Cautious optimism and low risk appetite driven by expected moderate GDP growth and a high external uncertainty

Central Europe CFO Survey 2016
Croatian CFOs expressed a cautious optimism and a low risk appetite driven by expected moderate GDP growth and a high level of external uncertainty.
Introduction

It gives us great pleasure to introduce this seventh edition of the Deloitte CFO Survey for Croatia. We have documented Croatian and Central CFOs’ sentiment across a range of economic and business issues that are relevant to their interests and economy in general. It also provides a comparison between the views of Croatian CFOs and those of their peer groups from elsewhere in Central Europe: Bosnia and Herzegovina, Bulgaria, the Czech Republic, Hungary, Lithuania, Poland, Romania, Serbia, Slovakia, and Slovenia.

CFOs predict 2016 to be a year of economic and financial stabilization for Central European countries - the main conclusion to be drawn from the findings of the seventh edition of the CFO opinion poll carried out by Deloitte in CE countries. This is similar to the findings identified in the last year’s edition and means that CFOs have for some time perceived the situation across the region as stable, which translates into their positive expectations for the future development of their companies.

Expectations of a modest economic growth in 2015 expressed by the majority of Croatian CFOs in the last year’s survey have proven to be true. According to analysts’ expectations, the real 2015 GDP growth would be around 1.0 percent, which would mark the first year of real GDP growth after six consecutive years of recession in the period 2009–2014. The real GDP growth was driven by several key factors such as higher household consumption, increased exports, continuing low interest rates and a very good tourist season.

Finally, it is indeed encouraging to see CFOs being optimistic about the growth of their companies, even slightly more optimistic about all the survey items than in the previous years. Nevertheless, internal funding is still considered to be the most attractive source of capital. This may mean that CFOs, although optimistic, retain a healthy dose of caution and still wish to avoid taking unnecessary risks.

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Croatian CFOs’ expectations about the country’s GDP growth for the year 2016 are somewhat better than in the previous survey. This time, 70 percent expect the GDP to grow between 0.6 and 1.5 percent in 2016, which is up from 58 percent reported in the 2015 research. Despite the positive trend, it is rather disturbing to see that, on the level of Central Europe, Croatian CFOs and their Serbian peers have the lowest expectation of all the surveyed CE countries about a GDP growth above 1.5 percent.

Croatian CFOs are the most optimistic of all the peers on the question: ‘Compared with six months ago, how you feel about the financial prospects for your company’, as 64 percent are either somewhat optimistic or very optimistic.

More than three quarters of Croatian CFOs believe this is not a good time to be taking greater risks onto their companies’ balance sheets. However, their percentage decreased from 90 percent last year to 78 percent in this year. Croatian CFOs appear to be slightly more risk averse than their average peers.

The percentage of Croatian CFOs expecting no change in the level of their companies’ CAPEX over the next 12 months was 58 percent, the highest of all the countries included in survey. The lowest expectations shown by Croatian CFOs regarding changes in the CAPEX level require attention because a lower CAPEX relative to other countries in the region could have an adverse impact on the competitive position of Croatian companies in the long run.

Twenty-three percent (23 %) of Croatian CFOs plan to use co-funding from EU for their strategic investments, which is a decrease from the previous survey when 27 percent of Croatian CFOs responded positively. This indicates the need for Croatian companies to become more active in seeking opportunities to obtain free EU funding or that there may be no adequate EU programs to address the needs of medium and large entities.
There is a lack of optimism regarding movements in interest rates on borrowings and the availability of loans in the following 12 months, as only 14 percent of the respondents find bank borrowings to be an attractive source of financing. This is the worst percentage comparing Croatian CFOs to their peers from other countries.

In the opinion of Croatian CFOs, attractiveness of equity financing is increasing, and 47 percent of them find this source attractive, which is a significant improvement from only 28 percent in the previous year.

In the year to come, 52 percent of Central European CFOs predict intensified M&A activity. However, despite the ongoing consolidation in certain industries, 54 percent of Croatian CFOs do not expect a higher level of mergers and acquisitions to occur in the next 12 months.
CE comparative analysis
Economic outlook (Key economic trends)

Graph 1 - CFOs expectations for Croatia GDP growth in 2016

GDP Growth
Croatian CFOs expectations about the country’s GDP growth for 2016 have improved from the previous year, as 70 percent of Croatian CFOs expect the GDP to between 0.6 and 1.5 percent in 2016, which is an increase from 58 percent reported in the 2015 research.

Despite the positive trend, it is rather disturbing to see that, on the level of Central Europe, Croatian CFOs and their Serbian peers have the lowest expectation of all the surveyed CE countries about a GDP growth above 1.5 percent. Only 8 percent of Croatian CFOs and 6 percent of Serbian CFOs expected their respective GDP figures to grow by more than 1.5 percent in 2016. Polish CFOs are by far the most optimistic in terms of the expected GDP growth in 2016, as 62 percent of them expect the 2016 GDP to grow more than 2.5 percent.

The results of the survey indicate that Croatian CFOs expect the economic recovery of Croatia to continue in 2016, but at lower growth rates than in the majority of other Central European countries.
Unemployment

Another potentially positive sign regarding the expected macroeconomic developments in Croatia in 2016 is the expected change of level of unemployment, as 36 percent expect the level of unemployment to decrease somewhat. This represents a significant improvement from the previous survey when only 7 percent expected a decrease in the level of unemployment. However, most of the surveyed Croatian CFOs (40 %) expect the level of unemployment to remain the same.

Crisis in Greece

Seventy-four percent (74 %) of Croatian CFOs who participated in survey saw the events in Greece in the previous months as damaging the prospects for achieving a stable and closely integrated European monetary union in the long run.

This sentiment is shared with CFOs from all other counties surveyed, except Lithuania where 47 percent of Lithuanian CFOs found the previous month’s events in Greece had no effect in terms of changing, in the long run, the prospects for achieving a stable and closely integrated European monetary union.

Graph 2 - Over the next 12 months how do you expect levels of unemployment to change in your country?

On the regional level, Slovakian CFOs are the most optimistic, as 88 percent of them expect a decrease in the level of unemployment over the next 12 months. Serbian CFOs are the most pessimistic with only 19 percent expecting the unemployment to decrease.
External Risks

Croatian CFOs still have the perception that there is an elevated level of external and financial economic uncertainties facing their businesses in 2016. Fifty-eight percent (58%) believe their businesses will operate in a highly uncertain business environment, 40 percent find the near-future environment to have a normal level of uncertainty, while only 2 percent think there is a low level of uncertainty. While the percentage of those expecting a high level of uncertainty remains similar to the last year’s survey (61%), a smaller percentage of those believing the level of uncertainty is low is quite interesting (2015: 11%).

For a majority of Croatian CFOs, market pressure to decrease the prices of offered goods and/or services (30%), followed by recession and a decrease of domestic demand (10%) are biggest risks.

Overall, Croatian CFOs are more pessimistic about uncertainties, and only Slovenia has reported the same percentage of CFOs that believe the level of uncertainty is low. Quite the opposite is in Croatia which, together with Serbia and Slovenia, has scored the highest percentage of CFOs with the perception of high uncertainty.
Financing

CFOs do not believe that debt financing is currently easily available in Croatia. Only 8 percent find obtaining new loans easy (a drop from the prior year’s 20 %), while 70 percent find loans normally available. The remaining 22 percent are pessimistic in this regard and think that loans are difficult to obtain under current market conditions.

Croatian CFOs have mixed opinions about future financing costs over the next 12 months. Increasing cost of financing are expected by 48 percent (43 % in the prior year), which is probably because CFOs are aware that the current, very low levels of Euribor, Libor and Zibor to which many loans are tied will most likely not last for much longer. Thirty percent (30 %) are neutral in their prognosis of the financing cost movements, while the remaining 22 percent believe the costs will decrease from the current level.

M&A Market

Currently, business combinations prevail in certain industries in Europe and globally. Despite the trend, local CFOs do not expect mergers and acquisitions to intensify in the next 12 months. No significant change in the level of M&As in 2016 is expected by 54 percent of Croatian CFOs (47 % in 2015), and 42 percent (47 % in 2015) believe that number of M&A transactions will increase compared with the prior year.

Only Serbian CFOs have similar expectations, while CFOs from other CE countries expect the level of mergers and acquisitions to increase. For example, 83 percent of CFOs in Bulgaria believe so, and the percentage in other countries ranges from 45 percent (Slovenia) to 63 percent (Lithuania).
Human Capital (Talent in Finance)

Despite the high unemployment in Croatia (17.7% in November 2015), there is an increasing concern among the country’s CFOs regarding the availability of wanted employees, especially top level staff. Finance talent shortage is expected by 40 percent, which is a significant increase from the prior year’s 28 percent.

Only CFOs in Poland and Serbia are more pessimistic about this matter, each for their own particular reasons.
Business growth outlook

Priorities and Risk Appetite

Revenue growth on the current markets remains the top strategic priority for Croatian CFOs over the next twelve months. Croatian CFOs indicate revenue growth on new markets as the second strategic priority, whereas in the previous survey it was placed at the bottom of strategic priorities.

New investments continue to be of the lowest strategic priority for Croatian, Bulgarian and Hungarian CFOs, in line with similar significantly below-average values for other countries. The fact that Croatian CFOs have rated the importance of new investments even lower than a year ago raises concern.

Graph 5 - What is your company’s business focus for the next 12 months?

Deloitte perspective

Croatian companies would need to develop and implement effective strategic options to achieve revenue growth on new markets. The growth can be achieved by selling existing products/services, new products/services, or a combination of both. Various strategic options are available to boost sales of existing products on new markets. For example, a business could expand geographically to new markets or find new market segments or niches for the existing products. New strategic choices could be supported by innovations in distribution, promotion and management systems.

Growth on new markets can be achieved organically, through mergers and acquisitions or various forms of strategic alliances (e.g. distribution agreements, licenses, joint ventures, etc.). Each strategic option would have its pros and cons in terms of awards and risk it brings. The most risky strategic choice would be an attempt to expand on a new market with a new product through acquisition. Regardless of the choice, growth on new markets is likely to change the risk profile of a company, as it will expose it to a number of new significant risks. Strategic risks associated with each strategic choice will need to be identified and evaluated, and an appropriate risk management strategy implemented to optimize the risks.
Business remodeling or restructuring is seen as a moderate or strong priority over the next 12 months by 68 percent of Croatian CFOs - a significant decrease from 85 percent a year ago. Seventy-one percent (71%) of Slovenian and Romanian CFO consider business remodeling or restructuring to be a moderate or strong priority, the highest percentage among all the countries, whereas only 37 percent of Slovakian CFOs shared the opinion.

The percentage of Croatian CFOs who believe that this is not a good time to be taking greater risks onto their companies’ balance sheets decreased from 90 percent last year to this year’s 78 percent. Croatian CFOs appear to be slightly more risk averse than their average peers. Just as last year, Lithuanian CFOs seem to have the highest risk appetite, as 63 percent of them think it is a good time to be taking greater risks onto their balance sheets.

Only 16 percent of Serbian CFOs share the opinion, which makes them the most risk averse of all the countries’ CFOs.
Growth Forecasts

Croatian CFOs are the most optimistic of all regarding the following question: ‘Compared with six months ago, how you feel about the financial prospects for your company’, as 64 percent are either somewhat optimistic or very optimistic. Last year only 31 percent of respondents from Croatia were somewhat optimistic, and this year the figure has increased to 48 percent.

The most positive sentiment of Croatian CFOs is very interesting, as the percentage of CFOs’ declining optimism is found in all the neighboring countries: Slovenia, Serbia and Hungary. This could be an interesting consideration for Croatian exporters, who have been traditionally significantly present on the markets of Serbia and Slovenia.

Sixty-two percent (62 %) of Croatian CFOs expect their company revenues to increase somewhat or significantly over the next twelve months, which is slightly below average. The most optimistic are CFOs from Romania, as 78 percent of them believe that revenues are likely to increase over the next twelve months. Overall, it is good to see 50 or more CFOs from all the surveyed countries finding an increase in revenues over the next twelve months likely. The lowest score of 50 percent is the one of CFOs from Bosnia and Herzegovina.

Forty-eight percent (48 %) of Croatian CFOs expect that their operating margins are likely to increase somewhat or significantly over the next twelve months, which is above the average of 40 percent for all the countries. It seems that a large portion of Croatian CFOs see opportunities for efficiency improvements and cost optimization.

Fifty-eight (58 %) of Croatian CFOs expect no change in the level of capital expenditure in their companies over the next 12 months, which is the highest percentage among all the surveyed countries. Only 30 percent of Croatian CFOs expect their CAPEX level to increase, the lowest percentage of all. The survey is not conclusive of such a low percentage. Another research indicates the higher average indebtedness of Croatian companies relative to other EU countries as a factor limiting cash available for investing.

Graph 10 - Compared with six months ago, how do you feel about the financial prospects for your company?
Debt & Financing

Only 14 percent of Croatian CFOs find bank borrowings attractive under the currently rather high financing cost. This is the lowest percentage compared with the peers from other countries where e.g. 63 percent of Lithuanian and very high 83 percent of Polish CFOs find bank borrowings to be attractive under the market conditions currently prevailing in their respective countries.

The attractiveness of equity financing is increasing among Croatian CFOs, as 47 percent find it attractive, which is a significant improvement from only 28 percent in the previous year. Only 12 percent find this type of finance unattractive (23 % in 2015), while others remain neutral in their view of this matter. The trend will hopefully lead to more successful IPOs on the Zagreb Stock Exchange in the following years, given their scarcity especially during the six-year recession period.

Croatian CFOs, demonstrating a low risk appetite, are also much more likely to use their internal sources to finance their operations and growth. Sixty-five percent find this form of financing attractive, with 31 percent being neutral and only 4 percent not preferring this option.

When it comes to corporate debt, the CFOs are quite neutral. Thirty-one percent consider it attractive, 29 percent find it unattractive, with the remainder being neutral.

Deloitte perspective

The lowest result of Croatian CFOs regarding the expected change in the CAPEX level deserves a closer consideration because CAPEX lower than in other countries in the region could adversely affect the competitive position of Croatian companies in the long run.

Croatian CFOs should revisit their CAPEX requirements and link them with their corporate strategies to support the sustainability of business and long-term competitiveness. This means ensuring an efficient and effective capital budgeting process with a pipeline of potential CAPEX projects appraised by appropriate methods that take into account quantitative and qualitative aspects. Croatian CFOs are encouraged to use, whenever possible, EU funds as the cheapest source of CAPEX financing.
CFOs are still risk averse mainly due to the bad experience of some companies with taking on a high level of debt during the economic boom in pre-recession years (a trend which peaked in 2007 and 2008); hence, most of them have no plans to raise the level of gearing.

Only 18 percent of Croatian CFOs have plans to worsen their gearing by taking on an additional significant amount of debt, while 32 percent intend to decrease it. The rest of them plan to keep it around the same level as in the prior year. This is, however, a mild improvement from 2015 when only 10 percent planned to raise their gearing levels, reflecting a slightly higher level of optimism of the Croatian business community.

Croatian CFOs are quite confident in their ability to service current debt levels in the future. Currently, 54 percent of them believe that their ability to service debt will increase over the next three years, while only 4 percent expect that their liquidity will get worse and that they might not be able to service their current debt level. This is quite an improvement from the last year’s 35 percent who believed that their ability to service debt will increase. It may be that most CFOs have simply got used to the current conditions and are confident of being capable of navigating financially through troubled waters.

**Graph 9 - What is your aim for your level of gearing over the next 12 months?**

- 18% Raise
- 50% No change
- 32% Reduce
EU funds

The survey results indicate a significant area for improvement regarding the reliance of Croatian companies on EU funding. In the next six months 23 percent of Croatian CFOs intend to resort to co-funding by the EU for their strategic investments. Responses provided regarding the types of planned investments vary from the research and development of new products, investments in new production lines and telecommunications equipment up to purchasing new machinery for factories and product processing plants.

The finding raises concern, as the situation has worsened since the previous survey when 27 percent of Croatian CFOs responded positively.

**Deloitte perspective**

This year’s survey pointed again to the need for Croatian companies to become more active in seeking opportunities to obtain free EU funding, as it should reflect itself positively on a project’s net value. First, Croatian CFOs and/or other company stakeholders should identify eligible EU funds, EU operational programs for Croatia and eligible projects. For Croatian companies eligible for EU funding, knowing how to obtain and manage EU-funded projects could become an issue of strategic importance.

Technology

Ninety percent of Croatian CFOs expects that technology will either somewhat (47 %) or significantly (43 %) impact the operational performance of their respective industries in the next 1 to 5 years. Consequently, it is obvious that Croatian CFOs are aware of the importance of technology, but as noted earlier, it seems they do not have sufficient resources to make necessary investments.

**Deloitte perspective**

Reliance on new technologies is closely interrelated with increased efficiency or productivity. In modern economies technology should be seen as important as other two key inputs of production (labor and capital).

Croatian companies are encouraged to pursue new technologies across the entire value chain, including support functions. It is crucial that Croatian companies adequately assess their needs for new technologies or technological upgrades in order to use new technologies economically, efficiently and effectively.

Examples of potential use of new technologies across the value chain are numerous, e.g. digitalization of operations and marketing activities, automatization of production processes and logistics, implementation of modern ERP systems, e-commerce, increased reliance on data analytics, the cloud, etc.
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About the survey

The 7th CE CFO survey took place in September & October 2015. A total of 450 CFOs across 11 countries completed our survey. The Deloitte CFO Survey is the only survey that seeks to establish the views of CFOs in relation to the financial markets, economic outlook and business trends on a quarterly basis.

We would like to thank all participating CFOs for their efforts in completing our survey. We hope the report makes an interesting read, clearly highlighting the challenges facing CFOs, and providing an important benchmark to understand how your organization rates among peers.

Deloitte CE CFO survey is a “pulse survey” that provides CFOs with information regarding their peers’ thinking across a variety of topics. It is not, nor is it intended to be, scientific in its number of respondents, selection of respondents, or response rate – especially within individual industries.