



# INVESTOR CONFIDENCE INDEX FOR LITHUANIA

IV QUARTER, 2014

**ICIL represents the evaluation of Lithuania's business and investment climate conducted by top executives and senior officers of the country's largest foreign capital firms. It is a direct reflection of the opinions and expectations that present business decision-makers in Lithuania have about the development of Lithuania's economy in the foreseeable future.**

The purpose of this index is to provide an alternative tool with which to assess the business conditions and investment climate in Lithuania, as well as to indicate the expectations of market participants for the short-term future.

The ICIL is an informative and useful tool for possible foreign

investors and other interested parties, providing them with relevant information and expected short-term developments in the economy through the eyes of market participants that face the existing challenges and exploit the opportunities of the Lithuanian market on a daily basis.

The established questionnaire enables the evaluation of Lithuania's economic conditions and the identification of existing barriers preventing the maximum business efficiency potential of the country being reached.

**ICIL survey** has been carried out by surveying largest foreign investors in Lithuania. The afore-mentioned survey's results are based on 62 received responses.

Index Value	Interpretation
ICIL = 2 (maximum)	All enterprises anticipate improvement (Maximum Positive Expectations).
ICIL > 1	There are more enterprises anticipating improvement than ones anticipating deterioration. The respondents feel that, in general, conditions are improving.
ICIL = 1	There is same number of enterprises with positive and negative expectations (Balanced Expectations). The respondents feel that, in general, conditions are unchanged.
ICIL < 1	There are more enterprises anticipating deterioration than ones anticipating improvement. The respondents feel that, in general, conditions are deteriorating.
ICIL = 0 (minimum)	All enterprises anticipate deterioration (Maximum Negative Expectations).

1. Table. Index Value and Interpretation

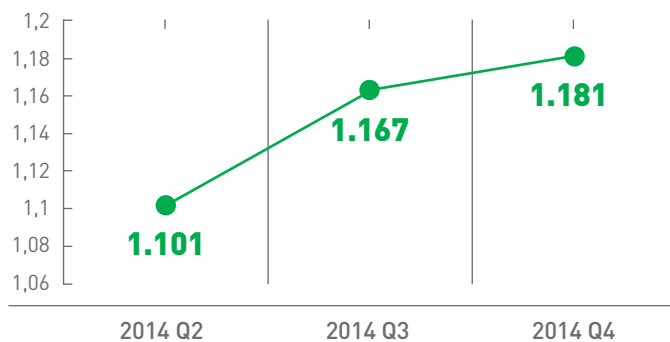
Contact: Gytis Trilikauskis, Investors' Forum  
Gytis@investorsforum.lt; +370 612 784 62

# SUMMARY AND CONCLUSIONS

**INVESTOR CONFIDENCE IN LITHUANIA'S ECONOMY REMAINS ROCK SOLID: expectations continue to be on the positive note towards the end of 2014**

► **ICIL 2014 Q4 = 1,181**

## ICIL dynamics (2014 Q2-Q4)



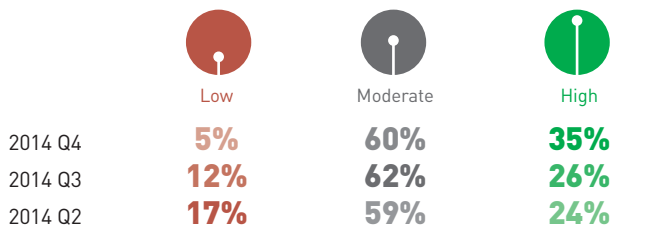
2. Table. ICIL dynamics 2014 Q2-Q4

Investor Confidence Index for Lithuania (ICIL) value reached 1.181 (out of the maximum value of 2) and has climbed the highest score benchmark throughout its existence. The continuously increasing value of ICIL signals that investor sentiment towards Lithuanian economy remains stable and is heading upwards for 3 quarters in a row. Investors have been expressing their confidence in the recent changes of Lithuanian business environment regularly. What is more, more resilient businesses after the global financial crisis alongside the rebounding economy let investors expect trade volumes to escalate in both, domestic and foreign markets. Confidence keeps on rising despite the unstable political situation in the region: tensions between Russia and Ukraine remain a highly potent threat for Lithuania's and whole Europe's economies and safety.

# KEY POSITIVE EXPECTATIONS

**BUSINESS ENVIRONMENT: investors expect more transparency, express their support for the government**

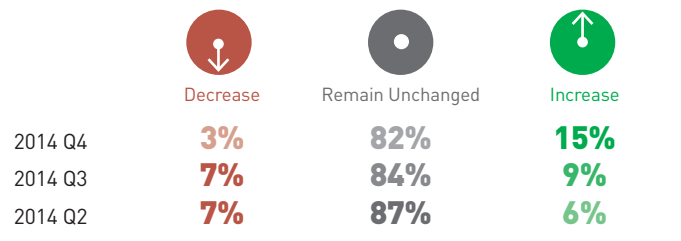
## Level of Political Stability in Lithuania



3. Table. Level of Political Stability in Lithuania (2014)

During the last 3 quarters of 2014 highest improvement has been reached in the area of country's political stability. Based on the initial ICIL (2014 Q2) survey (see Table 3), 17 per cent of survey respondents had evaluated Lithuania's level of political stability as low. However, negative perception of the matter has declined since. It reached 12 per cent in the third quarter of 2014 and now (2014 Q4) stands at 5 per cent. In contrast, the number of respondents expressing their perception of Lithuania's political stability level as high has increased in a similar proportion. It went up from 24% to 35% during the same period. ICIL findings indicate that Lithuanian political arena is becoming more and more trustworthy for the investors thus, increasing the overall attractiveness of the country. Based on the last ICIL survey, a staggering 95% of all survey participants have evaluated the level of Lithuanian political stability to be high or moderate.

## Expectations Towards the level of Transparency



4. Table. Expectations Towards the level of Transparency (2014)

According to the most recent ICIL results, 15 per cent of investors are expecting the level of transparency to escalate during the last quarter of the year, while 82% foresee no changes, and 3 per cent of survey participants expect it to decrease. An increasing amount of investors have been expecting the level of transparency to inflate in the country all throughout the year (see Table 4.). The ascending trend of transparency expectations informs that there is a notion of growing confidence in country's controlling institutions and their increasing operational efficiency potential.

Besides more stable political situation in the country and increasing transparency level, the upcoming introduction of the Euro is also posting positive impact on investor confidence. The establishment of the single European currency in Lithuania will increase price stability, consumers will be able to easily compare prices within the Euro-zone and the exchange rate risk will be eradicated. Businesses that deal a lot by exchanging Lithuanian Litas into Euros and vice versa will benefit greatly from the exchange rate risk being absolute.

**FIRM-SPECIFIC FACTORS:**  
**investors plan to increase capital investments and employees in order to catch up with boosting demand**

CEOs and senior managers that participated in the ICIL questionnaire have expressed positive expectations for a third consecutive quarter about the performance of the companies they are representing (see Table 5). More than half (55%) of all survey respondents claim they are expecting increasing demand for their products and services in the last quarter of 2014. That is the highest value point that this particular variable has reached since the introduction of Investor Confidence Index for Lithuania.

Upward-shifting demand was expected by 43 and 40 % of survey participants during the second and third quarters of 2014, respectively. The expansion of the Lithuanian economy and the ongoing development of the private sector in the country

is reflected by an growing part of investors who are planning to increase or maintain the same number of employees and capital investments. An equal amount – 55 % of participants are expecting the capacity of resources dedicated to creating additional workplaces or capital investments not to change. However, 39% of them are planning to elevate the resource dedication towards these two aspects. The accumulative amount of 94% investors expressed their plans to increase or at least not change the number of employed staff or capital investments they are currently making. Comparing this accumulative amount with previous ICIL surveys, it is the highest positive expectations towards these two aforementioned firm-specific factors ever recorded.

**Firm-specific Factors**

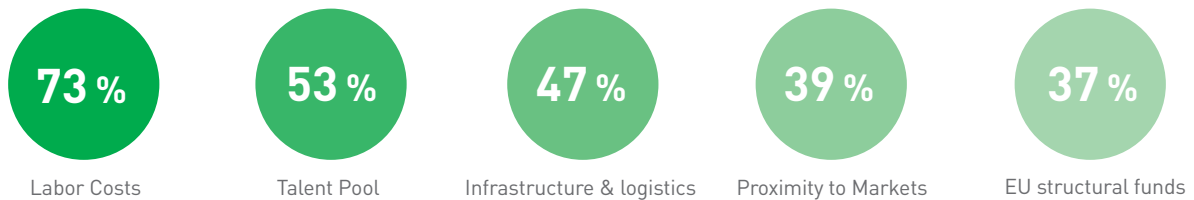
		2014 Q4	2014 Q3	2014 Q2
DEMAND FOR PRODUCTS/ SERVICES	Increase (%)	<b>55</b>	<b>43</b>	<b>40</b>
	Increase or Remain Unchanged (%)	<b>92</b>	<b>95</b>	<b>88</b>
NO. OF EMPLOYEES	Increase (%)	<b>39</b>	<b>31</b>	<b>28</b>
	Increase or Remain Unchanged (%)	<b>94</b>	<b>85</b>	<b>88</b>
CAPITAL INVESTMENTS	Increase (%)	<b>39</b>	<b>33</b>	<b>33</b>
	Increase or Remain Unchanged (%)	<b>94</b>	<b>98</b>	<b>99</b>

5. Table. Firm-specific Factors, ICIL 2014

Reportedly expanding economic capacity of the country, extending purchasing power of consumers and swelling trade orders reinforce investor confidence in Lithuanian and surrounding markets. To counterbalance boosting demand GMs are exercising all options at their disposal: hiring new staff,

investing into equipment and making other investments to hike operational capacity. Rebounding business in Lithuania has become more competitive after the global financial crisis and is shifting its attention towards growth.

**INVESTMENT PROMOTION:**  
**most enticing areas remain low-cost labor, talent aptitude & upcoming EU structural fund package**



6. Table. Most Enticing FDI Attracting Factors of Lithuania, ICIL 2014 Q4

Drawing upon the results of ICIL, Lithuania’s biggest competitive advantage in terms of FDI attraction is competitive labor force. Economical labour force costs has been second to none Lithuania’s advantage with regard to investment attraction for three sequential quarters. It has been designated as an advantage by 73% of investors in the most recent survey. Based upon investor opinion, the second most influential Lithuania’s asset is the talent pool and the aptitude it contains for future development – identified by 53%, followed by the level of infrastructure & logistics in the country (37%). What is more, a significant amount, 37%, has outlined the upcoming 2015-

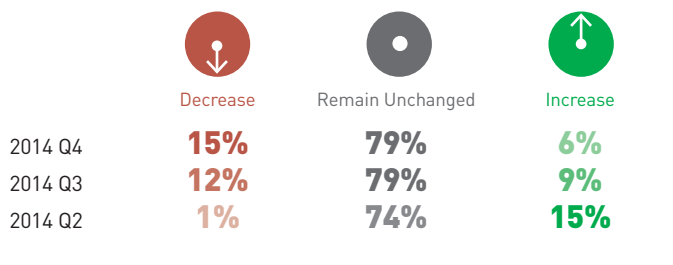
2020 EU structural funds package as a influential factor notably increasing Lithuania’s international competitiveness.

Increasing domestic demand and uplifting company performance indicators are fueling private sector expansion in the country. Moreover, Lithuania offers competitive, talented and highly-potential workforce which suggests that Lithuania is a feasible country to invest in. The increasing confidence can also be, to some extent, attributed to increasing political stability and the upcoming introduction of the Euro from the 1st of January, 2015.

# BARRIERS IMPEDING ECONOMIC DEVELOPMENT

## BUSINESS ENVIRONMENT: international tensity weighs down on macroeconomic stability; investors feel the lack of reform in labor relations, public sector efficiency and fight with shadow economy

Expectations of Macroeconomic Sustainability, ICIL 2014 Q2-Q4



7. Table. Expectations of Macroeconomic Sustainability, ICIL 2014 Q2-Q4

The biggest negative expectations are directed towards the changes of macroeconomic sustainability levels in the economy. No doubt, the unrest is candidly caused by the unpredictable and horrific situation concerning Ukrainian-Russian geopolitical crisis. Not even Euro introduction and its aftereffect potential of reduced exchange rate and therefore, downsized business

risk, cannot yet outbalance the unresolvable confrontation verging on war. 15% of survey participants expect the level of macroeconomic environment in Lithuania to decrease during the last quarter of 2014 and it is the lowest negative expectations during the whole presence of ICIL.

While evaluating internal areas of the economy (see Table 8), which are in the most need of correction, highest level of concern once again was shown regarding labor & employment regulations (66% of survey respondents), followed by fight with shadow economy (61%), public sector efficiency (50%), taxation system (44%) and the level of transparency in the country (44%). It is important to note, that "Public Sector Efficiency" and "Fight with Shadow Economy" answer options has been introduced to the ICIL questionnaire only in the most recent survey. Nevertheless, the importance and significance of these underlying growth determinants is mirrored by the compelling number of investors expressing their disturbance with newly-specified areas of the economy.

Supposing Government, legislators and business society both are in favour of creating fully-functioning, socially responsible society filled with businesses of integrity, it is of essential importance to prevent corruption and fraud, contain the spread of illegal work, and to ensure that market participants have equal competitive conditions to produce and realise their products or services. Without the already mentioned areas of the economy, 40% of survey participants also pointed out current systems of public procurement and education as having troublesome issues which need to be unravelled (ICIL data, 2014 Q4).



8. Table. Areas in Need of Attention, ICIL 2014 Q4

## FIRM-SPECIFIC FACTORS: Company Performance Obstructing Factors



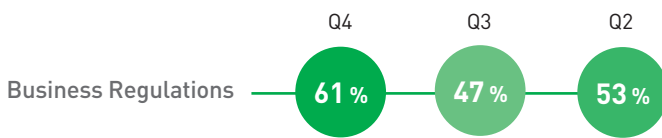
9. Table. Company Performance Obstructing Factors, ICIL 2014 Q4

In the same manner as previous ICIL surveys has shown, 52 % of investors notes insufficient demand as the most significant factor limiting their businesses. This situation persists in the market even though 55 percent of all investors are expecting the demand of their products to increase in the last quarter of this year. It stresses business desire to grow vastly and fast, offer increased volumes of production in Lithuania, EU as well as other countries throughout the world. Moreover, excessive regulation also remains as one of the major obstacles to rapid business

growth in Lithuania – 31% of survey participants feel its burdain on a constant basis. The exact same amount (31%) indicate the Russian-Ukraine conflict to be damaging for business practices. Despite the fact that foreign investors in Lithuania realize there is a significant threat in geopolitical matters, critical situation is not reached and therefore, foreign businesses in Lithuania are more concerned with exploiting possibilities of finding new markets or customers.

## INVESTMENT PROMOTION: excessive regulation deter new investments

Economists, investors and economic theory states that business regulations and investment climate in the economy are among the most influencing determinants for making the decision whether to invest or not. According to K. Hornberger, J. Battat ir P. Kusek (2011), the effectiveness of controlling institutions in the country and the quality of regulatory environment is the second most influential determinant for FDI surpassed only by the size and growth potential of the domestic market.

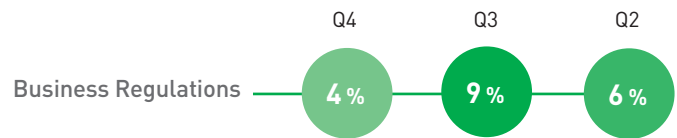


10. Table. Significance of Business Regulations as one of the Most Influencing Location Determinants for FDI, ICIL 2014

It is of common agreement among economists that investment climate and business environment significantly affect the amount of inward FDI into an economy. The benefits of FDI are the creation of new workplaces, spill-over effects on technology, organisational structures, “know-how” of best practices and etc. Business regulations was continuously stressed as a factor of significance by ICIL participants as well (see Table 10). Based on

the latest ICIL results, 61% of all investors believe that Business Regulations are among the decisive determinants for investment location planning.

The cause of concern is the fact that according to ICIL surveys, only a minimal fraction of respondents perceive Lithuania’s business regulations as advantageous in comparison with other economies (see Table 11). The biggest value in this particular variable has been reached during the 2014 Q3 ICIL survey when only 9% of all respondents have indicated business regulations as a competitive advantage for Lithuania.



11. Table. Lithuania’s Competitive Advantages for FDI, ICIL 2014

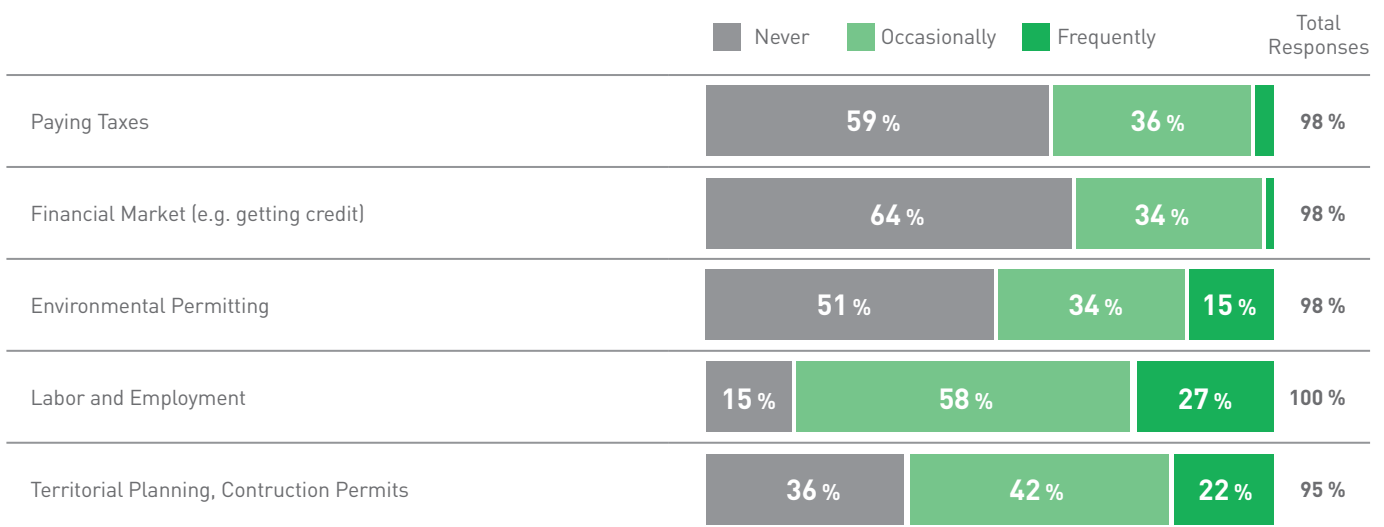
Apparently, the gap between the importance and current level of business regulations in the economy is vast and in order to increase inward FDI into Lithuania, this issue should be addressed sooner rather than later. It would not only increase Lithuania’s attractiveness for FDI but would improve conditions for domestic businesses as well.

## ADDITIONAL INSIGHTS

### CHALLENGES OF EVERYDAY ACTIVITIES

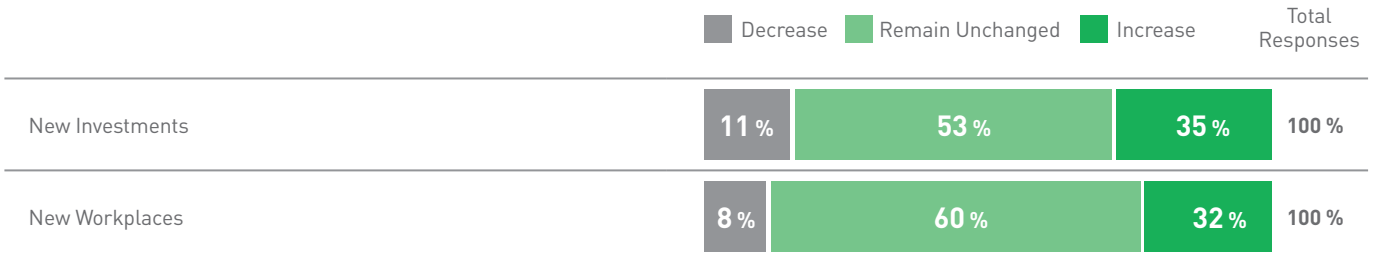
Whilst concentrating upon the problems companies face while carrying out their daily operations, labor and employment regulations tops the list once again. A surprising amount of 27% ICIL survey participants encounter obstacles regarding labor & employment on a frequent basis, 58% - occasionally and only 15% never face any problems in this area (see Table 12).

The second largest troubling issue remains territorial planning and construction permits: 22% of participating companies face obstacles frequently, 42% - occasionally. Another field of activity that strain business environment is surroundings in the country permitting – 49% of investors incur difficulties in this area frequently or occasionally.



12. Table. Challenges of Everyday Operations, ICIL 2014 Q4

## INVESTMENT PLANS



13. Table. Investment Plans, ICIL 2014

Investors stay positive when planning investments. 32% of all survey participants indicated their plans to increase the number of workplaces during the last quarter of 2014 and only 8% expressed their intentions to reduce investments into establishing workplaces (see Table 13). Similar optimism is trending in the area of new investments. More than a third (35%) of investors are going to engage in new investment projects in the fourth quarter of this year.

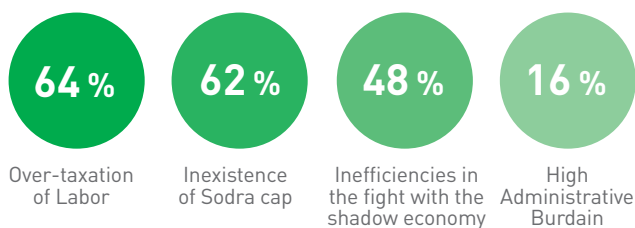
Investors and other market participants forecast further development of the economy and are trying to keep up with the growth by investing into their own capabilities – increase staff and operational capacities. Investors are confident that the economy will grow continuously.

## TAXATION SYSTEM INEFFICIENCIES: Causes

Investors in Lithuania has constantly criticised the existing taxation system in the country and has made numerous statements that reform is necessary. Based on ICIL results, 44% of investors have identified taxation as one of the issues in need of the upmost instantaneous attention from the Government. This issue was singled out even more on previous ICIL surveys – 57% in Q3 and 72% in Q2 of 2014.

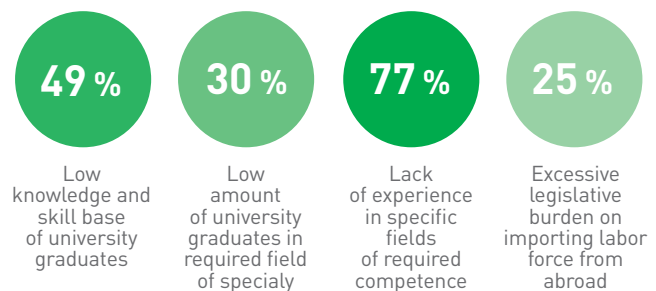
During the third quarter of 2014, ICIL respondents were asked to identify the underlying causes which lead to an inefficient taxation system (see Table 14). According to the data, the largest negative influence is generated by overtaxation of labor and the inexistence of SODRA (social security) payment cap – these matters were pinpointed by 64 and 62 per cent of survey respondents, respectively. Moreover, 48% of investors claim that improficient fight with the shadow economy is the cause of a faulty taxation system and 16% states that the administrative burdain is too high.

The inexistence of social security payment cap is a significant limitation towards businesses, especially ones that are creating higher value products and employ well-qualified, highly-compensated staff. In the current situation where the employer is responsible for social security payments and no payment cap is established, every additional employee accumulate significant costs for the employer. In addition to this, the higher salary (value) of the additional employee is, the more costs the employer incurs. Therefore, employers are indirectly encouraged to hire unqualified (cheaper) labor force instead investing in people with high potential in order to create higher value-adding production.



14. Table. Causes of Taxation System Inefficiencies, ICIL 2014 Q3

## SCARCITY OF QUALIFIED LABOUR: Causes



15. Table. Causes of Qualified Labour Scarcity

Another frequently raised concern of foreign investors in Lithuania is the scarcity of qualified labour force. Having in mind that competitive labor costs is the single most influential Lithuania’s competitive advantage for attracting FDI, it is essential that qualified-labor supply is increased or at least kept at the current state.

The most prominent cause of qualified labor force scarcity in the country is the lack of experience of applicants. This concept is supported by 77% of respondents (see Table 15).

Among other possible explanations lies the notion that current education system does not meet the market demand for particular occupations. Shocking 49% of ICIL participants state that graduates come to the labor market having inefficient knowledge and/or skill base. Futhermore, almost a third (30%) of investors believe that the current decomposition of graduates is faulty. In other words, there are too many lawyers and managers and too few engineers and IT professionals. With regard to the notion that Lithuania is among the leading countries in the world in terms of people with tertiary education, the fact of Lithuania graduating a disproportionate amount of required specialists seem not only disappointing but a bit ironic to say the least.

The current state is obviously causing negative market externalities in Lithuania and the Government should take a definitive action to stabilize the situation.