



**YOUNG GENERATION:
BARRIERS TO SETTING UP A BUSINESS
IN THE CZECH REPUBLIC**

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1. INTRODUCTION

The aim of this study is to identify main obstacles faced by young people when starting their own business. Authors of this study are students from the Metropolitan University in Prague, School of International and Public Relations in Prague, University of Economics in Prague and University of West Bohemia in Pilsen in the Czech Republic.

The study is based on a survey conducted among 700 respondents aged between 16 and 30 years with the aim of identifying obstacles to setting up a business in the Czech Republic. The second part of the study focuses on the analysis of legislative, financial and administrative barriers. Results of the survey and analysis of the barriers helped the authors to come up with recommendations on how to remove barriers to setting up a business by young people.

2. SURVEY RESULTS

Based on a survey in a form of questionnaire consisting of 21 questions we have analysed legislative, administrative and financial obstacles to young people when starting their own business in the Czech Republic. The survey was conducted among 700 students and graduates, aged between 16 and 30 years, coming from different regions of the Czech Republic and studying various fields of study.

The major group of respondents was formed by people between 21 and 24 years of age. The group of respondents consisted of **44% men** and **56% women**. A total of 176 respondents came from the capital city – Prague. Other regions were evenly represented. Regarding the field of study, the three most numerous groups were students of Socioeconomic sciences (28%), Humanities (25%) and Technical sciences of applied character (14%), whereas 17% marked the field 'others'.

A total of 79% of respondents indicated that they do not currently run their own business and 45% of them are considering starting up their own business within the next three years. 36% of respondents think that the initial capital for starting their own business should be between 100 000 – 500 000 CZK (approximately 4 000 – 18 000 EUR). One third of respondents indicated that they would need less than 100 000 CZK (4 000 EUR). Initial capital higher than 500 000 CZK (18 000 EUR) would be required by 35% of starting businessmen.

Regarding the financial means used when starting up a business, 35% of respondents would use their own capital and 23% would go for a financial assistance from their family. Only 7% indicated that they would use alternative financial options, such as crowdfunding, leasing, seed funds etc. The reason for this is the fact that almost 90% of respondents do not know how these alternative forms of financing work. That is why 70% indicated that they would use these forms only if they would be better informed.

Financing of new business by means of bank loans would use 17% of respondents. Only 7% have already applied for such a loan with a success rate of 30%. 70% of students who have applied for a bank loan have been rejected by the bank mostly due to low income or the reason was not mentioned.

For starting up their own business, 26% of students indicated that they would use financial means from the European Social Fund via available operational programmes. This corresponds to the fact that 57% of respondents are unaware of these programmes and 18% are discouraged due to excessive red tape.

According to 48% of respondents the form of a Limited company is the most suitable for budding entrepreneurs. The main reason for this is the fact that since 2014 the deposit obligation for the establishment of a limited liability company is 1 CZK (3 euro cents). This has been approved by 80% of respondents.

Also since 2014, pursuant to the new Czech legislation, people can start their own business at the age of 16. Almost 50% of respondents consider it as an advantage. The second favourite form of business is self-employment backed by 45% of students participating in the survey.

69% students indicated that they would not be willing to suspend or terminate their studies at university for the sake of their business plan. Remaining respondents answered positively in case that the study duties would hamper them in their business intents or they would be convinced of possible success of their business plan. According to the respondents, the biggest obstacle to setting up a business during their studies is the lack of their own capital (19%), lack of time and big market competition plus the risk of failure (both 14%), complicated legislation and burdensome red tape (10%).

Many thanks for filling in this questionnaire belong to the addressed universities, namely the Metropolitan University in Prague, University of Economics (VŠE) in Prague, Institute of Technology and Business (VŠTE) in České Budějovice and School of International and Public Relations in Prague (VŠMVV).

3. ANALYSES OF VARIOUS BARRIERS TO SETTING UP A BUSINESS IN THE CZECH REPUBLIC

The analysis focuses on legislative, financial, administrative and tax barriers to setting up a business in the Czech Republic. The aim is to describe obstacles which could discourage potential young entrepreneurs and bring some new possibilities which were laid down by law or EU programmes.

3.1. LEGISLATIVE BARRIERS

In the Czech Republic, the entrepreneurship is regulated by the Civil Code and Business Corporation Act. Recently, there were new amendments to both acts coming up with novelties such as basic capital for limited company – only 1CZK (3 euro cents), trust fund, age of starting the business, also entrepreneurial terminology was changed.

In the Czech Republic, both natural persons and legal entities may run a business within fulfillment of conditions laid down by law. While natural person is a human being, legal entity is artificially created by law. It has some rights and duties similar to a natural person. In practice, a natural person can run a business once granted a trade licence (or registered as a farmer) and after fulfilling other conditions laid by Trade Licensing Act; tax laws; pension, social and health insurance laws etc.

The trader can exercise the activity as the main activity or as a part-time. In both cases the entrepreneur will be defined as a self-employed. Trade License Act does not impose any requirements for entrepreneurs to register capital or create reserves or other funds. Establishment of a trade is the first step to proper and lawful business. Establishment of a trade is usually also the first direct meeting with the authority that based on the submitted application for issuing a trade license grants a trade license.

The form of self-employed is backed by 45% of students participating in the survey. But there are also several administrative duties for self-employed: to register to the Social Security Administration; to prove the character of self-employment; to calculate insurance and to pay related advances; to file an overview of the income and expenditure. Self-employed also have a duty to report towards the social Security Administration - it means to notify certain facts, e.g. termination or interruption of self-employment to a certain date. These administrative procedures usually lure potential entrepreneurs away. From the perspective of investors, an entrepreneur is considered to be relatively risky, in spite of the fact of being liable for his entrepreneurial activity with his own assets, and in turn, those of his/her family. For this reason, in certain cases it may be difficult to get a bank loan. And similar to investors, the lower credibility of trade license enterprise may become evident in relationship with a supplier.

Unlike self-employed, corporations can be created by one member or community of persons. General rules of its operation are covered by Civil Code, special rules are provided by Business Corporation Act. For corporations, we distinguish establishment (founding legal proceeding – for example founding deed) and formation of Business Corporation (registration to trade register). Corporation has to be registered within six months from establishment. Business corporations are divided into personal and capital corporations. The former include publicly owned corporation and special limited partnerships, the latter include limited companies and companies limited by shares.

Publicly owned company is a step between trade license enterprise and a business corporation. There is still liability of personal assets and the related risks. This form is suitable in situations where multiple entrepreneurs want to found a company. It is not very widespread, however, and its value has declined with the reduction in registered capital required to found a limited company (Ltd.), since in many aspects it is more advantageous for the founders to establish a Ltd.

Special Limited Partnership is more suitable for those graduates who are able to find a private investor. This investor generally becomes the limited partner and brings capital into the enterprise. On the other hand, the general partner brings know-how, but of course is a subject to unlimited liability.

From an administrative point of view, it is more difficult to establish a Limited Company than a trade license enterprise. On the other hand, the best benefits of this legal form include the potential good impression made on business partners and/or possible investors. The new advantage is its capital - 1 CZK (3 euro cents) instead of former 200 000 CZK (7 300 EUR), in the view of young entrepreneur, this step of Czech law makers is considered as huge simplification - especially in the financial point of view. It seems that one legal burden was eliminated and luckily in favour of young entrepreneurs. On the other hand a person must not forget that establishment of this form of company brings also inconsiderable responsibility - before new legislation came into effect, it was more advantageous. According to 48% of respondents, Limited company is the most suitable form of business for budding entrepreneurs. The main reason for this is the fact that since 2014 the deposit obligation for the establishment of a limited liability company is 1 CZK (3 euro cents). This has been approved by 80% of respondents.

A Company Limited by Shares is a capital company type which is more suitable for large companies. Main obstacles for students or young people generally are definitely the lack of regular income to provide their own financial resources to be used in the beginning. For a graduate it is best to establish a different form of enterprise first and when a business plan requires additional influx of capital to dynamically expand, and it may be reasonably assumed that a sufficient number of shareholders may be found to provide this capital, then the original enterprise can be transformed to a company limited by shares.

Rather than a barrier, there is a new opportunity that was introduced by law from 1. 1. 2014 to start up a business at the age of 16, lowered down from 18 years. This change is supported by almost 50% of surveyed respondents. However, the other half of respondents did not know about this change.

Another new alternative for Czech entrepreneurs since 1st January 2014 is the establishment of a so called "trust fund" or "trust". It is a property for fulfilling of a certain purpose without legal personality. It may serve for public or private purpose. We are not able to say if it brings advantage or disadvantage for young entrepreneurs, because it's really short time since trust came into effect. For example it can be used as investment fund.

3.2. FINANCIAL BARRIERS

The equity (E) constitutes a crucial element of any business. One of the main problems that students face when they wish to start their own business is the lack of equity. This is the reason why family or friends often participate in starting the business as well. In order to increase the capital, it is also possible to cooperate with a partner that will provide the student with the capital and input necessary.

The equity belongs to the proprietor, other owners, companions, etc., who bear the greatest liability. When setting up a company, it is important to realize that during the first years of business, the financial burden of the firm is the heaviest. The equity is not constant; rather it is a variable that changes according to economic performance during a particular period of time. Two possible outcomes exist. If the company is profitable, the equity increases (unless it is consumed). However, if the company is unprofitable, the equity decreases. The amount of equity of the enterprise is an indicator of financial security (financial independence) and thus makes the company appear as a reliable partner. The equity is comprised of owner's equity, capital funds, retained earnings and capital gains.

A student who decides to start a company in the Czech Republic faces several obstacles when trying to access finance. The key to success lies in choosing the right form of business which requires only such capital the student can possibly provide. The owner's equity, which becomes the starting property of the company, may consist of money, liabilities, tangible assets or intangible assets (know-how).

If a student decides to start a business and he/she does not have sufficient capital, he/she can arrange a bank loan or credit. Bank loan is the most traditional form of financing, but the process is lengthy, complicated and in the current economic crisis made getting a loan for a start-up much more difficult.

If they do so, they can choose a student loan or a business loan which are both available in the Czech Republic. It is important to explain whether they have a prior experience and only start their first business. If so, they are not eligible for a business loan, since it is only available to people who already have sufficient experience with business. Students can decide whether to arrange a loan or credit instead. Their respective advantages depend on a specific bank offer and the proceedings necessary to arrange them are very similar.

Although there are many banks on the Czech market, only two of them offer student loans appropriate for business. They are, namely, Česká spořitelna (the Czech Savings-bank) and Komerční banka (the Commercial Bank). Both of them also offer various business loans. The other banks on the Czech market also offer student loans but these can only be used for study purposes. The criteria that must be met in order to obtain a loan are as follows:

Česká spořitelna:	Komerční banka:
student verification form, aged 18 and over	a secondary school/ college/ university student
minimal sum loaned 20,000 – 300,000 CZK (750 to 11 000 EUR)	total credit limit is at 20 000 CZK (750 EUR) (debet limit + card limit)
interest rate is at 8.9 %	interest rate is at 12 %

Based on the aforementioned information, it is very difficult for students to access finance necessary for starting their own business. Only a few banks offer student loans or credit and if they do, the interest rates are very high. One of the factors that the banks fear is not being paid the money back as a lot of businesses go bankrupt at the beginning of their life cycle. This is the reason why they set such high interest rates (for business loans) or require guarantors. Hence it may seem that banks do not support students in starting their own businesses.

On the Internet we can find a lot of information concerning taking out a loan and its subsequent repayment. A student who is still not confident about certain matters should arrange an appointment at a bank and ask for an advice. If s/he is satisfied with a proposed product, s/he will then spend a long and challenging time arranging the loan.

Process of getting a credit has several basic parts:

- Introductory meeting with the client (obtaining the necessary information)
- Credit analysis
- Signing of the credit agreement
- Verification of compliance with credit agreement conditions

This process is lengthy, especially for business loans, where its processing might take up to several months. And even if you will make the bank satisfied, it does not mean that you will eventually be successful in getting a loan (you did not meet certain criteria). On the other hand, loans provided to students are usually handled within a few days.

For business loans it is important to prepare a carefully elaborated business plan. This plan may vary from bank to bank (number of pages, etc.). The most frequent reason for not getting the loan is an incorrectly processed business plan, a record in the register of debtors or insufficient guarantee. The biggest obstacles to students are administrative burden, high initial costs of starting a business and the lack of equity. Financing starting business by means of bank loans would use 17% of respondents. Only 7% have already applied for such a loan with a success rate of 30%. 70% of students who have applied for a bank loan have been rejected by the bank. Mostly due to low incomes or the reason was not mentioned.

In addition to these forms of financing in the Czech Republic it is possible to use alternative forms, such as: leasing, seed funds, business angels, crowdfunding, business incubators, factoring and forfaiting. Alternative forms of financing seem to be much more promising especially for

young and innovative entrepreneurs who could attract attention of business angels or public (crowdfunding) and could use the support provided by business incubators. In these cases they need just minimal funding of their own. Only 7% of respondents indicated that they would use alternative financial options, such as crowdfunding, leasing, seed funds etc. The reason for this is the fact that almost 90% of respondents do not know how these alternative forms of financing work. That is why 70% indicated that they would use these forms only if they had more information.

Regarding the financial means used when starting up a business, 35% would use their own capital and 23% would go for a financial assistance from their family.

Another way how to raise funds for setting up a new business is by means of grants and subsidies from the EU or by national and local intermediates.

Small and medium sized enterprises (SMEs) can obtain EU funding through grants, subsidised loans and guarantees (such as programmes Microfinance Facility, Start, Záruka). Funding from the EU is followed by strict rules to ensure control of using the funds. All costs must be transparent and accountable. This is a complex process because there are many different types of programmes managed by different entities. More than 76% of the EU budget is managed by the Member States. This category includes structural funds from which are funded regional policy, social and educational programs and agriculture (including subsistence farmers). For starting up their own business, 26% of students indicated that they would use finances from the European Social Fund via available operational programmes. This corresponds to the fact, that 57% of respondents are unaware of these programmes and 18% is discouraged due to excessive red tape.

Entrepreneurs can also benefit from different advisory services – private (paid) or public (unpaid). The pillars of current support system of advisory services in the Czech Republic consist of Consulting programme (as part of the Operational Programme Enterprise and Innovation), services different from innovation infrastructure (science and technology parks, innovation centres and business incubators) and specialized services provided by organizations that are organized in international networks (an example can be Enterprise Europe Network - EEN).

3.3. ADMINISTRATIVE BARRIERS

Administrative burden represents costs resulting from fulfilment of information duties set up by Czech law with relation to the state (financial authority) and third persons, such as consumers. Administrative burden results from national, international and EU standards. Process of decreasing administrative burden (at both – Union and national level) aims at reducing the number of unjustified requirements on businessmen posed by Czech legislation, increasing the business competitiveness and savings in the field of financial sources.

Process of decreasing the administrative burden in the Czech Republic is implemented in two ways. First approach can be classified as preventive. It presents a liability of selected ministry departments and central government bodies to carry out a Regulatory Impact Assessment (RIA) before a new government regulation is introduced. This assessment also contains impact evaluation of the proposed regulation on business.

The second way of reduction of administrative burden in the Czech Republic is the identification of current administrative burdens which are already given by existing legislation, evaluation of their necessity and their potential adjustment. Process of evaluation of administrative burdens has been launched in April 2005, based on Government Resolution (No. 421) as of 13th April

2005. This Resolution has approved the Action plan for reduction of administrative burdens for entrepreneurs and Methodology of determining the size and origin of administrative burdens

In relation to a sole trader, administrative procedure was simplified in the past few years and thereby the administrative burden was reduced for future entrepreneurs when setting up a business. However, in comparison with other countries the administrative burden is still high. Even there are promises that this situation will be changed, long procedures are considered to be the key issue if young entrepreneur would like to run a business. In business corporation point of view, the situation is similar. For example establishment of the company by sole founder requires foundation deed. It must be in the form of a notarial protocol and has pegged content. Further, the founder must complete a variety of forms and deliver them together with the trade license to the registration court. This kind of procedures does not simplify a situation for young entrepreneurs. We consider it as a crucial obstacle.

The tax issue is also very burdensome. Legal Entity Tax has by time decreased to recent 19% (in 1992 the tax amounted to 42%). Investment funds, investment companies, shares funds and institutions of superannuation scheme are liable to lower tax rate, which amounts to 5%.

Natural Person Income Tax is paid from the incomes from dependent (main) business activities, function benefits, incomes from business and self-employment, incomes from rents, incomes from capital assets and other incomes defined by law. In case of business and self-employment income physical persons may exert expenditure fixed payment tariffs, which can be (for someone) more financially effective and less time-consuming. Currently, further limitations on these tariffs are being negotiated.

Frequent modifications which complicate business strategic planning and increase expenses (e.g. training costs) belong among the weaknesses of the current tax system in the Czech Republic. Another disadvantage of the tax system is its complicated structure resulting in higher costs for tax advisory services. But in comparison with other OECD countries, the Czech Republic has the third lowest legal entity tax rate.

Regarding the tax obligations, e.g. tradesman pays income tax according to the rules for physical persons. The rate of this tax for 2014 amounts to 15%. The tax base here is the amount of income reduced by demonstrable costs for securing and maintaining income, or the amount equal to 60% of this income. Even this criterion meets the given requirements, because the tax obligation of this form of enterprise is minimal but according to study carried out by PriceWaterCooperhouse (Pwc), Czech firms spend in average about 413 hours/year on completing income tax returns. This fact places the Czech Republic at 122th position in the world rankings.

4. RECOMMENDATIONS

Self-employed is liable for the obligations arising with the trade activity, even with his/her personal assets, which may be considered a disadvantage of this form of enterprise. Another disadvantage lies in insolvency and its solution - there are no differences between a property of an entrepreneur and one which doesn't belong to him/her within his or her business activity. Hence, as a sole trader, you run your business on your name and you are liable with all your property. This form of liability is a crucial legal barrier - a person decided to start a business must count with this risk. Together with it entrepreneur must count with long administrative procedures. These barriers need to be removed by legislation, but representatives are not able to do so. Those barriers are also one of the aims in the within EU policy.

In relation to business corporations several legal barriers were removed. We mention the age of 16 and the basic capital as burdens as well as in the previous case of self-employed. Especially different forms of liability and number of partners within various business corporations are deemed to be main obstacles to establishment of a company. Since legislation is relatively new, there are various opinions on different forms of companies. Some changes are welcomed, some aren't. Thus before a person makes a decision to run a business in the Czech Republic, we can strongly recommend to thinking twice about pros and cons of each form of company and its extent of liability.

Young business people often have the most innovative ideas. Therefore, they can relatively easily use alternative forms of financing – such as crowdfunding, business incubators or business angels. We suggest that there should be a campaign or lectures at schools informing about these possibilities of financing new businesses.

There are many ways how to support young entrepreneurs through EU funding. It is necessary, however, to raise awareness among young people that such possibilities of financing exist and to make it easier for them to overcome administrative obstacles. Thus, we strongly recommend intensive advertisement via mass media and wide offer of consulting services.

As it is in the CR possible to run a business since the age of 16, it would be suitable to include a subject related to business matters in the high school curriculum. Such a subject should consist of basics in accounting, economy, finances, management and marketing. In a nutshell, student would by means of this subject acquire all necessary knowledge and skills to start their own business. The subject would be optional and included in the curriculums of both private and state high schools. It would mix theoretical and practical training from both professionals and trainers.

Regarding tax matters, young entrepreneurs should have some tax advantages/relieves. Those could encourage them to run their business. But reduction of tax rate for young entrepreneurs must be connected with reduction of administrative burdens. A potential young entrepreneur could be discouraged by those rates and burdens which pop up in many forms per year. Even if he/she could have a chance to gain good tax consultant or accountant service – also the price should be key element of not doing so. Hence, we would appreciate better support by state and also by these bodies and services to young talented people.

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