India CFO Survey 2016

CFO Signals

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Executive Summary

External risks- what to expect

Global economic activity is expected to remain subdued in 2016. Risks that are likely to shape the global outlook this year are (1) economic slowdown in China, (2) oil price volatility, (3) unconventional monetary policies by central banks of the advanced nations, (4) Global uncertainties stemming from the UK referendum as British citizens vote to exit the European Union, and (5) the pace at which the U.S. Federal Reserve tightens its monetary policy by raising the Fed funds rate.

At the same time, investor sentiments toward emerging markets have soured resulting in significant capital outflows from these economies. Consequently, the Indian equity market has witnessed a flight of institutional investments in the last few months, owing to negative global cues and weak corporate earnings.

Strong domestic fundamentals are the best defense

The Indian economy has shown resilience in the face of the global economic slowdown and rising uncertainty in the global financial world. India has maintained strong macroeconomic fundamentals, although a part of the credit goes to subdued commodity prices. GDP grew 7.6% in FY 2015-16 relative to 7.2% in FY 2014-15 and is forecasted to grow at a strong and steady pace in the next two years.

Consumer price inflation has come down from double digits to levels that are currently the lowest in the past nine years. The economy has a healthy twin deficit; while the current account deficit is at a comfortable level of 1.1% of GDP in FY 2015-16, the government has managed to contain the fiscal deficit to 3.9% of GDP this fiscal year[2]. There has been a significant improvement in foreign direct investment inflows, which grew 31 percent in FY 2015–16. However, the overall capital account halved as net portfolio investments turned negative owing to increasing global uncertainties in the past one year.

Policies to help the economy navigate through uncertain times

The government has continued its effort to turn India into a manufacturing hub by initiating programmes such as Make in India and Skill India; and increasing investment in infrastructure, digitalization, education and health, while sticking to the path of consolidation. In this year's budget, the government aims to buoy domestic demand through proposed spending on the rural and social sectors, such as farm loan interest subsidies, crop insurance, and health insurance schemes for farmers. The budget also includes measures such as improving various rural job schemes and encouraging diversification into dairies, fisheries, and horticulture, which are expected to improve avenues for farmers to earn higher income. The prime minister pledged to double the income of farmers by 2022, to mark India's 75 years of independence[3].

Adherence to the fiscal road map by the government, together with falling prices have led the Reserve Bank of India (RBI) to cut rates in the last few monetary policy meetings and ease credit conditions in the economy. The RBI also took measures to ease the liquidity constraints in the banking sector, thus encouraging banks to increase lending.

These policy measures have huge implications for the consumer and industrial sectors. Easing credit conditions, and a rising rural income, in conjunction with strong urban demand (as evident from the increasing consumer durable goods industry index) will likely raise demand for consumer as well as industrial products. Additionally, gradual reforms and investments in these sectors will likely remove structural bottlenecks, giving comfort to investors to increase spending on capital investment and capacity expansion.

Challenges that may throw a wrench

That said, significant challenges lie ahead because, despite strong economic growth, outlook for the manufacturing sector remains grim, while rising nonperforming assets and poor profitability have increased risks to the Indian banking sector.

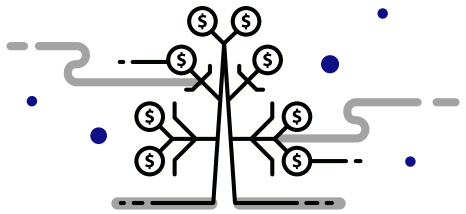
The manufacturing sector—the Achilles' heel of the economy—has failed to show an uptick despite the government's continuous effort to promote India as the upcoming manufacturing hub. In the past seven months, the sector has recorded either a negative year-on-year growth (5 out 7 months) or a negligible growth. The lackluster performance is primarily driven by low domestic demand, sluggish pace of reforms, and a slow improvement in ease of doing business. All these factors are gradually weaning investors' confidence and slowing capital investment in the sector. Delay in manufacturing sector recovery could have an impact on output and employment growth.

Banks are under stress due to their deteriorating balance sheets, which are impacting their ability to lend and thereby impacting credit conditions in the economy. In this budget, the government has allocated funds for banks' recapitalization. However, it has also emphasized on the need for merger and consolidation, as well as governance reforms for banks to clean up their balance sheets. In addition, various liquidity measures adopted by the RBI may lower financing costs of banks. These policy measures have significant implications for businesses in the financial sector, which are holding on to cash and are skeptical of lending.

1. There has been a change in the methodology to estimate GDP in India, and the GDP numbers have been revised up.
2. Economic Times Bureau, "Fiscal deficit bang on target, India a bright spot: Finance Ministry", June 1, 2016.
http://economictimes.indiatimes.com/news/economy/finance/fiscal-deficit-bang-on-target-india-a-bright-spot-finance-ministry/articleshow/52526449.cms

3.Omar Rashid, "Will double farm income by 2022: PM", The Hindu, February 29, 2016.
http://www.thehindu.com/news/national/will-double-farm-income-by-2022-pm/article8293327.ece

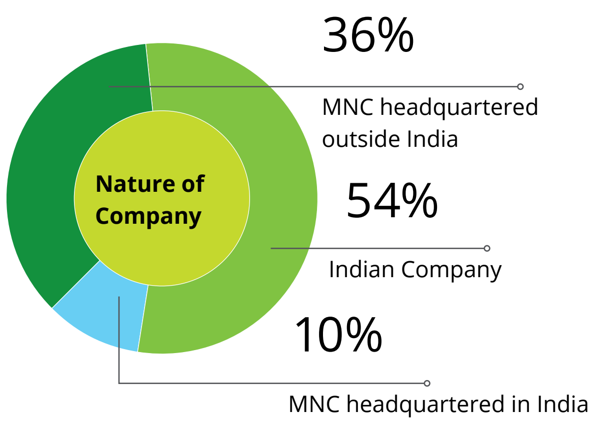
Survey Demographics

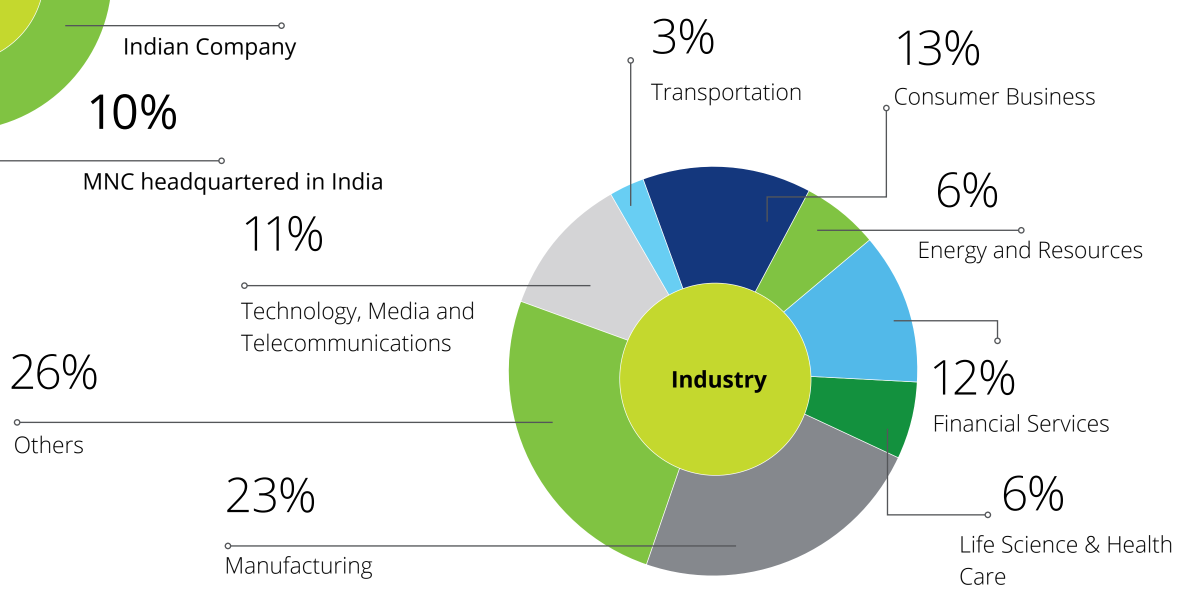


The Deloitte India CFO survey 2016 highlights the stance of CFOs in India on various facets of the Indian economy, investment climate, industry expectations and CFO role and readiness. The report is based on responses from over 300 CFOs comprising from small to large scale companies, with revenues spanning from INR less than 500 crores to more than 2500 crores;and their employee base varying from less than 500 to more than 20,000 employees.

The respondents include listed and unlisted companies from both government and private sectors; and Indian companies, MNCs headquartered in India as well as overseas.

It also encompassed industries across the sectors, including consumer business, energy & resources, financial services, life sciences & healthcare, manufacturing, technology, media, telecommunications and transportation.





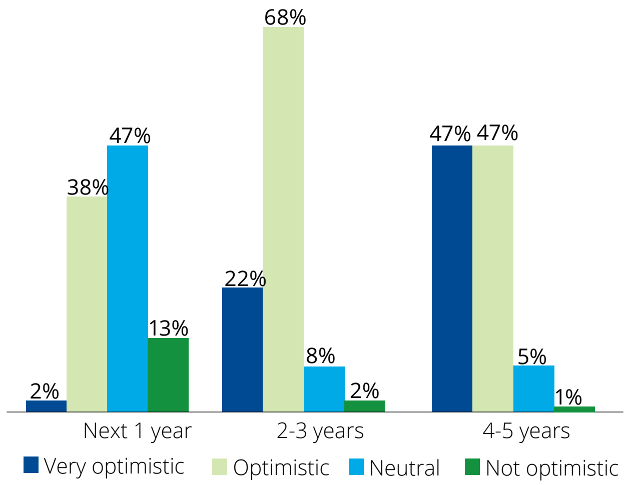
Macro Economy

Greater than 90 percent of the CFOs have expressed confidence in economy over medium and long term

Economic outlook

Business leaders continue to remain optimistic about Indian economy. 90% of the CFOs are optimistic about mid-term outlook and 94% of them have expressed their confidence on the economy even in the long term.

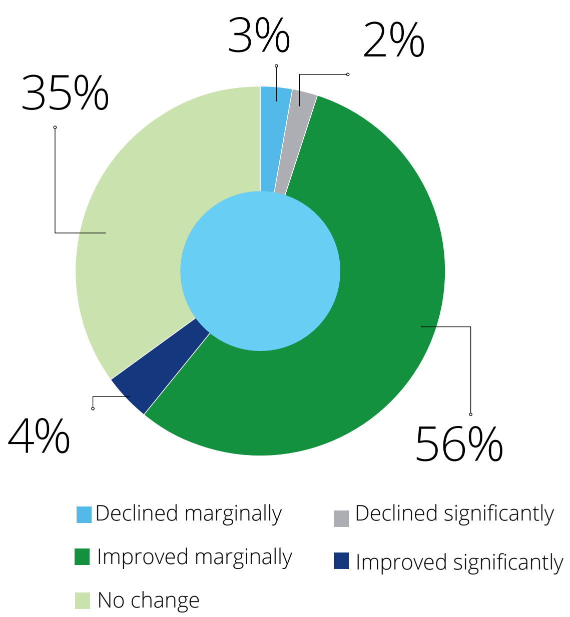
Strong economic performance amid global challenges, ongoing economic reforms, fiscal discipline, and astute monetary policy have contributed in shaping the positive outlook. Factors such as lower commodity prices including oil prices, and lower inflation bode well in the short term. In addition, macroeconomic stability, steadily rising urban demand, increased public investment in infrastructure, and recent policy announcements and reforms are crucial for a sustained growth path.



Ease of doing business

Around 60% of the executives reported a marginal improvement in ease of doing business in India, while 35% of them have seen no change.

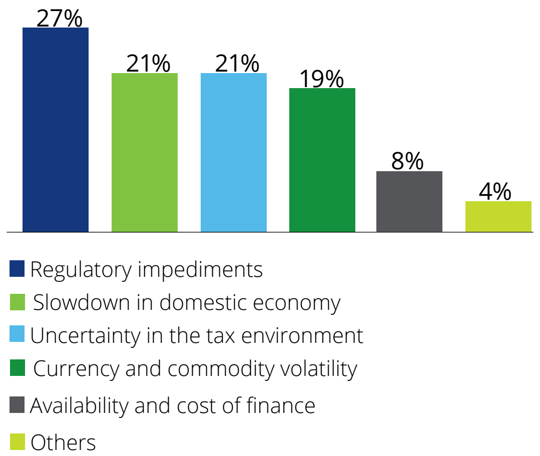
Rationalizing existing laws, encouraging foreign direct investments, increasing governance efficiency, and most importantly, the government's willingness to seek feedback from industries on challenges in doing business have marginally improved the business environment. According to the World Bank's Doing Business report, India moved up four spots and now ranks 130 out of 189 countries in the ease of doing business. However, a lot needs to be done to improve its ranking further. The government recognizes that this is an area which needs further improvement.



Major economic challenges

Despite strong economic confidence, 27% of the CFOs considered regulatory impediments as the biggest economic challenge, while 20% expressed concern over uncertainty in the tax environment posing risks to the economy. Delays in clearing goods and services tax bills and land acquisition bills, among others, are eroding business confidence on the regulatory mechanism. Alongside, factors such as current slowdown in the domestic economy, and volatility in currency and commodity prices, concern a fifth of the survey participants. The revision of the GDP numbers; appreciation of the US dollar; the impact of geopolitical tensions along with record-high oil production in the US on oil prices; and the slowdown of global growth have contributed to these concerns.

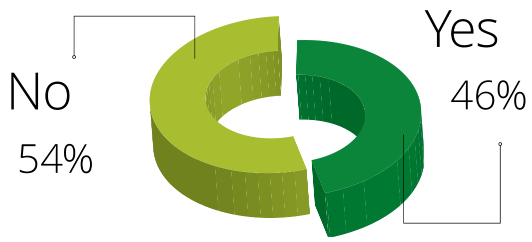
Availability and access to finance concerned only 8% of the CFOs. Despite a cumulative rate cut of 150 basis points since January 2015, the pace at which it is getting translated to lower lending rates, is slow. Besides, rising non-performing assets of banks have affected their lending ability.



Time to take greater business risk

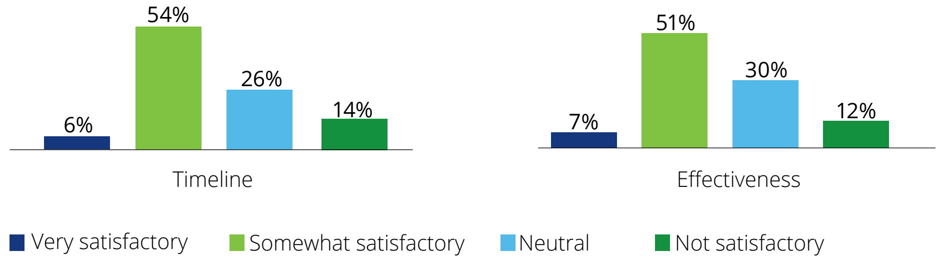
46 percent CFOs are inclined to take greater risk

Given the uncertain global economy and growth being concentrated in certain sectors of the domestic economy, the CFOs were almost equally divided on whether it was the right time to take risks. A key element in the current economic recovery is the pace of investments and the belief that taking risks would be productive and, as such, we have not seen that in our latest survey.



Timeline and effectiveness of government initiatives

60 percent of the CFOs have shown confidence in government programs



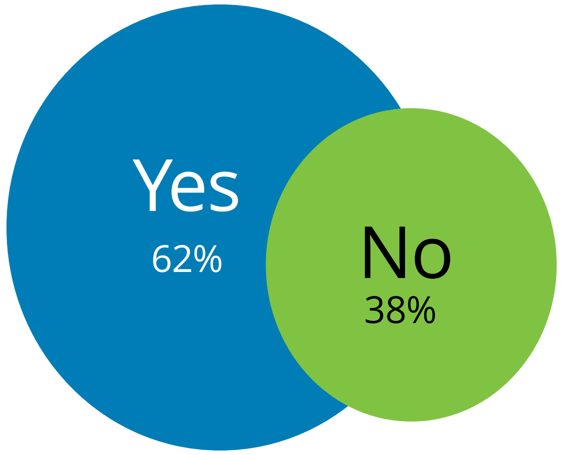
Close to 60% of the survey participants have expressed satisfaction on the timeline and effectiveness of the government initiatives.

Various programs and schemes such as 'Make in India', 'Digital India', 'Smart cities mission', 'Start up India' and 'Skill India', among others, were launched with the intention to improve manufacturing ability of the country, promote innovation and entrepreneurship, create job opportunities, and improve infrastructure and skills.

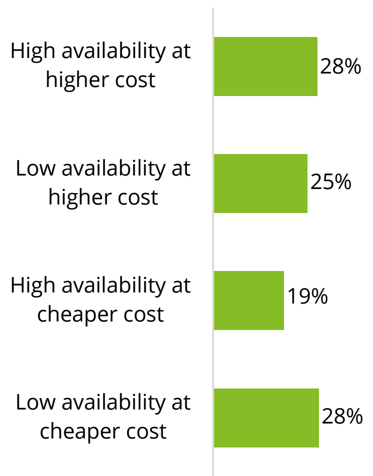
Although, the effectiveness of these programs cannot be fully assessed until they mature over the next several years, many CFOs are in support of these initiatives and are upbeat about the expected outcomes, as evident from the survey. However, a few are skeptical about the effective implementation in the long run and transparency.

Improvement in investment climate

More than 60% of the participants believe that there has been an improvement in the investment climate over the past one year. With the government taking a number of steps to improve the business climate, the CFOs seem to believe that the overall climate for investments has improved.



Cost and availability of credit



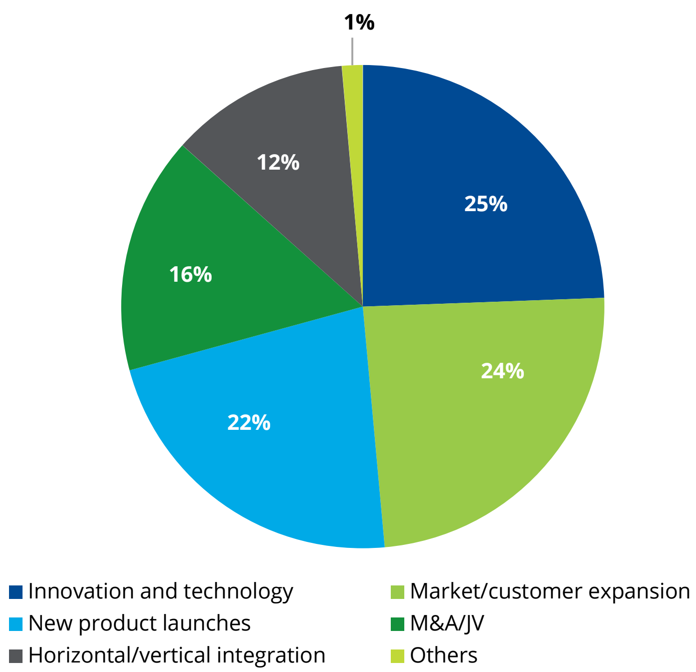
When asked about the availability of credit the responses were mixed with a majority of CFOs saying that credit was available at a higher cost. This seems to be counterintuitive in a year when the borrowing cost for banks have come down. However, this could possibly be based on the belief that banks would find it hard to lend due to the impending structural constraints and increasing risk aversion in the face of the ensuing slowdown in a number of sectors.

Industry Expectations

25 percent CFOs believe that innovation and technology will govern the future investment trends while 24 percent believe need to increase the market or customer base would determine investment trends

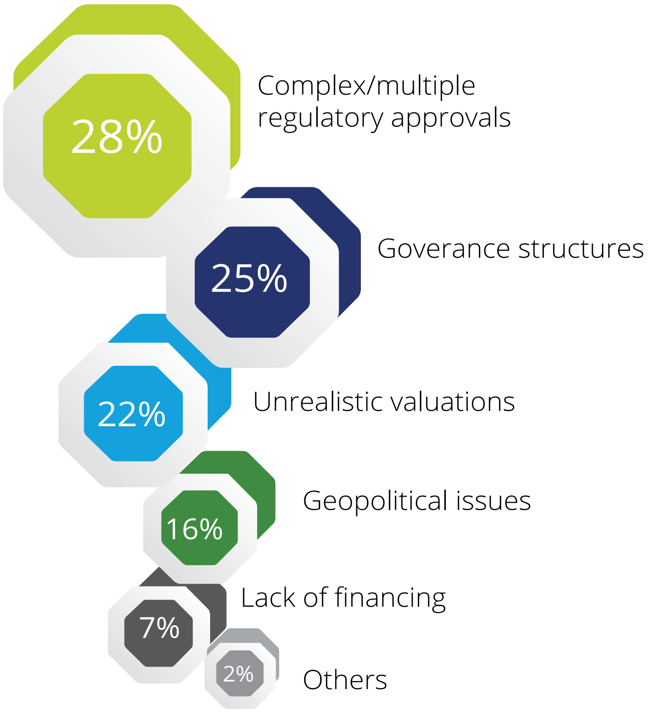
Investment trends

Investment trend expectations in the survey were varied and reflect firms' changing needs amidst developments in the economic situation and business environment. Results showed that CFOs are more focused towards technology and innovation, as it has become almost imperative to innovate in today's markets. The last few years has seen the emergence of big data analytics and a move to cloud based infrastructure bringing in more certainty and flexibility in businesses. Accordingly, the survey reveals that 25% of the CFOs believed that future investment trends will be governed by innovation & technology. This was closely followed by 24% who expected that expansion of their market and customer base is the most important area which would shape investment trends in the future. We believe these results showcase the changing economic landscape where investment in technology is no longer a choice but a necessity. Companies have to invest in all kinds of technologies to grow the business, identify trends, create efficiency and bring their businesses closer to the end consumer. Further, the results indicate investment in increasing the market and customer base would help companies to grow and expand.

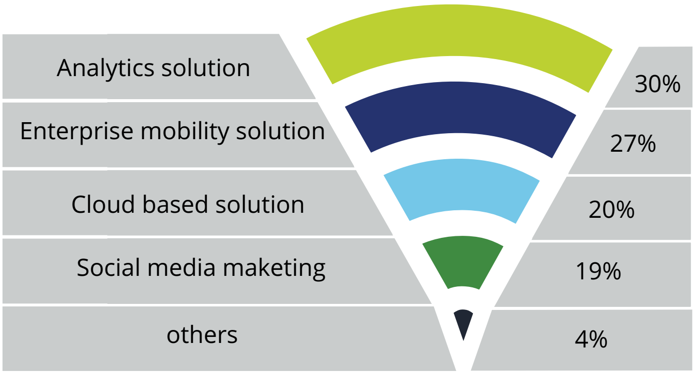


Domestic/ cross border M&A challenges

The M&A space has a number of issues that need to be addressed by the government to create a more favourable environment for firms and individuals to operate in. Regulatory approvals create the biggest challenge followed by issues related to governance structures. Unrealistic valuations in a world of ample liquidity also pose a major challenge and is third on the list. These responses clearly show that a lot can be achieved by merely simplifying some of the existing laws, and creating a more conducive environment with built-in checks and balances..



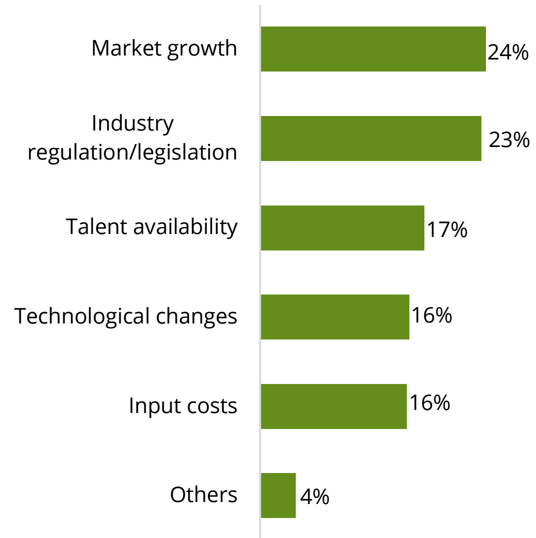
Key technological changes



In a volatile economic scenario where the pace of technological advances are continuously accelerating, companies will need to start adapting to these changes and implementing them into their operations in order to optimize growth through technology. The coming year could likely see numerous technological changes in company processes and procedures. In our survey, use of analytical solutions topped the minds of CFOs. The insights that analytics provide to enterprise on customers, suppliers and other key stakeholders drive the strategic decision making. It helps make business processes smart and more streamlined. Technological changes like cloud computing, analytics, social media marketing also enable mobility of resources and help enterprise provide complete suit of services to the customer. These technological changes have defined a new way of doing business by removing intuition based decisions, moving closer to stakeholders and driving maximum efficiency in business operations.

Key industry challenges in next 3 years

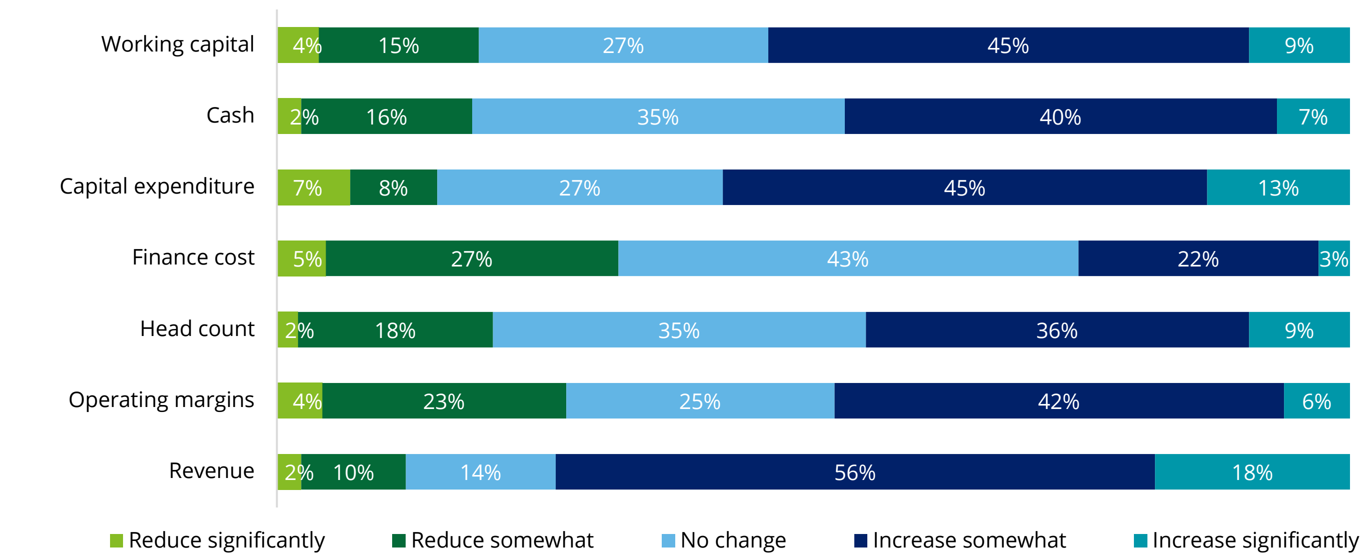
Taking a longer term view, there are some key industry challenges in the business environment which will need to be tackled in the next three years. CFOs believe that market growth will prove to be the biggest challenge in the hyper competitive landscape over the next three years. Despite the efforts of the government, industry regulation and legislation will continue to be an ongoing challenge. These facts indicate that a concerted effort by the policymakers to increase the ease of doing business can help acccelerate growth and provide a stimulus to the economy. With the changing technology, consumer behavior and volatile input costs, it is getting increasingly important for companies to adapt and strategise quickly. These changes are helping business but creating a hyper competitive market. Developing and managing the talent has also become a big challenge with machines replacing manual interventions. There is a need for changing the mindset and align the resources of the company.



Drivers of Business Performance

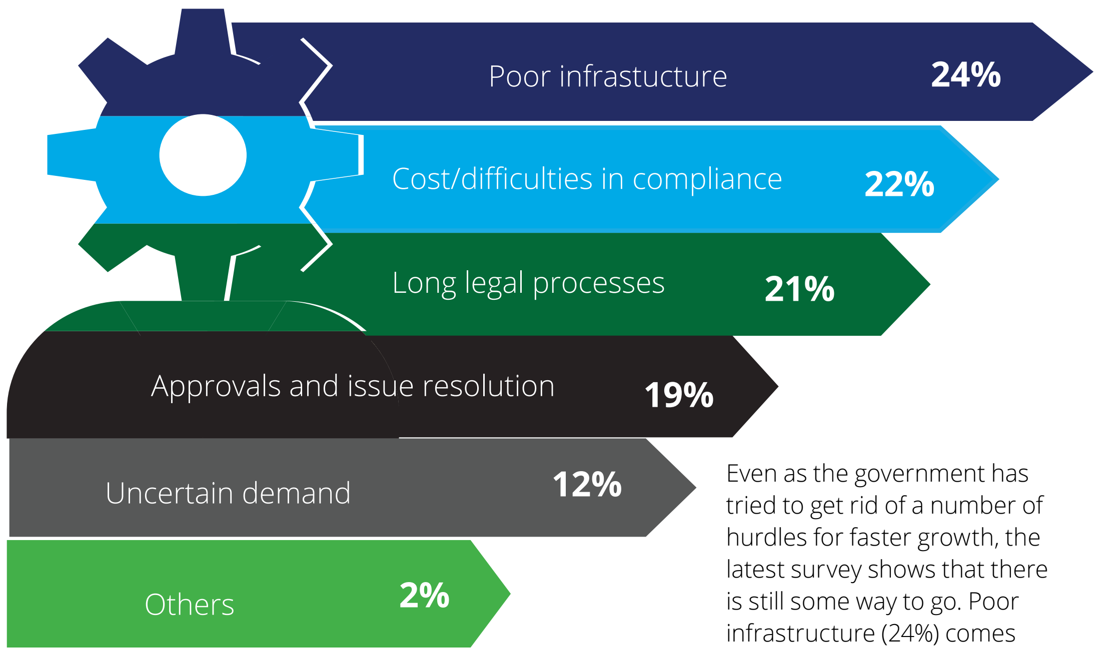
CFOs are optimistic about their company's performance with almost 74 percent believe revenues would increase over next 12 months and 48 percent believe operating margins would also increase

Expected performance



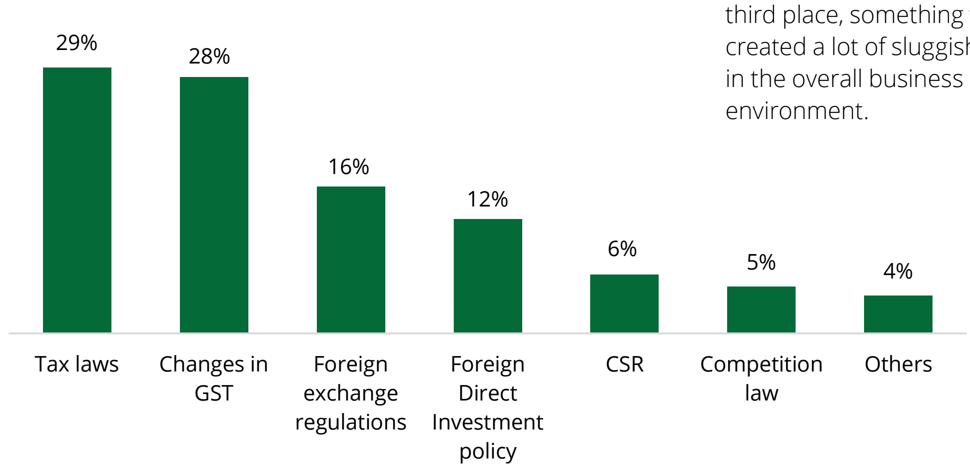
Even though 74% of CFOs are optimistic about increase in revenues in the next one year, the outlook on operating margins look uncertain wherein 48% of CFOs expect increase in margins while 52% expect reduction or no change in margins. However, there was still a silver lining with almost 45% expecting to increase their headcount while 35% said that their staffing levels are likely to be at the same levels. Encouragingly, 58% of the CFOs believe their capital expenditure will increase over the next one year giving credence to the fact that there were some green shoots of recovery in the investment cycle. Lastly, both working capital requirements and cash holdings are expected to increase for the companies over the next one year, which probably implies that they expect a higher inflation in both goods and services.

Business challenges



Even as the government has tried to get rid of a number of hurdles for faster growth, the latest survey shows that there is still some way to go. Poor infrastructure (24%) comes up as the biggest impediment to doing business closely followed by cost/difficulties in compliance (22%). Long legal processes (21%) comes in at third place, something that has created a lot of sluggishness in the overall business environment.

Impact of reforms

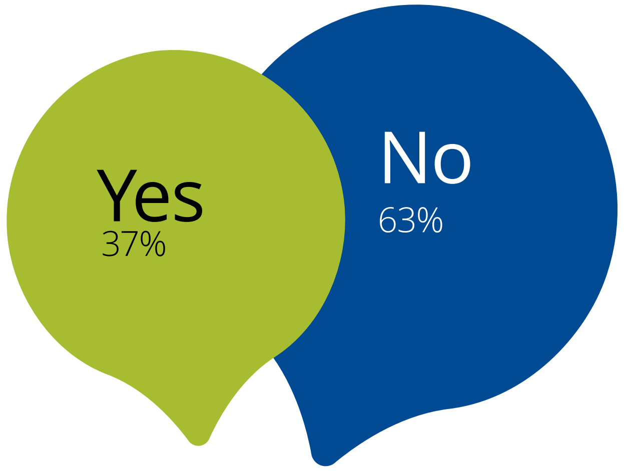


Looking at the regulatory framework, there are major hindrances in the complex regulatory environment which need to be addressed. The consequences of the burdensome and volatile regulatory environment have a significant impact on business operations, and are fundamental issues which CFOs are challenged with in today's business environment. The survey showed that matters relating to tax laws and the impending GST reform have the biggest potential impact on operations. Domestic tax laws have historically been cited as one of the major problem areas for corporates, and have a significant effect on business confidence. The survey showed that reforms in the area of foreign exchange regulations, FDI policy and CSR also have a major bearing on business performance. Whilst the government has initiated various measures to try and tackle these issues in the past year, there is still a long way to go before the processes will be streamlined.

Fraud susceptibility

In our experience, incidents of fraud are rising. The contributors to fraud could be many, ranging from the lack of an efficient internal control/ compliance system, diminishing ethical values, inadequate due diligence on employees/ third party associates, unrealistic targets/ goals linked to monetary compensations; to name a few.

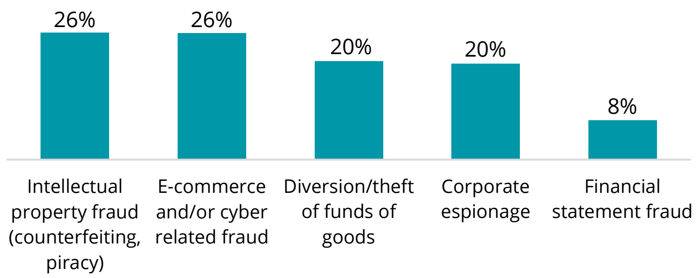
However, an interesting finding to note is that a very small number of respondents to the survey (37%) felt that their company was susceptible to fraud from third party elements. This could be for varying reasons such as companies relying only on internal controls to mitigate the risk from third parties. These controls may or may not detect red flags on a regular basis, leading to complacency on the part of the management.



Key frauds

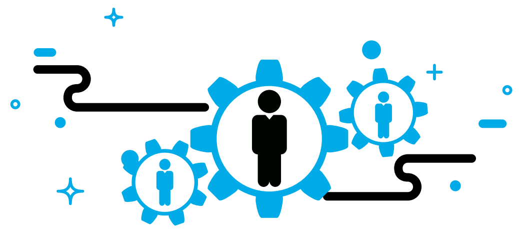
Another important aspect, in order to efficiently tackle the risk of fraud, is to understand the types of fraud that an organization is most vulnerable to. Survey respondents highlighted 'new age' frauds i.e. intellectual property and cyber related fraud that their organizations were most vulnerable to. A major contributing factor for this could be the increasing use of technology within business processes/ models as well as the lack of awareness of the associated risks (and how to prevent them). Increased use of technology in every aspect of business operations has resulted in a new set of dynamics around fraud risk management which companies need to be cognizant of.

Traditional frauds such as diversion of goods, financial statement fraud were also highlighted as vulnerable areas for organizations, indicating that existing fraud risk management mechanisms are perhaps dated and inadequately enforced to tackle these frauds.

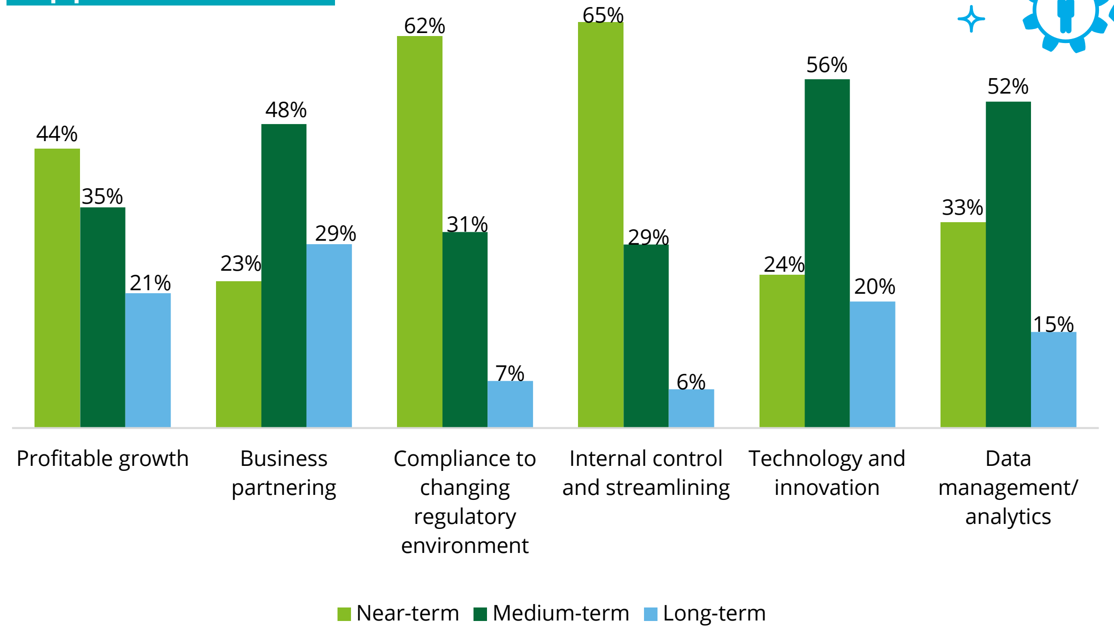


CFO Role

Over 60 percent of CFOs surveyed believe regulatory compliance and streamlining of internal controls would be the key priorities for them in the near term



Top priorities of a CFO



The survey also asked about the CFOs short, medium and long term goals. The survey revealed that 44% of the CFOs believe profitable growth is one of the top priorities in the near term while 35% felt it was important over the medium term and the remaining focused on the longer term.

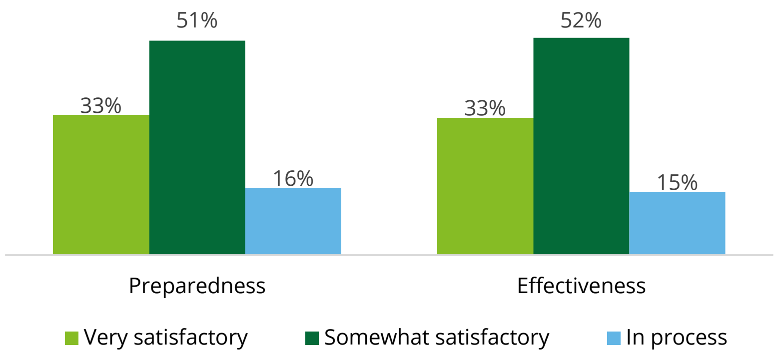
As goals of many functions have become aligned, business partnering has become an important facet of the whole process. However, 48% of CFOs felt that it was important over the medium term while 28% felt it was a priority over the longer term. Given the complex regulatory environment, compliance assumes a major part of the overall work. Results showed that 62% gave it top priority over the near term and 31% felt it was important over the medium term. These results clearly show that while the role of a CFO is changing and more is being demanded from them, the traditional roles remain as important as ever in the near term.

The survey questioned CFOs on how important it was for them to focus on technology and innovation. This question clearly resonated with the CFOs as it has become imperative to innovate in today's markets. Majority of the CFOs saw this as a priority over the medium term, which probably reflects the fact that they want to prepare the systems well before going in for innovation. Similar results were observed when asked to rank importance of data management and analytics. There was a difference though, 33% of the CFOs priortize analytics in the near term as compared to 24% under the category of technology and innovation.

Overall, the survey showed that while there are definite changes taking place in the functions and priority ladder of the CFO, the traditional roles are still being given the highest importance in the near term.

Preparedness and effectiveness of finance teams

Over the last few years complications in the market place have increased and so have the existing roles CFOs have had to play. Since the last crisis many companies have divested their non-core assets whilst also reducing debt, increasing their cash holdings and bringing in more efficiency in their businesses. Many of these transformations have been led by the CFOs and hence required a wider variety of skill sets. Today's CFOs are not only performing their traditional role of preserving the assets of the organization and running a tight and effective finance operation but are also performing the role of strategists and contributing towards deciding on the direction of the business. Research also supports the view that CFOs are being involved in more strategic and top level decision making. In fact, the finance function itself is being considered by some as a strategic business partner. Looking closely at the domestic economy, we see that we are still a high growth environment where CFOs are being pushed to greater lengths to achieve excellence in every sphere of operation.



We now operate in a very dynamic world wherein monetary and financing conditions have become interconnected and volatile. Our survey reveals that most CFOs believed that their finance team levels of preparedness and effectiveness was somewhat satisfactory. However, almost 33% were completely satisfied that their teams were prepared while almost 32% were satisfied with their effectiveness.

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About Deloitte's CFO Program

The CFO Program brings together a multidisciplinary team of Deloitte leaders and subject matter specialists to help CFOs stay ahead in the face of growing challenges and demands. The Program harnesses our organization's broad capabilities to deliver forward thinking and fresh insights for every stage of a CFO's career – helping CFOs manage the complexities of their roles, tackle their company's most compelling challenges, and adapt to strategic shifts in the market.