



# **Deloitte CFO Signals Survey Report**

2018 Q3

Date: November 13 2018

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# About Deloitte CFO Signals

Deloitte CFO Signals is a survey conducted globally at regular intervals by Deloitte to find out what is on the minds of Chief Financial Officers (CFOs). After every survey, the answers of CFOs are compiled and analyzed by Deloitte's experts and published as "Signals" from CFOs.

The survey consists of a survey on the economic environment, which is used globally every time, and a topical survey, whose content differs by country.

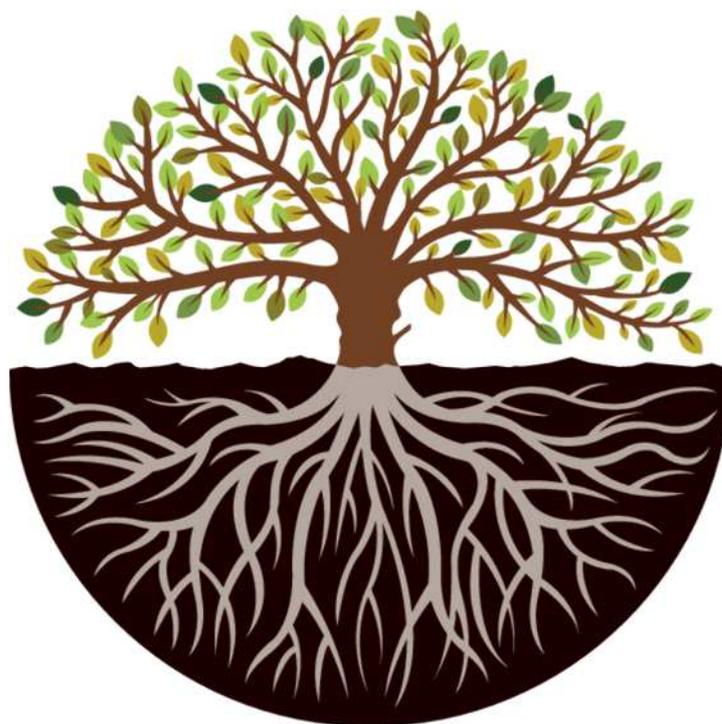
The first survey in Japan was taken in August 2015, and we are now reporting on its 13<sup>th</sup> edition.

Regarding the survey on the economic environment, we analyze chronological changes in CFOs' thinking as well as their latest forecasts at the time of the survey. In addition to the recurring questions, this time we also asked macro-level questions on the Japanese economy and possible risk scenarios affecting the world's major countries. As for Japan-specific topics, we chose to ask CFOs about issues related to private enterprises' social impact initiatives.

This edition of the survey was conducted in October 2018 and received responses from 33 CFOs. Thank you for your cooperation.

Deloitte Tohmatsu CFO Program  
November 13, 2018

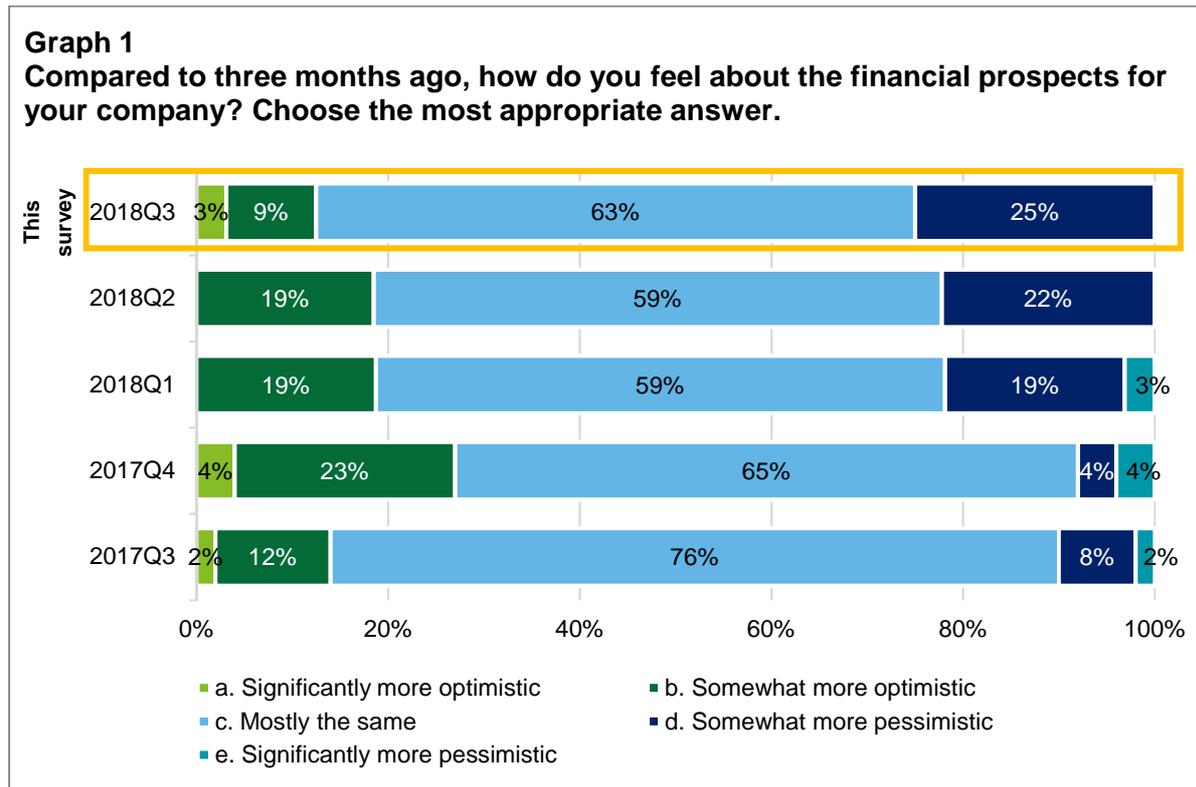
The **CFO** Program



# Survey on the economic environment

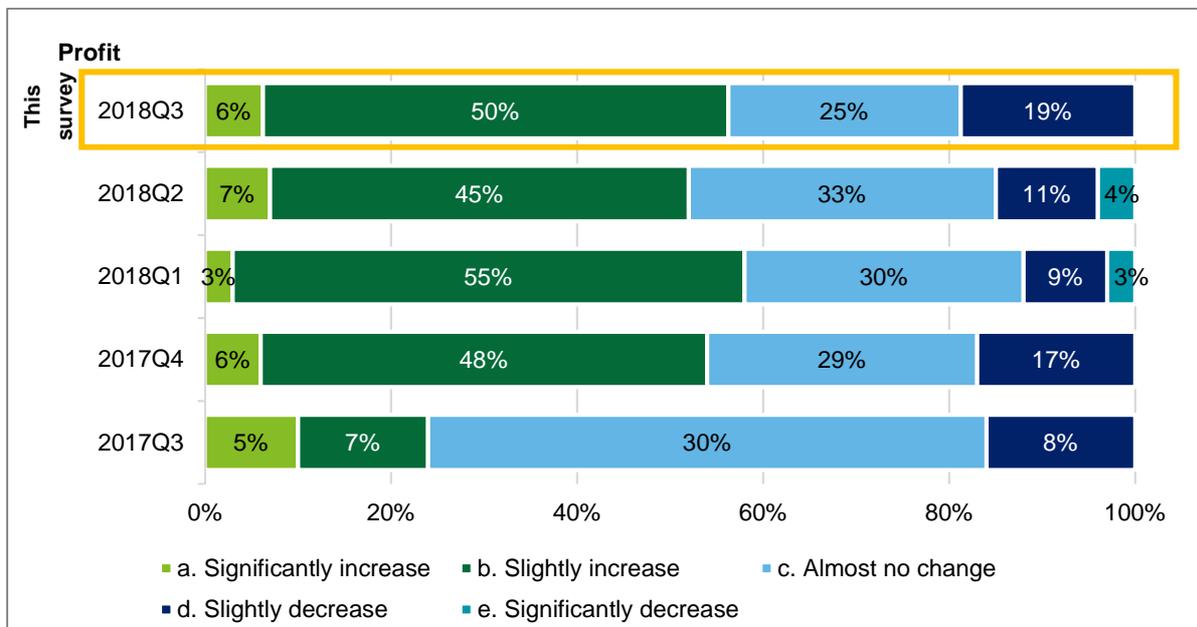
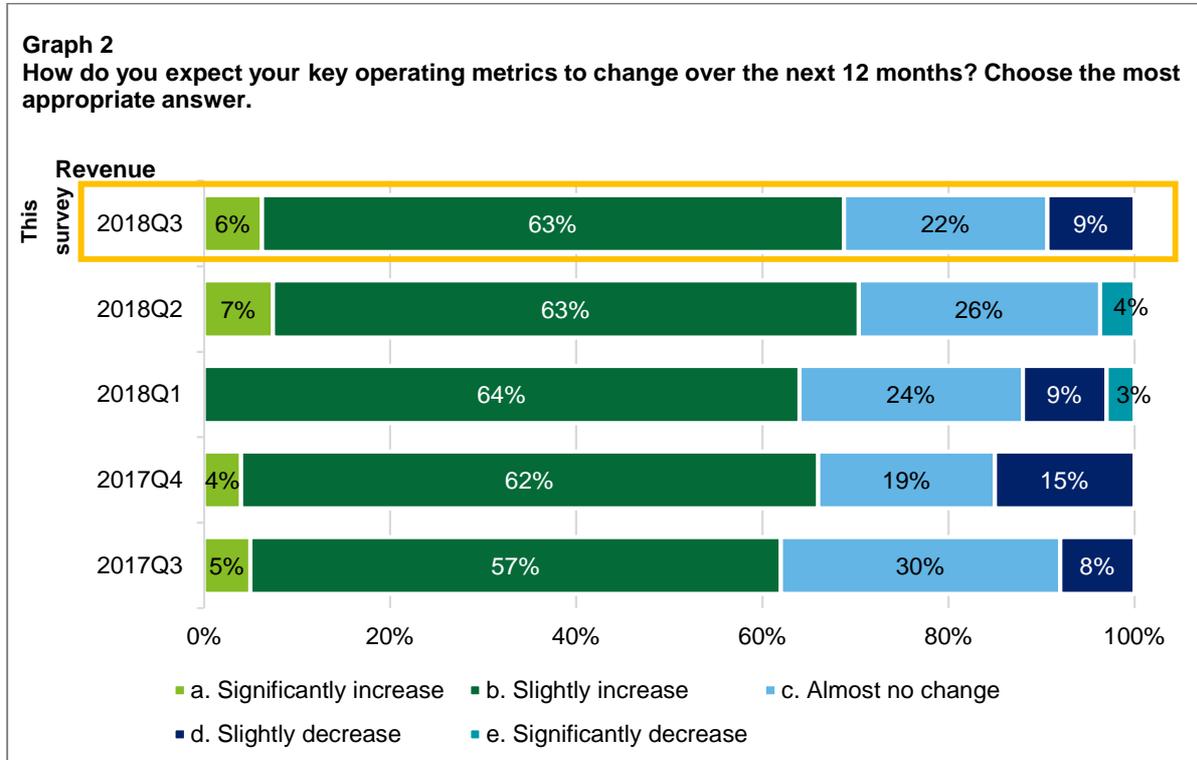
## Financial environment prospects

There has been a retreat from optimism in companies' financial prospects due to changes in the global environment



Graph 1 shows how companies' financial outlook has changed compared to 3 months ago. The percentage of respondents describing their company's financial outlook as "somewhat more optimistic" fell to 9% from the previous quarter's (2018 Q2) 19%. At the same time, the proportion of "somewhat more pessimistic" answers increased slightly from 22% to 25%. The period for this most recent survey, 2018 Q3, saw major changes in the global environment. The Trump administration brought its trade war with China into full force—from September, the US began levying a 10% tariff on USD 200B worth of Chinese imports—and China promptly enacted retaliatory tariffs. In Europe, Brexit negotiations grew more difficult, opening up the possibility of a "no-deal" Brexit. A number of emerging currencies saw major decreases, particularly Turkish lira and Brazilian reals. Chinese stocks and the yuan also saw major falls, raising fears that China's economic growth is slowing down. In Japan, damages from July's heavy rains, September's typhoon 21, and the Hokkaido Eastern Iburu Earthquake brought economic activity to a halt over large areas. These changes in the global economy and financial markets, as well as natural disasters in Japan, are likely to have affected CFOs' optimism toward their company's finances. Going forward, the results of US midterm elections, as well as what happens between now and the end of the year in US-China trade negotiations and Brexit negotiations, are events to focus on and will likely influence CFOs' opinions.

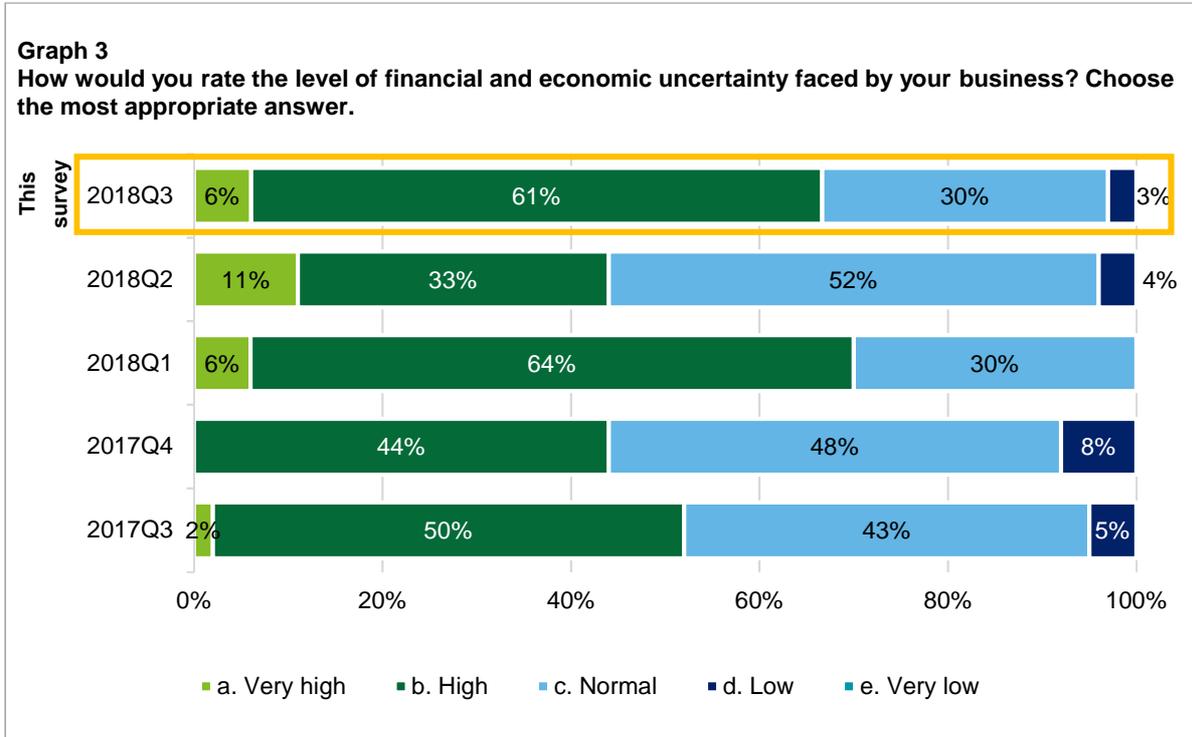
Revenue outlook remains the same



Graph 2 shows CFOs' outlook for their company's financial performance (revenue and profit) over the coming year. A total of 69% expected revenue to either "significantly increase" or "slightly increase," which is nearly the same as the 70% in the previous survey. This trend in financial outlook has continued mostly the same over the past several quarters and is relatively optimistic. As the external environment fluctuates,, CFOs continue to have a "wait and see" attitude toward their financial outlook same as previous survey. A total of

56% expected profits to “significantly increase” or “slightly increase”. Although optimism has increased slightly since the last survey’s 52%, this figure remains unchanged overall. At the same time, the percentage of respondents who expect profits to increase continues to fall below the percentage of those who expect revenues to increase, which suggests that as always, costs are exerting downward pressure on companies’ profits. This is likely a reflection that CFOs continue to expect business costs to rise as a result of labor shortages driving up wages, soaring materials costs, and similar factors. The fact that profit outlook remains relatively optimistic overall in spite of external change is likely due to economic conditions remaining favorable as we enter 2018 Q3 as a result of rising stock prices in developed markets, and the effects of US tax cuts. Nevertheless, it is good to see that most CFOs are keeping a watchful eye on future external changes such as trade wars and the US congressional elections.

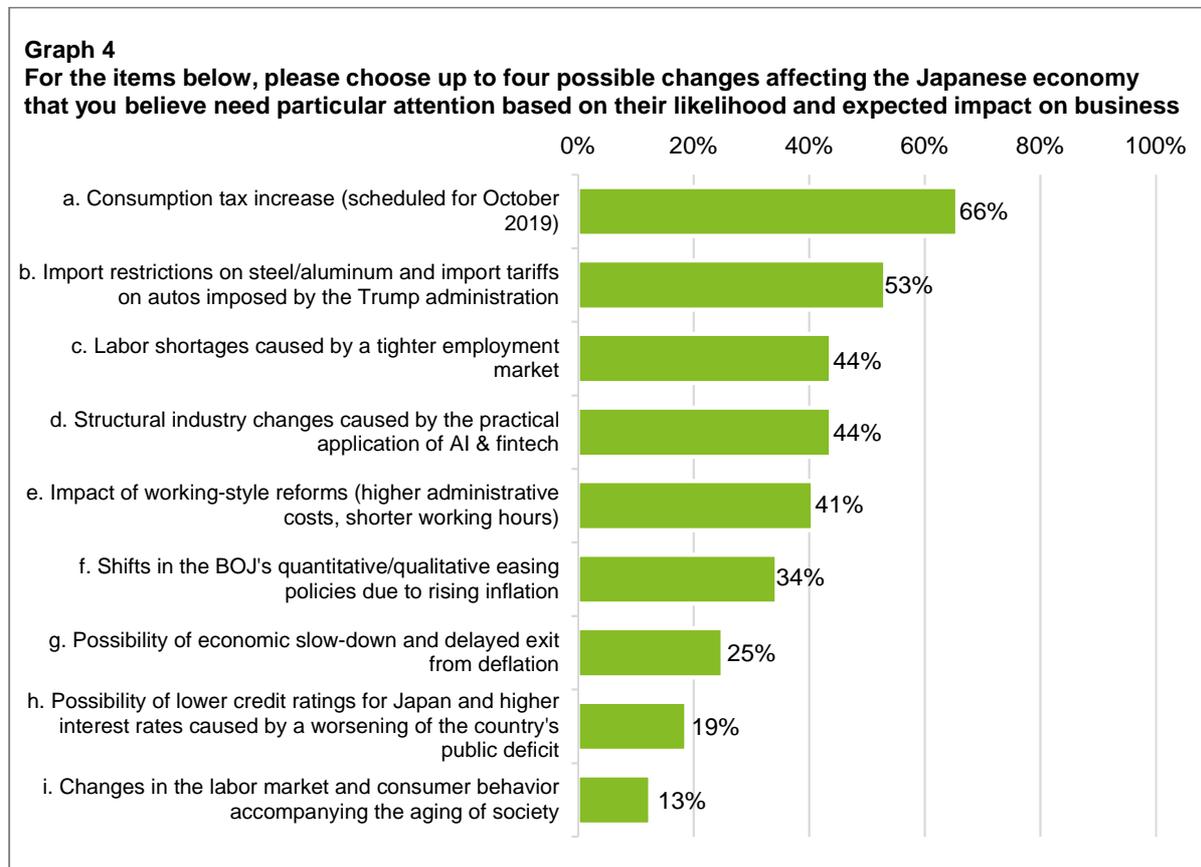
Uncertainty in the business environment has increased significantly



Graph 3 shows CFOs' perception of financial and economic uncertainty. A total of 67% of respondents said that uncertainty was “very high” or “high”—a significant increase from 44% in the previous survey. In the previous survey, there was a significant drop in CFOs' perception of uncertainty and the report predicted that CFOs would feel that uncertainty would increase in the near future, and this result exactly reflects that prognosis. As discussed at Graph 1, possible reasons for uncertainty are: increasing trade friction between the US and China, difficulties in Brexit negotiations, falling values of emerging currencies, and concerns that the Chinese economy is slowing down (detailed at graph 5). There is a strong expectation that the future direction of Brexit negotiations and the trade friction between the US and China will become clear within 2018. In that sense, it could be said that 2018 Q3 is the period with the most uncertainty. Another possible factor in uncertainty is the US congressional elections in November. Although polls suggest that Republicans will maintain a majority in the Senate (upper house), Republicans and Democrats are in a heated battle for the House of Representatives (lower house). The future of the Trump administration's policies and the so-called “Trump market”, which we see in rising stock prices, will depend on whether Republicans secure a majority in the House. For CFOs, financial and economic uncertainty will probably be swayed by ongoing events through the end of this year such as US-China trade negotiations, Brexit negotiations, and the results of US congressional elections.

 **Key change factors in the Japanese economy**

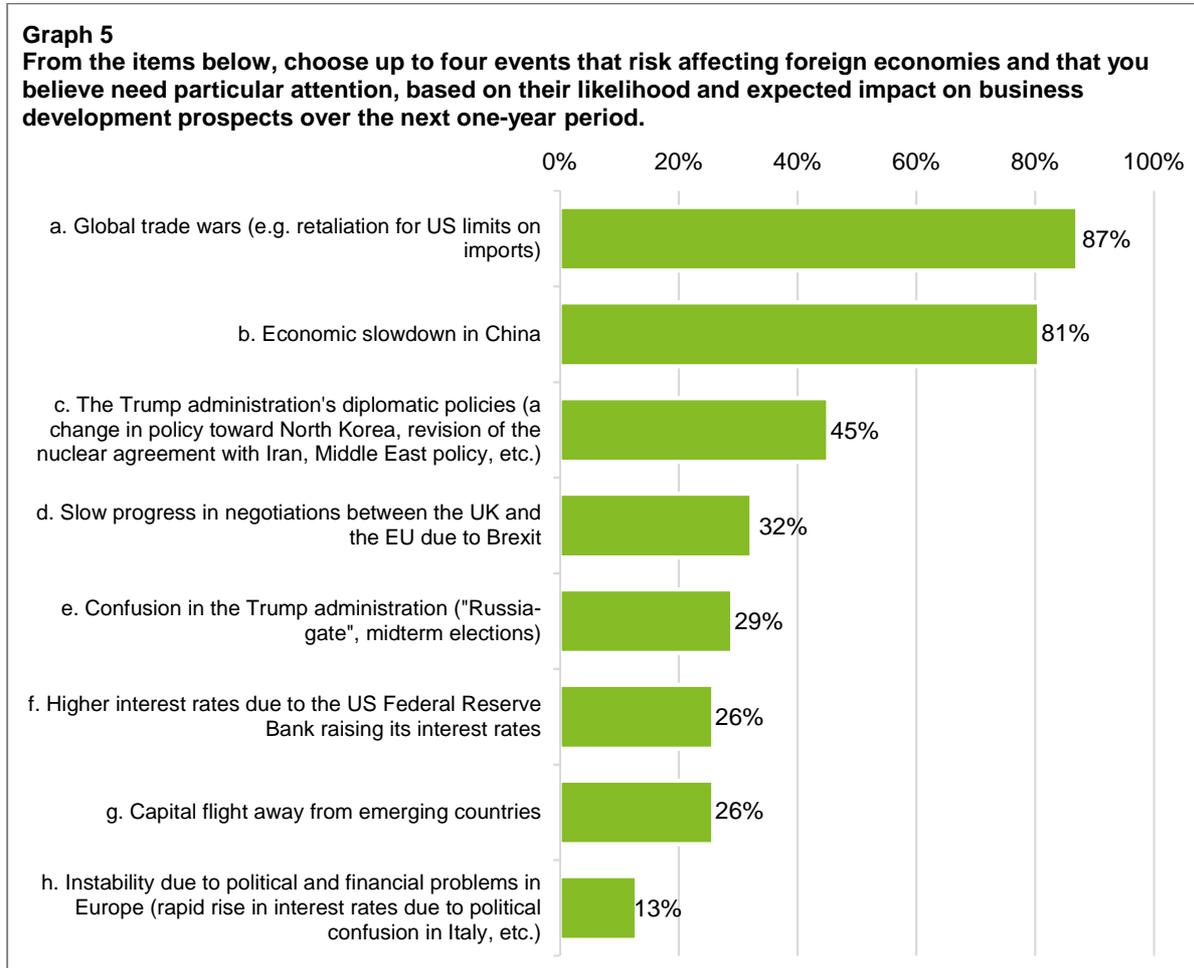
The consumption tax increase and JP-US trade are the highlights with most attentions



Graph 4 shows what trends in the Japanese economy are most closely watched by CFOs when planning business development over the next one-year period. This time, we included a new response, “consumption tax increase (scheduled for October 2019)”, which was the top answer. Just as last time, the number 2 answer was “import restrictions on steel/aluminum and import tariffs on autos imposed by the Trump administration”. After being the top answer for the past 3 quarters, “labor shortages caused by a tighter employment market” fell to number 3 in this survey. Although the labor shortage situation has not changed, it seems that the consumption tax hike and the Trump administration’s trade policies have begun to have a likelihood and impact that exceed that of the labor shortage. There is also a view that the impact of the October 2019 consumption tax increase will be more limited than the April 2014 hike, and the government is expected to provide some fiscal stimuli. However, when we consider that the effects of the April 2014 hike far exceeded government estimates, we really have no idea what results the upcoming increase will have. In Japan-US trade relations, the focus has shifted to the Trade Agreement on Goods agreed on at September’s Japan-US summit. Although the US has declined to impose auto tariffs at this time, it may propose harsh conditions against Japan too, considering that the new United States-Mexico-Canada Agreement includes provisions on exchange rates and limits on the number of vehicles that can be imported. Although the labor shortage issue fell to number 3 in this survey, it will remain a major concern of CFOs.

€ Key change factors in the global economy

The global trade war and the Chinese economy continue to be main points of focus



Graph 5 shows what trends in the global economy are most closely watched by CFOs when planning business development over the next one-year period. The most popular response this time was “global trade wars (e.g. retaliation for US limits on imports),” followed by “economic slowdown in China” and “the Trump administration’s diplomatic policies”. The top 3 responses did not change from the previous survey. As seen in Graph 4, the Trump administration’s trade policies on China invite retaliatory measures, and we are now witnessing a full-blown trade war to an even greater degree than predicted. Economic growth in China in Q3 was 6.5% higher than Q2, which was the lowest growth rate since 2009. The trade war may be becoming a weight on further economic growth. Although the Chinese government and central bank have implemented economic stimulus measures such as encouraging financing and lowering the deposit reserve rate, these effects have so far been limited. The Trump administration’s diplomatic policies against Turkey, Saudi Arabia, North Korea and others grow more complicated. Although in some views that the US-China trade wars will reach some sort of conclusion by the end of 2018, it is possible that economic slowdown in China will remain a medium-term risk factor. It is highly likely that for CFOs, the Chinese economy will continue to be one of the top risk factors.

# Awareness of companies' social impact initiatives

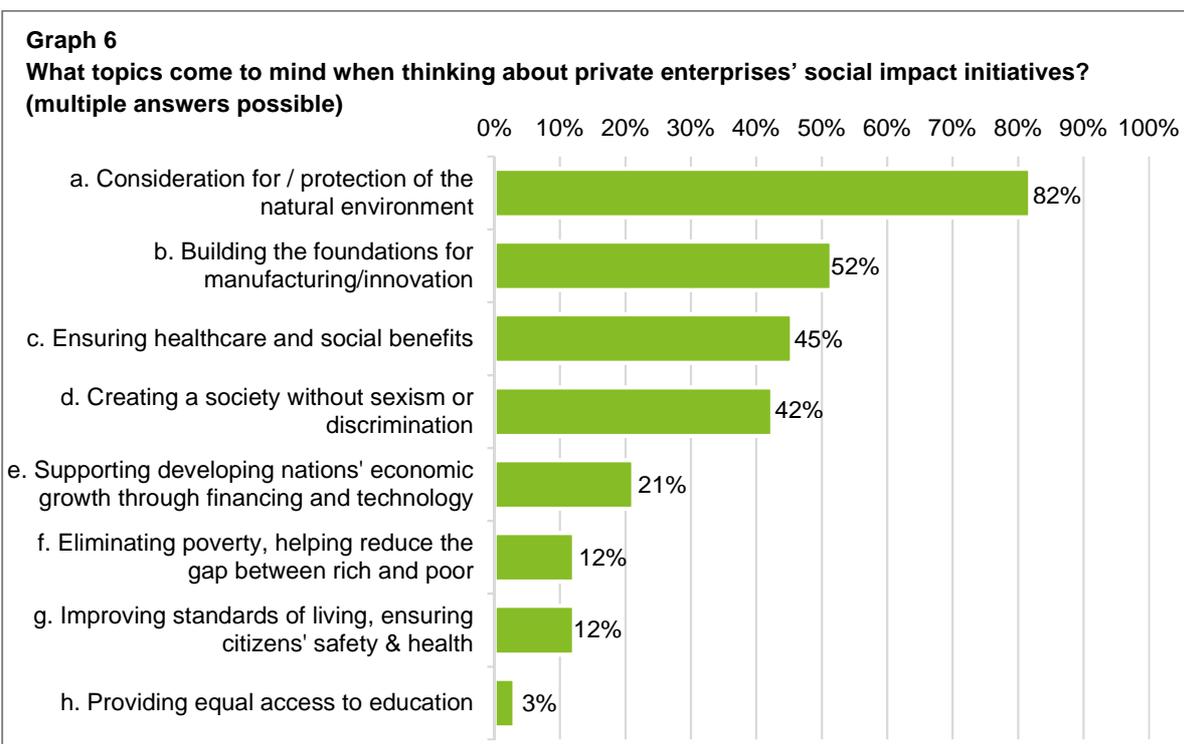
Recently, respondents are once again mentioning the importance of sustainability. In this survey, we asked CFOs for their thoughts about the current situation of and obstacles to private enterprises' social impact initiatives.

There is broad understanding that continued growth requires us to consider the natural environment as we grow economically, and to attempt to reduce discrimination in society. These issues were traditionally seen as items issues to be tackled at the national/UN level. In recent years, organizations like the Davos forum have been shining a light on issues that companies cannot ignore and even in Japan, there is renewed awareness of issues that companies must work on.

In a separate program where Deloitte directly interviewed companies, we learned that although several companies had been aware of the urgency of those issues for some time, they had only recently made company-level changes such as setting up departments to work on these issues, clarifying their policies, or beginning to publicize their initiatives in reports or on websites. One possible major issue is how to determine the appropriateness of allocating funds to tackle social issues, especially for private companies as they are required to be ever mindful of cost vs. performance. In this survey, we asked CFOs for their current assessment of and frank opinions on these hot topics that are once again commanding our attention.

The themes of this year's CFO Vision Conference, which the Deloitte Tohmatsu group holds every summer, was the strategic importance of sustainability-minded business management.

Event overview: <https://www2.deloitte.com/jp/en/pages/finance/articles/cfop/cfo-vision-2018.html>



Our first question asked respondents what they associated with the phrase “social issues” to learn how they understood the topic on a very basic level. We can see that the clear majority of respondents at 82% associate “social issues” with the longstanding issue of “consideration for / protection of the natural environment”. Although “building the foundations for manufacturing/innovation”, a choice that is likely relevant to many companies, had the second most responses, it has about the same level of awareness as the broader social issues of “healthcare and social benefits” and “creating a society without sexism or discrimination”.

On the other hand, the low awareness of issues such as “eliminating poverty, helping reduce the gap between rich and poor” and “improving standards of living, ensuring citizens’ safety & health” may be because CFOs view these as issues for developing countries. It is somewhat of a surprise that “providing equal access to education” had the lowest awareness, because this is an issue faced by developed and developing nations alike, and it is also considered a factor in supporting manufacturing platforms.

The 8 choices we provided in this survey summarize the United Nation’s 17 designated Sustainable Development Goals (SDGs)<sup>1</sup>, all of which are recognized as items that our global society must resolve.

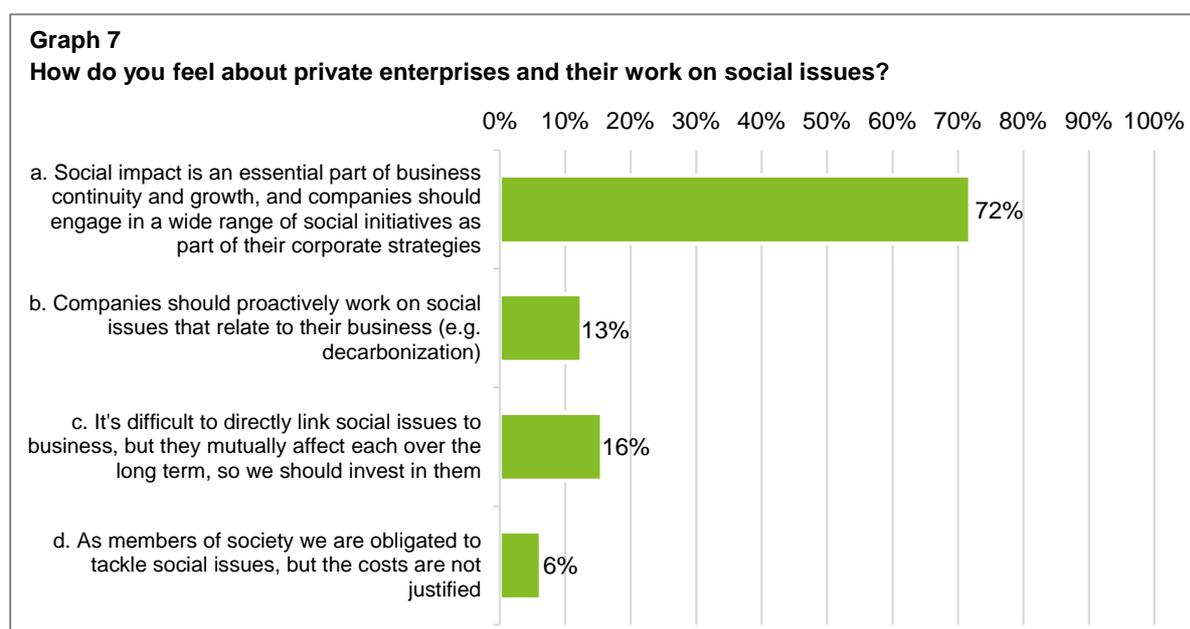
1. Member states of the United Nations adopted the 2030 Agenda for Sustainable Development to carry over Millennium Development Goals at a United Nations summit held at the UN HQ in New York in September 2015. The agenda includes Sustainable Development Goals (consisting of 17 goals and 169 targets) which are to be met on a global level between 2016 and 2030. The agenda also pledges to “leave no one behind” in global development.



## Opinions about private enterprises' social impact initiatives<sup>2</sup>

Next, in order to gauge their awareness of problems, we asked CFOs whether private enterprises should do to help resolve social issues, and how the cost vs. benefit relationship should be viewed.

The UN adopted its SDGs in 2015, but the importance of sustainability in business management was not revisited until the beginning of 2018 when SDGs were shared with business leaders as one of the topics of Davos forums. This time lag suggests that private enterprises are faced with a mental hurdle when it comes to investing in or covering the costs of something whose benefits are not immediately apparent.



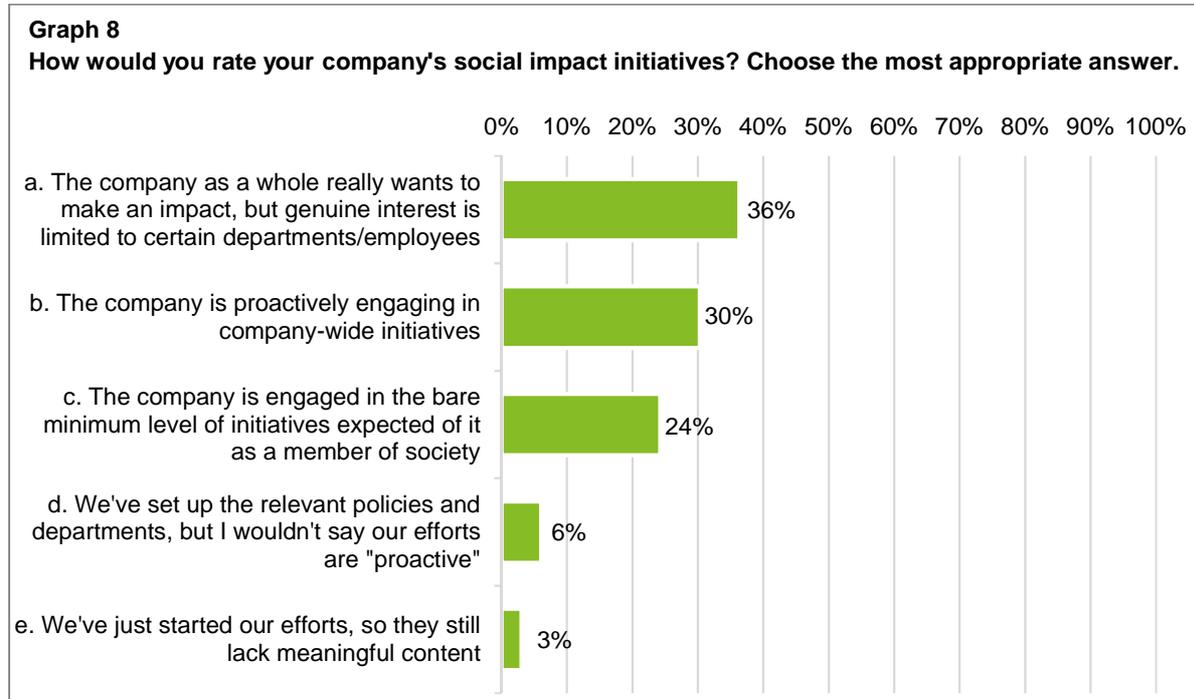
The most common response was “social impact is an essential part of business continuity and growth, and companies should engage in a wide range of social initiatives as part of their corporate strategies” at 72%. Moreover, the “clear-cut” response of “it’s difficult to directly link social issues to business, but they mutually affect each other over the long term, so we should invest them” had 3% more responses than “companies should proactively work on social issues that relate to their business (e.g. decarbonization)”. It seems that at least some companies feel that including environmental and social sustainability in business management is an effort whose direct contributions to the company’s business are difficult to see. In addition to that, more than a few respondents felt that the costs of social impact initiatives were an issue. Although CFOs understand that there is a significant need to make social impact, the fact that they don’t know how to determine the appropriateness of costs suggests that they are also aware of the reality of doing so.

2. Recalculated after allowing multiple answers



## State of your company's social impact initiatives

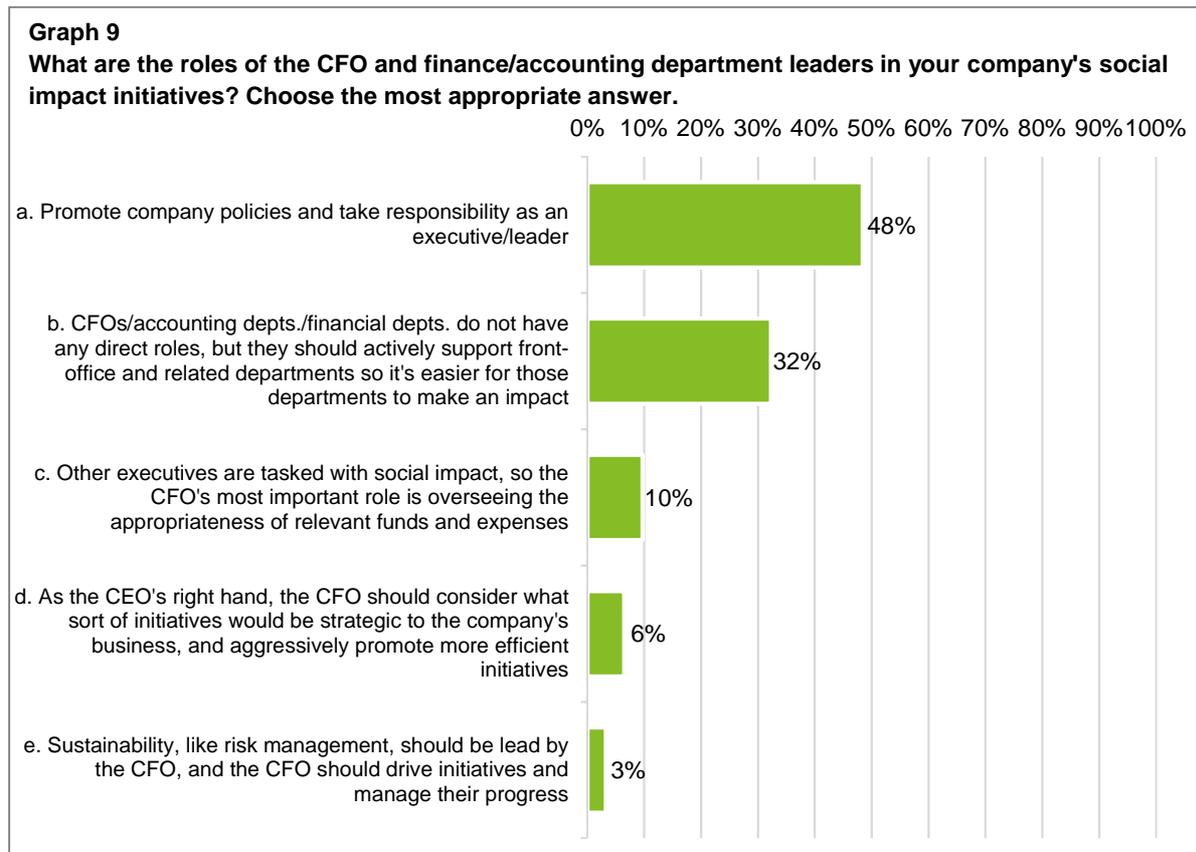
We asked CFOs 3 questions to get their appraisal of the state of social impact initiatives at their company.



Only 30% of CFOs said that their company was “proactively engaging in company-wide initiatives”, showing that only around 1/3 of companies had some level of confidence in their own initiatives. The fact that the most common answer was “the company as a whole really wants to make an impact, but genuine interest is limited to certain departments/employees” suggests that although companies have begun initiatives, many CFOs have their doubts about whether individual employees fully comprehend the importance of such initiatives. In recent years, investors started to evaluate enterprises' environmental awareness and degree of social impact, such as the case of ESG investment, and this trend might evoked enterprises to start formatting appearance to be seen as social matters conscious. . In actuality, nearly all large corporations have several pages of their websites devoted to their sustainability and humanitarian initiatives. Nonetheless, many CFOs seem to feel that such initiatives are a work-in-progress, and nearly all the companies we spoke with individually had similar answers to those in the above graph.

 Roles of the CFO in social impact initiatives

This survey's theme was "private enterprises and social impact initiatives", and we asked CFOs for their opinions on such initiatives so far. Although the majority of respondents understood that private enterprises should proactively work on social impact, most of them tended to feel that their own company's initiatives were not up to par. For our last question, we asked CFOs what their roles were in making social impact, given the current state of their company's initiatives.



Around half of respondents said that making social impact is part of the CFO's roles as an executive, and very few respondents felt that the CFO's role was to lead social impact initiatives. Those answering b, departments should provide support for initiatives, or c, the CFO's role is supervising expenses, might mean that CFOs want to proactively promote initiatives within the context of their existing roles in the company. If CFOs in Japan are expected to take on the role "promoting strategies as the CEO's right-hand person" as they are in western companies, they may need to become more actively involved in sustainability, social impact, and similar activities.

## What is the CFO program?

The CFO Program is a comprehensive initiative by Deloitte Tohmatsu Group, aiming to provide support to the CFOs of companies that underpin the Japanese economy, add to the capabilities of those CFOs' organizations, and thus revitalize the Japanese economy itself. Professionals with different specializations work together as trusted advisors to help CFOs solve the problems they face. We also endeavor to improve the competitiveness of Japanese businesses by providing CFOs with the latest information, including global trends, as well as networking opportunities across different companies and industries.

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