McKinsey&Company

Isn’t that Enough? What Comes After Austerity?

A handful of actions to stimulate the economy in the next 18-24 months

CAPITAL LINK CONFERENCE

New York, December 12, 2016

A quick reminder of McKinsey’s work for the benefit of Greece – 80% pro bono

Economy-wide

- **Greece 10 Years Ahead.** Analyzed barriers to competitiveness and growth; deep-dived into **14 sectors (5 largest & 9 Rising Stars)** and determined all reforms
- **Greece’s Growth Roadmap.** Prioritized **6 major investment & growth opportunities,** and detailed action lists per Ministry for execution of reforms
- **Strategic allocation of the 2014-2020 EU structural funds.** Quantified investment needs per sector to allocate **€21b of structural EU funds** to critical investments

Tourism

- **Tourism Sector Strategic Plan for 2013-2020 & Operational Plan for 2013-2014.** Developed plan for the six core tourism ‘products’ and for all major source markets
- **Design, setup and launch of “Marketing Greece”.** Developed not-for-profit entity with private sector know-how and talent and State endorsement, to take over the marketing strategy development and implementation of promotion activities. Entity financed with €2m from the private sector (www.discovergreece.com)

Other

- **Sector restructuring. Assessed sectors’ viability** and developed strategy to restore sustainable profitability
- **Pension reform.** Supported the domestic and international authorities, in assessing important trade-offs re: pensions; developed plan for Pillar II
- **Public debt.** Worked with the Public Debt Management Agency to prepare content for international investor roadshows, paving the way for Greece to return to the primary capital markets (in 2H.2014) after five years

Agenda

Economic context

Consumption

Investments

Exports

Actions going forward

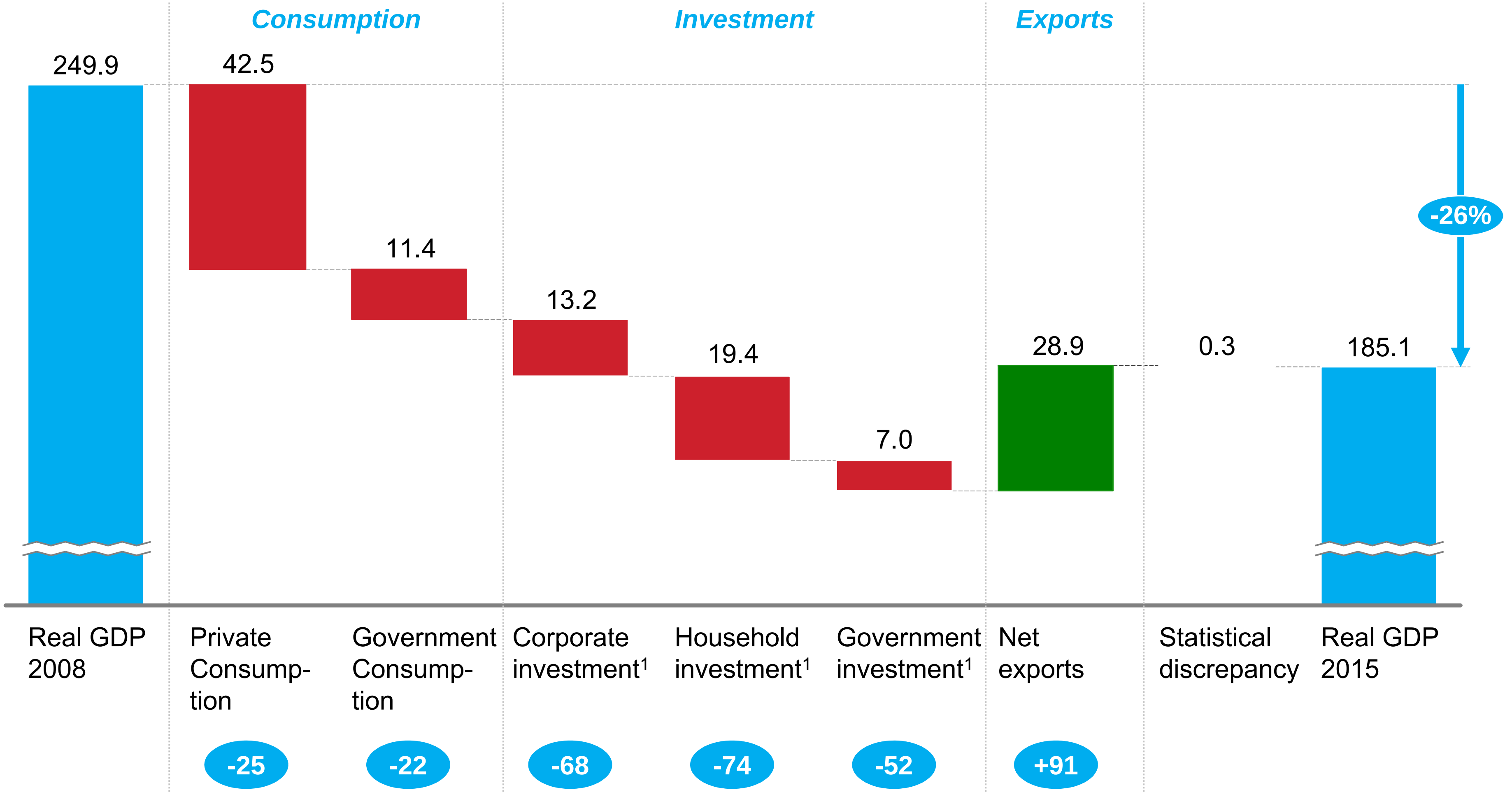
The decrease in investments (~€39b) and private consumption (~€43b) are the major drivers of the output drop

ESTIMATES

● Change from 2008 level, %

Change in Greece's real GDP, 2008–15

EUR billion, reference year 2010

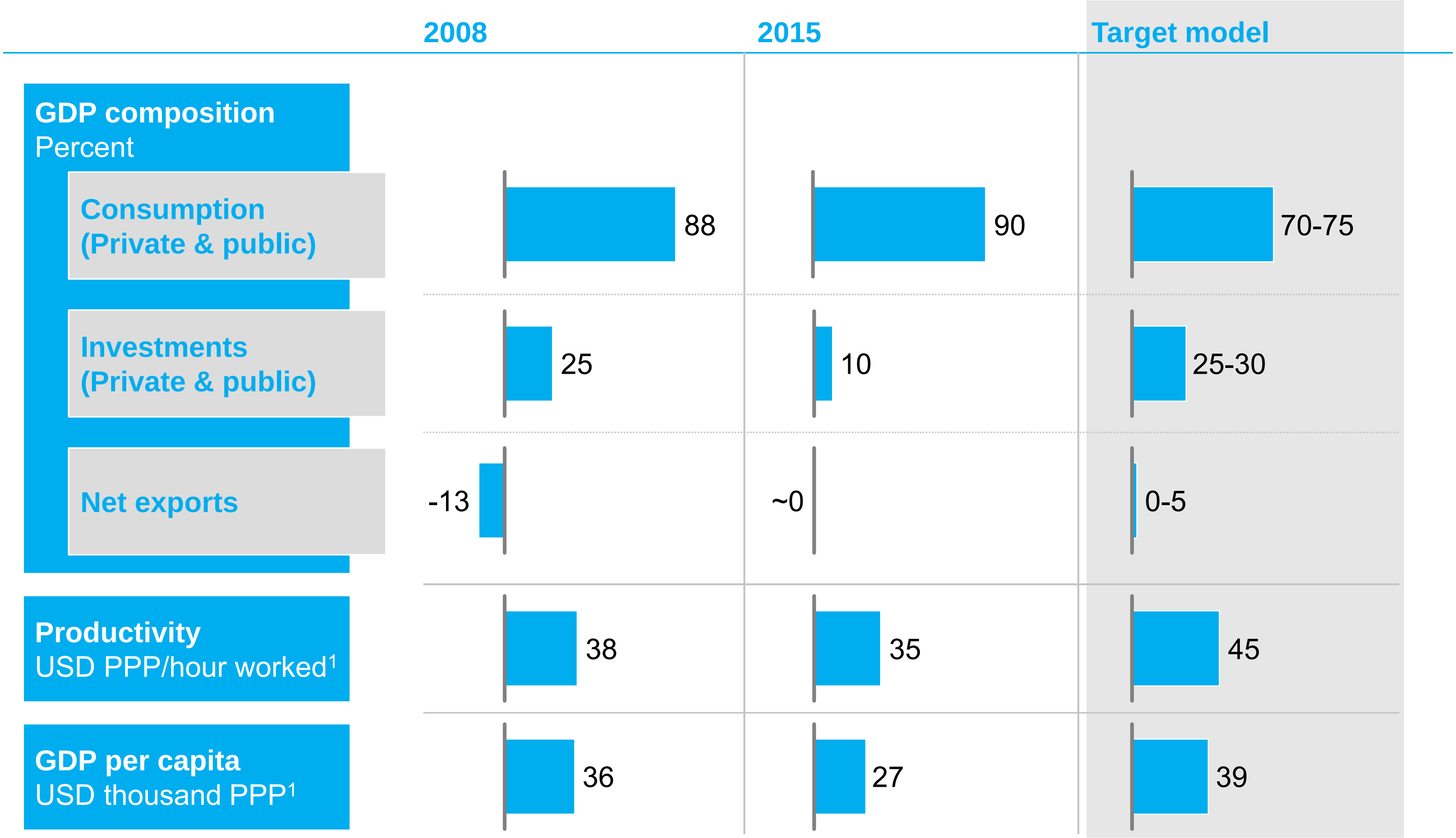


[1] Applied government/household/corporate split from AMECO database to Eurostat total investment levels

SOURCE: Eurostat; AMECO database

During the crisis, our economy diverted further away from its target economic model and aspiration

ESTIMATES



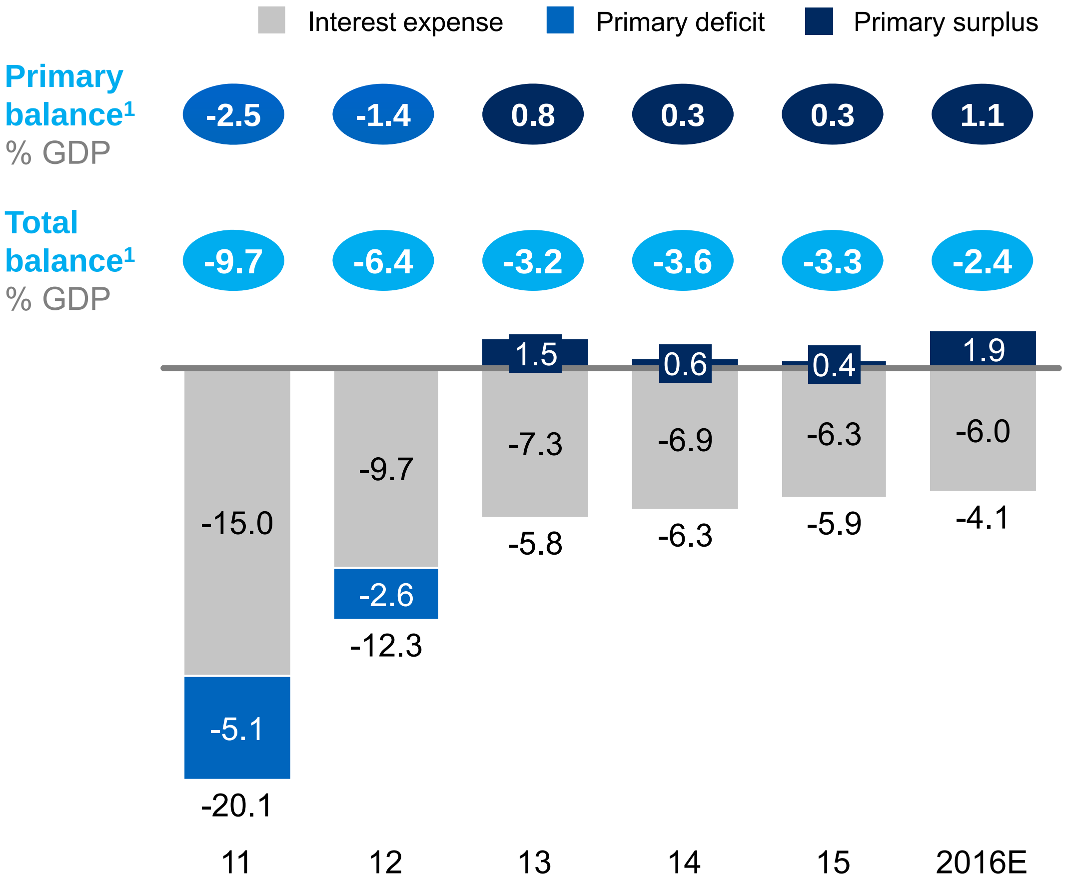
[1] Converted to 2015 price level with updated 2011 PPPs

SOURCE: Eurostat; Total Economy Database by The Conference Board; McKinsey analysis

Greece primary balance surplus vs. significant increase of State arrears; €1.4b in tax returns and €4.8b in expenditures

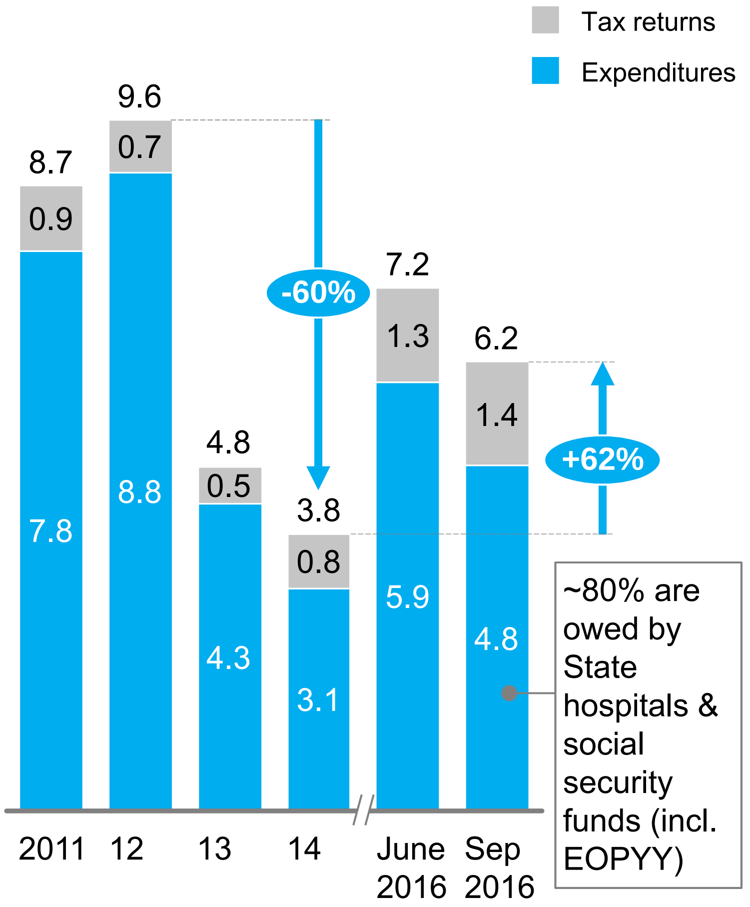
Key fiscal metrics evolution

EUR billion



Evolution of State arrears to private sector

EUR billion



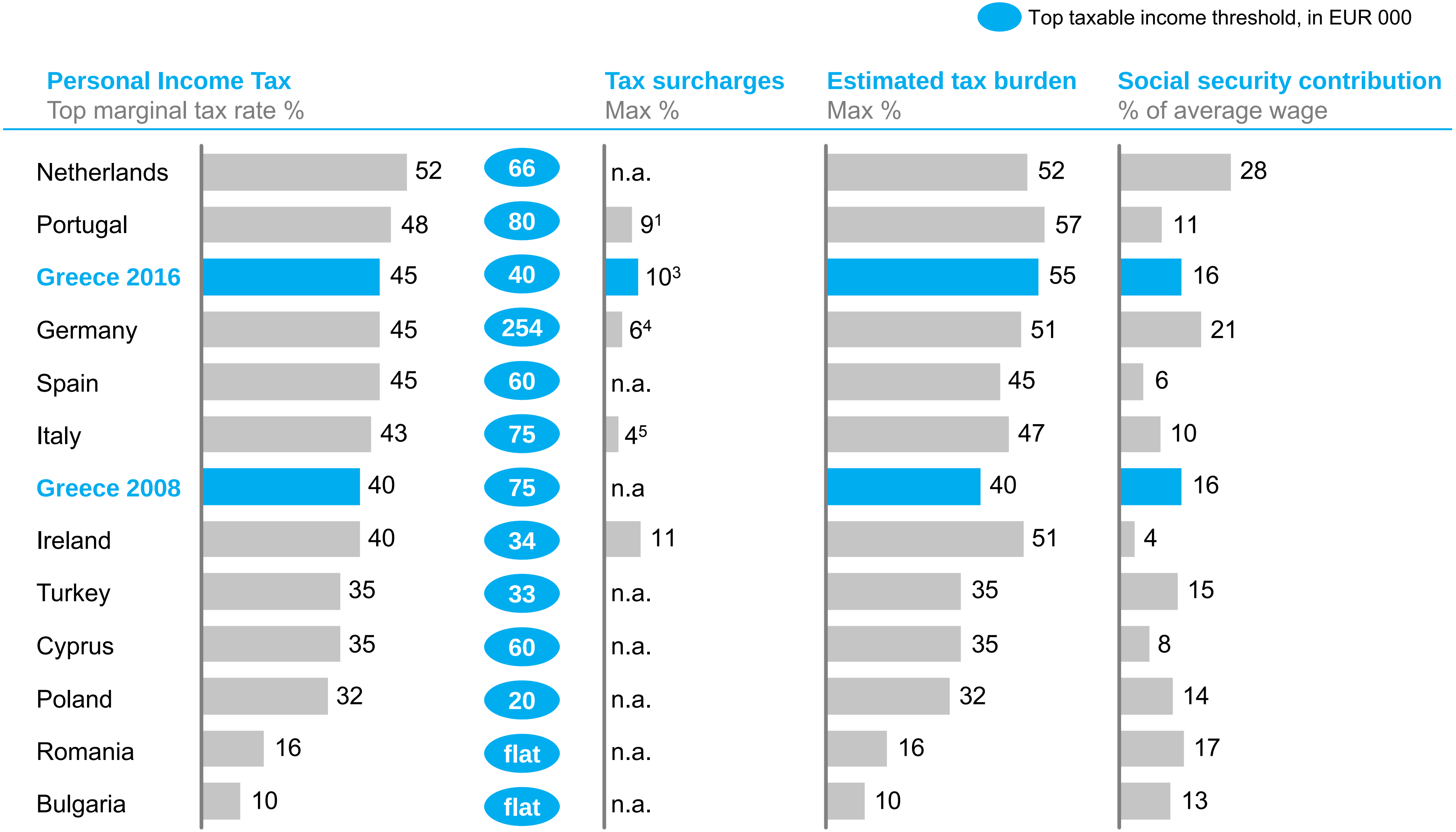
~80% are owed by State hospitals & social security funds (incl. EOPYY)

1 MoU definition, e.g., excluding Bank recapitalization costs

SOURCE: AMECO; EL.STAT.; Ministry of Finance; Press

Consecutive tax increases have taken us to a 55% personal tax burden excluding the rise in indirect / consumption taxes…

PRELIMINARY



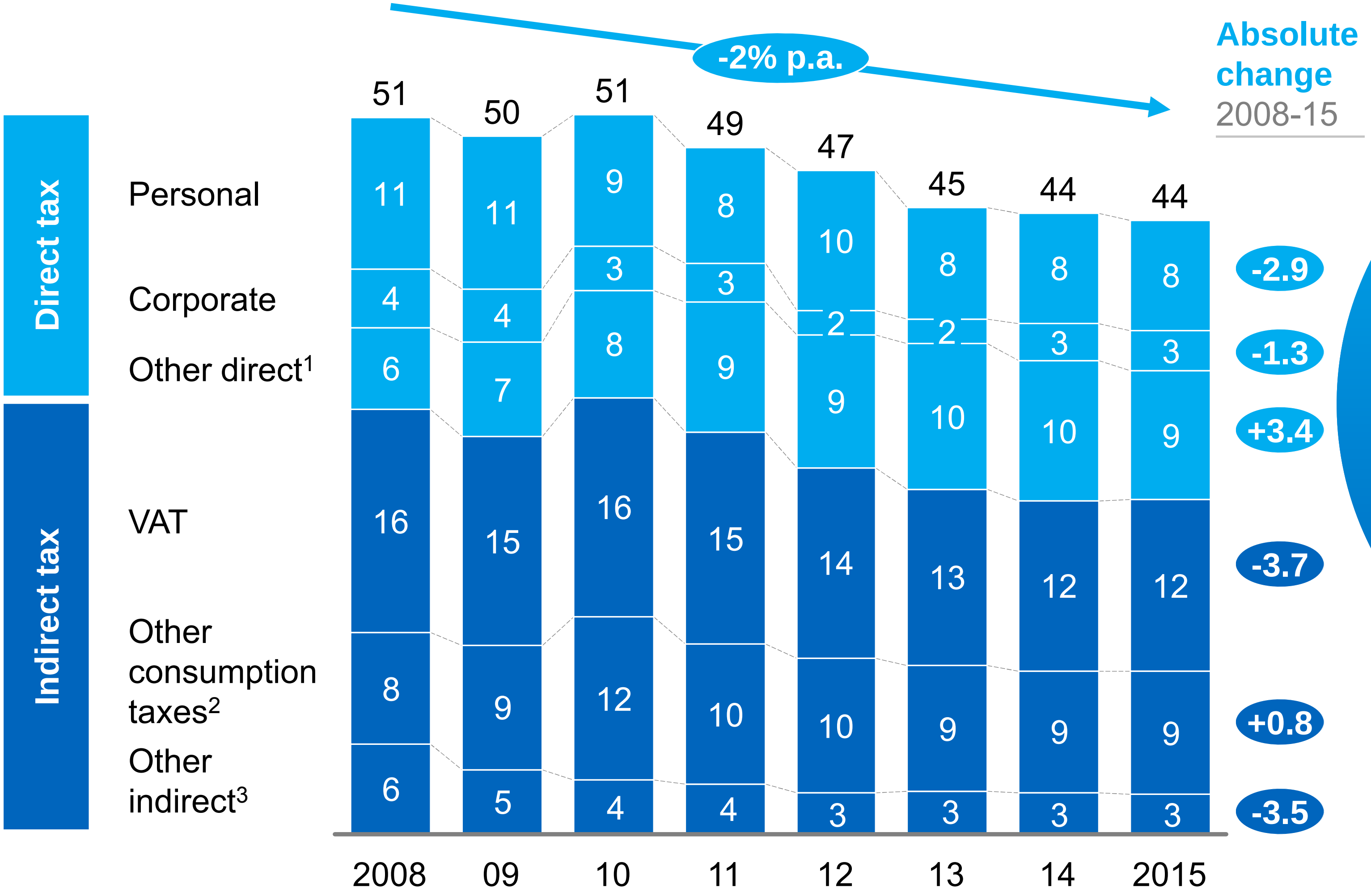
	Personal Income Tax Top marginal tax rate %	●	**Tax surcharges** Max %	**Estimated tax burden** Max %	**Social security contribution** % of average wage
Netherlands	52	66	n.a.	52	28
Portugal	48	80	9[1]	57	11
Greece 2016	45	40	10[3]	55	16
Germany	45	254	6[4]	51	21
Spain	45	60	n.a.	45	6
Italy	43	75	4[5]	47	10
Greece 2008	40	75	n.a	40	16
Ireland	40	34	11	51	4
Turkey	35	33	n.a.	35	15
Cyprus	35	60	n.a.	35	8
Poland	32	20	n.a.	32	14
Romania	16	flat	n.a.	16	17
Bulgaria	10	flat	n.a.	10	13

1 Max levy 3.5% >EUR 7,420 plus solidarity surcharge 2.5%-5%; 2 Plus USC top rate (other income tax of 8%) and 3% on those who have non-PAYE income >€100k.; 3 2.2-10% solidarity tax; 4 5.5% solidarity tax; 5 1.6-4.2% regional/municipal taxes

SOURCE: KPMG

…without the expected outcome despite also higher property and consumption taxes

Tax revenues
EUR billion



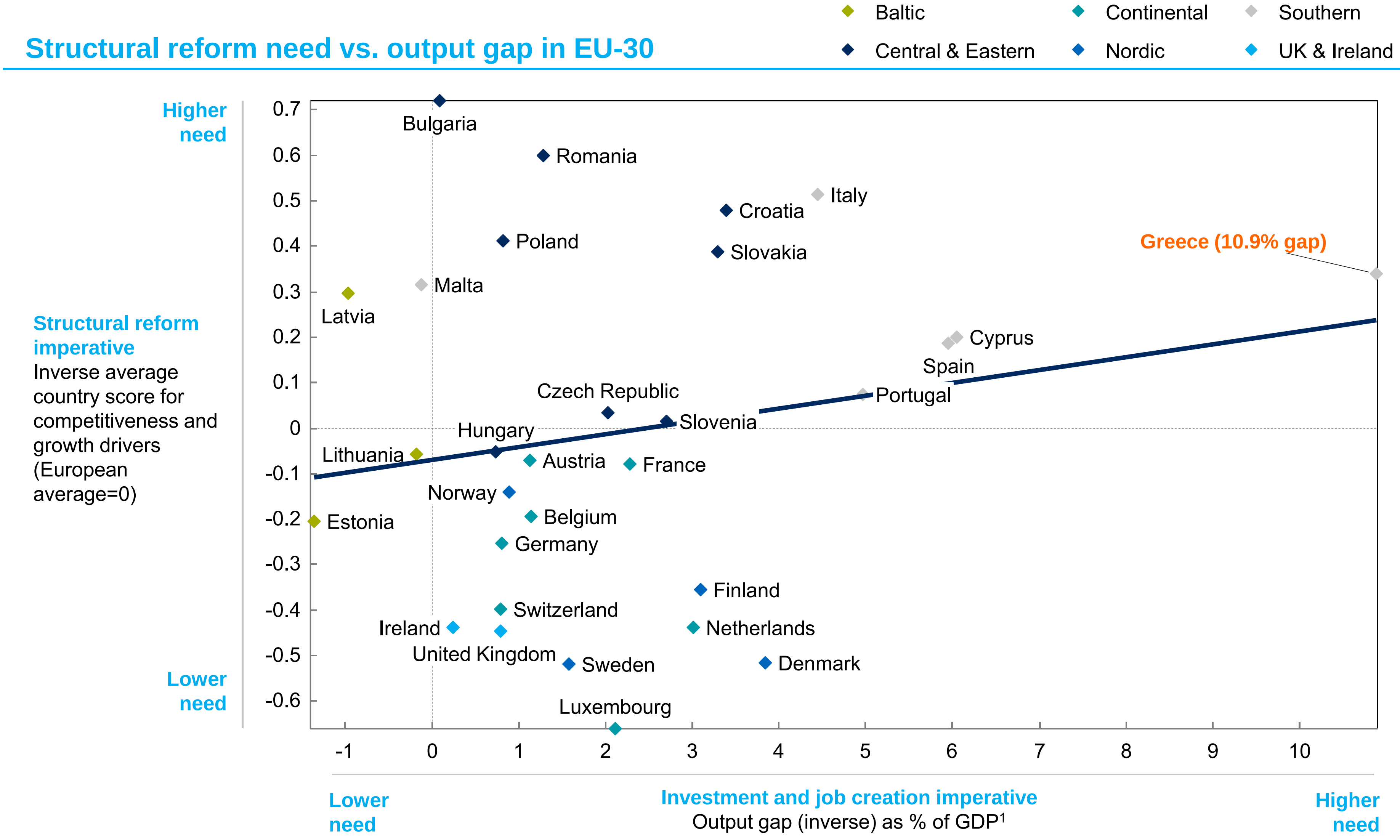
Increases in property and other **direct taxes** as well as **consumption taxes** (i.e., hikes in tobacco, fuels etc.) have held back a further decline but **have not increased tax revenues**

1 Property taxes, previous years taxes and n.e.c. ; 2 Fuel, tobacco, car taxation, n.e.c. ; 3 Trade taxes, import taxes, transaction taxes, previous years taxes

SOURCE: Bank of Greece – Governor's Annual Report; Budget 2017; Team analysis

Greece has the largest output gap among EU-30 countries confirming the imperative need for investment boost and job creation

Structural reform need vs. output gap in EU-30



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1 Positive values indicate an economy running below potential

SOURCE: European Commission; McKinsey Global Institute

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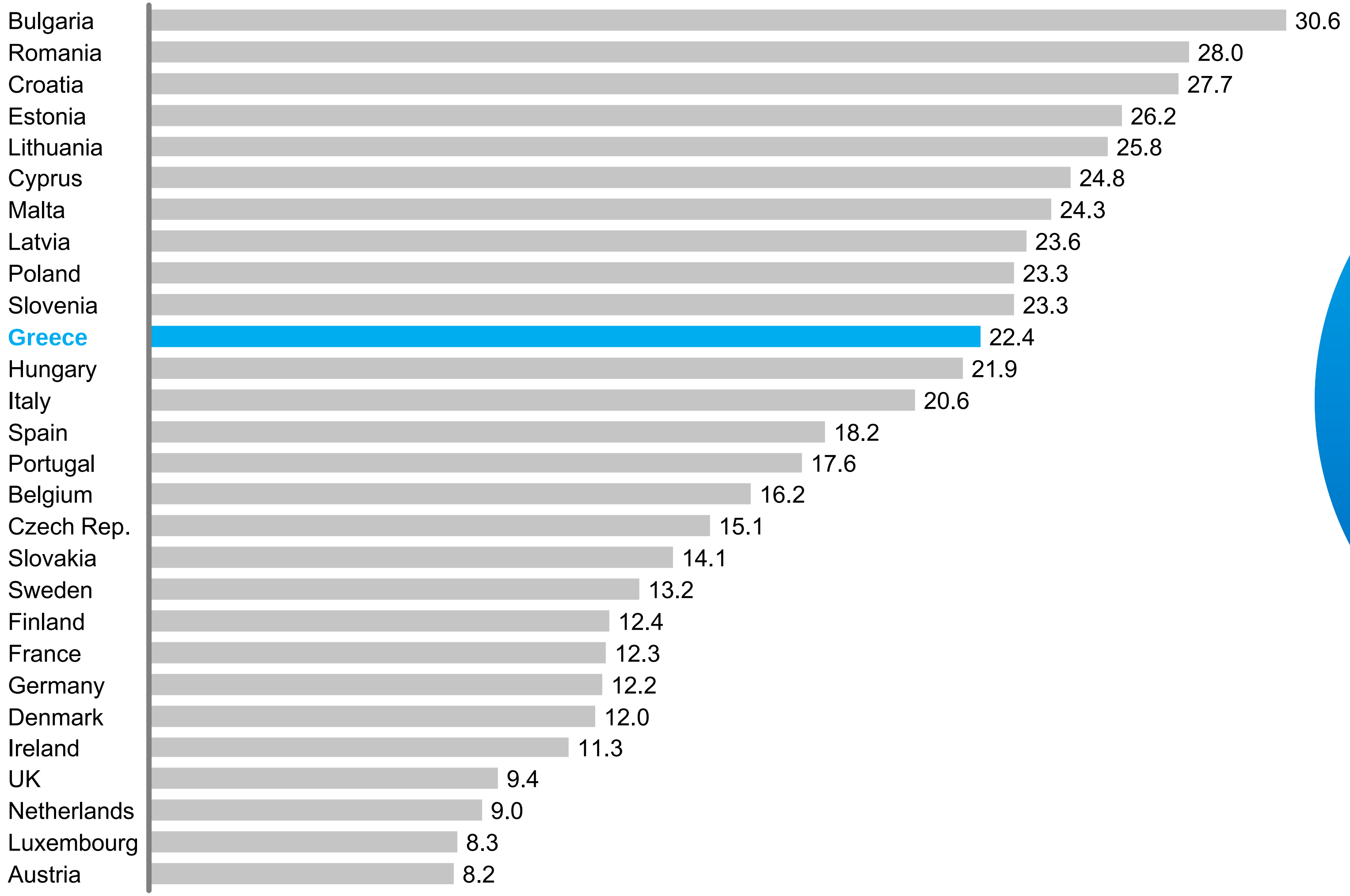
Among WEU Greece remains a champion in shadow economy with tax evasion estimated to ~€10-15b of annual state revenues

ESTIMATES

Shadow Economy

% of GDP



While shadow economy in Greece is estimated at ~22%, **tax evasion is estimated at ~6-9% of GDP** (~€10-15b)

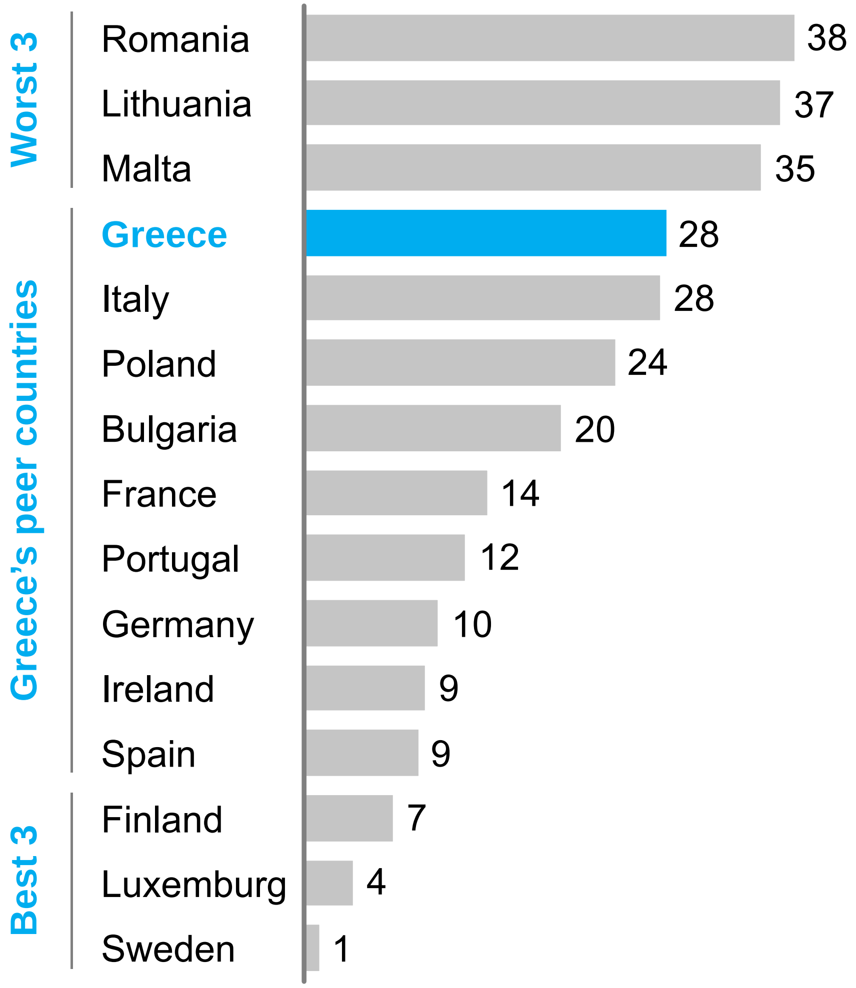
SOURCE: Schneider F. (2015), Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2015

Greece has ‘lost’ potential VAT revenues of ~€32b or 18% of GDP in 2010-14

ESTIMATES

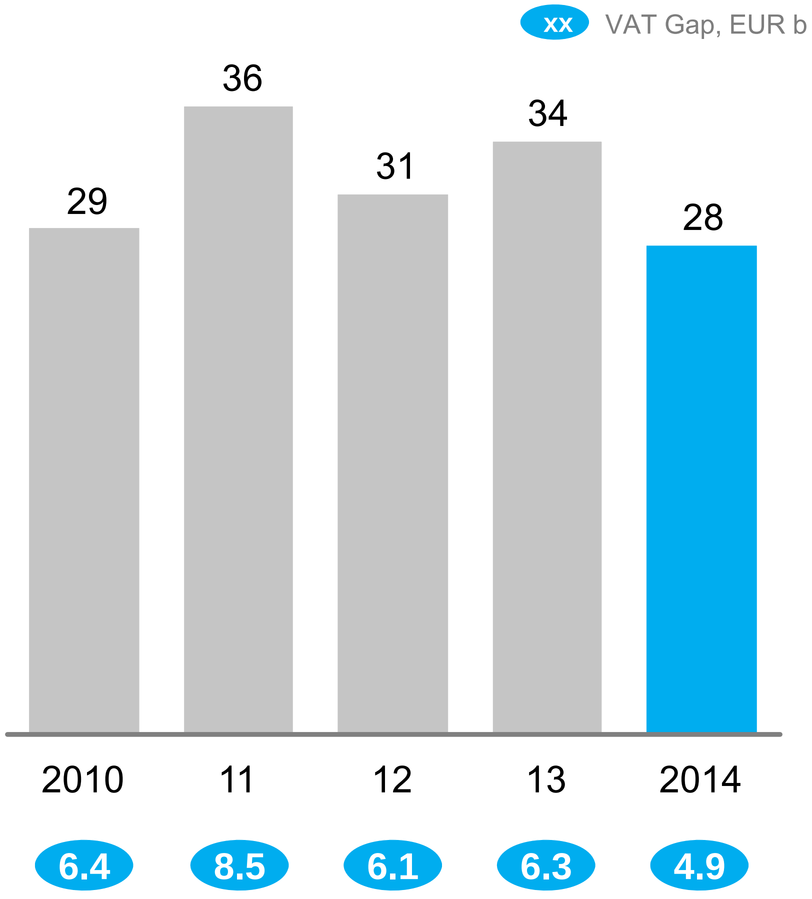
VAT Gap benchmarking 2014

% of expected VAT revenues



VAT Gap Greece evolution

% of expected VAT revenues



SOURCE: European Commission

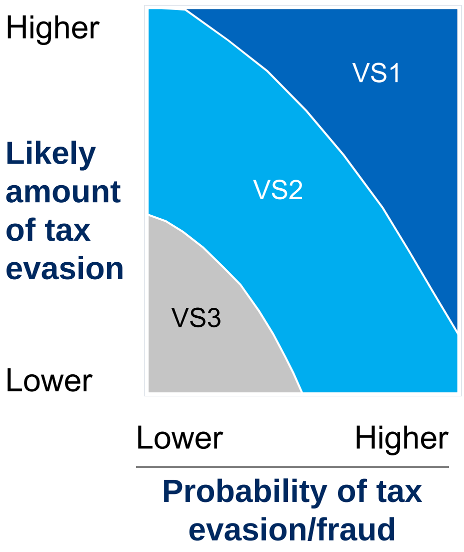
Application of proven Advanced Analytics know-how

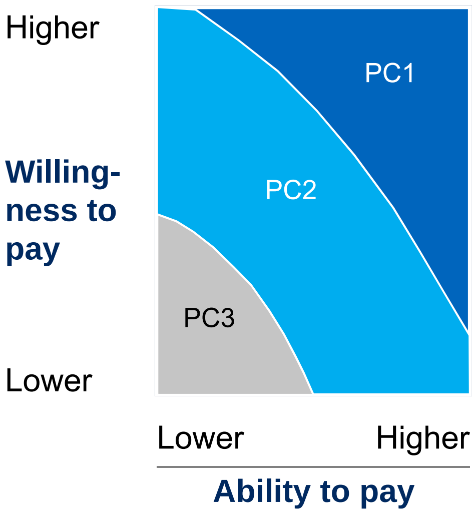
SIMPLIFIED

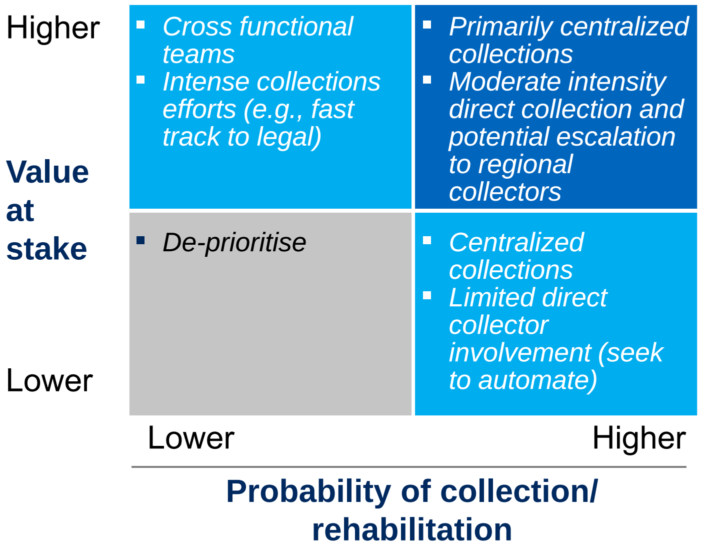
I **Determine value at stake**

II **Determine probability of collection/rehabilitation**

III **Segment and prioritize cases**







	Lower	Higher
Higher	*Cross functional teams* *Intense collections efforts (e.g., fast track to legal)*	*Primarily centralized collections* *Moderate intensity direct collection and potential escalation to regional collectors*
Lower	*De-prioritise*	*Centralized collections* *Limited direct collector involvement (seek to automate)*

- 25–30 indicators, e.g.,
  - Own/family assets
  - Transaction patterns
  - Past and current tax reporting
  - Profession
  - Residence

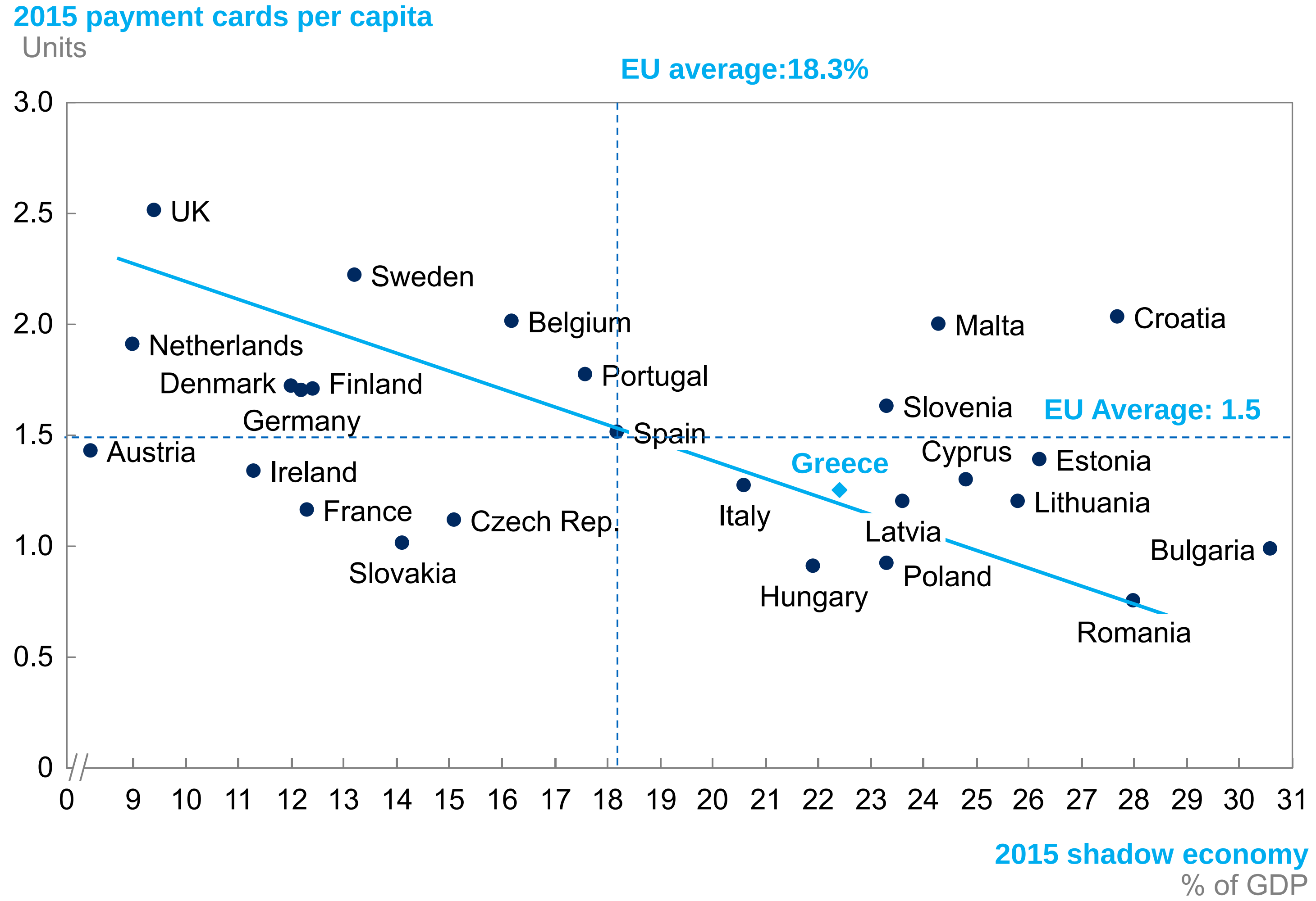
- Applied only to VS1 and VS2 cases which are most relevant
- 'Ability to pay' assessed through analysis of tax payers financials/assets
- 'Willingness to pay' assessed based on analysis of past behavior and direct contact with tax payer

- Combining VS1, VS2 with PC1, PC2, PC3
- Segment-specific strategies developed with clear implications to the collection strategy

SOURCE: McKinsey analysis

Direct link between tax evasion and cash based transactions

Payment cards penetration vs. shadow economy



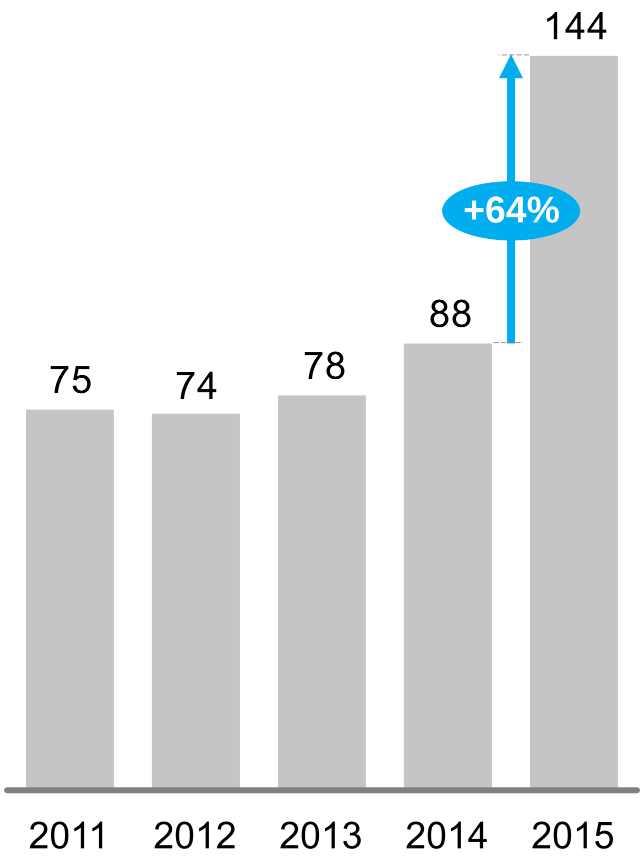
Research has shown that **increasing electronic payments** by ~10% p.a. for at least 4 years in a row **can shrink the shadow economy** by up to ~5%

1 Friedrich Schneider

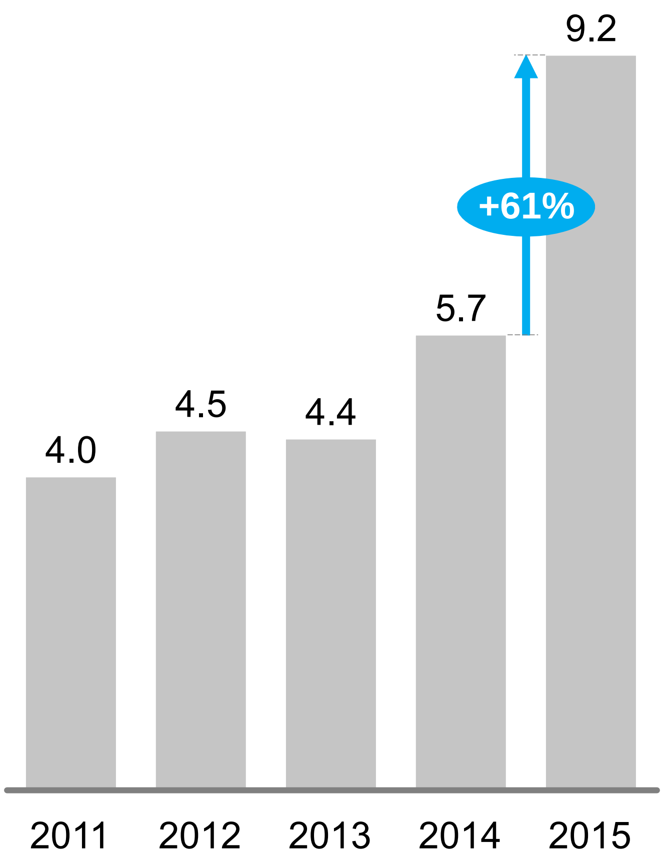
SOURCE: ECB; F. Schneider, “Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2015” (2015)

Despite the major uplift in plastic money transactions resulting from the 2015 capital controls…

# of payments made through cards
Millions of transactions



# of e-money payment transactions[1]
Millions of transactions



Lift of capital controls **not expected to reverse payment trends**. However, the penetration of POS in retailers/ freelancers and its evolution is a key factor for Greeks' payments practices

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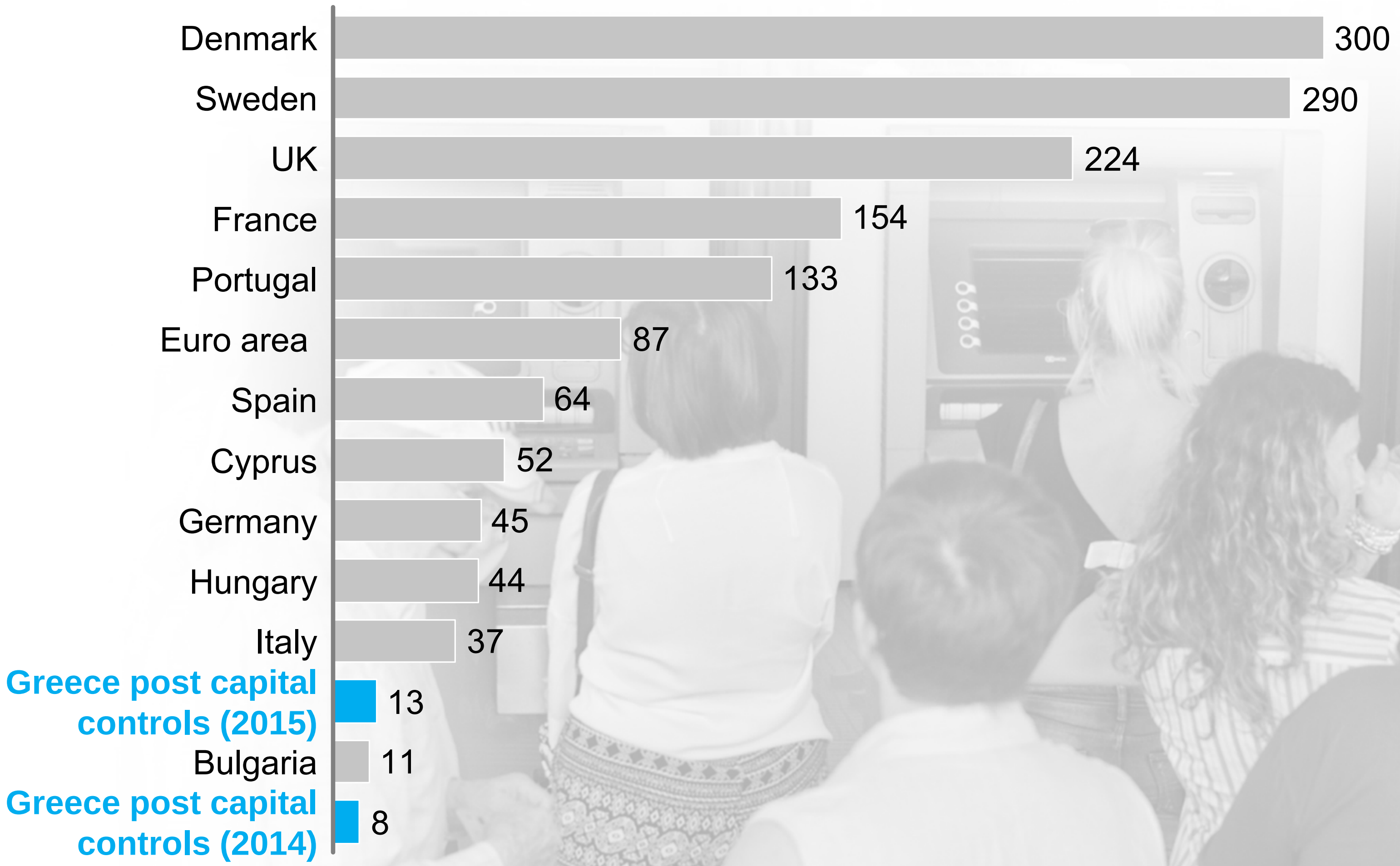
1 A transaction whereby a holder of e-money transfers e-money value from his/her own balance to the balance of the beneficiary, either with a card on which e-money can be stored directly or with e-money accounts.

SOURCE: ECB payments statistics 2015

…Greece remains very low relative to other European countries…

Number of Card payments[1] per capita year

Number of transactions per capita



[1] Payment transactions performed using cards with a debit, credit or delayed debit function at a terminal or via other channels

SOURCE: ECB payments statistics 2015

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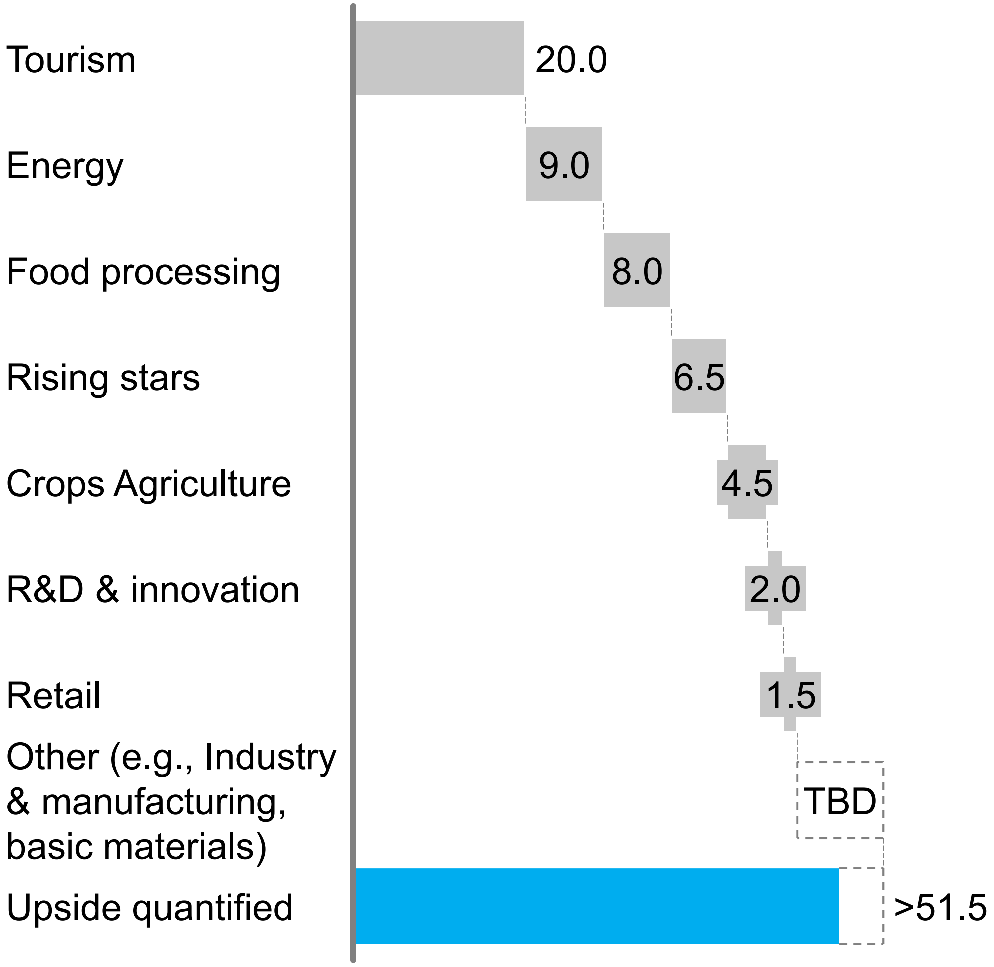
Over the next 8-10 years Greece has an annual GVA upside >€50b (~€55b GDP) and >640 thousand new jobs

ESTIMATE

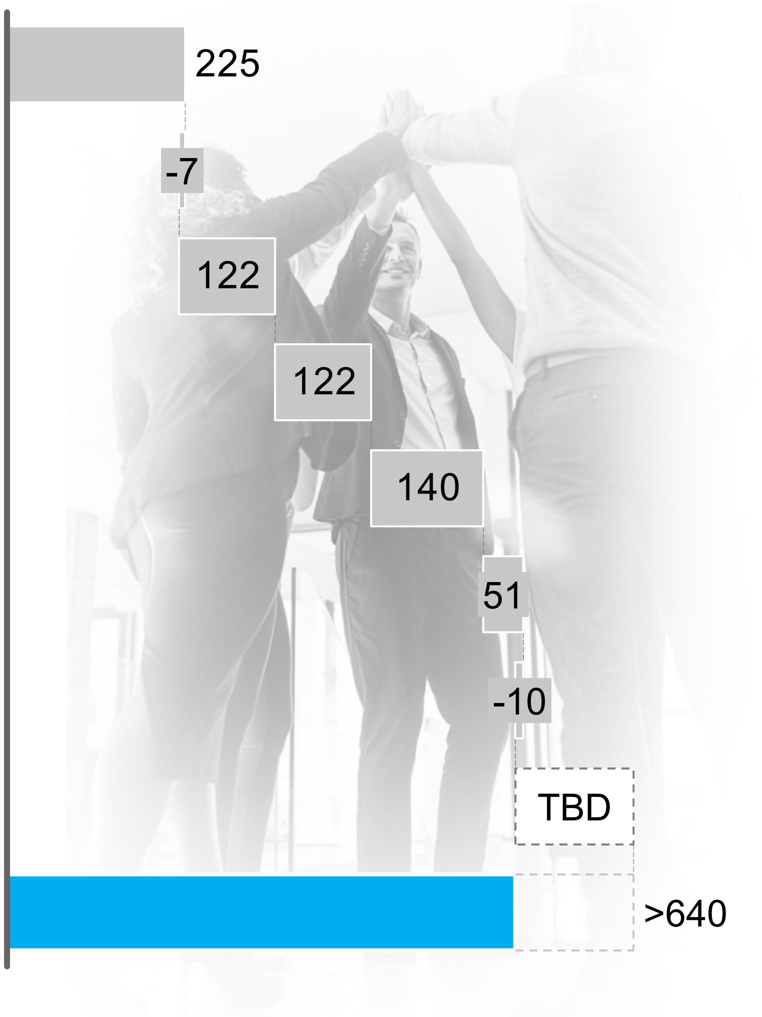
Incremental GVA

EUR billion



Incremental Employment

Thousand jobs



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1 Including energy efficiency measures, economy-wide

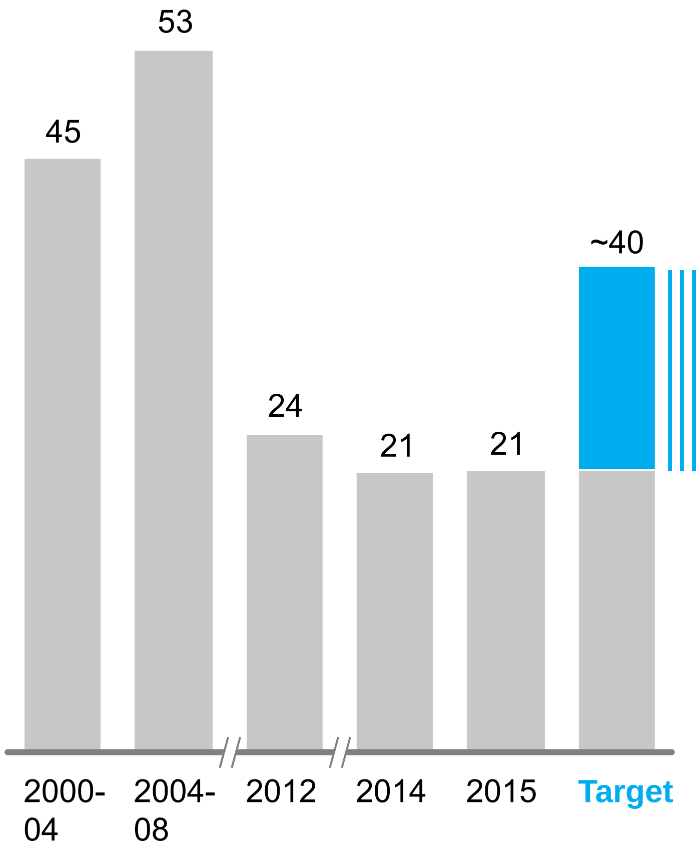
2 Rising Stars: Aquaculture, Medical Tourism, Generics Pharma., Cargo Hub, Long term & Elderly Care, Waste Mgmt, Classical Greece, Specialty Foods

SOURCE: McKinsey “Greece 10 Years Ahead” & “Growth Roadmap”

Capturing the upside would require an additional (vs. the 2013-2014 all-time low) annual investment of ~€19b

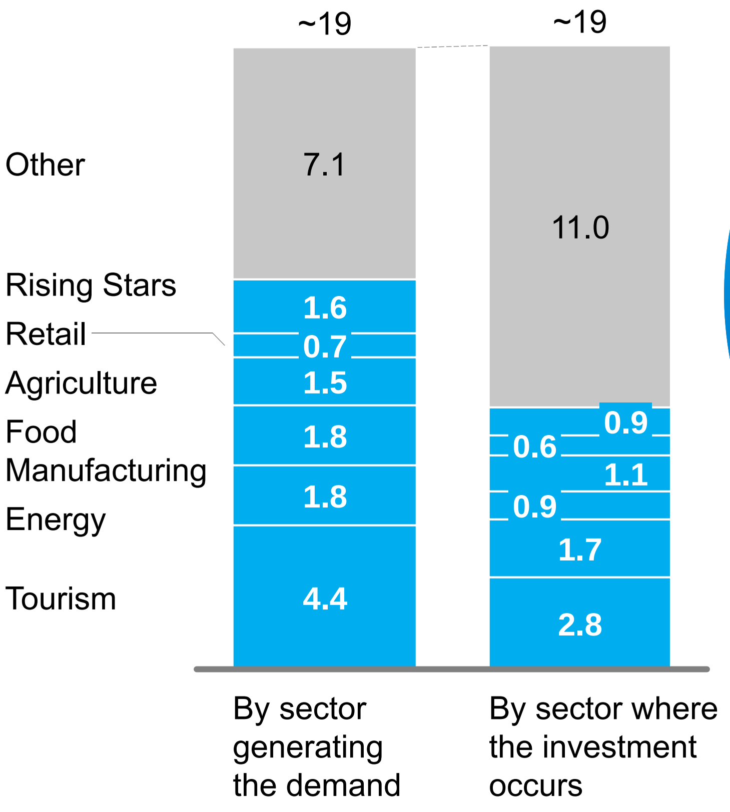
Average annual investments

EUR billion, 2010 prices



Average annual incremental investments by sector

EUR billion above the 2014-2015 all-time low, 2010 prices



~€150b of total additional investments needed in the next 8 years

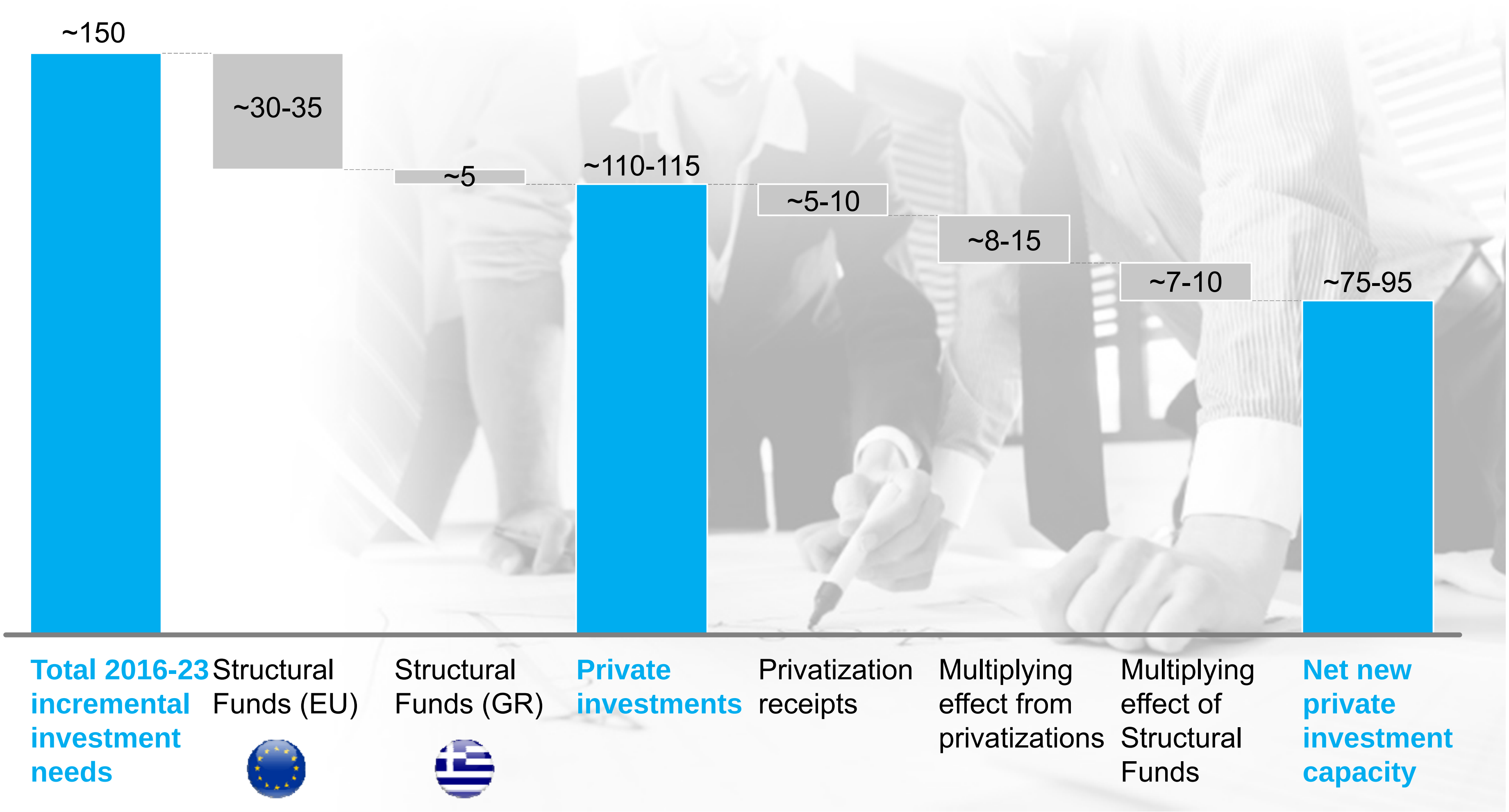
SOURCE: AMECO; McKinsey analysis

Incremental investments to come ~25% from public and ~75% from private funds, beyond Privatizations and Structural Funds

ESTIMATES

2016-23 incremental investment needs above 2014-15 (all time low)

EUR billion



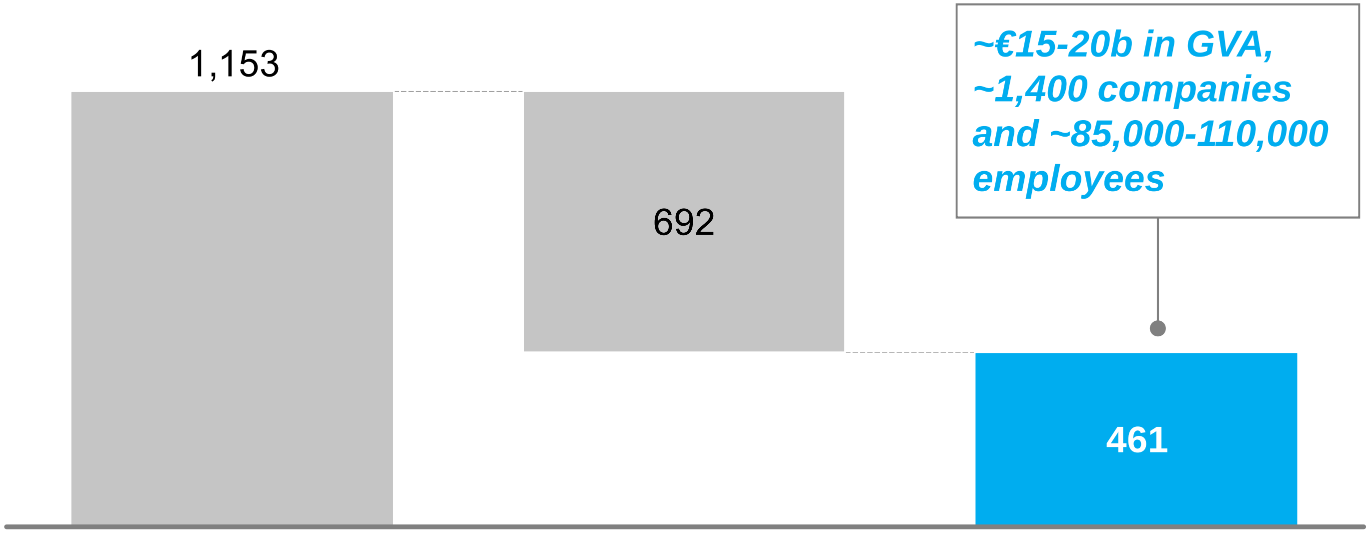
SOURCE: Eurostat; IMF; McKinsey analysis

40% of a sizeable sample of major companies are in need of imminent corporate restructuring; ~460 Groups and ~1,400 companies

ESTIMATES

Analysis of Greek corporates with >€20m turnover and >€10m exposure

Number of Groups



~€15-20b in GVA, ~1,400 companies and ~85,000-110,000 employees

Total sample of Groups analyzed (>€20m turnover and >€10m exposure)

'Healthy'[1] (641) or in progressed liquidation[2] (51)

Groups identified in need for imminent restructuring (financial and /or operational)

Total exposure EUR billion	36.2	14.7	21.5
NPE exposure EUR billion	19.9	2.2	17.7

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[1] <20 % NPE or <50% NPE and Debt/EBITDA <4.5

[2] Groups with at least 1 company (consisting of >20% of Group exposure) under bankruptcy, denounced & >2 years dpd in at least one bank

SOURCE: McKinsey analysis

Significant impediments identified for restructuring Corporates across 3 dimensions; new legislation under way addressing some

NOT EXHAUSTIVE

✔ Addressed by upcoming legislation
✓ In progress

Impediments for restructuring Corporates in Greece

Legal & Regulatory

- Based on the current context, significant **legal and regulatory impediments** hinder the effective and fast restructuring of large corporates. Some of the most important ones include:
  - **Limitations in the empowerment of creditors' rights** (e.g., shareholders' consent required for debt-to-equity swap, limited ability to effect restructuring plan / change in management) create bottlenecks in the process and disincentives for cooperation of involved parties ✔
  - Potential **liability of banks' personnel** for proposing, assessing or approving restructuring solutions (e.g., new financing in distressed company) penalize business judgement and make liquidation a "safer" option ✔
  - Potential **liability of interim management appointed by creditors or new shareholders** (under debt-to-equity swaps) for past liabilities of the company, limit the attractiveness of the position
  - **Constraints / omissions in the regulatory framework for servicing and selling NPLs** result in disincentives for potential private players that could play an active role in large corporate restructuring ✔
  - **Limited incentives for out-of-court settlements** (e.g., time to allow restructuring) do not allow for negotiations / time for alignment between various stakeholders and drive many companies to liquidation ✔

Tax & Accounting

- **Tax and accounting disincentives** for creditors and debtors pose constrains in the restructuring process:
  - Very **high real estate taxes** negatively affecting the liquidity of the real estate market and made foreclosures more difficult and less attractive for creditors; creditors also approach repossessions with caution due to the high liability they will inherit from past and future real estate taxes
  - There could be significant tax impact for debtors, as the **benefit from write-offs / write-downs is considered taxable income,** creating disincentives or unnecessary burden

Market

- **Lack of a formalized coordination mechanism** between the various creditors (incl., bank, state, commercial / suppliers) prolongs and sometimes blocks the restructuring process due to the absence of a uniform approach / process and a coordinated decision making process and due to the gaps in capabilities with regards to sophisticated restructuring ✓

SOURCE: McKinsey analysis

Agenda

Economic context

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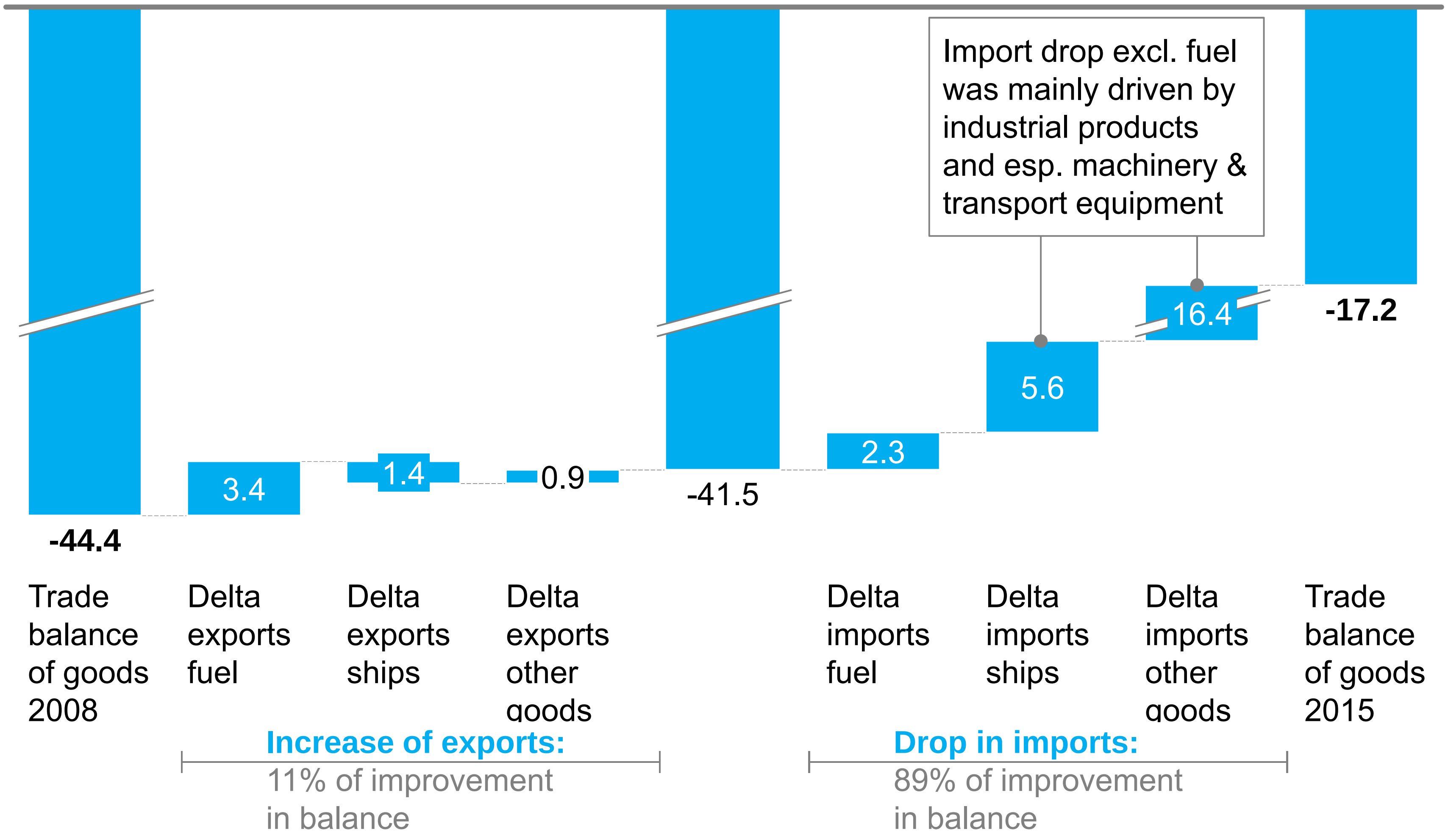
The improvement in trade balance between 2008-2015 was driven ~90% by drop in imports and especially by industrial products

ESTIMATES

Trade balance evolution 2008-15

EUR billion



Import drop excl. fuel was mainly driven by industrial products and esp. machinery & transport equipment

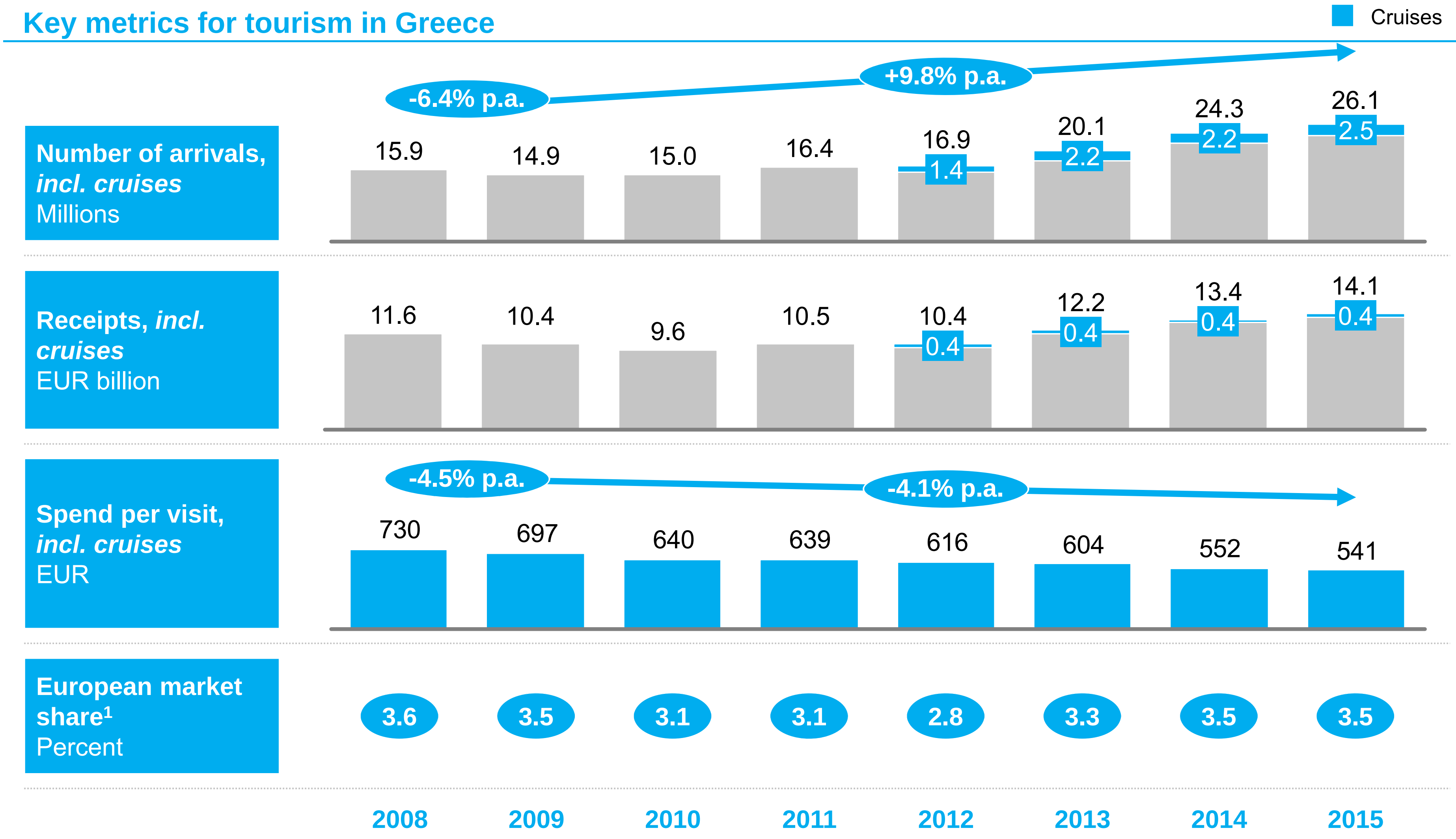
Increase of exports: 11% of improvement in balance

Drop in imports: 89% of improvement in balance

SOURCE : Bank of Greece; PanHellenic Exporters Association; McKinsey analysis

Strong growth on arrivals but receipts still far away from the €19-20b target due to declining per visit / arrival yield

Key metrics for tourism in Greece



1 Based on international tourism receipts

Note: Data includes cruises

SOURCE: Bank of Greece; UNWTO

Overview of the “Greek Foods Company”

NOT EXHAUSTIVE

Objectives	Description of major activities
Secure high quality sourcing at scale	▪ Define the **network of primary production/processing units** per category ▪ **Pool the production** of primary units (primarily small & medium) and establish/negotiate the **terms of cooperation** with them ▪ Undertake **productivity and know-how support programs** for primary units
Establish strong international access	▪ Define the suitable **market coverage model** per country (and category) ▪ Define **wholesaler and retailer network candidates** per country and understand consumer preferences via extensive market analysis and research ▪ Establish and manage **wholesale and retailer networks** per country/region
Pursue focused commercial initiatives	▪ Plan and coordinate **trade marketing and promotion initiatives** ▪ Set-up and operate a **limited retail store network (“Greek Corners”)** in selected high traffic locations (starting with priority 1 markets only) ▪ Provide input and **contribute** to the **“Greek Diet” international campaign**
Effectively manage logistics	▪ Design the **logistics and product flows network** ▪ Manage the **domestic logistics chain** including distribution and storage ▪ **Execute exports** (or facilitate in case of direct exports) to priority markets

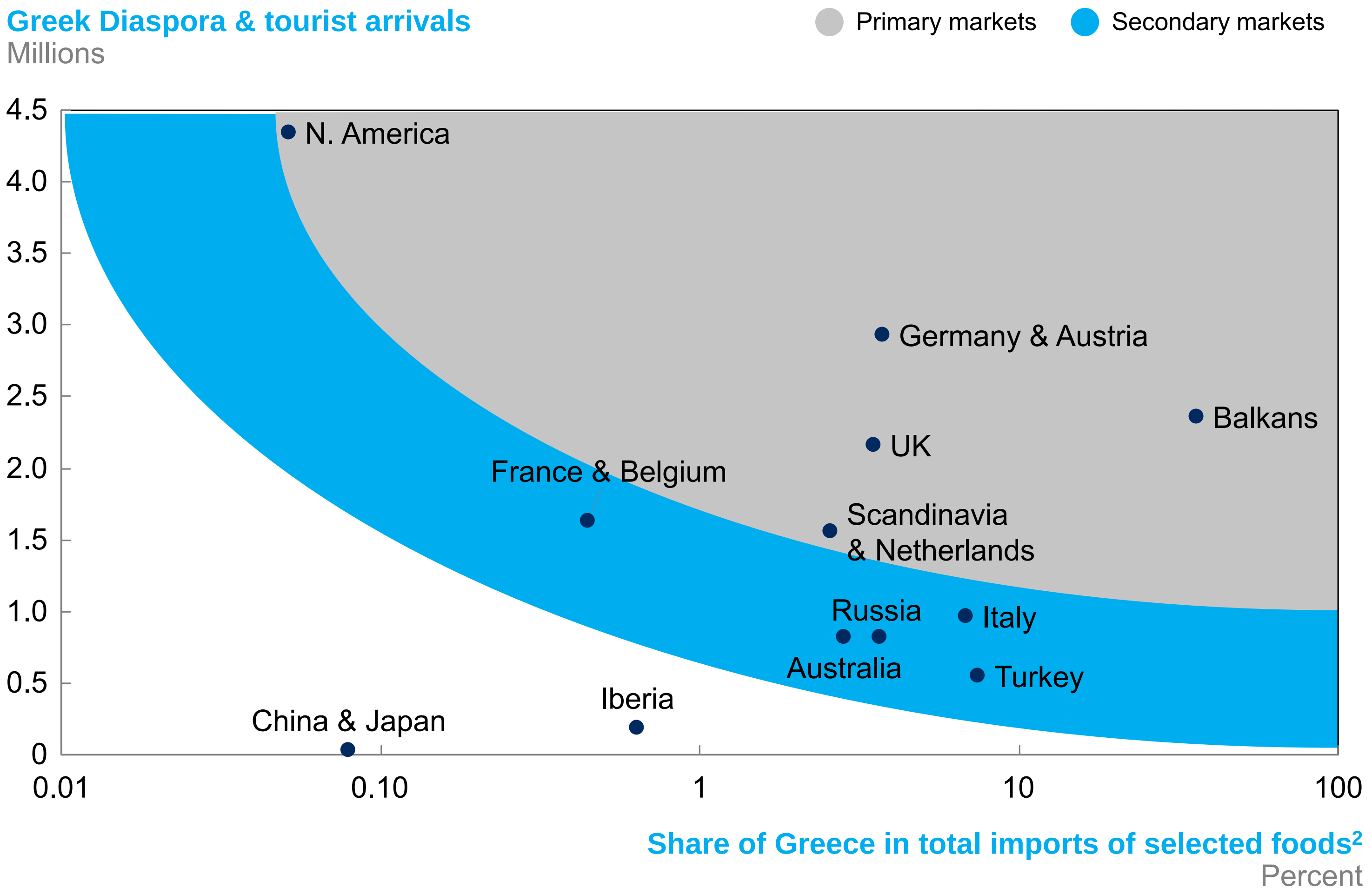
- ***“Greek Foods Company” scope covering both agriculture & processed priority categories***
- ***Private sector ownership or PPP with majority private sector participation***
- ***Greek primary production/processing companies and cooperatives taking a stake***

SOURCE: McKinsey “Greece 10 Years Ahead”

ESTIMATES

Greece should focus efforts in primary markets to increase share and try to further penetrate high growth markets

Prioritization matrix for food exports



Focus/target markets

Priority 1

- Germany & Austria
- Balkans (e.g., Romania, Bulgaria)
- UK
- Scandinavia
- Netherlands
- North America

Priority 2

- France & Belgium
- Italy
- Turkey
- Russia
- Australia

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[1] Domestic consumption of oranges, peaches, nectarines, grapes, cotton, apples, potatoes and kiwis

[2] Share of Greece in total imports of oranges, peaches, nectarines, grapes, cotton, apples, potatoes and kiwis

SOURCE: UN Comtrade; FAO; EL.STAT.; McKinsey analysis

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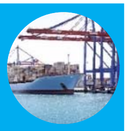
Actions going forward

A handful of actions to stimulate the economy in the next 18-24 months

	Objectives	Actions
 **Consumption** *Stop eroding incomes and rejuvenate consumption*	***Inject liquidity*** reducing state arrears	1 Prioritize **arrears payments** based on market impact; **offset** tax payables with tax receivables
	Seriously ***tackle tax evasion*** across segments	2 Apply proven **Advanced Analytics** know how; aggressively boost **non-cash** transactions
	Execute ***tax reform*** in line with the anti-tax-evasion impact	3 Gradually reduce personal, corporate and VAT **tax rates** to pre-crisis levels
	Cautiously ***rejuvenate lending*** to corporates and households	4 **'Cherry-pick'** new risks and pursue sector-wide project to address 'strategic defaulters'
 **Investments** *Get serious with corporate restructuring and new projects*	Remove barriers and accelerate ***corporate restructurings***	5 Complete necessary adjustments and execute new **restructuring** legislation; push **operational turnarounds**
	Direct ***funds*** to identified ***high GVA projects***	6 Mobilize **EU funds** and attract equity/debt from **private funds** towards value-generating sectors & large projects
	Free up barriers to ***investments in high priority sectors***	7 Effectively re-launch the **'one-stop shop' for barrier removal** backed by legislation
 **Exports** *Capture low hanging fruit (i.e., tourism, foods)*	Start recovering ***tourism affluence mix*** (spent per visit)	8 Materially invest in campaigns focused on **high value target markets** (e.g., N. America, Middle East, China)
	Capture readily available ***food export opportunities***	9 Launch a **"Greek Foods Company"** (incl. consolidating existing platforms) and focus on identified **target markets**

SOURCE: McKinsey analysis


THANK YOU