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CFO SURVEY: BUSINESS CONFIDENCE DOWN; INFLATIONARY LABOR COSTS, HEALTH CARE COSTS, DECREASING DOLLAR ARE MAJOR CONCERNS

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DURHAM, N.C. -- Chief financial officers are concerned about inflationary labor costs and the depreciating U.S. dollar hurting economic growth in the coming year. They are also concerned about the cost of health care, the U.S. budget deficit, high fuel costs and an increasingly competitive economic environment, all of which will slow earnings and capital spending growth in the coming year.

These are some of the findings of the Duke University/CFO Magazine Business Outlook survey, which asks chief financial officers from a broad range of public and private companies globally about their economic projections. The survey was concluded Feb. 27 and generated responses from 534 CFOs, including 293 from the United States, 183 from Asia and 58 from Europe. Results in this release are for the U.S. firms unless explicitly stated otherwise.

BUSINESS OPTIMISM DROPPING

This quarter, 46 percent of U.S. CFOs are more optimistic about the economy than they were last quarter. This continues the downward trend of the past year. Fifty-five percent of CFOs were more optimistic in each of the last two quarters, and more than 70 percent were optimistic three quarters ago.

"While there are still more optimists than pessimists, this is the least optimistic that CFOs have been in the last two years," said John Graham, professor of finance at Duke's Fuqua School of Business and director of the survey.

To understand the causes of this reduced optimism, the survey asked executives to choose the top four items, from a list of 16, that are concerns for their companies. The results showed that intense competition is the number one concern among CFOs around the world, with more than half listing competition among their top concerns. In the United States, 53 percent of CFOs cite high health care costs as a top issue. CFOs expect health care costs to increase by 9 percent in the coming year. High fuel prices, increased interest rates and fears about increased regulation round out the top concerns for U.S. CFOs.

European and Asian CFOs do not list health care costs as a major issue, but do cite concern about world economic stability and reduced pricing power.

“Nearly two-thirds of U.S. CFOs say that it is very important for Congress to address the cost of health care, and another 29 percent say that it is somewhat important,” Graham said. “A similar percentage say that it is important for Congress to address the budget deficit. Only 31 percent say that it is very important to implement Social Security reform.”

CONCERNS ABOUT UNIT LABOR COSTS, DEPRECIATING DOLLAR, TERRORISM

More than 20 percent of CFOs state that rising unit labor costs are a moderate or major problem at their companies, and another 30 percent say they are a small problem.

“Federal Reserve Board Chairman Alan Greenspan recently stated that increases in unit labor costs would be one of his major concerns if productivity falls as he anticipates,” Graham noted, and 69 percent of U.S. CFOs say that unit labor costs are increasing at their companies.

Meanwhile, the depreciating U.S. dollar is offering little relief for U.S. companies, said Campbell Harvey, professor of finance at Duke and founding director of the survey. “The conventional wisdom, especially out of Washington, is that a weaker dollar helps U.S. businesses,” Harvey said. “However, that’s not what Main Street is telling us.” Forty-seven percent of CFOs say the depreciating dollar will hurt their firms, compared to only 27 percent who say it will help.

The firms cite rising material costs on imported inputs as a major factor hurting their companies. “Many businesses cannot pass on the higher import costs and are being squeezed by the dollar. And, to make things worse, our exporters are seeing little or no action even after a substantial depreciation,” Harvey said.

Don Durfee, research editor of CFO Magazine, said concerns about domestic terrorism are similar to last quarter, “and our business terrorism index shows that the possibility of an attack is hurting business results.

“We asked the CFOs to rank on a scale from zero to 100 the negative impact that the threat of terrorism is having on their bottom lines (where zero means no impact and 100 indicates maximum negative impact). The terrorism index currently stands at about 18 in the U.S. and Europe, and 27 in Asia. About 35 percent of firms in all three regions say that the threat of terrorism is significantly affecting their bottom lines,” Durfee said.

EMPLOYMENT GROWTH TO SLOW, EARNINGS AND CAPITAL EXPENDITURES TO GROW MODESTLY

After robust growth last fall, anticipated employment gains have slowed. Fewer than half of CFOs expect employment to grow at their firms, in comparison to 60 percent expecting growth last quarter. Employment growth should average 1.7 percent domestically, down from 3.1 percent predicted last fall. This contrasts with expected 3 percent growth in outsourced employees.

Earnings and capital expenditures are expected to grow moderately, with an estimated earnings increase of 10 percent. Capital spending should show modest growth of 5.4 percent. However, tech spending will increase just 2.4 percent. Worse still, the CFOs say advertising and marketing expenditures will rise by only 0.9 percent, which is less than one-third of the growth predicted in last fall’s survey.

On a positive note, the survey results indicate that inflation should be subdued in the coming year. CFOs expect the prices of their products to increase only 2 percent in the next 12 months. Also, mergers and acquisitions are expected to increase at 49 percent of U.S. firms in the next 12 months. A similar number of companies in Europe (50 percent) and Asia (44 percent) expect to engage in more mergers & acquisitions in the coming year.

INTEREST RATES MAY SLOW GROWTH

The survey also asked CFOs about the balancing point with respect to growth and inflation for the Federal Funds rate. Thirty-five percent of CFOs cite a Fed Funds rate of 3.0 as the highest level the rate can reach without slowing growth, and another 29 percent cite a rate between 3.25 and 3.5 percent as the tipping point. On average, CFOs reported the mean tipping point for the Fed Funds rate is 3.1 percent.

“This is perhaps the most disturbing result in our survey,” Harvey said. “While the Federal Funds rate currently stands at 2.5 percent, the Wall Street consensus calls for a Fed Funds rate of 3.75 percent by the end of the year. CFOs are telling us that a rate this high will damage the economy.”

RESULTS UNIQUE TO ASIA

Nearly two-thirds of Asian CFOs say they will consider issuing new securities in countries other than the U.S. because of the phase-in of Sarbanes-Oxley rules for foreign firms listing in the U.S. While the CFOs acknowledge that Sarbanes-Oxley rules will lead to better corporate governance and improve their companies’ reputations, nearly two-thirds cite the added cost of fulfilling Sarbanes-Oxley requirements as a significant drawback. The CFOs are also concerned about the added complexity of Sarbanes-Oxley rules.

Twenty-seven percent of Asian CFOs say a revaluation of the Chinese currency would hurt their firms, compared to 25 percent who say that it would help.

Earnings are expected to soar 19.2 percent in Asia.

RESULTS UNIQUE TO EUROPE

European CFOs are very pessimistic about the Lisbon Agenda achieving its objectives of producing GDP growth of 3 percent and creating 6 million new jobs by 2010. Not a single surveyed CFO said it is very likely these objectives will be met. In contrast, 56 percent said it is likely that the goals will not be met. The remaining 44 percent said it is somewhat likely the goals will be achieved.

European CFOs are particularly concerned about labor reform (half say it is very important, and 19 percent say it is somewhat important, for their governments to address labor reform). “This concern is a reflection of the prediction of a slight contraction in European employment in the coming year,” Graham said.

Half of European CFOs say pension reform is very important, and another 24 percent say it is somewhat important.

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Among the industries represented in the survey are retail/wholesale, mining/construction, manufacturing, transportation/energy, communications/media, technology and banking/finance/insurance. Revenue-weighted mean growth rates are provided for earnings, revenues, capital spending, technology spending, and prices of products. Employee-weighted mean growth rates are used for health care costs, productivity, number of employees and outsourced employment. All of these weighted numbers are for public firms only. Except if explicitly noted, all other numbers are for all firms, including private.

Detailed results of this survey, including tabular summaries of the numbers in this release and results from previous surveys, are available at <http://www.cfosurvey.org>.

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