

**Project Partner Report – Latvia**

**Composed by Ministry of Economics, Republic of Latvia**

**30th of June, 2020**

**Activity 4.1. - Analyses**

According to the WP 4.1 of the application The Ministry of Economics should carry out two project studies:

1) Analysis of the State of affairs in the BSR (Interviews with national policy makers and stakeholders in all BSR countries concerning:

* Challenges and barriers facing companies in financial distress and restarters e.g. legal barriers, access to finance, social stigmatization, etc.
* National and/or regional policies and legal framework + support measures concerning non-technological innovation, crisis management and 2nd chance in the BSR countries (country profiles))

2) Analysis of best practice (Mapping and in-depth case studies based on expert interviews. The interviews will focus on identifying and analysing European and international best practice with regard to policy/legal framework and support measures).

Therefore a total of two reports should be produced as part of WP4.1. The two project reports should provide inputs to the process of developing policy recommendations, cf. WP4.2.

As it was planned in application the Analysis “The best European business support, early warning and “second chance” systems transferability analysis for the Baltic Sea Region States” had been done. The Analysis was made by Sia InnoMatrix from the 31st of March 2020 till the 30th of June 2020.

The research (Analysis) is an in-depth review research on the best opportunities for the transfer of European support, early warning and second chance systems in the Baltic Sea region countries. The following tasks have been performed in the research

- the methodology of the activities to be performed has been developed;

- information on support, early warning and second chance ecosystems of companies in financial difficulties in Latvia, Lithuania, Estonia and Poland has been compiled;

- interviews with experts have been conducted;

- conclusions on support, early warning and second chance ecosystems of companies in financial difficulties in Latvia, Lithuania, Estonia and Poland have been made;

- summaries on support, early warning and second chance ecosystems of companies in financial difficulties in each country - Latvia, Lithuania, Estonia and Poland, research – have been prepared;

- research has been carried out;

- interviews with experts on business support, early warning and “second chance” systems have been conducted, drawing thereby conclusions on the disadvantages and benefits of each system;

- proposals have been developed pertaining to the most appropriate model for support, early warning and “second chance” system for each country.

It should be noted that **instead of two analyses were made one Analysis consisting of two parts**:

**Part 1**: Analysis on the ecosystems of enterprises in financial difficulties in Latvia, Lithuania, Estonia and Poland;

**Part 2**: Analysis on the support, early warning and second-chance system, drawing up conclusions on the shortcomings and benefits of each system.

**Therefore instead of two reports the Ministry of Economics produced one report concerning the results of Analysis (research) made by Sia InnoMatrix and including all needed elements according WP 4.1 of the application.**

Below you can see the executive summary of the Analyse that will be used for work in the innovation labs. In the Annex of this report You can also see the summary of the research prepared by Sia InnoMatrix.

1. **Ecosystem of support, early warning and second chance companies in financial difficulties**

**LATVIA**

A company in financial difficulties in insolvency process in Latvia mostly isn't restructured but divided into assets, creditors receive 41.4 cents from each dollar invested, the average insolvency process takes 1,5 years and the costs of the insolvency process are 10% of the debtor's value.

Companies in financial difficulties and insolvency are restructuring and reopening in 44.6% of cases. Latvia's weakest position in the insolvency proceedings lies in the creditor's participation approach. Although the Latvian insolvency regulation contains provisions on the sale of a business as a permanent establishment, they are rarely applied in practice.

By the Europe Commission’s (EC) assessment, the “second chance” environment in Latvia is assessed as corresponding to the EU average. Latvia continues to increase growth in the area of ​​"second chance" and since 2008 has made moderate progress. Although growth has been observed, most indicators have remained stable compared to previous years. Latvia exceeds the EU average indicators in the field of “second chance” in two aspects - insolvency process time (1,5 in Latvia, EU average 2.01 years) and average costs (10% of the debtor's property, EU average 10.43%). "Fear of failure" refers to the percentage of the population aged 18-64 who express that fear of failure mainly prevents them from starting a business. In Latvia, they are 42.27% of the population, in the EU on average - 44.16%. In general, Latvia's “second chance” area according to the 2019 data has small, but positive progress in the period from 2008 to 2019.

Latvian government experts and entrepreneurs assess that in the prevention phase in Latvia, support is more incomplete and has little incentive to maintain entrepreneurship. In the legal framework Latvia’s support, by the assessment of Governmental sector experts, is assessed as more strong and stimulating for business restructuring and / or “second chance” than incomplete and little stimulating. On the other hand, by the opinion of entrepreneurs, legal insolvency framework is assessed as more incomplete and less stimulating for business restructuring and / or providing a “second chance” than strong and stimulating.

According to experts, the main obstacles that entrepreneurs face are the following: (1) dishonest actions of cooperation partners when they find out that there are difficulties, (2) state and municipal trust in entrepreneurs, (3) late reaction of entrepreneurs seeking support, (4) dishonest attitude of entrepreneurs towards the insolvency process, (5) economic stagnation or recession, and (6) weak performance of supporting NGOs in the insolvency prevention phase. According to entrepreneurs, the most significant obstacles are financial barriers, which are: (1) difficult access to risk capital, (2) unequal treatment of banks, (3) lack of information on restructuring opportunities and (4) an insufficient number of available support mechanisms.

Both entrepreneurs and government experts emphasize the availability of the necessary finances as the most important factor. Entrepreneurs emphasize political will as the second most important, while government experts point out the level of corruption in the country as the second most important.

The obtained results are in line with the results of a study conducted in 2018, where the main insolvency problems in Latvia were identified as follows: (1) SMEs lack financial skills, (2) SMEs start solving financial difficulties late, (3) insolvency status makes it difficult for debtors to engage in business, 4) insolvency costs are usually a significant burden for small businesses, and 5) the statutory funding model for the insolvency administrator does not work in practice.

Regarding the attitude, Latvian government experts assess the attitude of the society towards business failures as unfavourable and the attitude of entrepreneurs themselves towards business failures as more unfavourable than favourable. In turn, the attitude of state and local government policy towards business failures is assessed as more favourable than unfavourable.

**POLAND**

A company in insolvency process in Poland is mostly restructured and continues to operate as a single company, creditors receiving 60,9 cents for every dollar invested, average insolvency proceedings taking 3,0 years and insolvency costs 15,0% of the debtor's value. Companies in Poland that have experienced financial difficulties and insolvency are restructuring and reopening in 65,6% of cases. Poland's weakest position in the current insolvency proceedings is the possibility of creditor participation, high insolvency costs and long duration.

By the Europe Commission’s (EC) assessment of the “second chance”, Poland is in line with the EU average, although two of the indicators are below average – required time (Poland - 3 years, EU average – 2,01 years) and insolvency costs (Poland - 15 % of the value of the debtor's property, EU average - 10.43%). Both have remained unchanged since the previous reporting period in 2018, while the overall assessment of the insolvency process according to the World Bank Doing Business index is significantly above the EU average (Poland - 14 points, EU average - 11.73).

Fear of failure, which identifies the percentage of the population aged 18-64 who indicate that fear of failure mainly prevents them from starting a business, is 40.63% in Poland and 44.16% in the EU on average.

Organization "Early Warning Poland" (EWP) in Poland strongly contributes to early warning and “second chance” support ecosystem. The most common problems faced by entrepreneurs approaching the EWP are the identification of lines of action, the lack of a development strategy, declining sales, the risk of losing financial liquidity (debt to creditors, tax and tax administrations), organizational problems, privacy and personal reconciliation, change management and task division.

Polish experts assessed the existing support in Poland in both the prevention and insolvency legal frameworks as business-friendly and largely explain the favourable environment as result of “Early Warning Poland” result. In contrast, in the assessment of the legal framework for insolvency, Polish experts point out that the current system is strong in the legal context of insolvency, but it has improvement areas in supporting entrepreneurs in financial difficulties.

Experts consider the late recourse of entrepreneurs to help, when the financial crisis has deepened, to be the main problem in Poland, similarly to Estonia. Polish experts also talk about the stigma in which entrepreneurs are caught up in high psychological stress and responsibility.

Polish experts highlight the importance of organization “Early Warning Poland” in supporting entrepreneurs. The organization operates independently of the non-governmental organization, which is financially supported by the Poland’s Ministry of Economics. The organization's activities are widely publicized through public relations, social networks and websites. In Poland, work is being done on additional information channels to inform companies about possible support - printed materials in state and municipal institutions, the tax services, and elsewhere.

The same as in the Baltics, the main obstacles in Poland are the difficulty of accessing venture capital for a company in difficulty and the late reaction of entrepreneurs to seek support. In Poland, unequal treatment of banks has been identified as one of the most significant obstacles. The current Covid-19 pandemic (economic recession) was identified as a significant additional obstacle.

The availability of funding has also been identified as one of the most important factors influencing the establishment of a successful support system. In addition, Polish experts, like Estonian experts, point the low competence of entrepreneurs in business crisis prevention activities (i.e. financial literacy, crisis management, etc.) and the high fear of entrepreneurs to acknowledge the inability to cope with the crisis in the company.

Poland has a supportive and active business environment that supports companies that are not in financial difficulties. According to the interviewed experts, when the company is in financial difficulties and reaches any tax debt, business support from existing structures is closed.

In the field of insolvency, the main actors are the Ministry of Economy and Development, the Ministry of Justice, the Ministry of Social Affairs, PARP, Early Warning Europe, Marshall Office, FBF, FFR, NCBiR, WPT, ETC, business associations, mentors and consultants network, municipalities.

The policy framework for Polish support, early warning and “second chance” consists of the law on “second chance policy”, the early response instrument - PARPE Early Warning Poland and its continuation - PARP, Entrepreneurial package - BURA - PARP for restarters, local government policies.

**LITHUANIA**

The company in financial difficulties during insolvency process in Lithuania is mostly divided into assets and its operations are not continued as a single company. Creditors receive 40,3 cents for every dollar invested, the average insolvency process takes 2,3 years and the cost of the insolvency process is 15.0% of the value of the debtor. In Lithuania, the insolvency costs are estimated to be the highest among the Baltic States, but the average time required to recover a debt in Lithuania is estimated to be one of the second shortest among the Baltic countries, after Latvia. Lithuania's weakest positions are the assessment of the creditor's participation and the reorganization process in Lithuania.

According to the Europe Commission’s (EC), the “second chance” environment in Lithuania is relatively weaker than the EU average. One of the weakest areas is time and cost of resolving bankruptcy. Lithuania's performance in this area has declined since 2008. In 2019, the costs of insolvency proceedings in Lithuania are 15% (average in the EU 10.43%) of the value of the debtor's property. Lithuania's overall insolvency index is the second worst of all EU Member States according the World Bank Doing Business Index (8 points for Lithuania, EU average 11.73). At the same time, fears of business failure in Lithuania are similar - 44,77% of the population, compared to the EU average of 44,16%.

Since 2008, Lithuania has implemented the number of initiatives to increase the implementation of the "second chance" principles in the country. For example, since 2015, courts have appointed insolvency administrators in bankruptcy proceedings using a computer program. The rules have been amended to allow the sale of assets by electronic auction in the context of insolvency proceedings. These changes were intended to ensure transparency in the appointment of administrators and to shorten litigation. They were introduced by amendments to the Bankruptcy Law (Įmonių bankroto törvényymas) in December 2015, and changes were made to improve aspects of insolvency proceedings, e.g. calculation of insolvency expenses and remuneration of administrators. The support measures planned by the Lithuanian Ministry of Finance include the launch of a plan to prepare an early warning system to improve insolvency risk assessment, as well as to promote good practice and training.

Lithuania has also introduced measures to improve the public image of failed entrepreneurs. For example, success stories have been published about entrepreneurs who have successfully made a second attempt to start a business. However, prejudices persist and repeated business attempts are not always treated equally.

In 2018 and 2019, two legislative initiatives were introduced in Lithuania: (1) the amendments to the Law on Bankruptcy of Natural Persons (Fizinių personas bankroto juridymo pataisos), adopted in May 2018, are aimed at improving the bankruptcy process of natural persons; The Insolvency Law, promulgated in October 2018, regulates restructuring and bankruptcy processes, as well as the activities of insolvency administrators (areas previously regulated by separate laws). It broadens the scope of the regulation and introduces new "second chance" guarantees and opportunities in Lithuania.

In Lithuania, experts also pointed out that support in the field of prevention is currently more incomplete and has little incentive to maintain entrepreneurship. And in contrast to Latvia and Estonia, Lithuania experts pointed out that the legal framework of the Lithuanian support system for companies in difficulty in insolvency proceedings is also more incomplete and provides little incentive.

The same as in Latvia and Estonia, the most significant obstacles in Lithuania are related to the economic recession and lack of financial capital. Lithuania experts highlights negative public attitude towards business failures as a significant obstacle.

Economic stagnation and recession, insufficient funding for support from non-governmental organizations and difficult access to venture capital for entrepreneurs are mentioned as the most important factors for the implementation of support, early warning and “second chance” in Lithuania. This marks the common obstacles narrative of the Baltic States, which is related to the unfavourable external economic environment and insufficient funding.

The attitude of the Lithuanian state and local government towards business failures was assessed more negatively than in other neighbouring countries. Entrepreneurs attitude towards business failures is also assessed as more unfavourable than favourable. On the other hand, the public attitude towards business failures is assessed as more favourable than unfavourable in Lithuania.

Lithuanian entrepreneurs highlighted similar problems as entrepreneurs in Estonia and Latvia, emphasizing the closed support doors for the companies in lowest tax debts (<50 EUR), the feeling of loneliness in the struggle for the company's survival and the state of extreme stress, which leaves a significant drop in productivity when it is most needed. Entrepreneurs have repeatedly emphasized the lack of support and the fact that business associations, chambers of commerce, associations and other unifying organizations are focused on success and growth, and a company in financial difficulties does not find response and support.

Lithuania has an extensive business support ecosystem, but it is closed for the companies in the tax debt zone. The existing support system is focused for the companies in growth. Lithuanian experts were very positive about EWE's work, highly evaluating the existing system.

**ESTONIA**

The company in financial difficulties and in insolvency process in Estonia, as a result is mostly divided into assets and it does not continue to operate as a single company. Creditors receive 36,1 cents on the dollar for each dollar invested, the average insolvency process takes 3,0 years and the cost of the insolvency process is 9.0% of the debtor's value. The duration of Estonian insolvency proceedings is almost twice as long as the OECD average in high-income countries, where the average debt recovery time is 1.7 years.

By the Europe Commission’s (EC) assessment, Estonia's "second chance" area according to the 2019 data has a positive current assessment, but a negative progress assessment between 2008 and 2019. This indicates a deterioration compared to the EU average. One of the weakest area in Estonia in the field of “second chance” is the time required for the insolvency proceedings (3 years in Estonia, compared to the EU average of 2,01 years). In relation to costs and the overall process index, Estonia's result is above average. Fear of failure, on the other hand, is one of the lowest in the EU, with only 31,76% of people aged 18-64 expressing that fear of failure is the main reason why they do not start a business. The EU average fear of failure is 44.16% of the population.

In Estonia, there are still no policy guidelines to facilitate a "second chance" for honest entrepreneurs. Existing companies are not treated on an equal footing with start-ups, and there is no separation of honest entrepreneurs from unfair bankruptcy practices, nor is there an accelerated insolvency procedure for SMEs. There is also no early warning support system to prevent companies’ insolvencies. In Estonia, initiatives are being taken in 2019 and 2020 to address the lack of early warning and “second chance” systems.

Estonian experts and entrepreneurs also point out that the current system of support for prevention is more incomplete and provides little incentive for business retention. Insolvency legal proceedings are rated higher - as stronger and more stimulating for business restructuring and / or providing a 'second chance' than incomplete and weakly stimulating.

Estonia government experts point out that the most significant obstacles are the late reaction of entrepreneurs to seek support, economic recession and difficult access to financial capital. Experts also highlight the lack of support services, their effectiveness and the entrepreneur’s awareness about available support services.

Incomplete insolvency process is highlighted as one the most important influencing factor - a narrow view of the support, early warning and "second chance" process only from the legal point of view, without including prevention as an integrated support system in both legal and economic support schemes. The incomplete regional aid framework, which currently does not provide support schemes for entrepreneurs in difficulty, is also cited as a significant influencing factor.

Estonia has a supportive and active business environment that supports companies in growth, especially start-ups.

Estonian government experts highlight that the main reason for SME insolvencies is the lack of knowledge and skills of company managers. Experts have observed that companies do not notice signs of risk and therefore do not react in time. Estonian experts point the need to raise the awareness of small businesses about risk management, improve their management skills, including financial planning, and enable them to receive competent advice. At present, counselling opportunities exist in Estonia in county development centres, the Rural Development Fund Advisory Service and consulting companies.

1. **Recommendations for the most appropriate model of support, early warning and second chance support system for Latvia, Lithuania, Estonia and Poland**

* It is recommended to introduce an early warning and "second chance" support organization in the Baltic States as soon as possible. Within the framework of the research, negotiations with entrepreneurs have provided clear evidence of the acute need for such a support organization.
* It is recommended that the Baltic States evaluate in detail the possibilities of introducing support systems for EWE and / or TEAM U support models. The TEAM U model is the most cost-effective and service-efficient of the EU support models currently available. It is recommended to make detailed projective comparisons of the operation and economic benefits of both models, developing the basic principles of the Baltic support organization.
* The Ministries of Economy of the Baltic States and Poland are recommended to carefully evaluate the possibilities of obtaining funding for the establishment and operation of a support organization not only from national and EU target fund budgets, but also using other possible funding based on successful examples of other EU support organizations. By leveraging the budget in addition to grants from national and EU funds, it would be possible to provide more support, which is currently one of the main challenges for EU support organizations.
* The Baltic States, learning from the good practice of Poland and the experience of the support organizations of the EU countries, are recommended to provide resources for public relations and advertising communication in the operation of the support organization from the very beginning, informing entrepreneurs about the possibility to receive support.
* The Baltic States and Poland are recommended to consider the possibility of introducing modern customer management tools and systems, such as CRM and others, in support organizations, which help to ensure the economic productivity of the organization based on the transfer of good practice of the support organization "Team U".
* The Baltic States are not recommended to develop their own, new unique support model, because the available support models in the EU, which have already been developed over several years, as concluded in the Study within its field of research, are efficient and effective.
* It is recommended that the newly established support organization of the Baltic States be operationally unrelated to state institutions. As the Study concludes, for it to be effective, it must be neutral, independent, reliable and data anonymous.
* In order for the early warning system in the Baltic States to be effective, it is recommended that the Baltic support organization provide four main support functions from the outset: risk analysis, monitoring and alerting, information dissemination and communication and responsiveness with support for SME in crises and after crises.
* In order to make the early warning system in Poland even more effective, it is recommended that the support organization EW Poland strengthen the following functions: risk analysis, monitoring and alerting, dissemination of information and communication.
* It is recommended to provide new support organizations in the Baltic States with the following qualities:

1. Shared funding organization, which is ideally able to attract partial funding;
2. High reputation organization with high reputation leader, consultant, volunteer mentor and expert cooperation model organization;
3. Extensive and high-quality public relations communication organization that gives the organization wide visibility and helps to change the public's perception of business failures;
4. Based on a productive and high-quality customer relationship management model (s) that helps the organization to become more efficient;
5. Strong and an approved training program for counselors and mentors;
6. A full support cycle of insolvency proceedings, including support services in both early warning and post-bankruptcy situations;
7. Highly discreet, neutral and confidential against potentially repressive state institutions;
8. Extensive networking with banks, public authorities and other organizations seeking solutions to customer debt problems;
9. Based on the best practice model of EU support organizations.

* When implementing the guidelines of the new EC Directive in the legislation of the Baltic States and Poland, it is recommended to consider the insolvency process not only as improving the legal framework, but also as part of a dynamic and complex business environment, which is mainly the cause of experts from the legal and business environment support sectors, both in research and in the development of policy initiatives.
* When implementing the guidelines of the new EC Directive in the Baltic and Polish legislation on the artificial intelligence mechanism for early warning data, it is recommended to take into account the many academic studies conducted in this field for more than half a century, based on maximally econometric and risk analysis models. It is recommended that the Baltic States and, if possible, Poland, conduct a joint, in-depth study to identify the most effective models.
* It is recommended to conduct in-depth research to determine the effectiveness of support organizations in how many cases of corporate insolvency in countries have been a coincidence of unexpected circumstances (rapid crisis, dishonest actions of business partners, personal crises that significantly affect business (illness, tragedy, etc.)); and the proportion of corporate financial or crisis management incompetence, the findings of which will lead to a better understanding of the effectiveness of early warning and 'second chance' environments and thus of support organizations in providing better support to business environments.
* It is recommended to develop and implement a roadmap of activities, specific actions, in the Baltic States and Poland, which reorientes the attitude of entrepreneurship towards business failures from blocking experience to the acquisition of knowledge that ensures successful entrepreneurship in the future.
* It is recommended that regular annual evaluations of support, early warning and second chance systems be improved, including more detailed and streamlined components of evaluation in both international and national evaluations. The study outlines some of the necessary improvements, but their full development would require a wider team of international experts. Such improved assessments would allow evolutionary EU Member States to improve their support systems, thus improving both the EU and national business environment and the economy as a whole.

**In the Annex to the report, please see the summary of the research of the best European support, early warning and second-chance systems transferability in the Baltic Sea region countries**