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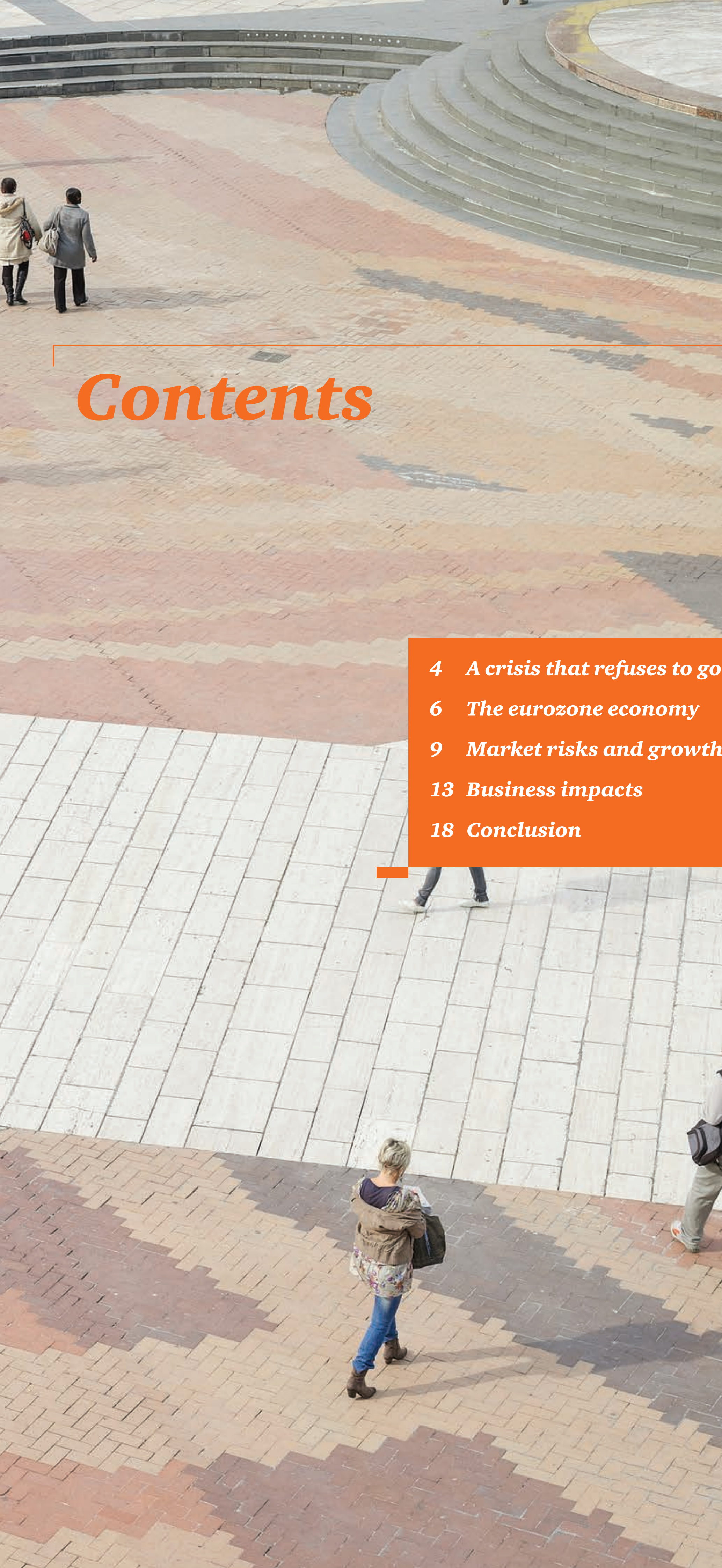
# ***Fit for business:*** Preparing for dramatic change within the eurozone

*Capitalising on market growth opportunities and addressing the emerging risks*

*November 2014*



# Contents

# *A crisis that refuses to go away…*

In April 2014 we published a paper called 'Fighting fit: Are you ready to tackle future Eurozone shocks?'[1] In it, we painted a picture of a eurozone in which the tensions from a rumbling debt crisis, divergent growth rates and other economic challenges, such as deflation, were being exacerbated by new factors, including renewed stresses in the eurozone's banking sector, austerity fatigue, high youth unemployment and the rise of extremist political parties. We also addressed a number of global megatrends including demographic and economic shifts.

We went on to investigate the implications for business and industry – asking how well prepared companies in and beyond the eurozone were for the crisis conditions that we see today. We urged business leaders to get their organisations fit for any eventuality, putting them in position to ride out the shocks and seize the opportunities across every aspect of their business – be it finance, tax, sales, research and development, production and sourcing and technology.

### *…exacerbated by uncertainty and confusion*

The implication of our analysis was that businesses within the eurozone were failing to use the crisis conditions as an opportunity to drive real economic growth for their stakeholders, shareholders and society at large. So, several months on, how much has changed? In fact, very little. The malaise, as evidenced through the sluggish performance of a large number of industry sectors, and the uncertainty over the health of the financial services sector caused by the review into bank balance sheets has done little to ease market concerns. Testimony to the ongoing confusion around the eurozone is the debate around quantitative easing.

Against this background, the status quo of economic flux and slow or non-existent economic growth is continuing to play out, amid ongoing fears over the long-term viability of the monetary union itself. The increasingly sclerotic state of the economy is throwing the spotlight on the European Central Bank (ECB), which has found itself under pressure to stimulate the eurozone economy. Hampered by its own remit, the ECB's attempt to restore confidence and growth is making little headway.

A key issue is an over–reliance on debt by the private and public sector. In the run up to the crisis this situation fuelled a divergence of competitiveness between those eurozone countries running a current account surplus and those running a deficit. The sizable and persistent imbalance was supported by a complementary flow of credit from the surplus countries to the deficit countries – for example from Germany to Greece. This situation fuelled a build-up in both public and private debt, delayed a correction in competitiveness, and allowed the structural problems of the eurozone to be hidden.

1 http://www.pwc.com/en_GX/gx/advisory-services/assets/pwc-non-fs-eurozone-paper-single.pdf

*In terms of the size and scope of the research study, it covers 384 senior executives and decision-makers in non-financial services companies based in countries across the core and periphery of the eurozone.*

The eurozone continues to be an uneasy and fragile place to conduct business. The current low-interest rate, low-inflation and low growth environment is raising structural and financial challenges for all types of businesses.

So the current conditions raise major causes for concern. There is a sense that when change does happen, the impacts will be sudden, dramatic and highly disruptive. How well-prepared are businesses across the eurozone for whatever developments may arrive? We call for businesses to prepare as a matter of urgency for the risks and the value creation opportunities that will occur within this new paradigm.

## *Why we conducted the 'Fit for Business' research...*

We decided to test out our point of view by conducting a research study of business leaders across the eurozone. The research, under the banner 'Fit for Business', is aimed at enabling us to understand the views of eurozone businesses around three key aspects of the current market environment:

- Their perceptions and expectations of current trends and future changes affected by the eurozone economy;
- Given these expectations, their own companies' positioning and responses within the eurozone economy, including opportunities and risks; and
- How well-prepared and resilient they consider their organisation to be to future developments in the eurozone economy, including a scenario where there is a worsening of crisis conditions and long-term stagnation.

We have used these three areas of focus to help us structure this paper, in which we provide an overview of the main results along with recommendations.

The research study covers 384 senior executives and decision-makers in non-financial services companies based in countries across the core and periphery of the eurozone. The study elicited an even response rate from the various eurozone territories included, as well as a good balance of industry, and size of organisation in both sales/turnover and employment terms. Around 80% of respondents were at C-level including CEO's, CFO's, COO's and CRO's. The remaining 20% were group and divisional heads. The majority of the organisations interviewed have a global presence, and just over 10% are headquartered outside the eurozone. The sample represents a comprehensive cross-section of the leading organisations operating within the eurozone today.

## *...to enhance businesses' readiness for threats and opportunities*

Our core aim in conducting the research is to help inform and enhance the preparations by businesses across the eurozone for whatever economic and political scenario emerges next. The current climate raises a number of new, and hitherto, unknown threats of which companies need to be aware of and take steps to address, through strategies and tools and implementing faster and more robust commercial operating plans and crisis response processes.

However, perhaps more significantly, today's situation in the eurozone and, indeed whatever situations arise in the future, will inevitably also produce opportunities for competitive advantage and growth. Companies will be able to seize these through a wide array of actions, whether restructuring, M&A and disposals, remodelling operations and business models by re-shoring activities from other regions and territories, or other strategies entirely.

We hope you will find this research informative and useful. It will help your business be prepared for whatever direction the eurozone and broader global economic landscape will take both now and in the future.

1

# The eurozone economy

## *Uncertainty reigns in the now…*

The overall economic mood in the eurozone is worsening, with clouds gathering not just over the financial services sector, but also over the real economy and broader business environment. The German economy – the traditional eurozone powerhouse – is slowing down, whilst countries like Italy have slipped back into recession. The overall growth outlook has worsened.

Against this economic backdrop, one might have expected our survey results to be consistently gloomy across both geographies and industries. However, the picture from our research is one of widespread confusion and uncertainty, with companies having no consistent view of the eurozone's current status or where the market is heading.

The sense that many businesses are mired in uncertainty is strengthened by their divided views on the currency bloc's current relative economic performance. Asked how they feel the eurozone economy is performing in relation to other developed markets, such as the US and Japan, just over 45% say they believe it is performing better, and only 36% think its performing worse. The findings on how they believe their own territory's economy is performing in relation to other developed markets are very similar.

***Competency and capability building is extremely difficult without careful consideration of scenarios be they economic, geopolitical or business and industry focused. It is nigh on impossible to understand the landscape around a business, whilst planning for the future, without dynamic tools and strategic frameworks.***

## *…as companies try to focus on a brighter future*

There is a general positive view which is mirrored in our respondents' perceptions of the prospects for the eurozone economy over the medium term. Asked to predict what the state of the eurozone economy will look like in 18 months' time, over 50% think it will be 'a bit' or 'much' better than today – just over twice the proportion expecting it to get worse (see Figure 1). Just under one-third expect it will stay the same.

**Figure 1: In your view, what will be the state of the eurozone economy in 18 months' time?**

| | | |
|---|---|---|
| Much worse | 12 | 3% |
| A bit worse | 64 | 15% |
| The same | 115 | 30% |
| A bit better | 134 | 40% |
| Much better | 38 | 12% |

This sense of relative optimism is sustained in our interviewees' expectations on inflation and interest rates. Whilst 48% believe that deflation is a likely risk this number is far outweighed by the 61% expecting an environment of low inflation. There is also little concern over the risk of high inflation. Similarly, over 70% strongly expect interest rates to remain low.

## *Expectations of a weaker Euro…*

When respondents were asked about the prospects for the Euro exchange rate, cold reality begins to dawn. There is a clear expectation that exchange rates will be volatile, with 49% thinking exchange rates are expected to remain volatile over the next 18 months against 14% saying it is unlikely. Over the course of this period, well over 60% expect the Euro currency to be weaker than it is today (see Figure 2). A weaker Euro would help exports, thereby supporting our respondents' generally optimistic view of the eurozone economy, but this does not necessarily align with their lack of concern about inflationary pressures resulting in higher energy importing costs.

**Figure 2: To what extent do you agree or disagree that the Euro currency will get weaker during the next 18 months?**

| | | |
|---|---|---|
| Strongly disagree | 4 | 1% |
| Disagree | 50 | 15% |
| Neither/nor | 77 | 19% |
| Agree | 180 | 51% |
| Strongly agree | 52 | 14% |

***As energy imports get more expensive with a weaker Euro there will be an ever increasing need for newer and more greener renewable sources of energy. This may provide opportunities for European companies to export green energy technology to global markets and as such extend their footprint outside of the eurozone.***

Further findings show that around 50% of companies believe the ECB's latest decision to cut the main refinancing rate will have a positive impact on the economy. The same holds true for cutting the rate the ECB pays on commercial bank deposits as well as the introduction of 'Targeted Longer-Term Refinancing Operations' (TLTROs).

2 http://www.pwc.com/gx/en/capital-projects-infrastructure/publications/assets/pwc-cities-of-opportunity-building-the-future.pdf – 'Cities of Opportunity: Building the future'

**Figure 3: To what extent do you agree or disagree that within your local operating territory the general economy will get weaker within the next 18 months?**

| | | |
|---|---|---|
| Strongly disagree | 3 | 1% |
| Disagree | 74 | 21% |
| Neither/nor | 97 | 24% |
| Agree | 146 | 42% |
| Strongly agree | 43 | 11% |

## *…and weaker local economies*

We believe many companies are unaware over the scale of the hurdles facing eurozone growth and are hoping the current malaise will simply blow over. This view is supported by our findings on respondents' growth expectations for their local markets. As Figure 3 shows, more than half of companies think the general economy within their local operating territory will get weaker within the next 18 months.

***According to the World Bank, inadequate infrastructure in cities can drive up costs of doing business and reduce firm productivity by up to 40 per cent[2]. Companies need to be confident that the cities from which they operate locally are able to provide them with the leverage they need to keep costs down and deliver improved profitability and margins.***

Whilst this view may be realistic, it aligns with the expectation we reported earlier of an overall improvement in the eurozone economy during the same period. There is, indeed, a stark contrast between their relatively gloomy expectations for their local economies, and their more positive view of the outlook for the eurozone as a whole as reported earlier.

## *Companies confident about their performance*

The findings on recent trading performance are significantly more positive. Asked to cite the extent to which they have seen an improvement in trading performance within their organisation over the past year, 78% of respondents say trading has improved. Companies are more positive about their own business's performance than that of the eurozone as a whole.

The results indicate that trading performance within the United States and the BRICS – Brazil, Russia, India, China, and South Africa – has outstripped the eurozone over the past year. Businesses also want the UK to remain part of the European Union with 68% saying the UK should stay within the EU, against 13% who think it should leave.

***Companies from abroad opening fresh operations within the eurozone have placed an emphasis on cutting costs but not to the detriment of quality. There are lessons to be learnt for companies of all sizes within the eurozone in how to manage commercial considerations relating to generating and maintaining productive growth.***

The confused, divided and often conflicting expectations expressed by businesses in our survey suggest that many feel unable to predict even short-term developments in the eurozone, let alone those for the longer term. This lack of forward visibility is making it hard to plan strategically for future threats and opportunities within and around the eurozone, but there are steps that companies can take to fix this as we'll discuss in section two.

***Recommendations:***

1. ***Develop an understanding of how the big economic, demographic, social, and environmental changes will affect your organisation and people by setting out scenarios that identify opportunities and risks on a global, regional and national level.***
2. ***Develop new market-oriented growth strategies tailored to your business's strengths, needs and ambitions and navigate global complexities by identifying the right priorities to deploy across business units, functions and respective geographies.***

2

# Market risks and growth opportunities

## *Eurozone threats are driven by fears of stagnation…*

Asked to name the top disruptors or risks to the eurozone that could threaten their company's strategy over the coming year, businesses point first to stagnation, followed by instability in the financial markets, and then changes in legislation and regulation. Threats around data, technology and cyber-attacks also feature on their risk radar. In addition to the key threats, consumer consumption was highlighted as another risk due, in the main part, to a lack of disposable consumer income.

> ***"An unexpected risk, new data compliance standards or fresh industry regulation are all examples of change within the eurozone. These events will place information-technology systems under severe stress. Specifically, IT departments must ensure that systems can function seamlessly and that, with significant contingency planning, systems can avoid problems such as payroll issues, severe outages and data losses."***

Across all of these concerns, the threat of deflation looms large on the horizon. Whilst we have already reported that businesses in our survey see a low-inflation environment as being more likely than deflation, they have little doubt that deflation would pose a severe risk to their organisations' growth if it were to emerge. Over 70% of respondents see deflation as a high–medium risk to the growth of their organisation.

In contrast, low inflation and low interest rates are seen as posing relatively little threat to growth. Companies are far more comfortable with an economic environment characterised by low inflation and even more so low interest rates than by deflation and negative interest rates.

> ***A risk that cannot be identified cannot be managed. In an uncertain environment a cohesive view of risk becomes a major problem. The current approaches to risk management are no longer adequate – companies need to evolve and expand the existing frameworks and tools they use. What was sufficient 5 years ago within the eurozone is clearly no longer suitable.***

*The strength of a supply chain depends on the level of value to its customers – we have seen a number of organisations with excess liquidity providing finance to suppliers having difficulties obtaining funds through the traditional banking channels.*

**Figure 4:** **Have you identified any value creation opportunities that may arise as a result of various eurozone scenarios (e.g. new currencies or legislation, etc.)?**

| | | |
|---|---|---|
| Yes | 112 | 32% |
| No | 170 | 48% |
| Don't know | 81 | 20% |

## *...with real value opportunities have yet to be identified*

It is clear that whilst businesses have a definite idea of the threats they face in the eurozone, they have given little thought to the value creation opportunities. Asked whether they have identified any business opportunities arising from a range of various eurozone scenarios, a mere 32% say they have done so (see Figure 4). The uncertainty and confusion we highlighted earlier are effectively transfixing and paralysing companies' search for strategic opportunities in the monetary union. It could be argued that even the 32% that have identified opportunities may have done so without a properly structured decision making process.

*With innovation and ideas comes value creation. An extensive pursuit of creativity will create a pipeline of increased demand also resulting in efficiency gains across a spectrum of new and established geographies and industries.*

Our respondents provided further information on what they thought would be the likely value creation outcomes caused by various eurozone scenarios. These are highlighted in Table 1 below.

We also asked our respondents which assets provide their company with the greatest strategic value in terms of their ability to compete and win in the European marketplace. Here our respondents ranked people and intellectual property as the most valuable asset, followed by the ability to innovate with business agility, and financial strength of the balance sheet, with profile of brand and reputation providing the least value.

## *Falling Euro and rising growth*

Whilst opportunities from the euro crisis may be proving hard to find, and even harder to take advantage of, that may be about to change given the latest decline in the value of the Euro. Asked whether the weaker currency will provide opportunities for their organisation – for example by making exports cheaper – over half of the organisations have stated it will. Such opportunities could well include further alignment of financial and strategic decision making around areas such as overseas investment, re-shoring, acquisitions and disposals and the mobility of people and production.

**Table 1**

| Industry sectors | Results of various eurozone scenarios |
|---|---|
| Energy, utilities and mining | • Evolution of EU legislation<br>• Increase in bank lending to SME's |
| Retail and consumer | • Trade agreements between new countries<br>• Open marketing of products within the EEC |
| Pharmaceutical and healthcare | • Reduction in trade costs<br>• Favourable exchange rates |
| Technology, entertainment and media, information and communications | • Less legal barriers and regulation<br>• Intervention from the ECB on monetary policies |

**Figure 5:** **To what extent do you agree that the weaker currency will provide opportunities for your organisation (e.g. by making exports cheaper)?**

| | | |
|---|---|---|
| Strongly agree | 47 | 13% |
| Agree | 147 | 41% |
| Neither/nor | 121 | 32% |
| Disagree | 37 | 10% |
| Strongly disagree | 11 | 3% |

*"We all know that relevant, reliable and timely information (beyond the purely financial) is vital to making informed decisions about risks, business models, strategies and governance. It is also essential for investors, employees, customers and other stakeholders. Companies have to understand the new business information, reporting and assurance requirements – they have to respond to the dramatic changes that all businesses are undergoing within the eurozone as they adapt to the fast-moving global issues, economic uncertainty and new technologies."*

*For complex industry sectors, a careful balancing act must be struck between the competing functional requirements (e.g. sourcing to supply chain to sales, etc.). An enterprise-wide approach to 'data' utilising advanced analytics will provide an organisation with the information it needs to move quickly and efficiently in and out of different markets utilising an agile footprint.*

That said, our study suggests it is questionable whether businesses are making the effort to identify and seize other opportunities apart from those generated by the falling Euro. A mere 31% of companies say they are unaware of the ECB's policy response to low inflation although, admittedly, the only sign they should see from these measures is banks channelling the resulting lending through to the 'real' economy. A more positive sign is that some 49% of companies say they are likely to apply for the new ECB TLTRO loans.

**Figure 6: Which of the following scenarios do you think is most likely within the eurozone?**

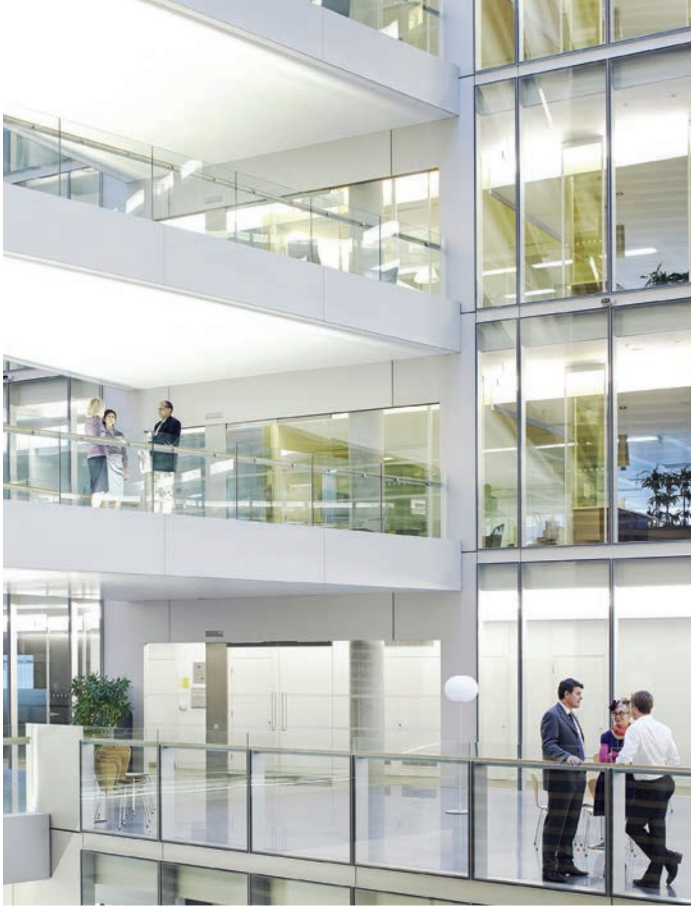
| | | |
|---|---|---|
| The Eurozone will remain unchanged | 109 | 29% |
| The Eurozone will collapse | 70 | 20% |
| Evolution into two tier Eurozone with a smaller set of countries | 90 | 26% |
| Completion of fiscal and political union | 40 | 12% |
| Exit of one or more countries | 50 | 12% |
| Other (please specify) | 4 | 1% |

## *Disruptive change in the eurozone is unexpectedly expected...*

If new opportunities are to emerge in the eurozone, what changes will drive them? The clear expectation amongst companies is that whatever changes will come, they are likely to be major ones. As Figure 6 shows, 71% of respondents expect the eurozone to change in a major way with only 29% believing it to remain unchanged. The changes expected range from a total collapse, to an evolution into a two tier structure with fewer countries, to an exit by one or more members. Rather surprisingly only 12% expect the EU to complete its mandate of a completion of fiscal and political union.

Further to this, 75% of respondents are currently in a comfort zone and believe their organisation can co-exist with the eurozone in its current shape (and with the existing level of uncertainty). But we know that the eurozone will not stay as per the status quo – **it is not a case of if the eurozone changes, but when.**

*"Many businesses rely on sourcing from non-eurozone countries to reduce costs or to be close to the customer. They need to assess where distressed vendors can cause supply chains to break down and if they can move rapidly to alternative vendors. Companies should also watch for opportunities. Are lower cost supply markets emerging from elsewhere within the eurozone?"*



## ...bringing change for your industry

The corollary is that over 50% of our respondents think the structure of their industry will also change as a result of the evolution of the eurozone – any radical changes to the norm will have a major impact.

> ***The situation currently in the eurozone can almost be referred to as a creeping crisis. There has been no one single catastrophic event – yet.***

A further feature of the current eurozone landscape is fiscal austerity – and here companies expect little change in the immediate future. As Figure 7 shows, the overwhelming majority, 90%, think austerity will still be around in over a year's time, with over a third thinking it will last between two and five years.

The business disruption caused by the new shift of the eurozone is simply not being heeded by major businesses or industries. A reactive approach to dealing with these shifts could well see these turn into real threats and risks for a business. Competitors who lead from the front will have the strategic advantage. Early adopters win in business – laggards will always be fighting a losing battle.

> ***The need to differentiate between the cyclical and structural changes, and between the shifts (temporary and permanent), that occur within an industry sector should be high on the agenda given some of these may well become obsolete and irrelevant or highly important in helping you establish and secure market share.***

> ***There is a need for a well-structured, effective and integrated industrial policy across the eurozone in order to boost jobs and growth. This integrated policy will have to consider the need to converge productivity across eurozone countries that are locked into a single exchange rate.***

**Figure 7: How long do you think austerity, in its current form, will be around for in the eurozone?**

| | | |
|---|---|---|
| Between 0–1 year | 25 | 7% |
| Between 1–2 years | 152 | 46% |
| Between 2–5 years | 136 | 36% |
| More than 5 years | 50 | 12% |

***Recommendations:***

3. ***Align every part of your organisation, from the boardroom to the shop floor, and transform your value chain with effective management and data analytic processes that brings all the facets of your business together.***
4. ***Prepare for the future by strengthening every aspect of your organisation, from people to performance and systems to strategy and innovate by exploring new markets and creating new business models and products that enable sustained, consistent results.***

3

# Business impacts

## *Companies believe they are ahead of the pack…*

How has the experience of a global financial crisis – followed by the continuation of the eurozone crisis – affected companies' positions compared to their competitors? According to our survey this series of events has done little harm to their businesses' competitiveness. As Figure 8 shows, over 50% of interviewees agree that their company is in an advantageous position compared to its competitors, with only 14% disagreeing with this statement.

Given the expectations of the major disruptive change to come, it is difficult to see on what this confidence is based or how it can be justified. Irrespective of whether it is based on a false sense of security, companies' confidence in their competitive positioning is further underlined by their merger and acquisition (M&A) intentions. Asked to state the likelihood that their business will capitalise on the eurozone crisis by acquiring other companies, just over 50% say they are likely to conduct M&A within the eurozone, with almost the same number expecting to do so outside the eurozone.

***The industry disruption fuelled by the eurozone crisis, coupled with some companies having strong balance sheets, has resulted in more deal activities and opportunities. There are M&A opportunities for all sizes of business within and outside the eurozone. Companies need to be alert to the availability and suitability of potential acquisitions as well as asset disposals.***

**Figure 8: To what extent do you agree or disagree that your company is in an advantageous position compared to your competitors during the economic crisis?**

| | | |
|---|---|---|
| Strongly disagree | 10 | 2% |
| Disagree | 46 | 12% |
| Neither/nor | 126 | 32% |
| Agree | 147 | 43% |
| Strongly agree | 34 | 11% |

**Figure 9: Have you seen an increase or a decrease in wages for skilled workers within your industry sector over the last 18 months?**

| | | |
|---|---|---|
| Increase | 135 | 37% |
| No change | 163 | 46% |
| Decrease | 65 | 17% |

## *...but access to skilled workers may change this*

At the same time, our respondents are already seeing and anticipating real impacts on their business from the evolving eurozone environment. As Figure 9 shows, over twice as many companies are reporting an increase in wages for skilled workers over the past 18 months as are reporting a decrease.

***The shortage of skilled labour in specific roles is a persistent problem for some industry sectors despite high unemployment levels in Europe. In manufacturing for instance, in the face of rapid economic recovery and productivity improvements, there may well be skill shortages across certain highly specialised activities.***

***"The talent crisis is no longer a problem of the future. It is here and now and is threatening business growth and economic prosperity within the eurozone. New sources of labour to build tomorrow's work force must be found, and the way in which people work, and where they will work, needs to be reconceived."***

Looking forward, companies are also concerned about the effects of a liquidity squeeze over the next 18 months. Just over half – 51% – of respondents think a lack of sufficient liquidity within the banking system will significantly impact their ability to operate, against 20% who think the impact will be insignificant.

## *Re-shoring lands and expands*

Against this backdrop, companies are already taking action to reshape and realign their operating models for developments in the eurozone – with the re-shoring of activities emerging as a major focus. As Figure 10 illustrates, almost 60% of companies have re-shored some activities in the past 12 months, with the single biggest focus for re-shoring being their production-related activities.

**Figure 10: Which of the following activities, if any, have you re-shored (brought back) within the last 12 months? Please answer in relation to the global activities of your organisation**

| | | |
|---|---|---|
| Finance & Treasury | 63 | 16.1% |
| Production | 105 | 31.5% |
| Tax & Legal | 70 | 20.1% |
| Sales, Marketing & Business Development | 67 | 19.8% |
| Procurement & Contracts | 56 | 16.7% |
| IT & Systems | 75 | 20.3% |
| Other (Please specify) | 2 | .8% |
| None of the above | 148 | 36.5% |

The regions from which re-shoring has been taking place vary by the type of activity. The re-shoring of finance and treasury functions is an increasingly relevant trend within the eurozone. Re-shoring of production has been heaviest from non-eurozone Europe, and IT and systems re-shoring has been dominated by activities being brought back from the rest of the world outside Europe.

Whilst the balance has clearly shifted towards re-shoring, some offshoring activities have continued. Around 55% of respondents have offshored one or more activities in the past 12 months, compared to almost 60% that have re-shored them. The main focus areas for offshoring have included production, tax and legal and IT and systems – with offshoring of production being highest within the eurozone, followed by non-eurozone Europe and then the rest of the world.

***"Companies need to determine which circumstances put their revenue most at risk. Over the past few years, European sales and distribution centres have been losing customers and finding increased competition for remaining customers. They should assess how long they can survive suppressed sales in the eurozone. And if they decide that it's prudent to exit some countries, how can the lost revenue be replaced? Already, for example, companies have accelerated plans for shifting European operations to more promising emerging markets – or back to within the local operating territory. As companies shift their focus, they may cause competition and costs to increase outside the eurozone and make emerging markets and safe havens more crowded. Companies need to think long-term about where attractive investments will come from — both inside and outside the eurozone."***

***"Companies need to be mindful of changing tax regimes (especially transfer pricing and permanent establishment rules) both in the Eurozone and globally. Assessing the tax implications of currency gains/losses and of actions such as modifying contracts, writing-off investments, refinancing and repatriating cash are all important. Additionally the competitiveness of a tax regime should be one of the most important factors for a business when deciding where to operate. Given the flux of the eurozone market, this is an extremely important aspect."***

Looking forward, the shift towards re-shoring appears set to continue. Almost half of respondents plan to re-shore activities in the next 12 months, with re-shoring of production from outside Europe ranking as a very high priority. This focus may also reflect the expectations of a decline in the value of the Euro, which would have the effect of pushing up Euro-denominated costs elsewhere.

***Companies are having to think long and hard over how they maximise the value of their assets and the cost, productivity and efficiency of its operations. Re-shoring is growing in popularity driven mostly by consumer preferences, a reduction of the wage gap in emerging economies, volatile transportation costs and a desire by management better to control quality and supply chain risks. For instance, it may make sense to look at the size and scale of certain parts of a business and make strategic decisions to re-shore parts of an operation back into the eurozone given market uncertainty and other risks.***

In terms of changes in the size of companies' global workforces over the coming year, most respondents believe their headcount will remain stable, with a slight inclination towards headcount reduction.

Asked which of the global megatrends will have the greatest impact on their organisations the most over the next 12 months – demographic trends, the shift in global economic power, accelerating urbanisation, resource scarcity and technological breakthroughs – the highest response is for the shift in global economic power, cited by more than one third of interviewees.

## *Effective scenario planning remains a scarce commodity…*

Whilst companies are already responding to the evolving environment by re-shoring operations, their preparations for the possibility of sudden and disruptive change in the eurozone remain patchy, and in some cases non-existent. Despite their high level of concern over a potential liquidity squeeze in the eurozone banking sector, just under half of our interviewees expressed limited awareness of the ECB's review of bank balance sheets.

With the results of this exercise now in, we should see some confidence and stability restored to the market. Yet we are still far from a solution to the banking crisis and the challenges facing the banking sector. The Comprehensive Assessment was only a one-off test of solvency, not of ongoing viability. The test of long-term viability is whether banks can generate sufficient returns to cover all their costs, including capital costs.

As a result, the implications for non-financial services companies, such as credit demand constraints, are likely to remain until broader economic solutions to address these issues can be found.

In this context, our survey discovered that almost 60% still do not have contingency plans or are not aware of any (either pre or post ECB review). Worryingly, this translates as less than 5% of respondents that have actually tested a contingency plan in a real situation. To be 'fit for business' in the future – companies need to be there in the future. It seems most companies are not even taking steps to ensure this is the case.

***Weakness in banks' balance sheets and uncertainty about their quality are contributing to fragmentation, constraining the ability and willingness of banks to support credit and investment to organisations of any size or purpose. Impaired balance sheets continue to inhibit monetary transmission and the flow of credit, particularly to small and medium enterprises. Those companies applying for loans are experiencing difficulties in obtaining credit from banks, particularly in the periphery economies, where about a fifth of such companies were credit rationed during the last year, either because their applications were rejected or offers were prohibitively expensive.***

Asked whether they have a plan to cope with continued crises within the eurozone, almost 60% of organisations admit they either do not have one or do not know if they do (see Figure 12). More positively, over 80% of those with a plan say they are confident they can execute it (see Figure 13). But when so few have a plan in place, there is little comfort to be gained from this.

One possible explanation for the apparent low degree of planning targeted at future eurozone crises may be that this planning is treated as part of wider risk management. As Figure 14 shows, over 40% of companies say their current approach to risk management includes planning for specific eurozone-related crises and contagion from other industry sectors. However, that still leaves over half of respondents not aware whether eurozone crisis planning is part of their risk management framework.

**Figure 11: How would you describe your organisation's contingency plans to deal with any negative implications caused by the European Central Bank's review into bank balance sheets?**

| | | |
|---|---|---|
| No contingency plan exists | 57 | 16% |
| Contingency plan being developed | 76 | 23% |
| Contingency plan is in place | 103 | 31% |
| Contingency plan has been tested | 32 | 9% |
| Contingency plan has been implemented in real situation | 17 | 4% |
| Don't know | 78 | 16% |

**Figure 12: Does your company have a plan to cope with continued crises within the eurozone…?**

| | | |
|---|---|---|
| Yes | 57 | 43% |
| No | 76 | 36% |
| Don't know | 103 | 21% |

**Figure 13: …And are you confident that your company can execute this plan?**

| | | |
|---|---|---|
| Not very confident | 11 | 7% |
| Neither/nor | 21 | 12% |
| Confident | 79 | 57% |
| Highly confident | 42 | 24% |

**Figure 14: Do your current approaches to risk management include planning for specific eurozone-related crises and contagion from other industry sectors?**

| | | |
|---|---|---|
| Yes | 157 | 41% |
| No | 123 | 38% |
| Don't know | 83 | 20% |

*"The failure of businesses is not usually down to specific shortcomings of risk management – it is more often to do with the failure properly to anticipate the effects of change or disruption, coupled with a lack of ability to respond when the risk is belatedly realised. It is increasingly difficult to predict risks or their consequences within the eurozone. The increasing levels of interdependency and speed of transactions means that businesses sit within complex systems where the impact of small changes can be greatly magnified and are certainly unpredictable. Traditional risk management is inadequate to protect business in today's global environment. Businesses need to think about resilience rather than risk. Resilience means having the ability to react to change wherever and however it arises."*

**Figure 15: What is your planning horizon for the leadership of your company in its thinking of the economic crisis?**

| | | |
|---|---|---|
| Less than a year | 39 | 11% |
| 1–3 years | 193 | 55% |
| More than 3 years | 85 | 22% |
| Don't know | 46 | 11% |

**Figure 16: Which of these best describes your company's philosophy about its strategy and objectives within the eurozone?**

| | | |
|---|---|---|
| We will pursue broad options and spread the risk | 107 | 32% |
| We will choose one market and be successful | 110 | 31% |
| We will capitalise on our business strengths and exploit them | 144 | 37% |
| Other (please specify) | 2 | 0% |

## *...but horizon scanning should be the new mantra*

Over 60% of companies say they have an economic planning horizon of three years or less, with 11% of companies only looking one year into the future (Figure 15). Within the past year, our respondents say that the factors having the greatest impact on their business strategy have been innovation and research and development; and new and emerging markets.

The same will be true in three years' time, but with regulation growing in significance.

***Recommendations:***

5. ***Optimise the priority transactions of your business (e.g. deals, investments, etc.) and value your business's social, environmental, tax and economic impacts by comparing the total impacts of your strategy and investment choices and managing the trade-offs.***
6. ***Deploy your talent strategically to make sure you have the right types of talent in the right places at the right time and engage with your people to manage the innovation process and embed behaviour that supports innovation in your organisational culture.***

*The current eurozone crisis has forced companies to re-examine their core market portfolios and activities, and in many cases to look for opportunities outside the eurozone – specifically in emerging markets. This is not only true for multinational companies who have traditionally been present in frontier markets but this now also holds true specifically for small and medium enterprises. This is allowing companies to re-invent themselves and diversify their business as well as explore new and untapped markets.*

We asked our respondents to choose from three statements, and say which would best describe their company's philosophy about its strategy and objectives within the eurozone. As Figure 16 shows, the result is an almost even three-way split. This highlights that companies have different competing models when it comes to achieving strategic, operational and financial success within the eurozone markets.

*Companies are increasingly looking at partnerships and alliances to leverage each other's strengths and capabilities (e.g. innovation and value chain, etc.). This has the obvious benefits of reducing costs and enhancing operational efficiencies. This can be within and across different industries, countries and regions.*

The message is clear: companies need to think hard today about the steps they will take to be successful in tomorrow's uncertain and highly regulated environment. If businesses lament until the turmoil is at its peak, then they could well find it is too little, too late.

*Collaboration between private and public sector decision makers is of paramount importance to optimise the balance between regulation and absolute freedom in the market. Policy makers on both sides need to work together to shape the industries of tomorrow enabling creativity and innovation which results in sustainable, competitive growth.*

# Conclusion:
# Preparing for growth and opportunity in the new paradigm

Our study indicates that whilst companies across the eurozone are anticipating both dramatic and disruptive changes, they are not too downbeat about the implications for their own business. Yet organisations are not adequately prepared to capitalise on these.

As this report has highlighted, there are specific opportunities both within and beyond the eurozone and we believe that new ones will always emerge as change occurs. In our opinion, the companies that will be best placed to capitalise on these opportunities are those that manage to position themselves ahead of the curve and that are proactively monitoring the market and industry, as well as leading and driving the planning and delivery of the changes required throughout their business.

### *Fit for business*

All businesses need robust and up-to-date contingency plans to cope with the increasing number of potential scenarios. In this context, our findings reveal a real and pressing need for structured planning processes to be put in place and tested against the possible strategic eventualities.

Depending on which scenario arises, it is clear that the current state of flux in the eurozone is simply not sustainable. Over 70% of our respondents agree that major changes are on the horizon – and all companies need to be prepared if they are to both maximise the resulting opportunities and limit their exposures.

### *Localisation versus globalisation*

Alongside the need for contingency planning, a further consideration is that – irrespective of events within the eurozone – safer and more dynamic markets exist elsewhere in the world. Many companies based in the eurozone are already trading successfully and growing their operations in such markets.

This points to a two-pronged strategy under which companies might look to foster their assets and operations within the eurozone, whilst developing new and potentially more reliable sources of income and growth outside the currency bloc.

### *No time to lose*

Whatever approach businesses decide to adopt, our study underlines the importance of preparing for the next phase of the eurozone's evolution for the new paradigm shift. The current malaise could continue for years or, as likely, it could erupt tomorrow into wider disruptive turmoil.

In a new eurozone environment, full and effective preparations are vital. It is time for every company across the eurozone to put these preparations in place and to face the future with the growth of your business in your hands.

If you found this paper provocative and thought provoking and you would like to discuss or debate any of the content in more depth please contact one of the authors below.

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