

If AI holds the answers, are CEOs asking the right strategic questions? (PART 1)



ISAAC SARPONG: Isaac is the Partner in charge of Tax Services. He has over 26 years' experience in the provision of multi-faceted advice to both local and international clients in taxation, accountancy, audit & assurance, and corporate law, among others. Isaac is a Chartered Accountant, a Chartered Tax Practitioner and a Lawyer.



The CEO Outlook Pulse – July 2023 finds CEOs' faith in artificial intelligence benefits tempered by concerns about unknown consequences.

In brief

- CEOs embrace AI as a force for good but have significant concerns about unintended ramifications.
- Sustainability priorities move as CEO and investor sentiment remains disconnected.
- The transformation imperative fuels near-record-high M&A appetite, but barriers to doing deals will likely hinder market activity.

CEOs globally are embracing AI as a force for good while remaining wary of unknown, unintended consequences. They believe more needs to be done to mitigate significant social, ethical and cyber risks.

An EY study of 1,200 CEOs globally focuses on how they currently use AI as well as their plans to leverage the technology in the future. It also provides insights on capital allocation, investment and transformation strategies, as well as plans to embed sustainability into the growth agenda – all against a backdrop of economic headwinds.

The latest edition of the CEO Imperative Series, which provides critical answers and actions to help CEOs reframe the future of their organizations, finds companies looking forward and positioning for growth, even as new technologies and geopolitical pressures make that future increasingly opaque.

CHAPTER 1

The rapid rise of AI compels CEOs to reconsider the future

CEOs embrace the promise of artificial intelligence – but with significant concerns.

The headline-grabbing explosion of generative AI in late 2022 and early 2023 has captured the imagination of business leaders, investors and consumers alike. Tens of billions of dollars have been invested into generative AI applications, with drug development and software coding being the most-funded use cases.

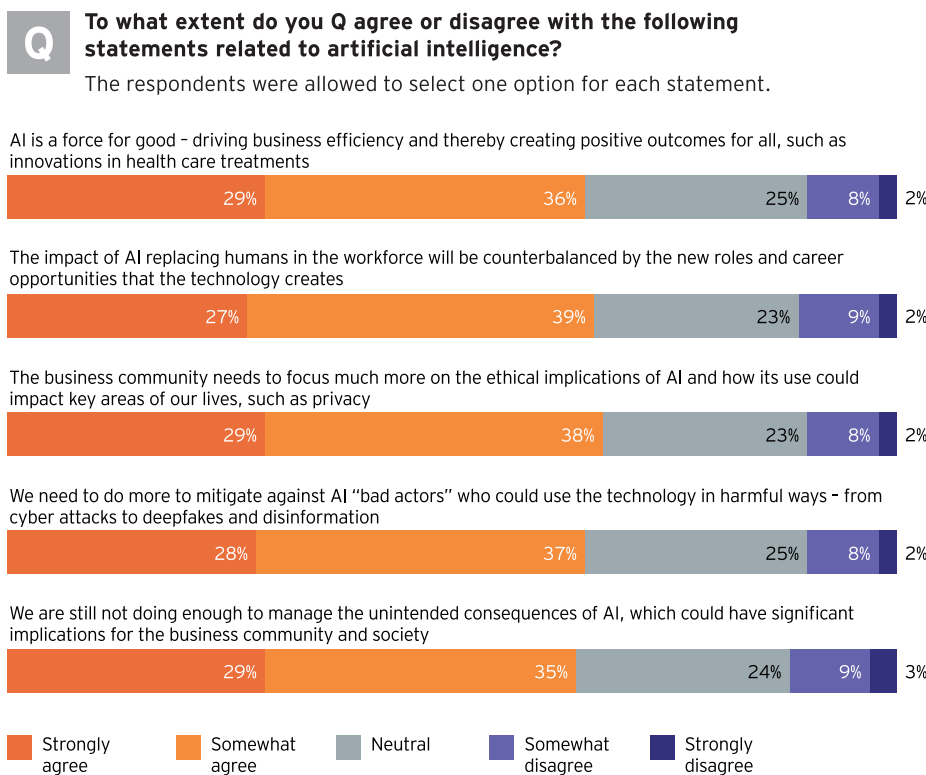


Image Description

An interactive chart showing that two-thirds of CEOs strongly or somewhat agree with these five statements related to artificial intelligence:

- AI is a force for good - driving business efficiency and thereby creating positive outcomes.
- The impact of AI replacing humans in the workforce will be counterbalanced by the new roles and career opportunities that the technology creates.
- The business community needs to focus much more on the ethical implications of AI.
- We need to do more to mitigate against AI "bad actors" who could use the technology in harmful ways.
- We are still not doing enough to manage the unintended consequences of AI.

CEOs clearly see the huge upside opportunities of AI. They recognize its potential to drive productivity and positive outcomes for all stakeholders. Two-thirds (65%) agree or somewhat agree that AI is a force for good - driving business efficiency and therefore creating positive outcomes for society, such as innovations in health care treatments.

A similar cohort believes the impact of AI replacing humans in the workforce will be counter-balanced by the new roles and career opportunities that the technology creates - they reject fears that AI could negatively impact workforce numbers.

But CEOs are simultaneously concerned about any unintended consequences of AI - reflecting a broader confluence of views in media, society and contemporary culture where the exciting potential of artificial intelligence is often contrasted with the tropes of dystopian science fiction.

Driving force

65%

of CEOs agree that AI is a force for good, driving business efficiency and therefore creating positive outcomes for all

Work to do

65%

of CEOs also say more work is needed to address the social, ethical and criminal risks in the new AI-fueled future

Almost two-thirds (65%) of CEOs say more work is needed to address the social, ethical and criminal risks inherent in the new AI-fueled future - from cyberattacks to disinformation and deepfakes. A similar number also worry that not enough is being done to manage the significant implications and unintended consequences for both the business community and society more broadly.

Government policymakers and regulators have a significant role to play in establishing rules and guardrails for how generative AI is used. And CEOs also see a role for the business community to engage much more on the ethical implications of AI and the impact of its use on key areas of our lives, such as privacy. They also highlight AI's potential to disrupt the entire digital environment that exists today, especially with regard to privacy and online security.

Despite these concerns, CEOs are devising investment strategies to maximize the current and future benefits that AI can bring to their businesses. Capital allocation is being focused on these new technologies. With nearly a half of CEOs already fully integrating AI-driven product or service changes into their capital allocation process and actively investing in AI-driven innovation. ■

(CONTINUED IN NEXT EDITION)

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If AI holds the answers, are CEOs asking the right strategic questions? (PART 2)



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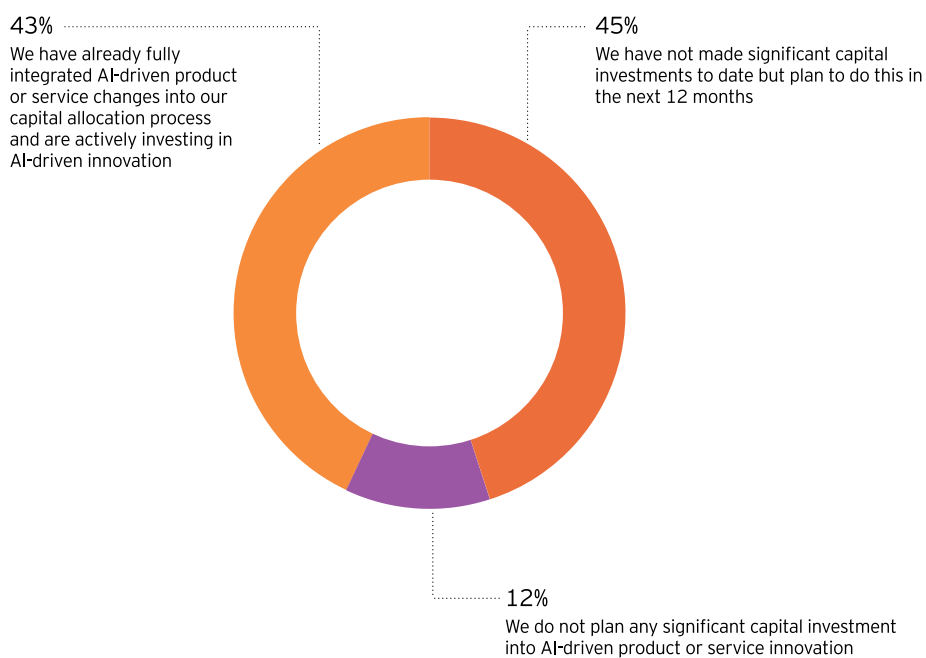


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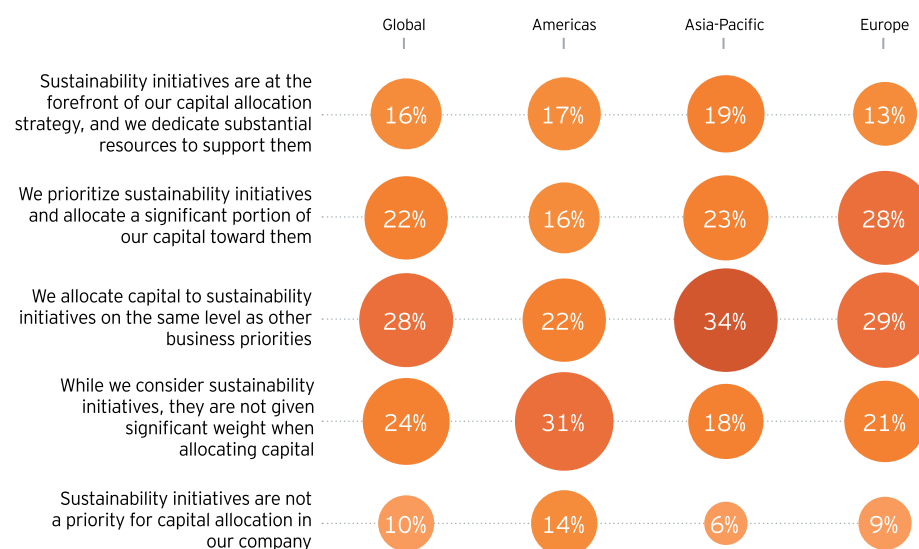
Q Which of the following best describes your current capital allocation approach to artificial intelligence?

The respondents were allowed to select one option only.



Q When it comes to your company's capital allocation process, which of the following best describes the importance of sustainability initiatives today?

The respondents were allowed to select one option only.



However, when it comes to the trade-off between short-term earnings and long-term value creation, there is a disconnect between investors and CFOs. Investors are more likely to favor decisions that lead to sustainable, long-term value creation, even at the expense of short-term earnings. Finance leaders appear much less inclined to make that trade-off.

The research found that 76% of investors are willing to accept "a lower rate of return on investment when the target company has a beneficial impact on planet or people."

This is in stark contrast to our CEO Outlook of January 2022 (pdf) when 65% of CEOs reported they had encountered resistance from investors about their sustainability transition strategy. Almost a quarter (21%) then said that investors are not showing support for long-term investment plans, or that they are fixated on quarterly earnings.

Investor support for ESG

76%

of investors are willing to accept a lower return on investment from a company with a beneficial impact on planet or people

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Image Description

A chart showing what CEOs consider to be their current capital allocation approach to AI. The highest-scoring response (45%) shows that they have not made significant capital investments to date but plan to do this in the next 12 months.

Just over a third (38%) prioritize sustainability issues when making capital allocation decisions, with a similar number (34%) not making such issues a priority. The remaining respondents (28%) apply an equal weight as other business priorities.

Image Description

A chart showing a global and regional comparison of how CEOs are responding to the importance of sustainability initiatives in the context of their company's capital allocation process. For example, the highest share of CEOs globally (28%) say sustainability initiatives are allocated capital on the same level as other business priorities. By comparison, 22% of CEOs in the Americas, 34% in Asia-Pacific and 29% in Europe report the same practice.

According to the latest EY Global Corporate Reporting and Institutional Investor Survey (pdf), businesses, and many of their biggest investors around the globe, are at odds over the action needed on sustainability - a clash of opinions that threatens to stifle access to capital for many organizations, which could hinder progress on decarbonization and other sustainability-driven initiatives.

CHAPTER 2

Sustainability focus slows in the face of other priorities

Sustainability initiatives are at a crossroads – a major CEO shift in past two years.

Many businesses see the potential of AI to accelerate their progress on sustainability at a time when investors, regulators and stakeholders across society are increasingly demanding greater environmental, social and governance (ESG) transparency. However, CEO respondents are split three ways in terms of how much capital to allocate to sustainability priorities.

If AI holds the answers, are CEOs asking the right strategic questions? (PART 3)



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CEO priorities

65%

of CEOs reported they had encountered resistance from investors about their sustainability transition strategy

Investor appetite has shifted toward sustainability-friendly businesses, while CEO prioritization seems to have moved in the opposite direction – short-term financial performance. The harsh realities of today's low-growth, high-inflation and interest rate environment have no doubt encouraged many CEOs to focus more sharply on quarterly performance. On the other hand, for many companies, sustainability may already be baked into their strategic direction.

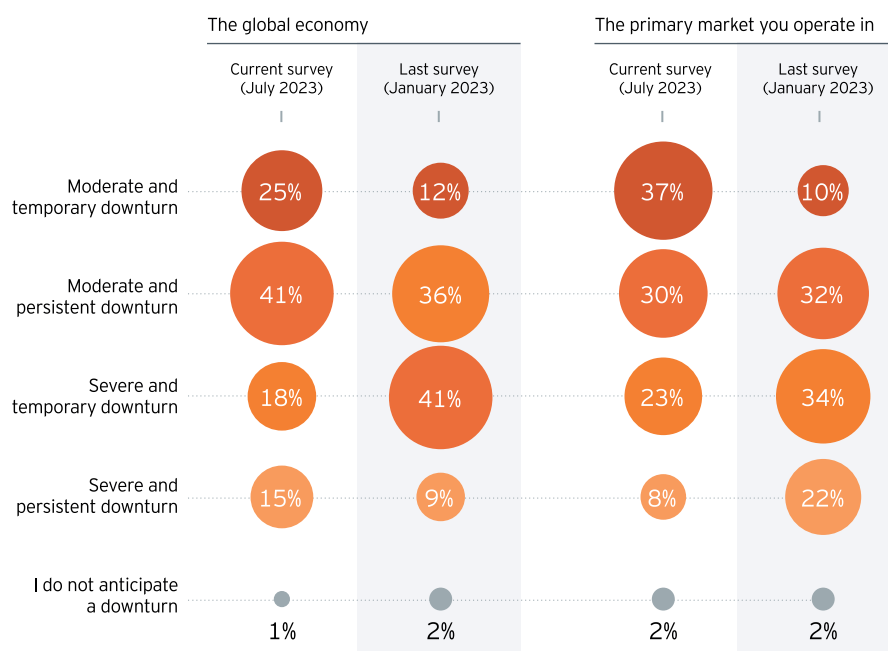
Nevertheless, to meet stakeholder demands, CEOs have to seek more effective ways of communicating strategic performance with both nonfinancial and financial metrics to help bridge the gap with investor expectations and align with more demanding stakeholders.

Accepting new realities, short-term volatility and risks

Given the near- to mid-term economic headwinds, the increasing cost of doing business, rising capital costs and elevated geopolitical tensions, it may come as a surprise that CEOs feel slightly more positive, with a net number of respondents agreeing that their performance over the next 12 months is looking brighter than at the start of the year.

Q Considering the current levels of global macroeconomic uncertainty, what scenario are you planning for in connection with a potential economic downturn?

The respondents were allowed to select one option only.



- ▶ Environmental, social and governance (ESG) and sustainability risks
- ▶ Technology and digital disruption, including cyber risks ■

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Image Description

An interactive chart showing that CEOs are cautiously more optimistic regarding a potential global economic downturn than at the start of 2023, with 33% of CEOs expecting a severe temporary or persistent downturn, compared with 50% in January. Regarding their own company's financial performance outlook, 47% of CEOs are more optimistic and 36% less optimistic than they were six months earlier.

However, CEOs are also having to manage a series of interconnected external risks to what would have previously been considered business as usual, with the majority anticipating a very significant or significant impact on their business over the next 12 months.

Image Description

A chart showing to what extent CEOs expect some risks will impact their business's performance over the next 12 months. More than half of CEOs indicate the following risks will have "very significant" or "significant" impact:

- ▶ Geopolitical conflicts or trade tensions
- ▶ Macroeconomic and market volatility
- ▶ Regulatory risks

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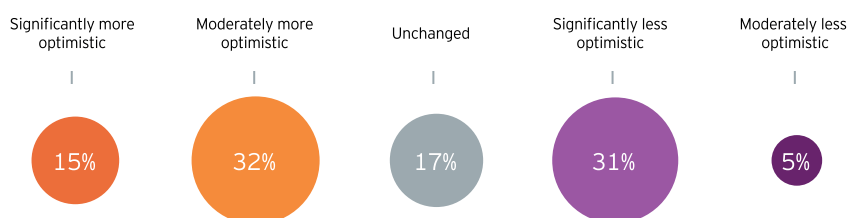
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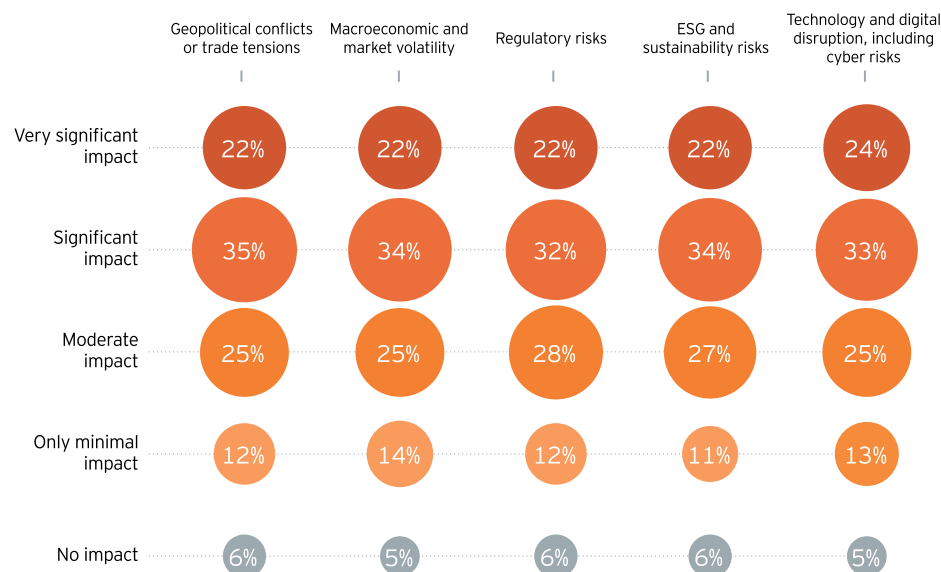
Q Compared with the start of 2023, how do you feel about your organization's financial performance prospects over the next 12 months?

The respondents were allowed to select one option only.



Q To what extent do you believe that the following risks will impact your business's performance over the next 12 months?

The respondents were allowed to select one option only.



If AI holds the answers, are CEOs asking the right strategic questions? (PART 4)



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The past three years have been notable for the nature and pace of the multiple crises confronting companies. CEOs' and business leaders' significant focus on processing the principles of this fast-paced, stacked disruption has led to two major consequences:

- ▶ Companies get trapped in a reactive spiral, adapting to fast and fundamentally fluid situations at an increasing pace. This forces them to become more and more tactical and creates a barrier to thinking strategically for the long term.
- ▶ Time and focus are increasingly wasted on trying to picture the exact shape and form of possible futures rather than dealing with the necessary, no-regret moves they can make now.

Actions to take now

Adopting advanced monitoring and scenario planning to play out their actions and reactions to any further acceleration of external headwinds is key for CEOs. Companies should be regularly assessing their portfolio of assets, operations, ecosystems and supply chains, including routes to customers, and considering how each aspect of their business is impacted at a fundamental level. Fine-tuning each area to strategically manage the complex risk environment will bring benefits across the whole organization.

CHAPTER 3

Capital matters

Focusing capital where it matters will boost long-term growth opportunities.

Focusing on the fundamentals and controlling what is in business leaders' power to control will be CEOs' most effective strategic and operational actions in the current environment. This can also be seen in capital allocation strategies.

Q How would you describe the primary focus of your company's capital allocation strategy over the next 12 months?

The respondents were allowed to select one option only.

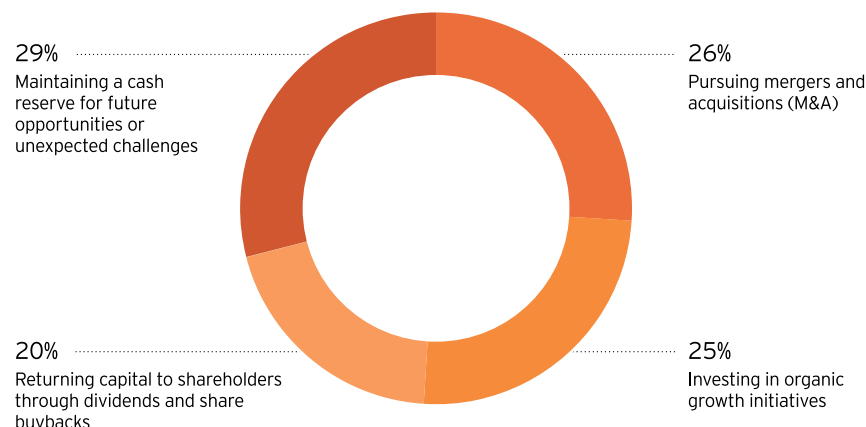


Image Description

A chart showing what CEOs consider to be the primary focus of their company's capital allocation strategy over the next 12 months, with the highest response (29%) being "maintaining a cash reserve for future opportunities or unexpected challenges."

An effective allocation is aimed at enabling value creation by finding and funding the right mix of investments, within financial and operational constraints, while building resilience and preparedness for any unforeseen events.

This process impacts multiple dimensions, including time horizons and different organization levels. For example, long-term

capital planning has to address the longer-term strategic objectives of an organization – three to five years out – while shorter-term capital budgeting must speak to a near-term horizon of one to three years, with both a top-down and a bottom-up dimension.

But capital allocation, as a key driver of value creation, has to be integrated with overall corporate strategy. It also has to include all uses and sources of capital, including investments, returning capital to shareholders and even divestitures.

For those CEOs who selected either organic growth or mergers and acquisitions (M&A) as their company's primary capital allocation strategy, there is a boldness in the primary goal they are trying to achieve with this approach.

Image Description

A chart showing a global and regional comparison of what CEOs are trying to achieve through organic growth or mergers and acquisitions (M&A) as their company's primary capital allocation strategy. For example, the highest response globally (16%) is to improve technology capabilities and innovation. The same primary goal was selected by 17% of CEOs in the Americas and 17% in Europe.

In many ways, these areas of focus mirror the major challenges that CEOs now face. Be it a shifting geopolitical landscape, accelerating technology innovation and disruption or the need to become a more sustainable business, CEOs are looking to be on the front foot.

Making smart capital allocation decisions that drive long-term growth as well as increase short-term shareholder returns and stakeholder confidence is essential for the C-suite. To improve their company's competitive position, leading CEOs are removing barriers to agile investing. ■

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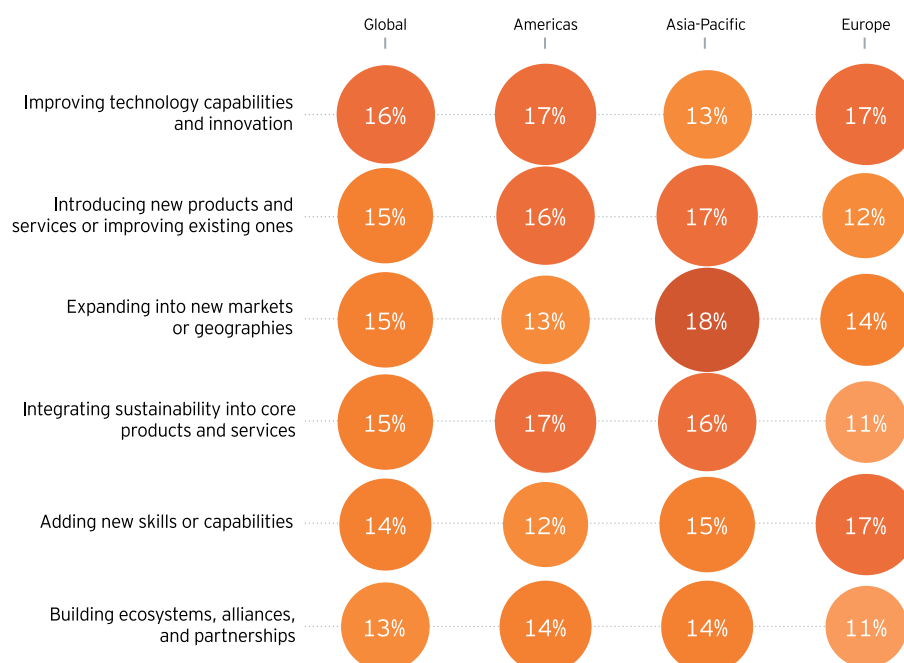
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Q You selected either organic growth or mergers and acquisitions (M&A) as your company's primary capital allocation strategy. What is the primary goal you are trying to achieve with your chosen approach?

The respondents were allowed to select up to two responses and list them in order of priority.



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A data-driven, consistent and enterprise-wide approach to capital allocation that focuses on qualitative and quantitative metrics can help CEOs make objective investment decisions, navigate disruption and drive long-term value creation.

Sustained transformation to fuel future prosperity

This proactiveness in capital is reflected in CEOs' plans for transformation.

for attractive temporary financing and subsidies, and the market is still partially flooded with these funds. However, more recent monetary policy moves to contain the unintended consequences of too much liquidity – sharply raising interest rates in a fight against high inflation – have created an environment where a resulting credit squeeze is possible.

As a result, companies are refocusing on short- to medium-term liquidity and furthering their efforts to control costs and financial risks. This threat emphasizes the need for liquidity focus and the immediate issues they are facing may center on:

- ▶ Striving for agile cost structures and light asset footprints

It is difficult to predict exactly how all of this will play out. But one thing is becoming more certain – the availability of external financing will continue to tighten and become more expensive. And that will mean that the cheapest, most accessible and reliable source of funding their company's transformation may be in the CEO's own internal cost control.

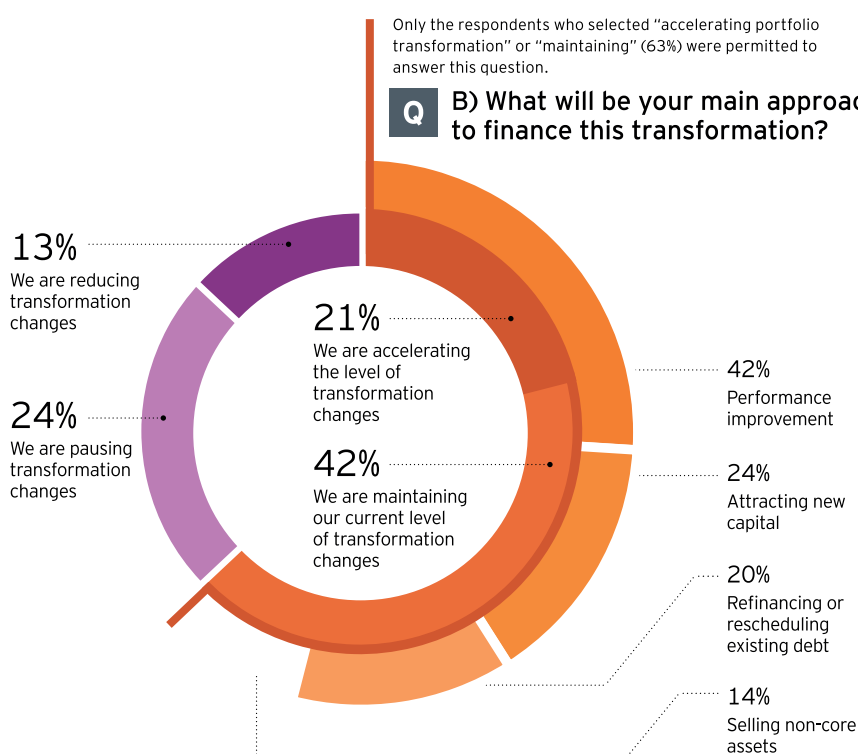
CEOs are clearly signaling that they want to increase the pace of M&A over the next 12 months.

Image Description

An interactive chart showing that 98% of CEOs expect to actively pursue transaction initiatives over the next 12 months, with almost two-thirds of respondents (59%) planning an acquisition.

Q What statement best characterizes your approach to portfolio transformation – including spin-offs, divestitures and acquisitions – over the next 12 months?

The respondents were allowed to select one option only.



CHAPTER 4

A return to the deal table?

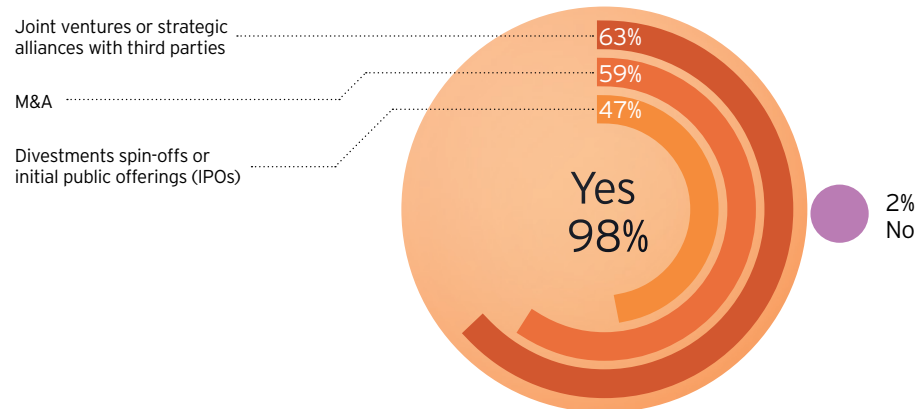
CEOs should reengage with M&A as a route to navigating an uncertain future.

A near-record-high of almost two-thirds of CEOs (59%) plan an acquisition in the next 12 months, up from 46% at the start of the year. Almost half (47%) plan to divest assets. This strong sentiment indicates an acceleration of dealmaking through the rest of 2023 and into 2024 – but current barriers to doing deals, such as increasingly restrictive regulation and a higher cost of capital, will likely mean many of those plans stall. ■

Q Do you expect to actively pursue any of the following transaction initiatives over the next 12 months?

The respondents were allowed to select multiple responses

CEOs are clearly signaling that they want to increase the pace of M&A over the next 12 months.



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Image Description

An interactive chart showing that the majority (63%) of respondents are either maintaining or accelerating their portfolio transformation.

The majority (63%) of respondents are either maintaining or accelerating their portfolio transformation. Of this bolder cohort, the main source of financing their transformation will come from performance improvement. This reflects how the environment has shifted over the past 18 months from one of growth at any cost, fueled by ultra-cheap money and elevated liquidity, to a new paradigm where investments have to be sustainable, with a clear path to profitability or value creation.

The context for financing has changed fundamentally. Policy interventions to mitigate crisis symptoms have been a source

- ▶ Understanding exposure
 - ▶ Understanding short- and medium-term capital and liquidity needs (coordination with treasury forecasts)
 - ▶ Assessing access to cash in the short term (balances, borrowing facilities, capital calls) and coordinating backup funding sources, as needed
 - ▶ Assessing exposure to financial institution partners (balances, terms of cash management accounts, cash products)
- ▶ Exploiting internal financing potential to the maximum and increasing resilience while freeing up capital for investment in transformation
 - ▶ Optimizing working capital management
 - ▶ Reducing direct and indirect costs through an attitude of constant challenge

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Expanding the footprint

59%

of CEOs plan an acquisition in the next year, up from 46% at the start of 2023

Divesting

47%

of CEOs plan to divest assets

While the deal market started 2023 very softly, there has been a pickup of deals through the second quarter. CEOs are accepting the new realities of deal fundamentals, including bridging a wider valuation gap, more expensive funding and a greater likelihood of regulatory scrutiny. However, all of these factors still have the potential to stop deals from getting over the line.

Despite an increasingly complex M&A environment making transactions more difficult, the fundamental deal drivers that accelerated the M&A market through the second half of 2020 to the end of the first half of 2022 remain intact. The need to respond to technology-driven disruption is not going away anytime soon.

With AI and new technologies emerging and maturing ever more quickly, companies that can leverage them as instruments of creativity will perform better. Companies will need to deploy technology faster to cater to the evolving needs of customers, employees and the business ecosystem. This is likely to accelerate investment in digital assets – such as AI capabilities – leading to more transactions, with companies looking to improve their value proposition and/or reinforce their market position.

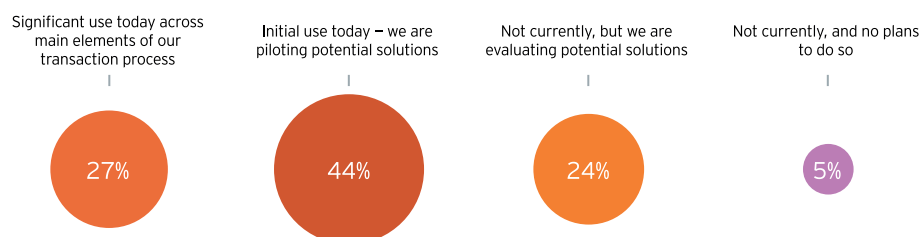
CEOs are also leveraging these technologies to strengthen their M&A processes themselves. When asked if they are making use of AI as part of their approach to transactions, only a tiny cohort (5%) is not currently using these capabilities or has no plans to – and they risk being outmaneuvered by the competition.

Image Description

A chart showing the level to which CEOs are making use of AI as part of their approach to transactions, with the highest response (44%) being “initial use today – we are piloting potential solutions.”

Q Are you making use of AI as part of your approach to transactions, including M&A or divestments (e.g., using AI as part of target selection or due diligence)?

The respondents were allowed to select one option only



M&A is a complex, challenging combination of strategy, capital and effective deal execution used to drive value. Getting it right will likely keep companies ahead of their competition. Get it wrong, and they may well fall behind.

The reality is that an increasingly data-saturated world is making getting it right harder still. The future of M&A dealmaking means significantly more information now needs to be captured, processed, analyzed and interpreted than ever before. Traditional means are no longer effective in delivering a competitive edge. Artificial intelligence capabilities, deployed correctly, may be the key to unlocking more value through M&A.

Focusing near-term capital decisions on long-term reward

CEOs are navigating a complex landscape, preparing for long-term success while addressing immediate challenges. They recognize the potential that AI offers and the need for sustainability action but also understand the potential risks associated with these transformative changes. By adopting proactive strategies, data-driven decision-making and a focus on capital allocation and M&A, CEOs can create value, drive growth and ensure their organizations remain competitive in an evolving business environment. Some of these value-creating actions include:

- ▶ Embrace the potential of artificial intelligence while managing risks: CEOs should recognize the value and positive outcomes that AI can bring to their organizations. They should invest in understanding the scope as well as the risks, define the value and capabilities needed for integrating AI, and ensure that AI is used responsibly and ethically. CEOs should also engage with the broader business community to address the social, ethical and cyber risks associated with AI.
- ▶ Utilize data-driven capital allocation and focus on transformation: CEOs should adopt a data-driven, consistent

and enterprise-wide approach to capital allocation. By focusing on qualitative and quantitative metrics, CEOs can make objective investment decisions, navigate disruption and drive long-term value creation. They should also embrace sustained transformation efforts by maintaining or accelerating portfolio transformation and financing it through performance improvement.

- ▶ Give appropriate weight to sustainability in capital allocation decisions: CEOs should respond to the increasing demand for transparency and performance in ESG matters. They should consider sustainability issues when making capital allocation decisions and broaden the scope of their reporting to include both nonfinancial and financial metrics. Aligning with investor expectations and stakeholder demands on sustainability can enhance the company's brand and competitive position.
- ▶ Accept new realities, manage risks and embrace scenario planning: CEOs should acknowledge the volatility, risks and interconnected external factors impacting their businesses. They should adopt a proactive approach to scenario planning, anticipating and reacting to further acceleration of external headwinds. Assessing the impact on various aspects of the business and fine-tuning each area can improve strategic planning and increase resilience across the organization.
- ▶ Return to the deal table to accelerate change: CEOs should consider leveraging M&A opportunities to respond to technology-driven disruption, improve their value proposition and reinforce their market position. They should make use of AI capabilities in the M&A process to capture, process, analyze and interpret the increasing amount of information available, ultimately unlocking more value through successful deal execution.

Survey Methodology

The EY CEO Outlook Pulse 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 FT Longitude, the specialist research and content marketing division of the Financial Times Group. In June and July 2023, FT Longitude surveyed on behalf of the global EY organization a panel of 1,200 CEOs across Brazil, Canada, Mexico, the United States, Belgium, Luxembourg, the Netherlands, France, Germany, Italy, Denmark, Finland, Norway, Sweden, the United Kingdom, Australia, China, India, Japan, Singapore and South Korea.

Summary

CEOs should adopt a balanced approach to AI by taking the long view and focusing on an AI-fueled future while also addressing the immediate challenges. This includes maintaining or accelerating transformation initiatives and making capital allocation decisions that drive long-term growth and value creation. ■

Sustainability and ESG strategy services

EY sustainability and ESG strategy teams can help you create long-term sustainability and ESG value through strategy, M&A, capital allocation, ESG due diligence and portfolio optimization.

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