A GROWING BUSINESS OPPORTUNITY

EUROPE AS A MARKET FOR BUSINESS IS CHANGING – AND INTERNATIONAL TREASURERS NEED TO BE FULLY BRIEFED AND ABLE TO OPERATE EFFECTIVELY IN THIS NEW MARKET SAYS **EDDIE FOGARTY** OF FTI.

Next year sees a major development within Europe. On 1 May 2004, 10 countries – Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia – will join the European Union (EU) and create a market of 25 countries and 450 million people.

This means Europe as a market for business is changing, and new trends and opportunities are emerging. There are many dimensions to this development – political, social and economic – and, undoubtedly, it will impact on business in a major way. It would be a mistake to see this development as solely a European issue, because, be it steel, bananas or subsidies, there are huge US-EU issues as well. International treasurers need to be fully briefed and able to operate effectively in this new market.

BACKGROUND. This article draws on FTI's experiences in many of the new EU countries, initially in the utility sector on financing and privatisation, later in sovereign treasury management and more recently – as companies look to take advantage of the single market and the euro – treasury structures, cash management and the normal issues that confront any international treasury.

In case this sounds like routine business, in reality, it has been a kaleidoscope of experiences – on one level, part of the great political and economic changes that were unfolding before our eyes, and on another, the buzz of interacting with a diverse and hugely interesting range of people and situations.

COSTS AND BENEFITS. Regardless of whether you see this as a further step in the creation of a European super-state governed by an unelected Brussels elite, or the achievement of the Schuman ideal of the end to war in Europe, the reality is that it is happening and the business threats and opportunities need to be grasped. At a basic level, we will have a market considerably larger than the US, and enlargement itself – 75 million people with rising incomes – is a major plus for European business. The transition is well underway and these countries are ceasing to be 'emerging economies'.

Economic estimates of the costs/benefits of enlargement state that this is a really good deal for the current EU15. The long-term benefits of political stability (admittedly, an assumption) and an enlarged single market significantly outweigh the costs. Overall, this is a 'positive sum' game.

EU membership provides opportunities but, as some economic research shows, the gains are not automatic. This has been the case with the existing 15 countries, which, as a group, were much more homogeneous than the new entrants. Quite simply, some countries will do better than others. There are costs for the new entrants. They

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TABLE 1
EU ACCESSING COUNTRIES – KEY FACTS

Accession country	Population (millions)	GDP per head	Country credit rating (S&P)
Cyprus	0.8	17,400	A
Czech Republic	10.0	14,400	A-
Estonia	1.4	10,000	A-
Hungary	10.2	13,600	A-
Latvia	2.3	8,500	BBB+
Lithuania	3.5	9,400	BBB+
Malta	0.4	n/a	A
Poland	38.6	9,500	BBB+
Slovak Republic	5.5	11,400	BBB
Slovenia	2.0	17,700	A+
Bulgaria	8.0	5,900	BB+
Romania	22.4	5,900	BB
EU 15	381	24,000	

GDP figures expressed in PPS (Purchasing Power Standards). Bulgaria and Romania expect to join EU in 2007.

will have to cope with the full weight of EU rules and regulations (estimated to run to more than 100,000 pages) from a much earlier stage of economic development than the current EU15.

BUSINESS TRENDS. A consequence of the single market, with differing cost levels, is that business will seek out the cost advantages. On a global scale this is already happening with, for example, manufacturing in China and software development in India. The experience of other countries on joining shows that membership gives a major boost to inward investment. For some time, given the certainty of enlargement, labour-intensive business has been moving east. In the treasury area, we see shared services centres relocate in Poland and Slovakia; previously, Ireland was a favoured location. EU membership and the adoption of the *acquis* (the detailed laws and rules of the EU) makes these countries less risky from an investor perspective, and business will move east to exploit market and cost advantages.

TREASURY ISSUES. One of the treasury challenges facing multinationals in the region is finding a banking solution that will integrate existing European or pan-European infrastructures. Bank service providers are facing up to this challenge in different ways – only a couple of the global banks have a presence across the region, while other major banks are looking to develop the partnership route. A number of well-established European banks have good presence and strong capability and existing European banking clubs, such as the IBOS Association, Connector and TES (Trans-European Banking Service), have access through the networks of existing participants.

Any company that has gone through the process of optimising cash and liquidity management solutions in existing EU member countries will be well aware of the fragmented nature of European regulatory, taxation and legal systems and the challenges they present. Unfortunately, these issues are even more complicated for the new entrants and generally do not facilitate easy integration into existing structures.

CURRENCY ISSUES. The accession countries do not automatically adopt the euro upon joining the EU, but they are expected to do this when they fulfil the Maastricht criteria. There is no fixed timetable for this. However, unlike the UK and Denmark, they do not have opt-out rights in relation to joining the euro; technically, they acquire the status of a 'member state with a derogation' in relation to joining the euro.

Participation in the exchange rate mechanism (ERM) – a central rate with a fluctuation band – for at least two years is one of the criteria for joining the euro. The final decision rests with a summit of member states acting on a recommendation from the Economic and Financial Affairs Council (ECOFIN). Clearly, there are a number of uncertainties in the process in relation to timetable and the exchange rate to be adopted. Apart from these technicalities, the trend of these currencies from hereon is likely to concern treasurers looking to finance assets in those countries. There is a *prima facie* case for expecting bouts of currency volatility and weakness and, almost certainly, all the 10 countries now joining the EU will not make it to the euro unscathed.

There is likely to be some trend towards adopting the euro as a parallel currency before formally joining the system. However, the European Central Bank (ECB) wants to see the adoption of the euro as an end to economic convergence, and does not want this process circumvented.

DOING BUSINESS IN THE ACCESSION COUNTRIES. There are cultural differences from country to country, even between close neighbours. For example, Slovenia is markedly different from Slovakia, as is the Czech Republic compared with Poland. Be prepared to recognise these differences – really, people differences – and to respond flexibly.

Decision-making can be slow and a big adjustment is required, especially in public administration, where things can be very procedural.

It can be difficult to find the right local professional firm. Local offices of the international brands are too eager to charge international rates for what is basically a local service.

The good news for all us English speakers is that generally this works in most situations. However, senior people in these countries can be uncomfortable when speaking it, especially for formal group discussions and negotiations. In these situations, having a good interpreter is essential.

It would be wrong to regard the new entrants as 'backward' countries. We always found that we could learn something as well. Communism definitely left its mark – even this varies from country to country, and besides, they were not all communist – however a younger, well-educated generation is coming to the fore.

The transition is far from complete but the changes have been phenomenal. The business opportunities will require us all to look east and come up with new solutions. If you have the opportunity to experience first-hand what is happening, take it. The Berlin Wall can come down only once and things will never be the same again.

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