Summer 2007

Topic:
Emerging Markets

From Istanbul to Kiev: just where are the opportunities for your business?

We look at 11 Emerging Eastern European Market countries, their rapid development and significant opportunity for business expansion…

iCAD is produced by Business Advantage, a B2B research, business development and marketing consulting practice operating in the global IT, Digital and Telecommunications sectors.

Introduction

Over the last years many multinationals have moved to take advantage of a swathe of opportunities opening up in central and southern Europe and Western Asia. Foreign Direct Investment (FDI) varies markedly across this crossroads between Europe, the Slavic nations and Asia. Being a crossroads is part of the attractiveness to investors – near enough to the consumer markets of Western Europe, with growing local market opportunities and openings into the Middle East and Asia. Many of the populations are well educated with generally lower wages. This article describes the main opportunities available in these 11 countries, which countries are developing most rapidly, the relative levels of salaries, tax and investment opportunities offered by local governments and the most attractive long-term opportunities.

Key areas of interest

Poland, the Czech Republic, Slovakia and Slovenia are already members of the European Union, bringing EU funds and faster developing opportunities. Bulgaria and Romania became members on the 1st January 2007. The remaining five countries covered by this article have all expressed an active interest in becoming part of the EU and are at disparate stages of the negotiation process.

Main features drawing employers to the area

- Cost Savings
- Educated Workforce
- Proximity to Western Europe
- EU funds and FDI
- Tax/Investment Incentives

When it comes to cost savings, the attractions are obvious: weekly pay across the 11 countries varies from as little as €37 a week (Bulgaria) to €247 (Slovenia) (source FedEE, Pay in Europe 2006) as well as offering well-educated workforces. However, one ex-VP from an EMEA Technology Firm comments that the challenge is "Finding people with high integrity, western business values and ethics, and a propensity for going the extra mile to achieve success. In most Eastern European countries, finding highly skilled labour is not an issue. It's the "soft" attributes that are essential for the long term."

Companies that have had success across these countries tend to recruit local management with knowledge of each country's individual idiosyncrasies as opposed to bringing in management from abroad. Some companies, as a matter of policy, pay for local young skilled staff to attend college abroad, or support the educational infrastructure of the local country.

With relatively low labour rates and yet a close geographical proximity to Western Europe, the countries can also offer a convenient manufacturing base. Some companies choose to outsource manufacturing to local companies, some set up their own centres. The Czech Republic and Slovakia have a skills base in manufacturing, particularly in the automotive industries. Turkey is also particularly strong in manufacturing, but success here depends on building alliances with strong local Turkish firms.

New market opportunities

The other reason that is drawing investors is growing market opportunities. From a point of view of potential market size, Turkey and Ukraine stand out with populations of over 70 million (Turkey) and over 45 million (Ukraine). Turkey's population is growing – set to rise to around 86 million by 2025 (source: http://www.prb.org) while Ukraine is set to fall by around 5 million in the same period. Bulgaria, Poland and Romania's populations are also set to fall by more than 1 million each over the next 20 years. (Source: http://www.prb.org).

Population and gross national income

Country	Est. Population (m), mid 2006	GNI PPP $US*
Bulgaria	7.7	8,630
Croatia	4.4	12,750
Czech Republic	10.3	20,140
Hungary	10.1	16,940
Poland	38.1	13,490
Romania	21.6	8,940
Serbia	9.5	Not available
Slovakia	5.4	15,760
Slovenia	2	22,160
Turkey	73.7	8,420
Ukraine	46.8	6,720

Source:PRB (http://www.prb.org)

*GNI PPP per capita is gross national income in purchasing power parity (PPP) divided by midyear population. GNI PPP refers to gross national income converted to "international" dollars using a purchasing power parity conversion factor. International dollars indicate the amount of goods and services one could buy in the United States with a given amount of money. Data is from the World Bank

What do local governments offer in terms of incentives?

Below is an indication of weekly salaries in Euros, together with an illustration of Government incentives, brief notes and the comparative costs of setting up businesses in each country. This gives an idea of the relative amount of 'red-tape' and time involved.

Comparative ease of setting up a business in each country

The table below contains information from the World Bank on the comparative ease of setting up a business in each of these countries. The countries with the highest cost are generally caused by much higher legal fees. The number of processes involved is fairly constant across the areas. The cheapest country in which to set up is Ukraine at $140 US dollars, while setting up in Hungary will cost you $2,095 US dollars.

Country	Number processes	Number of days taken (these can overlap)	Cost in $US
Ukraine	10	33	$140.18
Romania	5	11	$167.99
Bulgaria	9	32	$270.96
Serbia	10	18	$334.52
Slovakia	9	25	$384.00
Czech	10	24	$958.35
Croatia	10	45	$982.83
Turkey	8	9	$1,264.32
Poland	10	31	$1,521.31
Slovenia	9	60	$1,636.93
Hungary	6	38	$2,095.17

Source: World Bank, 2006 figures.

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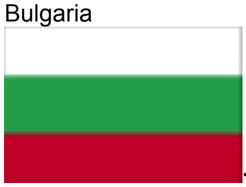
Mini portraits

Bulgaria



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weekly salary in €	Government incentives
37	15% corporate income tax. Incentive scheme based on three levels of investment. Manufacturers investing in high unemployment regions exempt from corporate income tax. Preferential VAT for import goods.

In October 2002 the EC stated that Bulgaria had a ‘functioning market economy’. The government has worked to attract foreign investment, reduce taxes and reduce corruption. Corruption is, however, one of the concerns most often expressed. The Bulgarian government has also begun to privatise some of the major state monopolies. Strengths: qualified staff.

Croatia

weekly salary in €	Government incentives
182	10% corporate tax for 10 years invest HFK 4M 7% corporate tax for 10 years invest HFK 10M 3% corporate tax for 10 years invest HFK 20M

Investors have been discouraged by many firms’ financial conditions, issues over property rights and ‘unrealistic’ market values by Croats. Some privatisation took place in 2004, but the progression in privatisation has halted. Salaries are also high, particularly in the public sector. Croatia is hoping to remove one million mines left over from the ex-Yugoslavian conflict by 2010. Strengths: qualified staff.

Source: World Bank

Czech Republic

weekly salary in €	Government incentives
145	Full/partial tax relief for 10 years. Subsidies for strategic services and technological centres are also available. This covers activities such as group headquarters, call centres, R&D centres

Out of these 11 countries, the Czech Republic has one of the most developed and industrialised economies and was the first ex-communist country to be given an investment-grade credit rating by international credit institutions. In 2005 the Czech Republic received $10 billion FDI, both from the West and from Asia. The telecommunications sector is privatised. Strengths: people with good language skills and qualifications.

Source: World Bank

Hungary

weekly salary in €	Government incentives
135	Government 'Smart Hungary' plan supporting investments that bring regional headquarters and regional centres, which consolidate back-office and information technology support functions to Hungary.

Since 1989 Hungary has received more than $60 billion in FDI. Two-thirds of Hungary's manufacturing is controlled by foreign investors. 90% of telecommunications is controlled from abroad and 60% of the energy sector is in foreign ownership. Hungary has a strong local culture, however, that is not easy for outside entrants to penetrate. Strengths: Hungary has people with both good language skills and a good level of qualifications.

Poland

weekly salary in €	Government incentives
147	14 special economic zones and technology parks with incentives attached, such as exemption from income tax, real estate tax etc. €90B allocated for development, infrastructure – Poland is the largest beneficiary of EU funds

Since 1990, Poland has received over $85 billion in FDI. Its main attractions are seen as its large, skilled work force, rising but competitive salaries and cheap land. Red tape is an issue. The telecommunications sector lacks the stimulus of competition. There are issues over continuing state-owned industries. Strengths: Poland can offer highly qualified employees with a good level of skills in the IT/Technology sector, as well as people with strengths in languages.

Source: World Bank

Romania

weekly salary in €	Government incentives
66	15% flat tax rate, simplified tax structure Three special economic zones with incentives attached

Romania has coal, oil, natural gas, hydro, and nuclear energy sources, offers a central point to access the Balkans, Middle East and North Africa, a labour rate that is significantly lower than other Eastern European countries and a large domestic market. Although Romania joined the EU this year, there are concerns over corruption, competition and judiciary issues. Most of its industrial state-owned businesses have been privatised. It offers one of the biggest potential opportunities for building an EU base to access countries further east following its accession to the EU. Strengths: Romania offers staff with a good degree of skills in languages.

Serbia

weekly salary in €	Government incentives
Not available, rising.	Corporate profit tax 10% Incentives €2,000 - €5,000 per employee manufacturing Incentives €5,000 - €10,000 per employee marketable services Incentives €5,000 - €10,000 per employee R&D centres

In 2006 the Norwegian company Telenor bought Serbia's leading mobile telephone company for US$3.5 billion. However, there are seen to be major challenges in restructuring Serbia's enterprises in general and in the rate of unemployment (20.8%). Serbia's banking sector has however been privatised: over 70% is owned by foreign investors. Serbia's GDP still languishes at 60% of its 1989 level. Strengths: Serbia can offer qualified staff.

Slovakia

weekly salary in €	Government incentives
113	Tax incentives (19% flat corporation and individual tax) and real estate incentives based around three economic zones and amount of investment. Top incentives for R&D and Technology Centres

From 2000 to end 2004, FDI into Slovakia grew by 600% to US $13.6 billion. Its skilled and cheap work force, low taxes and location are seen as its main attractions. It also has a well developed highway and railroad system. Strengths: Slovakia has strengths in the manufacturing sector.

"Slovakia's strong position is chiefly due to the fact that it offers the lowest labour rate outside the Baltics, it has plans to simplify its taxation system and has an improving economic situation. Its weakness, similarly to the Baltic states, is the poor standard of infrastructure." Consumer Electronics Co.

Slovenia

weekly salary in €	Government incentives
247	Grants of up to 40% (35% Osrednjeslovenska region) of costs of infrastructure, utility connection construction or purchase of buildings, new machinery and equipment. Jobs must remain in Slovenia for 5 years.

Although its population is small (2 million), Slovenia has a history of being the most productive Yugoslavian republic, which it maintains to this day: its GDP per capita in 2005 was estimated as US$17,008. A founding member of the World Trade Organisation, Slovenian culture has preferred to maintain home ownership of its businesses where possible. Strengths: Slovenia's population has good language skills.

Turkey

weekly salary in €	Government incentives
n/a, low	Tax incentives and real estate incentives based around three economic zones and dependent on investment

FDI into Turkey has recently increased from historically low levels, due to its negotiations for accession to the EU, economic growth, and changes in its banking, retail and telecommunications sectors. Its labour rates are low and its population large with huge opportunities for sales (=70 million). There are concerns over intellectual property rights and some high taxes on e.g. cola products. The country has to invest in infrastructure for water treatment plants, wastewater treatment facilities, solid waste management and biodiversity conservation. It has a historically strong commercial culture and alliances are necessary to enter its markets. Strengths: manufacturing.

Ukraine

weekly salary in €	Government incentives
n/a, low	Tax incentives and real estate incentives based around three economic zones and amount of investment

The Ukraine has coal, and large mineral deposits, a broad industrial base, agriculture and also provides a corridor for the transportation of Russian oil and gas across its land. It has a fast growing consumer market for electronics. It has, however, issues with excessive regulation, corruption. Its energy and telecoms sectors require restructuring and privatisation. Currently its FDI is one of the lowest per capita in the region. Long-term, it offers one of the largest potential opportunities due to its resources, population size and ability to access countries further East. Strengths: IT/Technology, manufacturing.

Key points

- The fastest developing countries are those that have already joined or are soon to join the EU
- Romania, Poland, Slovakia and Turkey and Ukraine may offer some of the best long-term opportunities, depending on your business focus
- Major multinationals have tended to enter these markets through purchasing ex-state assets, acquisitions and joint ventures.

In order for companies of all sizes to take advantage of the market opportunities at the crossroads between Europe and Asia, it is advisable to:

- begin by setting up a legal entity in the country
- recruit local managers who know the country's idiosyncrasies and then train them in your values, ethos and customer service
- outsource distribution and manufacturing to local companies
- invest in the country's development
- be aware of the differing 'lifestyle' preferences in each country
- get as close as possible to the customer – learn from them

- if investing in a number of countries, set up central 'hubs' in the most appropriate countries with the key skills needed in logistics, manufacturing, financing, IT, HR, purchasing.

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