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Q3 2021

The Deloitte CFO Survey

Investment is the focus

The labour shortages and supply disruptions British businesses are experiencing are likely to persist for a year, with no meaningful easing until late 2022 or 2023 according to Chief Financial Officers of the UK's largest companies. CFOs are particularly concerned about labour supply, with three-quarters reporting that their businesses have experienced some, significant or severe recruitment difficulties in the three months preceding the survey. They expect only limited improvement in the situation in a year's time.

CFOs rate labour shortages, the pandemic and inflation as the top risks facing their businesses. Amid growing wage and price pressures, CFO expectations for a rise in operating costs have hit a record high, with a majority of respondents also expecting a margin squeeze over the next 12 months. CFOs expect inflation to run higher for longer, with 54% expecting it to exceed 2.5% in two years' time, well above the Bank of England's 2.0% target rate.

CFO perceptions of uncertainty have ticked up but remain slightly below the average of the period since the EU referendum in 2016; risk appetite, though down from the second quarter peak, is well above the post-referendum average.

Despite labour and supply shortages, CFOs remain focussed on growth. Introducing new products or services and expanding into new markets is their top priority. CFOs are also placing greater emphasis on increasing capital expenditure now than at any time in the history of the survey. The post-financial crisis period was characterised by corporate caution, with cost control and cash conservation CFOs' primary response to economic shocks. Today, amid excess demand, and with the pandemic, the energy transition and Brexit driving change, corporates are focussing on investment, particularly in new technology.

With climate change a prominent factor in corporate decision making, we have, for the first time, sought CFOs' views on how it is affecting their business strategies. CFOs see the climate transition as fundamentally reshaping the business environment. More than two-thirds expect significant or wholesale change in their own business over the next 10 years as a result of the move to net zero emissions.

The reduction of carbon emissions is a public good of the first order. 87% of CFOs also see it as an opportunity. Building reputation and brand and attracting talent rank as the top two benefits of action, underscoring how climate is a pervasive business issue. Businesses are acting on climate as part of a broader social contract and, increasingly, as a key element in their corporate strategy.

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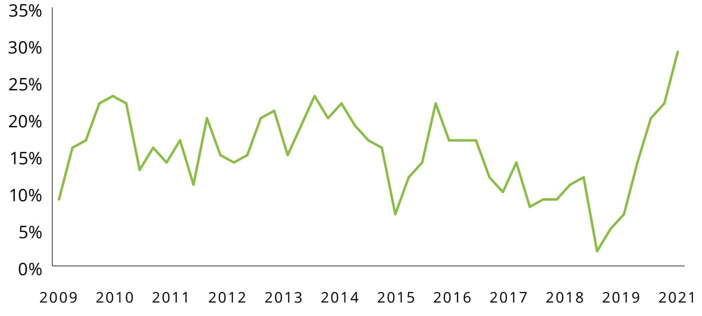
For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit:
www.deloitte.co.uk/cfosurvey

Chart 1. Capital expenditure
% of CFOs who rate increasing capital expenditure as a strong priority for their business in the next 12 months

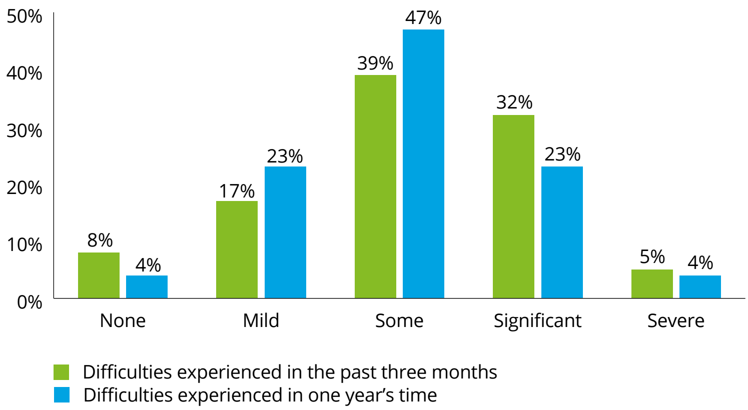


Supply disruptions to persist

Three-quarters of CFOs reported that their businesses experienced some, significant or severe recruitment difficulties or labour shortages over the last three months. They expect limited change in the situation in one year's time and meaningful improvement only in two years.

Chart 2. Recruitment difficulties and labour shortages

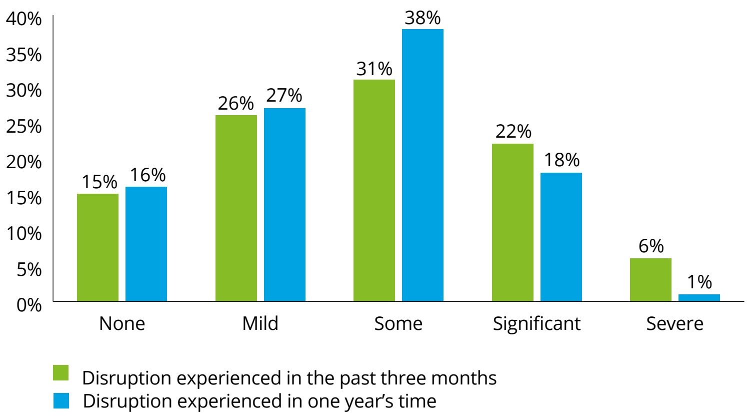
% of CFOs who report the following levels of recruitment difficulties or labour shortages experienced by their business over the last three months and the level they expect in one year's time



Almost six in ten CFOs reported that their businesses experienced some, significant or severe supply chain disruption over the last three months. Almost the same proportion expect similar levels of disruption in one year's time and meaningful improvement only in two years.

Chart 3. Supply chain disruption

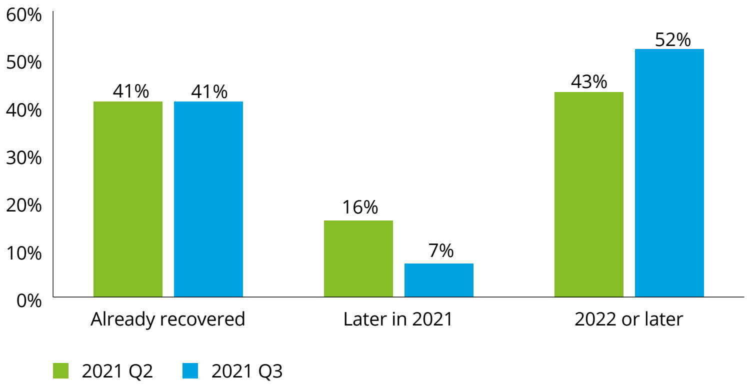
% of CFOs who report the following levels of supply chain disruption experienced by their business over the last three months and the level they expect in one year's time



The slowdown in growth over the third quarter has affected CFO expectations for the recovery of demand. 52% now expect demand for their businesses' products and services to return to pre-pandemic levels next year or later, up from 43% in the second quarter.

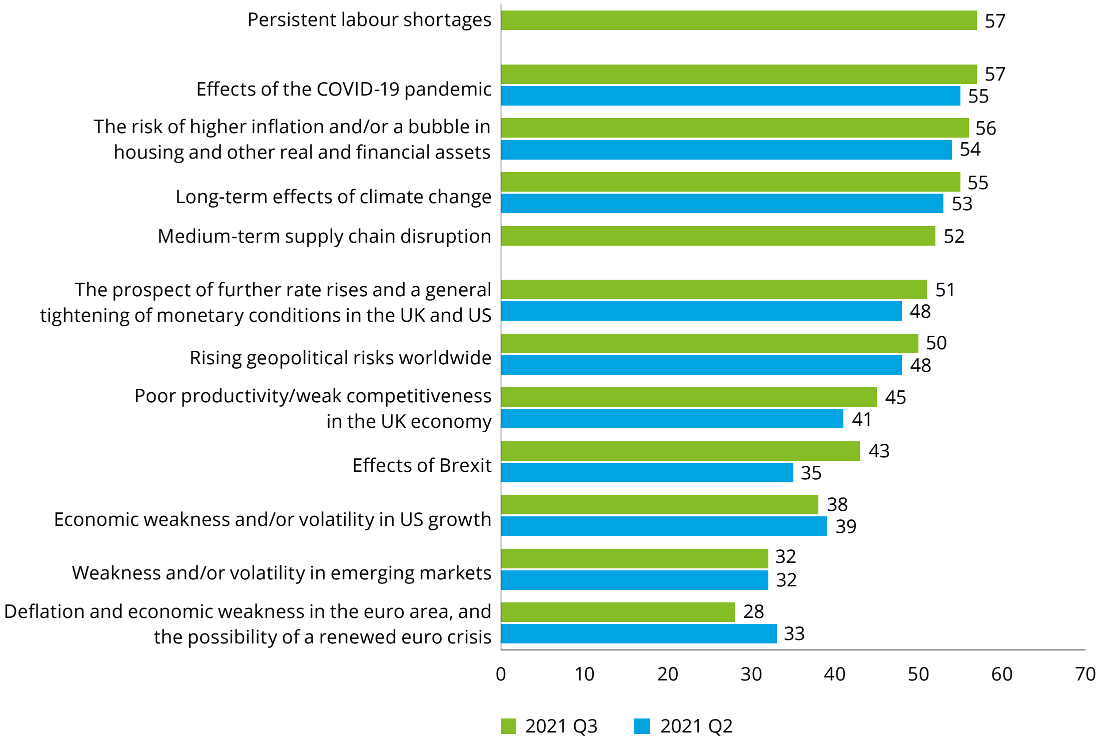
Chart 4. Recovery of demand to pre-pandemic levels

% of CFOs who expect demand for their businesses' products and services to return to pre-pandemic levels in the following periods



Labour shortages and COVID are top risks

Chart 5. Risk to business posed by the following factors
Weighted average ratings on a scale of 0-100 where 0 stands for no risk and 100 stands for the highest possible risk



CFOs have rated persistent labour shortages (introduced in this quarter's survey) and the effects of the COVID-19 pandemic as the top risks facing their businesses.

Higher inflation, the long-term effects of climate change, medium-term supply disruption and a tightening of monetary conditions also rank high up the list of CFO concerns.

The effects of Brexit ranks below these other risks, but registered the largest increase in its risk rating from the previous quarter, possibly reflecting frictions in cross-border trade and labour supply.

CFOs remain relatively less concerned about economic weakness in the euro area, the US and emerging markets.

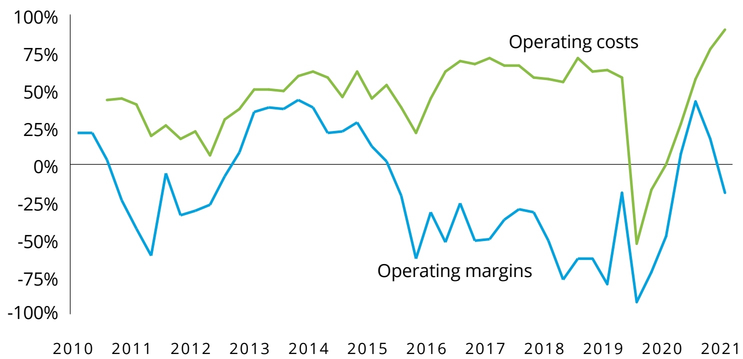
Operating costs to rise

CFO expectations for a rise in operating costs have hit a record high.

Expectations for margin growth have fallen, with CFOs, on balance, expecting margins to decrease over the next 12 months.

Chart 6. Outlook for operating costs and margins

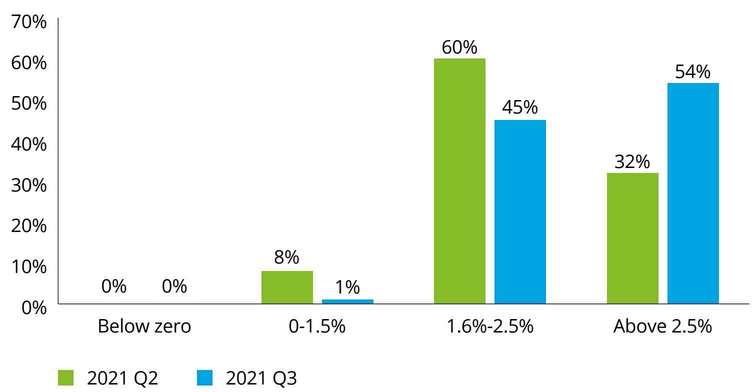
Net % of CFOs who expect UK corporates' operating costs and operating margins to rise over the next 12 months



CFOs expect inflation to run higher for longer. A majority expect inflation to exceed 2.5% in two-years' time, well above the Bank of England's 2% target.

Chart 7. Inflation expectations

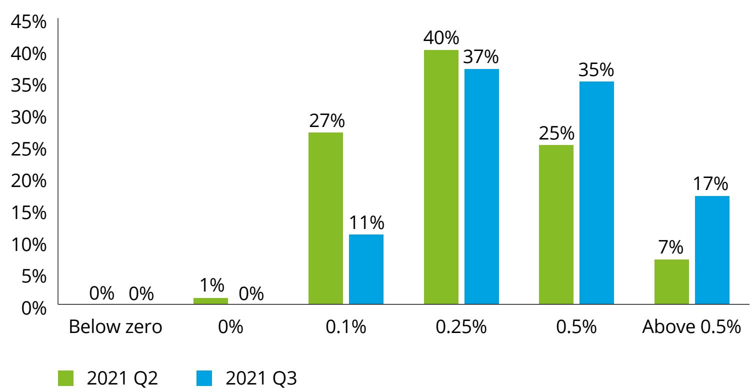
% of CFOs who expect inflation to be at the following levels in two-years' time



CFOs have also revised up their interest rate expectations, with a majority expecting the Bank of England's base rate to be 0.5% or higher in a year's time.

Chart 8. Interest rate expectations

% of CFOs who expect the Bank of England's base rate to be at the following levels in a year's time

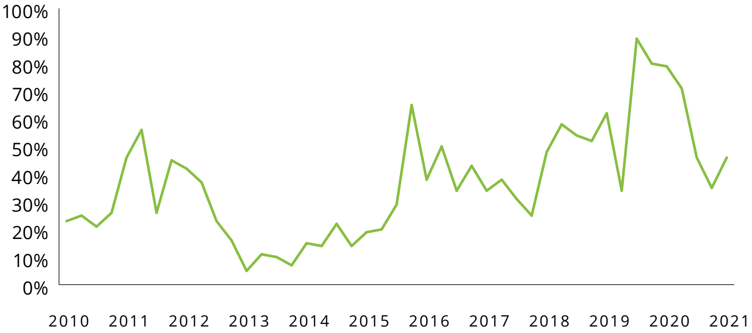


Decrease in risk appetite

CFO perceptions of uncertainty have ticked up. 46% of CFOs now assess the level of external financial and economic uncertainty facing their business as high or very high.

Chart 9. Uncertainty

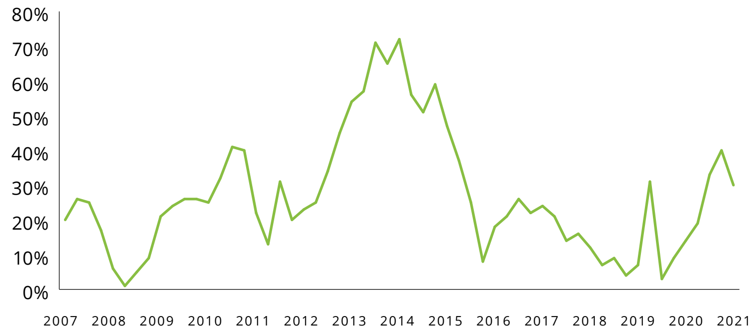
% of CFOs who rate the level of external financial and economic uncertainty facing their business as high or very high



CFO risk appetite has decreased somewhat but remains well above its post-EU referendum average.

Chart 10. Corporate risk appetite

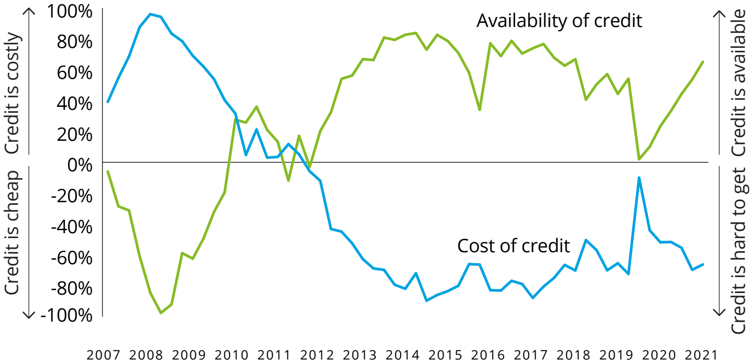
% of CFOs who think this is a good time to take greater risk onto their balance sheets



CFOs continue to rate credit as cheap and easily available for their, predominantly large, businesses.

Chart 11. Cost and availability of credit

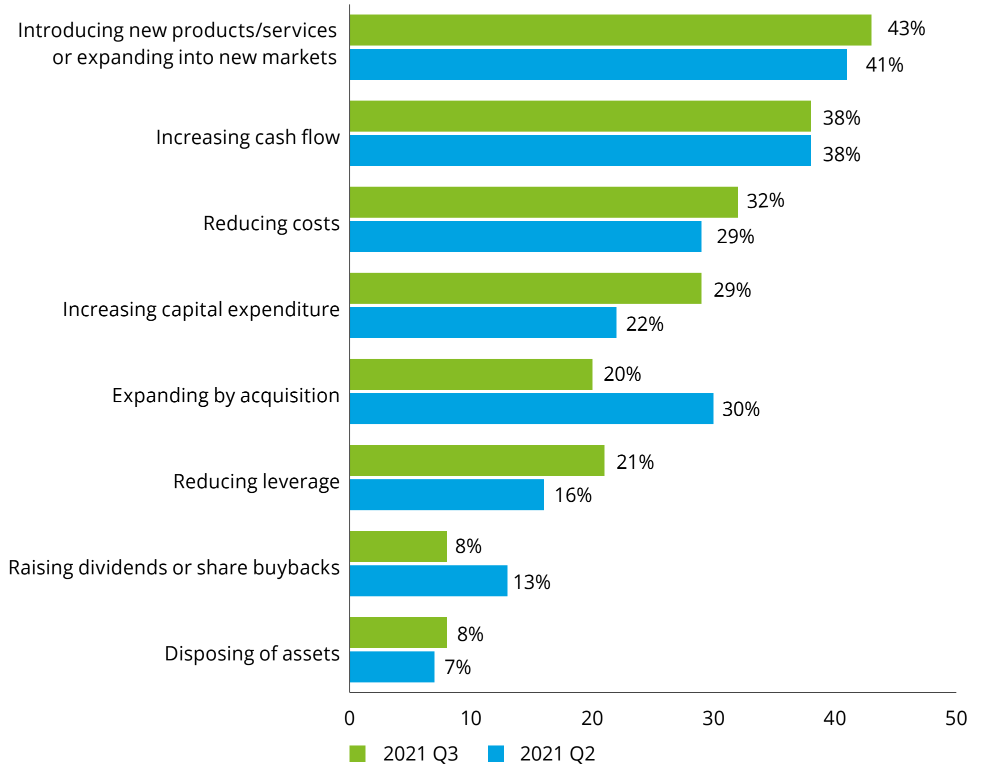
Net % of CFOs reporting credit is costly and credit is easily available



Expansion remains top priority

Chart 12. Corporate priorities in the next 12 months

% of CFOs who rate each of the following as a strong priority for their business in the next 12 months



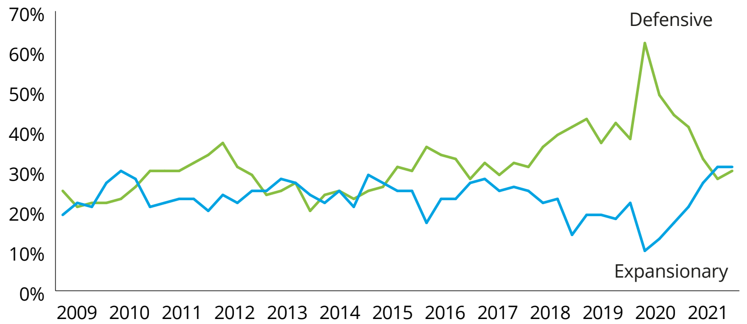
In response to the increase in uncertainty, CFOs have sharpened their focus on defensive strategies – increasing cashflow, reducing costs and reducing leverage.

But, introducing new products or services and expanding into new markets – an expansionary strategy – remains their top priority. They are also placing greater emphasis on increasing capex now than at any time in the history of the survey.

Although the gap between expansionary and defensive strategies has narrowed in the third quarter, on balance, CFOs maintain an expansionary strategy stance.

Chart 13. Expansionary and defensive strategies

Arithmetic average of the % of CFOs who rate expansionary and defensive strategies as a strong priority for their business in the next 12 months

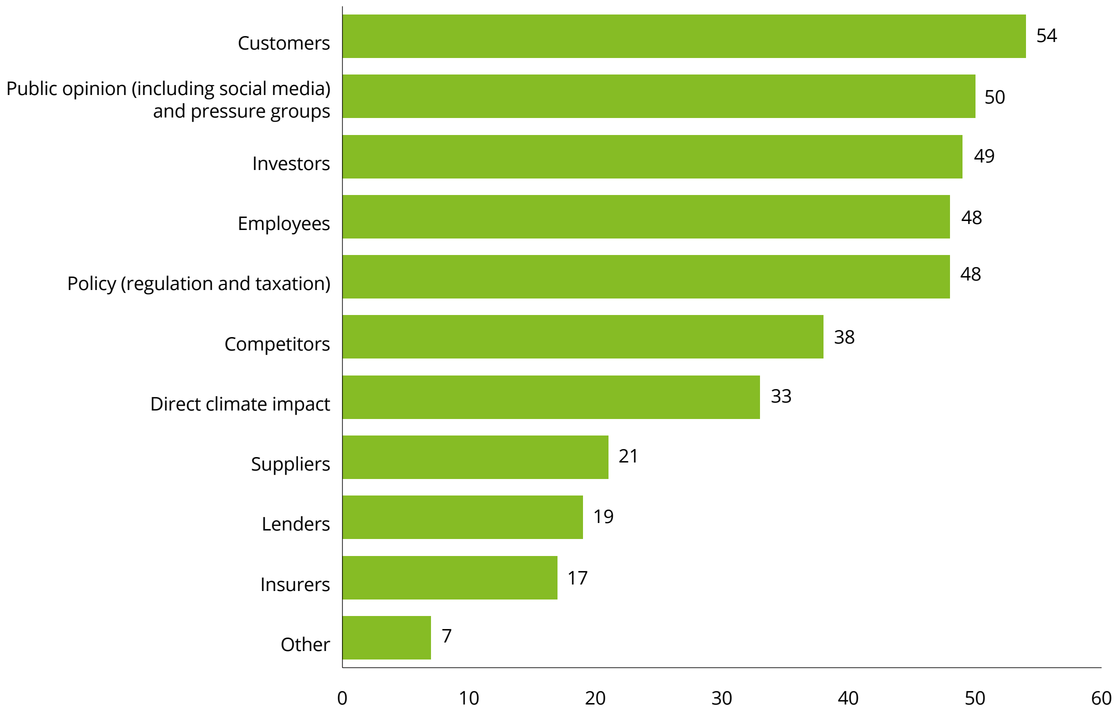


* Expansionary strategies are introducing new products/services or expanding into new markets, expanding by acquisition and increasing capital expenditure. Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

How climate is reshaping business

Chart 14. Drivers of change

Weighted average ratings on a scale of 0-100 where 0 stands for no driving force and 100 stands for the greatest possible driving force behind the CFO's own firm adapting its operations/business model in response to climate change



Since its launch 14 years ago the CFO Survey has maintained a tight focus on the big balance sheet issues facing British businesses. Now, with climate transition a prominent factor in corporate decision making, we have, for the first time, sought Chief Financial Officers' views on how climate policy is affecting their business strategies.

CFOs see the climate transition as fundamentally reshaping the business environment. More than two-thirds expect significant or wholesale change in their own business over the next 10 years as a result of the move to net zero emissions.

Amid growing short-term threats, CFOs rate climate change as one of the main risks facing their business now, almost on par with labour shortages, the pandemic and inflation, which top the risk list. Strikingly, three current challenges - supply chain disruptions, the risk of higher interest rates and Brexit - rank below climate on the list of threats.

The reduction of carbon emissions is a public good of the first order. But CFOs also see it as a business imperative, one which increasingly matters for firm revenues, financing and employees. CFOs see customers as the main driver of the reshaping of their own firms' operations in response to climate change. Public opinion rates as the next biggest driver, followed closely by investors, employees and government policy. The change that is underway in the corporate sector reflects a powerful societal consensus around the urgency of action.

That change is creating new opportunities too. Some 87% of CFOs see the climate transition as an opportunity, with 40% rating it as a 'significant' or 'very significant' opportunity. Building reputation and brand and attracting talent rank as the top two benefits of action, underscoring how climate is a pervasive business issue. The transition to net zero is a firm fixture on the boardroom agenda. Businesses are acting on climate as part of a broader social contract and, increasingly, as a key element in their corporate strategy.

Majority of CFOs see opportunities in climate transition

Chart 15. Scale of change required
% of CFOs who expect the following scale of change in their own businesses over the next 10 years because of the transition to a low-carbon economy

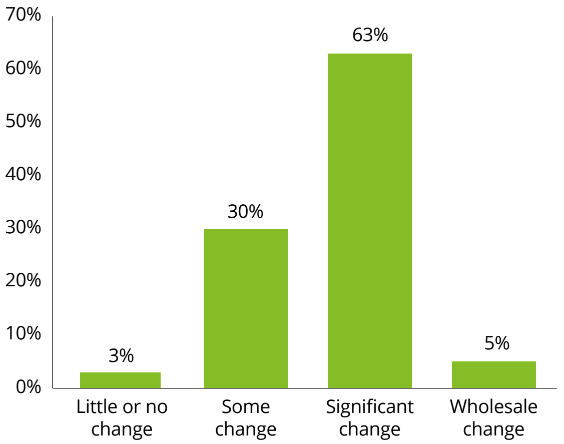
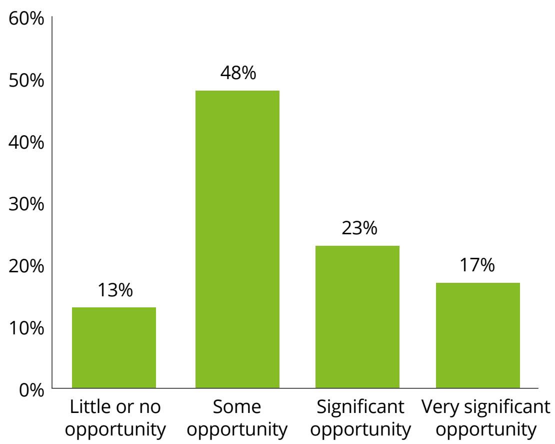


Chart 16. Opportunity
% of CFOs who expect the following levels of opportunity for their own firms because of the transition to a low-carbon economy



Despite the large-scale change expected by most CFOs in their own businesses due to the transition to a low-carbon economy, an overwhelming majority see opportunities arising out of it.

Chart 17. Key benefits from transition
Weighted average ratings on a scale of 0-100 where 0 stands for no benefit and 100 stands for the biggest possible benefit for the CFO's own firm from the transition to a low-carbon economy

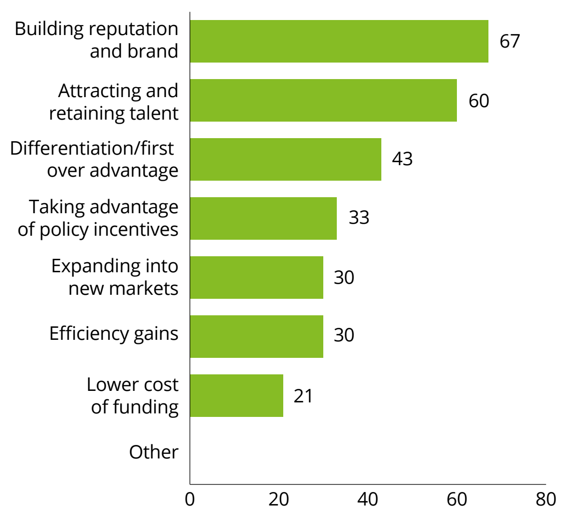
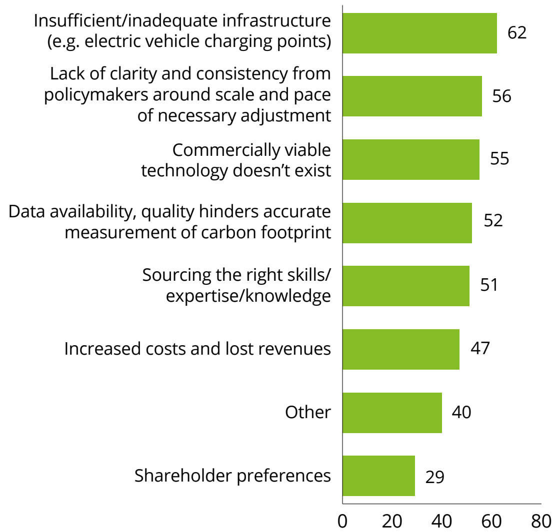


Chart 18. Key challenges to transition
Weighted average ratings on a scale of 0-100 where 0 stands for no challenge and 100 stands for the biggest possible challenge to the CFO's own firm's transition to a low-carbon economy



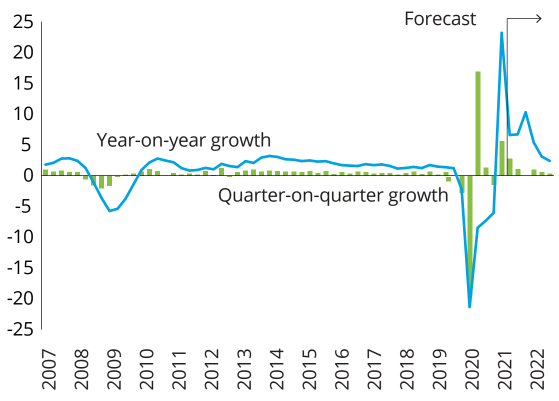
Brand building, attracting top talent and competitive advantage are seen as key benefits from transition. Inadequate infrastructure, lack of clarity around scale and pace of necessary adjustment and lack of commercially-viable enabling technologies are seen as key challenges to transition.

CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q3 2021

After an early summer bounce back in activity, growth slowed in the US, UK and euro area over the third quarter, reflecting a maturing recovery, supply and labour shortages, and a surge in cases of COVID-19 in the US. Outbreaks caused by the Delta variant also hit activity in emerging markets, disrupting global supply chains. Increasing worries over the real estate sector and strict lockdowns in response to small outbreaks slowed growth in China. Factory and port closures in the country further added to supply disruptions in advanced economies. Strong demand pushed commodity prices higher with the price of oil hitting a three-year high while gas prices spiked towards the end of the quarter. Many advanced economies reported shortages of goods and labour. Together with strong demand for goods, these contributed to a rapid increase in headline inflation rates in advanced and emerging economies. Western central banks maintained that they expect price pressures to fade but signalled they would act if this were not to pass, bringing forward market expectations of rate rises. Global equity prices rose before falling later in the quarter, as concern heightened over slowing growth and rising inflation. Despite high vaccination rates, fears remain over the future course of the pandemic as the northern hemisphere heads into the winter months.

UK GDP growth: Actual and forecast (%)



Source: Refinitiv Datastream, Deloitte calculations

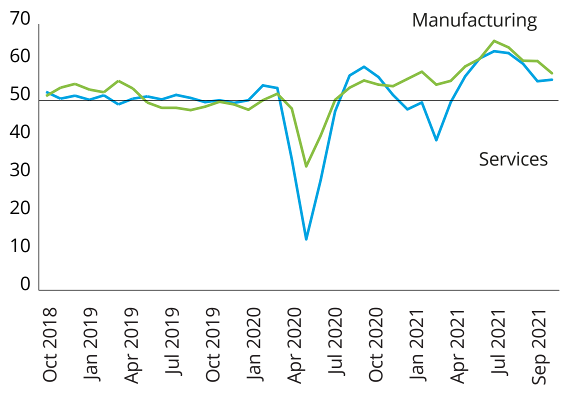
FTSE 100 price index

Source: Refinitiv Datastream

GfK Consumer Confidence Index (UK)

Source: Refinitiv Datastream

Markit Purchasing Manager Indices (UK)

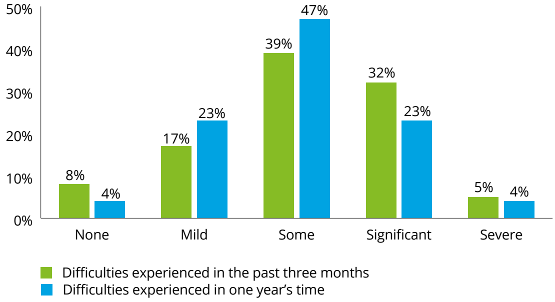


Source: Refinitiv Datastream, readings above 50 indicate expansion

Two key survey messages

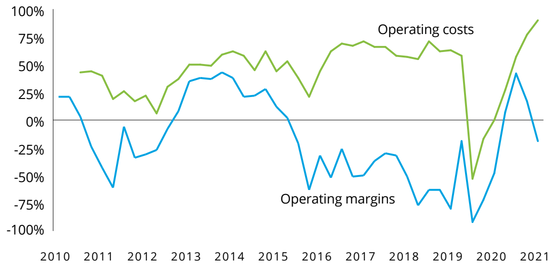
Recruitment difficulties and labour shortages

% of CFOs who report the following levels of recruitment difficulties or labour shortages experienced by their business over the last three months and the level they expect in one year's time



Outlook for operating costs and margins

Net % of CFOs who expect UK corporates' operating costs and operating margins to rise over the next 12 months



About the survey

This is the 57th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2021 third quarter survey took place between 20th September and 4th October. 92 CFOs participated, including the CFOs of 18 FTSE 100 and 32 FTSE 250 companies. The rest were CFOs of other UK-listed companies, large private companies and UK subsidiaries of major companies listed overseas. The combined market value of the 60 UK-listed companies surveyed is £471 billion, or approximately 18% of the UK quoted equity market.

The Deloitte CFO Survey is the only survey of major corporate users of capital that gauges attitudes to valuations, risk and financing. To join our panel of CFO respondents and for additional copies of this report, please contact Elaine Hoang on 020 7007 4717 or email ehhoang@deloitte.co.uk

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