Extended Summary of the Study

“Estonia – The Business Paradise”: How to pool forces to transform Estonia into an international business centre – a target country for talented people, profitable jobs and value-creating foreign investments? (FDI)? This is the question focused upon in the current analytical study report. The study was commissioned by the Government Office, in cooperation with the Ministry of Economic Affairs and Communication, Ministry of Education and Research, and Enterprise Estonia. The research project “Involvement of RD&I Intensive and Higher Value Added Foreign Investments as a Part of Estonia’s Innovation Policy” was implemented under the leadership of Technopolis Group Estonia.

The work involved several stages (for more information about the methodology involved see Chapter 26): 1) thematic background analysis on Estonia’s competitive position, FDIs with high added value and their conceptual framework in economic development; 2) international analysis of success factors and practice, based on the example of six countries: Finland, Sweden, Ireland, Singapore, the Czech Republic and Lithuania; 3) analysis of Estonia’s situation (including interviews with current and potential foreign investors, representatives of universities, technology development centres, science parks, ministries, city governments, etc.). Three fields were addressed to form the sample of companies: ICT (including manufacturing and services), health technologies and products and natural resources. The preliminary analysis referred to the RD&I strengths of Estonian ICT and broad spectrum of health area (including food and agricultural sciences, biotechnology) which are the main prerequisite for attracting high value added FDI. The need to use natural resources, available in Estonia, as efficiently as possible and to the maximum (processing until the end product) was the starting platform for resources.

Profile of foreign investments in the Estonian economy

Estonia has been open to foreign investors for longer than two decades. The rapid start began with the successful privatisation process in the 1990s. At the end of 2012, 24% of the FDI had gone to the financial and insurance sector and only 16% to manufacturing industry. Foreign enterprises hold a dominant position in Estonia’s export (59% of total export), employ 36% of the labour, implement 34% of R&D (based on expenditures) and contribute 44% of economic value added (in 2010). Estonia’s economy is characterised by high involvement of foreign investments (75.4% of GDP; in Ireland, Lithuania and Finland 112%, 32.6% and 31% respectively). The influence of FDI on the Estonian economy is obvious; also, foreign enterprises are more productive than the local businesses (above all, in the services sector). However, UNCTAD sees Estonia’s potential for attracting FDI in the future as low (75th position in an international ranking), which is, to a certain extent, characterised by the small scope of resources available to the country. Also, Estonia’s attempt to maintain today’s situation is aggravated by the fact that foreign investors, investing into manufacturing industry, have mostly been attracted there by certain price advantages. However, Estonia is losing this advantage due to limited resources. Over the last couple of years, Lithuania has enjoyed a relatively larger inflow of FDI in the Baltic region – above all, when it comes to FDI with higher added value.

Estonia’s manufacturing industry and services sector lack approximately 30,000 technologically advanced jobs and employees to achieve the structure of employment currently achieved for Finland (calculations made by the authors). The R&D expenditures of Estonian companies in general have grown more rapidly than in Europe on average, however, the main weaknesses originate from the business sophistication of companies, i.e. the role they hold in international distribution channels and innovative capacities of enterprises (according to the World Economic Forum - WEF). As for labour productivity, Estonia’s high-tech sector shows results 4.7 times lower than the respective indicator in Finland; in knowledge-based services, including ICT, the result is slightly better. Brining development activities or headquarters of companies to the country assumes a so-called knowledge-specific ecosystem, establishment of higher goals and pooling of resources and activities to fulfil the tasks established. The overall pyramid must be developed (see Chapter 22), including business tourism. For example, as we compare Tallinn to Helsinki and Stockholm, we lack ca. 800,000 business tourists per annum. Investments need to be made into infrastructures to develop business tourism (including international conference and exhibition centres), contribute to a higher share of international aspects of the higher education and research sector, develop transport connections and the social infrastructure (including international schools, culture).
The main success factors for involving higher value added FDI and integrating them to the competitiveness of local economy

All countries are always welcoming investments that will contribute to creation of valued, knowledge and skill-intensive new jobs. Strong RD&I bases, the innovative focus of a country, strong education and knowledge bases and focused work are the prerequisites for FDI with higher added value. High added value is not necessarily linked to RD&I. As we compare the countries, we can see common patterns emerging; the focus is on targeting those FDI that allow the country to respond by contributing its own capacities that may be linked to production, development, being familiar with certain markets, etc. Countries where the main indicators (including productivity, technological bases, and social infrastructure) are better and that consistently work with existing and potential investors achieve success. Such countries have a strong vision and strategy, regular communication with investors, strong sales organisation to attract new investors (e.g. Economic Development Board in Singapore, Team Finland), systematic national feedback system (e.g. by means of IDA Ireland), think tanks that monitors different economic areas and industrial axis (e.g. Forfas in Ireland) and they do consistent marketing work with the international image of the country. The key word for a country, attracting foreign investors, is the readiness to give this issue main focus, at organisational level (e.g. in Finland this sphere is controlled by the office of the Prime Minister) and, where appropriate, master various activities to achieve the established goals (e.g. in education, migration, spatial development). Foreign services of countries are committed to bringing foreign investors home. All the six reference countries are characterised by the existence of one or more (including regional) foreign investment agencies that have a clear mission and are distinguished at organisational level.

Implementation of policies of reference countries – measures and the best practice

Successful countries are characterised by an integrated approach to foreign enterprises with high added value. They focus on different levels of internationalisation of the economy, from stimulating business tourism to internationalisation of business and technology education. A large-scale effect on a country’s economy and employment can be achieved by developing the so-called industrial axis of a sphere with current potential in co-operation with foreign investors (the automotive industry in the Czech Republic, electronic and mobile communication application industry in Finland, petrochemical sector in Singapore). Enterprises attach the biggest importance to a favourable business environment, infrastructure and attractive human resources. A proactive approach to communication with investors, adopted by the state, and quickly provided assistance are as important. Special treatment of investors will involve specific agreements with the government (new jobs and markets, large-scale investments, etc.) and assistance provided by the country by creating some initial infrastructures (Singapore) and direct offer of required numbers of researchers and engineers (Finland, Ireland). It is also common to co-finance strategic investors by launching various programme efforts (capital investments, general or specialised training, expenses made to create new jobs) or applying tax incentives (Singapore). R&D competence centres have become one of the main attractions for integrating foreign enterprises into the country (CSET in Ireland, Valley in Lithuania, Technology Centre in the Czech Republic, Competence Centre in Sweden).

These are applied research centres, pursuing their activities as a combined effort of research institutions and enterprises, offering a critical mass of qualified human labour, including offspring, and the opportunity to contribute to strategic planning of educational establishments. Companies like Volvo, Bell Labs, GlaxoSmithKline, Honeywell, Volkswagen, Bosch, Siemens, IBM, Thermo Fisher Scientific, TEVA, etc. have joined such centres in different countries.

Challenges faced in attracting higher value added FDI to Estonia

A Fortune 500 IT services company interviewed considers good reputation for IT skills, good language skills, economic and political stability to be the strengths of Estonia. An international engineering company finds, however, that the preparation of human resources remains the biggest challenge for Estonia – financial, business and IT companies’ knowledge of employees are worse than expected. A Scandinavian company with global reach describes the quality of human capital of the Estonian ICT sector as worse than in Finland and Sweden and this will decrease the relative price advantage. Field-specific opportunities are expanded by Russian market contacts and co-operation and the IT industry in Russia. A Nordic financial enterprise describes the Estonian legal environment and bureaucracy, in comparison with other Baltic states, as much better. Corporate taxation policies (however, some adjustments of human resource taxation would be welcome) and technological infrastructure also speak in favour of Estonia. The ability for quick decision-making (e.g. the electric car project) is worth acknowledgement.

To establish a development centre in Estonia, a Finnish start-up company would need at least 30 highly qualified specialists; large companies would need at last 200 specialists. Establishment of a satellite unit of some Fortune 500 company in co-operation with units in Helsinki or Riga or development of a university laboratory are seen as good opportunities for Estonia. The development centre of Microsoft Skype in Estonia considers two possible development scenarios: to increase its personnel from a current 460 people to 700 or start cutting down its business here. Foreigners describe coming to live in Estonia and getting adjusted here as a complicated process, for example, those interested in a position in Skype prefer Prague or Stockholm instead. Foreign investors see the lack of long-term vision of Estonia’s future, established at state level, as a problem. Knowledge of Estonia as a trademark outside Europe is basically non-existent. The Estonian Government was recommended to communicate messages to the heads of branches of foreign companies, on regular bases, telling them that they are expected to bring business functions from other countries to their home country. Estonia should market itself as a business heaven in Northern Europe (“Entrepreneurs Paradise”), attracting both starting companies and entrepreneurs with global ambitions, already in business, to the country.

Challenges for involving foreign investors via the education and research sector

According to foreign investors, Estonian universities concentrate on competing with each other. The universities of Tallinn and Tartu should be consolidated to offer international competition. Adding an international dimension to curricula and attracting research and education leaders from foreign universities to Estonia would be welcome. New graduates still need special training to become top specialists for companies hiring them (foreign enterprises are willing to offer more positions for trainees). Rotation of research specialists needs to be increased
(growth of researchers with business experience from 10% to 25% by 2020), using more flexible technology competence centres, cross-department projects like Innovation and Business Centre MEKTORY at Tallinn University of Technology, etc. Compared to Finland, the number of Estonia’s researchers is smaller by nine times. Insufficient quality of management and business schools is remarkable (48th place in WEF’s 2012/2013 ranking). High quality of maths and science education is one of Estonia’s strengths. Poor business sophistication is linked to weak local co-operation networks and entrepreneurship clusters; foreign enterprises prefer innovation co-operation within the corporation. Increasing research and business sector co-operation in Estonia can be highlighted as a positive feature. The increase in numbers of researchers and engineers has been the largest, in 1996–2011, in social sciences (56%) and natural sciences (36%), while a decrease has taken place in technical and medical sciences. The number of state budgetary students is the largest in the area of technology, production and construction, natural and technical sciences and also in the area of health and welfare. The largest number of research specialists, hired by companies, work in ICT services and the manufacturing industry (computers, electronics, electrical and optical appliances, chemical products, machine engineering).

Vision of Estonia’s foreign investment policy and its implementation

The bigger the expected development shift that attracting FDI with bigger added value should help to achieve, the more powerful and wide-based should be the influence of the recommended solution. Countries that are more successful in attracting foreign investments have given this issue a central position within a cross-institutional framework and appointed a body accountable for the issue. Until now, bringing headquarters and R&D centres to Estonia has not been a goal in itself, however, it must become a central issue. We recommend the implementation of a strategy, including six parallel development directions, to achieve success and outrance competing countries. Based on international practice, it can be said that by failing to implement an integrated concept and only focussing on the launching and/or development of single measures it will not be possible to achieve success or sufficient scope of changes and development.

1. Integrated strategy for the development of international business environment. Estonia has to internationalise across the spectrum – from social and cultural living environment, education and research environment, economic and business environment to the country’s image and foreign economic policy. That means developing the entire pyramid of international business and understanding that its lower levels, for example existence of business tourism, are a prerequisite for success on upper levels, e.g. establishment of development centres and headquarters here. Setting and implementing specific goals is important at every level of that pyramid. For example, increasing the share of business tourists in Tallinn, compared to the total number of tourists, so that it reaches the level of Helsinki and Stockholm. Accounting for the size difference between those cities, we are currently short by ca 800,000 business tourists per year (2,200 people i.e. 30 plane loads a day). One way to do it is enlivening international conference and trade fair tourism. As ⅔ of conference tourists arrive by plane, it is worth considering establishing a multifunctional conference and trade fair centre in the immediate vicinity of the airport. Such highly specific goals and tasks have to be set on other levels of the pyramid as well, for example bringing three headquarters and three development centres to Estonia per year, developing one international education and research centre here every year, attracting 10,000 foreign top specialists by the year 2020, etc. It is worth conducting comprehensive audits of living, working and business environments for various talent groups from different countries, in order to understand the nuances that are important for e.g. smart Finnish or Ukrainian specialists working in Estonia.

2. Strategic co-operation model, TeamEstonia, that integrates different fields. The study shows that successful organisations attracting foreign investments have a clear mission, a strong mandate and a strong sense of responsibility. We recommend that the Estonian state in co-operation with the City of Tallinn and a consortium of various existing organisations build a sales and development organisation for international business environment – TeamEstonia. Its co-ordinating element and the part performing the effective work with foreign investors, developing the Estonian brand, monitoring the competitive position and developing of various industrial verticals could be today’s Foreign Investments Unit of Enterprise Estonia. For that, the aforementioned activity needs to be clearly differentiated from Enterprise Estonia’s other tasks and set to front-and-centre. The driving force of TeamEstonia will be a so-called tandem of professional sales managers, assigned by the Government of the Republic and the City Government. TeamEstonia will be supported by a council of worldwide business managers and a network of Estonian business ambassadors consisting of today’s foreign investors. The government connection of TeamEstonia will consist of leaders of today’s agencies (incl. Enterprise Estonia, the Archimedes Foundation, the Estonian Unemployment Insurance Fund, the Estonian Science Foundation, the migration department).

The private market based part of the consortium would include business organisations and area clusters (e.g. FinanceEstonia, the Logistics Cluster, etc.), and also parties from the field of education and research.

3. Strategy of growth areas. The study clusters seven domestic and international development areas (e.g. global demand and growth areas, joint challenge areas of Estonia and the world, Estonian experience and competence areas, and also areas related to natural resource advantage) into nine theme categories (e.g. the environment, sustainable energy and green economy, health and welfare, ICT) to be focussed on and to attract investments into. It is in turn critically important to initiate and implement landmark developments in those theme categories. Such developments could be e.g. a national green economy growth programme, or the establishment of
an interdisciplinary and international multi-university IT institute based on the IT Academy’s initiative. International experts involved in the study highlighted also the possibility of binding participation in large public procurements to a certain additional obligation to invest into Estonia. For example, if enterprises want to compete over building a generator unit for an Estonian power plant, winning the procurement would also mean undertaking an obligation to invest into development of the green economy theme category of the Tallinn University of Technology (funding X number of international professors for Y number of years). Technology competence centres which have by now grown primarily in the fields of ICT and, more widely, health, must be connected to bringing strategic investors into Estonia (by making state financing depend on it).

4. Strategy of city-state and Baltic Sea business hub. The synonym of attractive cities is energy and its keywords are favourable social and physical infrastructure. A modern city generates talents. It is an attractive place both for obtaining an education and for conducting long-term business. The biggest towns in Estonia, where most of the research and development activity and innovation resource has gathered and which produce a large share of the Estonian GDP, have a moral obligation there. Tallinn as a capital must be able to compete with Helsinki, Stockholm, Copenhagen, St. Petersburg and Riga. To create a believable story of “an attractive place for business” in Tallinn, Tartu or Narva, we need to set a target for what we want to look like in the global picture in ten years. The solution must be wholesome. What are the business regions with prioritised development, what is the list of strategic development sites? What are the development perspectives of the city’s living environment and social environment? Management of the city’s future, urban planning and special key development areas must be gathered into one place. Regarding education, the goal has to be set for consolidating universities and developing an interdisciplinary university ranking in the world’s top hundred in ca. 10 years, which would be able to successfully compete with e.g. Aalto University. In order to realise the Baltic Sea business hub vision, logistic integration and fast accessibility must be ensured at both the north-south and the east-west direction. Based on the intent to establish the image of Tallinn as a green city, we need to connect the various business sites, incl. the airport, to bicycle roads, to walking and sport tracks and to nature.

5. Regional specialisation strategy. In the context of wider development and attracting foreign investments with higher added value into the country, it is purposeful to consider separately the development of the capital area as a metropolis and the development of regional areas. In one end of Estonia, investments more probable for university cities may have higher added value, in the other end important foreign investments and enterprises may be those offering better employment, often depending on the region’s natural resources. Estonia’s various regions must specialise, highlighting their resources and competences. For example, if Eastern Virumaa (e.g. Narva-Jõesuu) would see deliberate development of health spas and health tourism, that development must be supported by teaching relevant managers and specialists both in Narva College of Tartu University and in local vocational education centres. Also, Narva Hospital could specialise in that field, etc. A pilot project could be arranged to analyse the specialisation opportunities of a particular Estonian region, incl. mapping the necessary parties and prerequisite actions. In order to enable more complex entrepreneurship to develop in Estonian regions, either by local development or by way of a foreign investment, the minimum requirement is at least the existence of technical schools offering proper applied education there. One of the quality indicators in this must be the availability of English-language study programmes, which enable bringing in foreign lecturers and expanding the circle of international students. The key issue is mobilisation of resources at the county level.

6. International and transnational co-operation strategy. Several interviews highlighted that “politicians and analysts should focus on specifying and creating a Helsinki-Tallinn joint economic space. This would allow marketing in more distant regions as a unified economic centre, enabling us together to compete with both the Stockholm and the Copenhagen-Malmö co-operation region”. Such co-operation has been conducted already (e.g. by joint visits of Foreign Ministers), but there is room for more consistency, involving inter alia both countries’ agencies directed to the international market, etc., in order to propose joint actions to foreign investors. Attracting strategic foreign investors is a long-term project and it is important for a small country to find smart solutions across country borders for this. We should also support the establishment of double degree programmes with Finnish, St. Petersburg’s, Swedish and Danish universities, as these would inter alia increase the quality of our own study programmes and connect more intensely the business networks of the respective countries. To make the entire activity of foreign investments and foreign economy front-and-centre, to mobilise the will-to-action and the resources of various organisations, and to drive all of the action at government level, it would be seriously worth considering establishing of a position of non-departmental foreign economic relations minister, the latter also being the leader of TeamEstonia and the everyday chief negotiator with foreign investors. It is less apparent in Europe, but in Asia, for example, formal positions are also important besides the content of negotiations.

Contact information
Katrin Männik
+372 5345 7272
katrin.mannik@technopolis-group.com

Amsterdam (NL)
Brighon (UK)
Brussels (BE)
Frankfurt/Main (DE)
Paris (FR)
Stockholm (SE)
Tallinn (EE)
Vienna (AT)