Thriving in Uncertainty – A Polish perspective

Summary

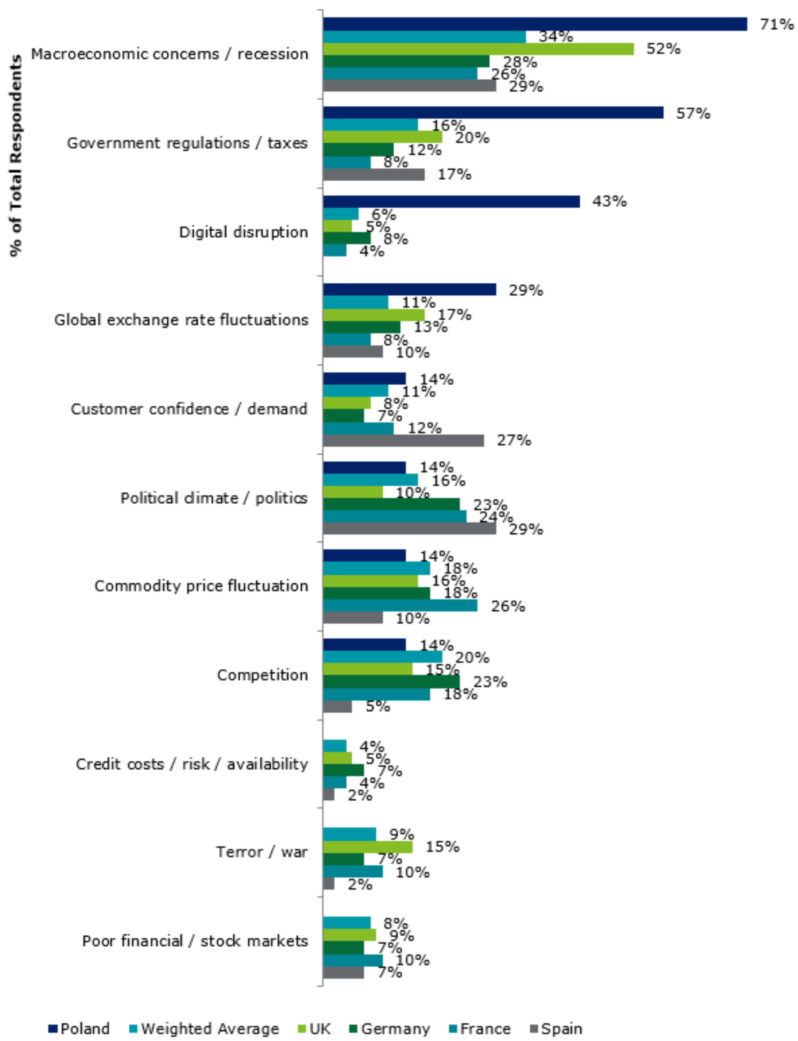
- The most often mentioned **external risks** by Polish executives were **macroeconomic concerns/ recession, government regulations/ taxes** as well as digital disruption. Additional listed concerns included: overall market instability, increase in labor costs and macroeconomic factors concerning commodity prices.
- **Digital disruption** and **global exchange rate fluctuations** are considered to be a much bigger **threat** in Poland than in other countries.
- Comparing to EU average, in Polish sample **significantly less** companies reported **positive growth of revenue** over last 2 years. They are also more certain about their future outcomes: whether it's decrease of increase of revenues, the latter being in overwhelming majority.
- **All Polish respondents declare cost reduction efforts** in the next 24 months
- Common cost management strategy of European companies called "save to grow" becomes crucial to Polish companies facing **growing cost of work and high** (as well as likely to increase) **fiscal burden.**
- **Product profitability** appears to be **higher priority** than reducing costs. Executives are more likely to work on revenue side by improving pricing than work purely on cost reduction. EU top priority - sales growth represents only the 4th most frequently cited strategic priority.
- Most popular actions foreseen in the **next 24 months** include tactical and strategic actions aimed at **transformation of business models**
- The survey results show that although Polish respondents have tried all cost management approached and have chosen **cost programs targets** more **conservatively**, the **failure rate** is exactly the same as in other European countries on average.
- The key lesson learnt from previous efforts is lack of understanding being **key barrier to effective cost management,** which is implied by **lack of proper change management** and clear **implementation strategy**. Challenges in implementing initiatives are considered second most crucial obstacle.
- Overall, Polish companies fall into category called "thriving in uncertainty" together with UK, Italy, France, Germany and Spain, but unlike the first 3, are more predestined to grow and prosper.

As Polish responses were much lesser in quantity comparing to those for other countries, the global survey report does not distinguish Poland's data, but includes them into all averages.

Survey findings

Risks identified by Polish companies are slightly different than those quoted by UE respondents

Figure 1: Top External Risks



Macroeconomic concerns / recession were the most often mentioned external risk by Polish respondents, similar to other European respondents. Listed examples included: overall market instability, increase in labor costs and macroeconomic factors concerning commodity prices.

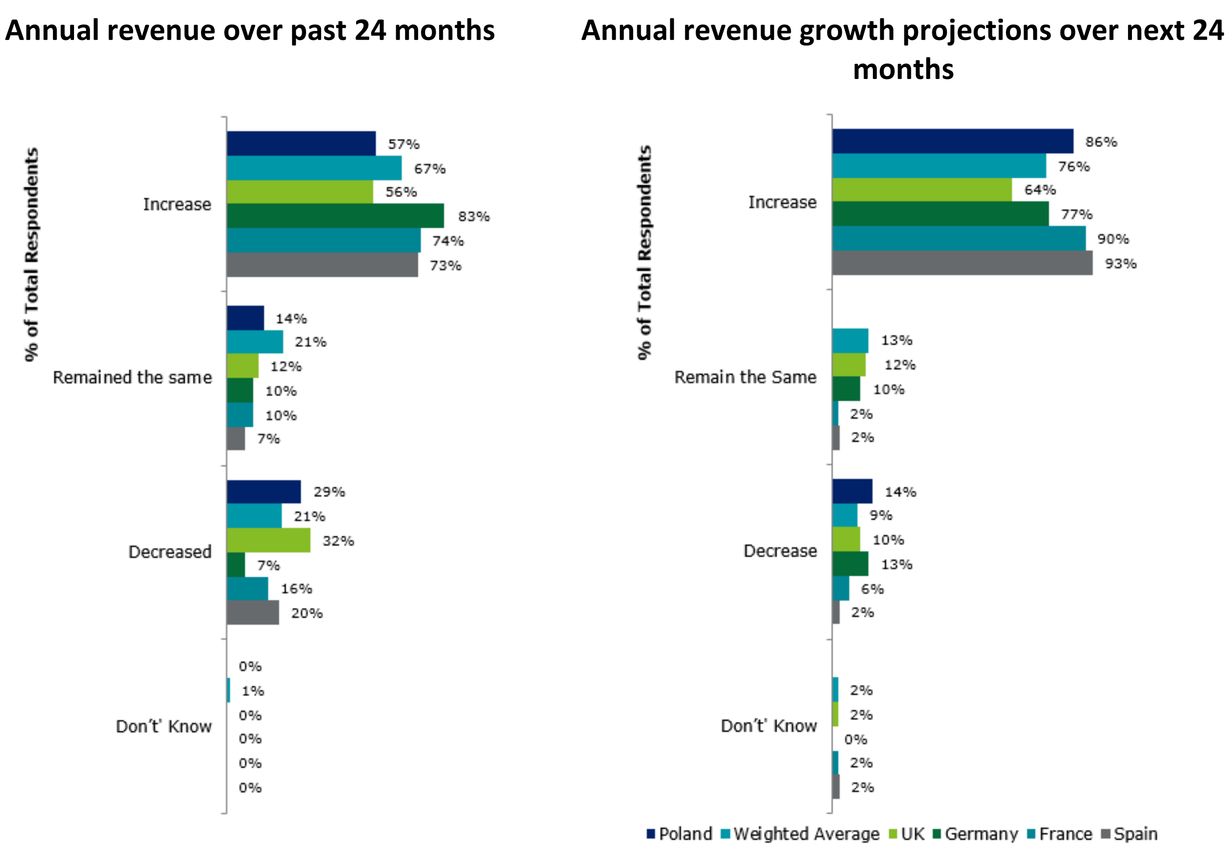
Second most often indicated threat in Poland was government regulations / taxes, which might be caused by numerous policy changes announced by Polish government.

Competition, mentioned frequently by European respondents on average, is not considered a significant risk according to Polish companies surveyed.

The substantial differences between Poland and other European countries can be seen in areas of digital disruption and global exchange rate fluctuations, where polish responses were much more frequent than elsewhere. The latter obviously stems from the fact that Poland is outside euro zone and Polish zloty volatility reflects economic moods of the whole CE region. Considerably higher perception of digital disruption as a threat comparing to respondents from other countries may reflect relatively low digital/ IT advancement of Polish companies and feeling of being unprepared for changes, whereas in Western countries digital economy is one of the most popular business topics.

Despite threats identified Polish managers are much more positive about the future than their European peers.

Figure 2: Annual Revenue Trends



Last 24 months example shows that, comparing to EU average, slightly smaller share (10 p.p.) of Polish companies faced increase in revenue, and, correspondingly, more of them suffered revenue decrease. However, Polish respondents seem much more optimistic about future, expecting in vast majority (86%) a boost in sales over the next 24 months.

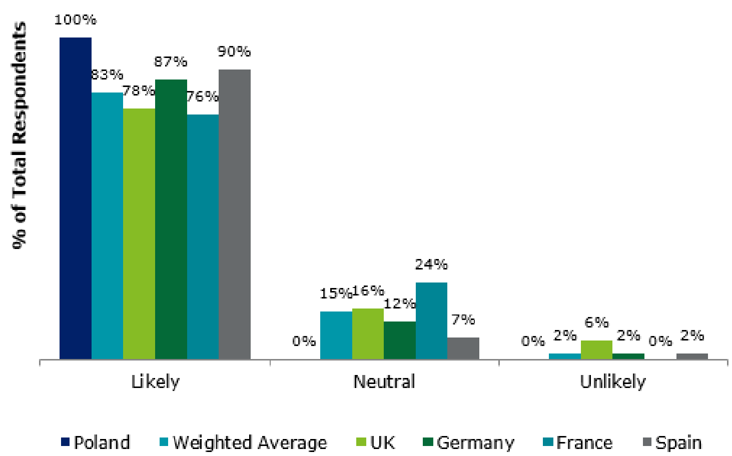
100% say cost cutting is likely

The importance of cost management become obvious while analyzing declared likelihood of cost reduction in the next 24 months. Enterprises realize that they need to prepare to allow revenue increases. Cost effectiveness is obviously one of the key factors of profitable growth.

Having said that, it's no surprise that all of the respondents declare cost cutting efforts over the next 24 months

When comes to strategic priorities Polish managers plan to concentrate on product profitability (57%) and cost reduction (43%) first rather than sales growth, being a top priority for EU companies. What's symptomatic, none of Polish respondents indicated neither Organization and Talent nor Balance Sheet Management as priorities choosing other instead. Looking at current HR trends in Poland connected with scarcity of workforce, growing labour cost and difficulties in recruitment, it seems that strategic priorities will have to be adjusted.

Figure 3: Likelihood of Cost Reduction in Next 24 Months

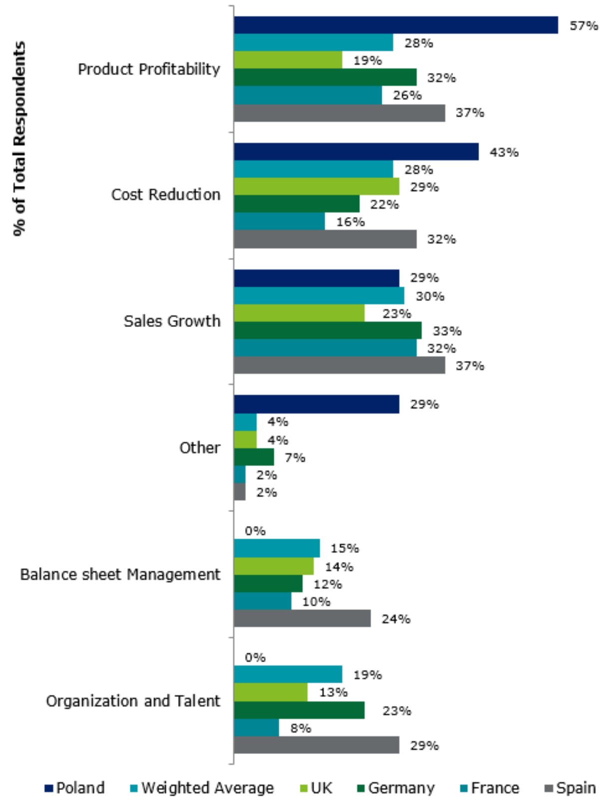


When combined with declared revenue projections it's visible that Polish companies adopt the same strategy as their European counterparts, called "save to grow" to position better against the same macro-economic concerns, government regulation changes and digital disruption. For Poles it becomes crucial due to global political trends affecting economic moods, currency volatility as well as internal issues connected with growing cost of work and high (as well as likely to increase) fiscal burden.

It becomes even more visible when one analyzes strategic priorities for sampled companies.

Product profitability becomes top priority

Figure 4: Strategic Priority in Next 24 Months



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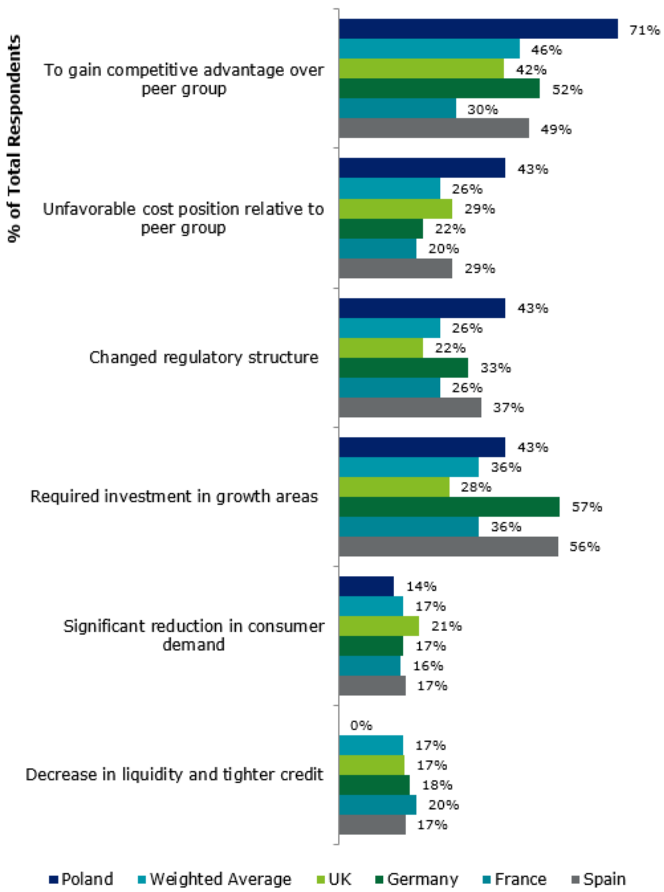
Poles realize that the strength of their products (both on domestic and international) lies in low costs thus concentration on product profitability and cost reduction.

Competition is a key driver

Figure 5: Drivers of cost reduction



Despite the fact that competition is not considered significant external risk, surveyed executives indicate gaining competitive advantage and improvement of cost position comparing to peer group (i.e. competition whether its internal or external) much more often than their peers from other EU countries.

This confirms 2 things: Poland is still a price oriented market; Polish manufacturing branches of international companies strive to cost-compete with manufacturing units located in other cheap labour countries

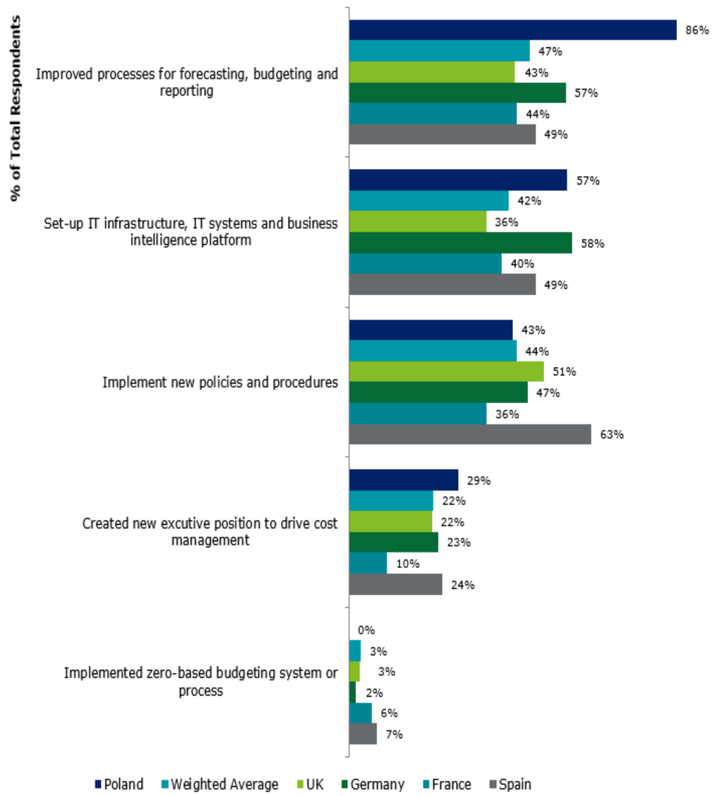
Polish respondents declare that they are much more often forced to work on costs due to changes in regulatory structure than their European peers (43 vs 26%), others which again highlights the fact that regulatory volatility is perceived as significant threat to business. Obviously Polish regulations are much less stable and undergo lots of changes recently. Other important cost reduction driver is the willingness to invest in growth areas and corresponding need to reassign funds. These responses indicate that Polish enterprises face more challenges from competition and regulatory environment but still are willing to invest and develop

On the positive side, significant reduction in customer demand is less frequent in surveyed companies as well as decrease in liquidity and tighter credit which was not indicated by any Polish respondent.

Bridging the gap

What are Polish companies doing different than EU companies to improve cost position? We're trying to bridge the efficiency gap in key areas like planning and systems support where Polish enterprises are lagging comparing to EU peers

<u>Figure 6: Capabilities Developed Over Past 24 Months</u>



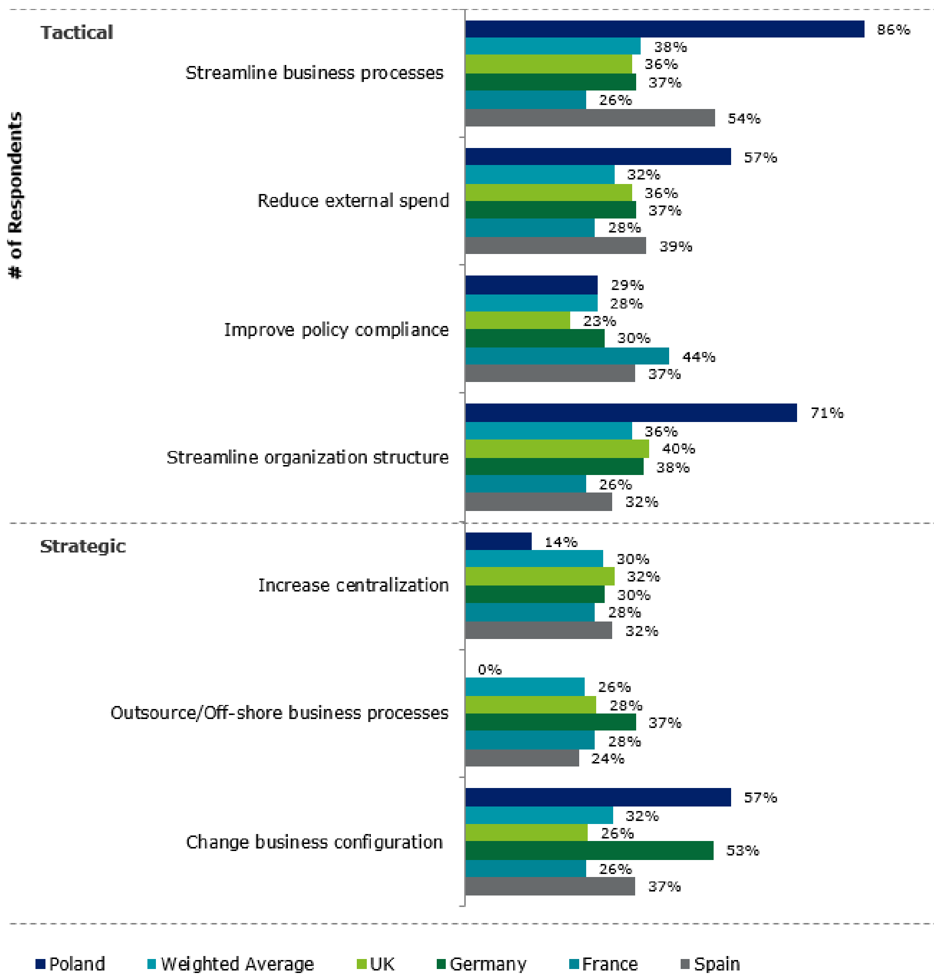
Over last 24 month Polish enterprises in majority (86%) worked on improving forecasting budgeting and reporting as well as implemented IT infrastructure and Business intelligence systems to track their performance (57%). It's highly likely that those two actions occurred in responses much more frequently than in other countries, due to Polish companies being less developed in these areas in general. Companies only recently had started to realize how bad forecasting influences their general performance and have begun implementing or improving Sales and Operation Planning/ Integrated Business Planning processes to gain control and visibility over their value chain and performance for the mid-term.

Correspondingly, as "you can't manage what you can't measure" quote from Peter F Drucker reads, companies are investing in performance tracking automation. With recent computing power and analytics software developments, it became affordable to much more companies and they are now using advanced analytics to derive additional value.

Also, significant part of PL and EU companies have implemented now policies and procedures as well appointed an executive to drive cost management efforts, knowing that clear accountability on higher organizational level supports achieving difficult targets.

Business model transformation is coming

Figure 7: Cost Actions Viewed as Most Likely in Next 24 Months



Future of cost management in Poland looks busy. All but one strategic and tactical cost actions are going to be applied over the next 24 months as Polish responses read. Companies have indicated that majority of their efforts will be focused on Business Model Transformation elements, from both strategic (change business configuration, 57%) and tactical (streamline business processes - 86%, and organization structure 71%) perspective.

Again, Polish enterprises surveyed seem to be chasing their global and European peers in that respect, who have been undergoing business model transformations on a global scale for several years already.

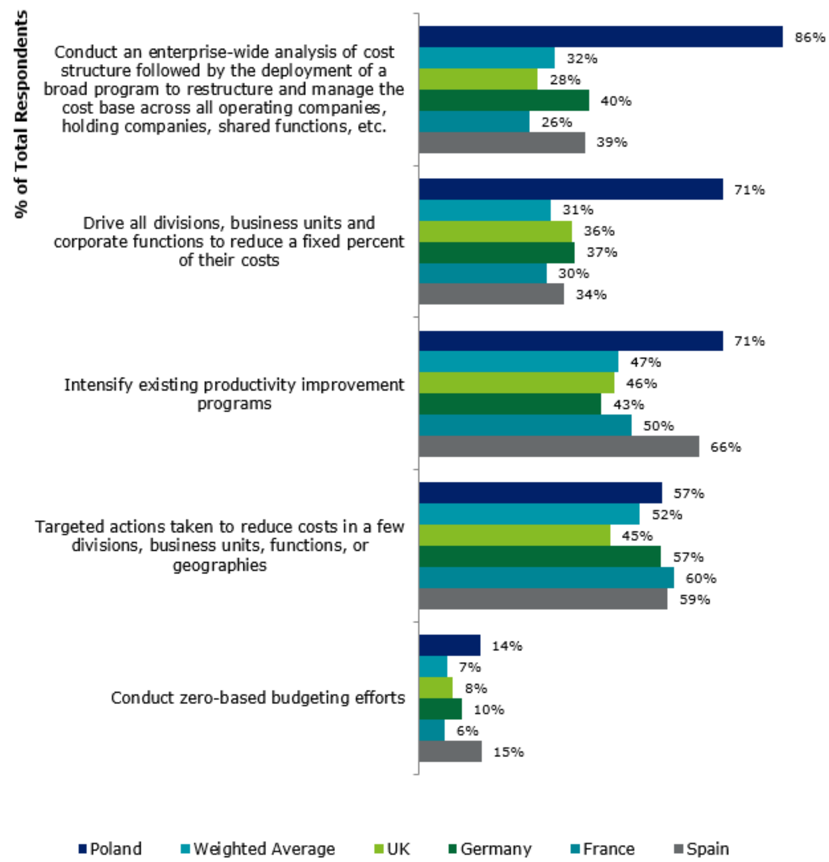
As the scale is different, Polish respondents clearly did not identify themselves much with increasing centralization, being already centralized on the country scale. It also goes without saying that outsourcing / off-shoring business processes was not a choice either, for Poland is an off-shoring/outsourcing destination already for European/ global enterprises.

Last, but no least - purchasing efficiency. Almost 60 % of surveyed enterprises will focus on reduction of external spend. Fortunately, there are lots of levers to be applied spanning from easy to implement but less effective to more yet more fruitful ones.

Clearly, all of the most likely actions require thorough preparation and good planning, as the evidence shows that even well prepared and wide scope initiatives may fail to deliver.

Polish enterprises have tried all approaches to cut costs

Figure 8: Approaches to Manage Costs over the Past 24 Months

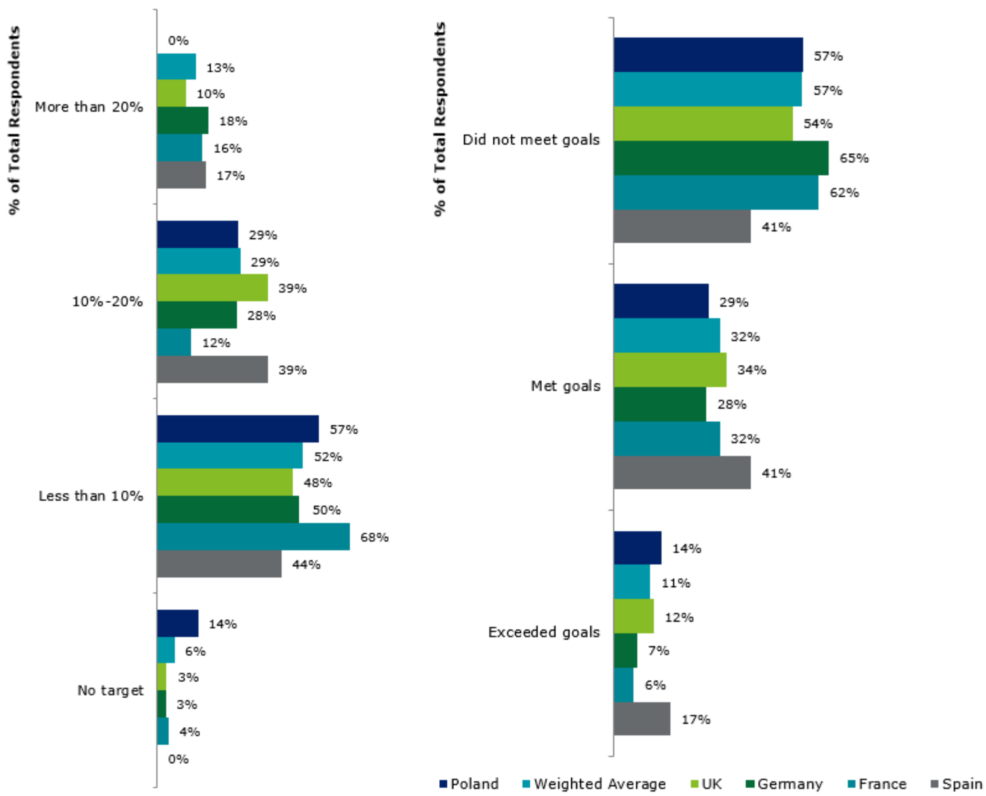


Comparing to their Western colleagues, Polish managers claim to have tried more approaches to manage costs over the last 2 years.
Majority of the respondents stated that they have tried either broad programs to restructure and manage cost base across all company units (86%), forced all units to cut a fix percent of their costs (71%) or invested in existing productivity improvement initiates (71%).
Having tried more approaches, Polish companies should have recorded more cost cutting success stories. Unfortunately, that's not the case.

Less ambitious yet still fail

Figure 9: Cost Reduction Targets and Success

Annual cost reduction targets **Success in meeting cost targets**



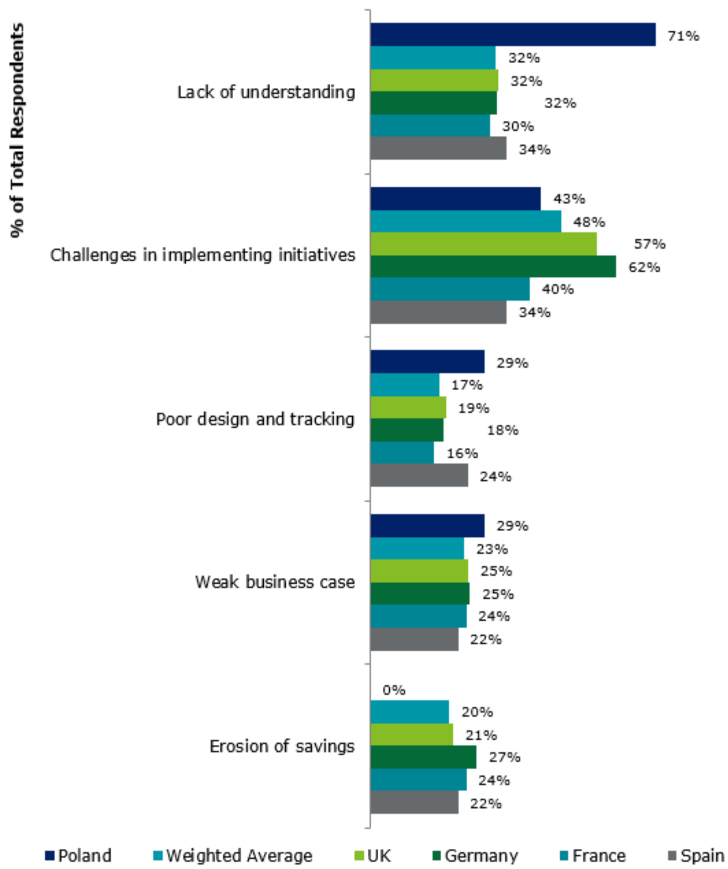
Survey responses show that on average Polish enterprises are less ambitious when it comes to cost reduction targets. None of surveyed companies from Poland had targets greater than 20%. Almost one third wanted to achieve 10-20 % reductions and over a half respondents claim to kept their targets set under 10% level. At the same time much more frequently they applied no targets approach despite implementing cost management policy.

What is more interesting, despite smaller average target and using variety of cost management approaches, the failure rate 57% is the same as EU average. That means that 43% respondents from Poland and EU (weighted average) met or exceeded their cost targets with Polish enterprises being slightly more successful on exceeding the targets.

What for …?

Comparing to other countries Polish enterprises indicate facing alternative difficulties. Whereas average EU enterprises simply faces challenges in implementation of cost reduction initiatives, overwhelming majority of Polish respondents struggle with lack of understanding.

Figure 10: Barriers to Effective Cost Management



Over 70% respondents report related to change management, as the key barrier to effective cost management.
As employees always associate cost management with redundancies, managers are typically cautious with communication.
Too often the information embargo goes too wide, influencing the relay of reasons and cost management strategy ti the middle management.
This clearly makes the changes more difficult to implement.

All too often managers are left on their own with cost reduction targets not being supported in any way by means to increase productivity (IT systems for instance)

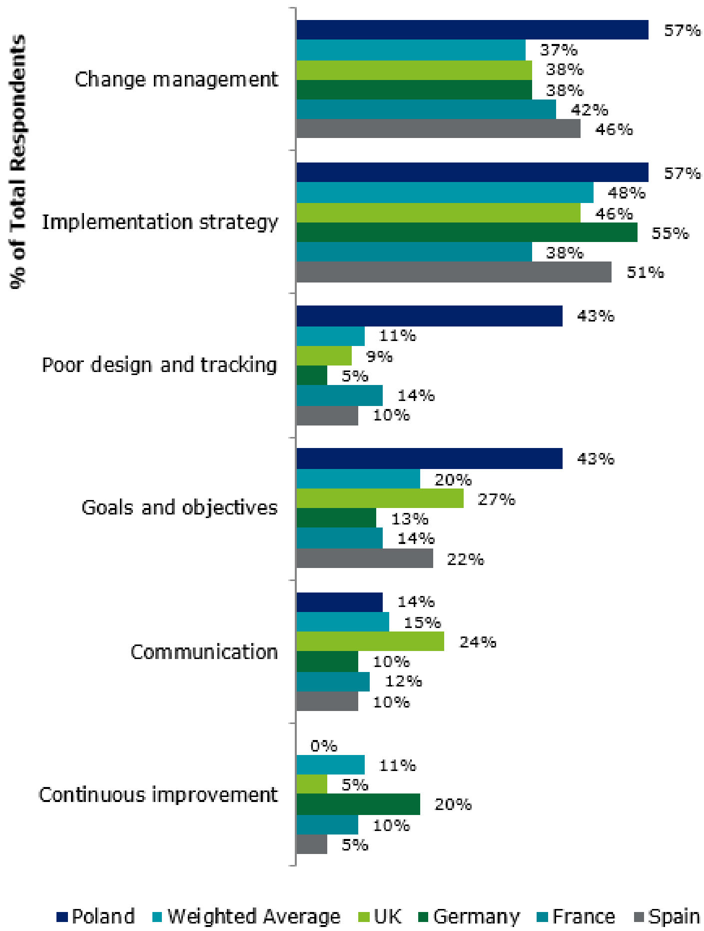
Most natural barrier - challenges in implementing initiatives (43%) are considered only second most crucial obstacle.

Other two barriers where Polish respondents stand out are poor design and tracking as well as weak business case. These two are clearly connected and add up to lack of understanding. Many cost reduction initiatives are not “value for money” tested. It means that they fail to bring value as they may seriously limit development capabilities or cost cut on one place crawl back in the other. This is mainly due to poor design and silo approach to cost management.

Previous cost management efforts should always be treated as a learning base for the future. So what are the lessons learned and how does it translate to actions planned for the next period?

Clear strategy and change management

Figure 11: Lessons learned – Poland



Polish respondents have learned the hard way about the necessity to have clear implementation strategy as well supporting the implementation with change management. (both 57%)

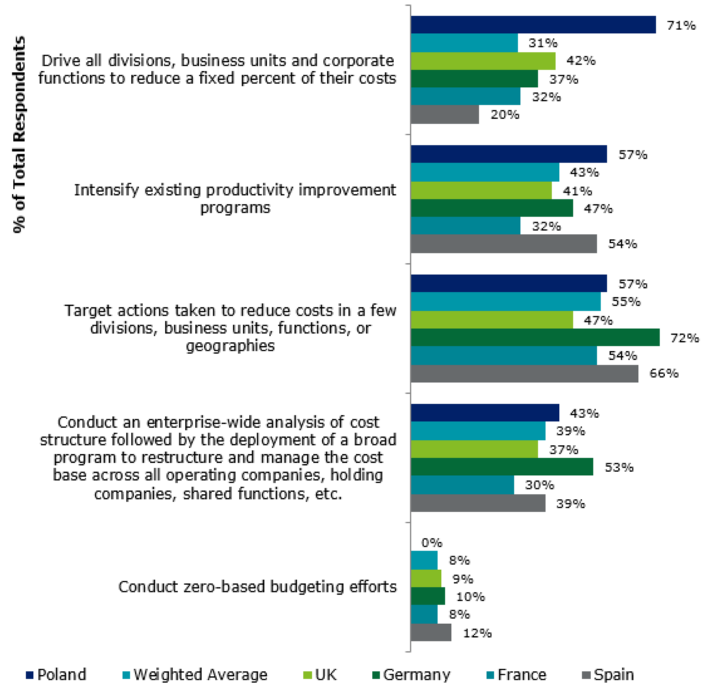
These are the two most important elements that are often get forgotten in Polish enterprises.

Cost management may seem an easy task but it's not about simple reductions. The initiatives need to be sustainable and not hamper business continuity / development. Thus surveyed companies see (much more often than their European peers) the need to have proper cost management initiatives design and implementation status tracking (43%) as well as the importance of setting clear goals and objectives (43%) to make the whole program understandable by managers and employees and to fight back the biggest indicated barrier to effective cost management.

It seems then, that Polish companies are well equipped with knowledge to continue the constant struggle for efficiency. Where do they plan to focus over the next 24 months?

Cheese slicing

Figure 12: Planned Cost Improvement Initiatives in Next 24 months



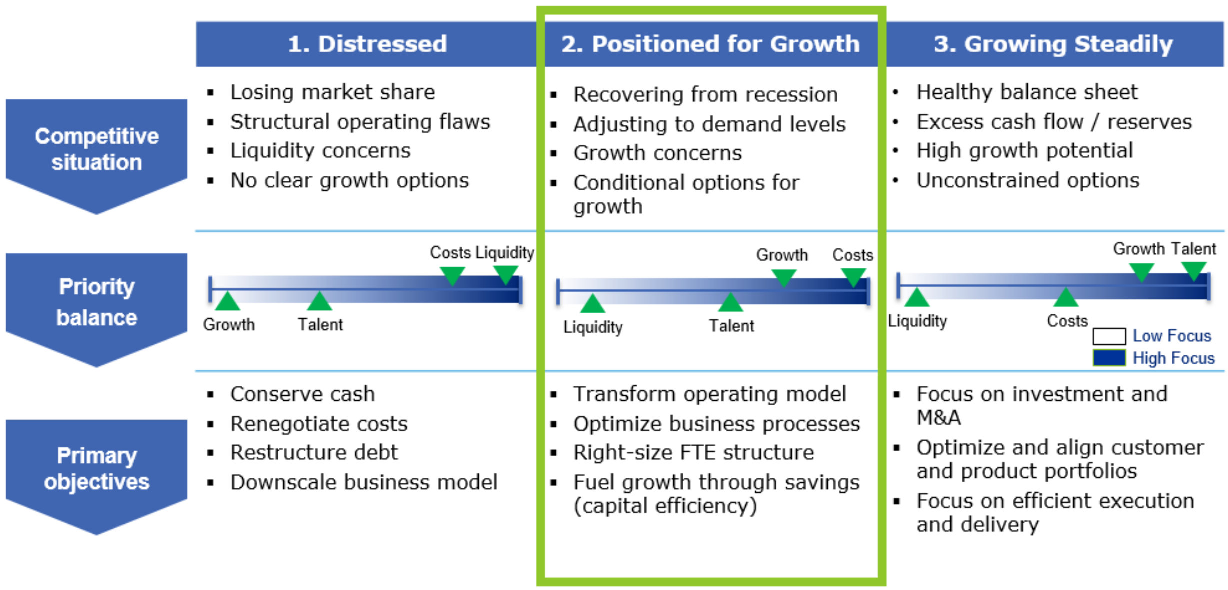
Building on their experience from the past as well as past initiatives, Polish enterprises are less likely to deploy broad cost management programs. Survey responses read that majority will employ a cheese slicing strategy, driving all units to cut a fix percent of their cost. Companies are also more likely (57%) to intensify existing productivity improvement programs than their European peers. The same 57 % share of respondents plan to take targeted actions in few corporate units.

Biggest popularity of cheese slicing may stem from the egalitarian character of this strategy. Having every unit share the same effort makes it easier to win employees commitment. However, the selection between cheese slicing and targeted actions must be a conscious one for costs are often distributed unevenly across enterprises and biggest efficiency gaps may be hidden in one or two units.

So what's the future for Poland?

For last couple of years since 2007 crisis, majority of European companies would fall into one of the traditional competitive scenarios presented on figure 13, called Positioned for Growth, where primary concern for companies are growth and costs.

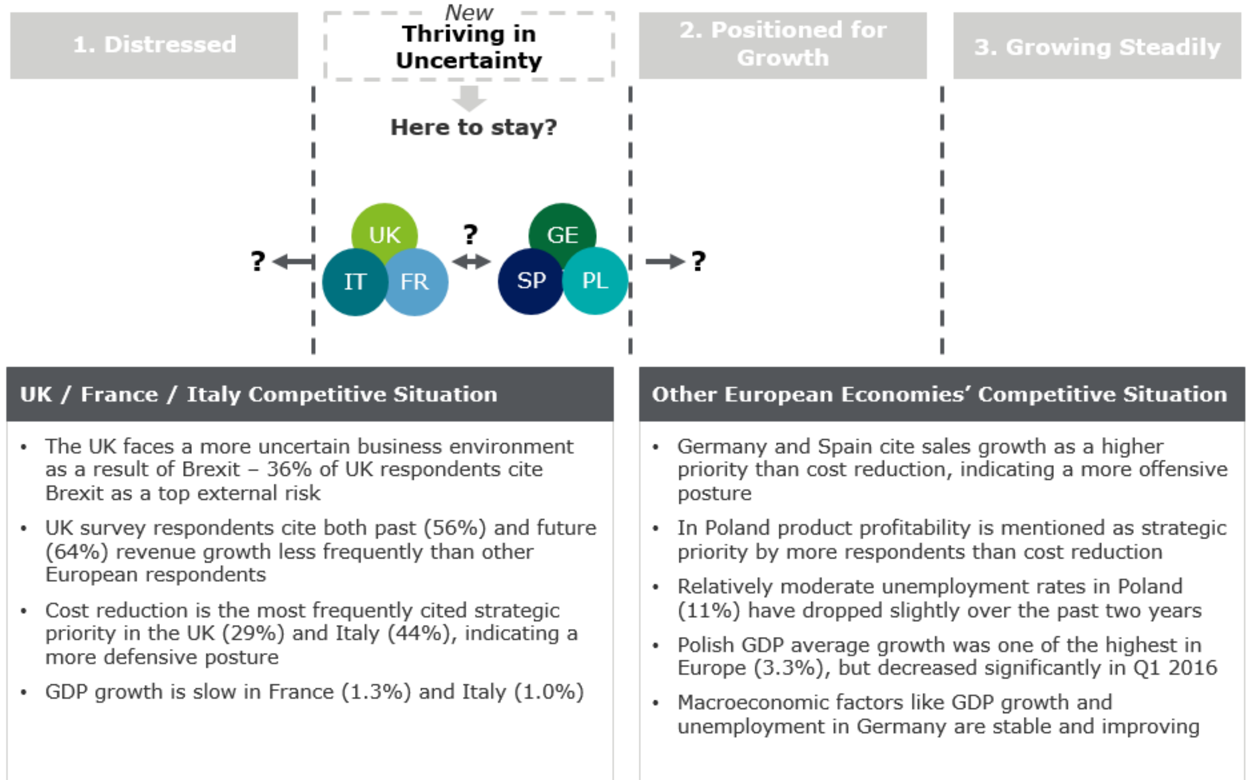
Figure 13: Traditional cost management scenarios



However, volatile market situation, uncertainty caused by Brexit and UE political crisis as well as regulatory uncertainty in Poland caused by initial policy change announcements made by Polish Government change the competitive landscape.

Uncertain times lead to definition of new competitive situation named "thriving in uncertainty", that involves organizations simultaneously pursuing the seemingly conflicting goals of growth and cost improvement. Recent economic outlook in Europe in general make majority of our survey respondents fall into this category.

Figure 14: Thriving in uncertainty

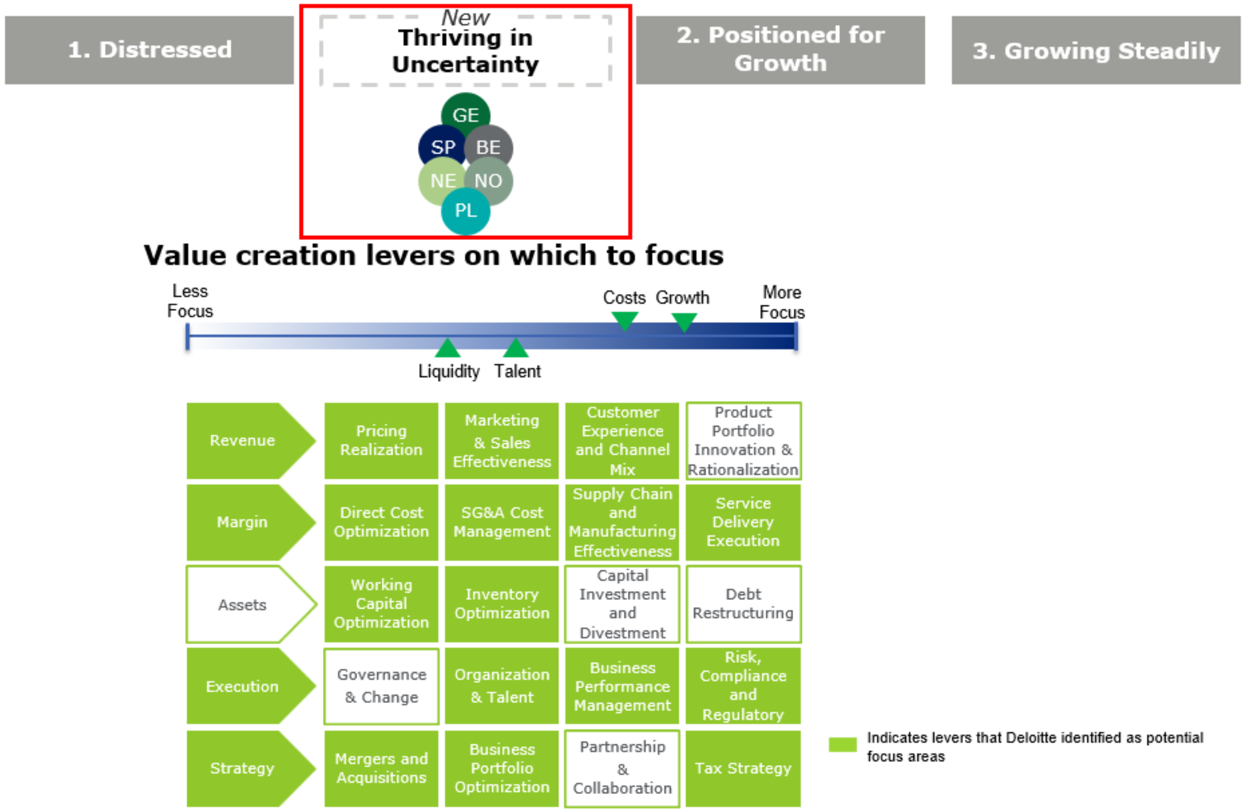


Survey answers of Polish companies reveal profitability focus, inclinations towards business model transformation, as well as main quoted (competitive and investment) reasons for cost cutting. This, together with their belief in revenue growth over the next 24 months positions them on a growth path together with German, Dutch, Belgian and Spanish peers.

Growth focus

Obviously Polish companies need to focus on profitable growth, which means that they need to tightly control their costs as much as they focus on increasing the revenue. In terms of value creation levers - uncertain times call for flexibility. Figure 15 presents variety of levers that can be adopted by companies in countries Poland to thrive and grow in uncertainty.

Figure 15: Growth-oriented Playbook;



What next

Even though the future is considered uncertain, entrepreneurs are not waiting passively for whatever comes. Apart from focusing on internal effectiveness tactics stipulated above they have to move with the market. And the market is changing. Apart from uncertainty, the biggest trends include increasing competitiveness, growing globalization, and multiplying regulation. On top of that, innovation cycle is shortening, and scale of innovations change completely change the business environment.

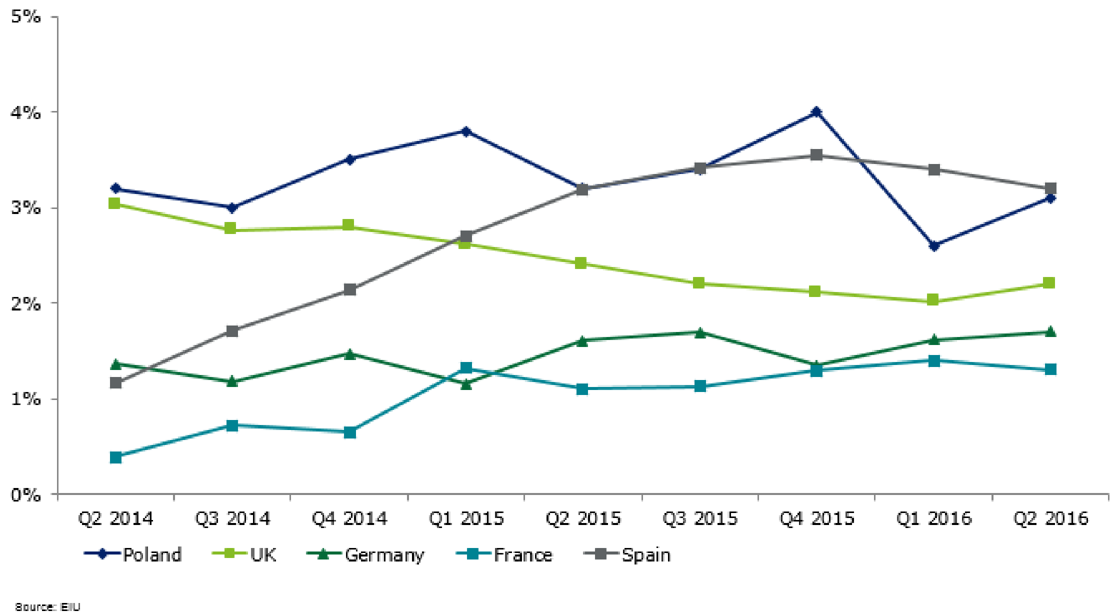
Thus, it has become more important than ever for companies to become efficient, nimble and responsive to changes. This may require applying 3 imperatives:

- transforming business model to make organization lighter and more flexible,
- becoming proactive by applying advanced analytics (ideally predictive or prescriptive) to anticipate business environment changes
- leverage technology to undergo Digital evolution.

Appendix

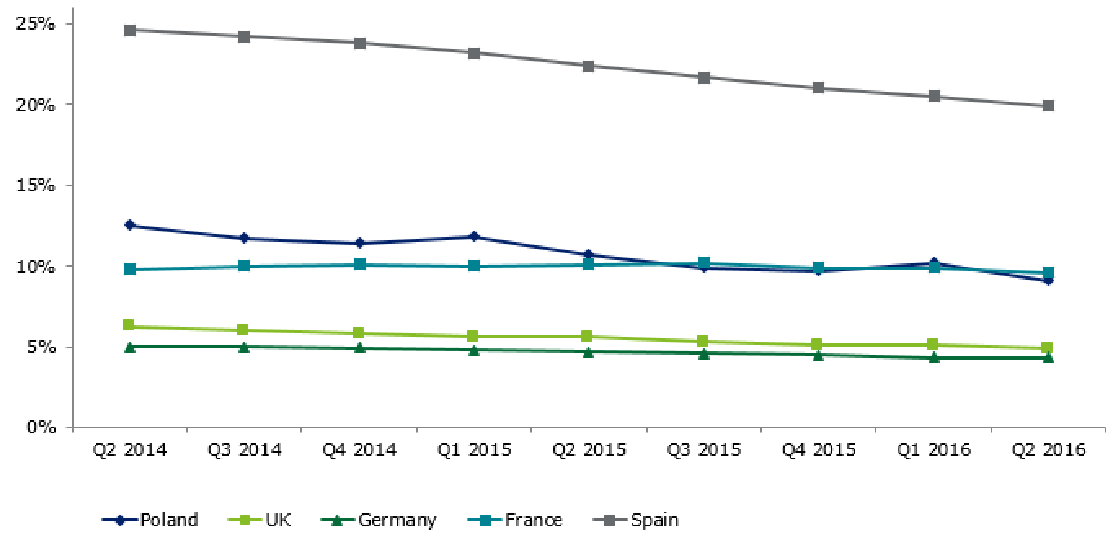
Macroeconomic trends for Poland

Figure A1: Real GDP in Past 24 Months



Poland's real GDP % change (YoY) during past 24 months was one of the highest among European countries surveyed. Poland's average growth over the period (3.3%) was significantly higher than in EU on average (1.9%). However Q1/2016 brought sharp decline in Polish GDP growth, with slight recovery trend in Q2/2016

Figure A2: Unemployment in Past 24 Months



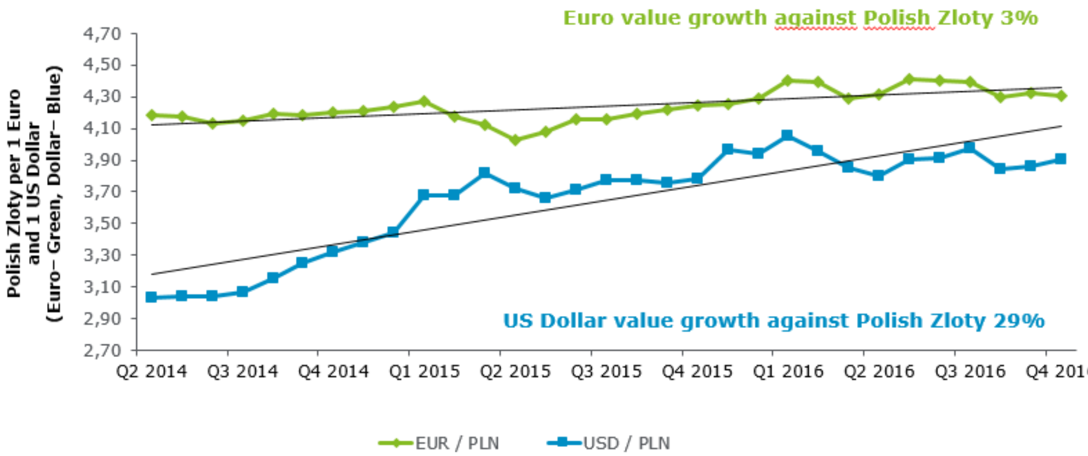
Source: EIU

Average Polish unemployment rate over the given period amounting to 11% is constantly falling and reached 8,3% in September 2016 according to GUS. Analysing unemployment rate, one must remember about huge differences between voivodships spanning from 5,1% in Wielkopolskie to 13.7% in Warminsko-Mazurskie (September 2016, GUS)

With current unemployment rate Poland places close to European average (10%). The highest unemployment rate was registered in Spain and exceeded 20% between Q2 2014 and Q1 2016. On the second end of scale, UK and Germany managed to keep unemployment rates relatively low - around 5-6% between 2014 and 2016.

During the considered period, Polish Zloty was steadily depreciating. Since Q2 2014 the currency lost its value against Euro by 3% and 27% against US Dollar. While this situation is favorable for Polish exporters, it negatively affects purchasing power in the economy. This was one of the reasons for Poland achieving, the first time in 21st century, a positive foreign trade balance in 2015.

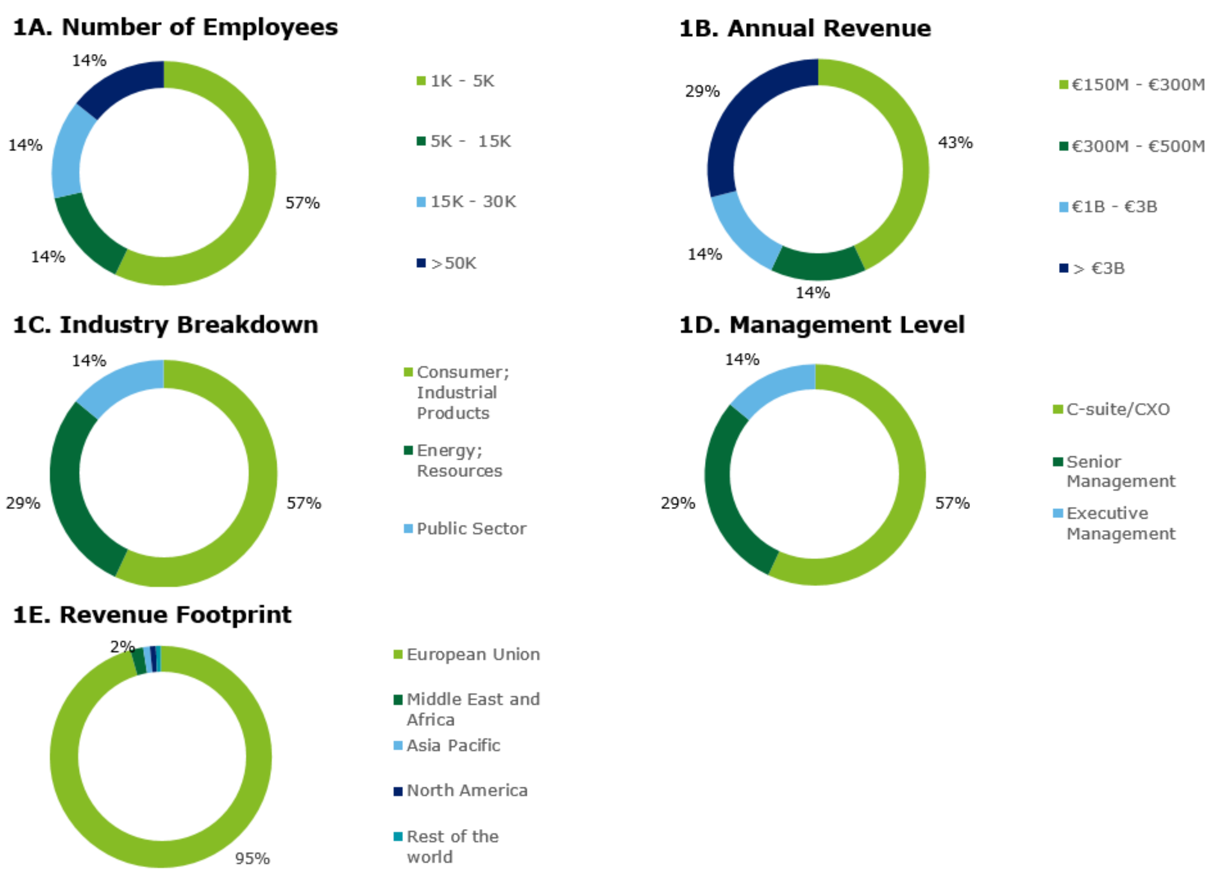
Figure A3: Exchange Rates in Past 24 Months (as of 03.11.16)



Source: x-rates.com

Firmographic summary for Poland

Figure A4: Firmographic summary for Polish respondents



This edition of the Cost Survey was the first that involved Polish companies. The sample of Polish companies that finally took part in the survey did not exceed 20.

Majority of Polish respondents (57%) are from organizations not exceeding 5 000 employees. Following the country economic size, we had overrepresentation of companies earning below €300M annually and underrepresentation of companies earning over €1B comparing to other countries.

Nearly all of respondent companies' revenues are generated within the EU (95%), indicating that the surveyed organizations are heavily dependent on trading within own continent.

Most surveyed executives work in consumer & industrial products industry (57%); 29% in energy and resources and 14% in public sector - transportation.

Great majority of respondents hold C-suite/CXO positions in their companies (57%).