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Innovative clustering and its development factors as a source of Latvia's competitiveness

Abstract. Small countries with transition economies have to choose their own path of economic development. Nowadays, the economic model of the EU countries implies the volume of the venture capital of 0.3% of GDP per year, i.e. the required volume of venture capital in Latvia is EUR 90 million per year, which implies a tenfold increase. The authors consider the influence of intellectual potential, free economic zones and venture capital as development factors of innovative clustering in terms of Latvia's competitiveness. The undertaken modelling confirms a stronger impact of the development of clusters on innovations and intellectual potential (IP) in comparison with the other positions. The positions of «Venture capital» and «Higher education and training», or IP, have a significant impact on the development of clusters, while the development of clusters impacts GDP and innovations which, in turn, affects the level of Latvia's competitiveness.

Keywords: Innovation; Innovation cluster; Intellectual potential; Venture Capital; Competitiveness; Latvia

JEL Classification: R11; R58

DOI: <https://doi.org/10.21003/ea.V168-06>

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Інноваційна кластеризація та чинники її розвитку як джерело конкурентоспроможності Латвії

Анотація. В умовах глобалізації невеликі країни з перехідною економікою змушені вибрати свій шлях економічного розвитку. У статті розглянуто вплив на конкурентоспроможність Латвії інтелектуального потенціалу, вільних економічних зон і венчурного капіталу як факторів розвитку інноваційної кластеризації.

Ключові слова: інновації; інноваційний кластер; інтелектуальний потенціал; венчурний капітал; конкурентоспроможність; Латвія.

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Инновационная кластеризация и факторы её развития как источник конкурентоспособности Латвии

Аннотация. В условиях глобализации небольшие страны с переходной экономикой вынуждены выбирать свой путь экономического развития. В статье рассмотрено влияние на конкурентоспособность Латвии интеллектуального потенциала, свободных экономических зон и венчурного капитала как факторов развития инновационной кластеризации.

Ключевые слова: инновации; инновационный кластер; интеллектуальный потенциал; венчурный капитал; конкурентоспособность; Латвия.

1. Introduction

Contributing to the flow of capital, resources and labour, and enhancing technological progress in the world, the globalisation process erases boundaries of states, reducing their self-identification. Multinational corporations are increasingly using resources of the developing countries, which results in environmental degradation and impoverishment of the population. Such corporations further their interests in the governments of host countries, which leads to corruption. Also, developed countries ensure growth of national economies partly due to resources obtained from developing countries. Consequently, for states lacking the desired level of competitiveness, globalisation is an inclusive process having a negative economic impact, when economic development is possible only under the condition of having an improved mechanism to protect the country's economy. This becomes possible due to a special qualitative system of its components: finances, education, public management, innovativeness and social cohesion, when innovative clustering based on intellectual potential, investments, venture capital and free economic zones is able to bring the economy of Latvia to the desired level of development and competitiveness.

2. Brief Literature Review

The classification of innovations proposed by authors such as P. N. Zavlin, A. V. Vasilyev [1] and A. I. Prigozhin [2] allows us to not only form a view of the diversity of this concept but also to understand its functionality, its concept, its impact on the internal and external environment, and its dependence on many factors.

V. Nusratullin [3] describes intellect as a powerful source of energy of the material world. According to S. R. Paseka [4], the dominant role of the intellectual potential is able to enhance the labour process.

L. Plakhova [5], A. Dyrdonova [6], A. Skoch [7], J. Hauknes [8], E. Bochkova [9] studied the issues relating to the determination of cluster efficiency.

3. The purpose of the article is to study a relationship between various factors of innovative clustering of the regional economy, contributing to the improvement of Latvia's competitiveness and investment attractiveness.

4. Results

On the one hand, innovations create new workplaces, contribute to the intellectualisation of labour and increase the level of education and culture. On the other hand, they cause

unemployment which may threaten the economic security of the country. According to the authors' opinion, the concept of innovation is best classified in the tables by P. N. Zavinlin, A. V. Vasilyev and A. I. Prigozhin. The classification of innovations allows focusing on some aspects relevant to innovations in the field of economic security of the country according to the speed of introduction, and the use of intellectual potential and its impact on social development (Table 1). It provides a different approach allowing us to draw conclusions in a different scientific context.

Based on the above, it is possible to consider innovations in fields such as import substitution, terms of introduction of innovations, economic security of the country, social background and society development. Clustering gives an opportunity to identify more promising innovations contributing to the emergency of favourable economic processes within the state.

Intellectualisation of the triple helix of the cluster

At the heart of any activity lies the understanding (intellect) of its direction and sense. Without the intellectual potential, it is impossible to identify the essence of what is happening in the country and to lead economic processes. As far as the dominant role of intellectual potential is recognised and confessed, we create conditions for the growing intellectualisation of labour activity, increasing the need in gaining knowledge, development of new knowledge and applying knowledge in the creation of new types of products, goods and services. S. R. Paseka considers that high-tech enterprises needed intellectually advanced employees rather than capital investments [4]. Innovative clusters, as a symbiosis of three structures, i.e. business, the state and science, represent a complex structure of interaction, where intellectual potential (IP) expresses itself depending on both the set values and the degree of given freedom.

Let us mark changes in Figure 1.

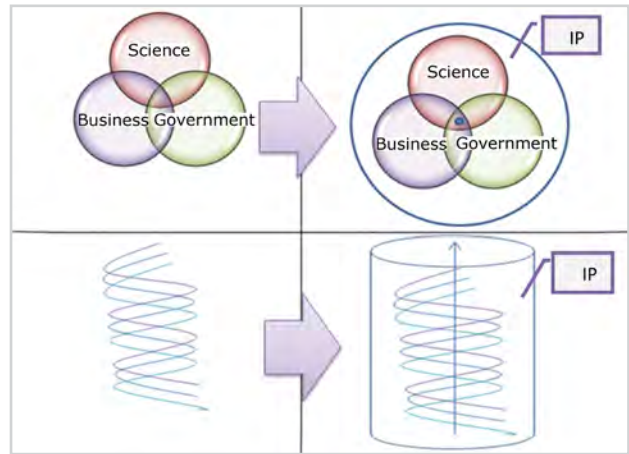
Intellectual potential fills the cluster, giving it the basis. It predetermines its quality, saturation and volume and is able to change the size and activity of the cluster, as well as to extend the period of its life cycle.

V. Nusratullin considers that there has always been an important productive force in the economy, which is intellect as a source of development and movement, which develops the achievements of scientific and technological process [3]. Nature keeps men of intellect free from physical labour in every possible way, giving such men more opportunities to be involved in mental activity, passing physical work to machines. Intellect has accelerated human evolution and human society, as well as its most important component, which is the economy. Extracting from the environment a certain amount of physical energy, man is able to transform it into intellectual energy, which is a special kind of energy, that cannot be described within the frameworks of physics or thermodynamics because the thinking ability of man is immeasurable and depends only on the physical state of man who is the bearer of the thinking ability. Thus, intellect is a powerful source of energy in the material world, where the development of clusters, and especially innovative ones, is impossible without the basic environment determining development and known as intellectual potential which, in its turn, depends not only on public policies, but also on the state of education and health-care of the country. Absorption of intellectual potential by the innovative cluster (IC) depends on the quality of

Tab. 1: Classification of innovations

Classification feature	Classification of innovation groupings
1. Innovation type	Services, products, processes, methods, relations
2. Innovations as a factor impacting import substitution	Neutral, positive, 100%
3. Terms of introduction of innovations by the degree of the use of intellectual/innovation facilities	Complex, medium, easy
4. Impact on the economic security of the country	Protective, ineffective, neutral, negative
5. Impact on social background including the rate of well-being, unemployment and additional benefits	Negative, neutral, positive
6. Impact on social development including intellectual development and education	Negative, weak, medium, average, strong

Source: Compiled by the authors



Note: IP - intellectual potential
 Fig. 1: Intellectualisation of the model of the «triple helix» of the cluster (top and side view)
 Source: Developed by the authors

public policies or management. The stance of the state policy towards the formation of the strategy of innovative clustering reveals many aspects of the economic development of Latvia. Innovative clusters, both existing and emerging, are actively changing the content of the economic activity of the country, increasing the country's economic development and competitiveness. Yet, the clustering process as a way of Latvia's innovative development is too slow [10].

As the basis for the development of innovative clustering, the intellectual potential of Latvia accounts for 4,000 scientists [11], of whom only 3-3.5 thousand are currently working as scientists, which is 75-88%. However, in order to raise the country's GDP per capita per annum by USD 200, it is necessary to have 95% of scientists working in the field (Table 2).

Impact of venture capital on the development of clusters

Since venture capital is an important factor of development of clusters, let us consider the interrelation between the development of clusters and the availability of venture capital in the Baltic states and some developed countries of the EU, with the use of indicators of the Global Competitiveness Index [13]. Using the example of developed countries (Italy,

Tab. 2: Some aspects of intellectual potential, venture capital and clustering in Latvia, requiring adjustments

Name	Latvia	Development of EU countries
Expenses on science	0.6-0.7 % of GDP	5-6 % of GDP
Expenses on education	5.7-6 % of GDP	5-9 % of GDP
Working scientists	75-88% (3-3.5 thousand out of 4000)	95 %
Percentage of scientists of the total population	0.21%	0.44%
Clustering	35%	70%
Volume of venture capital	About 0.03% of GDP	About 0.3 % of GDP
Number of employees in clusters	20-30%	40%

Source: Developed by the authors based on [12]

Sweden, Finland and Denmark), as well as developing countries (Latvia, Lithuania and Estonia), let us calculate the total variability - venture capital and the level of development of the relevant clusters (Table 3)

The dependence of the development of clusters on the availability of venture capital is observed more in the developing clusters of the Baltic states, including Latvia, in comparison with some developed countries like Italy, Sweden, Finland and Denmark (Table 4). This proves a great need of the venture capital for the development of clusters of these countries. The difference between the developed and developing countries is about 40%, with about 7% for Latvia.

Tab. 3: Table of estimated values

Country	Venture capital X (2011-2016)					Development of clusters Y (2011-2016)						
Latvia	2.7	2.9	2.8	3.0	2.9	2.7	3.1	3.2	3.4	3.5	3.6	3.5
Lithuania	2.2	2.4	2.5	2.7	3.0	3.0	2.8	3.0	3.3	3.5	3.5	3.3
Estonia	3.2	3.2	3.3	3.4	3.5	3.6	3.3	3.5	3.7	3.7	3.8	3.8
Italy	2.2	2.0	1.8	2.0	2.1	2.0	5.4	5.3	5.5	5.6	5.5	5.4
Sweden	4.3	4.4	4.3	4.2	3.8	4.1	5.1	5.0	4.8	4.7	4.8	5.0
Finland	4.2	3.9	4.0	4.3	4.5	4.6	5.3	5.2	5.1	5.1	4.9	4.9
Denmark	3.4	2.6	2.4	2.5	2.7	3.0	4.8	4.5	4.3	4.3	4.5	4.6

Source: Developed by the authors based on [13]

Tab. 4: Correlation indices and coefficients of determination between the positions of venture capital and the level of development of clusters of some countries

Country	Correlation index	Determination coefficient
Developing countries		
Latvia	0.37 (moderately)	0.14 (weakly)
Lithuania	0.82 (high)	0.66 (noticeably)
Estonia	0.85 (high)	0.73 (high)
Overall average	0.68	0.51
The developed countries		
Italy	-0.22 (no)	0.05 (weakly)
Sweden	0.36 (moderately)	0.13 (weakly)
Finland	-0.75 (no)	0.57 (noticeably)
Denmark	0.96 (very high)	0.93 (very high)
Overall average	0.09	0.42

Source: Developed by the authors

The availability of venture capital for innovative clusters is necessary because of the uncertainty in the economic path of Latvia, as well as because of the amount of financing from the state and the EU. Yet, one of the major deficiencies of the venture capital investments in Latvia is the underdevelopment of venture capitalists in the country [14]. To provide successful innovative clustering, the development of the venture market in Latvia should be carried out with the qualitative supervision from the part of the EU.

Latvia has potential not only for the development of the existing innovative clusters, using the venture capital, but also for the development of innovative clusters, since there are benefits such as a favourable environment in terms of financing on the part of the state and the EU, market of the innovative products in the EU and other countries and relatively developed infrastructure (intellectual, innovative, etc.). However, the tax policy of the state neither welcomes nor encourages the development of new businesses because taxes and legal formalities are far from being friendly.

In order for venture capital to become a stable source of stimulation of innovative clusters, entrepreneurship development and Latvia's economy, it is necessary to maintain the political, social and economic stability, to give support to innovative projects to enhance innovative attractiveness, to create self-sufficient venture capital market and to increase of the level of education in Latvian society.

The overall effectiveness of venture capital, free economic zones and innovative clusters. Calculation methods

If the country's competitiveness is an ability of the country to produce goods and services, meeting the requirements of

the world markets and to create the conditions for capacity-building at the rate which allows providing stable GDP growth and maintaining the quality of life of the population keeping to world standards [15], then the level of competitiveness of the economic system of Latvia can be expressed by a simple dependence:

$K=f(IC, VC, IP)$, i.e. the level of competitiveness depends on venture capital (VC), intellectual potential (IP) and the number of the other factors, the main of which is the innovative clustering (IC).

Latvian regions are in particular need of investments for innovative development. The abovementioned factors of formation of innovative clustering (FEZs and VC) may have a positive impact on the economic development of Latvia's regions:

- tourist (especially Latgale region) and innovative FEZs (especially within Riga region) may have a comprehensive impact on the economic development of the region, reducing the tax burden and attracting foreign and domestic capital for the development of business and innovation infrastructure;
- venture capital is able to enhance the welfare of the region, as well as to strengthen its economic position, contributing to the growth of the intellectual potential of the region.

The activity of the innovative clusters, together with such conditions of development as free economic zones and venture capital, is able to transform the region/country in accordance with the required result, i.e. lead it to the necessary level of social and economic development.

Having examined some of the positions of the authors (L. Plakhova, A. Dyrdonova, A. Skoch, J. Hauknes, E. Bochkova) regarding the determination of the efficiency/power of the cluster, we suggest methods to calculate the indicator of social and economic efficiency of the innovative cluster (IC) of either the region or the country, which includes the calculation of 11 coefficients (Table 5). More precise efficiency of IC can be traced through the use of options such as venture capital, FEZs, registered patents, the import-export ratio, etc.

The socio-economic indicator of the efficiency of the innovation cluster is calculated as the arithmetic mean of the sum of the eleven suggested coefficients:

$$P_c = \frac{C_e + C_p + C_{ia} + C_t + C_{ei} + C_{gs} + C_i + C_{va} + C_{sra} + C_{vc} + C_{fez}}{11} \quad (1)$$

The value of each coefficient is in the range from 0 to 1 (0 < C < 1). Consequently, the power indicator of the cluster will take the value from 0 to 1 (0 < P_c < 1). Each coefficient can be calculated both independently and together with the other indicators for the total calculation of the effectiveness of the cluster.

Let us consider the coefficient (10) of the ratio of the attraction of venture capital (C_{vc1}) of the cluster to the attraction of venture capital in the region/country (C_{vc2}). Based on the research above, the economy of Latvia is clustered at the rate of 35%, therefore it is possible to calculate the coefficient from 2007 to 2015, when the investments of the Latvian public venture funds accounted for EUR 34.6 million [16]:

$$C_{vc} = C_{vc1}/C_{vc2} = 12.11/34.6 = 0.35 \quad (2)$$

As a result, the cumulative attraction of venture capital by the clusters of Latvia (from 2007 to 2015) in relation to the attraction of venture capital by all Latvian enterprises is 0.35. Taking into consideration the level of clustering of the developed countries (75%), it can be noted that the mentioned coefficient, in the case of Latvia, should tend to 0.75 (for the total number of clusters). The increase of this coefficient (under the condition of the growing volume of attracted venture capital) triggers the multiplier mechanism - the growth of the other coefficients occurs.

The economic model of the EU countries implies the volume of the venture capital of 0.3% of GDP per year, i.e. the required volume of venture capital in Latvia is EUR 90 million per year, which implies a tenfold increase.

With the increased attraction of venture capital in Latvia, there occurs an increase in the national income, since even a small increase in investments, as well as their decrease, causes significant changes in the growth of the national income [17].

Thus, the revenue graph of the state increases by EUR 80 million. The multiplier effect will increase this indicator by 2-4 times, while the profitability of the enterprises involved in the FEZs (within the *IC* and *VC* frameworks) increases by 30%, which allows investors to withdraw from the projects within a period of 5-7 years obtaining 100% profit.

The interrelation of the examined factors

Based on the above research, we determine the correlation index between Latvia's indicators in the Global Competitiveness Index 2011-2016 such as innovations, availability of venture capital, higher education and the level of development of clusters in Latvia (Table 6).

This research confirms the impact of the development of clusters on the position «Innovations». Also, the availability

of venture capital, higher education and training positively affect the level of the development of clusters. We have noted a stronger impact of the development of clusters on innovations and intellectual potential in comparison with the other positions (Table 7).

Let us calculate the multifactor correlation between the index of competitiveness of Latvia (*Y*) and *VC* (*X3*), *IP* (*X2*), *CD* (*X1*) of Latvia (Figure 2 and Table 8).

Tab. 7: The indicators of the research of interrelation of venture capital, innovations, development of clusters

Name	Coefficient of determination / overall variability	Average coefficient of elasticity	Average error of approximation	Correlation index
Venture capital (VC) – Innovation (I)	0.00455 / 0.00455%	-0.0394	2.08	-0.0674
Development of cluster (CD) – Innovation (I)	0.5115 / 51.15%	0.312	1.18	0.715
Venture capital (VC) – Development of cluster (CD)	0.136 / 13.60%	0.275	3.13	0.369
Higher education and training (IP) – Development of cluster (CD)	0.7126 / 71.26%	0.449	1.14	0.844

Source: Developed by the authors

Tab. 5: Methodology of calculation of indicator of social and economic efficiency of the innovative cluster

Formula	Name
$C_e = \frac{ce1}{ce2}$	Coefficient of the number of persons employed in the cluster (C_{e1}) in relation to the number of persons employed in the region/country (C_{e2})
$C_p = \frac{cp1}{cp2}$	Coefficient – the number of registered patents in the cluster (C_{p1}) in relation to the number of registered patents in the region/country (C_{p2})
$C_{ia} = \frac{cia1}{cia2}$	Coefficient of inventive activity in the cluster (C_{ia1}) in relation to the inventive activity in the region/country (C_{ia2})
$C_t = \frac{ct1}{ct2}$	Coefficient of tax deduction to the state in the cluster (C_{t1}) in relation to the tax deduction in the region/country (C_{t2})
$C_{ei} = \frac{cei1}{cei2}$	Ratio of export to import in the cluster (C_{ei1}) in relation to the ratio of export and import in the region/country (C_{ei2})
$C_{gs} = \frac{cgs1}{cgs2}$	Coefficient of produced goods and services in the cluster (C_{gs1}) to the country's GDP (C_{gs2})
$C_i = \frac{ci1}{ci2}$	Ratio of the domestic and foreign investments in the cluster (C_{i1}) to the ratio of domestic and foreign investments in the region/country (C_{i2})
$C_{va} = \frac{cva1}{cva2}$	Coefficient of the added value in the cluster (C_{va1}) in relation to the added value in the region/country (C_{va2})
$C_{sra} = \frac{csra1}{csra2}$	Coefficient of scientific and research activity in the cluster (C_{sra1}) in relation to scientific and research activity in the region/country (C_{sra2}) – (expenses on R&D and innovations)
$C_{vc} = C_{vc1}/C_{vc2}$	Ratio of attraction of venture capital (C_{vc1}) in the cluster in relation to the attraction of venture capital in the region/country (C_{vc2})
$C_{tez} = C_{tez1}/C_{tez2}$	Number of enterprises within the FEZs in the cluster (C_{tez1}) to the number of enterprises in the FEZs in the region/country (C_{tez2})

Source: Developed by the authors

Tab. 6: Indicators of Latvia from the Global Competitiveness Index, 2011-2015

Year	State of cluster development	Higher education and training	Venture capital availability	The Global Competitiveness Index	Innovation
2011	3.1	4.8	2.7	4.2	3.2
2012	3.2	4.8	2.9	4.3	3.2
2013	3.4	4.8	2.8	4.4	3.2
2014	3.5	5.1	3.0	4.5	3.3
2015	3.6	5.1	2.9	4.5	3.3
2016	3.5	5.0	2.7	4.4	3.4

Source: Developed by the authors based on [13]

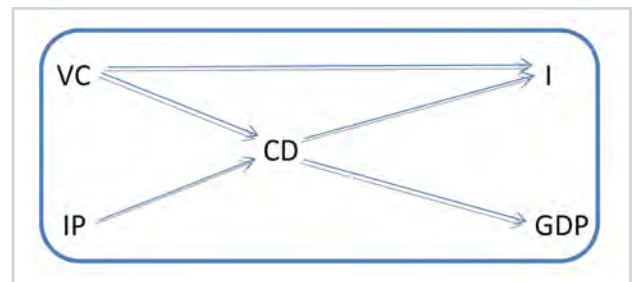


Fig. 2: Final interrelation between the development of clusters, venture capital, intellectual potential, innovations and GDP

Source: Developed by the authors

Tab. 8: Multifactor correlation

Y	X1	X2	X3
1			
0.954953	1		
0.833309	0.844186	1	
0.612146	0.368729	0.475327	1

Source: Developed by the authors

The R-square equals 0.99, which indicates the high accuracy of the approximation (the model describes the process well) (Table 9).

Tab. 9: Regression statistics

Multiple R	0.992031746
R-square	0.984126984
Normalised R-square	0.936507937
Standard error	0.021081851
Observations	5

Source: Developed by the authors

Thus, based on Tables 8 and 9, the positions of *VC* and *IP* have a significant impact on the development of clusters, while the development of clusters impacts GDP and innovations which, in turn, affects the level of Latvia's competitiveness.

5. Conclusions

Under conditions of globalisation, an increase of competitiveness due to the strengthening of the innovative clustering of the economy for small states the open economies is

a necessity. Due to the qualitative public management, such states trigger mechanisms helping to preserve their national identity and improve the socio-economic situation.

The Latvian innovative clustering, together with other factors boosting the country's development such as free eco-

nomie zones and venture capital, allows the region/country to obtain the required results by increasing intellectual potential and improving public management. This, in turn, leads to the necessary level of social and economic development, which raises the level of the country's competitiveness.

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Received 27.10.2016

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- Strengthening of local self-government system in Ukraine
- Establishment of partnership between authorities and business circles
- Forming of market ideology among wide society groups and national elite of Ukraine
- Development of innovative informational resources

Key activities:

- Organizing and holding of interactive workshops, roundtables, presentations
- Preparing of analytical materials, political and economical forecasts, commentaries and other intellectual products
- Organizing of study visits for state executives and business structures to states with stable democracy
- Realizing of public relations for organizations, companies, cities, regions
- Advisory work on current and strategic economical and political issues
- Publishing of research books (IST prepared and published 15 monographs)
- Publishing of The «Economical Annals-XXI» Journal
- Forming and supporting of IST's Internet holding (57 websites)
- Holding of on-line Internet conferences and polls etc.

Institute of Society Transformation has realized 85 large international projects.
IST created 16 regional Centres on European and Euro-Atlantic Integration.

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