
DUKE UNIVERSITY NEWS
Duke University Office of News & Communications
http://www.dukenews.duke.edu

HOLD FOR RELEASE: 4:45 p.m. EDT Tuesday, Nov. 29, 2005

CONTACT: Jim Gray (Duke)
(919) 660-2935
jigray@mail.duke.edu

or Jill Totenberg (CFO magazine)
(212) 994-7363
jtotenberg@totenberggroup.com

GLOBAL CFO SURVEY: INFLATION EXPECTED TO RISE; CORPORATE OPTIMISM SLIPS TO NEW LOW; MOST FIRMS TAKE NO ACTION TO OFFSET HIGH FUEL COSTS

Note to editors: For additional comment, contact Duke's John Graham at (919) 660-7857 or john.graham@duke.edu or CFO magazine's Don Durfee at (212) 698-9729 or dondurfee@cfo.com. For commentary about European results, contact Janet Kersnar at +44 207 830 1066 or janetkersnar@cfoeurope.com or Erasmus's Kees Koedijk +31 10 40 82748 or ckoedijk@rsm.nl. For commentary about Asian results, contact Tom Leander at +852 2585 3262 or tomleander@economist.com. Detailed results, including tabular summaries of the numbers in this release and results from previous surveys, are available at <http://www.cfosurvey.org>.

DURHAM, N.C. –- Chief financial officers fear that inflation will rise after Alan Greenspan steps down and are pessimistic about the U.S. economy. And even though high fuel costs are the No. 1 concern reported by U.S. corporations, only a minority have attempted to increase fuel efficiency.

Other top CFO concerns include high health care costs and increasing interest rates. In addition, CFOs predict only modest employment growth for the coming year, and 20 percent say they expect to reduce employment. Despite their concerns, CFOs expect solid earnings growth for their own companies.

These are some of the findings of the year-end 2005 Duke University/CFO Magazine Business Outlook survey, which asked chief financial officers from a broad range of public and private companies globally about their expectations for the economy. The survey of European CFOs was conducted jointly with RSM Erasmus University in the Netherlands. The survey was concluded Nov. 20 and generated responses from 811 CFOs, including 401 from the U.S., 132 from Asia and 278 from Europe. Results in this release are for the U.S. firms, unless stated otherwise.

INFLATION TO RISE; FEW FIRMS TAKE ACTION TO OFFSET HIGH FUEL COSTS

Relative to the low inflation of the last decade of the Greenspan era, 81.5 percent of CFOs believe that inflation will be higher over the coming decade. CFOs expect their own companies to raise prices by 3 percent in 2006, continuing an upward trend over the past year (a 2.8 percent price increase was expected in last quarter's survey, 2.1 percent two quarters ago and 1.7 percent one year ago).

"The pivotal result in the entire survey is the CFOs' perceptions of inflation in their own product prices. The doubling of inflation expectations over the past year is a disturbing trend," noted Campbell Harvey, professor of finance at Duke's Fuqua School of Business and the founding director of the survey. "There is a strong asymmetry in inflation expectations: 81.5 percent of respondents think inflation will rise, while only 0.5 percent believe inflation will fall. This is not news that the new Fed chairman wants to hear."

In other price news, CFOs say their fuel costs rose by 23 percent during the past year, but only 43.3 percent have taken steps to reduce those costs.

"Executives cite high fuel costs as their No. 1 business concern for 2006, but nearly 57 percent of firms say that they have not done anything to reduce these costs," said John Graham, a Duke finance professor and the director of the survey. "This suggests that many CFOs feel their hands are tied when it comes to fuel prices."

Of the 43 percent of firms that have taken actions to become more fuel efficient, half say they improved facility management, 41 percent now use more efficient shipping methods (such as consolidating shipments), 31 percent use a more fuel-efficient production process, 30 percent have reduced business travel and 29 percent have increased hedging to offset changes in energy prices.

"The specter of increased inflation is not being driven just by fuel costs," Harvey said. "The CFOs see continued upward pressure on wages, salaries and benefits over the next year."

BUSINESS OPTIMISM AT RECORD LOW

Business optimism about the U.S. economy remains low. Nearly 39 percent of CFOs are more pessimistic about the national economy now relative to how they felt last quarter, while 32.1 percent say they are more optimistic. The level of optimism is down sharply from one year ago, when 54.2 percent of CFOs said they were growing more optimistic.

European CFOs are somewhat more optimistic about their national economies, while Asian firms are quite upbeat: 59.2 percent of Asian CFOs say they have growing optimism about their economies.

"Since we began this survey in the mid-1990s, we have found CFOs to be optimistic about their firms and the economy," said Don Durfee, research editor of CFO magazine, "so it is alarming that American CFOs are so pessimistic. We've found that the optimism index is a good indicator of future economic growth. In a situation like this, where the growth in pessimism outweighs the growth in optimism, we expect slower economic growth."

To understand the causes of the reduced optimism, the survey asked executives to choose the top three items, from a list of 15, that are concerns for their companies. CFOs report high fuel costs as their No. 1 concern, followed by increasing health care costs and rising interest rates.

EMPLOYMENT AND CAPITAL SPENDING GROWTH MODEST

Fifty-three percent of U.S. firms expect to increase employment this year, while 20 percent expect to reduce employment. Overall employment should increase 0.6 percent in the next 12 months, less than half the expected growth expressed last quarter. At the same time, outsourced employment should increase at 40 percent of firms, with growth averaging 4.8 percent. Among Asian firms, own-country employment is expected to grow 8.9 percent.

"The U.S. employment picture is relatively stagnant and the European employment outlook is bleak," Graham said. "European firms expect to shrink their domestic workforces. Most employment growth among European firms appears to be headed outside of the continent, with a rapid 12.1 percent growth in off-shore employment."

U.S. capital spending plans remain modest. Sixty-four percent say they will increase capital spending in the next 12 months, with the average increase 5.7 percent (up from 4.7 percent last quarter). This finding stands in stark contrast to Asia, where capital spending is expected to rise by 9.7 percent.

EARNINGS EXPECTED TO GROW 11.4 PERCENT

Despite their gloominess about the economy, U.S. CFOs are more upbeat about their own companies. They expect strong earnings to continue in 2006, predicting an increase of 11.4 percent among public firms, on average.

To investigate how corporations have maintained strong earnings growth in the face of rising input costs and economic uncertainty, the CFOs were asked to rank the factors that were the greatest contributors to their profitability during 2005. Strong domestic demand was the greatest contributor to corporate profitability, followed by cost-cutting efforts. Increased operating leverage and productivity gains unrelated to information technology are also noted as big contributors to recent corporate profitability.

CASH ON BALANCE SHEET

Thirty-four percent of CFOs say their firms plan to increase their cash holdings, with an increase of 4.6 percent averaged over all firms.

“This continues a recent trend in which firms hoard cash whenever possible,” Graham noted. “Companies like to have a cash cushion in uncertain times, to shield them from unexpected negative shocks. However, at some point, holding too much cash becomes detrimental to stock returns because of the low return earned on cash and marketable securities.”

RESULTS UNIQUE TO EUROPE

Only 26 percent of European CFOs, and just 18 percent of German respondents, say the recent changes in the German political climate will make Germany a better place to do business. Fourteen percent of Europeans, and 23 percent of Germans, say the business climate will be worse under the new administration.

One-third of European CFOs say the new IFRS international accounting standards provide a more fair and true view of the financial position of their companies, while 18 percent say the view is less true.

RESULT UNIQUE TO ASIA

Asian CFOs see increased global competition as their No. 1 risk factor, followed by high fuel costs. A number of Asian CFOs also wrote in “bird flu” as a primary business concern.

Asian firms will expand technology spending at a remarkable 13.2 percent, and cash on balance sheet by 15.6 percent.

More than two-thirds of Asian CFOs expect own-country GDP growth to top 4 percent, and about one-third expect GDP growth of more than 6 percent.

– – – –

About the survey: 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. The earnings, dividends and cash on balance sheet weighted numbers are for public firms only. Unless explicitly noted, all other numbers are for all firms, including private.

About CFO Publishing: CFO and CFO.com are owned by CFO Publishing, an Economist Group business. With a rate base of 450,000, CFO is the leading business publication for C-level and senior financial executives. It reaches an international audience of corporate leaders with its global group of magazines, including CFO IT, CFO Europe, CFO Asia and CFO China. For more information, visit <cfo.com>.

The Fuqua School of Business at Duke was founded in 1970. Fuqua's mission is to educate business leaders worldwide and to promote the advancement of business management through research. For more information, visit <www.fuqua.duke.edu>.

###