

PROPERTY MANAGEMENT SERVICE DEBTS AND THEIR IMPACT ON ENTREPRENEURSHIP

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Abstract. The present research examines the causes and risks of property management service and utility debt collection and their impact on the operation of the management company.

Every day, civil relations arise in the society from the liabilities of the parties. By providing property management services, civil contracts are concluded in order to achieve a certain economic result – the fulfilment of specific work. The other party is usually interested in remuneration for the services provided.

The data of the Portal of the Latvian Court of Justice www.manas.tiesas.lv have been used to determine the current situation. Both the judicial authorities and the judgements have been chosen on a random basis. During the research, the court judgements and verdicts on debt collection, the regulatory enactments regulating the recovery of debts in Latvia, publications related to entrepreneurship and debt recovery issues have been reviewed.

The aim of the research is to investigate the current situation of property management service and utility debt collection, determine the causes of debts, the possibilities for debt recovery, and the risks of bad debts, as well as their impact on the operation of the management company.

The research analyses the results obtained by considering 17 court judgements of the Republic of Latvia. In the end, proposals are formulated for the management company's further activities to improve the fulfilment of the liabilities.

Analytical and quantitative methods have been used within the framework of the research.

Key words: debt collection, property management and utilities, causes of debt, risks of bad debts, entrepreneurship.

JEL code: K15, L26, L85

Introduction

Every company that provides property management and utility services struggles against debtors individually and, unfortunately, there are no data on the topicality of the issue nowadays, because no statistical study has been carried out so far at the national level, except for the informative report of the Ministry of Economics on measures addressing the recovery of property use debts. However, it should be noted that the information in the report has already become obsolete, as it analysed data from 2006 to 2010, and the data only concerned heat supply (Ministry of Economics, 2012). The website of the Ministry of Economics provides informative reports on the situation regarding heat supply services in 2015 (Ministry of Economics, 2016), in 2014 (Ministry of Economics, 2015) and in 2013 (Ministry of Economics, 2014), which analyse the dynamics of heat supply debt formation. This also indicates that at the national level only outstanding commitments for heat supply services are being investigated, but there are no data on water supply and sewage debts or on property management service debts.

The aim of the research is to investigate the current situation of property management service and utility debt collection, determine the causes of debts, the possibilities for debt recovery, and the risks of bad debts, as well as their impact on the operation of the management company.

The tasks of the research are the following:

- 1) to study statistics on the recovery of debts and determine the current situation of property management service and utility debt collection;
- 2) to investigate and determine the ways and procedure of debt recovery in the Republic of Latvia;
- 3) to examine the causes of property management service and utility debt formation, the procedure of debt collection and determine the risks of bad debts;

4) to draw conclusions and formulate proposals based on the research conducted.

To assess the topicality of the issue related to property management service and utility debt recovery, it is necessary to consider statistical indicators. Data of the Portal of the Latvian Court of Justice www.manas.tiesas.lv have been used to obtain the statistical data.

Within the framework of the research, the authors have analysed the following judgements made from January to June 2017 by Rezekne City Court, Daugavpils City Court, Kurzeme District Court of the City of Riga, Latgale District Court of the City of Riga, Vidzeme District Court of the City of Riga, Northern District Court of the City of Riga, Valmiera District Court, Aluksne District Court, Valka District Court, Bauska District Court, Jelgava City Court, Kuldīga District Court, Ventspils City Court, and Liepāja City Court (Latvian Court of Justice, 2017). A total of 500 judgements have been examined.

The following research methods have been used: the cognitive method – analytical one, by analysing legal acts, and the logically constructive method – by analysing results and making decisions, as well as the quantitative method: the statistical method using statistical data.

Research Results and Discussion

The position of real estate market phase in cycle is determined by a variety of indicators that have a great significance for business planning (Kauskale, L., Geipele, I., 2016).

Entrepreneurship is a highly dynamic and fast growing scholarly field of research with a long intellectual tradition. Its intellectual roots can be traced back to the work of economists (Chandra, Y., 2018) such as Cantillon (Cantillon, R., 1959), Smith (Smith, A., 2007), Knight (Knight, F. 2012), and Schumpeter (Schumpeter, J. A. 1982), who laid the foundations by defining entrepreneurship and its relationship with innovation, economic growth and uncertainty. After a rather sluggish growth for decades, entrepreneurship research has gained some momentum with an emphasis on the person-centric approach, which attributes psychological traits and people's characteristics as predictors of entrepreneurship (Hornaday, J. A, Aboud, J., 1971).

The personnel engaged in the real estate management industry should be professional and, at the same time, flexible, by concluding mutual agreements, empathic, (Daud, S. N., Abdullah, M., Hassan, N.A., 2017); they should also have the ability to recognise the progress of the process, the problems, as well as use their opportunities.

The conclusion of agreements for the provision of services and the fulfilment of their liabilities is one of the indicators for assessing the efficiency of the company's performance.

The Civil Law states that a contract legally entered into shall impose on a contracting party a duty to perform that which was promised, and neither the exceptional difficulty of the transaction, nor difficulties in performance arising later, shall give the right to one party to withdraw from the contract, even if the other party is compensated for losses (Legislation of the Republic of Latvia, 1937). One party may not withdraw from a contract without the consent of the other party, even if the latter fails to perform it and due to the failure to perform it (Law of the Republic of Latvia, 1937). However, often a situation arises when one party fails to fulfil its liabilities; as a result, nowadays non-fulfilment of liabilities is a common case. Real estate management and utilities sector are no exception.

In cases when the payment is not made in compliance with the terms of the concluded agreement, in accordance with the Civil Law, the terms shall be considered as not fulfilled. As the Civil Law states, each obligation shall be fulfilled in full, and no one may be forced to accept the

fulfilment of only part of the obligation, even when the subject-matter of the obligation is divisible (Legislation of the Republic of Latvia, 1937). As a result, a situation arises when the manager has to resolve issues about payment collection.

1. The Current situation of the sector in debt recovery

To assess the topicality of the issue related to property management service and utility debt recovery, it is necessary to consider statistical indicators. Data of the Portal of the Latvian Court of Justice www.manas.tiesas.lv have been used to obtain the statistical data.

Summarising the results obtained, all judgements have been divided into six groups:

- 1) action for damages;
- 2) action for recovery of loan;
- 3) action for recovery of arrears of maintenance;
- 4) action for declaration of insolvency proceedings;
- 5) action for repayment of debts for the property management, administration services and utilities (water and heat supply, electricity and gas supply, waste management);
- 6) action for other types of debt recovery (repayment of advance payments, payment of goods, reimbursement of wages etc.).

Having examined the information available at the website of the Latvian Court of Justice, it can be stated that the most common action is taken to recover debts for the property management, administration services and utilities (water and heat supply, electricity and gas supply, waste management): out of 500 examined judgements, they comprise 34.20 % or 170 cases. The least common action is taken to recover other types of debt: 7.40 % or 37 cases. The action for recovery of loan was taken in 90 cases (17.80 %); the action for damages was taken in 42 cases (8.40 %), the action for recovery of arrears of maintenance – in 102 cases (20.40 %), and the action for declaration of insolvency proceedings – in 59 cases (11.80 %).

Such a quantitative result demonstrates that the issue of property management service and utility debt recovery is very topical, since it exceeded all categories related to the recovery of debts. However, according to the qualitative result, this action amounts only to 20.47 % of the total amount claimed and takes the second place after the action for recovery of loan. This suggests that the debts for management, administration services and utilities apply to a fairly large group of low-income and low-solvency persons in Latvia. In this assessment, the action for recovery of arrears of maintenance and the action for declaration of insolvency proceedings are not taken into account because they do not specify the total amount claimed and, accordingly, they cannot be compared to the rest of the court actions by the quality indicator. The total amount of claims from the examined judgements is EUR 1 123 086.94.

Table 1 shows that the total amount of claims for property management, administration services and utilities received (water and heat supply, electricity and gas supply, waste management) is EUR 229 122.19. Provided that according to the data of the Central Statistical Bureau of Latvia, at present the population of Latvia is 1 941.3 (thou) (Central Statistical Bureau, 2017*), data for June 2017, of which 386 541 are children up to 19 years (Central Statistical Bureau, 2017**), it is probable that each resident of Latvia who is older than 19 years theoretically has a debt for property management services and utilities in the amount of EUR 0.15.

According to the services provided to ensure property maintenance and, on the basis of debt collectors' data, debts can be divided into the following groups:

- 1) property management service and utility debt (a debt collector is a company providing management and administration services, ensuring water supply and sewerage, as well as acts as an intermediary in the process of domestic waste removal);
- 2) heat supply debt (a debt collector is a company producing and supplying heat);
- 3) electricity supply debt (a debt collector is a company supplying electricity);
- 4) gas supply debt (a debt collector is a company supplying gas).

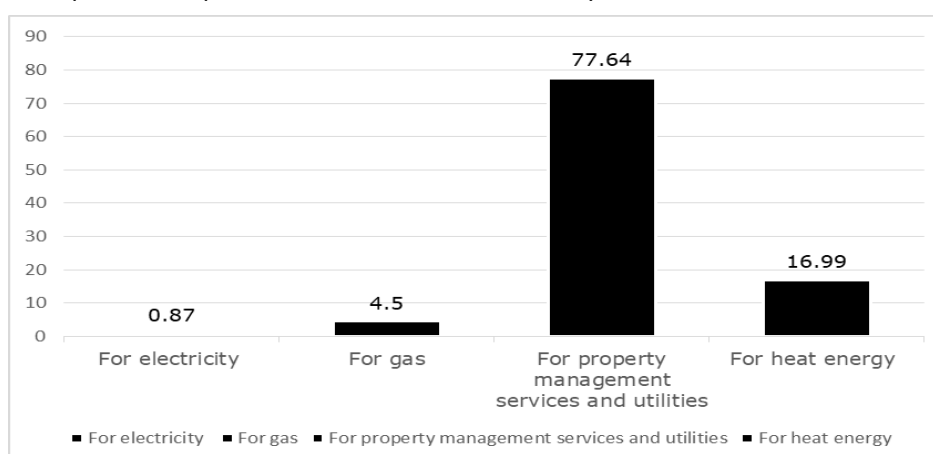
Table 1

Breakdown of total amount claimed by judgement groups in Latvia

No.	Judgement group	Amount claimed (EUR)	% of the total amount claimed
1	Action for damages	58479.06	5.21
2	Action for recovery of loan	776216.11	69.03
3	Action for repayment of debts for the property management, administration services and utilities	229122.19	20.47
4	Action for other types of debt recovery	59269.58	5.29
Total		1123086.94	100

Source: the authors' calculations based on the data available at www.manas.tiesas.lv

The amount claimed shows that the lowest debt is for electricity (total amount claimed accounts for EUR 2 000.32) and for gas (total amount claimed in the examined judgements is EUR 10 315.72). The highest debts are for property management services and utilities; the total amount claimed is EUR 177 883.60. The total amount claimed for heat energy is EUR 38 922.55. Figure 1 demonstrates that the property management service and utility debt makes up 77.64 %, the heat energy debt is 16.99 %, the gas debt – 4.50 %, and the electricity debt is only 0.87 % of the total amount claimed. This indicator shows how actively debt collectors work with debtors. The percentage breakdown clearly illustrates that the most advanced programme for dealing with debtors has been introduced for companies engaged in electricity and gas supply. These programmes are more proactive in pursuit of preventive measures aimed at avoiding debt trap, rather than taking corrective actions devoted to debt recovery. The indicators of 4.50 % and 0.87 % indicate that the programmes are implemented and work efficiently; accordingly, there is no need for companies to spend resources on debt recovery.



Source: the authors' calculations based on the data available at www.manas.tiesas.lv

Fig. 1. The percentage breakdown of property management, administration service and utility debt in Latvia

Thus, it can be concluded that the issue of property management service and utility debt recovery is very topical, because it exceeded quantitatively all categories considered in the area of

debt recovery. In fact, the situation has arisen that in the court about one of the three decisions on debt recovery is taken for the recovery of property management service and utility debts.

2. The causes of debts and risks of bad debts

Within the framework of the research, the authors have conducted a survey of 10 experts of residential property management companies on the research topic. Based on the results of an expert survey, the following causes of debts can be identified:

- 1) long-term status of unemployed person;
- 2) weak payment discipline;
- 3) family income is lower than the minimum subsistence level;
- 4) unforeseen family expenses related to family members' illnesses, funerals, unforeseen repair of the apartment for the purpose of eliminating the accident consequences.

The results of the survey show that the main reason of debts is related to payment expenses. The most frequently mentioned reason is unemployment or low income, which indicates economic problems in the area. The so-called "unforeseen expenses" are also mentioned among others. The explanation may be related to increased costs, lack of money, and the owners' priorities, where the payment of property management services and utility bills is not always one of the first priorities for expenditure. However, the weak payment discipline indicates that a company that provides property management services poorly and untimely works with its clients in order to ensure that regular payments are made.

There are always bad debts in the sphere of debt collection. An important risk arises when the debtor is an insolvent person and s/he has insufficient income to which the debt can be recovered. In this case, the decision to enforce payment obligations has been taken, but the office of the court is not able to recover the debt because the debtor either conceals his/her real income, or s/he is unemployed and s/he has been given a status of low-income person. In such a case, in order to prevent a debt increase, if the debtor is a tenant, there is a possibility to take an action not only for debt recovery, but also for the termination of the rental agreement and the debtor's expulsion from the dwelling. But, unfortunately, this does not solve the problem because often the insolvent debtor meets a certain status stipulated in the Law "On Municipal Assistance in Solving Apartment Matters", and accordingly the municipality once again leases housing units owned by the municipality to the debtor, but the debtor continues not to pay. As a result, it has a negative impact on payment discipline for other clients, and the amount of debt continues to increase.

If the debtor is the owner of the apartment, a debt recovery claim is made against property or real estate. In this case, there is a risk that the debt can practically become irrecoverable if the debtor has a mortgage or other debt obligations, since the Civil Procedure Law states that if the amount recovered from the debtor is insufficient to satisfy all claims pursuant to the execution documents, this amount shall be divided among the debt collectors in the order prescribed by law, if in a separate law there are no benefits for any debt collectors and any successive claims are satisfied after full payment of the previous claims (Legislation of the Republic of Latvia, 1998). From the money received for selling encumbered property, the costs of execution of the judgment shall be paid first, then the claims shall be satisfied in the following order: 1) the collateral security; 2) other claims in the order prescribed by the Civil Procedure Law (Legislation of the Republic of Latvia, 1998). First, the first-order claims (claims for child or parent maintenance) are satisfied. Then the second-order (claims for tax and non-tax payments in the budget), the third-

order (claims for damages caused by a criminal or administrative offense) and only then the fourth-order claims (all other claims) are satisfied, which also refer to property management service and utility debts.

The third significant risk is associated with persons who do not have movable or non-movable property, because after their death a debt becomes irrecoverable. This has an adverse effect on the pensioners' payment discipline, despite the fact that pensioners are considered to be the most disciplined clients, often a situation arises when payment of utility bills is no longer a priority for them, since a person who does not have heirs is a lonely person with a pension that is often lower than the subsistence minimum.

All risks are based on a low social level, as in Latvia there is a high rate of unemployment, especially in the regions. The risks are also affected by the level of education of the population, as people with a low level of education have fewer opportunities to find work and, at the same time, they are unable to qualitatively improve it (for example, to obtain higher education) due to their poor financial situation.

In general, low- and middle-income people predominantly have debts, for example, when in the family with children only one of the parents is employed, or there has been a long period of unemployment due to illness, dismissal or other reasons.

Debts are recoverable, it is only necessary to develop and implement effective preventive and corrective actions. However, this group of debtors is heavily dependent on external factors that may adversely affect their level of income: tax increases, inflation, liquidation of the enterprise and job cuts, and on internal family factors that influence family expense planning, such as illness of family members, funerals, and other family events that require unforeseen expenses, because they do not have the savings they could count on in emergency situations.

However, wealthy people also have property management service and utility debts. There is a small share of such debtors, and the amount of their debts is minimal. It is easy to recover debts from these debtors, as they are formed only due to a weak payment discipline, for example, the payment is made only partially or irregularly. Thanks to such debtors, there may be successful and fast debt recovery, as receiving notification they immediately pay for their debts in full without waiting for the processing of the claim and enforcement of judgment.

Based on the results of the research, it can be concluded that both the external and the internal factors influence the property management service and utility debts. External factors are tariff increases and inflation, tax increases, liquidation of companies and increase in the unemployment rate. Internal factors are the deterioration of tenant/owner payment discipline, income reduction, lack of savings due to low income, unforeseen expenses (course of treatment, funerals, payment of fines etc.).

3. The impact of customer debts on business

In accordance with the Law On Administration of Residential Houses, the residential house owner shall assign the administrative task to an administrator, entering into a residential house administration contract with him or her in writing. When assigning an administrator with the administrative task, the residential house owner has a duty to provide the financing necessary for the fulfilment of the task (Legislation of the Republic of Latvia, 2009). In the administration contract, the parties agree on the amount of expenses and terms of payment for the administration of a residential house.

The residential house owner or the tenant concludes contracts for water supply and sewerage services, heat supply, removal of solid municipal waste, by agreeing on the amount and terms of payment for services. As stipulated by the Law On Residential Property, the apartment owner shall cover residential house management expenses and pay for the services received associated with the use of the apartment (Law of the Republic of Latvia, 2010). The tenant is obliged to pay rent and service fees prescribed in the residential lease contract and, in accordance with the Law on Residential Tenancy, a rent is a fixed amount of money paid for the use of an apartment and the types of services received by the tenant during the use of the apartment (Legislation of the Republic of Latvia, 1993).

Ensuring that the terms of the contract are fulfilled, the company has to provide professional staff, facilities and equipment, as well as an office for administrative work and customer reception. This requires funding. In the absence of the planned funding, the company faces economic problems.

One of the problems: the impact on company's profit. Depending on the amount of the profit, a company is able to pay its employees additional remuneration for the work done, there are funds to invest in the development of its business by purchasing new and up-to-date equipment, developing information technologies (website creation, maintenance, modernisation, e-service creation, remote reading, computer programs etc.). Profit is the key to the company's performance. However, the non-fulfilment of commitments by customers, especially in the case of small and medium-sized enterprises, can often lead to a risk that the company is no longer able to pay its suppliers, employees and, as a result, insolvency is claimed either by the company itself or by one of the suppliers.

If a company faces problems with the fulfilment of its obligations and lacks funds, there is a risk that it will not be able to hire professional staff, which in turn will lead to the risk of poor services provided. Consequently, there is an opportunity for competitors to actively engage in client solicitation. It can lead to the deterioration of the company's publicity, public image and a decrease in the number of clients; once again the risk of insolvency arises.

Conclusions, proposals, recommendations

- 1) A real estate management company operates in the business segment for the consumer, which means that the service is sold to the consumer. For the services provided, it is expected that the customer will pay the full amount. The research demonstrates that one of the most important actions in the Court of Justice is the action for repayment of debts for the property management services and utilities.
- 2) To avoid new customers' debts and facilitate the recovery of debts for any company engaged in the management of residential buildings and the provision of utilities, it is necessary not only to take corrective but also preventive measures.
- 3) Proposals for preventive measures:
 - to develop and implement preventive measures in order to prevent the emergence of new debts. For example, to keep an active dialogue with the public, explaining how timely payments are important for the qualitative fulfilment of management tasks;
 - to strictly follow a payment discipline. For example, to develop and implement an electronic reminder program that sends a reminder letter to a customer's e-mail or phone when the payment is not made in due time;

- in co-operation with the municipality, to develop and implement a social program that will help not only low-income and poor persons, but also the families in which one of the two adult members of the family lost their jobs; however, income does not allow for the acquisition of a low-income family status.
- 4) The proposal for corrective measures: to develop and implement an effective debt recovery procedure, which will stipulate the activities to be taken for debt recovery, deadlines and the responsible person. It is especially important to set deadlines for debt recovery, for example, within 3 months from the creation of a debt, as a debt will only increase with time and will be more difficult to recover.

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