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Article

Can diversity encourage entrepreneurship in transition economies?

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Can diversity encourage entrepreneurship in transition economies?

Harnessing the benefits of diversity is essential for encouraging entrepreneurship in the transition region

Keywords: entrepreneurship, diversity, gender, transition

ELEVATOR PITCH

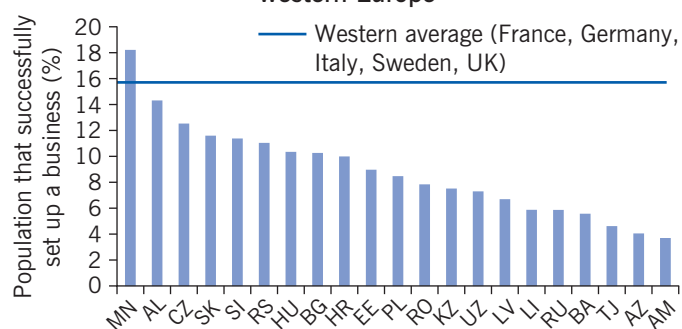
Entrepreneurship is an important lever for spurring transition in the economies of the former Soviet Union and Central and Eastern Europe. Utilizing diversity, in terms of religion or gender, can positively affect entrepreneurial development. Programs that encourage entrepreneurial initiatives (such as business start-ups) in culturally diverse localities should rank high on the policy agenda. Prompting women to start a business, along with female-friendly measures (including targeted legislation), can positively affect entrepreneurial behaviour and the performance of existing enterprises.

KEY FINDINGS

Pros

- ⊕ Cultural differences can encourage more innovative, creative, and productive business start-ups due to complementarities in skills and approaches.
- ⊕ Productivity gains resulting from cultural diversity may be higher in more economically advanced societies, as they have more financial and institutional resources to take advantage of diversity.
- ⊕ Enterprises with more women in top management positions are more successful in transition economies.
- ⊕ Companies with more female managers are better positioned for serving untapped markets dominated by women and children and for improving corporate governance.

Entrepreneurial success in the transition region is below western Europe



Source: EBRD–World Bank Life in Transition Survey 2010. Online at: <http://www.ebrd.com/what-we-do/economic-research-and-data/data/lits.html>

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Cons

- ⊖ Cultural diversity can breed conflict, less growth, and less trust in others, due to differences in social values and norms.
- ⊖ Culturally diverse societies may find it difficult to agree on the provision of public goods, such as education or healthcare.
- ⊖ Localities with low-quality public goods are more likely to have (or attract) residents engaging in entrepreneurship resulting from “necessity,” rather than from “opportunity” (which drives growth).
- ⊖ Entrepreneurship among women or religious minorities could be a sign of discrimination rather than a marker of entrepreneurial spirit.
- ⊖ More diverse groups (in terms of culture or gender) may find it harder to enforce contracts.

AUTHOR’S MAIN MESSAGE

Despite the importance of entrepreneurship for growth and transition in post-socialist countries, policymakers still know little about how to encourage the establishment of new businesses. Exploiting diversity (in terms of gender or religion) can serve as a powerful policy lever in a number of ways, including by supporting would-be entrepreneurs who reside in culturally diverse areas and who are female, and by paying particular attention to those with extensive social networks. Female-friendly policies in the public sector can help more women to start their own business.

MOTIVATION

During the socialist era in the former Soviet Union and Central and Eastern Europe, private ownership was largely abolished, most enterprises were nationalized, and the majority of land was collectivized. Creativity, innovation and the flow of new ideas were severely limited. State ownership created large production inefficiencies and stifled economic growth and living standards. While countries such as Poland, the Czech Republic, and the Baltics were successful in adopting a market economy shortly after the fall of the “iron curtain” in 1989, for others, including the Ukraine and many countries in Central Asia, the transition from a centrally planned economic system has been difficult.

Entrepreneurship is an important means of spurring transition in the post-socialist countries, for at least three reasons. First, small business owners have tended to establish businesses in industries that did not exist, or were stagnant, under socialism. Moreover, sales and employment grow faster in entrepreneurial ventures than in state or privatized firms, and new businesses are more efficient. Finally, entrepreneurship may be an effective way of mitigating income shocks—particularly following financial crises—by providing households with an alternative source of employment [1].

With the rising importance of globalization, migration and female labor force participation, and diversity of religion or gender, are more pronounced than ever before. Yet, policymakers still know little about how diversity affects entrepreneurship in transition economies.

DISCUSSION OF PROS AND CONS

Religious diversity: A double-edged sword?

More religiously diverse firms may be more creative and efficient and, as a result, may have better overall decision-making processes. At the country level, religious heterogeneity may spur productivity and growth, due to complementarities in skills and approaches. Countries and localities that are richer and more developed may also be better positioned to harness the benefits of diversity, due to the availability of appropriate financial and institutional resources [2].

At the same time, cultural differences can also have negative consequences. In firms and organizations, homogeneous groups can show higher trust and have fewer conflicts, because of shared values and norms, and formal and informal sanctions may therefore be more successful. Diverse localities are more likely to have lower spending on public goods (such as education, healthcare, and roads) as a result of divergent views on their importance, and higher spending on patronage and influence. This can affect entrepreneurship via two channels. First, since public finances are spent on less productive activities (e.g. corruption or patronage), there will be fewer opportunities for entrepreneurship. The profits of existing entrepreneurs may also be more likely to be expropriated as a result, which will limit business growth and development. Second, low-quality public goods will negatively affect human capital. Localities with higher human capital are more likely to have (or attract) residents engaging in high value-added entrepreneurship (“opportunity” entrepreneurship), as opposed to “necessity” entrepreneurship, which is a consequence of financial need. More religiously diverse countries may also be more likely to engage in civil war and armed conflict and consequently have lower growth [3].

Exploring the link between religious diversity and entrepreneurship

What then is the effect of religious diversity on entrepreneurship in transition economies? The literature provides little guidance on this question. On the one hand, language and religious differences in the post-socialist region are important and have led to conflict, including the civil wars in former Yugoslavia, Tajikistan, and the North Caucasus. On the other hand, living standards have improved tremendously in the region since the collapse of socialism, suggesting that transition countries should be better positioned to exploit the benefits of diversity.

To look empirically at the relationship between religious diversity and entrepreneurship in the transition region, it is useful to refer to the second round of the Life in Transition Survey (LiTS), which is a nationally representative, household-level survey conducted by the European Bank for Reconstruction and Development (EBRD) and the World Bank in 2010. The survey contains modules on household demographics, housing and expenses, attitudes and values, climate change, labor, education and entrepreneurial activity, governance, miscellaneous questions, and the impact of the 2008–2010 financial crisis. The entrepreneurial module also contains questions on the main reason why the respondent did not manage to set up a business, whether the respondent tried to borrow money to set up a business, and whether he or she was successful in doing so.

The survey covers all transition countries, with the exception of Turkmenistan (i.e. Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kosovo, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Mongolia, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Tajikistan, Ukraine, and Uzbekistan). There are 1,000 observations per country, with the exception of Poland, Russia, Serbia, Ukraine, and Uzbekistan, which contain 1,500 observations.

With the help of the survey, researchers are able to investigate the link between religious diversity in a respondent's community and two crucial stages of entrepreneurial behavior: (i) the individual's attempt to start a business; and (ii) whether the respondent actually founded the enterprise [1]. To date, this is the only research paper that has presented evidence on the link between diversity and entrepreneurship in the transition context.

Measuring entrepreneurship and religious diversity in the Life in Transition Survey

The first stage of entrepreneurship—"entrepreneurial attempt"—is captured by the survey question: "Have you ever tried to set up a business?". A second survey question, "Did you manage to set it up?" provides information on the actual business start-up (second stage of entrepreneurship). This definition of entrepreneurship includes both formal and informal business owners and, due to the nature of the survey, mostly small businesses, with one or at most two employees are captured. It is important to note that self-employment is not the same as entrepreneurship, at least in the transition context. One can be self-employed without actually setting up a business: for instance, self-employment due to tax reasons captures professionals who have a job "on the side" (such as doctors or lawyers) but who are not actually entrepreneurs [1].

Additional analysis suggests that the LiTS sample is mainly composed of entrepreneurs seeking to take advantage of a business opportunity, rather than respondents who only started a business because of financial necessity or because of discrimination in the

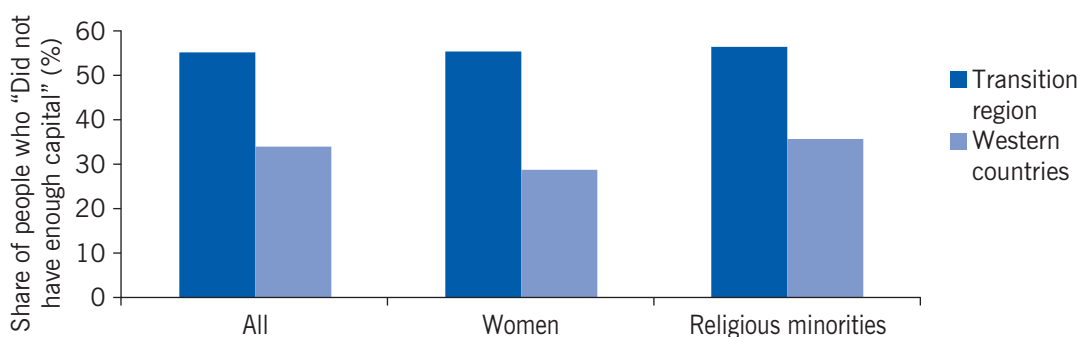
traditional workplace. This implies that post-socialist entrepreneurs captured by the LiTS are likely to drive growth (“opportunity” entrepreneurs), possibly by generating new ideas and knowledge transfers [1], [4].

The LiTS also includes useful information on the respondent’s gender and self-identified language and religion. Although information on ethnicity is also collected, the data are less reliable, as the question is open-ended, with no specific categories defined. The primary focus is on religious diversity, as a person can be multi-lingual or multi-ethnic, but rarely can have more than one religion. The level of religious diversity in each locality can be calculated by using a measure of diversity called Blau’s index, which calculates the probability that two randomly selected individuals in a given community belong to different religious groups. This statistic ranges from 0 (low diversity) to 1 (high diversity). As an illustration, a society with a single religious group is entirely homogeneous and the value of the diversity measure will be 0. In contrast, a society with three different religious groups of equal size will have relatively high diversity, at a value of 0.67.

Measuring religious diversity in this way is of course not perfect. Although the LiTS is representative at the country level, this is not the case at lower levels of aggregation (including the locality). However, comparable data on sub-national religious diversity across transition countries from other sources (such as country censuses) are not available. In addition, religious affiliation is not the same as religious “practice.” This is a limitation, as religious affiliation may capture ethnic identity, at least partially. Gender diversity is more straightforward to measure in the LiTS (using the share of men compared to women in a locality), although information beyond the traditional male/female division, such as options to identify as transgender or gender-fluid, is not available.

Religiously diverse localities in the post-socialist region have more respondents who have tried to start a business and a higher number of actual start-ups. This is a conditional correlation, and the authors of the paper present additional evidence suggesting that it is likely to be causal [1]. However, the relationship seems to be driven by the respondent’s access to borrowing (both from formal institutions, such as a bank, and from relatives and friends) and risk preferences. This is an important result, since it points to the role of financial constraints for businesses, restricting in particular entrepreneurs who are female or who belong to a religious minority (Figure 1).

Figure 1. Lack of access to finance is a constraint to entrepreneurship



Note: Western countries = France, Germany, Italy, Sweden, and the UK. The figure shows the share of respondents that listed the reason “Did not have enough capital” for not managing to set up a business calculated out of respondents that tried to set up a business and failed.

Source: EBRD–World Bank Life in Transition Survey 2010. Online at: <http://www.ebrd.com/what-we-do/economic-research-and-data/data/lits.html>

Social capital

According to the OECD, social capital is defined as “networks together with shared norms, values and understandings that facilitate cooperation within or among groups.”

More precisely, the OECD identified four different types of social capital:

- Personal relationships, relating to the structure of people’s networks (consisting of friends, relatives and acquaintances) and the frequency with which one communicates with the network (for instance, by meeting up with friends).
- Social network support, which refers to the financial, emotional, intellectual, professional or other resources available through one’s network.
- Civic engagement in one’s community via volunteering, political participation, and membership of community organizations such as youth organizations or bird-watching clubs.
- Trust in others and norms of reciprocity and cooperation. This usually refers to generalized trust to others (including strangers) and has been shown to be strongly related to growth, development and effective institutions.

Sources: OECD (2001). Online at: <http://www.oecd.org/site/worldforum/33703702.pdf>; and OECD (2014). Online at: <https://stats.oecd.org/glossary/detail.asp?ID=3560>

The authors also consider how social capital in diverse localities affects entrepreneurial behavior [1]. Two different measures, or definitions, of social capital are used. The first one measures how frequently the respondent meets friends, while the second one looks at how much the respondent’s network extends beyond the family, close friends and colleagues. There is also a variable capturing whether the respondent believes that hard work, or intelligence and skills (as opposed to political connections or breaking the law) are the most important factors for success in one’s country. Entrepreneurs who are not embedded in dense networks (definition 1) are actually *less* likely to engage in entrepreneurship in diverse areas, both at the trial and business start-up stages. In contrast, religious diversity has strong benefits for would-be business starters who have social ties extending beyond immediate family, friends or colleagues, or who believe that working hard is important for success (definition 2 and additional variable). However, the latter two effects are only present when one tries to start a business and do not translate into a higher rate of *actual* business starters in a locality.

This impact of social capital could be due to the fact that adherents of different religions may have different attitudes, including on issues such as work ethic or the importance of the private sector in the economy. Such beliefs may affect business trial and start-up by nurturing different perceptions of how important entrepreneurship is in a particular society.

Gender diversity: A win-win for everyone?***The state of gender diversity in a society and its implications for entrepreneurship***

In developed countries, even today, women who are equally qualified continue to earn less than men at *all* levels of qualification. Motherhood seems to be penalized harshly in transition countries as well as in Germany, in contrast to countries in Scandinavia. Recent

Figure 2. Obstacles to achieving gender diversity in the workplace

<i>Individual</i>	<i>Cultural</i>	<i>Workplace</i>	<i>Structure/policy</i>
Educational choices	Perception of female commitment	Face time and flexibility	Lack of shared parental leave
Sector choices	Double standards	Staff rather than line role promotions	Lack of childcare assistance
Pipeline availability	Spousal role and support	Mentoring for women rather than sponsorship	Differentiated taxation
Risk aversion disparity	Work–life balance priorities	Promotion rates	Organizations were designed for men and manufacturing

Source: Credit Suisse Research Institute. *The CS Gender 3000: Women in Senior Management*. 2014. Online at: <https://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=8128F3C0-99BC-22E6-838E2A5B1E4366DF> [7].

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research estimates that the motherhood wage penalty (i.e. the difference in wages between mothers and women who have no children) is 33% in Germany, 19% in Ukraine, 10–15% in Russia and Hungary, but virtually 0% in Finland and Sweden [5]. Additionally, sex ratios remain skewed in favor of boys, not only in places such as China and India, but also in transition countries in Central Asia and the Caucasus, largely due to the availability of sex-selective abortion [6]. Finally, there is still a big gender gap in political participation: as of December 2015, only three transition countries (Slovenia, Serbia, and FYR Macedonia) had met the target (set by the UN Economics and Social Council in 1990) of having 30% or more women in national legislative seats. Figure 2 summarizes some of the main obstacles to increasing gender diversity in the workplace.

The uneven representation of women in the private and public sectors may explain why women are actually less inclined than men to try to start a business in the transition region. This could be due to demands of child rearing, lower propensity to take risks, or lower availability of financial and non-financial resources for starting a business. Encouragingly, those women who attempt founding a business are as likely to succeed in setting it up as men [1]. Moreover, women do not seem to become entrepreneurs out of necessity, but rather because they want to exploit existing economic opportunities [4]. This strongly suggests that female businesses are important for growth and transition [8]. For example, catering to previously unexplored markets dominated by women and children is one channel through which this process may occur. Of course, this effect will be dampened if the majority of women start businesses as a response to discrimination in the traditional workplace, though as explained above, this does not seem to be the case in the LiTS sample.

The benefits of gender diversity

There are several pieces of evidence that suggest that gender diversity may be beneficial to entrepreneurship and that gender diversity at the firm level can have a positive effect on productivity and overall economic growth. For example, diverse groups are more likely to have access to non-overlapping information, and exposure to different views can lead to creativity and innovation. There is evidence (from Scandinavia) of a positive impact of women's presence on boards and in senior management on companies' performance:

companies with more than one woman on the board returned an excess return of 3.7% a year since 2005 compared to those with only men. Moreover, there is little evidence that women have an inherently risk-averse approach in company management [7]. In addition, companies that employ female managers may be better suited for serving consumer markets dominated by women and more gender-diverse boards could enhance corporate governance [9].

However, it may also be that women choose entrepreneurship not to exploit a business opportunity, but out of necessity or due to discrimination in the traditional workplace [4]. The impact of the latter type of entrepreneurship on growth and innovation is far less certain.

A well-functioning public sector is crucial for fostering business start-ups, and for encouraging more female entrepreneur. Research shows that women as policymakers make different decisions to men [10]. Women prefer policies that better reflect their own priorities, including child health and family nutrition, as well as policies that increase their bargaining position within the household, improve their rights in case of divorce, and raise their chances to access the labor market. Such policies can lead to long-term productivity, growth and development. This in turn can provide more opportunities for entrepreneurship in general. As an example, gender inequality in education has been found to reduce annual per capita growth rates by about 0.4–0.9 percentage points. Excluding women from education and the labor force may therefore stifle innovation (particularly if women's and men's skills in some areas, such as research, can be regarded as substitutes) [11]. Within the family, women's empowerment can positively affect child welfare, child health, and family nutrition. These outcomes may be particularly relevant for sustained labor force participation, employment and entrepreneurship in the fast-aging societies of the transition region.

LIMITATIONS AND GAPS

Not all types of diversity may affect entrepreneurship in the same way. This contribution has focused on religious and gender diversity principally because of theoretical and data-availability reasons. Future research should elucidate more clearly how different types—and combinations—of diversity affect entrepreneurship in both the long and short term.

Future research in this area should also look at how gender equality, at both the country and local levels (e.g. in terms of education and labor), affects the prevalence of entrepreneurship, the types of business established, and firm performance. Although there are some good data sets available at the country level—such as the Social Institutions and Gender Index by the OECD, or the Global Gender Gaps by the World Economic Forum—sub-national data are scarce but necessary.

Quantifying the effect of diversity on entrepreneurship may be difficult due to a possible reverse link running from entrepreneurship to diversity. For instance, more entrepreneurial localities may create the formal institutions (e.g. local governments and trade associations) and informal (e.g. social clubs and societies) that can foster diversity. Similarly, identifying precisely the effects of diversity on entrepreneurship may be hampered by the fact that people with diverse backgrounds may move to localities where entrepreneurship is booming. Accounting for respondents' migration patterns, on which there is information in the LiTS, may help to partially alleviate this concern [1]. Finally, since LiTS respondents are only asked whether they tried and managed to set up a business at a point in time, it is difficult to pinpoint the factors behind actual business *survival*.

SUMMARY AND POLICY ADVICE

Encouraging entrepreneurship is essential for creating dynamic market economies in the transition region. Policies that promote greater freedom, expression and participation in terms of religion and gender are likely to nurture pluralism, which in turn will support the benefits that can be achieved from greater diversity.

Increasing diversity can have a host of benefits for entrepreneurship, economic growth and transition more generally. The challenge for governments and policy makers is to come up with effective policies that target women and religious minorities, but that also minimize the costs to society of doing so. Policymakers should also be aware of whether women or religious minorities start a business in order to exploit a business opportunity, or become an entrepreneur out of necessity, or due to discrimination. Several important policies can encourage entrepreneurship through diversity in transition economies:

- Religious diversity may be particularly important for nurturing entrepreneurs who have high levels of social capital (measured as access to non-familial ties) and who believe that hard work, intelligence and skills are important for success. In addition, programs aimed at altering cultural norms and perceptions regarding the negative value of entrepreneurship (possibly associated with belonging to a particular religion) may be useful.
- Training and networking programs (with established entrepreneurs), particularly for women and religious minorities, are likely to be efficient in fostering social capital. One concrete suggestion could be to encourage the exchange of ideas among entrepreneurs who are female or belong to religious minorities in transition and developed countries, including the sharing of technical and management knowledge.
- Expanding the availability of credit should also rank high on the policy agenda, as the positive effect of religious diversity in the entrepreneurial start-up stage seems to be driven by access to finance. On the one hand, governments and financial institutions could come up with specific products tailored at small business owners, such as micro-loans. On the other hand, educating would-be entrepreneurs about the benefits and availability of different sources of financing is likely to have high payoffs, so financial literacy programs should be encouraged. Financing designed specifically for female entrepreneurs should also be explored.
- Policymakers should pay particular attention to nurturing “micro” entrepreneurs (i.e. enterprises employing fewer than ten people), and even more so in religiously diverse environments, which are conducive for successful entrepreneurship. While the large Silicon Valley type of firm is important for growth in advanced countries, small business owners are essential for fostering transition in the post-socialist region. Entrepreneurship may not only provide an important income buffer, but also spur the creation of more established businesses.
- Greater support, including information and lending, to encourage potential female entrepreneurs is needed. Such policies are likely to increase not only women’s own welfare, but also that of other family members, and could be a source of economic growth. In fact, many women start businesses at a point in their career when they feel that they will not be promoted any further in a staff role at an organization.

- Entrepreneurship could, in fact, provide women with the flexibility to juggle between household and work responsibilities, while at the same time making an important contribution to the economy. For example, shared parental leave in Scandinavia makes it easier for women to go back to work—or to start a business—after having children, if they want to. Shared parental leave is unheard of in the post-socialist region, and may be a useful way to spur entrepreneurial start-ups among women.
- Education is an important tool for promoting gender diversity, employment and business ownership. Many of today's entrepreneurial opportunities are likely to arise in STEM (science, technology, engineering, and mathematics) areas. Women are still under-represented in these subjects in secondary and tertiary education, so tapping into the unexplored female potential is essential.
- Culture and unconscious bias against women and traditional gender roles should be changed: in some countries or areas women may be unwilling to start a business due to negative perceptions by society of the female entrepreneur. This may also explain why female entrepreneurs may be more risk-averse and less optimistic about the success of their enterprises [4]. Companies, entrepreneurial associations, civil society and governments have a responsibility for encouraging entrepreneurship via awareness-raising, training programs and promoting female role models.

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Competing interests

The IZA World of Labor project is committed to the *IZA Guiding Principles of Research Integrity*. The author declares to have observed these principles.

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Further reading

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