



Czechs and Balances

By **Jeff Silver**

A smorgasbord of business opportunities are available in the Czech Republic. But beware, these deals are not for the faint of heart.

While many of us have been confused or even apathetic about eastern Europe's changing borders and politics over the past decade, others, like Jim Libby, partner in Williams Benator & Libby, LLP, CPAs and business advisors, have been paying attention and looking toward the future.

Williams Benator & Libby is part of Russell Bedford International, a network of independent accounting firms providing worldwide financial services. Libby took advantage of this connection to a Czech firm, Lubbock Fine s.r.o. Chartered Accountants, and has made several trips to Prague to investigate business and investment opportunities that might be interesting to his local clients.

He says there is a "smorgasbord of different businesses" available for investment because the privatization of industry that should have happened in 1989-1990 after the fall of communism never fully took place. In reality, the government ended up owning banks that owned companies which were supposed to be privatized.

The time is right for some good deals

Those investments have not turned out as well as had been hoped for, however, and in many cases, the banks are now looking for ways to let go of these holdings. As a result, Libby's contacts have told him the time is right for negotiating very attractive deals.

The Czech government is, in fact, actively courting foreign investment. For proof of that, look no further than the website for CzechInvest, an agency of the Ministry of Industry and Trade. CzechInvest facilitates direct foreign investment by acting as a source of information on the country's economy, providing referrals for local partnerships, site selection and case studies of successful foreign investments.

They must be doing something right, since between 1990 and 1996 over \$1 billion was invested by American companies like Phillip Morris, PepsiCo, Ford and ITT. (Total foreign direct investment as of early 1997 exceeded \$7 billion.) In 1996, American investments, which totaled \$232 million, were second only to the Netherlands'.

There are reasons the country has attracted this kind of interest.

Historically, it has a solid manufacturing base and in 1938 was actually the fourth-largest industrial country in the world. It also has a well-educated workforce (with a literacy rate at around 99%), low cost labor (CzechInvest cites a Morgan Stanley finding of hourly wages only 4% of those in Germany), a central location with close proximity to western Europe and the opportunity for companies to enter a less mature market than the west.

Some difficulties are looming on the horizon, however. Matt Richardson, who now handles European sales for T-Tech Inc., a prototype printed circuit board systems manufacturer, has done a great deal of consulting through his own company, Central Europe Initiatives, a consulting firm that helps develop relationships between US and European companies. He says the Czech Republic is now paying a price for not going through a radical restructuring 8 or 9 years ago.

"The Czechs were interested in maintaining a socialist state as long as possible and didn't perform the liberalization that was required. By contrast, Poland went to a free market economy right off the bat and consequently suffered." It may now be the Czech Republic's turn.

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— Matt Richardson, T-Tech Inc.

Royal financial problems

Czech unemployment has risen from 1% to 5% and the inflation rate is up to 10%. While these numbers may not be alarming by western standards, they represent a first-time negative trend which has included the recent devaluation of the Czech crown. "This signals the republic is not going to escape the painful realignment of its state industries and finance sectors," Richardson says.

Part of the communist legacy that hurt the Czechs was the concept that "everyone works," ultimately an inefficient practice. Since companies did not address that issue within the newly emerging free market economy, there was upward pressure on wages which contributed to inflation with very low unemployment and prices that were kept artificially low. As a result, the Czech Republic may post only a 1%-1¹/₂%

increase in GDP for 1998. Poland, which used the "Big Bang" approach to liberalizing prices and realigning various business sectors, is projecting 7% growth in GDP for this year.

The growing pains Czechs are experiencing can be illustrated by an encounter Libby had with a woman in her early 40s who found herself without a state-provided job and no particular job skills. She ultimately found work as a private tour guide. She told him under socialism everyone had jobs and was paid no matter what. "You could leave work early and the government still paid you," he says. Regardless of what other shortcomings communism might have had, she told him, you were able to spend a lot of time with your family.

That story, in fact, brings up an often-heard criticism of many former socialist labor forces: they don't adapt well to the rigors of a capitalist marketplace. Ed Grinvicz, CEO of the Geld Group and a veteran of business dealings in eastern Europe, says, "It's difficult to do business because people are used to working in forced fragmentation, distrust, in covert operations, and they carry that with them. You can teach them about free markets, but an ingrained attitude is still there."

Missing pieces can be disastrous

Grinvicz has also been frustrated by the legal landscape in the Czech Republic. He characterizes it this way: "Picture a big puzzle. In the west, you can complete the deal without all the pieces being ready to go. Laws are such that you can fill in after the fact. In eastern Europe, if you don't have every single piece in place they're very good at taking that one little piece you're missing and turning the deal to their advantage." He points out, however, that larger, multinational companies with highly desired commercial products — cigarettes, jeans, soft drinks — have an easier time getting established.

Richardson agrees Czech regulations can make foreign investment a tricky proposition. There are laws forbidding foreign companies to own land, but they can work around this by registering as a Czech company. However, that leads to financial requirements for local bank accounts with certain minimum balances; these are built-in difficulties one would never encounter in the west.

Richardson answers the criticism of work habits and labor practices, though, by pointing out the number of firms that are operating successfully. "Those companies are competing with the west and Asia, so they've learned to adopt new work habits." He points to the example of Skoda, a Czech joint venture with Volkswagen. "They're adopting German business practices with German money."

The greatest challenge for the Czech Republic, Richardson says, is to complete its restructuring of the banking and financial sectors so transactions will be more transparent and western investors will be able to determine their bottom line more easily. He believes with its educated workforce, longstanding industrial base and central location, the Czech Republic will accomplish these goals and remain an attractive market for western investment.

Anyone contemplating investment opportunities in eastern Europe, however, would do well to heed the advice of Grinvicz who, after 7 years, is preparing to pull out of the region. He went in with a great deal of excitement and found a "wild west situation" filled with the excitement of newly converted capitalists, fledgling entrepreneurs and a sky's-the-limit optimism.

"If you go in saying, 'This will be fun, something different and challenging,' you'll enjoy it," he says. "If you go expecting to use everything you've learned in business, you'll go crazy and probably lose money. It's not for the faint-hearted."

523