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## **Executive summary**

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under  
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## **Introduction**

The Regional Development Department, under the Ministry of Interior of the Republic of Lithuania, in particular the Kaunas County division, is aiming to update the Kaunas Regional Development Plan 2020. This study is looking at how to improve regional development planning in the field of investment promotion in Kaunas County. The reason for this is that the majority of foreign direct investments are landing in Vilnius and that the share of Kaunas County could be substantially enhanced.

Moreover, the processes and procedures to attract investors to Kaunas County are sub-optimal:

- there are no clearly derived target investment sectors at a regional level;
- a consistent organisational structure is lacking;
- the economic development ambition of the County is neither expressed nor formalised;
- the understanding of different investment levels (unstructured and non-formalised local investments versus structured and formalised foreign investments) is lacking.

Aim of this study is to select priority investment sectors, to provide insights on how to further develop these sectors and how to successfully market these sectors in order to attract (foreign) investments.

## **FDI and clusters**

Foreign Direct Investments (FDI) and clusters play a central role in the analysis to identify priority sectors. However, investments can also originate from the same region or country. As FDI is the best documented there is consequently a lot of data on FDI. Furthermore, local investments are in the region already and don't need to be attracted. Starting entrepreneurs tend to commence their businesses in the vicinity of their homes and investments on a national scale are usually determined by the desire to expand to a concentrated market. National investments follow the pattern of FDI. If a region is attractive for foreign investors in a particular sector, it is generally attractive for national investors as well.

One reason why a region would be attractive for a foreign investor is the presence of a cluster. Clusters are a group of geographically concentrated companies, specialised suppliers and service providers and related knowledge institutions that are active within a specific sector. Clusters provide benefits for all companies within them:

- Specialised labour market.
- Presence of suppliers and service providers.
- Knowledge spill overs that lead to faster and better innovation of products, services and processes.

As a result of these benefits, other companies will try to locate themselves in the geographical area where the cluster is located. Clusters are an important aspect of the marketing potential of a region.

### **Priority investment sector selection**

BCI developed a four step framework to analyse all of the sectors and determine the priority investment sectors. This four-step approach is visualised in table 1. Based on the weighted scores, Logistics, Machinery, Business Services ICT and Health priority sectors are selected. The small number of sectors enables to focus marketing time and effort.

Table 1: Four step approach to identify priority sectors

	Weight	Sub factors	
A Critical mass	20%	A1 Employment 2013	100%
B Growth potential	20%	B1 Employment growth in Lithuania	60%
		B2 Employment growth in Kaunas County	40%
C Distinctive capacity	30%	C1 Investment climate	50%
		C2 Specialisation degree	25%
		C3 Regional benefits	25%
D FDI Dynamics	30%	D1 Number of FDI projects 2011-2013	100%

Source: BCI, 2014

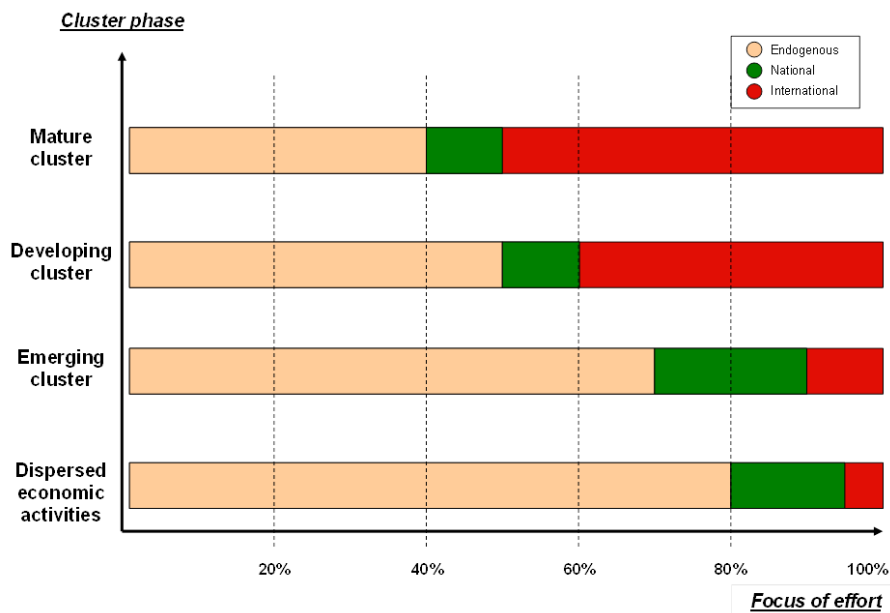
### **Cluster development**

There are 5 cluster development phases:

- 1 **Dispersed economic activities:** Not a cluster yet. The business sector exists of one or only a few companies with little interaction.
- 2 **Emerging cluster:** Growth and further development of companies within the sector. More companies in the same field locate or start up in the region and a few suppliers for the emerging cluster enter the market.
- 3 **Developing cluster:** The business sector is building up a reputation that is recognised within and outside of the direct region. New companies are attracted by the agglomeration of companies active within the same field. More suppliers and service companies locate in the region. The growth potential of companies within the emerging cluster is significant.
- 4 **Mature cluster:** Strong specialisation degree. A significant number of people are employed within the cluster, both by SME's and large companies. A substantial part of turnover is realised abroad. This gives the region a strong image and international/global brand awareness.
- 5 **Cluster congestion:** The growth of the cluster stagnates. This can be caused by e.g. lack of space for expansion, limited availability of employees resulting in an increase of labour costs etc. It is important in this phase to diversify and focus on niche activities.

For each of these cluster development phases, the appropriate potential actions and geographical focus is different, see figure 1.

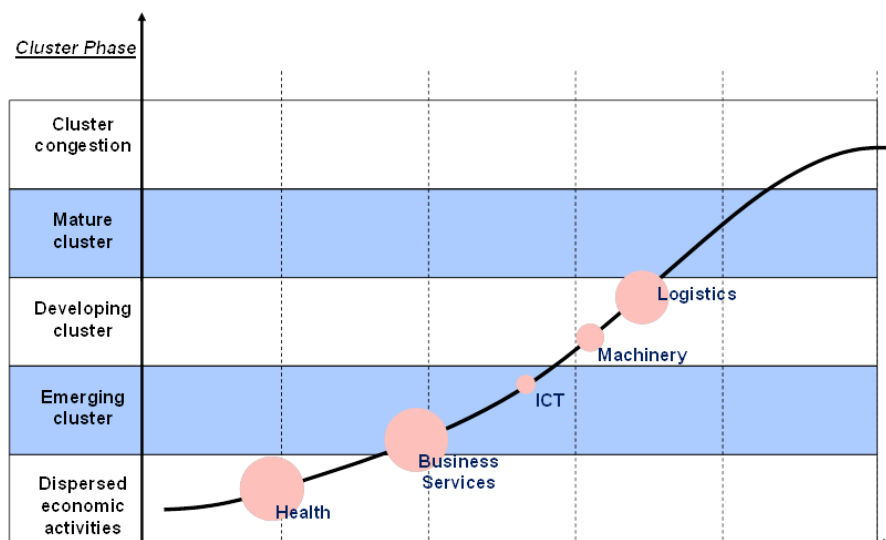
Figure 1: Cluster phases and focus of effort



Source: BCI, 2014

The weighted scores for the factors that are used to rank the business sectors are the basis for positioning the business sectors on the cluster life cycle (see figure 2). The size of the dots is determined by critical mass. The positioning is determined by the combined weighted score for growth potential, distinctive capacity and FDI potential.

Figure 2 Positioning 5 Kaunas region priority sectors on Cluster Life Cycle



Source: BCI, 2014

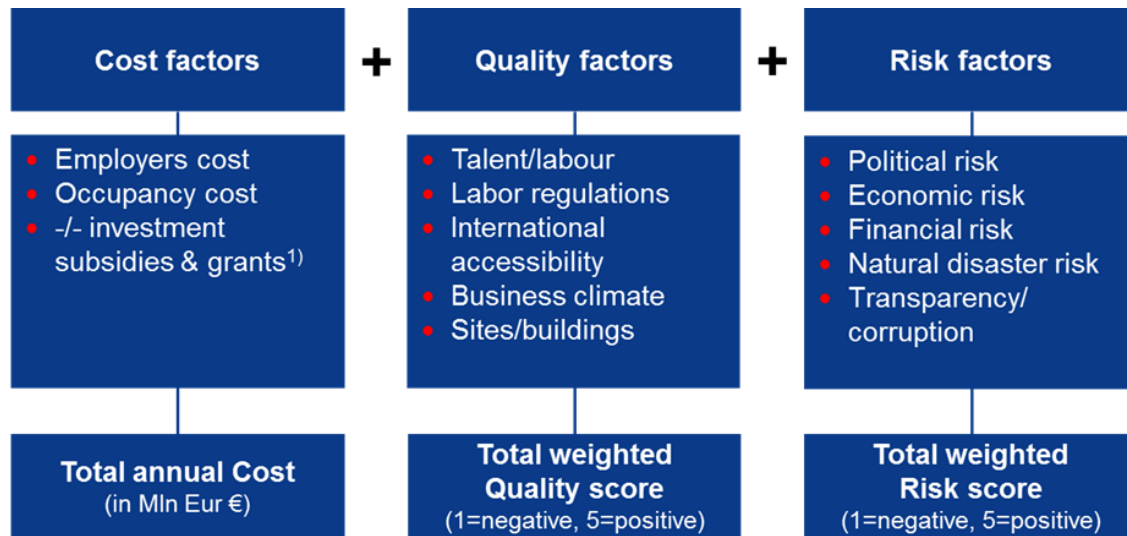
Health sector in Kaunas region is classified as dispersed economic activities and is not (yet) in a phase where (international) acquisition is appropriate. Furthermore, FDI flows in health

sector are very small. Health should therefore aim at visitors and is not included in the international benchmark that compares Kaunas County with other competing regions.

**Benchmark**

Kaunas County’s investment climate for Logistics, ICT, Business services and Machinery is compared with 7 regions in Central and Eastern Europe, similar to Kaunas County, to assess Kaunas County’s competitiveness. The following location factors are used to assess the 7 selected benchmark locations.

Figure 3 Location factors



All benchmark locations are positioned in a cost-quality-risk matrix. The more a location is positioned in the upper right corner, the better it scores. The results of all four priority sectors are shown in figures 4 up to 7.

Figure 4 Cost-quality-risk matrix business services

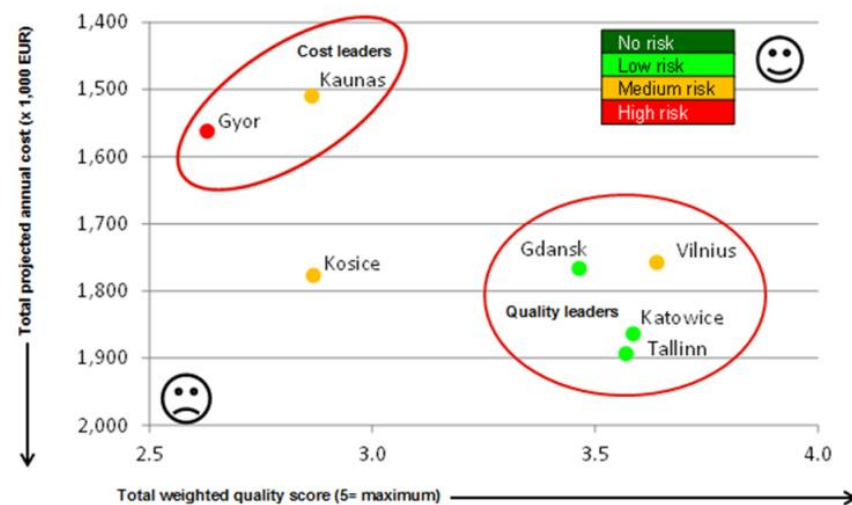


Figure 5 Cost-quality-risk matrix machinery



Figure 6 Cost-quality-risk matrix logistics

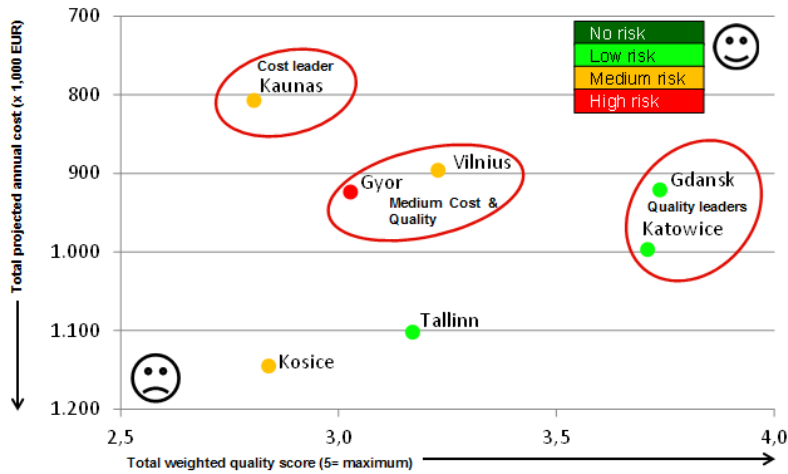
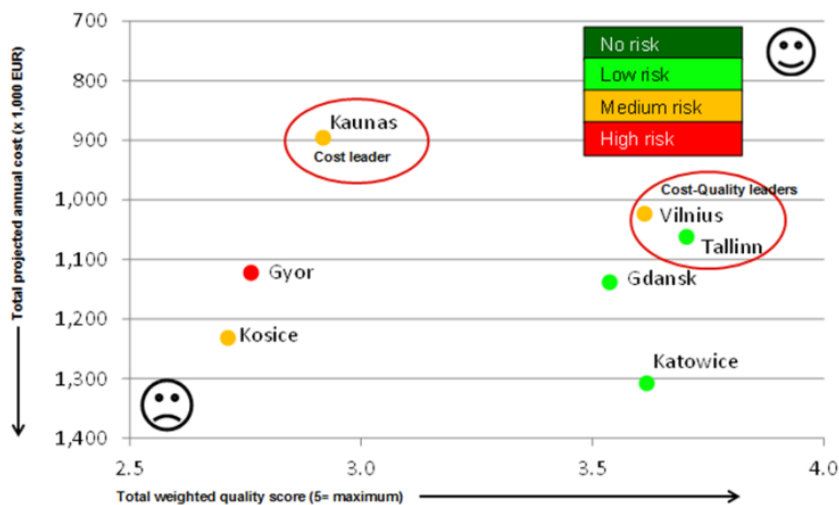


Figure 7 Cost-quality-risk matrix ICT



The benchmark shows that Kaunas County is cost leader in all four sectors, but lags behind on quality. In order to become more competitive certain location factors need to be improved to further develop priority sectors. This will strengthen the priority sectors and as a result, they will be able to attract larger flows of FDI.

### **Priority sectors' development**

All Kaunas County municipalities should contribute in order to develop the priority sectors. Regional coordination is key in the process to coordinate all required efforts of municipalities and institutions. The Regional Development Department under the Interior Ministry should coordinate this by appointing a program manager. This manager should:

- match the proposed actions with existing policy and plans
- line up the proper institutions per action

Table 2 Suggested actions to develop priority sectors

<b>Nr.</b>	<b>Action</b>	<b>Possible responsible body and source of funding</b>
1	Expand the education potential	The Ministry of Education and Science in cooperation with Kaunas County universities, colleges and vocational schools.
2	Offer courses to unemployed	Lithuanian Labour Exchange in cooperation with Kaunas County universities, colleges and vocational schools
3	Promote priority sectors to raise interest among youth and unemployed	The Ministry of Education and Science and Lithuanian Labour Exchange
4	Retain talent	Kaunas County Regional Development Agency (KCRDA) in cooperation with Invest Lithuania.
5	Offer English language courses to unemployed	Lithuanian Labour Exchange in cooperation with Kaunas County universities, colleges and vocational schools.
6	Improve English language education in primary and secondary schools	The Ministry of Education and Science in cooperation with Kaunas County primary and secondary schools.
7	Reduce mandatory severance pay	Ministry of Ministry of Social Security and Labour
8	Shorten the notice period	Ministry of Ministry of Social Security and Labour
9	Allow more hours of overtime	Ministry of Ministry of Social Security and Labour
10	Allow flexible spread of overtime over longer time frames	Ministry of Ministry of Social Security and Labour
11	Relax night-work regulations	Ministry of Ministry of Social Security and Labour
12	Faster access to utilities	The national government
13	Faster procedures for construction permits	The national government and the State Enterprise Centre of Registers
14	Setting up sector/cluster network organisations	KCRDA and Innovation Centre
15	Set clear rules concerning permits	The national government
16	Upgrade Via Baltica	The Ministry of Transport and Communications
17	Improve internal road network	Kaunas County municipalities and the State Enterprise Kauno regiono keliai
18	Support Marvelle port development	Local municipalities and Ministry of Transport and Communications
19	Develop logistic platform linked to rail terminal on Rail Baltica	Local municipalities, Ministry of Transport and Communications and Lithuanian Railways
20	Increase the number of available, fully prepared industrial sites	KCRDA and Kaunas County municipalities/ Kaunas County real estate council
21	Increase the number of available offices	KCRDA and Kaunas County municipalities/ Kaunas County real estate council

Kaunas County’s Health sector can be further developed by attracting national investment and marketing. Marketing can generate a multiplier effect. Due to the increasing number of visitors, profits and the reputation of Kaunas County resorts and health institutions will rise, this will improve the proposition for investors and generate investments in Kaunas County resorts. Due to these investments, the quality or the quantity of the resorts and health institutions will increase, new products or services can be offered. By doing so, more visitors can be attracted, etc.

The (international) demand for health and wellness is likely to rise:

- Aging population in most parts of Western Europe,
- Rising mobility,
- In 5 to 10 years these trends will likely generate increasing flows of FDI.

As long as Kaunas County health sector keeps developing and improving their proposition, it will be able to attract FDI in this sector in the near future.

**Priority sectors’ marketing**

Strengthening the priority sectors creates a more attractive investment climate for (foreign) companies. These companies need to be (more) aware of the attractive investment climate in Kaunas County and marketing is the tool to achieve this.

Currently, a lot of different institutions and municipalities are active in investment promotion. Funding and efforts are limited and scattered over all municipalities and institutions. Cooperation in investment promotion is required. BCI recommends to develop a regional IPA to match Kaunas County’s ambition on investment promotion. Furthermore, BCI recommends appointing a project manager who will steer the establishment of a regional investment promotion agency. This IPA can be a standalone organisation or a hybrid one, cooperating with Invest Lithuania. It should have from 4 to 7 full time equivalent (FTE) job positions and the required budget is in the range of 260.000 up to 425.000 Euro per year. The exact organization model and size depends on available budgets, efficiencies that can be reached and willingness among the various institutions to cooperate.

The following marketing actions with a broad (table 3) and a sector specific (table 4) focus are suggested.

*Table 3 Marketing actions with a broad focus*

<b>Nr.</b>	<b>Activity</b>	<b>Required action</b>
1	PR Material	Improvement of general promotion material about Kaunas County’s investment climate
2	Website	Keep the material updated and relevant Improve KRDA and municipality websites (all in English and with necessary information)
3	Multipliers	Keep the websites updated and relevant Development and strengthening of a multiplier network in Lithuania and abroad
4	Free publicity	Get an article on Kaunas County’s competitiveness published in real estate magazines Prepare and disseminate press releases about developments in Kaunas County
5	Relation management system	Development of an integrated account management approach and contact relation management system for foreign companies in Kaunas County



6	Investors' development program	Organisation of an investors' development program: - Investors' development day - Investors' relations workshops for new investors
7	Lobby towards public authorities	Regular contact with councils of municipalities, regional and national public authorities in order to share opinions of (foreign) companies and suggestions for improvement, and participation as a stakeholder in discussions regarding the operating investment climate of Kaunas County and Lithuania as a whole
8	Event marketing (broad focus)	Visit and/or exhibit large events having a broad focus in Europe such as: <ul style="list-style-type: none"> <li>• MIPIM – Annual leading real estate property exhibition and conference in Cannes (France)</li> <li>• Hannover Messe - Annual largest technology trade fair in Hannover (Germany)</li> <li>• Expo Real – Annual International Trade Fair for Property and Investment in Munich (Germany)</li> </ul>

Table 4 Marketing actions with a sector specific focus

Nr.	Activity	Required action
9	Logistics	Visit and/or exhibit large events focussing on logistics e.g.: <ul style="list-style-type: none"> <li>• Logistik Messe Munich (Germany)</li> </ul>
10	Machinery	Visit and/or exhibit large events focussing on machinery e.g.: <ul style="list-style-type: none"> <li>•Euroblech (Hannover, Germany)</li> </ul>
11	ICT	Visit and/or exhibit large events focussing on ICT e.g.: <ul style="list-style-type: none"> <li>•ICT Spring Europe (Luxembourg)</li> </ul>
12	Business Services	Visit and/or exhibit large events focussing on business services e.g.: <ul style="list-style-type: none"> <li>•Call Center World Berlin</li> </ul>
13	Logistics	Develop a contact database of 40 (inter)national industrial companies, focus on Germany, Scandinavia and France (e.g. DHL, Raben, TNT) Approach target companies by mailing of the value proposition & Follow-up
14	Machinery	Develop a contact database of 40 (inter)national industrial companies, focus on Germany, Scandinavia and France (e.g. ABB, AGCO, Alstom) Approach target companies by mailing of the value proposition & Follow-up
15	ICT	Develop a contact database of 20 (inter)national industrial companies, focus on UK, Scandinavia, US and Lithuania (e.g. SAP, HP, Cisco Systems) Approach target companies by mailing of the value proposition & Follow-up
16	Business Services	Develop a contact database of 20 (inter)national industrial companies, focus on: <ul style="list-style-type: none"> <li>• (inter-)national Business Process outsourcing (BPO) providers (incl. German, British, US and Lithuanian companies) e.g. Transcom, Arvato, Sitel</li> <li>• existing and strong growing international BPO/Shared Services Center (SSC)/Call Center (CC) companies located in Vilnius that would like to expand within Lithuania</li> </ul> Approach target companies by mailing of the value proposition & Follow-up
17	Health	Develop a contact database of top 10 (inter-)national resort groups and travel agencies in the Nordics, Russia and area's with a direct flight connection to Kaunas airport. Approach Ryan Air to lobby for direct flights towards larger metropolitan areas in Russia and Scandinavia. Approach target companies/agencies by mailing of the value proposition & Follow-up

## ***Cooperation and the role of municipalities***

Based on the high level analysis of the Regional Development Department among municipalities and KRDA, the following problems with the current state of investment promotion have been identified:

- Limited supply of land and/or buildings,
- Suitability of prepared land,
- Lack of funds for infrastructure development on the sites,
- Lack of budget for investment promotion,
- Lack of a common regional vision and agreement about investment promotion.

Funds and efforts are limited and scattered over all municipalities and institutions in Kaunas County. Bundling these funds and efforts in a regional investment promotion agency (IPA) will offer benefits and synergisms. Investment promotion on a municipal level is simply not cost effective and inefficient. That is the reason why it should be done on a county level with the different municipalities in back office. First, efforts of all municipalities are bundled to raise awareness and market Kaunas county as an attractive region for investors. When a foreign company is interested in investing in Kaunas County, municipalities can compete for it under the supervision of the regional investment promotion agency. Potential investors will want to visit the region and look at potential sites in different municipalities. In this manner, Kaunas County municipalities are able to cooperate and share the investors market.

Cooperation between municipalities is quite common. In every country within the European Union there are examples of regional investment promotion agencies that represent various municipalities, industrial/business/science & technology parks, Free Economic or Special Economic Zones and cooperate on a regional and even on a national level to attract foreign investors. Cooperation and competition co-exist. Many institutions perform investment promotion and try to market their city, district, park or region as an attractive FDI destination in an increasingly competitive market place. Cooperation in investment promotion provides benefits such as:

- Market – a larger market with more opportunities can be marketed, which provides more impact and more outreach internationally.
- Image transfer – places less well known or with less positive images can benefit from tagging onto the more positive or better known images of other places in the region.
- Economies of scale – by pooling resources, Kaunas County's institutions focused on investment promotion can leverage economics of scale to achieve synergies and added value, as well as reduce costs.
- Product development – the possibility of trans regional product development, e.g. networks of supporting clusters covering several municipalities for investment attraction.