

## Development of Business Incubators: Case Study of Latvia

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**Abstract.** Business incubation is increasingly playing an important role for new start-ups around the globe. In a growing number of countries, incubators that support the development of young, innovative firms are introduced as a way to strengthen the entrepreneurial activity (number of start-ups) and the ability for new companies to survive. This paper focuses on exploring the current situation in business incubation in Latvia. The research was based on the study of the regulatory enactments of the Republic of Latvia, scientific publications, and special literature related to the research topic. Adequate research methods – analysis and synthesis, logical and abstract constructive, data interpolation and expert – were used to carry out this study. The results of study showed that the development of business incubators in Latvia dated back to 1993 when the first establishment of this kind – the Latvian Technological Centre – was founded. Since that time, the number of business incubators in Latvia has grown to 17 (with 18 developed subsidiaries). It was also concluded that business incubators were distributed geographically throughout Latvia, thus providing balanced regional development. Finally, networking, which is in line with the latest development trends of business incubators all around the world, can be mentioned as a positive development tendency of Latvian business incubators.

**Key words:** business incubators, innovation, Latvia.

**JEL code:** O31, O38.

### Introduction

Once the famous economist J.A. Schumpeter (1962) has said: “*The fundamental impulse that keeps the capital engine in motion comes from the new consumers’ goods, the new methods of production and transportation, the new markets ... [The process] incessantly revolutionises from within, incessantly destroying the old one, incessantly creating a new one.*” This idea of J.A. Schumpeter clearly underlines the important role that new firms play in the development of economies, and particularly, in the development of certain industry sectors and geographic regions. It has been estimated that young firms are a major source of new jobs, sales and innovation in most economies (Stangler, Litan, 2009; Davis et al., 2008; OECD, 2000). However, young firms are fragile and very often new entrepreneurs face serious barriers to survive and thrive during the gestation period (Pena, 2004). To respond to this general concern and to stimulate new business creation, business incubators have emerged around the world.

The phenomenon of business incubators appeared spontaneously in the United States in the 1950s and 1960s (Sofouli, Vonortas, 2007). Since then, many European governments have tried to emulate this process and generate conditions appropriate for science and technology parks, technopoles and other similar concentrations of scientific, technological, industrial, and commercial activities (Abetti, 2004). Targeted European Union (EU) action towards development of new firms and innovative environment has been successful and today there are more than 1000 business incubators in the EU. The EU takes the second place after the North America where the highest number of business incubators

concentrates compared with other regions. This can be explained by the strong tradition of incubators as the first ones appeared in the United States (Callegati et al., 2005).

To understand the meaning of business incubators, Hackett and Dilts (2004) offer the following definition: “A business incubator is a shared office space facility that seeks to provide its incubators (i.e. “portfolio-” or “client-” or “tenant-companies”) with a strategic, value-adding intervention system (i.e. business incubation) of monitoring and business assistance. This system controls and links resources with the objective of facilitating the successful new venture development of the incubators, while, simultaneously containing the cost of their potential failure”. Thus, business incubators are designed specifically to help start-up firms. They usually provide:

- flexible space and leases, many times at very low rates;
- fee-based business support services, such as telephone answering, bookkeeping, secretarial, fax and copy machine access, libraries and meeting rooms;
- group rates for health, life and other insurance plans;
- business and technical assistance either on site or through a community referral system;
- assistance in obtaining funding;
- networking with other entrepreneurs.

Therefore, it is not surprise that in recent years the topic of business incubation has been examined by a growing body of literature (NESTA, 2008; Sofouli, Vonortas, 2007; Pena, 2004; Hackett, Dilts, 2004). Most of these studies provide detailed case study analyses where the

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unit of analysis is the incubation centre. However, most of scientific literature on business incubators covers mainly developed OECD member countries (OECD, 1999); some newly industrialising countries like the Middle East and the Central Asia (Johnsrud, Springs, 2004) and the economies in transition (Sipos, Szabo, 2006). In between these, there is a large set of small and medium-sized countries, like new European Union Member States, for which one knows less. The following **hypothesis** – business incubators in Latvia facilitate the emergence of new and innovative companies is highlighted to appraise the current situation.

Defined hypothesis emphasised the **aim** of the study – to explore the current situation on business incubation in Latvia.

The following research **tasks** are defined consistent with the set aim:

- to summarise the development tendencies of business incubators in Latvia;
- to characterise the specifics of Latvian business incubators;
- to assess the importance and necessity of business incubators in the formation of new enterprises.

The regulatory enactments of the Republic of Latvia, scientific publications, and special literature related to the research topic were used to meet the study objectives. The following adequate research methods: analysis and synthesis, logical and abstract interpretation and data interpolation were used to carry out this study.

## Research results and discussion

Regional and national competitiveness and economic growth are increasingly dependent on the underlying conditions supporting risk-taking and innovative ideas (Callegati et al., 2005). As a result, innovation has become a priority for firms, organisations, and governments in most countries throughout the world, including Latvia. This, in turn, has contributed to increased political and economic recognition of business incubation as essential element for strengthening the development of young, innovative firms.

### 1. Development of business incubators in Latvia

The development of business incubators in Latvia dates back to 1993 when the first establishment of this kind – the Latvian Technological Centre – was founded (with funding provided by the Ministry of Education and Science). At that time, the Latvian Technological Centre was the first and only on the innovation and technology development oriented business support structure in Latvia. Currently, the Latvian Technological Centre continues to provide incubation services (currently running 27 companies), as well as it works with other innovation-related activities, for instance, it is involved in the Enterprise Europe Network.

In 1996, the Latvian Technology Park partially fulfilling the business incubation function was established at Riga Technical University. The Latvian Technology Park still partially fulfils the functions of the incubator, as one of its activities is the creation and development of innovative companies.

In 1997, Liepaja business incubator was established; however, in 2001, it was closed up due to the failure of its operational policy and lack of funding.

New business incubators in Latvia were not developed in the following years. Latvia's accession to the European Union in 2004 and access to the EU co-financing gave a new impetus to the development of this area. In 2006, three new business incubators were established – Livani Engineering and Innovation Centre, Ogre Business and Innovation Incubator, and Ventspils Business Incubator through the financing from the PHARE 2003 programme for Economic and Social Cohesion.

Active development of new business incubators continued in 2007, when the Ministry of Economics launched the implementation of "Innovation Centre and Business Incubator Development Programme". During 2007 and 2008, five innovation centres and six business incubators were established in order to improve the innovation infrastructure and provide incubation services to young innovative companies in their formation and development stage. During this period, the following business incubators were established: Valmiera Business Incubator, Jelgava Innovation Centre Business Incubator, Tukums Business and Technology Incubator, Business and Technology Incubator "Valdeka BITIS" of Latvia University of Agriculture, Riga Biomaterials Innovation and Development Centre Business Incubator, and VHTP Business Incubator in Ventspils.

In 2009, the implementation of new support programme "Business Incubators" was launched as the move towards development of new business incubators. Generally, this programme addresses simultaneously two challenges faced by the national economy of Latvia – first, the low number of innovative companies, and, second, the marked regional disparities (including uneven distribution of entrepreneurial and innovative activities) present in the country. It is intended that this support programme will work until 2014 and its total costs are LVL 20.2 million, of which 85% is financed from the European Regional Development Fund and 15% from the Latvian State budget. Overall, nine contracts for offering the business incubator services have already been signed in the framework of this programme.

Although business incubation in Latvia is still in its early stage of development and most incubators have started operating in the early 2000s, the previous and current state policy as well as business incubator's development intensity may be evaluated as very successful. In 2011, there were already developed 17 business incubators in Latvia. Furthermore, several business incubators have expanded their activity by setting up subsidiaries in other cities or rural areas; thus creating network of business incubators in Latvia. Such progress in the establishment of business incubator network should be continued, as it brings the numerous advantages to improve the service quality for business incubator, and is in line with the latest development trends of business incubators all around the world. According to Rong (2006), the establishment of business incubator network brings the following advantages:

- for the new established incubator, the network could improve its management and service capability through exchange of experience;



Source: authors' construction

Fig. 1. Territorial distribution of business incubators in Latvia, 2011

- in the incubator network, there are much more tenant companies than in a single incubator, which means that there will be much more potential clients for incubator;
- it is possible to reduce the cost of services through the network;
- it is possible to create some special service programmes that are impossible to have in a single incubator.

More detailed information on the territorial distribution of business incubators and established business incubators' networks is shown in Figure 1.

From the information summarised in Figure 1 it can be concluded that business incubators are fairly evenly located all over the territory of Latvia, thus, creating favourable development conditions for those firms, which are located outside Riga and the major cities. Overall, at present about 580 new firms operate in 17 business incubators and their developed 18 subsidiaries. If one compares Latvia with other countries, then, for example, in Chile, which is almost eight times larger than Latvia, there are approximately 25–30 incubators primarily supported by a coalition of the government and universities. It is considered that business incubation in Chile is nascent, but growing business incubation industry makes it the second largest incubation market in the South America after Brazil (Chandra, Narczewska, 2009). Against this background, the situation in Latvia can be regarded as promising. More information on the specifics of Latvia's business incubators is analysed in the next sub-part.

## 2. Specifics of Latvia's business incubators

According to Lalkaka (2001), three "generations" of business incubators can be identified:

- in the 1970s and early 1980s, incubators were basically providing selected firms with low-priced room and collective services;
- in the 1990s, incubators started benefiting from additional facilities, such as counselling, training and networking services, and access to professional support and seed capital;
- starting from 1998, a new incubation model appeared in parallel, aimed at mobilising information and communication technologies (ICT), focusing exclusively on high-tech based ventures and relying more and more on intangible assets and services.

If one looks at the situation in Latvia, then Latvian business incubators represent a combined second and third generation of incubators. They seek to promote job creation, economic development, innovation, and high growth by providing a wide variety of services that are typical to most incubators: physical space and infrastructure, business consulting and training, help with funding applications (government and private), patenting assistance and protection, technology transfer, and networking. The main focus, however, seems to be on internal and external networking, assisting incubates with finding funding, and providing specialists expertise to the start-ups.

Assessing the activity of Latvian business incubators, it appears that their activity is mainly based on the development of businesses with very broad-spectrum activities. For example, 10 business incubators or 59%

**Characteristics of business incubators in Latvia, 2011**

Region	Number of incubators	Number of incubated firms	Priority areas
Riga	8	208	<ul style="list-style-type: none"> <li>- Supporting areas determined by the Ministry of Economics of the Republic of Latvia<sup>2</sup></li> <li>- High technologies</li> <li>- Electronics and electrical engineering, ICT</li> <li>- Creative industry</li> </ul>
Zemgale	2	96	<ul style="list-style-type: none"> <li>- Supporting areas determined by the Ministry of Economics of the Republic of Latvia</li> <li>- Agrobiotechnologies and environmental technologies</li> </ul>
Kurzeme	3	116	<ul style="list-style-type: none"> <li>- Supporting areas determined by the Ministry of Economics of the Republic of Latvia</li> <li>- ICT, electronics, telecommunications, mechanical engineering, automation, computer design and satellite technologies</li> <li>- Manufacturing, computers, scientific research, architecture and design, design services</li> </ul>
Latgale	2	93	<ul style="list-style-type: none"> <li>- Supporting areas determined by the Ministry of Economics of the Republic of Latvia</li> </ul>
Vidzeme	2	68	<ul style="list-style-type: none"> <li>- Supporting areas determined by the Ministry of Economics of the Republic of Latvia</li> <li>- ICT, products with high added value, in-depth woodworking, design, environmental technologies</li> </ul>

**Source:** authors' summarisation

of all business incubators support only firms representing industries such as mining industry and quarrying; manufacturing; electricity; gas supply; heating and air conditioning; water supply; wastewater and waste management, remediation; construction; information and communication services; professional, scientific and technical services; administrative and support services as well as other services.

While five business incubators or 29% of all incubators support firms with narrower specialisation – those that run only on high-tech field. One business incubator supports firms dealing with agrobiotechnologies and environmental technologies.

In Latvia, a specific business incubator that supports only the creative industry firms has been operating since 2010. These are the companies operating in architecture, design, film, art, music, TV, radio, interactive media, advertising, computer games and interactive software, heritage, culture, education, entertainment, and leisure areas.

More detailed information on the number of business incubators in the regions of Latvia, the number of incubated firms as well as the priority areas of Latvian business incubators are summarised in Table 1.

In general, Latvian business incubators mainly support business ideas related to different types of technologies: ICT, environment, telecommunications, electronics, engineering, computer design etc., as well as areas related to production – creating products with high value added and export opportunities. Incubators

do not support agricultural production, fisheries and aquaculture, coal, shipbuilding, financial intermediation, trade, commercial, transport, alcoholic beverages, tobacco, and gambling.

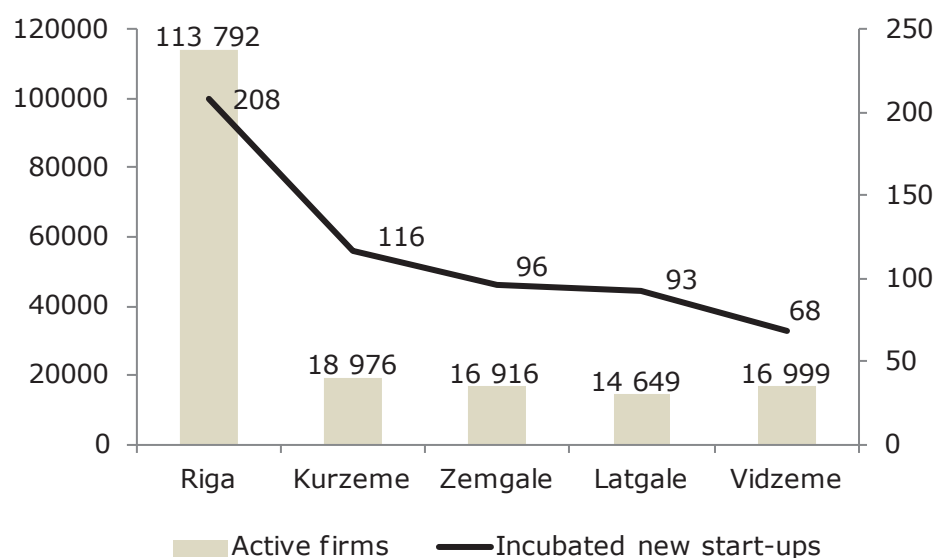
However, practice shows that it is not easy to attract technology-intensive manufacturing companies in Latvia. Demand for business incubator services mostly exists in the areas outside the high-tech industry, as production companies are less active. Therefore, this is the key area where Latvian business incubators shall continue developing.

### 3. Role of business incubators in the formation of new and innovative firms in Latvia

According to statistical data (Lursoft, 2012) on January 1, 2012, there were operating 181 332 companies in Latvia. Most of them or 63% are located in Riga region, followed by Kurzeme region with 10% of all active companies, and Vidzeme and Zemgale regions with 9% of all companies. The lowest entrepreneurial activity can be observed in Latgale region – with 8% of all companies located there. Unfortunately, the statistical information does not disclose the number of innovative and technologically oriented companies, and the fact whether their produced products or services are of considerable value added.

However, it is known that at present about 580 new and innovative companies operate under the umbrella of business incubators. Although, they represent only

<sup>2</sup> Mining industry and quarrying; manufacturing; electricity; gas supply; heating and air conditioning; water supply; wastewater and waste management, remediation; construction; information and communication services; professional, scientific and technical services; administrative and support services as well as other services.



Source: authors' construction based on Lursoft database

Fig. 2. Total number of companies and incubated new start-ups in the regions of Latvia, 2011

0.32% of the total number of companies, it indicates on good start in the development of science and innovation based entrepreneurship. The breakdown of total number of companies and incubated new start-ups by regions of Latvia are represented in Figure 2.

According to the data provided by the European Commission (2002), the operation of European business incubators has assisted in creating 29 000 new sustainable jobs every year in companies. Similar situation can be observed in Latvia – business incubators have positively affected the labour market and contributed to the employment in the regions of Latvia. According to the information provided by the Ministry of Finance of the Republic of Latvia (Finansu ministrija, 2010), emerging small and medium sized companies having received the support from business incubators have created 621 new workplaces by Quarter 2 of 2010. This means that business incubators foster not only the development of new start-ups but also a balanced regional development. Similar opinion has Callegati with co-authors (2005) emphasising that in societies with little entrepreneurial dynamism (like Latvia), the role of business incubators has turned out valuable for local development. For example, Valmiera Business Incubator has proven itself as an effective business support tool – more than 60 new jobs have been created in the region as well as a significant amount of taxes has been provided both from the domestic and export transactions. Furthermore, it has been proved that such incubated companies are much more viable than enterprises set up outside incubators. According to empirical estimations (NESTA, 2008) new firms drive the employment growth, with 4% of surviving start-ups responsible for 50% of the jobs created by all new firms over a 10-year period.

Despite the progress achieved, the number of incubated new start-ups as well as innovative companies in both Riga and other regions of Latvia lags far behind the EU level. However, a similar situation can be observed

in other new EU Member States, like, Greece (Sofouli, Vonortas, 2007). Therefore, taking into account the current government policy, which anticipates continuation of support for the development of business incubators in Latvia, it is expected that the number of new and innovative companies will continue to grow within the next two years. It is regarded as a positive signal for the regional development and overall development of Latvian economy.

## Conclusions

1. The first business incubator in Latvia, Latvian Technological Centre, was started in 1993 by the Ministry of Education and Science, with the objective to support innovative and technology-based businesses and to create new jobs. The number of business incubators in Latvia has grown to 17 (with 18 developed subsidiaries) since that time.
2. The incubators are distributed geographically throughout Latvia, so that every region has the capacity, resources, and expertise to support potentially high-impact and creative business.
3. The focus of Latvian incubators is on a wide variety of industries: ICT, environment, telecommunications, electronics, engineering, computer design etc., as well as areas related to production – creating products with high value added and export opportunities. However, practice shows that it is not easy to attract technology-intensive manufacturing companies in Latvia. Demand for business incubator services are mostly in the areas outside the high-tech industry, as production companies are less active.
4. Business incubation in Latvia is still in its early stage of development and most incubators have started operating in the early 2000s. Therefore, historically there has not been a strong networking tradition. Only in the past few years several business incubators have expanded their activity by setting up subsidiaries in other cities or rural areas, thus

creating network of business incubators in Latvia. Such progress in the establishment of business incubator network should be continued, since it brings the numerous advantages to improve the service quality for business incubator, and is in line with the latest development trends of business incubators all around the world.

5. In Latvia, business incubators have a positive development of new companies, thus, affecting the labour market and contributing to the development of the regions of Latvia –more than 620 new jobs have been created and a significant amount of taxes from both the domestic and export transactions has been provided through the operation of business incubators.

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