The Impact of Financial Factor on Family Entrepreneurship Development in Latvia

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Abstract

The business environment is a multi-factor framework for economic activity, divided into the internal and external environment. Internal environmental factors can be influenced, managed and controlled by entrepreneurs, while external environmental factors cannot. External environmental factors are determined and regulated by the highest authorities – the national government. The government shapes the external environment of business. The main external factors of the business environment most often identified by researchers are: political, economic, legal and technological. The financial factor is classified as an internal factor of the business environment. Experience shows that the financial factor in the case of Latvia cannot be seen in the context of the internal factors of the business environment as defined by the world's leading scientific sources. Given the international nature of financial decision-making and the inability of entrepreneurs to influence it, the financial factor of the Latvian business environment should be viewed in the context of the external factors of the business environment. Latvian family entrepreneurship should be seen in the context of small and medium-sized enterprises.

The aim of the study is to analyse the impact of the financial factor, which includes financial policy and financial system planning at the national level, on the Latvian family business environment.

The results of the study show that the national financial policies developed in Latvia since the 1990s have posed a threat to the Latvian business environment. The newly established tax structure, based on labour and consumption taxes, has not been able to ensure the generation of internal sources of finance at national level to foster the development of the business environment. Despite the fact that family entrepreneurship was initially envisaged in policy planning documents, it is not even mentioned in financial policy and planning documents, and hence has not been stimulated or supported by taxation.

Keywords

Business environment, family entrepreneurship, finance, policy, taxation.

JEL Classification

H Public Economics, **M Business Administration and Business Economics; Marketing; Accounting; Personnel Economics,** F International Economics, 5 International Relations, National Security, and International Political Economy; F6 Economic Impacts of Globalization; F64 Environment; **K Law and Economics;** K2 Regulation and Business Law; **O Economic Development, Innovation, Technological Change, and Growth;** O21 Planning Models; Planning Policy

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INTRODUCTION

The financial factor is one of the most important factors in the business process, belonging to the factors of the business environment.[1] According to the theory of Professors P. Kelly and A. Ashwin, the business environment is something that every individual interacts with in some way.[2] The external environment is complex and its future – uncertain, but managers must seek to understand it in order to identify opportunities and threats and respond accordingly. One of the first challenges is to identify the many factors in the external business environment, and the second is to break them down into manageable parts.[3] The environmental variables that affect an organisation are beyond its direct or positive control.[4] The external environment can be divided into different levels.[5] The macro-environment is the wider environment of social, legal, economic, political and technological influences. The macro-environment contains more general factors that can affect organisations in a similar way.[6]

Entrepreneurship is one of the ways in which society can generate income by creating its own financial source from the products or services it produces, so everyone has the opportunity to start a business to ensure their well-being. As a social form of entrepreneurship, the family business[7] has its own specific characteristics. It is becoming more and more relevant nowadays. When travelling between countries, there is no difference in cultures, because in almost every country today you can find chains of popular businesses, e.g. McDonald's fast food restaurants, Starbucks coffee or huge glass shopping malls, so the environment becomes boring**.** In the search for special sensations that are unique to a particular environment, be it taste, smell or some other pleasure, there is a desire to find something special and inimitable. Only local small family businesses – craftsmen, artists, jewellers, bakers, cake makers, fishermen, beer or wine makers, etc. – can provide this special colour.[8] The importance of family businesses for the European and Latvian economy was discussed in a previous publication.[9]

Overall, the Latvian business environment is very young. The first Latvian companies that have overcome economic and financial difficulties of various kinds have been around for about 30 years. At the same time, European companies have a history of 600 or even 1000 years, e.g. Italian or Swiss family businesses.[10] The small market and fierce competition between companies on the financial market similarly affect the whole Latvian business environment. Given the international nature of financial decision-making at national level and the inability of entrepreneurs to influence it, this publication analyses the financial factor as an external factor of the business environment, despite the fact that most researchers view the financial factor as an internal factor of the business environment – in the context of financial institutions[11] .

[1] Fernando, A. C. 2011. *Business environment*. Pearson India, 688.
[2] Kelly, P., & Ashwin, A. 2013. *The business environment*. Andover, Cengage Learning, 401–22.
[3] Kelly, P., & Ashwin, A. 2013. *The business environment*. Andover, Cengage Learning, 401–22.
[4] Ibid, p.22
[5] Ibid, p.22
[6] Ibid, p. 22
[7] Zelweger, T. 2017. *Managing the Family Business. Theory and practice*, Edward Elgar Pub., 613.
[8]Communication from the Commission to the Council, the European Parliament, the Committee of the Regions and the Economic and Social Committee Action Plan to Improve Access to Finance for SMEs https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0870:FIN:LV:PDF
[9] Svilane, I., Kalkis. H. *External Factors of Business Environment and Family Business: Theoretical Review.* http://bit.fsv.cvut.cz/issue.html. http://bit.fsv.cvut.cz/issues/02-23/full_02-23_01.pdf
[10] Goto, T. 2014. *Family Business and Its Longevity*. Kindai Management Review Vol. 2, 2014 (ISSN: 2186-6961) 19-1.
[11] Kelly, P., & Ashwin, A. 2013. *The business environment*. Andover, Cengage Learning, 401–22.

The aim of the study is to analyse the impact of the financial factor, which includes financial policy and financial system planning at the national level, on the Latvian family business environment.

Methodology. The monographic descriptive method is used in the theoretical review, analysis of scientific literature, research results and financial indicators. Primary data in the areas of Latvian households, government revenues and taxes. The monetary unit used in the study is EUR. Given that the EUR monetary unit was introduced in Latvia as of 1 January 2014, for ease of comprehension, the financial data used in the study and presented in the figures for the period 1990–2014 have been equated to the EUR value, */0.702, according to the value of the EUR relative to the LVL value as determined by the Bank of Latvia (BoL).[12]

RESULTS AND DISCUSSION

Analysis of financial policy developments in Latvia 1990–2023

There are several theories of financial policy based on financial decision-making, capital structure and investment policy and how they affect firms and the economy. Each offers its own unique perspective and approach to help economists and business professionals understand the role and implications of financial policy. Some of the most important theories underpinning modern finance are: (1) utility theory, (2) state preference theory, (3) mean-variance theory and the capital asset pricing model, (4) arbitrage pricing theory, (5) option pricing theory and (6) the Modigliani-Miller theorems.[13] In this publication we will use as an approach – *Gordon Donaldson's (1961) Pecking-order* theory[14] (7) – calling it the Financial Hierarchy Theory – enterprises use first their internal resources and only then use external sources of finance (borrowing or issuing liabilities, etc.), attributing national financial resources to internal resources. In this study, the authors will focus on this basic principle, considering it to be one of the most important in entrepreneurship, hence it is essential to understand how the Latvian business environment has evolved, how the development of financial sources and the foundations of the financial sector have been shaped. The family form of business belongs to small and medium-sized enterprises (SMEs). Undoubtedly, family businesses are not only small businesses, but also large businesses, but these will not be studied in this publication. In order to answer the question of how the financial factor affects family entrepreneurship in Latvia, we will study it in the context of the overall business environment and whether family entrepreneurship is included in it.

Financial policy planning in Latvia is reflected in the Programme of the Latvian Cabinet of Ministers (Government). Since 1990, it has been directed towards the development of a financial market, which is one of the most important components of a market economy, involving the movement of financial resources from their sources to their uses. **The main directions of Latvia's financial policy 1990–2023:**

- The main objective of the financial market (1990) is to stimulate the integration of all market economy agents acting in the financial market as payers or receivers of money, as lenders or borrowers, or as intermediaries in the movement of financial capital;[15]
- Financial system reform and development – macroeconomic stabilisation programme; financial market development programme; banking and stock exchange development programme; foreign

[12] https://www.bank.lv/statistika/dati-statistika/valutu-kursi/valutas-kursu-kalkulators

[13] Copeland, T. E., Weston, J. F. *Financial Theory and Corporate Policy*, Copyright © 1988 by Addison-Wesley Publishing Company. p. 958.

[14] Donaldson, G. 1961. *Corporate debt capacity: a study of corporate debt policy and the determination of corporate debt capacity.* Graduate School of Business Administration, Harvard University, Boston.

[15] Council of Ministers of the Republic of Latvia. Economic Development Programme of the Government of the Republic of Latvia, Riga, July 1990. Programme of the Government of Ivars Godmanis. 07.05.90.–03.08.93. 121. p. 25. Part 1: https://www.mk.gov.lv/sites/mk/files/media_file/godmanis_programma_1990_i.pdf; Part 2: www.mk.gov.lv/sites/mk/files/media_file/godmanis_programma_1990_ii.pdf;

credit programme; customs and financial inspection development programme; public asset management programme;[16]

- Long-term action programme to attract foreign capital; [17]
- Latvian companies go public on the stock exchange to ensure further development of the capital market (1990);
- Using privatisation proceeds to promote new private enterprises – granting loans to private entrepreneurs (1994);[18]
- Boosting private savings. Lowering bank interest rates and improving relations with the IMF, WB, EBRD, EIB and other international financial institutions, gradually reducing the share of the public sector in GDP (1999); [19]
- Latvia's Economic Stabilisation Programme (2011)[20] – to prevent state insolvency;
- Building Public-Private Partnerships (PPPs) – to encourage private capital and human resources to develop public infrastructure and deliver public services;
- Development of the securities market in the Baltics and its further integration into the European financial market;
- Investment Planning in Territorial Development (2014) in line with Latvia2030, NAP2020 and Regional Policy Guidelines; [21]
- Building Latvia's national financial system by encouraging people to form territorial cooperative credit unions (CCU) (2014); [22]
- Promoting long-term resource injections into the economy, including new instruments through pensions and investment plans (2015);[23]
- Promoting international financial institutions (2023), primarily EIB Group, EBRD, to mobilise long-term resources to finance objectives of public interest. [24]

The government plans to build up the internal financial system of Latvia by raising revenues from privatisation of enterprises and various mechanisms for private savings through pension investments. As we can see, one of them is the CCU. The question here is whether CCUs should be compared to Social Banks, which Dr. Roland Benedikter discusses in his 2011 article "*Social banking and social finance: responses to the economic crisis*"[25]:

"Local governments, mobilized with popular support, may take on the task of building new local banking infrastructures owned by the entire community. This could "evolve into a new confidence

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[16] A Report on the Formation of the Cabinet and a Statement of the Cabinet's Intended Activities. Declaration of the Government of Valdis Birkavs 03.08.93–19.09.94. 28. p. 13. https://www.mk.gov.lv/sites/mk/files/media_file/birkavs_zinojums.pdf;

[17] Council of Ministers of the Republic of Latvia. Economic Development Programme of the Government of the Republic of Latvia, Riga, July 1990. Programme of the Government of Ivars Godmanis 07.05.90.–03.08.93, 121– 38. Part 1:https://www.mk.gov.lv/sites/mk/files/media_file/godmanis_programma_1990_i.pdf; Part 2:www.mk.gov.lv/sites/mk/files/media_file/godmanis_programma_1990_ii.pdf

[18] A Report on the Formation of the Cabinet and a Statement of the Cabinet's Intended Activities. Declaration of the Government of Valdis Birkavs 03.08.93–19.09.94. 28, p. 2. https://www.mk.gov.lv/sites/mk/files/media_file/birkavs_zinojums.pdf

[19] Declaration on the intended activities of the Cabinet of Ministers. Declaration of the Government of Vilis Krištopāns. 26.11.98–16.07.99, p. 29. https://www.mk.gov.lv/sites/mk/files/media_file/kristopans-deklaracija.pdf ;

[20] Declaration on the intended activities of the Cabinet of Ministers chaired by Valdis Dombrovskis. For national growth and unity. 03.11.2010.–24.10.2011. p. 18 https://www.mk.gov.lv/sites/mk/files/media_file/dombrovskis-2-deklaracija.pdf

[21] Declaration on the intended activities of the Cabinet of Ministers led by Laimdota Straujuma. 05.11.2014-11.02.2016, p.17; https://www.mk.gov.lv/sites/mk/files/media_file/05_deklaracija.pdf ;

[22] Declaration on the intended activities of the Cabinet of Ministers led by Laimdota Straujuma. 05.11.2014-11.02.2016, p.17; https://www.mk.gov.lv/sites/mk/files/media_file/05_deklaracija.pdf ;

[23] Declaration on the intended activities of the Cabinet of Ministers led by Laimdota Straujuma. 05.11.2014-11.02.2016, p.17; https://www.mk.gov.lv/sites/mk/files/media_file/05_deklaracija.pdf ;

[24] Declaration on the intended activities of the Cabinet of Ministers chaired by Arturs Krišjānis Karinis, 14.12.2022-15.09.2023, p.49; https://www.mk.gov.lv/lv/media/14490/download?attachment

[25] Bendikter, R. 2011. European Answers to the Financial Crisis: Social Banking and Social Finance. *The Europe Center*. Article: DOI: 10.1007/978-1-4419-7774-8_1 , 4.p.

that citizens working in common can change their lives, and in doing so can change the world around them." Social banking and social finance can serve as a powerful instrument toward this purpose. Social banks try to invest their money only in endeavours that promote the greater good of society, instead of those which generate private profit just for a few. This means that social banks s considers social and economic "sustainability" when making financial decisions. "Sustainable" investments and lending practices are ones that produce a better quality of life for r the greatest possible amount of people, and whose effects endure over time and continue to produce a multiplicity of positive effects long after the initial investment is made.

In the wake of the financial crisis of 2007-10, many people have begun to seek a new, better system of money and finance. A more promising approach in the long run is to develop an entirely different type of bank, one that acts responsibly, and considers the long- term effects of its lending practices. Social banks fulfil this role. They can help the global financial system develop from within by providing "best practice" examples: concrete success cases that other banks and policymakers can learn from."[26]

According to the authors, the new economic environment that has emerged in Latvia since 1990 is marked by a lack of long-term financial policy planning. The viability of enterprises, especially family businesses, requires **internal sources of finance**. In Latvia's small financial environment, internal sources of finance are essential for entrepreneurs to ensure the stability and independence of the business environment. The funds obtained during privatization – the first national source of revenue and savings - were aimed for the development of the business environment but did not become a national source of finance for entrepreneurship because of the 2004 change of purpose[27] – to balance the social budget. On the other hand, the diversion of the pension fund to the economy, planned since 2015, could lead to a socio-economic crisis in the event of a global financial turmoil. This means that new solutions need to be found to create internal sources of finance.

Next, the authors will analyse other sources of financial leverage. The most important sources of finance are: income from business (1), from products or services that companies create themselves; investment (2), by putting money into various investments such as shares, bonds or real estate, in the hope that the money invested will provide growth; credit (3), borrowing from a bank or other financial institution to obtain the money needed, repayable over a fixed period of time, with interest payments; and public support (4), in the form of subsidies or guarantees provided. Each company situation may have its own unique combination of financial sources. In the next section, the authors will explore the history of the development of Latvian credit institutions.

Overview of the development of Latvian credit institutions 1990–2023

In 1992, the Law on Banks was adopted in Latvia, and the draft Statute of the Bank of Latvia was drawn up.[28] A complete banking system was gradually established.[29] It was planned that the BoL would perform the functions of the bank of banks. It would be the bank vis-à-vis all commercial banks and other credit institutions. It would hold the commercial banks' free funds and minimum reserves. It will grant them loans, take care of the treasury and other banking operations related to the regulation of the economy. The establishment of the banking system is closely linked to the stabilisation of the monetary system and the introduction of the national currency (the lat).[30] The transition to Latvian currency is a prerequisite for the functioning of the self-management of the

[26] Bendikter, R. 2011. European Answers to the Financial Crisis: Social Banking and Social Finance. *The Europe Center*. Article: DOI: 10.1007/978-1-4419-7774-8_1 , 4.p.
[27] Declaration on the intended activities of the Cabinet of Ministers chaired by Indulis Emsis. 09.03.2004.-02.12.2004. 25. p. 12; https://www.mk.gov.lv/sites/mk/files/media_file/emsis-deklaracija.pdf ;
[28] Council of Ministers of the Republic of Latvia. Programme of Economic Development of the Government of the Republic of Latvia, Riga, July 1990. Programme of the Government of Ivars Godmanis 07.05.90.-03.08.93. 121. p.30. Part 1:https://www.mk.gov.lv/sites/mk/files/media_file/godmanis_programma_1990_i.pdf; Part 2:www.mk.gov.lv/sites/mk/files/media_file/godmanis_programma_1990_ii.pdf
[29] Ibid - p.30.
[30] Ibid - p.31.

Republic of Latvia.[31] In May 1992, Latvia put into circulation its own unit of currency – the Latvian rouble.[32] On 14 September 1993, the BoL issued an order "On the complete withdrawal of Latvian roubles from circulation".[33] In 1993, the lat (LVL) was reinstated as the only legal tender. In 1994 the lat was pegged to a basket of five currencies: the US dollar, the German mark, the Japanese yen, the British pound sterling and the French franc.[34] On 1 January 2014, the euro was introduced.[35]

In 1993, the State became the sole founder of four banks (with a total paid-up share capital of 8 million lats and total assets of 152 million lats),[36] namely:

1. ***Latvijas investīciju banka*** **(**Investment Bank of Latvia), whose main task was to attract capital to the Republic of Latvia to promote investment in the economy.[37] In 1998, as a result of the privatisation of the state-owned shares of the JSC "Latvijas investīciju banka" (33.8% of the share capital at the beginning of the year), the bank became a subsidiary of Merita Bank Ltd. (Finland).[38]
2. ***Latvijas Hipotēku un zemes banka (LHZB*** **(**Latvian Mortgage and Land Bank**)**, which worked to revive and develop mortgage lending in the country.[39] In 2013, it was transformed into SJSC "Latvian Development Finance Institution Altum",[40] losing the state control in 2015.[41]
3. ***Latvijas Krājbanka*** (Latvian Savings Bank), which had the most extensive banking network (around 600 branches throughout the country) and had been in the business of attracting retail deposits for 70 years.[42] In 1995, the total paid-up share capital together with *LHZB* was LVL 2.6 mln, and total assets were LVL 83 mln.[43] On 26 February 1996, the state-owned JSC *"Latvijas Krājbanka"* was taken into possession by the non-profit organisation state-owned JSC "Latvian Privatization Agency". Privatisation was ongoing. In February, the joint-stock commercial bank "*Rīgas apvienotā Baltijas banka*" joined "*Latvijas Krājbanka*", reducing thus the State-owned share in the bank's share capital to 74.5%. In May and June, the shares of "Latvijas Krājbanka" were sold in a public offer for privatisation certificates. Following the approval of the results of the sale in September, the State's ownership share fell to 52.8%.[44] In October 1997, a new issue of shares in "Latvijas Krājbanka" took place, under which the State replaced the funds invested in the bank's subordinated capital with the shares in the bank. The State-owned share in the Bank's share capital increased to 54.3%.[45] The State-owned shares in 1998 made 54.30%;[46] in 2000 – 41.75%.[47] In 2011, the bank entered insolvency proceedings, but had not yet lost its credit institution licence.[48] State-owned shares in 2014 were 17,20%[49] and in 2015 – 0%.[50]
4. **Latvijas Universālā banka (**Universal Bank of Latvia), which is formed by merging the privatisation fund units of the non-privatised Latvian banks.[51] In 1995, the privatisation process of the state-owned JSC "Latvijas unibanka" was initiated and successfully carried out, as a result of which the

[31] Ibid - p.31.
[32] Annual Report of the Bank of Latvia 1992. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1992.pdf , p.6.
[33] Annual Report of the Bank of Latvia 1993. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1993.pdf , p.16.
[34] Annual Report of the Bank of Latvia 1994. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1994.pdf p.19.
[35] Bank of Latvia Annual Report 2014. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2014.pdf, p.24.
[36] Annual Report of the Bank of Latvia 1993. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1993.pdf , p.26.
[37] Ibid p.26.
[38] Annual Report of the Bank of Latvia 1998. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1998.pdf, p.26.
[39] Ibid - p.26.
[40] Bank of Latvia Annual Report 2013. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2013.pdf , p.25.
[41] Bank of Latvia Annual Report 2015. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2015.pdf, p.23.
[42] Ibid p.26.
[43] Bank of Latvia Annual Report 1995. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1995.pdf, p.25.
[44] Annual Report of the Bank of Latvia 1996. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1996.pdf, p.25.
[45] Annual Report of the Bank of Latvia 1997. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1997.pdf, p.25.
[46] Annual Report of the Bank of Latvia 1998. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1998.pdf, p.26.
[47] Bank of Latvia Annual Report 2000.
https://www.bank.lv/public_files/images/img_lb/izdevumi/latvian/year/2000/2000.pdf, p.24.
[48] Bank of Latvia Annual Report 2011. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2011.pdf, p.24.
[49] Bank of Latvia Annual Report 2014. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2014.pdf, p.23.
[50] Bank of Latvia Annual Report 2015. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2015.pdf, p.23.
[51] Ibid p.26.

state's ownership share in the bank was reduced to 47.8% of its share capital.[52] In 1996, the privatisation process resulted in a reduction of the state-owned share to 33.3% of the bank's share capital. The state-owned shares of A/s "Latvijas Unibanka" were sold through the Riga Stock Exchange under the Global Depository Receipt programme. The State's ownership in JSC "Latvijas Unibanka" decreased to 7.6%. Due to the increase of the share capital by foreign investor Skandinaviska Enskilda Banken AB (Sweden), the State's share in the share capital of JSC Latvijas Unibanka decreased from 7.6% at the beginning of the year to 5.9% at the end of the year.[53]

5. In 2008, the Latvian state acquired 85.14% of the shares in **JSC Parex banka.[54]**
6. **In 2010, Parex banka was acquired by Citadele AS as a result of restructuring.[55] In 2015,** the State shares in JSC "Citadele banka" were sold to a private investor. [56]

Banks are responsible for making financial resources available to businesses. It is the state's ability to offer cheaper credit and guarantee financial security for business in various crisis situations. To further investigate the situation, primary data on actual lending to the Latvian economy and the state's legal protection of businesses and households will be used.

According to the data of Latvian banks, the profit of the banking sector is: in 2020 – 151.543 mln; in 2021 – 292 mln; in 2022 – 325.046 mln EUR,[57] EUR 300 mln on average per year. By keeping the banks in state ownership, Latvia would have been able to secure an annual profit of EUR 300 mln for the benefit of the state, which could be used to further finance the economy.

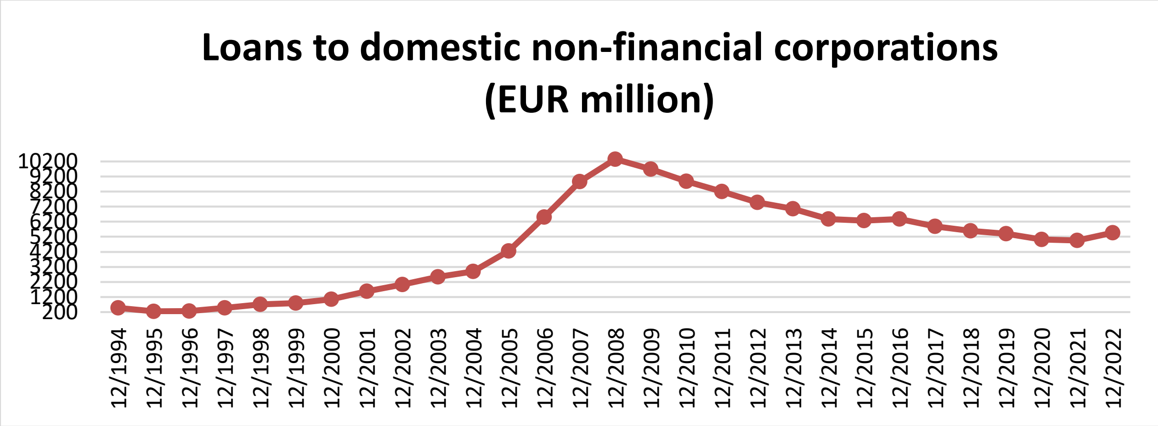

Figure 1. Loans granted in LR to non-financial corporations 1994-2022, EUR[58] . Author Ina Svilane.

According to the aggregated information on *Loans to domestic non-financial corporations 1994–2022* (See Fig. 1), the access of enterprises of the Republic of Latvia to sources of finance shows its dynamics over 29 years, **averaging EUR 4679.13 mln per year.** Comparing with the data on *Actions for damages and debt recovery against legal persons* (See Fig. 4), we can conclude that approximately 0.4% of investments in corporate assets are lost annually in the country.

Total number of households, thous. – time period. LATVIA.

[52] Annual Report of the Bank of Latvia 1995. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1995.pdf, p.25.
[53] Annual Report of the Bank of Latvia 1996. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1996.pdf, p.25.
[54] Bank of Latvia Annual Report 2008. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2008.pdf, p.19.
[55] Bank of Latvia Annual Report 2010. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2010.pdf, p.23.
[56] Bank of Latvia Annual Report 2015. https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2015.pdf, p.23.
[57] Bank of Latvia Summary of monthly balance sheet statements of monetary authorities of the Republic of Latvia. https://www.financelatvia.eu/wp-content/uploads/2023/01/Detalizeta-informacija-par-2019.-gada-4.-ceturksna-raditajiem.pdf, p.22.
[58] https://uzraudziba.bank.lv/statistika/kreditiestades/ceturksna-parskati/.

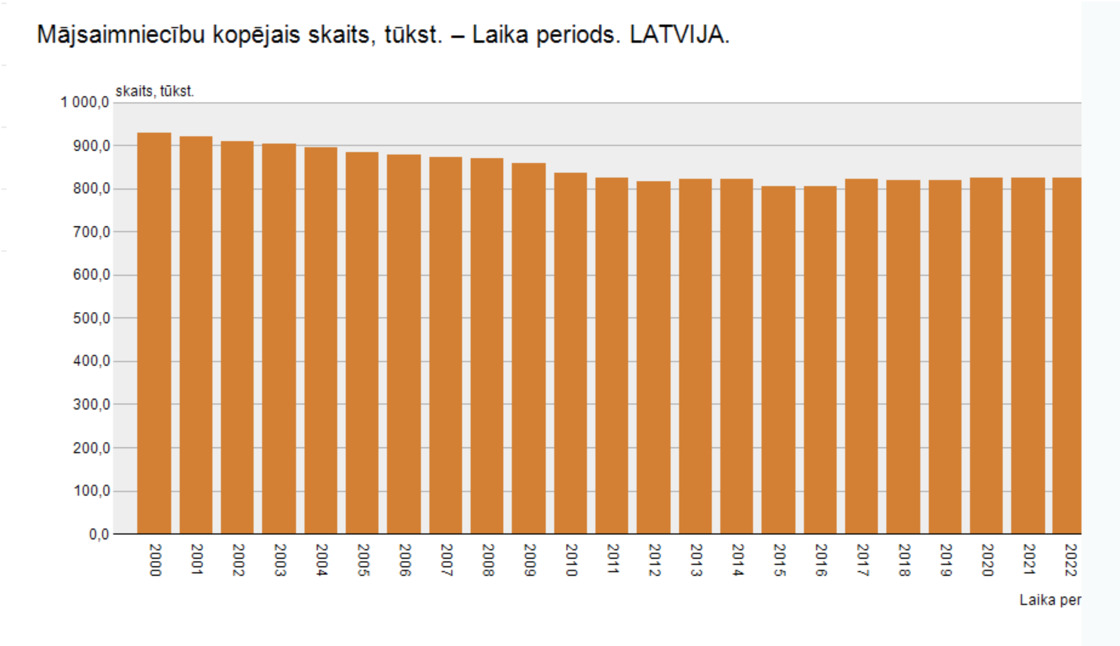

Figure 2. Dynamics of the total number of households in Latvia 2000-2022.[59]
Central Statistical Office of the Republic of Latvia.

According to the aggregated information on the *number of households in Latvia* (See Fig. 2) and the number of completed cases *in Actions for damages and debt recovery* (See Fig. 3), 20'377 cases have been filed over 23 years, with an average of 886 cases per year. The average number of Latvian households – 890 thousand households per year. If every household were considered a potential family business, then we can surely say that this business model is under threat in the Republic of Latvia, as systematically over 23 years the number of collections against businesses is almost 0.1% per year in relation to the number of households.

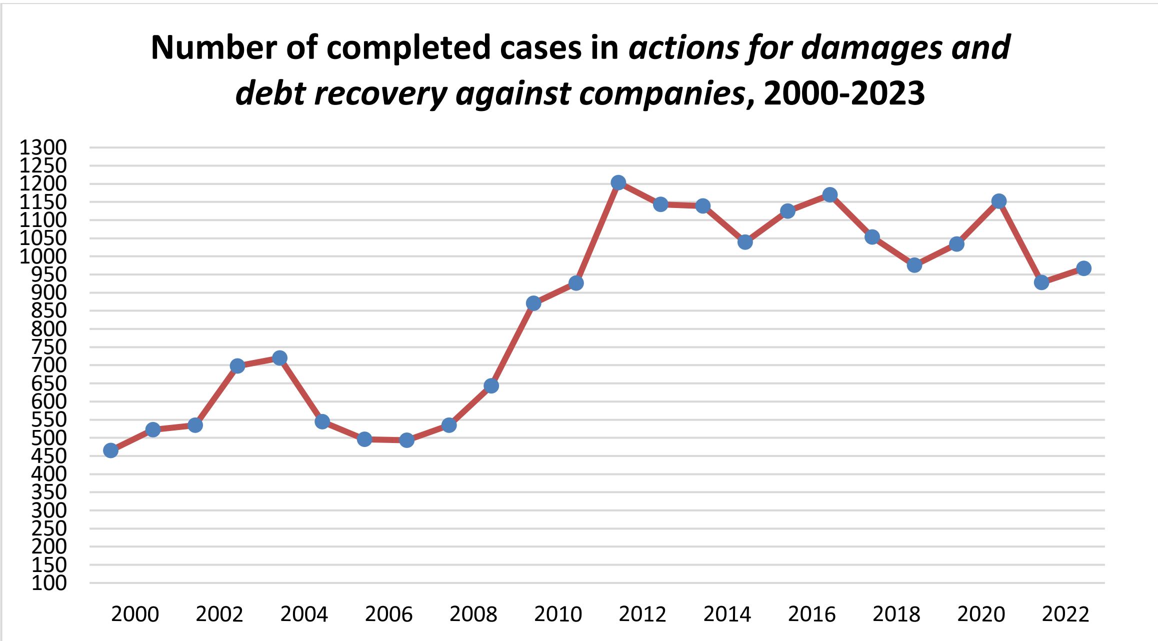

Figure 3. Number of completed cases in *actions for damages and debt recovery against companies* 2000-2023[60] **Author Ina Svilane.**

[59]Household dynamics in Latvia 2000–2022, https://data.stat.gov.lv/pxweb/lv/OSP_PUB/START__POP__MV__MVS/MVS010/table/tableViewLayout1/
[60] Number of completed cases in actions for damages and debt recovery against companies, 2000–2023, according to data compiled by the Courts Administration of the Republic of L Latvia

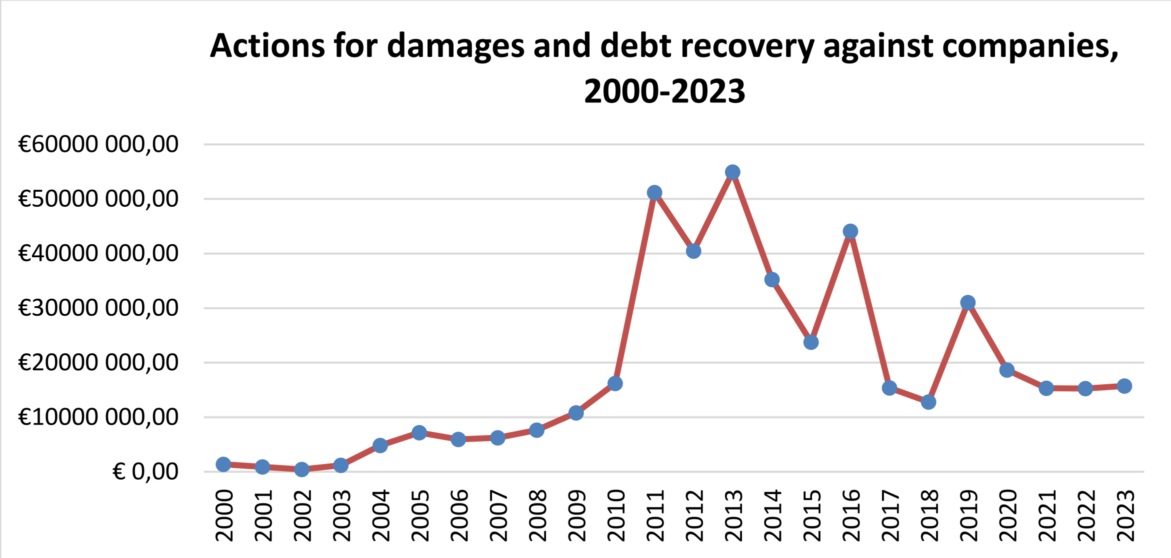

Figure 4. Actions for damages and debt recovery against legal persons, 2000–2023. Information compiled from data provided by the Courts Administration of the Republic of Latvia. Author Ina Svilane.[61] Following the 2008 financial crisis, in November 2011 the European Commission (EC) proposed an action plan to improve access to finance for EU businesses – the COSME programme, with a particular focus on SMEs, including family businesses, craft businesses, self-employed, freelancers, etc., to promote business transfers, spin-offs, spin-outs and **second chances for entrepreneurs**.[62] The COSME programme has not been implemented in Latvia since the 2008 financial crisis. According to the information collected on *Actions for damages and debt recovery against legal entities* (See Fig. 4), in 2000–2010, enforcement actions against companies amounted to EUR **62 649 472.66**, in 2011–2023 – to EUR **373 843 364.38**, – on average amounting to EUR 19 million. This represents a total of EUR 19 billion per year. The dynamics of foreclosure rates between 2000 and 2023 points to a lack of governance, monitoring and control mechanisms in the business environment, which ensures a systemic loss of assets for businesses, endangering households, which are the backbone of family business.

Since 2016, Latvia has been serviced by private commercial banks, making it more expensive for businesses to repay loans. **Structural changes in the credit institutions sector** are underway.[63] The change in the business model of Latvian credit institutions, with a decrease in the number of high-risk clients and the role of US dollars in transactions, is causing a corresponding change in the previously relatively stable trends in money markets, where Latvian credit institutions lend and borrow mostly for short periods and without collateral. A number of credit institutions continue to change their business model, refocusing the range of services provided to customers in Latvia and other EU countries. **In the area of EU budget and single market policies, plans are underway to** push for the **completion of the Banking Union**, where common supervisory and resolution mechanisms are complemented by retail deposit protection at European level. The aim of the Banking Union is to ensure that the banking sector in the euro area and the wider EU is stable, safe and sound, thereby contributing to financial stability.[64] At the same time, Development Finance Institution Altum A/S continues the support programmes implemented in the 2014–2020 programming period, both for business start-ups and for companies expanding their activities in the form of loans, guarantees or equity investments. In 2023, the Government plans to develop **ALTUM programmes** to ensure the

[61] Actions for damages and debt recovery against companies, 2000–2023, according to data compiled by the Courts Administration;
[62] https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0870:FIN:LV:PDF
[63] https://datnes.latvijasbanka.lv/gada/GP/LB_GP_2016.pdf
[64] Banking Union. https://www.consilium.europa.eu/lv/policies/banking-union/

availability of credit to boost productivity and exports through competitive supply and to make ALTUM financial instruments available for restructuring, succession or liquidity of companies.

To summarise, Latvia was losing the last of its state holdings in the banking sector in 2015. Since 2016, Latvia has been served by private commercial banks. The independence of the financial sector ensures a stable business environment. The authors argue that when a country loses independence over its financial resources, it loses independence over decision-making in the financial sector, which leads to a loss of control over the economy. The upward dynamics of the recovery rates in 2000–2023 points to a lack of governance, monitoring and control mechanisms of the business environment. As a result, this ensures a systemic loss of assets for Latvian enterprises and households. Households, which are the backbone of family business, are at risk. In Latvia, in times of financial crisis, there is insufficient state legal protection for entrepreneurship, households and family businesses.

Latvian tax policy development 1990-2023

The objectives and priorities of tax policy depend on the policies and values of the country or government in question. The most common objectives are: To raise an adequate amount of tax revenue for the national budget to cover public expenditure and provide public services; To promote economic growth and competitiveness by reducing the tax burden on businesses or specific economic sectors; To promote social justice and income redistribution, for example through a progressive income tax system or tax breaks for lower income groups; To incentivise certain activities or behaviours, for example by encouraging environmentally friendly behaviour through tax breaks; To artificially influence economic activity or exchange rates, for example through special tax rates or levies. Tax policy is an essential economic policy instrument that affects a country's economy, business environment, personal income and social welfare. “18th century economist and philosopher Adam Smith is considered the father of economics. Smith argued for a minimal role for government in regulating the market and argued that each person, by taking care of himself, inadvertently creates the best outcome for all. This means that by selling products that people want to buy, the butcher, baker and brewer hope to make a profit, and if they efficiently satisfy their customers' needs, they will earn financial rewards as well as create wealth for the whole nation. A wealthy nation is a country where people work productively to better meet their financial needs. Smith's influential book The Wealth of Nations[65] was published in 1776, where he argued that the natural inclination of people to their own well-being produces wealth for all.”[66]

Since 1990, a new Latvian tax system has been in place, which determines both the Latvian state's revenue and the business community's expenditure. One of the first Government declarations states that “The producer is interested in satisfying his own interests in making a profit, therefore one of the most pressing tasks of the State is to create legal and economic norms so that the entrepreneur, in pursuing his interests, also benefits society as a whole.[67] The tax system of the Republic of Latvia comprises the following taxes: **State taxes (**excise duty, turnover tax, profit tax, property tax, inheritance tax, customs duty, transit tax, capital movement tax, personal income tax, transport tax, consumer fund tax); **local taxes (**land tax, event tax, natural resource use tax, resort tax). The government's tax policy is aimed at ensuring that the overall tax rate, in the event of the normal operation of the business, ensures a normal reproduction process. **Latvia's fiscal (tax) policy** since 1994 has been to gradually bring Latvia's tax structure closer to that of industrialised countries, gradually changing the tax structure; let us trace how the tax structure has evolved over the years:

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[65] Adam Smith. 1776. *An Enquiry into the Nature and Causes of the Wealth of Nations*. London.

[66] Gerard O' Regan. A Guide to Business Mathematics, CRC, 2023, p.413,- 336.

[67] Council of Ministers of the Republic of Latvia. Programme of Economic Development of the Government of the Republic of Latvia, Riga, July 1990. Programme of the Government of Ivars Godmanis 07.05.90.-03.08.93, p.121. – p.26. Part 1:https://www.mk.gov.lv/sites/mk/files/media_file/godmanis_programma_1990_i.pdf; Part 2:www.mk.gov.lv/sites/mk/files/media_file/godmanis_programma_1990_ii.pdf;

- 1994 – higher **taxes on consumption, lower on income;** [68]
- 2011 – **gradual shift of the tax burden from labour to consumption and property;**[69]
- 2016 – **shifting the tax burden from labour to income from capital and capital gains, to consumption, to real estate** and to the **use of natural resources**. [70]
- 2019 – **shifting the tax burden from labour to indirect taxes** by raising the minimum wage and bringing the tax-free minimum closer to the minimum wage, and simplifying labour taxation. [71]
- 2023 - implementing the objectives of the European Green Deal, **developing sustainable tax policies**, and making tax policy a national competence.

As we can see from the Government's planning documents, Latvia's tax policy has been based on labour and consumption taxes for about 30 years. The Government is developing a tax policy that is far from conducive to the growth of the business environment. Rather, it is more like demoliting the business environment. "Keynesian economics once argued that the business cycle could be managed by active government intervention in the economy. This is done through fiscal policy (higher spending during recessions to stimulate demand) and monetary policy (stimulating demand through lower interest rates)." [72]

The authors draw attention to the term "intervention" – the role of government should not be to intervene, but to ensure the stability of public finances and stimulate the economy by restructuring the country's tax system and reforming fiscal policy towards a business tax on profits and away from labour taxes. The authors argue that the more entrepreneurship is triggered, the more profit is generated. The higher the profit, the higher the government revenue from it. Taxes on business profits would encourage the development of internal sources of finance, which in turn would provide more support for the development of the business environment.

Summarising Latvia's tax revenues**[73]**: (1) The three largest taxes in the Latvian tax basket in 1996–1999 are VAT – 60.7%, excise tax – 18.6%, corporate income tax (CIT) – 16.4%; (2) In 2000–2010, the three largest taxes in the Latvian tax basket are VAT – 60.7%, excise tax – 18.6%, CIT – 16.4%; (3) In 2000–2010, the three largest taxes in the Latvian tax basket are VAT – 60.7%, excise tax – 18.6%, CIT – 16.4%. VAT – 49%, excise tax – 21%, CIT – 11%, revenue from business and property – 7%; (3) The tax basket of the Republic of Latvia for 2011–2020 consists of VAT – 69.6%, excise tax – 13.2%, CIT – 4.81%, revenue from business and property – 4.12%.

An analysis of Latvia's public finances shows that Latvia's external debt has been on an upward trend since 1996, from LVL 227.4 mln[74] to EUR 21.052 billion in Q1 2023. [75]

Latvian Professor Ē. Žubule in her doctoral thesis "Analysis and Improvement of the State Budget Process" writes: "A complete understanding of the state budget process is possible by formulating its objective – the promotion of the socio-economic development of the state. It is essential to identify the tasks defined to achieve the objective of the state budget process, determining how to ensure fiscal outcomes consistent with financial policy."[76] This means creating a tax system that is capable of ensuring the fulfilment of the basic functions of the state and the development of the economy at the same time.

[68] A Report on the Formation of the Cabinet and a Statement of the Cabinet's Intended Activities. Declaration of the Government of Valdis Birkavs 03.08.93-19.09.94, p.28, – p.10 https://www.mk.gov.lv/sites/mk/files/media_file/birkavs_zinojums.pdf

[69] Declaration on the intended activities of the Cabinet of Ministers chaired by Valdis Dombrovskis. For national growth and unity. 03.11.2010-24.10.2011, p.18. https://www.mk.gov.lv/sites/mk/files/media_file/dombrovskis-2-deklaracija.pdf

[70] Declaration on the intended activities of the Cabinet of Ministers chaired by Māris Kučinskis, 11.02.2016-23.01.2019, p.15; https://www.mk.gov.lv/sites/mk/files/media_file/20160210_mkucinskis_vald_prior_gala_vers_0.pdf

[71] Declaration on the intended activities of the Cabinet of Ministers chaired by Arturos Krišjānis Karinis, 23.01.2019-14.12.2022, p.26; https://www.mk.gov.lv/sites/mk/files/media_file/kk-valdibas-deklaracija_red-gala-1.pdf

[72] O' Regan, G. 2023. *A Guide to Business Mathematics*. CRC, p.413, – 337.

[73]https://kase.gov.lv/parskati/latvijas-republikas-gada-parskats/1997-2020 ;

[74]Annual Report of the Bank of Latvia 1996, https://datnes.latvijasbanka.lv/gada/GP/LB_GP_1996.pdf, p.20.

[75] https://data.stat.gov.lv/pxweb/lv/OSP_PUB/START__VEK__VF__VFV/VFV040c/

[76] Žubule, Ē. 2012. Analysis and Improvement of the State Budget Process. LU, Riga, , p.219 – p.180.

Referring again to Keynes, the emergence of modern economics and macroeconomics is linked to the British economist John Maynard Keynes, whose ideas fundamentally changed economic thinking in the 1930s. Keynes argued that aggregate spending in an economy (aggregate demand) determines the overall level of economic activity and that inadequate spending can lead to negative economic consequences, such as periods of high unemployment. He advocated the use of fiscal and monetary instruments to mitigate and manage recessions and depressions, and his approach is described in his influential book[77] . In short, Keynes argues that governments should spend money they do not have in times of crisis, to be repaid by taxpayers in the future.

Keynesianism remained the dominant economic theory adopted by Western countries until the late 1970s, when the ideas of Milton Friedman and other monetarists became dominant. However, Keynesian economics became popular again in the wake of the financial crisis of 2007–2008. The COVID-19 pandemic in 2020 triggered Keynesian economics on a large scale worldwide. As a result, national bonds were issued to borrow money on a large scale, to be repaid from future taxpayers' income. This led to massive government intervention in the economy, bailing out whole sectors, and the focus shifted from balancing budgets and controlling inflation to saving the world's economies."[78] This trend is also reflected in Latvia's public finances, where the country spent by borrowing, significantly increasing its external debt.

The authors argue that the impact of the State on the business environment in a small economy like Latvia is enormous. Any legislation introduced by the government is immediately reflected in the financial performance of business – company profits, tax payments, etc. The overall financial situation of a country determines how successful or unsuccessful a business will be. From a system perspective, business is a subsystem of the state.[79] Consequently, in the authors' view, Keynesian economics is more of a threat to national economies than it is a stimulus to economic development at national level.

The direction of tax policy – here by taxing the consumption and less the income, there by gradually shifting the tax burden from labour to consumption and property – gives the impression of an unbalanced tax system and an ill-considered tax policy. Latvia's current tax structure demonstrates a "self-reinforcing mechanism" rather than a tax policy geared towards economic growth. The dominant taxes in the 1996–2020 national budget are VAT and excise duties. It is the income from business that should be generated to the extent that it can build up savings, develop production and become the backbone of the economy. The development of the business sector would require a tax policy for the development of manufacturing, based on taxes on manufacturing industries to encourage their development and investment. They would stimulate entrepreneurship and encourage the acquisition of new production equipment, innovation and job creation. They may include VAT rebates or rebates for investment in the development of production. Such tax incentives can help to stimulate economic growth, create new jobs and increase government revenues from business. In the future, Latvia's tax policy needs to be reformed and taxes restructured away from labour taxes, as is the case, for example, in the United Arab Emirates.

Future research direction for the authors will be related to the study of access to finance for family entrepreneurship, transformation of tax policy and structure at national level. Legal aspects to promote family entrepreneurship, financial savings at national level to support and sustain entrepreneurship.

[77] Keynes, J. M. 1936. The General Theory of Employment, Interest and Money, Macmillian, London.
[78] O'Regan, G. 2023. A Guide to Business Mathematics, CRC, p.413,- p.339
[79] Svilane, I., Kalkis, H. External factors of business environment and family business: theoretical review. http://bit.fsv.cvut.cz/issue.html. http://bit.fsv.cvut.cz/issues/02-23/full_02-23_01.pdf

CONCLUSIONS

An analysis of the development of Latvia's financial policy and financial system over the period 1990–2023 shows that it has not been geared towards supporting entrepreneurship in the local region. A stable business environment for foreign investors and capital was provided. Despite the fact that the Latvian Government initially planned to develop family businesses in Latvia, no references to family entrepreneurship were found in the planning documents, so we can only see this form of entrepreneurship in the context of SMEs. Looking back at the theory of financial hierarchy outlined by G. Donaldson at the beginning of the publication, which is based on the strategy of using internal resources in business, we can conclude that it has not been possible to follow this principle in the Latvian business environment, because in the new economy that has been developing in Latvia since 1990 it has not been possible to ensure the creation of internal financial reserves, neither at the national level, nor at the level of enterprises, in most of them.

Successful family businesses are based on decision-making and financial independence. Given international decision-making and the inability of entrepreneurs to influence it, the financial factor in the Latvian business environment should be included and assessed in the set of external factors of the business environment. The **security of the Latvian business environment** requires:

1) a vision of the government's long-term (30–50 years) goals
2) long-term financial planning by governments for business;
3) building a national financial system;
4) developing a family business policy.

National saving and business development are needed **to:**

1) Transforming the tax structure based on business and profit taxes;
2) Developing tax policies to support and promote family businesses;
3) abolishing labour taxes.

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