Restructuring in SMEs: Latvia

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Introduction

Latvia is located in northern Europe on the coastline of the Baltic Sea and is often perceived as being part of a common economic area, the Baltic States (Latvia, Lithuania and Estonia). Extending over an area of 64,589 km^2 and bordered by Estonia, Lithuania, Russia and Belarus, the country has approximately two million inhabitants. The economy of Latvia is dominated by the service sector, which made up approximately 70% of gross domestic product (GDP) in 2010 (source: **BalticExport.com**) with major sectors being retail and wholesale trade, real estate, renting and business activities (US Department of State, 2011), whereas manufacturing comprised only approximately 10% of 2010 GDP (source: **BalticExport.com**). Table 1 gives more information on core economic indicators for Latvia.

Table 1: *Core economic indicators*

	1999	2007	2008	2009	2010
GDP per capita (current USD)	3,049.00	12,638.10	14,857.90	11,475.70	10,723.40
GDP per capita growth (annual %)	5.6	10.6	-3.8	-17.5	0.4
Long-term unemployment (% of total unemployment)	53.8	26.4	25.7	26.7	45
GDP (current USD, millions)	7,288.50	28,765.70	33,669.40	25,875.80	24,009.70
Exports of goods and services (current USD, millions)	2,942.20	12.181.10	14,415.90	11,356.20	12,814.00
Exports of goods and services (% of GDP)	40.4	42.3	42.8	43.9	53.4
Merchandise exports (current USD, millions)	1,723.00	8,308.30	10,144.20	7,699.10	9,488.96
Merchandise exports to high-income economies (% of total merchandise exports)	78.5	64	59.7	58.7	58.3
Merchandise exports to developing economies in Europe and central Asia (% of total merchandise exports)	19.6	33.4	35.9	34.6	36.5
Ores and metals exports (% of merchandise exports)	4.2	3.5	4.2	2.8	3.7
Agricultural raw materials exports (% of merchandise exports)	29.8	14.4	9.4	9.9	12.2
Food exports (% of merchandise exports)	6.2	13.3	15.7	17.3	16.8
Fuel exports (% of merchandise exports)	2.9	3.7	3.5	5.1	5.3
Manufactures exports (% of merchandise exports)	56.6	61.4	63.2	60.7	58.6
High-technology exports (% of manufactured exports)	4.1	6.9	7	7.8	7.6

Note: €1 = USD 1.213 (as of 19 August 2012)
Source: *World databank* (**http://databank.worldbank.org**), *July 2012*

The dominance of the service sector is a relatively new trend in Latvia, occurring only during the last 20 years or so. Historically, Latvia was known as one of the most industrialised centres in the region. For instance, in the 19th century, the capital city Riga was the third largest industrial city in the Russian Empire behind Moscow and St. Petersburg (Švābe, 1990). Being a part of Russia, Riga was also one of the most important industrial centres in the 20th century. There were two main reasons for the heavy industrialisation of the territory of Latvia and its capital city – its favourable location and cheap yet qualified labour force (Bleiere et al, 2005).[1]

[1] In the 19th century, when the territory of Latvia was part of the Russian Empire, 85% of the inhabitants of Latvia could read and write compared with 54% of inhabitants of the Russian Empire.

In 1991, Latvia declared its independence from the Soviet Union and transition started with legal and market reforms, including the introduction of a legal framework for entrepreneurship. Initially the shift from socialism to a market economy was not easy for Latvia. The country experienced a steady decline in economic development, reaching real GDP growth of -34.0% in 1992. In addition, almost all big factories in Latvia – the heritage of the Soviet Union – collapsed during the early 1990s. Although there are various opinions on this issue, one 'excuse' often mentioned to explain the loss of these factories is that their main market (that is, the territory of the former Soviet Union) was virtually no longer accessible (Balabkins, 2002). Perhaps more importantly, however, a lack of skills with which to transform the factories so that they could operate under the conditions of the market economy is believed to be the main reason for the collapse of the industrial sector in Latvia. As a consequence, only a marginal proportion of the 'heavy industry heritage' remained in Latvia in mid-2011 and, as noted earlier, the country is currently dominated by the service sector. What has remained, however, is a considerable proportion of Russian speakers who entered Latvia during the period of the Soviet regime.[2]

In the later stages of transition, after joining the European Union and the North Atlantic Treaty Organisation (NATO) in 2004, Latvia experienced the fastest growth rates in the EU, achieving a growth in GDP of 12.2% in 2006 (source: **BalticExport.com**). However, this was followed by a sharp decline, starting in early 2008 – a consequence of the world financial crisis, with Latvia's GDP falling to approximately -18% in 2009 (source: Central Statistical Bureau of Latvia). The depth of the crisis in Latvia was also fuelled by greatly increased consumption resulting from the easy access to cheap bank loans (and overoptimistic forecasts of the future growth of the Latvian economy which influenced consumption behaviour) that occurred during the years of rapid economic growth. After the 'credit bubble' collapsed in early 2008, to stabilise the financial sector Latvia had to borrow some €7.5 billion from the European Commission and the World Bank as well as other organisations and governments (source: **BalticExport.com**).[3]

The deep recession also led to a reassessment of the role of entrepreneurship within the country, that is, both the quantity and quality of Latvian companies and the quality of the business environment in Latvia. As for the number of companies, even though there are positive signs of nascent entrepreneurship rates (Rastrigina, 2010), Latvia has one of the lowest scores in the EU as measured by the number of small and medium size enterprises (SMEs) per 1,000 inhabitants (Ministry of Regional Development and Local Government, 2006). Furthermore, various international reports and indicators such as the Innovation Union Scoreboard 2010 (UNU-MERIT, 2011), the Global Entrepreneurship Monitor[4] and the Global Competitiveness Report 2010–2011 (Schwab, 2010) show that there is also considerable potential to increase the quality of both Latvian companies and the Latvian business environment.

As in other transition countries, the first years of transition in Latvia were characterised by a 'boost' in entrepreneurship, reflected in a high number of business start-ups (Figure 1). This was because entrepreneurship simply became possible only after regaining independence. Or, to be more accurate, during Soviet times entrepreneurship was officially not allowed even though illegal or 'second economy' activities were tolerated.[5] Although cooperative enterprises were legalised in the late 1980s, many companies established during that time existed 'illegally' and were registered only when the legal framework allowed this.

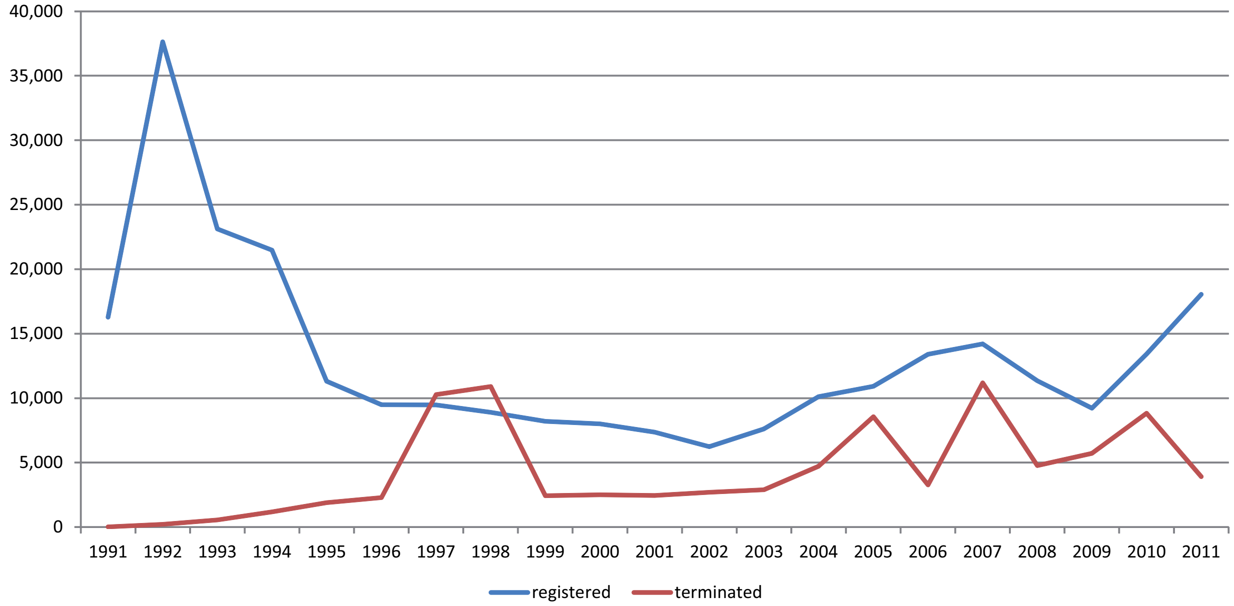
[2] In 2010, Latvians made up only 59.4% of the total population of Latvia, 27.6% being Russians, followed by Belarusians (3.6%), Ukrainians (2.5%) and Poles (2.3%) (US Department of State, 2011).

[3] More information on the state of economic recovery from 2008–2011 can be found in the **Republic of Latvia: Assessment letter for the World Bank, 11 May 2011**.

[4] See reports for Latvia at **http://biceps.org/en/GEM**

[5] Through the legalisation of cooperatives in the late 1980s, private sector development in Latvia began with reforms instigated by the Soviet Union's President Mikhail Gorbachev while Latvia was still under the centrally planned system.

Figure 1: *Dynamics of registered and terminated companies in Latvia*



Source: *Lursoft*

Along with high start-up rates at the very beginning of the transition process, there was a steady decline of entrepreneurship start-up activity until 2001 (Figure 1). In addition, there were increased levels of business termination during 1996–1999, influenced by external events including:

- banking crisis of 1995 in Latvia when the bankruptcy of several leading banks led to a considerable number of people losing their money and trust in the banking system;
- Russian financial crisis in 1998, which resulted in declining start-up rates and higher exit rates in Latvia.

Furthermore, many companies had to close down because the 'new entrepreneurs' did not know how to deal with business management issues. The steady increase in competition, and the flow of financial assets and other such factors fostered the decline of start-up activity and increasing rates of business termination until 2002. Moreover, frequent changes in the legal framework – often highlighted as one of the major constraints on SME development in the early stages of transition – contributed to business closures.

The period from 2002 until 2008 saw a positive trend in start-ups (Figure 1). As a result, Latvia, with a population of 2.4 million inhabitants, had more than 80,000 legally registered and active companies in 2007, creating more than 65% of GDP (source: Central Statistical Bureau of Latvia). In addition, due to the steady growth from 2002 until the middle of 2008, Latvia had the fastest growing economy among EU countries, with low inflation and unemployment rates. Yet, the growth of the economy slowed sharply from late 2007 as a consequence of deceleration in credit growth and high

[6] A company is considered to be active if annual or financial reports are submitted to the State Revenue Service or other appropriate institutions.

inflation. Furthermore, due to credit growth being tightened by banks and measures undertaken by the Latvian government in the spring of 2007, the average house price fell by approximately 30% in one year, causing a steady decline in construction activity (-10%) (EBRD, 2008). The decrease in GDP from late 2007 until early 2009 was also fostered by a sharp downturn in trade volumes (-17.2%), processing manufacturing (-11.5%) as well as financial intermediary services (-18%) (source: Central Statistical Bureau of Latvia).

As a result of these processes, entrepreneurship activity in Latvia decreased considerably in the first quarter of 2009 compared with the situation in early 2008, that is, 155,658 companies were registered in the company registry in January 2008 (source: Central Statistical Bureau of Latvia). But according to provisional data from the State Revenue Service and Lursoft, only slightly more than 50% of all registered companies were active, which amounts to approximately 80,000 active companies out of 155,658 registered companies in the official company register in January 2008. The data for early 2009 show 162,408 and 63,241 companies respectively, meaning that although the number of registered companies increased, there was a substantial decrease in the number of active companies. However, there was a positive trend with regard to start-up rates during 2010 (Figure 1), which can be explained by 'necessity entrepreneurship', that is, many unemployed people began a business activity because this was the only option from which to generate an income on which to live. Such behaviour is quite common for an economy in recession, yet it can be predicted with some certainty that most necessity entrepreneurs will stop their business once they find employment as an employee. Table 1 shows the numbers and proportion of SMEs in Latvia in 2010 by size of company.

Table 2: *SMEs in Latvia, 2010*

	Number of companies			**Employment**		
	Latvia		**EU27**	**Latvia**		**EU27**
	Number	**Proportion**	**Proportion**	**Number**	**Proportion**	**Proportion**
Micro	58,082	85.3%	92.1%	133,245	23.8%	29.8%
Small	8,353	12.3%	6.6%	160,441	28.7%	20.4%
Medium	1,473	2.2%	1.1%	141,793	25.3%	16.8%
SMEs	*67,908*	*99.7%*	*99.8%*	*435,479*	*77.8%*	*66.9%*
Large	194	0.3%	0.2%	124,218	22..2%	33.1%
Total	**68,102**	**100%**	**100%**	**559,697**	**100%**	**100%**

Source: *European Commission (2011, p. 1)*

One of the key challenges with regard to the Latvian business environment and economic development seems to be the country's relatively large 'shadow economy'.[7] According to Sauka and Putniņš (2011), the size of the shadow economy in Latvia reached 38.1% of GDP in 2010 and was close to double that of the neighbouring countries of Estonia (19.4%) and Lithuania (18.8%). According to Sauka and Putniņš (2011), the strong dissatisfaction in Latvia with the tax system and the government in particular – the inconsistency of tax policy and how the government spends taxpayers' money – is likely to be one of the main factors driving the large difference between the three countries in the size of their shadow economies. Other factors explaining the large amount of tax evasion in Latvia include optimising expenses by avoiding taxes and thus increasing the competitive advantage of companies, weak legal enforcement, and societal traditions of avoiding taxes as well as low standards of ethics and morality.

[7] The term 'shadow economy' is used here to refer to all legal production of goods and services that is deliberately concealed from public authorities. This definition corresponds to what OECD (2002) and the Inter-Secretariat Working Group on National Accounts (1993) refer to as 'underground production'. It is also consistent with definitions employed by other researchers such as by Schnieder et al (2010).

These findings, as well as various international indicators compiled by the World Bank, European Bank of Reconstruction and Development (EBRD) and other international organisations seeking to measure the quality of institutions, at least partly explain why the competitiveness of Latvian companies rank only 70th in the world compared with neighbouring countries Estonia and Lithuania which rank 33rd and 47th respectively (Schwab 2010). Sauka and Welter (2012) argue that the main challenges to improve the overall entrepreneurship climate in Latvia include:

- government improving the way it communicates with entrepreneurs;
- government regaining trust by demonstrating good practice by reducing governmental spending and implementing sound tax policies.

Following a steady decline as a result of the crisis in 2008, the Latvian economy began to recover in 2010 with a +3.3% GDP growth forecast for 2011 (Eurostat, 2011). There are various reasons for this remarkable achievement, but one of the most important is a steady increase in exports by Latvian companies. In 2010, Latvian exports increased by almost 30% compared with the previous year, with approximately 70% of exports going to other EU countries. The most important commodity groups of Latvian exports are wood and wood products (19.3% in 2010), followed by metal products, machinery and mechanical appliances, and electrical equipment (LIAA, 2011; for more information on business environment and the state of SMEs in Latvia, see Bruna and Sneidfre, 2011).

According to our best knowledge, neither before nor after the crisis has restructuring appeared as a topic in policy discussions and no specific programmes have been initiated and implemented in this regard.

Relevance of different types of restructuring for SMEs

There has been little research in Latvia on restructuring and entrepreneurship processes in general. General trends in the entrepreneurship climate are discussed in the Global Entrepreneurship Monitor (GEM) Latvia reports[8] by the Stockholm School of Economics in Riga (SSE). A Panel Study of Entrepreneurial Dynamics (PSED) was also undertaken in Latvia by SSE researchers using the methodology[9] developed by the Institute for Social Research at the University of Michigan in the USA (Dombrovsky et al, 2010).

According to our best knowledge, no surveys that address relocation, outsourcing or offshoring and delocalisation, as well as business acquisition of Latvian companies, have been conducted although such processes have certainly taken place. There is also no documented evidence on internal restructuring processes within companies. Anecdotal evidence suggests that the latter might be explained as follows: internal restructuring in SMEs is often not perceived as being significant, unlike restructuring in large companies to which the media and researchers pay much more attention – especially if the restructuring process is successful. Furthermore, more attention was paid to the restructuring processes that followed privatisation for instance, during the 1990s and early in 2000. The companies that were privatised were all large, previously state owned companies and had to restructure due to new market circumstances (that is, transition from planned to market economy). Usually, and especially at the beginning of transition, this process was far from transparent and thus no documented evidence on the processes of restructuring of these companies exists – see Toth (2004) for more information.

8 **http://gemdev.dev.marmaladeontoast.co.uk/teams/67/latvia**

9 **http://www.psed.isr.umich.edu/psed/home**

Drivers of restructuring

If the transition from the planned to a market economy was the main driver for the restructuring of companies (mostly large ones) in the early 1990s, then the financial downturn in Latvia was a key driver for restructuring after 2008. Also emphasised by the owner of Furniture Ltd., a company that was bankrupted by the economic recession, like many other businesses back in 2007, it simply did not realise soon enough what was happening in the market and how the sharp economic downturn would influence the performance of its companies. They did not realise it was necessary to restructure and, for some, this decision simply came too late. 'We continued to expand, as we had done in the previous three years, when reducing operations was the only way to survive', says the former CEO of Furniture Ltd. 'And this strategy for many had its negative consequences' (Sauka and Welter, 2012, p. 8). What this businessman is saying is also well represented in Figure 1; the number of bankruptcies in Latvia increased substantially during 2007, with the first waves of economic downturn.

It is not that this business or other companies did not understand what was going on in the market, of course. 'Looking back I had this strange feeling that "floods were coming" already in 2007, yet I had no idea that they would hit us so hard. No one did!', said the former owner, referring to the changing market conditions as a consequence of the economic downturn. 'After the state introduced stricter regulations for taking loans and capital was no longer as easily available, demand for many products, including office furniture, decreased sharply,' he continued adding that, as a consequence, property prices also started to go down.

> *But property was too expensive in 2007 and many knew that. So my guess was that these prices would fall, say, by about half … it is just that neither I nor many others anticipated what that meant, that is, what consequences for the economy and companies this would have … In addition, no one here knew what would happen in the world economy at that time … We all knew that there is some trouble with the US economy from time to time, but we also knew that since World War Two, in one way or another this country has always managed to overcome its problems. For instance, exchanging real money against bonds and 'staying alive', that is, always coming up with some solution. Well, not this time …*
>
> (Sauka and Welter, 2012, p. 8)

Both the overconfidence of entrepreneurs (Cooper et al, 1988; Busenitz and Barney, 1997) and their willingness to stick to the sales totals they used to achieve even during the economic downturn (Sauka and Welter, 2012) have been found to be reasons that may have increased the risk of failure. However, the former owner of the furniture manufacturing business disagreed with these arguments, claiming that at the beginning of 2007 it was neither about overconfidence nor the willingness to expand at any cost. 'We seemingly had all the prerequisites and reasons for expansion back then', he said. 'Even though the economy in Latvia and other parts of the world was going down, we really did not feel any trouble!', noting that customers were still building offices, needing furniture and placing orders. Also, the turnover of Furniture Ltd was increasing: 'The company was growing and our competitors were trying to copy us: we were a success story!'. Like many other companies, the business had simply got used to the fast growth over the past three years. 'What happens during economic growth', explains the business's former owner, 'is that you inevitably lose some rigour and do not pay attention to things that are very important!'. What he means is that, just as economists usually judge the growth of the economy by looking at GDP figures that come at the end of the year, his business judged their performance drawing on a profit and loss statement.

> *In business, the equivalent of the GDP figure is the profit and loss statement, which for various reasons can be evaluated after a full year, as the situation per quarters, for instance, with all the investments, etc. might not provide a clear picture of what is going on.*
>
> (Sauka and Welter, 2012, p. 9)

What this business learned from its bankruptcy, however, was that the first thing to look at to identify a crisis – either in the economy or in a company – is the company cash flow. ‘But trust me, only a few are paying attention to their cash flows, especially when everything is developing rapidly. Instead, owners and managers look at the turnover and profits!’, says the former owner, confirming empirical findings that the inability to control cash flow is among the main reasons behind bankruptcy, especially during an economic downturn (Sauka and Welter, 2012, p. 9).

Other fragmented research on the bankruptcy of Latvian companies compares reasons for insolvency before and after the crisis. Drawing on interviews with insolvency administrators, Sauka and Welter (2012, pp. 13–14) report the following:

> *… besides factors influencing business failures regardless of the context, a number of environment- and transition-specific factors exist, even within an advanced transition setting. Both during steady economic growth and especially after the 2008 economic crisis, a relatively high proportion of business insolvencies in Latvia, for instance, took place due to illegal or at least unethical entrepreneurial behaviour. To be more specific: the main reason behind business insolvency mentioned by most of our interviewees is company fraud. Thus, among other things, this study confirms findings from previous research on the often illegal or unethical behaviour of entrepreneurs within a transition setting.*
>
> (Aidis and van Praag, 2007)

Distinctive characteristics of restructuring in SMEs

As emphasised in the previous section, one of the most important reasons for restructuring in Latvia in the previous four to five years was the economic downturn. As often admitted by entrepreneurs themselves, during 'good times', many companies simply forgot how to work efficiently. The growth of companies was often determined by the rapidly growing economy rather than a consequence of entrepreneurial and management skills. Thus, following an economic downturn, many companies had to reassess the way they were doing business. And in many cases that meant restructuring. It could be only logical to assume that even though the key reasons of restructuring were the same for both SMEs and large companies, the process of restructuring was different in SMEs and large companies – simply due to size, which necessitates different decision-making processes, available resources that enable restructuring and other factors. Yet, according to our best knowledge there has been no research on the distinctiveness of SMEs compared with larger organisations with regard to types of restructuring, processes and those involved. This is a research gap, relevant to both academic and policy discussions, that should be filled.

Interviews with business insolvency administrators as compiled by Sauka and Welter (2010), however, reveal a more in-depth picture with regards to the restructuring reasons for SMEs:

> *"One of the major problems of companies that go bankrupt these days is the 'blind willingness' to stick to things they used to have. That is, many firms do not understand that due to the situation in the market, they cannot remain as big as they were in terms of market share, profits, number of employees and other indicators. These days are gone!", continues the administrator, "Firms simply have to live with the facts and adjust the strategies, by 'getting rid of unnecessary' market shares, profit margins and in some cases also product range as cheaply as they possibly can. In my view, the inability to cope with this is the major reason why companies went bankrupt."*
>
> (Sauka and Welter, 2010, p. 22)

Another insolvency administrator emphasised efficiency as one of the keys to getting through bankruptcy during an economic downturn:

> *Following trends of economic growth during recent years, many companies have gone as far as to forget how to work efficiently. Even worse – some cannot continue to do that any longer as, for example, manufacturing costs are simply too high to compete in the market due to the fact that firms have bought equipment, real estate, etc. for too high prices, which certainly influences production costs.*
>
> (Sauka and Welter, 2010, p. 22)

Very similar conclusions came from a case study by the same authors on the furniture manufacturing company that went bankrupt during economic downturn in Latvia

> *"At the beginning of 2007 and also the beginning of 2008 it all really looked different. We were growing for a number of years and simply forgot how to work effectively, got more relaxed, and I think this is very human. I am sure this will happen again and again: during good times you put on additional weight and your senses numb." … "In the peak of your growth, even if you experience preliminary problems," continues the entrepreneur, "it is also very difficult to tell anyone – management or employees – that we should slow down."*
>
> (Sauka and Welter, 2012, p. 11)

According to the entrepreneur, not only would this be perceived as a very silly idea, but many entrepreneurs might interpret such a signal as being a problem of the specific company only and thus might consider being 'on the safe side' by leaving to work for their competitors.

The overall transition context also plays a role when it comes to influencing restructuring processes in Latvia. Factors such as the inability to adapt to frequently changing business regulations and the unstable business environment that characterises transition economies can also influence restructuring processes in SMEs. In terms of implications for policymakers, it is thus crucial to ensure a stable business environment even in an advanced transition setting without introducing too much bureaucracy. In line with studies of business failure conducted within more advanced economies (Storey, 1994; Pasanen, 2005), non-transition specific factors related to entrepreneurs and enterprises (as indicated by a lack of working capital, knowledge and experience, or the overconfidence of the business owners) also play a role in explaining business failures. The situation seems to differ, however, considering the changes brought about by the 2008 crisis when factors such as lack of efficiency in conducting business activities, an inability to change strategies to adapt to new 'rules of the game' as well as various psychological aspects of entrepreneurial thinking played a decisive role in the business insolvency process.

Main challenges and constraints facing SMEs in restructuring

Emphasising the role of the external environment, several studies draw attention to environmental constraints and company-specific characteristics which impede the competitiveness of Latvian SMEs, at the same time acting as a key challenges and constraints for restructuring processes. According to the Latvian Technology Centre (2007), major barriers for the development of SMEs seem to be:

- access to qualified employees;
- access to funding (including access to credit) at reasonable cost;
- high competition;
- lack of current assets.

A recent study by Sauka (2011), however, shows that companies in Latvia are often forced to operate under relatively high costs (that is, an outcome of technologies or premises purchased during 2007–2008 at high prices) while at the same time offering low value added products and services. Sauka (2011) also suggests that, to become more competitive, Latvian companies should:

- increase the level of innovation considerably;
- be more active while working with their competitors;
- take more calculated business risks.

Furthermore, Latvian companies seem to be remarkably passive in using communication networks – a widely recognised tool used by successful, competitive companies around the world to attract external resources at low cost (or no cost at all) in order to achieve a competitive advantage (Simon, 2009). In this light, as reported by Sauka (2011), in general Latvian companies virtually ignored the opportunities that might be provided by cooperation with business laboratories, universities and research institutes – a potential source of innovations and market intelligence – as well as municipalities and business promotion organisations. Resources often used by companies across the world to penetrate new export markets as well as to establish the position of the company in the local market.

Thus, overcoming burdens created by the external environment and more careful planning of internal company strategies are the key challenges which need to be addressed by many Latvian companies in order to increase their competitiveness. At least in some cases, this could mean initiating a restructuring process – doing this earlier than others and thus becoming more competitive in the market place.

Business support from public and private sources

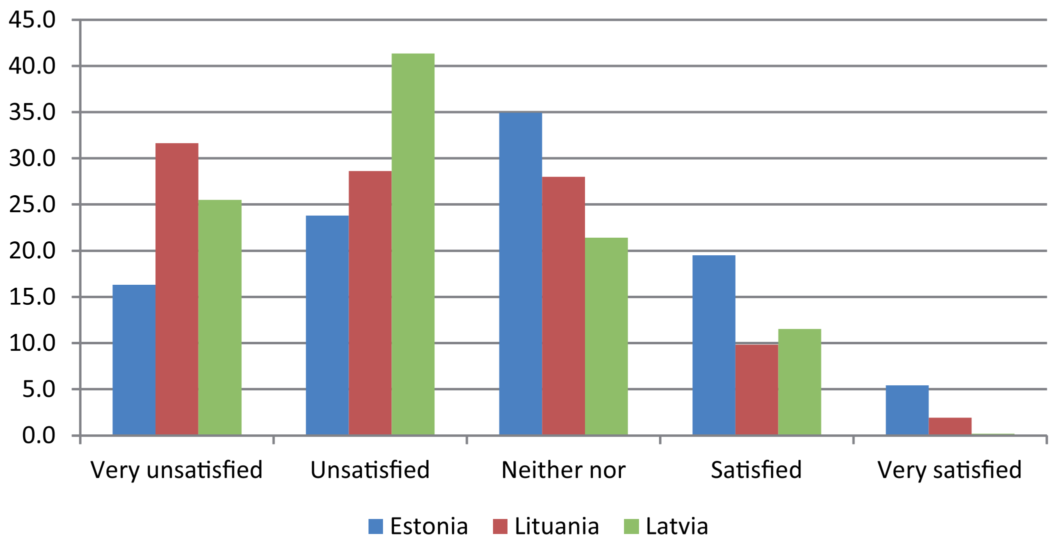
One way to assess the effectiveness of the support from the public sources is by measuring company satisfaction with various public authorities. Public authorities and the satisfaction of entrepreneurs with the infrastructure they provide is of particular importance given that the major driver of restructuring in Latvia after 2007, as described previously, was economic downturn – a situation that often requires not only tough decisions by entrepreneurs themselves, but also more attention from policymakers to support entrepreneurs in their efforts, including restructuring. Altogether such efforts should help to generate added value for the economy and thus help to overcome the economic crisis as fast as possible. In addition, information on both government support, as well as the support of other institutions (including the non-governmental sector), can also serve as a proxy for SMEs in restructuring.

In this light, a recent study by Putniņš and Sauka (2012), comparing Latvia with the two other Baltic countries, reveals the following picture. They found that companies in Estonia and Lithuania tended to be more satisfied with the State Revenue Service than in Latvia. In 2011, entrepreneurs in Latvia were particularly dissatisfied with the government's tax policy, with 70.5% of respondents reported being 'unsatisfied' or 'very unsatisfied' with tax policy. This is an ongoing and escalating concern which policymakers need to address. Addressing this issue could involve actions such as:

- making tax policy more stable (less frequent changes in procedures and tax rates);
- making taxes 'fairer' from the perspective of businesses and employees;
- increasing the transparency with which taxes are spent.

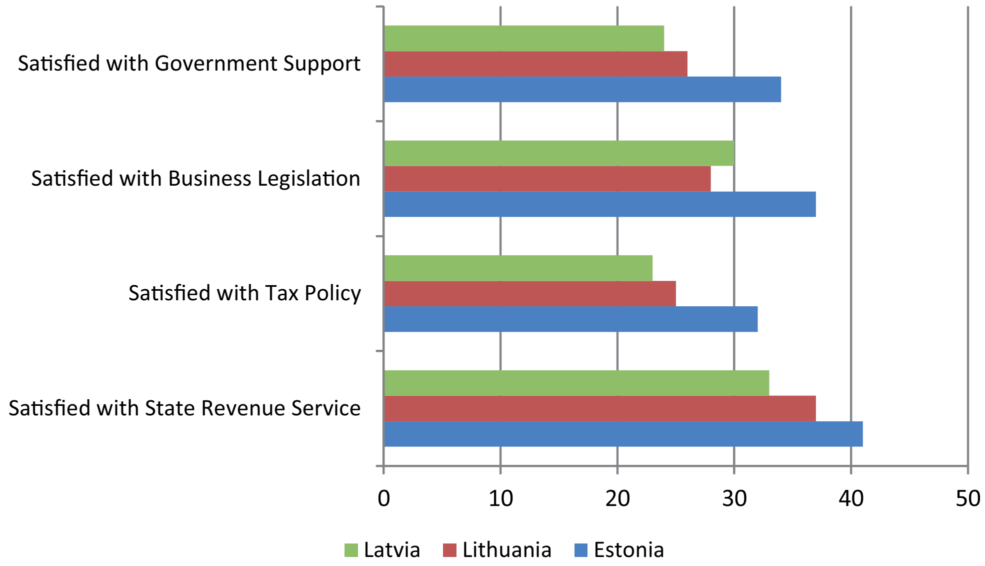
Entrepreneurs in Latvia were also dissatisfied with government support to entrepreneurs, although the proportion of 'very unsatisfied' and 'unsatisfied' was reversed, with 25% being 'very unsatisfied' in 2011 compared to 36% in 2010, and 41% being 'unsatisfied' in 2011 compared with 31% in 2010 (Figures 2 and 3).

Figure 2: *Satisfaction with government's support of entrepreneurs, 2011 (%)*



Note: Vertical axis measures percentage of each country's respondents in each category.
Source: *Putniņš and Sauka (2012)*

Figure 3: *Average satisfaction of companies with the tax system and government, 2011 (%)*



Source: *Putniņš and Sauka (2012)*

Other studies highlight entrepreneurs' low level of trust in the government (both 'in general' and expressed in the form of belief that the government spends tax payers' money appropriately) as being a major concern. According to Gudino and Liseks (2011), 70% of respondents stated that the government did not care about what people think and approximately the same proportion evaluated the Latvian government as being incompetent. Furthermore, the majority of entrepreneurs (80% of respondents) stated that the government was run by those with power looking for their own interests, and the same proportion believed that 'people like me have no say in what the government does'. Entrepreneurs were also asked to assess the government's performance in 2010 compared with that in 2007; regardless of the negative evaluation of the government as indicated above, almost 40% of respondents preferred the 2010 government, 30% did not see any difference between the government in 2010 and 2007, and less than 20% believed that government had performed better in 2007.

Despite entrepreneurs' negative opinions, Latvian policymakers have launched many support programmes. These are summarised in Latvia's first competitiveness report (SSE Riga, 2012). In this context, it seems appropriate to conclude that Latvia does not lack public support systems but that communication between entrepreneurs and the Latvian government should be improved. Another issue is that most programmes launched by policymakers are not evaluated properly after implementation and thus it is often difficult to assess their efficiency.

For instance, several programmes have been launched to foster the export competitiveness of Latvian companies. The key aims in this regard, as emphasised in 'Guidelines for promoting export of Latvian goods and services, and attracting foreign investments 2010–2016' are to:

- increase export competitiveness of Latvian goods and services;
- improve support mechanisms to implement activities aimed at increasing export competitiveness;
- improve the legal framework.

A number of activities have already been implemented in this regard. For instance, in June 2009 a credit guarantee programme was launched to protect Latvian exporters against unexpected risk in foreign markets. As a result 63 guarantees worth approximately €5.0 million have been granted. There has also been support for entrepreneurs interested in attending meetings with potential partners in various countries, including participation in trade shows, workshops and so on. In 2011 the Latvian Investment and Development Agency launched new economic missions (that is, established representative bodies) to support Latvian entrepreneurs working in specific markets. In 2010, a coordination council for large and strategically important investment projects, chaired by the President of Ministers of the Republic of Latvia, was launched. Although the direct influence of these programmes on restructuring processes cannot be measured due to lack of data, it can be assumed that such activities have positively influenced those companies that changed their export markets or increased market share as a result of restructuring processes.

Apart from promoting exporters, a number of other initiatives have been implemented by Latvian policymakers to support SMEs. These policies are targeted mainly at the aspects crucial for the development of SMEs such as:

- access to finance, including venture capital and loans for high-risk projects;
- development of business incubators;
- support for self-employment that by 2015 aims to consult approximately 1,200 individuals and further educate 800 owners of business start-ups.

Support mechanisms have been introduced to foster a climate of entrepreneurship in distressed regions of Latvia and increasing attention has been paid to taxation of SMEs resulting in reduced income tax for micro companies (introduced in 2010). New regulations on bankruptcy procedure were adopted in 2011 and administration fees for registering companies substantially reduced. Moreover, activities are planned to reduce the time necessary to register a company in Latvia. In summary, even though no direct measures have been taken to address the issue of restructuring in SMEs, most of these initiatives, like similar programmes aimed at fostering export competitiveness, are likely to have played a role in creating a better context for restructuring processes to take place in Latvian SMEs.

When it comes to the business support from the private sources, there are various organisations and initiatives in Latvia. These include business angel networks[10] that support mainly small-scale businesses as well as venture capitalists (see Vanags et al, 2010, for on overview on venture capital in Latvia). Furthermore, various mentoring clubs provide business advice as well as a network of business incubators. Considerable support to entrepreneurs is also provided by the non-governmental sector, for instance, organisations such as **Connect Latvia** and the Latvian Chamber of Commerce and Industry (**LCCI**). These organisations usually work very closely with policymakers and act both as initiators and implementing bodies of various policy initiatives to improve the entrepreneurship climate in Latvia. For example, LCCI is actively involved in the debate on taxation and Connect Latvia works to link scientists with entrepreneurs aiming to generate high value added products, while business angel networks should be credited for their work in trying to uncover the best business ideas that are worth investing in.

[10] **http://www.biznesaengeli.lv/be/index.php?action=setlang&NodeID=2&lang=en_EN**

Outcome of the restructuring events

As highlighted above, there is not enough evidence to argue about specific outcomes of restructuring process. Yet, as demonstrated by the case studies for Latvia, restructuring outcomes are usually positive if, companies can fulfil the following criteria:

- **Motivate or replace employees**. The quality of employees (that is, not only the people who manage, but also implement the restructuring process) appears to be the most crucial factor for successful restructuring. Three case studies from Latvia demonstrate that companies managed to complete the restructuring process successfully due to investment in motivating and replacing employees.
- **‘Changing mindsets’ of company owners**. This is particularly important in Latvia and other countries where economic growth was followed by steady recession. As argued by one entrepreneur, the owners of the companies simply forget how to work efficiently during ‘good times’ and thus changing the ‘mindset’ is the first prerequisite to start ‘moving into the right direction’.

These two actions, if implemented successfully, can help companies to work more efficiently (in using human and financial resources) and thus increase the likelihood that the restructuring process will be successful.

The ability to adapt rapidly to new situations in the market by introducing new products, services or entering new markets is another prerequisite for successful restructuring. This is crucial in the case of Latvia due to the recent economic downturn.

Conclusions and policy issues

The main conclusion from the literature that directly or indirectly deals with restructuring processes is that there is a gap in the research in this area. Only a few studies exist, capturing only some aspects of the phenomena. Moreover, research on entrepreneurship processes is also scarce. Given the role that entrepreneurship plays with regard to economic development, including change and innovation, this means that more time and money should be invested in entrepreneurship research processes in Latvia, including research on restructuring processes.

Those few studies we were able to identify focus mainly on competitiveness and growth, as well as bankruptcy and insolvency processes. Some studies also capture the influence of the external environment in shaping entrepreneurship processes in Latvia, thus also having implications for the restructuring process within Latvian companies.

To summarise and taking into account various international indicators, both the Latvian business environment and entrepreneurship in particular have good potential for development. When it comes to the Latvian business environment, according the first report on Latvian competitiveness (SSE Riga, 2012), two major aspects – a large shadow economy and a relatively low level of education – are major concerns for policymakers.

Other studies described in the report emphasise the importance of introducing a more stable tax policy, as well as highlighting the issue of (mis)trust between entrepreneurs and policymakers in Latvia. Other factors that foster competitiveness, including positive restructuring processes, include the ability to adapt to new conditions. This is especially relevant when the economy is changing from fast development to falling into deep recession. In such a setting it is crucial to be able to acquire the necessary resources at as low a cost as possible, and networking with suppliers and customers as well as with universities, business labs and business promotion organisations is one way to achieve this. Yet, the evidence suggests that Latvian companies are quite passive in using potential networks, which is another field to be developed.

Both Latvia as a country and companies that do business in Latvia have undergone dramatic changes in the past 20 years since the transition began from a planned to a market economy. This also includes changing mindsets – a process that directly influences interaction between formal and informal institutions. Evidence as described above suggests that this is still an ongoing process in both the private and public sectors which, depending on progress, will have a major influence on how the Latvian business environment develops in the coming years.

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