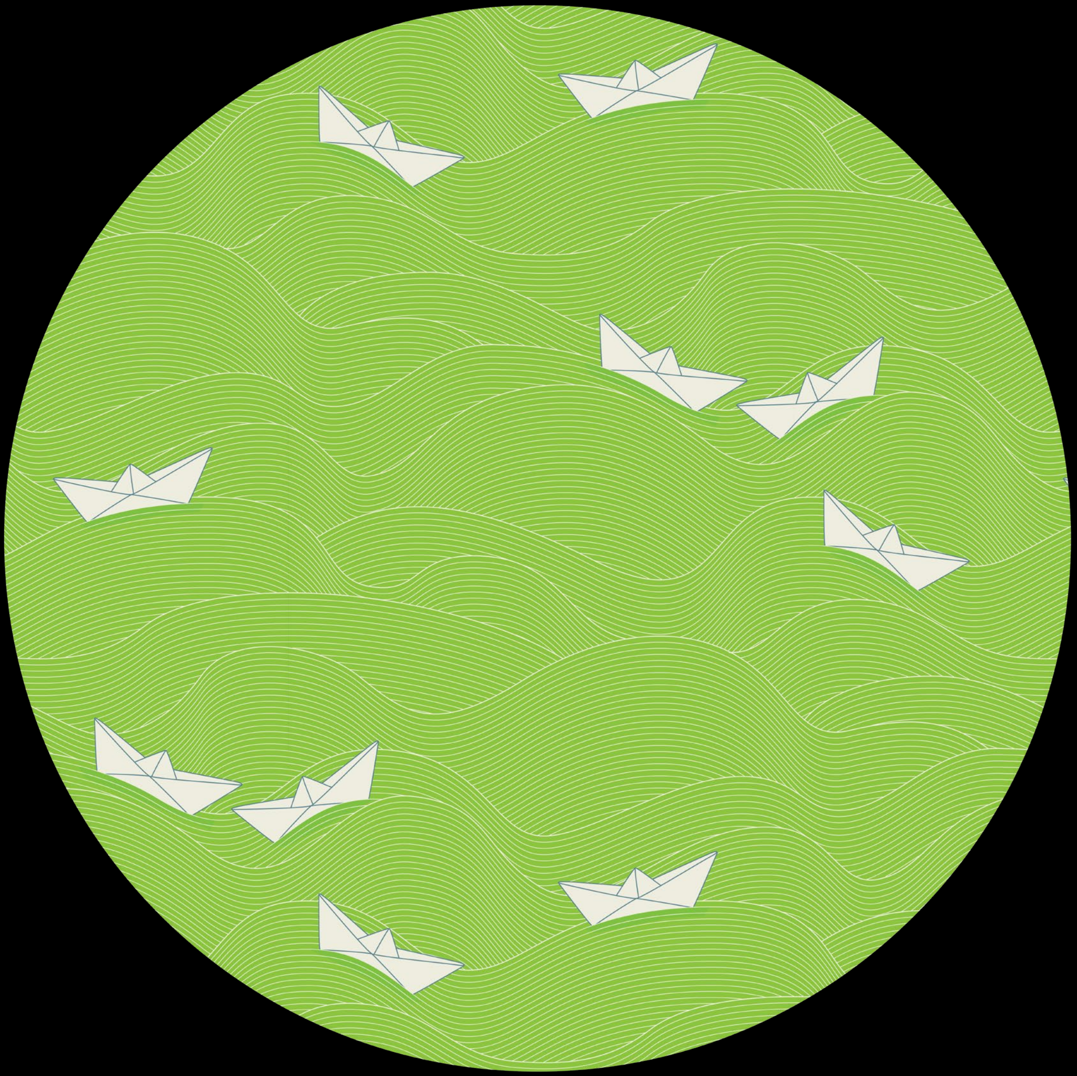

SA CFOs feel the weight of uncertainty

Deloitte South Africa CFO Survey | 2023 H1

June 2023

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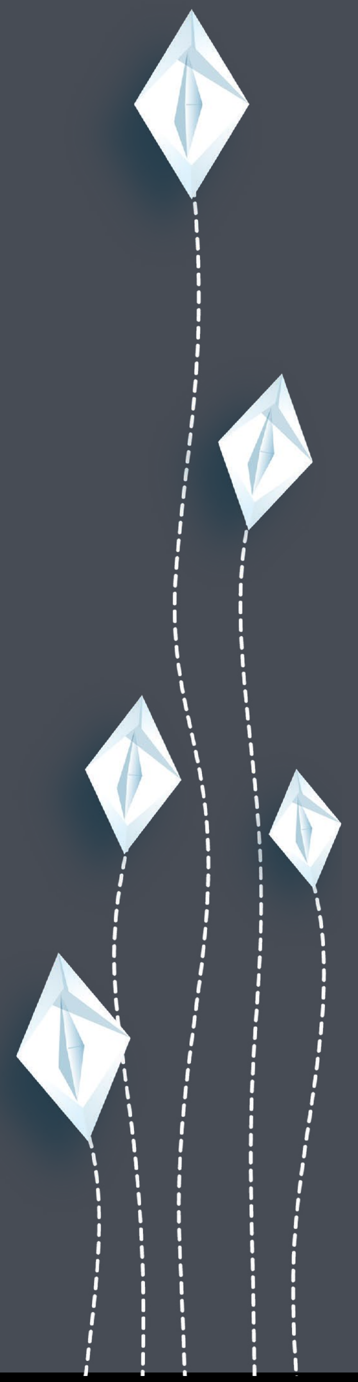


Introduction

South African chief financial officers (CFOs) show some optimism about their businesses' financial prospects moving into the third quarter of 2023. Is there possibly a bright spot amidst the doom and gloom of a challenging global and depressed domestic economic environment?

The International Monetary Fund (IMF) noted in its April 2023 update that the world outlook is set to remain uncertain, given stubbornly high inflation, recent banking sector vulnerabilities, and the ongoing effects of the Russian-Ukraine war, all of which pose risks to economic growth.[1]

While in that update, the fund cut its outlook for global growth marginally (by 0.1 percentage points) to 2.8% in 2023 from its January 2023 update, it slashed its forecast for South Africa forecast by 1.1 percentage points, from 1.2% forecast in January to a meagre 0.1% for 2023.[2] This is largely due to intensified power shortages in South Africa, and against the backdrop of an uncertain global environment. The forecast aligns with the low real GDP growth expectations pencilled in by the South African Reserve Bank (SARB) and others.[3]

Deloitte has conducted CFO surveys around the world for several years. For example, since 2015, the *European CFO Survey* has given a voice twice a year to more than 1 500 CFOs across that continent. Between 30 March and 2 May 2023, Deloitte South Africa fielded its pilot *South Africa CFO Survey*, inspired by Deloitte's survey of European CFOs.

This report provides an overview of the findings of this pilot survey, including CFOs' hiring and investment intentions, their view on critical business risks and strategic priorities, business transformation – specifically finance transformation, and other factors considered vital for success. CFOs were also asked about their expectations for medium-term prospects, including their views on inflation and the cost of capital.

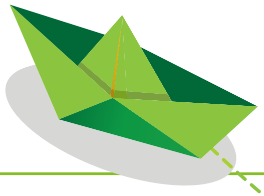
While the responses provided do signal caution over the next 12 months, at the time of the survey, there was a feeling that the worst might or could be over in the coming months for South African businesses, specifically constraints faced by businesses in a high-cost environment. These constraints included the cost-of-living squeezing consumers, notable currency depreciation, and increased loadshedding during winter. Business must continue to be part of the solution to overcome acute power supply shortages and other structural constraints to South Africa's growth.

Despite subdued business and consumer sentiment and a generally pessimistic news cycle, we hope the views set out in this report will nourish your thinking and inspire more CFOs to share their inputs, as we extend future surveys to other parts of Africa.

This report provides an overview of the findings of this pilot survey, including CFOs' hiring and investment intentions, their view on critical business transformation – specifically finance transformation, specifically finance transformation, and other factors considered vital for success.

Survey summary

- CFOs are broadly split on their companies' financial prospects, with some glimmers of hope: compared to the previous three months at the time of the survey, about 32% expect prospects to remain unchanged, while 29% are less optimistic, but 39% are more optimistic.
- CFOs' outlook for key company metrics, such as revenues, operating margins, and capital expenditure over the next year, signal cautious optimism. Yet, despite a net positive outlook especially on metrics such as revenues and operating margins, companies are more likely to make capital investments than hire more staff.
- Still, 92% of CFOs feel that the overall level of external financial and economic uncertainty facing their business is high, with two in three CFOs indicating that they do not anticipate taking greater risk onto their balance sheets in the next six months.
- Unsurprisingly, loadshedding, the poor economic growth outlook, political uncertainty and policy inconsistency, as well as currency fluctuations are seen as the most pressing business risks by CFOs over the next year.
- CFOs expect South Africa's average annual inflation in 2023 and in 2024 to remain outside of the SARB's inflation targeting band of 6%, and thus to only see a pause in the current monetary policy tightening cycle, with possible interest rate cuts, from 2024.
- Given these business risks, and an expected continued high-cost environment, CFOs indicate their companies are acting now by diversifying energy supply sources, undertaking stress testing/scenario modelling, and using more digital (planning) tools. Over the next 12 months, CFOs see cost optimisation, improved cash flow management and digitalisation as priority strategies.
- When looking specifically at priority finance areas for digital transformation, financial planning and analytics, as well as strategic finance come out tops, with digital tools such as data and analytics seen as key. Nonetheless, executing financial digital transformation can be a struggle largely because of execution fatigue, but also talent constraints and a resistance to change.
- Navigating the challenges of Covid-19 lockdowns, followed by a series of ongoing domestic and global headwinds have meant that CFOs haven't had much of a breather. Excessive workload and pressure due to poor company performance are seen as top job stressors.



Could the worst be over? Financial prospects, key metrics set to improve

At first glance, the pilot edition of the ***South Africa CFO Survey*** finds that CFOs are broadly split on their companies' financial prospects, compared to three months ago. As they navigate an environment of high inflation, low growth, tight monetary policy, currency depreciation, and unstable power supply, 31.6% expect financial prospects to remain broadly unchanged.

A "glass half empty versus half full" lens could explain the split between less optimistic and more optimistic views. About 29% are less optimistic (of that, 26.3% indicated they are only somewhat less optimistic). Over one third of CFOs in the sample (39.5%) are more optimistic, with just under one in five CFOs indicating they are ***significantly more*** optimistic.

Figure 1: Glass half empty or half full? CFOs see glimmers of improving financial prospects

Question asked: Compared to three months ago, how do you feel about the financial prospects for your company?

Source: Deloitte South Africa CFO Survey H1 2023 results

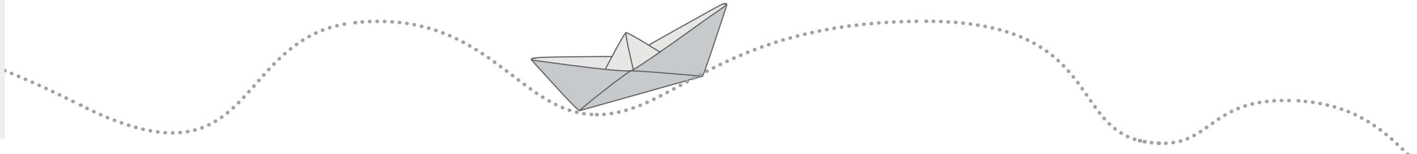
The small positive net balance (where the net balance is calculated as the difference between the share of positive and negative responses) of +10.5% for financial prospects in South Africa compares to +8% for the latest ***European CFO Survey*** (which surveyed 1 366 CFOs across 16 countries in February-March 2023).[4] This comes after declining net balances for financial prospects were recorded among European CFOs in the two 2022 survey editions (from -29% in H1 2022 to -48% in H2 2022) before recovering to +8% in H1 2023.[5]

South African CFOs' outlook for key company metrics, such as revenues, operating margins, and capital expenditure over the next year, signal cautious optimism. The net balance of expectations for the evolution of ***revenues*** in the next 12 months is the largest positive metric (+32%), with 63% of CFOs expecting revenues to increase.

This is likely as the growth outlook for South Africa is expected to improve into 2024. While low to no GDP growth in 2023 is a strong possibility (data released by Statistics South Africa (StatsSA) in early June 2023 indicated a marginal quarter-on-quarter increase in GDP of 0.4%),[6] economic growth could creep up to between 1% and 2% in 2024, particularly as the recent months' intensified power shortages are addressed.

On the other hand, the apparent marginal pick up in GDP growth rates in the short term coupled with lower commodity prices, logistical and transport challenges, as well as consumers that struggle with the cost-of-living squeeze could be behind the 32% of CFOs that expect a decline in revenues.

The net balances for expectations for ***operating margins*** and ***capital expenditure*** are lower (+18% and +16% respectively), with 50% of CFOs expecting increases in operating margins and 45% expecting increases in capital expenditure. 29% of CFOs surveyed expect a decrease in capital expenditure.



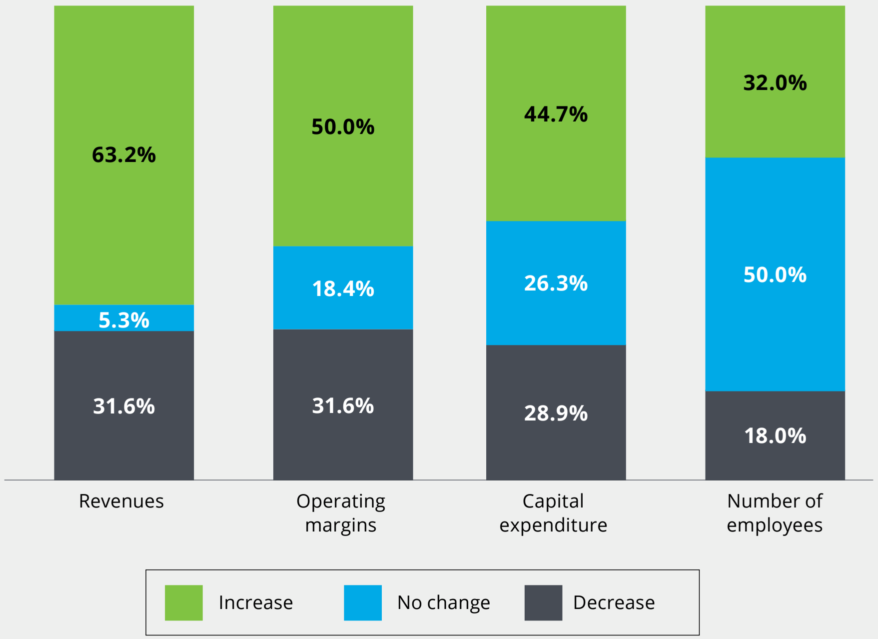
Operating margins have been under pressure as businesses have had to spend more on power backup solutions.

Operating margins have been under pressure as businesses have had to spend more on power backup solutions. Some companies have seen significant increases in their diesel bills for backup generators in recent months, additional maintenance costs and backup battery storage, while others have been subject to lost trading hours, production or output.[7] Indeed, South African companies have had to reallocate funding towards addressing loadshedding, and rand depreciation has had (and continues to have) a significant impact on companies' operating costs, such as diesel bills.

Figure 2: CFOs are net positive on key metrics, especially revenues

?

Question asked: In your view, how are the following key metrics (revenues, operating margins, capital expenditure and number of employees) for your company likely to change over the next 12 months?



Source: Deloitte South Africa CFO Survey H1 2023 results

This signals that companies are more likely to make capital investments than hire more staff, despite better revenue and operating margin outlooks.

In scenarios or assumptions of different organisations regarding loadshedding, the consensus is that 2023 is likely to be the worst year for electricity supply and demand mismatches, with less loadshedding anticipated from the latter part of 2024, as private sector capacity (independent power producers and small-scale embedded generation) is brought online. This will be complemented by an increasing share of renewables (such as solar) in the energy mix for households and businesses, which is, for example, expected to shift scheduled electricity outages to night, rather than day times.[8] The latter has also meant the re-routing of some capital expenditure to investing in solar panels and battery storage.

Tighter lending conditions have also dampened investment and hiring decisions for firms. Indeed, 61% of respondent CFOs see their company's current overall cost of credit as somewhat or very costly.

The net balance for ***employees*** (+13%) is the lowest among the four surveyed metrics; 50% of CFOs expect no change in the number of employees. This signals that companies are more likely to make capital investments than hire more staff, despite better revenue and operating margin outlooks.

South Africa's private sector fixed investment has been trending below target levels of investment.[9] Nonetheless, various sector reforms such as those in the energy sector could encourage private sector investment. This will need to link to more opportunities for job creation. As per data released by StatsSA in early 2023, employment remains below pre-pandemic levels, intensifying poverty and inequality.

Over the 2019-22 period, StatsSA reported that the economy expanded by a mere 0.3%, a fraction of population growth, with six key industries, most notably Construction, Mining and Manufacturing, yet to achieve pre-pandemic output levels.[10] Unemployment has remained above 30%, rising by 0.2 percentage points from the previous quarter to 32.9% in Q1 2023.[11] (The expanded definition of unemployment, including those that have given up looking for work, has remained above 40%, although it declined from 45.1% in Q1 2022 to 42.4% in Q1 2023.[12])

But, uncertainty is high and CFOs don't see this as the time to take on more risk

Still, CFOs experience great financial and economic uncertainty: 92% feel that the overall level of external financial and economic uncertainty facing their business is high.

This is compared with 65% in Europe (down from 81% in the ***European CFO Survey*** H2 2022), whereas 32% of CFOs in Europe feel that the level of uncertainty is normal. The *South Africa CFO Survey* will also track this net sentiment over time. In light of this, 66% of CFOs indicate that they do not anticipate taking greater risk onto their balance sheets in the next six months.

Furthermore, when asked about business risks, it is unsurprising that most CFOs identify ***loadshedding*** as the most significant risk to their business over the next year. Loadshedding and the subdued ***economic outlook and growth environment*** are considered the top business risks.

During the winter months – the colder months of June and July usually see peak electricity consumption in South Africa – a greater energy deficit due to increased demand for electrical heating, geysers, etc. is expected. Electricity supply constraints due to ongoing planned and unplanned outages have seen the national utility, Eskom, warn that "the national grid will be under severe strain in the coming months."[13] A difficult winter is expected, indicating that loadshedding and its impact on the economic outlook could worsen before improving.

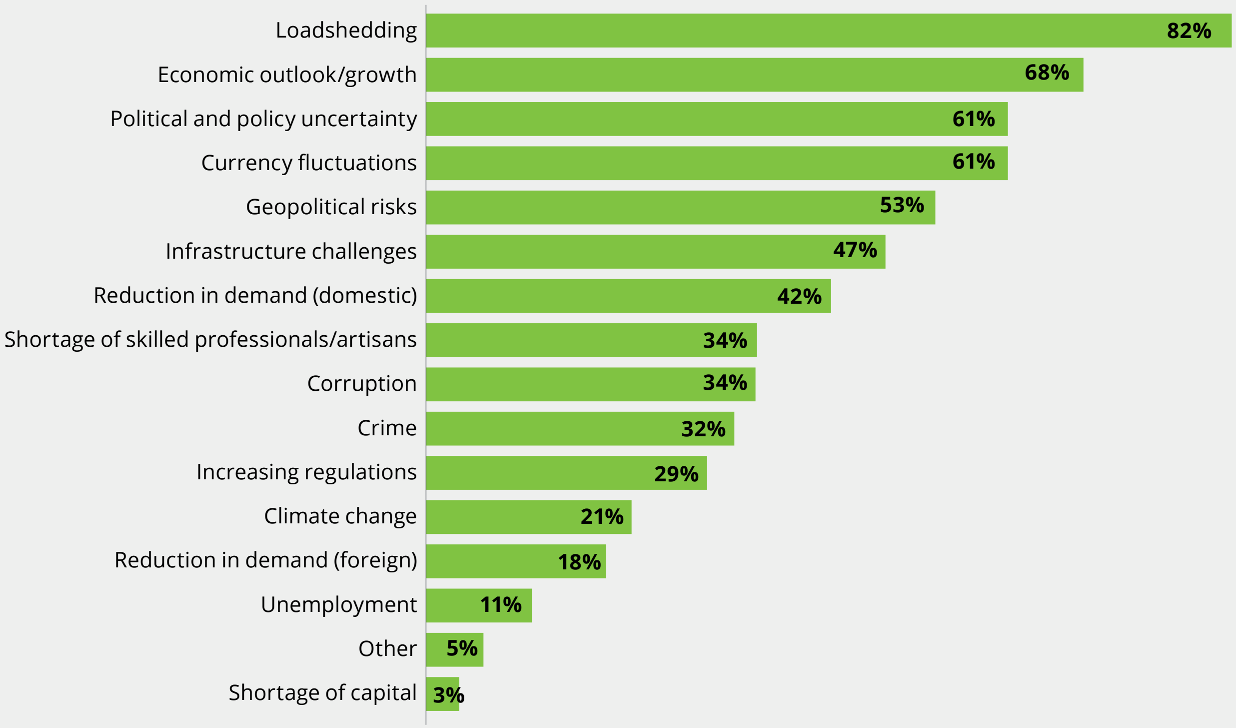
The rumours of a possible grid collapse and national blackouts remain a critical topic in boardrooms and "war" rooms. Loadshedding "manages" excess demand by cutting prompt usage of key areas, preventing country-wide blackouts. However, if there are unplanned generation capacity outages without the speedy implementation of electricity cuts, a blackout is possible. As a precaution, given the deterioration of the grid and energy supply, regulations to increase loadshedding from stages 8 to 16 were being finalised in May 2023.[14]

In the unlikely event of a grid failure – restoring power would take days – there would be serious business and economic repercussions, ranging from a loss of communication to possible fuel shortages. These in turn impact all industries, from the transport sector, essential services (such as hospitals), to food supplies, all which could result in social unrest.

> 92% of CFOs feel that the overall level of external financial and economic uncertainty facing their business is high.

Figure 3. Loadshedding and the economic outlook are top business risks for CFOs

Question asked: Which of the following factors are likely to pose a significant risk to your business over the next 12 months?



Source: Deloitte South Africa CFO Survey H1 2023 results
Note: Respondents could select multiple options for this question.

A third business risk identified is ***political and policy uncertainty***. This is arguably a heightened risk in the run-up to the 2024 national elections. Together with a shortage of electricity, political uncertainty and policy inconsistency have seen investor confidence wane over the years, dampening both foreign and local investment levels.

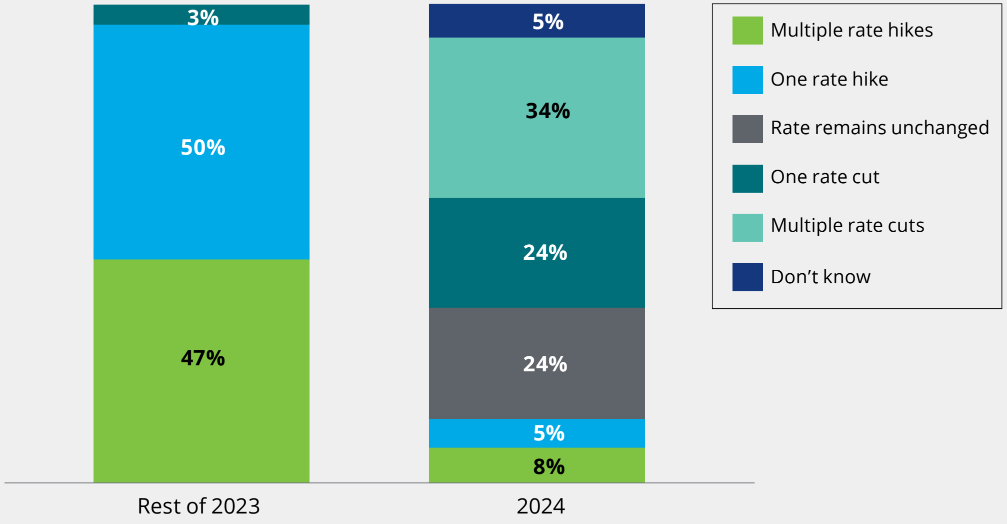
A related risk is that the South African elections may usher in reform inertia at a time when long-mooted energy, transport, and logistics reforms are more essential than ever. Elections can also fuel protests in a high-unemployment environment, give rise to disinformation campaigns, public discontent, and instability.

A fourth risk is ***currency fluctuations***, particularly considering the rand's depreciation, a stronger dollar (given a higher cumulative change in the United States (US) Federal Reserve Bank lending rate), and a general risk-off sentiment towards emerging markets. Indeed, the 30 March 2023 decision by the SARB Monetary Policy Committee (MPC) surprised markets and economists who expected an increase of 25 basis points (bps): the decision was a 50bps increase. Besides the SARB deeming risks to inflation to be on the upside (particularly food price inflation) amid tighter lending conditions globally, another concern has been the heightened risk profile of economies, such as South Africa, which rely on foreign capital to finance their current account shortfalls.[15]

Furthermore, events such as the US questioning South Africa's policy of non-alignment to Russia, with allegations of having provided arms to Russia have impacted currency fluctuations. Spooking off investors, the latter resulted in a steep depreciation of the rand, as well as sell-offs on the Johannesburg Stock Exchange (JSE) and in bond markets on the day (11 May 2023).[16]

Figure 4. CFOs see rate hikes to continue in 2023

Question asked: How do you see short-term interest rates changing in South Africa over the remainder of 2023, as well as for 2024?



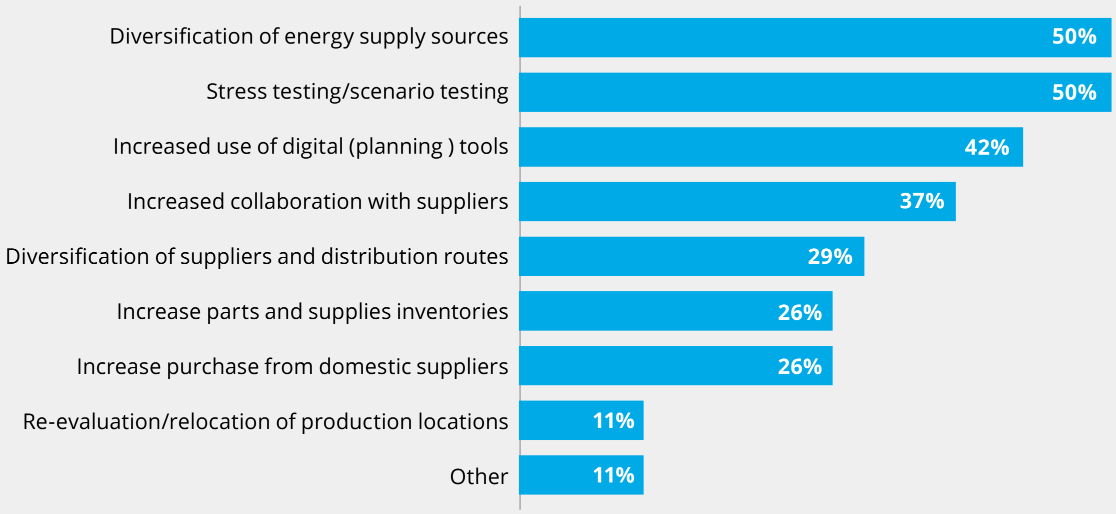
Source: Deloitte South Africa CFO Survey H1 2023 results

At the time of this survey, most CFOs expected at least one more rate hike in 2023, with half indicating only one more hike, and 47% expecting multiple rate hikes. Following the close of the survey, in the first half of May, markets priced in at least one more interest rate hike for 2023.[17] And on 25 May 2023 the SARB hiked the repo rate by 50bps again, as per market expectations, citing that "further currency weakness appears likely".[18] In line with moderating inflation expectations globally, 58% of CFOs surveyed expect at least one rate cut in 2024, while 24% expect rates to remain the same next year.

Surveyed CFOs expect South Africa's average annual inflation for 2023 to come in at 7%, and to moderate to 6.2% in 2024. This is 0.8 and 1.1 percentage points higher respectively than the SARB's 2023 and 2024 upwardly revised forecasts for headline inflation at the end of May.[19] It also sees CFOs still expecting average inflation to remain outside the targeting band of 3%-6% next year (contrary to the SARB).

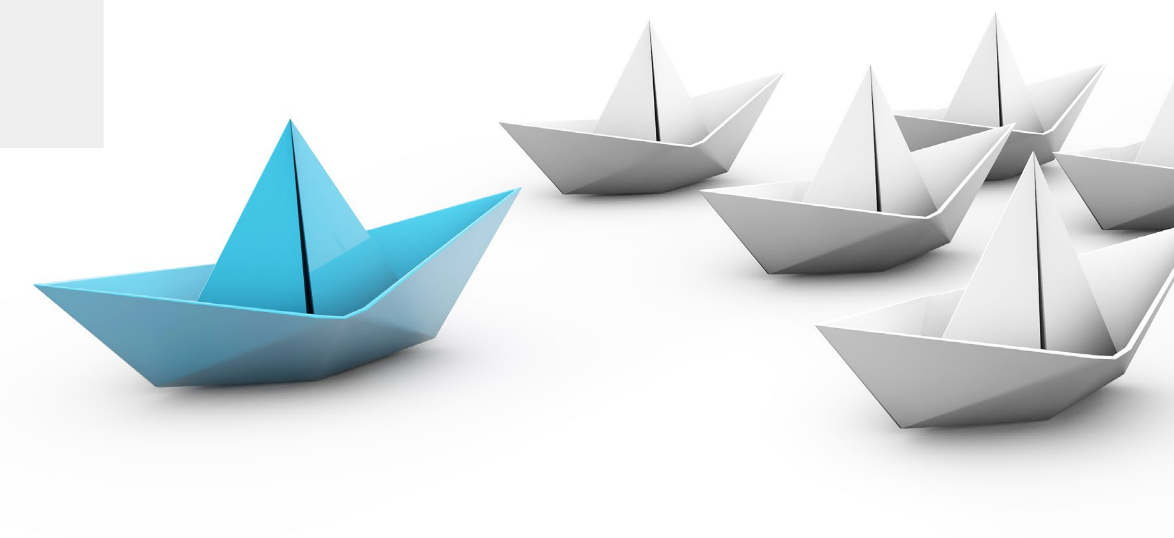
Figure 5. Companies are taking immediate actions to address business risks, such as energy supply diversification and stress/scenario testing

Question asked: Is your company taking or about to take any of the following actions?



Source: Deloitte South Africa CFO Survey H1 2023 results
Note: Respondents could select multiple options for this question.

Given the business risks identified, and a high-cost environment, it makes sense that CFOs indicate that their companies are acting now, specifically by ***diversifying energy supply sources, undertaking stress testing or scenario modelling***, and using more ***digital (planning) tools***. There is also ***increased collaboration with suppliers***, likely to manage costs along the supply chain, including the costs of loadshedding. In a high-cost funding environment, CFOs indicated that they are also more inclined to see internal financing (76%) and bank borrowing (50%) as attractive sources of funding compared to corporate debt, or equity.



Cost optimisation, better cash flow and digitalisation are key to navigating the harsh and uncertain environment

South African CFOs mostly ranked ***cost optimisation*** as a priority strategy for their business over the next 12 months. With a high cost of capital and an unfavourable economic outlook, it is no surprise that a defensive strategy tops the list. CFOs also see ***improved cash flow management*** as a priority strategy for their businesses in the next year. And when asked what their cash flow priorities would be, CFOs rate improving current operations, retaining cash for liquidity, and repaying debt as important.

Several CFOs see ***digitalisation*** as offering great benefit in the medium term, ranking it third highest in terms of strategic priorities for their business in the next year. Indeed, investing in digitalisation (including in finance) will not only help organisations be more agile, but will also support faster decision-making. Scenario planning and stress testing, as well as the use of data and AI-based tools driving automation are important tools in this regard, whereas a move to the cloud also drives cost optimisation. An environment of uncertainty is likely to underpin such investments.

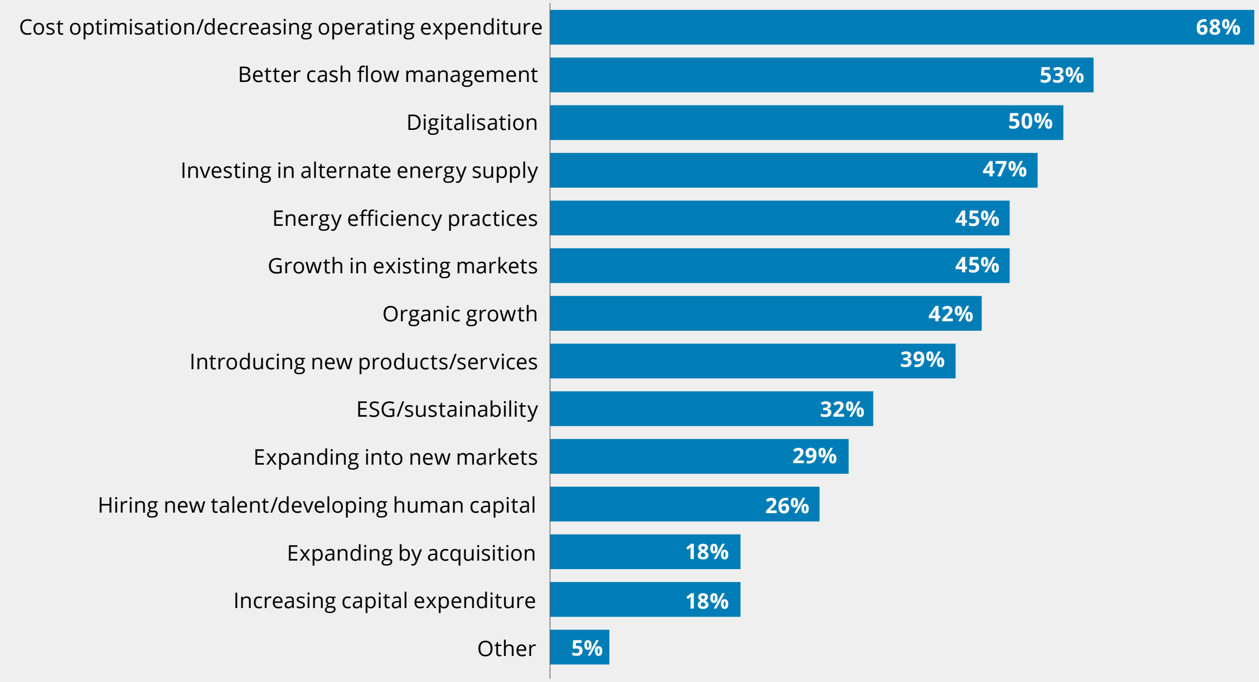
Also, an uncertain environment combined with ever-shifting market demands and a need for organisational agility have created an imperative for ***dynamic finance*** – meaning that finance needs to adapt with speed to create value for the business. Priority focus has now been given to planning and intelligence tools for decision-making.

As a side note, interestingly, 32% of CFOs are prioritising ***ESG/ sustainability*** strategies over the next 12 months, while only 21% indicated ***climate change*** as a business risk.

Both business leaders and investors are consistently and more frequently asking finance: What does this mean for your business? Do you have a response strategy? Will it work? Finance teams are likely to struggle to answer these questions without any form of current or future-looking financial analysis. Digitisation for real-time finance, robust planning, and analytics is therefore imperative.

Figure 6. CFOs' top strategic priorities over the next 12 months include cost reduction, cash flow and digitalisation

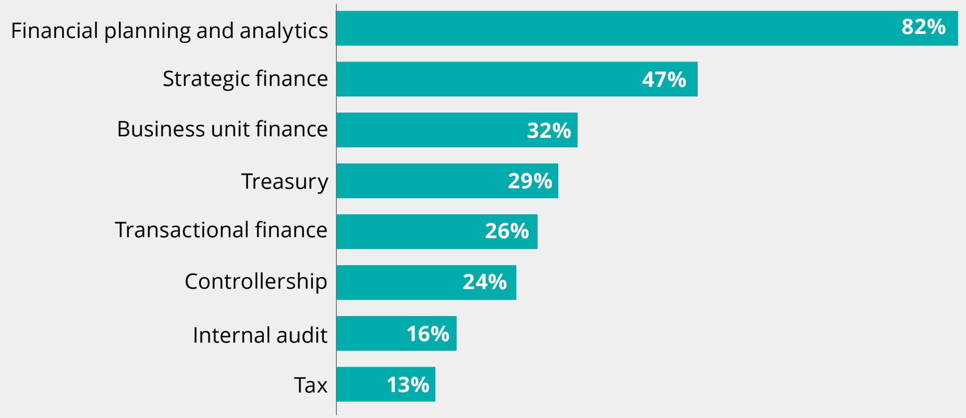
Question asked: Which of the following strategies are likely to be a priority for your business over the next 12 months?



Source: Deloitte South Africa CFO Survey H1 2023 results
Note: Respondents could select multiple options for this question.

Figure 7. Financial planning and analytics top finance areas for digital transformation

Question asked: What finance areas are you considering as a top priority for digital transformation in the next 12 months?



Source: Deloitte South Africa CFO Survey H1 2023 results
Note: Respondents could select multiple options for this question. Each category was defined in the survey.

CFOs feel that ***financial planning and analytics*** (including long-range planning, budget and forecasting, performance management reporting, insights and decision support, and business case evaluation) is a key area for digital transformation prioritisation. Using data to enable agile and faster decision-making, scenario planning and stress testing is increasingly important.

Organisations with long, drawn-out planning and budgeting cycles may find their key drivers and assumptions outdated. Some organisations are already completely rethinking planning processes and management information (MI) tools and introducing intelligent tools like algorithmic forecasting.

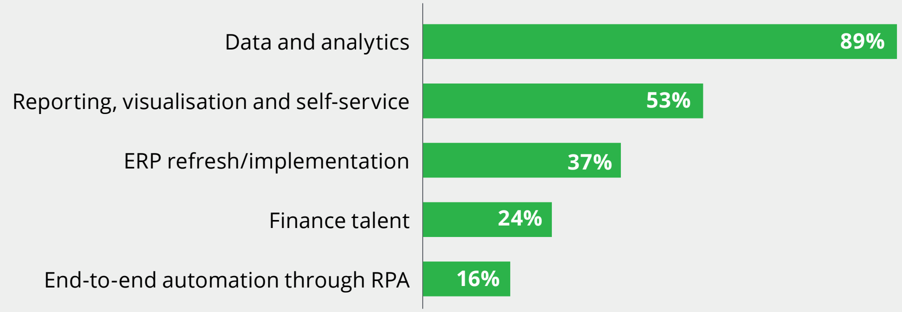
Other vital areas for digital transformation include ***strategic finance***, which includes finance visioning, capital optimisation, corporate development, finance and business transformation. Unfortunately, finance's capacity continues to be stretched because these areas are still seen as once-off.

Given these initiatives and previously noted immediate actions, CFOs ranked ***data and analytics*** as the highest priority for finance, followed by ***reporting, visualisation and self-service***. The former includes predictive analytics and scenario modelling to rapidly harness the value of both internal and external data for timely and informed decision-making. The latter focuses on accessibility and self-service of data through mobility solutions, including smartphones and tablets.

CFOs ranked data and analytics as the highest priority for finance.

Figure 8. Top tools for finance digital transformation include data and analytics

Question asked: Which digital tools do you see as a top priority for the finance digital transformation initiatives identified, in the next 12 months?

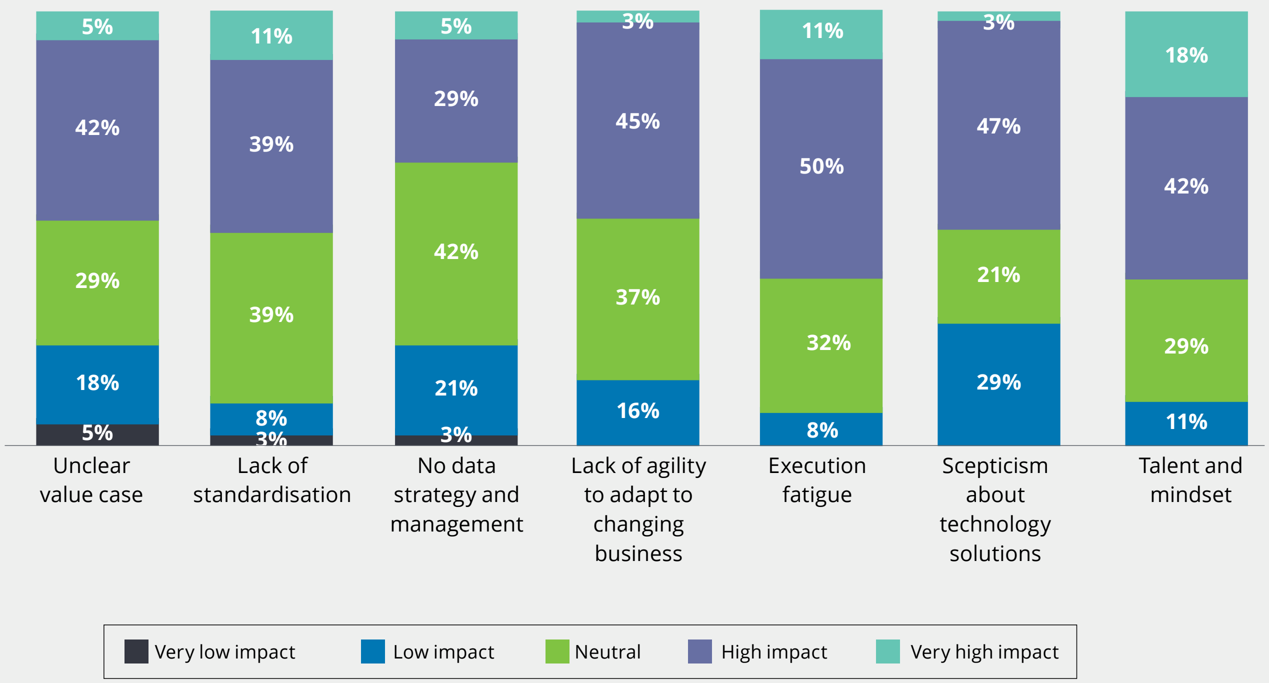


Source: Deloitte South Africa CFO Survey H1 2023 results
Note: Respondents could select multiple options for this question.

The implementation of technology generally requires resilient people to take organisations to the desired destination. When looking at those with a high or very high impact (and those with the highest net balances), ***execution fatigue*** (net balance: +53%), ***talent and mindset*** (+50%) and a ***lack of standardisation*** (+39%) top the list of obstacles to finance transformation. Beyond having the right mindset, this could also point to the need to hire a different skill set in the finance function.

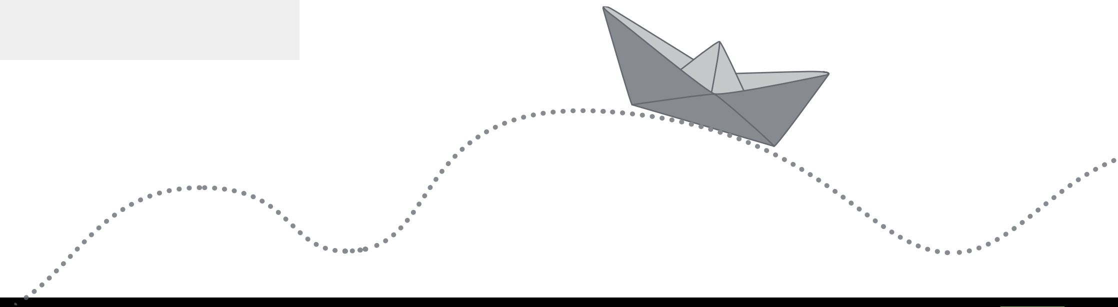
Figure 9. Executing financial digital transformation can be a struggle

Question asked: In pursuit of financial digital transformation, what have been the biggest obstacles in execution of your transformation journey?



Source: Deloitte South Africa CFO Survey H1 2023 results

Beyond having the right mindset, this could also point to the need to hire a different skill set in the finance function.



Workload and company performance are top job stressors

After navigating the challenges of Covid-19, including changing talent models, virtualising organisations, bolstering liquidity (while driving operational improvements), and managing risks (while preparing for the recovery and rebound), CFOs haven't taken much of a breather.

CFOs have been strategically navigating the headwinds and risks of a subdued global and local economic and financial environment. At the same time, they've faced local challenges of overcoming acute power cuts due to higher stages of loadshedding and persistent inflation.

Meanwhile, CFOs have been safeguarding business assets, accurately reporting on the financial position and operations, bringing change to outdated business models through automating finance, and balancing capabilities, talent and costs. Given the current (and likely ongoing) volatile and uncertain environment, CEOs are also calling on CFOs to be capable co-pilots, to help drive business strategy, identify new opportunities for growth, enhance overall performance, and create a risk-intelligent culture.[20]

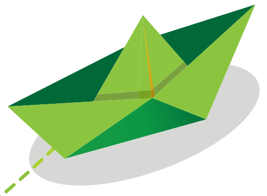
Meeting this series of challenges is by no means a small feat. This survey shows that the top job stressor for CFOs is the ***excessive workload*** demanded by their various roles and responsibilities. This is followed by ***pressures from poor company performance***, the ***changing regulatory requirements*** and the ***demands of the CEO and board.***

CEOs are also calling on CFOs to be capable co-pilots.

Figure 10: Excessive workload and poor company performance top job stressors for CFOs

Question asked: In your role as CFO, what do you consider as the top job stressors in the current environment?

Source: Deloitte South Africa CFO Survey H1 2023 results
Note: Respondents could select multiple options for this question.



Concluding remarks

South African CFOs have not had much of a breather over the past few years. Challenges have ranged from the Covid-19 pandemic, supply chain disruptions, the war in Ukraine, rising inflation, higher capital and business costs, slower global growth, an uneven local recovery post-Covid-19, and most notably, acute power shortages stalling growth in the South African economy.

While they are feeling the weight of uncertainty, South African CFOs are cautiously optimistic, showing some positivity on their firms' earning prospects, and capital expenditure. But they remain concerned about loadshedding and the country's economic outlook. Monetary policy has been tight, financing is far more expensive, consumers are experiencing an acute cost-of-living squeeze, and 2023 is likely to be the worst year on record for mismatches in electricity demand and supply.

Nonetheless, South African CFOs are taking immediate actions, such as diversifying energy sources but also preparing their businesses for the future by prioritising cost optimisation and investing in digitalisation and finance transformation, as they navigate identified business risks and challenges of an uncertain environment.

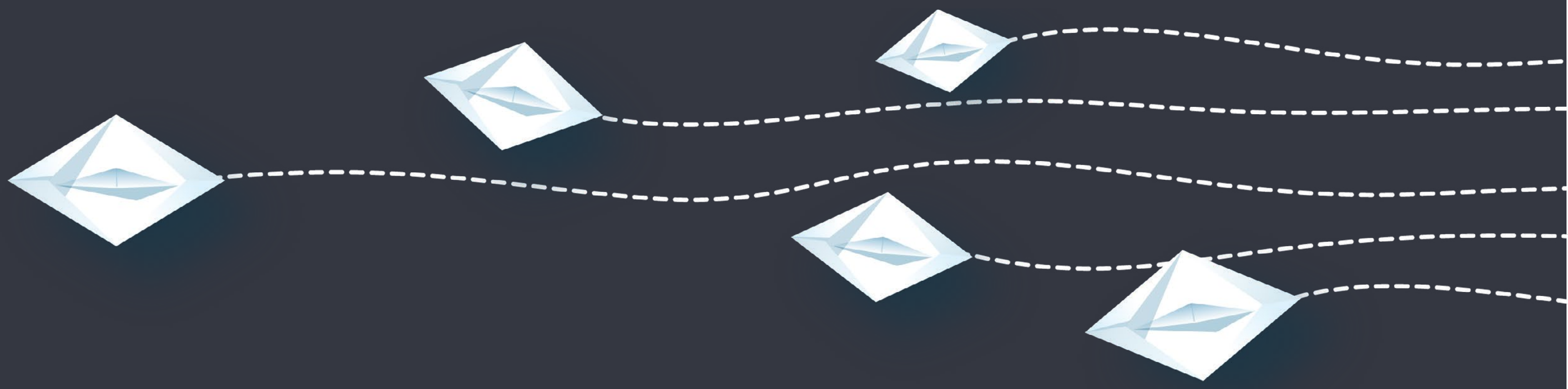
Methodology and respondent profile

Between 30 March 2023 and 2 May 2023, Deloitte Africa conducted an online survey of senior CFOs of some of South Africa's largest businesses to understand and share the CFO community's collective views on financial prospects, key business metrics and the broader business risks and strategic priorities CFOs have in their business plans.

The analysis is based on a pilot sample of 38 responses (6.4% response rate) from largely group CFOs (58%) but also single entity CFOs (24%) and divisional CFOs (18%). CFO respondents were mostly from listed companies (42%), followed by closely-held companies (18%) and PE-owned companies (also 18%).

Almost half of CFOs (47%) represent companies with 2022 annual revenues of between R1bn and R10bn. 16% represent companies with revenues of between R10bn-R20bn and 24% of CFOs represent companies with revenues of over R20bn revenues.

In this pilot sample, CFOs largely represent companies in the Retail and Consumer Goods (26%), Mining and Metals (24%) and Financial Services (13%) sectors.



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