

Financial Services 2018

ESTONIA'S EXPORT OPPORTUNITIES AND POLICY OPTIONS



ARENGUFOND
ESTONIAN DEVELOPMENT FUND

This Policy Brief, meant for policy-makers, concentrates on the conclusions of the foresight project "Financial Services 2018" conducted by the Estonian Development Fund: on Estonia's opportunities for exports of financial services and policy recommendations. Particular attention is given to a clarification of the concept of FinanceEstonia – the proposed solution for implementing the key activities. In the context of Estonia's economic policy, it is a novel partnership model between private and public sectors that will help to overcome failures related to coordination and mobilisation of resources and to develop a new growth area for Estonia in a focused way.

Financial services as a new growth area

The liberalisation of markets, globalisation, and introduction of information and communication technologies have created favourable conditions for the growth of knowledge-intensive business services in the world, including for the financial services sector. In 2009 – in the middle of economic crisis – the question whether Estonia might have opportunities to participate in this globally growing and changing business and, if so, how to convert these opportunities into exports, prompted the Development Fund to start a foresight project on financial services.

It can be said, based on the results of this project, that when designing a portfolio of Estonia's new growth areas, it is reasonable to include financial services together with other knowledge-intensive and high value added business areas. The increase

I wish that the Government of Estonia as well as the active financial sector would envision a common goal – to offer niche focused financial services, the only market for it being the international market.

Joakim Helenius, Trigon Capital, CEO
(Interview given to the Development Fund on 29/03/2010)



Exports of financial services: from opportunities to action

OPPORTUNITIES:

Estonia has three main niche opportunities to increase exports of the financial services sector

- core functions in asset management, using its knowledge of Central and Eastern Europe (CEE)
- private banking targeted at clients from the Commonwealth of Independent States (CIS)
- back office support services for international financial institutions

KEY ACTIVITIES:

in selected niches, the development of the most attractive business environments in the European Union

- regulations and taxes
- qualified labour
- the image of Estonia, awareness and foreign investments

IMPLEMENTATION:

private and public sector partnership – FinanceEstonia

- coordinated activities and leadership
- mobilisation of resources
- consistency

in exports of financial services and related support services would mean structural changes in Estonia's economy: higher value-added firms and foreign investments, more high-salaried jobs and higher tax revenues because labour-related costs constitute the greatest part of the total costs in the financial sector.

Internationalisation of Estonia's financial services sector would be an

inevitable precondition for the development of Estonia's economy in its entirety. The operating of financial institutions with international scope in Estonia would raise the competitiveness of the local business environment: it would support the development of other fields of the economy; and would secure better capitalisation of the private sector, the availability of leverage instruments, and links to a global economy.

Starting point

Estonia's relatively well-developed financial sector belongs predominantly to Nordic banks and targets the domestic market. There are merely a handful of small businesses with export ambitions. This picture is also illustrated by the statistics according to which financial services contribute around 4% of Estonia's gross value added and 2% of total services exports.



Estonia has some half-sized and imaginary strengths and a bunch of tangible weaknesses at the moment. But only because of that, one cannot give up the quest for new niches and experiments.

Villu Zirnask, Opinion Editor
(*Eesti Päevaleht*, 18/08/2009)

At the same time, the average salary in the financial sector is 1,500 euros (2010), double of Estonia's average.

Considering the starting point, Estonia could significantly increase exports of financial services primarily through attracting new foreign investments. For this, it is important to understand the factors that determine Estonia's success or failure in this aspiration.

The following factors are important for an international financial institution when choosing a location: costs, the availability and quality of labour, cultural and geographical proximity to the relevant markets, the availability and quality of infrastructure, taxation and regulation; also, more general aspects like the image of Estonia, quality of life, economic and political stability, and transport links.

In terms of its favourable geographic position, integration with Nordic countries, labour costs and IT infrastructure, Estonia is competitive; but the availability of skilled labour with financial education and IT skills is limited, the regulatory and tax regime is unfavourable in specific issues, general quality of life is relatively poor, and the image of Estonia (and of the region as well) is weak for internationally operating financial institutions.

Niche opportunities

Estonia's opportunities were identified by analysing different functions and areas of the value chain of the financial services sector from the point of view of exportability and by comparing the results to Estonia's current situation. As a result, three niche opportunities to increase the export of financial services in Estonia were identified:

- in asset management, by focusing on core functions and implementing its knowledge of CEE;
- in private banking, by providing services across the value chain, focusing on Russia and the CIS region;
- providing back office or support services for international financial institutions (e.g., accounting, management, data processing, IT support, legal matters, etc.).

Strong links with the Nordic financial sector, as well as economic and cultural proximity to CEE, provide Estonia with a good starting point for developing exports of financial services in asset management and private banking in its region. Estonia's relatively strong features such as IT capability and favourable labour costs will open a window of opportunity for back office services.

Estonia's pluses and minuses to increase financial services export

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- geographical position between the Nordic and CEE countries
- familiarity with the cultural context of potential markets
- image in its own region
- low cost base
- well-developed IT infrastructure and skills
- progressive attitude of supervisory authorities and regulators

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- vague image and low awareness of Estonia among international financial institutions
- scarcity of labour with appropriate skills (in the fields of finance and IT)
- low international assessment of the quality of life in Estonia
- taxation and regulatory regimes (in some aspects)
- political relations with countries of potential markets
- inadequacy of international transport links



The most tangible growth opportunity for Estonia is hidden in support services. In such foreign investment solicitation, the government could incur part of the costs needed to bring units into Estonia and support training.

Raul Allikivi, Head of Economic Policy Division, Ministry of Economic Affairs and Communications
(Financial Services Forum 31/03/2010)

Key activities

A considerable increase in exports of financial services requires a simultaneous, purposeful and consistent work with factors that affect Estonia's att-

ractiveness. A distinctiveness of the financial sector is the great importance of regulations; therefore, creating and retaining a competitive regulatory environment is an important precondition for increasing exports. But this alone is

not sufficient; in addition to legislation, it is necessary to establish an international image for Estonia in this field, proactively work with potential investors, and guarantee the availability of skilled labour needed for the growth.

The growth of exports requires action on three fronts

1. REGULATIONS

Constant comparison of Estonia's regulatory and tax environment relative to its competitors and its development according to the European Union's jurisdiction, for example:

- updating the Investment Funds Act, taking exports into account
- increasing the portfolio of conventions for the avoidance of double taxations (with the CIS countries)
- establishing an attractive tax environment for non-resident private persons

2. LABOUR

A short-term and long-term supply of well-trained labour, for example:

- subsidising the launch of relevant academic/vocational courses and qualifications such as CFA in Estonia
- in conjunction with the private sector, the provision of grants to employees for prompt individual development through international Master's programmes or upskilling
- engaging people with international experience and network (including Estonians working abroad in the financial services sector)
- relaxing immigration requirements for employees entering the financial services sector, especially from the third countries

3. FOREIGN INVESTMENTS

Raising awareness of Estonia, creating a positive image of Estonia, and attracting foreign investments into the country, for example:

- participation in European and international financial services platforms to gather information and establish relationships
- focused promotional campaigns, conferences, road shows, etc. in potential capital or service exports markets
- mapping of potential investors, and providing the government's package solutions to them
- better utilisation of foreign economic policy opportunities

Implementation

The analysis of experience of other countries indicates that starting from scratch, it is impossible to substantially increase exports of financial services without long-term political support and systemic engagement. Therefore, the development of Estonia as a niche-based financial centre requires political support and long-term commitment by involved parties of the public and private sectors. At the same time, there is no existing cooperation practice of this kind between private and public sectors in Estonian economic policy that would combine top-down strategic coordination and bottom-up familiarity with the field and market to develop new growth areas.

Taking the latter into consideration, officials and entrepreneurs participating in this foresight project worked out a novel cooperation model for

Estonia – FinanceEstonia. Its goal is to bring together financial and support services firms who export or have the ambition to export, and national authorities and institutions of higher education with the mission to promote Estonia's exports of financial services and related support services.

Why is it that the necessary activities cannot be done without FinanceEstonia?

As said above, to establish a favourable environment for financial services exports, the government should consistently deal with several different problems; it is of no use to approach problems only once and one by one. A function-based administrative apparatus where one ministry is dealing with taxes, another with education and yet another with economic development, does not favour coordinated development of a field. In addition, it is important to keep the private sector motivated, and to ensure that deci-

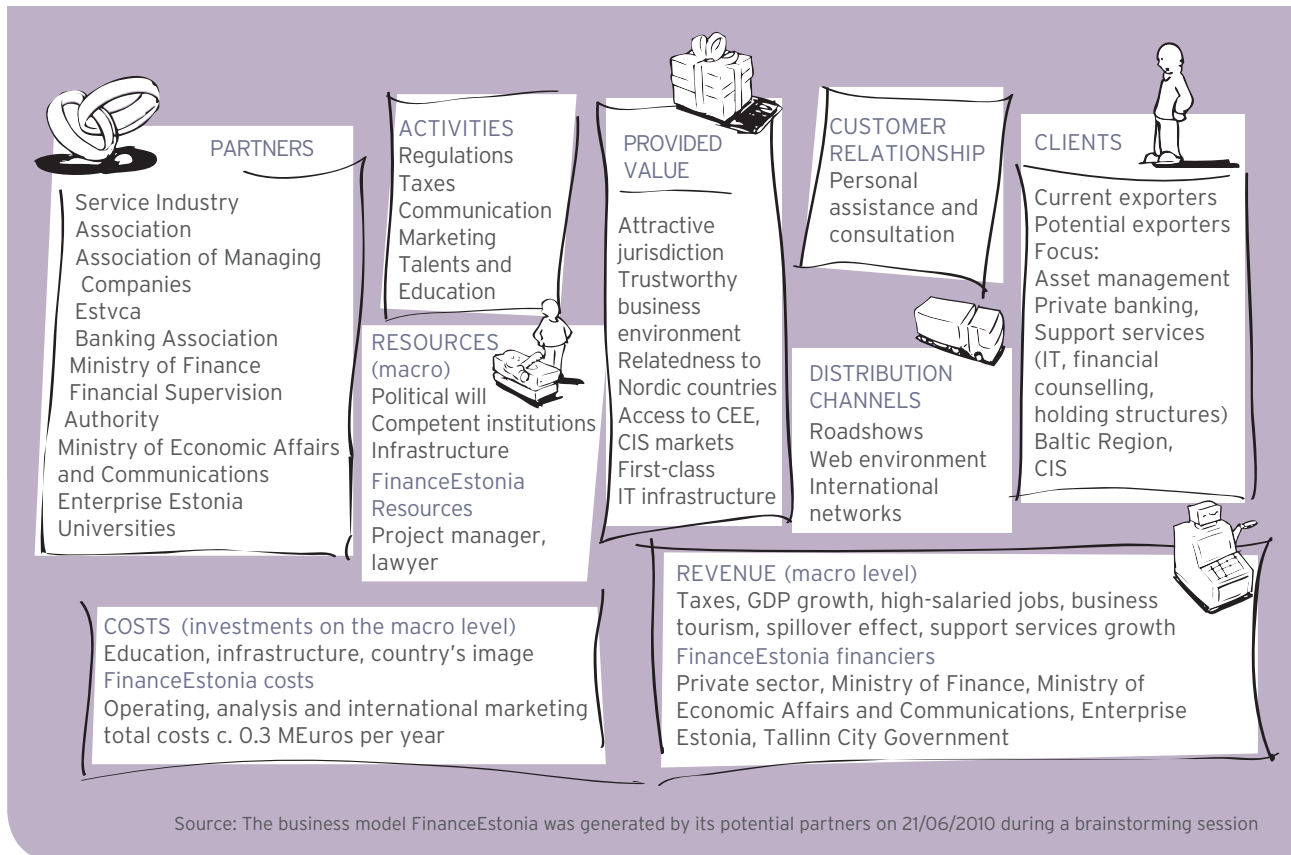
sions made in the public sector reflect business experience and feedback.



There is no sense to expect us to become a new London, but there are several niches in the world's financial sector that Estonia could successfully fill in. And today is the time to start, the one who starts first in this region, has the obvious advantage.

Kristjan Lepik, Head of Investment Committee, EFTEN Capital
(Saldo, May 2010)

The PPP platform FinanceEstonia to develop exports of financial services in a coordinated and consistent way



Journey of the foresight project

In 2009-2010, the Estonian Development Fund in cooperation with the Ministry of Economic Affairs and Communications, the Ministry of Finance, and involved parties of the financial sector undertook a foresight project "Financial Services 2018". The objectives were to analyse the export potential of

financial services and to consider the options for its realization. The British consultation firm Oxera Consulting Ltd. was selected as a research partner in this project. The project was co-financed by the Government Office's. As a result of the analysis and discussions, the report "Financial services

2018: Estonia's export opportunities and policy options" was prepared. The brief summary presented in this issue of Policy Brief is based on the report, the financial services forum held on 31 March 2010 after the publication of the report, and on the feedback from meetings with key decision-makers.

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The Estonian Development Fund is established by the Parliament to identify new sources of economic growth through foresight and to invest in knowledge-intensive and ambitious Estonian start-ups.



See also:

Interview with Joakim Helenius, CEO of Trigon Capital
<http://www.arengufond.ee/videocasts/videocast1621/>

Brendan Kelly, the Director of the Financial Services Ireland sharing his ideas of developing Ireland's financial centre.
<http://www.arengufond.ee/eng/videocasts/videocast1641/>

Read more:

Oxera Consulting "Financial services sector in Estonia: Growth opportunities and policy implications"
<http://www.arengufond.ee/eng/publications/>