







Weekly Briefing

Latvia economy briefing:
New Support Measures to Latvian SMEs for Business Development,
Innovation and Export
Institute of Economics at the Latvian Academy of Sciences

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New Support Measures to Latvian SMEs for Business Development, Innovation and Export

Summary

In Latvia, small and medium-sized enterprises (SMEs) face challenges in their expansion plans and finding qualified employees. The government focuses on regulatory enhancements and support for high-quality e-services to attract investments and create job opportunities. Despite these efforts, there has been a net decrease in registered companies, particularly in sectors like transport, processing industry, services, and agriculture. The scarcity of skilled workers is a significant hindrance to SME growth, with 86% of surveyed companies identifying it as a major obstacle. In July 2023, the government approved a new support program, executed by the Latvian Investment and Development Agency, with a substantial funding of 73.38 million euros for the 2021-2027 period. The program aims to foster innovative business development and export opportunities by promoting technologically intensive companies, incubating new businesses, and facilitating access to foreign markets for exportable products and services. The success of the program depends on effective implementation and collaboration between the government and private sector to address labor shortages and broader economic challenges.

Introduction

In Latvia, fostering a competitive economy is contingent on improving the business environment to attract higher investments and create more job opportunities, ultimately benefiting the populace. To achieve this, the government annually devises the Business Environment Improvement Action Plan (BEIAP), aiming to enhance regulatory norms and state-administered services. This strategic plan seeks to create a competitive business environment both within Latvia and on a global scale. Additionally, Latvia undertakes various reforms to simplify business processes and reduce administrative burdens, particularly in sectors like company establishment, construction, taxation, e-governance, and business termination. With a focus on offering high-quality e-services, these proposed support measures aim to propel business development, foster innovation, and promote exports, solidifying Latvia's position as an attractive destination for entrepreneurial ventures. Despite this, it is difficult for small and medium-sized enterprises (SMEs) in Latvia to survive due to several

factors. To combat the problem, the Ministry of Economy presented support mechanisms for SME development in July 2023.

Status-Quo of the Business Environment in Latvia

According to the latest data of the Ministry of Economy of the Republic of Latvia, there were 181,455 companies in Latvia at the beginning of August 2023. About 99% of the total number of companies correspond to the SME category.

The time spanning from October 2021 to October 2022 had been a tumultuous period for enterprises in Latvia, as reflected in the net decrease of 1,192 registered companies. The closure of 10,407 businesses, particularly in sectors such as transport, processing industry, services, and agriculture, has highlighted the significant challenges faced by companies during this time. Factors such as a drop in sales, soaring costs of raw materials, transportation, and energy, alongside the potential domino effect of sudden closures on other firms, have contributed to the decline.

There are a number of challenges faced by SMEs in Latvia regarding their plans to expand their businesses and the difficulties they encounter in finding qualified employees. According to the Financial Industry Association in the second half of 2022, despite a positive business outlook with 27% of SMEs in Latvia planning to expand and 19% considering it, the most significant hindrance to growth is the scarcity of qualified employees, as identified by the majority of surveyed companies (86%). The shortage of skilled workers is attributed to inadequate qualifications, a lack of applicants, and difficulties in meeting desired pay levels. Larger companies with over 50 employees face more pronounced difficulties, likely due to their greater need for a larger workforce. Specific industries, including construction, IT, management, and energy supply, experience a skills gap.

Additionally, 25% of companies struggle to balance job requirements and compensation, while 17% receive insufficient job applications. The issue is nationwide, but it is most intense in regions like Riga, Zemgale, and Latgale. The decline in the unemployment rate (currently at 6.3%) contributes to the overall labor shortage. Some SMEs (6%) are considering hiring Ukrainian refugees to address the problem, but this may not fully resolve specific profession-related language or knowledge requirements.

A survey conducted by "Tele2" and "Berg Research" at the end of 2022 reveals that only 37% of Latvian SMEs consistently conduct thorough data analysis before making decisions, while 48% do it irregularly and 15% do not analyze data at all. SMEs in the service sector and those with at least 11 employees are more likely to perform data analysis. Financial indicators

are the most commonly analyzed data (86%), while other crucial aspects like sales indicators, production data, customer service data, and marketing data are analyzed less frequently. Despite this, there is a growing interest in data analysis among corporate clients. The survey was conducted in November 2022, encompassing 302 SMEs.

Public Reception

The Cabinet of Ministers in July 2023 approved a new support program for Latvian SMEs to foster innovative business development and export opportunities. This program will span the 2021-2027 planning period of the EU Structural Funds and will be executed by the Latvian Investment and Development Agency (LIAA), with a substantial funding of 73.38 million euros.

The primary aim of this support program is to facilitate funding accessibility for the implementation of innovative business ideas and business growth within Latvia. It will focus on encouraging activities that increase the presence of innovative entrepreneurs in the economy, particularly in medium-high and high technology sectors and creative industries. Additionally, the program will promote export growth among supported companies, thus contributing to the realization of the goals set forth in the Latvian Smart Specialization Strategy of the National Industrial Policy.

To ensure a seamless transition from the previous period's programs, the government will introduce the new support initiatives gradually, preventing any gaps in assistance. These government-approved programs are designed to drive economic transformation, motivating companies to innovate and produce high-value-added products. The support program for exporting companies that produce or plan to produce products with high added value is expected to be announced at the end of 2023. In the meantime, the current LIAA business incubator program will continue until the end of 2023, and the implementation of the new support measures will commence the following year. Additionally, support will be provided for the innovation motivation program, aimed at stimulating the development of novel and innovative business ideas.

Under the new support program, LIAA will implement three key activities, adopting and building upon successful practices from the European Union Structural Funds and the Cohesion Fund 2014-2020.

1. **Innovation Motivation Activities:** The goal is to promote the emergence of technologically intensive companies, motivating them to create and develop products

and technologies with high added value. This activity will receive total financing of 4.82 million euros, and LIAA will organize measures to promote innovation and entrepreneurship, establish new partnerships and cooperation projects, and implement training programs aimed at fostering entrepreneurship and innovation.

2. **Business Incubation Support:** This activity aims to ensure the incubation of newly created technologically intensive and creative industries companies, with a focus on research and development components. Total financing for this activity is set at 37.96 million euros. Merchants will be eligible to receive support in the form of grants for starting a business, business development services, space rental, prototyping and technology development, production equipment and material procurement, one minimum monthly salary and related taxes and fees per employee per 12-month period. LIAA will also provide pre-incubation support and organize entrepreneurship and export promotion events and cooperation events with organizations. The plan is to establish LIAA representative offices or business incubators across Latvia, including those catering to the creative industries and technology sectors.
3. **Export Support:** The objective is to foster the creation of exportable products and services based on innovation and knowledge and to facilitate access to foreign markets. A total funding of 28.94 million euros has been allocated for this activity. Merchants will have the opportunity to receive grants for participation in international events and platforms, development of publicity and marketing materials, market research in target markets, assessment of production facilities and products, participation in international industry associations, attraction of relevant industry experts in export markets, development and registration of trademarks and designs, participation in international trade missions, and organizing international sports events and exhibitions. LIAA will also provide consultations, entrepreneurship, and export promotion activities through Latvia's external economic representations in person and online, participation in the beneficiary's national stands, product or service adaptation to foreign markets, and export consulting for establishing business contacts abroad.

Throughout the program's duration, it is anticipated that a total of 1,500 companies working on their business projects will receive support, including at least 300 companies with new ideas. The turnover of the supported companies is projected to increase by 12%, and the annual export volume is targeted to grow by 20% or 0.6 billion euros between 2024 and 2029.

Additionally, the program aims to create 1000 new jobs by supporting 700 exporting companies.

Conclusions

The proposed measures by the Ministry through the new support program for Latvian SMEs show promise in addressing the challenges faced by businesses, including the recent net decrease in registered companies and closures within various sectors. The program's focus on fostering innovation, entrepreneurship, and export growth aims to improve productivity levels, stimulate economic activity, and encourage SMEs to produce high-value-added products. Furthermore, the emphasis on cross-sectoral cooperation and commercializing creativity and innovation may help overcome obstacles related to skills gaps and labor shortages. The program's support for data analysis among SMEs can also empower them to make more informed decisions. However, the program's effectiveness will depend on proper implementation and collaboration between government support and private sector initiatives to address the broader economic landscape and scarcity of qualified employees.

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