

CONFIDENTIAL

Economic Reforms for Europe: Quality of Business Environment

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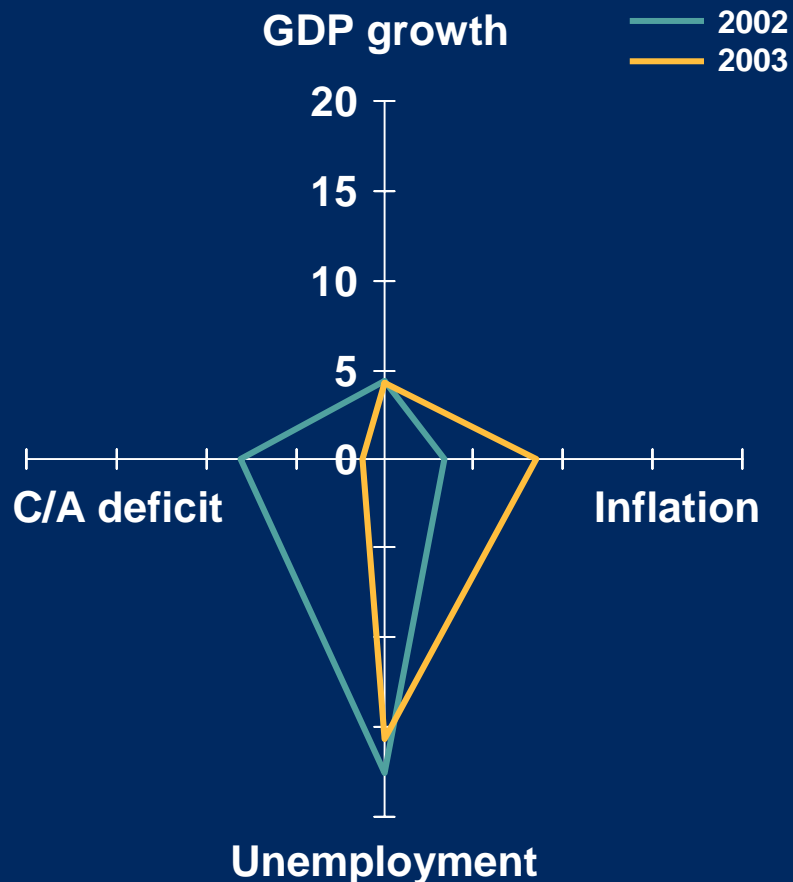
FRAMEWORK

- **Slovakia's strengths and weaknesses**
 - Economic environment
 - Bureaucracy and legal environment
 - Infrastructure
- **Themes to pursue**

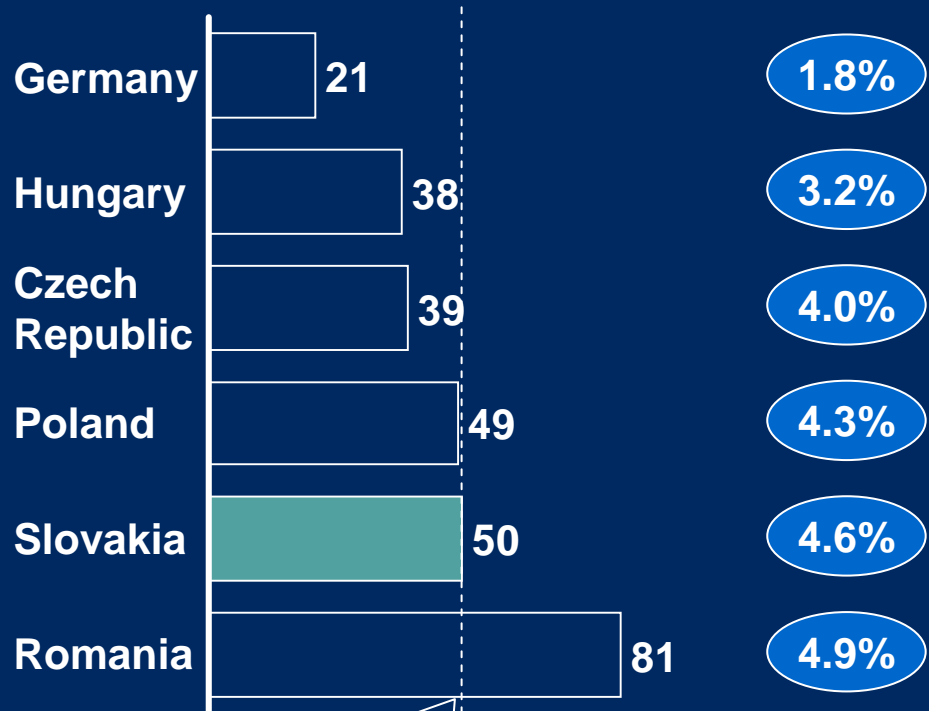


MACROECONOMICALLY, SLOVAKIA IS A STABLE COUNTRY

Diamond of macroeconomic indicators Percent



Macroeconomic environment index*



Slovakia has managed to stabilize her economy and nowadays scores among the Top 50 countries in the world

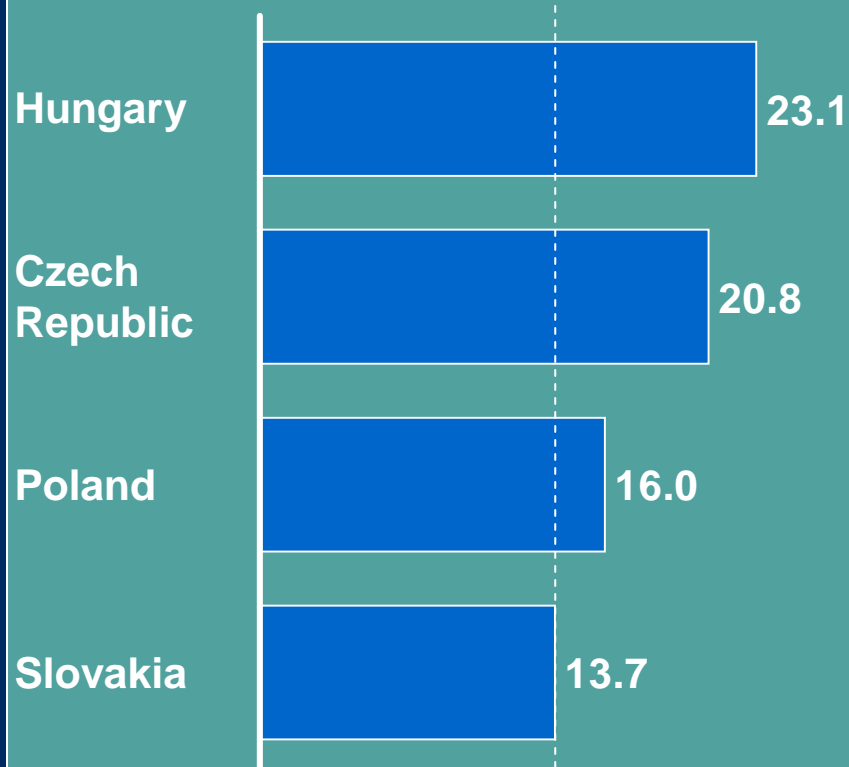
* Measures macroeconomic stability of a country



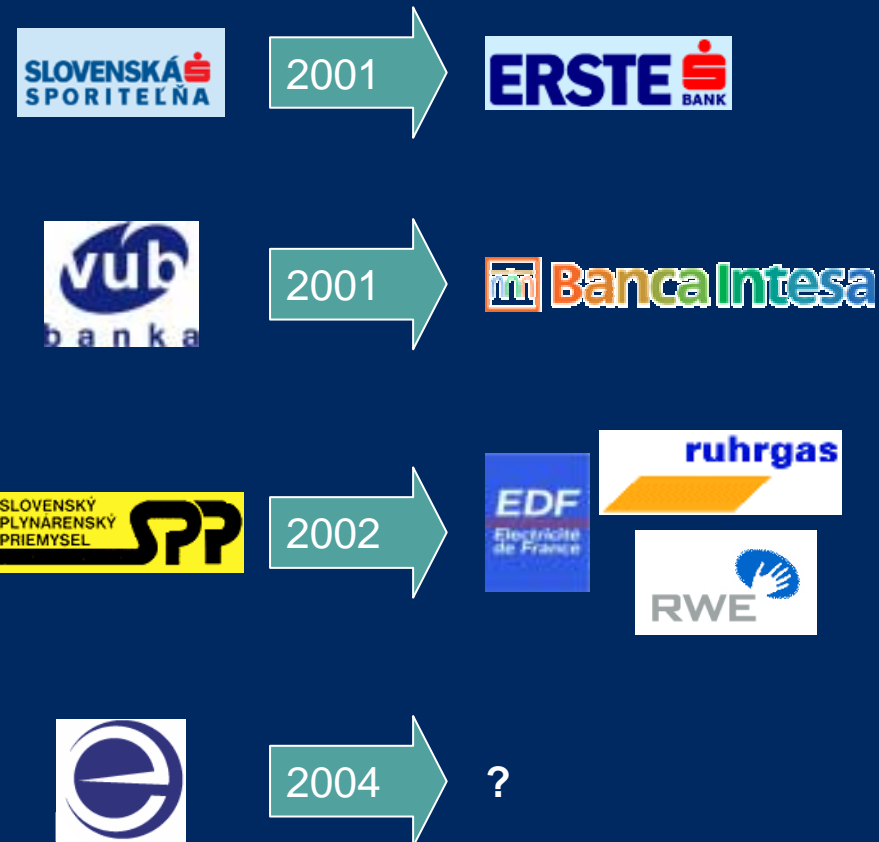
RECENT ECONOMIC POLICY CHANGES INDUCE FURTHER IMPROVEMENTS

After the tax reform of 2003, Slovakia has become the 'tax heaven' of Central Europe

Tax burden*
Percent



Major government stakes have been privatized recently





HOWEVER, BUREAUCRACY IS STILL AN ISSUE IN SLOVAKIA

Details

Transparency

- Perceived level of corruption is relatively high in Slovakia
- In 2003, Slovakia ranked at the tail of Top 50 countries and scored worse than e.g., Hungary or Czech Republic
- Also, administrative corruption is considered high, bribes reached 2.2% of firms' revenues

Speed of bureaucracy

- Speed of bureaucracy is considered a major obstacle for running business in Slovakia, e.g., setting-up a company requires on average 10 administrative tasks or 98 days*
- Recently, attempts have been made to improve the situation
 - Entry into Commercial Registry should take 5 days**
 - Land Registry is available on-line

Judiciary

- Performance of the court system is assessed quite negatively
 - 20% of inhabitants consider the court system quick
 - 65% believe the system is fair and impartial

* OECD average equals to 7 administrative tasks or 30 days

** Or 15 in extraordinary cases



INFRASTRUCTURE HAS BEEN IMPROVING DRAMATICALLY, HOWEVER, STILL REQUIRES FURTHER INVESTMENT

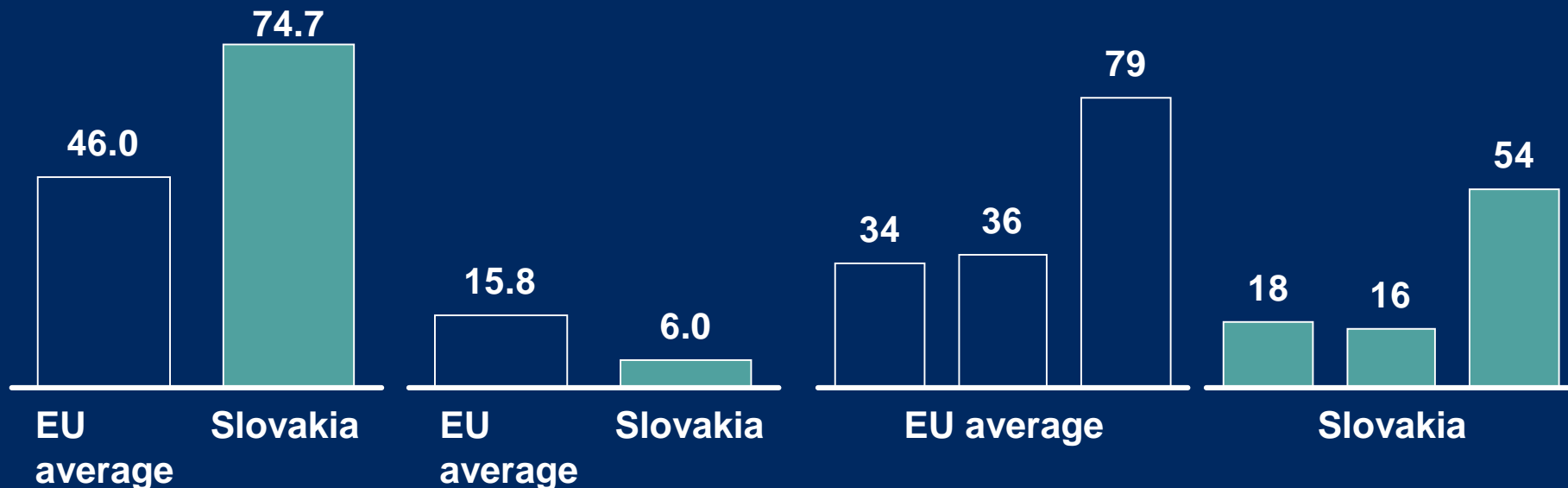
As in other Central European countries, Slovakia disposes over a dense railway network, whereas the road transportation requires significant improvements

Telecommunication infrastructure has been improving at a quick pace; further steps are still needed, especially in the PC and Internet areas

Railway density
Km per 1,000 km²

Motorway density
Km per 1,000 km²

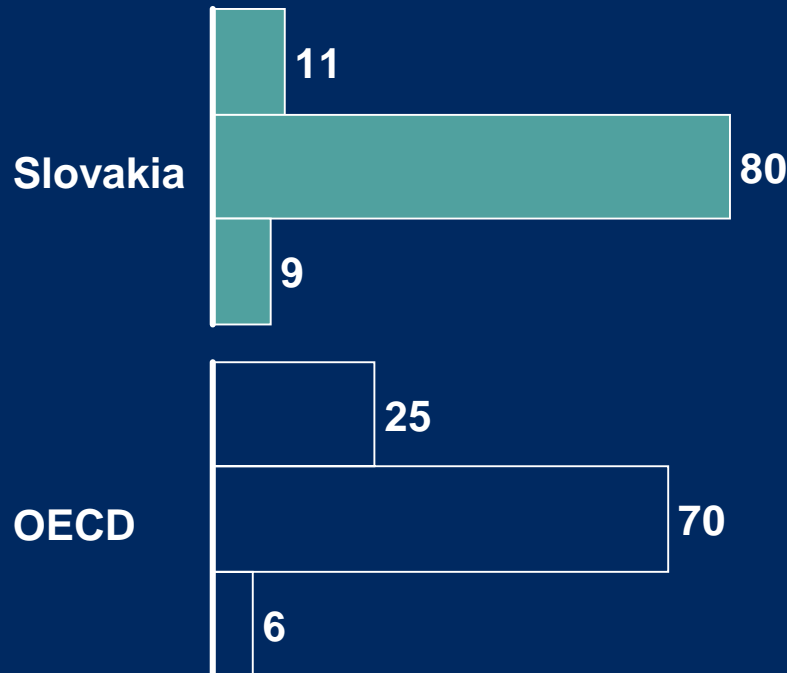
PC, Internet and Mobile penetration
Percent





SLOVAKIA DISPOSES OVER SKILLED LABOR AND FLEXIBLE LABOR MARKET; HOWEVER, FACES 'BRAIN DRAIN'

Educational structure of labor force Percent of University/secondary/other

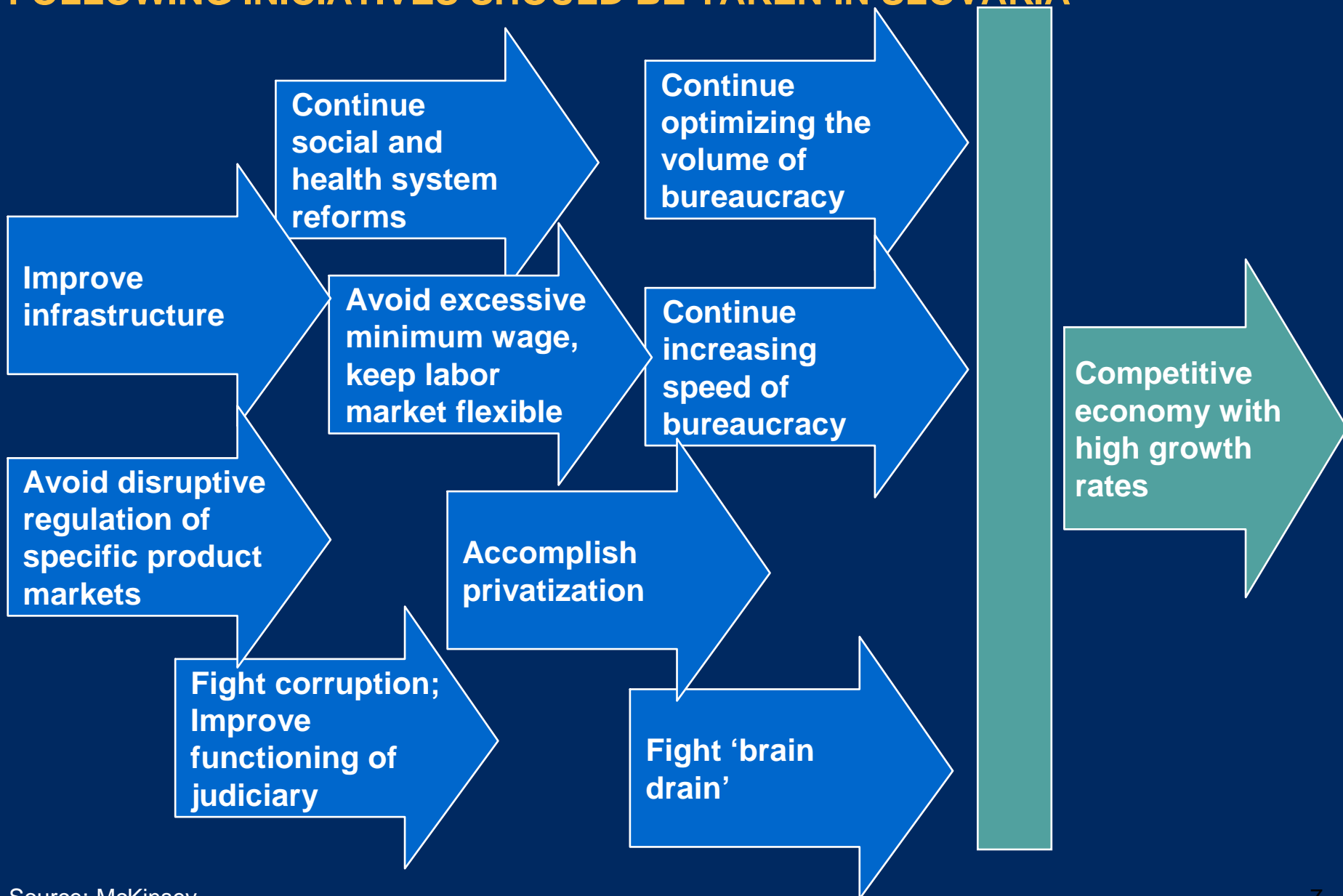


Recent legal changes have made the labor market more flexible

- Novelization of the Labor Code in 2003
 - More flexible labor contracts
 - Increased overtime hours
 - Easier firing for inadequate performance
- Decreased sick-payments while obligation to pay first 10 days of sick-compensation transferred onto employers
- New approach of Ministry of Labor to the extension of collective agreements on other companies

As many as 80 thousand university educated people have left Slovakia between 1994 and 2002, which equals to 7-10 thousands per year or 25.0% of fresh graduates every year. This 'brain drain' translates into 0.6% lower annual GDP growth.

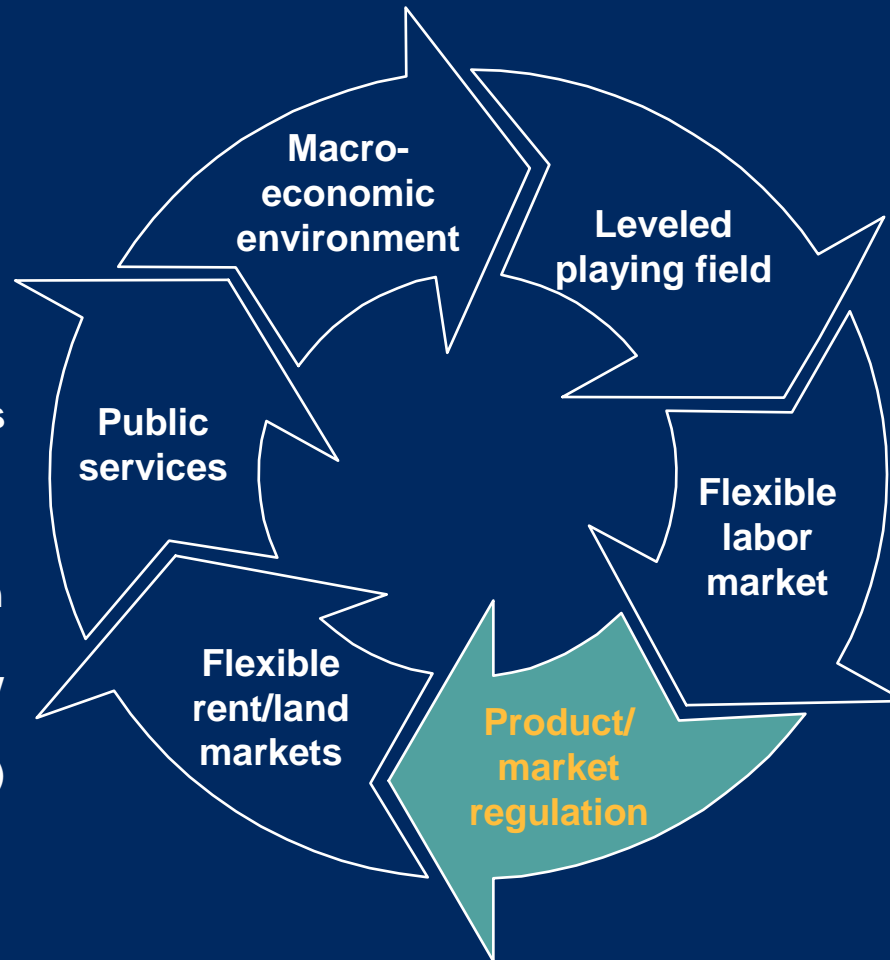
BASED ON THE ABOVE FACTS AND MCKINSEY RESEARCH, WE BELIEVE FOLLOWING INITIATIVES SHOULD BE TAKEN IN SLOVAKIA





McKINSEY RESEARCH HAS IDENTIFIED SOME OF THE CRITICAL GROWTH LEVERS AND POTENTIAL POLICY TRAPS (1/3)

- Eliminate restrictions inhibiting market access, free pricing, decision on operations etc.
- Examples
 - Strict licensing in Portuguese retail market prevented large format efficient players from entering the market
 - Prescribed opening times of hotels reduced operational efficiency of Portuguese players*
 - Pricing limits imposed on telecom operators in Germany and France (low subscription fees to provide universal access)



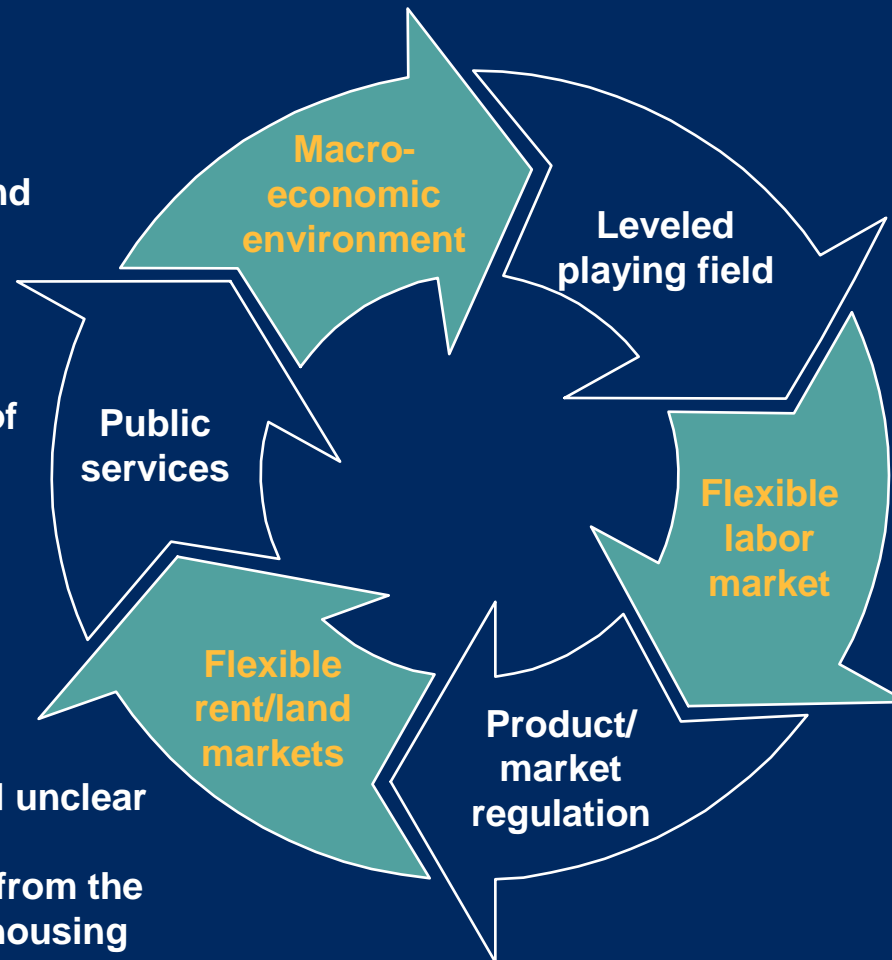
- Eliminate distortions in related market sectors (upstream/downstream)
- Examples
 - Regulated fixed-to-mobile interconnection fees encouraging mobile communication (and thus higher labor productivity but sub-optimal usage of capital-stock)

* Longer opening times (Portugal 358 vs.France 261 days) disabled significant operational savings in low season



McKINSEY RESEARCH HAS IDENTIFIED SOME OF THE CRITICAL GROWTH LEVERS AND POTENTIAL POLICY TRAPS (2/3)

- Keep tight monetary policy and fiscal discipline to manage inflationary pressures
- Liberalize capital market, accomplish privatization and pension fund reform
- Make the environment overall favorable for investors, avoid trade protection/ dissemination of global best practice



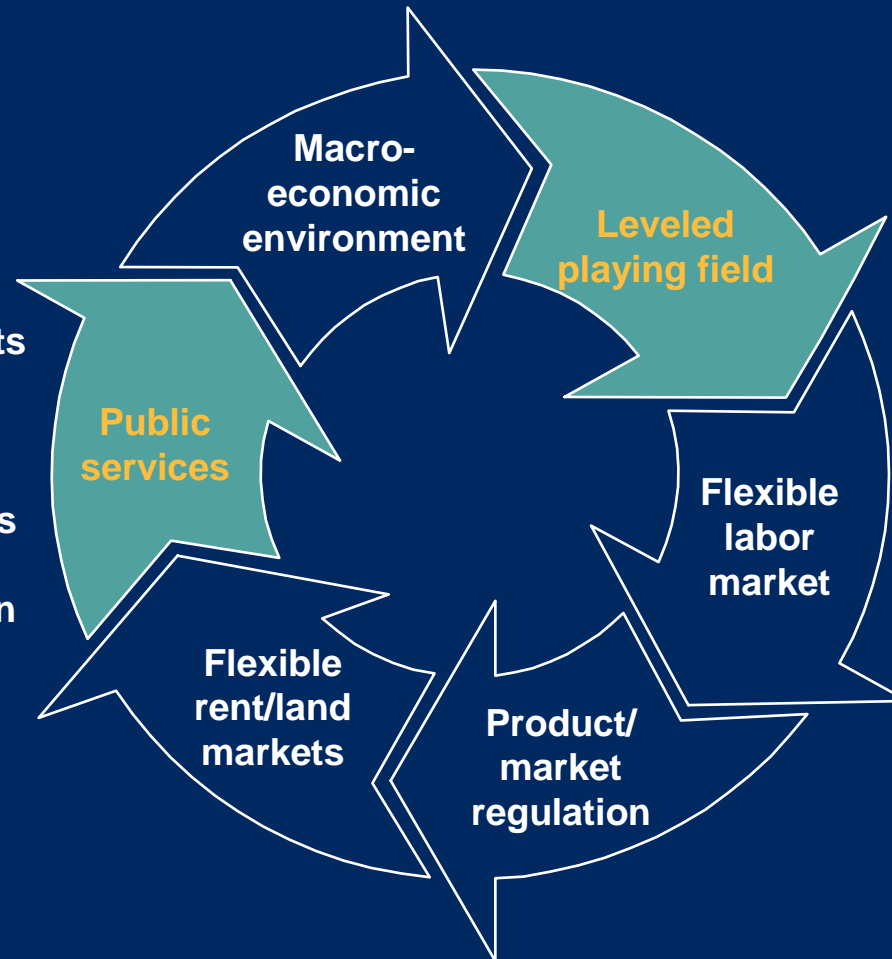
- Keep the processes of hiring/firing flexible
- Support labor mobility
- Avoid excessive minimum wages and employment related social obligations

- Avoid restrictive and unclear zoning regulations
- Remove distortions from the rental market (both housing and commercial)



McKINSEY RESEARCH HAS IDENTIFIED SOME OF THE CRITICAL GROWTH LEVERS AND POTENCIAL POLICY TRAPS (3/3)

- Strive for fiscal load proportionate to the benefits received from public services
- Implement commercial measures in public services (performance indicators, motivation and organization schemes, etc.)
- Provide necessary infrastructure



- Strive for fiscal load proportionate to the benefits received from public services
- Implement commercial measures in public services (performance indicators, motivation and organization schemes, etc.)
- Provide necessary infrastructure (transportation, telecommunication)