

University of Economics, Prague
International Business



**Business, Trade and Investment relations between the
Czech Republic and Germany
(from the Czech perspective)**

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Scholar year: 2017/2018

Declaration:

I hereby declare that I am the sole author of the thesis entitled Business, Trade and Investment relations between the Czech Republic and Germany (from the Czech perspective). I duly marked out all quotations. The used literature and sources are stated in the attached list of references.

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Acknowledgement – *this is not compulsory, only if you wish*

I hereby wish to express my appreciation and gratitude to the supervisor of my thesis, doc.
Ing. Ludmila Štěrbová, CSc.

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Introduction

The Czech Republic and Germany, due to their close geographical location, have a long and rich history of common trade. I find it interesting how this relationship evolved throughout history. How business and culture mixed together and then were separated, only to get together once again. Why in some cases the business culture is very similar, and on the other hand, sometimes very different.

Yet another, maybe more personal, reason why am I so interested in this topic is my personal relation to Germany. I have always liked this country. I strongly admire their economic success after WWII, which I consider to be close to a miracle. I appreciate the way Germans work and handle business and I would be extremely honoured if I could work in this country at least for a while.

These and many other reasons made me curious as to how the relationship regarding business, trade and investment has evolved in recent years. For these reasons I've decided to analyse their development. Therefore, the aim of this thesis is to find out whether this relationship is getting stronger, weaker, or if it is stagnating and who is better off in this relationship, since the Czech Republic joined European Union in 2004.

To be able to do so, I divided my thesis in to three main pillars, which will help me to find out the answers to my questions.

In the very first pillar or chapter I have focused on the brief history of the business relationship between the Czech Republic and Germany. This chapter consists of two parts, their relationship from 1993 until 2003 and more importantly on the time since the Czech Republic accessed the European Union in 2004.

In the second chapter I've written about trade and investments between the Czech Republic and Germany. Here I analyse the total amount, structure, and influence of trade, then I analysed the investment properties between these two countries. To be able to differentiate for the purpose of more detailed results, I divided this chapter into two subchapters. The first one will focus on the trade itself, whereas the second will focus on the investments that take place between these two countries.

In the final chapter, I've outlined one of the biggest investments of a German company in the Czech Republic, namely Volkswagen's acquisition of ŠKODA Auto. Here I have tried to analyse this case by following these steps: investment analysis (the reasons to

buy ŠKODA Auto), the problems connected to the acquisition and the first years after the acquisition, and the current status.

When I am done with these three pillars I should be able to analyse their development and be able to answer the questions aforementioned at the beginning. Those questions being:

1. Is the business, trade, and investment relationship between the Czech Republic and Germany getting stronger, weaker or is it stagnating?
2. Is this relationship more beneficial for the Czech Republic or Germany?

1 Historical Development of Trade and Investment between the Czech Republic and Germany

1.1 Before Czech Accession into EU (1993 till 2004)

1.1.1 Political Evolution

The Czech Republic and Germany have been good business partners for many years. This is most likely due to their close geographical proximity. Unfortunately, despite welcoming conditions, any kind of trade was almost impossible for over 40 years. This was caused by political influence in the Czechoslovak Republic, which was generally against trade with Western countries. Therefore, I will focus mostly on development after 1993; a year in which the Czech Republic was no longer under a communist government, a time in which Germany had already reunited, and a year in which the Czech Republic and Slovak Republic divided into two sovereign states.

Also, by 1993 the Czech Republic and Germany had already signed many preferential treaties supporting trade between these two countries, and were in the process of, or about to sign new ones. The two most significant treaties, that helped to improve trade and business between these two countries from the very beginning, were:

- *“Treaty between CSFR and Germany about support and mutual protection of investments, in Czech: Dohoda mezi ČSFR a SRN o podpoře a vzájemné ochraně investic (č. 573/1992 Sb.) Or in German: Vertrag zwischen der Tschechien und Slowakischen Föderativen Republik und der Bundes Republik Deutschland über die Förderung und den gegenseitigen Schutz von Kapitalanlagen*
 - *This treaty was signed in Prague at 2. 10. 1990 and entered into force 2. 8. 1992.”*
- *“Treaties for the avoidance of double taxation for income and property tax, in Czech: Dohoda o zamezení dvojího zdanění v oboru daní z příjmu a z majetku (č. 18/1984 Sb., podepsaná dne 19. 12. 1980 v Praze, platná od 17. 11. 1983). Or in German*

- : *Abkommen zwischen der Bundesrepublik Deutschland und der Tschechoslowakischen Sozialistischen Republik zur Vermeidung der Doppelbesteuerung auf dem Gebiet der Steuern vom Einkommen und vom Vermögen.*
 - *This treaty was signed 19. 12. 1980 and entered into force 17. 11. 1983.”*
(MZV, n.d.)

These two treaties laid the groundwork which helped to improve future cooperation regarding business and investment between these two countries. The first treaty is especially important. It provides equal rights and possibilities for investors from both countries to invest in the other's country. This means that in reality, a German investor has got the same right to invest in a Czech firm and there is no restriction by either a government or any other subject allowed. So, no limits, no prioritizing investors from home country or other countries. This right works both ways.

The second treaty is essential for workers who are working outside of their home country as well as for entrepreneurs or firms operating in a foreign country. It prevents double taxation which would likely be very costly. If it was the case that there was no treaty preventing double taxation, a company, an entrepreneur, or an employee would have to pay the full tax burden, first in the foreign country and then again in their home country. This would cause high entry barriers for companies considering expansion into a foreign country, therefore limiting future possible investments and trades between those countries, as well as adding limitations for exchange of labour force between the countries. Luckily, the Czech Republic and Germany have signed this treaty with each other as well as with most of the countries they do business with.

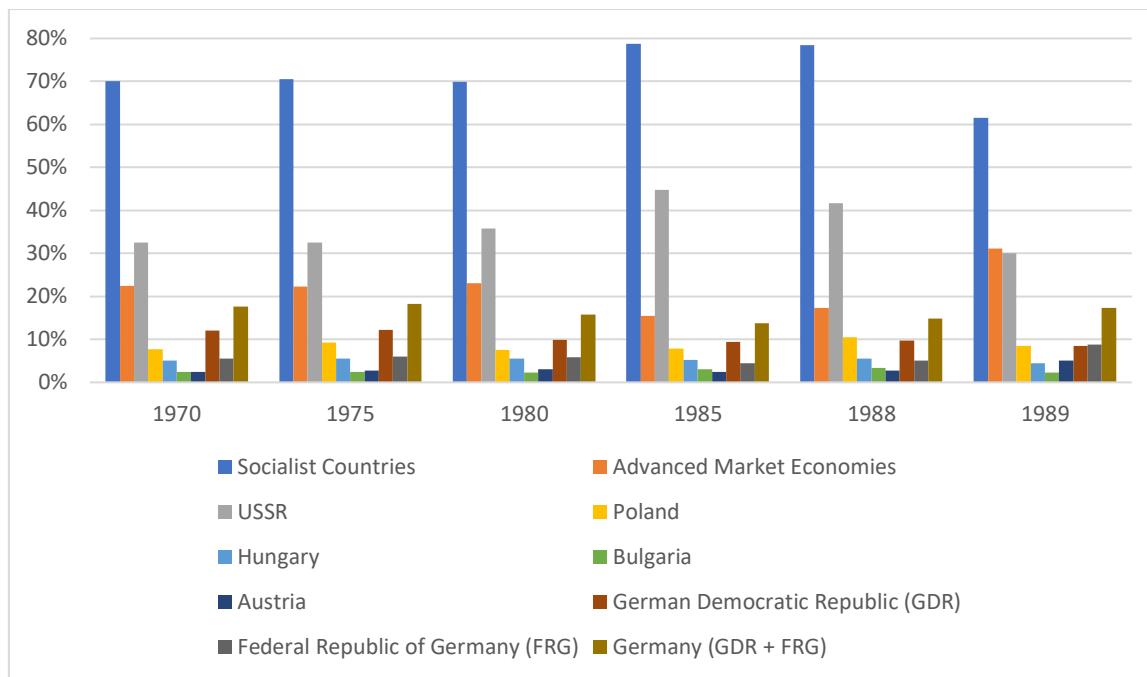
These two treaties were shortly followed by many other treaties which further improved the possibilities and rights of companies and entrepreneurs doing business between the Czech Republic and Germany. All these treaties signed, after those two, are still in force, though many of them are already outdated or have been overpowered. Since the Czech Republic accessed the European Union (furthermore referred to as EU) many of them are already involved in common EU legislation.

1.1.2 Economical Evolution

Political development between the Czech Republic and Western countries started to develop in a positive way since the end of the 80's and beginning of the 90's. This led to a massive increase of trade between the Czech Republic and Western Europe. This

development was especially successful between Czech Republic and Germany. These two countries created close connections in both political and economic terms which seems to continue and grow till nowadays.

Figure 1: Territorial orientation of foreign trade of Czechoslovak Federative Republic in years 1970-1989 (in %)



Source: (Průcha, 2009)

Though, before late 80's the Czech economy, which at that time was the economy of the former Czechoslovakia, was mostly oriented towards the Eastern bloc. Around 70% of all Czechoslovakian trade at that time was with countries of former Eastern bloc. Trade with countries like Poland, Hungary or Bulgaria were reaching numbers of around 8%, 5% and 2% respectively. Nevertheless, the most important business partner at that time was former USSR. Czechoslovakia was doing more than one third of its all trade with Russia and in the year 1985 the numbers reached 44,8% which is almost half of all trade done by Czechoslovakia. This was much more than the total trade with all of western market economies in total. In this particular year the trade with the West reached 15,5% which was the lowest point in the last 15 years. Even though the trade with the West slightly increased, the percentage was still very low. In the years 1970 and 1980 the total amount reached 22,4% and 23,1% respectively.

The only large trade partner from the west was Germany. Though at that time Germany was divided in to two parts, both of them were of trade importance for

Czechoslovakia. The German Democratic Republic (abbreviation: GDR), throughout the years 1970 - 1985 was the second biggest trade partner after USSR, and the Federal Republic of Germany (FRG) was the biggest western market economy partner.

The change of business partners that came in the 90's was not as unexpected as it might seem. Germany was already, for many years, a good business partner, and the fact that Russia, along with most of Eastern Europe, was facing hard economic conditions helped to make the transition from Russia to Germany easier and more natural.

This newly build relationship worked in both ways. While the Czech companies were exporting to Germany, German companies saw a great potential to export, invest, and do business with their Czech counterparts.

In table 1 we can see a constant growth of trade. These two countries managed to maintain this pattern since the very beginning of trade between Germany and the independent Czech Republic for over 10 years without any drop in volume.

As we can see in the table, published by the Czech Ministry of Foreign Affairs, the exports and imports were growing on both sides. If we look closely at the growth index, we can clearly see that the growth rates were relatively similar, with one country growing faster in one year and the second one in the next year. Though growth was relatively balanced, we can monitor a trend of growing positive trade balance on the side of the Czech Republic, except for the first year and then in years 1995, 1996 and 1997. In these years, German export into the Czech Republic as well as the growth rate overcame the Czech export and growth rate.

Table 1: Volume of Czech Export to and Import from Germany in thousands of Euro, since 1993 till 2003

										In thousand
	Export			Import			Turnover			Balance
	Euro	Ranking	Index	Euro	Ranking	Index	Euro	Ranking	Index	Euro
1993	3 589 107	1.	-	3 638 833	1.	-	7 227 940	1.	-	-49 726
1994	4 592 915	1.	128,0	4 387 588	1.	120,6	8 980 503	1.	124,2	205 327
1995	6 109 118	1.	133,0	6 111 696	1.	139,3	12 220 814	1.	136,1	-2 578
1996	6 436 534	1.	105,4	7 102 658	1.	116,2	13 539 192	1.	110,8	-666 124
1997	7 150 792	1.	111,1	7 691 147	1.	108,3	14 841 939	1.	109,6	-540 355
1998	8 870 141	1.	124,0	8 693 776	1.	113,0	17 563 917	1.	118,3	176 365
1999	10 335 606	1.	116,5	8 998 668	1.	103,5	19 334 274	1.	110,1	1 336 938
2000	12 735 790	1.	123,2	11 247 913	1.	125,0	23 983 703	1.	124,0	1 487 877
2001	14 213 070	1.	111,6	13 393 501	1.	119,1	27 606 571	1.	115,1	819 569
2002	14 832 533	1.	104,4	13 972 157	1.	104,3	28 804 690	1.	104,3	860 376
2003	15 926 198	1.	107,4	14 738 070	1.	105,5	30 664 268	1.	106,5	1 188 128

Source: (MZV, n.d.)

Rather surprising is that the growth rate was not constant. In general, we can say that the growth rate was decreasing. From the year 1995, where the growth rate was over 36%, to the year 2002, we can see that the growth rate dropped to as low as 4.3%. Yet even the decline was not steady, and we can see huge deviations. In 1995, growth was reaching 36% and suddenly in 1996 the growth rate dropped to as low as 10%, to be followed by a big increase of growth by almost 20% in year 1997.

From this evolution, we can see that the first years of Czech and German cooperation were pretty dramatic and unstable to some extent.

1.2 After Czech Accession to the EU (since 2004)

On the first of May 2004, the Czech Republic, entered the European Union. This was a huge step towards further improvement of Czech trade possibilities with countries within the EU as well as towards non-EU countries thanks to EU support. Entering EU and its European single market has many benefits for all member states. *“The Single Market refers to the EU as one territory without any internal borders or other regulatory obstacles to the free movement of goods and services. A functioning Single Market stimulates competition and trade, improves efficiency, raises quality, and helps cut prices. The European Single Market is one of the EU’s greatest achievements. It has fuelled economic growth and made the everyday life of European businesses and consumers easier.”*

From all the benefits that EU provides to their member states, the most important of them for business are:

1. Single Market for Goods – *“The EU Single Market accounts for 500 million consumers and 21 million small and medium-sized enterprises (SMEs). The Commission’s main goal is to ensure the free movement of goods within the market, and to set high safety standards for consumers and the protection of the environment.”*
2. Single Market for Services – *“Services are crucial to the Single Market. They account for over 70% of all economic activity in the EU and a similar proportion of its employment. EU companies have the freedom to establish themselves in other EU countries and the freedom to provide services in countries other than the one in which they are established.”*
3. Elimination of Barriers to Trade – *“The Commission works to remove or reduce barriers to intra-EU trade and prevent the creation of new ones, so enterprises can trade freely in the EU and beyond. It applies Treaty rules prohibiting quantitative restrictions on imports and exports (Articles 34 to 36 TFEU) and manages the notification procedures on technical regulations (2015/1535) and technical barriers to trade.”* (European Commission, n.d.)

These advantages of the single market are the biggest supporters of economic growth within EU, that support all forms of trade across borders as well as within one country. The possibility of easy expansion creates an environment where it is relatively easy to reach an

economy of scale, or at least makes it easier than with the previous barriers on borders in form of duties and other import taxes as well as non-tariff barriers.

As a member of EU, each state has obviously got many more benefits, as well as obligations. When the Czech Republic accessed the EU, Czech citizens, firms, as well as the government had to adapt to a new the environment to be able to fully take advantage of all the benefits of the single market. On the other hand, Germany had already been a member of EU for many years. Actually, Germany is one of the founding countries (with Belgium, France, Italy, Luxemburg and Netherlands) of the European Coal and Steel Community in early 50's.

Germany as well as this community evolved into one of the biggest economic powers in the world. Furthermore, Germany managed to be one of, if not the biggest, players within EU, the inheritor of the European Coal and Steel Community.

Despite Germany being an EU member from the very beginning, it had to adjust to a new relationship that was modified after the Czech accession into EU. Because the Czech Republic and Germany were good business partners even before the year 2004, many treaties already existed, and business was going on in between, and therefore the final difference was not as dramatic as in the relationship with other EU members.

Though the relationship did not change that much, we can still see a huge improvement of trade. In table 1, from previous chapter, we can see that for the last two years (years 2002 and 2003) trade between the Czech Republic and Germany was growing by about 5% a year. In year 2004 the growth jumped to little bit over 20% as we can see in table 2. This is a significant difference if compared to previous years.

Apart from the fact that the trade relatively maintained a pattern of deviation in the growth, after the Czech entrance into EU, those differences were not as dramatic as they used to be before. Even the growth is not as steep as compared to pre-EU years. In most of the cases, the growth rate was around 10%, except for in years 2004 and 2010 where the growth rate reached numbers above 20% and years 2009 and 2013 where the total amount of trade between countries was actually decreasing.

Those years with extreme deviations were historical in a way. In year 2004, the total increase of the trade reached 20,4%. This year was important because of Czech entrance into EU. The massive decrease in 2009 was a consequence of the huge economic crisis which began in 2008. *“The 2008 financial crisis was the worst economic disaster since the Great*

Depression of 1929. The root cause has been traced to no one single event or reason. Rather, it was the result of a sequence of events, each with its own triggering mechanism that led to near collapse of the banking system.” (Investopedia, n.d.) Yet to be followed by a massive increase of trade as a form of recovery in year 2010 where the market grew by astonishing 22,5% in comparison to previous year.

Table 2: Volume of Czech Export to and Import from Germany in thousands of Euro, since 2004 till presence

										In thousand
	Export			Import			Turnover			Balance
	Euro	Ranking	Index	Euro	Ranking	Index	Euro	Ranking	Index	Euro
2004	19 530 433	1.	122,6	17 375 132	1.	117,9	36 905 565	1.	120,4	2 155 301
2005	21 102 927	1.	108,1	18 482 919	1.	106,4	39 585 846	1.	107,3	2 620 008
2006	24 167 299	1.	114,5	20 998 832	1.	113,6	45 156 131	1.	114,1	3 178 467
2007	27 459 864	1.	113,6	24 140 390	1.	115,0	51 600 254	1.	114,3	3 319 474
2008	30 457 141	1.	110,9	25 792 950	1.	106,8	56 250 091	1.	109,0	4 664 191
2009	26 261 381	1.	86,2	19 990 519	1.	77,5	46 251 900	1.	82,2	6 270 862
2010	32 394 026	1.	123,4	24 266 429	1.	121,4	56 660 455	1.	122,5	8 127 597
2011	37 706 842	1.	116,4	28 048 091	1.	115,6	65 754 933	1.	116,1	9 658 751
2012	38 427 778	1.	101,9	27 825 610	1.	99,2	66 253 388	1.	100,8	10 602 168
2013	38 258 873	1.	99,6	27 859 066	1.	100,1	66 117 939	1.	99,8	10 399 807
2014	42 176 228	1.	110,2	30 317 567	1.	108,8	72 493 795	1.	109,6	11 858 661
2014/I-XI	39 089 054	1.	-	27 936 371	1.	-	67 025 425	1.	-	11 152 683
2015/I-XI	42 805 160	1.	109,5	30 378 498	1.	108,7	73 183 658	1.	109,2	12 426 662

Source: (MZV, n.d.)

After access into EU we can see that this huge positive jump of trade was not related only to Germany. In figure 2 we can clearly see that the whole Czech trade balance recorded a massive increase in both export and import. Furthermore, we can see that the difference between export and import was decreasing, and in 2005 the Czech Republic reached a total positive trade balance for the first time in history, since the foundation of independent Czech Republic. Ever since the year 2005 the Czech Republic has retained its statute of export economy with a positive trade balance and thus keeps exporting more than it is importing.

“The German economy has a trade surplus vis-à-vis all its major trading partner countries except China. This merely confirms Germany’s status as the “export engine” of the euro area, i.e. its key role on the European scale. The strongly export-oriented Czech economy’s links with the German economy are therefore crucial.

In the last five years, Germany has accounted for more than 29% of Czech foreign trade turnover. Out of all its trading partners, the Czech Republic’s trade surplus with Germany has also been the highest in the same period. This surplus has risen steadily and now exceeds the Czech Republic’s overall trade surplus. The interdependence of Czech goods exports and German goods imports and exports is very high. The same can also be observed for Czech goods imports as a result of strong collaboration imports. The share of goods exports to Germany was 31.6% on average, with the highest share (32.5%) having been recorded in 2009, i.e. during the deepest phase of the financial crisis.

The strong link between German and Czech exports is also reflected in their structure. Machinery and transport equipment is the largest item of German exports, accounting for around 50% of the total. Goods exports from the Czech Republic to Germany have a similar structure and are also dominated by machinery and equipment.” (ČNB, 2011)

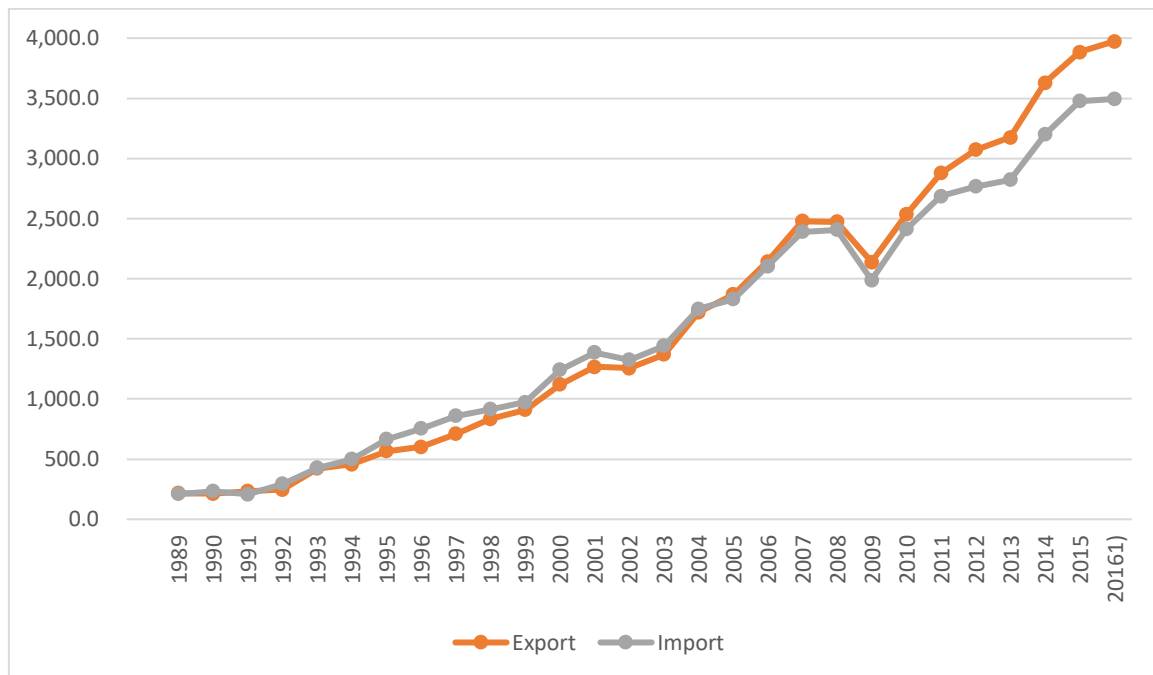
Germany has been the most important close trade connection for the Czech Republic, after all it is a gate to Western countries and to the developed markets. Furthermore, for the Czech Republic, Germany truly is business partner number one. This partnership, as we can see above, has many economically grounded reasons, such as interdependence of export, and import in the same industries.

Yet another good reason it is such a good partnership is the geographical location. Despite the decrease of transportation costs over time, these costs still play a significant role and create obstacles for small firms. Furthermore, this short distance brings another benefit: similar culture. This is especially important in business. Despite the trend of a multicultural managers, it is generally easier to communicate and do business with someone who is similar to you. This is mainly important for small and intermediate firms that cannot afford to pay an international manager with experience in cross cultural management or negotiations, which is necessary to do business with countries like China, USA, Japan, etc.

Although, for the Czech Republic, Germany has been the foremost business partner for many, many years, the same is not so for Germany. Germany has a huge economy and

though the Czech Republic imports and exports a significant amount of goods and services it is far from sufficient to cover German demand. Therefore, Germany requires many other business partners that can offer business on a much bigger scale. The number one business partner for Germany is the United States of America, with a total amount of trade of around 174 billion Euros, as we can see in figure 3 and 4. America or the USA is closely followed by France, Netherlands and China, with all of them reaching a total amount of trade over 160 billion of Euros (169, 167 and 163 respectively). The Czech Republic cannot compete with these hegemonies, though its position at eleventh place with total amount of trade a little bit over 75 billion of Euros is respectful, if we consider the fact that the Czech Republic has overtaken some large countries such as Russia, Spain or Japan.

Figure 2: Trade of Czech Republic (Export, Import) in billion of CZK

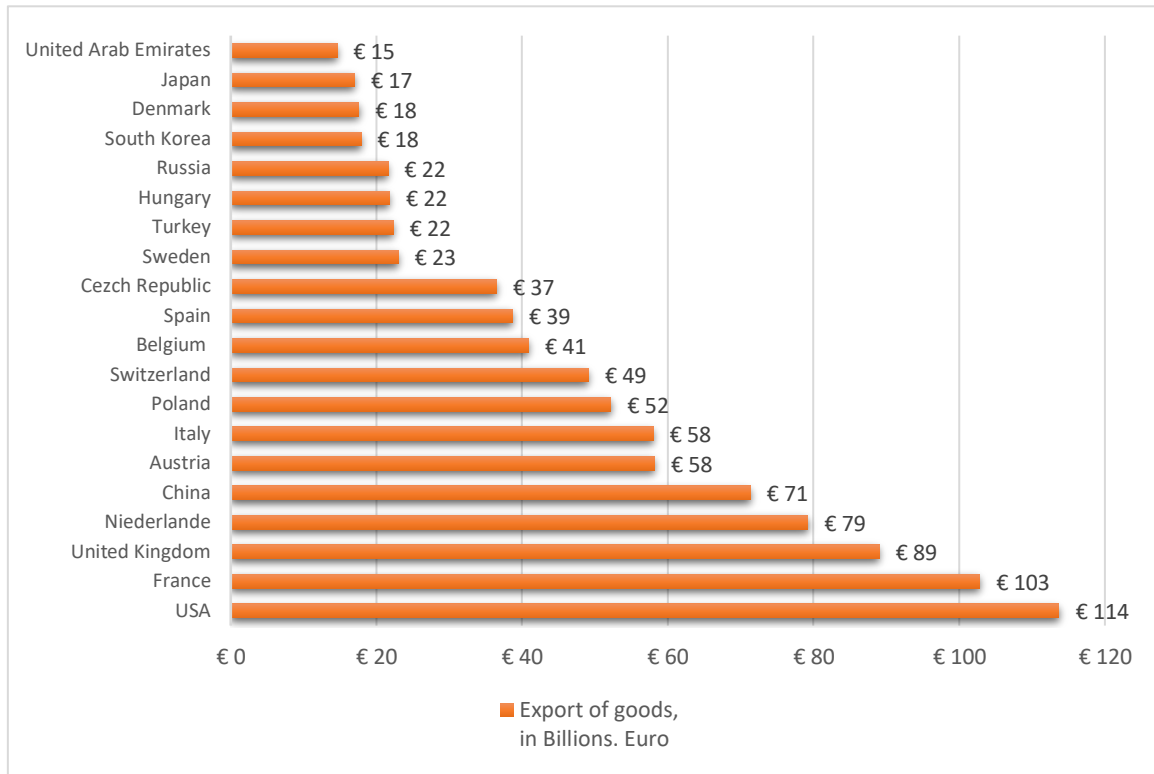


Source: (Český Statistický Úřad, 2015)

Germany, as well as the Czech Republic, has an export-oriented economy with positive trade balance. The German trade surplus in year 2015 is a little bit over 240 billion Euros, as we can see in figure 3 and 4. Whereas in the Czech, trade surplus in the year 2015 was almost 500 billion CZK, according to figure 2, which is a little bit over 19 billion Euros if we use exchange rate from 11. January 2018, 25,509 CZK/1 Euro. Actually, the whole Czech economy managed to generate a combined trade of total amount almost 7 500 billion CZK, which is a little over 291 billion Euros. This means that the German economy managed

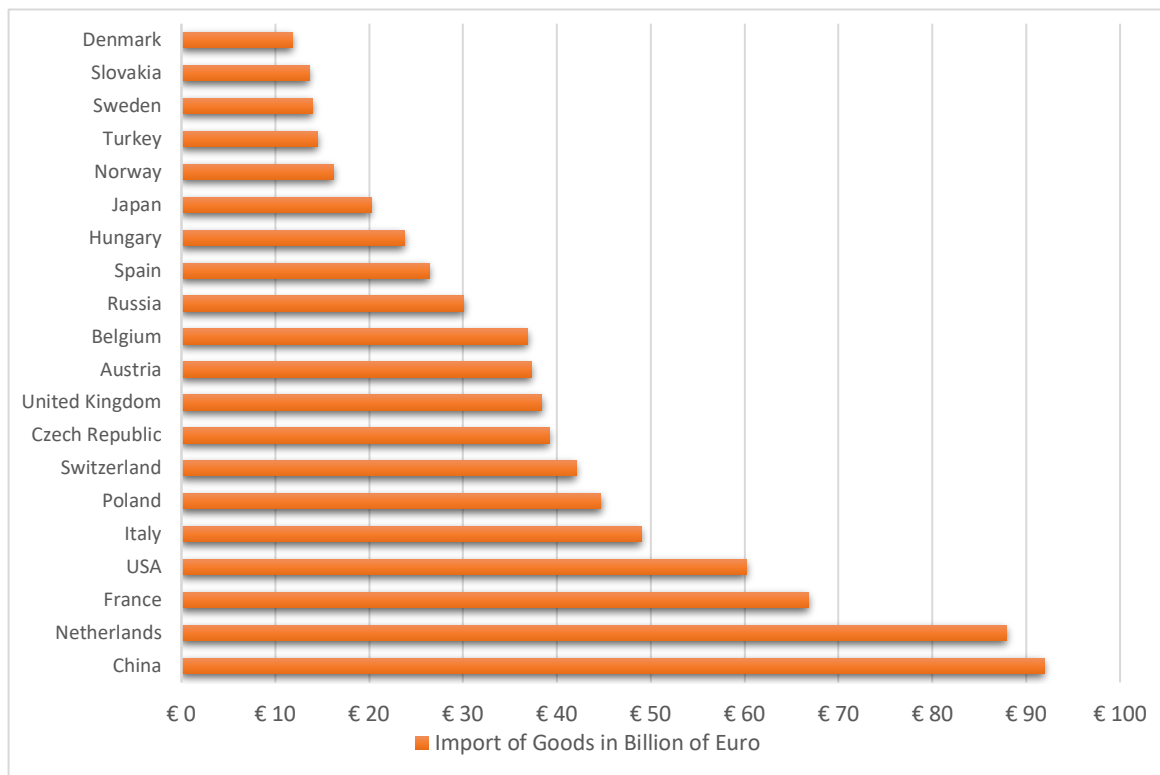
to generate profit, which is almost as high as the total amount of Czech foreign trade. This gives us an idea how enormous the German economy is and how much bigger it is compared to the Czech Republic.

Figure 3: Export from Germany in billion of Euro in year 2015



Source: (Bundeszentrale für politische Bildung, 2017)

Figure 4: Import into Germany in billion of Euro in year 2015



Source: (Bundeszentrale für politische Bildung, 2017)

2 Business and Trade between Czech Republic and Germany

2.1 Exportation

2.1.1 Czech Export to Germany

When it comes to closer analysis of export which takes place in-between the two countries in year 2016, the following has to be said. There was the highest export into Germany in the sector of machinery and transport equipment. Out of all exports, as we can see in figure 5, this particular segment reached 59% of all Czech export in to Germany. The main contributor to this part of the Czech industry was road vehicles, which by itself, made up to 21,4%. This one product made up, by far, more of Czech exports than any other product or remaining sector. Despite this success, car production is constantly increasing and performs with very high growth rate that attained 8.3% in year 2016. The biggest contributor to this growth is ŠKODA Auto, which is a Germany owned company.

“On January 17th Bohdan Wojnar, the president of the Czech Automotive Industry Association (AIA), announced that car production in the Czech Republic increased by 8.3% in 2016, to a record 1.3m cars.

A breakdown of production numbers from the AIA shows that the largest carmaker, Skoda Auto, which has its headquarters in Mlada Boleslav (about 50 km north-east of Prague, the capital), accounted for 57% of car production in the Czech Republic last year, and produced a total of 765,171 cars, up by 12.5% year on year. Hyundai, which is based in Nosovice (about 55 km east of Prague), produced 27% of the country's output last year, at 358,400, up by 4.7% year on year. Finally, the Toyota Peugeot Citroën Automobile joint venture, based in Kolin (in the east of the country, near the Polish border), accounted for 16.4% of total car production, at 220,611, up by 0.7% year on year.

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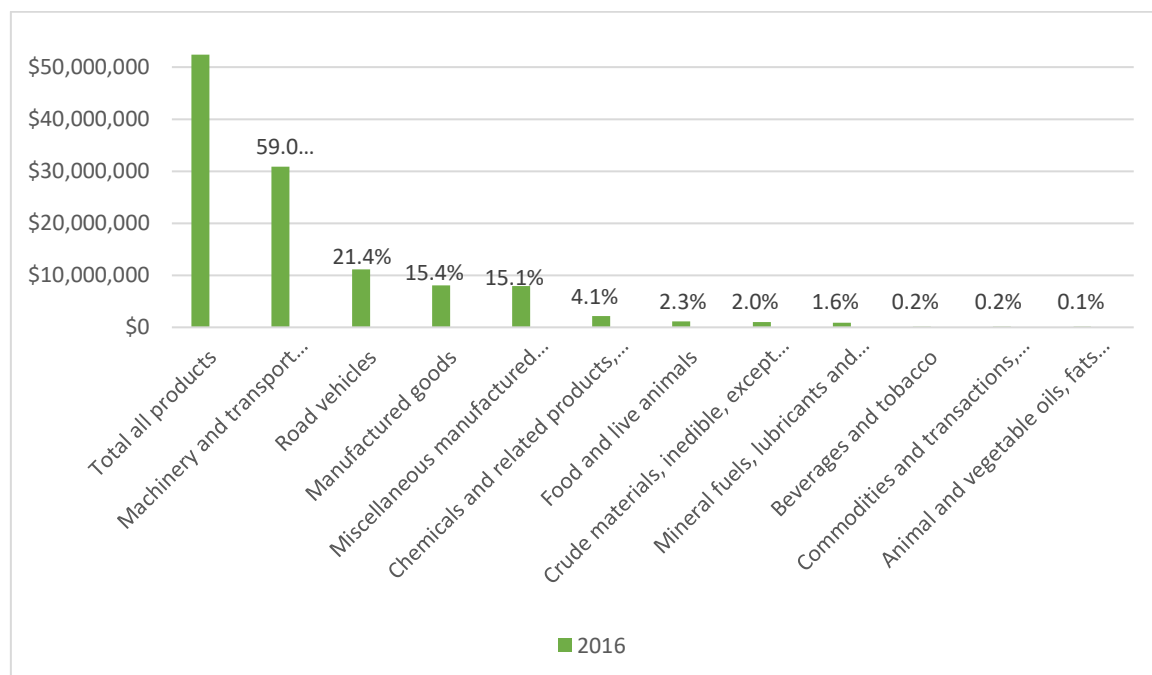
Mr Wojnar warned at his press conference that both Skoda Auto and Hyundai were approaching the ceilings of their production capacities, with the maximum number of possible shifts already in operation, and sub-contractors struggling to keep up with the

demand for their supplies. Data from the Czech Statistical Office back up separate reports that skilled workers are becoming harder to find: unemployment around some of the Skoda factories was below 2% in December. As a consequence of these emerging constraints on output growth, Mr Wojnar suggested that the annual growth rate of production might slow to around 5% in 2017.” (EIU ViewsWire, 2017)

This is clearly demonstrating the importance of ŠKODA Auto for the Czech Republic and shows that it is the primary Czech exporter, and is, at the same time the Czech leader in the automotive industry and the company with the biggest sales, as we can see in tables 3 and 4.

This high specialization in car production is currently very beneficial. Though it may potentially cause some serious problems, due to this high specialization and dependence on German import, in the case of a decrease in German demand for cars or more specifically Czech cars.

Figure 5: Total Czech Export in to Germany in 2016 in thousands of USD



Source: (United Nation , n.d.)

The distribution of Czech export relatively follows the order of the largest exporters, where, as was mentioned above, the leader is ŠKODA Auto as a representative of the machinery and transport equipment sector. This car producer is followed by FOXCONN CZ, which is generally accepted as the world leader in IT production established in Taiwan in

1974. (Foxconn, n.d.) As a representative of the manufactured goods sector, Foxconn managed to export goods in the total amount of 119.25 billion CZK in the year 2014. Other representatives of this particular sector that made it in to the list of top 10 exporters are Siemens, and Panasonic AVC Network Czech. This sector is the second largest and bares the share of 15,4% of all Czech export to Germany, which is more than 8 billion USD. Manufactured goods are closely followed by miscellaneous manufactured articles, which represent 15,1% of Czech export in to Germany. These three above mentioned sectors account for almost 90% of all Czech export in to Germany.

After the segment of miscellaneous manufactured articles there is a significant drop in volumes. Chemicals and related products with total amount of sales 2,166,027.134 thousand USD counts for only 4,1% of Czech export in to Germany. The biggest player in this segment would be AGROFERT. AGROFERT is a Czech based company with a 25-year tradition of doing business in the Czech territory which has more than 250 subsidiaries in many industries such as chemical industry, agriculture, food processing, forestry and timbering, ground-technologies, technology and transportation, renewable energy sources, and media. (AGROFERT, a.s., n.d.)

The segment of chemicals and related products is followed by food and live animals and crude materials, inedible, except fuels, with both accounting for about two percent of total exports, 2,3% and 2,0% respectively which makes 1,188,986.607 and 1,030,319.983 thousand USD. In the segment of food, the biggest player would be AGROFET once again.

The last segment, which makes up over 1%, respectively 1,6% of total export to Germany is the segment of mineral fuels, lubricants and related materials. When we look at the tables 3 and 4 we can see that this particular segment has its representatives in both biggest exporters and companies with biggest sales. Regarding export there it is UNIPETROL with export reaching 40.82 billion CZK, which is Czech the only manufacturer of oil and a leader in plastic production in Czech Republic. (UNIPETROL, n.d.) In terms of sales there are two companies, EPH, which is a Czech leading company in power generation, and natural gas transmission, gas storage, gas and electricity distribution and supply operating in six European countries (EPH, n.d.), and UNIPETROL with total sales of 126,904 and 124,721 billion CZK respectively.

After the segment of mineral fuels, lubricants and related materials there are segments of beverages and tobacco, commodities and transactions and animal and vegetable

oils, fats, and waxes. All of them combined, do not account for much more than 0,5% of total Czech export going to Germany, though they are still important part of Czech industry.

Table 3: Biggest Czech exporters in 2014

Ranking	Company	Exports in 2014 in billions of CZK
1.	ŠKODA AUTO	271.99
2.	FOXCONN CZ	119.25
3.	RWE Supply & Trading CZ	114.73
4.	AGROFERT	97.61
5.	UNIPETROL	40.82
6.	ArcelorMittal Ostrava	26.81
7.	Siemens	22.32
8.	Panasonic AVC Network Czech	21.81
9.	BOSCH DIESEL	21.62
10.	CGS HOLDING	15.39

Source: (CTK, 15 June 2015)

Table 4: Top 10 biggest Czech companies in term of sales in 2015

Ranking	Company	Sales in 2015 in billions of CZK
1.	ŠKODA AUTO	314.897
2.	CEZ	210.167
3.	AGROFERT	167.134
4.	EPH	126.904
5.	UNIPETROL	124.721
6.	FOXCONNN CZ	108.907
7.	Continental Barum	57.7
8.	CEPRO	50
9.	Bosh Group CR	48.4
10.	Tesco Stores CR	42.57

Source: (CTK English, 2015)

If comparing tables 3 and 4, there is undeniable relation between the biggest exporters and companies with the biggest sales. Five out of ten of the biggest companies in terms of sales are among the ten biggest exporters. This relation has a lot to say about Czech

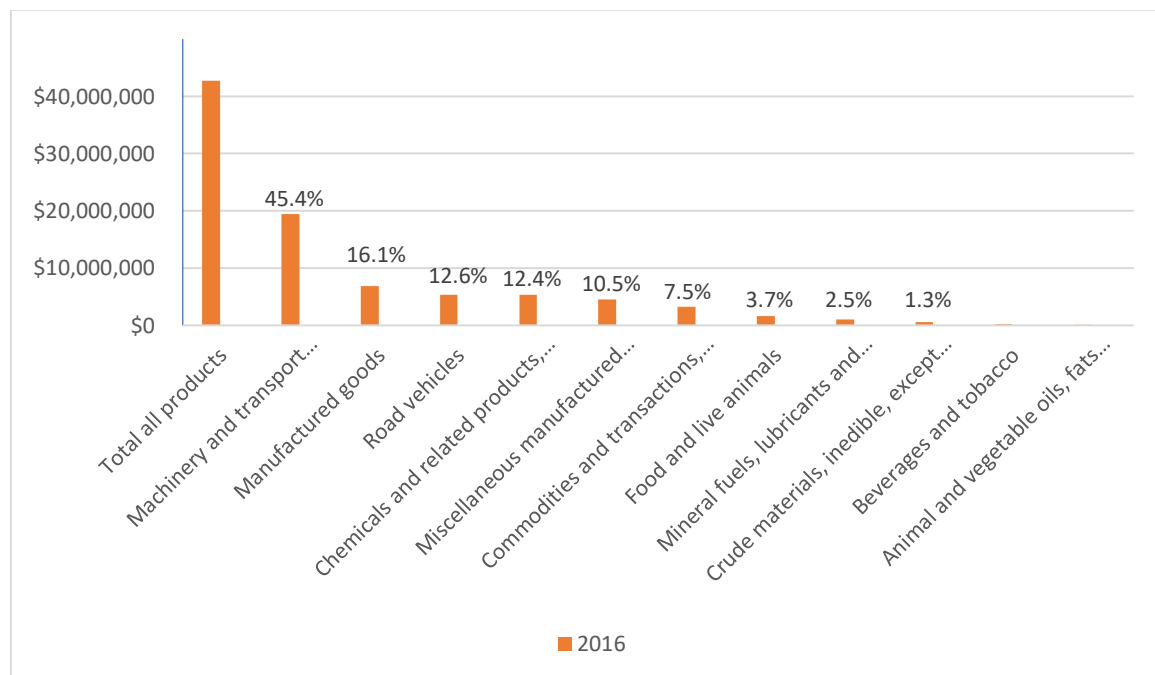
economy, which is export base economy with a surplus on balance of payment account and its connection on German market.

2.1.2 German Export to the Czech Republic

As well as the Czech Republic, German's export into the Czech Republic is very much oriented towards manufactured goods. In the case of Germany, this counts for 89% (United Nations, 2017) of export, which is a little below Czech Republic, where manufactured goods count for 90% (United Nations, 2017). This provides us with clear evidence that Czech and German industries are very alike. If we compare Germany with other western European countries, like UK or France we can see the difference in their specialization. Germany is very much manufactured good oriented economy, and conversely the UK and France are not. In the case of UK manufactured goods, export counts for only 78% (United Nations, 2017). In case of France, the percentage of manufactured goods is 82% (United Nations, 2017) which is by 7% less than in Germany. This is due to different specialization, the UK is world's second biggest exporter of services and exports a significant amount of fuels, and France specializes in food items.

For the reasons given above it is not a big surprise that Czech and German export structure are not that different at all.

Figure 6: Total German Export in to Czech Republic in 2016 in thousands of USD



(United Nation, n.d.)

If the export is analysed more in depth, then it is clear that machinery products, and transport equipment are Germany's export article number one. Although, as it holds true for the Czech Republic, they do export by almost 15% less than does the Czech Republic. This is supported by the difference of almost 9% between the Czech and German export of road vehicles, which is in favour of the Czech Republic.

The second biggest article of export is manufactured goods. They count in both countries for little above 15%, for 16,1% respectively in Germany.

Furthermore, we can see that German export is more evenly distributed around 10% than Czech export. Sectors that are represented around 10% would be: chemicals and related products, miscellaneous manufactured articles and commodities and transactions with 12.4%; 10.5% and 7.5% respectively. Even here in German export to the Czech Republic applies the fact that road vehicles with 12.6% on its own counts for more export than other strong and strategic segments. After all, in 2015, the German auto sector recorded a turnover of 404 billion Euro, which makes around 20% of total German industry revenue. (Germany Trade & Invest, 2016) Therefore, it is reasonable that this particular product comprises a very important part of German export.

Maybe the largest difference between German exports to the Czech Republic and Czech exports to Germany is the segment of chemicals and related products. In Germany this segment is in third place, meanwhile in the Czech, it's in the fourth place. Whereas in Germany, export of this particular segment counts for 12.4%, the Czech export counts for only 4,1% which is three times less than the German export to the Czech Republic.

The segment of chemicals and related products is followed by the segment of miscellaneous manufactured articles and segment of commodities and transactions which counts for 10.5% and 7.5% respectively.

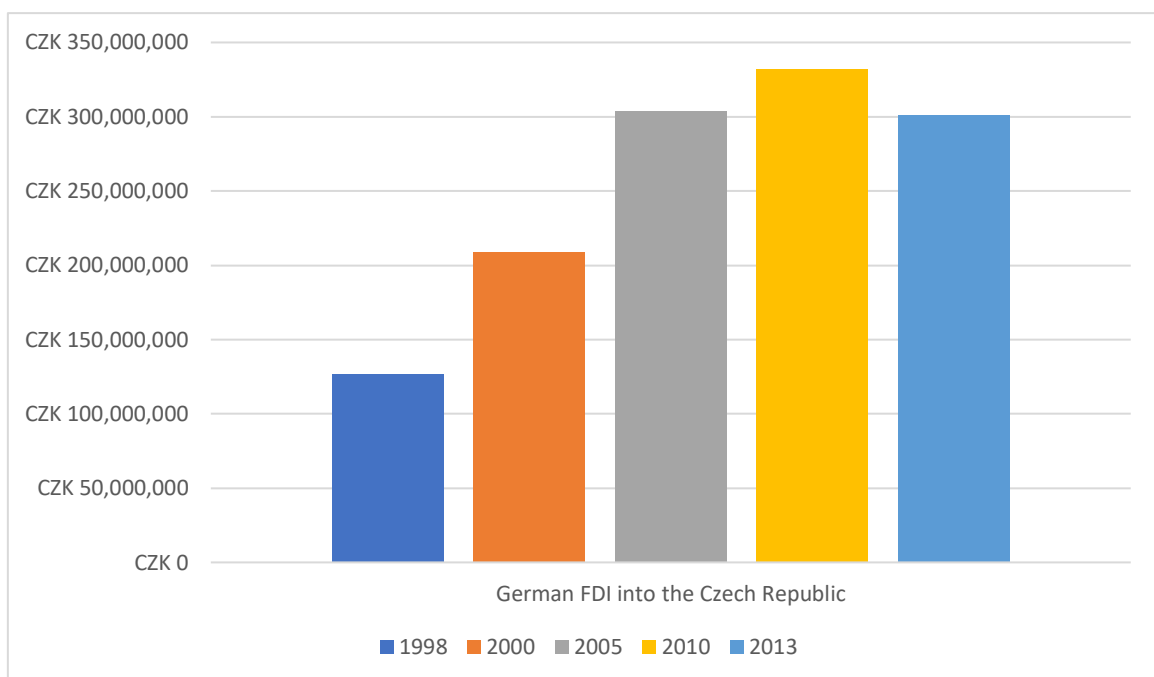
The last five segments, though important, (Food and live animals 3,7%; Mineral fuels, lubricants and related materials 2,5%; Crude materials, inedible, except fuels 1,3%; Beverages and tobacco 0,5%; Animal and vegetable oils, fats and waxes 0,1%) do count for less than 10% of total German export in to the Czech Republic even when combined together.

2.2 Investments

2.2.1 Investments development

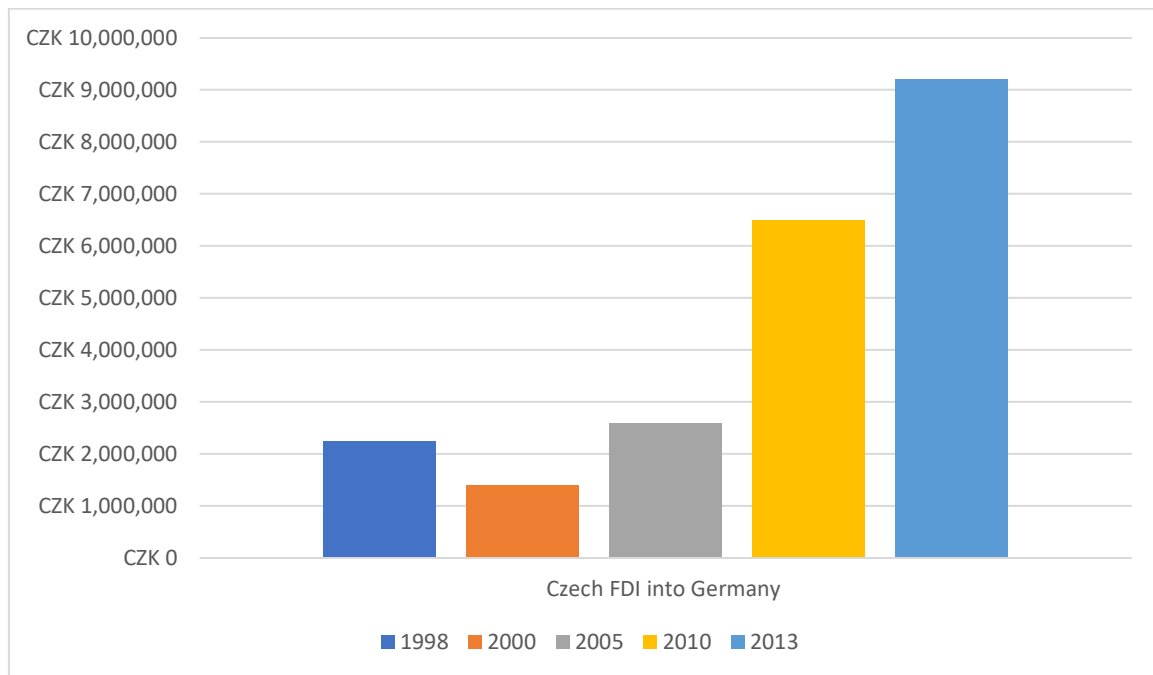
At the beginning of 1990, the Czech Republic was dependent on the inflow of capital from the West, and German influence was one of the most significant. This is very clear with the example of ŠKODA Auto, which I will present later, where without German investment intervention, ŠKODA Auto might have gone bankrupt or may have been in serious problems competing on the global auto market.

Figure 7: German FDI into the Czech Republic in thousands of CZK



Source: (ČNB, n.d.)

Figure 8: Czech FDI into Germany in thousands of CZK



Source: (ČNB, n.d.)

Germany has belonged for many years among the largest investors in Czech Republic and we can see that their motivation has a growing tendency. While in 1998 Germany invested a bit more than 100 billion CZK in to the Czech Republic. In the year 2013 it was about 300 billion CZK. The actual investments increased almost three times over the period of 15 years.

On the other side stands the Czech Republic. Though the motivation increased more than four times, and Germany has been among the countries with a constant inflow of Czech investments, the total numbers are lacking behind the German investments a lot. Whereas Germans invested about 300 billion CZK in to the Czech Republic in year 2013, Czech investors invested only about 9 billion CZK into Germany in the same year. This is 33 times less.

The positive fact is that the Czech investments are steadily increasing. For example, in year 2000 Germans were investing almost 150 times more into the Czech Republic than Czechs were investing in to Germany. The major development of Czech investors is clearly visible in this case. The investments that are made cannot be underestimated, Czech investors are buying major parts in strategic industries throughout Germany.

2.2.2 Current investments of Czech companies into Germany

Though German motivation to invest into the Czech Republic is still prevailing, there are many Czech firms that do invest into Germany and their investments cannot be underestimated. Such a company is, for example AGROFERT, a.s. or Energetický a průmyslový holding, a. s. (herein after as EPH). These two companies make investment into German strategic industries such as food production and energies.

AGROFERT, has recently bought two big German companies. The first one is Lieken AG, which AGROFERT acquired in 1. June 2013. *“Lieken Group is one of the leading bakery producers in Germany. These products include fresh bread & pastries, wholemeal bread brand Golden Toast and LIEKEN URKORN, but also a number of products under private labels, which are custom made for retail companies.”* (AGROFERT a. s., n.d.) AGROFERT further has acquired SKW Piesteritz, which is Germany’s largest producer of ammonia and urea. SKW Piesteritz specializes in AGROFERT’s main part of industry, which is a production of agrochemical and chemical products. SKW Piesteritz has become part of AGROFERT Group on 9. December 2016, which makes it a relatively new member to AGROFERT family. (SKW Piesteritz , n.d.)

Another company which is very active on German territory is EPH. This is a leading company in energies, which operates in the region of Central Europe. As of this moment, they own over 10 German power plants of different kinds. The biggest company which EPH co-owns in Germany, with another Czech investment company (PPF Investments), is LEAG. LEAG is the largest eastern German company in the segment of energies. It is also one of the biggest employer in the region with 8 000 employees. (LEAG, n.d.)

3 Investment of Volkswagen in to ŠKODA Auto

3.1 Investment analysis

After the Velvet Revolution in 1989, Czechoslovakia, later the Czech Republic, went through time of a massive privatization, which is a process of transferring the companies or organizations from a government ownership to the hands of private investors. (Cambridge Dictionary, n.d.) This privatisation was connected with huge inflow of foreign investors with their capital.

Many investors saw the future economic potential of the Czech industry and decided to invest in Czech factories and companies. ŠKODA Auto was among those companies that were bidden for sale.

Although, in Czech Republic, ŠKODA was considered to be among the best companies, the western market saw it differently. Due to very few competitors and bad management decisions, which were made by the communist government, ŠKODA lacked the necessary investment motivation. This led, not just to bad products that were not able to compete on western markets, but also, which is maybe even worse, to a poor reputation. There were many jokes about ŠKODA cars, like: “How do you double a Skoda's value? Fill the tank.” or “What do you call a Skoda convertible? A Dumpster.” (Underhill, 2001)

Despite many drawbacks, ŠKODA was still a strong brand with a tremendous tradition. After all, ŠKODA is, after Mercedes and Peugeot, the third oldest car brand in the world. Furthermore, the company had a skilled labour force which was a huge benefit, because there was no imminent need to search and train workers, like in green field investments. (Rädler, et al., 2007)

These conditions created a unique investment opportunity, if treated correctly could have led to huge success, as well as to great disaster due to many drawbacks that could jeopardize the final outcome.

If concluded, there were three main problems, that had to be solved after acquisition in order to make the company to prosper and become competitive on western markets, not just for its extremely low prices that were created by artificial devaluation of Czech currency. First, products that used old technologies and therefore were not able to compete on

innovation based western markets. Than very shaming reputation, which led to creation of many jokes, and lastly, an old and inefficient management style.

With this in mind, there were three potential buyers. Volkswagen AG (VW), Renault S.A. and AB Volvo. VW's 6.45 billion USD (9.5 billion DM) bid was more than double of what the competition was willing to pay. Renault's bid was 2.6 billion USD and Volvo valued Czech car company at 3 billion USD. Furthermore, VW promised to include guarantees of job security and the preservation of Skoda's identity within VW. This last point was particularly important because the other bidders wanted to use the factory as a cheap and skilled labour source for their own car production and to destroy the ŠKODA brand. (Roth, 1990)

3.2 Specificities of the Investment

3.2.1 Acquisition

The process of privatization was, due to its size and many related variables, very complicated and time consuming. For the Czech Republic this acquisition was of the high importance because ŠKODA was the largest employer in Mladá Boleslav region. For VW it was a very risky acquisition, but there was a potential gateway to newly opening Eastern European markets.

For all of these reasons the acquisition was divided in to three parts and took 10 years in total. The first and maybe the hardest part begun in 1990 and was finished in 1991. This initial phase accounted for the tender which was won by VW and then for acquiring the first portion of shares. In this initial phase VW acquired the stake of 31% of the company. (Rädler, et al., 2007) In that times it was "*the biggest-ever Western European investment in an Eastern European company.*" (ING, n.d.)

Due to the initial progress, VW decided to continue with the acquisition and moved onto the second phase. The second phase is sometimes divided into two sub parts and sometimes it is referred to as one. During this phase VW increased its stake to 60.3 percent in 1994 and to 70 percent one year later. By 1995 VW held the majority share in ŠKODA Auto, which further helped to implement ŠKODA into VW group. It had many benefits for both of the parties. One of the biggest benefits of this implementation was a shared platform strategy, that have greatly helped to reduce the cost of new cars, since the platform accounts for around 60% of cost in a new car. (Rädler, et al., 2007)

In the year 2000, after all negotiations, VW took full ownership of ŠKODA Auto. This was a historic benchmark and a dot after successful but far from easy acquisition.

3.2.2 Other Problems

Among other problems that have appeared during the initial phase one was to be solved with high importance. It was the problem with poor efficiency and quality of production. VW was aware of the inefficiency within the company, but they had to solve the issue of inefficient and low-quality suppliers.

The first problem was solved by the transfer of know-how. *“Overall, around 100 German expatriates joined Skoda in order to transfer know-how. The know-how transfer was actively encouraged by the 'tandem system', in which one foreign and one local manager were made jointly responsible for each management position, so that the process of knowledge transfer was institutionalised.*

Moreover, in the early days, Czech employees were encouraged to spend three weeks at VW's headquarters in Germany. In the morning, the participating employees attended language courses; in the afternoon they spent time in the equivalent departments of their job at VW, where they were able to see how their functions were handled by the German carmaker.

Furthermore, according to the Economist, the drive saw the quality of its products on the Volkswagen quality-scale improve from a poor rating of around five in 1991 to two in 1995 and about 1.5 in 2000.” (Rädler, et al., 2007)

The problem with bad suppliers was, perhaps a harder one, than solving the problem of bad quality within the factory itself. There VW could use their power as the owner, but they had no control over the ownership of ŠKODA's suppliers. *“A supplier certification study from 1993 revealed that only one per cent of Skoda's suppliers were ranked as top (A-suppliers), 39 per cent were ranked as B-suppliers and 60 per cent as C-suppliers.” (Rädler, et al., 2007)*

To solve this particular problem, VW encouraged their traditional suppliers to enter joint ventures with local suppliers. VW's suppliers followed this instruction and as a result this led to a massive increase of local suppliers' qualification and thus to the whole production of ŠKODA as such. When tested again, 61 per cent was ranked as A-suppliers,

34 per cent as B-suppliers, and only five per cent as C-suppliers. (Rädler, et al., 2007) This clearly demonstrated the improvement under VW initiative.

When VW managed to solve the quality, issues connected to production and products itself, they had to improve the brand image of the company. This was especially tricky task, since ŠKODA has been known in western markets as the cheapest possibility with bad quality standards. To change it, VW repositioned ŠKODA into value-for-money segment. To support this, ŠKODA greatly improved their dealership. Not just in the design way, but more importantly they started offering several financial services like leasing, financing and more.

Lastly to improve the global awareness of the brand, ŠKODA become the sponsor of Tour de France, which is one of the biggest cycling events in the world. “*ŠKODA is the official partner and official car of the Tour de France since 2004.*” (ŠKODA AUTO, n.d.) While doing so, they promote their cycling tradition, because ŠKODA was initially a bicycle company. (Rädler, et al., 2007)

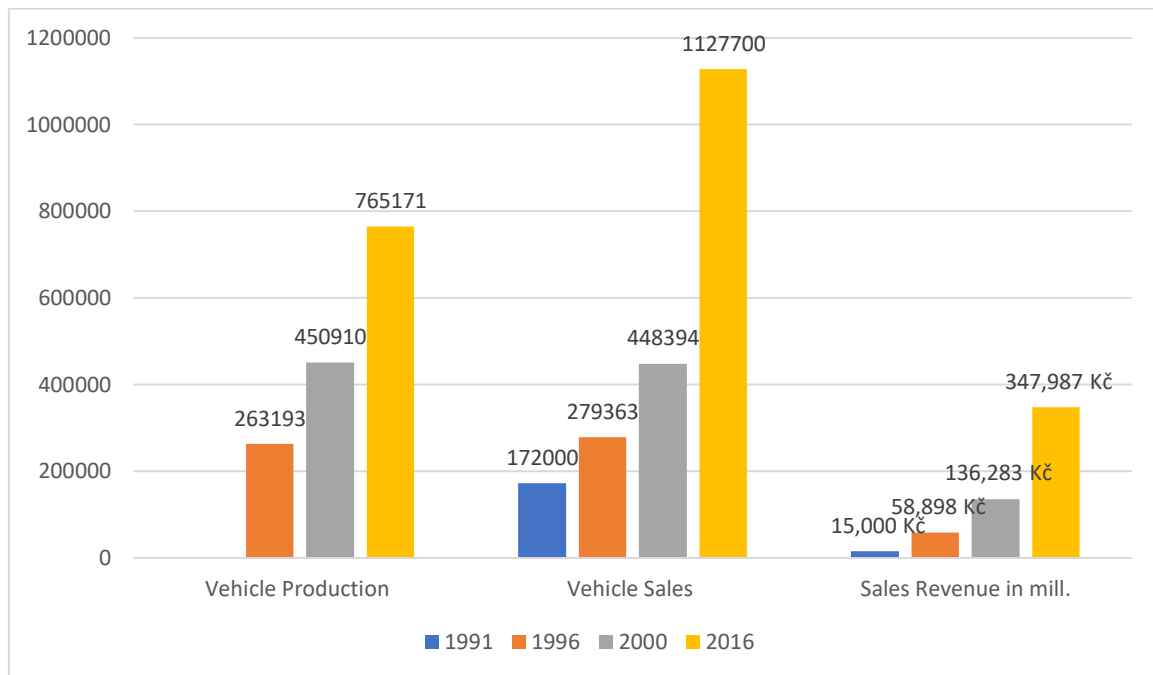
3.3 Current Position of the Investment

It has already been almost 30 years since VW decided to invest in to ŠKODA Auto. After this long time, we can certainly say that it was very wise decision with a lot of success.

VW, as a group of 12 brands sold a little more than 10.2 million vehicles (Chatham: Newstex, 2018) in 2016. This means that ŠKODA Auto by themselves with 1,127,700 cars sold, made almost 10% of the group sales. This is a remarkable success for a company that 25 years ago only had one car model with an engine that was more than 25 years old at that time. (Rädler, et al., 2007)

Not only the sales of vehicles have recorded a steep increase in numbers, the sales revenue has also performed very well. The revenue has increased more than 23 time since 1991, from 15 billion CZK in 1991 to an astronomic 347.9 billion CZK in year 2016. This makes ŠKODA the biggest Czech company in terms of sales.

Figure 9: ŠKODA AUTO Performance over years



Source: (idnes.cz, 2015) (ŠKODA AUTO a. s., 2001) (ŠKODA AUTO a.s., 2017)

A big step, which helped to achieve these outcomes was the improvement of product quality. This was a crucial step which was followed by the introduction of new models. Whereas in 1991 the car maker was offering only one product with one old engine, now the factory produces seven models with a huge variety of engines and other equipment. This greatly improved the sales and allowed ŠKODA to penetrate new markets like China and India and to attract new customers within already penetrated markets.

This all would not be possible without the investment of VW into ŠKODA Auto's production capacity and consequent incredible increase. Due to investment into the modernization of production lines and technical skills of employees the production capacity has increased by 445% with a relatively low increase of number of employees. While over the years the employment barely doubled, from 17,000 in 1991 to 30,000 in year 2016, the production increased by more than four times. (ŠKODA AUTO a.s, 2017)

Conclusion

Trade with Germany represents a significant part of Czech exportation and importation. Its impact on Czech as well as on German economy is undeniable and records are continually growing. This growth is connected to increase of the overall economic relationship between these two nations.

Based on the obtained data, I can now answer the two questions I stated at the beginning of this thesis. The questions were the following: Is the business, trade, and investment relationship getting stronger, weaker or is it stagnating? And the second one. Is this relationship more beneficial for the Czech Republic or Germany?

The simple answers are following. Yes, the actual relationship is getting stronger in both trade and investment. For the second question, for which country is this relationship more beneficial, the simple answer is the Czech Republic.

Though over the time I was writing this thesis I realised that the answers are more complex. Therefore now I would like to carefully analyse the whole text.

If I look at the growth rates I can say that the percentage increase is slowing year by year, though if I look closer and analyse the actual amount of trade, then the answer is that the trade is growing in total numbers and thus the overall relationship has been getting stronger and stronger every year for more than two decades.

It is not only the trade, but also the investments which are steadily increasing and making the bond between the countries stronger. With closer analysis I can say that many times, these investments are of strategic importance. Many Czech or German companies are acquiring firms in the other country in order to grow their main business and therefore expand in the other country in either a vertical or horizontal way.

Furthermore, I can say that the Czech and German economies are very alike and complement each other. For both countries, the strategic segments and main export articles are machinery and transport equipment, manufactured goods, and road vehicles. This is due to the similar structure of the industries that specializes in the same kind of product. An example of this statement is the high specialization in the car industry, which apply for both countries. Though even in this case, there are differences. Czech producers are exporting significantly more cars into Germany, than their counterparts export into the Czech Republic. There are many reasons for this behavior. Firstly, Germany has much

bigger market. The second reason could be the difference in the production segments; whereas Germans produce mostly luxurious car, Czech producers make mostly value for money cars. The market for the Czech produced cars is significantly bigger in both countries, which is part of the reason for such strong exportation. The examples of Czech production in this case would be ŠKODA Auto or Hyundai. On the other hand, German producers make high end cars like BMW, Mercedes, Audi or Porsche.

The result of such a high interconnectedness of these two markets have effects on the Czech export and industry. This leads to very high specialization and concentration of production factors on the side of the Czech Republic, where 90% of all Czech export into Germany is created by only three sectors. This is connected with high dependence of Czech production, on German demand, and economic decisions. On the other hand, the Czech Republic, though important, is not as influential on the German economy. Even at this moment, with the very high interconnectedness of the Czech and German economies, Germany could more easily substitute the Czech Republic for another business partner.

On the other hand, the German export into the Czech Republic is more evenly distributed over all the export segments. This could lead to more stability in the case of any unexpected disruption on the market.

This is a sign of an imbalance in this relationship in favor of Germany and thus gives them a better negotiating position on an international level.

Furthermore, there are visible signs of German influence on Czech entrepreneurs and firms, based on the above. Being active on German markets gives the company a competitive advantage over those which are not part of any trade with the Germans. It is not an accident that almost all the biggest Czech firms do a significant part of their trade with German counterparts. If there is a case in which a business or firm does not directly participate in direct trade itself, they usually do own a Germany company and in this way are represented on German market.

This presence on the German market is essential for many firms and access to this market is strategic if a firm wants to grow over a certain point.

Despite the fact that such a high importance of Germany for the Czech Republic could be a bit frightening, it is important to mention that for the Czech Republic, this bond to Germany is very beneficial and from an overall analysis of my thesis I have to say that the Czech Republic has more benefits from this relationship than Germany does. This

statement is grounded by the trade balance which has for many years now been positive on the Czech side. Though it is very important to say that both sides are much better off from this strong relationship.

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