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US Direct Investments in Latvia under Sustainability Perspective

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ABSTRACT: *The purpose of this paper is to disclose the process and structure of US direct investment in Latvia as sustainability driver. Both qualitative (literature review, personal observations, interviews) and quantitative (time series, structure analysis, case study) methods of research are applied. The linear trend and standard deviation are used to FDI indicators for the whole period of re-gained statehood and two sub-periods of before and after Latvia joined the EU. Industrial structure by NACE codes is analyzed. It is found that US direct investments in Latvia embody market management approaches making use of sustainability opportunities. Contradictory events take place. Indicators of the dynamics and structure may change their course. Political considerations do not collide with the investment flow. Relevance of the sustainability problematic in the long run is proven against the routine of management. Research limitations: Covid crisis is not included, cases need time to flourish, no questionnaire, bank of interviews instead. Practical implications are the recommended changes to FDI practice in favour of merging digitization with sustainability on the part of management. Profile of recipient of US investor in Latvia proposed on yearly basis. It will positively impact progress in the socio-economic sphere and accelerate structural changes. Contradictions are to be monitored and solved ad hoc. Original is study of FDI as sustainability driver, attracting its dynamics and structure under business management practice. Conclusions and charts can be introduced in the scientific circulation and used in mobilizing managers as well as raising sustainability awareness among entrepreneurs in Latvia and abroad.*

KEYWORDS – *business management, foreign direct investment, Latvia, NACE Code, sustainability, USA.*

I. INTRODUCTION

Business management faces the problem of running foreign direct investments (FDI). Recently, instead of yearly growth, wide fluctuations and cuts occur, which deserves study by a number of reasons both globally and regionally, including Latvia. Already in pre-covid19 period, FDI in Latvia declined adding in 2020 to covid crisis. The challenge is to manage growth on sustainability and digitisation platform.

Previous publications on FDI in Latvia prove scarce. There is no published research on USA direct investments (DI) in Latvia. The purpose of this paper is to disclose the process and structure of US DI in Latvia with a view to get impulse for sustainable growth. The paper is pioneering in introducing sustainability and digitisation stimulation by the US DI in Latvia in the scientific circulation.

There are two basic sections in the article. The first is devoted to literature review and methodology of research. The second discloses the stand of the US DI in Latvia with focus on its structure and cases under sustainability imperative. Author relied on in-depth interviews, market research, examinations of DI flows, Register of enterprises statistics by NACE codes, and exclusive data from top recipient enterprises.

FDI can generate enormous economic value, but their ultimate impact extends far beyond the financial realm.

II. REVIEW OF LITERATURE AND RESEARCH METHODOLOGY

Global foreign direct investment flows slid by 13% in 2018, to US$1.3 trillion from $1.5 trillion the previous year – the third consecutive annual decline, according to UNCTAD's World Investment Report 2019 [1].

On 1 January 2016, the world officially began the implementation of the 2030 Agenda for Sustainable Development – the transformative plan of action based on 17 Sustainable Development Goals – to address urgent global challenges over the next 15 years [2]. Regionally, the EU initiated own stimulation under Green deal in 2019. The European Green Deal Investment Plan is the investment pillar of the Green deal [3]. Additional impetus can be given by strategy of overcoming covid crisis through sustainability vector. Important role is expected to be played by FDI, especially in the recipient countries like Latvia [4].

According to the Ministry of Foreign Affairs (2020), "at the end of 2019, US direct investment in Latvia amounted to 140 million euro, which is 16% less than a year earlier, while direct investment balances in the USA from Latvia decreased by 28%, amounting to 76 mln. euro" [5]. The figures demand update.

Executive summary of foreign trade and investment by the state institution Latvian Investment and Development Agency LIAA (2019) introduced three valuable charts on Latvia's economic cooperation with the

United States based on Bank of Latvia yearly and quarterly data series covering 2000-2019 [6]. The rare visualisation available, it, however, lacks significant tendencies and covers only the recent years.

According to the US Ambassador (2020), "with its growing economy, educated population, lower operating costs, and notable reform efforts to improve its investment climate, Latvia is an excellent entry point for U.S. companies seeking to export or invest in the European Union or beyond" [7]. This line gets direction by President of the American Chamber of Commerce in Latvia (2012), an expert in the USA DI in Latvia, advising on local competitive advantages that may attract investments [8].

Sustainability Index by KIA Institute regularly investigates business environment in Latvia for FDI [9]. However, it contains no USA DI targeted research. Atstaja D et al (2017) voiced the role of economics in higher education for sustainable development in the Baltic states [10]. Literature review, unfortunately, did not mention FDI.

Boston Consulting Group and Hello Tomorrow's joint analysis of the 1,646 startups that qualified for its current (2019) annual Global Challenge, a startup competition that assesses deep tech startups on four criteria—technological innovation, business model, team skills, and expected impact—shows that these companies anticipate having an impact on a wide variety of the United Nations' sustainable development goals (SDGs). The goal receiving the most attention is good health and well-being (51% of startups), followed by those related to industry, innovation, and infrastructure (50%) and mitigating human impact on the environment (sustainable cities and communities—28%, responsible consumption and production—25%, climate action—22%, affordable and clean energy—18%, and clean water and sanitation—10%) [11]. This direction of FDI research has no published evidences in Latvia yet. However, sustainability as triangle of profitability, social and environmental awareness becomes mainstream in adjacent research.

According to Ministry of Economy (2019), FDI is an essential precondition for further growth of the Latvian economy, because FDI enables Latvian producers to use additional financial capital; promotes the acquisition of various production and management skills; promotes job creation; creates an opportunity to use new technologies/technology transfer to Latvia; promotes the integration of Latvian producers in international trade networks and supply chains; can have a positive impact on developments in indirectly related areas, such as medicine, education, infrastructure.

Correspondingly, FDI attraction policy in Latvia is aimed at raising the competitiveness of Latvia as an investment-friendly environment, taking into account the most important aspects for investors: national macroeconomic indicators, business environment - simplicity of bureaucratic procedures and stable tax policy, availability of suitably qualified labour, market potential, necessary infrastructure, support tools and incentives. It is important to attract foreign investment in sectors that ensure a change in the structure of the economy in favour of external demand-oriented sectors, especially in sectors that are defined as medium-high and high-tech sectors. Sustainability is not directly declared.

Attracting and promoting FDI is divided into four main processes, such as strategy and planning (national investment policy development, goal setting, investment promotion structure, competitive positioning, sector target analysis), interest promotion (marketing and business addressing), service (project management) and investment provision of services (after-sales service and service improvement, supervision).

The Ministry of Economy and the LIAA play an important role in attracting FDI in Latvia. The Ministry of Economics develops foreign investment attraction strategy and planning, while LIAA's activities are focused on servicing of incoming investment projects and attracting investment, addressing potential investors, as well as providing post-servicing of investment projects. LIAA proposed delineating the profile of a foreign investor desirable for the Latvian state. LIAA and Latvian Foreign Economic Representations provide assistance and information to foreign investors, for example, in connection with the implementation of investment projects in real estate/special economic zones and investment promotion, as well as contact the relevant institutions at the request of investors and help solve investor problems.

In attracting foreign direct investment, priority is given to geographically close neighbouring countries, where Latvia is recognizable, and no additional resources should be invested in information measures; economically stable and developed countries, where the development potential and needs of economic sectors correspond to Latvia's perspective cooperation opportunities; as well as the countries with the largest outflows of outbound investment globally - the USA, France, Germany, UK, Japan, China, Russia, India [12]. To conclude literature review, UNESCO policy monitoring platform (2020) deserves reference for Latvia 2030 - Sustainable Development Strategy of Latvia [13] despite not mentioning US DI in Latvia as sustainability driver.

Author of the article elaborates methodology of research of FDI in Latvia on the basis of statistics of registering DI deals by NACE codes [14]. Time series of non-financial and financial indicators of the US DI in Latvia are to be investigated in depth for 1991-2020, i.e. the whole period of restored statehood. Data for 2020 are used only where relevant since the year has not finished yet. Standard deviations are calculated to check uncertainty change after Latvia joined the EU. Case studies serve to focus on social and environment

responsibility in line with profitability as sustainability philosophy demands. Statistical big data on dynamics and structure of the US DI pre NACE Codes originates from the Register of enterprises of Latvian Republic and is available mainly per paid request from Lursoft, LLC [15]. Author managed to use selected data of State Revenue Service [16] on paying taxes by enterprises with the US capital in Latvia to deepen into social responsibility component of sustainable investment as well as recent Reports by enterprises with the US capital [17].

III. US DIRECT INVESTMENTS IN LATVIA AS SUSTAINABILITY DRIVER

The starting point is analysis of non-financial indicators of US direct investment flows in Latvia. These are the numbers of US investors and their recipient enterprises in Latvia as well as of the deals officially registered. They are disclosed in the Fig.1 below.

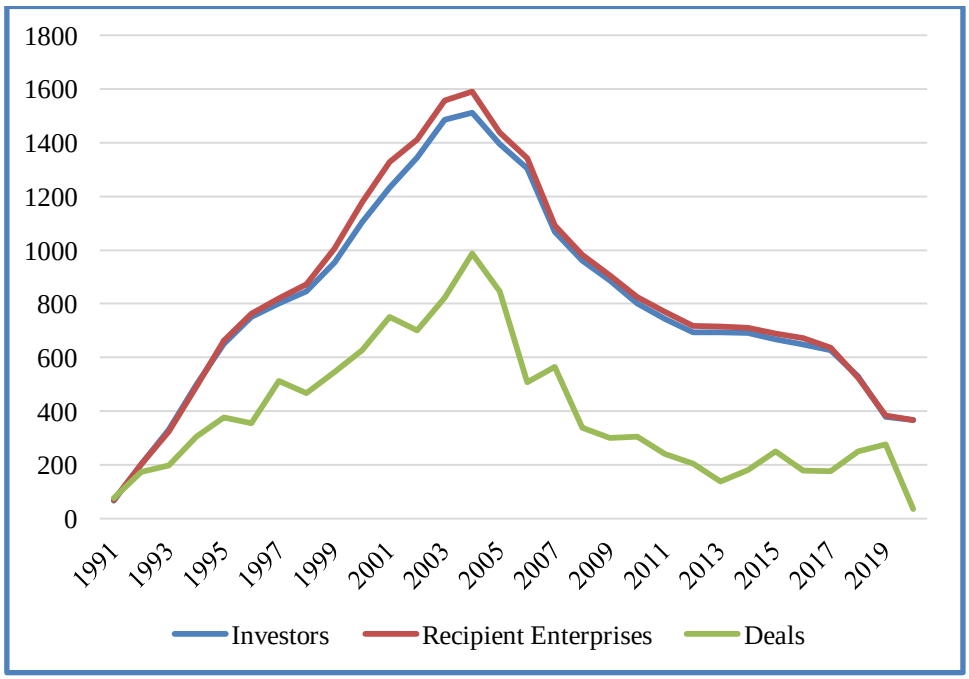

Figure 1 The number of recipients, investors and deals in the US direct investments in Latvia 1991-2020

The number of US investors as well as the number of recipient enterprises in Latvia peaked in 2004 at the level of above 1500 each. After that the numbers only declined year by year. The number of investment deals, 987, peaked in 2004 and then declined with more visible fluctuations. 11 695 deals were registered in 351 months running from March 1991.

Investors per deal are important to characterise non-financial indicators of DI from US in Latvia. Interviewed investors interpreted the indicator as readiness to take risks in Latvia. The coefficient below 1 indicates some investors participate in more than one deal during a year, e.g. the top investor of 2019 registered two deals. It gives the coefficient 0.5. Growth of the indicator may mean growing risk-awareness and wish to distribute risks among growing number of co-investors. The data with linear chart can be observed lower (see Fig.2).

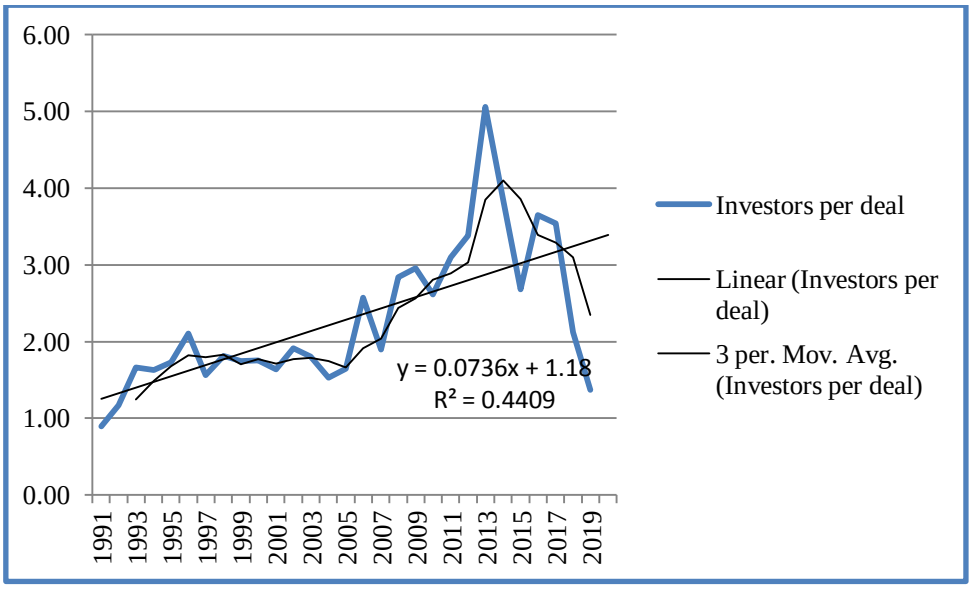

Figure 2 The number of investors per deal in the US direct investments in Latvia 1991-2020

The chart starts with the first deals in 1991 (coefficient 0.89). Some investors participated in more than one deal, namely 65 investors in 75 deals. It was unique. The indicator then fluctuated in the corridor between 1 and 2, with 1.53 in the year 2004 when Latvia joined the EU. A jump followed in year 2006 to 2.57 to fluctuate and reach 5.06 all-time high in 2013, the year of finishing preparation of Latvia for changing to euro on 01.01.2014. This explanation needs other factors to be added, e.g. higher readiness of former residents of Latvia who got the US citizenship to invest due to extra-knowledge of the market. Linear trend, however, shows R^2 below 0.5.

Smoothening of the chart by means of 3 period moving average lowers the top, but nevertheless anticipation of growing risks of the US investors can be observed.

Investors per recipient enterprise are mirrored in Fig.3.

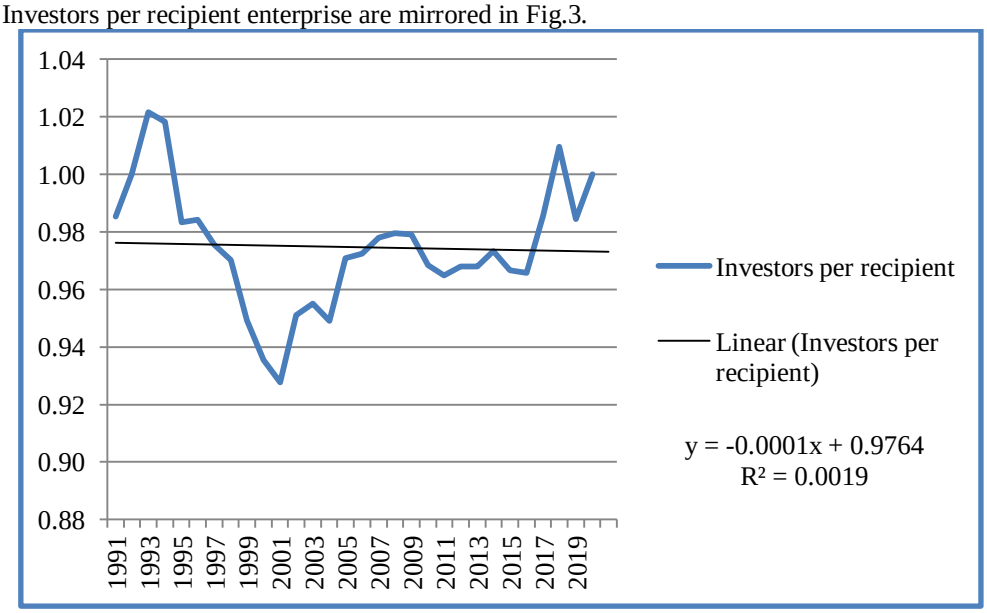

Figure 3 The number of investors per recipient in the US direct investments in Latvia 1991-2020

The coefficient fluctuates between 0,93 and 1,03 investors per recipient in the US direct investments. The fluctuations are insignificant. Since 2001, however, the increase is evident although the linear trend is slightly decreasing for 1991-2020. Investors attract investors. Some risks tend to be distributed.

Introduction of financial indicators gives depth to analysis of DI in Latvia. The fundamental among them are the flow and the cumulative values in EUR (see Fig.4)

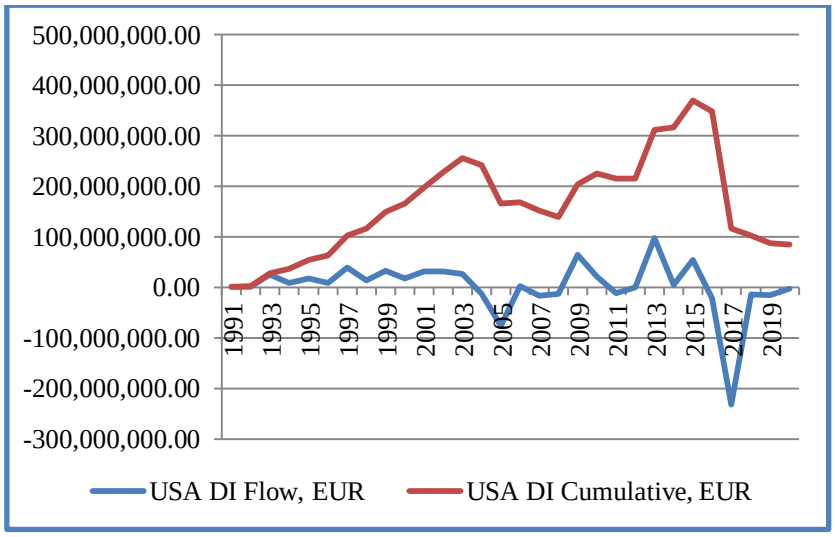

Figure 4 USA direct investments in Latvia yearly flow and cumulative, 1991-2020, EUR

One can observe two major waves in the US DI in Latvia. The first peak was achieved after a dozen of successful years in 2003 followed by five years of decline with bottom in 2008. The events behind this curve only partially are explained by the economic crisis that hit Latvian economy in 2008. Latvia joined the EU 01.05.2004 after the referendum of 20.09.2003. Both events can be expected to attract rather than to slow down FDI. In 2009-2015 revival occurred caused by DI inflow in a number of enterprises, especially the commercial bank Citadele. Unfortunately, the second wave exhausted soon and in 2016-2019 the cumulative figure shrimped dramatically 4.2 times. It was a record loss of the US DI in Latvia. The hopes for recovery seem destroyed by Covid crisis in 2020.

Analysis of DI flows per investor, recipient and deal give deeper insight (see Fig. 5).

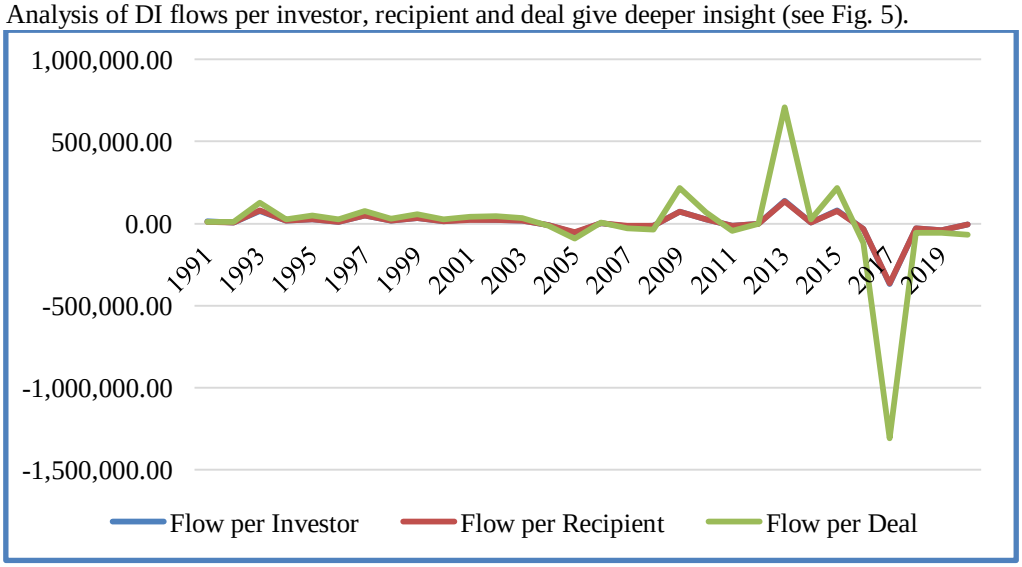

Figure 5 US direct investments per investor, recipient enterprise and deal in Latvia, 1991-2020, EUR

One can observe in general small volumes with an average flow per investor EUR 2840 up to now. It reflects specifics of Latvia being small and management tradition to register companies with EUR 2800 capital (reflecting the exchange rate of Latvian Lats to Euro). Two outstanding fluctuations in flow per deal can be noticed, with positive record in 2013 and negative one in 2017. Author applied linear trend and discovered negative coefficients by x for all three indicators. The coefficients are not introduced in the text because of extremely low R^2 (below 0.1). It means that the trend is not reliable. Nevertheless, lack of big projects is evident.

The GE Capital International Financing Corporation caused the all-time peak in 2013 by investing two tranches (EUR 121865554 and 226805767) in GE Money Latvia Holding.

Two more peaks of slightly below EUR 217000 each occurred in 2009 and 2015. In December 2015, a tranche of EUR 43279897 was invested by RA Citadele Holdings, LLC in Citadele Banka AS. By the way, the same month EUR 11464676 was invested by Archer D. Dodson in PNB Bank only to be withdrawn soon as EUR 11464676 in December 2016 when PNB Bank went into liquidation.

The biggest withdrawal occurred in December 2017 when GE Capital Global Financial Holdings, LLC took EUR 227029414 from GE Money Latvia that went into liquidation 01.12.2017.

A good example of how giant multinational corporations can affect recipient economies by investing from different sources is shown by famous General Electric. MG Capital AS (Reorganized 31.08.2015) received investment from General Electric Capital Corporation EUR 24,188,820 29.04.2013 simultaneously with GE Money Latvia Holdings SIA (Liquidated 01.12.2017) in which GE Capital International Financing Corporation invested EUR 11,667,549 24.04.2013. The above events demonstrate great uncertainty factor that business managers in Latvia have to deal with in the area of DI from the USA.

To investigate deeper in the uncertainty question, author calculated standard deviations for financial and non-financial indicators (see Table 1).

Table 1 Standard deviations for US direct investments indicators in Latvia, 1991-2020

	US DI Flow, EUR	**Investors**	**Recipients**	**Deals**
1991-2004	14 818 508,65	463	496	256
2005-2019	73 879 754,12	277	286	182
Times	4,99	0,60	0,58	0,71
1991-2019 average	54 069 442,80	365,21	387,99	237,82

Table 1 demonstrates controvercial results in financial and non-financial indicators' test for uncertainty in two periods. The first period embraces years of transition of Latvian economy from commando-administrative model to the market one. The second period covers market economy prepared for the EU entry and further development as the market economy mature for prestigious OECD entry in June 2016. The standard deviation for the yearly DI flows in the second period proves five times higher. Standard deviation gets even bigger than the average annual flow.

However, for non-financial indicators the uncertainty decreased. Experts interviewed by author have no general explanation of this phenomenon and attribute it to interplay of occasional decisions by investors. Accumulation of data series and questionnaire are needed to lead to more reliable explanation. Nevertheless, comparison of US DI flow standard deviations for the whole period and the two sub-periods demonstrates increasing uncertainty.

This conclusion based on yearly statistics is supported as well by plotting a chart and application of linear trend to the monthly statistics. Top inflow EUR 121 865 554 was registered in June 2013. The biggest withdrawal EUR-227 029 414 took place in December 2017. It was 1.86 times bigger. Two other monthly capital withdrawals of more that EUR 50 mln as well as two other inflows of above EUR 50 mln can be observed on the following chart (see Fig.4).

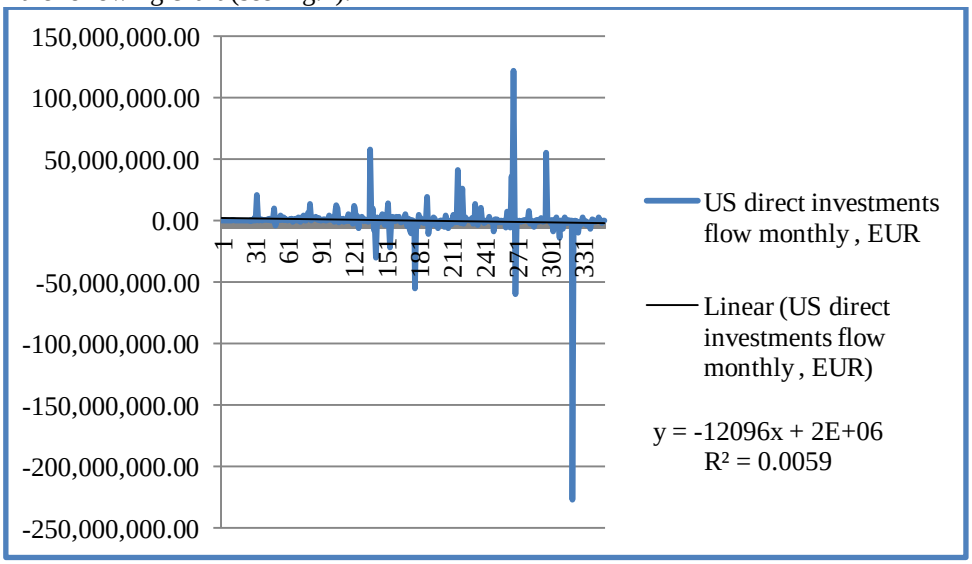

Figure 6 US DI flow in Latvia monthly 1991-2020, EUR

The extremely low indicator R^2 of the linear trend shows unpredictability of DI flow despite the fact that the number of months covered is 339.

To differentiate flows and withdrawals of the US DI in Latvia, author created a profile of US recipient enterprises in Latvia. Year 2019 was selected as a most recent representative full year. For each year, a separate profile is to be drawn.

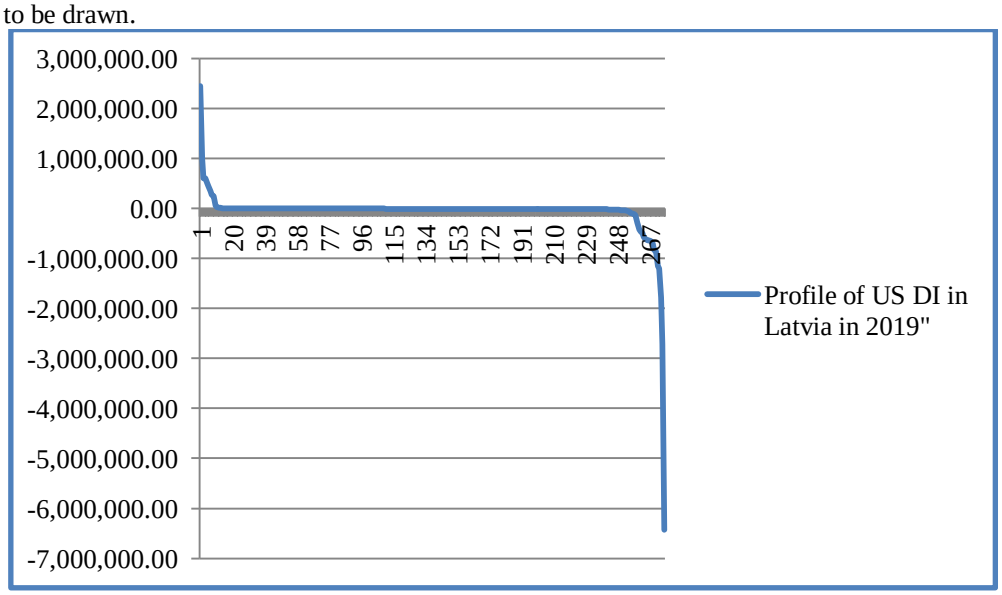

Figure 7 The profile of US DI recipient enterprises in Latvia, EUR, 2019

The linear chart demonstrated the dominance of US investment withdrawals in the deals registered in Latvia in 2019. The highest investment was EUR 2 450175 worth, the biggest withdrawal was EUR 6424621 (with minus sign). Of 276 deals, the major part, 221 deals, were withdrawals and only 55 deals were investments.

The biggest investment was in MONO, Ltd, a holding that is the all-time third biggest US investments recipient. The same investor made the 11th big investment earlier that year.

The biggest withdrawal on the chart was from a crediting and pharmaceutical wholesale holding Baltic Medical Program, Ltd. It constituted 100% of the statutory capital. In time of research, the enterprise was still active. Among US investors, experts notice a number of ex-USSR persons that gained the USA citizenship and invested in such status in Latvian enterprises. Both above mentioned recipient enterprises have such persons as beneficiaries.

To deepen research, structural analysis of DI from the US in Latvia is performed. NACE code is used as criteria for attributing an enterprise to a concrete industry. Two decimal signs lead to the deepest differentiation of an industry into sub-industries. Author put together data of sub-industries (decimals) to arrive to data by industries (see Fig.8).

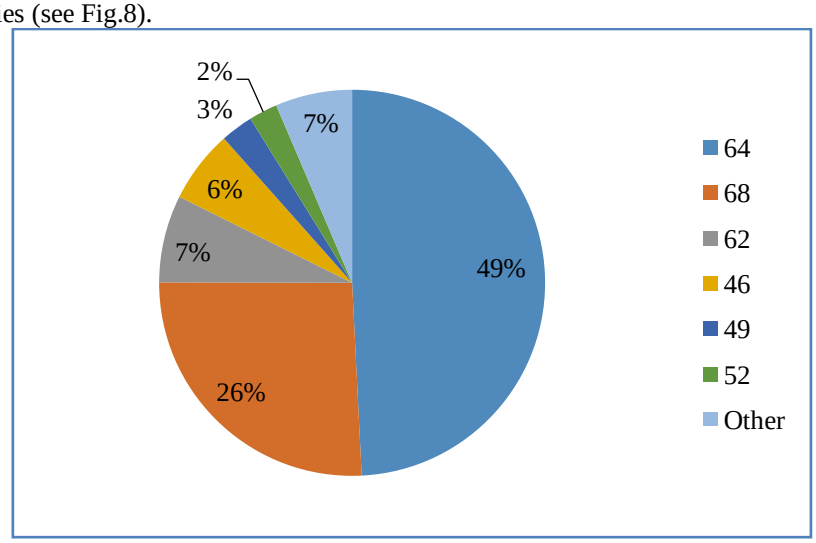

Figure 8 Structure of the US direct investments in Latvia by NACE codes, stand 20.05.2020

Following are the names of the industries in the pie-type chart: 64 Financial service activities, except insurance and pension funding; 68 Real estate activities; 62 Computer programming, consultancy and related activities; 46 Wholesale trade, except of motor vehicles and motorcycles; 49 Land transport and transport via pipelines; 52 Warehousing and support activities for transportation.

The industries specified cover 95.47% of all US DI in Latvia. Thus the chart is representative.

The dominance of financial services with 49.21% share is evident. It is followed by real estate activities with 25.83% of the total DI. The two together cover 75.04%.

Computer programming, consultancy and related activities constitute the third important segment with 6,09% of total. Wholesale trade with 2.73% and Warehousing and support activities for transportation with 2,40% conclude the top list.

Among other industries one finds Data processing, maintenance and related activities; Retail sale of household electrical appliances in specialised stores; Manufacture of aircraft, spacecraft and their equipment. Volumes invested are around EUR 0.5 mln each.

Overall, 126 NACE industries host the US direct investments in Latvia. From the point of view of sustainability driving, practically all US investments fit. Digitization is represented in the DI from the USA as higher share against one of all FDI in Latvia (6.09% against 4.4%). It underlines leading role of the US.

Case AEROXO LV SIA (grounded 03.04.2020 with statutory capital EUR 3043) demonstrates a tendency to high tech in Latvia. The recipient operates in production. By NACE 26.40 and 30.30 codes it belongs both to Electric appliances for home and Flight and space vehicles and appliances. The case attracted attention in Latvia in 2020. The company can be attributed to sustainability drivers. It is profitable, socially and environmentally responsible. Similar sustainability driver company, under attention in Latvia in 2020, is AS "Printful Latvia" (grounded 07.06.2012 by Printful Inc that invested 100% of EUR 350 000).

One more driver of sustainability is Infogram SIA (grounded 08.09.2017 with statutory capital EUR 2851). The company develops computer programming under NACE 62.01. Infogram Software, Inc. from the US registered DI EUR 2851 05.08.2013. American roots helped the start up to gain international level. Compliance with environmental ISO 14001: 2015 standards in the relevant areas is established. The company is thus environment friendly and socially responsible. It is profitable.

IV. CONCLUSION

Research for this report shows that the US DI in Latvia qualify for the 17th rank by cumulative value, with 346 active enterprises. Unfortunately, the yearly flows are not stable. In 11years of the 30 they were negative, especially, last five years running. Standard deviations calculated indicate the threat of growing instability in the US DI flow in Latvia.

Analysis by NACE codes proved instrumental for US DI from the point of view of being sustainable and driving sustainability. 75% of US DI in Latvia accumulate in finance and real estate. They are followed by Computer programming, consultancy and related activities. In general, more and more US investors are deploying a variety of innovation investment and development vehicles, matching the tool to the circumstances (such as time to market) and their objectives (such as assessing new or disruptive technologies, improving existing technologies, or gaining control of a new technology). US DI in Latvia proved mainly sustainable and became driver of sustainability.

US multinational entrepreneurs repatriate earnings from abroad, making use of tax reforms introduced by President Trump in 2017, designed for that purpose. However, DI from the US in Latvia in general sustain the gains and accelerate implementation of measures to set Latvia on a more sustainable development path.

One result of diversity of effort of direct investors from the USA in Latvia is that knowledge, skills, and information, while much more accessible, are also harder to collect because they reside in more, and more disparate, places—geographically, industrially, and functionally. This disparity is driving the need for new models of collaboration.

Despite global instability, Europe is still the largest US economic partner in the world and Latvia, as a member of the European Union (EU), has many advantages to offer to US investors. As one of Latvia's competitive advantages, access to the common EU market, as well as the opportunity to employ a talented, skilled and experienced workforce attract direct investors from the USA. Sustainability is to find vehicles to go into minds of managers, US investors and recipients in Latvia.

US investments in Latvia may exceed the official figures. Ultimate investing country approach by UNCTAD (2020) and Ultimate beneficiary disclosure by registering enterprise in Latvia deserve testing in additional research. Disclosure of the beneficiary became obligatory in Latvia 01.12.2017 and several hundreds of enterprises with FDI qualify liquidation due to failing to disclose in time. Some of them revive due to transparent investments.

Limitations of this research like absence of questionnaire and minimal number of presented cases do not undermine its novelty and results. Extension of research, especially in a team joining efforts of Latvian and

American partners, is demanded. The appeal to managers and other stakeholders like entrepreneurs, policy makers and relevant institutions in favour of sustainability vector in the FDI could be louder.

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