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PAA Baths, Latvia

- Type of restructuring:
Business expansion
- Employees before restructuring:
10-49
- Employees after restructuring:
50-249
- Nace/Sector:
Manufacturing
- Country:
Latvia
- Date:
14/12/2011
- Keywords:
GlobalisationRecession/Crisis

Abstract

PAA Baths is a leading Latvian manufacturer of high-quality bathtubs, washbasins, shower trays and bathroom furniture. Restructuring was triggered by the economic downturn in 2008 when sales decreased by 70% and export levels reached only 40% of the previous year. The company managed to survive and thrive by refocusing its objectives, acquiring foreign investment capital that allowed it to expand its customer base and diversifying its product range while lowering costs and prices.

Organisational profile

PAA Ltd was founded in 1993 by three friends – a doctor, a physicist and a carpenter – and is a 100% Latvian-based enterprise. The founders are still the owners of the company and all are active in the management of the firm. The idea behind the foundation of the company was to manufacture a bath using innovative materials, previously used only in aeromechanics. The idea was to create an original, high-quality acrylic bathtub that would be more durable, attractive and practical than baths made from cast-iron. After months of persistent work, encouraged by friends and blessed by good luck, the founders created the first bathtub. In 1996 the technology of cast stone was introduced. At present PAA Baths uses three technologies: acrylic, cast stone, and glass fibre-polyester resin technology and is a leading Latvian manufacturer of bathtubs, washbasins, shower trays and bathroom furniture for individual orders.

The company occupies a unique niche among the wide range of other producers, focusing on serving individual customer needs in product design, size and color. PAA Baths specialises in exclusive production. The firm's main customers are people interested in expensive, exclusive products. PAA Baths also offer products for 'middle range' customers.

PAA Baths has an advantage over competitors, because the size of the firm gives an opportunity to be flexible (which means that the firm can easily change the variety and assortment of products it produces). Another important advantage is having a plant located near the headquarters of

the firm. The company has owned the plant since 1999. This has allowed PAA to be less dependent of the changing situation and costs in a time of economic downturn: many other manufacturers renting their premises were tied to long term contracts based on the 'high prices of good years' and thus had limited options but to close their business due to high fixed costs.

PAA started exporting to Lithuania and Ukraine in 1999. At present, PAA Baths exports almost 40% of its production to eleven countries: Lithuania, Estonia, Switzerland, Norway, Sweden, UK, Poland, France, Ukraine, Russia, and Belarus. PAA uses two main strategies to enter foreign markets. Firstly, PAA produces under their own brand name and export through different wholesale dealers, sales representatives and joint ventures. Secondly, the firm manufactures shower-trays that are sold under the client's own brand name, too.

The number of employees has not been not constant during last few years, due to the 2008–2009 crisis. The main figures are presented below:

- Maximum number of employees at PAA (mid-2008) – intotal 107, with around 70 at the manufacturing plant;
- Minimum number of employees at PAA (mid-2009) – atotal of 38, with 28 in the plant;
- Number of employees at PAA at the end of 2011 –65in total, with around 50 in the plant;
- Average age of employees: 30–45 years. In thefactory there are also many very young workers.
- Education: in the office 95% have higher education; inthe factory mainly secondary education.
- Gender: in the office 20% men, 80% women; in the factory85% men, 15% women.
- There is no works council in the company.

Background to restructuring event

The major challenges for PAA Bath came with the economic downturn in 2008. As a result of the crisis, sales decreased by 70% and export levels reached only 40% of the previous year. This in turn influenced the company's income levels both on the Latvian market and abroad. Declining demand also led to reducing the number of employees, from 107 to 38.

To overcome these problems, the company decided to change several aspects inside the business. The two key decisions directly related to the restructuring are as follows: reduction of some production lines; and opening a new broad market in western Europe and eastern Asia with Premium-class products. The financial crisis forced PAA to retain only the best-selling products in its product portfolio. At the same time, being focused mainly on high quality and high price segment customers, PAA was looking for new markets abroad with the intention to expand in this market niche.

These two facts in turn implied a focus on even better production quality by PAA, including implementing changes in the management process, but even more importantly in the process of product design and manufacturing. Thus, the main reason for the restructuring process was closely linked with the necessity for technological progress within the company to satisfy the wishes and requirements of potential customers. To do that, new modern equipment had to be considered, the production process optimised, as well as introducing new types of production that correspond to the high-tech trends in the world.

Restructuring processes

PAA started with an internal restructuring without having a formal restructuring plan, as, according to the company representatives, in such a situation one should react very fast and there is no time for writing plans or other documents. The first decision of PAA was to implement changes with regard to the variety of goods sold. The company stopped the production of three different lines – upper segment products, targeted at high income customers (SKY line), medium segment products (SUN line) and economy segment products, mainly targeted at budget customers (SEE line) – and introduced a new catalogue which included only the best-selling items. All these decisions reflected changes in consumer preferences and required both understanding and support from employees. Thus, from the very beginning of the restructuring process, the company did their best to inform employees about the forthcoming changes, using informal ways of communication, such as face-to-face conversations with key people, as well as through various meetings devoted to discussing the way changes would be implemented, and information sent via e-mails, etc.

The next decision related to restructuring within PAA Baths was to expand this catalogue with new products that would correspond to emerging customers' needs. More specifically, PAA increased production using cast stone materials. Cast stone was previously not widely used in the production of bathtubs, yet the costs were lower than the cost of more commonly used materials. During the economic downturn, people are more cautious in their spending, thus by decreasing production costs at the same time as offering a good-quality product, PAA met the market demand.

PAA created several new models: TRE, TRE GRANDE, UNO, and GRANDE. Customers perceived these models to be more appealing and high grade (one of the characteristics of cast stone is to shine), yet they could be offered at a lower price. As a result, PAA managed to sell a substantial amount of this product line.

As previously, PAA continued to offer good-quality baths with an individual approach to each consumer when it came to choosing colour, size and other features. In sum, PAA aimed at providing customers with an exclusive product. With such a strategy, it was only logical to make the next step and open new markets in western Europe and eastern Asia, focusing on the upper-class segment.

It turned out that customers in these new markets were more interested in quality and design than price. Following this demand, PAA created a new type of production with more fashion design and using more modern materials: the company started using solid surface materials and

produced a new line of product. According to the export manager of PAA, Mrs Lipsane: 'We understood that if we offered the product that we have right now, we would not be competitive and would sell nothing'. Altogether, this aspect of the restructuring process that is often labeled as 'business expansion' took approximately one year to implement.

Challenges and constraints of restructuring

The main challenges facing PAA related to its operations in the high price and quality segment during the economic downturn. During the crisis customer income decreased. The material and forms for casting were very expensive; that is why the company needed a big turnover to produce new products. When sales were low, however, the company lacked money to buy a new batch of material, which made serving customers' needs rather complicated.

One of the most important points of restructuring was entering a new market. This was a good opportunity to explore the business, but it implied a lot of risks. To reduce such risks the company had to allocate a person who was responsible for organisational issues, knew the legislation and also the specifics of each market (such as extensive bribing in Post-Soviet countries: this person should know how to deal with such situations). Attracting new, qualified person costs money, and lack of money was indeed a challenge both for PAA, as well as many other companies in the market.

The restructuring process in PAA Baths is ongoing today, one of the reasons being the bankruptcy of one of the Latvian banks: Latvijas Krajbanka (Baltic News Network, 2011). PAA was about to receive a transaction of €10,000 through Latvijas Krajbanka when the bank went bankrupt, and therefore had major problems with cash: the transaction was made by a customer, yet never reached PAA Baths due to the bankruptcy of the bank. What makes this even more complicated is that PAA had to pay most of this money to its suppliers, thus the whole process of manufacturing was influenced with this transaction.

As acknowledged by the export manager of PAA Baths, the most challenging issue about doing business is uncertainty: '...we cannot be sure what will happen tomorrow, and no one is insured against failures'. That is why restructuring processes need planning, but this plan can change depending on external factors like changing market conditions, including changes in supply and demand, price fluctuations; the political situation at home and abroad; inflation; and the activities of the government.

Restructuring advice and support

The entry into the new market and all other changes in production had to be supported by the technological part of the venture. This issue was solved by participation in the annual competition 'Prize for export and innovation – 2010' (organised by the Ministry of Economy of Latvia and the State Agency 'Latvian Investment and Development Agency') where PAA Baths won first place in the category 'Industrial Design'. PAA Baths used this special grant, approximately €300,000, to change its equipment. This in turn allowed the company to successfully implement the restructuring process, that is, start producing an absolutely new line of products that in turn led both to a more effective manufacturing process and an increase of the workforce. The new equipment (new machines) also allowed the company to produce more output including new types of baths. This is of particular importance since the business expansion aspect of restructuring depends on the production of new, more prestigious varieties of baths, intended to be sold to wealthier clients, enabling PAA to expand and set up new shops in western Europe and Hong Kong.

Also, the Latvian Investment and Development Agency provided the contact and also paid for the work of an American marketing expert, who helps PAA baths. 'I think that marketing makes up two thirds of our success, therefore the assistance of this American marketing expert is very useful', commented Ingura Lipsane. The American marketing expert introduced new features of marketing based on their experience in the USA; it allows the firm to carry out a very successful marketing strategy.

Outcomes of restructuring

One of the most important outcomes of restructuring of PAA was to increase the number of employees from 35 to 65. Indeed, in order to keep up with the increased production that resulted from entering new markets and launching new products, more workers were needed. The good news is that all this has also led to better performance in financial terms. Namely, the profit forecast for 2012 was higher than for previous years. Restructuring also increased the overall competitiveness of PAA: something that was crucial to simply stay in the market.

The restructuring has led to the change in the firm's main objectives. As explained by the export manager of PAA: 'At the beginning (of the restructuring) the simple idea of survival in the very difficult market situation was the most important aim.' Now it has brought a new direction into PAA's export structure in order to expand in new directions and new (higher) market segments. In sum, currently the key focus is on the continuous development and growth of the company, rather than survival. Yet, even development plans include recovering from the losses that were made during the peak of the financial crisis.

Attracting more foreign investors is another objective set by the company owners after the restructuring process. PAA is looking for investors that could support the purchase of modern equipment, that, in turn, would increase the quality of products, reduce costs and increase the export share as well as sales in Latvia.

As further emphasised by the export manager, the current production still generates substantial cash inflow. Yet, it is expected that soon sales might peak and might not continue to grow. Therefore, the company has developed the following future plans:

Step 1: This step has already started and will continue until mid-2012. It includes creating a new product brand. This brand, or collection to be more specific, is targeted at customers that can pay a premium for the quality. High quality designer Massimo Farinatti has been invited to deal with design issues and thus make the offer as attractive as possible. Apart from developing the brand name and working on the design, PAA focuses also on improving the manufacturing process within this step.

Step 2: The second step started at the beginning of 2012. The key here is finding a strategic partner and launching a pilot project for strengthening presence in global markets (especially Asia: the company plans to start with Hong Kong). Further plans include western Europe.

Step 3: The third step is to create global brand awareness by participation in trade shows (ISH in Frankfurt; Milan). It is planned to have some results with regards to step 3 by 2013. The main goals are further expansion into global markets.

All these plans are mainly possible because of processes that have already happened. Another outcome of the restructuring process is the usage of new components in the production process. This allowed diversification of the product range, expanding target markets and, importantly, reducing costs and thus also price. Altogether, it led to an increase in the number of employees, which, in turn, required improving human resource management systems within the company. This includes improving the work of the human resource department, mainly by fostering better communication between management of the company and employees as well as amongst firm employees themselves.

All in all, as a result of the restructuring process, PAA Bath was able to make some significant changes that allowed the company to survive the period after the economic downturn in 2008. Even though the company lost a considerable amount of money during that time, it still managed to survive and regain its reputation on both local and foreign markets. This was mainly possible by refocusing objectives, an inflow of foreign investment that allowed searching for prospective clients in western Europe and eastern Asia, and, finally, through the diversification of the product range at the same time lowering costs and prices.

Commentary

PAA can be considered as quite a unique company. Founded by three friends from scratch, during its best times the company has managed to reach turnover of approximately €4 million (2007). The competitive advantage of PAA compared to other players in the segment is the individual approach to each customer, that is, people can choose the size, model and color of the baths and other goods offered by PAA.

The major reason for restructuring at PAA was the economic downturn. Even though crises are usually perceived negatively (and not without reason), this one pushed PAA to think in different directions in order to increase its competitiveness both in local markets and abroad. This was achieved by restructuring that, in fact is far from over as the company is constantly facing new challenges, namely, changes in the production process, improved sales and a marketing approach following new objectives, and using new materials. These are all prerequisites to take further steps, as described above.

Authors

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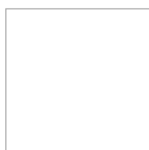
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