

Domańska, Ada; Zajkowski, Robert

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INFLUENCE OF STATE PARTICIPATION ON BUSINESS CONDITIONS AND ENTREPRENEURSHIP IN THE EU COUNTRIES OF THE FORMER EASTERN BLOC

ADA DOMAŃSKA¹, ROBERT ZAJKOWSKI²

Abstract

The purpose of this paper is to show the extent to which state interference in the economy affects the conditions of functioning for small and medium-sized enterprises in economies of the former eastern bloc which have already gone through the EU accession process. The data on SMEs' situation were taken from the Fact Sheets of the EU program Small Business Act. Due to the fact that the variables proposed to describe the business environment differ significantly it was necessary to standardize them. The zero unitarization method was applied to rank countries properly. Special attention in this paper is devoted to Poland and the situation of businesses operating in this country. The research has identified some areas requiring urgent changes. It is crucial to improve the situation so that companies can play a proper role in the economy. A country which could be an example of good solutions that support business development is also described.

JEL classification: L26, O57, P20

Keywords: SMEs, Small Business Act, formemr Eastern Bloc

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¹ Maria Curie-Skłodowska University in Lublin, Faculty of Economics, Department of Banking, e-mail: ada.domanska@umcs.pl, ORCID: 0000-0002-8239-4319.

² Maria Curie-Skłodowska University in Lublin, Faculty of Economics, Department of Banking, e-mail: robert.zajkowski@umcs.pl, ORCID: 0000-0002-0021-7977.

INTRODUCTION

The purpose of this paper is to show the extent to which state interference in the economy affects the conditions of functioning for small and medium-sized enterprises (SMEs) operating in the former eastern bloc countries, which now belong to the European Union. The SME sector plays a special role in development of individual economies. SMEs are considered to be stimulants for a country's economic situation. Their operation is a sign of fair competition and reflects a society's entrepreneurship (Ignatiuk, 2011).

The companies that have been prepared to take opportunities offered by globalization and acceleration of technological change are significant elements for further improvement of competitiveness and dynamic development of the EU economy, allowing creation of new jobs and ensuring a higher level of social cohesion. The ability to exploit the potential of small and medium-sized enterprises will be decisive for the future prosperity of the European Union (European Commission [EC], 2008a).

Because of the important role of the SME sector for the further development of the EU, it was positioned in the center of the Lisbon Strategy for growth and jobs through the use of a partnership approach (European Commission, 2005). Diversity of the environment in which individual economic entities operate makes it very important to create the right program to support SMEs - a program which would take into account the diversity. Thus, in June 2008 the European Commission presented an initiative which would further strengthen sustainable growth and competitiveness of SMEs, called the Small Business Act (SBA) for Europe (European Commission, 2008b).

The fundamental assumption of the SBA was that most important to achieving success is to change the perception of entrepreneurs in society. Positive perception of aspects concerning the SMEs functioning, in the form of increased employment and economic prosperity, should encourage people to start a business. It is a pivotal point, crucial for creation of a business-friendly environment, which is why the culture of entrepreneurship and the associated willingness to take risk should be supported by political leaders, the media, and the authorities.

The program aims to create a new policy framework, consolidating already operating support instruments for businesses. Its implementation is to take place through the political partnership between the EU and Member

States that respects the principles of subsidiarity and proportionality. A comprehensive policy framework is based on 10 principles employed to guide the development and implementation of policies at the EU and Member States level. These principles are essential to contribute added value, ensure equal conditions for SMEs and improve the legal and administrative environment throughout the European Union (European Commission, 2008b).

LITERATURE REVIEW

Research shows that due to the fact that former Eastern bloc economies were operating under the ideology of communism and later went through the EU accession process, a number of similarities may be noticed between them (Czarnecka, 2007).

For this reason, many researchers bring up the subject of functioning conditions of entrepreneurship in these countries. The final shape of the business environment in each country is tied to historical and cultural issues. This situation led to development of solutions which appeared not to be efficient enough in post-socialist countries (Estrin & Mickiewicz, 2012). The strong attachment of post-socialist countries to the past (path dependency) is referred to in Douglass North's theory (North, 1990). Other studies confirm that historical burden in these countries enhances a tendency towards corruption, which is intensified by weak institutions, bureaucracy and inefficient law (Tonoyan, et. al., 2010). Furthermore, there is a lower acceptance for entrepreneurial activities (Manolova, Eunni & Gyoshev, 2008).

Moreover, it is pointed out in literature on the issue of entrepreneurship in countries of the former Eastern bloc that the transition economies have lower rates of entrepreneurship than are observed in other economies (Estrin & Mickiewicz, 2010). Some other studies also confirm this state of affairs (McMillan & Woodruff, 2002; Estrin, Meyer & Bytchkova, 2006; Aidis & Mickiewicz, 2006). There are also significant differences that occur among the countries. The development of entrepreneurship in a given country corresponds to its level of economic development. Innovation-driven economies have higher institutional and individual levels of development than similarly developed efficiency-driven economies (Trumbull & Szerb, 2016). It is important to recognise the reasons for this differentiation.

The literature indicates that a large public sector has a negative impact on the functioning conditions of enterprises, both due to high taxes and high state spending (Henrekson, 2005; Minniti, 2008, Afonso, et. al., 2005, Boix, 2001, Warne, 1997, Van Thiel & Leeuw, 2002). High public debt can lead to limitation of funds available to private entities for financing their spending, i.e. the phenomenon of “crowding out” (Markiewicz & Miłaszewicz, 2006, Benedek, et. al., 2014, Zegarowicz & Wildowicz-Giegiel, 2017, Gaweł, 2004, Rogalska, 2012). On this basis, it was decided to formulate the hypothesis (H1), that a state’s considerable participation in the economy has a negative effect on the functioning conditions of enterprises. However, it is worth noting that simultaneously with a general “crowding out” effect there are some contradictory examples such as Germany and Norway where we can observe high involvement of the public sector in the economy and a relatively low level of public debt.

On the other hand, business support programs carried out by the state have a significant impact on improvement of the functioning conditions and development of enterprises. A positive impact of public programs on the level of employment was noted in Sweden (Norrman & Bager-Sjögren, 2010). The impact of local initiatives, launched by the Enterprise Insight, on the newly formed enterprises and self-employment rates was examined in Great Britain and turned out to be positive (Botham, 2012). The second hypothesis (H2) assumes that business support programs carried out by the State have a positive effect on functioning conditions of enterprises.

METHODOLOGY

As a part of the study an analysis was carried out on small and medium-sized enterprises in countries of the former Eastern bloc which are now members of the European Union. Relying on the literature, 11 countries were selected for a detailed analysis of the functioning conditions of enterprises: Bulgaria, Croatia, Czech Republic, Estonia, Lithuania, Latvia, Poland, Romania, Slovakia, Slovenia, and Hungary. The countries of the former Eastern bloc also include the states of the former Yugoslavia. What is more, it should be taken into consideration that Baltic Countries are former Soviet republics and additionally very small geographical entities. Due to the cultural and political past they have quite different background and

position than e.g. Poland, Hungary, or the Czech Republic. Hence sometimes solutions that are workable in Baltic countries could fail in other economic environments and cannot be implemented in other economies.

The information used in this article comes from the Fact Sheets of individual countries on the degree of implementation of the Programme of the Small Business Act in 2015. The advantages of employing this source are: statistical credibility, completeness of contained data, and high comparability. A significant drawback, on the other hand, are emerging delays in publishing parts of information by certain countries or their total lack.

As a part of the Small Business Act program, different areas concerning the functioning of small and medium-sized enterprises are presented in accordance with its 10 principles. They include:

- 1) Entrepreneurship,
- 2) “Second chance”,
- 3) “Think small first”,
- 4) “Responsive administration”,
- 5) State aid and public procurement,
- 6) Access to finance,
- 7) Single Market,
- 8) Skills and innovation,
- 9) Environment,
- 10) Internationalisation.

Because of the large extent of these analyses, aspects presented in the article focus only on flexibility of administration and availability of financing for SMEs. These areas were selected because of their importance for functioning and formation of business entities.

Due to the fact that the variables proposed to describe the business environment differ significantly it was necessary to standardize them. The zero unitarization method was applied to rank countries. This method is applicable with both quantitative and qualitative variables and its simplicity leads to easy interpretation of results. Moreover, this method fulfils three important criteria:

- 1) After normalisation lengths of intervals of variability for all features are the same.
- 2) The lower and upper limits of intervals of variability for all features are the same: [0,1].
- 3) Features which have a zero value can be also normalised (Kukuła, 2012).

In the case of boosters (their growth causes the growth in the level of analysed phenomena) the distance indicator was used which divides individual countries from

the best result (including the EU average). The following formula of standardization is used then in the form:

$$x_{s,K} = \frac{x_K - x_{Kmin}}{x_{Kmax} - x_{Kmin}}$$

where:

$x_{s,K}$ – value of a normalized variable x for a given country,

x_K – value of a raw variable x for a given country,

x_{Kmin}, x_{Kmax} – value of indicator in the weakest and the best country for a variable x.

In the case of inhibitors (if it increases, the value of analysed phenomena decreases) opposite scaling formula for standardizing was applied. It took the form of:

$$x_{s,K} = 1 - \frac{x_K - x_{Kmin}}{x_{Kmax} - x_{Kmin}}$$

By using this type of standardization data can be compared and aggregated. In addition, the diversification of scaling for boosters and inhibitors allow us to determine the correct direction and strength of an occurring phenomenon.

Data concerning the participation of the state in the economy and business support programs were taken from the Global Entrepreneurship Monitor (Kelley, Singer & Herrington, 2016). Spearman’s rank correlation coefficient which is a nonparametric measure of rank correlation,

was employed to verify the hypotheses (Lieberson, 1964).

RESULTS AND DISCUSSION

The formation of the SME sector and its impact on the functioning of economies proceed differently in individual countries. Its specificity depends on the level of development and socio-political system achieved by a given state. Even if there is a great similarity of operating conditions, the role of small and medium-sized enterprises will be different, and the degree of development will be differentiated (Ignatiuk, 2011).

When analyzing the proportion of the number of small and medium-sized enterprises in the total number of economic entities it must be made clear that it stood at a similar level in selected countries of the European Union (they accounted for more than 99.5% of all companies in all analyzed economies), so the information was not the subject of deeper inquiry. However, presentation of data concerning participation of people employed in the SME sector in relation to the total number of employees in enterprises and share in the added value of the various types of entities should be given more attention (Table 1).

Small and medium-sized enterprises employed from 67% to almost 79% of all company employees in 2015, so this share was significantly different in the countries

Table 1: The share of employed in the micro, small and medium enterprises in the total number of employees in enterprises and share in the added value of individual entities in selected EU countries

Country	Micro		Small		Medium - sized		SME	
	Employed	Value added	Employed	Value added	Employed	Value added	Employed	Value added
Poland	35,80%	15,00%	13,90%	13,90%	18,20%	21,60%	67,80%	50,50%
Bulgaria	30,20%	19,30%	23,80%	20,60%	22,10%	22,10%	76,10%	62,00%
Croatia	30,30%	18,70%	19,10%	17,50%	18,10%	19,00%	67,40%	55,20%
Czech Republic	32,60%	19,20%	18,10%	15,30%	18,90%	21,00%	69,60%	55,50%
Estonia	30,90%	25,20%	24,20%	23,70%	23,00%	26,60%	78,00%	75,60%
Lithuania	26,60%	15,40%	25,70%	24,10%	24,30%	29,20%	76,70%	68,50%
Latvia	29,40%	18,60%	25,70%	23,40%	23,60%	26,90%	78,60%	68,80%
Romania	22,20%	13,50%	23,30%	16,10%	21,70%	20,00%	67,20%	49,60%
Slovakia	39,00%	27,10%	15,80%	17,70%	15,90%	16,50%	70,70%	61,20%
Slovenia	35,10%	21,70%	18,20%	19,10%	19,40%	22,30%	72,70%	63,10%
Hungary	34,60%	18,70%	18,60%	16,10%	16,30%	18,80%	69,90%	53,60%
EU-28	29,20%	21,10%	20,40%	18,20%	17,30%	18,50%	66,90%	57,80%

Source: Author’s own elaboration based on 2015 SBA Fact Sheets

analyzed. The smallest percentage in this respect was noticed in Romania, Poland and Croatia (about 68%). Nonetheless, it should be mentioned that it did not differ significantly from the EU average and even surpassed it. The largest number of employed in the SME sector was in Latvia and also where such companies generated high (higher than the EU average) percentage of added value. This may be due to the almost equal dispersion of employment between the micro, small and medium enterprises. The highest share in the added value area, however, belonged to SMEs operating in Estonia (over 75%). The main asset in favour of such a high level seems to be a large percentage of companies in *the information technology and communication* sector. Moreover, the public sector of this country contributed significantly to the development of innovation.

The lowest added value in relation to SMEs from other countries was created by the sector in Romania. The problems to which attention was drawn primarily were the lack of a national tourism strategy as well as underdeveloped and uncompetitive hotel infrastructure. Low participation in this regard was also presented by small and medium-sized enterprises operating in Poland. It was probably due to a high proportion of people employed in the smallest entities - micro (over 35%), as

well as the sectoral structure of enterprises itself (low share of companies in *the business requiring professional expertise*).

Subsequently, the impact of the SME sector, expressed through the percentage of created jobs and created added value, on the economies of these European Union countries, did not differ significantly from the EU average. It should be noted, however, that the situation in northern countries (Lithuania, Latvia and Estonia) was much better than in other countries. They can therefore be a role model for other economies, such as Poland, where the SME sector's share in generated added value is still quite low.

Responsive administration is an important element evaluated in the framework of the Small Business Act which determines the degree of public sector capacity to respond to the needs of SMEs (Table 2). It should be stressed that in this regard the northern countries like Lithuania, Latvia and Estonia perform the best. The authorities in these countries try to create a friendly business environment. Therefore, different solutions are implemented such as the Latvian single customer service network, which integrates services of seven national institutions, considerably reducing the administrative burden. It may be accordingly assumed that creating

Table 2: Responsive Administration in the selected EU countries (normalized data, marking: BG - Bulgaria, PL - Poland, CZ - Czech Republic, EW - Estonia, H - Hungary, HR - Croatia, LV - Latvia, LT - Lithuania, R - Romania, SK - Slovakia, SLO – Slovenia)

Aspects	PL	BG	CZ	EW	H	HR	LV	LT	R	SK	SLO	UE
Time to start a business	1,00	0,67	0,78	0,72	0,89	0,78	0,89	0,67	0,89	0,00	0,79	0,72
Cost of starting a business	0,70	0,90	0,00	0,54	0,40	0,04	0,91	0,66	0,75	0,40	1,00	0,22
Paid-in-minimum capital	0,77	1,00	1,00	0,66	0,00	0,51	1,00	1,00	0,99	0,64	0,18	0,79
Time required to transfer property	0,71	0,93	0,80	0,86	0,87	0,35	0,86	1,00	0,85	0,87	0,00	0,78
Cost required to transfer property	0,94	0,42	0,20	0,92	0,00	0,00	0,60	0,84	0,70	1,00	0,60	0,11
Number of taxpayments per year	0,14	0,50	1,00	0,93	0,64	0,07	0,93	0,64	0,43	0,00	0,64	0,59
Time it takes to pay taxes	0,45	0,00	0,11	1,00	0,47	0,66	0,70	0,75	0,79	0,66	0,52	0,71
Cost of enforcing contracts	0,67	0,45	0,00	0,55	0,89	0,95	0,49	0,46	0,20	0,15	1,00	0,56
Fast-changing legislation and policies are a problem for doing business	0,34	0,45	0,20	1,00	0,09	0,06	0,38	0,57	0,00	0,08	0,25	0,28
The complexity of administrative procedures is a problem for doing business	0,34	0,01	0,22	1,00	0,22	0,10	0,59	0,66	0,00	0,12	0,10	0,28
SMEs interacting online with public authorities	0,74	0,53	0,83	0,89	0,55	0,81	0,80	1,00	0,00	0,80	0,81	0,66
Licenses and permit systems	0,55	0,08	1,00	0,78	0,53	0,00	0,60	0,27	0,15	0,44	0,01	0,34
Burden of government regulations	0,67	0,57	0,81	0,00	0,81	1,00	0,43	0,62	0,52	0,90	0,86	0,51
Sum	8,02	6,50	6,95	9,83	6,36	5,32	9,17	9,14	6,27	6,06	6,77	6,57

Source: Author's own estimations based on 2015 SBA Fact Sheets

favourable conditions for the development of the SME sector by the public authorities is conducive to subsequent high added value generated by these entities.

It is also worth paying attention to the fact that the indicators calculated for Poland are high as well. We can be proud of the short time necessary for the establishment of an enterprise and low cost of such a process. Problems occur in the tax system, especially in the large number and time spent on making tax payments. Enterprises also have to face high volatility in legal provisions and state policy, as well as the complexity of administrative procedures.

The biggest challenges, however, await the companies that operate in Croatia and Slovakia. The most important issues there are a considerable lack of stability of the law and complicated administrative practices. The high cost of starting a business and time needed for it also seem to be problematic issues.

The analysis of access to financing for SMEs in the selected EU countries was hampered due to the lack of partial data from some of the countries. However, on the basis of the available information, it should be noted that companies operating in Estonia have to struggle with the least problems in this area (Table 3). Problems are only caused by high losses from bad debts. Other aspects such as the total time of getting paid or banks' willingness to lend do not cause significant difficulties to economic entities.

There are also no major impediments to the access to financing for small and medium-sized enterprises in Poland. Nonetheless, the area that needs some repair indeed is the amount of venture capital investment in relation to GDP. It should be highlighted though, that this problem exists in most countries, the only exception being previously mentioned Estonia.

The biggest problems in terms of acquiring capital, are endured by the companies operating in Slovakia. This country has the lowest level of access to public financial support including guarantees, and low willingness of banks to lend. Moreover, the indicator of strength of legal regulations reached the lowest value in relation to the other countries. It is a measure that indicates whether legal provisions protect the rights of lenders and how it affects the ease of access to credit. The higher its value, the easier it is to obtain this form of financing (Zalewska & Zalewski, 2012).

In order to verify the presented hypotheses the Spearman's rank correlation coefficient was calculated between the functioning conditions of enterprises in respect of flexible administration, access to financing and public debt counted in relation to GDP, assessment of state policy in terms of taxes and bureaucracy (carried out by the Global Entrepreneurship Monitor [GEM]), claims on central government in relation to GDP, assessment of state policy in terms of support and relevance (GEM), as

Table 3: Access to financing for SMEs in the selected EU countries (normalized data, marking: BG - Bulgaria, PL - Poland, CZ - Czech Republic, EW - Estonia, H - Hungary, HR - Croatia, LV - Latvia, LT - Lithuania, R - Romania, SK - Slovakia, SLO – Slovenia)

Aspects	PL	BG	CZ	EW	H	HR	LV	LT	R	SK	SLO	UE
Rejected loan applications and unacceptable loan offers	0,64	0,46	1,00	0,87	0,44	0,68	0,27	0,00	0,65	0,70	0,41	0,72
Access to public financial support including guarantees	0,81	0,51	0,91	0,61	0,78	0,54	0,95	1,00	0,79	0,89	0,00	0,57
Willingness of banks to provide a loan	0,86	0,89	1,00	0,76	0,61	0,67	0,73	0,88	0,75	0,81	0,00	0,48
Cost of borrowing for small loans relative to large loans	0,98	1,00	0,40	0,64	0,57	0,39	0,46	0,49	0,73	0,00	0,60	0,44
Total amount of time it takes to get paid	0,51	0,45	0,46	1,00	0,42	0,00	0,64	0,38	0,57	0,39	0,04	0,17
Bad debt loss	0,98	0,84	1,00	0,00	0,96	0,70	0,92	1,00	0,88	0,97	0,88	0,97
Venture capital investments	0,00	0,00	0,00	1,00	0,01	ND	ND	ND	0,00	ND	ND	0,01
Strength of legal rights index	0,57	0,86	0,57	0,57	1,00	0,29	0,86	0,43	1,00	0,57	0,00	0,39
Sum	5,35	5,01	5,34	5,44	4,79	3,27	4,81	4,17	5,36	4,34	1,93	3,75

Description: ND – no data available

Source: Author's own estimations based on 2015 SBA Fact Sheets

Table 4: Spearman’s rank correlation coefficient between examined characteristics.

Features	Responsive administration	Access to finance
Public debt counted in relation to GDP	-0,591	-0,755**
Government policies: taxes and bureaucracy	0,583	0,833**
Claims on central government in relation to GDP	-0,745**	-0,518
Government policies: support and relevance	0,667*	0,200
Government entrepreneurship programs	0,788*	0,520

Source: Own estimations based on Small Business Act Fact Sheets and Global Entrepreneurship Monitor

***Correlation is significant at the 0.01 level*

**Correlation is significant at the 0.05 level*

well as the assessment of government entrepreneurship programs.

Calculated Spearman’s rank correlation coefficients (Table 4) show that the functioning conditions of enterprises are strongly negatively related with the level of public debt expressed in GDP (in relation to GDP) and claims on central government to GDP. They are however strongly positively correlated with the appropriate state policy on taxes and bureaucracy. This confirms the first hypothesis assuming that considerable state participation in the economy has a negative effect on the functioning conditions of enterprises.

State policy in the field of support and relevance, as well as government business support programs, are strongly positively correlated with functioning conditions of enterprises, which confirms the second hypothesis.

CONCLUSIONS AND RECOMMENDATIONS

There is a significant difference in the conditions under which businesses in the selected EU countries operate. The cause of this situation is a different level of state participation in individual economies, as well as the different effectiveness of business support programs. An example of a state which to a large extent supports the

development of entrepreneurship and creates conditions for a suitable business environment can be Estonia. Lithuania and Latvia stand out as well in comparison to the other economies. Poland came out quite average however. Hence it first should be recommended for Poland that for all groups of stakeholders it is crucial to observe best practices implemented in neighbouring countries which are supportive of entrepreneurship development. Next should be considered the likelihood of successful implementation (instillation) of business condition that are specific for Poland’s economy. This is an easier way to boost and get momentum for the sufficient development of Polish business entities.

On the other hand, in order to improve the functioning conditions of enterprises, the government must introduce business support programs. It has to be stressed however, that an increase in taxes cannot be the source of their funding because it is related to the limitation of income in the private sector. It is crucial to maintain public spending at an appropriate level so as not to trigger a budget deficit, which would lead to an increase in the public debt for it negatively affects the business environment. It is therefore important to keep a proper balance between the state’s participation in the economy, expressed in public debt, the amount of taxes, bureaucracy and government business support programs.

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