

A large, glowing golden ring, possibly a piece of jewelry, is the central focus of the cover. It is set against a dark background and has a bright, shimmering light reflecting off its surface, creating a circular glow.

*Introduction to
Business Costs in Iceland*

A Comparative Study of 87 Cities in Europe, North America and Japan



Reykjavik Resources

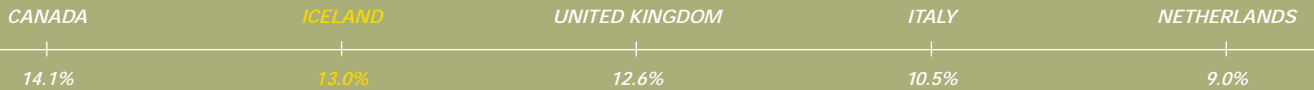


Landsbanki Islands



Invest in Ireland Agency

OVERALL RESULTS FOR FOURTEEN OPERATIONS



The Research Project

"Business Costs in Iceland" is a comprehensive guide for comparing business costs in Iceland to those in North America, Europe, and Japan. That KPMG report measures the combined impact of 27 cost components that are most likely to vary by location, as applied to specific business operations. The report has been produced by using the proprietary KPMG CCM-2002 Costing Model, which was developed by MMK Consulting for the January 2002 publication "Competitive Alternatives". That 10-month research programme covered cities throughout Austria, France, Italy, Germany, the Netherlands, the United Kingdom, Canada, the United States, and Japan. More than 1,000 individual business scenarios were examined and more than 30,000 items of data analysed. The basis for comparison is the after-tax cost of startup and operation for 12 specific types of business, over a 10-year time horizon.

For the purpose of the "Business Costs in Iceland" study, two additional operations were examined - server farms and medical devices - in addition to the standard 12 operations modelled in the Competitive Alternatives January 2002 publication.

"Business Costs in Iceland" is the result of an eight-month joint research project conducted from October 2001 until April 2002 by KPMG Consulting in Iceland and MMK Consulting.

Results for Iceland

As is demonstrated above, the overall results are positive for Iceland, as it is the lowest-cost country in Europe. Particular strengths include software, research & development operations, three manufacturing operations and the operation of server farms. Particular weaknesses are in some manufacturing operations like food processing and plastic products mainly due to high transportation costs. Iceland benefits from low energy costs, low labour costs, (especially in skilled labour), low land acquisition costs, and a favourable corporate tax structure. Due to its geographical position, Iceland has high transport costs and telecommunication costs.

The results for Iceland in the two additional operations are very positive. The server farm operation is energy- and capital-intensive, and its work force consists mainly of skilled technicians. These factors, in addition to limited transport requirements, work in Iceland's favour. The medical devices operation depends heavily on skilled labour; this factor, in addition to the beneficial corporate tax structure, works in favour of Iceland.

It is important to note, however, that recent developments in exchange rates have weakened the competitive position of Iceland while strengthening the comparative position of the US against other participating countries. The impact of exchange rate changes can be examined in detail online at www.CompetitiveAlternatives.com by registered users.

Costs by Industry Sector

Results for the standard 12 business operations modelled form the basis for comparing major industry sectors as well as individual industries. Results for these 12 operations, by industry sector, plus the two additional operations, are shown overleaf.

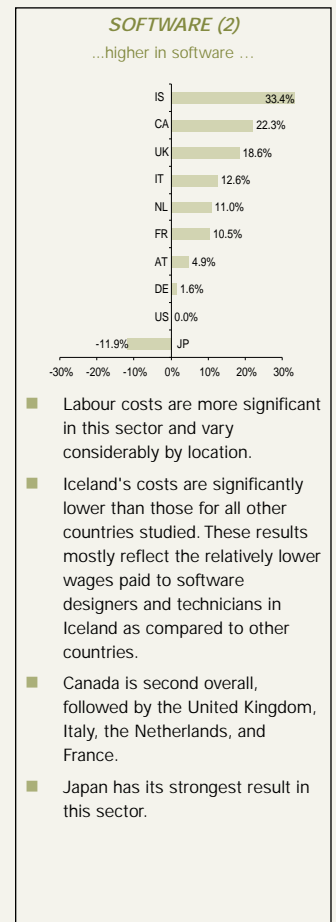
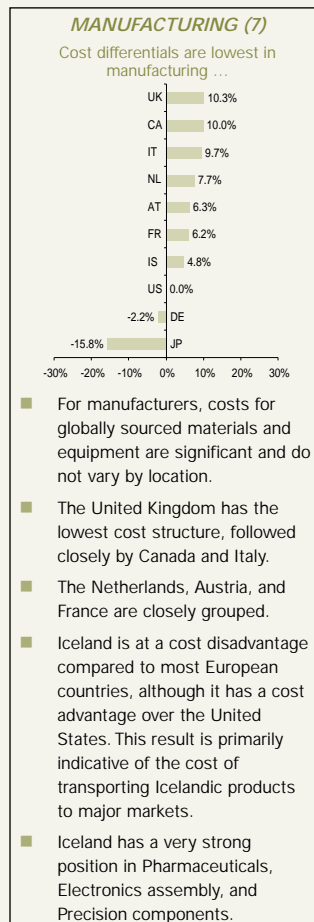
Cost Components

Labour is a key location-sensitive component, averaging 59 percent of location-sensitive costs for manufacturing and 81 percent for non-manufacturing operations. Total labour costs, including wages and salaries, statutory plans, and other benefits, are lowest in Canada, Iceland, the United Kingdom, Italy, and the Netherlands.

Taxes represent the second largest location-sensitive cost. On average, effective corporate income tax rates are lowest in Iceland, Canada, and the United Kingdom. Property-based taxes are lowest in Austria and the Netherlands.

Transportation costs represent 2 to 14 percent of costs for the manufacturing operations examined. Transportation costs-to-market are lowest in the Netherlands for road, sea, and air freight.

Energy costs represent 2 to 8 percent of costs for the manufacturing operations examined. Iceland offers the lowest electricity costs, while natural gas costs are lowest in France. For manufacturing, industrial **land** costs are lowest in Iceland, France, and the United States, while building **construction** costs are lowest in Italy and Canada. For non-manufacturing operations, **leasing** costs for suburban office space are lowest in Italy, Austria, France, and Iceland.



FRANCE

7.6%

AUSTRIA

6.1%

UNITED STATES

0.0%

GERMANY

-1.9%

JAPAN

-17.8%

International Results

Canada (CA) is the overall cost leader, i.e. has the lowest cost structure, with a cost index of 85.9, representing a 14.1 percent cost advantage over the United States (US = 100.0).

Iceland (IS, 87.0) is ranked second overall, closely behind the cost leader, Canada, with costs 13.0 percent lower than those in the US, making Iceland the cost leader in Europe.

The United Kingdom (UK, 87.4), with costs 12.6 percent lower than those in the US, is ranked third overall.

Italy (IT, 89.5) has improved its 1999 cost position against every other G7 country, due in part to significant reductions in employer costs for legally required employee benefits.

The Netherlands (NL, 91.0) ranks in fifth place, ahead of **France** (FR, 92.4).

Austria (AT, 93.9) has a cost structure similar to that in France; it has a significant cost advantage over neighbouring **Germany** (DE, 101.9).

The relative cost position of the **United States** (US, 100.0) has declined since 1999 due to the appreciation of the US dollar against major global currencies.

As in 1999, **Japan** (JP, 117.8) has the highest business cost structure among the countries examined in this study.

Cost Trends, 1999 - 2002

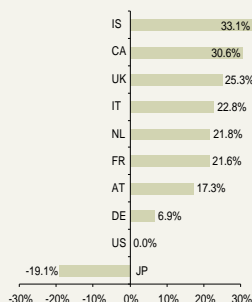
The competitiveness of all countries in the Euro currency zone has improved significantly due to the decline of the euro (EUR) against the US dollar (USD) since early 1999. Most European countries now rank ahead of the US in cost competitiveness. Other major currencies have also weakened relative to the US dollar, allowing all other countries to improve their cost positions compared to the United States.

The Icelandic krona (ISK) is pegged to a basket of eight currencies and is weighed annually with respect to the share of each country's currency in the trade of goods and services. The krona floats freely relative to a calculated inverse index of these currencies. In March 2001, the Central Bank of Iceland adopted an inflation target for the krona and abandoned a policy of stable exchange rates. Traditionally, volatility has been rather low in the past few years. However, oscillations have increased with the introduction of the new monetary regime. A gradual weakening of the krona was also witnessed which peaked in November but has since appreciated somewhat. At present, the krona seems to have stabilised.

Regarding other cost factors, trends have been downward in some cost areas. European utility and telecommunications costs have dropped due to deregulation. In addition, many jurisdictions have implemented sizeable tax reductions since 1999.

RESEARCH & DEVELOPMENT (2)

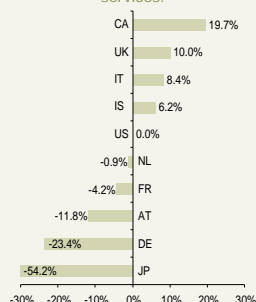
...even higher in R&D ...



- Salary costs for scientists and technicians are a major factor in this sector and vary dramatically among countries.
- Iceland's results are similarly strong for typical R&D operations, reflecting its competitive wage and salary levels for scientists and engineering positions.
- Germany has its strongest result in this sector, with a cost structure significantly lower than that in the US.

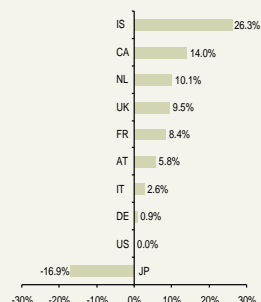
CORPORATE SERVICES (1)

... and significantly highest in corporate services.



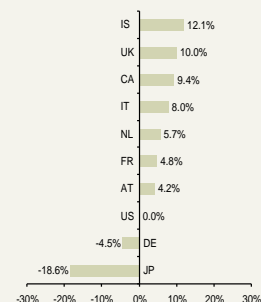
- Corporate services include centralized:
- account processing
 - call centres
 - IT support operations
- Canada has a very strong competitive position in corporate services, with the UK and Italy closely grouped almost 10% behind the cost leader. Iceland's competitive position is somewhat behind the three leading countries (Canada/ UK/ Italy). Results in this sector closely reflect relative labour costs (wages and benefits) for administrative staff positions.
- The United States has its strongest result in this sector, reflecting its relatively low clerical and administrative salaries.

SERVER FARMS (1)



- Labour and energy are the main cost factors in this sector (cost of bandwidth was not taken into account in the study).
- Iceland has a decisive cost advantage over other countries in this study, mainly due to low energy costs.
- Canada is in second place and has a 4% cost advantage over the Netherlands.
- Japan has a very high cost index, reflecting relatively high labour and energy cost levels.

MEDICAL DEVICES (1)



- The medical devices sector focuses on prosthetics manufacturing and is driven mainly by wage and salary levels.
- Iceland is the overall cost leader because of its favourable corporate tax structure and competitive labour costs. It is closely followed by the UK, Canada, and Italy.
- The Netherlands, France, and Austria are closely grouped, with higher labour costs than the cost leaders.
- The US, Germany, and Japan are less competitive.



BUSINESS OPERATIONS MODELLED IN THE STUDY

Manufacturing

Metal components
Plastic products
Food processing
Electronic assembly
Precision components
Pharmaceuticals
Specialty chemicals

Software

Advanced software
Content development

R&D

Biomedical R&D
Electronic systems development and testing

Corporate services

Shared service centre

Additional operations

Medical devices
Server farms

STUDY CONTACTS

Copies of the full report can be downloaded from www.kpmg.is or www.invest.is or purchased in printed format from KPMG Iceland. Access to the CCM-2002 Costing Model can be obtained via KPMG Iceland.

For further information about this study and its results, visit www.CompetitiveAlternatives.com, or contact any of the individuals listed below.

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