



Global Entrepreneurship Monitor

2010 Latvia Report

Marija Krumina

Olga Rastrigina

with contributions by **Anders Paalzow**

Arnis Sauka

Talis Putnins

Vitalijs Jascisens

Sponsored by TeliaSonera

The TeliaSonera Institute at the Stockholm School of Economics in Riga



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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 2010 Latvia participated in the GEM project for the sixth time. The current volume represents the Latvian Country Report based on original data collected in Latvia for GEM. In addition to reporting the findings of the GEM research as such, this year's report features four chapters taking an in-depth look at various aspects of Latvian entrepreneurship. These four chapters address: Latvia's entrepreneurial performance in an international perspective using data from the Global Entrepreneurship Development Index (GEDI); the increase in start-ups following the economic crisis and whether it reflects an increase in genuine business activity or if it more is to be seen as disguised unemployment; the size of the shadow economy in Latvia with a comparison to Estonia and Lithuania and its implications for entrepreneurship; and innovations in Latvia.

The Latvian participation in the Global Entrepreneurship Monitor would not have been possible without the generous support of TeliaSonera 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 wages 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 2010 Latvia Report provides detailed information on the latest trends in entrepreneurial activity and entrepreneurial spirit in Latvia. The report offers an international comparison with other countries participating in the GEM project. It discusses the impact of the crisis and evaluates the scope of entrepreneurial activity. Four additional chapters are contributed to the current report. These chapters aim at providing in-depth information on various aspects of Latvian entrepreneurship. The topics of the additional chapters are focused on Latvia's entrepreneurial performance in an international perspective using data from the Global Entrepreneurship Development Index (GEDI); creation of understanding whether a big inflow of start-ups observed after the crisis can be interpreted as an increase in genuine business activity or as development of another form of disguised unemployment; measurement of the size of shadow economies in the Baltic countries and exploration of the main factors of participating in the shadow economy; and last but not least - innovations in Latvia. We hope that the analysis included in this report will be informative for policy makers as well as for the business and academic community.

According to the GEM survey, slightly more than 142 thousand people were involved in early-stage entrepreneurial activity in Latvia in 2010. This represents about 9.7% of the adult population of the country. About 40% of all early-stage entrepreneurs in Latvia were owners of new businesses, the rest were actively involved in starting a business. Latvia demonstrated the second highest rate of early-stage entrepreneurial activity among the Central and Eastern European countries covered in the GEM project (e.g. Romania, Hungary, Russia, Montenegro, Macedonia). 7.6% of the adult population were own-

ers and managers of established firms running a business for at least 3.5 years and 21% of the adult population in Latvia had thoughts to start a business within the following three years.

Compared to the previous year in 2010 the prevalence rate of nascent entrepreneurs increased only marginally, while the prevalence of new business owners fell. As in the two preceding years the discontinuation rate continued to increase. The discontinuation rate for Latvia in 2010 was rather high (4.2%) compared to Eastern European countries participating in the GEM project (with the exception of Montenegro (7.3%)), as well as compared to Russia (0.8%), the Nordic countries, and Germany (1.5%). Business non-profitability and problems obtaining finance were among the main reasons for business exit in Latvia.

Despite the fact that the level of necessity-driven entrepreneurs started to decrease in 2010, it is still rather high (27% of total early-stage entrepreneurial activity). The level of necessity-driven entrepreneurship for Latvia is still significantly higher compared to the median for the EU-15, but the difference is smaller compared to the previous year. As compared to European Union countries, the level of necessity-driven entrepreneurship in early-stage entrepreneurial activity for Latvia is quite similar to what is observed in Ireland, Greece, Germany, Spain, France and Portugal, but is higher in comparison to Finland (18%), Sweden (13%) and Denmark (8%).

More people in 2010 saw good business opportunities compared to the previous year, while the entrepreneurial intentions of people who were not yet involved in entrepreneurship have also increased. We hope that this reflects Latvia's gradual recovery from the economic crisis.

A smaller proportion of early-stage entrepreneurs in Latvia had a belief that starting and growing a business was more difficult in the current year as compared to one year ago. Such positive and particularly noticeable developments among Eastern European countries were found not only in Latvia but also in Hungary. However, many countries among innovation-driven economies remained pessimistic with the exception of Finland, Slovenia and Iceland. A rather large proportion of early-stage entrepreneurs still believe that business opportunities were fewer compared to one year ago.

Early-stage entrepreneurs in Latvia are quite distinct from other groups of people. Even after the crisis, business starters remained quite different, and can hardly be considered similar to the disguised unemployed.

Fewer new technologies were used after the crisis. A large negative break in terms of innovations in Latvia was also identified, using the unique firm

level SIBiL dataset. Furthermore, in terms of employing new technologies, the findings revealed a significant difference between domestically and foreign-owned firms, with the foreign firms doing much better.

The size of the shadow economy in Latvia (38.1% of GDP in 2010) is close to double that of the neighbouring countries of Estonia (19.4%) and Lithuania (18.8%). Younger firms and firms in the construction sector tend to engage in more shadow activities compared correspondingly to older firms and firms in other sectors. This is a problem not only in terms of lost tax revenues, but also in the sense that it creates unfair competition or an uneven playing field between business operating in the shadow economy and those that do not. Furthermore, it also creates a distortion in favour of labour intensive companies in the cash-based part of the economy, e.g. the service sector, at the expense of innovation-based companies employing capital intensive technologies.

EXECUTIVE SUMMARY IN LATVIAN

KOPSAVILKUMS

Latvijas 2010. gada GEM Ziņojums sniedz detalizētu informāciju par jaunākajām uzņēmējdarbības aktivitātes tendencēm un uzņēmējdarbības garu Latvijā. Ziņojums piedāvā starptautisku salīdzinājumu ar pārējām GEM projekta dalībvalstīm. Ziņojumā apskatīta krīzes ietekme uz uzņēmējdarbību un novērtēts uzņēmējdarbības aktivitātes vēriens. Ziņojums ir papildināts ar četrām nodaļām, kuru mērķis ir nodrošināt padziļinātu informāciju par dažādām Latvijas uzņēmējdarbības sfērām. Papildus nodaļu tēmas ir orientētas uz Latvijas uzņēmējdarbības sniegumu starptautiskā līmenī, izmantojot datus no Globālā Uzņēmējdarbības Attīstības Indeksa (*Global Entrepreneurship Development Index (GEDI)*); izpratnes veidošanu par to, vai pēc krīzes novērotais jaunu uzņēmumu pieaugums var tikt interpretēts kā reāls biznesa aktivitātes pieaugums, vai kā slēpta bezdarba paveida attīstība; ēnu ekonomikas apmēriem Baltijas valstīs un galveno faktoru izpēti dalībai ēnu ekonomikā; un visbeidzot, bet ne mazāk svarīgi – inovācijām Latvijā. Mēs ceram, ka ziņojumā iekļautā analīze būs informatīva un noderīga gan politikas veidotājiem, gan uzņēmējiem un pētniekiem.

Saskaņā ar GEM pētījumu, Latvijā 2010. gadā nedaudz vairāk kā 142 tūkstoši cilvēku ir bijuši iesaistīti agrīnās stadijas uzņēmējdarbības aktivitātēs. Tie ir aptuveni 9.7% no visiem pieaugušajiem iedzīvotājiem valstī. Aptuveni 40% agrīnās stadijas uzņēmēju Latvijā ir bijuši jaunu uzņēmumu īpašnieki, bet pārējie individuāli ir bijuši aktīvi iesaistīti uzņēmējdarbības uzsākšanā. Latvija uzrāda otro augstāko agrīnās stadijas uzņēmējdarbības rādītāju Centrāleiropas un Austrumeiropas valstu vidū, kas apskatītas GEM projekta ietvaros (piemēram, Rumānija, Ungārija, Krievija, Montenegro, Maķedonija).

7.6% no pieaugušajiem iedzīvotājiem ir bijuši jaunu uzņēmumu īpašnieki vai vadītāji vismaz 3.5 gadus, un 21% no pieaugušajiem iedzīvotājiem Latvijā ir domājuši par uzņēmējdarbības uzsākšanu turpmāko trīs gadu laikā.

Salīdzinot ar iepriekšējo gadu, 2010. gadā topošo uzņēmēju īpatsvars ir palielinājies tikai nedaudz, bet jaunu uzņēmumu īpašnieku skaits samazinājies. Līdzīgi kā divos iepriekšējos gados, pārtraukto uzņēmējdarbību rādītājs turpināja pieaugt. 2010. gadā Latvijā pārtraukto uzņēmējdarbību rādītājs bija samērā augsts (4.2%), salīdzinot ar Austrumeiropas valstīm, kas piedalās GEM projektā (izņēmums ir Montenegro (7.3%)), kā arī salīdzinot ar Krieviju (0.8%), Ziemeļvalstīm un Vāciju (1.5%). Galvenie uzņēmējdarbības pārtraukšanas iemesli Latvijā bija zemais biznesa ienesīgums un grūtības iegūt finansējumu.

Neskatoties uz to, ka 2010. gadā nepieciešamības spiesto uzņēmēju īpatsvars sāka samazināties, tas joprojām ir salīdzinoši augsts (27% no kopējās agrīnās stadijas uzņēmējdarbības aktivitātes). Nepieciešamības spiesto uzņēmēju līmenis Latvijā joprojām ir ievērojami augstāks, salīdzinot ar ES-15 vidējo līmeni, tomēr starpība ir samazinājusies, ja salīdzina ar iepriekšējo gadu. Salīdzinot ar citām Eiropas Savienības valstīm, Latvijā nepieciešamības spiestu uzņēmēju rādītājs agrīnajā uzņēmējdarbības aktivitātes stadijā ir visai līdzīgs ar Īrijas, Grieķijas, Vācijas, Spānijas, Francijas un Portugāles rādītājiem, tomēr augstāks salīdzinājumā ar Somiju (18%), Zviedriju (13%) un Dāniju (8%).

Salīdzinot ar iepriekšējo gadu, 2010. gadā pieauga to cilvēku skaits, kuri saskatīja labas biznesa iespējas, kā arī ir augušas uzņēmējdarbības

ieceres cilvēkiem, kuri vēl nav iesaistījušies uzņēmējdarbībā. Mēs ceram, ka tas atspoguļo Latvijas pakāpenisku atgūšanos no ekonomiskās krīzes.

Ir samazinājusies agrinās stadijas uzņēmēju proporcija, kuri uzskatīja, ka 2010. gadā Latvijā uzsākt un attīstīt biznesu ir bijis grūtāk, nekā gadu iepriekš. Starp Austrumeiropas valstīm šāda pozitīva un ievērojama augšupeja tika konstatēta ne tikai Latvijā, bet arī Ungārijā. Tomēr daudzās valstīs, kur ekonomika balstās uz inovācijām, ir saglabājies pesimistisks noskaņojums, izņemot vien Somiju, Slovēniju un Īslandi. Diezgan liela daļa agrinās stadijas uzņēmēju joprojām uzskata, ka biznesa iespēju ir bijis mazāk nekā gadu iepriekš.

Agrinās stadijas uzņēmēji Latvijā ievērojami atšķiras no citām cilvēku grupām. Pat pēc krīzes pārvarēšanas uzņēmējdarbības uzsācēji joprojām ir diezgan atšķirīgi, un diez vai var tikt pielīdzināti slēptajiem bezdarbniekiem.

Pēc krīzes ir sarucis uzņēmējdarbībā izmantoto jauno tehnoloģiju skaits. Latvijā tika novērots

negatīvs pārtaukums inovāciju jomā arī izmantojot unikālu uzņēmumu limeņa datubāzi – SIBiL. Turklāt, runājot par jaunu tehnoloģiju izmantošanu, rezultāti atklāja būtiskas atšķirības starp vietējo un ārzemju īpašnieku uzņēmumiem, kur starptautisko uzņēmumu stāvoklis ir ievērojami labāks.

Ēnu ekonomikas apmēri Latvijā (38.1% no IKP 2010. gadā) ir gandrīz divtik lielāki kā kaimiņvalstīs Igaunijā (19.4%) un Lietuvā (18.8%). Jaunākiem uzņēmumiem, kā arī uzņēmumiem, kas darbojas būvniecības nozarē, ir tendence biežāk iesaistīties ēnu ekonomikas aktivitātēs, salīdzinot ar attiecīgi vecākiem uzņēmumiem un uzņēmumiem citās nozarēs. Tas rada ne tikai nodokļu ieņēmumu zaudējumus, bet arī negodīgu konkurenci vai nevienlīdzīgus konkurences apstākļus starp tiem uzņēmumiem, kas iesaistījušies ēnu ekonomikā, un tiem, kas nav. Turklāt tas rada ekonomikas deformāciju par labu darbaspēka ietilpīgiem uzņēmumiem uz skaidru naudu balstītā ekonomikas daļā, piemēram, pakalpojumu nozarē, uz to uzņēmumu rēķina, kas balstīti uz inovācijām un izmanto kapitālietilpīgas tehnoloģijas.

1. INTRODUCTION TO THE GEM PROJECT

The Global Entrepreneurship Monitor (GEM) is a not-for-profit academic research consortium that evaluates 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 by the London Business School and Babson College (USA) in 1999 with ten countries, the GEM research consortium had expanded to 59 countries by 2010. GEM is the largest single study of entrepreneurial activity in the world with the most geographically and economically diverse sample. Its contribution to knowledge and understanding of the entrepreneurial process in a global context is unique.

The three main objectives of the Global Entrepreneurship Monitor 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 the 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. GEM also considers the attitudes representing the climate for entrepreneurship in society. Finally, GEM offers a framework for conducting research on special topics in entrepreneurship (e.g. intrapreneurship, social entrepreneurship, entrepreneurial education) in an international context as well as enabling comparisons between entrepreneurial activities within and across geographic regions.

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 59 countries participating in GEM in 2010.

A professional survey provider, "SKDS" conducted the GEM adult population survey in Latvia in 2010. Via telephone interviews, a total of 2001 adults aged 18-64 years old were surveyed during May – (early) July 2010.

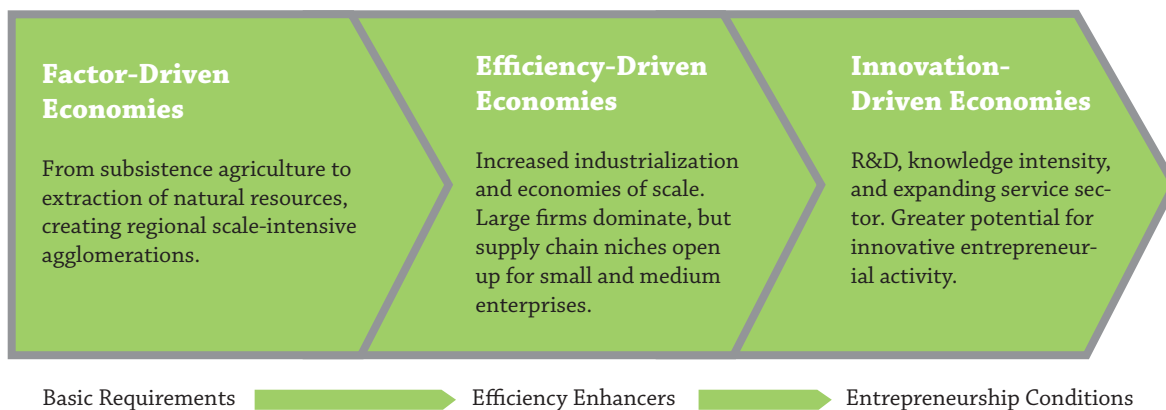
ENTREPRENEURSHIP AND STAGES OF ECONOMIC DEVELOPMENT

One of the main tasks of GEM is to understand the relationship between entrepreneurship and national economic development.

GEM groups countries into three stages of economic development as defined by the World Economic Forum's Global Competitiveness Report 2010–2011 (Schwab, 2010): Factor-driven, Efficiency-driven and Innovation-driven. This division is based on the level of GDP per capita and the extent to which countries are factor-driven in terms of the share of exports of primary goods in total exports. It is important to keep in mind that all three types of economic activity are present in all national economies, but their input to

economic development and relative dominance varies. Figure 1 shows the characteristics of these economic groups and the key development focus at each level. This classification of countries is discussed in more detail in the Global Competitiveness Report. Latvia according to the 2011–2012 Global Competitiveness Report is in transition between being Efficiency-Driven and Innovation-Driven, i.e. in the same group as Estonia and Lithuania and several other Eastern European EU member states – noticeable exceptions being the Czech Republic and Slovenia, which are at the third stage, Innovation-Driven, and Bulgaria and Romania, which are at the second stage, Efficiency-Driven Economies.

Figure 1: Characteristics of Economic Groups and Key Development Focus



Source: GEM 2010 Executive Report.

Basic requirements such as development of institutions, infrastructure, macroeconomic stability, health, and primary education are crucial to generation of a sustainable business environment for factor-driven economies with a prevalence of necessity-driven entrepreneurship. With further progress and relevance of scale economies, conditions that ensure proper functioning of the market become more important. These conditions are also called efficiency enhancers and include, e.g. higher education and training, the goods market

and labour market efficiency, and financial market sophistication. For innovation-driven economies entrepreneurship conditions (e.g., entrepreneurial finance, government entrepreneurial policies, entrepreneurial education) are the main factors stimulating economic development.

The contribution of entrepreneurs to an economy to a large extent depends on the phase of economic development. Figure 2 states the role of entrepreneurship in different phases of economic development.

Figure 2: The Role of Entrepreneurship in Different Phases of Economic Development

Entrepreneurship in Factor-Driven Economies

Economic development consists of changes in the quantity and character of economic value added (Lewis, 1954). These changes result in greater productivity and rising per Capita incomes, and they often coincide with migration of labor across different economic sectors in society, for example from primary and extractive sectors to the manufacturing sector, and eventually, services (Gries and Naude, 2008). Countries with low levels of economic development typically have a large agricultural sector, which provides subsistence for the majority of the population who mostly still live in the countryside. This situation changes as industrial activity starts to develop, often around extraction of natural resources. As extractive industry starts to develop, this triggers economic growth, prompting surplus population from agriculture to migrate toward extractive and emergent scale-intensive sectors, which are often located in specific regions. The resulting oversupply of labor feeds subsistence entrepreneurship in regional agglomerations, as surplus workers seek to create self-employment opportunities in order to make a living.

Entrepreneurship in Efficiency-Driven Economies

As the industrial sector develops further, institutions start to emerge to support further industrialization and the build up of scale in the pursuit of higher productivity through economies of scale. Typically, national economic policies in scale intensive economies shape their emerging economic and financial institutions to favor large national businesses. As increasing economic productivity contributes to financial capital formation, niches may open in in-

dustrial supply chains that service these national incumbents. This, combined with the opening up of independent supplies of financial capital from the emerging banking sector, would spur opportunities for development of small scale and medium-sized manufacturing sectors. Thus, in a scale-intensive economy, one would expect necessity-driven industrial activity to gradually fall and give way to an emerging small scale manufacturing sector.

Entrepreneurship in Innovation-Driven Economies

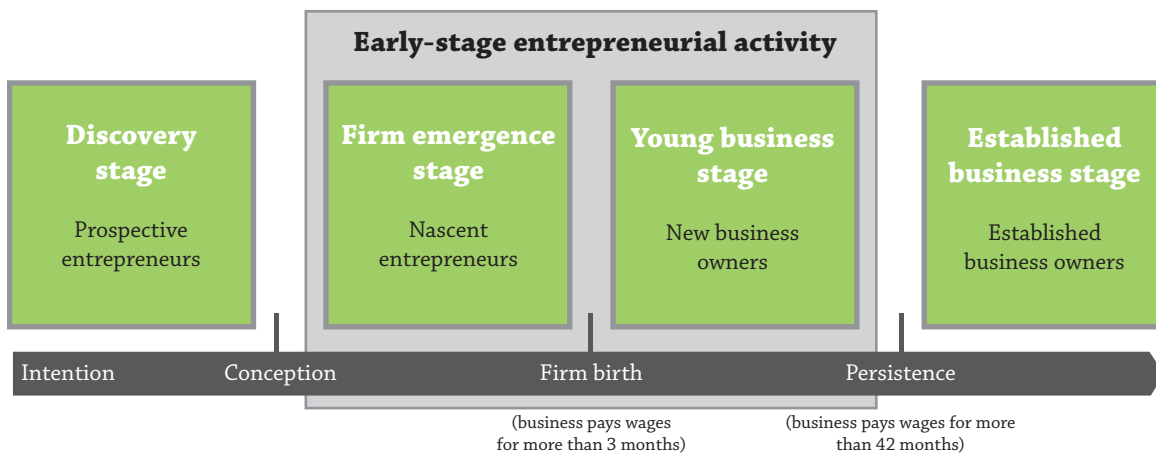
As an economy matures and its wealth increases, one may expect the emphasis in industrial activity to gradually shift toward an expanding service sector that caters to the needs of an increasingly affluent population and supplies the services normally expected of a high-income society. The industrial sector evolves and experiences improvements in variety and sophistication. This development would typically be associated with increasing research & development and knowledge intensity, as knowledge-generating institutions in the economy gain momentum. This development opens the way for development of innovative, opportunity-seeking entrepreneurial activity that is not afraid to challenge established incumbents in the economy. Often, small and innovative entrepreneurial firms enjoy an innovation productivity advantage over large incumbents, enabling them to operate as 'agents of creative destruction.' To the extent that economic and financial institutions created during the scale-intensive phase of the economy are able to accommodate and support opportunity-seeking entrepreneurial activity, innovative entrepreneurial firms may emerge as significant drivers of economic growth and wealth creation.

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 3 demonstrates these stages. The definitions used in Figure 3 are explained in the GEM Terminology section on page 8.

Figure 3: Stages of the entrepreneurial process in GEM



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

In that light, GEM data collection observes several points in the life-cycle of the entrepreneurial process, by looking at individuals:

- when they intend to start a business within three years (prospective entrepreneurs),
- when they commit resources or start a business (nascent entrepreneurs),
- when they own and manage a new business that has paid wages for more than three months but less than 42 months (new business owners), and
- when they own and manage an established business that has been in operation for more than 42 months (3.5 years) (established business owners).¹

For GEM, paying wages for more than three months to anybody, including the owner, is considered to be the “birth event” of actual businesses. Businesses that have paid salaries and wages

for more than three months and less than 42 months are considered to be new.

When considered together, nascent entrepreneurs and new business owners may be viewed as an indicator of early-stage entrepreneurial activity in a country. Business owners who have paid salaries and wages for more than 42 months are classified as “established business owners.” Their businesses have survived the liability of newness.

Research on early-stage business activity based on official data may suffer from serious selection bias because it looks only at successful start-ups. Nascent entrepreneurs may not yet have registered their businesses so that official data based on the Enterprise Register often do not completely cover early-stage activity. 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.

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).

2. SCOPE OF ENTREPRENEURIAL ACTIVITY

According to the GEM survey, 9.7% of the adult population of the country, which corresponds to slightly more than 142 thousand people, were involved in early-stage entrepreneurial activity in Latvia in 2010. 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 40% of early-stage entrepreneurs in Latvia were owner-managers of new businesses no older than 3.5 years². The rest were actively involved in starting new businesses. The prevalence of new business owners was 4.2%. The prevalence of nascent entrepreneurial activity in the adult population of Latvia was 5.6%.

The GEM screening procedure also allowed identification of *entrepreneurial intentions* of individuals, i.e. defining individuals who were thinking of starting a business within three years. In 2010 there were some 21% such individuals in the adult population in Latvia. Prospective entrepreneurial activity describes possible future tendencies of entrepreneurship development.

About 111 thousand people (7.6% of the adult population) in Latvia were *owners and managers of established firms*, which are at least 3.5 years old. Established entrepreneurship describes business owners whose businesses have already proved to be sustainable, i.e. those who form the basis of entrepreneurial activity in Latvia.

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 2010.

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 and are sorted by early-stage entrepreneurial activity within each group.

The first group – *innovation-driven countries* – includes most of the high-income countries participating in GEM. Aiming at a broader perspective of development of entrepreneurial activity in the EU as a whole and to assess Latvia's performance in comparison with other EU countries, we report separately the innovation-driven countries that are members of the European Union and countries outside the EU. Innovation-driven EU countries include Belgium, Denmark, Finland, France, Germany, Greece, Italy, Ireland, the Netherlands, Portugal, Slovenia, Spain, Sweden and the UK. The highest rates of entrepreneurial activity in this group are for the Netherlands and Ireland. The highest rates of entrepreneurial activity for the whole group of innovation-driven economies are identified in countries outside the EU, e.g. Australia, Iceland, Norway, and the United States.

The second group is *efficiency-driven countries*. This group includes three of the new EU member states participating in GEM (Romania, Hungary, and Latvia³). Russia and the Balkan countries are also classified as efficiency-driven. Among these countries Latvia demonstrates the second highest rate of early-stage entrepreneurial activity. Montenegro has the highest rate and Macedonia 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

² Some individuals are simultaneously involved in several business activities at different stages of development. When calculating early-stage entrepreneurial activity, these individuals are counted only once.

³ Slovenia is an exception. Because of its high level of development it is considered to be an innovation-driven country.

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. The main reasons for that are probably differences in 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.

Table 1: Prevalence rates of entrepreneurial activity across all GEM countries, 2010

			(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	Iceland	7.4	3.3	10.6	7	68
		Australia	3.9	4.0	7.8	19	59
		Norway	4.4	3.4	7.7	15	74
		United States	4.8	2.8	7.6	28	51
		Korea	1.8	4.8	6.6	39	49
		Israel	3.2	2.6	5.7	29	54
		Switzerland	2.0	3.1	5.0	14	60
		Japan	1.5	1.8	3.3	36	47
	EU	Netherlands	4.0	3.4	7.2	8	64
		Ireland	4.4	2.6	6.8	31	33
		UK	3.2	3.3	6.4	11	43
		France	3.7	2.3	5.8	25	56
		Finland	2.4	3.4	5.7	18	54
		Greece	2.0	3.5	5.5	28	39
		Sweden	2.3	2.6	4.9	13	72
		Slovenia	2.2	2.4	4.7	16	54
		Portugal	1.8	2.8	4.5	22	52
		Spain	2.2	2.1	4.3	25	42
		Germany	2.5	1.8	4.2	26	48
		Denmark	1.8	2.2	3.8	8	54
Belgium	2.3	1.4	3.7	10	54		
Italy	1.3	1.0	2.3	13	55		
Efficiency-driven	Central and Eastern Europe plus Russia	Montenegro	12.0	3.1	14.9	37	38
		LATVIA	5.6	4.2	9.7	27	51
		Macedonia	4.4	3.6	8.0	59	23
		Bosnia and Herzegovina	4.1	4.1	7.7	46	30
		Hungary	4.6	2.6	7.1	20	43
		Croatia	3.8	1.9	5.5	32	49
		Romania	3.3	1.1	4.3	31	47
		Russia	2.1	1.9	3.9	32	30
	Other	Peru	22.1	6.0	27.2	21	47
		Ecuador	10.4	11.5	21.3	28	45
		Colombia	8.6	12.7	20.6	40	41
		Brazil	5.8	11.8	17.5	31	46
		Chile	11.1	6.1	16.8	29	53
		Trinidad and Tobago	8.9	6.4	15.1	14	47
		China	4.6	10.0	14.4	42	34
		Argentina	7.0	7.4	14.2	36	43
		Costa Rica	10.4	3.6	13.5	32	38
		Uruguay	7.8	4.1	11.7	26	54
		Mexico	8.6	2.0	10.5	19	41
		South Africa	5.1	3.9	8.9	36	31
Turkey	3.7	5.1	8.6	37	47		
Taiwan	4.7	3.8	8.4	30	48		
Tunisia	1.7	4.4	6.1	24	48		
Malaysia	1.4	3.6	5.0	12	41		
Factor-driven	All	Vanuatu	31.2	28.2	52.2	38	24
		Bolivia	28.8	14.0	38.6	17	57
		Ghana	10.7	24.6	33.9	37	35
		Zambia	17.3	17.1	32.6	32	41
		Angola	13.6	19.1	32.4	36	30
		Uganda	10.6	22.0	31.3	50	33
		Guatemala	8.3	8.4	16.3	15	27
		Iran	4.8	7.8	12.4	38	39
		Jamaica	5.5	5.1	10.5	42	39
		West Bank & Gaza Strip	7.9	2.6	10.4	32	33
		Saudi Arabia	5.9	35	9.4	10	75
		Pakistan	6.6	2.7	9.1	41	39
Egypt	2.1	4.9	7.0	53	25		

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

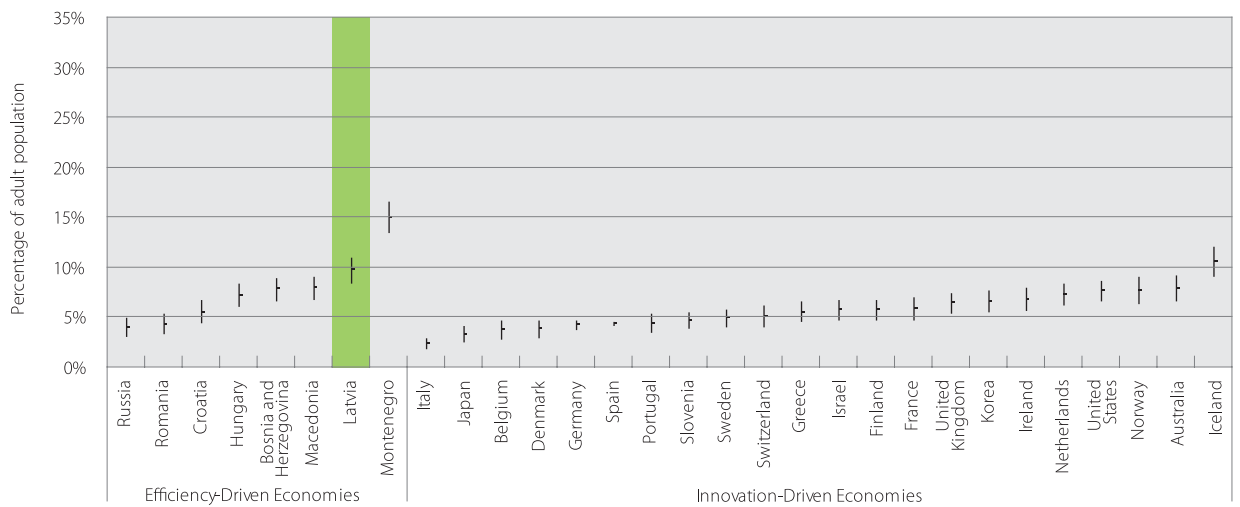
Columns (4) and (5) do not add up to 100%. A category not shown in the table includes early-stage entrepreneurs driven by opportunity but who seek only to maintain their income (not to increase their income or independence).

Source: GEM 2010 Executive Report.

Figure 4 visually demonstrates how the early-stage entrepreneurship rate in Latvia compares with other countries. Latvia has second highest level of early-stage entrepreneurial activity in its comparison group. Compared to countries

within innovation-driven economies, the level of early-stage entrepreneurial activity for Latvia is higher for all selected countries with the exception of Iceland.

Figure 4: Early-stage entrepreneurial activity by country, 2010



Note: The vertical bars in the chart display 95% confidence intervals.
Source: GEM 2010 Executive Report.

Table 2: Entrepreneurial attitudes and perceptions in all GEM countries, 2010

			(1)	(2)	(3)	(4)
	Region	Country	Perceived Opportunities	Perceived capabilities	Fear of failure ^a	Entrepreneurial intentions ^b
Innovation-driven	Non-EU	Iceland	49	49	34	16
		Australia	46	53	36	9
		Norway	50	40	27	8
		United States	35	60	27	8
		Korea	13	29	32	10
		Israel	35	42	46	14
		Switzerland	33	44	27	7
		Japan	6	14	33	3
	EU	Netherlands	45	46	24	5
		Ireland	23	49	33	6
		UK	29	52	30	5
		France	34	37	40	14
		Finland	51	40	29	6
		Greece	16	52	51	13
		Sweden	66	42	29	9
		Slovenia	27	56	28	9
		Portugal	20	52	30	9
		Spain	19	50	36	6
		Germany	28	42	34	6
		Denmark	46	41	32	6
		Belgium	40	45	35	8
		Italy	25	42	37	4
		Efficiency-driven	Central and Eastern Europe plus Russia	Montenegro	36	71
LATVIA	29			51	40	21
Macedonia	34			60	31	27
Bosnia and Herzegovina	38			63	27	17
Hungary	33			43	42	14
Croatia	23			53	31	7
Romania	18			38	41	9
Russia	22			23	42	3
Other	Peru		71	76	34	40
	Ecuador		50	77	31	46
	Colombia		68	65	28	41
	Brazil		48	58	33	26
	Chile		65	66	22	38
	Trinidad and Tobago		69	83	12	30
	China		36	42	32	27
	Argentina		50	64	21	21
	Costa Rica		46	69	36	13
	Uruguay		52	73	28	32
	Mexico		56	65	33	22
	South Africa		41	44	29	17
	Turkey		36	54	25	19
	Taiwan		30	26	44	25
	Tunisia		38	53	23	24
Malaysia	40	24	45	5		
Factor-driven	All	Vanuatu	74	80	47	51
		Bolivia	53	76	28	49
		Ghana	76	75	10	69
		Zambia	81	78	13	67
		Angola	67	73	32	55
		Uganda	81	87	21	77
		Guatemala	63	71	23	31
		Iran	42	66	30	31
		Jamaica	56	80	33	38
		West Bank & Gaza Strip	44	57	40	28
		Saudi Arabia	76	69	39	1
		Pakistan	52	56	34	32
		Egypt	2.1	4.9	7.0	53

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 not involved in entrepreneurial activity.

Source: GEM 2010 Executive Report.

Table 2 describes the entrepreneurial attitudes and perceptions prevailing in GEM countries in 2010. These indicators show the general feelings of the population regarding entrepreneurs and entrepreneurship. GEM measures several indicators of attitudes: the extent to which people think there are good opportunities for starting a business and subjectively assessed capabilities of a country's population to start a business. In almost all innovation driven economies, with the exception of the Nordic countries, and in efficiency driven countries the indicator of perceived capabilities is higher than the indicator of perceived opportunities. This discrepancy can be a signal for the existence of a hidden entrepreneurial potential of the population that may remain undeveloped in unfavourable circumstances. Eastern European countries compared to the rest of the efficiency-driven group show a lower than average opportunity perception. In Latvia, 29% of the adult population perceives good opportunities for starting a business over the next 6 months in the area where they live (Table 2, Column 1). This is an improvement in the indicator compared to last year when only 18% had the same expectation and probably reflects the fact that Latvia is gradually recovering from the economic crisis.

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 fail-

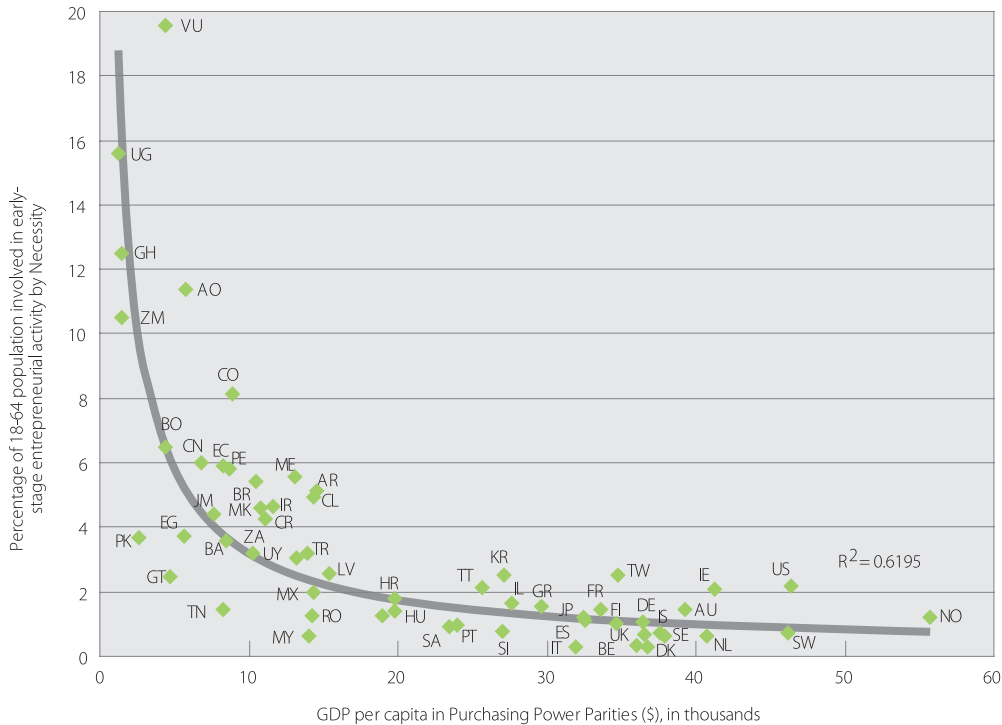
ure. This result is very similar to that reported in 2009. Fear of failure among all GEM economies was highest in Greece, where 51% of individuals who perceive good business opportunities admit that fear of failure can deter them from starting a business.

The entrepreneurial intentions of those people who are not yet active in entrepreneurial activity are presented in column 4. In general, it can be seen that entrepreneurial intentions in EU and Central and Eastern European countries are quite low, with Macedonia, Montenegro, Latvia, Bosnia/Herzegovina showing the highest figures.

As Table 1 shows, average early-stage entrepreneurial activity rates are highest for factor-driven economies. Plotting early-stage entrepreneurial activity against GDP per capita, adjusted for purchasing power parity, reveals a U-shaped relationship. Early-stage entrepreneurial activity rates are highest for the poorest countries, declining rather rapidly and then smoothing out in the efficiency stage until turning upward at increasing levels of wealth (Figure 6).

One of the main reasons for this relationship can be found in the differences between the level of necessity and opportunity-based entrepreneurship at particular levels of GDP.

Figure 5 plots the relationship between necessity-motivated entrepreneurship and GDP per capita for all countries that participated in GEM 2010.

Figure 5: Necessity-based early-stage entrepreneurial activity and per capita GDP, 2010

Source: GEM 2010 Executive Report.

Generally, low levels of GDP per capita are associated with a large number of small enterprises operating in the economy, and therefore high entrepreneurship rates. Necessity-driven entrepreneurship (mainly self-employment) is particularly high at low levels of economic development as demand for jobs is higher than supply. As a result, in order to generate income individuals have to create their own jobs. As GDP per capita grows, more large established firms come into the market, due to industrialization and economies of scale. Simultaneously, employment in large firms increases. The proportion of necessity-driven entrepreneurship declines as a result. However, if income grows further, the role of the entrepreneurial sector becomes important again. The reason for this is that

at the wealthiest societal levels the economic environment allows exploration of abundant opportunities; more individuals can access resources to start entrepreneurial activities themselves. In this stage of development it is mainly opportunity-driven entrepreneurship in knowledge intensive environments.

Thus, it is not surprising that some developing countries exhibit entrepreneurial rates higher than in the developed EU countries and the US.

Figure 6 below demonstrates this U-shaped relationship between GDP per capita and the early-stage entrepreneurship index in GEM 2010 countries.

Figure 6: Total early-stage entrepreneurial activity rates and per capita GDP, 2010^a

^a Bolivia and Vanuatu are not shown in this figure because their early-stage entrepreneurial activity rates are outsiders.

Source: GEM 2010 Executive Report.

Allocation of early-stage entrepreneurial activity estimates around the line of the best fit can be explained not only by differences in welfare but also, for example, by the demographic situation (i.e. population growth rates and age structure) in a particular country as well as the availability and existence of high professional owner-managers as a result of previous political regimes (e.g. communism), with cultural and institutional characteristics. Setting up a business can be enormously different across the globe.

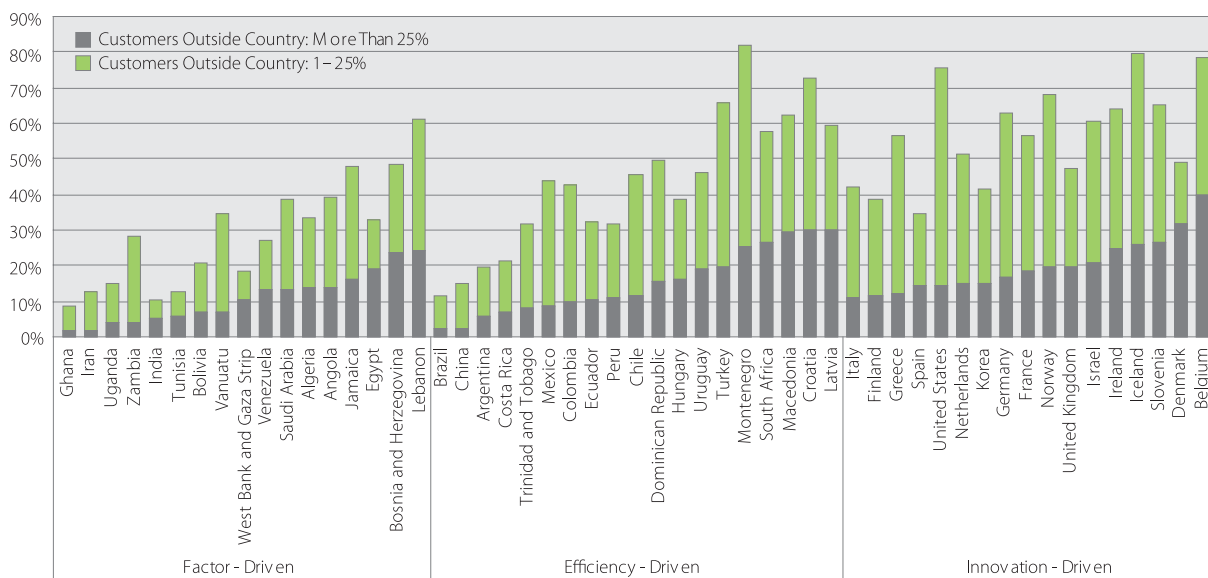
Latvia's early-stage entrepreneurial activity estimate is below the trend line, while the estimate of involvement in early-stage entrepreneurial activity by reasons of necessity appears to be above the trend line of the best fit.

Furthermore, entrepreneurs differ in the level of aspirations they have for their business. They have particular ambitions and beliefs about the growth prospects of their enterprises, have a particular level of innovativeness, willingness to introduce new products or services and create new production processes, different ambitions about entering foreign markets with their products. Therefore, if these aspirations are realized, they can have a significant effect on economic development. Product and process innovation, ambitions for high growth and internalization are regarded as the main characteristics of ambitious entrepreneurship.

One of the measures that describe entrepreneurial aspirations is the international orientation of early-stage entrepreneurs. This measure is based on the proportion of sales to customers outside local economies, i.e. exports, international customers buying online, or traveling to an economy for tourism or business.

Figure 7 shows the percentage of entrepreneurs stating that they have at least some customers, or more than 25% of customers, outside their economies in 2008–2010. Countries are grouped in the three phases of development and sorted within each phase by having more than 25% customers from outside.

Figure 7: Percentage of early-stage entrepreneurs with international orientation, 2008–2010



Source: Own calculations based on GEM 2010 master data.

It can be seen that countries of greater size have a lower international orientation and this is true for each phase of economic development. This is the case in e.g. India, Brazil, Argentina, and China. The United States also has a low share of early-stage entrepreneurs with a significant international orientation, although three fifths have at least some international orientation.

Latvia has the highest international orientation in the group of Efficiency-Driven countries, with the highest percentage of early stage entrepreneurs with more than 25% of customers outside the country. This can be explained by relatively small country size with a small internal market and a good geographical position.

3. RECESSION AND ENTREPRENEURIAL ACTIVITY

Latvia presents an interesting case among GEM countries, seeming to be a country where macro-economic conditions have a strong impact on the development of early-stage entrepreneurial activity. In fact early-stage entrepreneurial activity in Latvia seems to be counter-cyclical. It dropped from 6.6% to 4.4% during the years of high economic growth (2005–2007), and increased to approximately 10% during the crisis (2008–2010). In good years relatively more entrepreneurs were motivated by business opportunity, whereas in bad years more necessity-driven entrepreneurs were motivated by adverse labour market conditions.

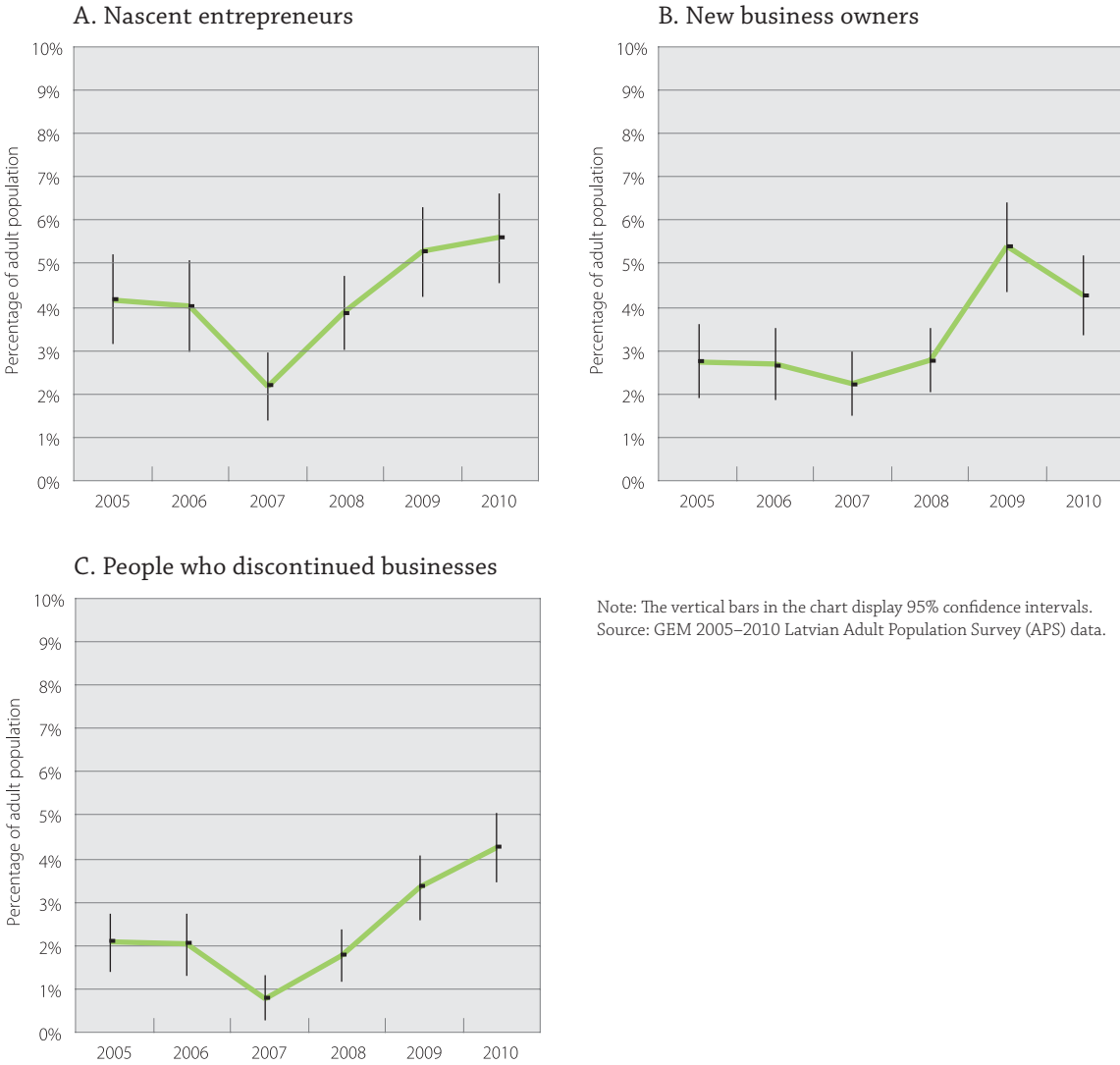
Figure 8 demonstrates tendencies in early-stage entrepreneurship activity in Latvia for the last six years i.e. 2005–2010. As we see the rate of early-stage entrepreneurship was rather stable over 2005 and 2006. Then a noticeable drop occurred in the early-stage entrepreneurship rate in 2007. This was the consequence of favourable conditions in the Latvian labour market and a switch of human resources from entrepreneurship to paid employment. Then a return of early-stage entrepreneurship to previous levels occurred in 2008. As discussed in the GEM 2008 Latvia Report, this

rebound can be explained by the fact that people who lost their jobs or expected wage cuts or even unemployment in the future might have decided to start self-employment or entrepreneurial activity to cope with the economic crisis. A sharp increase in the nascent entrepreneurship rate together with increases in the new business ownership rate and discontinuation rate followed in 2009.

It is arguable whether increases 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 economic crisis.

In 2010 the prevalence rate of nascent entrepreneurs increased only marginally. The prevalence of new business owners fell. This can be treated as a signal that the prediction of very low chances for survival of newly established businesses stated in the previous paragraph turned out to be true.

Figure 8: Indicators of entrepreneurial activity in Latvia, 2005–2010

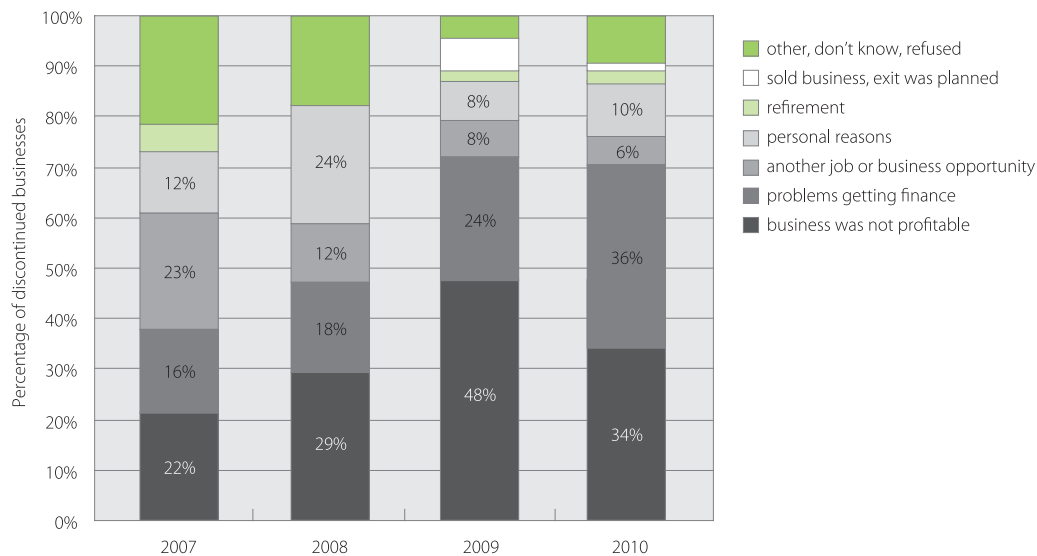


The business discontinuation rate (percentage of the 18–64 age group who in the past 12 months have discontinued a business) for Latvia is rather high compared to CEE countries, the Nordic countries, and Germany. The discontinuation rate started to grow quite substantially from 2008. The main conclusion is that the

proportion of nascent entrepreneurs who do not long survive is rather large.

Business non-profitability and problems obtaining finance are the main reasons for business exit in Latvia in recent years. (See Figure 9)

Figure 9: Reasons for business exit in Latvia, 2007–2010



Source: Own calculations based on GEM 2007–2010 master data.

Entrepreneurship does not impact an economy simply through higher numbers of entrepreneurs. It is very important to evaluate the motivation for entrepreneurship. GEM looks at the main drivers behind engagement in entrepreneurial activity. GEM methodology distinguishes between individuals *pulled* into entrepreneurship because of opportunity recognition (perceiving entrepreneurial opportunity, desire to be independent or earn higher income) and

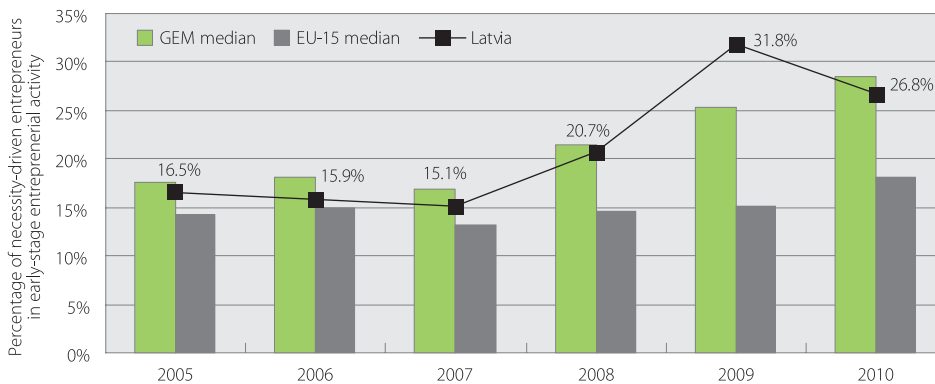
pushed into entrepreneurship for reasons of necessity (limited employment possibilities, threat of unemployment). Individuals that are pushed into entrepreneurial activity because of no alternative options are called ‘necessity-driven entrepreneurs’ and those who are pulled into entrepreneurial activity to pursue a business opportunity are called ‘improvement-driven opportunity entrepreneurs’⁴.

⁴ ‘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).

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 make 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). Despite the fact that the level of necessity-driven entrepreneurs started to decrease in 2010, it is still rather high. About one fourth of all early-stage entrepreneurs are driven by necessity motives. The tendencies of necessity-driven entrepreneurship in Latvia as well as median levels for all countries that participated in GEM surveys in 2005–2010 and EU-15 are illustrated in Figure 10.

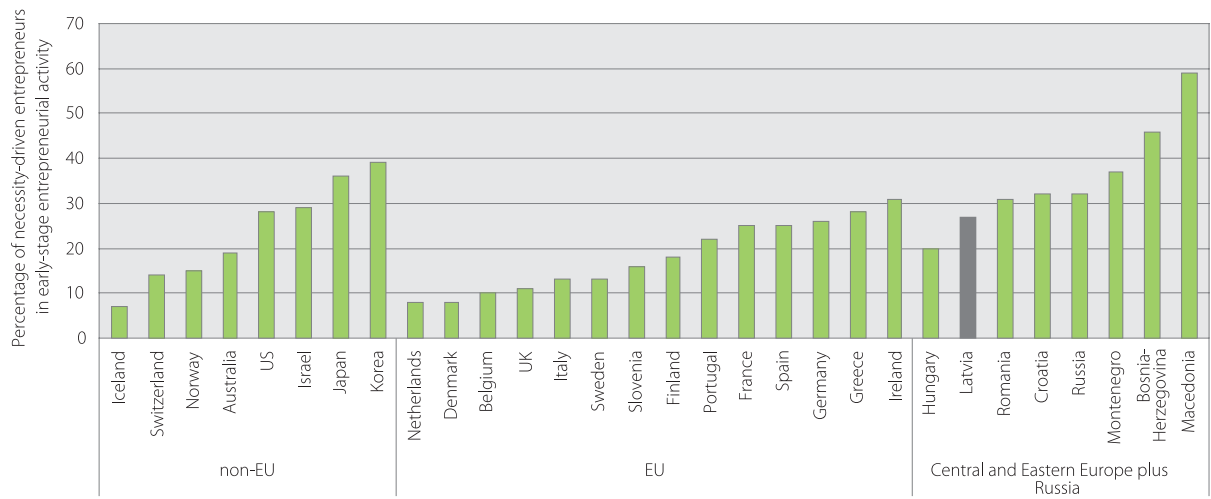
Figure 10: World trends in early-stage necessity-driven entrepreneurial activity, 2005–2010



Source: Own calculations based on GEM 2005–2010 master data.

One can see that compared to 2009 when the level of necessity-driven entrepreneurship for Latvia was above the median for all GEM countries, in 2010 it stands slightly below the median. It is still significantly higher compared to the median for the EU-15, but the difference is substantially smaller compared to the previous year. In 2010 an increase occurred both in the median level of EU-15 countries as well as worldwide on average. The level of necessity-driven entrepreneurship decreased almost for all countries within the Central and Eastern Europe and Russia block with the exception of Bosnia and Herzegovina. The share of entrepreneurship driven by necessity motives also increased in France, Finland and Germany.

Figure 11 demonstrates the percentage of necessity-driven entrepreneurship in early-stage entrepreneurial activity for some GEM countries. Countries are grouped in three categories: non-European Union, European Union and Central and Eastern Europe plus Russia and sorted within each group. The proportion of necessity-driven entrepreneurship is rather small in Latvia compared to other Central and Eastern Europe countries and Russia: only the rate for Hungary is lower. Compared to European Union countries, the level for Latvia is quite similar to what is observed in Ireland, Greece, Germany, Spain, France and Portugal, but is higher in comparison to the Nordic countries.

Figure 11: Proportion of early-stage entrepreneurs driven by necessity motive by country, 2010

Source: Own calculations based on GEM 2010 master data.

In order to evaluate early-stage entrepreneurs' views on the impact of recession, entrepreneurs were asked whether they agree with the following statements:

- Starting a business is more difficult now compared to one year ago;
- Growing a business is more difficult now compared to one year ago;
- Business opportunities are fewer this year as compared to one year before.

Figure 12 illustrates the results for selected GEM countries. It can be seen that 43% of early-stage entrepreneurs in Latvia had a belief that starting a business was more difficult in 2010 than one year before. Compared to the results presented in the GEM 2009 Latvia Report when almost 80% of early stage entrepreneurs believed that starting a business in 2009 was more difficult than one year before, one can conclude that the situation has improved and fewer people remained

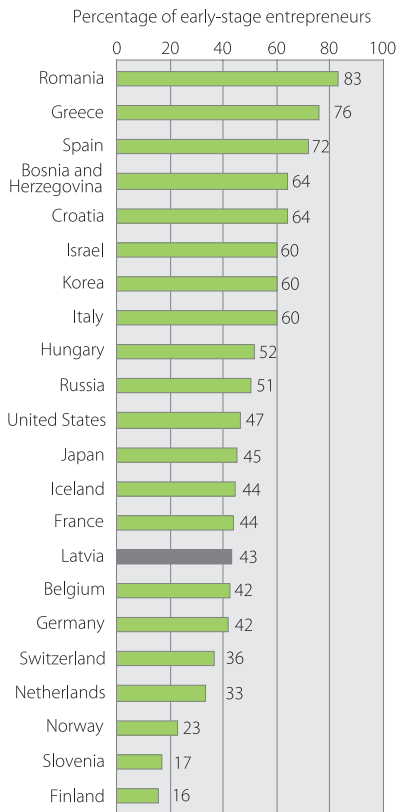
pessimistic about the difficulties of starting a business.

45% of early-stage entrepreneurs in Latvia were thinking that growing a business was more difficult in 2010 compared to one year before. In the previous year the proportion of entrepreneurs thinking that growing a business in the current year was more difficult than in the preceding year was almost 70%. Such positive and particularly noticeable developments among Eastern European countries were found not only in Latvia but also in Hungary. However, many countries among innovation-driven economies remained pessimistic with the exception of Finland, Slovenia and Iceland.

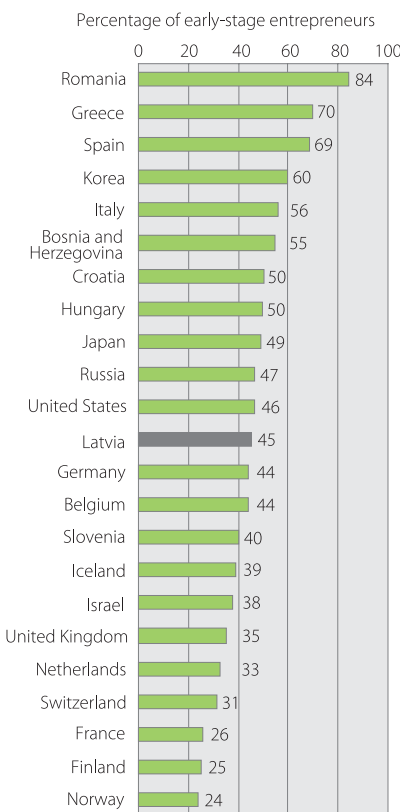
A rather large proportion of early-stage entrepreneurs still believe that business opportunities were fewer compared to one year ago.

Figure 12: Entrepreneurs' views on the impact of recession in selected GEM countries in 2010 (compared to one year ago)

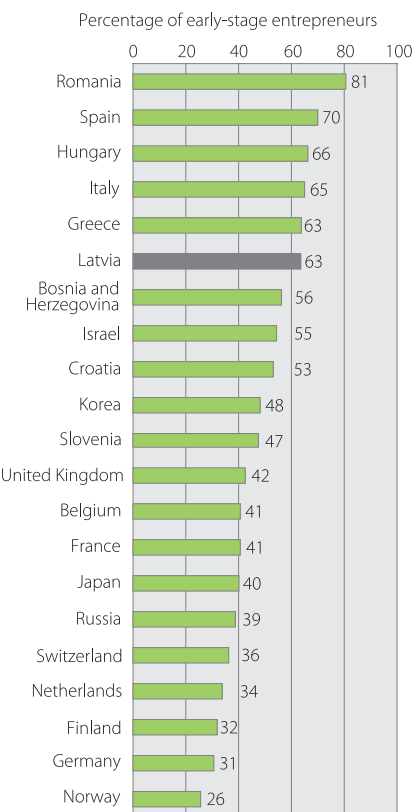
A. Starting a business is more difficult



B. Growing a business is more difficult



C. Business opportunities are fewer



Source: Own calculations based on GEM 2010 master data.

4. BUSINESS START-UPS OR THE DISGUISED UNEMPLOYED

The nature of entrepreneurial activity is dependent on the environment in which it arises. On the one hand, an entrepreneur might be a successful business owner who exploits business opportunities, introduces innovations, exports goods or services to foreign markets, and generates profits for further investment in business. On the other hand, an entrepreneur may be involved in entrepreneurial activity involuntarily, may undertake home production rather than selling goods in the market, and generate zero profits. In the latter case the activities and income of an entrepreneur might differ little from those of an unemployed person. This hypothesis is tested in a paper by John Earle and Zuzana Sakova (2000) in the context of transition economies in the early 1990s, and is partially supported for self-employed individuals.

In Latvia during the crisis the rate of early-stage entrepreneurial activity significantly increased: from 4.4% in 2007 to 9.7% in 2010. The number of new businesses more than doubled. This dra-

matic rise can be interpreted in different ways. It may reflect positive attitudes by the Latvian population towards risk-taking and an entrepreneurial career. It can be related to a drop in factor prices and opportunity cost, or anti-crisis policy measures to support business start-ups. It may also result from severe lack of jobs, and an underdeveloped social security net.

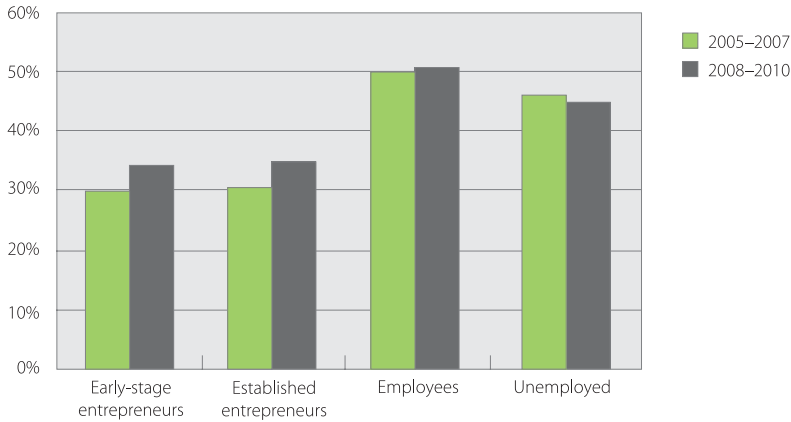
This section looks at the characteristics of early-stage entrepreneurs in Latvia, and compares them to established firm-owners, employees, and unemployed individuals. We exploit all GEM data collected for Latvia during the six years of participation in the GEM project. This gives an opportunity to check how the characteristics of early-stage entrepreneurs have changed over time: before the crisis (2005–2007) and after the crisis (2008–2010). We try to understand whether a big inflow of start-ups observed after the crisis can be interpreted as an increase in genuine business activity or as the development of another form of disguised unemployment.

DEMOGRAPHIC CHARACTERISTICS

A demographic portrait of early-stage entrepreneurs turns out to be very different from that of employees or unemployed (see Figures 13–15). People who start businesses in Latvia are relatively young, with a larger proportion of men and ethnic Latvians. Despite a considerable change

in the number of early-stage entrepreneurs over time, their demographic characteristics such as age, gender, and ethnicity remained quite stable. The only observed change is a slight increase in the share of women among early-stage entrepreneurs after the crisis.

Figure 13: Percentage of women among entrepreneurs and non-entrepreneurs, 2005–2010



Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

Figure 14: Age distribution of entrepreneurs and non-entrepreneurs, 2005–2010



Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

Figure 15: Ethnic structure of entrepreneurs and non-entrepreneurs, 2005–2010



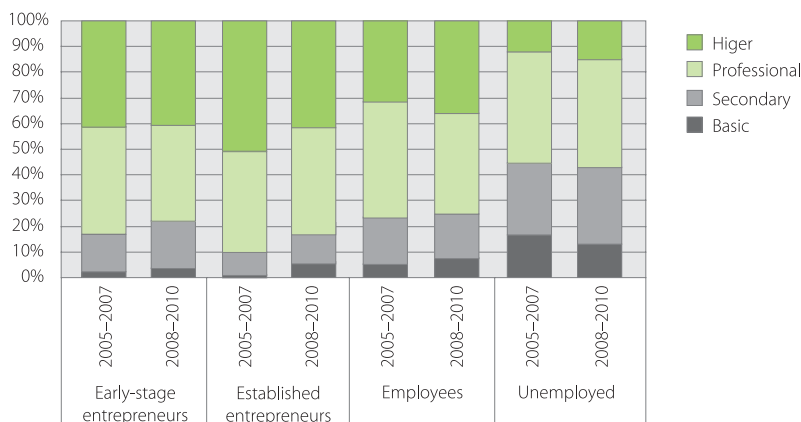
Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

HUMAN CAPITAL AND INCOME

Entrepreneurs have higher educational attainments and income⁵ compared to employees or the unemployed. Surprisingly little difference exists between the income of start-ups and established businesses. This implies that nascent entrepreneurs are likely to be selected from the right tail of income distribution, i.e. people who enter entrepreneurship are likely to have quite good fi-

ancial resources even before entering entrepreneurial activity. After the crisis an inflow of less educated individuals into entrepreneurship occurred, and the financial situation of early-stage entrepreneurs became slightly worse. Nevertheless, in comparison to unemployed individuals early-stage entrepreneurs still look like a privileged group of people.

Figure 16: Educational attainments of entrepreneurs and non-entrepreneurs, 2005–2010



Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

Figure 17: Income distribution of entrepreneurs and non-entrepreneurs, 2005–2010



Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

Notes: Income distribution is based on average household income after taxes.

⁵ Here we use data on average household income, but data on individual incomes collected in 2010 show a very similar result.

PERCEPTIONS

The GEM study collects data on people’s perceptions about entrepreneurial activity and the entrepreneurial environment in the country. The following aspects of the entrepreneurial environment are captured in GEM surveys:

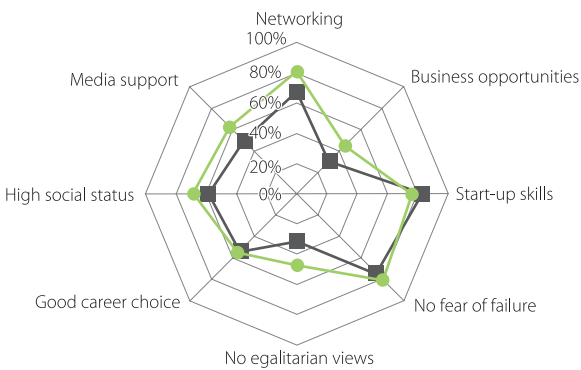
- Personal acquaintance with people who started a business (*Networking*)
- Perceived business opportunities in the next six months (*Business opportunities*)
- Skills and experience in starting up a business (*Start-up skills*)
- Fear of business failure (*Fear of failure*)

- Preference for similar standards of living (*Egalitarian views*)
- Popularity of entrepreneurship as a career (*Good career choice*)
- Social status of successful businessmen (*High social status*)
- Support for entrepreneurship in the mass media (*Media support*)

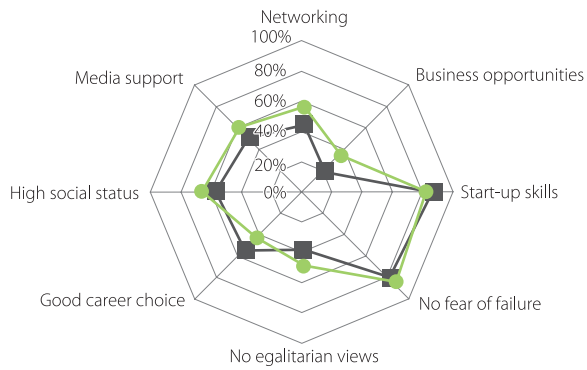
Figure 18 shows the perceptions of entrepreneurs, employees, and unemployed people, and how these perceptions have changed over time.

Figure 18: Perceptions of entrepreneurs and non-entrepreneurs, 2005–2010

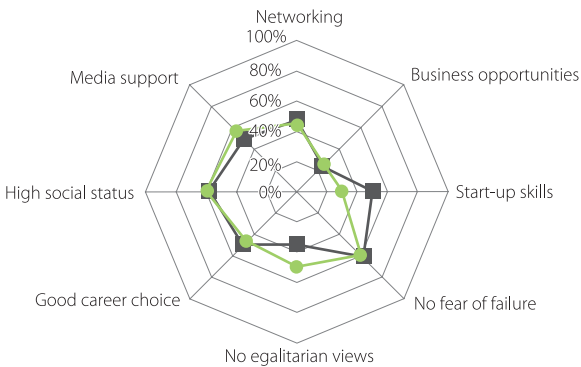
A. Early-stage entrepreneurs



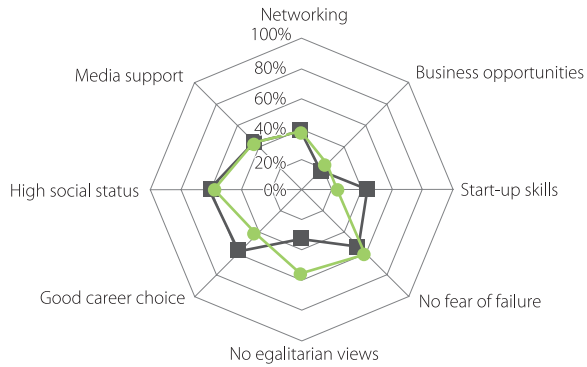
B. Established entrepreneurs



C. Employees



D. Unemployed



● 2005–2007 ■ 2008–2010

Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

Before the crisis, the perceptions of early-stage entrepreneurs differed significantly from those of unemployed people in all the measured dimensions. However, in 2008-2010 the difference shrank, especially with respect to egalitarian views, the popularity of entrepreneurship as a career, and views on the social status of business-

men. Not surprisingly, after the crisis all people regardless of their economic status expressed a greater preference towards similar standards of living. Another considerable change observed in the post-crisis years is a higher self-assessed measure of start-up skills among employees and the unemployed.

TYPE OF BUSINESS

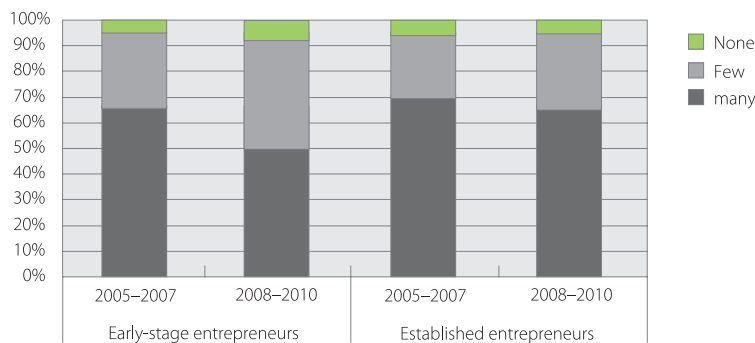
In order to understand whether the nature of entrepreneurial activity has changed after the crisis we compare the business characteristics of early-stage businesses started before the crisis with those started after 2007.

A slight change occurred in the type of business activity: fewer businesses were started in business-oriented services, and slightly more were started in consumer-oriented services. Businesses started after the crisis enjoyed less competition in the markets which they entered (see Figure 19). In comparison to 2005–2007, products offered by new firms in 2008–2010 were more innovative (i.e. new and unfamiliar to customers). This might

be related to a change in consumer preferences, or substitutions of more expensive goods with cheaper options. On the other hand, technologies used after the crisis have become less innovative (i.e. fewer new technologies have been used). Chapter 7 of the current Latvian Report states similar findings, hence confirming the observed pattern. This might reflect an attempt to reduce start-ups or might be related to more prudent behaviour by firms regarding long-term investment in business. The extent of export-orientation of early-stage entrepreneurs has not been affected significantly over time (see Figure 22). Not surprisingly, expected job creation has significantly reduced since the crisis (see Figure 23).

Figure 19: Number of competitors, 2005–2010

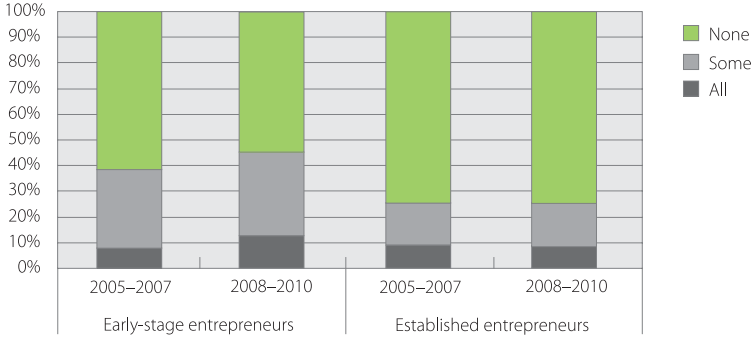
Are there many, few, or no other businesses offering the same products or services to your potential customers?



Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

Figure 20: Newness of products, 2005–2010

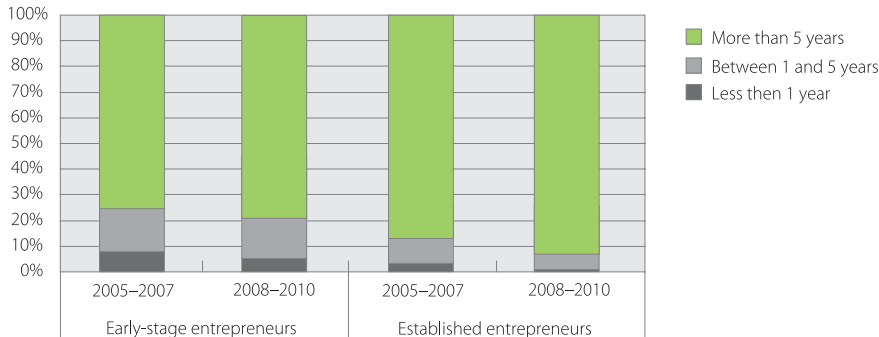
Do all, some, or none of your potential customers consider this product or service new and unfamiliar?



Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

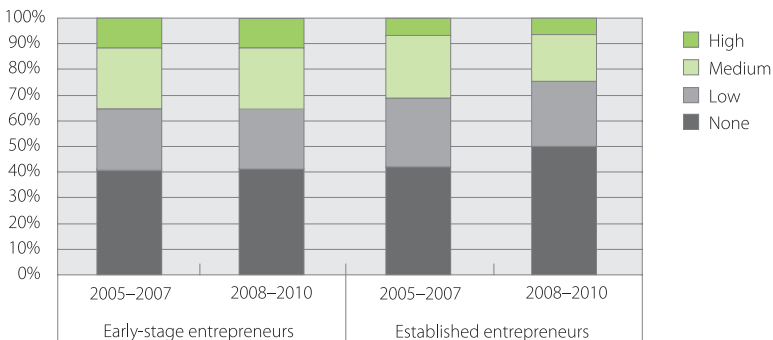
Figure 21: Newness of technology, 2005–2010

Have the technologies required for this product been available for less than a year, or between one to five years, or longer than five years?



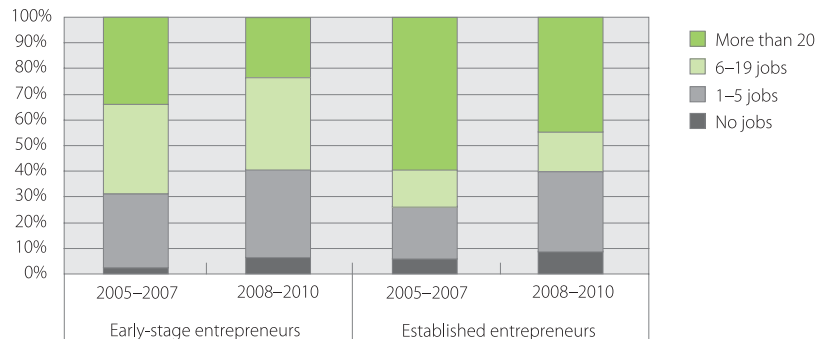
Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

Figure 22: Export orientation of entrepreneurs in Latvia, 2005–2010



Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

Notes: 'High' export orientation means that more than 75% of customers live outside the country; 'medium' – between 10% and 75%; 'low' – under 10%, 'none' – 0%.

Figure 23: Job creation over 5 years, 2005–2010

Source: GEM 2005–2010 Latvian Adult Population Survey (APS) data.

CONCLUSIONS

Early-stage entrepreneurs in Latvia are quite distinct from other groups of people. They differ from both employees and unemployed people in their demographic characteristics, human capital, financial resources and perceptions about entrepreneurial activity and the entrepreneurial environment in Latvia. The crisis slightly affected the financial situation of business start-ups. An inflow of less educated people in entrepreneurship occurred. The perceptions of entrepreneurs and non-entrepreneurs changed in such a way that brought these two groups closer together. However, even after the crisis business starters remained

quite different, and can hardly be considered similar to the disguised unemployed.

The business characteristics of newly started businesses have not dramatically changed over time. But it is likely that the types of products offered have changed: more consumer-oriented goods and services are offered. Fewer new technologies are used in the production process. Businesses started after the crisis are likely to be more prudent with long-term investment in business and more moderate in their growth aspirations.

5. LATVIA AND THE GLOBAL ENTREPRENEURSHIP DEVELOPMENT INDEX

CONTRIBUTED BY ANDERS PAALZOW

This chapter will briefly discuss Latvia's entrepreneurial performance in an international perspective using data from the Global Entrepreneurship Development Index (GEDI) research initiative. Data collected within the GEM initiative is, in addition to the GEM report as such, also published and analysed in the Global Entrepreneurship Development Index (GEDI)^{6,7}. The difference between GEM and GEDI is that GEM mainly focuses on the quantity of entrepreneurship whereas GEDI mainly focuses on the quality of entrepreneurship (although it also captures quantitative aspects of entrepreneurship). In particular it addresses issues related to opportunity driven entrepreneurship and innovation linking them to individual as well as institutional factors.

The Global Entrepreneurship Development Index captures three different dimensions of entrepreneurship – each of them defining a sub-index:

- The entrepreneurial attitude sub-index (ATT) reflects the attitudes of a nation's population

as it relates to entrepreneurship. Aspects covered by the sub-index include attitudes towards recognition of business opportunities and towards failure and fear of failure.

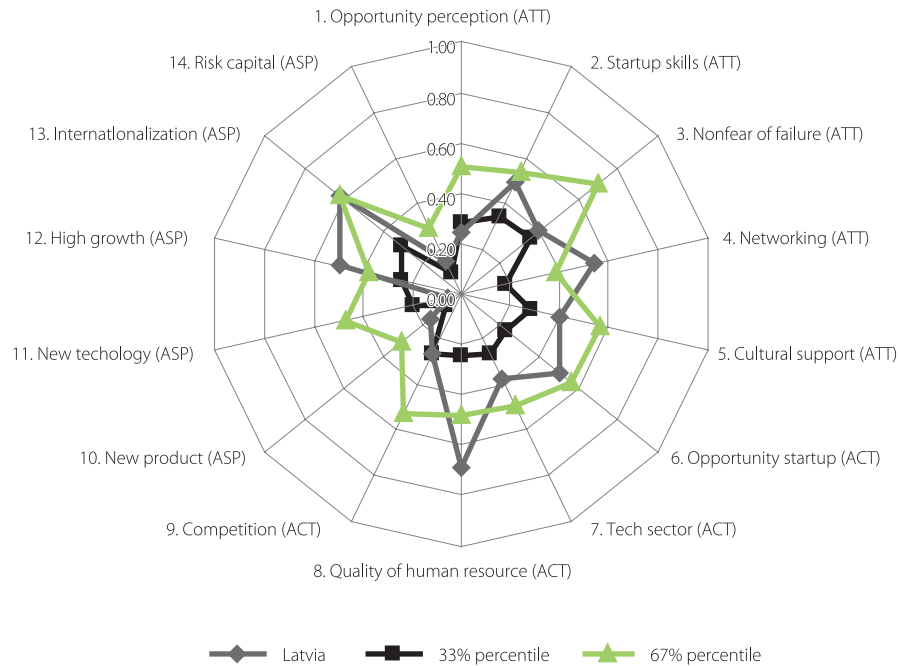
- The entrepreneurial activity sub-index (ACT) focuses on measuring entrepreneurial activity with high growth potential (cf. the GEM measures, which predominantly look at all types of entrepreneurial activity irrespective of growth potential). High growth potential is defined by various quality measures.
- Entrepreneurial aspiration (ASP) identifies the distinctive, qualitative and strategic nature of entrepreneurship. Examples include the newness of a product or technology, growth ambitions and internationalisation.

Each of these sub-indices comprises several dimensions and the findings for Latvia with respect to these dimensions are presented in Figure 24 which benchmarks Latvia against GEDI countries at the same level of economic development – efficiency driven economies.⁸

⁶ The Global Entrepreneurship and Development Index for 2011 is presented in Z.J. Ács and L. Szerb, (2010), *Global Entrepreneurship and Development Index*, Edward Elgar Publishing Ltd. The data for Latvia comes from op. cit. pp 206-209.

⁷ For a discussion of the Global Entrepreneurship Development Index see Z.J. Ács and L. Szerb, (2009), *The Global Entrepreneurship Index*, *Jena Economic Research Papers*, 2009-028.

⁸ The GEDI countries are grouped according to three levels of economic development – factor driven, efficiency driven and innovation driven. See the discussion in Chapters 1 and 2 of this Report.

Figure 24: The relative position of Latvia in the pillar level (efficiency driven)

Source: Z.J. Ács and L. Szerb Global Entrepreneurship and Development Index 2011.

Inspection of Figure 24 reveals that Latvia overall scores particularly poorly in several dimensions of “aspiration” including risk capital, new technology and new products. The only aspirational dimensions where Latvia scores well are internationalisation and high growth. These findings are somewhat surprising since Latvia scores very well in terms of quality of human capital and fairly well in terms of the percentage of early-stage entrepreneurs that are active in technological sectors (tech sector dimension) – dimensions that usually are believed to be positively correlated with new technologies, high growth etc.

As for the other two sub-indices, i.e. attitudes and activity, Latvia scores better. In particular Latvia seems to perform fairly well in terms of attitudes, especially networking and start-up skills with opportunity perception being the exception.

To conclude, if contrasted with discussion of Latvian innovation the picture painted by GEDI to a large extent confirms the findings of Chapters 4 and 7 of the current Latvian GEM Report: Latvian entrepreneurs are not very active in innovative sectors, i.e. sectors that are believed to yield high economic growth. Furthermore, as discussed in these two chapters, one possible explanation for Latvia’s poor performance in terms of innovative entrepreneurship could be found in the economic crisis which the Latvian economy is currently still suffering from. By combining GEM and GEDI data it seems that Latvia does well in terms of quantitative aspects of entrepreneurship whereas it scores poorly in terms of qualitative aspects.

6. ENTREPRENEURSHIP AND THE SHADOW ECONOMY

CONTRIBUTED BY ARNIS SAUKA AND TALIS PUTNINS

This chapter builds on research resulting in the SSE Riga Shadow Economy Index for the Baltic States 2009 and 2010.⁹ The aim of the SSE Riga “Shadow Economy Index” for the Baltic States is to measure the size of the shadow economies in Latvia, Lithuania and Estonia, as well as to explore the main factors that influence participation in the shadow economy. We use the term “shadow economy” to refer to all legal production of goods and services that is deliberately concealed from public authorities.¹⁰ The index is estimated in cooperation with the European Council for Small Business and Entrepreneurship and is intended to be published annually to provide policy makers with information for making justified policy decisions, as well as to foster a deeper understanding of entrepreneurship processes in Latvia, Lithuania and Estonia.

The SSE Riga “Shadow Economy Index” for the Baltic States draws on a survey of a representative sample of company owners/managers in the three Baltic States, under the reasoning that those that are most likely to know how much production/income goes unreported are the entrepreneurs that themselves engage in misreporting and shadow production. In total 591 phone interviews were conducted in Latvia, 536 in Lithuania and 500 in Estonia from March to April 2011. The questionnaire used in this study consists of 5 main blocks: external influences, amount of shadow activity, entrepreneurial ori-

entation, company and owner characteristics, and entrepreneurs’ attitudes.

Survey-based approaches, however, face the risk of underestimating the total size of the shadow economy due to non-response and untruthful response given the sensitive nature of the topic. We minimise this risk by employing a number of surveying and data collection techniques shown in previous studies to be effective in eliciting more truthful responses. These include framing the survey as a study of satisfaction with government policy, gradually introducing the most sensitive questions after less sensitive questions, phrasing misreporting questions indirectly and, in the analysis, controlling for factors that correlate with potential untruthful response such as tolerance towards misreporting.

We aggregate entrepreneurs’ responses about misreported business income, unregistered or hidden employees, as well as unreported “envelope” wages to obtain estimates of the shadow economies as a proportion of GDP.¹¹ Three common methods are used to measure GDP: the output, expenditure, and income approaches. Our index is based on the income approach, which calculates GDP as the sum of gross remuneration of employees (gross personal income) and gross operating income of firms (gross corporate income). Computation of the index proceeds in three steps: (i) estimate the extent of underre-

⁹ Putnins T., and Sauka A., “Shadow Economy Index for the Baltic Countries”, Mimeo, Stockholm School Of Economics in Riga, www.sseriga.edu.lv/shadow-economy-index.

¹⁰ This definition corresponds to what the Organisation for Economic Co-operation and Development (OECD) in their comprehensive 2002 handbook “Measuring the Non-observed Economy” as well as the System of National Accounts (SNA 1993) refer to as “underground production”. It is also consistent with definitions employed by other researchers (e.g., the World Bank study of 162 countries by Schneider, Buehn and Montenegro (2010)).

¹¹ Two caveats are worth noting: (i) because we do not measure shadow activity in the state (public) sector, our estimates refer to private sector shadow activity as a percentage of private sector domestic output; and (ii) we do not attempt to measure the “black economy”, i.e., illegal goods and services.

reporting of employee remuneration and under-reporting of firms' operating income by using the survey responses; (ii) estimate each firm's shadow production proportion as a weighted average of the two underreporting estimates with weights reflecting the proportions of employee remuneration and firms' operating income in the composition of GDP; and (iii) calculate a production-weighted average of shadow production across firms.

Our main findings are as follows. The size of the shadow economy in Latvia (38.1% of GDP in 2010) is close to double that of the neighbouring countries of Estonia (19.4%) and Lithuania (18.8%) (see Table 3). The proportion of economic activity "in the shadow" has increased from 2009 to 2010 in Latvia (by 1.5 percentage points) and Lithuania (by 0.8 percentage points), but decreased in Estonia (by 0.8 percentage points).

Table 3: SSE Riga 'Shadow Economy Index' for the Baltic States

This table reports point estimates and 95% confidence intervals for the size of the shadow economies as a proportion of GDP. The third column reports the change in the relative size of the shadow economy from 2009 to 2010.

	2009	2010	2010-2009
Estonia	20.2% (18.7%, 21.7%)	19.4% (18.0%, 20.8%)	-0.8% (-1.3%, -0.3%)
Lithuania	17.7% (15.8%, 19.7%)	18.8% (16.9%, 20.6%)	0.8% (0.3%, 1.3%)
Latvia	36.6% (34.3%, 38.9%)	38.1% (35.9%, 40.3%)	1.5% (0.8%, 2.2%)

Firms that are dissatisfied with the tax system or the government tend to engage in more shadow activity; satisfied firms engage in less. This result is consistent with previous research on tax evasion, and offers an explanation of why the size of the shadow economy is significantly larger in Latvia than in Estonia and Lithuania; namely that Latvian firms engage in more shadow activity because they are more dissatisfied with the tax system and the government. We also find that younger firms engage in proportionally more shadow activity than older firms, consistent with the anecdotal evidence that tax evasion is used by firms to gain a competitive edge, and that having an edge is important in entering an established market. Firms in the construction sector tend to engage in more shadow activity than firms in other sectors.

A number of themes were noted in entrepreneurs' responses as to why firms evade taxes and operate in the shadow economy, including: (i) the perception that taxes are too high; (ii) low

level of trust in government and the way taxes are spent; (iii) to increase competitive advantage and stay in business; and (iv) tax evasion is a widespread cultural norm.

The findings of this study have a number of policy implications. First, the relatively large size of the shadow economies in the Baltic States, and their different expansion/contraction trends, cause significant error in official estimates of GDP and its rates of change, because although statistics bureaus in each of the countries attempt to include some shadow production in GDP estimates they do not capture the full extent. Not only is GDP used in key policy ratios such as government deficit to GDP, debt to GDP, but also its rate of change is used as a key indicator of economic performance and therefore guides policy decisions. When the shadow economy is expanding (as in Latvia and Lithuania) official GDP growth rates underestimate true economic growth and when the shadow economy is contracting (as in Estonia) official GDP growth rates overstate true

economic growth. At a minimum, policy makers need to be aware of these biases in official statistics, but ideally statistical bureaus would implement more rigorous methods to estimate and incorporate shadow production in official statistics.

Second, our results suggest that to reduce the size of the shadow economies in the Baltic States by encouraging voluntary compliance, a key factor that needs to be addressed is the high level of dissatisfaction with the tax system and with government. Addressing this issue could involve actions such as making tax policy more stable (less

frequent changes in procedures and tax rates), and increasing the transparency with which taxes are spent.

Finally, our estimates of the size of the shadow economies suggest that significant scope exists for all three governments to increase their revenues by bringing production “out of the shadows”. Investment in programs aimed at reducing the size of shadow economies could be rather profitable for the Baltic governments, because even a small influence on entrepreneurial behaviour could result in significant revenue increases.

7. A BIRD'S EYE VIEW OF INNOVATIONS IN LATVIA

CONTRIBUTED BY VITALIJS JASCISENS

In the age of technology, innovation is an absolute precondition for the successful development of every economy. This aspect is especially important in time of financial crisis, when previously developed innovation can be used as one of the tools to gain a competitive edge and hence can lead to a sooner return to pre-crisis growth levels. In this focus we provide a bird's eye view of innovations in Latvia using the unique firm level SIBiL dataset. SIBiL combines face to face survey data with business registry data and focuses on micro (0–9) and small (1–49) enterprises. The SIBiL survey was done in two waves – the first wave covers the period 2005–2007, while the second wave focuses attention on 2008–2009. Such longitudinal structure of the data allows a view of development of innovations over time and hence to draw valuable lessons and provide suggestions to policy makers. The rest of the focus is structured as follows – first we provide some stylised facts using SIBiL and then compare our results with the results of the Community Innovation Survey (CIS) – a highly authoritative survey which collects various indicators on innovations at the enterprise level throughout the European Union and in Norway and Iceland.

We start our analysis by providing a general overview on the number of innovative enterprises in our sample and the corresponding change in time. First of all, it is necessary to mention that 27% of micro enterprises and 20% of small enterprises were lost to follow up due to such reasons as the end of operations or refusal to be interviewed again¹². The analysis of firms which were pres-

ent in both waves shows that the proportion of product-innovative firms decreased by more than two and half times. A similar picture emerges when analysing the decrease in the proportion of process-innovative firms where the proportion decreases more than two times. Although, as mentioned previously, the covered periods differ (3 years in the first wave and 2 in the second), we believe that the observed decrease is significant and is mainly attributable to the recent economic crisis and the following credit crunch. Similar results in the case of process innovations and product innovations indicate that during a crisis firms fail not only to produce new products but also are not able to produce more efficiently and hence reduce costs. Therefore firms in Latvia are following typical cyclical behaviour in terms of innovations – as external shock hits, they reduce innovations, which is understandable in the case of product innovations although completely unintuitive in the case of process innovations. Usually one would expect that during a crisis firms would try to introduce process innovations which would reduce costs thereby increasing their competitive position in the market.

Although a widespread belief exists that small firms are better prepared for financial shocks than micro firms and hence their ability to innovate should be less adversely affected than that of micro firms, the data show a different picture. Breakdown by the size of enterprises shows no significant differences in terms of innovations before and after a crisis among enterprises of different size.

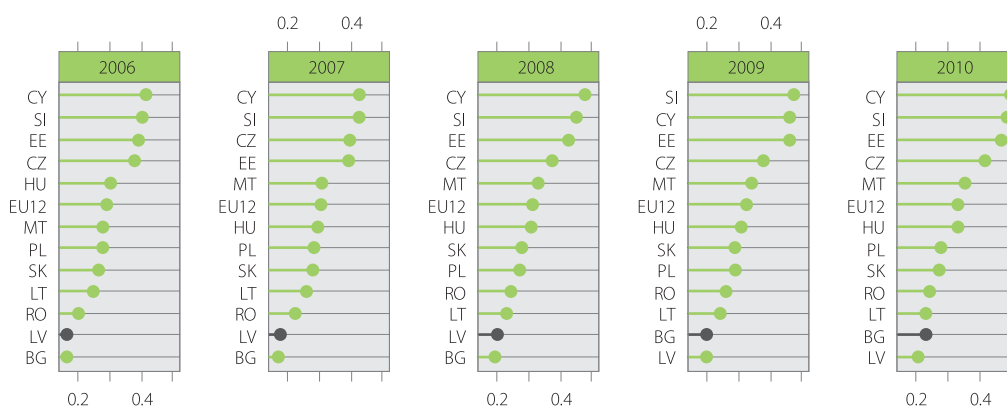
¹² Those enterprises are not analysed when the comparison is made between two waves.

It is a well-known fact that in Latvia the resources possessed by international enterprises¹³ are usually much larger than those possessed by domestic enterprises. As we believe that a positive correlation exists between the resources possessed by a firm and its innovations we would expect to see a higher proportion of innovative enterprises in the sample of enterprises which are part of an international group. Data show that if before the crisis our hypothesis is correct and there are 17% more product innovators in the sample of international enterprises compared to the sample of domestic enterprises, then after the crisis we do not observe any significant difference between international and domestic enterprises in terms of

innovations. The analysis of process innovations shows a different picture – if before the crisis the difference in the proportion of innovative enterprises is 11%, then after the crisis this difference increases to more than 19%. Therefore we observe signs of counter cyclical behaviour in the sample of international enterprises.

Now we turn our attention to comparison of the SIBiL results to the CIS. A summary innovation index, presented in Figure 25, shows that since 2006 Latvia has been constantly among the last among the New Member States (EU 12) in terms of innovations – only ahead of Bulgaria during 2006–2008 and last in the remaining two years.

Figure 25: Summary Innovation Index for the New Member States



Source: Innovation Union Scoreboard 2010.

One of the components of the index is small and medium sized enterprises (SMEs) introducing product or process innovations as a % of total SMEs. The data source for this variable is the Community Innovation Survey (CIS), which shows various kinds of indicators about innovations for the sample of European enterprises. In what follows we compare the proportion coming from CIS data with the proportion given by SIBiL. The comparison is possible because SIBiL is highly consistent with the CIS, although it has to be mentioned that

it also enjoys a number of considerable advantages¹⁴ and hence offers a more complete view of innovations in Latvia. Although the periods covered by SIBiL and CIS do not exactly match¹⁵ we still believe that the main trends can be identified and hence valid conclusions drawn.

Table 4 provides the proportion of product and process innovative firms in core industries related to innovations. Two main differences appear between the results provided by CIS and SIBiL.

¹³ Here, “international enterprises” means foreign owned ones.

¹⁴ The main advantages of SIBiL over CIS are face to face interviews as opposed to mailed surveys (used in CIS) and coverage of micro enterprises (1–9 employees) which are left untouched by CIS.

¹⁵ CIS 5 covers the period 2004–2006 and CIS 6 analyses 2006–2008.

Firstly, although in the case of both SIBiL and CIS there are more process innovators than product innovators, the difference between the two is larger in the case of SIBiL. Secondly, the proportion of innovative firms is larger in both product innovations and in process innovations in the case of SIBiL. For methodological reasons¹⁶ the results from CIS 5 are more comparable with the SIBiL first wave and hence we focus on this comparison.

For completeness, SIBiL Unadjusted results are also provided – showing the proportion of product innovative enterprises in the whole sample in the first wave (the SIBiL column provides the proportion for innovative industries as classified by Eurostat). The results in the SIBiL and SIBiL Unadjusted columns do not differ significantly, therefore indicating that firms in the industries which are not classified as innovative by Eurostat are as innovative as classified industries.

Table 4: The proportion of innovative firms in the sample

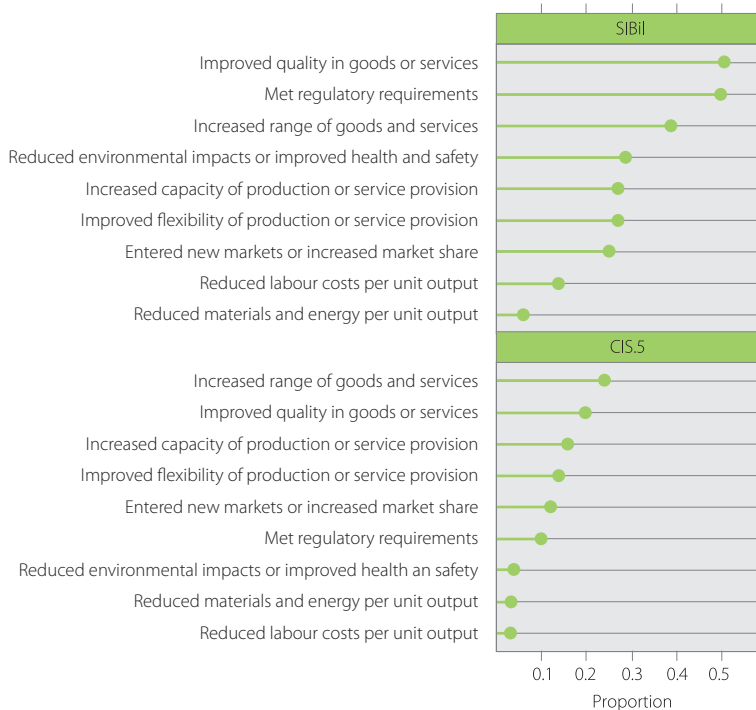
Category	Size	CIS 5	CIS 6	SIBiL	SIBiLUnadjusted
Novel Innovators, Product	Total	10%	12%	44%	45%
	Less than 10			42%	43%
	Between 10 and 49	8%	10%	49%	48%
	Between 50 and 249	15%	17%		
	250 or more	33%	43%		
Novel Innovators, Process	Total	12%	14%	56%	56%
	Less than 10			56%	56%
	Between 10 and 49	10%	11%	57%	55%
	Between 50 and 249	18%	24%		
	250 or more	39%	54%		
Novel Innovators, Either	Total	15%	18%	67%	67%
	Less than 10			67%	68%
	Between 10 and 49	12%	15%	66%	65%
	Between 50 and 249	23%	29%		
		46%	60%		

Conclusions can be drawn from the previous analysis. Firstly, data provided by the CIS severely underestimate the number of innovative firms in Latvia; thereby innovation indexes using CIS data might be incorrect and thus underestimate the position of Latvian enterprises internationally. Secondly, firms in industries which do not appear in the CIS sample are as innovative as firms which appear in the sample; therefore, for completeness, in the future industries omitted should also be included in the survey.

Next we compare the importance of innovations for the firms in CIS 5 and SIBiL first wave samples. Figure 26 compares the highly important effects of innovation in CIS 5 and first wave

SIBiL for the subsample of small enterprises. It is possible to conclude that in every single aspect innovations are more important in the SIBiL sample. CIS 5 results show that the most important reasons for innovations are either vertical or horizontal product differentiation – innovation is used to increase the variety and quality of products, thereby increasing the market power of enterprises using it. A similar picture can also be seen in the case of SIBiL where additionally innovations are mentioned as highly important in helping to meet regulatory requirements. Hence we conclude that the ranking of different alternatives is similar both in the case of SIBiL and CIS, although innovations are more important in the case of SIBiL.

¹⁶ Results in table one are provided for industries in core innovation activities as classified by Eurostat. In CIS 5 for classification purposes NACE Rev 1.1 is used in contrast to that in CIS 6 where classification is according to NACE Rev 2. SIBiL data are provided for the first wave, where the NACE Rev 1.1 classification is used, hence these data are comparable with CIS 5.

Figure 26: The Importance of Innovations

The possible implications from our analysis can be well understood by coming back to Figure 26 and to the first part of our analysis, where we show a high correlation between external shock and decrease in the proportion of innovative enterprises. From Figure 26 we infer a possible high positive correlation between product innovation and variety and quality of products available in the market. Hence with reduction of innovative firms we would also expect to witness a decrease in the quality and variety of products available in the market. Unfortunately data measuring product quality and variety are not available; hence the previously raised hypothesis is left for future empirical testing.

To conclude, we have shown that there has been a large negative break in terms of innovations in Latvia, the cause of which is possibly the financial crisis although the direct channel through which innovations are affected is not clear and further research is needed. We have also shown that the

impact of the break was approximately equal for both small and micro enterprises. By analysing the sample of international enterprises we have witnessed that international enterprises (i.e. foreign-owned) are better prepared to handle external shocks in terms of process innovations, which means that they are more likely to reduce their costs through innovations than through layoffs or wage decreases. The analysis of the importance of innovations showed that the decrease in innovations will most likely adversely affect the quality and variety of products available in the market. This result is in line with the findings discussed at the end of chapter 4 of this Report. Hence in times of crisis we might witness below-optimum levels of quality and variety. Finally by comparing the SIBIL data with the CIS data we have arrived at the conclusion that the international position of Latvian enterprises might be severely underestimated in terms of innovations and that improved methodology might show a completely different picture.

8. CONCLUSIONS

Latvia's economic development over recent years provides the context for interpreting entrepreneurship developments. Thus up to the middle of 2008 Latvia had the fastest developing economy in Europe but this was sharply reversed and the cumulative decline of about 25% of GDP over the recession was the deepest in the EU. In 2010 the Latvian economy started to recover.

Thus in 2010 the prevalence rate of nascent entrepreneurs increased marginally, but the proportion of new business owners fell. The rate of established businesses operating for more than 3 years also decreased from 9% in 2009 to 7.6% in 2010. These results suggest that over this difficult period many newly established businesses did not survive for long. Business non-profitability and problems obtaining finance are the main reasons for business discontinuation. The impact of recession is still felt.

The level of necessity-driven entrepreneurship (when individuals are pushed into entrepreneurial activities because of a lack of alternatives) started to decrease in Latvia in 2010 but remains rather high. About one fourth of all early-stage entrepreneurs are driven by necessity motives. This is higher than the median for the EU-15, but is quite similar to what is observed in Ireland, Greece, Germany, Spain, France and Portugal. Evidence suggests that necessity-driven entrepreneurship is considered to contribute much less to economic growth compared to opportunity-driven entrepreneurship (when individuals are pulled into entrepreneurial activity to pursue a business opportunity, to earn higher income or with a desire to be independent). Necessity-driven entrepreneurs are less likely to reinvest their income, less likely to grow in terms of turnover or employment, less likely to export their products and to introduce innovative products or use modern technologies.

As concluded in Chapter 4 an inflow of less educated people into entrepreneurship occurred as a result of the crisis. However, even after the crisis

business starters remained quite different from people who did not start a business, and hence should not be regarded as the disguised unemployed. Early-stage entrepreneurs in Latvia are quite distinct from other groups of people. They differ from both employees and unemployed people by their demographic characteristics, human capital, financial resources and perceptions about entrepreneurial activity and the entrepreneurial environment in Latvia.

Business characteristics of newly started businesses have not changed much over time. But it is likely that the types of products offered have changed: more consumer-oriented goods and services were offered. Fewer new technologies were used in the production process. Businesses started after the crisis seem to be more prudent with long-term investment in business and more moderate in their growth aspirations.

In terms of process innovation within the enterprise, Chapter 7 shows that international enterprises (i.e. foreign-owned) perform better than domestic ones, i.e. international companies are more likely to reduce their costs through innovations than through layoffs or wage cuts.

Three different dimensions of entrepreneurship, i.e. entrepreneurial attitudes, entrepreneurial activity and entrepreneurial aspirations are captured in the Global Entrepreneurship Development Index (GEDI) index. A specific sub-index is defined for each dimension and combining all three indexes results in the overall GEDI index. This index incorporates both quantitative (level-related measures) and qualitative aspects of entrepreneurial activity; it uses both individual-level and institutional variables. Chapter 5 reveals that Latvia overall scores particularly poorly in several areas of the aspiration dimension including: risk capital, new technology and new products. This

suggests that venture capital is not well provided, that Latvian entrepreneurs do not seem to produce much in the way of new products, and do not apply or create many new technologies. Despite the fact that Latvia scores very well in terms of human capital and fairly well in terms of the tech sector (a dimension that measures new startups in the medium- or high-tech sectors, dimensions that are usually believed to be positively correlated with new technologies etc), the picture painted by GEDI to a large extent confirms the findings of Chapters 4 and Chapter 7 of the current Latvian GEM Report: Latvian entrepreneurs are not very active in terms of innovations. The only aspiration dimensions in which Latvia scores well are internationalisation and high growth, meaning that Latvian entrepreneurs are very likely to engage in exporting and many entrepreneurs plan to grow fast within the next 5 years.

As for the other two sub-indexes, Latvia scores better. Latvia seems to perform fairly well in terms of the attitudes dimension, in particular networking and start-up skills, opportunity perception being the exception. Putting it differently, people in Latvia believe that they have adequate startup skills, networking plays an important role, but people's views on good opportunities to start a business in the area where they live are rather moderate.

It is well understood that the shadow economy creates an uneven playing field where entrepreneurs following the rules will be at a disadvantage compared to those that are engaged in informal

economy activities. As discussed in Chapter 6, it is very important to identify, understand and address the main reasons and motivations why entrepreneurs operate in the shadow economy. A number of themes were noted in entrepreneurs' responses as to why firms evade taxes and operate in the shadow economy. These themes were presented in Chapter 6 and include: (i) the perception that taxes are too high; (ii) a low level of trust in government and the way taxes are spent; (iii) the need to increase competitive advantage and stay in business; and (iv) tax evasion is a widespread cultural norm.

The GEM 2010 Latvia Report confirms that recovery from the recession is under way. In comparison to GEM 2009 a smaller proportion of entrepreneurs reported difficulty in starting and growing a business. In addition, there seems to be an increase in perceived business opportunities in comparison to the previous year. As a consequence, the number of people thinking of starting a business within the next three years has almost doubled.

It is rather hard to predict the development of early-stage entrepreneurial activity in the near future given the currently uncertain economic situation both at home and abroad. But we believe that the increasing trend of early-stage entrepreneurship is likely to continue in 2011 with a hope also of an increase in the share of the new business ownership rate and stabilisation of established businesses operations.

CONCLUSIONS IN LATVIAN

SECINĀJUMI

Uzņēmējdarbības attīstība Latvijā ir skatāma kontekstā ar ekonomikas attīstību pēdējo gadu laikā. Līdz 2008. gada vidum Latvija bija visstraujāk augošā ekonomika Eiropā, bet tas krasī mainījās, un kopējais IKP samazinājums par 25% recesijas laikā bija sliktākais rādītājs ES. 2010. gadā Latvijas ekonomika sāka atgūties.

2010. gadā topošo uzņēmēju īpatsvars palielinājās pavisam nedaudz, bet jauno uzņēmumu īpašnieku īpatsvars samazinājās. Arī nobriedušo uzņēmumu, kas darbojas vairāk nekā 3 gadus, rādītājs samazinājās no 9% 2009. gadā līdz 7.6% 2010. gadā. Rezultāti liecina, ka šajā sarežģītajā periodā daudzi jaundibinātie uzņēmumi nespēja pastāvēt ilgāku laiku. Biznesa zemais ienesīgums un problēmas ar finansējuma iegūšanu bija galvenie iemesli uzņēmējdarbības pārtraukšanai. Recesijas ietekme joprojām ir jūtama.

2010. gadā Latvijā nepieciešamības spiestas uzņēmējdarbības līmenis (kad indivīds tiek iegrūsts uzņēmējdarbības aktivitātēs, jo tam nav alternatīvas nodarbinātības iespējas) sāka samazināties, tomēr joprojām saglabājās salīdzinoši augsts. Aptuveni ceturtdaļa no visiem agrinās stadijas uzņēmējiem ir nepieciešamības spiesti. Šis rādītājs ir augstāks par ES-15 vidējo, tomēr tuvs Īrijas, Grieķijas, Spānijas, Francijas un Portugāles rādītājiem. Pētījumi liecina, ka nepieciešamības spiesta uzņēmējdarbība sniedz daudz mazāku ieguldījumu ekonomikas izaugsmē, nekā iespēju motivēta uzņēmējdarbība (kad indivīds tiek ierauts uzņēmējdarbības aktivitātēs, jo vēlas izmantot biznesa iespējas, palielināt savus ienākumus vai kļūt neatkarīgs). Nepieciešamības spiesti uzņēmēji retāk reinvestē savus uzņēmējdarbības ienākumus, to uzņēmumiem ir mazāka iespējamība sasniegt izaugsmi apgrozījuma vai nodarbinātības ziņā, tie retāk

eksportē, retāk ievieš inovatīvus produktus vai izmanto modernas tehnoloģijas.

Kā secināts 4. nodaļā, krīzes rezultātā mazāk izglītotu cilvēku ieplūdis uzņēmējdarbībā. Tomēr pat pēc krīzes uzņēmējdarbības uzsācēji krietni atšķiras no cilvēkiem, kuri nebija uzsākuši uzņēmējdarbību, un tamdēļ nav uzskatāmi par slēptajiem bezdarbniekiem. Agrinās stadijas uzņēmēji Latvijā ievērojami atšķiras no citām cilvēku grupām. Tie ir atšķirīgi gan no nodarbinātajiem, gan bezdarbniekiem pēc to demogrāfiskā raksturojuma, cilvēkkapitāla, finanšu resursiem un priekšstatiem par uzņēmējdarbības aktivitāti un uzņēmējdarbības vidi Latvijā.

Jaundibinātu uzņēmumu uzņēmējdarbības raksturojums laika gaitā nav daudz mainījies. Tomēr var novērot, ka ir mainījies produktu piedāvājums – tiek piedāvātas preces un pakalpojumi, kas vairāk orientēti uz patērētāju. Ražošanas procesā tika izmantots mazāks jaunu tehnoloģiju. Pēc krīzes dibinātie uzņēmumi ir piesardzīgāki ar ilgtermiņa ieguldījumiem uzņēmējdarbībā un sagaida mērenāku izaugsmi.

Attiecībā uz inovācijām uzņēmuma ražošanas procesos, 7. nodaļā liecina, ka starptautiskouzņēmumu (t.i., ārvalstu īpašnieki) sniegums ir labāks nekā vietējo uzņēmumu sniegums, t.i., starptautiskos uzņēmumos izmaksu samazināšanai drīzāk tiek ieviesti jauninājumi, nevis atlaisti darbinieki vai samazinātas algas.

Globālais Uzņēmējdarbības Attīstības Indekss (Global Entrepreneurship Development Index (GEDI)) ietver trīs dažādas uzņēmējdarbības sfēras – attieksmi pret uzņēmējdarbību, uzņēmējdarbības aktivitāti un uzņēmējdarbības centienus. Katrai sfērai ir definēts atsevišķs

apakšindekss, un, apvienojot šos trīs indeksus, veidojas kopējais GEDI indekss. Šis indekss ietver gan kvantitatīvos, gan kvalitatīvos uzņēmējdarbības rādītājus, tas izmanto gan individuālā līmeņa, gan institucionālos mainīgos. 5. nodaļa atklāj, ka kopumā Latvijas rādītāji ir īpaši slikti vairākās jomās, kas saistītas ar centieniem, tajā skaitā: riska kapitāls, jaunas tehnoloģijas un jauni produkti. Tas liecina, ka riska kapitāls ir grūti pieejams, ka Latvijas uzņēmēji īpaši neražo jaunus produktus, kā arī nepielieto vai nerada jaunas tehnoloģijas. Neskatoties uz to, ka cilvēkkapitāla rādītāji Latvijā ir ļoti labi, un arī tehnoloģiju nozarē tie ir salīdzinoši augsti (sfēra, kas mēra uzsāktu uzņēmējdarbību līmeni vidējo vai augsto tehnoloģiju nozarēs; tiek uzskatīts, ka šīs sfēras visbiežāk pozitīvi korelē ar jaunajām tehnoloģijām u.c.), GEDI radītā kopai lielā mērā apstiprina Latvijas GEM Ziņojuma 4. un 7. nodaļā minētos secinājumus, ka Latvijas uzņēmēji nav sevišķi aktīvi inovāciju jomā. Vienīgās ar centieniem saistītās jomas, kur Latvija uzrāda labus rezultātus, ir internacionalizācija un strauja izaugsme, kas nozīmē, ka Latvijas uzņēmēji labprāt eksportē un daudzi uzņēmēji plāno strauju izaugsmi tuvāko 5 gadu laikā.

Attiecībā uz pārējiem diviem apakšindeksiem Latvijas rādītāji ir labāki. Diezgan labs sniegums novērojams attieksmē pret uzņēmējdarbību, īpaši kontaktu veidošanā un uzņēmējdarbības uzsākšanas prasmēs, bet spēja saskatīt biznesa iespējas ir izņēmums. Citiem vārdiem sakot, cilvēki Latvijā uzskata, ka viņiem ir pietiekamas prasmes biznesa uzsākšanai un kontakti uzņēmējdarbības procesā ir nozīmīgi, bet cilvēku viedoklis par labām biznesa iespējām vietā, kur viņi dzīvo, ir visai pieticīgs.

Ir skaidri saprotams, ka ēnu ekonomika rada nevienlīdzīgus konkurences apstākļus, kur uzņēmēji, kas ievēro likumus, atrodas neizdevīgākā stāvoklī, salīdzinot ar uzņēmējiem, kas iesaistījušies ēnu ekonomikas darbībās. Kā minēts 6. nodaļā, lai risinātu šo problēmu, ir ļoti svarīgi identificēt un novērst galvenos iemeslus un motīvus, kādēļ uzņēmēji iesaistās ēnu ekonomikā. Uzņēmēji savās atbildēs bija minējuši vairākus iemeslus, kādēļ uzņēmumi izvairās no nodokļu maksāšanas un iesaistās ēnu ekonomikā. Šie iemesli aprakstīti Ziņojuma 6. nodaļā, un daži no tiem ir: i) uzskats, ka nodokļi ir pārāk augsti; ii) zema uzticība valdībai un tam, kā tiek izlietoti nodokļi; iii) nepieciešamība palielināt konkurētspēju un saglabāt uzņēmējdarbību un iv) izvairīšanās no nodokļu maksāšanas ir vispārīzplatīta norma.

2010. gada Latvijas GEM Ziņojums apstiprina, ka notiek pakāpeniska atgūšanās pēc recesijas. Salīdzinot ar 2009. gada GEM pētījumu, mazāka proporcija uzņēmēju norādīja uz grūtībām uzsākt un attīstīt uzņēmumu. Turklāt šķiet, ka, salīdzinot ar iepriekšējo gadu, biznesa iespējas ir augušas. Tamdēļ to cilvēku skaits, kas plāno uzsākt uzņēmējdarbību nākošo trīs gadu laikā, ir gandrīz dubultojies.

Ir diezgan grūti prognozēt agrīnās stadijas uzņēmējdarbības aktivitāti tuvākajā nākotnē, ņemot vērā šībrīža neskaidro ekonomisko situāciju gan Latvijā, gan ārvalstīs. Tomēr mēs uzskatām, ka agrīnās stadijas uzņēmējdarbības aktivitāte 2011. gadā turpinās pieaugt, un ceram, ka tādejādi palielināsies arī jaunu uzņēmumu īpašnieku skaits, kā arī nostabilizēsies nobriedušu uzņēmumu darbība.

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 59 countries in the 2010 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 2010. Similar to previous rounds of GEM, the interview schedule consisted of a set of questions used to derive entrepreneurial activity rates and additional ques-

tions concerning the attributes and characteristics of the respondents as well as their attitudes towards entrepreneurship.

Latvia has been a member of the GEM project since 2005, and continues its participation in the 2011 research cycle. In 2010 the GEM adult population survey in Latvia was conducted by a survey provider, "SKDS". Via telephone interviews, a total of 2001 adults aged 18-64 years old were surveyed during May – (early) July 2010. 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 94.6% of the adult population of Latvia¹⁷. 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 (96% 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 2009 to March 2010, 5.4% 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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