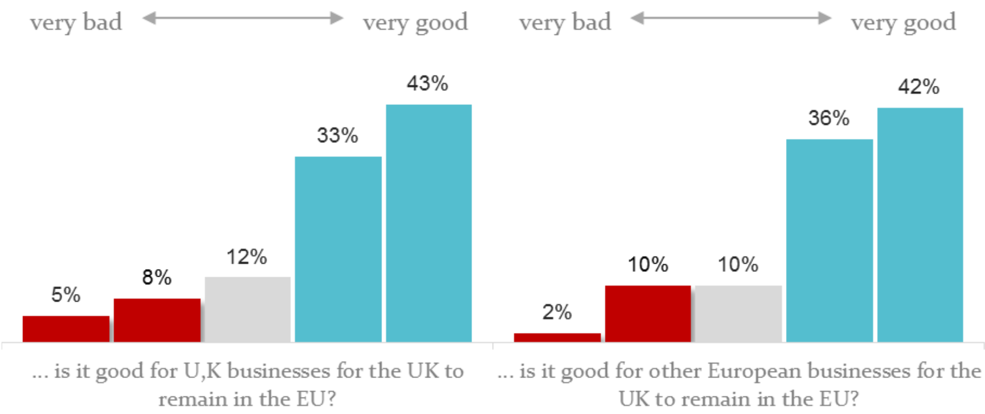
…with potential negative impacts on corporate level



Unsurprisingly, CFOs in Europe believe that it would have been better for businesses from both the U.K. as well as other European countries if the U.K. would have stayed in the EU (figure 7).

The majority of the European CFOs would have opted for the U.K to remain within the EU

Figure 7. In the European CFOs' opinion...



Overall, the political uncertainty which is fueled in large part by the Brexit vote, has quelled optimism among financial directors in Europe regarding the financial prospects of their own company (figure 8). The number of optimists maintains the level of the previous quarter (35%) whereas the number of CFOs with a pessimistic sentiment has increased to 32%. The average level of optimism, as measured on a scale of 0 to 100, has also declined from 62.5 in Q1 to 58.6 during Q2.

Recent developments have dampened CFOs' sentiment regarding the financial prospects of the own company

Figure 8. European CFO sentiment regarding financial prospects of own company in next twelve months.

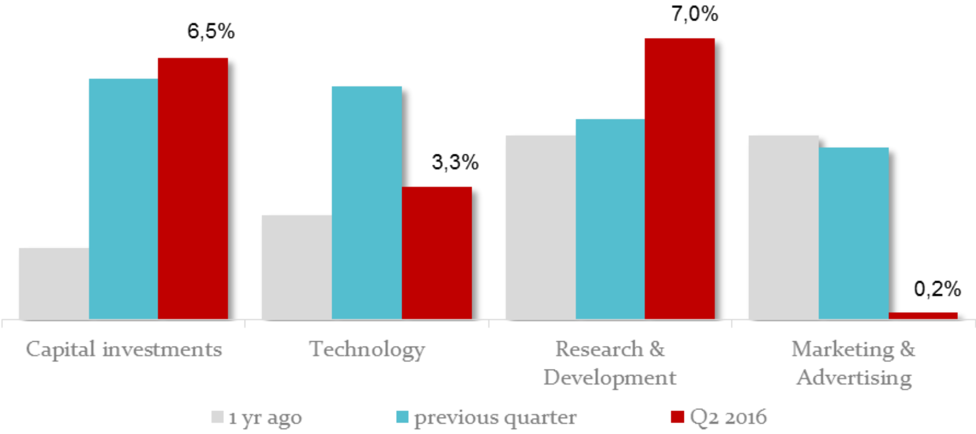
Finance & capital

Business spending that is anticipated for the next twelve months shows a mixed picture. Whereas expected growth in capital investments (6.5%) and R&D expenditures (7.0%) demonstrate a steady upsurge, spending on technology is expected to level off to 3.3%, while no growth is projected in marketing and advertising expenditures (figure 9).

Notwithstanding the extra caution of companies towards business spending, hiring and acquisitions…

…capital investments and R&D expenditures are expected to increase in the next twelve months

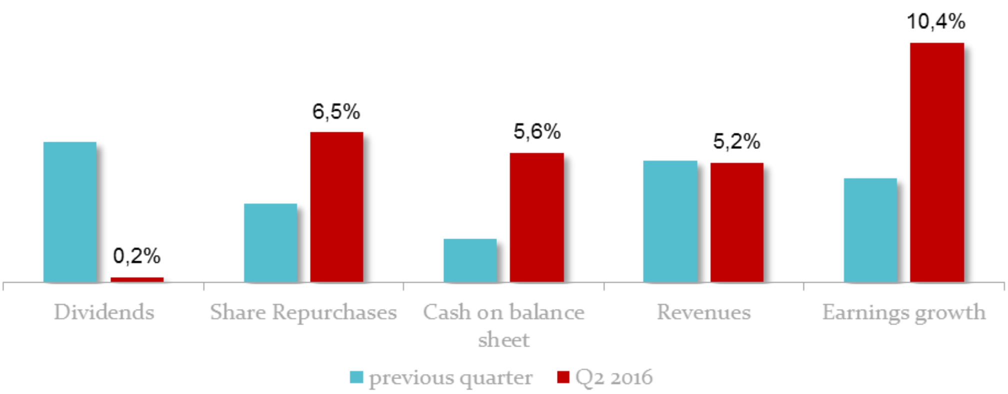
Figure 9. CFOs' expected growth in business spending for next 12 months



Substantial improvements in balance sheet and P&L is expected by CFOs from public companies. During the next twelve months, they anticipate increases in revenues and earnings by 5.2% and 10.4% respectively. Also, the cash positions are expected to improve during the next twelve months (figure 10).

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

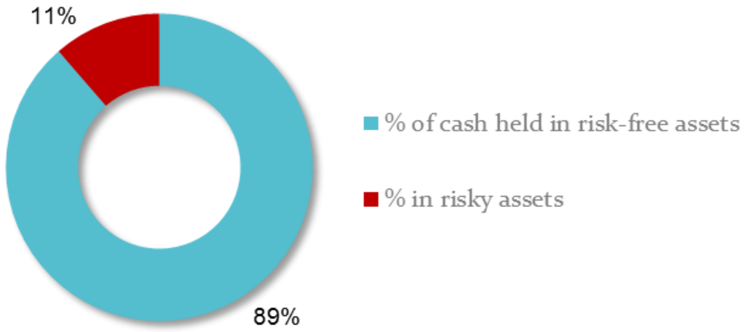
Public firms are expected to increase revenues and earnings, and their cash positions



Companies hold more cash today than they did one year ago…

About one third of the companies indicate to hold more cash and marketable securities today compared to one year ago, with most of these reserves held in risk-free assets (figure 11). On average, companies hold about 18.4% of cash and marketable securities as a percentage of total assets.

Figure 11. What portion of your balance sheet cash is held in risk-free versus risky assets?

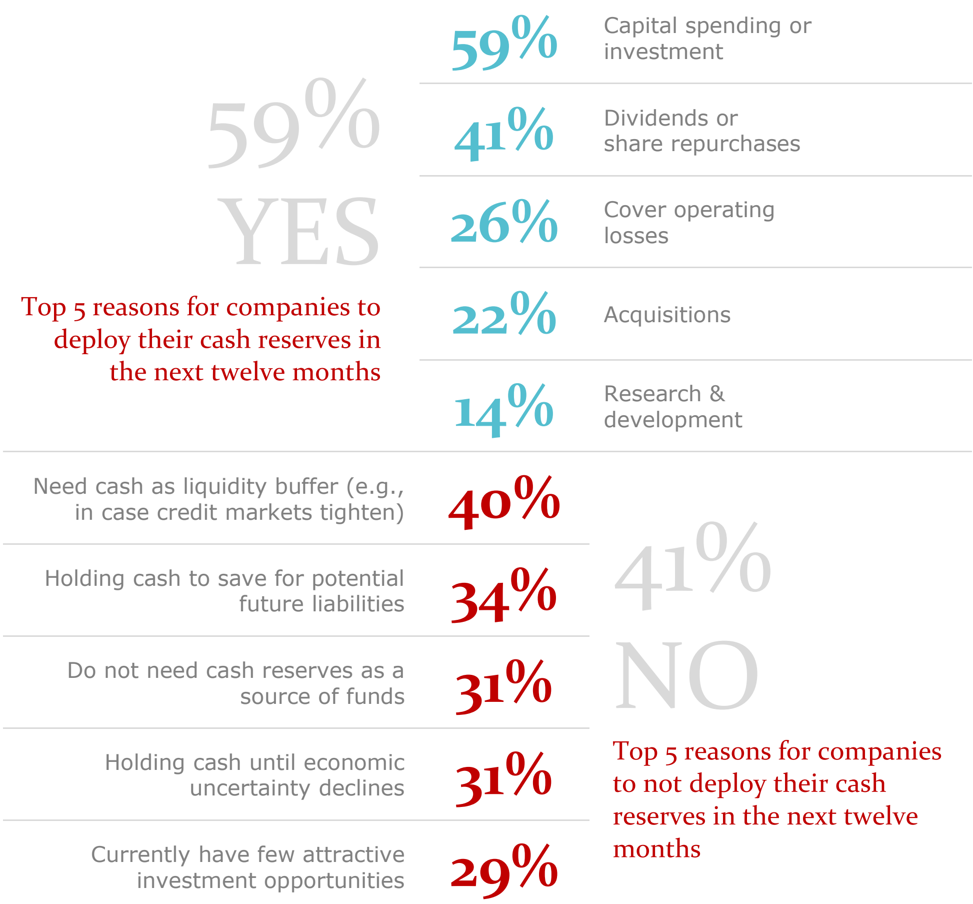


…enabling them to deploy cash reserves during the next twelve months…

During the next twelve months, approximately 60% of the companies expects to deploy their cash reserves, with capital spending and investments topping the list of priorities. Companies that have no intention of deploying their capital reserves, state that they need sufficient liquidity buffers in case of tight credit markets and potential future liabilities (figure 12).

…with capital spending and investments being a top priority

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

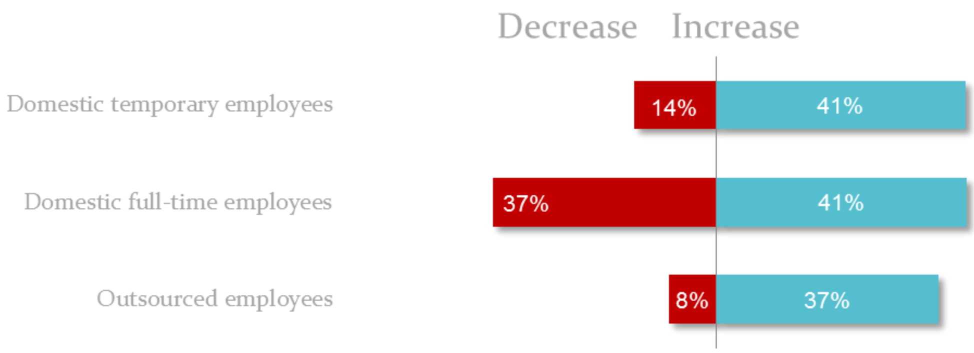


Employment

Employment figures are expected to improve considerably during the next twelve months. Approximately 40% of the companies believe that they will step up hiring for both temporary and fulltime employment (figure 12). Also outsourcing is believed to witness substantial increases during the next twelve months.

Companies are expected to beef up hiring during the next twelve months…

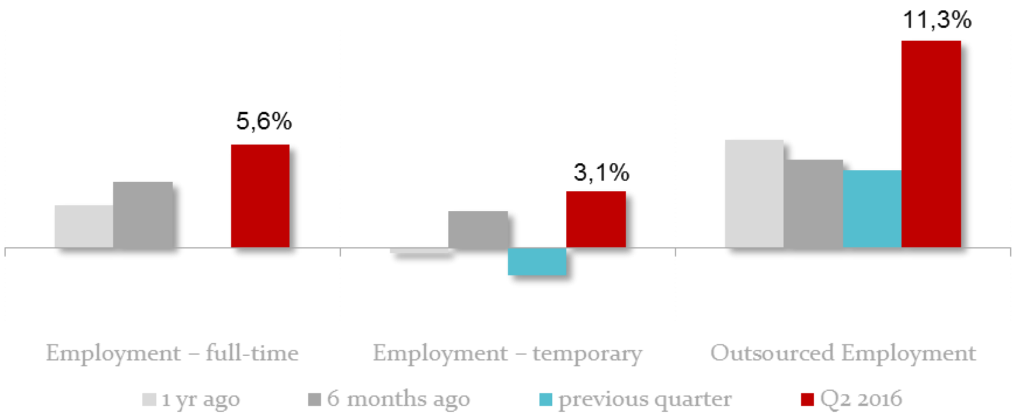
Figure 13. Relative to the previous twelve months, do you expect a positive (increase) or negative (decrease) change in the next twelve months for…?



Companies intend to step up productivity in the next twelve months at an average growth rate of 11%. More importantly, CFOs also anticipate recovery in employment. In contrast to the flat growth of the previous quarter, an increase of 6% in fulltime (permanent) contracts is now anticipated. European CFOs also point out that they expect to see significant improvement in temporary contracts, at an average growth rate of 3%. With an expected growth of no less than 11%, outsourcing could well provide the biggest positive surprise during the coming twelve months (figure 14).

…with substantial improvement in fulltime employment contracts, and outsourcing of employment potentially experiencing a significant hike

Figure 14. European CFOs expected growth for next 12 months in employee mix

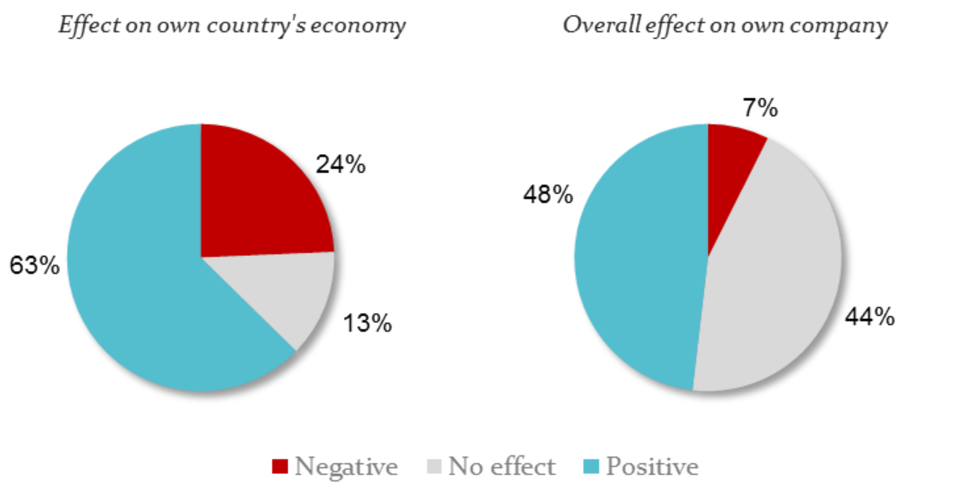


Next to the recent Brexit vote, the pending Trans-Atlantic Trade and Investment Partnership (TTIP) has flared up discussions about trade alliances, and in particular the added value that they may or may not bring.

In general, trade alliances are believed to contribute in a positive way…

…at both country and company level…

Figure 15. How do you think trade alliances between countries affect the economy of your country and your own company overall?



…potentially leading to additional jobs

Nearly two thirds of the European financial directors believe that in general, trade alliances contribute in a positive way to their own country's economy. Almost half of the CFOs are of the opinion that such partnerships are beneficial to the (financial) performance of their respective companies (figure 15). According to 30% of the respondents, trade alliances even create additional jobs at their respective companies.

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	33.6%	26.7%	31.1%	34.8%	42.5%
Less optimistic	29.7%	35.9%	43.7%	58.9%	43.1%
No change	36.7%	37.5%	25.2%	6.3%	14.4%
Own country optimism level	**55.3**	**59.4**	**52.9**	**47.4**	**58.7**
About own company					
More optimistic	34.9%	40.7%	33.6%	50.9%	44.7%
Less optimistic	31.8%	28.6%	31.3%	29.1%	32.2%
No change	33.3%	30.7%	35.1%	20.0%	23.0%
Own company optimism level	**58.6**	**66.3**	**61.2**	**62.1**	**62.8**
Business spending					
Capital spending	6.5%	1.1%	1.8%	4.0%	6.5%
Technology spending	3.3%	3.7%	4.2%	5.6%	9.3%
R&D spending	7.0%	1.8%	0.5%	0.8%	9.3%
Advertising and marketing spending	0.2%	3.0%	-0.1%	4.4%	7.3%
Employment					
Employment – full-time	5.6%	1.7%	-1.6%	-2.5%	0.8%
Employment – temporary	3.1%	1.6%	-2.5%	-0.7%	4.0%
Outsourced Employment	11.3%	1.5%	1.1%	-3.3%	3.4%
Wages and Salaries	1.7%	3.2%	5.7%	6.3%	7.0%
Health Care Costs	1.5%	7.0%	5.1%	8.3%	4.1%
Balance Sheet & P&L					
Productivity	11.2%	2.3%	4.7%	3.7%	4.6%
Inflation (own-firm products)	1.8%	1.5%	3.6%	5.0%	3.9%
Revenue growth	5.2%	4.8%	3.8%	10.5%	7.2%
Earnings growth*	10.4%	4.3%	0.7%	0.4%	13.2%
Dividends*	0.2%	3.0%	0.2%	3.5%	10.5%
Share Repurchases*	6.5%	3.0%	0.0%	0.4%	0%
Cash on balance sheet*	5.6%	1.2%	-3.6%	4.6%	9.4%
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 second quarter of 2016. The survey concluded June 3, 2016. Every quarter, CFOs in Europe, the US, Latin America, Asia (and China), and Africa are questioned about their economic expectations. Current quarterly records go back more than 20 years. The CFO Survey is conducted jointly by TIAS School for Business and Society (Tilburg, Netherlands), Duke University (Durham, North Carolina), 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

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