Deloitte CFO Signals Report

2023Q2

October 2023

Contents

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 the report as CFOs' Signals.

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 33rd edition. In the "Survey on the Economic Environment," we analyze 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 involvement in portfolio management (the appropriate allocation of management resources), a continued topic from the previous survey. Surveys for this 2023Q2 edition were conducted in August 2023, and we were able to receive responses from 35 CFOs and finance and accounting executives.

Thank you for your cooperation.

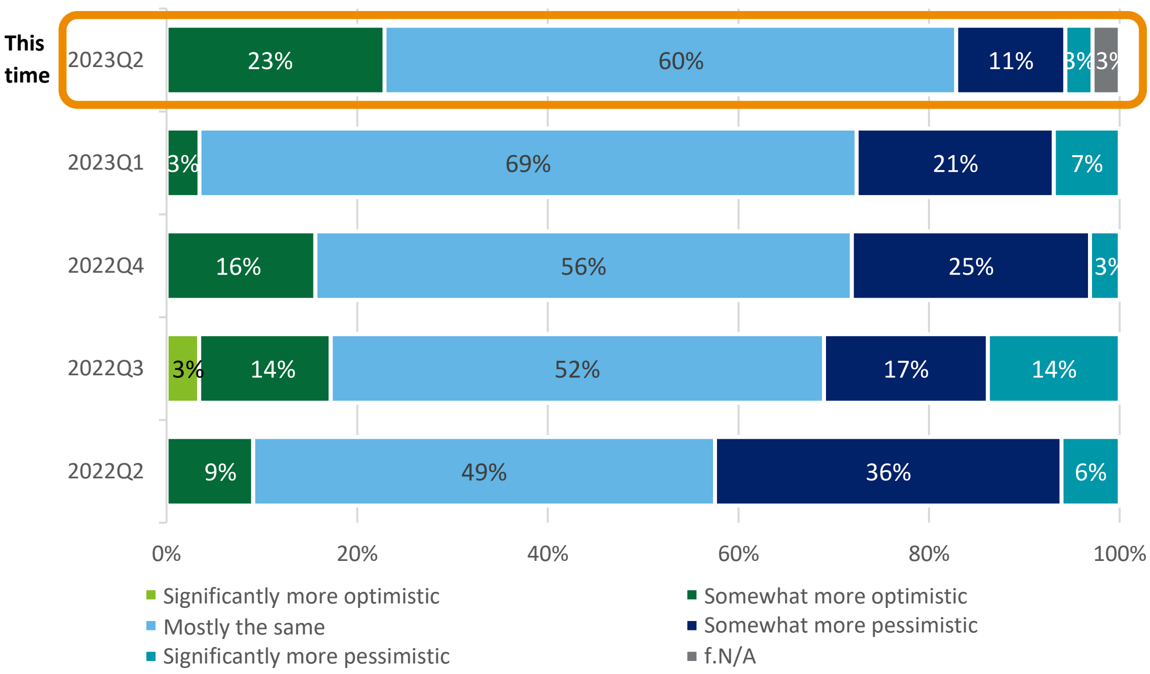
Deloitte Tohmatsu Group
The CFO Program
October 2023

Survey on the Economic Environment

Financial environment prospects

Financial prospects remain unchanged with a slight improvement

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 the current 2023Q2 survey, similar to the previous result, a majority of respondents (60%) said their financial prospects were "Mostly the same." A total of 23% of respondents said they were "Significantly more optimistic" or "Somewhat more optimistic," an increase from 3% in the previous survey. Meanwhile, a total of 14% said they were "Significantly more pessimistic" or "Somewhat more pessimistic," a decrease from 28% in the previous survey. This shows that overall, the optimism has tended to be slightly stronger for CFOs.During this survey period, August 2023, the Japanese economy was steadily recovering with domestic demands and inbound consumption, as well as the US economy expanding unexpectedly despite the FRB's interest rate hike. On the other hand, concerns about the deterioration of the real estate market in China have expanded. In regards to international relations, we saw a prominent separation between the US and China - China's ensuring export controls on some of the rare metals and the US tightening of regulations on investing in Chinese companies. Overall, the business environment was vague and could be interpreted in any way, and it was a period for CFOs to continue to assess the future economic and political trends.

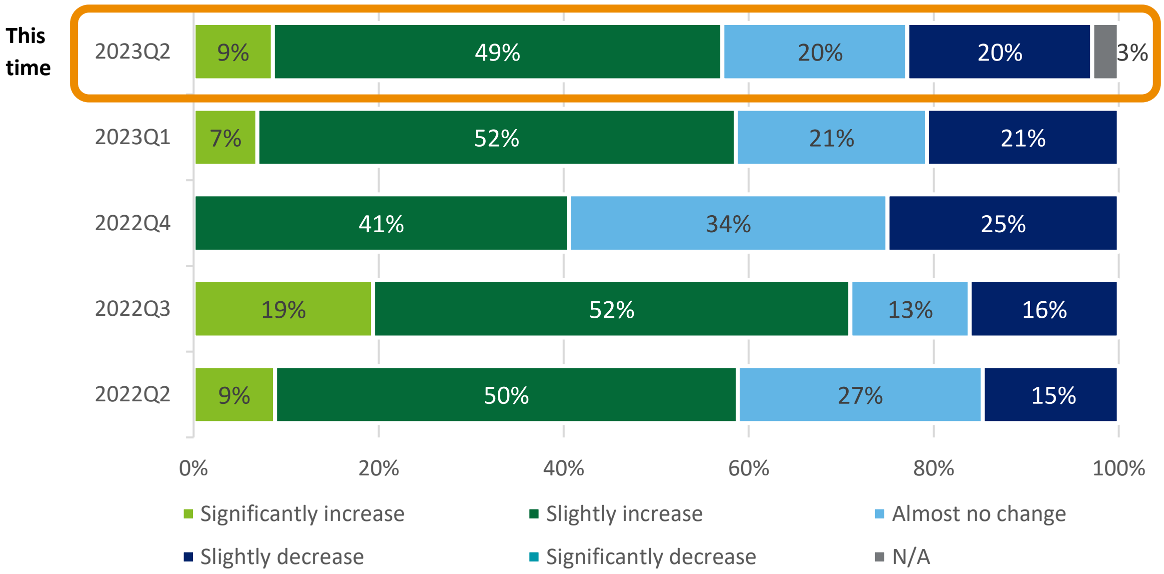
Going forward, the rise in resource costs and the inflationary trend will be the key factors in shaping the financial environment, such as the trend of the Chinese economy, the economic impact of monetary tightening in the US and Europe, and the recurring rise of crude oil prices. In addition, the fact that the Bank of Japan (BOJ) has decided to ease the operation of yield curve control in July may be a new factor to consider, showing their move to normalizing monetary policy in the future. Deloitte expects the US economy to slow down at the beginning of next year due to the impact of future interest rate hikes, and that the BOJ will lift its negative interest rate policy by next spring. If this scenario unfolds, gradually there will be a downward pressure on financial prospects for CFOs.

Business performance outlook

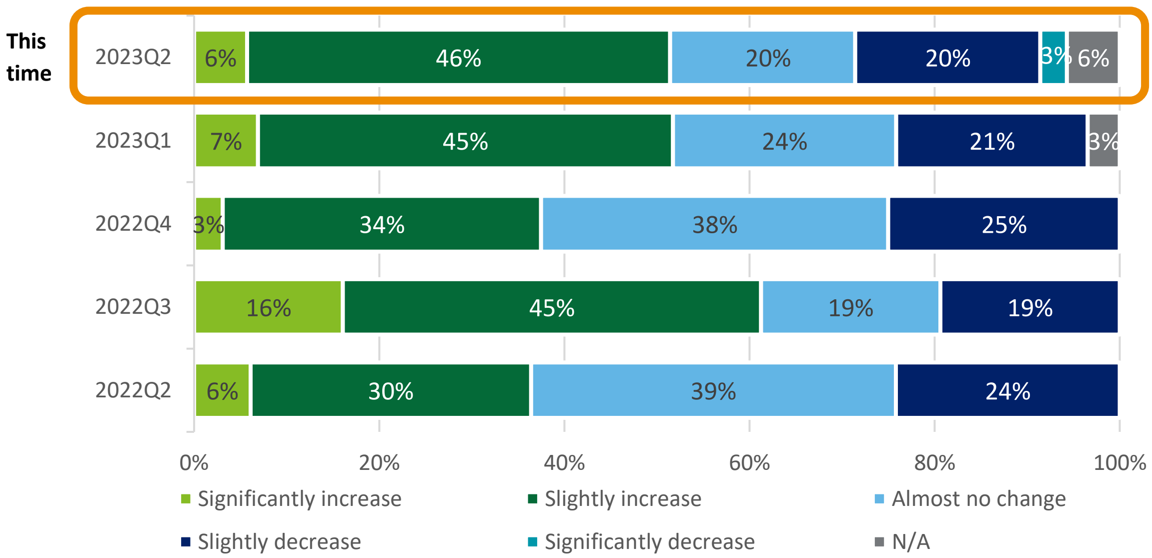
Business performance outlook is steadily high and unchanged, but rise in costs may become a risk again

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

[Revenue]



[Profit]

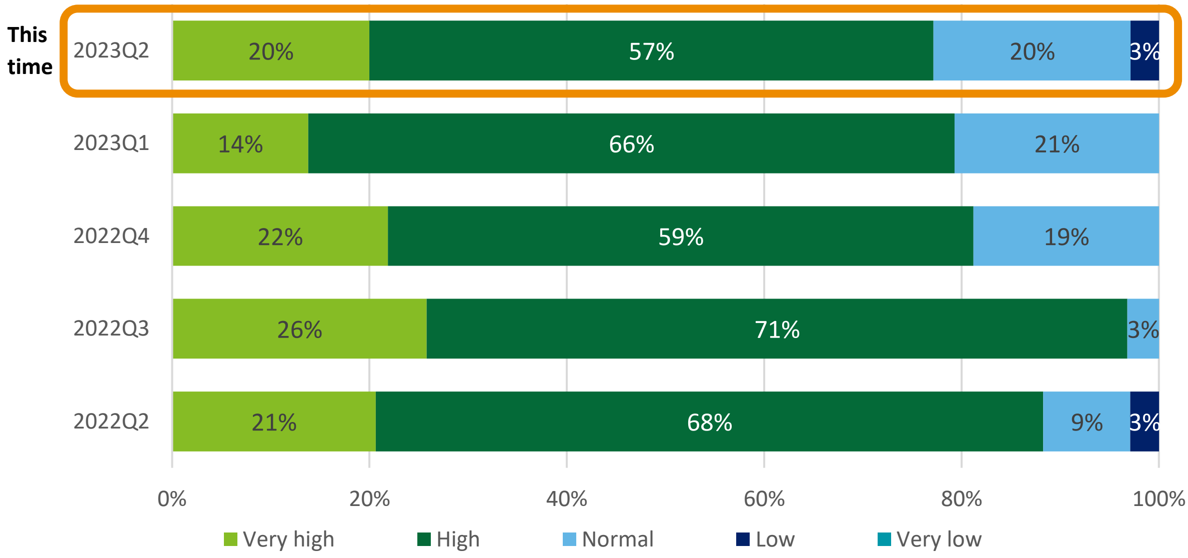


Graph 2 shows the CFOs' prospects for each company's financial performance (revenue and profit) for the coming year. Performance outlooks were almost the same as in the previous survey, generally with about half of CFOs expecting growth in performance. A total of 58% of respondents said that they expected the revenue to "Significantly increase" or "Slightly increase," nearly equal to the previous result (59%). Likewise, a total of 52% of respondents expected that the profit would "Significantly increase" or "Slightly increase," the same figure as last time. Similar to the financial environment, the environment surrounding revenue and profit is also facing a mixed situation of positive and negative factors, but overall it can be said that the economic expansions both in Japan and US have been a tailwind for corporate performance. In addition, the fact that companies have been able to reflect the increasing labor and raw material costs to customers to a certain extent is also a factor behind the stable business performance outlook. However, according to the BOJ's latest TANKAN (Short-Term Economic Survey of Enterprises in Japan) survey in June, the total businesss performance plan of large companies in FY2023 indicates increased revenue and decreased profit both in manufacturing and non-manufacturing industries. The BOJ survey suggests that even if the nominal sales increase along with the price hikes, this probably cannot cover the cost increase. If costs continue to increase, including further increases in crude oil prices, we may see a deterioration in the CFO's performance outlook in future surveys, especially in the profit outlook.

Uncertainty

Uncertainty remains high

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

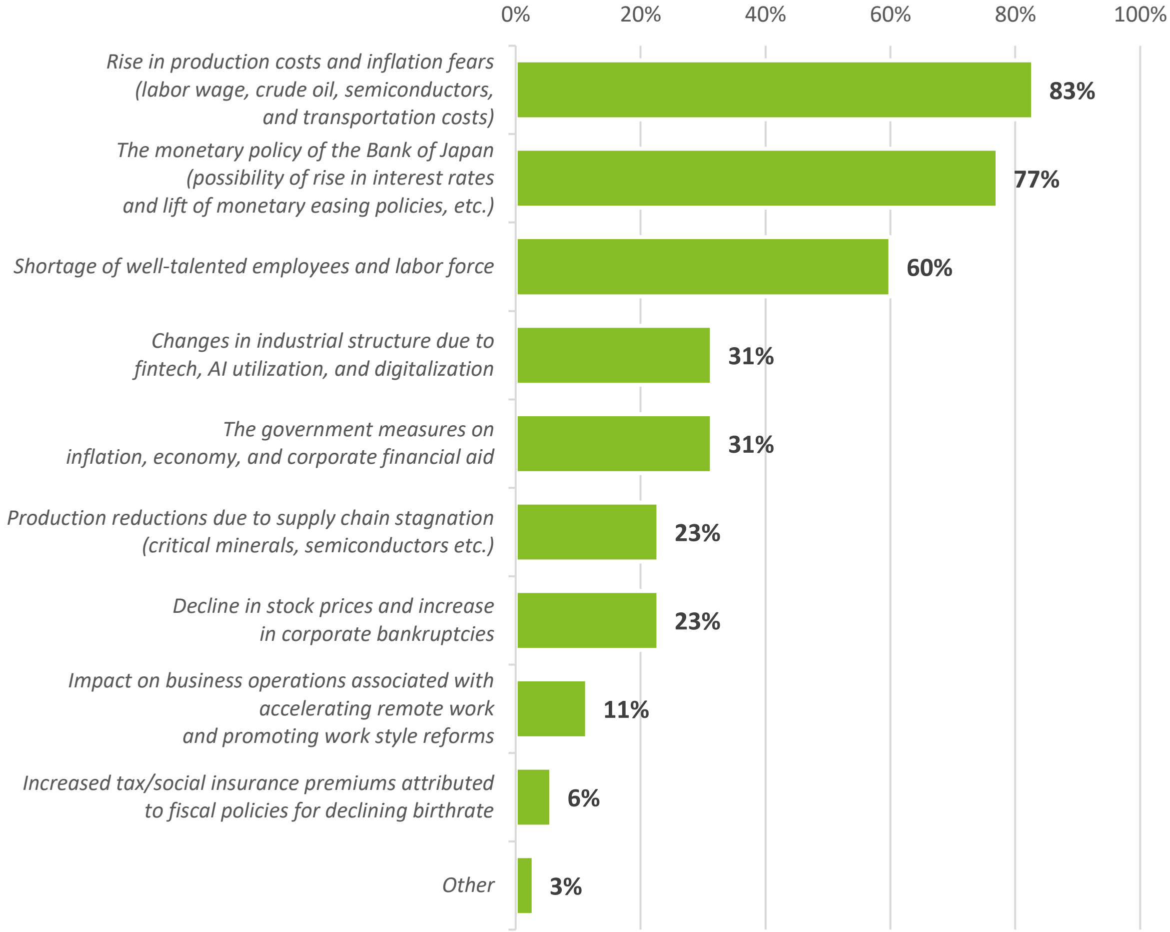


Graph 3 shows the outlook for financial and economic uncertainty. A total of 77% of respondents said that uncertainty was “Very high” or “High,” a consistently high level following the previous result of 80%. However, the proportion of CFOs giving these responses has declined for three consecutive quarters and for the first time fell below 80% since six quarters in this survey. It can be said that the high level of uncertainty reflects the existence of multiple uncertain factors such as the Russia-Ukraine situation, the Chinese economy, the US-China conflict, and supply chains. However, the fact that the Russia-Ukraine situation is stable (stalemate) compared to the early phase, and the degree of uncertainty and CFOs’ attention are declining (see Graph 5), may be a factor behind the result this time. On the other hand, there are emerging uncertainties; re-arising difficulties in Russia’s exporting Ukrainian agricultural products, the BOJ’s monetary policies, and the recent exchange market with continuous depreciation of the yen. A highly uncertain environment will likely remain unchanged for CFOs for the foreseeable future.

Key change factors in the Japanese economy

In addition to production costs/labor force, attention to BOJ's monetary policy and AI increased

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.

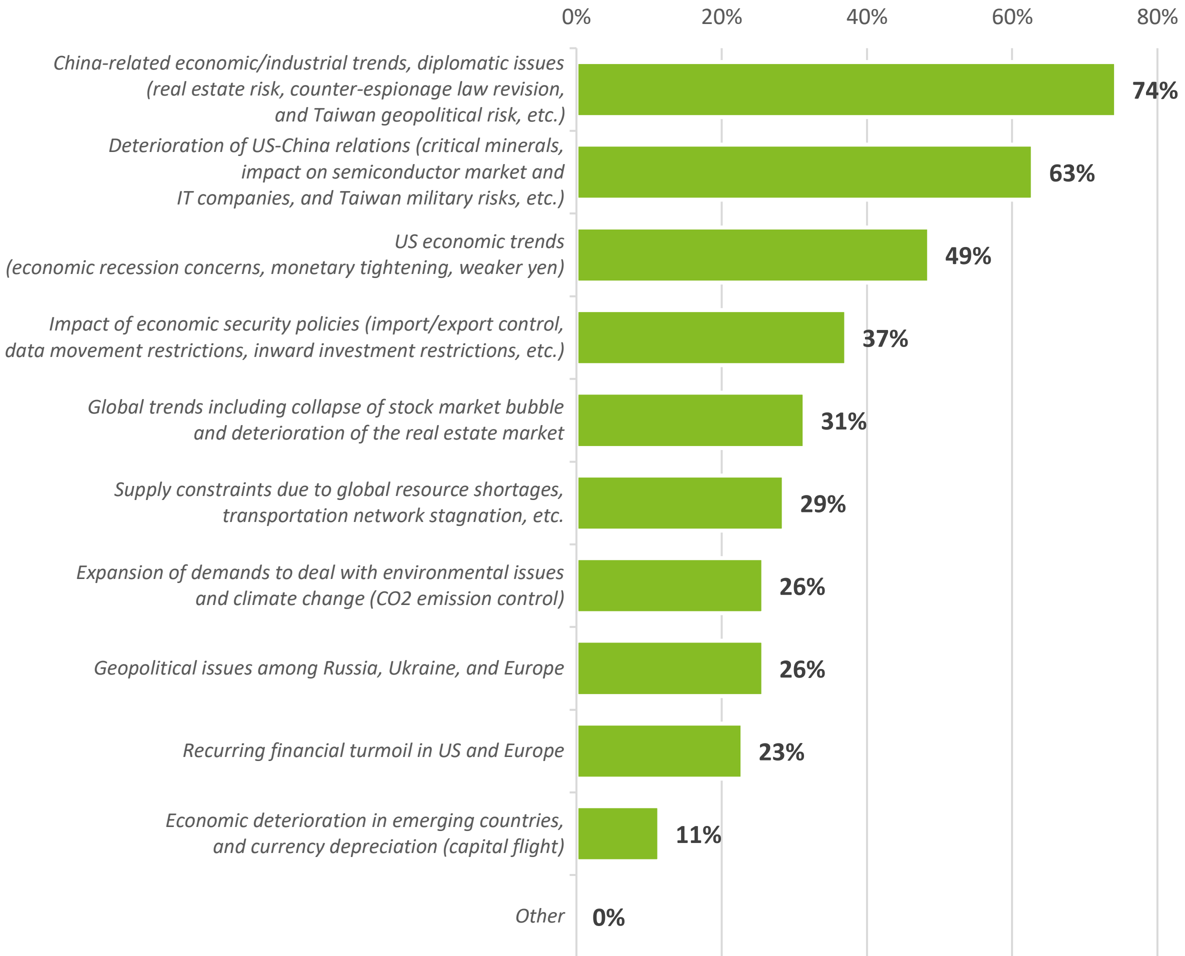


Graph 4 shows the key factors in the Japanese economy that CFOs will most closely watch when preparing business plans over the next year. In this survey, there were some notable changes in the key change factors related to the Japanese economy. Same as the previous survey, "Rise in production costs and inflation fears" ranked first, but "The monetary policy of the Bank of Japan" moved up from third to second place, replacing "Shortage of well-talented employees and labor force," which dropped from second to third place. "Changes in industrial structure due to fintech, AI utilization, and digitalization" ranked fourth this time, moving up from the previous fifth place. The concerns for costs and labor force have almost become a consistent key change factor, but the fact that CFOs are paying more attention to the BOJ's monetary policy and AI is a major emerging trend found in this survey. At its Monetary Policy Meeting (MPM) in July, the BOJ decided to make the operation of yield curve control more flexible, expanding the tolerance range for the rise in long-term interest rate in effect. The statement of BOJ's MPM and subsequent remarks by Governor Ueda indicated that monetary policy could be normalized depending on future economic and inflationary trends. Breaking free from the zero-interest rate/negative interest rate policy that has been in place for more than 20 years will presumably have a commensurate impact on finances, such as rising costs for capital procurement for companies. The BOJ's monetary policy will likely continue to be a major key change factor for CFOs going forward. With the rapid spread of generative AI such as ChatGPT, it can be assumed that companies are examining the effectiveness and risks of generative AI from various perspectives. Generative AI has the potential to have a significant impact on companies' business procedures and business models, and it will remain a captivating key change factor for CFOs.

Key change factors in the global economy

In addition to the Chinese economy/US-China conflict/US economy, attention to economic security has increased

Graph 5
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 one-year period.



Graph 5 shows what key factors in the global economy CFOs will most closely watch when preparing their business plans over the next year. The top key change factors were unchanged, with “China-related economic trends” in first place (previously second), “Deterioration of US-China relations” in second (previously first), and “US economic trends” in third (previously same in third), indicating only a partial change in the ranking. However, it is worth noting that “Impact of economic security policies” rose to fourth place this time compared to eighth in the previous survey. Regarding the Chinese economy, negative factors were revealed such as the new default of Chinese real estate companies following the previous survey. As for the US-China relationship, CFOs paid attention to the fact that China has ensured export controls on some of the rare metals and the US has tightened regulations on investing in Chinese companies in response. In terms of the US economy, the focus would be highlighted on the impact of the FRB’s interest rate hikes on the economy and the recurrence of financial system instability due to rising interest rates (although the current situation is under control). Regarding economic security, domestic legislation on security clearance is now undergoing. And with China's tightened export controls on rare metals, similar risks will likely arise for other important minerals in the future. Japanese companies must carefully analyze the current situation and formulate comprehensive countermeasures in advance. The key change factors mentioned will likely continue to be a high concern for CFOs going forward.

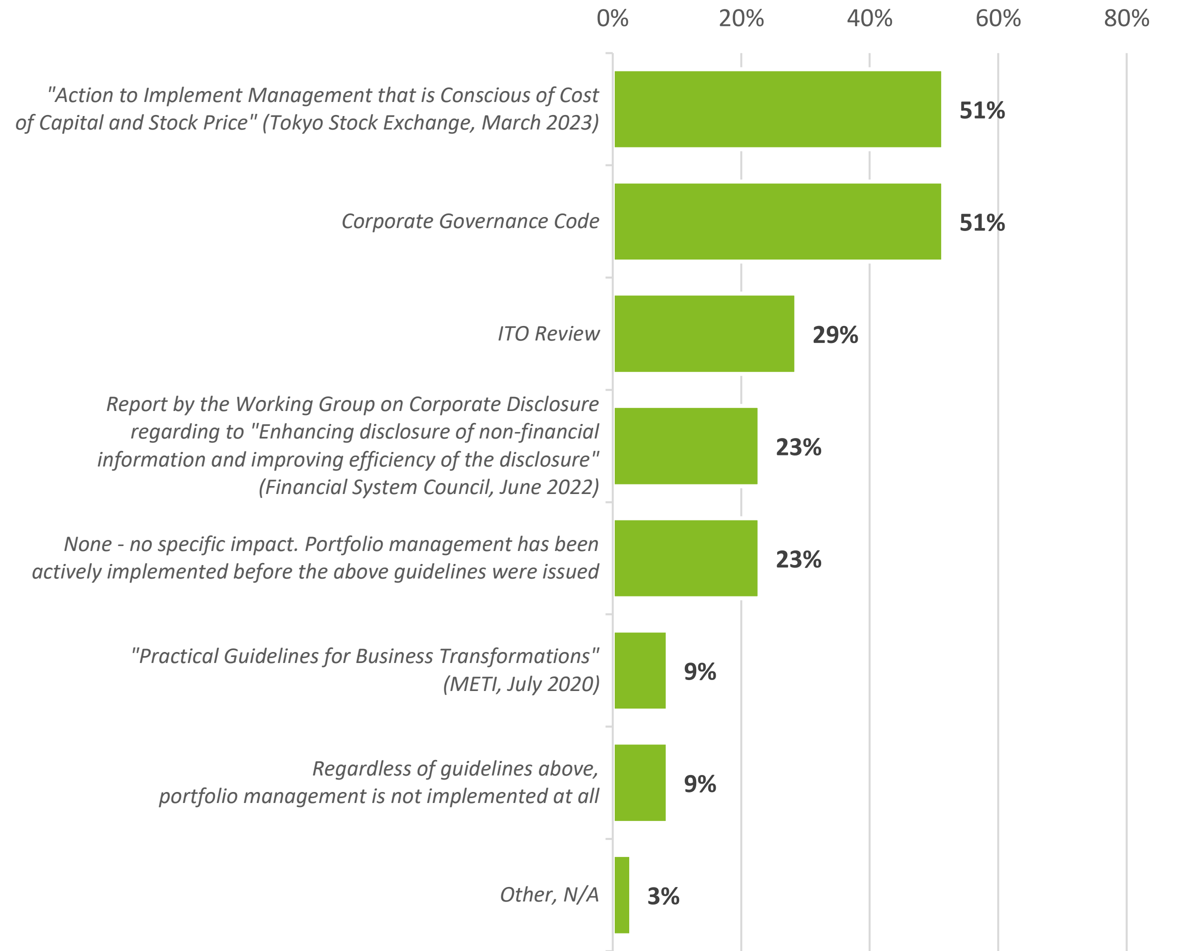
Survey on the Involvement in Portfolio Management
(The appropriate allocation of management resources)

In the latter section of this survey, we inquired about "involvement in portfolio management (the appropriate allocation of management resources)," a continued topic from the previous 2023Q1 survey.

Guidelines that influenced the implementation of portfolio management

Guidelines issued by the Tokyo Stock Exchange in March have influenced the implementation of portfolio management

Graph 6
Which of the guideline(s) had an impact on/led to changing the initiatives for implementing portfolio management? Please select all that apply.

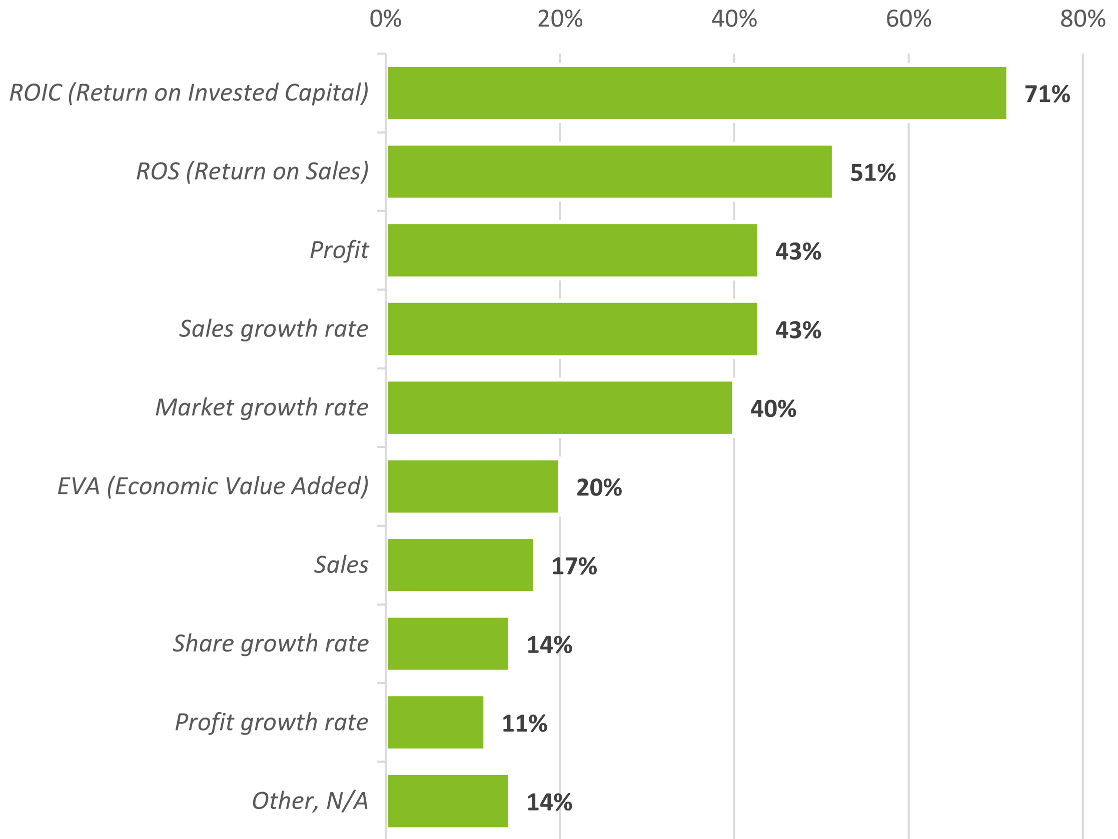


The results show that more than half of companies said that they were affected by the "Action to Implement Management that is Conscious of Cost of Capital and Stock Price" issued by the Tokyo Stock Exchange in March this year in implementing their portfolio management. This suggests that even for companies that have already been implementing portfolio management, the guidelines issued by the Tokyo Stock Exchange once again gave a chance to accelerate and /or review their portfolio management plans. Only 23% of companies responded "None - no specific impact. Portfolio management has been actively implemented before the above guidelines were issued," indicating that the guidelines from institutions and social/market trends add a significant impact on the decision-making for companies. On the other hand, 9% of respondents said "Regardless of the issuance of above guidelines, portfolio management is not implemented." These companies may need to actively consider implementing portfolio management to enhance their competitiveness going forward.

Quantitative criteria used to evaluate each business

More than 70% have adopted ROIC in implementing their portfolio management

Graph 7
Please select the quantitative criteria used to evaluate each business when implementing portfolio management. Please select all that apply.



Other quantitative criteria used to evaluate each business

・NPAT ・Operating income, ROE ・EBITDA

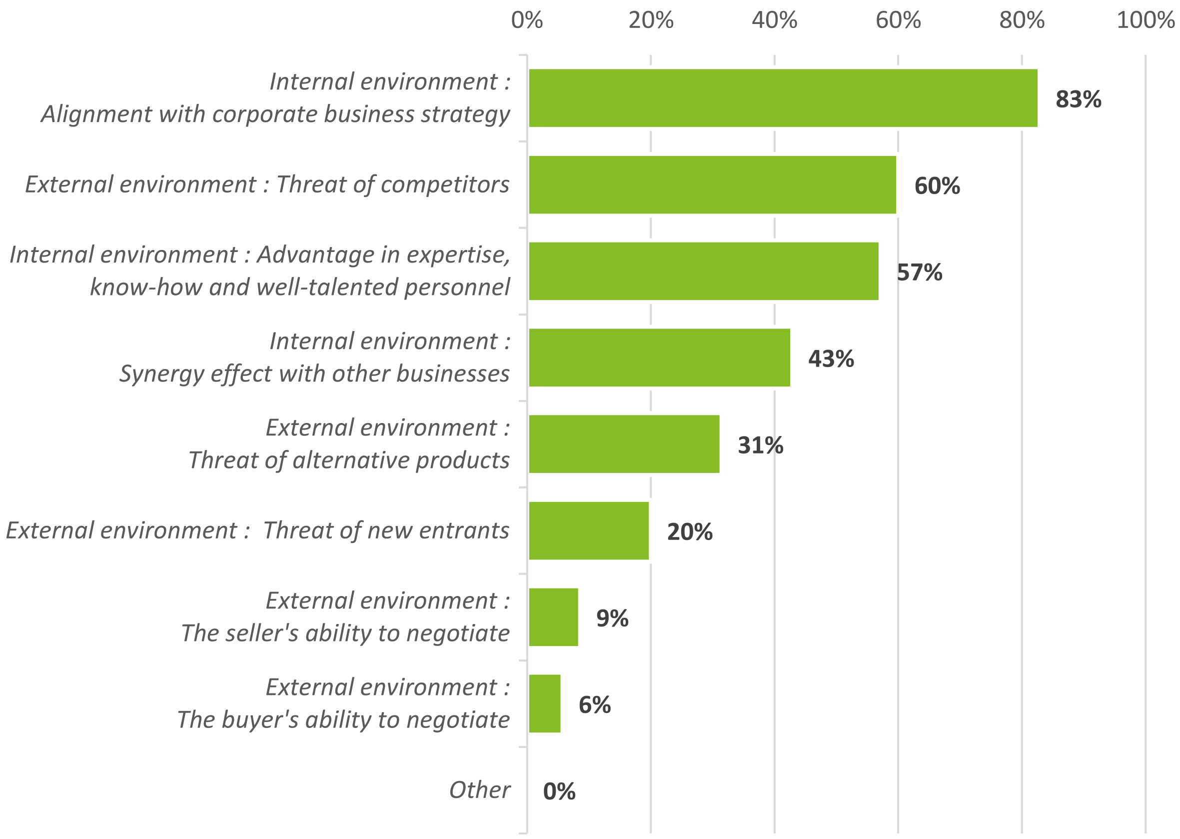
More than 70% of companies use ROIC (Return on Invested Capital) as a quantitative criteria to evaluate each business when implementing portfolio management. From this result, many companies tend to orient toward decisions that consider not only profit but also capital efficiency. As shown in Graph 6, many companies were influenced by the TSE guidelines, it is assumed that the company's attention and awareness of capital efficiency have increased following the guideline.

For indicators other than ROIC, the results dispersed with the number of votes at 51% or lower. Since it was pre-assumed that many companies were implementing profitability indicators such as "ROS (Return on Sales)" in their evaluation, this was slightly an unexpected result. This result, however, revealed that it confirmed the fact that evaluation is made not only by profitability but comprehensively with growth and efficiency measures.

Qualitative criteria used to evaluate each business

Alignment with business strategy ranked first as the qualitative criteria for evaluation

Graph 8
Please select the qualitative criteria used to evaluate each business when implementing portfolio management. Please select all that apply.



The results revealed that 83% of companies use "Alignment with business strategy" as one of the qualitative criteria to evaluate each business in implementing portfolio management. In the previous survey, when asked to select the initiatives which they wanted to implement for portfolio management, first place was "Strategic planning and business portfolio selection from a long-term perspective." It can be said that companies are incorporating this evaluation criteria in a way that reflects their commitment to the selected initiative.

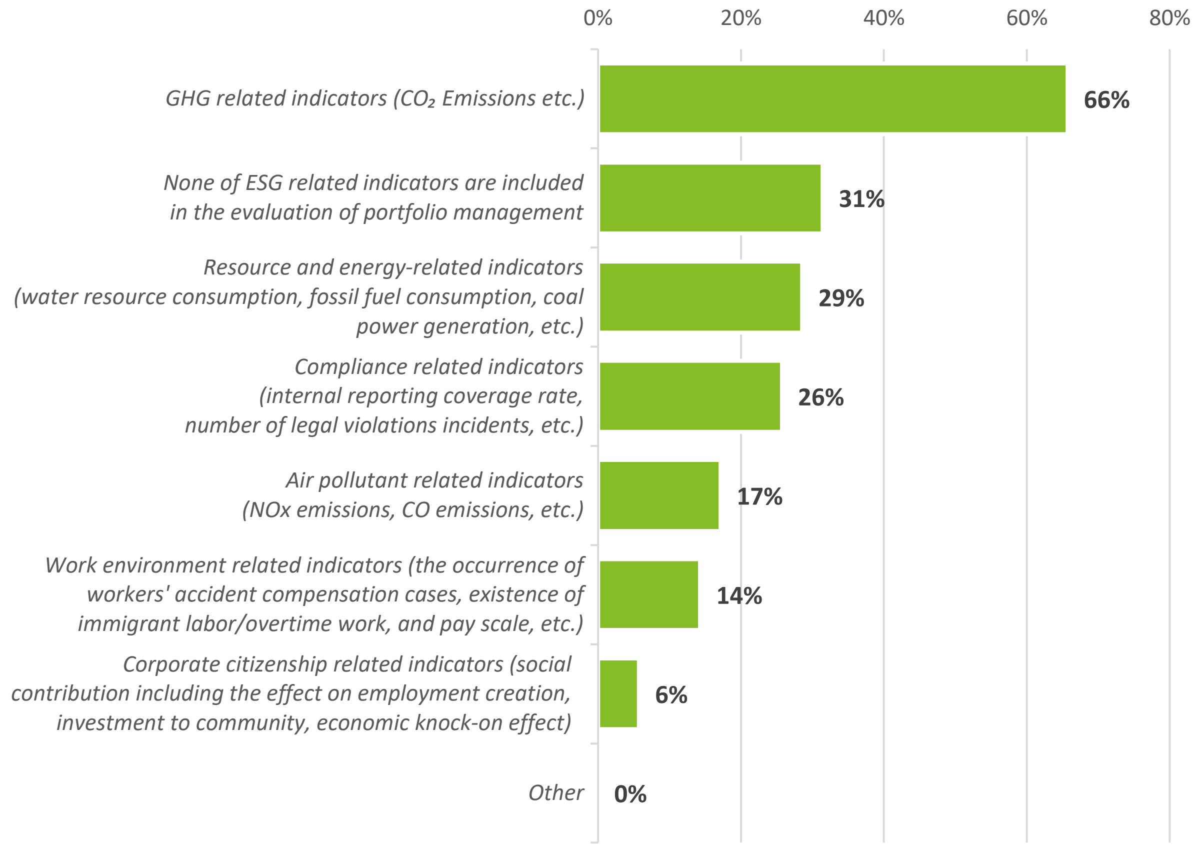
60% of companies responded "Threat of competitors" as the external environment evaluation criteria, but very few companies evaluated "The seller's negotiating power" or "The buyer's negotiating power", criteria which are based on relationships with suppliers and customers.

Moreover, it was surprising that less than half of companies responded "Synergy effect with other businesses." In the previous survey, we asked about the "Challenges in acquisitions and new business development," and 45% of companies responded "Failure to generate synergies with existing businesses." It is not clear whether synergies were not generated because the synergies were not evaluated in advance, or, whether companies did not set a criteria because companies felt the difficulty of generating synergies – however; in any case, companies are likely to find it necessary to anticipate a certain level of synergies in order to enforce companies' competitiveness going forward. More than half of companies incorporate “Advantage in expertise, know-how and well-talented human personnel” as an evaluation criteria, as the effective use of existing resources is also an important factor to investigate.

ESG-related indicators used to evaluate each business

GHG related indicators ranked first in ESG-related indicators used for evaluation

Graph 9
Please select the ESG-related indicators used to evaluate each business when implementing portfolio management. Please select all that apply.



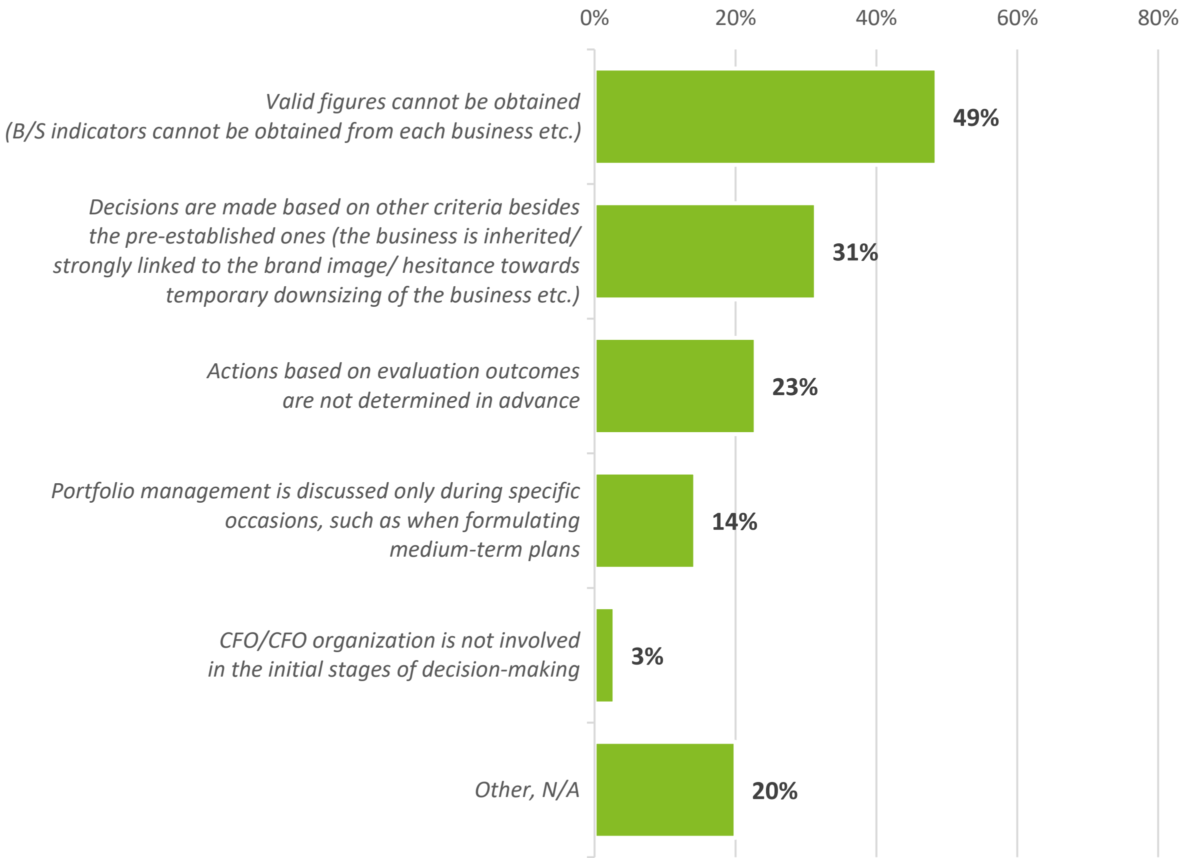
"GHG related indicators," one of the E (environment) indicators, by far ranked first in terms of ESG indicators incorporated into portfolio management. The third-ranking "Resource and energy-related indicators" is also an E indicator, which we can be assumed that it may be easier for companies to obtain and evaluate the E indicators at the business unit level, compared to S (social) and G (governance) indicators.

30% of companies also responded that "None of ESG related indicators are included in the evaluation of portfolio management." While ESG compliance is already an essential agenda for CFOs, it can be said that initiatives for disclosure and responses to institutions have been prioritized, and incorporating ESG-related initiatives into portfolio management has not been fully implemented yet. Considering recent trends and demands from stakeholders, it is expected that the application of ESG indicators in portfolio management will further expand in the future.

Challenges faced in selecting evaluation indicators and operation

Half of the companies face the challenge of obtaining valid figures

Graph 10
Please identify the challenges faced in selecting evaluation indicators and operating portfolio management.



Approximately half of the companies answered that "Valid figures cannot be obtained (B/S indicators cannot be obtained from each business etc.)" as a challenge in selecting evaluation indicators and operating portfolio management. In Graph 7, more than 70% of companies said that they have incorporated "ROIC" as a quantitative criteria. When combined with the responses in this graph, although ROIC is used as an indicator, it can be inferred that there is room for improvement in the accuracy of the figures and that companies may have difficulty in operation. In addition, it can be assumed that not being able to obtain valid figures for B/S indicators from each business, perhaps the same can be said for obtaining ESG-related indicators mentioned in Graph 9.

The result shows all options were selected by less than half of the companies. Given that many companies have started (accelerated) their initiatives based on the TSE guidelines issued this March as shown in Graph 6, it can be inferred that some companies are still in the process of considering the implementation of portfolio management and have not yet reached implementation, thus the specific challenges have not been identified at this point.

To conclude this section…

In this 2023Q2 CFO Signals survey, we further inquired about the involvement in portfolio management (appropriate allocation of management resources), as a continued topic from the previous survey.

Although CFOs' responses were dispersed regarding the criteria for evaluating each business among companies, it was again acknowledged that there are no one-fits-all evaluation criteria since business structures and their surrounding environment differ for each. Meanwhile, many companies have adopted ROIC in their evaluation criteria, and we were able to capture the growing attention and awareness for capital efficiency. Guidelines from various institutions and the Tokyo Stock Exchange are also supporting factors for implementing portfolio management.

It can be said that the incorporation of ESG indicators into portfolio management is still underway, but we expect that the implementation will expand further in the future.

There are still many challenges in portfolio management – such as obtaining accurate figures and setting/judging with fair standards –, but it is undoubtedly an important initiative that predicts the future of Japanese companies. In addition to responding to external demands, it would be crucial for companies to quickly grasp market/social trends and respond proactively to achieve competitiveness and obtain sustainable growth.

What is 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.

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