

# KPMG forum 14

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## In focus: Innovation and growth

Grow simply

Scenario planning insures swifter  
response to changes

Does happiness hide in growth?

Public private partnership: is Latvia's  
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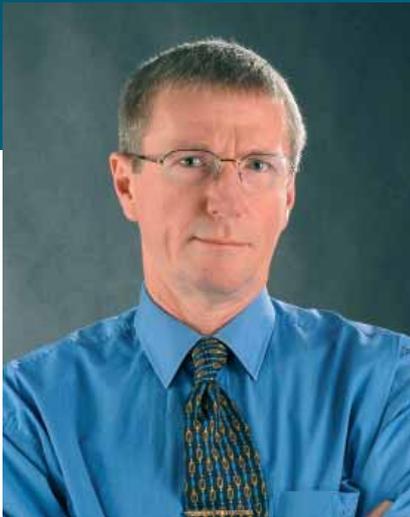


Company restructuring through a merger is one method for increasing equity. After the completion of the restructuring process, the acquired company ceases to exist while the acquiring company continues its operations using its own and the acquired company's assets.

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# Innovation and growth



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When the economy is flourishing, enterprises grow in size and number. We are surrounded by success stories, and also, as often as not, we encounter retrospective wisdom about opportunities not utilised.

Our focus in this Forum is innovation and growth. Market growth is a stimulus for making strategic investment decisions, for example, to gain market share, to expand geographically or to seize positions in other segments of a value chain in one's sector. But how can one plan so that in a changing environment more decisions today prove to be good decisions. In our articles and interviews we discuss various aspects of growth and innovation. We write about growth strategy, how to find new market niches, developing new business models instead of copying from one's successful

competitors. In the interview with management adviser Mait Raava we write about scenario planning when making decisions. One of the growth-related success stories is that of real estate company Arco Vara Group. The interview with Viljar Arakas, the Chairman of Arco Vara Management Board, tells us about his company's expansion into new markets.

We have also included articles on the increasing importance of public private partnerships in the Baltics, talent management and managing growth. We trust you will benefit from this edition of the KPMG Forum. •

# Grow simply

An enquiry conducted last November by an Estonian business paper Äripäev showed that within the first nine months of 2006 the turnover of the TOP 500 companies had increased by 30 per cent. So at below 20 per cent, last year's average growth for Estonian companies, enterprises could be considered as lagging behind. But just how can they consolidate their growth which was systematic and followed the objectives established by company management?

Based on the simplest strategy definition, you are successful if you do the right things right. When defining the right things and developing systematic strategies, a lot of issues need to be worked out. Our examination considers the following questions:

- How is it possible to beat competitors?
- How can you know what customers want to buy?

One basis for finding your own niche and defining your competitive advantages is the mantra "know your customer". The so-called sustaining strategy pays a lot of attention to segmenting the market based on customer profiling. Harvard Business School professor Clayton M. Christensen does not consider it always necessary to "portray a typical buyer". In this article we take a look at his somewhat distinct theory, which holds that when trying to take a market by storm, you may, instead,

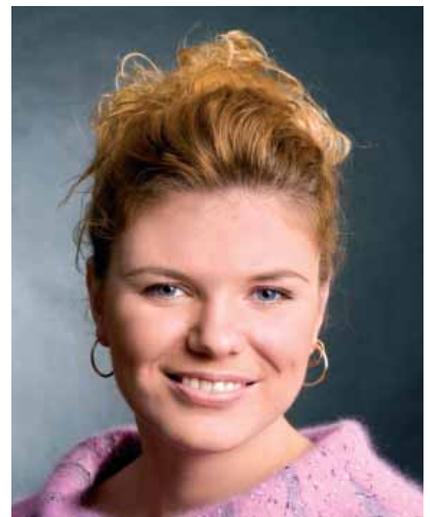
lose the desired benefits. This means that when an enterprise is still in the growth stage, it is better to "disrupt" one's competitors rather than bring a competing product onto the same market.

In product development one should bear in mind that customers are different. For some customers it is a must to have "the best-of-the-best" product even if they are not willing or able to use the whole range of available options. On the other hand, the needs of some less demanding customers can be met by a technologically unsophisticated product providing only basic functions. In terms of product development it would be sensible to focus on products whose performance is aimed at a mainstream customer's ability to utilise it. The "ability to utilise" comprises the needs, consumer habits and skills of a customer.

The development strategies of established enterprises are mostly

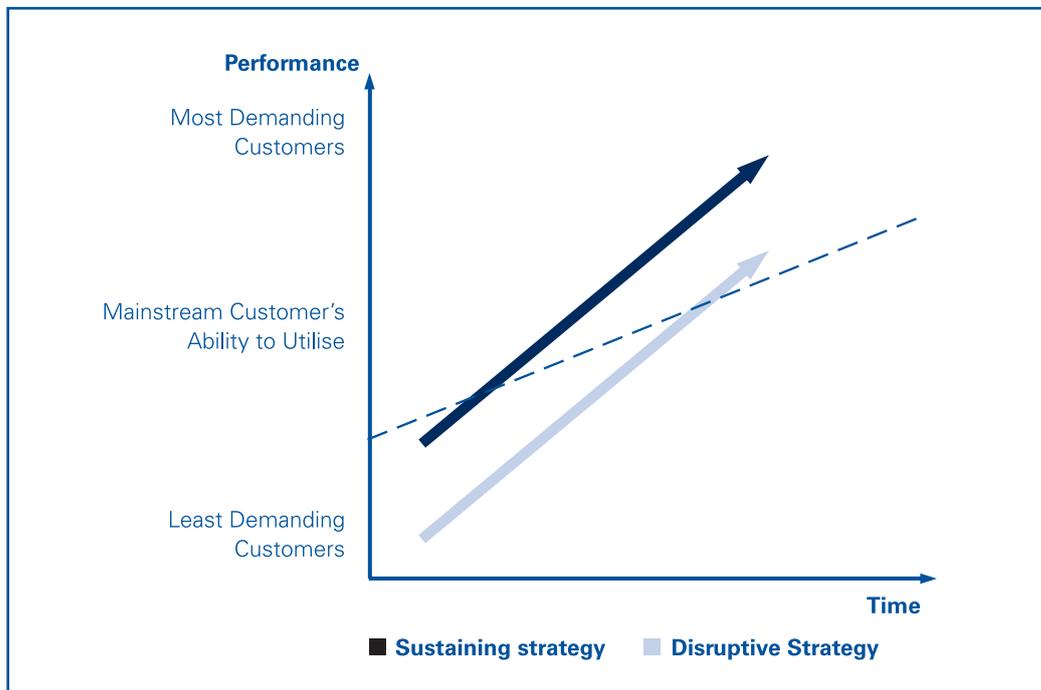


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## Disruptive Strategy



aimed at satisfying the needs of their demanding customers. The disruptive strategy, however, focuses more on cheaper products which are technologically less sophisticated and simpler to use. Such an approach enables companies to win totally new customers, and at the same time also sell their products to less demanding clientele of the existing market for whom the goods supplied so far have been either too complicated and/or expensive. As entering a market in this way means a comparatively small turnover and low profit margin, the leaders of the market often overlook such products. A product is improved according to the changes in the basic needs of a customer and at the same time, cost effectiveness is carefully monitored. The more an improved product meets a mainstream customer's ability to utilise, the more it will replace current products and the bigger market share it will gain. Such an innovative approach does not allow for generating quick, high earnings. Instead, a company has to be patient. In the case of disruptive

strategy, profit is earned through lower costs rather than by way of a higher price.

But what kind of a product does a customer want to buy? Who is the customer who buys it? These are the questions raised in every marketing text book. A market is usually segmented by the type and attributes of products or by the type and attributes of customers. On the whole, the available data of the current customer's age and sex does not give the information necessary for improving the product. Also, a lot of customers tend to set extremely high demands even if they are not able to raise their welfare with these improvements. For customers, above all a product's or service's ability to do one specific job for them is of primary importance. Therefore, segmentation will be more informative if it is based on the task of the product, i.e., why the goods are purchased. And even more relevant is the question, "Why does the customer buy the product?" Let us take the example of a fast food restaurant that decided it needed to

increase its milkshake sales. As the product improvement decisions based on segmenting by the attributes of customers and by the attributes of products did not increase the sales figures, management proceeded by asking why a milkshake is bought, i.e. what a milkshake does for a customer. An unexpected result appeared: half of the people who bought milkshakes consumed them early in the morning on their way to work while sitting in traffic jams. For these consumers it was important to make the boring commute at least a bit enjoyable, so they preferred a more viscous milkshake and a thinner straw plus a small amount of additives to make the product interesting and prolong the pleasure gained from it. Another larger group of consumers ordered milkshakes in the afternoon: mostly parents who bought a light sweet to reward their child for good behaviour. The manufacturer discovered that these customers preferred fun packages, healthy components and slightly smaller portions. Drawing conclusions



from this example, a milkshake fulfils at least two totally different tasks for customers – a pastime in traffic jams and a reward for a child. Therefore, milkshake-related expectations are also totally different. To sum it up: in order to simplify product improvement it is important to specify the need a product is purchased for. It is not advisable to build the hopes

**When an enterprise is still in the growth stage, it is better to “disrupt” one’s competitors rather than bring a competing product onto the same market.**

for success on a product whose content is similar to that of their competitors’. Such practice will increase supply so that very soon it will outstrip demand. If, in addition, differences between offered products are marginal and the products are above a mainstream customer’s ability to utilise, it may happen that the choice is made on impulse. In such a situation a manufacturer will lose its competitive advantage. A good example is mobile phones. The primary task of a mobile phone is to enable a consumer to make a call at any moment, irrespective

of the location. Consequently, all the models on the market do their primary job as you can make a call with all of them, and generally they are all reliable and comfortable to use. Differences appear in the number of additional functions which, in turn, are reflected in the selling price. The principle “something for everyone” works: those who desire an “up-to-

the-minute version” can purchase it, whereas a less demanding customer should be provided with a possibility to buy a cheaper model with only a few specific functions, which could be used for making calls, i.e. the model should satisfy a customer’s basic need.

According to Christensen’s theory, the disruptive strategy model is characterised by:

- An opportunity for people with smaller skills and income to use products or their analogues that were earlier available only to experts and people with a higher living standard;

- A pattern of behaviour where innovators are used for finding new fields of application for a product and thus discovering new markets - introducing similar products to the market is avoided;
- An attempt to achieve profitability by minimising costs;
- An aspiration for simplicity in the development process. Changes in customer behaviour are not predicted;
- Focusing on customers’ primary needs.

Applying the disruptive strategy model enables to create new opportunities for growth by developing a simple and cheap product that is easy to use. The target group is consumers for whom the product has so far been inaccessible or has seemed too expensive, technically over-sophisticated, too time-consuming, etc. Quite often, a customer does not even expect high technology, but is looking for a gadget that could help solve complicated or time-consuming and expensive problems simply and without significant investment of time. •

# Scenario planning ensures swifter response to changes



**Mait Raava**  
Pro Konsultatsioonid OÜ  
Management Adviser

*Mait Raava advises top executives on the development and implementation of strategies. In 2005-2006 he assisted eight organisations in applying scenario planning. Mr. Raava has worked as a management adviser in the business advisory company Pro Konsultatsioonid for a long time and is a lecturer in Estonian Business School.*

**Mait Raava was interviewed by Liisa Vuks.**

**How often have you come across leaders who apply the scenario method in their company strategic management?**

No big enterprise in Estonia uses such a planning method systematically. The market has been simple – they live in today's success and there have been no significant downfalls. Leaders do not prepare for long-term choices. The leaders who have taken up the scenario planning method understand that in the near future the environment will change and it will change intrinsically.

15 years ago, the business environment in Estonia was totally different. The leaders who were able to predict joining the European Union, and made the right strategic decisions, have been successful. They were able to predict changes and adapt to them. Darwin's theory of evolution also says that not only the species which are the strongest and most intelligent survive, but those that can also adapt the best to the changing environment.

In the case of Estonian enterprises, the need to apply the scenario method mostly results from expanding into foreign markets. It is sensible to consider various scenarios if you intend to engage in long-term business activities, not just be a "flash in the pan". In future, great success will be impossible to achieve without setting definite objectives and goals. The scenario planning method enables defining the most crucial factors for the future of a particular enterprise.

In the present era of globalisation our leaders have come to terms with the reality that their companies no longer have any intrinsic competitive advantage. Anyone who wants to, can do business. Therefore new niches are sought - something to differentiate from others. You will recognise your niche if you understand which market environment suits your enterprise the best. The description of such a market environment is, in effect, one variant of the possible future. When planning scenarios, various visions of future are written down. The ability to understand and picture different development patterns adds to the sense of security and certainty. There is no mystic, sudden, unexpected future – it is the future we have envisioned earlier. At the same time, the scenario planning method emphasises the transparency of management that enables the whole organisation to see why various choices are made.

**The present world and business environment are changing extremely fast and therefore predicting the future is quite a daunting task. However, the scenario method is based just on speculations about the future which can also be called predicting. Can you give any examples, what makes leaders apply that method?**

Still, it is not quite correct to say that the scenario planning method is predicting. When the method is used, the leader of an enterprise acknowledges different future

versions and its factors. Therefore, constructing scenarios could rather be called "playing through the future", i.e. simulating. When using the scenario planning method you are prepared to react faster to the changes of the market. And that is the most significant value of this method. For example, Ireland and Singapore have used scenarios for finding development patterns and opportunities for their countries for quite some time. Therefore they are much faster in their reactions and more certain in their decisions. Unlike Estonia, they are quite well prepared for any unexpected surprises. One of the most well-known implementers of the scenario planning method is the oil company, Shell. The most difficult task for Shell was to survive on the rapidly changing oil market. Thanks to elaborating different future scenarios they were able to monitor the more significant market factors and were better prepared for the fluctuating price of oil. Shell's experts have also shared their know-how outside their own company – they have consulted for other big corporations and also some countries such as Singapore and the Republic of South Africa, for example. In Estonia, the economic situation is in flux. Leaders understand that the future is not as rosy as it once was. This forces leaders to think very seriously about the future and planning scenarios. In addition, leaders have become more experienced and have begun to weigh their decisions more. Investments and risks have risen to such a level that for proceeding one needs a safer basis for risk management and risk mitigation. Management must discuss what to do "if...". This is the moment when scenario planning becomes vital.

**In theory, most of the methods of strategic management are quite logical and easy to understand. However, should anyone try and**

**apply them on their own, then sooner or later problems arise. It may happen that solutions cannot be found and therefore the idea is abandoned. What are the critical points for applying the scenario planning method according to your experience?**

The major danger is the faulty positioning of your company. If the vision of an enterprise's future is constructed separately from its background system, the vision is totally useless. If Tallinn, for example, tried to make similar decisions to those of Luxembourg it would not work – our countries have totally different economic and historical backgrounds.

I cannot understand what the Prime Minister Ansip has based his promise on, that Estonia will become one of the five most prosperous European countries. It is an excellent vision in itself which could be supported by several factors, and a strategy could be constructed. But being realistic we have to take into account that we are not the only ones who wish to achieve such standing - there are many countries pressing forward. What are the positive forces we can rely on for reaching our goal? Which are the main local as well as more global factors? Where is the advantage of sustainability? Do we actually have any distinct and unique competence? Where are the resources which would support this development? If all this has been worked out and written down as a project, it would seem a total fantasy at first. However, answering those questions will enable subsequent consideration of the item more adequately, and to construct a realistic future vision.

Another critical aspect is selecting the most vital factors from among the influencing macro factors. The right choice made in favour of two, three factors is the key, and therefore also the most error-prone spot in describing various scenarios. Future

scenarios are modelled by varying major factors. If the wrong choice is made, there can be a danger that insignificant factors have been identified.

You should also consider that actual scenarios are typically "classified" business information. This is the information no-one reveals. Only a portion of scenarios is disclosed, while the part of scenarios forming the basis for actual management decisions is highly confidential.

**Is it a universal method of strategic management or are there also cases when applying that method is not feasible?**

It is a universal method and not only in terms of enterprise management. Planning an enterprise's scenarios can be compared to a person's everyday life. When you make your career decisions it is important to define your goal in a longer perspective. People learn and expand their horizons by simulating various futures. Simulation is like a game and everyone can do it, and playing is the best way to learn. In fact, people are intuitively planning their scenarios all the time, although they are just not aware of it. Instead of a wandering and dreaming human being we can also depict an enterprise whose visions of the future should also be recorded and shared with the rest of the company. The process of simulating scenarios can also be called structured creativity.

**What literature would you suggest to business leaders who are interested in this topic?**

Peter Schwartz, *The Art of the Long View*. First published in 1991, the second edition in 1996. This is a book other more well-known scenario planning experts rely on. Unfortunately the book has not been translated into Estonian yet. And you can also search the Internet and periodicals. ●

# Does happiness hide in growth?

Viljar Arakas was interviewed by Kaire Pichen.



**Viljar Arakas**

Arco Vara Group  
Chairman of Management Board

*Viljar Arakas has been the Chairman of Arco Vara Group Management Board since 2002. Arco Vara is one of the biggest real estate companies in the Baltics with its more than 30 subsidiaries and over 150 employees. He has also worked in transport and trailer import companies.*

On 6 December 2006 the 10th strategy school workshop organised by KPMG Baltics AS and EBS Executive Training Centre took place. The subjects discussed included: enterprises' growth strategies, growth difficulties and how to overcome the difficulties. More than 30 people interested in these strategies participated in the workshop. One of the guest lecturers was Viljar Arakas, the Chairman of Arco Vara Management Board, who spoke about his company's expansion strategy.

**Arco Vara already operates in six countries – in addition to the Baltic States you have expanded into Ukraine, Bulgaria and Romania. In your estimation, what makes an enterprise expand?**

In the case of Arco Vara, the main reason for expansion is our ambition, our "hunger" for new challenges and development directions. It's a desire to do something more, go somewhere further. Another motive is our discontent with the present situation. Arco Vara's aspiration to develop into a bigger, better and more efficient company inevitably brings about a moment when Estonia remains too small for us and a logical advance is expansion into other countries. When The Baltic States eventually become too restricting for us, we will have to look further.

**Expanding into the Baltics seems quite natural and logical for**

**growing Estonian enterprises, but other countries Arco Vara has moved to are not as traditional. Why did you choose just those countries?**

It is an attempt to utilise growing markets. In the present world economic situation the two most rapidly growing regions are Asia and Eastern Europe. Moving to Ukrainian, Bulgarian and Romanian markets resulted from a wish to enter the markets where rapid market growth is still ahead.

The Ukrainian market is attractive also due to its size. The area of the country is the biggest in Europe and its population equals that of France. The western-mindedness of Ukrainians makes operating in the market easier than anywhere else.

We chose Bulgaria and Romania because they are new member-states of the European Union and therefore our entry into those markets is rather

a logical development in the process of expansion. And for Arco Vara the chosen countries together create one geographical unit.

**How long is the period between a decision to enter a new country and opening your office there? What should you definitely know about the target country?**

The period between an idea and opening an office takes almost a year. It is a year full of hard work. The process begins with thorough enquiries, preparing a business plan, and finishes with renting rooms and employing people. Building the right team is very important. Before making the decision to expand you have to study thoroughly the country's legislation. How is a company started in that country? What is the tax system like? You should perform the so-called fact finding mission. In order to get acquainted with the chosen country's market you have to be on the spot and find out who your local competitors are, and how they behave on the market. When expanding into other countries you should always remember that in spite of preparations it is still plunging headfirst into the water. Under no circumstances can you

**We consider attitude to be the foundation of everything. If an employee possesses the right attitude he or she will be able to go even to the ends of the earth.**

underestimate the importance of culture. When expanding into the Baltic States, cultural differences have been easier to understand. Differences are not so drastic, as we are still quite alike. In Ukraine and Bulgaria, however, they are Slavs, and therefore one has to take a totally different attitude into account. In Romania the influences come mostly from Italy and Germany, and the

people there are of Roman blood. Local traditions are very important and they should definitely be taken into consideration.

**How does Arco Vara find their personnel when entering new markets? Do you use local leaders or an emissary sent by the parent company?**

To a new country, Arco Vara usually sends a leader from Estonia who picks his team on the local labour market. The most ideal variant is a leader who can grasp the culture of the target country and understands where our company wants to arrive. We think that the primary task of every leader is to find their own employees so that the team will work as a unit. Recruiting a team is extremely important as all the employees have to support one common objective and share the same attitude. Generally we find people by differing from others. We inserted the word "vision" in our job advertisement, and offered challenge – not work – to our new employees. People get more interested in an advertisement that is atypical. In developing countries you can use such tricks which do not work in Estonia any more.

**Are Estonian leaders willing to go to foreign countries to "command troops" or do you have to stimulate them with a handsome motivation package?**

We consider attitude to be the foundation of everything. If an employee possesses the right attitude he or she will be able to go even to the ends of the earth. It is essential that a person share our vision and

have a will to develop. That is the basis for successful proceeding. But there are also a lot of barriers. It surely is difficult to go to another country when you have settled in Estonia, started a family, taken out a loan, etc. It is more likely that people who have acquired the necessary experience here, but have not settled so thoroughly yet, move on elsewhere. It is certainly easier to find an employee to work in Estonia than in some foreign country.

**What is most difficult when entering new markets?**

Quite often, the most difficult job turns out to be starting day-to-day work in an office after the opening ceremony. The first year offers the most surprises and unexpected situations when you have to be ready to solve various problems. It is a difficult moment when the "euphoria" of the planning period is replaced by real work. Making useful contacts and finding proper partners is also quite complicated.

**Could you reveal the most valuable experience you have gained from starting business in a new country?**

If you think that you already know everything about the target country, you should remember that in fact you know nothing. You should always be ready for the unexpected. Mati Alaver, the head coach of Estonian skiing team, has said that in fact their team knows nothing about skiing. This statement is truly insightful. We have applied the same attitude to our real estate business in new markets.

**How are finances planned when entering new markets?**

You definitely have to bear in mind that the first budget is only a "nice document". Usually it is not possible to calculate it very realistically. With great enthusiasm, expenses are budgeted as half as small as they



should be and income ten times what is actually feasible. At the end of the year, if you have not been able to stick to the compiled budget, don't despair. Still, the first budget has great importance for the future. When comparing the real outcome and initial calculations you can draw conclusions about the reasons for such differences. Where did you make mistakes, and why? Based on such experience and information you can prepare much more authentic budgets for the following years.

**In addition to the above, what else is important when occupying new markets?**

- **You should always have plan B.** For Arco Vara, plan B means the degree up to which we are ready to take risks. The limits are settled, i.e. if we have not received profit by a certain time, we will not continue. When the risk tolerance

limit has been exceeded, we leave the country. So far, we have not left any country although naturally we have had some problems.

- **The parent company's support** Arco Vara has got a "Flying Squad" for that. They go and help when help is needed. They have the necessary experience and they are able to assist. The parent company's support should be comprehensive. You cannot manage without it. If a leader going to open a new office in a foreign country is a novice, the supporting team has to be even stronger and more professional. There can always be some temporary setbacks, but in a longer-term perspective the setbacks make you stronger. If everything is OK with the attitude at the parent company, it is also easier to communicate with a subsidiary. We have a plan to put together a team whose task will be to start offices in new locations.

- **Problem solving**

The worst is a situation when solving problems is delayed and the decision making is lost between the levels of management. Even a bad decision is better than nothing. You have to be ready to solve problems. For reasons of clarity a responsibility pyramid is applied for determining the areas each division leader should answer to.

- **Attitude is the beginning and end of everything**

The ability to learn and adapt are the principle values. People and intra-company structure have to be thoroughly prepared for expansion. You do not necessarily need to go to foreign markets. If an enterprise is content with their existing position, they can always stay on the domestic market and focus on quality. Those who keep it small but perfect are also respected. •

# Public private partnership: is Latvia's socioeconomic growth a success story?

In several European Union (EU) countries, particularly Britain, the Netherlands and France, the number of projects being implemented using the Public private partnership (PPP) model has risen sharply in recent years. Public sector decision makers in several new EU member states – Czech Republic, Poland and Lithuania – are increasingly putting the issue of utilising the PPP model on their agendas.



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Insufficient investment in public infrastructure (roads, water and heating systems, kindergartens, schools etc.) has created the preconditions for a crisis in Latvia in this sphere, and as a result there is a need not so much for capital repairs to obsolete infrastructure as for the creation of new infrastructure that meets contemporary needs. It is no secret that the state does not have the financial resources to simultaneously realise all of these projects, and it is doubtful that this will change in the foreseeable future. PPP is not a miracle cure that will fix all of Latvia's problems in an instant. However, PPP is an instrument used by the world's most developed countries in situations where limited availability of state budget funds for implementing investment projects means inadequate development and maintenance of infrastructure. The basis for broad utilisation of public private partnerships is long-term cooperation between the public and

private sectors, under the auspices of which a public service or object is given to a private enterprise on the basis of a contract for a limited time period and subject to certain conditions in order for it to provide public services, with the public sector able to tender services of higher quality without the obligation to select the least cost option. In classic cases, quality is assured by the fact that, firstly, the private sector has more experience in providing a specific service, secondly it has broader knowledge of the methods, innovations and competitors' abilities to be applied to the field, and thirdly but equally importantly, payment is not guaranteed but is conditional upon the provision of quality services.

## **Preconditions for successful PPP**

As progressive PPP may be in other countries, there are several barriers which must be transformed into preconditions as soon as possible for successful application of PPP

in Latvia. Firstly, there is a lack of understanding about the principles of PPP, secondly there is inadequate long-term planning, and thirdly, the necessity of selecting the cheapest offer has been set as a priority. It cannot be denied that there is a lack of knowledge about the mechanisms of public private partnerships in state institutions and local governments and amongst the public at large. The cause of this lack of knowledge is a dismissive attitude toward PPP together with the public's negative view of the privatization process, and the public sector's tendency to try to control all ongoing processes without transferring responsibility to the private sector, which is regarded as an "untrustworthy partner." If we wish to change the public's attitude toward the quality of many state and municipal services, the time has come to view commercial enterprises not only as implementers of contracts, but also as persons that can be consulted in the initial stages of an investment idea, who can offer various technical and innovative approaches, take responsibility for implementing a project, and provide a service within a set time period and to a stipulated quality.

#### **The approaches of the public sector and commercial enterprises in evaluating projects**

The most significant differences between project cost evaluations performed by the public and private sectors are in long-term project planning, the identification of all costs and revenues and their calculation for the project's life cycle. At the moment of making a decision, a commercial enterprise requires full calculations for the project over a 20 year period, including analyses of conditions that could impact on the project's financial

data. In other words, the commercial enterprise wants an orderly and foreseeable view of the situation. For its part, at the moment of deciding whether to make an investment, all the public sector requires is information about a specific stage of the project – for example, to decide on whether to start construction of an object, the only requirements are the construction costs for the object and the funding possibilities for it. There are no possibilities for making decisions on the ongoing costs of the project arising from maintaining the object, its heating, employees; wages and other costs. As a result, the only option remaining open is to try and save money from year to year and to review the expenditure of resources to maintain the object.

In classic cases, quality is assured by the fact that, firstly, the private sector has more experience in providing a specific service, secondly it has broader knowledge of the methods, innovations and competitors' abilities to be applied to the field, and thirdly but equally importantly, payment is not guaranteed but is determined by the provision of quality services.

#### **What we pay for**

In a PPP project, the public sector pays for the quality of a rendered service which it can influence throughout the life cycle of the project, while with public procurements the public sector pays the lowest price for the service but has no influence over its quality. In order for the public sector to change its views from an attitude of "buy the cheapest" to "accept the offer of highest quality," systematic work is required with PPP pilot projects and successful examples of such cooperation must be discussed.

As a result, the society will not only accept but will demand that the public sector change its conceptual approach to ensure that additional funding is attracted, successful project management experience is utilised, efficiency is increased and service quality is improved.

#### **Experience of PPP in Latvia**

Currently work is progressing well in Latvia on developing several pilot projects, as a result of which, firstly, the feasibility studies for implementing PPP projects in several sectors where their utilisation would be advisable have been developed. Secondly, draft PPP contracts have been created, thirdly, work is continuing on procurement documentation in relation to tenders for selecting private partners, and fourthly, several contracts have been

concluded on commencing PPP realisation.

Reviewing the aforementioned, it can be concluded that the usage of the public private partnership model is in its infancy in Latvia, and therefore we have a great opportunity to learn from the experience of the world's most developed countries and to avoid making serious errors. Only well thought out, carefully assessed and successful cooperation between the public and private sectors can ensure the favourable development of Latvia's public infrastructure. •

# PPP's in Estonia

By Teele Alas, Financial Adviser, KPMG Baltics AS

In Estonia, public sector infrastructure has been short of funding during the last decade, similarly to Latvia, but the importance of Public Private Partnerships (PPP) in Estonia is rising. Until now, only a few PPP projects have been implemented in Estonia. The capital Tallinn is planning to renovate Haabersti crossroads (one of the busiest roundabouts in Tallinn) as a PPP model. In addition, Tallinn has activated a PPP municipal housing project which is in its final stage. Estonian entrepreneurs bear different opinions about the profitability of PPP – some think that their contributions to

PPP projects exceed their benefits from them, and they prefer traditional procurement, while others think of PPP as a new and fruitful market frontier.

One of the PPP pioneers in Estonia is Falck Group. Falck's cooperation with the local administration began in emergency services – Falck has been providing coast guard services since 1998 and ambulance services since 2001. In many cities, Falck is also managing pay-parking and ticket collection in public transport. Meanwhile, AS Infotar is planning a PPP project in Tallinn – an

entertainment centre called Tallink City which will contribute to the development plan of Lasnamäe district. Estonia is expected to draw about one million additional tourists a year thanks to Tallink City, whose completion deadline is in 2010, and which will host a ski-tunnel, a facility for alpine skiing and roller-skating, and a tropical garden, among other attractions.

Public private partnerships are instrumental in funding and improving the quality of Estonia's public infrastructure, and it seems that the PPP model is indeed gaining popularity in Estonia. ●

## Financial advice pays off

Since 2004, the number and total value of merger and acquisition (M&A) transactions have been rising all over the world. In the Baltics, most M&A transactions of the region are disclosed in the media. Information on changes in entities' shareholder structure can be obtained from state registers. However, significant transaction details (especially the price) often remain confidential. Therefore, the monetary value of the Baltic M&A market would be hard to measure. Nevertheless, KPMG in the Baltics' experience indicates that M&A activity in the region remains strong.



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The reasons for selling an operating entity may vary – shareholders may wish to start up a new business or dedicate more time to themselves and their families, or they may assume a decline in profitability. The owner planning a disposal of a shareholding has to decide whether to conduct the transaction with in-house resources or to involve a financial adviser. Large corporations have separate M&A divisions which are capable of performing several disposals a year. By contrast, in the 1990s it was quite common in the Baltics that a shareholder performed a disposal transaction practically single-handedly, asking for some legal advice only upon the conclusion of the purchase and sale agreement. In the past few years, however, Baltic companies have become more interested in seeking financial advice. As a result of strong economic growth, companies have expanded and accession to the EU has heightened competition. Furthermore, transactions have become more complex and private equity funds have penetrated the market. When the divestment decision has been made, shareholders and management should consider whether they have the time and competencies required for the transaction. If not, they should consider hiring a financial adviser. Why?

Firstly, the involvement of a financial adviser will save time for the management and the shareholders. The disposal process is extremely time-consuming, entailing countless details which need to be coordinated (see chart) with the counterpart and

the lawyers. Depending on the size of the entity which is being divested, the process can last for 6-12 months. Dealing with the sale of a company requires a lot of additional time and commitment, which can be especially difficult for an executive involved in daily management. Doing two things at once often means doing neither properly.

The use of a financial adviser allows management to continue to deal with day-to-day issues and to focus on enhancing the company's value. Depending on the client's wishes, the financial adviser can act contemporaneously as project manager, strategist, coordinator and executor of the transaction. The entire

**The disposal process is extremely time-consuming, entailing countless details which need to be coordinated (see chart) with the counterpart and the lawyers. Depending on the size of the entity which is being divested, the process can last for 6-12 months.**

process could be managed from the same source, to help ensure that the transaction was completed within the agreed timeframe and budget. Secondly, the experience, skills and contacts of a financial adviser can help maximise the disposal proceeds. With the exception of private equity funds and single "serial investors," Estonian entrepreneurs' experience with disposals is generally limited to one or two transactions. The lack of practical skills and experience may result in the divestment of the product of many years' hard work at a price considerably below the entity's

fair value.

Expertise and experience in conducting transactions of various size and complexity can assist financial advisers to attain the maximum price for the client. Moreover, financial advisers' fees are usually linked to the sales price. From the point of view of value, the preparatory phase is essential. Financial advisers can draw attention to shortcomings and help resolve tax, accounting and legal issues. Strong financial advisers have an extensive international network of contacts. They can involve the best professionals of the industry in the project and may extend the list of potential buyers. Financial

advisers are aware of the risks of the transaction and can help the shareholders and management with the development of the best divestment strategy, valuation of the company, negotiations, identifying the optimal structure of the transaction, etc. Thirdly, the involvement of a financial adviser will help reduce the risks related to information leaks. Historically, disposals of companies have been transactions which have been concealed from the public until the last minute. This is understandable because any information leak in the preparatory

phase will divulge information to competitors and cause insecurity among customers, suppliers and employees. How does the use of a financial adviser mitigate risks related to information leaks?

The primary method applied by financial advisers is the controlled and gradual disclosure of information. For example, in the initial stage of a disposal process when specific criteria for the investor have not been agreed and there are dozens of potential buyers, the adviser will publish a so-called "teaser" or brief survey which contains a summary of the entity's financials, main activities, markets and competitive advantages. In this phase, the name

of the company is not disclosed. Any investors wishing to obtain further information will have to sign a confidentiality agreement. After this, they will receive a memorandum

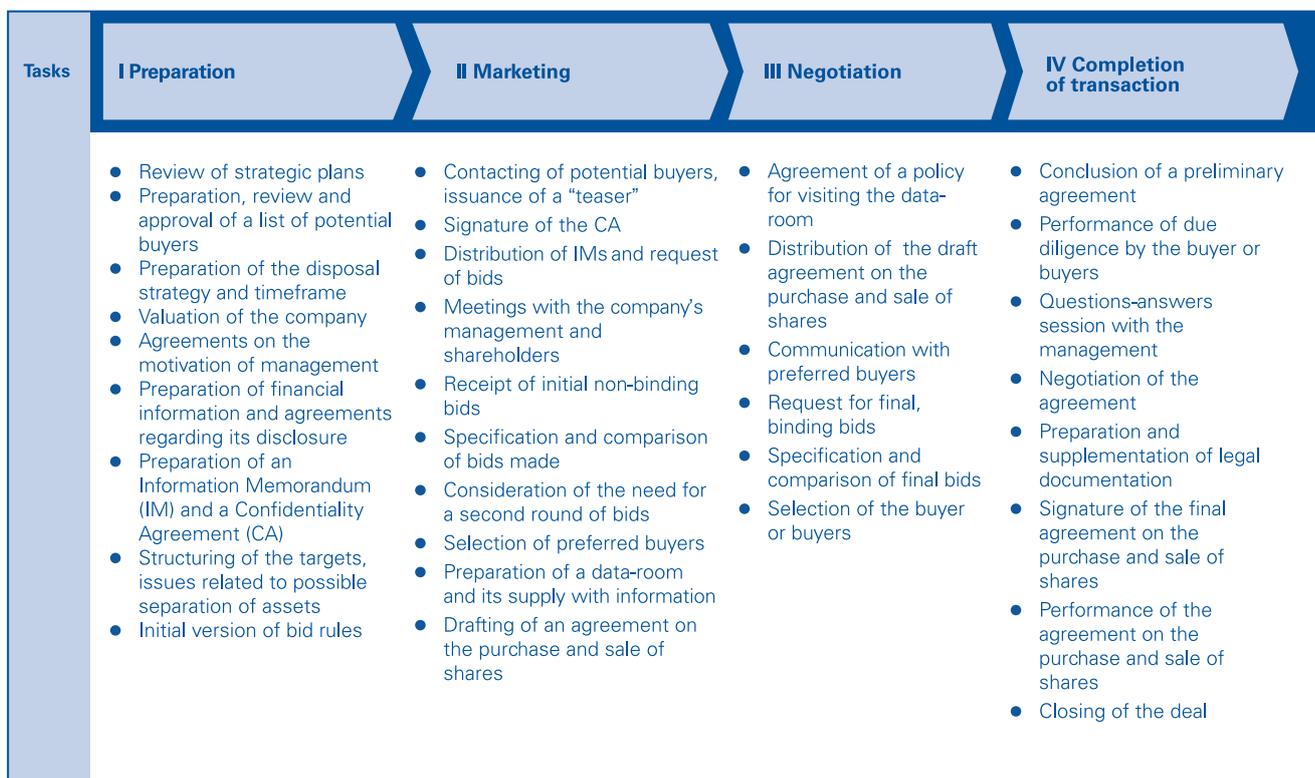
Depending on the client's wishes, the financial adviser can act contemporaneously as project manager, strategist, coordinator and executor of the transaction.

including the name of the company and a more detailed overview of its operations. Depending on the situation, some confidential information (e.g. the list of customers, etc) may still be excluded and made available only in the course of due diligence.

The divestment of a company may be a unique and interesting experience. At the same time it is a transaction whose value is crucial for the shareholders. Compared to the design

of a business strategy which may be reviewed and adjusted according to need, a divestment cannot be withdrawn or amended. From the point of view of the end result the involvement of an experienced financial adviser can add significant value and benefit for management and shareholders. •

**An example of the disposal process**



# The postponed accounting system for import VAT



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### **The tax burden for importers will decrease and the payment of VAT simplifies**

Applying PAS will give traders an advantage in cash flows as, when importing goods, they no longer have to pay into the state. Instead, similar to intra-Community transactions, VAT on importation will be accounted for on the VAT return where the VAT due and deductible can be reported. Attention should be paid to the criteria established for applying the preferential import regime to traders. Some of those criteria have to be qualified for as early as one year prior to the granting of the benefit.

### **Conditions to qualify for preferential treatment**

Pursuant to the draft law, the tax authorities will test importers against certain criteria to determine if the

The good news is that, in Estonia, a draft law is being prepared which allows for a tax incentive to traders. According to the draft law, importers do not have to pay VAT to the state any longer. Instead, VAT on importation may be accounted for on the VAT return (Postponed Accounting System "PAS" or the deferred payment system).

trader qualifies to operate according to the preferential import regime (PAS). For example, applicants must have been registered for VAT purposes in Estonia for one year or more in order to be eligible for the benefits of the PAS. In addition, the company must have submitted its VAT returns electronically for one year or more, and at least half of the supplies of the applicant must be zero-rated supplies in order to benefit from the preferential regime. Furthermore, the applicants must have a good tax compliance history - traders in debt to the tax authorities within one year prior to application will not qualify. It is possible that the details of the PAS will be amended before the preferential import regime is adopted. According to the draft law the postponed accounting system will become effective as of the beginning of 2008. The result is that when the draft law is adopted, the payment of VAT upon importation will become easier and the tax burden for importers will diminish. As a result, it will become more attractive to import goods through Estonia.

### **Current advantages of the tax system**

The Estonian tax system is generally considered favourable to foreign investors. There are several simplifications for foreign traders regarding VAT in Estonia. For example, the foreign trader who is not established in Estonia can sell goods or provide services in Estonia without registering for VAT purposes if the sale is taxable by the Estonian acquirer of the goods or services. In addition, traders may sell here exempt from VAT and without the need to register for VAT purposes in a free zone, tax warehouse or customs warehouse. If, for example, a Latvian company brings his goods from Norway to a customs warehouse, it is not obliged to pay VAT nor register as a taxable person in Estonia, provided the goods are sold to an Estonian company before taking them out of the warehouse. A Latvian company that is registered for VAT in Estonia is not required to pay import VAT if the imported goods are delivered from Estonia to some other Member State. ●



# The most talented win

To climb to the top you need two qualities – talent and hard work. Although on achieving success in different areas the value of either characteristic can vary, you surely and inevitably need both. Following the set objective, it is not so important to work a lot as to work effectively. However, the role of talent still seems to prevail slightly over diligence in the higher echelons of the business world.

In order to be successful in a competitive atmosphere an enterprise needs talent, meaning inventiveness, creativity, infallible intuition, an intrinsic grasp of market practices and expectations, in addition to confidence in one's own ability to cope with the competition and courage to trust oneself.

**Risk: talent exists but does not show itself**

To uncover its talent, an organisation has to satisfy several preconditions. First of all, an organisation should be aware of its talent. The more effective the intra-organisation communication is, and the more substantive discussions take place between the management and personnel, the greater the chance is that leaders are

able to acknowledge and understand the potential and talent of the entire organisation, including its personnel. If the leaders do not realise the abilities of their employees and do not possess an adequate overview of the social capital of their enterprise, the potential will remain untapped. Talent should be supported, employed and nurtured so as not to lose it. The capacity of an organisation is developed the same way children are educated: on the one hand, kids should be given enough freedom to discover their own talent while on the other hand their explorations have to be carefully supervised so that their pursuits are not just aimless roaming. Hence, for leaders, the development of talent primarily means skilful delegation, which is a precondition



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## COSO Risk Management Model



for revealing employees' and an organisation's abilities, in addition to setting boundaries and building a framework to avoid dissipating the enterprise's objectives and losing focus.

The expression and development of an organisation's talent greatly depend on the organisation's culture and, above all, on whether and to what extent employees are motivated to think together with the management and to share their ideas and observations with key people. In an autocratic and more formalised organisation than average, innovation and manifestation of talent are somewhat more complicated, as most of the accepted ideas, actions and choices have been presented by the leader. The more autocratic and bureaucratic an organisation is, the more likely employees have little opportunity to express their creativity and talent, and the capability of the organisation is limited to the abilities of its leader.

On the one hand, when creating an organisation whose goal is developing innovation and talent, leaders need the courage to delegate decision making and setting development visions to their personnel as much as necessary. On the other hand, they need to have well-founded

faith in the professional abilities of their employees. If the talent of an organisation cannot be expressed and developed, even sufficient diligence brings only mediocre, if not meagre success. The vibrant, yet austere activity of an organisation provides its competitors with an opportunity.

### How to activate an organisation's talent?

How is it possible to create a working environment encouraging innovation?

What are the work arrangement preconditions for developing, noticing and applying new ideas?

The opportunities to develop innovation in enterprises are being spoken about more and louder than ever. The aspect of innovation has clearly found its place in models of risk management – the COSO risk management model widely used by US listed companies has lately been supplemented with three significant nuances which are directly related to noticing and applying innovative ideas:

- objective setting
- event identification
- risk response.

**When creating an organisation whose goal is developing innovation and talent, leaders need the courage to delegate decision making and setting development visions to their personnel as much as necessary.**

Besides the categories of operating, reporting and compliance objectives, an equal category of strategic objectives was added.

When deciding how to orchestrate work, a leader first has to think through how his organisation's objectives should be established in order to best utilise the talent of the organisation and to fully survey

the organisation's potential for development.

For creating innovative ideas, it is essential to consider whether the existing information channels of the organisation enable communicating significant events and trend shifts in the market as well as in the organisation directly to key persons. The rate at which significant events are identified and the so-called ability to catch the trend may mean a remarkable competitive advantage to an organisation.

One precondition for capturing and developing innovative ideas is effective communication between the personnel and management. Employees should have an information channel to express their thoughts and ideas, be it regular meetings, web environment, active team work or performance reviews. It is important that such a channel has been created and employees have been able and willing to use it. The application of ideas should be carefully prepared mitigating all the more material risks which could fatally jeopardise a good idea.

In connection with an enterprise's innovativeness it is important to clearly acknowledge that "the deck of cards will be reshuffled after each game". The winner will be the enterprise which is more talented and diligent enough to utilise its talent faster and in a more risk-free manner than others. And the company's leader sets the rules of the game. •



# A formula for growth

The relationship model between upper management and rank and file workers in an enterprise, the culture and micro climate of communication, management's skills in delegating responsibility and employees' level of interest in the process of making important strategic decisions for the company – these are all important issues affecting a company's growth and the quality of its work.

The first-ever open discussion in Latvia about company growth issues and management priority was organized by the professional services firm KPMG in the Baltics. The participants included directors and project managers from enterprises and companies of very diverse fields of activity and size but with common issues.

How can company growth be achieved in Latvia? What should the management priorities of a competitive enterprise be? How do you achieve high quality indicators for the company's work? Is there a lack of high quality resources in Latvia, or are these resources going abroad?

How does the micro climate and interpersonal communication affect company growth? How do you ensure that an organization's employees are satisfied with their working conditions and material rewards?

These issues were discussed in the form of an informal conversation, whose participants discussed each others' views, and sketched out the problems Latvian companies will have to face on the road to stable business growth.

One of the problems that was raised is the need to develop personnel management systems, and in such a way that staff are motivated to increase their performance

productivity. At first glance, this seems simple: a person is interested in earning more money...- but this is a very superficial view. How should specific activities of the work be organised in order to create a situation where it is advantageous for employees to work harder, faster and better?

It is not obligatory to supervise a particular manager on a daily basis. Effort can be made to develop an effective work schedule and to accordingly optimise the periods between reporting deadlines. If a person is given an assignment that must be done in one week, he/she must decide when and how and what

to do to make the deadline. Naturally, this does not apply to production line workers or service staff whose duties include dealing directly with customers.

The discussion participants were unanimous in believing that internal communication is one of the most important aspects of regulating the production process. If it functions badly, a lot of work time is lost. Instead of working, employees are occupied with "relationship negotiations": what decision must be taken for a specific situation, and who is capable of making the decision and accepting responsibility.

The assumption that involving all employees in managing a company will help resolve communications issues and other problems deserves to be looked at more closely. Not all employees see the problem at the level of the whole enterprise. It is important to encourage employees to assess the situation not just from the position of their own sectors, but also from the management's viewpoint. There exists an interesting mechanism for this purpose which is connected with developing a corporate code of ethics. As many of a company's workers and customer service employees as possible should be involved in this process. As a result, the prepared corporate code of ethics would be of a recommendatory nature and includes the foundations for decision making ethics and interaction and communication between employees. Of course, the issue here is helping the employee to understand his/her place in the company's overall strategy, the social guarantees provided to him/her by the company, and the advantages he/she enjoys compared with workers at other companies who may possibly

earn more money.

However, often it is easier to resolve a few matters that are only connected with management than to create a new cultural model within the company. The employee may only envisage a limited task – performing his/her direct job satisfactorily, following orders and nothing more. The task of management is to encourage him/her to feel responsible for how the company is performing

**Not all employees see the problem at the level of the whole enterprise. It is important to encourage employees to assess the situation not only from the position of their own perspective, but also from the management's viewpoint.**

overall. Only in this case can a person be expected to show initiative and participate in strategic decision making.

The ability to work with people, to inspire them with your positive ideas and your enthusiasm – these are possibly even more important qualities for a leader than professional knowledge. There are certain cases where a leader endowed with such qualities but who is not a professional in a particular sphere has made a company previously on the verge of bankruptcy thrive.

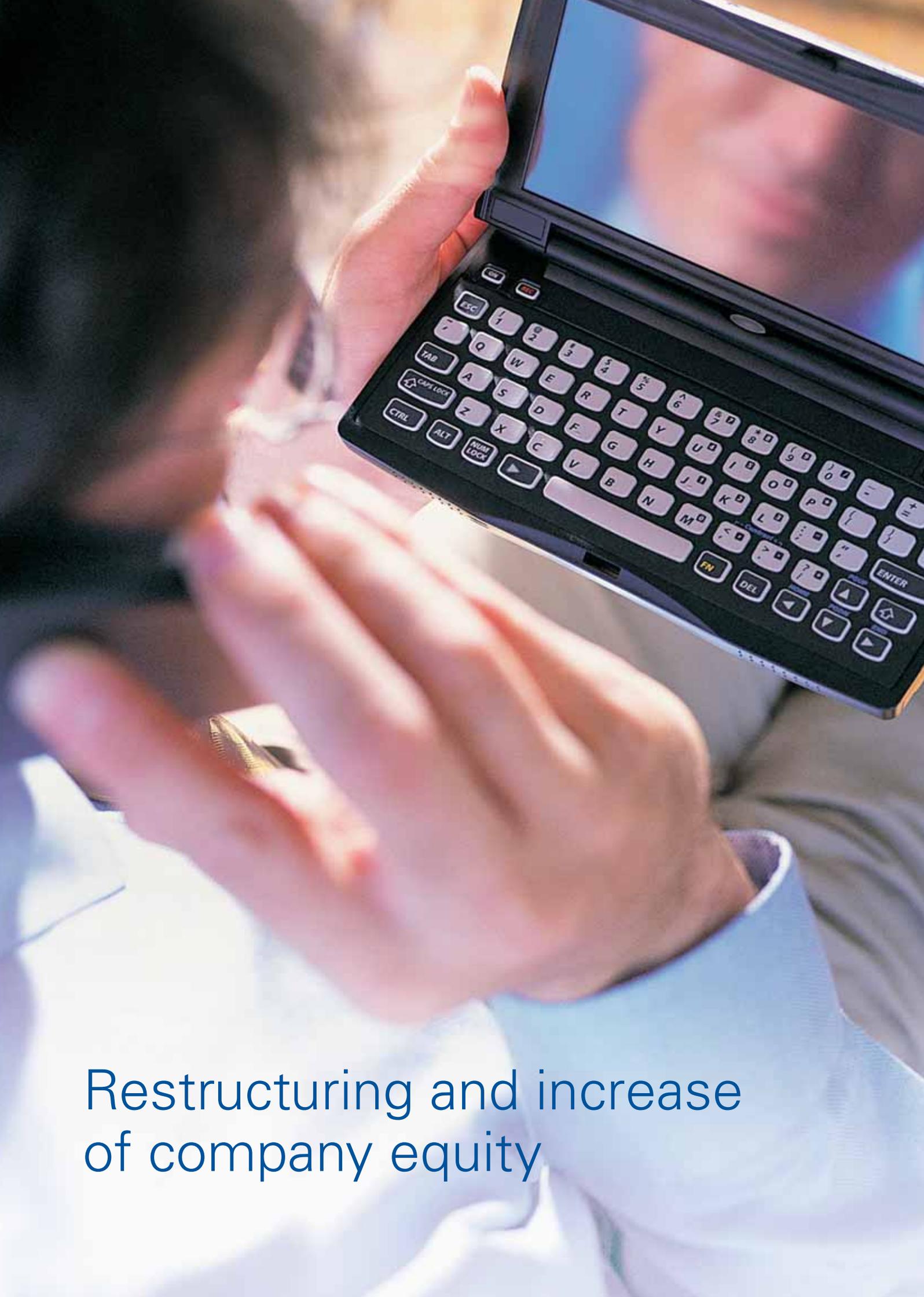
The quality of education and ambition of future employees is an issue that company heads have discussed a lot in the last year. If a student is not taught to think but merely to pass exams, it is doubtful whether much will come of him/her. It is a totally different situation if he/she knows from the second year of studies that he/she will work for a specific employer in a specific position: parallel to his/her studies the company gives him/her assistance to mature to a professional level and after graduating

the company has a specialist ready to perform real assignments. With regard to ambitions, it is often the case that straight after graduation a person demands a very high salary without realising that money has to be earned. Or more precisely, that to work in the conditions provided for him/her by the company, he/she must earn more money than is spent on his/her salary.

Speaking of motivation, methods

of encouragement should not be forgotten either. If too much stress is put on material motivation for achievements, a situation may arise where the employee starts to think that to receive his/her salary he/she simply has to turn up for work. However, this is unacceptable (bonuses cannot be paid just for performing ordinary direct duties). This sort of attitude is anti-social because it creates an unhealthy atmosphere in the work team, and the creator of such a situation must be dispatched promptly. The aforementioned problems can be encountered at any company. Each enterprise implements its own approaches. Openly discussing such problems is the first attempt to publicly share experience, while for the moment remaining at the level of discussion. It is possible that in future this conversation will become a practical seminar in which the participants inform others in detail about their successful decisions.

*By Vladimir Orehovsky, published in the Latvian monthly business magazine Director No 12, 2006* •



Restructuring and increase  
of company equity



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Company restructuring through a merger is one method for increasing equity. After the completion of the restructuring process, the acquired company ceases to exist while the acquiring company continues its operations using its own and the acquired company's assets. The restructuring process is more complex than it may seem and needs to be closely followed from a number of important perspectives.

As in the other Baltic countries, firms in Latvia are actively involved in restructuring processes, increasing their market share, seeking to enter new markets, and other equally strategic and ambitious goals. This article presents an overview of opportunities for increasing equity through restructuring based on the regulations of Latvia's Commercial Law<sup>1</sup>, using a comparative method in relation to regulations in Estonian and Lithuanian laws.

The restructuring process is subject to similar regulations in all the Baltic countries. There are certain differences in terminology, document formatting requirements and deadlines. For example, in Latvia and Estonia a restructuring agreement is drafted, while the equivalent in Lithuania is restructuring regulations<sup>2</sup>. However, there are no significant differences in the legal requirements pertaining to the content of such documents.

Restructuring may be accompanied by an increase in the company's equity. With respect to limited liability companies and joint stock companies, equity may be increased through a

merger (Latvia's Commercial Law, articles 334 and 335<sup>3</sup>). An equity increase through restructuring is a right rather than an obligation of the company shareholders.

After the completion of the restructuring process, the acquired company ceases to exist, while the acquiring company continues its operations utilising both its own assets and those of the acquired company. There are different legal regulations governing the increase of equity for limited liability companies and joint stock companies.

#### **Limited liability companies**

In accordance with the general regulations of Latvia's Commercial Law (article 197.) the equity of a limited liability company may be increased through current or new shareholders making additional investments and receiving new shares in return or through increasing the nominal value of existing shares, with a positive difference between the own capital and the amount comprising the own capital and reserves<sup>4</sup>.

<sup>1</sup> Latvia's Commercial Law- the Commercial Law adopted by the Parliament of the Republic of Latvia on 13/04/2000, published 5/4/2000 Latvijas Vēstnesis Nr. 158/160, in force from 01/01/2002.

<sup>2</sup> Article 63 of Lithuania's Companies Law (Lietuvos Respublikos Akcinių bendrovių įstatymas, adopted by Lithuania's Seimas on 13/07/2000, No VIII-1835, hereinafter Lithuania's Companies Law).

<sup>3</sup> Equity increase through restructuring is also discussed in Articles 413, 422 of Estonia's Commercial Code (Äriseadustik, adopted by the Estonian Parliament (Riigikogu) on 15/02/1995, in force from 01/09/1995), hereinafter Estonia's Commercial Code.

<sup>4</sup> This method of increase may be used after restructuring is completed, when preparing the acquiring company's financial report in accordance with the regulations of the aforementioned article of the law.

### Joint stock companies

For joint stock companies, equity can only be increased through one method – issuing new shares (Latvia's Commercial Law, article 250). Some exceptional regulations which differ from the general regulations of the law (for example, shareholders do not have first rights to acquire newly issued shares) are intended for cases where a joint stock company's equity is to be increased for a special purpose (Latvia's Commercial Law, article 254). The guidelines for

Before deciding to begin restructuring, it would be advisable to carefully assess the restructuring structure not only from an asset sufficiency assessment point of view, but also to draw attention to tax issues and the question of whether the exceptions stipulated in the law apply to each specific stage of restructuring.

increasing equity are explicitly set out in the law, and an increase in equity may not exceed the amount required for this purpose. Guidelines regulate the exchange of newly issued company shares in the event of restructuring (Latvia's Commercial Law, article 254 part two p. 2.). A joint stock company's equity may only be increased by the amount required for exchanging the shares of the company to be acquired for those of the acquiring company.

### The auditor's role in the restructuring process

At the beginning of the restructuring process, the company's board prepares a draft restructuring agreement (in specific cases provided for under Latvia's Commercial Law a reorganisation decision). In Latvia, simultaneously with the submission of the draft restructuring agreement

to the commercial registration body (Enterprise register), the companies involved in the restructuring request that the commercial registration body appoint an auditor<sup>5</sup> for the respective restructuring process.

The sworn auditor's tasks in the restructuring process are: firstly, to conduct a review of the restructuring agreement<sup>6</sup>, assessing whether the exchange coefficient of the stocks (shares) indicated in the draft contract and the supplementary payment amount are fair and reasonable;

secondly, to check whether the restructuring can cause losses to the company's creditors and whether the methods used for determining the exchange coefficient for the stocks (shares) and the supplementary payment amount are satisfactory (Latvia's Commercial Law, article 341. Estonia's Commercial Code article 396, Estonia's Commercial Code article 63); thirdly, to conduct an assessment of sufficiency of the assets, which is required if the acquiring company is increasing its equity as a result of the restructuring (Latvia's Commercial Law, article 372, Estonia's Commercial Code articles 416, 424, Estonia's Commercial Code article 8).

The auditor expresses his/her conclusions in a statement (Latvia's Commercial Law articles 340, 372, 377). Although it is not explicitly stated in the law, teleologically

interpreting the meaning of the law it must be assumed that the auditor's report must be positive in regard to the assessment of sufficiency of the assets.

The shareholders of the companies involved in the restructuring must have an opportunity to examine the auditor's statement at least one month in advance (Latvia's Commercial Law article 343, Estonia's Commercial Code article 419 (in relation to public limited liability companies), Lithuania's Commercial Law article 65). At the end of this term, a meeting of the company shareholders is held.

### The restructuring decision and amendments to the company's articles of incorporation

A decision on restructuring may not be taken earlier than one month following before the submission of the draft restructuring agreement to the commercial registration body and the preparation of the aforementioned auditor's statement (Latvia's Commercial Law, article 343). In preparing the draft restructuring agreement, along with other information stipulated by law in respect of companies involved in restructuring, information must also be indicated in relation to the distribution, number of stocks (shares) and nominal value of the acquiring company's equity, etc. The increase in the company's equity is marked out, however at this stage of the restructuring the company shareholders do not make any decisions about restructuring (except on the commencement of restructuring which is not directly required from the legal aspect) or increasing equity through

<sup>5</sup> At the request of the board of the company involved in the restructuring, the commercial registration body may grant its approval for an auditor to check the draft agreement. The auditor must be on the approved list of the Commercial Register and have the right to examine the company's annual report i.e. must be a sworn auditor with no conflict of interest in the company in accordance with part four of article 176 of Latvia's Commercial Law.

<sup>6</sup> An examination of the restructuring agreement does not have to be conducted if all the stocks or shares belong to the acquiring company, and in relation to a limited liability company if all of its shareholders agree that an auditor's review of the restructuring agreement is unnecessary (Latvia's Commercial Law articles 340, 368, Estonia's Commercial Code article 394, Lithuania's Companies Law article 70).

restructuring. In accordance with article 392 of Estonia's Commercial Code, a restructuring agreement is concluded at the initial stages of restructuring, however the rights and obligations arising from this only come into effect after specific approval has been obtained and acceptance procedures have been completed.

Between submission of the draft restructuring agreement to the commercial registration body and its approval by a Shareholders' meeting, the board can make amendments to the restructuring agreement draft. Such amendments are necessary if the auditor indicates that the assessment of sufficiency of the assets of the acquired company is insufficient to cover the planned equity expansion of the acquiring company.

After the draft restructuring agreement is submitted to the commercial registration body, the auditor's statement has been received and the shareholders have had the opportunity within the term stipulated by the law to examine the auditor's statement and other legally required documents, a company shareholders' meeting takes the decision to restructure the company, and approves the restructuring agreement, which is handed over for signing to the boards of the companies involved in the restructuring (Latvia's Commercial Law, article 343). If equity is increased through restructuring, this shareholders' meeting simultaneously takes a decision in respect of increasing equity, making the respective amendments in the acquiring company's articles of incorporation.

### **Exceptions where equity may not be increased as a result of acquisition**

The shareholders of the company to be acquired as a result of restructuring shall receive stocks (shares) in the acquiring company for their investment in the acquiring company. If the acquiring company does not have its own stocks (shares), the stocks (shares) required for the exchange may be obtained through increasing equity as a result of the restructuring.

The stocks (shares) of the company to be acquired are not exchanged for the stock of the acquiring company and are annulled in the following cases specifically stipulated by law:

- if the stocks (shares) of the company to be acquired have belonged to the acquiring company i.e. a subsidiary is acquired by its parent company;
- if the company to be acquired owns its own stocks (shares);
- if the stocks (shares) of the company to be acquired have belonged to a person acting in its own name but are respectively to be joined for the benefit of the obtaining company, thereby creating one of the aforementioned situations.

The special objective in increasing the company's equity becomes void simultaneously with the obligation to annul the share. If as a result of restructuring a subsidiary is acquired by a parent company, the equity of the latter cannot be increased taking into account the aforementioned regulations of the law on the annulment of the shares of the company to be acquired which belong to the acquiring company.

In these cases the acquiring

company's own capital increases, which allows a limited liability company to increase its equity in accordance with the regulations of Latvia's Commercial Law, article 197 (see reference 1 on page 23).

In other cases not directly prohibited by law, a company's equity may be increased through restructuring.

### **Advice from KPMG in the Baltics' professionals:**

The restructuring process is more complex than, for example, changes to a company's articles of incorporation, because it consists of several stages and involves not only the company's shareholders and board but also other persons whose work must all be coordinated. Before deciding to begin restructuring, it would be advisable to carefully assess the restructuring structure not only from an asset sufficiency assessment point of view, but also to draw attention to tax issues and the question of whether the exceptions stipulated in the law apply to each specific stage of restructuring. From the very beginning, it is important to choose a restructuring model which leads to the achievement of the desired objective.

Through acquisition, shareholders gain the opportunity to increase not only the assets of the company but the equity as well, without additional investments on their part. Of significant importance in this process is the sworn auditor's report on asset sufficiency assessment for increasing equity, because the increase may not exceed the auditor's opinion on the value of asset sufficiency. •

# Economics scholarship helps students

In autumn 2006, KPMG Baltics AS, in cooperation with the Alumni Association of Tallinn University of Technology (TUT), awarded two students with the Peeter Riit Scholarship. The EEK 17,000 scholarships were given to Teele Alas, a TUT public economics undergraduate, and to Tatevik Aslanjan, a corporate finance undergraduate at TUT, for their

outstanding academic results and active contributions to promoting student life and activities. The Scholarship was established to support the study of economics in Estonia and to commemorate Mr. Riit, a long-time Head of the TUT Department of Accounting, renowned economist and one of the founders of KPMG in Estonia. •



**Teele Alas receiving award from Andris Jegers, the head of KPMG in Estonia**

# Putting smiles on kids' faces



**The exhibition of children's artwork at KPMG in Latvia office**

For several years now, KPMG in Latvia has been offering some Christmas cheer to children missing the warmth and care of their families.

During December we offered kids the show "The Christmas Scrunchy". 120 children from the Rauda Special Children's Boarding School, the Dauguli Special Boarding Primary School and the Jelgava Orphanage enjoyed a festive day with KPMG staff at the VEF Palace of Culture. The cheer was mutual and business associates received electronic greeting cards created from drawings the children from three

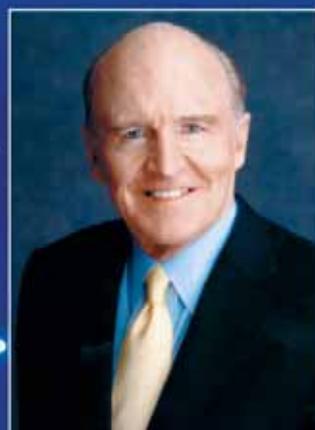
schools had sent in. True joy comes from sharing it, so in honour of Second Advent, the children of KPMG employees enjoyed party with children from foster families from the Zemgale region in the House of Architecture. In addition with support of KPMG staff, a campaign was organized in December to raise funds to purchase

winter shoes for the youngsters at the Rauda Special Children's Boarding School. Thanks to the American and British Chambers of Commerce, the range of donors was widened considerably. As a result of the campaign, the kids received more than 50 pairs of shoes, 100 jackets, clothing, gloves, toys and sporting equipment. •



**The children of KPMG employees in Latvia have fun with kids from foster families**

# Unique Jack Welch -seminar in Helsinki



## Leadership and Winning, 22 May 2007

Experience "Manager of the Century" live. Jack Welch, former CEO and Chairman of General Electric, is coming to Helsinki as a guest of KPMG. **KPMG's unique Jack Welch on Leadership and Winning -seminar will take place on 22 May 2007 at the Finlandia Hall, Helsinki, Finland.**

Jack Welch knows how to win. During his 20 years as CEO of GE, he led the company to year-after-year success around the globe. During his tenure, GE market value grew from \$13 billion to \$400 billion. At the seminar you will have a rare opportunity to hear Jack Welch's views and thinking on leadership and winning. In addition to Jack Welch's interactive sessions, participants will be offered a Nordic top executives' panel discussion.

**Don't miss this must-attend executive event in 2007 in Helsinki!**

Further information available at  
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