



Global Entrepreneurship Monitor

2009 Latvia Report

Olga Rastrigina

with a contribution by **Vyacheslav Dombrovsky**

Sponsored by TeliaSonera

The TeliaSonera Institute at the Stockholm School of Economics in Riga



TeliaSonera



RĪGAS EKONOMIKAS AUGSTSKOLA
STOCKHOLM SCHOOL OF ECONOMICS IN RIGA

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Founding and Cooperating Institutions:

TeliaSonera Institute at the Stockholm School of Economics in Riga
Baltic International Centre for Economic Policy Studies (BICEPS)
SKDS

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FOREWORD

The Global Entrepreneurship Monitor (GEM) is a major international research project aimed at describing and analysing entrepreneurial processes across a wide range of countries. In 2009 Latvia participated in the GEM project for the fifth time. This volume represents the Latvian Country report based on original data collected in Latvia for GEM. We believe that the Latvian GEM will contribute to knowledge and understanding of the factors influencing entrepreneurial activity in Latvia. This year the report discusses the impact of the recession on entrepreneurial activity and start-up finance, as well as providing an overview of social entrepreneurial activity in Latvia.

Latvian participation in GEM would not have been possible without the generous support of Telia-Sonera through the TeliaSonera Institute at the Stockholm School of Economics in Riga.

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GEM TERMINOLOGY

Nascent entrepreneurs

A nascent entrepreneur is an adult individual* who is actively trying to start up a new business that he or she will fully or partially own. This new business has already passed the stage of being merely an idea, because the individual has taken active steps over the last 12 months to help launch the business, such as looking for equipment or a location, organizing a start-up team, working on a business plan, or beginning to save money. However, the business is not yet fully operating, since it has not paid wages to its owners for more than three months.

New firm owners

A new firm owner is an adult individual who manages and fully or partly owns a new business that has paid wages to its owners for more than three months but less than 42 months (3.5 years).

Established business owners

An established business owner is an adult individual who manages and at least partly owns a business that has paid wages to its owners for more than 42 months (3.5 years).

Early-stage entrepreneurs

(nascent entrepreneurs + new firm owners)

An early-stage entrepreneur is an adult individual who is either a nascent entrepreneur or a new firm owner. The early-stage entrepreneurship phase covers entrepreneurial activity from the first active step taken to start up a business until the moment when the enterprise has paid salaries to its owners for 42 months (3.5 years).

Firm owners

(new firm owners + established business owners)

A firm owner is an adult individual who manages and fully or partly owns a business. This definition includes new firm owners and established business owners.

Overall entrepreneurial activity

(early-stage entrepreneurs + established business owners)

Overall entrepreneurial activity includes both early-stage entrepreneurs and established entrepreneurs. Therefore, this group covers all entrepreneurs at all stages of the business life-cycle.

Prospective entrepreneurs

A prospective entrepreneur is an adult individual who is planning to start their own business within three years.

* An adult individual is a person between 18 and 64 years old.

MAIN DISTINCTIONS BETWEEN GEM DATA AND BUSINESS REGISTRATION DATA**

GEM data are designed to measure entrepreneurial activity across a wide range of countries, including those where government business registration data may not provide a true and fair reflection of actual business activity. The main distinctions between GEM data and business registration data are as follows:

- The focus of GEM is on entrepreneurs as individuals rather than on business ventures. The primary purpose of GEM is not to count the number of new businesses in different countries. It is about measuring entrepreneurial spirit and entrepreneurial activity through different phases of the entrepreneurial process. Results of GEM research may not be directly comparable to studies based on Enterprise Register data because of different definitions used.
- GEM data are obtained using a research design that is harmonized across all participating countries. GEM data enable reliable comparisons across countries.
- The GEM research design implies statistical uncertainties in aggregate (country-level)

results. This is acknowledged by publishing confidence intervals for entrepreneurship indices obtained. Business registration data are “count data” and as such do not require confidence intervals. However, the accuracy of registration data as a measure of new business activity is unclear for some countries. For example, in the UK most businesses are not (and are not required to be) registered at all, while in Spain registration is compulsory before trading can commence. In some countries, businesses may be registered purely for tax reasons without entrepreneurial activity taking place, while in other countries businesses are deliberately not registered in order to avoid paying taxes.

- GEM tracks people who are in the process of setting up a business (nascent entrepreneurs) as well as people who own and manage operational businesses. These also include freelancers or other entrepreneurs who in some jurisdictions need not register. GEM also measures attitudes and self-perceptions regarding entrepreneurship.

** Based on GEM 2008 Executive Report.

EXECUTIVE SUMMARY

The GEM 2009 Latvia Report provides detailed information on the latest trends in entrepreneurial activity and on the entrepreneurial environment in Latvia. The report offers a comparison of Latvia with other countries participating in the GEM project. This year's report covers two special topics: i) the impact of the recession on entrepreneurial activity and start-up finance and ii) social entrepreneurship. We hope the analysis included in this report will be informative for policy makers as well as for the business and academic community.

Slightly more than 150 thousand people were involved in early-stage entrepreneurial activity in Latvia in 2009. This represents 10% of the adult population. Among early-stage entrepreneurs, about an equal number of people were actively involved in starting a business and actually owning or managing new firms. Latvia's early-stage entrepreneurship rate is the highest among the Central and Eastern European countries covered in the GEM project (e.g. Hungary, Russia).

In spite of the recession and although fewer people saw good business opportunities in Latvia during 2009 than in 2008, an increase has occurred in the proportion of people who were

involved in a business start-up, owned and managed a new business, or intended to start new businesses in the future. Additionally, Latvia is the only GEM country in 2009 with a decrease in the proportion of people who were inhibited from starting a business by fear of failure.

At the same time, 2009 saw a big jump in people who discontinued a business because it was not profitable – up from 29% to nearly half of those who discontinued. The number who quit because of problems in obtaining finance was also up by more than a third. Moreover, nearly 32% of all early-stage entrepreneurs in 2009 were necessity-driven, up from 21% the year before. This is higher than the median level in all GEM countries (25%), or the 15 old European Union member states (15%). In fact, the rate has more than doubled since 2007, when it was about 15%.

In 2009, the median financing required to start a new business in Latvia was 14,000 EUR, down from about 28,000 EUR the year before. In comparison to other countries, starting a business in Latvia is not particularly expensive and the reported start-up costs are consistent with Latvia's level of economic development.

The median amount of start-up financing provided by informal investors was also about 14,000 EUR. In comparison with other GEM countries, the prevalence of informal investors in Latvia is very high. So is the average amount of informal capital expressed as a percentage of GDP per capita.

The distribution of start-up costs differed according to the characteristics of the entrepreneur: male entrepreneurs and those with more education reported higher amounts of start-up financing, as did people who believed that they possessed skills in running a business. Start-up costs also differed according to the characteristics of the start-up: entrepreneurs who were exploiting attractive business opportunities, starting heavily export-oriented businesses, or using new technologies all quoted above-average required

sums to start their businesses, as did those who expected many competitors.

The social entrepreneurship rate in Latvia (1.9%) does not appear particularly unusual in cross-country comparisons. However, only 0.2% of the population combined social entrepreneurship and business activities, which is less than in most other countries. This is also reflected in the characteristics (or types) of social entrepreneurial activity prevalent in Latvia. The percentage of traditional NGOs in Latvia (18.9%) is higher than on average in other GEM countries. The proportion of for-profit social activities (7.5%) was 50-75% lower than elsewhere. Finally, many social enterprises in Latvia (35.8%) combine social goals with some complementary economic activity but do not have profit as their main goal.

1. INTRODUCTION TO THE GEM PROJECT

The Global Entrepreneurship Monitor (GEM) is a not-for-profit academic research consortium that produces assessment of entrepreneurial activity across the world. The goal of GEM lies in making high quality international research data on entrepreneurial activity available to a wide audience all over the world. Initiated in 1999 with ten countries, the GEM research consortium had expanded to 54 countries in 2009. GEM is the largest single study of entrepreneurial activity in the world. Its contribution to knowledge and understanding of the entrepreneurial process in a global context is unique.

The three main objectives of GEM are:

- To measure differences in the level of entrepreneurial activity between countries.
- To uncover factors determining levels of entrepreneurial activity.
- To identify policies that may enhance the level of entrepreneurial activity.

GEM's hallmark is its focus on the role played by individuals in entrepreneurship. The unit of analysis in GEM is the entrepreneur rather than a business venture, with entrepreneurs playing the role of informant on their business. In the GEM research perspective, individuals are primary agents in setting up, starting, and maintaining businesses. The GEM approach is not about counting the number of businesses. It is largely about measuring entrepreneurial activity within the adult population, entrepreneurial spirit, and attitudes to entrepreneurship.

GEM takes a comprehensive approach and considers the degree of involvement in entrepreneurial activity within a country, identifying different types and phases of entrepreneurial activity. GEM views entrepreneurship as a process and distinguishes entrepreneurs at different stages of their life-cycle: from the very early phase when the business is in gestation to the established phase and possibly discontinuation of the business. GEM also looks at the main drivers behind engagement in entrepreneurial activity, and differentiates between individuals pulled into entrepreneurship because of opportunity recognition and pushed into entrepreneurship for reasons of necessity. GEM also provides a means by which a wide variety of important entrepreneurial characteristics such as innovativeness, export-orientation, and high-growth aspirations can be systematically studied. Finally, GEM offers a framework for conducting research on special topics in entrepreneurship (e.g. social entrepreneurship) in an international context.

An important advantage of GEM is its reliance on high-quality data, collected via adult population surveys (APS) in each participating country. Representative samples of more than 2000 randomly selected adult individuals were collected in each of the 54 countries participating in GEM in 2009. The GEM adult population survey in Latvia took place in May-June 2009. The survey vendor "SKDS" conducted telephone interviews with 2003 adults aged 18-64 years old. In this report we present the findings from this survey, as well as the surveys that took place in other countries participating in GEM.

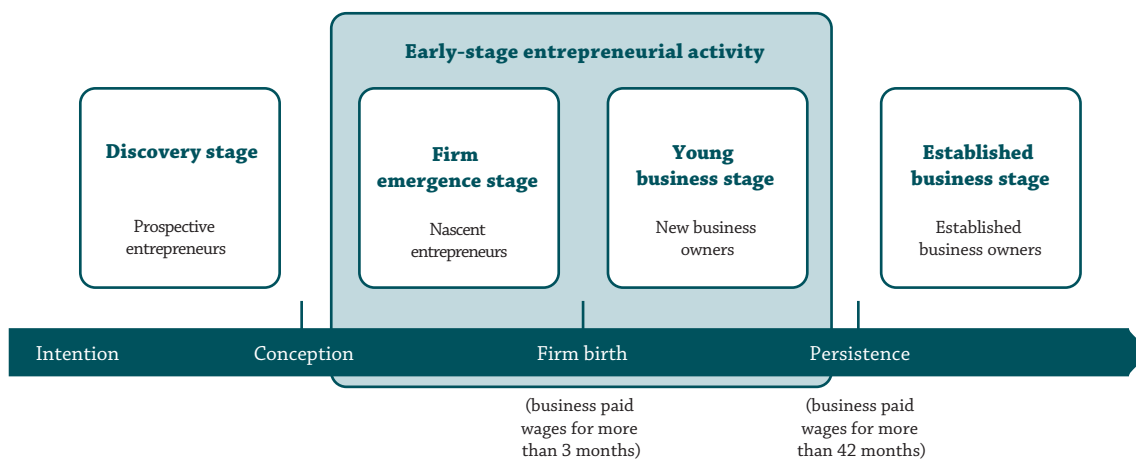
2. A SNAPSHOT OF ENTREPRENEURIAL ACTIVITY

STAGES OF THE ENTREPRENEURIAL PROCESS

Engagement in entrepreneurial activity is frequently seen as an occupational decision with just two outcomes: a person is an entrepreneur or not. However, the decision to pursue an entrepreneurial career is better described as a sequence of choices or a process consisting of several stages

(Reynolds, 1997). GEM distinguishes four major stages of the entrepreneurial process or business life cycle. Figure 1 demonstrates these stages. The definitions used in Figure 1 are explained in the GEM Terminology section on page 7.

Figure 1: Stages of the entrepreneurial process in GEM



Source: Inspired by Klyver (2008) and GEM 2008 Executive Report.

The first stage is the **discovery stage**. It includes individuals who intend to start a business within three years. In GEM these individuals are called *prospective entrepreneurs*.

The second stage is **firm emergence**. Individuals commit resources to start a business, i.e. they take active steps towards setting up a business such as working on a business plan, securing financing, looking for equipment or a location, or organizing a start-up team. Individuals operating in this stage are called *nascent entrepreneurs*.

Payment of wages or salaries to firm owners for more than three months signals a firm birth and the beginning of the **young business stage**. This lasts until the business has been in operation for more than 42 months (3.5 years)¹. This stage is the most vulnerable for a business.

After wages have been paid for more than 42 months a business is considered to be established and enters the **established business stage**.

¹ This cut-off point of 3.5 years was chosen by GEM based on a combination of theoretical and operational grounds. For more detail on this choice see GEM 2008 Executive Report or Reynolds et al. (2005).

The second and third stages together can be combined to define so called *early-stage entrepreneurial activity*. Early-stage entrepreneurial activity is the hallmark of GEM analysis. It represents a dynamic phase in new firm activity and is probably the most crucial period in the life of a new venture, decisive as to whether a business will thrive or perish.

Official data based on the Enterprise Register often do not completely cover early-stage activity,

since nascent entrepreneurs may not yet have registered their businesses. Therefore, research on early-stage business activity based on official data may suffer from serious selection bias because it looks only at successful start-ups. GEM overcomes this problem by identifying nascent entrepreneurs (as well as entrepreneurs at other stages of engagement in the entrepreneurial process) by screening the adult population of the country.

MAIN INDICATORS OF ENTREPRENEURIAL ACTIVITY

According to the GEM survey, slightly more than 150 thousand people were involved in early-stage entrepreneurial activity in Latvia in 2009. This represents about 10.4% of the adult population of the country. This GEM indicator is known as the *prevalence of early-stage entrepreneurial activity*. It serves as a measure of the dynamism and future potential of the economy, and is generally used to compare the entrepreneurial potential of countries with similar levels of development.

About a half of early-stage entrepreneurs in Latvia were nascent entrepreneurs. They were actively involved in starting a business. The rest were owner-managers of new businesses no older than 3.5 years². The prevalence of nascent entrepreneurial activity in the adult population of Latvia was 5.3%. The prevalence of new business owners was 5.4%.

GEM also looks at the main drivers behind engagement in entrepreneurial activity. GEM methodology distinguishes individuals *pulled* into entrepreneurship because of opportunity

recognition (perceiving entrepreneurial opportunity, desire to be independent or earn higher income) and *pushed* into entrepreneurship for reasons of necessity (limited employment possibilities, threat of unemployment). Individuals that are pushed into entrepreneurial activity because of no alternative options are called 'necessity-driven entrepreneurs' and those who are pulled into entrepreneurial activity to pursue a business opportunity are called 'improvement-driven opportunity entrepreneurs'³.

The distinction between opportunity-driven and necessity-driven entrepreneurial activity is important because the outcomes of these two types of entrepreneurial activity are also very different. It has been argued that opportunity entrepreneurship is more likely to have a higher contribution to the economy in terms of innovation and job creation (Reynolds *et al.*, 2002). In contrast, necessity-driven entrepreneurs are likely to contribute much less to economic growth (Acs and Varga, 2005). In 2009 almost a third of early-stage entrepreneurs in Latvia were driven by necessity.

² Few individuals are nascent entrepreneurs and new business owners at the same time. When calculating early-stage entrepreneurial activity, these individuals are counted only once.

³ 'Improvement-driven opportunity entrepreneurship' includes those individuals who are pulled into entrepreneurship by opportunity and because they desire independence or to increase their income. Those who sought only to maintain their income at a previous level are not included in this definition (GEM 2008 Executive Report).

Table 1 presents Latvia in the international context by illustrating prevalence rates of entrepreneurial activity at different levels of engagement for all countries that participated in GEM 2009. The table also shows the patterns of entrepreneurial motivation across countries.

The countries in Table 1 are divided into three major groups according to the phase of development: *innovation-driven*, *efficiency-driven* and *factor-driven* countries. This division is based on the level of GDP per capita and the extent to which countries are factor-driven in terms of the shares of exports of primary goods in total exports. This classification of countries is discussed in more detail in the Global Competitiveness Report 2009-2010 (Schwab, 2009).

The first group – *innovation-driven countries* – includes most of the high-income countries participating in GEM. In Table 1 we report separately the innovation-driven countries that are members of the European Union and countries outside the EU. We do so because our aim is to get a broader perspective on the development of entrepreneurial activity in the EU as a whole and to assess Latvia's performance in comparison with other EU countries. Innovation-driven EU countries include Belgium, Denmark, Finland, France, Germany, Greece, Italy, the Netherlands, Slovenia, Spain, and the UK. The highest rates of entrepreneurial activity in this group are for Greece and the Netherlands. Innovation-driven countries outside the EU have slightly higher rates of entrepreneurial activity, e.g. the United Arab Emirates, Iceland, Norway, the United States, and Switzerland.

The second group is *efficiency-driven countries*. This group includes three of the new EU member states participating in GEM (Romania, Hungary, and Latvia⁴). Russia and the Balkan countries are also classified as efficiency-driven. Among these countries Latvia demonstrates the highest rate of early-stage entrepreneurial activity. Hungary stands right next to Latvia in the rating. Many South American countries, some Asian, African and North American countries also belong to the category of efficiency-driven countries. We report them separately from the Central and Eastern European countries. Overall, rates of entrepreneurial activity in Central and Eastern European countries are slightly lower than for the rest of the group, probably, because of differences – for example as to culture, history, religion, population composition, and structure of the economy. It should be noted here that rates of entrepreneurial activity in efficiency-driven economies are higher than in innovation-driven economies, but also that the proportion of necessity-driven activity in the former is substantially larger.

The last group represents factor-driven economies. These countries also have quite high levels of early-stage entrepreneurial activity and a high proportion of necessity-driven entrepreneurial activity.

Most of the analysis in this chapter will be restricted to the countries of the European Union because our main focus is to assess the performance of Latvia in the EU context. Sometimes we shall also report figures for European countries outside the EU (e.g. Iceland, Norway, Russia, the Balkan countries) and the US, using the latter as a benchmark of a highly entrepreneurial economy.

⁴ Slovenia is an exception. Because of its high level of development it is considered to be an innovation-driven country.

Table 1: Prevalence rates of entrepreneurial activity across all GEM countries, 2009

			(1)	(2)	(3)	(4)	(5)
	Region	Country	Nascent entrepreneurship rate	New business ownership rate	Early-stage entrepreneurial activity (TEA)	Necessity-driven (% of TEA)	Improvement-driven opportunity (% of TEA)
Innovation-driven	Non-EU	United Arab Emirates	6.5	7.4	13.3	9	79
		Iceland	7.6	4.2	11.4	10	58
		Norway	5.0	3.9	8.5	9	74
		United States	4.9	3.2	8.0	23	55
		Switzerland	4.3	3.5	7.7	7	67
		South Korea	2.7	4.4	7.0	45	37
		Israel	3.4	2.7	6.1	25	48
		Hong Kong	1.6	2.2	3.6	19	49
		Japan	1.9	1.3	3.3	30	62
	EU	Greece	4.5	4.7	8.8	26	47
		Netherlands	3.1	4.1	7.2	10	57
		UK	2.7	3.2	5.7	16	43
		Slovenia	3.2	2.1	5.4	10	69
		Finland	2.9	2.3	5.2	19	62
		Spain	2.3	2.8	5.1	16	41
		France	3.1	1.4	4.3	14	67
		Germany	2.2	2.1	4.1	31	43
		Italy	1.8	1.9	3.7	14	57
		Denmark	1.6	2.0	3.6	7	56
		Belgium	2.0	1.6	3.5	9	55
Efficiency-driven	Central and Eastern Europe plus Russia	LATVIA	5.3	5.4	10.4	32	54
		Hungary	5.4	3.7	9.1	24	45
		Croatia	3.5	2.2	5.6	37	39
		Romania	2.8	2.3	5.0	34	31
		Serbia	2.2	2.8	4.9	41	46
		Bosnia and Herzegovina	3.1	1.3	4.4	39	20
		Russia	1.8	2.3	3.9	29	37
	Other	Colombia	15.0	8.0	22.4	34	45
		Peru	16.1	5.1	20.9	28	42
		China	7.4	11.8	18.8	48	29
		Dominican Republic	8.8	9.2	17.5	34	26
		Ecuador	6.3	9.7	15.8	32	43
		Morocco	6.9	9.4	15.8	25	57
		Brazil	5.8	9.8	15.3	39	48
		Chile	9.6	5.6	14.9	25	42
		Argentina	6.1	9.3	14.7	47	37
		Uruguay	8.1	4.2	12.2	22	57
		Iran	8.2	4.1	12.0	35	35
		Jordan	5.9	4.9	10.2	28	35
		Panama	6.2	3.5	9.6	24	59
Tunisia	2.2	7.2	9.4	20	57		
South Africa	3.6	2.5	5.9	33	38		
Malaysia	1.7	2.7	4.4	25	44		
Factor-driven	All	Uganda	12.4	22.7	33.6	45	45
		Guatemala	17.1	12.2	26.8	23	30
		Yemen	22.8	1.2	24.0	35	16
		Jamaica	13.0	10.6	22.7	33	45
		Venezuela	13.3	5.4	18.7	32	42
		Tonga	6.5	11.1	17.4	33	39
		Algeria	11.3	5.6	16.7	18	51
		Lebanon	6.7	8.8	15.0	18	60
		West Bank & Gaza Strip	3.0	5.9	8.6	37	33
		Syria	3.4	5.1	8.5	37	43
Saudi Arabia	2.9	1.9	4.7	12	63		

Note: Within each group, countries are sorted by early-stage entrepreneurial activity.

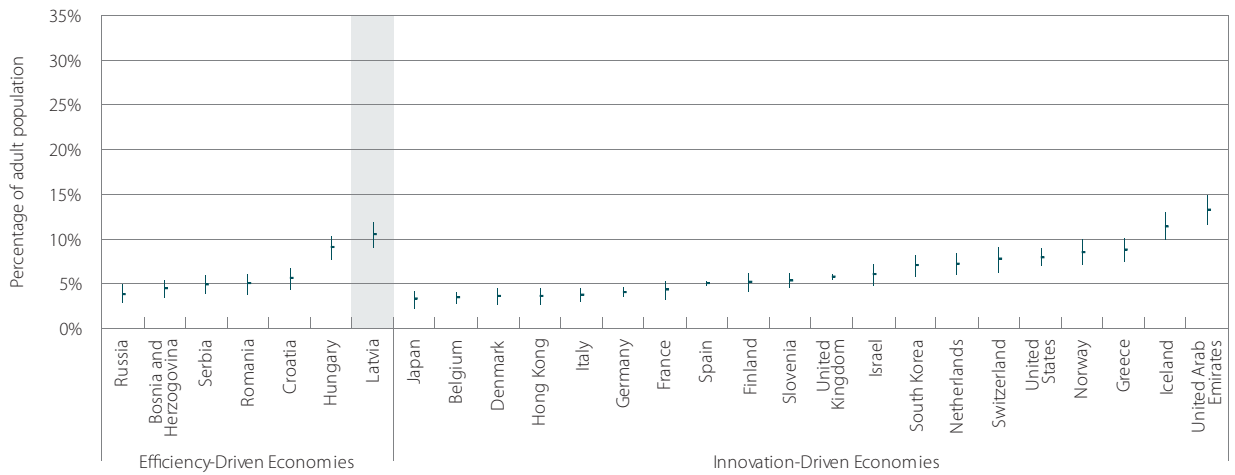
Columns (4) and (5) do not add up to 100%. A category not shown in the table includes early-stage entrepreneurs driven by opportunity but who seek only to maintain their income (not to increase their income or independence).

Source: GEM 2009 Executive Report.

Figure 2 visually demonstrates how the early-stage entrepreneurship rate in Latvia compares with other countries. Latvia has the highest level of early-stage entrepreneurial activity in its comparison group. However, Latvia also has a sub-

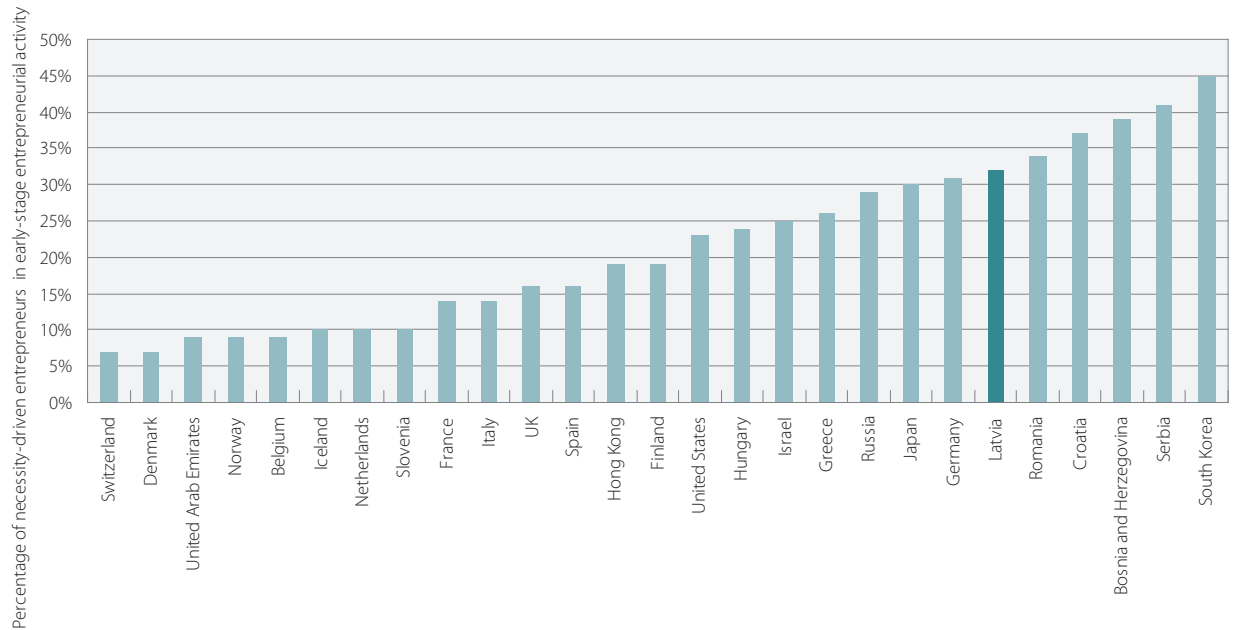
stantial share of necessity-driven entrepreneurial activity (shown in Figure 3). Only some Balkan countries, and, surprisingly, South Korea, have a higher proportion of early-stage entrepreneurship driven by necessity motives.

Figure 2: Early-stage entrepreneurial activity by country, 2009



Note: The vertical bars in the chart display 95% confidence intervals.
Source: GEM 2009 Executive Report.

Figure 3: Proportion of early-stage entrepreneurs driven by necessity motive by country, 2009



Source: Own calculations based on GEM 2009 master data.

Table 2: Entrepreneurial attitudes and perceptions in all GEM countries, 2009

			(1)	(2)	(3)	(4)	(5)	(6)
	Region	Country	Perceived Opportunities	Perceived capabilities	Fear of failure ^a	Entrepreneurial intentions ^b	Entrepreneurship as a good career choice	High Status to successful entrepreneurs
Innovation-driven	Non-EU	United Arab Emirates	45	68	26	36	70	75
		Iceland	44	50	36	15	51	62
		Norway	49	44	25	8	63	69
		United States	28	56	27	7	66	75
		Switzerland	35	49	29	7	66	84
		South Korea	13	53	23	11	65	65
		Israel	29	38	37	14	61	73
		Hong Kong	14	19	37	7	45	55
		Japan	8	14	50	3	28	50
	EU	Greece	26	58	45	15	66	68
		Netherlands	36	47	29	5	84	67
		UK	24	47	32	4	48	73
		Slovenia	29	52	30	10	56	78
		Finland	40	35	26	4	45	88
		Spain	16	48	45	4	63	55
		France	24	27	47	16	65	70
		Germany	22	40	37	5	54	75
		Italy	25	41	39	4	72	69
Efficiency-driven	Central and Eastern Europe plus Russia	LATVIA	18	50	40	10	59	66
		Hungary	3	41	33	13	42	72
		Croatia	37	59	35	8	68	49
		Romania	14	27	53	6	58	67
		Serbia	29	72	28	22	69	56
		Bosnia and Herzegovina	35	57	32	17	73	57
		Russia	17	24	52	2	60	63
	Other	Colombia	50	64	29	57	90	74
		Peru	61	74	32	32	88	75
		China	25	35	32	23	66	77
		Dominican Republic	50	78	27	25	92	88
		Ecuador	44	73	35	31	78	73
		Morocco	53	78	24	27	82	86
		Brazil	47	53	31	21	81	80
		Chile	52	66	23	35	87	70
		Argentina	44	65	37	14	68	76
		Uruguay	46	68	29	21	65	72
		Iran	31	58	32	22	56	78
Factor-driven	All	Uganda	74	85	29	58	81	85
		Guatemala	57	64	24	18	77	69
		Yemen	14	64	65	9	95	97
		Jamaica	42	77	24	29	76	77
		Venezuela	48	59	26	29	76	69
		Tonga	56	53	65	6	91	52
		Algeria	48	52	31	22	57	58
		Lebanon	54	77	21	22	85	79
		West Bank & Gaza Strip	50	56	36	24	88	78
		Saudi Arabia	69	73	49	34	80	89

Note: Within each group, countries are sorted by early-stage entrepreneurial activity (reported in Table 1).

^a Denominator: Adult age population perceiving good opportunities to start a business.

^b Denominator: Adult age population that is not involved in entrepreneurial activity.

Source: GEM 2009 Executive Report.

Table 2 describes the entrepreneurial attitudes and perceptions prevailing in GEM countries in 2009. First of all, it can be noticed that quite a low proportion of people in EU countries perceive good opportunities for starting a business over the next 6 months in the area where they live (Table 2, Column 1). On average, slightly less than a quarter of people surveyed in the EU expected good business opportunities in the near future. In Latvia, only 18% of the adult population had the same expectation. Unlike the majority of European countries, factor-driven and efficiency-driven countries outside Europe demonstrated a much more positive view of business opportunities in the future.

The second column of Table 2 shows the percentage of the adult population who admitted possessing the knowledge, skills and experience required to start up a business. This indicator describes the subjectively assessed capabilities of a country's population to start a business. In almost all countries the indicator of perceived capabilities is higher than the indicator of perceived opportunities. This discrepancy implies the existence of a hidden entrepreneurial potential of population that may remain undeveloped in unfavourable circumstances. The discrepancy is especially high in EU countries such as Hungary, Latvia, Spain, and Greece.

The third column covers persons who perceive good business opportunities and calculates how many of them admit that fear of failure can deter them from starting a business. In GEM countries on average about a third of people who perceive good business opportunities report fear of failure. In some EU countries the proportion is even higher: 40% in Latvia, 45% in Greece and Spain, 47% in France and 53% in Romania.

The entrepreneurial intentions of those people who are not yet active in entrepreneurial activity are presented in column 4. In general, entrepreneurial intentions are quite highly correlated with early-stage entrepreneurial activity: in countries where many people are involved in entrepreneurial activity, a large proportion of those who are not yet involved also plan to start a business in the future. In EU countries entrepreneurial intentions are quite low, with Slovenia, Latvia, Hungary, Greece and France showing the highest figures.

The last two columns provide indicators of the status of entrepreneurs and entrepreneurship in the society. Column 5 shows the percentage of people who consider entrepreneurship to be a good career choice. Column 6 gives the proportion of the adult population who believe that successful entrepreneurs enjoy high social status. There are no marked differences with respect to these indicators among EU countries, with Latvia showing average figures.

3. IMPACT OF THE RECESSION ON ENTREPRENEURIAL ACTIVITY

Theory suggests that economic recession can have two opposite effects on early-stage entrepreneurial activity.

On the one hand, it becomes more difficult to start and operate a business, so the probability of starting a profitable business decreases. It becomes harder for entrepreneurs to find customers and suppliers and to raise capital. Discouraged starters may drop out from the pool of nascent entrepreneurs and new business owners.

On the other hand, recession releases labour and capital from ineffective economic segments and allows newcomers to recombine these resources in new and more profitable ways. Qualified workers are easier to find, office space is cheaper to rent, and competition is reduced. Moreover, during an economic downturn people have lower opportunity costs in terms of foregone earnings from employment and more free time to start a new business and have a greater need to do so. Wage cuts, high unemployment, fewer job vacancies and other necessity reasons motivate people to think of starting entrepreneurial activity or becoming self-employed in order to maintain their income level.

If theoretically it is ambiguous which of the two effects will dominate, empirical evidence suggests that during recessions the proportion of self-employed and individual entrepreneurs generally increases (Van Stel *et al.*, 2008).

In 2005-2009 the Latvian economy went from real GDP annual growth rates above 10 percent to a decline of almost 18 percent in 2009. Changes in macroeconomic conditions brought substantial variation in the prevalence rate of early-stage entrepreneurs. The prevalence rate was about 6.6% in 2005-2006, dropped to 4.4% in 2007, and then

sharply increased to more than 10% in 2009. So the Latvian experience also shows that entrepreneurship seems to be counter-cyclical (i.e. it decreased in the boom but has increased during the recession). The findings of the Latvian GEM seem to support what in the literature is labelled the “refugee” or “push” effect, i.e. good years see a larger share of entrepreneurs motivated by business opportunity, whereas bad years see a larger share of necessity driven entrepreneurs motivated by adverse labour market conditions.

The considerable increase in early-stage entrepreneurial activity observed in Latvia is most probably driven by the worsening situation in the labour market, the threat of unemployment, and other necessity and opportunity cost motives. It is arguable whether the current increase in early-stage entrepreneurial activity will considerably contribute to major economic development. Much of it is likely to result in small business activities with low chances of survival. Many attempts to start a business will probably be transitory or unsuccessful. Nevertheless, self-employment and entrepreneurial activity can be an important source of temporary income for people hit by the economic crisis.

Table 3 shows that although people in Latvia see fewer opportunities for starting a business in the recession, an increase has occurred both in the percentage of respondents with intentions to start businesses and the start-up and ownership rates of new firms. However, the structure of start-ups has changed: more entrepreneurs were driven by the necessity motive in 2008-2009 than in 2006-2007 and they expected to employ fewer people and to export less.

Table 3 also reveals several trends in entrepreneurship indicators across all GEM countries. Firstly,

the proportion of respondents who saw good business opportunities for starting a business has decreased in all but two countries. Secondly, with the exception of Latvia, an increase has occurred in the proportion of respondents for whom fear of failure would inhibit them from starting a business. Moreover, the nascent entrepreneurship rate has decreased in most countries, while Latvia

is among those where the rate has increased. An opposite trend is observable in the rate of ownership of new firms: this has increased in the majority of countries (including Latvia). Interestingly, unlike Latvia, most countries have seen no change in the number of people that entrepreneurs expect to employ.

Table 3: Entrepreneurial tendencies in selected countries, 2008-2009 and 2006-2007

Country	GDP: Change in GDP per capita, on previous year (current prices)		Attitudes: 1. Perceived opportunities 2. Fear of failure 3. Intention to start a business 4. Good career choice				Activity: 5. Nascent entrepreneurship 6. Owner-managers new firms 7. Discontinuation rate 8. Necessity (% of TEA)				Aspiration (all % of TEA): 9. Job expectation 10. New product 11. New market 12. International orientation			
	2008	2009	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
LATVIA	-4.6	-18.0	-	-	+		+	+	+	+	-		+	-
Romania	7.1	-8.5	-	+	+			+		+	-			
Iceland	1.3	-8.5	-			-				+		+		
Russia	5.6	-7.5	-			+	-	+				-		+
Hungary	0.6	-6.7	-	+	+	-	+	+	+		+	+		+
Finland	1.0	-6.4	-		-	+	-			+				
Japan	-0.7	-5.4		+	-				-					-
Germany	1.2	-5.3			+		-					-		+
Croatia	2.4	-5.2	-	+	-	-	-		-			-		
Italy	-1.0	-5.1	-	+	-		-		-		-	-		-
Slovenia	3.5	-4.7	-				+	+						
United Kingdom	0.7	-4.4	-		-	-	-	+		+			-	+
Netherlands	2.0	-4.2	-	+	+			+	+		-			
Serbia	5.4	-4.0	-		-	-	-	-		-		+		
Spain	0.9	-3.8	-	+	-	-	-	-	+			-		-
Belgium	1.0	-3.2					-	+						+
USA	0.4	-2.7	-	+	-	+	-			+		-	-	-
Argentina	6.8	-2.5	-	+	-			+	-	+				-
Denmark	-1.2	-2.4	-		-	-	-	-	-	+				+
France	0.3	-2.4						+	-		+			
South Africa	3.1	-2.2	+					-	+	-		+		+
Venezuela	4.8	-2.0			+		-	-	-			+	+	+
Switzerland	1.8	-2.0				+	+			-				-
Norway	2.1	-1.9		+	+	+	+			+		+	+	
Chile	3.2	-1.7			+	+	+					+		+
Greece	2.9	-0.8			+		-	+		+	-	+	+	
Brazil	5.1	-0.7	+					+	-	-				-
Colombia	2.5	-0.3	-				+	-	-	-	+			+
United Arab Emirates	7.4	-0.2					+	+		-		-	+	
Israel	4.0	-0.1				+			+					
Dominican Republic	5.3	0.5		+	-	+								+
Uruguay	8.9	0.6			+				-	-				
Peru	9.8	1.5		+			-	-						+
China	9.0	8.5	-	+						+				-

Note: "+" indicates a positive trend; "-" indicates a negative trend; blank entries denote minor changes.

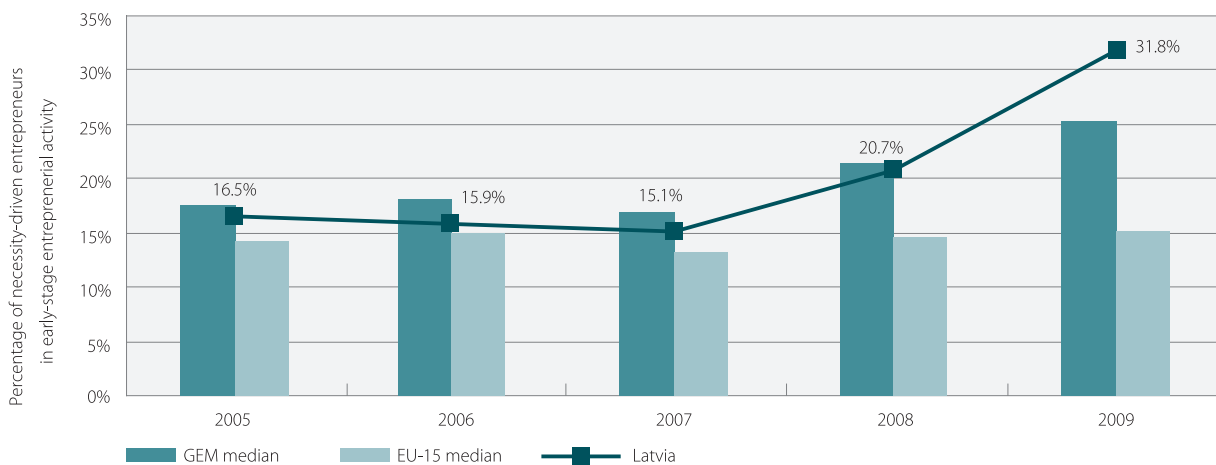
The countries are ranked by change in GDP per capita in 2009.

Source: GEM 2009 Executive Report.

The increase in the percentage of necessity-driven entrepreneurs is illustrated in more detail in Figure 4. It can be seen that the percentage of necessity-driven entrepreneurial activity has nearly doubled in Latvia since 2007. While an increase has occurred in the median level of necessity-driven entrepreneurship among all GEM countries, this has not been nearly as dramatic as in Latvia. It is highly likely that this is the result of the exceptionally severe recession in Latvia. A

positive relationship between the level of economic activity and the proportion of necessity-driven entrepreneurship could also explain why the latter has remained essentially unchanged among the 15 old European Union members: the overall yearly change in real GDP for this group of countries was only 0.5% in 2008 and -4.23% in 2009. By comparison, the change in Latvia was -4.55% and -18.02%, respectively.⁵

Figure 4: World trends in early-stage necessity-driven entrepreneurial activity, 2005-2009



Source: Own calculations based on GEM 2005-2009 master data.

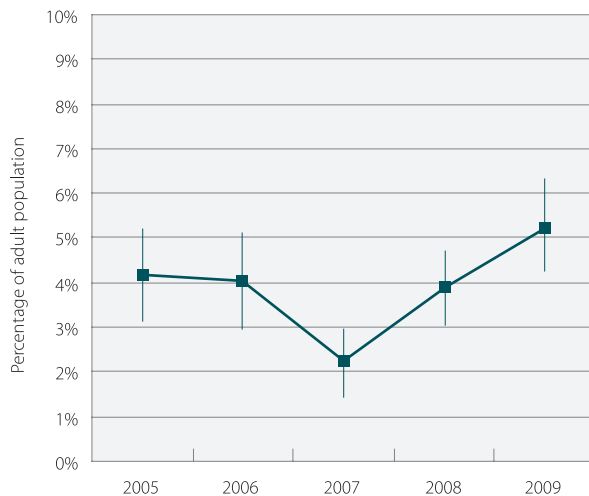
⁵ Eurostat national accounts data.

As shown in Figure 5, a general increase has also occurred in nascent entrepreneurship and new business ownership rates, as well as in the discontinuation rate. The increase in nascent entrepreneurship relates to the discussion at the beginning of this chapter and indicates that the creative effect of the recession (allowing labour and capital to be put to more efficient uses) dominates its destructive effect. In the future it might be

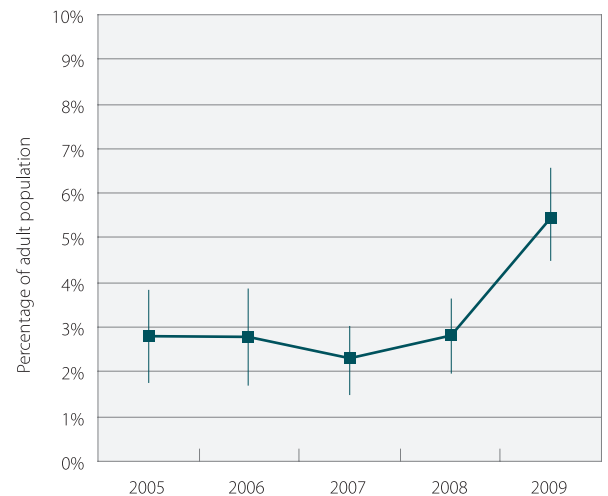
expected that new business ownership and discontinuation rates will continue to increase together with the nascent entrepreneurship rate. However it is likely that changes in business ownership and discontinuation rates will become smoother, because only some proportion of start-ups will survive long enough to be classified by GEM as new businesses, while others will be discontinued.

Figure 5: Indicators of entrepreneurial activity in Latvia, 2005-2009

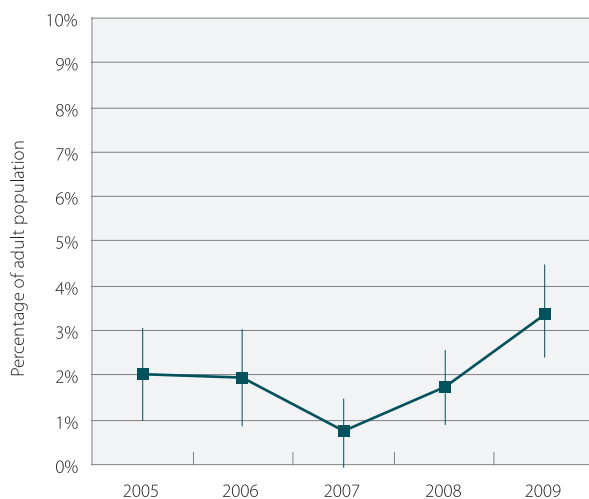
A. Nascent entrepreneurs



B. New business owners



C. People who discontinued businesses



Note: The vertical bars in the chart display 95% confidence intervals.
Source: GEM 2005-2009 Latvian Adult Population Survey (APS) data.

Interestingly, an overall increase in Latvian entrepreneurial activity has taken place despite a pessimistic mood among entrepreneurs regarding the business environment. Figure 6 reveals a general belief among entrepreneurs that starting or growing a business was more difficult in 2009 than in 2008, and that fewer business opportunities occurred in 2009. These beliefs were much more pronounced in Latvia, Romania, and Hungary than in

the other GEM countries, probably because of the particularly severe GDP decline that took place in these countries in 2009. In GEM data we observe a positive correlation between the extent of negative impact of recession on business opportunities (as reported in Figure 6, Panel C) and the proportion of necessity-driven entrepreneurs in early-stage entrepreneurial activity.

Figure 6: Entrepreneurs' views on the impact of recession in selected GEM countries in 2009 (compared to one year ago)



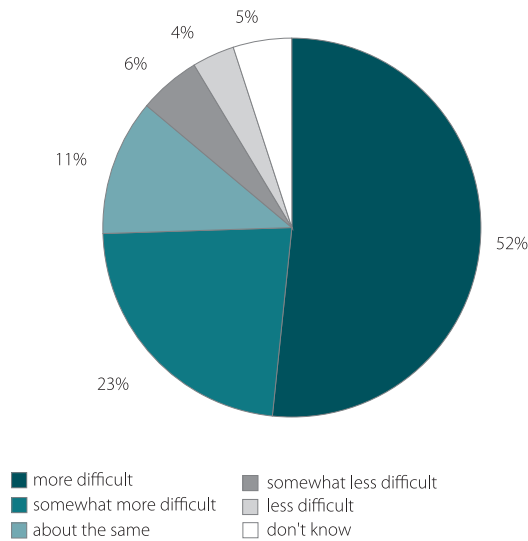
Source: Own calculations based on GEM 2009 master data.

Figure 7 examines these beliefs in more detail. While the percentage of entrepreneurs who did not report any negative effect of the crisis was approximately the same for all aspects (business opportunities, starting and growing a business), significantly more entrepreneurs felt a strong

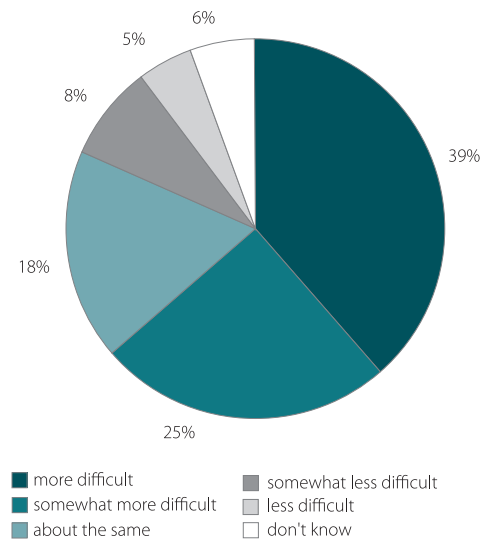
adverse impact on starting a business in particular. About half of respondents believed starting a business to be much more difficult compared to a year ago, while only 39% said this about growing a business.

Figure 7: Entrepreneurs' views on the impact of recession in Latvia in 2009 (compared to one year ago)

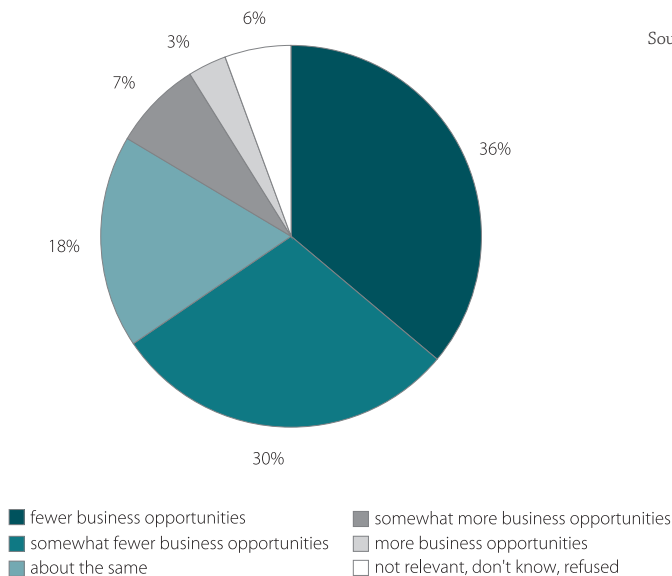
A. Starting a business



B. Growing a business



C. Business opportunities

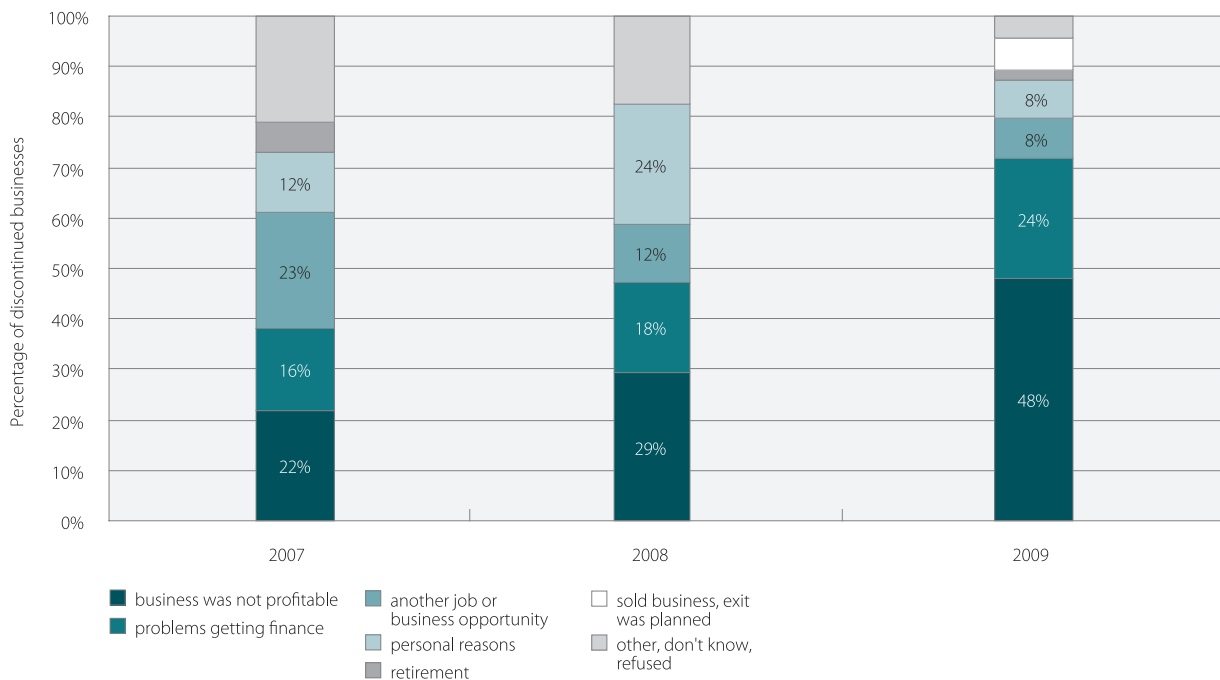


Source: GEM 2009 Latvian Adult Population Survey (APS) data.

While the overall effect of the recession on entrepreneurship rates has been positive, Figure 8 shows that the recession has markedly affected the reasons for business exit. Compared to 2008 and 2007, fewer of those who had discontinued their business reported that they did so to pursue another job or business opportunity (possibly because the set of available alternatives has shrunk).

Significantly more respondents quit because the business was not profitable (consistent with a decrease in both external and internal demand during a recession) or because they had problems getting finance (in turn consistent with financial institutions hoarding capital and liquidity during a financial crisis).

Figure 8: Reasons for business exit in Latvia, 2007-2009



Source: GEM 2007-2009 Latvian Adult Population Survey (APS) data.

4. START-UP FINANCE

On average, nascent entrepreneurs in 2009 believed that they would require 30 000 LVL (43 000 EUR) to start their business, while the median sum required⁶ was only 10 000 LVL (14 000 EUR)⁷. Table 4 divides the sample into

five quintiles⁸, which shows a distinct group of entrepreneurs (the fifth quintile) who require an amount of start-up financing that is up to ten times larger than for the other respondents.

Table 4: Start-up cost in Latvia by quintile, 2009

Quintile	Mean (LVL)	Mean (EUR)	Median (LVL)	Median (EUR)
I	1200	1700	1000	1400
II	4200	6000	5000	7100
III	9200	13000	10000	14000
IV	2200	30000	20000	28000
V	12200	173000	55000	78000

Note: Figures reported in the table are rounded.
Source: GEM 2009 Latvian APS Data.

As shown in Figure 9, a similar pattern of start-up financing needs was observed in 2008, even though the required amount across all subgroups was much higher. Two factors have contributed to the decrease. Firstly, the sharp fall in labour costs, real estate prices and prices of other inputs of production (such as intermediary goods) during the recession has made it less expensive to start any kind of business.

Secondly, the nature of business start-ups has changed. GEM survey responses reveal that significantly fewer entrepreneurs are now pursuing business opportunities in order to increase personal income, while more are doing so to achieve greater personal independence. Moreover, the survey results indicate that more early-stage entrepreneurs are driven by the necessity motive

in 2009 than in 2008. This is consistent with the evidence that participation in State Employment Agency measures to support entrepreneurship and self-employment has nearly tripled⁹.

In turn, the business ideas of necessity-driven entrepreneurs require less start-up financing, as is shown in Figure 12. This is also plausible: the entrepreneurship alternative was – by the definition of necessity-driven entrepreneur – not chosen when paid employment was an option, presumably because it was possible to earn more by pursuing regular employment than by starting a business. If business ideas that have greater earning potential are also more expensive to realise (as, again, is shown in Figure 12), then the start-up costs for necessity-driven ventures are lower. Similarly, as fewer entrepreneurs

⁶ The middle of a series arranged in order of magnitude. The median is the value below which 50% of observations fall.

⁷ Several respondents who quoted very large sums of money required to start their business are excluded from the analysis in this chapter, because they are likely to be outliers. The dropped observations consist of: two in 2009 with a value of one million in the amount required; one in 2008 with a value of ten million; and one in 2008 with a value of four million.

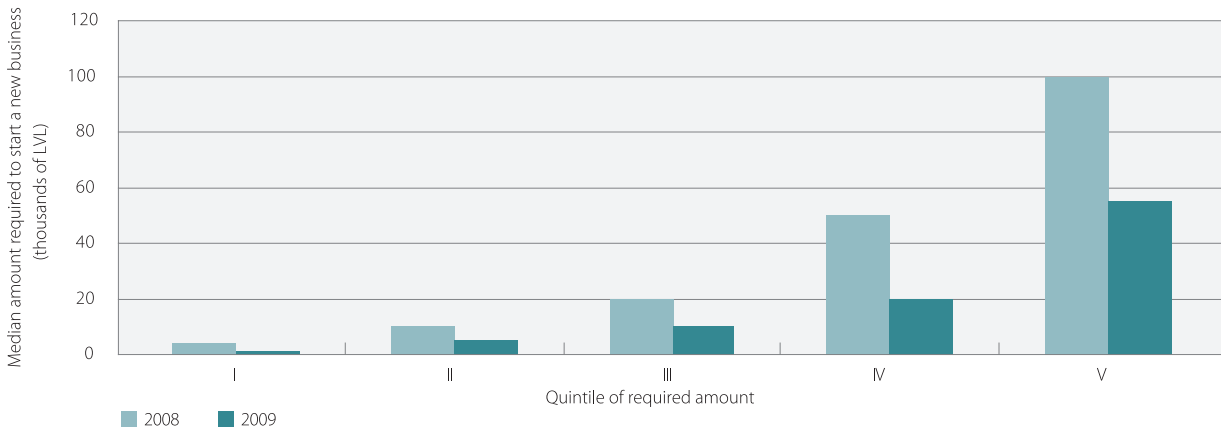
⁸ Each quintile represents a fifth of the observations arranged in order of magnitude. To group the data into quintiles, five values are chosen so that 20%, 40%, 60%, 80% and 100% of the observations are below these values.

⁹ According to data published by the State Employment Agency (www.nva.gov.lv).

start businesses with a primary motivation to increase their personal earnings, there will be fewer expensive-to-start businesses that make substantial, risky investments in the hope of higher growth and returns.

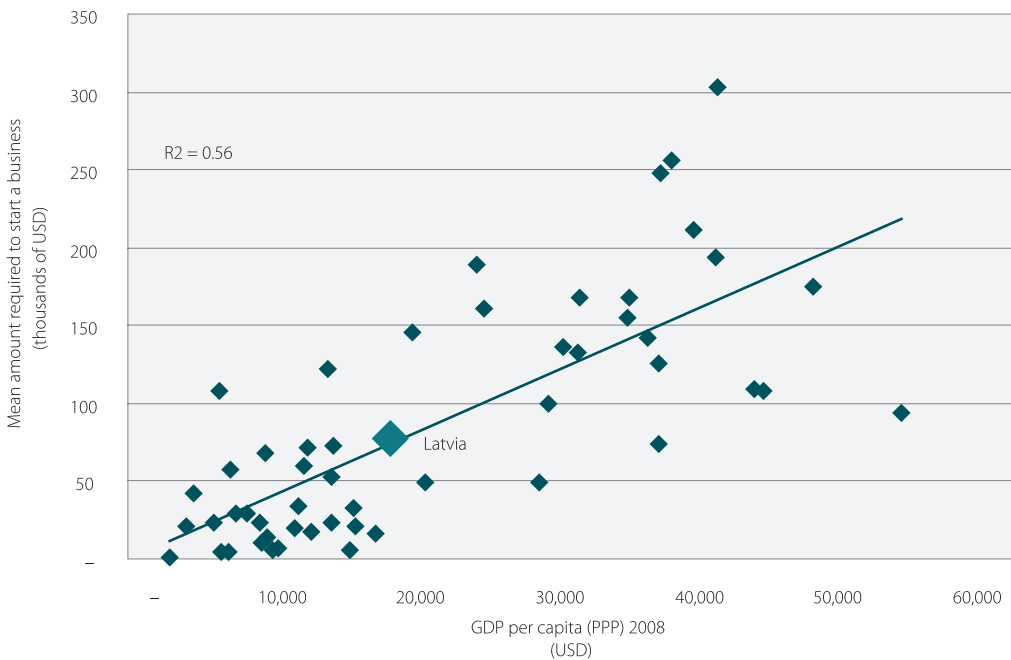
However, the decrease in start-up costs in 2009 is unlikely to stem from changes in the sectoral composition of businesses. In fact, sectoral composition exhibits a high degree of correlation from year to year, meaning that sectors with many start-ups

Figure 9: Median amount required to start a business by quintile, 2009



Source: GEM 2008 and GEM 2009 Latvian APS Data.

Figure 10: Relationship between GDP per capita and start-up cost of new ventures, 2009



Source: GEM 2009 Executive Report.

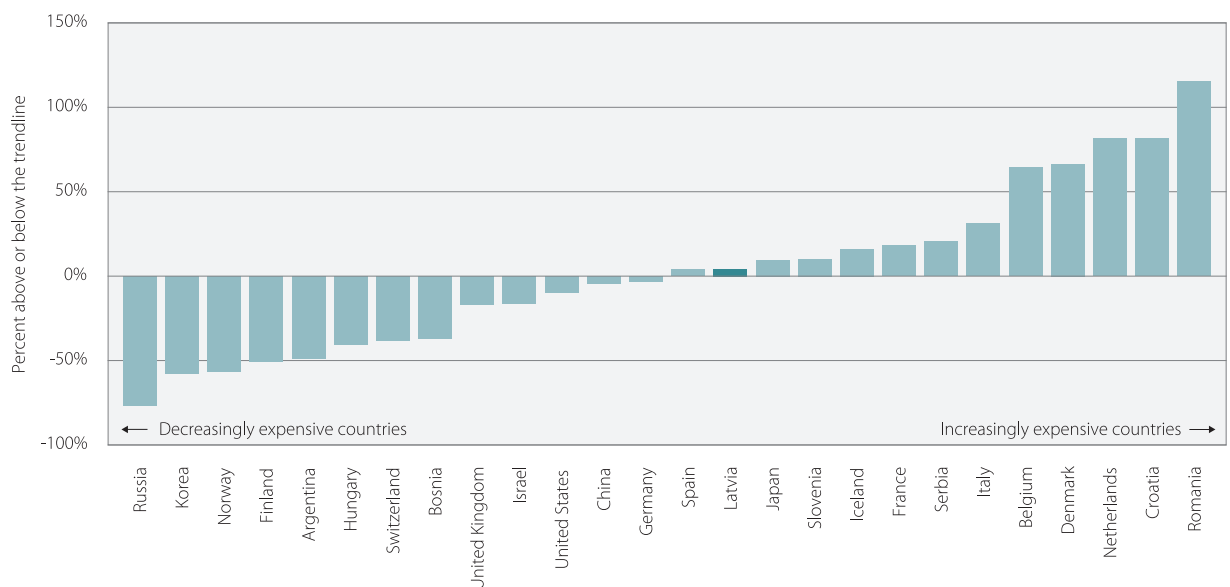
in 2008 also tended to have many in 2009. Moreover, various types of wholesale trade (relating to durable goods, building materials and garden supplies) remained dominant among the latest start-ups and these would in practice require relatively high initial financing.

Overall, the data do not seem to support the view that starting a business is particularly expensive in Latvia in comparison to other countries, bearing in mind that a country's stage of economic development and hence the overall price level directly influences start-up costs. Figure 10 plots the mean start-up cost against per capita GDP and shows that GDP per capita explains more than half the cross-country variation in start-up cost. Figure 11 shows the part of each country's start-up cost that is not explained by per capita GDP, which could be either because of omitted factors that influence start-up cost across all countries, or due to country-specific factors. It should be kept in mind that more advanced countries also tend to have more advanced start-ups, so that an indirect link also exists between a country's GDP per capita and the observed average start-up cost.

Figure 11 shows that in some countries (e.g. France, Belgium, Denmark) actual start-up costs are higher than suggested by the GDP per capita relationship, while the opposite is true in Norway, Finland, and Hungary. Interestingly, Russia and Romania – both less advanced than Latvia in terms of their institutional environment and GDP per capita – are on opposite sides of the start-up cost spectrum, with particularly low and high values above the trendline, respectively. This suggests that the determinants of start-up cost need to be further examined.

A particularly important point to note is that any such simple comparison of required start-up costs reflects not only the difficulty of starting a business but also the structure of new start-ups. It could be, for example, that it is relatively costless to start a business in Russia, but it may also be that the types of new businesses that are started in Russia are ones that require very little financing in the first place. An indicator that reflects the administrative costs of starting a business is necessary, and the data cannot, for example, be used to argue either for or against anecdotal

Figure 11: Percentage of start-up cost above or below the trendline for selected countries, 2009



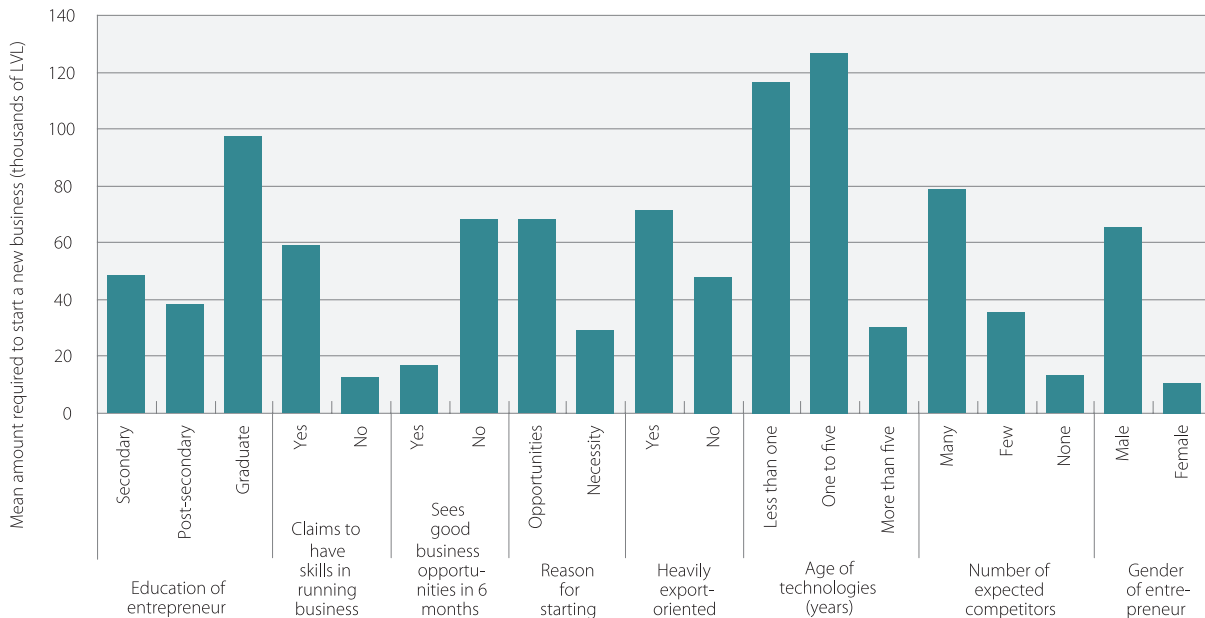
Source: GEM 2009 Executive Report.

evidence of an excessive bureaucratic burden that hampers creation of innovative enterprises in Latvia.

Figure 12 illustrates some of the characteristics that are important in the cost of starting a business. Respondents with graduate education appear to plan businesses that require almost twice as much to start than those of people with post-secondary or secondary education. Male respondents quoted amounts four to five times higher than female respondents, while respondents who believed they have skills in running a business also had ideas that required more financing compared to those respondents who did not believe they possess such skills.

Start-up cost is also associated with the characteristics of new start-ups. For example, those entrepreneurs who were starting their business to exploit an attractive opportunity saw higher start-up costs than those who started a business because of no better choices for work, i.e. necessity-driven. Likewise, entrepreneurs who were starting heavily export-oriented businesses or using technologies less than five years old quoted higher required sums than entrepreneurs whose product or service was oriented towards the domestic market, or who were relying on older technologies. At the same time, entrepreneurs who expected many competitors saw higher start-up costs than those who expected few competitors, as did those respondents who saw no good business opportunities in the following six months compared to people who claimed that they could see good opportunities.

Figure 12: Average start-up cost in Latvia by characteristics of nascent entrepreneurs, 2009



Source: GEM 2009 Latvian APS Data.

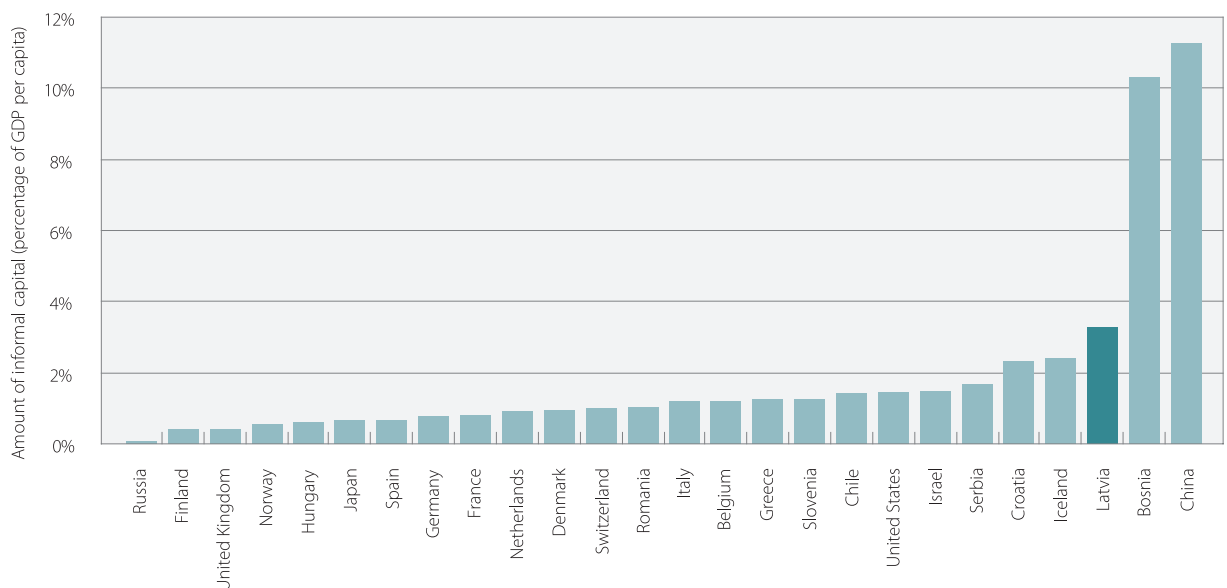
Turning to sources of financing, entrepreneurs in Latvia use large amounts of informal capital (i.e. financing from friends, relatives and colleagues). Expressed as a percentage of GDP, this source of capital is higher in Latvia than in most members of the European Union, as well as the United States, Israel, and Japan, while it is substantially lower than in China, Bosnia and Herzegovina, Syria, and Algeria (not shown in the graph). Latvia ranks even higher in terms of the number of people (relative to the adult population) who have provided informal capital. The median amount of informal capital was slightly below 10 000 LVL (14 000 EUR), while the mean was around 32 000 LVL (45 000 EUR). This means that 'on average' most of the perceived financing needs of nascent entrepreneurs are provided by informal investors.

While the prevalence of informal investors might indicate that Latvian society is supportive of entrepreneurial efforts as such, it also implies that entrepreneurs are reluctant or unable to seek more formal sources of financing (from banks,

capital markets, venture capitalists), which could help secure both a larger amount of capital and provide valuable expertise. It should be noted that banks in general have low competence in evaluating entrepreneurial projects and therefore are reluctant to lend to entrepreneurs.

The fact that developing countries (i.e. efficiency- and factor-driven economies) have generally higher levels of informal capital than developed ones lends support to this hypothesis, since they would be expected to have less developed capital markets. It is possible that this is not only due to reluctance on the part of banks and other formal providers of capital but also because the overall quality of planning and preparation for new start-ups is low, making formal investors conservative in providing financing. It is also true that business start-ups in these countries are on average less ambitious projects with smaller start-up requirements (many entrepreneurs are driven by necessity), so less incentive exists to approach formal lenders.

Figure 13: Amount of informal capital as percentage of GDP per capita in selected countries, 2009



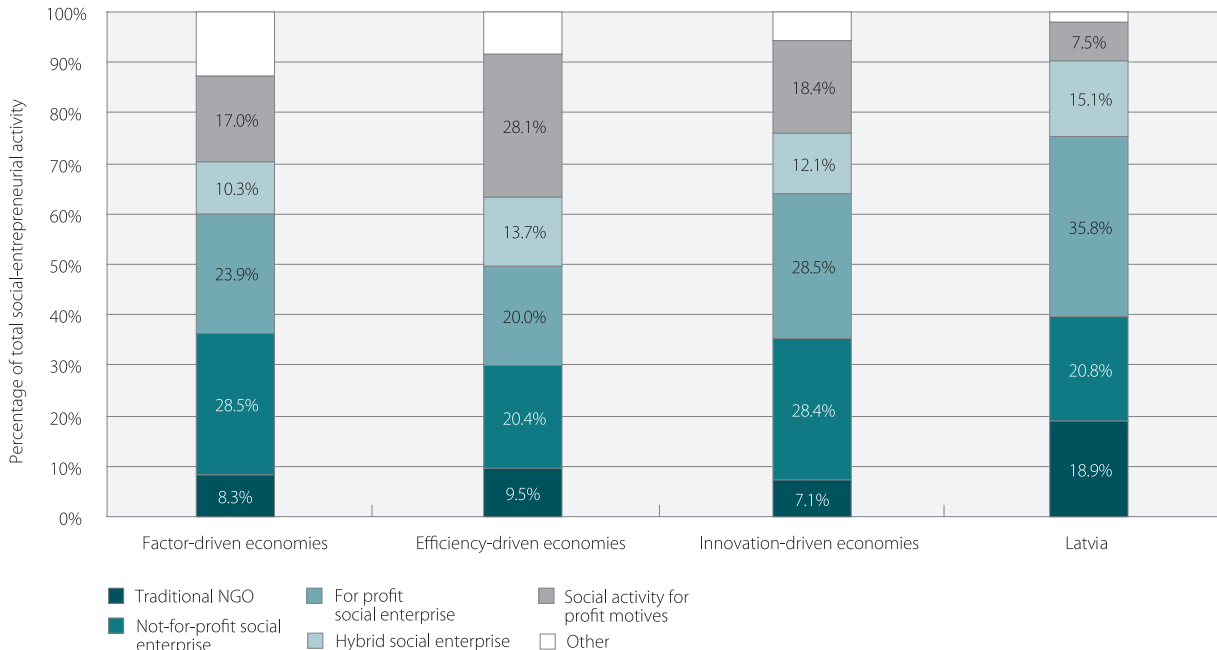
Source: GEM 2009 Executive Report.

5. SOCIAL ENTREPRENEURSHIP

GEM defines social entrepreneurs as “individuals or organizations engaged in entrepreneurial activities with a social goal.” Just as business entrepreneurs undertake to provide innovative goods and services to fulfil the unsatisfied needs of consumers and make a profit, so social entrepreneurs take the initiative and accommodate social needs that have been left unfulfilled by existing institutions. This encompasses a vast range of activities: organizing self-help groups, coordinating community action, creating websites that attract donations to humanitarian causes, and many others.

Figure 14 shows that 20.8% of entrepreneurial activity in Latvia consists of strictly not-for-profit social enterprises, which is also the average proportion in countries at similar levels of economic development to Latvia (efficiency-driven economies¹⁰). With 7.5% of total social entrepreneurship activity based primarily on the profit motive, in Latvia this number is exceptionally low compared to all three country groups. Latvia also stands out with its high proportion of traditional non-governmental organizations (18.9%) and the dominance of hybrid social enterprises (35.8% of all activity)¹¹.

Figure 14: Social entrepreneurship by type of activity in Latvia and other countries, 2009



Source: GEM 2009 Executive Report and GEM 2009 Master Data.

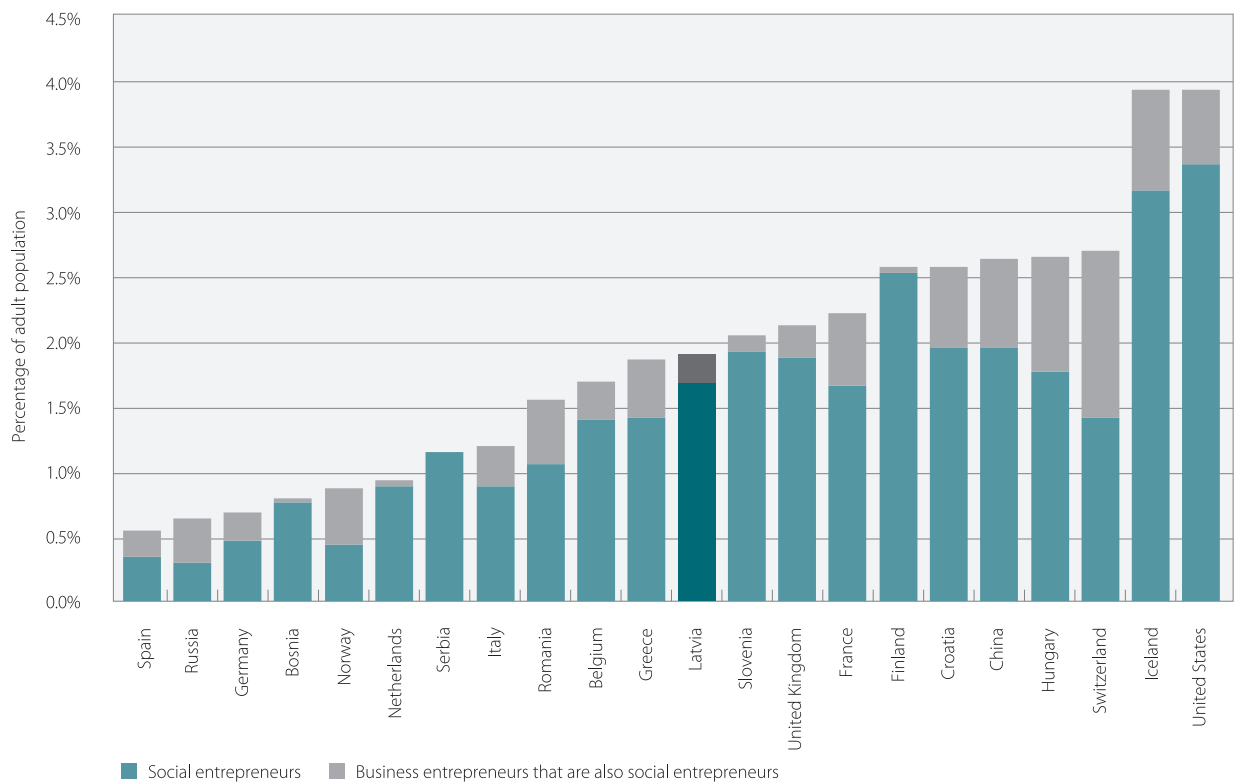
¹⁰ Factor-driven economies (e.g. Uganda) are extractive in nature, whereas efficiency-driven economies (e.g. China, Latvia) rely on scale-intensity as a driver of development, while innovation-driven economies (e.g. Germany) develop by producing new and unique goods and services.

¹¹ Traditional NGOs have purely social goals and not-for-profit status; not-for-profit social enterprises are innovative NGOs; hybrid social enterprises have purely social goals and some complementary economic activity. For profit social enterprises have both social and economic goals (though primarily social), while social activities for profit motives have primarily economic goals.

As Figure 15 shows, the social entrepreneurship rate in Latvia (1.9%) does not appear particularly large or small in a cross-country comparison. It does, however, appear that social entrepreneurs in Latvia are less likely to be simultaneously involved in traditional businesses than their counterparts in other countries: only 0.2% of the population combined social entrepreneurship and business activities. At the same time, social

enterprises and activities appear to be becoming more economically-oriented. Though the number of observations is too small to make statistical inferences, organisations started by today's early-stage social entrepreneurs derived almost twice as much income from sale of goods and services than those of established owner-managers and were twice as likely to strive for economic value-creation.

Figure 15: Social entrepreneurship rate by country, 2009

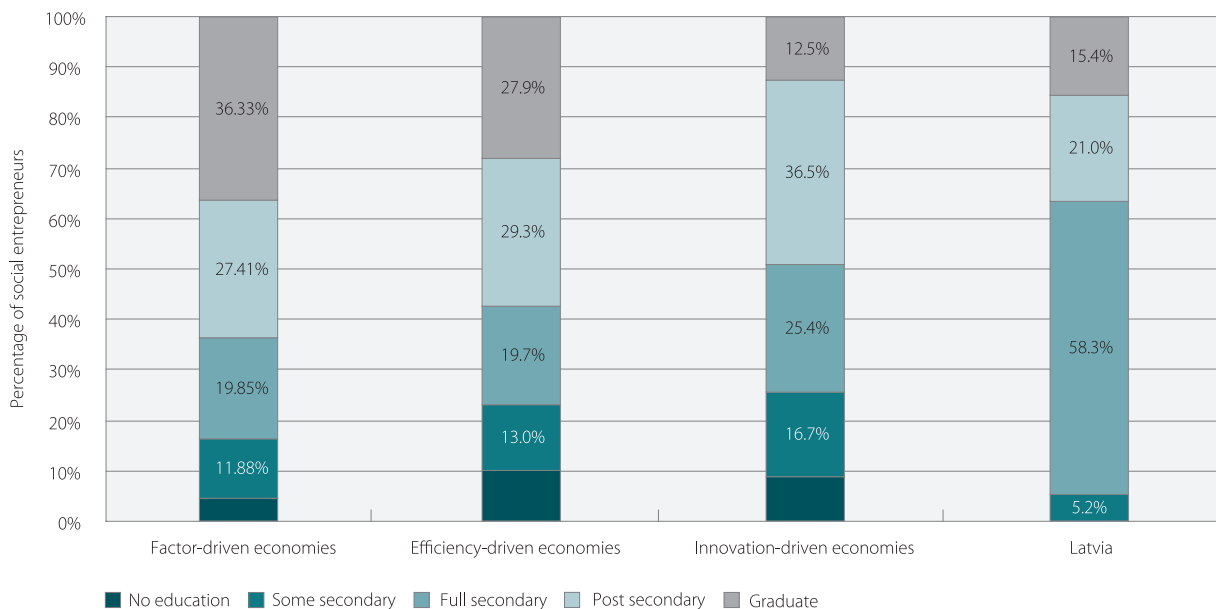


Source: GEM 2009 Master Data.

In comparison to other countries, in Latvia many more social entrepreneurs have only full secondary education but not beyond, as is shown in Figure 16. The difference is as large as 38 percentage points between Latvia and efficiency-driven economies. No social entrepreneurs in the sample were without any education at all, and very few had failed to finish secondary education; in efficiency- and innovation-driven economies these numbers were on average much larger. Partly, this could be explained by the relatively large overall share of people in Latvia with full secondary education.¹²

At the same time, a substantially smaller share of social entrepreneurs in Latvia had some sort of post-secondary education (i.e. post-secondary non-tertiary education or bachelor degree) than in either innovation- or efficiency-driven economies (21.0% compared to 36.5% and 29.3% respectively), while there were about as many social entrepreneurs with graduate education (master or doctoral degree) as in innovation-driven economies (15.4% compared to 12.5%).

Figure 16: Education of social entrepreneurs in Latvia and other countries, 2009



Note: *No education* refers to people who have no formal education beyond the primary level. *Some secondary* refers to incomplete secondary education; *full secondary education* refers to completed general secondary education and may involve professional or vocational education elements. *Post secondary education* refers to post-secondary non-tertiary education or bachelor degree. *Graduate education* refers to people who have completed a Master or PhD programme.

Source: GEM 2009 Executive Report and GEM 2009 Master Data.

By contrast, no substantial differences existed in the age structure of social entrepreneurs in Latvia, compared to other countries in the study. Most social entrepreneurs were in the 45-54 and 35-44 age groups (with 24.3% in each), followed by people in the 18-24 category (21.6%). A smaller number of social entrepreneurs were in the 25-34

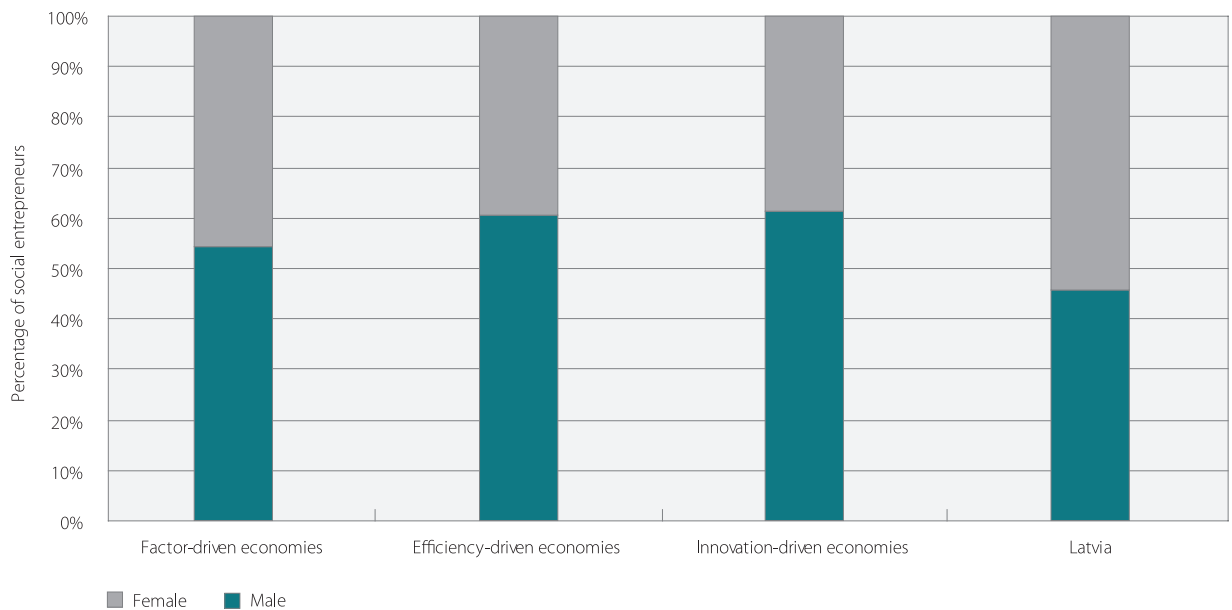
category (18.9%), and only very few people aged 55-64 were social entrepreneurs (10.8%). A fairly intuitive explanation would be that people either start social activities and organisations during or shortly after their education or after gaining experience in established organisations.

¹² E.g., according to Eurostat, 68.3 per cent of people in the 15 old European Union states had completed at least upper secondary education, in contrast to Latvia's 85.8 per cent.

According to Figure 17, males and females in Latvia appear almost equally likely to become social entrepreneurs – with 46% of respondents being males and 54% females – in contrast to other types of economy in the sample, in which social entrepreneurs tended to be males 60% of the time. One must first look at the demographic characteristics of the Latvian population to explain this

difference: overall, it has a higher female-male ratio than other countries.¹³ However, it is likely that factors causing social entrepreneurship to be more male-dominated in other countries are present in Latvia, too. Otherwise one would expect to see more female social entrepreneurs than the sample in fact shows.

Figure 17: Social entrepreneurs by gender in Latvia and other countries, 2009



Source: GEM 2009 Master Data.

¹³ E.g. in Latvia there were 116.9 females for every 100 males in 2008, while in the rest of the European Union the figure was only 104.9.

6. FOCUS INSERT: HOW HARD IS THE PATH OF A NASCENT ENTREPRENEUR? EVIDENCE FROM PSED

**CONTRIBUTED BY
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As shown by GEM, each year thousands of individuals become engaged in efforts to create new businesses. However, the relative stability of the number of established businesses over time suggests that many start-up efforts do not succeed. How many nascent entrepreneurs succeed after a year? After two years? How many abandon their projects? Are any factors associated with a greater likelihood of success or failure? Should or could policy-makers do anything about this? These are all important and interesting questions which GEM data cannot address. The reason is that each year GEM surveys a new random sample of adults – a *cross-section* that provides an accurate snapshot of the prevalence of entrepreneurship at a given point in time. In contrast, addressing these questions requires a *longitudinal* survey that would track entrepreneurs over time. Fortunately, the Panel Study of Entrepreneurial Dynamics (PSED) – another initiative of the TeliaSonera Institute – is exactly this kind of survey.¹⁴

PSED is a methodological approach to analysis of nascent entrepreneurship that has received wide international acclaim. The first PSED study was launched in the United States in the 1990s. Since then, PSED studies have been implemented in several countries including Sweden, Australia, China, Canada, Germany, Norway, the Netherlands, and recently also Latvia. The underlying idea of the PSED is to investigate what happens at the early stage of business creation *before* a business is registered, thereby becoming part of official databases and subject to traditional firm-level studies. Such an approach requires a two-stage methodol-

ogy. First, nascent entrepreneurs must be identified via massive screening of the adult population. Second, entrepreneurs must be interviewed and then tracked over a substantial period in order to determine the status of their business creation efforts. Latvia's own PSED study was launched in the autumn of 2006 thanks to financial support from the TeliaSonera Institute. By August 2007, after screening some 9,000 adults, interviews were conducted with a random sample of 400 nascent entrepreneurs. Then, in August 2008, 261 of these entrepreneurs participated in follow-up interviews.¹⁵

What were the outcomes of business creation efforts 12 months after the initial interviews? Out of 261 entrepreneurs who responded in the second wave, 27% succeeded in establishing operational new firms with revenues exceeding expenses, including salaries to the owners. Furthermore, 55% of entrepreneurs surveyed reported continuing efforts to create business ventures, whereas 18% of them had abandoned their start-up activities. Unfortunately, based on these data, providing a policy-relevant reliable estimate of the likelihood of terminating start-up activities after 12 months is difficult. The answer depends on our assumptions about business creation outcomes for those who refused to participate in the follow-up survey and those who could not be contacted. If business outcomes are independent from these events, the estimated probability of terminating a start-up after one year is 18%. However, if we plausibly assume that all of those who could not be contacted effectively abandoned business creation, this

¹⁴ What follows is based on the findings reported by Dombrovsky, Paalzow and Rastrigina (2010).

¹⁵ The remaining entrepreneurs either refused to participate in follow-up interviews, or could not be contacted.

probability increases to 38%. This latter estimate implies that, on average, 38 out of 100 nascent businesses fail after one year.

How do these results compare to other countries? Parker and Belghitar (2006) report business creation outcomes after one year across four studies for the U.S., Canada, and the Netherlands. Interestingly, they report 33-48 percent of nascent entrepreneurs being operational, i.e. having established a *new firm*, within one year, with 20-27 percent giving up. This is in contrast to Latvia where the percentage of operational nascent entrepreneurs is substantially smaller and the percentage of terminated nascent entrepreneurs is potentially higher, depending on our assumptions on what happened to the missing entrepreneurs.

These findings highlight the importance of inquiry into the causes of early terminations of nascent ventures. Dombrovsky, Paalzow, and Rastrigina (2010) take some first steps in this direction using Latvian PSED data. They use regression analysis to investigate how the decision to terminate a business start-up depends on a number of individual characteristics, such as educational attainment, professional and entrepreneurial experience, social capital, and demographic characteristics. The study reports that education and industry experience have the most robust and substantial effects on business outcomes. For example, having higher education reduces the likelihood of early (i.e. after 12 months) startup termination by about 12 percentage points, which is a very substantial effect. Interestingly, there is no evidence that other aspects of human capital (e.g. having managerial education), entrepreneurial experience (running businesses in the past), or social capital (e.g. having self-employed parents) have an effect on the likelihood of early termination. Demographic variables such as age, gender, and ethnicity also do not seem to matter to business survival.

Probably the most interesting finding concerns the effect of a rather specific aspect of entrepreneurs' human capital – knowledge of the tax system. Why does it matter whether nascent entrepreneurs understand the tax system? Clearly, the success of a venture, at least partly, is a function of a multitude of entrepreneurial decisions about allocations of resources. In every business decision an entrepreneur weighs the expected benefits of certain actions against expected costs. Taxes transform the costs of activities in ways which may not always be straightforward. Thus, it is plausible that a better understanding of the tax system may result in more 'correct' decisions by an entrepreneur and therefore a greater likelihood of a venture's survival in the early stages. Dombrovsky, Paalzow, and Rastrigina attempt to measure entrepreneurs' understanding of the tax system by using a simple test consisting of six questions. Essentially, entrepreneurs were asked how (i) hiring an employee, and (ii) purchasing a fixed asset (a computer) would affect the venture's tax liability, i.e. its costs. A substantial variation was found in nascent entrepreneurs' understanding of the tax system. About 19% of entrepreneurs were not able to answer any question correctly, and a median nascent entrepreneur managed to answer two questions correctly. Only 1% of all respondents were able to answer all six questions correctly. Further, regression analysis shows that, controlling for other factors, better knowledge (answering two more questions correctly) of the tax system is associated with a reduction of probability of early startup termination by almost 7 percentage points. This result is of substantial policy relevance as it suggests that efforts to simplify taxation of nascent businesses may result in a substantial increase in the number of nascent ventures that survive after one year.

CONCLUSIONS

Latvia has experienced the deepest recession in the EU with GDP declines of 4.6% in 2008 and 18% in 2009. The GDP decline has been accompanied by a rapidly rising unemployment rate, reaching 17.1% in 2009. According to GEM, the entrepreneurial environment in 2009 substantially deteriorated. People reported fewer business opportunities and greater difficulty in starting and growing a business as compared with the previous year. Nevertheless, growth in early-stage entrepreneurial activity observed in 2008 also continued in 2009 and at a faster pace. Intentions to start a business in the future also increased.

Latvia presents quite an interesting case among GEM countries, seeming to be the country where macroeconomic conditions have had a strong impact on the development of early-stage entrepreneurial activity. Entrepreneurial activity declined in 'good years' and substantially increased in 'bad years'. The push effect (necessity motivation) seems to have been the main driver for the currently observed level of early-stage entrepreneurial activity in Latvia.

Arguably, the contribution of necessity-driven entrepreneurial activity to economic recovery in Latvia may prove to be rather limited. The nature of early-stage entrepreneurial activity during a recession is quite different from years of economic growth. In 2009 entrepreneurs had fewer export-

oriented activities and lower aspirations for future job creation. Nevertheless, these entrepreneurial attempts are very important as they serve to maintain people's income while the economy recovers and new jobs are created.

The financial requirements of nascent entrepreneurs in 2009 decreased as compared with previous years. While this is certainly consistent with a fall in the overall price level, it also signals that start-ups in 2009 are likely to be not such ambitious projects as before i.e. necessity-driven. Informal financing is likely to remain the main source of start-up finance in Latvia. The prevalence of informal investors in Latvia remains quite high in comparison to other GEM countries. This probably reflects difficulty in obtaining financing from formal sources because of the conservative behaviour of banks and other formal investors and may point to relatively low quality of planning and preparation of new projects.

As the recovery in Latvia's economy is projected to be rather slow, it can be expected that in 2010 the increasing trend in early-stage entrepreneurial activity will continue. However, it is likely that the new business ownership rate will rise only marginally, because most business attempts during recession are likely to be transitory or unsuccessful. At the same time, it is expected that the business discontinuation rate may rise.

APPENDIX A: THE GEM APPROACH AND DATA COLLECTION

The Global Entrepreneurship Monitor (GEM) is a research programme started as a partnership between the London Business School (UK) and Babson College (US). Research also involves a consortium of national teams from each of the countries involved in the study. The aim of GEM is to create an annual assessment of levels of entrepreneurial activity across countries. The research identifies different types and phases of entrepreneurial activity and explores a variety of factors both within and across countries that might give rise to systematic differences in entrepreneurship rates.

GEM was initiated in 1999 with 10 countries and expanded to 54 countries in the 2009 research cycle. GEM is the largest survey-based study of entrepreneurship in the world. More than 100 scholars from the various national teams collaborated with the coordination centre in collecting data and developing the project. Every year each national team is responsible for conducting an adult population survey in its country. The surveys are conducted in strict adherence to the GEM methodology. An extensive description of the GEM methodology may be found in Reynolds *et al.* (2005).

Representative samples of more than 2000 randomly selected adults were surveyed in 54 countries participating in GEM 2009. Similar to previous rounds of GEM, the interview schedule consisted of a set of questions used to derive entrepreneurial activity rates and additional questions concerning the attributes and characteristics of

the respondents as well as their attitudes towards entrepreneurship. In 2009 the GEM study for the first time included an additional section of questions on 'Social Entrepreneurship'. This topic was chosen as a special research area for GEM 2009.

Latvia has been a member of the GEM project since 2005, and continues its participation in the 2010 research cycle. In 2009 the GEM adult population survey in Latvia was conducted by a survey vendor, "SKDS". Via telephone interviews, a total of 2003 adults aged 18-64 years old were surveyed during May-June 2009. To ensure better coverage of the population of Latvia, respondents were reached through both mobile phones and fixed-lined telephones. This method allowed construction of a sampling framework covering 94.0% of the adult population of Latvia¹⁶. Mobile telephone numbers were selected from a digital database on randomly generated mobile phone numbers, while fixed-line numbers were selected from district telephone catalogues. In the first place the sample was formed by mobile users because of their dominance in the sample (95% of all telephone users). After the mobile phone quota was achieved, the survey continued via fixed-line telephones. Of fixed-line telephone users, only those who do not have a mobile phone were interviewed to ensure no overlap between mobile and fixed-line phone coverage. Observations in the sample were weighted by age, gender, ethnicity, geographical region, and urban/rural division. Thus, GEM findings can be reliably generalised to the whole of Latvia's population.

¹⁶ According to SKDS statistics of 12 months national representative omnibus surveys, in the period from April 2008 to March 2009, 6.0% of the adult population of Latvia had no telecommunication.

APPENDIX B: SELECTED QUESTIONS FROM THE GEM ADULT POPULATION SURVEY

Screening questions

Which of the following would apply to you?

No.	Statements	Yes	No	Don't know	Refused
1a	You are, alone or with others, currently trying to start a new business, including any self-employment or selling any goods or services to others	1	2	8	9
1b	You are, alone or with others, currently trying to start a new business or a new venture for your employer - an effort that is part of your normal work	1	2	8	9
1c	You are, alone or with others, currently the owner of a company you help manage, self-employed, or selling any goods or services to others	1	2	8	9
1d	You have, in the past three years, personally provided funds for a new business started by someone else, excluding any purchases of stocks or mutual funds	1	2	8	9
1e	You are, alone or with others, expecting to start a new business, including any type of self-employment, within the next three years	1	2	8	9
1f	You have, in the past 12 months, sold, shut down, discontinued or quit a business you owned and managed, any form of self-employed, or selling goods or services to anyone	1	2	8	9

Questions on the entrepreneurial environment

Which of the following would apply to you?

No.	Statements	Yes	No	Don't know	Refused
1g	You know someone personally who started a business in the past 2 years	1	2	8	9
1h	In the next six months there will be good opportunities for starting a business in the area where you live	1	2	8	9
1i	You have the knowledge, skill and experience required to start a new business	1	2	8	9
1j	Fear of failure would prevent you from starting a business	1	2	8	9
1k	In Latvia, most people would prefer that everyone had a similar standard of living	1	2	8	9
1l	In Latvia, most people consider starting a new business a desirable career choice	1	2	8	9
1m	In Latvia, those successful at starting a new business have a high level of status and respect	1	2	8	9
1n	In Latvia, you will often see stories in the public media about successful new businesses	1	2	8	9

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