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CFOs Set to Unleash Spending

Optimistic finance chiefs are planning capital spending and employment increases, according to the most recent Duke University/CFO Magazine Business Outlook survey.
CFO Staff and CFO.com Staff, CFO.com
March 07, 2006

Optimism about the U.S. economy among chief financial officers has reached its highest level in a year, as cash-rich companies stand willing to withstand an increase in inflation and pay over $70 per barrel of oil to reduce U.S. dependency on Mid-East oil.

Those are some of the findings of the Spring 2006 Duke University/CFO Magazine Business Outlook survey, which asks CFOs from a broad range of public and private companies worldwide about their economic expectations. The latest quarterly survey was concluded March 5 and generated responses from 571 CFOs, including 323 from the United States, 153 from Europe, and 95 from Asia. (The survey of European CFOs was conducted jointly with RSM Erasmus University in the Netherlands. Results cited here are for U.S. companies unless explicitly stated otherwise.) Detailed results are available at www.cfosurvey.org.

This quarter, 42 percent of U.S. CFOs are more optimistic than in the previous quarter, while only one-fourth are less optimistic. Although the optimism of finance chiefs is high, however, it's significantly lower than it was two years ago.

"After several quarters of falling expectations, CFOs now see fewer reasons to hold back spending," says John Graham, a finance professor at Duke's Fuqua School of Business and director of the survey. "Increased optimism bodes well for the economy," he adds. Historically, the survey's measure of CFO optimism has been more than 70 percent correlated with future increases in capital spending and corporate earnings, according to Graham.

CFOs expect inflation to rise by 3.3 percent over the next 12 months, while wages and salaries are expected to mount by 4.2 percent. Yet two-thirds of finance chiefs said their companies' outlooks would not be harmed by a jump in the inflation rate to 3.5 percent.

"Even though CFOs expect inflation to rise well above the Fed's comfort level, the CFOs are sending a strong message to the new Federal Reserve chairman to back off," notes Campbell R. Harvey, a professor of international business at Duke's Fuqua School of Business and founding director of the survey. "CFOs are telling the Fed to halt or reverse the rate increases—remarkably nine-in-ten CFOs oppose an interest-rate increase at the end of March."

Finance chiefs are also concerned about other issues, though. Almost half of the CFOs listed intense global competition as the top risk factor for U.S. corporations; increasing health-care costs came in second. Other issues that concern CFOs are increased interest rates, high fuel costs, economic stability, and declining consumer demand. A notable segment of CFOs cited a shortage of skilled laborers as a risk factor.

While noting the long-term risks of dependence on Middle Eastern oil, CFOs report that on average, they would be willing to pay over $70 per barrel if it would reduce that dependence.

Optimism has risen in both Asia and Europe, where, respectively, two-thirds of CFOs are more optimistic than last quarter and 46 percent are more optimistic. In Asia, the price of fuel is the main concern for CFOs; in Europe, the cost of labor and declining consumer demand top the list of worries.

Protectionism is on the rise in national economies, according to almost 40 percent of European CFOs. Only 15 percent of European finance chiefs note that it has diminished. Half note that increased outsourcing of jobs will lower domestic European employment.

CFOs expect to boost cash holdings, which are already at an all-time high, by another 2.6 percent in the next 12 months. Asian companies forecast their cash holdings will jump 8.7 percent, while European companies expect cash to decline by 4.3 percent. "Historically, corporations have often held onto cash too tightly," notes Don Durfee, research editor at CFO magazine. "We'd like to see them put this cash to good use, or return it to investors."

Most CFOs intend to direct their companies to hold on to their cash. Those who do plan for their companies to use it will do so to increase investment and acquisitions. Fewer plan to use the cash to increase repurchases and dividends and to repay debt.

U.S. capital spending is poised to improve, with 60 percent of CFOs reporting plans to increase capital spending in the next 12 months. The average increase is 6.5 percent, up from 4.7 percent two quarters ago. European capital spending is expected to increase 6 percent; in Asia, it's expected to jump 17 percent.

Earnings should increase at 81.2 percent of companies this year, with an average boost of 13.1 percent -- an improvement from an excepted increase of last quarter's prediction of 11.4 percent.

This year, 59 percent of U.S. firms intend to increase employment, while 17 percent expect to reduce employment. Overall employment is expected to rise 2 percent in the next 12 months, significantly higher than last quarter's prediction of a 0.6 percent increase. Meanwhile, outsourced employment should rise at 36 percent of companies, with growth averaging 6.5 percent.