The CEO Imperative: How to remain resolute on investment as inflation surges

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The EY CEO Outlook Pulse – October 2022 survey finds CEOs actively managing headwinds to protect future growth.

In an increasingly uncertain and opaque environment, CEOs are intent on transforming their organizations to stay ahead of disruption while also dealing with a range of new and pre-existing challenges.

An EY study of more than 750 CEOs finds that while the external market environment offers significant challenges, many executives are remaining resolute and adapting their portfolios and ecosystems to compete in the new world that is emerging before their eyes.

In this edition of the CEO Imperative Series, which provides critical answers and actions to help CEOs reframe the future of their organizations, we explore how executives are responding to a febrile and uncertain environment of 2022, and how they are planning to weather the storm.

In brief

- Rampant inflation fears, geopolitical tensions and the shadow of COVID-19 pandemic are the critical threats occupying the minds of global CEOs.
- Despite these significant and interconnected threats – as well as many others – CEOs remain committed to investment plans to guard against challenges.
- M&A appetite is robust as CEOs make pre-emptive plans to navigate the new complexity.
Findings from the EY CEO Outlook Pulse – October 2022 show that most CEOs see inflation as a critical risk, with the majority of respondents (69%) predicting it will negatively impact their company’s performance and growth. That majority includes 16% who identified inflation as the single biggest threat to their company’s revenue and margins.

At the same time, there is a low level of confidence in effective policy responses, with only 15% believing government will control inflation without significant consequences for the business environment or growth.

The underlying drivers of surging inflation vary by geography and industry, but overall the vast majority of respondents are seeing major or extreme input price increases across all measures, from labor to raw materials. It is critical that CEOs pull what levers they can to mitigate these input pressures, recognizing that some may be out of their control or are secondary effects from other industries. Leading companies will focus on what they can control and mitigate where possible the other sources of impact.
New geopolitical problems and long-term pandemic issues present additional challenges to growth

In terms of other threats, a continuation or return of pandemic disruption, including new lockdowns and supply chain pressures, is seen as the greatest risk to growth by more than four in 10 (43%) CEOs. This risk is perceived to be higher in Asia-Pacific (48%) than in Europe (41%) or the Americas (43%). Given the zero-COVID-19 pandemic policy being followed by the Chinese government, this is unsurprising. However, with many global supply chains starting in China, this remains an international issue.

Another pandemic-related issue that continues to challenge growth plans is the scarcity and cost of attracting and retaining the right talent. This has become a more pressing issue during the pandemic, and over a quarter (29%) of CEOs cite this as an impediment to growth.
Geopolitical tensions also feature prominently in risk assessments – and have had a direct impact on accelerating input prices and inflation. The war in Ukraine has increased commodity prices and created yet more supply constraints as well as inflationary pressures.

CEOs need to recognize the interconnected nature of the myriad geopolitical crises they face in this highly uncertain environment. The specter of the COVID-19 pandemic also continues to stress supply chains, and the war in Ukraine has exacerbated pressures in energy and agricultural markets. Both are feeding into inflation, which is causing central banks to move faster and further in policy decisions. These factors are all combining to compel governments globally to take a more interventionist stance in strategic industries, further elevating geopolitical and supply chain complexity.

To navigate this web of geopolitical challenges, the vast majority (95%) of CEOs have adapted their cross-border strategic investment plans.

Companies are reconsidering their global operations and footprint. Regulatory uncertainty, especially in relation to technology and other strategically important industries, and trading tensions across blocs add to the complexity.

These proactive actions by CEOs, which show a willingness to act now before more profound barriers to business emerge, will help with navigating an increasingly complex global geopolitical environment in the future. It will also position them more positively now to counter some of the supply and pricing pressures they currently face.
CEOs aim to weather the numerous challenges they face by focusing on a range of strategic actions, with sustainability, the digital customer experience and innovation emerging as important areas:

**Sustainability:** Placing sustainability and environmental, social and governance (ESG) at the core of their business is a strategic priority for many over the next six months. Meeting the ESG expectations of key stakeholders, from shareholders to regulators, will be key, as well as growing and protecting value through a strong focus on ESG risks and opportunities. While the transition toward a more sustainable future presents significant operational challenges, proactive companies will create long-term value through cost-of-capital optimization, mitigated operational disruptions and a stronger connection with customers.

**Digital customer experience:** Engaging customers through technology to improve product suites and services as well as managing pricing is also top of the strategic agenda. Executive respondents to the EY-Parthenon 2022 Digital Investment Index (DII) also noted that customer acquisition, retention and experience will be one of the top digital priorities over the next two years. And technology will be central to further transforming customer experience and expectations, encouraging increased loyalty and price control.

Customer experience ranked highest in positive outcomes from important digital investments. More than half (55%) of executives indicate that improved customer experience is an area where their digital investments have created a positive impact.

Enhanced customer engagement will build trust, loyalty, and better enable companies to pass on costs ahead of their competition.

**Innovation:** CEOs are also looking to invest in early-stage businesses to enhance their existing portfolio, access new talent or create new business platforms. Adopting new pricing constructs or innovative pricing models to improve profitability is also seen as key. All of these strategic investments are designed to enhance their attractiveness and protect margins.
How will your capital investments in the following areas change, if at all, in the next six months?

Despite the multiple headwinds, many CEOs say they remain focused on building long-term optionality, resilience and value. CEOs are looking forward to proactively countering disruption and uncertainty by holding steady in their investment strategies.

A significant majority (64%) intend to increase capital investment vs. just 14% who plan to reduce.

<table>
<thead>
<tr>
<th>Area</th>
<th>Significantly Increase</th>
<th>Moderately Increase</th>
<th>No Planned</th>
<th>Moderately Reduce</th>
<th>Significantly Reduce</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall capital investment</td>
<td>20%</td>
<td>44%</td>
<td>22%</td>
<td>11%</td>
<td>3%</td>
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<tr>
<td>Investment in digital and technology</td>
<td>62%</td>
<td>35%</td>
<td>22%</td>
<td>9%</td>
<td>2%</td>
</tr>
<tr>
<td>Investment in existing products and services</td>
<td>22%</td>
<td>37%</td>
<td>28%</td>
<td>11%</td>
<td>2%</td>
</tr>
<tr>
<td>Investment in innovation and R&amp;D</td>
<td>23%</td>
<td>36%</td>
<td>28%</td>
<td>11%</td>
<td>2%</td>
</tr>
<tr>
<td>Investment in people and skills</td>
<td>21%</td>
<td>39%</td>
<td>24%</td>
<td>13%</td>
<td>3%</td>
</tr>
<tr>
<td>Investment in buying new assets and capabilities</td>
<td>24%</td>
<td>36%</td>
<td>26%</td>
<td>10%</td>
<td>4%</td>
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Investing in digital

Investment in digital and technology capabilities is the main area where companies plan to increase spending. This continues from the elevated digital investment seen in the immediate aftermath of the onset of pandemic in 2020, which accelerated in 2021.

Companies are making record-breaking investments in digital transformation this year, up 65% from 2020, according to the EY-Parthenon 2022 DII. Nearly three-quarters of executives surveyed for the DII (72%) say they must radically transform their operations during the next two years to compete effectively in their industry – up from 62% in the 2020 report. Across all sectors, companies will need to focus on scaling technology solutions and realizing benefits as they step up their investments in high-priority projects.

Companies require a data-driven, consistent and enterprise-wide approach to capital allocation that focuses on qualitative and quantitative metrics. These capabilities can help companies make objective investment decisions, navigate disruption and drive long-term value creation.
Build, buy or partner to win

CEOs’ deal intentions also remain broadly positive. While the record mergers and acquisitions (M&A) of the past two years have slowed to more normal levels, deals are still being done and there could be a strong bounce toward the end of 2022 and into 2023.

While the majority of CEOs plan to pursue some type of transaction over the next 12 months, 40% plan to be active on all fronts, looking to acquire, divest and enter new joint ventures (JVs) or strategic alliances.

The importance of JVs and strategic alliances has grown because of the pandemic and elevated economic and geopolitical uncertainty. The EY Ecosystem Study revealed that 71% of business leaders from companies that are part of an ecosystem believe ecosystems are very important to their company’s current success, and 91% agree that ecosystems have increased the resilience of their business.

The primary drivers behind their intentions mirror their strategic focus.

What would be the primary driver for your next planned transaction, including acquisitions, divestments, joint ventures, strategic alliances and other significant investments?

The respondents were allowed to select all applicable responses. The percentages are prorated to 100.

- Investing in an early-stage business to enhance our existing portfolio, access new talent and/or create new business platforms: 21%
- Acquiring a business in an adjacent sector to create new growth avenues: 15%
- A transformative deal to shift to a new business model and customer base: 15%
- To access new markets in countries we do not currently serve: 14%
- Consolidation to improve efficiencies and margins: 13%
- To enhance our sustainability/ESG performance/ranking/footprint: 12%
- To boost resiliency in our supply chain: 10%
Again, CEOs look to use another lever to increase and enhance their service offerings and growth opportunities for the long term. CEOs clearly still see M&A as a critical method of boosting long-term growth strategies – acquiring companies that bolster operational capabilities and innovation. Competitive landscapes have been redrawn across all sectors in the past 24 months, and there is more shifting of positions ahead. But they will proceed with strategic care. The vast majority (96%) have either failed to complete or canceled a planned transaction.

And the primary key risks to growth – the fallout from the pandemic, geopolitical tensions, and inflationary pressures and economic uncertainty – are at the heart of these go/no-go decisions.

### Have you failed to complete or canceled a planned acquisition in the past 12 months? If so, what is the primary reason?

(4% of respondents chose “No”)

96% Yes

- 19% COVID-19 pandemic
- 19% Geopolitical tensions and uncertainty
- 18% Inflation/expected interest rate rises and economic uncertainty
- 13% Concerns about competition or antitrust reviews
- 10% Issues uncovered during due diligence
- 9% Concerns about target’s ESG profile
- 8% Disagreement on price/valuation

Navigating the new complexity

Against a backdrop of increasing crises, CEOs need to fully focus on the issues they can control, those that can be mitigated, and understand how these issues are connected and where future pressures may evolve.

Leading companies are holding firm on transformational investment plans – or formulating new strategies to navigate the new complexity. They will be looking to reframe their strategy; reimagine their portfolio, global operations and footprint; and reinvent their ecosystems.

The new complexity requires strong foundations to boost optionality, agility and sustainability for CEOs looking to create the conditions for long-term value creation in the future.
CEOs committed to buying, building and partnering are making bold decisions and investing to create long-term sustainable value. They are actively adapting their portfolio, ecosystem and global operations to position for a rapidly evolving environment.
About the survey

The EY 2022 CEO Outlook Survey aims to provide valuable insights on the main trends and developments impacting the world's leading companies as well as business leaders' expectations for future growth and long-term value creation.

It is a regular pulse survey of CEOs from large companies around the world, conducted by Longitude Research Limited, a Financial Times company.

In August 2022, Longitude surveyed on behalf of the global EY organization a panel of 760 CEOs in 10 countries and across six industries. Respondents represented the following industries: advanced manufacturing and mobility, consumer products and retail, energy and resources, financial services, health sciences and wellness, technology, media and telecoms.

- Surveyed companies' annual global revenues were as follows: less than US$500m (20%), US$500m-US$999.9m (20%), US$1b-US$4.9b (30%) and greater than US$5b (30%).
- The CEO Imperative Series provides critical answers and actions to help CEOs reframe their organization's future. For more insights in this series, visit ey.com/en_gl/ceo.

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