CFO balancing act

Growth vibes tempered by cost concerns

The 45% optimism result was up from 39% in Q2, but still far below the 69% optimism recorded in the third quarter of 2021.

As interest rates continue to rise and inflation displays an unusually stubborn staying power, CFOs find themselves performing a delicate balancing act.

On one hand, optimism over the U.S. economy in Grant Thornton LLP's CFO survey for the third quarter of 2022 has risen slightly over the previous quarter, and by almost a 2-to-1 margin they expect to see net profit growth at their organizations over the next year.

On the other hand, they view cost control as their most urgent imperative, and they are concerned that they might not be able to meet their labor needs.

In some cases, their views in the survey seem almost contradictory. Consider:

- Supply chain was rated as the top business challenge in the survey, with 41% of CFOs choosing it as one of their top three challenges. But just 13% of respondents said they are not confident they will be able to meet their supply chain needs.
- While 58% expect continued challenges in attracting and retaining the right talent, the top area cited for potential cost cuts was human capital expense related to employee headcount and compensation levels. Forty-three percent said their organization is looking at this area for cost cuts in the current economic conditions.
- Nearly two-thirds (64%) predicted net profit growth at their organizations over the next 12 months, with 42% predicting growth of 6% or higher.

Meanwhile, confidence in the U.S. economy improved over the second quarter of 2022, even amid rising interest rates and entrenched inflation. Forty-five percent of CFOs said they are optimistic about the outlook for the U.S. economy over the next six months, while 31% were pessimistic.

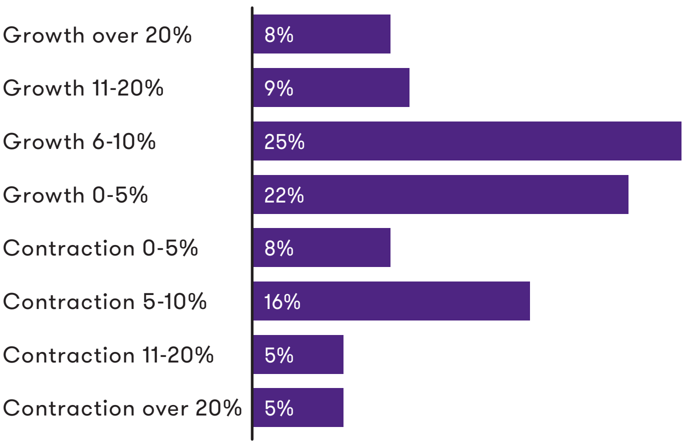
The 45% optimism result was up from 39% in Q2, but still far below the 69% optimism recorded in the third quarter of 2021 before inflation and rising interest rates began delivering body blows to the U.S. economy.

Optimistic CFOs say the economic impact of the COVID-19 pandemic is waning (71%) and that increased household wealth will continue to drive demand. But that demand may be greater for goods and services with budget-friendly prices that consumers see as necessities, whereas luxury items may see a decrease in demand.

"Some consumers are trading down brands because they're afraid that their wealth won't buy them as much," said Enzo Santilli, Grant Thornton's Chief Transformation Officer. "They're still buying things, but they're buying things that are cheaper or lower quality, and the effects of that will vary by sector."

Surprising optimism

Growth spurt
CFO net profit growth or contraction forecasts for the next 12 months, year over year



Note: Figures do not add to 100% due to rounding.

CFOs' improved opinion of the U.S. economy wasn't quite as rosy as the 69% optimism rate reflected in Grant Thornton's recent survey of M&A professionals. But the CFOs' growth projections, with 42% expecting growth of 6% or higher over the next 12 months, indicates a continuing healthy environment.

Some M&A activity could be affected in a positive way because the recent economic downturn has the potential to put the brakes on climbing valuations with respect to new investment opportunities. Christopher Schenkenberg, National Managing Partner, Regional Tax Business Lines for Grant Thornton, recently asked several private equity professionals their views on rising interest rates and the impact on deal values, the cost of capital, and the overall M&A market in general.

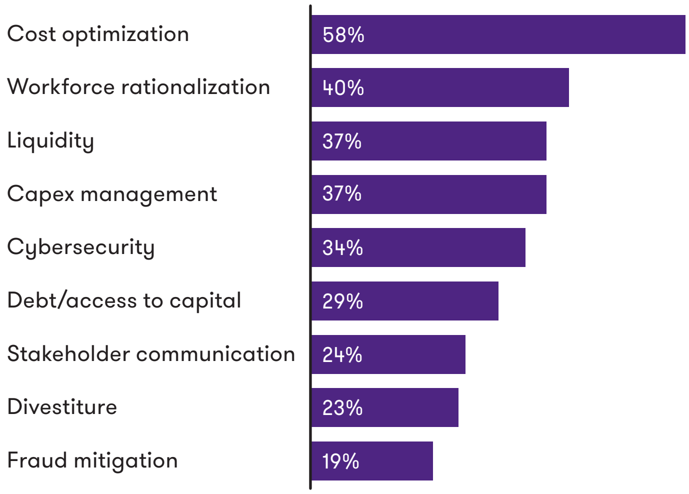
> "The sentiment is that M&A volumes are down year-over-year, and while rising interest rates certainly affect the cost of capital and investment models, recent decreases in valuations and multiples affects them positively in some industries."

Christopher Schenkenberg, National Managing Partner, Regional Tax Business Lines

Cost control remains a focus

Concern about costs

Portion of CFOs ranking the following among their top 3 areas of concern for the next 6 months



Shortly after the closure of the CFO survey, which was in the field for the last two weeks of October, Twitter cut more than 3,000 jobs and Meta announced a reduction of more than 7,000 jobs.

These moves reflected the top areas of focus in the CFO survey, as 58% of respondents listed cost optimization among their top three priorities for the next six months, and 40% chose workforce rationalization as one of their top three objectives.

Meanwhile, 32% said they could potentially introduce layoffs or workforce reductions in the next six months as a result of the economic downturn.

That's why the growth in economic optimism reflected in the survey could be considered surprising.

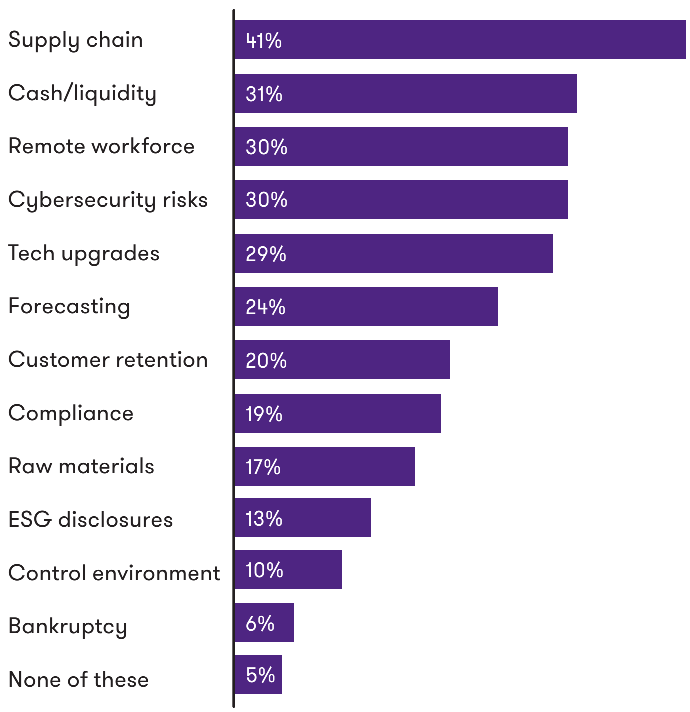
"The companies that I'm talking to all are focused on cost reductions," said Sean Denham, National Audit Growth Leader for Grant Thornton. "Whether it's through headcount or other means, that's what they're focused on. Usually when people are focused on cost reductions, it's because they don't have a positive outlook on the future."

For many companies, cost optimization may be accomplished through cuts in workforce and travel. Forty-three percent of respondents said cost cuts are possible in human capital expense related to employee headcount and compensation levels. External professional consulting support and fees (42%) and technology investments (41%) also were cited as areas for potential cuts.

Meanwhile, 38% of CFOs said they expect travel expenses to decrease over the next year. That's the highest percentage since the first quarter of 2021.

Supply chain still a huge concern

Searching for supply
Portion of CFOs rating the following areas among their top 3 challenges for the next 6 months



Persistent difficulties
Supply chain reached a seven-quarter high as a challenge in Q3 of 2022

Although ports are no longer jam-packed with backed-up goods because of pandemic shutdowns, the percentage of CFOs who rated supply chain as a top challenge was higher in Q3 than in any of the previous six quarters.

Even though shipping prices have dropped significantly, 41% of respondents rated supply chain as a top three challenge. Denham believes that the old supply chain challenges at the ports have been supplanted by new supply chain concerns related to rising interest rates.

Stockpiling inventory became an answer to the previous supply chain difficulties. But that's a more expensive option as the cost of capital continues to rise.

"When the cost of capital was close to zero, they could put all the inventory they want in their warehouses," Denham said. "Now that interest rates are going up, they have to decide whether to increase inventory because of potential supply chain issues. The cost of that is going to be a factor."

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Off limits for cuts: Compliance, cybersecurity and digital

While cost optimization is CFOs' biggest area of focus for the next six months, there are some areas where cuts will not be possible for the overwhelming majority of finance leaders.

Just 6% of respondents to Grant Thornton LLP's CFO survey for the third quarter of 2022 expect to spend less on compliance in the next year. Cybersecurity (9%) and IT/digital transformation (11%) also are areas where few finance leaders expect their expenses to decrease.

These areas overlap in some cases, as particularly in the banking industry, compliance with new cybersecurity regulations may require significant effort in the next 12 months. Meanwhile, spending in all three areas presents opportunities to increase the value of an organization and deliver cost savings through efficiency:

Compliance: At least some compliance spending at many companies is likely to be funneled toward complying with the SEC's upcoming climate disclosure regulations. This may lead to development of environmental, social and governance (ESG) initiatives that could trigger tax breaks, efficiency savings and even positive reactions from customers and investors that can help drive revenue.

"CFOs have always been key strategic players, and there's a recognition that ESG is a strategic business driver and not just a nice-to-have," said John Friedman, Managing Director, ESG & Sustainability Services for Grant Thornton.

Cybersecurity: Cyberrisks continue to demand spending, as 34% of CFOs ranked cybersecurity as one of their top three three challenges. Smart spending in this area now can provide protection from system breaches that could be much more costly down the road.

"All resources are limited for organizations, so you need to go through a risk calculus to determine what vectors leave you exposed from a cyber perspective," Grant Thornton Principal and National Practice Leader for Forensic Technology Johnny Lee said at the firm's recent Energy Symposium. "You need to translate that into which IT assets would be affected, or in the case of the energy industry, which operational technology assets might be affected by a technology disruption or compromise. And then you need to invest accordingly."

IT/digital transformation: Companies are spending to convert to digital processes that can drive efficiencies, long-term cost savings and even strategic advantages. For example, companies are implementing software and processes that speed up the financial close, quickly reconcile intercompany accounting and even overhaul finance operating models to more efficiently support the business.

"The pandemic revealed where all the inefficiencies were in the manual processes," said Lisa Heacock a Partner and West Region Market Leader with Grant Thornton's Finance Transformation Practice. "Because you had people working remotely and they realized, 'Wow, this is not automated or in a system. And it's all manual, and look how much time it takes.' "

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