

Venture capital guides to the Eastern wilderness

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Latvia, the Baltic States and Eastern Europe have drawn attention of the European venture capital investors. At this point, this is no longer just primary insignificant attention; it has turned into a stable interest. Initial investments are of course being made in Latvia and the rest of the Baltic States. Why is it so, that despite the fact that Latvia is incomparably smaller than, for instance, Russia or Ukraine and accordingly is a less attractive market for investors?

Explanation for this is quite simple: venture capitalists do not seek adventures (meaning they do not seek risk). They are willing to take a higher risk to gain higher profits and please note the word *w i l l i n g*. Venture capitalists are not extremists who make investments according to the principle 'the crazier — the better'! In an ideal situation, a venture capitalist would like to earn huge profits without any risk whatsoever. However, it is not possible; thus, venture capitalists make their first investments in the Baltic States.

For international investors the Baltic States are like a unique and precious pearl. It is based on the history and the present complemented by geographical location. In the recent past the three Baltic States were part of the union with other countries of Eastern Europe. That was the Soviet Union. We all together with Belarus, Russia, Ukraine, Kazakhstan and other countries of Eastern Europe were a single nation. However, the Baltic States were distinguishable among other countries as they were the western border and a special place by the Baltic Sea which everyone dreamt to go to on a holiday. The Baltic States and people of the Baltic States were and still are trade marks in the East. They trust us! Today the Baltic States are member states of the European Union, forming the eastern border of Europe. Business and life here goes on in a manner understandable to and habitual for Europeans. Everything is the same as or similar to any other country of old Europe. It is this Baltic synthesis between the East and the West and the special status of the Baltic people that forms the unique and precious pearl for international investors. It is easier and safer to make investments in Belarus, Russia or any other country of Eastern Europe through the Baltic States. It does not raise the costs significantly and helps to remarkably reduce risks. For this reason initial investments in Eastern Europe are made in the Baltic States, a home country and a habitual European environment, and post-socialist countries at the same time. Using this strategy investors make their profits in the Baltic States, get to know the specific features of the Eastern European Region and ensure a future deal flow in a wider region. Survey of a new market and establishing a position in it with-

out additional costs and a rapid rise in the investment risk is the phenomenon of this strategy. This means that investors are gradually moving from a developed market to a developing one, which is the case with the Baltic States, and then on to an emerging market: Belarus, Russia or some other market. This phenomenon has secured the interest of global venture capitalists in Latvia and the rest of the Baltic States, as a result of which in Latvia there have been tens of investments and successful "exits". Speaking of the size of Latvia and other Baltic States one has to remember that it is the extent of a project not the size of a country that matters to an investor. Projects matching the extent of international private and funded venture capital investment policies are, in their turn, on the menu of the Baltic investment projects.

A liberal tax system is used in Latvia providing for different options as regards the application of taxes. The average tax burden, i.e. the total amount of state taxes payable by an entrepreneur, is 30%. The tax burden can be lowered to 20% through application of the wide system of tax rebate available in Latvia. These are excellent conditions for business, as opposed to the Nordic countries where the tax burden amounts to 50%. It is only tax free zones that offer lower costs than Latvia.

In the Baltic Region, the attractive Latvian tax system is characterised by a company income tax rate or the so called profit tax rate, which is 15% in Latvia, 22% in Estonia and 26% in Lithuania. Estonia lures businesses with the opportunity not to pay taxes for profits which are invested in further development and not paid out. This is an attractive short-term solution, but one has to remember that these 22% — 7% more than in Latvia — will nevertheless be deducted when the profits are paid out.

The Latvian legal system is an integrated part of the legal system of the European Union. The system used at the Commercial Register of the Register of Enterprises is particularly convenient. Using a computer, one can check at any time whether a company exists, whether it is not going through an insolvency procedure, as well as check annual reports of the company, verify



authorised signatories of the company, and obtain information on commercial collateral. Title to any real property is registered in a special register called Land Register, including ownership, security and any burdens, including the right of use. This register is publicly available and it features any restrictions imposed by the state regarding the right of use or burdens of any kind. It is also important that this register — the Land Register — is a register that establishes rights. This means that ownership is not acquired as of the date of signature of, say, a real estate purchase agreement; instead, ownership is acquired upon registration of the purchaser's title in the Land Register. On the whole, the Land Register provides for transparency and security in transactions with real property.

The Latvian venture capital and private equity market has become an organised market, with the Latvian Venture Capital and Private Equity Association, an associated member of the European Private Equity & Venture Capital Association since 2003, operating in it. A Latvian Association of Business Angels was established last year. There are signs of support from the Latvian State as well — three venture capital funds co-financed by the Latvian State were established to finance small and medium enterprises where the state acts as a subordinated investor.

The Baltic Region has historically been the venue for Eastern and Western trade interests. Today, too, it is a place where demand meets supply, including Western capital and Eastern investment projects. Experience and history shows that the shortest way from London to Moscow leads through Riga and that the Baltic people are the best guides to the Eastern wilderness. •