



Inta BRUNA,
Ruta SNEIDERE

THE PRACTICE OF SMALL BUSINESS ACTIVITIES IN LATVIA

Abstract

At present, when in Latvia, as well as in the world we can observe slow increase of economical development, it is important to ensure the population with an opportunity to create additional income and to preserve the present living standard. The topical and important is the way, how the population could gain this income, is starting the entrepreneurship by individuals themselves. In Latvia the small and medium-sized enterprises (SMEs) constitute 99,6% of the national economy and they are very important for the creation of gross domestic product and employment. The authors study the EU activities for the facilitation of the development of SMEs, the normative regulation of business environment in Latvia, as well as the conception of support measures implemented by state, which is one of the parts of programs for the economical stabilization and the renewal of economical growth in Latvia. On the basis of research results, the authors develop the recommendations for the facilitation of small business in Latvia.

Key words:

Micro, small and medium-sized enterprises.

JEL: L26, L53.

© Inta Bruna, Ruta Sneidere, 2012.

Bruna Inta, Professor, University of Latvia.
Sneidere Ruta, Docent, University of Latvia.

1. Introduction

The global financial crisis has considerably affected the national economy of Latvia. The most difficult period for the economy of Latvia was at the end of the year 2008, when in the financial sector and state budget a critical situation developed and it continued until the year 2010. The level of unemployment increased from 5.3% at the end of 2007 up to 19.7% at the end of 2009. Alongside with the considerable decrease of revenues, the budget deficit reached 9% of GDP. Although already in 2008 the Parliament of the Republic of Latvia adopted *The Program for the Stabilization of Economy and Renewal of Economical Growth of Latvia*, where there were set the main directions for the overcoming of economical crisis, the measures for its implementation were taken slowly. At present, when in Latvia, as well as in the world we can observe slow increase of economical development, it is important to ensure the population with an opportunity to create additional income and to preserve the present living standard. The topical and important is the way, how the population could gain this income, is starting the entrepreneurship by individuals themselves. The small enterprises not only provide variety of services for consumers, they also help the large enterprises to function more efficiently (Lesonsky: 2001). The small enterprises are the suppliers of many large enterprises and the sellers of the products manufactured at these large enterprises. In Latvia the small and medium-sized enterprises (SMEs) constitute 99, 6% of the national economy and they are very important for the creation of gross domestic product and employment. The aim of the paper is to study the practice of small entrepreneurship in Latvia and to develop the recommendations for the facilitation of the development of small business. The authors study the activities of the EU and Latvia for the facilitation of the development of SMEs, the normative regulation of business environment in Latvia, as well as the conception of support measures implemented by state, which is one of the parts of programs for the economical stabilization and the renewal of economical growth in Latvia. The research methodology is based on the analysis of laws and regulations, the analysis of statistical data and the studies of economical and scientific literature. The authors do not include in the research such business forms as proprietorship, farms and fishing enterprises, because, in conformity with the provisions of laws and regulations, there had been a transition period determined for them and they had to be reregistered from the Company Register to the Commercial Register, choosing one of the business forms indicated in the Commercial Register.

2. Factors, Influencing the Development of Small Business

In order to motivate the economically active people, who have become unemployed, to start their own small business and to return into the economical circulation, there is a purposeful governmental policy necessary. In this sphere the significant stimulus was Commission staff working document – *Impact Assessment* who accompanies the Commission's proposal for a «Small Business Act» for Europe (SBA). Adopted in June 2008, the «Small Business Act» for Europe reflects the Commission's political will to recognize the central role of SMEs in the EU economy and for the first time puts into place a comprehensive SME policy framework for the EU and its Member States. It aims to improve the overall approach to entrepreneurship, to irreversibly anchor the «Think Small first» principle in policy making from regulation to public service, and to promote SMEs' growth by helping them tackle the remaining problems which hamper their development. «¹ SBA comprises 10 guidelines, binding to the Member States, in order to bring added value at EU level, ensure equal opportunities for SMEs and improve the legal and administrative environment throughout the EU, and these guidelines are the following:

1. Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded.
2. Ensure that *honest* entrepreneurs who have faced bankruptcy quickly get a second chance.
3. Design legislation according to the «Think Small First» principle.
4. Make public administrations responsive to SMEs' needs.
5. Adapt public policy tools to SME needs: facilitate SMEs' participation in public procurement and better use state aid possibilities for SMEs.
6. Facilitate SMEs' access to finance and develop a legal and business environment supportive to timely payments in commercial transactions.
7. Help SMEs to benefit more from the opportunities offered by the Single Market.
8. Promote the upgrading of skills in SMEs and all forms of innovation.
9. Enable SMEs to turn environmental challenges into opportunities.
10. Encourage and support SMEs to benefit from the growth of markets beyond the borders of the European Union.²

¹ Small Business Act: *Impact Assessment*, Commission of the European Communities Brussels, 25.6.2008, SEC(2008) 2101

² Small Business Act

There had been enterprises of different sizes included into the SMEs' category; therefore the European Commission has developed criteria for micro, small and medium-sized enterprises. Enterprises qualify as micro, small and medium-sized enterprises if they fulfill the criteria laid down in the Recommendation which are summarized in the Table 1. In addition to the staff headcount ceiling, an enterprise qualifies as a SME if it meets either the turnover ceiling or the balance sheet ceiling, but not necessarily both.

Table 1

Criteria for Micro, Small and Medium-Sized Enterprises

Enterprise category	Ceilings			
	Staff Headcount (number of persons expressed in annual work units)	Turnover	Or	Balance sheet total
medium-sized	< 250	≤ € 50 million		≤ € 43 million
small	< 50	≤ € 10 million		≤ € 10 million
micro	< 10	≤ € 2 million		≤ € 2 million

Sources: European Commission Staff Working Document

Within the non-financial business economy enterprise population, almost 92% are micro enterprises, having a staff headcount of less than 10. The typical European firm is a micro firm. About 1% (226,000) of enterprises is medium-sized. On average, an enterprise in the EU provides work for 6.4 persons; within individual size-classes, average enterprise size varies between only 2 in micro enterprises and about 1,000 in large scale enterprises (LSEs). Most new businesses are micro enterprises; the vast majority of start-ups employ less than 4 people, with over 60% of the new start-ups having no employees at all. As a result, micro enterprises play a dominant role in the net growth of the enterprise population.³

As a positive factor regarding the promotion of small business there should be mentioned also the position of the EU – to increase the EU means, envisaged for the SMEs, in order they would be available to a greater number of small enterprises. From 2007 till 2013 the regional developmental funds will utilize approximately 200 billions euros for the promotion of entrepreneurship, workplaces and growth, besides, the SMEs will benefit from the most of this sum. But the EU research and developmental programs will allocate almost 6

³ EIM Business & Policy Research with financial support of the European Communities, under the Competitiveness and Innovation Programme 2007–2013.

billions euros to meet the SMEs' research needs. According to the data of the EC forecast, by the end of 2013 the EU will utilize 40% company more funds for the promotion of entrepreneurship and innovations than in the year 2008 thanks to approximately 3.5 billions euros, allocated by the new competitiveness and innovations program. In addition, 1 billion euros from this sum is planned for the investments in the SMEs.⁴

There are several programs envisaged for the Latvian entrepreneurs to receive the EU funds. There are 2 programs envisaged for the start of entrepreneurship. One of them is *Support for the Self-Employment and Starting of Entrepreneurship*. The total amount of funds, available within the framework of this activity, is LVL (LVL – Latvian currency) 23,055,238, comprised by public funding in the amount of LVL 14,315,238 (the funding from the European Social Fund – LVL 12,167,953, state budget – LVL 2,147,285) and private funding in the amount of LVL 8,740,000 (CR No 293). The aim of the program is to promote the increase of economic activities in the country by developing the knowledge and skills of people, starting business, as well as by providing the necessary financial support for the start of business activities. The second program is *Business Incubators*, where the public funding, available within the framework of activity, is LVL 20,208,601, comprised by the financing of European Regional Development Fund in the amount of 85% and the funding from the state budget in the amount of 15%. The aim of the project is to promote the formation and development of new, full of vital capacity and competitive merchants in the regions of Latvia by ensuring them with the environment and advisory services, necessary for business (CR No 835). At present, 8 incubators have started their activities; they are evenly located in the largest regions of Latvia – Vidzeme, Kurzeme, Zemgale and Latgale.

The availability of financial resources is important for the economical development; the investments into the business enable to increase the efficiency and competitiveness of national economy, to ensure more rapid development. The national economical policy usually is being improved, if it cannot solve the existing problems (McConnell, Brue: 1999). According to the research performed by the authors, the availability of current assets and capital funding is a considerable obstacle in Latvia cumbersome for the increase of business activities and competitiveness of small and medium merchants, as well as for those starting business, particularly for innovative and rapidly developing merchants. The insufficiency of working capital is one of the most common reasons of bankruptcy and it may destroy even successful enterprises (Ludboržs: 2007). Therefore there are several programs with the aim to promote the availability of funding for the development of business activities. It is envisaged within the framework of such programs to introduce the mechanism of micro-crediting for small and medium merchants, and self-employed persons, to ensure guarantees for the merchants to receive the credit resources for performing business activities and ex-

⁴ Ministry of Economics of the Republic of Latvia: Economic Development of Latvia Report, Riga, 2010, pp. 49–51.

port, if the funding at the disposal of a merchant is not sufficient for the attraction of credit resources in the necessary amount. The micro-credits are envisaged for the implementation of business projects – for the investments and current assets – for enterprises, where there are up to 10 employees, as well as for self-employed persons. It is envisaged that within the framework of the program up to 300 enterprises will receive micro-credits until the year 2013⁵. The total support funding for the availability of financial resources is envisaged in the amount of LVL 106 millions.

In relation to the promotion of business, there should be mentioned the support programs with the aim to promote the investments into the human resources and improvement of performers of economic activities and labor force, hence promoting the labor productivity, facilitating the development of labor market and business activities, increasing the economical competitiveness. It is planned that by the year 2013 there would be 28,400 employed persons involved in the training, and the proportion of those economically active performers of economic activities, who had trained their employees by means of European Social Fund, constitutes 0.4% of the total number of the performers of economic activities. The maximum acceptable funding intensity from the total eligible costs of project: for the self-employed persons, micro and small merchants – 80%. The total funding of the program is LVL 34,757,538 (CR No 328). Several programs are envisaged also for the acquisition of external markets to facilitate the international competitiveness of sectors and for the investments for micro, small and medium-sized merchants in the territories which should be particularly supported. The indications, to be achieved within the activity, envisage that until the year 2013:

- The funding would be received by 360 micro and small, 71 medium merchants.
- There would be 32 economically active merchants per 1,000 inhabitants.
- Two years after the receiving the funding, the turnover of supported merchants has increased for 20% (CR No 197).

At present, all the above mentioned programs are at the stage of implementation, therefore the efficiency of these programs might be discussed only after the closing of these programs.

It should be pointed out that there is still serious concern in Latvia regarding the utilization of the EU funds. First, until August 31, 2010, the projects had been approved 61,7% of the financing of the EU funds, available to Latvia within the period of time from 2007 till 2013. The agreements on the project implementation had been concluded for approximately 58,1% out of the financing of the EU funds, but the receivers of financing had been paid approximately 19,2% of

⁵ Latvian Guarantee Agency

the allocated funding⁶. Second, the entrepreneurs very often criticize the government in the mass media for the procedures for the introduction of the EU aid programs, emphasizing that they are too bureaucratic and the criteria for the evaluation of submitted projects – vague. The administrative procedures should be simplified – there must be amendments made to the labor legislation, as well as the procedure for making changes in the projects of structural funds should be amended. The period for the evaluation of projects is too long – often it takes 6 months for a project to be accepted after its submission.

3. The Analysis of Business Environment in Latvia

The important indication, characterizing the economic activity, is the number of economically active merchants and commercial companies per 1,000 residents. The indication of Latvia has continuously increased during the last 8 years: from 17 in 2001 up to 32 in 2009⁷. In 2009 there were 80,000 economically active individual merchants and commercial companies, 99,6% of which corresponded to the SME category.

Table 2

Division of Economically Active SMEs in Latvia in 2009

Positions	Micro enterprises	Small enterprises	Medium enterprises	Large enterprises	Total
Numbers of enterprises	66,080	11,200	2,000	320	80,000
proportion,%	82,6	14,0	2,5	0,4	100
Number of employees,%	83,6	13,6	2,4	0,4	100

Sources: Ministry of Economics of the Republic of Latvia

In order to evaluate the business environment, the authors of the paper studied the results of the reforms of business environment. Since 2004 the rating of business environment is annually measured according to the index of World

⁶ Report of the Public Expenditure and Audit Commission at the Parliament of the Republic of Latvia.

⁷ Ministry of Economics of the Republic of Latvia/Statistics.

Bank's (WB) «Doing Business» (DB), where there are evaluated the administrative procedures regulating business and their application in different countries, and Latvia is also included into this rating.

Table 3

Assessment of Latvia, according to *Doing Business* Report, from 2008 till 2010

#	Sphere	2008	2009	2010
1.	Starting of business	30	35	51
2.	Receiving of construction permits	83	78	78
3.	Flexibility of employment legal relationships	99	125	128
4.	Registration of real property	91	77	58
5.	Availability of credits	13	12	4
6.	Protection of investors' rights	49	53	57
7.	Administrative burden, when paying taxes	30	37	45
8.	Foreign trade	18	17	22
9.	Ensuring of agreement fulfillment	5	2	15
10.	Discontinuation of business activities	67	89	88

Sources: Report on the Assessment of Business Environment and Reforms in Latvia

DB 2010 index shows (Table 3) that in the sphere of enterprise registration Latvia has faced the most considerable and unpleasant decline – Latvia has fallen down for 16 places – from the 35th place in the world in 2009 to the 51st place in 2010. These data prove that after the progressive reform of the Commercial Law and the initial modernization of enterprise registration, the reforms in this sphere have stopped in Latvia. The most significant positive changes in the business environment of Latvia in the year 2010 are related to the registration of real property and the availability of credits; however, such spheres as regulation of employment legal relationships, receiving of construction permits, discontinuation of business activities, as well as paying taxes, starting of business still need reforms in order the business environment of Latvia would become more attractive for both local entrepreneurs and foreign investors.

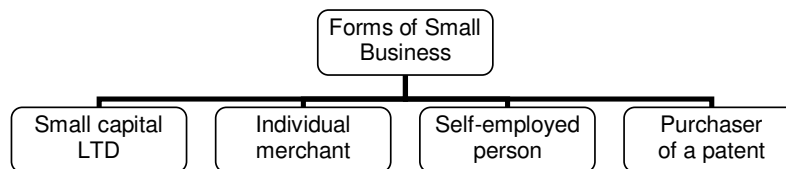
As important as performing analysis of the business environment of Latvia on the comparative background of other countries, it is important to find out the point of view of Latvian business people on the most significant obstacles for the business activities in Latvia. The results of research show that most often the entrepreneurs have mentioned the obstacles related to the administration of taxes (36%); they have indicated different financial problems (31%) and obstacles in the sphere of state aid and legislation (28%). It means that there should be significant improvements made in this sphere.

4. The Normative Regulation of Business Environment in Latvia

Having studied the normative regulation for the starting of small business in Latvia, the authors of the paper drew a conclusion that there are several opportunities – a physical entity, when starting its own business, can choose one of the forms of commercial activities or register its economic activity as a self-employed person at the State Revenue Service, or to purchase a patent for some kind of employment (Fig. 1).

Figure 1

Forms of Small Business in Latvia



* The Figure was designed by the authors of the paper
Sources: The Register of Enterprises of the Republic of Latvia (RE)

In order a physical entity would choose one or another form of small business, there should be taken into account several conditions – restrictions provided by the Commercial Law, taxes to be paid and the requirement set for organization of accounting. The experts, having performed survey regarding the factors hindering the business development, drew a conclusion that the main problems, faced by the micro-enterprises, are:

- Relatively high costs of starting business activities.
- Complicated tax system.
- Complicated procedure for organizing accounting.
- The minimum funding that could be attracted for starting business activities.
- Lack of unified information⁸.

⁸The conception of Micro-enterprise Support Measures.

In order to motivate the population to start the business activities, one of the most significant measures taken was the amendments to the Commercial Law, regulating the business activities, on the minimal amount of fixed capital, and since May 1, 2010, the persons may found the limited liability companies with a smaller fixed capital (even in the amount of LVL 1). The following criteria had been set for such a small capital LTD:

- The founders are physical entities (up to 5).
- The shareholders are physical entities (up to 5).
- The board consists of one or several members, and they all are the shareholders of the company.
- Each shareholder of the company is a shareholder only in one small capital company.
- There is a responsibility to form the annual obligatory reserve by making deductions from the annual net profit in the amount of at least 25%, until the standard fixed capital – LVL 2,000 – has been accumulated⁹.

Table 4

The Comparative Analysis of Foundation Costs for a Standard LTD and a Small Capital LTD*

Positions	Standard LTD	Small capital LTD
Legal status	Legal entity	Legal entity
Minimum fixed capital	LVL 2000	LVL 1
State tax for the registration	LVL 100	LVL 15
Publication in <i>Latvijas Vestnesis</i>	LVL 24	LVL 12.60
Certification of signature	LVL 2.75	LVL 2.75

* The table was designed by the authors of the paper.
Sources: The Register of Enterprises of the Republic of Latvia (RE).

The information, summarized in Table 4, shows that the costs of founding a small capital LTD are relatively lower than those of founding the standard LTD with the determined minimal amount of fixed capital being LVL 2,000. Since it is allowed in Latvia to found the small capital LTD, such an opportunity has been used by a significant number of entrepreneurs. The statistical data show that 43,53% out of all the registered limited liability companies had been those with a

⁹ The Commercial Law.

smaller capital. In its turn, the largest proportion of all registered small capital limited liability companies is constituted by LTD with the fixed capital of only LVL 1 (44%), but the LTD with the fixed capital within the sum from LVL 2 to LVL 10 constitute 27% of registered small capital limited liability companies. The statistical data for the year 2010 show that most often the small capital LTD had been founded by one or two physical persons – 4,439 (85,71%) enterprises are owned by one physical person, 620 (11,97%) enterprises are owned by two persons. For a very insignificant portion of founded small capital LTD – 23 (1,8%) – there are four owners.¹⁰ It should be added that almost every other, who founded a small capital LTD last year, has not been a co-owner or an owner of any enterprise – it means that the opportunity to register LTD with a smaller fixed capital has facilitated the involvement in business activities of such persons who, probably, had earlier postponed the implementation of such due to some reasons.

Such activity of founding small capital LTD is a prove of the necessity to continue the active development of programs for the support of small business.

As a negative factor regarding the functioning of small capital LTD there should be mentioned the regulation of accounting, because, irrespective of the size of LTD, the law «On Accounting» is applied to it, as well as it has to pay the taxes in compliance with the general procedure provided by the law, except, if it is a micro-enterprise tax payer.

As the next form of small business activity shall be mentioned an individual merchant. If a physical person does not want to found an enterprise, it may register his/her economic activity with the Commercial Register in the status of an individual merchant (IM). The physical person has the responsibility to register his/her economic activity in the status of an individual merchant, if the annual turnover from this activity exceeds LVL 20,000 and/or it simultaneously employs more than five employees for performing of this economic activity.

The physical person may apply for the registration with the Commercial Register as a merchant also, when the above mentioned conditions do not exist. The IM is responsible for his/her liabilities with his/her own property.¹¹ In relation to the organizing of accounting, the IM, if the annual turnover does not exceed LVL 200,000, may choose the form of organizing accounting – a single entry or a double entry system. In conformity with the chosen entry system, the IM shall pay the personal income tax or corporate income tax.

According to the statistical data, during the last three years the dynamics of IM registration has a tendency to decrease; and the smallest number is in 2010. It may be explained by the amendments to the Commercial Law, permitting the foundation of LTD with a smaller fixed capital. At present there are 13,475 IM in Latvia that constitute 7,6% of the business activity forms registered with the Commercial Register.

¹⁰ The Register of Enterprises of the Republic of Latvia (RE).

¹¹ The Commercial Law, Sections 74–76.

The physical person has also an opportunity to register his/her economic activity with the State Revenue Service, instead of registering it with the Commercial Register. When registering with the State Revenue Service, the physical person acquires the self-employed person's status (SEP). It is gainfully to register as a SEP, if the sphere of activity is related to the rendering of services. The SEP has a responsibility to pay the personal income tax and, when exceeding LVL 200 of monthly income – also the state mandatory social insurance payments. The organization of accounting is regulated – there should be organized a special register of income and expenses in compliance with the provisions of laws and regulations, once a quarter the SEP shall submit a report to the State Revenue Service on the state mandatory social insurance payments made and at the end of each calendar year – the Annual Income Statement.

The statistical data show that out of all tax payers 17.7% on average are SEP. This indicates that the population has a desire to perform the business activities. As a negative aspect it should be mentioned that in the year 2010 there was increased the personal income tax for the SEP from 15% to 26%, therefore the number of SEP decreased considerably – by 48%.

The second form, as a physical person may start the business activities, while registering with the State Revenue Service, is the purchase of a patent. Such an opportunity emerged at the end of the year 2009. The patent payment is a fixed tax, comprising the personal income tax and the state mandatory social insurance payment, for the physical person's economic activity in a particular profession. The monthly payment of a patent payment is set in detailed for each group of professions – its amount varies from LVL 30 to LVL 70 for a calendar month. The patent payment is related to the following spheres – craft, consumer services, floristics, photography services, beauty services, private household services, home care services and gathering of forest and meadow gifts for trade (CR No 1646). It is very easy for a physical person to register as a payer of a patent payment – submits to the State Revenue Service the corresponding application, indicating the group of professions, within which the economic activity would be performed, the period of time for which the physical person would like to make the patent payments. As a negative aspect it should be mentioned that alongside with the application there shall be paid also the patent payment, although the physical person has not gained any income yet from the economic activity. The patent payment cannot be chosen, if the annual income from the physical person's economic activity exceeds LVL 10,000 or the person has registered with the Register of VAT Payers. Similarly, the payer of the patent payment must not employ other persons and perform any other economic activity at the same time (not more than three calendar months within the taxation year). The statistical data show that in 2010 the state budget has collected LVL 65,000 from the patent payments.¹² In the sphere of accounting, the payers of patent payment carry out only the bookkeeping of income. When receiving the payment in cash, they may not use the cash register systems. The payers of

¹²Summary on the Fulfillment Budget Revenues Section, 2010.

patent payment have the responsibility to issue a registered receipt upon the request of transaction partner.

Significant impulse for the promotion of business activities was the introduction of *Conception on the Measures to Support Micro-Enterprises*. The aim of the conception was to create the necessary preconditions in order to encourage the unemployed to start the business activities, develop the business environment facilitating the activities of micro-enterprises, hence decreasing the level of unemployment, as well as to develop the entrepreneurs' skills, thus increasing the proportion of entrepreneurs within the total number of the employed. In order to achieve the aim of the conception, the following directions of activities were planned:

- To decrease the costs of starting the business activities of micro-enterprises.
- To introduce the tax-friendly policy in relation to micro-enterprises.
- To achieve that the micro-entrepreneur is able to organize the accounting independently.
- To ensure the availability of finances for micro-enterprises.
- To ensure the availability of full value information for micro-enterprises¹³.

As a result of conception there was adopted a completely new law *Micro-Enterprise Tax Law*, and since September 1, 2010, the enterprises may apply for obtaining the micro-enterprise tax payer's status. In compliance with this law, a micro-enterprise is an individual merchant, an individual undertaking, a farm or fishing enterprise, as well as a self-employed person registered as a performer of economic activity at the State Revenue Service, or a limited liability company, which conform to the set criteria (Figure 2).

The micro-enterprise tax rate is 9% of the turnover or the income from economic activity. The micro-enterprise tax comprises the state mandatory social insurance payment, the personal income tax and the state duty on the entrepreneurship risk for the employees of a micro-enterprise, as well as the corporate income tax¹⁴.

In the cases, if the micro-enterprise does not observe the criteria set, it pays the tax according to the higher rate (and loses the micro-tax payer's status starting from the next taxation year):

1) if the number of the employees of micro-enterprise in a quarter exceeds five employees, there are two percentage points added to the tax rate of 9% for each additionally employed person;

¹³ Support Measures for the Micro-Enterprise

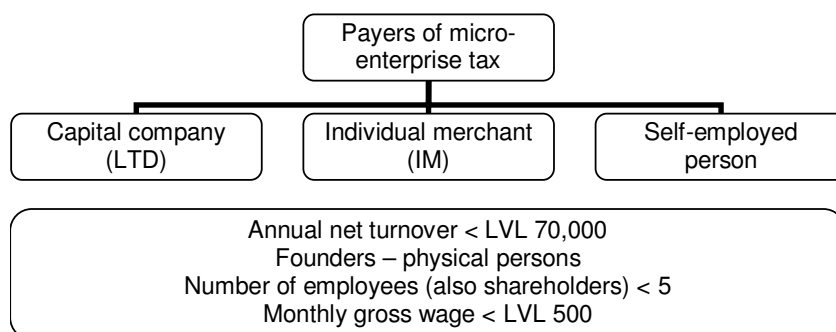
¹⁴ Micro-Enterprise Tax Law

2) if the annual turnover of the micro-enterprise exceeds LVL 70,000, the tax rate of 20% is being applied to the surplus;

3) if the income of a micro-enterprise employee exceeds LVL 500, the tax rate of 20% is being additionally applied to the part of income exceeding LVL 500¹⁵.

Figure 2

Payers of Micro Enterprise Tax and the Set Criteria*



*The Figure was designed by the authors of the paper
Sources: Micro-Enterprise Tax Law

A controversial matter is the issue on the determining of criteria for the employee's monthly wage. Taking into consideration that the employees' wages at the micro-enterprises depend considerably on the monthly revenues, and they are changeable, especially, if the rendering of services or manufacturing of goods is seasonal. It would be more useful to limit the amount of employees' wages within the calendar year, as it is provided in relation to the income gained from the economic activity. The evaluation of the aim envisaged in the conception – to decrease the costs of starting the business activities of micro-enterprises – enables to draw a conclusion that this aim has been achieved. There had been also introduced the extra types of relief regarding the procedure of the registration of economic activity: alongside with the application on the registration of an individual merchant and limited liability company in the Commercial Register it is possible to submit an application for the obtaining of a micro-enterprise tax payer's status.

¹⁵ Micro-Enterprise Tax Law.

Table 5

**The Benefits of an Employer and Employees,
when Having Different Status of Commercial Activities***

Positions	LTD – registered in the Commercial Register, LVL	LTD – registered in the Commercial Register and at the State Revenue Service as a micro-tax payer, LVL
Monthly net turnover	5,800.00	5,800.00
Gross wage (2 employees)	1,000.00	1,000.00
Employer's state mandatory social insurance payment (24.09%)	240.90	X
Employee's state mandatory social insurance payment (11%)	110.00	X
Risk duty	0.50	X
Personal income tax (25%)	222.50	X
Net wage	667.50	1000.00
Micro-enterprise tax (9%)	x	522.00
Other costs of economic activity	2000.00	2000.00
Profit	2558.60	3178.00
Corporate income tax (15%)	383.80	X
Dividends	2,174.80	3,178.00

* The table was designed by the authors of the paper

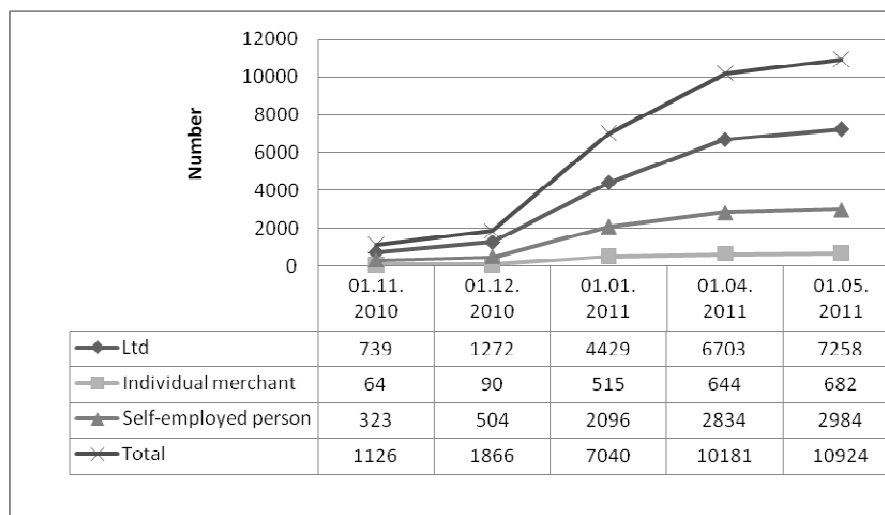
In order to evaluate, whether the micro-enterprise tax payer's status is gainful for entrepreneurs and also employees, the authors carried out the economical calculations (Table 5). In order to meet the criteria set for the micro-enterprise tax payer, if the annual net turnover is determined as LVL 70,000, the average monthly net turnover is LVL 5,800, and the authors assumed that there are two employees employed at the enterprise with the maximum gross wage LVL 500 for each of them. As it is showed by the calculations, when comparing two capital companies with the same monthly revenues, the same number of employees and the same other costs of economic activity, it is gainfully for LTD to register in the status of the micro-enterprise tax payer. The benefit for the employees – higher net wage, the benefits for the employer – lower labor costs, smaller sum to be paid for taxes, higher profit and possible size of dividends. When modeling the same situation with 5 employees, the authors drew a conclusion that it is gainful for a small enterprise with the annual net turnover up to LVL 70,000 to register for the status of a micro-enterprise tax payer.

As a negative aspect it should be indicated that the existing enterprises may choose only by December 15 of the pre-taxation year by submitting an application to the State Revenue Service, and they obtain the status only starting from January 1 of the next taxation period. It is not possible to acquire the status

of a micro-enterprise tax payer in the middle of the year. The new-founded enterprises have an advantage – they become the payers of the micro-enterprise tax since the moment of foundation, if they meet the criteria provided by the law.

Figure 3

Micro-Enterprise Tax Payers' Dynamics, November 1, 2010 – May 1, 2011*



*The figure was designed by the authors of the paper
Sources: The State Revenue Service

The analysis of the statistical information (Figure 3) on the micro-enterprise tax payers' dynamics enables to draw a conclusion that more often the advantages of the micro-tax payer's status is used by the capital companies; besides, the existing capital companies have already reregistered as the micro-tax payers, as well as the new micro-enterprises are being founded. The proportions of the present micro-tax payers constitute: 66% – capital companies, 27% – self-employed persons and 7% – individual merchants. It enables to conclude that the implementation of conception had been successful and provides significant state aid for the development of small business.

Having studied the provisions of laws and regulations on the regulation of accounting, the authors drew a conclusion that, in relation to the organizing of accounting, the same provisions are applied to the micro-enterprises that had been applied to the legal and physical entities, performing economic activities. The only exception is that the capital companies do not prepare the Corporate

Income Tax Statement and the individual merchants and the self-employed persons may not to prepare the Annual Income Statement, because these documents are replaced by the Micro Company Tax Statement that should be prepared and submitted to the State Revenue Service once a quarter.

In order to make easier for the micro entrepreneurs to organize the accounting, the Ministry of Economics concluded an agreement on co-operation with several software firms that developed freely accessible free of charge accounting software for the micro-enterprise tax payers. Such a step of the government shall be appreciated, because the use of free of charge software considerably decreases the costs of micro-enterprises. However, it does not ensure the achievement of the aim, envisaged by the conception, that a micro-entrepreneur is able to organize the accounting independently. The authors find that the setting of such an aim is a populist step of the government, because one of the main tasks of accounting is to provide the enterprise management, as well as the potential co-operation partners, credit institutions and other users of financial reports with the true and complete information on the enterprise's liabilities, results of economic activity and financial position (Jones: 2006).

Conclusions and proposals

As a result of the performed research, the authors see both positive and negative traits for starting the small business and for its development.

The significant stimulus for the development of small business was «Small Business Act» for Europe that comprises guidelines, binding to the Member States.

As a positive factor regarding the promotion of small business there should be mentioned also the position of the EU – to increase the EU means, envisaged for the SMEs, in order they would be available to a greater number of small enterprises. According to the statistical information, in the EU 98,7% are micro and small-sized enterprises. In total there are 50, 4% of the working population employed at these enterprises. In Latvia the proportion of the micro and small-sized enterprises constitutes 99.6%, and they employ 97.2% of all the working population, and they are very important for the creation of gross domestic product and employment.

During the last two years the government of Latvia has taken several significant measures to motivate the population to start their own small business. There are several programs of European Regional Development Fund envisaged for starting and promotion of business. It is envisaged within the framework of such programs to introduce the mechanism of micro-crediting for small and medium merchants, and self-employed persons, to ensure guarantees for the merchants to receive the credit resources for performing business activities and

export, if the funding at the disposal of a merchant is not sufficient for the attraction of credit resources in the necessary amount.

As a negative trait of the utilization of the EU funds it should be mentioned that the projects of the funds had been approved for 61.7% of the financing of the EU funds, available to Latvia, the agreements on the project implementation had been concluded for 58.1% out of the financing of the EU funds available, but the receivers of financing had been paid approximately 19.2% of the allocated funding. The procedures for the implementation of the EU support programs are too bureaucratic and the criteria for the evaluation of submitted projects – vague. The administrative procedures should be simplified – there must be amendments made to the labor legislation, as well as the procedure for making changes in the projects of structural funds should be amended, there should be determined the maximum period of time for the evaluation of projects.

The results of the analysis of business environment show that the main problems, hindering the business development, are the administrative and bureaucratic procedures, including the administration of taxes, the high burden of taxes, and different financial problems.

Having studied the normative regulation for the starting of small business in Latvia, the authors of the paper drew a conclusion that there are several opportunities – a physical entity, when starting its own business, can choose one of the forms of commercial activities or register its economic activity as a self-employed person at the State Revenue Service, or to purchase a patent for some kind of employment. Alongside with these forms of entrepreneurship, when meeting the particular criteria, it is possible to obtain also the status of a micro-tax payer that makes it easier to calculate and pay the taxes. The micro-tax payer's status does not relate to the purchaser of a patent.

Significant impulse for starting and development of small business was the implemented *Conception on the Measures to Support Micro-Enterprises*; as a result there were the amendments made to the laws and regulations, providing that the micro-enterprises shall pay one tax in the amount of 9% of the turnover. This tax comprises the state mandatory social insurance payment, the personal income tax and the state duty on the entrepreneurship risk for the employees of a micro-enterprise, as well as the corporate income tax. There had been decreased the costs for starting the business activities of micro-enterprises, and there had been also introduced the additional relief regarding the registration procedure of economic activity.

A controversial matter is the issue on the determining of criteria for the employee's monthly wage. Taking into consideration that the employees' wages at the micro-enterprises depend considerably on the monthly revenues, and they are changeable, especially, if the rendering of services or manufacturing of goods is seasonal. It would be more useful to limit the amount of employees' wages within the calendar year, as it is provided in relation to the income gained from the economic activity.

The opportunity to use the free of charge software shall be appreciated, since it considerably decreases the costs of micro-enterprises. The authors are critical about the aim, set in the conception, that a micro-entrepreneur is able to organize the accounting independently. The setting of such an aim is a populist step of the government, because one of the main tasks of accounting is to provide the enterprise management, as well as the potential co-operation partners, credit institutions and other users of financial reports with the true and complete information on the enterprise's liabilities, results of economic activity and financial position. And the normative regulation of accounting also sets for the micro-enterprises the same requirements that had been applied by the laws and regulations to the legal and physical entities, performing economic activities. The only exception is that the capital companies do not prepare the Corporate Income Tax Statement and the individual merchants and the self-employed persons may not to prepare the Annual Income Statement, because these documents are replaced by the Micro Company Tax Statement that should be prepared and submitted to the State Revenue Service once a quarter.

In order to make is easier for the micro entrepreneurs to organize accounting, the authors find that first of all there should be decreased the bureaucratic requirements set on the preparation of accounting statements and reports for the needs of State Revenue Service. Second, there should be set equal requirements for the payers of micro company tax, irrespective of the business form, regarding the organizing of accounting, namely, the accounting should be organized according to the single entry system. When organizing accounting according to the double entry system, the outsourcing of bookkeeping firms should be utilized.

Having evaluated the small business practice in Latvia in general, we can say that the significant stimulus for the development of small business was the introduction of a micro company tax, the programs of the EU funds to introduce the mechanism of micro-crediting for small and medium merchants and the self-employed persons. In order to promote the development of small business in Latvia, the government of Latvia should work on the lessening of administrative and bureaucratic burden, as well as should take particular measures for the decrease of tax burden and the prevention of deficiency of legislation.

Bibliography

1. Cabinet Regulation (CR) No. 1646 «Procedure for the Application of a Patent Payment to a Natural Person's Economic Activity in a Particular Profession and Its Amount» («LV», 206 (4192), 31.12.2009.) [effective since January 1, 2010].
2. Cabinet Regulation (CR) No. 197 «Regulations on the Operational Program «Entrepreneurship and Innovations» Supplementary Activity 2.3.2.2 «Sup-

- port to the Investments for Micro, Small and Medium-Sized in the Particularly Supported Territories», available: www.likumi.lv.
3. Cabinet Regulation (CR) No. 293 «Regulations on the Operational Program «Human Resources and Employment» Supplementary Activity 1.3.1.2. «Support for Starting Self-Employment and Business Activities», available: www.likumi.lv.
 4. Cabinet Regulation (CR) No. 328 Regulations on the Second and Further Selection Rounds of Projects Submitted within the Operational Program «Human Resources and Employment» Supplementary Sub-Activity 1.3.1.1.1. «Support for the Training of the Employed for the Promotion of Merchants' Competitiveness – Support for the Training, Organized on the Basis of Partnership» available: www.likumi.lv.
 5. Cabinet Regulation (CR) No.835 «Regulations on the Operational Program «Entrepreneurship and Innovations» Supplementary Activity 2.3.2.1. «Business Incubators», available: www.likumi.lv.
 6. EIM Business & Policy Research with Financial Support of the European Communities, under the Competitiveness and Innovation Programme 2007–2013. available: <http://ec.europa.eu/enterprise/policies/sme/facts-figures>.
 7. EUROPEAN COMMISSION STAFF WORKING DOCUMENT on the implementation of Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprise Brussels, 7.10.2009 SEC(2009) 1350 final, available: http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_report_2009_en.
 8. Jones, M. (2006), *Financial Accounting*, John Wiley & Sons, Ltd.
 9. Latvian Guarantee Agency: <http://www.lga.lv/eksporta-garantijas/>
 10. Lesonsky, R. (2001), *Start Your Own Business, 2nd Edition*, Entrepreneur Press Ludboržs, A. (2007), *Apgruzāmā kapitāla vadīšana nelielos uzņēmumos (Management of Working Capital at Small Enterprises)* LID, Riga.
 11. McConnell, C.,Brue, S. (1999), *Economics*, Irwin McGraw-Hill.
 12. Micro-Enterprise Tax Law, available: www.likumi.lv.
 13. Ministry of Economics of the Republic of Latvia/Statistics/ available: www.em.gov.lv/em/2nd/?cat=23394.
 14. Ministry of Economics of the Republic of Latvia (2010), *Economic Development of Latvia Report*, Riga,146 p.
 15. Report of the Public Expenditure and Audit Commission at the Saeima of the Republic of Latvia, available: www.delfi.lv.
 16. Report on the Assessment of Business Environment and Reforms in Latvia, Animus Account, available: www.em.gov.lv/em/2nd/?cat=30111.

-
17. Small Business Act, *Impact Assessment*, COMMISSION OF THE EUROPEAN COMMUNITIES Brussels, 25.6.2008, SEC(2008) 2101, available: http://ec.europa.eu/enterprise/policies/sme/small-business-act/index_en.htm.
 18. Statistics of Lursoft, available: www.lursoft.lv/lursoft-statistika.
 19. Summary on the Fulfillment Budget Revenues Section, (2010), available: www.vid.gov.lv/default.
 20. Support Measures for the Micro-Enterprise <http://www.em.gov.lv/em/2nd/?cat=30108>.
 21. The State Revenue Service, *Statistics*, available: www.vid.gov.lv/default.aspx?
 22. The Commercial Law, available: www.likumi.lv
 23. The conception of Micro-enterprise Support Measures, available: www.em.gov.lv/em
 24. Unpublished information of the State Revenue Service upon request