

BUSINESS SECTOR'S INVESTMENTS

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Investment means the long-term allocation of capital with the purpose of generating revenue. The invested capital is usually money, which can be invested in equipment, real estate, livestock, securities, precious metals, and so on. Enterprises' investment opportunities depend on their profits as well as on the lending conditions of banks. The possibility for tax-free reinvestment of net profit (available since 2000) has also fostered investment by enterprises. The article focuses on the business sector's investments in the period 2005–2010, with some data for 2011 also provided.

In 2005–2007, Estonia's economy flourished and enterprises' net sales, net profit and investments increased substantially. The increase was supported by low interest rates and growing optimism about the future. A significant part of the growth in investments can be attributed to the acquisition of real estate – both commercial and manufacturing premises – and to real-estate-related support service activities. When the economic environment started to change in the middle of 2007, ordinary people's investments in dwelling stock were the first to decrease, followed by enterprises' investments. The economic climate started to deteriorate in the second half of 2008, causing investment activity to decrease in almost all economic activities. In 2009 the recession in the business sector deepened and investment opportunities diminished even further. In 2009, enterprises invested 2.2 billion euros in fixed assets, which is 37% less than the year before and about 50% less than in the record year 2007 (Figure 1, p. 52). The turning point was in the last quarter of 2010 when the decline in investments – which had lasted for two and a half years – was replaced by growth in comparison with the same period of the previous year. The upturn was mainly supported by export-oriented manufacturing enterprises who had possibilities to expand production volumes. However, despite the consistent improvement in business conjuncture indicators since spring 2009, the investment activity in 2010 remained low and there was no increase in investments that year. The final decision on the adoption of the euro, made in the early summer of 2010, also did not have the expected boosting impact on investments, since production capacities were still under-exploited in most sectors and there was no need for investment. In 2011 the growth in investments was supported by the higher net profits earned in 2010 as a result of strict austerity measures, as well as by the improved economic climate and positive expectations for the future (adoption of the euro). In addition to that, the strong base effect (i.e. the low level of investment in 2010) should also be taken into account in growth assessments. According to preliminary data, the business sector's investments increased about one half compared to the previous year. The growth has continued in the first half of 2012. Compared to previous years, there have been relatively more investments in machinery and equipment needed for producing higher value added, and fewer investments in buildings.

Investments in fixed assets are divided into investments in tangible assets and intangible assets (Figure 1, p. 52). In the period under review, the share of investments in intangible assets has remained within two to six percent of the total business sector investment, whereas their share was the highest (6%) in 2009. Enterprises primarily invest in software and goodwill. Based on economic activity, information and communication enterprises and manufacturing enterprises are the biggest investors in intangible assets. As the share of investments in intangible assets in the total investments of the business sector is marginal, the following analysis will focus on investments in fixed assets only.

Investments react quickly to changes in the business conjuncture. Throughout the period under consideration, the greatest amount of resources has been allocated for the construction and alteration of buildings and structures. Their share in total investments was the highest in 2009 at

41%. Investments in equipment, machinery and inventory were the second-largest, while investments in other types of fixed assets are more sensitive to economic conditions. In the years of rapid economic growth, enterprises invested more in the acquisition of buildings, vehicles and land. In 2009, the decrease in these investments accounted for about a half of the total decline in investments. The decrease in investments in real estate (construction and alteration, the purchase of land) continued also in 2010. The growth in investments, which started in the second half of 2010, was primarily caused by increased investments in vehicles: their share in total investments increased from 8% to 14% compared to 2009. There was also an increase in investments in the acquisition of buildings. Investment in equipment and machinery remained at the same level as in 2009, while investments in land fell almost by half (Figure 2, p. 53).

About half of the business sector's total investment in 2010 was made by enterprises of three economic activities – manufacturing, transportation and storage, and energy. The nearly 20% growth in manufacturing investment was mainly based on increased investment in machinery and equipment by the wood, electronics and food industries. Although investment by transportation and storage enterprises decreased slightly in yearly comparison, these enterprises accounted for almost half of the growth in the business sector's transport investments. This was virtually the only type of investments in the sector's total investments that experienced a growth. The biggest growth – about two times – was recorded in the investments of administrative and support service activities and in accommodation and food service activities, whereas in these activities there was an increase in almost all types of investment.

The recession was the most painless for the energy and water supply activities. They did also have years when investments decreased compared to the preceding year, but the decline was smaller than the average.

Conditions were the worst in construction. Over the given period, investments in this economic activity decreased more than four times.

There have been no significant changes in the period under consideration when the investments of the three main sectors of the economy are compared. The share of the primary^a and secondary^b sectors ranged within 7% and 40% respectively, whereas in both 2005 and 2010 the tertiary^c sector accounted for more than half of the total investment in the business sector. The enterprises of all three sectors invested mainly in machinery and equipment and in construction and alteration. Furthermore, in the primary sector, investments in biological assets grew rapidly in the last two years. The secondary sector's investments in other types of fixed assets are marginal and their share has remained relatively stable in the period under review. The tertiary sector is characterised by a higher proportion of investments in vehicles; the share of these investments is nearly a fifth of total investment in this sector.

The size of an enterprise is determined based on the number of persons employed. The biggest investors in the business sector are enterprises with less than 10 and with at least 100 persons employed (Figure 3, p. 54). The reason why the first group is among major investors is that the number of such enterprises is very big (about 90% of the total number of enterprises). In 2010 the enterprises of these two size classes accounted for 36% and 33%, respectively, of the total investments of the business sector. Although the period under observation covers both boom and recession years, the division of investments by enterprise size class is relatively stable. The following patterns can be identified in the investments of different size groups: all size classes invest mainly in buildings and in machinery and equipment. Small enterprises invest more in buildings and less in machinery and equipment. The opposite is true in case of larger enterprises: enterprises with more than 100 persons employed invest more in equipment and machinery. This indicates that large enterprises focus more on increasing the technological capacity. Enterprises with 10–19 persons employed invest the most in vehicles, while enterprises (developers) with 1–9 persons employed invest the most in land. Investments in computers and computer systems are small in all enterprise size classes, ranging from one to three percent of total investment.

^a Primary sector – agriculture, hunting, forestry, and fishing.

^b Secondary sector – mining and quarrying, manufacturing, electricity, gas and water supply, and construction.

^c Tertiary sector – trade, services, etc.

In 2010, each enterprise invested an average of 34,000 euros in fixed assets – nearly one tenth less compared to the previous year (Figure 4, p. 54). Based on economic activity, the investments of energy, water supply and mining enterprises are higher than the average. In 2010, the average investment of these enterprises exceeded the business sector's average 36, 11 and 7 times, respectively. The smallest investors are the enterprises of other service activities, whose average investment in 2010 was only 3,100 euros per enterprise (Table 1, p. 55).

More than half of the business sector's investments in tangible fixed assets are made by enterprises with 20 or more persons employed. For an analysis of the regional distribution of investments, only the data on these enterprises have been used. In 2005–2010, investments in buildings and in equipment and machinery were the most common in almost all counties. The exceptions are Hiiu and Võru counties, where enterprises have invested more than average in vehicles, and Jõgeva and Viljandi counties, where enterprises have invested more than average in land. In 2009 there was a sharp increase in investments in biological assets, a sign of recovery after the crisis in the preceding year (Russia's trade embargo against Estonian agricultural products in 2008, high customs duties). More than half of this growth can be attributed to enterprises of Järva and Lääne counties. During the period 2005–2010, enterprises based in Harju and Ida-Viru counties invested the most and enterprises based in Hiiu, Põlva and Rapla counties invested the least.

If the number of enterprises in a given county is taken into account, the average investment per enterprise is the highest in Ida-Viru county (Figure 5, p. 56). In 2010 the average investment per enterprise in that county was 1,062,000 euros – nearly three times above the average of all counties. Almost 70% of these investments were made into the construction and alteration of buildings and structures. In Saare, Põlva and Harju counties, the average investment per enterprise is also higher than the average of all counties. Saare county is also the only one where investment per enterprise has grown year on year, despite the difficult economic times. Investment per enterprise is the smallest in Rapla county.

A comparison with other European countries shows that Estonia clearly has a low level of investment. One of the indicators characterising investment activity is the business sector's investments per person employed. Although the most recent data refer to 2009, it is interesting to see how the enterprises in European Union countries managed to invest in the recession years. The ranking of countries shown in Figure 6 (p. 57) has remained more or less the same over the years, and the economic downturn of 2009 did not cause any significant changes in the rankings. With 5,000 euros per person employed, Estonia ranks low, with only Hungary, Poland and the other two Baltic countries behind us. Estonia's Scandinavian neighbours, however, can be found at the top. Compared to Estonia, the investments per person employed are 1.7 times higher in Finland and 2.2 times higher in Sweden. The recession has affected investment volumes all over Europe. Compared to 2008, investments per person employed decreased in all the countries listed in Figure 6, with the biggest decline occurring in Latvia and Lithuania.

Sustained and fast growth of productivity is based on knowledge-intensive production, which competes internationally in the final product markets. Therefore, for the development of business it is particularly important to make investments aimed at the use of modern technologies, especially information technology solutions, in traditional industries, but also in various services. Let us take a closer look at the investments of manufacturing enterprises by level of technological intensity and compare Estonia to Germany, the leading industrialised country in Europe, and to some nearby countries, with 2009 as the reference year. 2009 was the year of the deepest economic crisis, but the crisis affected all European countries more or less equally in terms of investment activity. In Europe, the manufacturing industry is divided into four sectors by level of technological intensity: high-technology, medium-high-technology, medium-low-technology and low-technology sectors. High-technology manufacturing includes the manufacture of pharmaceutical and medicinal products, computers and electronics, and aircraft. Medium-high-technology manufacturing includes the manufacture of chemicals, weapons and ammunition, electrical appliances, machinery and equipment, motor vehicles and other transport equipment, and medical instruments. Medium-low-technology manufacturing includes reproduction of

recorded media, the manufacture of oil products, rubber and plastic products, building materials, metals and metal products; shipbuilding, and repair of machinery and equipment. Low-technology manufacturing includes the manufacture of food, beverages, textiles, clothing, leather, wood and paper products, and furniture.

In comparison with other countries, Estonia stands out with a relatively low level of investments in all technological intensity sectors. In case of investments into high-technology manufacturing, the situation is slightly better than in Latvia. Compared to the other four countries, the investments of Estonian enterprises were much lower. Estonia's manufacturing industry has invested the most into medium-low-technology manufacturing. In 2009 Estonia invested 2,800 euros per person employed in the high-technology manufacturing sector (Figure 7, p. 58). This was three times less than in Germany and two times less than in Sweden, but more than twice as much as in Latvia. Estonian enterprises' investments into medium-high-technology manufacturing amounted to 3,000 euros per person employed. It was more than two and a half times less than in Germany, Sweden and Finland, and also less than in Latvia. Investments into the medium-low-technology manufacturing sector totalled 4,700 euros per person employed in Estonia – two times less than in Finland and Latvia, and also less than in Germany and Sweden. Investments into the low-technology manufacturing sector reached 2,300 euros per person employed. This is more than three times less than in Sweden and Finland, and just as much as in Latvia.

Based on the efficiency of investments, which shows the value of investments made in euros per one euro of value added produced, Estonia stands out with relatively large investments in tangible assets, above all. For the production of one euro of value added Estonia invested 29 euros in tangible fixed assets (Figure 8, p. 58). This is more than twice as much as in the United Kingdom, Ireland, and Germany (about 13 euros each), but less than in Latvia and Lithuania (36 and 31 euros respectively). It should be noted that the investments are not necessarily reflected in the value added of the same year, but this fact does not significantly affect the ranking of the countries.

Investments in tangible assets are directly related to the tangible asset level indicator, which is the result of two processes – the addition of new fixed assets, on the one hand, and the reduction in the residual value of existing fixed assets, on the other hand. Considering Estonia's ranking based on investment efficiency, we will look at the usage of tangible assets in Estonia and changes over time. Utilisation of tangible assets is characterised by the fixed asset turnover ratio, which is obtained by dividing net sales by the book value of tangible assets.

Fixed asset turnover ratio indicates how efficiently fixed assets are used for the generation of revenue, and it expresses how many times fixed assets turn over within a year.

Figure 9 (p. 59) shows that the tangible asset turnover ratio of Estonian enterprises has fallen drastically in the crisis years. A slowdown in the tangible asset turnover ratio indicates that there is unused production capacity and that sales can grow in the future. In order to get an overview of the use of tangible assets in business, this indicator must be analysed by economic activity (Table 2, p. 60). This ratio is smaller in more capital-intensive activities and higher in less capital-intensive activities.

A comparison of the use of tangible assets in capital-intensive economic activities in 2005 (before the crisis) and in 2010 shows that the biggest decrease has occurred in agriculture. At the same time, the situation in other capital-intensive activities – such as mining and quarrying, manufacturing, transportation and storage – is much better than in 2005, in spite of the continued impact of the recession in 2010. In the field of energy, the use of tangible assets has considerably improved between 2005 and 2010.

Analyses of the use of tangible assets and of investments both show that, compared to Europe, there is a lack of and a great need for investment in Estonia, but also a great amount of unused production capacity.

An important driver of economic development is the involvement of foreign direct investment in a country's economy. Foreign investments do not only mean additional capital for the destination country, but also access to the latest technology and to marketing and management skills.

Foreign direct investments are investments which reflect net inflows to enterprises based in different countries, whereas the origin of capital is determined based on the residence of the direct investor or a foreign enterprise within the same enterprise group. These are commercial undertakings registered in the Estonian Commercial Register and controlled by legal or natural persons who are not Estonian residents; or branches of foreign enterprises. Control exists if a unit owns more than 50% of the voting shares or otherwise has dominant influence over the operating and financial strategies of another enterprise. Control means the ability to determine the general policy of an enterprise. It could mean a more than 50% share of the voting rights, or a legal or contractual right to appoint or remove the majority of the management team or members of a higher directing body. The ultimate controlling unit is a unit which, proceeding up a chain of control, is not controlled by any other unit. In case of large multinational enterprise groups, the chain of control can be very long and complicated and cover several countries.

The distribution of the investments of Estonian enterprises is shown in Table 3 (p. 61). The annual statistics on enterprises are collected with a sample survey where all enterprises with 20 or more persons employed are completely enumerated. Therefore, it is possible to provide financial indicators only for these enterprises. Also, agricultural, hunting, forestry and fishing enterprises are not included in the data.

Table 3 (p. 61) shows that in 2009, when the economy was in the deepest crisis, the decrease in investments by foreign-controlled enterprises was significantly smaller than the decrease in domestic enterprises' investments. Also, foreign investments have shown a more stable trend. The investments in 2010 did not yet reach the pre-crisis level, but the decrease in domestic investment slowed down significantly. Nevertheless, the share of investments made by foreign-controlled enterprises has even increased by a few percentage points: in 2008 foreign investments accounted for 31% of the total investments of all enterprises with 20 or more persons employed, whereas this share rose to 33% in 2010.

Figure 10 (p. 62) outlines the impact of domestically and foreign-controlled affiliates in Estonia, based on the most important economic indicators in 2010.

In 2010, foreign-controlled enterprises accounted for 24% of all enterprises with 20 or more persons employed. At the same time, these enterprises represented 33% of the investments in this enterprise group and generated 44% of the value added. The impact of foreign-controlled enterprises is the biggest in exports, with these enterprises accounting for more than half of exports (60%). Foreign-controlled enterprises are often able to produce more competitive products than domestically controlled enterprises. Foreign investors usually have a number of useful contacts in their home country, which means that these enterprises often start exporting to their investor's home country – a Swedish-controlled enterprise exports to Sweden, a Finnish-controlled enterprise exports to Finland, and so on. Figure 10 (p. 62) shows clearly that the Estonian enterprises under foreign control are more efficient.

In foreign affiliates, labour productivity, i.e. value added per person employed, is more than a third higher than in domestically controlled enterprises (Table 4, p. 62).

Most of the foreign direct investments in tangible assets are made by enterprises from other European Union countries. In 2010, nearly a half (47%) of all foreign investments were made by enterprises under Finnish control and almost 30% by enterprises under Swedish control. The share of enterprises from other countries is much smaller (Figure 11, p. 63).

Enterprises under the control of countries from the rest of the world (outside the EU) invested less into the Estonian business sector, but the distribution of investments between countries was much more even than the distribution of investments between European Union countries. A large share of these investments was made by enterprises under the shared control of non-EU countries. Sometimes the enterprises are not controlled by a single owner, but have been set up as a joint venture where no shareholder has a controlling interest. For example, the voting rights in an enterprise registered in Estonia are divided equally (50% and 50%) between a Finnish shareholder and a Swedish shareholder. This kind of enterprises are included in a separate category – enterprises under shared control. The control could be shared between owners from

different European Union countries or from other countries all over the world. If all the owners are from European Union countries, the enterprise is classified into the group "European Union, shared control". If all the owners are from non-EU countries, the enterprise is classified under "Rest of the world, shared control". As shown by Figure 12 (p. 63), in addition to enterprises under shared control of non-EU countries, the other biggest non-EU investors into Estonian enterprises in 2010 were enterprises controlled by the United States of America, followed by Russian and Norwegian enterprises.

Based on economic activity, the biggest investors among foreign affiliates are manufacturing enterprises. At the same time, manufacturing enterprises also hold the biggest share among domestic investors. The share of foreign affiliates' investments in manufacturing is 40% of total investment, whereas the impact of foreign affiliates is the greatest in the information and communication industry where foreign affiliates account for more than 80% of all investments (Figure 13, p. 64). More than a half of the investments in tangible assets are made by foreign affiliates also in administrative and support service activities and in accommodation and food service activities. By contrast, in construction, most of the investments are made by domestically controlled enterprises.

Conclusion

The economic crisis had a quite severe impact on the Estonian investment climate. Investments in tangible assets have decreased considerably compared to the pre-crisis years. There was a significant growth in investments in 2011, but even the level of 2006 has not been reached yet. At the same time, the investments structure, which did not change much in the years preceding the crisis, has started to change since 2009: the share of investments in machinery and equipment has increased. This is a sign of increased investment in technological innovation and of the restoration of production capacity that was unutilised during the crisis. Compared to large enterprises, small enterprises have a much smaller capacity to invest in machinery and equipment. A relatively large part of the investments in the Estonian economy is made by foreign-controlled enterprises, which in turn stimulates innovation and increases export potential.

Compared with other European countries, Estonia is characterised by a much lower level of investment and low efficiency of investments. To generate one euro of value added, Estonia invests more than most other European Union countries. During the economic crisis, there has also been a significant decrease in the fixed asset turnover ratio in Estonia, which indicates the presence of unused production capacity. In capital-intensive industries, the use of fixed assets is more efficient than in the business sector as a whole. The backlog of investments in high-technology industries, however, requires new investments to improve the enterprises' competitiveness in Europe and elsewhere in the world.

In the coming periods, enterprises' investments will mainly be influenced by the overall economic climate and how enterprises assess the duration of the financial and debt crisis. The current situation supports investment, as interest rates are favourable. However, a more significant growth in investment can only be expected once the level of uncertainty in the external environment decreases and there is a significant acceleration in export growth.