

# Moving foreign business in a soviet office?

*Foreign firm relocation in a context of a post-communist city  
and changing consumer patterns*

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## Preface

A good geographer is, in my opinion, a geographer who wants to observe geographical events on a short distance, who wants to experience the cultural differences between localities, understand the differences between them and how they came to be in the past. These differences can be found in small aspects of life as for example making coffee by pouring hot water in a cup over coffee powder and letting the powder sink a while before drinking and not handing over money at the cashier but throwing it in a small plastic bin, but can also be found in more influential aspects of daily life like shops and so on being open on Sunday and major popularity of folk-music amongst even youth, expressing indecency and the way in which the three Baltic countries regained independency through the 'singing' revolution. The differences and explanations for such habits can for a large part be found in the local context. Even though the E.U is sometimes seen as a homogenic group of nations, with 27 member states and more on the way, differences are huge of course. Being an Erasmus/Marco-Polo, or whatever scholar-ship you were able to draw funds from, helps understanding and appreciating these differences but thankfully, it does not erode them.

In the case of my exchange program, I decided to visit Latvia, one of the newer member-states. As a new member state to the E.U. brings along new investment-opportunities for European based firms, firms will relocate in order to benefit from different advantages offered in these states. There is much literature on the international relocation movement of firms, however not much is known towards the local relocation of foreign branches of international firms. In this thesis, an introduction towards it will be given.

In the past months, working on this thesis has proven to be a challenge and it would have been almost impossible without help and insight of a number of different people I would like to thank. First of all, I would like to thank my supervisor Paul Van Steen at the Rijksuniversiteit Groningen for providing good advice on constructing my thesis, correcting spelling mistakes and many other aspects of course. I also would like to thank Hoimar Wotava in being a good team-mate in visiting institutions together to obtain information necessary for both our theses. Thirdly, I would like to thank Ieva Dubanevica and Agate Tunika for their much appreciated help in translating articles, sites and documents from Latvian and Russian to English and pointing out useful words for searching information. Of course, I would like to thank my parents in being supportive in the more difficult times during the last months of my research.

Last, but not least, I also would like to thank the many respondents who took their time in filling out the questionnaires and especially the many respondents who managed to make a moment for a questionnaire into an interview on locational aspects in Riga, for which especially the location-manager(s) at Lattelekom, Latvijas Balzams and Heise Immobilien GmbH. They provided me in essential insight on trends in Riga.

Thank you & Paldies!

Tjitse de Vries

Groningen, 15 June 2008

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## Summary

In this thesis, a number of topics on location and relocation have been researched. As a transition economy becomes more attractive to invest in, foreign investors will soon invest for different investment purposes [Nachum & Zaheer 2005]. As the economic situation in a transition country improves, so may the external environment of the firm influencing the suitability of its premises. As the suitability deteriorates, a firm will build up location stress until eventually, it relocates because the situation is no longer acceptable.

With the important position of foreign firms and FDI towards the transition economies, it is important to know if a decrease in locational quality of the city centre leads to migration of foreign firms away from the city centre to other locations or if keep factors prevent these firms from leaving their current locations. The understanding of locational satisfaction, the latent willingness of foreign firms to relocate plus underlying explanations and the preference of new developed locations can lead to knowledge of which locations foreign firms will relocate to. Understanding locational satisfaction and location preference of foreign firms will make a contribution for answering the question in what degree the spatial policy of Riga's city development office corresponds with the demands of foreign entrepreneurs.

The thesis focuses on the locational patterns of foreign firms, location stress of foreign firms and the latent desire of foreign firms to relocate within the city. For this purpose, research has been done on locations of foreign firms, a questionnaire has been held amongst foreign firms and the external firm factors have been explored.

The locational pattern of foreign firms in Riga is as follows. A major concentration of firms can be found in the centre of Riga and its centre-edges around it, as well as near major roads leading to the centre. This is attributable to a number of causes, being a high preference for locating in the centre amongst firms in general and the major supply of office-stock being located in the centre, due to the process of CBD-ization taking place in post-communist cities. Within the pattern, it can be seen that firms located in the centre seem younger than their counterparts located elsewhere indicating that the seed-pod model by Schiller may be applicable as well.

The outcome of the questionnaire is that the general level of location stress is low. At the moment, only a small part of the respondents is experiencing a degree of location stress which would lead to relocation. The main causes of location stress are bad parking space quality at location, insufficient space for expansion at location and bad accessibility of the location. These causes can be attributed to the dynamics of the Latvian economy through shifting consumption patterns. The remnants of 50 years of socialist planning practice act as a catalyst in this process, leaving the city with an outdated road network and outdated office-stock. Nonetheless, the post-communist structure of the city is also causing the firms to choose the centre as a new location as not enough alternate locations are available yet. A new spatial policy of the city of Riga, focused on developing alternate locations will likely break this circle though, as it is likely to force firms towards the new locations.

Another outcome of the research is that the respondents experiencing a high degree of location stress seem to have a more diverse choice on locations than firms with no stress, which usually seem to opt for a location within the current city centre.

## Abstract

In this thesis, an analysis is made on foreign relocation behaviour in the city and surroundings of Riga. The findings are that the foreign and domestic firms both tend to locate in the centre of Riga due to the preference to locate in the city centre as well as the post-communist structure of the city. Additionally, the location stress among the foreign firms is surprisingly low, but amongst firms experiencing a high degree of location stress, there is a shift in preference from the centre towards the edges of the centre and edges of the city. Furthermore, the dynamics of the Latvian economy are affecting the level of location stress through shifting consumer patterns, increasing car-ownership and suburbanization. These are being worsened through the remnants of fifty years of socialist planning practices, by means of a shortage of high quality office-stock as well as a shortage of good industrial business premises as a result of large Brownfield areas due to an over focus on industrial production during soviet times. It is demonstrated that these factors influence relocation behaviour.

## Introduction

With the independence regained from the Soviet-union, Latvia's economy has successfully transformed from a central-planned economy to a market economy and joined the European Union in 2004. As a result of an improving economic climate, the country has become more attractive for foreign investors, resulting in an increasing inflow of Foreign Direct Investment into different sectors.

Of the total amount of FDI attracted, sixty percent is located in Riga. Additionally, ninety-five percent of all foreign firms are represented in Riga as well. The capital of Latvia can therefore be seen as a magnet of foreign direct investment in the country.

As the economic climate of a transition country improves and consumer-patterns change, the suitability of location premises of foreign firms may change as well, due to internal growth/shrink processes, external development due to for instance increasing car-ownership and sub-urbanization may lead to location stress amongst domestic and foreign firms. At the same time, city development agencies are trying to redevelop the post-communist cities to meet spatial quality standards of today, resulting in spatial policy plans that in the case of Riga, are very ambitious. With changing suitability of business premises for firms, a post-communist structure and a spatial strategy trying to develop the areas outside the centre, locational preference of foreign and domestic firms may shift as well.

In this thesis, the goal is to determine the degree of location stress amongst foreign firms, to determine the location preference of foreign firms in case location stress would cause the firm to move and to compare the preferred locations with the spatial plan of Riga in order to determine the feasibility of the strategy. This will be done by means of analysing previous and current locations of firms, determine their main relocation motives, their appreciation of the current location and the preference of the new location based on the locations in which redevelopment should take place according to the city development office of Riga. This will be done by means of a questionnaire that will be distributed amongst foreign firms in Riga.

At the same time, the spatial structure of post-communist cities should not be disregarded as 45 years of socialist planning practices is certain to have influence on relocation behaviour of firms, acting as a constraint on firm relocation. Therefore, these aspects will be linked with the research findings throughout this thesis. Finally, these aspects will be linked in the final chapter, concluding how the relocation behaviour of foreign firms in Riga will be influenced.

## Chapter 1 – Introduction to the research

### ***Paragraph 1.1 - Introduction to the research theme***

With the disintegration of the Soviet Union in 1991, there came an end to the central planned economy of Latvia. Since then, the economy of Latvia is in transition towards a market economy. This is why in literature the economies of these countries are being named transition economies [Szirmai 2005]. The transformation from a central planned economy towards a free market economy is not easily accomplished. It requires numerous tasks, as no longer being a central planned economy does not immediately imply being a reliable market economy [Fabry, Zeghni 2006]. First of all, macro- and micro economic reforms have to be set up aiding the institutions in supporting the market economy plus facilitating the development of the private sphere on an internationally competitive base. Secondly - as some of these former Soviet countries wanted to become members of the EU - political stability had to be obtained and an efficient market economy had to be present, able to cope with the competitive pressure and market forces within the EU. Third, these countries have to deal with the challenge of globalisation. In order to succeed in this countries have to host inward FDI to stay competitive.

To achieve modernisation of an economy in transition, FDI may prove a solution. To present a clear picture on what FDI is, the definition of FDI according to the IMF has been quoted. It will be used throughout this document [IMF 2004].

*The fifth edition of the IMF's Balance of Payments Manual (BPM5) defines FDI as a category of international investment that reflects the objective of a resident in one economy (the direct investor) obtaining a lasting interest in an enterprise resident in another economy (the direct investment enterprise). The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence by the investor on the management of the enterprise. A direct investment relationship is established when the direct investor has acquired 10 percent or more of the ordinary shares or voting power of an enterprise abroad.*

Foreign direct investment can bring financial resources into a country without increasing the volume of debt. It includes a complete package of finance, management experience, transfer of technology and skills, marketing expertise and access to world brand names and world markets [Szirmai 2005, p 544]. These sources do not only stay in the foreign enterprises, but diffuse into the region or sometimes even in an entire industry sector.

However, there are also disadvantages to FDI. FDI has a rather footloose character. In some sectors and economies, multinationals enter the economy in search of low-cost labour but leave when wages elsewhere are lower [Szirmai 2005]. Additionally, the benefits of multinationals and host countries are usually not evenly divided. Acquiring enough benefits as a host country is dependent on the bargaining power of the host economy. Once a multinational has committed its resources and the host country has gained more experience, the latter's bargaining position can improve, but till then they have a weak position towards large MNE's. Finally, the hosting of FDI has been known to decrease domestic competition when too many firms are taken over by MNE's, which leads to the process of crowding out domestic entrepreneurship [Szirmai 2005].

Liberalising of the economy and breaking down restrictions on foreign direct investment led to the successful inflow of FDI into Latvia. The update on the economy of Latvia in 2006 - published by the Ministry of Economics - states that in the previous 5 years almost thirty percent of investments can be classified as FDI. Of all obtained foreign capital, the biggest share was obtained by means of FDI. Per September 2006, the FDI stock of Latvia was 3639.6 million Lats, which covers thirty-four percent of the gross domestic product. Seventy-five percent of FDI has its origin in the European Union. Especially since the accession to the European Union, FDI inflow has made some significant progress as can be seen in the graph below. Compared to 2003, the inflow of FDI in 2004 has almost doubled and in 2006, inflow increased with one hundred-twenty-six percent compared to 2004.

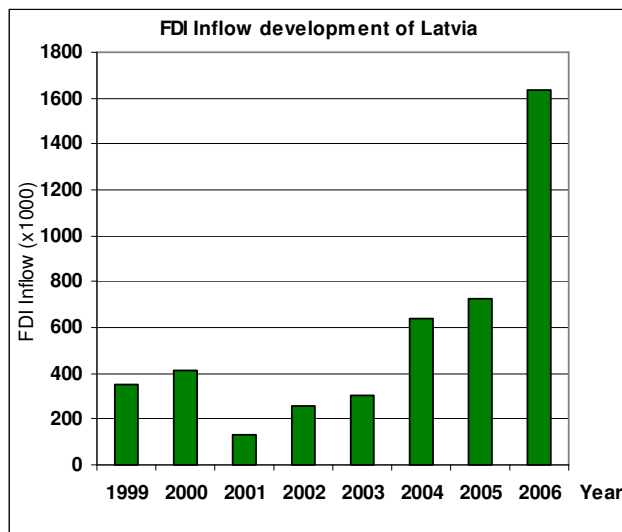


Figure 1.1: Annual FDI Inflow of Latvia, Source: UNCTAD 2007

The sectors receiving the highest share of FDI inflow are the commercial and financial sector [Ministry of Economics, 2006]. These sectors are typically sectors that produce for a national market, as services are usually consumed at the place of production. This means a lot of FDI projects are based on market seeking behaviour. In attracting FDI-inflows towards the economy of Latvia, the city of Riga has a central function. In the following graph, it is stated that seventy-six percent of FDI is located in Riga and ninety-five percent of foreign firms are represented in Riga. This makes Riga an important investment location. In combination with the fact that commercial and financial sector have the highest share in the FDI sector and the underlying market-seeking motives, it is obvious that these companies settle in Riga. The urbanised area of Riga represents forty percent of the population of Latvia. The municipality thirty-two percent.

The annual FDI inflow has increased greatly since the accession to the EU. As can be seen, there already was a reasonable inflow of FDI beforehand, often received in form of investment projects and partly in form of privatisation of state enterprises. It therefore can be assumed that a large part of the foreign funded enterprises has been operating in Riga for a longer time and may have inherited locations of purchased firms. The observation that a number of FDI projects may be based on market-seeking behaviour is an indication that Latvia is experiencing a change in consumer-preferences. One of these changes is the increasing use of car-ownership [Tosics 2004] that is being seen in all post-communist countries, causing cities and their centres to become less accessible and therefore less suitable for foreign firms.

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Riga's proportion in the national economy (in %)

Repres. of foreign enterprises	95
Stock capital of enterprises	77
Foreign investment	76
Value added	58
Industrial products	50
Number of employed	48
Non-financial investment	47
Number of inhabitants	32

Figure 2: Source Riga City Council



With the rapid economic development that Latvia has seen in the past years [Ministry of Economics 2006], the shift towards a consumer orientated economy that all post-communist countries have experienced [Tosics 2004] and a number of firms that have been active in Riga for a long while already, business locations of foreign firms may become unattractive due to various developments in or outside the firm. Another possibility is that the location of a foreign firm that has been acquired is not seen as appropriate by the new management. Relocation therefore may occur. The relocation of a firm can be seen in different perspectives and the reason to relocate can be attributable to a variety of reasons. One approach on studying relocation is the perspective of push, pull and keep factors. Push factors are reasons to leave the current location and pull factors are reasons to choose a specific location. Keep factors are reasons that keep firms at their current location. The most important push-factor amongst relocating firms is lack of space for expansion. The second most important factor is that the current premises is no longer regarded representative [Van Steen 1998]. For a more elaborate explanation it is advised to consult this publication.

Migration behaviour of firms can also be explained according to the model of Lloyd & Dicken (1997). According to this model, the migration of firms can be explained by three factors. These factors change over time and as a result can make a business location less or more optimal for the firm. These factors are:

- Firm internal factors (management quality, organisational targets, owner-structure, sales growth, job offers and obtained profit)
- Locational factors (absolute & relative characteristics like lot-size, space for expansion, distance to customers and suppliers)
- Firm external factors (government policy, regional economic structure, technological processes)

Due to the above mentioned factors it can be that a foreign firm in Riga or surroundings is no longer satisfied with it's current location. It could be due to decrease in accessibility of the city centre for firms, rising real estate prices or other factors. As such, the question can be raised what the effects stated above have on the locational behaviour of international firms. With the important position of foreign firms and FDI towards the transition economies, it is important to know if a decrease in locational quality of the city centre leads to migration of foreign firms away from the city centre to new locations or if keep factors prevent these firms from leaving their current locations. The understanding of locational satisfaction and the latent willingness of foreign firms to relocate plus the underlying explanations and the preference of new developed locations can lead to insight in which locations foreign firms will migrate to. Understanding locational satisfaction and location preference of foreign firms will make a contribution for answering the question in how far the spatial policy of Riga's city development office corresponds with the demands of foreign entrepreneurs.

Therefore, the subject of this research is locational satisfaction and location preferences of foreign firms in Riga and direct surroundings. For this, research will be done into the degree of location stress of foreign firms with the purpose of achieving insight the location preference of foreign firms and how the spatial policy of the city of Riga resembles the preference of foreign firms. Due to firm internal factors, locational factors and firm external factors, the locational satisfaction of foreign enterprises can improve or weaken. Lower locational satisfaction can lead to relocation behaviour of foreign firms in the area of Riga or possibly somewhere else.

## ***Paragraph 1.2 - Research goal definition***

The goal of this research is divided into two sub-goals. These are as follows.

- Analyse the location pattern of foreign enterprises in Riga and surroundings and explain why these enterprises are located here.
- Determine the degree of location stress plus the underlying motives and determining to which locations relocation movement will occur.

With the research goals of the thesis established, the following research questions can be distinguished.

1. What is the location pattern of foreign enterprises in the municipality of Riga?
2. Is there an explanation for the found pattern in literature?
3. At which locations, which entrepreneurs experience a high degree of location stress and what is the cause?
4. Which locations are being preferred in the case of a high degree of location stress?
5. A )Is there a proportion in the sample which has relocated in history?  
B) What was the reason for this proportion of firms to relocate?  
C) Do these reasons match the findings from the literature?
6. Do the locations of preference match the locations stimulated by the City development Office of Riga?

## ***Paragraph 1.3 - Research methodology***

The research has been done on the basis of a database of 156 enterprises with foreign background. The database has been assembled on an ad-hoc base. As a result, the list might not be representative and no general conclusions can be derived from it. On basis of this list, a location pattern has been assembled to determine if there was a spatial pattern. Additional data has been collected by means of a questionnaire since there was no data source which could provide answers to these questions. After this, a route was being derived to visit these locations to take interviews or pass-out questionnaires. Answering the first research question made it clear that visiting all 156 locations by foot or public transport was impossible. So was calculating an optimal route due to problems arising which can be described according to the travelling salesman theory. To solve this problem, it has been decided to visit only the firms in the city centre and address firms on the edges of Riga by means of telephone and send the questions by e-mail later on. Although the response rate on questionnaires by e-mail is very low, it was the only possibility which was feasible at the current circumstances.

The questionnaire has been set up according to the push, keep and pull factor model because this model is less complex as the model of Lloyd & Dicken. The model of push & pull factors also addresses the issue of relocation better than the model of Lloyd & Dicken to my opinion. The model of Lloyd & Dicken describes location factors more in detail but does not specifically address the issue where firms move to. Because of this, the push- and pull model was used.

After collecting the questionnaires the results have been processed in SPSS. In total, 54 questionnaires were returned, bringing the response total at around 35%. These results can be used for determining the location satisfaction and the degree of location stress. First, all numbers of negative awarded aspects have been counted, resulting in a number indicating

how many aspects of the location are rated negatively. However, as not all factors have the same influence on the decision to relocate, the negative factors have been awarded a number of points based on the likeliness of contributing to relocation<sup>1</sup>. Based on numbers by Van Steen [1998] and Louw [1996] on the likeliness that firms will relocate due to a negative location aspect, a score of 3, 2 or 1 points has been awarded. 3 points for negative aspects that are highly likely to cause relocation, 2 for likely aspects and 1 point for aspects that may cause relocations.

Of the 100 non-participating firms, these locations can also be used for establishing the spatial pattern and answering the question why they are located at this specific location. Next to SPSS, data has been analysed with ArcGIS. Information in the form of vector- files has been provided for the street grid, building locations, railway stations and building zoning plans with permission of the University of Latvia. Additional information on public transport routes of bus, trolley-bus and tram has been obtained from the site of “Riigas Satiksme” being the public transport company of Riga.

Data and spatial policy plans have been collected by means of interviews with policy makers of the City Development Office of Riga and consulting the planning strategy for the city of Riga till the year 2025. These data sources have provided the basis for determining which locations are available for firms to relocate to and their spatial quality. This information has also been used to give respondents their view on the locations which where to be developed and to which location they would give preference and why.

In the following chapter, an additional review on relocation theory of firms will be given. The goal is providing some additional insight to the reader on relocation theory.

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<sup>1</sup> Applying both methods and comparing them, does not really influence the number of firms experiencing location stress in the sample. The difference was 2 firms. However, these firms did experience factors that are major contributors to location stress.

## Chapter 2 – Theoretical Framework

### ***Paragraph 2.1 – Introduction***

In the following chapter, a brief review on the literature of firm relocation, international investment behaviour of firms and developments that take place in post-communist cities, will be given. In paragraph 2.2, a brief review will be given on the theme of relocation of firms. What exactly is relocation; is a firm likely to relocate during its life, where will it relocate and what are the various sorts of relocation of economic activities that can take place.

In paragraph 2.3, the topic is the various sorts of investment motives that currently dominate the international investment flows, how these motives influence the decision to relocate on a certain location and to what locations the various investment motives match.

In paragraph 2.4 the focus is on the various streams of location and relocation behaviour of firms. A review will be given on the various approaches towards relocation and a choice will be made towards which stream seems the most suitable for researching the questions at hand.

Paragraph 2.5 will be on the underlying push- pull and keep factors that influence the decision to respectively leave current location, choose the new location or stay at the current location and various other aspects towards the relocation behaviour of firms.

Conclusively, in paragraph 2.6 the topic of the location quality in post-communist cities is at hand. The location quality of many post-communist cities is still influenced by its socialist planning period and this has had significant influence on the location quality for business premises, as will be seen in paragraph 2.6.

### ***Paragraph 2.2 – Relocation, a phase in the life of a firm***

Firms relocate. Whether for relocating entire production locations, parts of production chains, or through reorganisation of business products, the relocation of firms is something that is happening quite frequently.

In a study amongst Dutch firms, held in 1997, it became clear that around eight per cent of Dutch enterprises changed addresses [Pellenbarg 1997, Van Steen 1998], influencing around 180.000 jobs. Most relocations occur within the same region, as 70 per cent of the relocated firms can still be found in the same municipality [Van Steen 1998], although some have longer distances. Nonetheless, relocation is a likely event to happen during the life of a firm.

The decision of a firm to move depends also on the investment made at a location. It can be said that through investments, firms are chaining themselves towards a certain geographical space. Firms that do not invest are dependent on the offer of the rental market at the location of choice [Van Steen 1998].

#### **The definition of relocation**

The first question applicable may be what relocation exactly is. There are numerous articles addressing the definition and forms of relocation [Mariotti 2005]. According to Mariotti, spatial moves can be categorised into three categories, namely intra-regional relocations, inter-regional relocations and international relocations. Intra-regional relocations can be described as moves in urban agglomerations. Inter-regional relocations are relocations from one region to another. Finally, international relocation can be seen as locational adjustment of economic activities from one country to another. The three types of relocation are described in *figure 2.1*.


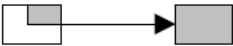
Types	Spatial scale		
	INTRA-REGIONAL	INTERREGIONAL	INTERNATIONAL
Integral relocation 	✓	✓	✓
Partial relocation or delocalisation (branch movement) 	✓	✓	
Foreign direct investment (FDI)			✓
International Strategic Alliance (ISA)			✓

Figure 2.1: The different types of relocation according to Mariotti Source Mariotti 2005

Two types of relocation are distinguished under inter-regional and intra-regional movement which are integral and partial relocation. According to Mariotti [2005], integral relocation is a form of relocation that is mainly used by single site firms and found on local scale as firms want to stay close to the original location to keep local suppliers and workforce. Partial relocation is mainly found amongst larger firms who want to differentiate their production in particular areas, taking advantage of the most favourable locations. It involves the opening up of a new branch plant that is linked to the existing plant, which keeps operating [Mariotti, 2005].

### International relocation of economic activities

The international relocation of economic activities (research/production/marketing) towards foreign countries can occur through foreign direct investment and through international strategic alliances (ISA) [Leamer 1998, Mariotti, 2005]. The definition of FDI has already been given. There are, however two forms of FDI as firms may invest in new factories or machinery, called Greenfield investment or invest in existing firms but the latter is the most occurring form nowadays [Szirmai, 2005, p. 341]. An international strategic alliance involves cooperation with another firm operating in a backward, forward or same stage of the production chain, to distribute, develop and/or produce on a foreign market [Gemser et al 2004, Mariotti 2005]. There are different forms of ISA's: *non-equity* strategic alliances, *equity* strategic alliances and *joint ventures* [Dunning, 2001, Mariotti 2005], however they do not lead to the creation of an offshore firm. Nonetheless, both types of international relocation forms have an important role to play in an ever growing world economy, with different pieces of production chains relocating to different locations [Szirmai 2005, p.340].

### The international relocation of the firm

Export may be the first thing that comes to mind when thinking of internationalization and for firms with international ambitions it is typically the first move to enter a foreign market [Buckley 2000, Mariotti 2005]. According to Mariotti, internationalization is becoming more popular for small and medium enterprises, similar to that of multinational enterprises. With the accession of new member states to the European Union, small and medium firms are using the increasing location opportunities offered, to relocate parts of their activities [Mariotti 2005]. This would provide the basis motivations for establishing new firms in the new member states, c.q. the Baltic States.

Based on Buckley [1989], Hollenstein argues that most of the analyses on the internationalization process of small and medium enterprises have in common that these firms

face higher resource constraints compared to large firms in terms of finance, information and management capacities” [Hollenstein 2005]. They also experience entry barriers like market imperfections and regulations [Acs et al 1997, Hollenstein 2005] and as a result, smaller firms are less likely to deploy international economic activities than large firms.

According to Hollenstein, the same reason can be given for the ownership mode of entry to a market. SME’s will often choose for contractual agreements and in the case that internationalization is equity based; it is likely it involves minority stakes. The contrary however is true for large firms [Berra et al 1995, Mutinelli et al 1998, Fujita 1995, Hollenstein 2005]. Therefore, it can be said that ‘soft forms’ of internationalization are a way to overcome the constraints that small firms have towards their larger counterparts [Hollenstein, 2005] and therefore, the way of investment or relocation of economic activities is dependent on the size of the firm. As already indicated above, there are many ways how the relocation of economic activities can be achieved, as can be seen. Nonetheless, since the different forms of internationalization by contractual form are not the topic of discussion, the above described classification is more than sufficient.

### ***Paragraph 2.3 - The relocation behavior of economic activities***

In the following paragraph, a review of relocation theories will be given. There are four main streams of literature discussing the relocation behavior of the firm. These are the neo-classical approach, the behavioral location approach, the institutional location approach and the evolutionary approach [Mariotti 2005].

In the literature on relocation of firms, history has brought a number of perspectives on the relocation. Although the final two decades have brought a wide spectrum on theories and approaches, none of these contributions offers a so to say ‘grand theory’ as Pellenbarg formulates it [Pellenbarg 2002, Scott 2000]. There are four categories. These are the neo-classical, behavioral, institutional and evolutionary approach [Mariotti 2005]. Difference between the first and the last three theories is that the neo-classical approach assumes the entrepreneur to be a homo economicus. All four however tell us that personal characteristics of the entrepreneur, personal and business relationships and cultural influences in the spatial economic setting have an important role to play [Mariotti 2005, Brons & Pellenbarg, 2003].

There is however a difference between location theories and relocation theories. Firm relocation theories differ from location theories because they are about the movement from one location to another [Mariotti 2005]. In the case of location theories just one location is chosen. Relocation theories thereby consist of two steps. The first step is to make the decision to relocate; the next is the decision to relocate to another site [Mariotti 2005].

In this view, the international relocation to the city of Riga can be seen as the creation of a new firm as well as an international relocation of activities but the relocation that occurs as a result of economic dynamism and firm internal changes can only be seen as relocation behavior on intra regional scale, neatly corresponding with figure 2.1. The group of location theories is therefore only interesting in explaining the first location, whilst relocation theories can provide the necessary insight in explaining the movement found under foreign firms located in the city of Riga.

#### *The neo-classical approach*

Based on Mariotti [2005], the neo-classical approach is an approach based on the assumption that there is a model for finding the optimal location of the firm or more firms, based on economic assumptions. It assumes that the entrepreneur is a homo economicus which means

he has complete information, the ability to use it to the maximum and able to maximize the profit of the firm [Mariotti, 2005]. Human and personal characteristics/preferences do not have a role in this approach as it is based on explanatory models of cost reduction, determining the optimal location of the firm. There is much criticism towards the neo-classical stream of theories [Mariotti, 2005]. First of all, it does not seem realistic and mathematical models seem hard to apply in the real world and in geography [Meester & Pellenbarg, 2004]. The neo-classical theories were more focused on the development of elegant theories based on location equilibrium and looking for a way to combine location and production theories, instead of looking for an empirical based approach for research [Mariotti, 2005]. It is therefore not an approach that seems suitable for analyzing the motives on why multinational firms in Riga, are relocating.

### *The behavioral approach*

As a result of criticism on the neo-classical theory, a behavioral theory of the firm was developed [Mariotti 2005]. As Mariotti says, the idea of optimal decisions is a theoretical abstraction [Simon 1959 Mariotti 2005]. Decisions are made without perfect knowledge and sub-optimal outcomes are good enough. In other words according to Pellenbarg, optimizing behavior was replaced by satisfier behavior. [Pellenbarg 2002]. More interestingly, the behavioral approach is focused on firm relocation instead of location. This means that, additionally to the pull-factors, there is also the push-factor to distinguish [Pellenbarg, 2002].

Based on the thought of a decision to relocate and the decision to choose a certain location, a number of models have been developed where the process of relocation is subdivided into more than two phases. In a number of different models, Pellenbarg distinguishes four different stages [Pellenbarg 2002];

These are the following:

1. the decision whether to move or not
2. the search for the alternative locations
3. evaluation of alternative locations
4. choice of the new location

*(A fifth stage might be added in which the implemented decision is assessed and evaluated).*

**Box 2.1: different stages in the relocation process of the firm. Source: Pellenbarg 2002**

Additionally, the behavioral theory does not only feature the decision relocation process. It is also based on four other key assumptions being: “1) *the role of limited information*, 2) *the ability to use information*, 3) *the perception and mental maps* and 4) *uncertainty*” [Pellenbarg 2002, Mariotti 2005]. According to Pellenbarg, the behavioral theory tells us that it is not only reality self that matters but also the perception of reality that influences decisions. These decisions are made on basis of mental maps and the perception of the geographic areas [Pellenbarg et al, 2003]. Based these principles of limited information, limited ability, perception and uncertainty all lead to a large spatial bias in relocation decision making. Distant locations will be chosen less as they less known and therefore are harder to imagine than nearer places. As a result, nearer locations are chosen more frequently. Additionally, as Pellenbarg writes [2003] “there is a strong distance decay in mental maps, caused by the lack of information and he perceived attractiveness of the place” and finally, the investment decision is also influenced by expectations about the future. Uncertainty is therefore not only caused by a knowledge gap or ability to analyze the information at hand [Pellenbarg et al, 2003].

Interestingly, the international relocation of firms has a great chance that it will involve great distances, as they cross borders. However, the larger the relocation distance, the larger the amount of uncertainty involved [Pellenbarg 2002]. To make the step to relocate economic activities internationally makes it apparent that there must be strong push and pull factors involved.

Within the behavioral approach, much research has been done after push- and pull factors that give detailed descriptions of motives and reasons for moving, both on push- and pull side of the process [Pellenbarg 2002]. They will be discussed later on in this chapter.

#### *The institutional approach*

“The institutional approaches are based on the assumption that economic processes in space are mainly shaped by society’s cultural institutions and value systems [Thrift and Olds 1996, Krumme 1969, Mariotti 2005]. In institutional approaches, emphasis is laid out on the interaction of firms, instead of the individual behavior and as a result, relocation behavior is attributable to the result of a firm’s investment strategy and its outcome of negotiation with suppliers of inputs, government, infrastructure and other key institutions that are necessary in the production process [Mariotti 2005]. However, the institutional approaches are less relevant for relocation [Pellenbarg 2002] and therefore, there is not much to discuss around this stream of theories.

Notwithstanding, there are some aspects that in light of findings in this research can shed some light on the relocation of firms in the centre of Riga. There are two types of institutions that are important for (re)location behavior of small and medium sized enterprises, being governments and the real estate market [Pellenbarg 2002]. Governmental facilitating factors are for instance infrastructure, zoning subsidies and tax reductions. Fiscal incentives and subsidies may decrease local cost surface and as a result these locations may now be profitable [Pellenbarg 2002]. The fiscal incentive program, applicable to the Freeport of Riga, is a good example of this.

More interesting is the role of the real estate market. The real estate sector is an important facilitator for firm relocation [Ball 1998, Pellenbarg 2002]. Especially for small and medium sized firms, the market acts as a facilitator for business locations since, as Louw puts it, these are usually dependent on existing demand on the real estate market for commercial property [Louw 1996]. The spatial characteristics of supply of real estate are therefore very important for understanding the choice of location of small firms, as well as the role of commercial real estate developers [Pellenbarg, 2003]. Since a number of FDI projects involve real estate agencies, the relocation of economic activities itself may well have influence on the relocation of other foreign firms. From this perspective, an institutional approach might prove to be interesting.

#### *Evolutionary approaches*

The evolutionary approach towards location and relocation choices is, as Mariotti writes [2005] a relative new one which approaches economic geography by means of ‘Darwinian biology. It applies concept’s like variation, selection and path dependence on spatial economic development [Mariotti 2005], resulting into the introduction of innovation, competition and routines in the economy. Path dependence can be described by means of the unwillingness of the firm to deploy activities out of its current portfolio and processes (new markets, new products, new techniques) on which they have little experience, or to change location [Pellenbarg and Brons 2003, Pellenbarg 2002]. However, in management literature they are encouraged to enter new fields of activities [Hamel & Prahalad 1995].



Nonetheless, the firm tends to cling to the current path, knowledge and experience it acquired in operating on its current markets, ignoring other less certain ways to achieve profits [Mariotti, 2005]. Still, according to management literature, a firm that wants to achieve prime or second position on its market should consider this way nonetheless [Hamel & Prahalad 1995]. As quoted: *The behavior of firms as a result may lead to lock-inn's, unexploited opportunities and sub-optimal behavior* [Boschma et al 2002; Brons & Pellenbarg 2003, Mariotti 2005] and it may eventually lead to the demise of a firm [Hamel & Prahalad 1995]. As the source of success of these firms lies in the informal knowledge and the roots they have in the region, firms are less willing to move out of their setting [Boschma & Frenken 2004]. It is because their competitive advantage, based on knowledge, routines and competencies are devised in the past, in this specific region. Leaving the region would then be abandoning the competitive edge of the firm [Boschma and Frenken 2004, Mariotti 2005]. So, 1), location choices are not made by firms or consumers, but take place due to localized knowledge and the presence of historical concentrations and, 2) due to locational inertia and path-dependence, firms are less prone to relocate. [Mariotti 2005]. However, due to the relative novelty of the approach, it has not delivered any statements on geography yet [Mariotti 2005] and can therefore not provide a real useful contribution to the analysis in this thesis.

### ***Paragraph 2.4 - Description of pull, keep and push factors***

Although there is criticism towards the behavioral approaches, treating the environment as a static plain and the entrepreneur as an active agent, there is a large body of literature that can provide detailed descriptions of motives and reasons for moving both on push- and pull side of the process [Mariotti 2005].

#### *Push-factors*

There are different motives for firms to decide to relocate [Van Steen 1998]. One method is to distinguish motives based on push- and pull factors [Lukkes 1988, Van Steen 1998]. According to Lukkes, push factors are factors that create the desire to leave or the inability to stay at the current location. Push factors can be divided into firm-internal push factors and firm-external push factors [Lloyd & Dicken 1977]. According to Van Steen (1998) firm-internal factors are considered more important in generating relocation movements than location specific firm-external push factors.

Following Van Steen (1998) firm-internal factors attributable to a relocation process can be changes in the product-portfolio, increase or decrease in production or changes in production and technology processes [Van Steen, 1998] Additionally, changes in distribution or marketing strategies and processes can also be seen as firm-internal factors. And finally, in firms with multiple locations, management decisions concerning the spatial rearrangement of activities can influence the relocation of parts of the firm significantly. The trend of global production chains running and changing across the entire world, made possible by increasing flows of FDI [Szirmai 2005, pp. 340], is a good example of relocation of certain firm-activities of the firm. Firm-external factors also create the desire to leave, or the inability to stay at the current location. The difference with internal factors is that the reasons to relocate are attributable to absolute or relative changes in the location premises [Van Steen 1998] due to changes in necessary inputs (labour, relocation of suppliers), outputs, characteristics of premises, lack of expansion space, not representative premises, decreasing accessibility or aspects regarding the social or political spectrum.

In a survey, conducted by Van Steen (1998), it showed that the most frequently given push factors in general are lack of space for expansion and unrepresentative premises. A listing of the ten most important factors is in *table 2.1*.

Rank	Push factor	Percentage Push-factor applicable
1	Impossibility to expand	77%
2	Limited representativity	31.6
3	Parking facilities	29.4
4	Room for logistic activities	25.7
5	Accessibility by car	17.4
6	Location position towards customers	10.4
7	Location position towards suppliers	4.8
8	Quality of living-environment	4.3
9	Demolition/"onteigening"/sale/calamitie	3.6
10	Merger/reorganization	3.4

**Table 2.1: Push factors of the most recent relocation of firms. | Source: Bedrijvenlandschap 2000+ (1998)**

The most occurring relocation reasons are the impossibility to expand, limited representativity of the premises, lack of parking facilities, room for logistic activities (delivery and supplying of necessary goods for the production process) and accessibility by car. These factors have a relative high role in decision to relocate and it is unlikely they have disappeared completely. They actually still match with the two major push factors being the limited expansion space and limited representativity of the present location [Pellenberg 2002].

### Pull factors

Following Van Steen (1998) pull factors draw a firm towards a new location. They are considered to be the opposite of the push-factors that are experienced negative. These are the aspects of new locations that are valued highly. From the same survey mentioned above [Van Steen 1998], the following pull factors have been obtained as well. The results are mentioned in *table 2.2*.

Rank	Pull factor	Percentage Pull-factor applicable
1	Possibility for future expansion	61.1%
2	Representative building	50.4
3	Sufficient parking facilities	46.7
4	Accessibility by car	45.0
5	Room for logistic activities	36
6	Large size of premises	29.3%
7	Location relative to customers/clients	19.2
8	Accessibility by public transport	16
9	Location relative to suppliers	9.2
10	Quality of living-environment	7.3

**Table 2.2: Pull factors of the most recent relocation of firms. | Source: Van Steen 1998**

The most frequently given reason to choose the new location is the possibility for future expansion, second is the representative state of the premises, third is sufficient parking facilities, fourth is the accessibility by car and fifth, room for logistic activities (delivery and supplying of goods necessary for the economic activities). These factors have a relative high role in the choice of the new location. It is also very unlikely that a shift in demand for location properties has caused these demands to disappear in the process of location choice.

In a more recent study, major pull factors are enough space for expansion, accessibility to deliverers, suppliers, customers, labour market, representativity, low cost and locational amenities [Pellenbarg, 2003].

According to insights of Van Dijk & Pellenbarg (2000) a number of studies distinguish a third factor next to push- and pull factors often described as keep-factor. They can be described as reasons to stay at the present location. It emphasizes the fact that the firm has done large investments at the current location and a decision to relocate implies that new investments have to be made at the current location and therefore result in a lower probability that the firm will relocate [Van Dijk & Pellenbarg 2000]. As a result, differences between the old and new location have to offer a large enough benefit to compensate for the cost of moving. The biggest keep factor is actually the labour market, since firms wish to hold on to their personnel. This influences the decision for the location choice. Firms will be more likely to locate in the vicinity of the previous location. It is, as [Van Dijk & Pellenbarg [2000] describes “especially attributable to highly specialized labour as the hiring, firing and training of employees on interregional moves may bring much higher costs as with intra-regional moves”.

### ***Paragraph 2.5 - The behavior of firms***

Although concepts of firm relocation theory have been discussed, the relocation behavior of firms is still not discussed. In other words, in what way do firms behave in the real world? Is there a difference in relocation behavior in terms of size, age, sector, etc?

According to Brouwer [2004] and Van Dijk and Pellenbarg [2000], the size of the firm is influencing the chance of relocation. As organizational problems and the cost of moving are considerable for large firms, it is less likely that a large firm will relocate. Smaller firms on contrary are more likely to move because according to Brouwer [2004];

- 1) They have less demanding premise requirements and less capital investment to write off.
- 2) Small firms make a series of small locational adjustments and select the first minimum requirement site which they find, while the relocation of large firms takes place in infrequent large locational changes.
- 3) Small firms are more affected by redevelopment.
- 4) Large firms have more flexibility in accommodating expansion.

**Box 2.2: Reasons on the high relocation occurrence of small firms. Source: Brouwer 2004**

Therefore, according to Brouwer [2004], the mobility of the firm decreases with both size and the age of the firm. Additionally [Dunne & Hughes 1994, Brouwer et al 2002], “younger firms have higher growth rates and therefore need more space, one incentive to relocate”.

In contrast to young firms, as Brouwer writes “older firms are more embedded in their spatial environment, their networks that have been established by long term trust-based relationships, which are likely to be facilitated by spatial proximity” [Atakhan 2001, Brouwer et al 2002]. As a result, they will move less then young firms.

The growth of firms however can also be external, as in the case of acquisition of firms, merger and take-over [Brouwer et al 2004]. These forms can be seen as a substitute for relocation. The acquisition of firms is a widely used form of FDI in foreign countries

[Szirmai, 2005 p. 341] and via this way, a lot of firms are entering the process of international internationalization (instead of Greenfield investment). Although Greenfield investment locations may be more interesting at first sight, the relocation behavior of purchased firms may actually offer interesting aspects to relocation as well according to Brouwer [2004]. Especially in previously owned state-enterprises in post-communist countries, relocation of scattered locations of economic activities and the relocation of them prove interesting developments to study as in the case of the biggest telecom enterprise of Latvia (Lattelekom).

The growth of firms through mergers, take-overs and acquisitions is a form of external growth and therefore external growth can be seen as a form of relocation of economic activities [Brouwer et al 2004], as they are, as mentioned above, a substitute for relocation. As Brouwer 2004] indicates, “external growth factors are particularly important to explain the relocation behavior of large firms”. It not only influences the relocation behavior of firms that are relocating their economic processes (the purchasing firm), as well as firms that are being purchased [Brouwer et al 2004].

To quote a foregoing study by Brouwer [Brouwer et al 2002], the following can be said about the behavior of purchasing and purchased firms.

1. *Firms that have been involved in acquisition have a lower probability of relocating. These firms expand by taking over other firms and as a result this reduces the need to relocate.*
2. *Firms were taken over have a little higher, but not significant, probability of relocating.*
3. *Firms that have been involved in mergers are significantly more mobile.*

**Box 2.3 – behavior of purchasing, merged and purchased firms. Source: Brouwer et al 2002**

To quote Pellenbarg [2002], “firms consider a local move before eventually deciding upon a move over greater distances. and Firm relocations over short distances can be very important in order to facilitate adjustment processes in the local economy” [Van Dijk & Pellenbarg, 2000] meaning that in the case of Riga, it is also likely that relocation behavior will occur in Riga, or its surrounding regions.

In the search process for new locations, an important contribution can of course be found in the behavioral stream of relocation theories, especially in the pull factors. There are some studies that base the spatial economic policy on the pull factors that have been found in the past [Haanemayer 1998] in order to improve the spatial factors of locations.

However, whether a firm wants to own the premises or rent has its influence on the outcome of the location search process. The importance of spatial factors in the location search process is more important for firms that want to own/build their premises and less important in the case a firm rents its premises according to Louw [1996, Van Dijk & Pellenbarg 2000], bringing consequences to the location search process for a large part of the firms in the sample as they rent their current accommodation. In this way, spatial factors are of less importance to them.

However, the process of relocation does not simply occur when certain push- and pull factors arise [Van Steen 1998]. The combination of push- and pull factors needs to have a certain momentum, described as “stress tolerance threshold” [Lloyd & Dicken, 1977, Van Steen, 1998]. According to Van Steen [1998] there has to be a negative effect, affecting the survival

chances of the firm in a negative way, which cannot be countered by means of a different advantage. Second, the short and medium term advantages of relocation have to be measured against the disadvantages faced with the process of relocation. There should be a positive difference in the balance. Last, but not least, a new and suitable location has to be found, that offers enough pull factors in qualitative and quantitative perspective [ Van Steen, 1998].

However, this opens the door to another theme, being the location quality of post-communist cities, the quality of office parks and of industrial premises or parks. Fifty, to seventy-five years of socialist planning influence on most central and east-European cities has had, although maybe not completely changed, significant influence on the spatial structure of most post-communist cities [Bertaud, 2004]. In the following paragraph, this matter will be discussed enough to understand how this may have influenced the quantity and quality of business premises, be it office-, warehousing- or industrial locations.

### ***Paragraph 2.6 - Location quality in post-communist cities***

For relocation to occur a sufficient supply of good business premises has to be offered and in Dutch literature, the provision and degradation of business premises is a widely discussed topic [Haanemayer 1998]. In the case of Riga and other post-communist cities, offering up to date business premises is complicated since fifty or more years of socialist planning practice has influenced the spatial structure in many Eastern European cities and has created a configuration of land use that does not represent demand of today [Bertaud 2006]. As Bertaud [2006] writes, “The absence of real estate markets had the most pervasive effect on the structure of socialist cities. Densities and land allocation between different uses – mainly industrial and residential use – were not reflecting demand from consumers but were mostly based on administrative decisions aiming at minimizing input rather than maximizing values”

A basic assumption towards how the spatial structure of post-communist cities has developed as it is today is that during the socialist economy almost all sectors faced shortages in the form of labour, raw materials, goods and capital [Bóren & Gentile 2007]. Due to shortages at all levels, a non-competitive environment was created where technological improvements did not occur. Instead of increasing productivity by means of technological innovation, obtaining as much inputs and labour as possible had priority [Kornai 1980 1992, Sjöberg 1999, Bóren & Gentile 2007]. In an economic environment of shortages, production-surplus will not occur, resulting in the situation that obsolete production methods can coexist with relative new ones, as new technologies supplement old ones instead of driving old ones out of competition [Bóren & Gentile 2007]. According to them, this had the effect of freezing the old industrial landscape, causing the outdated industrial facilities to remain after the collapse of the Soviet Union [Bóren 2005]. Nowadays, in the post-socialist era, these industrial facilities influence the urban development of post-communist cities as Brownfield's<sup>2</sup>, as the extensive inner city industrial areas could not survive in a market economy [Bóren 2007] but pose a challenge to the modernisation of the post-communist city as indicated by Bertaud [Bertaud 2006].

#### **The camelback-phenomenon**

The absence of a land market discouraged the replacement of obsolete forms of land use by economically more effective forms of land use and as a result led to the camelback phenomenon that is typical for cities that have been under socialist regime [Bertaud 2006] and

<sup>2</sup> <sup>2</sup> The term brownfield in this context has a different meaning as in the literature of Foreign Direct Investment. In FDI literature, it refers to the acquisition of an overseas business enterprise or its assets to access the market immediately [Buckley 2000].

to an over-allocation of land for industrial purposes in post-communist cities [Bóren & Gentile 2007].

According to Bóren & Gentile [2007] and Bertaud [2006] socialist-planning practices discouraged relocation behaviour, although unintentionally. In the case of the absence of land markets, relocation is costly, as the firm is not able to sell its premises, nor can it be compensated. [Bertaud 2006]. A firm under the influence of technological change therefore only has the option to expand at the current location, thus another discouraging factor for technological advancement can be found.

The camelback-phenomenon is a typical characteristic of post-communist cities, which comes into existence when industrial land built around the original historical core of the city is not recycled [Bertaud 2002 & 2006]. When looking at the population density proportional to the distance of the city centre, the ‘normal’ European city has a decreasing density further away from the centre. In the case of post-communist cities, the city centre itself has a high density, the industrial ring around it has a low density, but the high-rise housing in the suburbs have a high density again.

The historical core of many central and eastern European cities has been built before the arrival of socialism and the socialist planning period did not last long enough to alter the historical core, so there is still a European city to be found [Bertaud 2006] According to Bertaud, the cultural identities and historical cores of many eastern European centres have remained similar but, socialist planning practice did have significant influence on the spatial structure of these cities. These cities have suffered from a number of spatial malformations. The spatial malformations can be found in *box 2.4* [Bertaud 2006]. Based on his article, the spatial disadvantages of these types of cities are as follows;

*These spatial features inherited from socialism are:*

1. *Residential estates of high density panel housing in the suburbs.*
2. *Abnormally high amount of obsolete industrial land located close to the city centre.*
3. *Lack of retail and service space, located in the city centre.*
4. *A weak and poorly maintained infrastructure which is inadequate to support the high residential densities found in the city.*
5. *Property rights problems and fuzzy tenure, found mostly in the centrally located areas which prevent their timely renovation or recycling.*
6. *Underdeveloped local taxation system which relies on transfer rather than on local resources.*

**Box 2.4: spatial features inherited from socialism: Source: A. Bertaud 2006**

Because some features already have been discussed and not all spatial features mentioned here are of interest to the subject of the thesis, only the new ones that are of importance will be discussed.

#### *Lack of retail and service space in the centre*

The third feature is the lack of retail and service space in the centre of post-communist cities. The preference of communist ideology for industrialisation had a significant influence on the spatial structure of the city [Bóren & Gentile 2007]. The preference of communist ideology not only led to over-allocation of land for industrial purposes and an industrial belt around the original city core. It also led to under allocation of land for the service sector and retail sector (although the retail and commerce sector did not know as many commercial functions as we

know today (bankers, real estate advisors, insurance, etc)) resulting in the building of small kiosks at street corners and shops in basements. [Bertaud 2006]. However, since insufficient land was allocated to the commercial sector, the office supply in Riga has been low. In the post-communist era, this has turned into a lack of office-location in the city of Riga and office locations that are of low quality.

*Weak, poorly maintained and inadequate infrastructure*

The fourth feature, according to Bertaud, is the weak, poorly maintained infrastructure that is also inadequate for coping with the high residential traffic from suburbs towards the centre of the city. Since the fall of socialism, car-ownership is increasing and more people are relying on private cars for trips in urban areas [Bertaud 2006]. While under communism, car ownership was low and urban industrial development and residential development were developed divided from each other, creating demand between these locations for public transport [Grime and Duke 1996], the shift to a market economy brought increasing motorization [Tosics 2004]. The high priority of public transport under the socialist regime therefore has resulted in a dense network with high frequencies and as a result public transport is usually relatively cheap and of good quality [Grime & Duke 1996]. Nowadays, Riga faces problems with the increasing motorization and the infrastructure in the city centre is not equipped for this [Spatial Plan of Riga 2006].

*Property rights problems and fuzzy tenure, found mostly in the centrally located areas*

Another feature (5<sup>th</sup>) is the problem related to unclear ownership of buildings located in the city centre of post-communist cities. It concerns the pre-socialist buildings of the historical core that under socialist regime were left to decay [Musil 2005, Bóren and Gentile 2007]. However, due to unclear ownership, needed renovation stays out, weakening the economic activities of the centre of the city [Bertaud 2006] and creating less possibility for conversion of residential apartments towards office use, making the potential office space smaller. Additionally, the historical centre of the city is often invoked in justifying freezing land use in its socialist state, not making these buildings available for higher revenue activities that produce higher rents rates and higher tax rates, necessary for the maintenance costs of these historical buildings [Bertaud 2006].

When looking at the main processes of the larger post-socialist cities, the following aspects can be considered important for answering the research questions of this thesis. A quick review results in the following.

Due to the industrial belt around the original city core that hasn't been recycled, constant under-allocation of retail and office functions in the city centre and municipality, the city is lacking in industrial, warehousing and office-premises that can meet current standards. As the result of a lack in office locations, the city centres of some post-socialist cities are seeing residential apartments being converted to offices [Tosics 2004]. As noted by Bóren & Gentile, a lot of post-communist cities are experiencing this CBD-isation process, whereby as quoted "centrally located residential space is squeezed by the advancement of commercial and office functions" [Bóren & Gentile 2007]. However, it is resulting in CBD office-supply that is inflexible and does not meet current standards. Additionally, the property rights system mentioned above is preventing needed renovation of some residential buildings, causing possible office supply to be even smaller. Several sources indicate that there is a serious lack of available business locations in the municipality of Riga [Spatial Plan of Riga 2006, Oberhaus 2007, Colliers 2007] and as seen from the theoretical perspective of relocation, this may have strong influence on the ability of the firms to relocate and therefore probably also

the rate of relocation. This seems to correspond perfectly with the under-allocation for commercial space that took place during the socialist-era.



## Chapter 3 – Economical & sociological developments

### Paragraph 3.1 - Introduction

In the following chapter, a more thorough description of the Latvian economy and sociological developments in Latvia will be given. In the first paragraph, the focus will be on the development of GDP and labour productivity of Latvia and investment in the period of 2000-2005. The third paragraph will be the development of FDI Inflow in the three Baltic States. What is the difference between the different inflows of FDI and is there a geographical difference in FDI sources, the sectors of investment and how can differences between the levels of FDI in the three countries be explained. Second part of the third paragraph will be on the economic development of Latvia and how it may influence location behaviour of foreign firms. Next to economical developments, there are also sociological developments taking place in Latvia influencing the relocation behaviour of firms. Therefore, the third paragraph of this chapter will take in account sociological developments.

### Paragraph 3.2 - Economic situation of Latvia

As seen in the first chapter, the economic situation has improved a lot since the independence. Between 2001 and 2006 GDP per capita has more than doubled as can be seen in the graph below. Labour productivity per employed person has also risen with 11 points towards the EU 27 average in the period of 2001-2006, as can be seen the graph below. 2007 is based on estimates. Investment in the Latvian economy in the period of 2000-2005 increased with 15.8 percent annually [Latvian Ministry of Economics, 2006]. Additionally, in the time-period of 2001-2006, the share of investment in GDP constitutes 26,5% of GDP on average [Ministry of Economics Latvia, 2006]. This means that more than a quarter of the national income is annually used for investment. The investment dynamics are, according to the Ministry of Economics, ensured by several factors, especially such as the stability of the financial sector, continuous improvement of business environment, high domestic demand, rather low interest rates and inflow of foreign capital. As can be seen in table 3.1, the sectors that on average received the most investments in the time-period of 2001-2005 are the primary sector, manufacturing, construction and other commercial services. In 2005 the sectors manufacturing, construction and commercial services received the most investments.

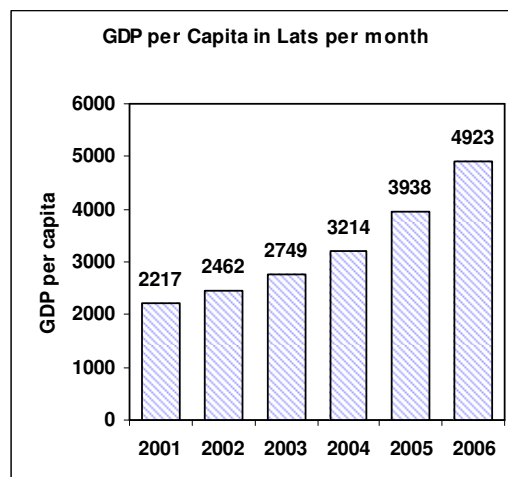


Figure 3.1: Source Latvijas Statistika 2007

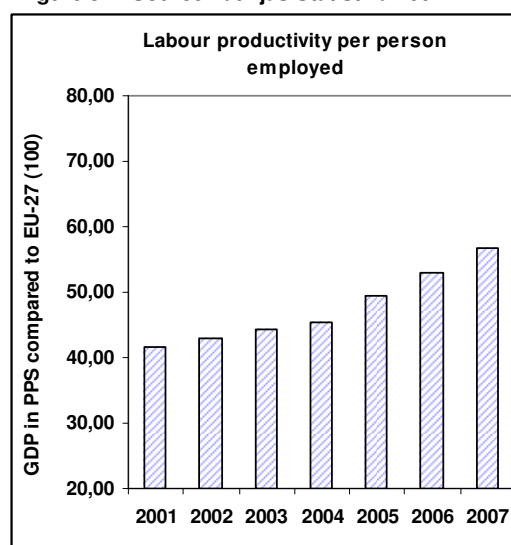


Figure 3.2: Source Eurostat 2007

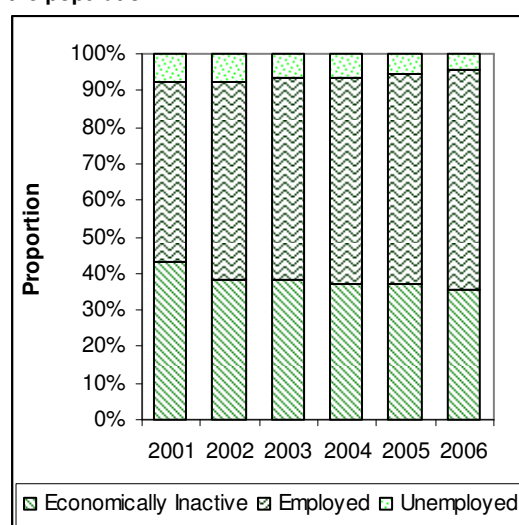
**Fixed Investment by sector**  
(excluding investment in individual construction, %)

	Growth			Structure		
	Average 2001-2005	2005	*9 months of 2006	Average 2001-2005	2005	*9 months of 2006
Primary sectors	33,7	34,1	-6,2	4,3	5,3	4,4
Manufacturing	19,3	27,6	-7,0	16,1	16,7	16,2
Electricity, gas and water supply	14,1	-3,4	-0,5	8,7	7,8	9,2
Construction	24,1	40,9	18,0	3,4	4,3	5,4
Trade	11,8	9,5	20,0	15,6	14,6	16,5
Transport & communications	4,5	16,3	-3,0	17,7	14,2	13,6
Other commercial services	23,0	26,5	87,6	20,1	22,3	25,8
Public services	14,9	11,8	6,6	14,1	14,9	8,9
Total	15,5	18,2	14,0	100	100	100

**Table 3.1: Source Ministry of Economics, 2006** \* Estimated using the quarterly data of 2006

Developments on the labour market also are positive. Where in 2000, the employment was 4.9 percent beneath EU-25 average, in 2005 it was 63.4 percent and only 0,4 percent beneath the EU-25. The level of education has also risen. Another source for economic development in Latvia are the increased incomes the country is experiencing. As can be seen in figure 3.6, the incomes and private consumption of households have increased significantly the last three years. The increase in income is of course a base for greater domestic demand and vice versa. According to the Ministry of Economics, the domestic demand is one of the motors of the Latvian economy [Ministry of Economics, 2006]

**Employment, Unemployment and inactive ratio of the population**



**Figure 3.3: Source: Latvija Statistika 2007**

According to the Ministry of Economics, there are some negative developments as well. Disposable household income amounts to 57-60% of GDP whilst final consumption expenditures exceed 62%. This means that the net savings are negative. In the last two years 2005-2006 consumption expenditures have grown faster which is resulting in an increase of debt of households [Ministry of Economics 2006]. In other words, households are spending more than they are earning, as can be seen in table 3.2.

**Disposable Income and Final Consumption Expenditures of Households, Net Savings**

	2003	2004	2005 e	2006 e
Disposable income of households (changes in % against the preceding year)	13.3	17.8	16.9	18.6
Final consumption expenditures of households (changes in % against the preceding year)	11.5	17.2	19.2	25.0
Net savings in % of disposable income	-4.3	-3.8	-6.0	-11.7
Net savings in % of GDP	-2.6	-2.3	-3.5	-6.6

e – estimation by the Ministry of Economics

**Table 3.2: Source, Ministry of Economics 2006**

In the opinion of different international experts, including Moody's investor service, this is the case in a lot of eastern European countries. Growth rates of domestic demand are caused by a rapid capital influx [Economist 2007].



Figure 3.4: Source, Ministry of Economics, 2006

The current trend is also visible when looking at the current account of Latvia. It has a relatively large current account deficit and the main cause of this is the negative trade balance [Ministry of Economics, 2006.] According to Szirmai [2005], Latvia and many other countries have a deficit that for a large part is covered by means of foreign investment. It is a characteristic that is normal when looking at the international order since 1950. Developing economies were able to import more consumer goods, capital goods and intermediate goods than they could have financed from export revenues. Capital flows consisted of commercial loans, direct investment, portfolio investment and development aid. Net capital inflows served to finance imports [Szirmai, 2005]. With a large account deficit, as in the case of Latvia, it is important to look at the types of inflow of financial flows.

**Inflow of Foreign Investment into Latvian Economy by Types of Investment**  
(million LVL)

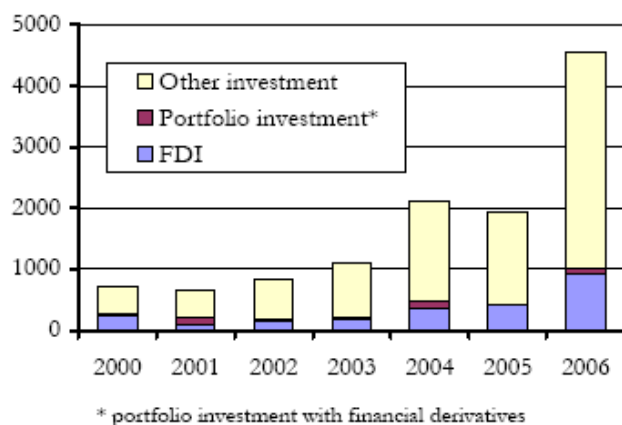


Figure 3.5: Source, Ministry of Economics, 2006

In figure 3.5, it can be seen that the major type of foreign investment-flows are categorised as "Other Investment". These are financial transactions that are not included in direct and portfolio investment, such as trade loans, credits and borrowings, cash and deposits. As noted earlier, investments and loans make a positive contribution to the productive potential of a country, then factor payments represent payments for the productive services of foreign capital [Szirmai, 2005]. However, when loans are used purely for consumptive purposes, it does have negative effects. In this case, a country can get caught up

in an increasing spiral of indebtedness, without any improvement of its productive potential [Szirmai, 2005]. Additionally, with the crisis on the credit-market today, high deficits on the current account can be seen as a risk because growth then may be affected negatively to a crisis on the currency market [Economist 2007].

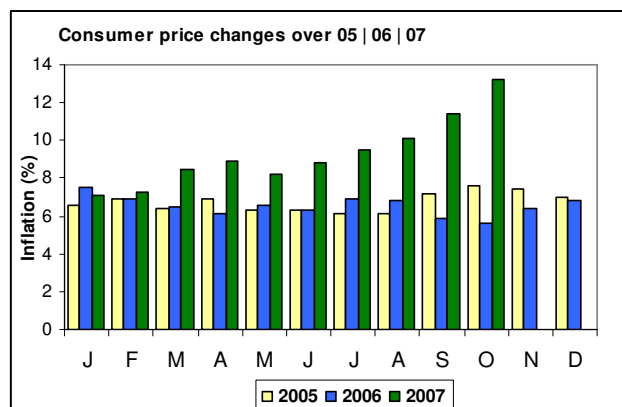


Figure 3.6: Source, Latvijas Statistika 2007

With the ongoing crisis in the credit-market, another problem is arising. Latvia and other Baltic countries are facing serious inflation, reaching 13.4 percent in last October. According to different financial experts, the government has started plans to counter this inflation, it is becoming a serious problem that threatens economic growth and may cause the Latvian economy to make a hard landing [HedgeWorld USA 2007]. The growth over October 2006 is causing all three Baltic economies to overheat,

according to ruling European experts and is spurring inflation to very dangerous levels. High volumes of mortgage crediting, substantial increases in wages, increases in prices, rising of construction costs and inflow of credit for EU-funded building projects are causing the high inflation. It is clear that the high inflation is a problem that needs serious attention, since the Lat is pegged to the Euro, it can not devalue. Devaluation could also bring neighbouring countries Estonia and Lithuania (who face serious inflation as well) in danger [The Economist, 2007]. In any way, the introduction to the euro is not likely to happen in the short-to medium term future

### Paragraph 3.3 - The Baltic FDI race

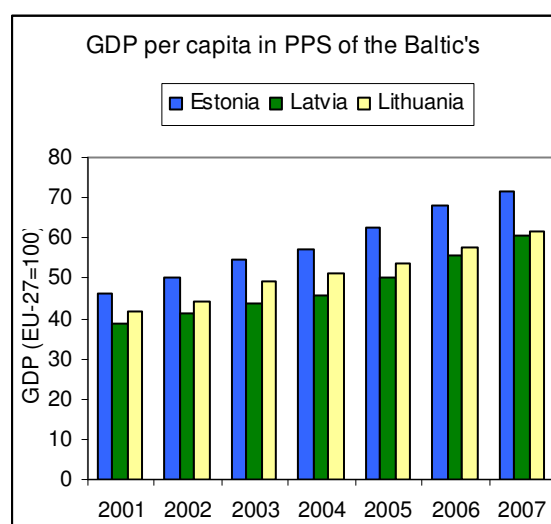


Figure 3.7: Source: Eurostat 2007

Without doubt, the economical situation in Latvia has improved. When looking at Lithuania and Estonia, the situation is about the same level. Taking the average of GDP per capita and labour productivity of the EU-27, Latvia is third of the three Baltic countries, but the differences between the three countries are very small, as can be seen in figure 3.7, Estonia is leading amongst the Baltic States. The same goes for labour productivity that can be seen in figure 3.8. In capital accumulation or better said investment growth, Latvia is doing better with 15.8% last half year 2006 against 12.2% and 11.9% for respectively.

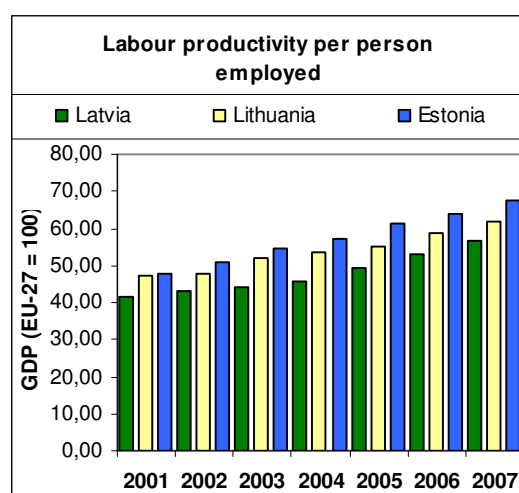


Figure 3.8: Eurostat 2007

### Estonia

An explanation for the high amount of FDI it attracted, is that Estonia was very actively involved in the privatisation process from the very beginning, whilst in Latvia there were delays, hesitation and political discussions concerning the selling of state enterprises to foreign firms [Lönnborg et al, 2003]. Due to the active approach towards the privatisation process, Estonia was able to finish its privatisation process in 1995 at a formal level [Lönnborg et al, 2003]. In 2001, the privatisation agency was closed. Although the share of privatisation never came above 20% of FDI share, this may have sent a clear signal towards investors. Also Estonia has received a very high share of Greenfield investments and is therefore a unique case. The geographical and cultural proximity with the Nordic countries can be seen as another explanation for this [Lönnborg et al, 2003]. By 1994, almost all inward FDI came from Sweden and Finland (70%) and so it could explain why the share of FDI from Nordic countries is much higher than in the other two Baltic nations. However, that this is an explanation for the high number of Greenfield investments cannot be said for certain. That Estonia was able to host a larger amount of FDI in the past however, has led to the fact that Estonian companies were able to invest FDI in Lithuania and Latvia [Lönnborg et al, 2003]

As stated before, foreign direct investment can nowadays be seen as an essential ingredient for modernising transition economies. In a lot of literature, the process of attracting FDI is described as “the Race for FDI” [Lönnborg et al, 2003]. Estonia took the leading role 1995, with the highest nominal amount of FDI (674 Mn USD) as well as per capita (482 USD) FDI stock [Lönnborg et al, 2003]. Second was Latvia with a nominal FDI stock of 615 Mn USD and 256 USD per capita. Lithuania had a nominal FDI stock of 352 Mn USD and 95 USD per capita.

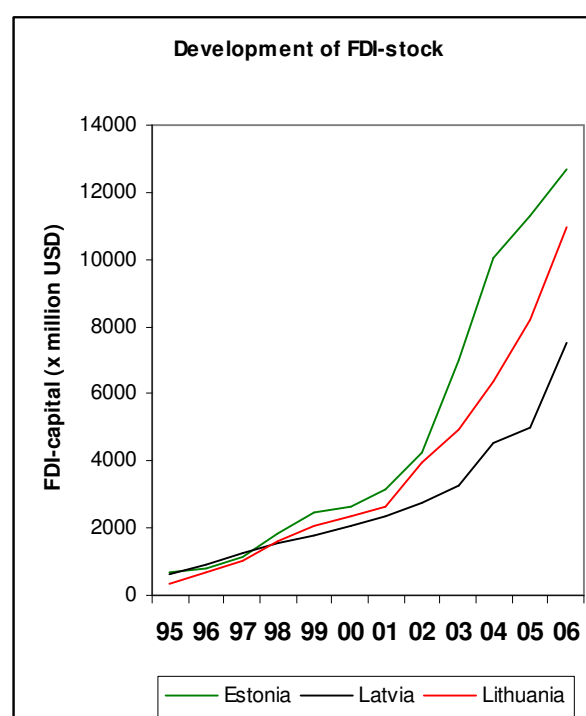


Figure 3.9 – UNCTAD 2007

### Lithuania

In the case of Lithuania, FDI was very modest in the beginning, due to the economic reform process. The process started with the privatisations of a few large companies [Lönnborg et al, 2003]. The privatisation of the telecom company, the oil refinery Mazeiku Nafta and a few banks are good examples of this [Lönnborg et al, 2003]. The privatisations of large companies can have a significant impact on FDI statistics of small countries, as in the case of the telecom

company, which accounted for a quarter of cumulative inward FDI. In this case, the inflow to a few FDI projects can dominate the picture of FDI hosting in a strong way. [Lönnborg et al, 2003]. After the projects mentioned, inward FDI accelerated and from 1996 till 1997, FDI stock doubled to 700 USD and continued growing. However, after 2001, the annual inward flow of FDI has been decreasing.

As noted above, sources of FDI can differ over time and the same is applicable for Lithuania. [Lönnborg et al, 2003] In 1996, Germany had a significant share of 20% in FDI, with the UK at second place (12%). By the end of 2001, their relative share was only 9 and 6 per cent [Hirvensalo & Juurikkala, 2000, Lönnborg et al. 2003] whilst Scandinavian and US based firms now where major sources of FDI. However, as said before, the Baltic economies are relatively small compared to Western-European economies so a single FDI project can tip the proportions of FDI from different countries easily.

### Latvia

Due to relative high barriers towards investment and political disagreement towards privatisation, Latvia wasn't as successful in attracting FDI. Removal of restrictions on the privatisations followed in 1995. After the liberalisation of the economy, considerable amounts of FDI were received, but in 2001, it still had the third position towards the two other Baltic nations on total FDI stock. By the end of 2006, the position has improved and Latvia has surpassed Lithuania on FDI-stock per capita [Ministry of Economics, 2006]. The majority of the FDI stock is concentrated in the financial service sector, the trade sector and transport & telecommunications. The financial service sector was also in 2006 the sector with the highest growth percentage. Growth of the manufacturing sector has been low. The sector is being dominated by low- and medium low technology sectors whose comparative advantages in the attraction of capital are mostly related to relatively low accessibility of labour and natural resources.

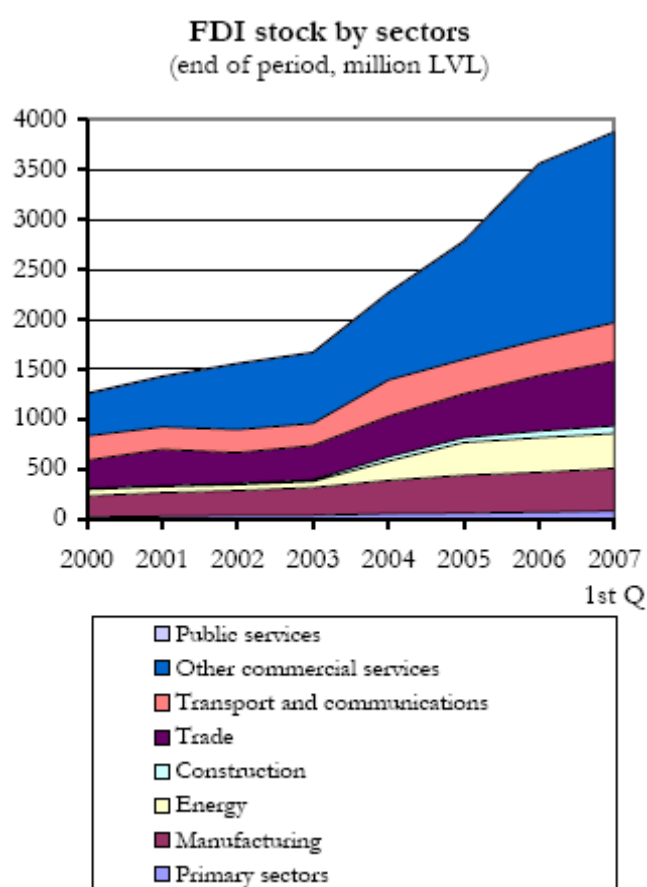


Figure 3.10: Source, Ministry of Economics, 2007

Diversity of the source countries leads to less risk towards foreign investment, i.e. a broader range of investing countries gives a more solid base towards the risk of de-investment and repatriation because the host economy becomes less vulnerable towards a foreign economy or sector. An interesting question therefore is where the FDI in Latvia has originated from. As can be seen from figure 3.11, at the end of the first quarter of 2007, Sweden (20%), Estonia (17%) and Germany (13%) were the biggest investors in Latvia and Denmark was fourth (11%) [Bank of Latvia, 2007]. To conclude this paragraph, it can be said that amongst the Baltic States, Estonia is definitely leading, by Nominal as well as per capita FDI stock, although both Latvia and Lithuania are both closing in. However, with the slowdown in economic growth for all three countries announced, the level of inflow of FDI may slow down in the near future.

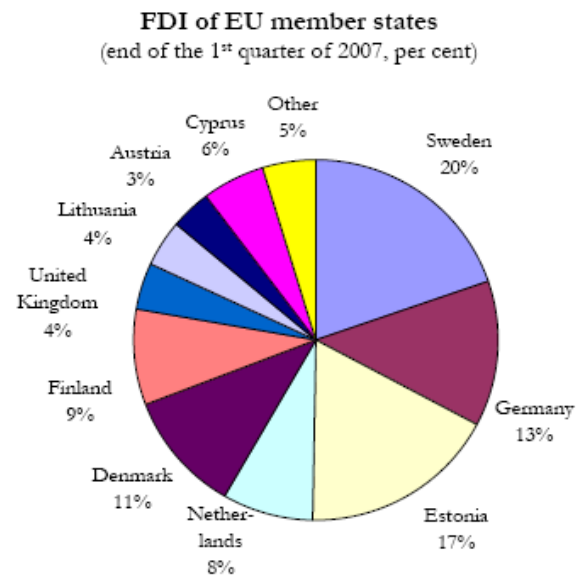


Figure 3.11: Source, Ministry Bank of Latvia 2007

### ***Paragraph 3.4 – Developments influencing the locational behaviour***

The economic growth Latvia has experienced in the last years has effect on numerous factors that may influence the locational behaviour of firms. With the economic progress that can be seen in Eastern-European cities, changes in demand and supply will change as well according to the model describing subsequent stages in the transition of the central east European cities [Tosics, 2004]. According to Tosics [2004], this will lead to changes in demographic trends, mobility processes and patterns in transport with emerging motorization. The process that is at hand in Riga and other post-communist cities can be perfectly described by Tosics [2004] as follows.

*“In the course of economic development, many factors change, which influence the mobility decision of the population. One of them is mass-privatisation. As a result of the mass, give-away privatisation most families became owners, income differentiation has increased and there was a huge growth in private car ownership. All these conditions led to an increase of residential mobility, the novelty of which was the emerging ‘real’ suburbanisation process: the prestige and also the value of real estate in suburban settlements increased, as opposed to the decline of many urban areas”.*

One of the problems arising in post-communist capital cities [Grime & Duke, 1996], which is also applicable to Riga, is the increased car-ownership in Riga region and [Latvia Spatial plan of Riga, 2006]. The total number of road vehicles in Riga has risen from 47875 in 2001 till 68363 in 2005. This is an increase of 43%. However, traffic intensity has risen even more, since a lot of commuters work in Riga but live in surrounding towns [Spatial plan of Riga, 2006]. During the period of last 10-12 years, the number of motorcars has increased two times reaching 304 cars per 1000 inhabitant in 2004 according to the city development office [Spatial Plan of Riga, 2006]. Combining this with the fact that Riga has a mono-ethnic character (meaning that all city functions are concentrated in the centre), it is becoming obvious that this is causing major congestion problems.

Commuting traffic in Riga is causing many traffic jams since most of the city business locations are in the current city centre, major bridges are located over the Daugava and a serious shortage of parking space although this is also contributable to the absence of a parking policy [Spatial plan of Riga, 2006]. Demand after parking spaces exceeds the supply, thus creating even a bigger traffic jam due to false parking, resulting from a shortage of parking spaces. A listing of the major streets which are experiencing traffic jams looks as follows [Spatial plan of Riga, 2006]. A detailed view of the situation can be found in appendix 1.

- Access to bridges, namely: Krisjane Valdemare iela, 13 Janvara iela, Lacplesa iela. Kalnciema iela, Uzvaras Bulvaris and Vienibas gatve.
- Before the rail crossings of the streets Brivibas, A. Caka, A, Deglava, Lacplesa, Gogola, Tilta, Gaujas, Slavu, Krustabaznicas, Viskalu – Dzutas, Liepajas, Krustpils and Zolitudes iela.
- Crossings of the main streets as Brivibas and Juglas, K, Ulmana – Vienibas gatve, K Ulmana gatve – Liepajas iela, Valmieras – Stabu and Terinu – Ceres iela

### Migration towards Pieriga

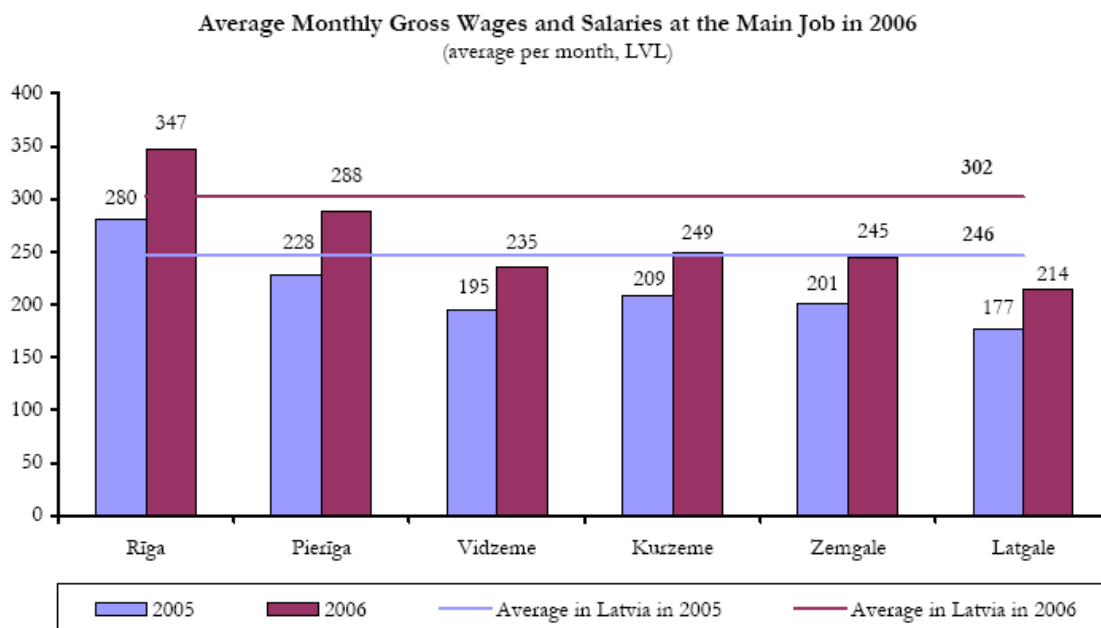


Figure 3.12: Source, Ministry of Economics 2007

In figure 3.12 it can be seen that residents in the area of Riga have a higher income compared to the rest of the country. As a result, a positive migration towards Riga from the rural areas of Latvia is being noticed [Spatial plan of Riga, 2005]. Although this provides a bigger labour market, it also is putting more pressure towards the city of Riga and speeding up the suburbanisation process of the city, increasing the pressure on the already insufficient infrastructure. Riga as a capital city is still responsible for 52,1% of the industrial production.



### **Spatial quality of Riga**

When determining how the dynamics of the economy of Riga influence the location behaviour of Riga, it is necessary to have insights in the spatial quality of Riga. In this way, the weak points of the city and the strong points can be put forward as explanations for the behaviour of international firms.

As noted in chapter two, a typical phenomenon of some post-communist cities is the camel-back distribution described by Alain Bertaud [2006]. Riga is showing this distribution [Bertaud 2002]. These areas contain very few usable production locations because they are not suitable for production according to current standards [Spatial Plan of Riga, 2006]. This is however the same for other production locations more around the city and especially the harbour area (Vežakšala, Podrags) [ Spatial Plan of Riga, 2006]. As a result, a lot of locations have to be renovated to create room for development projects.

### **Riga as central location**

The geographical location of Riga enables it to act as a node in a transport network. It offers the crossing of several motorways (including the via-baltica), transnational railways and the access airport and seaport and therefore a major factor in economical competitiveness of Riga at the international level. Especially in the area of trade and logistic services, this is a competitive advantage for international transport firms. It has the potential of becoming a significant logistic centre providing cargo shipment and logistical services between Russia and the European Union [Spatial Plan of Riga 2006].

The lack of beltways around the city can therefore be considered a major disadvantage, as all traffic has to cross the city, where all three bridges across the Daugava are located. This is causing extra load on the transport network of Riga and accessibility of the city centre to decrease, especially with the increasing motorization of the population. Plans are being developed however to reduce pressure on these bridges and already one new bridge is being built [Spatial plan of Riga 2006].

Another problem in the spatial quality of the city of Riga is the level of communication infrastructure needed for the development of business and housing. Except for the city centre, the level of infrastructure is currently insufficient to enable development on business locations outside of the centre [ Spatial plan of Riga, 2006]. As a result, Riga is still a mono centric city. Due to a larger demand of office locations over supply, firms will continue to settle in the city centre [Oberhaus, 2007] When this happens, it will lead to an even more mono centric character of the city, causing even more problems in the current circumstances. However, plans from the city development office to develop Riga in a polycentric way, have met severe criticism from planning authors [Diena, 2005]. It is claimed that not the centre itself is the problem but the infrastructure towards it. A polycentric Riga would therefore be bold and nearly impossible to realize. The city development office tries however to achieve development around the edges of the city by drawing businesses towards the more distant areas of the city and thus reducing the transport flow towards the city centre.

According to the City development office of Riga, the population of Riga itself is decreasing, but, the number of jobs is actually increasing [ Spatial plan of Riga, 2006]. This is possible due to the fact that a lot of people move towards the neighbouring communities, but still work in Riga. This may in the future cause even more stress on the city centre.

### Office & industrial premises development in Riga

The market for industrial and commercial premises and offices in Riga is experiencing dynamic and rapid development [Colliers, Oberhaus, Arco, 2007]. Land prices have risen with 60% in 2006 and are rising still today [Oberhaus, Colliers, 2007].

However, because of the dynamic character on the land market for commercial land, it is very hard to obtain data on all major business areas of Riga. Therefore, it was impossible to obtain a complete picture on these developments. However, not only the land market for both commercial properties, but also the real estate market is experiencing rapid development, due to new construction projects [Oberhaus 2007, Colliers, 2007].

According to Colliers, the total of rental office space in 2006, was 145.000 m<sup>2</sup>, of which 21% (31.140 m<sup>2</sup>) is classifiable as A locations, 63% (91.950 m<sup>2</sup>) classifiable as B1 locations and 15% (22230 m<sup>2</sup>) as B2 locations at the beginning of 2006. Oberhaus is estimating the total office supply at 31600 m<sup>2</sup> for A locations and 240.000m<sup>2</sup> of B locations at the beginning of 2006 and 338000 m<sup>2</sup> by the end of 2006. This leaves doubt on how much there is in total office supply, although one part of the office supply differences may be attributable to not counting 'build to suit' offices. However, as also indicated by both major real-estate advisors, the supply of office-space is not enough to suffice demand [Colliers, Oberhaus, 2007], although the supply in office locations has increased enormously since 2002, as can be seen in *figure 3.13* based on sources of Colliers [Colliers, 2007].

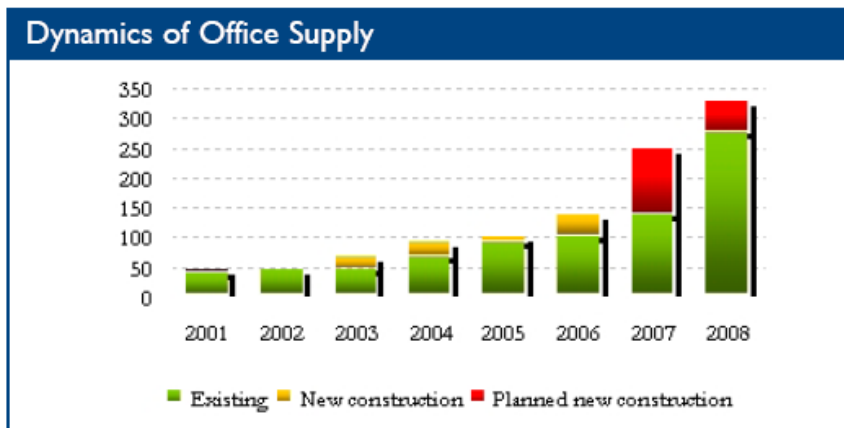


Figure 3.13: Source, Colliers, 2007.

As a result of the shortage of suitable office locations, the vacancy rate of A office locations dropped from 11 percent in 2006 to 0 percent in 07, expressing the inflexible supply of locations. Availability of B locations decreased from 24 per cent to 16 per cent. This is a disadvantage since firms willing to move simply do not have a location where they can move to. Additionally, according to a study focusing on the office-preferences of firms, the serious lack of A-class locations is causing confusion amongst foreign investors. These are anticipating international benchmarks and therefore look for A-class locations (of which supply is smaller than demand) [Beltina and Labeckis, 2006]. Lack of A-class office space can therefore be a factor influencing the behaviour of foreign firms that depend on the rental market of offices. Also, as there is no increase of A-class offices in the first half of 2007, it is likely that vacancy rates will stay low. As can be seen from figure 3.13, additionally supply of office floor space will be realised in the years 2007 and 2008 in the entire city of Riga.

Nonetheless, based on office-projects that are mentioned in both market year-reports by Oberhaus and Colliers, the amount of office floor space to be realised in the time span of 2007-2008 will be 148770 square meters (Build-to suit projects excluded) [Colliers 2007 B]. Included, this would provide an additional 68100 m<sup>2</sup> on office space.

The current city centre, that houses many of the current office-functions, is becoming less suitable for office locations, due to their dated layout from the Soviet era, their inflexible designs and traffic and parking problems that are arising in the centre nowadays. As a result, the larger businesses are moving away from the city centre, towards new locations. When looking at a list of where new office floor space is being located, it is already becoming visible that these locations are lying at the edges of Riga or at other locations in the city, but not at the current city centre.

The low vacancy rate that was discussed earlier is expected to stay the same in the near future (till 2010). After this, due to the increasing offer and quality on the real estate market, the market will be expected to saturate and so rents and vacancy rates will normalise [Oberhaus, Colliers, 2007]. According to Colliers [2007], it is expected that the greater demand of higher quality office space (spacious locations, higher accessibility abundant car parking space) of larger firms and international firms will push these firms out of the current city centre and towards the newly realised office locations. Smaller firms (lawyers, consultants, etc) will stay in the centre. This may already have happened, as indicated by the leading real estate companies operating in the Baltic markets [Oberhaus 2007, Colliers 2007]. To see if this development is taking place, it will be tested with the acquired sample if firms indeed have moved towards these new office locations. To test this, all major 'build-to-suit' projects and all rental-office locations, both realised and planned, will be made visible by map and compared towards the relocated firms in the sample.

Demand in industrial and warehousing premises in Riga is also higher than supply, as most of the current industrial and warehousing premises are dated from the Soviet era and have become obsolete [Spatial Plan of Riga, 2006 and Colliers 2007 & Oberhaus 2007]. However, supply of rental industrial premises has hardly increased in the last years and most firms needing warehousing or industrial premises, build for own use [Oberhaus, 2007]. These do not show up in most rental statistics. In 2007 and 2008, a number of rental and build to suit projects are being realised, as can be seen in *figure 3.14*. As a result warehouse space will increase in the coming years. In figure 3.14, it can be seen that where in 2006, warehousing space was zero square meters, an already significant contribution to industrial locations has been built in the first half of 2007 and forecasts are pointing out another increase in 2008 [Colliers 2007]. The increase in demand of warehousing space is contributable to the increase in retail trade according to Colliers [Colliers 2007A]. A visible trend in the market for industrial space however, is that there is a lot of differentiation in the point of leassable

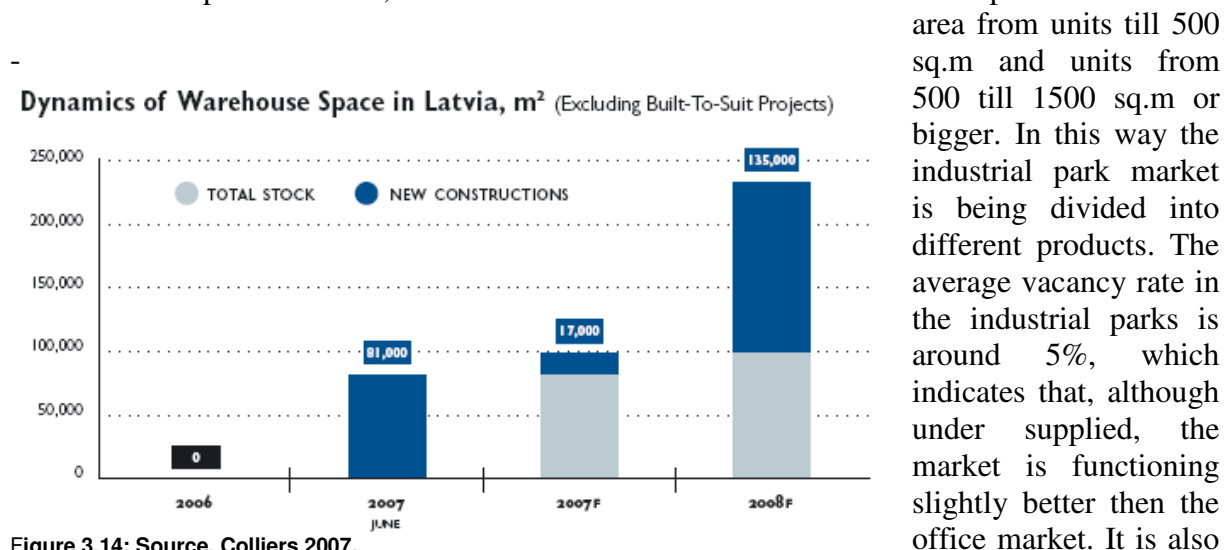


Figure 3.14: Source, Colliers 2007.

expected that the market for industrial and warehousing space will show stable development in the future. Just like the office market, it may be likely that relocating firms will move towards these new destinations, although in this case construction for own consumption may very well take place as well. In this case, the influence of new industrial and warehouse parks might not have such a big impact on the movement of international firms.

Now that a good description has been given of developments that might influence the behaviour of international firms, let us turn to the next chapters. In the following chapters, the focus will be on the discussion of the research results and analysis of the locational pattern.

## Chapter 4 - Discussion of research outcomes

### ***Paragraph 4.1 - Introduction to the chapter***

In this chapter, the main goal will be giving a description of the spatial pattern of foreign firms, located in Riga and its surroundings. The structure of the chapter will be as follows. In this paragraph, a description will be given on how the data used on deriving the spatial pattern has been obtained and on the general characteristics of the sample. In paragraph 4.3, the spatial pattern of firms in the city will be discussed, followed by the fourth paragraph in which an explanation of the found pattern will be given. Finally, the findings of this chapter will be compared towards earlier findings in the literature.

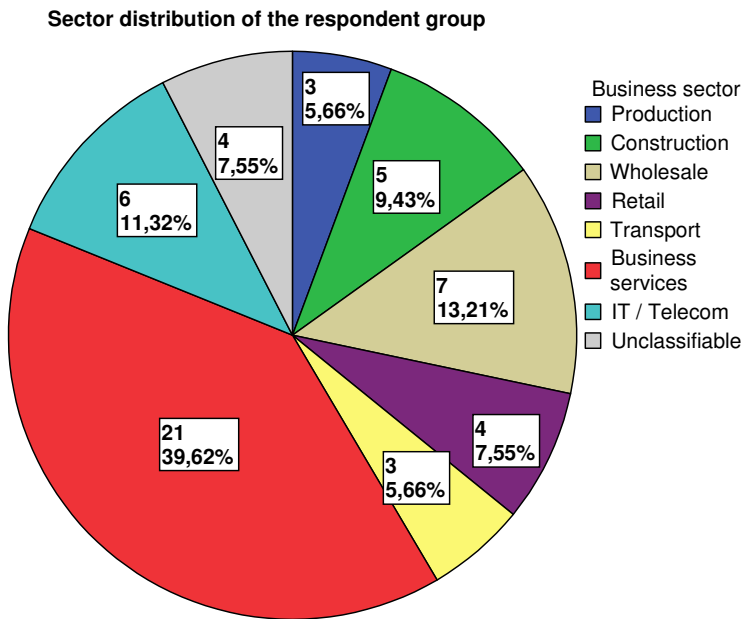
### ***Paragraph 4.2 –The spatial pattern of foreign firms in Riga***

In order to provide some clarity on the different data-sets used, a brief description will be given first. To provide in a data-set of foreign firms, necessary to derive a spatial pattern, data has been collected on an ad-hoc basis on the location of foreign firms located in Riga. This has been done by obtaining address lists from the Latvian organisation Lursoft and various other member lists of the foreign chambers of commerce located in Riga. During the process of visiting these locations, an additional number of firms has been found which were also interviewed. In this way, a data-set has been derived consisting of foreign firms, located in Riga or in the vicinity of Riga. The total response on the questionnaire is 54. The group of non-response firms consists of 98 firms. For a clear description of the data-set used, see the diagram in figure 4.1, which can be found under appendix 7?

The firms in the data-set are spread-out over the entire city and the surrounding region. As visiting every firm in the entire dataset is nearly impossible, only the firms in the centre have been visited at location. Firms located at the outskirts of Riga and the surrounding region have been approached by telephone to request their participation, after which a digital version of the questionnaire has been sent. The effects of this method are noticeable in the amount of response received. There is a significantly higher response rate in the centre, where questionnaires have been collected personally, in comparison to the outskirts of Riga where firms were approached by phone and e-mail. This was predictable as the response percentage of e-mail as medium is very low, due to unsolicited e-mail [Wilson 2006].

#### *4.2.1 - The sample*

A description on the data collected on the non-response group can be found in diagram 5.1. Data on the relocation occurrence has been determined by means of comparing an address-list of the firms dating from the year 2000 with one from medio 2007 and Latvian versions of yellow pages sites. In other words, data on the previous and current location have been obtained. Data on the year of founding as well as the business-sector that the firm is active in has been collected, respectively by means of the Latvian State revenue register and Latvian versions of yellow pages. The results have been added into the same variables used for the response group. As for the response group, the necessary information has been acquired by means of a questionnaire. In case the sector was not mentioned in the questionnaire, the respondent responded with writing a different sector at the bottom of the column. On basis of these different sectors, the original sectors in the questionnaire have been widened and an additional sector, namely IT & telecom has been added. The results are the variable '*business\_final*'. A sector distribution of both groups is visible below.



In both the respondent and non respondent group, the business sector is one of the largest groups with respectively 40 & 22 percent. However, in the non-respondent group, the production sector, wholesale sector and retail sector have a larger share then in the respondent group. The respondent group is dominated by the business sector.

Figure 4.2a: Sector distribution of the response group

Interestingly, the wholesale sector and business sector are amongst the respondents and non-respondents, both large sectors, indicating that for a lot of firms, market-seeking behaviour may be applicable [Nachum & Zaheer 2005].

The age profile of both the respondent and non-respondent group has been displayed in figure 4.4, visible on the following page. As can be seen, the diagram shows that the number firms founded per year, varies over time, likely due to the economic cycle, as firms based in foreign countries may well postpone foreign investment projects till better times arrive [Lönnborg 2003]. There are two time periods in which the number of firms founded are higher (1995-2000 & 2004-2006). Data on the non-respondent group is obtained by consulting records of the Latvian Tax Revenue service. Data on the respondent group has been collected by means of the questionnaire.

**Sector distribution of the non-respondent group**

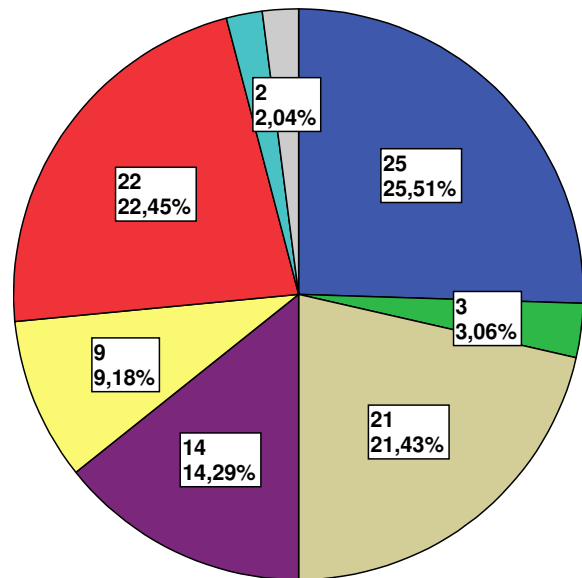


Figure 4.2b: Sector distribution of the non-response group

Relocation occurrence amongst both groups is different. Amongst the respondent group the rate of relocation is higher than amongst the non-respondent group. Note however that for the non-respondent group, it can only be determined if firms relocated after the year 2000. The low rate of relocation of the non-respondent group may also be attributable to the fact that for a percentage, relocation could therefore not be determined, so in fact, the rate of relocation may be higher, as we are only able to measure the top of the iceberg.

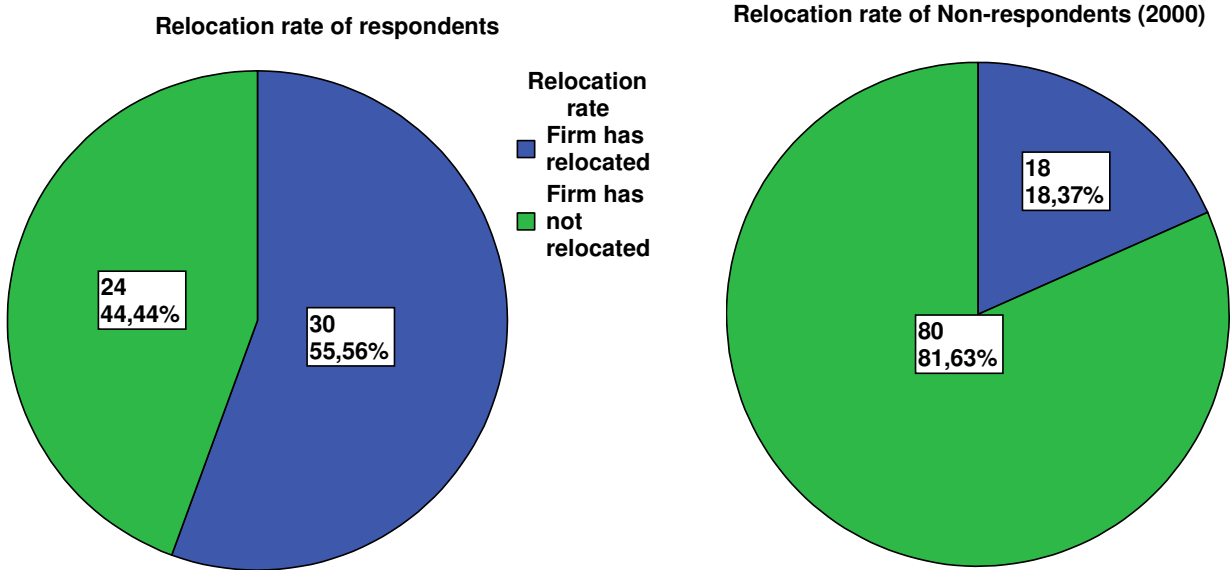


Figure 4.3: Relocation occurrence of both respondent and non-respondent group

Note the difference amongst the response-group and the non-response group. In the response group, 56 percent of the firms has relocated whilst with the non-response group only 18 percent has relocated.

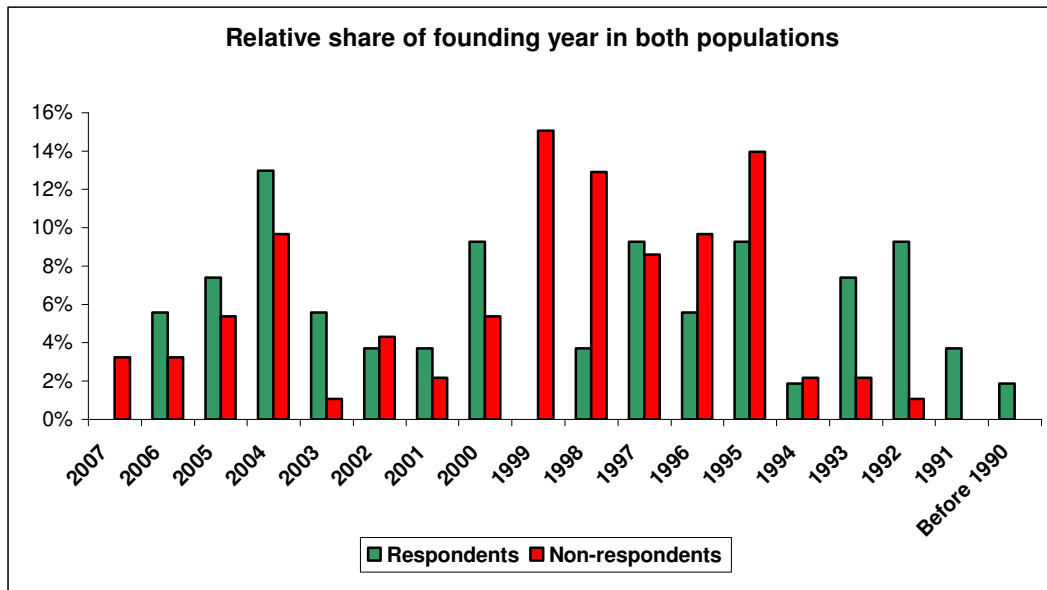


Figure 4.4: Share of founding year in both populations

*Duration of stay at location*

As the duration of settlement at location of the firm increases, it is likely that location stress will increase. Therefore, the duration of settlement of the firm has been determined. The results are as follows. Around 31 percent of the respondents have been located at their current location for the duration of 1-2 years. In other words, relocation has occurred only recently for one third of the respondents.

There are a number of ways in which FDI can enter a country, for instance through mergers with foreign firms, Brownfield investment and Greenfield investment. The investment form also determines if an investing firm inherits a location chosen by the purchased firm. The

distribution of ways of investing in the foreign firm amongst the respondent group is visible in figure 4.6. Exactly half of the respondents are firms that have been created as a foreign subsidiary by means of foreign capital. The second largest category are firms which were in history Latvian firms, but have been bought by foreign investors (for various reasons).

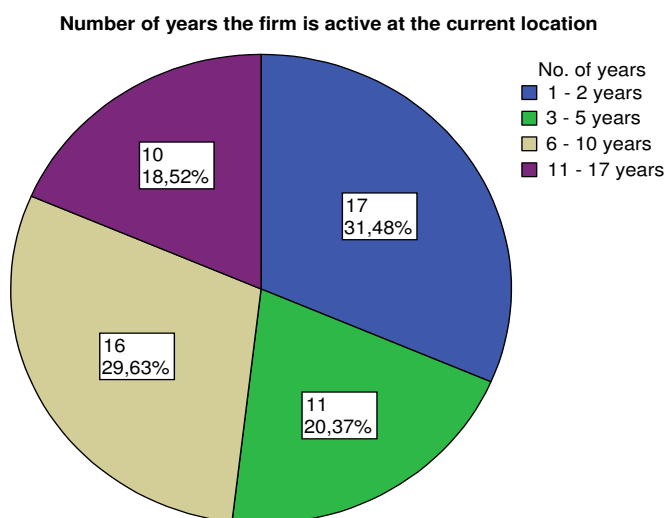


Figure 4.5: Duration of stay at the current location

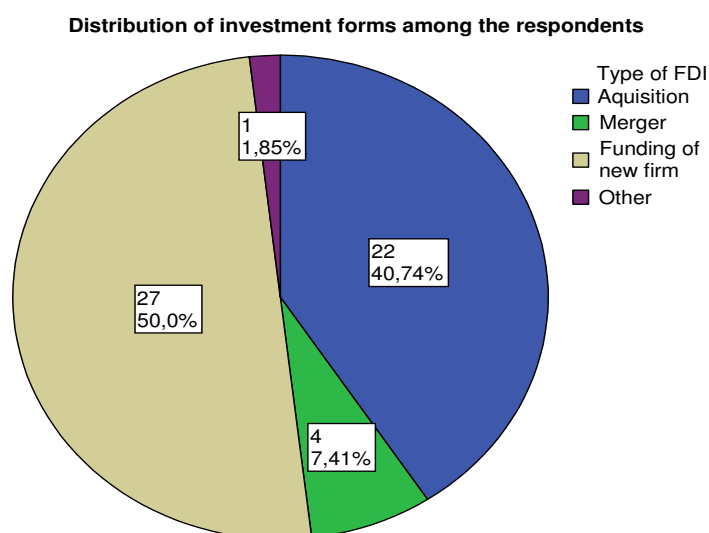


Figure 4.6: Distribution of investment forms amongst the respondents

#### *General characteristics of the sample*

What is the pattern of foreign firms in Riga? In order to answer that question, the pattern of firms is being described by means of locational characteristics, which can be defined according to their geographical position or towards transportation facilities. Therefore, the pattern of foreign firms is being described in terms of location characteristics on basis of a previously held study by Van Steen [Van Steen, 1998]. As starting point, each type of location is being described in terms of the firms that are present there.

The position of firms can be described according to different kinds of location typologies. According to the example of Van Steen [Van Steen, 1998], the following types of locations have been selected. However, as the situation described in this study differs in some aspects from the situation of Riga, some modifications have been made to make the model more

The point of interest however is not the form of investment, but the fact that firms have inherited their location from a decision made by the previous management to invest at that particular location. As noted by Myles Shaver, the location provided through acquisition and mergers may sometimes not correspond with the location preferences of the current owners, inducing relocation. We will go into this in chapter six.

#### *Location pattern of foreign firms*

In figure 4.7, which can be found in appendix 2, the locational pattern of foreign firms has been displayed by means of a map. The majority of both respondents and non respondents are located in the city centre. Additionally, a high number of firms is located next to, or in the vicinity of major roads leading to the city centre of Riga. A smaller number of firms is located in the vicinity of medium or smaller roads and rail roads.



applicable to the situation of this study. The location types that have been used for the description are as follows;

Box 4.1	
Location general:	A1 City centre of Riga A2 Edges of the city centre of Riga A3 Residential districts of Riga A4 City outskirts and the area of Riga rajons
Infrastructural access	B1 Within 500 meter of a major road leading to the inner-city B2 Within 350 meter of a major highway in or around Riga B3 Within 500 meter of a major road within the city limits B4 Within 350 meter of a trolley bus or auto bus halt B5 Within 350 meter of a tram halt B6 Within 500 meter of a train station

Two things should be mentioned however towards this approach. First, A and B are both different approaches in arranging results. A does not exclude B and vice versa. Second, the categories of B are also non-excluding amongst each other. In other words, firms can be in both category B1 and B4.

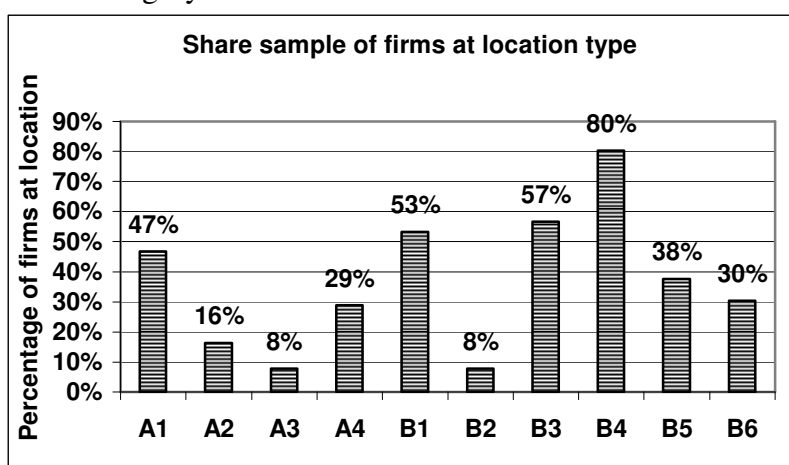


Figure 4.8: Distribution of firms amongst location types

In figure 4.8, the distribution of the sample according to the above approach has been given. The city-centre of Riga (A1) is the home to a large number of foreign firms ( $n=71$ ), with a smaller number ( $n=25$ ) locating around the city centre. Although the method of collecting data is certain to have some influence, the share of firms in the centre is very high. Twenty-nine percent is located on the outskirts of the city. For category B, the results are different as the categories of B are non-excluding. As established in figure 4.7, a large number of firms are located near major roads leading to the city centre. This same conclusion is being reconfirmed by a high share in category B1.

A second interesting aspect is a large share of the sample meeting criterion B4. As noted in chapter two already, post-communist cities have a public-transport network that is of relatively good quality. As Riga has a mono-centric character with both good public transport facilities in and leading to the centre, it explains that the share meeting criterion B4, B5 and B6 is very high. The categories of the B criterion are non-excluding, which also means that not all firms meet at least one criterion. Therefore, a new variable has been created indicating the number of B criteria the location of the firm meets. This variable will be used from now on. For a detailed view on the share of A-type locations meeting the different criteria, see Appendix 4. Roughly 11 percent does not meet any of the B-criteria. These locations are mainly located at the A4 location type (outskirts of Riga). As more B-criteria are met, the relative percentage of observations in A1 & A2 is increasing, which makes perfect sense as public transport routes and facilities are leading to the centre and major roads leading to the centre and in the centre are also present (remember the centre had the highest number of observations).

The types of firms that are present at the different locations, also varies. In figure 4.9, the distribution of business sectors has been displayed against the location typologies.

<b>Business sector according to accessibility score and general location type</b>											
<b>Within Criterion</b>	<b>Business sector</b>									<b>Total</b>	<b>Average</b>
	<b>In</b>	<b>Con</b>	<b>Wh.s.</b>	<b>Ret</b>	<b>Tra</b>	<b>B2B</b>	<b>IT/Com</b>	<b>UC</b>			
B1 (500 m major road)	16%	6%	19%	14%	5%	32%	6%	2%	100%	54%	
B2 (500 m major highway)	8%	0%	50%	8%	8%	17%	0%	8%	100%	8%	
B3 (500 m road city limits)	9%	5%	16%	11%	6%	42%	5%	6%	100%	56%	
B4 (350 m bus/trolley bus)	13%	5%	20%	12%	7%	33%	7%	4%	100%	80%	
B5 (350 m tram halt)	9%	4%	14%	16%	9%	36%	5%	7%	100%	37%	
B6 (500 m train station)	17%	9%	9%	13%	7%	28%	11%	7%	100%	30%	
<b>Accessibility score</b>	<b>In</b>	<b>Con</b>	<b>Wh.s.</b>	<b>Ret</b>	<b>Tra</b>	<b>B2B</b>	<b>IT/Com</b>	<b>UC</b>	<b>Total</b>	<b>General</b>	
Within none of all B criteria	50%	6%	0%	6%	25%	6%	0%	6%	100%	11%	
Within 1 of 6 B criteria	56%	0%	33%	11%	0%	0%	0%	0%	100%	6%	
Within 2 of 6 B criteria	11%	4%	28%	13%	4%	32%	6%	2%	100%	31%	
Within 3 of 6 B criteria	16%	10%	23%	10%	10%	23%	6%	3%	100%	21%	
Within 4 of 6 B criteria	11%	6%	11%	19%	6%	39%	6%	3%	100%	24%	
Within 5 of 6 B criteria	9%	0%	9%	0%	9%	55%	9%	9%	100%	7%	
Within all B criteria	0%	0%	0%	0%	0%	0%	0%	100%	100%	1%	
<b>General location type</b>	<b>In</b>	<b>Con</b>	<b>Wh.s.</b>	<b>Ret</b>	<b>Tra</b>	<b>B2B</b>	<b>IT/Com</b>	<b>UC</b>	<b>Total</b>	<b>General</b>	
A1	7%	3%	16%	10%	6%	47%	6%	6%	100%	46%	
A2	20%	12%	16%	16%	8%	20%	8%	0%	100%	17%	
A3	0%	0%	33%	25%	0%	33%	0%	8%	100%	8%	
A4	41%	7%	20%	9%	14%	2%	5%	2%	100%	29%	
<b>General distribution</b>	19%	5%	19%	12%	8%	29%	5%	4%	100%	100%	

Table 4.9: Share of business sector specified by Accessibility score and general location type

### Main points

Regarding the A1 and A4 location types, both can be regarded as being each others complete opposite for the sectors industry/production and business services. Where in type A1, industry/production is low and business services high, in A4 industry/production is high and business services low. The edges of the city and the firms within range of B1 however show some similarity with the general sector distribution.

This is corresponding with results by previous studies [Van Steen 1998] where its findings indicate that there is a strong deviation of the general sector composition in the inner city and a similar sector composition at the edges of the city. Although comparing the location behaviour of these foreign firms with that of domestic firms may not be justified at first sight, it should be noted that around 45 percent of the firms in the respondent-sample inherited its previous location, of which the location choice was made by management of a 'domestic' firm. Therefore it may correspond.

Previous locationtypes of relocated firms

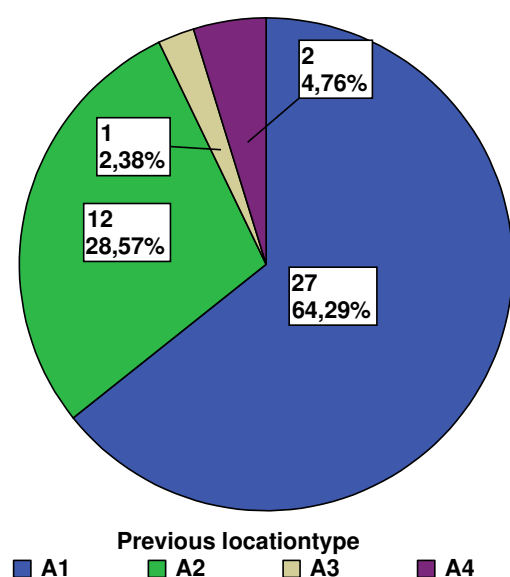


Figure 4.10: Distribution of firms amongst location type

Additionally, of the sector business services, the share is relatively high in the categories of two of six B criteria and upwards, pointing out that these firms are located at highly accessible locations.

#### *Previous relocations & relocation saldo*

As determined before, relocation amongst both respondents and non-respondents has occurred in the past. Providing a view on which location type the most relocations occurred, the previous locations have also been determined. The majority of relocations that occurred have occurred in the city centre (65 percent), of which 30 percent relocated to a location outside the centre. The saldo of relocations however was most positive for location type A1 (n=28), followed by location A4 (n=9) and type A2 (n=7).

#### *Age differences in location typologies*

Combining the two younger categories into a class representing 1 to 5 years and the three older ones into one category representing 6 years or older, a slight difference in age categories can be found. The city centre is having a slight higher share in younger firms, compared to the other location types. The difference is however not significant. This pattern would however match the theory of the so called seed-pod model that will be discussed later on.

To conclude, the following points of interest towards the geographical pattern are visible;

1. A high share of firms located in the city centre and the outskirts (A1 & A4).
2. A low share of firms located in the residential districts (A3).
3. A high share of firms located within reach of public transport facilities (B 4-6).
4. A high share of firms located near major roads leading to the city centre (B1).
5. A high share of business services in the city centre (A1).
6. A higher number of relocations in the city centre (A1).
7. A high share of retail and wholesale and no presence of industrial firms in residential areas (A3).
8. A high share of industrial firms and transport firms on the outskirts of the city (A4).
9. An under representation of business services on the outskirts of the city (A4).
10. An under representation of transportation firms and a slightly higher share than average of business services, retail and IT/Telecom firms within range of access roads leading to the city centre (B1).
11. An over representation of wholesale firms within range of a highway (B2).
12. An under representation of industry and over representation of business services within range of a major road (B3).
13. A lower share of industry and construction firms and a high share of business and IT/Telecom services within range of a trolleybus- or bus stop (B4).
14. A higher rate of relocation occurrence compared to other location types (4).
15. A high share of retail firms at tram halts (B5).

### Paragraph 4.3 – The relocation behaviour of firms in both samples

Of the respondent and non-respondent group together, 32 percent has relocated. There is a difference in the percentage of relocation between the respondent and non-respondent group however, as of the respondent group, 56 percent has relocated whilst of the non-respondent group 18 percent has relocated (Note however that for the non-respondent group, only relocations after 2000 were observed, explaining partly the difference in percentages).

The percentage of firms relocated at the different location types amongst the respondent group is as follows. Of type A1, it is 49 percent, of A2, A3 and A4 it is 100% with respectively 4, 1 and 2 observations. For the non-respondent group, the percentages are as follows; A1 29 percent, A2 10 percent, A3 0 percent and A4 with 21 percent. It is a complete opposite picture. When comparing both groups, the respondent group corresponds partly by findings in the literature [Van Steen 1998]. Because of the method that is used to determine the relocation occurrence, the decision is made to leave the non-respondent group out of this paragraph (unless the respondent group is not providing sufficient data).

#### *Business sector & relocation occurrence*

The construction sector has the highest occurrence of relocation with 100% (n=5) followed by the sector wholesale, 5 of 7 and retail with 3 of 4. The number of observations however is too low to make statements on these results. The business services sector has a relocation occurrence of 48 percent with a total number of observations of 21.

Combining the respondent-group with the non-respondent group still makes the business services sector the largest group, but reduces the relocation occurrence amongst the group to 35 percent. The construction sector still has the highest occurrence of relocation, though reduced to 63 percent with a total number of 8. Based on the respondent group, it cannot be said that the business sector of the firm influences the relocation behaviour.

		Location type				Total
		A1	A2	A3	A4	
Previous locationtype	A1	19	5	1	5	30
	A2	8	1	0	3	12
	A3	1	0	0	0	1
	A4	0	1	0	1	2
	Receiving total	28	7	1	9	45
Balance		-2	-5	0	7	0

Table 4.11: Migration numbers & net migration amongst location types

More interesting is the fact of the relocation movements made in the respondent group. If 49 percent of the respondents has relocated at A1 and 51 percent not, it is obvious that the last group has started in the city centre, indicating the centre was the most suitable location at first. However, the remaining 49% has relocated indicating that they were first located somewhere else. The question is at which location did these firms originate?

Establishing the past-location of respondents and non-respondents and displaying them against their current location resulted in table 4.11. As can be seen, location A4 was a net winner whilst A1 and A2 were net losers, of which A2 especially towards A1, followed by A4. A2 however gained a number of firms from A1. A4 was a winner towards both A1 and A2. It displays an out migration from the centre areas towards location type A4. Location A3 saw only one firm moving away and one firm moving to its location type. More interesting however is the high number of relocations within the centre itself. Although one third chooses to locate somewhere else, two thirds remains in the centre. The city centre does have a significant preference towards the relocating firms, because of certain pull-factors that will be discussed next.

### *Push & pull factors influencing the past relocation movements*

Before an explanation on the push- and pull factors is given, it should be noted that this part only involves the relocation of firms that participated in the questionnaire.

With a net immigration towards location type A4 and a high number of relocations occurring within the centre, the relocation movements of the past have been discussed. The remaining question however is why. Firms may have multiple reasons for leaving a location [Van Steen 1998, Louw 1996]. For the 30 firms that have relocated, 40 reasons were given why the firm left the previous location, creating an average of 1.33 push factor per firm. The low number is due to the setting of the question in the questionnaire.

Firms hardly choose a location based on one motive [Louw 1996] and in the respondent group, 30 relocated firms gave 62 grounds, which makes two grounds per firm. The difference between the average number of push- and pull factors can be explained by the fact that there are usually only a few grounds to leave a location, but the new location choice is made on basis of more motives [Louw 1996, Van Steen 1998].

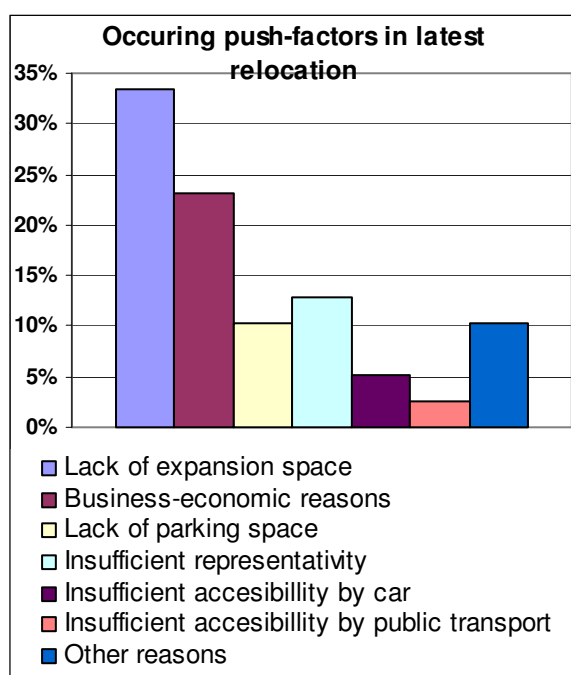


Figure 4.12: Share of push-factors occurring offered.

### *Push factors*

The major push-factor amongst the respondents was the lack of expansion space (33%) followed by the factor business-economic reasons as mergers, reorganisations, changes in rental prices, etc. Third was the insufficient representativeness of the location, followed by lack of parking space and 'other reasons'. This group is indicating that it was because of a different reason not mentioned in the survey. Mostly these concern building related properties as for example disoptimal layout, deterioration of the building to which the lessor refused to act, renovation of the building or changing of ownership. It reinstates the picture of low quality office space that can be found in the city centre [Beltina & Labeckis 2006] and therefore raises the question what will happen when new office space is being

### *Pull factors*

Amongst the relocated firms, the representativeness of the location is the most occurring pull factor (27%), followed by sufficient space for business expansion in the future (18%). The third place was shared with accessibility by road network, railroad and public transport (12%) and fourth where both the quality of parking facilities (10%).

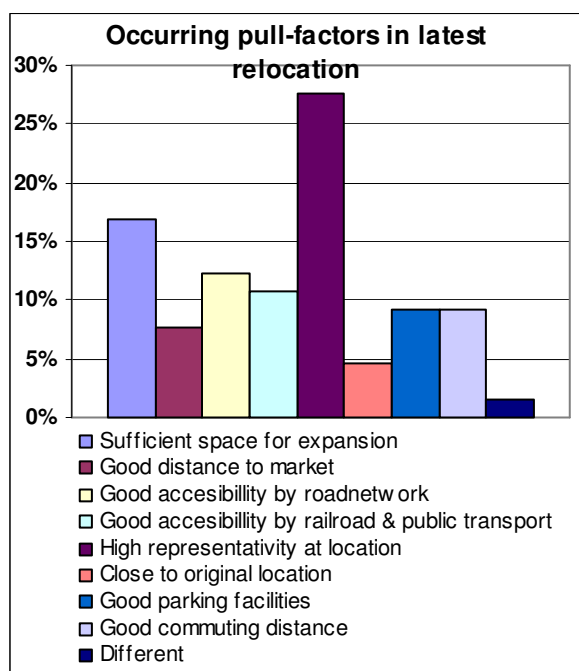


Figure 4.13: Share of pull-factors occurring

Comparing these push-factors with the findings in the literature leads to the conclusion that regarding push-factors, the difference with literature on relocation is that in the respondent group, the acquisition, merger and reorganisation of firms is a larger contributor to relocations than in the case of a domestic study as for example Van Steen [1998].

Also interesting is that 3 of 4 firms indicate they relocated because of building specific aspects as deteriorated state of the building, renovation of the building or design/layout properties of the building. This factor is relatively high compared to other studies [Louw 1996, Van Steen 1998]. As mentioned before, it reinstates the picture of low office quality found in the centre.

According to different sources of literature on relocation behaviour, major pull factors are sufficient space for expansion of business activities, accessibility to deliverers, suppliers and customers and representativity of the location [Pellenbarg et al 2002]. Other authors agree on these aspects but include additional aspects as sufficient parking-space, accessibility by public transport or presence of special services, all depending on the business sector involved [Haanemayer 1998 and Louw 1996]. As the ranking of these pull-factors differs over time and it concerns a sample that is slightly different from domestic firms, it is not fruitful to discuss difference in rankings.

The most mentioned reason for choosing the current location is good representativity at location, which is indeed one of the most occurring pull-factors for office-based firms [Louw 1996]. Looking at the current location of these firms, all are located in the centre or in the very close vicinity. In other words, the centre is regarded as being highly representative amongst the respondents. Sufficient space for expansion is another important pull-factor corresponding with the findings in the literature, as is accessibility by road and public transport in case of office-based firms [Louw 1996, Haanemayer 1998]. When observing the pull-factors mentioned, there aren't any pull-factors that are not mentioned in relocation literature. The degree in which they are mentioned however is different, but regarding the context in which the relocation decision is taken and the background of the respondents, this is well explainable.

### *Reflection on literature*

In different sources of relocation literature, limited expansion space at location and limited representativity of the present location are the most important push factors [Pellenbarg et al 2002]. According to Brouwer [2004], firms involved in mergers, acquisition and take-over have a higher chance of relocation, although in case of a take-over, the difference is not significant.

Examining the above mentioned push-factors, these results correspond with the findings in the literature.

Although the biggest contributor to relocation movement in the group is still lack of expansion space, second is the group of business-economic reasons which represents acquisition, merger, reorganisations etc (which makes perfectly sense as acquisition and mergers are large contributors to FDI).

### **Paragraph 4.4 – Explaining the locational pattern**

In paragraph 2, the locational pattern of foreign firms was discussed. In the following paragraph, an explanation on the pattern described in paragraph 2 will be given. To remain focused on the theme at hand, the question therefore will be; *is there an explanation for the found pattern in the literature?*

In order to provide an answer this question, it is of course important to look at both answers that can be found in the literature and explanations deriving from the specific circumstances of Riga. Therefore it is also necessary to search for explanations from this point of view. It should also be noted that it involves the group of respondents and non-respondents combined. As for the rest, there are no deviations in the location pattern that seem noteworthy of discussing. However, before we continue on explaining the above described pattern, a few notes have to be made on providing an explanation. First of all, it is important to understand that on the ‘foreign firm’ sample, only information on the sector and the year of investment has been obtained.

#### *Points 1, 5, 6, 8, 9 and 13*

The high share of firms located in the centre is partly due to the nature of the economic activity taking place at the firm and which requires office space. These activities are mainly consultancy, pr-agencies, banks, financial advisors, retail/wholesale companies and service firms and they are users of office space [Beltina & Labeckis 2006, Louw 1996]. A second reason why a high number of firms is located here is due to the representativity that the centre has relative to other areas as could be seen in paragraph three, which is also claimed by Schiller [2001]. At the same time, a representative location is valued highly by office users [Louw 1996]. Thirdly, the majority of the office-stock is located here and therefore, so must its users [Beltina & Labeckis 2006].

Firms located in the centre (as for instance business services) attribute more value to a high accessibility by public transport than firms located at less central locations [Haanemayer 1998]. At the same time, the coverage of public transport in the centre is very high as well [Grime & Duke 1996], providing an explanation why the share of IT/Telecom and business services near public transport facilities is higher. Additionally, factors as accessibility by car and parking space are less valued by firms in the centre, which is scarce in the centre of Riga. For the same reason, the business sector is overrepresented in the centre and under represented on the edges of the city. As it is a major user of office space, its location preferences can be regarded equal. These firms require a representative surrounding and building value accessibility by public transport higher. However, they also value parking space high, which is scarce in the centre.

In paragraph three, a high number of relocations within the city centre has been observed. The number of relocations within a city are usually higher than the number of relocations elsewhere in or at the edges of cities, due to location stress and the fact that firms who rent their premises experience more location stress. As the rental percentage in the centre is higher, the location stress and the number of relocations as a consequence is also higher.

A different concept, provided by Schiller [2001, p. 110] is called the seed-pod model. It describes that new firms, for example foreign banks start in high-cost central locations, expand and then move out. As quoted, as a new firm they are unknown and seek a location where they will have a high level of visibility and be able to make contacts easily. Being

small the high cost of rent per square foot of the space they occupy is less important than the fact that the total is bearable. After a while, when the firm expands, they will take on more staff. The firm will build up goodwill and the need for a high visible location becomes less. They will consider moving out, to a more remote location at the edge of the centre or maybe sometimes out of the centre completely [Schiller, 2001]. This would mean that as for now, they are still located in the centre but will move outwards as soon as the firm grows older. As earlier established, there is indeed a difference in location type and age profile, as established in paragraph two and the relocation pattern established in the previous paragraph suggests a slow migration of firms towards the edges of the city. However, further evidence on behaviour which could prove the theory is applicable cannot be found.

The city edges and outskirts of Riga are also home to a high number of firms and past relocations occurred towards this location type. The distribution of the sample at location A4 is as follows; industry has a share of 41 percent, wholesale has a share of 20 percent and transport 14 percent (figure 4.9). The relative large share (compared to other location types except A1) can be explained from the high share of industry, wholesale and modest share of the transport sector. Both first and last sectors are mainly located at the edges of the city and therefore make a large contribution to the share of location type A4. As typical location requirements of these sectors are high accessibility by road, sufficient expansion space (which are qualities that can be found easier at the outskirts of the city) and low appraisal of a representative location, a choice to locate at the outskirts is easily justified [Haanemayer 1998]. At the same time, these sectors value access by public transport less and will therefore not take these aspects in their location-choice process. Also, public transport is usually not as developed as in the city, explaining a low share of these types of firms within range of a bus- or trolley bus stop.

#### *Points 2, 3, 7 and 14*

The number of firms located in the residential areas is low. This is first of all due to remnants of spatial planning practices in which residential and industrial districts were segregated from each other [Grime and Duke 1996]. Room for commercial space was also hardly available, causing the residential district to be an unsuitable location for a firm to locate as these areas are not likely to offer space for large industrial complexes or transport firms. According to Van Steen [1998], firms located here face significantly higher location stress than other types of locations and will have higher chances of relocation.

What goes for industrial and transport firms, should go too for the wholesale sector. However, the wholesale sector is also present in the city centre. Both location types seem unlikely as these firms require high accessibility by means of road and facilities for loading and unloading, which both seem hard to realise in a residential area. An explanation can be found in the fact that these firms are office-based, as in the study of Beltina & Labeckis [2006] on office-demand and population of the centre of Riga. Therefore, it is likely that the perception of the firm, who itself considers itself wholesale, differs from the perception of studies as Haanemayer [1998] and Van Steen [1998]. This would lead to two completely different sets of location requirements for two sectors identifiable under the same name. In the case of a wholesale definition as in for instance Haanemayer [1998], the presence would be unexplainable. In case of an office-based definition, presence of a wholesale firm is possible due to new office development along access roads leading through residential areas.

However, there is a contradiction in case of the retail sector, which would explain a relative higher share of retail-activity based firms at location type A3. Retail firms have the tendency to locate near to their customers, which are located in residential areas. With the mono-centric



character of Riga and a lack of commercial space as a remnant from the socialist-planning practices, Riga has seen the construction of shopping malls near many residential areas [Spatial Plan of Riga 2005]. Additionally, retail firms are likely to be found at highly accessible locations. As public transport provides accessibility for customers, it is therefore likely that these firms will locate in the vicinity of public transport, explaining the high share of retail based firms at tram halts.

Firms located in the centre (as for instance business services) attribute more value to a high accessibility by public transport than firms located at less central locations [Haanemayer 1998]. Still, this leaves the location choice of firms outside the centre unexplained. The fact remains that coverage of public transport is also quite high outside the centre. Outside the centre, the percentages of firms within reach of at least one form of public transport range from 39 percent (B5) to 54 percent (B6). According to Haanemayer [1998], they do not value public transport access that highly. The number of office-based firms is also much lower. Why then the high percentages? As the city of Riga has a high coverage grade in public transport, dating from the socialist planning era, a lot of firms that are located in the city of Riga itself are also within range of public transport facilities. The choice to locate at these locations was probably made on other grounds, than presence of public transport facilities.

#### *Point 4, 10, 11 and 12*

Around one third of the group is located near roads leading to the inner-city, as could be seen from figure 4.9. There can be a number of reasons why the foreign firms have decided to locate here, of which the most obvious reason would be to obtain a location with higher access compared to other locations within the city. Main contributing sectors to the firms at location are the sectors industry and wholesale with respectively 20 percent and 24 percent. Both business and retail sector have a share of 16 percent. All sectors value accessibility, although the business sector in a lesser degree [Haanemayer 1998]. Nonetheless, in other studies, business services were found to locate along major access roads as well. An additional reason for locating at a major access road would be lower-land prices compared to locations in the centre. However, since the real-estate market and land market of Riga are momentarily influenced by heavy levels of inflation and real estate prices are soaring, land prices have not been collected, so nothing can be said on this subject.

As for the sector wholesale, there is also a presence of wholesale firms along highways in and around Riga. These firms require a high accessible location and as a result, these firms are located usually along specially designed business locations or at highly accessible locations as highways. This would provide an explanation of a high share of wholesale at this location.

The lower share of industry within reach of major roads is attributable to the fact that these firms are for a large part located outside the city, therefore they do not meet these criteria as the roads meeting the criteria of the analysis are inside Riga.

As for the firms in the business services, they appear in this statistic due to the fact that a number of roads used in the analysis are located in the centre. They are roads which have a high representative status as for instance Brivivas street, Elizabetes street or Lacplesa street [Beltina & Labeckis 2006]. As business firms are drawn towards locations that have a high representative status, they will locate there.

Since the geographical pattern that has been described in paragraph two has been explained, the fourth chapter is coming to an end. In paragraph one, a description was given of the properties of both samples and a description of the geographical pattern. It was followed-up by a description of push-factors which led to the relocation behaviour of firms arriving to the

conclusion that the relocation occurrence in the centre is significantly higher as at other locations. The most occurring push factor in general was lack of expansion space, followed by business economic reasons.

In paragraph four, maybe the most interesting point was the presence of wholesale firms that could be found in the city centre contradicting the fact that wholesale firms usually do not locate in the city centre. A possible explanation is that there are two types of wholesale firms, both having different types of activities and so requiring different location qualities. The next task at hand is trying to predict where firms with a high degree of location stress will relocate to. This will be done in chapter five.

## Chapter 5 - Relocation stress & synthesis

### Paragraph 5.1 – introduction to the chapter.

In the final chapter, the remaining research questions will be answered. In paragraph 5.2, the degree of location stress of the response group will be discussed, along with an explanation towards the outcome of the question whether there is a high degree of location stress amongst the sample. Secondly, in the case there is relocation stress beyond a threshold, an important question is what type of location is being preferred in the case the firm wants to leave and what location in Riga may correspond to these demands. These questions will be discussed in paragraph 5.3. Finally, to conclude this thesis, the hypothetical relocation movements will be compared to locations that the city council of Riga wishes to develop, to determine if the policy of the city council reflects the location demand put forward by firms. This will be done in paragraph 5.4.

### Paragraph 5.2 – Relocation stress within the sample

Central subject of this paragraph will be the following question: “Which firms at which locations experience location stress beyond the relocation-threshold and what is the cause?”

To determine which firms experience location stress, a number of questions have been asked in the questionnaire. It is based on a number of factors that are location specific and could be rated “very good, good, mediocre, bad and very bad”. The factors are as follows;

1. The size of the building
2. Expansion space
3. Accessibility
4. Parking space
5. Representative state building
6. Distance to customers
7. Distance to suppliers
8. Overall quality of surrounding area
9. Visibility for passing traffic

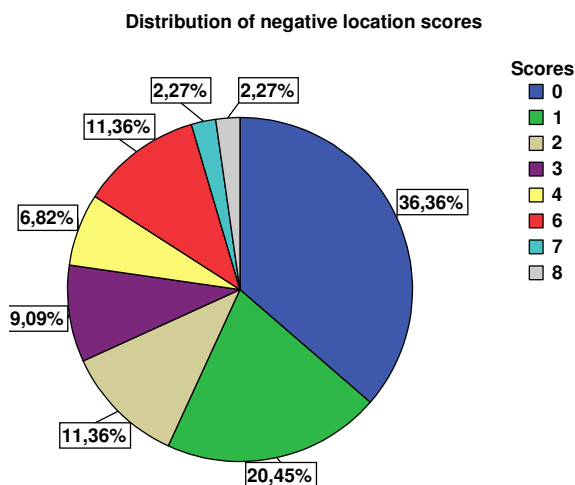


Figure 5.1: Distribution of negative location scores

As can be seen, 32 percent of the sample has a score of three or more points. A small portion of the sample has a score of 4 points or higher. As a score of three points or higher can be regarded as a high degree of location stress, according to this method around 32 percent of the sample is experiencing a high degree of relocation stress. Firms with 3 or more points can therefore be regarded as firms experiencing a high degree of location stress. To answer the third research question, this share of the sample will be used throughout this paragraph.

### *Location stress and type of location*

The total number of firms experiencing a high degree of location stress is fourteen, which can be regarded as extremely low. Mentioning percentages therefore does not contribute to more insight. The scores are as follows; of a total of fourteen, four have a score of three, three have a score of four, five have a score of six and both shares of seven and eight points represent one firm. The premises of these firms are all located in the city centre.

Does this correspond with findings in the literature? According to the results by Van Steen [1998] the inner-city-locations and residential areas faced high stress and outskirts of the city and the edge of the inner-city faced lower stress. Additionally, according to Louw [1996], firms that rent their premises are more likely to face location stress, as the premises they rent has not been specifically tailored to their need, as is the case with firms who decide to build a location themselves. Besides, with a relatively high number of observations in the city centre and a low number of observations at the outskirts of the city, with respectively high location stress and low location stress, it is not strange that all the firms experiencing location stress are located in the centre.

As towards the classification by means of the B-location types, the following results are obtained. In the category B1, 10 out of 14 firms not located within range of a major access road, are experiencing location stress. 4 out of 23 firms are experiencing location stress at their location (within range of a major access road). In the second category, (B2), there is no location stress amongst firms located within range of a highway. Unfortunately, the sample only contains 1 firm, therefore no conclusions can be based on this. In the third category, within range of a major road, 36 percent of the firms are experiencing location stress. Within range of a bus- or trolley bus halt (B4), around 13 of the 40 firms are experiencing location stress and within range of a tram halt, 7 of 22 firms are experiencing location stress. Within range of a train station, 5 of 17 firms are experiencing location stress.

### *Location stress and duration of stay at current location*

#### **Location stress vs. years at current location**

Count	Degree of location stress			Total
	Low degree of stress	High degree of stress		
Years at current location	1 - 2 years	8	2	10
	3 - 5 years	8	2	10
	5 - 10 years	10	4	14
	10 or more years	4	6	10
Total		30	14	44

Observing the duration of time a firm has stayed at its current location and whether the firm experiences location stress beyond the threshold of 3 points, the following figure can be derived.

First of all, the numbers of firms experiencing location stress beyond the threshold have a higher share in the two categories with the longest duration.

**Figure 5.2: Location stress and duration of stay at current location**

In comparison, the firms experiencing location stress below the threshold are more or less equally divided over all duration categories. Grouping the categories 1 – 2 years and 3 – 5 years together and grouping the remaining two categories together, a chi-square test can be performed, resulting in a significant difference between the number of firms experiencing a high degree of location stress and the number of years at current location, with a Pearson correlation of 0.047 p. In other words, there is a significant higher share of firms experiencing high location stress in the category five or more years at current location. It may well be an indication that conditions have worsened.

*Location stress and type of premises*

Between the amount of location stress experienced and the type of premises, there is hardly any difference between the degree in location stress of rental premises and owned premises. This goes in against findings in the literature, as Louw [1996] indicates that firms who rent their premises have a higher location stress than firms who own their building. The statement made before that the firms experiencing location stress in the city, is also due to the fact that a lot of firms rent their premises is therefore incorrect. The only thing that can be said regarding this aspect is that 71 percent of all firms facing high location stress are located in a rental premises.

*Location stress and relocation history*

As for the difference in relocation history, the share of firms that did not relocate and is experiencing location stress is higher than for firms that have relocated at least once in history. Of firms that have relocated in the past, 25 percent is experiencing location stress. Of firms that did not relocate, 42% is experiencing location stress. So, in this case, there is a difference although not significant ( $p > 0.101$ ). Amongst firms who endure location high location stress and have not relocated yet, 9 of 10 have been located here for duration of 5 or more years and one below the time of 5 years. The duration of stay of the firms is as follows. When looking at the duration of the stay, the following can be observed. Of the nine firms that have not relocated in the past, eight of them have been located at the current location for a duration of five or more years. In total, 11 of 14 firms experiencing location stress have been located here for a duration of longer than 5 or more years.

*Business sector and location stress*

Comparing the firms with high location stress and the business sector they are active in, results in the following results. Five of fourteen firms are active in the b2b sector, 3 in the IT/Tel.com sector and two in a remaining rest class, one in wholesale, one in retail and two in production. Note that all larger shares of the respondents with location stress are office-based firms (twelve out of fourteen). Only two firms are firms that are not office based. In other words; there is a high share in office users amongst the group of firms experiencing a high degree of location stress. In fact, almost all firms with location stress are office users.

*Number of employees and location stress*

As for the size of firms (number of employees) compared to the negative location score of firms, there is no distinct pattern visible. This is mainly due to the low number of observations within the category of firms of high location stress.

Regarding the above, the firms experiencing a high degree of location stress can be described as follows;

*All firms experiencing a high degree of location stress are located in the city-centre, are for the majority office-based and provide in business space by means of renting it in 70% of the cases. Only one third of all firms experiencing a high degree of location stress have relocated in its history, but 79% of the firms experiencing location stress have been active at their location for a period of 5 or more than 5 years.*

As the share of firms that experiences location stress has been described, a start can be made in answering the second part of the third research question, namely; what is the cause to the location stress. To provide an answer to the second part of the question, the number of

negative awarded factors has been counted and compared to the total number of firms who gave a rating. Results are visible below.

Factor	Number	Total	Percentage experienced
Parking space	19	44	43%
Accessibility	9	44	20%
Space for expansion	9	44	20%
Visibility for passing traffic	4	44	9%

**Figure 5.3 – Number and percentage of firms experiencing major stress contributors**

As can be seen, the factor parking space is being experienced negative by 19 of the 44 firms. Bad accessibility and insufficient space for expansion are both experienced negative by 9 of 44 firms. As for traffic visibility, only 4 of 44 regard this aspect negative and 3 of 44 regard the distance to suppliers and the size of the building negative. The distance to customers and the quality of the area are not being regarded negative at all.

Therefore, it can be said that the following factors are the main contributors of location-stress in our sample and certainly occurring the most.

- a) lack of parking space
- b) Insufficient space for business expansion
- c) Bad accessibility of premises

These factors are the largest contributors to the location stress of firms in the city. Therefore, these factors will be discussed.

That the factor “parking space” is experienced negative by almost 42% of the respondents is of no surprise. The problem of insufficient parking space is acknowledged in the spatial plan of Riga, not only as a problem in itself (as the centre is the destination for a large number of car based passenger traffic) but also as a cause for decreasing accessibility of the centre itself (9 of 44 firms are experiencing bad accessibility of their premises) due to additional traffic obstacles in the form of parked cars. A new parking policy therefore is deemed necessary to reduce the number of cars in the centre and freeing the central access roads towards the centre experiencing congestion (displayed in map “Appendix 1”). As noted by the Spatial Plan of Riga [2005], the purpose is to create large capacity parking facilities around the railway ring running around the city, combined with access to public transport routes leading to the cities.

The congestion in the city centre, as well as the resulting parking problems are a result of the inadequate road infrastructure from the socialist era, as well as the increased rate of car ownership in Riga and Riga rajons. The increased rate of car ownership is likely to be attributable to shifting consumer patterns [Tosics 2004, Latvijas Statistika 2007]. It can therefore be said that, if the shifting of consumer demand can be counted towards the dynamics of the Latvian economy, the dynamics of the Latvian economy are of influence on the location stress of firms in the form of car-usage, causing a serious lack of parking space in the centre. Bad accessibility is experienced to a lesser extent by firms in the centre, can also be attributed to the dynamics of the Latvian economy.

Additionally, the lack of expansion space at location, is also being mentioned as a negative factor. It should be noted however that lack of expansion space is a very important factor influencing relocation behaviour of firms [Van Steen 1998 and Pellenbarg 2002]. It means that at its current location, the firm does not have sufficient capacity to expand its firm. It

does not mean that the city centre in general has a lack of expansion space. Note however that the supply of office space is below demand, causing a low vacancy rate. This should have an impact on the relocation grade and the ability of firms to suffice in expansion space.

When taking together the two earlier mentioned factors however, it can be said that the increasing motorization of Latvia, made possible by economic growth, does have influence on the behaviour of firms.

### Paragraph 5.3 – Location preference in the case of location stress

In this research question, the locations being preferred by firms in the case if relocation stress occurred at the current location, are being discussed. In order to determine the preferred locations of firms, a question has been added to the questionnaire in which respondents were asked to indicate at which location they would likely relocate if location stress was too high to continue the current activities at the current location. For this purpose, a map was added on which respondents could pinpoint the location. As there are only fourteen out of forty-four firms that experience location stress, the preferred locations of all firms will be discussed first, followed by the results of firms experiencing location stress at moment.

The results of this are as follows; The majority of the respondents indicated they would look for a new business premises elsewhere in the city centre if location stress had reached the so-called relocation threshold (25 of 43) (2 & 1). Nine firms indicated they preferred the new to develop centre at the other side of the Daugava and the island of Kipsala and two firms preferred the business district of Teika / Cierkulkans. The other locations all had one vote. It indicates that amongst our respondents, the preferred locations are the city centre, the opposite area of the city centre across the Daugava (Kipsala) and Teika/Cierkulkans. Of all firms giving preference for the city centre, 76 percent has no location stress at the current moment. They do not see sufficient grounds on why to choose another location then the city centre in case of location stress. Of the fourteen firms with location stress, six indicate that they would again choose a location in the city centre. It is therefore likely that for these firms the presence of the firm in the city centre has a certain value, as the next location is likely to have some form of lower accessibility and/or less parking space again attributing to location stress at the next location.

#### The inner-city

The locations used in the above description have also been translated into a location type of A class. Because it is impossible to connect the geographical locations chosen by respondents with information on how accessible the locations are by public transport, there are no B classifications. The results of the A location types are as follows;

Count		Preference for different types of A locations		
		Experiencing location stress;		Total
		Yes	No	
Location type	Innercity	19	6	25
	Edges of the innercity	8	5	13
	Edges and surrounding of Riga	1	2	3
	Airport	1	0	1
	Outside of Riga	0	1	1
Total		29	14	43

Table 5.4: Preference for different types of A locations vs. degree of location stress

As can be seen from table 5.4, there is a strong preference for new locations in the city centre itself and for locations at the edges of the city, which combined reflects 89% of the location choices made. The city centre and its edges are still preferred above any other location. The preference for the inner-city as future

business location is clearly present. Motives towards these choices are as follows.



With 12 out of 19, the inner-city was regarded to the respondents as a place of high accessibility. 10 of 19 respondents believe it is a place with a representative status and 7 of 19 believe locating in the city centre gives the firm a central position. 6 of 19 would choose the location because it is close to the previous location. The fact that the inner-city is regarded as accessible by around 63% of the firms not experiencing high location stress, is contradicting with the fact that 20 percent of the respondents indicated they found that accessibility of the centre was bad. Either the opinion on this matter varies, or accessibility is rather different between different locations in the city centre. It is likely this is dependent on the relative location within the city centre, as not all locations have the same degree of accessibility of course.

Another important reason for the respondents to locate in the city centre is that the city-centre is regarded as a location with a representative status, according to 10 of 19 firms (53%). This is corresponding with the results of a study by Beltina & Labeckis [2006] on the quality of offices in Riga city centre. It is clear that being present in the centre of Riga is therefore important for some foreign firms. This goes for sectors as finance, corporate headquarters and business services as lawyers, real estate agencies, accountancy agencies etc and these business services are usually found in the central districts of the city because of it the representative status [Schiller 2001]. Corresponding with this view is the fact that 7 out of 19 firms indicate that they would locate in the city centre as the location of the firm offers them a central position to the market it is active in. These types of firms tend to locate close to their customers, which are also located in the centre and they benefit from the proximity of important people in other fields [Schiller 2001].

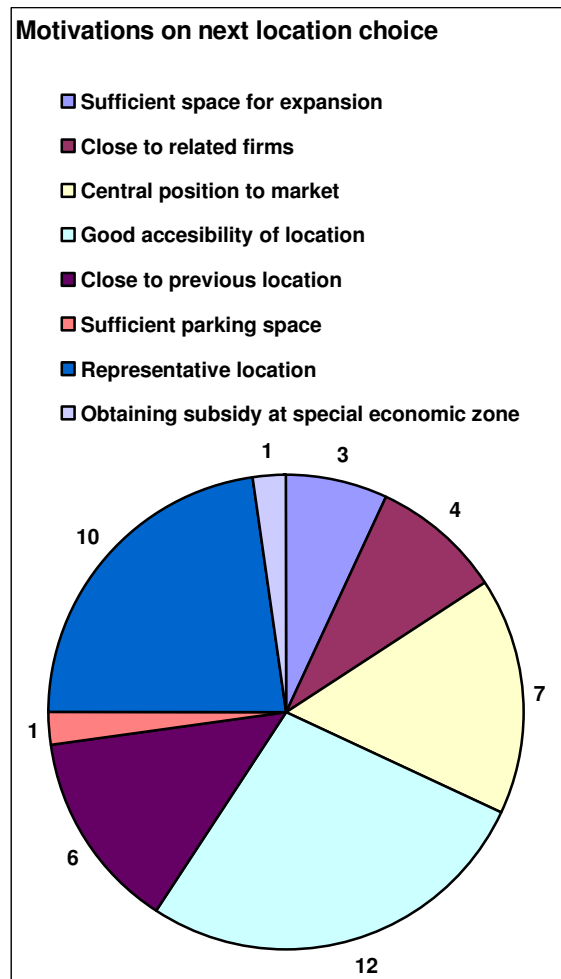


Figure 5.5: motivation of preference for the innercity

### The inner-city edges

As for the inner-city-edges, the reasons to locate there were as follows. Three out of eight would locate at the edges of the centre because of the central position it provides the firm to its market, sufficient parking space and good accessibility at the type of location. It illustrates that of the firms who would chose the edges of the centre as a next location, one third chooses it because it would provide in sufficient parking space. Whether it is the main ground for choosing this location is unclear, however it suggests that parking space in the centre is really problematic.

An equally often mentioned reason is that firms believe the edges of the city centre have a good accessibility. Of the three indicating they locate at the this location, two are actually experiencing bad accessibility at location. However, creating a group of firms with high and low location stress together, 7 firms indicate they would locate at the edges of the centre because of good accessibility. Three of these seven are experiencing bad accessibility. Additionally, of all firms experiencing bad accessibility (9), two-third would locate to the edges of the centre. So, it may be that indirect, the edges of the centre are an attractive location to firms experiencing bad accessibility.

A third equally mentioned reason is that the edges of the city centre provide a central location to the market of the firms. At a short distance from the centre, customers of the firms can still be reached, thus providing a good alternative for locating at the centre providing good parking facilities and better accessibility. In the study, mentioned by Beltina & Labeckis [2006], the edges of the centre are also mentioned as an alternative location providing access to the city centre within very little time.

### Edges of Riga and Riga rajons

There is only a low preference for locations at the edges of the city and the surrounding region of Riga amongst firms with low location stress (the actual number is 1). However considering the type of activities of the majority of the respondents, this is not strange as a high number of respondents are active in office-based activities and therefore are attracted to the centre of the city, reducing the relative demand for locations at the edges or the surrounding region of Riga. Motivation in case of the above firm was that a location outside of Riga or at the outskirts, would provide the firm in question with sufficient space for business expansion at location.

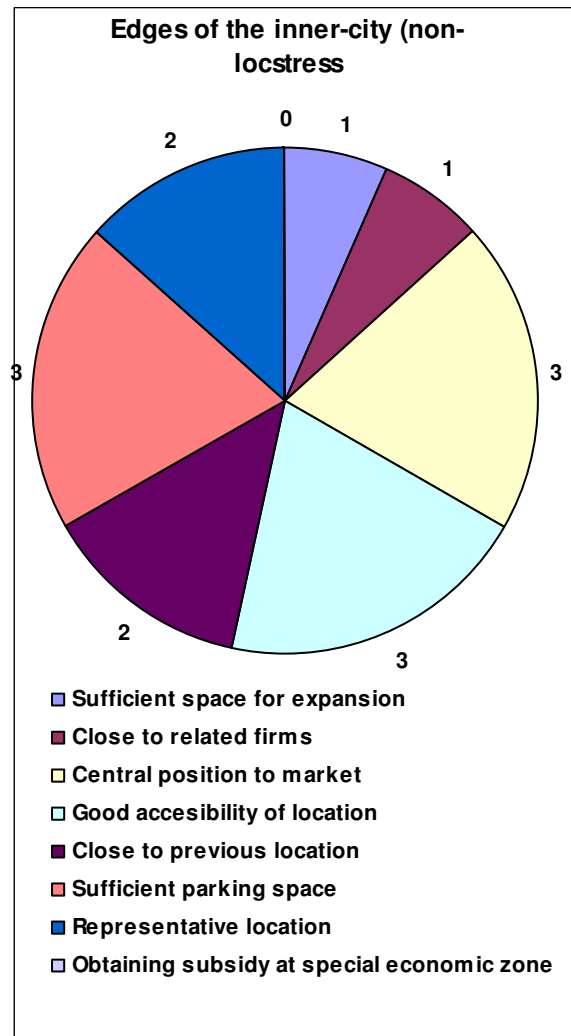


Figure 5.6: motivation of preference for centre-edges

The location preference for firms experiencing location stress is as follows. Six out of fourteen firms with location stress indicate they will stay in the inner-city (as all firms with too high location stress are already located in the centre. Eight out of fourteen indicate they will look at a different location outside the centre. Five out of fourteen indicate they will locate to the edges of the inner-city and three out of fourteen indicate they will locate at the edges of Riga and surrounding regions. Still, even amongst firms experiencing location stress beyond the threshold, an area as the inner city provides a suitable location. The reasons for the location choice will be discussed below.

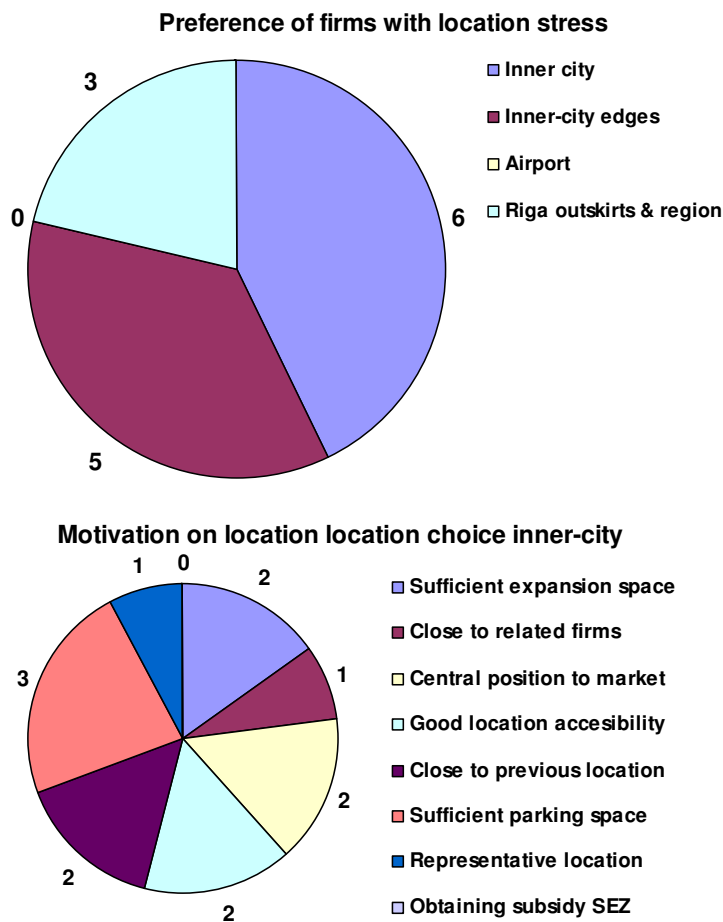


Figure 5.7: preference of location and motivation for city centre regarding firms with high location stress

indicate parking space quality is bad at their location. It does not stop them from looking for another location in the centre. Either they believe they can find a location in the city centre offering enough parking space, or ignore the bad parking space quality in the centre (due to different reasons). As for the other reasons given, 2 of 6 firms indicate they locate in the city centre because it offers a location that has a good accessibility, it would offer a central position to it's market, it would provide in a location offering sufficient expansion space at location or a location that it close to it's previous location (which is also in the inner-city centre). One of six indicates they would locate there because it would provide a location near related firms and another one believes it would provide in a location with high representative status.

For the aspects regarding the closeness to the previous location, location near related firms, provision of a highly representative status and the location close to the market the firm is active on, this seems very plausible as a city centre usually provides in this [Schiller 2001].

The motivations for the location choices are pictured below the pie-diagram of the preference of the firms.

Three of six firms indicate that they chose the inner-city as a location as they believe a new location in the centre would provide sufficient parking space. This is interesting as all firms choosing the city centre as area for the new location indicate that parking space quality is bad or very bad. It can be that they believe a better location with sufficient parking space may also be found in the centre itself (it should be known to the reader that there is a big difference between the parking quality in the Old-town of Riga and the area defined as the city centre in general).

In any way, all firms experiencing a degree of stress beyond the threshold choosing a location in the city centre

As for the accessibility aspect and the expansion aspect, it may well be that a new location with good qualities of the respective factors is found somewhere else in the city-centre. This however cannot be said unless the relocation movement is realised.

### Edges of the city-centre

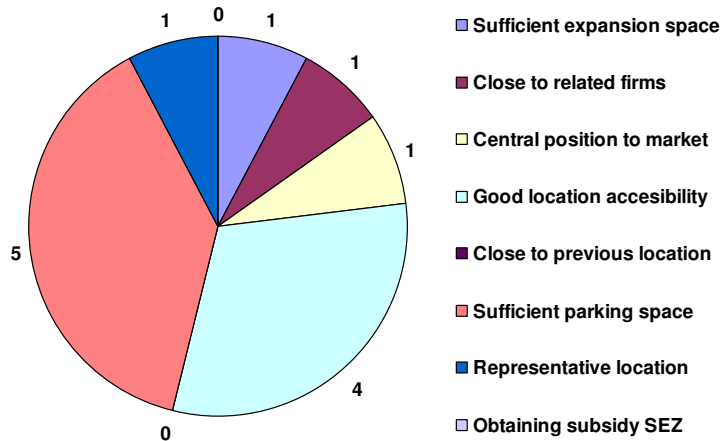


Figure 5.8: motivation for preference for centre-edges (high location stress)

Of all firms above the location stress threshold, 5 indicated they wanted to relocate towards the edges of the city centre. The motivations are as follows. All of the firms, wanting to locate at the edges, said they would locate here because it would provide in a location with sufficient parking space. Although the number of observations may be low, it does certainly point out that the lack of parking space is really causing firms to locate elsewhere, partly because they believe that parking facilities are better at locations at the edges of the centre<sup>3</sup>.

As for location accessibility, 4 of 5 indicate they chose the edges of the centre because they believe they can find a better accessible location at the edges of the city. Three firms of these four actually are experiencing bad accessibility at the current city centre. The fourth is not, but nonetheless chooses the edges of the inner-city because of this reason.

For the above mentioned firms, it is clear that these factors are causing inner-city based firms to locate at the edges in the future. However, since the number of observations is very low, it cannot be said if it is a pattern. For this, more observations of firms experiencing location stress beyond the relocation threshold are necessary. However, the fact that there is a low number of firms in this category already indicates that the factors mentioned do not cause enough stress amongst all respondents to go somewhere else, or to say differently, create a stronger pattern (also explaining why there are so many firms still giving preference to locate in the city centre without location stress and with location stress).

### City edges and outskirts

Finally, the locations beyond the edges of the city centre have a small attraction on firms with location stress. Three of fourteen firms indicate they would locate at the edges of the city, c.q. outskirts of Riga. The mostly given reasons are good accessibility of the location (3) and sufficient space for business expansion (2). Due to the low number of observations, comparison to the negative factors at location does not contribute anything.

As each type of classification separate does not have sufficient observations, all classifications except for the city centre have been grouped, creating a group who want to locate in the centre and one who want to locate outside or in the vicinity of the centre. The given arguments for the second group are displayed in figure 5.9 as follows. Not surprisingly, the biggest categories are parking space, accessibility and sufficient expansion space. Amongst the group of respondents, it can be said that these are the factors that are leading firms to locate elsewhere then the inner-city in case firms exceed the location stress threshold.

<sup>3</sup> Note that four of five firms experiencing location stress above the threshold are indeed experiencing bad or very bad parking space quality at their current location.

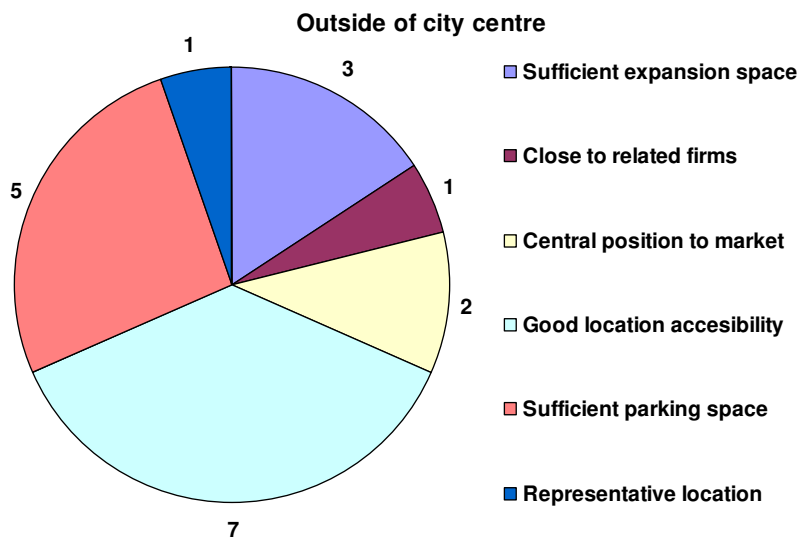


Figure 5.9: motivation of preference for locating outside the city centre

expansion space at current location. For these firms, the lack of expansion space is a big issue, as they experience a shortage at current location and choose the next because it can provide in sufficient space for expansion of business activities. The same goes for the other two factors, though in a lesser degree. Chances are great that a location meeting these qualities will be greater than in the inner-city.

As for the firms below the threshold of location stress (30), there is a difference with choice of location, compared to the firms beyond the threshold of location stress.

The firms with location stress beyond the threshold seem to base their location choices for a large part on the negative aspects experienced at location as seen above, which of course makes sense. As for firms with location stress below the threshold, or firms not experiencing stress at all, this can not be said as there is no negative aspect on which the decision is based.

## Conclusion

Both the city centre and its edges are the most popular locations to relocate to for firms with high and low location stress. The main reasons for the city centre are that it provides in a representative location, an accessible location, a central location to the market of many firms and finally, in many cases it is close to the previous location of many firms.

However, there is a difference between the location choices of firms with a high degree of location stress and firms with a low degree of location stress.

Firms experiencing a higher degree of location stress seem to have a relative higher preference for locations outside the city centre. Additionally, firms in the high-location stress group are located in the city centre, whilst firms in the low location stress group are spread over all types of locations, with 3 firms already located at the edges, of which one indicates it chooses the location to stay near its present location.

At least, it can be said that the sample of the study shows that there is a more diverse preference of locations amongst firms with high stress then with low stress. Adding all non-centre locations together for both high and low stress groups allows performing a chi-square test, but does not show significance. Test results can be found in appendix 6.

Accessibility is highest with 7 out of 8, followed by parking space (5 of 8) and third, expansion space (3 of 8).

At their current locations, four of these seven firms are experiencing bad accessibility, four of five are experiencing bad parking facilities and all three firms indicating they relocate outside the city are experiencing lack of

Now that a clear picture has been brought on what the preference of firms with high and low location stress is, the final research question can be answered. This will be done in the final chapter.

## **Paragraph 5.4 – Synthesis**

As seen in the previous paragraphs, there is still a great demand for office space in the city centre, as many firms would decide to locate in the city centre again in case of higher location stress. According to the Development and planning office of the city of Riga, this is also attributable to the underdeveloped infrastructure in the more distant communities of the city, making firms and managers of institutions stay in the centre. However, it is causing problems with traffic flow [Spatial Plan of Riga, 2005].

The city development office of Riga is of opinion that, although economic progress is not yet influenced by the problems arising from the high concentration, de-concentration of economic activities in the centre is necessary to allow for smooth economical progress of the city and for preservation of the historic city centre. Therefore, in the spatial planning document for the period of 2006 till 2008, the following strategy is pursued regarding the development of areas of economic activity. As for office development and locations with mixed economic activity, the following areas have been designated as areas for economic activity with growth potential.

### *Office development*

Office development of A-class offices in extensive form in the centre is not to continue in the current city centre, which reflects on the historic centre and the current city centre. The main share of office locations will take place in the new centres (which will be discussed later on) and the areas of the south end of Kipsala, Kliversala, Citadele andrejosta and near the zones of Hanza iela and Skanstes iela (note that at time of writing, construction on a number of office complexes has already started and some complexes finished). In perspective of the location typology used in the previous paragraph, the majority of the highest office class available will be realised at locations at the edge of the city centre.

As for office development of B and C class offices, the development of office locations is also very limited in the city centre itself and should be located mainly in the vicinity of the Citadele region and railway ring. In perspective of the location typology of the previous paragraph, this is at the edge of the city centre.

The main goal of the spatial plan of Riga (regarding space for economic activities) is focused on tackling the mono-centric structure of the city, trying to develop new development locations around the current city centre. These areas are mainly located between the current city centre and the railway circle surrounding the city centre, allowing the city centre to extend its borders.

Additionally, there are a number of locations designated for office development on the west-bank of the Daugava, opposing the current city centre. These territories are located along the Zunda-channel including the southern part of the island Kipsala, Kliversala into direction of Tornakalns and along Mukasalas iela and the area of Lukavsala and Zakusala (TV-island).

More northward of the current city centre, a new centre should be developed near Podrags and at the opposite side of the Daugava river at Andrejsala/Petersala. A visual representation of the area can be found in appendix 3. Other centre functions should only be realised in high-residential areas to provide local services, in order to relieve the mono-centric character of the city.

To summarize, the city of Riga is being transformed from a city with one centre where all activity is located towards a city where development of office locations in the current city centre is restricted and promoted around the edges of its centre. This should result in less

congestion and better opportunities for the surrounding areas and communities. Looking at these points of the spatial plan an interesting situation arises.

The city centre is at current still the location where the majority of office stock is located. The office market is, at time of research a market experiencing shortage and very low vacancy rates, therefore extra capacity would be beneficial, as it is also the most popular location amongst many firms, as just has been proven. At the same time, the same centre is experiencing a restrictive policy regarding the development of office-stock at location, compensated by stimulated office development at the edges of the centre where new and attractive office-stock is realised. The question arising is, what would happen in a circumstance like this.

#### *Locations for production functions*

As indicated before, the city of Riga has few good production locations left, while most former factory buildings are outdated and therefore lack efficient use. Therefore, a high number of locations need to be upgraded in order to be useful again. However, due to increasing commuter-traffic arising from a decreasing population in Riga itself and increasing population in neighbouring communities, new locations for production meeting current standards have to be provided.

For the provision of locations for production, warehousing and other logistic activities in the municipality of Riga, the city development office of Riga has indicated that these locations should be located at, either current locations of the same activity at the area of Skirotava/Latgale priekspilseta, the locations between the area of Spilve and Marupe, within the contours of Riga Airport and the location of the Freeport Riga is being designated as a suitable location for such activities. In other words, for the purpose of logistics and warehousing, production, wholesale and technological parks, these locations are stimulated. All three locations are visible in the map of appendix 3. In perspective of the location typology used in the previous paragraph, it corresponds with locations at the edges of the city (type A4).

To summarize the above results, the city development office of Riga is trying to shift the mono-centric character of Riga towards a city in which activities are more spread. Reason is that, due to the continuing trend of sub-urbanization and increasing commuting traffic as a result, the traffic problems will become severe. Therefore, new office-stock is to be located at the edges of the current city. In this way, the edges of the city-centre become attractive for investing as well and the city-centre borders are expanded. New locations for logistics, warehousing, wholesale and technological parks are located in the Freeport of Riga, Latgales priekpilseta,

Now that the locations stimulated by the city development office of Riga are clear, a comparison of the preferred locations of the firms, with those stimulated by the city development office, can be made.

As noted, the preference of industrial/production firms is that they wish to locate at locations outside the city. They prefer locations with sufficient expansion space, as seen in chapter four and in the previous paragraph, they also indicate they prefer the high accessibility of the location. In comparison towards the spatial plan of Riga, it can be said that there is a match regarding the locations stimulated by the Spatial Development Agency and the location preference of the firms.



Regarding the inner-city however, there is no match. The city centre is still, due to the various reasons discussed, a preferable location amongst firms. This is also traceable from the high score the area receives amongst our respondents. Additionally, the vacancy rate for offices is low as demand is higher than supply [Colliers 2006] and some office-stock however is becoming outdated [Beltina & Labeckis 2006]. However, at the same time, expansion of the current office-stock in the city centre is limited, due to the spatial policy of the city development office of Riga. In other words, the growth of office-stock in the city centre is reaching a halt<sup>4</sup>. With a low vacancy rate in the centre and new more modern office stock arising at the edges of the city, adapted to the current standards, old office stock becomes relatively unattractive. Especially when it would concern office-stock, obtained by the process of CBD-ization, mentioned before.

In a case like this, it would be likely that the relative preference of office locations at the edges of the centre would become more attractive as they offer a higher quality offices. In case relocation stress would reach the location stress threshold, a firm may be more likely to relocate to the edges of a centre.

Conclusion, there is no match between the preference of firms for the locations in the city centre and the stimulated locations of the spatial development agency, as the firms want to locate in the city because of higher representativeness, a close position to their market and a highly accessible location in terms of public transport, whilst the city development agency wants to spread the growing number of economic activities in the centre over multiple locations as to 1) develop economic activity at multiple locations to improve the quality of some sleeping districts and 2) to spread economic activity in the centre over a wider area to reduce traffic pressure, arising from increasing commuter traffic, due to sub-urbanization.

An arising question is of course; what does this have for result towards the relocation behaviour of firms?

Looking at the types of offices/buildings the respondents are located in, 79 percent of the firms at location type A1 of which data is available on the current type of location, is renting its current premises (n=52). 34 firms are located in a multi-tenancy building, 7 in a single tenancy building and 11 firms own their own building. The rental-market of office-stock is therefore the main contributor of office-space for our sample and as such, developments on this market will influence the majority of the firms in the sample. In other words, the majority of the firms in our sample is simply dependent on the offer on the rental market of offices, especially in a market where demand is high and supply is low. They will follow the trends, that are more or less, prescribed by the real-estate developers (a branch which is highly active in the centre of Riga).

In this situation, where new office-locations are provided at the edge of the centre, with higher location quality than at the city centre [Beltina & Labeckis 2006], firms are likely to accept a second best location in order to obtain a better quality location at the edges (assuming building quality of the new locations is better and building-specific properties determine the choice). As the construction of office-stock meeting modern European standards has only been underway for a period of four to five years, the amount of modern offices is still limited [Beltina & Labeckis 2006]. According to specific literature on office locations, Louw [1996] argues that the location choice of many firms, still is based on the

<sup>2</sup> It is of course not realistic to assume that the level of office stock will remain at a certain level. However, the spatial plan of Riga does clearly state that the main development of office space will be realised in the development centres, stated earlier.

building-specific features and the smaller the geographical scale, the more building-specific characteristics become important. Additionally, existing offer of office-locations is indeed an important motive for taking up residence [Louw 1996]. In other words, current offer acts as a constrain. With the above rules governing the ‘game’ of location choice of the office-based firms above, it is highly likely that in the future, the firms experiencing location stress in the centre, will chose for locations around the edges.

In the perspective of the City development office of Riga, it was clear already that there would be a negative match between the preferences of firms where to settle and the wish of the city council to develop other areas near the centre. As indicated in the Spatial Plan of Riga note [2005], there is a strong preference for firms to locate in the centre. However, as it leads to a number of problems, development of other areas near the centre is necessary. In case of the City development office, it simply becomes a situation of enforcing these guidelines and trying to develop the supporting infrastructure within the centre-edges to provide the quality necessary to cope with commuting traffic. Eventually, it will provide the city of Riga with an extended city centre, covering both sides of the Daugava, thereby decreasing traffic-flows on the bridges leading to the current centre (half of the traffic flows are at current originating from the direction of Jurmala). Also, as a result of the spread of office-stock, better parking-policy measures and traffic-flows, location stress may become less, thereby reducing the amount of location stress in the centre.

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## Chapter 6 – Conclusion

### ***Paragraph 6.1 – Introduction to the chapter***

In this final chapter, a reflection on the outcome of this thesis will be given. In the previous chapters, we discussed the locations of foreign firms, the relocation behaviour of firms as well as relocation stress and preferred locations in case firms wanted to relocate, followed by comparing the spatial plan of Riga with preferred locations. In the next paragraph a reflection on these outcomes will be given. In paragraph two, a conclusion on the results and a future perspective on firm relocation in Riga will be given, followed by paragraph three in which a discussion of the outcomes will be held. Focus in this paragraph will be on what the outcome of the research means regarding the future of Riga, what it mean in perspective of relocation literature and in perspective of foreign investment projects for the future. Finally, the fourth paragraph of this chapter will focus on a critical reflection of the outcomes of this research.

### ***Paragraph 6.2 - Conclusion***

In the introduction chapter, the focus was on how the dynamics of the Latvian economy and in which ways it may have influenced relocation behaviour of firms. The eventual goal of this thesis is to provide the reader with a view on where foreign firms in the city are located plus providing an explanation towards the found pattern. A second objective was to determine the degree of location stress plus underlying motives and to determine to which locations relocation movement will occur in case location stress rose above the threshold level.

The majority of foreign firms in Riga can be found in its centre and the edges of the centre or in the vicinity of major access roads. Due to the concentration of office-supply in the centre and the high number of firms, most relocation movements occur within the centre of Riga with only a small part of the firms locating at other destinations like the centre-edges and outskirts of Riga. However, the outskirts turn out to be the only net winner in the group of relocation movements studied. The main grounds for relocation movements made are still lack of expansion space and insufficient representativity of the location, corresponding with outcomes of previous literature on domestic firms. Differences however are that as it involves foreign firms, there was a higher share of firms relocating due to mergers, take-overs and acquisitions. This may be due to the background of the firms or simply due to a not representative sample. Second difference was a relatively high share of firms indicating they relocated due to the low quality of the premises.

The most occurring pull factor among the respondents was the representativeness of locations, followed by sufficient space for business expansion at the new location. Third was accessibility and fourth was quality of parking facilities. Further conclusions are that there are signs that a seed-pod model, as described by Schiller [2001] may be applicable to the situation in the centre of Riga, as firms located in the centre are slightly younger then their counterparts at the edges of the centre and the outskirts of Riga.

Greatest causes of location stress amongst all respondents and especially firms with location stress beyond a relocation threshold are the bad parking quality at location, insufficient space for expansion at location and a bad accessible location. Not only do these factors induce relocation behaviour, they also lead to a more diverse preference of locations amongst firms with a high degree of stress.

As mentioned earlier on, two of the three causes can be attributed to the economic circumstances in Latvia and Riga, as increasing car-ownership is attributable to shifting consumer-patterns made possible by a diverse number of reasons (including the much used forms of consumptive credits).

In the previous paragraphs and chapters, we saw that there were a number of factors that can be traced to the economic dynamics of Latvian/Riga's economy, which directly or indirectly may have influenced the location behaviour of foreign firms in Riga.

First of all, it can be concluded that the spatial structure, inherited from the socialist-planning era does in fact influence the location behaviour of firms, by means of preference for the city centre, explaining the high concentration of foreign firms in the centre. Secondly, by the lack of office space caused by the planning practices from that era and as a result, causing housing estates in the centre being converted to office use. As a result of that, office quality is of lower standard.

Thirdly, the socialist-planning era leaves the city with road infra-structure which is not sufficient to cope with the demand of today's traffic [Spatial Plan of Riga 2005]. Upgrading is indicated as necessary. Additionally, because of the mono-centric character of the city and the process of suburbanization made possible by financial loans becoming available in the last years, the commuter traffic is increasing [Spatial Plan of Riga 2005]. The same goes for increasing car-ownership also made possible by higher income and loans for consumptive credit. The demand of these products is due to a shifting consumptive pattern, typical for post-communist countries in transition [Tosics 2004].

These developments have indeed led to increasing commuter traffic, causing congestion problems in the centre, resulting in parking problems at numerous locations in the city, again influencing the amount of location stress foreign firms in the centre are experiencing. So, if car usage, suburbanization and increasing house-ownership are attributable to the dynamics of the Latvian economy, the resulting congestion and parking problems are in one way attributable to the dynamics of the Latvian economy as well. On the other hand, influence from the socialist-planning practice era is also attributable to location stress of firms, but is acting as a catalyst in the process.

However, this would picture the role of the internal firm dynamics as irrelevant. As noted, one of the most influential causes of relocation stress in the sample is the availability of floor space at location, which as mentioned earlier is according to Louw [1996], the most important reason to relocate for office-based firms. However, this of course is dependent on the growth of the organization. In this perspective, firm internal development is the main cause for relocation of the firms.

At the same time, the city development office is indicating that development of office complexes in the centre should be allowed to a minimum, whilst the edges of the centre should be developed. The same goes for the west-side of the Daugava, where new centres should be developed. This is done in order to reduce the flows of commuter traffic, to preserve the centre and to develop other parts of the city in order to create attractive investment opportunities elsewhere. The result will be new offices being offered at the edges of the centre and as offer of office-stock works as a constraint [Louw], firms will follow to the edges of the centre as well (specially in a market that is experiencing an over demand, this is likely to occur).

So, as a final conclusion, it is save to say the economic dynamics of Latvia are indeed influencing the location behaviour of firms, through consumption patterns that are shifting (and suburbanization as a result of this), through the spatial policy as a response to the

worsening conditions in the centre. The spatial structure of the city, inherited from the socialist planning practices is in this case acting as a catalyst in case of the infrastructure and as a constraint for location choice as it limits the choices of current office locations and industrial locations.

#### *A similar seed-pod model?*

Now, let us look on how the seed-pod model by Schiller (2001) fits into this. In chapter four, the seed-pod model by Schiller was briefly mentioned as an explanation for the presence of many firms in the centre and we found a slight difference in age as well. Looking at the centre from the perspective of this theory, the seed-pod model partly seems to be correct. New (foreign) firms will usually locate in the centre because of its popularity, its visibility and the relative closeness to other firms and facilities. However, it also became apparent that there were other causes (like the spatial structure of the city) to the concentration of firms in the centre. The difference however is as follows.

Firms who will move to the edges of the centre will do so due to the newly offered locations made possible by the spatial planning practices of the city development office of Riga as office stock works as a constraint in Riga. One could say this is enforcing the effects of the seed-pod model, or replacing the process described. Where in the seed-pod model by Schiller it is the rental price driving firms out of the centre, in Riga it may be the lower office-quality and the supply constraint of offices in the centre that has the upper hand in the process. Given the situation in present Riga, we could say that the spatial structure is creating a similar seed-pod effect, set in motion by the economic dynamics of Latvia. Supposing it would, the following situation may occur.

Newly realised office-locations outside the current centre will attract the larger foreign and domestic firms as age and size will make the firm choose a qualitative better and representable location [Louw 1996] (a location not realisable in the current centre). As a result, demand for current office stock in the inner-city will decrease, vacancy rates will go up, creating ‘stepping stones’ for new firms in an environment offering agglomeration benefits. In time, as demand and supply converge, the historical core may bring forward both a creative cluster as described by Weiping [2005] and firms requiring classical buildings (lawyers, notary’s, embassies, etc) [Louw 1996]. Possibly, the office-market of Riga would converge towards the office market of a western-European city with typical firms requiring specific buildings. Instead of where in the current situation, all firms are clustered together in a single centre because of the concentration of office-stock, a situation will arise where different types of office stock will be available at different locations.

#### *The difference between foreign and domestic relocation?*

The first subject under discussion in this thesis was Foreign Direct Investment, immediately identifying foreign firms as the population of this study. The benefits and strategies on attracting FDI were briefly discussed, signifying what most literature on FDI is about. FDI theory mostly focuses on determinants of foreign capital, explanations on attracting foreign capital and its benefits and drawbacks. However, it lacks theoretical insight in how they behave on a more local scale like an agglomeration as Riga. Once the choice for a specific region or agglomeration is made, they tend to focus on a different set of determinants which in some aspects are different from FDI determinants. Trying to explain locational behaviour by means of literature would push us into office-use theories as little is known on the specific site aspects of foreign firms as a separate group. FDI theories are for the majority based on how to attract them and keep them. The aspects of foreign firms relocating within the local sphere are, as a literature study shows, almost completely disregarded. This makes it hard to

explain geographical patterns of foreign firms. As for office use, it is known that international firms do usually choose A-class office buildings [Beltina & Labeckis 2006], so an explanation on the behaviour of foreign office users lies closer than an explanation on firms investing in a factory or warehouse. The picture becomes even more blur through the fact that the majority of FDI is acquisition based and therefore inherits its location. As we know, they are influenced more by factors as acquisition, mergers and take-overs [Brouwer 2002] making the process even more complicated. However, there are no strong indications in the response group that acquisition does in fact increase relocation. Does this mean that foreign and domestic firms have the same preferences? From this research, it is hard to tell as both domestic and foreign office-based firms in Riga are more or less forced in the same pattern. Further research into behavioural differences on foreign and domestic firms would be necessary.

### ***Paragraph 6.3 – Evaluation of the research***

Notwithstanding the fact most decisions in this research-thesis have been taken with great consideration, there are always some aspects worth reconsidering. To put it stronger, it is essential.

This research has been based on a combination of articles, statistical data from governmental organisations on a national (and sometimes regional) scale, data on tax-registries, yellow-pages and of course questionnaires. Although articles, statistical data, tax-registries and geographical data provide a solid base for research, the linking pin in this research is of course the questionnaire. As the questionnaire for a large part consists out of a series of questions on their evaluation of the business-environment, it is only comparable to other respondents. There are aspects of course which can be classified as ‘hard’ factors, but a large part of the obtained data by means of a questionnaire still can be classified as ‘soft’ data. The data obtained by means of the questionnaire is therefore less comparable with data used in a case-specific study as in Beltina & Labeckis [2006]. A focus on measurable aspects as floor space, rent and building year of premises would have offered great insight as well.

As mentioned above, the lack of ‘hard’ data in the questionnaire is one element which should be compensated in a following research project. One example would be the use of land market-prices. Obtaining land-market prices in geographical form would be a tedious task and as mentioned by a number of contacts, very difficult as levels of inflation and a booming real-estate market make price-levels very in-transparent.

However, adding the aspect of land-market prices in both the questionnaire and the analysis, would have offered a number of benefits, being 1) predict relocations on a more precise scale and determine which areas are valued higher/lower and 2) link typical users of office space with areas in which they would most likely locate. Additionally, focusing on land market values would have been a good step towards a more office-oriented approach. However, the fact that trying to use land-market values in order to predict preference and relocation choice should not be seen as giving preference towards a neo-classical approach. Using recent land-values in this master-thesis project could have provided useful additional insight.

Mentioning the use of an office-oriented approach also brings us to final following aspect, as a more office-orientated approach would offer the following benefits. First of all, the effects of a post-communist structure might have been easier to demonstrate in a study which focuses solely on the office-market. Secondly, as relocation in the centre was partly office quality driven, a focus on office-quality aspects would have resulted in interesting aspects as well.

With this conclusion, an end has come to this thesis on how the location behaviour of foreign firms in a transition economy is influenced by both economic dynamics, the spatial structure of post communist cities and policy towards locations. One of the things experienced, is that although there is much literature focusing on nationwide scale and on regional scale, it is hard to find on local scale. Although the original goal may not have been to add the structure of post-communist cities as an influencing factor on location behaviour, it soon became clear that it was important for understanding how certain things came to be. As a final word, it will be interesting to see how the future centre of Riga will be as expansion of business activities towards the edges will bring a great contrast between it's current historic core and if the new to develop centres. As the building boom was long underway already, some projects are to be realised in the near future.

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