ICEG EUROPEAN CENTER

NEWS OF THE MONTH
on EU-10 and CIS

January 2010

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News of the Month, *on EU-10 and CIS*

The ICEG European Center issues its monthly publication, which includes 2-4 brief analyses on macroeconomic and microeconomic issues. The publication focuses on two groups of countries: *Commonwealth of Independent States - CIS* (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan) and the ten post-soviet *New Member States of the European Union – EU-10* (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia).

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About us

ICEG European Center is an independent economic research institute based in Budapest, Hungary. The Center was founded by Dr. Pál Gáspár in 2001.

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Major Macroeconomic Indicators summarizing 2009

According to various indicators among CIS countries Ukraine is listed as a country greatly affected by economic crisis in 2009 (*Table 1*). State statistic data shows that annual inflation reached 12.3% (though the government expected about 9% inflation in the budget for the year of 2009). Over the third quarter of 2009 GDP fell by 15.9% (comparing to the relevant period of 2008). Decrease in business, investment and innovation activities, rapid national currency fluctuations, budget deficit, deterioration of international economic rankings of Ukraine testify to the degradation of general economic results of the country.

Table 1. Indexes of main socio-economic indicators for CIS countries in January-September 2009 (% comparing to January-September 2008)

Country	GDP	Consumer Prices Indexes	Retail commodity trade (according to all selling channels)
Azerbaijan	106,1	102,1	108,5
Belarus	99,7	113,9	102,6
Armenia	81,7	102,9	100,8
Kazakhstan	96,8	107,8	89,2
Kirghistan	102,9	109,1	103,0
Moldova	92,2	100,2	95,3
Russia	88,2	112,5	94,7
Tajikistan	102,7	107,2	110,1
Uzbekistan	108	...	117,7
Ukraine	82,2	116,8	83,8
CIS	91	112	94

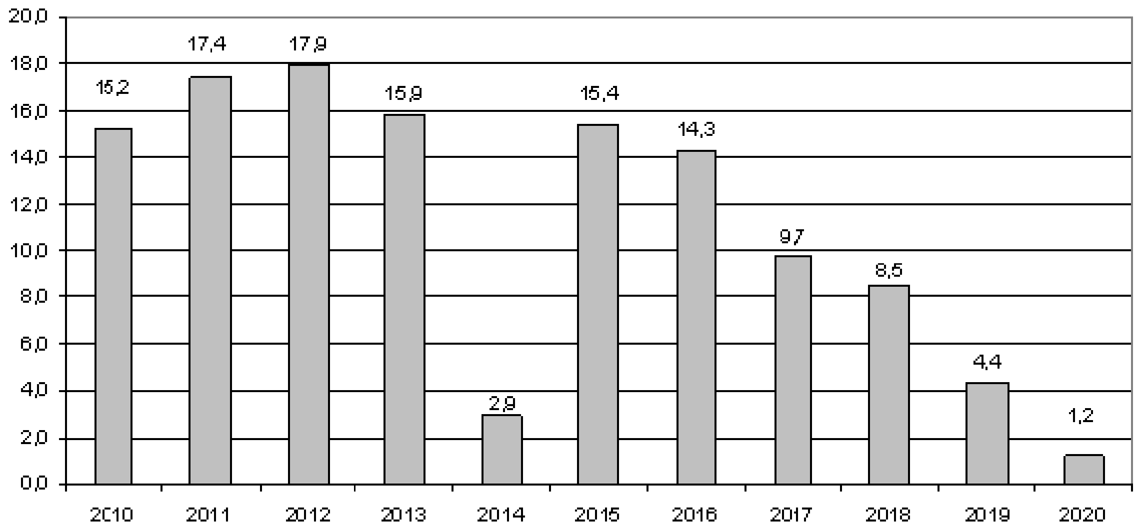
Source: State Statistics Committee of Ukraine, http://www.ukrstat.gov.ua/

Rapid Increase of State Debt – Not a Threat to State Economic Security yet?

2009 marked significant downfall of national economy and more importantly, rapid increase of country's national debt. According to the Ministry of Finances of Ukraine as of November 30th (and basically at the end of 2009) direct and guaranteed state national debt equals to UAH 286.1 billion (USD 35.871 billion). Over 2009 state debt of Ukraine increased by 45.8% in foreign currency (mainly due to the second and the third loan transfers in terms of stand-by arrangement supported by IMF[1]), which is USD 11.272 billion, while in national currency it increased by 51.1%, - UAH 96.876 billion (such situation was caused by providing state guarantees over corporate debts).

This number is especially striking comparing to 12.9% increase over 2006-2007. It can also be explained by the fact that the government provided state guarantees enabling restructuring of "Naftogaz of Ukraine" debts, which is the main state gas company. In 2010 debts of "Naftogaz" may serve as one of the biggest problems for the government and even economic security of Ukraine. Debts of the banks decreased by USD 8.6 billion and debts of other commercial organizations decreased by about USD 2.5 billion. At the same time the debts of the government and the National Bank of Ukraine increased by USD 12 billion. It is obvious that commercial debts were covered by the government and such policy is not sound and should not be continued in 2010. It should be mentioned that the state budget of 2009 included the expenditures on paying out the state debt which exceed relevant budget items in 2008 by four times (*Chart 1*).

Chart 1. Debt Repayment Plan (UAH billion)



Source: Ministry of Finances of Ukraine, available:
http://minfin.kmu.gov.ua/control/uk/publish/article?art_id=224494&cat_id=224493

Formally the numbers given above are within the line of state debt security (not exceeding 55% of country's GDP according to Ukrainian laws and relevantly 60% according to Maastricht Agreement), but the rate of debt increase is rather worrying. Further increase of state debt will affect budget security and investment attraction of Ukraine as well as threaten the stability of credit and monetary markets of Ukraine.

[1] IMF agreed to provide a stand-by tranche equaling to about USD 16,4 billion in terms of 2 year credit program. So far Ukraine received 3 transfers of about USD 12 billion, the fourth transfer has been postponed to the end of Presidential elections as well as after the state budget for 2010 is approved.

Real economic opportunities vs. populist promises given by state officials aiming for the Presidency

Economic policy of Cabinet of Ministers conducted during 2009 was largely criticized both by Ukrainian and international experts. The idea of using state gold and monetary reserves of the National Bank of Ukraine in order to receive the fourth transfer from International Monetary Fund as proposed by the Prime Minister was put under question by the IMF itself and opposed by Viktor Yushchenko, President at that time. Both IMF funds and national reserves should be used for levelling the payments, currency exchange rate and operating the debts, instead of populist social expenditures proposed in the programs of both candidates for the Presidency.

It should be underlined that the January payments for 2.55 billion cubic meters of gas supplies from Russian “Gasprom” were fully covered. The third tranche from IMF amounting to USD 3.5 billion was used to facilitate budget performance as well as for gas payments. It was made possible due to the decision of IMF to change criteria for Net International Reserves (NIR) in the current stand-by agreement and decrease USD 2 billion NIR rate in December. Such step allowed Ukraine to make use of the resources in terms of external payments, including gas supplies. Ukrainian authorities assured that taking into account these additional USD 2 billion and national reserves, Ukraine will be able to pay for gas in due time, even though the price in 2010 was raised from average USD 280 to 310 per 1000 cubic meters.

International experts emphasize that due to its high deficit Ukraine's budget can’t afford pension and wages raise as suggested by opposition leader Viktor Yanukovich and implemented by the Prime Minister Yuliya Tymoshenko, 2 main candidates during the election campaign of 2009. Thus, such policy aimed at raising social standards not backed up by realistic economic opportunities should be abandoned in 2010.

Economic perspectives of Ukraine for 2010 go hand in hand with Presidential elections, second round of which is to be held in February 2010. It is not surprising that programs of the two candidates are not very different when we analyze economic components. Both Tymoshenko and Yanukovich promote 60% of the state budget to be dispersed among local authorities; unrealistic decrease of tax burdens on citizens and business people; social benefits, overestimated GDP increase, low gas tariffs for Ukrainian population (however, Viktor Yanukovich also wants people with higher income to pay more for gas usage) and reducing gas prices in terms of new contracts with Russian Federation.

Special attention should be paid to the controversial issue of “re-privatization” – the process of nationalization of certain big strategic enterprises (which, according to the government's opinion, were “wrongfully” acquired by their owners) with the further aim to make them privately owned again, preferably by foreign investors. As the main lobbyist of such instrument for filling up state budget Yuliya Tymoshenko will most definitely renew the process of re-privatization, if she is elected the President of Ukraine, notwithstanding the fact that previous cases were strongly opposed by Viktor Yushchenko and entailed much debate among Ukrainian and foreign investors. As this process may reflect arguments between different business groupings in Ukraine, Viktor Yanukovich is unlikely to take such aggressive measures, but there is a risk of creating unfavorable conditions for significant foreign investors already working in Ukraine in order to support those national companies which finance certain political parties.

Both candidates held the position of the Prime Minister twice. Tymoshenko's relevant actions were marked by manual and even chaotic economic measures, in particular, while managing the state budget, by allocating and borrowing funds to cover sometimes unnecessary expenditures. Since Yanukovich's previous tactics and his proposed program for 2010 are more systematic and socially oriented, we expect him to concentrate on raising pensions, wages and other payments though not having sufficient financial means. Consequently, due to the lack of relevant legislation excluding potential business lobbying by state officials, corruption schemes in managing state finances will probably exist under the Presidency run by any of the candidates.

Problems to be solved in 2010

The most urgent item on the agenda for the future President and the Cabinet of Ministers is the final approval of State Budget for 2010. It is a precondition for receiving the fourth loan from IMF and it may serve as a positive signal for other creditors. Regardless the fact that the Cabinet of Ministers submitted a report on implementing the 2009 budget to IMF, it tries not to announce the report widely to the public while the Prime Minister is running for the Presidency. The reason behind such situation is the fact that the budget “lacks” UAH 81.5 billion (taking into account planned deficit, bank recapitalization and debts of “Naftogaz” of Ukraine). More strikingly, as of January 1st, 2010 State Treasury Account holds UAH 1,1 billion reaching its minimum over the last four years (i.e. as of December 1st, 2008 the account held UAH 20.9 billion).We believe that such warning numbers should motivate any of the candidates to review their populist promises and restructure the draft budget for 2010, excluding clauses aimed at unaffordable raise of social payments.

In conclusion, it should be emphasized that 2010 seems to be a very difficult year in economic terms as Ukrainian authorities will also have to find solutions for the following problems: rapid decrease in tax revenues, decline in major industries, bank crediting slowdown and, in particular, gas supply payments. The latter payments are to be increased in 2010 by 1.5 and will equal to USD 9.5 billion comparing to about USD 6 billion in 2009. As gas prices were not raised for

Ukrainian citizens, contrary to the requests of IMF, fiscal burden of extra USD 1.3 billion will be covered by the government.

Ukrainian economy will start its slow pace of recovery parallel to the global economic improvement, involving renewal of export activities, in particular metallurgy, chemicals, agricultural products, which are traditional areas for Ukrainian export. The idea of economic growth due to developing innovation and IT industry in Ukraine, found in Yuliya Tymoshenko's program, being a necessity in global terms, should be considered in the long run. Unfortunately, none of the candidates has a clear long term economic strategy. Both of them are likely to refer to the world crisis and make quick decisions “on the spot”.

Analyzing the situation from the legal perspective and taking into account provisions of current Constitution in Ukraine (amended in 2004) we may agree that economic power is focused in the hands of the Cabinet of Ministers of Ukraine, so economic programs proposed during elections may not be as important as appointing the new Prime Minister with efficient and reformative skills.

Will the oil-revenues be enough to accelerate Kazakhstanian transition into a much more diversified economy?

Olivér Kovács

Introduction

The Kazak's gross domestic product is likely to be hard hit by global economic turmoil. Its strong growth potential – the real GDP grew with 13.5% in 2001 – has obviously evaporated since the eruption of the crisis, which was accompanied with decline in oil-prices. This caused lower revenues, which was heightened by tax exemptions in reference to foreign firms working on large oil and gas projects.

The first question of this article is even if it seems that Kazakhstan has been able to maintain its oil-oriented export activity for years, can we expect a heightening transformation into modern and divers industrial economy in the near future or will it be hampered? The second question is in a way in connection with the first one. What trends can be anticipated in the foreign direct investment activity?

Macroeconomic position

CIS countries were attributed for a long time to the deep transformational recession as a result of the disintegration process of the Soviet Union. After the collapse of the decaying Soviet Union Kazakhstan had to inaugurate some stabilization measures in order to consolidate its economy. Albeit, its growth took a nosedive with its huge downturn in the first years of transition, the recovering process started in 1999 and it was supported by increasing income stemming from the tapping and exporting of natural resources. The growth performance improved especially after the discovery of Kashagan oil field in 2000.[2]

Numerous studies pointed out that the natural resources are able to trigger negative effect on GDP growth. The main findings bolster up that this effect mostly relied on the level of institutional development. Thus, natural resources can be regarded as *resource curse* in countries maintaining low quality of institutions.[3] There are many reasons behind why can institutions be conserved in a low quality level. First and foremost we have to consider the counter-incentive factors which obstruct the development (e.g. parallel economy, corruption). Kazakhstan can be attributed to

[2] Kashagan is located in Caspian Sea, and it was the biggest oil find of the last 30 years. After its discovery the Kazak GDP growth rate climbed at 13.5% in 2001. See IMF 2009, available: http://imf.org/external/pubs/ft/scr/2009/cr09300.pdf

[3] See Mehlum, H. - Moene, K. - Torvik, R. (2006): Insitutions and the Resources Curse? The Economic Journal 116. 1-20. p.

these factors, which are hampering government to make efforts in order to develop institutions. Corruption undermines and slows down the democratic development, the diversification efforts, and the performance of state institutions and efficient utilization of resources as well.

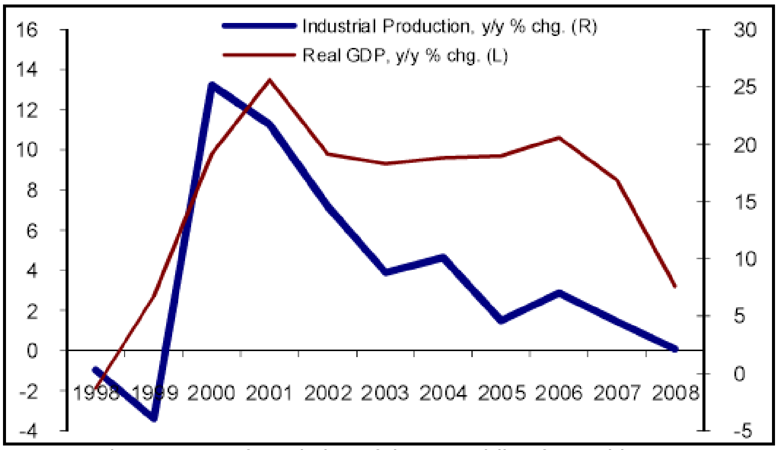
Table 1. Economic indicators of Kazakhstan (1990-2008)

Kazakhstan	1990	1992	1994	1996	1998	2000	2002	2004	2006	2008
Unemployment Rate %	n.a	n.a	n.a	n.a	n.a	12,8	9.3	8.4	7.8	6.6
Consumer Price Index, Growth Rate	n.a	n.a	1877	39.2	7.1	13.2	5.8	6.9	8.6	17.2
GDP growth %	n.a	-5.3	-12.6	0.5	-1.9	9.8	9.8	9.6	10.7	3.3
Private Sector Share in GDP %	10	12	20	25	65	65	65	65	70	70
Balance of Current Account GDP %	n.a	n.a	n.a	-3.6	-5,5	2	-4.2	0.8	-2.5	4.9
Inward direct investment*	n.a	n.a	n.a	1137	1151	1283	2590	4157	6278	14648
Outward direct investment*	n.a	n.a	n.a	0	-8	-4	-426	1279	385	-3826
Corruption perception**	n.a	n.a	n.a	n.a	n.a	3	2.3	2.2	2.6	2.2

Note: *in million US$.
**Transparency International Corruption Perception Index, with higher value indicating less corruption.
Source: UNECE Statistical Division Database, compiled from national and international (CIS, EUROSTAT, IMF, OECD) official sources.

The conceive of Kazakhstanian structural reforms led among other things to an imbalanced industrial output with the priority of oil and gas extraction (*Chart 1).* The distribution of sectors shows that the service sector takes the biggest slice of GDP with its 53.9% (industry 40.5%, and agriculture 5.5% of GDP).

Chart 1. Discrepancy between industrial production and real GDP



Source: The Agency of Statistics of the Republic of Kazakhstan

The reforms also led to a perceptibly enlarged private sector and to the increased inflow of foreign direct investment as well. In turn, there is no significant direct investment activity by the banking sector; on the contrary FDI has been concentrated only in a few sectors (oil, gas and minerals). International investors has been refraining themselves from considerable investment into the banking sector, because of its underdevelopment and the lack of convincing international policy and practice standard. Thus, the financial sector will not strongly foster the diversification process. It goes without saying that causality operates in both directions, as an effectively functioning financial system enables a society to raise the propensity to invest in risky but more productive projects, to fund new ideas and firms, thereby determining the degree of economic diversification. It seems that these facts roll hurdles in front of the Kazak's diversification effort in the long run.

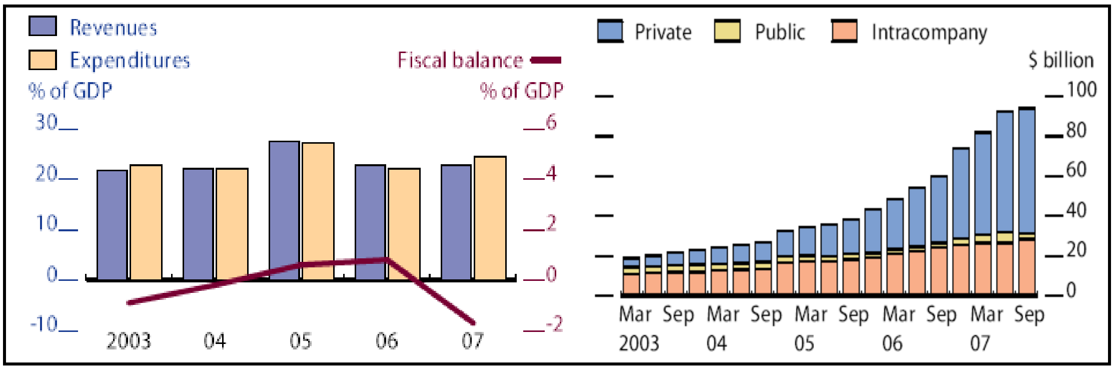
Status quo: Oil dependent state

Due to the favourable oil prices during the last decade Kazakhstan could manage its economy with surpassingly positive growth rate. This *per se* reveals the vulnerability of Kazakhstan through its oil-dependency, because all macroeconomic variables are highly oil price-sensitive.[4] Oil revenues generated approximately 39% of total government revenues and represented as high as 11% of the country's GDP (it was roughly between 20 and 40 percentage of GDP in the 2000-2006 period).

These changes imply that the growing GDP provides wider latitude for further consolidation of socio-economic situation, but it seems not realistic. If we try to pounce on the extraction dependency of Kazak GDP we take our focus on fiscal position.

After all the deficit and debt service process informs us about the consolidation willingness of government. High fiscal deficit, debt and debt service can be interpreted as the government has not got so distinct imagination and pro-activity for stabilizing and taking structural arrangements in order to dampen the burden on its own people.

Chart 2. Fiscal indicators and the composition of Kazakhstan's external debt (2000-2007)

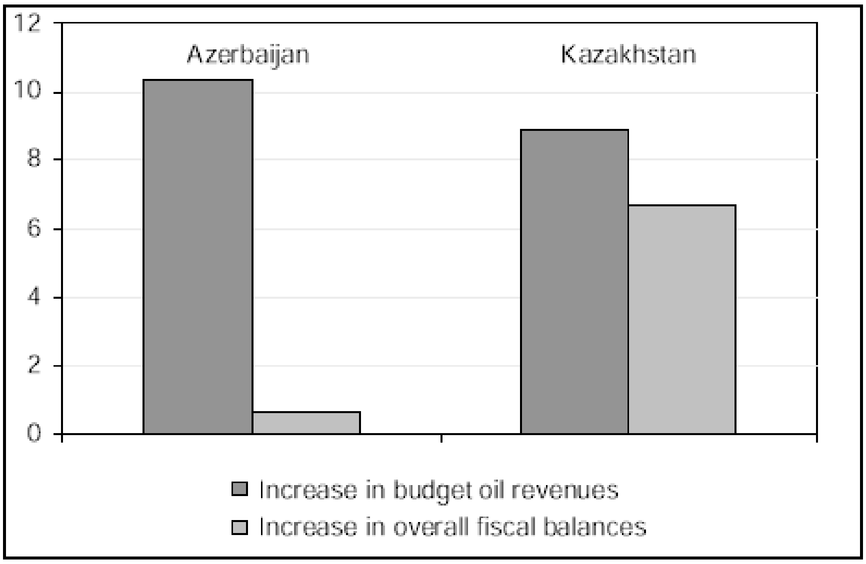


Source: National Bank of Kazakhstan

As it depicts on Chart 2 the revenues could overcompensate the expenditures, and the private external debt eclipses the volume of public debt. It is worth noting that the another petro-state Azerbaijan has gone through similar revenue soaring period at the same time, but in contrast Kazakhstan did not accelerate parallel its public spending like Azerbaijan did. Moreover, Kazak government saved the most of extra budget oil surpluses and ploughed them back for debt abatement. This can be recognizable on the Chart 3, Kazak's overall fiscal balance improved better than in Azerbaijan.

[4] For instance it is represented by inflation which course was above at 6% since 2003.

Chart 2. Increase in budget oil revenues and overall fiscal balance in 2006 (% of GDP)



Source: Asian Development Bank, 2007.

It is seemingly a good commitment by government, but if we take account that Kazak's fiscal performance including debt structure cannot be painted as an extremely precarious position, it is not so beatific. The stock of public debt is not too high, and the external debt is also generated by private sector. Therefore we can miss the appropriate measures for better socio-economic conditions. While we emphasise the importance of these measures, it is worth to mention that the debt management seems to be sustainable if the oil prices are favourable, but the dependency does not dampen until the economy as undiversified as nowadays. The socio-economic situation will not improve unless the government tries to make structural reforms in line with the modern challenges (e.g. pension system, tax system, health and education, infrastructure) and spends more on education, innovation and research which are the major contributor to economic growth in long run. But it needs the abandon of status quo.

Foreign direct investment

Kazakhstan simultaneously suffers from external and internal problems as well. The internal problem based on the fact that Kazak's economy is oil-rich which is a massive counter-incentive to institutional development to become more diversified and not too nationalised country. Within the confines of these above mentioned problems, the foreign direct investment activity was – especially after 2000 – considerable due to the opportunity to reach great profit potential in the oil-rich country. But, the credit crisis as an external impulse affects negatively the Kazak's economy. The number of mergers and acquisitions were decimated by the credit crunch. It is especially bad constellation, because of the special condition of foreign investment market.

Since the 1990s the largest target sector was the natural resource sector among foreign investors due to the favourable tax circumstances. Foreign investors gave tax exemptions stipulated in the contract signed in 1990s. This is a risky undertaking for budget revenues, but attractive to foreign investors. In order to be investment market in line with the new challenges, the tax exemption system was abolished by new tax laws took place in 2009. The new tax code increased state control as well, and indicated the different alluring-power of natural resources sector.

Conclusion

All in all, the classic *resource curse* phenomenon can be discernibled in the Kazak government's sentiment about the spending extra oil-revenues. Instead of spending extra oil-revenues on among more fields, the government insists on the *status quo*. To this end, the government has to break this *status quo* by diminishing existing administrative barriers ahead of foreign direct investors, providing the enforceability of warranties and indemnities, eliminating corruption to be the public administration transparent, as well as the regulation of financial sector. As the financial intermediation improves, and the banking system begins its more efficient lending practice, SMEs could develop, innovate and expand in various sectors.

Eventually, the state could be able to promote income independency on oil and gas export, it would be especially important, when the international financial markets are provide the most of bank and portfolio sources of Kazak's external financing. This also means that the Kazak's economy needs more than an initiative tax code changes, the process must go further. The maintained attraction of foreign investment provides efforts for government to stick henceforward to the *status quo*. Until it comes to that, we cannot expect the above mentioned heightening effect on the Kazak transition. The Kazak's economy will sensitively react to the weak global economy, through succumbed exports committed by declining oil prices.

The „wizzing" story of WizzAir or the importance of intangible assets

*Szilárd Földházi**

The Beginning and Background

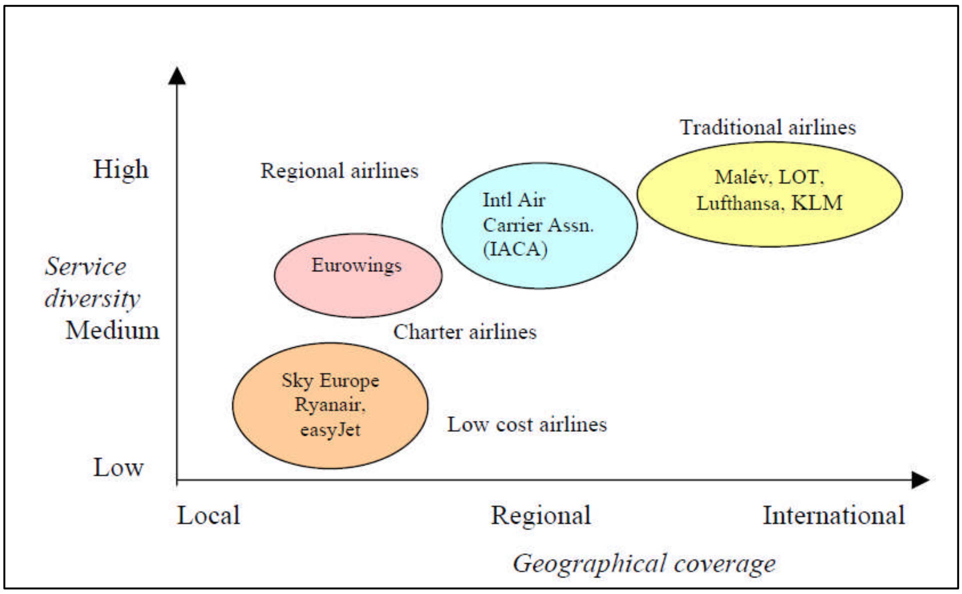
'Now we all can fly!' sounds the motto of the biggest Central European airline, indicating the aim of the company: to offer those passengers an affordable alternative, who travel long distances by train or bus. The airline provides a cheap way of travelling to the most popular European destinations. Out of 100 newly established companies in aviation, 97 go bankrupt in the first 2 or 3 years. This is especially true in the last 10 years when the aviation industry suffered from many problems mostly the effects of 9/11 and the financial crisis after 2007, which resulted in a fall in business and other travel. Competition is tough and even if the aviation market is growing they have to face more and more challenges, such as higher fuel prices and lack of trust in aviation after some big airplane crashes.

Analysing the airline industry according to Porter's Five forces model, we can see that there is a big competition and tension but strong connection between the bargaining power of suppliers, buyers, and potential new entrants, substitute products and services. For example when the management wanted to close the terminal building of Weeze Airport in Germany for the nights, Ryanair 'blackmailed' it by threatening to leave the airport. As a result, Weeze Airport is still open 24/7. Meanwhile, secondary airports gain more and more importance because of low cost airlines, major international airports are also involved in the process, as most of the passengers coming from overseas take another, in many cases discount airline, to reach their final destination. There is a threat that non-European companies will enter the market and there are threats for low cost airlines that most of the traditional airlines try to benchmark, cut on costs, and sell tickets for a competitive price.

The plan to launch a discount airline was conceived in June 2003, when six people with considerable airline expertise and successful track records from across different industries, teamed up with József Váradi, the former CEO of the Hungarian Airlines, Malév. The main idea behind the foundation of a new discount airline was the entry of Poland and Hungary in the single European aviation market due to the enlargement the European Union in 2004, and the low competitiveness of the national airlines in Central Europe. József Váradi realized the opportunity and the demand and was quick enough to found the company before West European competitors like Ryanair or EasyJet could take up the Central and Eastern European market.

* Szilard Foldhazi is student at Corvinus University Budapest studying International Business, working part time for Wizz Air.

Chart 1. Strategic groups within world airline industry



Source: My adaptations based on pattern from Grant, 2002. pp.67

The team of József Váradi could use the intangible and tangible assets they have accumulated, and not more than 19 days after the enlargement of the European Union in 2004, Wizz Air entered the aviation market and the first plane took off from Katowice to London. The first flight from Hungary departed one month later from Budapest to Athens.

During the years József Váradi spent as manager, later as CEO of the Hungarian National Airlines, Malév, he could learn a lot about the aviation industry and this knowledge combined with the experience of the P&G efficiency, where he worked before, could change a lot in the state owned company. They cut Malév's loss, by about USD 50 million a year, made the organization more efficient, begun to prepare the company for privatization and run the project Malév Express, which is considered a pilot project of Wizz Air.

Before his dismissal in 2003, there was a small group of six people with whom he worked closely at Malév. This group, whose members have a deep knowledge of the aviation industry, had trust in József Váradi and saw an opportunity in the foundation of a low cost airline in Central Europe. They became the founders of Wizz Air.

Basic information	
Foundation	2003
Capital	est. 40 Million Euros
Measure of the fleet	26
Routes operated	120+ routes to 18 countries and 52 destinations
Carried passengers:	6.2 million in FY 2008 (8 million expected in 2009)
Basis Airports	Budapest-Ferihegy T1 Bukarest-Băneasa Airport Gdańsk-Lech Wałęsa Airport Katowice Internatioanal Airport Kijev-Boryspil International Airport Cluj Napoca Airport Poznań-Ławica Airport Sofia Airport Timisoara-Traian Vuia Airport Warshawa-Frederic Chopin Airport Praha-Ruzyně Airport
Employees	900+
Mother Company	Wizz Air Limited, London
Management	Hungary, Vecsés
CEO	József "Joe" Váradi
Web Page	www.wizzair.hu

On the 10th of June, 2003 Swing Management Ltd. was founded with a capital of approximately Euro 60,000. This was the capital which the founders paid from their own pockets, in order to run the company until they find investors. At this point Mr. Váradi could offer no salary but 'blood and sweat' for his team. They created the business plan and went on a road show to collect venture capital. They needed Euro 2 million in the first round and an additional 30 million until the first flight is launched.

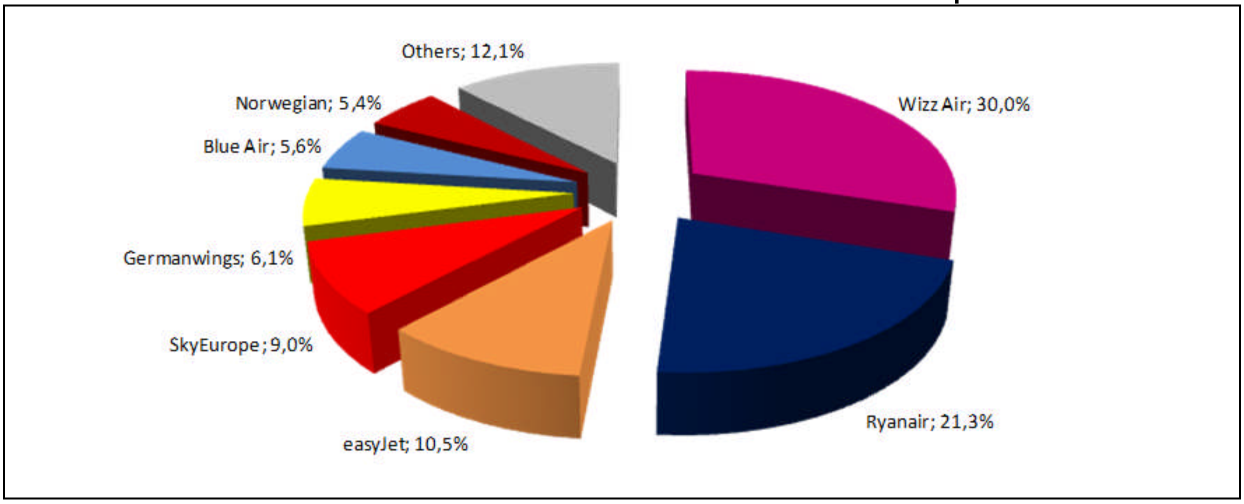
The company's strategy can be described by a few main elements. After the foundation of the company they tried to achieve seize thrift as soon as they could. As being a devotee of the ultra low cost model, they created a productive organization (8,000 passengers/employee/ year), using secondary airports and buying brand new airplanes because of technical reliability, which spend at least 13 hours a day in the air, compared to the 8 hours average of the aviation industry. To be a cost efficient airline there is a need for bases where they can provide technical support for the planes. It means Wizz Air stations 26 airplanes in 11 cities. These airplanes are all leased. All the new planes get into the ownership of GECAS, a company specialized for leasing out to the aviation industry. Wizz Air leases the planes for 11 years, but after five-seven years they begin to resell them, as reparation and servicing become more costly and older planes become more and more unreliable.

According to Wizz Air's philosophy they really try to make passengers pay only for services they actually use. Thus they can offer tickets for a really good price even for 10-20 Euros, which are sold on the Internet exclusively. During the financial crisis in 2008, when all airlines tried to cut costs as much as they could, the management of Wizz Air followed a different principle. The company expanded. It has just purchased the 26th 180-seat Airbus 320. This strategy has enabled Wizz Air to possess more than 30 percentage of the market share of discount airlines in Central Europe.

Ownership Structure

There is no public information on the ownership structure of Wizz Air Ltd available, however it is known that four Hungarian and British, German, Swiss and Polish companies and private investors, 20 altogether, put together the base capital of the company. It was registered in London in September 2003, because there was the most capital available for this type of ventures. The venture capital, needed for really launching the company, was provided by Indigo Partners, owned by two 'gurus of aeronautics' Bill Franke and David Bonderman, who were specialized in financing new companies of the aviation industry. József Váradi could only promise the investors, that they will get their money back quadrupled or quintupled, when the company's shares will be introduced on the stock exchange. The investors saw the potential and trusted the experience which he had. According to our estimation, about 50 percent of Wizz Air is owned by the American company, Indigo Partners, there are European investors and the share owned by Hungarian individuals can be only 1 or 2 percent. Even if the percentage owned by the Hungarian founders is negligible they have a big freedom in decision making, as investors do not have their say in the management of the company. The management is mostly Hungarian, strategic decisions are made by them, and also the headquarter is near the Hungarian capital, Budapest, that is why the company is regarded Hungarian.

Chart 3. Market share of discount airlines in Central Europe



Source: OAG Capacity Statistics for April 2009

Intangible Assets – The Key to Success

Intangible assets were really important at the beginning. These assets do not have the physical value of a factory or equipment, but they can prove to be very valuable for a firm and can be critical to its long-term success or failure. In the beginning József Váradi and his team possessed almost solely intangible assets.

These were their experience at Malév, personal contacts, deep knowledge about the aviation industry and as non intangible assets: less than Euro 60.000. It was important to build up the network with the stakeholders, such as investors, airplane manufacturers and suppliers.

Brand recognition is not a physical asset you can touch; its positive effects on bottom-line profits can prove extremely valuable to firms. So the team decided not to brainstorm but commissioned a professional boost agency in London, named FutureBrands, to create the brand. Other definite intangible asset is the General Conditions of Carriage which contains the elements of the business model and the online platform where the tickets are being sold. These assets could be bought for a price that time but now it is really hard to estimate their value, because of the ever growing company.

The value of the admission of the aeronautical authority, agreements with airports all around Europe, value of lobbying at national government cannot be measured but they have a strategic value for companies like Wizz Air. The organisational structure of the company, which was also created by a professional HR partner, is proved to be very valuable. Another very important asset is the passenger satisfaction and the trust in the airline, as it is somehow similar to a bank: any lack of trust because of delays or a plane crash can cause substantial loss directly and indirectly.

Foreign Direct Investments of Wizz Air

On foundation of Wizz Air it was clear that the company will be based on the East and Central European mostly Polish and Hungarian markets. After the registration of the company in London they immediately set up the Hungarian and Polish subsidiaries. Later Wizz Air Bulgaria was established as a subsidiary when the country joined the European Union. Wizz Air also operates in Ukraine. Wizz Air Ukraine is completely separated from the mother company because of legislative reasons. It uses only the brand and the main IT infrastructure.

Costs linked to appearing on a new market with a new base amount to approximately USD 100 million. This is the cost level, which Wizz Air takes into consideration before opening to a new country like Romania. An estimated investment of USD 100 million is needed to develop the infrastructure and gain a sufficient market share that is needed for efficient operation. Based on this estimation, the total value of foreign investments of this discount airline may be around USD 500 million. Due to the dominant foreign ownership these are regarded as ‘indirect’ outward foreign investments from Hungary.

Summary

The 'Wizzing' Story of Wizz Air underlines the importance of intangible assets. The history of this company hardly resembles other companies' in East and Central Europe. It was able to obtain a relatively large amount of venture capital and launch a successful company that was not only able to survive the first year and the biggest crisis of the last decades but even to expand to other countries and increase its market share in East and Central Europe. It is also a relatively important factor in Hungarian direct outward foreign investments due to its regional expansion strategy.