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## Andis Vasks (Latvia)

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## ANDIS VASKS

### **Introduction**

For Andis Vasks 2008 began with some tough and complicated considerations. In six months time his Masters Degree was to be obtained and then life as a 'grown-up' was to begin. Many of his fellow students had already begun looking for their ideal jobs all over the country but the demand for building (civil) engineers had suddenly come to an end. In the economy of the previous year it was possible to obtain a salary of €800 per month in a position of the lowest qualification in any construction firm, with the engineers and designers who had just left university obtaining, from their first day of work, a wage that was double or triple that amount. In addition to that, the owners of the construction firms had actually been coming to the universities promising a variety of extra benefits. The construction market was booming, customers were waiting in line, and labour, both legal and illegal, was being imported from nearby countries such as Belarus, Ukraine and Poland.

Then with less than a month left until graduation, Andis received an offer from his cousin to take charge of a small construction company in Valmiera (his place of birth, around 100 km from the capital city Riga). Considering the lack of opportunities due the existing market conditions, Andis arranged a meeting for the following weekend to evaluate the offer and to discuss his readiness for the position. After protracted discussions and negotiations Andis made a significant decision - he became the owner and manager of a construction company. In normal conditions, at the age of 22 and straight after graduation, these kinds of opportunities are rare, yet Latvia was still perceived locally as a country of possibilities. However, with a grave economic crisis ahead, the rate of unemployment has risen rapidly and was already over 10 percent, and many young Latvians were evaluating the possibility of working outside of the country. After a period of reflection, Andis had to admit to himself some time later that the decision he had made had not been associated with or influenced by existing economic conditions, nor did he have a pre-prepared strategy for the long term survival and success of the business. He had simply reacted quickly and had become the sole owner of a construction company about which he knew very little. Oskar, his cousin, had experienced a lot in his life, not only because he was twice as old as

Andis, but also because he was a professional and successful athlete. Oskar could not cope with the sudden ‘tightening of the belt’ and the increasing tension in the company which the financial crisis had caused. The unfortunate economic situation had impacted the entire country, and had caused three construction contracts to be abandoned within one month. One client of the construction company asked for a delay in the payment of a completed contract, the funds from which Oskar was personally dependant on for a family holiday, and as a result he decided that the construction industry held no further interest to him personally and professionally.

Early one Saturday morning shortly after graduation, making every effort to remember something useful from the knowledge he had gained during his studies, Andis tried to create a development plan for the company. Planning, budgeting, expenses, unit price, turnover, strategy, staff management, all this had to be put on paper in a reasonable manner and made comprehensible to himself and his employees. Andis had to develop a ‘real-life’ business plan that was not simply a project to be submitted to a university professor. The company was without debts which, given the economic climate in Latvia, was a good start. The accounts receivable were €7,000, but according to Oskar, they were to be considered hopeless, *“in the coming months these customers will hardly be able to pay even a cent”*. He had one client for whom repair works had already been commenced in a small workshop building where the reparation of the roof had been contracted. However, the client requested a halt to these repairs until he was certain he would be able to pay the estimated few thousand Euros to Andis’s building company. Some letters of intent had been prepared with cost estimates for construction work, but there was no evidence to suggest that the potential customers were willing to sign the contract. The company had no significant assets if the small office rooms which were joined with a warehouse of 200m<sup>2</sup> were not taken into account. The former operations depended on leasing the necessary construction equipment or signing an agreement with the subcontractors regarding the operation of complicated work, if the company was in need of some special technical equipment (for example a lift or other sophisticated construction device). All the employees of the company were on holiday, they had agreed to a voluntarily two month unpaid vacation, during which Andis realistically assumed that they sought to find a paid, or better, job. Andis was concerned that he would not be able to retrieve his small but professional and reputable team. The employees, small warehouse,

single client and accounts receivable of €7,000 were all that Valmiera Construction Ltd possessed and Andis had to make a success of it.

### **The Early Days**

Remembering these events two years later, Andis admitted that he was very lucky. To a certain extent, this luck had worked against all the theoretical rules he had learned at university. In 2008 Andis did not work out a medium or long-term development strategy which was based on detailed financial projections, nor a precise cash flow for the first 6 months. By October 2008 the main activity of Valmiera Construction Ltd involved developing small scale construction projects, providing construction supervision and reconciling various documents in the ‘bureaucratic machinery’ of the state to help the company stay active. Andis managed to keep the company in business together with his colleague Peter, an experienced construction supervisor who was an “*old asset of the company*” and whom Oskar had recommended as a reliable professional. Until now Andis had no necessity or desire to give work to his employees, many of whom had shown no sign of any initiative. Indeed not all employees were interested in the business, as some employees were happy to be full-time unemployed, others tried to establish individual businesses, and some employees even sought work in Ireland or in other countries where construction was booming. The revenue obtained from the reconciliation of the small repair projects and the supervision of construction repair jobs secured the life of the company. The jobs had made it possible to pay the monthly rent for the office rooms on time (including the rent of the warehouse at €110 euro per month), and also to pay himself and his employees a salary, although the wages never exceeded €500 a month. But winter was approaching and this threatened larger expenses and less income for the company. Andis had actually contacted a lawyer, who was an acquaintance of his relatives, about the option of liquidating his company. The lawyer advised against this as the company had no debt commitment, no non-liquid assets or bad track record with banks. Besides, the mass media was actively declaring that the crisis was a time of possibilities and that one must look around and make use of the crisis for the development of the business. However, the reality in such a small town gave evidence to the opposing argument, that businesses were not doing good and that there was a lack of opportunities in this financial and economic crisis – every third cafe was closed and on the streets there seemed to be strangely few cars. Around town Andis

had noticed a large variety of advertisements offering real estate for rent or for sale. It seemed that in the former busy town of almost 25,000 inhabitants, the number of people had suddenly decreased significantly. By this time Andis was in very low spirits because the most significant decrease in orders was forecasted specifically for the construction industry both this year and in the future. Some experts observed that in 2009 a decrease for new contracts of more than 50 percent was to be expected, and that the prices for construction materials already in September of 2008 were 15–20 percent lower on average than at the beginning of the year. Indeed it was now possible to hire a qualified bricklayer or plasterer for just €1 an hour. Reference appendix one for the macroeconomic indicators of Latvia 2003 – 2012.

### **Business Opportunities in Bad Times**

On a late October evening while looking through the business news on the internet, Andis read an announcement that in the forthcoming months the government of Latvia was preparing to introduce an activity supported and financed by the EU, “*introducing measures for the improvement of energy saving in apartment houses*”. There had been previous talks about this programme, but the government had not pledged to it any kind of special financial or other form of support. While the owners of houses had themselves sought to identify ways to decrease energy expenses, the delay of such an important measure for the whole population could be explained through the activity of the construction industry (because of the overheating of the economy, construction companies had become too pre-occupied with carrying out the many orders of a speculative nature). Also, the inflated material prices and workers’ salaries limited people’s desire to engage themselves with problems involving future gains. But the situation changed dramatically as the economy continued to decrease, with a fall of more than 20 percent of GDP been forecast for 2009, while most construction companies were without orders or contracts. However, the population’s paying capacity decreased dramatically, which in circumstances of steadily rising energy costs forced the government to take action because the bankruptcy of the large heating and electricity producing companies could not be allowed. If the country was to be in debt to Russia for gas, then the gas-pipe to Latvia from Russia would be shut down immediately if there was a delay in payments. According to the information highlighted in the short announcement, the funding was assigned to the owners of the buildings to be insulated, or to apartment and housing co-op companies or other

legally established societies in which the apartment owners had joined together. These companies had to choose a construction company, sign a contract with their chosen construction company, and then get a loan from a bank (or find some other initial funding) so as to pay for this work. The bureaucratic procedure was not simple, but it was promised that after finalising the insulation works, apartment owners would then be repaid up to 50 percent of the sum invested.

For Andis this proposed programme was good news, because although it did not promise instant action, there was the potential to sign contracts, receive prepayments and obtain guaranteed profits. This was an opportunity to gain real contracts and to activate his company. At this moment Andis could also congratulate himself on the fact that he had agreed to participate in an Investment and Development Agency of Latvia workshop a month previously which was dedicated to various support programmes for entrepreneurship. At this workshop Andis had started a conversation with a representative from the Ministry of Economics, whose field was related to construction and energy resources. The clerk and Andis had a friendly conversation over a glass of beer after the workshop, during which they discovered that they were both the same age and the clerk from the Ministry of Economics even had family in Valmiera. This was the right time to take advantage of the position of the new acquaintance made at the workshop. The Ministry of Economics was the responsible governmental institution that had to prepare the necessary set of rules and regulations for this 'Building Renovation Programme' and alongside the Ministry of Finance they were accountable for making the funding available. Immediately he found the business card needed and phoned the clerk. The acquaintance was unexpectedly cooperative and they arranged a lunch meeting for the following day.

### **Outcome of the Meeting – A Cause for Reasonable Optimism**

Although more than year and a half has now passed since the meeting with the acquaintance from the Ministry, Andis still remembers it vividly. He obtained a lot of information from the meeting, although it did not give him a readymade prescription of how to act. His notes from the meeting were as follows:

- 1. The main players in this Programme will be the companies or cooperative societies of the apartment, house and flat owners, who will have to make virtually every decision, including: to show readiness to carry out such a*

*project of insulation and renovation; to ensure energy-saving of the building; to prepare or to order the project; to choose a construction company to execute the work; to make an agreement with the construction supervisor; to submit all the necessary documents to the supervising governmental institution in order to obtain support funding; to raise initial funding.*

2. *Virtually every construction company were in a similar situation because the apartment building owning company had to choose the executor of work via a procurement procedure.*
3. *The regulations prescribed that the company that owned the apartment building had to make a deal, that is, the construction company has to be chosen based on the evaluation of the submitted tenders where the most important criteria is the price.*
4. *The construction companies did not have to question how the apartment owning company would obtain a loan from the bank, they had to think only about how to prove that their offer will be the most expedient one for the customer.*
5. *In Latvia there are at least 2 million square meters of apartment space, according to the data in Programme.*
6. *According to the calculations of the Ministry of Economics the highest allowable sum of the expenses for renovation and insulation should not exceed €71 per square meter.*
7. *The first year of the state budget envisaged that €24 million would be allocated to the Programme, and it was stated that the funding will be assigned to this support Programme also in the years to come.*
8. *Before the renovation and insulation of the building an energy-saving audit of the building has to be obtained, which has to serve as a source document for the necessary development of a technical project and construction expense estimate.*
9. *During the renovation of the building, the support funding was to pay for the necessary works which resulted from the energy-saving audit, and as a result would improve the energy efficiency of the building, for example:*
  - a. *the insulation of the external walls of the building,*
  - b. *roof and basement insulation,*
  - c. *stairway reparation,*

- d. window replacement,*
- e. heating system reparation or replacement,*
- f. ventilation system reparation of the building.*

The support funding could be received up to 80 percent for the development of the construction project. The information obtained, and other friendly advice from the clerk, was unexpectedly inspiring. Weighing up all the pros and cons, Andis came to the conclusion that there was an opportunity to achieve some real development for his construction company. Actually, he believed that the company had reasonable hopes to become a serious player, regardless of the fact that its existing activity was minimal. As noted at the initial workshop, small companies had a number of advantages over big companies and when Andis examined his advantages at that time, he admitted to himself that the company had the potential to succeed despite the fact that there were many disadvantages also.

Although the team had not been working together for some time, Andis was grateful that the specialists needed for this programme had gained experience with other companies. His current team included Peter who was an expert in the development of technical design projects and cost estimates; John who was the work superintendant and leader of the team; and Erik who had very good knowledge regarding heating systems and the subsequent related areas of the government programme. Andis felt that there was a good chance that he could bring back the core of the team, including the leading experts. The former team of four construction workers were occupied with small individual orders, interior decoration, the preparation of the roofs for the winter, etc. If Andis could guarantee regular contracts there was a hope that the men would return (Reference appendix two for the organisation structure of Valmiera Construction Ltd.). However, the company was still in need of an expert who was able to undertake an energy-saving audit of the building. Furthermore, there was a need for a specific device for this job, a heat loss meter which was a special photo camera and a thermograph which could take a picture that would allow Andis to identify the location of heat loss in the building and the amount of lost power. Andis had no idea where to obtain such specialist device, how much it would cost, or how to use it.



As he had found out in his meeting with the clerk from the Ministry, an energy-saving auditor is a necessary prerequisite to get the approval for the renovation project and also to justify the expenses of the renovation work and Andis understood that this professional energy auditor was a vital person to have as a team member within his organisation. Andis had already begun offering such energy-saving auditing to the building owners and while this would create some extra income, more importantly hiring such an expert would enable him to advertise his company to the eventual customers of the renovation and insulation works. In Valmiera, as is usually the case in small towns, virtually nobody had taken an interest in such subjects as energy-saving audits, heat loss in buildings, or joint management of the apartment buildings. Despite the fact that energy and fuel expenses had steadily increased over the past five years, people still did not strive to come together in order to create a solution to decrease their energy bills. It had to be admitted that until now all the parties concerned had shown very little initiative to draw attention and support the inhabitants of the apartment houses in such projects of renovation in Latvia.

The biggest challenge facing apartment and building owners wishing to participate on this programme was in getting a loan as there were no established governmental support programmes. The banks, of course, were ready to lend money but their stipulation that every household must sign a pledge agreement with the bank and provide additional security was a demand which realistically could not be met. Rarely was there a building which could hope to achieve a 100 percent consensus about the necessity to carry out any kind of activities to save energy, and thereby decrease their expenses. Even more complicated was the idea to encourage people to agree to the demand of such a pledge agreement with a bank. Besides, even if all the inhabitants of a certain building would mutually agree and would be willing to pledge their apartments through the signing of a loan contract, the attorney expenses related to the arrangement of various legal formalities had also to be taken into account. A system of bureaucracy had been established which was not a concern when the economy was developing rapidly and the banks could attract more borrowers.

### **The First Business Plan – Where Does the Money Come From?**

Having returned home from the meeting with the clerk from the Ministry, Andis immediately went to the office of his company where he met Peter who was

examining the documentation of a project. Although Peter seemed to be rather busy, Andis decided to share the latest information with his colleague. Peter admitted that when the first renovation and thermal insulation project was launched after the decision by Andis to take over the business, he had considered leaving the company. Peter was unsure about the future and the possibilities to receive new assignments in this small city which was constantly reducing. As they discussed the future of the business now, the first conclusion drawn was that their small company could manage renovation and thermal insulation of buildings. Of course, to engage in this business they had to find a specialist who was able to perform energy audits of buildings, draft recommendations about the work to be performed and make estimates to demonstrate to apartment owners the monetary savings in the case of a thermal insulation of the building. Initially it was impossible to find in Valmiera a specialist that would have at their disposal all of the necessary measuring devices, whereas in Riga energy audit services were offered by several companies. It was just necessary to find the most beneficial and cooperative partner.

In the opinion of both Andis and Peter, the most serious problem was their lack of financial sources. Valmiera Construction Ltd did not have enough turnover in order to settle the most urgent payments to the State Revenue Service and to their key suppliers. They understood that to start work in the building renovation sector Valmiera Construction Ltd required working capital and it would not be permissible to delay disbursement of salaries. Both Andis and Peter were aware that obtaining a loan from their servicing bank would not be possible, because to receive the existing credit facility Andis had already mortgaged his small apartment. However, the credit servicing facility and some work from construction supervision and construction plan approval allowed the company to keep its head above water. But some customers had delayed making payments for their construction work and were up to 45 days behind schedule on average. The banks were only interested in safe, liquid mortgages, and neither Andis nor Peter possessed any real estate that could be mortgaged with the bank to increase their credit facility. Peter suggestion to look for a new partner ready to invest in the equity was also unrealistic. Firstly, all entrepreneurs were trying to get rid of their construction companies and a massive bankruptcy of construction companies was forecasted on a national scale. Secondly, the current status of the company was not competitive, since the monthly turnover of a few thousand Euro,

even in a period of economic crisis, was nothing considerable. Thirdly, Andis was the owner of 100 percent of the equity, and had chosen a path very typical of Latvian entrepreneurs, ‘to earn the first million with one’s own efforts’. Moreover, simple economic estimates and assumptions showed that in the current situation only one transaction would be possible, ‘all or nothing’.

The approximate estimates made by Andis showed that the minimum amount of working capital necessary for launching and successfully completing renovation of an apartment building of 50–60 apartments would be at least €30-40,000. This amount would be necessary to order and prepare the required construction materials, because all suppliers require at least 50 percent advance payment. Likewise, the initial energy audit and renovation project costs would have to be anticipated. Furthermore, salaries for employees would also need to be secured for at least 3-4 months. Moreover, there was a serious risk that the building co-operative would delay the advance and the end payment after completion of the work, because the bank granting the loan to the building co-operative would have to undergo careful examination of the work and would not hurry with disbursement of the respective parts of the loan. In the existing crisis, lending was no longer the main sector of banking operations.

Only one possibility was left, to look for support in a business incubator. Some time ago Andis had read an announcement in the local press that a business and innovation incubator was being established in Valmiera, and they were encouraging entrepreneurs that have ideas for starting business to join them. At that time this offer did not seem serious enough for consideration and Andis associated this appeal with a youth club organising parties and imitating entrepreneurship. Which serious entrepreneur requires a greenhouse or incubator – just like a weak chicken!

### **Business Incubator – A Remedy or a Turning Point?**

It was clear to both Andis and Peter that there were not that many possibilities to retain the company and to bring into effect their plans for the future. Andis remembered some quotations from the information read about the business incubator:

*“Promotes development of commercial activity”*

*“Provides a company with premises and infrastructure”*

*“Renders consultations and services”*

*“Helps with contact search and attraction of financing”*

Andis decided that he would explore the possibilities, and afterwards make a final decision regarding the business and innovation incubator. Reference appendix three for details regarding business incubators in Latvia.

Andis has since admitted that joining the incubator was a well timed decision. Since Valmiera Construction Ltd fully complied with the requirements for being admitted into the incubator, the agreement on the incubator’s services was signed within a two month period – in the beginning of January 2009. By the end of 2008 Valmiera Construction Ltd had:

1. Complied with the status of a small company;
2. Was registered with the Commercial Register on the Register of Enterprises;
3. Had no tax debts;
4. Possessed a specific business idea, implementation of which would create new work environment and job opportunities.

The signed agreement promised a number of benefits to the company in the successive three years, as several services under the agreement are offered by the business incubator’s own resources, and also, by supporting the company financially. A premises lease, telecommunication and accounting services, legal services and comprehensive business consultations during the first incubation year were subsidised to the amount of approximately 85 percent, up to 60 percent in the second, 40 percent in the third and 10 percent in the fourth year. In order to obtain financial support and guidance from the business incubator, Andis had to develop a detailed business plan substantiating the feasibility of the business idea and proving company’s growth possibilities. By cooperating with Peter and external advisors, the business plan was drafted in a rather short period of time as it took the team just three weeks to identify and collect all the necessary information, including financial estimates and the selection of the development directions for the business. The information campaign, at the time, regarding the necessity to renovate multi-apartment residential buildings was of great assistance in the development of the business plan, as it was possible to access a comprehensive range of information and data. This business plan needed to detail the realistic possibilities of Valmiera Construction Ltd and its ability to survive financially in such comparatively small town.

According to rather conservative assumptions, the business plan forecast a turnover increase within the successive 4 years from €1.3 million to €2.4 million. To a considerable extent, the business plan was necessary to reduce uncertainty regarding significant decisions to be made for the commercial activity of the company and to ensure adequate forecasts about its financial condition and future development perspectives. For the implementation of the new project, as renovation and insulation was a new area of activity for Valmiera Construction Ltd, it was very important to track the cash flow on a regular basis, compare with estimates, and make the required adjustments, as it is quite probable that the company would face a lack of financial resources. The business plan highlighted the fact that no funds were blocked in the assets of the company. It would mean that Andis, together with his colleagues, had to monitor inventory and accounts receivables on a regular basis in order to avert the possibility of non-liquid inventory and the delay in the payment of their debtors' settlement. The business plan outlined the need for a specialist that would be engaged in the performance of the aforementioned duties, with responsibility for tracking the financial data of the company, monitoring accounts receivables on regular basis, and if necessary, applying respective debtors' control mechanisms. Reference appendix four for the financial projections of Valmiera Construction Ltd.

Andis planned to base the future cash flow of Valmiera Construction Ltd upon three main objectives:

1. Increase its income annually by expanding its range of services, attracting new customers and markets, and implementing a comprehensive information and marketing campaign;
2. Track increases in costs, not allowing costs exceed income increase rates;
3. Increase productivity on regular basis.

The cash flow was based on the assumptions that:

1. The average annual increase of the turnover shall be at least 20 percent;
2. The annual net profit of the company will be at least 10 percent from the total turnover.

The business plan foresaw that the largest share of income would constitute the income from multi-apartment building renovation work (90 percent), and a rather small part of the income was expected to come from planning, energy audit and other

services concerned. Regarding income generated, within the business plan, it was estimated that service prices would be annually increased by at least 2 percent, whereas the price for the renovation work would increase by at least 5 percent. The income forecasts were estimated with the assumption that the demand for the services offered by the company would annually increase by at least 15 percent on average, whereas the annual income will go up by approximately 20 percent. This assumption was made on the basis of the following arguments:

1. Valmiera Construction Ltd performs its economic activity with the assistance of the incubator, which would help to considerably reduce the company's costs, and as a result, allow the company to offer a price below that of their competitors. With the assistance of the business incubator the company was reducing its monthly expenses from property lease, property management, energy resources, security, internet access and local telephone lines, stationery and accounting by approximately 80 percent. Moreover, additional services were available to the company, such as marketing consultations, technological consultations, etc. which Valmiera Construction Ltd could receive with a discount of 80 percent.
2. 50 percent of the resources necessary for the implementation of energy efficiency improvement for multi-apartment buildings were to be covered by EU structural funds. This provided the basis for the assumption that potential customers of Valmiera Construction Ltd would be encouraged to take advantage of the opportunity to implement energy efficiency improvement measures in their houses, and would choose Andis's company as it would market itself as the best provider of this service in Valmiera.
3. In recognition of its former activities Valmiera Construction Ltd was a company comparatively well recognised in Valmiera, and the surrounding areas, and the company had good working relationships with suppliers.
4. Valmiera Construction Ltd would continue to actively work upon the advancement of its services in the market, and would encourage direct sales by launching information and educational campaigns to raise awareness by potential customers on the benefits of energy efficiency.

The business plan contained assumptions anticipating the support of the business incubator and the consequential savings from the services and financial aid of the

incubator. Furthermore, Andis considered that the work specifics chosen by the company (i.e. renovation projects) did not require huge material stock. According to a former practice that helped to develop estimates for the business plan of Valmiera Construction Ltd, the majority of the company's expenses would be costs connected with the performance of renovation work (i.e. the acquisition of construction materials, tools and auxiliary materials, salaries for construction workers and transport costs, comprise approximately 90 percent of the total costs). Sale and administrative costs had been estimated on the assumption that these costs would increase on average by 10 percent annually. The salary position had been calculated by assuming that the salaries of Valmiera Construction Ltd employees would increase in average by 5 percent annually.

It was planned to engage construction workers on the basis of construction work contracts. Andis had some long-term cooperation with a construction workers team that performed construction work for the company in previous years. The salaries for the employees have been calculated as approximately 30 percent from the total amount of renovation construction work, on the assumption that the construction work would be completed within 9 months. Such were the optimistic development plans of Valmiera Construction Ltd when it launched its cooperation with the business incubator in the beginning of 2009.

### **Development Scenarios: How to Attract Funding**

As June 2010 approached, Andis was again facing a hard decision. There were excel spreadsheets on his PC with figures that contained a severe message for any company manager: serious liquidity problems were to be expected in the forthcoming months, and even with the most optimistic forecasts the monetary income would not be able to cover the main payments. Moreover, there was a tax debt, although only €10,000 which was causing additional financial stress. During the one and a half year gap, the business plan did not progress as forecasted. By comparing the initial plans and calculations, Andis was forced to conclude that the key factor was time. The state aid program was initiated with a six month delay, and as a result the first renovation project was only began in October 2009. Although the project was completed before February of the following year, the cash flow forecast turned out to be offset by 5 -6 months. The financial indicators of 2010 were rather similar. Although service

contracts for almost 80 percent of the work projected in the business plan were concluded by June, customers' advance payments were considerably delayed. This was due to banks delaying the execution of the contracts with the owners of the buildings under reconstruction, and also the unexplainable delay in loan disbursement, despite the fact that the risk faced by the banks in financing such projects was actually minimal, if not practically non-existent. Andis also encountered problems with the banks when applying for a credit facility. Presenting a package of already concluded renovation contracts as a security, the bank were ready to grant this comparatively small loan not exceeding €60,000 (which was actually just 8 percent of the total contractual amount) only against liquid collateral. It seemed that banks in Latvia were facing more serious problems than the entrepreneurs.

*“What to do and how to act?”* were the questions Andis kept asking himself. The demand for renovation and thermal insulation services had increased, the government increased the available financial aid for 2010, and had promised that this increase would remain at approximately €50-90 million annually for the successive four years. Valmiera Construction Ltd had acquired a reputation as a professional partner, because the first renovation project in Valmiera was successful and the residents found evidence in their reduced heating bills. The fact that the neighbours living in a similar building had to pay by 60 percent more was highlighted by the local media. Such publicity attracted potential customers, and would hopefully increase the current work load of Valmiera Construction Ltd. The approximate estimates showed that it was possible to complete the initial 4 year target by the end of 2011. However, such rapid development required additional financial means, in an ideal case approximately €150,000. That would allow the company to start renovation work immediately after signing the contract without waiting for the advance from the building co-operative. And as a result Valmiera Construction Ltd could finally undertake the development of the company according to the business plan. But Andis wondered where would they get the money and were they risking overtrading?



### Appendix One

#### Republic of Latvia – Main macroeconomic indicators (as of January 1<sup>st</sup>, 2010)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
							<b>Forecast</b>			
Gross domestic product (GDP), million LVL*	6393	7434	9059	11172	14780	16243	13043	11892	11861	12359
GDP growth at current prices, in %	11.0	16.3	21.9	23.3	32.3	9.9	-19.7	-8.8	-0.3	4.2
GDP growth at constant prices, in %	7.2	8.7	10.6	12.2	10.0	-4.6	-18.0	-4.0	2.0	3.8
GDP deflator, in %	3.6	7.0	10.2	9.9	20.3	15.2	-2.1	-5.0	-2.2	0.4

CPI (December to December), in %	3.6	7.3	7.0	6.8	14.1	10.5	-1.2	-3.0	-1.6	0.7
CPI (year average), in %	2.9	6.2	6.7	6.5	10.1	15.4	3.5	-3.7	-2.8	0.0
Average monthly wage of those employed in the economy, LVL	192	211	246	302	398	479	455	411	410	421
growth at current prices, %	11.4	9.6	16.5	23.0	31.5	20.5	-5.0	-9.8	-0.2	2.7
Growth at constant prices, in %	8.3	3.2	9.2	15.5	19.4	4.4	-8.2	-6.3	2.7	2.7
Employment,	1006.9	1017.7	1035.9	1087.6	1119.0	1124.1	997.0	941.6	940.0	950.4

thousands										
Employment growth, in %	1.8	1.1	1.8	5.0	2.9	0.5	-11.3	-5.6	-0.2	1.1
Job seeker rate, in %	10.6	10.4	8.7	6.8	6.0	7.5	16.9	20.0	18.9	17.5
Registered unemployment rate (year average), in %	8.6	8.8	8.0	7.0	5.7	5.3	11.9	13.8	12.7	12.6
Exports of goods and services, million LVL	2689.3	3268.2	4334.7	5014.3	6241.4	6792.2	5211.3	5289.5	5666.1	6104.8
Growth at current prices, in %	14.3	21.5	32.6	15.7	24.5	8.8	-23.3	1.5	7.1	7.7
Growth at constant prices, in %	5.225	9.4	20.2	6.5	10.0	-1.3	-17.5	1.5	5.0	5.6

Imports of goods and services, million LVL	3493	4428.9	5637.8	7412.3	9219.5	8920.7	5421.6	4944.6	5174.7	5552.6
Growth at current prices, in %	19.8	26.8	27.3	31.5	24.4	-3.2	-39.2	-8.8	4.7	7.3
Growth at constant prices, in %	13.1	16.6	14.8	19.4	14.7	-13.6	-35.0	-9.7	2.6	5.2
Balance of payments Current account balance, million LVL	-522.8	-954.9	-1131.6	-2510.0	-3327.2	-2051.5	827.6	1051.0	1000.2	743.1
As % of GDP	-8.2	-12.8	-12.5	-22.5	-22.5	-12.6	6.3	8.8	8.4	6.0
Production industries,			6.5	4.8	-1.0	-8.3	-17.7	9.0	7.0	6.0

output change, in %										
Retail, change, in %			21.3	20.1	18.8	-8.2	-28.0	-7.0	3.0	6.0
Construction, change, in %			15.3	14.4	13.0	-3.1	-34.9	-18.0	4.0	7.0

\* Exchange rate lats/euro = 0.702804 (Latvian lats – LVL)

The Latvian economy, at the time of this case, was facing one of the sharpest and most complex recessions in the European Union. The downward economic conditions that started in 2008 and continued in 2009 were mainly based on the drop in domestic demand and a sharper worsening in the external international economic environment. The Latvian economy was simultaneously facing a domestic crisis of a cyclical and structural nature, along with the global financial crisis.

In 2008, the gross domestic product (GDP) drop in constant prices was 4.6%, caused by both internal and external factors. Initial contraction was caused by high inflation in 2007 and at the start of 2008 negatively impacted consumer confidence, as well as the rise in unit labour cost, thus reducing the competitiveness of Latvian producers. The burst of the real estate bubble and rapid decline in credit growth rates had negative impact on domestic demand, which in previous years was the main source of growth. Resulting from this was the contraction in retail sales and private demand at the start of 2008. The global financial crisis escalated in the autumn of 2008, creating restricted capital flows, and aggravating liquidity in the financial sector. Changes in the credit policies of banks and downgrades in Latvia's sovereign credit rating substantially reduced the resources available for investment. Additionally, global demand declined, leading to a drop in exports.

In 2009, GDP continued to drop, falling in the first half of 2009 by 18.4% when compared to the corresponding period of the previous year. Substantial drops were recorded in private consumption, gross fixed capital formation and exports, the negative impact of which was slightly offset by a fall in imports. Simultaneously with GDP, contraction inflation steadily declined from 17.9% in May of 2008 to 0.5% in September of 2009. Meanwhile, registered unemployment rose from 4.8% in May of 2008 to 13.2% in September of 2009. The job seeker rate reached 18.2% in August of 2009. The average wage in the economy during 2008 rose by 20.5%, but during the last quarter of 2008 growth rates slowed, particularly in the public sector and were below the inflation level. During the first quarter of 2009, the average wage in the economy decreased by 1% compared to the second quarter of 2008 to a level of 473 LVL. This average wage reduction was affected by a 0.1% increase in the private sector and a 6.2% reduction in the public sector, with the average wage in state-funded

institutions being reduced by 15.3%. Wage bills saw an even sharper reduction due to a fall in both employment and working hours.

Currently, statistical information is now indicating a stabilisation in the economy. The drop in manufacturing has decreased from a year-on-year drop of 24.2% in February of 2009 to 12.5% in August. The industry sentiment index has increased since its all-time low record in early 2009, and is currently at the level of December 2008, which is considerably higher than during the first quarter of 2009. Stabilisation and slight increases have also been observed in the retail trade sentiment index. Latvia is also experiencing a quicker than anticipated correction of external imbalances, not only reducing the current budget deficit, but also recording a surplus. According to data provided by the Bank of Latvia, the first half of 2009 saw a surplus in current account balances of 519.4 million LVL, compared to a 1,214.5 million LVL deficit in the same period of 2008. This surplus was mainly caused by deficit reduction in the trade balance for goods at a total of 831.0 million LVL, with the import contraction exceeding the export contraction rate. Improvements were also observed in the trade balance for services and in income amounts. In the first half of 2009, financial accounts had a deficit of 755.2 million LVL, compared to a 1,246.4 million LVL surplus in the same period of 2008. Financial accounts were negatively impacted by outflows of non-resident deposits and funds, amounting to 1,795.0 million LVL, and were positively affected by government borrowings and decreases in the Bank of Latvia's reserves.

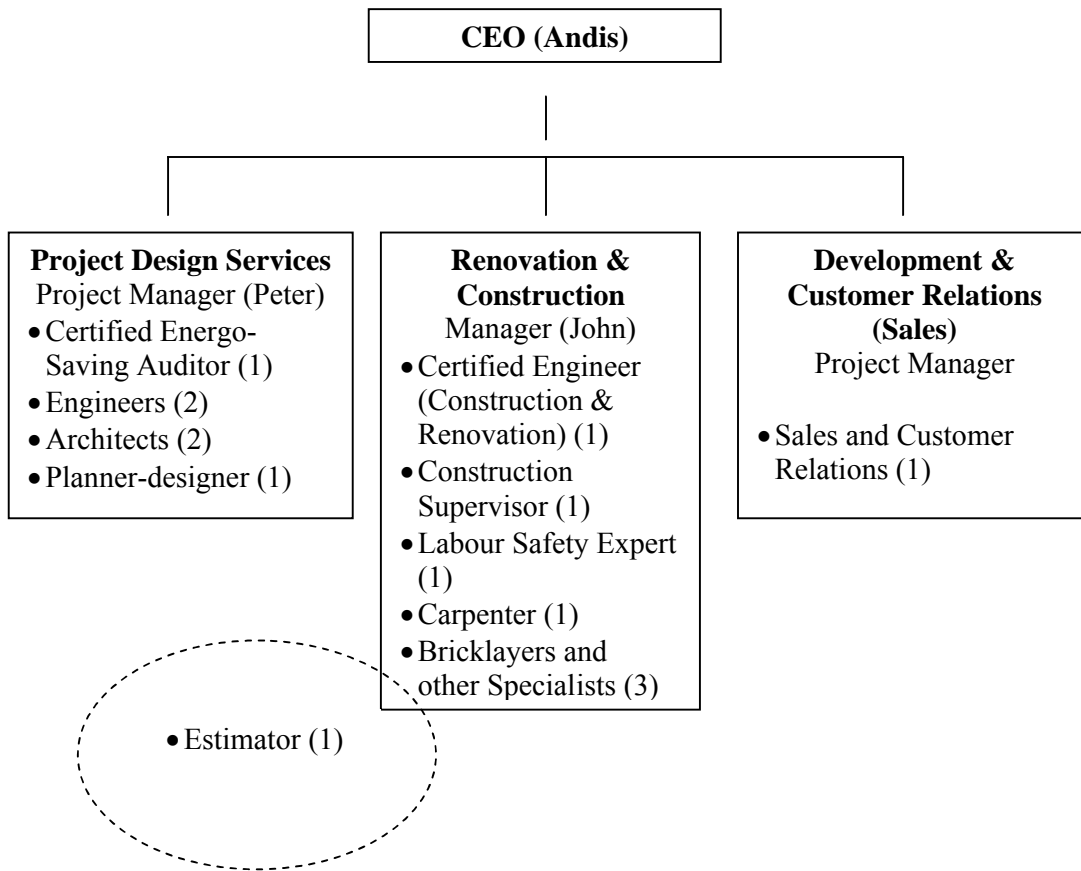
In the second quarter of 2009, several positive signs indicated that the situation in the global economy was stabilising and showing marginal improvements. Several developed countries recorded quarter-on-quarter growth in the second quarter, including leading EU economies. More positive data could be seen in JP Morgan's global PMI index, which indicated trends in global manufacturing as it rose to its highest 26-month level in August, and for the first time since May of 2008, indicated an expansion in manufacturing among the world's leading economies. This trend persisted into September and indicated that the recovery of global manufacturing was underway. Currently, a recovery of the global economy has mainly been driven by various fiscal stimulus packages around the world, as well as by the restocking of inventories. A large portion of the money from fiscal stimulus packages will run out

in 2010. Considering that improvements in the Latvian economic situation are closely tied with global and in particular EU recovery, the external economic environment can be viewed from a cautiously optimistic perspective

*Source: Ministry of Finance of the Republic of Latvia, Bank of Latvia*



**Appendix Two**  
**Valmiera Construction Ltd Organisational Structure**



According to its business plan, Valmiera Construction Ltd has three divisions with 18 persons. The project design services division's main activities include energo-saving audits, pre-design on-site building inspections, technical design projects for renovation and construction, as well as other in-house documentation. The renovation & construction division is projected to be the company's cash cow. Team leader John is responsible for seven employees. The number of this staff could be increased if Valmiera Construction Ltd finds economic grounds to do so. Otherwise, a part of renovation and construction will be done by subcontractors. Andis relies on the expertise of sales manager who together with their assistants are responsible for new customers and other marketing activities. Services such as accounting and bookkeeping are outsourced.

### **Appendix Three**

#### **Business Incubators in Latvia**

Business incubators exist worldwide, and for a vast portion of start-up companies, incubators offer significant support and guarantee rapid development. The possibility to be successful in business is greater when cooperating with a business incubator. Incubators are often local, providing jobs for the region. Around the world, as well as in Latvia, business incubators are becoming more active and more available. The challenge for start-ups is to achieve the best for its own business, and business incubators will continue to play a major role in helping to achieve this.

Thirteen incubators are active in Latvia, operating in Ventspils, Līvāni, Ogre, Valmiera, Rēzekne, Tukums, Jelgava and Riga. Some of them started or expanded their operations within the framework of the programme of the Ministry of Economics for Innovation Centres and Business Incubators. Today, business incubators combine premises and equipment with consultations for business development and financing. They assist start-ups that have ideas, courage companies to take a risk, and provide an awareness and assistance in the support these companies may need.

Business incubators in Latvia offer several services:

- Support and consultations registering the company;
- Opportunity to obtain a legal address and receive mail easily and safely;
- Infrastructure – modern premises, office equipment and furniture, access to laboratories, and public utility services at a low cost;
- Secretarial services at any time during the working day, including access to office equipment and conference premises and equipment;
- Opportunity to develop, test and introduce new technologies and innovative products, using collaborative network of incubators;
- Consultative services, receiving state co-financing in the following areas: marketing, attraction of capital, attraction of personnel, accountancy, development of business plans, legal services, documentation, development and testing of first technologies.

*“I’m convinced that many people think of having their own business, and that their dream is to work for themselves. A large number of these people have a business idea that is not implemented for several reasons. This is the moment when you should use a business incubator! It will help to start a business and complete formalities. A business incubator offers safety; start-ups won’t be left alone with their problems. Certainly, a business incubator will not do a company’s work for it. But start-ups will meet other businessmen, experts, and other people from the business world. This communication develops contact exchanges and sustains the conviction that, yes, I can do it!”* explains the manager of the business incubator in ‘Ventspils High Technology Park’.

Business incubators promote the establishment of new companies, ideas and their development. Business incubators offer business start-ups qualitative infrastructure and office services at reduced prices, business consultations for development, financing and organisation, as well as effective collaboration networks for sales of the ideas that result. Incubated companies all have the pre-requirements for rapid development, and increased turnover. They enter the local and global markets via the collaborated network of the incubator.

The four steps to begin the operational activities with a business incubator include:

1. Discuss the idea with the business incubator management;
2. Submit the application form for the operational activities supported by the business incubator;
3. Receive confirmation from support allocation commission;
4. Conclude a contract on operational activities with business incubator.

The business incubator provides:

1. The legal address of the company – if the legal address is necessary, it is available from the business incubator. Use of this legal address provides mail directly to your workplace. An additional charge for the use of this legal address is not required.

2. Support in the registration of company – using experience and collaboration channels, the business incubator may provide consultations on the establishment of the company, and solve other problems, e.g. capital acquisition.
3. Infrastructure – companies working with the business incubator receive modern office premises and advanced office equipment (computers, furniture). It also provides residential services and access to laboratories. Services of infrastructure are available at affordable, low prices that can be paid for even by new companies.
4. Secretarial services – secretary services are available at any time during working hours. Service is provided by the business incubator’s administration, and companies may use printers, photocopiers, scanners, faxes, postal services to send/receive mail, telephone services, as well as conference premises and their respective equipment.
5. Development of new technologies and innovative products – using the extensive collaboration network, new companies are provided with the opportunity to develop, test and introduce new technologies and new products for manufacturing.
6. Consultative services – state co-financing makes it possible to receive support for the following services:
  - a. marketing services (project of the special programme “The first clients”; marketing projects of the special programme “Foreign markets”);
  - b. capital attraction services (projects of the special programme “Capital attraction”);
  - c. selection and attraction of personnel (projects of the special programme “Attraction of personnel”);
  - d. other services such as accounting, development of business plans, legal services, consultations for organisation of business;
  - e. projects of the special programme “Development and testing of the first technologies”.

The use of these services will allow companies not only to save assets, but also to achieve their aims quickly.

Companies have the opportunity to apply for financial support provided by the state for the services mentioned depending on the age of the company:

	Age of the company			
	<1 year	1 - 2 years	2 - 3 years	3 - 5 years
Service	85%	70%	50%	25%

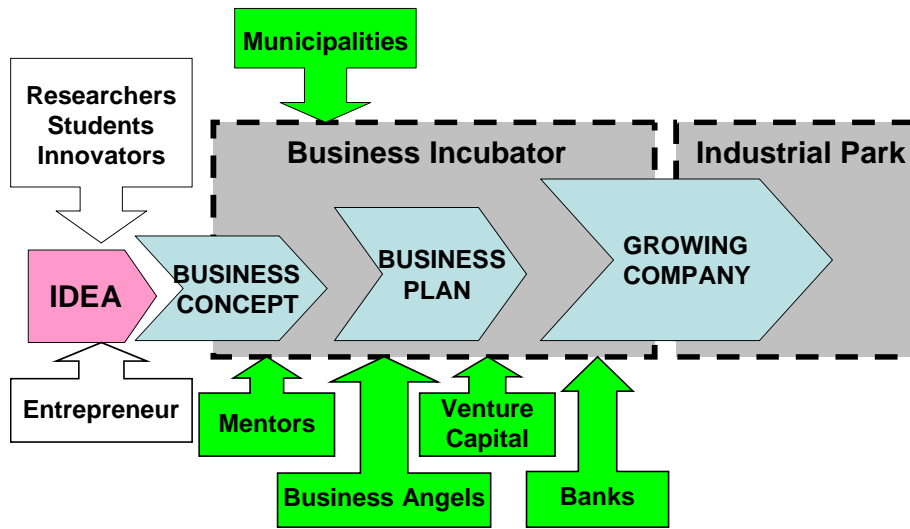
Admission of companies is based on two-stage criteria:

1. Company age should not exceed 3 years;
2. Residential time should not exceed 3 years, after leaving incubator, it should not exceed 5 years.

Assessment of company and its business plan (evaluation expressed in points). The business incubator uses the following criteria to choose the best applicants:

- Personnel analysis – availability of competencies for the implementation of the project;
- Analysis of business idea – assessment of vital capacity of project idea;
- Market analysis – accessibility of sales market, product sales potential;
- Financial analysis – financial forecast, availability, anticipated return;
- Prior sectors – companies working in one of the prior fields determined by the business incubator (information technologies, telecommunications, electronics, engineering, industrial automation, CAD), considered a priority and receive additional assessment points.

# Business Incubation As Process



**Appendix Four**  
**Valmiera Construction Ltd Financial Projections Year 1 (2010) – Year 5,**  
**in Euros**

<b>Services</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Energo-Saving Audit for Buildings	25,900	20,900	25,700	31,400	35,000
On-Site Technical Inspections (Pre-Renovation)	4,000	4,400	5,400	6,500	7,500
Technical Project Design, Related Services	50,000	70,000	85,600	104,800	110,000
On-Site Construction Supervision	14,000	14,000	17,100	21,000	24,000
Renovation and Construction	1,180,100	1,485,000	1,871,100	2,357,600	2,800,000
<b>Total</b>	<b>1,274,000</b>	<b>1,594,300</b>	<b>2,004,900</b>	<b>2,521,300</b>	<b>2,976,500</b>