The rise of Digital Challengers

How digitization can become the new growth engine for Latvia and Central and Eastern Europe (CEE)
Latvia, similarly to other CEE markets, cannot count on traditional growth levers any more and should look for the next growth engine.
An acceleration is needed for Latvia to catch up to Europe’s Digital Frontrunners

1 Digital economy is calculated as sum of sectors: ICT, e-commerce and consumer spending on digital equipment (e.g., computers, smartphones, smartwatches)
2 Spain, France, Germany, UK, Italy

SOURCE: Eurostat; Local institutes of statistics; McKinsey Global Institute
The digital economy in 2025 can bring up to 200 billion EUR in GDP in CEE and 4.9 billion in Latvia, adding up to 1.4 p.p. to GDP growth per year.

Digital economy growth potential for the CEE Digital Challengers & Latvia in the aspirational scenario

EUR bn

<table>
<thead>
<tr>
<th>Year</th>
<th>CEE Digital Challengers</th>
<th>Latvia</th>
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<tbody>
<tr>
<td>2016</td>
<td>76 (6% GDP)</td>
<td>1.6 (6.5% GDP)</td>
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<tr>
<td>2025</td>
<td>+200</td>
<td>+4.9</td>
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- 276 (16% GDP, +1 percentage point of GDP growth each year)
- 6.5 (18% GDP, +1.4 percentage point of GDP growth each year)

Capturing digitization potential in business and public sector
- Acceleration of e-commerce

1 Productivity growth captured by increase of traditional ICT usage (software, hardware, telecommunications) to the level of Sweden – representation of Digital Frontrunners

SOURCE: Eurostat; Local statistical offices; IHS; McKinsey Global Institute
Latvia’s digital potential can be achieved by addressing gaps in the digitization level of private and public sectors.
Four strengths supporting Latvia’s Digital Challenger status

1. **Good overall quality of the primary and secondary education systems**
   (mathematics, reading and science literacy PISA\(^1\) average of 487, close to Digital Frontrunners’ score of 505)

2. **Well educated workforce entering the job market**
   4.8% of all graduates are ICT graduates, higher than Digital Frontrunners benchmarks

3. **Well developed digital infrastructure**
   Approx. 98% of the population with 4G access, above the level of Germany and France

4. **A favorable structure of economic growth** –
   Based on the competitiveness of work, openness to the development of new sectors and the implementation of ambitious goals in the area of digitization

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\(^1\) Program for International Student Assessment (PISA)

SOURCE: Eurostat, OECD
Scores in Math, Reading, Science Literacy & English Proficiency, PISA (OECD) Synthetic scores, 2016

Math

482  477  505  ▼-4.6%  ▲505

Reading

488  473  507  ▼-3.7%  ▲507

Science

490  477  506  ▼-3.2%  ▲506

Avg. Digital Challengers  Avg. Digital Frontrunners

Overall primary and secondary education quality gap between Latvia and digital frontrunner countries is very small.

SOURCE: OECD, PISA, World Bank

1 Digital Frontrunners: Belgium, Denmark, Estonia, Finland, Holland, Ireland, Norway, Luxemburg, Sweden
Latvia has a relatively very high share of ICT graduates as part of its student population.

Number of STEM graduates per 100,000 inhabitants, 2016:
- Latvia: 164
- Germany: 244
- France: 296
- United Kingdom: 303
- Italy: 143
- Spain: 226
- Digital Frontrunners Average\(^1\): 215
- Digital Challengers Average: 221

\(^1\) Digital Frontrunners: Belgium, Denmark, Estonia, Finland, Holland (data for 2015 assumed), Ireland, Norway, Luxemburg, Sweden.

SOURCE: Eurostat, Unesco Institute for Statistics
In addition to fixed and mobile internet coverage in Latvia being on a par with Digital Frontrunners, the country exhibits one of the highest shares of ultrafast broadband subscriptions in Europe.
Additional work needs to be done in three major areas

- Development of digital and soft skills among the general population
- The adoption of digital tools in public and private sectors
- Support innovation and entrepreneurship developments and further ease of running a digital business
Across all age groups in Latvia, the percentage of people with advanced digital skills is below Northern European benchmarks.
The private sector in Latvia is less advanced in the use of digital tools than the countries of Northern Europe; SMEs do not fully use the potential of digitization.
1. Build skillset for the future by developing a wide-ranging reskilling strategy, updating youth education for the future and actively counteracting brain drain.

2. Support technology adoption in the public sector (e.g., speeding up the development of online public services and its adoption).

3. Support technology adoption among businesses (e.g., promote digitization benefits and digital transformation).

4. Strengthen regional cross-border digital collaboration (e.g., create a strong digital pillar within regional collaboration platforms).

5. Improve startup eco-system through e.g., improving entrepreneurial talent pool and increasing access to capital.

6. Actively adopt technology and innovation (e.g., adapt your business model to meet the demands of the digital economy).

7. Embrace a pro-digital organizational culture.

8. Invest in human capital (e.g., prepare your talent strategy for the digital economy).


10. Take advantage of digital tools in all aspects of your life.
Adoption of digital tools in public and private sectors and development of digital skills among the general population are essential to fully realize the potential of the digital economy in Latvia.

- Faster growth of the Digital Economy compared to the Non-Digital economy: 2x
- Digital economy annual growth in Sweden – Digital Challengers countries and Latvia may aspire to such a growth dynamic in the future: 10%
- Additional GDP potential can be achieved by digital economy in Latvia by 2025: 5 bn euro

The digital opportunity in Latvia – summary
Thank you

Available at: Digitalchallengers.mckinsey.com