As inflation soars, CFO optimism sinks

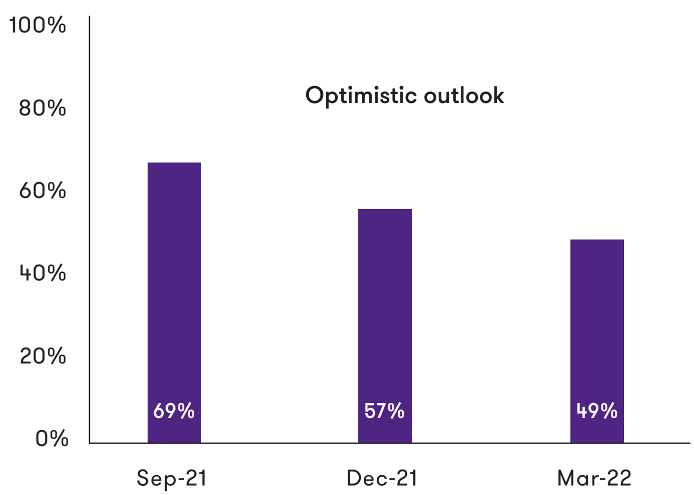
Do you miss 2021 yet?

Who would have thought that CFOs would be missing the spring of 2021?

In March 2021, inflation was at 2.7%. By March 2022, it had rocketed to 8.5%. A year ago, unemployment was still at 6%. This March, the unemployment rate plummeted below 4%; there are 1.8 job openings for every worker looking for work, with the quit rate hovering near a record high and reports of labor shortages intensifying. Last spring, most hoped that their supply chain issues were COVID-driven anomalies and that, with the first vaccines being rolled out aggressively, both the pandemic and those issues would recede quickly. Now, while the pandemic is better contained in most of the world, massive COVID shutdowns in China are roiling still-tangled supply chains that are further complicated by a major war in Europe that was not on the radar a year ago. Last spring, the Fed was far more concerned with stimulating the recovery than it was about inflation. Now? In his March 3 testimony before Congress, Fed Chairman Jay Powell stated that he would do “whatever it takes to restore price stability.” On March 16, the Fed raised rates a quarter point — the first rate hike since 2018 — and more than doubled its trajectory for rate hikes in 2022 from just three months earlier. The specter that the hoped-for soft landing will tip over into a recession is a growing concern.

A little nostalgia for 2021 is not unwarranted. That shows in our CFO survey results for the first quarter of 2022. In just the last two quarters, the percentage of respondents that were optimistic about the U.S. economy over the next six months has slumped from nearly 70% to less than 50%. Inflationary concerns are the prime culprit. When asked what’s driving worries about the economy, three of the top four items cited related to rising costs.

Economic outlook: CFO outlook continues to decline
Generally speaking, how would you classify your outlook regarding the U.S. economy over the next 6 months?



Economic outlook: Which of the following are reasons for your outlook regarding the US economy over the next 6 months?

Reasons for POSITIVE Outlook

Increased household wealth will continue to drive demand

64%

The economic impact of COVID is waning

50%

Rate hikes will cut inflation without causing a recession

45%

Low and stable unemployment

42%

Reasons for NEGATIVE Outlook

Increased cost of other goods and services

80%

Increased energy cost

65%

Supply chain and inventory concerns

64%

Inflationary wage spiral

62%

War in Ukraine/global instability

58%

Rate hikes causing a recession

52%

Increased cost of credit/capital

45%

New COVID variants/outbreaks

29%

How will the Ukraine invasion impact your business?
Our Q1 2022 CFO survey was released just as Russia invaded Ukraine. When asked how they expected the invasion to impact their business, CFOs identified increased energy costs and heightened cyberthreat concerns as top worries. Somewhat surprisingly, difficulty conducting business in Russia was as worrying as exacerbated supply chain concerns. “The real question for many of these impacts is how long the war continues,” says Enzo Santilli, Grant Thornton National Managing Partner for Transformation. “The International Monetary Fund just cut its projection for global economic growth from 6.1% in 2021 to 3.6% in 2022 and 2023, comparing the spreading impact of the invasion to an earthquake. The longer the war drags on, the more the consequences, economic and otherwise, will mount.”

Ukraine impact: How will the invasion of Ukraine impact your business?

CFOs turn to price hikes to blunt inflation's impact

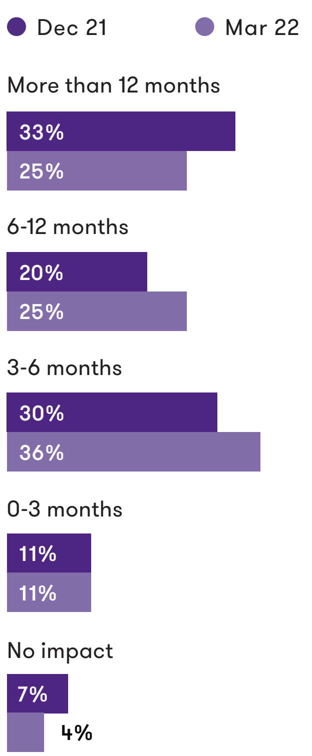
Hope that aggressive Fed stance will curb costs quickly

Almost half of CFOs expect inflation to have a negative impact on profits in fiscal 2022. Increasing budgets for compensation, changing forecasting processes and capabilities and raising prices are the strategies most commonly cited to address rising costs. Of note, 28% of respondents plan to increase their prices by more than the rate of inflation. "Inflation is not a monolith," says Sean Denham, Grant Thornton National Audit Growth Leader and Office Managing Partner, Philadelphia office. "It really depends on your cost drivers. Services companies are dealing with spiraling wages. Companies that are big energy consumers have to address rapid increase in energy costs. And not every market or consumer will react the same way to price increases. It makes sense that companies will tailor pricing decisions based on their costs and their markets."

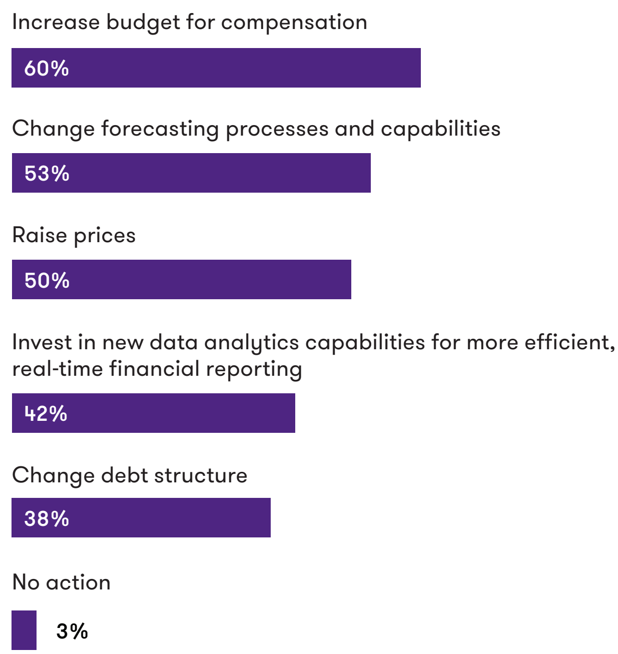
For more on how CFOs are responding to inflation, as well as supply chain and workforce challenges, see our 2022 CFO Outlook.

Interestingly, only 25% of Q1 2022 respondents expect inflation to impact their business for more than a year compared to 33% in our Q4 2021 survey. "Since the beginning of the year, the Fed has made it very clear that driving down inflation is now job one," says Santilli. "Given the aggressive rate hike schedule the Fed is now proposing, CFOs are hopeful that inflation will begin to moderate."

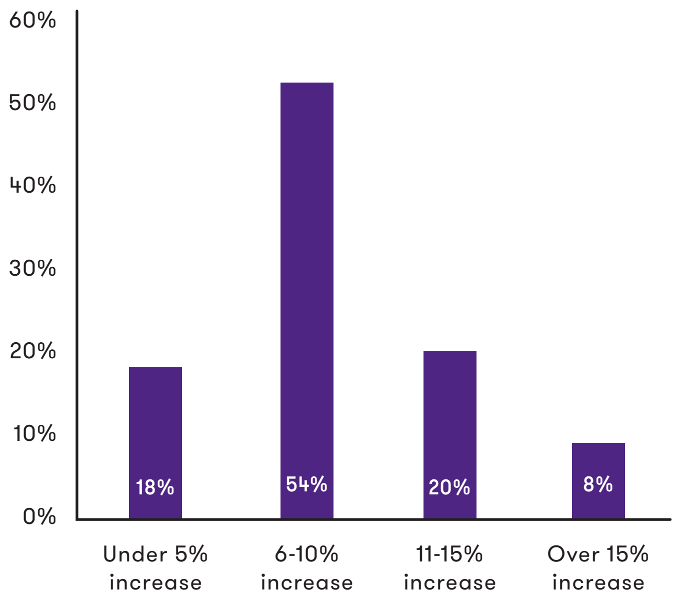
Inflation outlook
How long, if at all, do you anticipate inflation to have an impact your business?



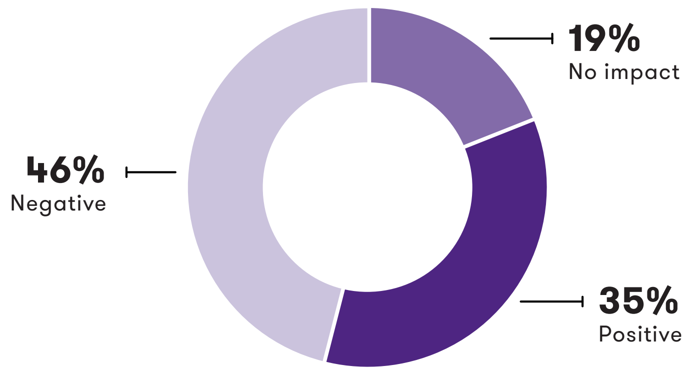
Inflation mitigation
Which of the following actions do you plan to take to manage inflation?



Inflation impact
By how much do you expect to raise your pricing over the coming months as a result of inflation?



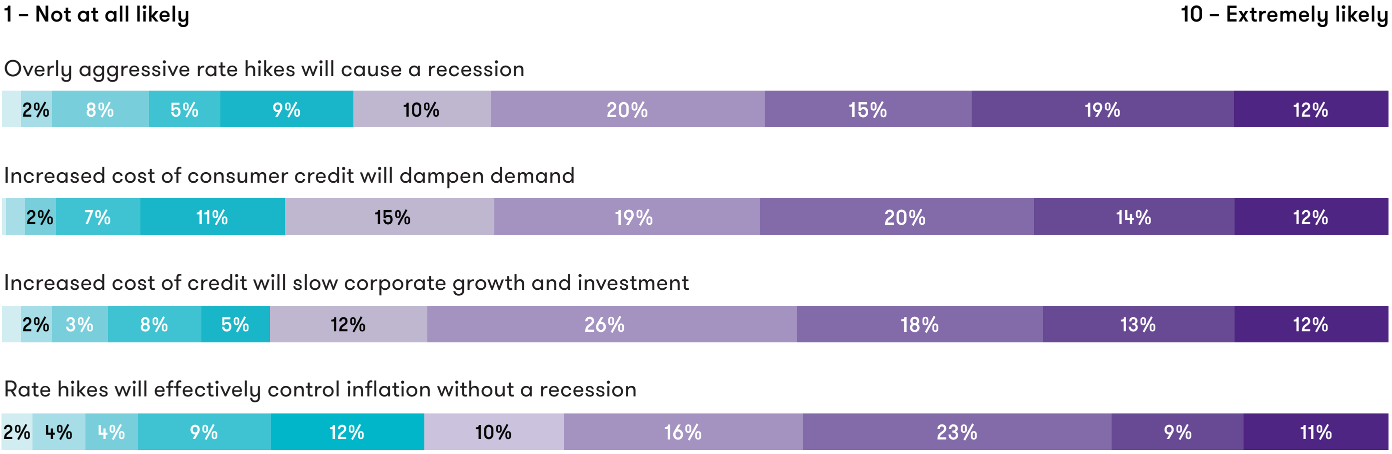
Inflation impact on profits
How do you expect inflationary pressures to impact your organization's profits in CY2022?



While respondents are guardedly hopeful that rate hikes will control inflation in the next year, they are also concerned that they will push the economy into recession. When asked to rank the likely impact of the Fed's proposed hikes in 2022 from 1 to 10, with 10 being the most likely result, 76% responded 6 or higher that rate hikes will cause a recession. "Concerns about a possible recession coupled with the challenge of dealing with spiraling costs are definitely shaping strategy," says Santilli. "I recently had the chance to speak with several board members from major companies, and they are tightening their focus on core business functions and efficiency."

Likely results of Fed rate hikes

Based on the list below, please rate how you expect the following to impact your business, if at all.



Cybersecurity back on top as key challenge

Supply chain, technology, workforce remain key concerns

One year ago, CFOs ranked cybersecurity as the top challenge facing their business. Cyber slipped behind supply chain and workforce as the year progressed but, at 40%, is back on top for Q1 2022, followed by supply chain at 35%, and technology upgrades at 34%.

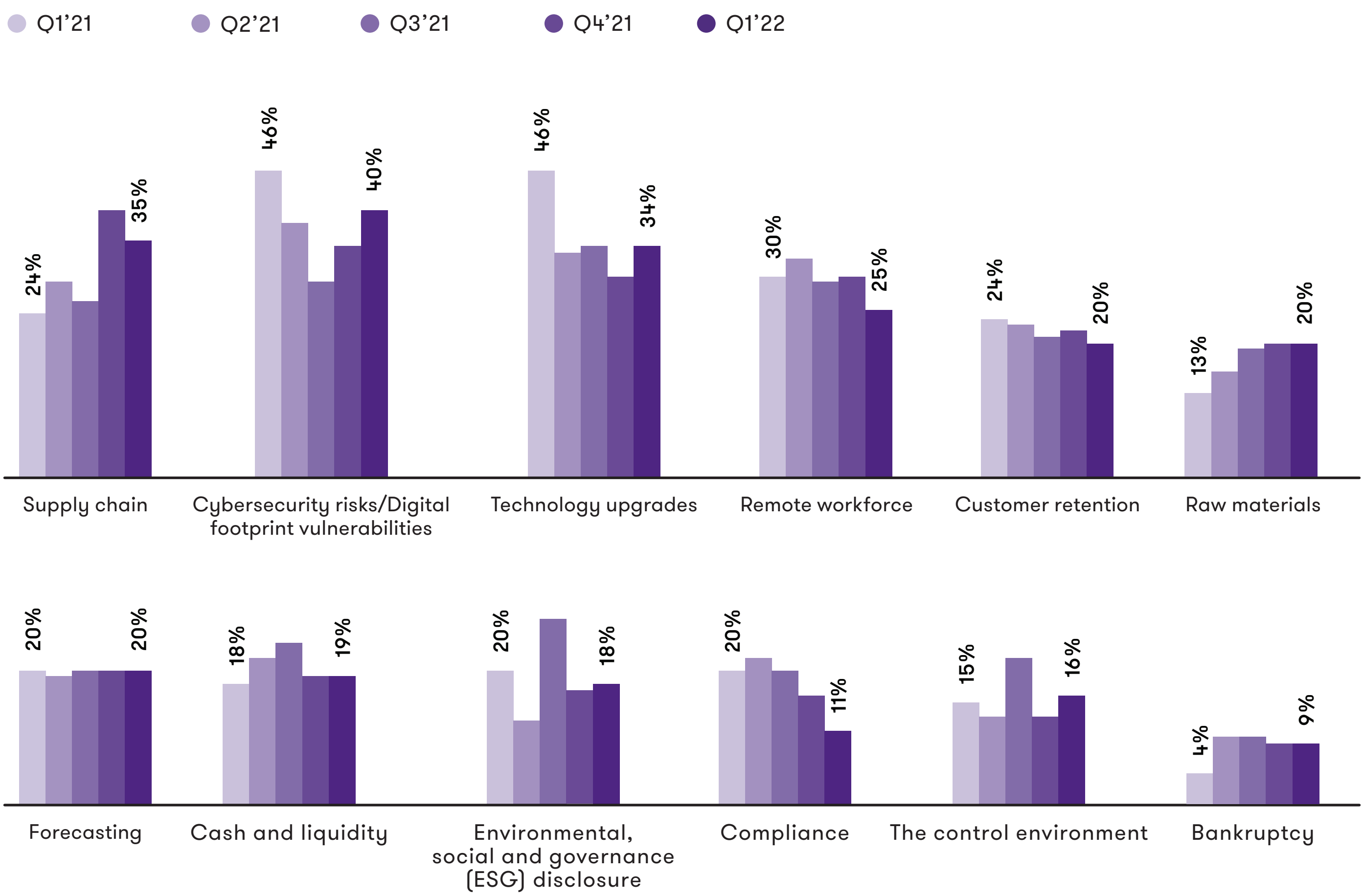
"The continued pervasiveness of ransomware attacks, coupled with the very recent significant efforts organizations have had to invest in mitigating the Log4j vulnerability, probably account for some of that increase," says John Pearce, Principal in Grant Thornton's Cyber Risk Advisory practice. "But increased investment doesn't likely reflect new activities, it's mostly devoted to existing issues like improving multi-factor authentication, and Endpoint Detection and Response (EDR) and enhanced incident response capabilities." Insurance is another factor pushing up cybersecurity budgets. "Not only is cybersecurity insurance getting more expensive," says Pearce, "the controls companies have to have in place to qualify for or retain coverage are also getting tighter."

Supply chain, at 35%, and technology upgrades, at 34%, are almost tied for the second spot. Supply chain issues are not just anomalous reactions to the pandemic that are going to fade away with COVID, but COVID is still playing a role, as recent large-scale lockdowns in key production centers in China recently demonstrated. Changes in consumer buying patterns, workforce shortages, the war in Ukraine, inflation — all these things are complicating supply chains.

What's next for ESG and DE&I?

Our Q3 2021 CFO survey saw ESG reporting and disclosures jump to 27% from 13% in Q1. Now, ESG has slipped back to 18%, even with the release of the new proposed SEC disclosure requirements. In Q1 2021, 46% of CFOs expected to increase investment in both ESG and DE&I over the course of the year. In Q1 2022, those expectations have dropped to 34% for DE&I and 31% for ESG. "It's tempting for CFOs to let focus on DE&I and ESG slip when conditions begin to tighten," says Marjorie Whittaker, Managing Director, ESG & Sustainability, "but the new SEC regulations won't be the last we see in this area, and public, employee, and investor focus isn't going away. Organizations will need to maintain, and probably even increase, these efforts."

Top challenges: CFOs face challenges
Which of the following, if any, do you think are the top 3 biggest challenges facing your business?



After spiking at 46% in Q1 2021, technology upgrades have been ranked steadily as a key challenge. “Most companies are in the middle of multi-year tech upgrade and cloud modernization efforts,” says Santilli. “That’s reflected in technology’s relatively steady position in the findings.”

While CFOs remain concerned about their ability to attract and retain key workers (57% report this as their most significant human capital challenge), inflation is also a workforce challenge, with 48% expecting compensation and benefits investments to increase and 45% looking to spend more on recruiting.
An interesting human capital side note: 61% of CFOs report being focused on getting most or all of their people returning to work on-site, while 74% state that hybrid and remote work are here to stay, and they are focused on improving that model.

For some businesses, like manufacturers, healthcare organizations and retail companies, on-site employees will always be a key part of their workforce. But even in those organizations, there are other back-office personnel who can take advantage of hybrid or remote work arrangements.
And even for on-site workers, increased flexibility can be possible. Flexibility is the bottom line. In Grant Thornton’s most recent State of Work in America survey, 80% of respondents indicated they wanted flexibility in when and where they worked; 75% said working from home had improved their work/life balance, and 46% would look for another job if forced to return to the office full time. Only 38% said they looked forward to returning to the office. Employers that ignore those preferences will struggle to compete for talent.

Should outsourcing be part of your workforce response?

As companies face a likely slowdown in growth — and possible hints of a recession — they are increasingly redoubling focus on aligning costs to what their customers will pay for. “Controlling costs that don’t relate to a customer’s willingness to pay for a product or service has resulted in more companies looking at outsourcing functions that are important to do but ancillary to the enterprise’s core business,” says Santilli. “This makes even more sense given the intense competition for talent in the current market. Companies are having a hard enough time getting and keeping the right people in their core functions. Why waste time, money and effort on other areas when they can contract professionals that focus on those issues full time?”

“Outsourcing also allows an elastic response in non-core functions that have fluctuating demand,” says Denham. “When you’re looking to control costs and boost efficiency, that helps. And, with the shift toward hybrid and remote work, companies have considerably improved their ability to manage remotely — that matters when you’re outsourcing.”

The “fasten seat belt” sign is on

The first quarter of 2022 has already seen a dramatic about-turn by the Fed, a major war erupting in Europe, China implementing its largest COVID lockdowns yet, and growing concerns about heading for a recession instead of a soft landing. Agility and resilience are the words of the day as CFOs continue to balance numerous competing priorities in an increasingly turbulent business climate.

Contacts

Enzo Santilli
National Managing Partner,
Transformation
T +1 412 586 3801
E enzo.santilli@us.gt.com

Sean Denham
National Audit Growth Leader
Office Managing Partner
T +1 215 376 6010
E sean.denham@us.gt.com

John Pearce
Principal, Cyber Risk
T +1 703 637 4071
E john.pearce@us.gt.com

Marjorie Whittaker
Managing Director,
SEC Regulatory Matters and
ESG & Sustainability Services
T +1 202 521 1535
E marjorie.whittaker@us.gt.com

Grant Thornton

GT.COM