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Conference Paper

Bottlenecks of SME in services and craft enterprises and their elimination in rural areas of the Czech Republic: A trial to use traditional regional economic measures

38th Congress of the European Regional Science Association: "Europe Quo Vadis? - Regional Questions at the Turn of the Century", 28 August - 1 September 1998, Vienna, Austria

Provided in Cooperation with:

European Regional Science Association (ERSA)

Suggested Citation: Jehle, Raimund (1998) : Bottlenecks of SME in services and craft enterprises and their elimination in rural areas of the Czech Republic: A trial to use traditional regional economic measures, 38th Congress of the European Regional Science Association: "Europe Quo Vadis? - Regional Questions at the Turn of the Century", 28 August - 1 September 1998, Vienna, Austria, European Regional Science Association (ERSA), Louvain-la-Neuve

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Bottlenecks of SME in services and craft enterprises and their elimination in Rural Areas of the Czech Republic¹

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The economic recovery of the Czech Republic which appeared very successful until 1996 is strongly related with the emergence of an increasing number of SME². But the success isn't nationwide. There is a difference between Rural and Urban Areas.

However, this isn't a peculiar problem of the transition countries. Western countries facing the same problems. But the already published paper about a transition theory, single out that the former command economy significantly influences the current development to a market economy and the regional structures. This is supported by results that disparities in the SME development even exists among Rural Areas. It was supposed that the economic structure in Rural Areas and the disadvantages in technical infrastructure could be an explanation for the differences. Therefore it could be assumed that locational disadvantages existing concerning the foundation of businesses. But they haven't been identified yet and their influence on the emergence of the enterprises is unknown.

The objective of the paper is to identify the sector with strong locational disadvantages and to specify the bottlenecks for the SME development in that sector in Rural Areas and derive some conclusions for the future regional policy. The elaboration is based on an empirical survey in two sample regions of the Czech Republic. The first part of the paper will stress the differences in SME development in the Czech Republic. This is followed by the identification of a sector with locational problems by *shift-share analysis*. The third part specify locational

¹ I am grateful to the European Union ACE-Phare program and to the Herzog-Carl-scholarship of the University of Hohenheim for providing the projects financing for this work. Useful assistance and information has been provided by Michal Lostak, Helena Hudeckova and Eva Kucerova of the Department of Humanities, Czech Agriculture University, Magdalena Hrabankova of the Research Institute of Agriculture Economics, Prague. Additional support came from Ladislav Charvat and Lubomir Klaban of the district office in Bruntál as well as Dagmar Hrebikova of the district office of Prachatice, various entrepreneurs in Bruntál and Prachatice, Czech Ministry of Agriculture, Czech Ministry of Regional Development and Anja Stolz for data processing and comments on the draft of the project report.

² The definition for SME is not quite clear in different contributions. In the context of the current paper it is used by number of employment. In the Czech Republic this is currently the only reliable figure for measurement. Enterprises up to 500 employees are SME. If they have less than 50 employees it is possible to classify them as small enterprises. As in various OECD publication on SME in transformation economies the paper also includes the selfemployed as enterprises. If there is part-time employment then it depends on the percentage of working hours per week. If more than 50% is used for the enterprise then it is calculated as fulltime.

disadvantages by a *standardized questionnaire* among the local businesses. The results of this case study are not representative for the overall situation in Rural Areas of the Czech Republic. The last part of the article summarize the support policy of the Czech Republic for SME in respect to the sample areas.

1 Differences between Rural and Urban areas in the number of new SME

Based on the entrepreneurial law of 1990 the foundation of new SME increased quickly.³ Within the so called *small privatization* more than 20.000 units of enterprises in the services and crafts were transformed.⁴ Most of the privatized units were retailshops and services.⁵ Although details exist about the restituted and privatized enterprises by auction and by voucher privatization there is no distinction in the development of SME between Rural and Urban Areas.

Figure 1 rules out the differences in the development of new firms between different structured regions. The data about the number of new firms are available on the district level. Therefore the comparison between the different structured districts makes the differences obvious. Ostrava and Pilsen are urban districts, whereas Bruntál and Prachatice⁶ are rural dominated. Both rural districts have a lower growth of new firms. The regions of South Bohemia and North Moravia as references are influenced by the cities Budweis and Olomouc respectively.

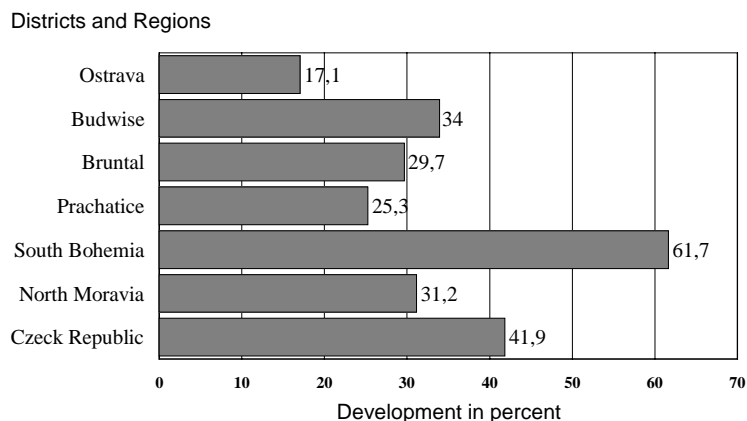
Figure 1 Development of the number of new SME in Urban and Rural dominated Areas between 1992 and 1995 in percent

³ Cf. Bohatá, M. (1996): Small and medium-sized enterprises in the Czech Manufacturing industry. CERGE EI Discussion papers, No. 94, Prague. p. 6

⁴ Cf. Mladek, J. (1997), p. 46; ; Němec, J. (1997), p. 74; Musil, J. et al. (1997): Regional Effects...a.a.O. p. 256

⁵ Cf. Earle, J. S. et al. (1994): p. 46ff ; Ministry of Economy (1996):

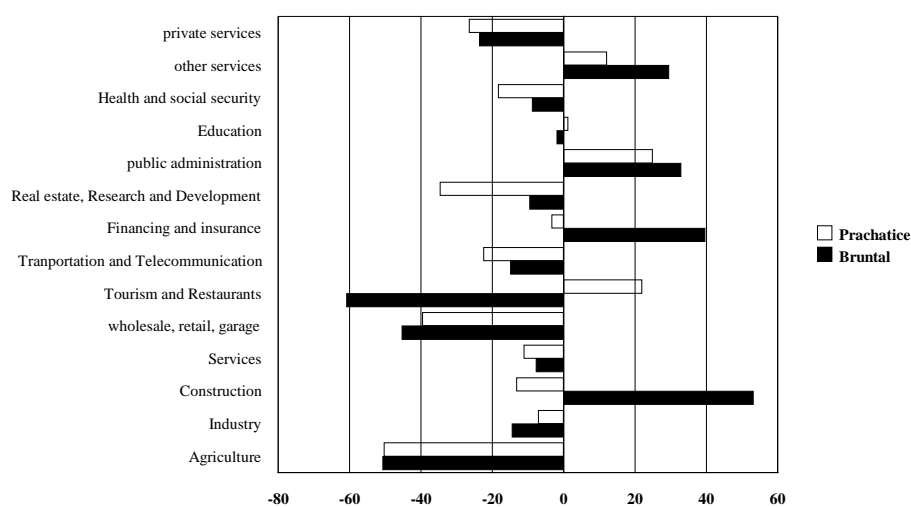
⁶ The two sample regions are Bruntál and Prachatice. They were picked on the basis of the socio-economic situation in the Czech Republic. The calculation included indicators such as share of unqualified labor, remoteness, unemployment, infrastructure, etc. cf. Jehle, R. (1997): Regional competition, regional potentials and their realization in rural areas as a strategy for the development of transition economies. Final Report ACE PHARE. University of Hohenheim. The chosen regions had the worst conditions and were at the bottom of the ranking. Bruntál is at the border to Poland and Prachatice is in the west at the border to Germany. They are both rural, less favored areas which had in the past mainly agriculture employment. The two districts are representative for rural less favored areas in boarder zones. As it is objective to identify obstacles in such kind of regions the case study makes it possible to draw some conclusions which could be of relevance for more than one rural area.



Besides the difference in the formation of new firms there is a change in the sectorial distribution of employment in Rural and Urban Areas. Figure 2 shows that in agriculture was strongest decrease in employment. In the past it was the main employer in Rural Areas. The spatial economic relationship were based so far on the organizational structure of the collectivized agriculture. This is remodeled now in accordance to the market and by market forces itself. It results in a decrease of the total employment and therefore in an increase of unemployment if the new firms are not able to absorb the redundant workers. Overall the distribution of employment shifts from agriculture to services and crafts.

Between 1991 and 1995 Prachatice had the sharpest reduction in the total workforce with more than 18%. In Bruntál this reduction counts 14%. But both districts were above the national average which was about 11,6% for the same time.

Figure 2 Development of the sectorial distribution of employment in % between 1991 and 1995 in Bruntál and Prachatice



But while the total employment in services was shrinking, inside the sector is a different development. Especially financing and insurance branches in services are growing. The growth of a sector or a branch depends on the economic attractiveness of the region. In other words,

regions can provide locational advantages and disadvantages which are of importance for the investment behavior of enterprises and therefore for the emergence of new firms. Usually these advantages or disadvantages are not obvious in all regions of a transformation economy, because it depends on the information systems. But to promote business and entrepreneurship, it is of significance to identify these conditions in order to support the first while eliminating the latter.

2 Methods for the identification of locational disadvantages

The *shift-share analysis* could be used for the identification of sectors where the development is strongly influenced by locational aspects. It is an appropriate instrument to single out reasons for different developments in regions by distinguishing in a *structural and a location effect*. But it doesn't identify these location factors. The data used for this are usually employment figures for a sector in a region or for the region in total.

The principal of the methodology is quite simple. The total change in employment in a sample region is the so-called *total effect*. This could be distinguished in a structure effect and a locational one. The structure effect is the change in employment in a region if the sector in question had the same growth rate as the reference region. In fact, it could be said that in the *structural effect* regional influences are excluded. Regional influences in this case could be infrastructure, climate, education, housing situation etc.

On the other hand the *location effect* shows the difference between the real change in the region and the change in the reference region. In other words, the change of employment which couldn't be explained by growth trend in the reference area is a result of *location effects*. By using this method for different branches it is possible to identify the sectors and branches which have the strongest locational influences on their development.

However, the identified sectors and branches which are influenced strongly by locational conditions doesn't give a complete picture of the situation. The results of the *shift-share analysis* are not precise because focusing on the basic year with the structure at that time can imply bias. The share of employment of the sectors is kept constant until the end of the period and changes in the structure between the beginning and the end are not considered. Furthermore, the outcome of the location effect is a residual figure and difficult to interpret. This implies that location and structure quality are not independent. But in fact exchanges exist between both⁷. Therefore, the analysis of the location factor⁸ by *shift-share analysis* can neither show

⁷ Cf. Tengler, H. (1989): Die Shift-Analyse als Instrument der Regionalforschung (Schriften zur Mittelstandsforschung, Nr. 28 NF), Stuttgart. S. 31.

determinants of the location quality nor results for the regional policy measures. It doesn't supply enough data for conclusions to be drawn as to how to proceed.

By using a standardized questionnaire, parts of this weaknesses could be eliminated. Therefore the study focused first on a bundle of *location factors*. A standardized questionnaire asking for the grading of importance and quality of location factors as well as the performance of enterprises, their employment characteristics, the backward and forward linkages, cooperation, institutions and financing gives a more detailed picture of the districts.

3 Sectors with locational influences

The results of the shift-share analysis listed by sectors and in services by branches, demonstrates locational influences onto the development of employment in both regions. Mainly affected were services and crafts. Figure 3 shows that especially the private services were affected negatively by local reasons. For Bruntál the *location factor* has a value of -18,4% and for Prachatice it is even higher. The strongest negative influence in Bruntál is in *tourism and restaurants*. In Prachatice these strong influence is on *finance and insurance*. A reason for the decline in Bruntál is the decrease as public holiday resort which were established in the mountain region of the district. The decline of *finance and insurance* in Prachatice is not possible to explain the current background information.

Besides locational disadvantages both regions show advantages as well. As we can see in Bruntál the *construction* sector heavily increased as well as the *industry* in Prachatice. The industry in Prachatice benefits from the closeness to Germany. After 1989 German companies transferred their production plants to the Czech Republic to use the advantage of the low labor costs. But overall Figure 3 demonstrates that Prachatice has more local disadvantages than Bruntál because the total location factor for Prachatice is lower than the one for Bruntál.

Figure 3 Results of shift-share analysis in Bruntál and Prachatice, location effect in %

⁸ In this context a location factor is an influence for the decision of the enterprise for the future development. There are existing hard and soft factors. A hard one is e.g. the traffic infrastructure such as the street network, railway tracks or the available information technology. Soft factors would be housing, environment etc.

	Bruntal	Prachatice
Sectors	%	%
Agriculture	-7,7	-7,3
Industry	2,8	10,1
Construction	35,8	-30,6
Services total	-5,0	-8,4
private services	-18,4	-21,2
Wholesale, retail, garage	-14,9	-9,1
Tourism and Restaurant	-69,0	13,8
Transportation and Telecommunication	-10,2	-17,7
Financing and Insurance	-14,2	-57,2
Real estate, Research and Development	-12,3	-37,4
public administration	5,1	-2,8
Education	0,3	3,4
Health and social security	5,5	-4,0
other services	26,6	9,2
Total	-2,4	-7,2

The two districts were chosen for the empirical analysis. Four villages⁹ were picked in each of them for the survey. The criterion for the choice was the size, the remoteness from the economic center of the district, the business structure and the number of enterprises. The size of each village is between 2.000 and 6.000 people. The remoteness from the economic centers should imply that just a minority is commuting from the sample village to the center of the district. The timeframe in the survey covers the actual situation in April 1997 and the year before.

The sample of 255 businesses was chosen from the commercial list in the district offices.¹⁰ The enterprises cover a wide variety of branches, although only services and crafts were chosen. But according to them they have to be active in various branches such as wholesale, crafts and food processing to survive. More than 28,5% were active in wholesale and services. As expected most of the small enterprises are *natural persons*. Only 25% of the enterprises had the legal status of a *limited liability company*. The foundation of the surveyed enterprises took place shortly after the velvet revolution between 1990 and 1991. The qualification of the owners and managers was dominated by manufacturing and technical education. Only 4% of the owners and managers in Prachatice had a background in agriculture. In Bruntál it were slightly more with 5,7%.

In respond to the questions asking for their *motivation* to establish the enterprise the main answer was the desire for *independence*. In Prachatice the second reason was the hope for *im-*

⁹ The chosen villages in both districts could seen as representative for the rural villages in the districts. They cover the full range of varieties in each of them.

¹⁰ The chosen enterprises are far from being representative for the region. But with the choice of them the different conditions in the districts were considered and the results of the questionnaire could be used as trend and basis for a broader analysis in this case. Anyway, it is not necessary to have for such kind of research the assumption that the enterprises' manager are fully informed because a case-studies objective is to identify trends and problems for further research.

proving their personal financial situation. In contrast the enterprises in Bruntál are more market oriented and mentioned because of *a good idea and a market chance.*

The economic performance of the enterprises was difficult to measure because they refused to give details about revenues, profits etc. Therefore it was tried to seize the performance on a qualitative basis by asking for the strengths and weaknesses of the business. Furthermore, the focus onto the development of revenues and labor gives further information. The development of labor and revenues is quite successful. Most of the enterprises had positive results in these figures, although there was a difference between Prachatice and Bruntál. In Bruntál, 69,3 % of the enterprises had increasing revenues, in Prachatice just 47,3 %. In contrast more than 20% (Figure 4) told in Prachatice that the revenues were decreasing. An explanation is probably the increase in competition with western companies and the shift of the demand. The development of the work force increased as well. Compared with Prachatice, Bruntál did better, because the closeness of Germany and Austria has a negative influence on Prachatice. One reason is that highly qualified labor commutes to Germany and Austria. Secondly, the sample in Bruntál consists of more enterprises with employees, whereas self-employed businesses (the share of them in the sample of Prachatice is higher) haven't had a need for additional labor.

Figure 4: Development of labor force and the revenues in the sample districts in the last two years

in%	Prachatice		Bruntal	
	labor	revenues	labor	revenues
increase	28,3	47,3	55,2	69,3
decrease	16,3	20,3	14,1	6,8
same level	55,3	23,4	30,6	23,9

The figures are the share of enterprises with the corresponding answer.

The focus on the strengths and weaknesses of the firms makes further conclusions possible although it is obvious that the managers are likely to blame rather external conditions for a failure than internal ones. However, the strongest point was seen in a *good service*. Especially construction companies see this as their main advantages in both districts. Furthermore, the qualification of the workforce is further seen as advantageous. The enterprises see weaknesses in the *lack of money for further investment*. Generally, the smaller the enterprises the more difficulties they have to get access to financial resources and credits. Former co-operatives have more problems with *the distance to the markets*.

After the identification of the services as a sector which is influenced strongly by locational conditions the description of the enterprises is a necessity but it doesn't single out the key issues for the problems in the foundation of new firms. In the following the barriers for these development on the basis of the survey are showed and analyzed.

4 Barriers to SME development in the sample Regions of Bruntál and Prachatice

SME in Central and Eastern European countries face different key barriers relating to various states of the transformation process and the enterprise's life cycle or its sector. Generally obstacles to development can be broadly classified in *external and internal factors*. *External barriers* include first of all the overall external environment of private enterprises: the macro economic development and the institutional – physical and non physical – infrastructure. *Internal barriers comprise obstacles* resulting out of the structure of the individual enterprise and possible weakness of the owner's respectively the employees' knowledge regarding the requirements of market economies.¹¹ In context with regional development the paper focus mainly on the external barriers and bottlenecks of the enterprises influenced by a meso economic development of the region in the Czech Republic.¹²

3.1 External barriers on the regional level

The „meso-economic development is a crucial barrier which influences SME in a basic way. Investment of enterprises can be seen as variable for the expectations relating to the long term economic development and stability of the economy.¹³ These investments are influenced by a bundle of *location factors* in a region. The quality and the future grading of location factors are of relevance for the investment behavior of the enterprises. These bundle of *location factors* could be compressed into different categories. These categories are the so called *potential factors*.¹⁴ In the survey we could distinguish *five factors*:

- Labor force and employment
- Supply and distribution network
- Regional cooperation
- Legal framework and institutions
- Financial infrastructure

In the following the *location factors* will be assigned to the five „factors“ and some conclusions drawn for the regional development and especially for the sample districts. Figure 5 shows the grading of the enterprises for 27 *location factors*. They were graded in the *importance* and the *quality*.¹⁵ The inner circle shows the *quality* and outside the *importance* is shown. The graph summarize the answers of the enterprises with the characteristic *important*

¹¹ Cf. Welter, F. (1997): Small and medium Enterprises in Central- and Eastern Europe: Trends, barriers and solutions. RWI - Papiere Nr. 51. Essen, p.7

¹² In this context meso-economic influences are the institutional conditions on a regional and a local level.

¹³ Cf. Smallbone, D. (1997): Developing a policy Agenda to support SMEs in Transition Economies. Quoted in Welter, F. (1997): Small and medium...a.a.O. p. 8

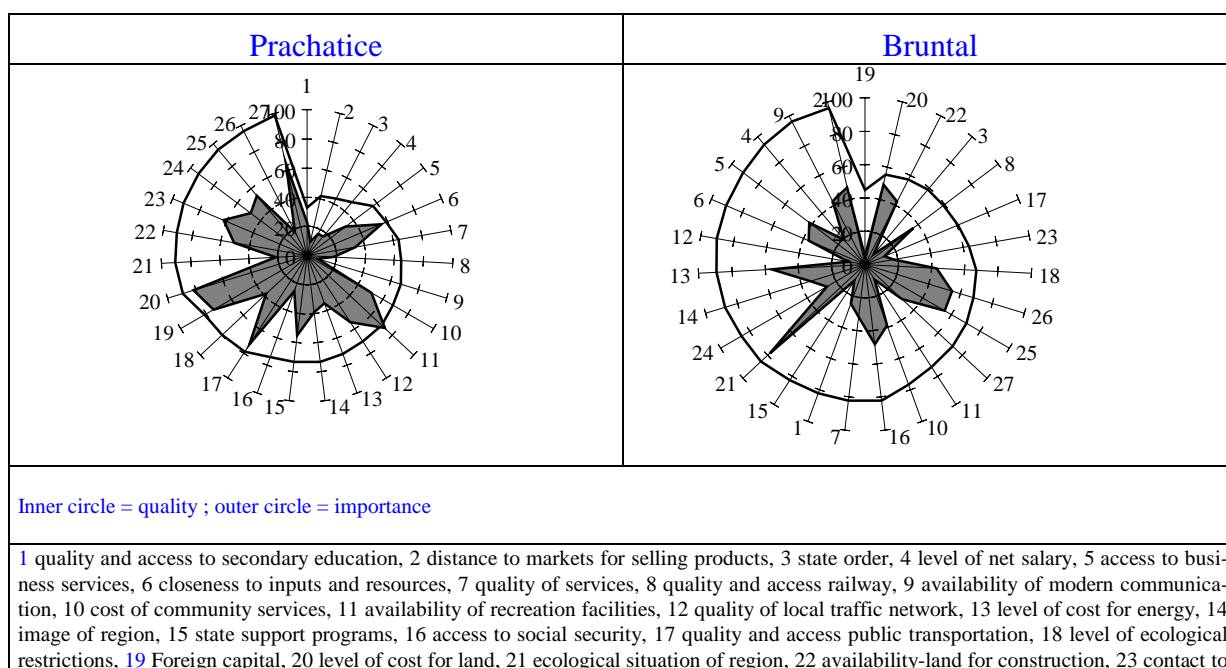
¹⁴ Cf. e.g. Biehl, D. et.al. (1975): Bestimmungsgründe des regionalen Entwicklungspotentials. Kieler Studien. Nr. 133 Institut für Weltwirtschaft an der Universität Kiel. Kiel p. 31ff.

¹⁵ The importance is a result of the number of enterprises which responded to this category. The enterprises had to grade the importance by a scale of four opportunities ranging from „very important“ to „not important“. The scale of the quality was divided in three categories.

and *not so important* on the side of the *importance* and *very high* and *high* on the side of the *quality*. The closer it is to 100% the more the enterprises see the corresponding *location factor* as important and the higher they grade the *quality* respectively. In a second step the graph allows some conclusions for the future development of the region. If *quality* and *importance* is compared it could be deduced the scarcity of a factor and therefore the potential for future development in the region.¹⁶ But first of all the most relevant *location factors* for the sample regions will be analyzed in a brief description.

In an overall perspective most important by far for businesses in **Bruntál** is the *distance to the markets for selling the products*. This is followed by *access to modern communications* and the *level of salaries*. The fourth point is *access to services*. As far as quality is considered we can see that the four factors mentioned have a very low quality from the enterprises' perspective. Graded according to by *quality*, demonstrated in the inner circle of the graph, enterprises in Bruntál said that the *quality of the local traffic network* and the *availability of recreation facilities* is worst. This is followed by *state support programs*. Very positive seen is the *ecological situation* in the region as well as the *closeness to other branches*. So far, there are no agglomeration advantages measurable in Bruntál. But in contrast enterprises see a good chance in the *image of the region* and the *price for land* for further industrial activities. The best development perspective according to the location factors would have tourism which is depended on the *image of the region* and the *ecological situation*.

Figure 5 Quality and Importance of location factors in the sample districts in 1997



¹⁶ The methodology on this hypothesis isn't elaborated here. It is referred to the literature of the identification of regional potential and endogenous potential.

research, 24 access to traffic network, 25 closeness to other branches, 26 closeness to same branch, 27 availability of housing.
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In contrast to that in **Prachatice** is the *quality and access to secondary education* the most important factor followed by the *availability of housing*. Furthermore the *closeness to other branches* and the *access to traffic network* is seen as significance too. This reflects the handicap of Prachatice that no major state road is passing this district as well as they haven't got any access to the railway network. Surprisingly in contrast to Bruntál the enterprises see a need in the *contacts to research facilities*. According to *quality* the enterprises see advantages in the *availability of foreign investment capital*. Therefore the region benefits from the closeness to Germany and Austria. Surprisingly the *regions ecological* situation isn't as good as it appears. But a positive perspective for the development of tourism provides the *availability of recreation facilities* as well as the *quality of the public transportation*. Overall the district would have chances in the potentials for development of the information technology and software, because the *contacts to research* and the *availability of foreign investment capital*. Furthermore, *the availability of recreation facilities* would make the district very attractive for such businesses.

3.1.1 Labor force and employment

In the following the categories of external barriers are analyzed closer in accordance to the results of the survey. The transition implies for the workers and employees as well as for the enterprises an adjustment process. The competitiveness of the enterprises in the national and international markets is determined not at least by its laborforce's motivation and qualification. The smaller a business (size of enterprises) is, the more the employees are responsible for the performance of the enterprise.

Although the distribution of employment shifted between 1992 and 1995 from Agriculture to services and crafts, most of the enterprises in the sample regions have difficulties to find adequate employees. Firstly most of the people have an agriculture background education and therefore not the skills for jobs in services and crafts. The advantage of the availability of labor force which is determined by the unemployment rate, is eliminated by the low skills of the non-qualified labor force. Furthermore the enterprises complained about the skills of the employees, holding a *University degree* or a *diploma of special training schools*. More than 50% of the enterprises were not satisfied with the skills of their educated employees. But there is a difference between men and women. Women's skills were worse evaluated than men's. Second key issue is the *motivation of labor*. Although motivation is difficult to measure, the enterprises responded that the involvement of the employees is usually quite low. In this case there is no strong distinction between men and female. But it is significant that there is a difference between the employees holding a degree or diploma and the ones without education. Generally the educated ones are graded to have a better motivation. The enterprises blame

mainly the „*high social benefits*“ and the „*lower standard of public transportation*“ in Rural Areas for the low motivation of the labor force.

A strategy to eliminate the deficits is the introducing training opportunities for the labor force in the region according to the requirements of the enterprises. The programs could be either public organized or the training opportunities of the enterprises have to be improved. Own training or targeted training by agencies to the enterprises requirements will significantly influence the success of the firms. In Bruntál only 26% of the business are offering training opportunities. While looking at the distribution of the training facilities by *legal status* of the companies, it is significant that more than half of them (54,2%) were *natural persons* and 42,2% were *limited liability companies*. By *branch* it was significant that the *processing industries* offered more opportunities than other branches. If it is distinguished by the *education of the owners*, the prejudice is confirmed that the ones *with university degrees* are more likely to offer training possibilities. Training contributes as well to the support of innovation and interregional and regional cooperation.¹⁷ An important contribution in this context could be made by the regional Universities and public training schools. But such institutions are not existing in the surveyed districts. In areas where such institutions didn't exist and the supply of qualified labor is less than average, further education opportunities¹⁸ gain importance for qualification. This could be equalized by training inside the companies.

Anyway, *further education* was offered to employees by 90% of the enterprises which also provide *training*. The *further education* has to be done outside the enterprise and has to be paid mainly by the employees themselves. Some businesses pay half of the costs. In contrast 28% of enterprises without training opportunities provide further education. By this they try to eliminate the lack of employees qualification. *Further education* is mainly offered in construction. Furthermore the survey singled out that enterprises which offer further education grade the qualification of their female labor force better than enterprises without. An important influence onto the motivation of the employees has the level of salaries which is low, the lack in education, the former socialistic working constitution and the lack of corporate identity.

A **conclusion** is that firstly the education system has to be adjusted to the needs of the firms. The system lacks especially in the skills for the business but as well in crafts. Secondly, training and further education has to be promoted by the administrations to make a better re-

¹⁷ Cf. Schroers, H.-G. (1995): *Regionspezifische Standortfaktoren und Entwicklung des Arbeitsplatzangebots: eine vergleichende Analyse von zwei Landkreisen der Bundesrepublik Deutschland*. Vauk, Kiel. P. 162.

¹⁸ In this context the expression „*further education*“ refers to learning new skills besides the regular employment. This could be either part time or full time. The opportunity could be given in special institutions or in the enterprise itself. In contrast to that is *training* an apprenticeship in the enterprises itself which last between two and three years and which result in a degree or a diploma for the student.

qualification of the workforce with an agriculture background possible and to improve the skills, flexibility and motivation of the current workforce.

3.1.2 Relations to the supply- and distribution network

But not just the workforce is relevant for the competitiveness of the firms. It depends on a bundle of macro- and meso economic conditions. This includes the up- and downstream sector for the relevant company. Transition economies usually have a lack in supply and distribution channels, because the former state enterprises had their own network. But most of these networks are still exists and therefore don't match the requirements of the SME. These distribution channels are not just of relevance for the interregional market but as well for the local one.

But SME are not just depended on the distribution channels. They need as well an operational supply industry. If e.g. the produced goods and services supposed to be competitive on the local or national market, the supply and demand has to be in coordination with the production. Furthermore, for SME it is more difficult to set up a distribution network then it is for big companies. Therefore the cooperation on a regional level is significant.

On the input side the companies complained about *price of the products*. The second problem was the *distance to the distributor* and the third was *the lack of a distributor or a market*. Also, some of them had problems with *the traffic network* in this case. The activities and the markets for the enterprises mainly took place in the community, the district and the Czech Republic. Only some buy in Poland, Germany and Austria.

Products were sold mainly to the consumers and other private enterprises. The share of state enterprises in the demand for goods is still high. Because most of the clients are private customers, the businesses usually don't have a problem with distribution. The clients pick up goods and services anyway. More problematic is market information. 32% complain about the lack of it or the unprofessional kind of services which are offered. A further point were the cost of labor, in distribution.

Furthermore, enterprises were concerned about the variation of demand. This implies that some of them are not familiar with the characteristics of market economies. Payment for products is mainly done in cash. 53% of businesses sell on a cash basis. Almost 43% offer bank transfer. Only a low percentage sells it on credit or barter.

3.1.3 Regional Cooperation, Consulting and institutional framework

Regional cooperation is not yet very widely accepted yet as a significant tool for improving the situation of enterprises. One significant aspect is the integration of enterprises. Especially

the support offered at the foundation of SME could be improved by integration. Further competitiveness could be improved by using economies of scales.

The survey showed that a lack in cooperation between companies exists, as well as between companies and public organization. Only 71% work together with any kind of other services or with public organizations. But there is a difference according to the form of enterprises. Only 70% of the *natural persons* cooperate whereas the figure is 80% for *limited liability companies* and 100% for *share holding companies*. The first told us that they think it is not necessary. Problems mainly exists in the cooperation with public administration. They do not trust them and see them as incompetent. But on the other hand the administration doesn't see a need for the development of SMEs according to them.

In cooperation with other services, the businesses see the most necessity in accounting. 31% are have an accountant and 26% working with insurance companies. Even 29% are work together with an advertising agency and 12% use other kinds of business consulting. The enterprises have problems with the quality in financial services and other business services. This could be improved where as tax consulting is seen as a good service. The businesses only demand tax information, because in replay to the question as to which services they are not interested in, they said financial and business consulting. 35% of enterprises mentioned that a branch is missing for them.

Legal institutions are fundamental for SME development in defining the property rights inclusive rules for exchanging them, in setting rules for the market entry and exit and in promoting competition.¹⁹ Creation of an adequate legal framework involves laws regulating the property rights, bankruptcy, contracts, commercial activities and taxes. The Czech Republic has taken steps to built up these legal framework. But in the banking sector some problems remain. It is almost completed. They base their law on some extent on pre-war models.²⁰ Furthermore the enterprises in the Czech Republic facing a frequent change of tax regulation which requires then a constant adjustment of the SME about the new regulation.

Overall, for both regions it is obvious that regional cooperation and networking is not seen yet as a tool among businesses to increase their competitiveness and to get access to future markets. With the formation of a chamber of commerce and a compulsory membership the enterprises would be forced to use this resources.

3.1.4 Financial infrastructure for SMEs in Rural Areas

¹⁹ Cf. World Bank (Ed.), From Plan to market. World Development Report 1996. Washington, D.C. p. 88

²⁰ Cf. Lageman, B. et al. (1994): Aufbau mittelständischer Strukturen in Polen...a.a.O. pp.116-117

One of the strongest barriers to SME development in advanced and less advanced countries is the financial infrastructure. While stock exchange boards in Prague developed quickly they are not available for SME in Rural Areas as well as national risk capital markets are virtually non-existent.²¹ The banking system in the Czech Republic is still highly inadequate, especially for SME in Rural Areas.²²

In discussion with the enterprises most of them complained about the *lack of financial resources* and *the conditions for loans and credits*. Most of the enterprises were founded in 1991 and 1992. At that time the banking system in the Czech Republic and the capital markets weren't established. This made it very difficult to get a loan or a credit. Furthermore, the density of banks in the Czech Republic is very low. In 1994 it was 1.319 people per branch. Only the Agrobank has a good network also in Rural Areas.

How does it look in the sample? In Bruntál 41% of the enterprises had a credit, whereas in Prachatice only 19% had a credit. Almost 20% of the surveyed enterprises said that they don't need a loan from the bank. In Prachatice this segment was even higher. A conclusion is that SMEs' first priorities aren't the demand for a loan. Especially the small ones are not interested in it. 34,3% of the enterprises without a loan told that the reason for not having a loan is the inability to fulfill the requirements for it. They are lacking in collateral. Furthermore, 19% of them complained that the interest rates were too high. 2,9% claimed other things like absence of a branch and the mistrust into banks. 20% told that the requirements couldn't be fulfilled **and** the interest rates are too high.

In the Czech Republic in general the banks are still oriented in favor of their „old“ clients and therefore discriminating the new ones. In this context especially the small enterprises are disadvantaged. Banks are rather risk adverse because of lacking information and expertise on their new target group.²³

Financial problems

While watching the development of the laborforce and the revenue of the sample we would assume that no acute problem exists for the sample enterprises. But in response to the question about financial problems there is another conclusion. The enterprises could be characterized generally by a sort of instability. Almost 11% of the sample were attacked already by financial

²¹ Cf. Zecchini, S. (1997): Transition Approaches in Retrospective. In: Zecchini, S. (Ed.); Lessons from the Economic Transition. Central and Eastern Europe in the 1990s. Dordrecht, p.26

²² Cf. Jehle, R. (1997): Die Transformation in der Tschechischen Republik. Entwicklungen und Hintergründe. In: Grosskopf, W. (Ed.): Genossenschaften im Transformationsprozeß der Tschechischen Republik. Arbeitspapiere 14. Forschungsstelle für Genossenschaftswesen an der Universität Hohenheim. p. 3-24.

²³ Cf. Schröder, K.; Pieper, B.: (1996): Osteuropas Bankensystem: Problematische Sanierung und Privatisierung der Staatsbanken: Sechs Transformationsländer im Vergleich. (Aktuelle Materialien zur Internationalen Politik, Bd. 44). Baden-Baden. P. 18.

problems. More than 25% told that they fear that they don't survive because of financial problems. And 10% of the enterprises answered that they never had financial problems. By identifying the group of enterprises with financial problems it is significant that mainly enterprises with less than 10 employees are affected by this financial problems. Distinguished the answers by branch, the manufacturing businesses are more affected than the services.

3.2 Internal barriers of SME development in Rural Areas

The main target of the survey were the external barriers of SME development. But the processing of the data and the interviews with the enterprises allows to mention some of them briefly. The main internal constraints in SME in the sample districts is the lack of special knowledge and specific technique to manage the enterprise in a market economy. The survey shows that the enterprises tend to mention mainly external barriers for their problems in the development. Internal deficits tend to be interpreted as implicitly hinting at entrepreneurial weaknesses. Generally it has to be added that the external barriers have been recognized in the meantime. The still remaining difficulty with respect to internal problems is to match the entrepreneur's perceived needs with the actual critical internal weaknesses impeding SME development. Besides, internal barriers are a result of the SME's live cycle and its sector as well as of certain characteristics of the entrepreneur.²⁴ For the surveyed enterprises it is difficult to grade this because of the youth of the private enterprises. It would be necessary to follow the development of enterprises by several surveys.

4 Support of SME in the Czech Republic

4.1 Strategies for the SME support

„SME support in transition economies is generally designed according to different underlying concepts in SME promotion; either governments tend to follow a more direct approach or they prefer an indirect one“.²⁵ The measures in the Czech Republic target more the support of the direct approach, because they try to solve the individual business financial problems not by strengthening the banking system which would be an indirect approach, but more by introducing special credit lines. The justification for the assistance lies usually in the time perspective. While the indirect support is seen as more effective for a long term, the companies benefit more from the short-term assistance.

However, the Czech Republic has emphasized broad support for enterprise development, instead of focusing on economic development in territorial terms. The government established an institutionalized form of assistance. Especially programs were established which cover financial helps, business advisory services and certain types of industrial parks. The govern-

²⁴ Cf. Klemmer et al. (1996): Mittelstandsförderung in Deutschland - Konsistenz, Transparenz und Ansatzpunkte für Verbesserungen. (Untersuchungen des Rheinisch-westfälischen Instituts für Wirtschaftsforschung) Heft 21. Essen pp. 49-54 and pp.60-64.

²⁵ Welter, F. (1997): Small and medium sized...a.a.O. S. 13

ment has concentrated most of its enterprise creation efforts on financial support, including grants, guarantees and subsidies. They cover support, ranging from grants to loan guarantees, and foster new investment projects in enterprises whose business plan fulfill certain profitability criteria²⁶.

The programs are available in all regions. Most of this programs target particular sectors or promote particular activities. But only two, so far focus on problem regions. Therefore they became a core element of the government's efforts to combat unemployment through the creation of small business. The REGION and ROZVOI programs are available in areas, deemed problematic, usually by virtue of a high unemployment rate²⁷. These programs were as well implemented in the sample districts. But most of the enterprises didn't know about any kind of these support.

Also further efforts to territorial assistance measures can be found. There is support for initiatives to establish local credit guarantee for venture capital programs in regions undergoing serious problems of unemployment and restructuring. For example there was an regional enterprises fund in Ostrava established as well as business advisory and information centers have been established in regional centers. As mentioned before the firms don't know about the initiatives and quite often it seems that they can't match the requirements to get access to them. Overall it could be concluded that the network of assistance is quite well developed for the industry and in parts for the SME in the Czech Republic²⁸.

4.2 Assessment of the assistance in respect to Rural Areas in the Czech Republic

Institutions working on a micro level were especially built up for SME promotion in the Czech Republic. They include for example training centers and technology centers. The main task is to carry out assistance at the firm level. They offer different minimalist or broad programs to overcome specific SME difficulties. Unfortunately the assistance for small enterprises in Rural Areas is lacking behind agglomerations, especially in crafts, manufacturing and services. As the survey showed most of the programs were not known to the enterprises and entrepreneurs didn't know how to get access to assistance and advisory work.

As identified earlier, the high interest rates were key issues which hindered the enterprises to get a credit²⁹. This proofs that it quite simple lacks the risk capital needed to implement the sort of active promotion policy it should. While there is a desire to promote SME, the princi-

²⁶ Cf. OECD(1996): Transition at the local level. The Czech Republic, Hungary, Poland and the Slovak Republic. Center for co-operation with the Economies in Transition. Paris 1996. S. 59f

²⁷ ebenda, S. 60

²⁸ Cf. OECD (1996): Transition at the ... a.a.O. S. 61f

²⁹ Bohatá, Marie (1996): Small and medium-sized enterprises in the Czech manufacturing industry. CERGE EI Working papers 94, Prague. S. 18

pal means for doing so - the provision of risk venture capital in the form of equity investment - is practically non-existent in Rural Areas. And where it is available it is only accessible for a limited sort of new firms, mainly in production but not in services. No doubt there are programs for lending to SME, but loans are a poor means for financing new emerging businesses. Such businesses, even if profitable, and especially if they are growing rapidly, do not generate the cash flow needed to service debt, especially debt carrying interest rates in excess of 15 percent. But in Rural Areas the situation is different. The infrastructure for this conditions is rather low. On the other hand the survey showed and proofed some results of studies that the financial resources aren't the first priorities for most of the small firms. Usually if they have decided that they start the business they have access to financial resources. Therefore it can said that investment capital is necessity but it doesn't provide alone the foundation of enterprises. More relevant in respect to the small firms are the consultancy in all kind of hurdles at the beginning. This includes technical skills as well as accounting and taxation.

The **conclusion** out of that is that the business assistance of the Czech Republic could help the foundation but just with access of the firms to the consultancy from the very beginning. But this is not available at the Rural level, because most of the business agencies haven't have a branch in Rural Areas.

Another problem connected to the institutional infrastructure is the necessity to match the evolving business support infrastructure - as well as their services - with the changing needs of SMEs in different sectors at different stages of their development.³⁰

5 Conclusions

Successful programs on the firm level and adequate institutional mechanisms can be seen in the surveyed areas. However, the fundamental problem with respect to the long term success in Rural Areas is the necessary shift from a more piecemeal approach - variety of institutions, lack of co-ordination and vision and awareness of SMEs' role - to an overall integrated strategy.³¹

An approach to solve some of these problems would be the creation of an integrated program for Rural Areas. This would cover political measures and conditions as well as economic ones.

First of all the creation of a macroeconomic framework which allows different organizations and institutions to work with clear regulations has to be accelerated. Secondly the decision

³⁰ Cf. Smallbone, D. (1996): Supporting SMEs Development in Economies in Transition: A view from the West. In: Dimitrov, M.; Todorov, K. (Eds.): Industrial Organization and Entrepreneurship in Transition. Sofia. p. 13

³¹ Cf. Smallbone, D. (1997): Developing a policy Agenda...a.a.O. S.

making process should be closer to the regional level. Therefore it is possible to consider regional peculiarities. A step forward could be the establishment of a higher regional body. This would mediate between the national level and the local municipalities. Without stressing here the structure of such an organization, one of the requirements would be to have an elected assembly with a wide range of competence mainly in regional policy and support measures.

Thirdly the technical assistance to the enterprises has to be improved. This should cover:

- Training and management development
- business advise and support services
- regional advice

The latter one is of significance for the sample regions. Regional advice (RAIC) could be provided by a regional advice and information center. The RAIC could be active in seeking new opportunities to built links between the regional and outside business as well as training for business counselor and different pilot projects.

Furthermore, a complex program of education and consultancy has to be set up. In cooperation with existing regional organizations training and seminars should be introduced in such areas like essentials of business, ISO 9000 quality management, marketing and financial management among others. In addition a program could be included for education and supporting unemployed persons who wish to start their own business³².

But before introducing these measures, or at least simultaneously an initiative is supposed to implement which is fostering the participation of the local people. Probably national and regional assistance will be not available for less favored areas. Therefore an endogenous development approach has to be encouraged. This encouragement is strongly related with the participation of the people. So an initiative which support these encouragement has to be implemented. In the European Union such a bottom-up approach the so called LEADER program is matching parts of the mentioned objectives.³³

Overall and as a final remark It has to be added that the significance of farming and the food industry for Rural Areas shouldn't neglected, although the importance of it in the economy is declining. In some cases, particularly in combination with tourism alternative farming methods and regional marketing network could be a further opportunity for the development of a region.

³² Cf. Batestone, S. (1997): SME Policy in Slovakia: The Role of BI-lateral and MULTI-Lateral aid. Paper presented at the „Third international conference on SME development policy in transition economies. Wolverhampton, October, 16-17, 1997. p. 18f.

³³ Cf. Jehle, R. (1998): The concept of endogenous rural development in the framework of its introduction in the regional policy of the Czech Republic. In: *Zemědělská Ekonomika*. Ročník 44. Praha (1)98. p. 9ff

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