Central and Eastern Europe Private Business Survey 2019

Time to act: moving from good to great in times of uncertainty and digital transformation

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Time to act: moving from good to great in times of uncertainty and digital transformation

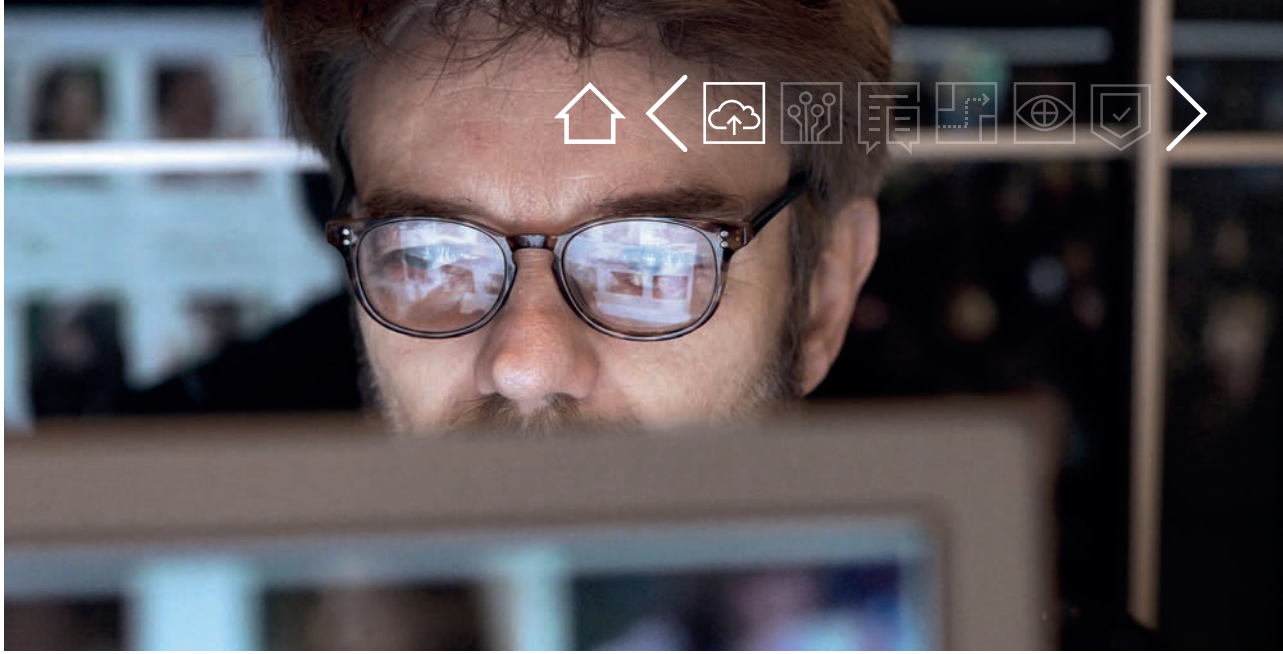
After several years of strong growth, leaders of private businesses in Central and Eastern Europe (CEE) are cautiously optimistic about the future.

In interviews we recently conducted with 600 key decision makers in 15 countries in CEE, including the Baltics and three countries in Eurasia (Ukraine, Georgia and Moldova), it was clear that most of those surveyed expect revenue growth in the next 12 months, while just 8% expected lower revenues. Optimism appeared highest in Croatia, followed by Eurasia. Overall, the mood was hopeful, tinged with a bit of uncertainty (see Exhibit 1).

The cautious mood possibly reflects global sentiment that storm clouds are looming. Many economists note evidence of an economic slowdown in 2019, which looks set to continue, driven largely by slowing growth in China and amid uncertainty caused by the US-China trade war. Concerns about Eurozone stability and weakness in Western European economies are also undermining confidence in CEE.

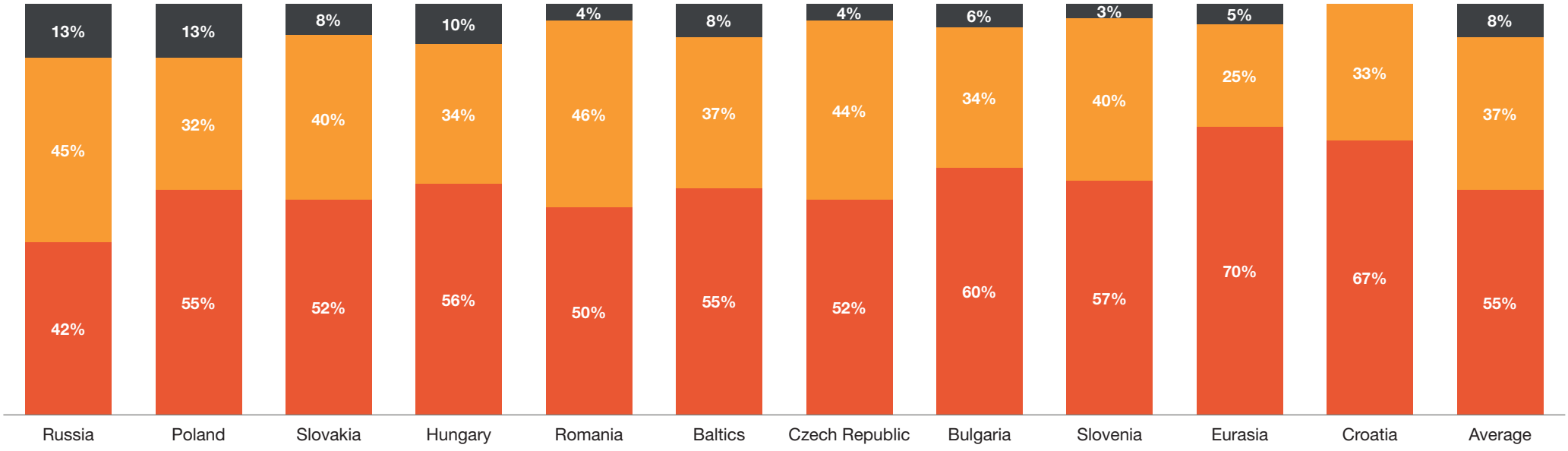
At the same time, business leaders are growing increasingly concerned about talent and skills shortages – and how they may hamper growth. Private companies in CEE face stiff competition for staff from multinational companies with bigger budgets and strong employer brands. Demographic factors are compounding matters. These include low birth rates, aging populations, and mass economic migration to Western countries, and also to Russia.

While only about one in five companies surveyed identified the precise impact of Brexit on their business – and these included companies in European Union member states – some companies told us they were taking steps to offset the effects such as negotiating (or renegotiating) contracts, adopting new sourcing strategies and potentially withdrawing from the UK market altogether.



Yet downturns often bring opportunities, and companies that prepare early – and advance rather than retreat – can benefit enormously during difficult times and beyond. Companies that see digital transformation as the key to unlocking the next stage of growth – and get the implementation right – have a fighting chance of growing faster when the next upturn comes.

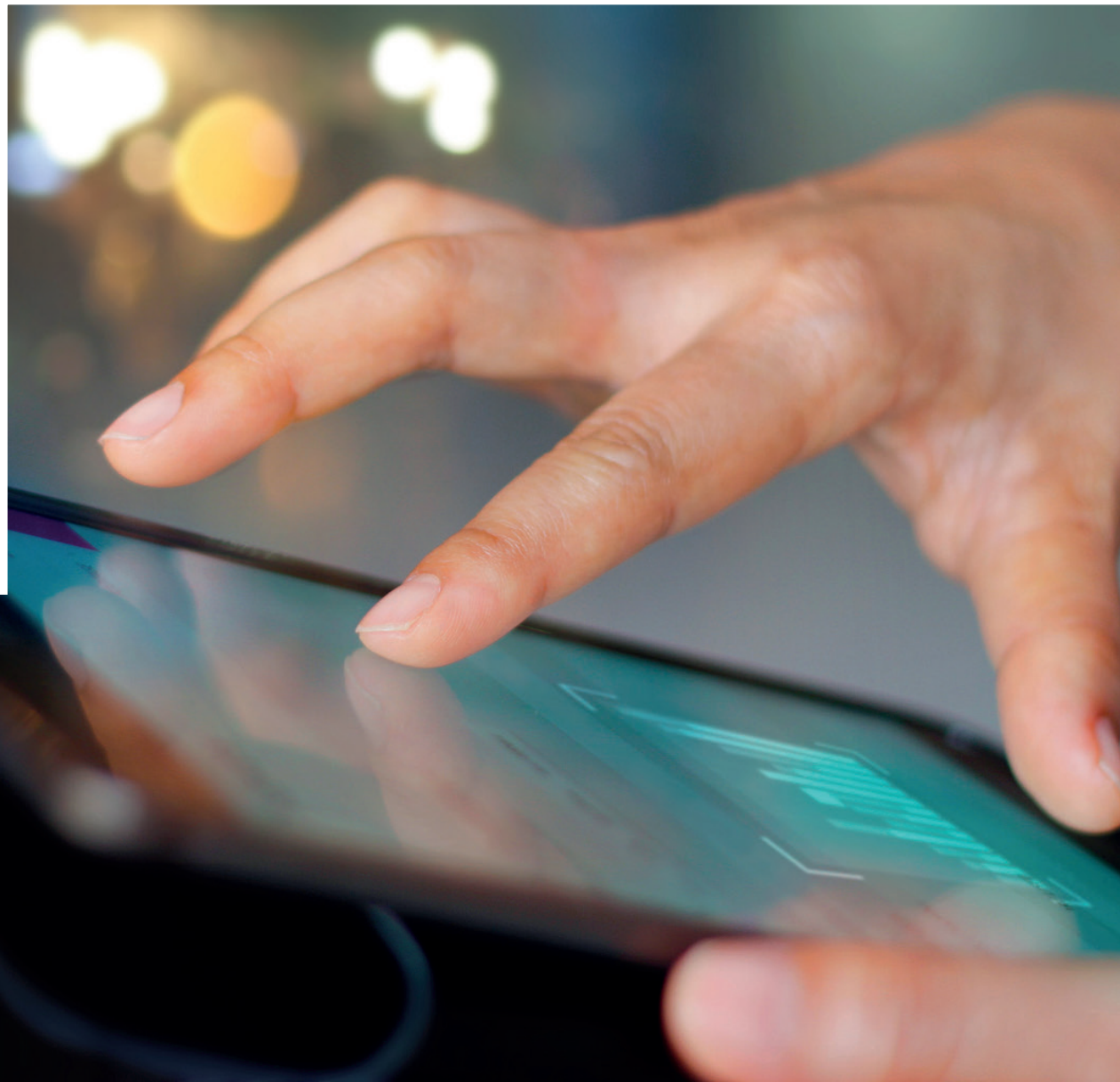
Exhibit 1: Expected performance: country/subarea overview



■ Improve ■ Remain the same ■ Deteriorate Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents. n=600

Getting digitalisation right

Encouragingly, 63% of business leaders surveyed recognise that digitalisation will have a high impact on the long-term viability of their businesses. This mirrors findings from a recent PwC CEO Survey in which 64% of top executives in 85 countries said they believed technology would disrupt how they do business in the next five years.



Yet many private businesses in CEE are just at the initial stages of digitalisation.

Our survey suggests that most leaders (68%) see digitalisation as a way to improve processes, and nearly half of those surveyed view it as a tool to analyse data to tailor products and services. Only 35% appear to have a more sophisticated take on digitalisation, seeing it as a way to develop end-to-end digital solutions that ultimately meet customer needs (see Exhibit 2).

Perhaps the biggest challenge for private businesses is their approach to digitalisation. Our findings suggest that many company leaders see digitalisation as a technical fix to solve specific issues in areas such as supply chains, when there are benefits to viewing it as a holistic strategy to transform an entire company - especially at a time when the economic cycle demands reinvention and renewal in preparation for the next era of growth.

Some business owners may also misunderstand the scale of change required and how to fund and staff for digital transformation. Being sure that private business boards are properly equipped to provide the necessary executive oversight for the next stage of digitalisation is also a key issue.

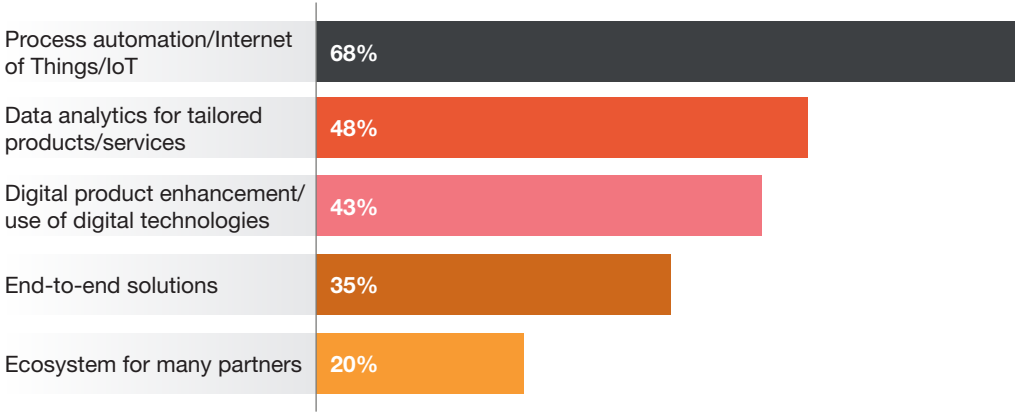
68%

of business leaders see digitalisation as a way to improve processes.

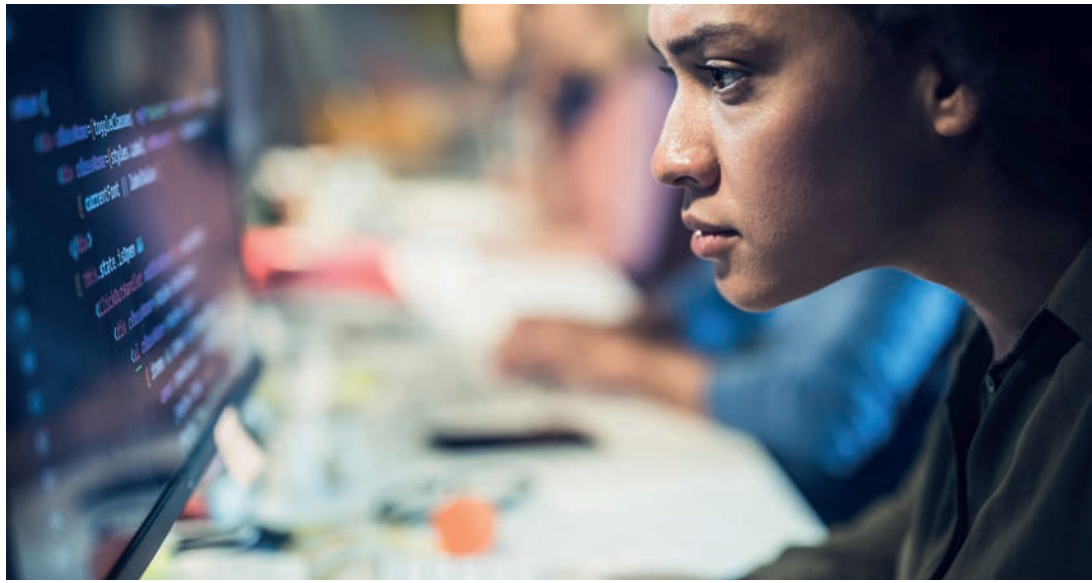
48%

view it as a tool to analyse data to tailor products and services.

Exhibit 2: Significance of digitalisation



Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents. n=600



We found that only 23% (just over one in five) private businesses in these regions plan to allocate more than 5% of their investments to digitalisation (see Exhibit 3), compared with 39% in more technologically advanced parts of Europe such as Scandinavia.

This allocation varied by industry. The service sector stood out with 28% of respondents saying they would spend more than 5% of investments on digitalisation, compared with 15% in building and construction. On a country level, Slovenia had the highest planned rate of investment with 31% of private businesses investing more than 5% in digitalisation. But overall, many businesses leaders appear to underestimate the scale of change required.

23%

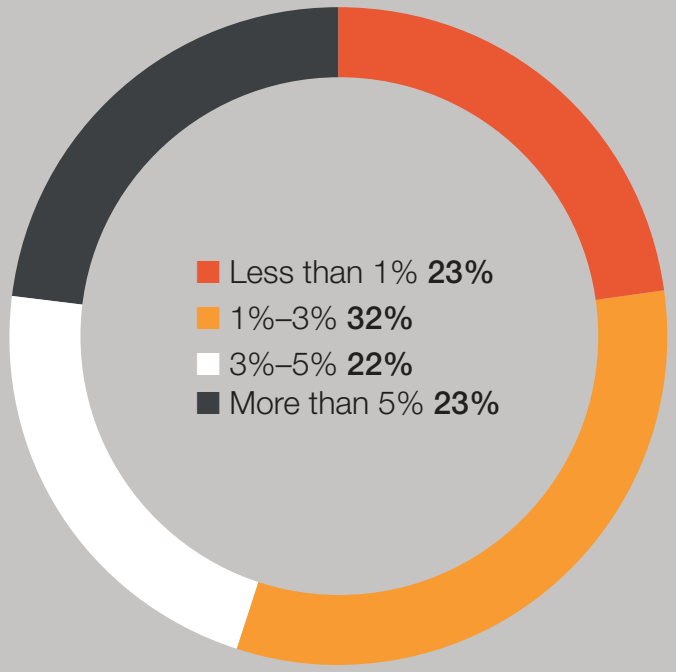
of private businesses in CEE plan to allocate more than 5% of their investments to digitalisation.

31%

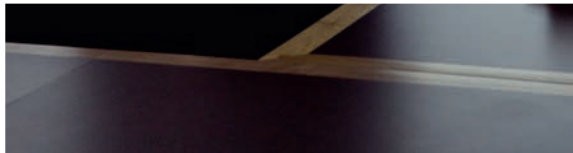
of private businesses in Slovenia investing more than 5% in digitalisation.

Exhibit 3: Overall investments in digitalisation

Please indicate the approximate average percentage of your overall investments which will be allocated to digitalisation in the next 5 years.



Source: PwC Central and Eastern Europe Private Business Survey 2019
all respondents.
n=600



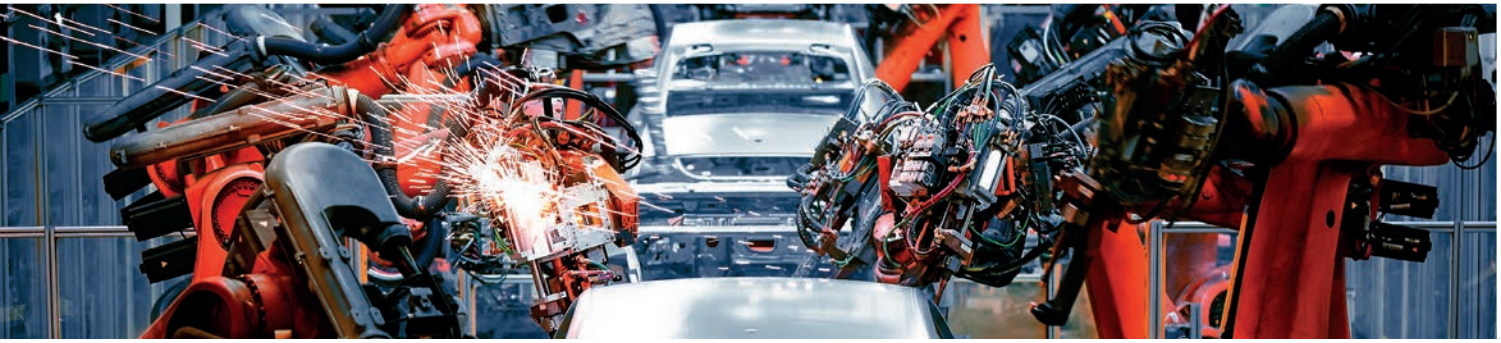
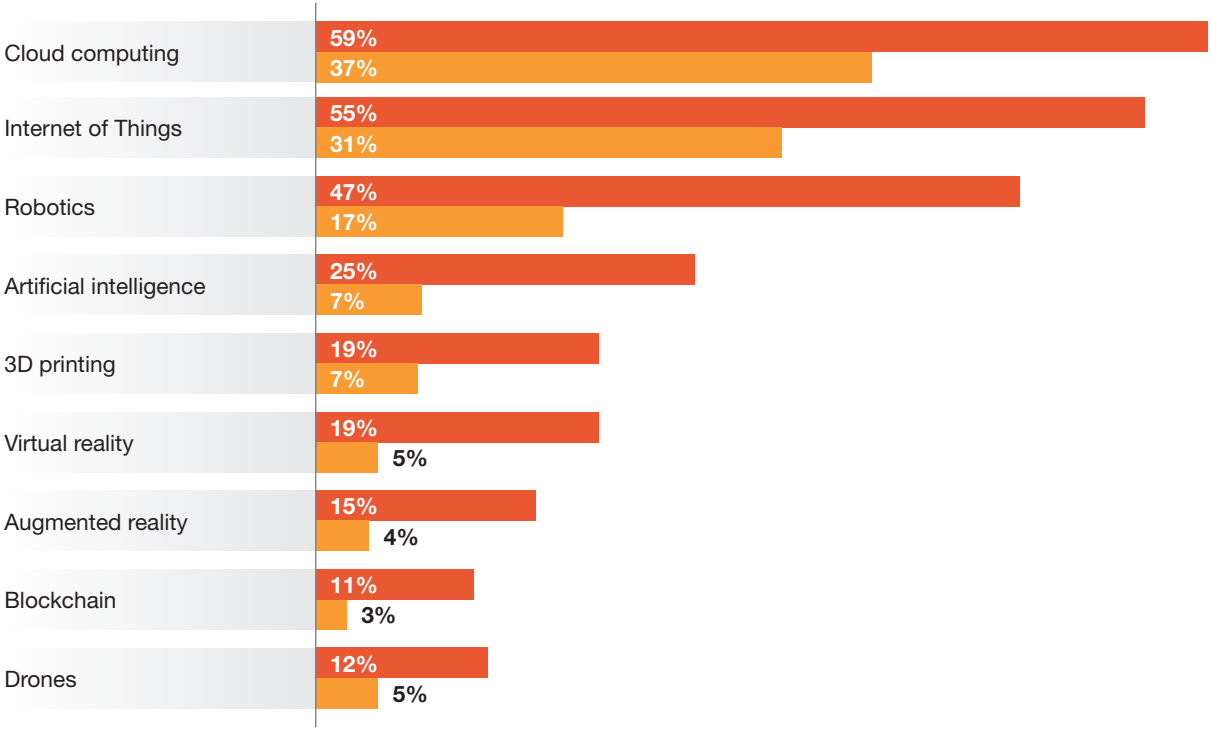


Exhibit 4: Usage and relevance of Essential Eight technologies, plus cloud computing



Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents. n=435

Even those who told us that particular technologies were relevant to their businesses, aren't actually using them. That's clearly seen in Exhibit 4, which shows the gap between the professed relevance by business owners of each of the "Essential Eight" technologies (AI, robotics, IoT, blockchain, 3D printing), and their actual use of them.

Many companies aren't investing enough either. Most companies surveyed in the CEE (55%) plan to allocate less than 3% of overall investments in digitalisation over the next five years.

Meanwhile, many are relying on their current teams – staff who have made companies successful so far – to address digitalisation issues, even though a new profile of worker may be required.

59%

of private businesses in CEE recognize Cloud Computing as the most relevant digital solution.

25%

only recognise artificial intelligence as a relevant digital solution.

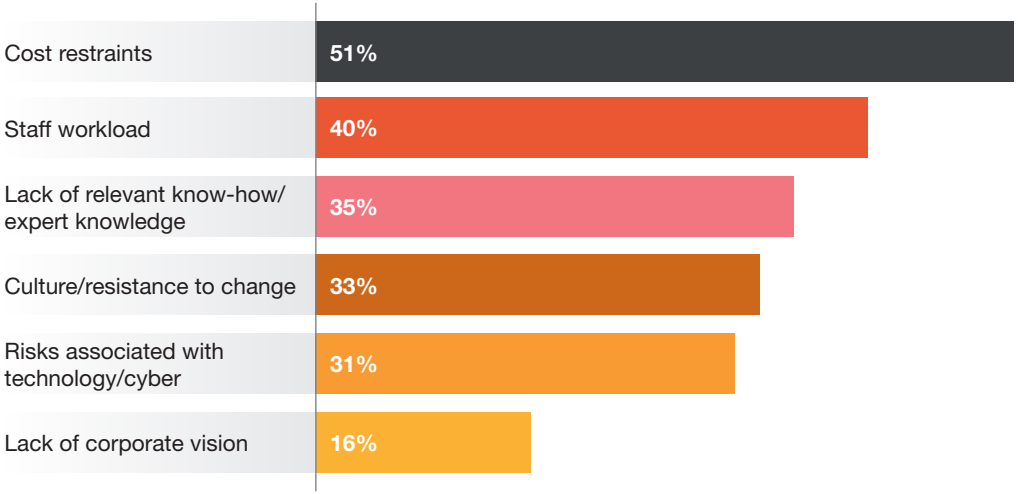
Staffing strategies are at odds with a crucial finding of our report: cost constraints, staff workload and lack of relevant know-how, as well as cultural resistance to change were the most prominent factors impacting the implementation of new technologies, according to these same companies (see Exhibit 5).

Our survey also suggests that some CEE private business leaders may underestimate the effect key technologies such as AI, virtual reality (VR) and 3D printing might have on their businesses.

51%

of companies surveyed in CEE see cost restraints as the biggest internal concern impacting the implementation of new technologies.

Exhibit 5: Main internal concerns impacting the implementation of new technologies



Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents. n=600

In other PwC research, we found that AI has the potential to boost gross domestic product in certain economies by up to 26% by 2030. AI can help companies to enhance products and stimulate consumer demand by driving greater product variety, with increased personalisation, attractiveness and affordability over time.

And the impact isn't just on product companies – service industries are benefitting too.

When asked about the potential impact of AI on their companies, 82% said they didn't find it very relevant. Meanwhile, 86% found VR not very relevant, and an equal percentage of respondents felt the same about 3D printing.

Yet it is undeniable that these technologies affect a broad range of industries, and are coming together to create the next wave of innovation. (See Essential Eight Box). Private businesses shouldn't be left behind.

Essential Eight technologies

Technology is evolving at breakneck speed and is already defining what's next for companies, industries and consumers. Business leaders understand this. They get that emerging technologies must be a key part of corporate strategy. But they seem hesitant to act. To help companies focus their emerging tech efforts, we analysed the business impact and commercial viability of more than 250 emerging technologies to zero in on the "Essential Eight." These are the core technologies that matter most for businesses, across every industry, over the next three to five years. The Essential Eight are the technology building blocks that every organisation must consider. But their real value is unlocked when they converge. While each company's strategy for how to best exploit and combine them with other technologies will vary, it is these essential eight technologies that will transform an organisation. "They are the building blocks of today that will get you to tomorrow," says Dan Eckert, Managing Director for PwC's Emerging Technology capabilities, which focuses on the impact of disruptive technologies on organisations.

What are the Essential Eight?

- **3D printing** is the process of creating a three-dimensional object by successively printing layers of materials on one another until an object is formed. It is used in practice to construct spare parts, architectural models, complex manufacturing and rapid prototyping.
- **Artificial Intelligence (AI)** is an umbrella term for "smart" technologies that are aware of and can learn from their environments to assist or augment human decision making. Machine learning, recommendation engines, chatbots and image recognition are only a few of the areas where AI is applied.
- **Augmented Reality (AR)** is a data or information "overlay" on the physical world that uses contextualised digital information to augment the user's real-world view. It is used for data visualisation, transportation safety, customer experience and manufacturing operations.
- **Blockchain** technology is a distributed shared ledger where transactions are recorded and confirmed without the need for a central authority. It is used for supply chain traceability, financial processes, identity verification and digital currencies.
- **Drones** are devices that fly or move without the presence of a pilot and can be used to collect a wide range of data or execute tasks remotely, i.e., remote delivery, infrastructure maintenance, security provision or video capture.
- **The Internet of Things (IoT)** extends network connectivity and enables a diverse range of devices to collect, process, and send back data. It is used in asset tracking, smart metering, fleet management and predictive maintenance.
- **Robotics** is the combination of engineering and computer science to create, design, and operate mechanical devices, i.e., robots. It is used in industrial manufacturing, medical procedures, transportation operations and product fulfilment.
- **Virtual Reality (VR)** is a simulation of a 3D image or complete environment where a user can interact in a seemingly realistic way. Marketing makes use of it. It's also used for training, virtual tours, prototyping and design.

https://www.pwc.com/gx/en/issues/technology/essential-eight-technologies.html

We asked business owners about the extent to which their companies were making use of various digital solutions and technologies.

Entrepreneurs in Romania were slightly more advanced in the use of most Essential Eight technologies than their peers in other countries in CEE, our survey found. Romania topped the list when it came to use of AI, AR, blockchain, drones, VR and 3D printing.

This relatively high use of Essential Eight technologies in Romania may reflect the emergence there of a vibrant tech ecosystem of start-ups, accelerators and funding hubs, no doubt boosted by the country's zero tax rate on personal income for software programmers.

Across CEE, private businesses are most likely to see IoT and robotics as highly relevant for their businesses. Far fewer acknowledge the importance of other critical technologies such as AI, 3D printing or VR. Of those who see each of these technologies as relevant, still fewer are actually using them. Take AI as an example. While a quarter of private businesses in CEE see it as relevant, only 7% of these companies are actually using it in their business.

When it comes to IoT, the Bulgarians were the most likely to cite it as relevant. Companies in Eurasia also rated it highly, followed by companies in Croatia and Romania. Robotics seemed most important to company leaders in the Czech Republic, with Polish companies also calling it significant. The fact that robotics matter in Poland should come as no surprise given that manufacturing accounts for about a quarter of the country's GDP, and automation is a significant focus there.

Exhibit 6: Top countries/subareas rating Essential Eight technologies as relevant

Artificial Intelligence

Country	Relevance
Romania	48.8%
Baltics	29.8%
Russia	29.6%
Eurasia	28.6%
(remaining countries)	**18.6%**

Augmented Reality

Country	Relevance
Romania	39.5%
Croatia	25.0%
Eurasia	20.4%
Slovakia	16.1%
(remaining countries)	**9.4%**

Blockchain

Country	Relevance
Romania	25.6%
Russia	14.8%
Slovakia	12.9%
Poland	12.7%
(remaining countries)	**7.0%**

Drones

Country	Relevance
Romania	27.9%
Russia	20.4%
Czech Republic	18.2%
Baltics	12.8%
(remaining countries)	**6.6%**

Internet of Things

Country	Relevance
Bulgaria	86.4%
Eurasia	69.4%
Croatia	62.5%
Romania	60.5%
(remaining countries)	**45.5%**

Robotics

Country	Relevance
Czech Republic	63.6%
Poland	61.9%
Romania	60.5%
Baltics	53.2%
(remaining countries)	**36.9%**

Virtual Reality

Country	Relevance
Romania	39.5%
Poland	22.7%
Bulgaria	21.3%
Baltics	20.8%
(remaining countries)	**14.4%**

3D Printing

Country	Relevance
Romania	37.2%
Slovakia	32.3%
Czech Republic	30.3%
Hungary	25.8%
(remaining countries)	**13.1%**

Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents. n=?????

Call to action

An economic downturn will put CEE's private businesses to the test. A cooling business climate – and potentially reduced growth rates, or even falling revenues – will likely force leaders to review costs. But private business leaders need to consider the long-term, and carefully balance potential cost savings with digital investment needs.

79%

have not yet identified the impact of Brexit.

To thrive during disruptive times, private businesses should employ a digital strategy that addresses every area of a company to meet present and future needs. If owners and managers don't think strategically now about how to transform their companies (and manage the trade-off between rising cost constraints and investment needs), they risk being unprepared for whatever future lies ahead: one marked by digitalisation, Brexit, a full-blown recession – or all three. The time to act is now.

To prepare for digital transformation, owners and managers should think afresh about three key areas.

64%

of the company leaders receive full approval from their supervisory board for their digital strategy.

Board composition: transformation starts at the top

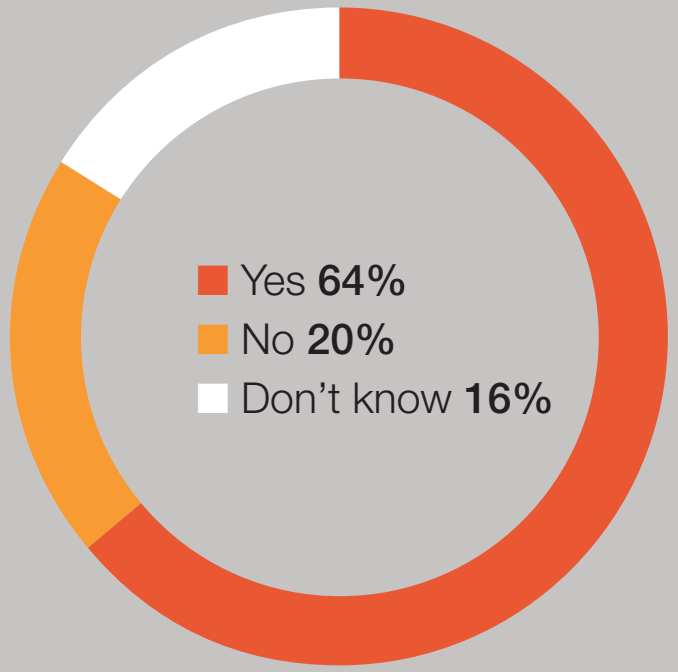
Many CEE private businesses have been experiencing economic highs in recent times, and current board members are partly responsible for that success. However, what helped bring companies to where they are now might not be sufficient to overcome future challenges.

The main role of a board is to act as a critical and controlling party, providing expert knowledge and advice. We asked company leaders whether their supervisory boards were suitably composed to support their digital strategies. Nearly two-thirds of companies said they were (see Exhibit 6).

Still, it is probably the right time to ask whether the composition of the current board is right for any storm that may come. Can it help business switch gears during a downturn? And is it well suited to address the next level of digital change?

Exhibit 7: Board composition

Is your advisory/supervisory board composition suitably composed to support your digital strategy?

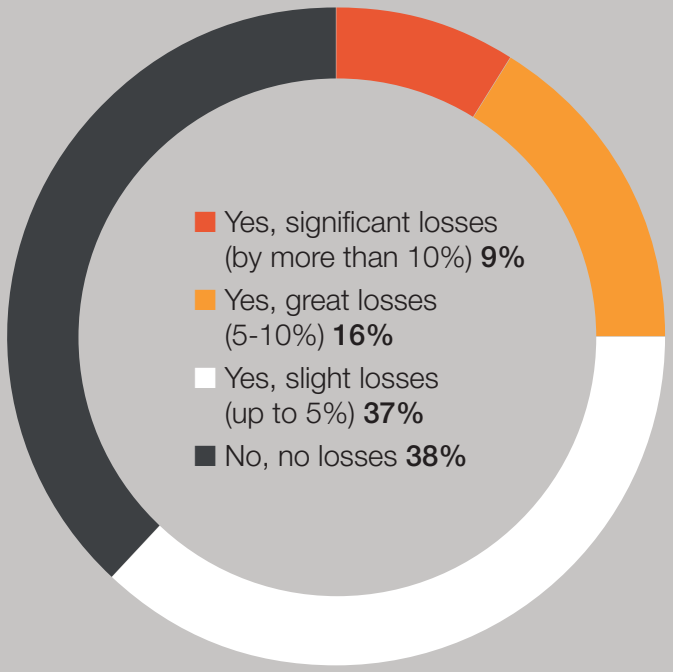


Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents.

n=600

Exhibit 8: Economic losses/unrealised revenues as a result of skills shortage

Is a lack of suitable skilled personnel causing a loss of turnover, or threatening potential turnover, at your company?



Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents.

n=600

25%

of companies said skill shortages were costing them 5% or more in turnover.

Here are some other questions to ask given the current climate:

Are your board members knowledgeable about technologies that are crucial to the business? If not, is there a local entrepreneur with that kind of technical knowledge who would trade expertise for insight into running a more mature company such as yours?

Is there a “Next Gen” on the board, one who is digitally native? Indeed, if yours is a family business, now may be a good time to bring in the next generation.

The point here is that the future is uncertain and supervisory boards are a great place to bring in much needed expertise and vision. It’s also a good way to engage with the next generation – some of whom may not be interested in managerial responsibilities.

Staffing: the right skills

Skills shortages are holding companies back from realising their full potential (see Exhibit 8). The problem is costing revenue - a quarter of companies said skill shortages were costing them 5% or more in turnover - and is significantly impacting economic growth in CEE. Turnover losses estimated by private business owners in the region are believed to be €358 billion, or more than 12% of gross domestic product (GDP). To put these potential losses into perspective, the projected economic losses due to skills shortages in the region are greater than the combined GDP of Croatia, Hungary and Slovakia.

Some countries appear harder hit than others when it comes to losses related to skills shortages. Countries in Eurasia reported the highest proportion of perceived losses due to skills shortages. By contrast, respondents in the Czech Republic, Latvia and Estonia reported the smallest losses.

Slovenia and Romania were the most likely to report having sufficient in-house talent to realise the full benefits of digital technologies. Interestingly, countries in Eurasia also reported a high level of in-house talent. The apparent contradiction between having sufficient in-house talent, while also reporting a significant loss of revenue, suggests that leaders in Eurasia feel growth could be much stronger but is compromised by skills shortages.

Overall, more than half of leaders surveyed (52.5%) felt they lacked the right in-house talent to realise the full benefits of digital efforts.

Compounding the issue are tightening restrictions on immigration from some non-EU countries, as well as the problem of mass emigration with skilled workers seeking more lucrative jobs in Western Europe, and also in Russia.

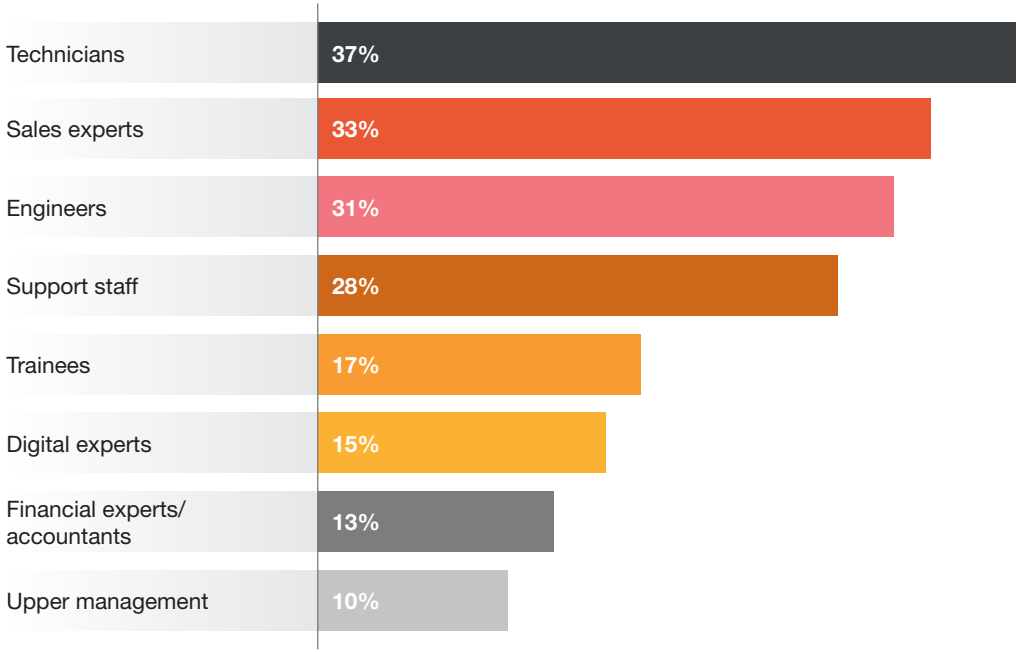
Recruitment and staff management is crucial to the future success of any company. But given the current environment, it's more important than ever to find people with the right skills, or at least the right potential to learn new skills.

There's often a misconception about which skills are required to succeed, however. Conversations with owners and managers of private businesses in CEE suggest that some companies may not know exactly what they need to transform digitally and future-proof their businesses. Often they are relying on internal staff to solve new issues. But like with boards, the people responsible for today's success may not be the same people best suited for the future.

Asked which measures companies would use to build up or get access to skills to advance digitalisation, implement and apply digital technologies, leaders rated internal and external training as the two most important, followed by recruiting of skilled experts. These were followed by the recruitment of national graduates and upskilling the workforce by collaborating with start-ups.

It is worth noting here that the skills required may not be available in the home country. Indeed, our survey suggests that this is often the case. We asked companies to be specific about the types of employees they required. "Technicians", perhaps not surprisingly, topped the list (see Exhibit 9). Demand for sales experts and engineers followed. Fewer than half as many companies said they are looking for digital experts as were looking for sales experts, despite the majority that see digitalisation as relevant for the future of their business.

Exhibit 9: Demand for skills



Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents. n=600

37%

of companies in CEE search for technicians.

15%

are looking for digital experts.

For some companies, attracting technically skilled workers may require them to step outside their comfort zones. We have often noted that private businesses across all parts of Europe tend to avoid the spotlight. Given growing competition for the best talent, being a "hidden champion" may no longer be a viable option. Companies should step out of the shadows to be visible and attractive to recruits.

Employer branding is crucial here and this starts with having a corporate culture that reinforces the brand – and which also supports change. We mentioned in PwC's latest Family Business Survey that great company cultures are built around clear and codified values. This notion is highly relevant when it comes to attracting and retaining talent to take a private business to the next level.

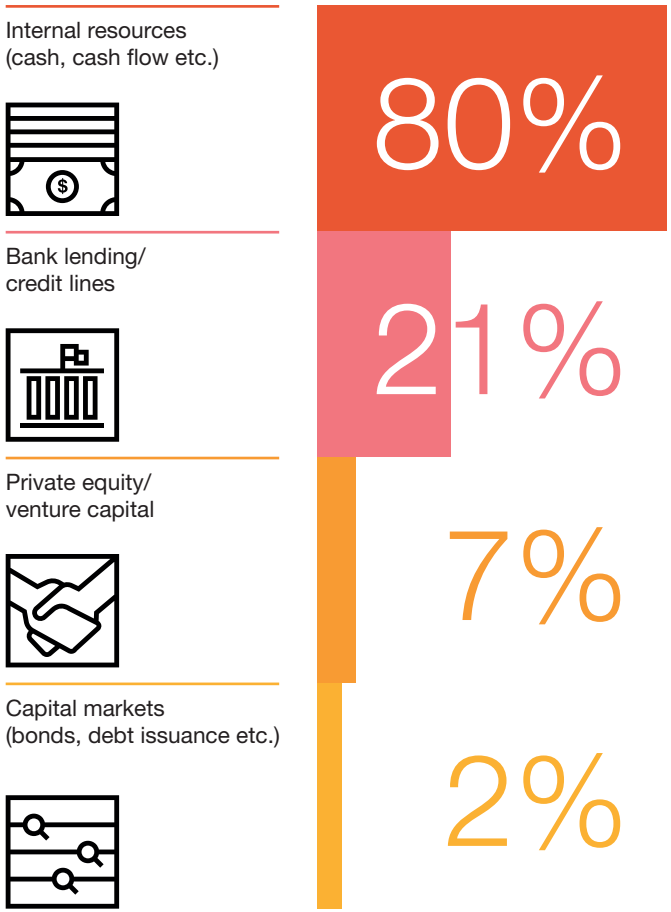
Our last point here: company leaders should clearly distinguish between short-term and long-term hiring needs. It may be worth thinking afresh about how to satisfy short-term transformation needs. One option for quickly finding technical expertise may be to collaborate with start-ups to fill the gaps, much like larger companies do. Slovakia and Romania are ahead of their neighbours in this regard: about one-fifth of companies have started using this approach in each of these countries.

Financing: funding the transformation

Most private businesses in CEE – 80% in our survey (see Exhibit 10) – fund digital efforts internally from cash flow. But there is a risk that this might change in a downturn as cash is diverted to other uses.

Exhibit 10: Sources to fund digitalisation

Which of the following sources will you use to help fund digitalisation?



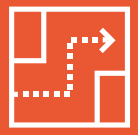
Source: PwC Central and Eastern Europe Private Business Survey 2019, all respondents.

Another 21% said they would turn to bank loans or credit lines. If traditional loans are a company's first choice, they should understand how banks conduct credit assessments and prepare themselves to be attractive to lenders. The last financial crisis showed that credit lines can disappear quickly, and with a downturn potentially around the corner, entrepreneurs can expect low interest loans to become much harder to obtain.

Private businesses should probably also explore alternative ways of funding digital investments. A downturn would likely lead to cost cutting on other fronts, leaving less cash to invest in digital overhaul.

Only 2% of those surveyed mentioned funding digitalisation via the capital markets. This is hardly surprising given that capital markets in most CEE countries are relatively underdeveloped. Another 7% said they would consider private equity or venture capital – the lowest level of any region we looked at, including Africa and the Middle East. By comparison, 23.5% of companies in Africa are considering private equity as a funding source for digitalisation, while 15% are considering it in the Middle East and 8.9% said the same in Western Europe.

Turning to private equity could kill two birds with one stone: by providing funding, as well as management support and expertise.



Conclusion

Private business leaders in CEE need to understand the far-reaching significance of digitalisation for the future of their companies. While we recognise the challenges of embarking on transformation in turbulent times, the time is now to capitalise on the opportunities digitalisation offers. Doing so will be critical in order to avoid falling behind in an ever-more competitive global landscape.

For governments the time is now to take a more active stance towards encouraging investors to finance innovation and supporting the advanced use of new technologies across private business sectors by creating regulations that promote digital uptake.

Meanwhile, governments will also need to rethink social policies. Hard-line stances on immigration will be put to the test when faced with a number of demographic factors such as mass migration, an aging population and low birth-rates, which are reducing the working age population and putting pressure on social systems. Dealing with these issues requires a comprehensive set of public and private sector policies to encourage workforce participation. These include tax incentives for families, improved public services such as hospitals, nurseries, and kindergartens, and greater job flexibility for working mothers.

On the digitalisation front, maintaining a competitive advantage in an age of change requires more than just technical fixes. Although this is an important component of future successful business activities, leaders need first to define an encompassing, holistic digital strategy. Equally important is to focus on people and skills, processes and organisation.

It's essential for private business leaders to determine their own "digital ambition" level and to thoroughly assess their organisation's status quo before defining concrete strategic measures to reach that ambition level. Alongside the technological component, these measures should include sustainable workforce decisions, an impactful investment strategy and a thoughtful approach to cultural change.

On that note, one aspect of a truly digital culture is building an environment where employees have the courage to constantly question the status quo. New revenue opportunities can emerge when existing business models are constantly challenged, and all staff are encouraged to rapidly develop and test new ideas. Encourage the Next Gen to play an essential role here.

Whichever strategies are employed, using digitalisation to drive growth is especially important now as uncertainty grows. The time to act is now.

Methodology

Between February and April 2019, PwC conducted interviews with key decision makers from 2,993 private businesses with a turnover of at least €10m in 53 countries in Europe, the Middle East and Africa. Of these, 600 private businesses from 15 countries in Central and Eastern Europe (CEE) were surveyed, the results of which form the basis of this report. Further insights on Western Europe, the Middle East and Africa are summarised in separate reports. The findings were analysed and evaluated by digital, strategy and private business experts at PwC.

Thanks and acknowledgements

First of all, we would like to thank the 600 Private Businesses across 15 countries in Central and Europe who generously gave their time to participate in the survey.

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