



**The impact of financial support on small and medium enterprises and its development towards export. The case study of Latvian's small and medium enterprises.**

# Title page

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Aalborg University – MCs in International Business Economics

Subject

**The impact of financial support on  
small and medium enterprises and its  
development towards export. The case  
study of Latvian's small and medium  
enterprises.**

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## **Executive summary**

This Master's Thesis provides an evaluation of the impact of financial support on small and medium enterprises and its development towards export. The research aims to evaluate importance of the state aid and to what extent the financial support help SMEs.

The methods of analysis include qualitative approach on the small and medium entrepreneurs from the Latvia. Other analysis includes secondary data elaboration in the research. For this reason the author want to find if financial support that comes from the state is efficient and provide additional opportunities for the SMEs in terms of export.

For this reason the international entry modes will be evaluated and especially emphasized those entry modes, which are common for Latvian SMEs. Identifying via primary data entry modes author will evaluate life cycle of financial support, which company can expect in certain period of development. Although SMEs can be linked to the commercial banks, author will emphasize both aspects of financial support, from banks and state.

The author via his research will try to find answer to the problem formulation, and drawing conclusion.

## **1. Introduction**

Small and medium enterprises are the engine of economic development due to high added value to gross domestic product. The business environment determines efficiency of entrepreneurship: small, medium and large. For this reason well-defined property rights, effective institution work, information availability all increase company efficiency. Many SMEs suffer lack of the financial support. This situation becomes worse with institution and government incapability to run sufficient state-aid programmes. The institutions issue different types of documents, which consist of development plans and strategies, how improve and make economy stable and profitable. Nevertheless documents do not take in account many factors, such as personal behavior, force-majeure and only serves as guidance.

The reality can be more different from the documents, which include always best-practice approaches and favorable situation development. The author in process of writing Master's Thesis will evaluate those instruments, which are implemented to address importance of the financial support to SMEs. To evaluate level of utilizing support, the author will rely on primary and second data. The primary data will be qualitative, and therefore not general, but secondary data more reliable.

The author wants research whether finance is key threshold resource, which is required for company's growth and prosperity. Entrepreneurship is about profit, but if financial support helps increase profitability or it just fake illusion. Another reason is to evaluate if there is correlation between the financial support and export. To what extent the export starts from owner willingness or finance determine export potential. What entry modes the company can adopt to successfully utilize export potential?

In the questionnaire the author will include regarding financial support's issues, and are their help to start export. The in-depth interview will be conducted with SMEs from Latvia, which operates in different industries such as pharmacy, beauty, food, and etc. The purpose is to obtain the primary data, which later can be implemented and confirm to what extend the financial support's issue is important for entrepreneurs.

## 2. Research Methodology

The next part of the project is to understand in which way research and analysis is going to be conducted. The idea of this section is to make clear the guidelines and structure of the whole project. This section consists of the definition of the paradigm as well as author's assumptions about reality and how society and environment are created. It should be stressed that there are numerous ways to solve the same problem differently, only results can be measured to indentify the most efficient one.

To build the project's fundament various certain paradigm approach must be used, from scholars as Burrell & Morgan (1979) and Arbnor & Bjerke (1997). These authors are known for their connection to business methodology.

### 2.1. Paradigms

The “word” paradigm was used already long time before B.C. by famous Greek philosophers. Thomas Samuel Kuhn (1922-1996) gave new claims concerning the progress of knowledge. In his book “The Structure of Scientific Revolutions “the word paradigm is brought into common parlance.<sup>1</sup>

Scholar Kuhn highly influential use of the term paradigm derives from his analysis of revolution in science<sup>2</sup>. Kuhn used the paradigm to describe his formulation as a constellation of facts, theories, methods and assumption about reality that allow researchers to isolate data, elaborate theories, and solve problems.<sup>3</sup> Time is significant factors, as long paradigm can solve and explain situation it takes dominant position. Kuhn argues that every field of research is characterized by a set of common understanding of what phenomenon is being studied, the kinds of questions that are useful to ask about the phenomenon, how researchers should structure their approach to answering their research questions, and how the results should be interpreted<sup>4</sup>. The only problem in terms paradigm is that it is not very specific<sup>5</sup>.

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1 <http://www.scottlondon.com/reviews/kuhn.html> access on 17.07.2012

2Aran Bryman, Emma Bell, Business research methods, Second edition, Oxford University Press, 2007

3 <http://www.scottlondon.com/reviews/kuhn.html> access on 17.07.2012

4 John Kuada, Paradigms in International Business Research – Classification and Applications, No. 52, 2009

5 Masterman, M. The Nature of Paradigms. In Criticism and the Growth of Knowledge, eds I Lakatos and A Musgrave, Cambridge University Press 1970.

Burrell, G., & Morgan, G. Sociological Paradigms and Organizational Analysis distinguish 4 types of Paradigms.

1. Functionalist Paradigm
2. Interpretive paradigm
3. Radical Humanist Paradigm
4. Radical Structuralist Paradigm

Each one represents certain way to conduct research. In some situation it can create incomprehension, which can lead to failure.

The four paradigms can be described as follows<sup>6</sup>:

The *functionalist paradigm* rests upon the premises that society has a real, concrete existence and a systematic character and is directed toward the production of order and regulation. The social science enterprise is believed to be objective and value free. The paradigm advocates a research process in which the scientist is distanced from the subject matter by the rigour of the scientific method. The paradigm possesses a pragmatic orientation; it is concerned with analyzing society in a way which produces useful knowledge.

In the *interpretive paradigm*, the social world possesses a precarious ontological status. From this perspective, social reality, although possessing order and regulation, does not possess an external concrete form. Instead it is the product of intersubjective experience. From the interpretive analyst, the social world is best understood from the viewpoint of the participant-in-action. The interpretive research seeks to construct the phenomenological process through which shared realities are created, sustained and changed. Research in this paradigm considers an attempt to develop a purely 'objective' social science as specious.

The *radical humanist paradigm* shares with the interpretive paradigm the assumption that everyday reality is socially constructed. However, from the radical humanist, this social construction is tied to a situation in which actors find themselves in prisoners of the social world they create. The radical humanist critique highlights the alienating

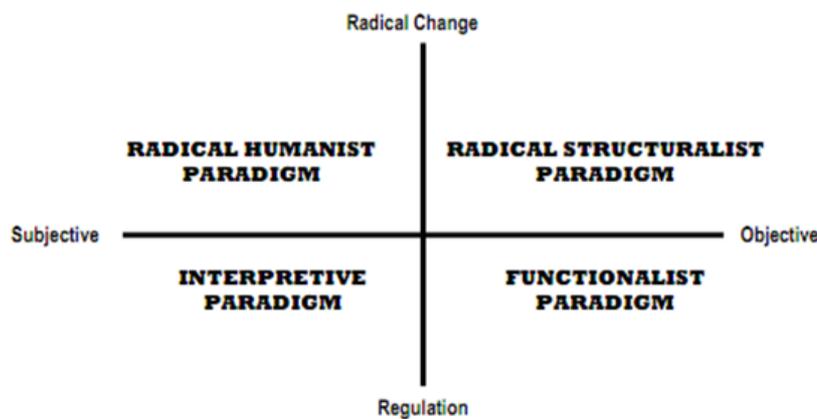
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<sup>6</sup> <http://www.uk.sagepub.com/managementresearch/Easterby-Smith%20Online%20Reading%20Links/Easterby%20Smith/Hassard%201991.pdf?ijkey=mACZHpL/606CA&keytype=ref&siteid=sposs> Access on 17.07.2012

model of thought which characterize life in modern industries societies. Capitalism, in particular, is subject to attack in the humanist’s concern to link together and action as means of transcending alienations.

Finally, in the *radical structuralist paradigm*, we also find a radical social critique, yet one at odds with that of the radical humanist paradigm in being tied to a materialist conception of the social world. In this paradigm, social reality is considered as a ‘fact’. It possesses a hard external existence of its own and takes from which is independent of the way it is socially constructed. In this paradigm, the social world is characterized by intrinsic tension and contraction. These forces server to bring about radical changes in the social system as a whole.

Figure 1.1. Burrell and Morgan’s Four Paradigms. Source: Ulla Johansson, Towards a better paradigmatic partnership between design and management. DMI Education Conference. 2008



Each paradigm involves certain ways to conduct research and apply theories. Functionalist has been the primary paradigm for organization study. Business economists adopting the functionalist paradigm hold the view that organization makes adaptive structural changes to their environment that render those more in fit with their situations and thereby maintain effectiveness<sup>7</sup>.

<sup>7</sup> John Kuada, Paradigms in International Business Research – Classification and Applications, No. 52, 2009

The interpretive paradigm emphasize situation in which individual is involved, through his experience and actions. The interpretation paradigm requires that the researcher is able to make interpretation and meaningful and clear understanding of event where actors is engaged. Researcher therefore focuses their work on understanding rather than explaining.

Scholars have emphasized that paradigm mixture is not appropriate way to solve a stated problem. They suggest that each paradigm results in the generation of a quite different type of organization analysis as each seek to address specific organization “problems”.<sup>8</sup> A synthesis between paradigms cannot be achieved<sup>9</sup>, every paradigm is unique and is building on different assumptions. Kuhn also argues that rival paradigms are incommensurable which mean there is no way in which one can compare them to each other in order to determine which is more accurate. This is basically because of divergent assumptions and methods. However there is critics from scholars Reed who suggests that paradigm determination lead to isolationisms and reduces “the potential for creative theoretical development”.<sup>10</sup>

Paradigms by themselves are grouped in two groups: research for regulation and research for radical changes. Research presupposes to contribute to society in social order or to social changes.<sup>11</sup>

First group regulation in human affairs is emphasizing oneness and ability to gather together, it tries explaining why human beings try to hold together rather than fall apart<sup>12</sup>.

The interpretative and functionalist paradigms relate to this group.

Last group research for radical changes emphasize on explanations for structural conflicts, where human being is against the structures, which dwarf its potential and

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<sup>8</sup> Aran Bryman, Emma Bell, Business research methods, Second edition, Oxford University Press, 2007, p.26

<sup>9</sup> Aran Bryman, Emma Bell, Business research methods, Second edition, Oxford University Press, 2007

<sup>10</sup> Aran Bryman, Emma Bell, Business research methods, Second edition, Oxford University Press, 2007 p. 27

p. 26

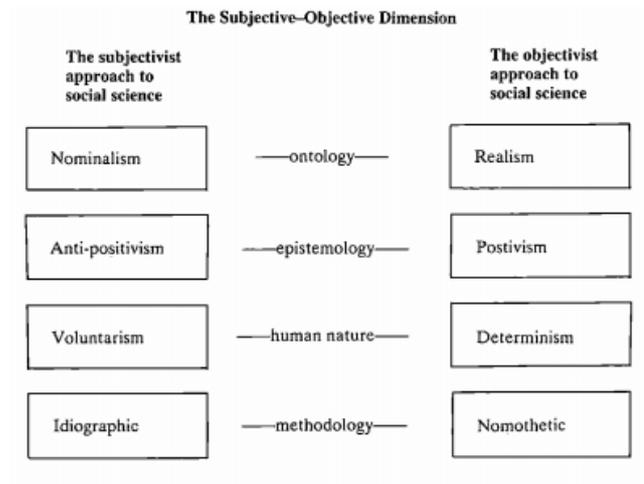
<sup>11</sup> G.Burrell and G. Morgan, Sociological paradigms and organisational analysis, The Chaucer Press, 1979

<sup>12</sup>[http://www.dmi.org/dmi/html/conference/academic08/papers/Johannssen%20and%20Woodilla/JohanssonWoodilla\\_DMIProceedings.pdf](http://www.dmi.org/dmi/html/conference/academic08/papers/Johannssen%20and%20Woodilla/JohanssonWoodilla_DMIProceedings.pdf) check May 5th

limits opportunities for development. The radical humanist and radical structuralist paradigms relate to this group.

Another classification showed in the figure 1.2. distinguish paradigm by dimensions: objective and subjective.

Figure 1.2. A scheme for analyzing assumptions about the nature of social science. Source: Burrell and Morgan 1979<sup>13</sup>



Taking above mentioned philosophy of science defines paradigm in terms of four sets of assumptions:

- ❖ Ontology
- ❖ Epistemology
- ❖ Methodology
- ❖ Human nature

Ontology - refers to the nature of social reality. To *the realist* the social world is tangible, hard made up of relatively immutable structures that exist independently of our individual descriptions. The social world is real and external to the individual. *The nominalist* however views reality as constructed in the names, labels and concepts that are used to structure that reality. Individuals create the social world; therefore there

<sup>13</sup> G.Burrell and G. Morgan, Sociological paradigms and organisational analysis, The Chaucer Press, 1979, Page 3.

are multiple realities. Burrell and Morgan believes that the ontological assumption is concerned with the very essence of the phenomena under investigation<sup>14</sup>

Epistemology – is a term which emphasize on understanding source of knowledge or “how we know what we know<sup>15</sup>”. The obtained knowledge by researcher should guarantee precise and correct information. Burrell & Morgan defines epistemology as “assumptions about the ground of knowledge, about how one might begin to understand the world and communicate this as knowledge to fellow human beings”<sup>16</sup>. An anti-positivist would understand social world from engaging with individuals who experience activities that are to be studied. For a positivist it is enough of understanding regularities and casual relationships between its constituent elements.

Human nature - Researcher should indicate what connection is between human being and surrounding environment. Are humans determined by environment in which he is located, or do they have “free will”. Free will relates to voluntarism point of view and defined activities to deterministic point of view.

Methodology – last assumption is framework of the research. It helps evaluate if actions will totally covers the research. Methodology enhances understanding how research should be done and which methods should be used. “The way in which one attempts to investigate and obtain knowledge about the social world”.<sup>17</sup>

## **2.2. Paradigm of choice.**

Burrell and Morgan have advocated each paradigm has unique style of approach toward the analyzed question. It was argued and proposed that paradigm mixture create clash of assumptions and methods. Therefore the author will evaluate most suitable paradigm in his opinion for the current Master’s Thesis. The author sees as the most appropriate paradigms interpretive and functionalist. Both paradigms belong to different assumption’s group.

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14 [http://www.eurojournals.com/ejsr\\_33\\_3\\_05.pdf](http://www.eurojournals.com/ejsr_33_3_05.pdf) check 05.05.2012

15 John Kuada, Paradigms in International Business Research – Classification and Applications, No. 52, 2009.

16 Andrew Holden, Tourism Studies and Social Science, Routledge, US, 2005

17 G. Burrell and G. Morgan, Sociological paradigms and organisational analysis, The Chaucer Press, 1979, Page 3.

The interpretive paradigm possess subjective approach to the research whereas functionalist paradigm objective.

General position within subjective approach<sup>18</sup>;

**Nominalist ontology** - assumptions that the social world is made up of nothing more than names, concepts, and labels that are used to structure reality.

**An anti positivism epistemology** – the social world can only be understood from the point of view of the individuals who are directly involved in the activities that are to be studied.

**Human nature** – people are autonomous and free-willed.

**Methodology** – social world can only be understood by obtaining first-hand knowledge of the subject under investigation. Due to that in case study qualitative approach should be used on individuals who are directly involved within the phenomena. Which mean it is first-hand knowledge and it is subjective.

General position within objective approach<sup>19</sup> :

**A reality ontology** – the reality is made up of hard, tangible and reality immutable structure

**A positivist epistemology** – the social world can be understood through regularities and casual relationships between its constituent elements.

A deterministic view of **human nature** – man and his activities are completely determined by the situation or “environment” in which he is located

**A nomothetic methodology** – focus on the analysis of relationships and regularities between the various elements which it comprises.

The interpretive paradigm is informed by a concern to understand the world at the level of subjective experience. It seeks explanation within the realm of individual consciousness and subjectivity, within the frame of reference of the participant as opposed to the observer of action. It seeks the social world as an emergent social process, which is created by the individuals concerned.<sup>20</sup> Interpretation paradigm requires that a researcher is able to make interpretation, meaningful and clear

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18 Ulla Johansson, Towards a better paradigmatic partnership between design and management. Inetnation DMI Education Conference. 2008 page 5.

19 Ulla Johansson, Towards a better paradigmatic partnership between design and management. Inetnation DMI Education Conference. 2008 page 6.

20 G.Burrell and G. Morgan, Sociological paradigms and organisational analysis, The Chaucer Press, 1979

understanding of event where actor is engaged. Thereby the projects are usually are emphasizing to understand rather than explain.

The functionalist paradigm seeks to provide essentially rational explanations of social affairs. It s a perspective which is highly pragmatic in orientation, concerned to understand society in way which generates knowledge which can be put to use. It is often problem-orientated in approach, concerned to provide practical solutions to practical problems.

### **2.3 Methodological approach**

The empirical data gathering helps obtain necessary information that later is used to support recommendation and solutions. Through this dialectical process more informed and sophisticated understanding of the social world can created. The scholars use data to rely upon on evidence or consequences that are observed. Empirical data collection methods are divided in two approaches: qualitative and quantitative.

The quantitative approach is focusing on number and frequencies, thus increasing quantity of answers. The quantitative approach allows create for the granted taken assumptions due to vast audience. The data usually is reliable and easy to analyse applying the statistical functions. However it cannot answer the question “why”, as it lack of an in-depth research.

The qualitative approach is used to explore and understand people’s beliefs, experience, attitude, behavior and interactions.<sup>21</sup> The qualitative approach techniques emphasize a focus group and in-depth interviews. The data is collection directly interacting with responded or group of respondents. The results cannot be used for granted and can be implemented answering question “why”. The particular approach is widely used in medicine where doctor through a questionnaire gather necessary information.

According with suggested and chosen paradigm, the author believes that the interpretative paradigm, which represents the subjectivism to social science, is most valuable paradigm in term to understand the problem in-depth. Therefore the author

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<sup>21</sup> <http://www.medicine.ox.ac.uk/bandolier/booth/glossary/qualres.html> access on 17.05.2012

decided to use the qualitative approach, interacting directly with entrepreneurship of SMEs and obtaining information that would be helpful to make precise and accurate conclusions and meaningful solutions to solve the problem.

The qualitative research method divides interviews into unstructured, structured and semi-structured interviews.

Characteristics of structured interviews:

- The questionnaire is standardized for all respondents.
- The interviewer and respondents engage in a formal interview.
- The interview's questions follow in order and have a framework.

The structured interview consists of close-ended questions. The structured interview allows combining and evaluating respondents using a common rating system. These types of interviews are best suited for engaging with the respondent or focus group studies in which it would be beneficial to compare/contrast participant responses in order to answer a research question or problem.<sup>22</sup> However, the quality and usefulness of the information is highly dependent upon the quality of the questions asked. The interviewer cannot add or subtract the questions.

Characteristics of the semi-structured interview:<sup>23</sup>

- The interviewer and respondents engage in a formal interview.
- The interviewer develops and uses an interview guide. The list of questions and topics that need to be covered during the conversation, usually in a particular order.
- The interviewer follows the guide, but is able to follow topical trajectories in the conversation that may stray from the guide when he or she feels this is appropriate.

The semi-structured interview consists of open-ended and close-ended questions to follow relevant topics that may stray from the interview guide and context, and still provide the opportunity for identifying new ways of seeing and understanding the topic at hand.

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<sup>22</sup> [http://en.wikipedia.org/wiki/Structured\\_interview#cite\\_note-1](http://en.wikipedia.org/wiki/Structured_interview#cite_note-1) access 17.05.2012

<sup>23</sup> <http://www.qualres.org/HomeSemi-3629.html> access on 17.05.2012

Characteristics of the unstructured interview:

- Respondents may be asked different questions.
- Interviewer may not agree on the answer and develop its further discussion.
- Interviews and respondents engage informal communication.
- The list of questions may vary and there is no common structure.

The unstructured interview appears attractiveness due to its loose framework, discretionary content and conversational flow. Yet, these same features make this type of interview very subjective, which reduces its accuracy and can lead interview in totally different direction context.<sup>24</sup> This type of the interview may involve lots of misunderstanding and misleading where the interviewer may focus on unimportant things forgetting about more serious. This interviews style in general is more chaotic.

The qualitative approach will provide the author with the first-hand data. However the secondary data is determined as collected by somebody else. The presence of secondary data increase reliability and supports proposed solutions. Where the secondary data is used, this will be indicated. In this master thesis in order to complement the information gathered during the research, newspapers, journals, books, web pages, reports, documents and etc. are considered for use. Both primary and secondary data is valid if it is meeting the requirements of the author.

Applying the qualitative approach the author gathers the data engaging small amount of participants who are interviewed separately. It is essential to select sample that can give in-depth understanding of the stated problem. The participants for the semi-structured interview are chosen from the wide range sectors and industries: pharmacy, food, beauty care and cloth production. The respondents are familiar with day-to-day SME's business. They are owners of their own business, who trying to survive within the economical system.

## **2.4. Research process**

After introducing paradigms and data collection methods, the author will introduce research process. Before attempting to solve the problem, the problem formulation

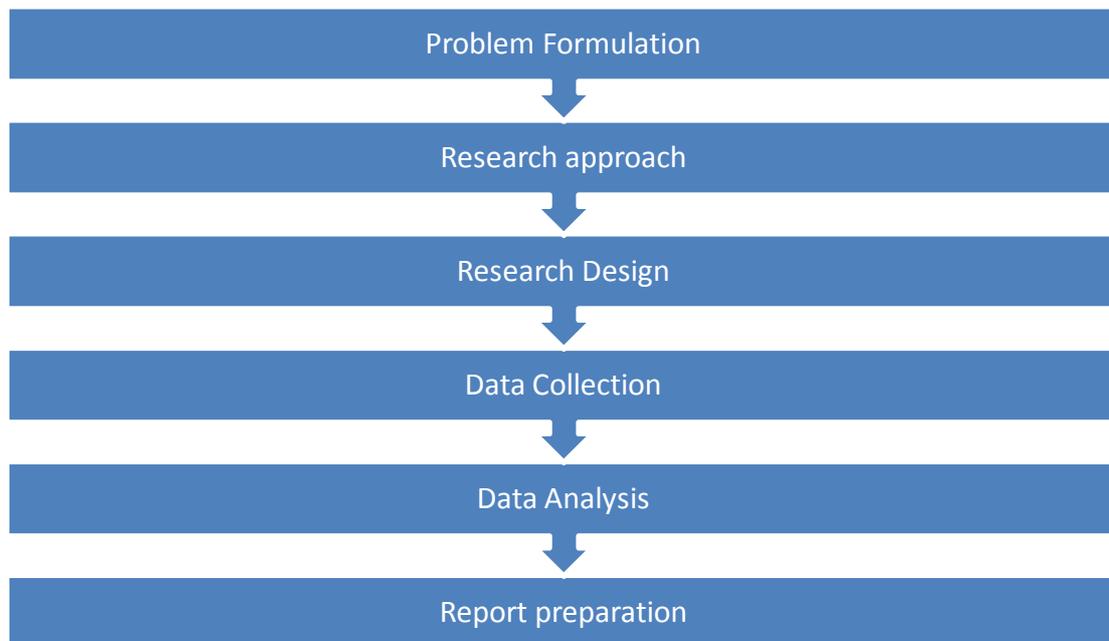
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<sup>24</sup> <https://apps.opm.gov/ADT/ContentFiles/SIGuide09.08.08.pdf> access on 15.07.2012

must be defined. The author will identify several key issues which are related with the problem.

In overall the author intend to solve problem applying in the figure 1.3. defined structure.

Figure 1.3. Research process. Source: own creation



### **Problem formulation**

**Problem formation: Does financial or state-aid support improve SMEs growth and prosperity?**

To determine if the financial support have impact on SMEs and how it helps in process of start-up and maintains of business.

**Does financial support determine efficiency of starting export?**

To what degree finance and internalization process are mutual related.

### **Research approach**

It was already described that the most suitable approach to gather primary data is the qualitative approach.

### **Research design**

*Chapter 1* consist the Introduction of the project: Main problem statement and description of importance of research.

*Chapter 2* gives interpretation to methodological part, description and justification of the methods, explanation of the research approach and paradigm choice.

*Chapter 3* outlines the theories related to the field of study and present literature which will be used.

*Chapter 4* content empirical data collected from samples which will be analyzed. Results should be affiliated with theory to get combination clear understanding how to solve problem statement and implementation towards the case.

*Chapter 5* discussed and concludes the problem formulation determining if finance is key factor for company's prosperity and to what extend it helps for the starting export.

### **Data collection**

The data will be collected through 10 semi-structured in-depth interviews. The author has developed the interview's questions, which are applied to every interview and are tackling the same subjects of interest. The interviews are not divided in segments and by age or gender. The author conducted in-depth interview in Latvian and Russian languages. This was done to allow entrepreneurs freely to talk in their native language avoiding language barriers. The author believes that entrepreneurs can better answer question if they are asked in native language. Therefore questionnaire was translated as well from English to Latvia.

Each in-depth interview will take between 15-30 minutes and will be conducted during the exhibition "Made in Baltic States 2012". The author can anticipated that place will be crowded and hope entrepreneurs will be willing to participate in the interviews. Throughout the interview the author write down brief answers. In order to have more details, and not lose importance pieces of information during the interview, entire meeting will be recorded, but not before asking for permission of the interviewee, due to privacy reason.

### **Data Analysis**

After collection the data from the entrepreneurs, the author will analyse gathered data in order to complete the research. First step will be data assembly. This stage includes

process to summarize information about each personal interview. Compare the response from footnotes with recorded video, add additional remarks and supplement answers. The author in some cases will evaluate the products what entrepreneur's offers and evaluate its potential for export. This aspect of data will be totally personal and based on the author's assumptions.

Next step in the research process is data reduction. Some of the data is not relevant to the study and it has to be thrown away in order to ease the work. Despite the core questions the author asked sub-questions, following the semi-structured interview guide introduced in the Master's Thesis part of methodological approach, which requires to break down the information into pieces and attach the references to it.

Fifth step of research process is data verification, where obtained data is checked. Although the sample used in Master's Thesis is not representing all SMEs in Latvia and therefore cannot draw for granted or general conclusion about financial impact on SMEs, but still final results can be used to give recommendations and solution to problem.

The last step of research process involves putting all previous step together. Based on data the author can make further analysis to investigate the problem and find the best solutions.

## **2.5. Validity and limitation**

The verity of research can be measured through reliability and validity. The term reliability is not applicable in terms of qualitative empirical approach due to lack of sufficient amount of data. Nevertheless the scholars have not come to common decision whether indeed it is wrong or correct. "The concept of reliability is even misleading in qualitative research"<sup>25</sup> others scholars admit that it should be taken in consideration.

The concept validity is not single, fixed or universal concept<sup>26</sup>. Joppe provides the following explanation of what validity is in quantitative research: Validity determines whether the research truly measures that which it was intended to measure or how

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25 Stenbacka, C. Qualitative research requires quality concepts of its own. *Management Decision*, 39(7), 551-555 access on 17.07.2012

26 Understanding Reliability and Validity in Qualitative Research, *The Qualitative Report* Volume 8 Number, 4 December 2003 597-607

truthful the research results are. In other words, does the research instrument allow you to hit "the bull's eye" of your research object? Researchers generally determine validity by asking a series of questions, and will often look for the answers in the research of others.

All respondents gave answers to all questions. Totally the researcher conducted 10 semi-structured qualitative interviews. After the interview information was divided and rewritten under each question. All answers had been treated with confidentiality and used in the analysis anonymously. The answers enhanced generally project value and gave more information about financial impact on SMEs and how its enhance its entrepreneurship.

As the author conducted qualitative interviews assumptions cannot be taken for granted. The role of qualitative approach is give detailed answer "why" and "how". Qualitative research collets a relatively broad range of data about a few cases. It is time consuming to conduct in-depth interviews and search for right people who would like participate.

Overall this type of limitations where highlighted in qualitative research<sup>27</sup>.

- Data is collected from a few cases or individuals, which means that findings cannot be generalized to the large populations
- Research quality is heavily dependent on the individual skills of the researcher
- The volume of data makes analysis and interpretation time consuming.
- Often results are harder to prove and convince other about its contribution.

Another limitation will be implemented in term of theory. The author will not cover trade-off and leverage theories due to insignificance in this Master's Theory. The company demonstrates individual growth opportunities and leverage is according to the industry they operate in.

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<sup>27</sup> [http://www.idrc.ca/cp/ev-106468-201-1-DO\\_TOPIC.html](http://www.idrc.ca/cp/ev-106468-201-1-DO_TOPIC.html) Access on 15.07.2012

### 3. Literature review

This chapter will cover issues related with the internalization of SMEs including entry modes and internalization theories which can be applied to penetrate the foreign market. The author from the theoretical point of view will argue importance of the finance as threshold resource.

#### 3.1. The finance as threshold capabilities.

The companies possess different type of capabilities, which help them achieve competitive advantage over others. These capabilities could be the resources the companies have. This explanation of competitive advantage in terms of strategic capabilities is called resource-based view. In turn this helps explain how some businesses are able to achieve extraordinary profits or returns compared with others. They have resources or competences that permit them to produce at lower cost or generate a superior product or service at standard cost in relation to other businesses with inferior resources or capabilities.<sup>28</sup>

Resource-based explains the importance of threshold capabilities both in terms of resources and competences. The resource is source or supply from which an organization gains profit. Resources are divided in two groups: intangible and tangible. Intangible resources are non-physical assets such as information, reputation and knowledge. Tangible resources are physical assets of an organization such as plant, labour and finance.<sup>29</sup>

Typically, an organization's resources can be considered under the following four broad categories:<sup>30</sup>

**Physical resources** – such as the number of machines, buildings or the production capacity of the organization. The nature of these resources, such as the age, condition, capacity and location of each resource, will determine the usefulness of such resources.

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<sup>28</sup> G. Johnson, K. Scholes, R. Whittington, Exploring Corporate Strategy, Prentice Hall, p. 116

<sup>29</sup> G. Johnson, K. Scholes, R. Whittington, Exploring Corporate Strategy, Prentice Hall p. 117

<sup>30</sup> G. Johnson, K. Scholes, R. Whittington, Exploring Corporate Strategy, Prentice Hall p. 118

**Financial resources** – such as capital, cash, debtors and creditors, and suppliers of money (shareholders, bankers, etc.).

**Human resources** – including the number and mix of people in an organization. The intangible resource of their skills and knowledge is also likely to be important. This applies both to employees and other people in an organization’s networks. In knowledge- based economies people do genuinely become the most valuable asset.

**Intellectual capital** is an important aspect of the intangible resources of an organization. This includes patents, brands, business systems and customer databases. The financial resources are threshold resource to start-up business, but another factor is competence. The term competence are used to mean the activities and process through which the company deploys its resources efficiency.

### 3.2. Life Cycle Theory of the Firm

The life cycle theory has been used to describe the progression of the successful firm through growth phases. Organizations are born, grow, and decline. The stage model of firm life cycle approach describes the development of the firm as a linear sequential process via the number of stages. In the book “Resourcing small and Medium sized enterprises” the author suggest use Weston and Brigham model<sup>31</sup>.

Table 3.1. The financial life cycle of the firm. Source: book Resource Small and Medium Sized Enterprises<sup>32</sup>

Stage	Sources of finance	Potential problems
Inception	Owners’ resources	Undercapitalisation
Growth I	As above plus: Retained profits, trade credit, bank loans and overdrafts, hire purchase, leasing	Overtrading, liquidity crises
Growth II	As above plus: Longer term finance from financial institutions	Finance gap
Growth III	As above plus: New market issue	Loss of control
Maturity	All sources available	Maintaining Return On Investment (ROI)
Decline	Withdrawal of finance: Firm taken over, share repurchase (US), liquidation	Falling ROI

<sup>31</sup> Weston, J. F. and Brigham, E. F., Managerial finance, 3rd edition. Fort Worth, Dryden Press 1970

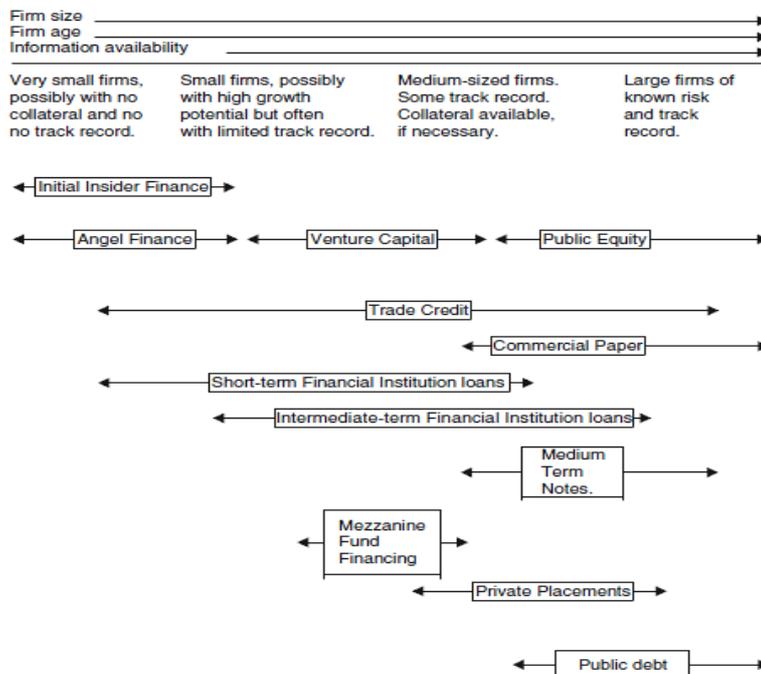
<sup>32</sup> Ciaran Mac an Bhaird, Resource Small and Medium Sized Enterprises, Physica-Verlag, 2010, p . 25

The model represents six stages during which the firm develops and sustains. The source of finance demonstrates available tools from finance attraction and last is potential problems, which can occur in case of high debts and other factors.

The first stage represents company's start-up phase where company have difficulty access to the external finance. In general, the external financing sources are limited to bank loans and trade credit in the first few years after start-up<sup>33</sup>. The most important and commonly-used sources of finance at this stage are personal savings of the firm owner, and finance from friends and family members.

After the company survive start-up phase a personal funding become less important as investment finance come from gained profit. Investment part can vary from period or session, which leads to slow development of the company. The model represents that available financial results, the banks can evaluate business performance and give opportunity receive loan. Using borrowed capital expands increase rapidly allowing company upgrade techniques, pay debts and increase turnover. In this stage overtrading problem is highest danger, due to use of the short-term debt especially overdraft facility. Each next stage opens new opportunities and possibilities to attach different type of loans.

Table 3.2. Application of the Life Cycle Approach to the SME sector. Source: book Resource Small and Medium Sized Enterprises<sup>34</sup>



<sup>33</sup> <http://www.usapr.org/paperpdfs/49.pdf> access on 15.07.2012

<sup>34</sup> Mac an Bhaird, Resource Small and Medium Sized Enterprises, Physica-Verlag, 2010 p . 27

The financial growth life cycle model developed by Berger and Udell presents firms on a size/age/information continuum, and describes the increasing array of financing options available to the firm as it grows.<sup>35</sup> As the companies advance along the continuum, they gain access to greater amount of capital in public debt and equity markets. Unlike models such as Weston and Brigham it does not specify stages of development of the firm, and whilst it includes a number of sources of external equity and debt not included in previous models, retained profits are not incorporated into the model.<sup>36</sup> The Berger and Udell model is little more innovated with features as information availability and adds important factor, which visually demonstrated phase when certain type of loan will be available.

The financial Life Cycle gives understanding of financial support that SMEs can expect. The financial present is crucial in each company's development stage. The author believes that the finance in term of resource is most valuable assets as it can be used to buy other resources. Therefore author in the Master's Thesis investigate how finance availability affects SMEs and is it related with the internalization process.

### **3.3. Internalization process of SMEs.**

In the economics, internalization has been viewed as process of increasing involvement of enterprises in international market. To discuss SMEs internalization process this section will introduce theories of internalization of companies. Furthermore, theories of market entry modes will be introduced for later discussion of the internalization process of SMEs. Also the connection to different entry strategies will be pointed out. The literate review of studies on service internalization showed a need to a thorough conceptual model to conduct further reason on service internalization. The Uppsala is internalization process is chosen as starting-point.

The Uppsala internationalization model was developed in the 1977 by Swedish researchers, Johanson and Vahlne, who studied how companies choose market and form of market entry when they have decided to go abroad.<sup>37</sup> The model is based on studies of Swedish companies who started internationalizing. The researchers

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<sup>35</sup> Mac an Bhaird, Resource Small and Medium Sized Enterprises, Physica-Verlag, 2010 p p .26

<sup>36</sup> Mac an Bhaird, Resource Small and Medium Sized Enterprises, Physica-Verlag, 2010 p p.26

<sup>37</sup> S. Hollensen, Global marketing, Prentice Hall, London, 2011 page. 74

observed that the companies in the beginning of their internationalization process choose nearby markets before expanding to more distant markets. Thereby they started penetrating new markets through export.<sup>38</sup>

The Uppsala internalization model represents four different approaches how to enter the international market. Each level represents certain stage of the internalization process. The first level represents regular export. The second level moves from sporadic export to export mode via independent representatives. On the third level the company promote them self and establish subsidiary. The last level includes maximum market commitment and foreign production and sales subsidiary. The models can growth in two directions: geographical dimension and market commitment. The geographical dimension not only includes physical distance, but refers to factors such as political system, language, culture, which is related with information flow in the market.

The state aspects of internationalization are market commitment and market knowledge. Market commitment and market knowledge are assumed to effect decisions regarding commitment of resources to foreign market and the way current activities are performed. The first step of internalization process is penetrating closes foreign market, further moving to the next market. Other conclusion was made by Johanson and Vahlne about factor that Swedish companies enter through export, instead of using sales organization or manufacturing subsidiaries. The process involves stage development, where company after several years of business in the foreign market can establish own operation facilities.

Nevertheless since small companies posses less resources than large companies that create obstacles in the internalization process. Small companies operatives with much less transaction than large companies and deals with less business partners. Therefore are limited in their actions.

The concept of market commitment contains two factors: the amount of resource commitment and the degree of commitment. The first factor or amount of resources commitment depends on the size of investment in the market, while the second factor refers to the problem of finding an alternative use for the resources and also transferring them to alternative use.<sup>39</sup> The degree of commitment is higher if the company invests more in certain market. For the example, sale representative or

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<sup>38</sup> S. Hollensen, Global marketing, Prentice Hall, London, 2011, p. 74

<sup>39</sup> S. Hollensen, Global marketing, Prentice Hall, London, 2011, page 74

marketing department in the foreign market will increase commitment and knowledge. SMEs in Latvia for this purpose are searching for the vendors or manufactures, which can use and sell the product. Avoiding to interaction with end-users.

The **market knowledge** is dividend as well in factors: general knowledge and market-specific knowledge. The market-specific knowledge in general is obtained interacting with the real world, via practice and experience in the market, where it can be transferred from one country to another. The general knowledge is basic information that consists from such themes as entrepreneurship registration, legislation, tax level and etc. The more precise knowledge company has about the market, more accurate decision it can make anticipating and evaluating all factors.

The Uppsala internalization model was created in 1977 therefore nowadays it has been criticized by scholars for several reasons. The main reason is for its old-fashion and distance between subsidiaries, which nowadays is not important factor due to new available technologies. The subjected to several different criticisms due to its inability to explain some modern and rapid changes in the internationalization processes. However the author must imply that distance between head office and subsidiaries affect productivity of subsidiary and concern. This happens due to lack of control and operation risks. The author, occupying the Auditor position in Moore Stephens, could evaluate work of the foreign subsidiaries in Latvia, and observed risk of fraud. Therefore existence of distance between head office and subsidiaries involves risks of inefficiency of particular subsidiary. The risks enlarge with subsidiaries which are located abroad; therefore geographical diversification is still reasonable aspects of the internalization process and the Uppsala theory.

Another reason is The World Wide Web (WWW) has marked a distinction between a traditional physical world with touchable and concrete resources and a virtual domain made predominantly of information. The companies have been using the Internet for various reasons, mainly for marketing purposes to build stronger brand identity and lately for selling their product online. The power of the Internet is to bypass the temporal and spatial barriers to achieve cross-border commerce. In this respect, electronic commerce (e-commerce) has been defined as “the buying and the selling of

products and services over the Internet or other electronic networks”<sup>40</sup> It possible to conclude that the **e-commerce allows small companies take advantage** and find alternative way to provide their products to clients, excluding business partners and shops and directly engaging with post or logistical agencies to send goods. It increases potential to start export and explore addition option that was not mention in the Uppsala model. The world become homogenous and traditional patterns for going abroad are moving away. Small companies have a higher flexibility and prosperity to follow new trends to adopt the e-commerce due to low cost, and fast information flow. However author must agree that export via post and logistical companies does not increase market commitment that can effect long-term development of products and service. The modernization and e-commerce does not give necessary knowledge which can be obtained through subsidiaries, which engage in day-to-day selling and interacting with clients. The market commitment is determined by the level of company’s participation in the foreign market. The Uppsala model is applicable in daily life to assess the company’s ability to start internalization process.

Table 3.3. Internalization of the firm: an incremental approach. Source: book “Global marketing”<sup>41</sup>

Mode of operation Market (country)	Not regular export (sporadic export)	Independent representatives (export mode)	Foreign sales subsidiary	Foreign production and sales subsidiary
Market A	Increasing geographic diversification	Increasing market commitment →		
Market B				
Market C				
Market D		Increasing internalization		
Market N				

<sup>40</sup><http://www.francescopignatti.com/francesco%20pignatti%20papers/The%20Uppsala%20model%20and%20the%20internationalization%20of%20fast-moving%20e-commerce%20companies.pdf> Access on 15.07.2012

<sup>41</sup> S. Hollensen, Global marketing, Prentice Hall, London, 2011 page 75

### 3.3. Market entry modes

After having described the Uppsala International model, the theories of market entry modes will be introduced. An international market entry mode is an institutional arrangement necessary for the entry of the company's products, technology and human capital into a foreign country or market. According to Hollensen, there are three modes to enter a foreign market: market modes, intermediate modes and hierarchical modes. Each market entry mode consists of different type of risks.

Figure 3.4. Market entry modes. Source: book Global Marketing<sup>42</sup>

	Exporting	Contractual Agreement	Joint Venture	Acquisition	Greenfield Investment
Risk	Low	Low	Moderate	High	High
Return	Low	Low	Moderate	High	High
Control	Low	Low	Moderate	High	High

The figure 3.4. represents the market entry modes. On the vertical column are three measures: risk, return and control. The risk is the potential that a chosen action or activity will lead to a loss. The notion implies that a choice results in on an influence of the outcome. The control system involves creation of programmes and activities, which operates and keeps activities under control. Return is the financial asset which determine outcome of all operation and investment. Return usually is tangible and measurable. Vertical row indentifies steps towards starting exporting. The first phase is exporting, which means the selling abroad item or services. The advantage of exporting:<sup>43</sup> The author have acquired the primary data where mainly all participants had only export, but not contractual agreement, joint venture, acquisition and Greenfield, therefore focus will be put especially on export in process of creation SWOT analysis. In beginning the will be presented those entry modes which were not present in primary data. The **contractual agreement**. The contractual agreement

<sup>42</sup> S. Hollensen, Global marketing, Prentice Hall, London, 2011

<sup>43</sup> <http://www.scribd.com/doc/22242895/Modes-of-Entry-Into-an-International-Business>

entry mode framework defines that the intermediate entry modes, which include a variety of arrangements such as licensing, franchising, management contracts, turnkey contracts, non-equity joint ventures, and technical know-how or co-production arrangements.<sup>44</sup> The costs of entering market through this mode are less costly. It gives flexibility for the company to choose any international location and enjoy advantage without incurring any obligation and responsibilities. This approach can be driven by cheap labour costs especially for large companies, which search for cheap production cost, cooperating with Chinese, Taiwanese and etc. manufactures.

Disadvantage of the **contractual agreement** is reduction of market opportunities, the control system is minimal. The process of promotion is totally company's responsibility. The company is exposed to high degree of conflict and misunderstanding between the manufactures and company.

The **joint venture** is the cooperation of two or more individuals or business in which each agrees to share profit, loss or control in a specific enterprise.<sup>45</sup>

The combining of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stocks.<sup>46</sup> **An acquisition** always involves the purchase of one company by other. As least in theory, merges creates synergies and economy of scale, expanding operations and cutting costs. Investors can take comfort in the idea that a merger will deliver enhance market power.<sup>47</sup> **Greenfield Investments.** A form of foreign direct investments where a parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up.

Export is first stage of the entry market mode and most common in Latvia. The author will create SWOT analysis to identify those features that makes export best for SMEs. Export entry mode differ from other two primary clusters of entry modes in that the goods are manufactured outside the target country and subsequently transferred to it. Exporting is in fact, the most common way to initially enter foreign market. In direct exporting, the products are sold in foreign markets, but no special market activities for this purpose are carried on within the company.<sup>48</sup>

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<sup>44</sup> S. Hollensen, Global marketing, Prentice Hall, London, 2011

<sup>45</sup> [www.investopedia.com/term/j/jointventure.asp](http://www.investopedia.com/term/j/jointventure.asp) access on 15.07.2012

<sup>46</sup> <http://www.investopedia.com/terms/m/merger.asp#axzz20Wx1N8Xx> access on 15.07.2012

<sup>47</sup> [www.investopedia.com/university/mergers/mergers6.asp](http://www.investopedia.com/university/mergers/mergers6.asp) access on 15.07.2012

<sup>48</sup> T. Andexer, Analysis and Evaluation of market entry modes into asia-pacific regions, Diploma Thesis, 2006, p 40

**Low initial investments.** If the company selects another company in the host country to distribute their production, it can enter the foreign market without or small financial resources, but this amount would be quite less compared to that would be necessary under other entry modes. Export is the cheapest way to enter foreign market.

**Less Risks.** Exporting involves less risk as the company understands the culture, customer and the market of the host country gradually. Later after understanding the host country the company can enter on a full scale. Suggested approach was developed as well in the Uppsala internalization theory.

**Motivation for exporting.** Motivation for exporting are proactive and reactive. Proactive motivations are opportunities available in the host country. Reactive motivators are those efforts taken by the company to export the product to the foreign country due to the decline in demand for its product in the home country. Usually the export company search for reduction of cost, and overcoming rivals, by entering the foreign market. Export can be defined cheapest way to enter market, with low risks. This most appropriate stage for Latvian SMEs, due to low investments, which usually are not enough and potential to increase market share.

Table 3.5. SWOT analysis of export. Source: own creation

Strengths	+Low initial investments +Reach customers quickly +Complete control over production	-Costs of trade: transportation cost duty and quotas -Difficult to respond to customer need -Weak knowledge about market -No representatives in foreign market	Weaknesses
Opportunity	+Learning for future expansion +Capture solid market share	-Competition push out: price dumping -Lose market share	Threat

In conclusion the entry mode framework defines that the intermediate entry modes include a variety of arrangements such as licensing, franchising, management contracts, turnkey contracts, non-equity joint ventures, and technical know-how or co-production arrangements. The hierarchical entry mode includes acquisitions, joint venture and start-up investments.<sup>10</sup>

Successful Greenfield example from point of view foreign companies is with peat production. The unsuccessful story from point of view of the local producers. Latvia export 95% produced peat abroad. Any investor who enters the market, he want 100% share of the business. If they cannot agree with other owners, they agree on joint venture to get resources, but the factory is build entirely own. These business principles are established within Latvian's peat market. The foreign investors rather build the new factory from scratch, than reconstruct old facilities. Greenfield investment can be positive effect on the domestic market via creation additional jobs and tax payment to the budget, but as well negative factor through exploiting Latvian's natural resources, that are sold extremely cheap abroad. In 2010 exported peak accounted only for 90 million and international companies acquire all profit.

Before deciding to export certain things must be evaluated: trade barriers and if home location has cost advantage. The process of evaluation requires precise and accurate evaluation of all internal and external factors, to make effective choose. SMEs despite low available resources still can follow market entry mode phases except last one (Greenfield investments) due to lack of finance and high risk of bankruptcy due to costs. The first phase would be to find appropriate foreign sales market, where products can be sold. Export would allow increase awareness about foreign market and find secure distributors and wholesalers. Small and medium companies due to low capacity of production cannot satisfy big procurements. The new trend development in past years shows that small companies prefer work with individual clients or procurements, which they are capable to produce or serve. The world wide example is sewing company, which become unique by providing its clients to send any image that children has drawn and they will create the exactly same toy. This idea was innovative and many people submitted their photos. This company in one day becomes international, with international clients all around the word. The overall idea behind this example is that the internet gives unseen opportunities. The Hillary Clinton on visit to Latvia, had emphasized importance of innovation and uniqueness. She explained that many 3<sup>rd</sup> World countries provide cheap and average quality goods, which outcompete others local producers. Therefore she implies that important is to apply creative thinking and produce something supreme to outcompete 3<sup>rd</sup> goods. The small companies in term of export have advantage, there are more flexible to environmental and legislation changes, they can adopt their production towards

demand and fulfill specific group of people. **The small companies find niche** in which they have value to add and deal in which they are experts. Peter Bregman wrote in his blog that small companies with low overhead, reliable owners, a small number of committed employees, personal client relationships and sustainable business models that drive a reasonable profit are the great opportunity of our time.<sup>49</sup>

P. Bregman gives another vision quotes, that small is the new big, sustainable is the new growth and trust is the new competitive advantage. He presented excellent example when client due to low service is choosing small company. The client is not looking for a vendor who has lots of time in the industry, or who's highly capitalized, or who has a long list of big names clients and a flashy office. I am sure those things do not hurt. But it is not what he looking for.<sup>50</sup> However this approach is not applicable for every industrial sector for example financial and audit sector, were are 4 major players in the world. The author agrees with P.Bregman opinion about advantage of trust that can be sold.

### **3.4. Financing gap**

The financing gap in prevalent in economies around the world. It is regarded as a huge barrier that interrupts development of SMEs. SMEs are the backbone of all economies and therefore financial means are more crucial for this type of firms. Even small companies are not multinational, they all face the same issued in their early stage – finding the money to enable them to start and build up the business and test their product or service.”Financial gap” is important in a fast changing knowledge-based economy because of the speed on innovation. If SMEs cannot find the financing they need, brilliant ideas may fall by the wayside and this represents a loss in potential growth for the economy.<sup>51</sup> The importance of this issue is presented in article<sup>52</sup> by joint effort of McKinsey & Company and International Finance Corporation. The results indentifies that around 365 million to 445 million enterprises in emerging markets approximately 85% suffer from credit constraints. Only 15 % can either fully access the credit they need or do not need it because are able to finance themselves through internal capital or informal source of finance.

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<sup>49</sup> [Blogs.hbr.org/bregman/2009/03/why-small-companies-will-win-i.html](https://blogs.hbr.org/bregman/2009/03/why-small-companies-will-win-i.html) Access on 15.07.2012

<sup>50</sup> [Blogs.hbr.org/bregman/2009/03/why-small-companies-will-win-i.html](https://blogs.hbr.org/bregman/2009/03/why-small-companies-will-win-i.html) Access on 15.07.2012

<sup>51</sup> [www.oecd.org/dataoecd/53/27/37704120.pdf](http://www.oecd.org/dataoecd/53/27/37704120.pdf) Access on 15.07.2012

<sup>52</sup> [www.mspartners.org/download/twotrillion.pdf](http://www.mspartners.org/download/twotrillion.pdf) Access on 15.07.2012

The difficulties that SMEs encounter for accessing the finance can be due regulation, legal framework, incomplete service and product, lack of information from financial institution (banks) and SMEs. Banks may avoid grant any loans for certain SMEs, especially to the start-up and new companies. This aspect is due to not available financial result that can help evaluate previous finance results and performance. Banks is required to make due diligence of the business plan and financial report. Another option to access financial funds is re-mortgage property to acquire start-up fund for company. When banks are dealing with large and sustainable company risk assessment is different. The consequences of high risk are usually higher cost of borrowed capital by charging higher interest rates. The overall criteria for the SMEs to borrow money are much tougher and in end it can create addition costs, because the price of credit is too high. This mean that SMEs even if they can access loans from banks, are not willing take it due to high interest rate.

If entrepreneur cannot gain access to finance through the regular system they may not start-up a business or simply go out of business, what creates potential lost to the economy. But the other danger is that they will abandon the formal the formal system altogether and operate in the informal economy, sidestepping taxes and regulations and thus not making a full contribution is to economic growth and job creation.<sup>53</sup> Latvia currently is on 5<sup>th</sup> place in EU-27 with highest the shadow economy.<sup>54</sup> This only demonstrated that entrepreneurs and employees are not willing to pay taxes. Both parties receive benefits, entrepreneurs reduce costs and employees gain more money to spend. The author must imply that shadow economy is part of high costs related with borrowed capital and high taxes.

The survey made by European Central Bank in April 2012 demonstrates sources of external financing of euro SMEs. This survey does not conclude all EU-27 countries, but only some of them, therefore this survey cannot be generalized for whole European Union. Nevertheless results represent trend and give more understanding of the financial source.

The majority of responses are using overdraft and credit lines. Overall increase comparing from first quarter 2009 to second quarter 2012 increased by 13%. The banks loans is second most popular external financing source that is grew by 2 %

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<sup>53</sup> [www.oecd.org/dataoecd/53/27/37704120.pdf](http://www.oecd.org/dataoecd/53/27/37704120.pdf) Access on 15.07.2012

<sup>54</sup> [www.delfi.lv/new/zinas/ek-latvija-ir-piekta-lielaka-enu-ekonomika-es.d?id=42467588](http://www.delfi.lv/new/zinas/ek-latvija-ir-piekta-lielaka-enu-ekonomika-es.d?id=42467588) Access on 15.07.2012

from 33 % to 35 %. The bank financing remains the most important source of the external financing. The use of trade credit also increased during the survey period, whereas the importance of leasing, hire purchase and factoring appears to have declined.

Even though SMEs account for a large share of enterprises, and represent potential employment and economic growth in emerging economies, they receive a very low share of credit. This statement further will be overview from point of the total Latvian credit portfolio issued to non-financial institution, to understand the in-depth thus industries with are financed. The characteristics of the banking system in emerging markets frequently inhibit SME lending. Many banks are state-owned; their credit may be allocated on the basis of government guarantees or in line with government targeting to develop special sectors. Often banks are subject to ceiling on the interest rates they can charge, which makes it difficult to price credit in a way that reflects the risk of lending to SMEs. Many banks may have ownership and other ties to industrial interests and will tend to favor affiliated companies. In a market where banks can earn acceptable return on other lending, it will not develop the skills needed to deal with SMEs.<sup>55</sup>

Nevertheless, credit from banks remains the most important source of formal external financing for most of SME. For example, recent analysis of the World Bank's and International Finance Corporate Enterprise Survey data found that financing from banks accounts for approximately 50% to 70% of the external financing used.<sup>56</sup>

Latvian governments has launched varies type of programmes to replace formal loans with the fund, which facilitating SME. Nowadays government acts as guarantee institution, which will cover all expenses in case of bankruptcy. This particular act improved situation where SMEs have access to bank financing.

Totally different situation exist with innovative SMEs which depends on investors and their money. One of option is to apply for the "seed<sup>57</sup>" or starting capital, funding allocated to study, evaluate and develop the original business idea. Seed capital is a risk funding in its early stage usually significant to technologically intensive projects, enabling them to develop, study and improve original product prototypes that later

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<sup>55</sup> [www.oecd.org/dataoecd/53/27/37704120.pdf](http://www.oecd.org/dataoecd/53/27/37704120.pdf)

<sup>56</sup> [www.mspartners.org/download/twotrillion.pdf](http://www.mspartners.org/download/twotrillion.pdf)

<sup>57</sup> Ministry of Regional development local government of the Republic of Latvia, Latvian national development plan 2007-2013 page 20

will form the basis of the future business. “Business angels<sup>58</sup>” are second option, where private person support realization of new technological ideas by participating as private investor in the set up of a company. The resource centre can provide consultative, informative and technical assistance, to promote the involvement of citizens in entrepreneurship. The first start-up resource centre was established in end of 2011 meant only for information technology. The TechHub originally belongs to Scandinavian investors, who seek new ideas, which can be implemented in real life. Right now most successful projects were Spotify, Wrapp and Videoplaza. The Latvian TechHub branch gives opportunity for young IT specials to realize they dream. TechHub cover all expenses related with project realization. The author friend went to the interview to apply for job in TechHub and was surprised about the behavior and culture. The managers were only concern about profit and not even about personal experience and knowledge. They were seeking similar thinking people, who would do anything for profit. The overall he received deny even he got working more than 5 years working experience in different IT sectors. The TechHub is only one small example of innovation process where money encourage people to fulfill they ideas.

The question how to reduce the SME financial gap must be addressed by government. The government can play an important role in supporting the SME sector, providing adequate financing. The government can act as guarantee institution and prioritize those sectors, which are most important for development of the economy.

Government should also act to improve awareness among entrepreneurs about financial support available from banks, investors and private funds. All mentioned actions can reduce the financial gap in SMEs.

Organization for economic co-operation and development (OECD) suggest some steps to reduce gap, where policy makers need to ensure that the tax system does not inadvertently place SMEs at a disadvantage. Government should also look at whether government technical support can be used generate the emergence of business angels and to make the existing business angel system operate for efficiently. They should also review legal, tax and regulatory framework to ensure that in encourages the development of venture capital. At same time, market for corporate control should be allowed to function efficiently from both domestic and foreign entities. In order to

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<sup>58</sup> Ministry of Regional development local government of the Republic of Latviam, Latvian nationa development plan 2007-2013 page 20

assess the success of such actions, governments need to be able to measure the size of the SMEs financing gap and evaluate the impact of government actions.<sup>59</sup>

**The author can conclude that the financial gap is a modern and actual problem  
how to describe the situation when the company cannot access to the borrowed  
capital.**

#### **4. Small and Medium Enterprises**

Micro, small and medium-sized enterprises (MSMEs) are the engine of the European economy. They are an essential source of jobs, create entrepreneurial spirit and innovation in the EU and are thus crucial for fostering competitiveness and employment. The new SME definition, which entered into force on 1 January 2005, represents a major step towards an improved business environment for SMEs and aims at promoting entrepreneurship, investments and growth. This definition has been elaborated after broad consultations with the stakeholders involved which proves that listening to SMEs is a key towards the successful implementation of the Lisbon goals<sup>60</sup>.

The table 3.6. represents current measures of SME and previous from the year 1996. Three classes of SME can be identified: micro enterprises, small and medium scale enterprises. The micro enterprises are enterprises that employ up to 9 people. The small enterprises employ between 10 and 49 people. The medium enterprises employ between 50 and 249 people. The large enterprises are thus defined as having 250 or more employees. The previous SME definition distinguished only two classes of SME: small and medium, whereas micro enterprises have not been taken into account. The new definition takes this development into account by setting financial thresholds for them. This action was taken to address the specific problem that micro enterprises face on the start-up phase.

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<sup>59</sup> [www.eocd.org/data/eocd/53/27/37704120.pdf](http://www.eocd.org/data/eocd/53/27/37704120.pdf) Access on 15.07.2012

<sup>60</sup> [http://ec.europa.eu/enterprise/policies/sme/files/sme\\_definition/sme\\_user\\_guide\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf) checked 21 May, 2012

SME are defined by EU and main factors determining whether a company is the SME are:

1. Number of employees and
2. Either turnover or balance sheet total

Table 4.1. SMEs qualification by 3 factors: employees, turnover and total balance sheet.

Enterprise category	Headcount: Annual Work Unit (AWU)	Annual turnover	or	Annual balance sheet total
Medium-sized	< 250	≤ €50 million (in 1996 € 40 million)	or	≤ €43 million (in 1996 € 27 million)
Small	< 50	≤ €10 million (in 1996 € 7 million)	or	≤ €10 million (in 1996 € 5 million)
Micro	< 10	≤ €2 million (previously not defined)	or	≤ €2 million (previously not defined)

The new definition was introduced due to requirement to improve situation with partnership and innovation. Criteria were adopted to increase SME amount and ensure that only those enterprises which require support are targeted by public schemes. European Commission defines that access to capital is a perennial problem because they SMEs encounter, largely because they are often unable to give the guarantees traditional lenders require. To help tackle this, the new definition facilitates equity financing for SMEs by granting favorable treatments to certain investors, such as regional funds, venture capital companies and business angels without the enterprises losing its SME status.<sup>61</sup>

<sup>61</sup> [http://ec.europa.eu/enterprise/policies/sme/files/sme\\_definition/sme\\_user\\_guide\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf) Access on 15.07.2012

The Annual Report of European SMEs represents fascinating data, where SMEs retain its position as backbone of European economy. In 2010, there were almost 20.8 million SMEs in the EU of which lion's share – 19.2 million<sup>62</sup>.

Table 4.2 Number of enterprises, employment and gross value added in EU-27, by size class, 2010.

	Micro	Small	Medium	SMEs	Large	Total
<b>Enterprises</b>						
Number	19,198,539	1,378,401	219,252	20,796,192	43,034	20,839,226
%	92.1	6.6	1.1	99.8	0.2	100
<b>Employment</b>						
Number	38,905,519	26,605,166	21,950,107	87,460,792	43,257,098	130,717,890
%	29.8	20.4	16.8	66.9	33.1	100
<b>Gross value added</b>						
EUR Millions	1,293,391	1,132,202	1,067,387	3,492,979	2,485,457	5,978,436
%	21.6	18.9	17.9	58.4	41.6	100

Source: Eurostat/National Statistics Offices of Member States/Cambridge Econometrics/Ecorys

From the table 3.7. can be draw conclusion, that micro enterprises are majority and represents 92.1 percent of all EU business. The large enterprise account for one third of total employment, while SMEs for two third. For this reason SMEs plays important role in providing and sustaining employment in whole EU-27. The gross value added (GVA) is important because it represents how much company provides a value for the amount of goods and services that have been produced, subtracting the cost of all inputs and raw materials (intermediate consumptions goods) that are directly attributable to production.<sup>63</sup> GVA indicated if the economy has recession or prosperity. Mostly micro, small and medium accounts for similar gross value added however it is due to amount of enterprises. Overall the trend show link between number of enterprises and size of company. Even if micro, small and medium share almost same gross value added volume, micro compensate it due to high number of enterprises, whereas large enterprises totally rely on larger scales and higher capital intensity, although SME accounted from nearly 59 % of GVA in 2010.<sup>64</sup>

<sup>62</sup> [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report_en.pdf) Access on 15.07.2012

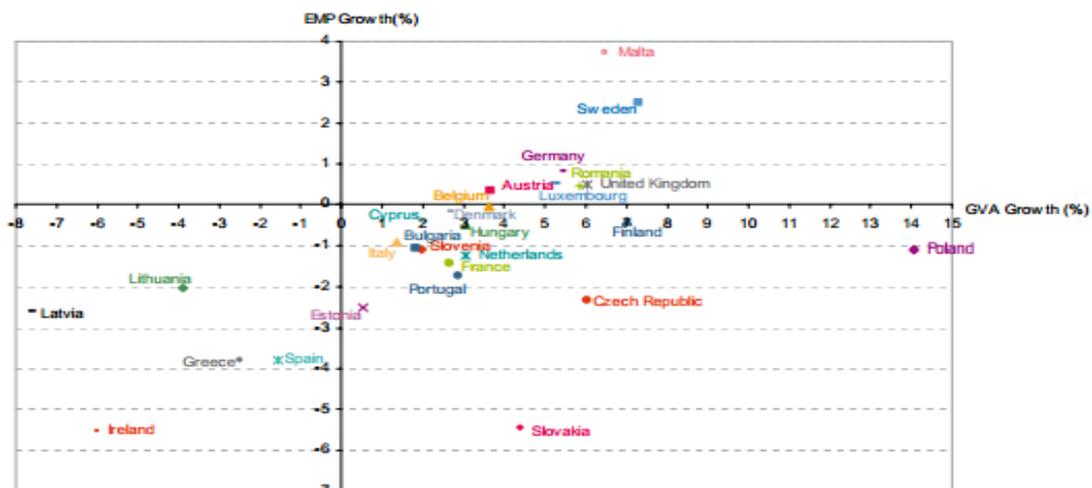
<sup>63</sup> <http://www.investopedia.com/terms/g/gross-value-added.asp#axzz1vjMxbWm6> check on May 24

<sup>64</sup> From table 4.2

Comparing the level of individual Member States, three groups can be distinguished based on growth rate of gross value added (GVA) and employment of SMES in 2010<sup>65</sup>:

1. The group of (P-P) countries – this group has a positive growth rate of both, GVA and employment, and includes Austria, Germany, Luxembourg, Malta, Romania, Sweden and United Kingdom
2. The group of (N-N) countries – this group has a negative growth rate of both, GVA and employment and covers Greece, Ireland, Spain, Latvia and Lithuania.
3. The group of (P-N) countries - this group has a positive growth rate of GVA but a negative growth rate of employment, amounting to a jobless recovery. This group contains Belgium, Bulgaria, the Czech Republic, Denmark, Estonia, France, Italy, Cyprus, Hungary, Netherlands, Poland, Portugal, Slovenia, Slovakia and Finland.

Figure 4.3. Value added at factor costs and employment growth rates of SMEs, 2010. Source: Eurostat<sup>66</sup>



The Member States such as Latvia represent the worst scenario from the total 3 groups. Both indicators, GVA and employment, in year 2010 were negative. For instance, the Member State Estonia has positive GVA in 2010, even if countries Latvian and

<sup>65</sup> [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report_en.pdf)

<sup>66</sup> [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report_en.pdf)

Estonia in terms of geography, history, populations and opportunities are quite similar, still Estonia is able to achieve higher results. Latvia from EU-27 shows the worst results lagging behind other European countries. Most EU-27 Members States had positive GVA production in 2010 and positive GDP growth, while Ireland, Latvia, Spain and Greece could not keep positive GDP growth, neither GVA in 2010. Article<sup>67</sup> in the newspaper Economist about the future of the EU defines problems of Ireland and Spain which kept to the euro's fiscal rules, they were vulnerable to a property bust or that Portugal and Italy were trapped by slow growth and declining competitiveness. In the Annual Report on EU Small and Medium sized Enterprises 2010/2011<sup>68</sup> is proposed that real GDP growth is regressed on or correlated with the GVA of SMEs in 2010 a significant relationship is found with a correlation coefficient of 0.53. It can be noted significant link between the development of business and overall economy as expressed in GDP growth.

Table 3.9. represents overview of main sectors where most enterprises are established. SMEs are more likely to be active in service rather than in manufacturing activities. Two biggest sectors are real estate, renting, business activities and wholesale and retail trade. Both sectors gather more than 12,6 million SMEs or more than half of all enterprises in trade and service. 40% from total large companies are engaged in manufacturing, while only 11% of SMEs are engaged in manufacturing. The reason for such sharp difference is due to fact that service and trade is less capital-intensive. SMEs in fact have difficulties to build up and attract large capital stock, hence manufacturing tends to be only fourth sector where SMEs are most. The two smallest sectors where SMEs have representatives are mining, quarrying and electricity, gas, water supply, which totally accounts for 1 % from total SMEs. The third sector with the highest number of SMEs is construction.

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<sup>67</sup> <http://www.economist.com/node/21555916?scode=3d26b0b17065c2cf29c06c010184c684> check May 28, 2012

<sup>68</sup> [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report_en.pdf) page 30. access on 15.07.2012

Table 4.4. Number of enterprises by sector of industry, EU-27, 2010. Source: Eurostat<sup>69</sup>

		Micro	Small	Medium	SMEs	Large	Total
<b>c- i, k</b>	<b>Total non-financial business economy By NACE section</b>	19,198,539	1,378,401	219,252	20,796,192	43,034	20,839,226
C	Mining and quarrying	15,667	4,794	941	21,402	275	21,677
D	Manufacturing	1,760,912	311,564	77,335	2,149,811	17,226	2,167,037
E	Electricity, gas and water supply	34,753	3,815	2,213	40,781	993	41,774
F	Construction	2,789,236	208,857	22,385	3,020,478	2,373	3,022,851
G	Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	5,968,300	361,222	42,324	6,371,846	6,948	6,378,794
H	Hotels and restaurants	1,552,574	151,018	12,066	1,715,658	1,527	1,717,185
I	Transport, storage and communication	1,109,424	93,533	16,956	1,219,913	4,046	1,223,959
K	Real estate, renting and business activities	5,967,673	243,598	45,032	6,256,303	9,646	6,265,949

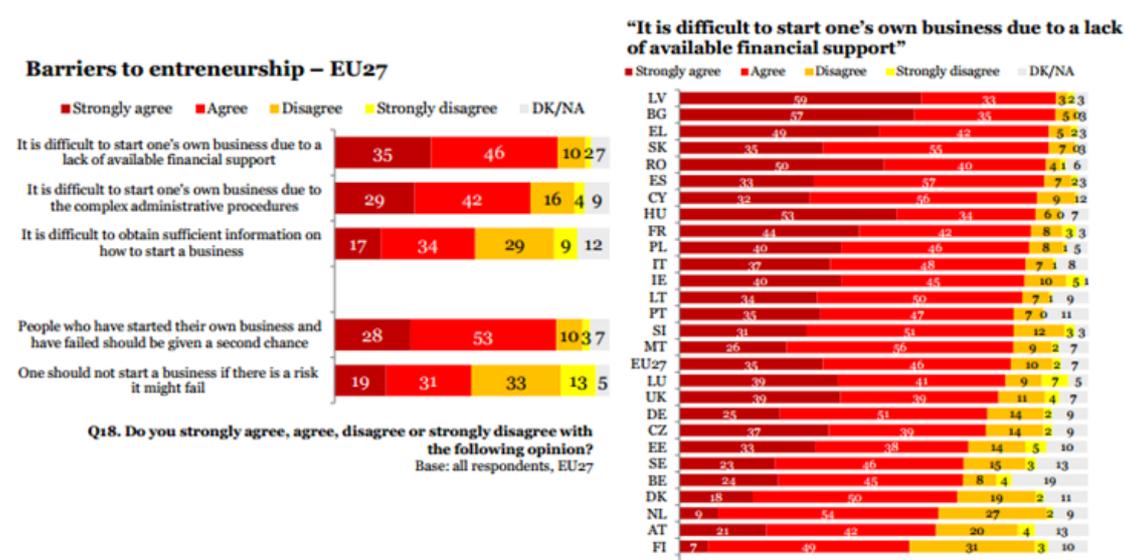
Within the Master's Thesis, emphasize is put on the internalization process of SMEs and answering question whereas finance support export and SMEs development. Therefore sector such as construction, wholesale and retail trade, real estate, renting and business activities are directed towards the domestic market instead of the international. Service are usually hard to export due to existing local competitor and only large companies search for an outsourcing potential for the cost reduction. This section part address the second data results from the European Commission Analytical report defines the perceived barriers to entrepreneurship. Respondents were asked whether they thought that business start-ups were difficult due to lack of financial support or due to complex administrative producers.

Figure 3.10. represents financial issue in as barrier to start entrepreneurship. Roughly 8 in 10 EU citizens agree that it was difficult to start up a business due to a lack of available financial support. The 35% strongly agree that this is the case. A large majority of respondents also agreed that business start-ups were difficult due to complex administrative procedures: 71%, in total, agreed and 29% strongly agreed. EU citizens were, however, less likely to agree that it was difficult to obtain sufficient information about how to start up a business: 51% agreed with this statement, while

<sup>69</sup> [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2010-2011/annual-report_en.pdf) access on 15.07.2012

38% disagreed.<sup>70</sup> In the interviews opinion number one challenge or barrier is to enquire the sufficient financial support. The figure next to the barrier of entrepreneurship gives specific information about each the EU Member States. Almost 9 of 10 respondents from Latvia agree that the lack of available financial support is key factor, which holds from establishment a new enterprise. The same results had shown Greece and Bulgaria in 2009. The comparison between the similar questionnaire of 2007 and 2019 years, show small growth of responses by 6% which strongly agree and agree that the lack of available financial support is critical factor, concluding 6%. The growth was observed by taking the average response rate in EU-27 and compared to 2007 year results. For this reason it is possible to conclude that the financial resources are most important initial resources for the start-up. The complexity of administration system, Latvia received third place among all European Union countries with an agreement 77%. The issue of the complexity of administration procedure had grown by 10% from 2007 to 2009 in Latvia.

Figures 4.5. The first figure represents the results of survey about the barriers to entrepreneurship and the second classified by the EU Member States results of difficult to start one's own business due to lack of available financial support. Source: Analytical Report<sup>71</sup>



<sup>70</sup> [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/eurobarometer/fl283\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/eurobarometer/fl283_en.pdf) page 75 access on 15.07.2012

<sup>71</sup> [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/eurobarometer/fl283\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/eurobarometer/fl283_en.pdf) Access on 15.07.2012

Overall the author based on secondary data that financial support is the most important aspect of the start-up. Latvia was one of top countries, which supported statement and scored first place in the issues related with the partnership and financial availability. For this reason the second data can be applied to the Master's Thesis and further evaluated and compare with the in-depth interviews prepared by the author. The main focus should be put on evaluating the financial support for SMEs and how this instrument helps SMEs in the internalization process.

#### **4.1. Background information about SMEs in Latvia.**

This section describe in-depth the SMEs role in Latvian economy and those factors which are implemented to improve SMEs quantity and survivability. More detailed will be overviewed available the financial instruments and supports that Latvian's banks and institutions offer.

According to the Bank of Latvia and The Central Statistical Agency's (CSP) updated indicators regarding the last quarter of 2011 GDP increased by 5,3%<sup>72</sup> compared to third quarter and by 5,7%<sup>73</sup> compared with the previous year 2010 the same quarter. With each passing quarter, as the data are updated and seasonally adjusted, the quarterly rate has been adjusted upwards, thus improving the annual performance as well. It can now be estimated that in 2011 the gross domestic product will amount to 14,16 billion LVL or 20,149 billion EUR. Overall increase of GDP between 2010 and 2011 was 11,1%. This factor represents the Latvian economical recovery.

Latvia by its geographical location is center of Baltic States and a gate between West and East. For centuries Latvia was located in crossroad of international commerce. The foreign trade in Latvia has consistently increasing since the independence, more rapidly after Latvia's accession to the EU. According to the figures 3.11 released by the Central Statistical Bureau of Latvia, in 2011 the value of total exports and imports increased by 28.1%<sup>74</sup> and 28.3%<sup>75</sup>, respectively, compared to the previous year. In 2011, exports to EU countries made up 72% of the total volume of Latvian exports and increased by 1.41 billion LVL or 29.4% over 2010. 1 LVL = 1,4 EUR. Wood and articles of wood comprise the most significant commodity group in Latvian exports

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<sup>72</sup> <http://www.csb.gov.lv/print/30138> Access on 15.07.2012

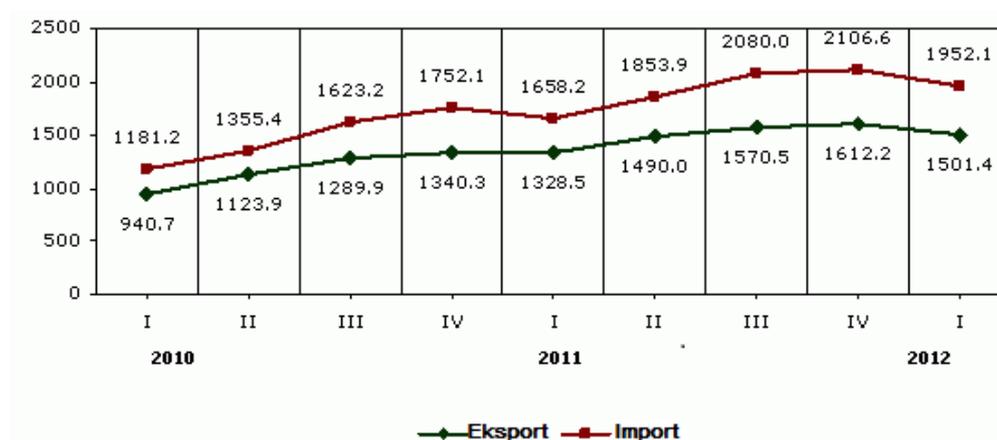
<sup>73</sup> <http://www.bank.lv/statistika/datu-telpa/galvenie-raditaji/galvenie-makroekonomiskie-raditaji> Access on 15.07.2012

<sup>74</sup> <http://data.csb.gov.lv> Access on 15.07.2012

<sup>75</sup> <http://data.csb.gov.lv> Access on 15.07.2012

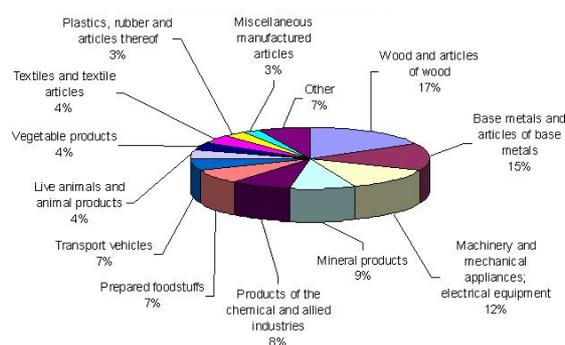
(also the main export commodities to the EU) and constituted 17% of them in 2011, followed by base metals and articles of base metals, machinery and mechanical appliances, electrical equipment, as well as mineral products.<sup>76</sup>

Table 4.6. The Latvian's foreign trade on a quarterly basis at current prices, million, LVL. Source [www.cbs.lv](http://www.cbs.lv)<sup>77</sup>



The most important commodities among Latvian imports were mineral products making up 18% of the total value of imports, whereas machinery and mechanical appliances, electrical equipment comprised 17% and base metals and articles of base metals - 11%.<sup>78</sup>

Figure 4.7. Latvian export by sectors, 2011. Source: The Central Statistical Agency and Latvian Export and Import Directory.<sup>79</sup>



In 2011, Latvia's biggest trading partners were Lithuania (18.3% of Latvia's total trade turnover), Germany (10.4%), Estonia (10.2%) and Russia (9.5%).<sup>80</sup>

<sup>76</sup> [http://www.exim.lv/?object\\_id=5255](http://www.exim.lv/?object_id=5255) Access on 15.07.2012

<sup>77</sup> <http://www.csb.gov.lv/notikumi/par-latvijas-arejo-tirdzniecibu-2012gada-janvari-marta-33361.html> Access on 15.07.2012

<sup>78</sup> [http://www.exim.lv/?object\\_id=5255](http://www.exim.lv/?object_id=5255) Access on 15.07.2012

<sup>79</sup> [http://www.exim.lv/?object\\_id=5255](http://www.exim.lv/?object_id=5255) Access on 15.07.2012

Unemployment has decreased from 22,8% in the end of 2009 to 10,7%<sup>81</sup> in 2012, which is fourth highest unemployment level in the EU, yet the presence of a variety of structural risks is felt ever more acutely: the lack of adequately qualified employees, the high and persistent level of prolonged unemployment, the ever more pronounced regional disproportions etc. Therefore some thought must be given to the implementation of national employment programmes in ways that would meet the demands of the market and be more goal-oriented.

Overall, general information about Latvia give more brief understanding about Latvian situation in terms of export, which growing and the biggest trade partners are exactly neighbors' countries: Lithuania and Estonia. The data indicates decrease of unemployment, which indentifies that it should not be barriers for SMEs to find employees, however the obstacle can occur due to unskilled workers.

Further explicit information would be given about the Latvian government action to improve SMEs situation in Latvia. In the Latvian National Development Plan 2007-2013<sup>82</sup>, Latvia has clearly stated that Latvian entrepreneurship is based on small and medium-sized enterprises (SMEs) with a relatively low production level, and the creation of new enterprises does not always mean the creation of new, well-paying jobs. However, the main advantage of small enterprises is their ability to respond quickly to changes in the market; therefore, as trends shift in the international market and as demand in some particular sector increases, diverse opportunities for specialization – for instance, in biological farming, ecotourism, information technology and in other knowledge-based spheres – open up. In general, the low level of entrepreneurial activity and self-employment is related to the lack of initiative in society, as well as to administrative obstacles within the business environment.<sup>83</sup>

Creation of new competitive companies not only will boost domestic competitiveness and develop sectors, but also will stimulate more rapid application of knowledge by companies and will significantly contribute to the export growth. It is necessary, with

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<sup>80</sup>[http://data.csb.gov.lv/Dialog/varval.asp?ma=AT0100&ti=AT10.+EKSPORTS+PA+VALST%C6%92M+UN+SVAR%C6%92KAJ%C6%92M+PRE%C6%92C8U+SADA%CF%C6%92M++\(%25\)&path=../DATABASE/atirdz/Ikgad%E7%92%20statistikas%20dati/%C6%92r%E7%92%20tirdzniec%E7%92%20EEba/&lang=16](http://data.csb.gov.lv/Dialog/varval.asp?ma=AT0100&ti=AT10.+EKSPORTS+PA+VALST%C6%92M+UN+SVAR%C6%92KAJ%C6%92M+PRE%C6%92C8U+SADA%CF%C6%92M++(%25)&path=../DATABASE/atirdz/Ikgad%E7%92%20statistikas%20dati/%C6%92r%E7%92%20tirdzniec%E7%92%20EEba/&lang=16)

<sup>81</sup>[http://financenet.tvnet.lv/zinas/412982latvija\\_janvari\\_saglabajas\\_ceturtais\\_augstakais\\_bezdarbs\\_es](http://financenet.tvnet.lv/zinas/412982latvija_janvari_saglabajas_ceturtais_augstakais_bezdarbs_es) access on 15.07.2012

<sup>82</sup> [http://www.rapl.gov.lv/uploads/filedir/National\\_development\\_plan\\_2007-2013\\_eng.pdf](http://www.rapl.gov.lv/uploads/filedir/National_development_plan_2007-2013_eng.pdf)

<sup>83</sup> [http://www.rapl.gov.lv/uploads/filedir/National\\_development\\_plan\\_2007-2013\\_eng.pdf](http://www.rapl.gov.lv/uploads/filedir/National_development_plan_2007-2013_eng.pdf) page 10 access of 15.07.2012

the help of various motivation and support mechanisms, to create a favorable public attitude towards entrepreneurs, an understanding of the role of entrepreneurship in the country's development, and to encourage people's economic activity and creation of new companies. It is particularly important to facilitate creation of new innovative companies Latvia's regions<sup>84</sup>.

Tasks set in the Latvian National Development Plan in regard to innovation are extremely well focus<sup>85</sup>:

1. to encourage people, particularly young people, to be entrepreneurs and set up their own business thereby increasing the prestige and reputation of entrepreneurship, as well as implementing a business setting up motivation program, training and consultations;
2. to ensure unified and effective support in setting up a business (mentor's consultations, financial support mechanisms – pre-seed grants, support to
3. networks of “business angels”, seed funds, micro-loans, investment guarantees, risk capital funds, resource centres etc.);
4. to develop a support infrastructure for new companies in their early stages of development business incubators etc.);
5. to increase availability of financial resources (starting capital, loans), to reduce administrative obstacles at the national and municipality level for business novices;
6. to particularly encourage creation of companies, including new innovative companies in traditional sectors, in Latvia's regions.

The course in creation of new competitive companies is divided in the five tasks. 2 of 5 tasks are directly related with the financial issue, whereas 3 others tasks are concerned with motivation, creation of infrastructure and system for start-ups and increasing availability of information. Such tasks are critical and necessary for Latvian's economy to fully recover from consequences of the financial crisis.

Most common source of the finance was long term loans from commercial banks. During the last 2 years the portfolio of commercial banks has been enlarged mostly because of the transactions with real estate without focus on the financing businesses.

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<sup>84</sup> [http://www.rapl.gov.lv/uploads/filedir/National\\_development\\_plan\\_2007-2013\\_eng.pdf](http://www.rapl.gov.lv/uploads/filedir/National_development_plan_2007-2013_eng.pdf) page 20

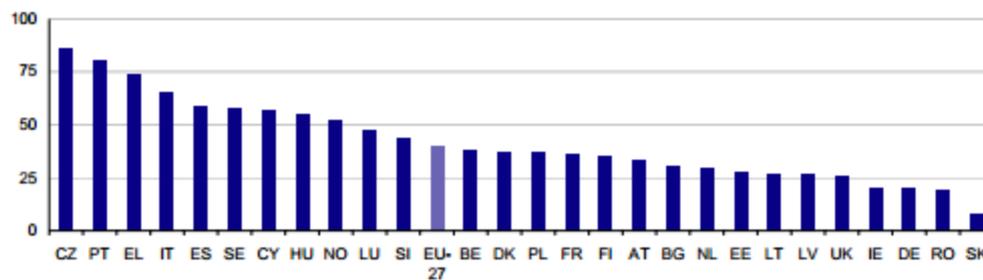
<sup>85</sup> [http://www.rapl.gov.lv/uploads/filedir/National\\_development\\_plan\\_2007-2013\\_eng.pdf](http://www.rapl.gov.lv/uploads/filedir/National_development_plan_2007-2013_eng.pdf) page 20

In the immediate future with an implementation Basel III regulations, banks will focus on attracting additional deposit, therefore increasing banks liquidity, stability and security. It is hard to anticipate consequences, which can be expected after Basel III is implemented and therefore a negative scenario may affect SMEs and accessibility to the long term loans. In 2011 the top banks ranked by profit after taxes the 4<sup>th</sup> was Rietumu bank. Rietumu bank is working only with cooperate clients, which means clients who have business and looking for expansion possibility or with clients who wish to start-up their own business (rarely). However the Rietumu bank has accurate and precise evaluation of business criteria's, before the loan is granted. One criteria specifically for this bank is the minimal loan amount for the enterprises, which accounts for 700'000 EUR non-resident and 280'000 EUR residents. Every business plan or credit request below 280'000 EUR is rejected. Many domestic banks only cooperate with Russian, Belarus and Ukrainian companies due to high market potential and high interest rates. The Russian market have huge potential hence it requires bigger investment. Local Latvian SME's are pushed out, making it difficult to benefit from the bank's loans with high interest rates.

The data available in the Central Statistic Agency represent the trend toward increasing number of enterprises. Between year 2009 and 2010 total increase was 5%. For this reason decrease in number of small and medium enterprises sector is compensated by increase of micro enterprises by 6,2%. The Latvian National Development Plan 2007-2013, clearly states that Latvian entrepreneurship is based on SMEs. Nevertheless the problem of low density of SMEs comparing to EU Member States need to be addressed and reconsidered. The Latvian government wishes boost entrepreneurship, due to two main reasons: employment and taxation.

Comparing the density of SMEs in Latvia per 1000 inhabitants with other EU Member States, Latvia had the 6<sup>th</sup> lowest density rate out of all 27 EU Member States in 2005. In the EU-27 there was an average of 39,3 SMEs within the non-financial business economy per 1000 inhabitants in 2005. It should be bearing in mind that overall contribution of SMEs to total employment within the non-financial business economy in the EU-27 in 2005 was 67,1%. Past years this situation had improved, due to total increase in enterprises and development of business incubators in regions, accessibility of the EU funds and etc. Thus, even proper access to finance and information would encourage more people start they own businesses.

**Figure 4.8. Density of SMEs – number of SMEs per 1000 inhabitants, non-financial business economy, 2005. Source: eurostat<sup>86</sup>**



In first look successful example of cooperation between two financial institutions is “Unicredit Leasing” and European Investment Bank (EIB). Both parties had signed in 2011 agreement that provide access to loans for SMEs in Estonia, Latvia and Lithuania. According to the , it will lend up to 45 million Euros to UniCredit Leasing, which will finance projects in Baltic counties to eligible SMEs.<sup>87</sup> The author cannot give specific information about success of this project; however he is able to add additional information related with the project. UniCredit Leasing in Serbia is published condition and criteria’s for the loan. The loan is available for SMEs, which have<sup>88</sup>:

- Company with total assets up to 27 mil. EUR
- Company with turnover up to 40 mil EUR
- Company with up to 250 employees
- Economically independent company or companied owned by municipalities

Comparing criteria with SMEs qualification, it is possible to conclude that SMEs with such indicators is the medium enterprises and measures are close to the large company. By such high criteria the bank is strictly limiting access to finance and protects its interests.

38,5% of the economically active enterprises are located in the Riga region and pull ahead of other regions more than twice. Riga and Pierigas regions accounts for more than half of enterprises or 53,7%. Other regions are very close to each other and range

<sup>86</sup> [http://epp.eurostat.ec.europa.eu/cache/ITY\\_OFFPUB/KS-SF-08-031/EN/KS-SF-08-031-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-08-031/EN/KS-SF-08-031-EN.PDF) access on 15.07.2012

<sup>87</sup> <http://commercialbanking.business-review.com/news/eib-unicredit-sign-loan-agreement-270111> access on 15.07.2012

<sup>88</sup> [http://www.unicreditleasing.co.rs/opencms/site/serbia/en/main/Products/SMEs\\_leasing.html](http://www.unicreditleasing.co.rs/opencms/site/serbia/en/main/Products/SMEs_leasing.html) access on 15.07.2012

between 2%. The above data supports the assumption that SME start-up programmes, micro lending programmes are required in rural regions. The aim of a polycentric country is to ensure the economic and social activity of its population, as well as the availability of services in all regions of Latvia at a distance acceptable to each inhabitant, implementing the scenario of balanced development providing for balanced development of the different areas of the country, accounting for their specifics and opportunities, and preserving their characteristic features. This can be accomplished by the implementation of measures aimed at the preservation of human resources, promotion of economic activity and the provision of availability and accessibility of varied services that, in turn, would provide for the attractiveness of the populated area and its standard of living.<sup>89</sup> Another factor which supports argument of high level density of enterprises is urbanization level in Latvia. Latvia has the highest urban growth in regions in EU-27,<sup>90</sup> even with decrease of 5,4% in 2010. Total urban level percentage of total population is 49%<sup>91</sup>, which is higher 3<sup>rd</sup> highest results in EU-27. The proportion of entrepreneurs living in rural areas is very low in Latvia. Nevertheless, the rate of entrepreneurial activity is higher among those living in rural areas than among city dwellers. Work force mobility has impact on rural regions where no longer is available qualified staff. It is important to distinguish difference between capital, small cities and rural regions; however the author only will focus on the financial issue, as it is universal resource required in each industrial sector, each company and each region.

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<sup>89</sup> Ministry of Finance Republic of Latvia, Operational programme „Enterpreneruship and innovations”, July 2007, Riga page 28

<sup>90</sup> [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/1-30032012-BP/EN/1-30032012-BP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/1-30032012-BP/EN/1-30032012-BP-EN.PDF) access on 15.07.2012

<sup>91</sup> [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/1-30032012-BP/EN/1-30032012-BP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/1-30032012-BP/EN/1-30032012-BP-EN.PDF) access on 15.07.2012

Table 4.9. Economically active statistical unites in regions of Latvia. Source: **Central Statistical Agency.**<sup>92</sup>

	2010					
	Self employed persons	Individual merchants	Companies	Farms and Fisheries	Total	% from total enterprises
Riga region	11701	2027	38624	60	52412	38,5
Pierigas region	7968	1237	9594	1928	20727	15,2
Vidzeme region	6635	900	4059	2994	14588	10,7
Kurzeme region	7873	1410	5162	2674	17119	12,6
Zemgale region	5963	1224	4179	2683	14049	10,3
Latgale region	8923	1344	4011	2794	17072	12,6
Total	49063	8142	65629	13133	135967	100

## 4.2. Background information on existing financial support and access.

All around the world governments are supporting and promoting entrepreneurship. However main criteria to start-up and maintain business are finance. The finance is not unique resource, but rather source of company's sustainability. The finance or money are is most liquid asset in the world, which can be used in different ways: such as investments in company or innovation, spend for private use, become independent or just survive tough financial period.

<sup>92</sup>[http://data.csb.gov.lv/Dialog/varval.asp?ma=SR0011&ti=SRG011%2E+EKONOMISKI+AKT%CEV%2S+STATISTIKAS+VIEN%CEBAS+STATISTISKAJOS+RE%CCIONOS%2C+REPUBLIKAS++PILS%C7T%2S+UN+NOVADOS&path=../DATABASE/uzreg/lkgad%E7jie%20statistikas%20dati/01\\_skaiti/&lang=16](http://data.csb.gov.lv/Dialog/varval.asp?ma=SR0011&ti=SRG011%2E+EKONOMISKI+AKT%CEV%2S+STATISTIKAS+VIEN%CEBAS+STATISTISKAJOS+RE%CCIONOS%2C+REPUBLIKAS++PILS%C7T%2S+UN+NOVADOS&path=../DATABASE/uzreg/lkgad%E7jie%20statistikas%20dati/01_skaiti/&lang=16) access on 15.07.2012

Table 4.11. Amount and Number of Loans Issued to Non-Banks in Latvia. Source: Financial and Capital Market Commission<sup>93</sup>

Category of Borrower	30.09.2011.		31.12.2011.		31.03.2012	
	LVL, thousands	Number of Loans	LVL, thousands	Number of Loans	LVL, thousands	Number of Loans
Resident(without transit on)	11 789 838	1 166 842	11 427 156	1 116 797	10 804 988	1 099 118
Financial institution	312 515	307	302 144	295	308 277	287
Enterprises (total)	6 003 970	50 506	5 771 162	48 650	5 426 259	48 332
-Large	862 543	760	827 255	739	834 824	749
-Medium	1 055 014	2 482	1 083 339	2 428	1 030 621	2 353
-Small	2 133 478	10 110	1 968 582	9 591	1 839 102	9 164
-Micro	1 951 729	37 114	1 891 967	35 853	1 721 707	36 030
-Other	1207	40	18	39	5	36
bPrivate persons (total)	5 383 874	1 115 154	5 264 130	1 067 007	4 981 160	1 049 623

Table 4.11. demonstrates portfolio and volume of total amount and number of loans issued to non-banks in Latvia, for three quarter period from 30.09.2011 till 31.03.2012. It is important highlight that other SMEs could as well receive loans from the different organizations or firms, which are not mentioned in this report. The table 4.11. shows unique results that in first quarter of 2012 only 4,39% of total number of loans is issued to SME, micro and large companies while it accounts for 50% of total sum issued. Total loans issued only to SMEs and micro is 47 547 or 4,32%. Average

<sup>93</sup> [http://www.fktk.lv/lv/statistika/kreditiestades/ceturksna\\_parskati/](http://www.fktk.lv/lv/statistika/kreditiestades/ceturksna_parskati/) access on 15.07.2012

loan amount for medium company is 438 003 LVL, for small 200 688 LVL and for micro 47 785 LVL. The results demonstrates that even loans for the micro enterprises are high, average 47 785 LVL or 66 988 EUR. The loan issue to the micro enterprises is growing however total loan issue and amount to the small enterprises is decreasing each quarter. Overall trend of the loan portfolio show slide moving towards the reduction each quarter.

The banks provide short term and long term loans. Majority is long term loans with approximate range of 5,5 to 9 % interest rate. For example if micro company took loan 47 000 EUR for period 6 year, each month it need return 801.30 EUR, totally different situation is with small enterprises which took 140 000 EUR for period 6 years and every month returns 2 386 EUR for the loan.

Another great example comes from Bangladeshi, where Muhammad Yunus economist and founder of the Grameen Bank, an institution provided microcredit (small loans to poor people possessing no collateral) to help its clients establish creditworthiness and financial self-sufficiency. In 2006<sup>94</sup> Muhammad Yunus received the Nobel Peace Prize "for their efforts through microcredit to create economic and social development from below". The micro-credit has proved to be an important liberating force in societies as well as great entrepreneurship stimulator.

Latvian government and EU provide financial help through research funds, competitiveness and innovation funding and similar national support programmes. SMEs are the main beneficiaries of the "Competitiveness and Innovation Frame Programme" and Lisbon Strategy.

The programmes's aid focus on three main activities: development of the science and research modernization, increase the capacity of the science and research thus facilitating high intensity of variety sectors to provide new ideas and creation of mutual link between research and business or bring together aspect of profit and modernization as well as support start-ups of entrepreneurship and improve and strength the competitiveness of existing companies. In Latvia several industry cluster

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<sup>94</sup> [http://www.nobelprize.org/nobel\\_prizes/peace/laureates/2006/press.html](http://www.nobelprize.org/nobel_prizes/peace/laureates/2006/press.html) access on 15.07.2012

can be singled out: wood processing, chemical industry (pharmacy), metallurgy, transport and logistics, information and communication technologies and others.<sup>95</sup>

### **4.3. Availability of Funding**

The Latvian's enterprises and companies will be able to sustain competitive position through exploiting the international markets. The Latvian's market capacity is limited by population, profit-pool and size. Nevertheless the geographical location is highly advanced and privileged. The objective of the Latvian external trade policy is the promotion of Latvian's competitiveness on foreign markets and the growth of exports. Increasing export capacity is highly important for Latvia considering its relatively small internal market and open economy. Surveys of those companies exporting their production indicated that the obstacles for the development of exports are the lack of information on export markets, insufficient business assets, insufficient export guarantees, the shortage of a highly qualified workforce and high marketing costs.<sup>96</sup>

Investment and Development Agency of Latvia has published instruments that are available for the enterprises. The support is divided into 9 groups:

- Investment and Development Agency of Latvia (LIAA) events
- European Business Support Network
- Latvian Guarantee Agency
- Seeds, Start-up and venture capital funds
- Latvian Mortgage and land bank (run by government)
- Fields support fund
- Fields development fund
- Ministry of Environmental protection and regional development "Climate financial instrument"
- Other support

5 of 9 programs are related with entrepreneurship and only one programme is related with export and its issues. More carefully each programme must be evaluated to

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<sup>95</sup> Ministry of Finance Republic of Latvia, Operational programme „Entrepreneurship and innovations”, July 2007, Riga

<sup>96</sup> Ministry of Finance Republic of Latvia, Operational programme „Entrepreneurship and innovations”, July 2007, Riga page 21

define those criteria's and instruments which can an entrepreneur apply for and hopefully expect to receive. The main task is to determine which programs are directed to the financial assistance, and the export incentives.

LIAA provide biggest variety of programmes nevertheless only some may be included in the search group. The objective of each is to promote business development by facilitating more foreign investment, in parallel increasing the competitiveness of Latvian entrepreneurs and both domestic and foreign markets.<sup>97</sup> The first programme is promoting an external marketing learning. It was most widely used programme by entrepreneurs in Latvia, the statistics identify that from 2006 till 2013 705 projects were approved. The main purpose of the programme was stimulate company's product recognition and participation in conferences, which could help find partners and distributors. The support is given to activities related with improve of the internalization process. In order to apply for the support the entrepreneur must specify its own good or service. The author in process of gathering the first-hand data, started with this specific programme due to high participation rate and available data.

The next programme is business incubators, which aim is provide help to entrepreneur, who has intervened in the business incubator, with just the most necessary services, to facilitate the business start-up. The business incubators evaluate the business and advice entrepreneur to help him. This help can informative or financial. With LIAA support 8 business incubators operates around the Latvia.

The third programme is new implementation and can correspond to 21th centuries new technologies. The web page [www.exim.lv](http://www.exim.lv) give participant opportunity to submit the company's information and add business proposal. Website is export-information on-line database, which is modern tool for promoting foreign trade. The [exim.lv](http://www.exim.lv) can access any who have the internet connection. The information submission and use is for free and only based on the participant initiation.

A last programme from the LIAA is directly related with SMEs. The programme covering 60% or maximum 2'000'000 LVL expensed for development of completely new product or service that has improved functional properties and is new project in targeted market. However such programmes is mainly is focusing on new

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<sup>97</sup> [www.liaa.gov.lv/eng/home/about\\_us/](http://www.liaa.gov.lv/eng/home/about_us/) access on 15.07.2012

technologies, equipment and software that can improve manufacturing or service process and methods. The entrepreneur is required to cover 40% of expenses by himself. For the example if the project would be worth 2 000 000 LVL the owner would need 800 000 LVL in advance to implement his ideas.

The Enterprise Europe Network (EEN)<sup>98</sup> is next organization which provide facilities and tools to promote business cooperation. EEN is largest business and innovation support network of contact point, providing practical information on specific issues from EU business about EU affairs, in particular emphasizing on small and medium enterprises. EEN is one of the European Commission's Competitive and Innovation Framework components that operate on the principles of the wrong door concept, providing uniform service to any entrepreneur any place. EEN provide the data base, which include thousands of companies' profiles and can be used as the network to find or receive updates on companies interested in the same kind of cross-border business. EEN provide chance the company to become international through matchmaking events across Europe where it is possible meet potential business partners.

The excellent example of internalization process is Polish and Latvia companies' cooperation and creation the distribution channel of organic buckwheat from Latvia to Poland. Polish SME was on a Network sponsored trade mission to Latvia, which gave opportunity find business partner.<sup>99</sup>

The next support is provided by Latvian Guarantee Agency (LGA). It offers mezzanine loan, which conceptual purpose is to reduce consequences regarding high credit risk, subordinate relation to a bank loan and strength entrepreneur chance to succeed. LGA cover 40 % from the project, but minimal is 100'000 and maximum 700'000 LVL and loan belong to long-term loans with 10 years period. The loan goal is stimulate the start-up, expand company, new product development and diversification, and overall production process change.

LGA provide the export credit guarantees for entrepreneur to pay for occurred losses in process of exporting service or goods due to foreign buyer, who outstand payments,

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<sup>98</sup> [Portal.enterprise-europe-network.ec.europa.eu/](http://Portal.enterprise-europe-network.ec.europa.eu/) access on 15.07.2012

<sup>99</sup> [Portal.enterprise-europe-network.ec.europa.eu/success-stories/healthy-harvest-polish-food-sme](http://Portal.enterprise-europe-network.ec.europa.eu/success-stories/healthy-harvest-polish-food-sme) access on 15.07.2012

which is specified in a contract. The guarantee limited with one debtor is EUR 1 000 000. The guarantee cover up to 90 % of the transaction value. LGA maintain diversification of funds and restructure part of finance to seeds, start-up and venture capital funds.

Next is Latvian Mortgage and Land bank, which provide variety support for different types of companies. First programme is the micro loans, with maximum available support 10' 000 LVL. The total employment do not exceeded 10 people. The credit amount is adequate for micro business requirements. Nevertheless company must pay interest rates, which are defined from 5-8 % per year. The loans can be taken up to 5 years, which mean in average entrepreneur will pay every month around 200 LVL. All conditions are favorable for micro enterprises and borrowed capital is very cheap.

The start-up programme is available for any people who wish to implement his idea in reality. The maximum support is 54 000 LVL. This support as well includes additionally full set of information help from specialist. The bank provides in-depth consulting about accounting and taxation procedures.

The bank offers SMEs development loan, competitiveness and credit fund for agriculture. Such variety of programmes only demonstrate positive signal that institution are aware of problem concerning lack of finance. The financial source mostly comes from EU, but much different organization applies this fund and redirects them in specific niches.

To test such funds and programmes, the author took initiation and applied for “Kick off”. Riga’s City Council in cooperation Swedbank has developed a grant program “Kick off”, which aim to promote SMEs, to motivate the return people to Latvia as well as strength Riga competitiveness compare to other EU cities. The offers 75 % cover of total expenses or maximum 8 000 LVL. The total budget is 98 000 LVL. The Kick off programme gives participant unique opportunity to evaluate they business idea, obtain knowledge and competence and most important gives chance to receive financial support for the start-up.

The author participated with his two ideas, one was related with creation of SPA salon in center of Riga, which would provide additional service for tourists and local inhabitants and second idea was web page hosting.

The SPA salon was unique with its fish pedicure called Garra fish. This service is developed in Greece and Turkey, where it originally comes from. The idea was adopted exactly from Greece, where it gained great popularity.

The second idea was created with help of IT specials, who advised to develop a platform for web page hosting. He explained that many hosts are busy and exceed its capability, therefore it important resource distribution equally to each web page. Many web pages are slow due to over capacity of servers and negligence of owners. None of ideas was approved by the judge committee and declared as good idea. Therefore the author made an interview with the winner of such contest to gather more specific information about the evaluation process and project realization. The winner admitted that priority is job creation and tax payment. The idea must be fresh and competitive. From the observation the author concluded that the project failed and winner just wrote-off it to expenses. Overall is possible to conclude that the winners of the contest are entrepreneurs with the unique ideas, which are superior over usual things and improve old ones, but the success of project is not obligate.

The comparison of the primary objectives of state aid within three Baltic States 2004-2009 reveals a substantial difference regarding the investment of the state aid. Each of the Baltic countries has chosen a different sector where to implement state aid in order to foster national development and competitiveness. The main objective for Latvia in 2004-2006 was investment into regional development (80%) and into SMEs (20%). In 2007-2009, the main focus stayed on the regional development (40%) and SMEs (12%), and environmental/energy saving projects (25%).

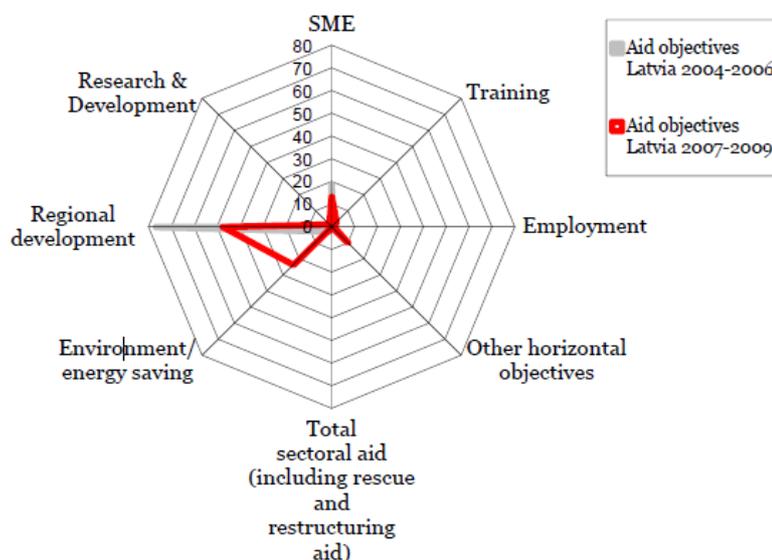
Furthermore, it was found that in many Member States the number of beneficiaries was rather high, in some instances more than 10,000 small companies. Having 134'794 economically active statistical units in SME segment in Latvia the author assumed than almost 10,000 economically active statistical units in SME segment are currently employing development instruments provided by existing development programmes in various institutions which makes usage of supporting instruments in 7,4% of all SMEs in Latvia. This number is only author's anticipation and is based on information gathered in different reports.

In 2010, the main areas where Member States focused the greatest amount of horizontal aid were environmental protection and energy saving, research and

development and innovation, and regional aid. The individual horizontal objectives are described in more details in the following paragraphs. The comparison between 2005-2007 and 2008-2010 is not significant. The author believe such huge difference between sectors: environmental aid, regional development, research and innovation comparing to SMEs sector is due to costs of technologies and long-term potential. All mentioned sectors especially energy saving and innovation are core segments and most expensive to develop. Energy saving and energy independence is related current geopolitical situation, when the EU is highly dependent on Russian gas. Only one European country Denmark successfully is implementing strategy of renewable energy via wind power. In 2012 the Danish government adopted the plan to increase the share of electricity production from wind to 50% by 2020.<sup>100</sup>

85% of support goes to the horizontal objective, nevertheless some disparities can found when examining the individual Member States. It is recalled that the horizontal aid objective, which is so called “primary objectives” of the aid, is established when the aid measure is approved by Commission.<sup>101</sup>

Figure 4.12. Trend in share of primary objectives as % of total aid. Latvia 2004-2009. (crisis measures excluded). Source: ec.europa.eu



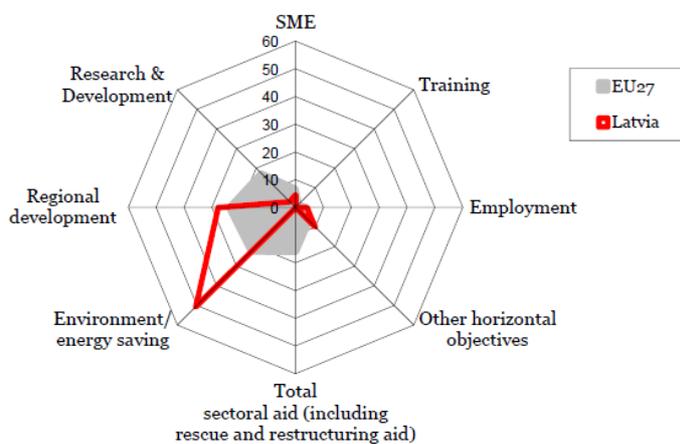
The comparison of the primary objectives of state aid within three Baltic States 2004-2009 reveals a substantial difference regarding the investment of the the state aid.

<sup>100</sup> The guardian: Denmark aims to get 50% of all electricity from wind power, 26, March 2012

<sup>101</sup> Ec.europa.eu/competition/state\_aid/studies\_report/2011\_autumn\_working\_paper\_en.pdf access on 15.07.2012

Each of the Baltic countries has chosen a different sector where to implement state aid in order to foster national development and competitiveness. The main objective for Latvia in 2004-2006 was investment into regional development 80% and into SMEs 20%. In 2007-2009, the main focus stayed on the regional development 40% and SMEs 12%, and environmental/energy saving projects 25%. It must be taken into account that the secondary objective could be SMEs under other programmes, for example, under the regional development or environment and energy saving, thus the primary objectives of the state aid continued to follow the initial direction.

Figure 4.13.. Trend in share of primary objectives as % of total aid. Latvia 2009. Source ec.europa.eu<sup>102</sup>



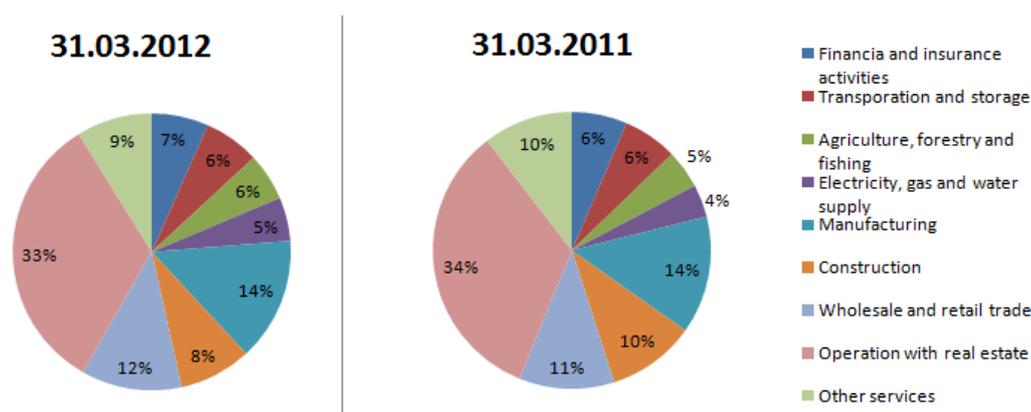
During 2009, when Latvia was experiencing a deep financial crisis, state aid was focused on environment and energy saving, making-up 50% of the annual state aid, with only 29% to regional development, 5% to SMEs, 3% to employment. Without detailed analysis it is possible to conclude that state aid distribution in Latvia could not adapt to the economic conditions as fast as required. Creating unified financial institutions which will provide state aid promotional programmes can be solution for quick reaction on better targeting of competitiveness of Latvia.

The comparison of year 2009 with 2010 state aid was distributed to sectors identifies that biggest growth was in sector of energy saving and environment from 50% to 78%. The SME was again only 1 % from total portfolio. The author doubts efficiency of promotion environmental issue in Latvia, due to low cost of natural gas In the

<sup>102</sup>[http://webcache.googleusercontent.com/search?q=cache:CrGEPNUT0eQJ:ec.europa.eu/competition/state\\_aid/studies\\_reports/ws3\\_1.xls+&cd=2&hl=lv&ct=clnk&gl=lv](http://webcache.googleusercontent.com/search?q=cache:CrGEPNUT0eQJ:ec.europa.eu/competition/state_aid/studies_reports/ws3_1.xls+&cd=2&hl=lv&ct=clnk&gl=lv) access on 16.07.2012

available catalogue of EU funded projects in Environmental research from 2007 to 2011, the main research areas was climate changes, natural hazards, environment and health, natural resource management, biodiversity, marine environment, land and urban management, environmental technologies, earth observation, tools for sustainable development and cultural heritage. The empiric data from [esfondi.lv](http://esfondi.lv) (eufunds) represents that activities is extremely low and for example funds for tourism have not been utilized.<sup>103</sup> Another proof is based on the conducted survey by TNS, were it carried out questionnaire with question “Do you think the European Union fund are effectively utilized in Latvia ?” The respondents were in age range from 18-55 and were economically active population. The replies indentifies that 81% of respondents believe that the EU funds are utilized ineffectively.

Figure 4.14 Latvian commercial banks loan portfolio. Source: Financial capital market commission.<sup>104</sup>



Next step is to evaluate other option for the financial access. The figure 4.14 shows total loan portfolio to non-financial institution. The major segment is operation with real estate. This type of loan mainly is for private use, therefore cannot be accounted as effecting SMEs. The second biggest segment is manufacturing. Next biggest segment is wholesale and retail trade, which share grew by 1% in 2012 comparing to 2011. This segment includes service providers who operate as distributors or intermediaries and etc. Fourth segment is other services, which includes social care, culture, education and other activities.

<sup>103</sup> [Ltvzinas.lv/?n=video&id=2632](http://Ltvzinas.lv/?n=video&id=2632) access on 16.07.2012

<sup>104</sup> [www.fktk.lv](http://www.fktk.lv) access on 16.07.2012

Most important segments, which are focusing on production, are agriculture, forestry and fishing, manufacturing. This two segments totally represents 20% or 1 146 906 000 LVL. In author opinion 20% there can exist correlation between agriculture, forestry and fishing

Next empirical data summarized in the figure 4.15. is the loan portfolio of Mortgage and Land bank of Latvia. Results demonstrated that biggest sector for issuing loan is manufacturing. Second was agriculture, forestry and fishing. Both sectors represent almost half of the portfolio or 48%.

Figure 4.15. The loan portfolio of the Latvian Mortgage and Land bank, 31.09.10.



The author believe that existing programmes such as competitiveness improvement, guarantees, SME development, business start-ups, micro lending, risk capital instruments should be targeted at a wide range of industries not particularly excluding any industries in order to continue balanced and structured economic development of Latvia. The only exceptions are gambling, financial and insurance services, manufacture and sale of weapons and ammunition, manufacture and sale of tobacco products and other industries that are to be specifically excluded under European Commission requirements.<sup>105</sup>

<sup>105</sup> [www.hipo.lv/lv/attistibas\\_programmas/mikrokreditesana\\_programma](http://www.hipo.lv/lv/attistibas_programmas/mikrokreditesana_programma) access on 16.07.2012

## **5. Primary data collection, analysis and conclusions**

This chapter will introduce the primary data collected by the author. The respondents are SMEs which represents different industries. The questionnaire consisted of 7 questions.

### **5.1. Questionnaire and primary data**

This chapter will introduce the primary data collected by the author. The respondents are SMEs which represents different industries. The questionnaire consisted of 7 questions.

#### **Questionnaire:**

1. What kind of state-aid or funds you received for your business?
2. Upon receiving the assistance what difficulties your company faced?
3. Do you believe that additional finance would stimulate company's growth. export? Does financial support determine efficiency of starting export?
4. Is your company exporting? How you start exporting?
5. What you expect from the internalization process?
6. How you develop your company to able to compete in domestic and international market?
7. What steps would you recommend to improve small and medium enterprises situation in Latvia?

#### **Interview 1.**

Ltd Latgales Vīns is operating in Latvian market for 2 years. Company produce vine and assemble it in bottles. The company's owner gave following answers to the questionnaire.

1. Has not attracted any financial support, not even from the EU. The reason is inconsistent market that is affected by external factors, which are hard to anticipate.

2. The owner has shared his unpleasant experience with the EU funds attraction. He advocated that he could not receive any support due to high level of bureaucracy.
3. The owner agreed that financial aid would stimulate the company's growth. The finance would not major to start export, rather business partner.
4. The company currently does not have any export abroad. The reason is the low level of activities of promotion especially abroad. The owner admits that even within Latvian's market there is still growth. Nevertheless the owner looks optimistic about export. He argues that most important thing to start export is to find collaboration partners. He advocated this rules applies on local and foreign markets. In the owner opinion the best option to find collaboration partner is to participate in the exhibitions.
5. The owner expect from the internalization increase brand identification and higher turnover.
6. Local company's strategy possesses certain values: quality, additional values, design, history and legend. The owner applies France style of promotion, where any can visit his factory and taste all types of wines and additionally taste it in the creepy, cold cave.
7. The owner listed the factors that directly effects entrepreneurship and slows down its development are attitude towards entrepreneurs. The owner argued entrepreneurs in Latvia are compared to criminals and thieves from the Latvian's government side. The owner gives an example when every time entrepreneurs come to State Revenue Service, which is responsible for Customs Tax and Customs Duties, they give to the entrepreneurs the statement of fraud to fill in. The owner of Latgales Vini was extremely unhappy that each entrepreneur before his actual violation of laws is consider as potential criminal, who should fill in the statement of fraud.
8. Additional question was asked about Social Medias. How the company promote themselves in terms of social media? The company once in a month has an article in newspaper. The company does not use the internet sources for promotion of their products.

## **Interview 2.**

The next questionnaire is conducted with the cloth company, Ltd Rupniecibas Kamera. The company produces dyne clothes. The questionnaire was conducted with the company's representative.

1. The company has never applied for the financial support. The reason was information vacuum and age of company's owner and employees.
2. Has not engaged in the state-aid programmes.
3. The financial support definitely would stimulate the company's growth. Company's export depends on orders from the foreign companies. The finance in this situation plays secondary role.
4. The company had few orders for the company Hermes. However due to the financial crisis delivery was cut down. The company does not promote themselves on the international market and lost contacts with previous partners. The main disadvantage of cloth industry is Chinese capacity and low end products. The owner admits that Chinese takes over their business with pure quality and substitutes. People are more willing to buy Latvian souvenirs made in China, rather than made in Latvia with high quality and higher price.
5. The owner expect from the internalization process higher income. Due to seasonal and fashion dynamics, the company suffers lack of the order from foreign companies. For more than 1 year the company has not received any order from the foreign companies.
6. The company provide specific type of cloth made from dyne, which is made applying old traditions. All products are eco friendly. The company emphasizes production of tablecloths and scarf.
7. The company finds taxation unfair and too heavy to pay all required duties. Taking in calculation all costs of raw materials, labour, rent and VAT the end cloths is extremely expensive for the domestic clients. This means that product price growths even twice if it is sold via shops, thereby the clients usually are people with high income and tourists. China can outcompete such expensive product with massive production. The only option is tax reduction.

### **Interview 3.**

The third interview was conducted with plastic's goods producer. The interviewee was owner of the company.

1. The company has received finance under the EU operation programme "Entrepreneurship and innovation".
2. The biggest barrier was bureaucracy.
3. The finance helped and stimulated company's development. The EU funds gave chance invest money in the company, and therefore there is export and demand.
4. The company export around 70 % from total production abroad, and only 30 % are sold on the local market. The owner implies that they sell to everyone who can pay. The finance gave opportunity to modernize equipment and provide qualitative product.
5. The company expects higher profit from the internationalization process.
6. The company follows the technological trend and enhances its technological equipment to reach state of art and low cost production. Right now don't have ISO certification. Without state aid would not achieve such technological level.
7. In the owner opinion competition is the number one barrier slow company's development. Associated factor is raw material costs and geographical location. Both factors are equally important in the production process. The owner mentioned that exist lack of professional workers. He emphasize that lots of young people are not willing to study certain professional, which create gap between demand and supply.

### **Interview 4.**

The fourth interview was conducted with the company that deals as intermediary between producers and clients. With the producer permission they are providing goods through their network. The producer does not need to have sales department that reduce costs.

1. The company just started business and till now has not attracted the funds and financial support.

2. Has not engaged in the state-aid programmes.
3. The owner agrees that finance would stimulate company's growth.
4. The company has not started exporting, due to local potential. Another reason was that the company is just established and still is in development process. Another aspect is that company does not have available finance to cover marketing and promotion campaigns in the foreign markets.
5. From the internalization process company's expects higher profit and additionally to create the long-term network with vendors.
6. The company on early stage of the development does not have the strategy how to promote and stay competitive on the domestic market.
7. The factors that create barriers for the SME are taxation, bureaucracy, lack of information, and the VAT payment's system disbalance. The owner gave the example when potential investor requires statistical information, which is not available; therefore lack of information generates misunderstanding. For this reason investors cannot trust and Latvian's reputation is low. All this consequences generate uncomfortable situations in term of the entrepreneurship.

### **Interview 5**

The next interview was conducted with designer, who produces bags for kids. The owner implies that it is her own design, which represents her feeling and how modern bag should look like.

1. The only financial and information support was provide via State Employment Agency (SEA). Due to high unemployment rate in Latvia (average 11, 7 % in January 2012), SEA each year provide sponsorship for 10 projects that are financed. The finance was provided by the European Social Fund.
2. It took long time before the owner could receive money.
3. The finance gave the owner chance to start-up own business, and integrated her back to the society. Without the finance the owner would never be able to purchase a technique and would never took such high risk to lose her funds. The support motivated the owner to invest her energy and time to become self-employed. To start export she is relaying on order.

4. The company took the first step towards the export, through the internet. The international strategy involves products sales via web page. Last week the owner got first delivery to the foreign country. Other step is facilitated the network between Latvians who went abroad and the company. The owner sees positive consequences from the marketing approach “world of mouth”. The owner describes that friends who went to UK tries to promote her products, which increase the brand’s recognition.
5. In the owner opinion the internalization give the company several benefits as well-know product, price reduction and focus on private orders. The price reduction or cost reduction per unite involves that with increasing capacity every next unite cost less. The company wants emphasize as well individual approach towards the clients, and are welcoming the private orders, which could stimulate a foreigner to purchase the high quality and fashion products.
6. The owner thinks that product’s competitive advantage is it’s the unique design and it meant for children that narrow a competition. The company looks optimistic about social media and product promotion via web page.
7. The owner describes that taxation are worst factor that affects its entrepreneurship. Another factor is lack of committed and skilled workers.

#### **Interview 6.**

The next interview was conducted with the candle producer. The in-depth interview was conducted with the owner of company.

1. The only support was provided via incubators. The incubators are development centers, which are spread all around the Latvia. The purposes of the local incubators are to attract the funds from the Investment and Development Agency of Latvia, give overall information about legislation and help establish contacts with venders.
2. There were no problems with the support acquire.
3. Definitely the financial and informational support helped to develop the company. The responded agree that finance would be helpful to start export. First of all, they need to cover transportation costs. Another reason is to find vendors who would like to purchase candles.

4. The company has not started exporting, nevertheless it possess valid information and market analysis. The priority were the company want focus its sales is Scandinavian countries, where candles are popular. However due to seasonal demand, the turnover is dynamical. Latvian consumption market is too small and thereby the owner already is looking for the distribution opportunities in Sweden. The hardest to start export is finding the vender who would like to purchase your production.
5. The owner expects that export will give addition profit and addition reserves to invest in company's development.
6. The company to maintain competitive has developed the unique product. The product allows any client create his own candles at home, using available materials and instruction within the purchased box. The company specializes on printing companies' logo types on candle surface. The candles are sold through local shops. The owner admits that with diversity and creativity they are hoping to impress their clients push out direct competitors.
7. The owner implies that finance is important factor for the company's prosperity and maintenance. The taxes in Latvia are extremely high, which reduce the company's profit and therefore it potential for the development. It would more helpful if personal income tax could be reduced. Another factor is lack of available information about sectors. Even if every year the companies submit forms, which consist such information, the Latvian government does not summarize it and does not publish it.

### **Interview 7.**

The next interview was conducted with cosmetics and soap producer Ltd 'Evita Cosmetics'. The owner has business in woods industry and decided 1,5 year ago to diverse his core business and start produce soap and beauty products.

1. The company has once applies for EU funds; however established foundation system creates uncomfortable situation for the company. The system implies that each entrepreneur before receiving the funds from EU must complete announced project attracting his finance or banks loan. The banks are not willing to support entrepreneurs, due to high risks. Therefore in Latvia does

not exist system that would allow entrepreneurs to attract the EU funds for SME development without banks loans or own reserves.

2. The question was answered above.
3. The cash would improve the company's situation and increase product diversity. The respondent does not know if finance is important thing to start exporting. Important factor in respondent opinion is the demand.
4. The company does not export. The reason is company is still in the development process. The owner implies about potential of the company's products in the Latvian market and therefore the export right now is not priority and goal. The only thing the owner is proud about; instead of the product export the owner maintain labour export to Estonia. The Estonian company attracts Latvian workers for a temporary work, due reputation and skilled employees.
5. Do not think about the export.
6. To promote the company's products, the owner participates with his products on the exhibition and searching for the vendors.
7. The owner specified the moral thing that he finds incorrect in Latvia and the Latvian government attitude to their duties and responsibilities. The owner gives clear evidence about the situation when taxes are not paid by the entrepreneurs, not because there are high, but rather how the government spends irrationally them.

### **Interview 8.**

To gather more qualitative data about SME the next interview was conducted with pharmacy producer and distributor Ltd. Elier International, who operated in Latvian's market for 1,5 year and achieved visible growth and popularity. The questionnaire was conducted with manager.

1. The company has not applied for any support from European Union. The company already acquired necessary financial support from own reserves.
2. The company has not received support.
3. The financial definitely gives boost for the company and gives owner more variety, for example to enter Russian market or Estonian. Both markets require different investment, different approach and awareness of legislation. The

company's manager implies importance of evaluation the financial reserves, which company has, whenever consider the international strategy.

4. The company started exporting via the network that was developed by individuals who were attracted to the business. Right now company has representatives in Germany, Russia and France. The export is maintained with help of Latvians who moved to live abroad. The company expects to open the sales representative's office in Russia, to allow people to receive product as fast as possible. The company has direct connection with clients and does not need make contract and search for the distributors. For the exporting abroad it is necessary to have a certificate for each product.
5. The export gives product recognition and increase sales. In total its pay off our costs of research and laboratories.
6. The manager advocated that their product is unique and there is not competition. They insisted that the competition exist between similar products, but when the company sells unique product, it does not has competition. The company sell product created from sludge, which is available only in Latvian's territory. This sludge can be used as cosmetics and for medical purpose. The company as well educated their employees who distribute the products. The company have developed AVON's distribution channel.
7. The company does not find anything that should be change. Only they admit that an employee usually does not possess English knowledge that radically affects its distribution process to Central Europe.

### **Interview 9.**

The next interview was conducted with the company that produces children cloth. Ltd Glam. The questionnaire was conducted with a woman who is owner and designer.

1. The company has not applied for EU funds, but rather invested their own.
2. The company attracted own finance for business development.
3. Yes, the finance would help develop and buy new technical equipment. The owner does not think that finance would help improve export. She implies to start exporting it is necessary to have orders and finance is not key aspect. The finance could be used to modernize equipment.

4. The hardest to start exporting is to find clients and equally hard is to promote product. The company's first step was emphasizing to promote the company in the internet and made pictures of their product and uploaded it on forums. After 8 month they got first order from Germany. The owner admitted that it is time demanding and requires a special skill to write and promote in the internet. Another step was to establish contacts with Latvians abroad who could give any helpful information about possibilities to sell and distribute. Thereby the company only works with orders and sends their product directly to the client. That allows maintain export even with small financial investment that requires only recognition in the internet.
5. The owner expect from international higher income, that will allow buy more advance techniques and develop the company even further.
6. The company focuses on narrow product's production that allows them to compete with the cloth production's companies. The owner put emphasize on design, making product more beautiful and more fashion. Another approach that owner developed is participation in the exhibition.
7. In this stage of development the company does not have any barriers. The government does not provide any support if your business operates in the non-prioritized sectors and does not provide educational sections for new entrepreneurs. The government agencies are not capable to answer certain question and provide information. For this reason the owner suffers lack of information about taxes, report and basic accounting principles.

#### **Interview 10.**

The last interview was conducted with company, which produce beauty and care products, Ltd Mai Soko. Company operates in the Latvia market already for 2 years. It posses wide range of specific products for a sauna and is emphasizing production on female gender. The questionnaire was conducted with owner of the company.

1. The company has not tried to apply for the EU funds due to the high level of bureaucracy. Another reason was related with the system of funding. The system is create in such way that every project for SME entrepreneurs need to be back up with equally same amount of money, that he is applying. For

example if you the company wish to buy new techniques, it requires first spend it own funds, and later EU will cover 50-70%. The owner implied that system does not allow and does not simulate apply for the EU funds. However exist another way to avoid this situation, and take loan from the banks, nevertheless banks after the financial crisis are skeptical about such loans, that have the high rate of risk. On base of Basel III all banks in the world shall more focus on rise of liquidity and deposit.

2. The owner gave example that usually EU funds cover certain percentage from total expenses. If this percentage is less than 65 % the owner would not even apply, due to expenses. Therefore the lack of money for the backup of the EU funds is the number one challenge for the owner.
3. The owner support idea that the finance is the key issue for the business maintenance. The owner need money to start exporting.
4. Most common difficulty to start the export is required to fulfill all criteria's of the EU rules about beauty care's products. Each product type requires to have the certificate, that approve its unharmed effect on humans. The owner argues that he needs 20'000 Euro investment to receive certificates for his production and start exporting. For this reason company right now only considering to start exporting.
5. The owner explains that internalization is crucial factor to stay alive. He explains that the Latvian consumption market is little and in same time high competitive. Many companies provide health and beauty products. The export would increase turnover and reduce costs per unit. The owner expects increase the price for his products by 2 times, for the international market.
6. The company focuses on narrow niche, offering the beauty products for sauna and substituting already existing product for face cleaning. The owner is proud about the products, which are made from natural components and are 100% pure. They have adopted competitive advantage and are following modern trend to purchase Bio products.
7. The owner argues that the biggest problem is the government. There is no support from the government and no ethical and moral principles. The owner is furious how the government spends taxes, which derogates his motivation to pay taxes. The owner asked the question: "Why should I pay taxes if the government spends it for private purpose?" The whole system in the owner

opinion is Draconic. The owner is afraid about future and incomprehension. The owner thinks the third barrier is change of rules that is hard to predict and anticipate.

## 5.2 Data analysis

Table 5.1. Data analysis of primary data.

Questions	1	2	3	4	5	6	7
Interview number.							
1	No	Bureaucracy	Agree that finance is crucial. Export does not require finance, rather partnership.	Doesn't export	Brand recognition and higher turnover	Developed certain qualities and values	Latvian government attitude towards entrepreneurs.
2	No	Has not engage in the state-aid programmes	Agree that finance is crucial. Export depends on orders.	Had export, but lost contracts. Chinese goods push out company from the Latvian market.	Higher income	Unique product from dyne, eco friendly.	Taxation to heavy and the taxation policy change is only solution.
3	Yes. EU fund "Entrepreneurship and innovation"	Bureaucracy	Agree with both questions and evidence is company's success.	70% of produced is exported.	Higher profit	State of art, modernization, cheap products.	Competition is Nr. 1 barrier, and secondary barriers is cost of raw materials and geographical location.
4	No	Has not engage in the state-aid programmes	Agree that finance is crucial. Export requires finance to invest in promotion campaign.	Domestic market has potential	Higher profit and long-term network with vendors.	Does not have strategy how promote and stay competitive.	Taxation, bureaucracy, lack of information.
5	Yes, State Employment Agency	To receive money takes long time.	Agree that finance is crucial. Export depends on orders.	Had first order from foreign company. Promotion via the internet and Latvians who lives abroad.	Recognizable product, price reduction and increasing demand.	Competitive advantage is uniqueness and meant only for kids.  Modern approach toward promotion bags via web page.	Taxation

6	Incubators	No problem	Agree that finance is crucial. Export depends on finance and orders.	Right now company does not export, but gathering information to start soon. The main target Scandinavian countries	Additional profit which can be redirected in development of company	Unique products: any client can create own candle. The company tries achieve creativity.	Taxation which reduce profit and potential for development.  Lack of public information
7	Once applied for EU funds.	To receive the EU fund, entrepreneurs is required to have own finance. The banks only available source of capital does not provide.	Agree that finance is crucial. Does not have opinion about mutual interaction between finance and export.	Does not export and not considering in future.	Does not think about export	Promotion products in the exhibitions were people can try out and immediately buy. Eco friendly.	Latvian government attitude towards entrepreneur, duties and responsibilities.
8	No, company had own reserves	Have not received	Agree on both questions. It gives the company maneuverity for penetrating the foreign markets.	Have representatives in Germany, Russia and France.	The export give recognition and increase sales.	Eco friendly and unique products created from sludge. Employees are educated to improve sales quality.	Everything is ok.
9	Have not applied, but invested own finance.	Have not received	Agree that finance is crucial. Export depends on orders.	Have made export to Germany	Higher income	Narrow product type that decrease competition. Unique design and fashion.	Does not have any barriers. Only feel lack of information from Latvian government about financial issues.
10	Have tried. Failed due to lack of finance.	Bureaucracy. To receive the EU fund, entrepreneurs is required to have own finance.	Agree that finance is crucial. The owner need money to start exporting.	Does not export due to EU regulations. The company is considering to start the export.	Increase sales and survivability. Reduce cost per unit. Increase product price for the international market.	Offering narrow product meant for sauna. Eco friendly products.	The Latvian government does not provide support. Change of political situations and laws.

The author has provided detailed information on available fund and state aid from different institution in Latvia. After conducting in-depth interview with SMEs owners have come to understanding that those funds are not effectively utilized. The primary data represents following trends:

- State-aid is not utilized effectively.

- The biggest obstacle to receive funds is bureaucracy and requirement to have own funds.
- All respondents agree that finance is source of company's prosperity.
- The owner expects higher profit from the export.
- Taxation is biggest barrier of the SMEs.

Those are just common answers, which respondents gave. From this point of view is possible to draw conclusion and bring together practice with theory and secondary data.

In Master's Thesis was given lot of secondary data, which gave more detailed understanding of situation about Latvia. Due to reason Latvia does not possess scientific research conducted about Latvia and SMEs, which covers financial issues, mostly available data is from the research conducted by EU. This situation is presented for the fact that Latvia is small country and does have major role in globalization, not political issues and EU has finance to run such research.

The primary data and above presented research must answer two significant question, answer two key questions **Does financial support or state-aid improve SMEs growth and prosperity?** and **Does financial support determine efficiency of starting export?**

All respondents agree that the finance is key factor for company's development and growth. Some of respondents had mentioned that competence of distributing finance is critical as well. This statement reflect to secondary data of table 5.1, where results represents that lack of finance is number one barrier to start-up entrepreneurship.

The questionnaire has not specified if company has taken loan from banks, rather it emphasized if owners have applied for the funds or state-aid. The author thought that such information is private and should not be asked. The worst problem, which entrepreneurs face in process of utilizing and applying for the funds, is bureaucracy. 4 from 10 agree that bureaucracy is obstacle. For this reason some respondents had negative attitude toward EU funds an state-aid. The institutional development defines financial obstacles for SMEs. The Beck has defined that Firms in countries with higher levels of institutional development report significantly lower financing obstacles than firms in countries with less developed institutions. The positive effect

of financial and institutional development can also be observed in the use of external finance. Better protection of property rights increases external financing of small firms significantly more than it does for large firms, particularly due to the differential impact it has on bank and supplier finance.<sup>106</sup> In this case respondents implied high level of bureaucracy that does not allow to utilize support.

To acquire more detailed understanding how company compete, the question regarding competitiveness was asked. Respondents gave different answers related to demands of industry; nevertheless half of respondents were common on one feature, which is uniqueness. They understood importance to sell unique products, which can compete with others similar products.

Second questions whether finance help and stimulate export respondents were divided in their answers. Half of respondents admitted importance of finance to start exporting. Other half were more skeptical and thought to start exporting it is necessary to have order and partnership. Non-secondary data or scientific papers were provided to what extend financial support and exporting is mutual. The author after performing in-depth interviews came to conclusion that financial support, if not directly, effects exporting potential, but helps develop company the way it can start exporting. For example the financial support usually is provided for the equipment modernization. In the interview the plastic producer implied that this funds granted opportunity to update equipment and start exporting.

Other observation that comes from the primary data is uniqueness and ecological products that entrepreneurs are trying to sold. Seven of ten respondents are possible to include in this group. Owners are entering foreign market not by providing cheap product, but rather by offering totally unique products, specially designed and suitable for you. The price for the domestic customers can be too high; therefore foreign market gives opportunity to sell products expensive.

The plastic producer, which have 70% export from total production, told that Nr.1. barrier is competition. This company was does not emphasized its uniqueness. On the other hand 4 other respondents who had or are exporting mentioned varies obstacles

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<sup>106</sup> T. Beck, and A. Demirgüç-Kunt.. Small and Medium Enterprises across the Globe: A New Database. 2003 World Bank mimeo.

for the internalization process and entrepreneurship in Latvia: competition from China, taxation, lack of information. Totally 5 companies from 10 are performing the export actions. 3 from 10 have received financial support. 2 from 10 have applied, however could not meet requirements for the financial warranty.

From all listed the financial support programmes that were mentioned in the section 4.3. the respondents only utilized LIAA incubators and start-up capital from State Employment Agency. This results are not general, nevertheless demonstrates low level of activity and vacuum. The entrepreneurs are not familiar with such programmes, or just do not meet requirements.

### **5.3. Recommendation and conclusion.**

SMEs in Latvia face different aspects and problem of entrepreneurship. Most common in problems are taxation, government attitude, unemployment, financial gap, unskilled workers, negative GVA, density and others. Only some of this problems where covered in this Master's Thesis. The main purpose of Master's Thesis was to indentify problem via primary data and secondary data. To find to what degree exist such problem, and are there measures to solve it. Which systems and instruments are used to reduce problem spread and expansion? The author indentifies two question: **Does financial support or state-aid improve SMEs growth and prosperity?** and **Does financial support determine efficiency of starting export?**

The first question was absolutely approved by primary data and secondary data. The second question was left without clear answer, due to variety of answers from respondents and no clear evidence of such mutual interaction. Nevertheless author expressed his own opinion that such link exist. In some industries it is indirect, when finance are invested in equipment modernization, which improve export potential, or direct covering related expenses on promotion campaign and covering transportation costs.

The respondents have indentified high level of bureaucracy. Companies in countries with more effective and more adaptable legal system report lower financing

obstacles.<sup>107</sup> Focusing on improving the institutions and the overall business environment is probably the most effective way to relaxing the growth constraints SMEs face and facilitate their contribution to economic growth.<sup>108</sup> However institution building is a long-term process and requires more human willingness to change, rather than any other thing. In order to improve situation people occupying leading positions in institution must address such problem and reduce level of bureaucracy.

Export gives great chance for company to explore additional markets and raise it revenues. From the primary data only 2 companies via the Internet managed to find potential orders. The Internet is changing our world, erasing boundaries to communicate, express opinion, promote products extremely cheap via the internet forums, web pages and etc. the Internet become concurrent part of every one life. In the interview 2, the company declared that it suffers lack of initiative and creative people, who would promote their product via the Internet. The overall company's contingent was old people, who have shortage of young people with 21th century overview. The author has recorded only one such example, but this does not mean that in Latvia there are more such companies. The institution must take care of such cases and implement education and training programmes. However Latvian institutions show immaturity to solve this problem. This conclusion come from the interview 9, where owner implied that internet promotion comes from own knowledge and institutional cannot even provide sufficient information about the financial issues in Latvia.

The positive observation that comes from the primary data is that entrepreneurs are willing to start export. This positive trends show important insight of behavior, that the entrepreneurs are not afraid step beyond their domestic market, and are ready to discover the international potential. Three most common answers for the internalization process is expectation for higher profit, scale up turnover and raise product recognition.

Another positive trend is developed by the Latvian financial institutions. In the table 4.11 enterprises are divided in four groups: large, medium, small and micro. The

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<sup>107</sup> T. Beck, and A. Demirgüç-Kunt.. Small and Medium Enterprises across the Globe: A New Database. 2003 World Bank mimeo.

micro loans represent banks awareness about the micro enterprises and that this type of companies requires different type of approach. Totally 36 030 loans was give to micro enterprises. Additionally loan portfolio of banks show trend to issue loans to operation with real estate, but never less 20% is connected with agriculture and manufacturing. The author cannot suggest that banks should change their strategy and policies and issue more loans to the key industries. This is only in bank's capability change such situation.

The author comes to the conclusion that the Latvian government provides variety of financial and informational support for the entrepreneurs, nevertheless from the primary data it possible to understand inefficiency of utilizing such support. Only 33% of respondents have received some support. It is necessary to improve distribution and development of less bureaucratic system, that would stimulate and motive entrepreneurs apply for the state aid.

Overall the author tried to provide sufficient amount of information to underline importance of the financial support in the start-up and development stage. The respondents determined that financial support is boosting company and gives additional flexibility, opportunity and chance for starting export.

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