Americas
CFO: need to know
Insights for CFOs

Optimism slips among finance executives
Insights for CFOs

Key findings

▷ 67% of CFOs say the US economy is improving, down from 82% at the end of 2013.

▷ About two-thirds of CFOs are either highly concerned or concerned about a cyberattack.

▷ CFOs rank weakening consumer demand as their largest external risk factor.

▷ The market for deals is improving: 61% of CFOs say deal activity is in line with historical averages, versus 70% who say activity was below said average at the end of 2013.
“Savvy CFOs are taking this time to elevate their growth agenda”

CFOs continue to be optimistic about the US economy, but less so than at the end of 2013, according to the latest CNBC Global CFO Council poll, which is sponsored exclusively by EY. New data show that 67% of CFOs think the economy is improving, compared to 82% who felt this way at the end of last year.

Why the decline in confidence? The lingering effects of a lackluster holiday season could be partly to blame: CFOs rank weakening consumer demand as their top external risk factor, ahead of US fiscal policy and emerging market economies. Recent regional crises also serve to remind us that geopolitical risks are always a concern for finance executives, who need to expect the unexpected.

However, CFOs appear to be encouraged by two positive developments in Washington: the raising of the debt ceiling and the confirmation of Janet Yellen to lead the Federal Reserve. In fact, CFOs say that monetary policy and the debt ceiling no longer rank among their top 10 external risk factors, a marked change since last quarter.

Savvy CEOs are taking this time to elevate their growth agenda. More of them are now seeking both organic and inorganic growth opportunities, and they are more confident in the market for deals. In the latest poll, 61% of CFOs say M&A activity is in line with historical averages – a significant improvement from December, when 70% reported below-average deal volume. For example, we are seeing many companies, including pharmaceuticals, life sciences and biotechnology, strategically repositioning themselves for growth.

Companies that aren’t looking to acquire can still power transformational change through cost cutting and rationalization. CFOs need to ensure all company divisions are fit for purpose and fit for the future. By doing so, this enables them to invest in growth where it makes most sense – and possibly divest where it doesn’t.

Indeed, this is a demanding time for CFOs, who need to drive efficiency in the present while keeping an eye out for future growth opportunities.

A note from Tom McGrath
EY Americas Senior Vice Chair – Accounts
Only modest GDP growth expected

In the first quarter of 2014, CFOs’ views of the health of the US economy regressed from the previous quarter. Two-thirds of CFOs see the economy modestly or strongly improving. At the end of 2013, 82% of CFOs said economic conditions were on the upswing.

Optimism in GDP projections is similarly moderate. CFOs expect GDP growth to remain stable in most of the world, with modest improvements in North America, Africa and parts of the Middle East. Overall, roughly 45% of CFOs say the global economy is moving in the right direction, while 40% say it is merely stable.

This mostly positive sentiment also aligns with the latest EY CFO Capital Confidence Barometer.

Our periodic survey of senior executives from large global companies, conducted by the Economist Intelligence Unit, also shows reasons for cautious optimism. Sixty percent of CFOs surveyed see improvement in the global economy.

However, there seems to be some uncertainty about how this growth will actually translate into improvement in specific components of the economy. When CNBC asked CFOs to rate the health of 10 different economic conditions, they reported that only four of them appear strong: cost of debt, credit availability, corporate earnings and stock market valuations. The rest were seen as stable. (See accompanying chart on page 5.)
Q: What is your perspective on the overall US economy today?

Q: Your current expectations for US GDP growth in 2014?

Q: Rate the health of the following US economic conditions

76% of CFOs feel that the US economy is modestly improving.
Confidence in economy takes a step back, cont’d.

Cost cuts, customer retention are priorities

As CFOs are cautiously optimistic about the US economy, they are becoming more buoyant about the fortunes of their own organizations. More than 70% expect their earnings per share to rise in the first quarter of 2014, indicating their rising prospects for profitability. Similarly, the latest EY CFO Capital Confidence Barometer shows that 55% of finance executives say their companies are focused on growth, the highest figure since October 2011.

CFOs say that two of their most important sources of growth are cost reduction and retaining existing customers. Perhaps this reflects the relatively risk-averse nature of many finance executives. But this also surfaces the question: How sustainable is growth via cost cutting and customer retention? In contrast, fewer CFOs cited as priorities dynamic, potentially game-changing growth strategies – growth strategies like emerging markets investments, opening new lines of business and M&A.

“CFOs do tend to be more conservative than their C-level counterparts,” says McGrath. “Running a corporation is a team sport. And CFOs usually play a key balancing role.”

Aside from moderate improvement in the US, CFOs see stability, not economic growth, on the world stage in 2014.
Q: What is your view of your firm’s EPS growth in Q1 2014 vs. Q1 2013?

- Significant Decrease: 0%
- Modest Decrease: 55.6%
- Flat: 11.1%
- Modest Increase: 27.8%
- Significant Increase: 5.6%

Source: CNBC Global CFO Council survey/75% response rate

17.6% of CFOs see customer retention as their most important growth engine.

Q: Your firm’s most important source for growth in 2014?

- Cost education: 17.6%
- Mergers & Acquisitions: 11.8%
- New investment in emerging overseas markets: 17.6%
- New product launches: 17.6%
- Opening new lines of business: 5.9%
- Retaining existing customers: 17.6%
- Other: 23.5%

Source: CNBC Global CFO Council/68% response rate
Recovery hinges on consumer demand and government debt

Emerging market economies closely watched

Concerns about weakening consumer demand may be to blame for CFOs’ less optimistic economic outlook. Retail sales varied in 2013, with only modest holiday sales, and overall retail sales grew 4.2%, the smallest gain in four years, according to the U.S. Department of Commerce.

Washington’s moves are also seen as major risks. CFOs cited US fiscal policy as a primary concern. This despite the fact that for the first quarter of the government’s fiscal year the deficit was actually 40% smaller than it was in the first quarter one year ago. Federal Reserve policy – ranked the fourth-biggest risk factor in the last poll – no longer ranks in the top 10, as Janet Yellen has succeeded Ben Bernanke as Chair of the Federal Reserve with little debate or controversy.

CFOs still have strong opinions about what the Fed should do: 83% say it should not pause its plans to taper quantitative easing.

Viewpoint
Supply chain vital to efficiency and growth

The latest CNBC Global CFO Council poll, which is exclusively sponsored by EY, shows a somewhat conflicted economic outlook. On one hand, CFOs are less optimistic about the US economy than they were at the end of 2013, but two-thirds still see the economy as improving. When they are asked where corporate growth will stem from, their most popular responses are cost cutting and retaining existing customers.

But this strategy could prove troublesome. Cost reductions and customer retention may not be the best long-term drivers of growth. Should CFOs be looking more toward dynamic avenues, such as new markets?

Perhaps they can pursue all of these simultaneously by transforming their supply chain.

By working closely with their supply chain leaders, CFOs can help their organizations become more efficient and drive organic growth. Companies that have a CFO-supply chain business partnering model in place are more likely to report better EBITDA growth than those that don’t, according to a recent EY study, Partnering for performance: Part 1: the CFO and the supply chain.

“One area to target is procurement, where CFOs can look to the supply chain for capital optimization and cost savings,” says Brian Meadows, Americas Leader of Supply Chain and Operations at EY.

“It’s important for CFOs to understand that the supply chain is a critical component of overall business performance,” Meadows adds. “By working together, CFOs and supply chain leaders can drive efficiency and growth simultaneously.”
CFOs can also help “variabilize” the cost structure of the supply chain, i.e., make it more agile to adjust to demand. Ideally, a supply chain should be flexible enough so that assets are not sitting in inventory waiting for demand to catch up or that capacity is overextended by unexpected demand.

A CFO-supply chain partnership can drive growth when entering new markets. In particular, when organizations are moving into emerging markets, there are five essentials that need to be top of mind when it comes to their supply chain:

1. Focus on cities for manufacturing and distribution, especially in markets where urbanization is underway and where existing customers are located.
2. Concentrate on innovating existing products to serve local market needs, rather than creating entirely new products.
3. Work closely with local suppliers and partners to extend product ranges, rather than bring your own new concepts.
4. Invest in high-quality talent, including leadership that knows the local culture.
5. Expect costs to be significantly higher than projected, so think of these moves as part of a long-term strategy, not an opportunity for a quick win.
Critical issues at the board level

Carefulness still top of mind

Reflecting their cautious optimism in the economy, CFOs report that carefulness continues to be a critical issue at the board level. Risk management is the second-most important corporate governance issue, and cost controls are tied for third-most important. This trend has been consistent for months. In the most recent EY CFO Capital Confidence Barometer, financial executives saw a greater emphasis on risk management and efficiency/cost control among their boards. In fact, 73% of CFOs reported that their boards had a greater emphasis on risk management than they did 12 months prior.

“All CFOs are increasingly aware that they should be more involved in corporate governance discussions with their institutional shareholders, because these issues connect closely with a company’s performance and strategy. CFOs know these discussions can certainly influence the way shareholders vote.”

Allie Rutherford
Director, Center for Board Matters
Ernst & Young LLP

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Q: Rank, in order of priority, the following corporate governance issues:

- Overall Corporate Strategy
- Risk Management
- Cost Controls
- Industry Regulations
- Activist Investors
- Board Member Diversity
- External Auditor Transparency

SOURCE: CNBC GLOBAL CFO COUNCIL/68% RESPONSE RATE
Cybertattack anxiety escalates

Spending to improve cybersecurity

CFOs seem to be taking cybersecurity more seriously than ever, as high-profile attacks in recent months have put companies on the defensive. Cybersecurity ranks in the top five external risk factors cited by CFOs in the latest CNBC Global CFO Council poll.

About two-thirds of CFOs are either highly concerned or concerned about a cyberattack, and they’re responding aggressively. Three quarters of CFOs say that they will increase spending on cybersecurity in 2014.

These plans should also cover ways to detect an attempted cyberattack. For many companies, an attack is inevitable — so detection may be the best prevention. “The key to detection is executing a plan for monitoring transaction activity that leads to continual investigations to locate potential cyberattacks,” says Terry Jost, Partner and Advisory Risk Technologies Leader at Ernst & Young LLP. “CFOs should help lead and ensure such plans are manifested to provide the best mechanisms for protecting critical assets and manage cyber vulnerabilities.”

Viewpoint

Cyberthreat challenges are here to stay

Perhaps no other business issue has captured more headlines recently than cybersecurity. Heavily publicized attacks have garnered attention from the newsroom and the boardroom to living rooms around the world.

CFOs should not see cybersecurity as just a trend — Y2K bug, anyone? “This is not a short-term issue. This is here to stay,” says Terry Jost, Partner and Advisory Risk Technologies Leader at Ernst & Young LLP. “In fact, this is a challenge that is only going to accelerate and grow as the global economy becomes increasingly digital.”

In fact, Jost adds, CFOs can expect more policies designed to protect consumers in light of recent events.

CFOs are wise to be concerned about cybersecurity. More and more, investors and other stakeholders who are concerned about a company’s financial risks are asking finance executives what they are doing to protect their assets. So how should a CFO approach their cybersecurity spend?

“They should look at what matters most to the business, what would be most devastating if it were compromised — and invest appropriately,” says Jost. “What’s interesting is that what matters most to the company might not be evident to outside stakeholders, like investors.” For example, a technology company’s treasured R&D data, kept secret from outsiders, might
be its most important asset. Alternatively, a manufacturer might consider the health and safety of its employees as paramount.

When an organization has identified its most critical components, it can then work backward, focusing on how a cyberattack might occur. This scenario-planning process should have an operational point of view, encompassing all the necessary steps to follow if and when a breach happens.

These plans should also cover ways to detect an attempted cyberattack. For many companies, an attack is inevitable, so detection may be the best prevention.

“The key to detection is having a plan to monitor transaction activity that leads to continual investigations to locate potential cyberattacks,” says Jost. “CFOs should help lead and ensure these plans are followed, and that they provide the best mechanisms for protecting critical assets and managing company cyber vulnerabilities.”
Where are the mergers and acquisitions?

Deal activity remains below normal

CFOs are more confident in the market for deals than they were at the end of 2013. In the latest poll, 61% of CFOs say deal activity is in line with historical averages, while just 22% say it is below average. In December, roughly 70% of CFOs said deal activity was lower than usual.

Interestingly, the latest EY CFO Capital Confidence Barometer shows that two-thirds of CFOs actually expect global dealmaking to increase.

“When it comes to M&A, CFOs are looking at deals in the future – tomorrow, not today. So we hope to see volume increase later in 2014” says McGrath. “Granted, many CFOs are ready to move if they see the right transaction. But there are still some concerns out there, particularly around valuations.”

Viewpoint

Deal-making: high-growth companies on the lookout

The latest CNBC Global CFO Council poll, which is exclusively sponsored by EY, suggests a rebound in M&A activity. “High-growth companies,” in particular, are looking at dealmaking to transform their companies and drive growth and innovation, as they are generally more bullish, agile and entrepreneurial than other businesses.

“For a long time, we have seen what we term the ‘confidence paradox,’ with many companies holding cash and having access to financing, but being reluctant to make deals,” says Herb Engert, Americas Leader, Strategic Growth Markets at EY. “Today, confidence is growing, and many high-growth companies are especially optimistic. They are putting M&A front and center.”

The role of the CFO in high-growth companies is changing – and becoming more challenging.

The role now demands more rigor, especially in private companies that intend to go public. At the same time, opportunities can arise for these CFOs to take their place at the center of transformative activities – including dealmaking.

“One aspect of this work is dealing more closely with private equity (PE) investors,” says Engert. “CFOs can
collaborate with their PE partners to transform finance and operations to drive growth.” A healthy relationship with a PE investor will bring a company more business contacts and help evolve its products to meet the needs of new markets and/or geographies. Of course, all of this empowers the PE investors’ ultimate goal: a liquidity event.

A CFO can also help lead an organization’s timing of a sale. “In today’s environment, many venture capital-backed companies seem to be built to sell, implying that they may be selling too quickly,” says Engert. “Smart finance executives are pointing out that these organizations may be leaving money on the table.” Instead, CFOs are seeking more support from the capital markets to drive product development and entry into new markets, and enhance growth. This can dramatically increase presale valuations, and requires more focus by the CFO on building rigor into the finance function.
This edition will be followed by others in a collection that provides insight on the events and experiences that CFOs encounter as part of their role. Previous titles in the series include:

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EYG no. CF0074
1402-1200381
ED 0115

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