

CFO Survey Europe – Quarterly Report



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In association with:
Eindhoven University of Technology



Q4 2013

- *Outlook for 2014: A Bright Year Ahead of us*
- *Positive Sentiment About Industry and Business Conditions*
- *Half of European CFOs More Optimistic About Financial Prospects of Firm in 2014*

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Introduction

Optimists outnumber pessimists in Europe

High expectations on sector performance could induce higher company valuations.

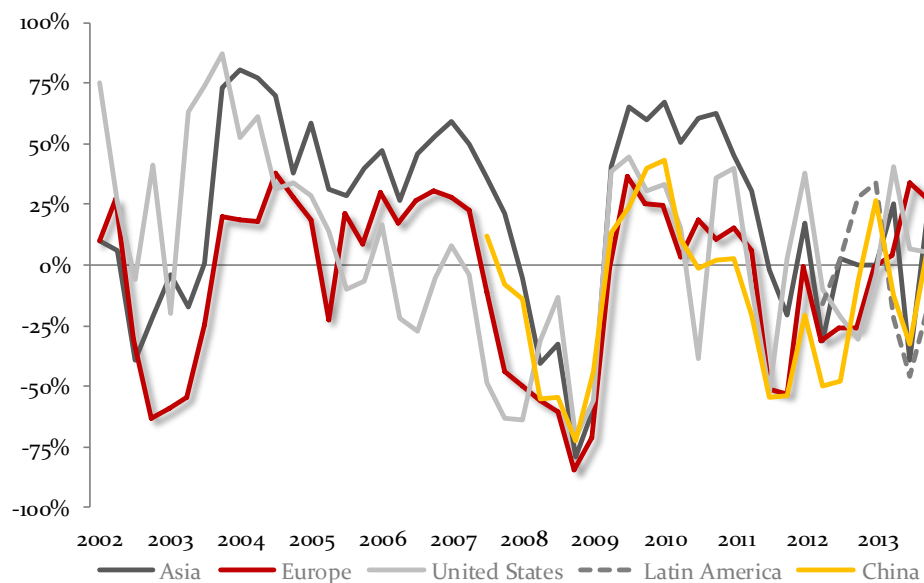
Q4 of 2013 signals a bright year ahead of us. 45% of the European financial executives are more optimistic about the macro economy next year. This positive sentiment is pervasive and translates to optimism on both sector and firm level. Though about half of the European CFOs indicate that economic conditions for their industry as a whole have deteriorated to some extent during 2013, almost 50% also believe that industry conditions will actually improve in 2014.

As one out of five financial directors also predicts that their sector will outperform the overall stock market, the anticipated uptick in 2014 could be substantial. According to more than a quarter of the executives, we should also expect to see increases in the average purchase price for target companies in their particular industry.

On a company level we observe similar encouraging indicators that point towards a favorable year ahead of us. More than half of the CFOs believe that business conditions for their firms will improve in 2014, relative to somewhat weak conditions in 2013. This adds to the confidence that European CFOs have in the performance of their own company during the next twelve months.

No less than 49% of the financial executives are more optimistic about the financial outlook of their own company, a level not observed since 2010. Financial executives expect to spend more on Technology, R&D, and Advertising & Marketing.

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

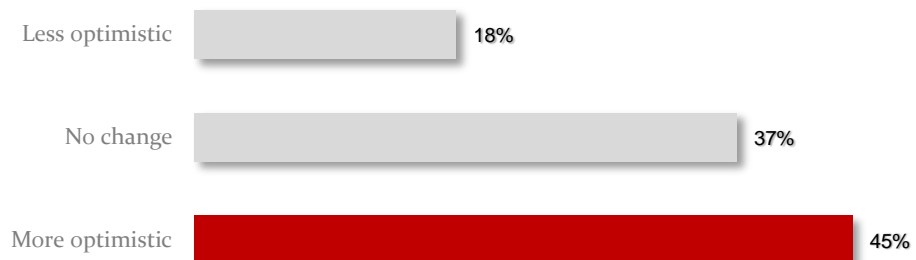


CFO optimism & sentiment

During the fourth quarter of 2013, economic sentiment among European CFOs has continued its upward trend of previous quarters; the average optimism level has inched upwards to 56.4 (up from 55.7 in Q3). With 45% of the financial directors having a more optimistic outlook, and only about 18% being less optimistic, overall economic confidence remains positive in Europe (figure 2).

Upward trend in European optimism continues in Q4

Figure 2. European CFO sentiment regarding economy of own country

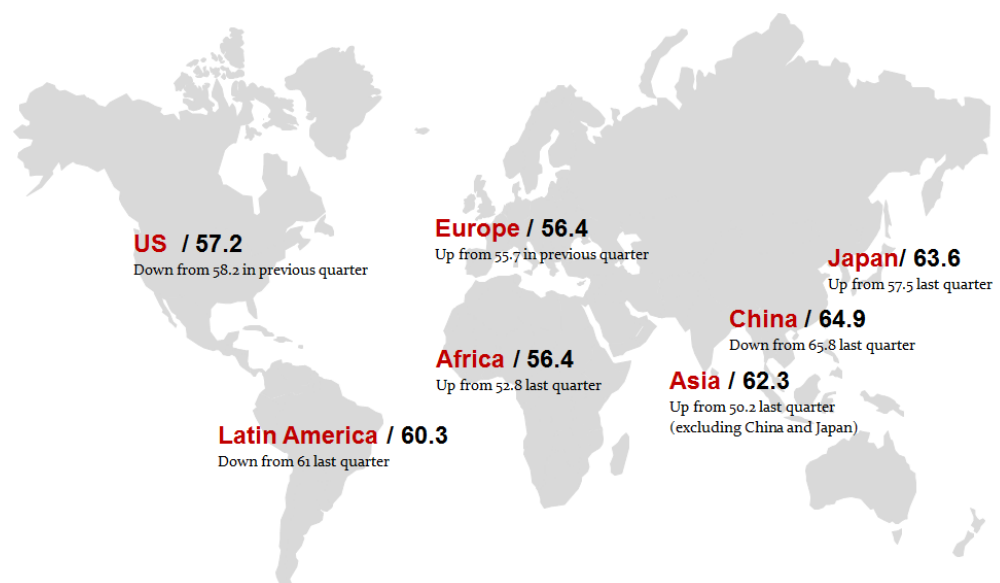


In other parts of the world we observe similar positive trends. We see substantial improvement in economic sentiment among financial executives in emerging regions; the number of optimists has increased to 47% in Asia (up from 22%) and 27% in Latin America (up from 14%). In the US however, sentiment about the economy remains moderate, with one third of the CFOs being more optimistic and almost one third being less optimistic.

This has translated into significant improvements in the average optimism levels for the Asian region (excluding China and Japan), Africa, and Japan (figure 3).

Figure 3. Optimism level about the own country and/or region's economy

...though optimism level in Europe still remains at lower end compared to rest of the world.



Whereas China and the Latin American region have witnessed a slight decline in average optimism level, they still remain among the strongest regions with most favorable economic outlooks:

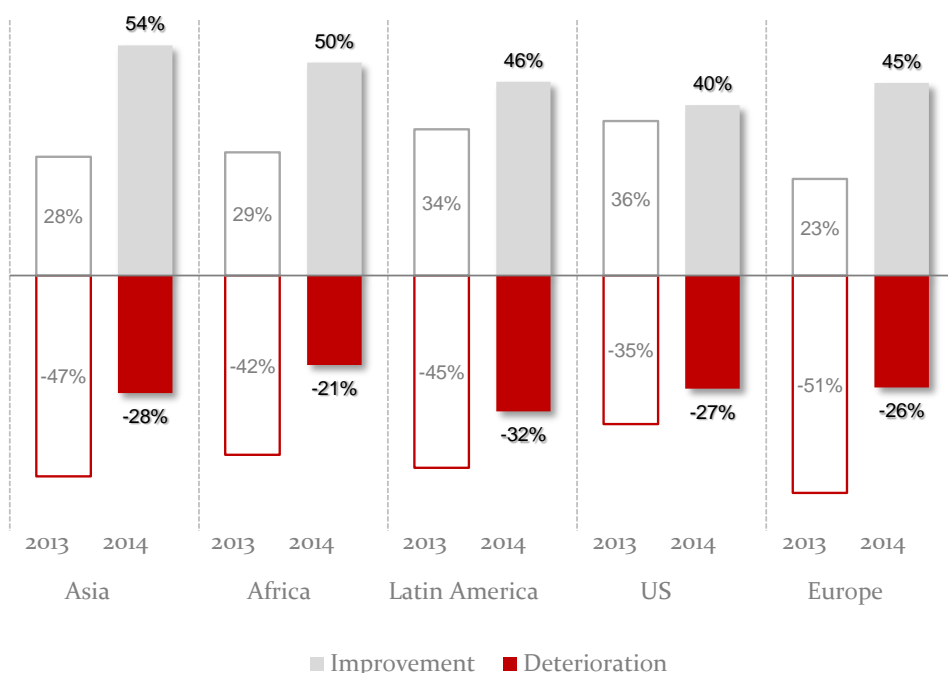
- The optimism level on the African continent reaches 56 on a scale of 100 during the fourth quarter (up from 52 in Q3).
- Latin American CFOs rate the economic outlook at 60 (down from 61 during previous quarter)
- The US optimism level has dropped slightly in Q4, to 57 (down from 58 during Q3)
- Optimism in Asia has witnessed the most impressive improvement from 50 on a scale of 100 during last quarter to more than 62 in this fourth quarter.
- Although down from previous quarter, China continues to take the lead over other regions with optimism level at 65 this quarter.

Compared to other world regions, the average European optimism level is at the lower end. This could be attributed to several factors; for example, about half of the European CFOs indicate that economic conditions for their industry as a whole have deteriorated to some extent during 2013. More than 20% of the financial executives indicate that they have witnessed an increase in their company's bad debt compared to 2012. Bad debts have increased to 4.7% of sales on average (measured as the unpaid and uncollectible portion of accounts receivables as a percentage of sales). Another 32% believes that counterparty default risk could increase to some extent during 2014.

But industry conditions in Europe are widely believed to improve in 2014

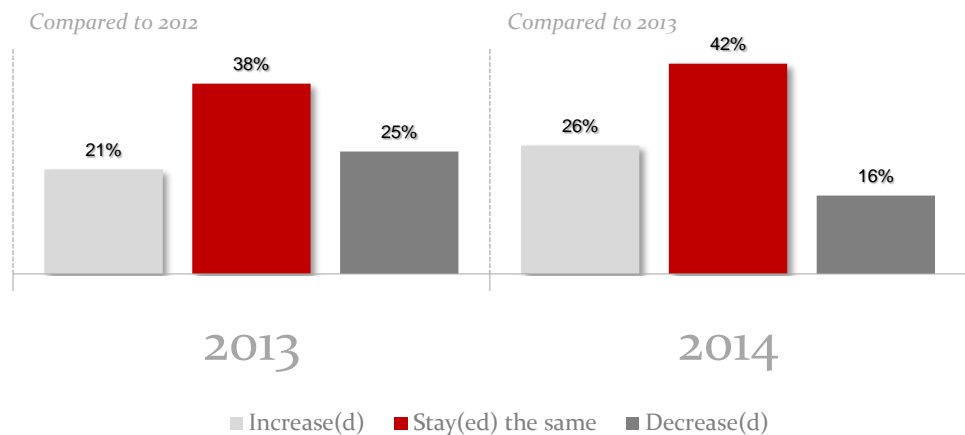
Nevertheless, sentiment in Europe is positive, pervasive and translates to optimism on both sector and firm level. 45% of the financial executives in Europe believe that industry conditions will improve in 2014 (figure 4).

Figure 4. Have economic conditions for your industry changed in 2013, and do you expect any change for 2014?



As approximately 22% of the European CFOs also believe that the industry or sector they operate in will actually outperform the overall stock market next year, the anticipated uptick in 2014 could be substantial. This may very well explain why more than a quarter of the executives also expect to see increases in the average purchase price for target companies in their particular industry (figure 5).

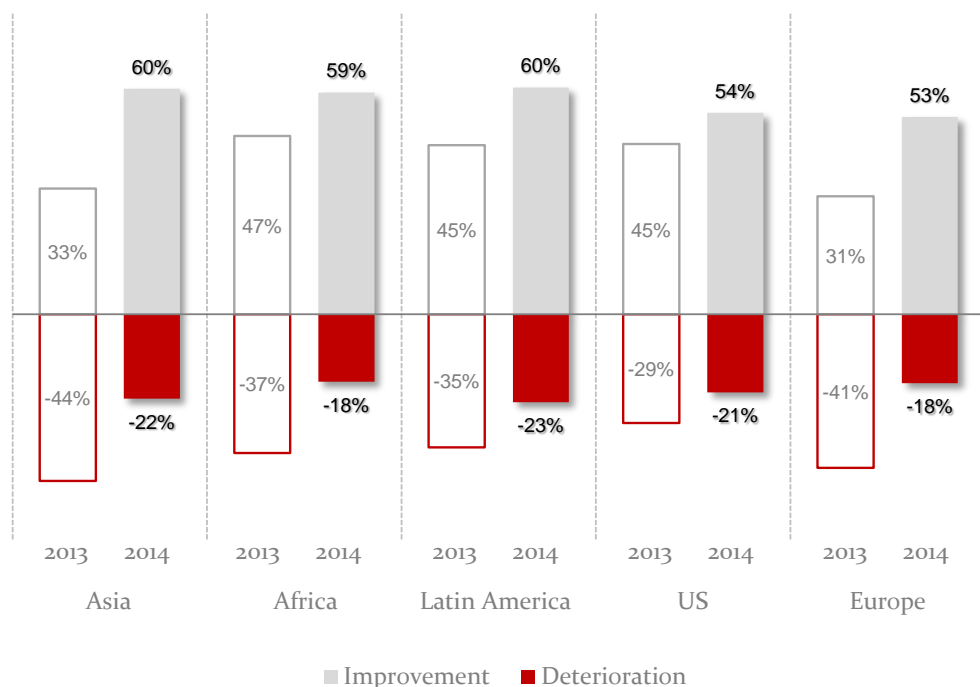
Figure 5. How have purchase prices for companies in your specific industry developed during 2013, and what are your expectations for 2014?



...and business conditions on firm level are also expected to improve

At company level we notice similar encouraging indicators that point towards a favorable year ahead of us. More than half of the CFOs believe that business conditions for their firms will improve in 2014 (figure 6).

Figure 6. Have economic conditions for your company changed in 2013, and do you expect any change for 2014?



This adds to the confidence that European CFOs have in the (financial) performance of their own company during the next twelve months. No less than 49% of the financial executives are more optimistic about the financial outlook of their own company, a level not observed since 2010.

Additionally, figure 7 also shows that the number of pessimists has decreased to 16% during this fourth quarter, whereas only a year ago more than 28% of the European CFOs were pessimistic. This further indicates that a significant improvement in sentiment is taking place.

Figure 7. European CFO sentiment regarding financial prospects of own company



Although the number of optimists has increased significantly, and the number of pessimists has decreased substantially, this has not yet translated into a further improvement in confidence in company performance relative to the previous quarter. In fact, the average optimism level among European financial directors about their own company has slightly decreased to 62 on a scale of 100 (compared to 64 during Q3).

...but internal concerns possibly inhibit a spike in optimism level

This is reflected by the concerns that European CFOs have regarding company performance; next to the more traditional concerns internal to the company (e.g. maintaining margins, forecasting results, and working capital management), CFOs now also mention balance sheet weakness as a main concern (table 1).

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 budget deficit	➤ Balance sheet weakness

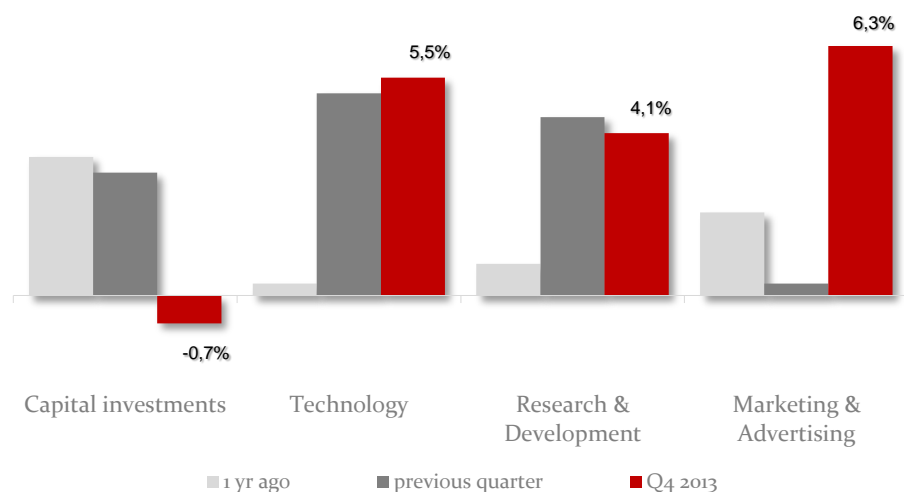
Finance & capital

Spending on Marketing & Advertising expected to pick up pace again in 2014

European CFOs indicate that business spending is likely to increase during the next twelve months. Almost 60% indicates to increase spending Marketing & Advertising, while more than 70% expect increased spending on Technology, and Research & Development.

- Capital spending and investments for the next twelve months are expected to decrease at an average of 0.7% compared to an increase of 3.1% in previous quarter.
- Technology spending continues its upward trend, and is expected to increase at 5.5% during the next twelve months (up from 5.1% in Q3).
- Spending on R&D roughly maintains the level of previous quarter and is expected to increase during the next twelve months at an average rate of 4.1%.
- Marketing and advertising expenditures are expected to improve substantially during the next twelve months as the anticipated growth rate is up from 0.3% in Q3 to 6.3% this quarter.

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



Signaling a strategic shift from improving competitive strength...

Throughout 2013 capital spending has been moderate but positive. This fourth quarter however, CFOs in Europe actually indicate that capital spending will slightly decrease during the next twelve months, whereas business spending on Technology, R&D, and Advertising & Marketing is expected to increase (figure 8). This shift may indicate that during 2013, companies have focused predominantly on improving their competitive strength by acquiring new, or upgrading existing, assets. Manufacturing data and data on the average return-on-assets provide evidence of this (table 2).

For instance, financial directors at manufacturing companies in Europe indicate that they have utilized their production capacity at an average rate of 75% during the first quarter, while they realized a ratio of 83% during the first half of 2013. For the next twelve months, 77% of the financial directors anticipate productivity increases (output per hour),

and whereas the return-on-assets was about 7% in 2013, European CFOs expect to realize an average return on assets of 9% in 2014.

...towards
capitalizing on
competitive strength

In anticipation of more favorable market conditions next year, companies seem to prefer directing financial resources towards the development and marketing of products and services. Such strategy would allow companies to position and prepare themselves for when consumer demand finally starts to pick up pace again.

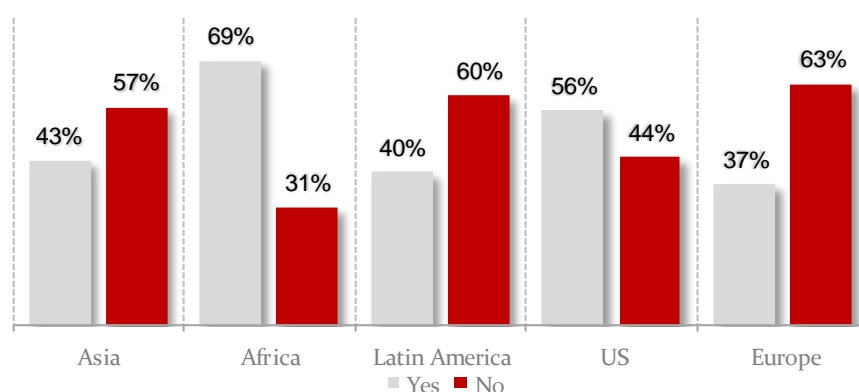
Table 2. Manufacturing capacity utilization and Return on assets (ROA)

	Asia	Africa	Latin America	US	Europe
<i>Capacity utilization for manufacturing companies</i>					
<i>Asked in Q3</i>					
Capacity utilized Q1 2013	68%	79%	74%	75%	75%
Planned capacity utilization for the remainder of 2013	72%	80%	76%	78%	79%
<i>Asked in Q4</i>					
Capacity utilized H1 2013	71%	73%	76%	75%	83%
Planned capacity utilization for the remainder of 2013	70%	80%	81%	76%	78%
<i>Return-on-Assets(ROA)</i>					
Approximate ROA in 2013	10,3%	10,8%	7,0%	9,2%	7,1%
Expected ROA in 2014	12,0%	17,9%	8,9%	11,2%	9,0%

The survey also provides new information on donations that companies make to charities. 37% of European companies have a corporate budget for charitable donations (figure 9).

Figure 9. Does your company have a corporate budget for charitable donations?

European companies
trail rest-of-world in
terms of charitable
donations



This represents a moderate decline, with about 4% of companies having terminated charitable donations, mainly due to a profits squeeze.

charitable donations: Did you ever have a corporate budget for charitable donations?

	Asia	Africa	Latin America	US	Europe
Yes	8%	20%	12%	13%	6%
No	92%	80%	88%	87%	94%

But donations are hardly affected by the recent crisis

Among firms that do participate in charitable giving, about one third have increased giving over the past five years. During 2013, 58% of the European companies have maintained their corporate budget for charitable donation, while another 25% have actually increased their budget for charities. This indicates that the crisis has had little to no effect on corporate charitable spending patterns in Europe.

Table 4. Companies that have a budget for charitable donations: Are you considering reducing the budget in the future?

	Asia	Africa	Latin America	US	Europe
Yes	6%	8%	5%	14%	10%
No	53%	50%	67%	58%	65%
Not sure	41%	42%	28%	28%	25%

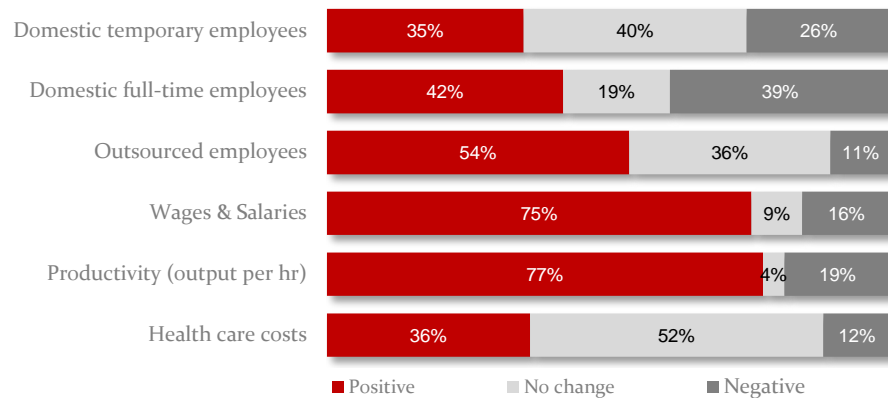
Table 3. Companies that do
not have a budget for

Employment

Employment conditions remain weak during the next 12 months...

European employment conditions remain weak in this fourth quarter; just over 40% of the companies expect to increase hiring of full time employees, while only 35% expect to increase hiring part-time employees. On the other end of the spectrum, about one out of four companies expect to cut back on part-time hiring and almost 40% expect to terminate full time contracts.

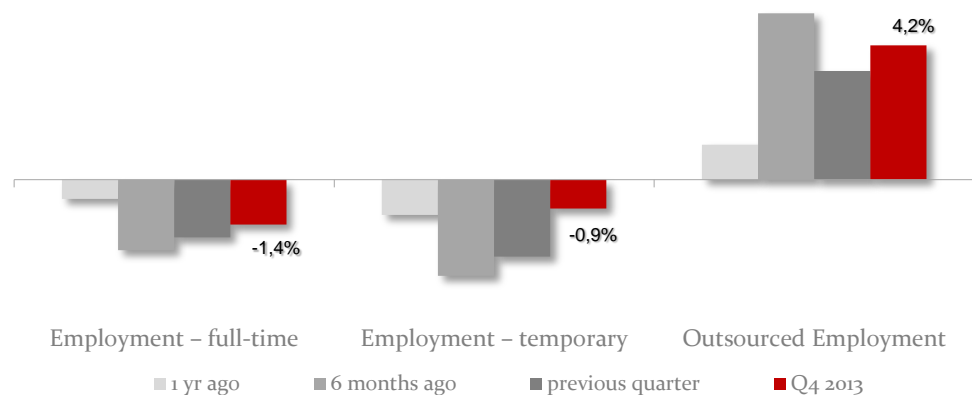
Figure . Relative to the previous 12 months, do you expect a positive or a negative change for your company in the following items?



The bleak employment outlook for the next twelve months translates into an expected contraction of 1.4% for full time employment and an expected decline of 0.9% in temporary employment contracts. To make up for this loss and still be able to achieve part of the anticipated productivity increases, companies are likely to resort to outsourced employment. For the next twelve months, outsourced employment is expected to increase with 4.2% (figure 11).

...translating into further contraction of full time and part-time employment

Figure 11. 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	45%	33.3%	26.8%	20.5%	47.0%
Less optimistic	17.9%	28.0%	44.5%	51.3%	29.8%
No change	37.1%	38.8%	28.8%	28.2%	23.2%
Own country optimism level	56.4	57.2	60.3	56.4	63.1
About own company					
More optimistic	48.9%	38.5%	48.9%	69.2%	51.2%
Less optimistic	16.3%	27.2%	21.1%	10.3%	28.6%
No change	34.8%	34.3%	30%	20.5%	20.2%
Own company optimism level	62.3	65.5	69.8	72.3	64.3
Business spending					
Capital spending	-0.7%	7.3%	5.8%	20.6% (Median=5%)	4.6%
Technology spending	5.5%	5.6%	6.7%	13.5%	9.1%
R&D spending	4.1%	2.3%	2.9%	9.9%	3.4%
Advertising and marketing spending	6.3%	4.1%	3.6%	10.9%	5.1%
Employment					
Employment – full-time	-1.4%	1.4%	3.4%	5.2%	1.9%
Employment – temporary	-0.9%	1.6%	1.4%	3.9%	-1.6%
Outsourced Employment	4.2%	3.2%	1.9%	4.7%	1.1%
Wages and Salaries	2.2%	2.7%	7.1%	10.7%	5.9%
Health Care Costs	0.4%	10.2%	5.3%	7.4%	2.4%
Balance Sheet & P&L					
Productivity	1.7%	3.1%	2.8%	3.7%	3.0%
Inflation (own-firm products)	-1.6%	2.0%	1.9%	6.0%	-0.2%
Revenue growth	2.8%	6.8%	8.3%	16.7%	7.6%
Earnings growth*	2.3%	14.3%	8.5%	19.2%	7.0%
Dividends*	1.3%	11.2%	6.6%	10.8% (Median=10%)	6.9%
Share Repurchases*	10.5%	5.4%	1.4%	0%	-0.4%
Cash on balance sheet*	4.1%	7.4%	-1.2%	27.8% (Median=0%)	1.2%
Mergers and Acquisitions	Not asked in Q4	Not asked in Q4	Not asked in Q4	Not asked in Q4	Not asked in Q4

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 2013. The survey concluded December 5, 2013. Every quarter, CFOs in Europe, the US, Asia and China are questioned about their economic expectations. Current records go back 71 quarters. The CFO Survey is conducted jointly by TiasNimbas Business School (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. Rian van Heur, TiasNimbas Business School, tel.+31-(0)-134668637 or e-mail m.j.vanheur@tiasnimbas.edu

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