

Česká Spořitelna Business Index 2012

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What is the Česká spořitelna Business Index?

Purposes and objectives of the index

The EU Office of Česká spořitelna has prepared the ČS Business Index, a tool that corresponds to the programme Guide to Doing Business (not only) in the EU. This is a simple and statistical tool, with the help of which it is possible to compare the business environments in the 27 EU states.

The Business Index also contains seven statistics, which are an important basis for entrepreneurs deciding about investments abroad. An important part of the Business Index is its dynamic dimension, thanks to the results of which it is possible to assess whether the business environment in a particular country has developed in a positive manner or whether negative aspects have prevailed. For these purposes the index has been figured retroactively to 2008.

The Česká spořitelna Business Index is not only a one-time analysis - it will be renewed each year in reaction to the changing business environment. The new version of the index is expected to be issued in the middle of the particular year.

In the introduction to the article, we familiarise readers with the ČS Business Index as it has been prepared for what it can be used for and what it contains. In the next chapter, the results will be summarised, which we will analyse in detail a chapter later. In conclusion, we would like to familiarise you with the assessment of the Czech Republic in the ČS Business Index, including what are its limits and how the country is strong.

Monitored areas

As has already been stated, the ČS Business Index consists of seven statistics. Their selection was based on a few rules: obviously the indicator had to be somewhat relevant for entrepreneurs, and this relationship had to be entirely clear and apparent. Several areas were highlighted which interest entrepreneurs, and the most representative characteristics were among them. An important role during selection of the statistics was played by their availability and relevance for all 27 EU member states, along with the option of regular updating and high credibility - all of the statistics must originate from renowned institutions, so that data cannot be questioned.

a) Expected growth of GDP

Twice per year the IMF issues the updated report world Economic Outlook (WEO). Experts from the IMF analyse the economic developments in more than 180 countries, and based on their analysis they estimate the economic development in the next 5 years. In the most recent WEO from April 2012 the IMF estimated the growth outlooks for 2012-2016. The index includes a 5-year average of estimates for future development.

The higher value of expected GDP growth is better for entrepreneurs, because it reflects optimistic expectations and economic stability.

b) Density of motorways

The density of motorways is an indicator that represents the area of infrastructure. There is no doubt that the quality and readiness of a country in terms of infrastructure is very important for entrepreneurs. Therefore, the motorway density infrastructure has been included in the ČS Business Index. We express it as the number of kilometres of motorways compared to the particular country's area in square kilometres according to Eurostat.

A higher value of the motorway density indicator is better for businesses in terms of logistics and effectiveness.

The purpose of business is to generate profit, meaning to maximise revenues and at the same time minimise costs. Investments into countries are often another option. All of the following statistics therefore deal with various costs. The lower the values of cost statistics, the better.

c) Electricity prices

The first cost indicator included in the index is the price of electricity. From available statistics provided by Eurostat, a "golden path" has been selected - the price of electricity for large consumers, who annually consume more than 2,000 MWh, but less than 20,000 MWh. Prices without VAT were selected, because electricity is an item that can be written off from taxes.

d) Interest rates from loans

Each business needs quality financing for its activities. It needs short-term financing for management of cash-flow and long-term for realisation of investment objectives. Only a slight proportion of businesses are capable (or willing) to cover all of their needs from their own sources. Due to the focus on small and mid-sized businesses, interest rates were selected from current loans to non-financial businesses with maturity periods of from 1 to 5 years monitored by the European Central Bank.

e) Labour costs

An essential part of business activities is employment of workers. The statistics have been obtained from the regularly evaluated Labour Force Survey, regularly published on Eurostat. Labour costs indicate how expensive the labour force is. They do not look at the problem from the point of view of average wages, but the statistics also include costs for social insurance, costs for clothing and non-wage costs related to employment. Eurostat monitors the particular characteristics for companies with 10 or more employees in the business sphere.

f) Costs for company establishment

A very important aspect of business is accommodation of the legal and administrative environment towards entrepreneurs. As an indicator of accommodation towards entrepreneurs, costs for company establishment were selected, of which there is an attempt to minimise. The World Bank monitors the bureaucratic demands of doing business in more than 180 countries. The cost of establishing a company is one of the major costs.

g) Tax rate

The last area (but certainly not the least important) is the tax system. Taxes in the EU greatly vary. Entrepreneurs will most likely be interested in the tax system as a whole, but the greatest emphasis will be placed on the corporate tax rate. The problem of the differing tax systems can be identified as their mutual non-comparability, because the minimum tax rates are counted from various bases. This problem can be solved with the help of an effective tax rate, which transfers all tax rates to a joint basis. An effective tax rate has been adopted by the European Commission.

Methodology in the nutshell

The statistics were transferred to non-dimensional numbers from 0 to 100. The worst results were 0, but countries that fared the best in the particular areas were rewarded with 100 points. In order to avoid extremes, the values were limited to the distance of two deviations from the arithmetic average. The resulting index is a direct unbalanced average of points for all seven monitored areas.

An important finding is that specific results are related to other countries. This is illustrated well in growth outlooks. While in 2008 average growth of more than 4% of GDP was expected in the Czech Republic, 4 years later only 2.5% was expected. However, in the sub-index of growth potential the Czech Republic reached approximately 68 points. The reason is that together with the Czech outlook, the outlook for the rest of the EU also worsened, and compared to other countries the Czech position practically remained unchanged.

ČS Business Index 2012 – Overall results

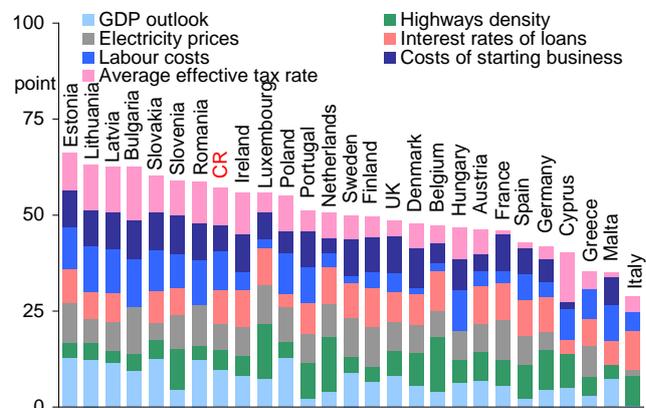
Winners from the northeast

The results of the analysis confirm what can be monitored in the trends on the capital markets. The Baltic states fared the best in the index. All three reached medal positions in the Business Index 2012. Led by Estonia, they gained points mainly due to low taxes and low labour costs. Taxes in Estonia are comparable to those in the Czech Republic - business operators are required to pay just under 17% of their overall profits in corporate taxes. In Latvia and Lithuania they pay more than 4% less. The costs of labour in these countries range around 1,000 euros per month, while the average in the EU is approximately 2.5 times higher. An important role is also played by the very good expected growth of GDP compared to European competition. While the eruption of the crisis had almost devastating effects on Estonia, Latvia and Lithuania (in 2009 these economies fell by two digits), they have managed to make use of opportunities, and today (together with Poland, Slovakia and Romania) they can again be described as Baltic tigers with expected growth of more than 3% annually.

However, this does not mean that the victors should fall asleep at the helm. In order to ensure their victory, they need to catch up with the rest of Europe, for example in infrastructure - in proportion to their size there are very few highways in the Baltic states, for example in Latvia there are not any according to statistics from Eurostat. A certain role is also played in these states by financial services. Interest rates are slightly higher there than in Western Europe.

The position of the Baltic states is comparable to that of other countries in Eastern Europe, lead by Bulgaria and followed by Slovakia and Slovenia. The reasons for their success are similar - very low labour costs and solid growth outlooks (with the exception of Slovenia, which makes up for its handicap thanks to its developed network of motorways and low business establishment costs) along with low taxes.

ČS Business Index 2012



Source: EU Office calculations

Defeat from the South

The current trend is also visible at the opposite end of the ranking. Recently there has been a lot of talk about the bad state of the southern European economies. The most talk has been about debt, but the ČS Business Index indicates that everything cannot be blamed on debt. Following the entire monitored period from 2008 to today, Italy remains in last place. It needs to be pointed out that its position compared to other European countries is not improving. Its decline increased even more in 2012. Countries that wound up in other places at the end of the ranking were Malta, Greece, Cyprus and somewhat surprisingly also Germany.

Italy and Greece can be described jointly, because their advantages and disadvantages are very similar. The common denominator of both staples of European civilisation are bad growth outlooks. According to the IMF the Italian economy is expected to grow in the next five years by about 0.1% annually, and in practice this means that for 5 years Italy will basically remain in the same place. In the case of Greece, the IMF is not much more optimistic; it expects average growth of 0.8%. Another problem facing both economies is the cost of establishing a company. While the cost of establishing a company in Europe as a whole is around 1,000 euros, in Greece it is more than 3,600 euros and is even 4,500 euros in Italy. Another disadvantage of these economies is their relatively high tax burden.

Malta and Cyprus have a common problem, which is very expensive electricity. Malta lacks a motorway network and has an effective corporate tax rate of more than 32.2%, which does not attract many investors. However, Cyprus is a tax paradise, and with its average effective tax rate of 10.6% it ranks in second place in Europe behind Bulgaria. However, it has relatively expensive interest and high costs for setting up a company.

Something interesting in itself is the very bad position of Germany. This is because Germany is often described as a strong and healthy economy that does not have to worry about its future as much as other states. There is certainly a lot of truth to this, but this does not mean that Germany can necessarily attract investors from other EU states. Although Germany increasingly presents itself as a highly developed market for product sales, production has gradually been shifted to cheaper destinations. Labour is very expensive in Germany compared to in the rest of Europe, at 4,000 euros per month, which is 1.5 times the European average. The situation is similar in the rest of Europe, but Germany does not have low taxes (just under 30%) and although growth is expected to be relatively stable, it is not expected to be fast. According to the IMF, in the next five years growth is expected to exceed slightly only 1% annually.

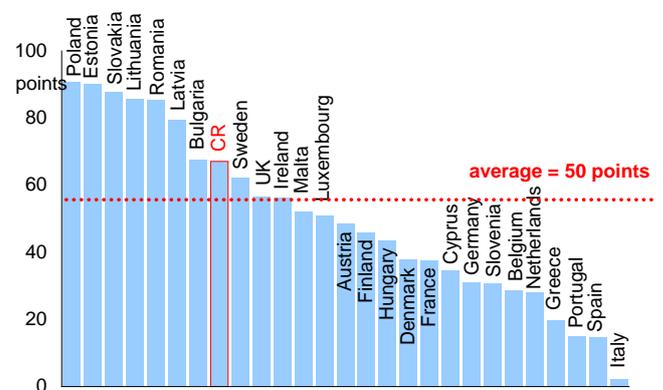
ČS Business index 2012 – Partial results

Expected growth of GDP

According to the IMF, the expected growth of GDP in recent years has significantly worsened. Whereas in 2008 outlooks in most states were relatively optimistic, in 2012 growth estimates are much more pessimistic. Poland has fared best and has profited from a large and strong internal market. Between 2012 and 2016, annual growth exceeding 3.4% annually is expected.

Certain geographical tendencies can also be derived from the expected growth. The best outlooks are expected for Eastern European countries, except Hungary. It is no surprise that the most pessimistic fate is predicted by the IMF for states in the south of Europe.

GDP growth outlook 2012



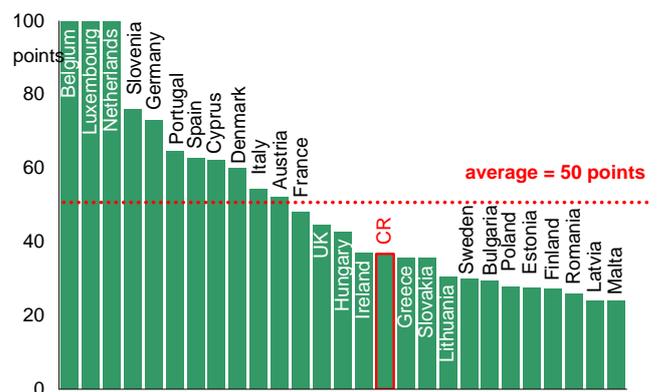
Ø GDP outlook for next 5 years in %; IMF
Source: EU Office calculations

Density of motorways

One of the main indicators in which Western Europe leads is motorway density. Specific results show that motorway density is the highest in the highly developed Benelux region, the success of which is due to a great extent to the region's advantageous position between Germany and France and between the UK and the Atlantic Ocean. According to Eurostat, there are no highways in Latvia or Malta. In Romania there are only just over 300 km of highways. Contrastingly, the UK has more than 10 times as many highways.

Since the construction of highways is a relatively demanding investment, there have not been very dramatic changes over time. The most progress has been registered in recent years by Ireland, which since 2007 thanks to massive investments into its infrastructure has nearly doubled the length of motorways on its territory and moved from 20th place in 2008 to 15th place this year.

Highways density 2012



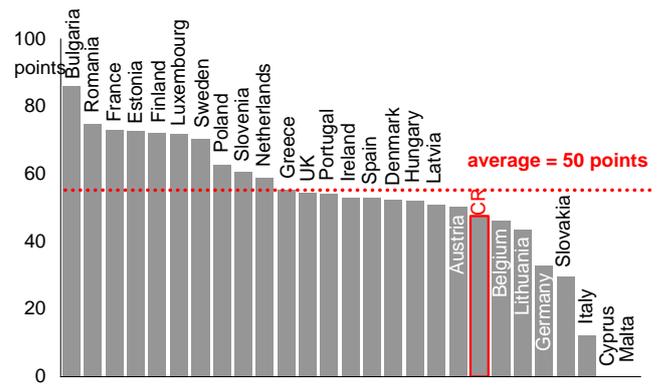
Length of motorways in km to total area in km²; Eurostat
Source: EU Office Calculations

Electricity prices

The first of the monitored cost indicators again relatively gives advantages to eastern states over western states, but this tendency is not as strong as it may seem. The cheapest energy prices are in the newest members of the EU, Bulgaria and Romania. However, rich France is in third place. The most expensive electricity is in Cyprus and Malta, island nations that do not have as much of an opportunity to participate in the internal European market.

The trend has been for electricity prices to grow, and electricity prices have grown in 21 U states and dropped slightly only in 6 states. Within the monitored period, they have grown the most in Malta and Cyprus, where they are grown by more than 70% and 35% respectively. Significant growth has also been registered in the Baltic states and in France and Germany. However, electricity prices have fallen in Ireland, Romania and the UK.

Electricity price 2012



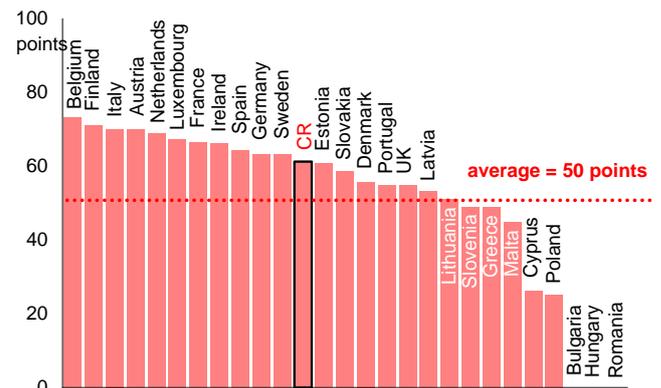
Ø wholesales prices in €/kWh excluding VAT; Eurostat
Source: EU Office Calculations

Interest rates from loans

Indicators in relation to which developed western countries have scored points include interest rates on loans. In Western Europe there is a more stable low-inflation macroeconomic environment, which is also maintaining a general ceiling of interest in the economy at the lowest levels. An absolute winner is Belgium, where approximately 3% annually is paid for arranged business loans. Loans in Finland, which ranked in second place, are only 0.2 percentage points more expensive. The most expensive loans are in Eastern Europe, and in Bulgaria, Hungary and Romania their annual interest rate is around 10%.

Since 2007 the prices of loans have relatively declined. The eruption of the world financial crisis brought two reasons for reducing rates. These were a combination of weakening inflation pressures and the expansive monetary policies of European central banks. Interest rates declined the most in Latvia, Ireland and the UK. The prices of loans slightly increased or stagnated only in three EU states - Poland, Cyprus and Bulgaria.

Average interest of loans 2012



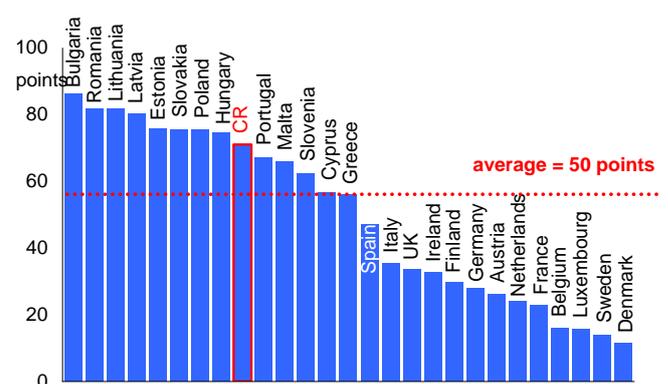
Ø interest rates of 1-5 years loans in % to non-financial corporations; ECB; Source: EU Office Calculations

Labour costs

Labour costs are an indicator that greatly favours new member states over traditional ones. While in Bulgaria, Romania, Lithuania and Latvia entrepreneurs pay less than 1,000 euros per month for employing workers, in rich Western European countries these costs are much higher. In the most expensive European countries, Denmark, Sweden, Luxembourg and Belgium, costs for employing workers even exceed 5,000 euros.

Labour costs over time will grow in all EU states. Between 2007 and 2011 they have grown the most among the newest EU members, Romania and Bulgaria,

Average Labour Cost 2012



Ø monthly labour costs in € in business sector; Eurostat
Source: EU Office calculations

where labour costs have grown by 52% and 64% respectively. Even despite the relatively dramatic growth, both countries have kept pace and remained in the first two positions from the point of view of labour costs. Labour costs have stagnated in Greece and Ireland.

Costs for company establishment

The first half of the ranking of costs for establishing a company does not differ much. In Denmark and Slovenia, setting up a standard limited liability company does not cost anything.

In countries that ended up behind the country in 14th place, Portugal, costs are beginning to sky-rocket, and in the "most expensive" countries, Greece and Italy, they are already huge and exceed 3,500 and 4,500 € respectively.

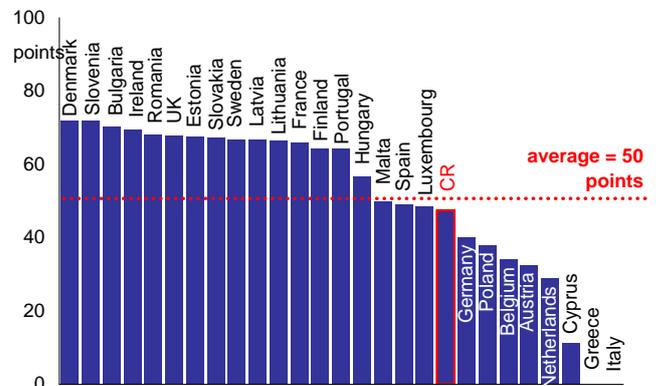
It seems overall that governments are preparing reforms that cater to businesses, and costs for establishing a company are declining. For example, in Slovenia these costs have fallen to zero, and they have been zero in Denmark since the beginning of the period. They have been significantly reduced in Spain, Hungary and Luxembourg as well. Wherever the costs have risen, they have done so only cosmetically, such as in Sweden, Belgium and Cyprus.

Effective tax rate

Corporate tax rates in Europe also differ greatly. They are the lowest in Bulgaria and Cyprus, where earnings are taxed at 8.9% and 10.6% respectively. The situation is also beneficial in Latvia, Lithuania and Ireland. However, there are relatively high corporate tax rates in France, Malta and Spain, where they exceed 30%.

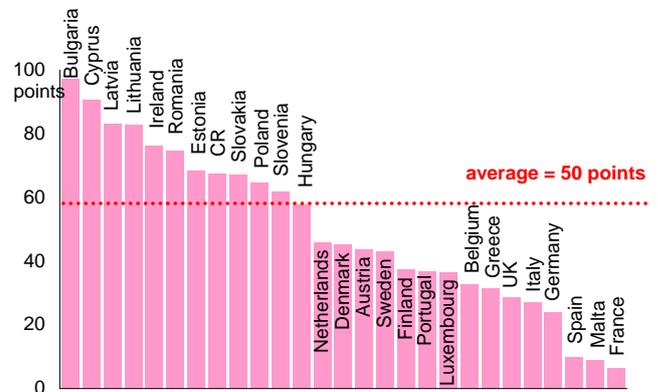
From a time point of view, it is interesting that the average effective tax rate for non-financial companies has been decreasing over time. For example, it has fallen in Germany, where in 2007 it exceeded 35% and has been reduced to 28%. It has also fallen in the Czech Republic from 21% in 2007 to 16.7% last year. The effective corporate tax rate has increased in only one EU state, Greece.

Cost of starting business 2012



Ø costs of starting business in €; World bank
Source: EU Office calculations

Average effective tax rate 2012



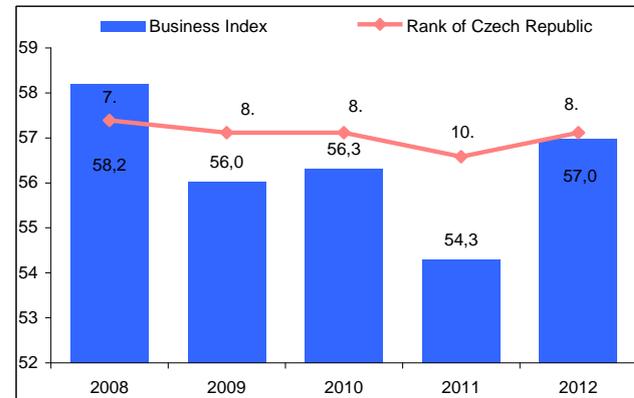
Ø corporate effective tax rate in business economy in %;
Source: European Commission; EU Office calculation

Business environment in Czech Republic

Since 2008 the Czech Republic has remained stably in the first half of the ranking and hovers around 8th place. The reason for the stable and good results is the relatively optimistic outlook regarding growth. It needs to be pointed out that this does not involve actual growth, but the average expected growth in the next 5 years. Compared to the rest of Europe, corporate taxes are also relatively low in the Czech Republic.

However, certain areas have distanced us from the best results. For example, the price of electricity is following conversion to euros above average in the European context. There is certainly room for improvement also at the level of the institutional environment, represented in the ČS Business Index by costs for setting up a company. The index also indicates that additional construction of motorway infrastructure is a positive measure also for the support of the business environment, because compared to the rest of Europe we have a lot to catch up with. This will be beneficial also due to the relatively balanced distribution of inhabitants in the CR and the country's high population density.

ČS Business Index in Czech Republic



Zdroj: EU Office České spořitelny

Subindex	Points	Rank	Basis statistics
ČS Business Index 2012	57.0	8.	--
1. Expected growth of GDP	67.1	8.	average growth pace 2.54% p.a.
2. Density of motorways	36.7	16.	0,93 km of motorways/100 km2
3. Electricity prices	47.5	20.	0.0982 EUR/kWh for large customers
4. Interest rates from loans	61.3	12.	4.03% p. a. for mid-sized loans
5. Labour costs	71.1	9.	1,508 euros per month per employee
6. Costs for company establishment	47.5	19.	1,119 euros for a standard limited liability company
7. Effective tax rate	67.6	8.	16.7% of profit

It could surprise someone that we regularly rank in eighth place, even though the average placement in individual sub-indexes is much worse. The first place holder Estonia is not first in all indicators. For victory it is enough that in most indicators it reaches above-average results. Similarly, in sub-indexes the Czech Republic usually ranks in eighth place, but only seven countries have an average number of points higher than the Czech Republic.

Compared to 2007 outlooks for GDP growth have declined. Whereas 5 years ago the IMF predicted more than 4% annual growth of production, this year it expects only 2.5% growth. Even despite this relatively significant decline, the point evaluation of the Czech Republic is practically unchanged. The reason is simple - just as the Czech Republic's growth outlook has worsened, so has that of the EU as a whole.

With indicators of motorway density during the monitored years, the Czech Republic remained in 16th place, with only one exception. According to Eurostat, 77 km of new roadways have been opened in the Czech Republic since 2007, meaning the Czech Republic has maintained a trend spanning across the EU.

The price of electricity is vulnerability for the Czech Republic. Since 2007 it has grown by 26%. That would not be anything unusual if energy prices were also growing similarly in other countries. Although energy prices have also grown in other countries, in the Czech Republic the pace of their growth has been faster. As a result, the Czech Republic has moved from 12th place in the sub-index for 2008 to 20th place this year.

The interest level in the Czech Republic has a slight declining trend. With the exception of the crisis year 2008, it has fallen each year. However, this trend has been faster in other EU states. In 2007 the Czech Republic had the third cheapest loans in Europe. Nonetheless, in subsequent years it lost its comparative advantage, and last year it ranked in 12th place. For next year it will certainly be interesting to watch what will happen to interest rates, now that the Czech National Bank has reduced its rates to a historic minimum, practically to zero, and how this will effect the Czech Republic's position in the index.

Labour costs are relatively low in the Czech Republic, even though even here they are slowly rising. In an international comparison, however, this slight growth has practically no effect, and the Czech Republic for the duration of the monitored period remains in 9th place out of the 27 EU member states.

The costs for establishing a company show one interesting characteristic of the ČS Business Index, which it is useful to take into consideration. The gradually declining ranking is not necessarily caused by the fact that "we are ruining something" - someone raises prices or makes a bad decision. It can also be caused by a passive approach - while everyone else is acting, we are staying in place. This is the case with costs for establishing a company. While in much of Europe an attempt has been made to knock down such costs, they have remained almost the same in the Czech Republic for several years already. As a result the Czech Republic has fallen since 2008 from 14th place to 19th place.

The last evaluated indicator is an effective tax rate. In recent years it has been reduced relatively drastically. The public finance reform introduced in 2008 has gradually reduced the effective corporate tax rate from the original 21% to 16.7%. Nonetheless, this trend is not likely to continue in the near future. Within the business environment, the Czech Republic has benefited from this change. It has gone from 12th place in the particular sub-index to its current position of 8th place.

Summary in conclusion

The Business Index is a useful tool intended for comparing the business environments in EU member states. It enables business operators who are considering expanding production or sale to other EU states to identify their needs quickly and find suitable candidates for investment. However, the final selection of the country for investment will depend on the specific details related to the business activities, and this index is not a suitable tool for a final decision. However, nonetheless it provides very useful information, an effective comparison of the quality of the business environment, both between individual countries and in relation to changes in time.

The results of the Business Index 2012 confirm the real capital flows. Production is clearly being moved from expensive western markets to more perspective eastern markets. Even sale is often moved to eastern countries - on the saturated markets in the west there is very high competition, and on the markets of the former Soviet block it tends to be much easier to get established, even at the expense of lower sales prices.

The Business Index can serve not only business owners. The bad positions of Greece, Italy and Spain confirm that the ongoing crisis is not only a debt crisis, but that the unfavourable business environments in those countries have hindered their economic growth. The combination of a bad business environment and an irresponsible approach to debt can seem like a very dangerous combination, which can cause much unpleasantness for a long time far in advance.