

# Evaluation of Institutional Factors of Self-Employment: Comparative Analysis of Lithuania and Latvia

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*Abstract:* - the article is aimed at the analysis of the main differences between the institutional factors of self-employment in Lithuania and Latvia. In order to fulfil the raised aim, the first section has been designed for the analysis of the experience of entrepreneurship promotion from governmental positions in different geographical areas (Europe and the USA). The second section introduces the methodology of the empirical research and the course of the expert evaluation. 5 experts from Latvia and 9 experts from Lithuania were involved in the research. The results of the empirical research propose the following conclusions: the number of the self-employed in Latvia could be increased by focusing on the financial measures of self-employment while in Lithuania it could be increased by focusing on tax incentives; the opportunity to receive a preferential credit is an influential factor of self-employment promotion in both Latvia and Lithuania; business expansion while becoming an employer could be promoted by facilitation of tax administration, less intensive regulation of the labour market and financial support provided for small and medium business.

*Key-Words:* - institutional factors of self-employment, self-employed, employers, Lithuania and Latvia, self-employment

## 1 Introduction

Self-employment is interpreted as generation of personal income from private business or performance of professional activities. The scientific literature [1] focuses on the promotion of entrepreneurship while the research of self-employment plays a secondary role since the researchers, as van Praag, Versloot (2007) [2] use the factor of self-employment as a measure of entrepreneurship evaluation. Such attitude can lead to inaccurate results considering the fact that not all self-employed people are treated as entrepreneurs, for instance, the people working on the basis of contracts (contractors), translators, reporters, artists, etc.

In this article, self-employment is treated as the business performed by an individual seeking for income earning, capital increase and expansion to new (foreign) markets. Up to now, self-employed people have not received sufficient attention from both scholars and governments while implementing business promotion measures. Business promotion measures are mainly oriented to the owners with already established enterprises (participation in public procurement tenders is limited in developing countries; labour institutions usually provide the

support to the unemployed who are planning to start-up a business). At present, Lithuanian government has advanced in the sphere of self-employment promotion: the Ministry of Economy of the Republic of Lithuania provides the support to the particular groups of individuals (young people, women, students) who seek for entrepreneurship; the company of limited liability “Invega” has been established to provide preferential warranty loans to small business including the individuals seeking for self-employment. With reference to Bruna, Sneiderė (2011) [3], Latvia has introduced business promotion programs and business incubators aimed at improving society’s knowledge of business start-up and providing the necessary funding.

García (2014) [4] researched the influential factors of entrepreneurship in 184 cities in 20 European countries during the period of 1999 – 2010. The research revealed that the EU countries, where self-employment was promoted with different measures, had the larger number of the established enterprises. According to Belitski & Korosteleva (2010) [5], the quality of institutional organisations, including the system of property rights and democratic institutions, has the impact on self-employment. With reference to the results of this research, it can

be stated that institutional factors of self-employment are significant while forming business-favourable environment.

The impact of institutional factors of self-employment has been researched in numerous scientific studies: García (2014) [4]; Aidis et al. (2009) [6]; Estrin, Mickiewicz (2010) [7]; Grilo, Irigoyen (2006) [8]; Nziramasanga et al. (2009) [9]; van Stel et al. (2007) [10]; Audretsch et al. (2007) [11]; Lockyer, George (2012) [12]; Ntayi et al. (2013) [13]; Pettersson (2012) [14]; Remeikiene, Startiene (2011) [15]; Remeikiene, Startiene (2013) [16]. The studies focused on the efficiency of the self-employment promotion measures in developed countries (e.g., the UK, the USA) and transition economies (e.g., the countries of Eastern Europe), the spread of the applied measures, and reduction of the barriers for business start-up.

With reference to World Bank group (2014) [17], in 2013, Lithuania went up eight positions in comparison to 2012, and was rated to be 17<sup>th</sup> country in the world by business environment index while Latvia was rated to be 24<sup>th</sup> country.

**The aim** of the article is to evaluate institutional factors of self-employment in Lithuania and Latvia. The rest of the paper has been organised as follows: in the next section, the scientific literature on the impact of self-employment factors has been reviewed; in the second section, the methodology of the empirical research has been presented; in the third section, the results of the empirical research have been introduced and the conclusions have been made.

## **2 Comparative analysis between EU and USA in promotion of self-employment**

Entry into self-employment and the viability of such enterprises are equally important aspects of labour markets and policies [9]. Up to now, the governments have focused rather on the promotion of self-employment start-up than its development providing preferential credits with subsidized interest rates. However, the research by Nziramasanga et al. (2009) [9], revealed that business life cycle is decreasing. With reference to Audretsch et al. (2007) [11], governments not only promote self-employment, but also restrict it. According to the authors, interference into the market distorts it. The initial European culture of entrepreneurship was mainly treated as one of the reasons for the large development gap between the EU and the USA. The process of the development of entrepreneurial culture in the EU faced numerous

challenges: from the fear of a complete business failure to unawareness that business can become a determinant of successful career. Considering educational purposes, government's interference in business can be tolerated and treated as one of the factors of public welfare.

Most governments aim at standardization of business conditions for all business subjects, although this aim contradicts to the sense of entrepreneurship. Taxes, regulation of the labour market, access to capital and administrative burden are the main parameters of standardization.

In order to identify what measures of self-employment promotion are efficient in international level, it is purposeful to review the results of the studies that were carried out in Europe and the USA (the above mentioned geographical zones were selected due to the differences in entrepreneurship culture). With reference to "Mutual Learning Programme: peer country comments – United Kingdom" [18], in the UK self-employment is mainly promoted creating business start-up and development favourable environment, reducing bureaucracy and costs, and providing financial support to particular population groups, for instance, to young people. However, in comparison to the UK, Spain faces more significant problems in the labour market: high unemployment rate, notable among young people (in 2011, youth unemployment rate in Spain reached 45 per cent while in the UK it made 21 per cent); a large number of the fixed-term labour contracts; higher labour market segmentation and higher coefficient of giving up school. The circumstances explicated above determine that the Spanish people, seeking to escape unemployment and instability in the labour market, prefer self-employment as an attractive alternative. Due to this reason, Spanish government takes measures for self-employment promotion. With reference to "Mutual Learning Programme: peer country comments – United Kingdom" [18], unemployment benefit is paid in the duration of 12 months and is equal to 80 per cent of the wages; if it is lower than 15.500 EUR, it does not have to be declared.

The other research Audretsch et al. (2007) [11] revealed that the restrictions on liquidity are relevant only when an enterprise is growing. Similar tendencies were noticed in Germany and the UK. Financial restrictions are equally significant for both men and women in 55 European countries [7], although women find it more difficult to start-up business due to household works and the responsibility for bringing up young children. For this reason, the governments could take measures to solve the problem of the care for young children.

According to van Stel et. al. [19], different governments apply different business promotion measures. The practice of the reduction of market entrance barriers for new enterprises is widely-spread in the USA. The reduction of market entrance barriers includes the period of business start-up, the costs of permissions and licences and the minimum capital requirements for the establishment of a new enterprise. The EU applies direct or indirect business support: provision of information, training, advice and creation of business incubators for both performing and new enterprises.

Summarizing, it can be stated that selection of the measures for business support mainly depend on the type of entrepreneurship culture in the country. The USA supports business eliminating market entrance barriers, reducing taxes and removing administrative bureaucracy while the EU provides financial and non-financial support. In any case, it is important to note that particular business promotion measures are efficient in the process of starting-up a business, others – in the process of business development.

### 3 The Methodology of the Research

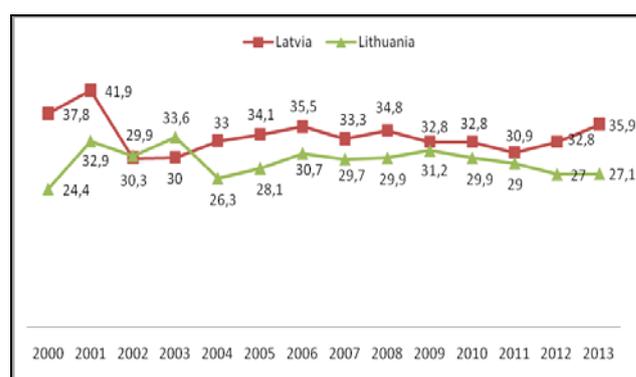
For the fulfilment of the empirical aim – to compare the institutional factors of self-employment in Latvia and Lithuania – the method of expert evaluation was selected. The members of Lithuanian and Latvian Chambers of Commerce with comprehensive knowledge of the business situation in their country, the employers with work experience not shorter than 5 years, and the people who started their activities as self-employed, but later successfully developed their businesses and became employers, were selected as experts. With reference to Augustinaitis et. al. (2009) [20], the efficiency of the research results for expert evaluation is ensured involving 5 – 9 people (experts). Following these recommendations, 5 experts were involved in the research in Latvia and 9 experts – in Lithuania. The questionnaires consisting of four questions were presented to the experts by e-mail or during the interviews. For the establishment of the prospects of self-employment development for a person without any hired employees, the following questions were formulated: *What reasons determine self-employment start-up and employment of other people? What reasons discourage a person from self-employment development and employment of other people? What governmental actions would encourage a person to become a self-employed?*

*What governmental actions would encourage a self-employed person to develop his business and become an employer?* The experts were asked to evaluate each of the alternative answers in points by Likert scale, where the lowest evaluation 1 means *completely disagree*, and the highest evaluation 5 means *completely agree*. Depending on the strength of the agreement, the experts could mark intermediate numerical values 2, 3 or 4.

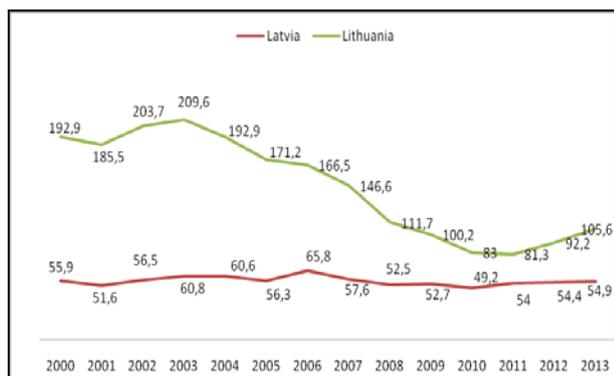
It should be noted that the interpretations of *Cronbach alpha* coefficient may differ while presenting the results of the expert evaluation. Some scientists, such as Nunnally, Bernstein (1994) [21], state that *Cronbach alpha* coefficient should not be lower than 0.7, others - Malhotra, Birks (2003) [22] are of the opinion that the critical value of reliability is 0.6. The different interpretations propose that the selection of the critical value is a subjective matter, and the value should be defined considering the nature and the qualitative aspects of the research. The critical value of *Cronbach alpha* coefficient defined for the empirical research introduced in this article is 0.7.

The level of significance established for verification of the questions is equal to 0.05. The differences of variables are considered to be statistically significant when  $p < 0.05$ . The research data was processed using SPSS (*Statistical Package for Social Sciences*) and “Microsoft Excel” software.

At first, the statistical data on the number of the employers and the self-employed in both researched countries during the period of 2000- 2013 will be compared (see Figures 1 and 2).



**Fig. 1.** The number of the employers, thousand people (compiled by the authors with reference to [23])



**Fig. 2.** The number of the self-employed, thousand people (compiled by the authors with reference to [23])

As it can be seen from Figures 1 and 2, in 2013, the number of the employers made 8.8 thousand people in Latvia while Lithuania had the larger number of the self-employed (50.7 thousand people). Although both Lithuania and Latvia are considered to be similar countries by their cultural, geographical and geopolitical situation, comparing the level of self-employment in both countries, different tendencies have been observed.

#### 4 The Results of the Empirical Research

The similarities and differences of the institutional factors in both countries, identified after the empirical research, have been introduced in Table 1.

**Table 1.** Summary of the expert evaluation results (mean rank values)

By the reasons that determine self-employment and employment of other people (mean ranks):	Lithuania	Latvia
Increasing demand for the products/services, expansion into new markets	<b>4.37</b>	<b>3.70</b>
Acquisition of higher skills because a single person cannot be sufficiently competent in all fields including finance, production or other spheres that require specific knowledge	<b>3.07</b>	<b>4.20</b>
Taking advantage of the economic situation (skilled employees agree to work for much lower wages, lower rent, etc. due to the increased unemployment level, etc.)	2.63	2.40
Peculiarities of the country or	2,63	2,70

EU's business funding availability (in order to get the funding, other people's employment is necessary)		
The fear to lose a skilled person who was previously paid on the basis of copyright agreement or other types of payment were engaged	2.33	2.40
<b>By the reasons that do not determine self-employment development or becoming an employer*:</b>		
Too high taxes employing another person (high labour force taxation) and additional taxes having established an enterprise (profit, VAT, excise, property, land and other taxes)	<b>14.35</b>	<b>13.3</b>
Unfavourable economic situation in the country (decreased consumption)	<b>11.58</b>	<b>13.7</b>
Customers' insolvency	<b>10.58</b>	8.6
Difficulties finding skilled and reliable labour force	<b>10.20</b>	<b>12.5</b>
Lack or inaccessibility of the capital necessary for business establishment, i.e. imperfections of the current bank loan system	9.22	<b>10.6</b>
Lack of marketing knowledge	9.13	6.9
Fear to take responsibility for another employee, i.e. the risk that the business will fail to maintain a hired employee	9	<b>10.6</b>
Legal – administrative barriers	8.72	<b>10.6</b>
Lack of management competence	8.58	6.9
Lack of family's support, fear not to match work and family life	8.30	6.10
Too intensive competition in the market	7.88	8.9
EU or country's support on condition another person is employed does not ensure business success	7.53	8.7
Distrust in employees	7.43	5.9
Too difficult procedure of business establishment	7.27	6.5
Lack of time due to the caring about little children and household	4.78	6.5

\*the reasons with mean rank 10 and higher are considered to be the most significant, the ones with mean rank between 9.9 and 7.5 – significant, and the ones with mean rank 7.4 and lower – insignificant.

The results of the expert evaluation have revealed that the questions formulated for the survey reflect the researched dimension with sufficient accuracy (*Cronbach alpha* coefficient is equal to 0.76 in Latvia, and to 0.798 in Lithuania).

Each expert was contacted personally by e-mail or by appointing an interview, so the meaning and the aim of each statement were explained personally to each of the experts. The experts were presented the same questions in order to have an opportunity to obtain comparable information while processing the data. The differences have been reflected in the research results.

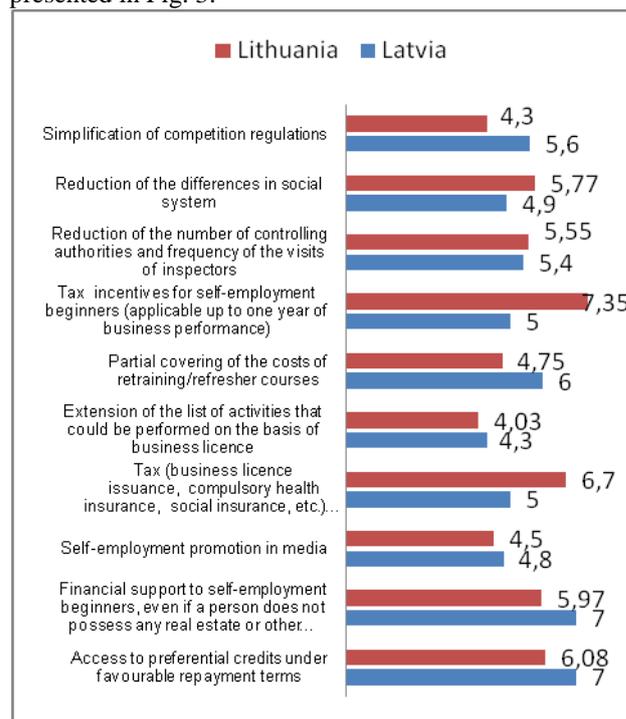
The data presented in Table 1 shows that in both Lithuania and Latvia, the main reasons that determine self-employment development and employment of other people are as follows: increasing demand for the products/services and expansion into new markets. Another significant reason is acquisition of higher skills because a single person cannot be sufficiently competent in all fields of business including finance, production, marketing, planning or other spheres that require specific knowledge. Other reasons (e.g., access to the EU support, the fear to lose a skilled person who was previously paid on the basis of copyright agreement or other types of payment were engaged, or economic situation in the country, when skilled employees agree to work for much lower wages, lower rent, etc. due to the increased unemployment level) are considered to be insignificant for both countries.

Comparative analysis of the reasons that do not determine self-employment development or becoming an employer in Lithuania and Latvia has revealed two main differences: 1) customers' insolvency is considered to be the most significant reason (mean rank 10.58) in Lithuanian case while Latvian experts treat it as less significant, thus, it has not been included in the list of the most significant reasons (mean rank 8.6); 2) imperfections of the current bank loan system, fear of business failure and legal – administrative barriers (mean ranks are equal to 10.6) have been pointed out as most significant reasons that impede becoming an employer in Latvian labour market while for Lithuanian experts the reasons mentioned above are significant, but not most significant.

A few similarities between the two countries have also been established: imperfections of the tax system as well as unfavourable economic conditions are considered to be the reasons that discourage the establishment of business with employees in both countries.

In order to make recommendations on what measures could be applied to promote self-employment in both countries, the experts were asked to rank the measures introduced in the questionnaire by their significance, i.e. to point out what measures could directly or indirectly increase the number of the self-employed in the

researched countries. The systematized results have been presented in Fig. 3.



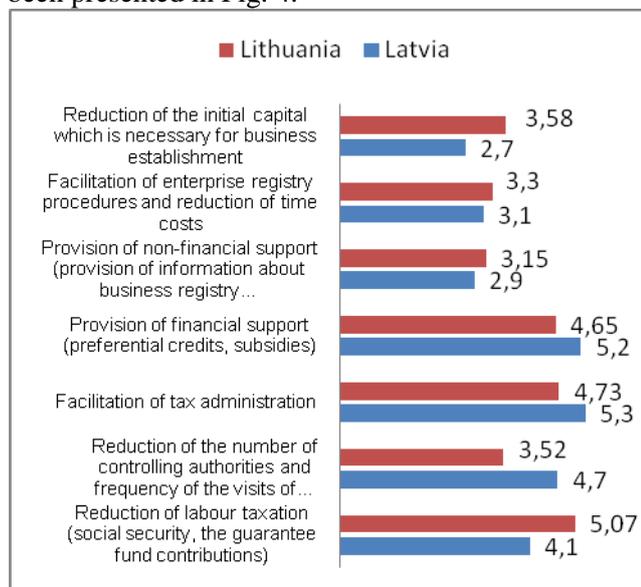
**Fig. 3.** Comparative analysis of the governmental actions that could promote self-employment in Lithuania and Latvia, mean rank (source: compiled by the authors)

\*if mean rank value varies in the interval from 6 to 7.35, the measure is considered to be effective, in the interval between 5.9 and 4.5 – medium effective, 4.4 and lower - ineffective.

It should be noted that the experts' opinions on the most effective measures to increase the level of self-employment in their countries differed: according to the research results, the level of self-employment in Lithuania could be increased by tax incentives for self-employment beginners (for example, the incentives could be applied up to one year of business performance), tax reduction and access to preferential credits under favourable repayment terms while in Latvia the most influential measures would be access to financial support for self-employment beginners, even if a person does not possess any real estate, and by partial covering of the costs of retraining/refresher courses.

Experts' opinions while evaluating the governmental actions aimed at promoting self-employers to become employers almost coincided. The most significant and efficient measures pointed out by the experts included provision of financial support, facilitation of tax administration and reduction of labour taxation. In Latvian business environment, it is important to reduce the frequency of the visits to controlling authorities whereas the

reduction of the initial capital which is necessary for business establishment is more significant to Lithuanian business environment (at present, the minimal required amount of the initial capital for the establishment of a joint-stock company makes 150000 LT (43443 EUR), for the establishment of a company of limited liability – 10000 LT (2896.2 EUR). Ranking of the measures by the countries has been presented in Fig. 4.



**Fig. 4.** Comparative analysis of the governmental actions that could promote a self-employed person to become an employer in Lithuania and Latvia, mean rank (source: compiled by the authors)

\*if mean rank varies in the interval from 4 to 5.3, the measure is considered to be effective, in the interval between 3.9 and 2.9 – medium effective, 2.8 and lower - ineffective.

## 5 Conclusions

The impact of institutional environment on self-employment can be really significant if the governments apply relevant target measures to promote self-employment start-up and duration. According to [8], one of the ways to increase the rate of self-employment is the focus on a hired person, i.e. when governments take measures to motivate a hired person to change the employment status and become a self-employed. The analysis of the scientific literature has revealed that the support is mainly provided to newly-established enterprises and the unemployed whereas potential businessmen (currently hired people) are hardly supported. The results of the empirical research propose the following conclusions:

- 1) The revealed **similarities** of Lithuania and Latvia include the equally significant motives to become an employer, namely the

necessity of development and the lack of competences. Evaluating the governmental actions that could promote becoming an employer, the experts pointed out provision of financial support, facilitation of tax administration and reduction of labour taxation.

- 2) The main **differences** have been captured while evaluating the reasons that do not determine self-employment development or becoming an employer: customers' insolvency is considered to be more significant problem in Lithuania than in Latvia while the latter faces such significant problems as imperfections of the current bank loan system, fear of business failure and legal – administrative barriers.
- 3) Self-employment in Latvia would be promoted by providing financial support to self-employment beginners, even if a person does not possess any real estate, and by partial covering of the costs of retraining/refreshing courses; in Lithuania, self-employment would be promoted by tax incentives for self-employment beginners (for example, the incentives could be applied up to one year of business performance) and by tax reduction.
- 4) Access to preferential credits in both countries is treated as a measure that has positive impact on self-employment in both countries.

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