

**SUMMARY**

**OF THE RESEARCH**

**of the best European support, early warning**

**and second-chance systems transferability**

**in the Baltic Sea region countries**



**Riga** 2020

The research 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 (hereinafter - the Research).

The ultimate objective of the Research is to promote the introduction of a business support model in four pilot countries (Latvia, Estonia, Lithuania and Poland) that, in accordance with the existing legislative Directives, would be the most efficient solution for companies in financial difficulties and institutions/persons involved.

**The objectives of the Research:**

1. To analyze **the trassferability** of the best European support, early warning and second chance systems in the Baltic Sea region countries within the framework of the Interreg Baltic Sea Region Transnational Cooperation Program project “RestartBSR”.
2. **To identify the most promising support model,** which would be the most efficient solution for companies in financial difficulties and the institutions/persons involved.

The results of the research, based on representative research, should improve the understanding of the necessary business support reforms.

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 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.

**Main results of the Research:**

In economics, an early warning system is generally interpreted as **a system, used to forecast the future performance of a company or country, possible deviations from the plan and to mitigate risks in times of crisis.** An early warning system refers to operations, systems, phenomena, people and other elements that constitute an economic system (ecosystem[[1]](#footnote-1)). The early warning system can identify the current situation and potential risks both qualitatively and quantitatively (Ozgulbas & Koyuncugil, 2010). [[2]](#footnote-2)

The European Commission points out[[3]](#footnote-3) that **insolvency rules cover a wide range of measures, from early intervention before a company is in serious difficulties, to timely restructuring** to ensure that viable companies are maintained, to liquidation of assets where companies cannot otherwise be rescued and, last, the so-called “second chance” for honest businessmen in the form of debt relief.

Until mid-2020, **no unified definition of support for companies in financial difficulties, early warning and “second chance”, binding for all EU Member States and parties involved, has been identified at EU level.** As other related definitions from the academic, partly governmental and civic sectors point out, legal insolvency proceedings are only a part of a wider system of support, early warning and “second chance”.

In academic environment, **early warning systems and their efficiency have been extensively studied** since the middle of the last century and cover a wide scope of research – at regional, national, sectoral and company level, including SMEs. **There are different conclusions, which are often contradictory.** The studies also draw very specific conclusions on the key factors that provide early warning of potential financial difficulties and insolvency of SMEs. In addition, the increasing technological capabilities of large data processing and the latest generation of business information approaches to data retrieving have increased the accuracy of the EWS. The unifying conclusion of various academic studies is that the logic of early warning systems operation is based on deviations from conventional indicators or finding unusual and untypical behaviour in the subject. Overall, the accuracy of early warning models depends on some basic factors: the reliability of the financial statements, the analyst’s knowledge and experience, knowledge of industry, knowing economic trends within the analysed period, and understanding of company management policy, which are highly variable components in economy.

**To date, neither theoretical studies nor practice have identified a high-reliability crisis identification data mechanism.** However, researches also point to the need to use data sets to reveal correlations, on the basis of which further models can be developed. This is especially true for large-scale analytics using sophisticated algorithms for the evolution of classical techniques, such as statistics, model recognition, artificial intelligence, machine learning, etc.

**Academic researches point to the dual systemic nature of the early warning system -** one early warning system refers to the determination of the object’s indicators (tools, models, subsystems, etc.) and the other interacts as a support system for the first system to activate it. Both systems interact with political, civic, academic and industrial environment. Only by interaction of the two systems an efficient result can be achieved. It is not enough to have increasingly efficient tools, models and subsystems in place to be able to identify the companies that need preventive actions to avoid insolvency. **It is equally important to create a support system(s) that launches these tools on a regular basis.**

The previous researches of support, early warning and “second chance” in most of cases have been focused primarily on the research of the legal framework of insolvency from legal point of view, with a secondary and fragmented assessment of the business environment that directly affects the causes of a company’s crisis.

A complete and efficient early warning system supports four main functions: **risk analysis, supervision and warning; distribution and communication and responsiveness.**

The EC puts forward four successive sub-sectors that constitute the process of a company in financial difficulty, taking into account its broadest possible role: from the moment a company is established, its possible warning, in situations where serious financial problems arise, from the moment when the company is finally reorganized or liquidated, and the subsequent effects of the company’s bankruptcy on the businessman. Thus, the EC conceptual framework has four main sections: (1) **prevention** (early warning systems, support mechanisms), (2) **out-of-court** settlements, (3) **trials**, followed by restructuring or liquidation of the company, (4) **attitude of the businessman towards bankruptcy and “second chance” conditions** (liquidation, termination of activity, debt relief and other consequences). This conceptual approach, as found in the Research, is also shared by most pf government experts of the Baltic countries and Poland.

When assessing the most appropriate potential support for companies in a crisis situation, it is also necessary to distinguish separately **what types of crises the companies experience in their different life cycles.** Studies show that all companies periodically go through life-cycle caused crises of different origins and, depending on how they manage to handle it, this can lead to financial difficulties and consequent insolvency. Different solutions are possible for each crisis, and **the solutions are largely determined by the internal ability and energy of the company’s manager to cope with the crisis.** This academic conclusion is confirmed by the statements of experienced mentors and experts of EWE, “Team-U”, “Dyzo”, “MKB Doorstart”, “60,000 Rebonds”, expressed in the course of the Research. The aspects of the reason of the crisis of business need to be taken into account when assessing the most appropriate support, early warning and “second chance” mechanisms in each country.

None of the in-depth interviews with EWE and other public organizations providing support to companies in difficulty in EU Member States, carried out in scope of the Research, mentions the distinction between the company and the businessman, thus all of them express the opinion, existing in expert practice, that **the owner and/or manager of a SME and its vision are the grounds of the company that determine the direction of the company and its ability or inability to cope with the crisis.** It was repeatedly emphasized in the interviews that the struggle of a company in financial difficulties is fought by one person or a small group of people - company owners and/or board members. In 28 interviews with businessmen from different countries, the opinion was unanimous that in the face of financial difficulties, the businessman is left alone and the severity and responsibility of the current crisis should be borne by the businessmen personally, finding the strength to solve them, whether the company continues to exist or is being liquidated, leaving the debt burden.

The EC Annual Report on SMEs 2018/2019 shows that more than 110 policy initiatives have been adopted in the EU in accordance with the “second chance” principle since 2011, including ten in 2018 and in the first quarter of 2019. **The registered number of policy initiatives,** aimed at promotion of the **“second chance”** and “single market” **principles, in the period from 2011 to Q1 2019 has been the smallest.**

**In most of the EU member states, it is still impossible to complete legal insolvency proceedings within one year and to release a company from insolvency proceedings within three years.** Similarly, half of *bona fide* businessmen in EU member states do not have an automatic discharge following liquidation or accelerated insolvency proceedings. Post-insolvency companies are generally defined the same way as start-ups in most og EU member states. However, just over half of EU member states have timely warning and assistance service mechanisms in place to help prevent businessmen bankruptcy.[[4]](#footnote-4)

The new EC Directive (EU) 2019/1023 on a preventive restructuring scheme and the “second chance”[[5]](#footnote-5) adopted on 20 June 2019 lays down rules (Article 21) that all member states must ensure that over-indebted companies have access to at least one procedure which may lead **to their debt being repaid in full within a maximum period of 3 years.** This will facilitate the “second chance” to start a new business.

The Directive provides for a significant restructuring of the insolvency proceedings by shifting the scales from company liquidation process to company restructuring process. **This is a fundamental difference that transforms the existing insolvency paradigm from a “how to better liquidate” to “how to better restore” approach.**

The Directive assumes specific and detailed actions to be taken in the “Preventive restructuring” and “Insolvency” phases. “Preventive restructuring” is a new, hitherto unregulated phase to which most of the Regulation’s directives are devoted. In turn, the main improvements for the “Insolvency” phase are related to the provision of well-ordered and efficient processes, which are maximally synchronized between the EU member states.

On the other hand, **just one point of the Directive is devoted to the early warning issue**, stating that EU member states need to develop **one or more tools to detect circumstances** that could lead to the possibility of insolvency. This fact largely indicates the Directive’s primary focus on improving the legal framework for restructuring or liquidation of a company in financial difficulty, **leaving prevention support initiatives secondary.** The new Directive emphasizes mainly the need to disclose the circumstances, while the positive experience of EU organizations so far points to the provision of mentoring as the most efficient tool.

The Research concludes that **early detection of financial difficulties determines success in coping with the crisis**, and that one of the major obstacles in EU member states is the late recourse of businessmen to seek for help, but according to the information obtained in the Research, **crises are different and one of their most spectacular common features is that they are unexpected**. **A crisis catches most of businessmen unawares,** as in the case of Covid-19, or as a sudden loss of a transaction, due to personal circumstances, which do not provide a preventive possibility to predict it.

In order to achieve the EC’s objective of increasing the number of restructured companies and “second chances”, it is essential **to consider the insolvency proceedings not only as improving the legal framework but also as a part of a dynamic and complex business environment** that assumes a close cooperation of legal and business environment support experts in the development of both research and policy initiatives.

**The support, early warning and “second chance” ecosystem is not homogeneous;** it is a complex system consisting of both a complex legal framework and a complex and dynamic business environment, affected by both companies’ internal factors and life cycle crises and changing external conditions. This is more pronounced in relation to the Baltic States as small economies, directly open to external influences.

The prevention section and pre-court components within the support, early warning and “second chance” ecosystems in international context are not supervised and analysed by international political or non-governmental organizations on regular basis. The OECD also points to an incomplete assessment of current insolvency proceedings, which is currently focused on a formal assessment of the output of the process data in both the World Bank’s Doing Business Index and the EC assessments. The OECD draws attention to three areas where improvements in assessment would be needed: the inclusion of personal costs of the businessman, the assessment of support for prevention mechanisms and barriers to restructuring.

The existing measurements of insolvency proceedings of the Baltic States, Poland and EU member states of the EC and the World Bank’s Doing Business Index should be improved, taking into account the OECD guidelines on productivity components and including measurements and key performance indicators for each extended procedural insolvency step.

Currently, the insolvency proceedings in the country is one of the most important performance indicators of support, early warning and second chance system. The World Bank’s Doing Business Index (hereinafter referred to also as the “DB” index) is currently one of the most respectable sources for qualitative and reliable comparisons of assessment of the environment of companies in difficulties.

According to the “DB” index, the overall framework of insolvency proceedings is rated the highest in Poland, comparing it among the target countries of the Research - the Baltic States and Poland. In Poland, the strength of the insolvency proceedings is evaluated at 87.5% of the maximum possible 100%, followed by Estonia - 81.3%, Latvia - 75%, and Lithuania - 50%.

The percentage of companies, restructuring their operations within insolvency proceedings in Poland is also the highest - 65.6%. The Baltic States lag far behind – In Latvia only 44.6%, in Lithuania - 43.4% and in Estonia - 38.9% of companies restructure their business within insolvency proceedings.

The insolvency proceedings take the longest time in Poland and Lithuania (3 years), while in Latvia their time is the shortest (1.5 years). In Estonia, the insolvency proceedings take 2.3 years, while the OECD average for high-income countries is 1.7 years. The 2016 EC research on insolvency proceedings in the EU[[6]](#footnote-6) emphasizes the need to reduce the duration of insolvency proceedings, as it has been proven that a shorter period for terminating insolvency proceedings provides a better opportunity for a successful “second chance” for the company and the businessman.

Poland also has the highest debt recovery rate - 60.9 cents on dollar, but does not reach the OECD high-income countries level of 70.2 cents on dollar. In the Baltic States, the recovery rate is the highest in Latvia - 41.4 cents on dollar, followed by Lithuania with 40.3 cents and Estonia with 36.1 cents on dollar. The costs of insolvency proceedings, measured in value of property, are the highest in Poland and Lithuania, 15% of the value of debtor’s property, respectively, while they are the lowest in Estonia - 9% and Latvia - 10%.

The insolvency proceedings quality index is the highest in Poland, with 14 points out of 16. The second highest rate is in Estonia, with 13 points, followed by Latvia with 12 points and Lithuania with 8 points. The OECD average for high-income countries is 11.90 points. Poland, Estonia and Latvia are all above the average.

The EC conducts an annual SME Performance Review, which is one of the main tools used by the EC to monitor and evaluate the progress of EU countries in assessing the SME environment on an annual basis. SMEs make up 99% of the total number of companies in the European Union. The complex SME assessment states that among target countries of the Research, the Baltic States and Poland, only Latvia’s “second chance” system has moved into the area that is assessed as positive current performance and growth in the period from 2008 to 2019, compared to the EU average growth. The assessment of Estonia’s “second system” reveals a high current performance, but in terms of historical progress there is a deterioration compared to the EU average.

Poland has a low current “second chance” assessment, but a positive growth is observed. In turn, Lithuania has a negative assessment of both the current “second chance” performance and the historical progress compared to the EU average and current growth. Overall, the target countries of the Research have a significant potential to improve their existing “second chance” performance against the EU average.

The overall internal assessment of Latvian experts (both the ones of government sector and business) indicates that support in the field of both prevention and the legal framework in Latvia is rather incomplete and has little incentive to keep the business strong and stimulating keeping of business.

In turn, Latvia’s government sector experts rate the support in legal framework higher, evaluating the support provided to the businessmen in Latvia as rather strong and stimulating business restructuring and/or providing a “second chance” than incomplete and little stimulating.

In Latvia, the most significant obstacles faced by companies in financial difficulties are the following: (1) low confidence of the state in businessmen, (2) insufficient efficiency of state and local government support services – the level of efficiency of available tools, services, mechanisms, incentives and (3) their quality. The significant obstacles that have also been identified include (1) economic recession, (2) lack of information on restructuring opportunities, (3) dishonest attitude of businessmen towards the insolvency proceedings, (4) dishonest behaviour of a cooperation partner when it learns about the existing difficulties, (5) insufficient number of support services provided by the state and municipality - lack of available support tools, services, mechanisms, incentives, etc., and (6) difficult access to risk capital for a company in difficulties.

The factors that significantly affect the implementation of Latvia’s support, early warning and “second chance” system in the country are: (1) lack of the coherence of political will - legal and economic, (2) economic stagnation and recession, (3) businessmen’s distrust in the efficiency of the support system, (4) low competencies of businessmen pertaining to in business crisis prevention activities (so-called financial literacy, crisis management, etc.), (5) level of corruption in the country, (6) unequal attitude of cooperation partners towards restructuring processes, (7) stability of political regulation, (8) proportion of grey economy in the country, (9) insufficient funding for participation in support on the part of the businessmen, (10) difficult access to risk capital for the businessmen, (11) low experience and lack of competence to implement support on the part of the government and civil support society - difficulties in ensuring system efficiency, and (12) public disbelief that business failures are the result of good faith.

The overall internal assessment of Estonian experts indicates that support in the field of prevention in Estonia is rather incomplete and has little incentive to keep business than strong and stimulating business keeping, while insolvency proceedings in the Estonian legal framework are rated higher, evaluating the support provided as rather strong and stimulating business restructuring and/or providing “Second chance” than incomplete and having little incentive.

Estonian government experts point out that the main reason for insolvency is insufficient knowledge and skills of managers. As the most important obstacles they mention late reaction of businessmen to seek for support, followed by economic recession and difficult access to financial capital. Experts also point to the lack of the number of support services, their efficiency and the awareness of businessmen about them.

The most significant factors influencing the implementation of Estonia’s support, early warning and “second chance” system in the country are: (1) incomplete insolvency legal framework - narrow view of the support, early warning and “second chance” process only from the legal side, not including providing prevention as an integrated support system in both legal and economic support schemes, (2) regional support regulation that does not provide for support programs for businessmen in difficulties and (3) the absence of regional support for companies in difficulties.

Similar to Latvia, the attitude of the society and businessmen towards business failures in Estonia is assessed as rather unfavourable than favourable. In turn, the attitude of the state and local government is assessed as rather favourable than unfavourable, which creates suitable preconditions for the necessary support mechanisms to be introduced.

According to experts, the current support of Lithuania’s support, early warning and “second chance” system, both in the field of prevention and in the legal framework, is rather incomplete and having little incentive to keep business than strong and stimulating to keep business.

The most significant obstacles faced by businessmen in financial difficulties in Lithuania are: (1) economic stagnation or recession, (2) difficult access to risk capital for a company in difficulties, (3) negative public attitude towards business failures, (4) time required for legal insolvency proceedings, and (5) the costs of insolvency administrators.

Similar to Latvia and Estonia, the most significant obstacles in Lithuania are related to the economic recession and lack of financial capital. Unlike neighbouring countries, Lithuania has seen a negative public attitude towards business failures as a significant obstacle.

The most significant factors influencing the introduction of Lithuania’s support, early warning and “second chance” system in the country are: (1) economic stagnation and recession, (2) insufficient funding for support from the part of non-government organizations and (3) difficult access to risk capital for businessmen.

The common denominator of the factors and barriers uniting the Baltic States is related to the strong impact of unfavourable external economic environment and insufficient funding.

In Lithuania, the attitude of Lithuanian state and local government policy towards business failures has a more negative assessment than in the other neighbouring countries in the Baltics - the attitude has been evaluated as rather unfavourable than favourable. Businessmen’s own attitude towards business failures is also assessed as rather unfavourable than favourable. In turn, the public attitude towards business failures is assessed as rather favourable than unfavourable.

Lithuanian businessmen point to similar problems as Estonian and Latvian businessmen do, emphasizing the closed support door in case of even a minor tax debt (<50 EUR), the feeling of being left alone in the struggle for the company’s survival and an extreme stress, which leaves a significant drop in productivity when it is most needed. The businessmen have repeatedly emphasized the lack of supportive hand 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 finds no response and support.

Lithuania has an extensive business support ecosystem, but it is closed for the company being in financial difficulties and in tax debt zone. The existing support system is focused on growth for start-ups and/or companies that are in growth stage.

In contrast to the Baltic States, Polish experts assessed the support available in Poland in both the prevention and insolvency legal frameworks stage as business stimulating, and it is largely explained by the activity of organization “Early Warning Poland” in Poland. Polish experts point out that the current system is strong within the legal framework for insolvency, but still needs to be improved to support businessmen in times of financial difficulties.

Similar to the Baltics, the main obstacles in Poland are: (1) difficult access to risk capital for a company in difficulties and (2) late reaction of businessmen to seek for support. In Poland, other key barriers that have been point out also include (3) unequal attitude of banks, (4) negative public attitude towards business failures and (5) negative attitude of businessmen towards business failures. The current Covid-19 pandemic and the ensuing economic recession have been stressed as a distinctively significant additional obstacle.

The most significant factors influencing the implementation of Poland’s support, early warning and “second chance” system in the country are: (1) insufficient funding for participation in support from the part of businessmen, (2) low competencies of businessmen in business crisis prevention activities (including financial literacy, crisis management, etc.) and (3) high fear of businessmen to recognize the inability to cope with the crisis in the company.

Polish experts, like Estonian experts, point to the low competence of businessmen in business crisis prevention activities (including financial literacy, crisis management, etc.) and the high fear of businessmen to acknowledge the inability to cope with the crisis in the company.

Polish experts assess the public’s attitude towards business failures in Poland as rather favourable than unfavourable.

Polish experts point to the success of “Early Warning Poland”, which is rated the highest, and the Ministry of Economy of Poland plans to expand it by setting up a regional network.

The Polish businessmen interviewed in the Research, whose companies were facing financial difficulties, mentioned that the success of their companies is now possible largely due to the support of mentors from “Early Warning Poland”.

The Research has found a significant difference between Polish and Baltic businessmen, that Polish businessmen are grateful for the support provided by “Early Warning Poland” and wish to get involved or are already involved in further support themselves, unlike Baltic businessmen that have a negative experience of the experienced crisis and for that an intense emotional bitterness about the gained experience remained.

In EU countries, the businessmen that have received support and successfully overcome their business crises value the psychological support provided significantly higher than the use of specific analytical tools and/or mechanisms. The proportion of support most often mentioned by the businessmen is 80% for psychological support and 20% for technical support. This can be explained to some extent by the high level of stress of the businessmen in crisis situations and the loss of productivity in the conditions of crisis and stress.

The support, early warning and “second chance” ecosystem is different in the Baltic States and Poland. In Poland, both government experts and businessmen assess the existing support of both prevention and insolvency legal framework stage as business stimulating, unlike in the Baltic States. This assessment is largely explained by the highly successful operation of the organization “Early Warning Poland” in Poland, which supports businessmen directly in the insolvency prevention phase and provides mentoring services during the insolvency legal framework phase, if necessary.

In the Baltic States, there are also various (different from the EWE approach) support tools for companies in financial difficulties, such as educational measures on insolvency proceedings, national taxpayers rating system, information available from the credit register, guidelines for the cases of out-of-court settlements, possibility to turn to insolvency support organizations for support anonymously, legal and out-of-court protection process, consultations in business support organizations, consultation opportunities in county development centres and rural development support funds, as well as consultations available in business consulting companies.

The businessmen interviewed in scope of the Research in the Baltics fragmentarily evaluate the support provided by the institutions of the Baltic States in the period when the businessman (company) is in financial difficulties. In turn, Polish businessmen highly appreciate the support of the organization “Early Warning Poland”, which, to cite the businessmen, has protected their companies from liquidation.

In the Baltics, the support tools for companies in financial difficulties are rather analytical than mentor support-oriented, and this marks the most significant difference between Poland and the Baltic States. One of the companies in financial difficulties, interviewed within the Research, was in incubation program for start-ups and, in contrast to the other Baltic businessmen, highly appreciated the support the company was currently receiving, and largely because of mentoring and networking services offered by the incubator environment.

Overall, the businessmen indicated that in all Baltic countries the business environment has intensive and positively stimulating support, however, it is not available to a company in financial difficulties if the company has even a minor tax debt (starting from 50 EUR). Thus, a common narrative of the Baltic problem have been outlined - a locked support door at the time when the company needs it the most and the businessman faces a holistic problem stigma, when, according to all businessmen involved in the research, the businessman has to face not only the company’s, but also its private life-related crises, leading to a significant drop in productivity (up to 90%), which further pushes companies into financial and problem stigma.

In Latvia, in addition, unlike in Lithuania and Estonia, a disagreement between the administration (support provider) and businessmen (support recipients) has been marked. In future, such a difference of opinion between the government and industry could stimulate a communication and feedback gap between businessmen and public authorities, which is better to avoid as a preventive measure.

The most significant obstacles faced by businessmen in financial difficulties in the Baltic States and Poland have been levelled out as follows: (1) lack of information on restructuring opportunities, (2) insufficient efficiency of state and local government support services – the level of effectiveness of the available tools, services, mechanisms, and incentives level, (3) insufficient number of support services provided by the state and local government - lack of the available support tools, services, mechanisms, incentives, etc., (4) economic stagnation or recession, dishonest behaviour of the cooperation partner, learning on the difficulties in place, and low availability of risk capital for a company in difficulties.

In addition, the late reaction of businessmen to seek for support, especially emphasized by Polish and Estonian experts, is a significant obstacle.

Overall, both in the Baltic States and Poland, the public’s attitude towards business failures is assessed as rather unfavourable than favourable. In turn, the attitude of state and local government policy towards business failures is rather favourable than unfavourable.

The most negatively assessed are the Baltic and Polish businessmen’s own attitudes towards business failures, which indicate that the attitudes towards business failures are rather unfavourable than favourable, and which mark the necessary reorientation of attitudes of businesses towards failures in all countries from blocking experience to the experience that would provide for successful business in the future.

In the EU, there are several supports, early warning and “second chance” organizations. One of the largest of them is EWE, which operates in many countries, including Poland. EWE uses the conceptual framework of support, early warning and “second chance”, defined by the EC and the OECD.

Theoretically, in accordance with the defined model and its name, EWE’s activities provide support at an early warning stage by alerting the company before the start of financial difficulties. However, according to the interviews with the businessmen and support organizations experts, conducted within the Research, the activities of the organization are much broader and primarily provide support to companies in a financial crisis situation, helping to resolve it. In a broader sense, it provides support to the company or the businessman throughout the entire cycle of financial difficulties, from the first signs of financial difficulties to the foundation of a new company and providing for its growth if the previous company has been liquidated during the process.

Overall, all the support, early warning and “second chance” organizations considered offer advisory support to the businessman that has experienced financial difficulties in the company in some way. The support organizations act as a missing link between the experts and specialists that professionally assist to the businessman in developing the most optimal growth roadmap in a crisis, pre-crisis or post-crisis situation.

The necessity for such a support appears as a result of a number of situation-specific aspects:

* 1. A businessman in financial difficulties is in a high stress situation, which requires quick action, that, in turn, creates additional stress,
	2. The businessman acts outside its area of competence, which is already related to legal aspects,
	3. In financial crisis situation, the businessman does not have access to financial resources for business and legal consultants,
	4. The businessman is often already in tax debt zone, which further closes the door to available potential support and/or potential growth.

These specific circumstances of the situation have an extremely strong impact on the businessman and its ability to act productively in times of crisis, when a fast and constructive action is crucial to resolve the crisis.

The businessmen also often have no previous experience in crisis management. The businessmen, interrogated within the Research, that had also experienced crises in the past, indicated that previous experience had helped them to deal with the situation in a constructive way and to be much better prepared. In turn, the businessmen that faced crisis for the first time, report extremely high levels of stress and relative paralysis of operations and stigma.

The number of services provided by EU support, early warning and “second chance” support organizations identified in the Research is very wide and covers a wide range of financial pre-crisis, crisis and post-crisis situations, from early warning when a company is not yet in crisis, but stagnant to the support of the businessman when the latter is planning or has started another business after bankruptcy.

Some of the EU support organizations have their own specific support focus. For example, “MKB Doorstart” is very successful in cooperating with banks and is able to assist the businessmen not only in the core of crisis, but also at a very early stage, when the company does not yet have direct financial difficulties, but the bank indicates early signs of risk. In turn, the “60,000 Rebonds” in France supports the businessmen after bankruptcy situations, helping to restore self-confidence and to start a new business.

Most of experts of EU support organizations point to the need to expand the activity, with a particular focus on prevention, early warning, businessmen’s capacity improving, ensuring that the businessmen turn to support in a timely manner, as time in crisis situation, as emphasized by absolutely all experts in support organizations, is the key component of how well a company succeeds in resolving a crisis. The most common reason for not doing so is limited financial resources available to the organization and the high demand for support services for the company in acute financial crisis, which forces the organization to focus the available resources on crisis situation solving here and now. It is likely that the priority for dealing with acute cases has been more pronounced at the time of conducting the Research due to the shocks to companies caused by the Covid-19 crisis.

All support organizations have more in common than a different, and the most important component, which is emphasized by all organizations, is the presence of capable, knowledgeable and professionally trained consultants and mentors. The organizations emphasize the importance of company’s trust in the organization and mentor and that confidentiality and anonymity is guaranteed to the businessman. It is very important that the mentor that supports the businessman has business experience, including crisis management.

Part of organizations are funded by the state and EU development funds, part of organizations operate as shared funding organizations, where a part of the budget is allocated from donations, state or local government, EU development funds and a part of the funding is obtained for services provided and/or support programs. Some organizations earn additional income by cooperating with other institutions, providing them with a generalized expertise. The organization “Team U” has one of the most advanced funding models, where in addition to donations and revenues from services provided, the organization acts as a venture capital for the supported companies and is able to obtain additional funds from this activity.

Regarding the quality of the organization's work, absolutely all businessmen addressed in the Research that received support from support organizations expressed the highest appreciation and gratitude for the support provided, often stating that the organization helped them save their company, therefore, differences in the quality at the individual level between organizations have not been identified within the Research.

As regards the organization of support activities, all support organizations have developed their own unique, methodology-based approach, which is obviously efficient in terms of the final result - the support provided to businessmen. In order to evaluate in details the tools and approach offered by organizations, an in-depth research is needed, including a detailed assessment of a statistically representative number of businessmen receiving support in each country and the definition of common, comparable measurements. This would be especially important for the early warning stage, which, according to the theoretical review conducted in the Research, is a complex and ambiguous process also academically. Similar to mentoring support activities, where there are many approaches and concepts.

According to research and the practice of EWE and other similar organizations, businessmen do not seek for help at an early stage. There are two additional factors enhancing this: the risk of loosing lose control of their business if they seek a financial arrangement with creditors, and more importantly, the psychological trauma of recognizing defeat.

The organization “Team U” operates most economically, helping an average of 4,800 companies and businessmen at the lowest cost per support contact per year.

The German support organization “Team U” uses the CRM model, tested in modern customer relationship management, which is probably one of the key components without other efficiency approaches, to create the most economically optimal support model compared to other EU organizations.

A significant influencing factor not only in the Baltic States and Poland, but also in the entire EU, is the negative public attitude towards business failures. It is concluded that action is needed to change public attitudes towards business failure, which is fundamental in the context of support, early warning and the development of a “second chance” support system.

In the Baltic States, it is necessary to introduce an organization of support, early warning and “second chance” promotion as soon as possible. Within the framework of the Research, negotiations with businessmen have provided a clear evidence of the need for such a support organization.

The Research has not identified any significant obstacles to the operation of any of the existing EU models in the Baltic States, especially given the successful pilot project of EW Poland, using EWE’s basic principles and circumstances that the “Team U” support model has already been operating in relation to the Estonian businessmen.

The upcoming organizations in the Baltics would need to consider adapting a model that already provides the widest possible support, including early warning at its core and extensive support, including group support, for the businessman to start a new business after bankruptcy. Currently, the organization “Team U” has one of the most advanced and extensive support models.

The Baltic States and Poland should thoroughly assess the possibility of obtaining funding for the establishment and operation of a support organization not only from the budgets of state and EU target funds, but also using other possible funding, based on the successful examples of other EU support organizations. By raising budget in addition to dotation 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.

Learning from the good practice of Poland and the experience of support organizations of the EU countries, it would be necessary for the Baltic States to provide resources for public relations and advertising communication from the very beginning, informing businessmen about the possibility to receive support.

The Baltic States and Poland should consider introducing modern customer management tools and systems in support organizations, such as CRM and others, that help ensure the organisation’s economic productivity, inspired by the operations of the good practice transfer organization “Team U”.

The Research has not identified reasons for the Baltic States to develop their own, new unique support model, as the available support models, existing in the EU and developed over several years, as concluded in the Research, are effective and efficient.

The Research has identified that the upcoming support organization should be independent of public authorities in its operations - it should be neutral, independent, reliable and data-anonymous, taking into account the good practices of EU organizations.

Thus, the recommended newly established support organization in the Baltics should have the following characteristics: (1) Shared funding organization, which is, in ideal situation, able to attract partial funding, (2) A high reputation organization with a high reputation leader, consultant, volunteer mentor and expert cooperation model organization, (3) Extensive and high-quality public relations communication organization that provides the organization with a wide recognition and helps to change the perception of business failures in the society, (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 approbated training program for consultants and mentors, (6) Full insolvency cycle support organization, 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 customers’ debt problems, (9) Based on the best practice model of EU support organizations.

For early warning systems to be efficient, they need to actively involve risk groups, promote public education and awareness of risks, distribute warnings efficiently, and ensure continuous monitoring. A comprehensive and efficient organization of early warning system should have four main functions: risk analysis, monitoring and warning, distribution and communication, and responsiveness, which includes support.

At the moment, it is premature to shift the scales of support to the field of artificial intelligence diagnostics, as so far neither a theoretical research nor a practical mechanism for identifying high-reliability crisis identification data is identified. The existing best practices of EU support organizations, as well as countless other academic studies, point to the irrationality of the person who runs a business, firstly, and, secondly, to its crucial role in being able to resolve (or not to resolve) the crisis, pertaining to the company. Best practice of EU support organizations shows that a combined support model, balancing psychological issues, data analysis and networking and cooperation support models, is currently the best-known way to support a businessman/ company in a potential or current crisis.

In order to successfully and efficiently introduce support, early warning and “second chance” systems in the Baltic States and to improve the support of Poland and other EU member states, it is recommended that the EC and member states agree on a common clear definition of support, early warning and “second chance”, as well as its elements and measurable values.

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, in negotiations with businessmen, clear evidence of the acute need for such a support organization has been obtained.

It is recommended that the Baltic States evaluate in detail the possibilities of introducing support models EWE and/ or “TEAM U” of the support systems. The “TEAM U” model is the most economically optimal and service-efficient of the EU support models currently available. It is recommended to make detailed projective comparisons of the operations 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 thoroughly assess the possibilities of obtaining funding for the establishment and operation of a support organization not only from the budgets of state and EU target funds, but also using other possible funding, based on successful examples of other EU support organizations. By raising the budget in addition to dotation from state and EU funds, it would be possible to provide a wider support, which is currently one of the main challenges for EU support organizations.

Learning from the good practice of Poland and the experience of support organizations of the EU countries, the Baltic States are recommended to provide resources for public relations and advertising communication in the operation of the support organization from the very beginning, informing businessmen 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 in support organizations, such as CRM and others, which help to ensure the economic productivity of the organization, based on the transfer of good practices of the support organization “Team U”.

The Baltic States are not recommended to develop their own, new and unique support model, because the available support models in the EU, which have already been developed over several years, as concluded in the Research within its field of research, are efficient and effective.

It is recommended to the newly established support organization in the Baltic States to be independent from state institutions in its operations. As the Research concludes, to be efficient, it needs to be neutral, independent, reliable and data-anonymous.

In order for the early warning system in the Baltic States to be efficient, it is recommended to ensure that the Baltic support organization has four main support functions from the very beginning: risk analysis, monitoring and warning, information distribution and communication and responsiveness that includes support to companies and businessmen in its broadest sense, as considered within the Research.

To make the early warning system in Poland even more efficient, it is recommended that the support organization EW Poland strengthens the following functions: risk analysis, monitoring and warning, distribution of information and communication.

Within the framework of the Research, it is recommended to provide new support organizations in the Baltic States with the following characteristics: (1) Shared funding organization, which is, in ideal situation, able to attract partial funding, (2) A high reputation organization with a high reputation leader, consultants, volunteer mentor and expert cooperation model organization, (3) Extensive and high-quality public relations communication organization that provides the organization with a wide recognition and helps to change the perception of business failures in the society, (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 approbated training program for consultants and mentors, (6) Full insolvency cycle support organization, 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 customers’ debt problems, (9) Based on the best practice model of EU support organizations.

When introducing the guidelines of the new EC Directive[[7]](#footnote-7) to the national regulation of the Baltic States and Poland, it is recommended to consider the insolvency proceedings not only in the context of improving the legal framework, but also as a part of a dynamic and complex business environment, which is mainly the cause of a potential or current crisis in the company in cases of in cases of fair insolvency, assuming close cooperation between experts in both the legal and business support sectors, both in research and in the development of policy initiatives.

When introducing the guidelines of the new EC Directive[[8]](#footnote-8) to the national regulation of the Baltics and Poland pertaining to the artificial intelligence mechanism for early warning data, it is recommended to take into account the numerous academic studies conducted in this field for more than half a century, basing the mechanism on maximally rationale econometric and risk analysis-based models. It is recommended that the Baltic States and, if possible, Poland conduct a joint, in-depth research to identify the most efficient models.

It is recommended to conduct an in-depth research to detect the efficiency of support organizations, revealing the number of cases of companies’ insolvency in the countries that have been a coincidence of unexpected circumstances (a sudden crisis, dishonest actions of business partners, personal crises of the businessman that significantly affected its business (illness, tragedy, etc.)); and the proportion of companies’ financial or crisis management incompetence. The findings of such a research will provide a better understanding of early warning and “second chance” environments and thus the efficiency of support organizations, providing a better support to business environments.

Within the framework of the Research, it is recommended to develop and implement activities, a roadmap of specific actions in the Baltic States and Poland, which redirects the attitude of business towards business failures from blocking experience to gaining knowledge that ensures successful business in the future.

The Research recommends to improve regular annual assessment of support, early warning and “second chance” systems, including more detailed and sophisticated evaluation components in both international and national level country evaluations. The research outlines some of the necessary improvements, but their complete development would require a wider team of international experts. Such improved assessments would allow the EU member states to evolutionary improve their support systems, thus improving both the EU and national business environment and the economy overall.

**Year of implementation of the research: 2020**

**Policy area, sector:** Business support policy

**Geographical coverage of the Research:** Latvia, the Baltics, the European Union

Target group(s) of the Research: Latvian business policy influencers and evaluators, experts.

**The following sources of information and research methods have been used in the Research:** 1) insolvency assessment of the World Bank’s “Doing Business 2020” Index for 2020, 2) analysis of the insolvency methodology of the World Bank’s “Doing Business” Index, 3) EC annual report on SMEs of EU member states[[9]](#footnote-9), 4) analysis of binding laws and regulations of support, early warning and “second chance” in the EU, Lithuania, Latvia, Estonia and Poland, 5) analysis of current business policy initiatives in Latvia, Lithuania, Estonia and Poland, 6) secondary analysis of the existing scientific and practical researches in the field of early warning, 7) in-depth interviews of 45 experts with a subsequent analysis, 8) expert survey, 9) investigation of best foreign practice cases.

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# ABBREVIATIONS AND METHODOLOGY OF THE RESEARCH

**ABBREVIATIONS**

|  |  |
| --- | --- |
| Research | The Research “Analysis of the best European support, early warningand second-chance systems transferability in the Baltic Sea region countries”/ 2020/ EM 2019/131 |
| Target countries of the Research | Poland, Latvia, Lithuania and Estonia |
| MoE  | Ministry of Economics |
| MoF | Ministry of Finance |
| OECD | The Organisation for Economic Co-operation and Development |
| IT | Information technologies |
| OOCLPP | Out-of-court legal protection process |
| LPP | Legal protection process |
| LPP plan | Action plan of Legal protection process |
| EC | European Commission |
| EU | European Union |
| EWE | The Organization “Early Warning Europe” |
| EWS |  Early Warning System |
| SME[[10]](#footnote-10) | A micro-enterprise is an enterprise that employs fewer than 10 persons and nnual turnover (revenue over a specified period) or balance sheet (statement of assets and liabilities of the enterprise) of which does not exceed EUR 2 million.A small enterprise is an enterprise that employs fewer than 50 persons and annual turnover or balance sheet total of which does not exceed EUR 10 million.A medium-sized enterprise is an enterprise that employs fewer than 250 persons and annual turnover of which does not exceed EUR 50 million or balance sheet total of which does not exceed EUR 43 million. |
| RestartBSR | The RestartBSR project has identified 7 systems as the best European support, early warning and second chance systems that have been established: 1) in Germany, the “Team U” system; 2) in Denmark, the Early Warning Denmark system; 3) in Sweden, the “Fōretagsjouren” system; 4) in Belgium, the “Dyzo” system; 5) in France, the “60,000 Rebonds” system; 6) in the Netherlands, the “MKB Doorstart” system; 7) in Poland, the “Early Warning Poland” system. The purpose of these European support, early warning and second chance systems is to provide advice to companies and businessmen in financial difficulties, to provide mentoring services for company restructuring, to provide services for fast termination of a business that cannot be rescued, or to start a new business. |
| Company in financial difficulties | A company with limited ability to settle its liabilities/payments and/or to make profit. |
| ICS | ICS – Insolvency Control Service of the Republic of Latvia  |
| LIAA | Investment and Development Agency of Latvia |
| AI | Artificial intelligence |

1. In economic terms, the term socio-economic ecosystem has become widespread over the last decade, referring to interinfluence and interdependence of all participants involved in the system, when changes pertaining to one participant affect the functioning of the rest of the system in the same way as it is in natural ecosystems. The term “economic ecosystem” is not unanimously accepted by economists due to several considerations. The term “ecosystem” is used in the research, but with the remark that there are differences in opinions on its applicability and some of the authors and experts of the Research have suggested replacing the term “ecosystem” with “economic system”. [↑](#footnote-ref-1)
2. Ozgulbas, N., & Koyuncugil, A. S. (2010) Financial early warning system for risk detection and prevention from financial crisis. In Surveillance Technologies and Early Warning Systems: Data Mining Applications for Risk Detection. In A. S. Koyuncugil, & N. Ozgulbas (Eds.). Surveillance Technologies and Early Warning Systems: Data Mining Applications for Risk Detection (pp. 76–108). New York: Idea Group Inc. [↑](#footnote-ref-2)
3. ## EU Proposal for the Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures, 2016/0359 (COD).

 [↑](#footnote-ref-3)
4. EU Proposal for the Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures, 2016/0359 (COD). [↑](#footnote-ref-4)
5. Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [↑](#footnote-ref-5)
6. “Research on a new approach to business failure and insolvency Comparative legal analysis of the Member States’ relevant provisions and practices”. EUROPEAN COMMISSION Directorate-General for JUSTICE AND CONSUMERS. Available: [file:///C:/Users/ligab/Downloads/DS0216331ENN.en%20(1).pdf](file:///C%3A%5CUsers%5Cligab%5CDownloads%5CDS0216331ENN.en%20%281%29.pdf) [↑](#footnote-ref-6)
7. Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency). [↑](#footnote-ref-7)
8. The same. [↑](#footnote-ref-8)
9. EU annual report on SMEs 2018/2019. 173 p. Available: <https://ec.europa.eu/growth/smes/business-friendly-environment/performance-review_en> [↑](#footnote-ref-9)
10. <https://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/> [↑](#footnote-ref-10)