

FEATURES OF STATE FINANCIAL SUPPORT TO THE SMALL BUSINESS SECTOR IN THE REPUBLIC OF LATVIA

Renate Indrika

*Baltic International Academy,
College of Accounting and Finance, Riga, Latvia, zujeva.renate@gmail.com*

Abstract. The purpose of this study is to identify, study and evaluate the state support measures for small businesses (SMEs) using the example of the Republic of Latvia. The subject of the study is a system of financial regulation and stimulation of the development of small and medium-sized businesses. The object of the research is the system of state financial support for SME, the subject - the possibility of obtaining this financial assistance from government institutions.

The methods of state support are generalized and proposals for improving the methods of support are developed. The practical significance of the research lies in the fact that the study supplements a number of conclusions and practical recommendations in the field of organizational measures for effective financial support and multilateral development of the small and medium business sector in the economy, recognition of the effectiveness of financial support and development of the small business sector as the main goal of the economic policy of the State of Latvia. The practical part of the work can also serve as information material for acquainting and comparing the possibilities of attracting state financing, in comparison with the proposals of Latvian commercial banks and private financial institutions.

Keywords: Government support for small businesses; Latvian economic; Small business; SME, COVID-19.

JEL codes: E60; G28; H71.

INTRODUCTION

Scientists from all over the world are studying the issue of opportunities and peculiarities of attracting financing for small businesses. Some drew attention to the impact of financing in the form of state and personal guarantees on the development of the small business sector (Zecchini & Ventura (2009), Ono & Uesugi (2009), others paid more attention to assessing the competence of entrepreneurs when applying to government and credit institutions (Moro, Fink, & Kautonen, (2014), Moritz (2015). Sarapaivanich & Kotey, 2006), while others considered funding opportunities in general (Roberts, (2015), Abdulsaleh & Worthington (2016), Bhusal. (2015), Barriers to when applying for financial support (Nguyen (2017); and the role of additional financing for the development of the small business sector in specific countries (Kodongo (2015), Oncioiu, (2012)). However, there have been no works devoted to the specifics of attracting public funding by Latvian entrepreneurs, despite the fact that this topic is especially relevant at the time of the pre-crisis state of the Latvian economy, caused by both the coronavirus pandemic and the negative trend towards a reduction in the number of Latvian enterprises over the past three years. Therefore, this study is relevant, and the generalized information can be used in the future by a wide range of users, from entrepreneurs to students and schoolchildren studying economic disciplines and the basics of entrepreneurial activity.



Fig.1. **Methods of government support for SME** (Source: author's compilation)

This article continues the author's study of the impact of state support on the development of small business in Latvia. The previous article "The Role of Small Business in the Economy and Methods of Its Government Support Using the Example of the Republic of Latvia" described the system of state support for small businesses, which is comprehensive assistance in the following areas: financial support, legislative, property, educational, consulting and informational.

The relevance of the article is confirmed by the data of the Register of Enterprises, the number of enterprises in Latvia has been rapidly decreasing in recent years, moreover, many more companies are being liquidated every year than are being created. In this regard, and taking into account the results of the study, the author of this article put forward a hypothesis that perhaps one of the most important factors affecting the viability of enterprises in the small business sector is insufficient government funding or its complete absence.

To prove or refute this hypothesis, the author of the article decided to comprehensively study the available possibilities of attracting state aid in the form of additional funding to facilitate the opening of new and development of existing enterprises, to get acquainted with the works of Latvian and foreign scientists who were also studying this issue. The object of the study was the system of state financial support for SME, the subject was the possibility of receiving this financial aid from state institutions.

METHODS OF STATE SUPPORT FOR ENTREPRENEURSHIP

The most popular and demanded by Latvian entrepreneur's measures of financial support of small business from the state are reflected in the diagram below, however, it should be noted that the majority of respondents named the loan as the main source of the desired additional financing.

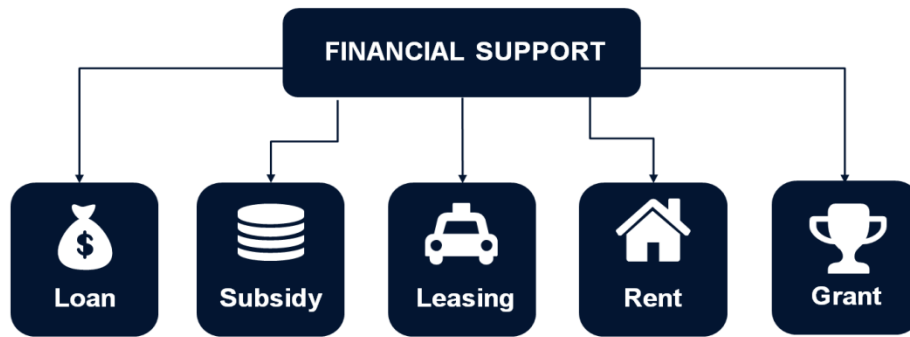


Fig.2. Methods of state financial support for SME (Source: author's compilation)

The data analyzed in the aforementioned study was obtained from participants in a survey organized and developed by the author of the study. A survey conducted in March 2019 was attended by 367 respondents, active Facebook users who are not indifferent to the economic situation in the Republic of Latvia. The questionnaire was developed by the author of the study and consisted of 13 questions offering different answer options, such as choosing a specific answer from the proposed ones, as well as a 6-point priority system for assessing various indicators. Key questions were devoted to the opinion of survey participants about the availability of the above methods of state support for small businesses. According to the survey results, respondents consider the most important and expected financial support from the state.

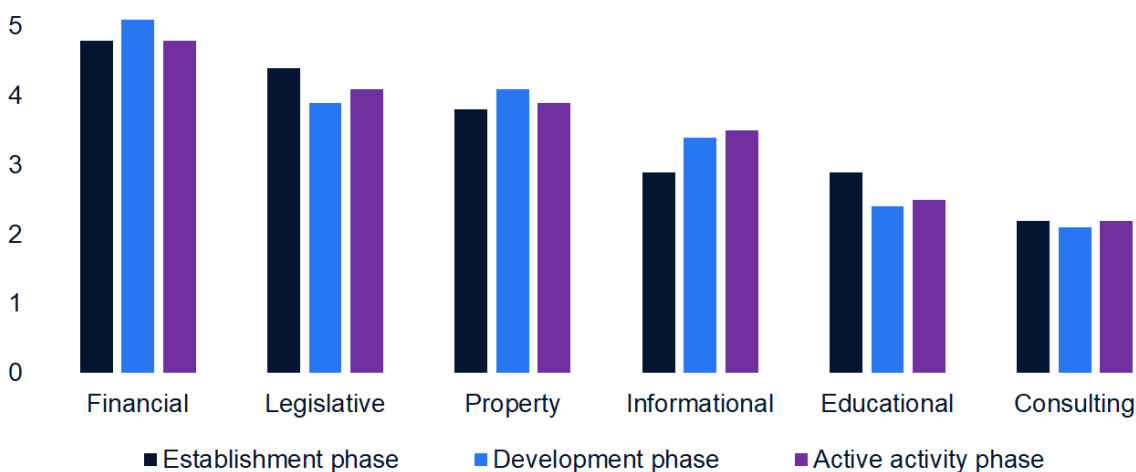


Fig. 3. Priorities of types of state support for the enterprise at different stages of its existence (Source: author's research results)

The main financial institution for the state development of the Republic of Latvia is ALTUM, which provides financing through various financial instruments such as loans, credits, grants, guarantees, investments in venture funds, etc. However, this financial assistance is provided to enterprises only in those areas that the state has identified as important and supported, and where sufficient financing from credit institutions is not available.

The main tasks of ALTUM are:

- assistance and support in creating a business, its development, increasing competitiveness, introducing new technologies and innovations;
- development of regions and agriculture;
- promoting the export of goods and services;
- increasing energy efficiency, etc.

As a state-owned company, ALTUM focuses on supporting business through financial instruments, without making donations, but through targeted cooperation and financial support for business promotion activities. ALTUM support programs are implemented at the expense of state resources - funding attracted by the European Union, other international organizations, the Latvian state and ALTUM. ALTUM shares are owned by the Ministry of Finance of the Republic of Latvia, the Ministry of Economy and the Ministry of Agriculture.

At the beginning of 2020, the author of this article conducted a study of the availability of various types of state financial support for ALTUM, statistics on loans granted for the creation and development of small businesses, as well as identifying obstacles and conditions for obtaining this type of financing. The initial data for this study were obtained from the responsible employees of ALTUM, and also taken from the home page of this institution - www.altum.lv.

According to the research, ALTUM provides enterprises and self-employed persons with the following lending opportunities as financial assistance:

- Loan for start-up entrepreneurs, which in turn is divided into 3 types:
- Loan against working capital (loan for the purchase of materials, fuel, rent, etc.);
- Investment loan for the purchase of machinery, equipment, commercial vehicles, etc. ;
- Financing of projects related to real estate (acquisition or reconstruction of industrial premises, etc.)

| Age of the company from 0 to 5 years | Provided amount, Euro | Annual interest rate from | Loan term, to | Own participation |
|--------------------------------------|-----------------------|--|---------------|-----------------------------|
| Working capital | up to 7,000 | 2.5% + Cost of the resources of the State Treasury (including service fees) 0.5% | 3 years | 0% of the project amount |
| | from 7,000-150,000 | | | 10% of the project amount * |
| Investment loan for equipment | up to 7,000 | 4% + Cost of the resources of the State Treasury (including service fees) 0.5% | 7 years | 0% of the project amount |
| | from 7,000-150,000 | | | 10% of the project amount * |
| Financing real estate | up to 7,000 | 2.5% + Cost of the resources of the State Treasury (including service fees) 0.5% | 15 years | 0% of the project amount |
| | from 7,000-150,000 | | | 10% of the project amount * |

Fig. 4. **Loan for start-up entrepreneurs** (Source: author's compilation from www.altum.lv)

* For amounts less than 7000 Euros, a personal guarantee from the owner is required, for amounts up to 25000 Euros, if the EaSI un COSME guarantee criteria are met, no additional collateral is required. In other cases, the value of the collateral is at least 74% of the loan amount; other property of the owner or other guarantors can be used as collateral.

- Loans for operating enterprises, which is also possible in three variations:
 - Loan against working capital (loan for the purchase of materials, fuel, rent, etc.);
 - Investment loan for the purchase of machinery, equipment, commercial vehicles, etc. ;
 - Financing of projects related to real estate (acquisition or reconstruction of industrial premises, etc.)

| Age of the company from 0 to 5 years | Provided amount, Euro | Annual interest rate from | Loan term, to | Own participation |
|--------------------------------------|-------------------------|--|----------------------------|-----------------------------|
| Working capital | from 2 000 - 25 000 | 2.5% + Cost of the resources of the State Treasury (including service fees) 0.5% | from six months to 3 years | 0% of the project amount |
| | from 25 000 - 1 000 000 | | | 10% of the project amount * |
| Investment loan for equipment | from 2 000 - 25 000 | 3% + Cost of the resources of the State Treasury (including service fees) 0.5% | from 2 to 7 years | 0% of the project amount |
| | from 25 000 - 2 850 000 | | | 10% of the project amount * |
| Financing real estate | from 2 000 - 25 000 | 3% + Cost of the resources of the State Treasury (including service fees) 0.5% | from 2 years to 15 years | 0% of the project amount |
| | from 25 000 - 2 850 000 | | | 10% of the project amount * |

Fig. 5. Loans for operating enterprises (Source: author's compilation from www.altum.lv)

* For amounts less than 7000 Euros, a personal guarantee from the owner is required, for amounts up to 25000 Euros, if the EaSI un COSME guarantee criteria are met, no additional collateral is required. In other cases, the value of the collateral is at least 74% of the loan amount; other property of the owner or other guarantors can be used as collateral.

| For the implementation of small business projects | Provided amount, Euro | Annual interest rate from | Loan term, to | Own participation |
|---|-----------------------|--|---------------|------------------------------|
| Working capital | up to 7,000 | 5% -8% + Cost of the resources of the State Treasury | up to 5 years | 0% of the project amount |
| | from 7,000-25,000 | | | 10% of the project amount ** |
| Investment loan | up to 7,000 | 5% -8% + Cost of the resources of the State Treasury | up to 8 years | 0% of the project amount |
| | from 7,000-25,000 | | | 10% of the project amount ** |

Fig. 6. Loans for the implementation of small business projects

(Source: author's compilation from www.altum.lv)

• Microcredits for small and medium-sized businesses for the implementation of small business projects:

** For loans up to 5,000 euros, a private guarantee of the owner (s) of the company, who own at least 10% of the shares, over 5,000 EUR is involved in the collateral value, starting from 74% of the amount.

• Loan for investments and current assets with reduced collateral requirements. The possibility of obtaining a loan, interest subsidy or guarantee (for the development of entrepreneurship and agricultural cooperatives).

| For the development of entrepreneurship and agricultural cooperatives | Branch of the economy | Provided amount, Euro | Annual interest rate from | Loan term, to | Own participation |
|---|--|-----------------------|---------------------------|--------------------|-----------------------------|
| Working capital | all ***, excluding fishing and aquaculture | up to 1,000,000 | 3 % + 6 monthly EURIBOR | from 2 to 5 years | 10% of the project amount * |
| | fisheries and aquaculture | up to 285,000 | | | |
| Investment loan | all*** | up to 2,850,000 | 3 % + 6 monthly EURIBOR | from 2 to 15 years | 10% of the project amount * |

Fig. 7. Loan for investments and current assets with reduced collateral requirements

(Source: author's compilation from www.altum.lv)

*** However, there are certain types of activities and industries for which loans are not provided:

- ✓ trade in alcohol;
- ✓ production and marketing of tobacco products;
- ✓ trade in arms and ammunition,
- ✓ gambling and betting;
- ✓ purchase of road transport for economic operators operating in the transport sector;
- ✓ financial and insurance activities;
- ✓ real estate transactions;
- ✓ for the purchase of undeveloped or built-up land;

Working capital loan is liquidity support for businesses, farmers and those in the fisheries industry, whose activities have been affected by Covid-19. Amount up to EUR 1 million, but the total loan does not exceed at least one of the criteria:

- 25% of 2019 turnover
- loan amount must not exceed twice the total remuneration of employees (incl. social contributions) in 2019 (for those established in 2019, planned two-year amount)
- the amount of liquidity required to ensure operation for the next 12 months.

By applying for a loan, entrepreneur confirms that the loan is necessary for liquidity support due to the negative impact of the Covid-19 crisis, as well as of 31.12.2019. the company has no tax debts or late payments, the loan will not finance activities in ineligible sectors, the loan will not be used for refinancing of other loans and principal payments, debt repayments of related companies, debt payments incurred before March 2020, as well as dividend payments.

The author of the study also carried out a comparative analysis of interest rates on loans granted to enterprises and individual entrepreneurs by private investment companies, credit companies and commercial banks in Latvia. The basis was the available information from the websites of commercial banks, as well as information from the platform for comparing available loans www.altero.lv, which is currently the leader on the Latvian market in providing information on available additional financing from 30 lending companies, banks and investment funds.

Below is information on loan offers of commercial banks of the Republic of Latvia and companies for the provision of fast lending services, which was compiled by the author on the basis of data from the websites of 4 largest Latvian banks (SEB Banka AS, Swedbanka AS, Citadele Banka AS, Luminor Banka AS).

| Commercial banks | Provided amount, Euro | Annual interest rate | Loan term, to | Loan fee |
|---|-----------------------|----------------------|---------------|--------------------------------|
| Microcredit against working capital with a guarantee from ALTUM | up to 50,000 | from 9,8 % | up to 5 years | 1% + 1.42% for ALTUM guarantee |
| Microcredit for an entrepreneur | from 1,000-20,000 | from 14 % | up to 5 years | 2% (or to 150 Euros) |

Fig. 8. **Loans from commercial banks** (Source: author's compilation)

| Lending firms | Provided amount, Euro | Annual interest rate | Loan term, to |
|--|-----------------------|----------------------|----------------------------|
| Loan secured by real estate | from 2 000 | from 8,4% | up to 2 years |
| Agricultural financing | from 5 000 | from 14 % | from 1 month up to 5 years |
| Factoring | from 500 | from 20 % | up to 90 days |
| Loan without collateral | from 1 000 | from 12 % | up to 3 years |
| Targeted financing (purchase of real estate, investment properties, renovations) | from 50 000 | from 5 % | up to 90 days |

Fig. 9. **Loans from lending firms** (Source: author's compilation from www.altero.lv)

RESULTS

Analyzing the statistical data provided to the author of the study, the financial institution ALTUM usually satisfies requests for loans for start-up entrepreneurs in 65-70% of cases, and in 10-15% of cases for already operating enterprises. The main reasons for refusal to receive funding are insufficient financial literacy of the applicants, the unviability of the idea or the financial history of the enterprise. Despite the fact that the bulk of ALTUM clients are enterprises or entrepreneurs who find it difficult to obtain additional financing from commercial banks. Below is the statistics of the last 3 years on the approved ALTUM financing for Latvian starting, developing and operating enterprises.

| Year | For start-up entrepreneurs | | | For existing enterprises | | | Total | |
|------|----------------------------|-------------------|----------------------------------|---------------------------|-------------------|----------------------------------|------------------------|----------------|
| | Number of loans issued, A | Amount in Euro, B | Average loan amount, Euro, B / A | Number of loans issued, A | Amount in Euro, B | Average loan amount, Euro, B / A | Number of loans issued | Amount in Euro |
| 2017 | 432 | 8 419 585 | 19 490 | 705 | 30 165 131 | 42 787 | 1137 | 38 584 716 |
| 2018 | 462 | 10 048 156 | 21 749 | 658 | 34 794 724 | 52 880 | 1120 | 44 842 880 |
| 2019 | 367 | 8 662 360 | 23 603 | 700 | 54 353 669 | 77 648 | 1067 | 63 016 029 |

Fig. 10. ALTUM issued loans (Source: author's compilation)

As you can see from the table above, the number of approved loans for start-up entrepreneurs in 2019 decreased by almost 100 requests compared to 2018, but the average amount of loans received is growing every year. For operating enterprises, there is also a trend towards an increase in the average amount of funding received.

As noted earlier, not every enterprise can apply for state credit assistance from ALTUM, because there are industries and activities for which funding is not provided. Statistical data on the distribution of the ALTUM loan portfolio by industry are as follows

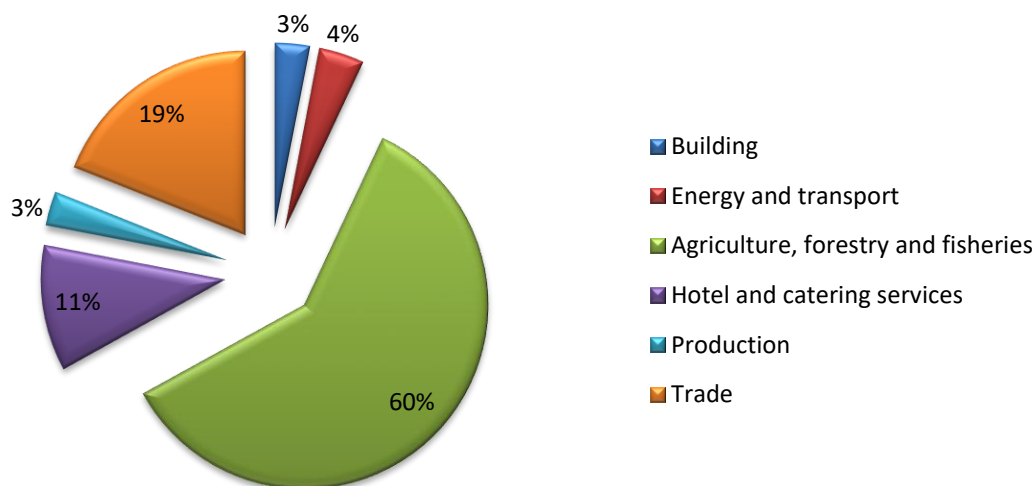


Fig. 11. ALTUM issued loans by industries (Source: author's compilation)

Based on the data of the above graph, it can be seen that the most supported sectors in Latvia are agriculture, forestry and fisheries, the total size of state financial investments is 60%, followed by manufacturing with 19% and hotel and catering services - 11%.

CONCLUSIONS

Analyzing the above data, it can be stated that the proposals of private investment companies, companies for fast lending, as well as commercial banks differ from the possibilities of obtaining additional government financing ALTUM by higher interest rates on loans, shorter terms and the amount of financing provided, as well as the amount of additional commission

In this regard, it should be noted that the state financial assistance that a start-up entrepreneur or an operating enterprise provided by ALTUM can receive looks more attractive, the amount of funding is limited only by approved industries and meeting certain criteria for applying. The state also provides an opportunity for additional financing in the form of a soft loan or grant to enterprises affected by COVID-19.

Having paid attention to the amount of ALTUM financing already provided, according to Fig.11, we have to state the following: there is state financing for small and medium-sized businesses in Latvia, the proposed interest rates are much lower than similar proposals from commercial banks and lending firms, the terms and conditions of obtaining are more affordable. Accordingly, the hypothesis that formed the basis of this study was not confirmed.

However, taking into account the data of the previous research, it should be noted that despite the fact that there is a real possibility of attracting additional government funding for the creation and development of their own enterprise, in particular, obtaining a loan at a good interest rate and possibly even without guarantees and additional security, entrepreneurs rarely use this feature.

Many respondents noted that they were not even aware of the possibility of such government funding. This shows that the population is poorly informed about the possibility of receiving financial assistance from the state, which in turn negatively affects the development of the Latvian economy in general, and private entrepreneurship in particular.

REFERENCES

- Abdulsaleh, M. A, Worthington A. (2016). Bank Financing for Small and Medium-sized Enterprises (SMEs) in Libya, [Accessed 28.09.2021]. Available from Internet: <https://www.semanticscholar.org/paper/Small-and-Medium-Sized-Enterprises-Financing%3A-A-of-Abdulsaleh-Worthington/f2d063d474408ebbf20eae1cb1b5e7905e7382d8>.
- Bhusal R.(2015). SME Finance in Nepal: relevance of bootstrapping finance [Accessed 28.09.2021]. Available from Internet: www.researchgate.net/publication/281901241_SME_Finance_in_Nepal_relevance_of_bootstrapping_finance.
- Kodongo O. (2015). The role of financial access in the success of small and medium enterprises in Swaziland - [Accessed 30.09.2021]. Available from Internet: [//wiredspace.wits.ac.za/jspui/bitstream/10539/21039/1/Zethu%20Mthethwa%20Final%20Paper%20Aug%202015.pdf](http://wiredspace.wits.ac.za/jspui/bitstream/10539/21039/1/Zethu%20Mthethwa%20Final%20Paper%20Aug%202015.pdf).
- Morduch, J & Bauchet, J 2013, 'Is micro too small?: microcredit vs. SME finance', *World Development*, vol. 43, pp. 288-297.
- Moritz A. (2015). Financing of Small and Medium-Sized Enterprises in Europe - Financing Patterns and 'Crowdfunding', [Accessed 28.09.2021]. Available from Internet: https://ubt.opus.hbz-nrw.de/opus45-ubtr/frontdoor/deliver/index/docId/693/file/Dissertation_Alexandra_Moritz.pdf.
- Moro, A, Fink, M & Kautonen, T 2014, 'How do banks assess entrepreneurial competence? the role of voluntary information disclosure', *International Small Business Journal*, vol. 32, no. 5, pp. 525-544.
- Nguyen S.T. (2017). An Analysis of SMEs Funding, Bank Efficiency and Barriers to Lending: Three Essays., [Accessed 28.09.2021]. Available from Internet: <https://eprints.soton.ac.uk/378767/1/Final%2520PhD%2520thesis%2520-%2520Son%2520Nguyen.pdf>.
- Oncioiu, I 2012, 'Small and medium enterprises' access to financing-a European concern: evidence from Romanian SME', *International Business Research*, vol. 5, no. 8, pp. 47- 58.
- Ono, A & Uesugi, I 2009, 'Role of collateral and personal guarantees in relationship lending: evidence from Japan's SME loan market', *Journal of Money, Credit and Banking*, vol. 41, no. 5, pp. 935-960.
- Roberts, RG 2015, *Finance for small and entrepreneurial businesses*, Taylor & Francis Ltd., London, United Kingdom.

- Sarapaivanich, N & Kotey, B 2006, 'The effect of financial information quality on ability to access external funds and performance of SMEs in Thailand', *Journal of Enterprising Culture*, vol. 14, no. 3, pp. 219-239.
- Verovska, L., & Zujeva, R. (2019). The Role of Small Business in the Economy and Methods of Its Government Support Using the Example of the Republic of Latvia, *Economics and Culture*, 16(2), 72-81. doi: <https://doi.org/10.2478/jec-2019-0023>.
- Wang J. (2016). SME financing in Zhejiang province, [Accessed 28.09.2021]. Available from Internet: http://etheses.dur.ac.uk/11675/1/SME_financing_in_Zhejiang_province_WANG_Jinhua.pdf?DDD2+.
- Zecchini, S & Ventura, M 2009, 'The impact of public guarantees on credit to SMEs', *Small Business Economics*, vol. 32, no. 2, pp. 191-206.
- Working Capital Loan-Covid-19, Available from Internet: www.altum.lv/en/services/businesses-covid-19/working-capital-loan-covid-19/about/.