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QUALITY COMPETITIVENESS OF LATVIA AND STRATEGY TO IMPROVE IT

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Abstract

Issues of competitiveness always have been important for countries and companies. Countries are looking for the ways to improve business environment so the companies within the country could develop and became more competitive which is very important issue especially in economical slowdown. And companies for their part search for different tools which will give them competitive advantage in internal and external markets.

Quality assurance and management has been very important issue for entrepreneurs since Japan showed to the entire world the power of quality and its place in competitiveness.

Today there are many competitiveness evaluations available with different methodology applied, for instance, World Economic Forum (WEF) every year is presenting Michael Porter's Global competitiveness report and Lisbon review as well, European Commission publishes European Competitiveness Report, Observatory of European SMEs, EU industrial structure, EU productivity and competitiveness, EU sectoral competitiveness indicators and other informative and exploration reports.

These reports contain very much information about components of competitiveness and their importance. It is also a very good ground for further detailed research of the authors on the particular topic.

Authors in this paper will analyze overall competitiveness of world's countries and Latvia by using different competitiveness reports. This will show principal comparison of main competitiveness indicators and will highlight main areas where improvements are needed.

As well as competitiveness comparison, authors in this paper will make quality competitiveness calculations and comparison of the Baltic States using method developed by Karl Aiginger. This method uses unit value of exports as the first main indicator on quality and that will help to make conclusions about quality of goods made in Latvia and also compare Latvia to other Baltic countries. Authors will also analyze different quality assurance and management issues in Latvia and make suggestions on necessary changes in Latvia's competitiveness strategy.

Main methods used in this research include study of scientific literature, legislation, data mining and analyzing of already collected data.

The main results will contain analysis of current situation and recognition of main problems in field of business environment and quality competition. Based on analysis and results authors will prepare recommendations for business environment improvements and necessary competitiveness strategy, specifically to improve quality competition.

Keywords:

Competitiveness, quality, export.

Introduction

Authors indicated a problem of quality's place in the competitiveness of the entrepreneurship in the XXI century. In the XX century Japanese entrepreneurs proved that quality is one of the main components of competitiveness. Is it still important in XXI century? Evaluation of quality competitiveness of Latvia and suggestions for necessary strategy to improve quality competitiveness is main novelty of this paper.

Research object is quality competitiveness of Latvia. The aim of this paper is to analyze components of competitiveness, evaluate quality competitiveness of Latvia and make suggestions for necessary strategy to improve quality competitiveness. Main methods used in this research include study of scientific literature, legislation, time-series, data mining and analyzing of already collected data.

Overall competitiveness of Latvia

Competitiveness has increasingly gained currency across the globe. The international trade theories explain that different countries have different comparative advantages. Thus, if a country is rich in natural resources or capital, it has a comparative advantage over the others

(Porter, 1990). However, in the current knowledge economy, knowledge as a resource has no natural home base and can be transferred easily anywhere in comparison to natural resources. This has made the XXI century more and more competitive (Pillania, 2009).

Competitiveness and country competitiveness rankings have increasingly become important and various studies are carried out on the subject. While competitiveness of enterprises has been studied by many scholars around the world, competitiveness of nations is a relatively new discipline (Garelli, 2006). There are two internationally well recognized and popular annual rankings on the competitiveness of countries, namely Global Competitiveness Rankings and World Competitiveness rankings.

The Global Competitiveness Rankings study is conducted by the World Economic Forum. In this paper authors will use rankings published by World Economic Forum – Global Competitiveness Report and Lisbon Review in order to characterize overall competitiveness of Latvia.

Main coordinators and investigators of Global Competitiveness Report are Michael Porter and Klaus Schwab. They define competitiveness as the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the sustainable level of prosperity that can be earned by an economy. In other words, more competitive economies tend to be able to produce higher levels of income for their citizens. The productivity level also determines the rates of return obtained by investments in an economy. Because the rates of return are the fundamental drivers of the growth rates of the economy, a more competitive economy is one that is likely to grow faster over the medium to long run.

The concept of competitiveness thus involves static and dynamic components: although the productivity of a country clearly determines its ability to sustain a high level of income, it is also one of the central determinants of the returns to investment, which is one of the key factors explaining an economy's growth potential (Porter, Schwab, 2008).

The determinants of competitiveness are many and complex. For competitiveness ranking of the countries, Global Competitiveness Report introduces the Global Competitiveness Index (GCI). The GCI captures this open-ended dimension by providing a weighted average of many different components, each of which reflects one aspect of the complex reality that we call competitiveness. Authors group all these components into 12 pillars of economic competitiveness (Fig. 1.).

If we look at those 12 pillars of competitiveness in detail, than "Business sophistication" pillar is the one where quality is mentioned. Quality issue will be discussed by the authors later in this paper. Business sophistication is conducive to higher efficiency in the production of goods and services. This leads, in turn, to increased productivity, thus enhancing a nation's competitiveness. Business sophistication concerns the quality of a country's overall business networks as well as the quality of individual firms' operations and strategies. The quality of a country's business networks and supporting industries, which we capture by using variables on the quantity and quality of local suppliers and the extent of their interaction, is important for a variety of reasons. When companies and suppliers from a particular sector are interconnected in geographically proximate groups ("clusters"), efficiency is heightened, greater opportunities for innovation are created, and barriers to entry for new firms are reduced. Individual firms' operations and strategies (branding, marketing, the presence of a value chain, and the production of unique and sophisticated products) all lead to sophisticated and modern business processes (Porter, 2008).

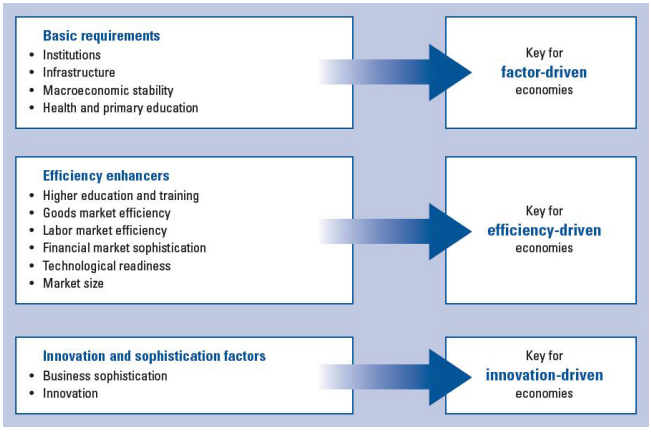

Fig. 1. The 12 pillars of competitiveness (Porter, Schwab, 2008)

According to the GCI, in the first stage, the economy is factor-driven and countries compete based on their factor endowments, primarily unskilled labour and natural resources. Companies compete on the basis of price and sell basic products or commodities, with their low productivity reflected in low wages. Maintaining competitiveness at this stage of development hinges primarily on well-functioning public and private institutions (pillar 1), well-developed infrastructure (pillar 2), a stable macroeconomic framework (pillar 3), and a healthy and literate workforce (pillar 4).

As wages rise with advancing development, countries move into the efficiency-driven stage of development, when they must begin to develop more efficient production processes and increase product quality. At this point, competitiveness is increasingly driven by higher education and training (pillar 5), efficient goods markets (pillar 6), well-functioning labour markets (pillar 7), sophisticated financial markets (pillar 8), a large domestic or foreign market (pillar 10), and the ability to

harness the benefits of existing technologies (pillar 9). Finally, as countries move into the innovation-driven stage, they are able to sustain higher wages and the associated standard of living only if their businesses are able to compete with new and unique products. At this stage, companies must compete through innovation (pillar 12), producing new and different goods using the most sophisticated production processes (pillar 11).

Weights of the three main groups of pillars at each stage of development used in the Global Competitiveness Report are shown in Figure 2.

Pillar group	Factor-driven stage (%)	Efficiency-driven stage (%)	Innovation-driven stage (%)
Basic requirements	60	40	20
Efficiency enhancers	35	50	50
Innovation and sophistication factors	5	10	30

Fig. 2. Weights of the three main groups of pillars at each stage of development (Porter, Schwab, 2008)

According to the Global Competitiveness Report in year 2008/2009 Latvia, Lithuania and Estonia was in transition from Efficiency-driven economy to innovation-driven economy. That means that Baltic States have to do more activities in the field of business sophistication and innovation.

The Global Competitiveness Report ranked 134 countries according to the GCI score. Top 10 most competitive countries in the world are United States, Switzerland, Denmark, Sweden, Singapore, Finland, Germany, Netherlands, Japan and Canada (Fig. 3.).

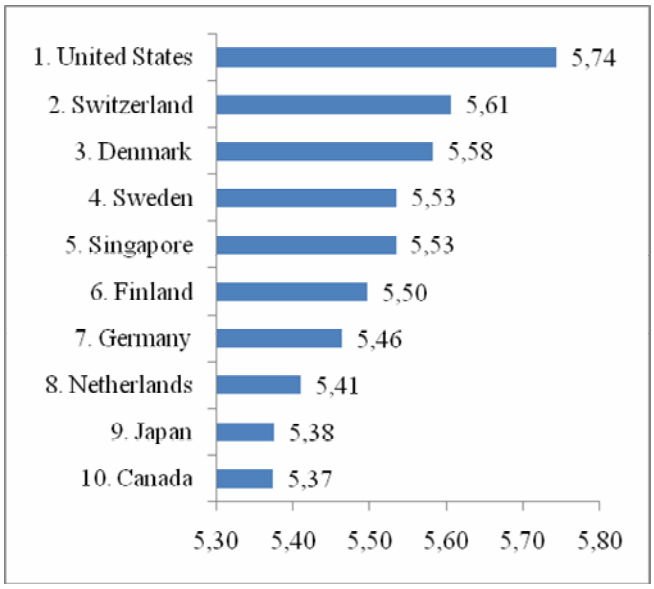

Fig. 3. Top 10 countries in competitiveness ranking, year 2008/2009 (Porter, Schwab, 2008)

Authors separately showed competitiveness ranking of Baltic Sea Region countries in Figure 4. In this Figure we can see that most competitive is Denmark, than follow Sweden, Finland, Germany, Estonia, Lithuania, Russian Federation, Poland and least competitive Latvia.

Consequently, several countries in the Baltic Sea Region score very high on World Economic Forum's Global Competitiveness Index with Denmark, Sweden, Finland and Germany in the top 10.

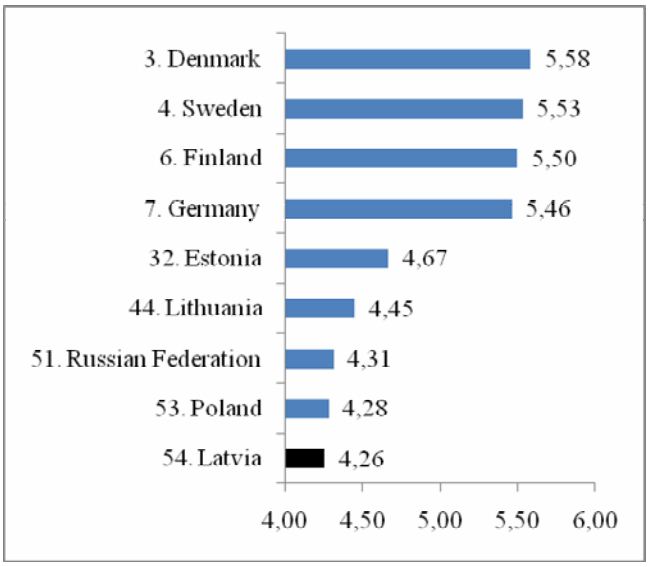

Fig. 4. Competitiveness ranking of the Baltic Sea Region countries, year 2008/2009 (Porter, Schwab, 2008)

According to the Dr Christian Ketels, Principal Associate at Harvard Business School, the key strengths of the Baltic Sea Region are its sophisticated companies, infrastructure and skill base, innovative capacity, and openness for competition at equal terms for domestic and international companies.

Despite its relative strengths, the Baltic Sea Region must prepare for an increasing global competition and worsening demographics, which threaten to erode its current competitive advantages over time. To remedy these threats, the Baltic Sea Region should draw more on its ability to cooperate across borders and work to integrate its business leaders closer in upgrading its competitiveness and business environment.

The real test for the Baltic Sea Region is whether it can create the mechanisms that will make its economies fit for the challenges of the future, such as global mobility and competition, demographic trends, climate change and increasing environmental challenges (Ketels, 2007).

Baltic Sea Region have four strong leaders in Region and very strong competitors in the world – Denmark, Sweden, Finland and Germany. The Baltic States are far behind. If Latvia is in such highly competitive region, than why it is only in 54th place in the ranking?

Answer to this question we can find in Figure 5. As we see, Latvia has lost 10 places in ranking since year 2006/2007.

	Rank (out of 134)	Score (1–7)
GCI 2008–2009	**54**	**4.3**
GCI 2007–2008 (out of 131)	45	4.4
GCI 2006–2007 (out of 122)	44	4.5
Basic requirements	**55**	**4.6**
1st pillar: Institutions	60	4.1
2nd pillar: Infrastructure	58	3.8
3rd pillar: Macroeconomic stability	71	4.9
4th pillar: Health and primary education	48	5.8
Efficiency enhancers	**47**	**4.3**
5th pillar: Higher education and training	33	4.7
6th pillar: Goods market efficiency	52	4.5
7th pillar: Labor market efficiency	32	4.7
8th pillar: Financial market sophistication	39	4.8
9th pillar: Technological readiness	41	4.0
10th pillar: Market size	79	3.2
Innovation and sophistication factors	**84**	**3.4**
11th pillar: Business sophistication	83	3.9
12th pillar: Innovation	93	2.9

Fig. 5. Components of Latvia's GCI, year 2008/2009 (Porter, Schwab, 2008)

Authors assess, that most critical results are in business sophistication (pillar 11) and innovation (pillar 12) area. If we compare business sophistication and innovation areas with other countries in transition stage, we can see that Latvia is losing positions to other countries (Fig. 6.). Authors in this paper further will discuss business sophistication area and possibilities to improve it in Latvia.

Quality competitiveness of Latvia

The European Union (EU) is a high wage region. A substantial portion of the high wages, as well as the costs for the social system, education, health and environment can be balanced by higher productivity. Cost increases have been successfully curbed by increasing the efficiency of institutions and markets through the reduction of transport costs, trade barriers and currency costs.

Nevertheless, cost restraints have a limit, and - as far as factor rewards (wages, profits) are concerned – to a certain extent also contradict the final goal of competitiveness, namely to increase the welfare of European citizens.

In addition, new competitors with much lower costs are arriving, be it the emerging economies or the accession countries. These competitors will always have lower absolute costs and, and usually even after correcting for productivity differences also lower unit labour costs. The consequence for a high wage country is to compete in quality. Here, pressure from the cost side is mitigated, since high wage countries have a competitive advantage: demand for high quality goods depends on disposable income and is therefore stronger in rich countries, providing them with a first mover advantage; additionally, resources in research and skilled labour support innovation. For firms, quality competition has the advantage that it enables high cost firms to remain competitive; margins needed for innovation can be earned, and price competition is mitigated. For countries, high wages become compatible with competitiveness (Aiginger, 2000).

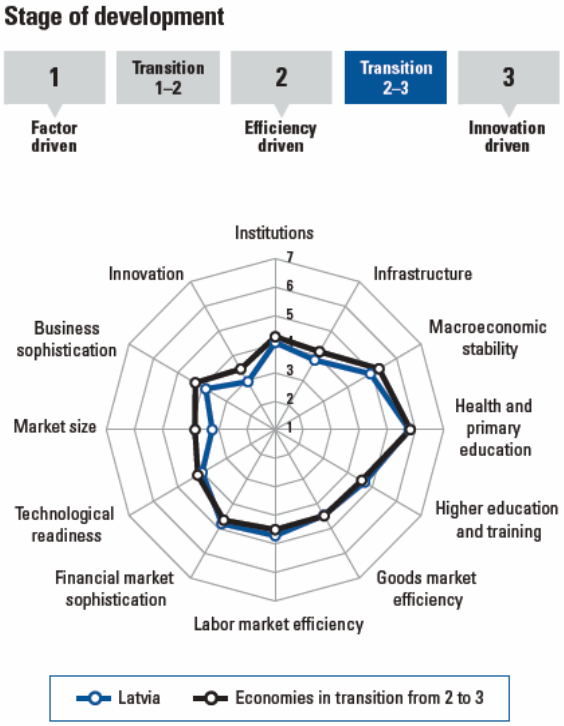

Fig. 6. Latvia's GCI components compared to other economies, year 2008/2009 (Porter, Schwab, 2008)

Figure 7 shows labour costs per hour in main economical areas of the world – USA, Japan, Europe and China.

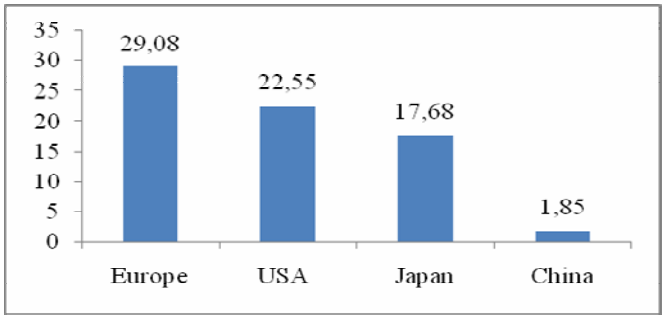

Fig. 7. Hourly compensation costs in manufacturing, EUR, year 2007 (United States Department of Labor, Eurostat, Eghbal)

Obvious, that Europe has the highest hourly labour costs and it is impossible to compete in prices with China.

If we explore labour costs in the Baltic Sea Region in detail, we can see that there is big dispersion (Fig. 8.).

As we can see in Figure 8, the highest labour costs in the Baltic Sea region is in Nordic countries: Denmark (31,80 euro per hour), Sweden (31,80 euro per hour) and Finland (31,80 euro per hour).

And the lowest costs of labour per hour is in Latvia – 3,58.

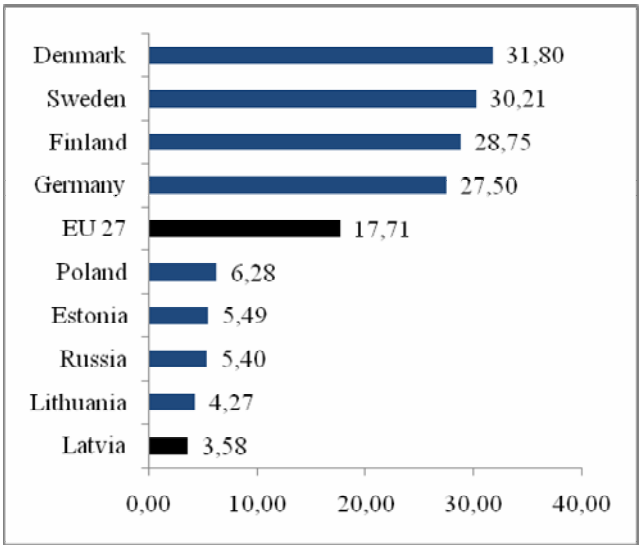

Fig. 8. Hourly labour costs in the Baltic Sea Region countries, EUR, year 2006 (Eurostat, Global production)

According to the statistics, Latvia has the lowest labour costs in the Baltic Sea region and one of the lowest in the EU (lower costs are only in Romania – 2,82 and Bulgaria – 1,71).

Labour costs in Latvia have grown very sharply since year 2000 (Fig. 9.).

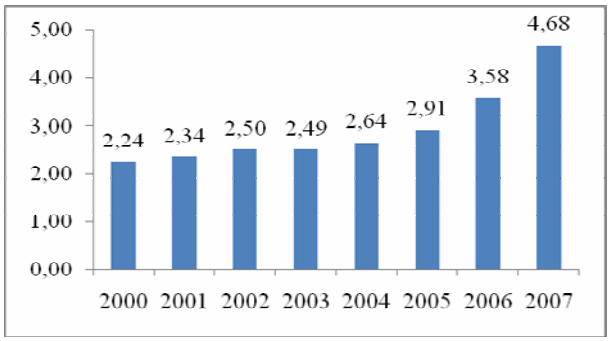

Fig. 9. Hourly labour costs in Latvia, EUR (Eurostat)

From year 2000 until the year 2007, labour costs have grown 108.93%, but the labour costs are still one of the lowest in the EU.

Karl Aiginger made investigation how Europe is positioned in quality competition in manufacturing. Manufacturing was chosen because author concentrated on manufacturing since the methods used to differentiate between high quality and high costs rely on the ability to measure the product physically (by weight). The data indicate that there is no immediate danger of European industries losing their mostly quality-based competitive advantages in foreign trade vis-à-vis the low cost providers; Europe has a surplus in manufacturing and specifically a large trade surplus vis-à-vis the accession countries and many emerging economies. A large part of this surplus can be attributed to Europe's ability to sell goods of a higher quality. Within the triad in general, goods of high quality are traded. Here, Europe is making progress in selling high quality goods; making inroads in important fields, although it still has a deficit in fast moving industries and productivity, and a slow speed of change. To increase income, Europe has to boost quality and productivity and increase its share of technology driven industries (Aiginger, 2000).

EU in general is very competitive region, but what about Latvia?

Authors used unit value of exports method developed by Aiginger to estimate the quality competitiveness of Latvia.

At this point authors will take a closer look on Latvia's export.

Exports of Latvian commodities in 2007 were by 22.7% higher than in 2006 in current prices, while in constant prices – by 8.3%. Exports of commodities exceeded the level of the corresponding period of the preceding year also in 2008 (January-November) (by 10.5% in current prices and approximately by 3.5% in constant prices). Imports and exports of Latvia are shown in Figure 10.

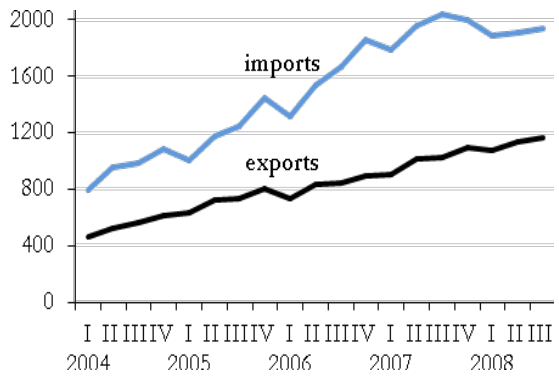

Fig. 10. Exports and Imports of Latvian Commodities by Quarters, million LVL (Ministry of Economics of the Republic of Latvia)

During three quarters of 2008, the commodity exports were favourably influenced by changes of trade conditions and the exports unit value index increased by 10.1%, but the imports unit value index – by 9.2%. Increase of exports unit value index was most substantially influenced by the rise of export prices for agricultural and food products, as well as the groups of products of chemical industry and metal-working products.

In the period of January-November of 2008, exports went up in almost all groups of goods, especially metal-

working products, which accounted for almost a half of the total growth of exports, as well as growth of exports of agricultural and food products (approximately one third of the total growth of exports), however, it should be noted that exports of wood and wood products rapidly decreased during this period and at present it has returned to the level of 2005.

Exports by the groups of countries are shown in Figure 11.

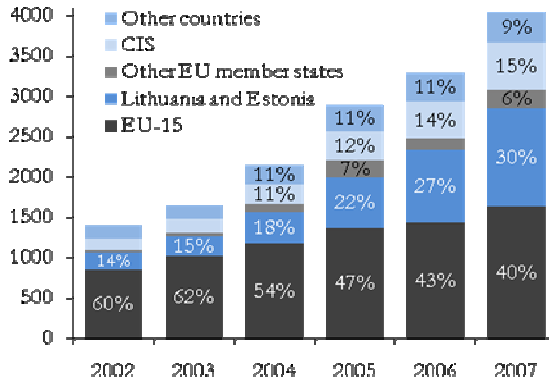

Fig. 11. Exports by Groups of Countries, million LVL (Ministry of Economics of the Republic of Latvia)

As we see in Figure 11, total export of Latvia is growing every year, but export share to the EU-15 is constantly decreasing and export share to the CIS is constantly increasing. That means that Latvia is exporting less to the countries with high incomes and more to the countries with relatively low incomes.

Authors hold a view that these changes in export structure are strongly related to the quality of the exported goods.

As we see 30 % of export in year 2007 was to Lithuania and Estonia. These countries are with a little bit higher incomes than Latvia, which means, Latvia can't manufacture goods with very high quality (higher price).

Authors decided to calculate Latvia's quality competitiveness in three markets: EU-15, Lithuania and Estonia, as these three markets compiled approximately 70% of all Latvia's export.

Authors will use unit value to estimate quality competitiveness of Latvia. The unit value (UV) of exports: this indicator is defined as nominal exports divided into kilograms. Higher unit values reflect higher willingness to pay for a given product, one reason for this is the higher quality in a market with vertically differentiated products. The unit value for an aggregate is higher if a country focus on more sophisticated or higher processed goods. We can call this indicator "indicator on overall quality" since it comprises many different aspects of product quality (Aiginger 2000).

First, authors calculated quality competitiveness of Latvia in Lithuanian market. Results are shown in Fig. 12.

As we see in Figure 12, Latvia has increased market share in the Lithuanian market, but the export prices has been very fluctuating. Correlation between the data is R^2=0,539, that mean that the correlation is weak.

Secondly, authors calculated quality competitiveness of Latvia in Estonian market. Results are shown in Fig. 13.

As we see in Figure 13, Latvia has increased market share in the Estonian market as well in Lithuanian, but the export prices has not been so fluctuating as it was in Lithuanian market. Correlation between the data is R^2=0,8336, that mean that the correlation is quite strong.

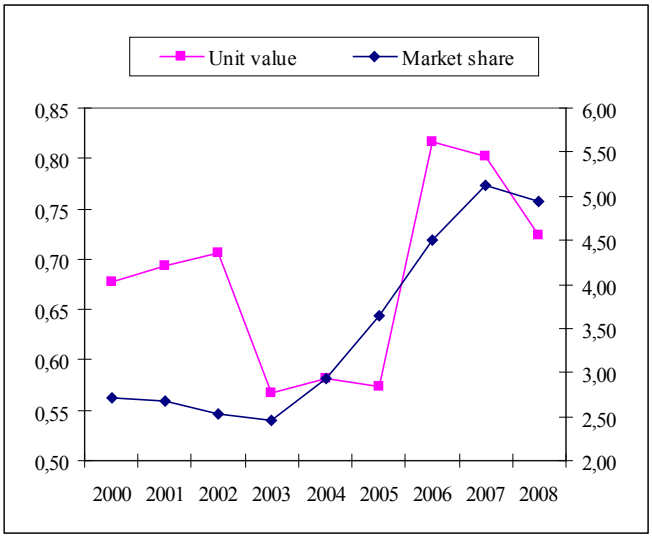

Fig. 12. Market share and unit value (euro/kg) of Latvia's exports in Lithuanian market (Eurostat)

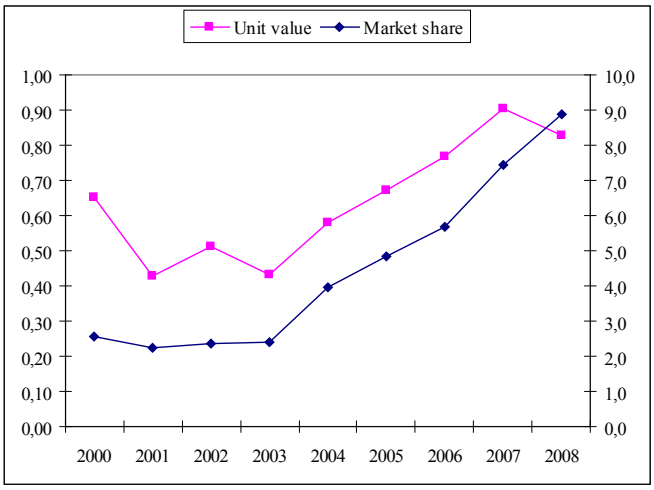

Fig. 13. Market share and unit value (euro/kg) of Latvia's exports in Estonian market (Eurostat)

In this situation authors agree with Aiginger: higher unit values reflect higher willingness to pay for a given product that means that Estonian market needs higher quality goods and Latvian manufacturers are offering that.

Thirdly, authors chose EU-15 market, which is biggest export market for Latvia. Results are shown in Fig. 14.

As we see in Figure 14, market share of Latvia's exports in EU-15 countries is quite constant, but unit value has increased very sharply since year 2005 until year 2007 (+150%) and decreased very sharply in year 2008 (-44%). Correlation between the data is R^2=0,0146, that mean that there is almost no correlation. Estonian market share in EU-15 countries is also quite constant, but unit value is increasing every year. Correlation between the data is R^2=0,3235. This correlation is higher than in case of Latvia, but there is still quite low correlation. Lithuania since year 2000 managed to increase market share in EU-15 countries and unit value as well. Correlation between the data is quite high R^2=0,532.

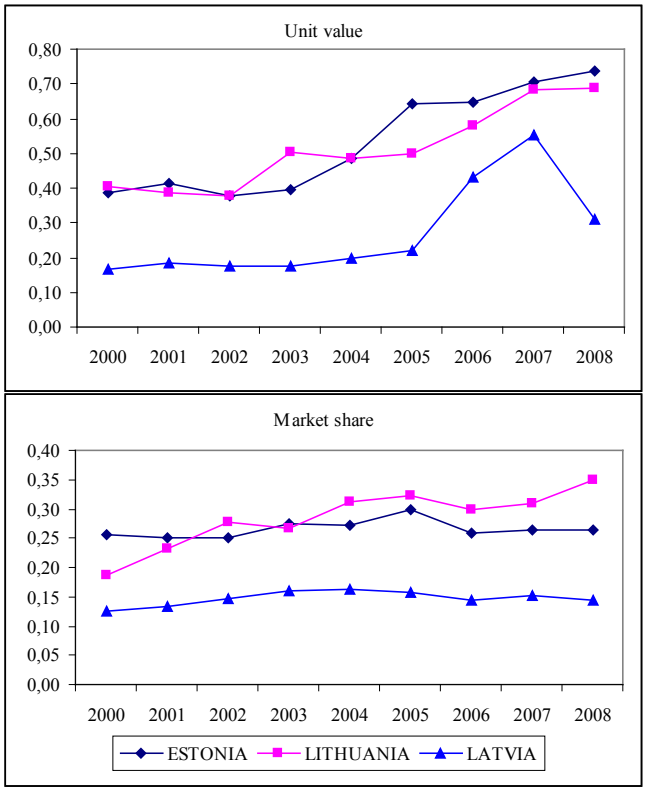

Fig. 14. Market share and unit value (euro/kg) of the Baltic States exports in EU-15 countries (Eurostat)

That is highest correlation within the Baltic Sates. Figure 14 also shows us, that Estonia and Lithuania has larger market share in EU-15 countries than Latvia, despite higher unit value. That means that Estonia and Lithuania managed to sell higher quality (higher technology) goods than Latvia.

Strategy to improve quality competitiveness of Latvia

Authors in the introduction indicated a problem of quality's place in the competitiveness and mentioned that Japanese entrepreneurs proved that quality is one of the main components of competitiveness.

What was the strategy of Japan in competitive struggle after World War II? History shows that quality of goods and business sophistication was main factors which brought Japan to the leading position in quality and competitiveness in the world. Of course, at the beginning low labour costs help Japan to conqueror markets with purchasing capacity (case with Japanese exports to the USA).

Authors hold a position, that this strategy is very effective – high quality goods and business sophistication and exports to the high income countries.

Authors will look a closer look at business sophistication in Latvia. As we cleared up – business sophistication is one of the positions, there Latvia should work on to gain more competitiveness.

According to the authors, one of the business sophistication indicators is ISO standards. The most widely used and recognizable is ISO 9001 standard (Fig. 15).

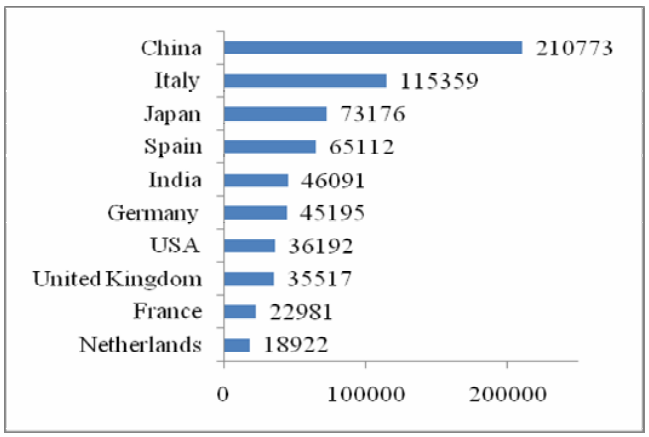

Fig. 15. Top 10 countries for ISO 9001:2000 certificates, 2007 (ISO Survey 2007)

As we see in Figure 15, China is leading country in the world by implemented systems ISO 9001. That shows that China is working very strongly on developing business sophistication in the country and that also helps to increase exports to other countries of the world.

In the Baltic Sea region countries the most certificates are in Germany and least in Latvia (Fig. 16). ISO Survey shows that in Latvia there was sharp decrease in certificates in year 2007, but Latvian Association for Quality still has data about more than 600 companies with certificate – authors can't explain differences in data. But still, as we can see in Figures 17 and 18, that Latvia is notable with great changes in annual growth on certification, comparing to Estonia and Lithuania, where we can observe gradualness and lasting growth.

If data about ISO 9001 certification in Latvia is correct than authors identify here a problem. The problem involves ability of Latvian companies to implement and maintain quality management system.

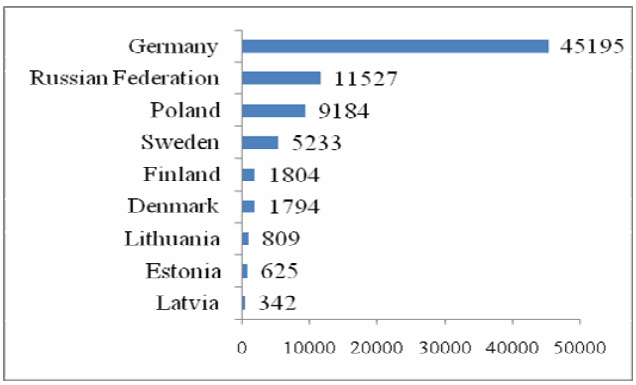

Fig. 16. The Baltic Sea region countries for ISO 9001:2000 certificates, 2007 (ISO Survey 2007)

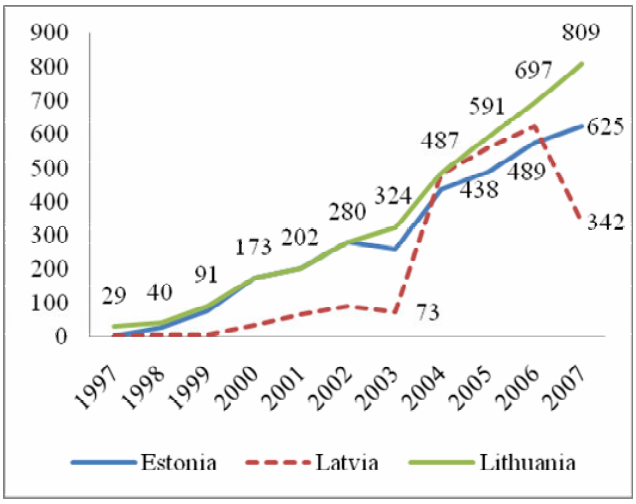

Fig. 17. The Baltic States for ISO 9001 certificates (ISO Survey 2000, 2003, 2004, 2005, 2006, 2007)

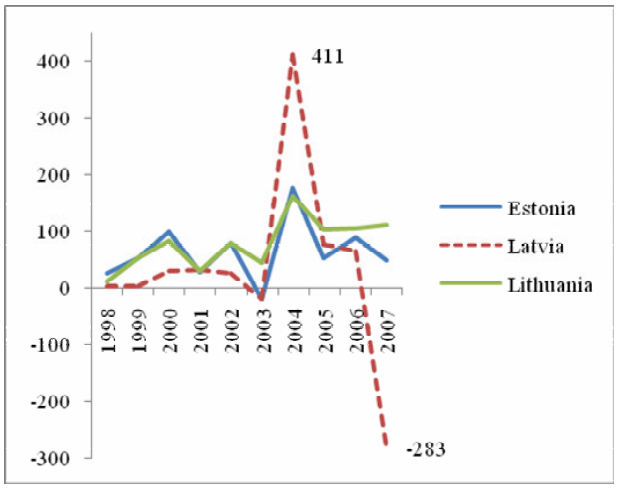

Fig. 18. Annual growth on the Baltic States for ISO 9001 certificates (ISO Survey 2000, 2003, 2004, 2005, 2006, 2007)

According to the authors Latvia should develop idea that government via Latvian Association for Quality (LAQ) promote quality movement. Government should increase funding of quality movement so LAQ could invite world's leading quality experts to read lectures for Latvian entrepreneurs.

Authors suggest making all these lectures available to the entrepreneurs - free of charge or very little fee. Especially important that would be for small and medium enterprises (SME).

Opinion about too commercialized quality movement in Europe holds also leading quality expert Juhani Anttila. He stated this problem at the 11th Annual International Quality Conference in year 2007, in Riga. He compared quality movements in Europe and USA, and admitted that in USA many things are free of charge and that promote quality movement and encourage entrepreneurs to make an interest about quality assurance and management to develop business sophistication.

For example, authors suggest lowering prices for different ISO standards. The most popular standard ISO 9001 costs 76 euro. If entrepreneur decides to certify system – that will cost extra (depending on the size of the company). Price lowering would favour that more standards reach the entrepreneurs and that will involve them in quality movement faster.

The same suggestion authors have for Quality Awards. Lowering the participation costs (630 euro for big companies and 350 euro for SME) will result in more participants and that will raise the competition and business sophistication within the Latvian companies.

Conclusions

Issues of competitiveness always have been important for countries and companies. Global Competitiveness Report is the most recognizable competitiveness comparison. This report shows that Latvia's weakest pillars are Business sophistication and Innovations.

Karl Aiginger's method uses unit value of exports to comparison quality competitiveness of countries. Calculations made by authors, showed that Lithuania and Estonia are more competitive in quality in EU-15 countries market than Latvia.

According to the authors, one of the business sophistication indicators is usage of ISO standards. The most widely used and recognizable standard in Latvia is ISO 9001 standard.

To promote quality movement in Latvia and encourage Latvian entrepreneurs to develop business sophistication, there should be actions made by government of Latvia. These actions should include funding increase for Latvian Association for Quality (LAQ), so LAQ could invite world's leading quality experts to read lectures for Latvian entrepreneurs. All these lectures should be available to the entrepreneurs - free of charge or very little fee. Especially important that would be for small and medium enterprises (SME). Price lowering for different ISO standards would favour that more standards reach the entrepreneurs and that would involve them in quality movement faster. Lowering the participation costs to the Latvian Quality Award will result in more participants and that will raise the competition and business sophistication within the Latvian companies.

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