

*INDUSTRIAL
ORGANISATION
AND
ENTREPRENEURSHIP
IN TRANSITION*

*Edited by
Mitko Dimitrov
Kiril Todorov*

Industrial Organisation and Entrepreneurship in Transition



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VARNA - ALBENA, BULGARIA, JUNE 5-8, 1995

Edited by

Mitko Dimitrov

Kiril Todorov

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Kiril Todorov

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Conference Team: Milen Baltov, Diana Dimitrova, Mitko Dimitrov, Dontcho Hadjiev, Angel Jeliazkov, Krasimir Ionov, Kostadin Kolarov, Zaharina Ninova, Evgeni Peev, Ani Petrova, Svetlana Prodanova, Radoslav Rachnev, Dimitrina Todorova, Kiril Todorov

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Introduction

This book is an outcome of an International Conference “Industrial Organisation and Entrepreneurship in Transition” held in Albena, Bulgaria, on 5 - 8 June 1995. The Conference was organised by the Institute of Economics at the Bulgarian Academy of Sciences and the University of National and World Economy, Sofia, with the financial support of the European Community ACE Programme. There were 45 representatives of 17 countries from West and East Europe.

During the last two or three years scholars from the developed industrial countries as well as from the Central and East European countries (CEEC) have shown considerable interest in the problems of industrial policy, business organisation, entrepreneurship and small business development. A number of national and international projects have been carried out or are currently in process treating different aspects of those problems in one or several economies in transition. At that point, the meeting of leading researchers, teachers and consultants in the sphere of the industrial organisation and entrepreneurship during the Conference was an ideal opportunity for discussions, exchange of ideas and practices and the opportunity of developing further the mutual collaboration.

Undoubtedly, the solution of the problems, concerning industrial organisation and entrepreneurship, is of crucial importance to a successful transition from central-planned to market economy carried out at present by the East European countries. The uniqueness of this transition - without an analogue in the human history and the originality of the solutions, which should be taken in the above mentioned spheres on one hand increases the interest of West and Eastern European researchers and practitioners but on the other hand puts extremely big challenges as a theory and practice.

The key moment in the Conference was finding the balance between the general and the specific for the particular countries and the opportunity for a transfer of “know - how” in the mentioned problems and from the developed industrial countries to the Eastern European countries, as well as enriching the existing theory and practice on the base of the practice of East European countries. In this context contributed the structure and the level of the participants in the Conference - delegates of European Union, Central and Eastern Europe as well as Russia and Belarus, representing universities, research bodies and other institutions.

Valuable ideas were exchanged concerning the behaviour of the enterprises in the transition and the strategies of their managers in the unique process of the transition. Different managerial strategies for restructuring and privatising of the enterprises were revealed: passive adaptation, adaptation to managerial expectations for state control, successful adapting without managerial initiatives for privatisation, active adapting and managerial initiatives for privatisation, shock adapting and managerial initiatives for privatisation.

Important accent was put also to the motivation of the human factor for change - starting with the top manager and ending with the common worker. This is so because, while the formal “know-how” as approaches and methods in the strategic management, the organisational structures, marketing, finances etc., is comparatively easily introduced and applied, in a completely different way is put the question for the change of human values, intentions and expectations, revealed by the organisational culture. In this context very interesting suggestions were made how to accomplish in practice the changes in the human factor, what eventually (and how much) could be borrowed from the other (Western) countries, but reading the concrete requirement of the transition and the specification of the relevant country.

Many different reports and discussions analysed the problems of the entrepreneurship as a motor of the changes in the ownership and the economies of Eastern European countries. Especially important result here was the analyses of the necessity and the opportunities for regulating the small business and the entrepreneurial activity on national, branch and region levels in the East European countries. That is so because, with little exceptions, for now the small business and the entrepreneurship in Eastern Europe develops extremely on the account of the motivation of the human factor, without having the relevant legal, tax, branch, technologic, export etc. facilitations and preferences. In this sense, the practice of the developed industrial countries and in the first place smaller West European countries was estimated as extremely useful, on condition that the local specification is read, more significant difficulties were diagnosed in the practice for the transfer of entrepreneurial “know-how” from West to East because of the strong influence of the subjective factor in this transfer (entrepreneurs), the different cultural-psychological adjustment and the little experience and traditions in the field of entrepreneurship. Interesting were the discussions concerning so called “intrapreneurship” in the big state enterprises. An agreement between the participants was achieved that because of the domination of the big state enterprises (including in the near future) in the economies of the East European countries, the stimulation of the inner entrepreneurship and the development of the proper methods, techniques in it is critically important for the dynamisation and modernisation of the East European economies.

The revealed papers and carried discussions during the Conference (some of them continued in more informal situation) allowed to form important conclusions which can be a base of the solving ones from the authorised institutions in the East European countries. Among them could be mentioned:

- * establishing of national, branch and regional strategies concerning the effective restructuring, recovering and privatisation of the big state enterprises (so called “mastodons”) on the base of consensus among the moving forces of the society;

- * establishing conditions for secondary concentration of the ownership of the enterprises after the primary privatisation by relevant legal base and infrastructure;
- * establishing of a clear legal frame for regulation and support development of the small and middle business, including tax alleviation, providing of technologic and entrepreneurial “know-how”, financing and crediting in alleviated conditions as well as consulting help;
- * stimulating the entrepreneurship and intrapreneurship by proper education, teaching and qualification (especially of the unemployed persons with high potential and developed sense of social responsibility);
- * supporting the SMEs for internationalisation of the their activity by using of different strategies and forms-export, licensing, franchising, participation in joint ventures

Mitko Dimitrov

Kiril Todorov

List of authors

- Bakardjieva, Radostina, Ph.D., research fellow, Institute of Economics of the Bulgarian Academy of Sciences, Sofia, Bulgaria
- Baltov, Milen, doctoral student, University of National and World Economy, Department of Industrial Business and Entrepreneurship, Sofia, Bulgaria
- Belousova, Ljudmila, Head of Department of Structural Reorganisation, Reformation of the State Property and Anti-monopoly Policy, Ministry of Industry, Minsk, Republic of Belarus
- Biesbrouck, Wouter, Katholieke Universiteit Leuven, The Leuven Institute for Central and East European Studies, Leuven, Belgium
- Bilsen, Valentin, Katholieke Universiteit Leuven, The Leuven Institute for Central and East European Studies, Leuven, Belgium
- Brennan, Michael, NISBI - The Small Business Institute, University of Ulster at Jordanstown, Northern Ireland, United Kingdom
- da Silva, Jose Amado, Universidade Catolica Portuguesa, CEA - Centro de Estudos Aplicados, Portugal
- Damyantov, Atanas, Ph.D., associate professor, Chancellor, Dimitar Tsenov Economic Institute - Svishtov, Bulgaria
- Delcheva, Evgenia, Ph.D., associate professor, University of National and World Economy, Department of Social and Cultural Management, Bulgaria
- Dimitrov, Mitko, Ph.D., senior research fellow, Bulgarian Academy of Sciences, Institute of Economics, Bulgaria
- Dziwota, Janusz, University of Lodz, Faculty of Management, Department of Entrepreneurship and Industrial Policy, Lodz, Poland
- Gadeshi, Ilir, Tirana University, Albania
- Glas, Miroslav, professor, University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia
- Golygowski, Janusz, LL.M., President, Chamber for International Economic and Scientific Cooperation, Lodz, Poland
- Hristov, Dimitar, Hiron Management Consulting Ltd, Bulgaria
- Ivanov, Alexander, Ph.D., Head of Laboratory, International Research Institute for Management Sciences, Moscow, Russia
- Jones-Evans, Dr. Dylan, University College Dublin, The Michael Smurfit Graduate School of Business, Blackrock, Co Dublin, Ireland

Jurickova, Vilma, Institute of Economics of the Slovak Academy of Sciences, Bratislava, Slovakia

Kizevitch, Tatjana, Head of Legal Department, Ministry of Industry, Minsk, Republic of Belarus

Koparanova, Malinka, Ph.D., research fellow, Bulgarian Academy of Sciences, Institute of Economics, Bulgaria

Krasilnikov, Sergei, D.Sc. (Econ.), Head of Department, International Research Institute for Management Sciences, Moscow, Russia

Lloyd-Reason, Lester, senior lecturer in business studies, Anglia Polytechnic University, Anglia Business School, Department of European Business Economics, Cambridge, United Kingdom

Mara, Hecuran, Academician, professor, Tirana University, Tirana, Albania

Marinova, Milena, Effective Management Foundation, Sofia, Bulgaria

Nicolescu, Ovidiu, professor, Ph.D., MANAGER International Management and Marketing Institute, Bucharest, Romania

Nikolov, Nikola, associate professor, Ph.D., Head of Department, University of National and World Economy, Department of Industrial Business and Entrepreneurship, Bulgaria

Peev, Evgeni, research fellow, Institute of Economics of the Bulgarian Academy of Sciences, Sofia, Bulgaria

Petrik, Borislav, Institute of Economics of the Slovak Academy of Sciences, Bratislava, Slovakia

Richet, Xavier, professor, University Rennes II & ROSES CNRS, Paris, France

Slowinski, Ryszard, University of Lodz, Faculty of Management, Department of Marketing, Lodz, Poland

Smailbone, David, Middlesex University, Centre for Enterprise and Economic Development Research, Enfield, Middlesex, United Kingdom

Tchipev, Plamen, Ph.D., research fellow, Institute of Economics of the Bulgarian Academy of Sciences, Sofia, Bulgaria

Todorov, Kiril, Ph.D., associate professor, University of National and World Economy, Department of Industrial Business and Entrepreneurship, Sofia, Bulgaria

Tust, Pawel, University of Lodz, Faculty of Management, Department of Marketing, Lodz, Poland

Tzvetkov, Tzanyo, Ph.D., Director, Institute for Mechanical Engineering Development, Sofia, Bulgaria

van der Horst, Rob, Manager EIM International, EIM Small Business Research and Consultancy, Zcetermeer, The Netherlands

Venesaar, Urve, Institute of Economics of the Estonian Academy of Sciences, Department of Economic Development, Estonia

Webb, Trevor J., Buckinghamshire College, The Business School, Chalfont St. Giles, Buckinghamshire, United Kingdom

Welter, Dr. Friederike, Rheinisch-Westfälisches Institut für Wirtschaftsforschung - RWI, Research Group "Small and Medium- sized Enterprises, Essen, Germany

Zaman, Dr. Gheorghe, professor, Director, Institut National de Recherches Scientifiques/ Institute of National Economy, Bucharest, Romania

Opening Plenary Sessions

Supporting SMEs Development in Economies in Transition: A View from the West

DAVID SMALLBONE

1. Introduction

This paper aims to contribute to the development of a policy agenda to support the contribution of SMEs to the process of economic transformation and development in economies in transition. Although the nature and extent of the social and economic change taking place in countries like Bulgaria presents many new challenges, it can be argued that the recent experience of West European countries with respect to SME development is potentially relevant in the context of the transformation of Central and East European economies. This is particularly the case if we take into account the substantial restructuring that has been taking place in western Europe which has resulted in a significant change in the contribution of SMEs in many countries and the development of policies designed to support this trend. The UK is a good illustration of this. Since the late 1970s, the UK has moved from having one of the lowest rates of new business formation in the OECD countries to a situation in 1989 where the number of new business start-ups as a percentage of the active labour force was higher than those of most other EU partners: 1.59% compared with 0.97% for the EU as a whole (Van der Horst, 1992).

However, in attempting to draw on the western European experience in this field two key points should be kept in mind. Firstly it is important to look critically at the western experience in the field of SME policy because it is a mistake to think that we have necessarily "got it right". This is where an academic perspective is important alongside that of the practitioner or consultant in order to try to present an independent and objective view. With this in mind it is just as important to learn from unsuccessful policy experiences as well as from successes. Although politicians are often be slow to admit it, we can learn lessons from policies that have been tried and failed as well as from those that appear to have been successful. Secondly in any discussion of possible policy transfer, it is important to recognise the nature and extent of any economic, social, political and institutional differences that may affect the impact a given policy has, and its chances of being successful. With these qualifications in mind, the paper will examine the recent experience of western Europe to try to draw out some of the lessons and issues concerning the contribution of SMEs to economic development and the types of policy that may help to maximise this.

Although the focus of this paper is on drawing on the Western European experience, comparisons with the development of the SME sector in less developed countries (LDCs) are also

relevant. Brunner (1993) for example, has suggested: "that Eastern Europe is faced with the very issues which the South faced thirty years ago and still faces". These include how to diversify the size structure of the economy; how to open up channels of technology transfer to small companies; how to narrow the productivity gap with western industrialised economies; and how to close the productivity and technology gap between the large informal small firm sector and the government supported large-scale industry sector of the economy. Interestingly however, the thrust of the policy lessons which Brunner draws from the experience of the LDCs is not significantly different from the lessons that can be drawn from the experience of some West European countries.

2. How can government influence the nature and pace of SME development?

Before considering the case for policies that are specifically aimed at assisting SME development (i.e. measures which governments introduce to assist small firms directly), it is important to recognise that government policy can affect the development of the SME sector in a number of ways:

*** through macro-economic policy which affects the economic climate for all business (including SMEs)**

Although macro-economic policy is not normally highly sensitive to the effects on smaller businesses, SME managers frequently see matters such as the level of aggregate demand (including the effect of changes in the level of public expenditure), interest rates and taxation as the key factors which influence the development of their business, and typically more important than government measures which are aimed specifically at small firms. The UK experience suggests that stability in macroeconomic management is a key requirement for SMEs since a stable external environment makes it easier for firms to plan, especially with respect to the timing of investment, expansion and taking on new initiatives. Thus from a policy perspective, it is important that the impact of macro-economic management policy on smaller businesses is recognised.

*** through the differential impact of government legislation on firms of different sizes**

This refers to the fact that "policies which are wholly neutral in intention and in administration may be far from neutral in their effects because of the different circumstances of large and small firms" (Bolton Committee, 1971). Two broad types of cost which government places on business may be identified: firstly those direct costs which fall on firms such as the costs of employers social security contributions or other taxes; secondly, the compliance costs of meeting particular legislative requirements (Bannock & Peacock, 1989). Compliance costs result from the time needed to understand the legal requirements of legislation, to deal with the necessary paperwork and to train and pay staff to carry out any additional work. For example, recent research undertaken at Middlesex University has demonstrated the negative effects of changes in the regulatory regime associated with the Single European Market programme on SMEs in the food sector in the UK and Portugal: 73% of firms surveyed

had been affected by some change in technical standards and regulations which in the majority of cases resulted in additional costs (Smallbone et al, 1994).

One issue that appears particularly relevant in an east European context, is that government regulations are one of the main factors encouraging entrepreneurs to move into the informal sector or shadow economy. Whilst a growth in the latter may be viewed as a policy problem to be reduced through stronger policing and controls, it may also be viewed positively as a potential source of entrepreneurship. However, in such circumstances, *the level of regulations imposed on small firms may need to be examined to ensure that it is compatible with the encouragement of enterprise in the formal economy and not placing too many burdens on emergent entrepreneurs.*

Whilst deregulation and legislative exemptions may be popular with small business owners and their lobby groups, and may be justified by politicians as contributing to the development of an environment in which enterprise can thrive, there are inevitable conflicts with other areas of policy (such as social policy) which do need to be recognised. David Storey has argued recently that the net welfare benefits of such deregulation remain unproved (Storey, 1994). It can also be argued that there are economic dangers in going too far down the deregulation route in terms of the type of strategies it can encourage SME managers to adopt. Nevertheless, in some Central and East European countries at the present time, competition from the informal sector is forcing other private firms to react by using similar methods (such as withholding sales data and artificially increasing overhead costs to reduce their tax liability) to firms outside the formal economy. Unless the cumulative tax and regulation burden on formal businesses is relaxed, and tax laws implemented across the entire economy, the legitimate private sector will increasingly resemble the grey market under the days of socialism (Arendarski et al 1994).

- **through influencing the value placed on enterprise and entrepreneurship within society**

Whilst it is difficult to disagree with Curran (1991) about the elusive nature of the notion of 'enterprise culture, it is clear that differences do exist between (western) countries and regions in the tradition and value placed on enterprise which may be revealed in the level of new firm formation (Mason, 1991). However, whilst governments (such as the Conservative Government in Britain in the 1980s) often claim to influence enterprise values through the promotion of schemes to encourage individuals to engage in entrepreneurial activity and through initiatives designed to encourage enterprise in schools and educational institutions, their ability to influence such values should not be exaggerated, at least in the short term. As the considerable regional variations in new business start-up within countries demonstrate, government is only one of the factors influencing the value placed on enterprise. Despite this, *governments in the CEC clearly do have a potential role in helping to shape cultural attitudes towards risk, private property and business ownership although such changes are likely to be long term rather than immediate in their impact.*

* through recognising and incorporating an SME dimension into industrial policy

This involves developing a programme of policy support which discriminates in favour of SMEs on the basis of their size. You may ask how such intervention is justified in western countries when the contribution of SMEs has been growing and they are claimed to be more flexible and more likely to create jobs than larger firms. If this is the case, why do they need policy support? How can intervention which discriminates in favour of firms in a particular size group be justified within the context of a market-based system? These are key questions that are considered in the following sections of the paper.

3. Why support SMEs?

The first step in a rational approach to the development of any policy is to clarify what the objectives of the policy are. Clear policy objectives are necessary if subsequent evaluation is to assess whether or not the policy is being successful and also its cost effectiveness. In this respect it may surprise some of you to hear that in the EU countries in general, explicit statements of the objectives of SME policy have (until recently) been noticeable by their absence. As a consequence, the approach in practice has tended to be pragmatic and it is often necessary to infer the objectives of policy from the actions of policy makers. Thus although a recent study of SME policy in EU member states was able to identify four main objectives that appear to drive policy at the national level: to increase competition; to strengthen the production chain; to diversify the economy; to create employment and reduce unemployment; only the latter is identified as an explicit objective and then only in a minority of countries (De Koning & Snijders, 1992). As David Storey has stressed, one of the consequences of a lack of clarity of objectives is that the development of policy is frequently very piecemeal, responding to pressure from small business lobby groups, short term fluctuations in macroeconomic conditions and political expediency (Storey, 1994). The result in Britain is that a highly complex set of measures has evolved, with frequent changes in detail; this makes them difficult to understand from the small business viewpoint thus limiting their impact. Thus *an important lesson is the need to clarify what the objectives of SME policy are and on what basis policy intervention can be justified.*

A rational approach to policy development would seem to be to:

- (i) Identify the reasons why SMEs may justify policies aimed to encourage and support them. From this it should be possible to establish a clear set of objectives for such policies.
- (ii) Identify the types of policy and programmes needed to implement these objectives. This involves clarifying the size characteristics and constraints which SMEs need help in overcoming.
- (iii) Identify the most effective delivery mechanisms for that policy in which the respective roles of the public and private sectors is clearly defined.

However, it must also be recognised that there may be social or political arguments to support such policy intervention and not just an economic rationale. Examples include the political

need to support a sector that appears to be creating jobs and/or an ideological commitment to individualism, self-help and enterprise. Indeed in the context of the economies in transition, the comprehensive nature of the social, economic and political transformation that is taking place make such factors impossible to ignore. This may be particularly important in the early stages of the process of transformation as Piasecki has pointed out:

"At an early stage of transformation, the development of the SME sector promoted in this way becomes one of the most effective instruments in the reorientation of social awareness without liberating social awareness, the emergence of the private sector and a market economy are impossible" (Piasecki, 1995)

In terms of economic or industrial policy, the main rationale for intervention to support SME development is based on the view that whilst small units of organisation offer some potential economic advantages (e.g. flexibility), their ability to achieve their potential may be impaired by certain size-related disadvantages (typically associated with their limited resource base and certain qualitative differences in their relationships with their external environment in comparison with larger firms). Economists frequently justify intervention in a market economy where there is evidence of market failure or market imperfections. This is the rationale which is currently used to guide small firms policy in the UK although such an emphasis has only really emerged in the 1990s:

"in any market economy, the primary responsibility for improving competitiveness lies with business itself. Markets, however, do not always work efficiently and whilst market failure may affect all firms, small firms face particular problems. Larger firms, for example, often benefit from economies of scale"

(UK Employment Department, 1994)

In other words, firms may experience size-related disadvantages in their relations with their markets (factor markets as well as product markets). For example, if it can be demonstrated that size related factors affect a firm's access to financial markets, an intervention may be justified which is designed to address that market failure. One example is a loan guarantee scheme (such as that introduced in the UK in 1981 or in Germany in the 1950s). These schemes are designed to assist small firms which have viable business proposals but which have been unable to secure a conventional loan because of a lack of collateral. By guaranteeing a substantial part of the loan, the government is intervening in the market for small business finance by carrying some of the risk.

However, for a liberal economist a demonstration of market failure is a necessary but not a sufficient condition for government intervention; welfare improvements must also be demonstrated after taking account of the bureaucratic costs of intervention. Clearly, the main welfare case for small firms policy is based on the argument that SMEs can contribute to economic development in various ways although an additional welfare benefit may be said to accrue from the creation of a self employed or entrepreneurial class as a source of social and political stability.

4. The role of SME in economic development and the implications for policy

In this section of the paper, the aim is to examine how policy intervention to encourage and support SMEs may be justified, identifying the potential roles that SMEs can play in the

economy and considering the implications for policy in each case. This is presented as a *rational* framework which can be used to guide the development of SME policy based on western experience.

The Contribution to Employment Generation

Ever since the publication of the Birch Report (Birch, 1979), it is the contribution of SMEs to employment generation which has been the main focus of attention of western policy makers. More recent work undertaken in the USA has shown that over the 1976-88 period, firms with less than 20 employees provided 37% of the net employment creation at a time when they provided 19% of total employment (US Small Business Administration, 1992). However, whilst few would disagree that small firms have been creating jobs at a faster rate than larger firms, the *nature* of their contribution has been the subject of more debate. One issue concerns *the number of SMEs which are employment generators* which is potentially important for policy makers since it raises the question of the extent to which there is a case for targeting those firms which have job generating potential and if so, how this can be achieved (Storey & Johnson, 1987). Some research evidence suggests that overall job growth in the small business sector is due to increased employment in a large number of firms (Daly et al, 1991) whilst other research suggests that relatively few SMEs actually create employment on a significant scale (Storey et al 1987). Another issue concerns *the type of jobs which are created in small firms*. In the past, some development organisations in Britain were reluctant to support small businesses because they considered that the jobs provided were of a poorer quality than those in larger companies. However, the research evidence to support this is not conclusive and the sectoral dimension is an important factor to consider in this respect and not just firm size.

There has also been debate about the extent to which the increase in employment in small firms represent *additional jobs for the economy or simply a transfer of jobs from large to small firms*. It has been argued that large firm fragmentation and externalisation strategies, have contributed to increased opportunities for small firms as subcontractors, franchisees or as suppliers of services which were previously provided in-house (Shutt & Whittington, 1987). Whilst this may contribute to increased business opportunities and employment in small firms, it is at the expense of a reduction in the number of jobs in the contracting organisations. Although there has undoubtedly been a shift towards more fragmented modes of production through the 1980s and 1990s in western industrialised countries, empirical evidence to support the "employment transfer" hypothesis is not conclusive (Keeble, 1990). Moreover, even if a transfer of employment is taking place, it can be argued that competitive economies increasingly need to be organised in ways which are different to those in the past, and a change in the nature of relationships between large and small firms may be a necessary condition if competitiveness is to be maintained. In short, a long term, dynamic view of the restructuring issue and of the role of SMEs within it, needs to be taken rather than simply a short-term one. In an eastern European context, it would appear that this argument takes on an additional dimension since SMEs have a particular role to play in the process of fragmentation which is implicit in the privatisation of state owned industries. In many cases, this may involve contributing to bringing privatised assets into productive use as an alternative to, or following their liquidation. In such cases, it can be argued that this represents a means by which resources which would otherwise lie dormant can be brought into production, and so increase output at marginal opportunity cost.

As in western economies which have experienced severe restructuring during the last 20 years, policies which are focused on supporting new business start-ups may help to reduce

unemployment in the economies in transition. However, the experience in the West is that in many cases the businesses developed with assistance from programmes aimed at the unemployed (such as the Enterprise Allowance Scheme in the UK), are typically in low entry threshold, low value added service activities rather than in sectors that may be seen as part of the motor of the economy. Nevertheless, in a CEC context the development of such activities can contribute to the diversification of the economic structure by contributing to the development of service activity, as well as to employment generation. However, such programmes do represent a good illustration of the need to clarify policy objectives and to prioritise them. *Policies to encourage new business start-up may help to reduce unemployment but from an economic development perspective, employment creation should be seen as a result of business growth rather than a prime policy objective not least because of the risk that job creation in the short-term may be at the expense of longer term competitiveness.* Brunner comes to a similar conclusion from his attempt to draw lessons from the LDCs for East European countries:

"governments should not institute expensive financial schemes for SMEs in the name of employment creation the employment effect may rather result from an overall effort of industrial and educational policies to increase productivity as a whole" (Brunner, 1993).

This can be supported with evidence from our own longitudinal study of the development of a group of manufacturing SMEs over 10 years which showed that jobs were created in those SMEs that were able to sustain sales growth over an extended period of time and were particularly concentrated in the best performing companies. Moreover, these 'high growth' firms were able to increase productivity at the same time as they were increasing employment which means that job generation was compatible with the development of increasingly competitive businesses in these cases (Smallbone et al, 1993).

The Contribution as a Source of Innovation

Innovation is important to local, regional, and national economies since it represents an opportunity to gain a competitive advantage which is potentially more sustainable than that based mainly on price (Porter, 1990). SMEs are often said to be a source of innovation at an aggregate level, on the basis that they are more flexible, more dynamic, and more sensitive to shifts in demand than larger firms. However, this is an area where even within the more developed economies, the variations between individual firms is enormous. On the one hand, the most dynamic high technology businesses may perform a role as a motor which is driving the regional economy, as in the case of Cambridge (UK) or Boston (USA) (Storey & Johnson, 1987). On the other hand, there are many conservatively managed, traditional manufacturing SMEs operating in niches relatively untouched by technological change where innovation is not an issue for managers.

This variety has led some authors to attempt to classify the various roles that small firms play in relation to innovative activities. Rizzoni (1991) for example, has produced a six-fold classification ranging from the "traditional" small firms on the one hand, to the "new technology-based" firms on the other, although the sectoral dimension is very important in this respect. Many of Rizzoni's "traditional" small firms are likely to be operating in craft-based sectors (such as clothing or furniture); others may be in sectors where technological change is more important (e.g. printing) although SMEs tend to be "imitators" rather than "innovation leaders" in these cases. At the same time in sectors which are much more technology driven, there are "technology-based" and new technology-based" SMEs which are often in the forefront of innovative activity. This is because as technology has become more complex, a degree of

fragmentation into individual fields of application has sometimes allowed SMEs to become leaders in specific fields.

However, it is important to recognise that from the point of view of maintaining competitiveness technological innovation may be only one of the factors involved; in other words, innovation is a broader concept than just technological innovation. Michael Porter refers to a hierarchy of sources of competitive advantage based on their sustainability. Whereas lower order advantages such as low labour costs or cheap materials are often readily duplicated by competitors, higher order advantages are less easily reproduced; examples include product differentiation based on unique products or services and types of customer relationships which are protected by the high costs for customers of switching vendors (Porter, 1990). These are the types of competitive advantage which SMEs are well equipped to develop in that they offer scope for firms to use the flexibility which their small scale offers, to their own and their customers advantage.

Since the number of firms which are likely to be truly innovative in a technological sense is fairly small, this emphasis on the broader concept of innovation is a more important issue for the majority of SMEs than one which is more narrowly based on technology alone. Creative and "innovative" management of the product portfolio (focused on the development of new products or services), linked to a strategy of differentiating one's firm from one's competitors and supported by attempts to increase productivity, would seem to offer a means of combining successful business development with sustainable economic growth. In the East European context, the message is that competitive advantage based on lower domestic costs or temporary price advantages is not sufficient for sustained long term growth. At best, it provide the basis for market entry and an opportunity to earn resources that must immediately be invested into upgrading the firms' assets, and thus the economy's asset base also.

From a policy perspective, this emphasises the importance of policies designed to support innovation at different levels:

- (i) Targeted support for the new technology based firms. Whilst this will almost certainly need to include finance, it has been argued that policy support needs to go beyond simply an attempt to fill gaps in the market for finance if the contribution of technology based firms to economic development is to be maximised. Oakey has argued for more proactive assistance to these firms throughout the innovation cycle, that is from the original product and development programme through production to the marketing of the final product (Oakey, 1991). In addition, such firms are frequently in need of external business advice since they are often owned and managed by individuals with stronger technical than business skills.
- (ii) Policies to support the upgrading of technological capability in more traditional sectors. Even in the more advanced industrial countries, such new technology based firms are likely to only represent a relatively small percentage of the total economic base. Thus another important policy priority is to aim for an upgrading of the productive capacity of SMEs across a broader range of sectors. From a CEC perspective, the point to stress is firstly that the technology component to industrial policy should not be confined to high technology sectors; and secondly that there may be firm size related characteristics impeding the process of technology upgrading associated

with the more limited resource base of SME (particularly in terms of finance and management) in comparison with larger companies.

(iii) Policies to support the upgrading of firms in a number of respects. Recognising that the competitiveness of any economy depends on the competitiveness of its businesses, policy to support innovation needs to stress the broader aim of seeking sustainable competitive advantages across a wider range of sectors. This places an emphasis on upgrading businesses in a number of respects such as management skills, marketing, workforce skills as well as production technology.

The Contribution as an Integral Part a Wider Economic Structure

Another way in which SMEs can contribute to economic development is through their contribution to the development of a diversified economic structure. As mentioned earlier, this can involve the development of new activities, in consumer services for example. It can also involve a complementarity with other businesses via supplier and customer relationships. *One role that SMEs can play is as suppliers to larger companies thus contributing to the external competitiveness of these firms.* Many small firms act as specialist suppliers to large companies of parts, sub-assemblies, components or (increasingly) services which are often produced at a lower cost than the large companies could achieve in-house. In this respect, small firms provide an important part of the infrastructure on which the competitiveness of an economy depends. The presence of a small firm supplier base can be an important factor in attracting internationally mobile branch plants of large firms in some sectors (Langley 1993) although to fulfil this function, SMEs typically need to achieve very demanding quality standards to meet the requirements of large firm customers. To achieve this, SMEs will almost certainly require tangible help (e.g. finance, training) to assist them in upgrading their production and human resource base to meet these requirements. The point is illustrated with reference to the Polish shipyards where many traditional local subcontracting firms are reported to have lost orders from the yards because their products fail to meet the demanding specifications of new western customers (The Guardian 1995).

It should also be noted that *in some parts of Europe, SMEs play more of a leading role in regional economic structures through various forms of inter-firm co-operation.* In regions such as Emilia Romagna for example, regional competitiveness is based on the interdependence between SMEs rather than on the strategies and actions of individual firms or a dependence on larger firms (Pyke, 1992). Whilst it may be argued that the social conditions within which such integrated production systems develop are highly specific, the potential advantages of cooperation between SMEs in terms of external economies of scale, make such regions of considerable policy interest in western Europe and maybe in the future in the East also.

The Contribution as a "Seed-Bed" from which Large Companies can Grow

One of the arguments which has been used to support a SME policy is that small firms represent a means of entry for new entrepreneurs and the seed-bed from which larger companies can grow. However, empirical evidence drawn from longitudinal studies of new business start-ups demonstrate that only a very small minority of new firms actually grow into larger companies. For example, one such study has shown that the probability of a new firm having 100 or more employees within 10 years after start-up is between 0.5% and 0.75% (Storey et al, 1987). This results from the fact that around 40% of new firms fail within 3 years after start-up and the vast majority of firms that do survive remain small, often because they do

not aspire to expand the size of their business. Nevertheless whilst they may only represent a minority of all SMEs, "high-flying" small firms are of more significance to the economy than their low numbers suggest since a few highly successful firms can act as flagships, demonstrators, incubators or motors to a regional or national economy. One possible conclusion is that an economy needs to maintain a high level of new business formation in order to maximise the chances of such "high flying" businesses emerging, though the quality of start-ups is as important as numbers in this respect.

5. Differences between the CEC and Western Europe which may affect the priorities for SME policy

In attempting to draw useful lessons from the western experience of SME development which can be used to support the development of SME policy in the CEC, we must also recognise the differences that exist between the economic and policy environments which may have implications for policy priorities. Whilst this is not claimed to be an exclusive list, a number of key differences are identified below that are potentially important in affecting policy priorities in this field:

(i) **The need for a social as well as an economic transformation**

Transforming a centrally planned, socialist society into a liberal, democratic, market based system involves fundamental social as well as economic change which means that the policies to support SME development in Eastern Europe cannot solely be assessed in economic terms. The creation of an entrepreneurial class is part of that process and may also be linked to the process of privatisation and/or the restitution of property. Although the extent of the transformation process which is required in the CEC is clearly extreme, it is worth pointing out that small firms have attracted policy support from government in some western European countries for ideological as well as for economic reasons. Examples include the UK in the 1980s or West Germany in the 1950s where small firms were seen to play a key role in the development of the social market economy, both economically and socially.

(ii) **The scale of the task presented by the transformation process has meant that developing SMEs has not been seen to be the first priority**

The first priority in the economies in transition has typically been macro-economic stabilisation programmes followed by the restructuring of the large state-owned companies and banking reforms. In Poland for example, whilst the establishment of small private firms was made possible by the removal of legal and bureaucratic restrictions, government policy has tended to be "laissez-faire" rather than proactive towards SMEs. Whilst such an approach may be understandable (and possibly justified) in the short term, it will need to change if the potential role of SMEs in economic development is to be fulfilled. Governments need to recognise the variety of ways in which policy may impact on small firms whilst at the same time taking steps to actively promote SME development for a combination of economic and social reasons.

(iii) **The lack of a recent entrepreneurial tradition which affects the current need for raising rates of new business start up**

The ability of SMEs to make a significant contribution to job generation and economic development in many Central and East European countries is dependent on raising start-up

rates although differences between East European countries also need to be recognised in this respect. Thus *although there may be a strong case for targeting support towards particular types of SME, strategies aimed at raising new firm formation rates remain a high priority in many countries*. Nevertheless, there are clear dangers in viewing the rate of new business start up as an end in itself. High rates of new firm formation may be associated with high failure rates which result from a combination of hostile external conditions (e.g. the inadequacies of the banking system) and the characteristics of entrepreneurs (such as a lack of even the most rudimentary business skills). Whilst some may argue that the market will determine the 'winners' and 'losers', there would appear to be particular dangers in an East European context of attempting to maximise new firm formation rates unless failure rates can be reduced. For example, evidence from Poland shows that the removal of legal barriers to market entry in 1989 contributed to what has been called "an explosion of entrepreneurship" (Piasecki & Rogut, 1993) although this has been followed by a decline in birth rates (at least in the formal economy) which have been affected by high failure rates among new firms.

(iv) **The lack of an established business infrastructure to provide support services for SMEs**

In western economies the priorities in this area are to improve the quality of the services offered by the various providers whilst attempting to break down the resistance of many SME owners to look outside their business for advice and expertise when appropriate. In Central and East European countries, the problem is that many of these business services are underdeveloped and where they do exist, they are often uncoordinated.

The aim should be to develop a business support infrastructure which is relevant to the needs of SMEs at different stages of their development. At the pre-start and start-up stage, business advice, information and counselling should be available in local centres together with training provision to enable new entrants to acquire a basic understanding of business principles. Once businesses become established, there is a need for a programme of aftercare to assist in improving survivability and to help firms with a potential for growth, to achieve it. As firms become more established, their support needs tend to become increasingly specialised and this applies particularly in the case of manufacturing SMEs (Smallbone et al, 1993b). Examples include business skills seminars, low-cost consultancy and specialist information and advice on a range of issues (e.g. technical advice, marketing, export intelligence, information technology, quality management, recruitment and training). Whilst there may be an expectation that by this stage firms will pay for assistance received, the potential advantages (in terms of competitiveness) of encouraging SME managers to become more outward looking, together with the initial reluctance of many SME managers to do so, justifies some "pump priming" by government at least.

One issue that arises in the delivery of business support is the respective roles for the public and private sectors. The key principles would seem to be that the state has a role in the provision of support because of the various ways in which SMEs contribute to economic development. On the other hand, it can be argued that the actual delivery of business support is best undertaken by those with private sector business experience. In Western Europe there are different delivery models. For example, in the UK the absence of strong Chambers of Commerce has meant that the state has had to play a stronger and more explicit role in small business support than it has in either Germany or the Netherlands. In the latter cases, the state

has provided the basis for strong Chambers of Commerce through compulsory business registration legislation and also by using the Chambers to deliver some aspects of small business support. In Britain on the other hand, government has had to adopt a more central role in developing, funding, monitoring and evaluating SME support programmes whilst being strongly committed to their delivery through private sector led agencies. In short, the goal should be to develop an institutional support infrastructure for SMEs which is focused on nongovernment associations although these are unlikely to develop effectively if left to market forces alone.

Whatever system is devised to suit the needs of particular national or regional environments, *the aim should be to avoid a proliferation and fragmentation of agencies* which can cause confusion in the minds of SME managers about who to approach for what types of assistance (Segal, Quince & Wicksteed, 1988). This is a particular danger in situations where funding organisations make resources available with little regard to the integration of programmes at the local level. This is a potential problem in the CEC where small business projects have so far depended on external funding regimes that have often not been well co-ordinated. The priority in the CEC is to develop local programmes and institutions which are better adapted to the specific requirements of SMEs at a local level whilst encouraging networking between support agencies.

(v) The inability of the banking sector to provide, finance for small business development

Although banks in most countries are criticised for their lack of support for small businesses, *in the CEC there would appear to be a particularly strong case for intervention designed to improve the supply of finance for small firms*. For example, in a recent survey of Polish small business owners undercapitalisation was identified as the root cause of the majority of the barriers to growth facing firms in the survey (Arendarski et al, 1994). According to Piasecki there are a number of reasons for this shortage of capital: insufficient own capital; the system of credit practised by many large state-owned firms which results in late payments and bad debts for many small firms; as well as the difficulties faced in accessing external sources of funds (Piasecki 1995). The experience from the west is that some intervention may be required in the market for finance if small firms are to obtain finance in the quantities and at a price which enables them to be competitive.

In the UK, relations between banks and small businesses have been under considerable strain since the late 1980s, and the subject has probably attracted more attention in the small business literature in recent years than any other single issue. From a small business perspective, the limitations of a collateral based approach to lending by the banks is one aspect; another is the level of bank charges. The debate in Britain has included comparison with countries such as Germany where the structure of the banking sector appears to be more supportive of SMEs. It has led to the suggestion of a government backed, small business development bank which would prioritise the provision of long term development finance for SMEs. One proposal is for a bank which is targeted at manufacturing SMEs in the £3m - £50m turnover range. Although in Britain, the "market failure" rationale for small business policy has not so far been extended to such interventions with the structure of the market, in an economy which is in the early stages of transformation to a market system, it may be a requirement.

Based on western European experience, interventions may also be required in the market for equity finance for SMEs. Because of diseconomies of scale to the suppliers of finance, the

managers of venture capital funds tend to favour larger investments. In 1990 for example, 80% of the funds of British Venture Capital Association members were invested in businesses with a minimum level of £250,000. As a consequence, most UK commentators recognise an "equity gap" as a shortage of "seed", "start-up" and "early stage" finance (Mason & Harrison, 1991). One solution is a government backed venture capital/loan fund which operates as a "minimerchant bank".

6. Some concluding observations

Despite differences in emphasis and priorities, it is suggested there are lessons that can be drawn from the recent experience in Western Europe which need to be considered in a discussion of SME policy in the CEC. In summary, the main points to be stressed are:

- * The need to have clear objectives for policy. There is scope for both a social and an economic role for SMEs although the policies priorities may not be the same in each case.
- * The need to recognise the disproportionate impact of government regulations on smaller companies.
- * The need to avoid overestimating the impact of government direct support measures.
- * The need to create an appropriate legal and institutional and framework within which SMEs can develop. This is one of the most difficult tasks of the transformation period yet one which is critical to the development of the SME sector.
- * The need to create favourable conditions for all new business start ups whilst targeting firms that can make a particular contribution to economic development e.g. growing firms, exporters, technology based firms.
- * The need to aim to improve the quality of new business start-ups in order to increase survivability and to minimise displacement effects.
- * The need to address supply side "failure" in the market for small business finance.
- * The need to recognise that the role of the state in relation to the development of a business support infrastructure is complementary to, and not an alternative for, private sector provision in this field. This is an important issue in an East European context where because of the recent past, "support" or "promotion" by the state are seen as interventions which are often viewed with particular scepticism by private business owners (Piasecki 1995).

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Internal and External Actors in the Restructuring Process of Former State Enterprises: 'Helpful' or 'Harmful' Networks?

FRIEDERIKE WELTER

Introduction

While during the first years of the transformation process researchers concentrated on questions concerning the overall national transformation policies - 'big bang' or gradual transformation, methods of privatisation, creation of the institutional framework - microeconomic topics are now put first. The following paper analyses the roles internal and external actors play with respect to the microeconomic restructuring of (former) state enterprises. The discussion will focus on the influence which networks going back to centrally planned economies have on the process of restructuring state enterprises. Poland, Hungary, the Czech and the Slovak republics serve as example to illustrate the relevant developments. This paper is organised as following: The first section deals with the development of the microeconomic restructuring until today, the second section outlines the different starting-points of the privatisation process. Section three and four shed some light on the roles of internal and external actors. Section five will allow for some conclusions.

1. Microeconomic restructuring of (former) state enterprises: a dead end?

Central European countries made visible progress with their macroeconomic stabilization policies by slowing down the decrease in industrial production and achieving real growth of GDP in 1994. The turning point of the transformation crisis has been reached¹: Inflation and unemployment rates have been reduced to a more or less tolerable level; an adequate institutional framework, including a modern tax system, redefined property rights and creating the legal framework, is nearly completed.

The results concerning the microeconomic transformation are, however, mixed. Generally speaking, all four countries made considerable progress with "hardening" the former "soft budget constraints" of state and privatized enterprises: These subsidies which were used during

¹ Cf. A. Brustle u.a. (1994), Die wirtschaftliche Entwicklung im Ausland. "RWI-Konjunkturberichte", Jg. 45, Heft 2, pp. 115ff; for a slightly different opinion cf. J. Habuda, M. Jennewein (1995), Unternehmensanpassung in den Transformationsländern. "IFO-Schnelldienst", no. 12, pp. 9-18.

the centrally planned economies - above all direct transfers from state budget to enterprises, fixed prices, soft loans from the state bank - are more and more substituted by measures which are conform to market economies (e.g. subsidized credit and credit guarantees)². In most enterprises, especially in industrial ones, the question of microeconomic restructuring has not been solved up to now: Even in the future state companies and privatized firms will have to further cut down their labour force; competition will force more and more enterprises to leave the market via bankruptcy. Nevertheless, at this moment governments in transformation countries would be ill advised to pursue a rigid bankruptcy policy resulting in massive closedowns.

Surprising at first sight, many privatized companies have problems concerning their micro-economic restructuring while vice versa state enterprises have been successful to a certain extent³. In all four countries the privatization process was obviously overloaded with excessive expectations because a nominal transfer of former state assets to private persons does not guarantee automatically a successful restructuring. In this context the following critical questions have to be taken into account⁴:

1. the problem of corporate governance in formally privatized firms
2. the question of financing a company, especially the possible access of privatized firms to external capital
3. the lack of management capacities as well as of technical know-how.

In most cases the chosen privatisation methods did not contribute answers to these questions; a successful microeconomic restructuring depends, however, on finding satisfying solutions. Take for example the voucher privatization in the Czech and Slovak Republics: Investment funds as well as dispersed shareholders are lacking financial and personal capabilities and therefore are hardly able to defend their property rights facing a sometimes obstinate management. The Polish capital privatisation which in most cases did not reach beyond a phase of commercialisation also did not succeed in a quick restructuring of enterprises. As long as capital markets are still not functioning well, fresh external money for ailing enterprises will only come through the engagement of foreign investors.

However, the transformation processes which reached a first peak with the formal privatization are not yet finished. The final success of the voucher privatisation will also depend on the development of a functioning secondary market supporting the exchange of property rights and shares. Since 1990 (in Hungary since 1987) the financial system changed considerably which in the near future will most probably result in further improving the companies' possibilities for financing. Management capabilities as well as technical know-how cannot be seen as rigid

² Cf. E. Voszka (1994), *The Revival of Redistribution in Hungary*. "Acta Oeconomica"¹, vol. 46, no. 1-2, pp. 63-78.

³ Cf. Secretariat of the Economic Commission for Europe (1994), *Economic Survey of Europe in 1993-1994*. New York and Geneva, especially chapter five: "Restructuring of state-owned enterprises in Eastern Europe".

⁴ For the relevant discussion cf. John S. Earle and S. Estrin (1995), *Alternative ownership forms: the impact on restructuring*. "Economics of Transition", vol. 3, no. 1, pp. 111-115; R. Frydman and A. Rapaczynski (1994), *Corporate Control and Financial Reform*. In: same authors, *Privatization in Eastern Europe: Is the State withering away?* London, pp. 100-140; P. Mihlyi (1994), *Common Patterns and Particularities in Privatisation: A Progress Report on the Transition Economies*. "Acta Oeconomica", vol. 46, no. 1-2, pp. 27-62, especially pp. 55f.

during this transformation process. Additionally people often neglect microeconomic restructuring being a very time-consuming process: The restructuring of the German AEG for example took place over more than a decade.

This situation leads experts to state certain *harmful constellations blocking the restructuring*. They consider restructuring at a dead end because of the earlier discussed problematic economic conditions (e.g. lack of adequate capital markets) and because of the possible negative influence internal and external participants might have on this process⁵. There are two main groups of actors whose role will be discussed in more detail in the following:

4. *Internal actors* are the ones inside the enterprise, e.g. managers, workers. While workers are mainly interested in keeping their job and getting higher wages, managers try to maintain their power and/or become owners of former state firms. Newly founded interest groups (trade unions, employers associations or chambers) are additionally used to enforce the respective interests.
5. *External actors* consist of government authorities, banks and financing institutions, and - to a minor extent - clients and other enterprises. Governments deliberately tend to apply policy measures to subsidise large enterprises in view of threatening bankruptcies which in turn can hamper the restructuring. For example, they try to prevent major closing down of large firms coming with social costs (rising unemployment) and - unwanted - political changes. Banks and financing institutions often act in a double role as coowners on the one hand and main creditors on the other hand, therefore they try their own tactics to support (former) state companies. The same applies to other enterprises as clients of (former) state enterprises.

2. Internal and external actors: Different starting points

A correct interpretation of Central European governments' attitudes towards state enterprises since the beginning of the transformation has to take into account the respective developments of the entrepreneurial framework. Two situations can be observed⁶: Czechoslovak enterprises were strictly controlled by the state until the velvet revolution while Polish and Hungarian enterprises became more independent because of the economic reforms during the 1980s.

Limits of Privatization in the Czech Republic. (WZB Working Paper FS I 94-101.) Berlin.

⁶ Cf. A. Hauer u.a. (1993), *Der Mittelstand im Transformationsprozeß Ostdeutschlands und Osteuropas*. (Beiträge zur Mittelstandsforschung, Band 1.) Heidelberg, pp. 209ff. for the Czech Republic; N. Noar and P. Bod (1986), *Socialist Entrepreneurship in Hungary: Reconciling the "Irreconcilables"*. "Columbia Journal of World Business", S. 55-68 and T. Laky (1991), *Small Business Organization in the Hungarian Economy*. In: H. Thomas u.a. (Eds.), *Small-Scale Production Strategies for Industrial Restructuring*. London, pp. 244-261 for Hungary; A. Aslund (1985), *Yellow Light for Private Enterprise in Poland?* "Osteuropa-Wirtschaft", vol. 30, no. 1, pp. 21-29 for Poland, and the general discussion in B. Lageman u.a. (1994), *Aufbau mittelständischer Strukturen in Polen, Ungarn, der Tschechischen Republik und der Slowakischen Republik*. (Untersuchungen des Rheinisch-Westfälischen Instituts für Wirtschaftsforschung, Heft 11.) Essen, pp. 213ff.

In *Hungary* the government already in 1982 allowed new relatively autonomous (semi-)state enterprises, most state property rights were actually transferred to enterprise management. Therefore after 1990 state managers felt free to commercialise and reorganise their companies without awaiting governmental instructions. The Hungarian government tried - more or less without result - to stop this "spontaneous privatization" by founding the State Property Agency and by making managers' efforts to reorganize subject to authorization⁷.

In *Poland* managers - however to a lesser extent than in Hungary - as well as employees of state enterprises also gained organizational freedom at the beginning of the 1980s, especially the Polish labour force was strengthened by introducing workers' councils which lost some of their influence again during the late 1980s⁸. However, in the beginning of the transformation these institutional arrangements resulted in so-called "nomenclatura" privatizations made possible by the teamwork of managers, party bureaucrats and labour force.

Only Czechoslovakia followed an economic policy strictly oriented along the principles of a soviet-type economy. The comprehensive reforms planned during the 1960s were stopped with the 1968 invasion; relatively moderate reforms planned at the beginning of the 1980s did not achieve any importance. 'Autonomy' and 'independent decision-making' remained foreign words for Czechoslovak managers who were still governed by state bureaucracy. Even after 1990 the Czechoslovak government used a strong state bureaucracy to pursue its privatization policy⁹.

The different starting points for entrepreneurial engagement in these four countries in turn determined the development of the privatization after 1990 as well as the respective constellations internal and external actors had to cope with to pursue their own interests. Nevertheless, a wrong conclusion would be that in the case of Czechoslovakia internal actors could not influence the restructuring and privatization whilst in Poland and Hungary they dominated this process. The following parts will show a situation somewhat more complicated.

3. The role of internal actors

The roles internal actors play in privatising and restructuring state enterprises depend to a large extent on the respective starting points - conditions for entrepreneurial development - in each country. Therefore several situations can be observed which will be illustrated by some examples. Internal actors never played a strictly destructive role but pursued their actual interests which in turn, as already mentioned above, were strongly determined by the privatization process and its results:

⁷ Cf. E. Voszka (1991), From Twilight into Twilight: Transformation of the Ownership Structure in the Big Industries. "Acta Oeconomica", vol. 43, no. 3-4, pp. 281-296; E. Voszka (1993), Escaping from the State - Escaping to the State: Managerial Motivation and Strategies in Changing the Ownership Structure in Hungary. In: L. Somogyi (ed.), Political Economy of the Transition Process in Eastern Europe: Proceedings of the 13th Arne Ryde Symposium, Rungsted Kyst, 11-12 June 1992. Aldershot and Vermont, pp. 227-239.

⁸ Cf. B. Albrecht, M. Thumm (1994), Privatization, Labor Participation, and the Threat of Bankruptcy: The Case of Poland. "Journal of Institutional and Theoretical Economics", vol. 150, no. 4, pp. 710-725, especially p. 711.

⁹ Cf. R. Frydman and A. Rapaczynski (1994), pp. 105f.

- In *Poland* because of the historic developments during the 1980s - Solidarnosc movement - the labour force commanded a strong influence further supported by employee-buy-outs as one of the most frequently used privatization method .
- In *Hungary* managers of state enterprises dominated during the first phase of transformation because of lacking privatization concepts, resulting in the already mentioned 'spontaneous privatizations'¹ . The government drove back the spontaneous element by creating an institutional setting and by introducing rigorous regulations, nevertheless managers continued to exert a dominant influence.
- A similar phenomenon - relatively strong influence of state managers - could also be observed in the former *Czechoslovakia* during the mass privatisation. Although every citizen was - at least formally - allowed to submit privatization projects, in more than 80% managers' proposals were accepted¹⁰, the situation was similar in Slovakia. The influence of new owners - investment funds, investors down to small scale shareholders - with respect to microeconomic restructuring is theoretically strengthened after the first and second wave of voucher privatisation. In reality however, 'old' managers keep their strong position which nevertheless does not imply any resistance on their side to microeconomic restructuring. Even 'old' managers are interested in profitable firms, the only problem most probably being a lack of relevant know-how.

None of these cases can already be classified as a harmful situation slowing down or finally impeding the microeconomic restructuring. Each privatization method can result in situations where *managers* either impede or accelerate the companies' restructuring:

- Managers will slow down first of all the commercialisation and privatisation, secondly also the necessary restructuring if the possible new owners are judged as a menace to managers' positions. In this situation managers will activate existing connections to their employees and - as will be discussed in the fourth part - to external actors. The recent developments in the Slovak Republic can serve as example: Managers of companies controlled by investment funds tried to regain resp. maintain their control of the enterprise. They used their influence with state bureaucracy to lobby for a law - currently under preparation by the Slovak government - which will separate corporate control and enterprises' ownership¹¹.
- On the contrary, as soon as managers are expecting personal gains they will not hesitate to accelerate their companies' privatisation and restructuring and also mobilise their networks accordingly. The Polish 'nomenclatura privatization' in which Polish managers and bureaucrats quickly used a temporary gap in governmental control as well as the efficiency of Hungarian and Czech Manager in turning deficits of the existing regulations for privatization to their own advantage may serve as excellent example.

¹⁰ Cf. B. Lageman u.a. (1994), p. 239, also R. Frydman and A. Rapaczynski (1994), p. 107.

¹¹ Cf. A. Marcinein (1995), Fate of Large Investment Funds in Slovakia. "The Privatization Newsletter of the Czech Republic and Slovakia", No. 32, pp. 5-8.

Judging from a moral point of view, the individual's normal reaction to existing incentives may be disgusting, on the whole, however, these reactions will add to a more dynamic market economy in Central European countries provided a stable legal framework exist.

The *labour force* of (former) state enterprise is also able to influence the process of privatizing and restructuring. However, employees' role with respect to microeconomic restructuring is on the whole indeed overestimated. A negative attitude of employees not wanting to loose their job seems to have impeded enterprises' restructuring only in the short run¹². In Hungarian and Czechoslovak enterprises workers' councils generally played a negligible role while in Poland these councils though installed in each enterprise played an active role in only some of them¹³. In addition, empirical studies show even enterprises which are dominated by employees are having a positive attitude concerning a reduction of the labour force and further restructuring measures¹⁴. Reasons are on the one hand managers deliberately using their labour force to support the managers' own interests, on the other hand conflicts of interests within the labour force.

At the same time the roles of internal actors in state companies resp. privatized firms are themselves gradually changing. Take for example the attitude of Hungarian managers: In the first phase of transformation they tried to 'escape from the state'¹⁵, as soon as the government applied rigorous regulations Hungarian managers again asked for governmental support to widen their restricted influence - they 'escaped to the state'¹⁶.

On the whole the importance of 'old' networks is overestimated because these internal networks themselves transformed due to changing interests and framework conditions. As soon as individual actors have a chance to act in a opportunistic way - rent-seeking - the 'old' networks from the period of centrally planned economies which are based on a 'do-ut-des' ratio will loose their original meaning.

4. The role of external actors

The already discussed transformation of the old structures of internal actors also applies to external ones: Networks resp. connections among governmental actors (e.g. representatives of ministries responsible for privatization and restructuring) as well as among banks and financial institutions and to internal actors are constantly and gradually changing.

Most of the former *state bureaucrats* lost their position, the engagement of 'new' employees adds to the development of new interests and new connections with internal actors. The 'old'

¹² Cf. K. Mayhew and P. Seabright (1991), Incentives and the Management of Enterprises in Economic Transition: Capital Markets are not enough. "Oxford Review of Economic Policy", vol. 8, no. 1, pp. 105-129.

¹³ Cf. M. M6ra (1991), The (Pseudo-)Privatization of State-Owned Enterprises (Changes in Organizational and Proprietary Forms, 1987-1990). "Acta Oeconomica", vol. 43, no. 1-2, pp. 37-58 for Hungary; R. Frydman and A. Rapaczynski (1994), p. 105 for former Czechoslovakia; M. Federowicz (1994), Poland's Economic Order: Persistence and Transformation. Warsaw for Poland.

¹⁴ Cf. B. Pinto, M. Belka and S. Krajewski (1993), Transforming State Enterprises in Poland: Evidence on Adjustment by Manufacturing Firms. "Brookings Papers on Economic Activity", Washington, D.C., no. 1, pp. 213-261.

¹⁵ Cf. E. Voszka (1993), pp. 228ff.

¹⁶ Cf. E. Voszka (1993), pp. 228ff.

networks which were based on personal contacts and relations and built up during the centrally planned economies mostly lost their function. However, the evolving new networks in connection with the interests of politicians - keeping their political power - (can) result in new harmful situations: Take for example the debt-conversion programmes with which governments in all Central European countries tried to support ailing state enterprises; these programmes might in the long run thoroughly prevent the necessary restructuring.

With respect to *banks* 'old' networks mainly exist in institutions based on the former state bank. These banks still prefer a more conservative credit policy in the sense of the prolongation of credits to 'trustworthy' former clients¹⁷. This strategy can slow down resp. impede a quick restructuring of these enterprises if restructuring implies the enterprise's liquidation consequently resulting in the bank's loss of credit. The existing 'symbiotic'¹⁸ relationship between (former) state banks and state enterprises are additionally supported by cross-ownership forms evolving in the meantime¹⁹. But even the (former) state banks are gradually changing which will consequently make the development of harmful situations more difficult and result in an increasing 'hardening' of credit restrictions: New employees are engaged, new tasks evolve, with the development of a functioning capital market new banks are founded acting as serious competitors and thereby forcing the state banks to behave in a more market-oriented way.

Besides external actors in state bureaucracy and banks the *investment funds* which came into being especially during the Czech mass privatisation sometimes are regarded as potential impediments for a successful microeconomic restructuring. However, relationships to 'old' structures can only be observed where large (former) state banks founded their own investment funds. But possibly arising interest conflicts within these funds were also judged critically²⁰: On the one hand investment funds had to act as portfolio-manager who are first of all concerned with the interests of their stakeholders. On the other hand investment funds had to take over a more active role in corporate governance resp. restructuring because of the worse economic situation of 'their' privatised state enterprises. As far as restructuring will mean bankruptcy of the respective firm conflicts of interest with stakeholders can arise. Therefore investment funds were mainly suspected to impede microeconomic restructuring. However, the actual developments allow the conclusion that on the whole investment funds are taking over an active role in restructuring 'their' enterprises²¹. A different situation is only to be observed in the Slovak Republic where privatization is a more or less political process affecting in turn also some

¹⁷ Cf. P. Dittus (1994), Corporate Governance in Central Europe: The Role of Banks. (BIS Economic Papers, no. 42.) Basel, p. 16 and Z. Mosolygó (1993), Financial Sources of Enterprises in 1992-93. "Acta Oeconomica", vol. 45, no. 3-4, pp. 375-390, especially p. 376.

¹⁸ P. Dittus (1994), p. 16.

¹⁹ Cf. S. Dhar und M. Selowsky (1994), Das Problem notleidender Forderungen in Transformationsländern. "Finanzierung und Entwicklung", pp. 44-47 for Poland; E. Voszka (1994), pp. 68ff. for Hungary; J. Matesová and R. Seda (1994), Financial Markets in the Czech Republic as a Means of Corporate Governance in Voucher Privatized Companies. (CERGE Working Paper Series, no. 62.) Prague, p. 52 for the Czech Republic.

²⁰ With respect to the role of the Czech investment funds cf. V. Dlouhy and J. Mldek (1994), Privatization and corporate control in the Czech Republic. "Economic Policy", pp. 156-170.

²¹ Cf. K. Brom and M. Orenstein, (1994), The Privatised Sector in the Czech Republic: Government and Bank Control in a Transitional Economy. "Europe-Asia Studies", vol. 46, no. 6, pp. 893-928, especially pp. 915 and J. Charap and A. Zemplerova (1994), Restructuring Larger Companies in Post-Communist Countries: The Case of the Czech Republic. "Trends and Policies in Privatisation", vol. 2, no. 1, pp. 75-102, especially p. 95.

of the large investment funds: As a result the Slovak government stopped the trade of some investment funds' shares²².

5. Towards an evolutionary view of microeconomic restructuring

Regarding only 'old' networks and structures still resulting from the centrally planned economies will necessarily lead astray. This 'structuralist' and more or less static attitude towards microeconomic restructuring underestimates the results achieved so far. De facto in all four countries actors moved within these structures as well as in between because everybody had to find a new position allowing further rent-seeking. Therefore networks themselves change and adapt their 'old' structure to the evolving market economy. At the same time networks are to be found everywhere and cannot be classified from the first as only 'helpful' or 'harmful'. Their respective function depends on the actual situation. The role of internal and external actors with respect to microeconomic restructuring should therefore be discussed in connection with an evolutionary approach.

Nevertheless the danger of harmful situations resulting from networks respective from the teamwork of different internal and external actors cannot be denied. These situations depend, however, on (country-)specific conditions. For example, they are connected with different privatization methods: Harmful situations may occur in Czech enterprises which were privatised by vouchers, they may also occur in Polish enterprises privatised by employee-buy-out or in the commercialised, but not yet privatized large enterprises in Hungary and Poland.

Because the privatization and restructuring process started only five years ago no final conclusions are possible. The tendencies observed so far however support a more evolutionary view of the process of microeconomic restructuring and actors' roles and influence within this process. On the whole, despite the problems discussed the respective efforts have been more successful in the Central European countries than elsewhere in Eastern Europe.

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²² Cf. A. Marcinein (1995), pp. 5.

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State Regulation in the Transition to Market Economy and Structural Reform of Industry

NIKOLA NIKOLOV

1. Description of the Problem

The successful transition of the country from centrally planned to market economy is to a high extent dependent on the role, rights and obligations of the state, respectively of its institutions. Various measures have been undertaken in this field in the recent years. An appraisal of the work done, however, will hardly point to considerable positive results. The question therefore arises about the reasons behind this situation. The problems have their origin in the lacking clear-cut view about the future development of the country and the directions of desired reforms, as well as in the existing conflicts connected with the structures and division of responsibilities between different state institutions. The decision-making institutions are paralysed while the actions of the government are not sufficiently clear and transparent. This prevents the active social forces from mobilising themselves for unified and well-co-ordinated activities. The management techniques and structures applied are inherited from the past and are not suitable for modern production in its entire complexity. In most of the cases, foreign mechanisms are implemented without being preliminary subjected to a nation-wide consensus.

Great expectations are assigned to various international aid and development agencies. Practice turned to be rather different, however. Different aid and development agencies have for decades long presented a lot of funds, technologies and expertise to developing countries without any considerable results. The efforts of the International Monetary Fund and the World Bank in the field of structural adjustments have had but only partial success. All these circumstances apply to Bulgaria, too. What is more, the activities of different international aid agencies lack coordination and integration. The officials who perform the projects are foreigners so they do not suffer the consequences of their actions in the assisted countries. The agencies develop their strategic plans on the basis of appraisals of international organisations experts who follow their own political and trade philosophy and have never faced or suffered the events and conditions in the reforming countries.

Under these conditions, the role of the government is reduced to just strictly following the prescriptions of the representatives of the international financial organisations. None of the governments has succeeded in working out an independent strategic framework of the reform in all its aspects. It should be clear that the progress of reforms and national development is absolutely dependent on the responsibilities taken by the government and the stabilisation of

the main institutions. The preconditions for the prosperity and development of the country include political stability and clarity, co-ordination and integration of different directions of reforms, transparency of public and private activities, responsibility of all actors on the economic stage, and sustained efforts. This effect can be achieved only under the leadership of a powerful and efficient government. On this background, the problem arises of the role of state in the new realities.

The state and its government should to a much greater extent bear the responsibility for the development of the strategic framework of reforms instead of shifting the task to foreign experts who, regardless of their world-wide experience, are neither familiar with the particular national situation, nor bear the responsibility for the reform. It is really a paradox that the strategy of reforms is developed by foreign experts while the performance and responsibility for outcomes is born by the government. The government must be solely responsible for developing the strategy of reforms and determining the priority strategic directions necessary for the transition from centralised to a market economy without damaging the social equilibrium. The government must be able to elaborate, implement and supervise its own programs of reforms not only on a macro-level (where the reform is relatively easier to perform) but on a micro-level as well, since microeconomic reforms are much more complicated and bear far reaching social consequences.

There is a lot of urgent reformation and recovery measures which seem to open opportunities for the government to demonstrate its efficiency by acting fast. This abundance of would-be possibilities is very hazardous since it contains a high probability of mis-allocation of resources, poor usage of funds, loss of confidence, and very costly disappointments. In order to avoid these negative effects, it is necessary to develop a national strategy of the reform and coordinate the national program of the government with the programs of different institutions financing the process.

Bulgarian institutions should bear the responsibility for both the elaboration of the national program of reforms and for the national recovery programs. They should be also responsible for reaching the necessary domestic consensus as well as the consensus with the financing organisations so that planned reforms and programs are financed and introduced in an atmosphere of social harmony.

2. Regulation of structural reforms in industry

The regulatory role of the state in structural reforms is expressed in two main directions, namely:

1. In the creation of adequate market environment to stimulate the restructuring of the economy, respectively of industry;
2. In the formation of the structural profile of sectors.

The reports treats the first aspect of the issue.

Formation of adequate market environment

Structural reforms are promoted by an environment formed out of three main elements, including: a) legal environment; b) economic regulators (economic environment); and c) institutional environment.

1. Legal Environment

Here the legal framework of the transition to market economy is created, by which the reform is given social status and legal regulation in compliance with the national interests. In the recent years, the Parliament has adopted a series of important but still insufficient reform-stimulating laws. Amendments and changes are necessary to be made in the following directions:

First, *making the necessary amendments to already adopted and acting laws*. This practice exists in the other East European countries as well and it is neither unusual nor fatal. The entirely new situation as well as the total lack of whatever analogues and experience before are serious obstacles to the legislative practice in the East European countries which result in a number of errors and omissions in the new laws adopted. For these reasons, amendments are often necessary to introduce. Some of the omissions are manifested from the very beginning, other appear at the later stages of applying of the laws. In many cases therefore the amendments to the laws are provoked by the objective circumstances. At the same time, however, there are also cases in which the amendments are backed by economic and even false social arguments but are in fact motivated by political engagements and ambitions. In this respect, both the Parliament as a whole and the represented political parties should be responsible not to the electorate who voted for them but to the whole nation and history, since the national interests always rank higher than the interests of certain economic groups or political forces regardless of their majority position in the Parliament.

It should be pointed out that the present foreign investments legislation fails to settle some issues which are determinant for attracting foreign investors in Bulgaria. According to the experts, the Law on Foreign Investments is well-made and does not require considerable amendments. Some amendments are however demanded with regard to state surety given to foreign investments. Foreign investors would hardly come unless legal state guarantees are provided. The latter stem from the national strategy of structural policy to be pursued in economy. The lack of such a strategy in the management practice is perhaps one of the reasons for the absence of concrete implementations of the liberal foreign investments regime with regard to both economic leverage (taxes, customs duties relieves, etc.) and economic regions. Due to this weakness Bulgaria is rather unfavourably ranked in the struggle for foreign investments as compared to Hungary, Poland, Romania, the Czech Republic, etc.²³

²³ In Hungary, 100 per cent tax relief in the first five years and 60 per cent in the next five years are extended to 14 fields of particular priority. These relief are given to joint ventures of more than HUF 50 mln. initial capital and foreign capital participation of at least 30 per cent. Thanks to the Hungarian legislation, the country managed to attract more than half the total real capital invested in the East European countries in the last years.

Poland has also provided considerable preferences to foreign investors, including tax relief in selected priority fields, customs and foreign currency facilitations, etc. The income tax for the foreign partners amounts to 30 per cent, but the latter are exempted from taxation in the first three years. If the foreign company operates in some of the priority economic fields, then it is exempted from income tax till the end of the second three years.

In Romania, foreign investors are exempted from profit tax for different periods of time provided they have made investments in priority economic fields.

The Law on Transformation and Privatisation of State and Municipal Enterprises (LTPSME)²⁴ provided for the legal framework of privatisation. The adoption of the Law was preceded by a broad discussion on the nature of privatisation, i.e. on whether it should be only market (cash) privatisation or should go in parallel with social (mass, voucher) privatisation. The first approach means real selling of state-owned and municipal enterprises or their privatisation by those who can pay for them (totally, partially, or buying shares). In social or mass privatisation the approach is different, i.e. each Bulgarian citizen aged 18 is eligible receiving a certain share of state or municipal property against free (or nearly free) privatisation coupons or vouchers. That's why this kind of privatisation is also called coupon or voucher privatisation. Initially, the market approach was adopted, due to the following reasons: a) it creates more powerful incentives for the efficient use of state and municipal property as the latter was obtained by means of real (in-cash) purchase; b) privatisation is accomplished by people disposing of real capital who can provide much better and efficient management of privatised enterprises; c) there will be an inflow of resources to the state budget thus preventing the further growth of budget deficit. After the LTPSME was adopted, discussions continued with providing arguments in support of the purposefulness of and necessity in social (mass) privatisation to complement the market (cash) privatisation. The main arguments in this respect were the following: a) state and municipal property was created by the labour efforts of all Bulgarian citizens, and the principles of equity therefore require that everybody obtains some part of it; b) the lack of resources in a large part of the population will deprive it from active and real participation in the market privatisation, i.e. in property acquisition and management and therefore in the process of transition to and building of the basis of market economy; c) to assist, expand and intensify the process of privatisation which is extremely important for the success of transition but is progressing too slowly; d) the positive results and practice of mass privatisation in other post-socialist countries, and in the Czech Republic in particular.

In 1994, the arguments and public opinion in support to mass privatisation proved to prevail, and the amendments and additions to the LTPSME gave the legal basis for its implementation along with market privatisation. The new Chapter 8 in the Law regulates the 'privatisation by means of investment bonds'. In order to assist and manage the process of mass privatisation, the Law provides for the creation of investment funds as stock companies or co-operatives which will attract the privatisation bonds of citizens and by which the privatised property will be managed. Besides, a Centre of Mass Privatisation will be created with the Council of Ministers. Suppose voucher privatisation is legally regulated, there should be no obstacles for its starting up. It seems, however, that it is deliberately delayed in order to secure the priority of cash privatisation and thus satisfy the interests of certain economic groups and formations. Until voucher privatisation is retarded it is very likely that considerable parts of the state property may be privatised by different formations with doubtful origin of capital.

Second, urgent adoption of new Laws.

The absence of a number of laws makes for the delay of reforms. The more important of them are the law on private business, on intellectual property, on state enterprises management, etc.

²⁴ Law on Transformation and Privatization of State and Municipal Enterprises, State Gazette, 38/1992, Amendments and Additions, SG, 51/1994.

The Law on Private Business is necessary so as to provide legal protection and assistance to the emerging private sector, moreover, that state ownership will certainly prevail in the long run. The Law would provide governmental assistance, advice, consultancy, and protection to the entrepreneur initiatives in economy. Particular attention should be devoted to the investments securing the growth, modernising and expansion of small private enterprises. Other priorities should include the regulation of banking loans to particular private projects, definition of the preferential conditions for investors in small industrial businesses, etc.

The Law on Intellectual Property, the highest form of property directly connected with the will and need for personal realisation, would provide more efficient legal protection of intellectual labour and its products (innovations, patents, industrial samples, trademarks, products and services, scientific literature, etc.) in connection with the opening of Bulgaria to the world markets, investment inflows, and technology transfer. The Law should also regulate the liabilities of the state in the intellectual property protection.

Law on State Enterprises Management. In the observable future, state enterprises in Bulgaria will continue holding a considerable share in the economy. In a polycentric system of production relations and economic interests, as is the market economy, enterprises are autonomous entities regardless of the form of ownership. The subjects who represent the personal factor of production and who manage the production process are independent commodity producers. All this requires adequate legal regulation of state-enterprise relations.

A *Law on Securities and Stock Exchanges* is to be adopted as well. The regulated selling of shares and securities will provide funds for accomplishing the structural reform as well as for speeding-up the privatisation process.

Some other laws should also be adopted, for instance a *Law on Free Trade Zones*, etc.

2. Economic Environment

In the promotion of structural reforms, it is not the legal but also the economic environment which plays an important role. Restrictive state policy should be accompanied by the creation of investment opportunities. A series of other measures are necessary, too, including the strengthening of banking control and reduction to zero of bad loans, control on the monetary aggregate, connection of interest policy with the inflation rate; maintenance of such a level of interest rates so as to prevent them turning into an inflation-generating factor, etc. In creating the economic environment, the interaction of different economic levers should be accounted for. In this respect, the more important directions of promoting the economic reform include:

First, *taxes*. The economic theory points out and the world practice confirms the undoubted relation between tax rates and economic growth. The reduction of tax rates stimulates the fast economic development. Low rates are one of the main indicators of an efficient economy. They are of vital importance for the progress of private business as well. The opposite situation demotivates savings, investments and labour investing and brings about low economic growth and respectively low incomes. According to the World Bank, a 1% increase of the tax load produces a 0.4% decline in the economic growth on the average. In this regard, the plans for structural reforms in industry and in the other economic sectors should be assisted by giving tax preferences to certain branches and industrial productions so as to stimulate their restructuring.

The latter should be selected from the standpoint of the whole national strategy for structural policy and in accordance with the national peculiarities and strategic goals and priorities.

Except for the measures in the system of state finances, connected with the settlement of foreign debt problems and the introduction of VAT and excise duties, the financial policy of the governments in the recent years can be defined as purely fiscal-oriented. Funds and ways have been searched in order to provide current budget incomes regardless of price and damages inflicted to the economy as a whole. Though paradoxically sounding, the main tax load in the Bulgarian economy is carried by the ordinary tax-payer, or the small businessman, in the best case. The large economic groups, either by playing tricks or by personal relations with 'responsible factors' manage to avoid taxes, or if any tax is paid, it is far below the amounts due.

Second, *customs and excise duties*. Customs and excise duties can act as incentives of business activity as a guarantee for economic growth. The external orientation allows for the utilisation of comparative advantages, which in the case of Bulgaria are connected with labour-intensive productions. On the other hand, the duty rates should protect the domestic consumers as well as the production of commodities for the domestic market. This lever is closely connected with the credit policy of the state.

Third, *credit policy*. Both the development of private business and the successful restructuring of industry require access to credits for business initiatives. The funds available are but far insufficient and are used for supporting state-owned enterprises mainly.

The role and use of credits as a lever in a market economy presupposes the elaboration of governmental programs for extending credits to carefully selected industries and activities, providing guarantees of bank loans extended to small and medium enterprises, creation of a venture-capital fund of different sources (industrial companies, private investors, pension and insurance companies, etc.), establishment of private financial institutions. It should be taken into account, however, that given the rigid credit control and high interest rates, a real danger exists of channelling credits to some privileged sectors. This will result in the promotion of large 'bad-loan' companies at the expense of small enterprises and in the stimulation of commercial instead of investment credits which will further deepen the economic crisis. On the other hand, unreasonably low interest rates may promote capital-intensive production methods and thus reduce the number of new jobs opened. The establishment of optimal interest rates on credits as well as the liberalisation of credit policy and the provision of equal terms for credit-searchers, regardless of the form of ownership, are important conditions for the intensification of structural reforms. A paradox exists, however. There is a sharp decline in consumption. Both the domestic market and production are in crisis and this happens in the conditions of strong credit support of the import of foreign products, instead of providing preferences and soft loans for the development of the domestic production.

Four, *prices*. Buyers and sellers can hardly reach an agreement unless information is available about the relative shortage of goods and services. This information is reflected by the prices. The lack of market makes its 'invisible hand' incapable to manage the economy, hence the turn of liberalised prices into an inflationary factor. The premature withdrawal of the state from the economy contributes to this end as well. Deemed to be a panacea for the deformations in economy, this withdrawal actually made them deeper due to its premature introduction. One of the deformations, for example, is that instead of a consequence prices turned to be a factor

effecting the price determinants. The sharp rise in prices is a limitation to consumer demand. The latter, in its turn, is a non-incentive to production thus reducing the rate of capital turnover. The results are sharp decline and further sharpening of the crisis in production as well as speculation upsurge. The latter is due to the fact that neither mechanisms were developed nor measures undertaken to ensure that price differences were covered by the producers or the budget, and not by the speculators. The conclusion is made, therefore, that if not all of them but some of the main commodities' prices should be kept under control so as to stimulate production and consumption. Given the present ratio between state and private ownership in economy, the main owner, i.e. the state, should intervene to bring order in the pricing system. What is more, prices should be 'frozen', then wages should be respectively adjusted and further on frozen themselves, in order to achieve production and productivity growth. Such measures could retard inflation. This way was followed by the West European countries after the World War II.

3. Institutional Environment

The structural reform suffers from a conceptual bottleneck which is the explanation for the absence of an economy restructuring strategy and the related program for its implementation in practice. The process of restructuring should be accompanied by the creation and enacting of market mechanisms.

The modern concept of the market includes the presence of competitive environment with respect to both demand and supply, high degree of information and independence of economic agents. Given this, the conclusion is made that the success of structural reforms is predetermined by the priority development of two aspects, i.e. organisational restructuring and ownership restructuring, both of them being of state competence mainly.

3.1. Organisational restructuring

The organisational restructuring is of priority importance in the transition from centrally planned to a market economy. In terms of the state's behaviour, it is usually reduced to a gradual, yet fast enough withdrawal from economic life, with retaining the regulation function through the respective mechanisms. This withdrawal can be performed in the following ways, namely:

First. *The state provides rights of autonomy to the state enterprises thus contributing to their transformation into independent economic entities responding adequately to the market signals.* Entirely autonomous enterprises work without state orders, taking into account the market developments, independently determine their production programs, their financial and resource policy, technologies, investments, staff, loans, and prices. In practice, however, it is neither logical nor justified if the principles of autonomy are applied to all state enterprises and in each enterprise to their full extent (i.e. with regard to all management functions and activities). The reason for this is that autonomous enterprises should be vital and have the economic chance in the long run. Moreover, some other enterprises will remain beyond the scope of autonomising, too, such as the forthcoming close-downs due to insolvency, lack of prospects or bankruptcy, enterprises included in the annual privatisation program, the problem of their autonomy being solved by the change in ownership status.

The rest of state enterprises should be autonomised depending on their readiness to work independently in market conditions. The part of them possessing financial stability and vitality should be autonomised without delay. The remaining part, prior to get autonomy, should be first totally or partially restructured or partially liquidated. Parallel with the stabilisation of each enterprise, a gradual autonomy should be introduced in particular, already stabilised activities (for example, in finances, investment policy, etc.).

Autonomy should not be considered an irrevocable right provided to state enterprises. It can and should be extended or limited depending on their economic condition.

Second. Organisational forms of management of state ownership. Through them, the state can find an adequate way to transfer part of its ownership rights to persons appointed by it who will present the state's interests in these structures. Such structures could be the following:

- *holding companies*, in which the ownership rights of the state are delegated to specially appointed members of the management bodies. Besides, they control the work of the holding-member enterprises;
- *limited liability companies*, in which the state preserves control through its stake in the capital and the appointed (according to the stake) members of the management bodies;
- *state enterprises transformed into joint-stock companies*, in which the state preserves and exercises control through its stake in the capital or by holding preference shares;
- *manager contracts*, through which the state selects and appoints the managers team in enterprises. The state's control is exercised by the clauses of the contract and their execution.

Third. Demonopolisation of the state sector. It is of significant importance for the creation of a real competition in economy. In this way, the number of economic agents is increased, who directly influence and are effected by the market, conditions are created for the intensification competition, protection of consumers' interests, and formation of real market. Demonopolisation should result from different state measures directed at the destruction of monopoly, including the providing of competitive imports, higher profits-tax rates for particular structures and sectors (out of foreign economic considerations mainly), development of new private businesses and breakdown of the existing monopolies into smaller economic entities. If applied in separate, each of these measures could hardly guarantee the success of demonopolisation, and this has been proved by the poor recent experience in the industrial sector.

The above-mentioned directions of organisational restructuring will produce respective changes in the behaviour of state enterprises, which should correspond to the behaviour of private firms. It is manifested in the persistent run after profits, non-subsidised production, independence, ability to gain and hold a permanent market share, professional management, non-stop innovations in production, high-quality striving, and favourisation of the customer.

3.2. Ownership restructuring

This is the second aspect of the institutional environment, the realisation of which bears a direct effect on the creation of market mechanisms in Bulgaria. It is a matter of state competence due to the monopoly position of the state ownership.

The reform of ownership includes several interrelated elements, namely:

First. *Clear-cut outlining of the 'borders' of state presence*, mainly through a state sector established within an economically reasonable framework. The restructuring of its inside organisation could bring about the creation of self-sufficient entities forced to operate efficiently by the surrounding market conditions.

Second. *A complete strategy and privatisation program for certain parts of the state sector* The success of such a strategy is to a great extent determined by the course of demonopolisation and autonomising. The latter should open room for competition on a micro level and help the withdrawal of the government from operational management of the economy.

Third. *State incentives to private business*. They should contribute to the fast strengthening of a vital private sector, as well as to the emergence of new private enterprises. Through their competition, financial participation and production-and-technical co-operation (as sub contractors and customers), the latter could assist the growth of state enterprises efficiency This co-operation can also bring about various forms of privatisation thus enriching the microeconomic policy of the state.

Fourth. *Abolition of the administrative regulation of foreign economic relations* and introduction of indirect instruments of economic policy, i.e. customs duties, taxes, market exchange rate and interest rates. This will contribute to the strengthening and stabilisation of market mechanisms and will rise the chances for successful structural reforms.

In *conclusion*, it should be pointed out that the pace of the structural reform in industry and its results will to a high extent depend on the properly defined reform strategy, and finding the optimal role of the state in this process, as a combination between the requirements for state withdrawal from the economic activity, on the one hand, and the necessity of intervention in directing and performing the restructuring of industry, on the other. Regardless of self-restricting its role in the economy, the state and its respective institutions bear the responsibility for the whole process of structural reforms and their results, and carry the initiative for all practical steps and measures, particularly in the sphere of demonopolisation, autonomising, and transformation of ownership.

Parallel Sessions

Industrial Organisation and Restructuring

Research and Technological Development Policies - Their Influence on the Transformation Process in Central and Eastern Europe

DYLAN JONES-EVANS

Introduction

The implementation of policies such as macro-economic stabilisation measures, liberalisation of prices and external trade, a sound financial sector, introduction of internal convertibility of the currency, the promotion of foreign direct investment and rapid mass privatisation are aiding the transformation of the economies of Central and Eastern European (CEE) countries (Thomas, 1993; Balcerowicz, 1994; Salzman, 1994). However, whilst competitive free markets, combined with economic stabilisation and privatisation, will bring prosperity and economic growth, a generally neglected, but nevertheless important, aspect of the economic transition process under way in Central and Eastern Europe is the development of effective RTD (research and technological development) policies (Biegelbauer, 1994). This paper will discuss the general role of RTD policies in the economic development of CEE countries. It will consider some of the main problems in implementing such policies including the development of indigenous R&D capabilities, human scientific resources and various technology transfer mechanisms. Finally, it will examine possible solutions to deficiencies within the RTD infrastructure within CEE countries, especially the role that could be undertaken by the European Commission.

Research and technological development policies and economic development

In recent years, the rapid development of new technology has become one of the most important forms of economic competition, with several countries having evolved, as a distinct component of their economic strategy, a RTD policy to help facilitate this process (Balazs *et al*, 1990). In fact, as Pavitt (1980) indicates, R&D activities are major sources of technology and technical knowledge and it is increasingly recognised that an explicit RTD policy for stimulating technological innovation is an essential and integral part of any country's future development. Economic change, social progress and political stability will be influenced by decisions in the RTD sphere, as on-going industrial renewal is dependent, to a large extent, on the development of technological knowledge and its dissemination to industry. This may be particularly the case within CEE economies where, as Pungor *et al* (1993) suggest, their competitiveness and the dynamism of evolution to a free market system is largely determined

by the intellectual potential capable of developing and applying new technologies. Moreover, coherent RTD policies can significantly aid the process of re-industrialisation within CEE countries, including the extent to which existing firms and plants can improve their performance (Hughes, 1991). Indeed, a number of Central and Eastern European countries have recognised that there are a number of priority areas which need to be addressed quickly in order to help the economy as a whole. These include:

- the dissemination of electronic data processing, information technology and telecommunications in the economy and society
- the development of small technology-based firms
- increasing the efficiency of technology transfer
- the dissemination of environment-friendly technologies
- the acceleration of the commercialisation of research results and inventions
- the development of an R&D infrastructure.

However, there is no recognised approach which addresses all these different issues for CEE countries as a whole, although a number of studies have examined the development of RTD policies in individual economies (Higgins, 1993; Pungor, 1993; SQW, 1993).

One of the major challenges a coherent RTD policy would have to address within Central and Eastern European countries is the development of convergence policies which would attempt to close the technology gap currently in existence between CEE economies and Western Europe. With the liberalisation of trade and the elimination of political barriers impeding technology flows, dramatic changes have occurred in the structure of many industries. Within the more advanced CEE countries, there are examples of some industries, such as pharmaceuticals, having eliminated the external technology gap with the West. However, in general, RTD within CEE countries faces considerable problems, with international indicators revealing that R&D in key industries is perceived as lagging behind foreign competitors and that, in general, production technologies are considered outdated and inferior compared to international competitors (WEF/IMD, 1991). Moreover, studies have also shown that the gap in the productivity level of CEE countries, as compared with the West, has widened very markedly during the 40 years of central planning, with many industries being slow in introducing some major innovations and, more significantly, in disseminating those innovations through their industry (Ray, 1991).

Problems of implementing RTD policies in CEE countries

Therefore, there is a need for modernisation of the RTD system within both state and private industries in many CEE countries (Balazs et al, 1990). However, the lack of available financial resources within indigenous firms is believed to seriously constrain technological development, and thus the economic development of the country. These monetary restrictions, maintained with a view to combat inflation, have led to the withdrawal of increasingly high financial resources from industry (Bonifert, 1994). In particular, there has been a large reduction in R&D investment within state and private enterprises in CEE countries (OECD, 1993). This has not been compensated by any significant capital input from foreign investors, who have shown a general lack of interest in the development of technology-based industries within CEE countries, with most of the foreign assets being targeted towards low-technology industries.

Even within those industries which are foreign-owned, indigenous technological development is typically negligible since these companies are generally integrated into the production structure of the foreign company, and tend to use imported technical blueprints, know-how and technology. As Laky (1992) points out, this has resulted in a fear within the larger companies in CEE countries that the foreign partner may eliminate the R&D capacity of that company, especially if the partner requires only the manufacturing facilities for foreign products. This is not surprising, as even within advanced industrial economies, research facilities are generally kept within the home country of the investing partner.

Development of indigenous R&D capabilities

The development of an independent indigenous R&D capability within CEE countries is of crucial importance to the future of CEE industries and their ability to compete on a global basis. However, there are significant financial and structural problems in this task, as there is increasing evidence that CEE countries, in the rush towards a market economy, are endangering the long term viability of their technological industries.

With the collapse of the COMECON agreement between CEE countries, and the movement towards a free market structure, various market pressures arising from these changes, coupled with an increasingly competitive environment, has led to increasingly severe company budget constraints. Consequently, many previously technically advanced companies are being forced, by these economic conditions, to adopt short-term strategies such as widening their product range to more easily marketable products. In such firms, the development of these low-technology products has taken the place of the previous large-scale prestige developments (such as robotisation).

Trade liberalisation and the lifting of various embargoes has led to the import of high-technology goods reaching an unprecedented scale, resulting in a rise in the technological levels within various industrial sectors (Futo *et al*, 1994). However, this has seriously affected the balance of trade within CEE industries over the period 1990-1994. Many commentators have argued for the development of a strong indigenous technological base for such products. In particular, the formation and development of high technology and science-absorbing industries (especially biotechnology, microelectronics and modern pharmaceutical products) in CEE countries is perceived as being imperative to the long-term success of their economies (Szczański, 1990).

Human resources and RTD policy in CEE countries

A hitherto neglected aspect of the economic transition under way in Eastern and Central Europe is the role of human factors (Torok, 1994). As Audretsch (1992) suggests, an effective RTD policy requires a high level of proficiency within the engineering and scientific professions, as well as an overall high level of human capital and skilled labour. Whilst CEE countries had succeeded in developing high human technological potential under the centralised system, the subsequent economic changes have resulted in unemployment and a change in professional activity and emigration (the 'brain-drain'). This has resulted in a serious decline in the total number of R&D personnel active within these countries (Gourtsoyannis, 1993).

Another human resource problem may be the lack of skilled business people in CEE economies, which may hinder the commercial development of many technological innovations, and one of the main challenges facing RTD policies is the development a supply of local employees

who are trained to Western standards (Groff *et al*, 1994). In the meantime, a difficult but pressing question with respect to both science and technology policy is the extent to which it is possible to maintain and use existing skills and resources. One solution is to assimilate CEE scientists and technologists into the international scientific community, which could be achieved through different exchange programmes with leading centres of technology in Western European countries. Therefore, there may also be a need to increase the participation by CEE countries in the programmes specifically addressing the infrastructural and human resource issues without which research and innovation activities cannot be carried out.

However, it has also been suggested that Western companies can benefit from accessing some of the different skills and expertise available in CEE countries, with commentators arguing that the opportunities exist for Western organisations to harness the top intellectuals, to tie in with centres of excellence, and to focus these resources on commercial applications (Kiser, 1992; Lepkowski, 1993). The industrial restructuring within various industries, combined with the disparity between the high level of intellectual capital and the low level of physical infrastructure in Eastern Europe, has produced a resourceful scientific and engineering community that is developing new commercially oriented skills. For example, most plants in Eastern Europe's civilian semiconductor industry are operating with production controls and quality systems that would be regarded as basic in Western industry (Pierce, 1992). Despite this, the adaptability of the skills of the personnel in those plants is considerable, especially in the use of outdated and outmoded technologies and processes to develop advanced products. These skills, if harnessed through a coherent RTD policy, could benefit both CEE companies (especially SMEs), and western organisations attempting to establish new joint venture facilities in these countries.

Transfer of technology within CEE countries

Another issue of concern to RTD policy is the process of transferring technology into CEE industries. Currently, the majority of technology transfer within CEE countries such as Hungary is carried out through the framework of joint ventures (Laky, 1992), with the foreign partners usually bringing in technology as an initial asset. This may place indigenous CEE companies at a disadvantage in establishing relationships with foreign-based organisations. Therefore, international co-operation may require the establishment of institutional frames that efficiently manage the technology transfer process, which as well as allowing broad access to the intellectual and technical values produced in foreign countries, may facilitate the introduction and marketing of CEE products abroad (Pungor *et al*, 1993). In particular, it has been argued that, as in the case of Japan and Germany during their post-war economic miracles, technology transfer policy should initially concentrate on technology that is relevant and applicable to manufacturing processes. This may then address some of the major problems of re-industrialisation existing within many of the former state-owned producers (Kwiatkowski, 1994; Audretsch, 1992).

Possible solutions to RTD deficiencies

Therefore, there is a strong need to arrest the decline of the RTD potential of CEE countries. This can be achieved in a number of ways, but the most efficient and effective method of developing science and technology in CEE countries may be through extending scientific and technical co-operation in the development of joint projects. Contact with different EC programmes

should be encouraged, especially as the fate of Central and Eastern Europe hinges on its ability to forge tight economic and political links to the European Community (EC). Such international programmes would contribute to the rapid modernisation and globalisation of the scientific potential of CEE countries and enable their economies to become more competitive by adopting innovative, modern methods of operation. For example, in the Slovak Republic, it has been suggested that the internationalisation of R&D is of primary importance to the economy as it would increase internal competition, and enable the possibilities of comparison between indigenous and foreign-based R&D (SQW, 1993).

However, many international RTD programmes will have little relevance to the strategic indigenous requirements of CEE industries, and whilst complete CEE access to RTD initiatives such as the Framework programme may be desirable, in many cases it would not be feasible, as it would not even begin to address many of the structural problems inherent to these economies. The technological capabilities of CEE countries may also not be high enough for access to different programmes. Another problem may be the selection system itself. As Pollett (1994) argues, only high-quality proposals will be accepted for these programmes. In particular, access to RTD may have a number of specific priorities, including joining to fields of international priority such as biotechnology and information technology; taking advantage of national comparative strengths (in Hungary's case, agro-food technology and chemistry); the transformation and creation of a market economy through the development of an infrastructure and the promotion of regional development and innovative SMEs.

Other priorities may depend on the urgency of CEE countries to have access to RTD programmes in order to address specific problems following the legacy of centralised scientific research policy. For example, as with other CEE countries, Bulgaria has problems with the safe use of nuclear energy and with environmental/ecological projects. In some cases, access to particular RTD programmes may benefit strategically important industries, which would be of direct benefit to the economy, and thus to the process of change to a market economy. This process of 'technology clustering' has been particularly successful within Western economies (Williams, 1984), leading to the development of specific industrial sectors such as biotechnology and electronics. For example, the Estonian government has recognised the need for specific technologies within important industries such as oil-shale mining, power generation and the production of advanced fertilisers. It has also recognised that there are certain scientific fields, such as biomedical sciences, solid state physics, environmental sciences and communications, where Estonian institutions have recognised strengths, and from which a sustainable high technology industrial sector could be established.

In particular, the EC RTD programmes' emphasis on the promotion of SMEs may be of particular benefit to CEE countries, as the process of decentralisation and privatisation has resulted in the development of many small technology-based ventures. For example, in Hungary, there were 2700 industrial companies and industrial co-operatives in Hungary in 1988 employing 30 percent of the labour force (with some 1.4 million jobs). In 1993, this had grown to 15,000 industrial companies and industrial co-operatives, employing roughly 850,000 people (Futo and Kallay, 1994). However, the lack of capital available to these firms makes it almost impossible for them to acquire or develop technologies quickly and, more importantly, to participate in various international RTD programmes. In fact, one study has suggested that inadequate innovation and R&D activities within small manufacturing firms may eventually

stagnate the growth and development of this sector altogether in Central and Eastern European economies (Kallay, 1992).

Conclusion

This paper has discussed some of the main issues concerning the role of research and technological development policies within Central and Eastern European economies, and has suggested that the development of a coherent and focused RTD policy may provide a significant input to aiding the transformation process within these countries. In particular, RTD policy initiatives must address the weaknesses inherent to these changing economies. These include:

- reducing the technology gap between East and West
- encouraging the development of a strong SME sector
- ensuring efficient technology transfer systems

Such policies, whilst dealing with these deficiencies, must also build on national technological advantages, especially in the efficient utilisation of highly capable scientific personnel, and the development of strong strategic industries. However, these issues cannot be addressed without a parallel development of human resource skills, a scientific base, international channels and basic technological support (Brunner, 1993), measures which could be encouraged and enhanced through increased access to specific RTD programmes within the European Communities.

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Industrial Policies in Transition: Necessity, Lost Gains or Absurd?

(Empirical Evidences from Bulgarian and Portuguese Experience in the 90's)

MALINKA KOPARANOVA, JOSE AMADO DA SILVA

I. Introduction

Since the start of the reforms in Central and Eastern European countries (CEEC) at the end of the 80's, the issues of industrial policies relevant to the period of transition are mentioned in a small number of papers, along with problems of enterprise adjustments and industrial performance (e.g. Estrin, Gelb and Singh (1993). The problems for the need of an 'active industrial policy' and the extent to which the Government should be involved in the transition countries remain vital and have become at the centre of discussions in the last two years (Industrial Policies in the Economies in Transition, UN).

The research aims at studying the industrial policy, its design and performance in a transitional environment on the experience of two cases: the Bulgarian and the Portuguese economies. The countries are taken as examples of two kinds of industrial policies on economies in different phase of transition. The Portugal industrial policy has been designed as a part of the EU policy and in a period of relatively stable economic growth, while the Bulgarian economy has experienced political and economic crises along with the transition and has become a member of the Association Agreement with the EU only a few months ago (i.e. at the beginning of 1995 effectively).

The pattern of industrial policy in a transitional environment differs from the classical model¹ (i.e. in a developed economy) and it substantially changes over time. Due to the supply side weakness of a transition economy: overstuffing, union restrictions, educational and training

¹ Industrial policy is usually defined as policy eliminating externalities, or other market imperfections (Holmes and Smith, 1993).

However the authors are pointing to the narrow view in the latter case. In fact industrial policy refers to any policy affecting the structure of industry on its relation to other sectors of the economy, or else to a more specific range of measures, and that there are inescapable political reasons for political authorities to act, through namely industrial policy if this could help hitting the targets.

system insufficiently geared to establishing new industrial structures, lack of research and development support, poor management that is not capable to adjust to the market conditions outside and promote its production into world markets and compete aggressively, financial squeeze of enterprises, the necessity of a relevant policy in the industrial development is obvious. However any policies to reverse the decline in industry by providing government incentives are rather limited due to the widely spread notion of the reducing government's role in economic activity. Encouragement to invest in the first years of the reform is hampered mainly by the following factors:

- (1) restrictions in macroeconomic policy as a result of the attempts to stabilise the national currency;
- (2) uncertainties in political life and changes in policy values reducing State's credibility at all;
- (3) lack of market behaviour of economic agents in nascent capital markets environment.

The emerging markets in CEEC are functioning at lower capacities and foreign investors are cautious. Therefore the power of industrial policy in this case is limited. The scope however is larger. It encompasses measures to overcome market externalities as well as such that will establish and foster market mechanisms. The difficulty in constructing and implementing later this kind of a policy comes from these two controversial issues: how to distribute and manage limited capacities to a large domain.

The assessment of industrial policy calls for evaluation of the role of state in the transition period. Being burdened historically with a policy strongly influencing the industrial development in centrally planned system the CEEC withdraw their attempts to control in the first years of the reform. In the next part we briefly summarise some of the arguments and the consequences of accepting the lazier faire state in the transition process.

We trace out the main directions of state intervention already applied in changing industrial performance in the 90's in the two countries under investigation. The main issues on industrial policy are analysed within the overlapping scope with related policies. Depending on the extent of its implementation in the country, key questions of trade policy, regional policy, privatisation policy, unemployment policy, FDI policy, R & D policy are included as well. Finally we discuss and draw conclusions on the lost gains for an economy due to the lack of relevant industrial policy, or inconsistent decisions in the field.

II. Industrial Policy and Transition: the Political Debate on the Role of the State

As the main focus is on evaluating industrial policies and their effects on creating environment for firms relevant to the market we introduce the key issues that have been in the centre of the discussion in the field since the beginning of the reforms in the CEEC with details on their features for Bulgaria and Portugal.

Being engaged in national economic planning the CEEC used to have the most comprehensive approach to industrial policy. However the normative base and the lack of prices as indicators of the scarcity of resources created a perverse picture of the economy reflected in policies. Starting upon such an initial position, the transition processes that the governments embarked upon were faced by substantial withdrawal of the state at the beginning. By 1992 however a reverse in the attitude could be observed in Hungary, Poland and Czech and Slovak Republics (Industrial Policies in Transition, UN, 1993). Bulgaria did not join this group however by that

time. The delay is due to the uncertain political stance and the on-going inflationary processes in the economy.

The transformation in Bulgaria started in the end of the 80's but in practice the implementation of a stabilisation programme in 1991 marked the beginning of more radical reforms. Much the efforts of the governments were directed to financial stabilisation: restrictive monetary, fiscal and incomes policies were implemented with different success for the four years period. The functions of the state for this period were focused on macroeconomic stability while managers got the freedom to manage the enterprise on their own in practice. Targeting market structures the governments' role was substantially underestimated in the restructuring process. Due to the existence of urgent problems however the Ministries (the Ministry of Industry Ministry of Trade, Ministry of Finance, and other Agencies) were making ad hoc decisions and applied different measures on spot.

The political instability and the changes of the governments was the second reason for the underestimation of the potentials of the state in the field. The restructuring of the economy and the privatisation issues were just mentioned in the declarations of the Governments without any substantial evidence to effect the real economy. The lack of these processes was the main reason for delays in the economic revival.

After a period of negative interpretation of the role of the state in industrial policy performance during the transition, at the beginning of 1995 the new elected government declared a reverse in the tendency. The willingness (yet) of the government to encourage industrial investment comes at a time when the economy is going out of the crises. The first signs of economic revival appearing in late 1994 are already evident in 1995: there is an increase in the industrial output of 3%² for the January-October, 1995 period compared to the same period of the previous year, and favourable macroeconomic conditions - reduced inflation rate for the same period of 26.3%, a decrease in unemployment rate of around 5 percentage points, stability of the exchange rate, more than double reduction in nominal interest rates.

The Bulgarian experience is pointing to a case where the change in the attitude to the role of the state and consequently to the character of the industrial policy goes along with the advancing of the transitional processes to a relatively stable political and economic stance.

The concept of the necessity of state intervention is very much related to the economic history of the country. The changes of the political environment in Portugal follows a path from capitalist system to a socialist one (the 1974 Revolution) and then to a liberal market-organised system, where the State is not a producer but a regulator of the economic activity.

State intervention in Portugal, through either a more liberal, or more interventionist approach is pursued by the Government since 1987. Industrial policy is explicitly formulated since then. However co-ordinating the state decisions within multinational boundaries is changing the practice of setting up the design and implementation of industrial policies.

Becoming a member of the European Union, Portugal is experiencing a direct influence on setting out its policies. Industrial policy was no exception of the rules.

² All data are reported from different issues of the National Statistical Institute, Sofia, unless otherwise stated.

III. The Portuguese Experience in Industrial Policy:

1. *Main elements of the Industrial policy after 1986:*

In the political regime before 1986 there was a clear ‘Visible Hand’ of the state on the economy and also a pre-eminence of producers over consumers preferences, with a sensible independent strategic design vis a vis foreign power (L. Mira Amaral, 1992).

With the EEC integration it was impossible and unreasonable to conceive a feasible and efficient strategy outside the European framework. This implies both co-ordination of Portuguese industrial strategy with the European one and the purpose to approximate the European specialisation pattern.

Industrial policy in Portugal is clearly that of a regulation state substituting for the one of an entrepreneur state since 1986.

Moreover before 1986 the industrial policy approach was rather interventionist and typically a sectoral one. On the contrary, the focus of the policy now is mainly on firms and their integrated strategic projects. Firms are considered as the real engines of industrial development and therefore the essentials of structural changes.

Main characteristics of the industrial policies in Bulgaria and Portugal are summarised in Table 1.

Table 1: Explicit State Policies

	Bulgaria	Portugal
I. Before the reforms		
1.1. Industrial Policy focused on	Yes sectors	Yes sectors
1.2. Trade Policy	within the CMEA on bilateral base	Yes
1.3. Regional Policy	Yes	Yes
II. After the reform		
1.1. Industrial Policy focused on	1991 - 1994 Ad hoc 1995 - Yes firms and projects	Programmes co-ordinated with the EC firms and projects
1.2. Trade Policy	Yes - 1991	Yes
1.3 Privatisation Policy	Yes - 1992	Yes
1.4. Regional Policy	Yes - 1992	Yes
1.5. Unemployment Policy	Yes - 1992	Yes
1.6. Investments Policy	Yes - 1995	Yes
1.7. R & D Policy	No	Yes
1.8. FDI Policy	Yes - 1995	Yes

The main tool of Portugal industrial policy in the last years was the PEDIP (Specific Programme for the Development of Portuguese Industry) supported by EC funds. It is considered as a big success by the EC authorities both in evaluation and achievements.

However there were some shortages, the main ones being the following:

a meaningful share of money was allocated to the acquisition of equipment either for increasing productive capacities, or often to reshape the production apparatus. The high interest rates could explain the figures as firms lacked funds even for their accounts;

- there was a lack of integrated projects, especially those including immaterial products, which enabled firms to be innovative;
- the Programme imposed a widespread support of firms but with a low quantitative limits to projects thus hampering most of the integrated programmes at firm's level;
- R&D bodies were established to provide conditions for the innovative functions of firms.

However, in such a case there is a danger of the projects being not co-ordinated and herefore these tools are not coherent in the sense of a comprehensive industrial policy.

Table 2: Economic Indicators

		1990	1991	1992	1993	1994
GDP per head (US \$)	Bg	1,922	943	1,008	1,276	1,187
	Por	6,897	7,941	9,752	8,690	8,850
GDP (real rate of growth, %)	Bg	-9.1	-11.7	-7.3	-2.4	1.4
	Por	4.2	2.2	1.5	-1.2	1.1
Industry (real growth rate, %)	Bg	-16.8	-22.2	-15.9	-10.9	4.5
	Por	9.0	-0.2	-2.2	-5.1	-
Manufacturing (real growth rate, %)	Bg	-16.4	-23.8	-17.3	-7.2	7.4
	Por	5.7	-2.0	-4.0	-6.0	-
Inflation rate, annual %	Bg	23.8	338.5	79.5	56.1	95.0
	Por	13.4	11.1	8.9	6.5	5.6
Unemployment rate, %	Bg	1.7	11.1	15.3	16.4	12.8
	Por	4.7	4.0	3.9	5.0	6.5
Trade balance (US \$) billions	Bg	312	734	-546	-1,337	-159
	Por	-5,448	-6,786	-8,586	-6,842	-
Export (US \$) billions	Bg	13,435	3,440	3,922	3,721	4,156
	Por	21,761	21,809	23,975	22,116	-
Imports (US \$) billions	Bg	13,123	2,706	4,468	5,058	4,315
	Por	27,209	28,595	32,560	28,958	-
Industrial share in GDP	Bg	51.0	48.1	44.6	41.7	36
	Por	37.4	35.2	33.6	33.2	-
Services share in GDP	Bg	30.7	45.8	44.0	47.3	52
	Por	56.9	59.2	60.9	61.7	-
Agriculture share in GDP	Bg	18.3	6.1	11.4	11.0	12
	Por	5.7	5.6	5.5	5.1	-
Investments share in GDP	Bg	21.3	18.3	19.6	15.1	11.6
	Por	29.8	29.8	30.6	29.6	-

Later a new programme was worked out, known as the new PEDIP II. Although the new programme was intent to begin in early 1994, effectively the whole year has been used for negotiations with Brussels and to the establishment of a legal work for the firms' participation and other bodies in the Programme. The first applications were submitted only in the last quarter of 1994.

In the first quarter of 1995 the number of applications increase dramatically but still there is not a clear picture of the projects. However the following tendencies were observed:

- The delay of the programme implementation was responsible for the fall in industrial investments both as a result of being not a stimulating environment and as incentive to firms delaying some not very urgent projects in expectation of benefits (profit) from the Programme advantages.

Meanwhile the clearer legal framework is followed by the actual and normal crises of the approach of new elections for Government which blurred investment prospects and could give misleading signals about the merits of the Programme.

- The bureaucratic controls which are imposed to the applicants are raising some uneasiness among the enterprises. The latter are complaining about the difficulties to have an access to the Programme and some of them are almost giving up.

In fact, it seems that a Programme that intends to be comprehensive and imposes to the applicants global and integrated strategy cannot be ruled by so many controls and so many officers. Maybe we are facing a problem of 'public performance' and, in particular, of hierarchical link inside the Body that is in charge of PEDIP II that, if not solved, may endanger the Programme success.

- Again, a good and suitable policy can be prevented by an inadequate behaviour of public agents, who may rather seek to pursue their own projects than to co-operate with entrepreneurs. What we know, for the moment, is that these projects, which pertain to the public initiative are much more advanced than those which are open to entrepreneurs.
- Having in mind that the main focus of the Programme is to upgrade the measures achieved in the former one, namely investing in immaterial, human and organisational assets, there is a strong need for co-operation between public administration and entrepreneurs and their associations in searching for a matching of interests and 'complexity' in defining and pursuing the main objectives.

We cannot reach a better quality, better human resources, better information technology, better energy efficiency, better R & D, if this 'complexity' is not achieved. This achievement imposes rediscovering of the role of state in market economy, which further more is embodied in a much wider economic space and is opened to globalisation forces.

Besides redefining strategies we need to reshape the mind of civil officers and to reassess the links between them and the entrepreneurs.

2. ***Institutional framework: decentralisation and co-ordination issues;***

The first important issue in establishing the co-ordination is the relation between the EU policy and that of Portugal. In the process of negotiation of the Programmes there were no big

limitations to the Portuguese actions and the required commitments were rather in the evaluation field than in big restrictions ex ante.

At national level the problems were of different character. Although the liberal approach is the guideline of the government policy there are some institutional bodies that do not share his opinion on the role of the state and are committed to the 'government strong hand' over Ministries. The structure of these bodies is of the kind that does not facilitate a clear definition of who is in charge of the industrial policy. In fact, besides the relevant Ministry of Industry and Energy, there is a control, or even leadership in some matters by the Ministry of Trade, the Ministry of Finance, the Ministry of Planning and even by the Ministry of Environment.

One of the most relevant example is that of privatisation policy. Privatisation was obviously a must in the context of a liberal approach but the procedures were not relevant.

Actually the first processes of privatisation of industrial firms were dealt by the Ministry of Industry and Energy and their aim was not merely to raise the maximum possible revenue for the state. On the contrary some other relevant objectives were put forward as: commitments to develop business in Portugal (local interests), to improve R&D services, and to guarantee some conditions for the labour force.

However a reverse in the tendency was put by removing some state owned industrial firms from the Ministry of Industry and Energy to the Ministry of Finance. Then they were considered assets and were to be sold under the maximisation of revenues objective. With this the use of privatisation as a tool for industrial policy was over.

The Ministry of Planning has twofold functions. It encompasses broader problems of coordination (Programmes with the EC) and specific issues related to the R&D and technological issues.

The overlapping of responsibilities is greater between the Ministry of Industry and Energy and the Ministry of Trade. Here a lots of problems exist. These problems are becoming sharper when we look at the FDI issues.

3. *Links of Industrial Policy and other economic policies with overlapping domains*

Regional policy changes its approach to industrial relations. A special programme was created to foster the regional development (SIBR). However the programme was less selective and projects were very much uncoordinated. Political interests and that of local lobbies were included as well.

Privatisation policy is recently used as an industrial policy tool by a third way: now privatisation policy has a new objective - to make the privatised companies more attractive to small savers and thus to have a wider shareholder basis. Through this approach two objectives could be gained: stimulation of the stock market and to keep the privatised companies in Portugal owners.

In the field of technological and R&D policy there is a strong effort to endow the Portuguese Scientific and Research System with Basic and Applied Research Units and establish the relations at firm's level. For the moment scientific and technological investments are not yet transferred at firms.

4. Financing Industrial Policy: problems and way of solving them

Having changed the focus of support to the firms from free grants to diminished interest rates and principal delayed payments, the policy is much closer to the aim of easing entry and equalising costs of capital but at the same time much more dependent on the financial system.

The Programmes collaborate with commercial and investment banks and are trying to solve the financial problems of the firms.

IV. Macroeconomic and Industrial Policies in Bulgaria in the transition period: Are macroeconomic instruments crowding out the industrial incentives?

1. Macroeconomic environment and the constraints to industrial policy implementation;

At the beginning of the 90's Bulgaria entered a period of sharp economic decline. The abrupt changes both in the political and economic life reflecting the accumulation of irrelevant to the country's endowments structure lead to a deep crisis. The economy suffered extremely severe supply shock followed by a demand shock later along with the political uncertainties during the four year period of the reform.

The adoption of a shock reform by liberalising prices from February, 1991 necessitated restrictive macroeconomic policy as an initial step. The first attempts were directed in the monetary sphere to reduce wave the monetary overhang and avoid hyperinflation. The focus of high nominal interest rates along with credit ceilings (the latter were abandoned in late 1994) coupled with restriction of the fiscal deficit deprived the industry of any financial resources for restructuring. Subsidies were dramatically cut and the change in the trade regime along with the exchange rate policy put the sectors using imported inputs under heavy conditions. The lack of retained earnings in the state owned enterprises made the price of survival expensive as companies are compelled to take new credits for their short-run activities with high interest rates. The reduction of domestic credit however compelled the companies to take credits among themselves thus the interenterprise arrears enormously increased.

The consequences of the investment policy before the reform in sectors selected not by economic criteria in most cases lead to accumulation of enormous amount of non-performing loans. The governments in the first two years of the reform neglected these problems and that lead to massive accumulations of payable both to the banking sector and to the government.

The financial situation, chaos and instability were the main reasons for the absurd of implementing any industrial policy focused on firm's level due to the impossibility of a reliable evaluation of enterprises in that time.

The consecutive changes of Governments resulted in delaying the structural reform as a complementing element to the stabilisation programmes. Therefore the only option for the state was to intervene at the last moment by ad hoc decisions with no coherence between them. The partial implementation on one side and the low effect on the real economy on the other were the obvious results.

2. Characteristics of the Industrial Policies Attempts of the Governments since the beginning of the Reform

2.1. Industrial Policy at the beginning of the reform

A stabilisation programme with restricted fiscal, monetary and incomes policies was followed with relatively few stops and goes for the whole period. The implemented set of instruments; high interest rates, ceilings on credit lending, restrictions on wage bills prevented from hyperinflation. The other side of these effects however was the lack of any credits that the enterprises could afford. A continuous shortage of cash exhausted the state-owned enterprises (SOE) in the industrial sector and most of them fall in a financial squeeze.

The price for the continuous macroeconomic stabilisation and the adaptation to the emerging market mechanisms created a management crises in the SOE. The Government was confronted by different and urgent problems and solutions were sought by ad hoc decisions. Despite several declarations of the Governments that a structural reform should be complementing the stabilisation policy for 1992, 1993 and 1994 no explicitly formulated programme for industrial policy became effective during that period. The only attempt to formulate an industrial policy was done by the Government of Prof. Berov. An investment programme was worked out focusing on infrastructure, industry and agriculture. The Government also promoted the idea of the mass privatisation as an instrument for restructuring. The political debates however took all the time and no effective implementation could be traced.

The popular notion of the role of the state during the transition favoured the withdrawal of the Government from economic life. In practice this attitude dominated till the end of 1994.

For this period several attempts to solve the problems of some sectors were done most effective among which is the reorganisation of tobacco industry. Several changes were done in the energy sector but problems remained unsolved.

The legal framework was set up by creating new laws for economic activities in market environment. On this base measures for decentralisation and demonopolisation were undertaken. Without a clearly defined criteria for decentralisation, breaks in technological chains were often the results of the 1991 attempts for demonopolisation. Commercialisation of enterprises has been carried out on a large scale for the period.

Changing the principle of state intervention in the firm's activities from direct subsidies to easing the credits and Government guarantees the access to state support became much more dependent on the financial system.

The main tool of Bulgarian industrial policy in the last years was the specially set up State Fund for Reconstruction and Development (SFRD). The fund was set up in 1991 with the help of the international organisations disbursing credits for restructuring of the economy (Table 3).

The aim of the fund is to finance the sectors with priority in the national economy (the so called structural determining sectors) giving privileges in the conditions for credits

Table 3. Credits by International Organisations and Countries for Restructuring, SFRD
(Millions)

Creditor	Amount	Currency	In USD	Interest Rate	Credit period
The World Bank	250.00	USD	250.00	6 m. LIBOR USD + 0.50 %	12 years (1996-2008)
EC	290.00	XEU	348.00	6 m. LIBOR XEU+ 0.20%	2 years (1998-1999)
Austria	210.00	ATS	18.90	6 m. LIBOR +0.125%	2001
Sweden	14.50	XEU	17.40	6 m. LIBOR XEU + 0.1875 %	2001
Switzerland	32	USD	32.00	6 m. USD TB +0.50%	2000
Japan	5,822.31	JPY	60.21	+ 0.20 %	10 years (1996-2006)
The World Bank	125.00	USD	125.00	6 m. LIBOR USD+ 0.50%	14 years (2000-2014)
Norway	10.68	XEU	12.82	6 m. LIBOR XEU	1999
Finland	10.00	USD	10.00	6 m. LIBOR USD + 0.50 %	2 year (1998-2001)
EU	70.00	XEU	84.00	6 m. LIBOR XEU+ 0.10%	2001

The Banker, No 27 and 28, September, 1995.

Bulgaria received credits from the World Bank, the EU and several countries (Table 3) totalling to 958.33 mill USD for restructuring. The sectors with priorities are determined in a special programme including the infrastructure sectors as the first group: transport, roads, communications, information and energy; the second group: agriculture and food processing industry, tourism and environment. The group of industry includes priorities for units under construction, and for SME. The bulk of the credits should be given for investments projects - 75%, for pre-export financing - 20% and 5% - for other short-term credits.

From the very start of the reform the Fund was the only available resource for solving some of the problems of the SOE due to the accumulated debts (Dobrinsky, 1994) and the loss of the external markets. Therefore the demand was exceeding the potentials of the fund. However for three years only 6 -7 credits were disbursed to firms from the SOE and till the middle of 1995 - 11 credits, while the available resources were increasing as a result of the devaluation of the national currency since the set up period. At the end of 1994 the fund resources totalled to 25 billion BGL.

Several factors were influencing the inefficiency of this resource including shortages in the regulation according to the rules of its establishment³. The credits should be used according to a preliminary approved by the CM programme for restructuring of enterprises. The second reason is the form of control and management of the fund - board of directors, consisting of the sector ministers and a representative of the Bulgarian National Bank (BNB).

The first credit was in practice a credit for financing fuel supply to 'Chimimport' in 1991 and not for restructuring. The next year records no credits at all and in 1993 a credit of 728 mill BGL is received by the NEC, a credit of 150 mill. BGL - by the Sofia municipality for the tube construction, and for by back of the external debt - 350 mill. USD. In 1994 several credits were disbursed: to the NEC - 15 million USD for purchasing nuclear fuel, to 'Balkancar' –

³ SFRD was set up by the Audience of the CM No 147, 1991.

230 million BGL by the First private Bank and two credits without any interests (after changing the rules in the audience of the CM): - to the national fund 'Energy Resources' of 1 billion BGL. This amount has been used for preparing heat producing companies. The other non interest credit is to the Ministry of Agriculture and Foodstuff Industry for 500 million BGL. 1

In 1995 several credits were received by 'Glavbulgarstroy' for constructions of three plants in the CIS with 10 % interest rate due in 1998. For technological equipment of a new line for the steel production the factory 'Kremikovzi' got 34 million USD credit with 11% interest rate. Till the end of the year several credits will be disbursed the biggest ones for the investment,,! programme of the energy sector - of the NEC - 3 million USD and the same amount for the ore mining at Pirdop.

In regards to the industrial policy carried out on the base of the SFRD financing there were some shortages, the main ones being the following:

- a small amount of money was allocated to the acquisition of equipment either for increasing productive capacities, or often to reshape the production apparatus, or for pre-export financing.
- the interest rates were high for the firms and low for the financial intermediaries;
- the projects were not integrated and there was no unique criteria for selection.

The changes of four Governments and the lack of a unique programme for restructuring is one of the reason for the inefficient work of the fund, and the second reason is in the fact that the fund includes the currency reserves necessary for the external debt payments to the bank- creditors of the London and Paris Club. By the end of 1992 the fund turned into reserves and even the possibility to use as restructuring tool was waved.

The third reason was in the lack of financial intermediaries to support the SFRD. According to the rules banks with special licenses should have to evaluate the projects and provide a decision for the board of directors, the lists of the banks was changing all the time and the banks had no interest to do this as the limit for the interest rates was set up at 2 percentage points above the approved with the creditors. Besides the disbursed credits till the moment are Government projects and as such they do not pass the evaluation procedures. By the end of 1994 there was no necessity for financial intermediaries because of the BNB involvement.

The Government programme for 1998 is focusing on the SFRD as the main tool for realisation of the investments in the country. Since 1995 the attitude to the Fund changed. The organisation structure changed as well: the representative of the BNB was substituted by the representative of the Ministry of Economics and development. The whole activities were analysed and a change in the legal status is ahead.

The results on the activities of the SFRD have shown that the fund is a loss maker⁴. Most of the means in the Fund are in BGL. they include the revenues from privatisation (totalling to 736 million BGL). The only exception when the revenues exceeded the expenditures is for 1991. taking into account the maturity period the losses are going to increase especially in 1998 the

⁴ The majority of the information on the SFRD is taken from different documents of the CM, and from 'Banker', No 27 and 28, July, 1995.

bad management is a fact that the Government is looking to correct by transferring the fund to an investment bank.

The structure of the disbursed credits is observed to favour big SOE with already accumulated amounts of bad loans and almost no perspective to return the credits. It is a well known fact that till now no private firm has been credited within the SFRD.

The plans for transferring the Fund into an independent subject are the first step in making the available resources efficient which is due to September, 1995. The legal independence is expected to rationalise the decision making process in allocating the credits and to take the responsibility and make the annual balances of the fund. The new status will have implications on the industrial policy due to the different levels of the interest rates on the credits. The interest will increase in order to make the licensed banks more efficient and to make the process dynamic. The other outcome will be decrease the credits with zero interest rates. In this case projects with a business plan for profitability and reliability will be financed only. The intentions in the new policy are to introduce new structure of the credits differentiated by ownership.

The second step is forming a bank out of the already independent Fund with the accumulated amount along with new credits disbursed to the country for restructuring from international institutions and countries as well. The targeting firms will be of medium and big size. The bank will be with limited licences without the rights to accumulate deposits from residents and firms, will have no current accounts and without activities for Government securities either. The third stage is to involve the bank in creating a new bank like the German bank Kreditanstalt to serve the SME needs.

2.2. Industrial Policy in 1995: An attempt for a New Start

The following characteristics of the industrial policy in 1995 were introduced:

- Declaration for an active industrial policy of the socialist Government setting up the policy in an explicit framework within the government programme;
- Institutional Changes were established to promote industrial policy: the Ministry of Economic Development is co-ordinating the Ministry of Industry and Ministry of Trade; Agency for FDI is established as well;
- Priorities for development in the economy are identified;
- Incentives for trade policy oriented to the CIS markets were created by signing contracts with the Russian government recently.

As a whole the following differences in the approach to industrial policy could be traced in:

- explicit measures to manage the enterprises in the state sector versus the ad hoc decisions by negotiations with banks about creation enterprises;
- changes of the attitude to the state intervention;
- uncertainties in the institutional framework and consequences for decentralisation and co-ordination are substituted by expectations for stability;

- the 1995 industrial policy design is the first step in a four year programme of the economic development as a whole.

The programme for restructuring of the banking system worked out and put for discussion in December, 1995 will soon become the most effective tool of industrial policy. Being highly indebted to the banking sector the SOE from all the sectors will undergo through a set of changes. Financial insolvency of industry will be liquidated and helped by the new consolidated banking sector is to develop on market principles.

3. *Links of Industrial Policy and other economic policies*

Privatisation policy though was admitted to be a must for the reform from the very beginning remained isolated for two years. For the 2-year period since the adoption of the Privatisation Law to September, 1994 the privatised commercial companies in industry were 18 out of the 226 authorised for privatisation. It is in the fifth year that privatisation is included in the national strategy for restructuring industrial sector within the government 4 years programme. The early stage of the latter however makes impossible any clear analysis of its efficiency. The massive privatisation planned to start in September this year focuses on a programme build up along with the other methods for privatisation and thus ensuring changes in the industrial performance in the medium and long-run. Such a strategy makes the privatisation policy one of the main tools for industrial policy. In 1995 according to some preliminary estimates of the privatised firms and their own capital the process has been accelerated and is moving twice faster than the proceeding quarter.

Trade policy has been the most active element of the policies on microeconomic level. The decrees and audiences regulated the trade regime. However most of them were controversial and the quick changes created uncertain environment. There was a lack of co-ordination between the Ministry of Trade and Ministry of Industry and Ministry of Agriculture. The priorities should be determined on the basis of the balance sheets reflecting the needs and development of sectors. The trade regime as well needs changes in every 3,6 months but not in a week time (as the recent practice was). The Ministry of Finance is also related to the trade and industry performance and the co-ordination between the three ministries is a necessity.

FDI policy was lagging behind the rest of the CEEC countries. From the overall amount of 467,240 mill USD 166.648 mill. USD are in industry including 349 entities from all - 3087. Their effects on industrial structure are still negligible. Besides most of the FDI are in trade, services (consulting and banking recently). The Commission for FDI was recently transformed into an Agency with the key function to promote FDI.

V. Comparison of the two cases:

1. *Political and socio-economic background of the two economies - reasons for differences and resemblance;*

- Unlike the CEEC Portugal has endured a radical political change, but the economic system and mainly the economic agent's behaviour though disturbed and suffering continuous quarrels had already most of the market based foundation. Bulgaria embarked upon the road to transition economy after an abrupt change in the economic processes as well not speaking of the market behaviour which cannot be adopted over night. The advantages of

having already goods and services market, labour and capital markets though not well developed but functioning is a fact that should be taken into account.

- Economic policies (both macro- and micro-levels) are designed and implemented for the first time in Bulgaria at the outset of the reform. Policies issues and their construction for a period of time is a practice known to the Portugal state;

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2. *Characteristics of the transition - two versions, or one version with different implementation*

- (a) an industrial policy within the EU sets out the following rules which effect directly:
- explicit formation of the targets, instruments and the object of impacts: sectors, firms, or project;
 - establishment of the procedures ex ante, and thus bringing to the relevant expectations and strategies of the firms;
 - delegates the responsibilities to the different ministries, agencies, or councils;
 - the national Governments have a response to their own strategies priori to implementation, i.e. in the process of formation of the programmes with the union.
- (b) a national industrial policy is under the pressure of continuous changing.

We have two examples of economics with different stage of integration to the EC. With this respect we could draw several conclusions on the pattern of industrial policy:

3. *Differences in the Industrial Policies applied*

- Different international environment is observed for Bulgaria and Portugal at the outset of the reform, affection the establishment of market mechanisms the international relationships. Portugal was with EFTA countries while Bulgaria - within the CMEA countries.
- FDI is c continuation for Portugal while it has just started for Bulgaria, and even is very slowly developing as compared to the CEEC.
- Geographical boundaries for the CEEC remained the same while for Portugal there was a lost of territories.
- Evolution of property rights follows opposite paths for the countries. This leads to differences in the privatisation processes;
- Different industrial structures at the outset of the transition - industry was overdeveloped in Bulgaria with special emphasis on heavy industry.
- Differences in the labour market - unemployment is a problem ever since the beginning of the reform;
- Volatility in the on-going processes is a characteristics of the transition in Bulgaria: in price movements, in exchange rates while there is a relative stability in Portugal.
- Political uncertainty during the transition process in Bulgaria - changing of governments even a change of the Parliament with opposite parties.

4. Conclusions:

- Conclusions on the industrial policy in transitional economy:
 - without political stability industrial policy is an absurd;
 - industrial policy needs relevant macroeconomic framework;
 - the coherence of the industrial and related policies is a necessary element of an efficient policy;
 - the institutional framework should be consistent with the tools and measures;
 - support of the industrial policy from international and foreign organization within the national programme creates certainty;
- Conclusions: lessons for the Bulgarian economy

The problems on creating consistent policies focusing on firm's level and already experienced in Portugal should be taken into account when the industrial policy in Bulgaria is set up and implemented. This includes the relations between the FDI policy and the privatisation policy. Special attention should be given to the privatisation issues and the criteria for privatising.

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Transnational Corporations, Direct Foreign Investment and Attractiveness of East European Economies in Transition

XAVIER RICHEL

The systemic changes that have occurred in East European Economies (EEEs) and the opening up of these economies have broadened opportunities for Transnational Corporations (TNC) to expand their business in this part of the world. Already a significant increase of capital inflows can be seen but this flow is quite low compared to direct foreign investment (DFI) realised in developing economies not to speak among developed market economies which capture more than 80% of the total outflow.

This lack of attractiveness of EEEs can largely be explained by the existence of many factors remaining from the old system as DFI is viewed by the new leadership as a mean to accelerate the adjustment of firms and to ease the reintroduction of these economies in the world economy.

After reviewing the main measures that have been taken by the new governments to attract DFI in their countries (I), we will analyse how the strategies followed by TNC will emphasised as well as the main factors which hamper the development of DFI discussed.

I. Economic Transformations and Attractiveness of EEEs

A. Systemic changes: a more favourable environment for DFI

The changes that have taken place in EEEs in 1989 - 1990 have opened up new opportunities and slightly modified the conditions necessary to enter these markets. Paradoxically, as it can be seen from Table 1 and 2, if the flow of DFI has strongly increased often starting from epsilon in some countries, it still remains far behind DFI in other parts of the world, like China or developing countries. It has also modified the nature of the co-operation, TNC favouring, in most cases, acquisition and greenfield investments to joint-ventures.

Table 1. Flows of DFI into the transition economies (cash basis), 1990-1994 (millions of dollars)

Country	1990	1991	1992	1993	January - June 1993 1994	
Albania	-	-	10	48	24	24
Bulgaria	4	56	42	55	22	25
Croatia	-	-	16	72	18	39
Czech Republic	180	511	1004	568	392	301
Hungary	311	1459	1471	2339	573	535
Poland (Cash)	88	117	284	580	94	291
Poland (BOP)	89	291	678	-	-	-
Romania	-	40	80	87	47	116
Slovakia	18	82	100	144	72	36
Slovenia	-	41	111	111	76	29
The FYR of Macedonia	21	38	15	15	7	7
<i>Eastern Europe</i>	622	2344	3132	4019	13255	1403
Belarus	-	-	7	7	4	4
Moldova	-	25	17	-	-	-
Russian Federation	-	100	1454	1404	700	600
Ukraine	-	-	200	198	100	100
<i>European CIS</i>	-	125	1678	1609	804	704
Estonia	-	-	58	160	65	119
Latvia	-	-	43	39	18	30
Lithuania	-	-	10	40	20	20
<i>Baltic States</i>	-	-	111	239	103	169
TOTAL ABOVE	622	2469	4922	5867	2232	2276

Source: UN/ECE foreign investment data base

Table 2. Direct foreign investment in the transition countries (cash basis), 1990-1994: cumulative total (a)

Country	Level (million dollars)			DFI per capita 1993(b)
	1992	1993	June 1994	
Albania	10	58	82(a)	18
Bulgaria	101	157	182	17
Croatia	16	88	127	19
Czech Republic	1951	2519	2820	242
Hungary	3442	5781	6316	558
Poland (Cash)	494	1074	1365	28
Poland (BOP)	1187	-	-	-
Romania	120	207	323	9
Slovakia	210	354	390(a)	83
Slovenia	152	263	292	130
The FYR of Macedonia	74	89	96(a)	45
<i>Eastern Europe</i>	6571	10590	11993	99
Belarus	7	14	18	1
Moldova	42	42	42	10
Russian Federation	1554	2958	3558(a)	20
Ukraine	200	398	498(a)	4
<i>European CIS</i>	1803	3412	4116	16
Estonia	58	218	337	139
Latvia	43	82	112	30
Lithuania	10	50	70(a)	13
<i>Baltic States</i>	111	350	519	44
TOTAL ABOVE	8485	14352	16628	43
Stocks of DFI in the developing countries (billion dollars)	420	489(c)		

Sources: UN/ECE

(a) Cumulations start in 1988; (b) Dollars per capita

Institutional changes have taken place in all countries and have clarified property rights; State-owned firms have been corporatised, other firms, small start-up, have mushroomed from scrap, privatisation programmes, the adoption and the enforcement of bankruptcy laws, the adoption of favourable legislation toward DFI (Figure 1) on the one hand, price liberalisation, the creation of financial markets and the quasi convertibility of currencies, on the other hand, have rapidly modified the economic environment, reducing some transaction costs and lowering most barriers to enter these countries to TNC.

Figure 1. Treatment of direct foreign investment

Czech Republic	National treatment, no special incentives
Estonia	Tax holidays and concession- Any rate after tax holidays ends
Hungary	National treatment. In 1991 incentive for foreign investors to be phased out by the end of 1993
Latvia	Tax holidays and breaks for foreign investors. No restriction on profit remittances
Lithuania	Tax holidays and breaks for foreign investors. No restriction on profit remittances
Poland	Until December 1993 any foreign investors may apply for a tax exemption if the investment exceeds 2 million ECU
Romania	Special incentives extended under 3 April 1991 law. Tax holidays for 25 years. Proposals submitted to the parliament to allow land ownership by foreigners
Russian Federation	National treatment with some remaining privileges for JVs registered before 1 January 1992 with foreign participation above 30%
Slovak Republic	1 April 1993 law extends a one year tax holiday to firms more than 30% foreign owned and further two years of reduced profit tax. New law differs from Czech national treatment policy

Sources: EBRD Outlook, September 1993

Macro-stabilisation and micro-adjustment policies have contributed to speed up the transformation by creating a strong constraint on firms and pushing them to adjust quickly to the new environment. In this new context, DFI plays an important role (Welfens & Jasinski, 1994) as one of the components of modernisation of enterprises even if in some countries governments want to limit their importance, where strong explicit or implicit nationalist feelings exist. For instance, internal (Russia) or external (Czech Republic) privatisations with vouchers, limit the role of foreign capital; for one part of the population, the selling off of some “Crown jewels” develops the feeling that country is depriving of its wealth. In Hungary, this feeling has led to the cancelling of the selling of Hungar Hotel, a chain of first category hotel to an American investor. Parallel to the redistribution of property rights and to the strengthening of the financial constraint on firms, DFI plays an important role in pushing enterprises to adjust; in a way, it is a kind of market industrial policy which picks up the winners and force enterprises that want to survive to adjust more rapidly and lets the other adrift (Brada and alii, 1994) as it as been shown through different case studies conducted in EEEs recently (Estrin & alii, 1994; Estrin & Richet, 1993). At a macro level, the inflow of foreign capital is shown as a means to generate exports, to reduce the deficit of the balance of trade, to link EEEs to the world market and to ease and speed up the restructuring of foreign trade after the collapse of former CMEA.

B. Distribution of DFI by plant size

A last discrimination of DFI concerns the size of assets acquired by foreign investors as the mode of control of these assets. In average, DFI by project is relatively low (Table 3) compared to DFI realised in developing economies where, in average, each project accounts for 4 millions US\$ against only 0,260 millions US\$ in EEEs. In Hungary, only 4% of the projects are over 1 million US\$ while in Romania, 95% of DFI projects account for more than half of total DFI in the car industry (Volkswagen - Skoda, Fiat - FSM).

Table 3. Cumulative foreign direct investment registrations in Eastern Europe, 1991-1993(a)
(Number of cases, Millions of dollars and percentage)

Country	1991	1991	1992	1992	1993	1993	1993
	Number	Millions of dollars	Number	Millions of dollars	Number	Millions of dollars	Percent
Bulgaria	900	130,0	1200	170,0	2300	200,0	1,0
former Czechoslovakia	4000	1076,0	-	-	-	-	-
Czech Republic	-	-	3120	1573,5	5000	2053,0	10,6
Slovakia	-	-	2875	231,2	4350	380,0	2,0
Hungary	9117	3137,0	17182	3680,0	21468	6005,7	30,8
Poland	5583	479,5	5740	1545,6	6800	2100,0	10,8

Sources: UNCTD: World Investment Report, 1994 (a) Cumulations start in 1988

This disparity in sizes can be explained by different reasons. The implementation of such projects, as the building of a car factory, implies the implementation of investments upward and downward in production, services, finance, transport, communication. A big investment creates a spin-off effect which adds up to the disbanding of old organisational structures of State- owned enterprises by splitting down activities which were not necessarily related. In the Czech republic, for instance, the restructuring of Skoda and the redefinition of the relationship with former sub-contractors has pushed most Czech sub-contractors to merge with Western parts suppliers in order to increase their capacities and to produce at lower costs. At this stage, the level of DFI is less important. Franchising, also, requires a much smaller amount of investment. In some sectors, down stream, in services and trade, for instance, barriers to entry are low and in some cases many Western firms follow a wait and see strategy as sleeping partners. Last, in some countries, State regulation concerning privatisations limit the stake that Western firms can hold. In a second stage, Western firms can commit by acquiring more stakes (Nestle in Hungary). On the other hand, the signature of incomplete contract can have a reserve effect and be followed by a reduction of the level of investment initially planned (Volkswagen - Skoda).

II. Models of control and constraints to the development of DFI

A. Ownership and control of firms

The nature of investments, the degree of organisational complexity, the legal environment have a direct effect on the mode of control of firms by Western investors (Table 4). Three models of control coexist:

1. Acquisition is when Western investors take full control of an existing company or parts of a company.
2. Creation of joint-ventures with local companies with a maximum stake of 50% but often a minority stake.
3. Creation of new plants from scrap, or green fields investments, where the cost of restructuring and refurbishing existing firms appear to high or when the investor wants to realise a quick move by transferring technology and building plant facilities, as in the automotive industry. In countries where property rights are clearly defined, mass privatisations have been launched and country risk ranking is high, which is the case of the Czech Republic, Hungary, Slovenia, Slovakia and Poland, the distribution of DFI among these three forms of control is more or less equal. On the contrary, where uncertainty remains high in terms of economic environment and prospects, as in Russia, DFI favours the setting up of joint ventures.

Table 4. Number of foreign direct investment projects in selected Eastern Europe countries, by type of transaction, 1st October 1991 - 31st March 1993 (a)

(Number of cases, Millions of dollars and percentage)

Country	Acquisitions		Joint ventures		Greenfield investments		Total investments	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Azerbaijan	-	-	7	100	-	-	7	100
Czech Republic	62	34	60	33	59	33	181	100
Hungary	121	36	121	36	92	28	334	100
Kazakhstan	-	-	43	74	15	26	58	100
Poland	48	30	46	28	68	42	162	100
Russian Federation	113	3	285	71	106	26	402	100
Total	242	21	562	49	340	30	1144	100
- excluding Kazakhstan Azerbaijan	242	22	519	48	325	30	1079	100

Country	Millions of dollars	Percent	Millions of dollars	Percent	Millions of dollars	Percent	Millions of dollars	Percent
	Azerbaijan	-	-	2565	100	-	-	2565
Czech Republic	880	63	444	32	66	5	1390	100
Hungary	1093	35	1141	36	929	29	3163	100
Kazakhstan	-	-	9118	100	-	-	9118	100
Poland	3135	56	1706	31	722	13	5560	100
Russian Federation	1167	11	9239	88	152	1	10559	100
Total	6275	19	24213	75	1875	6	32361	100
- excluding Kazakhstan Azerbaijan	6275	30	12530	61	1869	9	20672	100

Source: Anthony Robinson, "Ex-Soviet bloc attracts 42 bn \$", Financial Times, 28 September 1993

(a) Includes tentative, announced and concluded transactions.

These different models of control have not the same impact on the strategy of controlled firms, on the speed of their adjustment, on their trade destination. Acquisition of domestic firms allows a complete control over the assets and the management. As pointed out by Lakatos & Papanek (1994), it is a hostile take-over in the way that the new owners can impose quickly their vision of the strategy, the organisation and the functioning of the new unit even if they face high internal adjustment costs (laying down of redundant work force, retraining the remaining work force, designing of new lines of production, reorganisation of supply chains, building of a distribution system).

On the other hand, creating green fields investments reduces internal adjustment costs by directly and quickly transferring technology and managerial know-how in the host countries; therefore, the break-even point can be reached more quickly, the new plant can be located nearer to its market as is the case of the automotive industry in Hungary, principally located near the Austrian border. In terms of employment green fields contribute directly and indirectly to the creation of jobs, while acquisition of firms is often followed by the reduction of employment as firms are restructuring.

In case of a joint-venture, the picture is not as clear; the speed of restructuring depends on the role of the Western investor. All depends on if he has decided to play a passive or an active role in the new plant. In both cases, compared to the greenfield approach, Western investors face higher internal constraints which often delay the adjustment and the return to profitability.

B. Strategic move and limits to expansion of DFI in EEEs

DFI decision by Western companies is the result of a trade-off between advantages and disadvantages. Different factors push enterprises to move and to organise their production in other countries (Andreff, 1995). Push factors and deterrent factors (Figure 2) are at work in EEEs but some are more important than others such as factors costs, skills, market share, eventually vertical integration or integration in the world economy.

Figure 2. Attractiveness and non-attractiveness of transition economies to direct foreign investment

Push factors	Deterrent factors
Factor cost	Political stability
Skills	Legal and institutional infrastructure
The economic environment	Property rights, corporate governance
Expansion/establishment of markets, market access	Corruption
Strategic moves:	Supply network
- bargaining with government and/or labour	Nature of firms and plant and labour force
- oligopolistic games (first mover advantages, follow-my-leader, threats)	Narrow markets
Vertical integration	Low purchase power
Access to technology and plant	Business environment
Outcome export and import barriers	
Policy incentives, host country, home country, international institutions	

Source: adapted from Estrin & Hughes, 1994

Concerning market shares three approaches can be witnessed:

- penetration of domestic markets with extension of market shares, this strategy being
- repeated in each country (beverage, tobacco, consumer goods)
- penetration on one domestic market with the aim of conquering neighbour markets
- market penetration and integration strategy in the global economy (car industry)

In all three cases, the strategic move of incoming firms threatens the local firm, at least some part of the internal coalition of the firm (insiders) and also followers which have then not enough room to enter into the market. The strategy followed by Volkswagen in the Czech Republic highlights this point. Volkswagen has negotiated with the government, the management and labour of Skoda and has committed itself with a high price plus further investment promises that have left far behind offers proposed by others car markets such as Renault which had shown some interest.⁵ In making this deal, Volkswagen has closed off the possibility for competitor to enter on the market. An agreement with another car maker, with a narrower market shares (Tatra), would not had allowed any Western competitor to gain significant market shares. The main objective of Volkswagen, besides taking market shares, was the integration of Skoda in the global economy, by restructuring the firm and its affiliates in order to support the world competition.

Firms whose aim is to penetrate domestic markets (consumer goods, beverages, electrical industry) and to reach a monopolistic or oligopolistic position (Nestle, Schlumberger, in Hungary). Schlumberger, a French TNC which has acquired the majority stake in the performing Hungarian firm Ganz Meter has also bought the company in charge of measuring the consumption of electricity in Hungarian cities.

The control of domestic firms by Western investors has facilitated and speeded up their restructuring and their return to profitability. Several case studies conducted in Hungary (Iakatos & Papanek, 1994) have shown the existence of a strong correlation between the mode of control, flows of exports and profitability. Generally, firms with foreign capital are more profitable than local firms without foreign participation or oriented towards the domestic market. 100% controlled enterprises or with majority foreign participation are more profitable than enterprises with minority stake or oriented towards domestic market. In the first case, global integration and the flow of exports are higher; in the second case, and especially in the third one, profitability is linked to the level of internal demand which is stagnating.

In all cases, DFI has a strong effect on the adjustment and the behaviour of firms even if Western investors are facing big difficulties in implementing their programme as a case studies (Genco & alii, 1993) has concluded, reviewing internal and external factors that hamper the adjustment of DFI in different countries in the region. Seven factors have been pointed out by this study which importance might differ according to countries and sectors:

- Problems relating to the weakness of the infrastructure and production system

⁵ In fact, Renault was only moderately interested as its main objective was, at this time, the launching of a new small car, the Twingo that necessitated either the building or the acquisition of a assembly line for small cars; the aim of Skoda was, on the contrary, to benefitate of technology transfer in order to build bigger cars as Volkswagen was interesting in acquiring Skoda to extend the life cycle of some of its models such as the Passat.

- Manpower problems
- Lack or weakness of commercial channels
- Companies' organisational problems
- Financial problems
- Problems with local partners or due to "red tape"
- Problems relating to the uncertainty in the legal-legislative framework or political instability.

Restructuring of firms starts with the reorganisation of production lines, often by reducing the scope of product in order to attain the minimal efficiency scale, the development of marketing, accounting departments, the development of new links with suppliers and distributors; it has also a financial dimension with the settling up of bad debts. This point, generally, is fixed during the negotiation of the deal with the government agency in charge of selling off public property. As it has been previously noticed, local sub-constructors have been obliged to adjust in order to reduce production costs of the supply of parts (Volkswagen in Czech Republic, Renault in Slovenia, Ford in Hungary) in the case of strategies promoting the extension of market shares (Suzuki in Hungary); the incoming firm has tried to reinforce links with local suppliers, avoiding their control by foreign partners. The control of local enterprises has allowed the reduction of the range of products that could have competed with products made by Western firms. This is the case of General Electric with the control of Tungsram, or Schlumberger in Hungary, where, in the first case, production with high added value have been abandoned, and, in the second, the Hungarian branch was not allowed to ship its production on markets where the mother company has already a dominant position. In the paper industry in Hungary, the Austrian investor has rapidly closed down the operation of the firm in order to eliminate a potential competition from the newly acquired firms. Up to now, it is not clear what will be the strategy of Mercedes-Benz in Hungary after it took over the bus maker Ikarus which has witnessed a terrible fall of its sales on its Eastern markets. The closing down of the factory could be an option that would allow the German company to substitute its products instead of continuing to produce Hungarian buses and provide after-sales services in Eastern Europe and in Russia.

For some TNC, an investment in our country is the starting point for further investments in the region by taking advantage of the former links developed by the local firm as in consumer goods (Electrolux) or electronics firms (Bull, Siemens). This strategy has not always been successful. Bull, initially, had planned to buy one part of Videoton, a successful Hungarian electronic firm, in order to penetrate the FSU market. The collapse of the USSR and the opening up of its markets have lead the French firm to develop a commercial strategy instead of an industrial investment in Hungary.

Last, other Western firms develop a comparable approach to Eastern markets by developing investments in each country. This is the case for firms in the production goods sector (ABB, a Swedish-Swiss generator builder company) or in the consumption sector (food industry) or finance and banking.

Conclusion

The attractiveness of EEEs remains quite low compared to the world flows of DFI. At first sight, this situation seems paradoxical as most of these economies show apparent comparative advantages such as proximity, skill, and cost of man-power, high level of internal demand for Western goods and technologies. These advantages, of course, have to be balanced with quite numerous disadvantages:

Country risk is still high even if some countries show encouraging prospects such as Poland (growth), Czech Republic (macro-stability). Bureaucratic regulation, lack of convenient infrastructures, low development of financial services are some factors that contribute to slow down the process. It seems that, in fact, comparative advantages are very limited: the market is very fragmented, domestic purchase power is still low, cost of labour is relatively high compared to its productivity, the business climate is often superficial, political instability, and the reluctance to launch and active mass privatisations in some countries, hamper the flow of direct investment. In the near future, if these factors disappear, DFI could become more important and spur the adjustment of firms in a much more important way that it has been done up till now.

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The Approach of Life Cycle

ATANAS DAMYANOV

1. Expanding the sphere for applying the conceptions of product's life cycle

During the period 1977-1980 was investigated a complex of questions, connected with estimating the need from specialists with higher and secondary special education. In the course of this investigation we came to the idea of changes in the economic importance of the particular professions and specialists⁶.

Today, through the prism of modern knowledge the stages in changing the economic importance can be interpreted as ones of the life cycle of the particular profession or speciality.

In historical plan the contours of the life cycle conception are outlined by R. Vernon in his investigation, partially financed by Ford Foundation of the Harvard Business School⁷, in which he puts an emphasis on the product: fixing of new products; developing and improving of the product; standardised product.

In 1988 the conception of product's life cycle is included in the list of techniques and conceptions for doing strategic plan work.

The experience accumulated until now gives us the reason to think that the biological conception of life cycle can serve as an useful metaphor when examining the metamorphoses of different systems, processes, methods, techniques and objectives of whole instrumentaria.

In this sense we would outline a whole group, including:

- life cycle of a civilisation;
- life cycle of a country;
- life cycle of a national economy;
- life cycle of organisations (companies, firms etc.)

⁶ For details refer to: Damyanov, A., Improving Planning of the Needs from Specialists. Dissertation, National library "St. St. Cyril and Methodius", 1981, p.30-32.

⁷ For details refer to: Vemon, R. International Investment and International Trade in the Product Cycle. In: *Quarterly Journal of Economics*, May 1966, pp. 191-207

The last one, that of an organisation could be developed, specified in the following blocks:

Block # 1: Life cycle of raw materials, energy, etc.; of machines, equipment, production technologies, etc.; of professions, group of specialists, a particular speciality, etc.

Block # 2: Life cycle of the product at the home market; at the foreign market; with an investment character; with a consumer's character, for the population.

Block # 3: Life cycle of the company's management: of the systems for organisation; of the systems for planning; of the systems for giving accounts; of the systems for control, etc.

Block # 4: Life cycle of the relations and interrelations with suppliers; with clients; with partners-rivals, agreements, etc.

Block # 5: Life cycle of a specific and regulative type of impacts of governmental interference; of moments in the decrees of Foreign Trade regimes, Bulgarian and foreign; of regional and world programmes.

2. Life cycle of organisations and change

All organisations - small, medium, and large - undergo periods of ups and downs. The latter sometimes lead to their death.

Three critical stages are possible in the life of an organisation:

Stage # 1. Creation.

Stage # 2. Transformations.

Stage # 3. Decline.

Both the new-born organisms and the new-born organisations grow and develop various structures while maturing. Sooner or later they may decline or die.

Of course, this analogy is not perfect. An organisation differs from an organism because its life cycle doesn't flow in a regular, predictable sequence and its death is not inevitable. The process is more variegated instead, because people's variables, as well as organisational and environmental variables involve active forces which outline the evolution of each organisation. Although these actions are complicated, their fragmentary investigation shows marks in which the forces differ at the particular stages of the organisational cycle.

Lessons of stage # 1: Creation. Those who have industrious views contribute most to the creation of new organisations. These views later on are transformed into aims. The environment can and does influence the new systems as well.

The characteristics imposed upon can exist long after the conditions that have called them forth, have changed.

Therefore the configuration of organisational variables are very often, in the beginning, a product of the combined action of people's variables and environmental variables.

The new-born organisations have the ability to learn and when particular actions prove successful, they crystallise in standard programs. When the programmes are effective and the environment is favourable, the organisations can quickly outgrow their "young" structures and processes. In this way, regularly, the entrepreneurs face new management responsibilities - desired or not - according to their potentialities and beyond them.

Lessons of stage # 2: Transformation. The growth and expansion of organisations lead to their restructuring. Practically they enter the stage of transformation.

Transformations, however, are neither predictable nor inevitable.

Variant # 1. Some organisations prefer being small to being subjected to unpopular measures. Many of the young organisations soon decline and disappear.

Variant # 2. Others are capable of undergoing the future transformations.

Case # 1: the transformations are even and usual. They are carried out by the present managers.

Case # 2: the transformations are forerun by crises, characterised by great shocks. They are carried out by following management teams, because the previous ones have led to the crises. Their change symbolises the change.

The transformations are spread in equal intervals, when the programmed reactions grow and the search of new approaches decreases. Such organisations may fall into a critical situation, because the programmes become ineffective and the changes in the environment are not studied. Some organisations involuntarily create crises, when the handling of the organisational variables deprives the advantages of individuality. Other organisations avoid crises because the previous transformations have taught them to discern the symptoms, to expand their investigations and to accept tested strategies and programmes. Some of them even save themselves turning to new spheres.

Therefore, transformations represent the united influence of human, organisational and outer forces.

The results of some transformations are founded more on former decisions and historical premises than on present events or are a result of the market dynamics. Some organisations create whole sagas for their heroic deeds when creating them, and these sagas can perpetuate the company's ideologies and form answers for future phenomena and events.

Lessons of stage # 3: Decline. When the crises haven't been paid attention to or the transformations fail, then the organisations enter the age of decline.

Decline can come in, at least for the following reasons:

Variant # 1: When managers make improvident choices leading to stagnation.

Variant # 2: When the outer ones attack organisations with outdated qualities.

Variant # 3: When the shortage of resources increases the dependence and decreases the competitiveness of the organisations.

The decline can be stopped but new and various problems have to be overcome. The prolonged decline does by no means simply bring back the variables, accompanying the growth.

The actions connected with the decline often presuppose decisions which are not comprised in the workings of the organisation and the instinctive reactions can intensify the problems. A strategic reorientation is needed but there are also such people who support the outdated strategies with the purpose to bring their strength back. So the change of the managers is often the first essential step towards change and it is necessary that special strategies for situations like these should be developed.

The lessons of the relation: life cycle of an organisation - management of change

The three outlined critical stages in the development of organisations could possibly be further on developed and worked out in details. Such a concretisation makes the relation with the change localised and defined (refer to: relation: life cycle of organisation - management of change).

The verbal-graphical interpretation of this relation presupposes the following dimensions of its anatomy:

Path # 1: Development of organisation, positive change in the organisation, management of change through creating the future and some of the factors which are not under its control. This path comprises the stages: I. creation; II. growth; III. development of various structures; IV. becoming ripe; IV'. transformation - a new growth.

Basically, this path is open at least to the following two types of organisations:

First type - large business organisations, which influence the market situation, and to a great extent define what is being bought and the prices themselves. Of course, in this type could be placed medium and smaller companies as well, which become strong through strategic alliances and through suitable internal and international co-operation. They become strong through foreign channels of distribution, through using marketing researches, etc.

Second type - organisations with a marked innovation dimension and intrinsic mastering of a strategic instrumentarium, even in directions outlined in the first type - for example, participation in the modern business nets, in spite of the size of the free organisation.

Path # 2: An organisation with a marked tendency to adapt to the created environment after a certain stage of development - with less potentialities for an adequate management of change.

This path comprises the stages; I, II, III, IV, IV' - keeping the attained level.

Path # 3: Development of an organisation, accompanied by critical situations. This occurs within stages I - IV. In every critical situation it is possible for the company to die or to get down of the economic stage.

These are such types of organisations that cannot manage with the change - either internal or external.

The recent years in Bulgaria give a clear example of the confirmation of this path.

Path # 4: Movement of an organisation which 'has driven away' its intellectual and financial resources - stages V, VI, and VII. In each of these stages the state looks for a way out:

- Decline - reorganisation;
- Bankruptcy - sanning.

In this case the companies wonder what has happened and how they have come to such an end.

The three paths outlined here can be estimated as 'clean'. Practically, there is an overlapping with a dominant of the correspondent projection depending on the possibility to manage or not the change which comes in the environment.

Structural Changes in the Russian Economy

ALEXANDER IVANOV

In the very beginning of economic reforms in Russia, the systemic transformation of the industry was made one of their priorities. It was meant that the domestic demand will be restricted as competition will develop, including between domestic and foreign-made goods, as a result of price deregulation, intensive foreign trade and strict financial policy. All this was to make the manufacturer to produce goods to satisfy the consumer and ensure as low production costs as possible and as high quality as possible in order to secure a share of the market. The low-technology economy mainly based on exporting fuel and raw materials was to gradually transform into that producing ready-to-use goods on the basis of efficient technologies.

Over the last three years, Russia's economy has been developing according to market laws instead of administrative directives. The conditions for systemic transformation have been created. The domestic demand has been toughly restricted. The industry's structure, production decline or growth and the range of products are mainly determined by the effective demand and competitiveness on both domestic and foreign markets. The economy is starting to take into account the real market requirements. These are positive outcomes of the reforms. Nevertheless, the structural changes in Russia's economy have been following another way, far from the planned.

The following figures will show the structural changes produced by the reforms. Given the general production decline of 44% (by 1.8 times) from 1992 to 1994, that in the basic branches of the industry amounted to (in descending order):

Light Industry	72% or by 3.6 times
Machine-Building	57% or by 2.3 times
Chemical and Oil-Processing Industry	57% or by 2.3 times
Construction Materials Production	54% or by 2.2 times
Timber, Woodworking and Pulp Industry	52% or by 2.1 times
Métallurgie Industry	44% or by 1.8 times
Food Industry	42% or by 1.7 times
Fuel Industry	33% or by 1.5 times

Except for the food industry, the general trend is that the deeper is the processing, the worse is the production decline. In principle, the closer is the industry to the end product, the deeper is the production decline it is facing. The decline in the food industry is lower than the average in the industry because of a lower production decline in agriculture, its the main source of raw materials. As a result, Russia's industry has acquired an even more "raw-material" character than before the reforms, which is shown in the following table:

Table 1. Branch structure of industrial production (in %)

	1990	1993	1994
All Industry, Including:	100.	100	100
Extractive Industry	15.5	17.2	23.4
Processing Industry	84.5	82.8	76.6
By Branches:			
Electricity Production	5.0	7.2	8.0
Fuel Industry	16.0	18.8	22.8
Ferrous Metallurgy	7.9	8.1	8.8
Non-Ferrous Metallurgy	9.5	8.4	10.7
Chemical and Oil-Processing Industry	8.5	7.8	16.3
Machine-Building and Metal-Working Industry	20.1	20.6	16.3
Timber, Woodworking and Pulp Industry	4.6	4.6	4.5
Construction Materials Production	3.1	3.2	2.4
Light Industry	8.4	6.5	5.9
Food Industry	10.2	11.1	8.7

The fuel and energy complex and the non-ferrous metallurgy whose products enjoy a stable demand on both domestic and world market have gradually increased their share in Russia's total industrial output to 40%. Other branches of the industry which could not compete on the world market and operated only inside the country faced a considerable production decline due to the shrinking demand for their products.

The re-orientation for the production of raw materials and the de-industrialisation can also be observed inside individual branches of the industry. For instance, the oil industry lowered the depth of the primary processing of crude oil and its output of diesel fuel by 36% over the last three years, while its output of crude oil simultaneously fell by 31%. As a result, the depth of the crude oil processing dropped to 60.5% in 1994 against 64% in 1992.

In the ferrous metallurgy, the output of iron ore fell by a total of 20%, while that of cast iron by 26%. The decline in the output of steel and rolled stock amounted to 37% and 26% respectively. These products were mainly exported abroad. However, the production of high-technology

products faced a much deeper decline. The output of rolled sheets fell by 47%, that of stainless steel plates by more than 6 times, while that of rolled stock with strengthening treatment halved, etc.

In the chemical industry, the output of dye-stuff fell by 71%, that of synthetic fibre by 63% and that of mineral fertilisers by 46% against a general production decline of 57% over the last three years.

The machine-building found itself in a highly worrying situation as the output of electric machines and motors fell by nearly 4 times, that of machine-tools by 3.4 times, that of N/C machine-tools by 25 times and that of processing centres by 14 times from 1992 to 1994. Many enterprises virtually came to a standstill. Russia's machine-building could not prevent the production decline by boosting exports, because its products were not competitive. The reason was not only their quality (Russia did manufacture some world-class machines), but also the high production costs which sent their prices far higher than the world's average.

The deepest decline hit the light industry. This is understandable, because liberalised imports saturated the domestic market with high-quality foreign products. The share of imported goods in the retail turnover in Russia rose from 23% in 1992 to 35% in 1994.

All the above-mentioned trends continue in 1995. In principle, it would be wrong to give an unambiguously negative assessment to the structural changes, proceeding only from the table showing a growth of the fuel and raw materials industries. Moreover, this is a reflection of the equalisation of domestic prices against the world ones. The processing industry's lowering share at the expense of low-effective regular products and out-of-date technology, leaving afloat high technologies and science-intensive products, could have been regarded as a positive change, if the production of high-effective articles had not fallen even faster.

What factors contributed to this? In our opinion, the main factors could be summed up in the following way:

1. The structure of economy emerged by the start of reforms.
2. The break-up of commercial links between Russian manufacturers and their partners from Eastern Europe and former Soviet republics.
3. The flawed system of fixed prices existing by the start of reforms.
4. The equalisation of domestic and world prices.
5. The shrinking effective domestic demand.
6. The currency policy of the government and Central Bank.
7. Russian manufacturers' slow adaptation to the market conditions (high production costs, ignorance of the basics of the market economy, etc.)

The structure of economy by the start of reforms

Over the long years of administrative management of economic processes, the country had an extremely inadequate economic structure burdened with the military complex. The raw materials and defence industries were the most developed. Though the military and industrial complex designed up-to-date technologies, their use in other branches of the industry was

limited. In a relatively short time (three years), it is impossible to systematically transform the industry. Oil and gas have been the main export commodities for decades. During the reforms they retained the bulk of Russia's total exports. This explains a lesser production decline in the fuel industry, while the processing industry, traditionally operating only on the domestic market, had to curb the production as the demand for its products shrunk.

The break-up of commercial links

The former Soviet Union's economy was a single entity. The production of an entire number of goods was concentrated in one republic to be supplied to another according to the general plan. Many components of one product were manufactured in different republics. The break-up of commercial links also involved the loss of many potential consumers, which further aggravated the situation. Similar problems emerged after the collapse of the Council for Economic Assistance. Naturally, in the worst way the break-up affected branches with the highest level of co-operation, above all the machine-building.

The flawed system of fixed prices

The former Soviet Union had a misshapen pricing system. The prices of fuel and raw materials were relatively lower than those of end products. The cheapness of fuel and electricity resulted in their waste and, correspondingly, the need to constantly reproduce them. This had a considerable impact on the whole economic structure of the country.

The equalisation of domestic and world prices

The domestic prices in the pre-reform Russia were much lower than in the rest of the world. The natural equalisation process considerably affected the formation of the economy's structure. The fuel and energy complex found itself in a better position, because it exported the bulk of its products. However, the processing industry can offer a very limited range of competitive products. Therefore, it is possible to conclude that the structure of the Russian economy's decline was mainly determined by the changing shares of domestic and foreign products on the domestic market.

The shrinking effective domestic demand

The Russian government and the Central Bank of Russia pursue a strict financial policy seeking to stabilise the economy, keep down inflation and stimulate investments. All this does not arouse principal objections. At the same time, the suppressed money supply resulted in a shrinking effective demand of both enterprises and people. The simplest and relatively cheap products are in the demand now. The wave of non-payments was also triggered off by this factor. The solvency decline mainly affected the machine-building, chemical, oil-processing and other industries situated in the middle or the end of the technological chain, leaving almost intact the fuel and raw materials industries.

The currency policy of the government and Central Bank

Starting from July 1992, Russia has had a freely set ruble rate against the U.S. dollar on exchange auctions. Over the last three years, the ruble fell by about 25 times against the dollar. However, the domestic prices rose by 350 times over the same period. The gap between the fall

the ruble and the inflation rate mainly happened in 1992-1993. Since 1994, the Central Bank skilfully managed the hard currency exchange auctions, virtually linking the ruble decline to the inflation rate.

Nevertheless, during the reforms imports of foreign goods were the most profitable kind of commercial operations. The overwhelming majority of Russian goods cannot compete with foreign-made ones. This can be applied not only to low-quality products, but also to those which used to bear the comparison. Every end-product branch of the economy has a range of high-technology products. However, the high production costs remain the main difficulty for Russian manufacturers. The situation was caused by the same factor of flawed prices. The production costs will grow at the same ratio as the prices of fuel will grow for some time until they are in line with those of end products. There is a danger that many promising enterprises in Russia will be no more by the moment the prices have been equalised.

Russian manufacturers' slow adaptation to market conditions

Many enterprises continue to produce undemanded products that no one needs. The problem of high production costs, though objective in many ways, can be solved sometimes. As a rule, this does not happen, which reflects Russian enterprises' slow adaptation to the new conditions.

However, the process is less painful for fuel and raw materials enterprises.

Of course, the list of factors which have impact on Russia's economic structure could be continued. For instance, even if the high production costs issue is solved, Russian goods will not be able to compete with foreign ones due to their lower quality, provided the authorities continue their present currency policy. To raise the quality, enterprises need investments unavailable under the strict financial policy, and even if available, raising the production costs. The circle closes in. Time is also needed to introduce higher-quality goods. The equalisation of domestic and world prices as well as the currency policy also had their impact on the situation.

In its third reform program, the Russian government expects the recovery to start in 1996-1997. Proceeding from this assumption, possible options for the country's economic growth can be outlined. Most generally, there are two options.

The first option (colonial type economy) implies growth by dumping raw materials on the world market. This option's advantage is that the economy can enter the growth mode relatively quickly. However, closing down many processing enterprises would be inevitable. The economy will depend on the imports of these products and trends on the world market. Under such conditions, the possibility of moving from exports of raw materials to those of end products is extremely low, because it requires a technological breakthrough in the economy, which appears impossible without intensive investment activities on the domestic market.

If this option is chosen, Russia will be a supplier of raw materials to the world market for many years ahead. This will virtually determine the country's place in the international division of labour. From the point of view of Russia's national interests, there is a danger of becoming economically dependent from foreign states. Having to import light petroleum products and high-quality metal articles produced from Russian crude oil and rolled stock will be a sad reality.

The other option is an economy of technological growth. This option is likely to be implemented, if the domestic market is stimulated by its greater capacity and state support of the priority branches of the industry. The scenario will be implemented in the following way; individual, most promising enterprises will reorganise their production process with state support. Their efficiency will rise so that they will be able to stabilise the prices due to the growing demand. Through the interbranch relationship, the demand for other products will also grow raising the real incomes of both enterprises and people. Further, the process will reproduce itself. However, it requires investments to be made at the very beginning to give an impetus to the entire growth sequence. This is why stimulating investments, mainly private ones, may promote the implementation of this option.

In Russia, there are two extreme approaches to the systemic transformation of the economy. Some say "market does everything right and we should not interfere." If we proceed from this we will have to put up with the de-industrialisation and primitivisation of the economy, its fuel and raw materials orientation. Others argue that it is necessary to urgently support Russia's processing industry by granting it considerable privileged and even interest-free credits, impose high import duties, etc., that is to pursue a protectionist policy. If we follow this way, macroeconomic stabilisation will take several more years. Inflation will be so high that investments will not come to the Russian economy. In fact, this approach spells the return to the old administrative management system. In our opinion, this is unacceptable.

At the same time, the state's abandonment of its regulating functions seems inexpedient. Of course, in the first place it is necessary to suppress inflation already in 1995. As soon as macroeconomic stabilisation is achieved, the main goal will be to spot "points of growth" in the Russian industry, or such enterprises which would pull the rest of the economy like steam engines. The state should keep such enterprises within its sight. The state has wide possibilities to regulate economic processes: tax privileges, participation in investment projects jointly with private capital, state guarantees for private capital, including foreign, etc. Certain direct measures may also be required. If an enterprise experiences problems with selling its products, its technological level is extremely low and it cannot raise the competitiveness of its products, it must be declared bankrupt. If the enterprise is in principle promising, the technological level is rather high, the demand for its products will eventually grow, but it experiences difficulties at the moment, it must be supported, including with privileged credits. Such measures will not boost inflation as long as precisely points of growth are spoken about.

We can establish that on the first stage of reforms in Russia, inefficient and unnecessary enterprises were not sorted out even under the market conditions. All industries without exception were affected by the production decline, the promising ones even to a greater extent. On the second stage of reforms, if financial stabilisation is achieved and the state plays an active regulating part, the process may reverse. Then the true structural changes, for which the economic reforms were started, will be brought about.

State and Problems of Industrial Restructuring in the Republic of Belarus

LJUDMILA BELOUSOVA, TATJANA KIZEVITCH

Aiming at the unification of the country with the world economic community, the Program of Industrial Restructuring in the 1990s has been elaborated oriented at the conditions in the transition period and taking into consideration the crisis of the economy.

Due to a series of objective and subjective historical circumstances, the industrial potential of the country proved to be strongly deformed as viewed against the structure of final social necessities. The greater part of production yields in quality to foreign standards and is low- competitive at the world markets. Most of the facilities in operation are morally and by far not seldom physically worn-out. Changes in the foreign political situation produced a shrinkage in the traditional market space and raised the necessity in conversion of production. These as well as some other factors imposed the demand in restructuring the industrial complex thus making the latter an imperative for solving the most acute problems such as reduction of inflation rate, growth of production, and creation of conditions for overcoming the crisis.

To achieve this, it was necessary to, first, start the implementation and production of competitive products, and, second, reduce the energy and material intensity of the whole economy.

The main attention in the Program of Economic Restructuring of Belarus was devoted to several issues, namely: estimation of the research, production and resource potential of the country and the competitiveness of production, elaboration and argumentation of a system of research, production and organisation measures and their efficiency, creation of a working mechanism to implement the outlined measures.

The Program of Economic Restructuring of the Republic of Belarus covers several key aspects. First of all, changes in the general principles of industrial policy.

The main task here is the support of structural changes so as to strengthen the social orientation and the export potential, to promote entrepreneurship and private sector development, the accumulation and investment activities, and to provide purposeful support to potentially efficient and nationally high-important productions.

Another yet not least significant prerequisite of progressive structural changes in production is the accelerated and in parallel with macroeconomic stabilisation introduction of systematic

transformations in the organisational, legal, and institutional framework of the market system to be built, namely:

- a) a clear-cut legal formulation of the institution of ownership, and support of entrepreneurship and private sector development as a key precondition for promoting the most efficient utilisation of resources and production assets;
- b) transformation and reforming of state-owned enterprises thus giving them impetus to act as private corporations in a market economy, i.e. in a competitive and profit-maximisation environment;
- c) privatisation and demonopolisation of production as basic factors for the development of private initiative and creation of competitive markets, quick re-orientation of production at the criteria of efficiency, demand and technical progress;
- d) building-up a developed financial market to create the investment potential necessary for production restructuring and the conditions for free and quick transfer of capital from losing to new and prosperous sectors;
- e) creation of a labour market and social security system which will guarantee the connection of labour remuneration to real efforts and productivity, and will regulate the unjustified incomes differentiation and the necessary re-allocation of labour force;
- f) liberalisation of trade (domestic and foreign) and foreign currency regime as a key precondition to enact the mechanisms of competition, most efficiently allocate the resources, and determine the vital productions with real comparative advantages;
- g) legal and institutional transformations in the field of budget, credits, prices, trade and foreign currency regime, essential for the execution of the macroeconomic policy.

The reform of state-owned enterprises is a key element of the system of transformations, its main goal being to turn enterprises from the state sector into efficient and profitable companies operating as private corporations into a market economy and competitive at the international markets. This includes, first, the internal restructuring of enterprises (organisational, financial, and even physical) so that they can adapt to the new environment and start working on the principles of economical independence, and second, their corporatisation and commercialisation as main conditions and means for such a restructuring.

Reconstruction and modernisation of the production capacities of manufacturing branches in order to secure their competitiveness in the world market was determined a major target of industrial and structural policy in the next decade. The task was set for the fastest possible overcoming of the technological backwardness of the greater part of productions and considerable increase of their export share, including in the developed countries, in order to provide funds for the import of raw materials and energy-carriers.

This effect, industrial policy has to solve three main problems:

- 1) determine the direction of structural changes in industry and select the priorities;
- 2) provide state support for accelerated development of priority sectors with best prospects;
- 3) close-down of declining and non-profitable productions.

To overcome the crisis in industry some particular steps should be undertaken, including:

- prevention of further decline in production and stabilisation of vitally important systems in industry;
- preservation and efficient exploitation of the research and technical potential;
- rising the degree of economic independence of industrial branches through internal cooperation, resource-saving, and establishment of joint ventures;
- utilisation of available outlets of military production in order to gain additional financial sources for the civil sector and extension of taxation and credit facilitation to enterprises in conversion;
- re-orientation of the specialisation and profile of enterprises with developed production potential and of national importance yet in hard financial condition;
- promotion of priority investment research projects and export-oriented productions;
- entries into the world market by competitive products.

All the tasks mentioned above are of both tactical and strategic character.

The Program of restructuring of industry has outlined the following priority directions:

- development of machine-building in the field of universal metal-cutting machinery, light and foodstuff industry equipment, modern agricultural machinery and equipment, including for the needs of individual farms;
- solution of national transportation problems;
- considerable increase of consumer goods production based on the potential of radio-technical industry and electronics;
- solution of energy and resource-saving problems.

The conversion of the military industry, including mainly the radio-technical, optical-mechanical, aviation and electronics branches is devoted a particular role in the process of restructuring.

The final goal of conversion is to sharply expand the social orientation of the military-industrial complex at the expense of:

- demilitarisation of national economy yet preventing uncontrollable destruction;
- strengthening the export potential of the country;
- rising the living standard and decreasing the social tension;
- further improvement of international co-operation and specialisation, and humanisation of foreign economic relations;
- release of labour and material resources from the military sector and their gradual reallocation in the social sphere.

The integration of the military-industrial complex with the potential of the civil sector will provide for a capital non-consuming way of development of industry and for the production of modern competitive products aiming at the most complete satisfaction of social demands.

That part of demands which cannot be efficiently met by the national production neither at present nor in the realistic future will be satisfied by imports. The growing export potential will provide the necessary resources.

At the first stage, the most important tasks are determined as follows: rising the degree of self-sufficiency in industrial consumption goods, re-specialisation and re-profiling of enterprises of potential national significance; conversion of the military-industrial complex; attraction of foreign investments and providing of support to particularly important investment and research projects, and export-oriented productions.

The main task at the second stage comprises the maintenance and strengthening of the country's positions in the CIS markets as well as its efficient integration with the world economy. Priorities are laid with productions which satisfy the demands of population as well as the growth of the export potential.

The realisation of structural changes has some specific features, namely:

- as a rule, the re-profiling of production is impossible to achieve without considerable investments;
- long duration of investment periods;
- difficulties in the supply of home-made systems-oriented equipment.

This notwithstanding, the machine-building enterprises managed to considerably change the structure of production and implement new products. Given this, it can be spoken about a high demand potential and good domestic outlets of the branch. The export share, however, has marked a decline in the recent years, mostly due to incompatibility with world standards for safety, comfort, ergonomics and ecological consistency. In order to recover and further increase the volume of exports, attempts are made to intensify the financial mechanisms of structural changes, accelerate the process of unification of enterprises with international production and economic structures, and develop the marketing activity. Obviously, the export-oriented productions of high-tech goods can be created on the basis of pioneer resource-saving technologies which can contribute also to the solution of such a hard problem as is the reduction of post-effects of the Chernobyl catastrophe. At the same time, the task is set of consolidating the positions of Belarus in the world resources regions. This presupposes the establishment of a network of export-import banks and banks of international settlements, providing of favourable conditions to foreign capital engaged in production activities, as well as the adoption of a series of protective measures.

We have provided financial support to the development of a whole set of documents related to the improvement of the regulatory and technical framework of the production of competitive goods at all stages of the product cycle (complex standardisation) and to the creation of research and testing laboratories (14); a classification was made of more than 100 products subject to certification according to the safety standards of Belarus and the CIS; a number of international exhibitions, fairs, seminars, etc. was organised; the foreign-trade company

‘Belpromimpex’ was established, as well as about 100 joint ventures with companies from more than 20 countries world-wide.

Due to the realisation of conversion programs and their full support by the state, research-based productions were in general preserved and the implementation of high-tech civil products was made possible.

The Commission of the EU is providing technical assistance for the development and production of communication and computer facilities under the TASIC Program.

Twenty-eight conversion projects were developed and presented in the framework of the Pann-Lugaro Program. Accounting for the limited support of USD 10 million provided by the American part for military production conversion projects, it was jointly decided on the financing of only a part of the investment projects.

The course of rising the product competitiveness has predetermined the selection of particular priorities of industrial policy, i.e. these branches and productions which, in order to speedily develop, are given most favourable conditions. These include machine-building, electronics, radio-technical industry, etc.

Of course, this sphere is not short of problems, too. Among the main obstacles one should mention the insufficient financial resources (up to nearly two-third the necessary amount) for reconstruction and modernisation, the low profitability of long-term production investments under inflation, as well as the existing dispersal and inconsistency of tax and credit facilitations, budget subsidies and extra-budgetary funds. The recently made governmental decisions should aid the focusing the financial resources in priority tasks and directions.

The results of industrial restructuring, and especially in the conversion branches, are indicative of the fact that in the presence of reasonable state support of enterprises, regulation of the pricing of main resources and products, taxation policy stimulating the production of necessary goods, and subsidised investments in the most important projects, enterprises can react flexibly to market developments, realise research-based projects and produce high technology. In order to fulfil the above mentioned programs and stabilise the functioning of industry as a whole, the government has also worked out and started implementing a set of measures aiming at the protection of domestic producers of high-tech products and the unification of the interests of industry and banks. The task was set to fully exempt from taxation profits and turnover outcomes of competitive conversion productions in the first two years of full-scale production, extend easy credits for working capital to enterprises with long product cycle, introduce fixed- period firm prices on a particular set of strategic raw materials and goods which determine the prices of the bulk of commodities, as well as tax relieves for that part of profits which is actually invested in the development of conversion productions.

A list was made of purpose-oriented research-and-technical programs for innovation and investment activities. The programs are not equivalent in significance, volume of financing, terms of realisation, and expected efficiency. They will be subject to additional expertise and thereafter ranked by their importance for the national economy as a whole. If necessary, the programs will be further developed according to the present-day requirements. Then, the institutions to fulfil them will be approved and the realisation will start. This task makes the core of national industrial policy in the nearest future.

Finally, we should mention the transformation of ownership in industriy.

The privatisation of state-owned enterprises began in 1991 and since then has been progressing on an expanding scale. In 1991-1992, the transformation of state ownership was taking place in the absence of privatisation legislation and only on the basis of temporary normative documents which explains the rather slow pace of the process.

With the adoption in 1993 of the basic documents constituting the legislative framework of state ownership transformation, the privatisation authorities were able to undertake the privatisation of large enterprises.

By January 1, 1995, the state and municipal enterprises transformed into non-state form of ownership numbered 1146.

The pace of privatisation, however, as well as the impact of ownership transformation on the social and economic situation in the country is rather unsatisfactory.

Along with the main objective reason (unstable financial condition of the greater part of enterprises and unclear perspectives for their development), some other factors also exert negative effect on the progress of privatisation, namely:

- the lack of liquidation mechanism and bankruptcy-solving procedures;
- the non-functioning of a provision of the Law on Privatisation of State Ownership in Belarus under which the transformation of state entities can be initiated by the privatisation authorities;
- the inconsistency of a number of legal norms and provisions (on leasehold, taxation, investment activities, estimation of the value of privatised property, etc.) with the established and continuously changing economical and political situation in the country;
- the negative attitude towards privatisation of a considerable part of the population, stemming from the series of wrongdoings and mistakes made at the initial stage of its realisation.

The above mentioned reasons made for a decision by which the privatisation authorities were entitled the necessary competence to fulfil the outlined tasks, implement the programs of state assistance to privatised enterprises, and undertake a broad state campaign on the announcement and explanation of the objective necessity and tasks of privatisation aiming to promote and intensify the participation of both individuals and legal entities in the privatisation process.

In a number of cases, it was envisaged that blocks of shares were sold by auction to investors who dispose of business plans and capacity to develop the joint stock companies formed on the basis of former state enterprises which are not subject to privatisation restrictions.

In order to consolidate the partnership relations and develop the production in the cases of cash privatisation, the soften terms of sale are accompanied by regulation of the practice of auction sale of shares applying to technologically related non-state legal entities and physical persons.

The remainder of shares will be sold at the discretion of the government through stock exchanges, auctions or direct contracts between the privatisation authorities and the buyers.

The monopolist-enterprises, as well as the enterprises and organisations which are privatised by a special license of the Council of Ministers of Belarus, are subject to a legal provision under which the state preserves its share of stock within 1 to 3 years thus being able to influence the decision-making of the management bodies of the new-established joint stock companies.

As a rule, this block of shares cannot exceed 25% the equity capital of the company.

The realisation of the measures of the Privatisation Program will allow for:

- the creation of a critical mass of enterprises with non-state form of ownership;
- laying the grounds of the stock market;
- the creation of a group of private and collective owners;
- the reduction of the degree of state regulation of the economy;
- the creation of conditions favouring plant investments aiming at the renewal and adjustment of production to market conditions.

Privatisation of enterprises should be gradual, centrally controlled and, what is most important, secure, so that employees are protected from finding themselves into a 'broken boat'. All sectoral, technological, regional, and structural peculiarities of the privatised enterprises should be taken into consideration. The selection of enterprises to be privatised should be made according to a special set of criteria, and in terms of profitability first of all. Preconditions have been created for organising a total testing of enterprises regarding their readiness for privatisation and making a forecast of the results. To this effect, it would be useful to examine and adapt to the national conditions the methods and forms of privatisation applied to enterprises in the eastern regions of Germany.

Problems of Restructuring and Privatisation of Bulgarian Industry

TZANYO TZVETKOV

The restructuring and privatisation of the Bulgarian industry are interconnected processes aimed at increasing the efficiency and competitiveness of Bulgarian industrial production. It is far but a secret that the country is suffering a severe economic, political, ideological and moral crisis. The transition from centrally-planned to a market economy takes place under these conditions of a complex crisis which inevitably effects the progress and results of the privatisation and restructuring processes. Moreover, it hampers and prolongs the period of transition and additionally burdens the inefficient functioning of the economy. The transition to market economy therefore takes place in an environment of collapsed old values and non-established new ones. As a result, even the well-intended management decisions may be compromised, mis-targeted or spoiled. Within the last 50 years, it was only nationalisation and co-operation that were known in Bulgaria. On this background, it is quite natural that industrial specialists have no experience in the denationalisation and decooperation of enterprises. To overcome the crisis as soon as possible, the country needs urgent recovery measures. The latter, however, are often accompanied by errors and short-sightedness. Be it consciously or not, privatisation is very often looked at as a brilliant opportunity for individuals or groups of individuals to 'take over' the state, or a free or semi-free form of take-over of public property, or a 'dirty money' laundry, or a way for the former party nomenclature to strengthen its power by economic means. With such an understanding of the goals and essence of privatisation, concepts like 'equitable market price of enterprise assets', purposeful and well-organised privatisation, drawing financial benefits from privatisation, etc. have little more but theoretical meaning. On the other hand, the restructuring of industry is very often, and completely wrongly, connected with closedown of productions and enterprises. It is pretty obvious therefore that privatisation cannot be efficient in the absence of preliminary stated goals and subsequent effects. The same applies to industry restructuring. The answers of the questions why, what, when, and by what means and methods to restructure and privatise require a preliminary elaborated, well-grounded and approved strategy of industrial development. Unfortunately, such a national strategy is still non-available. It should lay in the basis of governmental privatisation programs and should precede and even justify them. There is still time to develop such a strategy so as to prevent the chaos in privatisation. According to statistical data, only 50 or 60 industrial enterprises have been privatised since the start of the process. There are cases, however, the finalisation or the very advanced stage of which will further burden and worsen the efficiency and other results of restructuring and privatisation.

Among the measures which were irreversibly missed, the non-accomplished monetary reform should be mentioned first. Given the imperfect legal environment, this made privatisation develop as unsociable Mafia-like process resulting into the enrichment of 8-10% of hardly the most respectable part of the population at the expense of the remaining 90 percent. For this reason, primary accumulation of capital in Bulgaria caused much greater disgust than expected. By their traditions, history and folklore Bulgarians are quite suspicious and hostile to the rich. If the 100-year struggle of Communists to implant capital-hostile attitude in the workers and the new-accumulated negative stand towards unscrupulous enrichment through privatisation is added, this is sure to result in a zero or even negative effect of privatisation regarding workers' motivation to achieve higher productivity.

Second with regard to industrial policy and privatisation, comes the revaluation of state enterprises assets under Decree 179/1991 of the Council of Ministers. In the conditions of high-level computerisation of management, a great variety of evaluation methods and techniques was applied, instead of a single methodology relying on common data base of up-dated price information. As a result, long-term assets with similar technical parameters, year of delivery, producer, amortisation, etc. were given different new prices and thus formed different capital of enterprises. This caused a lot of problems in the amortisation policy applied, the economic analysis and the statistics, and further produced an unreliable basis for the market estimation of the same assets. The state represented by the Government and the ministries has no real idea about the actual value of the long-term assets it owns. Therefore, a revaluation of the assets of enterprises is needed. It should be carried out by applying a common methodology, a common price data base, within a short period of time (and not several years), and by state officials, in order to minimise the possibilities for intentional non-adequate estimation of enterprise assets. A well-organised preparatory work would facilitate a quick and relatively inexpensive process of revaluation. The revaluation data should be submitted to the Ministry of Industry on floppy discs so that the latter or some other authorised research institution uses the computerised information for creating summarised sets of information necessary for the processes of control, analysis and forecasts, elaboration of adequate investment, standardisation, etc. industrial policies.

The third ill-organised measure was the training of evaluation experts and the market evaluation of the entities approved for privatisation. Again, various methods were applied and a great number of ad-hoc teams were formed which resulted in a lack of reliable control on estimations' objectivity. In this way, similar assets were offered for sale at different prices without any sound reasons. The lack of good organisation and control created conditions for corruption in the evaluation teams and possibilities for inadequately low-priced selling of whole enterprises, their single parts, or particular assets. The thesis of the present paper is that in future the market evaluation of enterprises for privatisation should be carried out by common methods and on the basis of common current prices data about individual assets, or at least about the long-term A-group fixed assets (the most expensive), and even the B-group (middle-class) assets as classified under the so-called "ABC analysis". The privatisation estimation of state-owned entities should be done exclusively by state institutions and staff so as to prevent intentionally non-objective estimations and to clearly determine personal duties and responsibilities.

CMEA and the former Soviet Union as a major consumer of Bulgarian industrial products, embargo on Iraq and former Yugoslavia, the technical progress developments, etc.

The restructuring of industry has a lot of aspects. In Bulgaria, it has a lot of specific difficulties, too, which are not typical for other countries.

The first aspect of the Bulgarian industrial restructuring is the restructuring of ownership, experience of other countries indicates that the transition from state to private ownership may help companies, branches or even whole sectors overcome the crisis. Ownership restructuring can be accomplished either by creating new private firms or by privatising the already established state enterprises. In this sense, privatisation can be considered one of the forms of industrial restructuring. A specific feature to mention here is that in Bulgaria the restructuring of industry goes parallel with the change of the political system from totalitarianism to democracy. Given this, it is rather difficult to state a single and clear-cut aim of privatisation. Most often, one of the following aims is indicated:

- transition from socialism to capitalism regardless of the price;
- rising the efficiency and competitiveness of Bulgarian production thus overcoming the economic crisis;
- attracting investments necessary for the renewal of production range and machinery;
- rising employees' motivation which has dropped to a dangerous level.

Taken as a basis, each of the above-mentioned aims contains different privatisation scenario.

The way it goes till now, the process of privatisation in Bulgaria can guarantee the attaining of the first aim only. Bulgarian population faced the collapse of socialism lacking sizeable savings or funds. Unlike some of the former socialist countries, Bulgaria entered the stage of socialism with underdeveloped industrial sector. In this sense and accounting for all the conditionalities of the act of restitution, it is obvious that it would hardly provide a sufficient primary capital for the formation of a capitalist class. The formation of a middle class (of owners) stemming from the agricultural lands restitution is more likely, yet it has been delayed for political reasons. Even if accomplished in time, however, it could hardly provide quick free resources for the industrial privatisation. The only possibility left therefore is foreign investment. Obviously, due to the Yugo-embargo, the proximity of the raging war, the political instability, and administrative and bureaucratic disorder foreign investors are reluctant to invest in Bulgarian state-owned enterprises offered for sale and direct their preferences to other former socialist countries. This set of factors and the forcing of the privatisation process with view to attaining the first of above-mentioned aims is partly explaining the negative image of primary capital accumulation in Bulgaria. In their great majority, Bulgarian capitalists are still 'credit millionaires'. They rely on state credits and on purchasing Brady bonds (Bulgarian foreign debt bonds amounting to 5137 mln. USD) below par and ZUNK bonds (Law on Non-performing Credits bonds amounting to 157 bln. BGL) in order to participate in privatisation by bonds' par value and therefore benefit from this operation. To accumulate funds, they often act on the edge of law and even, infringe it very often.

The restructuring of ownership and the transition from state to private ownership can be assisted also by the process of mass privatisation. The latter, however, comes with a very serious delay and will provide even less 'fresh money' than cash privatisation.

The second aspect of industrial restructuring comprises sectoral, branch and product restructuring. The sector and product restructuring of Bulgarian industry need a lot of time and a lot of money. To overcome an economic crisis, a country needs new constructions and new technologies. In Bulgaria, it was the branch institutes and the R&D departments which first bore the shocks of the crisis. Constructors and technologists were among the first specialists dismissed by enterprises; not a word about programmers. At that time, Bulgarian statesmen were too short-sighted to appreciate the necessity in those specialists. As a result, the best part of the technical intelligentsia was destroyed. Some emigrated, some turned into ambulant tradesmen or small businessmen. The great remuneration scissors between bank clerks, insurance agents, drivers, petroleum and chemical workers, on the one side, and branch institute specialists, on the other, is still existing. In order to recruit experienced specialists and organise efficiently working R&D units, the Parliament, the Government and the Privatisation Agency should change their way of thinking in the field of investment and technical policies and clearly state their intentions about the future development of the Bulgarian economy - be it an agrarian country with well-developed tourism, a banker country, a light-industry country, a modern machine-building and electronics country, or whatever else. Once the choice is made, invest there all the scarce state resources and wait for the lucky fortune.

The third aspect of industrial restructuring is the market restructuring.

Bulgarian industry has been for long years built-up, specialised, co-operated and planned within the CMEA system. Nearly 70% of total production was export-oriented. Of this, the major part was exported in the former Soviet Union. Obviously, it is not an easy task to cover this 70- percent share of production capacity by products oriented to the domestic market. Due to the economic crisis, domestic consumption has dropped significantly; moreover, the constructions and technologies of formerly imported goods have not been developed so as to undertake home production of these goods using the free from export capacities. Being an industrial country, Bulgaria used to produce industrial goods in volumes bigger than it really needed to meet the domestic demand. It is not feasible, and even not necessary, to restructure the whole production so as to meet the demands of the domestic market.

The CMEA collapse and the crisis of the former socialist market, and that of the former Soviet republics in particular, had a crucial effect on the Bulgarian industry and its exports. Each of the former socialist countries is attempting its own way out of the situation by searching for the import of mainly cheap modern machinery and equipment, technologies, industrial co-operation, and consumer goods. To get them from the developed capitalist countries, it must export either equal in technical level and quality products, or low-quality, resp. low-price products, and therefore suffer losses from such an exchange. Undoubtedly, each of the former socialist countries is interested in preserving its markets, including in Bulgaria, and at the same time is striving to enter the developed capitalist market, too, which is much more costly and difficult. In this connection, it is of little use to just complain about the uncompetitiveness of Bulgarian industry and easily liquidate a number of productions instead of undertaking quick reorganising (incl. restructuring) measures aimed at recovering of the Bulgarian positions in the former socialist markets. It is true that in terms of quality, Bulgarian industrial products are lagging behind the best world standards. We should keep in mind, however, that the level of all former socialist countries was quite similar due to the fact that all of them were parts of the socialist co-operation and followed the requirements of a single market, i.e. the CMEA market. The former socialist countries face similar hardships and if they fail to enter the Western markets

Bulgaria could benefit from the situation by providing them with outlets and create in turn opportunities for its own exports.

The above-mentioned considerations do not mean a denial of new markets breakthrough. Just on the contrary. Yet, the economic and technical background and potential should be taken into account. Bulgaria should to a maximum extent utilise its relations with the former socialist countries, respectively their markets, to the requirements of which it has historically adapted. Moreover, from the viewpoint of transportation costs, trading with neighbouring countries is the most efficient. New markets require higher expenses on advertising, service network creation, lower prices at entry, higher quality of goods, etc. Market expansion is a guarantee for the greater economic and political independence of the country, yet it usually demands a lot of additional investment. The latter should be taken into consideration when solving the tactical problem of preserving the present industrial potential of Bulgaria.

In Bulgaria, market restructuring is inevitably connected with the process of political restructuring. Unfortunately, the political orientation of the country is still a vague issue for the majority of Bulgarian electorate. Bulgarian national awareness is still keeping the memory for its socialist past. The last parliamentary elections were the best proof of it. Bulgaria is hesitant to decide on what does it wish (socialism or capitalism) and whom to go with - Russia, the United States, Germany, or other 'great power'. On the other hand, and it is witnessed by history, the Bulgarian government has not been so much successful in deciding the political orientation of the country. Very often, the great powers decided behind its back. Prior to undertaking any serious restructuring of industry, the Bulgarian nation has to develop and be ready to pursue a long-term political strategy, to trust its own potential and intelligentsia, to overcome the secular reliance on 'the older brother' and be grown-up enough for independent development. Otherwise, it should have to restructure the economy with any new government came in power.

An important aspect of industrial restructuring is the resource restructuring. The bulk of material resources necessary for the Bulgarian industrial production are imported, incl. steel, oil, natural gas, coal, chemicals, cotton, timber, etc. In this respect, there two problems to be solved: first, will there be changes in the domestic-to-imported resources ratio, and second, will there be changes in the shares of foreign supplies by type of resources.

The transition from planned to market regulated economy put the end of the material balances. Nobody can any longer force others to buy expensive or low-quality raw materials provided that cheaper or high-quality resources are offered in the market. Along with the liberalisation of imports, this has made a number of production activities, branches and even whole sectors gradually shrink and die out. This is characteristic of ore-mining and enrichment especially but it applies also to construction elements, co-operated parts and assembly products. Many enterprises prefer the import of assembly parts, equipment, electronics, hydraulics, etc. than waiting for the poorly operating and undisciplined Bulgarian suppliers. Transport companies prefer importing transport vehicles than making orders to and thus opening jobs in local enterprises. There is also a purely psychological aspect in the preferences of managers, i.e. imports are usually connected with business trips abroad, opportunities for hidden fees, etc. All this could be relatively bearable provided Bulgaria had rich and sufficient natural resources (ores, coal, oil, natural gas, water, wind, etc.), the enterprises were not state-owned but private, and the economy was really a market one. None of these, however, is available. Some profit at the expense of others, energy suppliers use their monopoly position to set high prices, and

losses and hardships are distributed and suffered by the whole industry and the ordinary people.

For example, the financial results of Kremikovtsi and the National Electricity Company bear relevance to the limited water supply regime in Sofia; bad loans and bankruptcies will be paid by the state, i.e. the people; unemployment and qualification and retraining measures are “Inmenced mainly by the state; gas and timber supplies are also problems to be solved by the government, etc. The issue of the degree of self-sufficiency and exploitation of national resources is directly related to industrial restructuring and the protectionist measures of the state. On the other hand, natural resources are state ownership and they are exhaustible. One can hardly specify the equitable market price of an exhaustible resource, accounting for its use and demands in the long-term prospective. There are cases when machinery is bought with the single purpose to melt it and use the cheap metal put in it. The state cannot be negligent about the term of exhaustion of the mineral resources of the country. Therefore, the selection of material-intensive or non-intensive goods in the process of product restructuring is not a task to solved by enterprises (be they private or state-owned) only as they use to run after local goals exclusively. A state policy and strategy should be developed and pursued in this field and it should be a keystone for product restructuring accompanied by relevant incentives and penalties.

The restructuring of material resources imports is of similar character. The imports should be compensated by exports. Otherwise, there will be no foreign currency inflow. It is good to produce active trade balance with a given country but this is what all countries are striving for. As a rule, in the international trade relations deficient resources are negotiated for other deficient resources, unsaleable products for other unsaleable products, etc. The by-country orientation of Bulgarian imports is a problem to be solved along with the problem of product restructuring.

Technological restructuring is of crucial importance for overcoming the crisis of Bulgarian industry. New technologies provide higher quality and/or lower costs of production. As a rule, the implementation of new products is connected with changes in technology. In discrete productions, the restructuring of production does not always require changes in machinery. In non-discrete productions (chemistry, metallurgy), however, the whole scheme of production is often changed and an entire or partial substitution of existing equipment is required. The old equipment is no longer used. Under the present regulations of depreciation allowances, enterprises are not allowed exceeding a certain fixed rate thus rising the production costs and therefore decreasing the taxable profit. They are not obliged to keep the allowances with a special purpose bank account. In the generally spread deficiency of cash, enterprises simply spend these funds on wage and other payments (to suppliers and creditors). Normally, industrial enterprises are short of capital construction fluids. Raging inflation, non-adequate estimations under Decree 179/1991, constantly growing prices of new products and spare parts, low depreciation rates, etc. make accumulated investment funds (if any) quickly disappear. Under these conditions, product restructuring is simply unfeasible without taking into account the related technology renewal costs. The hopes for ‘fresh money’ are directed here, too, as it decreases with any successive privatisation deal. Along with the resources necessary for direct technological restructuring, considerable funds are also needed for restructuring the infrastructure of enterprises. The latter, however, is rarely taken into account in determining the market price of enterprises. Production restructuring may result in a number of demographic and defence problems such as depopulation of some of the border regions, providing jobs for men or women only thus provoking the runaway of the other sex as well, reduction of the number of

Bulgarian ethnic population in those regions, necessity in building new roads, water and electricity supply systems, schools, hospitals, etc.

Industrial restructuring includes personnel and organisation aspects, too. They are not subject of a detailed examination due to the limited volume of this paper. It should be underline however, that in the process of restructuring and privatisation attention must be paid not only and exclusively to the price offered by the potential client. Securing the jobs of hundreds or thousands of qualified workers and specialists, who through their families are connected with other enterprises and branches is a very important problem as well. As far as the organisational aspects and problems of privatisation and restructuring are concerned, the effects should be determined with respect to the entire technological chain of interconnected enterprise producing a certain final product.

The Effectiveness Issues in the Privatised Enterprises

HEKURAN MARA, ILIR GADESHI

With the acceptance of the political pluralism and the market economy in Albania, in 1991, all the political forces considered the privatisation indispensability, as the most essential element of the transition towards a new social-economic system.

In order to reach such strategic objective, it would be considered the starting point and the special features of Albanian economy, which were so different from the other Eastern European countries, as follows:

- Closed and self isolated economy and with autarkies tendencies,
- An economy with the absolute domination of the social property (state and co-operative) under totally centralised plan,
- An economy with disequilibrated structure, old technology, great and non effective consume of the resources and a high production concentration, especially in the field of the industry,
- An economy, where during the last decade it was created the viscous circle of the stagnancy concerning the investment increase, which during the second half of 80s fell almost to zero. This caused such destabilising phenomena as unemployment and hidden inflation, the chronic deficit in the budget and the payment balance, increase of the foreign debts, etc.

In such conditions, the economic reform and its essential component the privatisation should intend to overturn these restraining characteristics for growing and development of the Albanian economy and rising of its effectiveness by stimulating the production and the employment.

For this purpose the Albanian Government that emerged from the pluralist elections of March 1992, has competed a strategy of quick and total privatisation of the economy, with the aim of the establishing of free market economy.

The implementation of this strategy is being carried out in two stages. The first stage includes small and medium enterprises of production and service with a value of the actives to

500 000 US \$ or up to 300 employees. This group includes also those big enterprises, that due to the privatisation acceleration, were split into smaller units by spoiling sometimes the technical unity among them. In this phase the priority for privatisation is firstly given to the ex-owners of the ground or the actives of the enterprise prior to the nationalisation, then to the enterprise employees and finally to the physical and juridical persons, Albanian or foreign citizens. Two first categories of the subjects and ex-political persecutors are excluded from the privatisation by auction. Now this phase can be considered almost finished.

The second stage, that should include the big enterprises are preliminary transformed into trade companies, has started its realisation in 1995 through free distribution of "the privatisation coupons", to a part of the population in Albania.

Now, four years after the initiation of the economy privatisation (1991-1994), the 50% of the GDP in Albania is obtained by the private sector. In this sector, excluding agriculture, approximately 120.000 people are employed, while the whole private sector provide 54% of export.

In Albania the transition process towards the market economy is also being realised in two ways, through the privatisation of the state property and the newly creation of the private property. So two forms of the private property are noticed:

- The authentic private property: a) newly established from the local and the foreign capital or b) when the state enterprise is bought by the foreign company, by one or two joint owners that have a joint project,
- The privatised property: a) by the ex-employees of the state enterprise, b) by the ex-owners of the ground or the enterprise actives prior to its nationalisation, c) by ex-political persecutors.

According to the datum of the National Privatisation Agency, only during 1993 - April 1995, when the privatisation process was accelerated, 4.397 small and medium enterprises in total have become private, out of which 1.760 or 40% are taken by their personnel, 1.105 or 25% by the ex-owners of the ground and 1.508 or 34,8% by Albanian physical and juridical person and only 12 enterprises are privatised by the foreign capital.

From a questionnaire performed during the first quarter of 1995 in 50 producing enterprises of the most industrialised zones of the country (Shkodra, Tirana, Elbasani, Durrresi, Korea), it result that some qualitative differentiation exists between the genuine private property and that which is actually privatised. These include a range of important *problems related with the managing, changing the managers attitude, the profitability increase, which are reflected to the effectiveness level that would secure the two forms of above property.*

The management of the enterprises, privatised by the personnel, when they are still functioning as per the destination of before being privatised, is made by the managers selected from the personnel, who are often lacking the managing abilities. Even in cases when skilled, they cannot work out a clear strategy on survival, restructuring and the further development of the enterprise under the market economy conditions.

The lack of such strategy is because in these enterprises none can exercise the real power for the solution of this problem, with the distribution equally of the ownership rights. In addition to this, the selected managers are under the continuous pressure of the joint owners, not to shorten the working places and to distribute the greatest part of the income as payments. This leads to the narrowing of the investments base, which has been and still remains one of the keenest problems for growing and the development of the Albanian economy.

There are also cases when the enterprise privatised by the personnel, due to conflicts between the joint owners, doesn't function at all. In such case attempts are made that its premises to be rented beyond production destination or working materials to be sold, and the received income to be shared among them, causing the enterprise liquidation. In such case, this form brings the decapitalisation.

The phenomena which are noticed to the enterprises privatised by their staff are not met to the enterprises privatised by ex-owners of the ground or the initial actives prior to their nationalisation. This because on them it is settled a survey structure and the real power over the managers, appointed by the owner or the group of most of shareholders, when the enterprise is turned into shareholders association. Nevertheless in this form of the privatisation, the keenest problem that is often encountered is the lack of the necessary capital for the physical restructuring of the enterprise and to realise a long-term strategy, even when it is clearly and exactly worked out.

The actual achievement of the survival under the new market conditions can be considered as a positive phenomenon of this form of the privatisation. The survival was made possible by the diminution of the employees number in production and administration, by the minimisation of the misuses, by discipline strengthening under the threatening of getting sacked. Excluding by law of these enterprises from the revenue tax for a period of 4 years, has also influenced positively.

When the privatisation of the state enterprises is realised through "the privatisation coupons" distributed to the ex-political persecutors since August 1994, two phenomena were present. The first has to do with the cases when the enterprises are bought by "the privatisation coupons", by the ex-political persecutors themselves. The second has to do with the cases when the above coupons are sold with 50 - 60% deduction from their face value to the physical and juridical persons, who used them to buy the enterprises fixed for privatisation.

In most of the cases, when the enterprises are put in function by a group of ex-political persecutors, it is noticed that due to missing of a joint undertaking project, they could not create a surveying structure and real power because they lack the managerial abilities, especially the necessary capital for restructuring or rarely for putting the enterprise in function. While in the second case such phenomena are not noticed or are greatly minimised.

Considerable transformations are also noticeable, concerning management and the managers attitude in the newly established private enterprises and the state ones, bought by the foreign companies, by one or some joint owners that have a joint project. In this case the privatisation has brought the appearance of the signs of the spiral form cycle: profit - investment - employing - productivity - income - saving - demand - profit. All this is expressed with the effectiveness increase of these enterprises.

Nevertheless, for almost all forms of the private enterprises that function in Albania, one of the sharpest problem faced by them is the competition of the import goods that threatens them to the bankruptcy. This makes evident the prompt and indispensable implementation of a projectionist policy, temporary and selective, by the Government, especially through the customs taxes system.

From all the privatisation forms realised till now, another meaningful fact is to be stressed: the negligible participation of the foreign capital (0,3% of the total number of the privatised enterprises). This is more evident if it is considered the circumstance that almost all the owners of the privatised enterprises hope, in the participation of the foreign capital for the universal restructuring of their enterprises. In such conditions another phenomenon is also noticed, that when the foreign capital is present or enter the enterprise, it dictates conditions to be predominant by taking the control and the real power of the enterprise.

Nevertheless the Government should create the most favourable conditions to the special branches and sectors of the economy to stimulate as much as possible the foreign capital participation to the privatisation process.

The procedure of the privatisation process until now in Albania justifies giving the priority by the Government to some of its forms, which have been more efficacious, such as the privatisation formula, when the control of the real power of the enterprise is in the hands of an owner or a group of owners. The execution of this formula doesn't exclude the employees participation in the capital, as a stimulating form and motive, combined with the participation of the foreign capital for the enterprise restructuring.

Considering the studied cases, we can conclude that the state privatised enterprises need a transition period to be changed into the authentic private ones, that can provide the increase of their effectiveness and of the economy on the whole.

The duration of this period is also connected with the measures that should be taken by the Government to provide a real privatisation that does not terminate only with the juridical alterations of the ownership rights, but also with the measures taken for the strengthening of the dynamic development of the entire private sector. The overcoming of the negative phenomena, which are already noticed to the privatised enterprises could not be left only to the market forces, but also to the active interference of the Government. The Government can't stay indifferent against the problem that has to do with the privatisation results and the procedure followed by the privatised enterprise. It is therefore the proper time that the Government bends the responsibility to solve the macroeconomic problem should also increase the responsibility and action for the microeconomic issues solutions.

The received experience suggest that the negative phenomena manifested on the small and medium enterprises privatisation process that lower the effectiveness level of the economy could be amplified in the process of the massive privatisation of the big enterprises. The dimensions of these phenomena will be minimised if the economic criterion is put in the base of the massive privatisation process and not the political - ideological one.

On the other hand, the same experience indicates that in particular cases, together with the privatisation of poor quality of the big enterprises, the way of the state enterprises transformation into the public ones, as per the practice of the West European countries would

be more efficient. This also results from the fact that until the privatisation process completion, the big state enterprises can't be abandoned by the state, and that all the measures that would be taken for their transformation don't serve only for the effectiveness increase of the economy on the whole but and that of the private sector in particular.

Finally it should be emphasised that however important and essential the privatisation for passing towards the market economy may be, the entire privatisation of the economy can't be considered as an indispensable objective of the transition.

The Mass Privatisation Funds: A Challenge for Corporate Governance

PLAMEN TCHIPEV

The large scale of the property to be privatised and the slow pace of the standard schemes of market privatisation together with the peculiarities of the post-communist economies imposed development and implementation of the mass privatisation schemes in these countries. Regard less the country specifics all those schemes are based upon of the particular type of financial intermediaries. To avoid misleading caused by the various terms introduced in literature and practice it will be used hereafter a descriptive term - Mass Privatisation Funds (MPFs). It simply denotes any type of intermediaries proposed to be created under the mass privatisation without predetermined meaning.

Beside important functions they have to play in mechanics of the process: collecting the vouchers from potential investors, identification of the enterprises to invest in and acquirement of their assets, the MPFs must perform a different more important function - to ensure an effective device for a corporate governance. And it is the main problem associated with the MPFs - is it justified to expect they would exert control and monitoring over the companies? Is it an implicit feature of their nature and if not is it possible to guide funds' activity in that direction through a special regulation? What kind may be such a regulation?

The questions come from the status financial intermediaries in a market economy have; the functions they perform differ from the functions expected to be performed in a transitional economy. This problem is treated in the first section of the presented paper and since it is relatively well-known the analysis concerns some contradictory points in the perception for the financial intermediaries. The second section deals with some proposals for resolving the corporate governance problem associated with MPFs through their development as investment banks. The third section is devoted to a critical review of the ideas and concepts for MPFs launched during almost the three years past since the beginning of the mass privatisation discussion in Bulgaria. The fourth concludes.

Non-Banking Financial Intermediaries in a Market Economy

Within a market economies there exist, apart from individual shareholders, a large number of financial (non-banking) institutions. It applies particularly for financial systems based on stock

market⁸. They perform various economic and social functions offering a number of financial instruments to their clients. As a result they concentrate and manage considerable funds. The large scope of these funds is in the basis of the idea they to be used in Mass privatisation schemes in CEE countries.

Although, there is a major problem associated with such a potential use of non-banking financial intermediaries in privatisation in post communist countries. The largely diversified portfolios they hold make investigators assume that intermediaries cannot and do not perform any significant role in corporate governance (Corbet and Mayer, 1991).

Applying this to transforming economies Corbet and Mayer (1991) say that the transfer of ownership on investment funds, pension funds and life assurance companies does not solve anything, since there remains the problem of their own monitoring. Since their ownership is also widely dispersed their holders cannot exert control over them. Hare (1993) points out that a rapid privatisation by mass give-away programs makes it possible for existing worker/management coalitions to continue dominating their firms with very limited external control.

Nevertheless, the opinion about financial intermediaries' indifference toward the corporate governance problem is questionable. There are some reports asserting that in the beginning of the 1990's the non-banking financial institutions have joined actively in corporate governance (Mulineaux (1992). It is difficult to decide, though, whether this is caused by recession or it is a lasting tendency. Ash, Hare and Canning (1992) also point out representation of institutional investors on companies' boards pressuring the management to improve performance. Such a tendency is notable in US where the pension funds get more involved in the same functions (The Economist (1993).

A different point of view on that problem presents Singh (1993). He discloses a survey data showing that banks exert control not through their equity holdings but through acting as representatives of outsider shareholders, i.e. through voting by proxy. In that sense, it seems to him that there are no restraints, this being the case of financial intermediaries as well.

That contradictory role of financial intermediaries lead to a number of different proposals for the way of constituency and regulation of such intermediaries in transforming economies in order to comply with the different functions assigned to them in mass privatisation.

Proposals for Specific Development of Financial Intermediaries in Transitional Economies

Most of the researchers in the field propose a specific development of financial intermediaries. Such a variant is suggested by Frydman, Phelps, Rapaczynsky and Shleifer (1993), who assign the main role in reforming systems to investment funds created through mass privatisation. They may take-over the bad loans and deposits from the state-owned banks and by this removal ease the need for capitalisation which must be supported by government. These funds may perform both investment bank and commercial bank functions, becoming the core of a new bank system based on private property and competing with the existing banks.

⁸ More of that problem is presented in Tchipev (1994)

A similar thesis is proposed by Coricelli and Thom (1992), though they suggest a third party between old banks and new investment funds, a temporary liquidation agency, which should take-over bad debts together with government deposits, central bank refinancing credits and even some of the deposits of the public, if necessary, to offset the bad loans. Further, this agency would restructure the enterprises and sell their bad loans to investment funds. This way the authors propose lessening the burden of expenditures on capitalisation of banks and increasing the collective rate of these loans. Under this scheme the creation of investment funds is not bound to the application of a mass privatisation programme.

Corbet and Mayer (1991) propose overcoming the lack of control exerted through capital markets by issuing to funds' outside investors debt instead of equity contracts.

Frydman, Phelps, Rapaczynsky and Shleifer (1993) argue that if investment funds created by mass privatisation do not wish to follow their counterparts in the English speaking world they must develop as universal banking. Since it is quite possible that these funds would try to avoid the cost and the trouble of supervising the company the authors suggest 'locking' intermediaries into the company in their portfolio. This could be done through limiting their holdings to a small number of companies, or through an appropriate design of the initial distribution of the shares, so that the intermediaries take large blocks of shares of individual enterprises.

The discussion reviewed, reveals that most of opinions tend to attribute to financial intermediaries in mass privatisation some specifics getting them closer to *new investment banks* in order to overcome their failure to exert efficient control and monitoring of the enterprise sector. It does not seem, however, that this is the ultimate solution to the problem and obviously this will be the object on intensive further research.

Whatever the concrete solution may be, it is doubtless that any privatisation model must consider the corporate governance problem and suggest a solution for it and any attempt for assessment of that model should examine this solution.

The Bulgarian Mass Privatisation Scheme and Financial Intermediaries

The idea for mass privatisation was launched in 1993. Despite the strong promotion of the idea in the beginning of 1993, when many reports, schemes, intentions, etc., have being announced, very soon the lack of political will and consensus on the main points of mass privatisation blocked its practical implementation. The struggle on the way of organising the funds resulted in unprecedented situation when the variant of the scheme adopted on first parliamentary reading was changed on second reading to quite different variant.

The Variant Based on State-Owned Privatisation Funds

The first variant of the mass privatisation scheme was created by Bill for Amendments to the Privatisation Act (the Bill) at the beginning of 1994 (Zakonoproekt (1993)).

According to the Bill a number of enterprises were to be identified for mass privatisation. In an earlier draft of the Mass Privatisation Scheme, the figure of 500 large companies was mentioned encompassing almost all branches of industry; ten state-owned banks were also mentioned. These enterprises were to be split into two groups: about 300 of them to be privatised through investment funds and the rest 200 - directly. According to a joint memorandum of a working group of the Bulgarian Government and the World Bank (Mass Privatisation in

Bulgaria. General Framework (1993), the assets share of directly privatised enterprises should not fall below 50 per cent. While the memorandum states that no preliminary conditions should be imposed on the enterprise choice, such as solvency, indebtedness, branch or scale, the aforementioned draft on the Mass Privatisation Scheme recommended that large, profitable enterprises or those which are of interest to foreign investors should not be included in the list.

The Bill left the rules for issuing mass privatisation certificates, determining the price and method of payment, to the Council of Ministers to decide.

For the certificates' owners was reserved the right to choose how to use their certificates: directly, i.e. to buy shares in some of the 200 enterprises; or indirectly, by buying shares in any of the purposely-created funds, among which the stock of remaining 300 mass-privatised enterprises was to be distributed.

These funds, called investment funds, were proposed to be founded as a state-owned holdings with two tiered management. Their business was envisaged to be trade and investment in securities and they were supposed to continue operating after being privatised. These funds had to be privatised by Bulgarian citizens presenting their certificates and thereby buying fund shares.

Furthermore, the Bill envisaged that the funds' state-appointed boards of Directors will be changed at the first new shareholders' meeting. Thus the investment funds will be turned into private entities governed by the Company Act.

The criterion for distribution of the shares of mass-privatised enterprises was not fixed in the Bill, but in an earlier proposal it was indicated that two of the projected funds (social security targeted) should have maximum diversified portfolios. The others were supposed to have certain branch-specialised portfolios.

It must be said that the variant presented here had encountered many critics originating from different social and political groups and it was not surprising that it was abandoned. The main specific problems created by it are following: *the centralised organisation of funds with state appointed management, bureaucratically-formed portfolios and high concentration (only 10 funds); the exclusion from the scheme of existing private intermediaries.*

Every one of these points, taken solely, may have a good reason. For example, centralised organisation could be seen as an attempt for a gradual shift of control from the government to other business parties, and thereby to prevent or limit possible lay-offs and closures. Such a practice is typical for the Treuhandanstalt in East Germany (see Carlin, (1993)).

The limited number of the funds is probably inspired by Polish experience, where it is connected with the prospects of contracting management of the intermediaries to foreign consultancy firms, and in this case a small number of funds would make the process easy manageable and probably cheaper.

Similar explanations can be found for the other particularities of the proposed mass privatisation scheme. But, taken altogether, they were likely to produce some difficulties during implementation.

First of all, centralised organisation of funds would hardly encourage competition between them from the stage of their foundation. Their portfolios created through simple division of state enterprises' assets, would offer few chances for choice to the would-be investors, since the difference in quality of their portfolios may distort demand for fund assets toward the more profitable ones. Receiving enterprise assets on a competitive basis would avoid, or at least decrease the problem because any fund will try to offer different policy and probably different targets in comprising its portfolio.

Lowering competition between funds does not stimulate their active involvement in corporate governance, since each fund is in a similar situation and applying excessive effort to that task is not vital for funds' performance.

Discouragement of private intermediaries does not seem to be very helpful for the system as well. It prevents fresh capital flowing into projected funds, which could have significance for the way they themselves are being managed and controlled. This was the crucial point of that variant of mass privatisation scheme. With dispersed ownership, state-appointed management, far-from-perfect portfolios, it is hard to believe, that these intermediaries would follow the will of their shareholders.

Exclusion of private intermediaries would not promote diversification of the instruments they offer, which is very important for their attractiveness in market economies.

These apparently weak points of the proposed variant together with the dissatisfaction of the representatives of the already created private funds were probably the reasons for abandonment of the variant and introduction of new one.

The Variant Based on Private Privatisation Funds

The Act of Amendments to the Privatisation Act (the Amendments Act) adopted in the middle of 1994 has introduced a variant for mass privatisation which is to be implemented through private investment funds. Actually it is better to say that it has simply omitted the norms of previous variant regulating centralised creation of privatisation funds this way allowing participation of private ones. The other characteristics of first variant remained unchanged. Following the old tradition to outline only the basics leaving all the details to be defined later in governmental ordinances the Amendments Act has added only few new elements to the picture. It specified the original amount every matured citizen can invest through privatising vouchers (25 000 leva) and the price of the voucher book (500 leva), (Zakon (1994)). This way all the mechanism of creating and functioning of the projected funds has left unregulated by now.

At this point it is worth saying a few words on the existing, though sparse, regulatory framework for the functioning of non-banking financial intermediaries in Bulgaria. The Law on Banking and Credit Activity (LBCA) has provided the opportunity for some banking deals to be performed by non-banking institutions which had been licensed for that purpose. In this act their activities are generally defined in terms of licensing rules and information required from the central bank (BNB). The LBCA contents also clauses for control and discipline for the businesses carrying out unauthorised deals.

The BNB regulations have elaborated the problem further. They specify three groups of nonbanking institutions: foreign currency exchange bureaux, brokers and financial houses.

These financial institutions are explicitly prohibited from receiving deposits and granting loans. To commence dealing, the non-bank institution must present bank's or other guarantee amounting to not less than 100 000 BGL and lasting for one year. Later this guarantee must be prolonged every year keeping the amount not less than 10 per cent of the average annual amount of its liabilities, decreased by its own capital.

Obviously this legislation framework is not sufficient to regulate functioning of current investment funds most of which are registered under the general rules of the Commercial Code. Some of aforementioned FBH perform functions on trusted management of funds but also without any specific regulation.

This situation seriously endangers successful implementation of the mass privatisation scheme and provoked issuing of few proposals for temporary regulation of the privatisation funds. They were dealing with problems of licensing, control, competition policy etc.

Although, these attempts were gradually replaced by the vision that it is impossible so complicated problem to be arranged by decrees, moreover temporarily and separately from the general regulation of the securities' trade and Stock Exchange. That way a new Bill for securities trade was proposed which treats in debt creation and functioning of investment funds as non-banking financial intermediaries.

The last proposal differs from the temporary variants, abandoning all the regulation of MPFs, which suggests that a process of reconsideration of the specifics of these funds is going on and with the most probability they will be treated later in different way.

Problems of the Scheme

In any case some conclusions for the proposed new structures could be drawn. Obviously, all the mass privatisation schemes aim to introduce new type of financial intermediaries easing the transfer of the property rights over the enterprises in private hands within a relatively short period. At the same time these institutions are expected to push establishment of stable and large stock market, which to activate in its turn investments.

Unfortunately, a lot of contradictory points may be found in the presented schemes, especially in the light of the proposals for resolving corporate governance problem reviewed in Section two.

The proposals for regulating the funds, and more generally the whole idea for mass privatisation, suggest that the character and the purpose of functioning of the funds are as to of investment funds. That means, the funds are to be expected by their shareholders to provide relatively high and stable income. Respectively, the funds will need high liquidity of their asset portfolios and of their own equity as well. That may be the reason for introducing compulsory buy-back of their shares in proposed regulations.

The problem is, that at most probability privatisation funds hardly will get not only high liquidity and even normal returns on their assets, since the enterprises they are supposed to invest in are with quite different profitability and many of them are losers. It is absolutely unpredictable how many of the funds and to what extent will be able to respond to the requirements of their shareholders.

Given that situation, it does not seem unlikely if too many of investors impose a pressure in order to have their shares bought back, which will force the funds to sell essential part of their assets.

Encountering that danger managers of the funds may choose to increase the quality of their portfolios during the 'closed period' by getting engaged deeper in the management of enterprises they hold stakes in, and to enlarge the last eventually. Such an engagement change the character of the funds toward that of holding companies, which may lead to internal conflict of interests within the funds.

In fact, the problem is much more complicated and requires a detailed analysis which goes beyond the purposes of this paper, but it seems apparently, that funds will encounter *the trade-off whether they to act like investment funds or like holding companies*.

The other serious problem associated with the proposals for mass privatisation scheme is the separation of mass scheme from the market one. It suggests that enterprises chosen for mass privatisation must be privatised entirely through it. It will result in establishing a single type of shareholders, either only institutional or only individual depending on whether direct or indirect mass privatisation is applied.

Alternatively, mixing methods would result in a mixed type of shareholders in these enterprises, with few larger shareholders alongside a great number of small ones.

Thus, the scheme loses an important tool both for activating the monitoring of companies and for simplifying the privatisation process itself. Practice has shown that even in privatisations through negotiations the bidders prefer not to take hundred per cent stake in a company but a majority one. Mixed shareholders would allow a decrease in the average size of the controlling package which would promote entry of private firms.

Furthermore, the split between the schemes decreases local privatisation incentives. In most cases of market privatisation, the initiative relies on existing contacts with potential investors or on the visions of incumbent management for further development. This initiative tends to be lost in overall mass privatisation, which thus loses flexibility. Combining methods is one of most fruitful features of Czech mass program, where stakes consigned for voucher distribution varied from 0 to 97 per cent of company stock, (Carlin and Mayer, 1992)).

Both variants do not promote the participation in mass privatisation of other non-banking, financial institutions emphasising the investment funds. On the one hand, centralised variant would make impossible the scheme to be joined by the life assurance companies. On the other hand, the regulation proposed for private funds by the other variant tend to uniform them. Thus the instruments offered to their investors will be equal - equities with more or less different liquidity depending on how well they perform. This is a real obstacle in attracting the interest of different groups of investors and thereby will be a serious limitation on mass participation.

In fact allowing pension funds, insurance companies etc. to be involved in mass privatisation could be very useful. The policies, for example, pension funds offer are with longer maturity and may decrease the pressure for liquidity for certain period of time providing an opportunity for restructuring the portfolios. It is important to note that in market economies investment funds have the less share in the corporate stock and often are the top of the pyramid of non

banking financial institutions, being themselves set-up by pension funds and life insurance companies.

Indeed, the first variant envisaged two of funds to have social security specialisation, which means that they were supposed to issue various instruments. Under the current variant this option has been forgotten.

But the real problem is not in that. The problem is in the way they were proposed to be created. The practice in financial systems under market economies shows that the constituency of portfolios of intermediaries depends on the instruments issued. So, the question is, whether social security funds (if created within mass privatisation) would be able to match claims against them with portfolios consisting mainly of equity, most of which would have low liquidity? By now, most social payments are collected and distributed by the budget. A separation of these funds from the budget and their foundation as independent entities before joining the mass privatisation scheme appears a better approach for their foundation, together of course with a permission for participation in the scheme for already existing ones.

All the deficiencies of the mass privatisation scheme pointed out here touch the core problem - ensuring the proper corporate governance for privatised enterprises. The problem emerges at two levels as control and monitoring of the privatisation funds and as control and monitoring of privatised companies. It may be said that the second variant of the scheme improves the solution about control and monitoring of the very funds, since it introduces block shareholdings held by the founders of the private funds. Even in these cases when in process of privatisation the eventual amount of the assets will exceed the founders capital many times, the mechanism of voucher conversion ensures so large diversification of the ownership among the population, that founders can keep decisive stake.

But there is another question arising about private privatisation funds. The scheme suggests two apparently different kinds of shareholders founders, these who invest real capital and all the others who would invest free vouchers. The different positions of these shareholder groups easy may inspire different goals adding a new dimension of the possible conflict outlined above between managers and shareholders as a whole.

What concerns the second level, that of privatised enterprises, it seems that corporate governance problem has been ignored almost completely within that scheme of mass privatisation. The emphasis on investment character of the funds, the limitations on funds' portfolio structure and prevention for other financial institutions from participation in the scheme show that all precautions and suggestions of the discussion reviewed in first section have been ignored.

A possible explanation for such a position could be the implicit expectations that very soon after transfer of the ownership to the funds they will sale sufficiently large stakes to large independent investors, both foreign and domestic, ensuring this way creation of block- shareholdings in most of privatised enterprises. But taking the point of view of current low investment interest in the same enterprises this perception on future does not seem very reliable.

More feasible seems the scenario of weak trade in securities of enterprises owned by funds, which may rise the goal trade-off described above together with the appropriate conflict of interests within the funds.

Conclusions

The review of the proposals for Bulgarian Mass Privatisation schemes presented above at the background of proposals for resolving the corporate governance problem emerging in a potential use of MPFs leads to some conclusions:

1. It is questionable if the MPFs can successfully perform corporate governance on privatisation enterprises without any special regulation.
2. If occur they cannot they need a regulatory treatment differentiating them from investment funds in general. That treatment should count for: 1. creating block-shareholdings both in the funds and in the privatised enterprises; 2. preventing internal conflicts between different groups of shareholders within the funds. A decentralised creation of the funds and unification of market and mass privatisation may promote such block-shareholdings.
3. A special attention should be paid to the proposals for directing some of these funds toward investment banking. It could be arranged through issuing debt instead of equity by MPFs.
4. Close but not equal tool is allowing for other types of financial intermediaries to take part in the process, offering that way various instruments against the population vouchers, e.g. life policies and pension arrangements.
5. An alternative option for resolving the corporate governance problem is introduction of regulations for 'locking' some of the funds in particular portfolios, i.e. a compulsory engagement in privatised companies' stock above a certain share. Those regulations are just the opposite the relevant regulations of investment funds in general case.
6. The final decision for determination of MPFs must be taken in accordance with the general concept for orientation of the financial system in a particular country, toward one or another type of exerting the control and monitoring over the privatised companies.

Notes

The above attempt to see the role of financial institutions in the Bulgarian privatisation programme, using recent investigations into that problem and some lessons derived from the role of financial institutions in the UK privatisation may be summarised as follows:

- (1) The role of financial institutions in privatisation depends on the orientation of financial system restructuring.
- (2) Given the specifics of the transition economies, the financial intermediaries are likely to develop a larger role in their financial systems and hence in privatisation.
- (3) The privatisation model being developed in Bulgaria does not show a clear orientation toward a definite type financial institution as its basis. Two different, independent privatisation schemes relying on the stock market and on investment funds, respectively, have been proposed.
- (4) The scheme relying on the stock market has still not proved successful. It lacks a developed system of functionally divided institutions, reliable regulation and comprehensive consumer protection.

- 5) The mass privatisation scheme relies on intermediaries encountering the trade-off whether to perform an investment fund or holding company functions. This carries the risk of conflicts of interests within them.
- 6) The banks are not currently involved in the restructuring of the enterprise sector and privatisation, but still there exists such an opportunity through the use of the government bonds issued to replace bad loans, particularly if banks' privatisation precedes privatisation of enterprise sector.

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Specific Features of Russian Commercial Banks' Investment Policy during Transition Period

SERGEI KRASILNIKOV

The economic and political situation in today's Russia has a rather complicated and mixed impact on commercial banks' investment policy. On the one hand, high inflation, political instability and a number of other factors cannot but restrict their ability to finance long-term projects, simultaneously encouraging the keeping of savings in the most liquid form. On the other hand, the recently observed financial stabilisation makes the banks look for new kinds of activities, including long-term projects. Even now an entire range of investment projects can provide high and sure profits.

Among other factors influencing the banks' investment policy, the presence of financial operations which are more profitable than investments should be highlighted. Treasury bills are at the top of the list of such operations. Operations with Vnesheconombank (the Foreign Economic Relations Bank), cash hard currency and others also bring high profits.

Obviously, if the state carries out a large-scale issue of treasury bills, it represents serious competition to enterprises on the financial market as it reduces the volume of funds which could be in principle invested in the production. The state sets a competitive profitability rate that few enterprises can bear.

Noteworthy is the fact that Russia has a paradoxical situation from the point of view of the experience gained by the rest of the world. The least risky investments in treasury bills are at the same time the most profitable. Normally, the situation is vice versa - the more profitable is the operation, the higher is the implied risk.

Along with the above-mentioned financial tools, there are other, more risky but also highly profitable operations such as speculation of shares issued by industrial enterprises.

However, the situation in this field changed dramatically at the end of 1994 due to a number of reasons.

Firstly, the initial growth of the shares was determined by their extremely low prices which had been set by the state. Obviously, the difference was gained by 1995, which resulted in the lower profitability of this kind of operations.

Secondly, the lower profitability rate was determined by the growing pressure from the highly profitable market of treasury bills and cash hard currency.

Nevertheless, experts believe that a number of portfolio investments will remain profitable in 1995. What is more, their relatively high profitability may rise against the background of the expected decline in the profitability of operations with treasury bills and cash hard currency provided inflation is kept down and the ruble rate stabilised. However, the low liquidity of shares remains a great problem, which is a consequence of the underdeveloped stock market infrastructure in Russia at the moment.

All these factors determine the banks' cautious attitude to portfolio investments, though many banks own major shares of various industrial enterprises.

According to specialists of the Expert Institute, the banks tend to put forward the following requirements to the enterprises they plan to invest in:

- The production must be based on well-mastered technology;
- The equipment in use must not require dramatic modernisation or repairs;
- The enterprise must produce competitive products enjoying stable demand.

The last requirement is the hardest to meet as many Russian enterprises producing mass and cheap (against imported goods) products are competitive only today, under the present ratio between the prices of domestic and imported goods. The future of such enterprises is very hard to foretell, because it heavily depends on the development of the whole Russian economy - whether the effective demand will rise sufficiently to switch to more expensive, but higher-quality imported goods, to what extent the Russian government's foreign economic policy will be protectionist, etc.

To bear in mind all of the factors is of principal importance for commercial banks as they determine their investment strategy - whether it will be short-term portfolio investments meeting the above-mentioned criteria or long-term investments in the development, upgrade and creation of new enterprises to conform to the world standards. At present, a number of banks makes large steps on the second way as they begin to invest in the development of high-efficient and competitive technologies.

At present, Russian commercial banks face the following problems as far as direct investment are concerned.

1. The present macroeconomic conditions, including the inflation and refinancing rates, and relatively higher profitability of other financial operations make commercial banks to make investments, if any, at a much higher interest than in the rest of the world. As a result, the requirements to the economic aspects of the investment projects' become very strict, and projects involving considerable investments in the upgrade of the production are sorted out. Basically, projects already having a developed production infrastructure and chiefly needing investments in the working capital have most chances. However, this kind of projects is a far cry from the edge of scientific and technological progress as it is not always intended to produce world-class competitive goods. As a result, investing to quickly justify the costs in many cases spells preserving the existing state of affairs instead of a

technological breakthrough which could comprise a basis for the enterprise's successful development in future.

2. The difficulty to forecast on the effective demand for the manufactured product due to the high probability of quick unpredictable changes in both macroeconomics and the sociopolitical situation. As a result, it proves extremely hard to assess the prospects for the demand for the product basing on widely used analytical methods, while other approaches reflecting the high dynamism of the situation in Russia are circumstantial and cannot be a reliable basis for the project analysis and forecast.
3. The organisational and guarantee issue lies in specific features of the company initiating the investment project under consideration. The financial situation of such companies, especially when major industrial enterprises are concerned, is in many cases disastrous and they hope to improve it by implementing the investment project. However, financing a project proposed by an organisation in a deep solvency crisis appears an extremely risky operation for any financial or investment institution. As a result, the circle closes in leaving the only way out - creating project-oriented structures, including in the form of a legal entity, to take up the implementation of the project. However, in this case another problem appears - the credit will be granted to a recently created organisation with a minimum charter capital and without any substantial guarantees.

Both options (a major enterprise and a project-oriented structure) suffer from serious faults. The goal is to determine the organisational form to ensure the credit is used only for the project and that reliable guarantees of payment are provided.

Along with granting an investment credit, the investor can also participate in the profits. In fact, it is a variation of portfolio investments and it has the same faults mainly caused by the low liquidity of shares. Experience shows that the investor prefers to invest in businesses where he has the controlling share. Otherwise, the control of the capital flow comes out of the investor's sight with all implied consequences. This is one of the reasons why many investors appeared reluctant to attend investment auctions during privatisation. According to the auction conditions, shares were sold to investors on the condition these or those financial projects were financed.

4. Problems concerning the initial period of commercial banks' investment activities. In this situation, the banks have to start with financing one or several investment projects. Partially, it is explained by the lack of sufficient funds to pursue a diversified investment policy, and they have to limit themselves with one or two projects. As a result, such projects cost Russian investors more than their western colleagues who can reduce the investment costs by simultaneously (at the same time, not simultaneously, if we consider that expenditures and costs on different projects are made at different times) implementing an entire range of investment projects and programs.

Another serious problem is the implementation of investment projects on the basis of self-financing when profits from one project are used to finance the next one. This approach enables the investor to localise the investment risks, but significantly reduces his ability to finance large-scale investment programs and projects.

5. The Central Bank of Russia's tougher requirements for commercial banks' compulsory reserve positions may also have a serious impact on their investment policy. Under the rather strict reserve requirements and taking into account that the Central Bank of Russia

does not pay commercial banks anything on their reserve positions (it is especially important given the high inflation rate), the step is likely to make the banks raise credit prices and reduce interest on attracted funds, which will in turn affect the investments the industry.

On the whole, it is necessary to remark that, despite the above-mentioned problems, a number of commercial banks in Russia already pursue a rather intensive investment policy as they finance projects in various fields, from the extraction of mineral resources to the construction of housing and the public service sector. The high profitability of individual projects is an important factor for the attraction of foreign investments to Russia, including in the form of joint financing of projects by Russian and foreign financial or investment institutions. This form appears to us rather promising and interesting from the point of view of implementing investment projects in Russia, because in a number of cases it allows to significantly reduce the price of the granted credits.

Adjustment of the Organisational and Management Structures of Enterprises

MITKO DIMITROV

1. Actuality and Methodology

The problems of structural reforms, i.e. ownership transformation, enterprises restructuring and their behaviour against the shock effects of the macroeconomic environment, changes in their inside organisation as well as in the motivation and behaviour of managers and workers, have become of ever growing interest in the recent years.

The importance of these problems was underlined even in the first studies on the transition to market economy (see, for instance, Svejnar 1991, Lipton and Sachs 1990, McKinnon 1991, Blanchard et al. 1991, Estrin 1991, Richet 1991). Later, some of them were discussed as parallel problems in papers and articles treating the issues of transition (Carlin and Mayer, 1992; Estrin and Hare, 1992; Richet, 1992). It was only in the last years when special research was undertaken on the problems of enterprises adjustment in the transition period (Estrin, 1994). Object of these studies were the Central European countries - Poland, Hungary and the Czech Republic. The processes of restructuring and adjustment of enterprises in Bulgaria and the rest of South-East European countries are characterised by a number of specific features which require a particular study.

To this end, two studies were made of the enterprises in South-East Europe in 1992-1995 (see, Dimitrov, 1994, 1995). In this paper, part of the results of the first study are presented, dedicated on the problems of enterprises behaviour in the transition to market economy in Bulgaria, and particularly on the adjustment of organisational and management structures to the changes in the outside environment.

The results of the study are presented in three parts. First, the difficult creation of market environment in Bulgaria is considered, with the main attention focused on those changes which are important for the enterprises functioning. Second, a summary is presented of the results of the study of enterprises as well as their short- and long-term responses to different in strength and nature shock effects. And, third, the results of each of the 15 case studies of enterprises are presented.

One of the crucial aspects of microeconomic research is the shortage of sufficient and reliable information about the ongoing processes. For this reason, the main research method applied in the two projects was the method of case studies.

The study in question included 15 industrial enterprises which differed in size, location, and production and economic characteristics. In their selection, the research team followed such kind of criteria and expertise aiming to meet the representation requirements.

First, the study was focused on state enterprises in the industrial sector. Private firms were beyond the scope of research due to their small size and insignificant share in industry. Enterprises from the military-industrial complex and infrastructure were not included, too, because of the specific character of their restructuring and adjustment, and the permanent control exerted on them by the administration.

Second, a set of criteria was determined, the variety of combinations of which served the basis in the selection of a provisional group of fifteen enterprises. The former included the legal status and organisational form of enterprises, their size and regional location, technology stage of production, market conditions, etc. A set of 8-10 indicators was used, and the goal was that no more than 4-5 indicators were repeatedly applied to any couple of enterprises.

The third step comprised the selection of real enterprises with characteristics corresponding to the preliminary list of 15 provisional enterprises.

The representation of the sample obtained as a result of the above-mentioned procedure should not be considered from a statistical point of view. Such a combination of various indicators was rather aimed which could guarantee a maximum representation of the problems and the respective responses of the studied enterprises.

2. Organisational and management structural changes in state enterprises

One of the most considerable changes in the industrial organisation of the Bulgarian economy took place in its organisational structure. They were undertaken mainly in two directions: first a change in the forms of organisation of state enterprises, and, second, a sharp increase in the number and forms of companies and firms owned by other subjects - legal entities and physical persons.

In April 1991, the Council of Ministers adopted a Decree providing for the decentralisation and demonopolisation of large state enterprises and combines in short terms. The firms in seven branches, including electronics, telecommunications, energetics, metallurgy, machine-building, chemical and grain-processing industry, representing technologically related complexes, as well as the military industry, were declared a subject of later restructuring, following a thorough and comprehensive expertise of the competent commissions.

Some large state and municipal firms with more than one enterprise were subjected to decentralisation as well.

In general, this programme was fulfilled within several months, with the greater part of combines being decentralised in July 1991.

In June 1991, the Commercial Law⁹ was adopted aiming at the harmonisation of the main economic legislation in Bulgaria with that in the developed market economies. Some of the provisions of the Commercial Law are anticipatory in nature, especially in the chapter for joint stock companies, since they regulate relations either non-existent or underdeveloped in the economic practice of that time.

Based on the Commercial Law, the Law on Commercial Companies Establishment¹⁰ was passed in July 1997, which regulated the transformation of state firms into sole-person commercial companies. State stock firms were re-registered as joint stock companies, and the rest of state firms as limited liability companies. Moreover, a number of new joint stock companies and ltd. companies were established after the act of decentralisation.

The measures of decentralisation and change in the organisational forms produced considerable changes in several directions. First, independent state enterprises increased more than 22 times in number, the greatest rise being in 1991. Second, various forms of economic organisation emerged, and different groups of companies were formed, including ltd. companies, joint stock companies, as well as different forms of combining of enterprises or activities. After their establishment in 1991, the number of joint stock companies remained relatively stable. Notwithstanding the state-owned status of all studied enterprises, the variety of their organisational forms can be considered a positive phenomenon. The latter reflects the attempts to bring harmony between the type of the enterprise and its nature of activity, place in the economy, etc.

The increased number of autonomous enterprises in economy as a whole and in the different sectors and branches is the basis for the abolition of monopoly in the economy. It can be stated that a maximum degree of decentralisation is reached in most of the sectors thus providing the grounds for demonopolisation of the economy. Some one-plant enterprises still retain their monopoly positions since they are the sole producer of a particular commodity. The same applies to some complexes of enterprises in sectors and productions in which Bulgaria has been specialised within the CMEA (for example, Balkancar, Bulgartabak, etc.). Even these complexes, however, are not the former combines of all enterprises in the branch any longer. In lifting-and-transport machine-building, for example, the production of lifting machinery (electric hoists, cranes, lifts, store equipment) is separated in single plants. The same applies to the enterprises in some primary echelons, e.g. production of electric motors, diesel engines, etc. As a result, in the lifting-and-transport branch there are still other 31 autonomous joint stock companies, ltd. companies and firms, apart from Balkancar.

It is well-known that the anti-monopoly policy is pursued by the effects of not only the domestic but also the foreign competition. The influence of foreign producers is of crucial importance to the large Bulgarian economic organisations. The example of Bulgartabak is indicative of the fact that such type of combines face very strong competition in both the foreign and the domestic markets.

The decentralisation of state-owned enterprises is still the main determinant of economy demonopolisation. Private firms exert a far weaker influence on the creation of competitive

⁹ Commercial Law, State Gazette, 48, 18 June 1991.

¹⁰ Law on Establishment of Sole-Person Commercial Companies with State Property, State Gazette, 55, 12 July 1991.

environment, although they are much more in number. This is due not only to their small size but also to the fact that in many branches of industry their presence is just symbolic.

State enterprises decentralisation is the basis and one of the steps towards the creation of competition-sensitive enterprises in a market environment. The next step should be the privatisation of the greater part of them and the creation of the market environment for their functioning.

The same estimation can be applied to the variety of organisational forms of enterprises. In Bulgaria, there is a relative variety of such forms and new ones will further emerge since they are regulated by the Commercial Law (for example, combines of commercial companies - consortia, holding companies, etc.). For the time being, it cannot be stated that the organisation forms of enterprises have been created as institutions of a normal market economy. On the one hand, their true creation and real operation need time; on the other, the course of this process is connected with and depends on the development of the rest of market economy institutions.

The changes in the management and control of enterprises are closely connected with the clear-cut determination of property rights. In this regard, a considerable change was made in 1991, when the ambiguous combination of workers' self-management, technocracy and state intervention was abolished. The Council of Ministers became in charge for the functioning of the state ownership, and in August 1991 it passed a Regulation on the management of single-person commercial companies with state property. The main principles of organising and holding managers competitions were adopted aiming at the appointment of professionally skilled managers to substitute the former executive staff praised for its political merits.

Another important regulation of state enterprises activity was adopted in early June 1992. Under a Decree of the Council of Ministers, the Ministers of Industry, Trade, Transport, etc. were assigned the transformation of still existing firms registered under Decree 56 into singleperson commercial companies with state property. In this was, the last step was made towards the unification of the status of state enterprises according to the provisions of the Commercial Law. The managers competitions were held by competent branch commissions appointed by the government. Moreover, the state participated directly in the management and control of enterprises by the presence of state officials in the collective governance bodies.

Apart from the personal and professional qualities of the applicants, the competition criteria included also estimation of suggestions for improving the functioning of the enterprise, a statement of the present condition, and a programme for development.

The goals of holding managers competitions were but only partially attained. Notwithstanding the great number of substitutions, in many cases the new appointed managers lacked competence and professional skills. Among the reasons, one should mention the short terms of holding the competitions and the strong pressure exerted by the powerful trade unions. The latter produced a lot of contradictions with the Ministry of Industry which were very hard to settle. In some cases, a compromise was reached by means of transforming the ltd. companies into joint stock companies, so that the candidates of the two parties could find positions in the collective governance bodies.

Regarding the second goal of the competitions, approval of enterprise development programmes, the results were even less significant. Due to the very short terms, it was impossible,

unless the candidate possessed a preliminary developed programme, to do the enormous work connected with state-of-affair analysis, estimation of capacities, strategy selection, and ways for its realisation. Moreover, a general branch commission is hardly expected to most precisely estimate the merits of the whole variety of specific proposals for each particular production.

3. Organisational and structural changes in the studied enterprises

Inside-organisation changes of enterprises are one of the main tools for their adjustment to outside conditions. In the transition from centrally planned to a market economy, the increasing degree of independence from the central management bodies, the branch ministries, is one of the main prerequisites for making these changes in state enterprises. In Bulgaria, the emergence of these prerequisites is connected with the changes in the organisational form of enterprises in compliance with the requirements of the new Commercial Law and the Decree of Council of Ministers on decentralisation and demonopolisation of state enterprises adopted in 1992.

The research data show that the major part of the enterprises (12) had changed their organisational form and status in 1991. Out of the remaining 3 enterprises, one was transformed in 1992, and two in 1994. Generally, this coincides with the intensity of these processes in the economy as a whole. The delayed transformation of some enterprises should not be explained with their branch position, legal status (joint stock company or ltd. company), or size. Two of the enterprises were units of horizontal integration (winery and shoe industry), while the third one had entirely changed its subject of activity. The delay, therefore, was produced by specific problems or by the central body which needed more time to clarify its position regarding the breakdown of horizontal monopolies in certain sectors.

The possibilities for inside restructuring of enterprises are determined by their initial inside organisation-production structure and the nature of production. In case it is an one-unit or continuous-technology-process enterprise, these possibilities are practically nil. In terms of technology, the analysis of the 15 case studies has pointed out that the mentioned limitations are most severe in oil processing, shoe and textile industry, regardless of whether multi- or one- plant enterprises are considered, with several technology lines. The remaining are with discrete technology production process, two of them multi-plant (electronics and machine-building), the rest multi-shop enterprises. In their major part, the units comprise different stages of the production, and in three of the cases (milling, trade) these are supply or sales units.

A specific characteristic of socialist enterprises is the presence of particular units servicing social and everyday needs of the employees. Usually, these are resort and recovery houses, health services, shops, etc. Except for some small units (buffet, shop, etc.), the study found out that only the largest enterprises have a full complex of social services units. The reasons to mention here are the following: first, in Bulgaria the network of resort houses was centralised by the trade unions; second, after the collapse of former combines, the social units remained with those enterprises which were either leaders in the branch or in which the combine's head-office was located.

The analysis of case studies data shows that the possibilities for inside restructuring are not efficiently used in the process of adjustment.

In some cases, the inside structure of the enterprise is entirely changed. Usually, this is connected with an overall change in the field of activity and a shift from production to trading

activities. Obviously, the shift is connected with the changes in the macro-environment and has been produced by the shocks in economy. According to the managers' estimation, liberalisation of prices and foreign trade made the production of small machines and tools in their firm inefficient. In estimating structural changes, it should be taken into account that they are carried out along with the change in the status and organisational form of enterprises required by a decision of the Council of Ministers and the relevant branch ministry. Therefore, it is not a response solely and mainly of enterprises themselves but rather an expression of the process of restructuring in the branch. In two of the cases, there is information about the liquidation of inefficient structural units (machine-building, pharmaceuticals). There is no case of partial selling of equipment or parts of enterprises. In one of the cases, part of the equipment is let on lease, and negotiations are going on the sale of unnecessary machinery and equipment.

The same situation is witnessed regarding the establishment of new additional units. There is only one case (milling) where a new production unit has been built. In three of the cases (machine-building, electrical engineering, milling) there is an expansion or creation of new sales network, including foreign representative offices. There are five cases in which the information system has been improved, including the creation of marketing units (electronics, machine-building, electrical engineering, pharmaceuticals, and textile industry). The managers of two of the studied enterprises are not quite certain about the results of changes introduced.

Apart from the changes in the inside structures, two of the enterprises have initiated improvements in the work organisation. These are expressed in rationalising the repair process (milling) and better utilisation of waste (electrical engineering).

There is a sphere of considerable changes, i.e. the changes in the size of enterprises in terms of number of employees. They are most considerable in the firm which has changed its field of activity. The personnel was reduced 6-7 times, and this is quite evident given the nature of the shift.

The remaining enterprises can be classified into three groups. First group: 4 enterprises with big reduction of staff, i.e. 50 to 70 per cent of the initial number, in electronics, machine-building, pharmaceuticals, and tailoring industry. Second group: the other extremity, in which there is an increase of the staff from 5 to 36 per cent, 3 companies in foodstuff industry. And the third group: 7 firms with staff reduction of 15 to 25 per cent, in machine-building, electronics, chemistry, pharmaceuticals, and light industry.

The changes in the number of personnel are only partially due to inside structural changes, i.e. closedown of former or opening of new units. To the cases of organisational restructuring, one should also add the changes in the labour force structure. In one of the studied enterprises (pharmaceuticals), administrative workers were directed in production. In most of the cases, however, the change in the number of employees is due to the increase/reduction of the volume of production within the existing production units.

As seen from the analysis made, the changes in the inside organisational structure of studied state enterprises are partial in scope, with considerable delay and apply to only part of the companies. The above-mentioned changes have been initiated and carried out in only 7 cases, while the greater part of enterprises (8) haven't made anything to adjust to the changing macroeconomic conditions by undertaking inside changes. If any, the changes made are only

partial and insufficient. Little is done in the creation of new units (marketing departments, etc.) as well as in the release of unnecessary machinery and equipment.

The seven enterprises which have realised structural changes represent the four studied branches, and include both joint stock and ltd. companies, large and middle-sized enterprises. The managers in all studied enterprises have equal degree of autonomy which is sufficient enough for the implementation of greater in scope and deepness changes. Moreover, these changes are indispensable. Therefore, no outside factors exist to predetermine the activity, resp. the lack of activity, of managers in the first or second group of enterprises. It can be concluded that the changes in the inside organisation and structure of state enterprises and their adjustment to the outside conditions depend most of all on the personal and professional qualities of the managers, as well as on the prospects for their participation in the enterprises management in the future.

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Enterprise Adjustment and Managerial Behaviour: Case Studies in the Industry in Bulgaria

EVGENI PEEV

1. Introduction

Since the beginning of the 1990s state enterprise transformation in Bulgaria has encountered three difficulties. First, the unestablished property rights and enterprise autonomy create the conditions for discretionary managerial behaviour. At first glance this is the problem of inefficient insiders. Second, the withdrawal of the state from enterprise control and the lack of new owners generate conditions for strong political influence on the managers. This is the problem of unproductive outsider control by interest groups. Third, the State preserves its role of formal owner of company assets without assuming economic liability and residual risk from the economic reform. This is the issue of inefficient state bureaucracy behaviour.

The Bulgarian practice follows neither the good objectives formulated in the different recommendations put forward by privatisation advisors nor even the privatisation programmes themselves. There is another logic of economic reform of state enterprises and it can be seen in Bulgaria's peculiar separation of ownership from control between insiders, state bureaucracy and interest groups.

In the early 1990s, all major non-financial companies in Bulgaria were wholly state-owned. This unique hybrid form was defined as the "sole-trader joint-stock company or sole-trader limited liability company" by the Commercial Code (Article 61). This newly established form of business organisation is the subject of the study presented. In what follows, this form is referred to as the company with 100% state participation.

2. Methods and Data

Theoretical knowledge about modern managerial firms in the West and the inefficient discretionary behaviour of "insiders" at large is not enough to draw up an efficient policy for the creation of efficient governance structures in the Bulgarian enterprises. In this paper, I try to give an overview of empirical investigations into the problems of separation of ownership and control during 1990-4 in Bulgaria.

The present survey mainly uses information collected during three different stages of company investigations between 1992-94. During May-July of 1992 one study was conducted on

joint-stock companies in industry. The sample included companies with different capital values: small-sized, with capital of less than 10 million leva; medium-sized, with authorised capital of 10 million to 20 million leva; large sized (20 million to 100 million); and extra-large-sized (over 100 million). The capital of the existing joint-stock companies was appraised according to book value before asset revaluation. The joint-stock companies studied represented 5% of the small-sized industrial joint-stock companies, 14% of the medium-sized, 10% of the large-sized, and some 11% of the extra-large-sized joint-stock companies in the sector. The study was carried out in the form of a standard interview with managers of sole-trader joint-stock companies. The investigation covered five points: ownership and management structure, shareholder' motivation, board of directors' motivation, managers' motivation, joint-stock company behaviour.

During the summer of 1993 another study was conducted to examine two large sole-trader joint-stock companies in industry. The investigation used a standard interview with company managers covering the following issues: ownership structure, "shocks" caused by the reform, short-term company responses, long-term responses.

The next study was carried out during September-October of 1993 and January-February of 1994. All subjects of the study were industrial enterprises. Of these 23 were sole-trader joint-stock companies and 47 sole-trader limited-liability companies.

This empirical study was based on a standard questionnaire. It included a wide range of problems such as ownership structure, market structure, state regulation, governance structures, company restructuring. The questionnaire comprised two parts: the actual state of the company in late 1993 and managerial expectations about the state of the company in late 1994. The questionnaires were completed by the company managing directors in person. The main results of the survey are presented below.

3. Ownership structure

The property-rights theory examines ownership structures in different kinds of business organisation. The best examples are the investigations of the so called "classical capitalist firm" (Alchian, Demsetz, 1972), the modern corporation (Fama, 1980), the self-managed socialist enterprise (Furubotn, Pejovich, 1972; Pejovich, 1990). I attempt to use the same property-rights approach in a study of the ownership structure of companies with 100% state participation.

The formal property-rights structure of the company with 100% state participation is characterised as follows: 1) state ownership of assets; 2) the state bears the residual risk; 3) the government appoints a board of directors which manages and represents the company and designates managers; 4) the state must privatise such a firm within five years. According to the Transformation and Privatisation of State-Owned and Municipal-Owned Enterprises Act in Bulgaria the state-owned enterprises transformed in companies with 100% state participation must be privatised within five years after their transformation. The company with 100% state participation is a transitional form of business organisation lying between the self-managed socialist enterprise and the modern corporation.

There is an essential difference between a company with 100% state participation and a self-managed socialist enterprise. Here the employees are not agents of property rights. This is a

peculiarity of the company with 100% state participation in Bulgaria. In Hungary and Poland, the workers' councils continued to exist after the commercialisation of enterprises, while in Czechoslovakia the workers' councils perished after April 1990. (Mejstrik, Burger, 1992). The essential similarity between a company with 100% state participation and a self-managed socialist enterprise is the preserving of state ownership of assets.

Another essential feature of companies with 100% state participation is their peculiar genesis. Examination of the origins of companies indicates that administrative initiative from the executive power is the main factor in their establishment. In a more careful analysis of the dynamics of the process, month by month, one will discover a strange activation prior to a pending election. This indicates that the establishment of companies occurs not so much as an adaptation to the changing economic environment, but rather as a result of political and administrative processes. But this means that the survival of a particular company should be guaranteed by the government even in the presence of high transaction costs to do with companies' adaptation to new markets, technological conditions, restructuring requirements, and the like. However, the government does not fulfil its obligations as owner, since it typically leaves companies to deal with these problems on their own.

The main agents of property rights in a company with 100% state participation are the government as an owner and the managers. The function of risk bearing, according to property-rights theory, is taken on by state officials and the function of management by managers. However, the state officials are risk-bearers not because of their higher motivation for risk-bearing, but because of their status.

Who is the actual bearer of the residual risk after the collapse of CMEA and the shock stabilisation programme in Bulgaria at the beginning of the 1990s? While a given enterprise is in state ownership the government, as owner, is the economic agent which, according to the property-rights theory, must bear the residual consequences of the shocks. The managers and workers of a particular enterprise have no liability with respect to the external difficulties felt by the enterprise.

In practice, however, state officials shift all the liabilities of the transition onto the enterprise. The company with 100% state participation obtains the so-called "autonomy", a hypothetical promise of freedom in the field of products, markets and investments. In fact, however, this is only quasi-autonomy because: first, the state remains the owner of the assets and shifts only the risk-bearing of the economic reform to the companies; second, the risk-bearer is again impersonal - managers or employees or the enterprise at large.

The main shock for companies with 100% state participation at the beginning of transition is not so much the CMEA collapse as their high "autonomy", a high degree of risk-bearing and managerial discretion, on the one hand, without ownership of assets and company rights to sell assets, on the other.

Case studies show that some companies have a higher degree of "autonomy" than others. The reasons lie in the complicated power distribution between state officials, managers and interest groups in each given enterprise. In this way some companies win without effort, while others lose. All this gives rise to an inefficient distribution of resources and to social tensions.

4 Types of control

Who has control over single-person companies? On this point there is the simple view that a 100% state-owned enterprise is subject to effective state control. From that point of view the government has control over newly founded companies, wholly owned by the state. But this is only the first impression, for there is a lot of empirical evidence showing a different picture. (The Bulgarian press reveals a number of cases of backstairs fights over appointments to boards of directors of some of the biggest Bulgarian enterprises in the electronics, machine-building, military industry.)

Unestablished property rights

Unestablished property rights are property rights structures which fail to determine clearly who owns company assets, who is a bearer of residual risk, who is a decision-maker, who nominates members of the board of directors. In this ownership structure, however, there are different degrees of managerial discretion.

Interest groups

Another key feature of the control structure of the company with 100% state participation is the influence of interest groups other than the State. This phenomenon is underestimated in the literature of "insider - outsider control" in the transition. There are, however, a number of examples known from the Bulgarian press that bear witness to a three-agent structure of company management: state officials-owners, managers, and so-called "other forces". (See also Financial times, Tuesday May 10, 1994, Ex-communists embrace a half-capitalist Bulgaria.)

In the Bulgarian companies with 100% state participation interest groups other than the owner state are trade unions, political forces, finance groups and others such as non-formal leaders, for example. In the distinct companies they have different degrees of influence on management.

Among companies with 100% state participation there are also companies with purposefully retained and clear government control. Examples of this type of company are to be found in the energy sector. But their number is small and this control structure is not typical of the sole-trader structure of business organisation.

Despite 100% state ownership, the companies with 100% state participation are mainly under managerial control and interest group control. These types of control are based on unestablished property rights and informal influence by groups other than the nominal owner State.

This peculiar transitional kind of control is implicit and unstable.

5. Governance structures

Which are the governance mechanisms that compel managers to behave efficiently? Western experience shows that in corporations there are agency problems between shareholders and managers that arise as a result of the former and the latter having different motives, different degrees of risk-aversion, and different strategies. Because the owners are residual risk-bearers, they are interested in pursuing efficient strategies and there are governance mechanisms for disciplining potential managerial opportunism and shirking.

Empirical studies of companies with 100% state participation indicate that the governance structures familiar in western corporations either occur in a peculiar form or do not exist at all.

The peculiarities of the single-person owner

In its policy of shifting all the risks of the reforms onto companies, the state clearly shows inefficient behaviour. Contrary to the theory, instead of the owner constraining the potential for managerial opportunism in the company with 100% state participation, the same opportunism is demonstrated by the owner himself. For instant, in an empirical study the managers give a number of negative answers of the question about the positive effect of the managerial supply of information to the owners' superior structures. One managing director of a firm in machinery industry said: "We do not receive real help from the owner." (The company headed by this manager employs 3,500 workers.) Another managing director of a company in the textile industry was more explicit: "In today's situation everybody must look out for himself". (The firm has a work force of about 1000 employees.) Another managing director said: "The state institutions receiving business information from us are unable to exert any positive influence." (The enterprise employs 800 people engaged in textile production.) One managing director said: "We supply business information to our ministry but so far we have had no response." (The firm, which employs 200 workers, is engaged in machinery production.) The director of a company in the food industry explains: "The Ministry simply has no interest in our affairs." (The firm has 80 employees.)

In this unique situation is it possible for anyone other than the nominal owner to constrain managers and encourage them to pursue strategies for efficient adjustment and restructuring? These efficient agents would be managers or interest groups but the efficiency of their behaviour depends on chance and not on the institutional structure given.

There are cases of very corrupting behaviour on the part of interest groups. For example, the managing director of a company in the machinery industry answered that the trade unions stand in the way of company restructuring. He continues: "They (trade unions) lead the company to bankruptcy because they serve political interests. They have total influence over each management decision. The trade unions look at us as their hostage." But, as will be indicate below, there are opposite cases of active adjustment initiated by interest groups.

Managerial ownership

In a company with 100% state participation, managers have no share in ownership because the State owns the entire company. The Privatisation Act does not provide special advantages for managers as a result of the privatisation of the company. (On this point the managerial position in Bulgarian companies is weaker than the position of their colleagues in other post-socialist countries such as Hungary and Russia, for example.) According to Article 4 of the Privatisation Act, managers may offer privatisation proposals on their own initiative. This is the legal way to change their implicit control over the company into explicit control based on private established property rights. (A recent study of 70 companies with 100% state participation showed that around a quarter of companies had privatisation proposals with active managerial approval. Concerning the future managerial property stake managers are very discreet. Only one company managing director in the sample said that he expects around 20% managerial stake in company assets after privatisation.)

Board of directors

In the sole-trader joint-stock company the board of directors is a specific governance structure introduced according to Article 219 of the Commercial Code. The lack of other shareholders besides the State in these companies suggest that the board of directors might be assigned a key role in the control of the enterprises. Empirical investigations, however, reveal that the role of the board of directors in company adjustment is quite passive.

Typically, the board of directors of a particular company is appointed by the government and the other interest groups which take no risk. It is controlled by them and, at the same time, must exhibit rational economic behaviour towards the company. In addition, this behaviour must be efficient and please those who determine the membership of the board. In the final analysis, all this leads to the members of the board taking a rather passive and temporising role which will depend on their moral and personal human qualities rather than on clear and accurate mechanisms for efficient behaviour.

Managerial compensation

This is a basic, explicit governance mechanism in a company with 100% state participation. But CEO compensation (only salaries and bonuses) are supposed to link managerial income with company profitability, along lines familiar from former economic reforms of socialist enterprises. They do not, however, create strong incentives for company restructuring, but only try to ensure "satisfying" managerial remuneration in the new business environment of primary accumulation of capital. Investigations show that in this process managerial remuneration only plays a limited role. The proportional difference between the average annual remuneration of the managing director and the average annual wage in the company may be up to 500%. But the managerial remuneration as a lump sum is usually several times lower than the personal incomes of the new small businessmen.

Capital and managerial labour markets

Empirical studies indicate that the influence of market mechanisms is and will be weak. Top managers have no plans for company participation in capital markets. The market for managerial services is only a fledgling one.

These perspectives provide some more general conclusions about the influence of external and internal governance structures on companies with 100% state participation and their future forms of business organisation.

The longer market mechanisms (capital and managerial labour markets and the market for corporate control) remain undeveloped, the more the key incentives for control over managers will be used directly in companies. Mechanisms of direct non-market control over managers may be introduced. Transaction costs, however, will rise because of the need to monitor managerial decisions by dispersed shareholders.

There is an essential difference between large managerial firms in the West and firms in transition. In a transition economy, the viability of any given company is associated with the interests of the shareholders rather than the managers.

Different governance structures requiring lower transaction costs are likely to be introduced: consolidation of shareholding by proxy battles, concentration of ownership in large blocks, pegging managerial compensation directly to shareholders' returns and other cheaper mechanisms to give shareholders more power over management.

The formal governance structures described above indicate the lack of strict institutional mechanisms for disciplining managers of companies with 100% state participation and the broad scope for managerial discretion. But investigations also show the existence of specific informal mechanisms for influencing managers. One such peculiar mechanism is the struggle between different interest groups for the control of a given company with 100% state participation. Indicators for this unorthodox "market for corporate control" are the extent of involvement of forces other than the nominally authorised ones in determining the board of directors and the managers, the extent of involvement of such forces in the day-to-day running of the company, the degree of replaceability of the company executives and others.

In companies with 100% state participation, managerial discretion is constrained by informal mechanisms and institutional governance structures. The latter is also used for informal influence by interest groups.

6. Managerial strategies

During 1992-94 the picture of different control structures and different managerial behaviour of companies with 100% state participation became more diversified. In some companies the battle for corporate control continues, but in others the controlling party is desperately trying to ensure its future control by taking a more active role in enterprise affairs. Empirical studies already reveal new features in the behaviour of managers and interest groups. Some types of managerial strategy may be outlined.

Passive management. There are companies where managers lack initiative and rely on the government to solve all problems of the company. The main managerial strategy is to preserve the labour force of the company and the managerial positions.

Passive adjustment. In some companies managers seek extra-company services for marketing, finance management, etc., in a drive to survive in the new environment. Managerial motivation, however, is the same as in the companies mentioned above. Managers expect somebody else to take the initiative. Meanwhile, the effectiveness of external managerial services is considered low or average.

Restructuring. There are companies with 100% state participation where managers conduct active adjustment to the new conditions. They have a policy of company restructuring, active management for output, capital and employment adjustment. This kind of managerial behaviour contradicts the conventional wisdom that only private owners can restructure former socialist enterprises.

Aggressive management. In some companies managers have a strategy to resolve the problems of unestablished property rights through initiatives of their own. Despite all the difficulties of the quasi-market environment they take active restructuring measures and introduce privatisation proposals. Some proposals are offered formally by employees but usually the primary

initiative comes from managers. Among these companies there are some that will be privatised by the end of 1994 and managers will acquire a property stake.

The real managerial responses described above, and companies' behaviour in general, present a challenge to property-rights and agency theory. It is very difficult to determine why some companies with 100% state ownership exhibit more active adjustment than others. Perhaps some of the answers are to be found in the different types of control surveyed above. But the control structures alone are not sufficient to explain the different managerial strategies. There is, of course, a strong influence of the personal proficiency and competency of the individual managers. This factor should not be underestimated, especially under conditions of undeveloped governance structures. But there are also other, objective factors determining managerial behaviour, besides the ownership structure. Such factors are, for example, the market structure, market environment, and state regulation.

The picture of the Bulgarian economy in transition is too complicated and changeable to draw general conclusions about the effects on company behaviour of the different types of managerial and interest group control. Certainly, there is efficient enterprise restructuring, but there is also simple wealth redistribution and even asset-stripping of companies.

In the medium term two trends are likely to emerge: establishment of clear property rights in some companies and the preservation of companies with 100% state participation.

The first group of companies are those with established property rights and specific interest group control (private and employee), "ordinary" private control and employee control, and clear government control, including companies with 100% state ownership where government control has been retained. In companies with an established ownership structure, the familiar market-economy mechanisms for efficient managerial behaviour can be expected to come into play quite quickly.

The second group of companies are those with continued obscure property rights and managerial control, struggle between interest groups for company control and loose control with low managerial discretion. It is to be expected that the second group of companies will prevail. The problems of managerial initiative, discussed above, will continue to work in these companies.

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Strategic Behaviour of Industrial Enterprises during the Transition to the Market Economy in Romania

GHEORGHE ZAMAN

1. Some trends in Romanian industry

As far the evolution of Romanian industrial output is concerned, in the period 1989-1995 one can distinguish two different subperiods:

- a) the subperiod of sharp decline year by year (1989-1992);
- b) the subperiod of modest relaunching (1993-1995).

Table 1. Evolution of industrial output in Romania in the period 1989-1995
percentage change as against the previous year

Years	1989	1990	1991	1992	1993	1994	1995*
%	-1.9	-23.7	22.8	-21.9	1.3	3.3	4.5

(*) estimates

Source: CCSRE, Buletin 28, 1995, Bucuresti p. 11.

The decrease in industrial output was extremely large compared with its rate of growth in the last three years. The 1989-1992 crisis situation in Romanian economy and industry had strong aftermaths especially for State owned enterprises (SOEs) which, in some cases, recorded a dramatic drop in output exceeding more than 50% as compared to 1989 level.

A recent inquiry comprising a sample of 410 managers (from which 87,7% in public sector) covering more than 50% of manufacturing industry established that the main causes limiting the growth of output in the period 1992-1995 were in the order of their importance the following:

- *financial difficulties* (arrears, debts, high interest rates, increasing inter-enterprises credits);
- lack of domestic and external demand leading in the growth of stocks of finished products whose value in March 1995 amounted lei 2,267.1 billion representing 61.8% compared to March industrial output (71.7% in February); the highest level of stocks was recorded in textiles (122.2%), fur, leather, clothing (83.1%), footwear (105.1%)
- lack of raw materials and semifinished products;
- lack of energy supply.

The responses concerning the trends in output, contract and employment in 1995 of the inquired managers from manufacturing Romanian industry are presented in a synthetic manner of the symbols: +(increase); =(stagnation); -(decrease).

Table 2. Estimated tendencies for the manufacturing industry in 1995

(+) increase; (-) decrease; (=) stagnation

	Output			Orders and contracts									Employment		
	+	=	-	Total			Export			Domestic			+	=	-
				+	=	-	+	=	-	+	=	-			
Manufacturing industry	43	52	5	42	53	5	54	45	1	31	53	16	1	62	37
1. Consumer goods	37	52	11	36	53	11	52	46	2	26	55	19	0	70	30
• food, drinks	29	57	14	31	59	10	61	39	0	31	5	11	0	76	24
• textile	46	44	10	38	46	16	40	51	9	24	44	32	3	66	31
• electric machines	68	32	0	80	20	0	88	12	0	58	42	0	0	22	78
2. Investment goods	30	65	3	42	58	0	59	40	1	27	46	37	2	60	38
• machines and equipment	31	100	4	33	67	0	61	38	1	33	30	27	0	74	26
• computers and burotics	0	44	0	0	100	0	0	100	0	0	100	0	0	100	0
3. Intermediate goods	56	44	0	49	49	2	54	45	1	37	54	9	0	56	44
• Wood	19	74	7	15	85	0	55	39	6	4	80	16	4	37	59
• Cellulose, paper	90	10	0	100	0	0	90	10	0	44	56	0	0	56	44
• Chemical products	37	63	0	30	70	0	40	60	0	14	63	23	0	68	32
• Metals	75	25	0	79	21	0	91	9	0	79	21	0	0	40	60
• Rubber and synthetic fibre	11	89	0	0	100	0	52	48	0	11	89	0		89	11

Source: Studii de conjuntura economica, Nr. 2/1995, CNS.

In a certain sense the figures in the table no. 2 suggest us the possible behaviour of managers as regards the strategic issues (increase of output, the situation of contracts and the employment) for consumer goods, investment goods and intermediate goods. It is worth mentioning the

predominance of respondents estimating in 1995 a stagnation of output and contracts (demand) although the forecasting for the same year shows an increase in industrial output. In the case of employment it should be noted what mainly could be explained by SOEs overstaffing.

Investments are considered as a vital factor for industrial output relaunching in Romania. From the inquiry it resulted that the most relevant factors hindering investment decisions were:

- a) high cost of investments, especially of large ones and on long term (45%);
- b) low availability and difficult access to bank credits (32%);
- c) low returns to investment (14%);
- d) insufficient demand (6%);
- e) other factors (3%).

The respondents considered also that the most desirable investment allocation should have the following priorities: replacement of outdated equipment (26%); mechanisation and automation of technological processes (15%); introduction of new technologies (15%); decrease in energy consumption (12%); environmental investment (12%); new products and increase of production capacities (8%); improvement in labour protection systems (7%); other (5%).

Due to the crisis situated in industrial sector, the economic agents have been obliged to start changing their behaviour and objectives in two directions:

- a) *the output diversification and flexibility* aiming to a better meeting of market needs, the profit maximisation and avoidance as much as possible of the persuasiveness of risks in a transition economy with many uncertainties, confusion and speculative activities;
- b) new strategic schemes of divisions and mergers in order to cope with the competition especially from the side of foreign economic operators as a consequence of trade and price liberalisation, obtained functional autonomy and promoted decentralisation and deregulation policies.

Among the main measures for implementing these strategic objectives the privatisation and restructuring of industrial SOEs are considered of paramount importance. In the next chapter we'll tackle problems related to these two issues as an strategic behaviour of industrial enterprises in Romania during the transition period.

2. Privatisation of industrial SOEs

The legal framework and procedures of SO privatisation methods in Romania (Laws 58/1991, 18/1991, 77/1994) are in compliance with the macroeconomic objectives and goals of reform among which the most important are: macroeconomic stabilisation, relaunching economic growth, diminishing and control of inflation, minimal unemployment, improvement in economic efficiency, labour productivity and competitiveness, etc.

An important pillar of reform is the transfer of State ownership to private sector by using different methods adequate to specific conditions of sold enterprise. In this respect it is necessary to mention the peculiar attention paid to possible macroeconomic impact and influence of each privatisation case.

Another important, including privatisation, pillar of economic and social reform in Romania is the restructuring at different levels (macro, sectoral and micro) which implies a huge number of interrelated and propagation changes of management, organisation to the principles of transition to the market economy in Romania.

A first criterion of implementing privatisation methods is the *size of enterprise*, which might influence directly or by propagated ways the macroaggregates of Romanian economy.

For small SOEs (up to 500 employees) representing not more than 4% of the social privatisable capital, a *standard procedure* of privatisation has been adopted. This procedure has the advantage of simplicity and rapidity of implementation and avoids the relatively long lasting work of evaluating and negotiations. The main beneficiaries of such a privatisation method are managers and employees of the respective privatised enterprises sold at book value price (as a rule not taking into account inflationary impacts prior privatisation and consequently being more or less undervalued in the majority of the cases). Standard procedure comprises also a lot of other facilities for buyers such as those concerning the credit conditions, the interest rate which is much more reduced than that used by commercial banks.

In the case a small enterprise has a special position, goodwill (for instance well known foreign trade companies, applied research institutes, etc.), an evaluation report is required. The final selling price is established anyhow by negotiation with the buyers, but the price proposed by the evaluators is always considered as a starting point.

The SOF's and POF's financial inflow from selling small SOEs are not so important due to their modest weight in the total capital as well as to facilities awarded for 5-6 years credits whose reimbursement and interest rates are favourably influenced by inflation eroding. So the proceeds from small privatised enterprises do not account for a major source of macroeconomic restructuring and change.

On the other hand, it shouldn't be neglected the economic potential created in the private sector by these small enterprises more flexible to changes, mergers and co-operation with domestic and foreign private or state owned enterprises of different size.

Under the legislation in force, the medium and large SOEs are privatised by using different methods:

- direct negotiations;
- open or limited competitive tender procedure to preselected bidders;
- public offering of shares;
- each other combination of the above mentioned methods.

It is important to point out that medium and large SOEs privatisation is requiring an obligatory evaluation report worked out by specialised and SOF agreed evaluation firms. The used evaluation methods are relying on patrimonial and non-patrimonial basis. In the valuation activity the most frequent difficulty faced is caused by the lack of genuine market value or prices, due to the slow pace and complexity of transition in our country.

In order to overpass a good part of related to evaluation difficulties and confusion, the final results of the evaluation report, especially when different methods are not leading to convergent figures, are checked up by SOF or POFs appointed expertise commissions including Romanian and foreign specialists.

A largely discussed problem is the selling price of SOEs shares. It seems that the mentality according to which book value has to be an inferior limit of share prices is still persistent to a lot of responsible persons in the field of privatisation. Unfortunately such a mentality has in the majority of situations a counterproductive influence on the privatisation pace because the congruence between the book value price and market price in fact is only a very rare phenomenon. If assets were sold below the book value price, the seller (e.g. SOF or POFs) is often criticised under the charge of undervaluation. After acquiring of almost two years of practical privatisation experience, people are more aware that market price is the determinant factor of property rights transfer and not the book value of assets.

The problem of assets valuation was acutely raised after the approval of G.D. 500/1994 when fixed assets value of SOEs on average increased 4-5 times (in some cases up to nine cases) in comparison with 1992 level of fixed assets book value. This decision was generally explained by the need of taking into account the inflation effects during the last three years.

On the other side, a quasi mechanical value increase of fixed assets had a lot of discouraging influences on the privatising process. Assuming book value as a rigid basis for privatisation decision it is equal to an automatic increase of selling price and as a result a reduction of potential numbers of buyers and investors. These negative impacts can be observed in the period after the G.D. application. If in January-July 1994 SOF was succeeding to sell on average more than fifty enterprises per month (the peak being in July-120 privatised enterprises), in September-November 1994 the number of privatised enterprises dropped dramatically whereas many enterprises were prepared to be privatised.

An important impulse for SOEs privatisation in Romania has been the promulgation of the Law no. 77/August 1994 concerning the management and employees associations in the state companies which have to be submitted to privatising. The general conception and principles of this law partly coincide with well-known MEBO (Management Employees led By Outs). This law in Romanian language is briefly called PAS (Programul Actiunilor Salariatilor) which means program of employees' and managers' shares.¹¹

As it resulted from the practice of PAS privatisation the companies having a large number of employees are more suitable for using this method because the gathering of necessary funds for buying SOEs is easier. The achieved by this method privatisation allow to distinguish several types of property pattern of sharing:

- 100 per cent PAS property especially in the case of small and some medium enterprises;
- majority (more than 51 per cent) PAS property;

¹¹ - See Legislatia Romaniei, 1 iulie-30 septembrie 1994, Vol. 3, Parlamentul Romaniei, Regia autonoma Monitorul Oficial, p. 343-355.

- minority (less than 50 per cent) as it is the case of the medium and the large enterprises.

The PAS ownership can be differently combined with the private domestic and foreign capital or state capital. The PAS privatisation is partly implemented with the help of property certificate and bank credits. One can assume that after the reducing *in* the second half of 1994 of the annual interest rate as a consequence of inflation decrease more and more PAS credit requests might be registered, the bank collateral for them consisting mainly of patrimony of PAS members. However, for the time being the bank capacity to meet an increasing credit need are extremely limited due to the chronic undercapitalisation.

Another significant macroeconomic aspect of accomplished so far privatisation in Romania is linked to the tendency of foreign investors to detain the major part of social capital in the enterprise bought in association with PAS or other domestic investors. The tendency is fully understandable for the cases of each new owner interested to exert the total right of decision.

In the frame of the macroeconomic policy aiming at a new privatisation impetus we also mention the *new draft law of privatisation accelerating*, which is passing through the parliamentary debates. This draft law is known as mass privatisation law because of a large number of involved enterprises. Its approval at the Senate level has been completed. The essence of the draft law consists in transforming the property certificates and nominative coupons free of charge distributed to the adult population of Romania into shares at a number of 3,000 SOEs. Each enterprise could sell up to 30-60 per cent of its total social capital function on existing demand. The transforming operation was initially supposed to be finished until the end of June

1994. The remainder of SOF shares have to be sold by auctions and half of the money proceedings from them will belong to privatised enterprise for its capitalisation. This Government legislative initiative is also intended to assure by nominative coupons distribution equal chances and access for all the adult Romania's population to SOEs privatisation.

A list of 3,000 selected SOEs has to be completed from a total of about 7,000, the main criteria of selection being the high profitability and financial performances.

An important element stimulating the privatisation in Romania is represented by measures concerning SOEs management. The Law on the management contract has been adopted as a step towards improved functioning of country's organisational and managerial structures. The law is applicable both to regius autonomies and commercial companies and is designed to accelerate transition, and to maintain into position the most competent managers at the same time. The management contract is concluded for a maximum period of 4 year and stipulates: the names of the contracting parties, the object and duration of contract, the manager's rights and obligations, the rights and obligations of the owner-legal person, reference indices and performance criteria, special clauses, etc.

The most intricate issues arisen from the application of this law are:

- the selection of the professional managers;
- ascertaining the indicators level and the performance criteria.

Notwithstanding the relatively comprehensive legal and administrative framework set up in Romania for SOEs sales to the private sector, the effective results of the privatisation drive in

the period 1993-1994 are only partly satisfactory. From about 2,500 SOEs officially so far listed for privatisation, only 823 privatised enterprises (see table no. 3) were registered.

Table 3. Concluded privatisation in Romania in the period 1992-1994 (end of December)

Size of company	Number	%	Social capital (billions of current lei)	%	Number of employees	
Small	750	86.9	99,932	25.5	135,495	51,1
Medium	103	11.9	250,631	63.9	81,522	30,7
Large	10	1.2	41,925	10.6	48,151	18.2
Total	863	100.0	392,488	100.0	265,168	100.0

Source: data from SOF

*) small - up to 500 employees; medium - up to 1,500 employees; large - more than 1,500 employees.

As far as the stage of privatisation in Romania are concerned, from the table no. 3 one can deduce the following more significant aspects:

- the biggest number of already accomplished privatisations (89.8) belongs to small SOEs what can be explained by: simple procedures of privatising; more reduced capital needs; easier methods of evaluation;
- medium companies have the most important weight (about 47%) in the total volume of the privatised assets;
- large companies have so far a modest role in the privatisation process due to requirements of important amounts of needed capital and complexity of evaluation.

As one can notice, in the first stage of privatisation in Romania, the most important role has been played by small and medium enterprises whose economic power and impact are however limited. The next stage of privatisation must cope with the problems of transfer of medium and especially large enterprises.

3. Restructuring SOEs

Another major aspect linked to macroeconomic impact of privatisation in Romania is represented by restructuring of SOEs using different financial resources among which the privatisation proceeds have an important role in promoting economic efficiency and performance and finally ensuring the prerequisites for macrostabilisation.

In Romania, the restructuring process is taking into account macroeconomic options comprised in the Program of the economic reform, established by the Government, and the sectoral strategies elaborated by the ministries and departments. At the same time it is aiming at the privatisation preparing of the SOEs included in the priority programs.

The following elements are taken into consideration by SOF in selecting the SOEs for restructuring:

- representativeness of firms and their links with the horizontal industries;
- the value of production for export;
- economic and social impact generated by restructuring at different levels;
- firms' capacity for economic and financial rehabilitation.

In order to establish the restructuring priorities and the performance criteria, several economic and financial analysis have been undertaken for each firm and, on their basis, feasibility studies for restructuring and privatisation were elaborated. These studies containing concrete schemes for restructuring and privatisation are approved by different competent bodies directly involved in the process (ministries, departments, Agency for Restructuring, Romanian Agency for Development, etc.). A special attention is paid to types of restructuring prior and after privatisation in compliance with efficiency maximisation on different time horizon.

The aims of SOEs restructuring usually are:

1. modification of the firm size and production capacities in accordance with the market demand, having in view the available resources of labour, raw materials and financial funds;
2. implementing divisions and mergers for privatisation, better use of the existing production capacities, labour force and setting up of competition;
3. temporary stopping or diminishing the activities of loss making enterprises which have rehabilitation perspective, until technical and economic solutions and financial resources are found;
4. liquidation of inefficient firms which have no perspectives for rehabilitation.

Funds allocated by SOF for restructuring in 1994 represented lei 147 billion for 319 industrial firms and more than lei 96 billion for 187 firms in agricultural sector. The total volume of SOF funds for SOEs restructuring was very modest (7% of global investments in the whole economy in 1994) in comparison with the existing requests. That is why the insufficiency of restructuring recourses at the macrolevel is very seriously raising the problem of their optimal allocation, the danger of dissipated or egalitarian distribution being in fact a real danger.

The distribution of restructuring funds in industrial sectors was the following: textile, fabrics, leather goods (more than lei 38.7 billion); machine building (lei 27 billion); electronics and electrotechnics (lei 22 billion); metallurgy (lei 11.4 billion); wood industry and construction materials (lei 2.8 billion) etc.

In the framework of restructuring process an important role has been played by *enterprise divisions*, *mergers* and setting up of *joint ventures* with the participation of foreign and Romanian private capital.

In 1994 SOF approved the division of 111 commercial companies into 381 units with an increased economic and financial potential. On the other hand, a number of 81 companies received the approval to merge into 30 units, from which 10 units in the field of agriculture.

The main reasons of divisions and mergers referred to economic effective arguments, optimal economic and technological size of enterprises.

SOF also approved the setting up of 64 joint ventures with foreign capital participation, having a social capital of more than lei 684 billion of which US \$ 204 million is the contribution of foreign capital. This form of restructuring is expecting to obtain an important infusion of investment in new technologies, know-how from developed countries as well as new markets for their products and services. In the field of sectoral restructuring, SOF is financing the modernisation of more than 20 export-oriented commercial companies. Funding is supplied from the proceeds already privatised companies pay to SOF.

Funding of the restructuring and privatisation strategy of certain projects involving the infrastructure is also supplied from external resources. A series of foreign financial assistance subprograms, amounting to ECU 70 mill., have already become operational through PHARE-REPEDE projects; e.g., restructuring of the Romanian banking system, of the major state-capital enterprises, export activity boosting, specialist training a.s.o.

The manner of restructuring procedures has varied according to the case, the most frequent being:

- *operational restructuring*, which generally implies improvement and efficiency of production technologies, issues such as resource allocation, size of manufacturing operations, marketing and computerised economic organisation; this type of restructuring is a difficult, if not impossible, task to be accomplished by the state, the reason why, in many cases, privatisation has taken precedence, the buy-sell agreements being provided with clauses on subsequent technological investment, irrespective of the nature of the social capital implied - domestic or foreign;
- *financial restructuring*, which is targeted on the resettlement of enterprise arrears and the reorganisation of its assets, and thus promote projected revenues; enterprise arrears could be settled in various forms: set up of debit clearing houses; set up of loan restructuring bank or agencies; arrears conversion, discount or even write off.

As a result of the analysis made for the enterprises whose restructuring was funded one can notice two tendencies:

- a) normalisation and improvement of financial situation due to increasing profitability, strengthened solvency and important diminishing of arrears and inefficient stocks;
- b) maintaining or even worsening of the precarious financial situation caused by an inadequate management restructuring or the influence of other factors.

The surveys concerning the 1990-1994 industrial technological updating carried out (I) show that its funding is primarily assured by own resources of the companies (about 70%) followed by external (20%) and internal (10%).

Table 4. The structure of financial resources of technological restructuring of industrial SOEs in Romania in 1990 - 1994 period % from the total restructuring funds

Branch	Own resources	Credits	
		Domestic	Foreign
Total industry			
• I*)	69,6	10,4	20,0
• II**)	41,5	2,1	34,4
Electric energy			
• I	97,8	2,2	
• II	96,2	-	3,8
Mining			
• I	11,9	5,9	82,2
• II	-	-	10,0
Metallurgy			
• I	59,1	5,9	35,0
• II	49,8	8,8	41,4
Machine and equipment			
• I	54,0	46,0	
• II	58,8	41,2	-
Electric and electronic machine and equipment			
• I	86,2	9,4	4,4
• II	51,8	41,1	7,1
Chemistry			
• I	77,4	17,9	4,7
• II	27,3	32,0	40,7
Wood industry			
• I	43,8	56,2	.
• II	47,6	52,4	-
Construction materials			
• I	5,2	39,1	55,7
• II	72,7	27,3	-
Glass and ceramics			
• I	9,6	90,4	-
• II	-	-	-
Light industry			
• I	89,3	3,4	0,7
• II	84,9	15,0	-
Food industry			
• I	12,0	4,4	3,6
• II	54,9	39,9	5 ^

I*) - finished restructuring II***) - restructuring in progress.

Source: CCSRE, Buletin nr. 28/1995, p. 167-176.

As far as restructuring in progress is concerned one can see an increase in the relative importance of foreign and domestic credits.

Table 5. The pattern of restructuring funds by industrial sectors in Romania in 1990-1994 period

	Total fund value		of which						
			Own resources		Credits				
	I	II			I	II	Domestic		Foreign
I			II	I			II	I	II
Total industry, of which	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Electric energy	33,2	2,8	46,6	6,5	-	-	3,6	-	-
Mining	14,6	0,2	2,5	-	8,2	-	60,3	0,6	0,6
Metallurgy	3,4	32,3	2,9	38,8	1,9	11,8	5,9	38,9	38,9
Machines and equipment	4,6	4,3	3,6	6,1	20,6	7,4	-	-	-
Electrotechnic and electronic industry	4,6	2,5	5,8	3,1	4,3	4,3	1,0	0,5	0,5
Chemistry	7,9	49,5	18,1	32,6	28,0	65,8	3,9	58,3	58,3
Wood industry	0,3	0,3	0,1	0,3	1,8	0,6	-	-	-
Construction materials	7,5	0,0	0,5	0,0	28,0	0,0	20,8	-	-
Glass and ceramics	0,0	0,0	0,0	0,0	0,0	0,0	-	-	-
Light industry	9,8	2,7	12,5	5,6	3,3	1,7	3,5	-	-
Food industry	5,4	5,0	7,1	6,6	2,3	8,3	0,9	0,7	0,7
Others	8,7	4,0	2,3	0,4	1,6	0,1	0,1	1,0	1,0

I - achieved restructuring

II - restructuring in progress

Source: calculated on the data from CCSRE, Comisia Nationala de Prognoza

From the data presented in the table no. 5 we come to the following main conclusions:

- for the achieved upgrading of industrial enterprises the main funds have been allocated to electric energy autonomous authorities, mining and light industry, although the distribution by own resources and credits has a different structure;
- for technological restructuring in progress, chemistry and metallurgy consume more than 82% of the total funds that could be explained by the real potential of rehabilitation of these sectors in a new configuration; this our finding is proved also by the distribution of foreign credits to the same two sectors.

Post-privatisation experience

Romania's privatisation program is still in progress, and therefore it is too soon to assess its quantitative effects. Nevertheless, since the change in administration of the privatised SOEs one can observe significant improvements in their performances, labour productivity, quality and technologies. The privatised enterprises are among the most profitable in the country what could be reflected in the future in a substantial increase in the price of their stock. For some of them, exports grew unprecedentedly, production discipline improved substantially and employment level has not been reduced.

A survey for 447 privatised commercial companies (see table no. 6) as regards their main economic and financial indicators for the first three quarters of 1994 leads to the following preliminary conclusions:

- profit rate increased in industry (significantly), commerce, tourism, culture and local economy and slightly decreased in constructions and transport;
- in all sectors then number of employed persons dropped what in fact means that state assets transfers to private ownership are not creating at least on short run new jobs but on the contrary is accompanied by the reduction of the personnel in overstuffed and bureaucratic enterprises;
- the degree of the indebtedness in all cases increased with the exception of the commerce and tourism.

**Table 6. Post-privatisation situation of 447 commercial companies in the period
December 1993 - October 1994**

Sectors		Social capital (billions lei)	Number of employees	Profit rate (%)	Indebtedness degree (debt/total income)
• Agriculture & food ind.					
94	31.12.1993	51.7	29,601	6.28	0.14
firms	01.10.1994	86.9	22,408	6.44	0.22
• Industry					
96	31.12.1993	43.2	50,910	6.61	0.37
firms	01.10.1994	72.9	47,484	9.05	0.56
• Commerce & tourism					
33	31.12.1993	11.7	6,325	4.62	0.37
firms	01.10.1994	13.4	5,921	5.59	0.20
• Construction					
58	31.12.1993	11.9	27,109	8.43	0.25
firms	01.10.1994	34.3	26,613	7.23	0.31
• Transport					
22	31.12.1993	8.2	6,447	10.49	0.18
firms	01.10.1994	28.1	5,991	9.36	0.26
• Culture					
5	31.12.1993	0.4	363	3.04	0.20
firms	01.10.1994	0.4	314	5.12	0.29
• 144 firms of local importance					
	31.12.1993	21.4	23,023	4.55	0.16
	01.10.1994	37.7	21,598	5.27	0.24

Source: SOF preliminary data.

A first supplementary comment to the above mentioned conclusions is that increased employment in private sector of Romanian economy could be generated so far not by the privatised SOEs, but by newly created firms in the framework of the private sector itself. That means the existence of a gap between employment increasing and decreasing as a consequence of the transfers and creation of new private enterprises.

A second aspect regards the relatively high capital accumulation of the privatised SOEs in all sectors, especially in industry, agriculture and constructions.

Thirdly, the danger of increasing indebtedness of private enterprises is still remaining what could negatively influence their economic performances at the present and in the future.

It is absolutely clear that post-privatisation period is not exempt of problems and difficulties mainly due to the high restructuring costs, lack of cheap credits and of other financial and economic facilities. For instance the high gap between the rate of inflation which was 4.4% (monthly average) in 1994 and the interest rate (more than 60%) does not represent an encouraging basis for investment relaunching in Romania the key condition for speeding-up privatisation and fostering its favourable macroeconomic influence.

As a final remark we draw the attention that our conclusion and comments in this chapter have of course a preliminary character, the surveyed period being too short for getting a long-lasting relevance in this respect.

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Operation of Economic Self-government System In Economy in Transition

JANUSZ GOLYGOWSKI

The change of political system in the countries of former socialist bloc brought about major parallel changes in their economic system. The main functions in the new economic model are performed by the market and its mechanisms. A vast majority of the countries transforming their economic structures would welcome close relationships with the member countries of the European Union. However, for these countries to be admitted to the European Union it is not only necessary to adopt a market economy model but also an appropriate economic structure, which includes also a system of economic self-government.

Economic self-governments in the countries of the European Union are the main link in the economic system. The scope of rights and responsibilities of economic chambers belonging to these self-governments tends to differ considerably in particular countries. A form of economic self-government that can be met earlier are chambers of commerce and industry playing a very important role in economic system in the post-communist countries is quite differentiated. In some of them, for instance in the countries of the former Soviet Union there operated in the past and continue to operate today chambers of commerce and industry, which have changed only their function to a smaller or greater extent.

In Poland, chambers of commerce and industry date back to the interwar period, when they associated economic units operating in the then economic system. After the war their activity was not revived, while their role was taken over by diverse central, regional or industrial organisations and institutions, which did not practically have anything in common with chambers of commerce and industry, as they were charged with controlling or managing economic units. Anyway, that situation was an outcome of a strong or even very strong system of centralised management all the more so that, in principle, only one type of economic units could be met, which is state-owned enterprises. The system of economic self-governments concerned two sectors:

- the co-operative sector. In different periods, this sector was more or less “state-owned”.

The Centre through various mechanisms and interfered strongly in the operation of this sector violating the fundamental principles of co-operative movement.

- the private sector. This sector, which is commonly referred to today as the small business sector, defended itself, and it should be admitted that it defended itself, and it should be admitted that it defended itself effectively, from the state interference and intervention,

which aimed at weakening it to the highest possible extent. From among all the postcommunist countries, Poland had the strongest private sector, which once the market economy emerged managed to adapt itself rapidly to the new reality, with the chambers of crafts being a traditional self-government organisation in this sector.

Economic self-governments during transformation period

The introduction of legal regulations concerning the entire economy including economic self-government is one of the most difficult tasks in the transformation period. These activity determines, to a big extent, the pace of economic transformations and development. At its early stage, the systemic transformation in Poland generally involved the elimination of legal and administrative barriers to market entry of private firms and liberalisation of principles governing economic activity. Hence, it was a direct of legislative processes eliminating these barriers. This refers also to the formation of economic self-government organisation, which were restored in 1989.

It is the decision of the law-maker that economic self-government should be organised in the form of chambers of commerce and industry (economic chambers) grouping along voluntary principles economic units irrespective of their size or legal status (private, state-owned and cooperative partnerships). Regulations pertaining to chambers of commerce and industry were issued by the law-market in a great hurry to allow an early formation of economic self-governments. Unfortunately, they were drafted without appropriate legislative thoroughness, without substantive preparation and familiarity with the principles according to which such chambers operated in Western Europe.

One of such regulations stipulates that in order to establish a regional chamber of commerce and trade the so-called founding declaration should be submitted by minimum 50 firms regardless of their size, industry or branch to which they belong, and their legal status, or 100 firms, in which case a national chamber of commerce and industry is set up. What happened is that, for example, in Lodz - the second largest city of Poland, in which textile industries dominate, there operate the following chambers: the Chambers of Industry and Trade of Textile Industry, the National Chamber of Fashions, the Small Business Chamber of Industry and Trade. All these chambers are linked with textile industries. Other chambers could be listed as well, but they will not be discussed here. From the theoretical point of view such situation might seem favourable, as competition between particular chamber can appear and, moreover, they should all be actively seeking new members. In practice, these chambers are weak and inefficient organisations, which only sporadically operate or act on behalf of the firms begin their members. These chambers are quite small, their source of funding are only and solely membership fees paid irregularly and in small amounts. These fees are insufficient to finance the costs of organisational and promotion activity, as well as other services provided for members such as consultancy, training, counselling, promotion, and so forth. Their big number causes that the administrative authorities do not perceive them drafting the policy of economic development of a given city or region. Consequently, they can hardly represent economic entities as a whole, as they associate only about 30% of them. It is also the central level that economic self-government is not representative.

In fact, the National Economic Chamber in Warsaw reserved for itself the right to represent regional chamber, which can but do not have to belong to the National Economic Chamber. Moreover, in the city of Lodz there operate the two already mentioned national economic

chambers with a similar hierarchy status, that is the Chamber of Fashions and the Chamber of Textile, while two other national chambers: the Chamber of Fuels and the National Tourist Chamber also operate in Warsaw.

The organisational chaos caused by legislative loopholes exerts a very negative influence on the prestige and reliability of chambers among economic units, whose interests they should represent. The lack of a uniform, and even if not uniform then at least well-organised, representation of firms' interests accounts for quite frequent lawlessness of the Centre, whose activities do not always pave the way for adopting a desirable tax or social insurance policy not mentioning privatisation and reprivatisation processes.

Summing up the above remarks, it can be said that the present legislative solutions largely account for quite a common critical assessment of the performance of chambers as a very important element not only in the transformation process but also in the entire process of economic activity. If we take into account the fact that the transformation process is a very vital process, as the economy almost fully centralised was transformed into a marked economy almost from one day to another, then the situation presented above is most unfavourable both for the economy as a whole and for economic units operating within it. The situation is aggravated by the fact that legal foundations, on which economic self-government bases its activity, are all the more incohesive as other existing forms of economic self-government such as chambers of crafts, the Association of Private Transport, and co-operatives operate in accordance with different legal regulations issued by the law-maker in the previous sociopolitical system.

A negative evaluation of the existing situation, and especially as regards this part of economic self-government, which is represented by chambers of commerce and industry or organisations, whose operation is based on the same regulation disclosed an urgent need for standardisation of legal system pertaining to all self-governments (and their forms).

As a result of very active and consolidated involvement of all organisations of economic self-government grouping economic units in particular sectors there have been started preparatory works aimed at drafting act of law, which in its assumptions is to regulate legal foundations of the operation of self-government system.

Long months of controversies, discussions and polemics have resulted in working out a *draft Act of Self-government*. It should be stressed that its draft assumes equipping economic self-government organs with their appropriate role and importance within the central and regional economic system, as it stipulates that economic self-government organisations will be passing their opinions on the assumptions of regional or national economic policy in co-operation with relevant government administration and economic self-government organs, *with these organs being obliged to consult appropriate organisations of economic self-government* on all issues connected with the formulation and implementation of economic policy.

A legal regulation imposing an obligation on the government and local administration to consult self-government organisations in economic issues certainly enhances the rank and importance of self-government organisations. Still, it must be pointed out that the term *consulting* is very broad and rather imprecise term here, while a desirable effect can be yielded only through an effective interaction of sides.

Another legal regulation says that at the instance of an economic self-government organisation or with its approval, the Council of Ministers can delegate to it certain tasks, which are reserved by law for the government administration. This legal provision is of a strategic importance, as it envisages that priorities in the development of economic life will be transferred from the central administration to self-government structures, which is the case in many countries of Western Europe. Unfortunately, the draft act does not envisage that the same solution will find application in relation to the local administration, which is hard to understand, as the Centre agrees to have some of its functions concerning the shaping of economic policy transferred, while such delegation of power or functions is not envisaged with regard to the place where this policy is implemented. And this is a very serious loophole in legal regulations, as in practice the processes of reprivatisation, privatisation, and model transformation are implemented at the local level. Meanwhile, a successful implementation of processes planned by the Centre largely depends on the willingness and involvement of local decision-makers, that is of the local administration. If its role continues to be as strategically string as it is the case today, it will be impossible to transfer powers or functions to the local (territorial) economic self-government in the future. In such case, it may appear that there is not cohesion between the drafting and the implementing of programme assumptions.

As regards the organisation of self-governments, the draft law envisages that five self-government sectors will operate in the future:

- regional and branch chambers of industry and commerce
- chambers of crafts
- association of trade, catering and services
- association of car transport
- agricultural chambers

This division into five sectors is quite a specific combination of the old with the new including novel solutions.

The Chambers of Crafts, the Association of Trade and Services, and the Association of Transport operated in the previous economic system and they continue to operate in accordance with old regulations. They were incorporated into the draft act as separate structures, while the regulations on the basis of which they operated were included into its content in different chapter. Meanwhile, the chapter concerning chamber of commerce and industry was formulated in line with the binding regulation issued already in the present socio-economic system, which is commonly evaluated negatively. Additionally, the draft proposes quite a novel and radical innovation, that is setting up agricultural chambers. This proposal is innovational and radical in this sense that most people are familiar with a specific mentality of a Polish farmer, who has been independent for ages, fought for survival as a private producer in the previous system, and who generally *did not agree* to subordinate himself and have his farm included to a state farm or a co-operative of agricultural circles, although the previous system offered such incentives as subsidies, suggested and sometimes commanded that it should be done. Telling the Polish farmer today that he must join an agricultural chamber and also telling him that he will have to pay a membership fee for it, as the draft envisages an obligatory membership of all

economic units irrespective of the type of their activity, make this draft certainly an innovatory and radical one.

Generally, as regards the association issue, the draft also has quite significant loopholes and ambiguities:

- an economic entity involved in trade should be associated in the chamber of commerce and industry or in the Association of Trade and Services,
- a craftsman - in the Chamber of Crafts or in the Chamber of Commerce and Trade,
- a farmer involved in trade should be associated in the Agricultural Chamber or in the Association of Trade and Services.

We could speak about a freedom of choosing the type of self-government organisation, in which a given entity will belong, only when there was a voluntary element. In the situation when such association is obligatory, there should not be created appearances of its voluntary character. The future act should classify economic entities according to their types and assign them to particular self-government sectors. *There can be no freedom of choice if an obligation is imposed.*

The draft act has many other similar substantive and formal shortcomings, which are its weak side. It can be hoped that they will be removed before it is finally adopted, and that it will not be issued in a hurry similarly to the regulations concerning chambers of commerce and industry.

The draft in question has also its major merits. Its content clearly points at its addressee, in the name of whom it has been drafted. These are small and medium-sized economic units. This is quite explicit from the tasks of self-governments assigned to particular sectors:

- providing assistance for associated members in solving economic, organisational and legal problems connected with their activity;
- promoting and assisting members in establishing contacts with partners in Poland and abroad;
- initiating, conducting and supporting various forms of training;
- counselling and consultancy in the field of marketing, tax regulations, employee health protection and environment protection.

Large and very large economic units can solve above problems by themselves through their specialised sections and departments, and their membership in chambers should be treated as a form of *supporting them*, and contributing in this way to the development of small and medium-sized enterprises.

The provision concerning the Council of Economy contained in the draft should be also evaluated positively. Namely, regional and branch chambers and associations create their own national associations, which, in turn, establish one Council of Economy (at the national level). Among its tasks are:

- participation in elaborating the assumptions of long-term and current economic policy in co-operation with appropriate organs of the government administration and local self-government through:
 - 1) submitting proposals of systemic and legal solutions regulating economic problems,
 - 2) passing opinions on proposals of systemic and legal solutions worked out by appropriate organs;
- co-operating in creating:
 - 3) the country's economic infrastructure by developing and maintaining the system of economic information covering the entire Polish economy,
 - 4) the system of promotion and financing of entrepreneurship in Poland, as well as co-operation in implementing economic programmes with national and regional coverage,
- organising promotion of Polish firms and establishing contacts between Polish and international economic promotion systems,
- organising and running the system of professional training and economic consultancy in the whole country including training and consultancy services provided in co-operation with foreign partners'
- setting and popularising general principles of ethics and behaviour in economic relation, as well as developing the system of conciliatory settlements of economic disputes,
- co-operating with international economic organisations.

The above provisions indicate that chambers and associations can play a very important role in the process of economic transformations. Despite certain legal and substantive deficiencies, chamber and associations are best prepared to play the role of a representative of economic units and they are able to perform these duties most effectively as:

- they have a better access to particular groups of economic units and are familiar with their problems and needs,
- they are able to raise forces capable of counteracting the policy determining economic growth,
- they have know-how and possibilities of providing more practical assistance,
- they can ensure a higher effectiveness as regards costs,
- they are less bureaucratic and more elastic in taking decisions,
- they can be controlled and approved by the community of small business owners,
- they are run by means of a democratic participation of their members,
- they reduce demand for services of an insufficient number of government administration staff,

-- they are able to balance the interests of government policy and need of small and medium-sized enterprises.

However, there appears a doubt whether and what extent economic self-government organisations in less economically developed countries are able to play the role of a catalyst in this process, and whether they are able to perform such functions as aggregating, co-ordinating and representing the interests of the entire community of small and medium-sized business owners in these countries. Observations show that:

- many organisations attempt to play the role of chambers and associations, but *in* most cases the number of their members is quite small and, hence, their formal powers to represent a given milieu are limited as well,
- their organisational structure is weak, and they are not always run properly,
- they have an insignificant or no influence on the central and local administration, and are accepted by these institutions as a partner to a very small degree in the present legal setup,
- the scope and character of services provided by them is quite often not very attractive,
- their resources are too small and they are frequently developed countries is due to many reasons including primarily:
- the political climate not very favourable for the development of economic self-government and not accepting its organisations as representatives of the milieu of business owners,
- the country's difficult economic situation, which restricts the development of chambers and associations,
- the lack of tradition in participating in the self-government activity and in representative organs.

The present organisations of economic self-government are frequently dominated by large private and state-owned firms, whose fees allow these organisations to survive, with which it is easier to establish contacts due to their small number, and which guarantee stronger influences due to their strong political leverage. Thus, most of them cannot be regarded as organisations representing small business.

Consequently, one of the most difficult political and organisational problems connected with the development of economic self-government and with promotion of the sector of small and medium enterprises is the delegating of decision-making powers and other functions to chambers and associations by the central and local administration. For this to be accomplished there is needed a great deal of mutual confidence and a conviction that these organisations are to perform such role. This is obviously possible, which is confirmed by the experience of many countries, but it is also connected with the political position held by these organisations, the number of their members, and with services provided by these organisations. In most less economically developed countries, the process of formation and stabilisation of economic self-government organisations is a complex and long-term process. However, these organisations and their strong position are indispensable for an efficient implementation of the policy of support for the development of economic self-government as a very important instrument in economic transformation processes.

Parallel Sessions

Entrepreneurship and Small Business Development

Entrepreneurial Developments in Slovenia

MIROSLAV GLAS

Following the Company Law (1988) in former Yugoslavia and the Small Business Development Law (1991) of independent Slovenia, the rapid development of small businesses has changed the picture of the Slovene economy significantly. The statement of the minister of economic affairs that it is "beyond any doubt the most interesting part of the Slovene economy at the moment" (Tajnikar, 1993; 149) simply gave due attention to the huge structural shift underway. Nevertheless, the development of the small business in Slovenia lags far behind the circumstances in the European Union, where 99,9 % of all enterprises belong to small and medium enterprises (SME) employing 71 % of the total workforce. Slovenia still has to follow the path of small business development for a number of years before virtually closing the socialist black hole" in the size distribution of firms.

1. Creation of new businesses

The increasing role of small firms in the Slovene economy has been partly the consequence of the decrease in economic strength of the socially-owned enterprises, which are facing the challenges of huge market loss of the former Yugoslav market as well as a part of exports to Eastern European countries.¹ The large conglomerates almost disappeared in a very short time and a tough process of downsizing and restructuring started, resulting in increased unemployment peaking at 14,5 % of workforce employed in mid 1994. In the year 1989 there were 3.735 socially-owned companies, 33 of them employing over 2.500 employees and 7,15 % of them with over 600 workers. At the end of 1993 only 12 companies still employed over 2.500 employees and 2,56 % out of 4.813 socially-owned companies employed more than 600 workers.²

The wave of creation of new private businesses was a rapid one, exceeding the expectations of Slovene liberal economists. It is difficult to trace the process of restructuring during the first years of transition, due to the confusing statistical data dealing with different classifications of businesses according to their legal status. At the end of 1989 there were only 1.271 enterprises

¹ In a survey of companies in Gorenjska region companies assessed their loss of markets as 41 % of sales. Small business advisors estimated the loss as 31 % of sales. Some companies have not only lost markets but production units located in other republics, raw material supplies etc. These markets were known to be the markets where Slovene companies were able to sell with profit margins well above those on other export markets.

² Data are taken from the file of the Privatization Agency of Slovenia, 1994.

already registered according to the Company Law, with 226 socially-owned, 944 private companies, 1 co-operative and 100 mixed companies. But in the same year there were 4.234 organisations and communities still registered as work organisations under the Law of Associated Labour. The reorganisation complying with the Company Law reduced the number of such entities in manufacturing and mining from 1.586 in 1988 to a mere 84 in 1991.

The dynamics of the process of new firm creation can be seen for the period of 1990-1994 by listing the number of enterprises registered at the Registration Court in Table 1.

Table 1. Number of legally registered enterprises in Slovenia, 1990-1994

	31.12. 1990	31.12. 1991	30.6. 1992	31.12. 1992	30.6. 1993	31.12. 1993	30.6. 1994	31.12. 1994
TOTAL	14.597	23.348	30.201	36.448	42.986	47.734	49.712	51.031
Social	1.766	2.515	2.779	2.897	2.948	3.053	3.060	3.051
Private	12.321	19.698	26.017	31.882	38.192	42.746	44.688	46.010
Co-operative	58	114	124	226	324	360	379	390
Mixed	452	1.021	1.281	1.443	1.522	1.575	1.585	1.587
Share of private firms (in %)	84,4	84,4	86,1	87,5	88,8	89,6	89,9	90,1

Source: Statistical information, Office of Statistics (different issues)

The number of enterprises increased 3,5-times in four years with the share of privately owned companies increasing steadily from 84,4 % to 90,1 % in 1994. However, the number of socially-owned companies increased during this period due to restructuring (only towards the end of 1994 did the process of privatisation start to diminish their number slightly). The number of co-operatives partly increased due to the fact that co-operatives were favourably treated when privatising a part of the food industry.

Nevertheless, the rate of increase in the number of new companies slowed down significantly after the first "explosion" in 1991.³ This trend might be attributed to the following facts:

- gradually the entrepreneurial talents become exhausted after establishing a number of privately owned companies,
- government has considerably increased the amount of the founding capital for both a limited liability company (legal form used for 93,2 % of enterprises in 1994) and joint stock company in order to enhance the protection of their customers and creditors,
- competition has stiffened and it has become more difficult to identify promising business opportunities or market niches.

³ The quarterly growth rate fell from 14,1 % in the first quarter of 1992 down to only 1,7 % in the last quarter of 1994.

2. Active and "sleeping" firms

The first wave of entrepreneurship in Slovenia did not bring the vast numbers of private companies as it did in Poland, Czech Republic or Hungary. Slovenians were not so eager to found multiple new firms for "just-in-case" reasons.⁴ Nevertheless, the number of registered firms does not give the full account of the economic impact of new private firms. Not all of the firms registered did actually operate. Operating firms were liable to present their financial reports to the Social Accounting Service. According to SAS information 66,5 % of enterprises registered handed in their financial statements for the first half of 1992 and for 1993 this share was estimated at 63,5 % of registered companies.⁵ Even within operating companies a large part still did not employ any full-time staff.

Table 2. Size structure of operating businesses in Slovenia, 1993

	Number of enterprises	Share in total (%)	Number of employees	Share in total (%)	Share of sales revenues (%)
no employees	13.927	45,97	0	0	5,87
1-2	7.879	26,01	10.443	1,80	3,99
3-5	2.878	9,50	10.669	1,84	3,99
6-9	1.177	3,89	8.445	1,46	2,93
Micro firms (0-9)	25.861	85,37	29.557	5,10	16,78
10-24	1.311	4,33	20.280	3,50	5,54
25-49	893	2,95	31.806	5,48	4,80
50-99	973	3,21	67.661	11,67	8,68
Small firms (10-99)	3.177	10,49	119.747	20,65	19,02
100-249	779	2,57	119.615	20,62	17,90
250-499	299	0,99	103.671	17,88	16,17
Medium (100-499)	1.078	3,56	223.286	38,50	34,07
500-999	120	0,40	81.958	14,13	12,11
1000+	57	0,19	125.405	21,62	18,02
Large firms (500+)	177	0,59	207.363	35,75	30,13
TOTAL	30.293	100,00	579.953	100,00	100,00

Source: PASEF (Centre for Economic Analysis) and the files of Social Accounting Service, 1994

According to the data in Table 2 the small business sector has become a really vital part of the Slovene economy. What about those 46 % of enterprises with no employees? These enterprises, though active up to a certain level with approximately 6 % share of sales revenues, constitute the part of businesses founded by people moving very carefully towards an entrepreneurial career. These companies use extensively some forms of part-time and contractual work. Their founders are still employed in larger companies, they might work in the public sector, or they may be registered as formally unemployed, enjoying the unemployment benefits, or they might have created more than one company. They have already started their first attempts at doing

⁴ Estimates from PASEF, Centre for Economic Analysis at the Faculty of Economics, Ljubljana.

⁵ Kondratowicz and Maciejewski (1994) listed 1,42 million private firms in Poland as per December 31, 1992, compared to less than 20.000 in Slovenia in the same year.

business but their entrepreneurial commitment is very uncertain. Still, their careful and calculated risk taking behaviour could be understood taking into account the volatile market, strong competition in some sectors and the lack of the government support for small businesses.

The substantial increase of the small business potential in Slovenia is easy to identify from the data on the financial results for the Slovene economy. The share in total revenues and profits might be attributed, at least partly, also to the amount of informal work engaged in the small business units.

Table 3. The share of small businesses (firms employing up to 50 employees) in the Slovene economy in 1990-1993 (in %)

The share of small businesses	1990	1991	1992	1993
Number of enterprises	79.6	87.0	91.6	94.1
Number of employees	3.5	6.1	10.5	14.2
Total revenues	8.6	13.3	19.2	25.4
Export sales	2.4	4.7	7.7	18.7
Profits (after tax)	15.2	38.0	51.9	45.4
Losses	4.3	6.1	8.8	22.9

Source: Financial results of the Slovene economy in 1993 (SAS, 1994)

3. Enterprises by the structure of activities

New firms have changed the economic structure of Slovenia considerably. Until 1990 Slovenia developed into a highly industrialised country as a result of a strong industrial tradition, raw material supplies from other parts of Yugoslavia and the then prevailing development strategy, very supportive to manufacturing.⁶ The structure of new enterprises deviates substantially from this activity pattern in developing trade, financial and business services.

These developments are easily attributed to the lack of retailing in smaller towns as well as to the shortage of financial and business services. Business services which were previously virtually non-existent have now developed, including real estate agents, accounting firms, consultants, financial services tied to the emergence of stock exchange and mutual funds etc. The low capital requirements of these activities have reinforced these trends enabling people to start businesses in their own houses or flats with modest equipment.

4. Slovene crafts sector

Slovenia has traditionally had a strong private crafts sector that developed as a part of the private sector during the socialist period although suffering under strict limitations on workforce employed, ownership of premises and some equipment e.g. trucks and buses

⁶ This strategy has become largely a part of the very positive attitude towards manufacturing widely spread among Slovene people. It is still a common complaint about the structure of newly founded businesses that they lack "production units".

(see Table 4).⁷ According to the new Law on Crafts (1994) independent craftsmen will re-register as sole proprietors or they will have to confirm their status by proving certain skill requirements. This is the reason why the category of sole proprietors increased heavily in 1994. A strong category of part-time craftsmen includes people doing their second job. In 1993 craftsmen accounted for 58.768 employees with additional 37.089 owners working full-time in their craft shops.

Table 4. Operating enterprises by activity, Slovenia 1993

	Number of firms	Share in total (%)	Share of employees (%)	Share of sales (%)	Employee per enterprise
Manufacturing & mining	4.356	14,4	44,2	39,9	58,9
Agriculture & fishing	432	1,4	2,5	3,2	33,8
Forestry & hunting	72	0,2	1,1	0,4	85,4
Water management	12	0,0	0,2	0,1	88,4
Construction	1.554	5,1	5,5	4,4	20,5
Transport & communications	757	2,5	6,0	4,0	46,0
Trade	6.298	20,8	10,3	24,2	9,5
Catering & tourism	1.027	3,4	2,5	2,1	13,9
Crafts & personal services	2.015	6,7	2,5	2,0	7,3
Community services	328	1,1	1,9	4,2	34,1
Financial & buss, services	11.126	36,7	5,3	10,3	2,8
Education & culture	1.849	6,1	8,8	4,0	27,6
Health & social work	464	1,5	9,2	4,2	115,3
TOTAL	30.290	100,0	100,0	100,0	19,1

Source: PASEF database

Table 5. The structure of crafts sector in Slovenia, 1992-1994

	31.12.1991	31.12.1992	31.12.1993	31.12.1994
Independent craft shops	34.380	35.650	35.911	34.607
Joint craft shops	1.099	1.158	1.152	1.056
Craft shops by tax application	2.470	2.639	2.591	2.500
Part-time craftsmen	12.699	12.021	11.255	10.563
Sole proprietorship	-	-	2.157	10.643
Others	693	580	569	545
TOTAL	51.341	52.048	53.635	59.914

Source: Statistical Information, Office of Statistics (different issues)

⁷ Craft as a sector is subject to a dynamic process of exit and entry of units. In 1992, 9.536 new craftshops opened with 8.829 closings; the process is becoming more steady in 1994, with 8.834 newly created and only 4.321 closings.

Two other activities of the Slovene population have to be mentioned. In agriculture the private activities have developed in the direction of secondary activities e.g. tourism, health food production, bee-keeping. The population census in 1991 accounted for 156.531 households with some agricultural activities (24,5 % of all households), but the average landowning of 5,88 hectares with only 2,50 hectares of arable land does not allow the development of profitable activities in the majority of them. The interesting area of economic activities is the second economy. According to some estimates in 1988 for the group of workers' households (Glas, 1989) it contributed 23,7 % to the households earnings. An even larger share can be expected for households in rural area and rising unemployment might reinforce hidden activities among the population. Researchers (Kukar, 1994) have provided for the year 1993 the estimates of 239.000 persons involved in the second economy (28,3 % of the active population) accounting for 10 % of the official GDP figure.

5. Emergence of foreign capital

For a comprehensive picture of the Slovene economy we have to look at the number of enterprises with foreign capital. Their share increased through the period 1990-94 with the growth rate well above the growth of all enterprises but still not exceeding 3 % for foreign-owned enterprises and 5 % for enterprises with mixed capital.

Table 6. Registered firms by source of capital, Slovenia, 1990-1994

Source of capital	31.12. 1990	31.12. 1991	31.12. 1992	31.12. 1993	30.6. 1994	31.12. 1994
Domestic	14.152	22.424	34.478	44.610	46.327	47.434
Foreign	74	147	638	1.252	1.384	1.503
Mixed	371	777	1.332	1.872	2.001	2.101
Shares of firms (in %)	0,51	0,63	1,75	2,62	2,78	2,94
- foreign capital	2,54	3,33	3,65	3,92	4,03	4,12
- mixed capital						
TOTAL	14.597	23.348	36.448	47.734	49.712	51.038

Source: Statistical Information, Office of Statistics (various issues)

The explanation for this rather low share of foreign-owned enterprises may be linked to the following facts:

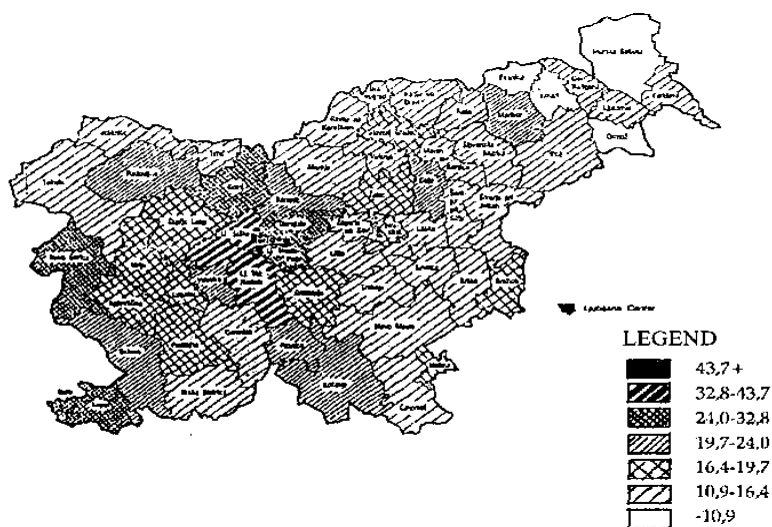
- a) small domestic market of limited interest to larger companies,
- b) fairly expensive though skilled workforce,
- c) unresolved questions of land ownership for foreigners,
- d) complications following the war for independence and
- e) delayed privatisation with dominating scheme of workers co-ownership.

Foreign capital with the exception of some purchases of larger companies and joint-ventures from the pre-1991 period accounts mostly for small investments, a kind of cautious testing of the Slovene business environment.

6. Regional differences in entrepreneurship

Regional distribution of enterprises reveals a picture of highly uneven developments. Although it is not just the number of enterprises that determines the magnitude of activity but the employment and turnover as well, the sole number of enterprises tells us a lot. In the map of Slovenia the number of enterprises per June 30th, 1993, is compared to the population of individual community according to the census data on March 31st, 1991. On the average 21.86 enterprises were registered per 1.000 of population, with 7.85 as the lowest and 76.05 as the highest figure.

Diagram 1. The regional distribution of enterprises per 1.000 inhabitants in Slovenian communities, June 30th, 1993



We can identify a marked concentration of enterprises around Ljubljana, that attracted the largest share of trade, financial and business services.⁸ The second area of high enterprise concentration is located in the coastal region and along the Italian border. The open economy attracted many Italian companies to start doing business with Slovene entrepreneurs across the border. It is not the same story with the area located at other borders. Rather surprising is the

⁸ This issues is discussed in Glas (1993) with more details.

weak impact of Austria on the northern part of Slovenia. Regional centres of Celje and Maribor have taken over the regional supply of services but still remaining only at the average density of enterprise, far below their real potential for economic development. Some industrial centres e.g. Velenje, Trbovlje, Novo mesto, Jesenice and Murska Sobota, are doing surprisingly weak, but for two different reasons: in some of these centres existing companies are still doing well, with virtually no lay-offs, so there was not such an urgent need for self-employment. The other centres have strong structural problems but the skills of laid-off people do not fit with the demands of start-ups (e.g. miners, steelworkers). The communities at the Croatian border suffer from uncertainty about the warfare in former Yugoslavia. Besides, those are more agricultural regions, not very conducive for entrepreneurial developments.

7. Intrapreneuring

Contrary to the entrepreneurial wave that brought to an increasing number of start-ups, intrapreneurship has not been highly appreciated by the management of socially owned companies. Although Slovenia has encountered some models of mass innovation promotion during the eighties, the real innovative culture has never spread considerably. The egalitarian socialist culture has never really given way to a stimulating innovative environment. In addition, the transfer of R&D from existing research institutes to industry meets many obstacles. The huge loss of markets opened the way to turnaround management and downsizing strategies, not to intrapreneurial ventures. The post-privatisation period is expected to give a new impetus to the management of innovations and the process of corporate venturing.

8. Spin-offs from existing larger companies

The delayed process of privatisation caused many uncertainties about the ways of restructuring existing companies. Employees expected to become major owners of privatised companies by the very sense of self-management system. They were therefore watching the process of enterprise restructuring very cautiously, trying to prevent the management from acquiring a major share. This climate of their bilateral mistrust has stopped the process of spin-offs from becoming an important source of the nuclei for new expanding companies. It is a pity, because due to the diversified structure of Slovene companies spin-offs could become an efficient way of creating new enterprises with appreciable growth potential. This adverse political climate prevented many spin-offs from succeeding, maligning them as "wild privatisations". However, some successful spin-offs developed despite this situation:

- a) spin-offs of parts of the diversified product mix,
- b) spin-offs of networks of factory shops,
- c) transformation of cleaning services, restaurants, security services, internal travel agencies etc. to independent businesses,
- d) spin-offs of the R&D, construction or engineering units,
- e) separation of the maintenance and repairs, tooling, some administrative services, transport (trucking, rent-a-car use of company cars),

f) spin-offs of accounting services, computer centres etc.⁹

The privatisation will open the restructuring processes in larger firms and spin-offs will become parts of new business creation.

9. Small business support network

The need for a support network to assist start-up entrepreneurs and existing small businesses was acknowledged early in the process of new business creation. Ministry for Economic Affairs (MEA) as the founder persuaded four partners with existing networks of local subsidiaries⁹ to join the new Support Network for Small Businesses headed by Small Business Development Centre (SBDC). The network has formally developed from 1992 onwards, with the membership (institutions and individuals) expanding from 326 in 1992 to 510 in 1994. These members represent a varied community:

- a) representatives of local (municipal) governments and their small business departments,
- b) local development centres and entrepreneurship agencies,
- c) regional Employment Offices,
- d) regional branches of Chamber of Economy and local offices of Chamber of Crafts,
- e) education and training institutions,
- f) enterprises providing business services and counselling to small businesses,
- g) individual counsellors trained through SBDC.

SBDC has developed different forms of assistance ranging from "hard assistance", provision of premises (BIG - Business Incubators Group) and finance (SLEVCA - Slovene Association for Venture Capital) to "soft" forms of information, training and counselling (Small Business Advisors Group, Association of Clubs of Entrepreneurs, SPIM - Slovene Entrepreneurial Network of Innovators). The network was supposed to provide on-site assistance to entrepreneurs on the local level as well as to manage projects in the areas of the development of small business infra-structure, the development of alternative activities in agriculture, tourism, crafts and other sectors, the promotion of entrepreneur-ship, research, and development of training programmes.

The original vision of this network reveals many weaknesses:

- a) up till now the network has not assumed any formal structure on regional and local levels, it has acted as a rather chaotic addition of members with different goals, interests and resources;
- b) there was no transparent portfolio of services and no unique system of assistance provision to entrepreneurs;

⁹The Ministry for Labour traditionally involved Employment Offices on the regional level (with advisers for active employment policy); Chamber of Economy had regional branches and Chamber of Crafts has developed the most densely network of local offices throughout Slovenia.

- c) the most important unit, SBDC, virtually did not function due to understaffing, lack of strategy and scarce resources;
- d) the budget of network was far from sufficient to provide for proper assistance to small businesses;
- e) Slovene territory has not been equally covered and an uneven quality of services was supplied by the members;
- f) no efficient monitoring system was in place.

During 1993, SBDC participated financially at 36 national, 17 regional and 53 local projects, contributing some 2,15 Mio DEM to the total amount of 6,7 Mio DEM of projects' budgets.¹⁰ Despite apparent weaknesses the network provided valuable assistance to small businesses, managing additional local financial support and other projects co-sponsored by Ministry of Labour and Ministry for Science and Technology.¹¹ It is fair to point out some effective achievements:

- a) the extensive training of nearly 140 small business counsellors,
- b) the development of local entrepreneurial infrastructure: 26 business centres, 7 consortia including members of the network, 15 incubators, local and national information systems;
- c) the promotion of entrepreneurship through organisation or participation at 9 international and 8 domestic fairs, 24 local exhibitions, local small business directories;
- d) subsidised entrepreneurial textbooks, papers, journals, videos;
- e) subsidised on-site counselling to small business owners;
- f) co-operation with foreign institutions and associations, transfer of know-how, promotion of Slovene innovators abroad.

10. Small Business Development Fund (SBDF)

The Slovene government has funded SBDF from the budget to fulfil two tasks:

- a) subsidise interest rates of commercial bank loans to expanding small businesses, providing the bank agreed to the maximum yearly interest rate of $R+15\%$ (R - inflation clause): in 1993 some 243 out of 622 proposals have been approved, totalling 8.6 m. DEM, supporting the loans of 106.3 m. DEM;
- b) guarantee scheme for commercial bank loans: in 1993 only 33 out of 160 proposals submitted have been approved, supporting 138 m. DEM in loans.

The management of SBDF estimated that 1 SIT invested from budget sources attracted an additional 12,3 SIT from other sources (private savings, commercial banks) with some 1.463 new jobs created through all the projects supported by SBDF resources. The major criticism of the policy of SBDF focused on insufficient resources, extremely slow processing of applications,

¹⁰ Official report of SBDC to the government.

¹¹ Local authorities have in the period MX/1994 put some 9.2 m. DEM and banks and insurance companies added 10.7 m. DEM on top of these resources.

weak professional staff with virtually no previous entrepreneurial experience, providing no assistance to applicants in business plan preparation.

sliDF did not succeed in covering the lack of equity capital in Slovenia, particularly as seed capital. Entrepreneurs themselves are also not used to working with outside equity capital - they prefer to retain full control of their businesses. In the future, the newly founded Technology Fund at the Ministry for Science and Technology will take care of high-technology ventures. The venture fund Horizonte, backed by Austrian capital, will look after dynamic entrepreneurs with high growth potential. Nevertheless, the future of some local funds for small business assistance is still uncertain after the reform of local administration.

The study of 150 dynamic entrepreneurs revealed the fact that 71 % of them used their own savings at start-up and during the first year of operation and only 4 % were backed by commercial or investment bank loans.¹² After three years in business only 15 % of investment and working capital came from bank loans, with profits from the business (57 %) and own savings (20 %) as the most important sources.

11. Incubator network

The experience of the SPEDD incubator network from Pittsburgh (USA) inspired as early as in 1989 the opening of the first incubators in Slovenia, founded either by the local government or by larger companies as a tool for their restructuring and promotion of entrepreneurial ventures among excess workers. The indifferent government did not show a real commitment to this line of small business assistance and the overall economic impact of the network of incubators remained fairly modest. Some 18 institutions resumed the services of incubators but over time many of them substituted their original mission with more commercial activities only partly related to new venture creation. Only lately has the government committed itself to two projects. One is the Technology Centre in Maribor, exploiting the know-how of TZ Graz in Austria, with Ministry for Science and Technology as the major supporter. The other is the Business and Innovation Centre (BIC) in Kranj that will build on two activities. The activity of DIC, using the experience of the EBN network, will aim at the creation of new entrepreneurial ventures and spin-offs from larger companies, focusing on advanced technologies. BIC will encourage West European partner companies to invest in these companies. The other is the Subcontracting and Partnership Exchange Centre (SPX) promoting subcontracting relationships with SMEs in Slovenia and its neighbours. The SPX activity should provide for the access of existing SMEs to international business and the transfer of technology, and has the ultimate goal of promoting joint ventures and strategic partnerships. Both projects are still in the initial stage and have yet to fulfil their *raison d'être*.

12. Conclusion

These trends in entrepreneurial developments could be further explained by the growth of education and training in entrepreneurial skills, from the level of secondary schools up to the graduate programmes in entrepreneurship (Glas, 1994a). However, the small businesses are facing lots of problems in the areas of marketing, finance, exports, taxation. Many entrepreneurs

¹² These figures are the highest (for own savings) and the lowest for 5 Eastern European countries involved in the survey.

need further training and the Association of Entrepreneurs, founded in 1994, is strongly in favour of education and training.

Unfortunately, small business is still a kind of "terra incognita" for lots of powerful and influential people from academia and government. Slovenia lacks strong political commitment and a proper small business development strategy. We have identified some focal points of this strategy as being: unlocking the entrepreneurial potential, widening the entrepreneurial base to more women and younger people, improving the business environment by business support networks, improving access to finance, particularly equity and development capital, developing start-ups in all sectors to fill the "black hole", supporting growth companies and promoting high-technology ventures, spin-offs and the creation of clusters of small firms (Glas, 1994b). This strategy has to ensure a change in the behaviour of households and businesses, valuing highly flexibility, creativity and innovations.

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The Importance of SMEs Restructuring with an Application to Poland

WOUTER BIESBROUC, VALENTIJN BILSEN

1. Introduction

The transformation of post communist economies towards a type of market economy is one of the largest structural changes in the recent history of economics. On one hand, it implies a lot of government (de-) regulatory action to define the contours of the market economy. On the other hand spontaneous interaction of the ‘homo economicus’ driven by the motive to earn a living and create wealth within that drastically changed environment is the engine of a growing market economy. In a market economy, the earning of an income by the creation of value added mostly takes place in private enterprises. In plan economies almost all income was generated in state owned enterprises. As a consequence a straightforward answer to create private enterprises was to privatize the state owned enterprises. Privatization is a necessary process to create a market economy. However it is not sufficient. The changing environment generates other needs in the production units. A firm operating in a planning system has other needs than a firm operating in a transition environment. Firms operating in market economies need goods and services that were not always produced before transition. This creates the scope for existing enterprises to start with new activities and also to start new private enterprises from scratch. Many of these activities have small minimum efficiency scales and allow small enterprises to be profitable. As a consequence SMEs are an important institution for income and wealth creation, the output of which serves the needs of both consumers and producers.

The wide scope of goods and services that are demanded by families and firms in a young market economy, can be considered as opportunities for entrepreneurs to enter a market or even to start a new one. Growing entrepreneurship is a stimulus for employment. The entrepreneur himself receives an income. After some time when the business is growing, additional employment opportunities are created for others. Not every business that starts will be successful. Especially because in a transition environment there is high uncertainty, lack of knowledge on the operation of the firm, difficulties to get reliable and appropriate information, and with emerging capital markets.

This paper reports empirical findings on the development of the private sector in the Polish economy with particular interest to self-employment and entrepreneurship. The potential contribution of SMEs to restructuring is outlined and compared with the facts. On the base of a

time series cross section analysis, the determinants of self-employment and total private employment are estimated.

2. Descriptive statistics on private sector development in Poland

Because the agricultural sector in Poland mainly remained in private hands during the communist era (it has never known massive collectivisation), at the beginning of transition, the size of the private sector was much larger than that in the other Central European countries. Nevertheless, that share grew considerably, reaching almost 60% in 1993.

2.1. Share of private sector in total employment

The marked growth of the private sector share employment was not only due to new firm setups, but also to a decrease in the total number of employed (from 17 mio. in 1989 to 14,6 mio in 1993). However, this global picture hides some interesting features of private sector employment. Table 1 below gives a more accurate idea of the situation at the end of 1993.

More than 40% of employment in the private sector is due to agriculture, another 40% is taken by those employed in sole proprietorships & partnerships (labelled here as ‘self-employed’). What is more commonly understood as private sector employment represents only 20% of that group in Poland. Hence, the picture is maybe not as bright as one would expect (for a more profound discussion of self-employment, see p. 82).

Table 1: Contribution to private sector employment

private employment 12-93	
total (#000)	8389.0
of which (%):	100.0
in agriculture	41.0
self-employed	38.4
rest	20.6

Source: own calculations based on GUS, 1994, Poland Quarterly Statistics, vol. II, No. 1 and table 2.

Well over half of the total employed work in the private sector. Sectoral differentiation learns that the largest but diminishing part is employed in agriculture. The share of industry and transport have more or less remained constant (although the number of employed increased in both categories) In those sectors, a majority is still employed in the state sector. The growth of employment share in construction and especially trade is spectacular.

2.2. Self-employment

We now turn to what we have named “self-employment”. Several names for these kind of firms are current, such as unincorporated firms, sole proprietorships & partnerships, and very small firms.¹ Their importance in terms of employment has already been pointed out. Table 2 shows that by the end of 1993, more than 3.2 million people were employed in those unincorporated

¹ The Polish monthly statistics translate this as “establishments of natural persons carrying out economic activities”.

firms (the average number of employees per establishment being 1.8). They represents about 22 % of the total number of employed.²

Table 2: Employment in unincorporated firms (in thousands)

sector	dec-89	dec-90	jun-91	dec-91	jun-92	dec-92	jun-93	dec-93
total	1475.5	1915.5	2338.6	2591.1	2800	3008.7	3105.5	3220.7
<i>industry share</i>	73.6	37.4	34.9	32.2	29.9	33.5	33.1	33.7
<i>constr. share</i>	-	18.2	16.3	15.4	15.2	16.9	16.7	16.6
<i>trade sham</i>	-	25.3	30.7	33.6	33.7	35.0	34.7	34.7
<i>service share</i>	-	19.0	18.2	18.7	21.3	14.6	15.5	15.0

Note: Catering is included in services, not in trade

Source: own calculations based on Biuletyn Statystyczny and Webster [1993] for data on 1989.

Looking at the sectoral evolution, the main findings are:

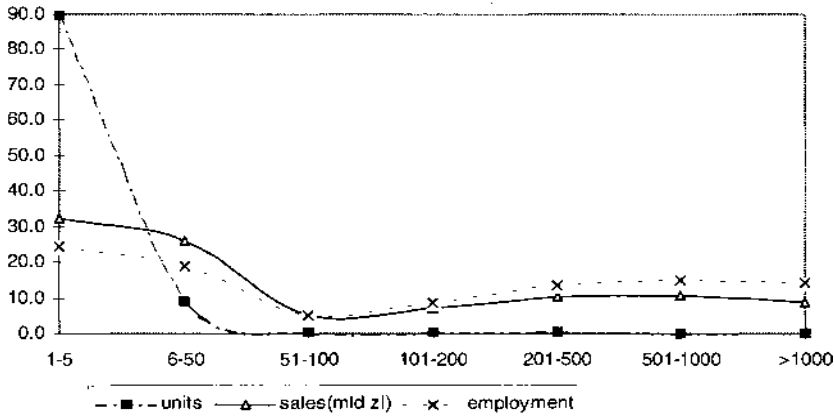
- self-employment in trade has known a fast growth, both in absolute terms as in share of total;
- apart from a sharp decrease during 1990, self-employment in industry remained relative stable in terms of share of total, although in absolute terms a steady increase was made since end 1990;
- the service sector (including catering) shows a more puzzling evolution. Especially 1992 was a strange year for self-employment in services. The first half of the year recorded a sharp increase, while the second half shows an even steeper decrease. Although we have no fixed idea as to what the reason of this evolution can be, we suppose that there may be some connection to changes in the tax system. During the period 1990-91, it was very easy to register a new business activity (by paying a minimal fee) so that many of those registration were likely not serious. This argument is less applicable to the more recent years: in fact, starting from 1992, tax offices have been computerised and fiscal police introduced so that registered firms have found it increasingly difficult to avoid paying income taxes (Blawat et al. [1994]);
- finally, the year 1993 was more or less stable for all categories, both in absolute terms as in their respective shares. This may indicate that the empty organisational space existing at the start of transition, has now largely been filled and that a 'normal' selection process of entry and exit will occur, without too big changes in the absolute numbers, but with high producer turnover. Other reasons could be decreasing domestic demand, increasing domestic and foreign competition, and rising tax burdens and elimination of tax exemptions (Blawat et al. [1994]).

² To stress the importance of these small entrepreneurs, Polanska [1993] remarked that they outnumbered the total number of unemployed in Poland end 1991. This is still the case at the end of 1993.

3. Distribution by enterprise size in construction and industry

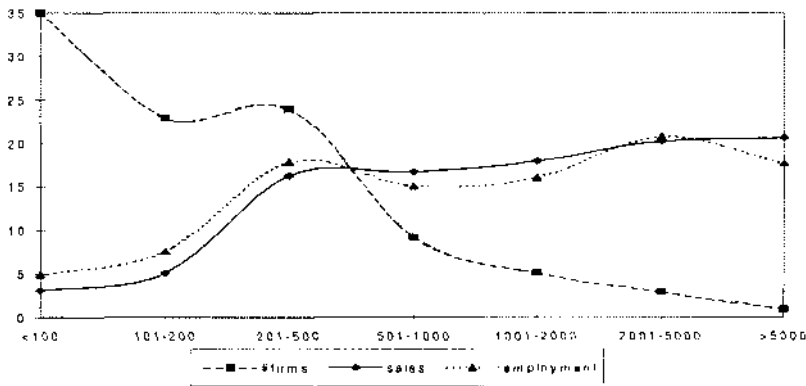
It is interesting to compare the size distribution in construction with industry. Figures 1 and 2 present the size distribution of firms in both sectors for the year 1992. In construction, almost all enterprises are SMEs. 99% of all firms have a size smaller than 100 employees. In industry SMEs represent an important share as well, but the share is lower: 82%. Furthermore, the industry sector is more concentrated than the construction sector. In industry, 82% of the firms have about a quarter of total sales. In construction 99.8% of all enterprises sell 80.7% of total sales.

Figure 1: Size structure of Polish construction firms in 1992



Source: own calculations based on Rocznik Statystyczny 1993, p.307

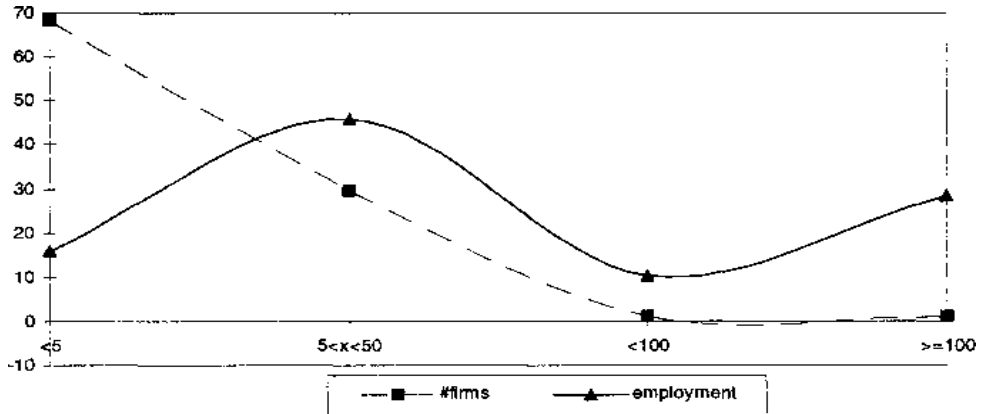
Figure 2: Size structure of Polish Industrial firms in 1992



Source: own calculations based on Rocznik Statystyczny, 1993.

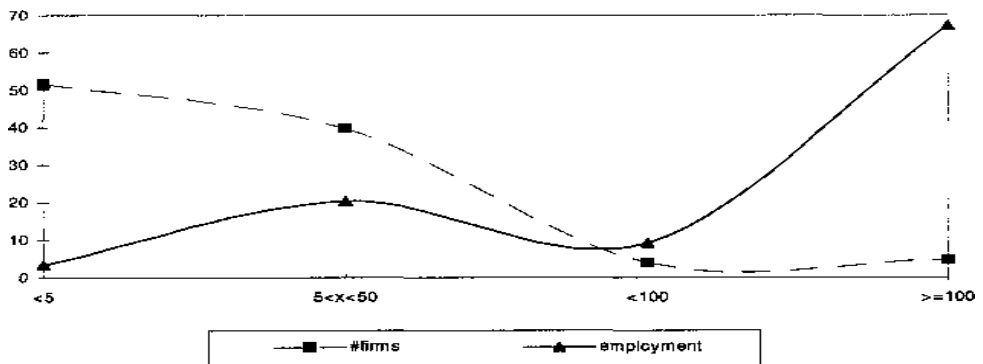
The fact that they are almost opposite with respect to employment or sales is not only due to different sectoral characteristics, such as a much smaller minimum efficient scale (MES) and more local markets in construction. Another reason is connected with the historical evolution during the planning system, where industry was overemphasised. In construction, much more than in industry there was an empty organisational space, which has now largely been filled through the creation of new and small firms.

Figure 3: Size structure of Belgian construction firms, 1983



Source: own calculations based on Donckels [1984]

Figure 4: Size structure of Belgian Industrial firms, 1983



Source: own calculations based on Donckels [1984]

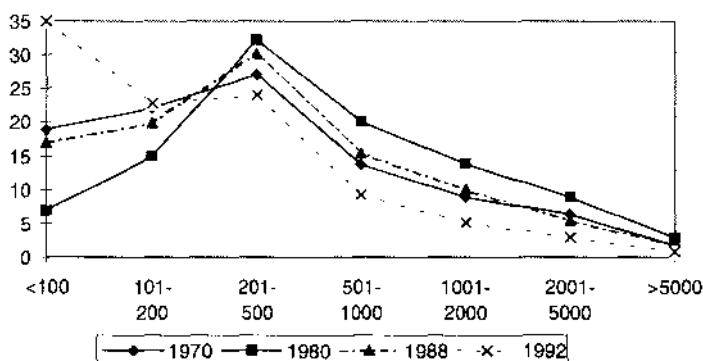
Comparing these findings with the situation in a mature market economy would shed more light on this issue. We take Belgian data (for 1983) for comparison (see figures 3 and 4). In Belgian construction 99% of all firms are smaller than 100 employees. This is similar to the Polish case

except that in Poland almost all firms are smaller than 5 employees, whereas Belgium also has a considerable number of firms between 5 and 50 employees. Looking at the number of firms in Industry, we see that 95% of Belgium firms are smaller than 100 employees, the Polish number being only 35%. However when one looks at employment figures, the situation is even more divergent: 40% of Polish employment in construction is in firms <100, while in Belgium this is 70%. In Belgian industry, 30% of employment is in firms <100, while in Poland this share is only 5%.

4. Structure of production before and after transition in construction and industry

It has already been widely documented in the literature about transition economies that the production structure before transition was characterised by a high concentration and huge plant sizes. Jackson [1991], reports: *"It has long been a common opinion among specialists that the centrally planned economies in Central and Eastern Europe had larger average-sized units with less deviation around the average size than did market economies"*³. The implications of the planning environment compared to those of a market environment on the size of a firm, are very well summarised by Keren [1993], in his survey article on optimal tautness and the economics of incentives in bureaucracies. Considering the firm as a hierarchical organisation itself, he states: *"It is only where markets cannot exist, or where they are stifled, that hierarchies may grow to be much too large, far beyond their optimal size. In these cases they display openly the dysfunctional behaviour, of the type attributed to the Soviet bureaucracy."*⁴ Iwanek and Ordovery [1993], portray the sectoral structure at the eve of transition as: *"...an inefficient concentrated market structure built around the dual requirements of partial central planning and tight political control..."*⁵

Figure 5: Size structure of Polish Industrial Enterprises by number of units



Source: based on CSO, Poland, statistical data, 1989, 1990 and GUS, Rocznik Statystyczny 1993

³ Jackson [1991], p. 4.

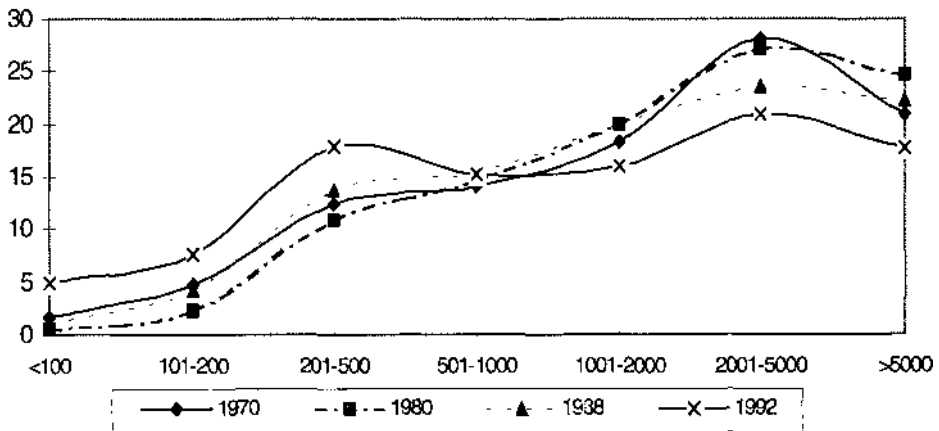
⁴ Keren [1993], p. 110.

⁵ Iwanek & Ordovery [1993], p.154.

Did transition cause a big change in the sectoral structure? The available data allowed to answer this question for the industry and construction sectors. Figure 5 shows the evolution of the size structure of the industrial enterprises in Poland over time measured in units. The first striking characteristic is that the majority of firms had a size between 201 and 500 employees for all years under communist rule. Even after transition this feature is still somewhat visible. Between 1970 and 1980 the percentage of small enterprises diminished in favour of the enterprises with a size of 200 and larger. After 1980 the importance of SMEs increased.

Combining the information of figure 5 with that of figure 6 on the size distribution according to employment, reveals that the employment concentration over time diminished. In 1970, the largest firms (>5000) which amounted for less than 2% of the industrial firm population, employed more than 20% of the employees. 68% of the industrial firms were SMEs. They employed all together 18.8% of the industrial workforce. In 1980 the concentration of employment increased. In 1988, the situation was similar to that of 1970. After the start of transition, the concentration of employment decreased to a level which was not reached before. In 1992 the largest firms amounted to less than 1% of the industrial firms and employed 17.7% of the workforce. The SMEs accounted for 82% of the industrial firms and employed almost 30% of the industrial workforce.

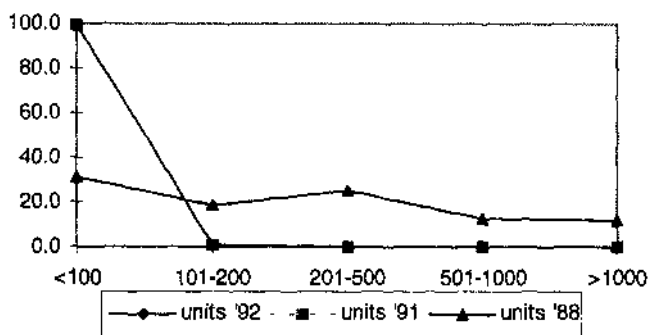
Figure 6: Size structure of Polish Industrial Enterprises by employment



Source: based on CSO, Poland, statistical data, 1989, 1990 and GUS, Rocznik Statystyczny 1993

In the construction sector, the impact of transition on restructuring seems to be greater than in the industry. Figures 7, 8, and 9 show the size structure of construction firms by units, by employment and by sales. From figure 7 it is clear that after the end of the central planning period, an important shift towards SME size occurred. In 1988, 36% of all enterprises had a size that is smaller than 100 employees. In 1992, 99% of the enterprises belong to this group.

Figure 7: Size structure of Polish Construction firms by number of units



Source: Rocznik Statystyczny 1993, 1992, 1989.

The structural change after the start of transition is also illustrated by the changed concentration of employment, as depicted in figure 8. In 1988, almost 50% of the workforce in construction was employed in enterprises with a size larger than 1000 employees. The SME sector at that time employed 29% of the workforce in construction. In 1992, the big enterprises employed 14.3% while the SMEs provided 71% of the employment in the construction sector. After the start of transition, employment was more concentrated in SMEs with a size equal or smaller than 100 employees.

Figure 8: Size structure of Polish construction enterprises by employment



Source: Rocznik Statystyczny 1993, 1992, 1989.

The size distribution of sales in construction points to the same conclusion as employment concentration. From 1991 onwards the SMEs sell more than 50% of total sales. While in 1988, the large enterprises with more than 1000 employees sold almost 53% of total sales, the SMEs

sold in 1992 81% of total construction sales. This indicates a serious restructuring of the construction sector in terms of sales.

5. Explaining private sector employment and self-employment. Evidence from panel data.

To investigate the determinants of the private sector development, we estimated the impact of certain variables on the number of self-employed and the number of employees in the private sector in Poland on the base of a panel data set. Although other variables are suitable to measure the development of the private sector like sales and output, employment was the only one for which sufficient observations were available to perform a thorough regression analysis.

The panel data set consists of observations across the 49 voivodships for the years 1991, 1992 and 1993. A fixed effect model is estimated using the Fuller-Battese method in SAS for estimating regression parameters on the base of longitudinal data⁶. The choice of a fixed effects model seems to be appropriate since the analysis is entirely focused on Poland and all voivodships are included in the sample. The model can be specified as:

$$(1) \quad y_{it} = \sum_{k=1}^K X_{itk} \beta_k + u_{it}$$

with: $i=1, \dots, 49$; $t=1991, \dots, 1993$; and k the number of explanatory variables.

The error term is decomposed in the following parts:

$$(2) \quad u_{it} = v_i + e_t + \varepsilon_{it}$$

with: $i=1, \dots, 49$; $t=1991, \dots, 1993$.

v_i , the error component per voivodship constant over time,

e_t , the error component per time period constant over voivodships,

ε_{it} , the error component specific for time and voivodship.

The errors are independently distributed with zero means and positive variances, respectively:

$$\sigma_v^2, \sigma_e^2, \sigma_\varepsilon^2$$

The X -matrix consists of the following explanatory variables: an unemployment indicator, a wealth indicator, the urbanisation rate, a wage indicator, and the agricultural employment. Note that some interesting financial variables were not available on a regional basis and could not be included. For instance a sectoral profit indicator was not available per region. Given the high share of trade in self-employment, it could be expected that a high profit share in trade would induce more entry (pull-factor). Also a higher profit rate can result in expansion of the firm and result in higher total private employment. Neither did we find personal savings per voivodship. As the literature suggests, start-ups of SMEs are predominantly financed with personal savings and that of family and friends.

⁶ SAS Institute, [1993], p.871 - 881, and Fuller, W.A., Battese, G.E., [1974], pp. 67- 78.

Unemployment was chosen to see if we could find it to be a push-factor for self-employment as has been suggested in the literature (Bartlett & Hoggett [1993]). The labour market conditions guide individuals' choices between wage-employment, remaining in unemployment, or various forms of self-employment. Unemployment is interpreted as a push-factor since it can encourage unemployed to set up their own business. This corresponds with a positive sign of the regressor. That is, unemployment (or the threat of unemployment) is considered to have such negative effects on personal well-being (income and personal development) that it outbalances the risks connected with becoming self-employed. A negative sign for this variable in the self-employment equation would indicate a state of more or less lethargy on the part of the unemployed.⁷ The unemployment indicator was calculated as unemployment relative to the population. Since the size of unemployment is determined by the population and the latter varies seriously across voivodships, a correction for population size was done.

The urbanisation rate was included in the regression for three reasons. On the one hand, some of the literature suggests that urban areas offer more possibilities to establish networks, have a larger potential demand, and superior institutional arrangements. On the other hand, previous research on self-employment suggests that people living in the countryside are significantly more probable to be self-employed than people living in town (Lindh & Ohlsson [1994], p. 19). Therefore, we are not sure what sign to expect. Third, the economic environment of the voivodships is quite heterogeneous. A heritage from the past is that economic activity was concentrated in certain urban areas, e.g. Warszawa, Gdansk, Lodz, Poznan, Wroclaw, Katowice and Krakow. We suppose these regions attract a lot of human capital and are an environment inductive to private entrepreneurship. This effect would result in a positive coefficient.

Further, the average real wage was introduced. If the average real wage is a reliable indicator of past earnings as well, we could expect a positive effect on self-employment, because higher wages *ceteris paribus* lead to higher savings and thus to more potential for starting-up your own business. Note that the real wage is based on wages in both the private and state sector. The effect on private employment is *a priori* not easy to predict. When real wages decline, private sector demand for labour will increase which might increase actual perceived private employment. This supposes a good working labour market with sufficient employment opportunities. In voivodships without a lot of employment opportunities, both a low real wage and low private employment can persist.

As an indicator of wealth, the relative number of cars per 1000 inhabitants in each voivodship was used. In order to buy a car, one needs to have a minimum amount of capital. It is expected that it has a positive effect on self-employment, as it is suggested in the literature (Lindh and Ohlsson, [1994]). The effect on total private employment is expected to be smaller.

The results of the estimations for the self-employment regression are shown in table 3. The same explanatory variables were used to estimate the effects on total private employment. First of all, because on a national level, self-employment counts for 38% of total private employment, as was shown in table 1. Second, it is plausible that the same variables have an effect on other components of private employment as well, although not always with the same interpretation.

⁷ Another possible explanation in a rather dramatic scenario is that if too many people are unemployed, the average wealth falls below a certain threshold, and people no longer have the means to buy the products and services from self-employed. Due to this lack of demand, only a smaller number of self-employed could remain in the market.

A separate regression for these components was not performed since data per voivodship about private agricultural employment were not at our disposal. Neither did we have regional data on the private employment in non-family enterprises, labelled as ‘rest’ in table 1. Therefore a separate regression for the total private employment was performed. The results for the total private employment regression are shown in table 4. All variables are expressed in natural logarithms.

Table 3: Estimation results for the self-employment regression on the base of panel data, fixed effects model estimated by Fuller-Battese method.

	self-empl.	self-empl.	self-empl.	self-empl.
intercept	6.657***	4.681***	-0.883	0.007
unemployment ratio	-0.205**	-0.1798	-0.164	-0.156
urbanisation ratio	1.811***	1.709***	1.679***	1.629***
cars per 1000 inhab.		0.394**		0.374**
real wage			0.772**	0.489
Variance components:				
for cross sections	0.168115	0.161264	0.169393	0.164056
for time series	0.006825	0.005902	0.001857	0.002298
for error	0.005157	0.005089	0.005212	0.005139

Note: 49 voivodships x 3 time periods = 149 observations mean of the dependent variable: 6.0357

* significant different from 0 at the 10% level of significance

** significant different from 0 at the 5% level of significance

*** significant different from 0 at the 1% level of significance

Findings and interpretation of the results:

- There is no evidence that unemployment is a push factor. Only in the regressions without the real wage, a significant estimate was obtained. These regressions indicate an elasticity of around -0.2.
- Urbanisation is significantly positive related to self-employment. The coefficients are stable for all regressions. An increase of the urbanisation ratio with 1% increases the number of self-employed by 1.7%. This points to the importance of networks, institutional arrangements and markets and gives no support to the finding of Lindh & Ohlsson [1994] that people living in the countryside are significantly more probable to be self-employed than people living in a town.
- The wealth indicator, cars per 1000 inhabitants, is significantly positive and stable. This evidence is consistent with other studies that stressed the importance of wealth in the determination of self-employment.
- Real wage is positive as expected, but not always significant. In the regression without the wealth indicator, the coefficient is significant. If we control for the wealth effect, the real wage remains positive but insignificant. This means that the average real wage is an indicator

of the personal wealth if other wealth factors are not included. This in turn support the view that the wealth aspect of the wage is determining the self-employment.

The same explanatory variables were used to estimate the effects on private employment. First of all, because on a national level, self-employment counts for 38% of total private employment, as was shown in table 1. Second, it is plausible that the same variables have an effect on other components of private employment as well, although not always with the same interpretation. A separate regression for these components was not performed since data per voivodship about private agricultural employment were not at our disposal. Neither did we have regional data on the private employment in non-family enterprises, labelled as ‘rest’ in table 1. Therefore a separate regression for the total private employment was performed. The results for the total private employment regression are shown in table 4. Applying the same set of explanatory variables on the total private employment, didn’t provide good estimates. Only the intercept could be significantly estimated, leaving considerable doubt about the effects in which we are actually interested in. Since the size of private employment is determined by the population size in each voivodship, population was introduced as an explanatory variable. The results of the regression analysis are shown in table 4. As before, all variables are expressed in natural logarithms.

Table 4: Estimation results for the private employment regression on the base of panel data, fixed effects model estimated by Fuller-Battese method.

	private empl.	private empl.	private empl.	private empl.
intercept	-2.356***	-2.302***	-0.772	-0.949
population	1.029***	1.029***	1.046***	1.043***
unemployment ratio	-0.078	-0.082*	-0.065	-0.063
urbanisation ratio	-0.712***	-0.710***	-0.694***	-0.699***
cars per 1000 inhab.		-0.013		0.023
real wage			-0.172	-0.163
Variance components:				
for cross sections	0.012762	0.013018	0.012493	0.012653
for time series	0.000181	0.000118	0.000536	0.000308
for error	0.002840	0.002849	0.002834	0.002853

Note: 49 voivodships x 3 time periods = 149 observations; mean of the dependent variable: 7.3748; for significance levels, see table 3.

Findings and interpretation of the results.

- The population effect is significant positive and robust across all regressions. The elasticity is close to 1.
- The unemployment ratio is negative in all regressions, and its values are quite robust. Only for the regression in the third column the coefficient is significant at the 10% level. Although the private sector is quite dynamic and grows rapidly, its base is not yet large enough to compensate for the lay-offs in the restructuring state sector.

The urbanisation rate is significantly negative and fairly robust, contrary to our expectations. However, private agricultural employment counts for 41% of total private employment

and *ceteris paribus*, there is more private agricultural activity in rural areas than in urban regions.

- The wealth effect is not significant as was expected: the personal wealth plays less a role in total private employment than for self-employment.
- The effect of real wage is negative but not significant.

Conclusion

Liberalisation started a real boost in the number of private firms, which had growing importance in number of employees and output. This is especially so in construction and trade, but to a lesser extent in industry. Although the private sector by now employs about 60% of total employed, a large part is due to private agricultural employment. An equally large part are for the account of the self-employed, numbering more than 3.2 million. This group should be distinctively approached, not only by researchers, but also by policy-makers. Those employed in the private sector are not a homogeneous group, but are either farmers (40%), self-employed (40%), or those employed in the private SME sector (20%).

Looking at the data, we found that the impact of transition on restructuring was much more outspoken in construction than in industry. The growing impact of SMEs in industry is limited to their share in the number of units. Their share of output and employment remains rather small. In the construction sector, the size distribution almost reversed in the first years of transition, with the share of SMEs in output growing from 25% in 1988 to 80% in 1992.

Finally, we tried to learn something more about the determinants of self-employment and total private sector employment, through a time series cross-section analysis. We couldn't find evidence that (the threat of) unemployment operates as a push factor for both self-employment and total private sector employment. Urbanisation is positively related to self-employment, indicating the importance of networks, institutional arrangements and markets. The impact on total private employment is less straightforward. Wealth was found to be a crucial determinant of self-employment. In total private employment this effect was not significant.

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The External Environment for SMEs in Estonia

URVE VENESAAR

Introduction

An analysis of changes in Estonia's economic environment shows a constantly improving situation for entrepreneurship between 1992 and 1994. The packet of laws regulating decentralisation of management, defining of the principles of economic and social relations and the implementation of the structural reforms, promotion of foreign investment, etc. laid the basis for the growth and development of SMEs and the private sector. But the fast speed of economic and social changes and difficult economic conditions of the transition period have created many problems for enterprises which need an improved external environment for their operation.

This paper focuses on analysis of legal, economic and social factors of the external environment of entrepreneurship and changes in them, impact on the growth and survival of SMEs in Estonia. At present, in the period of transition to a market economy, it is of great significance both to improve the external environment conditions and to raise the enterprises' initiative and management.

1. The role of SMEs in the economy

The role of SMEs in Estonian economy is characterised by the fast increase in the number of enterprises and its share in the economy during the last five years. The birth rate of SMEs has exceeded the growth of total number of enterprises and culminated in 1992-1993, when the increase was 13 enterprises per 1000 inhabitants. In 1994 the birth rate of enterprises slowed down to 9 enterprises per 1000 inhabitants. Mainly due to the increase in SMEs the number of registered enterprises increased to 39 per 1000 inhabitants by the beginning of 1995 (average in EU countries - 49 in 1994) [1]. Still, a number of enterprises have not started operation yet.

According to the Enterprise Register a typical Estonian business is a micro enterprise (0-9 employees), which accounted for about 88% of the total number of enterprises at the end of 1994. Small enterprises accounted for 11% and medium-sized enterprises for 1% of the total. The enterprises with up to 100 employees are in majority in all spheres, but most of all in trade and services because of the traditional role of SMEs in these branches, at first. Secondly, and very characteristic for Estonia, the low level of savings, high rate of inflation and extremely high lending rates together do not encourage enterprises make long-term investments. Therefore businessmen look for areas with a big turnover and relatively high profit margin.

The efficiency of the SMEs (which has been influenced also by external environment) can be measured by comparing the life time of firms. According to the Estonian Enterprise Register 25% of all firms established in 1990-1991 were still in business [2].

The share of output by SMEs can be indirectly estimated by the help of private sector, as the SMEs are operated largely in private sector. The private sector accounted for 55% of GDP in 1994.

In spite of the stabilisation of enterprises' birth rate, the share of employment of SMEs was steadily increasing and reached 50% of the total employment by the end of 1994 [3]. It may be assumed that SMEs are becoming stronger and the number of employees in them is growing. Though large enterprises still have an important role in manufacturing, power engineering, fishing, transport and communication, the share of SMEs has increased here in the number of employees, turnover and cost of fixed assets. In over one fourth of the branches of production (by ISIC) the share of employment by SMEs is over 50% of the total number of employees of these branches.

SMEs as creators of new jobs help partly engage labour dismissed from large enterprises as a result of privatisation, but it is not easy to evaluate its impact on unemployment. Though the development of entrepreneurship and rate of unemployment varies very much by region, the correlation analysis did not reveal any important connections between these indicators. Labour market studies prove that entrepreneurship has not been an alternative to unemployment. Stronger impact here is probably exerted by other factors, primarily external environment of entrepreneurship. Next we will discuss changes in some factors of external economic environment and their impact on the development of entrepreneurship in recent years.

2. The characterisation of external environment

2.1 *Economic environment*

The external environment has an essential impact on the nature and pace of the development of SMEs in Estonia. The economic, social and legal factors have changed gradually, accompanied by changes in the structure of ownership and control, in the external environment and in the internal operation of enterprises.

In Estonia like in other countries in transition, an important factors influencing the external environment of entrepreneurship is ownership and enterprise reform as well as reforms of other spheres. Enterprise reform was introduced and undertaken already within the planned economy system, which has influenced the breaking of the government monopoly in most of the branches. During this process the dominating role of state-owned sector has inevitably generated some restrictions and obstacles, and external environment was not in favour of the development of SMEs, the economic policy has not promoted the direct support to the development of private enterprises. In spite of the difficulties the external environment of entrepreneurship has moved towards the stabilisation during last years in Estonia alongside with the development of reforms (political, economic etc.).

Along with implementation of reforms the macroeconomic situation also changed in Estonia. The attainment of control over inflation during last years (mostly after the introduction of national currency in 1992) and using measures of curbing inflation the raise of prices has been stabilising, though the rise of prices was still high (42% in 1994) compared with developed

countries. However, a further rise of prices and wages should be anticipated. The restrictions on wages and salaries in state institutions and low pensions and benefits have essentially increased the stratification of population.

Systemic and structural changes have caused unemployment. Though the open unemployment rate is quite low, it accounted for about 5% of the economically active population in Estonia at the beginning of 1995, there is the extensive hidden unemployment. Recent months have shown that long-term unemployment is increasing. Increase in unemployment may cause serious economic and social problems. Economic factors have to be regulated in order to promote development of entrepreneurship and creation of new jobs.

The rapidly emerging SMEs have generated a huge need for financial resources. Due to the scarcity of capital opportunities to borrow are limited because of high interest rates. This problem involves both short-term and long-term loans. 70-80% of the loans issued by banks are short-term loans with the term of 6-12 months. The average annual weighted interest rate decreased from 23% to 19% on loans in EEK and from 29% to 15% on loans in foreign currency during 1994 [4]. The managers of SME still think these interest rate are too high. This is also confirmed by the analysis of real investments by source of financing, where the share of bank loans was 17%. However, the share of bank loans has increased in recent years (9% in 1993) [5].

The economic policy should lead to low rate of inflation, with stable interest and exchange rates. The economic policy targeted at favourable overall economic conditions *to* induce investment is the only sustainable way.

2.2 Legal regulations

An important component of the encouragement of reforms and external environment of enterprises has been the development of the legal framework, which has helped stabilise the economic (as well as political) situation. Enterprises are most concerned about the government's legislative regulation, embracing legal forms of enterprises, tax policies, foreign trade policies, labour market regulation, etc.

The removal of legal entry barriers to the market and the simplified registration of companies have been the main reasons for the rapid growth of SMEs in Estonia. But the Estonian government has been rather passive in introducing direct support for the development of SMEs. Several bills aimed at supporting SMEs have been overruled by the parliament. The Foundation for Crediting SMEs, which was set up by the government in September 1993 and reorganised in July 1994, is not operating on the basis of the established rules. Therefore all enterprises (small and large) have had to perform under equal conditions (tax and credit policies etc.) in Estonia since 1990.

The structure of legal forms of enterprises depends on the conditions created by legal requirements. The limited liability and joint-stock companies have become the most favourable entrepreneurship forms in Estonia: they accounted for 87% of the total number of enterprises as of April 1, 1995. This is mostly due to the relatively low minimum capital requirement for joint stock companies (EEK 300 = USD 23). In order to evaluate the amount of this capital requirement it may be compared with the minimum and average wages. This requirement remained

unchanged during five last years and was equal to minimum wage or one third of the average wages in 1993 and one seventh in 1994.

Easy conditions for the establishment of enterprises promote the growth of entrepreneurship, on the one hand. On the other hand, it also produces numerous weak and non operating enterprises. Therefore, a lot of enterprises (nearly one-third according to estimates) have not yet started operation in Estonia [6]. Most of these enterprises can be classified into the micro group. The latter includes also the so called 'dummies', which have been created with the view of resale. Therefore the information about the distribution of enterprises has to be regarded with some reservation.

The Estonian Business Code (will come into force gradually from 1 September 1995 to 1 September 1999) is an important step in the improvement of legislation concerning entrepreneurship. This law invalidates the previous Enterprise Law, makes amendments to the laws on co-operative societies, accounting, real right, foreign investment, insurance, taxation and many other laws, liquidating many of the previous discrepancies. The Business Code stipulates that there are six entrepreneurship forms: sole proprietorship, general partnership, limited partnership, limited liability company, joint-stock company, and co-operative society.

The law introduces new market economy terms, changes the meaning of capital stock, defines the need to create a business register and protection of minority shareholders, and makes other amendments in enterprise management, distribution of profits, etc.. According to the Business Code the minimum capital requirement will be established for limited liability companies and increased for joint-stock companies. The enterprises registered before the enforcement of the business code have two years for re-registration (until 1 September 1997). Qualified for business register before 1 September 1997 are limited liability companies with the minimum capital of EEK 10,000 (USD 750) and joint-stock companies with minimum capital of EEK (USD 7500). As of 1 September 1999 the minimum capital requirements will be EEK (USD 3,000) and EEK 400,000 (USD 30,000) respectively.

Estonia is using extensive licensing of activities, where enterprises have to apply for the license from the government that the enterprise is competent to operate in a particular field of activity and will make it in obedience to all rules and regulations. Over 40 activities are subject to licensing at present: starting from trade in arms and securities market operation to the distribution of goods. The issue is whether the state is able to control all enterprises operating on the basis of licences if their number grows very big. Or should its license only some particular enterprises which need special attention. Thus, there is a danger that the excessive licensing may become an obstacle to business activity.

2.3 Political factors

Of great importance for the activity of enterprises was the tax policies and trade regulation. Taxation has been the most frequently changing sphere as compared with other government regulations. Since 1994 the uniform income tax rate of 26% has been adopted for enterprises, where most of the tax allowances (incl. allowances for foreign investors) have been abolished. The only tax allowances permitted are for investments - no more than 5%, and for donations no more than 10% of the operating profit. From the taxable income is also deducted the annual rate of depreciation of fixed assets: 8% in case of buildings and their structural components; up

to 40% in case of other fixed assets. Income tax is not imposed on registered non-profit societies and associations and on production enterprises for disabled persons.

The high social tax rate of 33% for employers since June 1992 increase the total tax burden of enterprises, especially of SMEs, where the labour intensive production is prevailing.

The income tax collection system is important for regional development. Estonia has chosen the centralised enterprise income tax collection: 2/3 of the revenue is income of the state budget and 1/3 of local budgets. The pegging of taxes from entrepreneurship to the local government income would considerably increase their interest in promoting entrepreneurship in regions. This would help to solve social problems, reduce unemployment and promote the local initiative, including the development of entrepreneurship (incl. SMEs).

The development of foreign trade and the whole economy has been promoted by the liberalisation of foreign trade policies in Estonia which consist in reducing or eliminating barriers on exports and imports, conclusion of free trade agreements, growth of enterprises with foreign capital and their economic activity.

In Estonia only 10% of imports are subject to custom duties (a tax of 10% on furs, tea and motor vehicles). There are licenses for alcohol and tobacco, but no quantitative restrictions. Import subsidies were abolished at the beginning of 1992.

Export barriers have been reduced to the minimum. A 100% export tax is levied on antiques and art works. Quotas have been removed except for export ban on gravel and special clay. Most restricting requirements were removed in 1991. There is no export subsidisation. But enterprises are disturbed by some bureaucracy in settling customs formalities, which is incompatible with a liberal trade policy. The government should discuss the possibility of simplifying customs formalities.

Due to the liberal trade regulations Estonia had to absorb significant changes in terms of foreign trade and considerable efforts were made to reorient trade from East to West, changing the foreign trade geography and the structure of goods and services in exports and imports.

The legislation concerning foreign trade, customs and guarantees to foreign investments as well as consumer protection is improving. Mutually beneficial international co-operation between trade and customs authorities becomes stronger, bilateral and multilateral trade and tariff agreements and conventions have been concluded. Estonia becomes integrated into international economic and foreign trade structures.

The development and implementation of the regional policy concept is on the agenda in Estonia. It contains besides other things the modelling of a favourable environment for entrepreneurship in all regions of the country, building of a infrastructure embracing the whole country, and promotion of local initiative.

2.4 Social factors

Due to the high inflation and emergence of unemployment the real money income has remained low and about half of the Estonian households lived on income below the average. The ratio of the average income per household member between the lowest group to that of the highest income group (15.5) shows the inequality of income distribution in Estonia.

Income of the poorest 40% of the households accounted for a quarter of the total income in 1994, whereas the ratio of the income of the richest 20% to the poorest 20% of the household! was a little over three-fold. It means that most of the income is concentrated in a small group of households and most of the households were relatively poor and the population of Estonia highly stratified on the basis of income. Due to the relatively low level of average wages and salaries (USD 170) as well as that of personal income the income differentiation of the living standards increased during recent years. Therefore the consumption of goods and services is limited for a large part of population and the consumption structure is characterised by a high share of expenditure on basic needs (food, housing, clothes): 60% of the total consumption expenditures.

A major problem of manufacturing SMEs is besides the shortage of sources of financing and skilled labour the low domestic purchasing power. That is why the manufacturing SMEs in particular are making efforts to enter foreign markets, find co-operation partners abroad, become subcontractors for foreign companies or increase their exports. Its role here is played by Estonian cheap labour and comparatively highly skilled labour. Subcontracts have helped to upgrade production technologies and train workers.

Subcontracting for foreign companies in textile and wood processing industries as well as machinery and metal works is an important field of activity. The contractors are most often Finnish and other Nordic, as well as Germany and British firms, companies have also discovered the relatively cheap Baltic production possibilities. The expanding SMEs may have been able to accommodate a large number of new workers.

Labour market in Estonia is characterised by the decline of working-age population due to the ageing, emigration and decline in natural increase of population during recent years. Besides, the general economic decline, decline in the output of primary and secondary sector enterprises, and structural changes induced the decline in employment. The activity rate of working-age population was about 72% in 1993 and a quite large part of population are operating in shadow economy. The reasons for the high share of shadow economy besides other factors are the limited opportunities to find a job because of a mismatch between skills and demand for labour, as well as limited retraining opportunities, inadequacy of legislative regulation, which enables to operate under shadow economy, etc. An important issue of the labour policy is and will be upgrading of the skills and knowledge of employees, and investment in human capital.

2.5 Business support services

Besides the development of macroeconomic policies and improvement of the legislation, the network of business services has been developing in Estonia in recent years. Several projects have been initiated and realised by local associations in co-operation with foreign countries. Good results have been achieved in establishing business consulting centres within the framework of the PHARE programme, the European Union programme for assisting East European countries, as well as some other programmes.

Most probably the network of such centres will expand and they will play an important role in the retraining and refresher courses both for private businessmen and managers in state-owned enterprises. Small entrepreneurs do not use these services much because of their high price as well as their low professional level. Improvement of services in the future will help to promote local initiative and regional development of entrepreneurship.

Besides, there is an increasing need for business education. The economic reform process has forced businessmen to study the principles of a market economy, improve their knowledge in modern business and banking, and business administration in general. By now there is demand for systematic, high level business education. There is a need for improved high-level advanced training. Economic training should be available for all people.

The only direct support services by labour market offices were the start-up grants, which are given to persons who want to start their-own business instead of remaining unemployed, though its share in the total labour market expenses is extremely low. But any additional firm can increase the supply which at least means increasing competition (and lower prices).

The policies that promote and encourage a favourable legal and economic environment and facilitate local private initiative, including SMEs, help to create new jobs for people dismissed from state owned enterprises. At the present time, it is of great significance both to improve people's living conditions and to energise economy.

In spite of the stabilising trends in society the external environment is quite risk-demanding for SMEs. The implementation of ownership reform and privatisation of the state owned sector have been relatively slow processes and creates social tensions. The most important role of the governments has been to encourage the elaboration of new laws as well as measures for stabilising the macroeconomic situation and stimulating foreign investment. Fundamental changes in the principles of society (democracy, etc.) and fast rearrangements have been accompanied by the inadequate legal framework, contradictions between several laws, difficulties in implementing the principles stipulated by laws and problems connected with economic environment.

Therefore, a deeper environmental analysis must be undertaken to identify the critical thresholds in the development of SMEs, which helps to elaborate adequate policy programmes and determine the support needs for growth and survival of SMEs in Estonia.

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Possibilities of Small and Medium-sized Enterprises in Transformation Process of the Slovak Economy

VILMA JURICKOVA, BORISLAV PETRIK

Introduction

Small and medium-sized enterprises in the Slovak Republic are a relatively new phenomenon, 40 years suspension's after. Renaissance of small and medium-sized entrepreneurship is an important part of transformation process of the Slovak economy.

Despite of many barriers S and M enterprises must face, their present development and role in the economy can be positively evaluated. They contribute substantially on the production of GDP and on solving unemployment problems in the Slovak Republic.

Since the very beginning of transformation process (1990) small and medium-sized enterprises are the object of interest of scientific institutions. These institutions are facing problems of relevant statistical data and have to rely on own empirical studies and sample analysis.

Institute of Economics of the Slovak Academy of Sciences brings into being such an empirical researches regularly and on this basis works out an analysis focused on solving of individual problem topics. Results are provided to decisive sphere.

Presented study describes main research results in the area of small and medium-sized enterprises, which have been realised by the Institute of Economics of the Slovak Academy of Sciences.

Parti

1. Development of Small and Medium-sized Enterprises (SME) after the year 1989

The initial situation for the formation of appropriate SME sector was worse in Slovakia than in other Middle European countries where political changes occurred much earlier.

In creating the SME sector, Slovakia *in* the year 1989 was starting almost from nothing, though it is better to shift this "zero" point to the year 1982 when increasing problems in the sector of services forced the government to loosen its attitude towards the private sector by accepting the Governmental Resolution 55/1982, that made entrepreneurial activities of individuals easier.

In the year 1980 the number of permissions issued by local administration to individuals to open their own trade, comparable to present day trade licenses, was 1762. By the year 1989 this number had risen to 21,548.

Real growth of entrepreneurship appears after the political changes in the year 1989. Though there were initially very poor conditions, and since 1989 a prolonged economic recession (in developed market economies in such periods of crisis there is a decline in entrepreneurial activity), today the SME sector is already established. A naturally created atmosphere of political and economic stability has significance in this discussion. Despite this fact, entrepreneurship, mostly in form of trade undertaking, does not belong after the year 1989 to a completely new phenomena of the Slovak economy. Its survival in the totalitarian regime, mostly through the system "cash" (of course without taxes) belonged to one of the possibilities of providing or increasing the standard of living. It was of assistance in solving problems of the official economy. The new possibilities after the year 1989 were therefore just legalisation of previous practices. This is supported by the fact that in the year 1991 one third of all entrepreneurs were working for additional sources of income (some were working on a part time basis).

We can trace the picture of the breakthrough of entrepreneurial subjects into the economic scene from the beginning of the process of transformation, when great changes in the economic and social structure in Slovakia occurred. Individual periods of this process are presented further.

Already at the beginning of the year 1990, an increased interest in entrepreneurship appeared. In the course of this year, the development of individual entrepreneurship was faster. As of December 31, 1990, according to the Government Regulation No. 2/88 and the Act No. 105/90, there were 118,440 permissions granted to private citizens for entrepreneurial activities, which was by 96,892 more than at the same time the previous year, and produced 1 billion Kcs.

The year 1991, thanks to the continuing transformation of ownership forms and the support of private undertaking was a year of further development of the private sector. As of December 31, 1991, there were 295,353 citizens involved in private undertaking, which was an increase of 12,948 from the previous year. High entrepreneurial activity was concentrated mostly in big cities as Bratislava, Kosice, and Zilina, which can also show that in big cities people who started their activities had in the past accumulated resources (not always in a legal way).

The activities of private entrepreneurs concentrated mainly in the fields of construction (24.6%), industry (22.4%), internal trade (20.9%), trade technical services (13.1%) and other non producing services (6.4%). The growth appeared also in the number of established private companies; companies with limited liability (increase by 4206), joint stock companies (by 426), companies with unlimited partnership (by 315), business representatives of foreign companies (by 81), and joint ventures with foreign partnership (by 41).

The year 1992 witnessed a boom for growth in the private sector and for small and medium sized firms. As of December 31, 1992, there were 300,637 trade entrepreneurs (other than those listed in the Business register) registered with the Statistical Office of the Slovak Republic, which was the highest number of entrepreneurs in Slovakia in the transformation period. The sector structure of trade entrepreneurs was as follows: trade and repair services (23.8%), construction (20.9%), elaborating industry (19%), other business services (13.7%), agriculture wood industry and fishing (6.5%), restaurants and accommodation (4%), transportation and

telecommunications (3.7%), other public and private services (3.9%), real estate services for companies, research and development (2.7%).

The number of companies had risen since the beginning of the year by 127.6% (mostly companies with limited partnership by 128.2% and joint stock companies by 178.8%) as well as private entrepreneurs listed in the Business register by 125.7%. The participation of private sector on the creation of the National Income for the year 1992 was almost 21% and the private sector employed 320,000 persons.

The greatest number of entrepreneurs was in Bratislava, where there were 42,787 entrepreneurs registered (p.a. 15%).

The feature of big cities with opportunities for trade entrepreneurs (high degree of urbanisation, rather good infrastructure) caused the high number of undertaking citizens in Kosice city (17,861 p.a. 12.6%), Zilina (15,261 p.a. 16.5%), Banska Bystrica (11,585 p.a. 12.2%), Nitra (14,424 p.a. 15.4%), Trnava (11,690 p.a. 10.2%).

If the year 1992 was the year of sharp increase of private SME, particularly small tradesmen (private entrepreneurs not listed in Business register). This increase continued partly in the year 1993, which from the point of view of private sector development could be considered as a controversial year. On the one hand, there was a continual growth in the number of private enterprises having more than 25 employees, on the other hand, after the culmination of the growth in the number of entrepreneurs in the previous year, we can see in 1993 a slight decrease in their number.

The total number of entrepreneurs had from the beginning of the year decreased by 22,200 to 289,608. In general, the decrease was caused predominantly by a duty to pay to the funds of National Insurance, and the concept of tax system. After meeting these requirements, not enough resources remained to small entrepreneurs for the development of their trade. In their effort to survive and overcome these external negative factors, some entrepreneurs associated into companies (which caused the increase of their number), others handed back their trade licences and entered as employees some private companies, eventually oriented to other spheres of economics.

The year 1994 was characterised by a further increase of private ownership, that as of June 30, 1994 meant 29,879 enterprises, companies and co-operatives. Their number compared with the end of 1993 increased by 4165 and their share on GDP reached 40% (including co-operative form of business). The decrease of the number of people undertaking outside Business code continued and at the end of the first half-year there were 2230 less registered small tradesmen than at the end of the year 1993. Their structure in Slovakia was: 259,809 of small tradesmen, 19,387 privately undertaking farmer, and 1468 citizens in the form of freelance professions. Small tradesmen, the number of which decreased since the beginning of the year by 1.6%, were undertaking mainly in trade and repair services (30.8%), in processing industry (18.7%), and in construction (17.7%). In June of that year, tradesmen employed 166,900 persons.

Most of the undertaking persons were in Bratislava city (42,277), in districts Bratislava province (10,069), Trnava (12,831), Senica (9840), Kosice city (17,525) where the number of entrepreneurs increased in comparison with the end of the previous year.

From the review of the private sector development in Slovakia, we can see its controversial and fluctuating character throughout the individual periods of transformation process. On the one hand, there is a permanent increase of the number of private enterprises with more than 2.5 employees, on the other hand, following the boom of the number of small entrepreneurs (not listed in Business register), slight decrease of their numbers took place (with different intensity in particular regions) throughout 1992 and partly in 1993.

Because most of the private activities of small entrepreneurs is concentrated mainly in the sphere of trade, repairing and other service branches, transport and construction, they are more vulnerable which causes not only the decrease of their number but also a small ability to create employment opportunities.

Part II

2. *Small and medium sized enterprises' share on total production of economy*

Ascertaining of the small and medium sized enterprises' share on the production of economy is more difficult than the definition of the enterprise efficiency alone. Relatively reliable data exist only on the enterprises listed in business register.

By adding estimates for individuals we obtain the following results.

Small and medium sized enterprises have the highest share on the production of industry in trade where they realise 82% of performances 73.9% of that small enterprises and 8.1% medium sized enterprises.

In road freight transportation this share represents 68%. Small enterprises realise in this branch 62.5% and medium sized enterprises 5.5%.

In construction, small and medium sized enterprises produce 44.2% of construction production volume. Bigger share in this industry is realised by medium sized enterprises 34.4%, the rest 9.8% is covered by small enterprises.

Similarly as in construction, in industry too, the share on the production of industry is higher by medium sized firms 23.3%, small enterprises represent 8% of production.

It is evident that small enterprises were developing most dynamically in industry where their production rose by 74.2%. The increase in construction represented 55.4% and in retail trade 44.6%. On the other hand, the decline in efficiency of small enterprises was recorded in road freight transportation where the volume of performances was lower by 2.9% compared to the previous year.

The development pace of medium sized enterprises (see graph 3) was the highest in road freight transportation by 32.6%, in trade by 9.7%. On the other hand, a decline was recorded in industry by 13%, in construction even by 26%.

3. *Share of the small and medium size enterprises in the employment situation*

Private enterprises pursue not only their major objective, e. g. accumulating the profit, but also include other aspects, first of all their contribution to the employment development, which is performed in two ways:

- new possibilities of creating the working places
- creating a space for new employment forms.

As has been stated, there have been no serious difficulties in determining the development of the number of tradesmen and SME since 1990 (thanks to the validity of the Citizens' Private Entrepreneurship Act No. 105 and the official statistics). We know the disproportionate SME development in time horizon, according to its forms, and from the standpoint of territorial distribution.

However, there are problems in detecting the employment development in SME. Unlike the development of the number of enterprises in this sector, the official statistics does not take into evidence, respectively publish the number of employees in trades and SME. Therefore it is necessary to acquire this data by empirical research and special statistical methods.

Several institutions have realised researches and empirical probes into the SME problem since 1991. Some of them focused on the employment situation in these subjects.

The Research Institute of Employment and Social Affairs in Bratislava accomplished a representative empirical research concentrated on employment in the private sector in June 1992. Relevant results of this representative research manifest that:

- the highest percentage of respondents (27%) employed 2-5 workers,
- 47% of respondents did not intend to engage any employees.

The Public Opinion Research Institute of the Slovak Statistical Office performed six empirical studies concerning the private entrepreneurs in the field of construction industry, business, industry, and transport during the years 1991-1993, none of them was recorded in the Business Register.

The entrepreneurship progress in regard to the employment development in separate industrial activities in the years 1991, 1992 and 1993 is presented in the Table 1.

In spite of the fact that the unemployment growth index taken as an average for industrial activities of one entrepreneur demonstrates increase by 47%, compared to the year 1991 the employment rate development is differentiated in each industrial activity and displays the decrease of employment rate in these following branches: manufacture of chemical products, manufacture of metal constructions, and in particular, waste processing. The most noticeable employment growth was achieved in the following branches: manufacture of food products and beverages, manufacture of clothing, manufacture of leather and shoes, manufacture of wood and wooden products, manufacture of fabricated metal products and manufacture of machinery and equipment.

The average employment rate including the entrepreneur and members of his family was in average 3.1 employee per one enterprise in 1993. If we multiply this amount by the number of small enterprises, which are not recorded in the Business Register (289,608 in 1993), the result would be 897,795, that is about 40% of the total 2,196,300 employees in the whole Slovak national economy, which corresponds, or at least approaches the above mentioned figure.

The Institute of Economics of the Slovak Academy of Sciences (IE SAS) completed two surveys in April and November 1993, that also analysed the employment rate in the small private entrepreunering.

Table 1

Industrial activities	Average number of employees			Index 93/91
	1991	1992	1993	
Food and beverage industry	3.5	4.7	6.9	194
Textile industry	2.4	2.4	2.4	100
Clothing industry	1.1	2.0	2.3	210
Shoe industry	1.2	2.1	2.4	197
Wood industry	1.2	4.5	4.8	392
Press and publishing industry	2.2	3.8	3.9	177
Chemical industry	20.0	20.0	15.0	75
Manufacture of rubber products	1.0	2.8	2.8	280
Manufacture of non-metallic mineral products	1.6	1.7	1.7	101
Manufacture of metals	1.0	2.2	2.1	210
Manufacture of fabricated metal products	2.6	2.4	2.4	87
Manufacture of machinery and equipment	1.0	1.8	1.8	180
Manufacture of bureau machines and computers	1.0	1.0	1.3	130
Manufacture of electrical equipment	1.2	1.7	1.7	137
Manufacture of telecommunication equipment	1.5	1.5	1.3	85
Manufacture of health and optical equipment	1.2	1.4	1.7	139
Manufacture of furniture and not elsewhere classified	4.1	3.6	5.0	121
Waste processing	5.5	7.3	1.7	30
Gas and water supply	1.5	1.7	1.6	110
Average	2.1	2.7	3.1	147

In the first one the following trend of the employment development was detected (comparison of number of permanent employees in the beginning of their business activities and in the time of the research).

Table 2

Number of employees	in the beginning (%)	in the time of research (%)
0	25	9
1-5	64	68
6-10	7	13
11-25	3.5	8
more than 25	0.5	2

This review manifests an unambiguously positive tendency. The increase of the number of employees was noted in each category along with the decrease of a number of self employers.

Another result of the research correlates with this finding, too. In 1993, 29% of respondents intended to extend the number of their permanent employees, 46% planned to maintain the same condition and 19% were undecided. The least number (6%) of the surveyed group of entrepreneurs wanted to reduce the number of employees.

The second survey of IE SAS presented similar trend of the employment development.

Table 3

Number of employees	in the beginning (%)	in the time of research (%)
0	23.5	9
1-5	65	63
6-10	7.8	16
11-25	3.5	9
more than 25	0.2	3

The survey reveals the same trends and the same optimistic tendency as the previous one. That is manifested by the decrease of a number of self employers and an increase of number of employees in other categories (with only one exception, which indicates a negligible decline).

Another result correlates with this optimistic finding: in the next half-year 32% of respondents planned to increase the number of employees, 50% did not plan any change and 13% did not know. The rest (5%) intended to reduce the number of employees.

The empirical surveys thus presented mildly positive results in the trend of employment development.

In the empirical surveys mentioned previously, the factors determining the employment development in the SME were studied too. They resulted from the opinions of respondents of the two IE SAS surveys in 1993. (In 1992, the opinions were influenced by the old tax system and the problems of the former Czecho-Slovak Federation.)

The review of the responses to the first survey concerning the expectations from the economic policy of the state relating to the employment development in the private sector:

Table 4

Issue	Score
- tax reduction	195
- social and health insurance payments reduction	84
- tax system modification (simplification, differentiation, suspension)	69
- alteration, simplification, stabilisation of the legislation	54
- better credit policy, cheaper and more easily accessible credits	30
- bureaucracy and corruption eradication	29
- no good prospects	23
- customs policy improvement	13
- the progress business conditions for entrepreneurs	10
- no response	84

It is clear from this survey that the tax problem is the cardinal issue which represents the most significant barrier of employment in the private sector.

Review of responses to the second survey:

Table 5

Issue	Score
- reduce the tax burden	160
- modify the tax system	53
- improve the credit policy	75
- alter the social and health insurance payments	62
- ameliorate the entrepreneuring conditions	39
- nothing	27
- change and simplify the legislation	25

Comparison of both surveys explicitly confirmed the main barriers in this area. The most important questions are the tax issue and the social and health insurance payments. The second package of problems includes the unsuitable credit policy with a high interest rate and the third one is the legislation topic.

4. Analysis of the SME financial burden

In compliance with the majority of the empirical surveys accomplished after 1990 in our conditions, the key problem of the economically active small or medium size subjects is the financial burden. Two basic elements are included in the financial burden: tax and insurance payments.

The presented analysis of the tax burden according to the tax payments is based on selected data from the files of tax returns of individuals for 1993.

In the entire file the average was observed to be 18%, the median 15%. The maximum percentage for one entrepreneur was 67%, minimum 0%. In Bratislava the average was 16%, the median was 15%, in Nitra and Rimavska Sobota the same as in Bratislava, in Bardejov the average was 17%, the median was 15%. Considering the branches, following relative frequencies were revealed: processing industry average 17%, median 15%; construction industry average 18%, median 15%; services average 17%, median 15%. This means, that the income tax burden of the entrepreneurs individuals in Slovakia concerning the total, regional, and also the branch point of view, was 16 - 18% (according to the arithmetical average) and 15% (according to median).

The income fixed taxes are the most important of all direct taxes. The real estate tax is an item subtractable from the tax base of the income tax of the individuals. For our purpose the gift and inheritance taxes can be neglected. (Indirect taxes are not associated with our topic, since these taxes are transferred from entrepreneurs to the customers). This means that from the whole system of the direct taxes road tax (related to vehicles used in the business) must be added to the 16 - 18% income tax too.

According to the Road Tax Act No. 319/1992 in case of the entrepreneurs' personal vehicles, the burden ranges between SK 1200 and SK 3600 per year according to their cubic volume; in case of lorries (trucks), the range is between SK 1,800 and SK 54,000 according to their weight.

As the tax offices of the Slovak Republic have not processed the road tax yet, it was impossible to consider the concrete data from chosen entrepreneurs in the relevant analysis. That is why in this analysis the road tax burden is used just as a hypothetical value.

The second main item of the entrepreneurs' financial burden are the insurance payments: for themselves and for their employees. The law from 1993 on National Insurance Company (NIC) no longer existing, obliged the entrepreneurs to deliver 46% from their monthly earnings to the NIC. If they had employees, they had to pay another 35% (11% were paid by the employees themselves). The government, because of protests of the private sector representatives, approved so called small NIC Act amendment, which enabled the entrepreneurs to pay minimum amounts regardless of the amount of the entrepreneur's earning until June 30, 1994. This amount is calculated out of the minimum wage, which is SK 1,100.

We can state with certainty that all the entrepreneurs tax payers, who were included in this analysis, used the opportunity, what means that they paid SK 13,200 as an insurance payments for themselves.

The total financial burden

Table 6

Item	Average (in SK)	relative frequency (%)
tax base	135 000	100 %
income tax	25 000	18 %
road tax	- personal vehicle 2 000	1 %
	- lorry(truck) 20 000	15 %
insurance payments	13 000	10 %

The table shows obviously that the financial burden of the selected entrepreneurs, considering the average tax base of SK 135,000, is 43%, which means SK 58,000 in case a lorry (truck) is used. In the case of a personal vehicle, the burden is 29%, which means SK 40,000.

Considering the financial burden of 29%, the net profit of an entrepreneur was SK 95,000 (i.e. SK 8,000 a month), with the 43% financial burden the net profit was SK 77,000 (i.e. SK 6,400 a month). For comparison: in the countries of the European Community the average tax burden is 39.5%; in Austria it is 41%.

Conclusion

The possibilities of the SME in the situation of the political and economical instability necessitate a resolute intervention of the decisive sphere, which would lead to the turning point particularly in the legislation field. It can be stated in general, that the primary role of the state (government) in the market economy is to create equal conditions for the activities of all subjects. But as in fact they never will be equal (the small companies are always handicapped to some extent), it is necessary to assist SME by specific support measures. The basic principle of the state activities, which can be verified in every economically developed country, declares the obligation of the government to provide a long term legal security, that is provided by a simple and stable legislative system. What is the situation in legislation concerning the private sector in Slovakia since 1990, after passing the Citizens' Private Entrepreneurship Act No. 105, the first legal document related to the business in the last 42 years. More than 1200 legal regulations are directly linked with the private business and the changes ceaselessly increase. It is hardly possible for an entrepreneur to familiarise with this volume of knowledge. Consequently, this situation requires modification, that would include establishing so called De regulation Departments in all Ministries, which would permanently consider every law, declaration or amendment as to its purpose, effect, and duplicity; present proposals and logical and systematic measures. If the private SME should become a dynamic factor of the economics in our country, too, it is inevitable for the decisive sphere to stop the proclamatory support and start the real assistance.

Profile of the Romanian Entrepreneur

OVIDIU NICOLESCU

The main way of achieving a modern market economy in Romania is the accelerated and large- scale development of the entrepreneurial phenomenon. With a view to knowing the main “authors” of this phenomenon - entrepreneurs - we show some of the main conclusions drawn from the analysis of 421 questionnaires filled in on the basis of interviews taken in 1993.¹

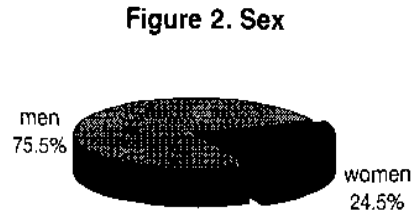
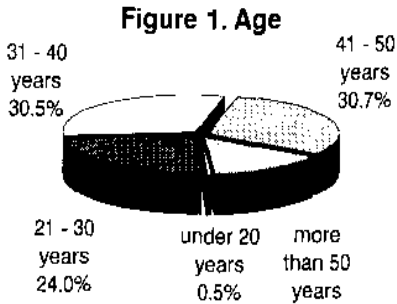
1. Who are the Romanian entrepreneurs?

Relative to the *age of entrepreneurs* (Fig. 1) we have found that *middle-age persons are predominant* in a proportion of 61.2%, more exactly between 31 and 40 - 30.5%, and between 41 and 50 years of age - 30.7%. Entrepreneurs exceeding 50 years of age are in a smaller number - 14,3%. It is important to highlight the large number of young entrepreneurs of up to 30 years of age - 24.5%, practically 1/4 of the sample, which proves their optimism, self- confidence and confidence and, last but not least, the courage characterising younger generations. This involvement of young entrepreneurs is a positive aspect from several points of view. On the one hand, for understanding the laws of a market economy, for its “rules of the game”, without the routine of the past years. It is all the more important as at present the mentality of a considerable part of the population is characterised by lack of initiative, by an atrophy of creativeness and dynamism, which are blocking the mechanism of the market economy. On the other hand, young people are more open to the environmental changes and manage to involve themselves creatively and adaptively into the high rate of fluctuations of the environment in a shorter period of time than entrepreneurs of the second and the third ages.

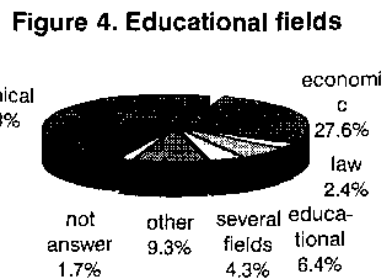
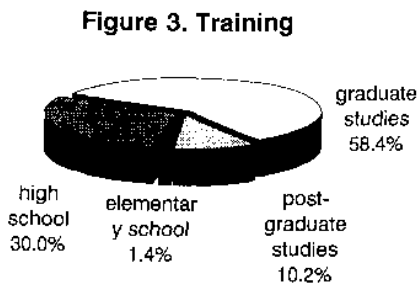
As natural (Fig. 2), *male entrepreneurs* are predominant with a weight of 75.5%, while female entrepreneurs account for only 24.5%. We consider the male predominance as normal for at least 3 reasons: the difficulty of this occupation, the special time pressures, the large physical and nervous stress involved, this statement may entail some problems. That is why we consider it necessary to make the following specification: we do not deny the female entrepreneur’s potential to be successful in business and all the less so the right of women to choose this occupation for themselves. We only draw attention to the fact that each occupation involves having specific qualities and the fulfilment of certain conditions, a rule from which the occupation of entrepreneur is no exemption. If we think of the special time pressures brought to

¹ An inquiry achieved with the contribution of the students of the Department of Management in the Academy of Economic Studies in Bucharest.

bear, for reasons we do not consider necessary to speak about in detail, we can state that females as a rule “lose” in favour of males from the biological, natural viewpoint as well as from that of their marital status, as mothers and wives.



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Relative to their training (Fig. 3), the largest weight, 58.3%, was found to be held by *persons with higher education*; 30% of the interviewees had attended the secondary school and only 10.2% had postgraduate studies. 1.4% were leavers of a only a general school. It is possible that a good part of the entrepreneurs in the last class may not resist in time mainly owing to the insufficient competence of the founders. Instead, the relatively large weight of entrepreneurs with higher education can only be of good omen as there are better chances in this way for the strengthening and development of their firms.

Relative to the field of their studies (Fig. 4), interesting situations were recorded. It is surprising that the 48.3% of the persons with technological training in their majority have trading companies and not companies specialised in their field of production, as it was to be expected. The large weight is explicable by the fact that by their vocation persons with a technological training in general and engineers especially know how to do something, how to produce something. To this one may also add the fact that most of the managerial staff in businesses, about 80% in 1989, were engineers, managerial experience being a major advantage in opening a business. Another possible explanation, unfortunately strongly rooted in reality, is that of the lack of prospects of a considerable part of engineers in Romanian enterprises under the conditions of the lack of competitiveness of numerous enterprises. *Economists rank 2nd with 27.6%*. They have a better outlined role, which is a natural situation as they by their training have specialised knowledge and are better endowed to utilise the specific instruments of entrepreneurial activities.

Their weight is smaller as compared to that of engineers as opening one's own business was mostly in parallel to keeping one's position prior to the changes. It is a fact that demand on the labour market of specialists in economics, of economic education persons in general, still maintains very high. In addition, the number of engineers in Romania is over 9 times as high as that of economists. 6.4% is held by persons with education in the humanities, 99% of them are teachers. This situation can be accounted for by their low incomes, their lack of prospects in vocational self-achievement and progress and, last but not least, of material thriving of this class of intellectuals with a major role to play for the future of Romania. It is surprising that the comparatively small percentage of lawyers, 2.4%, as compared especially with the situation in other countries and taking into account the major importance of the legal factor in this period of intensive changes of laws accompanying the transition to market economy.

The structure of entrepreneurs related to their *marital status* naturally corresponds to the that of age groups. The fact that about 1/4 (23.6%) are not married is to be correlated with the 24.5% of the persons below 30 years of age, with the natural exceptions of the rule.

2. Experience and fields of activity

We consider it useful to record *the number of years of experience in the professional activity* as well as the number of years of experience in business and we related them to the percentages of adult entrepreneurs and those of young entrepreneurs. The *importance of vocational experience* is determined by the double, conflicting role it has: it may either be a positive factor underlying development or an adverse factor refraining the development of one's own business and implicitly of the national economy. We highlight the following situations:

- In case the previous field corresponds to the present field of business and there is a greater experience in the professional activity, we can only grasp a positive influence on the display of the economic activity of the particular agent;
- In case there is no experience irrespective of the field of activity, the situation is ambiguous and often major difficulties are come across in the development of the activity and inadequate behaviour of the management is recorded when they face "problem situations" which should be solved under the pressure of time as well as of other endogenous and exogenous factors of that particular firm;

- Experience can sometimes be a limitation under the conditions of a mentality characterised by rigidity, inflexibility, closed system activity added to it, which characteristics are contrary to the present-day diametrically opposite conditions and requirements, which involve dynamism, suppleness, systemic view, high inventiveness. We referred to the interdependence between the number of years of vocational experience and mentality due to the fact that by our poll 34.8% of the entrepreneurs with a longer experience than 20 years were recorded, and 16.7% between 16 and 20 years and 19.7% between 10 and 15 years, respectively. The 12.6% of the persons with an experience above 5 years in the field of business is comparatively small and is related to the persons who had also worked in trading positions before 1989. The experience of the 12.6% of entrepreneurs is a major advantage favouring the grasp and acquisition of the specificity of activities of firms in the market economy, at the opposite pole of those characteristic of a supercentralised economy of the Communistic type.

Relative to the *field prior to the present business*, as shown in the chart enclosed, the largest share, 34.9% is recorded by persons who had worked in industry. This situation is not surprising and can be accounted for by the elements mentioned above. 20.7% of the subjects had worked in other fields of activity and 15% of them in trade. The comparatively low percentage of trade workers prior to the present business is not satisfactory. The existence of a great number of trading firms owned by persons with an economic speciality and who had previously worked in trade would have had a main advantage in their view on and experience of the market. Going along the co-ordinates presented above, this would have implicitly led to running economic activities at higher standards as compared to that of other companies.

We also find that none of the present entrepreneur covered by the sample had previously worked in such fields as insurance, real estate agencies, consulting. Even if the investigation is extended to a larger sample, the situation will not change significantly and smaller percentages will probably be recorded. This situation is not paradoxical, as there are fields of activity which under the past regime were very slightly developed. A questioning mark is the 16.9% of the persons denying to state the enterprise in which they had worked, their position and field.

Relatively to the *present field of business* of the firms in the sample, most frequently, in accordance with our expectations, they deal in trade exclusively - 37.52%, in *trade* combined with services - 11.87%, and in a combination of other side fields - 16.15%. Thus, about 2/3 of the entrepreneurs are engaged in trading activities and this situation can be accounted for by the small starting capitals, by the lower complexity and especially by the larger and faster profits as a consequence of a larger number of business cycles of money as compared to the situation in industry and agriculture. The second position is taken by the firms in the field of *services*, with a proportion of 9.02% exclusively and of 26.6% in that of services combined with other fields of activity. The entrepreneurs dealing exclusively in *industry* account for only 2.37% and those who besides industrial processes also perform other types of activity hold 11.16% of the total. Predominating are the businesses dealing in footwear, ready-made clothes, wheat grinding and bread making, gloves, etc. We list only some of the reasons accounting for this orientation: relatively simple technological flowsheets, accessible prices of installations and equipment, small number of employees, better chances of supply with raw materials, secure outlet markets.

In the field of construction, 2.37% businesses in the profile and 4.75% in combination with other fields, preponderantly trading activities were identified. It is surprising that in the

investigated sample there is business achieving only transport activities but there are 5.46% in combination with services and trade. Mention should also be made of the absolute absence of businesses strictly specialised in consulting. The approximately 3% identified developed their activity in combination with insurance or real estate activities.

The low percentage - 0.7% - of entrepreneurs specialised in farming seems to us normal, as the examined sample was in a proportion of 80% from Bucharest. In combination with other fields, farming accounts for about 3% of the examined businesses.

3. The extent of involvement of the family members

The analysis of the number of family members working in the firm (Fig. 5) was achieved in a differentiated way depending on the their time of work as follows:

- full time;
- part time.

a) *Firms having employed a single member of the family hold the largest share - 40.3%, followed by the percentage - 26% offirms with two employed family members.* The share of the firms with over 2 employees from the family of the employer is relatively small - 5.9%.

These percentages are correlated at an appreciable level with the number of family members having invested in the firm. This allows us to state that as a rule the family members who had subscribed to the firm's capital retained for themselves the right to participate in the activity of the firm full time.

b) *The family members employed part time are in a small proportion - about 15%.*

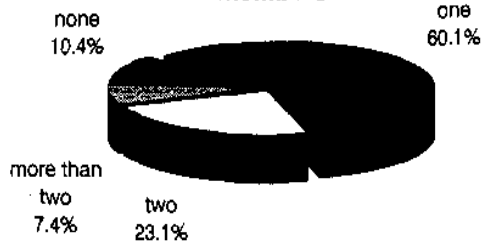
As a whole, the figures mentioned show the high degree of involvement of the entrepreneurs' family members in the activities of the firm. The involvement is as a rule the result of either of the two causes:

- in order to carry on an activity in agreement with the level of training of the family members paid better than in state-owned firms;
- for the purpose of avoiding employing and paying third parties.

We consider the first variant as more frequent and this is also accounted for by the important weight of family members with a higher education - 56.25%, and postgraduate studies - 10.76%. The usually low size of the firms with an industrial, service and trade profile leads us to the conclusion - also proved by our direct observations - that family members who had subscribed in the firm's capital also participate in the executive activity, not only in the management of the firm.

Their specialised knowledge is used in their own interests and they also obtain, besides moral satisfactions, high incomes as compared to the situation of being employed by another employer or by a state-owned enterprise, in addition, the employment of the family members in the firm has the advantage of a higher level of confidence.

Figure 5. Investment of family members



Relative to the *number of family members who had invested in the firm*, as stated above, the percentage is near the one of full time employees in the firm. In 59% of the cases, investment was made by only one member of the family, and in 23.1% by two members. The investment was made especially in the field of trade - 44.51%, in that of industry - 29.67% and in that of services - 21.36%.

4. Age and type of firm

From the viewpoint of the seniority of the firms, the situation is rather well balanced, as resulting from Figure 6. 1% of the firms were established before 1990. They are in fact family associations which continue their activities under conditions of an increased profitability at present.

Figure 6. Beginnig of the investment

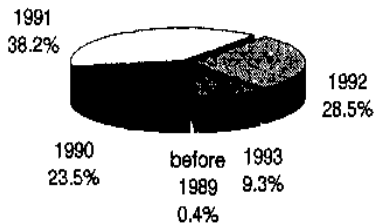
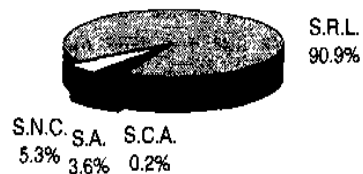


Figure 7. Enterprise type



The majority weight is held, as expected, by young firms established in the past 4 years. The best represented year in the sample is 1991 with approximately 40%.

In dynamics, certain changes can be found depending on the class of activity of economic agent. Thus, *the firms with an industrial profile were as many as 60% in 1992* and about the same were those with a mixed industrial and trading profile.

In exchange, the period in *which most of the firms were opened in trade and services, in their proportion, was that of 1991*. Such a development is natural and reflects the process of intensification of competition in trade and industry, which makes them less attractive to entrepreneurs as well as the accumulation of capital ensuring the financial prerequisite for

establishing industrial companies requiring perceptibly higher amounts of capital as compared to those in services and trade.

As related to the legal status of the trading companies, the situation is shown in a summarised form in Figure 7. From its examination, it results that out of the 5 types of trading company laid down by law, there are 4 in the sample. None of the investigated firms belongs to the class of limited partnerships. As one may expect, *pride of place is taken by limited liability companies (in the Romanian acronym, SRL's) with a proportion of over 90%*.

The second place is taken by general partnerships (in the Romanian acronym, S.N.C's). A small number, i.e. 15 firms, are public companies (in the Romanian acronym, S.A.'s), out of which 3 carry on their activity in the field of trade, and 8 in trade combined with other fields. The other S.A.'s, with the exception of one operating in industry, are in the field of services.

5. Capital and owners of firms

A variety of situations can also be found relative to the ownership of the firm's capital. Only *in 44% of the investigated firms 1 of the entrepreneurs owns over 75% of the firm's capital*, and in 8.5% of them between 51 and 75%. This structure is to some extent an expression of the shortage of capital, especially if we take into account that most of them are of small and medium size.

Another aspect to notice is that *in the firms in which the entrepreneur managing it is female the weight of her participation in the firm's capital is often small*, thus, in about 40% of the firms in which the main shareholder is the owner of below 25% of the total capital, the owner is female, this situation can be explained by the fact that in general women are less willing to take run risks. As a consequence, also in this case female entrepreneurs preferred having business partners in order, on the other hand, to share responsibilities, thus having a higher degree of confidence when third parties are involved.

A certain correlation can be found between the entrepreneur's age and their share in the firm's capital. As a rule, *the older they are the larger the percentage of the firm's capital*. For example, 55% of the persons over 50 years of age and 51% of the ones aged between 41 and 50 years own above 75% of the firm's capital as against only 33% corresponding to the entrepreneurs up to 30 years of age. The situation is fully explicable from the economic viewpoint. In order to open a business one needs money. Young persons are creative, they have ideas, many of them are higher education graduates and they have the ability to put them in practice but they have not the capital required. Those who, however, have a minimum capital seek partners for subscription up to the completion of the amount necessary for funding a business.

Concerning the correlation between the level of training of entrepreneurs and their participation in the firm's capital, the following surprising, at least at first sight, situation is found: over 80% of the entrepreneurs who attended the secondary school own a share of capital of over 75% and are followed by those having higher education and who hold over 75% of the firm's capital only in proportion of 24.6%. The conclusion to draw is that *the lower the level of education the more such entrepreneurs own of the firm's capital* and the less they accept to have partners in establishing firms.

6. Entrepreneurs' time budget

A telling indicator regarding the nature of private property and the degree of motivation in entrepreneurs' work is the number of hours devoted to their own firms. *84% of entrepreneurs work on an average over 40 hours a week, almost half of them - 47.5% devoting over 60 hours to their firms.* This factor accounts considerably for absolutely superior the economic achievements of private businesses as compared to those of state-owned enterprises. Entrepreneurs are also motivated in the existence of their own businesses as a consequence of the fact that they are masters of their own time and devote a large portion of to the strengthening and expansion of the firms as they are aware that the achievements of their economic activities are in direct proportion to their own efforts and corresponding time devoted.

The marital status of entrepreneurs does not differentiate them in a significant manner from the viewpoint of the volume of work. However, the figures concerning the correlation of the amount of work with the field of activity are surprising. Thus, *entrepreneurs who work in the industrial field work perceptibly less than those in the other fields.* For example, 61% of them work less than 20 hours a week. This can be accounted for by the fact that there is no demand in the market for their products or they do not possess enough raw materials to produce at least 40 hours a week.

A relatively large number of hours a week, *slightly exceeding 60 hours, is devoted to their firms by the entrepreneurship in the field of services and trade.* This is natural, as the business hours of trade firms are of about 10 hours a day. And entrepreneurs, besides selectively supervising the operations inside the firms, must be concerned with the successive supplies, at short intervals, as compared with the successive supplies, at short intervals, as compared to the case of the other branches, having in view the large amount of sales in various classes of goods. This involves seeking new supply markets, identifying new potential partners, contacting them, having negotiations and concluding the corresponding contracts.

7. Size of firms

We also investigated the indicators related to the turnover and number of employees of the firms under consideration. For this purpose, our analysis included the following intervals:

- 1992,
- 1993,
- forecasts for 1994,
- forecasts for the coming 5 years,
- ideal forecasts.

For the *turnover figures*, data were solicited for 1992 and for 1993, in order to compare the achievement of the previous year with the forecast ones of the current year. The forecasts for 1994 as well as those for the coming 5 years prove the capability of entrepreneurs to make forecasts, an activity which involves taking into consideration several endogenous and exogenous factors and variables of the firms.

The largest share, 43% is held by the firms which in 1992 achieved a turnover of approximately 10 million Lei, followed by 29,5% of the businesses which had a turnover ranging between 11 and 100 million Lei. 9). 3% was achieved by firms having below 1 million Lei.

A certain change is found for 1993, which may be caused by the high of inflation, which was taken into consideration by entrepreneurs, other doubled by their ambition and determination to make an additional effort for the increase in their incomes. Thus, if in 1992 43% of entrepreneurs had a turnover ranging from 1 to 10 million Lei, in 1993 their shares decreased to 34% but, however, there was an increase in the percentage of entrepreneurs with a turnover in the range of 11 to 100 million Lei from 29% in 1992 to 41,8% in 1993.

The newly established private firms have a special social importance as they employ labour and this is all the more so as at present Romania is facing a high rate of unemployment. Relative to the number of employees, it was forecast to be over 50 in 21,9 of the cases, but it was achieved in only 6,9% of them. A large weight of firms with a number of 1 to 5 employees was found in 53,1%, followed by those with 6 to 10 employees in 17,7% of the cases.

For 1994, a proportions of 55,7% of the businesses suggested an increase in their number of employees of up to 50.

The opinions concerning the number of employees do not show marked differences depending on the years of the employers' professional experience or the number of hours worked in their firms but are differentiated by the legal status of the firms. As SRL's are predominant, the structure of the number of employees is the following: in 48,7% of the cases they have up to 5 employees, in 33,16% of the cases they have up to 20 employees and in only 6,7% of the cases number of employees exceeds 50.

This situation is natural as the largest weight in SRL's is held by trading companies, where as a rule it is not necessary to have a large number of employees. In industry and construction, 33,16% of the firms have up to 20 employees, and in 6,7% of them they have above 50 employees.

We, therefore, have found that the number of places of employment taken is relatively small as compared to the number of firms. Possible explanations are:

- the small volume of activity of the firms, even if they are in the industrial field and the small size in frequent cases as they are at incipient stages of a probable future development;
- the small floor space where they carry on their activities;
- the complex and difficult circumstantial conditions which do not a rapid development of businesses.

8. Complex motivations for becoming an entrepreneur

In order to understand, stimulated and develop the phenomenon of entrepreneurship - the real motive force of the achievement of a genuine market economy - it is essential to know the motivations which caused the present entrepreneurs to run the risks of establishing small and

medium size private businesses in Romania. For this purpose, the entrepreneurs investigated stated their opinions on 14 classes of motivations generally considered by specialists throughout the world as common.

Motivation 1: Development and application of an idea of a product or a business

Out of the 14 elements considered, the motivation mentioned above was the one most frequently considered as a priority by the examined entrepreneurs. *86,4% of them appreciated it as a decisive element determining them to establish a private firm.* Such a motivation derives from the fact that their previous places of employment, almost all of them state-owned enterprises and institutions, had not offered them the opportunity to show their initiative, to materialise their economic ideas or to achieve some products. Of course, such a situation is a consequence of the kind of activity carried on in organisations based on state ownership which, by its very nature, is not entrepreneurial.

Motivation 2: Work with selected persons

The frequency with which this motivation was considered as a priority - in 84,3% of the total of responses - is surprising at first sight. In fact, such a position is very telling. It highlights the major role for each individual played by the people with whom he carries most of his activity during a day. In the second place, this shows in an indirect way but very convincingly that a good part of the present entrepreneurs were compelled in the preceding period to work with people with whom from the professional intensity of the variable "persons with whom one collaborates daily" an influence - not very great - has the level of training. It was found that *entrepreneurs with a lower level of training assign a smaller weight to this factors.* Thus, entrepreneurs who were general school leavers considered it in a proportion of only 66% as being prevalent in the choice of persons with whom he was to work in the substantiation of the decision to start a business.

Motivation 3: Personal and family security

This motivation falls in the class of those of a human nature as well. The percentage of entrepreneurs *who placed it first is 83,7%.* The explanations for the amplitude of this option lies no doubt in the uncertainties sweeping over our daily lives in this period of transition as well as in the fact that state enterprises especially due to their poor economic condition do not offer the security of a safe place of employment. As a consequence, the persons who had the courage and, of course, a minimum of financial and/or material resources carry on their own economic activities which ensure them independence and, at the same time, a feeling of security for themselves and for their families. The priority of this factor proves how intensely insecurity and risk are felt by the population.

Motivation 4: Self-achievement

We find full congruence with the previous motivations here. In as many as *81,2%* of the cases, the achievement of the status of entrepreneur with its complex implications was chiefly caused by the necessity for acquiring *a feeling of self-achievement.* What underlies this option is obvious: for this class of persons the previous places of employment had not afforded them the essential and motivating feeling for each individual of self-achievement. Without generalising, such a situation is telling very much about the preceding state of mind and the preceding state

of mind and the condition of personal involvement of a portion of the population under the conditions of the "multilaterally developed socialist society".

Motivation 5: Better earnings

Placing the motivation "obtaining better earnings" in the 5th position is, to be sure, not surprising. In as many as 79,5% of the cases, the interviewed persons considered as *a priority the size of personal incomes*. When we interpret this figure, it is necessary to take into account some elements. In the first place, the difference from the previous motivations is not large, only some percentage points. In the second place, Romanian entrepreneurs lived fully or almost fully in Communistic type society, where an intensive campaign was waged against those who had large incomes, against "exploiters", which has left marks in each individual, at least on the lane of the legitimacy of obtaining large amounts of money. Hence, some understatement towards other people and/or towards themselves in a part of the entrepreneurs in asserting the priority of acquiring their earnings. In the third place, there is no contradiction with the preceding motivations. For entrepreneurs who want to achieve something in life, the content of their activity, the environment of their work and the results on the plane of their own status and that of their families can often be the same, or even more important than immediate pecuniary earnings.

To this conclusion also leads the analysis of the influence of the level of training of entrepreneurs. Those *with a lower level of training considered personal earning as the most important factors - 100%* of the entrepreneurs having general school education. Instead, the other classes, with university level and postgraduate studies gave priority to the other motivations (1 to 4) with a high frequency.

Various complementary motivations

We included in the class of complementary motivations the following:

- the desire to have more flexibility in one's personal and family life - 76,9%;
- the desire to be master of one's own time - 74,5%;
- the wish to have the opportunity to manage rather than be managed - 72,9%;
- the contribution to the welfare of the community in which they live - 60,6%;
- the wish to seize the opportunity arisen - 55,5%;
- the desire to be respected by friends - 55,2%;
- the wish to rise to a higher rank in society - 50%;
- the wish to a tinge of variety and adventure in one's work - 46,5%;
- the frustrations caused by one's former job - 36,5%.

As resulting from our reading them, the motivations have a common point: the relation between the individual and his environment, with the concomitant placing of some important elements of it in the first place such as society, friends, circumstantial opportunities or social position.

9. Priority directions of action

Starting from the premise that the efficiency of each firm is conditioned to a considerable extent by the anticipation and preparation of one's own future, we suggested to the entrepreneurs to pronounce themselves on the possible activities in their firms in the years to come. This enables us to outline some defining features in the entrepreneurial behaviour.

A. *Precedence of trade actions*

A first group of priorities of development is related to:

- * adding a new product or service;
- * selling in a new market;
- * extending the channels of distribution;
- * expanding promotional and advertising activities;
- * research into new markets.

This group includes activities specific to the field of trade and, to a large extent, of marketing, whose existence is absolutely necessary but not sufficient for the development of a firm. Entrepreneurs who did not set for themselves the listed activities as short or medium term objectives are to be found on an average in 81,5% of the cases. It is a positive aspect proving that private businesses have integrated into the dynamism of the market economy, that their managers are aware that in order to set themselves in the market, to overcome competition, it is essential to expand their activities by adding new products. Likewise, the research into new markets with a view to identifying new outlets for their products as well as a corresponding promotional and advertising activity lead to superior economic achievements.

B. *Stress on technical and computer endowment*

Another group of priorities is related to funding for:

- * replacement of present equipment - 58,7%;
- * acquisition of new equipment - 76,7%;
- * computer processing of running operations - 67,7%;
- * development of the computer system - 62,5%;
- * adding new working floor space - 81,5%

The percentages above are relevant for the sharpness of the problems related to production equipment and floor space and computer endowment of firms. Their substantial expansion and improvement is essential for the development of firms. There is an ever better understanding of the fact that ensuring operative and relevant information and increasing the degree of substantiation of decisions and actions of their implementation depend in a decisive way on the computer potential of the firm.

In this context, we stress the fact that about 62,5% of the entrepreneurs opt for the development of the computer system, which proves that there is already such endowment.

The option for renewing equipment is also caused by the fact that most of the entrepreneurs are convinced that their use is efficient and, on the other hand, that the financial achievements of the firm enable them to allocate funds for future development.

The 41,3% of the entrepreneurs who did not intend to replace their present computer equipment, as a rule less effective, was found in small firms, without large financial means and whose employers often have secondary school education.

C. Problems of the human potential

Another major direction of development is related to the ensurance of superior human resources. The priorities in were employing specialist and in the further training of employees were major in 75,5% of the responses of the entrepreneur. To this added the search for specialists in consulting - 59,9%. Such an operation of entrepreneurs is edifying to the effect of accepting reality that in order to carry on superior activities and to achieve competitive economic results it is necessary to have a well-trained team. For this purpose, it is to be sure necessary to allocate considerable funds that will recovered from the additional profits to the achievement of which they will contribute.

In conclusion, the interviewed entrepreneurs show a *steady concern with carrying on multiple actions of development in the years to come* and, what is also positive, within a multidimensional view: marketing, technology, computer systems training and finances.

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The Small Business and Entrepreneurship in Bulgaria and Germany

RADOSTINA BAKARDJIEVA

The role of the entrepreneurship and the small business is of great importance as far as the restructuring of the national economy is concerned. This is a question of present interest in all ex-socialist countries which are in a state of transition to market economy. The disintegration of CMEA and its research structures prevents the collecting of information about the current economic processes and phenomena. This means that each country now uses different criteria for evaluation which additionally complicates the comparative analysis. At the same time, the positive experience in the different countries should be thoroughly studied and applied after careful evaluation of the specific conditions. In this connection our aim is on the basis of the available statistic data to make an attempt for a comparative analysis of the current processes and extent of the entrepreneur activity in Bulgaria and Germany respectively.

I. Specificity of the frame conditions

The frame conditions (macroeconomic, sociopolitic, financial and infrastructural) in Central and Eastern Europe are absolutely different. While Poland, Hungary and the Czech Republic are quite ahead with the market reform, Bulgaria, Romania and Albania are in a state of stagnation; in these countries the transition to market economy is being carried out at a very slow pace. This conclusion is absolutely valid especially in the context of a given comparative analysis between Bulgaria and East Germany which has become an integral part of the West German economy i.e. an integral part of the most powerful European economy. The basic reason for this is to be found firstly in the great difference in the general frame for the establishment of small and middle firms in this country and in Germany and secondly in the different methods of stimulating the entrepreneur.

Despite the fact that the transition to market economy in Bulgaria began five years ago, still there is no established legislative and institutional mechanism for stimulating the small business. There is almost no intervention in support of the small and middle firms. There is no institution (state or social) to control the entrepreneur processes in this country. The want of specialised state programs for financial support of the entrepreneur initiatives can be felt. Practically, the state and private banks are extremely reserved as to the support of entrepreneur initiatives. The unemployed as well as the more qualified receive an unsatisfactory training in entrepreneurship.

As a country with a long established powerful sector of small and middle firms, in Germany functions an effective system for structuring and supporting of the entrepreneurship and small business. After the Reunification this system encompassed the ex-German Democratic Republic as well. The effective functioning of the small and middle firms is generally viewed as the core of the restructuring in the New Eastern Provinces. To the macroeconomic frame for stimulating of the sector in question could be related:

- a) purposive policy of encouraging the growth of the small and middle firms and supporting the entrepreneurship;
- b) availability of a number of specialised programmes (of federal, regional and local level) for financial stimulation of entrepreneur initiatives;
- c) functioning of specialised bank institutions for crediting of newly established firms;
- d) consulting activity on the part of the industrial and commercial chambers;
- e) availability of different unions between the entrepreneur and the small and middle firms for protection of their interests.

II. Comparative analysis of the entrepreneur activity in Bulgaria and Germany

1. Size and age of the small firms

The dynamics of the process of formation of small firms in Bulgaria and Germany for the period 1990-94 is quite stable. For obvious reasons the activity is much more stronger in the ex-GDR in comparison with the old provinces of the Federation. The basic reasons for this are the disintegration of the ex-state owned industries and the high rate of unemployment.

By the end of 1992 according to the East Germany statistics there are 7500 new small firms. This process remains stable in 1993 when a number of about 6900 small firms is registered, of which 4100 are privatised including about 1200 firms created on the basis of Management- Buy-Out/Management-Buy-In method. The number of the restituted firms in the ex-GDR is about 2800 [1]. Moreover the largest part of them are small firms with less than twenty workers each. There is a clear trend of increasing the number of the small firms with less than 100 people in staff. Meanwhile the number of the middle and big firms is quickly decreasing.

The official statistics in Bulgaria for the same period of time reveals that the number of registered private firms increases from 24537 in 1989 to 353 449 in 1993 [2]. The relative share of those who are employed in the private sector of the national economy in 1993 is 28.3% [3]. The contribution in the private sector to the Gross Value Added in 1993 is 25% [4]. The tangible long-term assets in the private sector for the same year amount to 9 255 mln. BGL [5]. The largest part of private firms within the country are the middle and small ones. About 40% of the private firms in 1993 employ up to 5 workers each. The middle size companies employ from 20 to 100 people each and form about 58% of all the private firms. Only 2-3% of the private firms employ more than 100 people.

It is not surprising that the small firms in Germany are of longer experience than the Bulgarian, since the small business was deregulated even under the conditions in the ex-GDR. The small craftsman firms were never destroyed there and have long experience and time-honoured traditions.

The small business was widely spread especially in the sphere of trade and services in the previous years.

2. *Competition and Markets*

One of the basic problems in the business strategy of the small firms is the alternation of their market orientation. It is mainly the foreign trade barriers that prevent the production increase. From this perspective we could say that this country is in a quite adverse position because of its strong commitment to the ex-members of CMEA. It becomes clear from the statistic data that in 1993 the total import (\$ 5 120 mln.) is rather large in comparison with the export (\$ 3 768 mln). This breakdown will become much more evident if we make a comparison with 1990 when the export and import amounted to the value \$13 366 mln. and \$ 13 057 mln, respectively. However, Bulgarian foreign-economic positions are much more stronger than they were in 1991 when the export was reduced to the value of \$ 3 433 mln while the import to the value of \$ 2 700 mln [6].

The foreign trade positions of Germany are much more stable. The total export in 1993 amounts to the value of \$ 368 620 mln while the import amounts to the value of \$332 663. In comparison with 1991 when the export amounts to \$ 402 845 mln and the import to \$ 389 206 mln, there is a kind of breakdown but it is very slight compared to that in Bulgaria. Moreover, the foreign trade balance of Germany is positive and the export prevails the import [7].

It is another story that the active participation of the business on a micro level in the foreign economic relations can activate the export-oriented character of the national economy. This would increase the opportunities for the Bulgarian firms to win a position at the markets of the European Community. According to the statistics data Bulgarian export for Germany has decreased from 940.8 mln. DM in 1990 to 563.3 mln. DM in 1993 [8]. Moreover, as the former links of Bulgarian firms with their East German partners are destroyed, there is greater activity on the side of the West German firms to establish anew the contact with our firms. That is why the Bulgarian export should be encouraged and new technologies introduced in Bulgaria.

3. *The Entrepreneur*

It is very difficult to reach at a general conclusion about the social background of the Entrepreneur. It seems that in Bulgaria most of them come from the ex-communist party members because of the peculiarities of the privatisation processes within the country. There are really few examples of legal transformation of property but in the sphere of services and the food industry. The closer relation of the German Entrepreneur with the production is easily explained with the time-honoured traditions in craftsmanship and the better attitude towards the small business.

The statistics makes its obvious that in 1993 there are 37 701 premises restituted at the value of 8 503 550 BGL [9]. Still, those that are directly related to production are mostly a passive source of income for their owners rather than a cause for higher motivation for the entrepreneur activity on the part of the inheritors.

One of the reasons for the huge increase in the number of the small firms is the high unemployment rate. The number of the unemployed in the old provinces in 1990 is 1 883 147 (7.2%) and in 1993 it is already 2 270 349 (8.2%). In the ex-GDR the number of the unemployed is 912 838 (10.3%) in 1991 and it is 1 148 792 (15.3%) in 1993.

The number of the partially employed in the old federation is 766 935 in 1993 and it is 181 428 in the ex-GDR. The unemployment rate among the women is relatively higher than that of men [10]. In 1993 the number of the unemployed women in West Germany, ex-GDR and Bulgaria is respectively 993 261, 734 320 and 327 740 [11].

4. *Property and Control*

The existing judicial forms in the German firms reveal that the new structures follow the experience of close counteragents. That is why the share of the Limited Liability Companies and the General Partnerships is relatively bigger than that of the others. The number of the Limited Liability Companies is 433 731 in 1991 and 549 659 in 1992, and their capital is respectively 195 815 mln. DM and 246 114 mln. DM. Most of the Limited Liability Companies in Germany are dealing with various services. Their number is 163 773 in 1990 and 208 278 in 1991. The number of the joint-stock companies including that of the General Partnerships with stock holders for the same period is increased from 2 682 to 3 219 and their capital is respectively increased from 149 109 mln. DM to 173 814 mln. DM [12].

There are 341 818 Sole Proprietorships registered in Bulgaria in 1994, 37 187 General Partnerships, 21 887 Limited Liability Companies, 1391 joint-stock companies. [13].

Another confirmation of our thesis is that most of the new firms are operationally independent. In East Germany about 68% of the firms are virtually independent and 10% are associated. 22% of the new firms are created as associated to older ones. All these prove that the West German firms invest in their East German counteragents and thus secure their own growth. Through this process the East German firms are given a good start and an entrepreneurship is formed.

5. *Spheres of Activity. Economic Potential*

When comparing the data for Germany and Bulgaria there are certain similarities in the activities of the new firms which are self-evident. A common tendency is that both German and Bulgarian Entrepreneur prefer to direct their efforts mainly to the trade and services and somehow neglect the sphere of production. This is due to the difficulties in investment, the macroeconomic instability and insufficiency of capital of the entrepreneur himself. One of the main problems in Germany lies in the supply of costly modern technologies. About 53% of the newly registered German firms are dealing with services. More than 41% of the firms are dealing with trade and 2-3% are in the construction business. Only 3-4% of the East German firms are dealing with production.

The situation in Bulgaria is similar. Services and trade are at the top of the Entrepreneur attention with respectively 45% and 32%. The sales of foods and non-foods in the private sector have increased from 31 mln. BGL in 1989 to 71 347 mln. BGL in 1993 [14]. The Entrepreneur activity in the sphere of construction is increased with approximately 15%. The production level in the private construction business increases from 379.3 mln. BGL in 1989 to 13 972.6 mln. BGL in 1993 [15]. The new firms in the sphere of production are about 12% of all, in the transport they are about 4.5% and in all other activities they are approximately 10%. The private farms in 1993 have cultivated 1 386 000 hectares of land and only 635 000 in 1989 [16].

The amount of the initial finances of a firm is of great importance for its economic potential. Its future competition thoroughly depends on it. Moreover, one has to have in mind that the firms dealing with services require less money than those dealing with production since the latter have to rely on long-term material actives. In East Germany most of the smaller firms are registered with the initial capital of about 10 000 DM. Still, some firms succeed in their business even with 100 DM initial capital. These usually concern highly qualified experts in finances, insurance, etc.

The Bulgarian Entrepreneurs usually start with about 5000 - 15 000 BGL. There are not enough facts to prove the difference in the investment policy in both countries. Greater discrepancies are revealed later in the analysis of the initial capital investments.

For example about 25% of the German Entrepreneur have the opportunity to invest 50-100 000 DM and about 10% even more than 100 000 DM. The information on this matter in Bulgaria is insufficient and contradictory. The official statistics does not posses reliable facts. The annual return of capital varies widely from 150 000 to 2 000 000 BGL.

6. *Business Contacts*

An important element of the inter-firm relations are the contacts for fulfilling certain activity or task (subcontract). In the period of transition to a market economy the prosperity of the small firms depends greatly on the successful decentralisation of the large factories, on the formation of a flexible system of supply under the new market conditions. That is why it is of vital importance for the smaller firms to fit into the economic structure of the national economy and to be integrated on all different levels of industrial relations, especially as far as competition is concerned. Certainly, the deeper German experience on that matter is acknowledged. We should pay special attention to the higher business ethics and time-honoured traditions.

7. *Financing*

The data available for the equity and liabilities capital in the start of a new firm is rather different. About 70% of the German Entrepreneurs can invest equity capital of approximately 20 000 DM. Still, one has to have in mind the various sources of investment available in the different government programmes and funds for subsidising smaller firms in Germany. These provide relative freedom to the entrepreneur even if his own equity capital is not enough.

In Bulgaria the situation is just the opposite. Most Bulgarian Entrepreneur invest their own equity capital and will rather receive loans from their relatives. Recently, about 60% of the private firms rely on credits as a means of achieving certain business goals. The balance of the private firms by the end of 1993 reveals that the ratio between the equity and the liabilities capital is 29.6% (11 285.5 mln. BGL) to 66.4% (25 348.7 mln. BGL). The loans received by the private firms amount to 8 818.2 mln. BGL including 5 412.2 short-term and 3 403.1 mln. BGL long-term loans [17].

8. *Difficulties in Establishing and Developing the Small Firms*

Having in mind the initial conditions for the small business in Bulgaria, it is hardly surprising that there is almost no support for it in its beginning stage. The taxes prove to be unbearable for the small Entrepreneurship Bulgarian firms are expected to resist: profit tax at the rate of 40%, value added tax at the rate of 18%, municipality tax at the rate of 10%, infrastructure tax at the rate of 2%. In contrast to this the total assessment in Germany does not exceed 25%-30% of their incomes. What is more, taking into account the high price of the credit resource defined

by the upper limits of the interest rates, we arrive at a conclusion that it is the economic conditions that restrict the development of the small business in this country. In order to provoke the interest in the small business and in the privatising of different activities or just to revive the attachment to the private property, we should take preliminary cares. The success of such an enterprise will depend on the specific industrial preconditions as well as on the social support.

Obviously, the financial support is the most important among the incentives. The financial aid of the Ministry of Industry as well as the Fund middle and small firms (established in 1992) are used without any programme for work. Only 15 projects of 17.5 mln. BGL all have been credited and the issued subsidies are no more than 1 500 000 BGL. That is why it is of little importance for the entrepreneurship [18].

The macroeconomic decisions for support of the smaller firms in Germany are strictly defined, especially those concerning the ex-GDR. There are 750 mln. DM granted for crediting in 1992. [19] This trend remains stable in the period 1993-95. Smaller innovative firms of greater risk have the priority in the financial support. Particularly important is the initial two-year period of low interest for the new firms. In agriculture, trade and craftsmanship there is a minimum profit of 50 000 DM which is free from taxation [20]. All the investments in the ex-GDR after 1990 directed to the production of new-technology export-oriented goods undergo a special consumption of basic funds. Most of the new entrepreneurs are specially trained in management of small and middle firms. These new firms are granted the right of free consultations for the first five-year period. All this illustrates the significant support to the smaller firms in Germany.

The positive experience in the support and economic incentives for the smaller firms in Germany should be carefully studied. Having in mind the conditions typical for Bulgaria we have to consider which of the elements of the German experience can be appropriate to adopt.

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The Entrepreneurship in the Social Sphere: A Dim Alternative

EVGENIA DELCHEVA

While an industrial society defines the standard of living by the quantity of goods, the post-industrial society is concerned with the quality of life, as measured by services such as health, education, recreation...

Daniel Bell

The problem for the former socialistic countries especially Bulgaria is that they have to solve simultaneously pre-industrial (agriculture, mining), industrial and post-industrial issues. The last of them are concerned with delivering and extending of social and cultural sphere activities. Despite undoubted priority on the primary production (extractive and industrial goods producing) the development stage of services refining and extending human capacities is an important indicator for civilising and European attendance.

In the great scarcity of public funds for social and cultural sphere operating, *the entrepreneurship should be necessary and willing alternative*. The purpose of this paper is to highlight and discuss the nature, modes, determinants, dimensions and competitive service strategies of the entrepreneurship in the main sectors of social sphere in Bulgaria - health care, social insurance, recreation and education during the period 1990-199

Nature and modes

For our purpose, however, the term "entrepreneurship in the social sphere" means running of a own business and/or organisation taking the financial risks in the personal and public services with social nature - health care, social care and insurance, recreation, education and other.

Usually the entrepreneurship is assimilated to private initiative and private property. Some authors (Saltman, Enthoven) highlight "public competition model" in social sphere, in which public entrepreneurs are operating. Advocating the classic notion (private form), consider the financial risk taken by private entrepreneur as key feature.

We differ *two modes of entrepreneurship according to objective function: for profit and non profit organisations and activities*. In dissimilarity of developed countries, for profit function is predominating for private firms in Bulgarian social sphere (1, 2, 4, 10, 13). Clearly this study is concentrated upon for profit entrepreneurship.

With regard to the level of organising of entrepreneurial structure it is possible to separate three others modes: individual (self-employees, private practitioners), group (group practice of independent entrepreneurs) and institutional entrepreneurship (firms, companies, corporations, health care establishment, schools and others.).

Depending on the information scarcity our analysis is focused mainly on institutional mode of entrepreneurship and with regard to individual medical and dental practitioners.

Macro environment and determinants

The macro environment in Bulgaria is too unfavourable for entrepreneurial development in the social area. Some negative conditions are following:

economic crisis in the primary production;

- social crisis expressing in worsened living standard, high unemployment, decreased income proportion spent on the necessities of health, education, culture;
- financial and legislative uncertainty repulsive potential investors;
- low net internal return of the private capital in traditionally public providing sectors (health care, social insurance, education) and other.

Determinants of the entrepreneurship are governmental influences and regulations. Some of them have supporting meaning (permissions of private practice, public funding) and the others operate as barriers or obstacles (extra regulation or under regulation).

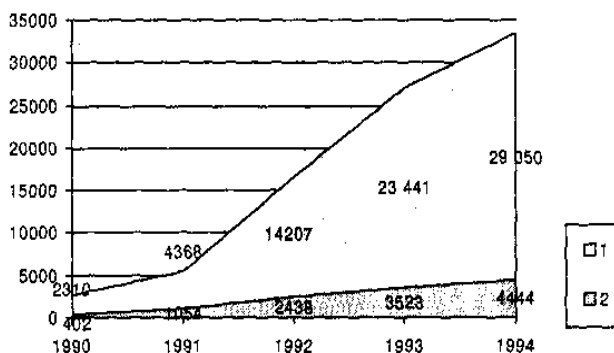
Some studies on market diffusion in the social and cultural area showed that Bulgaria uses extra liberal approach founded on the lack of necessary regulation - market information, pricing control, quality monitoring and others. (1, 2, 3, 4, 5). For example the absence of regulation of higher education led to escalation of specialities, faculties and higher schools at worsen training quality. As well it was permitted private medical practice without necessary regulation. The state interventions are extremely important in the refining and promoting human capacities area. Moreover the monopoly state reactions are justifiable to be delivered merit and public goods consumption on the equity criteria. It was reviewed that Bulgaria has not completed strategy and effective policy for market development and reforming of the social and cultural sectors (1, 2, 4, 5).

Extent and dynamics

We could define the entrepreneurship extent in the social sphere approximately because of insufficient statistical and research data. This analysis relays all available information sources: official statistics, target and research questionnaires as well presented papers at national conference "Social and cultural market: transition challenges" (1994).

The sizes of entrepreneurship vary across service subsectors, as shown on fig. 1, 2, 3, 4, 5 and 6.

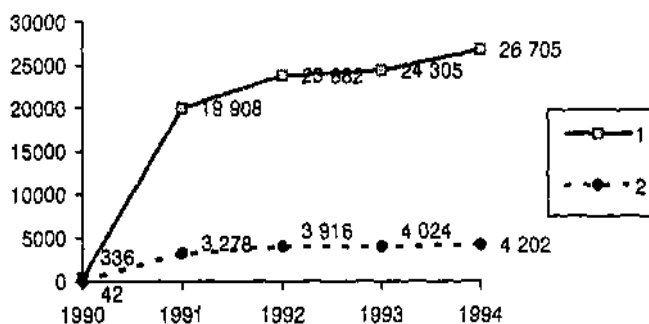
Figure 1 - Private firms in unmaterial sectors (1) and in main sectors of social sphere (2)



The most important findings are:

- the entrepreneurship extent in social sphere is permanently expanding especially after 1991, when was permitted private practice (fig. 1, 2, 3, 4, 5, 6);

Figure 2 • Public firms in unmaterial sectors (1) and in main sectors of social sphere (2)



- individual entrepreneurial mode is rapidly extended particular in health care and education. To 1994 82% of dentists and 38% of physicians are in private practice (fig. 3);

- the institutional mode is the real generator of this process. During the past 5 years more than 4000 new private firms are run in health care, social insurance, recreation, tourism and sport. These private firms enlarge 11 times in 1994 towards 1990. In comparison, the private national sectors rate (without trade accounting 60% of the whole private extent) is 8 times during the same period (fig. 1).

Figure 3 - Private practitioners

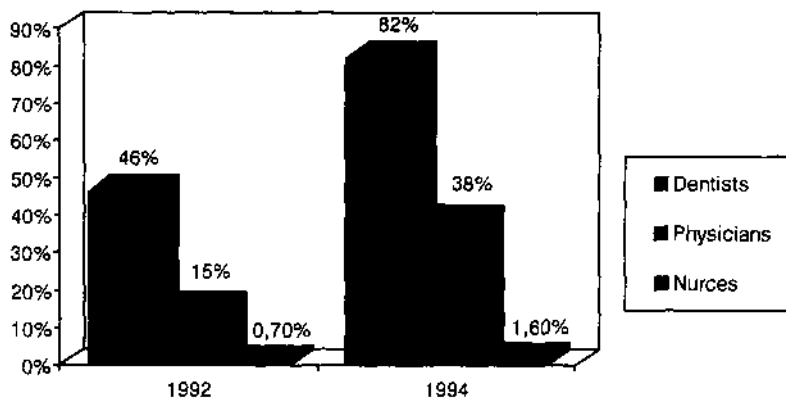
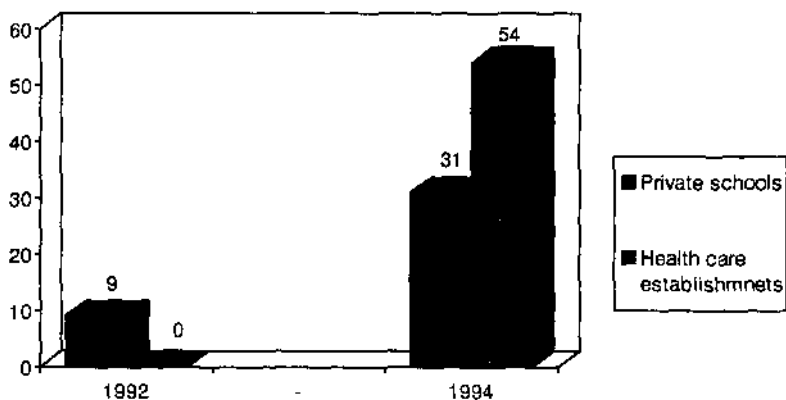


Figure 4 - Private schools and health care establishments



- the private firms in the majority of social services subsectors expand more rapidly than state firms. In 1994 the first rate is 6,7 and second rate - only 1,3 towards 1991 (the year of demonopolisation in some services) (fig. 2);

- the institutional entrepreneurship is more developed into auxiliary and economic activities of social subsectors. The private institutional sector into the main social services is more modest. In 1994 only 0,7% of all primary and secondary schools and 1% of all medical care facilities are private. The share of private hospitals is higher - about 5% of hospitals.

Figure 5 - Private and public drug distributors

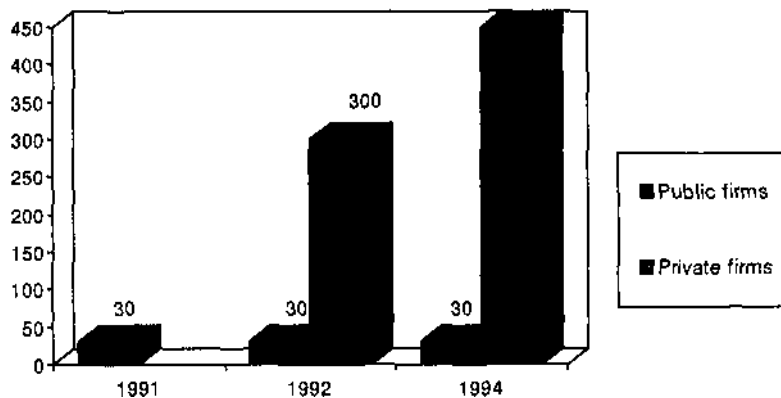
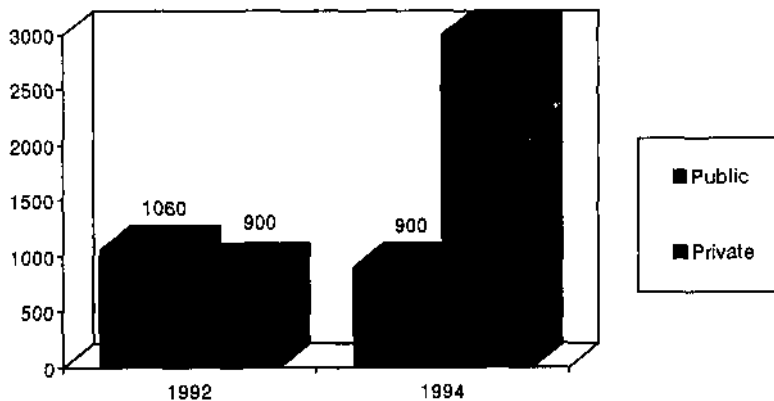


Figure 6 - Private and public pharmacies



- because of legislative determinants there are not private social and nursing homes yet. Despite the lack of insurance low and health insurance low, the majority of insurance companies supply commercial health insurance;

- - most effective development of the entrepreneurship could be seen into traditional market subsectors as recreation and drug distribution. Since 1989 the total public sector in this area was squeezed from 100% to more less than 50% to 1994. In 1994 the private pharmacies number is 3 times and the private drug distributors are 10 times more than the publics. The entrepreneurship development rate in these subsectors are one of the highest among the former COCOM countries (fig. 5,6).

Resources and activity

According to labour force engaged in the all private subjects in social sphere in Bulgaria, we could classify them as small business. The small private firms (not over 10 employees or part-timers) have dominated in these subsectors.

There are some evidences that financial and technology investment in own business in social area is too small and means low financial risk. Even in capital intensive services as medical care, the average investment ratio is 3400 lv per physician and 24000 lv per dentist in the beginning of the private practices (8). In spite of this pure picture, we could see extreme cases of high tech in private sector - scanners and first magnetic resonance imagine (we have not MRI in public health care).

It is important to pay attention to one interesting feature of the entrepreneurship in the main social services as medical, dental practice and teaching. This practice is an additional activity realised after state work time. For instance about 80% of registered private medical and dental practitioners have state work places (8).

One of results of public-private mix for same person and inadequate state regulation is black market incidence in the public sector. In 1994 every 3 citizen has paid fee or gift for state health care use (3).

Normatively the black market in public sector is ugly feature of market transition. In the same time, it is a compensatory of the lack of a legal market. From other side, the black market is an real obstacle to entrepreneurial development in social area because of price advantages.

Under low effective demand (supply is many times bigger than demand), the new private firms and practices realise insignificant activity in comparison with the public sector: 30-35 times less medical visits and 18 times less dental visits; 4-5 times less pupils in private schools (2, 7, 8).

The widest activity is developed by new private firms in traditional market sectors (drug distribution, recreation), in more competitive environment (higher education, pharmacies) and in running own business without the public sector alternative (health insurance).

Applied strategies

The three generic competitive strategies (after M. Porter classification: overall cost leadership, differentiation and market focus) are spontaneously used by private firms and practices in Bulgarian social sphere, more often in parallel (1, 2, 4, 5, 12). In the struggle for surviving such a growth strategy as differentiation is applied on the earl stage of life cycle.

It should be seen that focus strategy dominates in Bulgarian conditions. Specialised private schools, medical practices and health care establishments prevail over multiprofiled structures.

Between main private drug distributors is met product leadership, allowing monopoly actions (2, 4, 5, 8, 9).

The focus strategy is used very often to particular geographic market aiming monopoly and competitive advantages. An important competitive advantage towards the public sector is manifested better quality and attitude to clients.

The other common met service strategy is differentiation with many approaches: brand image (pharmaceutical firms), product differentiation (extending the package of services), technology innovation (hi-tech in diagnostic, modern equipment in fitness centres, multi-media in education), customer groups extending (private hospitals, health insurance companies), dealer network and others.

Unfavourable business conditions as well increased competition force the entrepreneurs to apply the third strategy - overall cost leadership also. It is expressed in the market price. We have evidences about price advantage of the small firms in social sphere. Successfully operating on the pharmaceutical market are those distributors which use economies of scope and perceive low transition cost (2, 9).

Interesting example of this strategy is using of pre-payment system by some medical care institutions, contributing for clear funding, cost and risk sharing with clients. This approach reminds of USA Health Maintenance Organisations but in fact there are more differences (2, 11).

Conclusion

The rapid appearance, extending sizes and manifested flexibility of the new private structures in social sphere are evidences for entrepreneurial spirit of the majority of Bulgarian brain workers. Because of insignificant activity and investment as well some market defects, the entrepreneurship in social area (excepting drug distribution and fitness centres) would not be a serious alternative of the vigorous public sector.

But it has some advantages including higher quality, courteous attitude, faster access to specialised service. In the traditional internal markets are achieved price advantages for the new private small firms.

The entrepreneurship in Bulgarian social sphere likes an orchestra performance for elite audience without conductor. But needs for a good music are more over and rest outside.

Then the first question is how to combine the private interest (making better music) with social benefit (completed market and satisfied needs). One possible solution is reforming of public sector and creating of internal market between public and private units. The introduction of social health insurance and voucher educational funding should contribute for more equivalent public/private competition.

The second question is how to conduct successfully the performance. For this purpose is necessary to build wide information system for three kinds of consumers: governmental bodies, providers of services and demanders. The state and public regulation of private social services sector is essential because in this area is focused the public interest of promoting and refining the most important production factor.

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National SME Policy and Education in Northern Ireland

MICHAEL BRENNAN

Introduction

In terms of National SME policies and education Northern Ireland could be seen to have had a distinctive history within the European Union. This derives from a troubled past that severely hindered economic development together with the creation of an SME support network that is, it could be argued, pioneering with the United Kingdom.

Currently SMEs in Northern Ireland are faced with major opportunities and threats. This is due to a unique period of change that has come about with the apparent ending of terrorism and social unrest in August 1994.

In essence the economic "playing field" has and will continue to be radically altered as external investment is attracted into the country and newly confident local business begin to "gear-up" for an anticipated surge in local as well as international demand.

On the down-side however is the increasing realisation that SMEs that grew as part of the security situation will face an uncertain future. This will be combined with a reduction in security force personnel and the consequent loss of income to the local economy.

Conceptually the determinants and dynamics of national advantage have been identified by Michael Porter (1990) as being:

- factor conditions, e.g. skilled labour and infrastructure,
- home demand conditions,
- the presence or absence of related and supporting industries and
- firm strategy, structure and rivalry.

In Northern Ireland these factors have been depressed and inhibited due to the unsettled social situation and the small local economy. The factors have also been distorted due to the nature of the high level of social and economic support measures that were implemented through successive British Government policy makers.

As the factor conditions in a mutually reinforcing system then clearly the opening-up of the economy combined with a rapidly changing government policy agenda will create a dynamic business environment. The challenge for SMEs is to adjust to the new conditions and exploit opportunities of risk stagnation and an uncertain future.

Northern Ireland - Key Economic Characteristics

In the European Union context Northern Ireland is categorised as an objective one region that warrants enhanced social and economic assistance.

GDP per capita estimates in 1990 placed the Province 49 in a list of 62 European regions. (Source: Rapid Reports, Regions, 1993: 1, Eurostat).

There is a population of 1.6 million with a birth rate of 14.7 per 1000 inhabitants - the highest in Europe. However the population increase has actually been closely in line with the UK average due to continual migration (Compton 1995).

In UK terms the Province is distinguished by the very high percentage of employees in public sector employment compared to other regions in the UK. Indeed as Table 1 below shows, this high public sector emphasis has increased significantly since the 1970's.

Table 1. Public Sector Employment as a Percentage of Employees in Employment

	1971	1981	1991
English Regions: South East	20.7	23.3	25.0
East Anglia	20.2	21.8	23.7
South West	21.0	24.0	26.2
West Midlands	15.7	20.3	23.5
East Midlands	17.0	19.6	23.3
Yorkshire & Humberside	16.5	21.2	25.1
North West	17.4	22.1	25.7
North	18.0	22.5	27.6
Wales	21.4	27.7	29.2
Scotland	19.1	24.9	28.4
Northern Ireland	23.1	36.5	38.9

(NIERC 1995)

In contrast the manufacturing sector in the province is small accounting for 19% of GDP, compared to a UK figure of 22%. Furthermore manufacturing to be concentrated in low technology industries especially when compared to other constituent countries of the UK

Table 2. Employment in High, Medium and Low Technology Industries

Technological intensity	% of Manufacturing Employment in: Each Technology Industry Grouping in:			
	N. Ireland	Scotland	Wales	UK
HIGH Total	17.1	18.6	23.7	19.4
Aerospace	8.0	2.2	3.8	3.3
Office Machines, Computers	0.1	2.7	1.3	1.6
Electrical & Electronic Engineering	7.6	10.8	15.5	11.0
Pharmaceuticals	0.4	1.5	1.5	1.7
Instruments	1.0	1.4	1.5	1.8
MEDIUM Total	16.7	24.3	28.4	30.9
Chemicals	2.3	3.3	3.5	4.6
Automobiles	2.7	1.3	4.8	4.9
Other Manufacturing	0.5	0.9	2.9	1.6
Mechanical Engineering	7.3	14.9	9.2	14.6
Rubber, Plastics	4.0	3.3	5.4	4.3
Non-Ferrous Metals	0.0	0.6	2.6	1.1
LOW Total	65.5	56.9	47.2	49.1
Non-Metallic Mineral Products	5.7	3.6	4.3	4.7
Food, Drink & Tobacco	18.2	17.4	9.1	10.6
Shipbuilding	2.4	3.4	0.2	1.0
Ferrous Metals	0.3	2.1	9.6	2.0
Fabricated Metal Products	1.9	4.4	5.7	6.3
Paper, Printing	5.7	8.6	6.4	9.4
Timber, Wooden Furniture	5.1	4.6	5.2	4.8
Textiles, Clothing, Footwear	26.3	12.8	6.8	10.2

(NIERC 1993)

A major review and identification of barriers to economic growth was undertaken by the British Government in 1987= This identified five factors that would need to be addressed:

Table 3. Barriers to Economic Growth

- 1 Lack of an enterprising tradition
- 2 Deficiencies in training, work and managerial competencies
- 3 Distance from key markets
- 4 Small size of local market
- 5 Small manufacturing sector

(Source: Pathfinder Report 1987)

In terms of SME development the following additional barriers to start-up and growth were identified.

Table 4. Barriers to SME Start-Up and Growth

1	Lack of business information
2	Few practical business skills
3	Financial gap
4	Inappropriate premises
5	Poor understanding of the market
6	Limited product/service development

(Source: LEDU 1990-93 Local Enterprise Development Unit. Various annual reports)

SME Policy Measures

Policy measures implemented as a result of the review of barriers to growth have changed significantly since the 1980's. Originally such policies focused on 'Job Created' as a primary outcome of assistance - mainly the awarding of grants.

Since 1990 the policy measures have shifted to enhancing the competitiveness of SMEs in the Province and internationally.

The actual measures are reviewed and changed regularly, however they tend to be targeted at the barriers identified in Table 4. i.e.

- the provision of business information
- access to advice from trained SME advisers
- training in enterprise and management development
- access to first-class premises and business services
- financial support - especially in terms of exporting and innovation.

A study of the usefulness of such assistance (Scott 1993) found evidence to suggest that a regime of intensive assistance to SMEs in Northern Ireland resulted in higher employment growth and higher survival rate of firms.

The study also showed that a small but significant number of supported SMEs tended to account for a substantial proportion of employment created in assisted small firms.

The author concluded that a "picking winners" strategy may be a more cost affective method for promoting growth among small firms.

SME Business Support Network

On a wider scale has been a realisation that SMEs in Northern Ireland are part of a large economic network of contacts and sources of help and assistance.

This network consists of Government agencies, Universities, public and private sectors. Perhaps the most encouraging aspect of this network is the realisation by the network components that it should be a mutually supporting relationship.

A particularly effective mechanism for developing and enhancing this network is through educational organisations and in particular through the work of NISBI - The Small Business Institute.

For example one element of the network the "Training and Employment Agency" works with NISBI as part of the Ulster Business School in improving business performance through management and work force development.

NISBI in effect acts as a catalyst linking government policy makers, university expertise and private sector goodwill. The outcome is the provision of education and training aimed at fostering a healthy SME environment while addressing the practical needs of SMEs in Northern Ireland.

NISBI - The Small Business Institute

Two aspects of NISBI's work are relevant to the theme of national SME policy and education.

The first concerns the provision of entrepreneurship education as an important component in some undergraduate and postgraduate courses within the university.

The objectives of such education are not primarily the creation of new SMEs - although this is an implicit, desired outcome. Entrepreneurship education aims to: enhance knowledge; develop understanding; change attitudes and develop skills in students. It does this through developing an opportunity orientation amongst students and creates a situation where students can undertake action learning while investigating new venture proposals (Brennan 1994)

The second aspect of NISBI's work is the provision of management development programmes for SMEs.

Such programmes change according to perceived market needs and demand. However they essentially address the needs of SMEs at different stages, i.e. start-up, development and growth.

Central to an understanding of how these programmes are designed is the belief that SME owner/managers i.e. entrepreneurs learn most effectively whenever the following factors are taken into account:

- entrepreneurs tend to be interested in practical problems and opportunities - rarely interested in concepts,
- their major focus is on the short-term,
- entrepreneurs prefer to learn by doing,

- personal and business goals are closely linked,
- information is most effectively absorbed from verbal sources.

The components of NISBI programmes tend therefore to consist of a combination of:

- a business needs and personal skills audit
- practical management training and developing seminars
- small group working
- company visits
- individual advice from advisers
- skills development
- compilation of business and feasibility plans
- intensive networking with individuals from relevant parts of the business support network especially bankers.

Future SME policy and education in Northern Ireland

The dramatic changes that are anticipated for the business environment in Northern Ireland will mean that there will be an even greater need for an up-dating of skills and an ability to react proactively to new opportunities.

Certainly on a UK-wide basis the government see SMEs as important and a generator of economic growth. A policy document ("Competitiveness Helping Smaller Firms") was published in May 1995 and detailed additional measures and funding for the SME sector.

The main disadvantages identified for SMEs when compared to larger firms were:

1. the higher relative burdens of regulation and costs of collecting taxes.
2. greater difficulties in raising external finance.
3. difficulties in penetrating overseas markets.
4. limitations in management skills.

Policy measures are to be implemented that specifically address these barriers.

For SMEs in Northern Ireland additional considerations will need to be taken into account.

Three major issues will involve:

1. a greater interest in investing in plant, machinery, research and development given the new confidence in longer term social and economic stability.
2. more integration into the European and indeed world economy as a result of changing perceptions regarding Northern Ireland as a place to do business. This will not only provide opportunities for local expansion but also export opportunities. Threats will also occur from foreign firms entering the local economy.

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3. increasing effectiveness of the existing government measures to stimulate economic growth and exporting - i.e. firms will be more willing to take risks.

(Source Górecki 1995)

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Small Business and Entrepreneurship in Three Dimensions: Education, Research, Consultancy

(The Case of Bulgaria in Process of Transformation)

KIRIL TODOROV

Introduction

A key moment in the unique and specific transition to market economy in East European countries is the formation of so-called dual economy by establishing strong small business (SB) sector. That is quite important having in mind state property is still dominant and there are too many large state enterprises (LSEs). That is also true for Bulgaria since the share of the state property is considerable and LSEs' number is much greater than in other post-communist countries. Small business and entrepreneurial activity can help to overcome the negative situation. Small business and entrepreneurship can speed up privatisation as they can do the things LSEs can not and also support LSEs in spheres they do not operate efficiently.

Everybody can see the tendency small and medium enterprises to grow up and it is them to consist the major part of the turnover in some sectors (trade, services, transport). The tendency is the very same in Bulgaria nevertheless there is insufficient legislation and underdeveloped infrastructure. Some data sources say there are over 360 000 SMEs and we know the number is quite changeable.

We can assume small business role in East European countries and Bulgaria in the following directions referred to state of economy and the transformation:

- property change and diversity;
- dynamising national economy and making its structure more rational;
- satisfaction of changeable market demand and small free niches;
- innovation generation and diffusion. We all know SMEs are innovators. In Bulgaria that is very important having in mind state property is dominant and yet there are LSEs technologically back-up with non-market behaviour;

- utilising local resources and materials in order to make economy competitive (at present 65% of resources are imported);
- solving important social issues (unemployment problem at first place). There are 800 000 people working in small business sector and that makes 1/4 of all employed;
- solving regional problems (some come because of collapse of COMECON). Some LSEs ceased functioning or reduced production after the socialist markets close down and that lead to close their subsidiaries in border regions;
- preserving and development of traditional crafts and arts in Bulgaria. That is very important regarding tourism development;
- better orientation and positions of Bulgaria in international aspect and more active participation in subcontracting, joint ventures, etc.
- Small business and entrepreneurial activity can be vital only in the presence of: good state policy (legislation, preferences, facilitation, etc.);
- entrepreneurship education system is to be well-developed (universities and business schools);
- developed system of small business and entrepreneurship research along with recommendations for future development (localised in universities and some special institutions);
- advanced infrastructure (primarily consultancy). SMEs need of consultancy because of their nature and limited resources. Moreover, consultant infrastructure is necessary in Bulgaria having in mind on-going transition and hardly predicted business environment. We must consider the fact most Bulgarian entrepreneurs come from LSEs and they possess some leftovers.

Further on in this paper we are going to comment the three stones - education, research and consultancy that support small business and entrepreneurship (fig. 1). The first and the most important one - state regulation of SMEs is subject to another discussion (you can follow the state's role in some other publications, e.g. I. Donald, 1993).

To be more clear the author presents some examples in the spheres where the three stones function best. The author is an actor in these examples and that proves their true nature.

Small business and entrepreneurship in three dimensions: education, research and consultancy

Education

Two facts are sure: there is need of entrepreneurial education and it has its own specificity (compared to management education e.g. that is referred to LSEs where the owner's function is divided from manager's functions). Koning, 1992 suggests there is the relation between SMEs and the personnel (firstly entrepreneur-manager):

- entrepreneur dominating role;

- limited human factor in SMEs;
- lack of functional specialisation;
- vulnerability to environment changes.

Here we can add the need of strategic vision; risk evaluation and risk taking; innovation propensity (in its five dimensions: product, technologies, market, consumers and organisation).

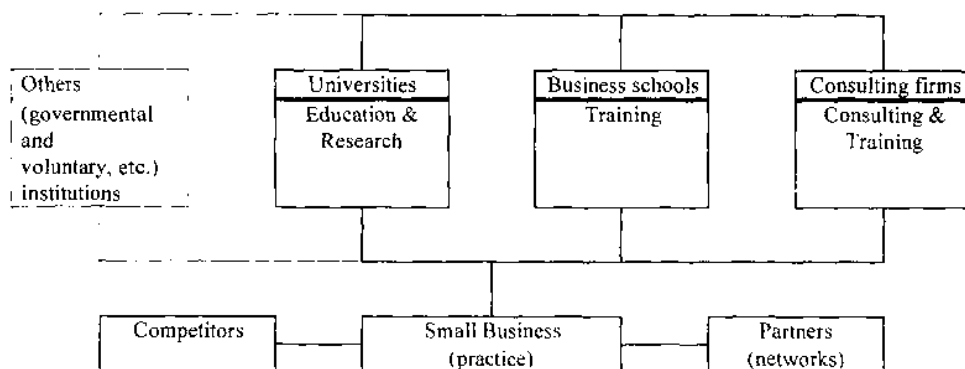


Figure 1. Three Dimensions of Small Business: Education, Research and Consultancy

On the other hand the need of entrepreneurial knowledge and skills can be defined according to business life-cycle stages:

- SMEs starting (idea generation and evaluation; choice of equipment; market positioning and competitors; costs and financing, etc.);
- management (budgeting; analysis and control; decision-making; communication; structuring; personnel management);
- growth/development (prognosis, strategies; cost of risk).

The knowledge and skills are necessary in any market economy, they have specificity in countries with unique transition and on the other hand there is need of combining them with more knowledge and skills (Todorov, 1993; Gibb, 1992). The new knowledge concern:

- readiness to work in unclear turbulent environment (state property, insufficient regulation, underdeveloped infrastructure);
- necessary knowledge and skills for successful transition from manager to entrepreneur, from working in state enterprise to owner-manager;
- necessary knowledge and skills fro successful transition from entrepreneur to manager (dividing the owner's functions from manager' functions and their combination when the company grows);

- acquiring knowledge and skills to motivate the personnel in specific transition conditions (old values begin to change and new values are not yet formed).

Acquiring entrepreneurial knowledge and skills in transition period is on at Universities (economic and technical ones) and special business schools. That education is not equally spread. E.g. while there are 300 universities in the USA who incorporate entrepreneurial education in programmes and there are less than 20 universities in Western Europe.

Naturally that education is yet in the very beginning in East Europe and Bulgaria. The beginner is Department of Industrial Business and Entrepreneurship at the University of National and World Economy in Sofia. Entrepreneurial programme was established in the beginning of 1991. All students have chosen the discipline SMALL BUSINESS AND ENTREPRENEURSHIP and now it is obligatory. Besides teachers some bankers, consultants and entrepreneurs teach too. Students discuss cases (both successful and of failure) and try to better understand key factors for success. Some students with good potential write down business plans using their own idea and then defend it (sometimes in an open discussion). Students having the best business plans are free from the exam and sometimes they can start own business. A number of young entrepreneurs have graduated as a result of several-years education in small business and entrepreneurship. Some have been invited to teach. The Inter-university Entrepreneurship Training Centre to be open this autumn will represent itself the synthesis of accumulated knowledge. Next year three local centres will start their activity in the towns of Svishtov, Veliko Tarnovo and Plovdiv.

Here are some main problems concerning education: selecting high-potential students; information supply for business plans writing; stressing on practice; training teachers (with good knowledge and experience).

Business schools (private, associated to universities) train beginners-entrepreneurs (graduated) who lack knowledge. We can take as an example the business school called INFORMA INTELLECT that has good image. The school organises short-term and long-term courses on industrial and firm management, office management, personnel management, accounting and finances, entrepreneurship and small business. Modern methods are used in training by Bulgarian and foreign teachers. The school co-operates with K. Duisberg and Zeidel foundations. There have already started joint Bulgarian-Dutch project on teachers' training consultants in small business.

Special attention is paid to training courses for unemployed University graduates - engineers mostly, who have worked in LSEs oriented to ex-socialist market. Participants are selected by a special methodology in a week and some experts (in marketing, management, finances, psychology) do the selection and they find out potential entrepreneurs. The latest course was organised for 12 engineers and it lasted 4 months instead of two. The participants have technocrat way of thinking and bad communication skills. Moreover they have been priority specialists in the past (Bulgaria has been specialised in electronics) and now they feel as outsiders though they are highly qualified. That is why trainers acted as nurses. The results are positive - eleven have prepared business plans, seven showed to be the best and four of them are waiting to be funded by PHARE.

Research

Small business research is very important as a source of analysis, key problems defining and some cure. If we consider the state of science in East Europe and Bulgaria (lack of money, personnel problems, bad image, being far from practice) and the underdeveloped small business and entrepreneurship we can make some crystal clear conclusions. Moreover entrepreneurship does not have own theory (it combines managerial, social, psychological, economic and anthropology theory); on the other hand it is difficult to transfer entrepreneurial know-how (because of too many entrepreneurs and personal characteristics, Todorov, 1993).

There are difficulties yet some researches are reality and they are done in Universities and organisation. First that is the Dutch research led by the SME Institute of Zoetermeer in 1992. It is large-scale one and gives a good picture of small business and entrepreneurship in Bulgaria, and some recommendations. It also has some disadvantages e.g. methods are transferred one-to-one (it lacks local specificity, insufficient information in some sectors, bad choice of right partners, etc.)

National Statistics Institute has already done the first small business and entrepreneurship research. Unfortunately it did not cover the whole sector (business in shadow, phantoms who do not pay taxes).

Some universities have started research projects of their own in order to make education more practice-oriented. That is the one called “Entrepreneurship and Small Business Development in Bulgaria 1993-1996”. The project goal is to analyse the main spheres concerning small business and entrepreneurship - environment study and change of property, SMEs starting and functioning and introducing the results in teaching, some students take part in the project and that is good in view of combining education and research. It is important to make and introduces cases in training.

Unfortunately small business and entrepreneurship researches are improvised and not connected as there is no institutional and financial support. Everything relies on teachers’ motivation and their informal contacts (e.g. to finance to projects).

Consultancy

Generally consultant activity is a new one for East Europe including Bulgaria - especially concerning small business (SB) and entrepreneurship (E). Consultancy isn’t absolutely unknown referred to LSEs (including know-how transfer) while in view of SB it’s simply in the very beginning.

There’s a great number of consultancy companies in Bulgaria nowadays (joint, foreign and Bulgarian). The foreign ones are: KPMG, Arthur Anderson & Co., Price Waterhouse, East-West Consulting. In practice none of them is dealing with consultancy just only. The latter consult both SMEs and LSEs (in strategic management, structures, marketing, finances, auditing, privatisation).

If we discuss the profile of Hiron - Management Consulting (Bulgarian property), Sofia - one of the comparatively successful consultant companies, we will ascertain the following key moments:

* The company consults business at each development level and support foreign companies to enter Bulgarian market.

* The company is working in several spheres:

- LSEs restructuring and privatisation;
- entrepreneurship development;
- research and projecting.

* Partnership and co-operation. Hiron is a partner and co-operates with UNIDO, JICA, PHARE programme and with renowned consulting firms as KPMG. It keeps good contacts with the most important state institutions (Privatisation Agency, the Ministries of Industry and Trade, and etc.). It is a chamber of the Bulgarian Association of Management Consulting.

In the direction of entrepreneurship development the fields of primarily interest are:

- business planning and evaluation;
- financial statements;
- analysis and evaluation of investment projects;
- evaluation of real estate and equipment to be mortgaged;
- knowledge and skills transfer and entrepreneurs training.

The company is planning to speed up activity regarding entrepreneurship thus it must overcome the following barriers:

- undeveloped market of consulting services;
- low qualified entrepreneurs in view of demand and supply of consulting services; Here it must be noting that some entrepreneurs think they can cope with any difficulties and haven't "so much money thrown away" for consulting;
- too many small and weak client-firms balancing on "the edge of the blade" that can't afford to pay consulting services;
- presence of "omnivorous" consulting firms, the so-called "pain-killer", which count on "strikes" and they worse the image of the others;
- weak unions of SB on the one hand and consulting companies on the other. They have to get together and make consultancy popular.

Consulting services market is one of high potential yet rules of the game are needed and institutional support (national, regional and branch). Special attention should be paid to consulting services licensing and control.

Relations among education, research and consulting: problems and solutions

It is fact the relation among education, research and consulting is of decisive importance. It is their diffusion to had to joint, synergetic effect to reach all small companies and entrepreneurs. We'll try to reveal the problems and make recommendations trying to view all possible relations among the three dimensions.

A) Problems of relationship: education, research, consulting

Education - research

It has already been mentioned both education and research in small business and entrepreneurship are in the very beginning. Foreign knowledge and skills are transferred and adapted according to local specificity and transition conclusions. So far we can't mention any important achievements. First, we lack the Bulgarian specificity and co-ordination institution to relate education and research successfully. Secondly, there are no standards in education and research and naturally that leads to negative results. As to problem they are in the following aspects:

- Lack of co-ordination among teachers and researches; often they aren't informed about mutual results;
- Teachers and researches talk in a different languages - some are supporters of the US science, others prefer the German or Scandinavian one; thus the approach they use is individual. Some of them like statistic studies and avoid case study method and back.
- Unreliable statistics; SB and entrepreneurship are analysed in a few dimension and that's the reason for mistrust and insecurity when using statistics studies in education (e.g. the number of SME is disputable).
-

Research - consulting

Problems are likely the same here. Consultant companies often act independently and they have to make researches by themselves, sometimes in spheres out of their activity. Consulting companies feel the need of that define problems and give keys regarding SB and entrepreneurship. Research results are necessary in order to consult business starting or to work out growth strategies. Researches, on their behalf, don't contact consultants to correct or add their researches. That way for co-operation could be very efficient especially when case study method applied in researches.

Education - consulting

A prior that relation is expected to be very strong. On one hand because the entrepreneur could look for consultancy service and the consultant often advises education in certain sphere. Consultants have to be well educated and prepared. Experienced ones are to refresh knowledge. The main problem is lack of regular relations between training and consultant institutions (teachers + consultants). It reflects in the following directions:

- Where selecting young (new) consultants from graduates and business courses participants;
- When using consultants in education;
- When making SB and entrepreneurship programmes consultants can help to:
 - make education more practical;
 - have effective transfer of entrepreneurial know-how that has already been adapted to local condition

- When implementing joint project where education and consulting sustain an important part of the project. That's also true when applying for complex projects funded by various sources (including foreign).

B) Directions to better relationship: education, research, consulting and practical implementation

It is hard to give any advice on SB and entrepreneurship moreover in transition period. Yet experience and forming infrastructure with its problems (already discussed) allow us to mark basic directions to improve the relations.

1. First it's necessary the state to be more engaged concerning: legislation on SB and entrepreneurship; establishment of good statistics base; encouragement to set supporting infrastructure (education, research, consulting, communication, know-how transfer, etc.). State role isn't subject of discussion here, yet it's impossible for the rest infrastructure to exist if we lack state support.
2. Business centres establishment in universities (in economic and technical) to combine education, science and practice. First, that concerns business plan preparation for the purpose of education as well as discussion problems in marketing, investments, personnel. Secondly, young people can get training in SB and entrepreneurship there and become entrepreneurs. On one hand joint research objects can start that are to help education and discovering young researchers.
3. Establishment of regular purposeful relation between National Employment Service and business schools teaching entrepreneurs. There is the fund "Requalification of jobless" and the money can be used more efficiently if there is a good programme will be co-ordinated by National Training Centre and its regional offices. A key accent is on training highly - potential University graduates. The centres can be "vaar-water" in education and killer of unemployment (people at work can be trained though not yet jobless as well as university students). Government investments in this field would be more effective than granting of the money "per unemployed capita".
4. Expansion of consultant services range and quality by creating special consultant centres as state or private formations. Along with usual consultant services some extra services will be offered: finding the right partner, entrepreneurial networks creation; subcontracting; helping business to internationalise. State will pay money for some services to be done by private companies (e.g. supporting hi-tech entrepreneurs, exporters, who produce utilising local resources).
5. Forming branch and regional unions to aid SB and entrepreneurship regarding education, research and consultancy like the cases of Utland (Denmark) and Northern Italy. The main stress is on finding and helping dynamic entrepreneurs in a region as the latter would be the engines to drive other entrepreneurs.
6. Organising joint activities between institutions and people responsible for education, research and consultancy in SB and entrepreneurship. It's proper to organise seminars (in branches, life-cycle phases), round tables in order to discuss the main problems and to look for keys. "Ad hoc" co-ordinating structure is suitable to set here - e.g. on the basis of Organisation of Science and Technical Unions that is to make the schedule and try to find sponsors.

Conclusion

There is no doubt that vital SB and active entrepreneurs are of crucial importance for successful transition from central planned to market economy. Education, research and consultancy development is of decisive importance to provide the creation. In this sense private and state, branch and regional, institutional and informal aspects would allow to reflect the most important general and specific interests that occur when developing SB and entrepreneurship. Thus it is necessary to form a national programme and subprograms that will co-ordinate the ways, forms and resources to fulfil the interests. Therefore it will help to bring together the three stones: education, research and consultancy.

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Trade Centres as a Factor Stimulating Economic Growth of a Region in the Light of Marketing Research

JANUSZ DZIWOTA, RYSZARD SLOWINSKI, PAWEŁ TUST

1. Brief description of the problem

The socio-political transformations taking place more and more rapidly since 1990 have brought about major changes in many sectors of the economy, and particularly in industry and trade. These changes are accompanied by new phenomena hitherto unknown such as, for example, unemployment, which has characteristics of structural unemployment in the Administrative Province of Lodz, and dynamically increasing number of new economic units.

One of special cases of such phenomena is the emergence of a large market-place within the urban region of Lodz in the vicinity of a busy motorway leading from Gdansk in the north of Poland through Lodz to the south of Poland, that is to Katowice in Silesia. The trade centre in question is located near two small towns of Tuszyn and Rzgow, and it consists of four open-air markets stretching, with small intervals, along 11 kilometres of the motorway. As regards the size of this trade centre it is by far the biggest in Poland. The markets occupy an area of about 30 hectares, on which there operate about 6,500 stands and roofed shops. In three of them, trade is carried under umbrella roofs, mainly directly from passenger cars and vans, and the fourth and the newest, which is also best developed, offers stands in huge malls built from corrugated steel sheets.

On these markets predominates trade in textile products. You can buy here products individually or in bulk having a choice of a wide range of clothes, fabrics, yam, hosiery, leather, or fancy goods, and so on. The offer includes, once in a while, electronic products, household appliances, or tourist equipment. The big variety of offered products finds numerous customers, which is mainly due to the fact that the prices here are, on average, by 20 to 25% lower than in the City of Lodz.

The markets began emerging spontaneously in summer of 1990. The explosion of entrepreneurship, which started in 1990, was connected with setting up thousands of new small firms. Many of them launched production of textiles being traditional for the Region of Lodz. The difficulties connected with their sales, and mainly with sale of garments, were caused by the collapse of exports to the former Soviet Union and of largely illegal tourist trade in locally made garments especially in Hungary and the former Yugoslavia. These difficulties caused that

producers started attracting customers on their own opening primitive stands near the motorway, selling directly from their cars, trundle-beds, or simply peddling. Such "wild" trade became more civilised when the town authorities in Tuszyn provided sites for the first regular market. Since that time the land area occupied by different markets has been expanding steadily, and although the markets are expanding it is impossible to satisfy the huge demand for new trade stands.

2. Methodology of the survey

In February and March 1995, researchers from the University of Lodz carried out a survey of the markets. The findings of this survey are discussed in this paper.

2.1. *Research techniques*

The survey was done in two stages:

- an extensive survey based on quantitative methods (between 9th and 15th of February 1995);
- an intensive survey based on qualitative methods (7th March 1995).

2.2. *Research process*

The survey was ordered by the local government of the town and district of Tuszyn and it covered three markets in Tuszyn and Gluchow.

The quantitative survey (extensive) was done by means of questionnaire interviews. There were prepared four versions of the questionnaire for the following groups:

- inhabitants of the Administrative District of Tuszyn;
- market traders;
- customers of textile wholesalers;
- individual customers.

The qualitative survey (intensive) was conducted by means of the focused interview. It was carried out within two working or discussion groups, each composed of eight persons including the market traders and the inhabitants of Tuszyn. This survey allowed to enrich the information gathered during the quantitative survey.

2.3. *Size and choice of the sample*

(a) The quantitative survey:

- traders - 250 interviews (choice of the sample - random, systematic choice);
- shoppers (choice of the sample - method of quota selection);
 - wholesale customers - 200 interviews;
 - retail customers - 200 interviews;
- inhabitants of the Tuszyn District:

- inhabitants of the town of Tuszyn - 202 interviews;
- inhabitants of villages in the Tuszyn District - 98 interviews;

Altogether there were made 905 interviews.

(b) The qualitative survey:

- two working groups of eight participants each:
 - 8 inhabitants of the town and district of Tuszyn;
 - 8 traders from the markets in Tuszyn.

3. Scale of the phenomenon

The annual turnover of the surveyed markets, where 4,533 stands operated on 15th March 1995, was estimated at 19,000 billion of old zloties. It can be assumed that a significant part of this turnover is never disclosed in official income statements of the stand owners, which is confirmed by a comparison of actual turnover (exceeding 19,000 billion zloty) with the turnover declared by the respondents (6,000 billion zloty).

There was also assessed the number of transactions concluded during one year. It was estimated that it reaches 13.2 million transactions annually on the markets under analysis, of which:

- 8.2 million are transactions with retail customers; and
- 5 million are transactions with wholesale customers.

With regards to the structure of goods sold here according to their origin, there dominated domestic products - 77% (or 14,600 billion zloty annually), of which 89% were made in the Region of Lodz (13,000 billion zloty).

A major problem, which we wanted to grasp, was estimating the number of traders directly involved in manufacturing of sold products. Due to a very big number of economic units operating within the informal sector it was impossible to obtain reliable data about employment from the respondents themselves. Consequently, we resorted to a comparison with turnover of several clothing plants officially declaring their turnover for tax purposes. This comparison revealed that about 100,000 persons are directly involved in the manufacturing of products sold on these markets, of which about 80,000 in the Administrative Province of Lodz, and about 60,000 in the City of Lodz alone. Of course, this is only a rough approximation and it may contain an error in estimation.

4. Characteristics of the traders

The inhabitants of the Province of Lodz and nearby provinces (that is, the administrative provinces of Piotrkow, Skiemiewice and Sieradz) predominate among the traders. Namely, 76.5% of the traders come from the Lodz Province, and a high 89.4% from the entire region of Lodz.

The Lodz Region is a traditional centre of clothing industry in Poland. This accounts for the fact that clothing markets are opened in this area being a natural place for selling the output of over ten thousand small clothing firms. These small and dynamic firms successfully take over the role of large, inelastic state-owned clothing enterprises, which for their biggest part cope with their bad financial standing.

The economic pressure and the chance of financial success are the main reasons behind starting trade activity on the markets in question.

There can be distinguished two groups of the traders:

- former salaried employees and unemployed persons (61%) - people who found jobs owing to this trade centre or changed jobs for more attractive releasing their earlier places of work;
- people already earlier self-employed (34%). This group saw in the market trade an opportunity to increase their incomes, and for producers it was a new outlet for their goods.

Among reasons motivating people to embark upon economic activity in the market-place, the following seem to be the most important:

- economic pressure:
 - customers stopped purchasing directly at firms (they prefer to buy in this trade centre where the sale offer is much wider);
 - deficit of jobs;
 - lack of good prospects in the previous place of work (in the case of salaried employees);
- chance for development:
 - accepting the challenge of being self-employed, increasing incomes (salaried employees);
 - changing the type of conducted economic activity for a more profitable one (persons running their own businesses earlier on).

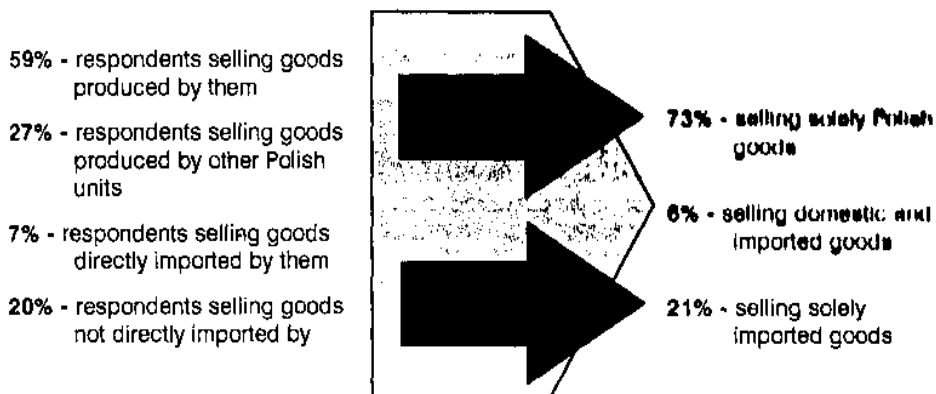
On the markets of Tuszyn and Gluchow, the object of trade are primarily domestic goods produced in most cases by the traders themselves.

Among the respondents selling products on the markets of Tuszyn and Gluchow:

- 80% are owners of stands;
- 20% are persons hired by owners of stands.

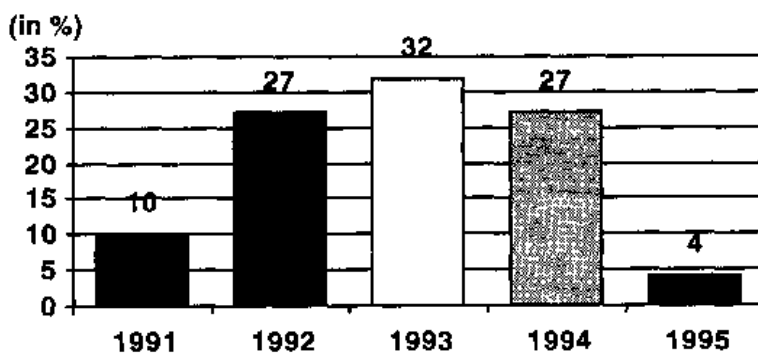
The respondents are engaged in trade on the markets of Tuszyn and Gluchow on average during five days a week

Structure of traders according to type of sold good



The respondents trading on the markets and engaged, simultaneously, in manufacturing activity estimate that they sell about 70% of their annual production on these markets.

Structure of traders in market-places in Tuszyn and Gluchow according to year of commencing sales

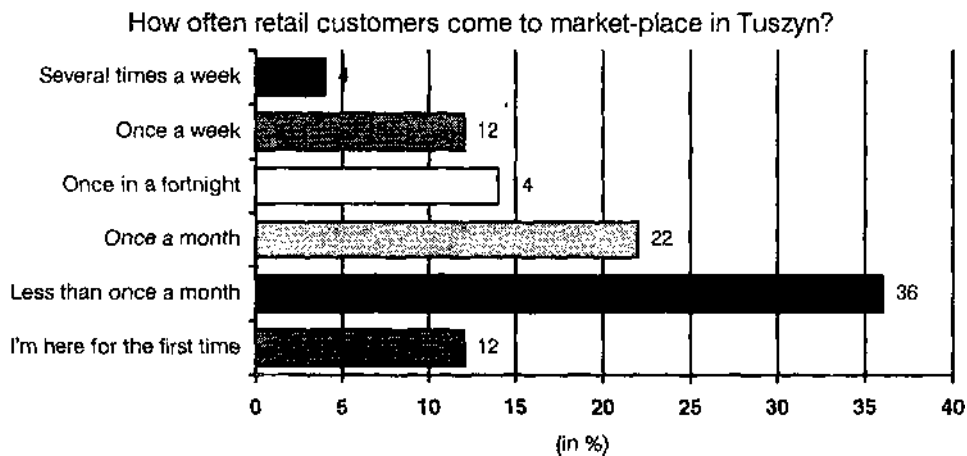
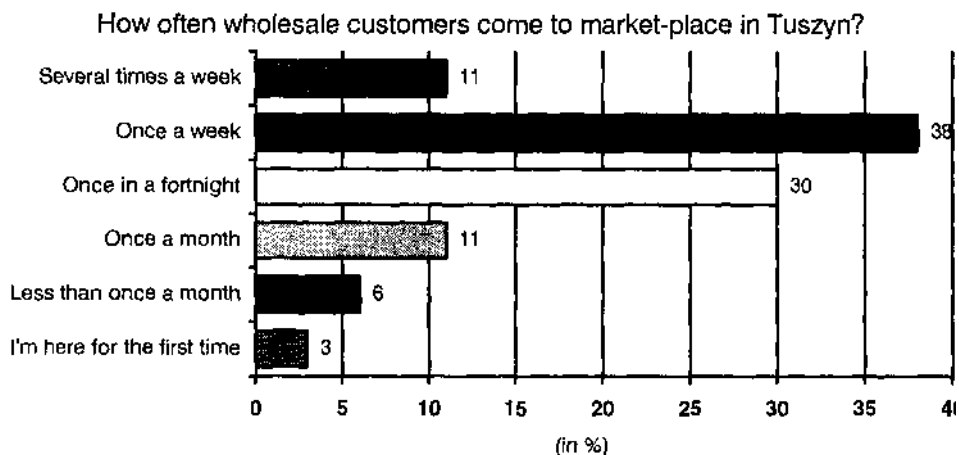


5. Characteristics of customers

The main group of customers are persons buying in bulk and regularly visiting the markets. Wholesale customers are a stable group of over 10,000 persons, who are usually regular customers for particular traders (according to the traders, regular customers account for 49% of turnover of the stands).

Individual or retail customers are partly accidental customers (passing the market they do their shopping here), and partly these are persons doing their shopping regularly here.

Frequency of purchases



Structure of customers according to turnover share in market-places in Tuszyn and Gluchow



Definitely, the two most important reasons for shopping in the market-place in Tuszyn are:

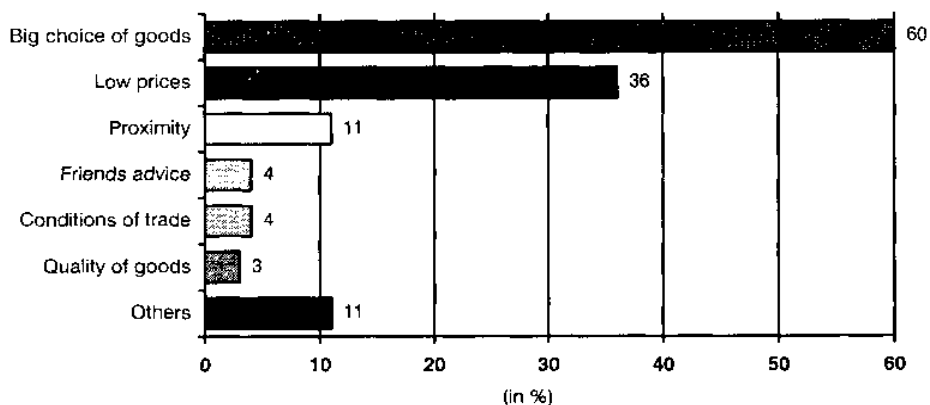
- big selection of goods;
- low prices.

There can be noticed a significant difference in perception of the above factors by wholesale and retail customers. Wholesale customers who can buy products from various wholesale centres or directly from producers point, first of all, at a broad offer of goods (which means also a possibility of comparing prices charged by different producers or of observing changing trends in fashions). For individual customers, shopping in Tuszyn is a unique opportunity to purchase products at producers' prices and also compare and choose products, as they would normally do in shops. In their case (and especially those who come here for the first time), an important role is also played by advice given by friends and acquaintances, which means informal advertising.

Among other reasons prompting them to come here, the customers would add:

- possibility of price haggling;
- chance shopping (travelling on the motorway in the vicinity of the markets);
- opportunity of purchasing products directly from producers.

Reasons for choosing markets in Tuszyn according to wholesale customers



Average value of purchases made in Tuszyn:

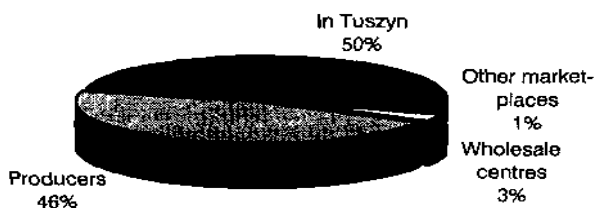
- wholesale customers - 30 million zloty;
- individual customers - 7 million zloty.

Wholesale customers supply the purchased products to:

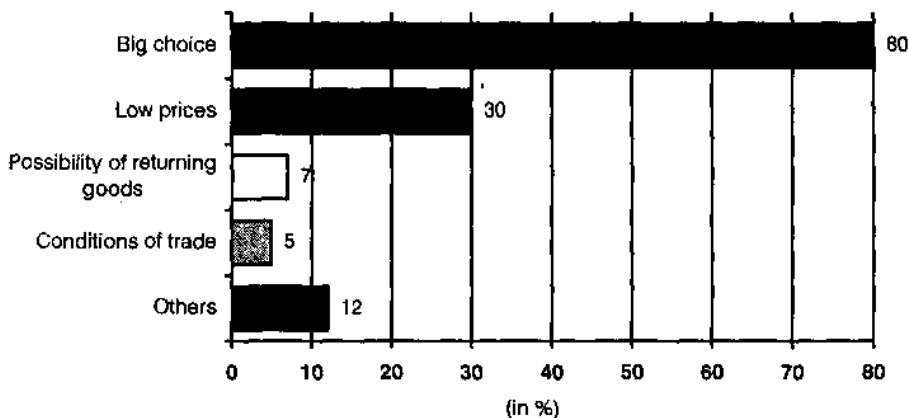
- stands in other market-places - 55% of the respondents;
- retail shops - 45% of the respondents;

- wholesale centres - 8%;
- for export - 6%.

Which form of supply is the best according to wholesale customers in Tuszyn



Why the best form of supply is market-place in Tuszyn



The analysis of geographical structure of customers reveals two main relationships:

- Individual customers are most frequently inhabitants of the administrative provinces of Lodz, Piotrkow and other nearby provinces, which means that in the case of this group of customers the distance and costs of travel determine its structure.
- Wholesale customers come to the trade centre in Tuszyn from different parts of Poland, and the distance they have to cover does not practically have any influence on their structure (with the exception of those from the administrative provinces of Lodz and Piotrkow). Their structure is determined by:
 - the number of population in a given administrative province of the country and, consequently, by the size of demand for products bought in Tuszyn (Poznan, Katowice, Cracow, and Warsaw);

- vicinity of the border (this concerns Poland's western and southern borders – products meant for Germans, Czechs and Slovaks);
- in the case of Poland's eastern border, it can be supposed that the citizens from the Community of Independent States by-pass middlemen in boarder regions and purchase products directly in Tuszyn (hence, a small number of wholesale customers from these border regions).

6. Citizens from the Community of Independent States In the market-place

The share of citizens from the Community of Independent States in the turnover of the markets under survey reaches 12.5% (2,400 billion old zlotys). The average value of purchases made by them from one trader amounts to 3.5 million old zlotys.

Changes in the value of purchases made by citizens of the CIS are due to two major factors:

- increasing number of citizens from the CIS visiting Poland and their bigger propensity to do shopping in Poland (hitherto they were rather involved in selling their products in Poland),
- emerging competitive markets close to Poland's eastern border.

Citizens from the Community of Independent States usually buy Polish products. They account for 15% of turnover of the traders offering exclusively Polish products, and for 8.5% of turnover of the traders offering imported goods. This points at a big price attractiveness of Polish products.

7. Future of the market-place in opinions of the traders

The survey findings do not allow to make an explicit assessment of the future of this marketplace. It means that the traders are aware of a still insecure position of the markets and they are not quite certain as regards their economic future either, which is characteristic for economic units operating in the informal economy.

At the same time, they link their plans for the future with the markets realising that it is necessary to compete with other newly-emerging market-places in other regions of Poland. They would appreciate if conditions of trade on the markets improved and they would like the markets to be promoted in Poland and in the neighbouring countries (particularly in the CIS).

SME Problems - Challenge and Opportunity for Management Consulting

MILEN BALTOV

Introduction

The interest for development of small business in Bulgaria increased considerably in the last five years. In this period the number of new registered firms reached about 400 000 and more than 90% of them have 10 people employees. At the same time the big number of small firms is not a pure Bulgarian phenomenon but a normal status quo for every developed market economy.

In spite of this the management consulting for small enterprises is rarely engaged. This segment of the market of the consulting services, because of the specification, difficulty and uncertainty, groundlessly, and not only in Bulgaria, was neglected and not enough studied. At the same time it turned to be an exiting challenge.

The sceptic attitude towards the necessity and opportunity for a consulting interference concerning the small business problems began to step aside to the achievements in an analytic and practical aspect. At the same time the management consulting should adapt (so far quite unsuccessfully) to the problems of the small business and should sacrifice a part of its lustre. The tendency on one hand is towards the types of consulting services-their role for developing of the firms and the management process. On the other hand the new place of the generally profile consultant and uncomplicated approach towards the small enterprises outlines.

In this way subject of study in the following paper is the specific processes and problems of the management consulting of small enterprises. The content is considered in three dimensions: the problems of the small enterprises; the points and the character of the necessary consulting help for them; as well as the attitude of the management consulting towards these problems, the manifestation of weak points and accents in this sphere.

Widely spread are the analysis and the discussion upon other studies, results of conferences and publications as well as interviews among the small firms and discussions with Western specialists.

In the mentioned subject, content and methodology of the study is set the aspiration for putting more clearness and completeness concerning the mentioned problems, as well as giving a tendency for future developments and decision.

1. Small businesses and their problems

In the consulting process it is at most importance, together with the dangers and advantages of the sphere as whole, to estimate and consider the specific weak and strong points of the small businesses. Some of these weak points can be overcome by health measures, others can be influenced just indirectly because they are inter peculiar for the small business.

In order to define more clearly the observed group of economic subjects, it is proper to abide by the criteria of the Committee Bolton (1971):

- *limited influence to the market* - the small firm should have considerably limited market share and could not influence to the market
- *independence* - should be independent and should not be a part of a bigger company
- *"personal" management* - the firm should be managed with the personal participation of the owner or a partner.

As far as the quantitative characteristics are concerned, the firms differ usually (in this case the criteria of the Administration of Small Business in USA (7.3)) by (1) the number of employed staff, (2) the estimation of the assets and (3) the volume of the turnovers. Concrete in Bulgaria, if the version of Union for Private Economic Enterprises is applied (2.14), by which the limit for a small enterprise was 10 ml levs long-term material assets and 20 people staff. This version could not establish and has not the necessary normative power and publicity that is why usually as small are taken the firms till 50 people, as middle till 200 (according to the norms of Ministry of Industry),

As it is understood by the definition above, even in the characteristics carrying advantage in the business are hidden many weak points. For example, the price of the independence and the "personal" management is paid by the usual impossibility of the general manager to share and discuss with somebody the main problems for which he responds. This price is paid also with the tendency to operate without adequate quantitative information or without enough professional training (11.6).

The mentioned weak points refer to the common policy and the projects which require more essential engagement of funds as for significant expansion of the capacity or for adding a new product. On the other hand, without proper set up informational system, especially when the business is growing, it gets extremely difficult for the general manager to have a balanced look only through informal, verbal communications and to save the needed information in his head.

In connection with the weaknesses in the management and the problems of small businesses as a whole, arises the question for recruit qualified staff. It is no chance that the owner - manager is often compared to a "one man band" - ready for compatibility and addition of many functions (7.55). In the comparison between small and big firms, is established the term "dual labour markets". The big firms prefer qualified, stable and experienced employees, predominantly with successful family status and with trade union membership. The small firms are prepared to hire the people who did not respond to these requirements and can afford to pay less and they usually hire in informal ways.

Partly it was mentioned about the difficulties of the typical small firm in the change of its methods of operating in the growth. It is more and more difficult for the manager to deal with

the daily operations and at the same time the necessity of realising, planning and implementing the changes in his organisation (11.7).

Other chronic difficulty is concerned with providing the capital investments. Reading the future of a firm, depending on the decision usually of one man, the net account of correlation returning to risk usually would not attract a professional investor. Often the owners of the small business are not inclined to have a partner with whom they obliged themselves to advise for important decision. That is why usually remain the versions with incomes of the activity or bank loans. Bank loans are possible only in quick turning business.

The small businesses are extremely sensible to the recessions. They appear to be a buffer for the problems of the whole economy. Comparison between crisis periods and progress periods for the private sector in Bulgaria is still impossible but the reactions in the other European countries will be logical. So in Great Britain, where historically 11% per year of the firms stop existing, during the period 1991 - 1992 this percentage was 18% (allowance 7%). Usually 75% of them are in static situation and hardly 4% of them could be called "quick tugs" (with maintenance of the height in the sales and stuff).

If the problems should be rated, two methods are possible. From researchers' point of view they are concerned mainly with incompetence / inexperience - 44%; lack of management practice - 17%; non-balanced experience - 16%; inexperience in the branch - 15%; carelessness and frauds - 1% each (the data is for Great Britain based on a research of Dun and Bradstreet in 1987). Owners' point of view is a little bit different. The problems are almost completely financial as inadequate sales - 49%; hard operative costs - 13,6%; difficulties with the debtors - 8,3% (for Great Britain) and often negative cash flow - 25% and difficult control of costs - 11% (for USA) (9.728).

Similar conclusions make the owners of small enterprises in Bulgaria. Financial problems are on the first place. This time the question is about high taxes - 87% or opportunities for a credit - 61%, prominent in the research of EIM, made at the beginning of 1992 (the calculations are based on 100%)(4.32). This understanding is supported by the data of the research of the ESBID project from the summer of 1994 (see Appendixes, Table 1) in the points of insufficient finances - 33,33% and difficulties in collecting the debts 8,33%. On the other hand to the question does exist for them a pressing need of managerial education about 3/4 of the interviewed owners of small businesses answer positive (4.49). And though in comparison to the necessity of financial support (77%), services concerned with the education on marketing and management (each 55%), which should not make conspicuous, are more conscious necessity (4.41).

Even though it is not correctly, the absolute comparison between the data in both researches, after a certain allowance it is noticed that for 2,5 years this enthusiasm to choose by priority the courses on management is faded. The results of ESBID show an interest from 14,58% of the interviewed (see Appendixes, Table 2). In parallel with this the image of the small firm as an "one man band" remains if it is read that also during 1994 not a small part are these owners having before managerial functions 31,25% (see Appendixes, diagram 1). The number of businessmen sure that their business is managed by a qualified managerial team are less - 29,16% (see Appendixes, diagram 2).

Thus, as a conclusion, in providing of capitals and financial inadequacy for small enterprises, they are intensified by the isolation, the managerial inexperience and incompetence and sensibility for crises.

2. The necessity of a consultant's aid

It is logical after these facts to put concretely the question: do the owners-managers of small firms need a consultant's aid? In the world practice the share of this kind consultant's services to the common volume is not a significant quantity. In Bulgaria the use of these services by the small businesses is a white crow but the necessity of a consultant's aid is not rejected by the businessmen, 89.61% of the answered to the interviews of ESBID declare that such a need (see Appendixes, Diagram 3). "Stick to the simpler", appeal in their article about "Journal of Management Consulting" the New Zealand authors Richard J. Petch and Alester Matthew (12.61). According to them the good methods in the big companies most probably would not be suitable for the small entrepreneurs. In more general aspect answering the question why the small firms need help, Malcolm Harper points the attention to 5 directions (8.5). They are: capital, clients, mutual actions, management and information. Worth for attention is the accent on the development of mutual actions where it is underlined that every form of co-operation needs an initiative of an experienced person (the best - consultant) who has the time and abilities to organise it. Unfortunately, the problem in the applied ideas is that the role of the government interference is overestimated. The need of a consultant activity specialised in the management is totally equalled to the need of educational preparation and the most important - the reasons in their complexity are not accepted.

The present method is demonstrated by the mentioned already New Zealand authors. The aim of the objectives in giving advises for the small business is the better introduction of the firms. To achieve a better introduction first the reasons for the failure of so many small firms should be identified. Already mentioned managerial incompetence is the most important reason also for Petch and Matthew (12.61).

Some authors point also another specific fields. The high interest percentages, the inflation and the government policy truly make the survival of the small firms difficult. The ability of the owner to survive depends on the personal characteristics, the education, the qualification and the experience.

After the concrete factors for using a consultant's aid the two authors point (12.62):

- lack of managerial experience, skills and education;
- inability of the managers to be functional experts in every business area;
- their financial impossibility to hire internal experts;
- the great emotional dependence and non-financial motives to be in the business;
- often not enough resources for answering the small crises and mistakes.

The discussion on the problems of small enterprises will develop more and more and the reading of different positions of researchers and owners will be very necessary. It would carry

out some positive results at an exact identification of the fields for consultant's interference and of the mechanisms of initiation of the contacts with the consultant.

3. Main features, difficulties and possibilities for management consulting for small businesses

In the previous chapter the position that the simplification is the key moment working with the owners of small firms is confirmed. This accent will be in the base of the further topics.

The understanding that it will be useful for the small business the consultant to give advises based on the real needs of the client but not as a part of packed, mass fabricated decision about the problems of life as a whole is concerned with him too. The New Zealand authors Petch and Matthew give examples for brilliant plans which the owner of a small business can not afford (12.61). According to them the entrepreneur has time and money only for comparatively simple and easy applied plans. Similar position has also Baumbeck (7.85). According to him what most of the small firms need is (1) specialised help when having serious difficulties and (2) periodically checks for revealing of hidden "traps" which can be avoided if found on time.

Together with that the representatives of the Asia organisation on productivity, based in Tokyo, consider that the bigger firms need more specialised consulting (11.47). The potential for decreasing of the costs in specialised fields usually is bigger for the bigger firm and thus the consultant's fees are easily accounted for; in the small firms the situation is the opposite.

The present applying of innovations is concerned with much more risk for the small firms than they can afford themselves; while in the big firm the risk can be distributed to several projects and there exists bigger potential for using them in a long-term plan. This, according to the team of Kuan Lee (11.47) also must be read by the consultants.

The discussion on these points is often subordinate to the opposition between the specialised and generally profiled consultant. The ideal situation is both types of consultants to be at position of the small firm but this is financially and functionally almost impossible. That is why it should be estimated that in most cases the problem on which the consultant is hired is not proper realised by the owner-manager and it turns out that it is just a symptom. Often the estimated difficulty in one part of the firm is a consequence from the problem in another typically for small businesses. So the generally profiled method turned to be more necessary for avoiding the needless cost of time on the developing the proper decision for the wrong problem.

Other specific characteristics of the management consulting of small businesses which were already mentioned are the limited financial resources of the firms and in parallel with this the practice consultant to be needed only when the crisis moment has come (11.47). These facts emphasise on the immediate actions in spite of the fact that a better decision could be found if there is enough time. The financial insufficiency limited the alternatives which can be recommended. The insufficient education and skills for applying of part of the decisions which could be suitable for the big firm should be also estimated.

It is important to be known that the owner-manager of the small firm is inclined to feel that the act of turning to a consultant for an advice reveals the estimation for his own managerial abilities. This is also a reason the engagements of the small firms to be engagements of the

crises. Therefore, the small business consultant meets the specific problem of avoiding the lesion of the hurt pride of the owner-manager. In fact one of the tasks of the consultant is the "repairing" of the ego of the owner-manager.

Usually it is difficult for the consultant to get information for the small firm because the owner-manager would not spare enough time for giving the needed data. It is necessary to convince the owner-manager in the need of estimation of the time. At the same time the consultant should be flexible in preparing and changing the work plans engaging with the small business.

Another point for positions is concerned with the problem in what capacity the consultant is hired - as an internal or outside consultant. The opinion that for the small firms hiring an internal (called own too) consultant is economically unjustified predominates (5.8). It is so because the costs for maintenance of one consultant are constant and at comparatively low sales they become a significant percentage of the prime cost of the product.

Many of the consultant companies develop their separate offices and the offering a "permanent management". The phenomenon is extremely interesting but among the clients are still just big companies - venture companies and banks for EIM or state companies for Stream Resources (10.9).

In spite of this for some consultant services, for example accounting, The "subscription management" principle is possible and is applying. Here the hour base for engagement is not so big (respectively the needed finances) but is distributed optimally in the time. It is also possible to the contracts for consultant's aid to have annexes about following help allowing the providing of also mentioned periodical checks for revealing hidden "traps". Thus so important for both sides confidence is achieved.

The underestimation of the small business as a market for these services is still valid but a tendency of reorientation of a part of the operations and resources is observed and from serious firms. In the copy from March 1993 of the bulletin "Consulting News" (6.1) are quoted 7 national and regional companies in USA whose incomes from the contracts with small firms for 1992 reach to 135 ml USD and the profit of a partner for them is average 125 thousand USD per year - 15% higher than the average profit of all members of ACME.

Interesting is the introducing to the concrete sectors of these operations. The leader in this field, George C. May Co., gives mainly services concerned with the production control, industrial engineering, improving the profitability and organisational development. They think that they do not engage "if they do not save to the client at least twice bigger amounts of the fees they have received".

Kurt Celman Association offers a general management, production and informational technologies, management of the human resources, marketing. The method of Philip Crosby Association which demonstrates the introduction of services to an enormous number of small markets and how this to happen at a competitive price is interesting. The fact that Eamst and Young sponsors one of its competitor Moot Korp inviting teams of graduating students to develop plans for growing of new firms is very curious.

As far as it is concerned with some concrete actions of the consultant when problems appear, the quoted already New Zealand authors give systematic idea through the form for quick estimation and recommendations (12.63), (see Appendixes, Table 3).

This form for quick estimation and recommendations is really useful to a systematic initial studying of the client. But applying the recommendation for simple actions working with small businesses requires the estimation of a whole complex of factors as financial limit, lack of managerial education and experience, emotional colour, difficulties in applying the recommendations. The generally profiled method and complexity in the offered services is established.

Conclusion

The hit of 80s - "the small is beautiful" begins to sound in a new refrain. The problems of the small businesses with their significance and seriousness are already interesting for otherwise aristocratic occupations of the management consultants. The consulting although should subordinate to the uncomplicated methods and establish the role of the generally profiled consultant. Thus a new and promising sector helping development of the small business appears.

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Appendices

Table 1. The most serious problems influencing on the business of small enterprises

None	6,25
Non developed market	14,58
Insufficient financial resources / impossibility to provide such	T3,33
Old technology	4,16
Insufficient high qualified workers	2,08
Difficulties in collecting the debts	8,33
Bad quality of the sources	10,41
Difficulties in transporting	4,16
Unsuitable state regulation	10,41
Other	6,25
Not answered	0,00

Table 2. Most useful short course chosen by the businessmen.

None	14,58
On accounting	16,66
On marketing	10,41
For providing financing from banks and other financial institutions	10,41
On law	2,08
On management	14,58
Import / export	6,25
Technologies	8,33
Language	10,41
Other	2,08
Cannot estimate	4,16

Table 3. Form for quick estimation and recommendations

Question	Having negative answer	Recommendation
On what is based the business?	Proves for provided market or for understanding of such market are completely or almost missing.	Implementing of a research of the market and establishing of the base for developing of the business.
Are there any proves for a financial planning of the future activities?	Lack of prove for financial planning or similar to it for more than 3 months.	Bringing in a financial planning and its connecting with the known market.
What is the situation of the accounting documentation?	Lack of estimation or maintained bad.	Bringing in an exact system for estimation which the owner should understand and maintain.
In what way the debts of the business are declared?	Prove for planning is completely or almost missing.	With the help of marketing information and financial plans, the forecasts for the cash flows will indicate the levels of the needed borrowed capital.
How the costs for services are determined / How the prices of the sold products are formed?	Lack of methodological approach in defining the costs and the prices.	With the bringing in of the upper recommendations a cost and price policy is formed.
Does the owner understand and use the movement of the cash flows?	Lack of reports for the movement of the cash flows or if there are any, they are not significant for the owner.	Beginning of understandable accounting system which maintains correct reports for cash flows.
Does the firm use and maintain a system for management of the debts?	Lack of such system for the moment or it is difficult for using.	Bringing in a correct system for management of the debts and establishing of a realistic policy concerning the management of the debts.
How the equipment is planed, ordered, preserved and maintained?	The equipment is too big or arrives too late. It is badly preserved and is not protected by robberies.	A start of exact and easy for using system for planning, ordering, preserving and controlling of the equipment.

Diagram 1. Position of the interviewed businessmen occupied on the previous place of work

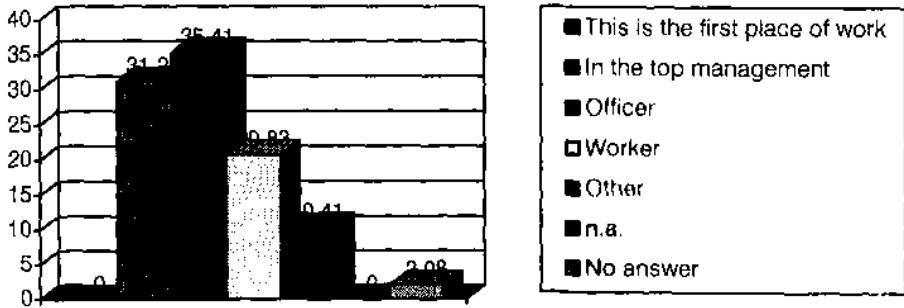


Diagram 2. Management of the business by a qualified management team

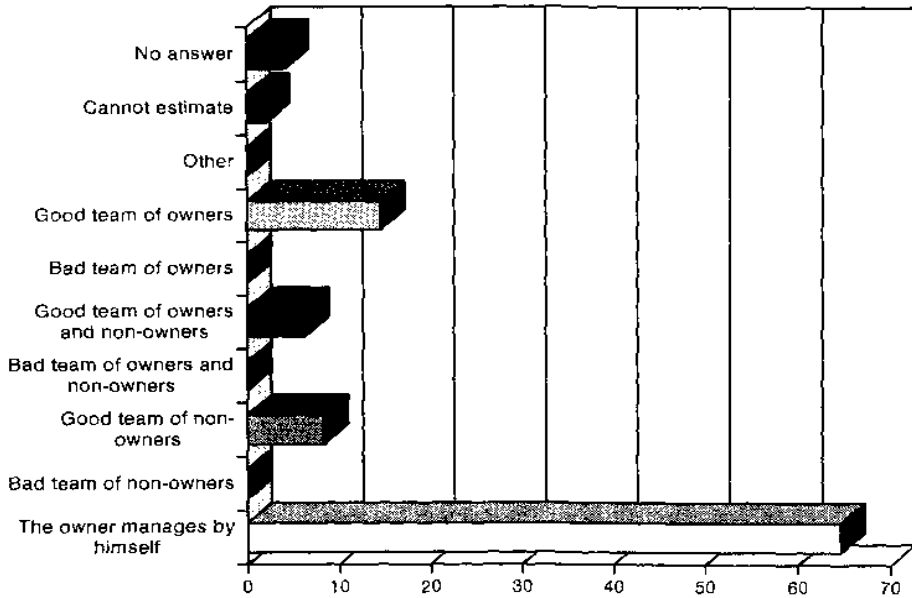
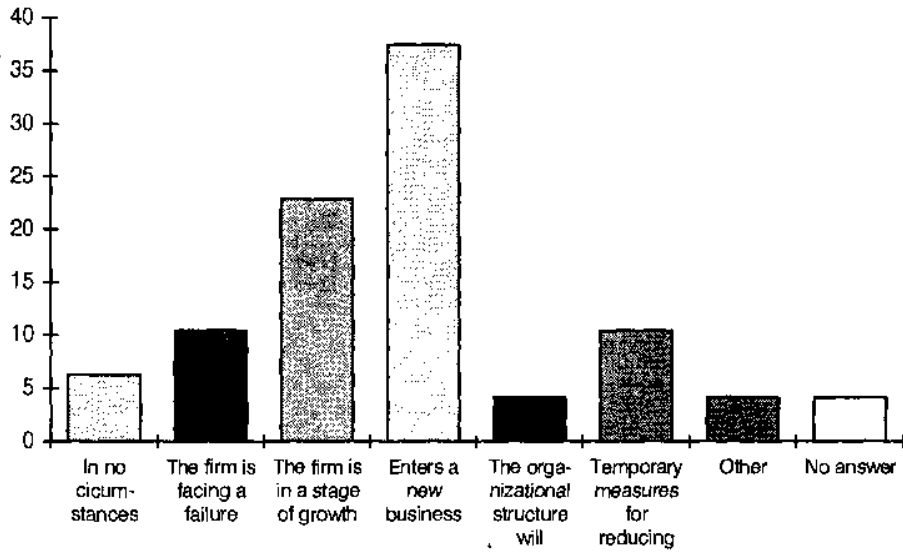


Diagram 3. Circumstances by which the owners of small businesses would ask for consultant's aid



Building Business Support in Central and Eastern Europe

LESTER LLOYD-REASON, TREVOR J. WEBB, MILENA MARINOVA

Introduction

In the newly liberalised smaller economies of south-eastern Europe and elsewhere, large companies have caught the attention foreign investors as well as becoming a target for service providers from abroad. Very small firms are struggling to maintain their existence. In the absence of a mature legal and commercial infrastructure, they are doing so with the minimum of formality. Between the two extremes of size lies a swathe of enterprise that is neither so small that it can be managed entirely by its proprietor(s) nor large enough to support in-house specialist services. These circumstances define the very large group of businesses that, in developed countries, form the clientele for business support services. Providers range from banks and chambers of commerce by way of accounting, consulting and legal firms to government agencies and such entities as securities market operators, actuaries, surveyors, patent agents and others, plus the professional bodies governing their activities, as well as a range of commercial firms and non-profit agencies. In the newly market-oriented economies this infrastructure is arguably essential to survival in competition with the developed world, but is either still lacking or being put into place piecemeal under the pressure of rapid political and economic change. We seek to establish the state of play, draw useful inferences for policy in the Small and Medium Size Enterprise sector and set down a benchmark by which progress can be measured in future.

In the following sections we discuss the objectives and scope of the research project, the benefits expected to flow from publication of results and the detailed methodology employed. Preliminary design, interviews and meetings with associate researchers has formed the burden of the project workload to date. As result, our findings and conclusions so far, which form the main discussion point in this paper, are concerned with these aspects. Some very different perspectives have opened out to those initially anticipated.

Desk research to produce comparative economic and business profiles from the pre-war period to the present day has, on the other hand (and with one exception), proved rewarding but uneventful. The published result will point to a serviceable literature on the countries of the period between the wars, revealing a complex web of economic relationships, many of which are reappearing at the present time.

And the exception? For the researchers, members of a generation for whom cold war politics and institutions, notably the CMEA, formed an established backdrop to events before 1989, there was what can only be described as a cultural shock in perceiving the enormity of the damage to national life in so many countries when comparison with the pre-war period is made. Examining the results of ruthless pre-war German commercial and political expansion, then, after briefly raised of a return to informality, the total extinction of economic plurality and enterprise in the region, followed by the post 1989 stocktaking, as an activity destined to bring home the extent of the historic disaster the countries in the survey region have suffered. This is not without influence on the way the empirical research is now being conducted.

Objectives and scope of the research

The objective of the research project is to measure the extent to which the business support infrastructure exists or is emerging, and how much it is able to contribute to the commercial development of a group of countries lying in a sensitive region of south-eastern Europe. The countries chosen for empirical work are closely related and territorially contiguous, namely Hungary, the Czech Republic, Slovenia, Rumania and Bulgaria. Austria also features in the research as a source of comparative data and as a relevant model for the emerging smaller economies of the region. Greece will form part of the survey as a country which has long been an EU member, but continues to resemble the newly-liberalised economies of the region in many particulars.

The research is exclusively focused on smaller Countries, the size of the domestic economy being an important determinant of the scale of resources able to be deployed in the business support infrastructure. Poland is, accordingly, excluded. Slovakia is excluded on the different ground that its commercial infrastructure is highly distorted and its future hard to predict. Slovenia on the other hand is brought in on the basis of its increasingly symbiotic relationship with Austria, offering the possibility for a small country to acquire a sophisticated business support infrastructure very rapidly.

Hungary and the Czech Republic are the prime focus of the research since they are following different development paths but offer a number of relevant comparisons. The geographical location of the selected countries is also significant. The opening of the Rhine-Main-Danube canal in 1992 has created a continuous commercial pathway between North-West Europe and the Black Sea. Small economies are open economies and, even allowing for the distortions of the Balkan conflict, all the countries chosen will be obliged to trade within the international supply chain, particularly in the addition of value to agricultural production and the exploitation of modern manufacturing technologies, if they are to enjoy future economic growth. That implies the necessity of acquiring and adopting the standards of the outside world as soon as possible. Rumania and Bulgaria are included as examples of countries affected by all of the developments mentioned but significantly differently placed to Hungary and the Czech Republic as regards starting point and prospects.

Who will benefit?

The chief beneficiaries of the programme will be the enterprises co-operating in the research programme and the service organisations being developed to support them. The results are expected to motivate companies and service providers alike to co-operate in creating and

developing business support organisations and to work together to influence public makers in the same direction. Policy formulators in turn may be persuaded directly by the evidence to provide better legislative frameworks and real resources for the development of a modern business support infrastructure. This powerful nexus of knowledge-disseminating organisms is possibly the biggest single factor differentiating the countries studied, many of whom possess rich productive resources, from their western customers, suppliers and competitors. The regional emphasis to the research programme is also expected to highlight opportunities for cooperation between neighbouring countries in the shared development of mutually useful business support mechanisms and institutions. The appended tables I and II indicate the size and type of business organisation targeted by the research in each country, as well as the specific business support services and providers examined.

Research methods and outcomes

The empirical research is being conducted by means of structured interviews and personally administered questionnaires against a background of quantitative and qualitative research into business and economic structure of each country, separately considered. The two approaches are described below.

1.0 Business and economic structure

Three profiles are being prepared on the basis of pre-existing published research and statistical material as under:

1.1 *Historical baseline study*

It will be argued that, on grounds of general culture, history and tradition, the model most likely to obtain for the future stable form of the business support infrastructure in any country is, all other things being equal, likely to resemble the one it last enjoyed under constrained circumstances. Many countries exhibit long-term stable patterns of commercial infrastructure despite severe political distortions: as witness for example Spain and Portugal. Similarly the future development of an economy may continue to be based on long-standing comparative advantage. For this reason, a preliminary study is being undertaken to establish the relevant background at the most recent moment of history for which it is appropriate. The basic economic and industrial structure and supporting institutions of each country are being surveyed as at or around the year 1936, with further evidence from the period 1945-48 as required. This survey constitutes approximately 20-25% of the research work and is based on collections of contemporary data and literature held by the British Library of Political and Economic Science housed at the London School of Economics.

1.2 *Economic Profiles*

The current economic and business structures of the selected countries are being profiled and contemporary developments analysed for their influence on the evolution of business activity in general and the business support infrastructure in evolution of business activity in general and the business support infrastructure in particular. Other small countries which have followed a steep development profile in recent years, such as Portugal, will be included where relevant.

1.3 The Austrian model

Austria is a well-known example of a highly developed country with an effective business support infrastructure particularly appropriate to a small, mixed, open economy. The country's close geographical, historical and cultural relationship with the subjects of the empirical research makes it an appropriate model for comparative analysis and discussion of possible policy options.

2.0 Research interviews and questionnaires

Two interviewing stages are involved, based on and utilising previous work as well as the information base referred to above:

2.1 Initial interviews

These are being conducted with a range of existing and currently sought contacts of the coresearchers in order to determine the areas of business support provision considered most important by business managers and proprietors, as well as some principal providers of services. Opportunity is also being taken to test early draft versions of the intended final questionnaires.

2.2 Final Interviews

Questionnaires will be completed in the presence of business managers and proprietors, service providers and others as part of a structured interview. The sample will be as large and balanced as possible but restricted to a distribution that can be dealt with by structured interviews designed (a) to ensure that an appropriate selection strategy is followed when the questionnaires are filled in and (b), to obtain additional information and insights from the respondents themselves and their colleagues by personal contact.

3.0 Dissemination

The results will be distributed by means of dissemination events and a published report plus conference papers and articles, as well as being incorporated, where relevant, into advisory work and business school teaching programmes. Conclusions and policy recommendations will be made available for consideration by business and public policy makers in the countries studied as well as in other similarly placed and their counterparts in western Europe. The Final Report will be published at a conference and press event to be held at the Soros Foundation, Budapest, in March 1996.

The nature of the research programme

We discuss here the definition of business support services themselves, the research questions asked, the design of the questionnaire and the balancing of the multi-country, multi-culture mix among researchers, respondents and the object of research itself, together with some implications for data analysis.

Definitions

Business support services are defined here as the set of operations that result from the deployment, by one person or organisation on behalf of another in the circumstances defined below, of material, non-material, human or intellectual assets of any kind. Such assets include information and information processing; special knowledge or skills embodied in person or systems; privileged access to third parties; technical procedures or means of communication, or transferable previous experience of any kind.

We avoid the numerous grey areas which open up in deciding what is or is not a business support service by two devices: first a definition that attempts to stake out the ground, and then a definitive list of what constitutes the services studied. By this means grey is overpainted black or white according to taste. The technique may give rise to debate the context of the present survey - others may choose a different definition and, in an extreme case, base their own research upon it - but with the need to corral the background and empirical environment of many researchers within the confines of one project, we have felt it better to adopt a prescriptive approach after the fullest consultation with colleagues on the project. Definitions follow: the definitive list is under development and available but does not form part of this paper.

Business support services EXCLUDE routine services that are an integral part of a firm's normal operations, (example: product distribution). They do however encompass the process of advising upon, designing, setting up and accepting initial responsibility for the provision of a basic service (example: setting up a product distribution system).

Business support services INCLUDE the provision of services which, although they are integral to a firm's activity,

- require resources or expertise larger in scale or more technically specialised than firms in the industry typically possess (example: materials testing), and/or
- are used only at intervals or for specific projects (example: factory design and layout).

Business support services are, in other words, services which would normally be uneconomic or unfeasible for typical individual firms in a given industry to supply for themselves. Competitive disadvantage would thus be expected to follow from any or all of:

- non-availability of an external service
- excessive resource cost of self-provision
- efficiency loss due to inadequate self-provision.

On the supply side, business support services may not necessarily, or indeed in the majority of cases, be provided by commercially oriented business entities. Their motive for supply often requires to be established.

The way in which service providers are funded or otherwise induced to commence supply has to be examined separately. Funding is an important consideration in determining both the real cost of business support services and the manner in which resources are allocated to them. It should also be possible to measure by this means the extent to which supply is motivated by commercial, broadly economic or other, non-economic, considerations.

Support service users are in general, assumed to be normal commercial entities, motivated by the desire to survive and flourish in a competitive environment and seeking to meet their resource needs, including those for specialised services, at the lowest cost consistent with acceptable standards.

Research questions

We ask accordingly:

1. What operations constitute business support services?
2. What is the level of provision of business support services in the countries studied and how is it organised and funded?
3. What are the mechanisms of supply and demand for services and what relationships exist between and among providers and users?
4. What are the present and prospective levels of efficiency of provision?
5. What identifiable models are evolving, being adopted from elsewhere or renewed from an existing tradition, to shape the overall infrastructure of business support service provision?
6. What is the economics of business support service provision in the group of countries studied, in smaller economies in general, and overall?

Research effort in Bulgaria

The following section of this paper sets out to present the preliminary work undertaken in Bulgaria. In particular, the focus will be on the methodology used and on some findings at this early stage of the field work.

This research project is being funded by the European Union PHARE ACE 1994 programme. The empirical work is being undertaken between May and July 1995. The sample comprises 100 enterprises (commercial and industrial companies) and 20 service providers. The main methodology consists of pre-arranged, structured face-to-face interviews whereby a questionnaire is administered. Targeted respondents are business managers and proprietors as demanders for business support services, and people identified as having responsibility for provision of those services. The duration of the interviews ranges from approximately three quarters of an hour to one and a half hours, considering the busy nature of work and the time constraints. Teams of interviewers are being formed in regions listed below which saves time and resources. Familiarity with some of the actors involved means that the access to companies is good and interviewees' opinion and observation could be better uncovered. Therefore, interviews constitute major source of data, as they provide an opportunity to reveal not only what has been established, but why. Questionnaires consist of 8 rather detailed questions. There is an option for including additional comments and notes by the interviewers. Breakdown of companies using support services is based on the following categories: size, location, history, sector and ownership. As noted earlier, personal contacts helped the access, but one should take into account the psychological factors such as negative attitude towards research and the lack of understanding as far as long-term positive effect of building an adequate business support structure is concerned. Results of this research will be published after the completion of the project.

Preliminary work

The master questionnaire incorporates a country specific definitions used to clarify the main categorisation of the respondents. Those definitions concern mainly the following categories - size of companies and service providers; number of employees; turnover and number of years since start-up. Thus, prior to the interviewing stage the research team had to made the final choices of the relevant for Bulgaria exact numerical limits for each category. As it will be discussed later on these categories have some peculiarities which are the main source of awkwardness faced by the researchers.

Size - One can point out the considerable descriptive and theoretical efforts made to analyse the issues of small businesses in Bulgaria. However, there is, in fact, no agreed definition of small and middle enterprises (SME). Evidence from the relevant literature has suggested that there is some degree of diversity in the terminology regarding SME and different authors use different definitions (e.g. the European Union's definition, the Bolton report's definition, and others). Further investigation revealed that some of the foreign service providers use American classification for SME. Review of the legislation showed that some definitions based on of turnover criterion are already out-of-date (e.g. definition of SME in the Decree on Small Enterprises Fund). Data from various sources - the Ministry of Finance, the Central Bank, the Bulgarian Chamber of Commerce and Industry, etc. did not reveal contingency in the practical use of this term. Although, the models available are often conflicting, in the majority of cases two elements were obligatory included and namely number of employees and turnover. However, it is beyond the scope of this paper to discuss the problem of determining the main elements of what constitutes a small company. For the purpose of the interviews we use *the number of employees* as a main criterion for the size of both the companies and the service providers. Hence, very small/micro company has from 1 to 4 employs, small company - from 5 to 49, medium company - from 50 to 199, and large company - 200 and more employees. *Turnover* is used as a supporting criterion.

Location - The majority of the companies of the sample are located in Sofia-city (35), with the rest located in Plovdiv, Varna, Pleven, Bourgas, Haskovo and Silistra (in total 45). Included is a small number of companies (20) from small towns and villages in order to estimate how strong is the influence of the location factor on the level of support services and their usage. Plovdiv has been chosen as the second largest region in terms of population, where all sectors are presented in proportion to their countrywide share. Varna and Bourgas were included as regions with high concentration of country's labour force, out of which a significant part is employed in the industrial and service sector. Haskovo represents an interesting case where 10.7 per cent of the population is concentrated and has largest than the average national in industry - 56 per cent. Personal contacts in identifying companies and providers to be interviewed was also an important factor for choosing the location.

History - As a turning point of economic liberalisation in Bulgaria the year 1990 has been defined, since business could effectively started after that time due to relatively better economic climate. Accordingly, the companies fall into two groups - new-start companies vs. continuously operated through liberalisation.

Sector - Manufacturing, trade and services are included. According to the earlier agreed approach no agricultural companies were to be included, but food processing companies may be included. Closed monopolies (e.g. Bulgartabac) which determine the entire basis of their

operation are not included in the survey. Location was taken into account when breakdown by sectors was done.

Ownership - Preliminary work into this matter suggested that some difficulties will occur in ensuring the necessary number of state and mixed (state/private) companies in certain sectors. This required to keep the numerical limits to the minimum.

Some research findings

Since the project is in the beginning, it is too early to analyse the results of the research into business support structure in Bulgaria. However, some interesting findings have already come out. Even at this early stage, there has been quite a mixed picture of the kind of services being used and the amount and type of business support services given, as shown by the analysis of the questionnaires administered so far. The expansion of SME has stimulated managers to consider the issue of business support services more carefully, in spite of the fact that their approach to the use of those services is still contradictory. The need to invest in the business support services does seem to be more widely accepted. Examples of a more strategic approach to the use of business support services are found amongst the large companies or the overseas-owned ones. However, size, type of operations, ownership and location are only some of the factors that define the extent and the way in which business support services are being used. The gaps between providers and users, as well as some weak or missing elements of the SME support structure (e.g. lack of risk assessment skills and risk insurance mechanisms, inadequate legal base and law enforcement abilities, etc.) are major constraints in respect to the use of support services.

In summary, the volume of theoretical surveys on SME in Bulgaria is considerable. At the same time, there have been only limited empirical investigations of the environment surrounding the business activity. Thus, the study of the business support structure has potential value in illustrating the trends and process taking place in this respect in Bulgaria.

The contemporary nature of the topic makes it a worthwhile research area and the findings of the study could contribute to the more general debate on the SME development and could be possibly used as a base for follow-on projects.

Table I. Characteristics and choice of enterprise.

	LARGE	MEDIUM (The target group)	SMALL
SIZE	250+ EMPLOYEES	25-250 EMPLOYEES	< 25 EMPLOYEES
MARKETS	Home and abroad, able to enter .developed markets	Largely internal markets, poorly developed	Largely local markets, poorly developed
WESTERN SUPPORT	High level of attraction and attention from west	Little attraction or involvement on part of western companies	Virtually no western involvement
CURRENCY	Access to hard currency	Limited access to hard currency	Restricted to local currency
STATUS	Access to centres of power and resources	Weak, dependent on support but inefficient and little access to resources needed	Isolated and weak but with access to informal resources
PRODUCTS/ SERVICES	Capable of development and high margins	Low margins especially agriculturally based products and poorly developed	Low margins and narrow niches or commodity products
FINANCE	Good access and adequate balance sheet structure	Poor access, weak asset, credit and financing pos'n.	No accounts, little access to finance or credit
SUPPORT MECHANISMS	Access to foreign supporters and advisers plus few local specialists	Dependent on common support mechanisms mostly still under development, rudimentary or not legislated for	Dependent on locally available support and traditional co-operative mechanisms
COMPETITIVE CAPABILITY	Aware of requirements and able to respond	Not aware of many opportunities and market requirements particularly in neighbour countries and further abroad	Competing with locally based rivals with poorly differentiated products
TYPICAL PRODUCTS/ SERVICES	Consumer and industrial goods, specially regional food/drink and confectionery; retail chains	Haulage, distribution, construction, light engineering and other manufacturing, 'agro-alimentaire'	Agricultural produce, crafts, retail, tourist services

Table II Typical business support services and their providers

SERVICE	FOR LARGE FIRMS	FOR SMALL FIRMS	RESEARCH INTEREST
Export documentation and advisory services	Internal or agency or Chamber of Commerce	Agency or Chamber of Commerce	Locate expertise and identify company needs
Product labelling certification of origin and compliance with foreign standards	Internal, advice from foreign partner or advisers or 'capital city' agencies	Existing internal knowhow, trial and error, buyer, Chamber of Commerce or agency	Level of in-company expertise and availability of advice and services
Patent search and registration, design protection and copyright, outward licensing	Internal service or national level agencies	State of legislation and provision not know or unclear	Identify need and provision, at local and international level
Legal, Actuarial, Accountancy and Tax including contract drafting and negotiation	Internal service, foreign partners or agencies	Government, local advisers and agencies, newly developing official bodies and own resources	Identify needs, provision, structural weaknesses and local problems of development
Management consultancy and training services	Foreign partners and agencies	Foreign, local, public and private agencies	Identify needs and risk of poor provision
Property advice valuation and planning	Own services and foreign and local agencies	Local agencies, present provision unclear	Identify need as legislation evolves
Employer and Trade Association services, joint information and co-operative arrangements	National bodies and trade associations	Present development of local organisations and networks unclear	Measure state of provision and needs and identify optimal policies for targeted firms
Lobbying and negotiation with supranational, national and local authorities	National bodies, trade associations and national Chambers of Commerce	National and local Chambers of Commerce, employers and trade assoc.	Measure and assess need for aims, policies, organisations and initiatives
Commercial and technical information	Government services and national bodies	Present provision and awareness of need unclear	Identify level of provision and need
Foreign marketing export and trade promotion	Foreign partners own resources or agencies	Present provision and degree of co-operation unclear	Measure level of provision and assess policy needs

SME's Support Institutions

DIMITAR HRISTOV

Resume

A project for SME support Agency establishing in Sofia is presented. Based on the weaknesses of the current state economic policy and the lack of institutions to support the small business in the country, the author has proposed an approach to create a "suitable institutional environment" for the development of the small business in Sofia. The background, requirements, purposes, statute and the tasks, which the so proposed institution will solve are presented, helping on this way to develop the small private business. The article is a part of the author's and his partners term of reference and preliminary study intended for the international programs financing projects for restructuring and the SME's development in Bulgaria. The author is a managing director of "Hiron - MK" LTD and he is co-ordinator of subproject for creating interuniversity center for entrepreneurship as a part of TEMPUS project to University of Word and National Economy in Sofia.

Introduction

In the presented project the interests of a group of organisations who have the real understanding of the idea that only the uniting and the serious and system approach can help to the SME's in the country are sequenced. The project covers the establishment of Sofia SME Agency and is intended to provide the needed foreign financing. The project initiators participating in different international SME's support programs realise that after the financing period, these projects just stop existing. The project for such Agency in Sofia, will have useful influence for many years in the future and because of this reason it is accepted with a lot of hope and interest.

Without getting involved in details to research the SME's condition in the country we can assume that in the period 1990 to 1994 the "proper environment" wasn't created (because of objective and subjective reasons). The situation is namely the next:

- there isn't legal base systematically oriented toward SME's support in the country;
- there are no any institutions and mechanisms for venture capital financing and guarantee schemes for SME's;

- there are not created proper institutions for SME's support and development;
- and what is very unpleasant, the foreign technical and financial assistance was not totally involved in the process of restructuring of the economy and private sector development.

Why Sofia SME Agency ?

It is considered, that the establishing of a Sofia SME Agency will be very successful instrument for creating of such "environment" for SME's development which at first (in the end of 1996) can activate and thereafter can facilitate the structuring of a national framework for SME's support.

The applied up to this moment "up to bottom" approach on the beaten track - a public act - state institution - executive institution (for example, Council of Ministers Decree No 108 - to SME Fund - to SME Department at the Ministry of Industry) did not lead to the desired success. Even something more, found an external expression in the impossibility of the state institutions to use and to attract foreign technical and financial aim in this sphere fast and effective, this approach became one of the main reasons for the present failure.

In the practice of the developed countries where acts the logic of the economical and social progress the governmental aim for SME's is a part of the whole macroframe and governmental policy. This support has a priority over the others private and public schemes for facilitating. In Bulgarian situation the needs of the small enterprises go far ahead of the public abilities to create mechanisms and to accumulate funds. In this case the only possible formula is to use to the highest degree the foreign grants and to mobilise the whole potential of the local business circles by means of applying the "bottom up" approach. First to establish non-governmental working unit and thereafter to integrate it normatively and functionally into the state policy.

The Sofia - city as the most active "arena" for development of the small private business possesses the particular features of the future system for SME support (at regional and at local level). So that's why as distinct from the biggest part of the PHARE consultants who recommend the establishing of such structures in the country (Plovdiv, Bourgas, Smolian) we consider that first there must be created Sofia SME Agency and then its experience to be transmitted to the other towns.

Who are the parties concerned and who will be the founders?

When we take into consideration the economical and the political process in our country, founders and initiators for creating of the Agency can be such kind of circles who have closer contact with the growing private business especially in the areas of the manufacture, services and trade. These circles are public and private organisations, which now to some degree participate in the process of training, information, financing and regulating of the business of the small enterprises and the entrepreneurs. These are business centres, business schools and Universities, information and advertising agencies, consulting and accounting companies, as well as banks and investment funds, foundations, professional and economic chambers, governmental and municipal structures.

The foreign "donors" who at the moment justify their helplessness in the realisation of the EEC programs in Bulgaria with the lack of adequate "recipient" should be concerned of the existence of such an Agency.

It's logical to expect interest from the side of the foreign investors, big privatised enterprises and even from the big state companies, which should be searching for subcontractors in realising of their industrial and commercial activities. It is clear that all these circles will gain from the settling of "rules of the game", from decrease of the risk level and of course the new partnership with the newly growing SME's.

The founders of the Agency can expect more liveliness and expansion of the economy as a result of the agency's activity. And this definitely will influent positive on their business work. With the Agency can be started that what the industrial chambers, the unions and associations don't have the potential to realise themselves and that is purposive, active and combined with the state policy support for creating and supporting of SME. Of course the macroframe, the law environment and the social status at all are determining but in conditions of limited resources the only suitable approach is to find out the mechanism of their rational use and that is the Agency.

The government will be interested of such Agency. By means of it the government will receive more indicative "signals" for the results of its policy especially concerning the unemployment, professional orientation of the youth, forming of the middle class and development of the private sector at all. It is clear the potential interest of the municipals to realise part of their social and economic programs with the co-operation of one good functioning and specialised in these scopes institution.

What statute, purposes and tasks the Agency will have?

The answer of these questions must be given after a careful study what will be an object of the first stage of the prepared for realisation project. Our definite conclusion up to now is that the Agency must be a non-governmental (quasi-governmental) structure, created by initiative "bottom up" and acknowledged from the state and municipal authorities with their active participation in agency's management. It can't and it mustn't be profit oriented but it must be able to provide self- financing. The Agency must be institutionalised what means to have structure, staff, premises, equipment, industrial and office areas, halls for training and etc. The mechanism for the agency's management and control must be clear.

The agency ought to direct it's activities as well as to participate in the solving of the following problem areas connected with the SME and private business support:

- professional orientation and qualification of the active part of the population; unemployment and opening of working places;
- entrepreneurship and crafts;
- establishing of new SME's.

The Agency must be in condition to co-operate in realisation of the government and municipal policy and to implement the following three basic tasks:

1. To provide all kinds of services to SME's (information, consulting, training and others);
2. To incubate small enterprises in facilitating for them terms;
3. To support the functioning of the SME's in the conditions of "inimical environment"

These purposes can be reached in case the Agency establish as an agency's units so called *SME's business centre* and *business incubator*, which will have the potential to "cultivate" constantly at about 80 - 100 enterprises.

As early as in the middle of 1997 it is planned that the Incubator to the Agency to establish over 25 small enterprises in the scope of the services, machine-building, chemical and food and beverages industries.

The first studies show that the incubator formed to the Agency will be in condition for self-financing and in addition to the expected 350 working places in the incubated by it enterprises it will provide job for 30 specialists, trainers, consultants and other more. If the beginning in 1996 is successful in the following years up to 1999 there is expected increase of the agency's offices in Sofia and the region as well as establishing of another 1- 3 incubators.

The program of the Agency will be a result of consenting interests of the community with the governmental and municipal institutions. The Sofia Agency won't be the SME National Agency, planned according SME Law, but it have to co-ordinate and co-operate it's activities with that one. On other respect the National Agency will have enormous role especially in the efforts for that the decisions for SME's support not to "fade away" in the corridors of the Ministry of industry and the others authority institutions.

The Sofia Agency will be at the third level of the national system for SME support. It won't depend on the governmental decisions, on personal and politic changes or on Parliament's "whiffs". The Agency will decide the particular industrial and professional tasks of the SME and it will work as an independent social institution.

Will the Agency be able to be self-financing institution?

The answer is "yes" because the character of it's activities is such that can attract funds from many sources as:

- international programs in the fields directly connected with the small enterprises development like: socialising, unemployment, regional development, ecology, entrepreneurship, export promotion, co-operation between the enterprises from different countries and s.o.
- governmental and municipal programs financing particular economical and regional policy
- foundations, big sized enterprises, foreign investors and other sources who can realise their purposes aimed by the Agency's functions

With the incomes from these sources there could be ensured covering of the fixed costs and the maintenance of the office as well as covering of the financial facilities for SME's as: price decrease for the services provided to SME's, expenditures for exhibition, information bulletins, consultations and s.o. There is expected that the Business Centre and the Business Incubator to provide their own costs at all and even to provide excess which can be used for increase of the financial incomes.

The primary establishing and financing could not be realised without the technical and financial support from a international programs. There should be expected and the help of international financial institution. It is considered that when the financing of a 3 year lasting project is provided all the elements of the Agency can begin their functioning in the middle of 1997 while in the third year the same project will ensure adequate support of the Agency work in the first year functioning period.

In order to be realised the idea, the project for Agency must be implemented so that:

- to develop conception and business plan of the Agency for 5 years;
- to provide financing, to establish and to equip the Business Centre
- to provide financing, to organise and to activate the Business Incubator.

Bulgarian part must prepare and provide the minimal preconditions consisting generally of:

- organising the Bulgarian interested circles in participation in the project;
- providing of suitable base for offices and for the Business Centre;
- providing of industrial areas for situating of the Business Incubator.

The last two premises must be ensured for nothing or at very low (not market) rents.

The project can finance the technical assistance from foreign experts, renovation of the selected premises, the purchase of equipment, the organisation costs and may be part of the exploitation costs for the first year.

What is done up to now?

On initiative of "Euro info centre" formed to UEIC and HIRON MC Ltd there are developed a preliminary study and term of reference for the project. Up to now it is co-ordinated the support of representatives of different organisations as - foundations, banks, unions, chambers, consulting companies, universities and business schools.

The Ministry of Labour, Regional development and the Ministry of trade gave their principal agreements. All these organisations have presented their opinions by letters of intent.

There were held conversations with representatives of PHARE, UNIDO and other international institutions.

It is received agreement for financing of the first (preliminary study) stage of the project and it's developed preliminary proposal for location of the Agency with the incubator and business centre. There is studied a suitable institution in EEC country and its principal confirmation for establishing of such structure with their help is received.

What else have to be done ?

The project must receive the principal support from the Cabinet and from The Sofia municipal. There must be received also parliament's confirmation that such project will service the needs of the society. There must be received Decree referring the proposed building because its statute is connected with Ministry of industry. The choice of this building must be co-ordinated with the program of this Ministry for restructuring and privatisation.

The representatives of the mentioned above communities must form co-operation and must start the realisation of the studying stage. For this purpose together with their foreign consultants they must develop the conception and the business plan of the Agency. There must be find with common efforts resource for the financing of the other part of the project.

Entrepreneurship in Western and Eastern Europe

ROB VAN DER HORST

1. Introduction

More and more attention is paid to SMEs, as they are as a source of job generation and a weapon against unemployment. All EU Member States know in one way or another programmes or measures aimed at SMEs or entrepreneurs. It is important to know the situation and developments in the Member States, to be able to create adequate policy. The Annual Report 'The European Observatory for SMEs' is an abundant source of information¹ and this paper is based on its contents.

2. The European observation for SMEs

2.1 What it is

What is the European Observatory for SMEs all about? Are we watching stars in the sky or observing jet-fighters from a distant enemy? In some languages it is hard to explain what an observatory is able to do apart from this, but the fact is that we are monitoring structure and development of small and medium-sized enterprises in the EU.

The project was set up in 1992 by the Directorate-General XXIII (Enterprise policy, Distributive Trades, Tourism and Co-operatives) of the Commission of the European Communities. A major objective of the Observatory is to provide the Commission with structured information on behalf of its policy-making activity in relation to SMEs including the craft sector. Besides, the information should be of importance for national governments as well as for intermediary organisations in the business sector.

¹ European Network for SME Research, *The European Observatory for SMEs, First Annual Report*, May 1993 (437 pages).

European Network for SME Research, *The European Observatory for SMEs, Second Annual Report*, April 1994 (380 pages).

European Network for SME Research, *The European Observatory for SMEs, Third Annual Report*, May 1995 (481 pages).

The reports can be ordered through the coordinator of the project: EIM Small Business Research and Consultancy, PO Box 7001,2701 AA Zoetermeer, The Netherlands, Fax 31 79425786

In the framework of the project an *independent annual* report is prepared, which gives a structured overview of European SMEs and the craft trades in both quantitative terms.

The First Annual Report was published in May 1993 and concentrated on the *structure* of both SMEs in general and their fields of operation. Apart from the structure of SMEs, the Second Annual Report also reviews the *development* of SMEs, especially those reflecting the completion of the Internal Market. Furthermore it contains an in-depth study into the crafts sector.

The Third Annual Report, published in April 1995, reviews developments that relate to SMEs, and in particular that have arisen through the completion of the internal market. The Third Annual Report, contrary to the other previous two reports, provides information on 16 countries: the twelve “existing” Member States of the EU, the three new Member States (Austria, Finland and Sweden) and Norway. I will explain later on the structure of the Third Annual Report (see paragraph 2.3.).

2.2 Organisation

Each report is produced by the European Network for SME Research (ENSR) and co-ordinated by EIM Small Business Research and Consultancy in The Netherlands as main contractor. The ENSR is a network of leading organisations which specialise in SME research and cover all Member States of the European Union.

Each chapter of the report has been co-ordinated by a partner of the Network. Two reference groups have been established to reflect on the research findings and to advise the ENSR. The General Reference Group was already active during the first year of the project and is mainly composed of representatives of *European* organisations which are generally active in the field of SMEs or the business sector in general. Furthermore a Craft Reference Board has been established in order to support the project team in carrying out the in-depth study on the craft trades. It is mainly composed of representatives of *European and national* organisations active in the field of the craft trades or SME in general. The European Commission (Directorate- General XXIII) attends the meeting of both reference groups as an observer.

The Third Annual Report is available in English, French and German. (The first one in English only.) An Executive Summary of the reports is available separately in the nine official languages of the European Union.

2.3 Contents of the Third Annual Report

The design of the Third Annual Report is a bit different from the other two reports. The main part of the Report concerns the development of the SME Internal Market Monitor (SIMM). This monitor measures the effects of the completion of the internal market on SMEs. As the completion of the internal market has influenced the business performance and the business environment of SMEs, the first two parts of this Third Report are dedicated to these two themes: part one contains information on business performance and the second part contains information on the business environment. In details:

Part I on business performance contains:

- Chapter 1 Business dynamics and entrepreneurship
- Chapter 2 Economic growth and sectoral development
- Chapter 3 Labour

Chapter 4	Regional disparities
Chapter 5	Export and international orientation

Part II on business environment contains:

Chapter 6	Macro economic environment
Chapter 7	Recent policy developments affecting SMEs
Chapter 8	Labour market
Chapter 9	Capital and finance
Chapter 10	Infrastructures
Chapter 11	Technology and innovation
Chapter 12	Education and entrepreneurship
Chapter 13	Legal environment

Part III contains theme studies on the Administrative Burdens on SMEs, on the Producer Services sector and on the Craft Trades.

Part IV contains the conclusion, the main results of the SIMM and an overview of the policy issues resulting from the information contained in the Report.

3. Enterprises

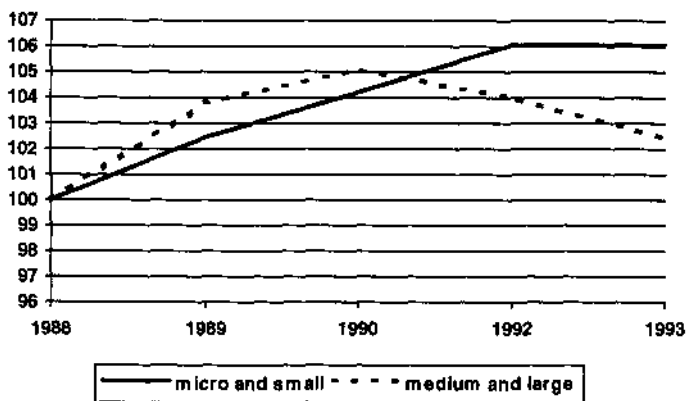
Europe-16 had a total of almost 16.4 million enterprises in 1990, of which 99,9% were SMEs (<500 employees). These enterprises employed 72,5 million, people, almost 72% of total employment in non-primary private enterprises.

Main indicators by size class, Europe -16, 1990

	0-9	10-99	100-499	>500
Number of enterprises	15 210	1 045	75	15
Employment	31 450	25 500	15 550	28 900
Average enterprise size	2	24	204	2 064
Turnover per enterp. (ECU 1000)	190	3 050	33 200	273 750
Value added per occupied (ECU 1000)	25	30	45	40

Between 1988 and 1993, the number of enterprises increased strongly. The most expanding sectors were wholesale trade, transport and communications and producer services. During the recession 1990-1993 the increase in the number of micro and small firms slowed down. The number of medium and large firms, however, decreased in absolute terms. The unfavourable economic conditions during the recession had a negative impact on the number of enterprises. On the one hand the conditions became relatively unattractive to start a new firm and, on the other, increased competition led to an increase in death rate of enterprises.

Number of enterprises by size class, Europe-16, 1988-1993 (1988=100)



The number of enterprises per 1,000 inhabitants show differences between countries. This number show greater differences between regions in the southern EU Member States (especially Greece and Portugal) than in the northern EU Member States (especially Denmark, The Netherlands and Belgium). Broadly speaking the number of enterprises per 1,000 inhabitants decrease as one moves from south to north through the EU Member States.

Number of enterprises per 1,000 inhabitants

European Union	45
USA	57
Russian Federation	7
Bulgaria (1992)	22

4. Employment

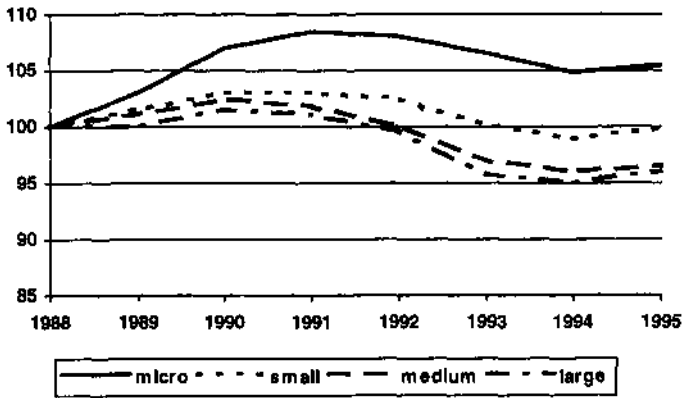
Micro enterprises account, both in Europe-16, for almost one third of total employment in the non-primary private sector, small enterprises for 25% and medium-sized enterprises for 15%.

The average enterprises in the EU-12 and in Europe-16 employs 6 persons, including the entrepreneur, the average SME 4 persons. The scale of enterprises varies a lot between countries. The average enterprise size is 6, but it varies between 3 and 13. Enterprises are relatively small in southern Europe: Greece, Italy, Spain and Portugal and it is respectively 3,4 and 4. In Greece, Italy and Spain micro enterprises are dominant. The scale of enterprises increases in northern Europe. Countries with relatively large enterprises are Denmark (9), Germany (9), Luxembourg (10), The Netherlands (10) and the EFTA-4 countries whose average firm size is 12. In the First and Second Annual Report a correlation between GDP, per capita corresponds with a high degree of concentration, and, therefore with a relatively large scale of enterprise.

Between 1988 and 1990 a concentration of employment in micro and small enterprises was apparent, implying decreasing employment shares of medium-sized and large enterprises. This pattern is extremely strong whereas in Germany, Greece, The Netherlands and Spain, only micro enterprises experienced an increase in employment share. Ireland shows an opposite change in the size structure of employment which is exactly contradictory to the results of EU: concentration in medium-sized and large enterprises, and decreasing shares for micro and small enterprises.

Between 1988 and 1990 employment growth in SMEs was well above that in LSEs. Within SMEs especially micro enterprises employment growth increased. During the 1990-1993 recession, employment decreased steadily in both medium-sized and large enterprises. In small firms employment was stable in 1991, and decreased subsequently. The decrease in employment started in LSEs and medium sized enterprises. After a time lag employment also fell in small and micro enterprise.

Development of employment in micro, small, medium and large enterprises, Europe-16, 1995, index 1988=100



The next table presents the data on job creation only for EU-12.

Net job creation by size class, EU-12, 1989-1992

	micro	small	medium	large	total
	x 1000				
1989-1990	620	615	400	800	2,435
1991-1992	190	-10	-180	-300	-300
1989-1992	810	605	220	500	2,135

The table presents the estimated job growth by size-class in absolute numbers. Over the period 1989-1992 the SME sector has achieved net employment creation of about 1.6 million jobs. This is slightly more than 75% of total job generation in the non-primary economy. Micro firms have created 800,000 jobs. This is 38% of all job creation, which compares very favourable with the 30% share of micro firms in the total stock of job. Medium-sized and large firms have suffered a decrease of their share in total employment.

5. Business dynamics

5.1 Introduction

The changing stock of enterprises at any time reflects the birth of new enterprises, the death of enterprises and the time period over which established enterprises are able to survive. Simple observation of enterprise stock alone cannot illuminate the underlying causes of changes, e.g. increased numbers may reflect equally higher of new business start-ups or improved survival times and hence lower death rates.

High enterprise natality rates are of policy interest since they are often said to reflect entrepreneurial zeal, business flexibility, innovativeness and (potential) job creation. However, clear evidence on their economic impact aside from job creation remains scarce.

5.2 Natality and mortality

The natality rate can be defined as the ratio of the number of new enterprises to the existing stock of enterprises; the mortality rate is defined as the ratio of closures to the existing stock. Gross natality rate in the EU-12 was 10.1% in 1989, meaning more than 1.4 million start-ups. Due to differences in definition a comparison between countries is difficult and shows big differences. To avoid these problems the trend in natality rates is looked at.

Trends in natality and mortality rates, all sectors 1990-1992.

	Natality	Mortality
Belgium	–	=
Denmark	+	N.A.
France	–	+
Germany	+	+
Ireland*	–	–
Italy	+	+
Netherlands	+	+
Portugal	–	N.A.
Spain*	–	–
United Kingdom	–	+

* 1988-1990, NACE 2-4

+ increasing rate of natality/mortality

– decreasing rate of natality/mortality

= constant rate of natality/mortality

Trends in natality rates differ across Europe, trends in mortality rates are undoubtedly upward. Enterprise mortality rates are positively associated with natality rates, countries recording high 'birth' rates, also experience high 'death' rates. Across Europe the recession has dramatically increased mortality rates, and during 1990-1992 mortality rate fell in none of the countries for which data are available.

5.3 *Survival*

The survival of a new enterprise will depend upon factors, both internally and externally. Internal factors are for example the quality of the business plan, the ability in adapting to market and prevailing technological conditions; external factors are economic developments, national and international.

Consideration of survival rates requires the careful tracking of enterprises set up in the base year and inevitably there are significant time lags before the relevant statistics are finalised and for most countries they are not updated frequently. On average, of all European (Europe-16) start-ups, 87% survive their first year, 68% survive for at least three years and 55% survive to the end of their fifth year. However, European countries show important differences, for example, the five year survival rate varies from 45% in Luxembourg, to 63% in Germany.

Survival rate, percentage of firms				
	1st Year	3rd Year	5th Year	Start
B	84	n.a.	n.a.	1990
DK	n.a.	69	58	1985
F	84	62	48	1987
D	86	70	63	1985
IRL	91	70	57	1986
I	87	66	54	1987
L	76	56	45	1980
NL	90	74	n.a.	1988
P	76	56	47	'86/'87
SP	n.a.	70	n.a.	1986
UK	87	62	47	1980
FIN	91	63	55	various
NOR	92	68	53	1980
SWE	n.a.	70	54	1988

Differences in survival rate may be partially explained by differences in the sectors and periods covered, especially considering the impact of the recession. Denmark, Germany, Ireland and Sweden show relatively higher survival rates. In such analysis closures or contractions can be explained in many ways, but one explanation of the generally high rate of survival rate may be

that many of these enterprises were started as a hobby; hence the likelihood of business "failure" and subsequent closure, is less than would be the case among conventional business.

However, much more work is needed before intra-EU differences are adequately documented, let alone explained. In general the factors hampering the smooth operation of young firms, thereby decreasing the probability of survival, are similar in all countries. Those are financial, organisational, technical, even bureaucratic and personal problems.

6. Self employment in the EU

One key feature of the European labour market during the 1980s has been the growth of self employment. Across the countries which formed the (then) European Economic Community in 1970 total self employment grew nearly 25% by 1989 while overall employment only expanded 9%. Since the late 1970s all EU-12 countries have introduced programmes to encourage people to become self employed and support those doing so.

The rising share of self employment within total employment in the vast majority of EU countries between 1986 and 1991 reflects both the structural shift in most European economies away from manufacturing and a combination of a number of other socio-economic factors, for instance changing tax regimes, increases in contracted out services and more flexible manufacturing systems. High growth rates were achieved in Portugal with 35%, Ireland, the UK and Spain (24%-20%) during the mentioned period.

Germany (60%) and Denmark (53%) have a greater proportion of self employed with employees than without, although France and Luxembourg approach half. In Ireland, The Netherlands, Portugal and UK around one third of all self employed have employees, whilst in the remaining four member States one quarter or less of the self employed have employees. The reasons for these differences are unclear and no doubt reflect differences in national, legal and fiscal frameworks. However, in Germany the strong 'dual' apprentice system emphasises the responsibilities of small enterprises in providing initial youth training. Furthermore, in the craft trades a 'Meister' must be employed to supervise apprentices if the owner does not have 'meister' status. *The implications for employment are potentially quite significant.* Policy measures designed at increasing flows into self employment will have a stronger effect on employment in those countries who have high proportions of self employed with employees. Research on new enterprise formation in the UK has shown that the individual self employed rarely exhibit any growth potential and tend not to pursue growth. So policies that seek to increase self employed rarely exhibit any growth potential and tend not to pursue growth. So policies that seek to increase self employment are likely to result in a 1 for 1 shift in employment in countries such as Italy, whereas in Germany a 1 unit increase in self employment may result in a gross employment shift in excess of 1. Apart from the employment generation aspects, it may be important for policy-makers more generally to differentiate between self employed with employees, who are to all intents and purposes micro-businesses, and individuals in self employment for other reasons. Clearly the problems faced by the two groups are potentially quite different and ask for a personal approach.

7. Women and entrepreneurship

Self employment is currently very much a male domain. Only in The Netherlands, Portugal and Luxembourg women's share of total self employment exceeds 30%, whilst in Greece and

Ireland women accounted for less than 20% of total self employment. Taking labour-force participation for women into account, the likelihood of a woman in the Danish labour force being self employed is only 21%, whereas this rises to 33% for an Italian, Dutch, Belgian, Luxembourg, Portuguese or Spanish woman. For the majority of EU states there are significant differences between men and women in terms of proportions of having employees. Only in the UK is the probability of a self employed individual having or not having employees independent of gender. At the other end of scale, a self employed man in Belgium is 3 times more likely to have employees than a self employed woman. These points raise important questions. Do women have less entrepreneurial "spirit", are there additional or financial barriers preventing them to become self employed? If it is the latter, policy-makers must address this issue and seek to correct the imbalance.

8. Job generation

The role of small enterprises in employment creation and reducing unemployment is undoubtedly very important. An US study showed that during 1969-1975 small enterprises (<20 workers) provided 37% of new jobs, while accounting for just under 20% of total US employment. Job generation studies during the 1980s in Denmark, Germany, Italy and the UK show that for the first three EU members employment expansion and contraction in established businesses was much more important (almost twice as) as enterprise births or closures in accounting for job change. However for the UK gross job losses due to enterprise deaths accounted for 4,8% of base year employment while contractions accounted for 2,6%.

Most of research and policy interests has focused primarily on the employment impact of new enterprise formation. New enterprise growth is only one element in the wider job generation study framework, although impressive rates of job growth have sometimes been recorded. Thus, for example, among new non-primary businesses started at the end of 1985 in The Netherlands by 1990 the average number of jobs per business had grown from 1,5 to 3,2 (among the 61% of business still surviving)giving an overall job growth of some 30% over 4,5 years. In France the National Agency for Start-Up Business (ANCE) has tracked employment patterns in new enterprises since the 1980s. Job generation studies focusing on the enterprise size dimension exist in Denmark and the UK. In Denmark net job growth was entirely confined to micro and small enterprises (<100 employees) and were actually dominated by micro enterprises (<10 employees) during 1981 -1989. The UK studies show a European-based contrasts between the period of rapid economic growth (1978 - 1988) and the onset of economic recession (1989 - 1991). However, while the general impression given by the two study periods is one of surprisingly stability in the various job generation study components across the SME size-class categories, in spite of sharply differing macro-economic circumstances, this is not true for job losses in large enterprises (LSEs) with more than 500 employees.

In spite of the policy and research focus on new enterprises births, gross new jobs through expansions accounted for 70% of gross job growth from 1987 - 1989 and for 75% from 1989 - 1991 in the UK. Even among SMEs, which, of course account for 99% of all enterprises "births" in both periods, expansions accounted for 69% and 63% of gross new jobs over the two studied periods. Any full consideration of the employment impact of SMEs need to embrace the "quality" and characteristics of the jobs generated as well as simply their numbers. Unfortunately, the available evidence within the EU is fragmented and sparse and confident to employment in SMEs as a whole rather than newly created jobs.

9. EU policy

The European Union's White Paper on Growth, Competitiveness and Employment stressed the need to create an environment as favourable as possible to business, particularly for SMEs. A global approach, hence an improving of the macroeconomic framework began a very important objective for the national governments and for the EU. This approach is not completely new since the creation of a favourable business climate has been present in the SME policy of some Member States (i.e. Denmark, The Netherlands). The recommendations of the EU has been taken into account by the member States. Member States where launching new programmes for SMEs, introduce measures aimed at improving the economic environment for their enterprises, for instance, deregulation, liberalisation, privatisation, reformation of the tax system. The most popular policy are: reducing administrative burdens, increasing flexibility in the labour market, reducing regulation in the labour market. Administrative burdens are widely recognised to fall relatively heavily on SMEs. In the opinion of entrepreneurs the main causes for administrative burdens are the complexity, the number and the frequency of the forms and/or obligations and the number of changes in the forms and/or obligations. The total annual costs of administrative burdens for enterprises in Europe has been estimated at between 180 and 230 billion ECU. This is between 3 and 4% of the GDP.

Specific SME policy have been launching as well. Policies designed to strengthen SMEs include: assistance with innovation, product development and risk taking investments; assistance with exporting and better access to finance. To reduce SMEs dependence on bank finance several countries have introduced schemes to encourage equity investments in SMEs. Efforts have been made to improve the human capital within SMEs. These are mainly in the form of management and work force training programmes.

10. Central and Eastern Europe

In many countries in Central and Eastern Europe the growth of new private enterprises is impressive. A number of years ago EIM carried out a project under the PHARE programme. We estimated that the number of private 'registrations' was about 200,000 (Feb. 1995)

Number of private enterprises per 1000 inhabitants	
European Union	45
USA	57
Russian Federation	7
Bulgaria (1992)	22

This means that there were about 22 private enterprises per 1000 inhabitants in Bulgaria. That is much more than in the Russian Federation, where this process tends to be slower.

Many new firms are active in trade (retail and wholesale). Due to a lack of capital starting a business in trade is much easier than in manufacturing industry. The accumulation of capital therefor takes place in the commercial sector. A new economic nomenclatura is emerging, quite different from the old political nomenclatura.

One of the main problems in all countries in transition is the lack of an institutional framework and a legal basis for entrepreneurship. In Western countries governments have recognised the importance of SMEs in terms of economic growth and job creation. Taking into account the problems SMEs have in starting a business, getting the right information, acquiring capital, starting export, developing new products, etc. all governments have developed policy instruments to assist SMEs.

The legal framework is extremely important in order to secure a smooth operation of private firms:

- fair competition
- protection of employees
- protection of consumers
- protection of the environment
- bankruptcy law, ect.