

Entrepreneurship in Latvia and Other Baltic States: Results from the Global Entrepreneurship Monitor

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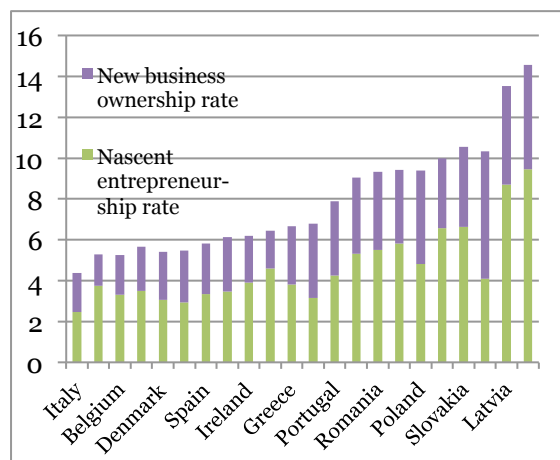
This policy brief summarises the results and implications of an upcoming Global Entrepreneurship Monitor (GEM) 2012 Latvia Report: a study on the entrepreneurial spirit and the latest trends in entrepreneurial activity in Latvia. The results suggest that Latvia is a rather entrepreneurial country (it rates second out of all EU countries by the share of population in early-stage entrepreneurial activity). GEM also finds that Latvian early-stage entrepreneurial activity is counter-cyclical. Early-stage entrepreneurship and self-employment have been important supports for those who were hit by the crisis in 2008-2009. Latvian entrepreneurs are measured to have strong international orientation and growth ambitions. The majority of them are young and middle-age males; in turn, females and the older age group (55-64) represent an “untapped entrepreneurial resource” potential to be addressed by policymakers.

The Global Entrepreneurship Monitor (GEM) is a not-for-profit academic research consortium that produces an annual evaluation of entrepreneurial activity across the world (69 countries participated in 2012; see more at www.gemconsortium.org). Latvia has participated in GEM since 2005. Thus GEM results provide a picture of Latvian entrepreneurial activity over a period that includes the boom-bust-recovery of recent years. The other two Baltic states, Estonia and Lithuania, have only recently participated in GEM, and this year is the first in which all three have participated thereby providing an opportunity for a comparative analysis.

GEM indicates that, overall, Latvia is a rather entrepreneurial country. A total of 13.4% of Latvia's adult population (age 18-64) were involved in early-stage entrepreneurial activity in 2012, where early-stage entrepreneurship is defined to include both nascent entrepreneurs and businesses younger than 3.5 years, see appendix for the precise definition. As illustrated by Figure 1A, Latvia ranks 2nd out of 22 EU countries participated in the GEM project. However, the participation of both women and older persons in entrepreneurship in Latvia is quite low, suggesting a potential that could be exploited.

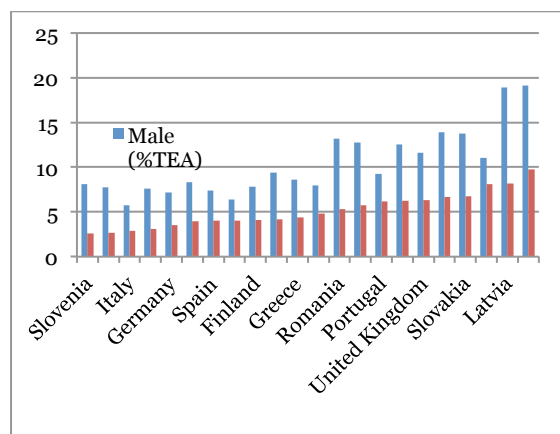
The Hidden Potential of Latvian Entrepreneurship: an Age and Gender Perspective

Figure 1A. New Business Ownership and Nascent Entrepreneurship Rates by Country, 2012, (% of adults)



Source: GEM Adult Population Survey

Figure 1B. Male and Female Entrepreneurship Rates by Country, 2012, (% of total early stage entrepreneurial activity (TEA))



Source: GEM Adult Population Survey

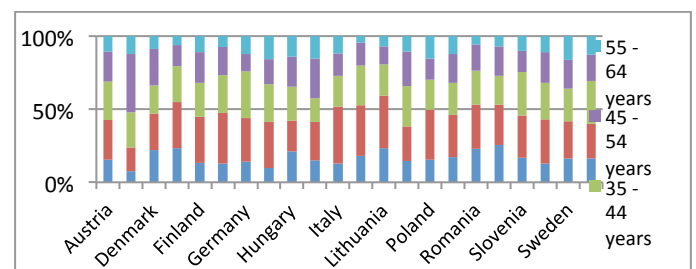
In particular, similarly to other EU countries participating in the GEM project, the number of females engaged in entrepreneurial activity in Latvia is lower than for their male counterparts with a male entrepreneurial activity rate of almost 19% as compared with 8% for women, see figure 1B. This is at odds with other indicators of female economic activity in Latvia. Indeed the Latvian female labour force participation rate is high; almost two thirds of higher education institution graduates are women; close to 60% of doctoral degrees are awarded to females; Latvia has

one of the highest proportions of female managers in the European Union. In other words, Latvian women have risen to the top in business as well as the public sector much more than in the entrepreneurial sector. This suggests that there is an untapped entrepreneurial potential in Latvia.

From an international perspective, the Latvian situation is not unique. Mitchell (2011), who discusses the gender gap and female entrepreneurs as economic drivers in general and the US situation in particular, recognizes that women have made great strides in breaking through the “glass ceiling”. However, a “glass wall” seems to be preventing them from going into entrepreneurship. Breaking through this wall is a challenge not only in Latvia, but also in the United States and a number of other countries. In the Latvian context, until this wall is breached, women capable of starting a business will remain a major under-used economic resource.

In terms of age, entrepreneurship in Latvia is overwhelmingly carried out by young and middle-aged people (Figure 2). Latvia has the lowest share among the EU GEM countries for the oldest age group, i.e. 55-64. Similar pattern is evident for the same age group in Estonia and Lithuania. Part of the explanation for the Baltic States’ lagging performance within the older age group might be found in its Soviet heritage: the oldest cohorts were brought up and spent a considerably period of their professional life in the Soviet system, which did not encourage business and entrepreneurship.

Figure 2. Early-Stage Entrepreneurial Activity by Age Groups for GEM EU Countries, 2012



Source: GEM Adult Population Survey

Entrepreneurial Activity and the Latvian Business Cycle

Figure 3A-F illustrates various aspects of the dynamics of Latvian entrepreneurial activity over 2005-2012. One immediate observation is that Latvian entrepreneurial activity has exhibited considerable variability. In the boom years of 2005-2007, entrepreneurial activity fell as the economy grew faster. With the recession of 2008-2010, entrepreneurial activity, measured as the TEA (total early-stage entrepreneurial activity) rate, increased almost threefold from approximately 4% in 2007 to around 12% in 2011. Thus, the experience of the last eight years suggests that Latvian early-stage entrepreneurial activity is counter-cyclical. At first sight this might appear counter-intuitive since one would expect entrepreneurship to increase in good times, following increased demand for products and services, and fall in a recession. However, the other force at work is the opportunity cost of entrepreneurship; in the boom years of 2005-2007, the Latvian economy in general and its labour market in particular became seriously overheated with very large increases in wages and salaries. This meant that for many potential entrepreneurs the opportunity cost of leaving a highly paid employment to enter entrepreneurship was high and rising.

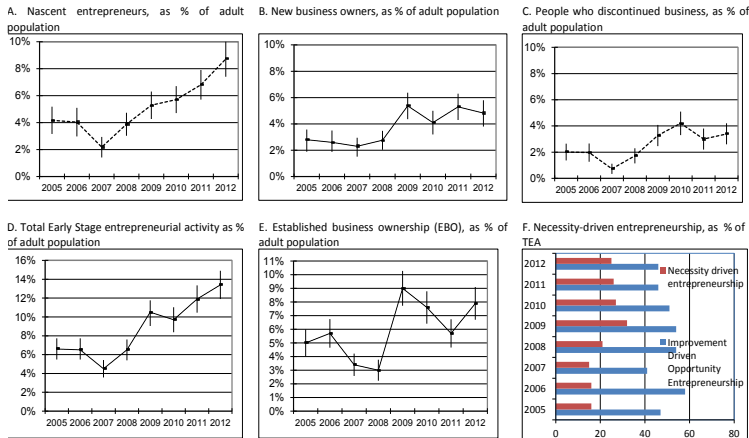
Furthermore, the fact that the labour market was overheated and virtually anyone employable was employed naturally reduced the number of persons in the age group 18-64 forced into necessity-driven entrepreneurship. By contrast, when the economic crisis hit, jobs were cut or wages reduced, or both, so that many were forced into entrepreneurship in order to survive. Figure 3F confirms this scenario: during the good years 2005-2007 necessity-driven entrepreneurship was fairly stable around 15% of early-stage entrepreneurial activity. When the crisis struck, the share of necessity-driven entrepreneurship almost doubled and although it has fallen slightly, it still amounts to 26% of Latvian early-stage entrepreneurial activity. This of course raises the question of whether the recently observed increases in Latvian early-stage entrepreneurial activity will have

an enduring impact on overall Latvian economic development.

We also observe (from Figure 3A and Figure 3B) that during most of the period studied, a fairly strong co-variation exists between the two components of TEA: 'new business owners' correlates positively with nascent entrepreneurs (that is, people who only do first steps towards starting their own business). This is reasonable since nascent entrepreneurship 'feeds into' new business owners even though not all nascent entrepreneurs end up as new business owners. In 2010 this co-variation seems to be broken: although the prevalence rate of nascent entrepreneurs has increased since 2009, the prevalence of new business owners has fallen from its peak in 2009. This can be seen as an indication that many start-ups during the crisis were not viable and most likely necessity-driven.

The business discontinuation rate (percentage of the 18-64 age group who in the past 12 months have discontinued a business) is presented in Figure 3C. It should be no surprise that the discontinuation rate has moved with the Latvian business cycle. When the economy reached its peak in 2007 the percentage of adult population that had discontinued a business was less than 1% and this peaked at 4% in 2010 (reflecting businesses closed down from May 2009 to May 2010). Part of this increase stems from the fact that during the crisis (as discussed above) the level of early-stage entrepreneurial activity more than doubled and hence, everything else being equal, the fraction of the adult population who with a time-lag had discontinued a business should roughly also have doubled. However, this could just explain only half of the increase in the business discontinuation rate (the 8 year sample of GEM data is too small for any 'serious' econometric analysis). The remaining failures can probably be attributed to the large number of necessity-driven and in many cases non-viable businesses started during the recession.

Figure 3A-F. Indicators of Entrepreneurial Activity in Latvia, 2005-2012



Entrepreneurship in the Baltic Countries

2012 is the first year that all three Baltic countries participated in the GEM project. Given that these countries experienced fairly similar starting conditions when they regained independence in 1991, it is interesting to compare their respective performance. Latvia was the first of the Baltic countries to start participating in the GEM project (from 2005), Lithuania joined in 2011 and Estonia did not join until 2012.

Figure 4 compares various aspects of entrepreneurial activity across the three Baltic States and the GEM EU countries. Inspection reveals that, with respect to the seven dimensions analysed, Lithuanian performance is more or less exactly similar to that of the GEM EU countries. Latvian performance, on the other hand, is very similar to the Estonian performance. In comparison to Lithuania and the GEM EU countries, both Estonia and Latvia scored considerably higher in terms of early-stage and nascent entrepreneurship.

Figure 4. Indicators of Entrepreneurial Activity in the Three Baltic Countries and EU GEM Average, 2012

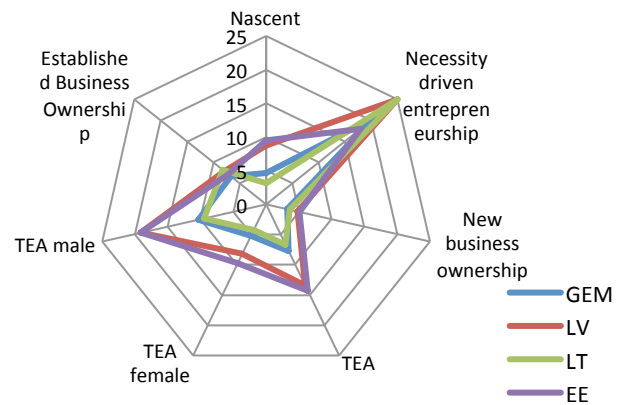
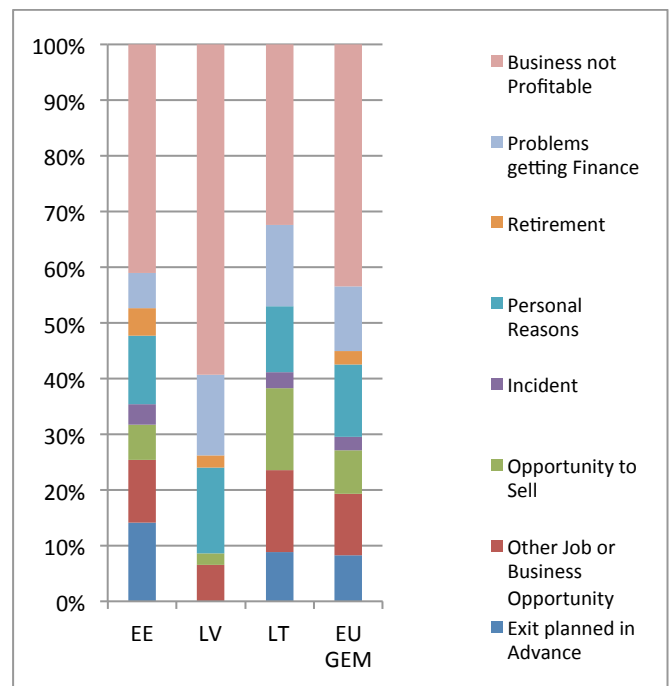


Figure 5 illustrates a comparison of the reasons for business discontinuation.

Figure 5. Reason for Business Exit in the Three Baltic Countries Compared to GEM EU Average Results, 2012



Latvia stands out with the lack of profitability being the reason for discontinuation in 40% of Latvian cases. This is higher compared both to Estonia (35%) and Lithuania (25%) as well as the average level of GEM EU countries (30%). For Latvian respondents, the second and third

main reasons for business discontinuations were personal reasons and problems obtaining finance – both quoted by roughly 10%. For Estonians, in about 12% of cases of discontinuation was planned in advance and in about 11% exit happened for personal reasons. For Lithuania, about 11% of discontinuations were attributed to each of the following reasons: problems obtaining finance, another job or business opportunity, and opportunity to sell.

GEM also measures the aspiration levels of entrepreneurs as to development of their enterprises using three main measures: growth expectations; innovativeness of products and/or services; and internationalisation of business activities. These three indicators are closely related to economic development and hence prosperity (Wennekers et al., 2010) and therefore provide insight into the overall impact of entrepreneurship on the economy. In terms of international orientation, Estonia and Latvia are quite similar (about 30% of all early stage entrepreneurs indicate having at least 25% of their customers coming from other countries) with Lithuania standing out as being more internationally oriented (40% of TEA). In terms of growth expectations, Latvia and Lithuania are similar (about 50% of all early stage entrepreneurs expect to have at least five employees five years from now) and Estonia scores slightly worse with 40%. In terms of innovation, Latvia and Estonia are similar (perhaps surprisingly), with about 50% of TEA indicating that their product or service is new to at least some customers. For Lithuania this indicator is considerably lower at only 31%.

To sum up, recent participation of Estonia and Lithuania in the GEM reveals that despite some differences, entrepreneurship is broadly similar across the three countries.

Concluding remarks

The eight-year participation of Latvia in the GEM reveals the role of entrepreneurship in

the boom-bust-recovery of recent years. Entrepreneurship was shunned in the boom when good jobs and high wages were readily available, and offered a safety valve as jobs vanished in the bust. Thereby, it is not clear to which extent recent entrepreneurial boom in Latvia will project to Latvian longer-term economic development. However, such features of Latvian entrepreneurship as innovativeness and international orientation contribute to more optimistic view on the future role of entrepreneurial sector in Latvian economy.

Taking into account unused entrepreneurial potential of females and individuals aged 55-64, specific programmes aimed at promoting entrepreneurship for these groups may also contribute to the growth and competitiveness of the national economy.

References

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Appendix

The unit of analysis in GEM is the entrepreneur rather than the business venture, with entrepreneurs playing the role of informant on their business. 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 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 even discontinuation of the business. GEM 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 provides means by which a wide variety of important entrepreneurial characteristics such as innovativeness, export-orientation, and high-growth aspirations can be systematically studied; attitudes representing the climate for entrepreneurship in a society can be considered. An important advantage of GEM is its reliance on high-quality data, collected via adult population surveys (APS) in each participating country.

Nascent entrepreneurs - A nascent entrepreneur is an adult individual (a person between 18 and 64 years old) who is actively trying to start up a new business that they 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 – TEA (nascent entrepreneurs + new firm owners) - An early-stage entrepreneur is an adult individual who is either a nascent entrepreneur or a new firm owner. The early-stage entrepreneurship phase covers entrepreneurial activity from the first active step taken to start up a business until the moment when the enterprise has paid salaries to its owners for 42 months (3.5 years).

Necessity-driven entrepreneurship - Percentage of those involved in TEA who are involved in entrepreneurship because they had no other option for work.

Improvement-driven entrepreneurship - Percentage of those involved in

TEA who (i) claim to be driven by opportunity as opposed to finding no other option for work; and (ii) who indicate the main driver for being involved in this opportunity is being independent or increasing their income, rather than just maintaining their income.

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