



Spotlight on the Czech Republic

Preface: why location really matters

Europe is a diverse market: culturally, linguistically, and economically. Many U.S. companies expanding to Europe make the mistake of applying the 'Lemming principle' - expanding without much thought to nations where they see other U.S. businesses such as the United Kingdom, Germany, the Netherlands, or France. While this might make sense for ventures that want to specifically access those national markets or have excellent logistical/manufacturing partners in the region, for many companies it is simply a failure to dig deep and see whether better options are out there. This business planning failure can doom an expansion at its inception.

At Samson Atlantic, we work with companies to find the best locations throughout Europe - market research that is tailored to the needs of your company, your clients, and your employees. There are a host of factors that we apply to ensure that you identify the best matches for your business (the **Samson Factors™**). In this *Spotlight*, we will delve into the Czech Republic, a dynamic nation in the very heart of Europe.

The Czech Republic: the European market at your doorstep, at one-third the price of Germany

The Czech Republic promotes itself as 'the Heart of Europe', and a quick look at the map of the European Union member states supports this claim. Wedged between Austria, Germany, Poland and Slovakia, the country represents a major transportation crossroads for goods traveling both east to west and north to south within the EU common market. The country's proud manufacturing



tradition and technical expertise survived the 50-year darkness of totalitarianism, and since the 'Velvet Revolution' in 1989 the country has done much to reclaim the technical leadership it held in industries such as automotive manufacturing and nanotechnology. It is closely lashed to the German economy, but labor costs are one-third of those found in Germany, which offers substantial savings in production costs with only a single day of transportation time to reach all of Germany and much of France, Switzerland, northern Italy and of course the other Central European countries.

The Czech Republic joined NATO in 1999 and the EU in 2004. The IMF and OECD expect continued modest annual growth in the Czech Republic of slightly over 2% for the next six years, but note some problems in the flattening of consumer spending, the comparatively low level of participation in the economy by Czech women, and some infrastructure limitations; all of which act as minor brakes to growth. Inflation is stable between 1 and 2%.

Market strengths: location, corporate tax rate, and skilled labor

The Czech Republic offers an excellent location for sales into Germany, Europe's largest national economy and the fourth national economy globally. In addition to the dramatic labor costs savings discussed previously, locating in the Czech Republic offers companies a 10% savings in the corporate tax rate as compared to Germany. Combined with a competitive real estate market for commercial and manufacturing space (dramatically cheaper in some areas compared to the German or Austrian averages) as well as private housing costs (Prague being a notable exception), establishing a new company location in the Czech Republic is significantly less expensive than it would be across the border. The Czech Republic scores below Germany in the Doing Business rankings¹ but ahead of a number of other EU nations (not to mention Mexico and China).

¹ <http://www.doingbusiness.org/rankings> Germany is at 15, the Czech Republic at 36.



Supporting these positive aspects is an excellent labor pool in the technical, IT and services industries. The Czech Republic has the highest percentage of upper secondary education in the OECD, a remarkable fact which underscores the focus on education in Czech culture and ensures an excellent breadth of skilled labor for new companies coming into the country. Combined with a current unemployment rate of just over 6%, the market for employees is competitive but not as tight as Germany (currently sitting at around 4%) where the government had had to start a program to attract skilled labor such as engineers and medical personnel into the country.

Challenges: corruption, the Czech Crown, and the government

The positive aspects of the Czech economy are extremely attractive, but there are some concerns worth noting. Most obvious is the dependence on the German market - when Germany sneezes, the Czech Republic (and most of Central Europe) catches a cold. This dependence on the German market is inevitable, however, and there is no greater risk in establishing a manufacturing or R&D facility in the Czech Republic than there would be in Germany in that regard. However, the other three factors we discuss below are Czech-specific.

Corruption continues to be a notable problem in the Czech Republic. Transparency International ranks the country at 37 in their latest annual survey, which is a significant improvement from 4 years ago (when they ranked 57 out of 182) but still lower than neighboring Poland and significantly lower than Germany or Austria. The corruption will most likely impact businesses that compete for public sector contracts; the most problematic area for the Czech Republic.

For other businesses, the biggest issue is likely to be the Czech currency. Operating in the Czech Republic is not a problem per se, in that contracts with suppliers and customers can easily be done on the basis of Euros, but there is a transaction cost in working with the Czech Crown and a greater concern that the



monetary policy can change without warning. The Czech crown is currently in a 'dirty float' and the Central Bank maintains a floor of 27 Czech Crowns to the Euro to keep exports competitive. The Central Bank intervened in the currency market without warning in 2013, devaluing the Crown to the detriment of many businesses that had not hedged their currency concerns. This continues to be an area of concern for businesses and would require smart financial planning from U.S. companies to prevent loss from unexpected currency fluctuation.

The final issue is the instability of the government(s) in the Czech Republic in the last decade, an issue tied in part to the corruption concerns discussed above. In the last 10 years, there have been six Prime Ministers as governments have come and gone. By way of comparison, Angela Merkel has been Chancellor of Germany during that same 10-year period. How this governmental instability impacts the economy is hard to pinpoint, but it does give rise to concerns that important policies or regulations that impact industries may change on short notice. Some wry observers have noted that this government instability is beneficial to the Czech business environment, as it keeps government 'meddling' to a minimum, but for equity investments that want assurance that promises from local, regional, or national governments on incentives can be relied upon, it requires some additional foresight and hedging.

Summary: Is the Czech Republic perfect for you?

If this discussion of the Czech market and the great opportunities it offers interests you, please reach out to us at Samson Atlantic for comparative market research information. The Czech Republic might not be exactly what you are looking for, but the wide variety of options available in the broader European market means that your perfect new business location is sure to be found somewhere in Europe. We look forward to helping you find it!