



Deloitte CFO Signals Report

2021Q2

Sept 2021

Contents

Survey on the economical environment

Financial environment prospects	3
Business performance outlook	4
Uncertainty	6
Key factors in the Japanese economy.....	7
Key factors in the global economy.....	9

Survey on M&A and Business restructuring

Status of your consideration of M&A amid the COVID-19 situation.....	11
Challenges in promoting M&A amid the COVID-19 situation	14
Countermeasures against uncertainty in the business outlook	15
Need for business restructuring amid the COVID-19 situation	16
Business restructuring theme that you feel needed to be addressed	17
Obstacles and concerns in driving business restructuring	19
<i>What is the CFO Program?</i>	21

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 sections: the “Survey on the Economic Environment,” which is assessed globally in every edition, and the “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 how the CFO and the Finance & Accounting Department are tackling M&A and business restructuring.

Surveys for this edition were conducted in August 2021, and we were able to receive responses from 56 CFOs and finance and accounting executives.

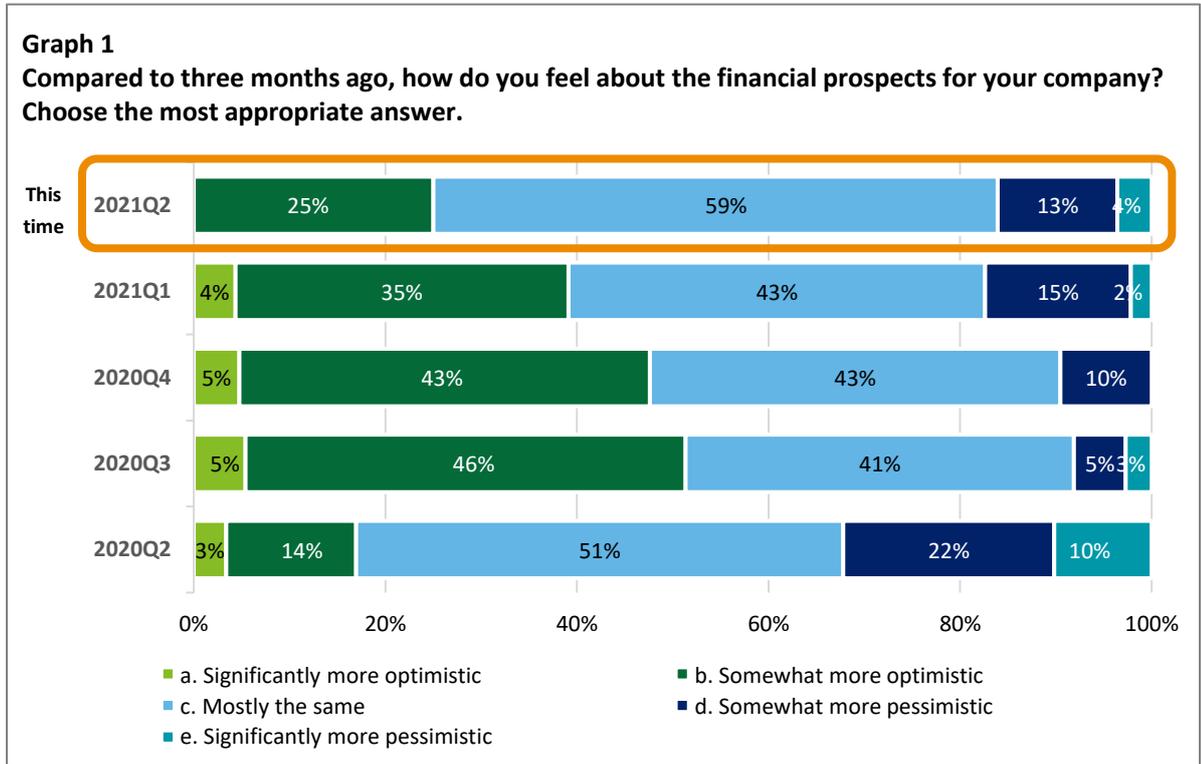
Thank you for your cooperation.

Deloitte Tohmatsu Group
The CFO program
September 2021

Survey on the economic environment

Financial environment prospects

Financial environment prospects remain unchanged under the state of emergency.



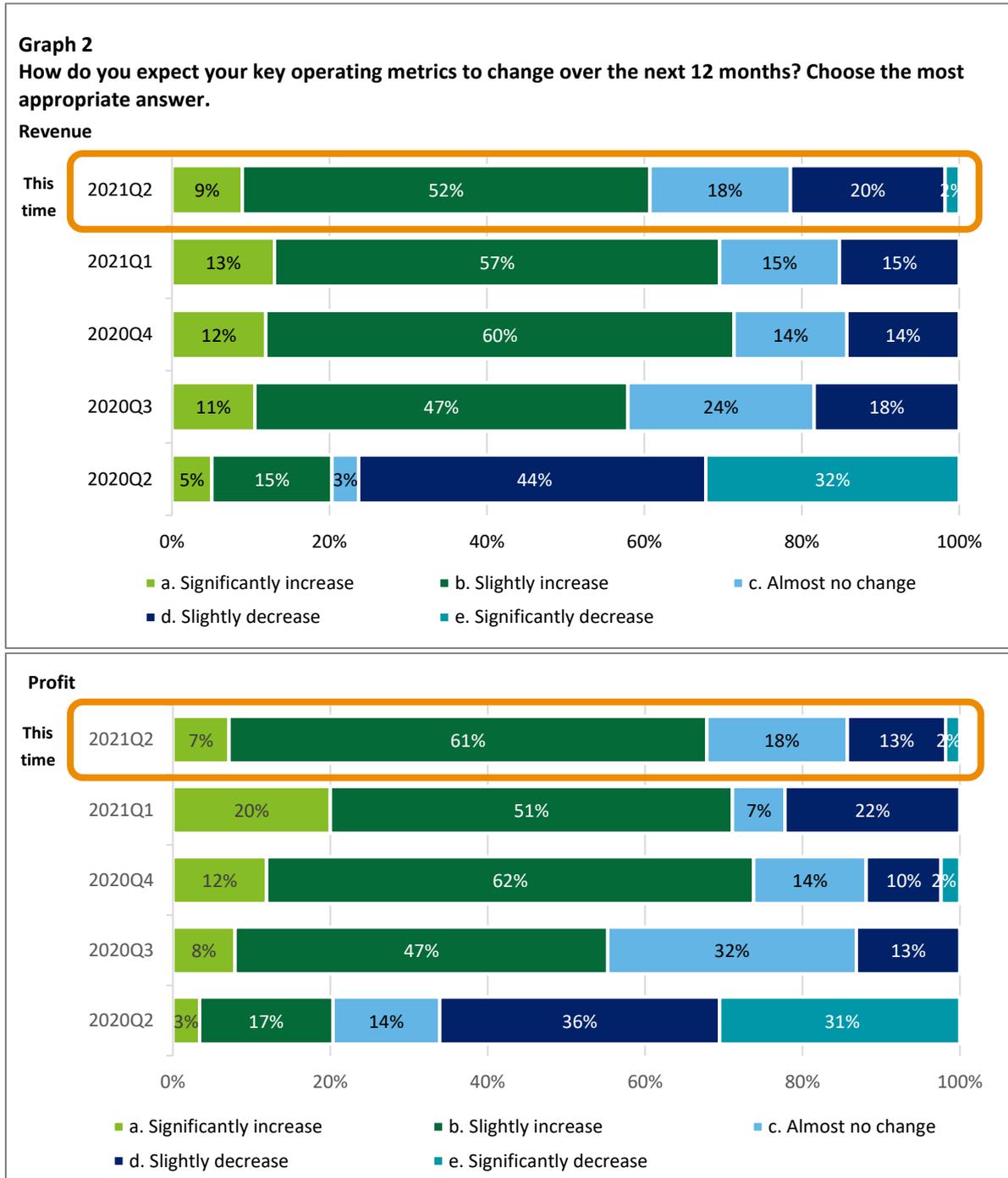
Graph 1 shows how the financial prospects of the respondents’ businesses have changed over the last three months. In this 2021Q2 survey, 25% of respondents were “significantly more optimistic” or “somewhat more optimistic,” and the level of optimism worsened for the third consecutive quarter; meanwhile, almost 60% answered “mostly the same” compared to three months ago. This survey was conducted in August, when the Tokyo Olympics and Paralympics were held in Japan and new coronavirus infections were spreading rapidly, while a spike in the number of infected people was seen overseas especially in the United States and Southeast Asia. As with the previous Q1 2021 survey period, a state of emergency was declared in some prefectures in Japan. Amid the situation of COVID-19 and movement restrictions, it is a natural consequence that the CFO’s financial outlook has been largely unchanged or slightly deteriorated.

The vaccination program is currently underway in Japan, and the vaccination rate is among the highest in the developed world. The government is discussing lifting the declaration at the end of September and easing restrictions on activities as the vaccination progresses. The number of newly infected patients overseas is also on the decline as of mid-September. It is likely that the CFO’s fiscal prospects will gradually improve due to expectations for a resumption of economic activity. However, there are still risk factors, including the expansion of new variants and stretched medical care due to an increase in the number of seriously ill patients.



Business performance outlook

Business performance outlook is slightly on the conservative side.

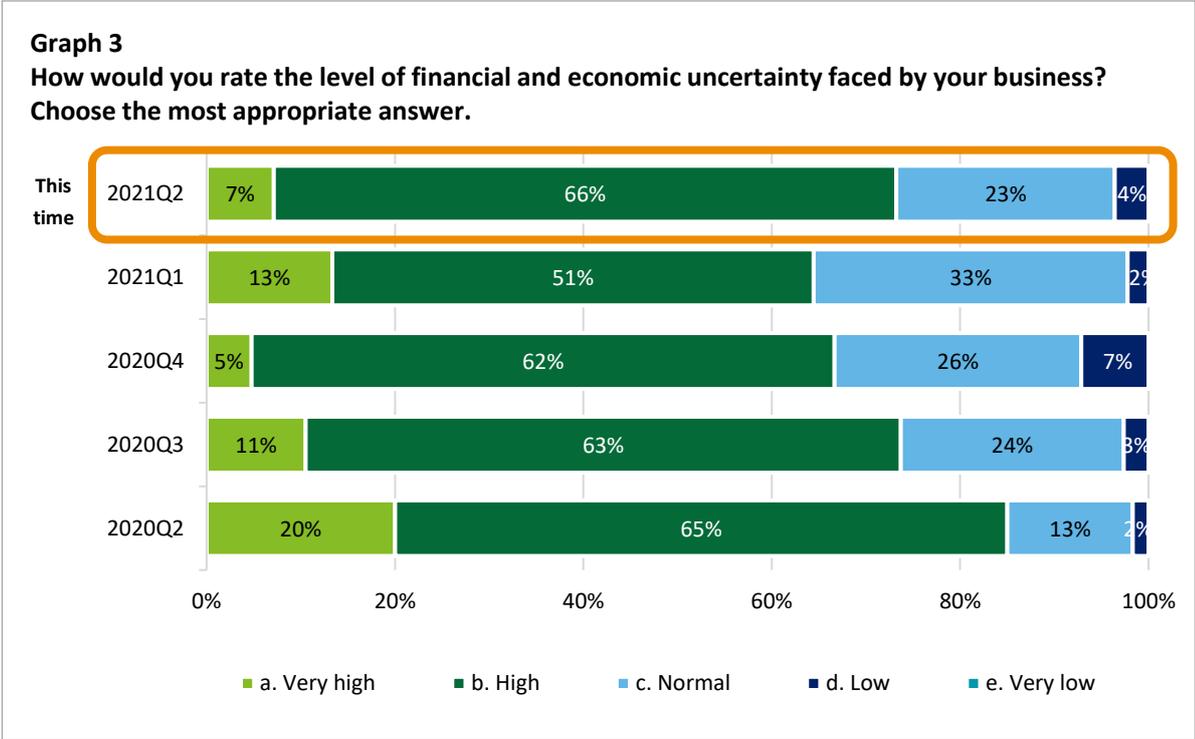


Graph 2 shows the CFOs' prospects for their company's financial performance (revenue and profit) over the coming year. In this most recent survey, a total of 61% of respondents said they expect their earnings to "significantly increase" and "slightly increase," down slightly from 70% in the previous survey. As for their profit, 68% answered they expect them to "significantly increase" and "slightly increase," down from 71% in the previous survey.

The business environment in industries such as food and beverage and entertainment will remain tough due to additional waves of COVID-19. Negative effects on corporate performance are also expected in certain industries due to the reduction in automobile production caused by the shortage of semiconductor supplies and the sharp rise in raw material prices. While the negative impact of COVID-19 is expected to gradually dissipate with the easing of behavioral restrictions, we believe that shortages in semiconductor supply, supply chain disruptions due to the U.S.–China conflict and production stagnation in Southeast Asia are likely to remain a medium-term threat to the CFO's business performance outlook.

 **Uncertainty**

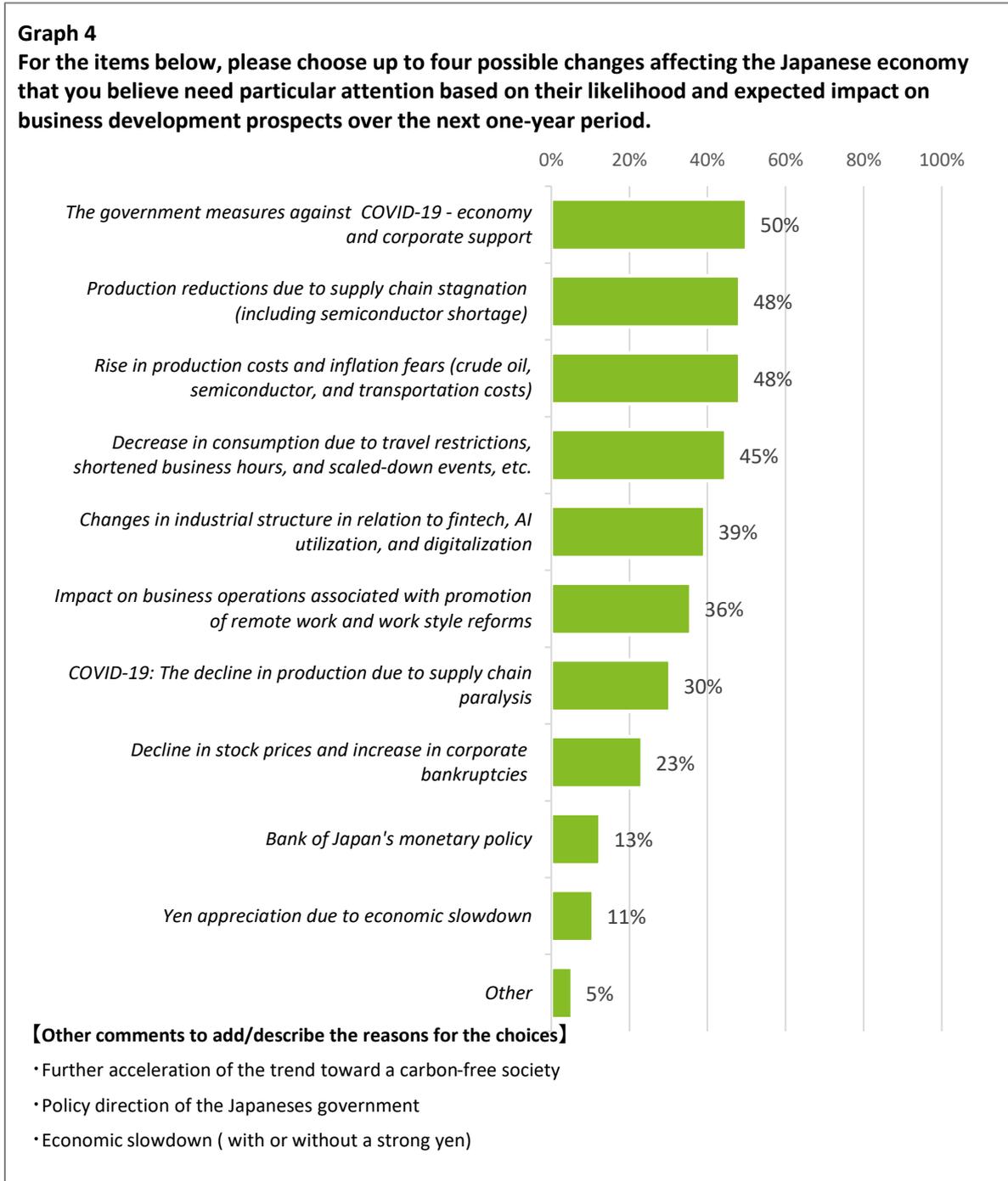
High and growing levels of uncertainty



Graph 3 shows CFOs' perceptions of financial and economic uncertainty. The total number of respondents who answered that uncertainty was "very high" or "high" increased to 73% from 64% in the previous survey and remained at a very high level. During this survey period, there was not only the COVID-19 situation and a supply shortage, but also the geopolitical crisis of a regime collapse in Afghanistan. Uncertainty in Japanese politics was also growing as the Liberal Democratic Party (LDP) presidential and general elections were coming up. These factors may have collectively raised the uncertainty in CFO business confidence. International uncertainties, including the U.S.–China conflict, are likely to continue to increase, and CFOs' view of uncertainty is likely to remain high for the foreseeable future.

¥ Key factors in the Japanese economy

Top CFO concerns: Semiconductor shortage and rising production costs

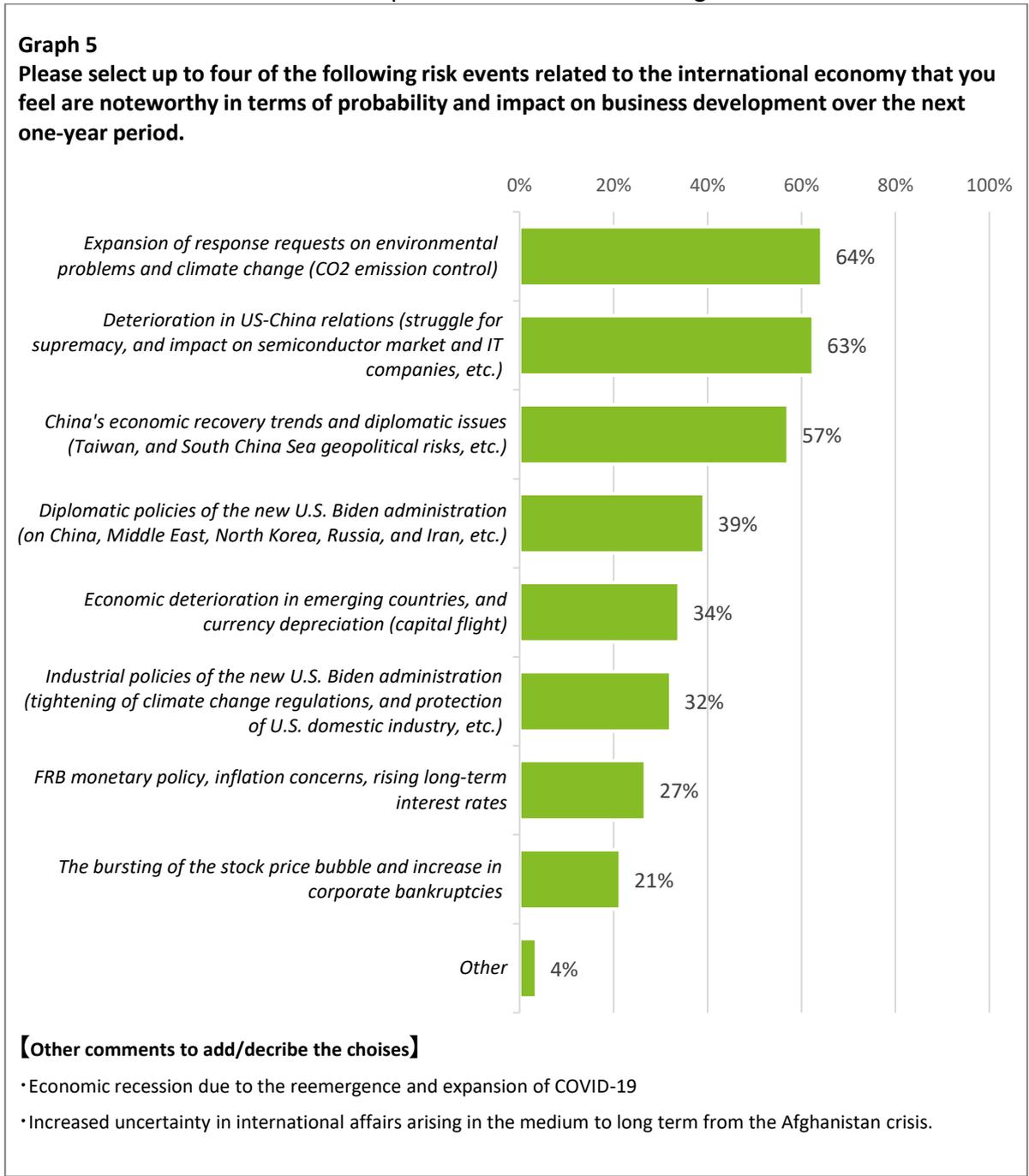


Graph 4 shows the key factors in the Japanese economy that CFOs will most closely watch when preparing business plans over the next year. The top ranking one was the same as in the previous survey, "the government measures against COVID-19," but there were changes in the second and third places. The second most key factor was "production reduction due to the supply chain stagnation" (ranked third in the previous survey), followed by "rise in production costs and inflation fear" (ranked fourth in the previous survey), and in its place "travel

restrictions” dropped to fourth from second in the previous survey. The shortage of semiconductors and the rising cost of raw materials are gradually having an increasing impact on business activities. While some believe that factors in the supply shortage and rising inflation overseas, such as the policy set by the U.S. Federal Open Market Committee, are temporary, there are several structural factors that are likely to persist over the long term, including the restructuring of global supply chains and tightening of transportation networks due to the confrontation between the U.S. and China, rising IT demand due to structural changes in the post-COVID-19 era, and global semiconductor supply concerns in light of geopolitical risks in Taiwan. With increasing foreign demand, Japan's exports have been growing in recent months, but rising production costs and supply shortages will be factors that reduce this growth. As the risks of coronavirus gradually reduce, the risks associated with such structural changes will attract more attention from CFOs.

€ Key factors in the global economy

No.1 CFO concern: Environmental problems and climate change.



Graph 5 shows what trends in the global economy CFOs will most closely watch when preparing their business plans over the next year. Again, there was a shift in the top responses. The rankings were switched as the No. 1 concern was "response to the environment and climate change" (No. 2 in the previous survey), and the No. 2 concern was "deterioration in U.S.–China relations" (No. 1 in the previous survey). In third place, as in the previous survey, was "China's economic recovery trends." It is worth highlighting that the environment and climate change response has overtaken the political and economic situation

as the biggest concerns of companies. With regard to responding to climate change, we are gradually approaching 2030, the year in which Japan has set a CO₂ emission reduction target of 46%. In other countries, the EU and the UK are pushing for regulation, and the new Biden administration in the U.S. has made climate change a major policy initiative. In addition to climate change, there has been a growing demand for companies to address human rights issues — the “social” part of so-called ESG (Environmental, Social and Governance). Addressing these environmental and social issues will force companies to drastically redesign their production processes, supply chains, and product and service offerings. In order to meet the expectations of shareholders and other stakeholders and to maintain corporate value, CFOs will continue to be very concerned about environmental and climate change issues.

Survey on M&A and business restructuring

In an environment of high uncertainty due to the spread of COVID-19, we recognize that finance and accounting departments are considering and implementing both offensive and defensive strategies for further corporate growth. In the second section of this survey, we asked how CFOs and finance and accounting departments are tackling M&A and business restructuring.



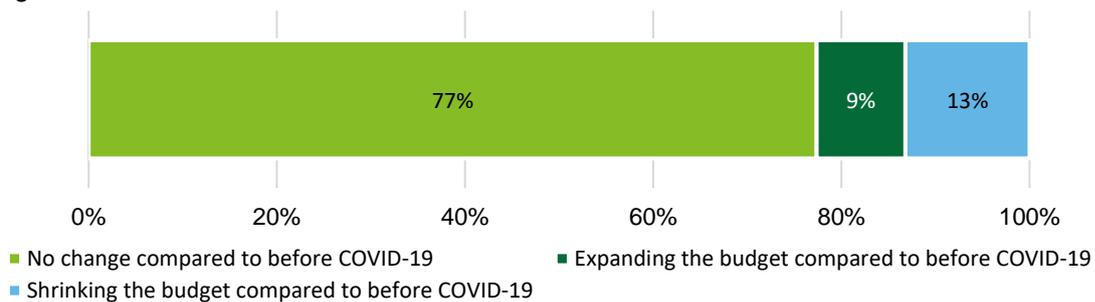
Status of your consideration of M&A amid the COVID-19 situation

The survey in the second section first asked about changes in the status of consideration of M&A before and after the COVID-19 situation in terms of the budget, speed of examination, and investment scopes (fields and geographical areas). While the majority of the respondents chose “No change compared to before COVID-19,” we will focus on those who answered that there was a change.

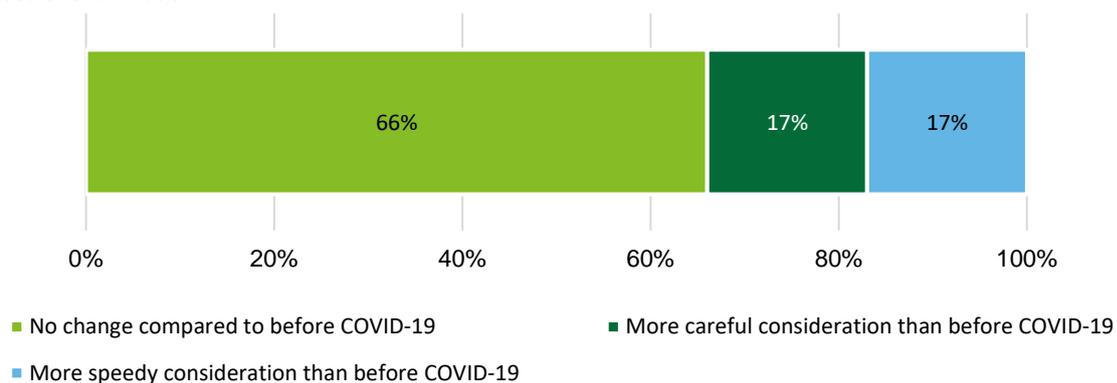
Graph 6

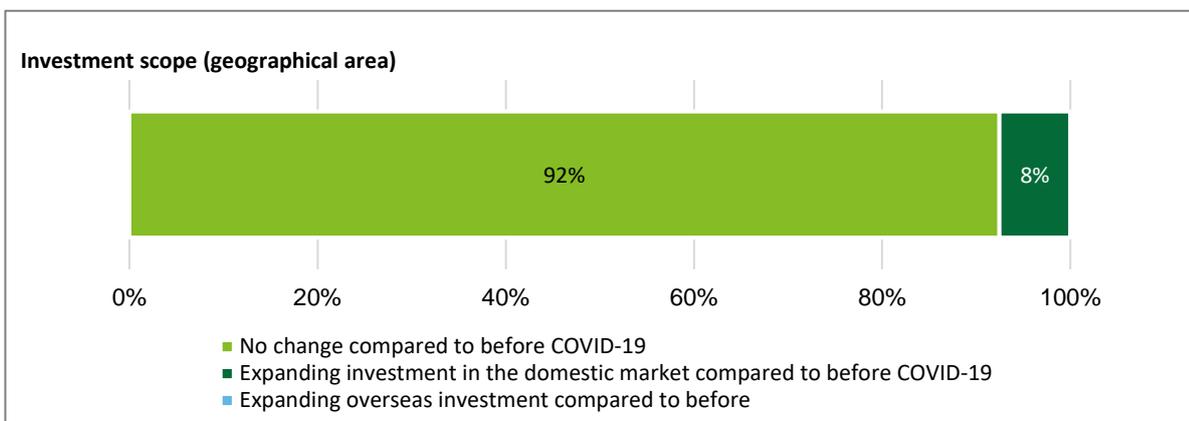
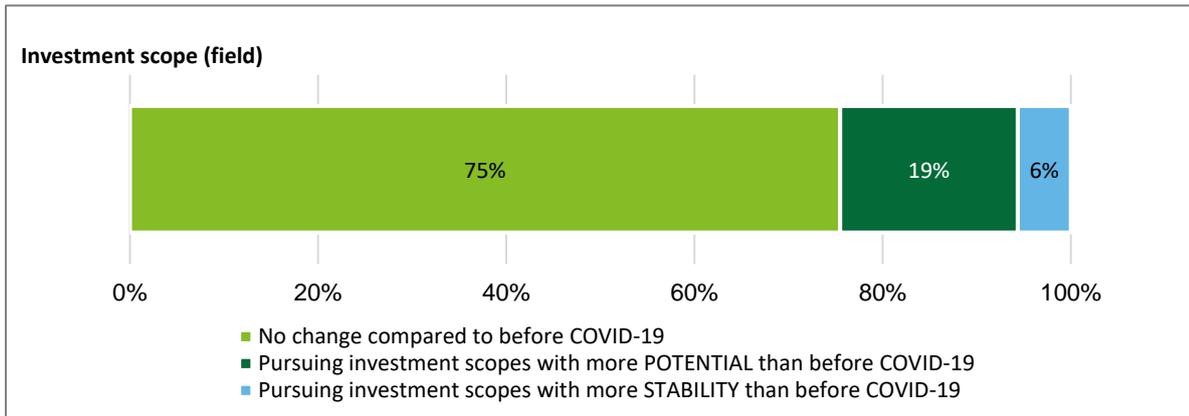
Please select one for each of sub-question that apply to the status of your consideration of M&A amid the COVID-19 situation. Note that "before COVID-19" refers to 'Before February 2020.'

Budget



Speed of examination





As for the budget, respondents who chose “Shrinking the budget compared to before COVID-19” outnumbered those who chose “Expanding the budget compared to before COVID-19.” This result suggests that, at the moment, there are slightly more companies that are reducing their investment budgets due to the deteriorating business performance caused by COVID-19 and are curbing investment in an uncertain environment than those that show an aggressive investment stance even amid the COVID-19 situation.

When asked about the speed of examination, the largest number of respondents indicated that there was a change compared to before COVID-19. In addition, the result of this question was somewhat unique in that the percentage of respondents who chose “More careful consideration than before COVID-19” was the same as that of those who chose “More speedy consideration than before COVID-19.” This indicates that the respondents’ businesses are becoming more polarized in terms of the sense of speed in considering M&A. This may also indicate that, while some companies have created an environment that allows for speedy examinations by using online meeting tools such as Zoom, others find it necessary to consider many challenges in order to deal with an uncertain external environment.

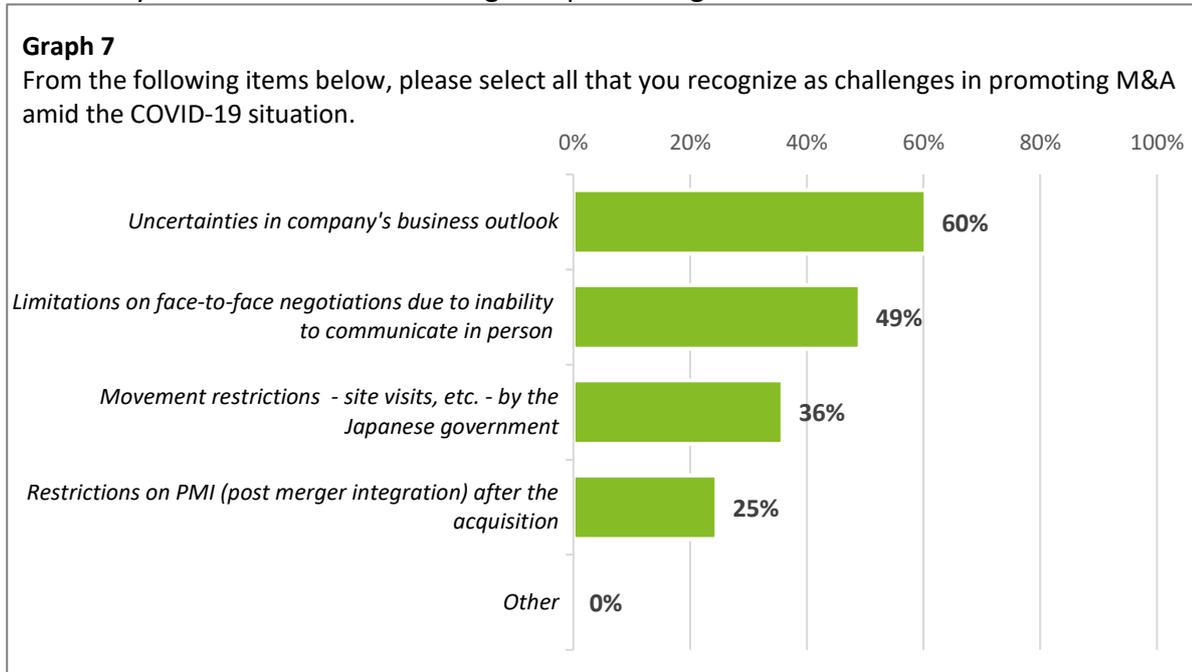
As for the investment scope (field), respondents who chose “Pursuing investment scopes with more POTENTIAL than before COVID-19” outnumbered those who chose “Pursuing investment scopes with more STABILITY than before COVID-19.” This result suggests that the respondents’ businesses are placing more emphasis on investments in companies with potential, such as venture investments, in anticipation of the post-COVID new normal.

Finally, as for investment scope (geographical area), those who chose “No change compared to before COVID-19” account for 92% of all the respondents. This result shows that COVID-19 did little to trigger companies to change their policy on the investment scope (geographical area). On the other hand, all the respondents who replied there was a change chose “Expanding investment in the domestic market compared to before COVID-19.” This suggests that companies are increasing their investment within the country in light of movement restrictions amid the COVID-19 situation.



Challenges in promoting M&A amid the COVID-19 situation

The survey then asked about challenges in promoting M&A amid the COVID-19 situation.



When asked about challenges in promoting M&A amid the COVID-19 situation, the largest number of respondents chose “Uncertainties in company's business outlook,” followed by “Limitations on face-to-face negotiations due to inability to communicate in person,” and “Movement restrictions — site visits, etc. — by the Japanese government.”

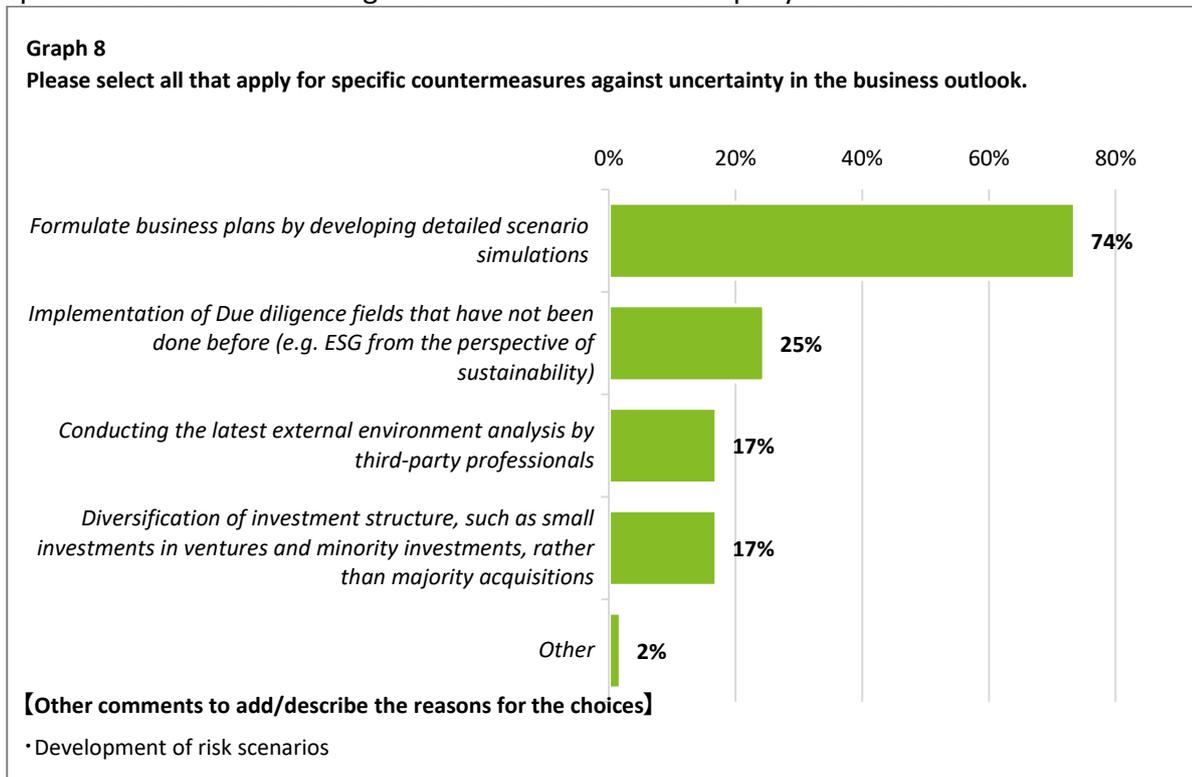
Companies can make the most of online meeting tools such as Zoom and take certain measures against “Limitations on face-to-face negotiations due to inability to communicate in person,” “Movement restrictions — site visits, etc. — by the Japanese government,” and “Restrictions on PMI (post merger integration) after the acquisition.” On the other hand, “Uncertainties in company's business outlook” is a risk for the future, so companies may find it difficult to eliminate the risk and perceive this as a major challenge.

“Limitations on face-to-face negotiations due to inability to communicate in person” was chosen by the second largest number of respondents. About half of all the respondents do not recognize these limitations as an issue, while the other half recognize them as an issue. This fact suggests that many respondents are aware that online negotiations are not a complete substitute for face-to-face negotiations.



Countermeasures against uncertainty in the business outlook

The previous question has revealed that “Uncertainties in company's business outlook” is the most recognized challenge for M&A amid the COVID-19 situation. This question asked about specific countermeasures against “Uncertainties in company's business outlook.”



For this question, the majority of respondents chose “Formulate business plans by developing detailed scenario simulations.” This result suggests that, in order to deal with the risk of uncertainty in the business performance outlook, companies consider the construction of convincing business plans and pricing based on such scenarios to be important, as they formulate business plans based on multiple scenarios in a more detailed manner than before.

In addition, it is only less than 20% of the respondents that chose “Diversification of investment structure, such as small investments in ventures and minority investments, rather than majority acquisitions.” However, as seen in the responses to the question about the status of consideration of M&A amid the COVID-19 situation in terms of the investment scope (field), these businesses seem to be placing more emphasis on investments in companies with potential in anticipation of the post-COVID new normal.

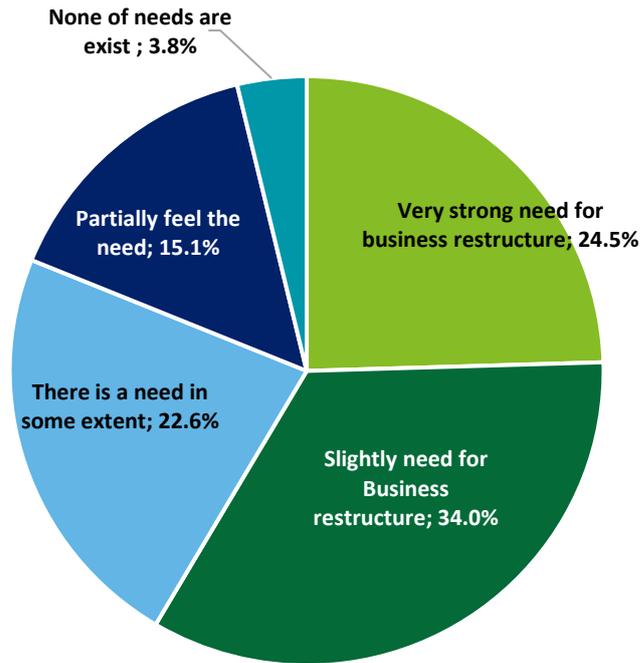


Need for business restructuring amid the COVID-19 situation

From the questions below, as a survey on business restructure, we first asked about the need for business restructuring.

Graph 9

How do you feel regarding the need for business restructuring amid the COVID-19 situation?



Graph 9 shows the perception of the respondents' businesses about the need for business restructuring amid the COVID-19 situation.

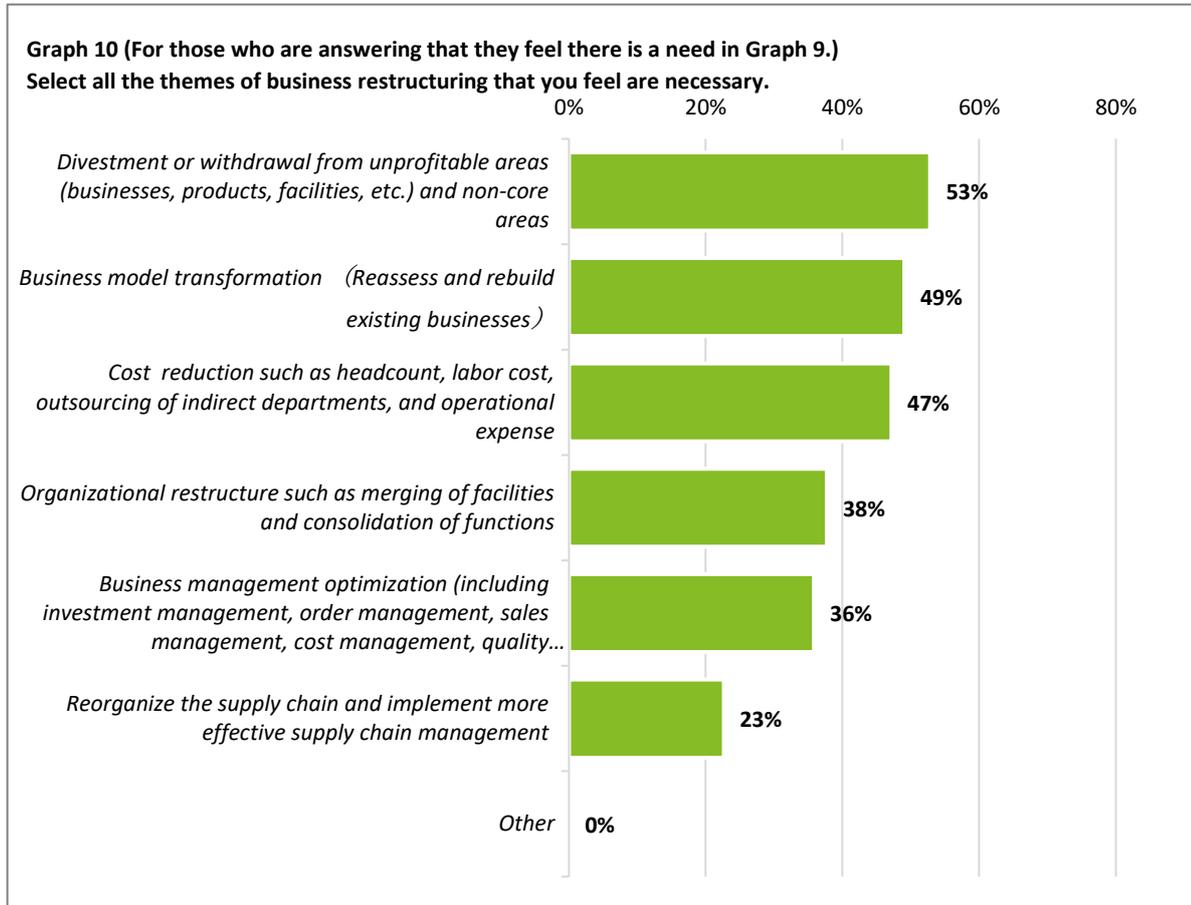
The total of those who answered "Very strong need for business restructuring" and "Slightly need for business restructuring" was about 60%, and including those who answered "There is a need to some extent," the figure was over 80%. This result indicates that many companies are aware of the need to restructure their businesses with an eye to coexistence with COVID-19 and the post-COVID era.

We can assume that companies are increasingly aware of the need to restructure their businesses because of the question of how to respond to the decline in demand and changes in consumer and customer behaviors caused by COVID-19, and also because of the structural problems that had existed but came to the fore amid the COVID-19 situation.



Business restructuring theme that you feel needed to be addressed

The previous question has revealed that the respondents' businesses are strongly aware of the need for business restructuring. The next question asked about the themes of business restructuring that the respondents feel needed to be addressed.



Graph 10 shows themes of business restructuring that the respondents' businesses feel needed to be addressed.

Over 50% of the respondents cited "Divestment or withdrawal from unprofitable areas and non-core areas," indicating that they feel the need to review the businesses where the market environment has deteriorated or where competitiveness has declined amid the COVID-19 situation.

Many companies also feel a strong need for measures including "Cost reduction such as headcount, labor cost, outsourcing of indirect departments, and operational expense" and "Organizational restructuring such as merging of facilities and consolidation of functions." This result suggests that many companies are aware that there is still room for efficiency improvement.

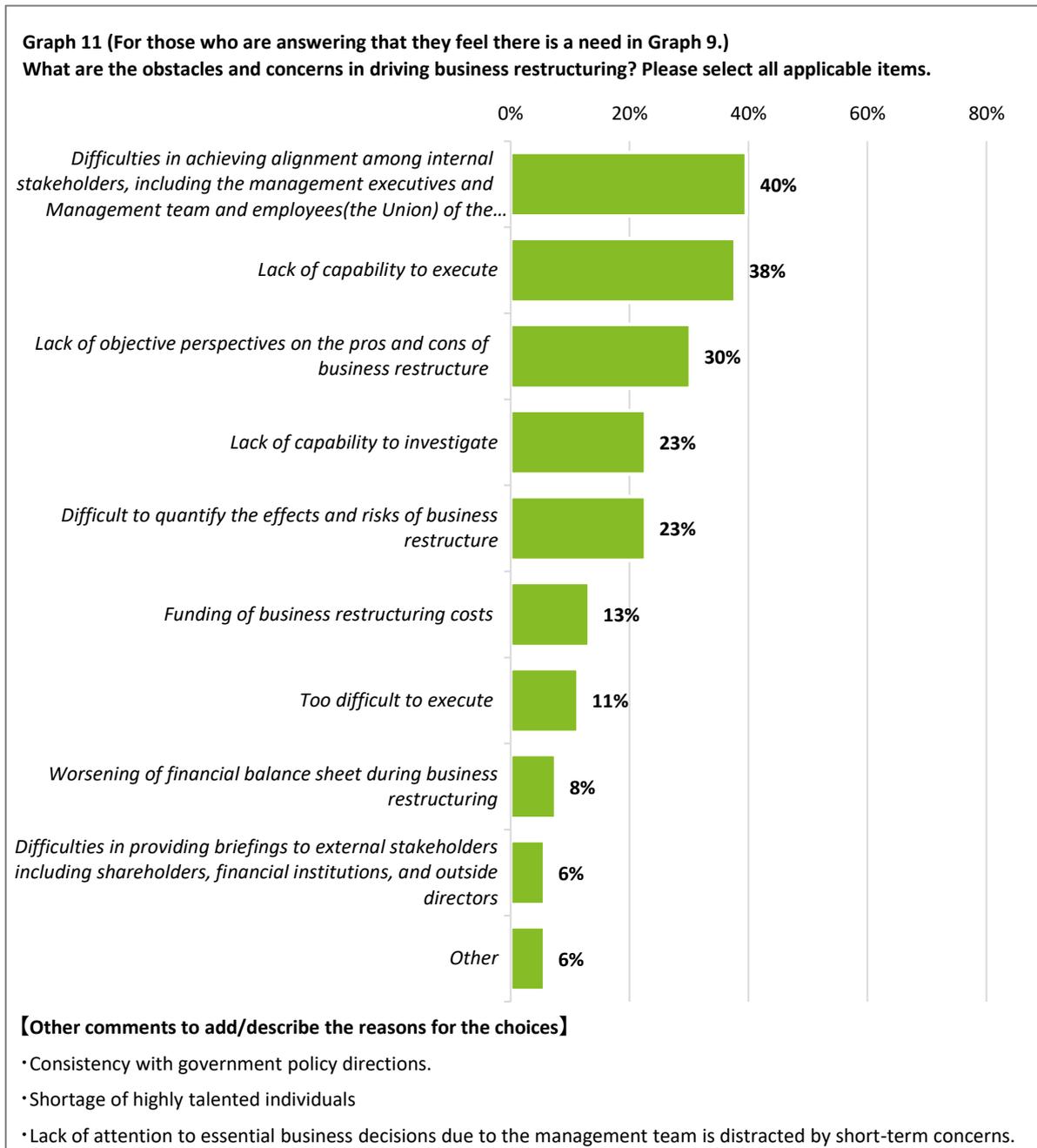
It is noteworthy that nearly 50% of the respondents feel the need for "Business model transformation," a theme that involves a fundamental review of the business structure. It is assumed that many companies are finding it difficult to compete in the post-COVID market with their traditional business models. We consider that an increasing number of companies

are recognizing the importance of making bold changes to the way they operate from a medium- to long-term perspective by, for example, reforming their business concepts, leveraging digital transformation (DX), investing aggressively in growth areas, and promoting M&A and alliances.



Obstacles and concerns in driving business restructuring

This question asked about obstacles and concerns in driving the business restructuring and promoting the themes asked in the previous questions.



Graph 11 shows obstacles and concerns in driving business restructuring.

Forty percent of the respondents' businesses recognize "Difficulties in achieving alignment among internal stakeholders, including the management executives and management team and employees of the restructuring target business." Many companies are concerned about internal explanations, which have traditionally been a major concern in business restructuring.

While 20–40% of the respondents cited as obstacles and concerns “Lack of capability to execute,” “Lack of objective perspectives on the pros and cons of business restructuring,” “Lack of capability to investigate” and “Difficult to quantify the effects and risks of business restructuring,” a mere 10% cited “Funding of business restructuring costs” and “Too difficult to execute.” This suggests that in promoting business restructuring, many companies are more concerned about their own capability in considering and executing business restructuring than about financial constraints or the difficulty of restructuring itself.



Summary

The results of this survey have confirmed that many companies are strongly aware of the necessity of M&A and business restructuring, but are also confronted with various challenges including the impact of COVID-19, along with the details of these challenges.

The future of these companies will be undoubtedly greatly influenced by their ability to overcome these challenges and correctly promote M&A and business restructuring, which is the fundamental mission of corporate management. We hope that all companies will continue to tackle these challenges without stopping.

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

The CFO Program

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