



How to improve business innovation support policy

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Audit report

How to improve business innovation support policy

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Performance audit “Is planning and implementation of business innovation policy effective and facilitating efficiency and competitiveness increase of enterprises?”

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Dear Reader,

The State Audit Office of Latvia has conducted an audit on the planning and implementation of the business innovation policy to assess whether this policy is effective in our country, including whether and to what extent the funds used have succeeded in advancing achievement of the policy results set in the National Industrial Policy Guidelines 2014-2020 in the field of improving the competitiveness and productivity of businesses.

Investments in research and development in Latvia should increase and should reach 1.5% of the gross domestic product in 2027. However, without eliminating the deficiencies in the planning and implementation of the innovation development policy found during the audit, increasing the amount of funding alone will not ensure the achievement of better policy results such as an increase in productivity, competitiveness or export capacity and the associated increase in the well-being of the population.

After the audit, we have invited the Ministry of Economics and the Ministry of Education and Science to continue working together and improve policy planning, developing and actually launching its new implementation monitoring system, by considering not only improving the process of implementing innovation support measures, but also the results of the implemented activities assessment more persistently in order to see the impact of the investments made on the economics,

community, and the development of the community of innovative businesses clearly.

The innovation support system in our country must be sustainable, it must not depend on the availability of European Union structural funds too much. This system should be reliable and motivating in the long term so that enterprises both dare to take risks and innovate and are interested in cooperating with state institutions, including providing data on investments in research and development, making proposals and being heard in solving systemic problems. Therefore, the State Audit Office of Latvia made recommendations to the ministries regarding the provision of the access to funding for enterprises and scientific organizations by accelerating the harmonization of the Cabinet Regulations as well as raising public awareness on innovation support measures.

During the audit, we have provided a detailed assessment of the business support measures implemented by the Ministry of Economics to achieve the goals of the innovation policy, as well as compared them with the approaches of other countries. We hope that this assessment will help further effective implementation of the innovation policy.

We thank those involved for their cooperation in drafting the audit report!

Respectfully
Ms Inese Kalvāne
Department Director

Summary

Innovation is the successful implementation of scientific, technical, social, cultural or other ideas, developments and technologies in a new product, service or process¹. An innovation policy provides an interface between a research and technological development policy and an industrial policy and aims to create a favourable environment for bringing ideas to market².

The Organization for Economic Cooperation and Development (hereinafter - OECD) states in the Economic Survey Latvia of March 2022³ that the export of Latvia's industrial sector showed signs of maturity in its development, however, the advantages of Latvia's competitiveness were still based on low labour costs and innovations played a very crucial role in the development of exports in the long term. Latvia has one of the lowest indicators of investment in technological equipment and intellectual property in Europe.

Similar to other OECD member countries, the high costs of innovations and the lack of internal resources of businesses are indicated as the main problem of innovation development in Latvia. Difficulties in attracting public funding and insecurity caused by unclear prospects of market demand are noted as additional obstacles to the development of innovations in Latvia⁴.

Latvia's innovation performance has a low rating internationally, and Latvia's position in international rankings has slightly deteriorated since 2019. In the 2022 ranking of the Global Innovation Index⁵, Latvia is ranked 42nd among the 132 surveyed countries, which is a drop of eight positions compared to 2019.

In the European Innovation Scoreboard, Latvia is ranked 25th among the 27 EU countries in 2023, and after five years of representing the group of moderate innovator countries, it has fallen to the lowest group of emerging innovator countries. Institutional shortcomings, insufficient quality of infrastructure, low innovation performance, and insufficient business development and quality weaken Latvia's competitiveness significantly.

In this audit, the State Audit Office of Latvia assessed the planning and implementation of the innovation support policy of the Ministry of Education and Science and the Ministry of Economics by paying special attention to the planning and implementation of support measures aimed at the development of innovations in enterprises, thereby contributing to the improvement of the competitiveness and productivity of businesses. Taking into account a broad range of people involved in the implementation of innovation promotion support measures (Ministry of Economics, Investment and Development Agency of Latvia and industry clusters and competence centres representing businesses), we assessed the effectiveness of monitoring the implementation of business innovation support measures established by the Ministry of Economics separately.

Main conclusions

The activities carried out by the Ministry of Education and Science and the Ministry of Economics as the ministries responsible for innovation development policy in policy planning for the period 2014-2020 have not been sufficient, although with the public funding support of 681 million euros for project implementers, it would achieve results that would contribute significantly to the achievement of the policy results set in the National Industrial Policy Guidelines for 2014-2020⁶ (hereinafter – NIPG 2020) in the field of improving the competitiveness and productivity of enterprises.

Although the Ministry of Economics and the Ministry of Education and Science have improved the planning of indicators of innovation support measures in certain areas, we have established during the audit that the problems identified in the planning of innovation development support policy are still not addressed systematically and consistently. It poses a risk that support measures of 721 million euros⁷ might not achieve the economic development indicators specified in the national development policy documents in the programming period of 2021-2027.

The innovation support measures implemented by the Ministry of Economics and the Ministry of Education and Science cannot affect the achievement of policy goals significantly

Although the Ministry of Education and Science and the Ministry of Economics have planned specific tasks, the measures to be taken and the necessary funding for their implementation, as well as the institutions responsible for the implementation of the tasks are clearly defined in the development planning documents for the programming period of 2014-2020, the main problems hindering the development of innovations remain unchanged in the current planning documents for 2021-2027. At the same time, the auditors found that there was a number of problems that were mentioned periodically in various planning documents or in their implementation evaluations, but no information was available on the progress of their solution. For example, the NIPG2020 identified that the financial sector was not ready to finance business investment in R&D, but the auditors did not identify measures to address this problem.

The auditors have also found that the policy planning documents developed by the Ministry of Education and Science and the Ministry of Economics do not assess the significance of the identified problems and do not prioritise them in the order of their solution. Without assessing the significance of problems, the ministries cannot determine impartially which problem solving in the context of limited funds could provide better performance in the development of innovations, thus also contributing to the achievement of policy goals.



Innovation support measures are a step in the right direction, however, the actions taken will not ensure the development of innovations in the planned scope and the goals of national economic development are not achieved.

When assessing the policy development planning implemented by the Ministry of Economics and the support measures chosen for it in-depth and separately, we conclude that the planned indicators have been achieved in the implementation of the measures, which indicate the interest and ability of businesses to implement projects and achieve the specified outcome indicators. In the audit, we found that the innovation support measures chosen in Latvia were similar content-wise to the innovation support measures implemented in other EU Member States. In addition, a much broader basket of measures is offered to support the development of innovations in Latvia than in the countries included in the evaluation, however, Latvia is lagging behind the countries included in the comparison in the evaluation of the European Innovation Index increasingly.

In determining the outcome indicators of the measures during the EU programming period 2014-2020, the Ministry of Economics did not ensure compliance with the principles of intervention logic and the outcome indicators did not characterize the impact of the implementation of the measures on the achievement of the policy goal. Seven of the twelve outcome indicators of innovation support measures included in the audit describe the number of supported businesses and one outcome indicator describes the number of newly created products and technologies. Although these indicators are clearly defined, measurable and achievable during the implementation of the respective measures, they do not characterize either the goal of the measures (to promote the productivity and competitiveness of enterprises), nor the progress of achievement of the policy results (for example, the share of the manufacturing industry in gross domestic product, the increase in the productivity of manufacturing industry or the increase in value created by manufacturing industry).

This can send wrong signals to beneficiaries resulting in a situation where the number of products created or the number of enterprises supported is considered a good project result, rather than an increase in exports and an increase in productivity. The auditors found that in determining the indicators for the programming period 2021-2027, the Ministry of Economics improved the quality of outcome indicators of support measures and policy result indicators by setting clear goals for attracting private funding in the development of innovations. However, even in the programming period 2021-2027, the indicators are basically measuring the number of enterprises or scientific institutions that received support, without characterizing the expected impact of the planned support measures on export growth, which is the major target of NIPG2027.

The assessment of changes in competitiveness and productivity indicators of enterprises carried out during the audit that received support after receiving innovation support shows that only the support measure “Support for the improvement of the technology transfer system” has contributed to the increase in the productivity of enterprises three years after receiving the support. The positive impact of the three implemented support measures, id est, “Promotion of international competitiveness”, “Regional business incubators and creative industries incubator”, and “Cluster Program” on improving the competitiveness of enterprises is commendable. It is advisable to reconsider determination of implementation goals and outcome indicators of the support measures “Support for the development of new products and technologies within the framework of competence centres” and “Support for the introduction of new products in production” to promote a greater connection of the results of those measures with the achievement of the indicators set in the development policy because in the assessment carried out during the audit, there were the worst results in terms of

changes in productivity and competitiveness of companies after receiving support among the implementers of these measures in particular.

The inability of the responsible ministries to develop the rules for the implementation of measures financed by EU funds in a timely and qualitative manner leads to interruptions of support measures

Innovation development is gradual and requires financial support at all stages of its development, from an idea and concept phase to technical readiness and commercial implementation. The development of innovations in Latvia depends on the availability of funding from EU funds. In the period from 2014 to the end of 2023, financing from EU funds amounts to 61 % or 520 million euros from the funding supporting the development of innovation.

One cannot deny that the availability of EU funds for innovation support in enterprises is affected by changes in the priorities of EU fund programming periods and the ability of the responsible ministries to safeguard laws and regulations necessary for the start of the use of EU funds quickly. However, we detected during the audit that the Ministry of Economics was not able to ensure the timely development of laws and regulations necessary for the use of EU funds, which was affected by changes in the external regulations related to the provision of support and the coordination of laws and regulations with the participating institutions. It caused interruptions in the availability of innovation development support for scientific institutions and enterprises. The ability of the responsible ministries to provide additional support for the development of innovations from the state budget is limited (the size of the state budget and the needs of other sectors) in the event of an interruption of EU funding, which makes it difficult for enterprises to plan targeted investments and creates a risk for the sustainability of innovation development, the development of the community of innovative enterprises and the creation of new innovations.

Although the Ministry of Economics and the Ministry of Education and Science have assessed the need for support measures at each stage of the innovation development cycle when planning support measures, redistribution of the originally planned funding for the implementation of support measures up to 55%, which takes place only within the ministries and among the support measures under the control of the ministries, creates a risk that the goals of the innovation support policy will not be achieved in the long term.

The planning of indicators of support measures implemented by the Investment and Development Agency of Latvia should be improved and more targeted and cost-effective awareness raising among enterprises about available support measures should be ensured

In the EU programming period 2014-2020, there were six innovation-promoting support measures under the supervision of the Ministry of Economics financed from EU funds that aimed to improve the productivity and competitiveness of enterprises. For the implementation of these measures, funding of 376.7 million euros was allocated, including the funding of 229.8 million euros or 61% from the European Regional Development Fund (hereinafter - ERDF). For the implementation of the measures, the Ministry of Economics chose different governance and monitoring models:

- The Ministry of Economics entrusted the Investment and Development Agency of Latvia with the organization of the implementation of three support measures, id est, “Support for the improvement of the technology transfer system”, “Regional business incubators and creative industries incubator”, and “Promotion of international competitiveness”;
- The implementation of the projects of the support measure “Support for the introduction of new products in production” was ensured by enterprises that were also the final beneficiaries of the support;
- The implementation of projects of the support measure “Cluster program” was ensured by clusters such as associations or foundations that unite enterprises, research and knowledge dissemination organizations and other institutions operating in interrelated industries, product or service group or value chain in a common network;
- The implementation of the projects of the support measure “Support for the development of new products and technologies within the framework of competence centres” was ensured by competence centres, a union of unrelated industry enterprises with an aim of increasing the competitiveness of enterprises, promoting the cooperation of the research and industrial sectors, implementing projects that develop new products and technologies and introduce them into production. In the opinion of the Ministry of Economics one required to create an additional level of supervision to increase the effectiveness of the implementation of the mentioned support measure, that is, the Competence Centre Management Project implemented by the Ministry of Economics.

During the audit, we have established that enterprises, clusters and competence centres have ensured the implementation of the activities envisaged in the projects, the achievement of the planned project results and the use of funding in accordance with the projects envisaged in general. In their turn, the actions implemented by the Ministry of Economics and the Investment and Development Agency of Latvia in the implementation of support measures and the monitoring of the achievement of their goals should be improved.

The Investment and Development Agency of Latvia has established a procedure for monitoring planning and achievement of the indicators of the innovation support measures implemented by it, however, the significant imbalance of the changes in the planned indicators and the changes in the funding required for the implementation of the measures, found by the auditors, indicates deficiencies in the planning of the measure indicators. In addition, the progress in the use of funding for the support measures implemented by the Investment and Development Agency of Latvia⁸ shows the risk of not using the planned funding because when 10% of the planned time for project implementation was left on 28 March 2023, the funding balance was 30% on average.

Within the framework of the competence centre management project⁹, the Ministry of Economics performed such functions as already determined for the Ministry of Economics as a responsible authority or the Central Finance and Contracting Agency of Latvia as a cooperation institution. Moreover, the Ministry of Economics has not ensured the implementation of the competence centre management project as planned because not all planned activities (for example, attracting external experts for evaluation of studies) were implemented, thus there unused funding of 443,013 euros or 44% of the total project funding remained at the end of the project implementation, which, in case of timely action by the Ministry of Economics, could have been used for the main purpose of the program to support the operation of competence centres.

The auditors conclude that the implementation mechanism of the competence centre support program established by the Ministry of Economics was not cost-effective, and the Ministry of Economics used the funding intended for innovation support to finance functions that were already assigned to other institutions and were financed from other financial resources. The State Audit Office of Latvia assesses that the supervision of the implementation of the support measure for competence centres could be provided by the Central Finance and Contracting Agency of Latvia, which had also carried out the evaluation and selection of studies of a similar nature by attracting foreign experts in the science support measures supervised by the Ministry of Education and Science.

The Investment and Development Agency of Latvia provides information on measures promoting innovation and research to enterprises and scientific institutions on 11 websites, the development of which cost 546,017 euros and the maintenance costs another 254,361 euros every year. The State Audit Office of Latvia concludes that the approach of the Investment and Development Agency of Latvia in providing information on available state support is not effective, as those interested in receiving support always point to fragmentation, instability and insufficiency of the available information, which encumbers the planning of business development.

Key recommendations

Based on the conclusions of the performance audit, there are seven recommendations provided to the Ministry of Economics and the Ministry of Education and Science as the responsible institutions for planning science and innovation support measures, as well as to the Investment and Development Agency of Latvia as the responsible institution for the implementation of innovation promotion support measures.

To facilitate a greater impact of the implemented support measures on the achievement of policy results and to reduce the obstacles hindering the development of innovations purposefully:

- The Ministry of Economics and the Ministry of Education and Science should safeguard the priority implementation of innovation development support measures aimed at preventing the most significant identified problems and which are expected to have the greatest impact on the achievement of policy goals;
- The Ministry of Economics and the Ministry of Education and Science shall assess the impact of the planned innovation support measures (including those financed from EU funds in the programming period 2021-2027) on the achievement of the policy goals set in NIPG2027 and ZTAIP2027 (Science, Technology Development and Innovation Guidelines 2027) when developing the RIS3 monitoring report in 2026 and carry out actions to improve the effectiveness of support measures.

To improve the availability of information for policy planners about the results of the implemented support measures, as well as to improve the completeness of the statistics prepared by the Central Statistical Office of Latvia, we invite the Ministry of Economics to assess the amount and structure of information to be included in the project submissions of innovation and research support measures and in the documents related to the implementation of the projects (for example, the

payment request form) so that it can be used for the production of official statistics on investment in innovation and research. At the same time, we note that the Ministry of Economics has started the work on supplementing the data fields of the KPVIS (Management information system of cohesion policy funds) in cooperation with the Ministry of Education and Science and the Central Finance and Contracting Agency already during the audit in order to ensure the accumulation of data in the framework of support measures in accordance with RIS3 fields as early as 2024.

To improve the availability of funding for enterprises and scientific institutions that plan or make investments in research and development, we invite the Ministry of Economics and the Ministry of Education and Science to find solutions to ensure the adequacy and continuity of state support for the development of innovative products in time, including by reducing the dependence of policy implementation from EU funding.

To raise awareness of enterprises and scientific organizations about the support provided by the state for the development of innovations and to use the funding intended for informing enterprises more efficiently, we recommend the Ministry of Economics and the Investment and Development Agency of Latvia to assess the effectiveness of communication activities to provide enterprises and their representative organizations with targeted and effective information about available support measures for the development of innovations.

After the audit, we issued a recommendation to the Ministry of Economics to ensure the adoption of the rules for the implementation of support measures as soon as possible, thus reducing gaps in the availability of innovation development support. However, the Ministry of Economics pointed out that it had already established multi-level risk management supervision and the Ministry of Economics did not see the need and opportunities to improve it. Therefore, the Ministry of Economics did not propose actions that would improve the current situation.

References

- ¹ National Industrial Policy Guidelines 2014-2020 (supported by Cabinet Order No 282 of 28 June 2013).
- ² Innovation policy, available: <https://www.europarl.europa.eu/factsheets/lv/sheet/67/inovacijas-politika>, viewed on 11 September 2022.
- ³ *OECD Economic Surveys LATVIA, March 2022*, available at: <https://www.oecd.org/latvia/oecd-economic-surveys-latvia-25222988.htm>, viewed on 12 August 2022.
- ⁴ *OECD Economic Surveys LATVIA, March 2022*, available at: <https://www.oecd.org/latvia/oecd-economic-surveys-latvia-25222988.htm>, viewed on 12 August 2022.
- ⁵ *The Global Innovation Index 2022*, available at: https://www.wipo.int/global_innovation_index/en/2022/, viewed on 21 April 2023.
- ⁶ National Industrial Policy Guidelines 2014-2020 (supported by Cabinet Order No 282 of 28 June 2013).
- ⁷ The planned ERDF and public funding under priority 1.1 “Research and skills” and priority 1.2 “Support for business” of specific support objective “A more competitive and smarter Europe by promoting innovative and smart economic transformation and regional ICT connectivity” of the European Union Cohesion Policy Program 2021-2027 (approved by Cabinet Order No 841 of 16 November 2021).
- ⁸ Measure 1.2.1.2 “Support for the improvement of the technology transfer system”, measure 3.1.1.6 “Regional business incubators and creative industries incubator”, and measure 3.2.1.2 “Promotion of international competitiveness”.
- ⁹ Project submission No 1.2.1.1/16/I/001 “Competence centre management project” by the Ministry of Economics of 10 March 2016.