



The Pulse of the Economy 2016

**Survey by KPMG in
Central & Eastern Europe**

Albania, Bosnia and Herzegovina,
Bulgaria, Croatia, Czech Republic,
Macedonia, Poland, Romania,
Slovakia



kpmgpulsesurvey.com



Contents

Foreword	3
Outlook for the economy	5
Outlook for enterprise	13
Profile of respondents	43

Foreword



Leszek Wronski

Head of Management Consulting
in KPMG in Central & Eastern Europe

Dear Reader,

In an era of historically low interest rates in many markets and political challenges related to Europe, this year's edition of KPMG's survey the Pulse of the Economy elaborates on current trends in economy and entrepreneurship, to measure the sentiment among the business leaders in Central & Eastern Europe (CEE). This eighth edition of the well-received survey that reached out to 759 respondents this year, brings together views of business communities from nine countries – for the first time from Albania, Bulgaria and Macedonia.

The headline result of the survey is that despite of several economic and political uncertainties the business confidence remains promising, affirmed by 44% of respondents in the region who believe that in 2017 economic situation will improve somewhat or even significantly – however, compared to the previous year it shows a slight decline down from 51%. For meeting the objectives, sound business environment is of utmost importance and, like previously, simplified tax payment and administration procedures are holding the pole position in the tax policy suggestions to the respective governments.

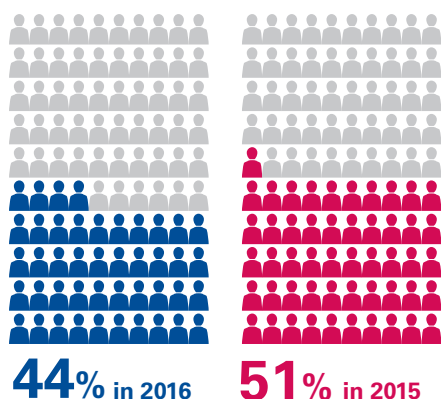
Number of respondents in 2016 vs. 2015



Today doing all things right may not be sufficient in business, which triggered us to ask about innovation and use of disruptive technologies in the companies. The enterprises in the region take innovation seriously because for about half of their CEOs it is either on top of the CEO's personal agenda or among the top three issues. Data & analytics is clearly an emerging field when about a half of respondents believe that their companies are using it fairly effectively and 6% consider themselves as a leader in this field.

Human factor remains a key issue for businesses when 75% admit that retaining good employees is the key focus area, reflected also in the belief that 69% of CEE respondents intend to raise employee salaries in 2017. Of CEE respondents, 40% plan to increase headcount during the next 12 months and about two-thirds over the next three years.

Business confidence in the CEE region according to respondents



In 2016, KPMG also published the Global CEO Outlook, based on a study that was held in spring 2016, to collect the perspectives and insights of nearly 1,300 CEOs from companies across 11 industries in 10 countries. A number of questions from the Global CEO Outlook was used in the Pulse of the Economy survey. In comparing global and CEE results, we see that global companies are using more disruptive technologies, are keen to explore the benefits of innovation and data & analytics, and are more concerned about cyber risks. The message for CEE companies is that they should look more closely at the opportunities and challenges that come with the emergence of a digital society.

We sincerely believe that the survey's findings give you food for thought when devising your business roadmap for 2017 and beyond.

Yours faithfully,

Leszek Wronski

Head of Management Consulting
in KPMG in Central & Eastern Europe

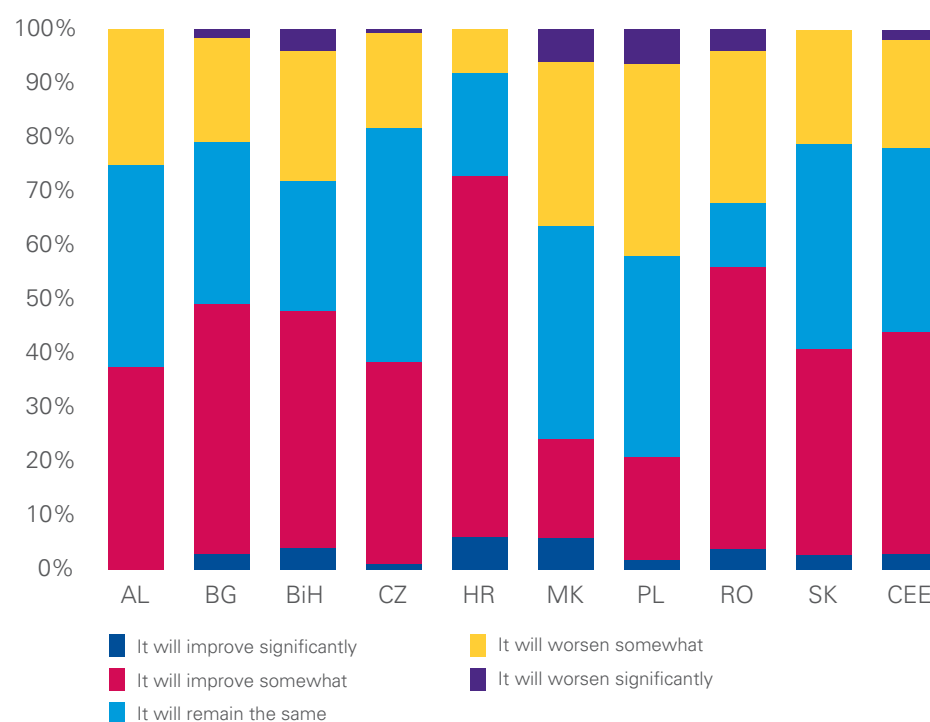


Business environment

Less optimism regarding GDP growth, but no indication of downturn

Although the share of respondents who believe that the economic situation will improve has fallen from last year's 51% to 44%, the overall sentiment is satisfactory, as 34% do not foresee any particular changes and only 22% expect worse times ahead. Moving up from last year's second place, among all countries included Croatian business leaders are most confident, with 73% thinking that the economic situation will improve, followed by Romania (56%). In the Czech Republic, the share of optimists regarding the economy has fallen from 66% to 39% and the biggest group (43%) contends that the situation will remain the same. In Poland (41%) and Macedonia (36%) a substantial number of respondents predicts deterioration of the economic situation.

How do you expect the economic situation to change in 2017 in your country?



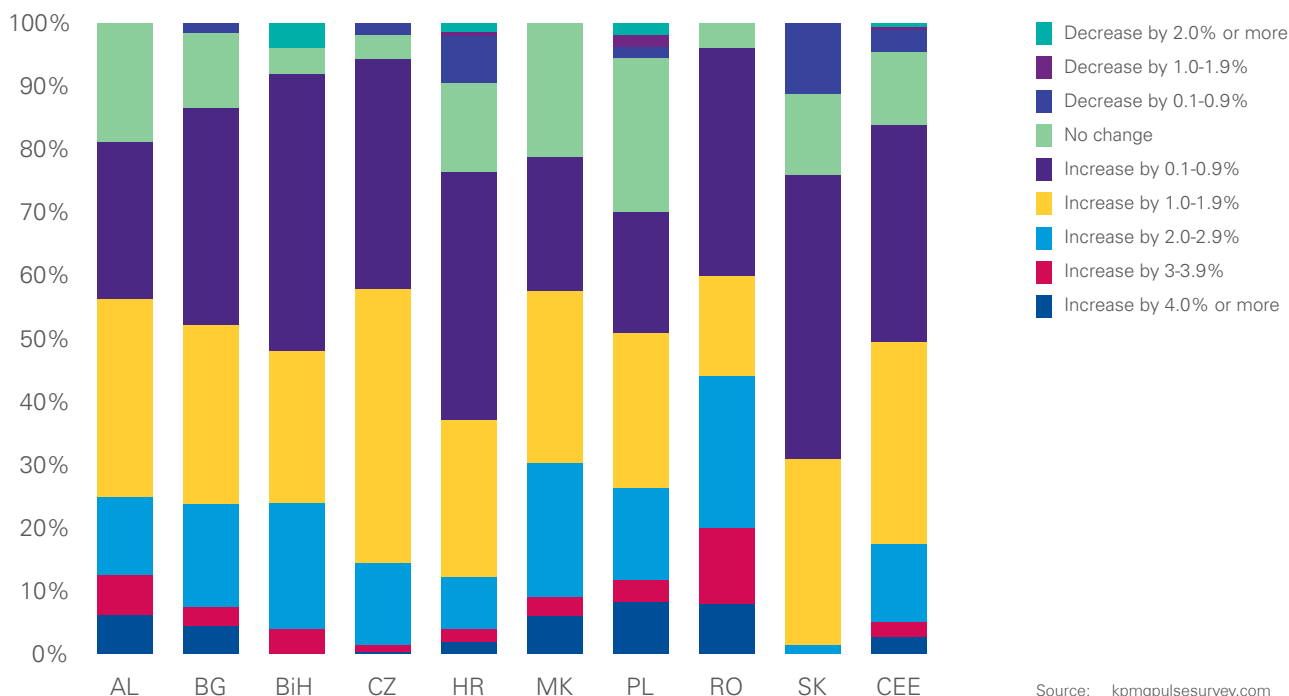
Source: kpmgpulsesurvey.com

Inflation not a substantial concern

Sixty-six percent of respondents in nine countries do not perceive any inflationary pressures and indicate that the inflation rate in 2017 will remain under 2%, exhibiting no significant change from the previous survey (62%). About 17% of respondents hold that inflation could exceed the 2% threshold.

The strongest price pressures are predicted in Romania, where 44% of the respondents think that inflation will exceed 2% (23% last year). In Slovakia, 11% expect that the consumer price index will fall slightly in 2017, and 9% are of the same opinion in Croatia.

What do you expect the consumer price index change to be in your country in 2017?



Response options that were most frequently selected in CEE:

Implementing simplified tax payment and administration procedures

Introducing or increasing tax incentives for research and development activities

Implementing/maintaining flat personal income tax system

Lowering social taxes

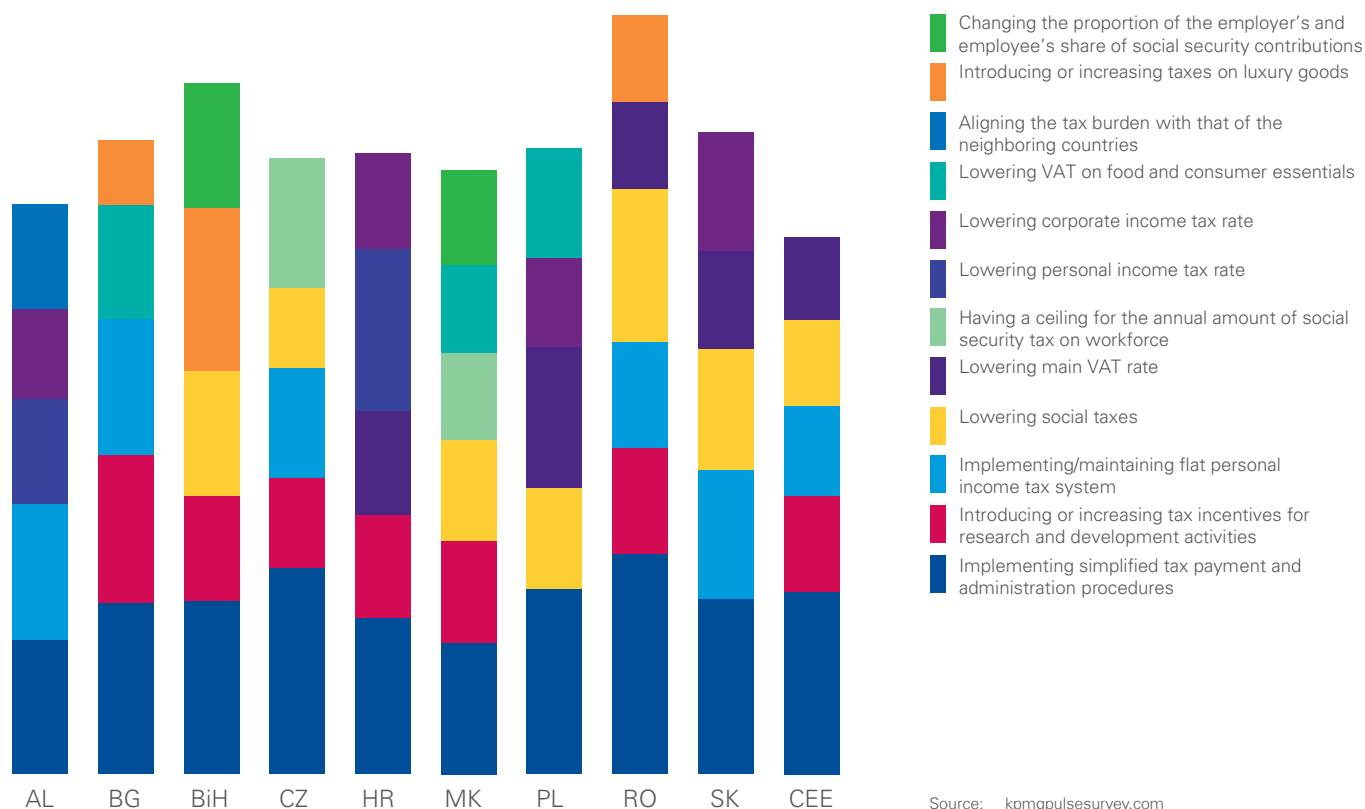
Lowering main VAT rate

Simplification of tax procedures

Simplified tax payment and administration procedures remain the most important tax policy issues to be tackled by the government, according to 76% of respondents in the CEE sample (79% in 2015), most strongly supported by business leaders in Romania (92%) and in the Czech Republic (86%). Meanwhile, in Croatia lowering the personal income tax rate took the top spot (68%), followed by simplified tax payment and administration.

Forty percent of respondents are in favor of introducing or increasing tax incentives for R&D activities and 37% cast their vote for implementing or maintaining a flat personal income tax system. Introducing or increasing taxes on private property received the least support (9%) along with lowering excise tax rates (10%). Across the region, taxes on luxury goods are not seen as important, except in Bosnia and Herzegovina, where 68% of survey participants were in favor of this idea.

Please select FIVE tax policy issues that should be tackled by the government

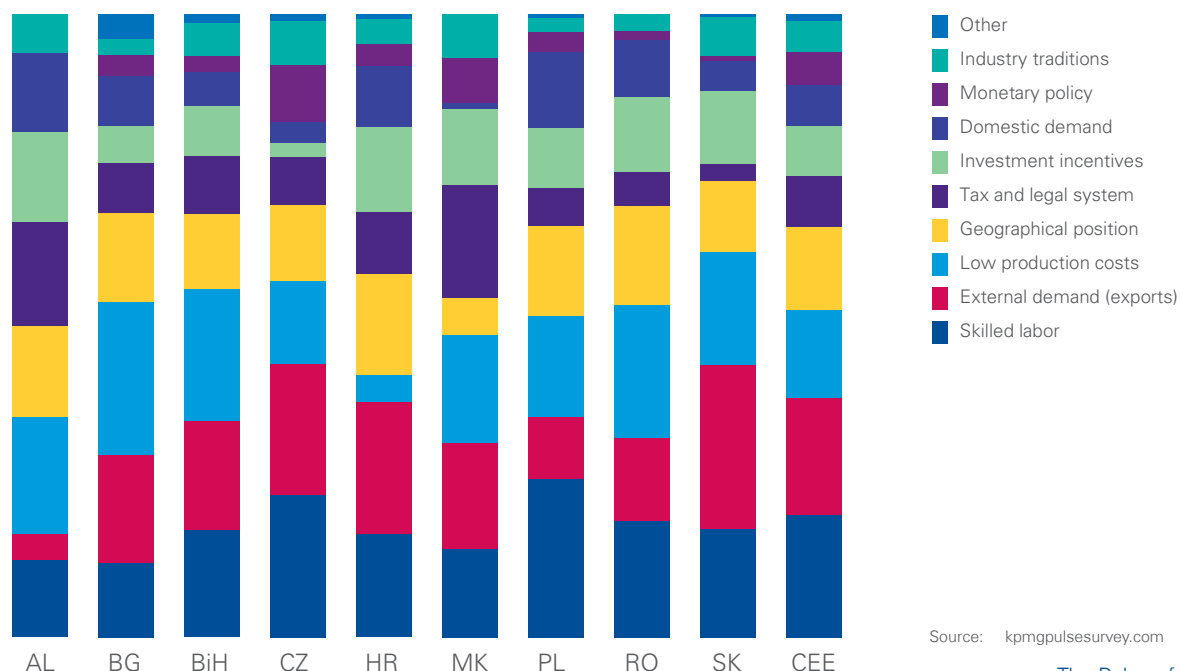


Skilled labor helps to maintain competitive edge

Across the region, skilled labor maintains the leading position among the key drivers for competitiveness, according to 59% of respondents overall (60% in 2015), getting the highest levels of response in Poland (76%) and the Czech Republic (69%), while seen as least essential according to survey participants in Bulgaria (36%), Albania (38%) and Macedonia (42%).

At 56%, the external demand response has maintained the second slot, especially in Slovakia (52%), followed by low production costs (43%) and geographical position (40%). The tax and legal system is an important asset in Macedonia (55%). Industrial traditions, monetary policy and domestic demand are seen as least relevant, mentioned by about 15-20% of respondents.

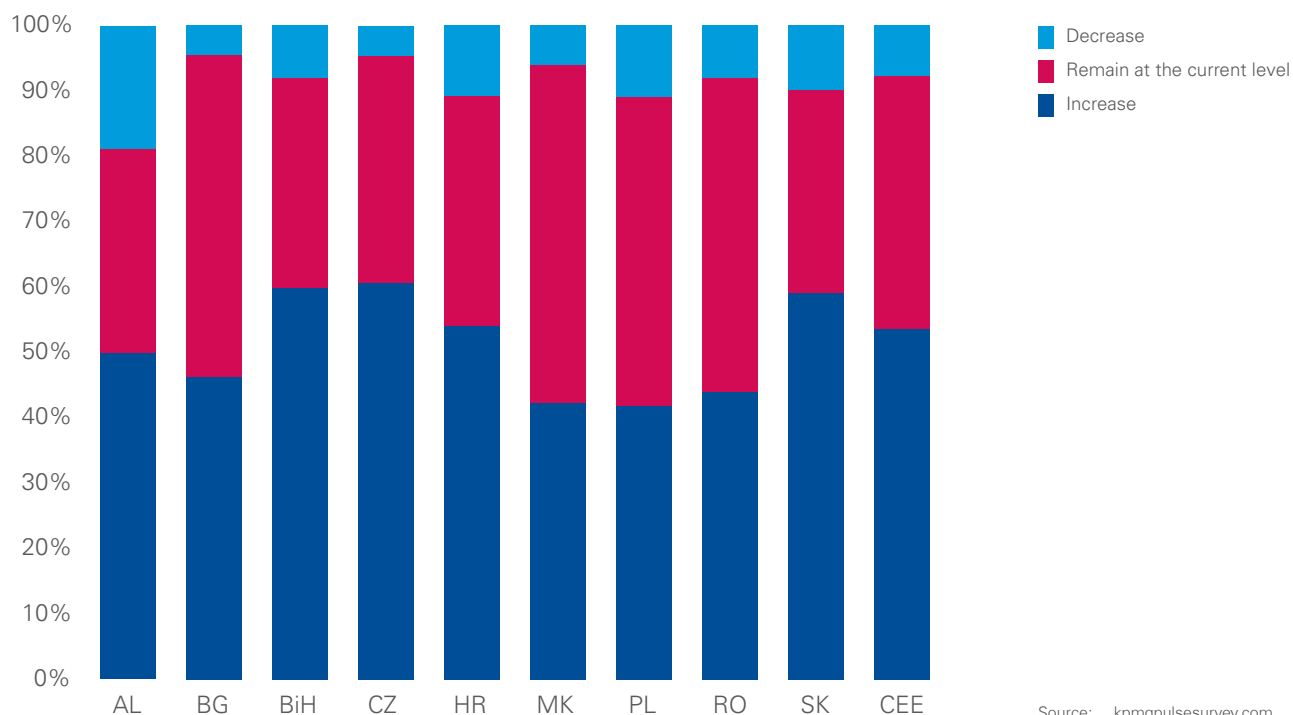
In your opinion, what are the three key drivers of economic competitiveness in your country?



Oil prices likely to increase

According to a majority of respondents, the era of cheap oil will be over, as 54% see a price increase on the horizon. Of all respondents in the region, 39% indicate that prices will remain at the current level and only 8% expect they will decrease. In the Czech Republic (61%), Bosnia and Herzegovina (60%) and Slovakia (59%) the belief in higher oil prices is the strongest, while in Albania, 19% say oil prices will fall.

How are oil prices likely to trend?



Source: kpmgpulsesurvey.com

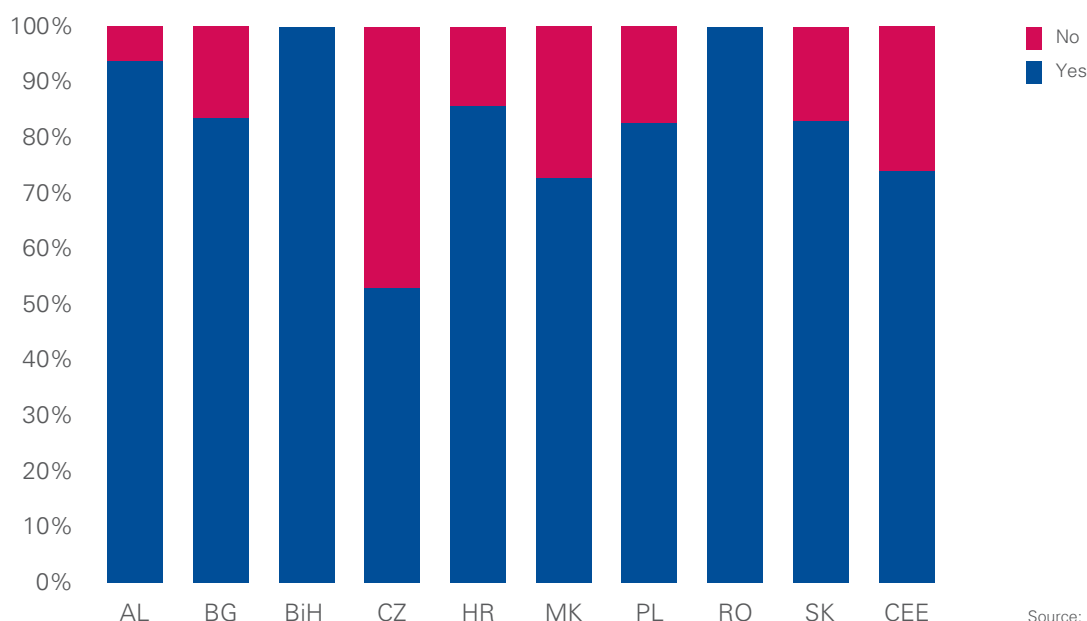


Shadow economy remains an issue

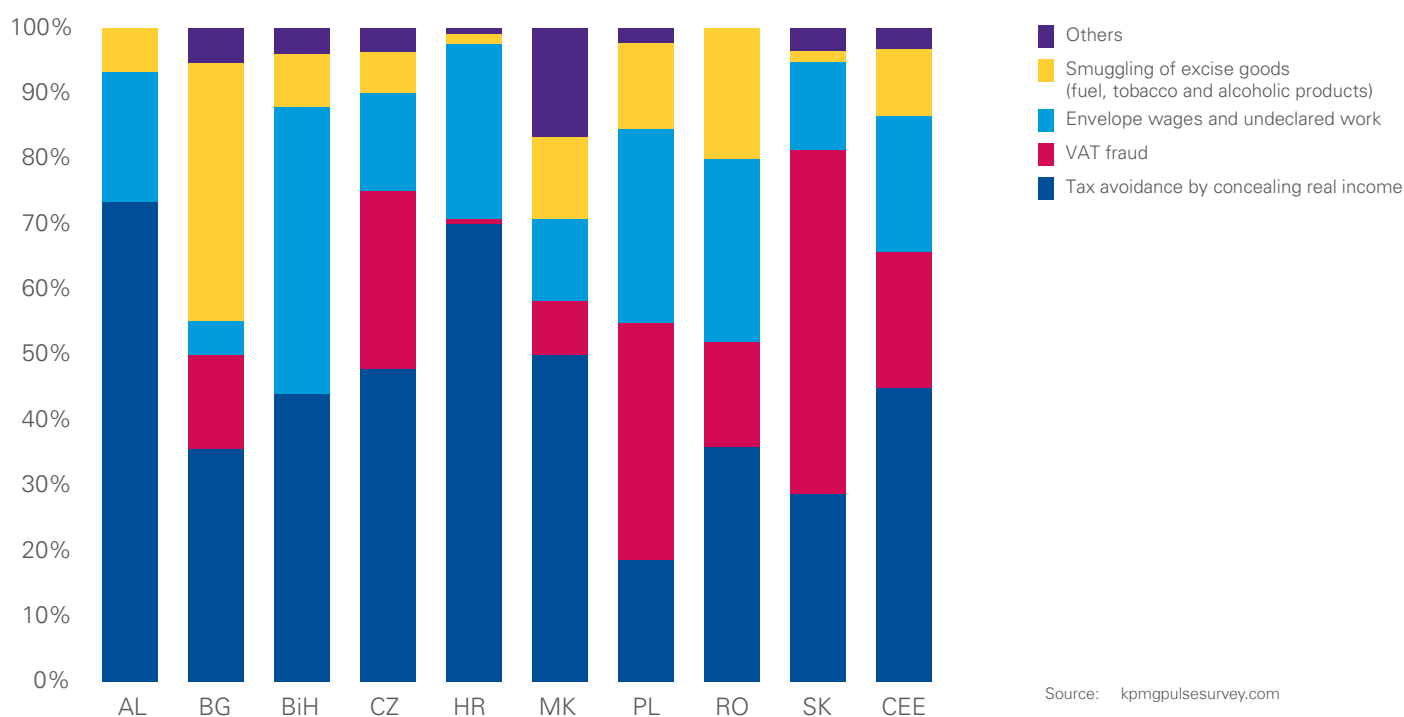
In CEE, 74% of respondents (up from 73% in 2015) indicate that the shadow economy is a problem in their respective countries. Also known as the “grey” economy, it remains the most challenging issue in Bosnia and Herzegovina and Romania (where both received 100% response), while in the Czech Republic the indicator stands at 53%, the lowest in the region.

Forty-five percent of respondents say tax avoidance by concealing real income is the number one problem related to the shadow economy, most often mentioned in Albania (73%) and Croatia (70%), followed by VAT fraud along with envelope wages and undeclared work (21% for both). Smuggling of excise goods (10%) is not an issue in most markets, except for Bulgaria (where it was indicated at a rate of 39%).

Do you think that the shadow economy is a serious issue in your country?



In your opinion, what makes the largest part of the shadow economy in your country?

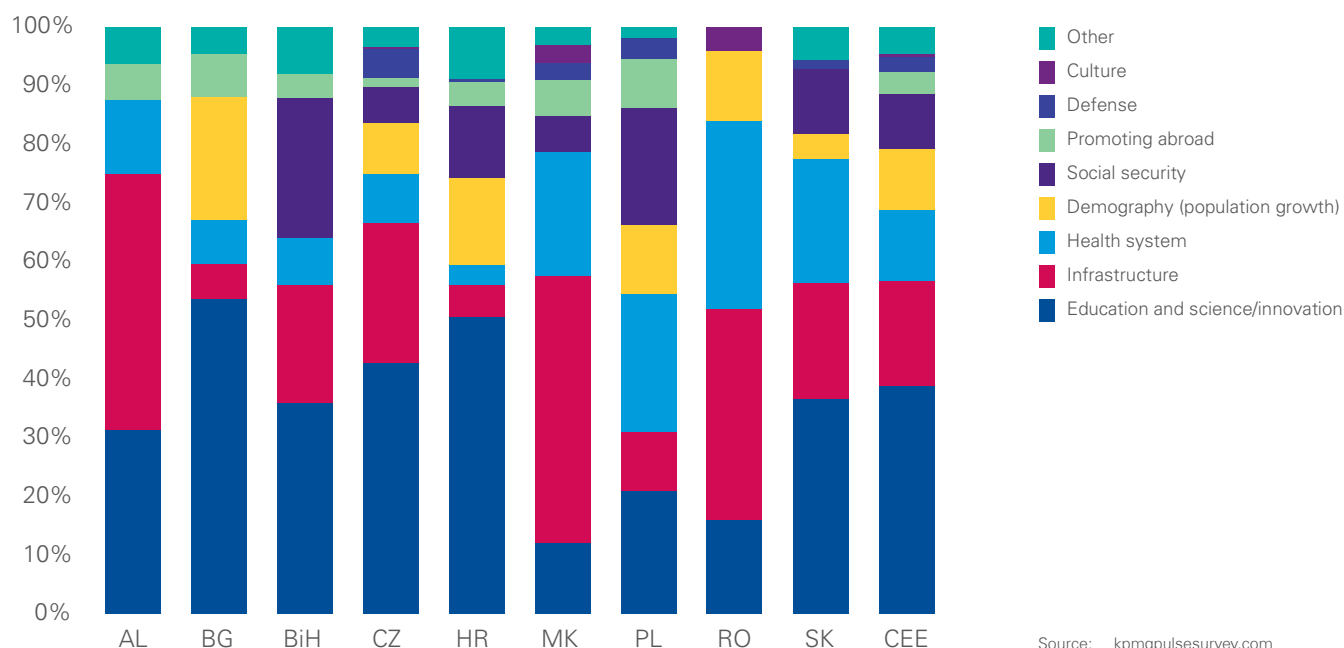


Education, science and innovation as a priority for governments

Education, science and innovation should be the top priority in governments' to-do lists, according to 39% of respondents. This sentiment is the highest in Bulgaria (54%), followed by Croatia (51%) and the Czech Republic (43%). According to business sector, respondents from the insurance industry were most strongly in favor of education, science and innovation (48%), with the other sectors following by a narrow margin.

The sentiment of fostering infrastructure development is supported by 18% of survey participants in CEE, most strongly in Macedonia (45%) and Albania (44%). While only 9% mentioned social security in the region, 20% did in Poland. Culture is rarely seen as a priority, and defense issues and promoting the country were only selected by 4% and 3% of survey participants, respectively.

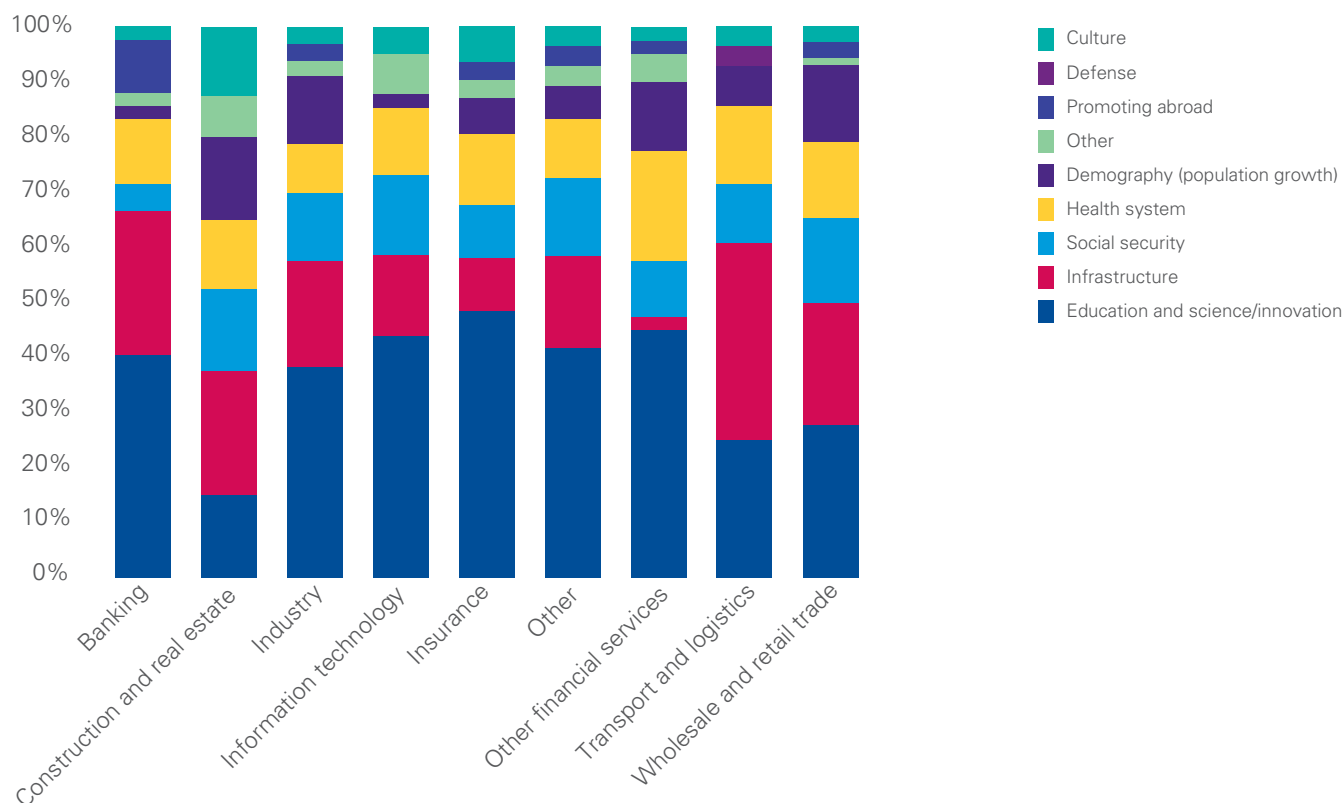
Which area should the government tackle as a priority in your country in the 2017-2019 period?



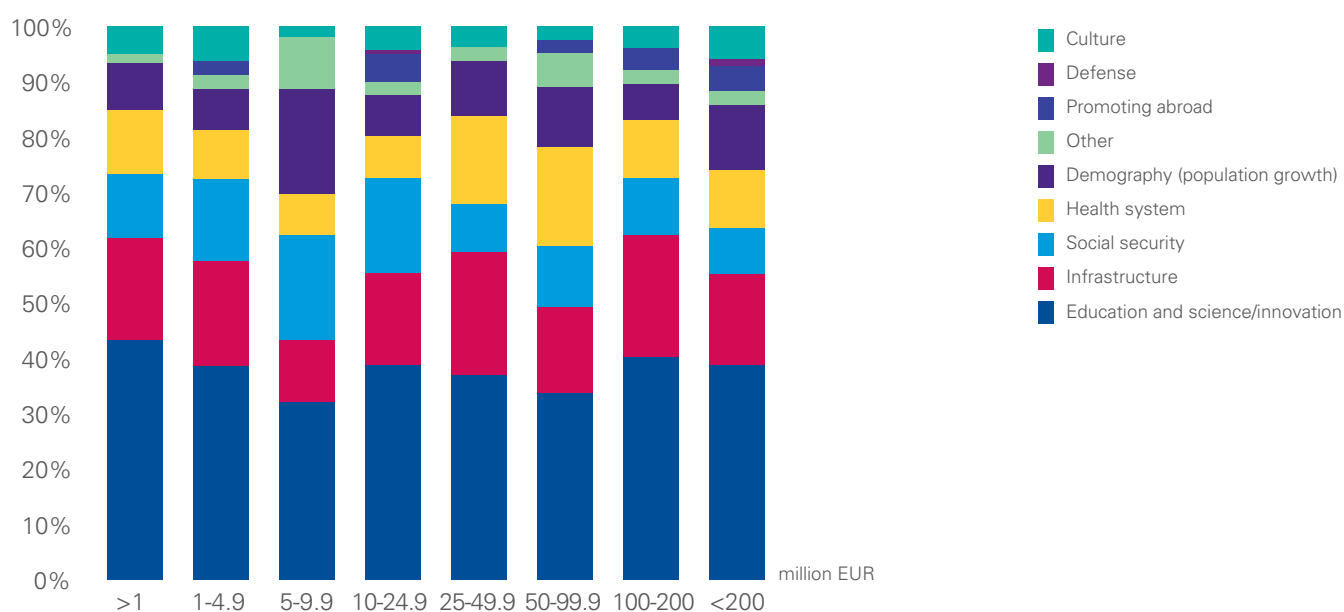
Source: kpmgpulsesurvey.com



By sector



By turnover



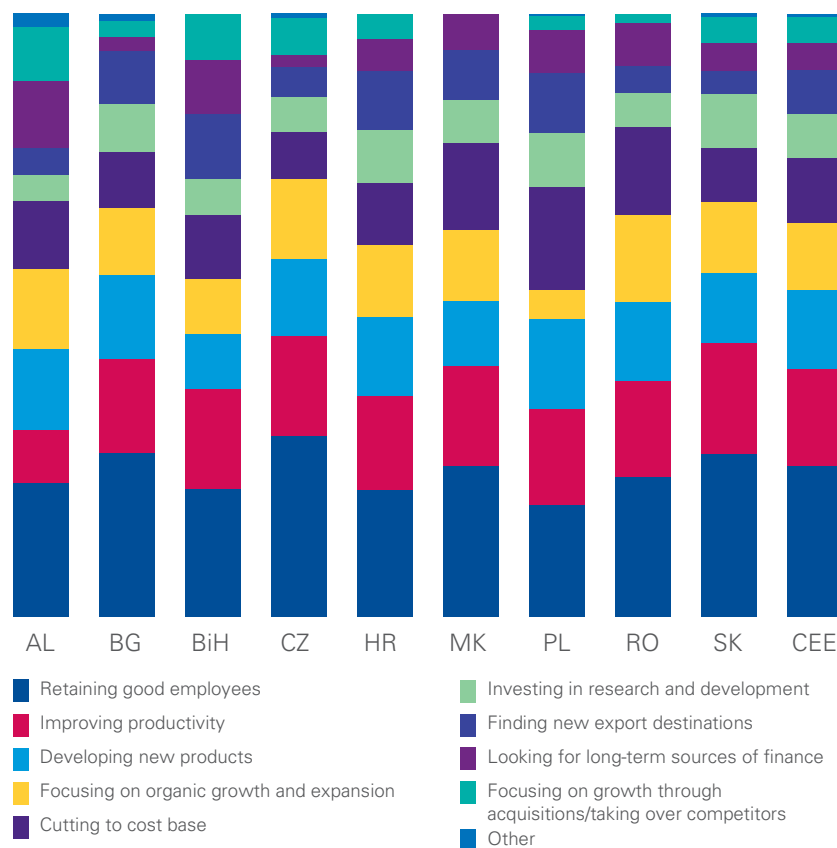


Outlook for enterprise

Companies determined to keep good employees

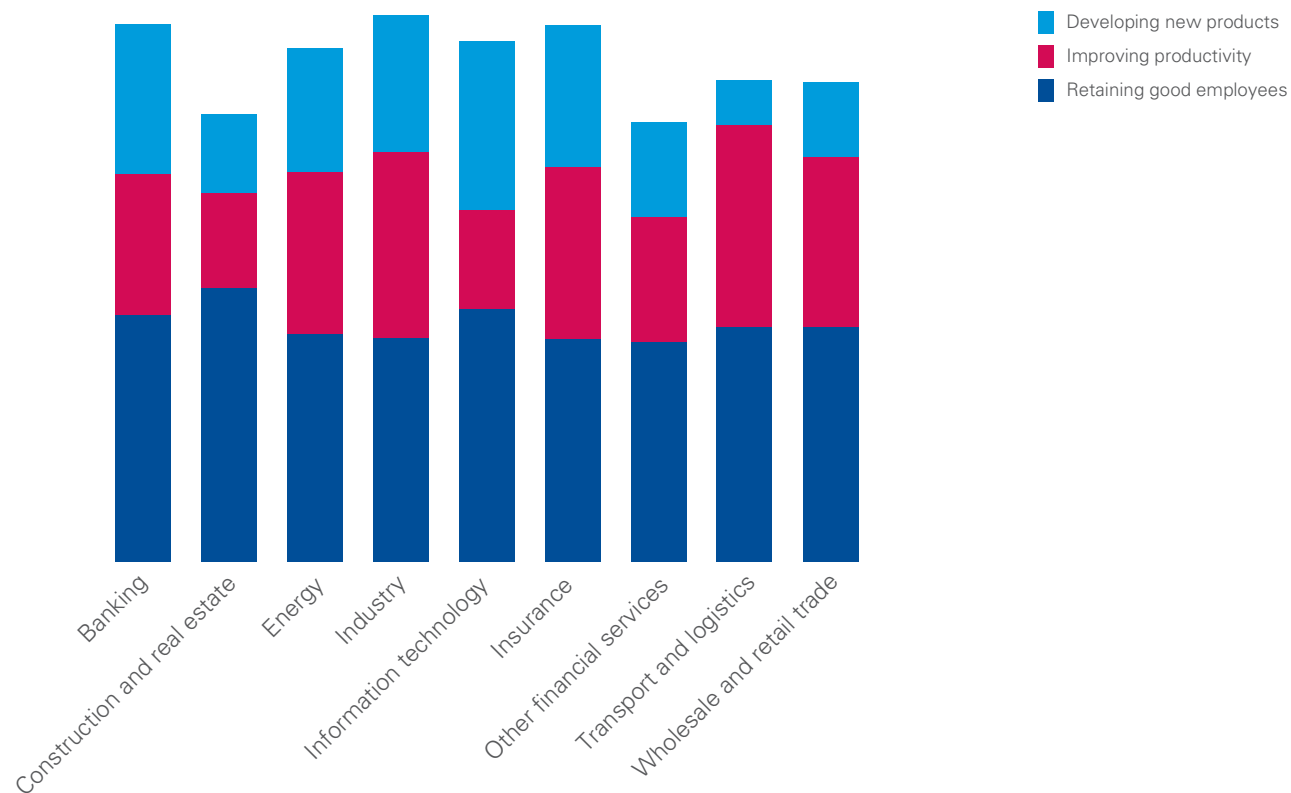
As in 2015, retaining good employees is a key focus area, highlighted by 75% of business leaders, unanimously preferred across all business sectors and turnover segments. Unchanged from the previous year is the runner-up – improving productivity – which received support from 49% of respondents, followed by development of new products (39%) and focus on organic growth and expansion (34%). Cutting the cost base is for Polish respondents (51%) an issue well over the CEE average response rate of 32%. Acquisitions and takeovers is not a relevant field, according to respondents, while neither is the pursuit of long-term sources of finance.

In the current economic situation, what are the three key aspects your company should focus on?

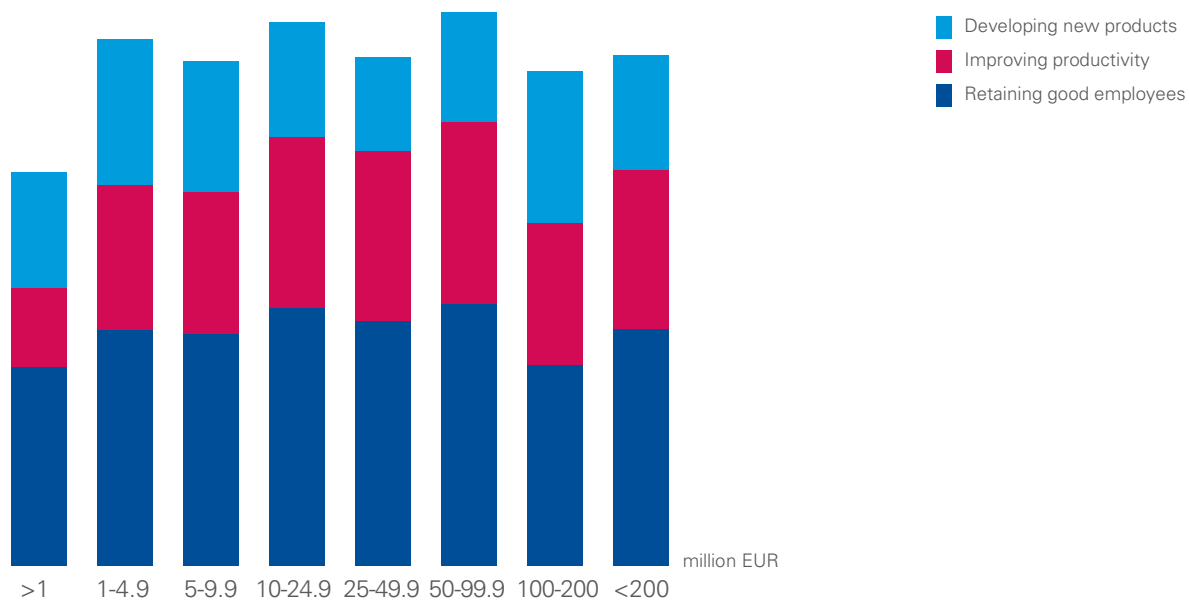


Source: kpmgpulsesurvey.com

By sector



By turnover

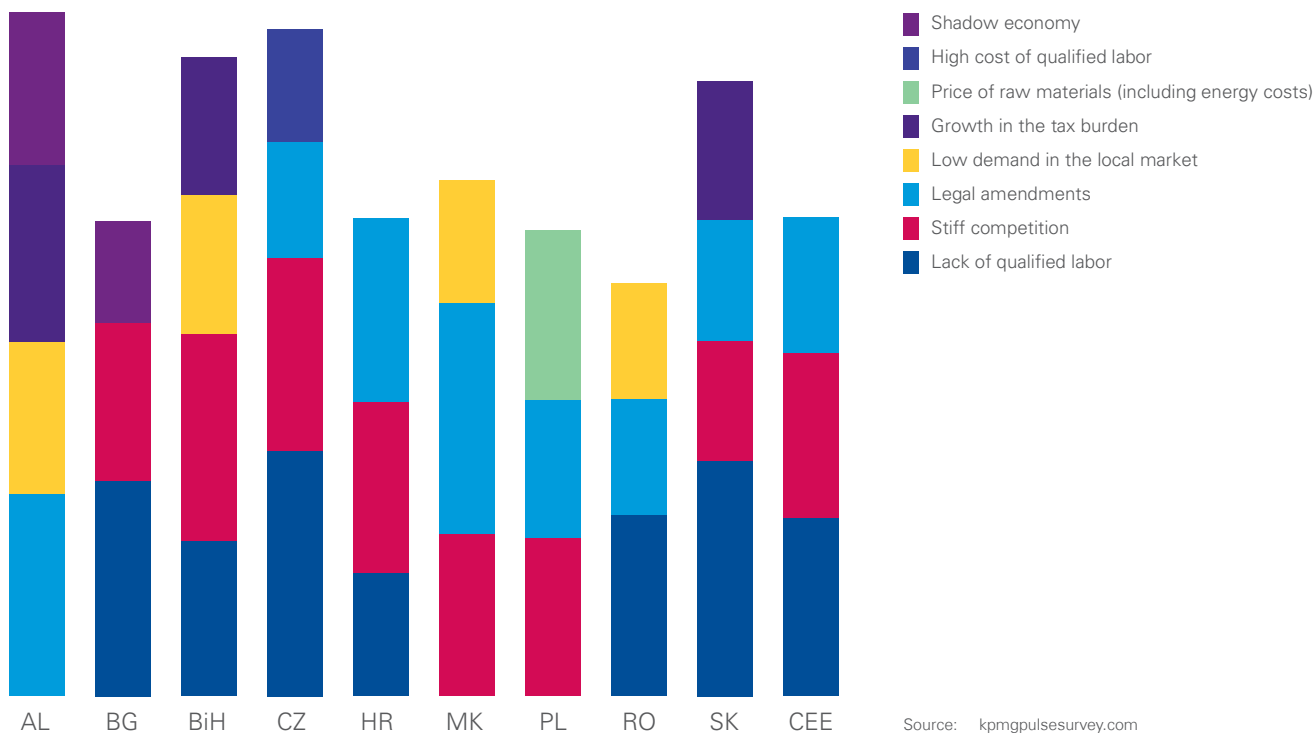


Lack of qualified labor restricts turnover growth

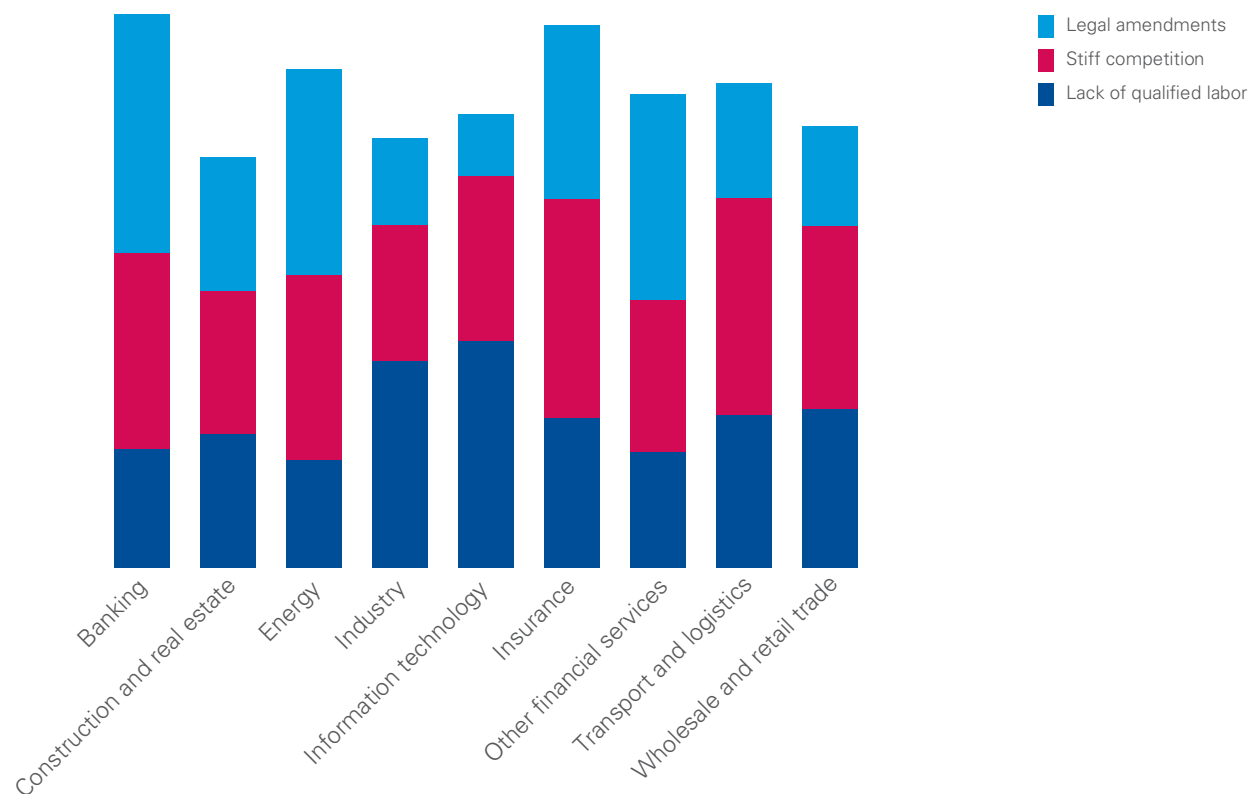
Lack of qualified labor has become the main issue that restricts companies’ turnover growth, with 47% of respondents selecting it – a notable increase from last year’s 36%. It is the most burning issue in the Czech Republic (65%) and Slovakia (62%), while in Albania it was singled out by only 7% of respondents. Leading the list in 2015 at 45%, stiff competition now comes second at 43% and legal amendments are an area indicated by 36%.

Almost unanimously, most vital issues in every country come from the top three categories identified within the CEE ranking, except for Poland where the price of raw materials (45%) is seen as the key issue that restricts turnover growth. According to business sector, the lack of qualified labor is most dramatic in IT (63%), followed by industry (58%).

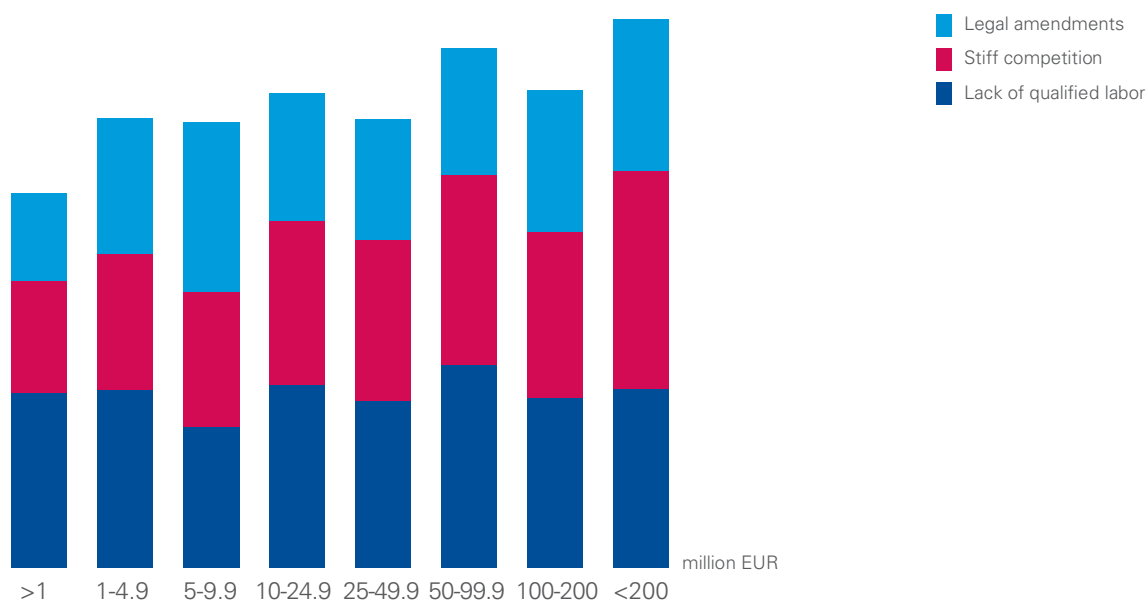
What are the three key issues that you expect will restrict the growth of your company’s turnover through to the end of 2017?



By sector



By turnover



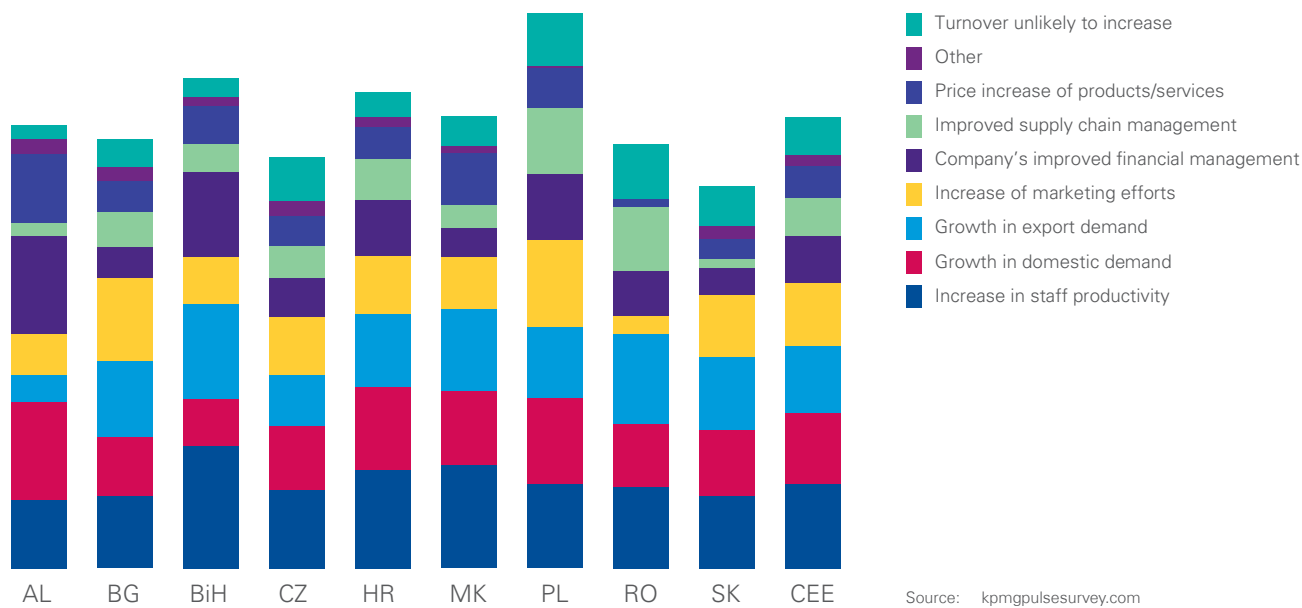
Higher productivity to drive turnover growth

Business leaders in the region believe that higher staff productivity (according to 41% of respondents) will mainly lead to higher turnover, most frequently selected in Bosnia and Herzegovina (59%) and Macedonia (50%), followed by growth in domestic demand (34%) and export demand (32%). Respondents in Albania (47%) and Bosnia and Herzegovina (41%) highlight companies' improved financial management that in the CEE aggregate was indicated by 23% of respondents.

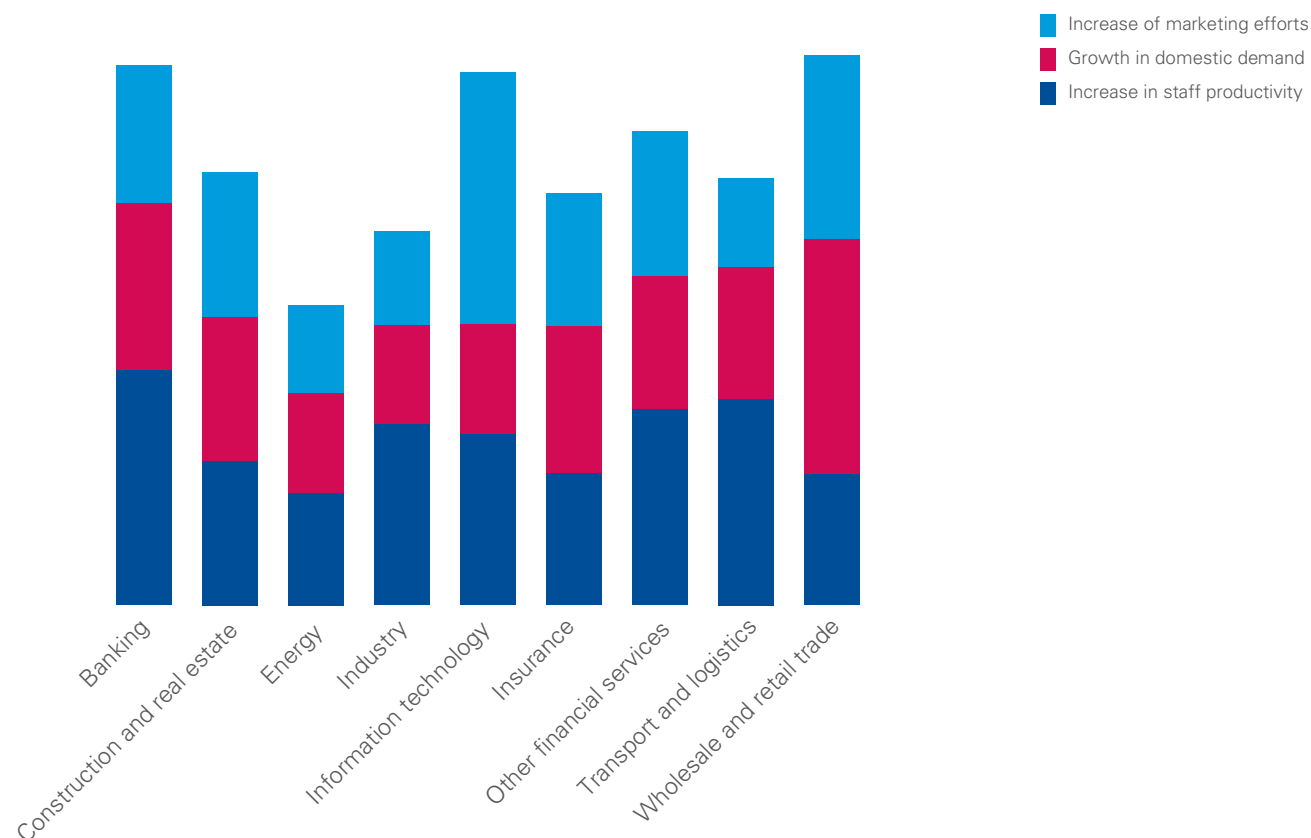
Like in 2015, price increases of products or services are regarded as not helpful for higher turnover, as only 16% on average have chosen this response option. In the banking sector, 57% of respondents chose productivity, the highest number across the sectors, while in insurance and energy it is not deemed as crucial.

On average, 18% of CEE respondents do not see turnover growth in 2017, the share of such responses being the highest in Romania (26%) and Poland (25%).

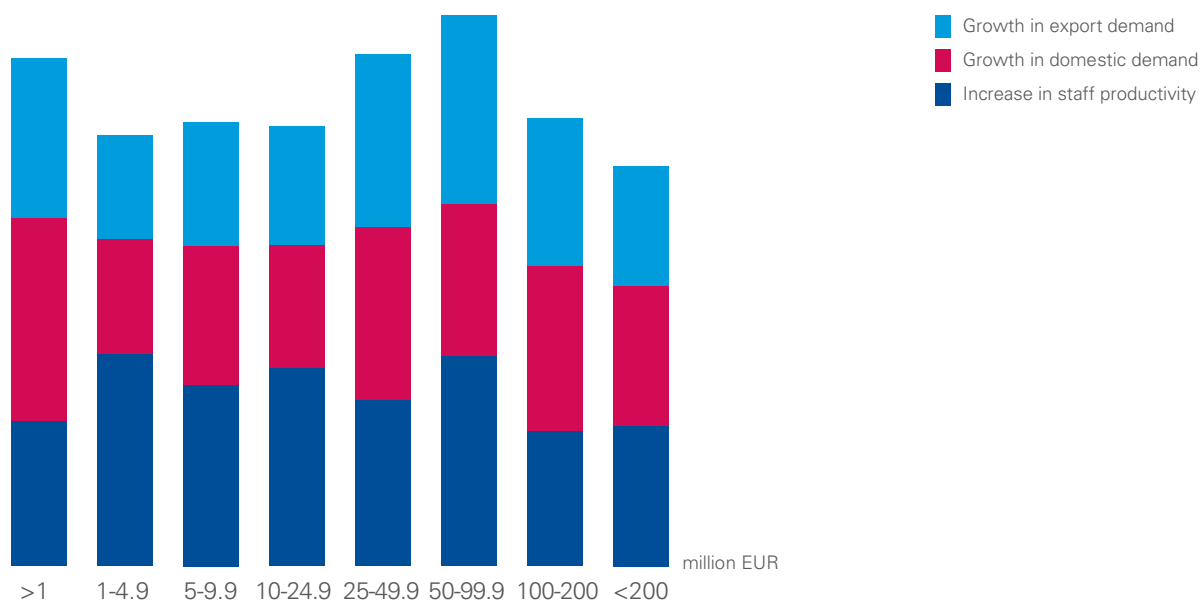
What are the main drivers of your company's turnover growth in 2017?



By sector



By turnover



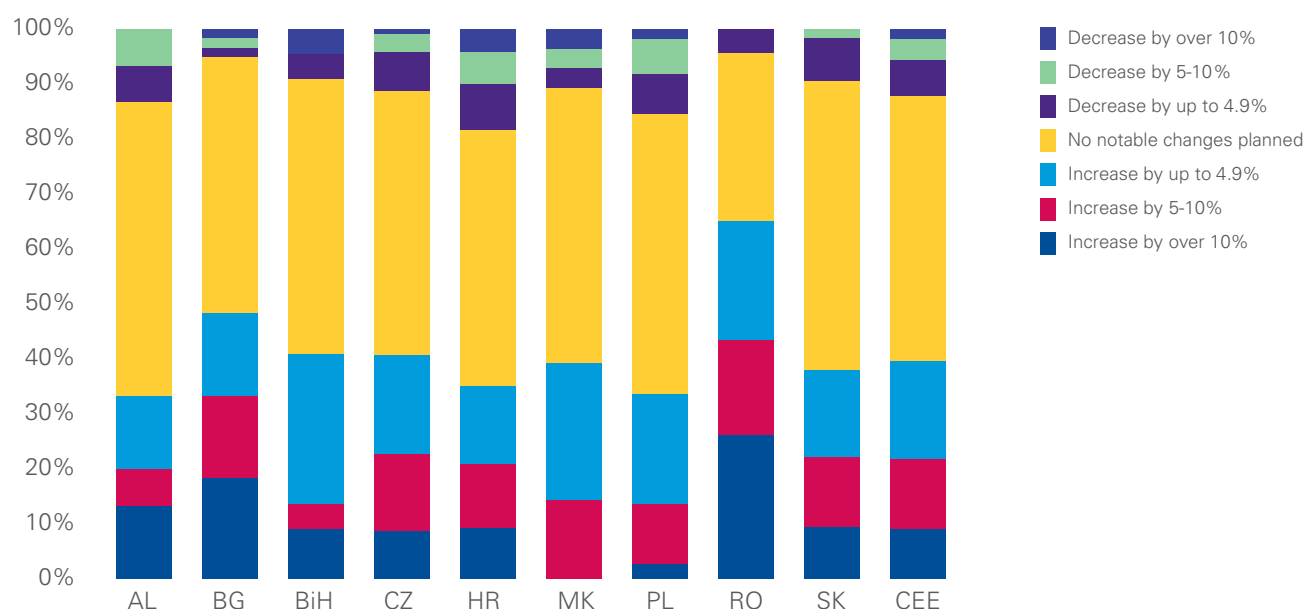


About 40% of companies increasing staff in near future

The CEE average of companies planning to increase headcount during the next 12 months stands at 40% (slightly up from last year's 36%), the average boosted by Romania (65%) and Bulgaria (48%). Only 13% expect staff numbers to fall, most strongly in Croatia (18%) and in Poland (15%). Of CEE respondents, 48% do not plan any notable changes in employee numbers in the short term.

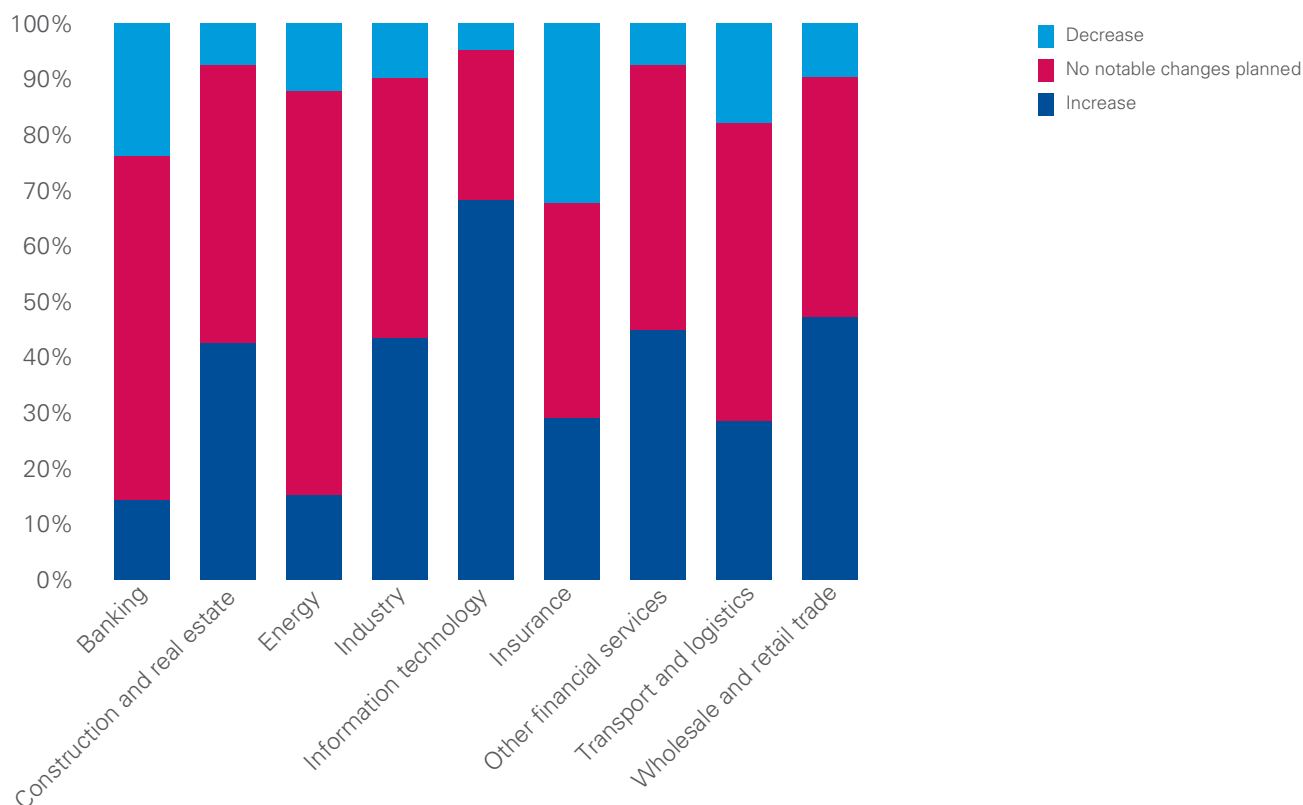
By sector, not surprisingly 68% of respondents in IT admit they intend to hire, but that sentiment is not the same in banking (14%) or the energy (15%) sectors. About one-third in the insurance sector plan to reduce staff. Considering staffing needs according to company sales, 58% of firms with annual turnover of up to EUR 1m are planning to increase headcount, while only 25% in the group of over EUR 200m plan to do the same.

How do you expect your organization's headcount will change over the next 12 months?

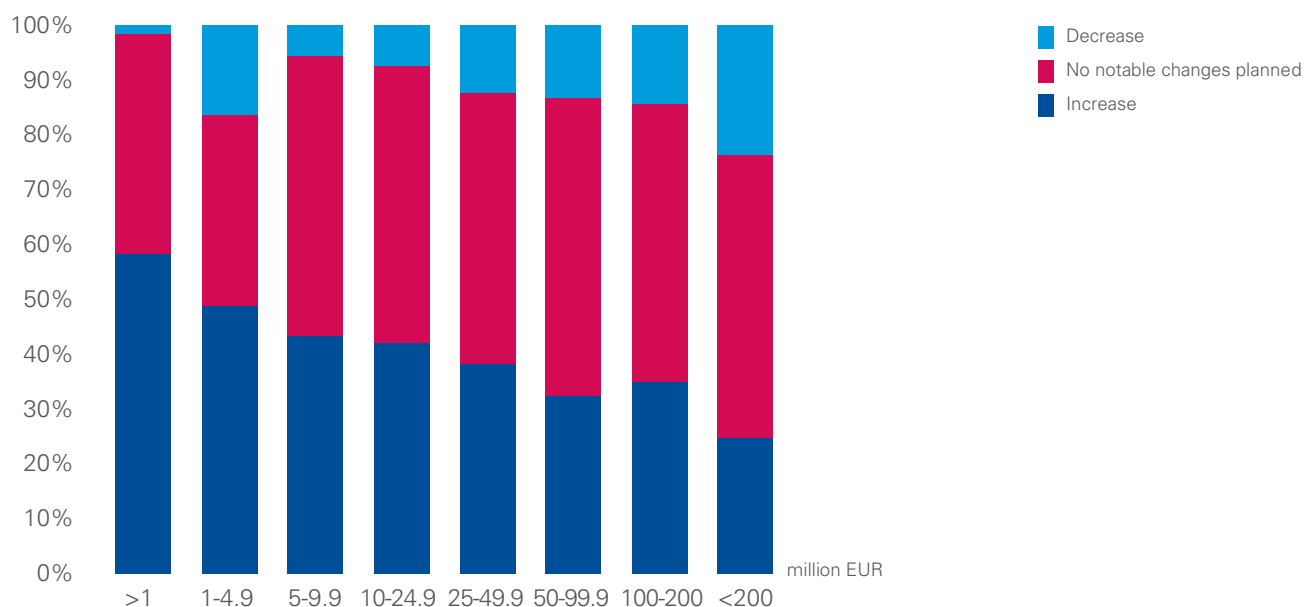


Source: kpmgpulsesurvey.com

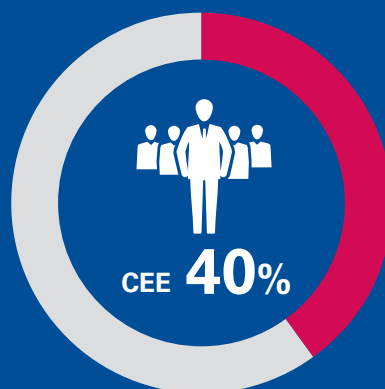
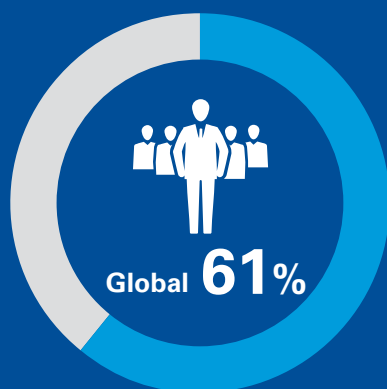
By sector



By turnover



CEE vs. Global: headcount change in span of 12 months

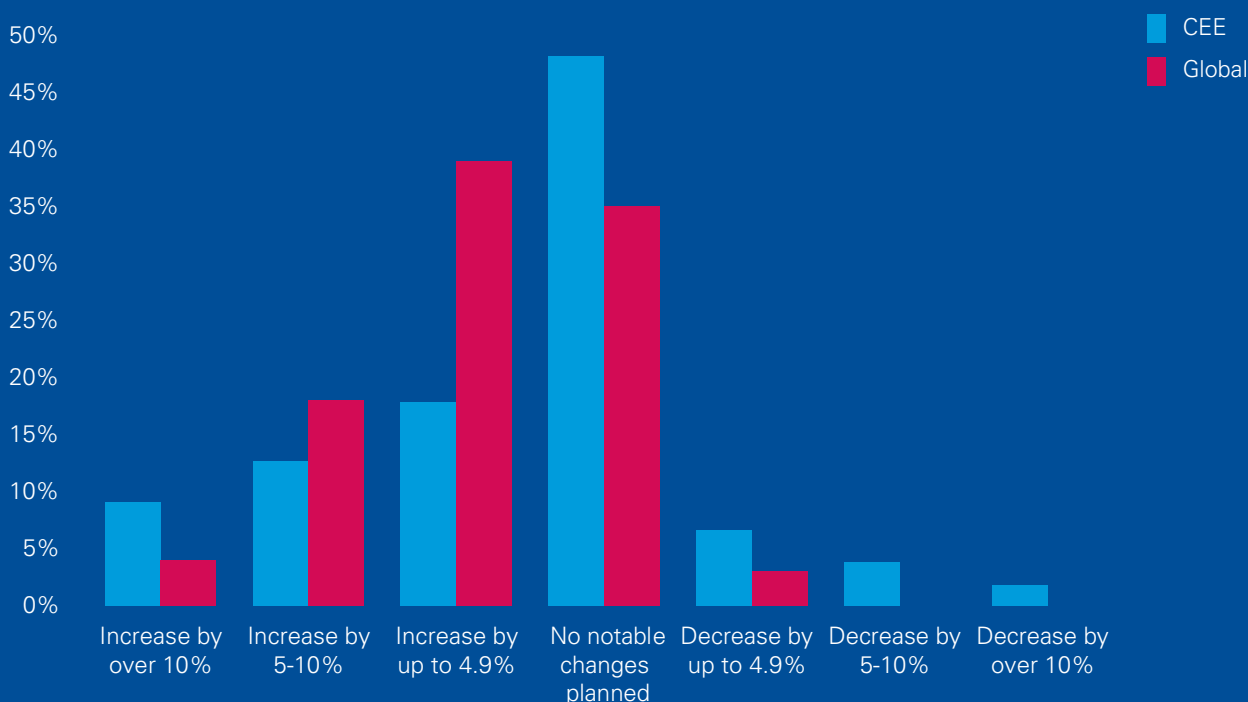


Sources: 2016 Global CEO Outlook, KPMG International
The Pulse of the Economy 2016, KPMG in CEE

Global business leaders expect to hire more actively in the short-term than their counterparts in CEE, the percentages being 61% vs. 40%.

Globally, 39% of the headcount change will be under the 5% mark. Decreasing headcount would be a very rare occurrence in the next 12 months.

How do you expect your organization's headcount will change over the next 12 months?

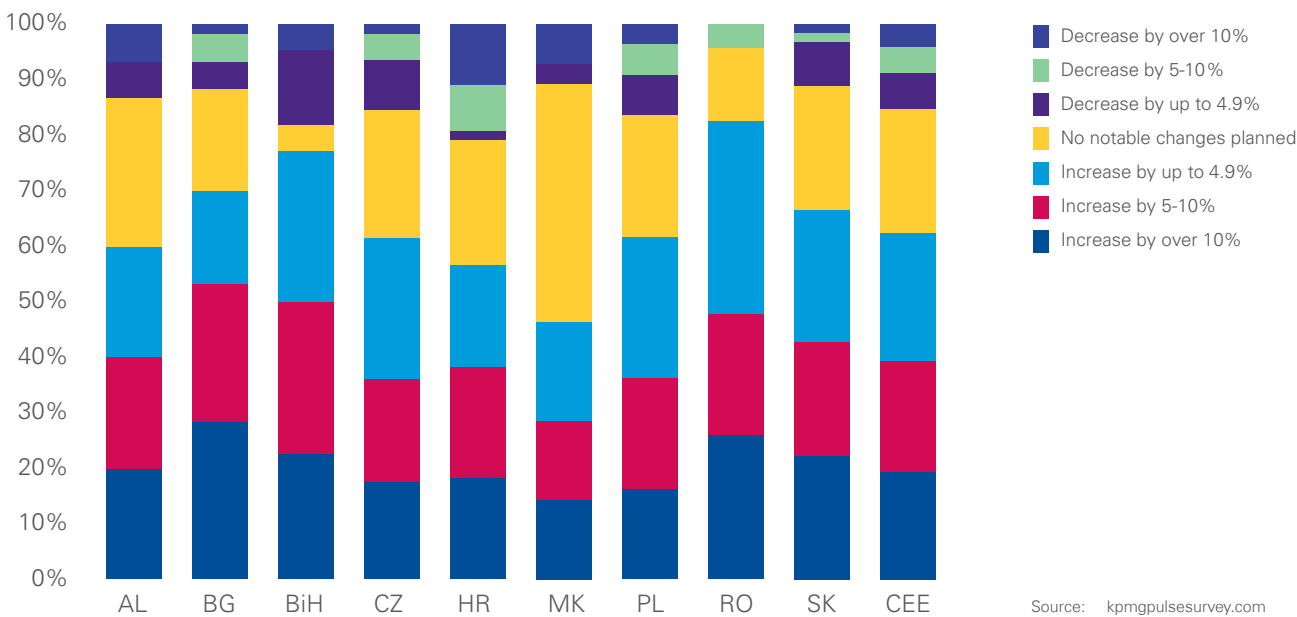


Sources: 2016 Global CEO Outlook, KPMG International
The Pulse of the Economy 2016, KPMG in CEE

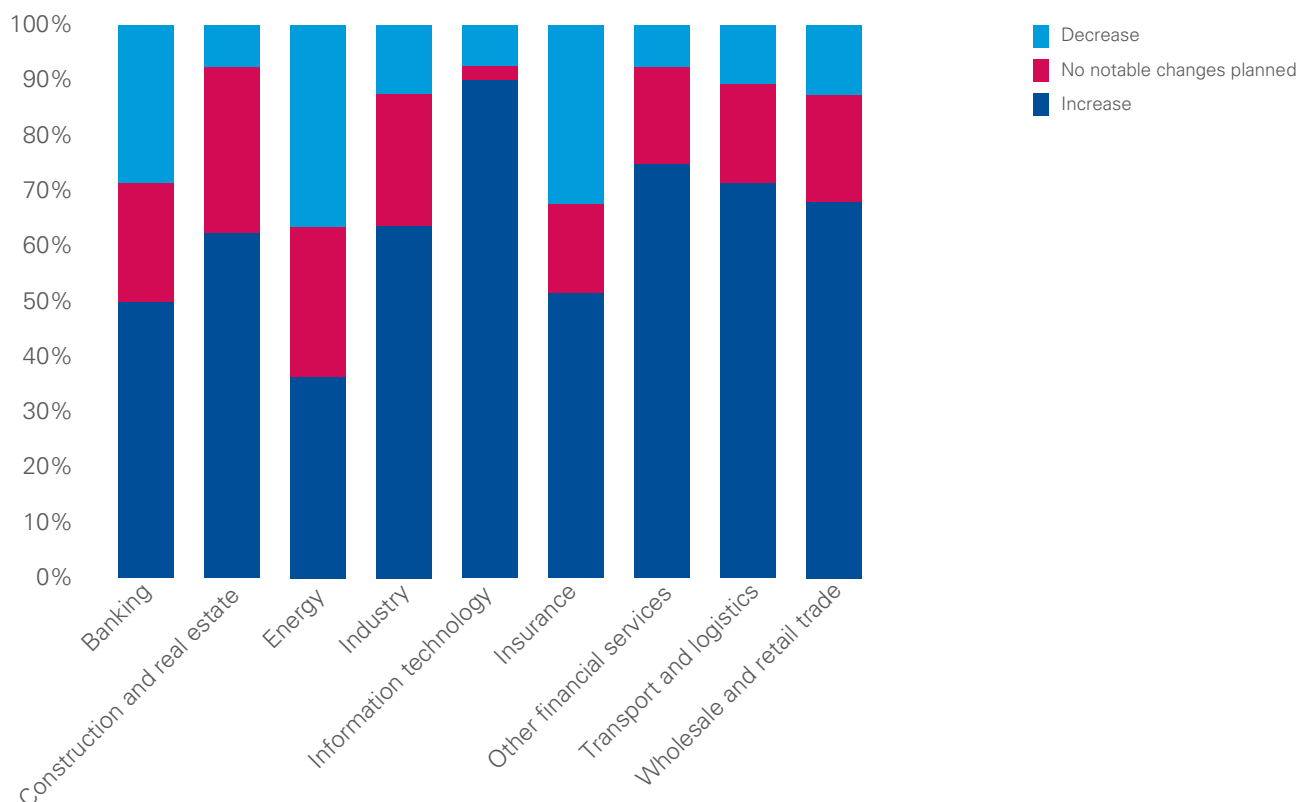
Stronger hiring in next 3 years

Sixty-two percent of CEE respondents say they plan to increase headcount in the following 3 years, with only 15% expecting lower staff numbers. Enterprises in Romania (83%) and Bosnia and Herzegovina (77%) plan to hire most actively. Lower staff numbers are expected in the CEE by 15% of respondents, on average – by 21% in Croatia, and 19% in Bosnia and Herzegovina.

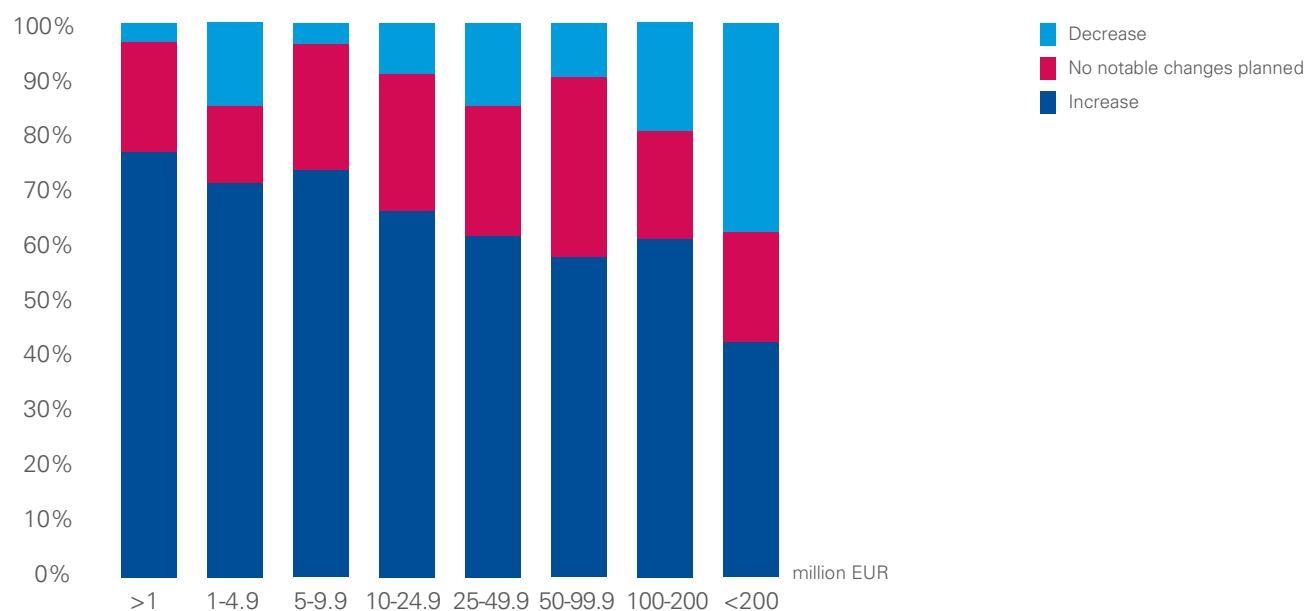
How do you expect your organization’s headcount will change over the next 3 years?



By sector



By turnover



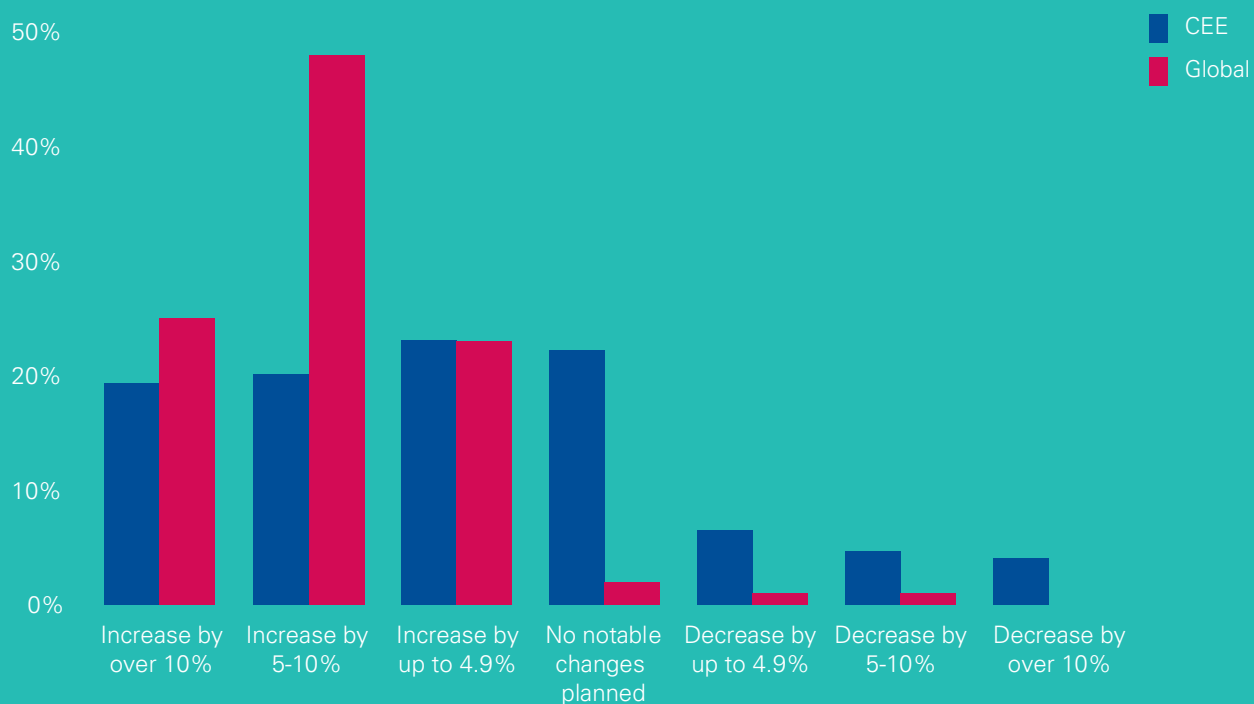
CEE vs. Global: headcount change in span of 3 years



Practically unanimously (96% of the sample) global business leaders expect to increase staff over the next 3 years.

The same intention is expressed by 62% in CEE. Globally, the most likely headcount growth will be about 5-10% of staff, as indicated by 48% of respondents.

How do you expect your organization's headcount will change over the next 3 years?



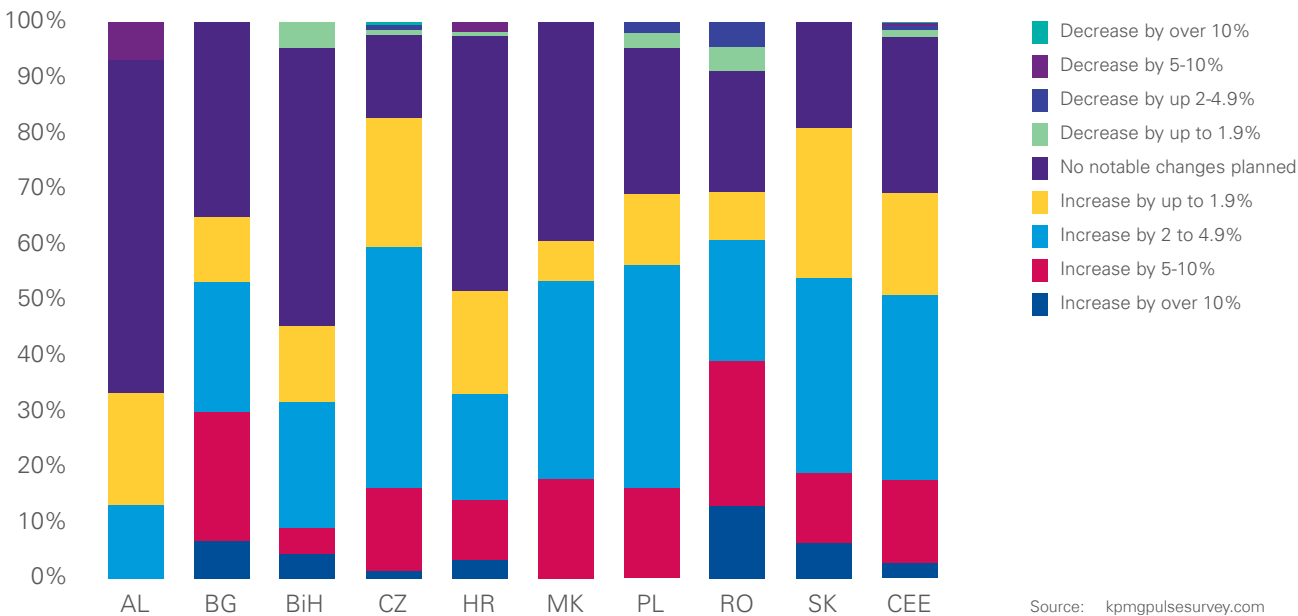
Sources: 2016 Global CEO Outlook, KPMG International
The Pulse of the Economy 2016, KPMG in CEE

Salaries trending upwards

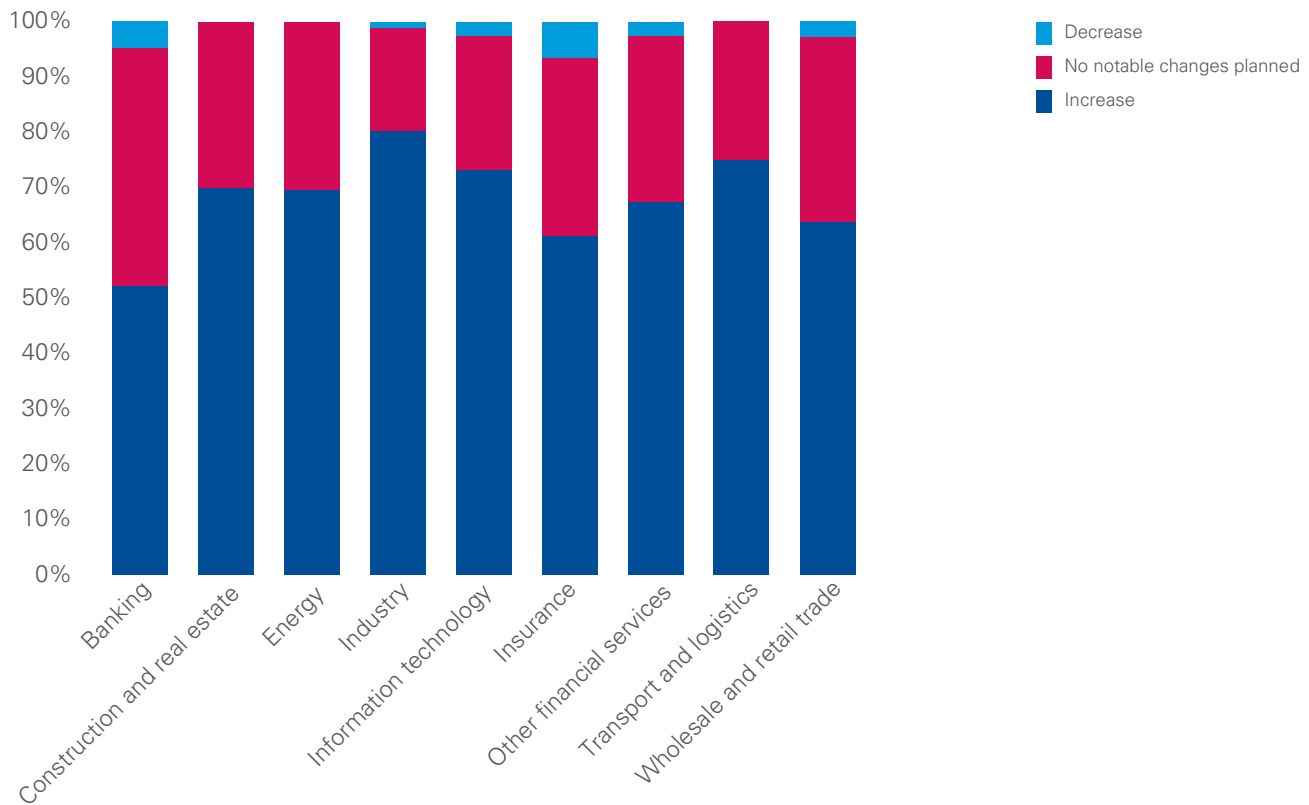
Sixty-nine percent of CEE respondents indicate they intend to raise employee salaries in 2017, clearly up from last year’s 58% and at the same level with survey results from 2014. In the Czech Republic, 83% of respondents predict pay rises, while in Slovakia the corresponding rate is 81%, in Romania 70%, and in Poland 69%. Responses from business leaders in Albania indicate a more conservative approach: 60% of the sample hold that salaries will not change substantially. According to

aggregate results, salary cuts will be rather rare as they are indicated by only 3% of respondents in CEE average. According to a breakdown by sector, industry, transport and logistics and IT belong to the leading group – in all about three-quarters of respondents are planning salary increases – while banking is the most conservative (at 52%).

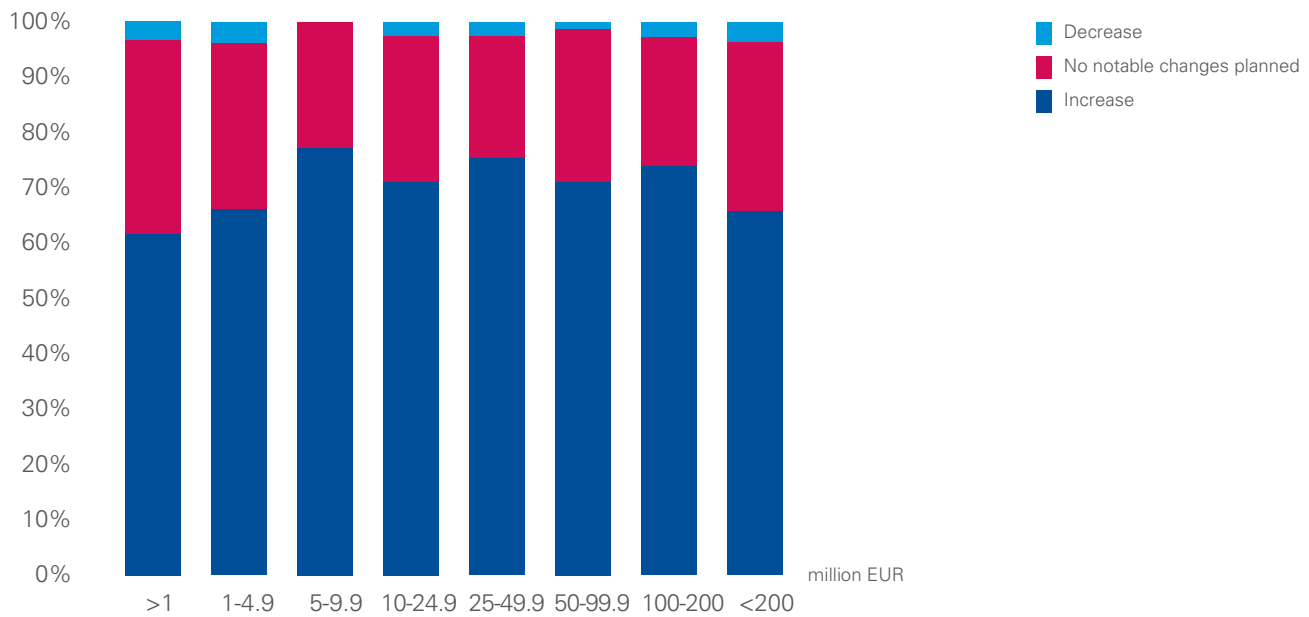
What are your plans regarding employee salaries in your company in 2017?



By sector



By turnover



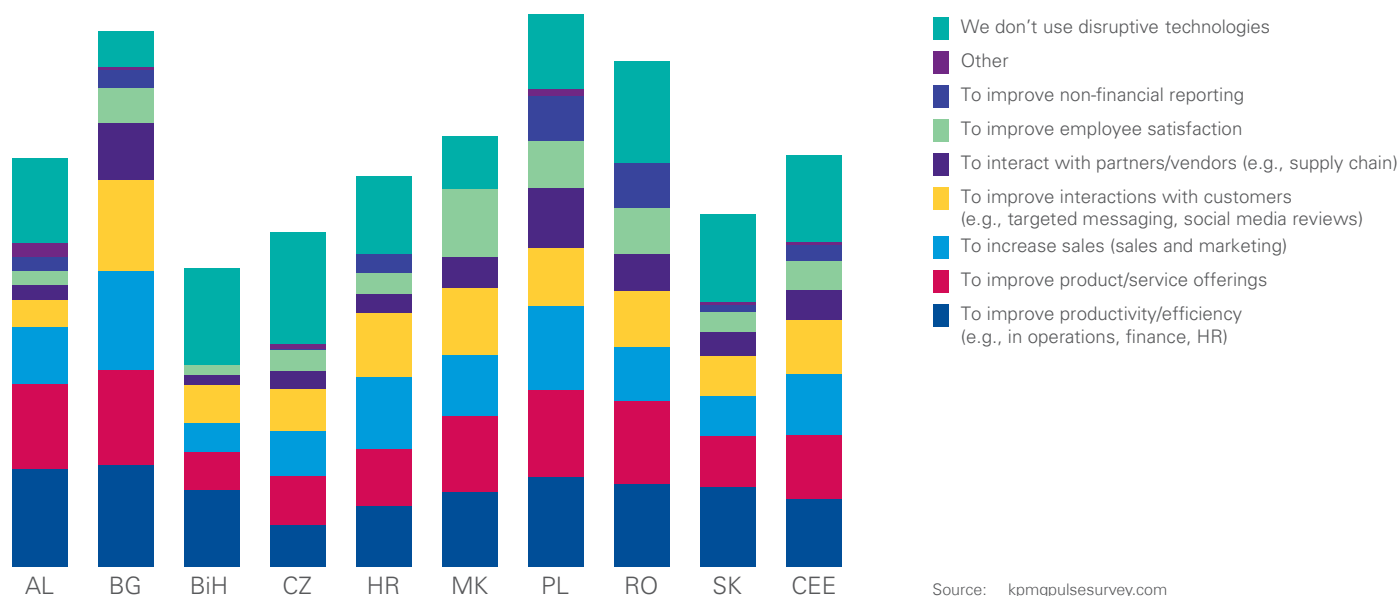


Majority using disruptive technologies

On average in CEE, 59% of respondents are using disruptive technologies and 32% are applying them to improve productivity and efficiency. Thirty percent apply disruptive technologies for improving product and service offerings and 29% for increasing

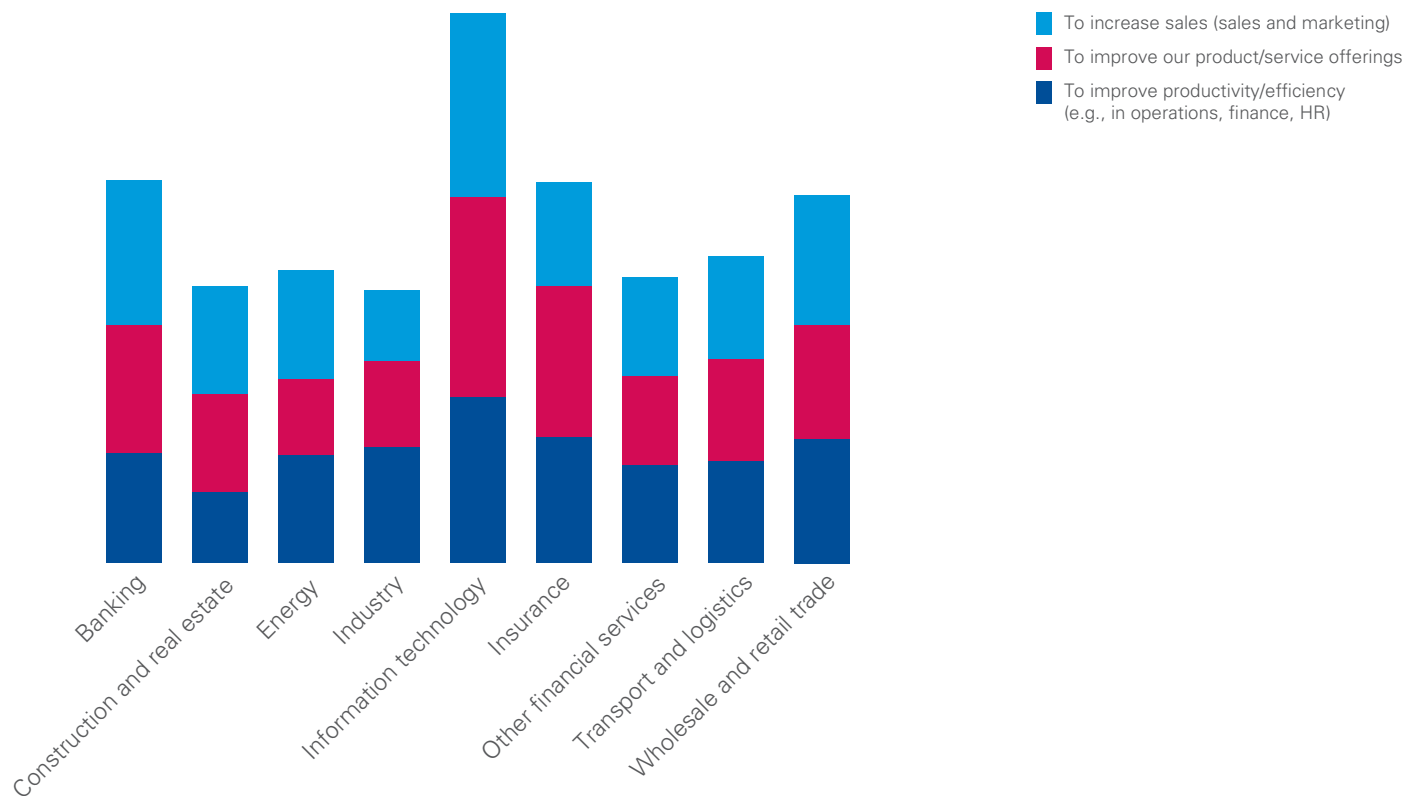
sales. Not surprisingly, the IT sector is most active in this field, followed by banking, insurance and wholesale & retail trade. The survey indicates that the smallest companies are more eager to adopt disruptive technologies.

How does your organization currently make use of disruptive technologies?

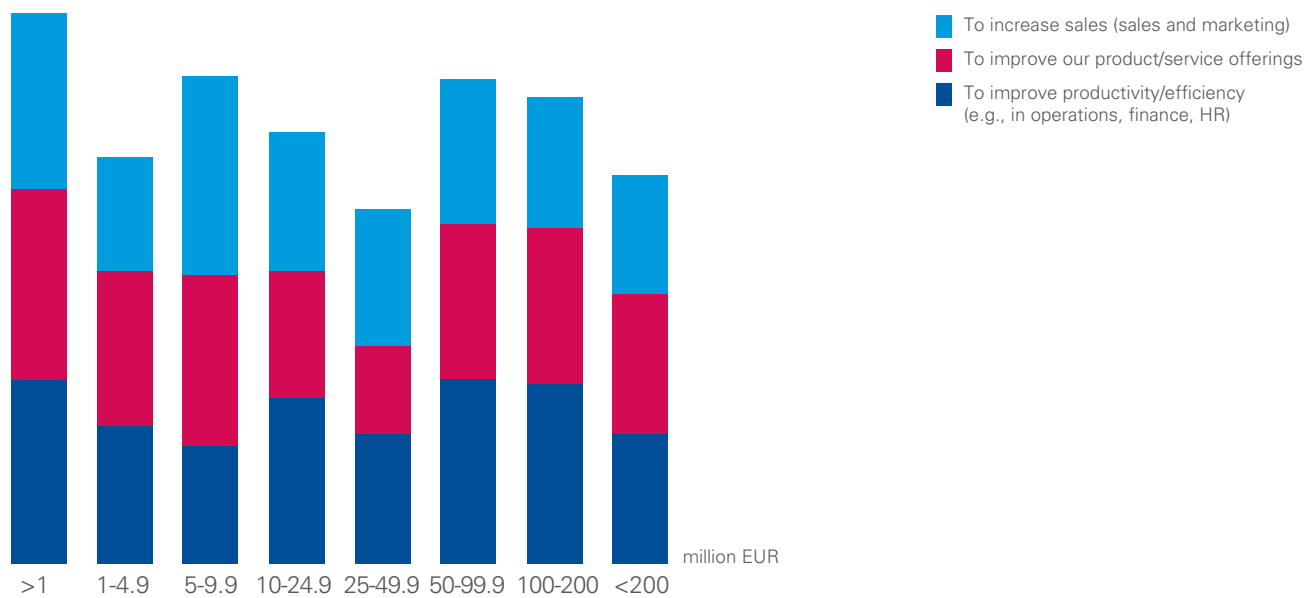


Source: kpmgpulsesurvey.com

By sector



By turnover

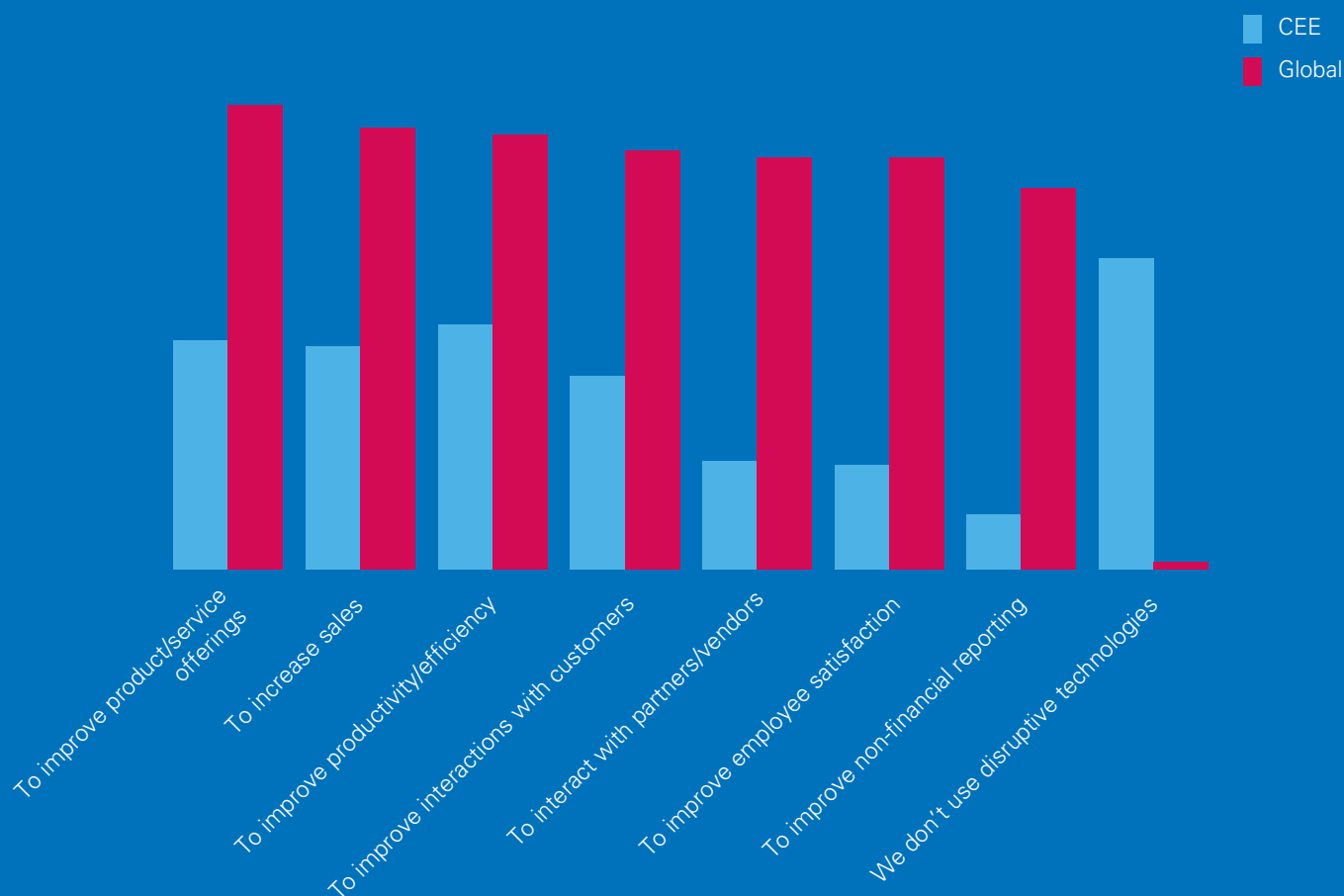


CEE vs. Global: use of disruptive technologies



There is a discrepancy in the use of disruptive technologies: 41% in CEE admit they are not using them, while globally the share of such responses is next to nothing. Global companies are keener to explore the possibilities of disruptive technologies, as in any field at least a half of respondents admit using them.

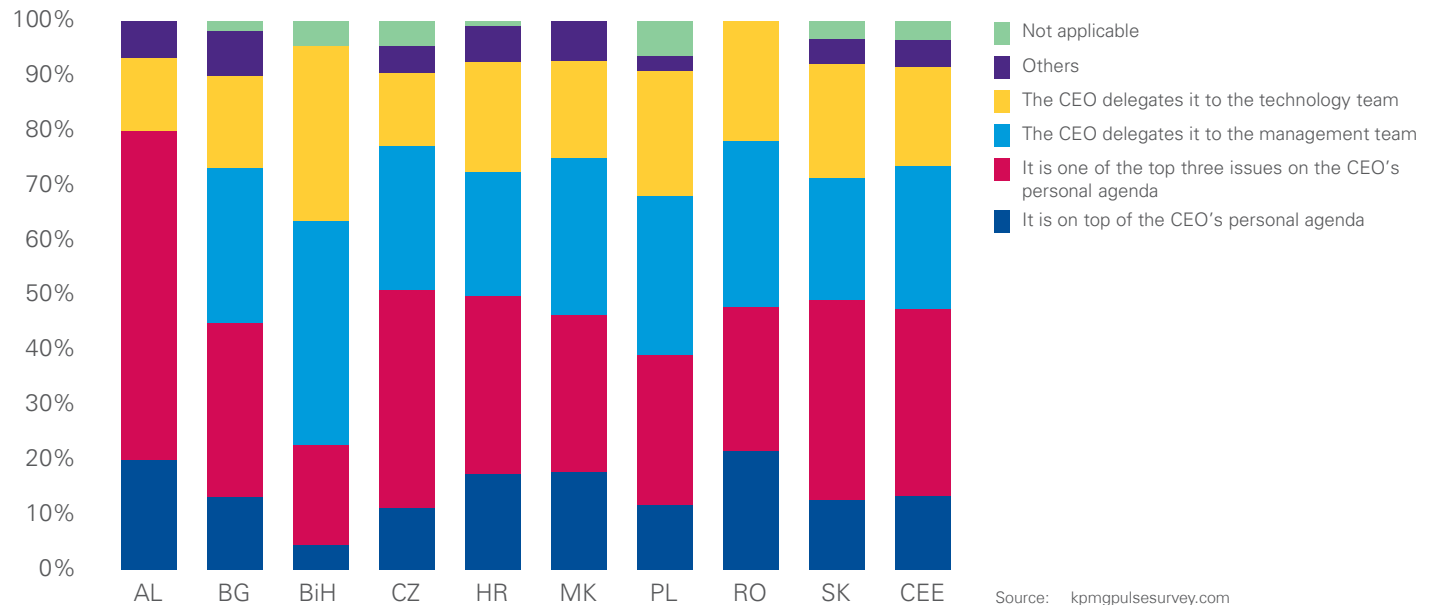
How does your organization currently make use of disruptive technologies?



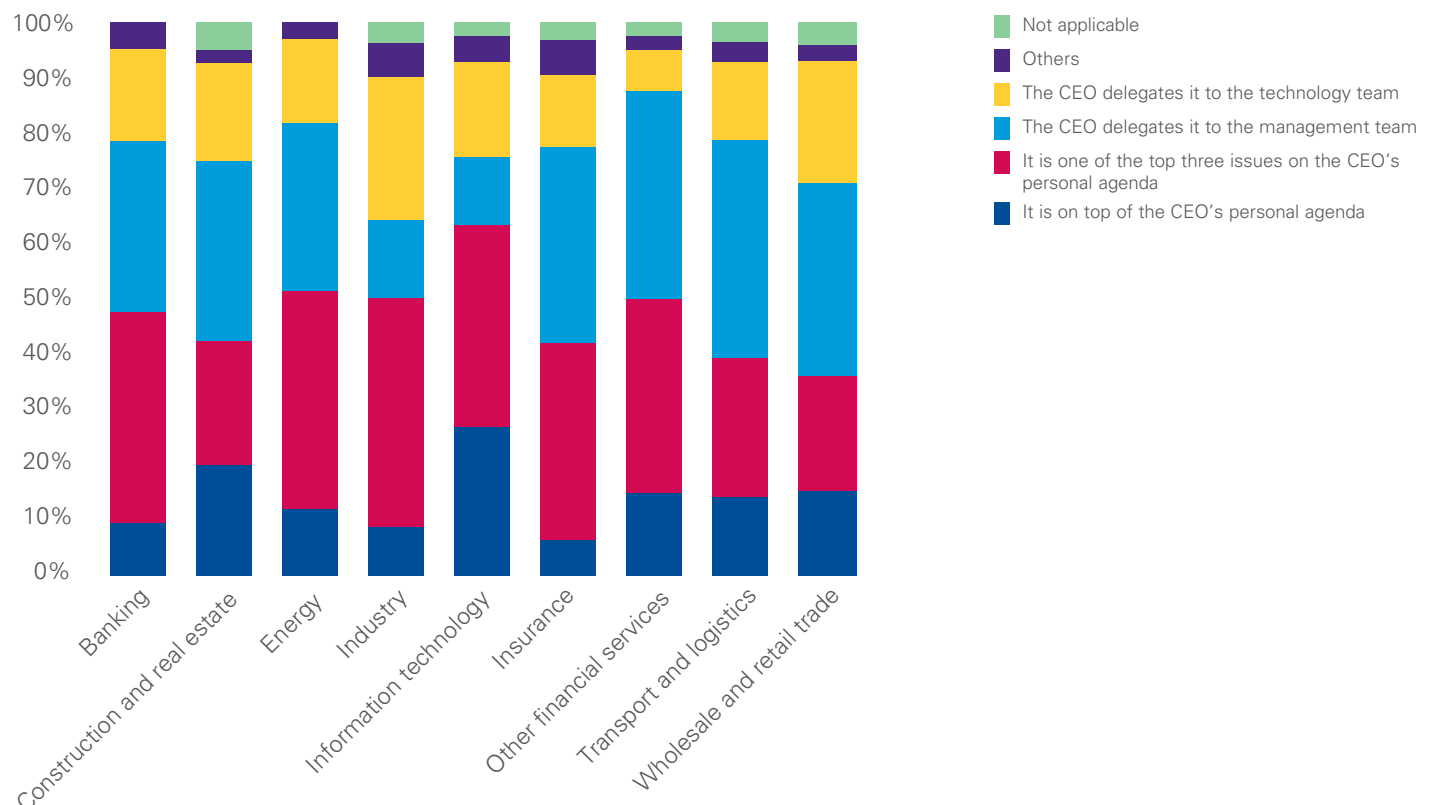
CEOs value innovation

Thirteen percent of CEE respondents reveal that innovation is at the top of their CEO's personal agenda and for 34% it is a top three issue for the CEO, meaning that for almost half of the respondents innovation falls under the CEO's purview. Quite often innovation is delegated to the management team (according to 26%). Innovation is most often at the top of the CEO's personal agenda in IT (27%), followed by construction and real estate (20%).

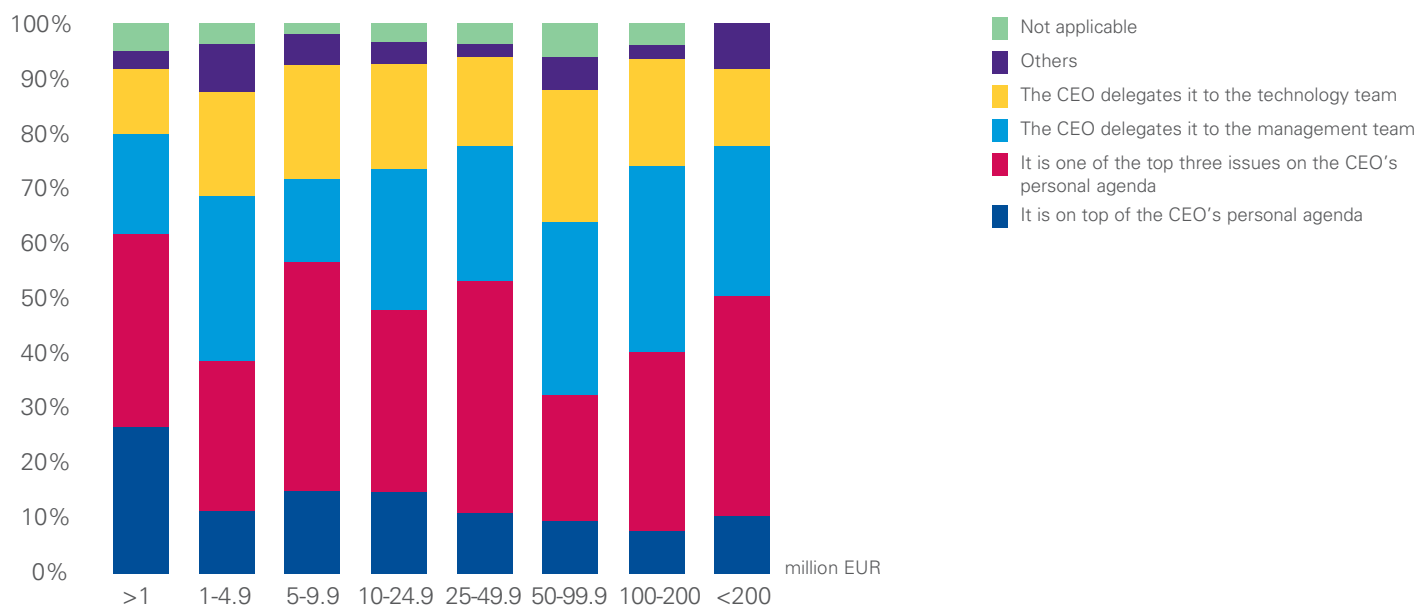
How do you approach innovation in your organization?



By sector

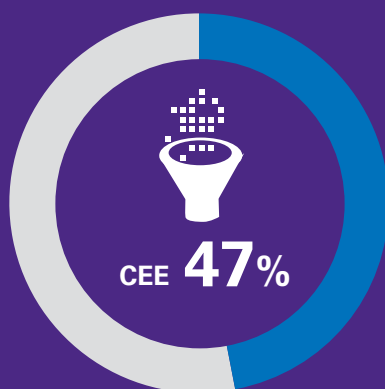
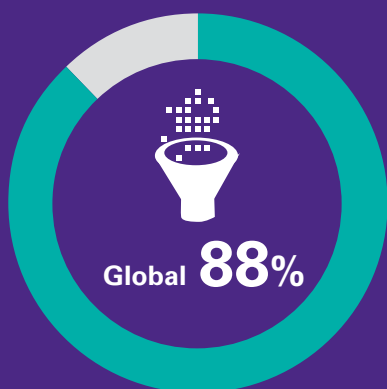


By turnover



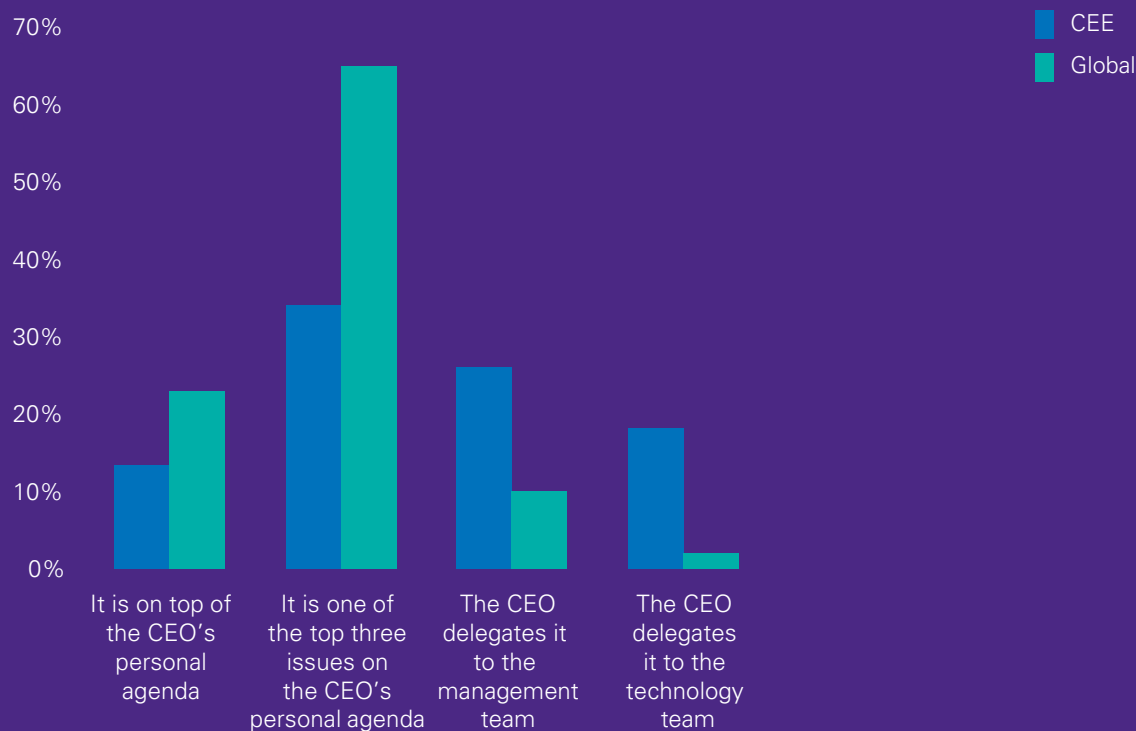
CEE vs. Global: innovation and CEOs

Innovation is a personal, key topic for global CEOs, as 88% refrain from delegating it to management or a technology team, while in CEE the corresponding value is 47%.



Sources: 2016 Global CEO Outlook, KPMG International
The Pulse of the Economy 2016, KPMG in CEE

How do you approach innovation in your organization?



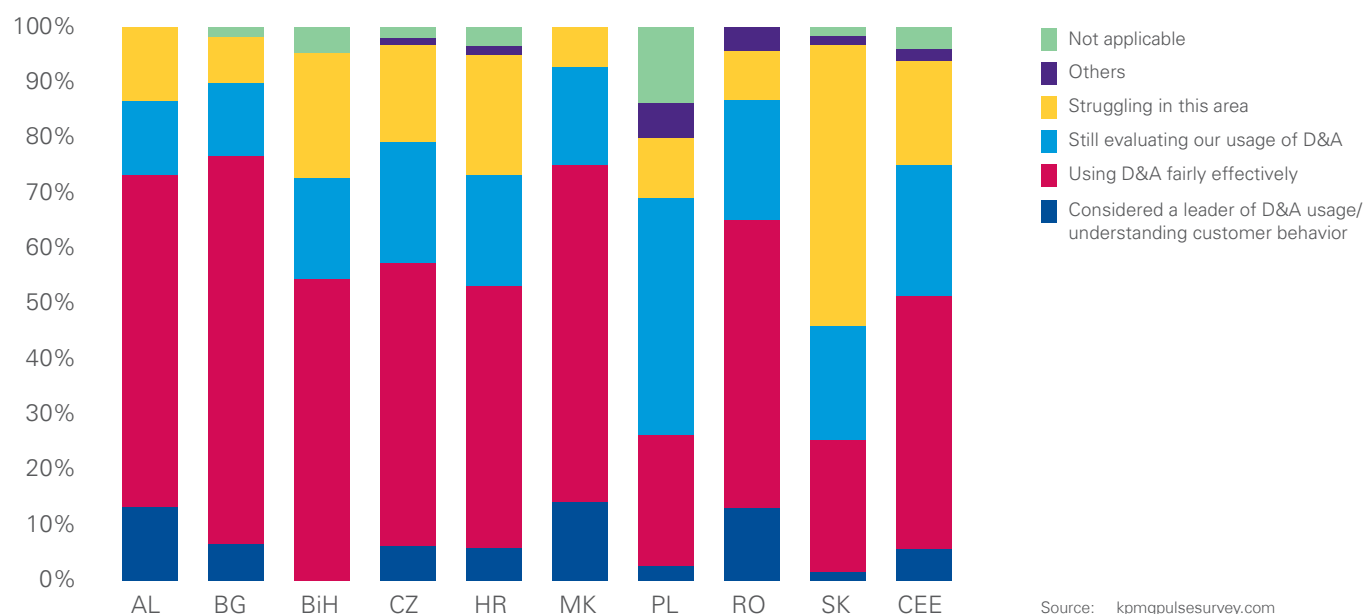
Sources: 2016 Global CEO Outlook, KPMG International
The Pulse of the Economy 2016, KPMG in CEE

Effective use of data and analytics

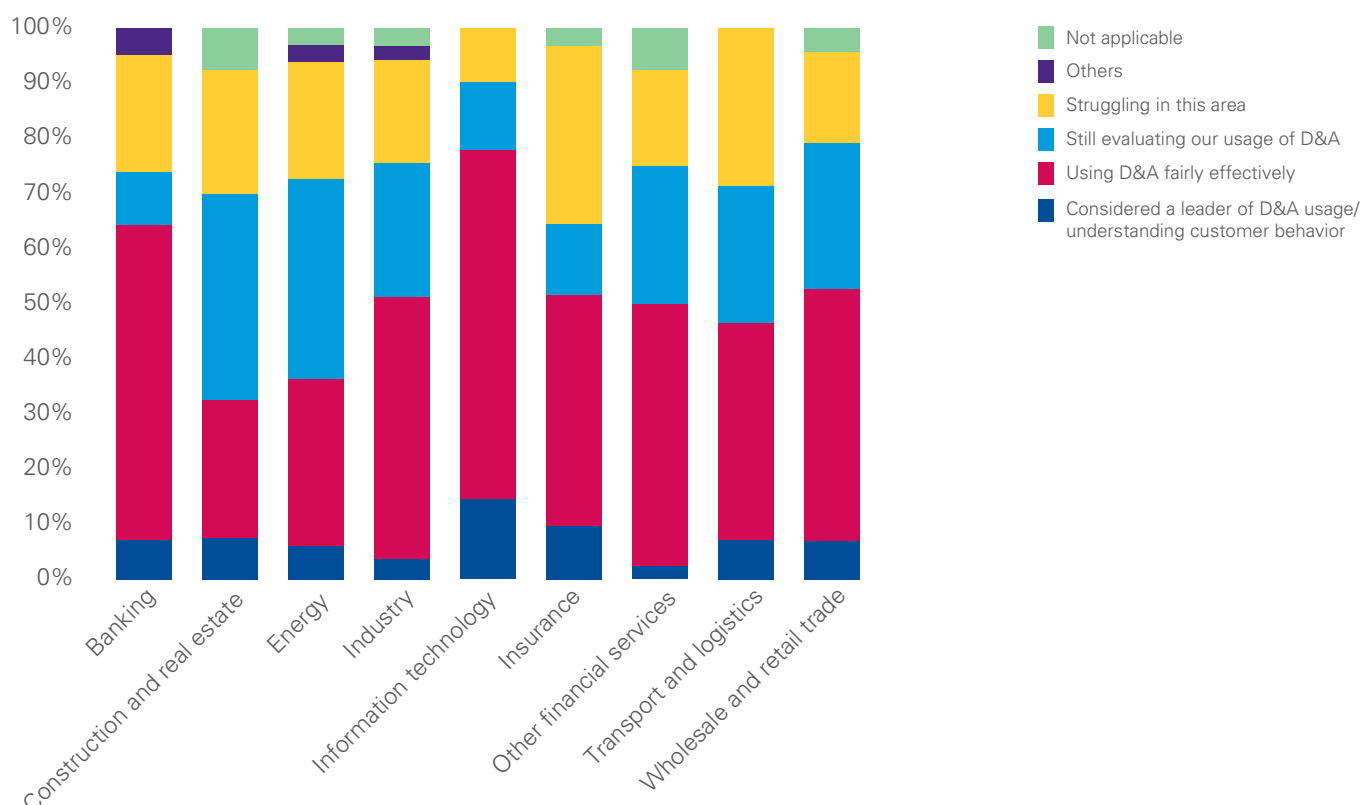
Forty-six percent of respondents in CEE believe that their companies are using data and analytics fairly effectively while 6% consider themselves as a leader, with IT and banking setting the pace in a comparison by sector. However, 19% of companies admit that they are struggling in this field.

Fifty percent of respondents say that data and analytics primarily comprises analysis of existing customers. It is also important for driving process and cost efficiency (according to 42%) and monitoring the market (37%). Remarkably, data and analytics is not often used for spotting fraud (indicated by only 17% of respondents).

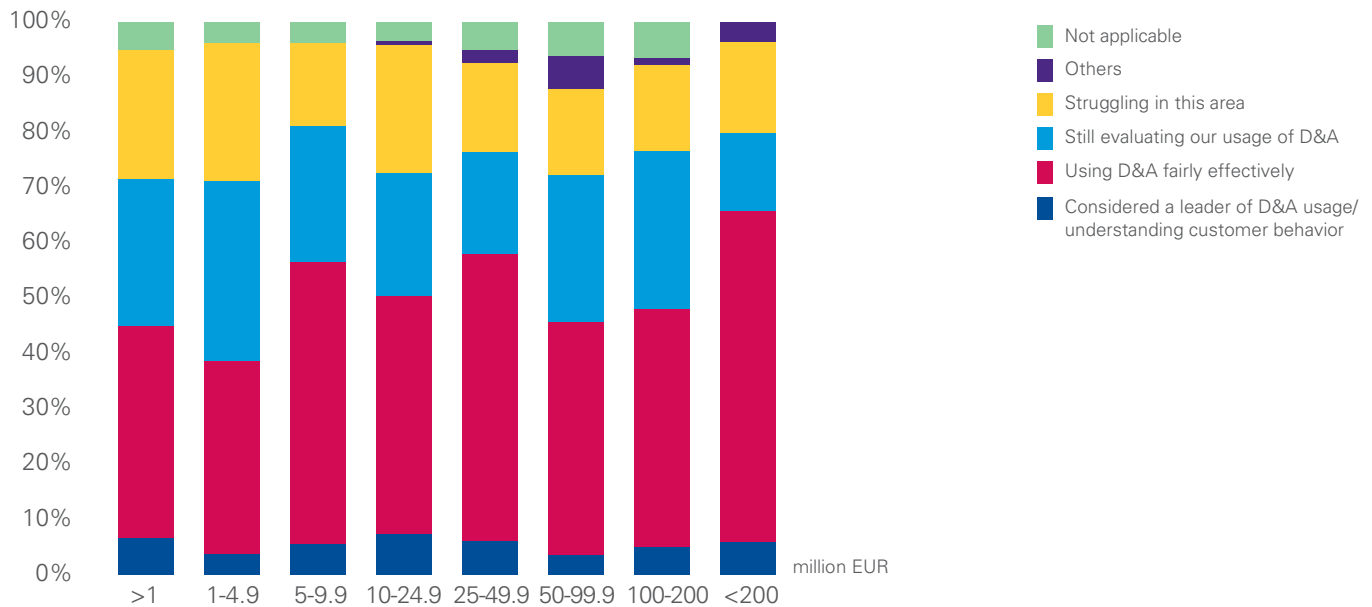
How effectively is your organization using data and analytics (D&A) to improve performance?



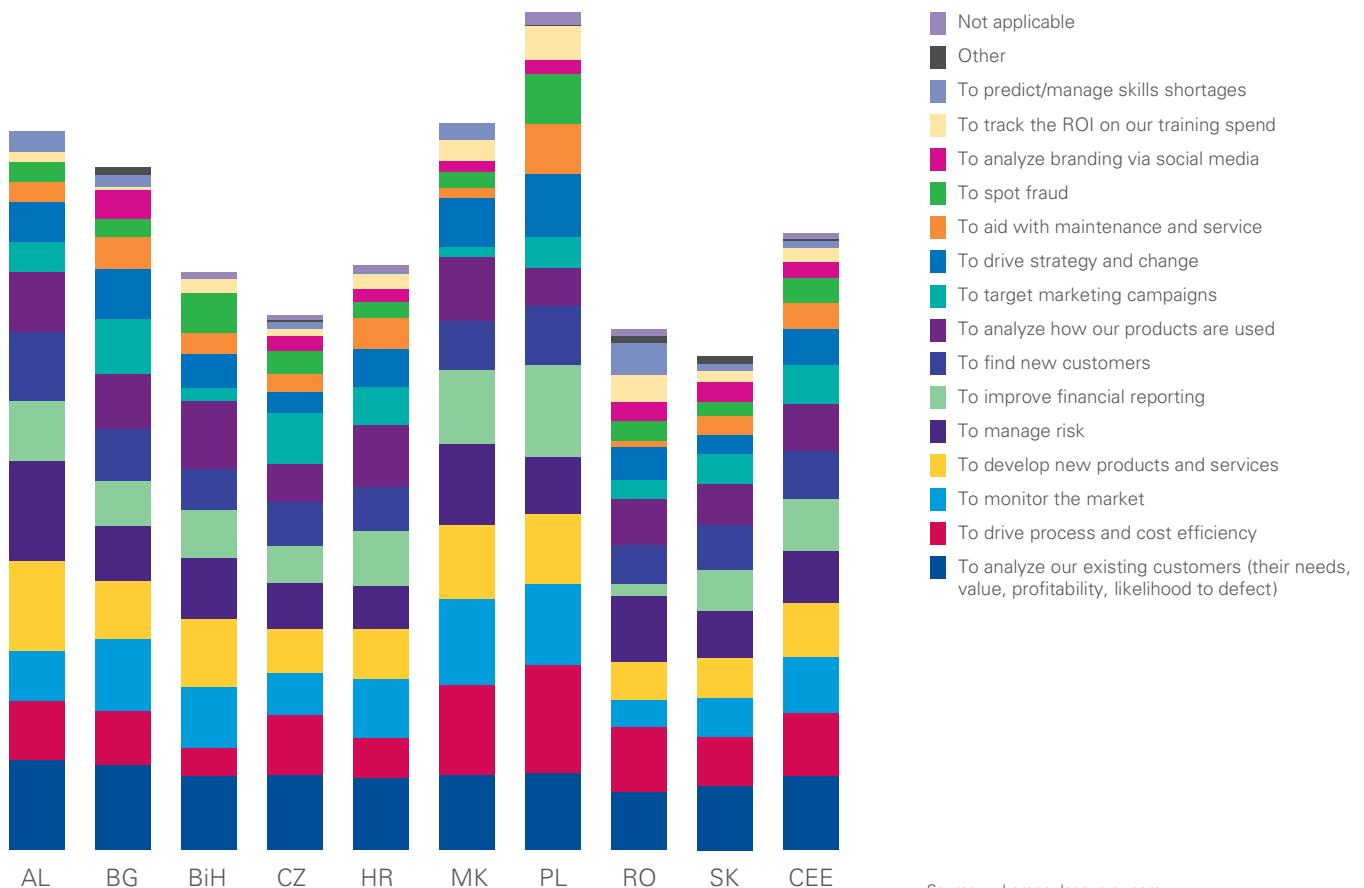
By sector



By turnover

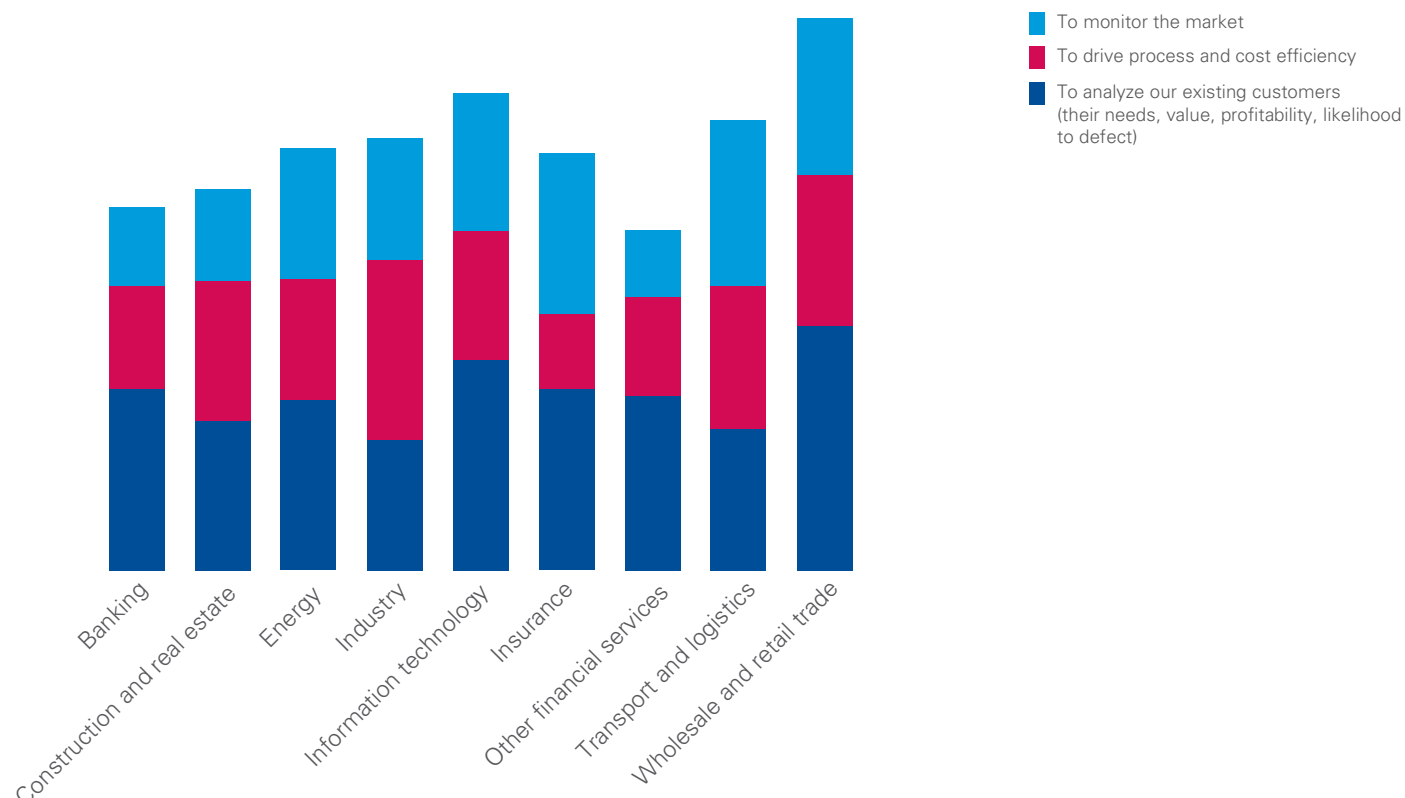


How is your organization using data and analytics?

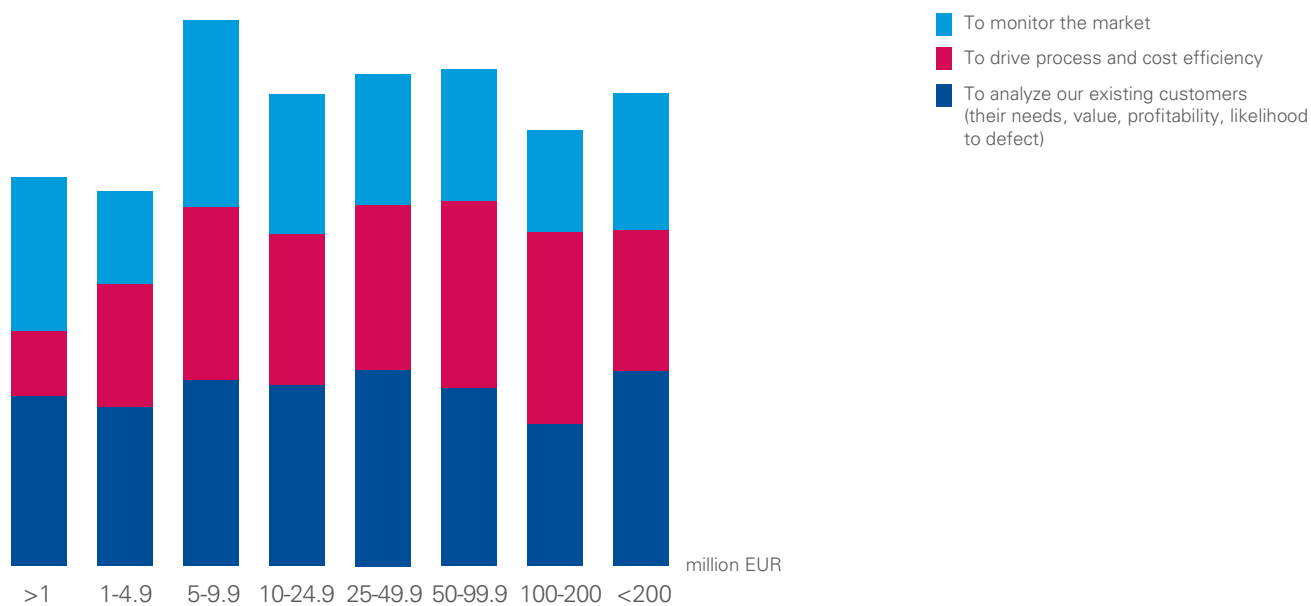


Source: kpmgpulsesurvey.com

By sector



By turnover

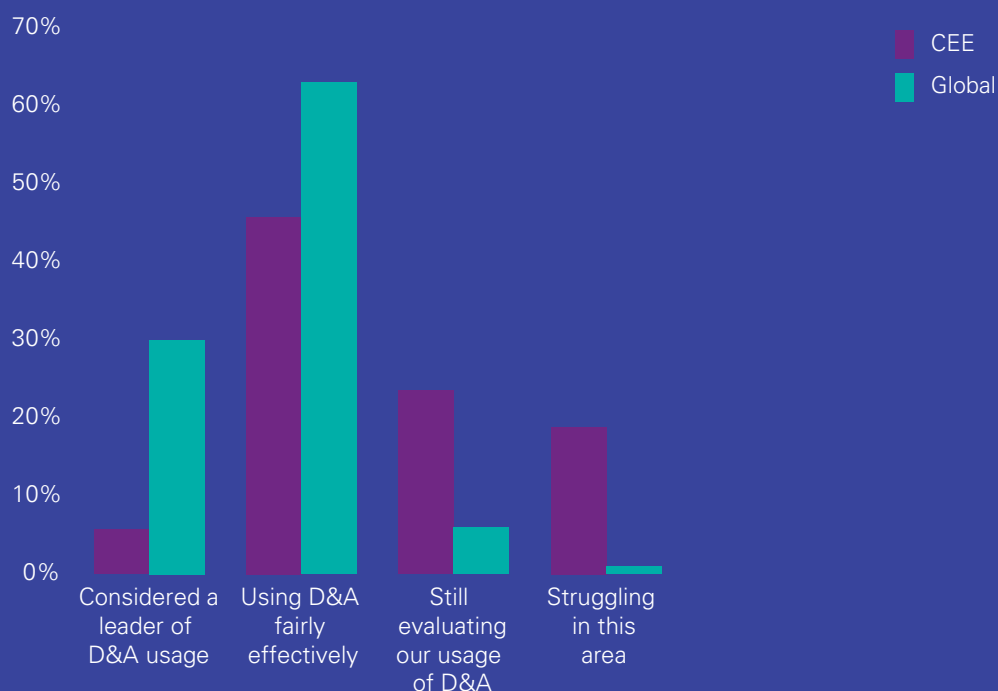


CEE vs. Global: using data & analytics

While 93% of global business leaders believe that their companies are either leaders in D&A usage or are using it fairly effectively, the respective rate in CEE remains at 52%, and 19% admit that they are struggling in this area.



How effectively is your organization using data and analytics (D&A) to improve performance?

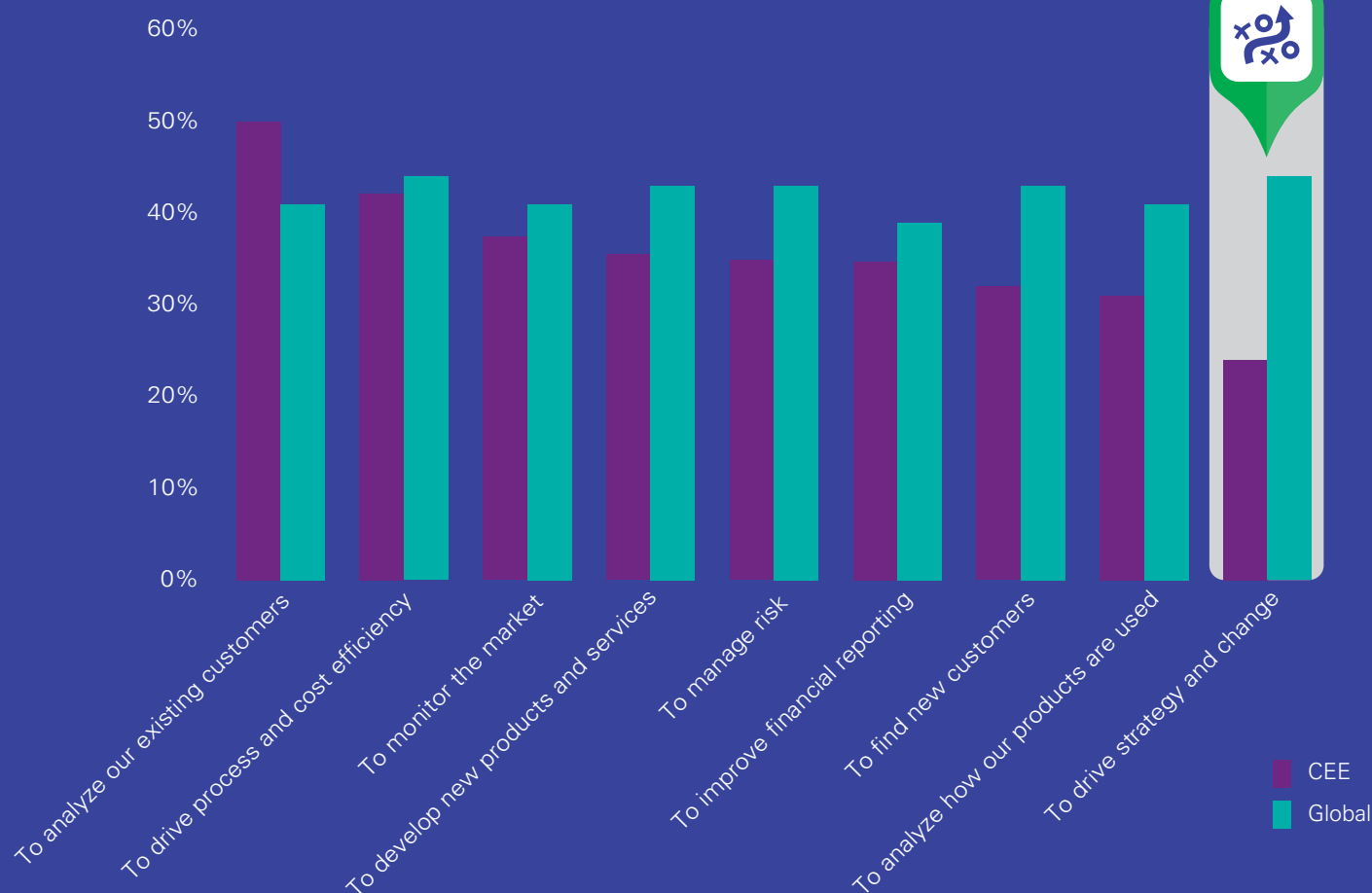


Sources: 2016 Global CEO Outlook, KPMG International
The Pulse of the Economy 2016, KPMG in CEE

CEE vs. Global: how D&A is used

While the intensity of using D&A is in many areas overlapping among global and CEE respondents, a strong difference is observed in the category “to drive strategy and change,” the percentages being 44% and 24%, respectively. In CEE, D&A is primarily used for analyzing existing customers.

How is your organization using data and analytics?

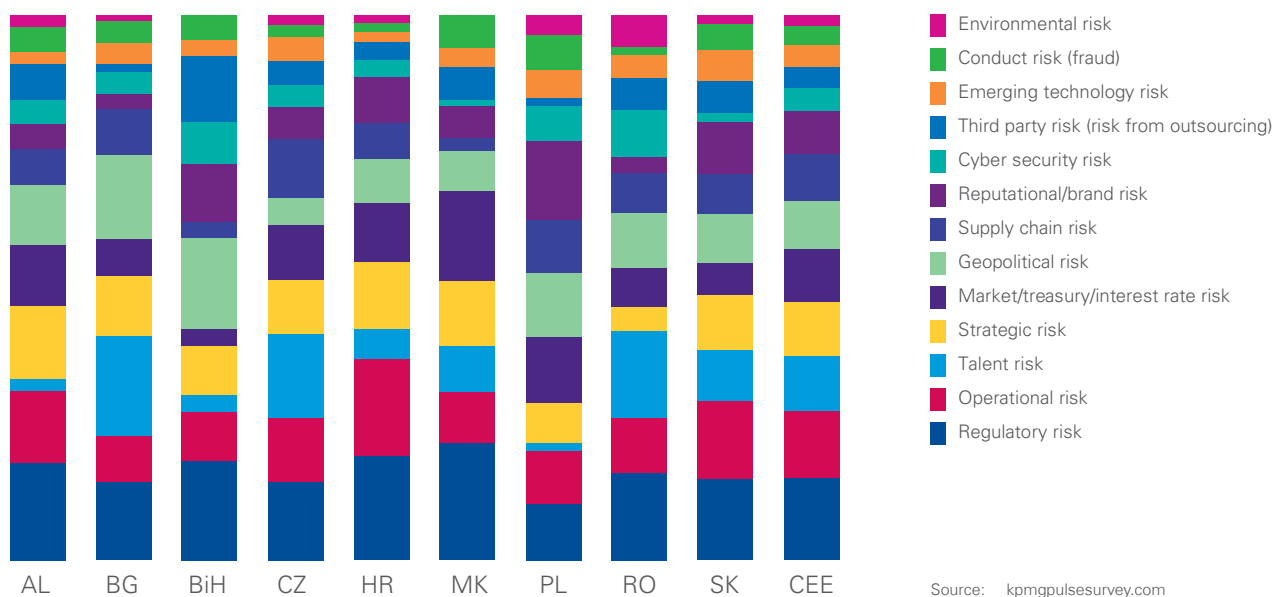


Sources: 2016 Global CEO Outlook, KPMG International
The Pulse of the Economy 2016, KPMG in CEE

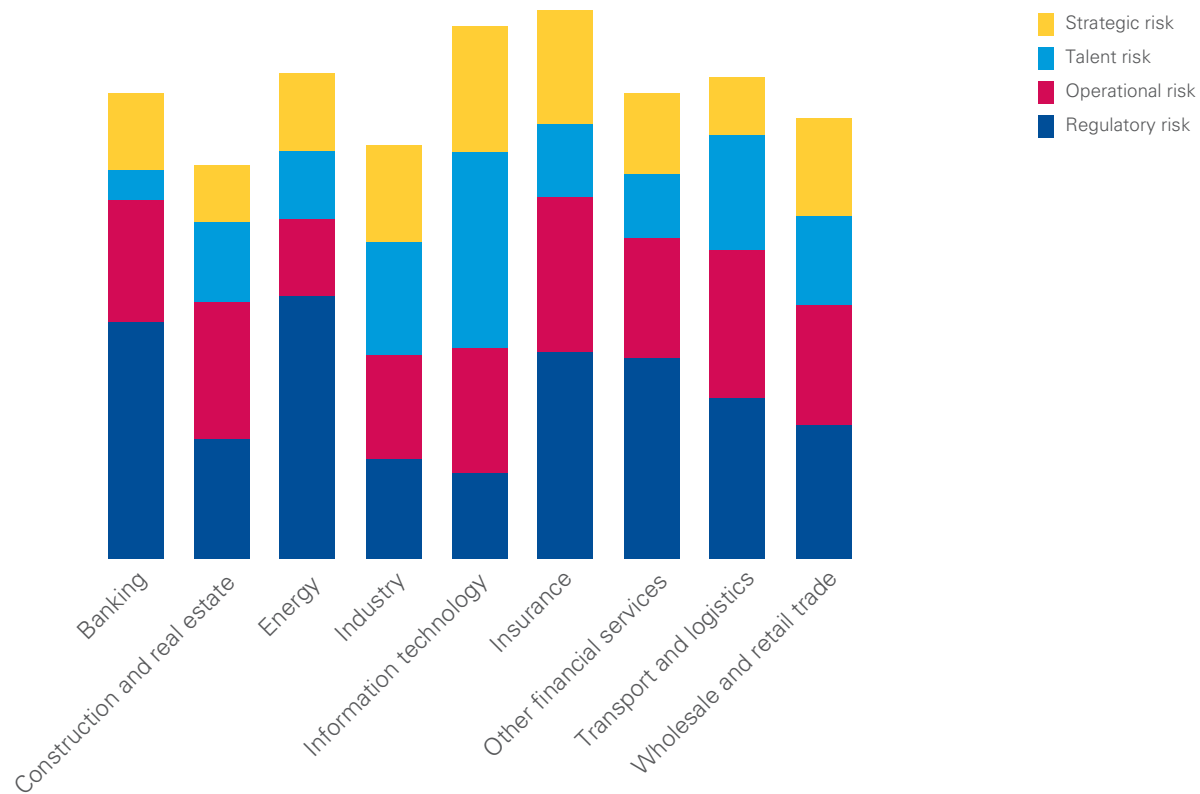
Regulatory risks most severe

Overall within CEE, respondents are most concerned with regulatory (45%), operational (37%), talent and strategic risks (both receiving 30% response rates), whereas regulatory risk is the highest in Macedonia (64%) and Croatia (58%) and, according to sector, in energy (82%) and banking (74%). Of little relevance to survey participants are environmental risk (6%) and conduct risk or fraud (10%), followed by emerging technology risk, third party risk and cyber security risk (all 12%).

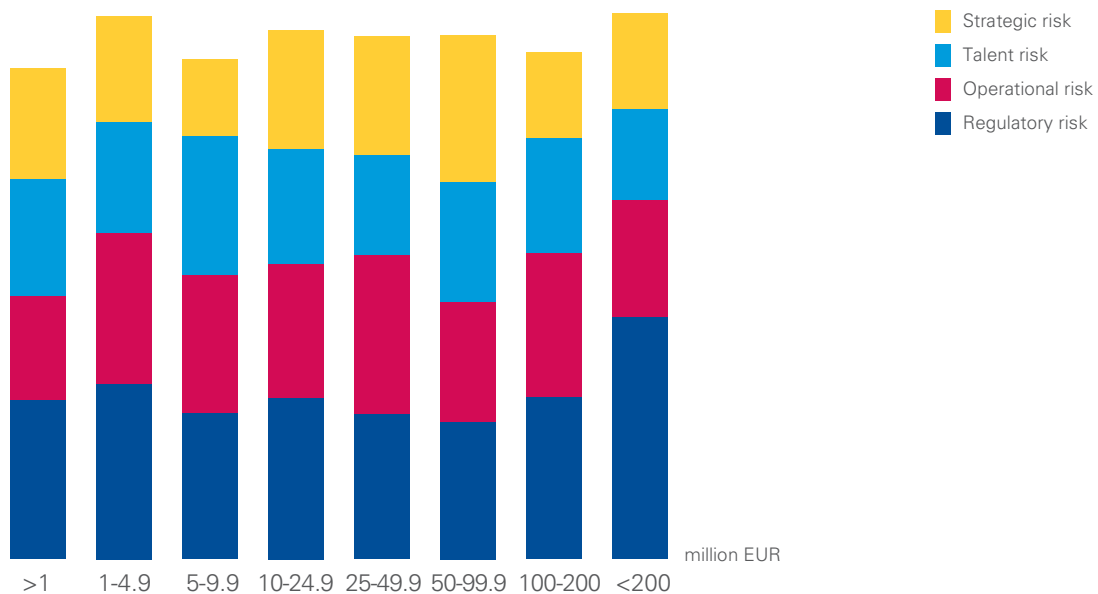
Which of the following risks are you most concerned about?



By sector



By turnover

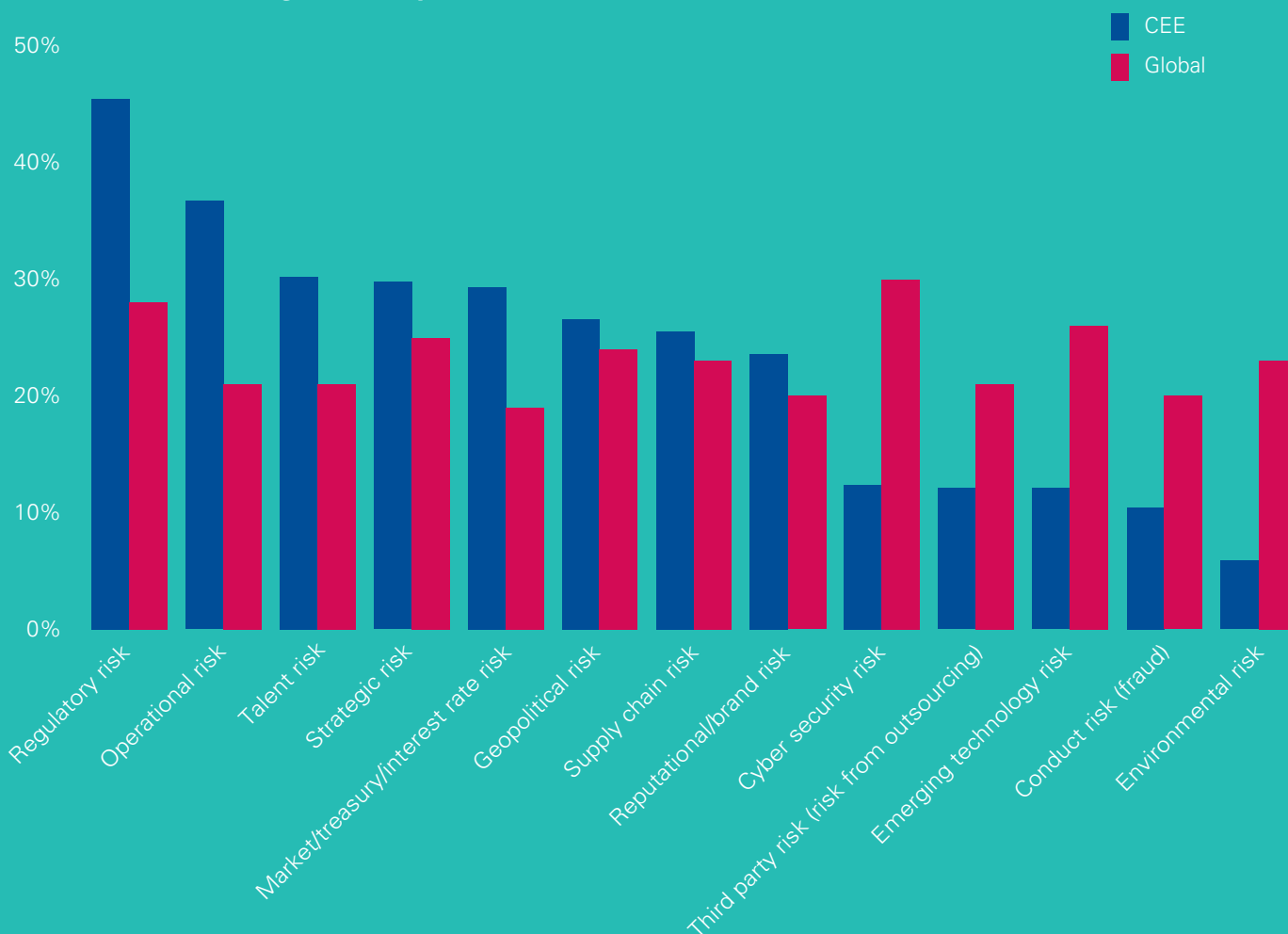


CEE vs. Global: risks



In the CEE sample, business leaders are most concerned about regulatory risk, as indicated by 45%. Cyber security risk holds the first position in the global ranking and regulatory and emerging technology risks are also important.

Which of the following risks are you most concerned about?



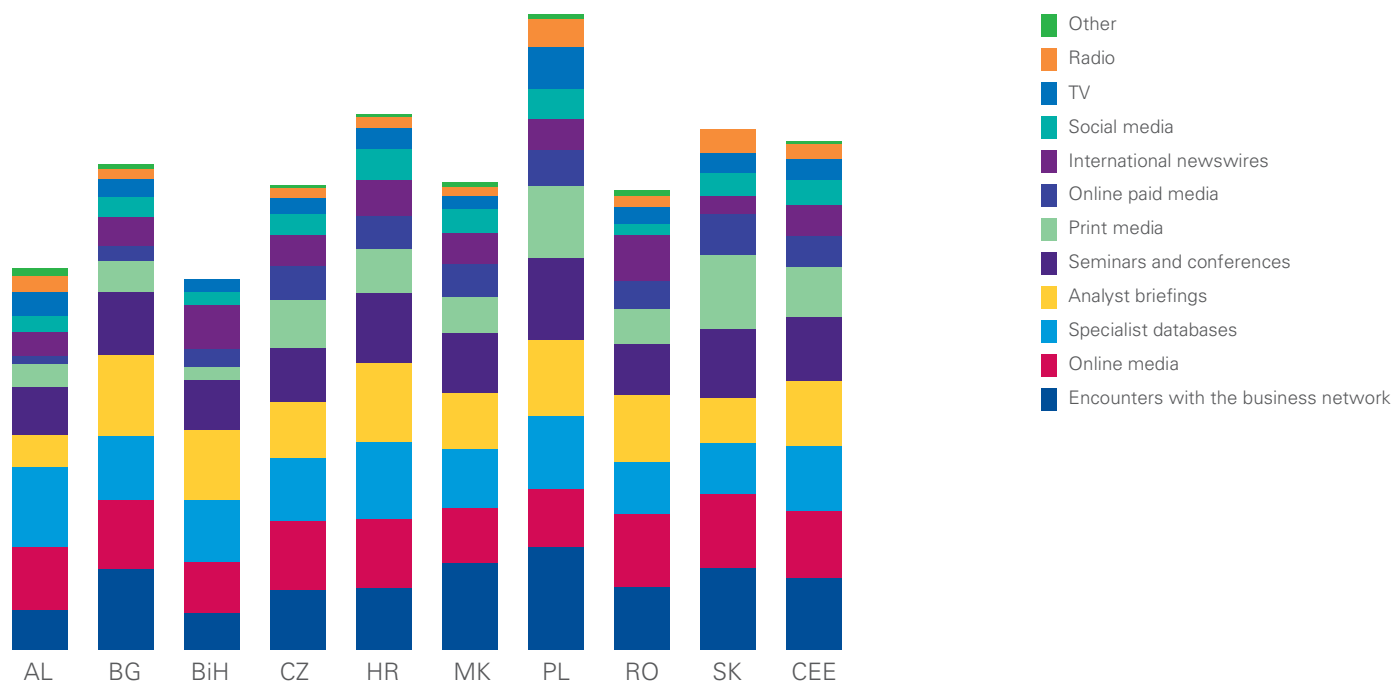
Sources: 2016 Global CEO Outlook, KPMG International
The Pulse of the Economy 2016, KPMG in CEE

Informational channels

When queried on the sources of information utilized for making business decisions, those surveyed say the preferred source is encounters with a business network (indicated by 60%), followed by online media (56%) and specialist databases (55%). Print media is seen as an important channel for decision-making for 42% of respondents, while radio (12%), TV (18%) and social media (20%) play a minor role.



Where do you obtain information when making business decisions?

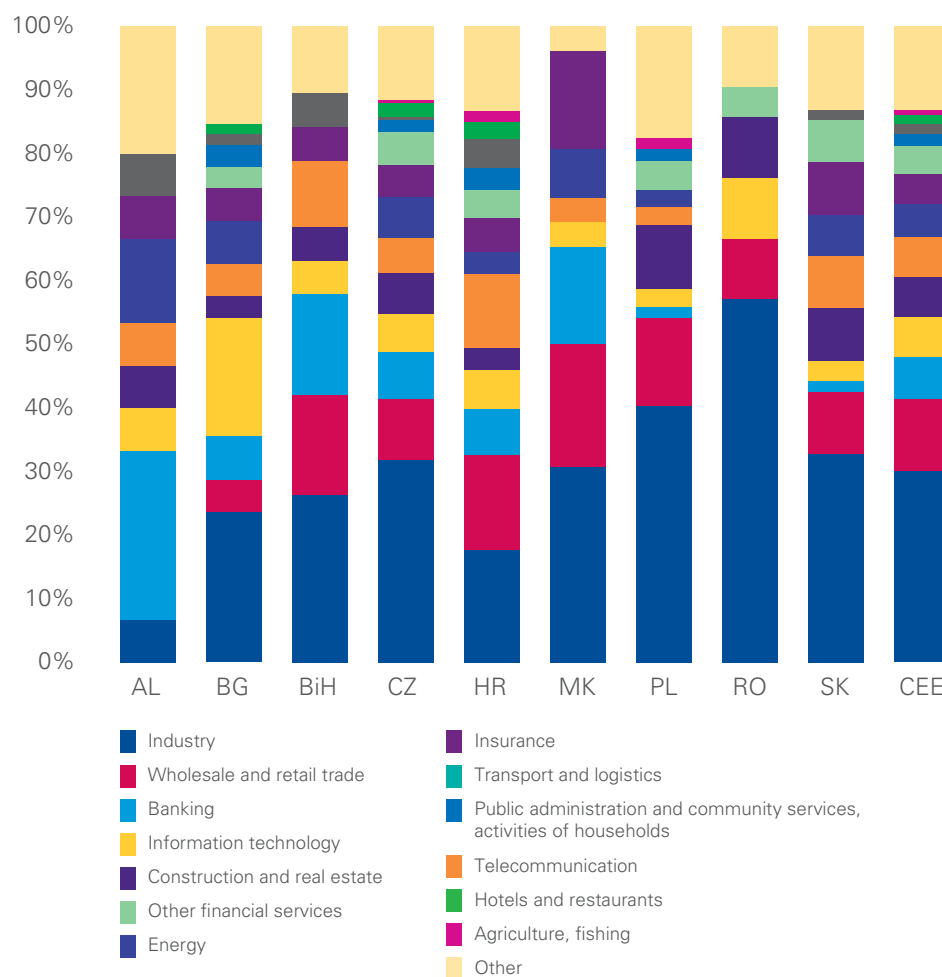




Profile of respondents

A total of 759 responses was collected in the survey. By business sector, industry accounts for 30% of responses, followed by wholesale and retail trade (11%) and banking (7%).

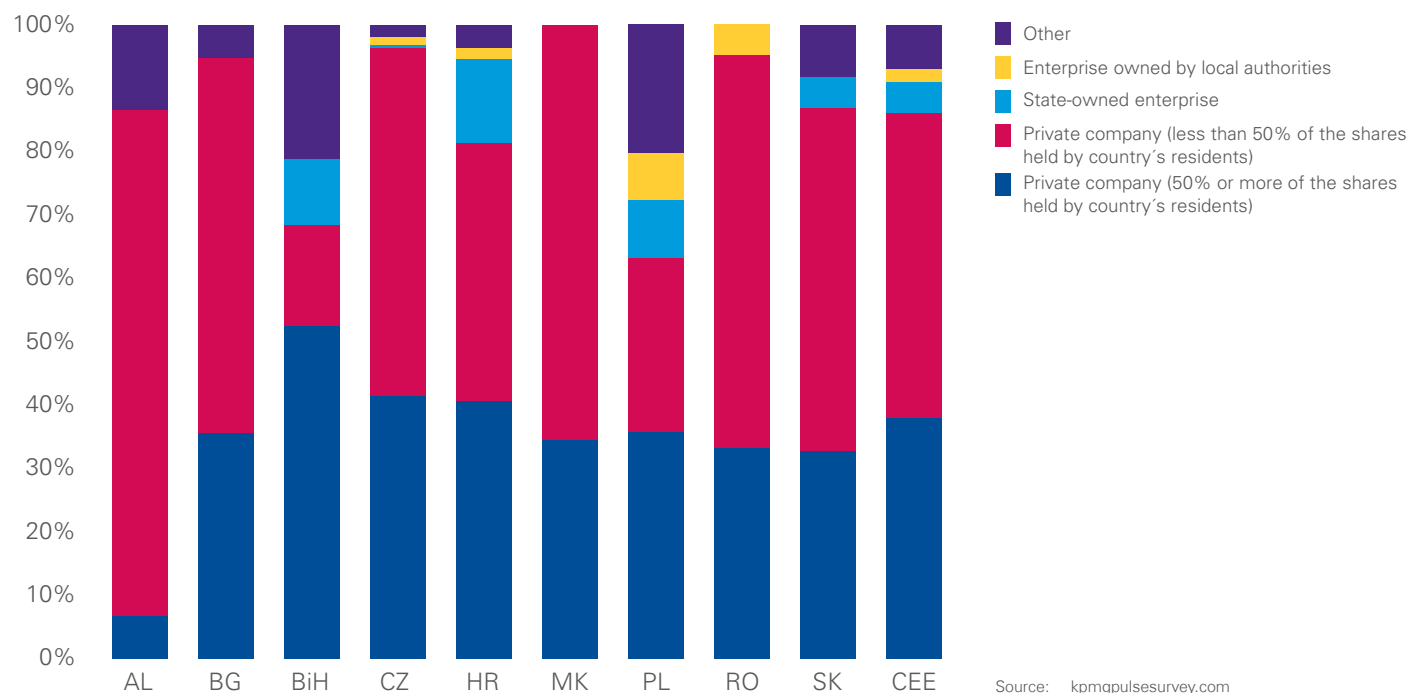
Business sectors



Source: kpmgpulsesurvey.com

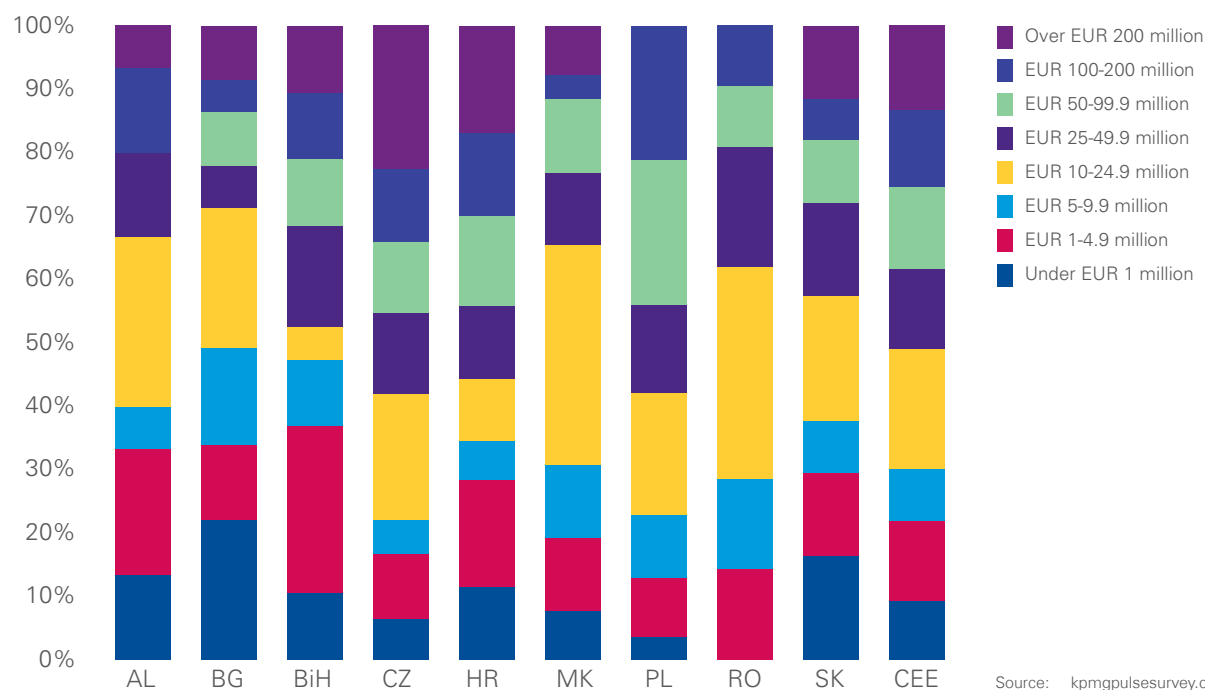
Forty-eight percent of the respondents came from companies where less than half of the shares are held by residents, this share being the highest in Albania (80%) and Macedonia (65%). The share of local private companies is the highest in Bosnia and Herzegovina (53%).

Type of organization



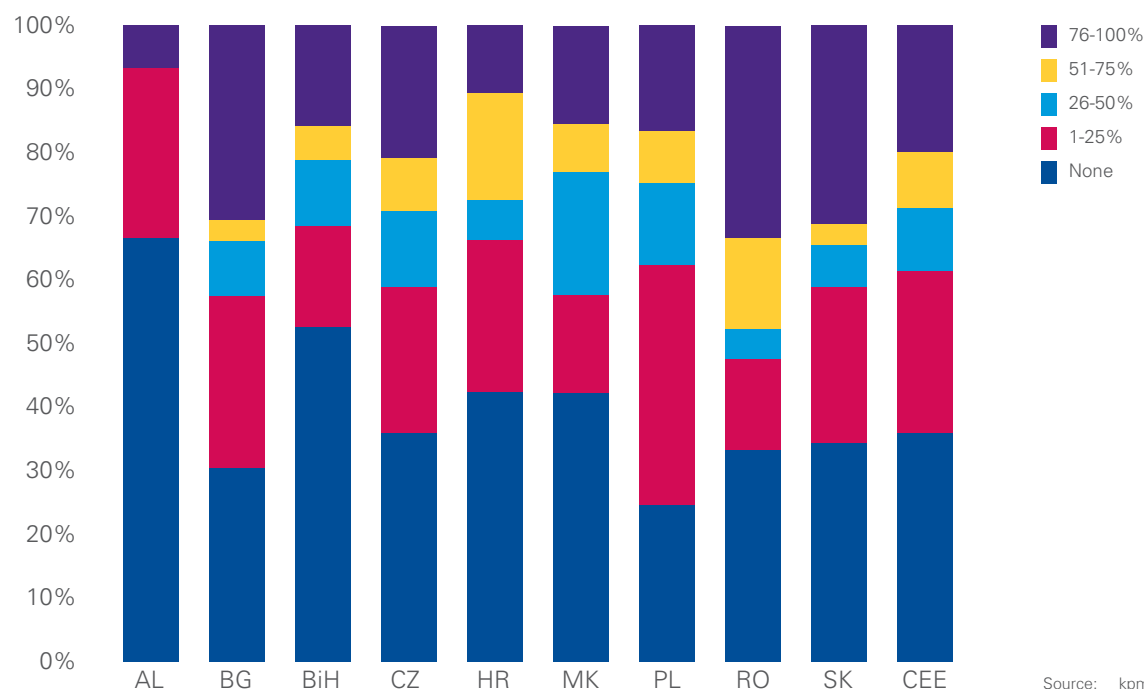
By turnover, 51% of respondents in the survey sample came from companies with annual turnover exceeding EUR 25m in 2015.

Company turnover (2015)



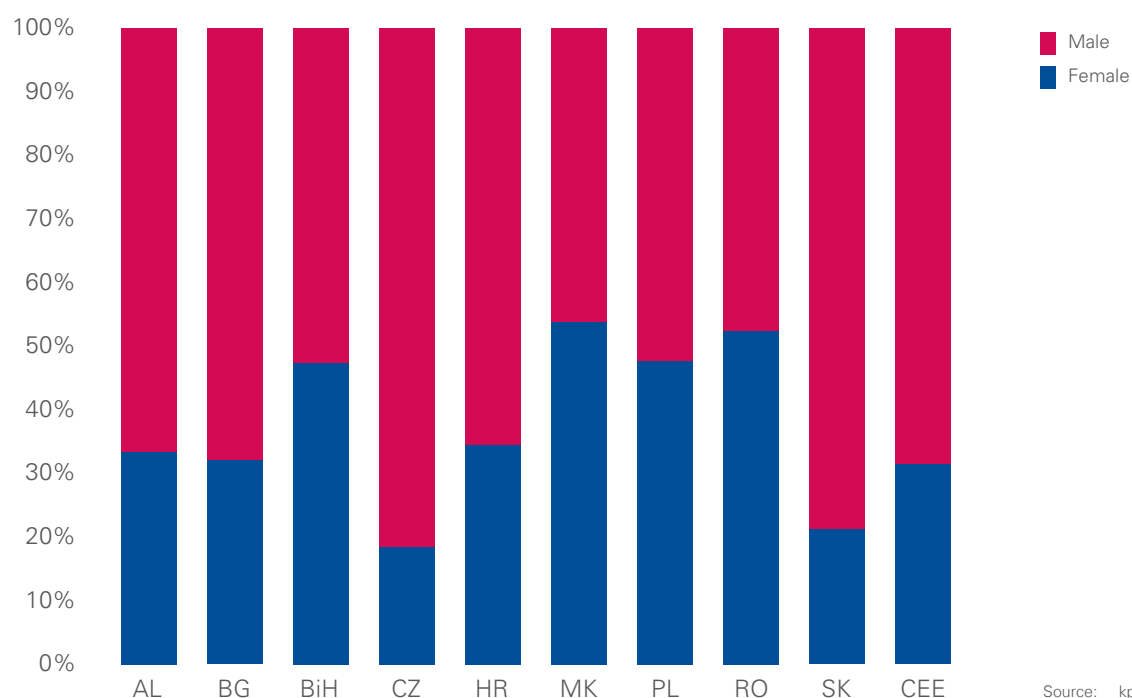
Sixty-four percent are exporting companies, according to sales statistics from 2015, and for 29% the share of exports is over half of annual sales.

Share of exports in the company's sales (2015)



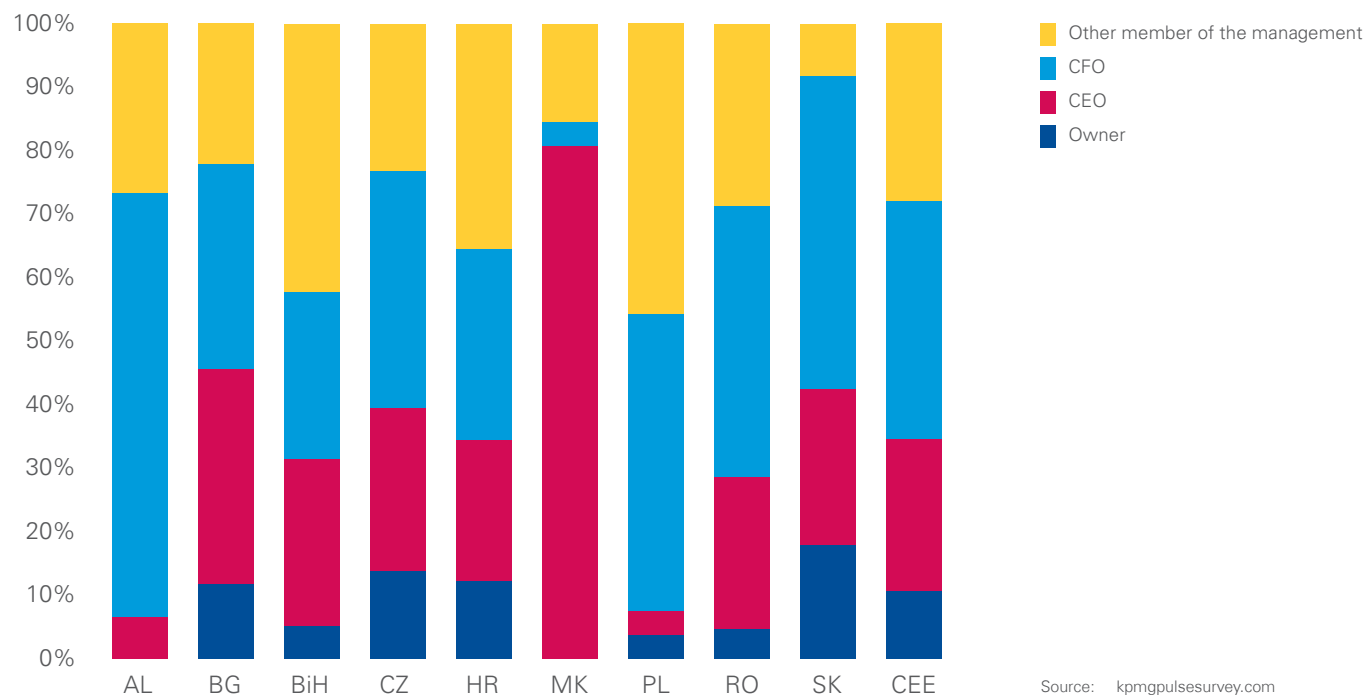
By gender, 68% of respondents are male while the share of female respondents was the highest in Macedonia (54%) and Romania (52%).

Gender



By function, 37% of respondents are CFOs (in Albania 67%), 28% other members of management, 24% CEOs and 11% company owners, their share being the highest in Slovakia (18%).

Position





Contact us

Albania

Heris Jani

T: +355 4 2274 524

E: hjani@kpmg.com

kpmg.com/al

Bulgaria

Gergana Mantarkova

T: +359 2 9697 500

E: gerganamantarkova@kpmg.com

kpmg.com/bg

Croatia and Bosnia & Herzegovina

Domagoj Vukovic

T: +385 1 5390 049

E: dvukovic@kpmg.com

kpmg.com/hr

Czech Republic

Radek Halicek

T: +420 222 123 111

E: rhalicek@kpmg.com

kpmg.com/cz

Macedonia

Srdjan Randjelovic

T: +389 2 3135 220

E: srandjelovic@kpmg.com

kpmg.com/mk

Romania

Serban Toader

T: +40 372 377 800

E: stoader@kpmg.com

kpmg.com/ro

Slovakia

Lubos Vanco

T: +421 2 59984 602

E: lvanco@kpmg.com

kpmg.com/sk

Poland

Leszek Wronski

T: +48 22 528 11 00

E: lwronski@kpmg.com

kpmg.com/pl

General contact:

Andrea Dintser

Director, Marketing & Communication

in KPMG Central & Eastern Europe

E: adintser@kpmg.com

kpmg.com/cee

kpmgpulsesurvey.com



kpmg.com/app



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

© 2016 KPMG Central & Eastern Europe Limited, a limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

