

FICIL

DEVELOPMENT OF THE INVESTMENT
CLIMATE IN LATVIA: THE VIEWPOINTS OF
FOREIGN INVESTORS

SENTIMENT INDEX

2018



FICIL
20



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ABOUT THE AUTHOR

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His academic research findings have appeared in journals such as Journal of Business Ethics, International Small Business Journal, Journal of Comparative Economics as well as books published by Springer, Routledge, Edward Elgar, IGI Global, Blackwell and Peter Lang. Arnis is extensively involved in applied research, including studies contracted by the OECD, Eurofound and various banks, industry associations and NGOs. He is co-author of the Shadow Economy Index for the Baltic Countries.

FOREWORD

The European economy has been growing at its fastest rate for a decade. However, in Latvia, during 2018, the influx of foreign direct investment has been mercurial. In the first half of 2018, the flow of investment was twice as low as compared to the same time last year. This could be interpreted as a reaction to the reputation crisis of the financial sector, but is probably also a result of years of uncertainty and volatility. Of course, action taken to attract new investment is commendable, but first and foremost, pressing issues constraining growth need to be addressed.

2018, overall, has been a significant year for Latvia. The “FICIL Sentiment Index 2018” has been compiled over a time period stretching from the pre-election debates all the way to the 100th anniversary celebration of the Proclamation Day of the Republic of Latvia. Every election period elicits a sense of a new beginning, and this feeling has been amplified this year as the country enters its next centenary.



While FICIL appreciates the government's efforts in enhancing the business environment, the foreign investors have identified areas that need critical attention and comprehensive action in order to facilitate economic growth for Latvia. For the fourth year in a row, FICIL members have drawn attention to the availability of workforce, reform of higher education and the capability to combat

economic and financial crime as being amongst the main issues. The government's response to the MONEYVAL report will constitute the will to deal with economic and financial crime and, if successful, could restore some of the reputational damage suffered in 2018.

During the 22nd High Council meeting in 2018, the conversation revolved around an important aspect of cooperation – building trust. Respect for the rule of law, sound use of public funds, enforcing law and engaging with citizens are all important contributors towards building trust. With increased transparency, we see sound controls and healthy governance prevailing.

FICIL is celebrating its 20th anniversary this year. We are determined and committed to continue to work hand in hand with the government and responsible institutions to improve the investment climate and business environment in Latvia. With the said new beginning taking place, this is exactly the right time to work together to boost Latvia's future, for tomorrow is the consequence of now.

Julia Sundberg

Foreign Investors' Council in Latvia

Chairperson of the Board

THE NUMBER OF
COMPANIES ABOVE
145K EUR TURNOVER
AND 50% FOREIGN
CAPITAL (MAJORITY)

4423

OR 1/5 OF TOTAL NUMBER OF COMPANIES IN LATVIA



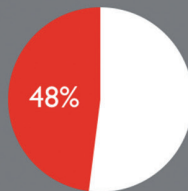
OF TOTAL
SOCIAL TAX



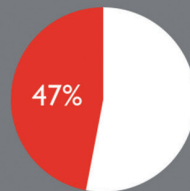
OF TOTAL
TAXES PAID



OF TOTAL
WORKFORCE

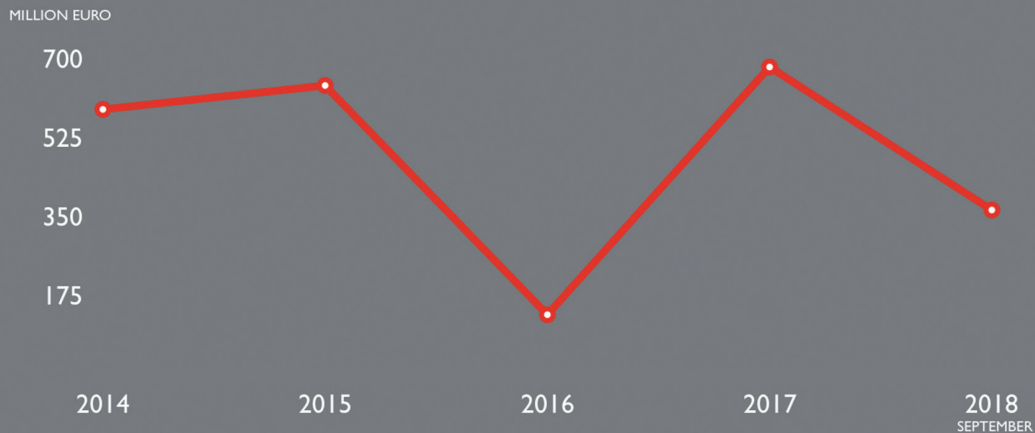


OF TOTAL
TURNOVER



OF TOTAL
PROFIT

INFLOW OF FOREIGN DIRECT INVESTMENT IN LATVIA



INTRODUCTION

The FICIL Sentiment Index was established in 2015 by the Foreign Investors' Council in Latvia (FICIL), in cooperation with the Stockholm School of Economics in Riga (SSE Riga).

This is the fourth FICIL Sentiment Index report, following the three reports written in 2015, 2016 and 2017. The key aim of the Index is to foster more evidence-based policy decisions to further promote a favourable investment climate in Latvia. We aim to achieve this by summarising the key concerns and suggestions of the main foreign investors in Latvia – representatives of companies that have made the decision to invest in the country and have been operating here for a considerable period of time.

As in 2015, 2016 and 2017, this report draws on a survey: mini case studies of foreign investors in Latvia. From September to early November 2018, we interviewed the same 38 (out of 42) companies that took part in the 2017 study. In addition, 2 new companies joined the sample in 2018.

Altogether, these companies (including their subsidiaries) contribute to 9% of Latvia's total tax revenue, 18% of total profit and employ 4% of total workforce of companies above 145000 EUR turnover and 50% foreign capital (data from Firms.lv, 2017).

We hope that similarly to the previous three reports, this report will also provide policy-makers with better grounds for making informed policy decisions in such a way that the overall competitiveness of the entrepreneurship climate in Latvia will be improved. It is also hoped that it will continue to foster further constructive communication between foreign investors and the government of Latvia.

FICIL SENTIMENT INDEX

FOREIGN INVESTORS' IN LATVIA ASSESSMENT OF THE POTENTIAL
DRIVERS OF ECONOMIC COMPETITIVENESS OF LATVIA.



AVAILABILITY
OF LABOUR



EFFICIENCY OF
LABOUR



DEMAND FOR
PRODUCTS AND
SERVICES



ATTITUDE TOWARDS
FOREIGN INVESTORS



QUALITY OF
BUSINESS
LEGISLATION



QUALITY OF
EDUCATION
AND SCIENCE



QUALITY OF
HEALTH AND
SOCIAL SECURITY



HARD
INFRASTRUCTURE



SOFT
INFRASTRUCTURE



DEMOGRAPHY



STANDARD OF
LIVING IN LATVIA



FIRST ESTABLISHED IN 2015 TO
FOSTER MORE EVIDENCE-BASED
POLICY DECISIONS IN PROMOTING
A FAVOURABLE INVESTMENT
CLIMATE IN LATVIA

FOCUS OF 2018 STUDY:



DO INVESTORS SEE PROGRESS WITH REGARDS TO
POLICY INITIATIVES TO MEET THE MAIN CHALLENGES
AS IDENTIFIED IN 2015, 2016 AND 2017 STUDIES?



HOW INVESTORS EVALUATE GOVERNMENT'S
EFFORTS AND CURRENT POLICY INITIATIVES AIMED
TO IMPROVE INVESTMENT CLIMATE IN LATVIA?



WHICH HAVE BEEN THE 'BEST' AND 'WORST' DECISIONS
OR POLICY INITIATIVES THAT HAVE BEEN INTRODUCED
BY THE LATVIAN GOVERNMENT OVER THE LAST 5 YEARS
AND HAD A POSITIVE OR NEGATIVE IMPACT ON THE
BUSINESS ENVIRONMENT OF LATVIA?

A hand holding a blue pen points to a business report. The report features a bar chart with red, teal, and orange bars, and a line graph with green and red lines. The text 'KEY RESULTS' is overlaid in large white letters. The background is a blurred office setting.

KEY RESULTS

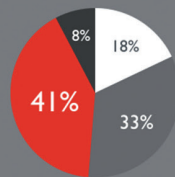
FOREIGN INVESTORS' ASSESSMENT OF THE PROGRESS OVER THE PAST 12 MONTHS WITH REGARDS TO THE KEY AREAS OF CONCERN AS IDENTIFIED IN THE 2015, 2016 AND 2017 STUDIES: FINDINGS FROM 2018



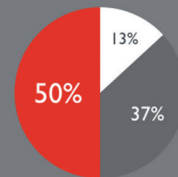
DEMOGRAPHY



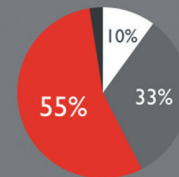
ACCESS TO LABOUR



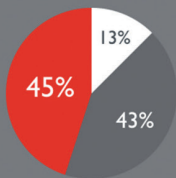
THE HEALTHCARE
SYSTEM IN LATVIA



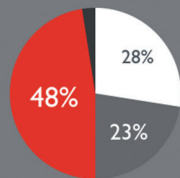
COURT SYSTEM IN LATVIA



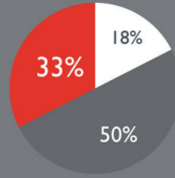
UNCERTAINTY



QUALITY OF THE
BUSINESS LEGISLATION



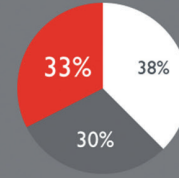
UNETHICAL /
ILLEGAL BEHAVIOUR
BY ENTREPRENEURS,
UNFAIR COMPETITION



QUALITY OF THE
TAX SYSTEM



LEVEL OF EDUCATION
AND SCIENCE



SUPPORT FROM THE
GOVERNMENT AND
COMMUNICATION WITH
THE POLICY MAKERS

YES
 NO
 PARTLY
 N/A



Significantly (negatively) affected by banking reputation crises – due to implementing AML procedures and due to the Bank of Latvia crisis

MANUFACTURING COMPANY



The only positive aspect at the current time is the increasing economic trends, however, I'm not sure whether this can be correlated with the government's active work.

CONSULTANCY AND IT COMPANY



There might be small changes in the overall efficiency when it comes to administrative tasks, some improvements with digitalisation; it's a bit easier to handle some things online. But, in terms of demography, access to labour and the banking sector – things have got worse.

MANUFACTURING COMPANY

HAS THE INVESTMENT ATTRACTIVENESS OF LATVIA IMPROVED DURING THE PAST 12 MONTHS?



SCALE 1-5 WHERE: '1' – INVESTMENT ATTRACTIVENESS HAS NOT IMPROVED AT ALL, '3' – THERE HAVE BEEN SOME POSITIVE IMPROVEMENTS, '5' – INVESTMENT ATTRACTIVENESS HAS IMPROVED SIGNIFICANTLY.



Short-term and reactive
behaviour.

RETAIL TRADE AND SERVICE COMPANY



I believe that the government acknowledged
the need for the structural reforms, but has
not really done anything to properly plan
and perform them.

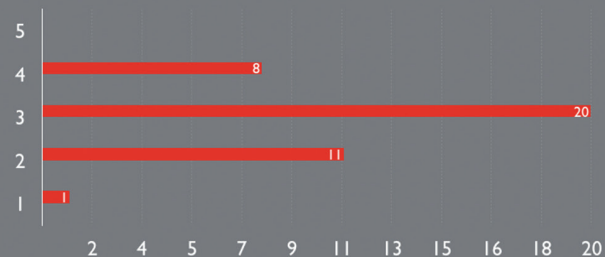
PPROFESSIONAL ASSURANCE AND ADVISORY SERVICES COMPANY



Last year was better than the average year in
Latvia, the general view is that there have been
small improvements, some decisions have been
made with far-reaching consequences.

FINANCE AND BANKING COMPANY

FOREIGN INVESTORS' ASSESSMENT OF POLICY MAKERS' EFFORTS TO IMPROVE THE INVESTMENT CLIMATE OVER THE PAST YEAR



SCALE 1 TO 5, WHERE '1' – FAIL, '3' – AVERAGE AND '5' – EXCELLENT



YEAR 2018
MARKS NEW
CONCERNS



SITUATION IN THE
FINANCIAL SECTOR, ITS
CONSEQUENCES AND
REPUTATION ISSUES



ROLE OF RIGA



SITUATION IN THE FINANCIAL SECTOR, ITS CONSEQUENCES AND REPUTATION ISSUES

"It seems like the government was unable to react quickly and efficiently to the crisis in the financial sector; a lot of things could have been done differently to salvage whatever good reputation was left. The government didn't effectively communicate the crises, meaning policies in place regarding non-residents."

PPROFESSIONAL ASSURANCE AND
ADVISORY SERVICES COMPANY

"Non-resident finances – the idea to clean up the financial sector was good, but the way it was carried out was very bad. This has damaged Latvia's reputation for years to come. Looks like the country is handing its functions over to the private sector."

SERVICE COMPANY

"Poor management of Latvia's reputation in the international arena with regard to finance sector transparency and integrity. Latvia is still perceived as the centre of money laundering."

MANUFACTURING COMPANY

"The pace of introducing AML procedures in Latvia is extremely slow (the banking system is very shaky right now)."

PROFESSIONAL ASSURANCE AND
ADVISORY SERVICES COMPANY



ROLE OF RIGA

“We need to join forces and place Riga on the map where it deserves to be – right next to other Nordic metropolises. According to several sources (including the sustainable development strategy for Latvia 2030), more than 1 million live in metropolitan Riga. And, almost 100 000 out of these 1 million are students (local, foreign) who are our future. We belong in the company of the big Nordic metropolises – Stockholm (2.2 million), Copenhagen (2 million), Helsinki (1.6 million) and Oslo (1.2 million). We should have already been in that company for many years and stopped competing with Tallinn and Vilnius! The first step for getting there is to become more active, vocal and ambitious and everyone up to the highest echelons of the government should fight for the place of Riga on the European map!”

REAL ESTATE COMPANY

ACUTE PROBLEMS



CORRUPTION
IN THE PUBLIC
SECTOR



AVAILABILITY
AND QUALITY
OF LABOUR



EFFECTIVENESS
OF THE PUBLIC
SECTOR



CORRUPTION IN THE PUBLIC SECTOR

"In our (Latvia) case, the shadow economy is more under control now than it was before. Positive developments over the years. Almost every month you can see new cases of corruption coming to light in society and in the media, so I guess there is still a lot of corruption, it just needs to be tackled more effectively."

RETAIL TRADE AND SERVICE COMPANY

"No improvements with regard to Riga City council and its companies. But a slight decrease of the shadow economy in general."

FINANCE AND BANKING COMPANY

"Inability to deal with the non-resident issue and anti-money laundering and other financial crimes [is a major problem]. Society seems to be uneducated on this topic. Latvia lacks a clear vision and strategic thinking when dealing with these problems."

FINANCE AND BANKING COMPANY

"Corruption is still there and I do not see that there will be any progress. I think there are many areas where there is no transparency, esp., regarding EU funding."

CONSULTANCY AND IT COMPANY



AVAILABILITY AND QUALITY OF LABOUR

"I would say that the situation has worsened: there is practically no unemployment in Riga; it has become harder and more expensive to find employees."

CONSULTANCY AND IT COMPANY

"We have a lot of vacancies all over Latvia; it shows economic growth, but also shows that we don't have enough workforce. This situation has worsened."

MANUFACTURING COMPANY

"There are some improvements in immigration laws but dealing with all the paperwork for immigration is very heavy stuff. There are so many inconsequent decisions. Everything depends on the clerk that you get at the window."

CONSULTANCY AND IT COMPANY

"Bureaucracy is very heavy regarding immigration. No digitalisation in this area. The processes could have been much easier."

CONSULTANCY AND IT COMPANY



EFFECTIVENESS OF THE PUBLIC SECTOR

“Many things have not been done; no proactive actions from the government to improve the business environment.”

FINANCE AND BANKING COMPANY

“The government is not clear, they don't explain their decisions and reasons for certain actions. When it comes to the environment - if they really care about the environment why are they unable to implement any favourable policies in reality?”

WHOLESALE AND RETAIL COMPANY

“Lack of long-term strategy and decision-making ability. Unwillingness to make important decisions that would make a difference.”

RETAIL TRADE AND SERVICE COMPANY

“Inertia from the government, very inward focused, with a survival instinct. They didn't really address the big problems like education, health.”

SERVICE COMPANY

CHRONIC PROBLEMS



UNCERTAINTY



SHADOW
ECONOMY



EDUCATION
SYSTEM



UNCERTAINTY

“Uncertainty is increasing based on all the failed changes the government has made.”

MANUFACTURING COMPANY

“It seems that bureaucracy at municipality level has increased. For example, if once there were mostly building inspectors and building engineers in Riga City Construction Board then now they mainly have teams of lawyers.”

RETAIL TRADE AND SERVICE COMPANY

[uncertainty] is still strong due to geopolitical aspects, business environment and new government.”

MANUFACTURING COMPANY

“Stability of taxation is very important.”

MANUFACTURING COMPANY



SHADOW ECONOMY

“Some initiatives to tackle the shadow economy. Maybe efficiency is not there but the government should be credited for doing this.”

REAL ESTATE COMPANY

“Inability to combat the grey economy in construction [is a major problem]. Inability to hold Riga City Council and its companies accountable for all the corrupt methods and terrible governance. Lack of investigation of economic crimes.”

FINANCE AND BANKING COMPANY

“It seems that public enterprises are becoming more and more transparent; however, the statistics show that it's not the case. The corruption at state level might have decreased, but not at municipality level.”

FINANCE AND BANKING COMPANY

“More should be done. Why is no-one controlling all those who are paying 500 EUR banknotes into supermarket cash machines? Overall, the situation in the SRS has improved. It is doing better and performing better; their staff are more responsive.”

PROFESSIONAL ASSURANCE AND ADVISORY SERVICES
COMPANY



EDUCATION SYSTEM

"Not really getting better, science is just sad, not much improvement. EU Horizon programme is great - gives more Latvians an opportunity to excel at science. Money can be won in competitions for innovation. Latvia spends little money on science, and the role of science in Latvia is also very small."

FINANCE AND BANKING COMPANY

"No progress, extremely important."

REAL ESTATE COMPANY

"The idea is good in reforms for secondary education, but how it will be implemented is another question."

RETAIL TRADE AND SERVICE COMPANY

"We do not feel that the quality of, for example, IT employees, is insufficient."

CONSULTANCY AND IT COMPANY

PARTLY SOLVED PROBLEMS



DEMOGRAPHY
AND HEALTHCARE
SYSTEM



TAX REFORM



UNETHICAL OR
ILLEGAL BEHAVIOUR
BY ENTREPRENEURS,
UNFAIR COMPETITION



DEMOGRAPHY
AND HEALTHCARE
SYSTEM

“Very little change for the better. Immigrants and emigrants seem to level out. Subjectively, I feel that newborn numbers are increasing.”

MANUFACTURING COMPANY

“Population decline continues, but at a slower pace.”

FINANCE AND BANKING
COMPANY

“Current policy-makers’ ambitions to improve the Latvian demography seem to be more like a banner, rather than a long-term goal with an actionable step-by-step plan for how to get there.”

RETAIL TRADE AND SERVICE COMPANY

“Still an issue, size of the population is decreasing.”

CONSULTANCY AND IT COMPANY



TAX REFORM

“Tax reform was a good idea, but the implementation was lacking. Wasn’t carried out well.”

MANUFACTURING COMPANY

“It is too early to speak about the possible impact.”

PROFESSIONAL ASSURANCE AND
ADVISORY SERVICES COMPANY

“So much ambiguity, the timeline was impossible for businesses to prepare themselves appropriately. And responsible authorities are not able to provide timely explanations.”

CONSULTANCY AND IT COMPANY

“Remained complex, a lot of changes. The changes are good for a big company. We are fully transparent.”

CONSULTANCY AND IT COMPANY



UNETHICAL OR
ILLEGAL BEHAVIOUR
BY ENTREPRENEURS,
UNFAIR COMPETITION

“Overall the negative tendencies seem to be decreasing; this field is becoming more honest”

MANUFACTURING COMPANY

“Some of the banks are not entirely fair in how they deal with their customers. And then it goes to the entire industry. A lot of pressure in the banking sector”

FINANCE AND BANKING COMPANY

“We have introduced comprehensive guidelines in our company group, the awareness of ethical practice and its importance is growing.”

REAL ESTATE COMPANY

“Employees are the asset that we compete for and in this area, we do see unfair competition. Sometimes businesses accept unfair behaviour because they do not want to waste time and money going to court.”

CONSULTANCY AND IT COMPANY





FICIL SENTIMENT INDEX

FOREIGN INVESTORS' IN LATVIA ASSESSMENT OF THE POTENTIAL DRIVERS OF
ECONOMIC COMPETITIVENESS OF LATVIA.

SCALE 1–5, WHERE 1 REPRESENTS ATTITUDE ABOUT LOW COMPETITIVENESS
AND 5 REPRESENTS ATTITUDE OF VERY HIGH COMPETITIVENESS.



AVAILABILITY
OF LABOUR



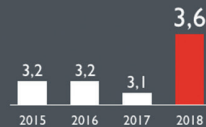
EFFICIENCY OF
LABOUR



DEMAND FOR PRODUCTS
AND SERVICES



ATTITUDE TOWARDS
FOREIGN INVESTORS



QUALITY OF BUSINESS
LEGISLATION



QUALITY OF EDUCATION
AND SCIENCE



QUALITY OF HEALTH
AND SOCIAL SECURITY



HARD
INFRASTRUCTURE



SOFT
INFRASTRUCTURE

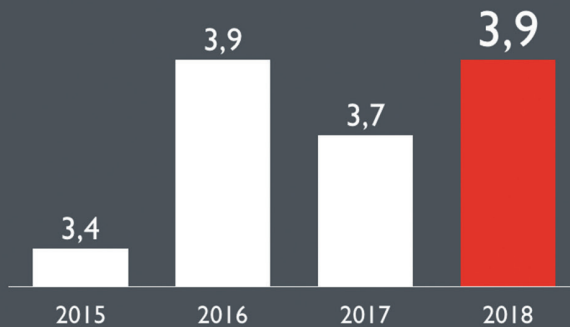


DEMOGRAPHY

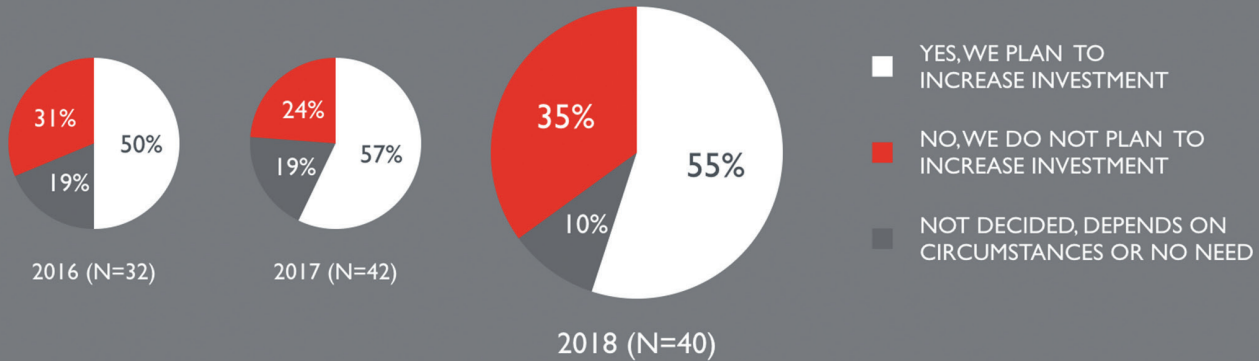




STANDARD OF LIVING IN LATVIA



FURTHER INVESTMENT PLANS





YES, WE PLAN TO INCREASE INVESTMENT



Yes, we believe that there will be development within the circular economy sector. Probably between 2020-2021, 50-100 million.

RETAIL TRADE AND SERVICE COMPANY

We continue to invest in Latvia, we invest about 2-4 million every year, and we will continue investing the same amount in the next few years as well.



RETAIL TRADE AND SERVICE COMPANY



We are planning on investing a lot. It will be around 13 million in total by the end of 2019. Our aim is more towards the local consumers, we will be making changes in packaging and we will be adding new products as well. There will be a small amount aimed at export but mostly we are targeting locals. Export is more tended towards Denmark, Romania, Norway.

MANUFACTURING COMPANY



NO, WE DO NOT PLAN TO INCREASE INVESTMENT



Not in the coming year. Our group company decided to expand in other countries – Georgia and Malta. One of the reasons – access to labour. Also attitude towards foreign investors is much better there.

CONSULTANCY AND IT COMPANY

We are not planning on increasing investment at the moment. No specific reason.



CONSULTANCY AND IT COMPANY



No, not planning on increasing. The key reason is that at global level Latvia is viewed as a high-risk country because of the financial sector. It's a matter of – the country is small, we will maintain the same level of operations.”

PROFESSIONAL ASSURANCE AND ADVISORY SERVICES COMPANY



NOT DECIDED, DEPENDS ON CIRCUMSTANCES OR NO NEED

Our investment will depend on availability of workforce. There will be some investment, but it will depend on labour.



CONSULTANCY AND IT COMPANY



Probably yes, everything depends on construction prices and availability of labour. We have been offered to take over some assets from other developers who are leaving or freezing their projects due to the problems in the construction sector in Latvia. In terms of our own investment, we are thinking about renting houses, offices as well. Investment of around 50 million.

REAL ESTATE COMPANY

COMPANIES THAT TOOK PART IN THE STUDY



ALTOGETHER, THESE



COMPANIES (INCLUDING
THEIR SUBSIDIARIES)
CONTRIBUTE TO

9%



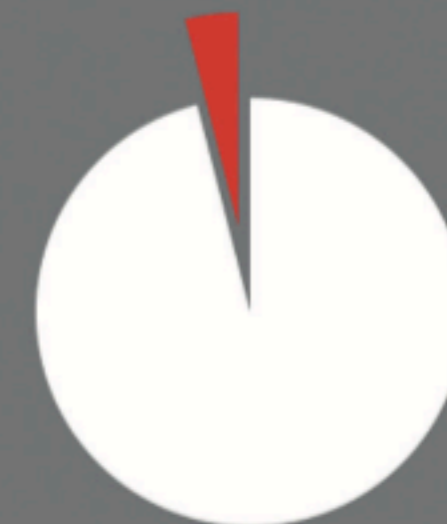
OF TOTAL TAX
REVENUE

18%



OF TOTAL
PROFIT

4%



OF TOTAL
WORKFORCE*

* CONTRIBUTION AS COMPARED TO COMPANIES ABOVE A 145000 EUR TURNOVER AND 50% FOREIGN CAPITAL, SOURCE FIRMAS.LV

Foreign Investors' Council in Latvia (FICIL) is a non-governmental organisation that brings together the largest foreign companies in Latvia, the foreign chambers of commerce and the Stockholm School of Economics in Riga.

FICIL actively searches for and proposes solutions to improve and develop the business and investment environment in the country in cooperation with the government of Latvia.

Full FICIL Sentiment Index report available at

www.ficil.lv



British Embassy
Riga



Government of the
United States