Grant Thornton

As conditions get tough, CFOs get tougher

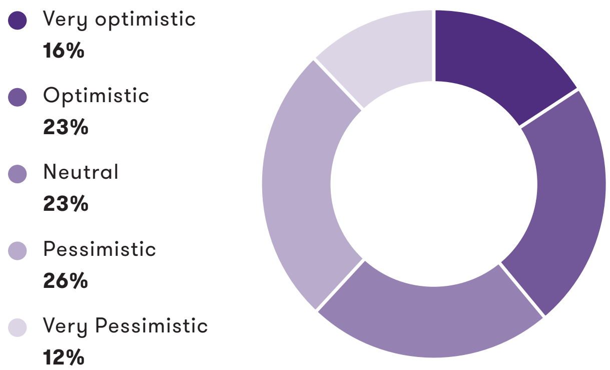
Most expect to meet growth goals even as confidence wanes

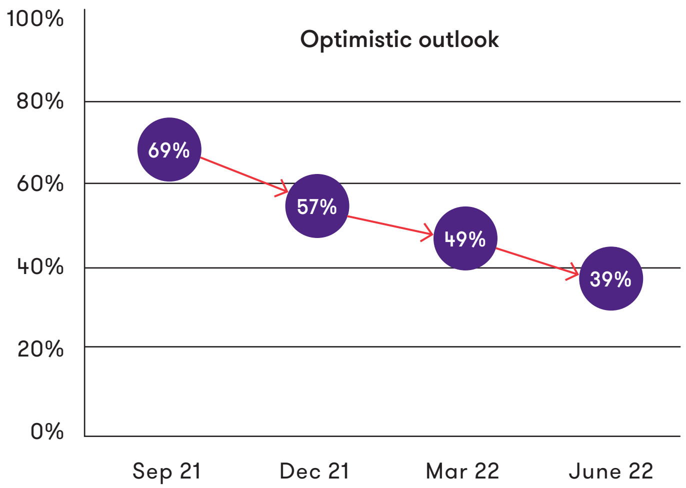
Everything CFOs didn't like about Q1 2022 they liked less in Q2. Unsurprisingly, inflation is the chief, but not the only, concern. In June, the last month for which numbers were reported before the survey was fielded, inflation was still edging up, at 9.1% over the past year, and GDP had shrunk for two consecutive quarters — one traditional marker of a recession. Yet unemployment had continued to drop, with the June jobs report showing 372,000 new jobs — and that was before the shocking July employment report showing a gain of 528,000 jobs. These mixed economic signals had CFOs facing a variety of challenges and have continued to push confidence in the economy down among our respondents. The percentage of CFOs who are optimistic about the US economy over the next six months dropped from 49% in Q1 to 39% in Q2 — and that was down from 69% in the third quarter of 2021.

When asked what's driving this pessimistic mood, inflation — and the steps the Fed is taking to fight it — topped the list of concerns. Increased costs of goods and services, increased energy costs, the possibility that rate hikes will spark a recession, increased cost of capital, and the potential for an inflationary wage spiral were all at the top of the list, along with lingering supply chain and inventory concerns.

On the plus side, 65% of CFOs see the economic impact of COVID waning, and 60% believe that increased household wealth will continue to drive demand.

Economic outlook: CFO outlook continues to decline
Generally speaking, how would you classify your outlook regarding the U.S. economy over the next 6 months?





Economic outlook: Which of the following are reasons for your outlook regarding the U.S. economy over the next 6 months?

Reasons for POSITIVE outlook

The economic impact of COVID is waning

65%

Increased household wealth will continue to drive demand

60%

Low and stable unemployment

49%

Rate hikes will cut inflation without causing a recession

39%

Reasons for NEGATIVE outlook

Increased cost of other goods and services

73%

Increased energy cost

71%

Supply chain and inventory concerns

66%

Rate hikes causing a recession

64%

Increased cost of credit/capital

61%

Inflationary wage spiral

57%

War in Ukraine/global instability

45%

New COVID variants/outbreaks

19%

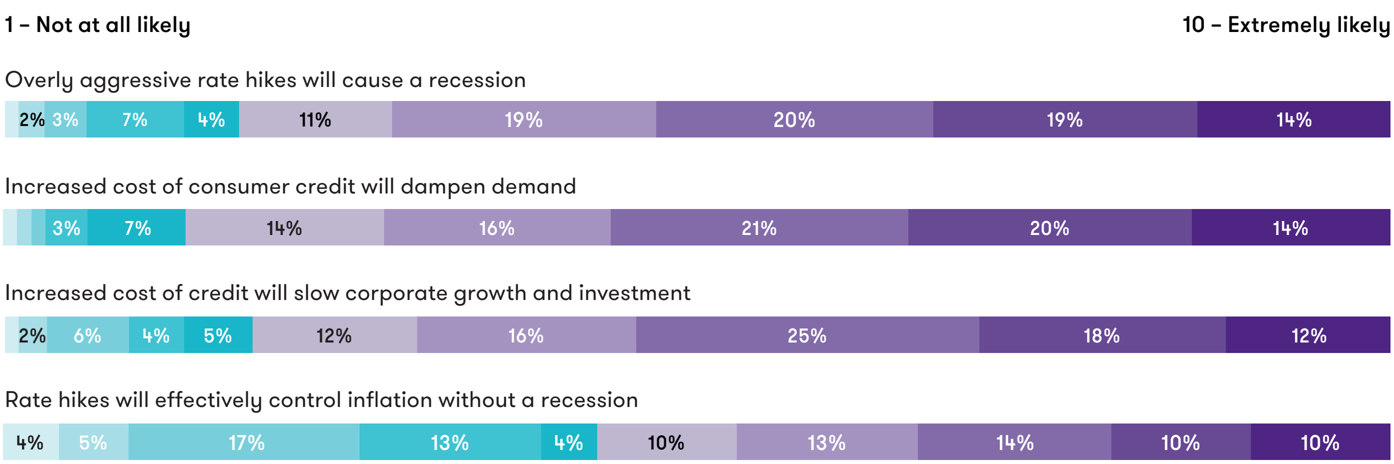
Inflation, recession and supply chain fears won't keep CFOs from meeting growth goals

But inflation is muting expectations

Inflation doesn't just have CFOs' attention. The Fed continues to hike rates to cool the economy and slow price increases, announcing 75 basis point jumps in both June and July. Most CFOs responding to our survey do not believe that the Fed can manage a soft landing, with 72% expecting rate hikes to lead to a recession.

But, in an interesting juxtaposition, 66% of CFOs surveyed still expect to meet their companies own growth goals — down from 67% in Q1. "For some companies, inflation may be helping to drive growth," says Enzo Santilli, Grant Thornton National Managing Partner for Transformation. "Inflation can push revenue up even while volume is down. That can be good for some companies, but bad for others."

Likely results of Fed rate hikes
Based on the list below, please rate how you expect the following to impact your business, if at all.



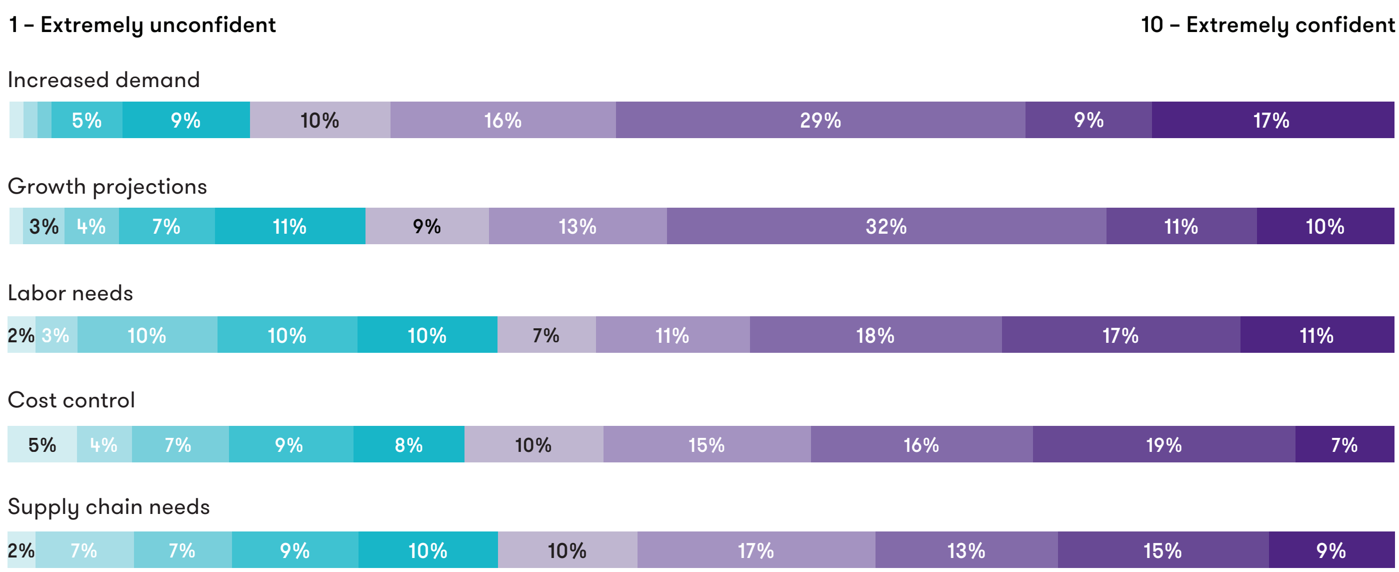
It might seem counterintuitive to expect growth while also expecting a recession, but it's also important to look at how much growth companies expect. First, note that, while 66% of respondents say they will meet their growth projections, only 61% expect an increase in net profits over the next 12 months, so some companies' projections are neutral at best. Also, of the 61% expecting increased profits, only 15% expect growth of more than 10% — and 39% expect a contraction. That's not a trivial number.

"If you look at the strategic goals, the concerns are chiefly around cost, not demand," says Christopher Schenkenberg, Grant Thornton Partner and National Tax Business Lines Leader. "That's exactly what I'm hearing from clients. Among our respondents, 71% are confident on demand, but only 57% are confident about controlling costs."

But supply chain, which has been an issue since the pandemic hit in 2020, is still the biggest challenge confronting CFOs, with only 54% of CFOs confident of meeting supply chain goals — down from 62% in Q1.

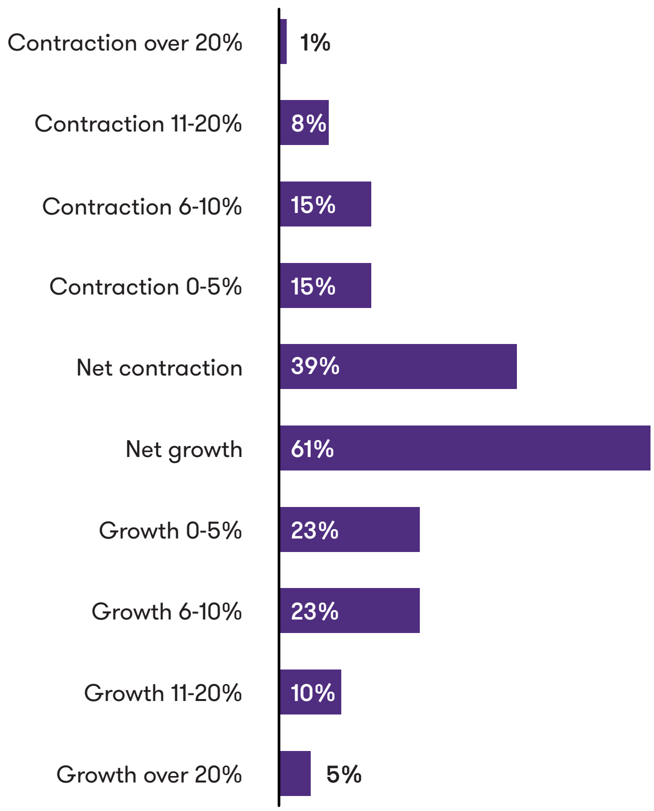
"One of the strategies businesses were using to address supply chain issues was to build up inventories, which runs counter to the just-in-time practices of the last few decades," says Denham. "And that was fine when interest rates were around zero, so you had a low cost of capital. Now, with rates shooting up, that gets expensive. And the inventory itself is getting more expensive. So companies that are still struggling with the logistical challenges of sourcing and moving materials are now facing financial challenges as well."

Meeting strategic goals: Confidence in meeting supply chain needs has diminished since Q1.
Please rate your confidence concerning your business' ability to meet its goals in each of these areas:



Percentage growth/contraction

What percentage growth or contraction are you expecting in net profit over the next 12 months, year over year?



Cost control is back in vogue

CFOs are tightening their belts

Through 2021, as CFOs navigated the recovery from lockdowns, a recession and the early impact of COVID, they were largely focused on rebuilding their workforce through a historically tight labor market and fighting novel supply chain challenges to maintain inventory. Cost control was not top of mind. “At the beginning of 2021, there was this sense that COVID was ending and growth was going to ramp up. Businesses were far more confident about the economy and were loosening their belts a little,” says Denham, “Now, with most expecting a recession, they’ve tightened their belts considerably.”

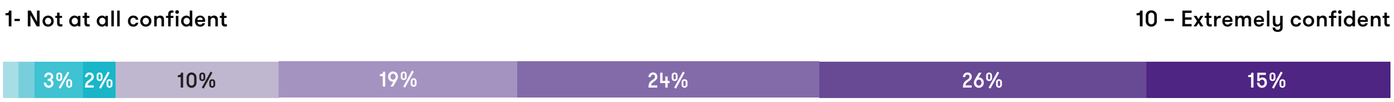
One area CFOs may be targeting in particular? Travel. When asked where they expected to reduce investment in the coming year, travel was the top weighted choice at 29% — more than twice as likely to be chosen than any other category.

Renewed emphasis on cost control is clear in our survey results. When asked to rank areas of focus, cost control was the top choice by more than a two-to-one margin over all other options, with liquidity and debt/access to capital coming in second and third. Clearly, CFOs are expecting difficult conditions and are preparing to meet them.

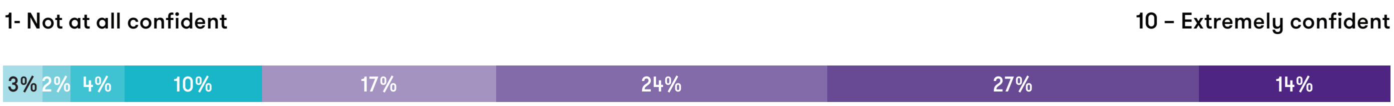
Areas of focus, ranked: Cost optimization, liquidity and debt/access to capital are most important.
Please rank the following areas of focus from most important to least important given the economic outlook over the next six months.

How confident are CFOs in their financial modernization efforts?
The performance and efficiency of the finance function is a key focus for CFOs, especially with heightened attention on controlling costs. We asked CFOs to rate their confidence on their continuous performance improvement processes in general and in regard to performance in selling, general and administrative (SG&A) expenses. We also asked where they planned improvements in their SG&A processes over the next year.

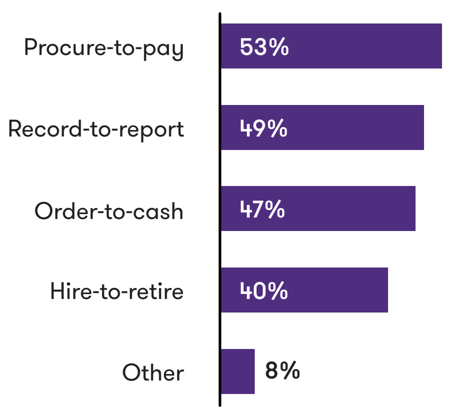
Confidence in performance improvement
How confident are you in your organization's current continuous performance improvement process?



Confidence in performance SG&A functions
How confident are you in your organization's current continuous performance improvement process?



Investment increase near term
In which areas are you planning to improve SG&A processes over the next 12 months?



Cybersecurity, supply chain, liquidity — all major challenges

Workforce issues continue to be a major concern

When asked to list their top three challenges over the next six months, 41% of respondents picked cybersecurity first — up slightly from 40% in Q1. Supply chain was second at 37% — up from 35% — remote workforce jumped from 25% to 32%, and cash and liquidity spiked from 19% to 31%.

"The cyberthreat environment continues to evolve, so continuous investment is necessary to keep up," says Denham. "I don't expect to see cybersecurity fall down the challenge list any time soon."

Meanwhile, inflation and interest rates are adding financial complications to the already muddled logistics in the supply chain picture, so its number two showing is no surprise — nor is the 12-point jump in liquidity concerns. "As conditions tighten, liquidity always becomes an issue," says Santilli, "When times get tough, cash is king."

Top challenges

As a finance leader, which of the following, if any, do you think are the top 3 biggest challenges your business will be facing over the next 6 months?

But seeing remote workforce jump back up to 32% was a surprise. Remote workforce peaked at 32% in Q2 of 2021 and had declined since, dropping to 25% by Q1 2022.

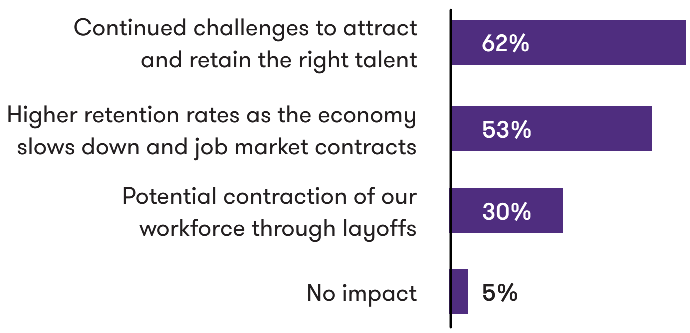
"I don't think it's managing remote workforce itself that's the issue — companies have had time to adjust to that reality," says Tim Glowa, Principal of Human Capital Services. "With CFOs focused on cost, I think it's a confluence of issues." Glowa points to a few areas CFOs and businesses need to consider:

- **Real Estate -** With costs control top of mind, and with the long-term reality of remote work sinking in, many businesses are re-evaluating their real estate footprint. "Many companies want employees back in the office — and some employees want to be there — but employers can't ignore employees' preference for flexibility in where and when they work," says Glowa. "For many companies, that means less need for office space. But how much less? And where?"

- **Layoffs -** Layoffs are back in the news, particularly in the tech sector. With a potential recession looming, 30% of survey respondents are considering layoffs. "Be careful," says Glowa. "In this Glassdoor age, the impact of layoffs or other cuts to the employee value proposition can linger for employers. Companies that were quick to cut headcount at the beginning of the pandemic suffered in the intense competition to rebuild workforces during the recovery."

- **Training -** Focus on training and development. Q2 survey results show a big jump in anticipated investment in training and development — from 35% to 49%. "That's smart," says Glowa. "Employees, especially higher paid employees, value training — it's one of the keys to building engagement."

Impact on human capital plans:
How do you expect a pending economic downturn to impact your human capital plans over the next 6 months?



- **Benefits -** Take a close look at benefits costs. "There's not a lot that companies can do to control compensation costs in this job market, but companies routinely waste money on benefits that employees don't want or value, often to the tune of $1,500 or more per worker annually," says Glowa. "Reinvesting those dollars either to meet compensation needs or in benefits more aligned with employees' values can control costs and boost retention."

A last thought? "One size does not fit all," says Glowa. "It's vital to understand what your employees really want. And what minimum wage employees want is often different from what more highly paid employees are looking for. What works for a tech company will likely differ than what works for a small manufacturer. You've got to tailor your approach to the people you have and the people you want."

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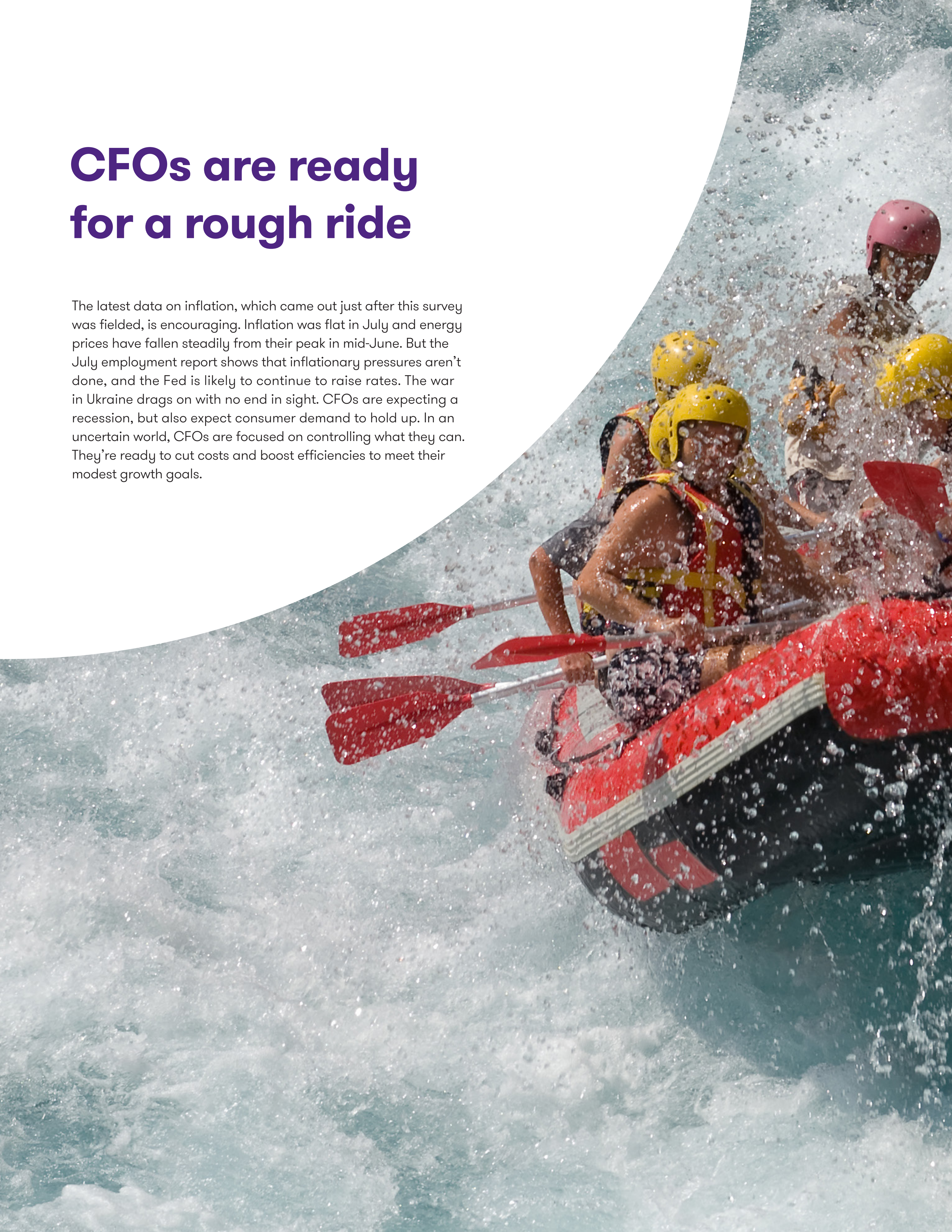
CFOs are ready for a rough ride

The latest data on inflation, which came out just after this survey was fielded, is encouraging. Inflation was flat in July and energy prices have fallen steadily from their peak in mid-June. But the July employment report shows that inflationary pressures aren't done, and the Fed is likely to continue to raise rates. The war in Ukraine drags on with no end in sight. CFOs are expecting a recession, but also expect consumer demand to hold up. In an uncertain world, CFOs are focused on controlling what they can. They're ready to cut costs and boost efficiencies to meet their modest growth goals.



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