

LATVIA

1. Introduction




Latvia has put considerable effort into boosting its start-up ecosystem by setting up various types of support mechanisms, cutting the administrative burden and digitalising public services. Nevertheless, investments in R&D are deemed to be insufficient, digital maturity remains low and SME lending is declining.

SMEs in Latvia have been badly affected by the COVID-19 pandemic and the policy measures taken to fight the pandemic and support the economy. In 2020, SME value added and SME employment were well below their 2019 levels, down 4% and 2.5% respectively¹. The *accommodation and food services* sector sharply declined both in terms of SME value added, which fell by 32.9%, and SME employment, down 16.1%. Another badly affected sector was *transportation and storage*, where SME value added decreased by 22.1% and SME employment by 2.1%. However, the *construction* sector, which also saw SME employment fall by 3.3%, experienced an increase in SME value added of 5.8%, going against the overall declining trend in SME value added.

The downturn in 2020 is expected to be followed by a partial recovery in 2021. Forecasts expect SME value to grow by 7.3% and SME employment by 2.2% compared to 2020. Accordingly, SME value added will exceed its 2019 level by 3.1% in 2021, while SME employment will remain 0.4 % below its 2019 level.

SMEs play a key role in the Latvian 'non-financial business economy'. In 2020, they generated 72% of value added and 78.7% of employment, outstripping the respective EU averages of 53% and 65.2%. However, the average productivity of SMEs, defined as value added per person employed, was only EUR 18 500, well below the EU average of EUR 40 000. Latvian SMEs employed an average of 4.6 people in 2020, higher than the EU average of 3.7.

Figure 1: Number of enterprises, persons employed and value added in 2020

	 Number of enterprises			 Number of persons employed			 Value added		
	Latvia		EU-27	Latvia		EU-27	Latvia		EU-27
	Number	Share	Share	Number	Share	Share	€ bn	Share	Share
Micro	99 091	91.1%	93.3%	206 310	32.3%	29.6%	3.1	24.2%	18.7%
Small	8 027	7.4%	5.7%	157 595	24.7%	19.7%	2.9	22.8%	17%
Medium-sized	1 413	1.3%	0.9%	138 010	21.6%	15.8%	3.2	25.1%	17.3%
SMEs	108 531	99.8%	99.8%	501 915	78.7%	65.2%	9.3	72%	53%
Large	198	0.2%	0.2%	135 834	21.3%	34.8%	3.6	28%	47%
Total	108 729	100%	100%	637 749	100%	100%	12.9	100%	100%

Source: These are estimates for 2020 produced by DIW Econ, based on 2008-2018 figures from the Structural Business Statistics Database as well as provisional data for 2019-2020 from the National Accounts Database and the Short-Term Business Statistics Database (Eurostat). The data cover the 'non-financial business economy', which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. The following size-class definitions are applied: micro firms (0-9 persons employed), small firms (10-49 persons employed), medium-sized firms (50-249 persons employed), and large firms (250+ persons employed).

2. Key strengths

Ease of starting business and administrative burden

For several years, Latvia has been cutting the administrative burden, especially on the administrative process related to launching a business.

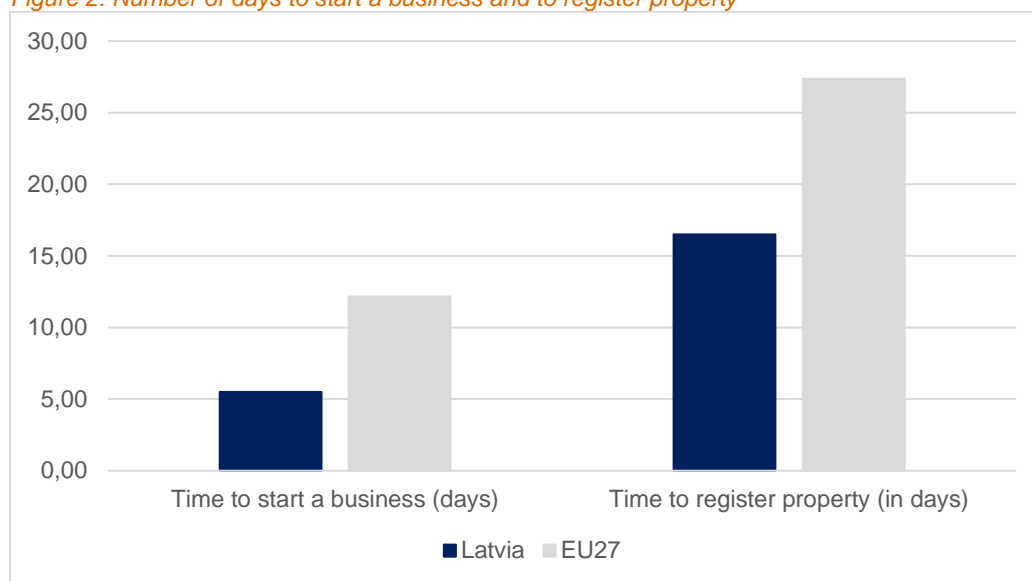
For example, the government recently developed a company registration e-service, which can be used to set up a limited liability company with one founder. It will be included in the new government e-service portal (www.latvija.lv).

In 2019, the government introduced the 'Zero Bureaucracy' principle to reduce the regulatory burden. When submitting a draft legal act that increases the administrative burden, the responsible ministry has to simultaneously submit a draft legal act that reduce the burden for the same target group by an equivalent amount².

Latvia has also introduced the 'Consult first' principle, which ensures that applicable requirements are clearly understandable to entrepreneurs. This therefore helps create an excellent business environment and promote a mutual understanding of duties to be performed between supervisory authorities and businesses³.

Thanks to these efforts, the amount of procedures, time and costs to start a business in Latvia is relatively small compared to the average in Europe, Central Asia as well as high income OECD countries. Latvia therefore ranks 19th out of 190 countries in the Ease of Doing Business rankings and 7th among EU countries in the World Bank's Doing Business 2020. The country also ranks high on ease of starting a business (26th out of 190 countries)⁴. In addition, Latvia also scored higher than the EU average on the burden of government regulation (1 worst, 7 best), with 3.55 against 3.39 for the EU on average in 2019⁵.

Figure 2: Number of days to start a business and to register property



Source: World Bank Doing Business, 2020⁶

Start-up ecosystem

In the last 5 years, Latvia has strengthened its start-up ecosystem. Its start-up support system is among the most competitive in the Baltic and in the EU⁷. The country has put considerable effort into boosting its start-up ecosystem by providing various types of support mechanisms as financial support (university incubators, Magnetic Latvia Startup, the development finance institution ALTUM, venture capital funds, Magnetic Latvia incubators, start-up accelerators and business angels), a favourable tax regime for start-ups, a start-up visa programme, acceleration funds and incubation support⁸. This environment has also made it possible to organise large industry events like TechChill and 5G Techritory.

The Start-up Law, which came into force in January 2017, has created a favourable tax regime for start-ups. It provides for two scenarios: 1) a special flat tax regime, currently EUR 302 per month per employee, regardless of the salary paid, combined with the 0% individual income tax rate, or 2) 45% co-financing for highly qualified specialists⁹.

Thanks to this favourable environment, the number of start-ups in Latvia has increased four-fold since 2012, reaching 450 active start-ups in 2020 and attracting EUR 303 million in investments¹⁰. Moreover, the established business ownership¹¹ rate has been increasing in recent years, from 7.7% in 2017 to 12.9% in 2019, against the EU average of 7.5% in 2019¹².

Availability of public e-services

With a score of 50.7 in the 2020 Digital Economy and Society Index, Latvia ranks 18th out of 27 EU Member States in digital competitiveness. It performs particularly well in the area of digital public services, with a score of 85.1 significantly higher than the EU average of 72.0¹³.

The digitalisation of public administration constitutes a priority for the Latvian government in the coming years, as stated in its Digital Transformation Guidelines 2021-2027¹⁴. In recent years, the quality of e-government services has continued to improve, with the number of users also on the rise. Companies can now benefit from all the necessary tax services online. The time to pay taxes

in Latvia is lower compared to the EU average (169 hours per year in Latvia against 173.7 hours for the EU)¹⁵.

Latvia has also developed very good broadband coverage, with fast and very high capacity networks, and has already allocated a radio spectrum for 5G. The country has also started to standardise e-invoices.

3. Key challenges

Access to finance

Lending to companies in Latvia decreased by around 62% between 2011 and 2019, with the highest decrease (-23.8%) registered between 2019 and 2018. This decline in the loans provided to SMEs impacts the availability of equity finance to SMEs and therefore weakens their potential growth and competitiveness. Economic index data from the Latvian Chamber of Commerce and Industry shows that 43% of companies took out loans or used leasing services in 2020, while 56% did not. While entrepreneurs' ability and willingness to borrow has grown, real demand for loans has fallen, which points to entrepreneurs' caution in planning investments to grow their company¹⁶. Moreover, credit interest rates in Latvia (3.6% on average) remain high compared to other eurozone countries, which limits the ability of entrepreneurs to borrow¹⁷. The annual average interest rate for small loans was also significantly higher in Latvia: 3.6% against the EU average of 2.9%¹⁸. Similarly, the percentage of rejected loan applications and loan offers whose conditions were deemed unacceptable (as a percentage of loan applications by SMEs) was also high in Latvia (27.5%) compared to the EU average of 10.9%¹⁹.

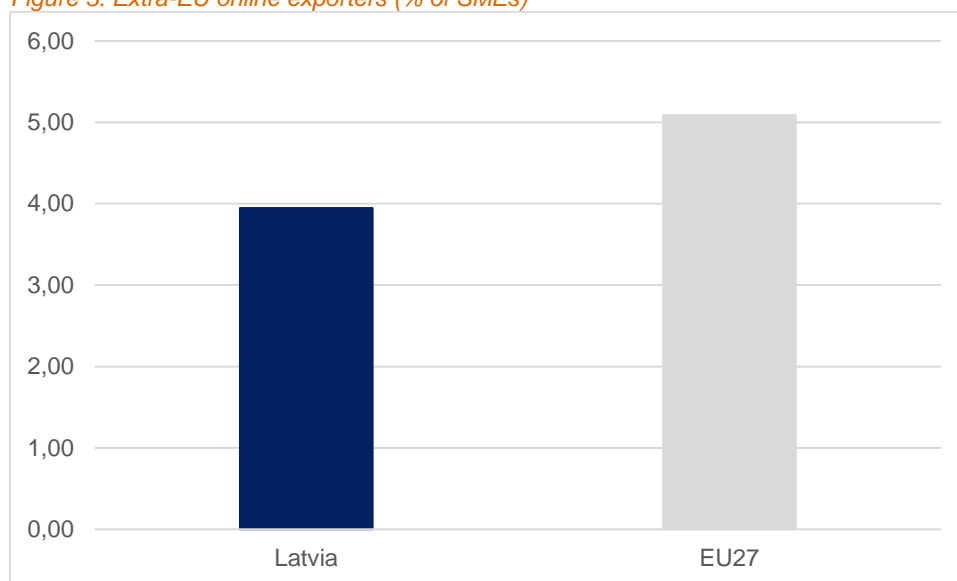
In 2019, Latvia adopted a comprehensive strategy to reform the financial sector. Related regulation focused on strengthening the capacity of all authorities to combat money laundering. This revamping of the financial sector will hopefully address the remaining vulnerabilities of the sector and therefore improve companies' ability to borrow in the future²⁰.

To support access to finance, ALTUM provides Latvia's SMEs with various financial tools such as loans, credit guarantees, investing in venture capital funds, etc.²¹. During the COVID-19 crisis, it launched a EUR 200 million *COVID-19 Working Capital Loan Programme* and other programmes to support Latvian businesses impacted²² by the crisis.

Low level of SME digitalisation

SMEs' digital maturity remains low, and the business sector fails to take advantage of the opportunities offered by digital technologies. In 2020, Latvia ranked 23rd in the Digital Economy and Society Index on the integration of new technology by business. Only 8% of Latvian companies use big data, 19% have social media activities and 11% rely on cloud services. In addition, only 11% of SMEs sell their products and services online and only 5% of SME turnover comes from e-commerce. Basic and advanced digital skill levels remain well below the EU average as only 43% of people aged 16 to 74 have at least basic digital skills (EU average 58%) and only 24% have advanced skills (EU average 33%). The percentage of total people employed in Latvia that have ICT specialist skills is only 18.7% (EU average 19.5%), while the share of SMEs that provide training to their staff to develop and upgrade their ICT skills was 16.7%, lower than the EU average of 21.6%²³. While efforts still need to be made in this area, the development of digital skills is addressed in several sectoral policies despite the absence of a specific digital skills strategy²⁴.

Figure 3: Extra-EU online exporters (% of SMEs)



Source: Eurostat, 2019²⁵

Insufficient investments in R&D

Public and private investments in R&D in Latvia are insufficient. Latvia's 2020 target indicator for investment in R&D is 1.5% of GDP²⁶, while it amounted to only 0.63% in 2019. According to the European Innovation Scoreboard 2020, Latvia ranks 20th among 27 EU Member States, maintaining its position as a moderate innovator despite continuous improvements in recent years²⁷. Only 758 companies in Latvia employed in-house researchers in 2019²⁸.

4. Other key SME-related brief insights



IMPACT OF COVID-19 CRISIS ON SMES

The retail trade turnover in constant prices fell by 0.9% in July over a month, with annual growth declining to 3.8%²⁹. Manufacturing output fell by 5.9% month-on-month in April 2020 (seasonally adjusted data) and by 9.0% year-on-year³⁰. ALTUM launched a EUR 200 million *COVID-19 Working Capital Loan Programme to support* Latvian businesses impacted by the COVID-19 crisis. The loan will be available in situations where credit institutions have stopped financing or do not grant new working capital loans or credit facility lines and will be provided for up to 3 years³¹.



GREEN TRANSITION OF SMES

Developed and adopted in 2020 by the Ministry of Environmental Protection and Regional Development, the circular economy action plan aims to increase resource productivity and investments in R&D activities, help create conditions conducive to the reuse of materials, and to develop awareness-raising activities in order to change people's habits³².

Only 13% of the total volume of public procurement tenders was in line with the green public procurement (GPP) principles in 2019³³. To increase the share of GPP in the total amount of public procurements, the Cabinet of Ministers approved amendments to

green public procurement regulations in 2020³⁴. Funding for energy efficiency and substitution of fossil energy resources with renewable energy resources has increased over the years, with state aid in particular being provided to companies in the form of a grant representing up to 30% of the eligible costs³⁵.



SOCIAL ASPECTS OF SUSTAINABILITY

Launched in the first half of 2017 and implemented by the Ministry of Welfare, the social entrepreneurship programme offers grants (ranging from EUR 5 000 to EUR 200 000) to businesses involved in social entrepreneurship in order to promote the establishment and development of social enterprises³⁶. In 2020, the government developed guidelines to promote socially responsible public procurement³⁷.



MARKET ACCESS

The Latvian Investment and Development Agency is a single contact point for all companies already exporting or those interested in exporting. The international competitiveness support programme is available to SMEs and offers a wide range of services. The cluster programme, with EUR 6.2 million available from the European Regional Development Fund, supports SME internationalisation and the development of new products and services. The programme has funded 15 clusters so far, with export volumes of their members increasing 3.5 times since 2014³⁸.

According to the European observatory for clusters and industrial change Latvia has the highest number of strong clusters per region (13.0), followed by Italy (12.8) and Spain (10.7)³⁹.

- ¹ The data for 2020 are estimates produced by DIW Econ, based on 2008-2018 figures from the Structural Business Statistics Database as well as provisional data for 2019-2020 from the National Accounts Database and the Short-Term Business Statistics Database (Eurostat).
- ² LSM.LV (2019), *Government launches 'zero bureaucracy' drive*, available at: <https://eng.lsm.lv/article/economy/business/government-launches-zero-bureaucracy-drive.a329324/>
- Cabinet of Ministers (2019), *Informatīvais ziņojums "Par "nulles birokrātijas" pieejas ieviešanu tiesību aktu izstrādes procesā"*, available at: <http://tap.mk.gov.lv/lv/mk/tap/?pid=40476165&mode=mk&date=2019-08-20>
- ³ State Revenue Service (2018), *Consult first*, available at: <https://www.vid.gov.lv/en/consult-first#:~:text=The%20State%20Revenue%20Service%2C%20like,are%20clearly%20understandable%20to%20entrepreneurs.>
- ⁴ World Bank (2020), *Doing Business 2020*, available at: <https://www.doingbusiness.org/en/data/exploreconomies/latvia>
- ⁵ World Economic Forum (2019), *Global Competitiveness Report 2018-2019*, available at: http://www3.weforum.org/docs/GCR2018/GCI_4.0_2018_Dataset.xlsx
- ⁶ World Bank (2020), *Doing Business*, available at: <http://www.doingbusiness.org/>
- ⁷ EIT Digital (2019), *Baltic Start-up scene report 2018/2019*, available at: <https://www.eitdigital.eu/newsroom/news/article/baltic-startup-scene-report-2018-2019-published/>
- ⁸ EU-Startups.com (2020), *Latvia's startup ecosystem at a glance*, available at: <https://www.eu-startups.com/2020/07/latvias-startup-ecosystem-at-a-glance/>; Investment and Development Agency of Latvia (2020), *Start-up Ecosystem*, available at: <https://www.liaa.gov.lv/en/invest-latvia/start-ecosystem>
- ⁹ Magnetic Latvia, *Startup law benefits*, available at: <https://startuplatvia.eu/startup-law-benefits>
- ¹⁰ EIT Digital (2019), *Baltic Start-up scene report 2018/2019*, available at: <https://www.eitdigital.eu/newsroom/news/article/baltic-startup-scene-report-2018-2019-published/>; Ministry of Economics of the Republic of Latvia (2019), *Latvia's startup ecosystem*, available at: https://em.gov.lv/files/attachments/2019-03-27_11_46_18_Jaunuznemumu_petijums.pdf
- ¹¹ The established business ownership refers to the percentage of the 18-64 population who are currently owner-manager of an established business, i.e. owning and managing a business that has paid salaries, wages or any other payments to the owners for more than 42 months.
- ¹² Global Entrepreneurship Monitor (2019), *Global Entrepreneurship Report*, available at: <http://www.gemconsortium.org/data/key-aps>
- ¹³ European Commission (2020), *The Digital Economy and Society Index*, available at: <https://ec.europa.eu/digital-single-market/en/scoreboard/latvia>
- ¹⁴ Ministry of Environmental Protection and Regional Development (2020), *Latvian Digital Transformation Guidelines 2021-2027*, available at: https://www.varam.gov.lv/sites/varam/files/content/files/digitalas-transformacijas-pamatnostadnes-_2021-27.pdf
- ¹⁵ See Note 4.
- ¹⁶ Latvian Chamber of Commerce and Industry (2020), *Itrk ekonomikas indekss: joprojām pesimistisks noskaņojums visās tautsaimniecības jomās*, available at: <https://www.chamber.lv/lv/content/jaunumi/4842>
- ¹⁷ Ibid.
- ¹⁸ European Central Bank (2019), available at: <http://sdw.ecb.europa.eu/browse.do?node=9484266>
- ¹⁹ European Commission (2019), *Survey on the Access to Finance of Enterprises*, available at: http://ec.europa.eu/growth/access-to-finance/data-surveys/index_en.htm
- ²⁰ Latvia.eu (2019), *Latvia updates on banking system reforms*, available at: <https://www.latvia.eu/news/latvia-updates-banking-system-reforms>
- ²¹ ALTUM, available at: <https://www.altum.lv/en/>
- ²² European Investment Bank (2020), *Latvia: EIB supports ALTUM to help Latvian businesses*, available at: <https://www.eib.org/en/press/all/2020-294-eib-supports-altum-to-help-latvian-businesses>
- ²³ Eurostat (2019), *Community survey on ICT usage and eCommerce in enterprises*, available at: http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=isoc_ske_itspen2&lang=en
- ²⁴ See Note 13.
- ²⁵ See Note 23.
- ²⁶ Ministry of Economics (2013), *Guidelines for Science, Technology Development, and Innovation 2014-2020*, available at: <https://www.em.gov.lv/en/media/120/download>
- ²⁷ European Commission (2020), *European Innovation Scoreboard*, available at: https://ec.europa.eu/growth/industry/policy/innovation/scoreboards_en
- ²⁸ Centralas statistikas parvaldes datubāzes (2019), ZIG010. *Iestādes, uzņēmumi un organizācijas, kurās tiek veikts pētniecības darbs*, available at: https://data.csb.gov.lv/pxweb/lv/zin/zin__zin/ZIG010.px/table/tableViewLayout1/
- ²⁹ Paula D. (2020), *Retail trade development is slightly losing strength*, <https://www.macroeconomics.lv/retail-trade-development-slightly-losing-strength>
- ³⁰ Rutkovska A. (2020), *Has the manufacturing output already bottomed out?*, <https://www.macroeconomics.lv/has-manufacturing-output-already-bottomed-out>
- ³¹ Ministry of Economics (2020), *In order to mitigate the effects of COVID-19, economic operators will have access to loans for working capital and credit holiday guarantees*, available at: <https://www.em.gov.lv/en/article/order-mitigate-effects-covid-19-economic-operators-will-have-access-loans-working-capital-and-credit-holiday-guarantees>; ALTUM (2020), *Working Capital Loan | Covid-19*, available at: <https://www.altum.lv/en/services/businesses-covid-19/working-capital-loan-covid-19/about/>
- ³² Latvijas Republikas tiesību akti (legal acts of the Republic of Latvia) (2020), *Par Rīcības plānu pārejai uz aprites*

ekonomiku 2020.-2027. Gadam, available at: <https://likumi.lv/ta/id/317168-par-ricibas-planu-parejai-uz-aprites-ekonomiku-2020-2027-gadam>

³³ Ministry of Welfare (2019), *Informatīvais ziņojums "Par zaļā iepirkuma īstenošanu valsts pārvaldē 2019. gadā"*, available at: https://www.varam.gov.lv/sites/varam/files/content/files/varamzino_140420_zpi_2019.pdf

³⁴ Ministry of Environmental Protection and Regional Development (2019), *Informatīvais ziņojums "Par zaļā iepirkuma īstenošanu valsts pārvaldē 2019. gadā"*, available at: https://www.varam.gov.lv/sites/varam/files/content/files/varamzino_140420_zpi_2019.pdf

³⁵ Cabinet of Ministers (2019), *Rudenī komersantiem būs pieejams atbalsts energoefektivitātes paaugstināšanai ražošanas objektos*, available at: <https://www.mk.gov.lv/lv/jaunums/rudeni-komersantiem-bus-pieejams-atbalsts-energoefektivitates-paaugstinasanai-razosanas-objektos>

³⁶ ALTUM (2017), *About the Social Entrepreneurship Programme*, <https://www.altum.lv/en/services/enterprises/grants/Social-Entrepreneurship-Programme/about-the-programme/>

³⁷ Ministry of Environmental Protection and Regional Development (2020), *Green Public Procurement*, available at: <https://www.varam.gov.lv/en/green-public-procurement>

³⁸ Interreg Europe, *Good practice: Cluster Policy in Latvia*, available at:

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³⁹ European Commission (2020), European observatory for clusters and industrial change, *European Panorama of Clusters and Industrial Change*, available at:

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