



Doing Business in Central and Eastern Europe

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This report provides an overview of the key issues facing businesses wishing to conduct business in Central and Eastern Europe, together with an analysis of selected countries in the region, based on the views of Nexia International member firms.

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With more than 500 offices in over 100 countries, we have a substantial presence in the world's major financial and economic centres. We are strategically placed to serve the diverse international requirements of our clients, ranging from globally listed entities and international subsidiaries, to owner-managed businesses and high-net-worth individuals.

Experts from around the Nexia International network work together to provide cohesive, customised services to solve cross-border business issues and advise individuals on wealth creation and preservation.

Providing a consistent quality of service, regardless of location, is fundamental to our work with anyone engaging professional advice across international borders. Through our tight knit global community, you can expect shared values, close and enduring relationships between member firms and the highest standard of professional advice – anywhere in the world.

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# Doing Business in Central and Eastern Europe

## The business landscape

Since the major political upheaval in Central and Eastern Europe in the late 1980s, the region has witnessed a surge in foreign investment, attracted by a skilled and relatively low-cost workforce, some of Europe's most favourable taxes and a gradually improving infrastructure.

The region's strategic location and a combined internal market of over 100 million people in increasingly open economies have presented opportunities in many sectors.

Membership of the European Union (EU) for the majority of the region (although not for Russia and Ukraine) has helped to provide stable business conditions, higher regulatory standards, an increasingly sound banking system and a relatively safe investment environment, as well as the benefit of EU funding for infrastructure improvements.

There are generally few restrictions on setting up businesses or trading with other countries. Instead, foreign investors tend to enjoy the same rights and guarantees as local businesses and foreign capital is allowed to access most fields of the economy, although some countries do have restrictions in banking and strategic sectors.

Foreign investment helped modernise industries, create jobs and boost exports, with growing consumption and private investment helping to drive economic growth. That is, until the global financial crisis.

## Impact of the financial crisis

Most of Central and Eastern Europe was hit hard by the 2009 global financial crisis and recovery has been slow.

Nenad Pacek, a leading authority on emerging markets and a guest at a recent Nexia International European conference, says that 1999 to mid-2008 was a great time for business and the region grew faster than any other: "Anyone in a multinational company responsible for running an East European division was a corporate star at HQ meetings. But now, these CEOs are 'chief explaining officers' because they spend all their time explaining what has gone wrong," he says.

2009 left the region highly indebted, particularly with foreign debt, which has affected companies, households and some governments. Lending collapsed as foreign-owned banks invested elsewhere, and rising unemployment hit consumer spending. This was exacerbated by an initial lack of state intervention. By the time most governments woke up to the issues, it was too late.

Some markets stabilised in 2010. Russia and, to some extent, Ukraine showed growth while the rest of the region continued to struggle. Measured by gross domestic product (GDP), the Czech Republic is currently at around 80% of the EU average followed by Slovakia (74%), Hungary (64%), Poland (62%) and Romania (45%).

The rest of 2011 is expected to be difficult too, with Central and Eastern Europe showing the slowest growth among world emerging markets. According to Nenad Pacek, the region will grow around 3.7% – not the swift recovery hoped for. Growth is unlikely to be more than 3% once commodities-driven markets like Russia are excluded, which Pacek describes as “disappointing” compared to Asia (7.5%), Latin America (4.5%) and sub-Saharan Africa (6%).

## Divided

The countries of Central and Eastern Europe have emerged from the crisis divided. The Visegrad states of Poland, the Czech Republic and Slovakia have fared better, with sound public finances and strong banking sectors. Poland, almost alone, escaped recession, though government spending had a lot to do with this. Austerity measures in both the Czech Republic and Slovakia will inevitably impact on growth. The fourth Visegrad state – Hungary – has a solid export sector and has tapped into the German market, but it has huge public debts. Against International Monetary Fund (IMF) advice, it has chosen growth over austerity, which Nenad Pacek refers to as a “gamble”. He says, “it’ll succeed but simply take time”.

While business isn't booming in Russia, according to Pacek, it is “showing signs of life in a number of areas”. It has no public debt, no foreign debt, the third-largest level of foreign exchange reserves, and is a top priority for growth for many multinationals in the region. Government plans to introduce ten investment ‘precepts’ intended to improve the investment climate, largely by attracting Russian and foreign investors back to the country, should only serve to advance the country’s upward trajectory. The only risk is a big fall in oil prices.

By contrast, Ukraine’s recovery is hamstrung by debt and growth in Romania is likely to be slow.

## Access to finance

Prior to the financial crisis, business finance was readily available due to a large foreign presence and significant competition in the banking sector. Since the crisis, banks have increased their capital adequacy ratios and are reducing loan-to-debt ratios.

For example, in Hungary many banks are now limiting foreign currency denominated lending, forint loans to businesses are also harder to obtain, as banks limit lending to the less risky consumer loan sector. On the whole, foreign investors continue to have equal access to credit on the local market, with the exception of special governmental credit concessions such as small business loans. Markets for direct finance are thin.

The economic crisis also resulted in a rapid decrease of market capitalisation on stock exchanges around the region, with a few notable exceptions. Warsaw now rivals Moscow as the place to go public for mid-market initial public offerings (IPOs). Poland’s well-developed infrastructure of banks and independent brokers, together with privatisation of state companies, has established active private investment in the country. Prague and Bratislava are also developing as commercial capitals in their own right. Outside of these centres, the performance of domestic capital markets remains patchy.

## Policy response

The debate in Central and Eastern Europe (and elsewhere) has been whether to try to stimulate growth to beat debt problems or introduce austerity programmes. The “double-whammy inflation/growth” trade-off has caused significant headaches to policy-makers.

Hungary’s decision to opt for the growth route, believing that austerity will only make the slowdown worse, is in contrast to countries like Ukraine, which have been quick to cut the budget deficit and approve a very conservative budget for 2011.

According to the World Bank, the global crisis has led to some important legal and institutional reforms in many countries in the region. Facing rising numbers of insolvencies, many have reformed their insolvency regimes in an attempt to ensure that assets can be reallocated and viable firms can continue operating. Other reforms have been aimed at making it easier for firms to start up and to pay taxes.

In Hungary the government is pursuing a policy of significant economic reform, including reductions in personal income and corporate tax rates in order to increase Hungary’s regional competitiveness for investment and eliminating the need for “crisis taxes”, designed to shore up the government budget until more long-term, structural changes are made. The “tax exemption for reinvested profit” recently introduced in Romania is another example of tax reform measures.

Russia’s measures to facilitate regional private investment projects, privatise state-owned banks and infrastructure companies and establish a private equity fund to act as a co-investor to direct foreign investment in industrial projects are intended to improve investment in the country. It also aims to increase the quality of services for the investment community, such as customs, registration, and working visas.

## Issues to consider

In the light of these changes, below is a brief checklist for anyone doing business in the region:

- Ease and speed of establishing a legal entity.
- Access to credit, which is generally available to foreign investors with the exception of special governmental concessions, such as small business loans.
- Availability of tax incentives, such as full or partial corporate tax relief for either newly established or expanding companies, capital gains tax (CGT) exemptions, tax allowances for small and medium-sized enterprises (SMEs), development allowances, and tax reliefs for research and development (R&D).
- Application of withholding tax on employment income, dividends, interest payments, royalties, rent or even the sale of property.
- Availability of incentive packages for investments over a certain value or in particular sectors, such as cash subsidies and training and job creation subsidies in regions affected by unemployment.
- Availability of incentive packages for setting up a business in enterprise zones, industrial or business parks.
- Performance requirements, such as job creation or investment minimums that may be imposed as a condition for establishing, maintaining or expanding an investment.
- Requirements to purchase from local sources and the application of EU Rule of Origin.

- Restrictions on participation in government-financed or subsidised R&D programmes.
- Access to business expertise and support, quality of infrastructure and services to help overseas businesses become established.
- Options available to enforce outstanding debts.
- Ease and speed of winding up a legal entity, including ability for foreign investors to remit profits and investment capital to their home country.

## Obstacles remain

Despite reforms, many obstacles to overseas investment remain. One is the need for further investment in infrastructure just when many governments in the region are cutting back their spending and overseas borrowing is less viable.

Governments will increasingly rely on domestic savings and home-grown capital markets at a time when the region's citizens are likely to be a lot more cautious with their money – they will need to find better ways of funnelling these savings into local businesses.

Bureaucracy can still be an issue – a relatively high administrative burden for companies, fast-changing legislation, complex and inconsistent tax regulations, outdated attitudes, lack of transparency and even the remnants of corruption in public sector institutions remain a feature of some countries. This is slowly being addressed: for instance, Ukraine has recently overhauled its anti-corruption laws in an effort to crackdown on corruption within the country.

## Euro woes

The crisis in the Eurozone, the region's biggest export market, will inevitably affect exports and growth. Given the euro's recent difficulties, with most countries currently still outside the single currency – Slovakia being an exception – many of the region's leaders are reappraising earlier promises to join the euro.

Devaluation helped some countries – notably the Czech Republic and Poland – to remain competitive during the downturn, thanks in part to the sharp drop in their currencies. This would clearly not have been an option inside the euro. Others, although technically outside the single currency, have pegged their currencies to the euro.

Central and Eastern Europe is also among the most vulnerable regions to a protracted oil price rise, according to recent research from Nomura, with Slovakia topping the list of at-risk countries, and Hungary, Poland and the Czech Republic all featuring prominently.

## Tax issues

The main technique for investment continues to be through:

- branches or representative offices
- separate legal entities (in various forms)
- joint venture arrangements.

With the exception of representative offices, all other forms constitute a taxable presence in the country and need to comply with various registration formalities with the local Chamber of Commerce. This generally entails:

- accreditation and incorporation with the state register of foreign businesses
- registration with the tax authorities (for direct tax VAT, payroll taxes, etc).

The registration process generally takes at least six weeks, with the need to have the statutory documents of the home country appropriately 'apostilled'.

A sample of the tax facts for the principal countries in the region is set out in Table 1. Generally, corporation tax rates in the region are relatively low, but it is usually necessary to structure a business through a suitable intermediate holding company to minimise the impact of withholding taxes on any future extraction of profits by dividends, royalties or interest payments. (Hungary is the exception, with no withholding tax payable on payments to parent companies.) Austria, Cyprus and Luxembourg are commonly used as locations for intermediate holding companies.

It is important to consider the domestic rules for any payments to the parent company or associates, as the deductibility for such payments requires formal legal contracts, which are likely to be scrutinised by the tax authorities to ensure that only costs that have benefited the local business are deductible.

Equally, financing of the overseas operation will require some consideration, particularly due to the thin capitalisation and other restrictions imposed by many territories. To the extent that local borrowing has been secured, anti-avoidance rules apply if parental guarantees have been provided to secure the financing.

Transfer pricing is an increasingly complex area that is foremost in any review by the tax authorities. Accordingly, the methodology to determine arm's length prices for transactions between related parties should be produced to comply with the local rules. The main areas subject to transfer pricing audits are payment for intellectual property, intra-group loans, management and support services.

**Table I: Summary of key tax facts\***

	<b>Czech Republic</b>	<b>Hungary</b>	<b>Poland</b>	<b>Romania</b>	<b>Russia</b>	<b>Slovakia</b>	<b>Ukraine</b>
Corporate tax rate	19%	19%	19%	16%	20%	19%	25%
Withholding taxes (subject to double taxation treaties)							
- dividends	15%	0%	19%	16%	15%	0%	15%
- royalties	15%	0%	20%	16%	20%	19%	15%
- interest	15%	0%	20%	16%	20%	19%	15%
VAT	20%	25%	23%	19%	18%	20%	20%
Anti-avoidance provisions							
Transfer pricing	✓	✓	✓	✓	✓	✓	✓
Thin capitalisation	✓	✓	✓	✓	✓	N/A	N/A

\*All tax rates are standard tax rates before tax treaties or the EU Parent Subsidiary Directive have been applied.

## What next?

After a difficult two years, Central and Eastern Europe is gradually getting back on its feet and looking to the future. It is clear the region has much to offer foreign investors. As Nenad Pacek points out, the emerging markets already account for 50% of all exports and hold nearly 80% of reserves. Add to this a growing population and "the emerging markets will outperform the developed world by a factor of three or four to one". On this basis, the potential for doing business in Central and Eastern Europe should not be underestimated.

## Advice from local experts

The following advice echoes the views of many of Nexia International's Central and Eastern European experts.

- **Find a local partner**

To help understand and operate within the legal, tax and regulatory system, find a local partner with local expertise (or hire someone with the right know-how) who can deal with the bureaucratic complexities. If you try to tackle these issues yourself, you will have no time for anything else.

- **Do your research first**

This will give you the best chance of developing a proper strategy for jumping the administrative hurdles. Get a local adviser with experience in the specific areas of interest to you. Working with local professionals is usually a good way to increase your chances of success.

- **Strike a balance**

Often the local authorities will insist that you follow their own processes and interpretation of the law. Finding a balance between these demands and the implementation of international best practice when dealing with compliance issues is likely to influence the success of your business in the region.

- **Check the paperwork**

If acquiring a local company, make sure the purchasing contract contains the usual set of representations and warranties, as well as a mechanism to enforce them. Engage a good lawyer to check the contract and ensure that it covers any unexpected eventualities.

- **Be vigilant**

Perform controls on all aspects of the company, regardless of how long you have been dealing with your local partner. Monitor progress closely and insist on regular reporting of key company data. Hiring an external accountant will help.

- **Be flexible**

Very often, your business experience elsewhere will not apply in Central and Eastern Europe, so your management approach should be tailored to the local mentality, although not completely forgotten.

- **Use the language ...**

... Or find someone else who does. It's very difficult to get to grips with the red tape if you don't understand the language. Making an effort will help you to become an integral part of the community.

## Czech Republic

### Key facts



Capital:	<b>Prague</b>
Population:	<b>10.5m</b>
Official language:	<b>Czech</b>
Currency:	<b>Koruna</b>
GDP per capita:	<b>US\$25,600</b>

The Czech Republic is an EU member and Schengen<sup>1</sup> country. One of the most stable and prosperous post-Communist states, it offers a safe investment environment, a skilled workforce and favourable labour costs.

### Economy

The country's GDP has increased significantly in the last 20 years, reaching CZK 3667.4bn in 2010 compared to CZK 1466.5bn in 1995. The private sector accounts for 80% of GDP, with the country well known for its scientific, manufacturing and engineering heritage. In 2009, GDP fell by about 4% due to the recession. But the economy is improving and GDP grew by 2.5% in the first quarter of 2011 compared to the same period the previous year.

Inflation is around 1.7% compared to 2.5% before the recession, while unemployment is nearing 10%.

### Inward investment trends

The Czech government is close to completing its privatisation programme, which began in the early 1990s. Foreign investors have played a major role in the privatisation process, with all four of the country's main banks in foreign hands.

The Czech Republic has attracted significant foreign direct investment in recent years, running at twice per capita that of any other country in the region. According to statistics from CzechInvest, the Investment and Business Development Agency, nearly 30% of all new investments (at least those mediated by CzechInvest) are concerned with information technology and software development.

<sup>1</sup> Under the Schengen Agreement, it is possible to travel from one Schengen country to another without border controls.

Opportunities for overseas investors are particularly strong in the following sectors:

- Aerospace
- Automotive
- Electrical engineering and electronics
- Nanotechnologies
- Life sciences
- Cleantech
- High-tech mechanical engineering
- IT and software development
- Business support services
- Research and development (R&D)

Companies that have based their research and development operations in the Czech Republic include Honeywell, Rockwell Automotive, Bosch and ON Semiconductor. IBM has based its delivery centre for Central Europe in the Czech Republic and, along with Rolls Royce, Mott MacDonald, BAE, Crown Relocations and Logica, has its Central European headquarters located there.

## EU funding

The Czech Republic provides several programmes for both Czech and foreign investors. These programmes are focused on various areas of business and are financed using EU structural funds and by the Czech government. For example, extensive research capabilities in the form of science and technology parks and incubators are being developed with EU structural funds, while the Czech government has introduced various investment incentives for the manufacturing industry.

For the period 2007-13, EU investment in the Czech Republic will total €26.7bn, with around €5bn allocated to investment in R&D and innovation. Some €1.5bn will be invested to support entrepreneurship, especially SMEs.

Czech law protects foreign investments from expropriation. The country has also concluded various bilateral treaties to support and protect foreign investments and is a member of the Multilateral Investment Guarantee Agency, an international organisation for the protection of investments.

## Capital markets

Shortly after the recession began, the Czech capital markets saw high volumes of stocks being sold as concerned investors the world over chose to invest in other assets or to have cash at their disposal.

By 2010 the outlook was more optimistic, with PX, the main index of the Prague Stock Exchange, growing by 10%.

But despite the introduction of various Acts regulating the Czech capital markets, including the Bond Act, the Securities Act and the Stock Exchange Act, regulation of the Czech capital markets remains less strict than in the banking sector:

## Incentives for inward investment

The Czech Republic offers various investment incentives to Czech and foreign investors who are setting up or expanding existing production in the manufacturing industry. Full corporate tax relief is available for five years to newly established businesses, while partial corporate tax relief is on offer to expanding businesses for the same period.

In those regions worst affected by unemployment, job creation grants of CZK50,000 per employee are available, along with 25% of training and re-training costs.

The total amount of investment incentives (with the exception of training and re-training grants) must not exceed 40% (50% in the case of medium-sized businesses and 60% for small businesses) of the investment made in long-term tangible and intangible assets.

There is no upper limit on foreign investment.

## Obstacles to inward investment

There are no specific restrictions on foreign investors. Instead, Czech law allows overseas companies to conduct trading activities under the same conditions and to the same extent as Czech entrepreneurs.

Foreigners may become founders or co-founders of a company or join an existing Czech company. Those with business operations abroad may also run trading activities in the Czech Republic, provided that they own an enterprise or branch office in the country.

The main challenges for investors are focused around the significant administrative burden for companies, a fast-changing legislative environment and a relatively high level of corruption in the public sector:

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**VGD s.r.o**

# Hungary

## Key facts



Capital:	<b>Budapest</b>
Population:	<b>10m</b>
Official language:	<b>Hungarian</b>
Currency:	<b>Forint</b>
GDP per capita:	<b>US\$19,501</b>

Hungary continues to work its way through an era of significant economic reform. The government announced a new structural reform programme in March 2011, which promises to reduce expenditure and eliminate the need for special taxes at the "crisis-tax" level. Hungary offers the same opportunities for domestic and overseas investors, in line with EU legislation.

## Economy

Post-Communism, Hungary has moved fully from a centrally planned economy to a market-based one. According to Eurostat, the EU's statistics office, its GDP for 2010 was 64% of the EU average, lagging behind the Czech Republic (80%) and Slovakia (74%), but ahead of Poland (62%) and Romania (45%). GDP is expected to grow by 2.7% in 2011 and 2.6% in 2012.

Inflation is anticipated to be 4% in 2011 and 3.5% in 2012. Unemployment is predicted to decrease from the current figure of 11% to 9.3% in 2012.

Hungary's large external debt, reliance on external financing and high level of foreign currency borrowing by its citizens meant its vulnerable economy was hit hard by the recession.

The country was bolstered by borrowings from the IMF and other financial institutions, totalling €25.1bn. The new government has declined to negotiate a follow-on Stand-by Arrangement with the IMF, stating that it has the ability to meet its current and short-term funding needs through market financing.

These loans have helped balance a large current account and budget deficit, prop up a partially overvalued currency, support a low stock of foreign reserve and secure a high level of short-term foreign currency debt. In short the package has boosted the economy's stability and improved its long-term growth potential.

## Inward investment trends

Hungary maintains an open economy and attracting foreign investment remains a stated priority for the Hungarian government.

The Hungarian Constitution guarantees private ownership, right of enterprise, and freedom of competition. A substantial body of law protects foreign investment in Hungary, the most notable of which is the Foreign Investment Act of 1988. It grants full protection to the investments and businesses of foreign investors and guarantees that they will be treated in the same way as national investors. It also contains a repatriation guarantee under which foreign investors are free to remit profits and investment capital to their home country in the event of partial or complete termination of their business.

Foreign direct investment in Hungary has helped modernise industries, create jobs, boost exports and spur economic growth. Cumulative foreign investment stock has totalled more than €75bn since 1989, the highest in the region on a per capita basis. The largest amount of foreign investment comes from Germany (22%), followed by Austria (14%) and the Netherlands (13%).

Key sectors offering opportunities for overseas investors include:

- Automotive
- Electronics
- Biotechnology
- Renewable energy
- Business support services

The automotive sector is one of Hungary's core industries and contributes 20% of total exports. Since the 1990s, several foreign car manufacturers including Audi, General Motors and Suzuki have set up production facilities in Hungary. In 2012, Daimler will open its new factory with an investment of €800m, while Opel will finish building its new engine factory, investing €500m. Other companies that have located operations there include GE, Alcoa, Bosch, ExxonMobil, GE, IBM, Morgan Stanley, Sony and Vodafone.

## EU funding

Hungary has been allocated €25.3bn of EU investment for 2007-13. It plans to invest over €2.16bn in R&D and innovation, and is also committed to developing the country's ICT infrastructure.

Support for SMEs will amount to €829m, with €794m allocated for JEREMIE. JEREMIE is a recent initiative of the European Commission, the European Investment Fund and the European Investment Bank for improved access to finance for start-ups and SMEs. Hungary is one of the first countries to make use of this opportunity.

## Access to finance

Ahead of the recent global financial crisis and recession, funding was readily available to businesses due in large part to a strong foreign presence and significant competition in the banking sector. Since the financial crisis, banks have increased their capital adequacy ratios above the required 8% and reduced loan-to-debt ratios.

Lack of confidence in financial markets has affected Hungarian banks, many of which are now limiting foreign currency denominated lending; previously popular Swiss franc and Japanese yen loans have largely disappeared. There are reports that forint loans to businesses are also hard to obtain, as banks increase their debt-to-loan ratios, forcing them to promote deposits aggressively and limit lending to the less risky consumer loan sector. On the whole, foreign investors continue to have equal access to credit on the local market, with the exception of special governmental credit concessions such as small business loans. Markets for direct finance are thin.

## Capital markets

The Budapest Stock Exchange (BSE) was re-opened in the summer of 1990 as the first post-Communist stock exchange in Central and Eastern Europe. The BSE currently has nearly 50 members, with 40 companies floating their securities on the primary and secondary markets, and the securities of more than 80 funds available to investors.

## Incentives for inward investment

Hungary has a well-developed incentive system for overseas investors, the cornerstone of which is a special incentive package for investments over a certain value (typically €10m plus). The incentives are aimed at investors setting up facilities for manufacturing, logistics, R&D, bioenergy and tourism, as well as regional service centres. Incentive packages include cash subsidies, development tax allowances, training and job creation subsidies.

Performance requirements, such as a minimum investment or job creation, may be imposed as a condition for establishing, maintaining or expanding an investment. There is no requirement that investors purchase from local sources, but the EU Rule of Origin applies. Also, there are no restrictions on participating in government financed or subsidised R&D programmes, but the government imposes offset requirements on defence sector investments over €4m.

Recent cuts in personal and corporate income tax rates are intended to help stimulate domestic consumption and attract investment.

Other tax incentives include:

- capital gains participation exemptions
- tax allowances for SMEs
- development allowances
- tax benefits on R&D, software development and the production of motion pictures
- tax exemptions in preferred regions and/or industrial parks.

Taxpayers can reduce their pre-tax profits by 50% of the royalty income arising. Furthermore, there is no withholding tax on dividends, royalties and interest payments between corporate entities from a Hungarian source.

In order to attract real estate investors, companies with over US\$53.5m registered in Hungary are exempt from corporate income tax and local income tax.

In January 2011 the Hungarian government launched the New Szechenyi Plan, which will allow companies to apply for up to 100 state subsidies, totalling HUF1,100bn.

## Tax regime

The Hungarian government introduced crisis taxes targeting the banking, energy, telecommunications and retail sectors in June 2010. Manufacturing, a sector clearly valued by the Hungarian government, was not targeted.

The crisis taxes were unveiled as three-year, limited duration, extraordinary measures, enabling the government to shore up its budget until more long-term, structural changes were made. In March 2011, a structural reform programme was announced, which promises to reduce expenditure and eliminate the need for crisis taxes.

## Obstacles to inward investment

Commercial law in Hungary is well developed, but most analysts see a need to continue revising the corporate legal code and improve the judicial and administrative capacity for enforcing it. There continue to be complaints from foreign investors about the slow pace of the judicial system.

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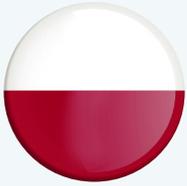
**ABT Hungaria Kft.**

**Anita Pali**

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# Poland

## Key facts



Capital:	<b>Warsaw</b>
Population:	<b>38.4m</b>
Official language:	<b>Polish</b>
Currency:	<b>Zloty</b>
GDP per capita:	<b>US\$18,800</b>

Poland is currently the second-fastest growing economy in Europe. It is both an EU member and Schengen<sup>2</sup> country, and will co-host the UEFA European Football Championships with Ukraine in 2012.

## Economy

Since 1992, Poland has experienced uninterrupted growth. Most notably, it recorded growth of 1.8% and 3.8% in 2009 and 2010, respectively, making it the best-performing economy in the EU and the most effective in managing the global financial crisis.

GDP in the first quarter of 2011 expanded by 1% over the previous quarter. It is expected to be around 4% for 2011, rising slightly to 4.2% in 2012.

Inflation has risen sharply in 2011 to 5%, up 2.4% from 2010. Unemployment is 11.8%, which is undeniably high, but down 1.4% on the worst month in 2010.

## Inward investment trends

According to the World Bank, private investment will be one of the major economic drivers for Poland in 2011. Foreign direct investment inflow was €7.5bn in 2010, down €2.4bn on the previous year:

A diversified Polish economy means no single industry dominates when it comes to foreign investments. Opportunities for overseas investors exist in a range of sectors including:

- Automotive
- Engineering
- Healthcare
- Infrastructure
- Real estate and business services
- Financial services
- FMCG

Major foreign investors based in Poland include Aviva, GSK, Hamilton Sundstrand, HP, IKEA, and Marks & Spencer. The largest amounts of foreign investment come from Germany (18%), France (16%) and Luxembourg (11%).

<sup>2</sup> Under the Schengen Agreement, it is possible to travel from one Schengen country to another without border controls.

The Polish government's privatisation programme has been important to the country's development and reconstruction following the end of Communism. Successful privatisations have given foreign investors access to the Polish consumer and manufacturing markets.

The government has made huge strides in a programme to privatise 802 companies by the end of 2011. At present, there are just 45 companies still to be sold. Companies on offer come from a range of industry sectors, including energy and natural resources, transport, defence and financial institutions.

These treasury auctions represent a relatively efficient way to acquire financially stable Polish SMEs. Acquiring these formerly state-owned businesses also provides a potential platform to access Poland's growing and well-structured capital markets.

## Capital markets

Warsaw is fast becoming the destination of choice – rivalling even Moscow – for IPOs among companies from Central Europe and the former Soviet countries. Moscow continues to focus on larger companies, while Warsaw is becoming an increasingly attractive choice for SMEs.

As the Polish economy grows, a stable and hard-working middle class is ready to put its cash into the Warsaw Stock Exchange (WSE) and its recently launched alternative market, NewConnect.

There are currently over 1.6m active, individual investors on the WSE, where both shares and corporate bonds are playing an expanding role. The WSE was ranked first in Europe for number of IPOs (32) in 2010, while London came second place with 20. The total value of WSE's placings was €60m, the fourth highest in Europe.

This demonstrates a stock market that is increasingly attractive to foreign investors looking to do business in the region.

## Access to finance

Polish banks are open for business, but a desire to avoid weak projects and toxic debts has resulted in a conservative approach when it comes to granting loans to businesses. High-tech businesses, in particular, tend to turn to private equity and venture capital firms for funding, as a lack of knowledge about the sector means banks are unlikely to lend.

## EU funding

Poland has been allocated €67bn of EU funds, making it the largest beneficiary for 2007-13. R&D expenditure is expected to reach 1.5% of Polish GDP, compared to 0.57% in 2005, while another €3.6bn will be invested to promote SMEs.

JEREMIE (Joint European Resources for Micro to Medium Enterprises) and other financial instruments will be used to promote funding through loans and grants. For example, as part of the 'Innovative Economy' programme, a JEREMIE-type holding fund will be created and should receive €153m from the European Regional Development Fund. A JEREMIE instrument is also planned at regional level.

## Incentives for inward investment

Poland offers various investment incentives to Polish and foreign investors.

Businesses set up in one of Poland's Special Economic Zones (SEZs) qualify for special treatment and tax exemptions including:

- Income tax exemption
- Exemption from property tax in certain municipalities
- A site fully prepared for development by the investor at a competitive price
- Free assistance in dealing with formalities relating to the investment.

Exemption from income tax for businesses situated in a SEZ is considered publicly funded regional aid, intended to hasten the development of EU regions that most need it by supporting new investments and creating new workplaces.

Beyond the SEZs, entrepreneurs may be exempt from real estate tax as a form of state aid, depending on the municipal council.

Support is also available to foreign investors carrying out new investments in Poland under the 'Scheme for the promotion of investments of priority interest for the Polish economy'.

Entrepreneurs who plan to invest in the following priority sectors may apply for grants:

- Automotive
- Aviation
- Biotechnology
- Electronic
- R&D

The scheme aims to boost innovation and productivity of the Polish economy by increasing the inflow of technologically advanced investments and creating highly productive jobs.

## Obstacles to inward investment

Despite Poland's successful political and economic transformation, foreign investors continue to experience some difficulties in the country.

Bureaucracy, a lack of clarity and transparency in tax administration, the tax burden and a slow judicial system continue to hinder the country's progress. Infrastructure is also a problem, although this is being addressed ahead of Euro 2012.

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## Romania

### Key facts



Capital:	<b>Bucharest</b>
Population:	<b>21.9m</b>
Official language:	<b>Romanian</b>
Currency:	<b>Leu</b>
GDP per capita:	<b>US\$11,600</b>

Following the end of Communist rule, unlike its regional neighbours, Romania experienced a long and not particularly well-managed transition to a market economy. After a few years of rapid economic growth the country went into recession, but since 2010 when much of Central and Eastern Europe has begun to recover, Romania's economy has continued to slide.

### Economy

According to the IMF, economic recovery is likely to remain more subdued in those countries that experienced an unsustainable economic boom, as was the case in Romania, which experienced quick and borrowing-dependent growth. After a 1.3% decline in 2010, Romania's economy is projected to grow by around 1.5% in 2011 and accelerate to a figure close to 4% in 2012.

Inflation is expected to reach around 4% at the end of 2011, which is at the upper limit of Romania Central Bank's target. Unemployment is expected to fall from 7.6% in 2010 to 6.6% in 2011 and 5.8% in 2012.

Economic recovery in Romania is predicted to be slow compared to other countries in the region, but a reduction in public budget deficits, interest rate cuts, re-allocation of public funds, infrastructure development and a strong banking system mean the country is on the right track. Moreover, the recent decision to replace Romania's expiring IMF Stand-by Arrangement with merely a Precautionary Stand-By Arrangement (although funds are not expected to be drawn), demonstrates some level of progress.

### Inward investment trends

Foreign direct investment in Romania more than doubled in the first quarter of 2011 reaching €294m, compared to €140m in the same period in 2010. Of this figure, €267m consisted of intra-group loans and €27m were capital holdings, with a massive 90% of these investments in the real estate sector alone. Nonetheless, until the end of 2011, retail is expected to be the leading sector for overseas investments given Romania's pronounced appetite for consumption.

Other industries generally acknowledged as offering the most attractive opportunities for investors include:

- Energy
- Medical and health services
- Capital markets

Romania has become a focal point for leading international companies willing to invest significant sums in wind power projects, including Spain's Iberdrola, the Czech Republic's CEZ, and Austria's Verbund. Investment in wind energy currently totals around €1bn, but the path from idea to actual construction and sale is long and full of challenges due to bureaucracy, legislation, and a long approvals process.

Similarly, investment could be more significant in the medical and health services sector if the state could guarantee the timely payment of products and services offered by private providers. But with payment terms often exceeding 300 days, private investment in this area is likely to be limited.

## EU funding

For 2007-13, Romania has been allocated around €20bn of EU funding, of which €2.6bn will be ring-fenced for research and innovation to ensure long-term sustainable economic competitiveness.

Nearly €570m will be invested in business support, with the majority share of these resources focused on supporting SMEs. Romania also plans to use new innovative financial tools, such as JEREMIE, which offers grants and loans to micro to medium-sized businesses.

Of concern however is that from 2007-09, Romania only absorbed 10% of available EU funding, which suggests improvement is needed in this area.

## Privatisation and capital markets

In line with IMF recommendations, Romania will close, restructure or privatise some state-owned energy and transport companies to keep the losses from weighing on public finances. Among those targeted are gas and nuclear energy groups, the national railways, road transport and national airlines company, Tarom.

The state will remain the main shareholder of strategically important companies. For example, it plans to sell only minority stakes in Petrom (10%), Transelectrica (15%), Transgaz (15%) and Romgaz (15%).

These secondary public offerings, as well as the high-profile listing of Fondul Proprietatea, a property fund, are expected to bring the Bucharest Stock Exchange to the attention of foreign investors, as well as SMEs with good financial results and growth potential looking to go to market.

## Incentives for inward investment

In Romania, two state aid schemes have been introduced aimed at supporting regional development and sustaining economic growth. Funds may be granted to Romanian businesses for an initial investment in fixed assets, either tangible or intangible, to be used for:

- Creating a new business
- Extending an existing business
- Diversifying activities by adding supplementary new products
- Changing fundamentally the global production process of an existing establishment.

Businesses applying for state aid must meet certain requirements, for instance, invest no less than €30m and create no fewer than 300 new jobs; or invest no less than €100m and generate no fewer than 500 new jobs, following receipt of initial investment.

There are various tax incentives available for foreign investors, for example, a delay in paying VAT after start up. Also, profit reinvested in acquiring/manufacturing equipment and machinery may be exempt from corporate income tax.

Dividend tax is reduced to nil if the beneficiary is a company resident in an EU (including Romania) or European Free Trade Association member state that holds, for at least two years, a minimum 10% of the shares of the company distributing the dividends. Payments of interest and royalties made to non-residents are also exempt from withholding tax.

## Obstacles to inward investment

Some of the main challenges for foreign investors in Romania are bureaucracy, legislative inconsistencies and lack of transparency relating to the legal system. Corruption continues to be evident. Access to finance, poor infrastructure, and regulations that limit the flexibility of labour are also a concern.

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# Russia

## Key facts



Capital:	<b>Moscow</b>
Population:	<b>138.7m</b>
Official language:	<b>Russian</b>
Currency:	<b>Ruble</b>
GDP per capita:	<b>US\$15,900</b>

Russia has undergone massive change since the fall of the Soviet Union. Most industries were privatised in the 1990s, with the exception of certain strategic industries, yet state involvement in the private sector remains high.

## Economy

Russia's economy grew by 4.1% in the first quarter of 2011 compared to a year earlier, having increased 4.5% in the previous three months.

Concerns have heightened however, that if Russia is to keep up with other major emerging markets the economy will need to grow by at least 8% annually within five years. This goal appears increasingly out of reach, as the fragile economic situations in Europe, the US and Japan stymie the global recovery and, ultimately, weaken demand for Russia's commodity exports.

Inflation is currently at 9.4%, while unemployment is at 7.6% compared to 8.4% a year earlier.

## Inward investment trends

Foreign direct investment is allowed across most areas of Russia's economy, with the exception of the banking industry and several strategic sectors including nuclear energy, natural monopolies, military and special machinery, the space industry and subsoil development.

The total volume of accumulated foreign investment is around US\$300bn, with the bulk of foreign investments aimed at the extractive industries.

According to statistics published by the Central Bank of Russia, direct investments in Russia fell US\$34bn in 2010 from a record high of US\$75bn in 2008. Moreover, in 2010 only US\$17.3bn was reinvested revenue, down US\$16.1bn from 2008.

Overseas investors are primarily from Cyprus and Luxemburg, with the Netherlands (43%), UK (20%) and Germany (20%) following closely behind.

## Access to finance

Access to finance, particularly for SMEs, remains a challenge in Russia. The country is not short of savings deposits, but money tends to be tied up in state-run banks, making it difficult for SMEs to access loans. But with more foreign banks operating in the country and more flow of cash due to the oil and gas boom the problem is now less severe than it was in the past.

## Incentives for inward investment

The Russian government has recently put forward ten investment 'precepts' intended to improve the country's weak investment climate. Most of these precepts seek to entice back Russian investors who, reluctant to invest in their home country, have looked to the west for opportunities instead. There are also opportunities available to foreign investors.

Russia will assign each region with a special investment representative to facilitate the implementation of private investment projects. Some investors, namely international financial companies, Russian companies or foreign business structures controlled by Russian citizens, will be allowed to invest in strategic industries. And they will no longer need approval from the special governmental commission to conclude deals.

The main incentive for investors is a type of insurance similar to state guarantees. A Russian fund of direct investments (RFDI) will be set up as a classic private equity fund. It will act as a co-investor in any industrial projects that large foreign companies may want to implement in Russia, provided the projects are beneficial to the country's economy, for instance:

- Power
- Pharmaceuticals and healthcare
- Telecommunications and IT
- Innovative mining
- Construction
- Transport and logistics

A team of investment professionals will manage the fund, although the government will monitor its performance – not least because it plans to invest US\$2bn in the fund by the end of the year.

RFDI is expected to partner some of the world's largest investment structures, with companies such as Apollo Management, Blackstone and Carlyle having already expressed interest in the fund. Total investment from interested parties must be at least five times more than that invested by the Russian state.

Investments in a single project will range from US\$50-500m, providing support to between 30 and 50 projects over the next 10 years. RFDI's interest in each project will be limited to 10-25%, with the eventual plan being to sell its interest to its strategic partner.

Other tax incentives are available to both newly formed and existing companies in line with the country's Tax Code. For example, organisations involved in educational and/or medical activities may be exempt from corporate tax, provided certain conditions are met. In other cases, taxpayers may be able to offset some or all of their losses from previous tax years.

## Obstacles to inward investment

One of the fundamental challenges for foreign investors is not knowing which sectors are open to investment without the need for Russian majority partners.

However, a variety of other factors were identified in a recent web poll by Nexia International member firm, ICLC. Topping the poll are corruption (29%), inefficient government bureaucracy (17%) and access to finance (13%). Tax regulations, weak law enforcement and police instability, as well as tax rates and foreign currency regulations, were also cited as obstacles in the poll.

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# Slovakia

## Key facts



Capital:	<b>Bratislava</b>
Population:	<b>5.4m</b>
Official language:	<b>Slovak</b>
Currency:	<b>Euro</b>
GDP per capita:	<b>US\$22,000</b>

As an EU member and Schengen<sup>3</sup> country, Slovakia enjoys a free and open economy. Having joined the European Monetary Union in January 2009, the following year it became the fastest-growing Eurozone country.

## Economy

More than 20 years after the Velvet Revolution, Slovakia's economy has transformed dramatically, with the country experiencing strong economic growth during the last two decades. In fact, estimates place Slovakia among the countries with the highest economic growth in the region.

As a result of the global financial crisis and recession, GDP fell by 4.8% in 2009. However, by 2010, it had bounced back, growing by 4%. It is expected to continue growing by 3.5% in 2011 and 4.8% in 2012.

Inflation is close to 4%, compared to 0.9% in the same period last year. But unemployment remains the biggest challenge at 13.3%, although it is subsiding thanks to economic growth and the creation of new businesses.

## Inward investment trends

Those sectors that are of most interest to foreign investors looking at Slovakia include:

- Manufacturing
- IT
- Shared services
- Electronics

Slovakia manufactures the most cars per capita in the world, with companies such as Volkswagen, PSA Peugeot Citroen, Kia Motors and Getrag Ford based in the country. Large manufacturing plants building consumer electronics in the country include Samsung, Foxcom and AU Optronics, while retail businesses include Tesco, H&M, Debenhams, Marks & Spencer, Next and many others.

<sup>3</sup> Under the Schengen Agreement, it is possible to travel from one Schengen country to another without border controls.

There are a handful of opportunities for foreign investors to acquire businesses being privatised by the government. There are plans to privatise or obtain long-term rent for the Slovak railway cargo business, as well as Bratislava Airport and local energy companies. There may also be some opportunities to acquire businesses from local municipalities.

## EU funding

Slovakia has been allocated €11.7bn of EU investment for 2007-13. In relative terms, it has the highest allocation for ICT of any EU member state, accounting for 10% of its total funds or roughly €1.2bn.

Around €2.6bn will be invested in R&D and innovation, and to stimulate entrepreneurship. Some €432m has been allocated for projects supporting the competitiveness and innovation of enterprises, with 820 co-operation projects between enterprises and research institutions expected to be supported between 2007-13.

Slovakia will use technical assistance from JASPERS (Joint Assistance to Support Projects in European Regions) to help prepare project applications for potential financing from the funds. It will also use JEREMIE, which offers grants and loans to micro to medium-sized businesses. JEREMIE will be supported to the tune of €120m.

## Access to finance

Slovak banks have been in good shape for quite a few years now. They were privatised and revitalised at the end of the 20th century, and their exposure to the financial crisis was minimal. They are also more conservative in their lending than many, which has meant little growth in overdue and unpaid loans by borrowers during the recession – even when unemployment grew.

This conservative approach can, however, create complications when it comes to access to finance – especially for start-ups. Interest rates for loans continue to be among the highest within the Eurozone.

## Capital markets

The Slovak stock market is neither as developed nor as active as those in Poland or the Czech Republic. Plans to sell the stock exchange to an investor who will bring about change are being considered as part of a range of options to activate the Slovak capital markets. It's also hoped that closer co-operation with the Prague Stock Exchange, even before a potential sale, might help to activate the capital markets.

Most Slovak enterprises are privately owned (by natural or legal entities) and not interested in the public selling of stocks. But for those that are, investments from private, as well as institutional investors, may be attracted through banks and Slovak private equity corporations in the normal way.

## Incentives for inward investment

Slovakia offers various incentives to foreign investors. For example, the country has no thin capitalisation rules, which determine how much of the interest paid on corporate debt is deductible for tax purposes. This may be significant when financing projects – especially as this is not typical in Slovakia's neighbouring countries.

Furthermore, there is no tax payable on dividends for legal entities and, more unusually, for individuals.

The Slovak government may grant state aid to an investor wishing to do business in the country. There are various types of assistance available, including income tax relief, staff training grants and financial support for investors setting up businesses in regions with high unemployment.

## Obstacles to inward investment

For Slovakia, the main challenges to inward investment centre on infrastructure and access to the region; the need for further investment in R&D and innovation, as well as electronic services to support competitiveness; and improving the education and skills of the country's workforce.

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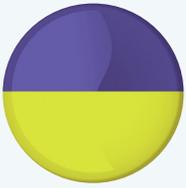
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# Ukraine



## Key facts

Capital:	<b>Kiev or Kyiv</b>
Population:	<b>45.1m</b>
Language:	<b>Ukrainian</b>
Currency:	<b>Hryvnia</b>
GDP per capita:	<b>\$6,700</b>

Ukraine's large domestic market, access to a variety of resources including some of Europe's best agricultural land, significant coal and some oil and gas reserves, and strategic location connecting Europe, Russia and Asian markets are the main factors behind its economic potential. In 2012, it will co-host the UEFA European Football Championships with Poland.

## Economy

Before the recession of 2009, Ukraine experienced rapid economic growth and a high return on investment. From 2000-08 the annual growth rate was over 7%, but the following year the country experienced a 15% decline in GDP as the global financial crisis took hold.

In response to the sharp economic downturn, the IMF approved a US\$16.4bn Stand-By Arrangement in November 2008, on the basis that Ukraine's banking sector underwent reforms and there were also adjustments to fiscal and monetary policy.

Since then the economy has recovered, with GDP growth in 2010 at 4.3%. Thanks to economic stabilisation, strong gross national product and production growth in specific areas, Ukrainian companies are expected to look far more attractive to potential foreign investors through 2011.

## Inward investment trends

Ukraine encourages foreign trade and investment, with the EU and Commonwealth of Independent States countries accounting for about 30% and 40% of Ukraine's trade, respectively.

The Ukrainian government has approved a foreign investment law allowing western investors to purchase businesses and property, repatriate revenue and profits, and receive compensation if their property is nationalised by a future government.

Following the difficulties of the past couple of years, investors have been returning to Ukraine, attracted by its low-cost production base, which makes it an appealing destination for companies looking to produce for the EU market. Similarly, companies looking to expand into new markets may be attracted by Ukraine's 45 million plus consumers.

Sectors of particular interest to foreign investors include:

- Financial
- FMCG
- Retail
- Real estate
- Manufacturing
- Agriculture

The country boasts a large British presence of over 100 companies including Shell, Marks & Spencer, GSK, BP, BAT, Mothercare, Unilever, Next, Baker Tilly, HSBC, Arup, Mott MacDonald and others.

At present however, Ukraine is considering whether to move towards a deep and comprehensive European Free Trade Agreement or to join the Customs Union between Russia, Kazakhstan and Belarus to benefit from stronger trade links in the Euro-Asian space.

On the other hand, there is concern that by joining the Customs Union, it would make it more difficult for Ukraine to conduct trade negotiations with the EU, as countries within the Customs Union have no preferential agreements with the EU and would therefore apply a common tariff to other partners.

## International funding

In 2010 the European Bank of Reconstruction and Development (EBRD) agreed to fund a total of 32 projects in Ukraine, with a financial commitment of €964m. One of the most significant of these investments was a €450m sovereign loan facility to upgrade the road networks into Kiev. This includes part of the transport corridor linking the Ukrainian capital to the EU. This project has been co-financed by the European Investment Bank and is expected to stimulate economic growth and provide a significant boost ahead of Euro 2012.

The majority of transactions undertaken by the EBRD in 2010 were direct engagements with locally owned companies, such as a US\$50m loan to Nibulon Ltd, a leading grain exporter and producer registered in Ukraine.

The World Bank has also financed various projects in Ukraine focusing on energy efficiency, hydropower and urban infrastructure.

## Capital markets

The economic crisis saw the volume of trading through the PFTS Stock Trading System, the largest stock exchange in Ukraine, fall dramatically.

The situation has improved since 2010, although current currency control regulations and cross-border investment rules, coupled with the fragile economic situation, continue to discourage foreign investors from making investments through Ukraine's stock exchange.

Nevertheless, with proper legislative support for the stock market and the political situation stabilising, it is predicted that the number of Ukrainian IPOs could soon exceed pre-crisis figures.

Going forward, it is also believed that Ukrainian and other CIS companies will be among IPO investment targets on the Alternative Investment Market of the London Stock Exchange, as local markets and the status of individual companies become more important to investors than their country's political climate.

## Incentives for inward investment

In January 2011, the new Ukrainian Tax Code came into effect. The code is intended to reduce substantially the number of taxes charged and ease the administrative tax burden on businesses, which, only a couple of years ago, had to pay in the region of 99 separate taxes.

The introduction of the tax code means Ukraine now has no restrictions on thin capitalisation, unlike many of its Central and Eastern European neighbours, and a corporate tax rate that will decrease from 23% to 16% over the next five years.

## Obstacles to inward investment

Complex laws and regulations, poor corporate governance, weak enforcement of contract law by the courts, and corruption all continue to hinder direct large-scale foreign investment in Ukraine. According to a recent Transparency International survey, it was estimated that Ukrainians pay between 10-20% of income in bribes and that 80% of Ukrainians pay for services they are entitled to receive free of charge (higher than in any other country surveyed).

Ukraine has recently overhauled its anti-corruption laws in an effort to address this issue. Two new statutes were signed into law including The Framework Anti-Corruption Law, which is much more detailed and specific than its forerunner, with distinct provisions covering corruption in both the private and public sectors.

The lack of protection for shareholders' rights is another concern and can severely restrict portfolio investment activities.

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