

The fastest and smartest to win in Europe

After having regained their independence the Baltic countries reformed their legislation in compliance with the preconditions for successful business. Lithuania established a relatively independent system, while Latvia and Estonia took over their pre-war laws by supplementing them with the best elements from the neighbouring countries. Magazine *Kapitāls* discussed the issue of what entrepreneurs should take into account upon accession into the EU with Aku Sorainen, the managing partner of *Sorainen Law Offices* and attorney-at-law in Estonia, Gints Vilgerts, attorney-at-law in Latvia, and Kestutis Adamonis, a partner of *Sorainen Law Offices* and attorney-at-law in Lithuania.

What changes in the legislation of the Baltic countries should mostly be minded by the entrepreneurs after the accession into the EU?

Aku Sorainen: Most changes have already taken place and there is nothing radical to be expected. However, most laws contain details that are to be amended due to their non-compliance with the EU requirements. The accession will impact the activities of courts, since they will have to take into account the European Court practice. When the lawyers protect their client's rights in the court, they will refer not only to the local laws but also to the EU legislation. If the local legislation should turn out to be in conflict with the EU laws, the courts will have to give priority to the EU legislation and judgements passed by the European Court of Justice. The businesses and even lawyers are not yet fully aware of this change to come.

Where can the businesses receive the information necessary for them?

Kestutis Adamonis: Already ca. a year ago major Lithuanian companies, for instance, chemical producers, transportation companies carried out special research on the impact of the new political, economic, financial and legal environment upon Lithuania joining the EU. For the companies that already find themselves within the European environment and are affected by various customs duties and legal environment this process started already a couple of years ago. The role of consulting is of especial importance. In seminars, entrepreneurs can obtain an insight into what is to take place in a year's time. If an entrepreneur is active, he can get access to the information needed.

Gints Vilgerts: It is important that the local businesses start working on their long-term development models. The next three years will have the decisive role in defining the future of the Baltic businesses. Local companies will either be bought or they will have to merge with other companies, since otherwise they most likely will disappear from the market.

Numerous Latvian entrepreneurs are worried about the frequent changes and unpredictability of the national legislation and believe these changes to be the key reason for the inability to form long-term development plans. When will the legislation stabilise?

K. A.: Approximately 90 % of the legislative acts will remain as they are now. Businesses have survived the changes and the changes will never again reach the scope of the past 4-5 years.

G. V.: At the end of the next year thousands of inactive businesses will face liquidation also in relation to the new commercial register. Problems are encountered when enforcing the legislative changes. Neither the businesses, nor the state or municipal institutions are ready for the practical implementation of these laws. Moreover, the institutions are being too strict on the companies.

K. A.: Currently most part of the legislative acts regulating the business environment in the Baltic countries has already been drastically changed. It is only that the entrepreneur cannot be certain that subsequent to its adoption the law will be enforced and implemented adequately and according to a single method. For instance, in Lithuania the Civil Code consists of 6 volumes and more than 3000 articles. Many of the latter are brand-new and there have been no court or other precedents in their application. Neither the businesses, nor the court system and the state institutions are sure that the way they interpret these laws is the correct way to do that. However, I believe that this is but a natural outcome of the changes experienced by us over the past 10 years.

G. V.: Already in the next 7-10 years we will come to feel stability.

How important a role in the EU will be assumed by the common competitiveness of each country?

A. S.: It will be of utmost importance. I come from Finland and I remember the changes that took place upon Finland acceding to the EU. Prior to the accession Finland had a very protected market. Agriculture in the country received much more state subsidies than now from the EU, and there were several restrictions placed on imports. After accession, the EU paid to the farmers only half of the money that they used to receive for their products prior to accession. In Finland there were new products, especially – new agricultural products appearing in the stores. The national competitiveness turned into a very significant factor. The advantage of the Baltic countries lies in the fact that they are very open already now, and therefore the accession into the EU does not necessarily mean that life will become more difficult for businesses. I trust that most companies will be able to survive within the EU. The competition will grow, but so will the opportunities.

G. V.: Already now it is not only that foreign companies are entering the Baltic markets, but also Estonian companies are competing with the local businesses on the Finnish market. This is a two-way movement. It brings not only threat that large companies will enter the small countries, but also opportunities for small, medium-size and large businesses to enter the western markets. Also in Latvia there is a number of such companies, for instance, *Latvijas Finieris* has established branches in several European countries.

Only ca. 7% of the Latvian companies are exporting their production. Will the companies producing for the local market have to change focus and restructure in order to survive in the common EU market?

A. S.: If the European companies wish to export their production to the Baltic countries, they may do so already now without paying additional customs duties. This means that if these Western European companies have not entered the market by now, most likely they have no competitive advantage with respect to the local companies.

Therefore it is impossible to predict whether the local companies will be subject to so much bigger competition.

Does this apply also to the businesses of other EU candidate countries? For instance, is there not going to be a huge inflow of Polish agricultural products due to the lower cost of the products there?

A.S.: The EU goods are flooding Estonia already now. There are no customs duties on agricultural products in Estonia. The EU is granting subsidies to the farmers exporting agricultural goods outside the EU, mainly due to the production surpluses. Therefore the Estonian farmers right now are in a really difficult situation. For instance, while butter costs one Latvian lat in Finland, in Tallinn it would be sold for 50-60 santims only. The Estonians have to compete with the EU subsidised prices. After accession the EU prices in both countries will be similar – one lat both in Finland and in Tallinn. Thus in agriculture the competition in Estonia will be easier. I am not afraid of Polish goods flooding Estonia, since, if they were so cheap, they would have already been here. Polish apples are the cheapest and best apples available in Tallinn and they are already there.

G. V.: In Denmark we were discussing the pros and cons of the EU accession with our colleagues lawyers. It was weird that there were more arguments against the accession. This was due to the fact that lawyers are rather conservative and reluctant in respect of changes. A Danish lawyer was telling us about his cousin who owns a major farm, receives a good amount of subsidies and drives a Mercedes. Now he is worried that a considerable part of these subsidies will go to the farmers of the current EU candidate countries and he will lose his Mercedes. Therefore also the EU member states are in two minds about the EU enlargement. The Estonian and Latvian farmers have already suffered a lot over the few past years and thus will find the changes easier to take. Lithuania might find more painful.

A.S.: Mergers among larger farms is a considerably common thing in Latvia and Estonia. This consolidation will continue but not because of the increasing competition and the reduced prices on the market, rather – due to the fact that otherwise it would be more difficult to apply for the subsidies.

Are the Baltic countries to be viewed more as competitors or as partners?

K. A.: In an open market everybody is a competitor.

A. S.: This issue has two angles. We may talk of political and business area. Many politicians in Scandinavia are currently considering how the EU policy will look like from the point of view of the Nordic countries: whether the Baltic countries might join them in establishing a strong alliance within the EU, whether these countries have common interests. There might be also other potential groups of interest, for example, an alliance of small countries. Almost every topic that becomes of importance within the EU, gathers various interest groups and coalitions. However, when we are talking business, we all are competitors.

K. A.: The borders of the European Union in the economic sense of the word no more exist, and the market becomes open. I may purchase goods from Portugal and this a completely free competition.

G. V.: If we take aside the different capital basis of the Baltic companies and the western companies, I am sure that the management is quicker and more active in the Baltic countries than in Western Europe. My friends Latvians - managers of international companies are quick, dynamic and smart. The managers from the Baltics may take up managing positions in European companies since they are hungry for things they have not experienced.

K. A.: Companies of Baltic origin have a competitive advantage, since they have been through drastic changes, refocusing from one lifestyle to another, and therefore have been forced to act efficiently, quickly and they are able to be fast in decision-making. If a German company might require three months to decide on an acquisition of a real estate, a Lithuanian entrepreneur will take this decision within a day or two. This is required by the environment, since three days later the real estate might already been sold to and agreement concluded with someone else. The tempo of life is different in the Baltics and Western Europe.

A. S.: The accession of the Baltic countries in the EU will supplement the circle of the Baltic Sea countries. A number of our clients already have a strategy for the Baltic Sea region. They view the Baltic Sea countries as their home market and direct their investments to this region. An Estonian company may acquire a Latvian company, and then be bought by a Finnish company, which again could be bought by a Swedish company and finally the whole group might be acquired by Americans. This has already been experienced. Another angle of the EU accession is characterised by the *Nokia* example. The accession of Finland into the EU provided *Nokia* with certain competitive edge. The goods were easier to sell on the new market. In mid-nineties *Nokia* developed a new GSM standard that became the common EU standard only due to the fact that Finland had joined the EU. The ability to develop a standard and then introduce it to be the standard of Europe may be a significant factor in achieving competitive advantages.

Which are the industries where the companies are the most prepared for entering the EU?

K. A.: 50% of the Lithuania's exports currently go to the EU countries. The export volumes are mainly comprised of textile products, furniture, timber and fertilisers. These goods are being sold in the EU already now and their producers are ready to face the open EU market. More difficulties will be experienced by the small and medium-size companies that currently are producing only for the local market.

G. V.: The Baltic countries will be competitive. Even though this may not be a very popular argument, the Baltic countries will be an oasis for the Russian-speaking companies. They will see partners and people who can talk Russian. The business environment is more or less familiar. It is a friendly, comfortable place for their investments. Therefore the Baltic countries will provide a comfortable environment for Russian speaking companies, even though emotionally this might be an ambiguous issue. I hereby mean not only Russia, but also the Ukraine, Belarus. This is a very interesting and valuable competitive advantage.

What kind of investments would you expect from Russia?

G. V.: I can only judge on the basis of my own experience and analysis of the past three years. The investments will mainly go to real estate and transportation sector, then to other industries. And these will be industries that require large capital, as I really doubt that they would enter the service sector. But, of course, everything is possible.

A. S.: This also depends on the future trade relationships with the EU and Russia. For instance, BMW established a factory in Kaliningrad only because due to the import and customs duties they wanted to produce cars in Russia. It was cheaper to produce cars in Russia than to export them from the EU into Russia. If in the future a Russian company would decide to produce goods in the EU because that facilitates the sales, then the Baltic countries are the most likely target countries for locating such production units.

To what extent will this process be affected by the political relations? By now these have not been very successful between Latvia and Russia.

A. S.: First of all, trade is mostly likely to grow between Latvia and Estonia, and Russia, since currently Russia still persists in applying double tariffs to goods from Estonia and Latvia.

G. V.: To my mind, in the Baltic countries the trade is affected only by taxes and tariffs. The entrepreneurs have acquired valuable experience in applying creative solutions that will be used to solve the situation in other ways than by requesting the politicians to improve the relations between the countries. The Baltic countries will be in a better position, since we are going to be under the EU umbrella. The relations should improve due to the fact that it will no more be dialogue between the Baltic countries and Moscow, but between Brussels and Moscow.

K. A.: Entrepreneurs are playing a very important role, as they are the ones shaping the national politics. Trade respects no political borders. For instance, these milk or meat wars between Latvia and Lithuania arose as an initiative of the entrepreneurs.

A. S.: Another important factor having a positive impact on the Baltic countries and promoting competitiveness today is the low tax burden on the companies in comparison, for instance, with Nordic and many other European countries.

Is tax burden expected to increase due to the fact that it is larger in the EU member states?

A. S.: Not necessarily, no. Estonia was discussing the reduction of the corporate income tax over the next 3-4 years. The EU does not define the level of the corporate income tax or the VAT rate, it merely offers a method to be used in VAT calculation.

G. V.: The current tax system in comparison with the EU standards is very investment-friendly.

A. S.: In all the three Baltic countries there still exist companies that do not pay taxes and make envelope-salary payments to the employees. I believe that the tax collection

will become more effective, which means that the governments will not have to increase the tax burden, they will collect larger tax amounts anyway.

For instance, construction companies complain that they would not be able to survive due to the excessive competition if they were paying all the taxes. What could be done to improve the situation?

A. S.: If all the companies were paying taxes, then there would no problems and they would all find themselves on the same level of competition.

G. V.: In Latvia currently there are 2,500 construction companies. Out of these approximately 20-40 are large companies. Not all of them are perfectly loyal to the country. The accession into the EU will be survived by those companies that are either large or occupy a certain niche of the market. These companies will face similar regulations and the tax collection will improve. Those that are not ready to do business in an efficient and professional manner and that have non-payment of taxes as their competitive advantage, will not survive.

A. S.: In Estonia we have already experienced a major “clean-up” from the tax police. The inspectors identified the companies that do not pay taxes and now many a company has to pay huge fines. Other companies are being more careful and have started tax payments.

The EU pays more attention to supervision, whereby the state and municipal procurement will become more transparent. Already now Latvia has announced the policy of transparency, but nothing has really changed. How is this supervision to be implemented?

G. V.: The key problem lies in the fact that it is difficult to bargain with natural monopolies. Municipalities and the state being the only market participants are monopolies that are worse than any other market participant. This will never change. The problem lies in the very system, since currently there is no sufficiently strong authority in any of the countries that might cancel a decision of the government or municipality. There are courts, but the courts are aware that any damage collected from the state comes from the taxpayers.

A. S.: In the future there is going to be another authority – the European Commission that will have a say in the public procurement area. It will be interested in examining large procurement contracts and assuring that the procurement has been conducted with sufficient transparency. When there was a bridge built in Denmark between two islands, according to the EU requirements the Danish government announced an international tender for the construction. The tender was won by a Danish construction company. Then the Commission examined the case and declared the tender to be unlawful. It is just that I do not really remember whether the state of Denmark only had to pay huge amounts as damage to other foreign construction companies or whether the tendering process had to be started anew.

G. V.: Meanwhile, the Danish companies built this bridge and the Danish government provided active support to them. It is common that the government carries out lobbying within the legislative framework and protects local companies from the western companies in large projects.

The Latvian entrepreneurs say that the key problem they have encountered with receiving the financing from structural funds has been the project development. What is the situation in this respect in Lithuania and Estonia?

A. S.: I noticed an interesting fact yesterday. One of the Nordic structural funds granted a loan to an Estonian farm in the amount of EEK 700,000 (LVL 30,000). The farmers had intended to make minor investments and the fund granted the respective financing. It is not that difficult to apply to these funds and occasionally they even compete with local banks for the chance to provide financing even to the small companies. Meanwhile, their total role has decreased. This means that local banks have been successful in increasing their role in corporate financing. The structural funds enjoyed their golden age approximately 7-8 years ago. They had much more of importance at the time, however, even now any financing is always welcome.

K. A.: In Lithuania many various structural funds are being used, for instance, PHARE, SAPARD. It was not very complicated since the applicants received relatively accurate information on the project development etc. In the future, however, the concept of structural funds will change. The previous task of support will be replaced by co-financing or refinancing function. Companies will have to invest their own money and then they will become eligible for co-financing.

G. V.: In Lithuania there were so many applicants for the SAPARD funds that the EU even got worried and there was quite a fuss generated regarding the issue. Moreover, SAPARD are used not only by the farmers but also by western companies incorporated in Latvia. And here again the winner is the one who is the fastest, smartest and quickest in decision-making.

Some companies believe that Brussels will bring about too much of unnecessary bureaucracy?

A. S.: For instance, there are certain hygiene standards defined for the agricultural production defining the requirements for slaughterhouses and dairy processing plants. The EU standards regulate the dairy production and in Estonia many of these regulations have already been implemented, therefore many dairy plants and slaughterhouses have already been closed down due to the fact that they failed to obtain funds for renovating the buildings.

G. V.: The bureaucracy is a concern. However, many of our entrepreneurs have been dealing with this problem for years. By now they have received good training in solving the bureaucracy-related problems both in the soviet times and now. All they have to do at the moment is to learn how to take advantage of the requirements of the European bureaucracy, especially how to protect their interests in relation to public tenders and elsewhere. It is upsetting that the businesses in the Baltic countries are relatively skilled in dealing with this issue in their own region but have no knowledge regarding the issue elsewhere. There is a necessity to explain to the top management of companies the ways of Brussels, what are the commissions, what they do and what are their interests. In this respect not only academic knowledge on the existing regulations is needed, but also exchange of experience between the business leaders from the current EU member states and the local entrepreneurs. Exchange of opinions between the European experts and locals would be of considerable help.

How could this exchange of experience be effected?

A. S.: The EU is conducting a programme for the EU officials. The countries are exchanging their officials for training purposes and the programme is mostly financed by the EU.

G. V.: To my mind, it should be started by establishing contacts with the people who are currently working in Brussels representing the Baltic countries there. They know the backyard of Brussels. In problem solving it is best to contact the country representatives of own nationality. They may be able to advise on what to do, ways to take and things to say.

A. S.: The legal business also is subject to the EU standards requiring the third party insurance for the law firms. It is also generally accepted that law firms specialise in certain areas. Sorainen Law Offices introduced these principles approximately five years ago and I know that other law firms have done the same; therefore we are ready for the EU.

The Latvian government has not defined the national priorities despite the existence of the National Development Plan. What has been done in Lithuania and Estonia in this respect?

A. S.: If we are talking about business, the key thing is to retain the current taxation system that is rather unusual for the EU. For example, the corporate income tax is 0%, taxable are only dividends when the cash is disbursed by the company. Estonia was successful in protecting this system against change after accession to the EU, and this was definitely one of the priorities in the EU accession negotiations. If we turn to spheres other than business, one of the EU priorities currently is internal security, which has been specifically noted in all the Baltic countries.

K. A.: In Lithuania one of the key priorities is agriculture – how to educate the farmers, promote the development of their business and survival in the new competition situation, the new market.

A. S.: Altogether, as weird as it may sound, the Baltic countries found it easy to conduct the EU accession negotiations, since their economies were already open to a large extent. There were no priorities to be especially protected by these countries after the accession into the EU. Sweden and Finland prior to their accession had a completely different situation. Sweden wanted to protect a range of structures from rapid change.

Latvia has experienced both positive and negative examples of foreigners acquiring agricultural land. How to ensure that the land is really being used after its acquisition?

A. S.: The experience of Estonia shows that in 95% of cases many of the so-called investors who purchase land cheaply with the speculative purpose instead of using the land are Estonians and not foreigners who perform research before the acquisition and know what and why they are purchasing. They usually get down to work as soon as possible.

K. A.: In Lithuania there exist restrictions regarding land acquisition by foreigners. There is a requirement that the land has to be cultivated. There are also requirements

applied to local companies that acquire land. They have to be experienced in agriculture. We may take several EU member states as a good example of how they develop the system that protects the EU interests in agricultural sector. For instance, in Denmark the locals are satisfied with the efficiency of their system. There, if you own a farm, you have to reside there. You may be Dutch or German, but you have to live in the farm. They check the electricity and phone bills and various expenses. The control is effected by relatively radical means.

There are systems that have survived for a longer period of time and have proved to be effective and able to ensure that the land does get cultivated instead of being acquired for speculative purposes.

G. V: However, the EU is more supportive of forest cultivation, since they are going to have a sufficient number of problems with Poland. The small countries have to specialise in any industry and have to sell high-priced goods in small quantities. I know it is easy for me to say, since I am not involved in agricultural business, while farmers probably find it hard to change what they have been doing for years.

What would you recommend to local businesses for survival in the market? How are they to perceive the new situation?

A. S: Everything is going to become much more international than before. It is also expected that production plants will be relocated from the EU member states to the Baltic countries. Also a number of small and medium-size companies from the EU will start operating in the Baltic region. Service providers will establish their representative offices here and will provide service from here to the whole of Europe. For instance, transportation or construction companies might locate their management in the Baltic region and then deliver services from here to other European countries. These could be also telecommunication centres. Already now there are, for example, service and hotel booking centres in Estonia. Each *Hilton* hotel has a service centre in Estonia, therefore when dialling from the Nordic countries to book a room in *Hilton* in Finland, Sweden or Norway you would be connected with Tallinn where people speak all these languages. This new trend will increase and boost the competition, as well as provide new opportunities to local companies.

K. A.: Local companies have to use their competitive advantages. These will exist for a couple more years. First, it is the skilled, educated but yet still cheap labour force that is reflected in the expenses. Flexibility and quick response to changes, to my mind, is another significant competitive advantage. Therefore I do not think that most of the companies will suffer or experience major complications due to the EU enlargement.

G. V: When comparing the level of knowledge and quality, at the moment the managers and shareholders are more educated in purchasing and selling businesses. They start thinking in a completely different scale: mergers, increasing their market share. Earlier they had a much narrower focus on issues and problems within their own little company. Now the focus includes a wider perspective, including sale and purchase of companies. One of the Latvian companies opened offices in Warsaw. They established successful business there and now are selling it to western companies. Life is getting really interesting. The entrepreneurs are learning by days.

A. S.: After joining the EU the Baltic countries are likely to feel a gradual growth in investments. Now most of the investments come from Scandinavian countries, Germany, Great Britain and the USA. In future they will come mostly from Asia, Southern European countries and other non-traditional places.

G. V.: It is my opinion that there will be more of direct investments from the USA and Great Britain. Currently most investments from these countries come via Scandinavia.

A. S.: The Scandinavian countries consider the Baltic countries to be something of an extended home (domestic) market. This means that in their calculations they project rather low income from investments in the Baltic countries. They would be potentially happy to generate even less than 10% of annual return on investments due to the fact that they have strategic interest in the region. Meanwhile, Spanish or French companies still believe the Baltic countries to be a kind of exotic place and therefore would require no less than 15-20% of annual return. If a French and Finish company were to compete in acquiring a Baltic firm, most likely the Finish company would win the competition. Within the EU this type of difference will disappear. French and Spanish companies will be satisfied with a lesser annual return.