

FICIL

SENTIMENT

VIEWPOINTS OF FOREIGN INVESTORS
ON THE DEVELOPMENT OF THE INVESTMENT
CLIMATE IN LATVIA: THE IMPACT OF THE
COVID-19 PANDEMIC

INDEX

2020



FICIL



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ABOUT THE AUTHOR

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His academic research findings have appeared in journals such as *Strategic Entrepreneurship Journal*, *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 a co-author of the Shadow Economy Index for the Baltic Countries.

FOREWORD

For a long time to come, 2020 for all of us will be the dividing line between before and after. We will not find out when, or if, we will be returning to the "old life" before the second half of 2021. But the reassuring news is that everything comes to an end eventually, including a pandemic. This year, foreign investors, just like the rest of the business world, adapted and reorganised their operations. However, although concerns about the future hampered the implementation of investment plans, they were not completely halted. But we entrepreneurs are already looking ahead and planning growth, hoping that the country will be a partner in overcoming the consequences of Covid-19.



FICIL thanks the government for investors feeling heard in 2020. We commend the determined and swift action in the spring, as well as the open negotiations and the implementation of the FICIL recommendations. We continue to look forward to a conversation in which we are heard, even during the escalated times of a crisis.

The million-euro question is: how skilfully and wisely will we invest the funds allocated to our country in the European Recovery and Sustainability Mechanism. Are we thinking only of short-term needs, or are we looking into the future? Yes, these funds can partially address the challenges posed by the pandemic, but they can also be used for long-term goals for the country's growth: digitalisation and the development of a green economy.

Our most valuable resource for the future will be our citizens. There is a paradox. The pandemic crisis has increased unemployment, while employers still lack a skilled, modern workforce. The state should work to close this gap, with a long-term perspective. How capable will our future employees be? The simplest functions will soon be taken over by robots, but the job market will need employees with programming skills, complex problem-solving skills, the ability to work in a team (also remotely), and language skills. The country's success will be based on a long-term plan for developing the skills of the workforce.

The pandemic has also had a "positive effect". We have quickly learned to work remotely, sell and provide services digitally, and now is the time to plan the next step in the country's digital transformation. We will make a huge leap, both by growing the digital skills of the population and by skilfully connecting large national IT systems. FICIL considers that the experience of other countries, where the national digital transformation is monitored and coordinated uniformly at national level, is significant.

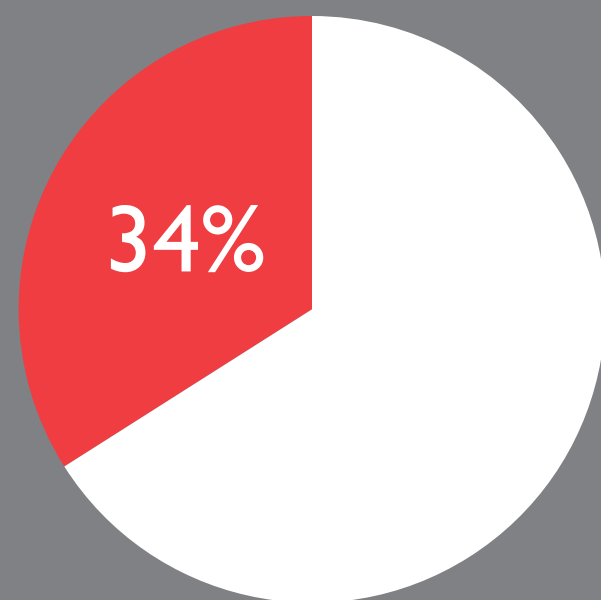
The year 2020 will, of course, leave quite painful scars, but there is no reason to believe that everyone has experienced a decline. The FICIL Sentiment Index 2020 reveals that more than half of investors have managed to maintain, or even grow, turnover, and most investors plan to increase investment in 2021. Attracting investment will be one of the ways for Latvia to recover from the consequences of the crisis as soon as possible. It must be remembered that the crisis has impacted the whole world and all countries are fighting to attract investors. It would be wiser to maintain and increase the amount of investment among existing investors. We, the investors, will appreciate a well thought-out and timely tax policy, a credible judiciary, stability and predictability in legislation, as well as a generally constructive and open dialogue between investors and the state.

Gunta Jēkabsone
FICIL Chairperson of the board

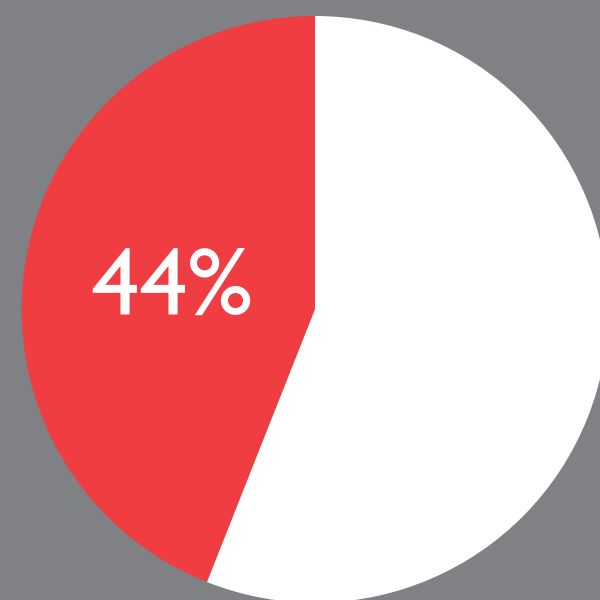
THE NUMBER OF
COMPANIES ABOVE
145K EUR TURNOVER
AND 50% FOREIGN
CAPITAL (MAJORITY)

4310

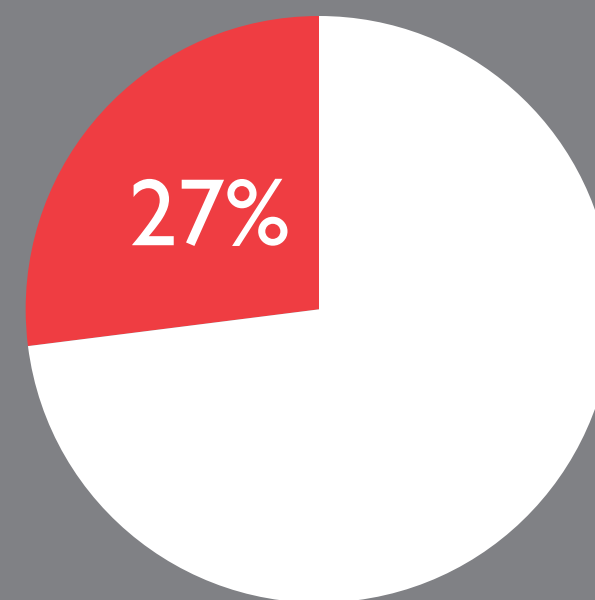
OR 1/6 OF TOTAL NUMBER OF COMPANIES IN LATVIA



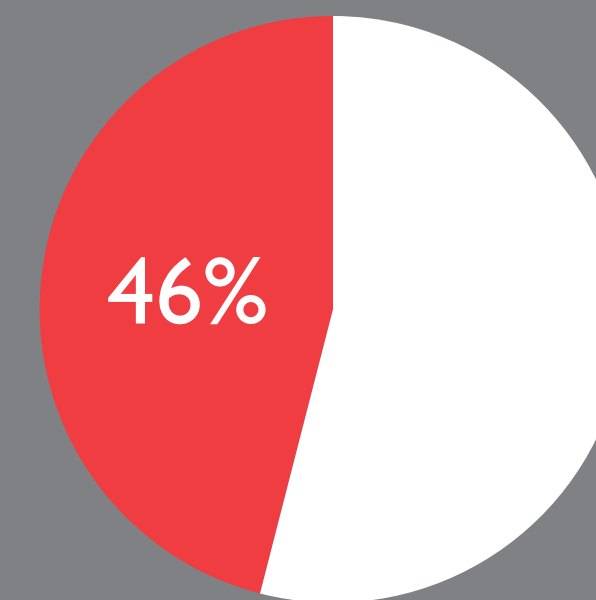
OF TOTAL
SOCIAL TAX



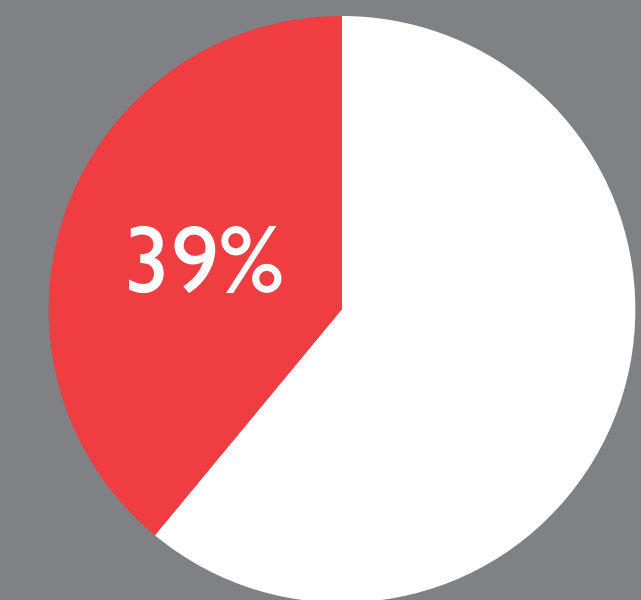
OF TOTAL
TAXES PAID



OF TOTAL
WORKFORCE



OF TOTAL
TURNOVER



OF TOTAL
PROFIT

INFLOW OF FOREIGN DIRECT INVESTMENTS IN LATVIA

MILLION EUR

900

720

540

360

180

2015

2016

2017

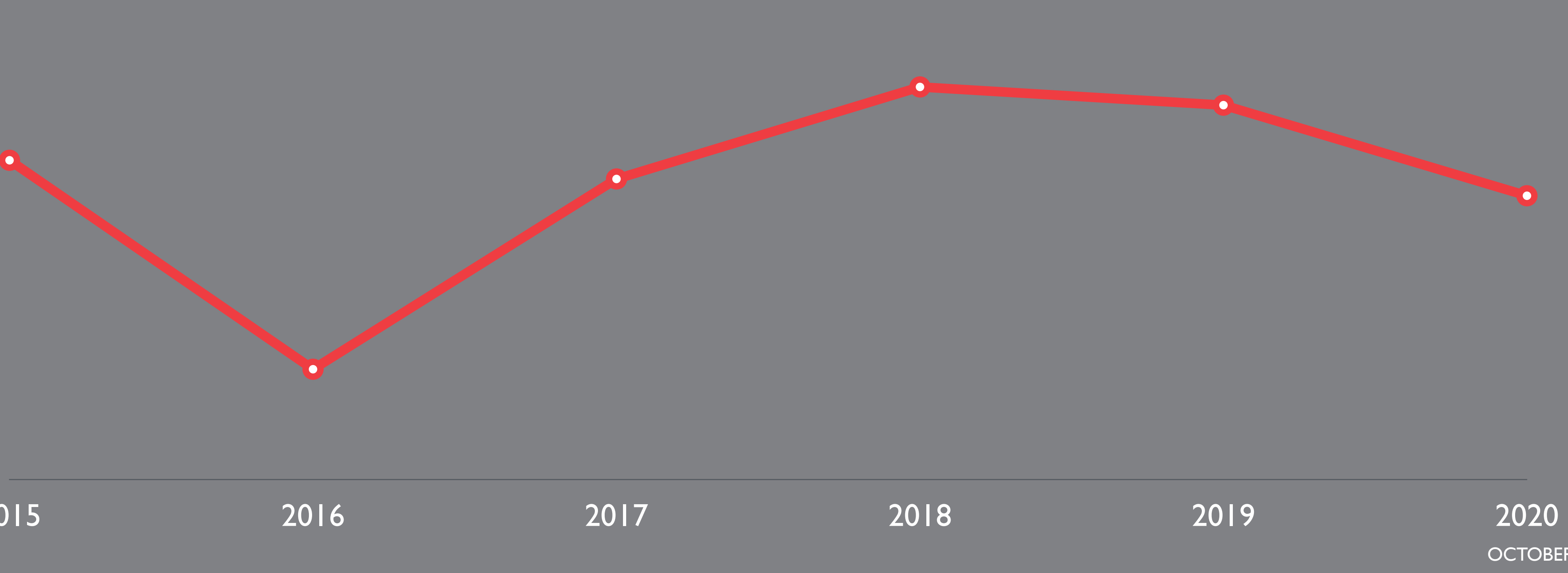
2018

2019

2020

OCTOBER

BANK OF LATVIA, 2020



INTRODUCTION

The FICIL Sentiment Index was first launched 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 sixth FICIL Sentiment Index report, following the five reports written in 2015, 2016, 2017, 2018 and 2019. The key aim of this report is to provide an in-depth exploration of the main challenges and concerns for the foreign investors in Latvia, in particular considering the impact of the Covid-19 pandemic, both by identifying problems and offering solutions.

As in previous studies, this report draws on a survey: mini case studies of foreign investors in Latvia. From September to early November 2020, we interviewed 44 senior executives representing companies that are key investors in Latvia.

Altogether, these companies (including their subsidiaries) contribute to 16% of Latvia's total tax revenue, 13% of the total profit and employ 10% of the total workforce of companies with a turnover above 145 000 EUR and 50% foreign capital (data from Lursoft, 2019).

FOCUS OF 2020 STUDY:



Do investors see progress with regards to policy initiatives to meet the main challenges as identified in previous studies?



How do investors evaluate government's efforts and current policy initiatives aimed at improving the investment climate in Latvia?

AREAS HIGHLIGHTED IN 2020 STUDY:



Challenges investors faced in 2020 and proposed solutions

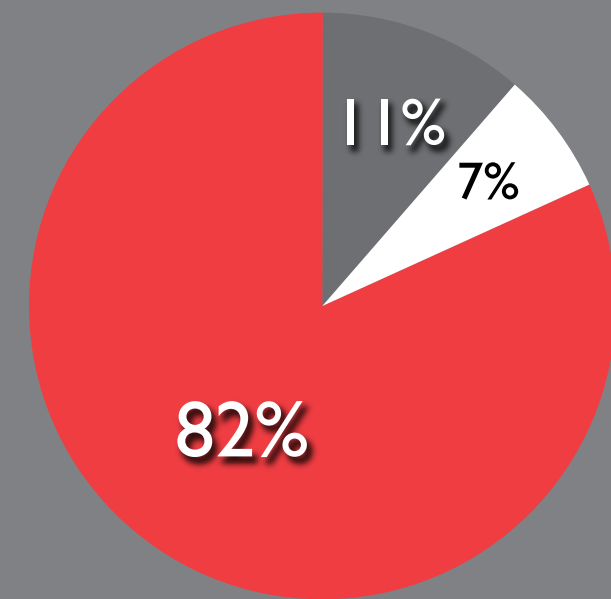


Investors' viewpoint on EU recovery fund spending priorities

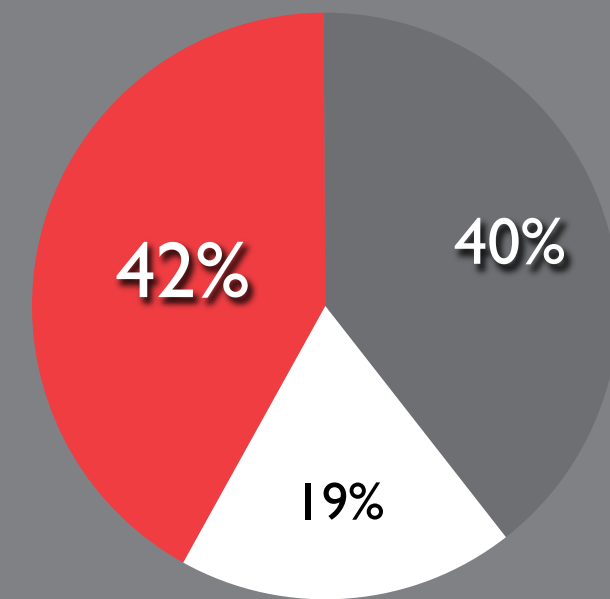


KEY RESULTS

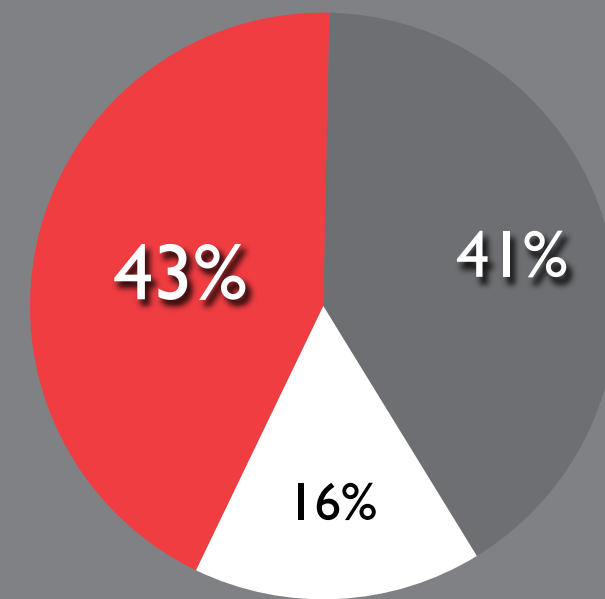
FOREIGN INVESTORS' ASSESSMENT OF THE PROGRESS OVER THE PAST 12 MONTHS WITH REGARD TO THE KEY AREAS OF CONCERN AS IDENTIFIED IN THE PREVIOUS STUDIES: FINDINGS FROM 2020



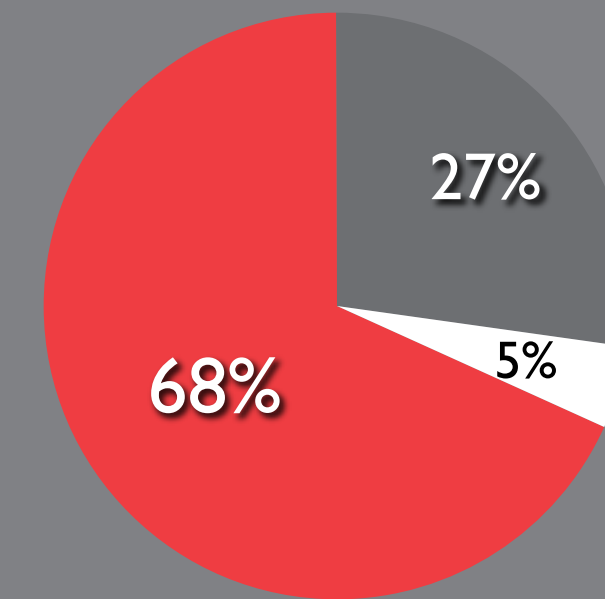
DEMOGRAPHY



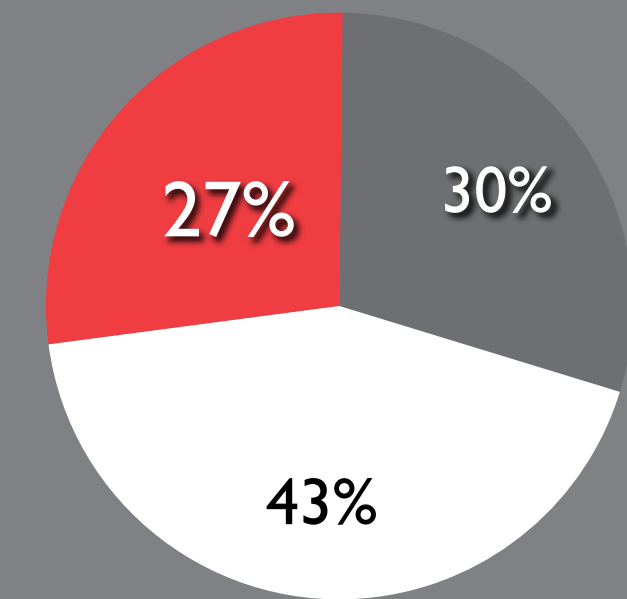
ACCESS TO LABOR



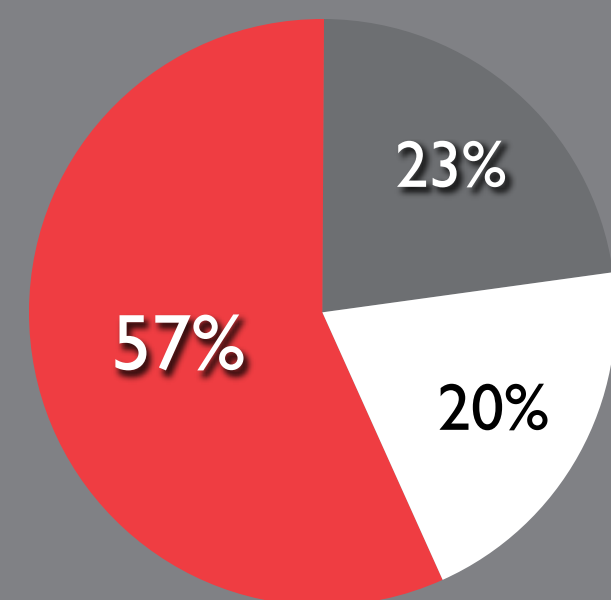
LEVEL OF HIGHER EDUCATION AND SCIENCE



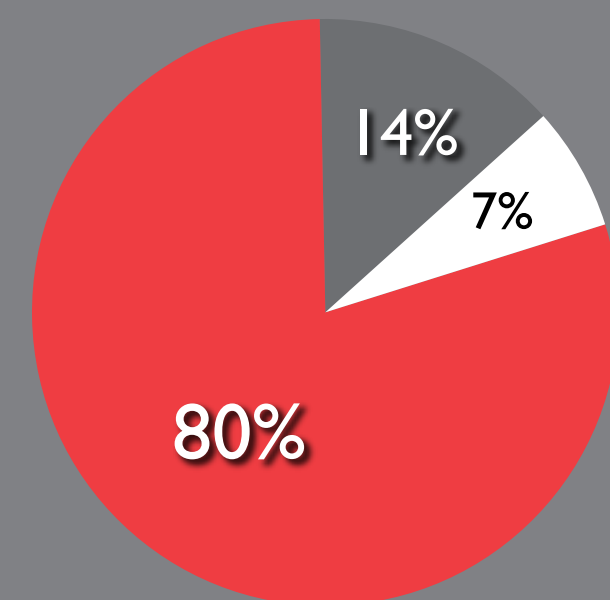
QUALITY OF THE TAX SYSTEM



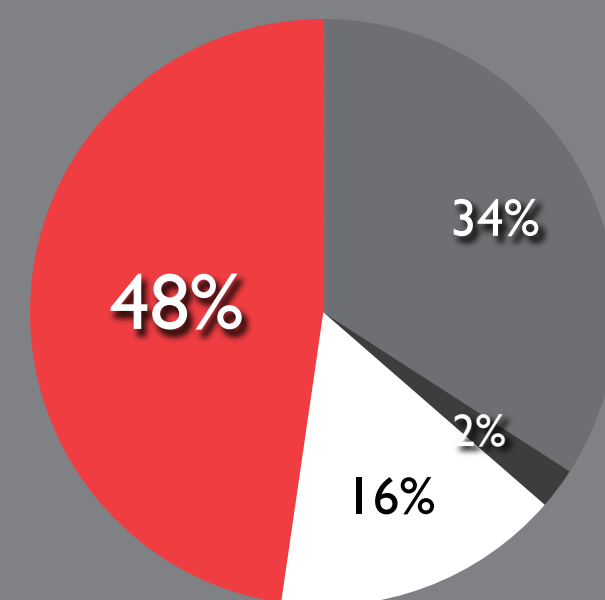
SUPPORT FROM THE GOVERNMENT AND COMMUNICATION WITH THE POLICY MAKERS



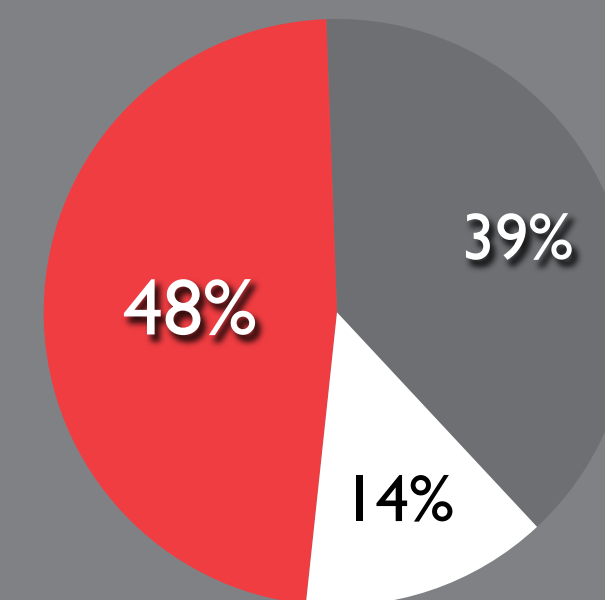
UNETHICAL / ILLEGAL BEHAVIOUR BY ENTREPRENEURS, UNFAIR COMPETITION



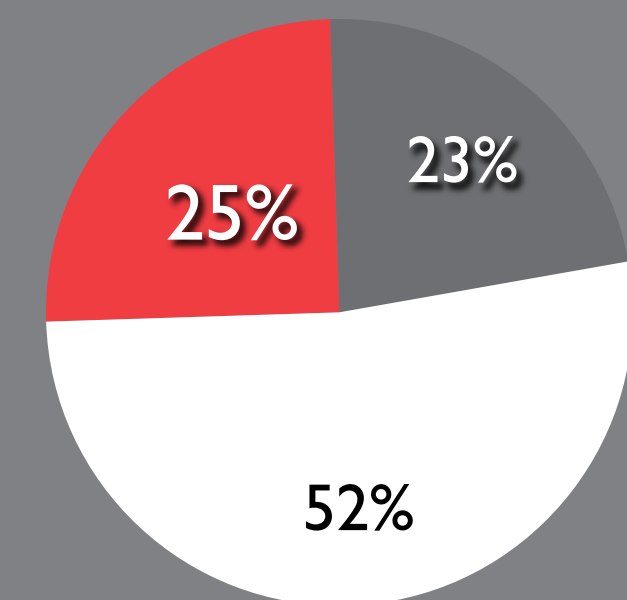
UNCERTAINTY



THE COURT SYSTEM IN LATVIA



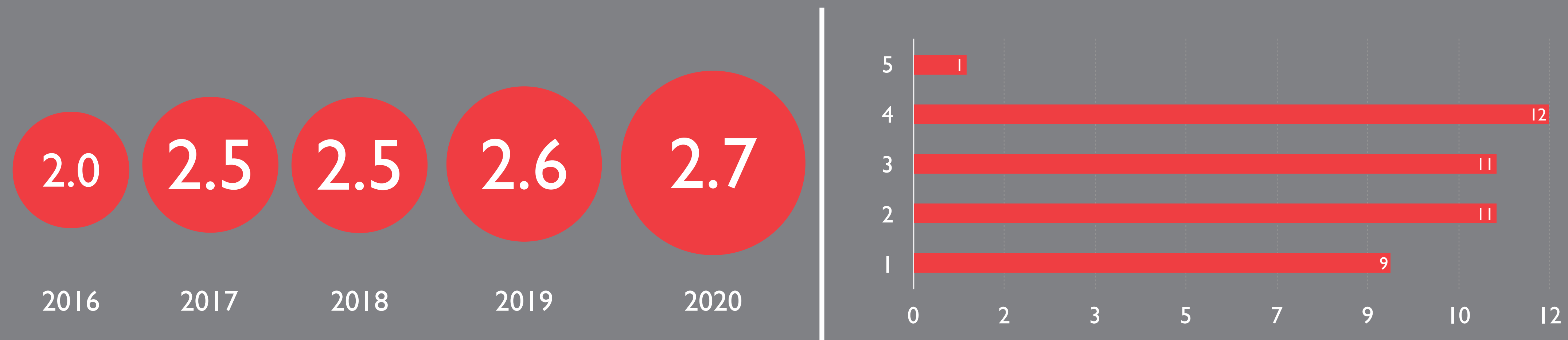
THE HEALTHCARE SYSTEM IN LATVIA



FINANCIAL SECTOR STABILITY IN LATVIA

GOOD PROGRESS
 NO PROGRESS
 SOME PROGRESS
 N/A

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.



Let's start there – investors will have a hard time opening up a bank account. Then – where will an investor find work force? I don't want to be too negative, but investors face a lot of issues in Latvia.

ICT COMPANY



Because of changes in the financial market, the investment climate has improved significantly.

FINANCE AND BANKING COMPANY



Positive praise goes to LIAA having a strong vision on improvement areas, this included the goal to reduce the grey economy significantly.

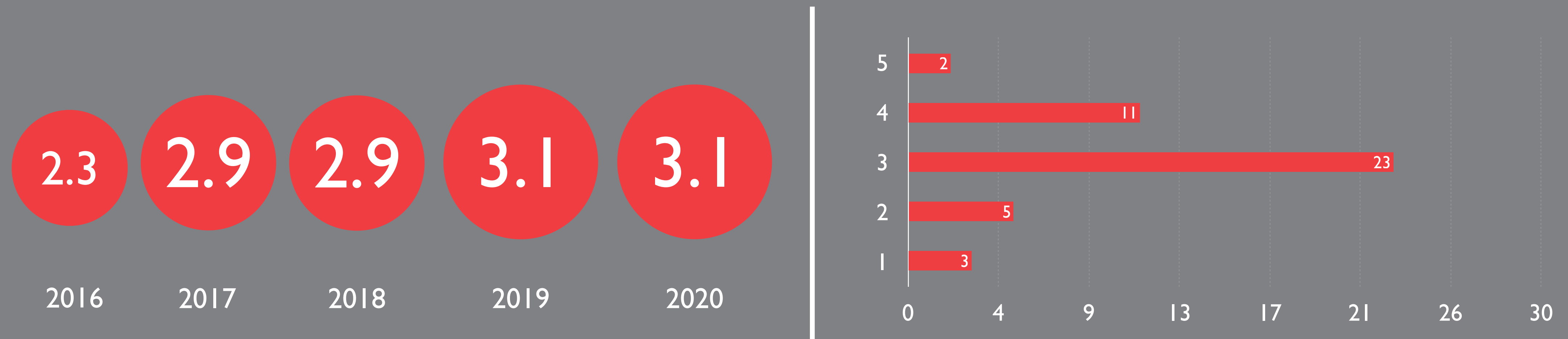
RETAIL TRADE AND SERVICE COMPANY



We have the right foundation, also with Riga, new blood in LIAA, but have to give people time to work and create a positive effect.

FINANCE AND BANKING COMPANY

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



SCALE 1-5, WHERE '1'- FAIL, '3'- AVERAGE' AND '5'- EXCELLENT



Some separate occasions are embarrassing, we have people who are a 5 and also people who are a 1 among policy-makers. The Prime Minister and President are excellent, but we need to raise the rest of the standard.

ICT COMPANY



As much as we don't want to, we need to take a look at what our neighbouring countries are doing. The vision and image of our country, the websites for future investors and other people looking into Latvia – it is so unclear. Look at Invest Lithuania – that is a good example of how it should be.

WHOLESALE AND RETAIL COMPANY



Nothing better. Nothing worse. A lot of uncertainty.

SERVICE COMPANY



There were many incidents that did send the wrong signals, it looked like the business environment is not predictable. For example, the energy sector, the OIK saga, it really dismisses investors' trust in the government.

PROFESSIONAL ASSURANCE AND ADVISORY SERVICES COMPANY

CHALLENGES INVESTORS FACED DURING 2020

TOP 3 CHALLENGES



ADAPTING TO NEW WAYS OF WORKING
(MOSTLY TO REMOTE WORKING),
CHANGING THE BUSINESS MODEL AND
ADAPTING TO THE CHANGING MARKET
ENVIRONMENT



DEALING WITH THE
UNCERTAINTY
(INCLUDING IN THE TAX SYSTEM),
PLANNING THE BUSINESS AHEAD

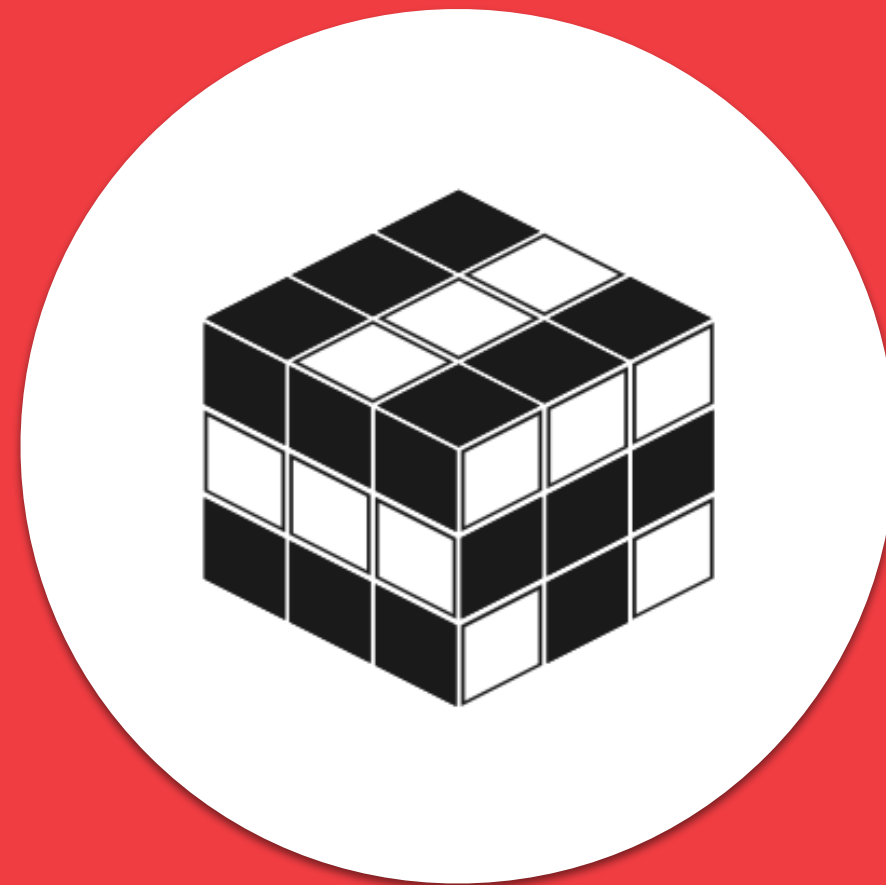


FINANCIAL ISSUES, E.G. DECREASE
OF BUSINESS VOLUMES



CHALLENGES INVESTORS FACED DURING 2020

OTHER CHALLENGES MENTIONED



LOGISTICS, GLOBAL SUPPLY CHAINS,
TRAVEL RESTRICTIONS



ENSURING THE SAFETY OF STAFF AND
CUSTOMERS



COMMUNICATION WITH THE POLICY-
MAKERS AND/OR POLICY ACTION



FINANCIAL SECTOR (BANKING)



SHORTAGE OF EMPLOYEES, ESPECIALLY
HIGHLY EDUCATED AND SKILLED EXPERTS



FAIR COMPETITION AND THE
SHADOW ECONOMY



POTENTIAL
SOLUTIONS TO
INVESTOR
CHALLENGES AS
HIGHLIGHTED
DURING
SENTIMENT INDEX
2020 INTERVIEWS



“With regard to expenditure vs income, we rebalance, we made decisions to clarify stable finances, planning future business is still a problem. Taxation is still like a penalty, not a helpful tool.”

ICT company

“Various virtual events were organised (including virtual coffee breaks, extensive programs of various wellbeing events, addressing both physical and mental wellbeing), involving internal resources, as well as engaging external experts. Also before restrictions related to Covid-19 were imposed, our company was promoting remote working and had provided the employees with appropriate equipment and IT tools, however, extensive training and continuous support from IT was required to enable proper use of the tools.”

Service company

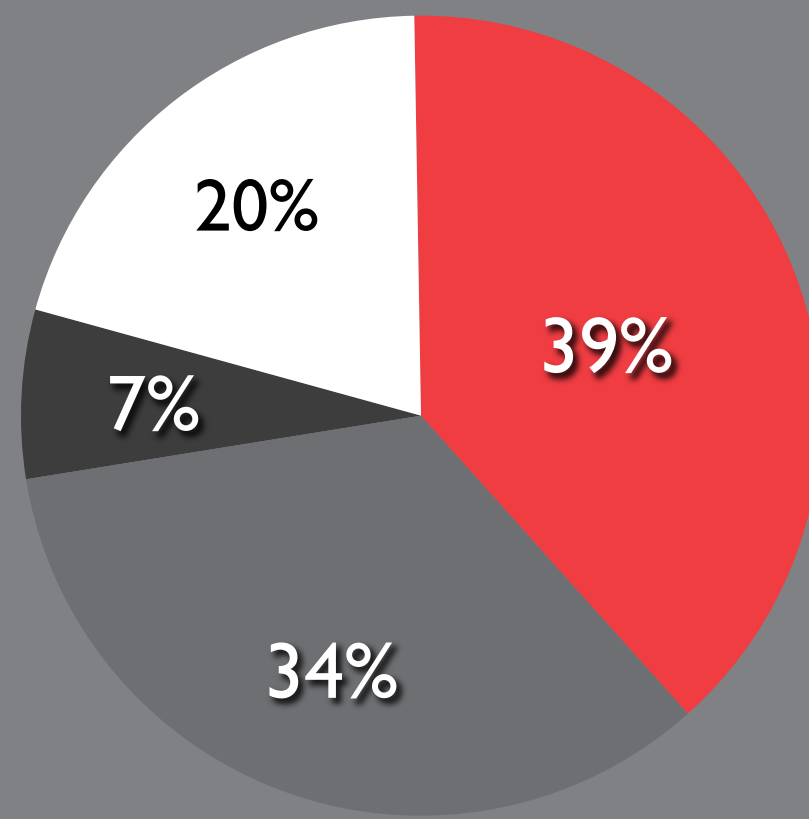
“Reducing cost is the only thing you can really do. Rearrange financial assets with banks to discuss how they will move forward. (..) Are we in a position to invest?”

Real estate company

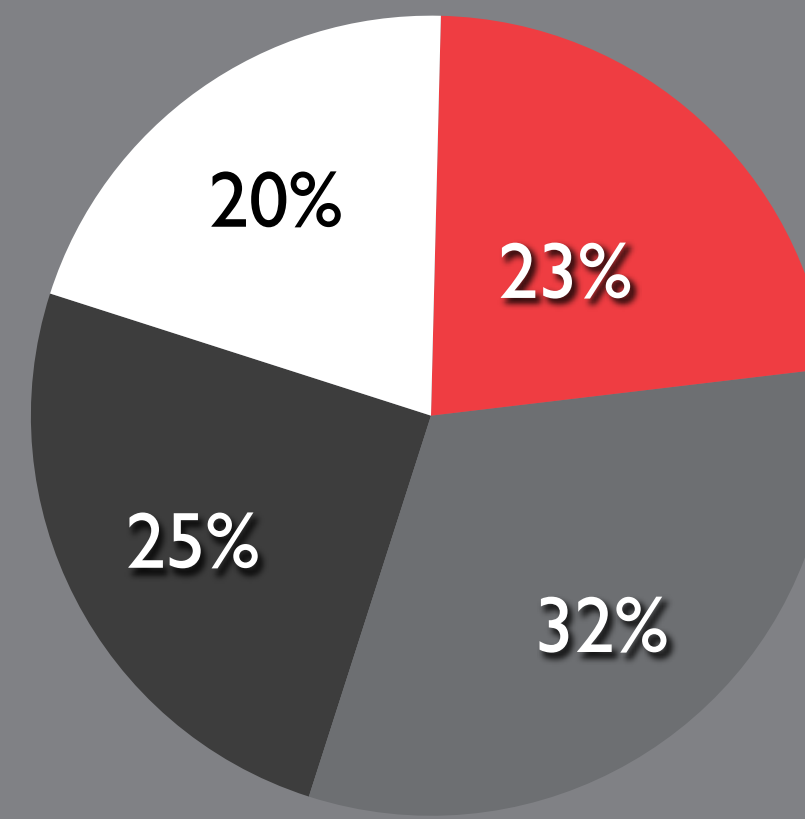
“Most of the challenges cannot be solved straightaway and we are managing them. We have prioritised some of the investment needs over others, continuously monitoring the situation and following government recommendations in order to provide accurate services to customers and meet requirements to protect employees. We have re-established some of the planning processes to be more proactive in order to react quicker.”

Retail trade and service company

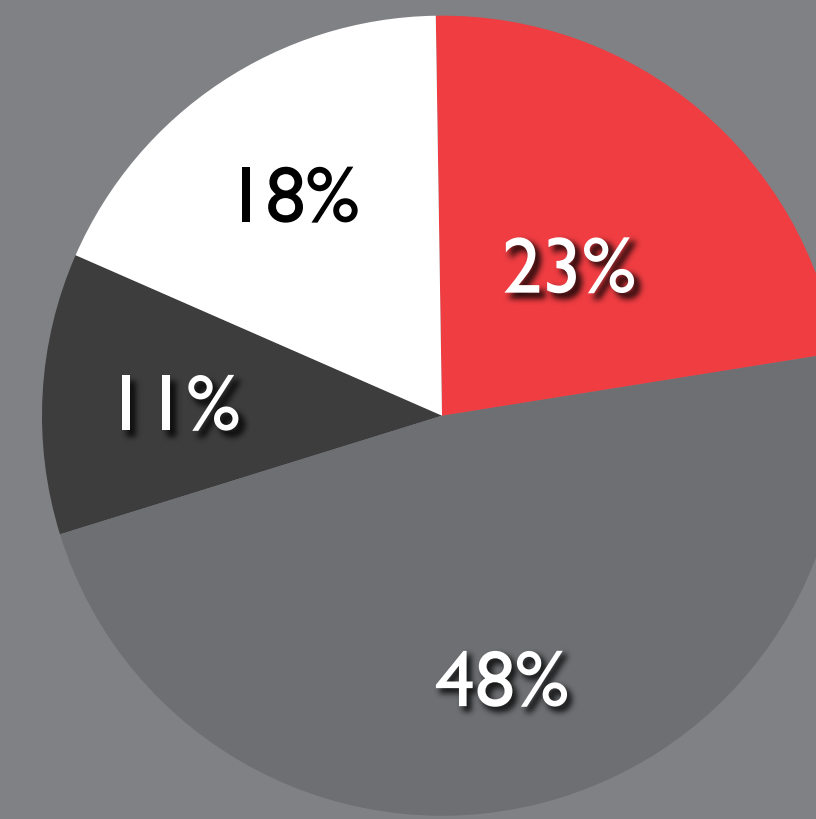
HAS TURNOVER, PROFITS AND NUMBER OF EMPLOYEES FOR YOUR COMPANY (IN LATVIA) INCREASED/DECREASED OR REMAINED THE SAME DURING 2020 (EFFECT OF COVID-19)?



TURNOVER



PROFITS



NUMBER OF EMPLOYEES

■ INCREASED ■ DECREASED ■ REMAINED THE SAME ■ N/A

WE ASKED FOR THE OPINION OF FOREIGN INVESTORS IN LATVIA AS TO WHAT THE PRIORITIES ARE FOR LATVIA IN BEST UTILISING COVID-19 SUPPORT MEASURES AND FUNDS AVAILABLE FROM THE EUROPEAN UNION

MOST OF THE
ANSWERS
MENTIONED A
STRONGER FOCUS
ON:



Digitalisation



Human resource



Green economy



MORE INFORMATION ON INVESTORS' ANSWERS CAN BE FOUND IN SECTION 8 OF FICIL SENTIMENT INDEX 2020 RESEARCH WWW.FICIL.LV

“We have a good data transmission infrastructure, further investment in this is essential, we need to keep developing this infrastructure and maintaining it. Latvia has a strong base for a public transport infrastructure, for a **digital environment**, so investment is needed in schools and education – we have demonstrated that we have completely missed the goal – investing in both infrastructure and content. Let parents and teachers be more productive.

A very smart investment would be into **re-profiling employees**, investing into digital skills, the ability to analyse data, I don't mean just working with MS Excel. We will most definitely have a hybrid environment after the crisis. Let's not kid ourselves that it will be easy, modern digital skills are vitally important.”

ICT company



“Don't just spend – make it count. Invest in areas that are aligned with Latvia's long-term outlooks, **digitalisation, sustainability**. Latvia is in the right position to make the best of these, so use the preconditions you already have, develop new businesses and new jobs. Don't focus on the old, move towards the new. The conservative industries need to change.”

Retail trade and service company



“We need a healthy society and an educated society – an unhealthy population will not pay taxes. We need to invest in the healthcare sector. If we can show in a small period of time that the defence industry is important to us, then we should also invest in the healthcare system. Reforms need to take place and can be financed through this – hospital network reforms ensuring high quality across all hospitals. The question **of accurate data in the healthcare sector** is important. Our biggest problem is short-term thinking, we don't focus on the bigger goals that can be achieved and will put us in a better situation for development, but just focus on quick fixes. Businesses have world experience and know-how – just ask us what to do, we will help”

Wholesale and retail company

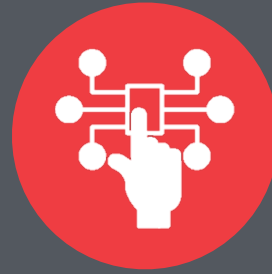


“Reorganise the health system, education system, ‘upgrade’ export guarantees mechanism. Latvia needs to evaluate why the offered Covid related support was utilised so little. Investments into **green energy** (wind energy?), digital infrastructure, investments into universities after education reform - done!”

Finance and banking company



“We need to clean up the public sector and infrastructure. We are already working on regional reform, but we have to go further. Public sector machinery has to become more effective – we are at the end of the rope here. Centralised governance of **digitalisation** is needed so this becomes embedded in all processes across the public sector. Healthcare system also affects the availability of labour force in the country. We should invest in the healthcare system during this time. Support for new and innovative business ideas is needed, support for businesses that export and manufacture goods. We need to work on the digitalisation level of Latvian investors as well.”



Retail trade and service company

“When we had the last economic crisis 10 years ago, the one thing we (Estonia and Latvia) did really badly – the policies we put forward resulted in a huge loss of motivated and educated human capital. Small states should try to avoid that, try to avoid the loss of employment and loss of people in the medium- and long-term perspective. Transition of the economy towards **climate neutrality** is currently happening, it is a very heavy problem, once it starts moving it will be impossible to stop it, so we need to focus on and invest in this. How can we take advantage and move ahead in the green deal saga?”



Manufacturing company

“In my opinion, it is important to invest the money into developing infrastructure, roads, buildings, not just the EU money. People are discussing financial possibilities for attracting investments and how to create a better system to **optimise business** in Latvia, also how to make the starting point easier. This is a good period because of many global changes, we need to use this as a benefit to attract new investors who were previously looking from the Eastern market and Asia. The Baltic States is a good location for investment.”



Retail trade and service company

“Sustainable investments in **green deal projects**. Not supporting companies who clearly work in the shadow economy. Keep alive companies the most hit by the crisis but with a good recovery perspective.”



Manufacturing company

INVESTORS ALSO
EMPHASISED NEED
FOR A CLEAR
STRATEGY AND
TRANSPARENCY
WHEN INVESTING
EU FUNDS:



“There is always the question of human capital versus infrastructure, Latvia has no clear plan or understanding of how to develop human capital. So I say let’s invest in an infrastructure that will serve for a long time, for example – bicycle lanes.”

Service company

“I think that all measures relating to medicine are adequate. We expect more predictability from the Ministry of Economics because there are too many tensions. There are rumours that there will be no money in construction, a lot of people are looking for work, there is no stability in matters of specificity. We want a more positive attitude towards plans, not to be afraid of overheating the economy. You have to worry about what has not been done and realised.”

Manufacturing company

“Strengthening of the healthcare system. Increasing quality of police work. Sustainable, transparent and well thought-out support to the affected businesses. Institutional reforms in civil service.”

Service company

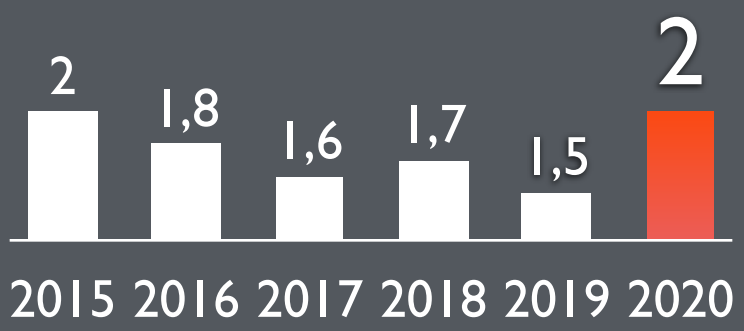
“The amount of money is available, it’s our future generation’s money, tax payer’s revenue of the future is injected at the moment. The good news is that this government is the least corrupt over the last 25 years, I believe this is a good government, so I hope this money won’t be lost.”

Finance and banking company

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



DEMOGRAPHY

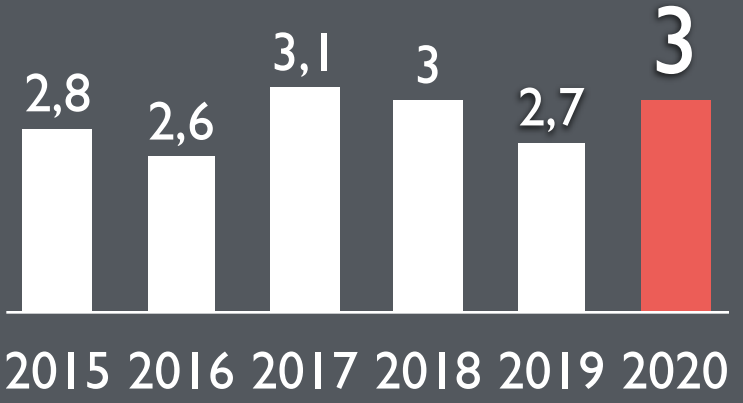


“Still don’t see any serious actions from the government not only for increasing birth rates but also on stopping emigration.”

Professional assurance and advisory services company



QUALITY OF EDUCATION AND SCIENCE

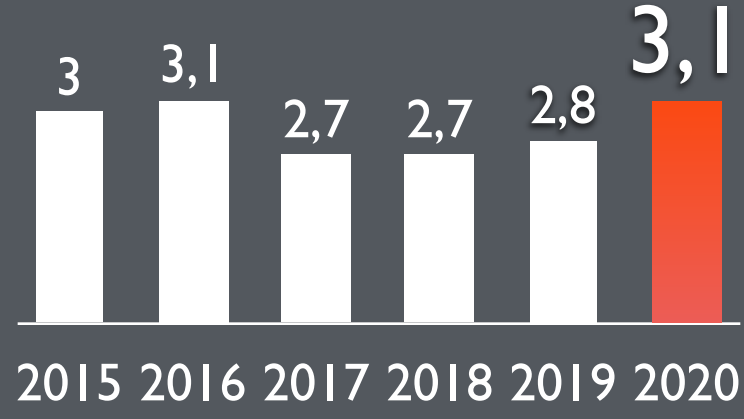


“It needs to be more focused, with a small market and small funding should focus on specific areas not be spread so wide.”

ICT company



AVAILABILITY OF LABOUR

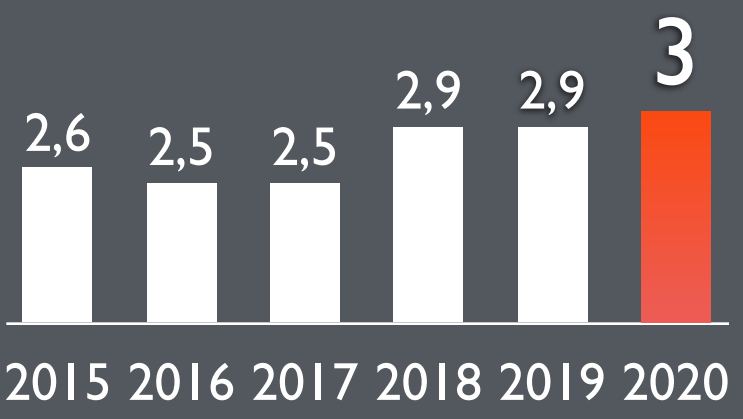


“Unemployment has increased due to Covid-19, however this is short-term and does not resolve the overall situation.”

Retail trade and service company



QUALITY OF HEALTHCARE SYSTEM



“Covid-19 has highlighted the issues with medical equipment, lack of workforce and healthcare system. Any changes made have been driven by Covid-19 rather than long-term planning of healthcare in this country.”

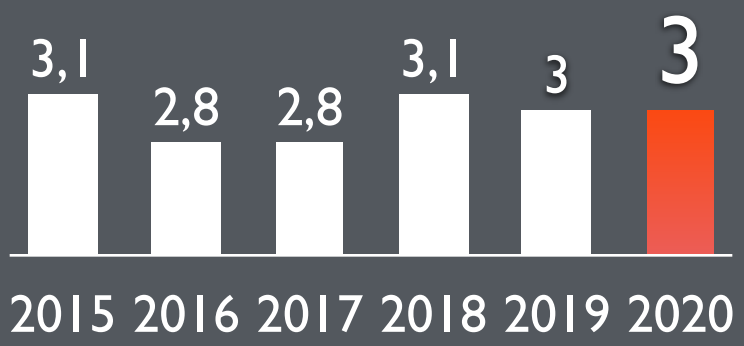
Retail trade and service company

SCALE 1-5, WHERE ‘1’- REPRESENTS LOW COMPETITIVENESS AND, ‘5’ - REPRESENTS HIGH COMPETITIVENESS

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



TAX SYSTEM

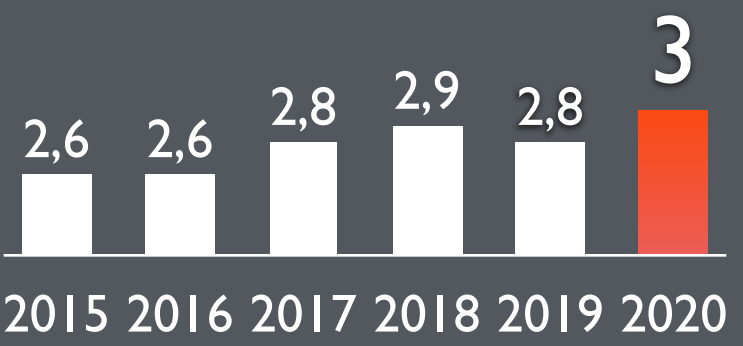


“Completely unpredictable, the biggest risk for the country, every once in a while we evaluate the option of moving our office to another country because of the fluctuations in the tax system.”

Manufacturing company



LEGAL SYSTEM

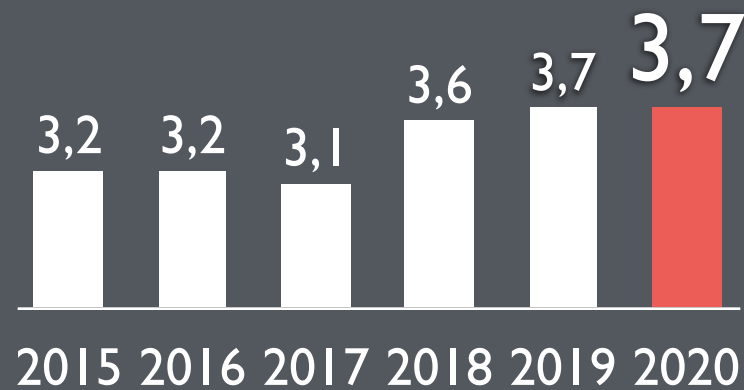


“I appreciate steps taken to establish an Economic Court, but the court system needs to be practiced and needs to evolve, this will take time, but there is still a long way to go.”

Finance and banking company



ATTITUDES TOWARDS FOREIGN INVESTORS

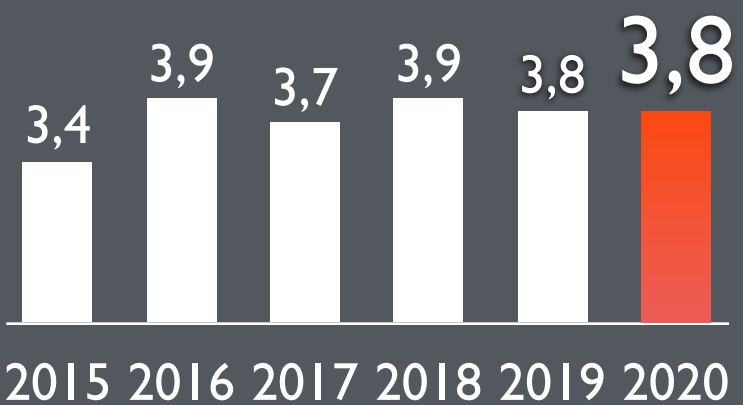


“The current government is really communicating with us, we appreciate what they do very much, I see a lot of improvement.”

Finance and banking company



STANDARD OF LIVING IN LATVIA

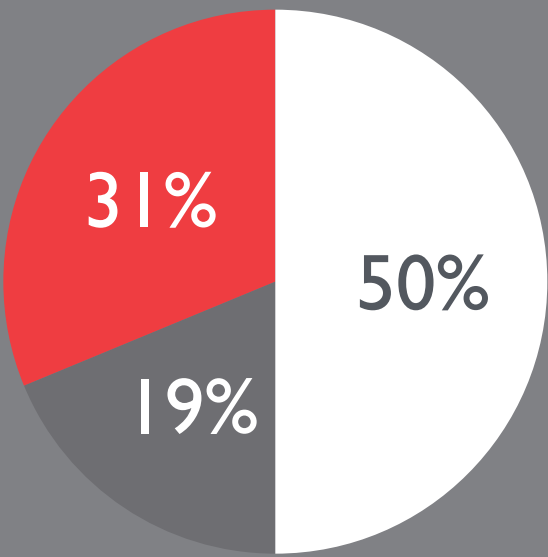


“Latvia is a great place to live, environment, space, safe environment, rather developed, proximity to sea.”

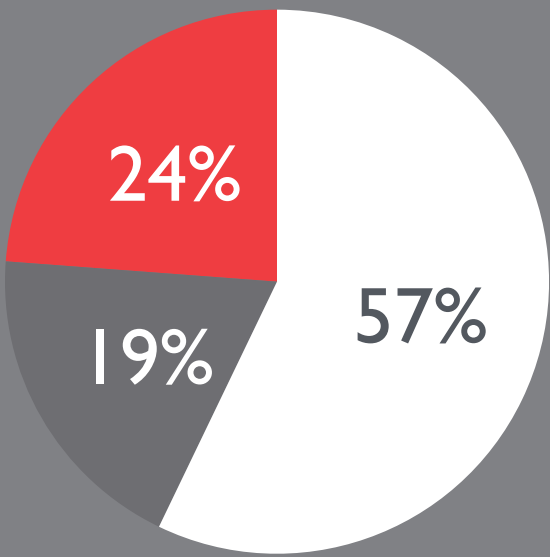
Real estate company

SCALE 1-5, WHERE '1'- REPRESENTS LOW COMPETITIVENESS AND, '5' - REPRESENTS HIGH COMPETITIVENESS

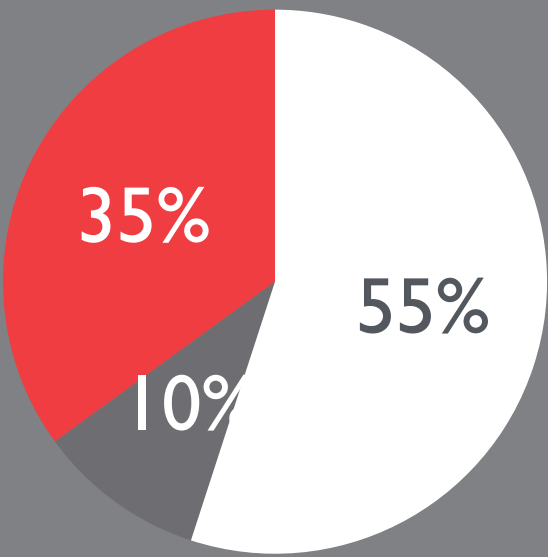
FURTHER INVESTMENT PLANS



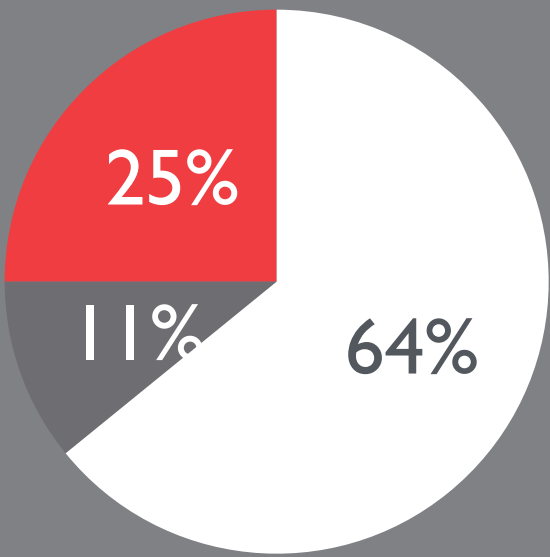
2016 (N=32)



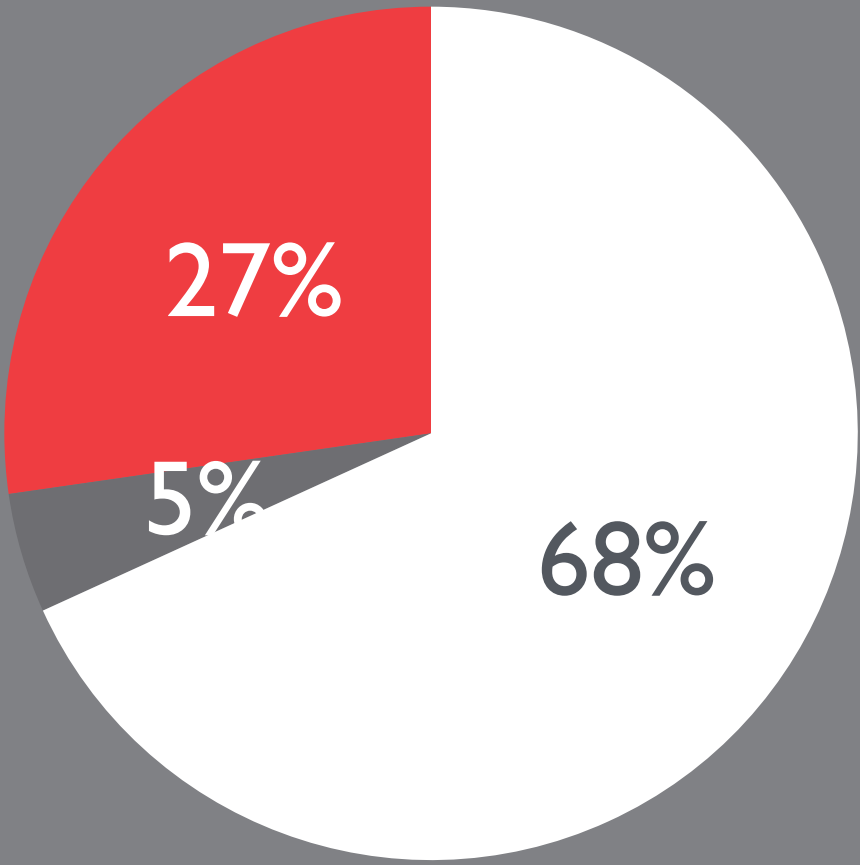
2017 (N=42)



2018 (N=40)



2019 (N=47)



2020 (N=44)

■ YES, WE PLAN TO INCREASE INVESTMENT ■ NO, WE DO NOT PLAN TO INCREASE INVESTMENT ■ NOT DECIDED, DEPENDS ON CIRCUMSTANCES OR NO NEED



YES, WE PLAN TO INCREASE INVESTMENT



Yes. The investment is mainly people, and we do plan to grow and develop here. Plans to grow to at least twice the size.

ICT COMPANY



Yes, we have major investments in the business, over 100 million EUR will be invested in the next 3 years.

MANUFACTURING COMPANY



Yes, but we do not have a specific figure, it will involve attracting labour. We are currently missing 100 employees who cannot be recruited for over a month.

ICT COMPANY



Yes, the appetite for investment was higher prior to Covid, but a little bit more cautious now. However, the attitude to move forward with investment is positive.

ICT COMPANY



NO, WE DO NOT PLAN TO INCREASE INVESTMENT



No, we are keeping the same level, the tax system needs to change and the legal system needs to be predictable.

RETAIL TRADE AND SERVICE COMPANY



No, the train has left the station, the excellence centre was opened in Lithuania.

FINANCE AND BANKING COMPANY



No, because of the healthcare budget unpredictability.

WHOLESALE AND RETAIL COMPANY



We do not plan to develop and expand investments, as nothing has changed significantly in the country. It is clear that new investors are coming, the environment and the approach are appreciable.

ICT COMPANY



NOT DECIDED, DEPENDS ON CIRCUMSTANCES OR NO NEED



We would like to invest, but this is not yet possible due to the legal and economic situation. We are looking at new projects and we have ideas. It is evident that in Latvia many things are arranged. Legislation changes are too fast and are diametrically opposed.

REAL ESTATE COMPANY



The company would consider buying additional market shares in industry (subject to available companies and competition legislation restrictions) as well as expand its presence in connected industries if there are synergies and business cases.

FINANCE AND BANKING COMPANY

BEST ONE-LINERS
FROM INVESTORS'
LETTERS TO THE
**PRIME
MINISTER**



“Any changes planned really need to be discussed with the industry, businesses are very open to cooperation. (..) This cooperation needs to be based on substance not just formalities.”

Service company

“Stability, predictability, transparency and dialogue are the cornerstones of an attractive investment climate.”

Service company

“If I can tell my board of directors that the tax system will not change for 5 years, and legislation will be thoroughly discussed with involved parties – that would go a long way to feeling like investment is protected in Latvia.”

ICT company

“You have already done a lot to improve the investors’ trust in Latvia, we need to keep working towards a transparent business environment and we need to work towards excellence. As FICIL has said many times this year – raise the bar!”

ICT company

“Bring “the island of Riga” into sync with Latvia and the rewards will be multiple.”

Finance and banking company

BEST ONE-LINERS
FROM INVESTORS'
LETTERS TO THE
**PRIME
MINISTER**



“If you are a foreign investor that comes to Latvia, the stability of the economic and legal environment is crucial. Any country that wants to prosper in foreign investment, when you lose that trust – it is extremely hard to get the trust back.”

Manufacturing company

“Your chair is a lot hotter than our chairs. What you have managed to achieve already – I can only say well done. To do even more than you have already done – we need to improve the political culture and emotional intelligence of the ruling elite...”

Manufacturing company

“The Prime Minister is in the right place and is doing an excellent job as far as we can see and sometimes even reaching superhuman levels. The government ship needs to be steered not just a few months into the future, but years into the future, looking at strategic goals, despite certain ministers’ peculiar behaviour...”

Retail trade and service company

“The positive news makes the headlines, but the focus needs to be on execution of these positive plans, because if the ideas are great only on paper – that doesn’t bring much hope.”

Professional assurance and advisory services company

“If we don’t focus – we will always be average in everything.”

ICT company

COMPANIES THAT TOOK PART IN THE STUDY

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



Norwegian Embassy