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Public distrust, threat of severe Russian sanctions impacting global economy: CFO survey

16 June 2014

Chief financial officers around the world indicate that public mistrust of business and political leaders has harmed the business environment. They also say that severe sanctions on Russia would hurt the economies of their home countries.

These are just some of the findings of the latest Duke University/CFO Magazine Global Business Outlook Survey, which concluded 6 June. Other results indicate that companies are continuing to stockpile cash and that economic optimism is up in the US and Asia, but down sharply in Latin American and Africa.

The survey has been conducted for 73 consecutive quarters and spans the globe, making it the world's longest-running and most comprehensive research on senior finance executives.

Survey results show nearly 60 per cent of U.S. financial executives think the business environment has been harmed by a lack of public trust of business and governmental leaders. An even larger percentage of CFOs in Africa (64 percent), Europe (68 percent), Asia (71 percent) and Latin

America (79 percent) believe public mistrust is creating a drag on the economy.

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"Public distrust inhibits the economy from reaching its full potential," said John Graham, a finance professor at Duke's Fuqua School of Business and director of the survey. "Mistrust can reduce growth and it causes companies to devote time and resources to counteract mistrust's negative effects."

Results also show the lack of trust has caused firms to alter business decisions, change governance and emphasise transparency. "While all of these effects may not be negative, like increasing transparency, several of the effects are negative, and they all require companies to expend resources and can distract management's focus," Graham said.

Sanctions on Russia

Most companies with business connections to Russia believe that stepped-up sanctions would have a negative to a severely negative effect on their businesses (US, 53 percent; Europe, 82 per cent; Asia, 51 per cent; Japan, 82 per cent; Africa, 78 per cent; Latin America, 62 per cent.)

"There are two interesting findings," said Campbell R. Harvey, founding director of the survey. "First, a large number of firms are either considering reducing their footprint in Russia or already actively pulling back. This includes 22 per cent of US firms and 31 per cent of European firms."

"Second, there is a lot of talk about China benefiting from the sanctions. This is not what the CFOs are telling us. Fifty five per cent of the Chinese CFOs see stepped-up sanctions as bad news and 33 per cent are either reducing exposure to Russia or are considering pulling back," Harvey continued. "The CFOs are telling us that the current sanctions as well as their expectations of future actions have already impacted their business plans for Russia. This is certainly bad news for the Russian economy."

Cash holdings

US and European firms are evenly split on whether they will begin to deploy cash reserves this year or will continue to hold the cash tightly. By comparison, among firms that indicate a clear direction, 60 to 70 per cent of companies in emerging economies (Asia, Africa, Latin America) plan to spend some of their accumulated cash during the next year.

"Most companies tell us that they do not have a narrow target for how much cash they hold," said David W. Owens, director of research at CFO Publishing. "Rather, they accumulate cash when they feel they have to and spend it again when they are feeling more confident. Those companies that expect to start spending down their reserves are primarily looking to invest in their own growth, which I take to be a positive sign."

Worldwide, among businesses that will unleash cash, the most common use by far will be for capital spending and investment. Acquisitions and paying down existing debt trail distantly in the US and Europe.

Asian and African firms will also use cash to hire and for marketing, while firms in Latin America are more likely to pay down debt but are reluctant to use their cash to boost hiring. Among companies that will not begin to spend their cash holdings, those in the US and Asia are more likely than others to say they won't need to use cash to fund their businesses.

Firms in Europe and Latin America, on the other hand, either want to continue holding onto their cash as a buffer or simply don't have excess cash to spend.

Labour unrest in Latina America, Africa, China

Almost three-fourths of Latin American CFOs expect there to be work stoppages and strikes during the next 12 months that will adversely affect their countries' economies.

Labour concerns are particularly acute in Brazil (85 per cent), though CFOs in Chile (68 per cent) and Peru (52 per cent) are also concerned. In Africa, half of the CFOs expect economic damage from labor unrest, as do 29 per cent in China and 22 per cent in Europe. Only 9 per cent of US executives expect trouble from labour.

"Emerging economies have been grappling with reduced demand and slower growth over the past couple years," said Graham. "Now on top of weak demand, business leaders are dealing with a restless and, in some cases, combative workforce. This is especially concerning in Brazil as it hosts the World Cup."

When asked about the causes of labour unrest, CFOs say it stems primarily from wage pressures and general economic problems like slow growth.

In China, CFOs note that poor working conditions also drive labour unrest, while African CFOs say that income inequality is a notable cause.

Deflation in Europe

About one-third of European CFOs believe that deflation is already happening, or soon will occur, in the Eurozone, and two-thirds of these firms believe that deflation will continue for two or more years. Most see the effects of deflation as damaging to the economy.

"These findings are particularly surprising because last week's actions by the European Central Bank (ECB) had been widely anticipated at the time of our survey. These European CFOs are effectively saying that the ECB's actions will not be sufficient to stave off deflation," Harvey said.

CFO optimism and top concerns

On a scale from 0 to 100, CFO optimism about the US economy has increased to 61, only the second time the optimism index has been this high since mid-2007. U.S. optimism still trails Asia (65).

One year ago, Latin American CFOs were the most optimistic in the world. In a dramatic turnaround, the Latin American optimism index has fallen to 53, with Brazilian and Chilean CFOs rating optimism below 50.

Africa is the least optimistic region of the world, with an optimism index of only 45.

Business leaders around the world, and particularly in Latin America, include governmental policies as a primary concern for the year ahead.

Other worldwide concerns include attracting a skilled workforce (especially in Asia) and maintaining employee morale.

In the US, CFOs are also worried about the cost of benefits and the negative drag of economic uncertainty. African CFOs have significant concerns about currency risk.

Half of Japanese CFOs believe that reaching an agreement on the Trans-Pacific Partnership (TPP) trade agreement would have a large positive impact on the Japanese economy, and another one-third think TPP would lead to a small positive effect.

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