Deloitte CFO Signals Report

2021Q1

June 2021

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About Deloitte CFO Signals

Deloitte CFO Signals is a quarterly global survey for investigating the thinking and actions of leading Chief Financial Officers (CFOs). We share the highlights of survey results with analysis from Deloitte Tohmatsu and publish them as the CFO Signals report.

The survey consists of two sessions: the “Survey on the Economic Environment”, which is assessed globally in every edition, and “Survey on Hot Topics”, which varies for each country.

In Japan, it was conducted for the first time in August 2015, making this the 23rd edition. In the “Survey on the Economic Environment”, we analyse chronological changes in CFOs’ thinking as well as the latest forecast at the time of the survey. In addition to recurring questions, we also inquire about the ESG/sustainability management.

Surveys for this edition were conducted in May 2021, and we were able to receive responses from 46 CFOs and finance and accounting executives.

Thank you for your cooperation.

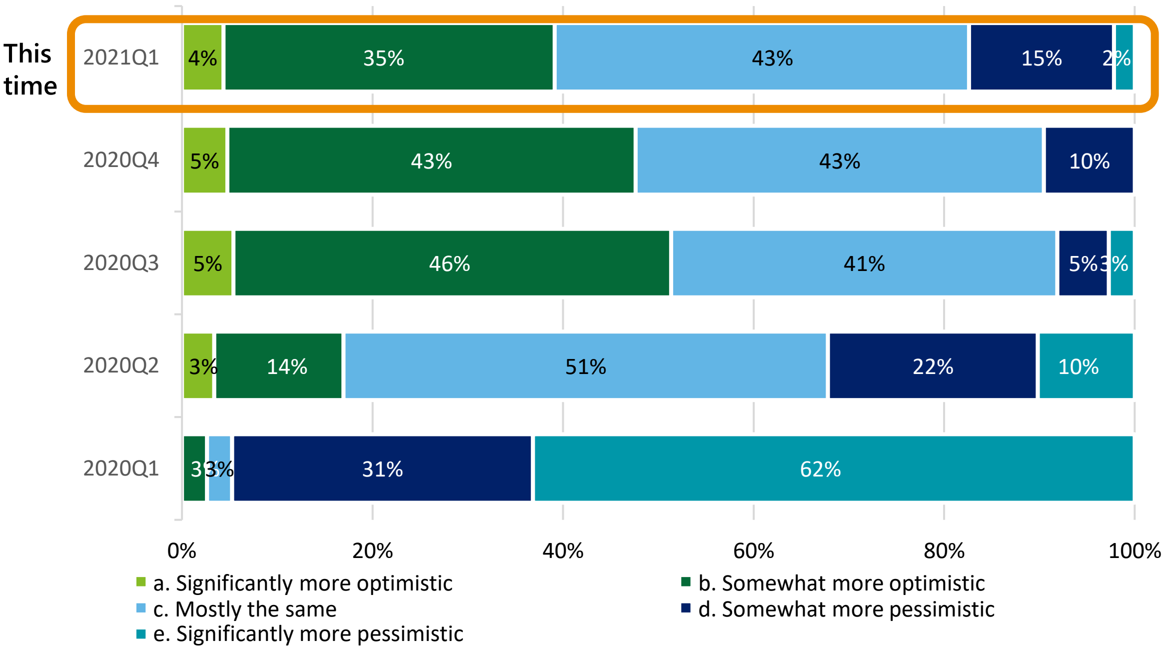
Deloitte Tohmatsu Group
The CFO program
June, 2021

Survey on the economic environment

Financial environment prospects

Optimism in the financial prospects is on the decline.

Graph 1
Compared to three months ago, how do you feel about the financial prospects for your company? Choose the most appropriate answer.

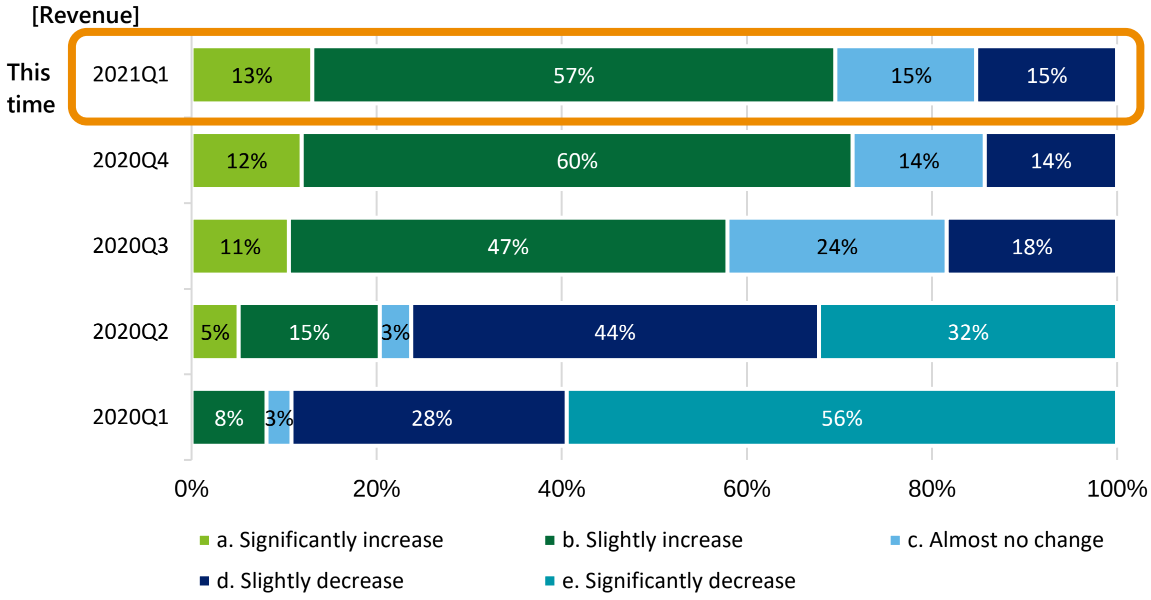


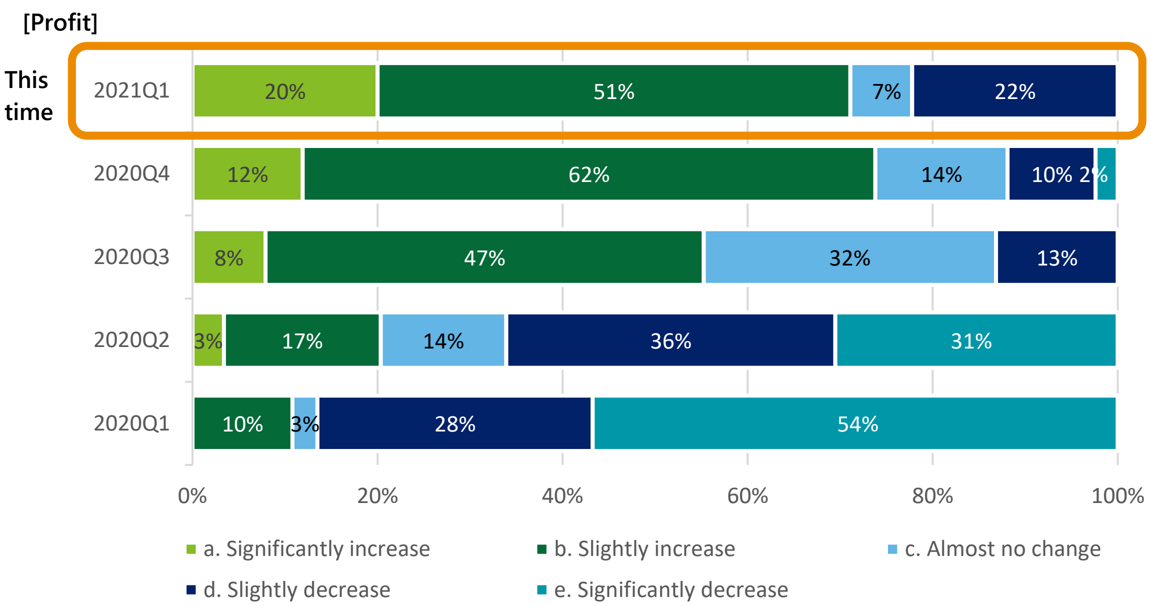
Graph 1 shows how the financial prospects of the respondents' businesses have changed over the last three months. In this 2021Q1 survey, 39% of respondents were "Significantly more optimistic" or "Somewhat more optimistic," down from 48% in the previous survey, while 17% were "Significantly more pessimistic" or "Somewhat more pessimistic," up from 10% in the previous survey. For the second consecutive quarter, the level of optimism in the financial prospects worsened. This survey was conducted in May 2021, when Japan declared its third state of emergency regarding a new coronavirus infection in April and decided to extend it in May. It is likely that the third wave of COVID-19 and the resulting restrictions on economic activity have worsened the CFO's financial outlook. However, we should expect an improvement in the financial prospects going forward. The declaration of a state of emergency was lifted on June 20, and the Tokyo Olympics are expected to be held as scheduled. According to the Cabinet Office's Economic Watcher Survey, the DI for the economic outlook declined in March and April, and then improved slightly in May. Vaccinations are underway in Japan as well, and it is expected that the comapanies' concerns regarding the coronavirus will gradually recede in near future. If there is no major rebound after the declaration is lifted or a rapid expansion of mutated strains, we should expect CFO business sentiment to improve in the next 2021Q2 survey for the first time in a while.

Business performance outlook

Business outlook is stable.

Graph 2
How do you expect your key operating metrics to change over the next 12 months? Choose the most appropriate answer.



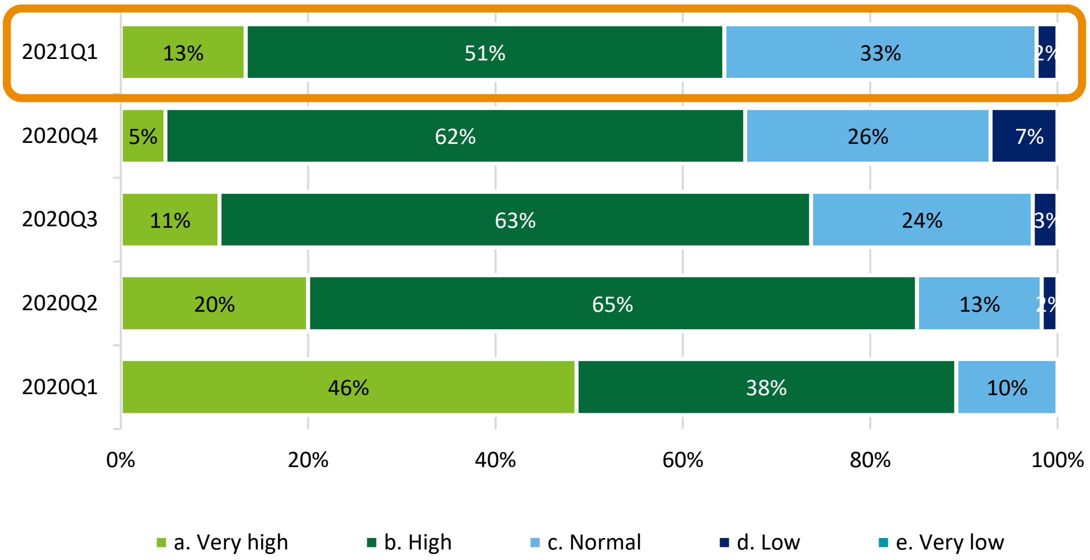


Graph 2 shows CFOs' prospects for their company's financial performance (revenue and profit) over the coming year. In this 2021Q1 survey, 70% of the respondents answered that they expected revenue to "Significantly increase" and "Slightly increase," while 71% answered the same for profit. Although these figures were slightly down from the previous survey, they accounted for the majority for the third consecutive quarter. The optimistic outlook regarding the performance prospects has remained stable despite rapid changes in the business environment. Today, more than a year after the outbreak of the new coronavirus infection, the sensitivity of corporate earnings in correlation with COVID-19 situation is expected to decline. In addition to telework and other working style reforms, we see reasonable progresses in promoting and implementing business model reforms to suit the newly work environment. The accelerating economic recovery overseas, especially in the US and China, also provides a tailwind for exporters. The corporate business performance outlook is expected to improve further as the COVID-19 pandemic comes to an end globally. However, it should be noted that 22% of the respondents expected a "Significantly decrease" or "Slightly decrease" in revenue, up from 12% in the previous survey, suggesting that the impacts and the response of COVID-19 varied by the business industry.

Uncertainty

Uncertainty continues to be high.

Graph 3
How would you rate the level of financial and economic uncertainty faced by your business? Choose the most appropriate answer.

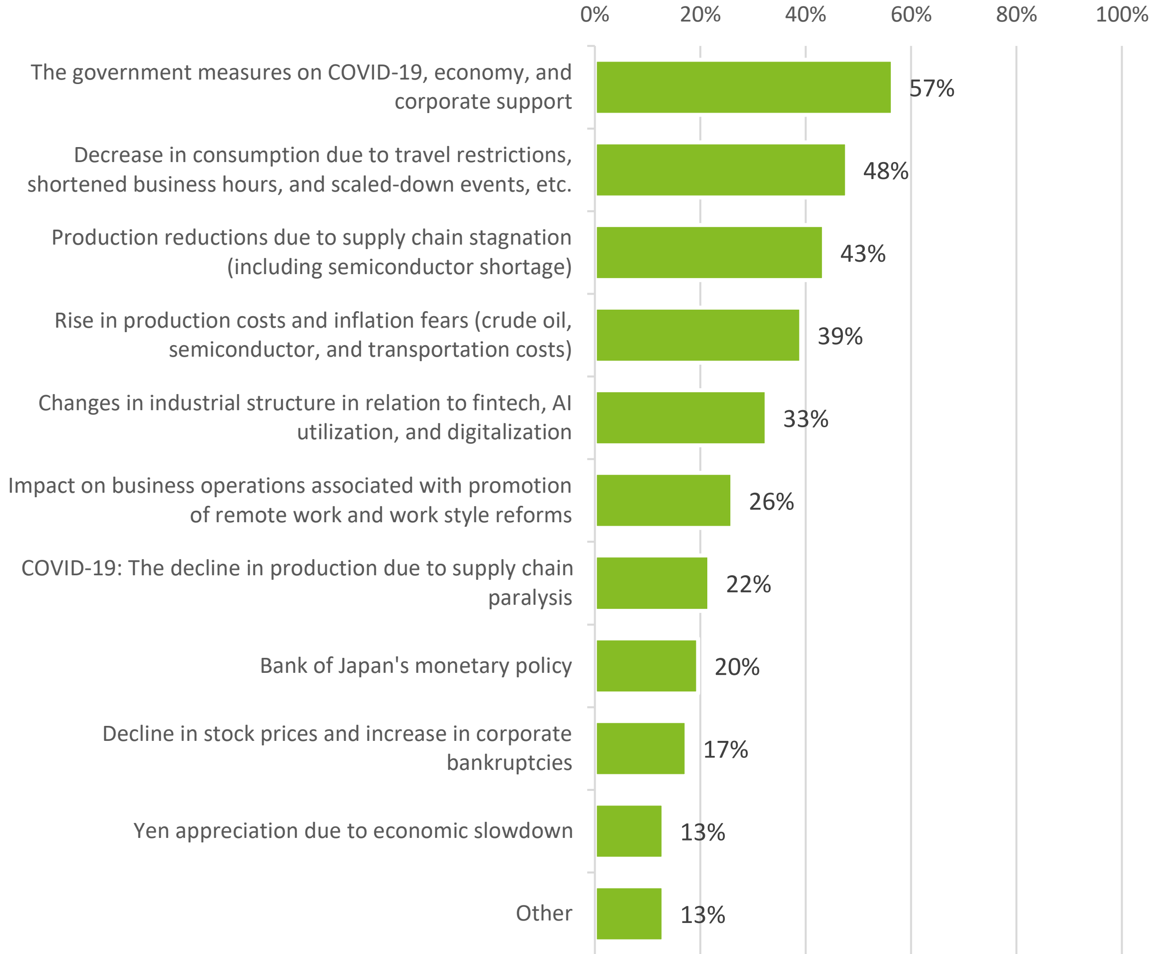


Graph 3 shows CFOs' perceptions of financial and economic uncertainty. The total number of respondents who answered that financial and economic uncertainty was "Very high" or "High" was 64%, almost unchanged from 67% in the previous survey. Uncertainty toward the environment remains high among CFOs. However, uncertainty has declined for four consecutive quarters since the outbreak of the coronavirus last year. Uncertainty has been gradually decreasing as a result of the penetration of government and corporate countermeasures against this infectious and the progressive vaccination. However, there are still uncertainty factors in the global political economy as well as concerns about the expansion of mutant stocks. These include military tensions over Taiwan, US-China political and economic confrontations, rising interest rates as the economy recovers, and concerns about inflation. There is also much yet to be determined in ESG-related markets, such as climate change and human rights issues, that companies are required to address. Even if the coronavirus appears to be under control, it is difficult to say that each company has a clear scenario for normalization after the coronavirus has been contained. Uncertainty associated with coronavirus is expected to continue to recede, but uncertainty in the new normal era is likely to remain to some extent.

Key factors in the Japanese economy

Growing focus on supply chain stagnation and production costs.

Graph 4
For the items below, please choose up to four possible changes affecting the Japanese economy that you believe need particular attention based on their likelihood and expected impact on business development prospects over the next one-year period.



[Other free comments to add/decrible the reasons for the selection]

・Acceleration toward a decarbonized society
・Progress and acceleration of cashless and touchless transactions
・Vaccination status of coronavirus in Japan
・Inbound travel from abroad for tourism and business purposes.
・Political instabilities ;
the possibility of holding the Olympics & the general election for the House of Representatives

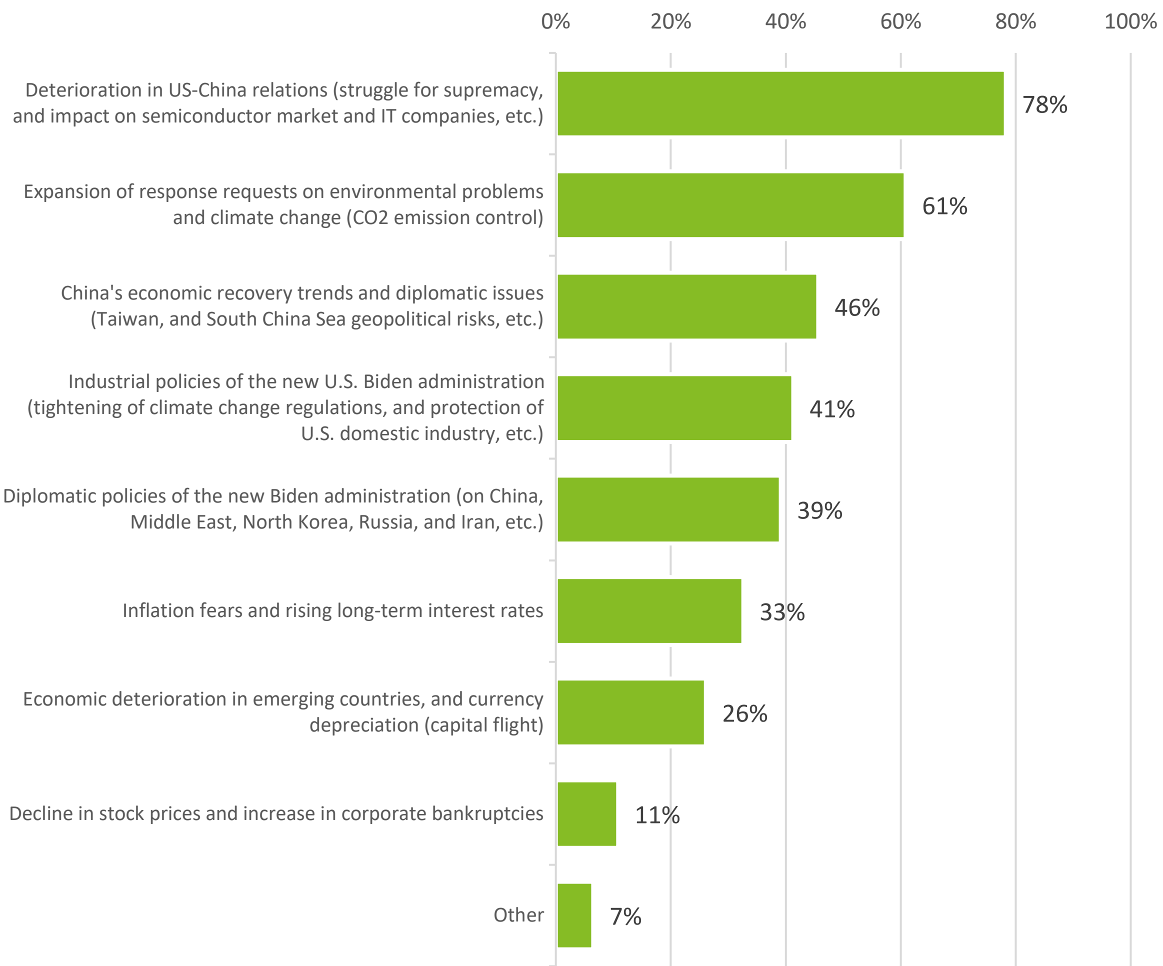
Graph 4 shows the key factors in the Japanese economy CFOs will most closely watch when preparing business plans over the next year. The top three concerns regarding the Japanese economy were as following in order; “The government measures on COVID-19, economy, and corporate support,” “Decrease in consumption due to travel restrictions, shortened business hours, and scaled-down events, etc.,” and “Production reductions due to supply chain stagnation (including semiconductor shortage).” While Japanese government measures and restrictions on economic activity continued to rank in the top three, supply chain stagnation caused by COVID-19 and telework and other work style reforms dropped significantly in the rankings. This time, on the other hand, a new option, the supply chain impact of semiconductor shortages, was ranked third. In addition, "Rising production costs" moved up to fourth place from fifth place in the previous survey. The government's measures against COVID-19 and restrictions on movement continue to be of high interest as external factors that directly affect the corporate performance, but it can be seen that internal processes such as telework and in-house supply chains have already been addressed and are no longer a major concern. Meanwhile, the global shortage of semiconductors and rising production costs such as raw material and transportation costs have become new concerns for CFOs. The shortage of semiconductors and rising production costs are likely to continue to be a concern for CFOs in the future, regardless of the COVID-19 trend, as they may be associated with global structural changes.

Key factors in the global economy

Notable focus on US-China relations and diplomatic issues.

Graph5

Please select up to four of the following risk events related to the international economy that you feel are noteworthy in terms of probability and impact on business development over the next



【Other comments to add/decribe the choises】

・Supply situation and raw material prices

・Medium- to long-term negative impact of coronavirus on the economy

Graph 5 shows what trends in the global economy CFOs will most closely watch when preparing their business plans over the next year. The top three responses this time were, in order, " Deterioration US-China relations" (3rd place last time), "Environmental problems and climate change" (1st place), and "China's economic trends and diplomatic issues" (5th place). China's economic trends and diplomatic issues rose to third place from fifth place in the previous survey, while the "Industrial policies of the U.S. Biden administration" dropped from second to fourth place. The reasons for the increased focus on the US-China relations issue are the sharpening and multilateralization of the US-China confrontation in the political and economic aspect that became apparent about six months after the inauguration of the US Biden administration, as well as concerns about the supply of semiconductors and procurement of Chinese products that can be said to be caused by the US-China confrontation. Taiwan's geopolitical risks and China's expansion into the South China Sea are also major concerns for Japanese companies that depend on Taiwan for their semiconductor supplies, as well as companies that have expanded into the ASEAN region. The domestic politics of the Biden administration are not expected to have a major impact on Japanese companies, and the focus will be on the diplomatic side of his administration. Economic and political issues arising from US-China tensions are likely to continue to be a concern for CFOs. Environmental problem and climate change remained at the top in this survey, and will likely remain a primary focus for CFOs for the foreseeable future.

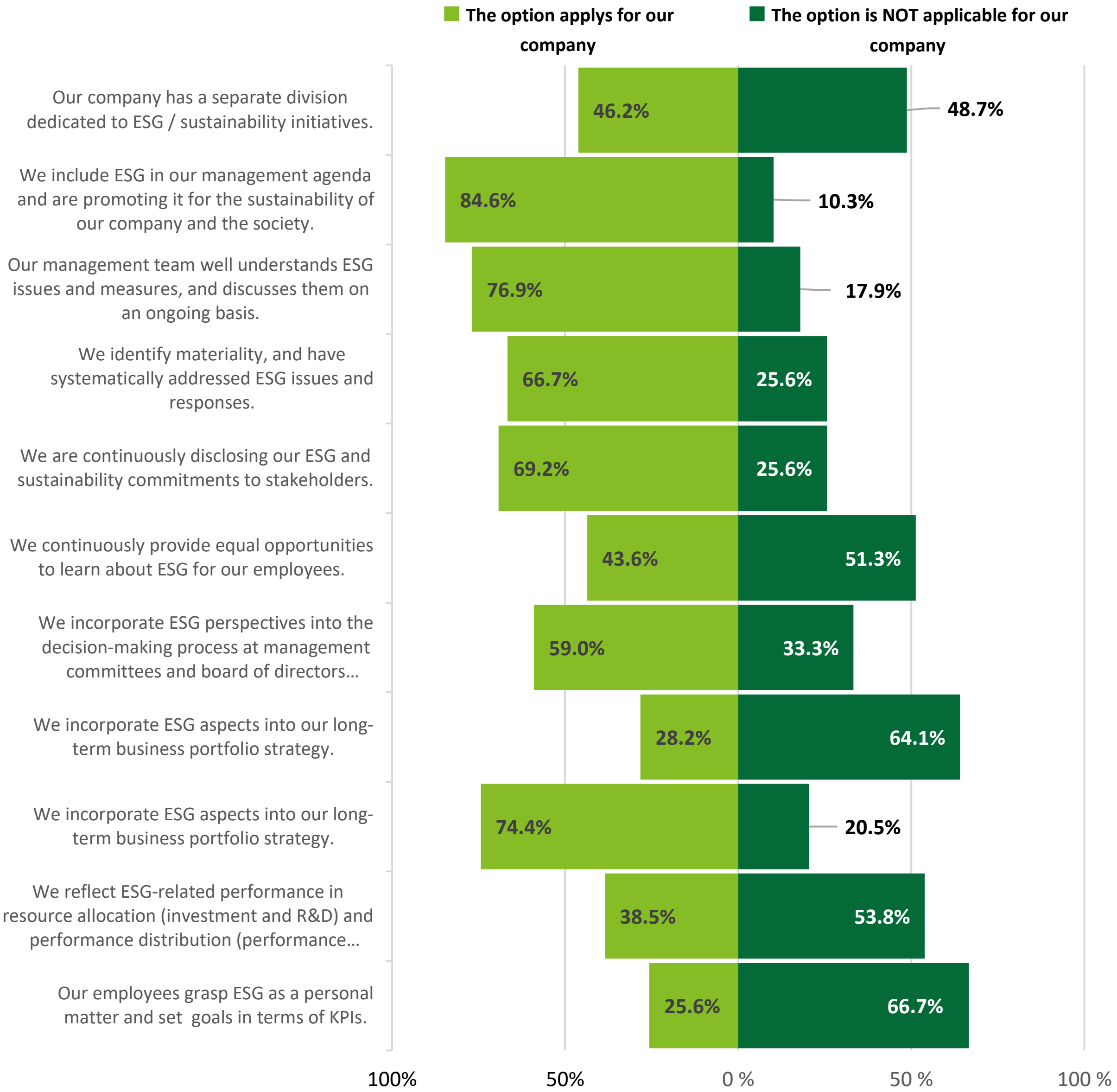
Survey on the ESG and sustainability management

The status of ESG and sustainability initiatives

Starting by asking about the status of ESG and sustainability initiatives, which have become hot topics in the management agenda over the last few years.

Graph 6

What kind of initiatives does your company undertake regarding ESG and sustainability? Please move each option into the appropriate boxes.（Note that the total for each item does not add up to 100% the unanswered responses are not reflected in the chart.）



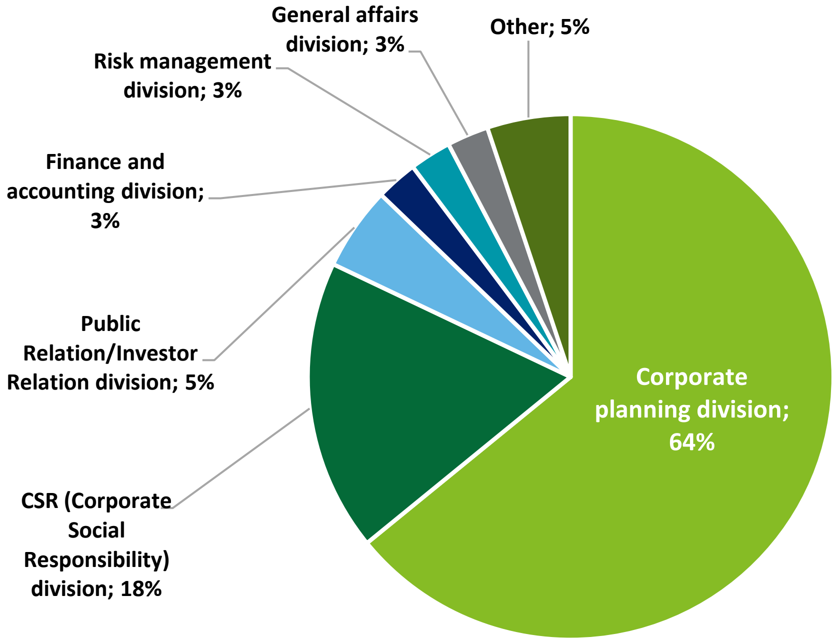
The survey revealed that about 70% of companies have already addressed management agendas among CXOs, including incorporating ESG into management strategies, identifying materiality, disclosing ESG and sustainability goals to stakeholders, and considering ESG factors in their long-term business portfolio strategies. On the other hand, slightly more than 50% of companies have not been able to reflect their resource and performance allocation into ESG-related performance, and have not set the targets which is necessary to make decisions on such resource and performance allocation for each business unit. We believe that the new role of CFOs will require to set ESG and sustainability targets for each of their business units. It was also found that less than 70% of companies have yet to go beyond setting ESG-related goals, such as making ESG a personal matter for employees and setting KPIs.

These results suggest that ESG and sustainability initiatives, which have been implemented in a top-down manner with a strong CXO commitment, will be taken a step further as company-wide initiatives. More than 60% of the companies indicated that they need to develop a scheme (including IT systems) to measure, collect, and report non-financial information, and in many cases, the same sense of challenge was mentioned in actual discussions with companies. With the increasing importance of non-financial information, it is likely that practical issues will need to be addressed more frequently.

Main division responsible for ESG and sustainability initiatives

Asking CFOs about the appropriate division, which used to be the Public Relation/Investor relation division or the CSR division, that should be in charge of ESG and sustainability initiatives.

Graph 7
Which division do you think is the most appropriate to take charge of ESG and sustainability?



【Other comments to add/decribe the choises 】

・Not only in a single department, but also across multiple departments

・Department specializing in ESG and sustainability strategies

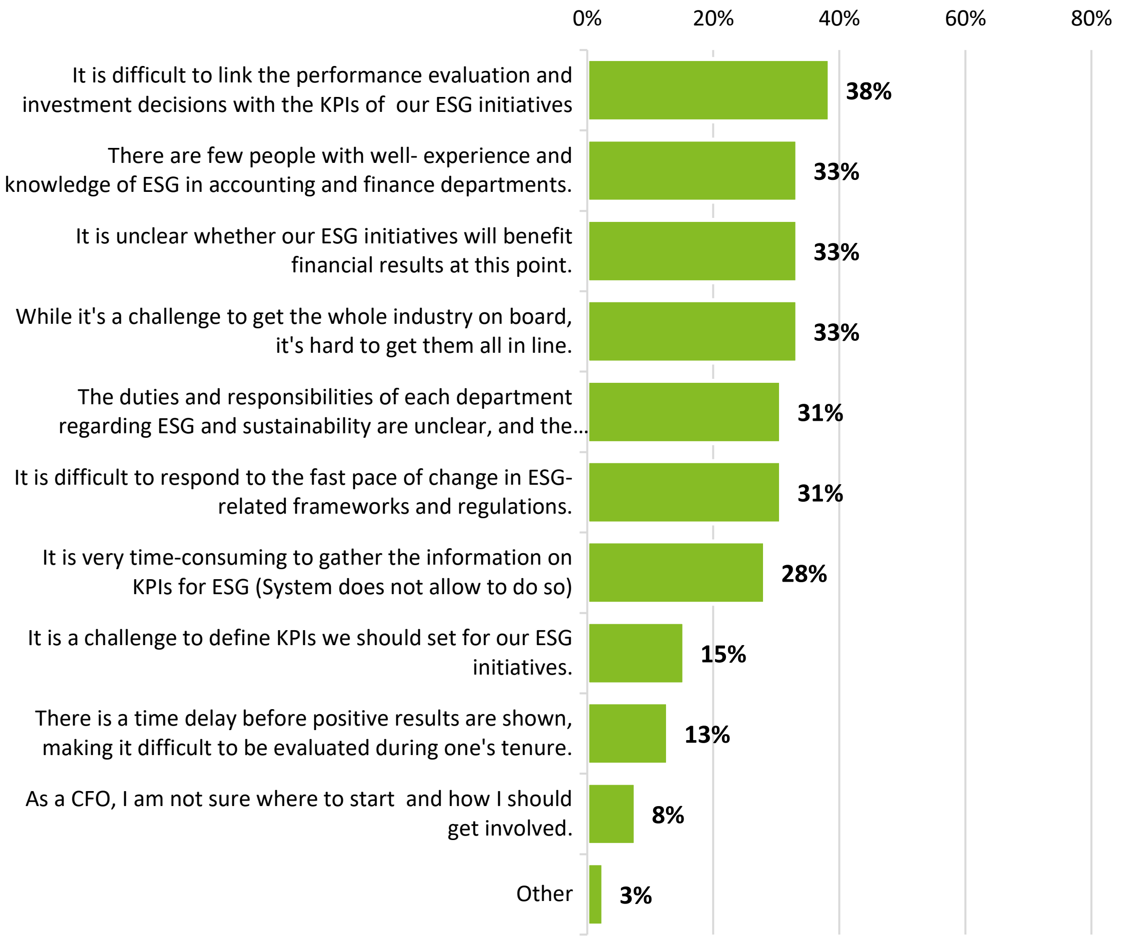
The result of Graph 7 implies that there is a shift in the positioning of ESG and sustainability within companies. While the CSR and PR/IR division, which had traditionally been responsible for ESG/sustainability, accounted for only 23%, the Corporate Planning division accounted for 64%, indicating that the recognition of ESG and sustainability is shifting from being part of a company's social contribution activities and branding activities to being part of a company's growth strategy.

It can be stated that ESG/sustainability is not something that can be addressed by vertical organizations, but it is recognized as a management agenda that should be addressed cross-functionally. This was because that some respondents suggested that not only a single department, but also multiple departments should be in charge of ESG/sustainability, while others suggested that a department dedicated to ESG/sustainability strategy should be in charge of ESG/sustainability.

Challenges CFOs feel in promoting ESG and sustainability initiatives

The questions revealed some challenges that have emerged in asking about the current status of initiatives, but we asked about challenges in the process of implementing ESG and sustainability into management here in Graph 8.

Graph 8
What challenges do you see in your ESG and sustainability initiatives? Please select all that apply.



【Other comments to add/decribe the choises】

・None of challenge as as we are able to keep up with the latest industry respose

While only a small number of respondents (15%) did not know what KPIs should be set for ESG, 38% said it was difficult to link ESG KPIs to performance evaluation and investment decisions, highlighting the difficulty of using non-financial KPIs and other non-financial information for financial decisions. In the same manner, 33% of respondents were not sure whether ESG initiatives would lead to financial results, indicating that the lack of a convincing logic to link ESG, a type of non-financial information, to financial value is an issue.

Although recent empirical studies have shown significant correlations between somewhat qualitative events such as ESG and financial performance, they have not yet demonstrated causal relationships in many cases, and it will be important to continue to accumulate scientific facts and evidence to demonstrate the economic rationale for engaging in ESG to make it easier for companies to engage in ESG.

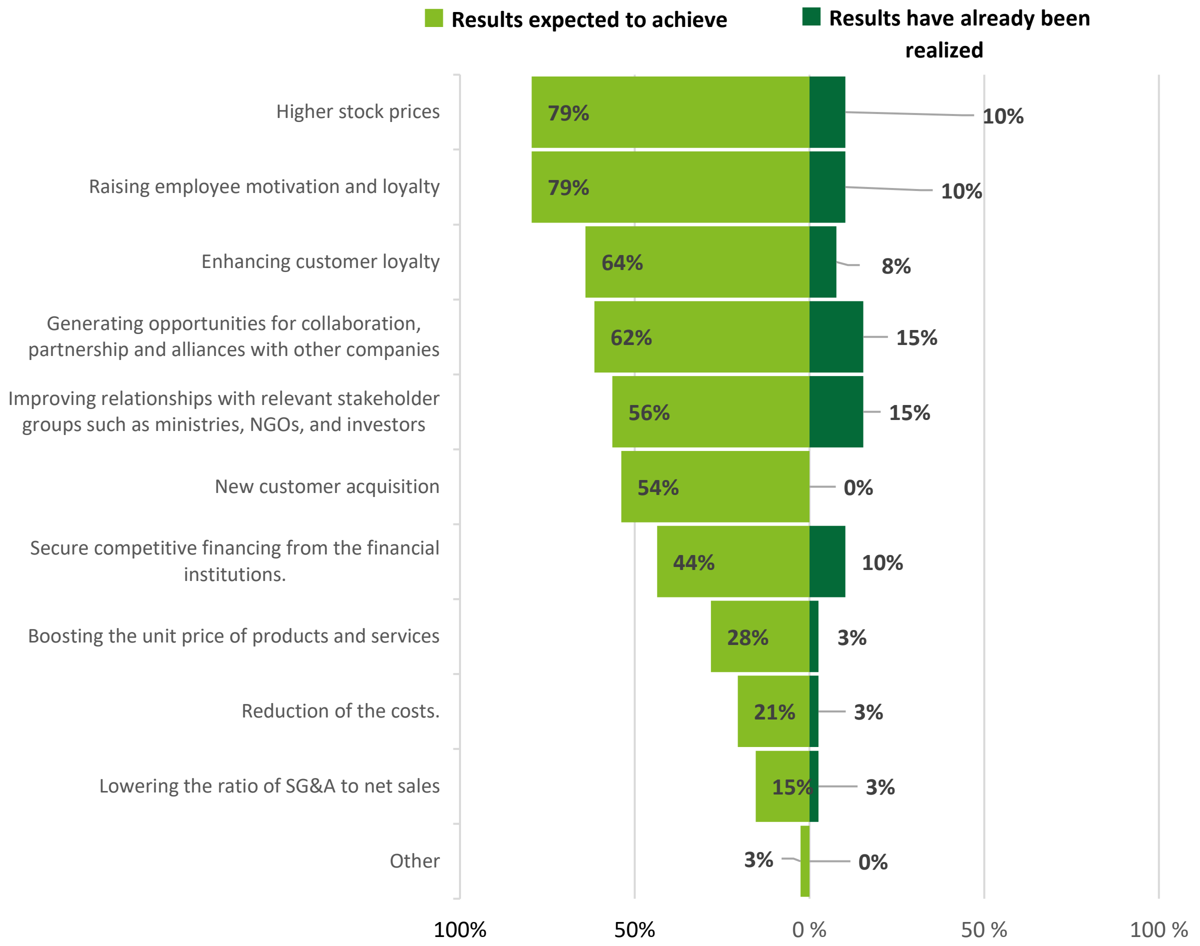
In addition, the fact that many of the perceptions of the issues raised in this question were dispersed in similar proportions may be partly due to the fact that obtaining long-term results such as ESG and sustainability is not currently seen as a common and important issue for CFOs. For this reason, as a role of the CFO, it may be necessary to set goals and KPIs that provide incentives to obtain not only medium- and short-term results such as financial indicators, but also long-term results such as non-financial indicators. This would probably mean reviewing KPIs in such a way that continued achievement of medium- and short-term KPIs would lead to achievement of long-term KPIs, and vice versa.

Another point worth noting was that 33% of the respondents answered that "While it is difficult to achieve results unless the entire industry is involved, it is also difficult to get everyone on the same page." This result shows the dilemma that companies are facing, namely that they want to promote and strengthen their initiatives for the sake of society and the environment, but they find it difficult to do so due to the various hurdles that arise in practice. Because private sector initiatives are inevitably less enforceable, the role of politics, including ministries and regulators, may be to create a competitive environment that overcomes this dilemma of the industry.

Expected and actual effects of ESG initiatives

While the above question highlighted the issues in the process of implementing ESG and sustainability into management, we would now like to discuss the issues regarding the results of incorporating ESG and sustainability into management by identifying the gap between the expected effects of ESG initiatives and the effects that have already been realized.

Graph 7
What do you expect to achieve as a result of your ESG initiatives, and how have you seen the positive results? Please indicate "results expected to achieve" and "results have already been realized" for each item.



【Other comments to add/decribe the choises 】

・Improving brand recognition and value

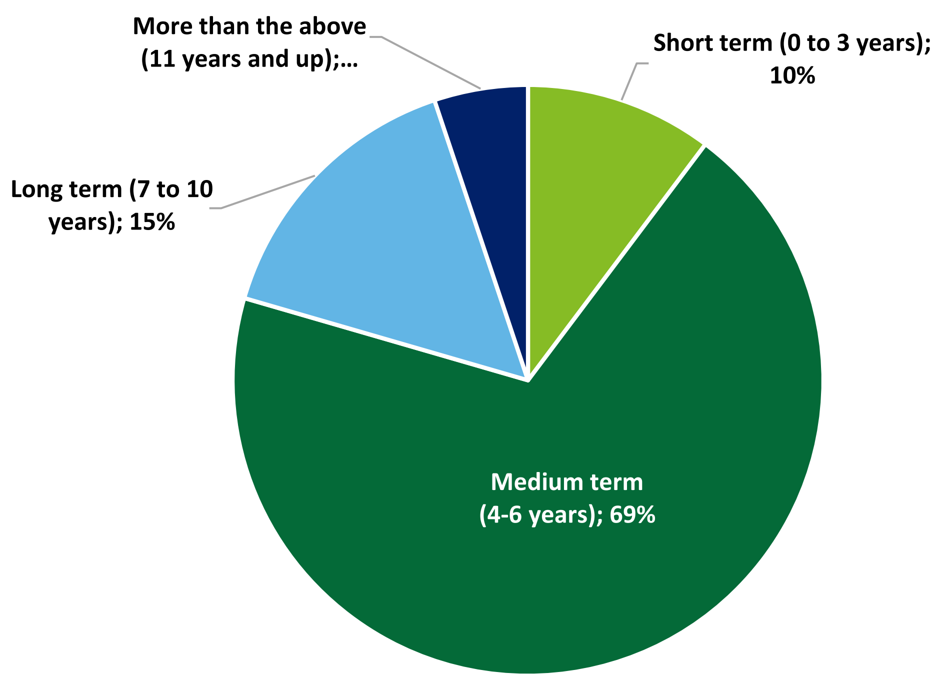
In the area of ESG and sustainability, which is generally considered to be difficult to see the effects of, we believe that the 10% to 15% of " Results have already been realized" can be interpreted as relatively positive.

The effects of the ESG and sustainability initiatives that have been implemented, such as "Increase in stock price" and "Increase in employee motivation and loyalty," are still limited compared to the expected values. However, the results were encouraging in that 15% of the respondents reported that "Effects have already been seen" they had already seen the effects of their ESG and sustainability initiatives for items that it is easy to see and feel the effects for, such as "Creation of opportunities for collaboration, partnerships, and alliances with other companies" and "Improvement of relationships with stakeholders, including relevant government agencies, NGOs, and investors." This may be due in part to the fact that the concept of stakeholder capitalism has become more widespread due to the influence of the Business Roundtable in the US and the World Economic Forum's Davos meeting. Meanwhile, for items such as "Raising the unit price of products and services," "Reducing costs," and "Lowering the ratio of SG&A expenses to sales," the expectation of benefits is not high to begin with, and the responses for "Effects have already been seen" are very limited, which indicates the difficulty of reaping economic benefits from ESG initiatives at this time.

Expected time period from the beginning of the initiative until the effect is realized

The results of the above question show that there is currently a gap between the expected effects of ESG initiatives and the effects that have already appeared. If this is the case, how long is it expected to take from the start of the initiatives to see the effects?

Graph 10
How long do you expect your ESG and sustainability initiatives to be effective？



In general, ESG and sustainability are often associated with long-term visions and strategies, so companies should expect to see benefits from these initiatives over the long term. However, in reality, we found that many companies expect the effects to emerge at an earlier stage (four to six years). Although it is understood that ESG/sustainability effects are supposed to appear over a long period of time, the reality is that companies are under pressure from the capital markets every time they report their quarterly or annual financial results, and it can be inferred that there is a psychological bias to expect results in a shorter period of time than what should really be expected. In addition, although the percentage of companies that expect to see results in the short term (zero to three years) is low (10%), but this may be due in part to the fact that companies do not have the mindset or attitude of being accountable to investors by setting a course for what results they will produce within 3 years based on the concept of long-term back-casting.

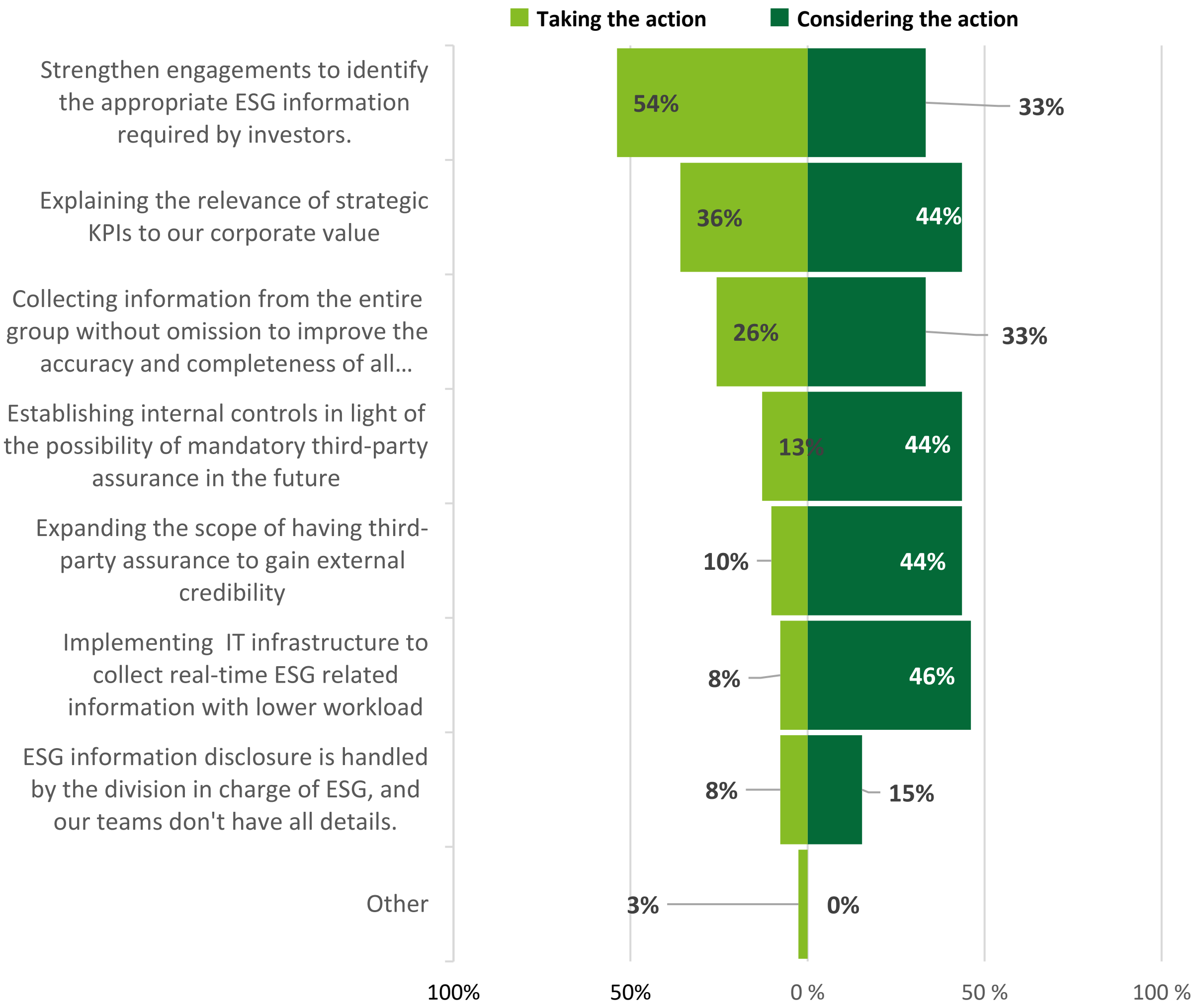
In order for companies to become more serious about ESG and sustainability, it will be important for them to develop a way of communicating with their stakeholders, and to create frameworks and systems to implement them, so that the percentage of companies that expect to see results in seven years or more, which accounted for only 20% in this survey, will increase.

Key items to consider when disclosing ESG information

In the previous questions, we asked about the status of efforts to incorporate ESG and sustainability into management, the perceived challenges, and the effects of such initiatives. What are companies trying to do to disclose their ESG initiatives to the public?

Graph 11

Please select all items from the followings that you are taking or considering in disclosing the status of your ESG initiatives to the public.



【Other comments to add/decribe the choises】

・Not considering external disclosure due to unlisted status

In the previous questions, "Increase in stock price" was stated as the most expected effect of ESG initiatives. The results for this question indicate more than 80% of companies are taking action or considering taking action on two issues that are strongly related to stock prices; strengthening engagement to understand ESG information required by investors and explaining the relationship between key KPIs and corporate value. The results show that companies have a strong will to link ESG and sustainability initiatives to corporate and stock value. On the other hand, about 50% of companies are considering improving internal controls, expanding the scope of third-party assurance, and introducing IT infrastructure to collect ESG information, which many companies have yet to do, and these results suggest that companies will accelerate their investment and efforts in these areas, indicating that they are serious about building credibility to avoid criticism of greenwashing.

Summary

There are emerging global changes including Environmental changes on a global scale, such as climate change, and social changes such as the elimination of poverty and the realization of gender equality. How can they, as a company and as a CFO/accounting and finance departments, overcome these changes? In this situation, we conducted a survey on management agenda, particularly ESG and sustainability management, in an environment of high uncertainty.

The survey revealed that companies have been promoting ESG and sustainability initiatives in a top-down manner under the strong CXO commitment. However, they are now facing practical challenges, such as how to make ESG a company-wide initiative by educating employees and setting goals, and how to establish mechanism (including IT system) for collecting, measuring, and reporting ESG information. In addition, many of CFOs considered that the corporate planning division is the appropriate division to take charge of ESG and sustainability initiatives, indicating that these initiatives are shifting from being positioned as part of a company's social contribution activities and branding activities to being positioned as part of a company's growth strategy.

The results also showed that companies have a strong intension to link ESG and sustainability initiatives to corporate value and stock value, as these initiatives are widely recognized as part of their growth strategies. On the other hand, we found that there is a lack of clear logic to link ESG, a non-financial type of information, to corporate value and stock value. It became clear that it is difficult to receive economical benefits from the fact that the effects of "boosting the unit price of products and services," "reduction of the costs," and "lowering the ratio of SG&A to net sales" are very limited, while the effects have already been seen in items related to strengthening and improving relationships, where the effects are easy to realize, such as "generating opportunities for collaboration, partnerships and alliances with other companies" and "improving relationships with relevant stakeholders group such as ministries, NGOs, and investors.

Although it is difficult to obtain economical benefits as a short-term outcome, it is also important to create a way of communicating with stakeholders and a system and framework to facilitate the emergence of long-term results for companies to become more serious about these initiatives.

As for the company side, we were able to see a sincere effort to build reliability in ESG and sustainability by improving internal controls, expanding the scope of third-party assurance, and introducing IT infrastructure to collect ESG information, which remains a challenge for many companies.

Most of the respondents answered that the Corporate Planning Department is the appropriate division to be in charge of ESG/sustainability, but the CFO need to identify how to link ESG/sustainability initiatives to corporate value and stock value. It is highly expected that CFOs will take this uncertain era as a huge opportunity to work more intensively on ESG and sustainability management.

What is the CFO Program?
The Deloitte Tohmatsu Group's CFO Program is a comprehensive program to revitalize the Japanese economy by supporting the CFOs of companies that it rests on and contributing to improving the capabilities of CFO organizations. As a Trusted Advisor, we bring together professionals from all walks of life to help CFOs solve challenges. In addition, we aim to improve the competitiveness of Japanese companies by providing the latest information, including global trends, and CFO-networking beyond corporate and industry boundaries.

Deloitte Tohmatsu Group
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