

# JOSEFIN

## Regional Market Study

Region: Estonia



## Content Structure

<b>1. Introduction</b> .....	<b>3</b>
<b>2. Methodology</b> .....	<b>4</b>
<b>3. Regional Economic Profile</b> .....	<b>4</b>
3.1. Macroeconomic indicators .....	4
3.2. Regional context for SMEs .....	4
<b>4. Demand analysis for SMEs</b> .....	<b>5</b>
4.1. Degree and forms of Internationalisation in the region .....	5
4.2. Demand Analysis Finance .....	5
<b>5. Supply Analysis for Financial and Non-Financial Schemes</b> .....	<b>6</b>
5.1. Analysis of Financial Schemes .....	6
5.2. Analysis of Non-Financial Support Schemes .....	7
<b>6. Conclusions</b> .....	<b>7</b>



## 1. Introduction

Estonia is a small country with an open economy:

- area 45,200 km<sup>2</sup>;
- population 1.4 million.

Almost 50,000 companies have been registered in Estonia. The majority of them are SMEs, which are the main source of new jobs and economic growth. Swedish banks own most of the banks in Estonia and they have considerably increased their interference in local banking as a result of the global recession. This has had an adverse impact on Estonian companies as they have been unable to obtain the financing they require. Even though the banks have recently started to finance more projects, most of the loan recipients are projects in certain sectors that have good business plans and sufficient collateral.

## 2. Methodology

## 3. Regional Economic Profile

### 3.1. Macroeconomic indicators

The economy of Estonia suffered a serious crisis in 2009. The country's economy decreased by 14.1% over the year as a result of the weak domestic and foreign demand. The volumes of industrial production, export and retail trade decreased considerably. The income of households dropped and unemployment grew. However, it is positive that the decrease in sales figures was smaller in the second half of the year and both companies and consumers felt more secure than they did in spring.

The state's measures to save banking and boost the country's economy, which had an impact on real economy, played a certain role in this improvement. Similarly to other countries, Estonia developed a 6-billion kroon package to alleviate the short-term financial problems caused to Estonian export companies by the recession.

The trends that had appeared in banking in 2009 and 2008 became stronger. The loan portfolio of companies and households decreased due to the drop in income and the overall security.

The global financial crisis also caused a decrease in the insurance of export transactions and increased the price of such insurance. The international insurance companies that had been operating in Estonia downsized their operations here. It became impossible for Estonian exporters to obtain insurance in respect of several products and markets.

The economy of Estonia should stabilise in 2010. Different analysts believe that the GDP will remain around a couple of percentage points. The recovery of economic growth in the second half of the year is supported by the recovery of foreign demand, which has been faster than expected and promotes export from Estonia. This in its turn increases interest in export guarantees and other products aimed at exporters. The increase in the sales of companies will lead to an increase in loans in the second half of 2010. The expected decrease of loan margins related to the euro will support the issue of new loans. The quality of the loan portfolio will deteriorate at least until spring 2010, because the income level of companies and households will remain low and employment will stay high.

### 3.2. Regional context for SMEs

Estonia is a small country, which means that competition on the domestic market is very tough. This means that all companies that want to grow have to keep up with the latest developments on the market and be flexible and innovative. The companies that have received grants from Enterprise Estonia (Technology Invest Grant) have been active in implementing new technologies in order to cut their costs and increase the efficiency of their production/operations. Companies are interested in new support



schemes and financing opportunities. The indicators of business activity of Estonian people remain below the average indicators in Europe. The state has made considerable efforts to eliminate this drawback and make it easier for people with great ideas to start their own businesses:

- establishment of companies electronically;
- affordable loans; and
- various grants.

## 4. Demand analysis for SMEs

### 4.1. Degree and forms of Internationalisation in the region

The most companies aim is to take their products and services to foreign markets as well. The following is primarily used to achieve this:

- export and import;
- bigger and more active companies have established their branches either by creating production units or for the purpose of providing their services mainly in neighbouring countries – Finland, Sweden, - ---- Latvia, Lithuania and Russia; and
- many businesses in Estonia offer subcontracting to large companies from abroad.

IT is a truly global industry and the Estonian companies operating in this field have been very active in selling their products and ideas on the international market. However, these are the companies whose financial capability is difficult to assess and they usually have no collateral.

Obstacles:

- shortage of information;
- shortage of finances and the possibility of involvement; and
- risk management.

### 4.2. Demand Analysis Finance

Companies are using the following sources of financing in the case of internationalisation:

- bank loan (+ loan guarantee);
- subordinated KredEx loan; and
- private investors/investment companies.

Extra funds are usually required for internationalisation in order to establish companies, purchase companies or develop operations. Estonian companies usually prefer to act on their own and not with others in their vision of internationalisation. The search for a source of financing generally starts with a bank loan, which is the most affordable and probably also the most flexible option. Those that have been turned down by banks look for more expensive and less flexible options. The awareness of companies of various financing options is different. It is not surprising that bank loans are better known than alternative sources of financing.



Obstacles in financing:

- insufficient collateral;
- insufficient self-financing;
- inflexibility of banks;

- If the company has businesses in several/other countries, banks do not want to take risks outside of Estonia

- passivity of private investors in the current economic situation; and
- risk management;

## 5. Supply Analysis for Financial and Non-Financial Schemes

### 5.1. Analysis of Financial Schemes

Companies can obtain assistance in the resolution of their financial problems from the following sources in Estonia:

- Estonian commercial banks – loan, leasing, factoring;
- KredEx – loan surety, subordinated loan, export guarantee;
- Enterprise Estonia (EAS) – grants;
- Estonian Development Fund – venture capital; and
- private investors.

This should mean that financing is guaranteed for companies in each stage of development. Companies can realise their ideas by combining the options offered by different channels (grant + loan, loan + surety, bank loan + loan surety + subordinated loan, etc.). These schemes work well in good times. In the current economic environment, however, it is more difficult for companies to find money. The reason is that the main source of financing – commercial banks – have become stricter in their activities. This is also proven by the fact that banks have started to use sureties considerably more than before. However, meeting the collateral requirements alone is not enough as the business plan also has to be reliable and secure. In 2009 many companies that were turned down for loans by traditional channels such as banks turned to the so-called alternative financing scheme – the subordinated loan.

This has highlighted the following problems:

- companies currently have limited access to the loan market;
- it is easier for companies operating in traditional fields to obtain loans; and
- the collateral (especially property) offered by companies is valued considerably less than before, which means that companies do not have the required collateral.

International schemes are not used as financing schemes in Estonia. KredEx and EAS use the money of European structural funds in their activities.

## 5.2. Analysis of Non-Financial Support Schemes

Non-financial assistance is granted to companies by the following institutions in Estonia:

Companies obtain assistance in operating on the regional market and to some extent also in operating on the international market. The shortage of international links and cooperation can be highlighted as a problem.

## 6. Conclusions

Companies whose products and services have at least some export potential are prepared to go on foreign markets as the domestic market in Estonia is very small. There are various financial and non-financial options on the market that help companies to direct their operations outside Estonia. In the current economic cycle, it is difficult for companies that want to do something different, like something more substantive on the foreign market, to find the required financial resources.