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**Monetary and fiscal instruments in business –  
problems, risks, challenges**



# THE MEANING OF INTUITIVE AND RATIONAL THINKING IN MANAGEMENT DECISION MAKING

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## Abstract

In current economic situation and rapidly changing environment when it is difficult to predict the process of economic development and what will happen to currency, stocks and trade markets, taking into consideration that the information exchange is very quick, very often the winner on the market is a company which is the fastest to react. Every day the manager of the enterprise has to make decisions affecting the development of the enterprise and to foresee the consequences of the adopted decisions, and above all, to process large amount of information that can significantly influence these decisions. In the context of current globalization and rapid economic development, as well as considering the impact of the economic crisis, it is very important for the company's manager to find an appropriate way of decision making to be able to react quickly and to be confident in the positive impact of decisions made on company's development, earnings and growth.

The scientific article describes the methods of decision-making and explains the difference between rational and intuitive decision making. Scientists have carried out a number of researches, but a sole proper method of decision making has not been found yet. Therefore the following questions remain open:

- Is it possible to rely on intuition only or a careful data analysis is needed?
- Is it possible to make decisions based merely on the obtained results?
- How to cope with limited time resources and huge amount of information to have positive consequences of the decisions taken?

**Key words:** *Decision-making, intuition, intuitive decisions, rational decisions.*

## Introduction

Decision making is a great challenge for managers in today's rapidly changing economic environment, since time resources are limited, while the amount of information to be analyzed is enormous, and it keeps changing. The managers must not only study all available information, but also understand which information is useful and which is useless for decision making. Therefore decision-making is one of the most difficult tasks for the manager. Two styles of decision-making – rational and intuitive – will be discussed in the research paper, as well as benefits and flaws of each decision to provide

every individual with the opportunity to choose the decision-making style that would lead to the best result.

The paper describes a study of the validity of two independent thinking styles: rational and intuitive.

Research methods – qualitative research method and literature analysis.

The paper aims at comparing the intuitive thinking and rational thinking, looking for similarities and differences, as well as summarizing the scientific research on these issues.

## Decision Making

Decision making is often characterized by the lack of essential information, lack of time, the effect and significance of decisions for business, often high-level of complexity. The skills which help managers deal successfully with such difficult conditions to a great extent determine their success in ensuring control over business processes. The most essential aspects which influence the decision making are the amount of information and time resources, since exchange of information in current global world is very rapid, and there is a great amount of information on the factors influencing the development of an enterprise: market changes, currency fluctuations, movements in the labour market and it takes time to process all the information.

Since many managers work under the pressure of time limits, the success in dealing with challenges impacts the outcomes of the processes under their control. The objective parameters of a business process, such as precise relations of the input (human and financial resources) and benefits usually are assessed by the features outside the process. Nevertheless, independently of what are the precise parameters, the performance of the process, i.e., the extent to which the responsible managers meet or exceed these parameters is positively and strongly related to the effectiveness by which managers are making decisions (Van Riel *et al.*, 2003).

Several styles of managerial decision making are distinguished. Simon was the first to distinguish the two formally different ways of decision making: rationally analytical and intuitive style (Simon, 1997). Simon referred the first one to rational use of information and the second one to competence and experience. Rational cognition is focused on symbolic objectivity, reflection of the known reality. For centuries intuitive cognition, mostly considered to be the innermost, most primitive, most subjective or even the most private form of intelligence, could not compete with objectively proven and universally reproducible facts of rational cognition. Anyway, in the 20<sup>th</sup> century, mainly as a result of works by Brunswik and Meehl in the field of cognitive psychology (Meehl, 1996), Simon's works in the field of management theory (Simon, 1997) and Hammond's (Hammond *et al.*, 1987) works in social sciences, the phenomenon of intuitive intelligence has regained remarkable scientific and practical interest. Intuition



is no longer considered as simply lower and more primitive form of cognition, it is endowed with a potential to improve and to replenish rational cognition in the circumstances which obstruct rational cognition and clearly formulated justifications, for example, if they appear in strategic decision making (Burke and Miller, 1999). The observation of cognitive activities which belong to two different categories in psychology had lead the scientists to the conclusion of existence of two separate although interacting information processing systems in human brain – rational and intuitive systems (Epstein, 1994; Epstein *et al.*, 1992; Myers, 2002). These two interacting systems seem to be used simultaneously, although the relative extent to which each system is used, one can say, reflects the style of the cognition (Epstein, 1998). Individual preference to one system instead of the other is considered and respectively studied as personal trait or feature, or personal style of each decision maker.

## Rational Decision Making

Rational decision making is comprehensible, easy to explain and justify because it is based on particular facts, summarized and analyzed information. The rational decision making models comprise the process of cognition where each succeeding step rises from the one before. The value of each step is conscious and assessed, bringing it until the uppermost level of usability. The steps of decision making are to:

- define the situation / a decision to be made;
- identify the key criteria, main processes and necessary result;
- consider all possible solutions;
- estimate the consequences of these solutions, to compare the obtained results;
- choose the best option.

The analysis of acquired data is carried out by developing diagrams, matrix, decision trees etc. Different methods are used, for example, decision tree, decision grids, Pugh matrix, David matrix etc. The meaning, coefficient or values are given for each achieved criteria which provide for the estimation of consequences and meaning of the decisions made. Such decision making mostly results in weighted and carefully considered decisions, although it is not taken into consideration that there are time limits and extremely large amount of information. Choosing rational decision making managers of enterprises should keep in mind time factor which has a great impact on today's business environment. Therefore other ways and possibilities to make decisions, human ability to make decisions relying on experience and knowledge are explored. Rational or analytic information processing system is related to verbalized, symbolic and clearly definable reason – consequential thinking, while an intuition-based system is related to tacit, implicit and lately also associative (coherent) cognitive activities. Some fundamental features of these two cognitive systems are contrasted in *Table 1*.

*Table 1*

**Two Cognitive Systems**

<b>Feature</b>	<b>Experiential System</b>	<b>Rational System</b>
Perspective	Holistic	Analytic
Control	Automatic, effortless	Intentional, effortful
Orientation	Affective: pleasure-pain oriented (what feels good)	Logical: reason oriented (what is sensible)
Structure of knowledge	Associationist connections	Logical connections
Effect on behaviour	Behaviour mediated by “vibes” from past events	Behaviour mediated by conscious appraisal of events
Form	Encodes reality in concrete images, metaphors and narratives: subjective	Objective representation of reality in abstract symbols: words and numbers
Productivity	More rapid processing: oriented toward immediate action	Slower processing: oriented toward delayed action
Adaptivity	Slower and more resistant to change: changes with repetitive/intense experience	Changes more rapidly and easily: changes with strength of argument
Detail	More crudely differentiated: broad generalization gradient, stereotypical thinking	More highly differentiated
Coherence of output	More crudely integrated: dissociative, emotional complexes, context-specific processing	More highly integrated: context-general principles
Control	Experienced passively and preconscious: we are seized by emotion	Experienced actively and consciously: we are in control of our thoughts
Validity	Self-evidently valid: “experiencing is believing”	Requires justification via logic and empirical evidence

*Source: Adapted from Teglasi and Epstein (1998)*

## Intuitive Decision Making

Dane and Pratt (2007: 40) have defined intuition as “affectively-charged judgments that arise through rapid, non-conscious, and holistic associations”. This definition will be further exploited, since in the author’s opinion it reflects and substantiates the essence of intuition. Technically, intuition is based on experience, knowledge, affective memories, both pleasant and unpleasant, of each individual. The decisions of enterprises’ managers are affected by previously accumulated knowledge that is analyzed and summarized in unconscious processes. Therefore it is important for managers to continue learning, to acquire new knowledge as it provides new experiences which can be compared with those obtained before, and offers unexpected solutions to existing

problems. Basically, previously offered solutions of problems may be inappropriate for managers of modern enterprises, since business is confronting new unexpected challenges and situations that never existed before and therefore there is no investigation or advice on how to deal with new market situations. In today's economical situation each enterprise manager confronts globalization, enormous amount of information and factors that influence the operation of the enterprise – state politics, international relations, tax policy, labour market etc., which he/she is unable to influence. Therefore the enterprise manager should be able to foresee several situations and make decisions that will influence both internal activity and further development of an enterprise on the market, and it becomes of special importance if enterprise's shares are sellable on stock market. Given the above, it is crucial how the decisions are made and where do the solutions to problems come from. Therefore every manager should understand the impact of intuition on decision making, how to make effective decisions and whether subconscious, unexpected problem solutions can be trusted. Regardless of our wishes, we all accumulate our individual affective experience from situations which appear at home, at school, at the university or at work. We aggregate information by learning consciously and selecting knowledge that appears important to us, and later compare and analyze it. There are situations when we struggle to aggregate previously known facts and to analyze obtained information, but there are also situations when a solution to the problem appears suddenly. Therefore intuition has an impact on decisions made and offers solutions to the problems.

There is no integrated definition or explanation of intuition, every individual defines its meaning himself/herself, but it does not diminish the significance of intuition in decision making, and features that could make it possible to characterize intuition are being searched. Cognition of these features would simplify the adoption of an integrated definition of the intuition. Further the features that characterize intuition will be considered, as well as distinctions between intuition and other ways of thinking.

Intuition can be developed in specific fields by deliberate learning and accumulation of experience, for it is said that part of decisions proposed by intuition are subconscious, they are created in the process of analyzing previous experiences or facts, furthermore, it is irrelevant if learning is conscious or the facts are accumulated by reading literature, watching movies or theatre. All obtained information is aggregated, classified and analyzed to provide an answer or to propose the solution to the problem.

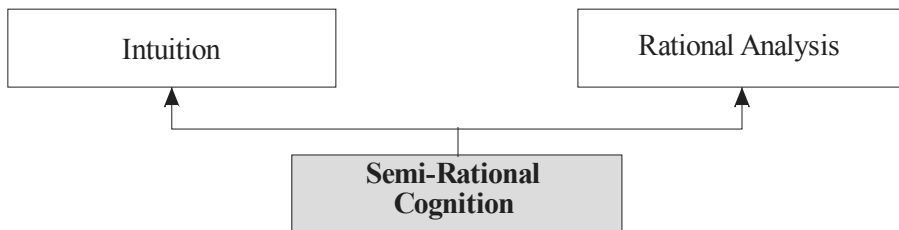
Simon (1997) describes one of such experiments conducted by Chase and Simon (1987), during which chess grand masters and novices were shown the layout of chess pieces from an actual chess game and were asked to reproduce it; the chess experts succeeded with 95% accuracy while the novices with only 25% accuracy. The same task was repeated with chess pieces arranged randomly and resulted in both experts and novices scoring around 25% in terms of accuracy of recall. Simon interpreted this as evidence that chess grand masters hold in their memory not only a set of patterns, but also

information about the significance of the pattern (including information concerning its emotional salience, such as danger or satisfaction from previous episodes associated with it). The intuitive ability of an expert is derived, to a great extent, from many patterns held in long-term memory. Simon estimated, for example, that chess grand masters hold 50 000 patterns in long-term storage. The results of Chase and Simon indicated that the superior memory of experts is not photographic, it requires arrangements of chess pieces that can be encoded using associations with the experts' extensive knowledge of chess typically acquired over ten years experience and practice or more.

Meanwhile, it is noted that grandiose statements of incorrigibility regarding revelations of unquestionable "truths" contrast with the fact that intuitive judgments can be wrong and are better treated as "hypotheses" to be tested (Myers, 2002).

## Comparison of Intuitive and Rational Systems

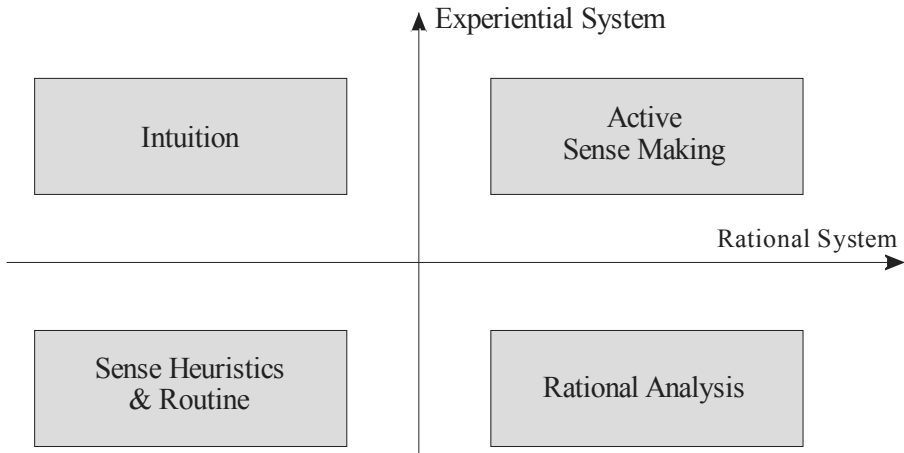
The observation that managers in real practice often use hybrid styles – combinations of rational and intuitive information processing – has led to the development of cognitive continuum theory (Hammond and Brehmer, 1973), suggesting that decision making styles can be arranged on sequencing scale, whose one extreme is based on entirely rational cognition and the opposite extreme – on entirely intuitive cognition. Different semi-rational levels of the cognition can be arranged between these two extremes (Hammond, 2000).



*Figure 1: The cognitive continuum. Adapted from: Shanteau (1992)*

The decision making style shown in *Figure 1* basically does not reflect real situation, since there is no option of mutual overlapping of styles, and it does not show actually the ways of decision making. Entirely intuitive or rational decision making does not exist; these two styles overlap creating two-dimensional system where the decision making styles can be observed. It is graphically shown in *Figure 2* as a matrix of four quadrants. One must note that the decision making style is influenced also by personal features of the individual, his or her views, attitude towards decision making, previously obtained experience and personal ability to process and analyze information, which is individual for each manager.

On the grounds of information analysis, processing of obtained data, and getting approvals from observations of practicing decision makers (Van Riel and Lievens, 2004), we suggest distinguishing four basic decision making styles which reflect four quadrants in the matrix of cognition styles (see *Figure 2*).



*Figure 2:* The matrix of cognition styles

**First**, a primarily rational style is characterized by the predominant use of the rational information processing system. This style is stepwise, calculative, critical and explicit. It is externalized in rule-based decision support systems.

**Second**, a style is characterized by a mix of relatively effortless analytical thinking and the use of experiential cognition of a limited scope can be observed. Common sense, and also heuristic or routine decision-making are practical examples of this style. It is appropriately characterized by the term ‘habit frozen into memory’.

**Third**, a predominantly intuitive style is distinguished, characterized by almost exclusive and ‘intensive’ use of the experiential information processing system. This style is inherently uncritical, since the validity of insights is taken for granted.

**Finally**, a combination or integration of effortful rational thinking and the intensive use of experiential cognition characterizes the fourth style. The term active sense making preliminarily refers to this style. The style is simultaneously critical, and creative. (Van Riel and Lievens, 2004).

Therefore, the decision makers are biasing towards one of the four basic decision making styles which are based on relative usage of two fundamentally different systems of processing the cognitive information. Rational analysis and intuition are widely discussed, although two quite differing hybrid styles are identified which require further

explanation. Therefore, further in this study the intuitive decision style will be analyzed, since it is harder to recognize, justify, and for a long time it was not considered to be a serious matter of investigation. Thanks to recent scientific developments in psychology, the term ‘intuitive decision making’ is considered as an object of investigation, and intuition, intuitive thinking, subconscious processes influence daily decision making at the management level.

Similarly, there exist two different decision making systems; each manager can decide which way of decision making is more suitable and leads to better results. It should be noted that both systems exist simultaneously and are of equal value.

Although there are various forms of dual process theories, they mostly reflect initial general distinctions between processes of System 1 and System 2, offered by Stanovich and West. Processing of System 1 depends on context, it is associative, heuristic, subtle, intuitive and implicit/automatic by nature; therefore it is relatively low-demanding in terms of its frugal usage of cognitive resources. On the contrary, processing of System 2 does not depend on context, it is rule-governed, analytic and immediate by nature; therefore it is relatively slow and requires much more cognitive resources than its counterpart in System 1. Epstein’s and his colleagues’ (Epstein, 1994) cognitive-experiential self-theory (CEST) is a general example of a dual process theory. Just like in papers by other dual process theorists, Epstein and his colleagues build up two parallel, mutually interacting methods of information processing, ensured by different cognitive systems. Cognitive-experiential and Self-theory in an empirical – rational system, and comparison of both theories is provided in *Table 2*.

Rational system acts on the level of consciousness and it is analytic, verbal and relatively emotion-free. It allows for accessing the information by intention, making effort to perform deliberate analysis. On the contrary, the experience-based system which is considered to be evolutionary older, performs automatically, based on purpose and it is primary non-verbal by nature. Experience-based system is clearly emotionally operated (Epstein, 1994). Action is a product created by these two systems which are usually connected in imperceptible interaction, although sometimes creating conflicts, usually known as contradictions between “heart and head” (Epstein, 2000). It is noted that ‘experience-based’ in wider meaning is equivalent to ‘intuitive’ and quite closely reflects the essence of intuition.

Table 2

**Comparison of Both Theories**

<b>Experiential system</b>	<b>Rational system</b>
Holistic	Analytic
Emotional: Pleasure-pain oriented (What feels good)	Logical: Reason oriented (What is sensible)
Associationistic connections	Cause-and-effect connections
More outcome oriented	More process oriented
Behaviour mediated by “vibes” from past experience	Behaviour mediated by conscious appraisal of events
Encodes reality in concrete images, metaphors& narratives	Encodes reality in abstract symbols, words&numbers
More rapid processing: oriented towards immediate action	Slower processing: oriented towards delayed action
Slower to change: Changes with repetitive or intense experience	Changes more rapidly: changes with speed of thought
More crudely differentiated: Broad generalization gradient; Categorical thinking	More highly differentiated; Dimensional thinking
More crudely integrated: Dissociative, organized in part by emotional complexes (cognitive-affective modules)	More highly integrated
Experienced passively and pre-consciously: We are seized by our emotions	Experienced actively and consciously: We are in control of our thoughts
Self-evidently valid: “Experiencing is believing”	Requires justification via Logic&Evidence

*Source: (Epstein, 1994)*

Therefore the perfect case of pure intuition or pure rational decision making does not exist in reality. When differentiating separate strategies of decision making, first, one must assess relative input of both processes into gained result, moreover, each decision maker’s individual features must be taken into account. If automatic process of decision making prevails, it can be expected that judgments or decisions are made fast due to simultaneous processing. At the same time, judgments or decisions are influenced by previous experience even if it is very extensive since simultaneously operating processes can process unlimited amounts of information. Besides, intuitive judgments and decisions will tend to weight new facts in insufficient manner, since they rely on experience and consolidated knowledge (Betsch, 2004).

Attention is paid mainly to the existing situation. Therefore previous knowledge and intuition are less prevailing in conscious analysis of facts. The level of information consolidation is very low, and active analysis is open to new evidences and allows an individual to actualize the context and adapt to changing situations fast. Meanwhile, with

the help of intuition, it is more possible to gain conservative judgments and decisions, since it is grounded on consolidated knowledge (Betsch, 2004).

## Conclusions

Enterprise managers make decisions every day. This is a great challenge in the modern changing world which is encumbered with time limits and large amounts of information to be processed. Therefore scientists continue searching for the most effective way of decision making. As discussed in this article, both decision making styles, intuitive and rational, have their benefits and disadvantages. The inquiry of enterprise managers will be performed in further studies, based on items of preference for intuition and deliberation scale (Betsch, 2004), which will be correlated to manager levels and managerial style; on the grounds of inquiry and obtained results it will be possible to assess which decision styles are preferred by managers of each level.

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# LIFE CYCLE COSTING AS A TOOL OF LIFE CYCLE MANAGEMENT

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## Abstract

Enterprises require a management tool that is measurable and might be used to monitor internal and external targets as well as for external management communication. Firms need methods that can be understandable, standardized and applied on a large scale. Life Cycle Costing can be an effective tool to identify additional business opportunities by expanding the scope of the financial analysis. This article presents the main goals, scopes and framework of Life Cycle Management. It aims to review reports on LCC applications to provide an overview of LCC uses and implementation feasibility in Life Cycle Management. The aim of the study is to present Life Cycle Management as a tool for making more informed business decisions.

**Key words:** *life cycle costing, life cycle management, accounting, costing, environmental accounting*

## Introduction

In practice the design team has an opportunity to use many physical and performance data during the product planning. However it is likely that the data will not always be collected in a manner suitable for Life Cycle Costing Analysis in the place where the product has been offered for some time. The client is unlikely to keep records on the performance and qualitative aspects of the product. Information is available in the form of cost invoices on using the product. The management team should simply ask the following questions:

- What is the product type?
- Where is it offered?
- Are there any modifications available?
- What is the general construction?
- What is its' general condition?
- When was it built?
- What running cost information is available?
- What is the condition of the individual elements of the product?

At this stage, it should be emphasized that the major consideration is the desire for simplicity. Life Cycle Costing Analysis deals with historical costs and does not involve discounting methods, which are included by some authors as developed life cycle costing procedures (Ciambrone, 1997: 6–9).

Many possible benefits will be lost if the product's performance and costs of ownership are not monitored directly throughout its life cycle. It is important for the management team that there is feedback on the costs. There hasn't been any standardized approach to the collection of product cost data. There is a huge time gap between design, occupation, and availability of reliable data on planning and running costs.

Life Cycle Cost Management (LCCM) is a derivative of LCCA. In other words, it identifies the areas where running costs detailed by the Life Cycle Cost Analysis might be reduced, either by changing the operating and planning practice or by changing the system.

## Framework of the Life Cycle Management System

Every activity has an impact on social, economic and environmental area which is not so obvious. There are many hidden or indirect impacts which appear only when the enterprises take a step back and examine the complete life cycle cost of their products. A life cycle consists of all the activities related to making, selling, using, transporting and disposing a product from initial design, right through the supply chain. Life Cycle Management completes the picture of all stages. It has been developed as a business approach for managing the total life cycle of products (EPA, 2008b:1). To manage a life cycle of a product effectively, a firm can uncover a wealth of business, environmental and social value, and then make the choice to engage in more sustainable activities and production patterns. Life Cycle Management is a framework for business planning and management. It is useful for a business to:

- analyze and understand the life cycle stages of a product;
- identify the potential economic, social, or environmental risks and opportunities at every stage;
- establish proactive systems to pursue the opportunities and manage the risks.

It is not expensive to implement the Life Cycle Management. Adopting a life cycle perspective to management helps ensure that a business is either environmentally friendly or helps to identify opportunities to gain a stronger competitive advantage, reduce costs, improve strategic decision-making, design better products, identify new business opportunities and markets, and improve relationships with key stakeholders and even manage any inherent risks (EPA, 2008b:1).

Life Cycle Management is about making more informed and detailed business decisions such as:

- which products should be launched;
- design of the product or service;
- sources of energy to use;
- type and amount of packaging;
- management of manufacturing wastes;
- recycling considerations;
- preferred suppliers.

Life Cycle Management is a system to help firms make decisions in a more deliberate and systematic way. Enterprises could engage in more sustainable production and consumption, and clearly define and measure the business value (EPA, 2008a:1).

Life Cycle Management can be deployed as a part of a specific methodology, technique or "add on" environmental requirement. On the one hand, it is a systematic approach, mindset and culture embraced throughout the business, where decisions are made affecting both the input and output of the product life cycle. On the other hand, it is a practical approach to improving decision making, which integrates environmental improvements and sustainability with economic efficiency. Therefore, Life Cycle Management is getting to be systematic integration of product sustainability in company planning, product design and development, purchasing decisions and communication systems. Life Cycle Management is a relatively new approach that gets one different element of practices that have been used in businesses and delivers clear business benefits to complement its environmental advantages. Firms are positioned to identify and realize cost savings through their product life cycle including all stages. These cost savings and environmental benefits can result from design or process changes that reduce material and energy consumption, emissions and wastes. Lower and reduced toxicity of wastes involves less risk of fines and penalties for compliance with health and environmental regulations. It can be helpful to reduce the risk of future liabilities by assisting to minimize the environmental problems associated with the product's production, use, servicing and disposal (EPA, 2008a:1).

There are many reasons to implement LCM into business. The main reason is to know and understand your customers' characteristics and needs. Life Cycle Management encourages thinking beyond potential and present customers. Who are they? What are they like? Whether trends in other markets may influence our market? This information provides answers to the question – how the market is launching the adoption of Life Cycle Management? It can be done either locally or internationally, i.e. the consumer behaviour, the building industry, climate change.

## Environmental Life Cycle Costing as a Part of Life Cycle Management

Environmental Life Cycle Costing presents simultaneously costs and life cycle impacts. Scaling the environmental and cost impact on products can result in subjective analysis because a general service is provided. Environmental Life Cycle Costing is neither a financial accounting system nor a managerial accounting system converting indirect costs to direct costs. Moreover it is not detailed calculation; therefore it must be complemented with estimates, procedures and techniques. Enterprises are confronted with a very competitive market that pushes for increased efficiency and reduced costs. The global scope of industrial activity has an increasing impact on natural systems, challenging companies to reflect more effectively environmental impacts of their business decisions. It makes firms consider both monetary and physical measures of business activity. Life Cycle Costing can be used to expand managerial decision limits to include suppliers and customers and extend the time horizon into the future (Hunkeler&Lichtenvort&Rebitzer, 2008: 12–13).

SETAC experts conclude, “Environmental managers are interested in LCC owing to a general consensus that present accounting practices do not fully capture the costs of many business decisions.” It requires significant effort to identify various indirect or partially hidden costs, contingent costs, and less tangible image and relationship costs to estimate the true cost. On the one hand, these efforts are focused on the cost structure that has been covered during the financial transaction. Environmental LCC tries to get any monetary flow anticipated in the decision-relevant future. On the other hand, it can be an effective tool to identify additional business opportunities by expanding the scope of the financial analysis covering longer time horizons, including cost categories already addressed by the industry sector. Environmental Life Cycle Costing contains real costs to be internalized in the decision-relevant future. This is complementary with life cycle management (Hunkeler&Lichtenvort&Rebitze, 2008: 75–90).

ELCC might be implemented within the second stage of the LCA system, i.e., through input data inventorying as well as output data inventorying for individual processes and for selected functional units. Input data – a catalogue of materials and energy which can be supplemented by cost data pertaining to each item. Output data taking into account emission and waste production data, one may supplement them with corresponding cost of economic use of environment. This way, both ‘input’ and ‘output’ may be presented in monetary terms [Hendrikson&Lave&Matthews, 2006:10).

## Conclusions

General conclusions which suit the LCM environment and Life Cycle Costing principles well include the following information:

- It is a good communication tool both internally and externally.
- The sensitivity studies provide means to interrogate the LCC into LCM.
- Discount rates on the decision follow processes that would be applied to financial assessments.
- The estimation of monetary flows is likely to be internalized in the decision.
- LCM can trigger product improvements and enhancements that uncover greater value to the end user.
- LCM also opens the door to new ideas for providing the same products, but with reduced environmental impacts.
- LCM demonstrates a proactive approach to environmental management and sustainability.

The implementation of Life Cycle Management in businesses helps to take better quality products to market, that consumers will see as attractive or holding real value. There is increasing environmental awareness in the consumer market, with the sentiment that they would like to contribute to a more sustainable world. LCM is a result of a global trend to incorporate environmental considerations into purchasing decisions. This provides an opportunity for businesses to differentiate their products and services as environmentally preferred (Hunkeler & Lichtenvort & Rebitzer, 2008: 75–90).

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## METHODOLOGY OF DECISION MAKING IN SMEs

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### Abstract

**The objective** of this research is to examine and understand the process of decision making in small and medium-sized enterprises (SMEs). Successful operation of SMEs is a guarantee of economic development and stability of the country, as well as prosperity of the people. Competitiveness and sustainability of a SME depends on adequacy and quality of management decisions, the right choice of alternatives.

**Method** of research is the analysis of scientific publications in the field of theory of a company, decision making and implementation.

**Outcomes** of the research are the classification and scientific analysis of management decisions, methods and principles of decision making.

The research has practical **value** for scientists conducting research in the field of decision making strategies and for entrepreneurs.

**Key words and phrases:** *decision making, management decision, process of decision making*

### Introduction

The time of operation and real experience of small and medium-sized enterprises (SMEs) in Latvia differs a lot from experienced SMEs in the EU and the USA. Enterprises with 100 and more years of sustainable operation have extensive experience of effective managerial decision making and decision implementation. SMEs produce big part of national GDP and are cornerstones of country's economics. Effective operation of every SME is a guarantee of country's economic development and stability, as well as prosperity of the people. Increasing of SME's effectiveness is a priority of countries' economic policy.

Competitiveness and sustainability of a SME depends on adequacy and quality of management decisions, the right choice of alternatives.

Decision making in business is:

- basic competence of managerial process;
- purposeful and well-considered reaction of a manager to the problem or task and action to reach the set goal, based on the full-scale information and existing resources;
- cooperation among manager, personnel and experts to solve the existing problem;
- choice of the best alternative to reach the goal based on detailed evaluation, understanding, analysis and forecasting of internal and external environment – the art of effective compromise (Mescon, Albert, Khedouri, 2001: 237).

Taking into account that even in the developed EU countries the biggest part of newly organized SMEs go out of business during first 5 years, we can conclude, that business start-up's decisions are neither precise nor wrong. More often enterprises established by experienced managers and business persons survive and grow (Storey, 1994: 124).

This research is orientated towards analyzing the managerial decision making and implementation process in SMEs.

## Entrepreneurial Theory of the Firm

Since the appearance of the classical entrepreneurial theory of the firm (Schumpeter, 1912: 78) and (Coase, 1937: 386) many researchers have considered entrepreneurship as an important field of research and have paid their attention to theoretical analyses of entrepreneurship and growth of an enterprise (Sautet, 2000: 97), (Mueller & Sautet, 2002: 53), (Casson, 2005: 327), (Noteboom, 2003: 3), (Shane & Venkataraman, 2000: 217).

The researchers link entrepreneurship with growth (Acs, 2006: 97), (Wennekers & Thurik, 1999: 27), development of new markets, introduction of inventions and innovations, variety and selection of ideas, competition and renovation of old enterprises. Enterprises are categorized as “high technological” and “low technological”. The author of the present paper discusses two aspects of innovations: first, discoveries and inventions (seldom), and, second, innovations which are new combinations of well-known technological and organizational elements (usually, more often).

The definition of entrepreneurship (Carree & Thurik, 2003: 246), “Entrepreneurship is willingness and capability of a person to create new economic potentialities (new products, new methods of production, new managerial decisions, new market combinations, etc.) and introduce them into market under circumstances of uncertainty and under different unfavorable factors, **making decisions** about status and location of enterprise, about using recourses.” For example, an entrepreneur makes a decision to carry out some operations which were outsourced before, if this step brings economic and organizational advantages

and raises competitiveness. Or vice versa – an entrepreneur makes a decision to contract some companies for outsourcing, if it reduces total production expenses.

The entrepreneurial theory of the firm is closely linked to the process of **decision making and implementation** (Horowitz, 1970: 357). The difference between the entrepreneurial theory of the firm and the theory of the entrepreneurial firm is emphasized (Langlois, 2007: 1107). He considers the entrepreneurship as the process of producing new products, services and new economic knowledge. The significant quality of the firm is flexibility in changing and uncertain environment.

There is experimental confirmation (Audretsch, 1995: 176) that the role of SMEs in creation of technological innovations and in growth of economy (Schmitz, 1989: 721) is significant as entrepreneurs are problem solvers and creators of new combinations. The firm is solver of complicated combinatory optimization problems and tasks (Weizman, 1996: 207), (Weizman, 1998: 331), (Auerswald, 2000: 389).

### Conclusions

- The entrepreneurial theory of the firm initiated detailed and deep research in the field of entrepreneurship.
- The entrepreneurial theory of the firm laid a foundation for deep understanding of establishing the firm, its functioning, developing and managerial decision making.

## Classification of Managerial Decisions

American engineer Taylor was the first who developed the fundamentals of industrial engineering (Taylor, 1911: 69), while another American scientist Norbert Wiener developed methodological fundamentals of management and created new management science – cybernetics (Wiener, 1948: 38).

Management, in the field of entrepreneurship, is a special case of application of management principles and methods. Decision making is an important element of management theory.

Management decisions are made in all fields of entrepreneurship. Decisions have different levels of importance, they have different form and quality (Бирман, 2004: 138), (Thompson & Strickland, 2002: 1104).

Table 1

**Classification of Managerial Decisions**

	<b>Classification feature, characteristic</b>	<b>Decision types</b>	<b>Explanation</b>
1	2	3	4
1.	Area of decision	Economics	<b>Economical</b> decisions relate to increasing of effectiveness of enterprise.
		Technical	<b>Technical</b> decisions relate to development of technical resources of enterprise: modernization of computers, purchasing of transport, mastering of new technologies, etc.
		Organizational	<b>Organizational</b> decisions relate to improvement of operation of enterprise.
		Social	<b>Social</b> decisions relate to raising motivation of personnel and improvement of working conditions.
		Inspection	<b>Inspection</b> decisions define principles of measuring results of operation.
		Often decisions cover several areas at the same time	
2.	According to the influence of decision on the operation of enterprise	Strategic	<b>Strategic</b> decisions follow from the strategic plans of enterprise and define common perspectives of operation of enterprise for coming years.
		Tactical	<b>Tactical</b> decisions define operation of enterprise in the framework of a year.
		Planned and periodical	<b>Planned and periodical</b> decisions define operation of enterprise for fixed aim or period of time.
		Initiative	<b>Initiative</b> decisions arise as a result of creative cooperation between managers and employees.
		Operative or extreme	<b>Operative or extreme</b> decisions are reaction of an entrepreneur to the expected or unexpected, favourable or unfavourable nonstandard situation.
3.	According to the level of novelty	Innovative	<b>Innovative</b> decisions provide unique, competitive advantages for enterprise.
		Adaptive	<b>Adaptive</b> decisions are made using creative, nonstandard approach to standard situations.
		Routine	<b>Routine</b> decisions are made in standard situations.
4.	According to the level of certainty	Determined	<b>Determined</b> decisions are made in conditions of complete information.
		Probable	<b>Probable</b> decisions are made under conditions of probable information or lack of information.

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1	2	3	4
5.	According to the quality of decision	Adequate	<b>Adequate</b> decisions meet set evaluation criteria. Noble prize winner H. Simon worked out a concept of limited rationality of decision maker (Simon, 1977: 45).
		Compromise	<b>Compromise</b> decisions do not lead to ideal result, but give possibility to solve existing problem with minimum resources and in time.
		Simple	<b>Simple</b> decisions are based on small part of all necessary information. These decisions sometimes are called <b>adaptive</b> decisions.
		Inadequate	<b>Inadequate</b> decisions give results which do not meet set evaluation criteria, for example, planned indicators.
6.	According to the way of regulation	Directive	<b>Directive proscriptive</b> decisions define restricting rules for personnel behaviour. <b>Directive permissive</b> decisions give freedom for initiative of personnel. <b>Directive constructive</b> decisions give detailed regulation for personnel in the process of moving towards set goal.
		Approximate	<b>Approximate</b> decisions define the final goal, but not the procedure to reach it.
		Recommended	<b>Recommended</b> decisions advise possible ways of reaching the set goal.
7.	According to the form of decision	Plan	<b>Plan</b> defines activities, responsible persons and time limits.
		Order	<b>Order</b> defines activities, acting persons, time limits, responsibilities and sanctions.
		Instruction	<b>Instruction</b> describes procedure of implementation of a decision.
8.	According to the level of formalization	Formalized	<b>Formalized</b> decisions are made in the process of calculation, using existing information and mathematical methods.
		Unformalized	<b>Unformalised</b> decisions are made in situations when there are no possibilities to perform precise calculations using mathematical methods.
		Combined	<b>Combined</b> decisions are made in circumstances, when it is possible to raise quality of decisions, using both – formalized and unformalized methods.

1	2	3	4
9.	According to the type of situations	Typical	<b>Typical</b> decisions are necessary for standard situations which often happen.
		Unique	<b>Unique</b> decisions are necessary for nonstandard cases.
		Reasonable	<b>Reasonable</b> decisions are made when there is full information.
		Intuitive	<b>Intuitive</b> decisions – decisions based on the feeling, that they are right.
		Creative	<b>Creative</b> decisions are made either in typical or untraditional situations.
		Heuristic	<b>Heuristic</b> decisions are made using specific algorithms and procedures for creative work.
10.	According to the technology of decision making	Individual	Entrepreneur chooses the technology of decision making according to personal experience, skills, awareness, time limits and qualification of personnel.
		Collegiate	
		Collective	
11.	According to the timeliness	In time	Entrepreneur chooses the timeliness of decision making according personal experience, skills, awareness, time limits and qualification of personnel.
		Late	
		Too early	
12.	According to the way of announcing	Written	Entrepreneur chooses the way of announcing the decision according to personal experience, skills, awareness, time limits and qualification of personnel.
		Verbal	
13.	According to the type of logics	Logical	<b>Logical</b> decisions are rational decisions.
		Illogical	<b>Illogical</b> decisions are irrational decisions.
14.	According personal qualities of entrepreneur	Based on experience	Decisions based on knowledge and experience.
		Rational	<b>Rational</b> decisions are based on analysis.
		Impulsive	<b>Impulsive</b> decisions are the result of generation of ideas.
		Careful decisions	<b>Careful</b> decisions are made based on careful searching analyzing all possible variants.
		Risky decisions	<b>Risky</b> decisions are made under conditions of a lack of information.
15.	According to the level of algorithmization	Programmed decisions	H. Simon introduced the term ' <b>programmed decisions</b> '. These decisions transform into strict roles after the first successful probation. Sometimes these decisions are called ' <b>structured decisions</b> ' (Simon, 1977: 54).
		Non programmed decisions	There is no decision making algorithm.

Conclusions

- Classification of management decisions by various authors differs according to the specific goals of their research. Presented summary of the classification shows different view on management decisions.
- Every decision has all 15 classification features – characteristics.

## Decision Making Methods

Entrepreneurship escalates broadly, and many decisions must be made in rather complicated situations. To make decisions entrepreneurs must be more and more competent and must have higher responsibility. To guarantee competitiveness and sustainability of enterprises it was necessary to have methods of decision making, which increase its precision and effectiveness. Such methods were developed.

**Formalized methods** provide the best results in decision making as they are based on precise calculations using complete primary information, taking into account limitations and the set effectiveness criteria. The statistical data processing is a formalized method as well.

*Table 2*

**Formalized Decision Making Methods**

	Method	Description of Method
1	2	3
1.	Balance method	Based on comparison and correlation of enterprise balance figures
2.	Lagrange method	Method of differential calculation
3.	Gauss method	Solving optimization task
4.	Method of tree of parameters	Tree is drawn where the trunk is the main problem to be solved. All influential factors are divided to groups and subgroups.
5.	Method of histogram	Result is calculated for every value of condition.
6.	Method of dynamic programming	Method is based on optimization principle by Bellman – sequence of calculations providing maximum profit in every step.
7.	Graphical method	Changes in time are shown in graphical form.
8.	DuPont method	Can be used to analyze effectiveness of business from point of view of financial management.
9.	Two parameter graphical method	Is used when it is necessary to analyze influence of two parameters for the same result together.
10.	Method optimal management of resources	Aim of this method is to minimize negative consequences because of a lack or big reserves of resources or production.
11.	Method of interpolation and extrapolation	Gives possibility to carry out prognosis based on dynamics of previous periods.
12.	Method of Pareto group	Deals with cases where increasing of effectiveness according to one of the criteria is possible only by decreasing effectiveness according another criteria.

1	2	3
13.	Normative method	Analyzes and fixes interrelations between economical, technical and organizational characteristics of enterprise.
14.	Functioning without losses	Conditions are calculated under which an enterprise operates without profit and without losses as well.
15.	Network planning method	Analyzes and finds logical interrelations between different processes in enterprise and estimates the time necessary for reaching the goal.
16.	System optimization method	Search for optimal solution under existing limitations. Foresees possibility to make corrections under restrictions to reach planned goal.
17.	Game theory	Choice of decision and argumentation in case of uncertainty.
18.	Factor analyses method	Gives possibility to perform analysis in case of many variables and interconnected parameters.
19.	Payment matrix method	Payment matrix is used for analyses of decision variants for evaluation and selection of the best strategy.
20.	Linear program method	Those values of parameters are found under which goal function reaches minimum and maximum.

(Kimmel, Weygandt, Kieso, 2008: 54), (Box, Kansmasu, 1972: 17), (Byars, Nunn, 1967: 41), (Pham, 2004: 85), (Brigham, 2001: 30), (Little P., Little B., Coffe D., 2009: 71), (Soliman, 2008: 823), (Chatterjee, Chakrabarti, Manna, 2004: 155), (ATTC, 1963: 13), (Bouysson, Dubois, Pirlot, 2009: 28), (Saloner, 1991: 119), (Brandenburger & Stuart, 1996: 5), (Watson, 2001: 95), (Horst, 1969: 127).

We often confront situations when there is a lack of information or information is not quantitative – these are cases when there is no possibility to use any formal method of decision making. In these cases decision maker use one of **unformalized** methods of decision making. These methods do not guarantee perfect decisions and do not exclude mistakes (Eddowes & Stansfield, 1991: 318).

Table 3

### Unformalized Decision Making Methods

	Method	Description of method
1	2	3
1.	Method of free association	Decisions, which were made in another case, are transformed to this situation.
2.	Method Boffalo	Sequence of next steps – collection of information, definition of problem, generating of proposals, selection of the best decision.
3.	Method Delfi	Every expert offers his opinion about possible solving of problem → every expert is introduced with the point of view of others → every expert makes correction to his solution → procedure goes on until experts come to single decision.
4.	Kepner – Trigo method	This method offers multistep analysis of complicated problem.



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1	2	3
5.	Method of eliminating the shortcomings	Method offers detailed analysis of shortcomings of existing problem solving and making alternative decisions.
6.	Decomposition method	Complicated problem is spit into several groups of simpler questions.
7.	Brainstorm method	Group members propose all possible ideas about solving the problem. These ideas are noted, but not commented and not criticized.
8.	Notebook method	Every group member writes down ideas how to solve existing problem during some period of time. At the end of the period a manager summarizes all suggestions and works out final decision.
9.	Sinektik method	The team is made up from professionals from other fields. This approach helps overcome traditional ways of problem solving.
10.	Morphological method	The combination of different possible decisions are tried to design the best decision.
11.	Method of focused discussion	The open discussion is organized about possible solving of problem, all advantages and disadvantages are discussed.
12.	Method of inventory	The audit of all interfering factors for problem solving is made and suggestions are formulated how to overcome these difficulties.
13.	Method of tests and mistakes	Decision is implemented → shortcomings are fixed → decision is corrected → corrected decision is implemented → etc.
14.	Evaluation of quality of products	Entrepreneur must take into consideration that higher quality of product leads to rising of self cost.
15.	Method of investigation of motivation	Conscious and subconscious motivation of customers is investigated.
16.	Customer questionnaire	Customers are asked to evaluate their possible needs in future and express their demands for new products.
17.	Ecological method	Comparing alternatives, decision maker analyzes every possible decision from the point of view of influence on environment.
18.	Method of incitement	Manager defines a concept that contradicts the opinion of group members to generate an active discussion.
19.	Method of utopian game	Team works out future decisions, which cannot be currently realized. Then group tries to find the rational ideas in these decisions.

*(Ekvall, 1993: 17), (Brahm & Kleiner, 1995: 30), (Osborn, 1963: 63).*

Sometimes it is possible to combine advantages of formalized and unformalized methods in the process of decision making. This approach is called **combined** methods of decision making.

Table 4

**Combined Decision Making Methods**

	<b>Method</b>	<b>Description of method</b>
1.	SWOT analysis	Comprehensive audit of current situation in an enterprise is carried out – analyses of strengths and weaknesses are performed, possible threats and opportunities are recognized. This audit gives the necessary understanding for decision making.
2.	Balanced scorecard system method	This method provides collection, systematization and analyses of information necessary for decision making. This system is the essence of management and guarantees sustainable development of an enterprise.
3.	Boston matrix method	Method gives possibility to analyze the speed of development of a product and market share.
4.	Experts' method	The team of experts of different profiles is organized.
5.	Method of 7 criteria	7 criteria of effective operation of an enterprise are analyzed together: strategy, structure, system of decision making, personnel, qualification of personnel, style of management, values of organization.
6.	Sum of values of criteria method	Quotient of value is given to every criterion. Different alternatives of decision are compared by the sum of values of criteria.
7.	Method of scenario	Scenario of development of events and conditions is built for certain period of time.
8.	Method of prognoses	Economic prognoses, technology development prognoses, competition changes prognoses are developed.
9.	Method of analyses of hierarchy	Method is based on multi-criteria description of the problem. The tree of criteria is drawn. Quotient of impotency is defined for every group of criteria.
10.	Method of system analyses	All alternatives of reaching the goal are compared from the aspect of risk, effectiveness and costs.
11.	Modelling method	The mathematical, physical or heuristic model – an analogue of real process or situation is built. Static and dynamic, analytic and imitation, physical and abstract, natural models are built and used.

(Kaplan & Norton, 1996: 47), (Karlöf & Lövingsson, 2005: 183), (Saloner, 1991: 119).

**Conclusions**

- Number of different methods of decision making is high. It is impossible that any entrepreneur can professionally use every listed method for everyday needs.
- Different decision making methods are more effective for enterprises of different profile, different scale and for different kind of decisions. That is why every entrepreneur must acquire limited group of methods which correspond to typical situations in enterprise.

**Principles of Decision Making**

	<b>Principle</b>	<b>Description of principle</b>
1	Systematic	Deep evaluation of all significant factors.
2	Situative principle	Analysis of dynamic changes in an enterprise is made before decision making.
3	Principle of standardization	Entrepreneur formulates decisions for typical situations in enterprise – standard decisions. Entrepreneur reduces any real case to one of standard situations and uses standard decision.
4	Optimal base of information	Not too small, not too large. To make rational decision an entrepreneur must have reasonable information base.
5	Principle of rational compromise	Complicated decision is simplified by making equivalent replacement (for example, renting premises for office we are ready to reduce space of office to minimize distance from home to office).
6	Temporary solution	It is a principle of very quick decision which does not solve the problem completely and does not make the problem more acute either.
7	Principle of automatic realization	Decision is formulated in the way that it becomes a program for real activities for every employee.
8	Principle of consequence evaluation	Selecting decision among possible alternatives it is necessary to evaluate possible consequences for every alternative.
9	Principle of full responsibility	Decision maker takes full responsibility for possible consequences.
10	Balance of rights and responsibility	Balance of rights and responsibility means optimal division of responsibility and rights between all management levels and employees.
11	Principle of creativity and flexibility	Creativity is necessary in cases of clarifying problem and looking for ideas in nonstandard situations.
12	Principle of timeliness	Not too early and not too late. This principle leads an entrepreneur towards determining the right moment for decision making and implementing.
13	Balance of fellowship and individuality	Individual decision making foresees full rights and full personal responsibility for the consequences. Fellowship means collective responsibility and rights. It is possible to combine both approaches.
14	Co-partnership and sharing responsibility	This approach anticipates co-partnership in decision making of all employees involved in implementation.

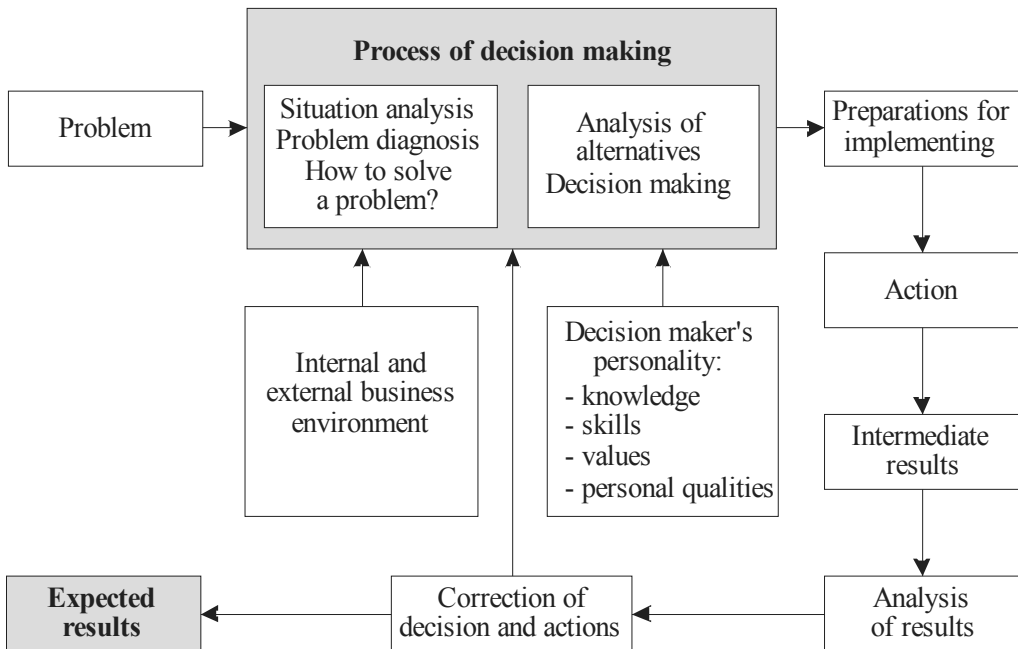


Figure 1. Theoretical decision making algorithm. Source: (Kennedy, Boddy, Paton, 2006: 368), (Mescon, Albert, Khedouri, 2001: 241)

### Conclusions

- Summarized principles cover all sides and specific characters of enterprise operation.
- Making decisions an entrepreneur must take into account as many principles as possible.

Effectiveness of summarized principles which are analyzed by many researchers (Bouyssou, Dubois, Pirlot, 2009: 138), (Smith, 2008: 46) confirms the author's extensive experience in entrepreneurship.

## Theoretical Decision Making Algorithm

It is necessary to pay attention to the fact that decisions are made not only as a result of analysis of collected formal information and applying methods of decision making, but also based on personal values, qualities and ambitions of this particular entrepreneur.

An important result of analyses of scientific publications and personal experience in managerial decision making in SMEs is presented by the author in the theoretical decision making algorithm (see *Figure 1*).

## Conclusions

- 1) The entrepreneurial theory of the firm is an important approach for understanding and developing business. It initiated deep research in the field of entrepreneurship.
- 2) The entrepreneurial theory of the firm laid a foundation for deep understanding of establishing the firm, its functioning, developing and managerial decision making.
- 3) Different researchers classify management decisions differently according to the specific goals of their research. Any management decision has 15 important characteristics.
- 4) There are three important groups of decision making methods. There are 20 key formalized methods, 19 key unformalized methods and 11 key combined methods. Number of different methods of decision making in every of these three groups is high. It is important that any entrepreneur can professionally use each method.
- 5) Different decision making methods are more effective for enterprises of different profile, different scale and for different kind of decisions. That is why every entrepreneur must acquire limited set of methods which correspond to typical situations in the enterprise.
- 6) Professionalism of an entrepreneur is characterized by the amount of methods and principles used for decision making.
- 7) Entrepreneur must regularly analyze his/her own mistakes and mistakes of other entrepreneurs in decision making to reduce possible mistakes in future decision making.
- 8) It is actually necessary to build a national data base (DB) of the most common SME's decisions. This DB would be of great importance for business start-ups as they might not have encountered complicated problem situations yet. It would be useful to classify decisions in DB, to make it easy to find necessary solution.

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## **PROBLEMS AND TENDENCIES OF VENTURE CAPITAL: A CRITICAL ANALYSIS**

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### **Abstract**

Over the past five years a significant change in the flow of investment trends and motivation has taken place caused by the global financial crisis. Experts get involved in discussions evaluating the venture capital investment trends and influencing factors. Several authors in their publications have expressed evaluations and conclusions regarding a rapid decline and internal structure changes in venture capital investment sector (J. Ghalbouni, D. Rousies, W. Miller, etc.). The topic of discussion is a live issue, because venture capital is a source of innovation funding. To support their views, analysts widely use statistics provided by such authoritative sources as Thomson Reuters, Dow Jones Venture Source, Cambridge Associates LLC U.S. Venture Capital Index. However, several studies do not include a number of important factors that affect the venture capital investment status, situation assessment and further development, while a number of factors are not sufficiently explored and analyzed. The authors suggest to continue the discussion and to link it to the private venture capital investment trends in Latvia, identifying major troublesome factors and proving the need to activate the process of innovation in Latvia.

**Key words:** *venture capital, innovation, Latvia, innovation management system model*

JEL code: G24, F21, M13

## Introduction

Joseph Ghalbouni and Dominique Rousies (Галбуни & Рузие, 2010:16) in their publication in Harvard Business Review as of October, 2010 analyze the reasons for rapid shrinking of the venture capital investment industry, the internal structural changes of the industry and development opportunities during the last 10–18 years. They point to the significant changes in development trends that are reflected in the dynamics of such important indicators as Thomson Reuters, Dow Jones Venture Source and Cambridge Associates LLC U.S. Venture Capital Index. The indicators characterizing the industry dynamics include the number and volume of investment deals, quarterly profitability, investment cycle and realization (the exit of venture capital from the project). Several researchers (Josh Learner and William Kerra from the Harvard Business School) analyze activities and efficiency of a venture capital. To obtain the latest data, Joseph Ghalbouni and Dominique Rousies carried out the survey among the leading experts of the venture capital investment industry and interviewed investment managers who worked with the leading representatives of this business. The results of the research let them draw conclusions that the venture capital industry is in a deep crisis and its future is endangered.

The aim of this paper is to analyze the conclusions and arguments of the above-mentioned authors, to get involved in the discussion and express their point of view regarding several factors and their impact on the venture capital development in the new states of Europe, including Latvia, to examine the situation and trends in venture investment management.

The authors have set forth two research objectives: first, to get involved in the discussion on the issues of the venture capital investment development and its influencing factors worldwide as well as in Latvia; second, to analyze the development level of the venture capital funding, to determine the main disturbing factors and justify the necessity to activate the innovation process in Latvia, designing an innovation management system model.

## Data Sources and Research Methods

The previous research of the authors was based on the assessment and comparative analysis of the innovation development indicator and other indicators of Latvia and other EU countries. The assessment of the level of innovation performance in Latvia and a comparative analysis of related achievements in Estonia, Lithuania, Sweden, and Denmark were based on the methodology of the Innovation Union Scoreboard 2010 (IUS, 2010:6) that includes 24 indicators. Reports of the European Commission (Europe2020, 2010:5), IUS 2010 data compiled by INNO METRICS, data of the

Central Statistical Bureau (CSB) of Latvia, survey data obtained by the marketing and public opinion research centre SKDS of Latvia (Kaktiņš, 2010:8), expert interviews and researches of scientists from the Baltic countries regarding assessing and financing of innovation performance were used as data sources. In addition, the views of the members of the Association of Latvian Private Investors and the Association of Venture Capital, the views expressed by Joseph Ghalbouni and Dominique Rousies in the publication in Harvard Business Review (Галбуни & Рузие, 2010:16), as well as opinions and forecasts published by several venture capital investment experts were analyzed.

## Results

The authors of the present paper focus on several conclusions expressed by Joseph Ghalbouni and Dominique Rousies (hereinafter in the text – J. G. and D. R.) in their publication in Harvard Business Review as of October, 2010. The above-mentioned publication summarizes the results of the research and draws a conclusion that the venture capital has been ineffective in the last decade and the industry should be revolutionized so that investors would gain noticeable profit (sufficient to motivate them to invest in the projects with high risk level) and influence funding of innovations; since venture capitalists have lost their ability to attract projects that would provide high investment returns. J. G. and D. R. suggest that a business primarily requires good advice and then capital, they consider that the venture capital investments will shrink in the existing capital environment: the number of companies and specialists will decrease in the nearest future. Since the investment cycle is disturbed, the venture capital companies should double their return from the investments. Either they should increase the amount of risk assets to improve the situation or they will have to face the double decrease of the industry. Only some leading venture investment companies are comparatively safe, others have to develop their own unique strategies otherwise they will face major problems attracting investors' funding.

It should be mentioned that the statements expressed by J. G. and D. R. cannot be unequivocally referred to the whole venture capital industry, since the conditions may vary in different regions and countries, and it could be influenced by the combination of both social and economic factors.

The time period of the research (2008–2010) by J. G. and D. R. coincided with the global financial crisis and the decline in other financial businesses in the time period of three years was not less than in venture capital investment industry in the whole decade (Галбуни & Рузие, 2010:16).

The analysis of the investment cycle (from investing funds in a venture project till the exit of the venture capital from the company) was based on the amount of IPO (stock market launch), that is more relevant to large companies whose shares are quoted in

the stock exchange rather than to small and medium-sized companies which dominate in the implementation of the venture capital project.

It should be noted that the majority of funded venture projects referred to the computer and Internet industry at the end of the 90s and at the beginning of the 2000s and decreased rapidly during the crisis of this market sector, the so-called *datacom* collapse, from which it has not completely recovered yet. The researchers have not performed an in-depth structural analysis on the loss structure of the venture capital industry, but the reason could be “over-heating” of the computer industry.

In fact, one of the issues of an on-going debate among economists regards either a cyclical or structural origin of changes of the venture capital investments. The more detailed research and analysis of the information are required to obtain a grounded answer to this essential question.

Concerning the issue of further significant decrease in the number of venture capital investors and experts, in the authors' opinion, the conclusion is too much globalized. It seems that “shrinking” of the financial venture investment companies and their adjustment to new market conditions, the search for new fields, investment regions and segments, organizational changes will be necessary in the future. The effectively working companies should replace ineffective companies as well as business angels that all in all will not cause the reduction of the number of industry experts and investors particularly due to the reason that innovation funding is not becoming outdated and will not lose its topicality. The amount of venture capital investment funds, companies and business angels is not large in many small market segments, for example, in Latvia. The Latvian economists (Boļšakovs, 2004:1; Deniņš, 2005:2; Deniņš & Lipmans, 2011:3; Deniņš & Zakovics, 2008:4; Kaktiņš, 2010:8; Jakušonoka & Prohorovs, 2011:7; Lukjanska, 2011:10; Zvīgulis, 2011:15) have repeatedly singled out the insufficient development of the venture capital industry and the necessity to raise the potential significantly. Estonia is ahead of the other two Baltic countries in the area of innovations, mostly due to the successfully attracted foreign investments, favourable tax policy, a positive and close relationship with the Nordic countries, particularly Finland and Sweden (Paas & Poltimäe, 2010:13).

The research by J. G. and D. R. does not take into account huge computer companies, such as Apple, Microsoft, Google, IBM etc. They have accumulated significant financial resources in recent years and do not need venture capital and investments. Moreover, they can finance merger and acquisition deals with their free financial resources which account for several tens of billions of the USA dollars, creating a competition to the existing venture capital investment companies in the IT technology sector. In addition, the above-mentioned companies have advantages since the capital does not leave the industry after the implementation of the project, thus they become strategic and not financial investors. In comparison to venture investors, IT companies have the competence

and highly professional expertise to enhance the development of the industry, innovations, technical and technological aspects of the implemented innovation projects.

It is obvious that a project implementation requires advisors and business experience which is often offered by experts and advisors, however, the provision of funds obtained at the lowest price is an essential precondition.

Dr. William F. Miller, Stanford University Professor in the interview for the magazine "Expert" (Никифорова, 2011:17) stated that the reason for many problems in the majority of countries is wrong attitude of the society towards risk, failures, cooperation and openness. Innovation development requires, on the one hand, entrepreneurs ready to risk, on the other hand, financiers capable of assessing these risks, since many start-ups fail and are closed down. This is an integral part of the process; therefore, start-ups and new ideas should be supported. Besides, real life examples show that profitable business segments and companies emerge during the crisis.

Each member state of the EU Innovation Union has to perform self-assessment that would result in identifying strengths, weaknesses and opportunities to activate certain processes. The authors of the paper hold the view that the analysis of the alternations in the economic structure of Latvia in the last 20 years should be performed to identify what changes could be expected in the future, including the organizations dealing with business research and its commercialization. The analysis could assess the effectiveness of innovative management process in Latvia and how it is reflected in the National Development Plan, programme documents, development plans of industries, their quality and provision with resources, if there is responsible staff capable of implementing them, if there is an effective control system and possibilities of adjustment. The authors consider that efficiency of the innovation process could be increased by actively involving different institutions and organizations (e.g. universities, the Academy of Sciences, the Association of Venture Capital, Latvian Chamber of Commerce and Industry and other state and public institutions) in the innovation process.

Comparing total R&D costs with the EU goal to reach 3% of GDP in 2010, the expenses for research in the higher education sector, public sector and business sector have decreased significantly, particularly in 2009, and account for only 0.46% of its GDP (Research and Development, 2010:12). The IUS data show that Latvia's ranking in the IUS-2010 is the lowest among the EU-27 and its growth rate has to be significantly stimulated. Qualitative research on innovative performance in Latvia reveals insufficient cooperation between business and science as well as it points at the need to activate venture capital funds for developing innovative processes. However, the motivation to use the venture capital is very low and the system of attracting business angels has not been formed yet; there is insufficient information and statistical analysis regarding the opportunities to use the private capital. It should be noted that financial infrastructure and the cooperation between investors and innovative project management is missing (Jakušonoka & Prohorovs, 2011:7).

It is necessary to raise awareness in Latvia about the source of funding for the best achievements in the commercialization of innovations promoting the further development of positive processes. Besides, the global experience reveals that in most cases it is more effective to support successful innovative export-oriented companies than to set up new ones.

In the light of the above-mentioned, the innovation management system model and its institutional and organizational provision should be developed in Latvia. The development of such a model requires:

- a clearly stated policy of innovation development and its funding at the national level;
- a relevant infrastructure;
- national development priorities.

Up to now the National Development Plan has outlined the “innovative society” development trends as a result of which the Competitiveness Promotion and Innovation Programme 2007–2013 was elaborated. The programme “Entrepreneurship and Innovations” was supported by the EU ERAF funding and “Development of Science and Research” was activated. In 2012, Latvia could not ensure qualitative management and supervision of this program, therefore the full amount of the ERAF funding for the programme “Entrepreneurship and Innovations” was not received since the EU suspended the payments from January 2012.

It is important to decide if innovative development priorities should be determined under conditions of financial resources deficit in the country, how to stimulate innovative development at different levels, which innovative development model should be chosen and which countries’ innovative development experience would be most suitable for Latvia.

On the whole, innovation development and introduction of new technologies in Latvia are at a very low level, therefore the potential of creating new inventions, their commercialization and introduction is insufficient. However, the struggle of Latvia to maintain the innovative performance development rate is on average 2.71% per years 2006–2010, and this rate is higher than the average in the EU-27 (Jakušonoka & Prohorovs, 2011:7).

The analysis of the growth rates of innovation performance in Latvia compared with the respective average EU-27 rates shows that an increase in investments in R&D is 7.3% lower, in SME – 14.3% lower, but registration of licences and patents – 24.6% lower (Innovation Union Scoreboard, 2010:6). Latvia presents relatively better results in human resources, economic effects of innovation, and public financial support. However, if Latvia’s innovative activities are compared with those of Finland, Estonia, Germany, and Slovenia, one has to conclude that over the recent five years Latvia’s performance is lower in all significant indicators and Latvia’s ranking in the IUS-2010

is the lowest among the EU-27, thus the country's growth rate has to be significantly stimulated (Jakušonoka & Prohorovs, 2011:7).

According to the opinion of several experts (Пеpez, 2012:18) concerning the change indicators of long technological cycles, the world economy will move from the fifth technological cycle (characterized by the development of ICT technologies, micro-electronics, biotechnology etc) to the sixth cycle (characterized by the introduction of nanotechnologies in the widest range of industries, creation of new sources of energy and artificial intelligence etc.) in the nearest decades. The world economy experiences waves of maximum and minimum points of innovation development, but each country tries to follow the latest tendencies and be ready for new challenges. R. Conway (*SV Angel* special advisor) states that approximately 90% of worldwide data have been created in the last two years. Data processing or data combination for the creation of better information gives huge opportunities to new companies all over the world. *EMC*, *IBM* and *HP* have announced that huge investments have been made in 2012 in this field suggesting where new companies could create new products for serving gigantic data flow (Konvejs, 2012:9).

Professor Carlota Perez considers that the countries, which have serious intentions regarding the new cycle, work out relevant long-term development strategies. Venture capital investors who understand global cyclic dynamics will be able to gain significant economic benefits from the development of new technologies (Пеpez, 2012:18).

The priorities of the Latvian National Development Plan state that the focus of 2014–2020 time period will be on “the economic breakthrough” (Nacionālais attīstības plāns, 2012:11). To move onto the next technological cycle that, in the authors' opinion, is of utmost importance for Latvia, it is necessary to find answers to the questions put forth in the present discussion:

- Which knowledge areas hold strong traditions in Latvia and have successful research findings for the possible commercialization?
- Which processes are the first to be stimulated in the priority order (taking into account that stimulation will take place on competitive basis under conditions of scarce financial resources); how could the existing resources be redistributed to achieve the acceleration of innovative development rate?
- Which countries could be interested in technology transfer to Latvia, if commercialized market-oriented research is insufficient?
- Could the higher education export have a positive influence on the innovative development (we consider it as a strategically significant factor) and what kind of cooperation results do entrepreneurs and market-oriented researchers (including universities) have (we consider it as one of the most important factors); how are they being stimulated on the behalf of the government?
- How correctly are the innovation realization indicators identified, taking into account that the commercialized innovation should be the end product; in that

case, should innovation commercialization development and support institutions be established in Latvia; what kind of institutions?

- What is the number of specialists in Latvia who are experts in innovative economic development and management issues, in commercialization of business research, technology transfer, fundraising in venture capital company in order to implement the country's objective – the provision of development of innovative processes? If the number of such specialists is insufficient (the authors consider that the number is insufficient) or if it is impossible to recruit them, how would it be possible to educate or "import" the necessary amount; could Latvia educate skilful specialists to provide for sustainable innovative development?
- What could be done to adjust the terms used in the Latvian language to the terms practiced in the English language – *venture capital*, *venture company*, *venture capital funds*, *venture investment funds* etc.? The concept 'risk capital' is much broader and causes ambiguity and misunderstanding among investors, financiers, government institutions, start-up businesses and other participants involved into the innovation processes.
- How could one, at short notice, find the support, and, in cooperation with politicians, (the *Saeima*, the Cabinet of Ministers, respective ministries) adopt the necessary specific programmes for the acceleration of innovative development, including (according to the National Development Plan 2014–2020) the transfer of knowledge-based economy to the sixth technological cycle, providing it with financial resources?

## Conclusions

The participation in the further discussion on the venture capital industry's global problems links the topicality of the issue with the objective of the development of innovative procedures significant for Latvia. Therefore the following conclusions can be made:

- 1) The problems of the venture capital industry described in the publication by J. G. and D. R. in *Harvard Business Review* could be referred mostly to the global scale, to large countries with the developed economy.
- 2) Since the private venture capital is one of the instruments for financing an innovation project, the performance of a venture capital under present conditions and on Latvia's scale should be assessed in close connection with the performance of the whole innovative ecosystem.
- 3) Latvia's last places in innovation launch among other European states are caused by a range of problems not the 'lack of talents'. The problems are related to the understanding of the coordination and cooperation among state governance institutions, the Academy of Sciences, universities and public organizations,



the existence of specific programmes supported by funds, high level specialists and their education.

- 4) In order to implement the Latvian National Development Plan 2014–2020, the keynote of which is ‘economic breakthrough’, all possible resources should be concentrated on those knowledge directions that would secure the relevant place in the sixth technological cycle. The world’s leading researchers consider that along with the economic cyclical development, along with the impact of political, technological, social, culture and other factors, the most **significant driving force for development is technological and information development level**. The authors hold the view that particularly these knowledge areas and the relevant industries are the priorities for the country.

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## **CHALLENGES OF GLOBALIZATION TO ECONOMICS SCIENCE AND LATVIA**

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### **Abstract**

The research deals with explanation of globalisation challenges to economic science, taking into consideration the analysis of development processes of the society during the last century. In economic theory, as it is well known, the last thirties of the 20<sup>th</sup> century and the beginning of the 21<sup>st</sup> century elapsed under sign of the “new economy”. With collapse of the Berlin wall and breakdown of the centralized planning system of the USSR, a kind of euphoria set in the circles of politicians, economists and scientists. In several countries, scientific conferences took place, the subject matter of which was related to the study of the problems of the “new economy”. It all gave evidence that, in the global economic space, a new world order may be anticipated, and that the world’s economic growth will demonstrate distinction, because the socialism, that “evil empire”, will no more hinder the victorious course of capitalist economy to the oncoming “sunlit” future.

However, the first decade of the 21<sup>st</sup> century surprised the world with the second biggest financial crisis in the history of the society. The “new economy” was befallen by such economic challenges, never experienced since the big depression of the 1930s. And the national states turned out as least prepared ones to anticipate the global crisis of the 21<sup>st</sup> century.

After the bankruptcy of the investment bank “Lehman Brothers” in the USA, Latvia was one of the first countries burdened with consequences of the global financial economic crisis. Together with insolvency of the “Parex” bank, in providing of which liquidity the Latvian Government invested almost 1 billion LVL, it was pressed to turn to international financial institutions itself and ask for a loan to stabilize the balance of payment.

If the society has accepted the cyclic economic development as a self-evident norm under the conditions of market economy, then the paper offers a discussion on the topic what kind of progress is achieved in development of the economic thought during the last century, during what time period the policy has began to dominate over the economic laws, the representatives of, exactly, what economic schools have made

an essential impact on the global processes of society's development and on other problems.

**Key words:** *cyclic economic development, financial economic crises, the gold standard, qualitative and quantitative research methods in economic science, the new economy, the global economy of the 21<sup>st</sup> century*

## Introduction

Since the middle of the 18<sup>th</sup> century to the 1930s, the history of development of economic thought has been rich with innovative searches related to the study of society's development regularities. However, it should be recognized that, under conditions of the market economy, the cyclic development of economy and the financial economic crises in economic theory are being explained as self-evident phenomenon. In this area, nothing new has been achieved also during the last century and in study there remains still a challenge to the economic science.

If earlier it was used to speak about the cyclic **overproduction crises** characteristic to market economy, then, under the impact of the globalisation, the today reality manifests that they are turned into chronic **consumption crises**. Not only the entrepreneurship societies and the households, but also the national states are pressed to deal with insolvency problems. Such is the reality of the first decade of the 21<sup>st</sup> century.

In the study of cyclic development problems in economy, during the last centuries, the research activities were focused of such well-known researchers in the area of the development history of economic theory as K. Marx, J. Schumpeter, G. M. Keynes, P. Samuelson and others.

However it must be recognized that, in the characteristic cyclic development of economy, the global economy, with a certain time interval, becomes endangered by financial and/or economic crises. The economic science has accepted such turn of events and considers it to be a norm, regularity or even a fatality inherent to the global economy development.

Since the financial-economic crisis of the 1929–1933, the destructive implications of which fell heavily on the society, also the representatives of exact sciences began to pay attention to the study of development processes of the society related to the solution of global economic problems. With achievements of the mathematic school in such areas as the mathematical statistics, econometrics and application of economic mathematical methods, in the length of time, the representatives of exact sciences began even to question, if the study of the functioning development processes of the society may be regarded as the research object of economic academic science.

From the viewpoint of exact sciences, the economic relations, dominant in the society, in the processes of production, exchange and consumption has begun to be explained

even with mathematic formulas, mathematic statistical methods and with the concepts based on results of their analysis.

The mathematical set of instruments of exact sciences can, with a great precision, model any process of natural sciences. In the natural sciences, in contradistinction to social sciences, a special necessity of qualitative research methods does not take place, because the research object is the study of regularities in the area of inanimate nature. However, the society functions on the basis of its own development laws and regularities. And these processes are studied by the economic science with typical to it specific quantitative and qualitative research methods.

Of course, the explanation of the quantitative coherence is easy to substantiate, but the behaviour viewpoint of the society does not subject to the previously calculated results of mathematical connections only. In behaviour activities of the society, the qualitative verities of the subjective component also are to be observed that do not fit in the programmed mathematical interrelationships. The subjects of society, sometimes, act contrariwise to the norms accepted by the society at the moment, and, as a result of it all, chef-d'oeuvres and innovative products become created in the world that is a regular development process of the society. To substantiate the explanation of all logical and natural processes taking place in the development of the society with the use of exact sciences research methods only, cannot be justified from the methodological viewpoint of economic sciences, because in development of the society the role of human factor is not questioned in creation of innovative products.

Without belittling of quantitative research methods in the study of society's behaviour processes, as regular are also to be recognized the qualitative research methods, to which it must be appropriated the same significance as to the quantitative research methods. The consolidation of arsenal of the quantitative and qualitative research methods is, exactly, the quintessence of the economic theory and the economic science, the research object of which is the laws of the study of the society and which is enriched by the development history of the economic thought, independently of the circumstance how deeply the development regularities of the society and the impact of regulating norms of the global economy on the increase of society's welfare level are found out.

Instead to seek for a way to find out the cyclic economic development problems in the study of economic theory development regularities, still the viewpoint of exact sciences prevails over the contribution of economic science to the study of development regularities of the society. It is evidenced by the Nobel Prizes in economy.

In their researches, several Nobel Prize Laureates have explained the development processes of the society from the viewpoint of mathematical interrelationship. In general, there become analyzed the relationships of demand and supply that subject most easily to the interpretation of quantitative indicators obtained in result of using of mathematical statistical methods. But less attention is paid to the study of such essential areas of society's life as the value theory, rent theory and other areas.

It all evidences that, since the 1920, a lack of new approaches related to the researches in economic theory has set in the development of economic theory. A lack of innovative approach takes place in the study of economic processes, regularities and legislation of the society. The last financial economic crisis of the 2008 confirms it because the causes of crises are to be related to an excessive consumption stimulation of a great many of market economy countries that is incommensurable with the increase of the productivity in economy in general. The emergence of disproportions between the consumption and the economic growth rate in the country is related in a most direct way to the crediting policy carried out by the financial market institutions, by stock exchanges and banks. The motivation of a maximal profit gaining that influences essentially the mortgage crediting and furthers inadequate increase in value of immovable property in comparison with its real market value, dismantled basically the regularities of demand and supply characteristic to a free market economy.

Becoming a member state of the EU in the beginning of the 21<sup>st</sup> century, Latvia has turned into an important component of the global economy, as its population and entrepreneurs participate directly in the international labour division. If, with accession to the EU, Latvia cherished great hopes related to the welfare increase and improvement of democratic values, then the EU expects from Latvia its contribution to the economic potential growth of the EU.

After collapse of the soviet era, twenty years have elapsed, and the population of Latvia live in a free country, in which they pass the laws and keep the order in formation of a civic society. However, since beginning of the global financial economic crisis in the 2008, the population of Latvia can no more follow what, exactly, takes place in Latvia, in the European Union and all over the world. The one thing is what is to be heard from the mass media, the second – what decisions are made by the Latvian Government and the Parliament, the third – what kind of policy becomes implemented by the institutions of the EU, and in such cross-border organizations, as the International Monetary Fund (IMF), the World Bank (WB), the World Trade Organisation (WTO), the United Nations Organisation (UNO), the Nord Atlantic Treaty Organisation (NATO) and others in their activities of regulating of the global economy. The rapid development of events is so dynamic that the population cannot follow even the day-long turnabouts, irrespective of the fact that Latvia is a lawful member of the EU and lives together with the ES in a united global economic space.

The last global financial economic crisis of the 2008, having affected Latvia painfully, creates a basis for Latvian inhabitants to think that not all is in the right order in relation to the reigning of economic affairs. Even the former President of Latvia Vaira Vīķe-Freiberga (1999–2007), who was born in the pre-war Latvia in 1937, and during the period 1945–1998 lived in foreign countries, has concluded that the capitalist world has got into a heavy situation of the crisis, and that there is something that is not quite

okay in relation to the existing capitalism, and she recognizes that a general crisis of the capitalism has set in (Tas kapitālisms 2012).

The **aim of research**: to analyze the cyclic development problems, influencing the global economy in the context of development of the economic theory.

To achieve the aim of research the following **tasks** were fulfilled:

- to study theoretical conclusions of the cyclic development of market economy;
- to analyse interrelationships of the causes and implications, being recognized by the economic theory;
- to offer solutions for research on urgent problems in development of economic theory.

The research **object** is the globalisation challenges to economic science in the 21<sup>st</sup> century.

The research is based on the following methods: monographic, historical research, synthesis and analysis, logical-constructive and statistical data analysis.

## Results and Discussion

The globalisation process began with the social division of labour and the development of international trade. A new acceleration it obtained after the First World War (1914–1918). As a result of the First World War, when the German, Russian, Austro-Hungarian and Ottoman Empires broke down, 38 economically independent states emerged in Europe, instead of the former 26 independent states (Zālīte, 1994: 8).

Before the First World War, the basic idea of the world's economic development rooted in social division of the labour. In European economic space there dominated a liberal economic system, developing in line with a free market and competition.

In the 18<sup>th</sup>–19<sup>th</sup> centuries, the classical school of political economy dominated in the development of economic theory that is based on the concept that a sound in body and mind individual must not be subjected to the generosity and kindness of other members of the society to satisfy his needs, but he is obliged to rely on himself. The opinion of representatives of the classical economic school is that the economy is a self-governing process, which, functioning according to united regularities, functions most efficiently under conditions of a free market. The founder of this school is the English economist, Adam Smith (Ekonomikas 2003: 181). His book “The Wealth of Nations” was written in the 1776, i.e. in the same year the *Declaration of Independence of the USA* was passed.

Although the countries desolated in result of the First World War tried, during the 1920s, to renew the pre-war liberal economic system and the free exchange of goods, nonetheless it is to be recognized that the First World War had brought an essential turn into economic relations of the European countries – the transition from the **liberal**

**economy system** to so called **national economy system**, based on origin of domination of the ideas of government regulation and protectionism.

Also the new-established states – Latvia, Estonia, Lithuania, Finland, Turkey, Austria, Yugoslavia, Czechoslovakia, Hungary and others started to create their national institutions and to elaborate an adequate to that time economic policy, in accordance with the political and economic conditions of that time, (Zālīte, 1994: 8).

With the implementation of self-determination ideas of the nations after the First World War, the political independence of the new states and their involvement into the European economic system created also a new competition in the global economic space. With the aim to develop the renovation of destroyed by the war economy, all the new national states, started the consolidation of the constitutional law of the state, the building of the economy system's basics, the development of agricultural and industrial sectors, taking as basis the national ideology bottomed on the idea of freedom and independency.

In result of the First World War, all the European economic space experienced some kind of development exhaustion in economic life. It was caused by the breakdown of the currency system and the interruption of normal trade relations because of the beginning of the First World War. Especially, more acute there became the problems, related to the sales markets of industrial products. If in 1913 the Europe gave 43% of the world's production amount, then in the early 1930s – only 34% (Zālīte, 1994: 10).

In the globalized economy of the world, the period 1870–1913 is mentioned as the *liberal gold age*.

The breakdown of the currency system, in result of the First World War, is to be understood as a change in the procedure of circulation and replacement of banknotes in comparison with the established order in the international practice of the pre-war time. Until the First World War, the value of national monetary units was based on the so called mono-metallic system in the form of *gold coin standard*. The gold coin standard meant that gold coins of a full value circulate in the country and fulfil all functions of the money. Functioning of the gold coin standard required that big gold reserves had to be kept by the central banks of the states.

Along with the gold coins, the national countries issued also their own notes – the banknotes and fusion coins of different metals. During the First World War, also some Latvian cities and self-governments were compelled to issue their own banknotes: Liepāja self-government notes (1915–1919), Jelgava city promissory notes (1915–1919), Ventspils city promissory notes (1915), Riga Labour Deputy Council notes (1919), loan coupons of the Executive Committee of Cesis district Labour Deputy Council (1919), Riga city notes (1919–1920), temporary exchange notes of Voluntary West Army (1919) and notes for the needs of foreign troops during the wartime in Latvia



(1916–1920) (Ducmane, Vēciņš, 1995: 117–136) to provide a more or less normal functioning of economic life throughout the war.

Historically, in the real life, the gold standard existed in the form of gold coins, bullions and gold exchange standard. The **gold standard** meant that all other monetary units, in the form of banknotes and non-gold coins, issued by the countries counted as base notes, because the gold content of the money meant, essentially, a decrease in a certain part of collateral of the banknotes nominal in comparison with the emission bank's gold reserves, taking into account the precondition that it was possible to exchange the banknotes against the gold coins (Vēciņš, 1993: 95). In economic theory, there is, to this period, related the appearance of such concept as the inflation.

The *gold standard* was such currency system, in which the currency price, expressed in gold, was statutory and the authorities had to be ready to exchange, on demand, the gold against currency at existing exchange rate. The main conditions related to the *gold standard* were that, regarding every monetary units, there was defined the gold cover, that the gold reserves cover the whole money supply and that the export and import of the gold was permitted.

In the international trade practice, the gold could circulate unrestrictedly among the individuals and the countries, and the gold standard was recognized as the measure of value of national currencies and as the collateral of base money unit issued by the national countries.

The gold coin standard lasted until the 1913, when the First World War broke out. This period was characterized by circulation of the gold coins and by a free coinage right on the condition that the gold content of the monetary unit remains constant. Also a free exchange of banknotes against the gold coins was guaranteed, and it was entitled to bring the gold into the country and out of it (Vēciņš, 1993: 136).

During the First World War, the increase of budget deficit of the countries created a necessity to enlarge the mass of money in the circulation. The gold reserves of money emission banks began to run out and, therefore, to satisfy the demand in money of a full value in the form of gold coins, it was necessary to issue additionally also base banknotes that increased the amount of the money in circulation. As a result, all of the countries, taking part in First World War (except the USA) forbade to bring the gold out of the country and the exchange of the gold coins (Kutuzova, 2012: 49).

To stabilize the economy, the countries, having suffered because of the war, introduced the **bullion standard** instead of the gold coins and exchanged the banknotes and other base money against the bullions with the weight of 12,5 kg only (Kutuzova, 2012: 49, 50).

During existing of the bullion standard, it was allowed to exchange against the bullions only big sums of banknotes, for example, in England not less than 1700 sterling pounds, in France – 215 thousand French francs and so on (Vēciņš, 1993: 136).

In their turn, other countries, with restricted gold reserves (Germany, Denmark, Norway, Austria) introduced the **gold banknote standard**. The gold banknote standard was based on the gold and two reserve currencies – to the US dollar and the sterling pounds. The gold banknote standard foresaw the right to exchange the banknotes against the foreign currency, but not against the gold (Vēciņš, 1993: 136). The gold banknote standard became the monetary system in 30 countries (Kutuzova 2010: 50).

After the First World War, the development of economy of the European national states was stimulated by the role of the state, having grown considerably in regulation of the economic processes. The economic life of both the old industrial countries and the new East European countries, including trade problems, was influenced by the government decisions in a much higher degree than before the war (Zālīte, 1994: 10).

To stimulate the increase of the national wealth, the European countries, which had suffered very heavy during the wartime, got involved more intensively in the regulation of trade processes. As a result, the authoritarian regimes came into power, and, in some countries, it led even to the dictatorship.

To stabilize the economic situation, the countries began to turn also actively to undertakings of the protectionism. As a usual of Germany, Austria and other industrial countries reaction to these difficulties was the introduction of import restrictions and other arrangements of the protectionism with the aim to avoid imports from other countries. This step turned out as acceptable also to the new European countries, and they carried out appropriate protective undertakings (Zālīte, 1994: 10).

The breakdown and devastations of economies of the warring countries during the First World War stimulated the growth of production in the USA, Japan and other overseas countries, which gained incommensurably high, for that time, profits from the international trade with the countries, having suffered during the wartime.

An especially rapid economic growth was experienced by the USA. During the 1920s, being called the *golden twenties*, a rapid growth of inhabitant wealth was to be seen. Also the entrepreneurs were convinced that their success, related to a profitable business development, would never come to an end. The self-assertion of entrepreneurs influenced other spheres as well. The economic growth of the USA was based on an hyperbolic development of crediting and stock market.

The *golden twenties* of the USA created the illusion of beginning of the era of prosperity. In 1929, the amount of industrial production of the super powers had grown by 47% in comparison with the 1913. The highest increase took place in the USA – 72% (Pasaules 2012).

After the First World War, millions of Americans did what they would not have been even dreaming about. Most households invested the money they had earned into purchasing of shares that led to a rapid increase of shares' value in stock exchanges. The shareholders gained incommensurately high profits, and got, more and more, involved

into risky transactions. Evaluating the situation of that time from a today viewpoint, it is clear that the prices of shares exceeded far their real value and that their inadequate market price would once decrease and the profit opportunities shrink. However, the stock market euphoria continued until the summer of the 1929, when the income of American firms, beginning with the 1929, began to shrink essentially.

In the history of the USA, the 20<sup>th</sup> century is characterized by such significant dates as the October 24, 1929 (“The Black Friday”) and the October 29, 1929 (“The Black Tuesday”), when the shares in New York Stock Exchange began to lose rapidly their value and the prices decreased dramatically. In the society, a panic broke out; the selling of shares took place that resulted in decrease of their value even by 50%. To these developments, there is related the Concept of the *Great Depression* in the USA that, in economic history, is used to characterize the World’s Economic Crisis that took it begin in the October, 1929.

During the period from the beginning of the Great Depression until 1932, the prices of the shares had decreased more than by 80%. The confidence to the production was lost, because the economic crisis had overwhelmed the whole world and the demand in goods and services had shrunken considerably and the market turnover decreased essentially.

Historically, the beginning of the crisis of 1929 is related to the bankruptcy of several banks of the USA and the collapse of the stock market. It was sought for the causes of the crisis. Ones began to consider that the free market itself was to be blamed for the collapse of the market; the others – that the outbreak of the crisis was caused by the faults of the governments, having begun to implement elements restricting the protectionism during the post-war period. There exists also such viewpoint of economists (Peter Temina, Bredly Eihengreen) that one of the causes of the crisis are the attempts of the Great Britain to restore the gold standard relation up to pre-war level (4.86 USD : 1 GBP).

Many countries didn’t succeed in recovery from the implications of the economic crisis fully, even up to 1939, when the Second World War broke out.

After the First World War, the processes of market regulation began to dominate in the economic development policy of the states, forming the basis to overcome the implications created by the First World War and the World Economic Crisis of the 1929–1932. The theoretical basis for the practice of regulation of market processes was provided by the English economist John Maynard Keynes, who, in his work “The General Theory of Employment, Interest and Money, 1936) had defined the macroeconomic theoretical principles of the first half of the 20<sup>th</sup> century. The main concept, regarding to political, social and economic troubles, was that the money market and the labour market cannot come to a balance without involvement of the state policy, because the production amount in economy and the employment are determined by demand. Without demand there is not supply, but, at an insufficient

demand, the development of economy begin to slow down. To avoid such implications, a great significance, in revival of the economy, was ascribed to the support of the state (Ekonomikas 2003: 181).

The most characteristic features of Keynesianism are: macroeconomic approach; 2) stimulation of demand; 3) anti-cyclic regulation; 4) strict policy in regulation of wages and prices; 5) active monetary and fiscal policy.

These macroeconomic theoretical concepts, having emerged, as a result of the impact of the first worldwide economic crisis, have got, in the history of economic theory, the designation *Keynesianism* that is derived from the author's surname.

The main theoretical concept of the *Keynesianism* is that, to provide that the state may regulate and stabilize the demand, it is necessary it have a considerable monetary and fiscal policy.

The theoretical concepts of *Keynesianism* were used by industrial states even up to 1990s (Ekonomikas 2003: 181).

Although the economic concepts of J. M. Keynes, related to the intervention of the state into regulation of market processes, played a great role in the overcoming of implications of the Great Depression, there were, however, economists, who distinguished that, in defined by Keynes principles of the monetary and fiscal policy, regulating the macro economy, there was abandonment from liberal values in development of market economy theory.

One of the most popular scientists of that time, who started to speak openly on the topic that, with an overwhelmed state intervention in regulation of the market processes, the way-out of the crises is impossible, was the Austrian economist Joseph Alois Schumpeter (1883–1950). While working as lecturer at Harvard University, he had little supporters because the Schumpeter's concepts contradicted to the popular theory of the *Keynesianism* of that time.

However, it must be recognized that Schumpeter's theory related to **business cycle theory** created a rich soil for a further development of economic theory. The researchers of economic mathematics continued to develop his theoretical concepts. Although Schumpeter himself was not mathematician, but economist, he was able to gather around him young mathematicians-economists. After the death of the economist, his followers recognized that it was impossible to prove Schumpeter's theory of economic development and business cycle with the mathematical methods of that time.

Schumpeter's business cycle theory was based on the thesis that the main impulse for economic development is innovations, manifesting as new technological, economic and other kind solutions, where every bearer of business idea undertakes to develop it from the moment of creation until the practical realisation, undertaking all possible risks related to the realisation of the business project.

Although Schumpeter's business cycle theory was based on the assumption that the **economic development is possible only in the form of a cyclic development**, in his work "*Capitalism, Socialism and Democracy* (1942), he opposed to overwhelmed intervention of states into the regulation of market processes aimed to the finding of the way out of the crises. Being a supporter of the liberal values, expressed in classical economic theory, the economic development under conditions of market economy, he saw, however, in a cyclic form only.

Of course, if there is cycle, it is easy to substantiate the processes of economic development with the methods of mathematical statistics. The mathematical methods were an enough powerful instrument to explain the processes, taking place in the society, in the cases of cyclic economic development and of financial economic crises.

The First World War, the years of the Great Depression and The Second World War created the basis for economic theorists to assume the cyclic development as a natural process in explanation of market economy processes. Also in the text books of macroeconomic theory "ECONOMICS", the methods of mathematical statistics, econometrics and economic mathematics became used more and more in explanation of economic processes of the society.

If in the *balance sheet* the photo of the enterprise is fixed in the form of the numbers at the beginning of the period, then in the text books of *macroeconomics* it is explained what kinds of development scenarios are possible in the framework of the cycle.

If the 3 golden rules of the balance, defined in the *Accounting Theory*, say that the entrepreneurs have to take strongly into consideration that they would not get into the situation of insolvency, then the today *Macroeconomic Theory* offer a situation analysis that is to be developed in the framework of one cycle only, without offering, in the framework of one cycle, the developments for a long term growth and an uninterrupted providing of economic stability. In the course of *Macroeconomics*, there are analysed the interrelationships how to be in case, if the curve of an indicator ascends or descends, what is the meaning of the situation, when it has reached the upper point of maximum or the lower point of minimum, how long such situation is able to exist, and what may happen, if the economic situation returns to a normal level.

It cannot be said that the special literature of economic science lacks of definition of the **aims of economic policy**, being necessary to be implemented by the government of every country under the conditions of market economy. The aims of the economic policy are based on the politics related to the providing of economic growth in the country, of the political, economic and social system, as well as of the stability of legislation, the implementation of which in democratic countries is the function of the members of the parliament, the political parties and the formed by them governments.

In the special literature, there are mentioned four aims of economic policy:

- 1) control of inflation, or providing of price level stability (control of inflation);

- 2) decrease of unemployment, or providing of high employment level (control of unemployment);
- 3) control of balance of payments, providing a balance between the budget revenues and the spending part (balanced budget);
- 4) providing of continual and sufficient economic growth (Beardshaw, 1989: 72).

As the fifth aim of the economic policy, the support to less developed countries is mentioned. It is motivated with a generally established principle of the civilized world about rendering of help, which manifests itself in the way that the rich countries hand out from their budget resources to support the countries coming into a situation of the crisis (natural disasters, implications of hostilities and others).

In the literature, the four mentioned economic aims (Rund, 1987: 99.–100.) are called the magic quadrangle. With these aims of economic policy the basic principles of free market economy become implemented.

The economic theory says that the governments have to take into consideration that the aims of economic development of every country and the political, economic, social and financial undertakings are to be carried out in such way that, in the framework of market economy, they would provide a possibly *simultaneous* investment in maintaining of price level stability, high employment level and providing of inhabitants' social security, the foreign payment balance, as well as *sufficient* economic growth level, maintaining of the planned in long term programme growth rate of the GDP.

However, regarding the real life, it must be mentioned the contradiction of these four aims. It is impossible to achieve and realise them at one and the same time. The well known gap is the gap between the price stability and the employment level. In the economic literature, there is expressed the concepts that the rise in price of living standard, created by the growth of inflation, may provide an increase in employment level. However, the experience of 1970s evidences that, exactly, the inflation may cause the unemployment, and the stability of price level does not compete with other aims, but figures as a precondition in their achievement (Rund, 1987: 99.–100.).

Dependently on economic development level and on concrete economic situation in the country, the governments of different countries are setting priorities related to the above mentioned aims. Not always it takes place in a unanimous atmosphere among the parties forming the coalition. The cause is that, in the framework of parties' programmes, there often take place different viewpoints in relation to the realisation of different aims (development of entrepreneurship, social protection of inhabitants and other arrangements). In the declaration of the parties forming the government, a united approach becomes to be found after long discussions only. The different viewpoints are related, mostly, to redistribution of budget revenues, which, as a rule, takes place

either **in favour of entrepreneurship development** (liberal development) or **in realisation of social protection programmes of inhabitants** (social-democratic development).

The preconditions of economic development of the country are:

- the level of capital concentration (natural resources, geographical location, historically developed concentration of money and capital flow, qualification of labour force);
- the level of added value production (production and selling of products produced by innovative and creative industries of domestic entrepreneurship);
- competition in the foreign trade (balance of foreign payment balance – with the deficit or surplus) (Keišs, 1999: 101).

For creation of economic development preconditions and realisation of the aims of economic policy, the fiscal, budget and monetary policy is employed. However, under conditions of globalisation, the role of national governments is restricted. Especially, it manifested itself during the 1980s.

In the end of the 1960s, the reality came to a contradiction with the **economic theory of Keynes** that was based on the meaning of regulating role of the national states in regulation of market processes.

If after the Great depression the Keynes economic school brought to life the economic life of countries touched by the crisis, then, in the 1960s and 1970s, the global economy anticipated yet unprecedented challenges.

The strategy of economic development based on protectionism, subsidies and regulation of market processes, which the industrial countries began to adopt in the 1920s and 1930s, was taken over by a many of Latin American countries in the 1960s and 1970s. The lesser developed countries began to implement industrialisation programmes based on the substitution of the import. To the countries, which began to protect their national economies, substituting imported good with domestic products, it provided the opportunity to strengthen the economic independence and stimulate the growth of the country. Such economic policy adopted by less developed countries is called *Import substitution industrialisation (ISI)*.

In 1970s, the industrial countries had to solve such a problem as to bring to the life the international trade. There emerged the ideas of monetarism (monetary policy), which support such basic statements of market economy that foresee a minimal interference of the state into economic relations.

The founder of the monetary economic theory is the economist of the USA, Milton Friedman, the Nobel Prize Laureate in economy (1976). Friedman was one of the most consequent advocates of the monetarism and the free market. The concepts of Friedman's monetary theory are based on changes in the mass of money that serve as the driving force of economic development. As a result of regulation of the amount of

the mass of money, there is made an impact on both the price level and income and employment of the population, but the stabilisation of the money mass, being in circulation, provides a common stability of economy (Ekonomikas 2003: 231. lpp.).

In relation to the development of the monetary theory, a new direction of liberalism or the neo-liberalism emerged, which began to declare that the countries have to adopt such rules of the game that are signed by international organisations. It meant that the national countries could no more participate actively in regulation of economic processes because they could face a trespass of a signed agreement. The countries, which carry out the stabilisation of economic situation and regulation of market processes (recession, depression, stagnation, activity, prosperity) self-dependently with fiscal, monetary or budget policy measures, come to a situation that their independence sometimes becomes restricted with requirements and regulations dictated by cross-border organisations.

The opinion of the advocates of liberalism economic theory was that the best solution in every area is the natural process of affairs, including also the economic life of the country, therefore free trade and competition is the best guarantee for economic progress and increase of the wealth. Liberalism means a refuse of direct state control of domestic and international deals, relying on price mechanism regularities (Ekonomikas 2003).

At the early period of liberalism, an essential role was played also by the *gold standard* etalon. In global economy, there the problems emerged, when a gradual abandonment of it took place, coming to a culmination in the 1970s and the 1980s. It is significantly that the period from the 1930s to the 1980s is called the years of **non-liberal** policy in the economy (Čangs, 2011: 51.).

The **non-liberal** economic policy was replaced by **neo-liberalism**. Representatives of economic theory interpret the **neo-liberalism** as such direction of economic theory that supports a free market, minimal interference of the state into economic relationship and regulation of property rights. The economist J. Bredford De Long indicates to two basic principles of neo-liberalism: 1) close economic contact between the capitalist or developed countries and the less developed countries that is the best way how to accelerate the movement of technologies. It is a principal precondition to provide that the poor countries may become more well-off; 2) the governments, in general, lack the ability to manage big industrial or commercial enterprises, therefore the state administration must be diminished and it has to carry out the very essential tasks – income distribution, legal system management, providing of social benefits and others. The rest of the sectors must be privatized.

The concepts of neo-liberalism began to be implemented in the 1980s, when Mexico, as the first country, was pressed, in 1982, to turn to the international organisations for a loan to overcome the financial crisis. The debt crisis solution was assigned to IMF and World Bank that financed the countries, having cover a big debt, but only in the case, if they agreed to strict reforms in the frame of adaption programmes of structural reforms. As a condition for further support and loans, it was required that the state-



receiver would keep at the fiscal, monetary and economic policy set by the international institutions. Step by step there strengthened the “Washington consensus” that was based on the principles of neo-liberalism, and the three most essential elements of it were: 1) macroeconomic stabilisation; 2) liberalization and 3) privatisation (Alksnis, 2006: 27).

The “Washington consensus” is a totality of macroeconomic principles used to lend the money to the states. The financing mechanism of the states was elaborated by the specialists of the USA, IMF and World Bank with the aim to find a solution how to overcome the financial crisis in the countries of Latin America. With the concept of “Washington consensus” there is described the unanimity that took place between the economists of three significant Washington institutions (IMF, World Bank and Treasury of the USA) in relation to the necessary reforms in Latin America (Alksnis, 2006: 25.–26.).

The totality of macroeconomic principles is to be regarded as the keyword for further collaboration because, similar to Latin America, problems were experienced almost by all developing countries, and the economic stabilisation, liberalisation and privatization became significant issues of agenda of that collaboration. For the countries, having got into the debt crisis, was not left anything else than to follow these principles of “Washington consensus”, to receive the loans from the IMF and World Bank (Alksnis, 2006: 28).

The 21<sup>st</sup> century is not distinguished by something especial. A great blow to the global economy gave the financial economic crisis of the 2008, in result of which already the member states of the EU are pressed to ask for loans from international donors to overcome the insolvency of the country. The situation is made more complicated by the three biggest credit rating agencies (Fitch Ratings, Moody’s Investors Service, Standard & Poor’s), the allotted credit ratings of which sometimes create clamours in international stock exchanges and financial markets. Of course, no country can live beyond its means. However, the last global financial economic crisis shows that the economic theory comprises a great many of unresolved problems also in relation to the evaluation of immovable property. The solution might be given by the researches in the area of rent theory, facilitating the understanding on the topic why an inadequate evaluation is possible in the case of both the traded securities in stock exchanges and the things traded in the markets of immovable property.

## Conclusions

In the 21<sup>st</sup> century, the liberalism concepts expressed by the classical economic theory have got into contradiction with the significance of the regulating role of the state in development of the global economy. The analysis of the globalisation processes gives evidence that, during the last 50 years, the dominance of such cross-border organisations, as IMF, WB, WTO, ES, UNO, NATO and others, constantly conflict with democratic value principles implemented by the governments of national states. Since to Monetary and finance conference of the UNO, having taken place in Breton Woods in 1944, about one hundred states in the world have experienced crises of different scale

and depth. Also the global space faces crises, notwithstanding that the principal task of cross-border organisations is to provide stability in development of the world's economy.

In the global economy, there is not a world's government that would be responsible and could control the globalisation processes in general, similarly, as it is done by the governments of national states. However, in the 21<sup>st</sup> century, a system has developed in the world that might be called a global management without a global government, in which the above mentioned cross-border organisations dominate. The decisions made by them, the heads of states, presidents of central banks, ministers of finance, trade and economy are pressed to implement. Such economic order on global scale create instability that is to be paid high by all participants.

The rules of the order of international economy may be changed on the basis of the study of dominating regularities in development of the society and the laws of economic theory. Certain postulates advanced in macroeconomic theory and the regulation measures implemented in the economic practice must be left aside. The attention must be turned to the roots of the academic economic theory, and the researches must be deepened in such economic segment as the Law of value and the Law of rent.

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# QUALITY OF FINANCIAL INFORMATION AS AN IMPORTANT ELEMENT OF CORPORATE GOVERNANCE

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## Abstract

Nowadays economy, tendencies of its development and competition among companies increase the need to analyze the factors influencing efficiency of company's operation.

Competitiveness of every company depends on various financial and non-financial factors and their mutual influence. One of such factors is corporate governance that influences processes of decision making about investments to be made.

A company making significant investments in long-term assets does this with one objective – to earn the highest profit within the usage period of these assets. In order to evaluate the effectiveness of corporate governance, more and more often the increase in the company's market value has been used.

In this article, the following key issues will be discussed:

- corporate governance;
- quality measurements of corporate governance; how to improve it;
- definition of qualitative financial information as an element of corporate governance;
- key criteria of corporate governance – transparency of financial information;
- long-term asset management, its impact on transparency of financial information on a real example – company *Latvia Statoil Ltd.*

The questions discussed and explored in this article reveal various existing problems in the company related to corporate governance; which is considered by the author of this article to be the effective practical benefit of this research.

**Key words:** *Corporate governance, financial information, quality of financial information, long-term assets, long-term asset management*

## Introduction

In the process of decision making regarding financing and possible future investments, it is essential that the management and shareholders have transparent and fair information, which reflects the real situation and possible basic risks. Financial accounting at the highest level is one of the key characteristics of qualitative corporate governance. Its main rules and requirements are in accordance with the ones announced by shareholders. However, it is quite a common situation that there is no consensus about priorities of strategic goals among investors that could influence company's future and its long-term financial stability.

Nowadays, when ensuring of company's liquidity is a key priority of its management, quite often the management accounts for company's resources as for current income and does not pay enough attention to the policy of long-term asset management; this fact makes it difficult to evaluate future cash-flows and forecast possible market value of this company.

The quality of corporate governance has usually been evaluated by international rating agencies authorized by Nationally Recognized Statistical Rating Organizations (NRSROs) based on their criteria (Moody's Investors Service, Standard&Poor's, Mominion Bond Rating Service, A. M. Best Co. and Fitch Ratings). And one of the key criteria to evaluate the quality of corporate governance of a particular company is transparency of accounting reports.

The *aim* of this article is to develop criteria with a view to evaluate the quality of financial information within the system of corporate governance for an international retail company located in Latvia based on the investigation, analysis and summary of economic literature and other articles on the given topic.

To attain the aims set, *the main questions* of the research include the following:

- corporate governance – definition and description;
- basic rules of corporate governance, its position within a corporate control mechanism;
- key characteristics of financial information, methods to attain them;
- *transparency* of financial information – description and its assessment process;
- qualitative management of long-term assets and its influence on transparency of financial information.

*The methodology* of the research includes a qualitative, theoretical research approach, involving literature review, collecting data from the international retail company *Latvija Statoil Ltd.*, data analysis and drawing conclusions.

## 'Corporate Governance' – Definition and Description

Because there is quite a substantial amount of literature available about the term 'corporate governance', the author chose some of the most creative definitions.

Thomas Clarke (Clarke, 2008: 1) described this term by using the definition proposed by the Organization for Economic Cooperation and Development (OECD) – that corporate governance is a system by which various companies have been managed. And its structure defines rights and responsibilities of each person within a particular company. Although, Kevin Keasey and Mike Wright (Keasey & Wright, 1997: 1) claim that this term has been an issue for quite a long period of time (already since the late 1980s); it has included accounting, various business mistakes, strictly defined and quite limited role of auditors, also insignificant relation between executive compensation and results of the company, and forces stranded for the market for corporate control, institutional investors developing short-term perspectives damaging economic performance of the company. Elaine Sternberg (Sternberg, 2004: 1) described corporate governance as follows – corporate governance is a process, how to ensure, that activities, agents and assets of a particular company have been used to achieve goals set by its shareholders. Raphaela Henze (Henze, 2010:1) in her publication has defined the main objectives of corporate governance, which are also key factors influencing its control mechanism – transparency, growth, leadership, social responsibility, trust, strong protection of assets and shareholders of the company.

As author explored, the development of the term 'corporate governance' started meanwhile the economic development of industrial capitalism. As the first recorded instance of a non-financial company owing diffused share capital was the Dutch East India Company founded in the 17<sup>th</sup> century. It was also mentioned by such persons as Berle and Means (1932), Marshall (1920) and Adam Smith (1776) who defined this term as a separation of beneficial ownership and executive decision-making in a joint-stock company (Keasey, Thompson, Wright, 1997: 1). As author investigated in economic literature available on this topic, more profound studies on this issue started only in the 1990s. In the 1990s, when capitalism was the main factor that changed the existing economic systems, the development of corporate governance started. The ways it happened differed across the countries. For example, in America, it was a system including many independent corporations competing to get as many customers as possible (Morck, 2005: 1). In the author's opinion, it is important to mention, that its owners were millions of middle-class shareholders having shares, but in reality they had no influence on decision making processes; only very few of them were owners owing 3–5% of a particular company's stock having definite power in a decision making process. However, in most countries of the world, capitalism was a system where only a few very healthy families held and controlled almost all of the most

influential corporations in a particular country. Very good examples to mention are Mexico and Argentina, where the large corporate sector has been controlled only by some very rich families. It is called 'family capitalism', which is defined as the most typical kind of a common system of corporate governance in the world. The same phenomenon has also been observed in relatively rich economies, e.g., Sweden, Hong Kong, Israel. Therefore, there are significant differences in countries' economies and their corporate governance. The aforementioned phenomenon could be defined as one of the main characteristic features of corporate governance. The main idea is to understand that the main differences in country's corporate governance are in different forms of capitalism in the respective country (e.g. bank capitalism, state capitalism, family capitalism). Randall K. Morck (Morck, 2005: 1) announced, that the main differences in corporate governance among the countries are due to the following factors – country's history, rich families, influence of various factors (e.g. wars, catastrophes, upheavals, etc.), various business groups (e.g. very common in Japan), law (e.g. stock market has to be positively correlated with shareholder legal protection), trust, origins (each of country has its own culture, traditions, legal systems, etc.), evolution, transplants, large outside shareholders, financial development, politics, entrenchment.

The author has also studied findings by different authors regarding the development of corporate governance in Europe. Kevin Keasey, Steve Thompson and Mike Wright (Keasey, Thompson and Wright, 1997: 10) have discovered an interesting fact that in Europe, mostly in Central and Eastern Europe, the development of corporate governance was strongly influenced by the process of privatization. In the years of post-privatization the decline in share ownership by employees and increase in share ownership by management and other investors outside the company was discovered (a proportion depends on a particular country). However, all companies in Europe faced several common problems – absence of external financing, inadequate system of corporate governance and variable quality of entrepreneurship. The author discovered an interesting fact that the system of corporate governance developed in Europe is based on powerful control by shareholders, who are much involved in decision taking processes and based on the number of shares they own they are authorized to influence various decisions. This is the main factor influencing the entry of other potential investors in these markets, because they understand that their rights will be limited (Soderstrom, Berglof, Holmstrom, Hogfeldt, Milgrom, 2003: 10).

Based on review of the available literature, the author assumes that corporate governance is a process by which a particular company is led, that differs across countries and continents all over the world because of their different histories and that corporate governance is still in the process of development.

## Corporate Governance Control Mechanism

In this section, the author explored the control mechanism of corporate governance. Traditionally, corporate governance includes various internal, external and multiple control mechanisms. In this part of the paper the author describes all possible control mechanisms to be applied in order to evaluate the quality of corporate governance.

Internal control mechanism of corporate governance includes the following elements:

- 1) *Board of directors* – author has found out, that in most cases a board consists of persons elected by shareholders and these persons represent interests of shareholders by controlling respective management (Weston, Siu, Johnson, 2001: 20).
- 2) *Ownership concentration* – according to the author, that this usually happens in situations when company's management owns shares in a company and therefore their performance increases and also interests are more or less the same as to other shareholders that eliminates any possible deviations from value maximization. The author discovered various interesting findings in the field of ownership and performance. In the author's opinion, one of the most interesting has been performed by three scientists – Morck, Shleifer, and Vishny (1988) who studied mutual influence of performance and ownership (Weston J. F., Juan A. Siu J. A., Johnson. B. A, 2001: 20). There are different discussions on the issue, whether to choose an outsider or insider for the top-position. The most interesting to mention was performed and led by Rakesh Khurana (discussion was among several outstanding CEOs (Philip Caldwell, George D. Kennedy, G. G. Michelson, Henry Wendt, Alfred M. Zeien)). Almost all of them confirmed that the best practice is to take an outsider for the CEO position, except Henry Wendt, who explained this by saying that in such a situation some people could leave a company, because they were also working hard to receive this position (Harvard Business Review on Corporate Governance, 2000: 6).
- 3) *Executive compensation* – in respective literature, the author found, that the interest between two sides (owners and managers) has been explored already in 1932 by Berle and Means, and this has been a focus of attention of many other researches performed up to nowadays. The main idea – it is a serious problem in cases when shareholders are not able to control management, because managers usually have definite information availability that the shareholders do not have. The author found out, that this problem was called '*agency cost*' explored by various scientists, e.g., Jensen and Meckling's, Fama, Roson, Main, Pvlik, Scott and Tiessen, etc. (Keasey, Wright, 1997: 3).

Outside control mechanisms include the following elements:

- 1) Stock price performance – the author, based on the literature review on this topic, concluded, that there is a direct correlation between stock prices and management performance (CEO, president, chairman of the board, etc.). This idea has been supported by various scientists -Warner, Watts, and Wruck (1988) who found out that a decrease in stock price increases turnover among management. Also, scientists Denis and Denis (1995) investigated the fact that forced changes in management cause unusual returns for a company – decrease in performance that further changes into significant improvement, while normal retirements from the side of top management cause only insignificant effect on returns. Although, scientists Shleifer and Vishny (1997) invented and performed a survey whose results confirm the above-mentioned direct correlation between stock price and management performance in the United States – poor scores increase turnover among management and opposite (Weston Siu, Johnson, 1997: 20).
- 2) Institutional investors – by institutional investors we should understand the public pension funds (in the United States). The author has realized that the main reason why these funds are accounted as institutional investors is their size and structure. Today in the United States it has been performed only by some of them (Weston, Siu, Johnson, 1997: 20).

*Multiple control mechanisms* – the author has ascertained that a multiple control mechanism includes the following elements: insider shareholdings, outside representation on the board, debt policy, activity in the corporate control market, institutional shareholdings, shareholdings of large block holders, and the managerial labor market. The author discovered that there have been various investigations performed on this issue – Agrawal and Knoeber (1996) explored 400 largest companies by the use of measurement of *Tobin's q*. By measuring each of them separately, the following were statistically related to company's performance: insider shareholdings, outside representation on the board, debt policy, and activity in corporate control market. When they are considered separately, the influence of insider shareholders does not work; and when all mechanisms are considered together, the only one with a negative effect on performance is outsiders on the board. In the author's opinion it is worth to mention that other studies define the last conclusion opposite – that the outside directors have positive influence on the company's performance (Weston, Siu, Johnson, 1997: 20).

The author found out that there is one more control mechanism of corporate governance called *proxy contests* – it is another corporate control mechanism, that consists of dissident group of shareholders to gain board representation; and it does not matter whether they attain the goal or not. This process has a significant effect on the wealth of shareholders anyway (Weston, Siu, Johnson, 1997: 20).



## Financial Information Quality Disclosure as an Important Element of Corporate Governance

In this section, the author expands the discussion on the quality of financial information. In the author's opinion, for company's shareholders to take important decisions toward future activities to define the value creation opportunities (e.g. investments, acquisitions, alliances, takeovers, etc.); it is essential to have access to all the information needed. In real life we quite often encounter situations when only company's management or some shareholders have this access. This is a significant risk, because they are the ones who actually control a company, its business and future development. They are also the ones who can change figures in order to show specific activities the way it is needed. In case the remuneration system is connected with company's results, it is even more risky, because it motivates managers to achieve personal goals instead of company's goals. The author concludes that the persons taking positions of accountants and auditors affect this process quite strongly in both ways, because quality of financial data influences company's cash-flows and cost of capital at which cash-flow has been discounted. *Audit and accounting* at all times have been the most important corporate monitoring systems. Accountants are responsible for presenting current financial situation of the company via balance sheets, income statements, cash-flow statements and supporting disclosures. Auditors (internal and external) are the ones who inspect these documents, whether this information is correct. Therefore their overview of accounting and auditing is really crucial for shareholders, banks, investors, creditors and other related parties.

Based on literature review, the author concludes that in order to ensure that reporting is performed according a single model in all countries (e.g. international company owing subsidiaries all over the world), both – accountants and auditors have been governed by the SEC recognized, non-government entity consisting of members relating to accounting, business, academic professions and it is the Financial Accounting Standard Board (FASB). This entity sets accounting standards called Generally Accepted Accounting Principles (GAAP). The American Institute of Certified Public Accountants (AICPA) is another instance established with a view to lead work of external auditors by setting auditing standards. In 2002, when the Sarbanes-Oxley Act of 2002 was drafted and approved, a new instance for governing auditors was established – the Public Company Accounting Oversight Board (PCAOB). The International Accounting Standards Board (IASB) is another entity defining global accounting standards in order to ensure and be able to translate the information of financial statements of various companies all around the world (Kim, Nofsinger, 2007: 10).

## Transparency of Financial Information – Description, its Assessment Process

The studies reviewed in the previous section provide the evidence that quality of company's financial information plays really essential role. One of the characteristics of effective financial reporting is *transparency of financial information* meaning, that all possible users could see and understand economics of the business reflected in the financial statements of the company, which has been achieved by full disclosure and fair presentation of real financial situation in this company. The author examined this issue in more detail. During the last decades, the importance and main tasks of accountants have changed from reports and bookings to increasing the profits by applying various accounting methods. This process was called 'managing earnings' and accountancy has been viewed from the side of management as '*profit centre*'. It is a really sensitive area, because accountants are able to use various kinds of practices by manipulating figures and increasing or decreasing earnings per definite period. Because of such practices, it is quite risky and, therefore, important to understand, where is already a case of fraud (Kim, Nofsinger, 2007: 3). In order to discuss the transparency of financial information further, in the author's opinion, it is worth taking a look into the history of some of the world's most famous significant fraudulent cases in accounting:

- Enron – developed a system, when by the use of accounting loopholes, special purpose entities, and poor financial reporting, its management could not to show its billions of debt from non-existent deals and projects.
- Adeptia – inflated share price by performing sales to non-existent companies.
- Worldcom – management booked operating expenses as capital expenses and signed significant loans for themselves.
- Dynegy – performed selling of goods with Enron and other similar companies and got a significant profit, etc. (Weston, Mitchell, Mulherin, 2004: 20).

The above-mentioned cases are only a few examples occurring among corporations all around the world. The author has found out that a person named Howard Schilit established a centre for Financial Research and Analysis (CFRA) with a goal to control and discover any fraudulent cases as soon as possible. He also wrote a book „Financial Shenanigans” (1993), where the most common cases and techniques to hide real condition and financial data of a particular company are described by defining real examples of public listed companies. Mulford and Comisky (2002) also published similar book.

There are some studies toward fraud cases among firms performed by Agrawal, Jaffe and Karpoff (1999). They have found out, that there are no connections between fraud

and any changes performed in the leadership structure (Weston, Mitchell, Mulherin, 2004: 20).

By exploring transparency of financial information, the author also studied regulatory documents, e.g., the Sarbanes-Oxley Act (SOA) – a legal and regulatory framework for the control mechanism of fraudulent cases mentioned above. It has been effective since July 30, 2002 (as a result of Enron scandal – described above). It was passed with a goal to strengthen corporate governance, audit, analyst standards, and disclosers of large corporations. The SOA includes the following rules of control to ensure transparency of financial data per corporation:

- auditor independence – there is a limitation in current activities, the auditors are prevented from performing non-audit services and audit partners should rotate every five years etc.;
- certification of chief executive officer (CEO) and chief financial officer (CFO) – both have to be certified by 10-K and 10-Q;
- conflicts of interest – personal loans for management and officers are forbidden;
- studies and reports – various studies have to be managed;
- securities and exchange commission (SEC) power;
- possible penalties – all audit documents have to be available for five years;
- professional responsibilities;
- insider trading – need to report in two days, by use of special procedure;
- disclosers – annual/ quarterly reports have to be filled out in accordance with SEC rules, and time period is two days;
- fraud accountabilities – strong rules against fraudulent activities and strong protection to whistle-blowers;

The Public Company Accounting Oversight Board (PCAOB) – a private and non-profit corporation subject to SEC regulations, responsible for overseeing the auditing for public companies and for defining standards for audit reports. Every audit company has to be registered in the PCAOB. The document (SOA) delivers a significant importance to the company's audit committees, which have to consist of at least one financial expert from the SEC.

At the same time other significant changes in the legislation occurred – in the New York Stock Exchange (NYSE) that defined new rules for listed-companies (2002). The new NYSE corporate governance rules were toward structure, incentives of the boards of directors and function. The NASDAQ Stock Market implemented some changes in the year 2002; its rules were similar to the ones defined by the NYSE (Weston, Mitchell, Mulherin, 2004: 20).

## Credit Rating Agencies

In this section the author studies the information available and gives a short summary about existing rating agencies. The author concludes that in theory and practice not only shareholders, but also lenders care about corporate governance of a particular company. There are two types of lenders – institutional lenders (e.g. banks) and individual lenders (e.g. bondholders). If company's corporate governance is at low level, respective lenders suffer via decline of value of a stock. For banks it is easier to control a company invested, while it is different and more complicated for individual lenders or bondholders because of limited resources available to be invested in this monitoring. Therefore, they are able to use the service provided by a rating agency providing essential and important information to existing and potential lenders and bond investors. Credit rating is a tool that investors can use to make decisions regarding purchasing of bonds or other fixed income investments. There are few firms which, by performing credit analysis, give the so-called safety ratings to companies: Fitch Ratings, Moody's Investors Service, Standard & Poor's – or so called Big 3 credit rating agencies, also Dominion Bond Rating Service, A. M. Best Co, Credit Lyonnais Securities Asia, etc. (Kim, Nofsinger, 2007: 6).

*Fitch Ratings* – one of the three ratings agencies first recognized by the Securities and Exchange Commission as a nationally recognized statistical rating organization (NRSRO) in 1975. It rates a variety of scales (credit ratings, scores and other relative opinions relating to financial or operational strength). It provides long-term and short-term credit ratings and gives ratings describing the relative ability of a particular company to meet its financial obligations (e.g. interest, repayment of principal, counterparty obligations etc.). There are two kinds of grades used: long-term: AAA (highest credit quality), AA, A, BBB, BB, B, CCC and CC, C, RD, D (default). Grades „AAA” to „BBB” called investment grade indicate low to moderate risks, and grade „BB” to „D” called speculative grade indicates higher level of risk or even default has happened; grade „NR” or „Not Rated” – used to indicate securities not rated by this agency. Short-term grades have been split by the following grades: F1 (highest short-term credit quality), F2, F3, B, C, RD, D (Default).

*Standard & Poor's* – established in 1960, defining financial research and analysis on stocks and bonds applying credit ratings for debt of public and private corporations and similar to Fitch Ratings issuing long-term (investment/ non-investment grade) and short-term credit ratings. It rates borrowers on a scale from AAA (highest rating), AA, A, BBB, BB, B, CCC, to CC, C and D (payments default on financial commitment). Ratings from AA to CCC could be modified by addition of „+” or „-” showing relative standing within major categories (e.g. BBB+, BBB, BBB-).

*Moody's Investors Service* – this system was developed by John Moody in 1909 with the aim to provide investors with a simple system of gradation by which future relative creditworthiness of securities may be gauged. Gradations of creditworthiness are indicated

by rating symbols (long-term and short-term), with each symbol representing a group in which the credit characteristics are broadly the same. It consists of the following long-term symbols: Aaa Aa A Baa Ba B Caa Ca C, showing least (A) to greatest (C) credit risk. And short-term symbols – appends numerical modifiers: P1 (superior ability), P2 (strong ability), P3 (acceptable ability) to each generic rating classification from Aa through Caa and NP – meaning that do not fall in any of prime rating categories.

The author has studied the key players among the credit rating agencies, their history and main activities; and has come to a conclusion, that credit rating is a useful, easy to use tool that investors or possible investors can use in order to decide, whether to purchase bonds and other fixed income assets of a particular company. It is also necessary to understand that these ratings are not something like investment advices or recommendations for future activities to be performed in the stock market, but only one of several key factors to be considered before deciding on possible investments. Also, the credit rating applied is not a guarantee for investors that this investment will be with 100% guarantee for the future incomes, but it is necessary to understand that it is only one of the key tools to be used before taking an important decision.

## Corporate Governance, Assessment of Quality of Financial Information within the Corporate Governance System in an International Retail Company

In this section, the author gives a short overview of the corporate governance system and quality of existing financial information in this system in the international retail company *Latvia Statoil Ltd*. This company is a subsidiary of company *Statoil Fuel & Retail* – a leading Scandinavian road transportation fuel retailer, which has been operating for more than 100 years. It has been listed in the Oslo Stock Exchange (since the year 2010) with goal to achieve the growth and development by possible access to capital markets. The company's board of directors consisting of eight persons is responsible for managing the group and supervising the group's day-to-day management and its operations. The company's corporate executive committee consisting of 11 persons is responsible for company's daily operations and leading its strategy, goals and financial statements and investments. The author concludes that due to the fact that the company is listed one, of course, the attention to management and financial reports is much stronger. The author investigated that in order to develop and implement the new corporate governance within this organization, various activities have been performed. For example, changes in the management remuneration system (25–40 employees) have been made by implementing a share – base salary. The same process was applied for remuneration system of the board members. The group has implemented tax motivated share saving program for ordinary employees in some countries – Norway, Sweden and Denmark. Because of the company's new status,

its management has, in the process of development of clear and transparent relations with its investors, performed quarterly reporting, analyzed relations, held regular meetings and made various conference calls to investors.

The author has discovered that the company is already paying attention to transparency of financial data. It is done mainly by improving the existing processes within the company (e.g. more detailed, regular reporting, specific reports concerning definite areas and cost centres, etc.). The author has also explored, that one of the company's main strategic goals for next 3–5 years is improvement of capital efficiency by optimizing its balance-sheet (because long-term assets are the most significant position in company's assets on the balance-sheet). Therefore, it is planned to develop the real estate asset management strategy (real estate optimization project). The main goals of this project are to:

- establish a strategy with a view to develop long-term value for these assets;
- maintain necessary operational control and flexibility;
- develop common database for the real estate portfolio;
- optimize and standardize the strategy among markets;
- increase capital efficiency, profitability;
- maximize shareholders' and customers' value etc.

## Conclusions and Recommendations

### Conclusions

Based on the results of this paper, the author has made the following conclusions:

- 1) Company's competitiveness depends on various financial and non-financial factors, as well as their mutual influence. One of the factors – corporate governance significantly influences the processes related to existing and planned investments.
- 2) Corporate governance includes a few internal control mechanisms (e.g. board of directors, ownership concentration and executive compensation), external control mechanisms (e.g. stock price performance, institutional investors), multiple control mechanisms and proxy contests.
- 3) Before shareholders take important decisions they need to have access to *all* the information needed, but in real life this opportunity is provided only for management, thereby, shareholders receive all information from management.
- 4) The quality of financial information plays essential role, and one of the characteristics of company's effective financial reporting is *transparency* of financial information.
- 5) Based on evaluation of the quality of existing financial information, the current corporate governance of *Latvia Statoil Ltd.* – an international retail company listed in the Oslo Stock Exchange in 2010, needs to be improved.

- 6) Due to the fact that financial reporting of *Latvia Statoil Ltd.* (also, *Statoil Fuel&Retail*) is one of the aspects where substantial improvements are required to ensure company's reporting process at the highest level, the following activities are suggested for company's management:
- to ensure transparency in reporting of financial data and key drivers;
  - to ensure that company's analysts (e.g. Barclays Capital, Carnegie, Danske Bank, Nordea, Pareto, ABG Sundal Collier, Terra, Handelsbanken, Bank o America Merrill Lynch, etc.) and their reporting are not influenced, as well as that the analysts' opinion does not affect company's reports;
  - significant concentration on the development and improvement of the existing reporting system in order to ensure a clear reporting system;
  - to ensure transparency of figures and strategies for shareholders;
  - to ensure qualitative and efficient mutual communication between company's investors and research analysts.
- 7) From the results obtained it can be concluded, that due to the fact that long-term assets (mainly real estate) are a really significant position on the balance-sheet of *Statoil Fuel& Retail*, and taking into account the current situation in the world economy (incl., in the real estate market) the company's management has to ensure transparency of financial accounting at the highest level and improve existing disclosure, especially on financial reporting of long-term assets (real estate).

## Recommendations

Based on the results of the research and conclusions, in order to evaluate the quality of financial information within company's existing/planned corporate governance system and to develop possible improvements, the author defined key criteria for the evaluation process. The author suggests using the *BPS Corporate Transparency Measurement Scheme* developed by Bushman, Piotroski and Smith (2001). The author used this scheme to ensure evaluation of the quality of corporate reporting, measurement principles, timeliness and credibility of disclosures.

Key elements to be measured and evaluated to ensure quality of company's financial information are: financial accounting disclosures, segment disclosures, subsidiary disclosures, footnote disclosures, governance disclosures (e.g. identity of major shareholders/managers/ board members/ affiliations, range of shareholders, remuneration of officers and directors, shares owned by officers, directors), timeliness of disclosures (frequency of reporting, etc.), accounting policies, credibility of disclosures (share of Big-4 accounting firms in total value audited) and other (e.g. availability of financial statements in English etc.).

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- [www.theiia.org](http://www.theiia.org) – website of the Institute of Internal Auditors.



# THE EXPERT ASSESSMENT OF THE MINERAL RESOURCE MARKET DEVELOPMENT IN LATVIA

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## Abstract

Mineral resource extraction and use are important to the economy. When economic conditions are changing it is important to know how market will evolve in the future. The present study aims at defining the general future direction of the Latvian mining industry, using expert method. Based on the Analysis of Hierarchy Process (hereinafter in the text – the AHP) method, the experts proposed “building production of mineral resources sector” as the main alternative. This market can increase the number of jobs and provide a stable salary in the industry, as well as the opportunities for improving the quality of life. In the opinion of experts the second most important alternative is the development of regional infrastructure and mineral stocks, high-quality research.

**Key words:** *analysis hierarchy process, mineral resource, expert, market, assessment*

## Introduction

Wealth of natural resources, incl. subsoil, plays an important role in the national economy of Latvia. The author of the present paper is talking about the subsoil wealth, while many authors call it “beneficial mineral resources” (gypsum, clay, limestone, dolomite, quartz sand, sand, gravel) (Segliņš, 2007: 4). Mineral resources are used as building materials or in construction of buildings, roads, railways. The development of mineral resources market is linked to job creation, technology development, acquisition of mineral properties etc.

The aim of the research is to clarify the strategy for mineral resources market development using the AHP method (Jankova, 2011: 2).

## Research Results and Discussion

To determine the direction of market development, the AHP method was applied (Ramute, 2008:1). The method involved seven experts (a road construction expert, a specialist in construction, two environmental experts and one expert from each of the

following institutions: the Ministry of Economics, the Investment and Development Agency of Latvia, the Latvia University of Agriculture, the Faculty of Economics).

Mineral resource extraction and use occurs in the whole territory Latvia, and it means that it is a part of the market, which brings income for businesses, residents and the Treasury.

The author establishes a hierarchy in the research. It consists of the following four levels (see *Figure 1*):

- the goal of the mineral resource market development is set;
- expert assessment of the AHP criteria;
- market characteristics of grouping by the principle of reasonableness;
- the mineral resource market development alternatives; evaluated by applying the second and third level criteria.

The basic issue for experts was the development of the market of mineral resources extraction in Latvia. The author groups the mineral resource extraction in Latvia by specific interest groups (national interests, regional interests, municipal interests, business interests, personal interests and formal criteria). The author has defined each interest group in a hierarchical analysis, which consists of three levels.

The results of the research show the alternatives and criteria for the development of the resources market, which have been evaluated by the sector experts.

The author presents an alternative for the development of the mineral resources market (see *Table 1*).

*Table 1*

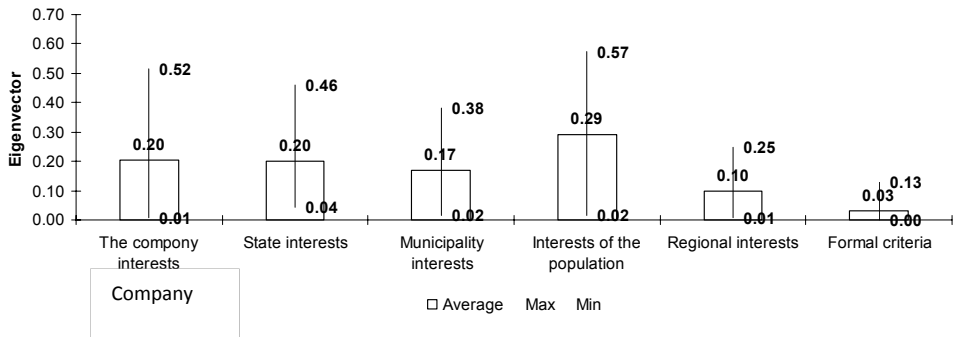
**Alternative Models of the of  
Mineral Resources Extraction Development in Latvia**

No.	Alternative models	Characteristics
1.	Steady development of the mining industry of all regions	Steady development of the mining industry of all the regions with high added value is the possibility to sell the end product in domestic and international markets
2.	Enrolment of foreign investment and an enterprise in the industry	Fast development of extraction and processing industry focused mainly on foreign markets, attracting foreign investment
3.	Development of mineral resources sector for construction materials	Development of the regional construction manufacturing with the aim to sell in domestic or foreign market
4.	Development of new materials production for exports	To develop mineral resource extraction and processing industry, offering new materials with new properties that meet local and international market requirements

*Source: Author's survey*

To fill up the analysis of the hierarchical matrix, the experts use the criteria assessment according the methodology to the nine-point scale (Saaty, 2008: 5).

In order to better explain the importance of expert evaluation, standard deviation (S) and the coefficients of variation (V) are calculated. The coefficient of variation shows squared deviations percentage and makes it possible to compare responses (Gringlazz & Kopitovs, 2003: 3). The small coefficient of variation is indicative of the state of phenomena, but a high coefficient of variation indicates, that the results are not relatively stable.

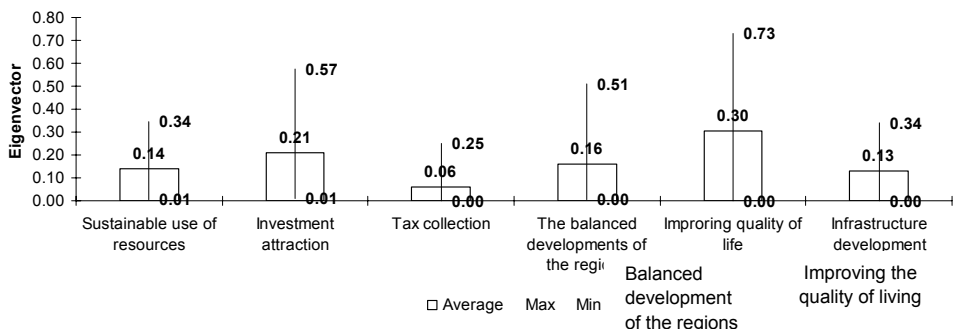


Source: Author's survey

Figure 1. Expert assessment by mutual comparison of interest groups of the development of extraction of mineral resources market.

Aggregating experts' view and comparing it with different set of criteria groups (Figure 1), the highest assessment is given to “state interests” (0.461) followed by the “interests of the population” (0.381), “municipality interests” (0.344), “company interests” (0.275), “regional interests”, “formal criteria” (0.157).

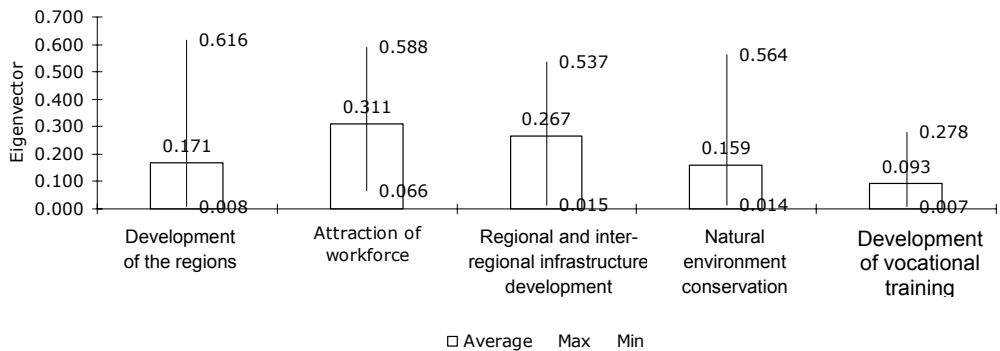
Calculating the variation coefficients of the criteria group, the lowest level includes “municipality interests” (75%) and “state interests” (76%), followed by “interests of the population” (86%), “company interests” (93%), “regional interests” (98%), “formal criteria” (143%). The lowest index shows that the experts’ viewpoints are similar.



Source: Author's survey

Figure 2. Expert assessment of the state interests in the development of the mineral resources.

Experts analyzed the criteria of the data group and obtained the following results. The national interest group (Figure 2) – the highest rate – “improving the quality of living” (0.728), followed by “investment attraction” (0.574), “balanced development of the regions” (0.509), “infrastructure development” (0.343), “sustainable use of resources” (0.341), while the lowest score goes for “tax collection” (0.252). The groups of vectors which coordinate the minimum and maximum value are broad. It has been indicated by the expert assessment which is not of equal significance. The variations coefficient shows the experts’ opinions on the criteria of public interest groups, which show the approach “improving the quality of life” as the highest (87%), followed by “sustainable use of resources” (96%), “investment attraction” (105%), “infrastructure development” (110%), “balanced development of the regions” (117%) and “tax collection” (144%).

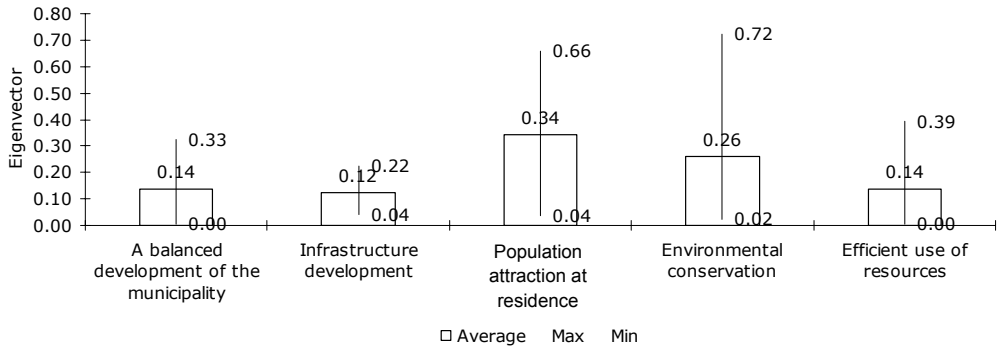


Source: Author's survey

Figure 3. Expert assessment of the development of regional interests of the mineral resources market.

Experts have given the highest rating (Figure 3) to the regional interest in group “development of regions” (0.616), lower score to “attraction of workforce” (0.588), “natural environment conservation” (0.564), “regional and inter-regional infrastructure development” (0.537), while the lowest score – “development of vocational training” (0.278).

The lowest index calculated and assessed by experts has the greatest viewpoints of coincidence, "attraction of workforce" (64%) and "regional and inter-regional infrastructure development" (76%). The biggest amplitude of average in experts’ opinion is: "development of vocational training" (116%), “development of regions” (121%) and "natural environment conservation" (132%).

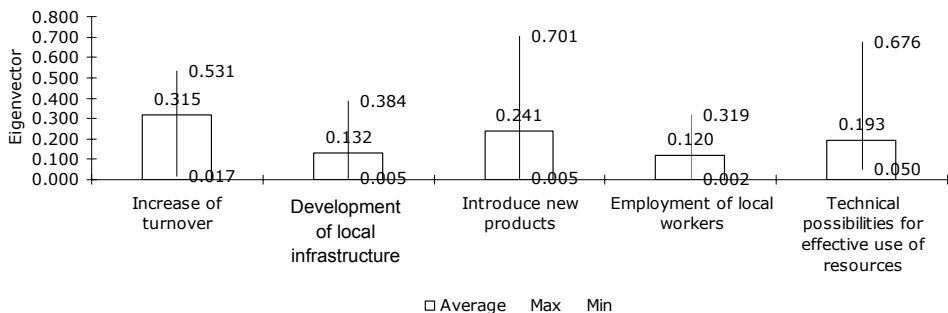


Source: Author's survey

Figure 4. Expert assessment about the development of municipality interests of the market of mineral resources.

The municipal interest group, which is represented by local authorities and helps to develop business, is one of the most important (Figure 4). The highest rating has been given to "environment conservation" (0.722), lower levels – "population attraction at residence" (0.660), "efficient use of resources" (0.395), "balanced development of the municipality" (0.326), while the lowest score for "infrastructure development" (0.223). The range of the municipal interest group ratings is wide; however experts give low assessment to "infrastructure development" category, but dipped amplitudes suggesting about the chief role of municipality in the infrastructure.

Calculating the expert assessment variation coefficient, the variation coefficient with the lowest value (61%) is "infrastructure development". "The population attraction at residence" has (64%), while "environmental conservation" (88%). According to the experts' opinion, the biggest difference is presented by "balanced development of the municipality" (101%) and "effective use of resources" (107%).

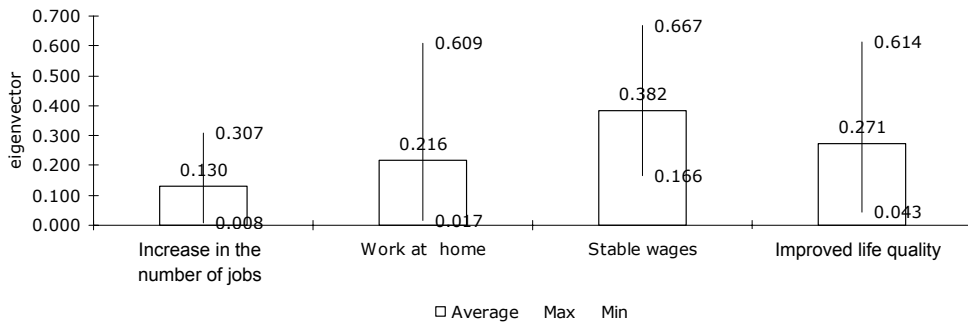


Source: Author's survey

Figure 5. Expert assessment about business interests in the development of mineral resources market.

In today's rapidly changing economic environment, it is important to be able to compete (Figure 5). The experts have given the highest rating to the criterion "introduce new products" (0.701), but it is closely related with "technical possibilities for effective use of resources" (0.676). Logically, the third criterion is "increase of turnover" (0.531) – the companies' turnover is important; however the lowest rating is assigned to "development of local infrastructure" (0.384), and "employment of local workers" (0.319).

The coefficient of variation shows that the assessment "increase of turnover" (64%) and "development of local infrastructure" (97%) are the lowest among the business interest groups. The highest variation coefficient is for "employment of local workers" (106%), "introducing new products" (111%) and "technical possibilities for effective use of resources" (118%).

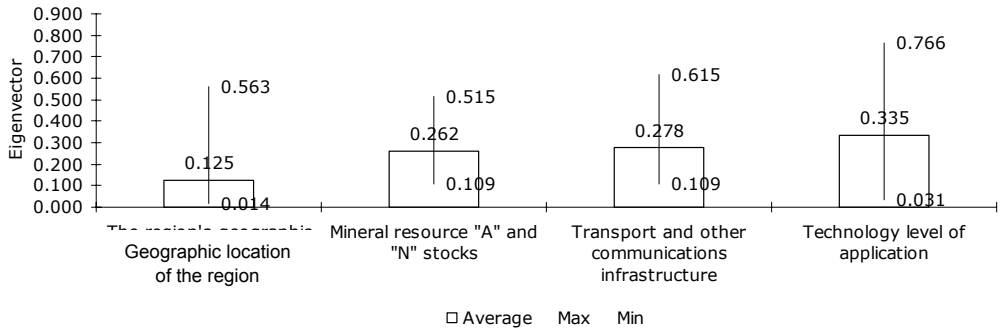


Source: Author's survey

Figure 6. Expert assessment about the population interests in the mineral resources market development.

The main mineral resources are located near populated rural areas. Experts deal with the population interest and natural environment of conservation, employment, good infrastructure, availability of services (Figure 6). The highest criterion in the citizen group interest is "stable wages" (0.667), but the criterion "work at home" has (0.609), while "improved life quality" experts have valued as (0.614). "The increase in the number of jobs" has the lowest criterion value (0.307).

Calculating and comparing the variation coefficient, the experts have assigned the lowest rate and given the biggest coincidence to "stable wages" (45%), "life quality of the improving" has (82%), but "increase in the number of jobs" (94%). The highest coefficient of variation is for "work at home" (104%).

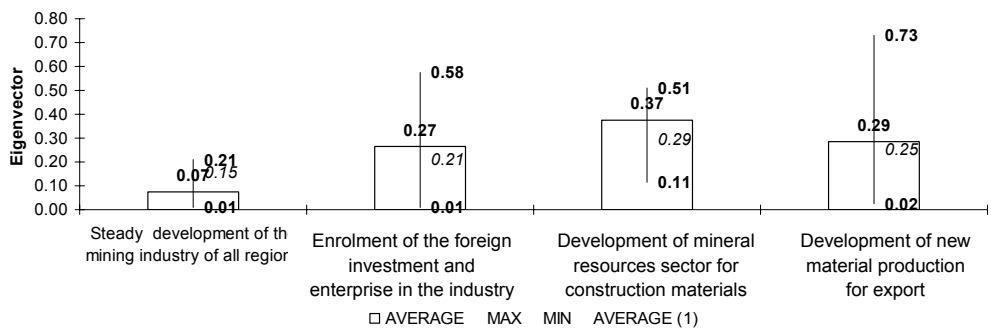


Source: Author's survey

Figure 7. Expert assessment of the formal factors of the mineral resources market development.

The formal factor of the assessment of the highest value is "technology level of application" (Figure 7) that is the highest value in a priority, vectors (0.766). The second level is "transport and other communications infrastructure" (0.615), followed by „geographic location of the region" (0.563), „mineral resources for A and N stocks" (0.515). Experts give the highest assessment for "mineral resource for A and N stocks" that is the related to the resource extraction quality.

The expert variation coefficients show that the mining of mineral resources "A" and "N" stocks is an important criterion (59%), but "transport and other communications infrastructure" (61%) is less important, followed by "technology level of application" (82%) and "geographic location of the region" (158%).



Source: Author's survey

Figure 8. The expert assessment of the market development alternatives.

According to the fourth level of the expert rating (Figure 8), the highest value is assigned to "development of new materials production for export" (0.731), second best alternative is "enrolment of the foreign investment and enterprise in the industry"

(0.576), followed by "development of mineral resources sector for construction materials" (0.512), "steady development of the mining industry of all regions" (0.209). By comparing the levels (matrix multiplication), the main alternative to the highlighted is the "development of mineral resources sector for construction materials" (0.294) (see curve "AVERAGE (1)"), the second best alternative is the "development of new materials production export" (0.249), followed by "foreign investment in the mineral extraction sector" (0.209), "steady development of the mining industry of all regions" (0.154).

## Conclusions

1. The hierarchical method has revealed the following factors influencing the market development:

- The efficient market development depends, firstly, on the people's interests and, secondly, on the state interests.
- For the provision of the state interests, the experts forward the quality of living as the main criterion. Great attention is paid also to the sustainability of resources.
- The labour force and its attraction to the production is a driving force of regional development. The experts also highlight the great importance of the regional and inter-regional infrastructure development.

2. In the experts' opinion, a stable salary can attract workers, improve the quality of living and develop the production.

3. Experts believe that the developed regional infrastructure and the explored mineral resources can ensure the development of mineral resources market.

4. The most significant alternative is the production of building materials and mineral resource extraction development that can develop also the market of the sector.

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# **SOCIAL INVESTMENT IN BUSINESS AS A BASIS OF MODERNIZATION OF ECONOMY OF THE COUNTRIES IN THE CONDITIONS OF GLOBALIZATION**

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## **Abstract**

This work is devoted to the problems that have multiple dimensions of social investment in the business which do not have fundamental and comprehensive reflection of the economic literature. We consider social investment in the business as a basis for modernization of economies. Research of problems of modernization of society, modernization of economy of the state, becoming and development of the social states, companies in recent year is actively examined by scientific circles, public institutes, and also representatives of central and executive government bodies. Just the same approach predetermines interest in this range of problems.

**Key words:** *social investment, modernization of the economy, globalization, investment scope, investments, innovations*

## **The impact of globalization on the country's economic processes**

Present time is characterized by permanent economic, sociocultural, political changes that embrace the whole world. Such changes are accompanied by the tendency of globalization that grew into mighty force, stimulates a world economy, world order, allocation of resources, competition. As a result, political and economic priorities move from local and national levels on levels regional and international. The growing role of globalization touches development of world community, and cardinal changes in the field of international relations are characterized by transformation and modernization changes, and carry out direct influence on development of the world countries, including Ukraine that is on the transitional stage of the development.

Thus, realities of our life it, foremost, growing role of the globalization. Globalization as process in itself is not bad, and is not good. In a “new economy” negative or positive she is done by the mechanisms of introduction in life. For the most world countries

she did not bring the expected benefit, and moreover turned around for them a catastrophe: ruined the environment of existence, increased a corruption, resulted in the increase of unemployment, disintegration of social structures, and origin of ethnic conflicts. And it all arose up, in opinion of Nobel laureate in the economies (in 2001) of Joseph E. Stiglitz, on that reason, that globalization moved up the financial structures and transnational companies that is closely bound by commercial interests interested in the benefit (Стиглиц, 2003: 28, 41). Exactly business foremost, interested in these changes.

Today most specialists examine globalization from positions of economy as follows (Scholte, 1996: 15 – 17):

- 1) globalization as internationalization – characterized by global international relations between countries and nations, that results in the increase of exchange and interdependence between countries;
- 2) globalization as liberalization – characterized by creation of boundless, liberal, free economy;
- 3) globalization as universalization – characterized as the world phenomenon, where commodities and knowledge spread for all to the world countries;
- 4) globalization as westernization or modernization – characterized by transformation of culture, powerful cultures, civilizations take in, absorb for itself less weak cultures, on verge of extinction there is part of modern “living” civilizations;
- 5) globalization as deterritorialization – characterized by transformation of cultures in the conditions of globalization (comes forward as a cultural condition of globalization) (Gil-Manuel, 2006). Deterritorialization is also examined in the acceleration of social life in a context (Eriksen, 2001; Scheurman, 2004; Scheurman, 2010).

Thus, today exactly globalization changed the geopolitical orientation of modern civilization process that opens before society enormous possibilities in expansion of exchange commodities, services, information, technologies and capital. Will mark that “globalization disconnects not less than, than unites, she disconnects, uniting – dissidences take place on the same reasons, that and increase of the world monotony. In parallel the process of localization moves to this process of planetary scale. Taken together these two closely interdependent to the process stipulate sharp differentiation of terms of existence of population of whole countries, regions and different segments of this population. That for one is globalization, for other – turns around localization; for one is the forecaster of new freedom, for other is an unexpected and hard blow” (Bauman, 1998: 6). The consequence of such motion is an unevenness of development of countries.

It costs to mark that only the last decades are characterized by that globalization substantially influenced on an economic constituent, namely coincided with an economic concept: the economies of countries are integrated in a world economy through trade, direct foreign investments, capital flow, migration and distribution of technologies (Bhagwati, 2010). As a result of what revolution is not only in human life but also to economic development of countries.

Thus, globalization develops not evenly, results in the unevenness of development of world economy, differently carries out influence on the different countries of the world, develops their instability that results in the danger of development from one side, and to the necessity of modernization of their economies – on the other hand. Taking into account that interested in globalization, and processes that take place there is business, then he must help the states in modernization of economies and adaptation of them to the new terms of ménage.

Most researchers, specialists of concept “modernization”, expose as a process of transformation of traditional society in society that is characterized to applications of machine technology and transformation in society with front-rank technologies, by innovations on the basis of knowledge. It costs to acknowledge that a concept “modernization” is not very clear, admits certain ambiguities to interpretation of his maintenance, but, at the same time, it more comfortable in the use as compared to other terms. Thus, in the article a term “modernization” we examine as totality of elements of the system of any level on the basis of innovations that touch base directions to human activity (economic, technological, social and others like that).

On verge of XX–XXI of centuries industrial society that leans against innovative modernization of industrial production is organically transformed in society of postindustrial type (informative society, society, is based on knowledge). Such modernization innovations are the basis of in area of science and education; high degree of creativity of subject of activity, business that uses the different world streams of information. At the same time, there is a decline of role of the state in parallel, why such factors promote, as (Ясин, 2007: 163–164):

- 1) intensifying of competition is between multinational corporations and small business;
- 2) completion of urbanization, aging of stationary population;
- 3) advantages (dignities) of the American model, advantage (dignities) of the European model (advantages of the American model are against European);
- 4) a competition of countries of going after development is with subzero nominal part of the government spending;
- 5) globalization and increase of role of international and regional institutes are at delegation to them of part of plenary powers of the national states.

Today modernized society can be examined as separate processes of economic, political, social and cultural modernization.

Modernization of economy foremost Ukrainian is for a country no alternative; knowledge as inexhaustible resource become the basic source of economic development gradually, that allow to provide firmness of national economy in relation to an environment (for example, by oscillation on world markets). Different institutional projects, what economies sent to modernization, will be realized for this purpose, attracting businesses.

It costs to mark that becoming of socially responsible business and social state on the whole was assisted by such reasons among that will distinguish most compelling reasons: globalization; reduction of public sector is in a social sphere; moving of private capital is through national limits (country's economic meltdown); considerable increase of private assets and incomes (influence is on the process of acceptance of political decisions, lobbying of business-interests).

## **Projects of modernization of economy of the state: socially responsible business**

Thus, Ukraine must develop for today, foremost, as the social state that must take into account interests of society. In the socially responsible state there must be socially responsible business, that assumes responsibility for a decision-making for those, on whom directly or these decisions are mediated influence. The responsible relation of the state and business that will be realized through social politics will assist the economy growing of the state will provide a high level and quality of life of population, to the decision of social problems. The basic social constituents of mechanism of steady development are: social responsibility, social integration, overcoming of mass apathy and parasitic community spirits, effective support of beggarly, high quality of population, effective worker and effective proprietor (Лібанова, 2010). Thus, the social investing of business comes forward to one of factors of modernization of economy of the state for providing of steady development.

In our view today institutional reforms in Ukraine only begin to be inculcated in practice; but in most these reforms touch a political sphere, their orientation talks that it quicker support of project of modernization "from above". The project of modernization "from above" is based on government control for assistance to development of economy. Really, on the stage of modernization of economy the function of assistance to development of economy must increase exactly. The project of modernization "from below" assumes an accent on legality and law and order, on providing of supremacy of law, on providing of independence of court and creation of mechanisms of democratic public inspection above all imperious institutes.

About the project of modernization “from below” in Ukraine (in the first decade of XXI of century) the question is not while, it obviously. The American researcher James Scott distinguishes four factors of failure of the state, when it sets so much to regulate and modernize an economy (Scott, 1998: 85–181): (1) it is an administrative ardor; (2) that J. Skott names high modernism. It is the exaggerated faith of technocrats in scientific rationality of planning. It is a characteristic limit of industrial epoch; (3) it is the authoritarian state that gives force for to bursting of ambitious projects and stopping of their criticism; and, finally; (4) weakness of civil society, that not in forces to offer resistance these actions of the authoritarian state. Last two factors especially dangerous, if they unite together.

International experience shows that by the main subjects of modernization, “from” below or “from above”, there are exactly the state and business. Coming from it, the state is examined as the state of development (Frye, 1997). It is such state that moves forward and supports economic development. Combination stably of high rates of the economy growing, structural changes in a national economy and improvement of quality of life of all population of country understands under such state (Саблин, 2010). Economic development takes form modernization: firstly, when the state carries out “introduction” of new mechanisms, stimulant development and realization of long-term strategy of development of economy of that or other country; secondly, when business stimulates research and design developments, uses technological, organizational innovations, that will result in the increase of GDP of country.

Thus, by means of production of blessing the economy growing is stimulated and provided steady economic development of the state. For this purpose it costs to provide realization of modernization project, under that the complex of measures understands on the acceleration of economic development of country by means of realization of converting into an institutional environment, bringing in of investments and mastering of new technologies, and also upgrading of human capital and creation of innovative infrastructure.

In such context a modernization process shows by itself dynamism of global processes. Then it is possible to distinguish such “circles of modernization” (Лось, 2010: 58):

- the first circle of modernization is a transition from the medieval model of development to the dynamics of New time;
- the second round is modernization of western type, the process of automation of spheres of activity and existence of society comes forward as technological basis of that;
- the third circle is modernization of western type, that is formed on verge of XX–XXI of centuries, that innovations are the basis of.

Economic modernization in basis has intensification of process of economic recreation; lately by a basic constituent her there is an increase of industrialization.

The first stage of economic modernization had a display through reforms, namely, liberalization of economy, financial stabilizing. Today is a next level of economic modernization that began in 2000th; for him the characteristic providing of competitiveness of economy of country is by means of increase of competitiveness of companies. It is today possible to consider a competitiveness, openness of national economies, flexibility (readiness is to the changes) the calls of economic modernization.

## **Social investments of business as component part of economic modernization of the state**

Modernization of investment sphere, that is modernization of organization of long-term investment capital with the aim of the extended recreation of capital assets by the institutional subjects of investment activity, comes forward as component part of economic modernization. In the state with the market economy of investment give the real increase of national income. An accumulation is the major source of modernization and extended production. Than more GDP goes to the accumulation, the higher rates of updating and modernization of capital assets, perfection of technologies, that positively influences on the increase of production of goods, increase of economic efficiency and economy growing. Receivable's increase in the state budget, and as a result of it, the increase of GDP increases in a future period. All of it assists realization of modernization of economy of the state.

Thus, forming of effective social economy of Ukraine in the conditions of globalization and further development and economy growing comes true by means of social investments of business.

Place of the social investing in business in the system of activity of company it is possible to present as a pyramid (*Figure 1*) (Баюра, 2011: 213).

The necessity of clear and pragmatic determination of category of the social investing is grounded by such factors, that presently practically not maybe on the basis of analysis of the social programs, corporate social (unfinancial) reports, ethic and corporate codes of companies to carry out and give an unambiguous estimation to the actions of company in the field of corporate social responsibility. The evaluation of level of the social investing can also become the form of clearer structuring of relations between business, society and power and indisputably would assist forming of socially market economy of country.

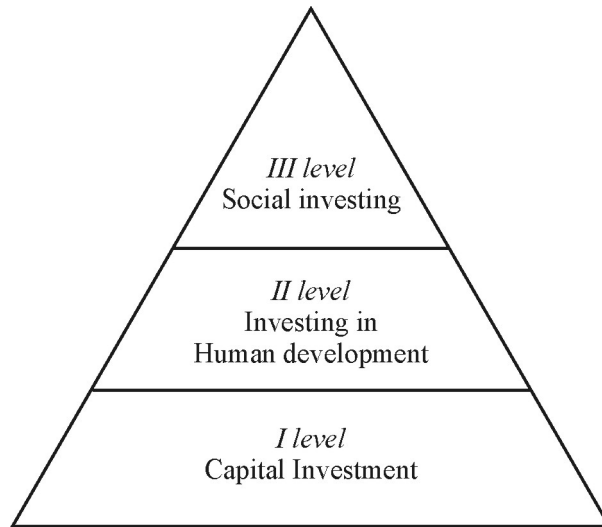


Figure 1. The social investing is in the system of investment activity and capital investments

At the same time, examine the social investments of business as the special form of financial or other resource help. Such help can given by corporations, for example, on realization of the long-term or compatible partner programs sent to the decline of social tension in the regions of presence of corporation and increase of standard of living of different layers of society and others like that. Social investments include the long-term programs and projects.

The social investing is examined both internal and external. The internal social investing in business will be realized through the programs of internal investments that as a rule, sent to:

- development of personnel, increase of professionally-qualifying level of population in the state;
- forming of corporate culture;
- improvement of health of nation;
- bringing in and support of young people, including in the educational programs; and sporting programs and others like that.

The external social investing in business will be realized through the programs of external investments, namely:

- grant competitions (what support talented scientists, young people from other countries);
- the having a special purpose and complex programs (including after participation with other countries);
- compatible financing research programs, projects and others like that.

Classifying the social investments of business is possible as follows:

- 1) the object of investment are investments in human capital, investments in the production of socially meaningful commodities and services, investment in the guard of environment;
- 2) after a kind are having a special purpose capital investments, actions and other securities; personal and immovable chattels; technical, technological knowledge are as technical documentation; right for using earth, by water, houses, building and others like that;
- 3) the nature of participating in an investment process are lines and indirect (portfolio);
- 4) after the aim of investment – to the market, investments for the increase of labor, profitable, forced;
- 5) on a form property – state, private, general;
- 6) commercialization of social sphere are commercial social investments, and noncommercial social investments;
- 7) after the method of realization and expected results are lines (provide the improvement of quality of human capital) indirect (provide public benefits and improve quality of life) and mixed (give public benefits and provide a human capital increase);
- 8) after the got effect social noncommercial investments are divided into investments oriented to the unmarked production of the social blessing of the general use, and investments are oriented to the production of the individual blessing;
- 9) on a regional sign are foreign, internal investments, national (local) investments, external (foreign) investments;
- 10) after the degree of risk – to the risk and risk free;
- 11) after the expected result – with a direct social effect, with an indirect social effect, with the mediated social effect;
- 12) after the period of investing – short-term, medium-term and long-term; but on other signs.

Among principles of the social investing of business in the context of modernization of economy of the state will mark the following:

- principle of efficiency and optimality that consists in creation of perfect and optimal socio-economic structure;
- principle of innovativeness, consists in the necessity of increase of efficiency of present innovations through their modernization;
- principle of the system gives an opportunity to examine the objects of the social investing as associate elements of the certain system, exposure of their



place in the system, functions, determination of tendencies, conformities to law of functioning and development;

- principle of synergies, consists in the achievement of the synergistically, animated effect ( $2+2=5$ );
- principle of problem, consists in the orientation of investments on the decision of social problems, but at the same time their realization must not generate new problems.

We should also mark that social investing is unable to work out power all social problems of the state that is why it follows more active to cooperate with business. So basic directions of social partnership of power and business are: participating in financing of scale investments that is initiated by power, in religious, medical, sporting, cultural objects; support of activity and forming of base of medical, educational and cultural establishments; realization of educational projects is for a population; assistance to development of culture, art, education, spiritual development; support of the innovative projects sent to development of local concord; guard of natural environment and defense of animals; support of unprotected groups of population and others like that.

Substantial role in modernization of economy of the state, her investment sphere and activation of investment activity of Ukraine, in the conditions of globalization, liberalization, able to play the direct foreign investments of corporations. Bringing in of direct foreign investments is normal world economic practice. Such financial resources are needed: firstly, on medium-term and especially on a long-term period for the economy of the state; and secondly, on a short-term period at external economic copulas.

Potentially Ukraine is one of attractive countries after the investments of direct investments, including social investments. And having an attractive investment climate, Ukraine can become and by an attractive country for portfolio foreign investments. Assists it her capacious internal market, presence of cheap and skilled labor force, scientific and technical potential, natural resources. But, in spite of attractiveness of home economy, private foreign capital as yet not play of considerable role as an additional sourcing for structural modernization of economy of Ukraine.

Such situation can be changed, if to spare more attention to the social investing in business as bases of modernization of economy of the state and to modernize an investment sphere, namely:

- 1) the volume of receivable's of foreign investments in a country must answer necessary necessities that it follows annually to expect. Thus basic attention it follows to spare to the mechanism of investing with the specification of state priorities, including on a social sphere;
- 2) to educe and find potential investors that will be able to carry out social investments in the economy of Ukraine. The state creates corresponding terms for motivation of potential corporate investors in investing of social

sphere in those directions that most necessary and priority for the state coming from this economic situation;

- 3) to assist minimization of risk and maximization of positive consequences of activity of private corporate investors, creation of maximally favorable environment for realization of effective investment activity, made service of informative essentials, support and state guarantees, that will allow to provide the increase of incomes of corporations with an investment capital, increase of receivable's in a budget and to the improvement of social infrastructure. Realization over of these directions will bring to realization of state aim – economy growing;
- 4) to form effective informative system, that would allow to the potential investors in a social sphere exactly to present the sizes of investing, and creation of transparent barriers of entrance to the investment market;
- 5) to provide stability of legislation in an investment sphere. For example, to accept an investment code. Today in Ukraine while unfavorable legislative climate in the field of the foreign investing; there is an enormous amount of normatively-legislative acts from adjusting of the foreign investing;
- 6) except legal measures it follows to accept and row of organizationally-technical that would assist to further development of socially responsible business in a country.

## Conclusions

Thus, summarizing accent attention on that modern civilization progress of economic and political planes of world economy trends induce the most world countries to form and enter the modernized economic model that would be adequate to the new global calls. To Tom, it is necessary to analyze the features of forming and development of world economy, that or other country, all aspects and consequences of tendency of globalization, that has a substantial theoretical and practical value for understanding of problems and prospects of development of world community, held in the context of socio-economic modernization of crisis period.

The decision of modern and perspective problems of world society is possible only at approaching, if not to the consensus, then to the structural compromise. And decision of all problems of constrained directly with modernization of economy of the state, Ukraine, his constituent of investment sphere and basic factor of increase of economy – social investments it maybe to decide by means of successive realization the systems of the associate economic, legal, organizational and informative measures sent to creation of attractive investment climate and revival of investment activity.

The state as yet cannot provide entering of social investments economy. It is therefore needed in the conditions of modernization of economy of Ukraine to change going near the social investing business thus, that by means of purposeful and system public policy corporate investments were examined as one of instruments of modernization of economy of our state, effective use of that impossible without state stimulation investing.

Thus, the social investing in business assists forming and becoming of socially market economy of the state and comes forward to one of factors of modernization of economy of the state that will assist providing of her steady development.

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## HOW DO MARKETS VALUE IFRS RECONCILIATION ADJUSTMENTS IN FINLAND

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### Abstract

This study focuses on the value relevance of the mandatory transition to International Financial Reporting Standards (IFRS), using a sample of Finnish first-time IFRS adopters. The Finnish data is used since prior research findings suggest large differences between Finnish Accounting Standards (FAS) and IFRS. The results suggest that aggregate IFRS reconciliations have an inconclusive impact on value relevance. The IFRS reconciliation adjustments on earnings seem to have an insignificant impact on value relevance. Correspondingly, the IFRS reconciliation adjustments on book value of shareholders' equity seem to somewhat impair value relevance. Our findings facilitate the anticipation of market consequences of major accounting changes also in other emerging markets. This knowledge is important for legislators, producers and users of financial reports alike.

JEL Classification: D82, G14, M41

**Key words:** *economics, accounting disclosure, accounting standards, IFRS, valuation impacts.*

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## Introduction

The primary role of financial accounting is to communicate information from companies to their stakeholders. Accounting standards and accounting harmonization across countries are crucial elements in this communication process. International Financial Reporting Standards (IFRS), launched by the European Parliament and Council, is a major attempt to harmonize financial statements, especially for companies listed in the European Union (EU) and member countries of the European Economic Area. Ball (2006) describes worldwide adoption of IFRS as an extraordinary success.

Accounting quality has economic consequences related to cost of capital (Leuz & Verrecchia, 2000) and capital allocation (Bushman *et al.*, 2006). Prior studies show that the adoption of IFRS improves accounting quality of listed companies in Europe, as evidenced in previous research (e.g. Leuz, 2003; Hung & Subramanyam, 2007; Barth *et al.*, 2008; Armstrong *et al.*, 2010; Horton & Serafeim, 2010). Jaafar & McLeay (2007) show that the harmonization process differs throughout countries and sectors. Findings based on Finnish data (Kinnunen *et al.* 2000) suggest that the predecessor of IFRS, International Accounting Standards (IAS), helps companies to supply information that meets the information needs of foreign investors.

Our study will evaluate how markets value the IFRS reconciliation adjustments of earnings and shareholders' equity required by IFRS 1 transition documents in Finland. These documents detail the reconciliation adjustments necessary to a listed company previously reported using FAS (Finnish Accounting Standards) to achieve compliance with IFRS. Prior research has shown that accounting practice in Finland deviates strongly from IFRS (Ding *et al.*, 2007). Reconciliations can enhance the association between accounting measures and market value thus providing value relevant information. If IFRS adjustments provide closer association to market values then the transition information benefits the market.

The topic is important since, in many countries and companies, globalization of accounting standards causes a need to prepare their financial statements using international accounting standards. Thus, the results provided useful insights for many other countries (e.g. in Europe and Asian countries) in roughly the same situation. On the other hand, very little is known about the value relevance of the mandatory IFRS transition. There are several reasons to apply the Finnish data for the evaluation of IFRS preparation and reporting. First, this paper links IFRS transition to the state of Finnish accounting legislation and its previous developments. Finnish accounting systems have been stakeholder-oriented, which has a major impact on taxation and governmental bodies. Second, prior studies (e.g. Kinnunen *et al.* 2000; Rätty, 1992; Kettunen, 1993; Pirinen, 2005; Ding *et al.* 2007) with Finnish data suggest that reconciliation adjustments (difference between FAS and IFRS) are quite large in Finland compared with many other countries.

Thus, Finnish environment provides especially fruitful environment to study what kind of financial statement implications IFRS adoption has for preparers and accounting information users.

## Finnish Content of IFRS Implementation

According to IFRS 1, the first-time adopter must provide comparative information for one year in accordance with IFRS. The year 2005 is special in the sense that companies had to report 2004 figures in line with local GAAP and IFRS. First financial information release based on FAS concerning the fiscal year 2004 and IFRS-related pre-reporting, second IFRS reconciliations concerning the fiscal year 2004, and finally financial information releases based on IFRS concerning the fiscal year 2005. Thus the companies have not released two sets of financial reports at one time. In line with the recommendation of the Committee of European Securities Regulators (CESR 2003), companies have performed IFRS pre-reporting.

The Finnish financial accounting regulation has been harmonized with the EU's Fourth and Seventh Company Law Directives by the two latest reforms of accounting legislation in 1992 and 1997. Historically, in Finland, the national accounting theory model "expenditure-revenue-accounting" (e.g., Pirinen, 2005; Näsi & Virtanen, 1998) has been highly influential in the developing of accounting legislation, teaching and research. The major differences between FAS and IFRS are described by Sahlström and Lantto (2009). Their study shows how IFRS implementation has affected financial ratios in Finland. Are these effects also value relevant (Barth *et al.*, 2001)? Our paper focuses on market valuation issue using an approach in line with Ohlson (1995). In that setting company's market value of equity equals company's book value of equity plus abnormal earnings. In other words, if a company earns only normal rate of return on its equity capital its market value of equity equals its book value of equity. Positive (negative) abnormal earnings will increase (decrease) the market value of a company, respectively. Thus our focus is on the earnings and the book value of shareholders' equity.

## Hypotheses and Methods

The literature provided two approaches to evaluate whether accounting numbers are related to stock market measures put forward by Collins and Kothari (1989:144). The first one uses an association study methodology and investigates the association between accounting measures and corporate market value. Accounting measures are said to be value relevant if they have a predicted significant relation to share prices (e.g. Barth *et al.*, 2001). Consequently, IFRS reconciliation is predicted to provide value relevant information for investors if the reconciliations enhance the association between accounting measures and market value. Thus, we test the following hypothesis: *The aggregate reconciliations*

on earnings and shareholders' equity are relatively and incrementally value-relevant over FAS.

Another approach called an event study methodology by Collins and Kothari (1989:144) is to investigate whether the information release, *per se*, causes investors to revise their cash flow expectations. However we recognize that there are several reasons that severely limit its applicability. First, if stock prices respond to new information quickly then the financial reports prepared under FAS contain detailed information in their notes about the accounting principles and it is possible that a careful investor may be able to reconstruct some IFRS adjustments by herself/himself. This means that adjustments are at least to some extent anticipated and priced. Second, taking into account a company's IFRS pre-reporting, the valuation impacts can be disseminated into prices to some extent even before the release of the reconciliation report. Finally, infrequent trading might cause noise in stock price data. The association study methodology employed is not especially sensitive when accounting numbers are exactly reflected in market values. IFRS are generally perceived more closely to follow fair values and therefore likely to incorporate the effects of economic events in a more timely manner in the financial statements (e.g. Alexander & Archer, 2001; IASB 2004, 25). The transition to IFRS can have major impact on the accounting figures reported by companies, due to the differences between FAS and IFRS.

### Models Related to Value Relevance of IFRS Adjustments

In line with Hung and Subramanyam (2007) we regress market value on both book value of equity and earnings variable (Ohlson, 1995). The set of models used are detailed below. Models (1) through (4) are used to test relative value relevance and models (5) and (6) are models for testing incremental value relevance, respectively.

$$MV_{it} = \alpha_0 + \alpha_1 BV_{it-1}^{FAS} + \alpha_2 EBIT_{it}^{FAS} + \varepsilon_{it} \quad (1)$$

$$MV_{it} = \beta_0 + \beta_1 BV_{it-1}^{IFRS} + \beta_2 EBIT_{it}^{IFRS} + \phi_{it} \quad (2)$$

$$MV_{it} = \chi_0 + \chi_1 BV_{it-1}^{FAS} + \chi_2 NI_{it}^{FAS} + \gamma_{it} \quad (3)$$

$$MV_{it} = \delta_0 + \delta_1 BV_{it-1}^{IFRS} + \delta_2 NI_{it}^{IFRS} + \eta_{it} \quad (4)$$

$$MV_{it} = \mu_0 + \mu_1 BV_{it-1}^{FAS} + \mu_2 BV_{it-1}^{IFRS-FAS} + \mu_3 EBIT_{it}^{FAS} + \mu_4 EBIT_{it}^{IFRS-FAS} + \kappa_{it} \quad (5)$$

$$MV_{it} = \nu_0 + \nu_1 BV_{it-1}^{FAS} + \nu_2 BV_{it-1}^{IFRS-FAS} + \nu_3 NI_{it}^{FAS} + \nu_4 NI_{it}^{IFRS-FAS} + \lambda_{it} \quad (6)$$



where  $MV_{it}$  is market value of shareholders' equity for company's  $i$  five days after the release of the IFRS reconciliation document,  $BV_{it-1}^{FAS}$  is opening book value of shareholders' equity under FAS for company's  $i$  reported in the reconciliation report,  $EBIT_{it}^{FAS}$  is earnings before interest and taxes under FAS for company's  $i$  reported in the reconciliation report,  $BV_{it}^{IFRS-FAS}$  is difference between IFRS and FAS book value of shareholders' equity for company's  $i$  reported in the reconciliation report,  $EBIT_{it}^{IFRS-FAS}$  is difference between IFRS and FAS earnings before interest and taxes for company's  $i$  reported in the reconciliation report  $\varepsilon_{it}$ ,  $\phi_{it}$ ,  $\gamma_{it}$ ,  $\eta_{it}$ ,  $\kappa_{it}$ ,  $\lambda_{it}$  is error term in Eq. (1), (2), (3), (4), (5), and (6), respectively.

Our relative value relevance models (Eqs (1) through (4)) will show, in the spirit of Ohlson (1995), how well FAS/IFRS  $BV$  and FAS/IFRS *Earnings* explain  $MV$ . Similar to Barth and Kallapur (1996) all the models (1) through (6) are first estimated using market value specification undefeated with a proxy for scale: number of shares. In order to examine the robustness of the results also various other specifications are employed (descriptive statistics are in *Table 2*). Price-per-share specifications are achieved using the number of shares outstanding (*NOSH*) as a deflator. Besides earnings before interest and taxes (*EBIT*) also net income (*NI*) is used as a proxy for earnings. Furthermore, industry specific fixed effect is considered and industry dummies are included into the model<sup>1</sup>. The results are estimated using White's (1980) correction for heteroscedasticity, while potential multicollinearity among the independent variables is examined by variance inflation factor (Rawlings, 1988: 277).

## Sample Description

The reconciliation data is hand collected from OMHEX homepage ([www.omhex.fi](http://www.omhex.fi)) where the press releases for each company are stored. Each transitional document (pre-announcement of IFRS impacts and reconciliation adjustments) was downloaded and relevant data collected. *Table 1* shows the number of listed companies in the HSE (Helsinki Stock Exchange) and the final sample after exclusions. The number of listed companies in the HSE is 133. After elimination caused by several reasons (early IFRS adopters, mergers, IPOs, incomplete IFRS transition information etc.) there are 86 companies (64.7 % of the HSE companies) with a statement comparing IFRS and FAS figures in the transition sample. *Table 1* shows that the market value of early IFRS users was 64.9% of the market value of the all listed companies on the HSE. This

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<sup>1</sup> When the regressions were run without industry dummies the results were very similar.

supports the conclusion that company's size is an important factor, which encourages a company voluntarily to publish IFRS figures.

Table 1

**Stage of Transition to IFRS on 1<sup>st</sup> April 2006**

Category	# of companies	# of companies in percentage	Proportion of market value
<b>Listed companies</b>	<b>133</b>	<b>100.0 %</b>	<b>100.0 %</b>
Early IFRS adoption	13	9.8	64.9
<b>First-time IFRS users</b>	<b>120</b>	<b>90.2</b>	<b>35.1</b>
Excluded (various reasons, e.g.,	17	12.8	15.4
Only opening IFRS balance	9	6.8	0.6
Separate opening IFRS balance	8	6.0	2.9
<b>Transition sample</b>	<b>86</b>	<b>64.7</b>	<b>16.2</b>

Descriptive statistics in Table 2 show that IFRS reconciliation adjustments tend to increase book value of equity and earnings. This is supported by positive mean and medium values for variables  $BV_{it}^{IFRS-FAS}$ ,  $EBIT_{it}^{FAS}$  and  $NI_{it}^{IFRS-FAS}$ . This is in line with Vieru & Schadewitz (2010) and Lantto & Sahlström (2009) who report a positive change in income statement numbers resulting from lower expenses.

Table 2

**Comparative Financial Statistics for the Sample of Recent IFRS Adopters (N=86)**

Variable	Mean	Std	Min	Median	Max
<b>Panel A: Key balance sheet and income statement variables (million euros)</b>					
$MV_{it}$	340.431	577.047	3.305	81.300	2 417.000
$BV_{it-1}^{FAS}$	155.760	267.884	1.051	45.960	1 375.000
$BV_{it}^{IFRS-FAS}$	0.644	23.575	-89.200	0.123	116.000
$EBIT_{it}^{FAS}$	34.721	74.134	-31.388	6.326	475.000
$EBIT_{it}^{IFRS-FAS}$	1.176	33.094	-221.200	0.653	104.000
$NI_{it}^{FAS}$	24.700	55.309	-33.841	4.667	313.000
$NI_{it}^{IFRS-FAS}$	4.606	14.774	-30.600	0.736	74.000
<b>Panel B: Key balance sheet and income statement variables (value-per-share)</b>					
$MV_{it} / NOSH_{it}$	10.878	18.306	0.100	6.140	128.103
$BV_{it-1}^{FAS} / NOSH_{it}$	5.415	6.966	0.017	3.596	38.004
$BV_{it}^{IFRS-FAS} / NOSH_{it}$	0.026	0.739	-2.932	0.013	3.841
$EBIT_{it}^{FAS} / NOSH_{it}$	0.940	1.752	-1.859	0.480	11.625
$EBIT_{it}^{IFRS-FAS} / NOSH_{it}$	0.097	0.422	-2.476	0.037	1.465
$NI_{it}^{FAS} / NOSH_{it}$	0.665	1.422	-2.004	0.371	10.276
$NI_{it}^{IFRS-FAS} / NOSH_{it}$	0.125	0.279	-0.520	0.051	1.454

Note:  $MV_{it}$  = market value of shareholders' equity for company's  $i$  five days after the release of IFRS reconciliation document;  $BV_{it-1}^{FAS}$  = is opening book value of shareholders' equity under FAS for company's  $i$  reported in the reconciliation report.  $EBIT_{it}^{FAS}$  = earnings before interest and taxes or under FAS for company's  $i$  reported in the reconciliation report.  $BV_{it}^{IFRS-FAS}$  = difference between IFRS and FAS book value of shareholders' equity for company's  $i$  reported in the reconciliation report.  $NI_{it}^{IFRS-FAS}$  = difference between IFRS and FAS net income for company's  $i$  reported in the reconciliation report,  $NOSH_i$  = number of outstanding shares for company  $i$ .

## Empirical Results

Table 3 presents the estimation results<sup>2</sup>. Industry specific fixed effect is considered by adding industry dummies into the model<sup>3</sup>. Table 3 shows relative value relevance analyses in Panels A and B and incremental value relevance analyses in Panels C and D, respectively. First, we discuss the results with relative value relevance models. The explanatory power of the relative value relevance model is fairly high ranging between 71.5% and 82.2% in Table 3 (Panels A and B). Also previous studies report quite high adjusted  $R^2$  (e.g., Hung & Subramanyam, 2007; Horton & Serafeim, 2010). In three model specifications the Vuong (1989) statistics suggest that the difference in explanatory power is insignificant at  $p < 10\%$  (two-tailed). The model presented in Table 3 (Panel B) having  $BV$  and  $NI$  as explanatory variables gains statistically significant difference between FAS and IFRS at  $p < 10\%$  (two-tailed). Similarly to Hung & Subramanyam (2007) and Horton & Serafeim (2010), the results imply that the combined value relevance of IFRS book value of equity ( $BV$ ) and earnings ( $EBIT$  and  $NI$ ) is marginally lower than that of FAS.

The coefficients on book value of shareholders' equity and earnings are analyzed next. In Panel A and B  $BV$ s according to FAS are systematically higher than  $BV$ s according to IFRS. As a whole the difference between FAS and IFRS  $BV$ -coefficients is at least marginally significant ( $p < 10\%$ ) based on SUR-estimation. The variable measuring the difference between IFRS and FAS book value ( $BV_{it}^{IFRS-FAS}$ ) has significantly negative

<sup>2</sup> We analyze potential multicollinearity among the independent variables. Rawlings (1988: 277) suggests a variance inflation factor,  $VIF > 10$  as a guideline for serious multicollinearity.  $VIF$ s of the variables in our regressions are clearly below that threshold value – the highest  $VIF$  is 6.72. In other words, multicollinearity, at least of the type recognized by  $VIF$ , does not bias our results. Because  $EBIT$  and  $NI$  greatly resemble each other (Pearson correlation coefficient is 0.96), those variables are in separate regressions. We also performed additional robustness check by excluding extreme observations (using 1% cut-off rule) in each variable. The results remain quite similar.

<sup>3</sup> In the table intercepts and industry fixed effects parameter estimates are not tabulated.

signs in market value specification regressions (*Table 3*, Panel A) and the variables measuring the difference between IFRS and FAS earnings ( $EBIT_{it}^{IFRS-FAS}$ ,  $NI_{it}^{IFRS-FAS}$ ) have positive but insignificant signs in Value-per-share specification models (*Table 3*, Panel B). This result suggests as Hung & Subramanyam (2007) that IFRS does not seem to improve the combined value relevance of book value of shareholders' equity and net income. However, shareholders' equity reconciliations tend to impair value relevance.

The results with incremental value relevance models are discussed next (*Table 3*, Panels C and D). Overall, the incremental value models explain market values well. The explanatory power of the models ranges between 77.9% and 83.5%. We find that the coefficient on book value adjustments in shareholders' equity is significantly negative at  $p < 5\%$  (two-tailed) in Panel C (Market value model specification). Panel D (Value-per-share model specification) shows that FAS earnings figure (*EBIT* or *NI*) alone (without IFRS-FAS adjustments) is statistically significant explanatory variable for value-per-share figure. Overall, relative value relevance models (*Table 3*, Panels A and B) and incremental value relevance models (*Table 3*, Panels C and D) show that *BV* according to FAS is strong explanatory variable for market value and for value-per-share. With earnings' variables (*EBIT* and *NI*) the obtained results are inconclusive.

The results suggest that aggregate IFRS reconciliations have an inconclusive impact on value relevance. The IFRS reconciliation adjustments on earnings seem to perform somewhat better than corresponding IFRS reconciliation adjustments on book value of shareholders' equity. Surprisingly, contrasting with our expectations, shareholders' equity reconciliations tend to impair value relevance. Thus, the aggregate IFRS reconciliations on shareholders' equity do not, on average, narrow the gap between book values of equity and corresponding market values. One reason might be that fair value estimates for tangible and intangible assets under IFRS are not properly recognized in financial statements but priced in market values. Thus, fair value estimates and their impairments might be still quite noisy (e.g. Bugeja & Gallery 2006; Hamberg *et al.*, 2011). However, removal of the amortization of purchased goodwill under IFRS 3 is the most important reason for a considerable increase in profitability ratios (Lantto & Sahlström, 2009; Jones & Higgins, 2006). Thus, fair value accounting has challenges.

**Relative and Incremental Value Relevance of Finnish (FAS) and IFRS Book Value of Stockholders' Equity (BV), Earnings before Interest and Taxes (EBIT) and Net Income (NI), N=86**

Panel A: Market value model specification, relative value relevance (Eqs (1) through (4))											
superscript	intercept	p-value <sup>a</sup>	$R^2$	p-value	$EBIT$	p-value	p-value	Adj. $R^2$	p-value <sup>c</sup>		
FAS	35.166	(0.045)	1.675	(0.000)	0.749	(0.699)		0.813			
IFRS	49.745	(0.010)	1.267	(0.003)	2.189	(0.332)		0.807			
IFRS-FAS <sup>b</sup>	14.578		-0.408	(0.127)	1.440	(0.146)	[0.183]	-0.006	(0.824)		
	intercept	p-value	$R^2$	p-value	NI	p-value	p-value	Adj. $R^2$	p-value		
FAS	34.868	(0.061)	1.570	(0.000)	1.773	(0.447)		0.822			
IFRS	43.934	(0.034)	1.324	(0.000)	2.557	(0.244)		0.809			
IFRS-FAS	9.066		-0.246	(0.284)	0.784	(0.477)	[0.164]	-0.013	(0.297)		
Panel B: Value-per-share model specification, relative value relevance (Eqs (1) through (4))											
	intercept	p-value	$R^2$	p-value	$EBIT$	p-value	p-value	Adj. $R^2$	p-value		
FAS	0.853	(0.428)	0.5469	(0.198)	7.441	(0.002)		0.796			
IFRS	0.532	(0.641)	0.2397	(0.644)	8.687	(0.001)		0.789			
IFRS-FAS	-0.321		-0.3072	(0.284)	1.246	(0.308)	[0.065]	-0.006	(0.851)		
	intercept	p-value	$R^2$	p-value	NI	p-value	p-value	Adj. $R^2$	p-value		
FAS	1.1483	(0.265)	0.8809	(0.002)	7.292	(0.002)		0.740			
IFRS	1.3558	(0.184)	0.5797	(0.120)	7.973	(0.005)		0.715			
IFRS-FAS	0.2075		-0.3012	(0.338)	0.681	(0.668)	[0.682]	-0.025	(0.067)		
Panel C: Market value model specification, incremental value relevance (Eqs (5) and (6))											
	intercept	p-value	$R^2$ FAS	p-value	$R^2$ IFRS-FAS	p-value	$EBIT$ FAS	p-value	$EBIT$ IFRS-FAS	p-value	Adj. $R^2$
Coeff. (p-value)	37.636	(0.011)	1.585	(0.002)	-2.908	(0.027)	1.118	(0.659)	1.410	(0.457)	0.833
	intercept	p-value	$R^2$ FAS	p-value	$R^2$ IFRS-FAS	p-value	$NI$ FAS	p-value	$NI$ IFRS-FAS	p-value	Adj. $R^2$
Coeff. (p-value)	33.387	(0.071)	1.591	(0.000)	-3.076	(0.036)	1.634	(0.488)	0.728	(0.860)	0.835
Panel D: Value-per-share model specification, incremental value relevance (Eqs (5) and (6))											
	intercept	p-value	$R^2$ FAS	p-value	$R^2$ IFRS-FAS	p-value	$EBIT$ FAS	p-value	$EBIT$ IFRS-FAS	p-value	Adj. $R^2$
Coeff. (p-value)	0.672	(0.545)	0.551	(0.164)	-3.766	(0.116)	7.431	(0.000)	2.742	(0.526)	0.820
	intercept	p-value	$R^2$ FAS	p-value	$R^2$ IFRS-FAS	p-value	$NI$ FAS	p-value	$NI$ IFRS-FAS	p-value	Adj. $R^2$
Coeff. (p-value)	1.075	(0.299)	0.884	(0.001)	-5.285	(0.157)	7.096	(0.000)	2.591	(0.656)	0.779

a) The two-tailed p-values for models (1) and (6) are estimated using White's (1980) correction for heteroscedasticity.  
 b) The difference of estimated coefficients is tested, first, with strong assumptions of equality of residual variances across the two regressions and normality (in parenthesis). Alternative p-values are also estimated taking into account correlation of residuals and without assumption of equality of residual variances and using SUR-estimation [in bracket].  
 c) The tests in adjusted  $R^2$  are based on Vuong (1989).

## Conclusions

Our main objective for this paper was to investigate value relevance of IFRS reconciliation adjustments in Finland. Keeping in mind previous findings (e.g. Lantto & Sahlström, 2009) of large difference between FAS and IFRS, the mandatory transition to IFRS in Finland provides a suitable platform upon which to evaluate the valuation of IFRS reconciliations adjustments. We report insightful results from Finland on how stock markets value IFRS reconciliations in a stakeholder-oriented accounting system with high law enforcement. The results are somewhat similar compared to value relevance of IFRS reconciliation adjustments in Germany (Hung & Subramanyam, 2007) and UK (Horton & Serafeim, 2010).

Overall, the findings suggest that aggregate IFRS reconciliations have an inconclusive impact on value relevance. IFRS does not seem to improve the combined value relevance of book value of shareholders' equity and net income. The IFRS reconciliation adjustments on earnings seem to have insignificant impact on value relevance. Correspondingly, IFRS reconciliation adjustments on book value of shareholders' equity seem to somewhat impair value relevance. Our sample consists of Finnish firms with mandatory IFRS transition which means that companies with voluntary transition are excluded. As the result our sample comprises small and medium sized listed companies. Foreign ownership of these companies is lower than that of large companies. Thus it is possible that the information users are more familiar with FAS figures than IFRS ones. Our findings facilitate the anticipation of market consequences of IFRS adjustments also in other emerging markets.

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## **PROBLEMATIC ASPECTS OF VALUE ADDED TAX AND THEIR IMPROVEMENT POSSIBILITIES IN LATVIA**

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### **Abstract**

The present research led to the conclusion that an increase in the effectiveness of collecting tax revenues for economic development can be reached by extending the tax base as well as by applying a selective scientific approach to tackling tax problems, especially in agriculture. The hypothesis of the research – *improving the Latvian tax system is necessary to ensure economic development and social justice* – stresses the need to make taxes simple, fair, comprehensible, and neutral. The scientific findings will be used to improve the regulatory mechanisms for developing certain industries by means of taxes in order to promote the sustainability of the national economy in the common EU market. Tax burden has to be differentiated according to income, thus reducing social tension in the country. An improved tax system has to promote the nation's wellbeing, culture and the emergence of a strong middle class by reducing the proportion of poor people in the society. It also has to prove its great economic and social role in the national economy. In 2011, amendments to the tax legislation were made in Latvia, which would have to increase tax revenues for the government budget. The basic VAT rate was raised from 21% to 22% and the reduced VAT rate – from 10% to 12%, whereas the PIT rate was reduced from 26% to 25%. Studies performed in Latvia and Lithuania in the period from 2007–2011 showed that VAT revenues in Latvia and Lithuania significantly declined. It means that raising the VAT rates in Latvia and Lithuania did not increase tax revenues for the government budget and the development of economic activity was not observed. The Latvian tax system has to be reformed and improved according to the principle of paying capacity, at the same time national interests have to be taken into account.

**Key words:** *tax system, value added tax, world practices*

## Introduction

The amendments made to tax laws are oriented towards increasing budget revenues; however, no possible impacts of these changes on the economic situation, future development of the economy, and population's paying capacity are taken into account.

During an economic recession, a large proportion of the population having loan commitments is a hindering factor for implementing tax policies and for economic development.

A positive effect on tax revenues used to be more explicitly observed in countries where population has less loan commitments. Since the proportion of population with loan commitments is quite high and the economic recession is observed in Latvia, one can conclude that the expected tax revenues will not be collected for the government budget.

Therefore, the large loan commitments of the population (mortgage and consumption loans) are a hindering factor for implementing tax policies and for developing the national economy.

To overcome such a big economic crisis under the present conditions and to provide the financial sustainability of the European countries as well as to increase the competitiveness of the continent, countries have to cooperate to a greater extent than ever, and it urges the EU to reassess the coordination of its economic, incl., fiscal policies.

Since the beginning of the 1990s, significant changes have occurred in tax systems of the majority of the EU countries. Their tax systems have been reformed several times by taking into account sometimes even controversial interests. An increase in revenues is required and expected from fiscal systems so that the Maastricht criteria and their stability are met. On the other hand, a decrease in fiscal pressure is required along with a possibility to foster GDP growth and the factors impacting its growth as well as to raise the employment rate. While improving the tax system, new solutions to the problems emerge, for instance, extending the tax base etc. It has been reoriented from overall tax stimulation to selective tax stimulation, mainly in such areas like small enterprises, investment feasibility studies, risk capital etc.

Tax policy has many and various goals. They include: redistributing income of all residents by providing areas related to education and in-service training of residents, increasing work capabilities of individuals by means of health care and social care, ensuring public order and security, providing national defence, promoting national culture and sports etc. To achieve the above-mentioned goals, the government can introduce a tax system that is oriented towards interests of rich classes or one that includes the principle of justice.

The overall goal is to increase the national economy's efficiency, thus emphasising the need to make taxes simpler, more comprehensible and neutral.

The tax policy of any country is developed by taking into account its national interests. The Latvian tax system has to be reformed according to the principle of paying capacity. Taxes have to be paid by those who are able to do it, thus reducing social tension in the country. The tax system has to promote the nation's wellbeing and culture, as well as the emergence of a strong middle class by reducing the proportion of poor people in the society. It is also indicative of the great economic and social role of tax system in the national economy.

In the present paper, value added tax (VAT) revenues were analysed for the years 2009 and 2011.

The aim of the research is to investigate and reveal the performance of value added tax, its position in the tax system, and especially its reformation according to principles of taxation.

To achieve the aim, the following research tasks are set:

- investigation of the nature and role of value added tax;
- solution to the problem of value added tax in Latvia (in the aspects of the national economy's industries and of certain product groups);
- elaboration of recommendations for improving the performance of value added tax in Latvia.

Research methods: general analysis, descriptive, analytical and logically constructive methods and expert evaluations.

The paper is based on studies of improving the tax system in Latvia. In 2010, tax revenues amounted to LVL 3402.8 million or 73.9% of total government revenues, while non-tax revenues amounted to LVL 752.0 million or 22.1%. Thus, the role of taxes is great despite the fact that tax revenues tended to decrease over the recent years. In 2010, according to the Central Statistical Bureau's data, direct tax revenues accounted for 46.4% of the total tax revenue, incl., compulsory state social insurance contributions amounting to LVL 1157.5 million or 25.1%, which are used for special purposes. In 2010, indirect taxes amounted to LVL 1305.5 million or 28.3%; VAT revenues amounted to LVL 825.2 million or 17.9% and played a significant role (*Table 1*).

Like in many EU countries (e.g. Austria, Belgium, Germany, France, Italy etc.), the proportion of indirect taxes is high and the amount of social insurance contributions is large also in Latvia, therefore, the country belongs to the European continental system according to the criterion of tax pattern (Ketners, 2009).

*Table 1*

**Percentage Distribution of the Government Consolidated Budget Revenues in Latvia for 2005–2011**

<b>Tax and non-tax revenues</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Government consolidated budget revenues	100	100	100	100	100	100	100
Tax revenues	79.6	79.9	81.6	82.7	77.7	73.9	76.5
incl. PIT	15.9	15.8	16.6	17.9	15.4	16.9	15.5
CIT	5.6	6.1	7.5	8.8	4.2	2.4	3.8
IPT	1.9	1.6	1.4	1.2	1.5	1.9	1.8
PIT, CIT, IPT in total	23.5	23.5	25.5	27.9	21.1	21.3	21.1
Value added tax	23.5	22.4	22.5	19.5	16.9	17.9	18.8
Compulsory state social insurance contributions	30.4	24.0	25.7	24.5	28.1	25.1	25.3
Excise tax	0.6	8.8	8.4	9.4	10.6	9.9	9.5
Customs tax	0.3	0.5	0.5	0.5	0.3	0.4	0.4
Natural resource tax	0.7	0.3	0.2	0.2	0.2	0.2	0.2
Other tax revenues	0.6	0.5	0.9	0.7	0.5	0.5	0.5
Non-tax revenues, other payments and national level donations	20.4	20.1	18.4	17.3	22.3	26.1	24.2

*Source: Statistical Yearbooks 2005–2009, Budget Structure 2010, 2011.  
<http://www.valsts.kase.lv>*

Having analysed the government’s consolidated budget, one can conclude that due to the economic recession in 2008, the proportions of tax revenues changed – direct tax revenues accounted for 52.5% of the total tax revenue, but in 2011 this indicator fell to 46% or by 6.1 % – points; the proportion of indirect tax revenues fell as well (*Table 1*). VAT plays a significant role among indirect tax revenues. Over the analysis period, a relatively high proportion belongs to non-tax and other revenues in the total tax revenue – 24.7% in 2011 (*Table 1*). The main purpose of this paper is to analyse the value added tax paid by any consumer (buyer) spending his/her money income on goods and services as well as imposed on self-consumption.

At the end of 2008 in Latvia, a few tax rates were decreased and some were increased. The personal income tax rate was decreased from 25% to 23% based on the idea that individuals will get higher wages, however, at the same time the VAT rate was increased from 18% to 21%, but the reduced VAT rate was increased from 5% to 10%; on 1 January 2011, the VAT rate was increased from 21% to 22% and the reduced VAT rate – from 10% to 12%. However, the personal income tax (PIT) rate was reduced from 26% to 25% or by one percentage point. Therefore, a situation emerged that individuals with relatively higher wages not always spent them on consumption, but a great deal of the country’s individuals who had loan commitments paid their loans, even partially, since

there was a lack of money and the expected tax revenues were not collected. This assertion is proved by a study conducted in 19 OECD countries in 1970–2002 on an impact of fiscal policy on private consumption during economic recessions and growth periods (Tagkalakis, 2008).

Tax revenues are better collected in countries where the individual loan market is less expanded. Since the proportion of the population with loan commitments is quite high in Latvia and there is an economic downturn, one can conclude that the government will not collect the expected tax revenues. So, the large loan commitments of the population (mortgage and consumption loans) are a hindering factor for implementing tax policies and for developing the national economy.

After correction of the tax revenue forecast for 2008, the Territorial Departments of the State Revenue Service were not able to collect the necessary amount of revenues from taxpayers because the turnover of many enterprises had decreased due to the worsening economic situation in the country, which led to a decrease in VAT revenues as well as to laying off employees, that, in its turn, reduced social security contributions and personal income tax revenues. Just as with a decrease in activity in the real estate market, fee revenues gained from registering properties in the Land Register fell by more than a quarter (Vītola & Baraškina, 2010).

VAT revenues in Latvia are collected to a lower extent compared with other Baltic countries, as the proportion of its grey economy is one of the highest in the EU, reaching 38.1% of its gross domestic product (GDP). The grey economy of other new member states ranges within 18–20% (Sauka&Putniņa, 2011).

Since tax revenue problems are tackled by raising tax rates, many households and enterprises face problems paying their taxes. As of 1 January 2010, the total outstanding tax debt (excluding debt arising from exploiting state-owned capital) accounted for LVL 613.1, which was LVL 64.3 million or 11.7% more than on 1 January 2009; it was mostly made up of increases in debts of personal income tax and social insurance contributions. In the entire period of analysis, an increase in the outstanding debt of immovable property tax was also observed (*Table 2*); it amounted to LVL 1.2 million in 2010.

VAT debts in Latvia (*Table 2*) declined by LVL 7.4 mln in 2010 compared to 2009, whereas a slight increase was observed compared to 2008.

A justified question arises – is the rate of VAT correctly set in the country and what is the possibility to adjust and improve it, which means that individuals with higher income pay a higher tax according to the so-called progressive scale of rates?

Total tax revenue as a percentage of GDP is usually used as an indicator of tax burden. In Latvia, this indicator was continuously increasing from 27.2% in 2004 to 30.3% in 2008.

*Table 2*

**Tax Debts in Latvia in 2008–2010, mln LVL**

Taxes	2008	2009	2010	Change (2010/2009)	
				mln LVL	%
Value added tax	244.2	291.0	283.6	-7.4	-2.5
Personal income tax	59.5	97.0	145.6	48.6	50.1
Corporate income tax	34.7	53.7	59.1	5.4	10.0
Compulsory state social insurance contributions	39.9	66.5	104.0	37.5	56.4
Social tax	18.6	17.0	7.9	-9.1	-53.5
Excise tax	7.2	18.3	8.6	-9.7	-52.8
Immovable property tax	1.5	1.3	1.2	-0.1	-4.0
Other taxes	–	4.8	4.0	-0.8	-17.1
Taxes in total	405.6	549.7	613.1	64.3	11.7

*Source: Vītola, 2010*

Irrespective of decreases in the rates of few taxes such as the PIT and the CIT, the overall tax burden grows in the country. The proportion of tax revenues in GDP in the world is around 35% – within a range of 10% to 50%, but sometimes this range is exceeded. In 2009 and 2010, the tax burden decreased relatively sharply in Latvia, as the total tax revenue significantly fell; besides, tax revenues decreased at a greater rate than GDP in the period of analysis. The GDP contracted by 18.8% in 2009 compared to 2008.

Sweden and Denmark could be mentioned as the countries with the highest tax burden (*Table 3*). The countries with high taxes may be classified into two groups: the group of Nordic countries – Denmark, Sweden, Finland, and Norway; the group of the EU’s central part – Belgium, France, Italy, and Austria. The tax burden exceeds 40% in these countries. Cyprus is an exception because it had the tax burden below the EU average just a few years ago. In general, a trend is observed in the EU-27 countries that the most remote countries from the EU’s central part, especially in Eastern Europe, have lower tax burdens (*Taxation Trends in the European Union, 2009*).

*Table 3*

**Total Tax Burden as a Percentage of GDP in the EU-27 and Norway in 2008**

Total tax burden	Countries
< 30	Lithuania, Slovakia, Romania
30 – < 35	Latvia, Ireland, Poland, Estonia, Bulgaria, Greece, Malta
35 – < 40	United Kingdom, Portugal, Spain, Netherlands, Luxembourg, Germany, Czech Republic, Hungary, Slovenia
40 – < 45	Norway, Finland, France, Austria, Italy, Belgium, Cyprus
45 – < 50	Sweden, Denmark

*Source: developed by the authors based on EUROSTAT data, 2009*

To reduce tax burden on economy, the so-called tax-free (offshore) zones have been established. More than 50 world countries and their regions as well as several free economic zones in Latvia: Liepāja, Ventspils, Rīga, and Rēzekne belong to them. In these Latvian tax-free zones, a reduction of tax burden reached LVL 120 million in 2009, which accounted for more than 6% of the total tax burden in the country. Taxes of the above-mentioned zones are paid by other taxpayers, and additional studies have to be carried out on these zones. It has to be mentioned that even the GDP indicator is not an unambiguous one, as a methodology of computing GDP is not the same in all countries.

The law “On Value Added Tax” in Latvia has been in force since 1 May 1995; until 2009, the basic VAT rate was 18%. Any individual irrespective of his/her income level pays this tax rate when buying goods or services that are not exempt from VAT. A reduced VAT rate was 5%, but on 1 January 2009 the VAT rates were raised to 21% and 10% respectively, and these rates were effective in 2010 as well (Par pievienotās vērtības nodokli, 2011).

After the amendment to the law came into force on 1 January 2009, the VAT rates were classified as follows:

- the basic rate of 21% was also applied to 13 types of transactions that had a 5% rate before;
- the amendment to the law has not changed the application of 0% rate as well as exemptions from VAT.

The number of transaction types on which a 10% rate was imposed was significantly reduced, i.e., 13 types of transactions, which previously had a 5% rate were cancelled. The reduced VAT rate, which had doubled, was retained only for 8 transaction types that belonged to necessities (medicine, medical equipment and medical goods, products for infants, supply of heating, natural gas, and electrical energy, transportation services, and the press). Paragraph 6 of the law stipulates a 0% VAT rate for international trade, transportation, supply of goods and services, tourism, supply of goods and services in tax-free stores to individuals leaving their homeland for third countries or territories and other areas. On 1 January 2011, the VAT rate was raised again from 21% to 22% or by one percentage point. At the same time, the reduced VAT rate was raised to 12%.

In almost all countries of the world where the value added tax is collected, the VAT rates on several goods and services are differentiated according to the principle: lower rates than the standard rate are for necessities, whereas higher rates than the standard rate are for luxury goods and services. However, very essential goods, services and transactions are exempt from paying VAT.

*Table 4*

**VAT Rates in the EU-27 in 2009 and 2011, %**

Country	Basic tax rate		Reduced tax rate		Specially reduced tax rate	
	2009	2011	2009	2011	2009	2011
Belgium	21	21	6/12	6/12	–	–
Bulgaria	20	20	7	7	–	–
Czech Republic	19	20	9	10	–	–
Denmark	25	25	–	–	–	–
Germany	19	19	7	7	–	–
Estonia	18	20	5	9	–	–
Ireland	21.5	21	13.5	13.5	4.8	4.8
Greece	19	23	9	6.5/13	4.5	–
Spain	16	18	7	8	4	4
France	19.6	19.6	5.5	5.5	2.1	2.1
Italy	20	20	10	10	4	4
Cyprus	15	15	5/8	5/8	–	–
Latvia	21	22	10	12	–	–
Lithuania	19	21	5/9	5/9	–	–
Luxembourg	15	15	6/12	6/12	3	3
Hungary	20	25	5	5/18	–	–
Malta	18	18	5	5	–	–
Netherlands	19	19	6	6	–	–
Austria	20	20	10	10	–	–
Poland	22	22	7	5.8	3	3
Portugal	20	23	5/12	6/13	–	–
Romania	19	24	9	5/9	–	–
Slovenia	20	20	8.5	8.5	–	–
Slovakia	19	20	10	10	–	–
Finland	22	23	8/17	9/13	–	–
Sweden	25	25	6/12	6/12	–	–
United Kingdom	15	20	5	5	–	–

*Source: Pievienotās vērtības nodokļa normatīvie dokumenti, 2012; Taxation Trends in the European Union, 2011.*

In 2011, VAT basic rates as well as reduced rates were raised in several EU member countries: Greece, Hungary, Spain, Portugal, Romania, Slovakia, Finland, the United Kingdom, Latvia, Lithuania, and Estonia. In the period of analysis, the VAT rates were kept the same in such countries as Belgium, Bulgaria, Denmark, Germany, France, Italy, Cyprus, Luxembourg, Malta, the Netherlands, Austria, and Sweden, whereas Ireland reduced its basic VAT rate by 0.5 percentage points from 21.5% to 21% (Table 4).



However, in countries such as the United Kingdom, Portugal, and Romania, the VAT rates were reduced to cope with the economic crisis. During the economic crisis, the VAT rate was reduced by 2.5 percentage points – from 17.5% to 15% – in the United Kingdom for the period from 1 December 2008 to the end of 2009. In the post-crisis period – in 2011 – the rate was raised again by 5 percentage points. In Portugal, both the basic VAT rate and the reduced rate were lowered by 1 percentage point. France, too, announced that the VAT basic rate would be reduced for hotel and restaurant services from the rate of 19.6% to 14%. Anyway, such reductions of the VAT rate for a certain period foster business development. In these countries, the development of respective industries and, at the same time, tax revenues are boosted (Vītola & Baraškina, 2010).

However, in the majority of new EU member states, incl., Latvia, the situation with tax policies is different. To overcome the deep economic crisis under current circumstances and to ensure the financial sustainability of the European countries as well as to increase the competitiveness of the continent, the countries will have to cooperate as closely as never before, and it makes the EU to reassess the coordination of its economic, incl., fiscal policies.

Finland's Prime Minister Matti Vanhanen believes that problems of financial sustainability, in the long-term, can be solved by raising tax rates. For instance, rates of property tax and inheritance tax can be set at the national level. However, the above-mentioned taxes do not significantly increase turnover and, at the same time, tax revenues. Only changes in VAT, various excise taxes or income tax will bring real changes in a national economy (Bīders, 2009). The authors agree with Matti Vanhanen because VAT is a consumption tax that brings tax revenues in government budgets immediately, but it has to be mentioned that any increase in the above mentioned taxes might cause migration, businesses might be registered and/or services consumed in regions with lower VAT rates. For instance, the residents of Latvia living along the border of Estonia buy goods in Valga where the VAT rate by 2 %-points lower – 20%. That's why cooperation among the EU countries is necessary irrespective of the fact that taxation, according to laws, is a national level competence. The process will be difficult, still possible.

Since VAT is an indirect tax, it directly impacts incomes of poor people. This tax is an instrument for increasing the standard of living of the poor.

The gains or effectiveness of raising the VAT rate were estimated by analysing the VAT revenues collected in Latvia, Lithuania, and Estonia in the period from 2007–2011 (*Table 5*).

*Table 5*

**VAT Revenues and Rates in the Baltic Countries in 2007–2011, mln EUR and %**

Year	Revenues collected, mln EUR	Increase / decrease against the previous year		VAT basic rate, %	VAT reduced rate, %
		mln EUR	%		
Latvia					
2011	1110.3	-63.9	-5.8	22	12
2010	1174.2	38.2	3.3	21	10
2009	1136.0	-453.6	-39.9	21	10
2008	1589.6	-122.0	-7.7	18	5
2007	1711.6	–	–	18	5
Lithuania					
2011	2936.1	417.5	14.2	21	5/9
2010	2518.6	170.9	6.8	21	5/9
2009	2347.7	-843.9	-35.9	19	5/9
2008	3191.6	489.9	15.3	18	5/9
2007	2701.7	–	–	18	5/9
Estonia					
2011	1110.3	-137.9	-12.4	20	9
2010	1248.2	46.0	3.7	20	9
2009	1202.2	-111.1	-9.2	20	9
2008	1313.3	-112.2	-8.5	18	5
2007	1425.5	–	–	18	5

*Source: calculated by the authors based on the Latvian State Revenue Service's reports on tax revenues, Ministry of Finance of the Republic of Lithuania, Statistics Estonia, 2012.*

In the Baltic countries, the greatest amount of VAT revenues was collected during the years of economic boom – in 2007 and 2008 – when the basic and reduced rates were equal or 18% and 5%, respectively, in all three Baltic countries. Raising the VAT rate in 2009 has not proved to be right in none of the Baltic countries (*Table 5*). In 2009 in Latvia, the VAT revenues of the government consolidated budget declined by 39.9%, in Lithuania – by 35.9%, and Estonia – by 9.2%. The main reasons for decline are a decrease in the purchasing power of residents, outflow of labour from the country in search for a job, as well as an increase in the grey economy in the country.

One can conclude that the increase in the VAT basic rate has not justified itself. Value added tax is mostly introduced in the developed European countries, but not in the USA, Hong Kong etc. The VAT rates in the EU are mostly within a range of 0–25% and unprocessed agricultural commodities, medicines, educational services, real estate are exempt from paying this tax; therefore, the VAT revenues are lower if computed per all products sold. In this respect, there is no reason to assure that the VAT is high in the EU – it is high for several product groups, mostly those purchased by individuals with higher incomes (Sproģis, Vītola et al., 2000).

Increasing the wellbeing of residents, especially of the poor or people with low incomes, by eliminating the possibilities for gaining unreasonable incomes has to be one of the major goals of tax policy. As regards the value added tax, it has to be paid by anyone who does business, and it has to decrease speculative transactions. It has to be paid in any resale transaction (process) (Sproģis, Vītola et al., 2003). This tax has to establish effective ties between a producer and a consumer without any unnecessary entity between them (wholesaler, intermediary and retailer). This idea has to be introduced right now to overcome the crisis in the country as well as in the area of modern information technologies (for instance, direct sales through the Internet), thus promoting product sales without intermediaries and, at the same time, reducing product prices that are higher due to intermediation operations.

According to studies by several authors, there is a strong causal relationship between quantities of products purchased through the Internet and the VAT rates. In countries where the VAT rates are high, people are more interested in purchasing goods through the Internet, thus reducing high expenses on goods due to intermediation operations. It has to be also admitted that it creates a possibility for expanding the grey economy and VAT is not fully collected, while, at the same time, positive ties will exist between producers and consumers, which also relates to paying VAT.

## Conclusions

- 1) The amendments made to the tax laws in Latvia are oriented mainly towards increasing tax revenues, however, the impact of these changes on the economic situation, future economic development, and population's paying capacity are not taken into account.
- 2) The amendments to the tax laws include various methods of increasing tax revenues, which have to ensure extra tax revenues, i.e., the basic VAT rate was increased from 21% to 22% and the reduced VAT rate was increased from 10% to 12%.
- 3) The VAT revenues in Latvia fell on average by 5.8% in 2011 compared with the previous year, which means that the increase in the VAT rate up to 22% did not promote an extra inflow of tax revenues into the government budget and the development of economic activity was not observed as well.
- 4) Latvia's tax system is continuously improved and harmonised with the EU tax policy.
- 5) To promote economic development, the tax system has to depend on region, industry, and type of products.
- 6) By boosting incomes of residents through tax policy, the government did not achieve the desired results, as Latvian residents had large loan commitments; they tried to pay loan bills first instead of increasing their private consumption.

- 7) During the economic recession, the large loan commitments of the population (mortgage and consumption loans) are a hindering factor for implementing tax policies and for developing the national economy.

## Recommendations

- 1) The improved tax policy has to ensure that taxes are paid fairly and voluntarily as well as international cooperation has to be developed to solve the problem of financial sustainability.
- 2) The SRS has to pay more attention to informing taxpayers on future changes in the legislation as well as to provide quality consultations on tax issues, thus promoting rational cooperation between taxpayers and the SRS.
- 3) During the economic crisis, the government has to consider not only the possibility for increasing taxes, but also to find an opportunity for developing production and businesses, which would slow down increase in the grey economy and consolidate the society that is a significant development factor.
- 4) Higher tax rates have to be imposed on special goods and services (luxury and prestigious ones, harmful to human health etc.).
- 5) Special attention has to be paid to the tax system of Latvia, including VAT (personal income tax and real estate tax), as it determines the way the society develops: whether it is the way of destruction and mass poverty or the way of growth and prosperity for the entire society.
- 6) The value added tax has to be paid by anyone who does business and the tax has to decrease speculative transactions. It has to be paid in any resale transaction (process). This tax has to establish more effective ties between a producer and a consumer without any unnecessary entity between them to overcome the crisis in the country.
- 7) A significant increase in tax revenues and growth in the national economy can be achieved by changing the rates of value added tax, various excise taxes, as well as personal income tax; increasing these tax rates has to be planned in a long-term by differentiating the value added tax rates by industry and product group.

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# THE CORPORATE INCOME TAXES IMPACT ON INNOVATION

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## Abstract

The article contains analyzed authors survey results and drawn conclusions. Analyzes the theoretical aspects of tax relief and incentives in the current structure. The authors developed the proposals for the corporate income tax incentives for improving the system, the inclusion of innovative facilities granted to the target population.

The study aims to determine the necessary changes to the taxation of corporate income tax in order to promote innovation in products and services.

**Key words:** *taxes, tax incentives, innovation*

## Introduction

Topicality of the themes:

- the innovative low level of Latvian;
- tax incentive features under-use of innovation related activities;
- the need to raise the corporate income tax reduction efficiency.

Article aims to discover opportunities for promotion of innovation through the company's income tax relief system. To achieve the goal have been made following tasks:

- carry out a survey on corporate innovation activities and funding sources desirable advantages in taxation;
- analyze the current corporate income tax reduction and efficiency goals;
- proposing the corporate income tax incentives for improving the system.

The study shall be used for monographic method. The object of research: tax incentives.

## Innovative factors influencing the activity

In order to further explore the innovation challenges in research cooperation project Latvian Council of Science “Innovative economic development opportunities in today's changing environment” was made for business survey. 102 respondents answered 12 questions on State aid for innovation, tax incentives for innovative enterprises innovation funding opportunities, the survey was designed to collect information from direct sources to identify innovation development challenges, identify the host views on the innovative development of the economy and the factors contributing to invasive.

To provide a representation of the company's innovative activities in General, was asked the question “do the last 3 years in your company you've introduced some innovative products.” Respondents replies showed that the most – 50% – of those surveyed companies have introduced new technologies, 30% – introduced an innovative service and launched to produce 20% of the relevant authorities receive or develop innovative products. New technologies and products are introduced in the chemical and pharmaceutical industry. Special highlights of the joint stock company *Grindeks*. Food companies introduced new types of packaging, in the field of information technology introduced innovative services

In order to examine further the innovation-related problems in the Latvian Council of Science collaborative research project “Innovative economic development opportunities in a changing environment” within the company survey was carried out. 102 respondents answered 12 questions about public support for innovation, tax incentives for innovative companies and innovative funding opportunities for others. The survey aimed at collecting information from direct sources, to identify innovative development problems, find out the view of business on the economic development of innovative and disturbing inequalities.

In order to find a picture of their innovative activities in general, was asked “whether in the past 3 years, his company have introduced some innovative products”. The respondents answers show that most – 50% – of surveyed companies have implemented new technologies, 30% – have introduced an innovative service and started to produce 20% of research institutions receive the same or to develop innovative products. New technologies and products introduced in the chemical and pharmaceutical industry. Particularity stand out in a joint stock company *Grindeks*. Food manufacturing companies have introduced new types of packaging, information technology deployment of innovative services.

Innovative activity development is characterized by the respondents ' answers to the question "does your company's needs (economic interest) to introduce innovative products and technology." Companies in their responses to the notes that need technologies that reduce resource consumption per unit of output production. Need a new innovative hardware, new customer service system, e-services. For example, do not require air pollution measuring equipment, electronic products testing equipment, technology of



light emitting diode lamp for the production of canola harvesting equipment, fresh fruit storage and processing technologies. Also that every business needs an individual within a certain time to start something new, in order to facilitate the development of new ideas for corporate image building and motivating employees.

During the dialogue was attempted to find out what bothers to get innovative products from the Latvian research entities or to develop themselves. Of the respondents' replies, it can be concluded that the greatest barrier to innovation Association is lack of funding. No cooperation between research institutes and enterprises, the lack of information on the inventions and innovative developments.

Survey participants are very low-valued state aid for innovation. As there is insufficient public support for the 90% of the survey participants. In their responses to the questionnaire respondents writes that the lack of funding, the daring, the State does not inform the companies about the opportunities and insufficient financing innovation, quality, etc.

Some respondents noted that the public is not interested to introduce innovations that are not encouraged small business support. There is no specific definition of innovation, there are specific programs are rated the same idea. The idea of marketing the probability is independent of the initial phase of financing. On the other hand, a part of the host was unable to formulate any real financial assistance could get out of the country. That scientific progress is not commercialised.

Some respondents noted positive moments that take place prior to the submission of the draft free workshops where you can get all information about the project. Respondents believe that the contribution from the European Regional Development funds learning interferes with a bureaucracy, a large quantity of paper to fill and formalities.

State aid for innovation is linked to the question of the Latvian investment and development agency of operational efficiency. Of the respondents' replies, it can be concluded that the agency work is insufficient, the operation is not being promoted, the Agency's structure is complex, difficult to obtain. Respondents believe that too little running advertising idal, incomplete marketing.

The Agency is not visible, do not put pressure on Governments to implement and enforce the projects. The Agency does not contribute to the funding of innovative projects. In response to this that the Agency is seeking funding for projects worth billions, but not conducive to public partnership project implementation. Also too big to carry the veil.

Most of the respondents – 85% noted that innovation in the manufacturing and services significantly enhance tax incentives. Respondents believe the greatest effects on the innovation activity leaving tax rates and taxable base. Some respondents consider that there is a need to extend the time limit for payment of the tax and to grant tax credits and tax holidays.

Tax relief is primarily associated with the Corporation. 40% of respondents believe that it should be granted a 10% discount for small businesses that establish their business innovation and attract investment. The duty will be reduced to about 30% of the company proposes 42%, 26%, and noted that the responses should be reduced by 100% of those companies that produce high-tech products and programming. While 30% of the replies indicated that it should be granted a tax credit for companies that work with the introduction of new technologies and creating more jobs.

Interesting is the respondent answers about financing sources linked. 57 responses indicate that there is attracted to the EU structural funds, it is not done 39 interviewees. Some respondents provided their comments on it, why not use the EU structural funds. EU funds as a reason not to use this: your company's non-compliance with the requirements of the project, lack of time for the preparation of the project, great contest, awareness, bureaucracy, complex processes, not receiving State aid, the allocation of corruption involving.

Of all respondents only 63 have used bank credit for their innovative projects. Companies that did not use the credits noted that there is no guarantee that innovation will pay off, but credit will still be returned in addition to pay high interest. Companies do not want to enter into commitments, so as not to get into debt, does not satisfy the bank credit policy is implemented.

One of the sources of funding is a venture capital fund. 58 respondents in their responses to the questionnaire are mentioned, there is no information on the venture capital fund of funds. 10 respondents used venture capital funds and cooperation is considered to be positive. 32 respondents would like to use these funds, but 5 respondents indicates that this type of fundraising company is not acceptable because it would require too much profit or interest rates. Others don't want to incur obligations.

From the survey results of the analysis can be done a number of conclusions.

1. Companies are interested in introducing innovations that contribute to the consumable resource saving, productivity increases and financial results.
2. State aid for innovation is not enough.
3. The State does not use the tax rebates to stimulate innovative activities.
4. Bank credit, the EU funds, venture capital funds are difficult, sometimes uneconomical.
5. Respondents to be taken into consideration are proposals for corporate income tax reduction to companies in introducing innovation.

## Corporate income tax relief analysis

Further analyse the corporate income taxes revenue of the State budget and the current benefits, in order to assess the survey made proposals on corporate income taxes rate reduction. Currently, the rate of 15% of the taxable income has been in effect since

2004 and is one of the lowest in the EU countries. Despite the reduction in tax rates, total tax revenue since 2004 rapidly.

Table 1

**Corporate income tax revenue plan and fulfilment Latvia  
from 2002–2011, thous. Ls**

	<b>Plan</b>	<b>Fact</b>	<b>Plan execution, %</b>
2002	97633,1	109713,0	112,4
2003	93200,0	93938,6	100,8
2004	126645,0	127847,6	100,9
2005	170250,0	180668,3	106,1
2006	246550,0	253810,1	102,9
2007	405321,0	399751,4	98,6
2008	529000,0	503116,8	95,1
2009	210000,0	197176,6	93,9
2010	77000	112175,8	145,7
2011	121287	196076	161,78

If the 2003 corporate income taxes payments in the budget was 100 million. Lat, or 2% of the total tax revenue, the 2008 corporate income tax revenues were more than \$ 500 million. Lat, or 11% of the total tax revenue.

Corporate income tax revenue drop was held in 2009 and 2010 in this case, the cause of the fall was not a tax rate, but the taxable income a significant reduction in the economic and financial crisis. Currently statutory rather wide range of benefits-total 23. target all benefits can be grouped into five groups.

1. That group relief, which aims to promote investment. Facilities are as follows:

- a new production of technological equipment (article 13 of the law “On corporate income tax” part 1);
- specially supported territories are used for fixed asset acquisition (article 13 part 1, point 9);
- taxable income by a reduction of the amount of notional interest (law “On corporate income tax” article 6, part 17);
- investment in ports and special economic zones ( the law “On the application of free ports and special economic zones” part 3);
- asset substitution (law “On corporate income tax” article 10);
- research and development costs (law “On corporate income tax” article 13, part 4.1.);
- tax period losses and loss transfer company (law “On corporate income tax” article 14.1);
- accelerated depreciation of property, plant and equipment (law “On corporate income tax” article 13, paragraph 3 of part 1);

- eligible investment projects carried out in the framework of the initial investment (law “On corporate income tax” article 17.2).
2. Set includes facilities that are assigned to the taxpayers, in order to contribute to the financial crisis:
- income derived from loans to bank capitalisation resulting from the disposal of shares (law “On corporate income tax” article 7.1);
  - provisions for unsecured debts (law “On corporate income tax” article 9.1).
3. The group relief in various sectors of the economy:
- for the carriage of domestic enterprises (law “On corporate income tax” article 2.1);
  - agricultural land (law “On corporate income tax” article 18);
  - subsidies for agriculture and rural development in the applicant countries, which paid as State or EU support (law “On corporate income tax” article 6, paragraph 4, part 2);
  - discount air transport firms (law “On corporate income tax” article 4.6);
  - income from public circulation of securities sales (law “On corporate income tax” article 6, part 1);
  - banks and cooperative societies accounts receivable created stocks (law “On corporate income tax” article 8).
4. Social relief:
- discounts to donors (law “On corporate income tax” article 20.1)
  - discount disabled associations and charitable fund corporations (law “On corporate income tax” article 21);
  - creation of employment for people with disabilities (law “On corporate income tax” article 6);
  - free of charge transferred to computing equipment (law “On corporate income tax” article 6).
5. Other incentives:
- on the training of the militia (law “On corporate income tax” article 6);
  - on the compulsory copies of production costs (law “On corporate income tax” article 6).

This relief is relatively large, and different goals. However, the law does not provide direct incentives for innovation in the production or provision of services. In General, not to mention the concept of “innovation”. In an indirect way innovation can be associated with relief of the new technology and equipment for production purposes,

incentives for research and development. More incentives laid down a very narrow targets with no broader economic interest. A whole line of relief in general corporate income tax declaration did not provide details. Consequently, it is not possible to assess the amount of tax relief and economic significance. The importance of each relief can only be judged after the table data.

Table 2

**A single corporate income tax relief, the specific weight of total relief amount%**

<b>Incentive</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
The benefit to the purchase of new manufacturing technology equipment	6,1	16,1	11,8
Able to cover a tax period losses and to transfer the losses within a group of companies	23,7	26,3	40,7
Accelerated depreciation of fixed assets	46,3	31,9	14,7
Tax relief for agriculture amounts to be paid to the form of grants for the development	3,4	5,8	6,0
Exemption for research and development	1,0	3,8	12,1
Discounts for donors	15,2	12,9	8,8
The Rest Of The	4,3	3,2	5,9
<b>Total:</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>

The latest statistics were not available. From the table data can be done in a number of conclusions.

1. Of the 23 facilities provided for by law, only 6 have been taken into account in the specific weight in the total amount of relief. Major tax relief are those whose objective is to promote investment. One of them is the ability to cover the previous tax period losses and to transfer the losses within a group of companies. *Table 2* created by corporate income tax Declaration. During the period the benefit is increased both in absolute influence and increased its specific weight in the total relief.
2. Tax relief amounts are very different, reflecting the quality of very different relief effects on the budget revenue and the financial position of the company.

## **General conclusions**

The need to regularly evaluate each tax benefit for attainment of the objective pursued. Analysis and assessment must be carried out in three aspects:

1. from the economic standpoint (the output growth, rising productivity, etc.);
2. the revenue of the State budget;
3. from the taxpayer's point of view.

Relief is one of the national tax policy instruments. Incentives aim to be the result of tax policy strategic objective and tactical costs to be attained in a given period of time. If the strategic objective in accordance with national economic policy is defined expiration period (5–10 years), then the tactical tasks of the short-term nature (1–3 years) and can change the course of the economic cycle. According to the tactical mission changes may change tools including tax credits. It should be noted that the tax credit is an incentive tool and an incentive effect be achieved by setting low rates and creating a broad base for taxation.

Assessing the current corporate income tax relief, I must admit that they are fragmented, with incentives for the tax incentive effect is concentrated and directed to one of the most important for the economy of Latvia, currently targeted. Many different objectives, existence itself, the objectives and effects and overlaps penalizes relief effectiveness evaluation. In the light of the current largest economic topicality – the creation of new jobs, as a major corporate income tax relief targets for authors suggesting to put innovation and implementation in production. Not at all important to promote investment, but with corporate income tax incentives to encourage investment in innovative technologies, which can lead to higher added value. Through such relief, increase taxable income, so the income in the budget as well as increasing the profit margin will remain at the disposal of the company's future investments

There may also be another option. Namely, relief goals remain the same, but a prerequisite for any relief is innovation. For example, the host does not simply invest in particular assisted areas but the investment is made in the innovative technologies, innovative products, services, which of course, is located in assisted areas. So lagging behind the formation of new companies, jobs, innovation centre, founded on innovation in business incubators. The whole transaction is to be stimulated with a significant corporate income tax relief.

## **Conclusion**

The survey showed that the company supports the relief of taxation on the corporate income tax, if introduced innovations. Existing corporate income tax relief, the analysis showed that the direct tax relief in cases of innovation is not intended. The

authors regard it as very significant tax policy gaps and propose changes to the law on corporate income tax.

*Firstly*, to reduce the current statutory relief. Opt-out preferences, which does not give sufficient economic and social effects, such as support for the financial sector in relation to the publicly traded securities, in relief, on compulsory copy of production costs.

*Secondly*, as the sole criteria for receipt of benefits to innovation in the production and provision of services. Thirdly, the incentives set a limited period of time, thus providing for automatic review of the benefits, including the benefits according to the situation and limiting wasteful spending.

*Fourthly*, the need to regularly monitor the amount of relief and the impact on the budget revenue, the tax payer's financial situation, relief goal. Fifthly, to get full information about tax relief and the achievement of the objectives of the Declaration, supplemented, and to include information on all incentives.

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**Balanced and sustainable  
regional cultural development**



# TERRITORIAL POSITIONING AS A FACTOR OF SUSTAINABLE DEVELOPMENT OF THE REGION

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## Abstract

Positioning plays an important role in the territorial marketing, as the necessary precondition of development is the formation of the image according to potentialities of the territory itself. Marketing practitioner Jack Trout (in collaboration with Al Ries) defines positioning as the principle of differentiation, i.e., creating and maintaining particular qualities of the product in the mind of people. It is possible to accomplish it by the means of particular positioning strategies. Michael Porter and Philip Kotler represent slightly different approaches. After a detailed and comparative analysis of all aforementioned approaches, the authors of the present article came to the conclusion that in the rapidly changing and difficult economic situation of the local territories of Latvia, positioning is one of the essential factors of sustainability, while the most efficient strategies of positioning are the ones worked out by Trout. The territorial positioning in Latvia can be based on the following principles: a) positioning of characteristic features; b) positioning of advantages of Latvia; c) positioning of specific possibilities; d) positioning of the user; e) positioning of categories; f) positioning of quality/price.

The aim of this article is to develop the theoretical background for further empirical research in the field of territorial marketing in Latvia.

**Key words:** *positioning, differentiation, territorial marketing, territorial branding, sustainability, competitiveness, competitive identity*

## Introduction

Positioning of a territory has been acknowledged to be one of the core activities of territorial marketing and place branding, as it can be central to customers' perception and decision-making. The task of the present article is to conceptualize basic notions of territorial (place/destination) marketing and positioning/differentiation of the

territory (region, city, nation). “By directing all of its marketing efforts towards a desired position, the nation maintains a coherence and unity in its activities and establishes a specific image” (Harrison-Walker, 2011:136).

The aim of this article is to develop the theoretical background for further empirical research in the field of territorial marketing in Latvia and to formulate the research hypothesis. To reach the objective, mainly the monographic method was used in the research.

The article consists of two parts – the first part is devoted to the issues of territorial marketing, while the second one – to the strategies of positioning/differentiation of the territory itself. In the conclusion, a set of principles applicable to developing the specific positioning strategies of the Latvian territories are put forward.

## **Role of Territorial Marketing in the Regional Development**

In human perception a territory is usually related to memories, associations, feelings; nevertheless a territory is a place with particular market value. Each and every territory has its unique places, people and events. In order to make the territory appealing to specific target groups, it is necessary to research their needs and possible ways to satisfy them. Hence, the role of marketing becomes especially important. Territorial marketing can help to attract tourists, entrepreneurs and investors, as well as new residents.

There are many definitions of territory marketing – some authors believe that regional marketing should be implemented at the regional level taking into account specific features of the territory. Others, in their turn, emphasize the role of the image in attracting businesses and people (Pike, 2008; Smyth, 2005; Ward, 1998). In our opinion, the most effective way is to define the territory marketing as marketing that complies with interests of internal and external objects, in other words, specific products are offered inside and outside the territory in question (Панкрухин, 2007: 555). The outside (external) society is interested in welfare of the territory, as it is interested to acquire a part of the profit (resources, knowledge, consumer goods, financial resources), taking it outside. The insiders (internal society) relate their welfare (personal and business) to the territory welfare. From the viewpoint of territory both positions are interesting, but approaches to the internal and external society should differ (Панкрухин, 2007: 556). It means that diverse marketing strategies should be planned.

It is significant that under certain conditions both parties could be interested or not interested in the development of the territory. What are these interests like? Predominantly they are related to effective use of the territory’s competitive advantages – permanent residency, entrepreneurship, and short-time residency. More precisely, they could be as follows: size of the market, solvency, development of the infrastructure, possibilities in culture, education and health care, raw material resources and labour force (profile, qualification, quantity, costs, etc.) (Панкрухин, 2007: 558).

According to Philip Kotler, there are five factors that determine results of the territory marketing in Europe. In the authors' opinion, they all can be applied to Latvia's situation:

- Necessity to stress the superiority of some territory in Europe (Ph. Kotler believes that the strongest territory brands are located in Europe today);
- Introduction of the term 'Euroland' and the unified currency. It means the birth of the huge common market and new possibilities for particular territories or places;
- Territories are becoming responsible for their marketing;
- Development of information technologies allows small territories to be competitive on the European scale;
- Possibilities to manage communication process and to create the integrated marketing communication plan for the image of the territory (Котлер, Асплунд, Рейн, Хайдер, 2005: 72–73).

Currently, Europe faces stiff competition; therefore the task to develop the territory marketing strategy is becoming quite acute. Different factors of the global economy, not the least the world economical recession (or even the global economic crisis) escalate the competition among territories. Thus it is necessary to find new marketing tools and innovative approaches to territory marketing, one of them being positioning.

## Strategies of Territory Positioning

One of the marketing tools in the product positioning according to the classical marketing conception is branding, because pretty often success in business depends upon the memorability and respectability of the sign. The brand makes it possible for a customer to recognize the product and create loyalty. It facilitates the popularity of the territory, creates the image of the territory, as well as fosters economic development of the territory. The brand should exhibit three main components: the functional, i.e., it has to guarantee the optimal correlation between price and necessary qualities for consumption (speaking of territory – it should be accessible); the social – the brand should reflect the income level of its user and the system of values (living in certain city or suburb can be prestigious), thus a person ensures his positioning in the social environment; the emotional – the brand offers spiritual values that customer adopts as his own (people can identify themselves with and be proud of their place of residence).

Prior turning to the concept of positioning we have to make a few significant distinctions as they are often used in an interchangeable manner, though they convey different information and connotations. In short, it has to do with such concepts as positioning, image and reputation. In our present article we use distinctions summed up by L. J. Harrison-Walker in her article "Strategic Positioning of Nations as Brands" (Harrison-Walker, 2011). Thus, according to the author, *an image* is, first of all, an immediate impression about something or somebody. "While images can be personal (an image

held by an individual) or collective (an image shared by many individuals), it is the collective image that is of interest to marketers” (Harrison-Walker, 2011: 136). Country image can be more specifically defined as a set of beliefs about a particular country. While most institutions have distinguishable images, the image of most nations is vague because there is a general level of ignorance of countries other than one’s own (O’Shaunessy, O’Shaunessy, 2000). This is actually where marketing specialists can step up and offer their visions of the place as a marketable good. *Reputation*, in its turn, is the collective representation of the past image, the expression of attitude (the most decisive characteristic), which can be reinforced by well-conceived communication programs. Both image and reputation are very difficult to alter once they have been set in people’s memory, while the concept of *position* stresses the angle of competitiveness (something can be positioned only with regard to something else). “Unlike image, *position* evolves and, if managed effectively, becomes stronger over time. In contrast, an image is not static, but has elements that fade in and out while only the vaguest image is retained without sustained effort. Furthermore, position differs from image in that it implies a frame of reference, the reference point usually being the competition. This is an important distinction since it is not sufficient for a nation to have positive image in order to be successful over the long term, the nation’s offerings must be perceived more favourably than competitive offerings” (Harrison-Walker, 2011: 137).

Positioning is important in the territorial marketing. According to T. Sachuk, the territory development begins, first of all, with the creation of the image of a territory in accordance with its resources. The total image can and should be supplemented with several significant factors (Сачук, 2009). Thus, for example, if a city like Sigulda positions itself as the place for recreation, then it is necessary to stress that there are many outdoor activities (white water rafting, skiing, horseback riding, hiking etc.), as well as historical sites (e.g. medieval castles) and culture festivals (e.g. the annual opera festival). If the emphasis is placed upon the aforementioned factors, the territory can develop the place marketing, positioning itself among other territories.

The new positioning approach took shape in the 1980s; it was related to the publishing of Michael Porter’s book “Competitive Strategies” (Porter, 1998). Followers of this school believe that each industry requires accounts for a particular strategy, and offer the method of analysis of competitiveness within the limits of the industry, as well as the chain of values.

The basis of the analysis of competitiveness consists of external factors and the competition level within the industry:

- threat of newcomers;
- power of suppliers;
- power of customers;
- threat of substitution;
- intensity of cooperation between competitors (Porter, 1998).

M. Porter thought that analysis is necessary in order a certain territory would gain the competitive advantages; therefore, the role of positioning is to support, to ensure the strategic process of a territory, but not to substitute the strategic process itself (Porter, 1998).

Jack Trout, in his turn, stresses that the basic principle of positioning is creation of the impression of difference (Trout, 2004). In order to take and maintain a place in the market, the offerer of a product or service should pay attention not to improving goods or performance, but rather to the ‘distribution of difference’ and securing it in the mind of a customer that is already oversaturated with abundance of information. “The basic approach of positioning is not to create something new and different, but to manipulate what’s already up there in the mind, to retie the connections that already exist” (Ries, Trout, 2001: 5). The following table depicts problems/tasks/suggested actions of the process of differentiation developed by *Trout and Partners* (Trout, 2004).

Table 1

**Process and Steps of Differentiation**

<b>Problem</b>	<b>Slogans</b>	<b>Suggested actions</b>
1	2	3
1. Differentiate or die	The main task is to be different. The basis of successful strategy is finding ways to be different. Why is your product to be chosen?	To be the first is to be different. Patenting specific features is a way to differ. Leadership is a way to be different. Patenting the category. Showing oneself off. Tradition is the way to be different. Production itself can create difference. Attractiveness is a way to differ.
2. If there is no difference	Competition is the basis of everything. Getting to know competitors in order to avoid their strengths. Using competitors’ weak points as leverage	The lowest price. False idea of ‘the best employees’. False idea of ‘the best products’. Marketing is a warfare.
3. If it is impossible to win competitors	Specialization is the basis of everything. Better to be unique in one field rather than good in several fields.	Principle of specialization accords to contemporary tendencies of development. The main tool is general recognition.
4. If all this doesn’t work...	Simplicity is the basis. Complex strategic ideas are expressed in simple terms.	Simplicity is the axiom. Task – to get into consumers’ minds The best terms are the simplest ones.

1	2	3
5. Leadership	Ability to be a leader is the basis of everything.	The duty of the leader is to manage. It is necessary to know the direction of movement. Striking leader influences consumers and potential clients.
6. If you don't know where you're going, nobody will follow.	Reality is the basis of everything.	"Big brands – big problems" Real and unreal goals Not losing touch with the real market situation

*Source: Table created by the authors*

Let's dwell on the suggested action in a more detailed way.

1. To be the first is to be different. If it is possible to get people to pay attention to a new idea, a product or a benefit, it is a great advantage. People tend to stick to the known ways. If competitors strive to copy the product or concept, the original idea becomes of prime importance.

Patenting specific features is a way to differ. The term 'feature' is one of the most used terms in marketing. At the same time, it is the least understood. The feature is a quality of a person or a thing, a particularity or the most vivid and telling aspect. Each product, depending on the category, exhibits a complex of features. The product of a territory becomes unique due to one or another specific feature. Patenting this feature of unique expression is perhaps the best way to stress the difference of the product. As an example we can mention the "Corporate Identity Manual: Switzerland" (Corporate Identity Manual: Switzerland, 2008), renewed and republished yearly, that fixates the most important visual features of the state, as well as associations and marketing tasks. Thus another territory can't use the same set of visual markers and values; it has to look for something different – a contrasting feature.

Leadership is a way to be different. If some territory has acquired the status of a leader then it is much easier to attract people as the leadership itself is a guarantee of a certain quality (of service, of living conditions, of spectacular sites etc.).

Patenting the category. In the territory marketing it means patenting a certain set of associations like – trustworthiness, solidity and safety in the case of Switzerland (Corporate Identity Manual: Switzerland, 2008: 13).

Showing oneself off. Sometimes despite the obvious advantages of some territory, or even the leadership in the field, the leaders are inclined to speak not of their success. They don't realize that the leading position is the best platform to inform the public



about the history of success. If a territory is perceived as the leader, people will believe everything told and heard by it and about it.

Tradition is the way to be different. Traditions of a particular place can make the territory shine amongst the others. The long history of a place has a natural psychological appeal; it strengthens people's confidence in the choice they have made. Many territories strive to emphasize their difference by the means of traditions and culture. Often this aspect is included in the slogan of the country, for instance, "*Malta – the Sun, the Sea and 7000 Years of History*" (Metaxas, 2009).

Production itself can create difference. Territories put a lot of effort in developing new product, and people are entitled to know about the process and technologies employed. Specific products, ingredients, or techniques (hand-made, traditional goods) can be features to put forward to attract investments and visitors to the place. For instance, just as recently, culture and trade tourism is becoming popular, people can visit small-scale bakeries, dairies, and potteries and so on, where they can observe and participate in the process of production.

Attractiveness is the way to differ. If a territory is attractive the world has to know about it and has to talk about it (a buzz principle – the more people know about some place the more they speak of it). There are some ways to stress the quality of the place in question: number of tourism objects in comparison with other places, tourism awards, opinion leaders' favourable expressions, etc.

2. It is necessary to think about the existing competition: which are competitors' advantages, which are weaknesses? Only this way it is possible to demonstrate the strengths of the given territory. The most disastrous approach to take in the contemporary marketing is striving to change people's opinion "... the average person cannot tolerate being told he/she is wrong. Mind-changing is the road to advertising disaster" (Ries, Trout, 2001: 6).

Marketing is warfare. This principle becomes of special importance in the situation of globalization when territories have to compete at international level (with a rare exception of the so-called 'closed countries', which are closed mainly due to political regiments).

How to become a client-oriented venue. Today almost all territories insist that they are client-oriented. But if one and the same client is being served or allured by 12 more territories, knowing client's needs doesn't help anymore. The main task is to implement the appropriate competitive strategy, to choose one of marketing warfare tactics. Market leaders employ *the defensive tactics* (the aim is to defend the current position). At the same time territories playing the second and the third fiddle use *the aggressive warfare tactics*. It includes, firstly, avoiding the strengths of competitors and, secondly, to take on the offensive onto the weakest defence lines. Mainly small enterprises or territories use *the guerrilla warfare tactics*. These territories have to find the market small enough to be defensible.

3. If entrepreneurship is the warfare for a territory to survive, it has to exhibit some superiority over real or virtual competitors. The strategy of differentiation has to be related to the so-called main competence. This is important, as people are impressed if a territory concentrates upon specific aspect or production. Therefore, some territories are being credited with high levels of knowledge and experience though they are not as high in reality.

Specialization is an efficient tool when competing with larger territories having rather wide range of activities. The reason for this is that clients don't believe in territory to be successful in all spheres; and they are inclined to choose the best place possible. J. Trout suggests to position territories as "specialists in one or another field" (Trout, 2004).

4. Like the most complicated military missions, the complex strategies are often doomed. The solution lies in simplicity. Nevertheless, strategists have to be aware that people tend to admire complex rather than simple solutions. The antidote to such perception is to be found in common sense but this aspect is often left out of sight. People are inclined to look for deeper and hidden meanings of the things, while at the same time stereotypes and primary perceptions play a great role in advertising and marketing. In other words, it is necessary to get 'under the skin' of potential customers. This means that success of the territory is guaranteed if and only if it can become the 'holder' of the particular name or slogan. This word shouldn't be complicated and/or fictional; the best words are the simplest ones – straight from the dictionary.

5. The leader should know where to go. J. Trout believes that the leader is the one who sets goals, priorities as well as standards, and stands by them in all cases. Besides that he has to be able to express his vision, to be the ambassador/spokesperson/symbol of the territory.

6. If the leader doesn't know where to go, it can result in unrealistic expectations and plans. Leaders who are obsessed with planning insist on setting goals regardless their correspondence to the market situation. Asked about their reasons they admit that these goals are milestones, signposts. Concentration onto the prospects and prospective gains solely can result in the actual losses, not the least of the position. Thus the *prima facie* principle is to stick to the reality and to employ effectively all resources at hand. Perhaps this is best captured by the S. Anholt's concept of competitive identity. According to the author, the concept comprises such main factors as brands, policy, investment, culture, people, and tourism (Anholt, 2005). If these aspects are reinforced and coordinated, nations stand a good chance of building and maintaining a competitive national identity internally and externally – to the lasting benefit of exporters, importers, government, the culture sector, tourism, immigration and pretty much every aspect of international relations" (Anholt, 2007: 26).

Taking into account all theoretical and practical considerations, the authors of the present paper believe that positioning of the territory of Latvia can be grounded in: a) positioning of characteristic features; b) positioning of benefits; c) positioning of different possibilities; d) positioning of user; e) positioning of categories; f) positioning of quality/price.

Strategies put forward by J. Trout determine activities helpful in the process of positioning not only of companies, but also of territories. Recognisability of products/ companies allocated to the particular territory, can create a special appeal to the place, to make it recognizable and thus position itself among competitors (Trout, 2004).

In our opinion, the classical methods of positioning by M. Porter are not effective enough in the rapidly changing and difficult economic situation where the local governments of Latvia find themselves at present. Therefore, we find that J. Trout's methods and techniques of positioning can be of a better use under current circumstances.

## Conclusions

- 1) Today there is a tendency that territories compete among them to attract tourists, retain residents, attract businesses.
- 2) It is essential for territorial development to set the criteria of competitiveness for the territory.
- 3) Positioning is important in the territorial marketing, as territory development begins with the creation of the image of a place in accordance with its inner resources.
- 4) M. Porter's analysis of competitive strategies stresses that the role of positioning is to support, to ensure the strategic process of territory, but not to substitute the strategic process itself.
- 5) J. Trout stresses that the basic principle of positioning is creation of the impression of difference. In order to take and maintain a place in the market, it is necessary to pay attention not to improving goods or performance, but rather – to the 'distribution of difference'.
- 6) S. Anholt proposes the concept of competitive identity of a territory; the concept comprises such main factors as brands, policy, investment, culture, people, and tourism that, if maintained and reinforced, could ensure long term benefits.
- 7) Taking into account all theoretical and practical considerations, the authors of the present paper believe that positioning of the territory of Latvia can be grounded in: a) positioning of characteristic features; b) positioning of benefits; c) positioning of different possibilities; d) positioning of user; e) positioning of categories; f) positioning of quality/price.

- 8) The classical methods of positioning by M. Porter are not effective enough in the rapidly changing and difficult economic situation where the local governments of Latvia find themselves at present. Therefore, J. Trout's methods and techniques of positioning can be of better use in the current circumstances.

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# **SLOW MOVEMENT LIFESTYLE – THE FOUNDATION OF NATION’S SUSTAINABLE DEVELOPMENT AND LIFESTYLE BUSINESS**

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## **Abstract**

The aim of the article is to highlight how the development of technologies and the dynamics of the modern era have harmed the understanding of the life basis and how postulating the new lifestyle philosophy – ‘slow living’, can be a basis for sustainable development, as well as what fallacies the people have had about the preconditions of a happy life. Human potential is greater than we consider it to be. Thus, the originality of the article is determined by the fact that it is essential to believe that you will succeed. If success is grounded in one’s consciousness and is realized in the material world (it is never vice versa), then one should logically start with himself/herself. The idea of ‘slow living’ originates from the new Slow Movement, which expresses itself in various life aspects and actions, tries to renew the approach that people used in their lifestyle several generations ago. The practical significance of the article is determined by the fact that in the last fifty years since the income of the population has increased several times; the people’s satisfaction, welfare and feeling of happiness have not increased proportionally. Life dynamics and fast lifestyle makes keeping up, otherwise one can lose his/her position in the professional labour market, experience aggravation of relations and social competition. The article provides a practical solution to the burning economic and cultural crisis. The world is transforming under our feet. Ecology, economics, social culture and human lifestyle change seasonally, annually and over dynamically. We are on the verge of the future when our action is decisive. The life begins anew every day. It is art not to be in continuous rush; and it requires mental openness, time and patience. How to find balance in life and how to live sustainably? Qualitative methods of diverse opinions are used in the article. Taking into account historical aspects, the author of the present paper analyzes the postulates of various viewpoints to reach a happy and prosperous life and defines conclusions regarding sustainable development and transformation of a new form of lifestyle for business perspective. What form of business adapts to slow living and why is it the most perspective in the modern era? Is sustainable welfare possible? Nowadays people

are more distinguished by social environment where they come from, money, faith and desires than skin colour.

**Key words:** *sustainable development, Slow Movement, slow living, lifestyle business, economic growth*

## Introduction

The topicality of the problem researched in the article is determined by the fact that upon speeded up pace of life it is essential to find a way how to be in harmony with oneself and have welfare not losing one’s place in the professional business environment and being within the framework of the society. Eastern spiritual philosophy and physical practices become increasingly popular and casual in the society. Returning to naturally grown food and communication is a new tendency. Stopping the world and coming back to feelings are inducements, which make an act and re-evaluate the life model. The task of the article is to analyze how the slow lifestyle provides an answer to the fast pace of the world and how lifestyle business can turn out to be the basic postulate of the sustainable development.

The more reachable and closer the world seems to us, the less we have in relations with it. We can compare family models several generations ago and nowadays. Cohabitation of several generations is changed to aloofness. The relations of children with relatives and kinsmen are formed differently than it was earlier.

Technological growth also dictates everyday habits. Technologies facilitate our everyday life and we can do more and faster. The tempo implacably speeds up and, as it becomes relentlessly fast, a contradiction with natural flow appears. We rush meals, time spent with the family, everything. It’s time to re-evaluate what is essential and what are the priorities. The most complicated task is to change one’s attitude and thinking, reconsider one’s priorities and their meaning.

The profile of the article – a conceptual article. The period of research: the year 2011.

The aim of the article is to analyze the new lifestyle philosophy – ‘slow living’ with a view to find a solution to sustainable development, which would serve for the everyday life in developing lifestyle business and discovering a welfare life model.

The task put forward in the first chapter – to analyze the philosophy of Slow Movement, distinguishing the idea of ‘slow living’ and ‘slow money’; in the second chapter – the perspective and nature of sustainable development; in the third chapter – the new business philosophy – lifestyle business and, finally, in the fourth chapter – to make conclusions and provide suggestions how to create a welfare life model being in harmony with oneself, era, economy, fashion, trends. The conclusions are grounded and definite, based on the results of the research.

## A New Lifestyle Perspective – Slow Movement

### Slow Living

The people tired of the modern life rhythm wish and strive for a peaceful life. However it is becoming increasingly difficult to realize it. The rapid pace of life is felt everywhere – fast cars, fast food, fast families, fast holidays and fast talks. When we steal time from one's life, we chase fashion, the aim of which we misunderstand. Self-realization of one's life is a solution. One should slow down and establish contacts with his/her own nature.

"Think globally and act locally" has become a popular slogan that identifies the local as a site of existence against global culture, where consumers are assumed to have a sense of global responsibility, and new articulations have occurred between the 'global' and the 'local' (Hall, 1992: 304).

Defining "slow communities ... *themselves* [as] the residues of exclusion from dominant expressions and structures of modern living', they see 'entities such as slow communities' as 'expressions of resistance' in the face of threats to cultural difference and the standardization of everyday practice" (Parkins & Wendy & Geoffrey Craig, 2006: 82).

A human being has no atom, which would remain unchanged during the lifetime. It is a challenge to accept opportunities for change. Each second and day change and it depends on our thoughts and behaviour. People reach and notice what they have expected. Thus, thinking positively and vice versa – negatively, the expected result is reached. People create their reality by themselves. Fear keeps us in the framework of old habits. Restricted thinking about only one action plan possible limits our potential and blocks development. The lifestyle conception lets enjoy life more directly and genuinely. Become a creator, a person who enjoys the present day, which is the only reality.

The concept of 'slow living' envisages listening into our bodies and following their needs, not the fashion imposed by consumer culture. Stress arises from unsatisfied desires, which are artificially created to increase income and satisfy wishes. However, the system is illogical and sooner or later fails.

Reconsideration of values is not oriented towards losing something, but towards gaining more and more. Giving up things leads to crystallization of values. Too often we observe how material benefits become a mirror of the life. Associating oneself with things belonging to you is false identification. It is directed towards delusion because safety and fulfilment provided by belongings is evanescent. Anything can serve as a source of greed – ideas, knowledge, friends, travels, some God, deals, one's own ego. When shoulders sag under the weight of belongings, properties and relations, a tendency to accrue, collect, consume and buy more increases. Only in case you manage

to give up something, you can feel how insignificant some things are. People quite often use a thing because they have it, not because they need it.

Since human needs are positioned as a necessity, national revenue is defined as national happiness (Dāvidsone, 2011c). There are a lot of pragmatic objections to the principle of happiness. Happiness cannot be defined and discussions about it are vain. No one can measure happiness because we cannot identify the absolute degree. It is impossible to reach long lasting happiness, thus we strive for short-term delusion for an easier life. The last objection – we cannot give happiness to ourselves. It is essential to consider pros and cons of the ones mentioned above (Veenhoven, 2010: 22).

Thinking itself is a key to switch to thinking of slow lifestyle because it is an answer. A person can analyze his/her relations and lifestyle by meditation. Peace unites with present reality. Simplicity is a positive and enriching value. It lets get rid of prejudices, contradictions and burden which making one’s life so stressful. It is a solution to many problems.

Deepness of thoughts is a way to open oneself for renewal by returning to the purity of mind and finding the real essence in oneself, aside from delusion and imposed norms. A human being *is*, not a human being *does*. When we exercise deep thoughts, emotional intelligence lets us find incentives of happiness and balance the guidelines of duties, dogmas, family, relations, money flow and general life.

Persons living in the same period of time and getting different income regard money as a definite indicator of power of superiority. Welfare is the highest possible approach to economic resources, the highest level of welfare, incl., happiness, guaranteed minimum income to avoid living in poverty and taking into consideration opportunities to ensure a good life to the population (Greve, 2008: 58). Welfare can be related to collective or individual material, however, to a large extent, it will be related to various interpretations of social justice. It can include altruism, involvement of personal interests and demonstration of authority. It can be interpreted as a science, what portion of food and water should be used per twenty-hours to survive (Dāvidsone, 2011a).

Historically, it has been difficult to interpret the concept of welfare. The same applies to economy. The economist Arthur Cecil Pigou determined that it is sufficient to define dogmatically two proposals – the elements of welfare and their possible relations are dependent on the state of conscience, and welfare can be reached according to the category – greater and smaller (Pigou, 2006: 10).

Is money a measure of welfare? In classical economics welfare depends on individual usefulness and, thus, limits the role of the state, especially in action with market fallacies. The role and essence of money have cardinally changed. Money is a fundamental aspect of a human life anywhere around the world (Diener & Biswas – Diener, 2002: 120). Money encourages action. It lets enjoy and it drives into despair. Money expresses and measures everything.



Thinking about money activates feelings of *self-sufficiency* (Vohs & Mead & Goode, 2006: 1154–1156). Although the pleasure we get from the power of money can influence us only for a short period of time, its power is so extensive that we strive to feel it as frequently as possible. Getting pleasure is a feature symbolically reflecting the contemporary life (Dāvidsone, 2011c). Economic growth itself does not seem to bring happiness, except very temporarily. After a short time, people get used to their new standard of living and go back to being as (un)happy as they were before, but at a higher level of consumption (Easterlin, 1996).

## **Slow Money**

‘Slow money’ is a trend of Slow Movement. It was launched by Woody Tasch, a former chairman of the Investors Circle who has emphasized the significance of socially responsible philosophy determining the dominance of social benefits over fast profit and introduced a term ‘patient capital’. The ‘slow money’ movement is dedicated to connecting investors to their local economies by marshalling financial resources to invest in small food enterprises and local food systems. Tasch's vision represents a complete overhaul of the way we think about and spend our money. The ‘slow money’ movement organizes sustainable investments of investors and money providers into new kinds of capital investments, managing organic farms, food industry and local food processing.

In his book *Inquiries into the Nature of slow Money: Investing as if Food Farms and Fertility Mattered*, Woody Tasch says that investors no longer know where their money goes. He has coined the phrase ‘nurture capital’, a healthier and more sustainable alternative to venture capital for funding new businesses. His aim is to shorten the distance between investors and their investments.

Money is a sign of achievement, freedom and security (Tang, 1993: 93–99). ‘Slow money’ ensures sustainable development for a city, a country or a geographical area. The next chapter will be devoted to more detailed analysis of the essence, role, meaning of the sustainable development conception.

Purchasing in the local markets, selling products on the local scale, not using foreign labour force, while facilitating local training are needed to ensure the activities in all practicing fields because only with the support to local community and flourishing of economic markets or at least their successful and productive performance, money turnover is local and it does not go to foreign financial markets.

Money is considered as the instrument of commerce and the measure of value (Smith, 1776/1937). McClelland stated that the meaning of money is "in the eyes of the beholder" (McClelland, 1967: 10); to some people, money is a medium of exchange (Smith, 1973/1776).

People report higher satisfaction if they receive money and are asked to spend money on others (a gift for someone else or charitable donation) rather than on themselves (pay a bill or buy a gift for themselves) (Dunn & Aknin & Norton, 2008: 1687–1688).

The informal 'slow money' movement aimed at sustainability and resilience of local economy has millions of followers and creates a real change, as well fosters new economy.

## Conception of Sustainable Development

Slow Movement is based on the idea of sustainable development because only by thinking in perspective it is possible to identify the significance of motives for everyday actions. Although the term seems understandable and clear, its meaningful existence was accepted for the first time only in 1974 in the meeting of the World Church Council. Later in 1980, the concept was presented in the International Union for Conservation of Nature and Natural Resources (International Union for Conservation of Nature and Natural Resources 1980). The integration of conservation and development to ensure that modification to the planet do indeed secure the survival and well-being of all people (*World Conservation Strategy*, 1980: 1–2).

In 1987, in the World Commission for Environment and Development of the United Nations Organization, Gro Harlem Brundtland published a report *Our Common Future*, postulating that one can manage a circle between the preservation of environment and flourishing of economy through a standpoint of sustainable development (*Our Common Future*, 1987). The new standpoint was supported in the United Nations Conference on Environment and Development (*UNCED*) held in 1992 in Rio de Janeiro. Since that time the term is explained both by economic growth and environmental protection. The book *Sustainable Society* was the first, which discussed the problem of how to harmonize growth limits and concerns about social justice (Pirages, 1977: 342).

So far, the course of the humankind has been sustainable; it was endangered only by rapid development of technologies, when the humans' mental development started lagging behind. Money and material benefits were considered to be not the aim, but the means for welfare. The field of sustainable development has emerged in response to the mounting ecological and social challenges stemming from the traditional economic paradigm. Upon the fast technological flourishing in the end of the 20<sup>th</sup> century, the attitude towards material values swiftly changed; their purchase was considered to be a self-sufficient value.

People want money because it serves as a tool to obtain biological rewards that satisfy their needs (Lea & Webley, 2006). But everyone, incl., economists, knows perfectly well that the economy takes in raw materials from environment and gives back waste. So, why is this undisputed fact ignored in the circular flow paradigm? Economists are interested in scarcity (Daly, 1996: 34). Sustainable development can be ensured; there should be an interaction not only between the development of national economy,

social sphere and environmental protection, but also among the branches of national economy and their thematic elements. Besides, active participation of the society in prompting the development shall be ensured. People who assign high value to money become more private, self-centred, socially isolated, have higher psychological stress, lower happiness, poorer mental and physical health, are less open to others, and are less concerned for humanity and spirituality than those without across cultures (Kasser, 2002).

If one assigns constructive meaning to the conception of sustainable development, the principles of sustainability shall be facilitated by appropriate means which allow for regulation of globalization in another way.

## New Business Philosophy – Lifestyle Business

Nowadays, when the stages of economic inflation, deflation and recession are casual, a new form of business should be found letting not only economic fluctuations influence business less, but also being more adaptable to the businessman's lifestyle, daily habits and skills. Besides, it is essential to find a form of business, which allows ensuring regular, sufficient income in the long-run. Such opportunity is provided by the new form of business – lifestyle business.

We see entrepreneurship as the creation of new enterprising activities, that is, innovation, new venture and strategic renewal (Davidsson & Wiklund). The term 'lifestyle entrepreneur' was for the first time used by William Wetzel, professor of the University of New Hampshire in a magazine article in 1987.

Tom Richman in his article *The Hottest Entrepreneur in America, Inc.* 9 (Feb. 1987: 50) describes a category of entrepreneurs with "one overarching distinction: they've all started companies because it is the best way, sometimes the only way they could get the work they wanted, were they wanted, and on the terms that they wanted". So William Wetzel's suggested the term 'lifestyle entrepreneur'.

Professor Wetzel, an expert of joint companies' capital, used the term to refer to the companies, which are not oriented towards gaining profit, cannot expect funding from external investors because they will never be sold for capital gains. In the financial jargon they have no growth potential to create wealth. They can ensure attractive income for small businesses, but have no potential for creating wealth (Dāvidsone, 2011b). In other countries and cultures, lifestyle entrepreneurs are considered a norm, and business owners who are primarily focused on financial gain are looked on as unusual (Henricks, 2002: 230).

In the minds of many people, growth has become synonymous with an increase in wealth. They say that we must have growth to be rich enough to afford the cost of cleaning up and curing poverty. That all problems are easier to solve if we are richer is not in dispute (Wennekers & Thurik, 1999). Talking about small companies, sometimes the

concepts 'development' and 'growth' are misused. Due to misunderstanding of the meaning of the above-mentioned concepts, the essence changes not only semantically. Growth is an increase in size, while development is an increase in quality and diversity. Development increases the value of both public and private investments, while growth tends to require increases in these investments that may or may not increase value (Kinsley & Lovins, 1997).

Lifestyle businessmen do not strive for enlargement in terms of the company's volume. Development can be unrelated to enlargement. Lifestyle ventures generally are not run for the financial benefit of someone else, such as investors who backed the enterprise in hopes of achieving a rich return (Henricks, 2002: 230). When rapidly growing companies have developed themselves and created new products, favourable environment is created for lifestyle companies.

Definitions of the 'local' are relative as well as problematic, and can be applied to a specific geographical site as well as to a particular human organization (Parkins & Craig, 2006: 72). Technologies, global communication and modern inventions in lifestyle business are more significant than in other kinds of companies because they determine work flexibility in relation to the place and time conditions (Schine, 2003: 275). The local must be defined more than at the level of locale. It is "attributed with meaning through the complex composite of flows of people, goods and services and representations that occur from, to and between it" (Parkins and Craig, 2006: 72).

Pleasant work letting enjoy a definite lifestyle and ensuring sufficient income for life to a large extent is a top condition for welfare. What is happy life? It is harmony of one's mind and sustainable peace. You can reach it if you have greatness of mind. You can also have it if you have imperturbability, steadiness and firmness, lean to a good decision just reached (Seneca, 1917).

In lifestyle business, a businessman is the owner of business and also an employee. The owner perceives business as demonstration of one's personality, related to the needs and wishes of the family (Carland & Boulton & Carland, 1984). Since the introduction of mechanical power, the worker's function has totally changed in many industries. More and more often, he/she does not work in the physical sense, but directs an inanimate source of power to do what, left alone, it could not do (Soddy, 1926: 318).

Businessmen demonstrate the limits of their internal control (Borland C.). What is the greatest advantage for the owner of a lifestyle business in comparison to the representatives of other businesses? A significant aspect is one's ability to control all processes taking place in the company; however, the greatest advantage is freedom.

Waste of time is the most terrible of all sins (Li-Ping Tang, 2010). Freedom of time determines the opportunities to choose when to work or not. Financial freedom determines a sufficient level of income to maintain the chosen lifestyle. Money leads to movement.

Freedom of dislocation determines opportunities to choose a place where to work, from which place to work; this mobility is an evident support to the lifestyle.

Furthermore, time is money. Time and money can compensate each other in some situations, but time is irrevocable, cannot be stored, exchanged or loaned between people, or relived. Therefore, we all need to use our time wisely, and set a goal (Locke & Latham, 1990). Focus on what is important in our lives and do only one thing at a time with the highest level of concentration. Money cannot buy everything.

When people are paid fairly with sufficient resources and support, they can take their minds off money and focus on the tasks on hand (Kohn, 1993: 275).

Consequently, lifestyle business can be an economically advantageous platform for low lifestyle businessmen where to realize themselves by earning income and providing welfare to themselves in the broadest sense of this notion.

## Conclusions

Self-exploration is the first requirement for self-realization. In order to be truly free, you should break chains restricting you. These are the chains with the external world, era, people, modern thinking and topical tendencies. Already in ancient times Socrates was searching for the ideal of universal truth because the only universe known to people to strive for is the universe of a human being. Only in direct communication with human beings one can get apprehension of a person's character. The rapid pace of development has turned the humankind to the beginning when the tempo shall be slowed down and a new form of life shall be found.

Simple living lets reveal oneself and inner thrill giving up illusory passions, desires and requirements, which would let live according to essence and set professionally reachable business goals according to the principles of lifestyle philosophy. Lifestyle business is a response to the hasty era because the technological achievements of the modern era let choose other form of business differing from the classical understanding, however, it is the most ancient form of business. It lets do business and express one's lifestyle in action regardless of geographical location, time zones and hierarchy, which ensure the financial aspect of one's everyday life.

The results of the research are indicative of the fact that slow living can be a form of welfare and a happy life, which allows gaining financial resources by leading a certain lifestyle and having lifestyle business. A perspective of sustainable development has special significance, when you live according to the 'slow living' philosophy.

A scientific discussion is chosen as the scientific research method for the article. It lets analyze bulks of information and position various views, as well as to evaluate ideas. Postulating the conformity of new lifestyle and business philosophy is not an aim because public thought is not fashion changing seasonally. It is the issue of life tempo

among generations. Even sustainable development, which is a concept introduced almost fifty years ago, is often misunderstood and misdefined, consequently, lifestyle business and 'slow living' needs a long time to assimilate in the public thought and understanding. People will continue to search for happiness in money, material benefits, things and other people for a long time. Thus, welfare is also defined by external factors. Long time ago Herman Dali stated that 'enlargement' means becoming larger, while 'development' means becoming better, which might not be related to enlargement. These are not only semantic differences. In the modern society, people leading slow living are a threat to economy because their existence is a challenge to consumer society.

Happiness is a reachable aim to strive for because a mortal human being, no matter how influential, strong and understanding she/he is, has obvious desires. Happiness is one of the central issues in our lives because the humankind is programmed to strive for happiness. Wealth and property can cause fear, concern and tension; a long life can turn out to be nothing more than a long secret and unsolved riddle. Only an omniscient human being can consciously determine what could really make him/her happy.

The analysis of the terms Slow Movement, 'slow living', 'slow money' and 'lifestyle business' is the novelty in the article. An innovative element is also the definition of a precondition for a happy life derived from the 'slow living' philosophy – to understand the essence of things, rhythm of nature and a link with a human being, taking place in life and not to strive for unreachable things. The modern society strives for a concept of joint benefit, which will combine all benefits for its members; however, the society itself is not able to facilitate dissemination of happiness. The innovative element of the article is the postulate of 'slow living' and lifestyle in the context of sustainable development. The practical application of the article is determined by the fact that the respective form of business – lifestyle business is less exposed to cyclical economic fluctuations, thus it is more stable, sustainable and practically applicable in daily business environment. The contribution of lifestyle business to the balanced, happy, full and sustainable life is also practically evaluated. Conclusions are based on the results of the research, determining diverse evaluation of lifestyle business as potentially advantageous for sustainable performance.

The results of the research show that lifestyle business can be the basis of welfare. If a person acts according to his/her interests and abilities, knowledge and skills, professional success can be reached. In addition, lifestyle business provides stability, sustainability of the sense of happiness because actions are taken in compliance with personal interests and lifestyle.

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# THE INNOVATIVE METHODS OF THE LOCAL COMMUNITY ANIMATION IN THE SOCIO-CULTURAL FIELD IN THE EXAMPLE OF THE ASSOCIATION OF LOCAL ACTIVITY CENTER

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## Abstract

A socio-cultural animation is understood as an attempt to activate the local communities in the direction of creative, active ways of solving a variety of specific problems of the local environment and meeting the cultural and social needs of local community residents. The Association of Local Activity Support Center CAL has been operating since 2000. The essence of the CAL method is an attempt of a comprehensive look at the characteristics of the community and its problems, and inspiring the citizens to organize themselves in order to use their potential inherent towards taking different action to a broadly understood social and cultural development. The basic condition for the effectiveness of the CAL method is the involvement of the society as an entity that is best versed in the local issues, needs, as well as considerations. Today, the CAL method is one of the most popular methods of mobilizing local communities. Its superior advantage is the creation of the strong, well-integrated communities, a development of local self-organization and solidarity, which in turn provides a very valuable potential to contribute to the socio-cultural development.

**Key words:** *society, development, animation, CAL, activity, culture*

The purpose of this article is to present innovative solutions for the socio-cultural communities in Poland on the example of the Association of Local Activity Centre (CAL).

The concept of animation comes from the Latin words *anima* – soul, *animus* – soul bestowal, bestowal of life. In the literature, is understood as an attempt to activate the local communities in the direction of creative, active to solve specific problems of the local environment and meeting the cultural and social needs of local community residents. On the basis of the Article. A paragraph. 1 of the Act dated. 08.03.1990r. the Local Government (Journal of Laws of 2001. No. 142, item. 1591, as amended. amended) members of the commune by law are all inhabitants of the isolated territory which forms a self-governing commune. A similar provision applies in relation to both

the district and provincial self-governing community. Such position stresses the importance of the legislature of the universality principle of local government. It means that the only criterion for getting membership to the local community is the very fact of living in a given area (which is the municipal, county or province area). The members of the local community are all inhabitants of this territory, regardless of their level of activity and their involvement in its operation (Klimek, 2006: 44). It can be stated that the local community is a network of personal relationships, group contacts, traditions and patterns of behavior that arise according to a particular type of village and its socio-economic situation. The community development is primarily aimed at enriching the network, developing the self-confidence and skills among the people, so make the social activity the basis on that the living conditions of local communities can be improved (ed. Jordan, Skrzypczak, 2002: 10). The animation is the process of stimulation of the local communities. Barbara Szacka from a sociological point of view stresses the importance of three major determinants as far as the existence of the local community is concerned: the territory, a social interaction taking place between the residents and the relationships expressed in the psychological sense of community with the people residing within a defined territory (Szacka, 2003: 171)<sup>1</sup>.

The concept of the functioning of Local Activity Center is the result of many years of experience of the local entertainers and their search for more effective methods of encouraging the community involvement processes. CAL history dates back to 1997, when the Office for the Movement of Social Initiatives BORIS formed the first group of training. Then the concepts developed and experiences formed the basis of the ideas and methods for Local Activity Center. After some time, the realization of the CAL ideas began to attract some successive partners. As a result, already in 2002, the CAL program gathered nearly 100 local communities throughout the Polish. A turning point was the inclusion in 2000, coordinating the activities undertaken by the Association of Local Activity Support Center. It was appointed by the organizers, partners and coaches CAL. The main goal of initiating of his appointment in 2000 was to create a thriving center of directing more and more dynamic program of CAL (ed. Jordan, Skrzypczak, 2002: 88). The essence of the CAL method is to attempt a comprehensive look at the characteristics of the community and its problems, and inspire their people to organize themselves and use

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<sup>1</sup> In the sociological literature we may find many attempts to extract the theoretical positions in the recognition of local communities. In one of the typology Sanders enumerates four types of concepts: 1) quality – engaging the local community as a place of life, 2) Ecological – treating the local community as a natural spatial unit, 3) ethnographic – engaging the local community as a “way of life”, 4) sociological – treating the local community as a social system (Turowski 1994: 139).

the potential inherent in them towards taking action to broadly understood social and cultural development<sup>2</sup>.

The concept of community development focuses on the residents themselves as the subjects of this process, taking into account their experience and encouraging the participants to become fully involved in social life, as well as to be distinctive actors of ongoing changes (ed. Jordan, Skrzypczak, 2002: 11). According to this idea the community development process has two main objectives: 1) improving the quality of social interaction, relationships and networks of care in the community, 2) helping people in creating and playing their own community and social groups as ways to cope with the locally defined problems and their resolution, and to take over their lives (ed. Jordan, Skrzypczak 2002: 11). Local Activity Center is a form of realization of the social animation. It is the method of operation based primarily on the local self-government body involvement, NGOs, etc. Innovative aspect is taking this concept by these entities into the complex and multifaceted efforts to make them engaged into the social life. It does not focus on one area of activity (eg, culture, or on social assistance), but acts in a multi-faceted, trying to influence and needed to be articulated issues present in the local area (ed. Jordan, Skrzypczak, 2002: 22). CAL is therefore a method of stimulating the residents social activity to organize themselves to solve common problems mainly concerning the local development, e.g. in the fields of culture, education, social welfare, etc. The objectives of the Association of Local Activity Support Center include: 1) supporting the development of local communities, 2) promotion of social, educational, charitable activity of local communities, 3) animating and stimulating local development based on active citizenship, 4) promoting active and creative way of life of local communities in harmony with nature, tradition and modernity, 5) support the activities of organizations, local institutions and citizens working in the area of self, culture, education, entrepreneurship, social welfare and environmental protection, 6) foster and support innovative forms of local public institutions and NGOs, 7) promoting the measures for social communication in the

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<sup>2</sup> The most common methods of activation of the local environment include: 1) community organizing – focuses on the community organized for social tasks, 2) social-cultural animation – improving the social environment by showing a vision of a development and motivating people to be active, 3) community development – measures residents living in certain territories, a joint effort who wish to satisfy their needs and improve the living conditions in their area, mainly by creating the new structures, 4) social planning – implemented by the local government to develop the concept and implementation of the long-term measures aimed at limiting the extent of social problems, 5) community education – implemented by schools and universities, folk, societies, educational faculties, etc., 6) social action – the actions taken by groups of disadvantaged people, 7) community building – producing a situation of cooperation and understanding of the different operators in the local environment, 8) comprehensive community Initiatives – creating a comprehensive strategy for the local development (ed. Jordan, Skrzypczak 2002: 13–19).

local environment, 8) creating a platform for international, national and regional cooperation of local leaders and public institutions and NGOs, 9) development of citizen participation in public life with particular emphasis on the marginalized groups and the unemployed, 10) supporting the idea of European integration (Statute of the Association of Local Activity Support Centre 2011: 1) The Association accomplishes its tasks by: 1) organizing and conducting training and placement of domestic and foreign-raising skills of local leaders and staff of NGOs and public institutions, 2) providing counseling and consultation, 3) collecting, sharing and dissemination of information in accordance with the objectives of the Association, 4) organizing and participating in a variety of national and international meetings, conferences and seminars, 5) publishing activity and information, including the development and publication of materials connected with the objectives of the Association, 6) developing and implementing programs and projects consistent with the objectives of the Association, 7) social research and development of the expertise and reports on the local environment, 8) providing support, including financial, broadening the local civic initiatives, 9) interaction with the centres of social communication, 10) development and maintenance of socio-educational institutions, 11) promoting the idea of European integration, 12) implementation of works and projects consistent with the objectives of the Association, commissioned by other institutions and organizations, 13) implementation of the idea of Local Activity Centers (Statute of the Association of Local Activity Support Centre, 2011: 2).

The association has taken many initiatives since it was established. The main emphasis is placed on the staff education and support for local public institutions in the implementation of environmental and social services as well as the participatory governance. For this purpose, a network of established Local Activity Centres (currently 80 institutions have a Certificate of Quality CAL) was developed mainly basing on the Polish public institutions. An important role in the preparation of future animators of the socio-cultural community education and social workers play the social welfare institutions, officials, librarians, cultural activists, teachers and the community leaders. A variety of training and animation courses concerning particularly social entrepreneurship, active inclusion and social policies and innovative solutions to socio-educational have been conducted. The School of Social Animation has been working since 2002 and it is addressed to the individuals and the institutions which aim at the activation and development the local communities. An important role in the development of animation environment is played by the mutual exchange of views and experiences, and presentation methods of animation. For this purpose, the Association initiated the organization of regular meetings for the animators in the Forum for Social Animators. For years, the Association has been actively supporting the environmental and social movements (the exact example of this type of activity is the Q Neighbourhood Association – building a platform for cooperation, support and education for the active

people working for their local communities). In addition, in 2010 the Association together with the Collegium Civitas, created the Research Communities and Local Policies Center – an analytical research facility where the current studies, observation, testing and diagnosis on the functioning of local communities and their social activity are conducted. Plenty of the innovative solutions to problems and social services have been developed as a part of the laboratories social network. Another aspect of the Association CAL is the socio-educational development of a system of social policy solutions for government, in particular through the implementation of projects system co-financed by the European Union under the European Social Fund. For years, the Association has been actively promoting the social activity within the Active Communities campaign. The platform for creating an environment and space for meetings as well as reflecting on the determinants of social development is the Radlinski Institute). Academic and postgraduate master's degree at the Collegium Civitas co-organized by the Association<sup>3</sup> are the forms of educational organizations linking the social practice and the informal education.

Each local community is a particularly important potential. Its members are the residents well-oriented in the local conditions, problems, needs and resources and opportunities. They know best what their communities need most. Therefore, the essence of the socio-cultural animation should be aware of their potential residents, mining hitherto hidden forces and capabilities, and creative in their use to benefit the entire community. The Local Activity Idea Center perceives the local development as an integrated local system whose functions start from the economy (finance, manufacturing, services), through a social life (structure, relations, relationships) and cultural (lifestyles, values, work ethic) to the power system (government, politics). Therefore it is a complex system (ed. Jordan, Skrzypczak, 2002: 20). The most important role in this process is a full mobilizing and empowering the community (local community) to work towards its development. CAL primarily involves the activation the internal potential of the residents, which is their social and cultural capital.

The CAL long-term goals include: 1) creating the strong and integrated communities, 2) a development of local self-organization, to create bonds of the solidarity and the mutual aid, 3) strengthening and integration of the local civic groups, 4) mobilizing local resources – institutions and local government organizations, NGOs, business, 5) identity-building of the local communities by improving the quality of the social interaction, relationships and networking, 6) helping people in creating and working on their own communities and social groups, which allow to solve the local problems and to seize the control over their lives (ed. Jordan, Skrzypczak, 2002: 23).

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<sup>3</sup> The information on the activities of the Association of CAL was developed basing on the data published on the website [http://www.cal.org.pl/o-nas/jak-dzialamy/misja\\_i\\_cele](http://www.cal.org.pl/o-nas/jak-dzialamy/misja_i_cele) (Accessed: 21/01/2012).

That is why, local community development leaders and entertainers play an enormous role. Leon Dyczewski points out that the real animator is a man who clearly sees a new and better life. It is tied to his vision and to the people with whom he works. He also respects every manifestation of their good will, the slightest interest in what is new and better and supports their efforts to improve the living conditions. The method of his work is not commanded the people, but running their slumbering forces. The value of his work is manifested not in what he invents and makes, but what can extract from the people among whom he works (Dyczewski, 1995: 209–210). Leon Dyczewski presents the tasks of the community animator on the example of the culture animator. These are in his opinion, the following actions: 1) Fostering interest, showing the personal ideals and patterns and disseminating the values, norms and patterns of behavior, 2) Developing personal relationships, creating a variety of groups, integration, 3) Formation and validity of self-esteem, awareness of individuality and love of their environment, 4) learning better ways to perform everyday work and desire for artistic work, 5) Linking the past with the future, 6) Developing the ability to use general culture, primarily of the modern means of social communication, 7) Developing a socio-cultural infrastructure (Dyczewski, 1995: 210–212).

Grassroots citizens' initiatives are today one of the most desirable forms of activity in the public life. In a significant way, they complement the activities of the state and local government. A Social capital is an extremely valuable potential that should be used wherever it is possible. It should be noted that the priority of these bottom-up initiatives directly results from the assumptions of the principle of subsidiarity, which entered the classical formulation of Pope Pius XI in his encyclical *Quadragesimo anno* in 1931. To provide the necessary dynamics of development at the local level there is a need to organize the community in the form of movements, associations, civic groups and political. The scope of their social involvement and quality of the relationship between them is the basis for work on community development and building the local social capital. The Community development highlights the fact that the correct relationships between different actors in public life are based primarily on honesty, self-esteem and mutual respect, friendship and opportunities to learn and develop, along with others (ed. Jordan, Skrzypczak, 2002: 12).

Today, Local Activity Center method is one of the most popular methods of mobilizing local communities. At the same time it is one of the most innovative solutions in terms of promoting the social activity in the direction of solving problems independently of the local environment. The basic condition for its effectiveness is the involvement of society as an entity is best versed in local issues, needs, conditions, and therefore having the potential action in the most creative and effective. Past experience and actions effects show that other countries should benefit from the similar solutions. The implementation of CAL methods contributes to the empowerment of the society, gives the opportunity to build a strong, active and integrated



communities. The increase of social activity contributes to the development of the local self-organization and solidarity, awareness of the need for the common good care and, consequently, a very valuable potential to contribute to the socio-cultural development.

To make the effects of CAL activities long lasting, one of the major assumptions of this method is to build a local partnership, based on the active cooperation of many local actors – institutions, social organizations and residents. Extremely valuable are the initiatives based on the so-called Three Sectors Partnership: public administration, business and NGOs. Each of these entities has its own competence, tasks and opportunities, which they can perfectly fulfill with each other in taking joint action concerning the local community development.

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## **POTENTIALITIES OF SUSTAINABLE DEVELOPMENT: INTERACTION OF CULTURE AND TOURISM**

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### **Abstract**

Sustainable development is world-wide recognized as the main principle of further development of countries and nations. The sustainable development should be guided by the following principles: holistic perspective – development and sustainability are global challenges; futurity – the emphasis should be on the long-term future; equity – development should be fair and equitable both within and between generations. Alongside the well-known three pillars of sustainable development: the environment, the economy and the social aspect, the fourth pillar of equal importance – culture. Culture contributes directly to economic development and every field of culture – be it profit or non-profit, public or private, based on heritage or creative industry – is known to produce employment and revenues. Tourism has assumed a vital role in the development of destinations around the world, and in most cases, culture is a major asset for tourism development as well as one of the major beneficiaries of this development. Moreover, culture in its various forms and dimensions has a significant impact on tourism. The growing interaction or synergy of tourism and culture has been one of the major themes in tourism development and marketing in recent years. At the same time, tourism provides an important means of enhancing culture and creating income which can support and strengthen cultural heritage, cultural production and creativity.

***Key words:*** *culture, sustainability, development, impact, tourism*

### **Introduction**

Sustainable development, although a widely used phrase and idea, has many different meanings and therefore provokes many different responses; in broad terms, the concept of sustainable development is an attempt to combine growing concerns about a range of environmental issues with socio-economic issues (Hopwood et al., 2005: 38). The widespread rise of interest in the concept of sustainable development is potentially an important shift (Kates *et al.*, 2005: 8) in understanding relationships of humanity with nature and between people (Hopwood *et al.*, 2005: 38). Culture can be regarded as a fundamental issue, even a precondition to be met on the path towards sustainable

development that is necessary to get to grips (Soini, 2011). Taking into account that tourism has assumed a vital role in the development; and properly managed, has the potential to participate, change, and improve the social, cultural, economic, political, and ecological dimension of the future lifestyles (Edgell, 2006: 1), culture is a major asset for tourism development as well as one of the major beneficiaries of this development (Reisinger & Turner, 2003: 29; OECD, 2009: 19). Moreover, culture is a deeply embedded aspect of tourism (George *et al.*, 2009: 5) and the growing synergy of tourism and culture has been one of the major themes in tourism development and marketing in recent years (Richards & Wilson, 2007: 1).

The aim of the study is to evaluate the role of culture in sustainable development, particularly development of tourism, which is covered due to following tasks: to review sustainable development's pillars, *inter alia* culture; to evaluate definition of culture for understanding its place in tourism's development; to investigate interaction between culture and tourism, *inter alia* cultural tourism.

The principal materials used for the studies are as follows: different sources of scholar publications, research papers, and the reports of international and EU institutions. The following research methods have been used in the process of study: systematic review, analysis and synthesis, comparative analysis, critical appraisal, logical induction and deduction and etc.

## Sustainable Development and Culture

This chapter aims to provide an overview of the various terms related to culture, to enhance understanding of the corresponding concepts and of their relationship to sustainability and development. The term and definition of culture is widely interpreted (Reisinger & Turner, 2003: 32), considering the different levels and application aims and the term culture receives a variety of interpretations in the academic literature (Hall *et al.*, 2004: 7), but Ivanovic (2008: 11) even argues that defining culture is an impossible task. Moreover, Hawkes (2001: 3) considers that the word culture is one of the most complex and contested words in the English language. The term 'culture' is as old as civilisation and it is derived from the Latin '*cultura*' meaning 'cultivation' and refers to the cultivation of soil in agriculture (Ivanovic, 2008: 6). 'Culture' refers to a general phenomenon characteristic of all human groups as their way of living (Ivanovic, 2008: 10) and has been connected to cultivating the mind through learning (the scholar) or cultivating the arts (the artist) (Hall *et al.*, 2004: 7). Many scientists have divided culture into various levels or layers according to their views. For example, Jussila *et al.*, (2007: 90) consider that culture is found on three levels: micro for individuals, meso as for corporate level and macro for national and international culture. Papageorgiou (2007: 1) outlines that these three levels are interdependent – the culture of the individual depends upon the group and the culture of the various

groups depends upon the culture of the society which these groups belong to. Culture is a multivariate concept and has many definitions. These definitions are complex, unclear and there is no one widely accepted definition (*Table 1*).

*Table 1*

**Definitions of Culture by Different Scholars**

<b>Author</b>	<b>Definition</b>
Hall <i>et al.</i> (2010: 213)	Culture should be conceptualized as a set of actions, material objects, and forms of discourse held and used by groups of individuals
Hawkes (2001: 7)	Culture is the way we live and the way we express ourselves
Hesmondhalgh (2007: 11)	Culture in the broadest anthropological sense as a “whole way of life” of a distinct people or other social group
Ivanovic (2008, 10–11)	Culture is all encompassing part of social life
Reisinger & Turner (2003: 5)	Culture is a complex, which includes knowledge, beliefs, art, morals, law, customs, and any other capabilities and habits acquired by man as a member of society
Siivonen (2007: 181)	Culture is to which individuals are connected and with the help of which they interpret and act in the world
Telfer & Sharpley (2008: 78)	Culture is not only an attribute of destination it is also a product

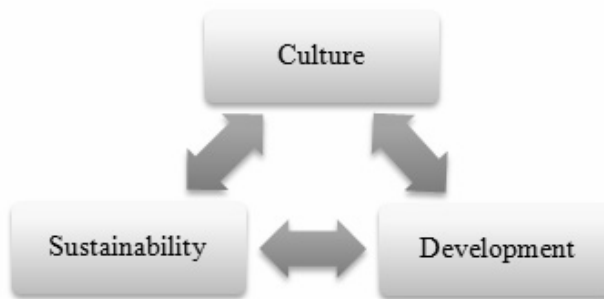
*Source: Author’s summarization*

First of all, it is Nurse (2006: 35) who argues that the area of culture is often narrowly defined and thus made irrelevant to the wider development debate. Hawkes (2001: 3) emphasizes that the word ‘culture’ is one of the most complex and contested words and stands out two inter-related definitions of culture. Without delving too deeply into the mass of scholarly literature that has developed around this word, Hawkes argues that culture is: values, aspirations, memories, purposes, attitudes and understanding; the ‘way of life’ of a particular set of humans: customs, faiths and conventions; codes of manners, dress, cuisine, language, arts, science, technology, religion and rituals; norms and regulations of behaviour, traditions and institutions. Culture, in this sense, includes the values, religious beliefs, norms, social rules, languages and protocols people use to relate to each other, as well as their patterns of behaviour and even the material products they create. Ivanovic (2008: 10) specifies that broadly speaking, ‘culture’ refers to a general phenomena characteristic of all human groups as their way of living.

Non-material expressions of culture incorporate traditional practices and expression of culture such as traditional rites, dances, norms, values, ceremonies, beliefs and cultural identities (Ivanovic, 2008: 17), which are structured and maintained through institutions such as the family, the church, the education system, the economy and the government.

Marsio (2007: 4) stresses that the cooperation of cultural sector, creativity and innovations is important and cultural sector has an important role in enabling sustainable social and cultural development and reducing poverty. He (Marsio, 2007: 6) argues that culture can be identified as identity: common values, attitudes, preferences, knowledge that underlie behaviour in a particular social group, and that can have a positive or a negative influence on social development in a given country or region. In development work this means that culture needs to be taken into consideration.

Kates *et al.* (2005: 8) outline that the concept of sustainable development is now enshrined and featured on 8 720 000 web pages, but the most widely accepted definition is creatively ambiguous. It states, “Humanity has the ability to make development sustainable-to ensure that it meets the needs of the present without compromising the ability of future generations to meet their own needs.” To understand it better, the relationships between culture, sustainability and development are shown in the graphical image (*Figure 1*).



*Source: Soini, 2011*

*Figure 1.* The relationships between culture, sustainability and development

Telfer & Sharpley (2008: 35) outline that sustainable development should be guided by the following principles: holistic perspective: development and sustainability are global challenges; futurity: the emphasis should be on the long-term future; equity: development should be fair and equitable both within and between generations.

Although the economic, environmental, and social pillars have been well defined and documented in community’s sustainability planning, inclusion of the cultural pillar is a relatively new phenomenon in sustainable development. Recognizing that the trio of economic growth, social inclusion and environmental balance no longer reflect all the dimensions of global societies, in November 2010, the United Cities and Local Governments (UCLG) declared that culture was the ‘fourth pillar’ of sustainable development (United Cities and Local Governments 2010); and stresses that many voices, including UNESCO

and researchers, are calling for the inclusion of ‘culture’ in the sustainable development model. As Papageorgiou (2007: 7–8) writes, the cultural issues have for a long time been neglected or given low priority in the sustainability debate; and an integrated approach takes account of all the dimensions of sustainability: economic, social, environmental, cultural, and political; needs to be re-emphasised (*Figure 2*).



*Source: Papageorgiou, 2007: 7*

*Figure 2.* The ‘Square’ of sustainable development

Hawkes (2001: 24) provides the characteristics of four pillars of sustainability (*Table 2*), where he prescribes some relevant attributes. As shown in *Table 2*, cultural vitality is as essential to a healthy and sustainable society as social equity, environmental responsibility and economic vitality.

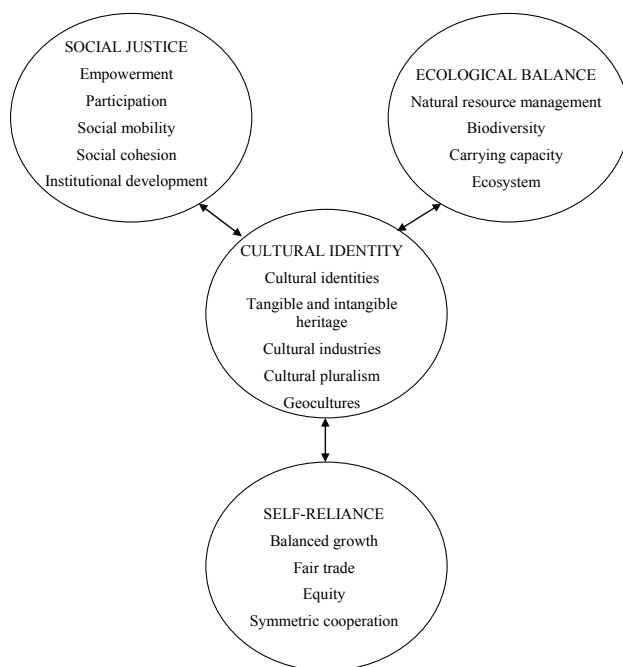
*Table 2*

**Characteristics of Four Pillars of Sustainability**

<b>Pillar of sustainability</b>	<b>Characteristics</b>
Cultural vitality	wellbeing, creativity, diversity and innovation
Social equity	justice, engagement, cohesion, welfare
Environmental responsibility	ecological balance
Economic viability	material prosperity

*Source: Based on Hawkes (2001: 25)*

Nurse (2006: 35) describes the linkage between culture and sustainable development. We fully agree with the argument of Nurse (2006: 38) that the culture must be placed as the central pillar and fully integrated into that of the other pillars of the economy, the social and the ecological (*Figure 3*).



Source: Author's construction based on Nurse, 2006

Figure 3. Four pillars of sustainable development

This figure is just an illustrative example of the shift that more accurately describes the four pillars of the sustainable development. One of the pillars named 'economic' in *Figure 3* is replaced with 'self-reliance', which integrates the main economic directions of development. Thus, it is proposed by Nurse (2006: 38) that an alternative approach to sustainable development prioritizes the following values:

- Cultural identity (the social unit of development is a culturally defined community and the development of this community is rooted in the specific values and institutions of this culture);
- Self-reliance (each community relies primarily on its own strength and resources);
- Social justice (the development effort should give priority to those most in need);
- Ecological balance (the resources of the biosphere are utilized in full awareness of the potential of local ecosystems as well as the global and local limits imposed on present and future generations).



Culture is often confused with art (Hawkes, 2001: 7), although culture has broader perception and application. Bandarin *et al.* (2011: 18) argue that culture contributes directly to economic development and every field of culture – be it profit or non-profit, public or private, based on heritage or creative industry – is known to produce employment and revenues. Sharpley and Telfer (2002: 216) identify three major types of culture, which are of interest to tourists:

- 1) inanimate forms of culture (historical building, monuments, traditional arts and crafts);
- 2) reflection of normal day-to-day life and activities of host communities;
- 3) animated forms of culture (religious events, carnivals and traditional festivals).

## Culture and Tourism Interaction

UNESCO emphasises that “tourism can contribute to cultural revitalization, drawing from authentic sources and stimulated by an increasing market of postmodern tourists who are searching for ‘meaning and truth’ in culture (George *et al.*, 2009: 130). The revenue generated by tourism has become a very important resource and a key factor in the balance of payment for many countries and has been a major contributor to their economic growth (Ivanov and Webster, 2007: 379). Hall (Hall, 2007: 4.) argues that tourism needs greater recognitions for its capacity to general economic, environmental and social benefits. Tourism has a positive economic impact on the balance of payments, employment, gross income and production, but it may also have negative effects, particularly on the environment (Creaco and Querini, 2003); and it has multiplier effect (Flecha *et al.*, 2010: 29). In this global economical situation, the only sector that really demonstrates a continuous upward trend has been tourism (World Travel Media 2010). Keller (2002: 1) indicates that tourism and culture are new paradigms for the sustainable development of tourism. Scholars outline that the culture and tourism have a mutually beneficial relationship (Jamal and Robinson, 2009; OECD, 2009: 17), which can strengthen competitiveness of regions and countries. Culture in its various forms and dimensions has a significant impact on tourism (Reisinger & Turner, 2003: xii) and it also creates distinctiveness in a crowded global marketplace (Telfer & Sharpley, 2008: 74). However, it has eroded distinction between culture, tourism and everyday life (Ivanovic, 2008: 43). At the same time, tourism provides an important means of enhancing culture and creating income, which can support and strengthen cultural heritage, cultural production and creativity (OECD, 2009: 17). The current cultural tourism market represents the latest phase in a long standing process of convergence between culture and tourism (Richards, 2003: 2). Cultural tourism has to be explained within the broader context of culture (Akama & Sterry, 2000: 14).

The concept of interaction is fundamental to understanding this phenomenon and such interaction is, at the same time, intersocietal, intercultural and intersectoral (Parris,

2002: 1). Manap *et al.* (2011: 337) indicate the various interacted impacts on tourism: economy, social, cultural and environmental.

Cultural tourism has been identified as one of the major growth markets in global tourism (Richards, 2002: 35; Smith, 2009: 14); and it delivers benefits to local communities. These benefits include: creating jobs and businesses; increasing tax revenues; diversifying the local economy; creating opportunities for partnerships; attracting visitors interested in history and preservation; increasing historic attraction revenues; preserving local traditions and culture; generating local investment in historic resources; building community pride in heritage; and increasing awareness of the site or area's significance (OECD, 2009: 22). Cultural tourism, much of which is based on heritage, accounts for an estimated 40 per cent of total tourism revenue (Bandarin *et al.*, 2011: 18). Moreover, Minnaert *et al.* (2006: 12) argue that the forms of social tourism like ecotourism or sociotourism, supporting local cultures, communities, and ecosystems would be a preferable alternative for the traditional tourist industry, and would be more acceptable.

Despite the aforementioned benefits of cultural tourism, the term 'cultural tourism' is very much misleading and therefore not readily accepted by many scholars (Kastenholz *et al.*, 2005: 2–3; Sgouris, 2007). Some researchers use a narrow definition of 'cultural tourism', while others choose a broader one (Kastenholz *et al.*, 2005: 2–3). Moreover, Richards (2003: 13) is yet even more categorical and argues that culture is itself so difficult to define, but the different approaches to cultural tourism have tended to add to the confusion and the needs of the cultural object of tourism could be avoided. Because culture touches every aspect of human life, it can be argued that everything is cultural (OECD, 2009: 25). According to this view, all tourism might be considered as 'cultural tourism', because "all movements of persons...satisfy the human need for diversity, tending to raise the cultural level of the individual and giving rise to new knowledge, experience and encounters" (OECD, 2009: 25). This broad approach is not very useful because it does not allow us to identify those forms of culture which are particularly important for tourism. Furthermore, Pedersen (2002: 24) argues that, because culture is subjective, definitions of cultural tourism tend to be either too wide or too narrow, limiting their practical use in the field. As the complexity of cultural tourism grows, so new approaches to development and marketing are required (Richards & Wilson, 2007: 32). Hull (2010: 7) offers new approach to cultural tourism – need for creative activities / packages that promote a system of 'co-production' between tourist and the producers in the destination; and proposes that new cultural developments must focus on needs of residents and tourists to maximize local benefits.

The economic benefits of cultural activities are usually judged by the revenue they generate (Papageorgiou, 2007: 28). Such revenue falls into three types:

- 1) direct spending by visitors, i.e., spending at a site or an event. This may include entrance fees, catering and accommodation services, purchase of souvenirs etc.;

- 2) indirect spending, i.e., spending by businesses that provide the above goods and services, as producers of cultural goods and services or as producers of tourism services;
- 3) induced spending (spin-offs), i.e., spending sparked by these indirect business expenditures (e.g. orders placed by cultural or tourism businesses with their suppliers will generate further orders to yet other businesses). This is usually called the ‘multiplier’ effect of direct and indirect spending.

The process of attaching monetary value to various cultural objects and activities of their intrinsic value is known as the commodification of culture (Ivanovic, 2008: 10). It is globalisation and the new economy which has transformed culture into a commodity as well (Reid, 2002: 27) and in many areas, tourism has hastened the commodification of traditional and unique cultures (Shepherd, 2002: 183).

## Conclusions

Although the definition of culture is world-wide used, the term is widely interpreted considering the different levels and application aims and receives a variety of interpretations in the academic literature.

Nevertheless, it is argued by scholars that the fourth pillar of the sustainable development is culture. The culture must be placed as the central pillar and fully integrated into other pillars of the economy, the social and the ecological. It means that culture, broadly or narrowly interpreted, plays an important role in sustainable development.

Narrowly defined, culture is often confused with art, although culture has broader perception and application. There are three major types of culture, which are of interest for tourists: 1) inanimate forms of culture (historical building, monuments, and traditional arts and crafts); 2) reflection of normal day-to-day life and activities of host communities; and 3) animated forms of culture (religious events, carnivals and traditional festivals).

Since in the current global economical situation the only sector that really demonstrates a continuous upward trend is tourism, the interaction of culture and tourism has growing importance. Scholars outline that the culture and tourism have a mutually beneficial relationship which can strengthen the attractiveness and competitiveness of regions and countries. Moreover, culture in its various forms and dimensions has a significant impact on tourism development, which delivers benefits to local communities. These benefits include: creating jobs and businesses; increasing tax revenues; diversifying the local economy; creating opportunities for partnerships; attracting visitors interested in history and preservation; increasing historic attraction revenues; preserving local traditions and culture; generating local investment in historic resources; building community pride in heritage; and increasing awareness of the site or area’s significance. Through

growing well-being of local communities, the country's development and well-being are facilitated.

The detailed research of impact's evaluation of culture on tourism development in Latvia should be conducted after studying and assessment of evaluation methodology and methods. Such studies should be useful for policy and programming development in the sphere of tourism.

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# THE PERSPECTIVES OF THE UKRAINIAN-LATVIAN INTERNATIONAL INTERREGIONAL COOPERATION

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## Abstract

The modern approaches to international policy cooperation in the Baltic-Black Sea-Caspian region have been analyzed in the paper. A new tool which can stimulate regional development in Ukraine is the international interregional cooperation. Interregional cooperation in Ukraine with the European Union is one of the priorities of Ukraine's European integration. In this scenario the context of the presentation are task interaction between the Ukrainian regions, Latvia and other Baltic States.

**Key words:** *international interregional cooperation, International cluster, sustainable development, economic interests, socially responsible business, regional policy*

## Introduction

Sustainable balanced socio-economic development requires the activation of market reforms and improvement of regional policy which is the main criterion of effectiveness in improving the competitiveness of regional economies. The current post-crisis stage of the Ukraine's economy is characterized by limited state financial resources that could be directed at minimizing regional disparities of socio-economic development. This requires an active search for other factors that strengthen competitiveness.

New tool which stimulate regional development in the Ukraine is the international interregional cooperation on the cross-border level, transnational and interregional cooperation. Interregional cooperation of the Ukraine with the European Union is one of the priorities of the Ukraine's European integration. The main goal of international interregional cooperation policy should be the intensification of cooperation relations between the economic systems of different regions of the Ukraine and its partner countries.

Problems of interregional cooperation, the development of international trade and economic relations are considered to be the subjects of study for many European scientists and research teams. In Ukraine, the majority of researches and practical actions concerning cooperation in border regions are on the level of cross-border, transnational and interregional co-operation with neighboring countries.

It is promoted by the EU, that projects which are funded by the European Neighborhood and Partnership Instrument (ENPI), which is the main financial mechanism through which assistance is given to European Neighborhood Policy (ENP) countries, plus Russia. The Ukrainian state policy on the regulation of international cooperation regions are also largely focused on immigration and border cooperation. One of the three priority areas in Ukraine, which are funded through the “European Neighborhood and Partnership Instrument” (ENPI), defined by the National Indicative Program (2011–2013), concerning sustainable development and supports the cooperation in areas such as energy, environment and climate change, transport, regional and rural development. Positioning Ukraine as a country and its territories in sub-regional and global economic space as business entities with significant aggregate capacity development needs to consider the possibilities and prospects of cooperation with other countries and its territories that do not have direct common borders.

The greatest interest of Ukrainian regions are found to strengthen and diversify relations with partners from the EU countries, including the Baltic states at the expense of the common (regional) projects in areas of manufacturing, services and infrastructure provision.

The objective is to identify major trends and prospects for regional economic and cultural cooperation with the regions of Latvia.

## The main material

International and interregional cooperation is carried out as inter-territorial, interregional and transborder process. Generalization of these types of cooperation's first introduced by Hans-Martin Chudi (Switzerland) on the IX meeting of the Congress of Local and Regional Authorities of Europe (Strasbourg, 4–6 July 2002) in the report “Promoting cross-border cooperation: an important factor of democratic stability in Europe” (Olejniczak K., 2008: 110). “To identify all forms of cooperation, we have to use the “trans-European cooperation” (trans-European cooperation). Differences in concepts can be caused when defining cooperation in the following cases:

- Cross-border cooperation (cross-border co-operation) multilateral cooperation between local and regional authorities, carried out in geographically contiguous areas;



- Inter-territorial cooperation (inter-territorial co-operation) multilateral cooperation between local and regional authorities (private entities may also be included in this context) that takes place between non-adjacent territories;
- Transnational cooperation (transnational co-operation) – cooperation between national, regional and local authorities under transnational programs and projects.”

For all regions of the European Union, listed areas of cooperation are included in one section – “Europe as territorial cooperation”, which, under the new cohesion policy provides (Olejniczak K., 2008: 110–111):

- Cross-border cooperation (cross border co-operation) between the neighboring regions of the EU, which are located both at internal and external borders (land and sea);
- Transnational cooperation (transnational co-operation) within the zones of supranational cooperation that covers the major European territories (the Baltic Sea region and the Alps);
- Interregional cooperation (interregional co-operation) within the framework of cooperation that emerged between arbitrary regions of the EU.

The types of “interregional cooperation” can be:

- Government-Regional work-based on interstate agreements.
- Regional-local – the personal contact partners that are caused by economic needs and cooperation in culture and science.

In the history of bilateral and multilateral cooperation between the Ukraine and the Republic of Latvia the resolved issues are political, economic, social and environmental. Analysis of existing organizations and projects confirms the priority of the political interests of both parties.

One explanation for this can be the fact that even in the basic documents – Resolution of the Verkhovna Rada of the Ukraine “On main directions of foreign policy of the Ukraine” dated July 2, 1993, we find that “foreign policy efforts should be constantly directed to that border states which are formed around the Ukraine as reliable zone of peace and stability”.

In this context, each border state is a strategic partner for the Ukraine “and” geographically close to the state with some neighboring countries; they act as a bridge between the Ukraine and Western Europe. The Baltic States, in turn, has long considered the Ukraine as an integral element of the Great Baltic region, indicating that the border through Ukraine Baltic Europe with other geopolitical regions important for them.

Enhancing economic cooperation between the Ukraine and the Republic of Latvia started when Government of Ukraine and Government of Latvia have signed a Riga

Agreement about economic, industrial, scientific and technical cooperation between each other on 5<sup>th</sup> of October 2004.

According to the State Statistics Committee in the Ukraine (Зовнішня торгівля України товарами з країнами ЄС 2011), for the period of 2006–2010, the figures of external trade (goods and services) between the Ukraine and Latvia changed from positive dynamics of growth in the pre-crisis period to the reduction the rate of turnover during crisis 2009–2010 (*Table 1*).

*Table 1*

**Indicators of Foreign Trade (in goods and services) between Ukraine and Latvia, million (according to State Statistics Committee of Ukraine)**

<b>Indicators</b>	<b>2006, mill. dollars (USA)</b>	<b>+/-, %</b>	<b>2007, mill. dollars (USA)</b>	<b>+/-, %</b>	<b>2008, mill. dollars (USA)</b>	<b>+/-, %</b>	<b>2009, mill. dollars (USA)</b>	<b>+/-, %</b>	<b>2010, mill. dollars (USA)</b>	<b>+/-, %</b>
<u>Commodity circulation</u>	430,34	+0,3	446,7	+3,8	472,6	+5,8	352,4	-25,5	328,8	-6,7
<u>Export</u>	326,52	-7,1	305,8	-6,4	337,2	+10,3	219,7	-35	211,5	-3,7
<u>Imports</u>	103,82	+33,9	140,9	+35,7	135,4	-3,9	132,7	-2	117,3	-11,7
<u>Balance</u>	+222,70	–	+164,9		+201,8		+87,0		+94,2	

## Interregional Cooperation

An important step in the development of bilateral relations between Ukraine and Latvia, we consider the expansion of economic cooperation, support of political and cultural relations, forming partnerships and contacts between both regions.

Note that until recently the regional aspects of the Ukrainian-Latvian cooperation wasn't really brought up for attention at the state level by both countries.

Most contacts were on the declarative level concluded cooperation agreements (e.g., agreement of cooperation between Kharkov and Daugavpils (2006), Ivano-Frankivsk and Yelhavoyu (2007) or the protocols of intentions (e.g., the protocol of intentions of cooperation between Lvov City Council and the Riga City Council (June 26–27, 2008), the letter of intent of cooperation between the Daugavpils regional Council and Ichnyansky district administration (July 2010), the letter of intent of cooperation between Drohobych and Smiltene areas (July 2011)).

The regional policy appeared first among the main areas of economic cooperation (transport, energy, enterprise, industry, tourism, education and scientific and technical cooperation) in the third meeting of the Ukrainian-Latvian intergovernmental commission on economic, industrial, scientific and technical cooperation (29 July, 2010).

Describing interregional cooperation at the present stage of development of the Ukraine, it should be noted that the dominance for a long period of supply and marketing of

economic relations between Ukrainian and foreign regions caused the formation of economic relations with the predominance of trade as the simplest form of economic cooperation.

The mutual exchange of goods and services between the Ukraine's regions and regions of Europe are based on the current specialization of regions and determined their level of development. The regions with lower level of development and with the investment deficit and surplus labor specialize in producing and export in labor-intensive products.

The developed regions that receive a significant amount of investment and a substantial amount of capital (including innovation, research and development) specialize in export of capital-intensive products.

It is determined that the Ukraine is the most active in developing interregional cooperation in agriculture, tourism, construction and provision of advisory service. Instead, a slow developing interregional cooperation in the fields of new technology, industrial cooperation, import substitution, medicine, development of alternative energy (especially in the development of renewable energy sources).

For entry into a fully fledged interregional cooperation the transition from trade to designing a model of relations of regions should take place. This refers to providing practical dimension of the European integration strategy of the Ukraine – in the way of establishing direct links between stakeholders and to establish interregional cooperation with the EU regions.

By definition, the European Commission (Eastern regional program strategy paper 2007–2013. 2007) should promote the regional cooperation: strengthening regional integration, stimulating the exchange of experience and its transferring, developing and promoting the best practices, identifying the common thematic strategies and action plans for the joint implementation of specific projects, networking with individuals and organizations, strengthening the national capacity and local administration, strengthening the civil society.

The policy priorities of interregional cooperation should include:

- Expansion of regional and international cooperation ties of small, medium and large manufacturing enterprises and establish direct contacts between customers and potential suppliers, contracts;
- Exchange of experience on effective management and organization of industrial production of small and medium enterprises, restructuring of large enterprises and holding companies;
- Implementation of investment reforms, improving the investment climate, the formation of innovation-oriented investment projects (Біла С.О. 2011: 6), the formation of “investment map of the region”, creation of a series of new tools of financing investment;
- Use of external economic potential of the regions and their export-oriented production;

- Development of regional and interregional infrastructure, including transport;
- Realization of potential regional cluster initiatives.

In 2011, the Ukraine has started the formation of the Institute of International Cooperation of Regions according to the Cabinet of Ministers of the Ukraine action plan to stimulate interregional cooperation, cooperation and integration (registration № 896-p, 21 September 2011). The interregional cooperation action plan provides the following:

- Agreements (development programs) of cooperation between the regions of the Ukraine and administrative-territorial units of foreign countries in various fields that contribute to spontaneous transformation of contacts in the system of stable economic relations, implementation of common cultural, scientific and technical projects;
- Introduction of the annual Regional Forums of the Ukraine, as well as holding on an ongoing basis business meetings, presentations, exhibitions, round tables, etc. In the concluded agreements on cooperation between the regions of the Ukraine and administrative-territorial units of foreign countries;
- Creation of interregional database on the amount of demand and supply of goods (works, services) produced (performed, rendered) by the enterprises of the region.

Today, the Republic of Latvia and the Ukraine are looking for opportunities for the domestic enterprises in the framework of the transnational cooperation (transnational co-operation) by including in the production flow of multinational corporation at any stage of the creation of good relations. In one of the main planning documents, long-term development of the Latvian state – “Strategies for sustainable development in Latvia in 2030” (Стратегия устойчивого развития Латвии до 2030 года, 2010: 47), approved by the Parliament of the Republic of Latvia, the stated aim is to become the one of the leaders of the European Union with innovative distribution and exporting enterprises. To achieve this goal the strategy developers the necessity of implementation of the Cluster Development, as the leading enterprises of the country must become part of international post-subject cluster. In this scenario it is appropriate to consider the context of industrial clusters, according to M. Porter, as a set of productions where there are relations “purchaser-provider” and “supplier-buyer”, or common technologies, common buyers or distribution channels, or general human resources.

On the territory of Latvia there are large numbers of active clusters and cluster initiatives which increases economic cooperation between actors from the regions of the Ukraine. However, analysis of the cluster initiatives in the Republic of Latvia and the Ukraine demonstrates two significant differences in cluster development policies of both countries. First, the cluster policies in different regions are markedly different in their scale. The financial resources to develop clusters are ranging from the

significant strategic EU budget in the Republic of Latvia to the financing of some small projects from the State budget of the Ukraine. In order to stimulate the business development, the European Regional Development Fund in 2007–2013, is supporting the Republic of Latvia in the cluster. The main problem in the matters of international cooperation of the Ukrainian regions remains an imperfect mechanism for financing of the joint projects implemented with the support of the EU programs. In the Ukraine for the period of 2011–2015 the external transnational cooperation includes the public funding of 10 projects with a total financial support of 48.3 million UAH (Державна програма розвитку транскордонного співробітництва на 2011–2015 роки, 2010).

The second aspect concerns the differences in the immediate goals and instruments in the cluster policy. Politics in the Republic of Latvia is largely focused on supporting the network of interactions between members of the cluster, while the cluster policy in the Ukraine so far is to support the projects focused on the specific sectors. A common drawback is that the main aim of cluster policy of both countries is to increase the economic efficiency and increase the skill level of labor, rather than support the innovations.

Under conditions of the increasing competition for resources the innovative potential of international regional cooperation development should be actively used, that includes the implementation of joint international research and development projects aimed at modernizing production innovation as the basis of structural modernization of the national economy (Жаліло Я.А., 2011: 26). In the context of our research, we stress the urgency of cluster approach in politics of interregional cooperation, that is an element of innovation and investment strategy of the Ukraine and the Republic of Latvia.

## Cluster Analysis

Let's define the joint industry cluster policy, priorities for both countries:

1. *Promote "green" economy.* A cluster of technology is possible to attract green investment and innovation of environmentally oriented interregional projects in Ukraine and the Republic of Latvia.
2. *Transit and transport area.* Creation of transport and logistics cluster could become a strategic direction of cooperation between Ukraine and the Republic of Latvia in the development of international transport between the Baltic and Black Seas.
3. *Construction and architecture.* Cluster technology in construction and architecture will enable the exchange of experience and knowledge of the planning area.

4. *Tourism*. Recreational potential of both countries to promote the use of cluster technology to improve tourism infrastructure, tourism and recreation, promoting tourism opportunities in both countries at the international level.
5. *Forestry and woodworking*. In the western regions of Ukraine and eastern regions of Latvia's wood production is sufficiently developed and it is a relatively free niche (manufacture of wooden products with higher added value) that can develop in conjunction with using clustered technology.

At the government-regional level the cooperation between the Ukraine and the Republic of Latvia institutional structures concerned in the formation of innovative business environment and economic space clustering are as follows: Ministry of Regional Development, Construction and Housing and Communal Services of Ukraine, Ministry of Regional Development and Ministry self-government of Republic of Latvia, Ministry of Economic development and Trade of Ukraine, Ministry of environment and Regional Development of Latvia, the Council of Ministers of the Autonomous Republic of Crimea, oblast, Kyiv and Sevastopol city administration, the Latvian investment and Development Agency, Latvian Confederation of Employers (LDDK) and others.

Only during 2011 the indicated institutions initiated a number of proposals of cooperation that can be realized through the use of cluster technology. Thus, the Embassy of the Ukraine in the Republic of Latvia initiated cooperation with the Ventspils region and Zemgale area in Latvia. Zemgale District planning in Latvia expressed interest in cooperation with the Vinnytsia region on the following issues: economic development areas (use of industrial areas, the use of minerals in road construction, food processing, woodworking, etc.), development of cooperation between the Latvian Agricultural University and the Vinnitsa National Agricultural University; development of cooperation between rehabilitation facilities and the development of tourism, the development of museums and cultural activities. On the level of "Department of the Riga Council – Lviv Regional State Administration" began implementing a center for trainings for prospective projects that can be made using the European regional funds, and established an exchange of experience with the European integration issues at the national and regional levels (Міжрегіональне співробітництво, 2011). Within days of the Crimea in Riga in September 2011, the first meeting of the Working Group of the Ministry of resorts in the ARC and the Riga Council, which was established to form a stable bilateral tourism flow between the Crimea and Latvia. During the meeting, there was signed a protocol on cooperation, which defined the main priorities of the cooperation in tourism, culture, and some economic blocs.

To start the cluster initiatives at interregional level is necessary to determine and compare the international specialization of regions of both countries (*Table 2*).

Table 2

<b>Regions (functional network)</b>	<b>The largest development centers</b>	<b>International specialization (individual profile) and cluster interests</b>
<i>Republic of Latvia</i>		
<b>Kurzeme</b>	Liepaja, Ventspils, Kuldīga, Talsi, Saldus	Transit and logistics business, technologically advanced food production, fisheries and tourism, Modular construction and manufacturing, production of goods for domestic use, space technology.
<b>Zemgale</b>	Jelgava, Jekabpils, Bauska, Dobele, Aizkraukle	Activities of industrial, logistics and technology parks, research cooperation centers and placement services Packaging for paper, dairy products.
<b>Rīga district</b>	Rīga, Jūrmala, Tukums, Ogrē, Sigulda	Formation of globally oriented Nordic business, academic and financial center – Rīga, production, recreation of Medical Clinics, recycling of sorted materials, the production of ultra-thin coatings, automotive technological development of wireless systems, steel production, producing marine and industrial diesel generator sets, thermoplastic materials, ecotourism.
<b>Vidzeme</b>	Valmiera, Cēsis, Valka, Limbaži, Madona, Smiltene, Alūksne, Gulbene	Educational, industrial innovations, cultural and tourist services Metal, woodworking, food production facilities.
<b>Latgale</b>	Daugavpils, Rēzekne, Jekabpils	Research, cultural and educational services, innovation enterprise, transit Recycling wood waste, the production chain for vehicles, bicycles and various lifting, mechanisms, flax processing, development of multimodal logistics centers.
<i>Ukraine</i>		
<b>Donetsk</b>	Donetsk, Makeyevka, Mariupol, Gorlovka, Lugansk	Production of vehicles, aircraft, craft and related equipment and transport equipment, components, development and implementation of new technologies for their assembly (manufacturing);
<b>Pridneprovsky</b>	Dnipropetrovsk, Dnipropetrovsk	Production and processing of agricultural products and food production, light industry; Improving chemical technologies, new materials, development of biotechnology, transport and trade logistics services, health and healing people and the environment.
<b>Northeast</b>	Kharkiv, Poltava, Sumy	
<b>Capital</b>	Kyiv, Zhytomyr, Chernihiv	Upgrading power plants, new and renewable energy; new resource technologies, nanotechnology, microelectronics, information technology, telecommunications, high-tech agriculture and processing industry, development of innovation culture society
<b>Central</b>	Kirovograd, Cherkassy, Alexandria	
<b>Black Sea</b>	Simferopol, Nikolaev, Kherson, Odessa	

<b>Carpathian</b>	Lviv, Uzhgorod, Ivano-Frankivsk, Chernivtsi	Tourism, decorative textiles, garments, construction, food processing, wood working. Improved transport links, a Euro border, high ways and roads, as well as regional airports, the development of enterprises with environmental protection, improvement of tourism services in the Carpathian region.
<b>Podolsky</b>	Vinnytsia, Khmelnytsky, Ternopil	
<b>Northwestern</b>	Lutsk, Kovel, Rovno	

## Offers

Important measures to strengthen interregional cooperation between Ukraine and the Republic of Latvia we offer:

- Definition of interregional cooperation within the Euro regions are one of the priorities of regional development strategy and foresight in the local budgets of Ukraine funds to support programs and projects of interregional cooperation;
- Development of regulatory framework for the mechanism of formation of interregional clusters, providing state support or their operation and development;
- Regional development programs of international cooperation, which determine the competitive advantages of regions and priority areas for international cooperation in developing and implementing international projects in industry and research field;
- Establishment of regional banks and international projects implementation monitoring and evaluation of completed projects;
- Ukraine's accession to the European strategy of clustering industry and the ratification of the "Manifesto clustering EU" (2007) and Cluster Memorandum (2008) and Ukraine to become a full member of EUREKA program;
- Signing the Memorandum of Understanding and cooperation on regional development between Ukraine and the Republic of Latvia in order to exchange experience in various regional projects, cooperation in the planning area and establish business and cultural relations between regional parties.

## Conclusion

Implementation of cluster strategies in Latvia and Ukraine in the near future should be the main priorities not only at national but at regional and local levels. Regions and their agents should act as the main and most active spokesmen cluster of interest. Finally, the use of cluster technology at the level of interregional cooperation between the two countries will provide additional growth opportunities of trade relations, mutual investment, exchange of information and business experience, adapting to innovative changes in the world by increasing competitiveness.



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# DECENTRALIZATION OF CULTURE IN LATVIA DURING THE TRANSITION PERIOD (1991–2010)

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## Abstract

The paper will review the process of decentralization of culture in Latvia during the transition period (1991–2010) aiming to analyse whether the changes have driven to the balanced regional development. The framework of the study is the concept of social cohesion that includes the concern of equal distribution of public services to all inhabitants. The paper will focus on the cultural decentralisation that aims at providing common cultural standards across the country. During the transition period, both cultural accessibility and availability have changed significantly and these changes have affected regions and rural areas of Latvia.

**Key words:** *decentralisation, culture, transition, cultural policy, social cohesion*

## Introduction

The paper will review the process of decentralization of culture in Latvia during the transition period (1991–2010) aiming to analyse whether the changes have driven to the balanced regional development. This will be tracked, having in mind the developments in the field of social cohesion in Europe. The issue of social cohesion is the core of the policies of the European Union and the Council of Europe, defining social cohesion as the 'capacity of a society to ensure the well-being of all its members, minimising disparities and avoiding marginalisation' (Council of Europe, 2008: 14). The main principles include equal access to rights and resources, with attention also to vulnerable groups, and dignity/recognition for individuals, as expressed through human rights and managing the balance across interests, generations and domains of action (Council of Europe, 2008: 14). In the field of cultural policy, decentralisation as an issue of concern includes many social cohesion tasks. Heiskanen (2001: 7–8) suggests that decentralisation in culture among other issues is concerned with providing equal cultural opportunities for all citizens.

Even though there is no articulated social cohesion policy in Latvia, the main planning documents address the issues that might be included in the social cohesion policy. The Latvian National Development Plan 2007–2013 (Ministry of Regional Development and Local Government of the Republic of Latvia 2006), among other priorities,

envisages development of the regions, equalisation of employment opportunities between the capital and the regions, as well as augmentation of welfare of inhabitants. Similarly, the *State Cultural Policy Guidelines 2006–2015* (Ministry of Culture of the Republic of Latvia, 2006) have defined several objectives matching the social cohesion concerns, for instance – to keep and increase audiences and customers of cultural products and services; to diminish social and regional discrepancies in the quality of life and accessibility of culture; to establish a unified cultural environment, emphasizing national values that would consolidate society; and to foster involvement and self-organisation in society. *The Sustainable Development Strategy of Latvia until 2030* (Saeima of the Republic of Latvia 2010) maps out the spatial development perspective, setting the ensuring of equal life and work conditions for all the inhabitants regardless of their place of residence as one of the objectives.

In order to analyse the developments of cultural policy aiming at balanced regional development during the transition period<sup>1</sup>, a phenomena of cultural decentralisation will be reviewed. The reasons for such a choice are numerous. First, the social cohesion issues are mapped out in major policy documents and cultural decentralisation as phenomena comprising a broad range of issues supporting social cohesion concerns. Second, decentralisation is one of the key aspects of transition process. Third, different aspects of decentralization developed at different speed and had divergent effects on cultural policy, allowing for illustration of different patterns of change. It is significant to see how the goals that are set at policy level aiming to create equal conditions and opportunities for all the inhabitants are put into practice. Although in other European countries social cohesion issues concern the living standards of immigrant communities, the immigration in Latvia has not reached significant level (3,541 persons in 2007; 3,465 persons in 2008, 2,688 persons in 2009, according to the data of the Central Statistical Bureau (CSB)). Thereby the social cohesion issues are directed at the social stratification and social inequality of the permanent residents (both citizens and non-citizens), development of the regions, especially in the context

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<sup>1</sup> Transition is understood as a period of reforms after the collapse of the Communism, starting with 1991 when the independence of Latvia was regained *de jure*. In a broad sense, two processes started: transition from command economy to market economy and from the totalitarian regime to democracy. In the field of culture, transition to market economy significantly influenced culture consumption patterns, funding models and operation of cultural organisations. Transition to democracy multiplied actors of public cultural life, diversified legal structures of cultural organisations and altered values and ethics, among many other changes. Although from the economic and political perspective it is considered that transition is over for the countries that joined the EU, the author of the present paper argues that cultural systems are still in the transformation phase and transition in cultural policy is not fully completed. So I shall discuss the transition period from 1991 to 2010. For the sake of comparison, statistics of the year 1990 will be used to compare the change before and after the independence was regained.

of centralisation of inhabitants, business, entertainment and other activities in the capital city (According to the data of the CSB, in 2010, 31.4% of the population lived in Rīga; 48.7% of the population resided in Rīga and its neighbourhood – Pierīga region).

## Cultural Decentralisation: Theoretical Considerations

Speaking about cultural decentralisation, I would refer to the work by Nabuko Kawashima (2004<sup>2</sup>) who proposes division of three types of decentralisation: cultural decentralisation, political and fiscal decentralisation. This division is slightly different from the general classification of decentralisation in political science: in Kawashima's classification, political decentralisation includes also administrative decentralisation (classified separately by Work (2001) and Treisman (2007)) and additionally proposes the concept of cultural decentralisation.

One of the basic values of modern, liberal democratic societies is, in principle, to achieve equality. In other words, to achieve equality in culture requires the government's intervention in the market which would otherwise behave to create, retain or exacerbate inequality (Kawashima, 2004). Thus optimising equality must be one of the main objectives and principles of cultural policy.

Concerning the debate on cultural decentralisation, two other concepts in cultural policy are important – 'democratization of culture' and 'cultural democracy'. The earlier concept of 'democratization of culture' that called for increased accessibility of cultural production, to a wider target group, but still emanating from elite institutions of culture was replaced by the concept of 'cultural democracy' that emphasizes the number and diversity of its cultural initiatives, especially those which are local, and which help to raise the overall standard of cultural life (Dragičević Šešić & Dragojević, 2005: 25). Mulcahy (2006: 323–324) indicates that this change includes the shift from top-down and centre-periphery approach (democratization of culture) to bottom-up policy and participatory model (cultural democracy). The objective of cultural democratization is the aesthetic enlightenment, enhanced dignity, and educational development of the general citizenry, remarks Mulcahy (2006: 324). The strategies include dissemination to establish equal opportunity for all citizens to participate in publicly organized and financed cultural activities, such as performances and exhibitions at low cost; public art education; national institutions touring and performing in work places, retirement homes, and housing complexes. While the objective of cultural democracy, on the other hand, is to provide for a more participatory (or populist) approach in the definition and provision of cultural opportunities (Mulcahy, 2006: 324).

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<sup>2</sup> The author of the present paper uses the most recent study by Kawashima "Planning for Equality? Decentralisation in Cultural Policy" (2004) as a reference. Kawashima has discussed decentralisation also in other articles (1995; 1997).

The main idea is to provide equal opportunities for citizens to be culturally active on their own terms. The strategies include cultural activities that comprise popular entertainment, folk festivals, amateur sports, choral societies, and dancing schools. The programmatic emphases recognize cultural diversity among regions, between the capital and the provinces, between urban and rural areas, among the social groups. Hansen (2009: 189) indicates that the shift from democratization of culture to cultural democracy also entails a shift from a politically centralized model, focusing on geographic equality and based on a mono-cultural understanding of culture, to a politically decentralized model that strengthens power at the local level.

Kawashima's (2004) definition of 'cultural decentralisation' that will be used in the present study integrates both concepts (democratization of culture and democracy of culture), although it is closer to the first concept – democratization of culture. The difference between these two concepts depends on the level of political decentralisation. Depending on what type of political decentralisation model is applied, the developments could be closer either to democratization of culture or democracy of culture.

Cultural decentralisation aims to promote 'fair' distribution of the arts to a wider population. Barriers to access in culture and the arts can be geographical, socio-economic, physical and cultural (Kawashima, 2004). Such policy is concerned with providing equal opportunities for the consumption of culture and the arts for every citizen, regardless of his/her residence, physical ability or disability, income, social class and cultural attributes such as race and gender. One of the three types of cultural decentralization concerned with geography represents the most common usage of the term 'decentralisation' in policy documents and literature. In Britain, the term 'accessibility' is often used in discussing decentralisation. The policy is often discussed in terms of spatial diffusion of arts-related facilities and organisations, but the purpose of this is to benefit audience and population at large, suggests Kawashima (2004).

The author of the present paper will focus on cultural decentralisation only, as this concept involves majority of concerns of social cohesion and balanced regional development. The indicators which can help measure distribution of arts and culture within the country will be reviewed. Concretely, the author will look at the changes in cultural infrastructure, cultural consumption and participation.

## Cultural Infrastructure

The transition to market economy has caused changes in cultural infrastructure, because state and municipal subsidies have dramatically decreased, high prices and restitution of property have led to the closure of many state managed cultural objects – libraries, cultural centres, etc. (Ministry of Culture, 1998: 37). The number of public libraries has decreased from 1317 in 1990 to 827 in 2010. Public libraries have been closed proportionally in the cities and in the countryside. Similarly, the number of

cultural centres has decreased from 891 in 1990 to 538 in 2010. A great majority of the centres has been situated outside Rīga, providing the basis for cultural activities and cultural participation. The decrease in the cultural centres has more affected the capital city than the rest of the country, as the number of cultural houses has decreased by 58% in Rīga and by 39% outside Rīga between the years 1990 and 2010 (source: CSB).

Cinemas have gone through the most radical changes. The number of cinemas has decreased from 90 in 1990 to 17 in 2010. In 1990, there were 90 cinema houses and altogether 1103 venues suitable for film demonstration (including cinemas, cultural centres and other venues with appropriate equipment), while in 2010 – only 17 cinemas and 26 venues. The total number of the screens has decreased from 1103 in 1990 to 63 in 2010 (source: National Cinema Centre). The changes in cinema infrastructure have substantially influenced accessibility of film art in regions. If we take a look at number of the seats in cinemas, in 1990, 62% of seats were in the cinemas outside the urban areas, while in 2010, 71% of the seats were in multiplex cinemas in the capital city Rīga (source: National Cinema Centre).

The number of theatres has not decreased significantly (according to the data of the CSB, in 1990 there were 10 theatres, while in 2010 – 9 theatres). Similarly museums did not experience significant changes. The number of museums has not decreased since 1990. On the contrary, as the CSB statistics include also city and municipal museums since 1998, it shows the increase in the number of museums. Moreover, there are more museums in reality, but as the Ministry of Culture has established standards for the museums (accreditation), not all museums are included in the statistics.

The number of cultural establishments in most fields (except museums and theatres) has significantly decreased and there are several reasons for changes, such as privatization and restitution of the property, reduction of the state budget and also drop in culture consumption and decrease in household budgets. Cultural industries in the fields which can operate more successfully under the free market conditions, for example, book and press publishing, film distribution, audio-visual companies were privatized. Other cultural industry sectors, such as performing arts stayed in the shelter of the Ministry of Culture and continued to receive public subsidies. Notwithstanding the difficulties and losses, there were also benefits of the privatisation, as it helped the government to discard its managerial functions (Smithuijsen, 1998: 90), paying greater attention to governance and policy development. Moreover, privatization has helped cultural managers to act with more autonomy and self-reliance (Smithuijsen, 1998: 90). The role of civil society has significantly increased in the field of culture as well.

Another reason for the changes in infrastructure was reduction of the state budget for culture. Although, it is difficult to compare the financial support to culture in the 1980ies and the beginning of the 1990ies, because of the currency changes, it is clear that the budget for culture has been significantly reduced. In 1991, there was a hyperinflation, followed by instabilities associated with the gradual restoration of the national

currency (the Lats) and a number of organisational changes in the management system for cultural activities. Therefore, it was difficult to include the first two years of the transition period in the overview about financial support to culture (Ministry of Culture, 1998: 47). The year 1993 is considered as the first relatively stable period. In the first years, the financing for culture was mainly used for the maintenance of cultural infrastructure and employee salaries, as well as for payment of the social tax (Ministry of Culture, 1998: 48). Later on, more or less stable increase in the budget followed until the year 2008 and only the economic recession led to the reduction of the state budget for culture.

Despite the sharp reduction in numbers of cultural establishments, significant investments and substantial improvements in cultural infrastructure followed, as well as the whole non-governmental sector developed during the transition period. In the recent years, cultural centres in Latvia have been reconstructed with the support of the state funding and to a great extent with the support of the EU funding, including the EU Structural Funds. According to the information by the Ministry of Culture, until 2009, 74% of cultural centres in Latvia have been reconstructed (Cabinet of Ministers 2011).

Looking at geographical availability, the author has to conclude that the changes are divergent. In the case of cinemas the changes are fully in favour of the capital city Rīga, where the majority of cinemas were situated in 2010. Also in case of the public theatres, situation is favourable for the cities and particularly for the capital city Rīga where 6 out of 9 public theatres are situated. However, the cultural centres have been closed in Rīga in greater numbers than in the rest of the country. In case of cultural heritage, rural areas have not significantly suffered, as the number of museums has increased, while the number of public libraries has declined proportionally in the urban and rural areas. Moreover, rural areas and cities outside Rīga have significantly benefited from considerable investments in cultural infrastructure.

According to the Law “On Local Self-Governments” (1994: 15(5)), the task of the local government is “to maintain culture and facilitate the preservation of traditional cultural values and the development of creative folk activity (organisational and financial assistance to cultural institutions and events, support for the preservation of cultural monuments etc.).” In practice, municipalities are directly responsible for funding and administering municipal libraries, municipal museums, cultural heritage objects and intangible heritage, notably folk art and culture education institutions. In rural areas and towns outside Rīga a network of cultural infrastructure has been developed which is under the supervision of municipalities (cultural centres, public libraries, partly – museums), while professional art institutions which are under the supervision of the state (theatres) or private operators (cinemas) are concentrated in the capital city.



## Culture Consumption and Participation

In addition to the reduction of the state budget for culture, also culture consumption and participation decreased during the transition period. Concerning consumption expenditure of households for recreation and culture, the data are available only from the year 1992 (source: Eurostat), showing a gradual increase starting from this year. The data on participation in culture and consumption of cultural activities, provided by the CSB and the Ministry of Culture are more explicit. For example, participation in amateur art groups decreased by 50% in five years' time (comparing data of 1990 and 1995, source: CSB). The decrease is linked to many "soft" factors, especially the diversification of culture and recreation possibilities as well as to the decrease in the infrastructure, as the number of cultural centres in the same period has been reduced by 32% and amateur art activities are associated with cultural centres to a great extent.

Similarly, consumption of culture and arts activities diminished in all fields. The reduction was particularly sharp in 1991 as compared to 1990. The decrease in the number of visits to cultural institutions followed until 1994–1996 when situation became more stable. The number of the museum visits reached the lowest point in 1994; according to the statistics, it was by 68% less than in 1990. The number of the theatre visits decreased by 58% between 1990 and 1995. The most significant reduction was in the cinema field, as the number of visits decreased by 95% between the years 1990 and 1996. There is a certain correlation between the decrease in the number of cultural establishments and the consumption and participation in cultural activities; as the cinema infrastructure collapsed, the number of cinema audiences was sharply reduced. The public libraries experienced a smaller decrease in number of visits than other public culture organisations. The reduction was 47% between the years 1990 and 1994. After 1994, the number of visits to the public libraries has constantly grown; a particular increase is visible for visits to the public municipal libraries during the period of crisis (source: CSB).

There is limited data available to compare the consumption of culture in rural and urban areas and to see the change in consumption pattern during the transition period in the regions. There are several reasons for the lack of proper information. First, the regional reform was carried out in 2009 after long political negotiations. Since 2009, there are six statistical regions instead of previously scattered regional units. That is why the majority of statistics concerning regions is not comparable before and after 2009. Second, the annual poll about culture consumption was first conducted only in 2007 and other studies discussing the discrepancies between rural areas and urban areas followed in 2008. Data of the CSB about consumption expenditure by region are available starting from 2002.

Studies suggest that, in comparison to the rest of the country, inhabitants of Rīga are more active in attending professional cultural activities; reasons given are as follows: there are more cultural and entertainment activities in Rīga; inhabitants in the capital have higher income levels, thus can afford to pay for cultural products, and have higher education level that leads to a larger interest in professional art. The findings of the study on culture consumption (VKKF 2009) show that a significant part of the Latvian population does not have access to cultural events in their neighbourhood. In 2007, about 69% of the respondents were satisfied with the choice of and access to culture events, while in 2008 only 60% responded positively. 40% of the respondents mentioned high prices as the major obstacle; 19% regarded the location and means to access it as a barrier for attending cultural events.

Another study on culture consumption (VKKF 2007) analyses how much people are willing to spend on cultural activities per month. In 2007, Rīga's inhabitants spent on average LVL 14.90, inhabitants outside Rīga less: those living in the regions of Zemgale, Kurzeme and Latgale – approximately LVL 13, while in Vidzeme – only LVL 9.60. Also data of the CSB about household expenditure clearly indicate that Rīgians spend more money for recreation and culture than inhabitants of other regions.

In contrast to the lower culture consumption and spending for culture and recreation in regions, participation in cultural activities and amateur art is higher in rural areas than in the cities. In 2010, 1.5% of the total number of city residents participated in amateur art groups in cultural centres, while it was 4.9% in towns and 4% in countryside (source: Ministry of Culture). Also the public libraries are visited more regularly in rural areas than in the cities. This could mean that the activities requiring less financial resources or those which are for free are more accessible for the inhabitants in rural areas where willingness and possibilities to pay for cultural activities are lower. Moreover, a more diverse offer in culture and arts, especially in professional culture sector is available in cities.

## Conclusions

The concept of social cohesion includes the concern of equal distribution of public services to all inhabitants which is an important issue for cultural policy makers as well. Social cohesion and balanced regional development is recognised as a critical factor in the European and national policies concerning the overall development of the country and culture. The cultural field in Latvia experienced significant changes during the transition period that affected also regions and rural areas of the country. As concerns cultural infrastructure, the decline between the years 1990 and 2010 was more than 30% in all fields except theatres and museums. Concerning the geographical distribution, the reduction in the case of municipality run cultural centres and libraries was in favour of rural areas and towns, while the distribution of professional art

institutions like theatres or private cultural industries, such as cinemas, is more concentrated in the capital city Rīga.

The decline in culture consumption and participation over 30% has been observed in all fields. Particularly sharp decline has taken place during the first 5–6 years of the transition. The analysis suggests that in the fields where participation or consumption is less expensive, inhabitants in rural areas demonstrate higher rate of participation; similarly the data on consumption signify that culture in the capital city Rīga is more accessible.

The further research could include the analysis of correlation between the cultural decentralisation and political and financial decentralisation of culture. The current review of indicators suggests that municipalities provide better and more demanded cultural services for local inhabitants; thus, in order to secure a balanced regional development in the field of culture, the principle of subsidiarity has to be respected where it is possible and the administration of cultural field has to be decentralised to the administrative level which is closer to inhabitants. Meanwhile, as the professional art and culture institutions are mainly supervised by the state (Ministry of Culture) or private actors (as in the case of cultural industries, e.g., cinema, publishing sector), support schemes for the distribution of professional art in rural areas and towns should be developed. Professional art is not sufficiently available for rural inhabitants. For example, in 2009, 25,617 events took place in the culture centres all over Latvia, but only 6.9% were professional art events, while amateur art events constituted 38% (source: Ministry of Culture). The current efforts of the Ministry of Culture (e.g. contracts with the state funded performing art institutions stipulate a certain number of performances to be presented outside their venue) are not sufficient; moreover, these are top-down initiatives. The author would suggest focusing more on bottom-up initiatives where municipal actors could decide and develop professional art events in their local cultural institutions (e.g. regional support fund, or earmarked subsidies to municipalities or local cultural institutions).

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## **LAWFUL USE OF INTELLECTUAL PROPERTY – THE BASIS FOR SUSTAINABLE COMPETITION**

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### **Abstract**

The present papers deals with intellectual property protection problems in the information society, when it is so easy to access unauthorised content (to pirate).

Society does not care much about the damages to the right owners. The Internet is often considered as a “public place”, and works on the Internet as “displayed in public places”, from where lawful restriction of rights is permitted.

It promotes unfair competition and hinders the development of sustainable business. Lawful use of copyright protected content is a tool for ensuring equal and sustainable competition level among entrepreneurs.

***Key words:*** *copyright, information society, competition, piracy, ACTA.*

### **Adequate Regulation of the Intellectual Property Rights – the Basis for Balanced and Sustainable Cultural Development**

The legal regulation of intellectual property has been formed in recent years. Certainly, the results of intellectual work can be found in all ages, even in the earliest stages of civilization, but its legal regulation has developed much later than other fields of law (Rozenfelds, 2004:17). Intellectual property and related issues are important in the development of every country and economy. Intellectual property rights may constitute a significant capital. However, from the moment when a person acquires or creates objects of intellectual property, we must be aware of perils from those persons who wish to violate these rights and use them in their favour and we must be aware of possibilities against such violators (Viļuma, 2005).

Why is it so necessary to grant and defend copyright? Simply because there is nothing more easy to steal, copy, duplicate and distribute than incorporeal or intangible property – musical or literary work, computer programmes, song performances, sound or film recording or broadcasting organisations’ signal. The author’s work can be stolen easily. Although the work is an intellectual property of its creator, it can pass

borders of states in the pocket of a thief without any effort. It does not take much effort to:

- make a copy from sound record or a film and then sell it at half price;
- record the performance of a popular singer and then use it in bars or clubs for customer attraction;
- publicly perform a song without compensation for copyrights;
- download a software for drawing a competitive project of architecture or design;
- translate a book without the author's permission;
- sell pirated audio or video recording;

If usually there is no doubt regarding the necessity to prosecute car thieves or burglars, the same conviction is not always applied towards a person who infringes copyrights.

The following methods are used in the paper:

- analysis of various documents and normative acts, finding out what certain modifications to the Latvian and international normative acts should be made and what administrative or legal measures should be carried out to improve the situation;
- observations in daily work;
- survey (viewpoints expressed, interviews, personal conversations).

No doubt, it is very important for an author to receive remuneration from users of his/her work; therefore the legislation has created such rights as copyright. Moreover, copyright nowadays protects not only literary and artistic works, but also performers of the work and contributors to films (film producers), broadcasts (broadcasting organizations) and phonograms (sound record companies). These rights are known as neighbouring rights. But each copyright system has to find a balance between two interests: those of the copyright holders and those of the society (*Universal Declaration of Human Rights*, 1948: 27).

These two fundamental principles clash in virtually every copyright conflict: on the one hand, the necessity to protect the financial interests of the work's creator, on the other hand – the necessity to provide each individual with the right to access the human art and knowledge treasures.

Scandalous Anti-Counterfeiting Trade Agreement (ACTA 2012) does not make the European Union member states adopt any new or firmer laws and regulations. Instead, it only makes the member states implement in reality what has been stipulated in the existing laws and regulations long ago and successfully forgotten. Nothing in this Agreement shall require the member states to disclose the information that would be contrary to its law, including laws protecting privacy rights, or confidential information, the disclosure of which would prejudice the legitimate commercial interest of particular



enterprises, public or private. This Agreement does not create any obligation on a party to apply measures where a right in intellectual property is not protected under its laws and regulations (Paragraph 2, Article 3).

Online service providers oppose the Agreement by comparing the Internet with a street, namely a public place, where each member of the information society (each of us) has the right to freely wander along and freely release and receive information. In this connection, a comparison with cars parked along the street comes to mind – it is definitely not harder to open and steal them than to download the latest movies, music records or computer programmes. It is likely that some car has been left unlocked but even those that have been locked can surely be decoded easily using the latest technology achievements. Yet somehow car theft is considered a crime while theft of the author's work is not – it is a simple daily activity carried out by everyone and it is anything but condemnable! At the same time, this Agreement in no way prohibits a member of the information society (each of us) from going into any store operating legally and buying any product supplied legally to this store.

What are the main problems of copyright development? How to keep it on the right track? How to keep a balance among groups of rights holders and society? Why does society support the illegal use of copyright works and does not see the negative consequences of piracy?

## Protection of Intellectual Property Rights – Ensuring of Fair Competition in Entrepreneurship

Not to fight piracy means to develop *black market*, it means to contribute to *grey economy* and undermine fair competition in business.

Although the new Copyright Law was adopted in Latvia in 1993, changing the old Soviet rules, and Latvia rejoined the international *Berne Convention* for the Protection of Literary and Artistic Works in 1995, the term ‘copyright’ is not always understood, while the term ‘neighbouring rights’ is hardly recognized at all. Such an ignorance and negligence on a part of property rights, although incorporeal, is not justifiable, because without protection of an intellectual work and skills of creative people, (writers, composers, artists) it is impossible to establish and maintain cultural and harmonic society, while further users of these works – performers, producers of sound tracks and films, radio and television organisations cannot exist without legal protection.

Why does it happen like this? Partly because neither in secondary nor in higher education adequate attention is devoted to explaining the principles of intellectual property, raising awareness of one's rights and building general understanding of negative effects of piracy on the national economy.

Society rather supports than disapproves of these illegal activities by saying that everything is so expensive anyway and "why not to take something if it is so easy to do technically...".

Today, it is hard to imagine a business area or a state institution that would not be dependent in one way or another on different information technology resources. Moreover, contemporary world shows an increasing tendency to systematically connect both state administration and business to electronic information processing, transmission and storage. This means that unhampered efficient activities of a company are significantly dependent on the stability, quality and safety of IT solutions used. Today international communication mainly takes place through electronic communications. General trends show that the number of network crimes committed keeps rising every year (Segliņš, 2011).

The International Intellectual Property Alliance (IIPA) mentioned Latvia again in 2011 as an unsafe country in terms of protection of intellectual property rights and recommended to include Latvia into the USTR (United States Trade Representative) 301 Report watch list (Special 301 Recommendation 2012). Taking into account that intellectual property is one of the core economical instruments in the modern knowledge-based economy, the situation creates additional risks for Latvia's economy, especially in the period of financial difficulties.

Business Software Alliance (BSA) – a non-governmental organisation representing software manufacturers, conducts studies on a regular basis in order to gather information about the use of unlicensed software in different world countries by region. Latvia is included in Central and Eastern Europe region consisting of 25 countries (IIPA 2012)<sup>1</sup>.

The 2010 Software Piracy Study shows that the commercial value of illegal software installed on computers in Latvia amounted to LVL 15 million in 2010, which is by 25% more than a year before (LVL 13 million in 2006). The software piracy rate is reported to be 56%, which is the same as for the last five years. This can be described as a stable figure, but in fact it is stagnation, which can hurt not only the software owners, but the entire economy of the country.<sup>2</sup>

It would also be interesting to learn the piracy rate in other authors' works (music records, audiovisual pieces, photographs, books etc.) but unfortunately no other organisation conducts such comprehensive studies.

The Government Action Plan (Cabinet of Ministers 2012) for next three years includes only a couple of sentences regarding protection of intellectual property. Clause 122 defines that Plan shall provide an efficient mechanism for protection of intellectual property, including authors' rights.

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<sup>1</sup> A list of countries where IIPA has contributed to public comments. [Online] Available from: <http://www.iipa.com/countryreports.html> [Accessed 17/01/2012]

<sup>2</sup> Other countries – Russia 65%, Rumania – 64%, Bulgaria – 65%, Croatia – 54%, Poland – 54%, Slovenia – 47%, Slovakia – 42%, Hungary – 41%.

## Government's Attitude towards Protection of Intellectual Property Rights in Latvia

The true reason for piracy is not economy of funds but a lack of organizational skills and mentality that accepts illegal actions. Therefore, to change the current mindset of intellectual property right infringements being more of a cultural problem, the government should show a good example to the public. By struggling to legalize its software, the government shows its attitude to the society and it is very likely to expect the same from home users.

The Government Action Plan (Cabinet of Ministers 2012) for the next three years includes only a couple of sentences regarding protection of intellectual property. Clause 122 defines that the Plan shall provide an efficient mechanism for protection of intellectual property, including authors' rights. This sounds really nice, except that it has neither explained the mechanism itself nor its introduction. The plan stipulates the necessity to draft a document "Protection of Intellectual Property Rights for 2013–2017" in order to establish fundamental principles, aims and main directions of the policy for intellectual property rights. Aim: to create preconditions for development of entrepreneurship with higher value-added in terms of intellectual property rights and for educating society. Every year the Government prepares an informative report on the implementation of this plan in Latvia (Cabinet of Ministers 2008), but the problem remains the same and does not diminish. Apparently, it is not enough with formal documents; a real effective action from the state institutions should follow.

Protection of IPR should be included again into the list of national priorities to drive the knowledge-based economy and combat the *black market*. It is very important to have a proper focus of police forces, prosecutors and judges on IPR cases and to encourage the cooperation with colleagues from the EU and other developed countries.

It is quite easy to calculate, that due to piracy the state loses more than LVL 3 million in VAT. However there are other taxes to consider, for example, income tax, which is harder to evaluate. Therefore it is clear that the total loss on the state budget is much bigger.

Despite the cooperation agreement with the State Revenue Service regarding the tax audit initiative which has been effective for years, there is a need to revive the program. The State Revenue Service currently lacks both personnel capacity and expertise.

It is expected to reach a more specific agreement between non-governmental organisations and the State Revenue Service stating that members of NGOs will preserve salaries at a certain level in their business, thus guaranteeing payment of certain amount of tax, while the State Revenue Service will assist in controlling licences.

Although the State Revenue Service's officials are currently very busy with explaining the requirements of the so-called "Initial Declaration Law", they have agreed to devote attention to the legal use of software in the course of audits. Industry representatives think that it would be necessary to send reminder letters to entrepreneurs on a regular basis reminding of the necessity to take care of software legitimacy and explaining its legal, social and other aspects.

The Ministry of the Interior is planning to establish a new Advisory Board for Protection of Intellectual Property Rights.

The Ministry of Justice should make an effort to include the fight against piracy in the Government Action Plan and to ensure real activity of the Intellectual Property Board.

The Ministry of Foreign Affairs is thinking about preserving international ratings. As we all know, on 30 April 2007, Latvia managed to get removed from the so-called blacklist, and after that the concern expressed by state institutions about intellectual property protection in the country practically came to an end. Unfortunately, this idleness could lead Latvia to falling back in this list.

The Copyright Division of the Ministry of Culture was shut down, thus special attention is no longer given to intellectual property protection. This area is currently under the supervision of the Ministry of Justice and the Ministry of Culture, however without clear distribution of responsibility.

## Activities of Non-governmental Organizations Regarding Protection of Intellectual Property Rights in Latvia

The Business Software Alliance<sup>3</sup> regularly conducts "mystery shopper" studies aimed at grasping actual situation regarding the offer of legal and illegal software in the Latvian computer stores. According to the latest study, more than a half of the stores' employees surveyed have a positive attitude towards the use of illegal software and 29% of them are ready to assist customers in obtaining illegal software (TVNET 2011). "Mystery shopper" test is a method widely used in market research. During this test previously selected people corresponding to the characteristics of a typical customer of the specific company visit the company, make a purchase (or use a service) and after the visit evaluate the company according to previously established criteria.

In autumn 2011, a "mystery shopper" visited 121 stores within the framework of this study, looking for a computer with inexpensive software for personal use. In addition

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<sup>3</sup> The Business Software Alliance – a non-governmental organisation established to support software and computer manufacturers. The BSA is the major organisation promoting safe and legal digital environment. Its headquarters are in Washington D. C. but its activities cover 80 countries all over the world.

to gathering information about the offer of licensed and unlicensed software, the aim of the study was also to find out the attitude of the stores' employees towards installation and use of illegal software, as well as to ascertain whether they understand the risks of illegal software and are willing and able to warn a customer about them.

Fewer and fewer Latvian companies offer installation of illegal software and many people in Latvia still lack the understanding of intellectual property protection and piracy threats. Therefore it would be necessary to improve the public understanding of the fact that by supporting illegal products or activities we impede effective development of the country and endanger one of the fundamental human rights to enjoy scientific, cultural and artistic achievements accumulated by the society. The use of unlicensed computer programs produces not only moral but also financial effects, therefore it is necessary to regularly repeat the simple truth that creators of incorporeal works should also receive payment for their work and this payment should be balanced with the actual purchasing power.

## Conclusions

To enhance fair competition and the development of sustainable business, the following steps should be taken:

- 1) The society does not care much about damages to the right owners due to absence of the study subject on IPR protection in study programmes. Intellectual property and protection of intellectual property rights should be an integral part of the curricula starting from elementary school and all the way through the university, so that children and young people would understand the necessity to protect intellectual (incorporeal) property from early age and would treat the intellectual property exactly like corporeal property.
- 2) It is necessary to increase the liability of online service providers for violations tolerated online in case of infringement of the authors' rights and related rights on the specific website, as well as to apply the adopted legal provisions both during pre-trial investigation proceedings and trial proceedings.
- 3) Lawful use of copyright protected content is a tool for ensuring equal and sustainable competition level among entrepreneurs. To develop fair competition, intellectual property protection should be placed under the supervision of the Ministry of Justice by establishing a separate division and final distribution of responsibility among different ministries. So far this area has been supervised by the Ministry of Justice, the Ministry of Culture and the Ministry of Economics. However, they do not have a common view and clear vision on the above-mentioned matter.

- 4) There is a need to promote training of law enforcement officers (customs, police, prosecutor's office, court) on issues of intellectual property protection.
- 5) The amendments to the Copyright Law of Latvia should be made, so that an author would have a real (instead of only theoretical) possibility to receive compensation for infringement of his/her rights.
- 6) State institutions involved in the protection of intellectual property rights should be provided with modern material and technical resources to be able to support and sustain capabilities of the State Police Division in charge of such matters as cybercrime and protection of intellectual property rights.

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# THE DOMINANT CULTURE IMPACT ON THE POLISH STUDENTS' CHOICE OF MARRIAGE AND FAMILY MODEL

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## Abstract

The present article describes the main features of postmodernism culture. It presents new forms of conjugal lives and family. The changes have been described that get in family influenced by new culture. The article presents opinions of Polish students about personal vision of a family and marriage. The article also deals with the issue of whether the Polish students still remain faithful to traditional family model or they are under the influence of the new dominant culture in Europe, preferring new forms of life. The study was conducted using a questionnaire survey and in-depth interviews. The author presents the opinions regarding the creation of informal relationships. Young Polish people expressed opinions about life with no life partner as well as what is the marriage for them. The article also describes how modern media influence the image of marriage and family. The new dominant culture certainly plays an important role in the decisions of young people. Today's youth pay less and less attention to direct parental opinion and their lives are less based on traditional values. A new culture becomes increasingly attractive for them and is based on willingness to pursue their own project of life.

**Key words:** *family, culture, students, postmodernism, Polish society*

## Research and findings

Culture in the life of every human being is one of the most important elements of existence. Culture is the social dimension; therefore it is difficult to imagine the actual process of education and socialization of an individual, as well as various social groups without coexistence with others. A form of human life is variable but in every social group we deal with a certain characteristic way of life, which imposes certain patterns of thought activity. We often deal with an internal homogeneity that connects members of the community action (Sztompka, 2005: 233). Discussing the life of a man, as well as various social groups in this family in the context of culture, it should be noted that in human history and culture, there were three great epochs: savagery,

barbarism and civilization. They are divided into three periods, including the period of civilization. Within civilization, we can distinguish: Antiquity, the Middle Ages and Modernity. However, nowadays it is determined that we live in the fourth period of culture, called postmodern (Gajda, 2008: 28).

Janusz Gajda distinguished several characteristic features of the postmodern culture. One of them is the opposition to modernism. Wisdom replaces reason. This is an attempt to find an individual who is lost in the surrounding world. A man tries to create a new vision of the world based on new ideals and new way of thinking. Another feature of postmodernism is pluralism, which is characterized by the acceptance of new lifestyles, ideas, thinking and acting. Another feature of this is cultural relativism.

A distinction between high and low culture disappears. There is a noticeable departure from the traditions and culture, followed by style mixing. Another feature of postmodern culture is the epistemological openness and new aesthetic sensibility which occurs in the openness to everything that is new. All restrictions in the way of thinking and acting are rejected and we are dealing with the return to the irrationality and intuitionism. Next important feature of postmodern culture is an attempt to make it universal. Culture is duplicated while it is inappropriate to criticize low or mass culture (Gajda, 2008: 29). Therefore this mass culture becomes more and more attractive. The different ways of life promoted in the media are becoming increasingly determinant in answering the question how to live. The main characteristics of post-modernity – one should be able to live the life. This applies to different patterns of family life. This way of life becomes particularly attractive in the former socialist countries, which almost to the end of the 80s were closed, including the Western culture. Political and social revolutions in these countries have brought not only political but also social freedom. The society in the former socialist countries wanted to lead similar lifestyle as in the Westerns countries. The imitation of the lifestyle of people representing different social groups from Western Europe or the United States was a must. This also applies to the new patterns of marriage and family. The behaviour was copied more or less quickly. In turn, as Zygmunt Bauman writes, in contemporary pop culture we are dealing with consumer market at various levels. A characteristic feature of this market is the attitude of being ready for consumption, immediate satisfaction and benefit (Bauman, 2008: 63). This behaviour also more and more applies to a modern human life in the creation of relationships between men and women. Self-satisfaction becomes a dominant value. In postmodernism, we are dealing with the processes of individualization and rationalization. Yet another important feature of postmodern culture is the process of secularization and desacralization of social life. Jolanta Kociuba writes, “It leads to dehumanization and depersonalization, as well as to the mechanization of life and the enslavement of one person by a group of experts and totalitarian intrusion into the privacy and even intimacy. A form of depersonalization is the destruction of the mind, which can gradually enslave a man in his thinking, judging abilities and free will” (Kociuba, 2009: 207).



We are dealing with an attempt of various institutions to influence the behaviour and attitudes of individuals and various social groups. It also applies to creating a new family model. The model is often different from the previously applicable. The media and celebrities, speaking about their own family picture, perpetuate it among others. The postmodern culture is characterized by reproduction, distribution of similar patterns of life which makes the groups of people want to behave like a person from the TV screen. We cannot observe reflection in this kind of behaviour, especially when a celebrity speaks of how she or he lives. Others want to live in a similar way, because they perceive it as a standard. Yet another important feature of contemporary culture is the dominant secularism.

Janusz Mariański writes that secularism is a specific program of belief, which is based on a materialistic conception of the human body and is based, in principle, on a materialistic conception of a man. The program also postulates atheisation (Mariański, 2006: 25). This view is primarily based on the rationalistic way of thinking, contesting transcendent human value. Therefore, one must act to maximize the pleasurable sensations in the world today. If someone decides to get married simply because it gives him/her a lot of joy and happiness, and then is deprived of the pleasurable values, it may become a reason for parting and seeking the pleasures in the next relationship. In turn, Slawomir Zareba writes that the processes associated with the transformation of traditional Polish society are accompanied with a kind of mental transformation. Controversial and outrageous behaviour is approved. The postmodern world of freedom is characterized by subjectivity and pragmatism. The liberalization is becoming a casualty in various aspects, especially in moral attitudes. On the one hand, one of the basic values is tolerance, on the other hand, the objections to religious morality (Zareba, 2009:219).

We are dealing with the acquiescence of various behaviours that were once stigmatized, but today they have almost become a norm. In terms of marital life, divorces were the exception, mostly very badly perceived, but today the problem of divorce or remarriage does not attract anybody's attention. The same applies to single parenthood and loneliness, i.e., being single. Once a single person was regarded as the one unable to find a partner for life, while nowadays being single is fashionable. Being single does not have the negative connotation. A single person is viewed as someone who is self-reliant and independent, and engaged in self-realization. Therefore, there is no wonder why do more and more people form independent households. Another example is the increasing number of people opting for only civil not sacramental marriage. Another characteristic feature of post-modernity in the field of family and marriage is the increasing number of births outside the marriage. The processes of secularization make Poles behave less and less in accordance with the teachings of the Catholic Church. The teaching of the Church proclaims certain demands regarding human behaviour in many aspects of human life. Not all behaviours are permitted. Certain behaviours even require many sacrifices and efforts to solve the problems. This is

quite different from the ideology of postmodern. The Church proclaims the indissolubility of marriage. In the case of emerging problems, one should do anything to ensure the sustainability of marriage. Postmodernism states that if the marriage does not give happiness and there are conflicts that continue to struggle, one should decide to divorce and find joy in new relationship. After all, everyone has the right to happiness. The other person's feelings and responsibility towards him or her are largely omitted here. The marriage becomes meaningless. It is the only element of tradition and culture of the society. Often the words of the wedding vows are merely empty and meaningless phrases.

In contemporary Polish society, there are changes concerning marriages. The age of the decision of getting married has changed. Young people decide to have the first child when they are older. The number of children within the family has also changed. The change is also apparent in the number of marriages that are falling apart, illegitimate births and single parenthood. The CSO statistics in Poland show that in 2010 there were 230 000 new marriages. The number has decreased by about 20 thousand in comparison to the previous year. This decrease is observed for the second year in a row. Among the newlywed about 85% were the first time marriages. The majority (nearly 70%) were marriages both in churches and in the offices of civil status. The Poles get married when they are older. The average age of a man ascending into marriage is 28 years, while for women – 26 years. In the 90's, the average age of the newlyweds was 26 for men and 23 for women. We can also observe a steadily increasing number of divorces. At the beginning of the 90's, about 40 000 couples decided to divorce in Poland, while in 2010, already 64 000 divorced. 14 years is the average time of staying together in the marriage. The average age of a man who decides to divorce is 40 years, in turn, a woman is 38 years old. 60% of divorced couples had 56 000 children under the age of 18 (GUS: 2011).

In Poland, the major problem is very low fertility. In 1960, the fertility rate was 2.980, in 1990 – 1.989, while in the year 2009 it amounted to only 1.398. This is one of the lowest rates among all European countries. This is a consequence of the subsequent ascension of women into marriage. Therefore, the average age of women giving birth to the first child increased. In 1990, it was 23.5 years, while in 2009 already 26.3 years. Also the average age of women giving birth to a child has been changing. In 1990 it was 26.7, in 2009 – 28.5 years. The fertility rate was largely determined by the number of marriages concluded. In Poland, 80% of children were born in families created by legally concluded marriages. However, since the late 90s of the 20<sup>th</sup> century, the percentage of births outside marriage increases. In the first half of the 90's of the last century the number of births outside marriage was about 6–7%, in 2000 – about 12–14%, while in 2009 – 20.2% of all children in Poland were born outside marriage (Demographic Yearbook, 2010: 254). This is indicative of increasing number of informal relationships as well as of the fact that more and more women decide to have a child outside marriage. Certain changes can be observed also in the modern

family model. A Polish family is usually a nuclear family. In the traditional family, the most important was generational continuity. For this reason, one of the most important goals of marriage was to ensure the survival of a mankind. By contrast, according to the modern view, the luck is happiness while misfortune cannot be accepted. People strive to reach the agreement in all areas of the family life, and when it is impossible, they do not always want to wait for their explanation. Therefore, instead of seeking compromise, they decide to break up (Kocik, 2002: 318).

The spouses want to enjoy themselves, make a career while a child will cause a lot of difficulties in their plans. Women's emancipation also plays an important role in creating a new model of marriage and family life. We are dealing with an explosion of manners. This applies to both, growth of solitude lives or loose associations and re-union of divorced persons. Lucjan Kocik writes even about the so-called future shock, which would happen if our great-grandparents faced the contemporary reality of marriage and family life (Kocik, 2002: 338). A few generations ago we were dealing with a completely different culture of marriage and family life. Also the relationship within the family was quite different. The position of a husband, wife, children or the elderly in the family were different. In the past, it was a kind of prioritizing while nowadays the roles within the family are equalized. The sociologists studying the family claim that changes in the perception of a family can be observed since the mid-20<sup>th</sup> century. The changes especially concern young people who are increasingly moving away from the previously accepted moral standards that are usually a guarantee of consistency, durability and indissolubility of the family. Changes in attitudes and behaviour of people take place, as Joseph Baniak writes, because of the increasing role of women in the society and the primacy of the value choices that result in personal independence and the separation of procreation from the sexual life. We are dealing with the hitherto unprecedented situation within the family. Some modern cultural and civilization factors are trying to undermine the ideological foundations of the family, while proposing alternative forms and styles for life of two people. New compounds are often formed without any obligation (Baniak, 2010: 97). They create a new alternative form of life which would have been unacceptable a few decades ago. But the contemporary postmodern culture, in the name of freedom and tolerance, allows for the new alternative forms of human life to be respected. Therefore the scientists questioned the generation of Poles that will soon decide on starting the family life. The generation of students, i.e., those who formulate or have already specified certain values and life goals, including those relating to marriage and the family life.

Students of one of the universities in Lublin were asked about their vision of marriage and family. Would they like to live in a formal relationship or prefer partnerships with no obligations? What is their opinion regarding wedding? How do they imagine their own family? The students were asked more specific questions. They described their own vision of the future family life. Has postmodern culture had a significant impact

on the young Poles in their family lives and changed families of the Polish students as compared to families of the generation of their parents or grandparents? Or maybe still the smallest group plays an important role in their lives and the impact of a new culture has not fundamentally changed their vision of the families they would like to have?

According to the information obtained from the students, a family is still very important to them. Despite the impact of postmodern culture on the media and the promotion the loose union between a man and a woman, a traditional family model is still attractive for the young people. One of the students wrote, "I want to marry my partner, it is my main goal in life; I want to create a long lasting responsible relationship, family and have children. It is more important to me than a great social position or well paid jobs. After the graduation, I would like to work and earn for living, the most important are relationships in the family, relationships, happiness, family, marriage and starting my own family, raising responsible children, caring the spouse and children, care for the wellness of the marriage and family." In the opinion of this student, not only the family, but also all its members, both husband and children are valid. It is important to complete the studies, professional work, but they are not the most important, do not fulfil the self-realization. Sustainable relationship based on love and mutual respect seems to be more important. In turn, another student says, "In my opinion, marriage is the connection between two people who have a special feeling – love. It is concluded with the sacrament in church where people vow fidelity and love to each other, and by the conclusion of this sacrament, people decide to possess the offspring, the fruit of their love." In this case, the postmodern culture seems to have no meaning for respondent students. The vision of marriage is still the same as in a traditional Polish family. Marriage is a sacrament and a compound concluded primarily in the Church, not loose partnerships. Marriage is, first and foremost, love and mutual fidelity. This picture of marriage has nothing to do with the trade promoted by the contemporary mass culture where the loose temporary relationships are dominant. This is confirmed by another student who states, "Marriage is one of the most important sacraments, to which every believer should strive for. This is a special bond of a man and a woman. The purpose of marriage is having children."

Another student states, "Marriage is a community of life for each other, getting and upbringing children, mutual assistance, love, faithfulness, respect." These statements show how much the young Poles value durable and common life, which is hard to imagine without the procreation and upbringing of children. The child, in the opinion of students, is a very important value in the created relationship. It is assumed as one of the most important purposes of marriage. Another student admits, "Marriage is an indissoluble union of two persons, a woman and a man. It aims at strengthening mutual ties between them and enriching each other as people." Also in this case the indissolubility of the union between a man and a woman is emphasized. It emphasizes the special importance of relationships in marriage. The student advocates for the traditional family model and a characteristic division of roles in it. However, it has no

absolute reason and can be changed depending on the circumstances. It does not exclude his wife's work. He also writes, "The husband is the head of the family and provides the material means for the functioning of the house. A woman looks after the children and takes care of the house. Both of them raise their children as equally as possible. In case of low-income of a husband, the professional wife's work is acceptable." It should also be noted that in most cases the students did not correspond to the division of roles in the family, but the vast majority of them pointed to the importance of the indissolubility of marriage. Another student writes, "According to me, marriage is an indissoluble tie between two people, a man and a woman. The spouses should be mutually supportive and respectful. They should be responsible for themselves." In this case, besides the importance of the marriage indissolubility as well as the union only between a man and a woman such aspects as mutual support, respect and responsibility were also highlighted. It is assumed that all those for whom marriage is indissoluble will negatively relate to its disintegration and will oppose divorce.

Still other students write briefly that marriage is the most important value for them. This is not surprising because, according to sociological research, marriage and family are still on the top of the hierarchy of values preferred by the Poles. Despite so many changes in culture and moral system, the media attack the Polish family which has its particular value. For the vast majority of the students family is a value itself. However, it seems that in addition to the understanding of marriage as indissoluble, i.e., that which provides long term stability, it also gives a sense of security. A student writes, "Marriage is a sacramental union, which is designed to develop and ensure the mental and physical safety of the family members." In this case, the aspect of safety is raised. In the statements of young Poles, the sacramental dimension of marriage is often emphasized. Another student states: "For me, marriage is a sacrament, an association of a woman and a man voluntarily tied with love. The spouses should be encouraged, faithful, honest, responsible, equally share the household responsibilities". The sacrament is in the first place. The importance of love in this relationship and mutual support are emphasized by the student, while other important characteristics of marriage – egalitarianism and neolocality are clearly visible. The student points at a slightly different part of the marriage than her colleagues. There is no clear indication that this particular man and woman should work to educate children. Here we have an equal share of household chores. However, the majority of young Poles stress such elements as mutual support, loyalty and honesty.

Still another student wrote that marriage is a seal of love between two people. A declaration of a pure love and that they will be together for better, for worse, until death. Marriage should be a deliberate decision, taken voluntarily, partners should get to know each other very well and desire this. In this case the importance of indissoluble marriage is underlined. Young people take actions in a very responsible way, after a long and deliberate thinking. There is no room for pressure. This is an important manifestation of the modern choice of the spouse. The role of parents or other family

members as the matchmakers has no meaning today. Everyone chooses his/her own future spouse or a life partner. The main causative factor is the selection of spouse because of love. However, many students argue that economic factors are still significant. One of the students had a slightly different idea concerning the marriage and family plans. She stated that she did not think about marriage. First, she wants to get good education, then look for a good job and only later realize her family plans. She writes, "Marriage is something very distant for me, because I do not plan it in the near future. I think most young people are reluctant to get married (by choice) in such a young age. Everyone (and me too) tries to get education and find a well-paid job to earn a living."

The opinion of this student differs from her other colleagues. She points out that the young did not hurry to settle the family, but also did not resign from it at all. The ideas on marriage and the family do not differ as far as the gender of the Polish students is concerned. Both women and men understand marriage and family in a very similar way. Love and loyalty are the basis for a successful marriage. The student writes, "Marriage is a spiritual community of spouses loving each other. It is also important for the spouses to be faithful. Children should be raised in a traditional way and parents should devote them much more time than today. Divorce is only admitted when it is an outcome of a betrayal. Sexual life should be initiated after the wedding, but it is known that sometimes there is a need to "verify" the partner and if the relationship is guided by love and sex is the effect, it can be allowed." In this case, despite the traditional understanding of marriage and premarital morality, it can be observed that sexual relationship is prior to entering into legal relations as well as in relation to the divorce.

The college students from Warsaw were asked about their marriage and how the ideal relationship between spouses should look like. For the students from Warsaw universities the problem of marriage and family is also very important (*Table 1*). Most students surveyed responded that this is the most important goal of every human being (49.72%). In turn, every third respondent said that marriage and family are important, but there are more important things (33.15%). Only 1.69% of the surveyed Polish students said that it is a matter of little importance. These results are confirmed in the studies by Tomasz Biernat, who also shows the institution of marriage, which is now and will be in the future a matter of a great importance (Biernat, 2007: 63).

Table 1

**Marriage and Family in the Opinion of Students (data in %)**

What is marriage for you and your family?	Total
	N-356
This is the most important goal of every man.	49.72
It is important, but there are more important things.	33.15
It is a matter of little importance.	1.69
It does not matter.	1.40
It is difficult to say.	7.02
God will guide me.	0.28
It is the way to salvation.	0.28
It is an important goal of a human.	1.40
Family is the most important.	1.12
I do not know.	0.28
It depends on whether you are truly in love.	0.28
It as important as other areas of life.	0.28
It is condition for self-fulfilment.	0.28
It is as important as other things.	0.28
It is as important as other spheres of life.	0.28
It is to support.	0.28
It is the way to ensure the welfare.	0.28
No data	0.58
Total	100.00

Table 2

**Picture of a Perfect Marriage by Students of Warsaw (data in %)**

What does the perfect marriage looks like?	Total
	N-356
Where there is mutual trust and respect	34.83
Where is the mutual sincerity and fidelity	18.54
Where is the selflessness and love	34.27
Where there is a "fit" and harmonious sexual intercourse	2.53
Where is the peace agreement	3.93
Where there is proper upbringing of children	0.56
Difficult to say	1.69
God was the most important	0.28
Trust, honesty, loyalty, love, life successful	1.97
I cannot choose the answer	0.28
All the answers	0.28
When the husband is obedient	0.28
No data.	0.56
Total	100.00

What is the picture of perfect marriage provided by the students from Warsaw? For these students the ideal marriage is primarily a relationship where there is a mutual trust and respect (34.83%). A similar proportion of students (34.27%) state that selflessness and love are present in the ideal marriage. For 18.83% of young Poles, the most important in marriage are honesty and faithfulness. (See *Table 2*)

The other items considered as a guarantee of a successful marriage were not numerous.

## Conclusions

It can be argued that the postmodern culture, promoting such alternative family models as: cohabitation, singles, single parents, Dinks families, homosexual unions or LAT relationships (Szlendak, 2011: 463), and does not find the approval among the Polish students. Changes in the image of marriage and family are clearly noticeable, but not as advanced as in other European countries, not only Western Europe. Young Polish students are still closer to the traditional family model than to its alternative forms. The emergence of a modern society based on postmodern culture is accompanied by the disintegration of many communities in their traditional form. This also applies to the family. Although the impact of this culture in the Polish society is also appreciated, it has not significantly changed the preferred model of marriage and family. This is because, as Leon Dyczewski writes, the Poles continued to maintain the contacts with their relatives, although they are a selective form generally concerning the immediate family. The bond between generations in the family is still strong (Dyczewski, 2002: 115). Therefore, for the young people, their own family model is often more important than the model promoted by the dominant culture in Europe today. The importance of family stems from the fact that the students' own families seem to continue to have crucial impact on the Polish students' choices. This is also confirmed by Janusz Mariański's survey among the Polish youth. He writes that for many young Poles the style of upbringing in their family of origin is a model of how these young people will follow in their adult life. The child-parent relationship still has a lot more positive atmosphere, such as kindness, explanation and presentation of positive formulas (Mariański, 2003: 478). It can be concluded that the impact of the dominant culture has not radically changed the young Poles' perception of the preferred model of marriage and family. The most popular Polish students often see their place in a traditional marriage and traditional family; although it has a more egalitarian form than before.



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# CULTURAL HERITAGE REVITALIZATION IN THE HISTORICAL CENTRES OF SMALL TOWNS IN ZEMGALE

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## Abstract

Each society possesses not only material but also intellectual values, incl., the aesthetics and compositionality connected with the surrounding environment. Forming the landscape of the town space requires increased mutual cooperation between architects, artists, territorial planners and experts in engineering and communications. The influence of information created by the technical space can be felt everywhere. It also concerns the notion in which the form-like language of architectural buildings includes the information. The aim of development planning is to model a harmonic space in old towns of Zemgale by providing a possibility to save resources and show respect to local national identity. “Variability through stability” – a principle that has to be strengthened in the development of historical centres of towns (1).

**Key words:** *cultural heritage, transformation processes, cultural-historic landscape space, space of compositionality, revitalization*

## Introduction

The aim of this research is to estimate changes in the cultural-historic landscapes along with the transformation processes resulting from economically political situations. The task of the research is to establish the working groups at the municipality level in order to work successfully on the financial projects aimed at revitalizing the historical town landscape. It particularly concerns the present situation when the tourism infrastructure becomes increasingly important in the municipalities as the result of the territorial reform. The main tasks and aim concerns the cultural landscape of the 19th century of the Lielupe basin where the character-relief of the landscape elements, the compositional location of main streets and roads, streets or parks having groups of tree and shrub plantings, tree lanes and rows were taken into consideration in building the towns and rural estates.



*Figure 1.* The historical town-hall place of Bauska after the reconstruction (2011)

To analyze the preservation and revitalization of historical centres of Zemgale's old towns and avoid mistakes in planning the development of towns, the author explores planning of towns' historical centres and already performed activities to preserve and develop the historical centres (1).

## Methodology

The main objective is to preserve and develop an authentic space and urban historical town centre in old towns of Zemgale. The cultural part of the town space – a zone of cultural-historic heritage, that has old buildings and green plantings, is particularly important in small towns of Zemgale. Its central part is a favourite space for recreative rest. The research uses the method proving the importance of the compositional elements of the landscape, as well as the necessity to preserve and restore the architectonical historical landscapes, which under the influence of present transformation processes lose their visually aesthetic quality. To preserve the values mentioned by inhabitants, specialists and tourists, the sustainable development has to be considered. First of all, it is necessary to define the values, then the most important functional elaborations and, finally, the borderlines should be established to find the possibilities to implement (3).

The statements of protection, preservation and development of cultural heritage of the historical town centres are particularly examined in the development program of Kuldīga town (1). This research uses cognitions about the experience of small old towns in Europe and Northern countries which might also be used in the rural populated places in Zemgale (2).

The preservation and restoration of cultural-historic space have been particularly significant during the last ten years, because while the project funding or investments in the territorial planning are used and construction develops, the problem of preserving the identity of landscape space and historical buildings becomes more and more acute.

The central part of Dobele town, including the church, the Church place park and the perimetral building around the church create an expressive green recreative space of the town. It makes possible to plan the church park not only as a transit zone for pedestrians, but also to reach solutions regarding separate zones of the park for placing some works of art or creating some quiet places for recreation and zones of low plantings. It is particularly important at present moment when the dismantling of deserted structures of the building is taking place.

The central part of Dobele town with its Church place has experienced rebuilding during the post-war years. The longitudinal axis of the place and its connection in the western and eastern parts create a good sunny place. The historical two-story building with windows rhythm and an old roof construction are well preserved in the southern part of the place. During the post-war years, the place obtained a new row of lime-trees, which partly covers up the expressiveness of the architectonically artistic language of the buildings.



*Figure 2.* The restored town-hall of Bauska

The height of the branches of the tree crown should be considered carefully not to let a surplus to overshadow the historical facades. Sawing out the existing trees will not be a solution because the amount of green network will decrease in the town.

In the 70's of the 20th century, the memorial ensemble for the victims of political terror built in the square has been dismantled while levelling too lowered zone of hard covering having a semicircle form. A new dominant accent was created – a free standing installation. Its form, scale, location and compositional expression are disputable. The accent in the historical town centre should be put to emphasize the architectural values of the old building (small-pane windows, shutters, flower boxes, signboards of small shops, colours of building walls, accents of entrances with container plants, street cafe terraces with tables and dividing flow boxes etc.). While introducing a new installation element, the context of the existing cultural-historic space should be taken into consideration.

The historical Bauska town-hall place or market place was perimetrically planted with rows of lime-trees during the post-war years. During the war, the town-hall was turned down and the ruins were removed. A new public building was built in its place. Thanks to these lime-tree rows, the low aesthetic quality was suppressed. The town obtained new green planting or a zone with flower plantings and recreation places. In 2009, the restoration of the town-hall started, and the conception on regaining the historical town-hall was developed. The project envisaged sawing out of row plantings of streets, thus uncovering both the sight line to the town-hall and a perimetrical building of the place with architectonically expressive building of the 2nd half of the 19th century. The structure of the green territory changed along with changes in the visual image of the central part of the town.

Auce town has retained its historical structure – a historical building of Vecauce estate ensemble with a pictorial park and pond in northern part, while in southern part – a street network with buildings. The backbone of the town is a 200m long street with a building of the 90's of the 19th century. The main street is connected with small streets having detached houses and flowing gardens. The spire of the church belfry as a vertical accent cannot be seen in the town space because the church is located approximately 150m from the main street, thus hiding itself behind the building and gardens, the scale of which is comparatively large against the proportion of the historical building of the street and architectural image of buildings. It introduces the beginning of the main street of the town (from the side of the ensemble of estate building). Therefore the municipality should consider the possibility to reconstruct green plantings while working on the arrangement of tourism infrastructure. The historical centre of the town is small. There is a pedestrian zone with a church and a castle. Southern part of the castle has characteristic pictorial terraces made by the relief. At present, this place is covered by hothouses of low aesthetic quality. These hothouses do not function anymore and dismantling is necessary. By using the terraces and sawing out the inferior trees and shrubs, the historical town space would have the castle and its park, at the same time forming the unity of the town part and green park network, as well as compositional harmony.



*Figure 3.* The design of reconstruction of the Church place in Dobeles

## Results and Discussion

While studying the examples of the historical town centre's landscape, the principal accents taken into consideration are as follows:

- the language of architectural forms of historical building and its compositional elements (axis, distance of sight lines, silhouettes, dominants, reliefs etc.);
- transformation processes and their influence on the cultural-historic space (functional changes of buildings, use of new scale and elements of the building etc.), which are to be considered in planning the level of municipality territories;
- green plantings and their network on the scale of historical town space (covering of sight points, row or lane plantings of streets, overshadow – light, dendrological features of plantings).

It should be remembered that both activity and inactivity influence the specific landscape. With our economic activity – agriculture, building etc., the landscape becomes poorer, and any exaggerated activity may have certain danger.

The cultural-historic heritage and a balanced economic and social environment may provide for permanent development of environment. While working in the historical environment, it is necessary to determine responsibility for aesthetic and professional aspects.

## Conclusions

Each town has its old part, which is characterized by the building height, density and architectonically artistic values, thus creating the identity of the region which is linked with the past and provides for bringing the intellectual values from one generation to the next.

According to the research results and defined tasks, it is not possible to preserve the cultural-historic space without a proper methodology for preservation of economic activities and cultural heritage. Particular attention should be paid to policy of tax reduction in support of management of historical properties, thus creating personal interest in reconstruction (restoration) works and forming the activities for further entrepreneurship capable to develop the cultural-historic environment.

The new administratively territorial reform, particularly in present socio-economic conditions, does not provide any support to the revitalization of the architectonically historical space, which, after the changes in property relations, brings in different understanding and interest about the cultural heritage.

The positive fact is that during the last years, it has become possible to use funding provided by international projects to build temporary roofs, rain grooves or restore the hydro isolation of foundations and to clean them from the earth addition, to replace the window-frames, to carry out chimney repair, anti-septization of wood elements, preservation of more valuable trees etc.



*Figure 4. The new performance in the Church place in Dobele*





Figure 5. The project of the performance in Church place in Dobeles

A qualitative historical landscape is well-cultivated and restored cultural heritage. Its preservation policy should be taken into consideration in the development of the conception of municipality territories.

Quality of living environment and environmental quality play an essential role in the economic development of any city or town. Attractive scenery and cultural environment are unique qualities, the economic and social value of which is constantly increasing. When investors make decisions on the location of new economic activities, they evaluate the quality of life and environment, which implies well-preserved natural and cultural heritage, developed infrastructure and environmental administration.

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