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ACCOUNTING

Financial Execs More Optimistic on Long-Term Growth

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Financial executives are increasingly optimistic in the long term prospects of their businesses, according to a new survey.

The second quarter (Q2 2016) Deloitte *CFO Signals* survey shows a marked rebound of chief financial officers' confidence in their companies' longer-term prospects, likely in response to equity markets improving substantially since the first quarter of 2016. CFOs are significantly more optimistic, as the survey recorded a net optimism reading of +30.0, representing the 14th consecutive quarter of positive net optimism and a sharp reversal from last quarter's reading of +1.7.

The percentage of the 140 CFOs surveyed who express rising optimism rose from 33 percent to 49 percent, while those expressing declining optimism fell from 31 percent to 19 percent quarter-over-quarter. Sentiment is net-positive across all industries, with CFOs in both the Manufacturing and Energy/Resources industries significantly more optimistic than they were last quarter. The survey was completed prior to the recent British referendum to leave the European Union, aka, Brexit.

Four business outlook metrics tracked by the *CFO Signals* survey for 25 consecutive quarters —CFO expectations for growth in revenue, earnings, capital spending and domestic hiring — rebounded from multiple survey lows last quarter, but the gains for some metrics were modest. Revenue growth expectations, for example, rose to 4.0 percent from 3.3 percent from last quarter; earnings growth expectations rose to 7.7 percent from last quarter's survey low of 6.0 percent; and domestic hiring growth expectations rose to 1.1 percent up from a survey low of 0.6 percent last quarter. Capital spending expectations, however, rebounded sharply to 5.4 percent from a survey low of 1.7 percent last quarter. Meanwhile, dividend growth expectations fell to 2.9 percent — a new survey low — from 4.0 percent last quarter.

"This quarter, our survey shows CFOs' sentiment rebounded significantly after a rapid and decisive downturn in equity markets last quarter likely weighed on their thinking. Since then, the equity markets have recovered, and CFOs seem to have responded in kind," said Sanford Cockrell III, national managing partner of the U.S. CFO Program, Deloitte LLP. "However, it's also important to note that all four business outlook measures are down when compared with long-term survey averages, which could indicate potential substantial headwinds for some companies such as the potential effects of oil and commodity prices, as well as concern over a U.S. economic pullback."

Each quarter, CFOs are asked which risks they regard as most worrisome. This quarter, the top five external risks cited were: 1) oil/commodity prices, 2) U.S. economy pullback, 3) new/burdensome regulation, 4) the upcoming election/political uncertainty in the U.S., and 5) global growth/recession/volatility and capital markets liquidity/stability (tied for fifth place). In line with these concerns, assessments of the North American economy are only slightly better than they were last quarter, with 40 percent of CFOs describing it as good or very good compared with 41 percent last quarter.

CFO confidence in Europe remains weak, with only 6 percent of CFOs describing that economy as good compared with 5 percent last quarter, and perceptions of China's economy remain pessimistic — only 9 percent describe it as good or very good, the same as the last quarter. Also like last quarter, the top internal risks are talent-related: retaining key employees and securing qualified talent.

Likely in response to U.S. equity markets bouncing back strongly between the first and second quarters, 56 percent of CFOs once again regard U.S. equity markets as overvalued, up from just 30 percent last quarter. Eighty percent of CFOs say debt is

currently an attractive financing option, up from 68 percent last quarter and back in line with levels from late 2015, and 30 percent of public company CFOs say equity financing is attractive (up from 22 percent last quarter).

In terms of business focus, nearly 60 percent of surveyed CFOs say they are biased toward revenue growth, the highest level in more than a year, and 53 percent have a strong bias toward investing cash over returning it to shareholders.

"Last quarter, CFOs voiced very strong concerns about the impact of volatile equity markets and unfavorable economic news on financial market liquidity and customer demand," said Greg Dickinson, director, Deloitte LLP, who leads the North American *CFO Signals* survey. "While it is encouraging that CFOs' sentiment regarding their companies' prospects rose sharply this quarter, it is important to note that the survey's net optimism measure is relative and not absolute — meaning that sentiment is a lot better than it was last quarter, but is not necessarily good compared to longer time frames."

In the fourth quarter of 2010 and again this quarter, CFOs were asked about their own working styles and those of their CEOs based on Business Chemistry, a proprietary personality system designed for use in a business context which draws upon the latest analytics technologies to reveal four scientifically-based patterns of behavior: Pioneers, who like variety, possibilities and generating new ideas; Drivers, who like logic, systems and a laser focus on goals; Guardians, who like concrete details and stability; and Integrators, who like personal connection and seeing how the pieces fit together.

Sixty percent of CFOs consider themselves Drivers, well above 51 percent in 2010, and Integrators increased from 11 percent to 19 percent. Guardians, which were the second-most prevalent in Q4 2010 at 29 percent, fell by nearly half to 16 percent. About 35 percent of CFOs consider their CEOs to be Pioneers, up slightly from 33 percent in 2010, while Driver CEOs declined slightly from 34 percent to about 33 percent.

Based on these responses, Pioneer/Driver and Driver/Driver pairings are expected to be the most common, followed by Integrator/Driver. As expected, Pioneer/Driver (CEO/CFO) pairings are the most common, accounting for 22 percent of all pairings. Driver/Driver pairings, however, are less common than expected (14 percent actual versus 20 percent expected), while Integrator/Driver pairings are more common than expected (16 percent actual versus 12 percent expected) and twice as common as they were in Q4 2010. As was the case in 2010, some CEO/CFO pairings appear more

common than random pairing would predict — suggesting some pairings may be more effective than others. The survey also provides new insights into how CFOs adapt to their CEO's style and also about the CEO types with whom CFOs believe they work best.

Deloitte's second quarter *CFO Signals* survey also provides CFOs' responses on what roles they are playing in the current business environment, the scope of CFOs' direct and indirect functional responsibility, the structure of their finance functions, outcomes of operating model delivery and more. To download a copy of the survey, please visit: http://www.deloitte.com/us/cfosignals2016Q2

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