



INVESTOR CONFIDENCE INDEX FOR LITHUANIA (5), Quarter II, 2015

The investor confidence index for Lithuania (ICIL) reflects the attitudes and expectations that the largest foreign capital businesses operating in Lithuania have for the country's business and investment climate. The purpose of the index is to help evaluate the country's business environment and the attractiveness of the Lithuanian economy to foreign investors based on the experiences and observations of market players already operating in Lithuania.

Not only is the index used for assessing the conditions of the Lithuanian market, it also serves as a tool for identifying the most influential factors that shape these conditions.

investors and other shareholders with principal information about the Lithuanian economy, national market and short-term prospects for development.

The index consists of three indicators that provide an overview of the business environment, factors that influence business and the investment plans of companies operating in the country. When measuring ICIL, the priority is to present adequate and relevant information that reflects real market trends. With this in mind, only the heads of foreign companies and top tier management are invited to participate in the survey.

The ICIL survey is carried out by the initiative of Investors' Forum, an association of Lithuania's largest investors. A total of 42 of Lithuania's foreign capital businesses participated in this quarter's survey.

ICIL is an instrument of information that provides potential

Index value	Interpretation
ICIL = 2 (maximum value)	All participants indicate positive expectations (absolutely positive expectations).
ICIL > 1	The percentage of participants with positive expectations exceeds the percentage of respondents with negative expectations.
ICIL = 1	Equal numbers of participants indicate positive and negative expectations.
ICIL < 1	The percentage of participants with negative expectations exceeds the percentage of respondents with positive expectations.
ICIL = 0 (minimum value)	All participants indicate negative expectations (absolutely negative expectations).

Fig. 1. Index values and descriptions

Contacts: Andželika Rusteikienė, Investors' Forum info@investorsforum.lt; +370 5 2755258

SUMMARY AND CONCLUSIONS

5th QUARTERLY ICIL SURVEY: investors' projections are improving, expectations remain positive

Investors' expectations as of Q2 of 2015 have surpassed the results of the year's first quarter. Smooth introduction of the euro has built confidence in the country's economy and business climate

► **ICIL_{Q2, 2015} = 1.174**

For the second quarter of 2015, the value of the investor confidence index for Lithuania (ICIL) has reached 1.174. Compared to the previous quarter, the value of ICIL has increased (the ICIL value of the first quarter was 1.136) and continues to climb above a value of 1. In other words, the number of participants indicating positive expectations continues to exceed the number of participants indicating negative expectations. This leads to the conclusion that participants see developments within the Lithuanian economy as favourable and feel that the investment climate and business conditions are improving (see Figure 2). According to the respondents, such trends should perpetuate into the near future.

The growth of the ICIL value was mostly the result of a smooth transition to the euro, which ended a period of economic uncertainty that had given investors and other market participants cause for concern. The absolute value of ICIL has increased, almost meeting its highest previous value, 1.181. Figure 2 demonstrates that the index has maintained a value above 1 throughout all of the ICIL surveys. Thus, for five quarters in a row, foreign investors in Lithuania have expressed favourable outlooks and a confidence in the stable development of the economy. Foreign investors expect further positive change. Such positive expectations have been expressed for 5 quarters in a row.

This promotes confidence in the Lithuanian market as well as business and export conditions, and increases Lithuania's competitiveness and the likelihood of attracting foreign direct investment (FDI).



Fig. 2. ICIL value dynamics: Q2, 2014 - Q2, 2015.

Positive expectations continue to be bolstered by infrastructure

Legend: Deteriorate (grey), Remain the same (light green), Improve (dark green). No. of answers

Factor	Deteriorate	Remain the same	Improve	No. of answers
Macroeconomic sustainability	0%	79% (33)	21%	100% (42)
Political stability	0%	83% (35)	17%	100% (42)
Effectiveness of tax system	0%	90% (38)	10%	100% (42)
Transparency in the business environment	0%	93% (39)	7%	100% (42)
Effectiveness of transport and logistics infrastructure	0%	86% (36)	14%	100% (42)
Effectiveness of internet and telecommunications infrastructure	0%	76% (32)	24% (10)	100% (42)

Fig. 3. Evaluation of macroeconomic conditions, ICIL Q2, 2015

Asked to evaluate the factors that had the greatest impact on the investment climate and business environment, investors gave their most favourable opinions towards the areas of transport and logistics as well as telecommunications and internet infrastructure. Evaluations for these factors remain the highest.

Not a single participant expressed any expectations that the effectiveness of these areas will decrease in the near future. On the contrary, 14 and 24% of survey participants believe that infrastructure should develop even more in the second quarter of this year (see Fig. 3).

The remaining 86% of participants believe that transportation infrastructure will not experience any significant change during the coming quarter, and 76% believe the same to be true for telecommunications and internet infrastructure.

This ICIL indicator clearly illustrates the competitive advantage that Lithuania offers and suggests possible avenues for further business development. Continually increasing quality and decreasing service costs due to competition among the country's main communications service providers have led to the establishment of a widely accessible internet network and the fastest data transfer rates in the world, in turn creating great conditions for businesses and the public sector to take advantage of such services at a relatively low cost. The quality of telecommunications and IT infrastructure can also attract the headquarters and regional divisions of certain foreign companies.

Lithuania's status as a transitional country and its transportation infrastructure also continue to be factors that have a significant impact on the country's

attractiveness to foreign businesses. This means that it is important that strategic projects such as the Trans-European Rail Baltic railway line and the Klaipėdos Smeltė international container distribution centre continue to be developed successfully, ensuring uninterrupted flow of cargo through the territory of Lithuania by taking full advantage of the non-freezing port of Klaipėda.

On a further positive note, ICIL respondents continue to evaluate the transparency of the Lithuanian business environment more favourably. As many as 93% of participants believe that the level of business transparency will remain unchanged and 7% expect to see a further change for the better. Not one participant predicted that the situation would deteriorate. In the first quarter of this year, 41% of ICIL participants indicated that Lithuania must take active steps to improve business transparency, however, Q2 results reveal that market participants are paying increasingly more attention to business ethics and social responsibility.

FACTORS THAT INFLUENCE BUSINESS PERFORMANCE: expectations for performance indicators remain positive

Evaluate your expectations for the second quarter of 2015 (April-June).

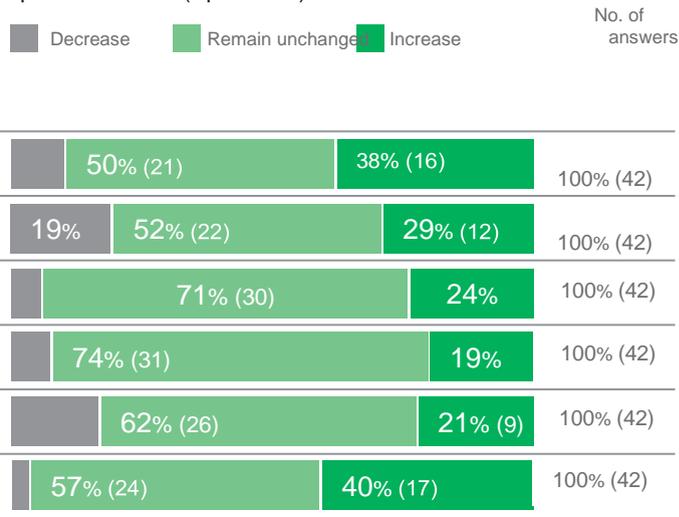


Fig. 4. Factors that impact business performance, ICIL Q2, 2015

One of the most important reasons behind the increase of ICIL indicator values is the positive expectations foreign investors have for business performance. This quarter's survey reveals that as many as 40% of participants plan to increase capital investment in the coming quarter. More than half (57%) plan to maintain the same level of capital investment and only 3% plan to decrease capital investment (see Fig. 4).

Another area that has a significant effect on investor confidence is assumed demand for a company's products and services. 38% of respondents surveyed expect an increase in demand, 50% do not expect any change at all and slightly more than a tenth (12%) predict a decrease in demand.

It is important to note that expectations for demand were the most pessimistic compared to all previous ICIL surveys. The number of participants that expect an increase in demand decreased by 11% this quarter. Such a decrease has only been observed in this past quarter and does not constitute a trend, however, if this tendency remains, investors and other market participants might have to begin exploring the markets of third countries, expanding their product/service ranges or

consolidating services. It is worth emphasising that insufficient demand is one of the factors that foreign business finds the most limiting – in Q1 of 2015, as many as 59% of respondents indicated that insufficient demand would be the greatest barrier for foreign business.

Expectations for profitability also decreased by a slight margin. A total of 29% of respondents expect an increase in their company's profitability – this is 7% less than last quarter. Almost a fifth of respondents (19%) predict a decrease in the profitability of the companies they represent.

Investors still have positive, though more modest expectations for business performance, so this should not cause any serious concern for now. However, if slowing growth becomes a trend in the future, this could possibly indicate that the country's foreign capital businesses and possibly domestic ones are experiencing certain difficulties. Stable or even decreasing demand can lead to decreasing income and, in turn, profit. Hopefully, the coming quarter will reveal that this is simply a temporary pit stop.

INVESTMENT PROJECTS and NEW JOBS: investors have no intention of slowing down

Evaluate your expectations for the second quarter of 2015 (April-June) regarding the following:

No. of answers

Will deteriorate Remain unchanged Will grow

Category	Will deteriorate	Remain unchanged	Will grow	No. of answers
New investments	0%	62% (26)	38% (16)	100% (42)
New jobs	0%	60% (25)	38% (16)	100% (42)

Fig. 5. Investment plans, ICIL Q2, 2015

The investment plans of foreign capital businesses in Lithuania demonstrate that now is the best time to take up or continue developing investment projects, expand business operations, intensify production operations and expand employee base by increasing production capacity. 38% of respondents indicated that they plan to take up new investment projects, with an equal percentage indicating that they plan to create new jobs (last quarter, the percentages were 36 and 34% respectively) (see Fig. 5). Correspondingly, 62 and 60% of survey

participants expect to maintain these indicators unchanged. It is important to note that not a single participant plans to discontinue their investment projects and only 2% intend to reduce their number of jobs.

The investment plan indicator reflected the positive expectations of investors across all the ICIL surveys. This shows that investors are making an effort to increase production capacity or at least maintain previous levels.

Availability of qualified labour continues to raise concern

An especially large percentage of investors indicate that the availability of qualified labour remains insufficient in Lithuania – an average of 38.4% of survey participants indicated this shortcoming across all four ICIL surveys. Lithuania can offer relatively inexpensive labour, but qualified employees are hard to find. There are several possible reasons for this: a system of education that fails to meet market demands, poor choices of profession, inadequate career consulting for school leavers, insufficient work experience, etc.

It is especially important to note that this phenomenon can have a significant negative impact on Lithuania's competitiveness in the long run. In other words, labour costs will start to increase due to the small number of qualified employees available and the country will be forced to import labour from abroad. There is also a certain likelihood that businesses which employ qualified labour will discontinue operations in Lithuania. In order to maintain high standards of growth and simultaneously raise the standard of living in the country, it is crucial that these discrepancies between supply and demand are addressed sooner rather than later. Implementing change in the labour force, training new specialists and requalifying existing specialists will, of course, take a substantial amount of time, but is an absolute necessity.

		Availability of labour force	
Quarter	Insufficient	Sufficient	Percentage
Q2, 2015	insufficient		40%
	sufficient		60%
Q1, 2015	insufficient		43%
	sufficient		56%
Q4, 2014	insufficient		37%
	sufficient		58%
Q3, 2014	insufficient		26%
	sufficient		67%
Q2, 2014	insufficient		46%
	sufficient		50%
AVERAGE	insufficient		38.4%
	sufficient		58.2%

Fig. 6. Availability of a qualified labour force, ICIL

ADDITIONAL INSIGHTS: A PROJECT FOR A NEW SOCIAL MODEL and the NATIONAL AIRLINE

A few additional questions are incorporated into the ICIL questionnaire every quarter in order to address the most recent developments in economics and politics.

A PROJECT FOR A NEW SOCIAL MODEL: an assessment of the effectiveness and contents of public information efforts

Currently, one of the most publicly debated political and economic developments in the country is the new Social Model project. The project has currently been handed over to social partners for evaluation and submissions. The reception or rejection of the new model by the Lithuanian Seimas (parliament) will have a significant impact on the country's legal framework and business environment as well as having a great influence on the employment situation and social security system. In view of this development, this quarter's survey was drawn up to include a question addressing the issue.

New Social Model project. Knowledge of the project

I have had time to acquaint myself with the project well	29%
I have some knowledge of the project, but not as much as I would like	55%
I have not yet had time to look into the project	17%

Fig 7. Evaluation of investors' knowledge of the new Social Model project, ICIL Q2 2015.

Investors were asked how well acquainted they were with the new project. Almost a third (29%) of participants had managed to acquaint themselves with the project well. Over half (55%) only had time to gain some knowledge of the project and 17% had not yet had time to look into the project (see Fig. 7). Because the implementation of such a model would have an enormous effect on business and the economy, this number is simply too high.

When asked to evaluate the dissemination of public information about the new social model, investors were sceptical. As many as 76% of participants evaluated the public information effort as poorly done or worse than expected. Only 7% evaluated the public information effort positively. Several respondents indicated that the public information process started out very slowly and in an uncoordinated manner but improved over time.

How would you evaluate the activity of controlling institutions with regard to informing and educating businesses, the public and other stakeholders about the new Social Model project?

Very good	0%
Good	7%
Better than expected	2%
Worse than expected	32%
Poor	44%
Other	15%

Fig. 8. Evaluation of public information efforts regarding the new Social Model project, ICIL Q2 2015.

Based on your knowledge of the new Social Model project, how would you evaluate the proposal?

Positive. The model incorporates long-needed reforms that will close the gap between regulation and the actual situation in the market	21%
More positive than negative. The model has certain faults but these can be resolved	40%
Neutral. The model fixes certain faults but also creates new ones	12%
Negative. The model does not address the actual situation in the market and will be ineffective unless essential changes are made	12%
Other	14%

Fig. 9. Evaluation of the new Social Model project, ICIL Q2 2015.

When asked to evaluate the content of the new Social Model project, investors' answers varied. A total of 21% of respondents evaluated the project positively, indicating that, in their opinion, the project incorporates essential reforms that will help reduce the imbalance between official regulation and the actual situation in the market. 40% of respondents evaluated the model as more positive than negative, indicating that the project had certain faults that could be eliminated. Neutral and negative evaluations of the project were presented by 12% of respondents in each category.

Evaluation of Lithuanian air carrier infrastructure and the necessity for a national airline

Another widely discussed topic is the issue of a national airline and air carriers in Lithuania. The survey sought to identify investors' attitudes towards this long-term problem.

When asked to evaluate the level of air infrastructure in the country, only 5% of respondents indicated that Lithuania's international flight system is active and efficient. 55% of respondents evaluated it as average and as many as 40% of investors are not satisfied with Lithuania's air travel sector (see Fig. 10).

The interesting thing is that as many as 85% of respondents indicated encountering certain difficulties when travelling by air to or from Lithuania or having heard similar complaints from their colleagues. Only 13% of respondents had not encountered any such problems. In order to remain competitive and attractive to tourists, foreign investors, businessmen and other individuals, it is of crucial importance to have efficient transport infrastructure. In consideration of the fact that the majority of long-distance journeys are made by air, Lithuania must take action in order to fix the present situation.

Evaluation of Lithuania's air travel infrastructure

High. The system is active and efficient	5%
Average. Operates satisfactorily but needs improvement	55%
Low. The sector is inefficient and requires reorganisation	40%

Fig. 10. Evaluation of Lithuania's air travel infrastructure, ICIL Q2 2015.

Have you encountered any difficulties such as flight availability, availability of certain routes, etc. when travelling to or from Lithuanian airspace?

Yes	65%
Personally, no, but I have heard such complaints from others	20%
No, never	13%
Other	3%

Fig. 11. Difficulties encountered when travelling by air, ICIL Q2, 2015.

Currently, Lithuania has a single national airline company called AIR Lituania. It is managed by a company of the Vilnius City Municipality. The newly elected mayor of Vilnius and other public figures as well as businessmen doubt whether such a solution is effective.

Investors have varying opinions regarding this issue: 12% believe that the national airline functions effectively, 36% have a neutral opinion on the situation, believing that the current management of the airline is ineffective but that this is the best solution for the present situation in the market. 33% of participants believe that AIR Lituania is being managed ineffectively: 21% of respondents say that the national airline should be managed by the state and not a municipality government. The remaining 12% are of the opinion that Lithuania does not need a national airline at all because of low air passenger flow. 14% did not have an opinion on the issue altogether.

What is your evaluation of AIR Lituania airline, its efficiency and how it is managed?

Functions well	12%
Neutral. There are certain shortcomings, however, this is the best solution for the current market situation	36%
Inefficient. The national airline should not be managed by a municipal government	21%
Inefficient. Lithuania does not need a national airline	12%
I do not have an opinion on the matter	14%
Other	5%

Fig. 12. Evaluation of the AIR Lituania airline, ICIL Q2 2015.