Clear sky ahead
but beware of unexpected turbulences
Romania CFO Survey 2017
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Andreas Matje

Chief Financial Officer and
Member of the Executive Board
OMV Petrom SA

“The most important responsibility of a CFO is to ensure financial stability and flexibility. At OMV Petrom, ensuring a strong balance sheet will enable us to continue investing in line with our strategy.”
Introduction

In 2016, Romania continued to lead the region in terms of Gross Domestic Product growth and the expectations of the Chief Financial Officers are that this trend will continue in the following year. However, after a year marked by international turbulences, predictions are even harder to make, especially on a complex environment as the one we are operating right now.

The Romanian economy went a long way from the “moment zero” of post-socialist reality, the transition phase, growth, global crisis and back into another development cycle. We are experiencing now a window of prosperity in a maturing economy, with lots of opportunities for both local and foreign entrepreneurs, and with a pool of brilliant talent who can turn dreams into reality.

This positive trend is reflected also in the balance sheets of the Romanian companies but most importantly in the role of the Romanian CFOs. From simple accountants with narrow and old-style responsibilities, they have transformed into emerging leaders, with a significant role to play in their companies and complex attributions that include strategic thinking and vast knowledge: the role of the Chief Financial Officer.

In order to continue to grow in a sustainable way, both CFOs and companies need stability and predictability. This can ensure not only healthy, thriving organizations that contribute to society, more jobs and a better prepared workforce, but also a heritage for the next generation, be it entrepreneurs, future CFOs or anything else they aspire to become.
Lucian Vilau

VP Finance and Indirect Procurement, CFO Mega Image

“Constant changes in the fiscal regulatory environment are driving us to become increasingly flexible so we can adapt faster to new demands than ever before.”
Local Insight

Romanian CFOs are the most optimistic in the region in terms of GDP growth and other financial indicators, but we must keep in mind the complexity and unpredictability of the current environment in which businesses operate nowadays.

A growth of more than 2.6% in GDP is expected in the next 12 months by almost 47% of the interviewed CFOs, making them the most optimistic in the region, along with Polish CFOs. Expectations are supported by positive prospects for the economy for the coming year.

The optimism expressed by interviewed CFOs makes us confident that the appetite for investment is rising. As we know from our experience, the perception is very important as it influences business decisions. However, the sentiment is sensitive to sudden changes and, in this regard, we have to take into consideration the fluctuations that may occur in the fiscal environment.

At the beginning of this year, a plan for tax cuts in 2018 has been presented: VAT is to be decreased from 19% to 18%, tax on individuals’ income from dividends from 5% to 0%, cumulative reduction of social security contributions of 4.25 pp, decrease of tax on income from 16% to 10% for incomes higher than 2,000 RON and from 16% to 0% for those lower than 2,000 RON.

Shortage of qualified work force remains an area of concern in 2017 with respect to the potential risks the companies may be facing. Since this is one the biggest risks for companies, a decrease in taxation might be welcomed. One of the major concerns expressed by the CFOs relates to the current educational system, which is not always adjusted to the companies’ needs. Companies need to invest significantly in training the newly hired to be able to fulfill the required tasks at the required standards.

On the positive side, we note that 70% of the CFOs expect that the revenues of their companies to increase by 34% considering that the revenue increase will be also accompanied by increased profit margins.
The Role of the CFO

The role of the CFO continues to develop in Romania as the market gains in maturity. The responsibilities of the CFO are more and more diverse, touching strategic areas of the business, being a solid pillar in the future development.

As reflected in the answers to the survey, classical roles like cost guardian, handling compliance work, supervising day-to-day activities are not at as high on the agenda of today’s CFO. This may be a reflection of multiple (including but not limited to) influencers such as economic cycle of industry, change in company’s strategic outlook and general development of the CFOs role in the economy.

Business and financial strategies are considered the most important ones by more than half of the CFOs. These strategies are driven and rely on external factors influencing the business, which however cannot be controlled by but the business. A change in tax environment, either local or at European level can influence significantly the companies’ strategy and CFOs must react quickly in order to adjust to the new requirements. More than 31% of the CFOs find it challenging to manage and control the budgeting process. Be it large or smaller company, budgeting requires making assumptions about growth, development of the market, cost evolution, etc which are more difficult to estimate.
Andreas Matje
Chief Financial Officer and Member of the Executive Board
OMV Petrom SA

“The international decline in crude prices and continuous strengthening of the US dollar are creating additional volatility and uncertainty. These represent a major challenge in the current market and form one of the priority risk areas for us to address.”
Economic Outlook
GDP Growth in Romania

Romania’s GDP growth has been above expectations, which led to a boost of confidence in the economy. When asked what is their expectation regarding GDP growth in 2017, we see almost half of the CFOs are looking at the highest interval for growth, a significant one compared to the previous year, when CFOs were a bit more cautious in their estimations.

On the opposite side, we see almost 30% of the CFOs expecting a growth of less than 1.5%.

Fig. 2: Local CFOs expectations for the GDP growth in Romania in 2017
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This level of confidence is confirmed by the World Bank predictions, as it can be seen in the above graph. Compared to Central Europe, Romanian CFOs seem to be the most optimistic in the region together with the Polish respondents.

Looking at the region, Hungarian CFOs are most pessimistic about their country’s GDP growth, with 0% opting for the highest growth interval. Croatia and Czech Republic seem to be more cautious as well, in line with Eurozone’s CFOs.
Consumer Price Index

Almost 60% of the local CFOs expect consumer price index to rise over the next year. These expectations rely more on normal business cycles and macroeconomic evolutions and do not give rise to worries about excess inflation.

However, current government decisions to increase minimum wage could give rise to inflation if not compensated by the labor productivity.

Unemployment

Similar to last year, most CFOs expect a decrease in the level of unemployment. Very few of them (15%) would expect an increase in this area.

This expectation is well correlated to the shortage that is felt by companies with their workforce. The favorable economic environment with the GDP growth leads to creation of new jobs. The unemployment rate in 2016 recorded an average of 4.7% according to National Institute for Statistics, which is one of the lowest since 2008.
Brexit

Given the complexity of the event, opinions regarding Brexit are rather diverse. However, over half of the Romanian CFOs have a negative feeling caused most likely by the uncertainty of the actual effects during the negotiations and post-Brexit events.

39% though have a positive sentiment. This could be linked to a perceived future increase in the ability of retaining workforce in the local market due to mobility restrictions.

Romanian CFO Survey shows a significant difference in expectations compared to Eurozone countries, where more than 29% of the CFOs expect a negative impact.

It is most probable that the vote from United Kingdom has created some panic due to its novelty, but the effects will be seen in the years to come. It remains to be seen how not only UK but also across the other rest of EU member states will adjust to these new realities.

The chart above illustrates the various difficulties that may result after the Brexit and how these have been rated by the Romanian CFOs.

Overall, when compared to the region’s averages, Romanian CFOs are more concerned about Brexit than the rest of the participating countries.

Once again, taxation and workforce mobility are the two topics that score high on the chart above, introducing additional factors and uncertainties for CFOs.
Economic Outlook

30% GDP growth of over 3.5%

47% expect unemployment to decrease
Consumer Price Index levels to increase

59%

53% Brexit will have a negative impact
Romanian CFOs continue to believe that although there are no huge threats within line of sight, the current economic balance is still fragile and an eyes wide-open policy should be a must for all companies.

The results of the survey regarding uncertainty show almost no change compared to previous year, with 62.5% of the CFOs indicating a normal level of uncertainty for both years. This could be linked with a good evolution of the businesses, where tackling day-to-day uncertainties has become normal and can be described as prudent level of caution when assessing uncertainties.

Fig. 9. Local CFOs’ view on external financial and economic uncertainty facing their business
Shortage of qualified workforce has become a significant area of attention for Romanian CFOs, with almost half of them indicating this as an area of concern. This represents a significant increase compared to 2016 and will most probably continue to stay high on the agenda, considering the shift of generations that is currently taking place all over the world.

Millennials are replacing boomers in the work force and have different expectations from their employment experience. Companies and human resources departments, specifically, will need to change and adapt their strategies to meet those requirements to meet retention targets.

Pressure on prices, together with unstable economic and tax law also have risen the level of concern. This may be linked to the recent elections in Romania and changes new government may bring.

Continuous stability and positive expectations for the year to come has developed the risk appetite of the CFOs. Nevertheless, risk taking is more an entrepreneurial and leadership attribute thus the overall view as to taking additional risk is still strongly negative in the view of the CFOs. It is natural and expected that CFOs are more cautious and risk averse due to their job description as custodian of the company’s assets.
Debt Servicing Capacity

With a large number of CFOs believing that 2017 will bring more revenues and better margins to their companies and 62.5% considering internal financing as attractive, we notice an increase in the expectations with respect to debt servicing capacity.

Nevertheless, this is not expected to lead to a change in the financing structure of the companies as half of the respondents aim for increased gearing in 2017.

Fig. 12. Local CFOs view on the financial prospects of their companies, compared with six months ago
The latest tax changes seem to impact differently various market sectors as we can see from the significant variations from last year in all expected outcomes of the tax changes.

This change shows that lack of predictability affects the companies’ capacity to have stable development.

For 2017, CFOs are looking at maintaining traditional company departments. The interest for Shared Service Centers seems to have faded away somewhat, from 40% in 2016 to 26.6% in 2017. Outsourcing seems to be more interesting than the use of Shared Service Center. Outsourcing may bring results faster than the time required to set up a Shared Service Center, due to the fact that you can directly target the company with the desired resources and skills, instead of spending the time with hiring and training people for a Shared Service Center.
M&A Market

2016 was an exceptionally good year in the Mergers and Acquisitions (M&A) market, both from the volume point of view – between 3.4 and 4 billion EUR, but as well in respect of the number of transactions and the number of large transactions. The end of the year was decisive in the market’s development, with most of the large transactions being concluded in the last quarter. Our financial advisory consultants expect that 2017 would be most probably similar in terms of size of the market, however they expect that the advisory number of large transactions will reduce compared to 2016.

Fig. 15. Local CFOs expectations on M&A levels in Romania
Human Capital - Talents in Finance

Lack of required skills and an out of date education system are the main challenges in attracting qualified personnel. As technology evolves and businesses become more and more complex, lack of qualified workforce will be more and more a competitive disadvantage and there are no clear signs that the necessary efforts are being made to modernise the education system in order to start minding the gap.

Fig. 16. What are the main reasons why you consider your company has difficulties in finding qualified personnel on the market?
Business Environment Outlook

Romanian CFOs are highly optimistic

45% believe that shortage of qualified workforce is posing the highest risk to their business

52% believe that M&A market will be attractive in the next 12 months

44% believe that current tax changes do not have any impact on the company’s business

70% believe it is not a good time to take a greater risk in balance sheets
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Romanian CFOs are highly optimistic:

- 55% are optimistic about the financial prospects of their company.
- Believe it is not a good time to take a greater risk in the balance sheets.
- Believe that the M&A market will be attractive in the next 12 months.
Company Growth Outlook
Priorities and Risk Appetite

Despite a favorable economic context, both local as well as international companies are still cautious with respect to new investments as well as market share. Focus seems to be on the cost control and expanding through current product portfolio and market diversification.

Correlated with the reduced appetite for expanding into new markets, expansion through acquisition is not favored by 64% of Romanian CFOs. For 2017, M&A remains under the control of investment funds and banks.
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Tapping into current market reputation and transferring it to new products/services seems to be the key strategy for business development, according to the survey.

55% of the CFOs consider it is important to introduce new products and services to the market, to increase the business. In an ever-changing world, with instant access to information, consumers are able to make comparisons, access novelties sooner and companies must react quickly to meet expectations.

In this era of technology, most of the CAPEX expenditure ideas are IT related. Although most of the interviewed CFOs see CAPEX development as an area of focus, the fast pace of technological evolution casts also some doubt on the actual CAPEX decision, as the impression is that investments done “today” are already obsolete “tomorrow”.

In Fig. 18, we see the distribution of priorities for introducing new products/services over the next 12 months. 55% of respondents consider this important, 31% somewhat important, and 14% less important.

In Fig. 19, we see the distribution of priorities for increasing capital expenditure (CAPEX) over the next 12 months. 47% of respondents consider this important, 28% somewhat important, and 25% less important.

In Fig. 20, we see the CAPEX focus areas for the next 12 months, with IT Hardware and Software being the most focused area in 2017 at 37.5%, followed by Plant & equipment - new technology at 32.8% and Plant & equipment - upgrade current technology at 34.38%. Real Estate and Other reasons are the least focused areas.
According to the survey, companies are not yet eager to increase OPEX spending, correlated with the strict cost control that is still on the radar of most of the companies. Only 5% of Romanian CFOs believe it would be important to increase OPEX, while 38% of the respondents consider this increase as not important.

According to the survey, companies are not yet eager to increase OPEX spending, correlated with the strict cost control that is still on the radar of most of the companies. Only 5% of Romanian CFOs believe it would be important to increase OPEX, while 38% of the respondents consider this increase as not important.

Cost reduction - direct costs

<table>
<thead>
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<th>Importance</th>
<th>Less important</th>
<th>Somehow important</th>
<th>Important</th>
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<tr>
<td>2017</td>
<td>14%</td>
<td>44%</td>
<td>42%</td>
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<tr>
<td>2016</td>
<td>43%</td>
<td>39%</td>
<td>18%</td>
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Cost reduction - indirect costs

<table>
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<tr>
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<th>Less important</th>
<th>Somehow important</th>
<th>Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>8%</td>
<td>50%</td>
<td>42%</td>
</tr>
<tr>
<td>2016</td>
<td>13%</td>
<td>67%</td>
<td>20%</td>
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</table>

Cost control

<table>
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<th>Importance</th>
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<tr>
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<td>3%</td>
<td>24%</td>
<td>74%</td>
</tr>
<tr>
<td>2016</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
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Direct and indirect costs have reappeared on the CFOs radar as an area of focus with 42% of them considering costs reduction as an important area of concern. This could be linked with the expectation that technology will bring a corresponding efficiency and reduction in other costs. Cost control and cost reduction will be a priority for CFOs in 2017. It seems that the very positive view with respect to financial prospects of their company is also accompanied by a bigger need to control costs, as CFOs believe that the faster the speed increases, the need for better control grows. At high speed, even small mistakes can have a huge impact in the company.
Growth Forecasts

Fig. 23. In your view, how are revenues for your company likely to change over the next 12 months?

- **Decrease in 2017**: 11% (2016: 6%)
- **No change in 2017**: 19% (2016: 16%)
- **Increase in 2017**: 70% (2016: 78%)

Although confidence levels have slightly dropped in 2017, the CFOs in Romania are the most optimistic in the region.

Compared to 2016, there is a decrease of 8% in the number of CFOs expecting their revenue to grow for the coming year. Those CFOs seem to have moved to the “decrease” bucket, however, the expectations for revenue growth are vastly positive.

Fig. 24. In your view, how are operating margins for your company likely to change over the next 12 months?

- **Decrease in 2017**: 19% (2016: 16%)
- **No change in 2017**: 47% (2016: 34%)
- **Increase in 2017**: 34% (2016: 50%)

The number of CFOs who estimate an increased operational performance for their companies has decreased to 34%, compared to more than half the year before. 47% of the CFOs expect stagnation for operating margins, suggesting that companies are keener on maintaining current operational performances and benefits only from revenue growth.

Fig. 25. In your view, how is the number of employees for your company likely to change over the next twelve months?

- **Decrease in 2017**: 11% (2016: 12%)
- **No change in 2017**: 42% (2016: 31%)
- **Increase in 2017**: 47% (2016: 57%)

The greatest proportion of CFOs predict their companies workforces will grow. Even though expectations over downsizing have decreased since last year, more CFOs than last year are predicting stable workforce size for 2017.

We believe that this might have a downwards long-term effect through a decline in the talent retaining capabilities of the company, which will impact its overall business activities.
Debt & Financing

The financial crisis established a significant break in the chain of trust and created very high barriers for debt availability which then led to a reduced attractiveness of financing. Our survey is clearly suggesting that the negative effects of the financial crisis are over and investment sources seem to become again both attractive and easily available.

Most of the CFOs perceive bank borrowings as attractive, in contrast with last year. This is due to the drop in interest rates and it may also indicate that the commercial banks in Romania have performed better in their approach to the Romanian companies.

Equity and corporate debt continue to be at the low end of the attractiveness specter for the Romanian CFOs. This continues to reflect that the private equity market in Romania is underperforming.
Bank borrowings have gained in attractiveness, as the number of CFOs looking at this financing source has almost doubled compared to previous year. The shift has been made from the neutral category, while the number of CFOs finding this unattractive has remained somewhat stable.

Also EU funds and internal financing continue to be very attractive, mainly because they are perceived as a very low, if any cost for the company.
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Fig. 31. What is your aim for your level of gearing over the next twelve months?

50% of the CFOs are expecting an increase in the gearing level for the year to come. This seems correlated with the increase in turnover and expectations for CAPEX investment, or introducing new products or services to the market.

Fig. 32. Local CFO's expectations regarding their ability to service debt

Half of the Romanian CFOs have expressed positive expectations related to their ability to service debt over the next three years compared to 44% last year. This seems to show that positive feelings regarding revenue and margins development will also result in more liquidities available to service debt.
Workforce-related costs are very likely to increase in the view of the CFOs, most probably because of changes in the level of minimum salary in Romania and also due to low availability of qualified work force. This seems to also impact the expectation over production cost and business-related services expenses. Real estate costs are thought to be increasing, showing that the real estate market continues to pick up after the financial crisis.

The focus remains high on improving the IT infrastructure regarding cyber security, hardware & software, the quality of the workforce and adopting new technologies.

For hardware, the trend is set for a more conservative development, the main spending being channeled towards upgrading the current asset base, rather than adopting new technologies.

The Romanian CFOs seem to prefer more the road in developing the IT infrastructure, while maintaining a more cautious approach in adopting new technologies, even in the context of a positive economic outlook. The choice is consistent with the risk-averse behavior, which prefers smaller, and more stable returns, rather than adhering to a more uncertain environment, which brings the uncertain promise of larger returns.
Company Growth Outlook

Strategies that are likely to be a priority for businesses over the next 12 months:

- 74% consider expanding into new markets important
- 55% believe introducing new products/services is important
- 38% believe cost control is important
- 63% are optimistic about internal financing

(60% in CE)
70% consider revenues will increase.

More than 70% of companies consider that revenues will increase over the next 12 months.

- 70% of companies are optimistic about internal financing.
- 10% believe that cost control is important.
- 10% consider that introducing new products/services is important.
- 10% consider that expanding into new markets is important.
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Mega Image

“Legislative changes can lead to distortions in the food trade market. As new legislative initiatives have been introduced across Central Europe, I’ve noticed that in Romania besides neglecting the free market principles a lack of real consultation, poor deployment plans, inconsistent guidance and short implementation deadlines.”