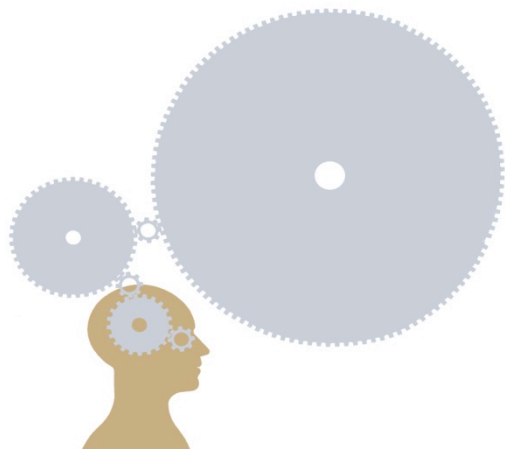


# Financial services sector in Estonia: growth opportunities and policy implications

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## Overview

- objectives and timeline
- analytical framework
- workshop

## Objectives

- study on the growth opportunities of the financial services (FS) sector in Estonia
- focus on identifying the elements of the value chain in selected segments of the FS sector where Estonia is likely to have a competitive advantage
- propose a set of high-level policy options to promote growth and development of Estonian FS sector, based on this assessment

## Timeline

- start of project: April 2009
- **first workshop:** May 18th
  - opportunity for Oxera to listen to the views of those active in the FS industry
- **draft report:** provisional delivery time—early July
- **second workshop:** provisionally scheduled for July
  - opportunity to outline identified growth opportunities and policy implications
- **final report:** delivery after the second workshop

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# Overview of approach

## Topology of the FS sector

Identify relevant segments within FS

Identify relevant parts of the value chain and functions

Early focus on functions with potential for Estonia

## Financial institutions' perspective

Which functions can be moved?

How location choices fit into financial institutions' strategies?

General factors for location choice

What are the implications of the financial crisis?

## Matching factors and functions

Which location factors are critical for which functions?

Which location factors might be particularly important for Estonia?

## Implications for Estonia

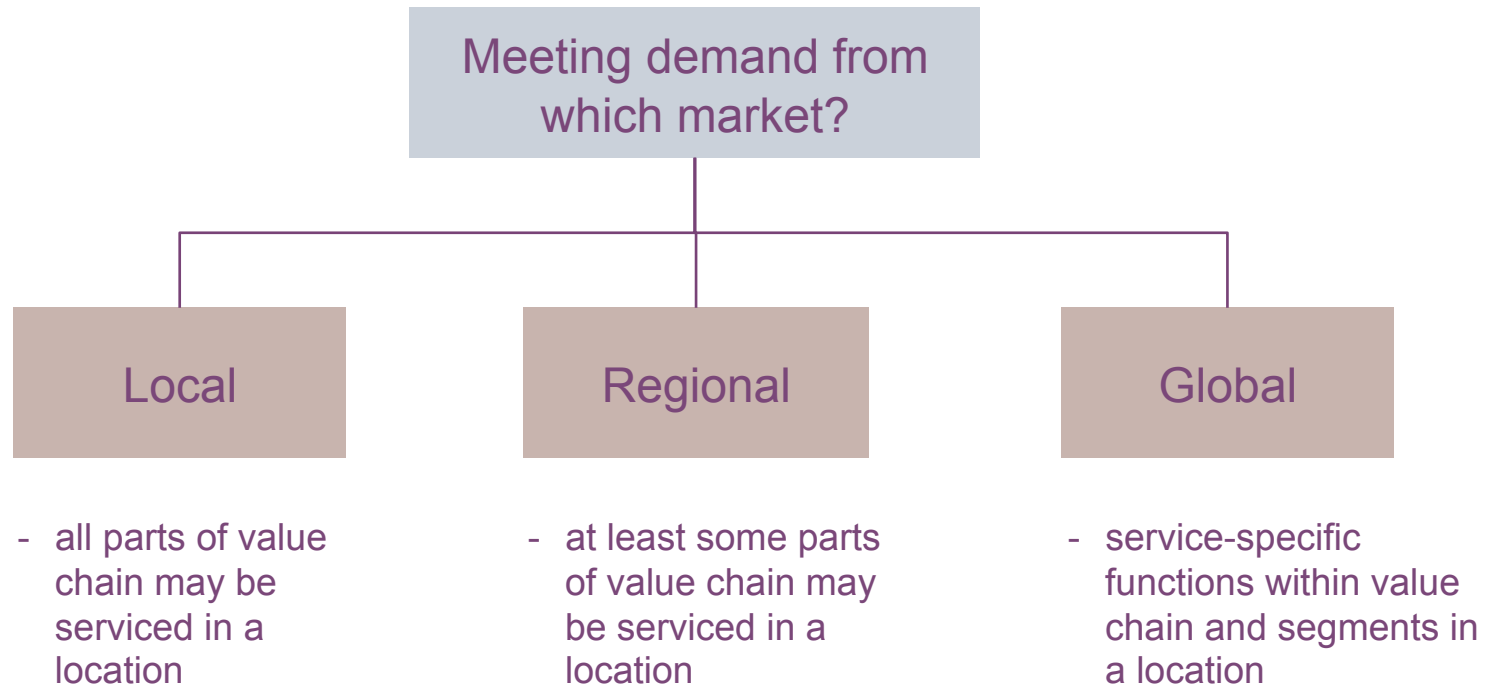
Building on segments of the value chain present in Estonia

What factors would make Estonia an attractive location choice?

Identify potential areas for development and policy options

# Supply of financial services

## Local, regional and global markets



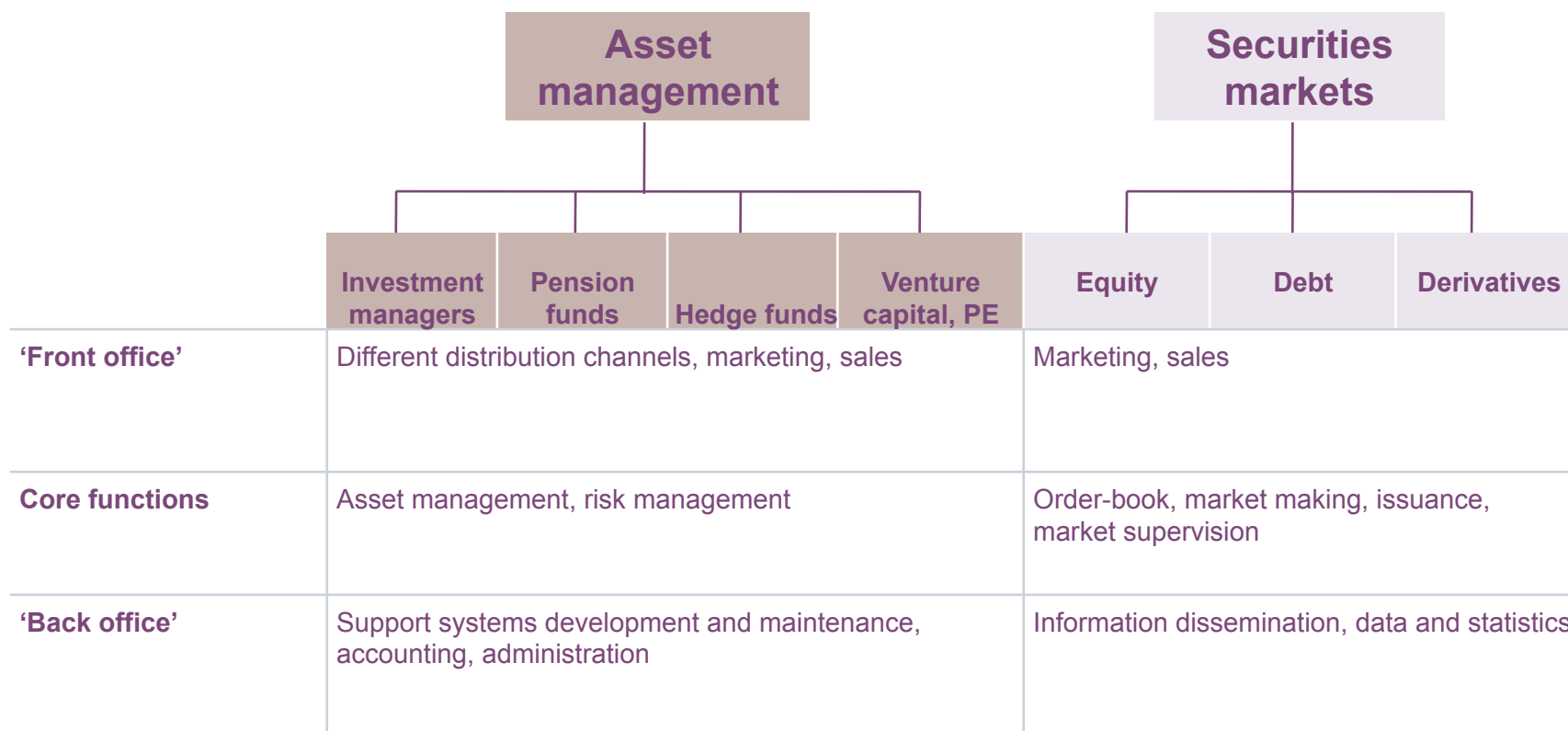
# Topology of the FS sector

Parts of the value chain cut across different segments

	Banking			Insurance	
	Consumer	Investment	Private	Life	Non-life
'Front office'	Sales, marketing, deposit taking, lending	Origination, sales, relationship banking	Sales, customer relationship management, tax advice	Marketing, sales, claims management	
Core functions	Financial operations, risk management, product development	Advisory, trading, brokerage, custody services	Global custody, product sourcing, investment research, trust administration	Underwriting, risk management, asset management	
'Back office'	Accountancy, IT systems, call centres, administration	Electronic trading support, IT support, settlement, accountancy, clearing and settlement	IT systems, settlement, securities processing, accountancy	Administration, accountancy, IT systems	

# Topology of the FS sector

Parts of the value chain cut across different segments



## General factors for location choice

### Factors determining competitive advantage

Labour	Technology, infrastructure	Taxation, regulation	Institutional, other
<ul style="list-style-type: none"> <li>- level of wages</li> <li>- general skill level</li> <li>- specific skills (eg, finance, accounting)</li> <li>- language skills</li> </ul>	<ul style="list-style-type: none"> <li>- market infrastructure</li> <li>- airports and transport links</li> <li>- transport costs</li> <li>- telecoms services and cost</li> <li>- internet access and cost</li> </ul>	<ul style="list-style-type: none"> <li>- transparency and simplicity of tax regime</li> <li>- level of taxes (corporate, personal, etc)</li> <li>- attitude of the tax/regulatory authority</li> <li>- regulation of FS products</li> </ul>	<ul style="list-style-type: none"> <li>- institutional and market framework</li> <li>- property costs</li> <li>- political and economic stability</li> <li>- ease of doing business</li> <li>- corruption level</li> </ul>

## Matching factors with FS functions

- location choice factors differ in their importance to the various FS functions
- matching necessary to examine Estonia's current position and to identify opportunities for growth
  - specificity ensures targeted approach
- example: asset management sector

Factor	Marketing and distribution functions	Core asset management functions	Middle-/back-office functions
Pool of savings, proximity to clients	Very important	Less important	Unimportant
Performance and liquidity of markets	Less important	Important	Unimportant
Flexibility of labour market	Important	Important	Very important
Total labour cost	Important	Important	Very important
Rental/property cost	Important	Less important	Important
Price/quality of financial infrastructure	Important	Very important	Important
Regulatory regime	Very important	Important	Important
Size of labour pool	Very important	Very important	Very important

Source: Oxera (2005), 'The future of UK asset management: competitive position and location choice', prepared for the City of London and Investment Management Association.

# Strategic considerations by financial institutions

## Considering location choice

- financial institution's strategy
  - global expansion versus reduction of cross-border exposure
  - local, regional, global level strategies
- can the function be moved?
  - proximity to demand
  - some functions locate mainly in financial centres
  - pros and cons of outsourcing
- clustering
  - reduce costs as well as increase or create demand
- costs and favourable economic and business environment
  - geographical and cultural proximity may matter
  - market structure and institutional setting in a location

# Implications for Estonia

## Opportunities and challenges in a changing environment

- what factors make Estonia an attractive location choice?
  - focus on FS functions that have a potential to be in Estonia
- analysis of current situation
  - how developed are different segments and FS functions, and why?
  - what is the significance of Estonia's institutional setting?
  - what is its competitive position with respect to location choice factors?
- identifying growth opportunities
  - realistically, which functions could Estonia attract?
  - what factors are necessary to be attractive for these functions?
- policy implications
  - high-level policy options and areas of focus

# Policy implications

## Examples

### Promotion, marketing

- functions for which Estonia already has a competitive advantage in terms of the required factors
- consider whether there are any functions that could 'trigger' clustering

### Economic policy and political conditions

- specific functions that might be currently constrained by the lack of adequacy of the required factors
- functions that could be stimulated by appropriate economic policy

### Regulatory and fiscal stimulus

- functions that are currently unduly constrained by regulatory or tax regime
- consider the role of regulatory and tax regime for increasing attractiveness for the relevant FS functions

## Conclusions

### Growth opportunities for Estonian FS sector

- objective: to identify FS functions with growth potential, given Estonia's position
  - how do FS institutions think about location choice?
  - what factors are important for which functions?
  - how is Estonia doing in terms of these factors?
- objective: to identify what improves Estonia's attractiveness as a location choice for specific segments of the FS sector
  - focus on products and parts of value chain with a potential for growth and value added in Estonia
- policy implications for improving competitiveness

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## Workshop (I)

### Objectives and plan

- objectives
  - to gain a better understanding of the challenges and opportunities facing the Estonian FS industry
  - to obtain insights into participants' views on the industry segments that are likely to be important in the future
- plan
  - discussion in groups (45 minutes)
  - reporting back with the conclusions (15 min each group)
  - plenary discussion (10-20min)

## Workshop (II)

### Questions for discussion

- local market
  - what have been the main trends in development of the demand for FS in Estonia?
  - what are the challenges currently facing the FS industry in the local market?
- competitive functions/sectors – international perspective (export of FS services)
  - which functions/sectors currently service international demand?
  - what geographic markets (eg, Baltics, Baltics + Nordic, CIS, pan-European)?
- future growth functions/sectors – international perspective (export of FS services)
  - which functions/sectors have strong growth potential?
  - what geographic markets (eg, Baltics, Baltics + Nordic, CIS, pan-European)?
- factors that make Estonia attractive
  - what makes Estonia attractive (eg, low costs, good FS infrastructure, good legal system) for particular functions/sectors?
- obstacles to growth of FS
  - what are the obstacles that currently hamper growth of activity across different functions/sectors?

## Workshop (III) Framework

- classifying functions
  - 'front office' (distribution, sales, the client-facing part of the business)
  - 'core functions' (financial operations, asset management, underwriting, etc)
  - 'back office' (administration, IT and other systems, etc)

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